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Title

CHALLENGES IN INDIAN FINANCIAL SECTOR TO BECOME ECONOMIC SUPER POWER IN THE COMING DECADE

Author(s)

M. S. Vasudev

K.M. Nagendra

ABSTRACT:

Presently India is borrowing heavily from World Bank and ADB for Government Projects. The Private ventures are looking for FDIs but the ceiling is restricted by government policy. Hence a considerable fiscal from GDP is diverted towards interest or dividend towards these finances. High inflation and global recession are adding to considerable fiscal deficit making the funds more volatile and costly. High inflation and delays in completion are resulting in huge cost over runs thereby rendering the ventures less profitable. PPP models are also highly affected by local demands, making them less attractive for investment. PPP consortiums are mostly having Indian partnerships to bare minimum, thereby keeping them away from all strategic decision process. Most of these PPP Consortiums outsource most of the project execution to parent firms outside India, hence least beneficial to Indian corporate. The corruption and scams have pushed India's credit rations to the rocks bottom (CWG). The political instability due to coalition government also reduced India's credit ratings. Most of the ventures are shadowed by local politics, making them less credible for future investment. Delayed reforms in Direct and Indirect Taxes have made the corporate ventures more defensive towards global initiates.

Key Words: *FDI, PPP, Corporate Governance, Corruption, Taxation*

The Challenges

Ramping up investments in infrastructure is critical for India's growth, and to sustain the country's battle against poverty. Supporting infrastructure investment is particularly important at this time, not just to sustain total domestic demand at a time of global crisis, but also to lay the foundations for stronger economic growth in the future. However, since the onset of the global financial crisis in late 2008, long-term financing to sustain the development of infrastructure has become difficult to obtain. While in 2007, India was the leading destination among low and middle-income countries for private investment in infrastructure, recent evidence indicates that newer projects are being delayed because of the difficulties in securing private financing - particularly long-term private investment.

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The development of infrastructure is a central theme of the Government of India's 11th Five-Year Plan (2007–12). The Plan estimates that investments to the tune of $492 billion are needed during the five-year period in the roads, railways, ports, power, and water sectors. This means almost doubling infrastructure spending from its current 5 percent of GDP. Of this, the private sector would need to contribute a little over 30 percent – or some $160 billion - about *four* times more than it has done in the past five years.

In the current global financial crisis, the availability of private long-term finance has reduced considerably. To foster the country's continued growth and enable it to continue its battle against poverty, the World Bank, at the request Government of India, will finance the India Infrastructure Finance Company Limited (IIFCL) - a financial intermediary - for on-lending to specific sub-projects. The IIFCL is a wholly government-owned financial institution that was established in 2006 to catalyze long-term private financing for PPP projects in infrastructure. Through the IIFCL, World Bank financing will support infrastructure sub-projects in the core sectors of roads (national and state highways), power generation and transmission, and ports.

The lending instrument is a Financial Intermediary Loan, or "FIL", to be financed by an IBRD line of credit of $1.195 billion. The IIFCL will then on-lend the line of credit to specific infrastructure sub-projects including for roads, ports and power. These sub-projects will need to comply with the Bank's eligibility criteria. These criteria include the Bank's environmental and social safeguards, its procurement policies, as well as its accounting and auditing standards. The sub-projects must also show economic and financial rates of return of at least 12 percent.

But looking into the current trends in the global economy over shadowed by the civil wars in oil rich nations like Libya and the catastrophe in Japan, sustaining the rates of return @12% is the biggest challenge.

GOI is working on a number of initiatives to assist and encourage capacity building at the state and central levels. It is identifying the capacity building needs of state governments, providing assistance for the creation of state-level PPP cells as nodal agency, streamlining PPP approval process, developing PPP toolkits, model concession agreements (MCAs), bidding documents, and project preparation manuals. It is also building a central database and website on PPPs to disseminate updated information to the states and the private sector. Arrangements are being finalized under which state governments would be able to avail of consultancy support for developing PPP projects. Institutions like the ADB have begun supporting the capacity building process through these workshops and proposed technical assistance projects.

State governments have identified a whole range of sectors for PPP, including roads/highways, ports (air, sea, container), telecommunication, water supply, waste management, tourism, power, industrial infrastructure, township development, leisure, and health. States have also identified the potential PPP projects that could be developed over the next few years. Many of the projects are already in the bidding stage using both memorandum of understanding (MOU) and competitive bidding procedures.

High inflation and delays in completion are resulting in huge cost over runs thereby rendering the ventures less profitable. PPP models are also highly affected by local demands, making them less attractive for investment PPP consortiums are mostly having Indian partnerships to bare minimum, thereby keeping them away from all strategic decision process. Most of these PPP Consortiums outsource most of the project execution to parent firms outside India, hence least beneficial to Indian corporate.

