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Changing Trends of FDI - FDI in Pension Funds

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***Abstract*-** In recent years, emerging market economies (EMEs) are increasingly becoming a source of foreign investment for rest of the world. It is not only a sign of their increasing participation in the global economy but also of their increasing competence. More importantly, a growing impetus for change today is coming from developing countries and economies in transition, where a number of private as well as state-owned enterprises are increasingly undertaking outward expansion through foreign direct investments (FDI). Companies are expanding their business operations by investing overseas with a view to acquiring a regional and global reach. . Foreign direct investment (FDI) in India country assumed critical importance in the context of this liberalization. Though India is the tenth most industrialized country in the world, it is well known that it is mainly agro-based with around 70% population engaged in the farm sector. However, in the initial stage of liberalization, FDI was centered on the urban manufacturing sectors because of its civic infrastructure, labor availability, flexible taxation mechanism etc. The success story of FDI in these sectors is known to us. The present paper is an attempt to study the future prospects of FDI in India in pension funds.

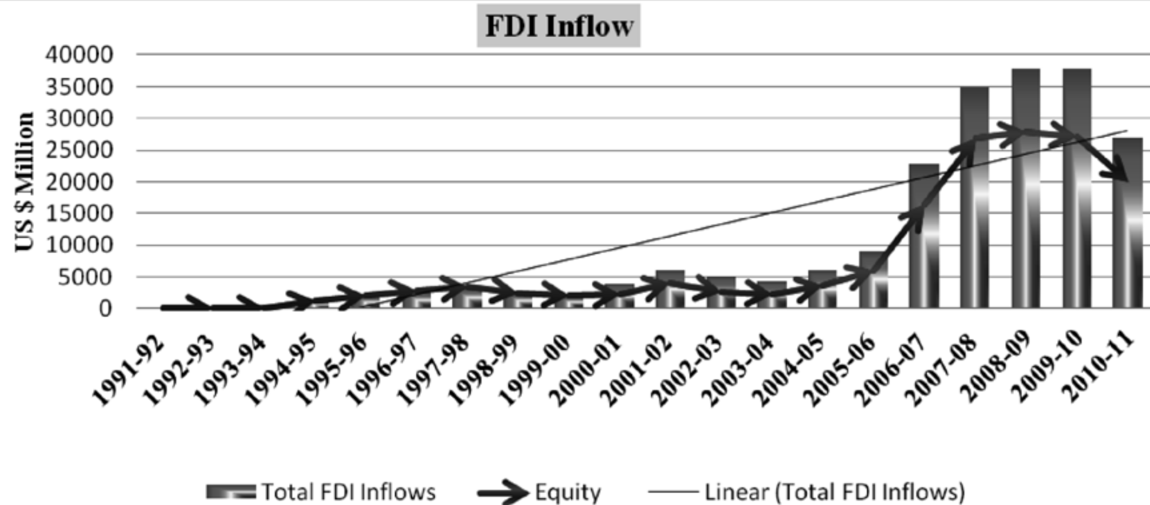
I. Background

There are In 1997, the Indian retail sector witnessed the first footprints of FDI with 100% FDI being permitted in cash & carry wholesale trading under the government approval route, subsequently brought under the automatic route in 2006. As a step ahead, FDI in single brand retail was permitted to the extent of 51% in 2006, while FDI in multi-brand retail remained prohibited till recently. In July 2010, the Department of Industrial Policy and Promotion (DIPP) had put up a discussion paper proposing FDI in multi-brand retail. In July 2011, a Committee of Secretaries (CoS) had cleared the proposal to allow upto 51% FDI in multi-brand retail, which has been approved by the Union Cabinet in November 2011, albeit with a few riders. The Union Cabinet has also approved increasing the FDI limit in single brand retail to 100% with government approval. While no parliamentary approval is needed for the decision, State Governments have the prerogative to disallow the same in their respective states. Mounting opposition by several political parties and State Governments have raised hurdles in the effective implementation of the key reform measure.

II. FDI Inflows Trends: 1991-2011

The data on FDI inflows into the country shows that foreign investors have shown a keen interest in the Indian economy ever since it has been liberalized. An increasing trend of flows can be observed since 1991 with the peak of FDI flows being reached in 2008-09. (Chart 1) Therefore the trend gives support to the fact that as and when the government various reasons which work in favour of India and increase the level of interest shown in by foreign organization's some of them being its demographics' with a young population there is a huge consumer base that is to be tapped, the growing middle class, increased urbanization and awareness, rising disposable incomes.

