"Our investment policies are among the most liberal..."

Kamal Nath is India's Minister of Commerce and Industry. He speaks to **INDIA NOW** about the importance of foreign investment in economic growth, his government's initiatives in attracting such investment and the growing relevance of regional trade.

Kamal Nath has been a parliamentarian, winning every general election, since 1985. First inducted to the council of ministers in 1991 when he was made the Minister for Environment and Forests, he was later the Minister for Textiles in 1995.

As the Minister for Environment and Forests, Kamal Nath led the Indian delegation to the World Forestry Conference in Paris in 1991. The following year, he led the delegation to the UNEP Governing Council meeting in Nairobi, the PREPCOM IV discussions in New York and the Kuala Lumpur Conference. He emerged as one of the chief spokesmen for developing countries at the UNCED in Rio de Janeiro in June 1992.

Kamal Nath was educated at the prestigious Doon School in Dehra Dun, and subsequently obtained his Bachelor's Degree in Commerce from St. Xavier's College, Kolkata. He is a keen sportsman and has a deep interest in welfare issues, particularly tribal uplift and rural development.

Hon'ble Minister, it is almost thirteen years since India liberalised its economic policies. Yet there is a feeling among some foreign investors that our policies are not liberal enough...

India's investment policies, including policies on foreign direct investment, are among the most liberal in developing economies, particularly in this part of the world. There are no restrictions on FDI in most sectors. There are no restrictions on repatriation of either the investment or profits.

At 120 billion dollars, India today holds the sixth largest foreign exchange reserves in the world. Today, we find many Indian companies trying to consolidate their position and achieve economies of scale by expanding their operations overseas. Overseas investments by Indian companies have exceeded 3 billion dollars in the last two years, with nearly 60 per cent in the manufacturing sector. You will, perhaps, be surprised to learn that Indian investment in the UK is almost equal to British investment in India!

In the last one year, close to 2500 megawatts of power projects have achieved financial closure. But we would really like to add 10,000 megawatts per year. This is our vision

There is a backlash being felt against India emerging as the back office to the world. What are the views of your Ministry on the fastest-growing segment of the services sector?

We consider the political backlash against outsourcing in developed countries to be misplaced. This signals an inclination to protectionism, which is unfortunate. In any event, such moves are misplaced since this is a phenomenon that benefits both the source and destination countries: the key driver for off-shoring by companies in the developed world is, after all, cost cutting.

Studies indicate that a developed economy gains as much for each dollar of business services off-shored, as the countries to which the outsourcing takes place. Indeed, outsourcing cannot be avoided if the developed world wishes to tackle the impending problem of shortage of workers and high cost of labour in their home countries.

In the emerging international economic environment, wherein services is assuming a crucial role in global trade, there are tremendous potential gains for both developed and developing countries in a successful round of negotiations.

Your government is seeking 150 billion dollars of investment in infrastructure. But such investments need long gestation periods to become viable. What, according to you, are the USPs of India to attract such funds?

Our stable democracy, an independent judiciary, and the general rule of law that prevails in India make long-term investments in infrastructure absolutely safe and sound. And let me add here that a committee on infrastructure has been set up by the Prime Minister with him presiding over it. That's the priority the government is according to investments in infrastructure.

Power is slated to attract the largest share of foreign investment in India's infrastructure. What has the government done to facilitate investment in this sector?

The power sector is an area where the government has responded to the challenges of attracting investment from the private sector. The new Electricity Act allows the sector to align with market features and addresses many of the difficulties coming in the way of greater participation of the private sector. In the last one year, close to 2500 megawatts of power projects have achieved financial closure. But we would really like to add 10,000 megawatts per year. This is our vision — indeed, this is our requirement.

Ever since India adopted liberal economic policies in 1992, we have been concerned about the level of foreign investment in our industry. There is a belief that such investment can give a fillip to GDP growth. But is this not a rather simplistic view? Other Asian countries, such as Japan and Korea, have achieved high growth rates without depending on foreign investment...

Foreign investment, like foreign trade, is a major driver of growth and development. Trade and investment are both complementary and competitive. It is true that countries like Japan and Korea increased their GDP substantially with minimal or no dependence on FDI. But that was decades ago, and in a different global environment.

