Make It Easier For PE Funds To Invest

THE Prime Minister's Economic Advisory Council's report is, as these reports tend to be, a methodically compiled snapshot of the Indian economy at a point in time. Its recommendation that private equity flows be treated as portfolio flows though does appear a little odd. The government's seeming obsession with classification stems from the fact that India's foreign exchange reserves, in contrast to those of China and the oil rich economies, originates due to capital, and not trade, flows. These, the policymakers fear, are likely to be more volatile. However private equity, which India has been attracting in copious amounts, is hard to classify. In some cases private equity firms such as Blackstone, ICICI Ventures and Actis have taken over companies and are running them. All private equity firms, of course, eventually exit but the time horizons range from three to five years. Plainly, these cannot be characterised as portfolio flows. Even pre-IPO placements to FIIs are subject to one year lock-ins. Overall, private equity has played a positive role in India's economic growth, the poster child being Warburg Pincus' investment in Bharti's telecom arm. It's not clear what the policy implications of classifying private equity as portfolio investment would be. Sectoral caps are composite ones and cover both direct and portfolio investment. The overall policy stance should be to make it easier for PE firms to invest. Indeed, there is a good case for allowing, as an intermediate measure, private funds to invest in sectors like retail, where FDI is banned.

The EAC is right in reportedly recommending a cut in indirect taxes. According to McKinsey, taxes in India should be about 15% of the retail price of manufactured products, the same level as in China. Towards this end, the government should stick to its goal of rolling out a nation-wide goods and service tax by 2010. The EAC could also have recommended an easing of licensing norms for the mining sector for Indian and foreign investors. Slow growth in mining has pulled down growth in industrial production. One way to ease infrastructure constraints, another impediment to growth, is for the government to streamline its tendering process for projects under the PPP route.

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