Chart 1: Trends of FDI Inflow



Source: DIPP

III. FDI Inflow by Components

There has been a change in the method of estimation of FDI inflows since 2000-01, prior to this only equity inflows was taken as the FDI inflow figure however post 2000-01 the RBI has started following the international practice and taken into account other components of FDI inflows namely re-invested earnings and other capital. A look at the contribution of various components of FDI reveals that the share of re-invested earnings was rising from2000 on inflows has risen sharply since 2000-01 when it stood at 59.6 per cent to 74.3 percent in. wards up till 2005-06 after which it has constantly been declining inflows has risen sharply since 2000-01 when risen sharply since 2000-01 when it stood at 59.6 per cent to 74.3 percent in 2010-11.

IV. FDI in Pension Funds

As per the 12th Draft Approach paper of the Planning Commission **The total investment in infrastructure would have to be over Rs. 45 lakh crore or $ 1 trillion during the 12th Plan period.** The year wise requirement of infrastructure investments is given in the table below:

Table 1.: Projected Investment in Infrastructure during the Twelfth Five Year Plan

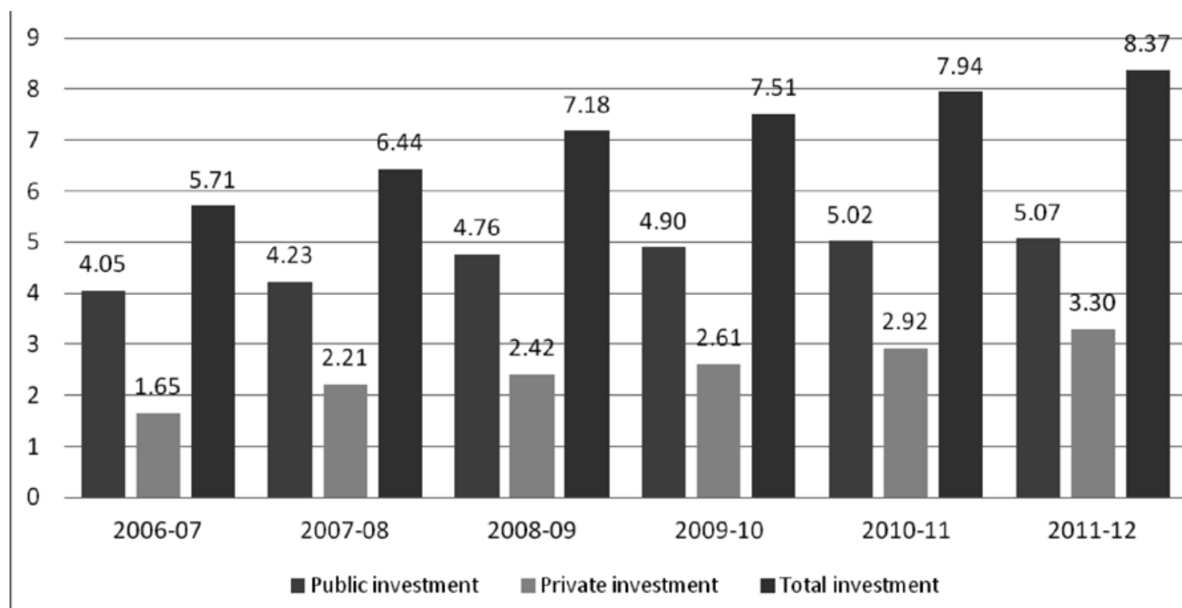
Year	Base year (2011-12)	2012-13	2013-14	2014-15	2015-16	2016-17	Total 12th Plan
GDP at market prices (Rs crore)	63,14,265	68,82,549	75,01,978	81,77,156	89,13,100	97,15,280	4,11,90,064
Rate of growth of GDP (%)	9.00	9.00	9.00	9.00	9.00	9.00	9.00
Infrastructure investment as % of GDP	8.37	9.00	9.50	9.90	10.30	10.70	9.95
Infrastructure investment (Rs crore)	5,28,316	6,19,429	7,12,688	8,09,538	9,18,049	10,39,535	40,99,240
Infrastructure investment (US$	132.08	154.86	178.17	202.38	229.51	259.88	1,024.81