The scarcity of capital in developing countries is, of course, there — but what is an even more cogent reason for welcoming foreign investment in industry, in my opinion, is the fact that such investment is a major source of skills-upgradation and technology transfer. I am a firm believer that technology alone can enable developing countries to do the 'catching up' that could leapfrog them into the frontiers of progress.

India is both, a demander of technology as well as a supplier of it. We have a reservoir of technologies useful for developing countries. We are in the process of preparing a new Technology Transfer Policy aimed at attracting state-of-the-art technology. The short point is that we see FDI, both, as a source of capital as well as a vehicle for technology transfer.

There is a general perception that world trade is dominated by multilateral trading arrangements. But the truth is different. As you have been saying in various fora, regional trade agreements, popularly referred to as RTAs, seem to be the flavour of the day. Over half of global trade is outside the purview of global mechanisms; it takes place within some RTA or the other. Why is there this grow-

> Regional Trade Agreements consolidate peace and regional security, and also confer greater bargaining power in multilateral negotiations by tying in partner countries

ing preference for regional trade?

There are some 200 Regional Trade Agreements existing in the world... there are actually more RTAs than countries, and yet their efficacy continues to be hotly debated. Leave alone journalists, even economists do not seem to agree on whether Regional Trading Agreements are 'building blocks' or 'stumbling blocks'.

However, one thing which has been acknowledged by all is that RTAs are driven by both economic as well as political considerations. Look at the EU, look at ASEAN, MERCOSUL — a Spanish acronym for 'Common Market of the South' involving Brazil, Argentina, Uruguay and Paraguay. There is SACU — a grouping of five southern African countries led by South Africa; and now look at our own proposed South Asia Free Trade Area, or SAFTA.

Economics and politics enjoy a symbiotic relationship in this area. And this cannot but be so. After all, trading cannot flourish between countries that are at loggerheads with each other; and conversely, countries which are bound by intimate commercial relationships would find it very difficult to be aloof from each other diplomatically. Having said this, I must clarify that an FTA should not be entered into for diplomatic reasons alone. There must be a solid underlying economic justification for it as well.

India too has been very active in having Free-Trade Agreements, Regional Trading Arrangements and Bilateral Trading Agreements. What do you think will be the emerging pattern of India's trade?

As far as India is concerned, we have always stood for an open, equitable, non-discriminatory and rule-based international trading system. It is our belief that our endeavours at creating regional economic spaces do not detract from the overall objectives at the multilateral level. I feel, instead, that these RTAs supplement and complement the multilateral order. It is also a fact that Regional Trade Agreements consolidate peace and regio al security, and also confer greater bargaining power in multilateral negotiations by tying in partner countries through regional commitments. With the above objectives in mind, India has engaged in a number of bilateral and regional initiatives.

We are currently negotiating comprehensive economic cooperation agreements with ASEAN and with Singapore, as also with MERCOSUL. We are also talking to SACU. The Framework Agreement between Bangladesh, India, Myanmar, Sri Lanka and Thailand is called BIMST-EC. It is visualised as a bridging link between two major regional groupings i.e. ASEAN and SAARC.

Recently, we signed an Early Harvest Programme as the first step towards establishing a free trade area between India and Thailand. We have established Joint Study Groups with Pakistan, with Israel and with the Gulf countries.

I believe that India's economic engagement with this vast spread of countries in the East as well as the West open up immense business opportunities. It is for this reason that we have been pursuing this economic strategy for the past seven months. Of course, we have been very careful about the way we have gone about it. Whether an FTA can act as an engine for growth or otherwise would depend on the various features and contours of such an agreement.

The Great Indian Paper Chase

Why are foreign portfolio investors increasing their exposure in the Indian equities market? What are the economic fundamentals driving their investment decisions? Financial analyst **MUKARRAM BHAGAT**, provides the perspective

There can be little doubt that the year 2004 has seen India emerge as a preferred destination of foreign portfolio investors, referred to locally as FIIs for foreign institutional investors. Year to date, the country has a net inflow of $ 6 billion in equity market investments by FIIs, which represents a 9 per cent higher inflow on an annualised basis.

2004 has also seen a boom in new FIIs registering with the Securities and Exchange Board of India — up by 122 to 623 through October 2004. 'CalPERS' (California Public Employees' Retirement System), USA, the world's largest and most respected pension fund, made a debut in the Indian markets in the year 2004 and, for starters, has poured in $ 110 million in Indian equities. A number of other US funds are sure to follow the leader who is not only humungous but also exacting in its corporate governance standards.