No clear link between institutional structure and success of PPP is apparent. State/UT governments have indicated marked differences in the process of PPP development, including variations in existence of infrastructure legislation and policies, institutional arrangements for identifying and approving PPPs, project development funds and companies, financial structuring, procurement procedures, etc.

The projects like Bangalore – Mysore Express Corridor by NICE have run in to long battles of litigations due to these differences in the process of PPP development. This will definitely deter others from participating in PPP projects.

The challenge is to streamline the policies for PPP development across the nation in order to bring transparency in PPP development process.

Global ratings firm Fitch has said it may downgrade India's sovereign rating if the country's fiscal deficit worsens. The rating agency has, however, retained its current local and foreign currency ratings.

Besides the fiscal position, the rating agency has also expressed concerns about India's low ratings in World Bank's governance indicators and also poor physical infrastructure. The World Bank's year 2011 'Doing Business' ranking of India is 134 as against 135 in the year 2010. Hence there is no substantial improvement in the overall ranking.

The challenge is to improve the governance indicators and physical infrastructure.

In recognition of the important role of Foreign Direct Investment (FDI) in the accelerated economic growth of the country, Government of India initiated a slew of economic and financial reforms in 1991. India is now ushering in the second generation reforms aimed at further and faster integration of Indian economy with the global economy. As a result of the various policy initiatives taken, India has been rapidly changing from a restrictive regime to a liberal one, and FDI is encouraged in almost all the economic activities under the automatic route. Over the years, FDI inflow in the country is increasing. However, India has tremendous potential for absorbing greater flow of FDI in the coming years. Serious efforts are being made to attract greater inflow of FDI in the country by taking several actions both on policy and implementation front.

FDI investments are permitted through financial collaborations, through private equity or preferential allotments, by way of capital markets through Euro issues, and in joint ventures. FDI is not permitted in the arms, nuclear, railway, coal & lignite or mining industries.

A number of projects have been announced in areas such as electricity generation, distribution and transmission, as well as the development of roads and highways, with opportunities for foreign investors.

Currently, FDI is allowed in financial services, including the growing credit card business. These services include the non-banking financial services sector. Foreign investors can buy up to 40% of the equity in private banks, although there is condition that stipulates that these banks must be multilateral financial organizations. Up to 45% of the shares of companies in the global mobile personal communication by satellite services (GMPCSS) sector can also be purchased. The current status of cumulative FDI flow into India is $190 billion. Most of the FDI (nearly 42%) has come from Mauritius alone. The cumulative FDI from EU is 13% and from USA is just 7%. Also major portion of the FDI is in service sector (nearly 21%) and just 7% in infrastructure construction.

The challenge is to attract more FDI towards Infrastructure Development from developed nations.

In recent years the issue of corporate governance and the design of appropriate governance mechanisms have become important subjects of academic research and policy discourse in both developed and developing countries. The increasing importance of governance mechanisms comes in the wake of major corporate scandals in internationally renowned companies like Enron , Tyco and Worldcom as well as East Asian crisis in the early nineties and Satyam, IPL, CWG, 2G spectrum scams in India, with a large body of empirical and theoretical research highlighting the significant impact that an economy's corporate governance system can have on the profitability and growth of corporations.

The challenge is to restore the investor's confidence in the economy shaken by scandals and corruption.

One of the most important reasons for recent tax reforms in many developing and transitional economies has been to evolve a tax system to meet the requirements of international competition. The transition from a predominantly centrally planned development strategy to market based resource allocation has changed the perspective of the role of the state in development. The transition from a public sector based, heavy industry dominated, import substituting industrialization strategy to one of allocating resources according to market signals has necessitated systemic changes in the tax system. In an export-led open economy, the tax system should not only raise the necessary revenues to provide the social and physical infrastructure but also minimize distortions. The current World Bank ranking for tax regime of India is 164.

Thus, the challenge is reform tax system to adjust to the requirements of a market economy to ensure international competitiveness.

Conclusion:

It is clearly evident from the above facts and figures that India has to tackle these challenges effectives in order to establish itself as an economic super power by year 2020. As the challenges of the financial sector are heavily dominated by the foreign investments and also considering the facts that very less investment from the developed nation in to the core areas of infrastructure building in India, it is obvious that these nations lack interest in development of India. We should also foresee the greatest threat that the moment India starts asserting as economic super power, these foreign investments will vanish from the Indian economy creating a huge void, thus pushing India to the recession it has resisted so far.

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