billion) @ Rs 40/$							

Source: Mid-Term Appraisal of the Eleventh Five Year Plan

Such **high level of investments cannot be financed by traditional sources of public finance** alone. Moreover, with increased globalization, provisions will have to be made to counter any global risks that might be prevailing as is the case with Euro zone crises currently.in the light of such events therefore the Central Government might have to pursue an even more cautious approach while incurring expenditures. **This could lead to a significant infrastructure gap and therefore there is need to recognize the importance of private sector's role** in developing **rise.** Please refer to the figure below: **Chart 2.: Share in Total Investment** the infrastructure requirements of the nation. The **share of private sector investments in infrastructure has been marginal on rise.** Please refer to the figure below

Chart 2.: Share in Total Investment



Source: Mid-Term Appraisal of the Eleventh Five Year Plan

However amidst a slowing economy and a fall in corporate performance there might be a situation wherein even the private sector might have monetary constraints to fund huge infrastructure projects.

To fill this Infrastructure Gap
• Pension Fund investments into infrastructure seem to be a befitting alternative given the match of interests for both the sectors.
• FDI in pension funds would further increase the volume of assets that can be invested into infrastructure and help in realizing the infrastructure needs of the country.

Characteristics of infrastructure projects that assist in attracting investments from pension funds:

- Long term income streams
- Stability
- Predictable cash flows
- Low default rates
- Diversification of projects
- The project stands to benefit the society at large

Given the large infrastructure financing requirements, all potential resources must be tapped into by channeling available domestic and international funds into project finance.

However, long-term investors, such as pension and insurance funds, have had a limited presence in the Indian market due to regulatory restrictions.

The contribution of Pension and Insurance companies to infrastructure financing has been relatively small as indicated by their percentage share as sources of debt during the Eleventh Five Year Plan. Please refer to table below:

Table 2.: Likely Sources of Debt Financing for Infrastructure (Rs crore 2006-07 price

	2007-08	2008-09	2009-10	2010-11	*2011-12*	Total Eleventh Plan
Pension /Insurance companies	9077	9984	10983	12081	13289	55414
External Commercial Borrowing	19593	21768	24184	26868	29851	1222263
Estimated Requirement of Debt	131718	155014	187333	229571	283709	988035
% Share of Pension/ Insurance in estimated Requirement of Fund	6.9	6.4	5.9	5.3	4.7	5.6
% Share of ECB's in Estimated Requirement of Fund	14.9	14.0	12.9	11.7	10.5	12.4

Source: Eleventh Five Year Plan

Therefore it is imperative that financial sector reforms continue in order to offer products and services to meet financing and risk management of the needs infrastructure projects.

V. Size of Pension Funds Market

As per an OECD report8 "According to the OECD calculations, the funded pensions market (both occupational and work related) has a size of US$ 24.6tr worldwide. Of this, US$ 16.2tr is held by pension funds". According to another report9 The OECD (Organization for Economic Cooperation and Development) countries account for more than 90 percent of the world's private pension assets and the US account for nearly half of the total assets of private pension assets. **Pension fund assets in BRIC countries are relatively low in relation to their GDP (17 percent in Brazil, 2 percent in Russia, 5 percent in India, and one percent in China).** The total pension assets in 13 markets at the end of 201010 are given in the table below:

Table 3.: Pension Fund Asset

Country	Plan	%GDP
Australia	1261	103
Brazil	342	17
Canada	1140	73
73France	133	5
Germany	471	14
Hongkong	87	38
Ireland	100	49
Japan	3471	64

Netherlands	1032	134
South Africa	256	72
Switzerland	661	126
UK	2279	101
US	15265	104
Total	26496	76

Source: Global Pension Asset Study 2011 Towers Watson

As per the Global Pension Asset Study 2011 **the trend observed in the allocation of pension assets** at a world level are:

Table 4: Asset Allocation in 2010

Asset Allocation	Percentage Alloted
Equity	47
Bonds	33
Others	19
Cash	1

Source: Global Pension Asset Study 2011 Towers Watson

VI. Pension Fund Assets in India

Table 5: Current Status

	Rs. Crores	USD	
India'S GDP in 2010-11	4877842	97556	Exchage Rate taken as 1US$=50 Indian Rupees
Pension Fund Assets		48.78	As stated earlier Pension Fund Asset in India is 5% of GDP
Fund Allocation			
Equity		22.93	Assuming that allocation is done as per the world trend indicators in earlier table.
Bonds		16.10	
Others		9.27	
Cash		0.49	

Allowing FDI in Pension funds would give access to global pension fund companies to the vast untapped Indian market and **assuming that opening up of FDI in Pension Funds shall help India in attracting slightly more than 1 percent of the total pension funds held by pension fund companies (size of pension fund holdings assumed to be US $ 16.2 trillion as given in an OECD report).**

India would be able to raise the share of Pension fund assets to GDP from the current level of 5 percent to close to 17 percent

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which would be similar to that of another emerging economy Brazil's level in 2010.

Moreover a 2.1 percent allocation of total pension fund assets to India would increase its reserves to US $ 342 billion the level of pension assets that were there in Brazil in 2010.

• If Pension Funds reach 17 per cent of India's GDP then this would result in assets worth US$ 165.85 Billion

• Moreover if India is able to reach the levels witnessed in Brazil in 2010 then going by the world trends the Equity allocation of these alone could be as high as US$ 160 Billion

• A CAGR of 16.5 percent as witnessed by Brazil would result in total pension assets of US$ 733.93 Billion, of which equity would be US$ 344.95 Billion. Of this even if 30 per cent goes into Infrastructure Sector then it would mean an investment of US $ 103.49 billion which is close to one tenth of the infrastructure investment requirement of the 12th Plan.

Table 6: Potential Scenario

Asset Allocation	Percentage Allocated	Pension Fund Assets at 5% of GDP	Pension Fund Assets at 17% of GDP	Pension Fund Assets at Brazil's Current Level	Pension Fund Assets at the end of 2017 if CAGR is16.5%
Total Available Assets (USD Billion		48.18	165.85	342.00	733.93
Equity	47	22.93	77.95	160.74	344.95
Bonds	33	16.10	54.73	112.86	242.00
Others	19	9.27	31.51	64.98	139.45
cash	1	0.49	1.66	3.42	7.34

*CAGR is taken as 16.5 per cent as this has been the rate achieved by Brazil in the period 31/12/2000 to 31/12/2010 as per Global Pension Asset Study 2011 Towers Watson.

VII. Other Benefits

• A vast majority of India's population is not covered by any formal old age income scheme and is dependent on their earnings and transfer from family members.
• The unorganized sector has no access to formal channels of old age economic support.
• As indicated in remarks made on the pension system in India12:
 Only about 12 per cent of the working population in India is covered by some form of retirement benefit scheme.
 The total pension liability on account of the Central Government employees has increased at a compound annual growth rate of more than 21% during the 1990s, the comparable rate for the State Government was 27% per annum.
 The implications of demographic dynamics for pension planning in India becomes more evident when one takes into account the fact that average life expectancy at age 60, which is currently 17 years, is likely to rise to more than 20 years in the next three decades and that the population over 60 years of age will approach 200 million in 2030.

Therefore large scale reforms are required to ease the pressure on the treasury, to provide for a social security net for growing numbers of senior citizens as well as a growing workforce.

VIII. Suggestions

We would like to propose a few suggestions to the policymakers for their consideration:

• Bureaucratic delays and various governmental approvals and clearances involving different ministries need to be fastened so as to increase the absorption rate of FDI into the country.
• Restrictions on sector caps and entry route to sectors other than those of national importance need to be liberalized further and constant reviewing of policies must be done.
• Government must ensure consistency of policy so as to improve the business and investor's confidence.
• It is in the interest of the industry at large if a mechanism could be developed which facilitates a consultation between Centre and State governments before a policy rollout so that once the decision is taken its implementation does not get affected.

• Government must recognise that good regulations and efficient processes are key catalysts for FDI. Accessible and reliable

information and efficient and predictable actions by public institutions help create a business environment conducive to investment.

• Time bound, non-discretionary, simplified and less number of procedures and approvals would also help in uplifting the international investor's confidence and help foster more investment into India.

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