According to a recent research report by Morgan Stanley, USA, India is attracting fairly high share of FII flows into emerging markets — 20 per cent in 2004 through September. Even though India's weight in the MSCI Emerging Markets equity benchmark is only 5.5 per cent, Morgan Stanley believes that international investors are 'overweight' on India.

So what is the allure of India for foreign portfolio investors? I believe the answers lie in the revolutionary change that has occurred in the Indian stockmarket infrastructure over the last decade and the slow but steady pace of economic reforms underneath a façade of eye-catching political turbulence. In sum, both the 'technical' and 'fundamental' factors are in place to attract foreign portfolio money on a much bigger scale than hitherto imagined.

The last 10 years or so have seen a paradig-

DINODIA PICTURE AGENCY

DINODIA PICTURE AGENCY

THE STOCK EXCHANGE IN MUMBAI: Attracting over $ 6 billion by foreign investors

The Indian economy is already the fourth largest in terms of Purchasing Power Parity after the USA, China and Japan and is likely to move up to second position after China.

matic shift in the systems, processes and physical infrastructure of the Indian equities market. The outcry system of trading has been replaced by a fully electronic screen-based trading platform with much greater transparency and anonymity. The 15 and 5-day account period settlement of yesteryears now look laughable when compared to today's T+2 rolling settlement cycle and STP (straight through processing) involving institutional trades.

The 100 per cent physical securities settlements are now replaced by 99.95 per cent dematerialised securities settlements eliminating truck loads of paperwork and bad deliveries. Soft infrastructure, such as the trade guarantee fund, market intelligence gathering, risk management systems, disclosure and transparency standards, have also been put in place by the exchanges and clearing corporations to ensure smooth and fair trading.

Not surprising, the Indian equity market is now one of the most advanced markets in the world comparable to the best anywhere. The average daily trading volume is $ 1 billion in the cash markets and nearly $ 1.5 billion in the derivatives market making it one of the top turnover emerging markets in the world. The top three deciles of stocks are very liquid and comparable to similar stocks in the New York Stock Exchange though the lack of liquidity in the mid-cap stocks is a cause of concern.

India's market capitalisation at $ 300 billion makes it the second largest market in Emerging Asia, after Hong Kong and China, and accounts for over 27 per cent of the region's market cap. And, last, but not the least, unlike other emerging markets, Indian benchmark indices have a very well distributed market cap across industries/sectors and ownership structures, including leading MILLIONCs, which enable foreigners to get a stake in diverse market 'plays' and 'stories'.

Of late, the Indian market has also witnessed mega sized $ 1 billion to $ 2 billion IPOs, especially by government companies. The year 2004 has seen three such issues, all through 100 per cent book-building route, namely ONGC ($ 2.2 billion), TCS ($ 1 billion) and NTPC ($ 1 billion). In fact, foreign buyers lapped up the NTPC issue within minutes of opening, indicating the voracious appetite for quality Indian paper among global investors.

On the fundamentals side, there can be little doubt that the India story has finally 'emerged' and is now engaging the serious attention of institutional portfolio investors, if not direct project investors, across the globe. The India scrip has also been popularised by the famous BRICs research report of 2003 brought out by global investment bank, Goldman Sachs, USA.

More than a decade after the economic reforms of 1992, India today is on the way to becoming one of the largest economies in the world by the year 2050 or thereabouts. The Indian economy is already the fourth largest in terms of Purchasing Power Parity after the USA, China and Japan and is likely to move up to second position after China given the far slower GDP growth rates of the US and Japan.

While India's current sustainable GDP growth rate of 6 per cent is well below China's 9-10 per cent, it is still much higher than most large economies of the world, especially the mature and wealthy OECD countries that are growing at a sluggish 1- 3 per cent a year. This high growth differential and the low levels of consumption/ market penetration of most modern products makes the Indian economy with a population exceeding one billion, a very attractive growth story for foreign investors.

India's democratic, plural and open society — a rarity in the Second and Third Worlds — has given it remarkable political stability in the face of rapid socio-economic change and modernisation. True, the country's long-term trend growth rate of 6 per cent is far below its potential and need. But the stability of the economy and the gradual increase in trend growth rates is having a remarkable compounding effect over time.

Considering the remarkable boom in India's services sector, with its steady 7.5 per cent a year growth rate and 51 per cent share in GDP, it is now almost a mathematical certainty that the country's GDP growth rate will automatically trend up to 6.4 per cent by 2010. The growth laggard is agriculture with its 3 per cent growth rate but its 22 per cent GDP share is steadily falling due to the faster growth of manufacturing — which has a 27 per cent share of GDP — at 6 per cent and of services. Global demographics are having seismic effects in favour of the large population countries, especially India and China. Today, half of India's population is below the age of 30 years and in about 10 year's time, this proportion will rise to 60 per cent. Indeed, long-term demographic trends suggest that India will continue to become younger even beyond 2040 and well after China stops doing so.

In stark contrast, the populations of wealthy Europe, Japan, USA are aging and most of their people will be above 40 or 50 years. So, you have rich but aging populations in the OECD world while you have less rich but younger populations in developing countries like India.

In such a scenario, it is not too much to expect continuing outsourcing of manufacturing and services to young, low cost economies like India and away from the aging, high cost, wealthy economies of the world. And if the bulk of the world's young population is concentrated in India and China, that is also where you will find increasing new product acceptance and innovation — any marketer's delight!

India is already among the largest markets in the world for two-wheelers (6 million units a year and growing at 12 per cent annually), mobile phones (40 million plus and growing by 12 million new subscribers a year), banking/financial services and a range of consumer products.

The rapid advances over the last decade in global computing and telecom technologies have now made services 'tradeable'. In the 1970s and 1980s, the world economy witnessed a mega trend of manufacturing outsourcing to the then poor East Asian countries. Rapid progress in transportation and communication technologies post-World War II and the low cost advantages of these regions coupled with liberal, outward looking economic policies made this possible.

I believe what the world economy is now experiencing is the beginning of a new mega trend of global services outsourcing via software services and business process outsourcing. In this latest dynamic, India is firmly on the global radar screen as an attractive and viable destination. Services are labour intensive and are exported via telecommunication networks.

India with its abundant supply of low cost, well-educated, English-speaking youngsters is well placed to benefit from this brand new opportunity. The now liberal, open and business-friendly policies of Indian governments of all political hues and the increasingly global mindsets of leading Indian executives and entrepreneurs are converting the opportunities into reality.

Already, the top Indian software services companies are among the 10 largest in the world and growing at a breath-taking 30-40 per cent a year (on revenues of $ 1.5-2 billion a year). Almost all big manufacturing companies are putting global marketing and production strategies in place including acquisitions abroad.

Services is the new engine of global growth and value addition in this age of the Digital-Knowledge Revolution that has dawned after 200 years of the Industrial Revolution. Luckily for India, it needs everything that India has — quality people willing to work hard at low wages and good telecom infrastructure. And it does not need what India does not have — large amounts of capital and physical infrastructure like power, roads, ports. This new paradigm of global growth and value creation is also very beneficial to India. In value terms, it implies a high return on capital and low capital to output ratio — a money manager's delight! — relative to the manufacturing-led boom of China.

The largest component of GDP factor incomes across the globe is services with the USA leading at 75 per cent plus share. Services outsourcing is leading to a transfer of well paying jobs to young Indians in their own country and out of the US and other rich countries without any need for human relocation or migration.

Both trading partners benefit with rising incomes and employment in India and lower cost of services in the rich countries where workers need to move up the value chain in their part of the world in order to justify their much higher costs. The typical wage differential for the same type of work is about four times!

While I see India as mainly a services-led economy during the next 5-10 years, there is now a perceptible pick-up in infrastructure spending and manufacturing scale and competitiveness as well. Telecom, particularly mobile telephony, and new roads and expressways are already making perceptible changes in the lives of the masses.

In sum, faster economic growth and the realisation of the enormous long term potential would lead to a massive expansion of Indian equity market capitalisation. India's market capitalisation at $ 300 billion is currently about 53 per cent of the country's GDP against the world average of 93 per cent. This means there's a lot more room for Indian equity capitalisation to grow.

So, if the Indian story unfolds as depicted above, then clearly the country's equity markets offer a multiple expansion opportunity or what money managers call a 'multi-bagger' opportunity.

India's market capitalisation at $ 300 bn makes it the second largest market in Emerging Asia, after Hong Kong and China.

MUKARRAM BHAGAT
CEO & Managing Partner
ASK-Raymond James & Associates
Mumbai
The views expressed here are personal