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The Bihar Election: Impact on Reform

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Following the Bharatiya Janata Party (BJP) loss in the Bihar state assembly election, the world began to wonder what impact these results might have on the Narendra Modi government's interest and ability to enact economic reforms. Separately, there had been an emerging narrative that India had already achieved high, sustainable growth rates and that India had emerged as the world's top investment destination—data points that could potentially erode the administration's interest in expending political capital on reforms. But just two days after the Bihar election results were announced, we clearly found the answer with the announcement of foreign investment reforms in 20 sectors and subsectors, several of which will likely be individually significant.

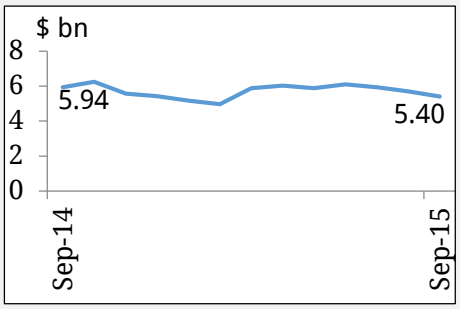
Following the November 10 announcement, the government will now allow foreign investors to participate in a much wider range of economic activity in India, including:

- **E-commerce:** Manufacturers can now sell what they produce directly to consumers via e-commerce, which had been previously banned.
- **E-commerce 2:** Foreign-owned, single-brand retailers can sell to consumers via e-commerce, an activity that had previously been banned.
- **Duty-free Shops:** Foreign firms can now own duty-free shops, without a foreign equity limit.
- **Single Ownership of Multiple Sales Channels:** A foreign firm can simultaneously own both a single-brand retail chain, as well as a cash and carry wholesale chain.
- **Nonresident Indians Exempted from Foreign Direct Investment (FDI) Caps:** Companies owned by nonresident Indians (NRIs) are no longer subject to FDI caps at all. So sectors where foreign investment is banned, limited, or have poisonous provisions that have precluded FDI inflows, are now open to NRI investors.
- **Defense:** Foreign firms can now potentially own a majority stake in an Indian subsidiary without meeting the ill-defined requirement that the investment give the Indian subsidiary access to "state-of-the-art" technology.

In all, the government liberalized foreign investment rules in nearly 20 subsectors. In some, foreign equity limitations were raised. In others, rules governing foreign investment were eased. For a third group, the process for getting investment approvals was simplified. And lastly, for one sector—operating duty-free stores—this marks the first time this business has been included in the list of sectors where foreign investment is, or is not, permitted. Other reforms, such as increasing the size of investments that are reviewed by the Foreign Investment Promotion Board, rather than the Cabinet Committee on Economic Affairs, will impact multiple industries.

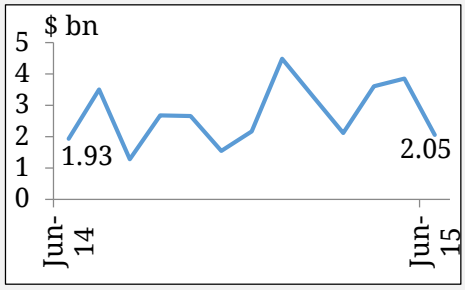
KEY DATA

+6.3%



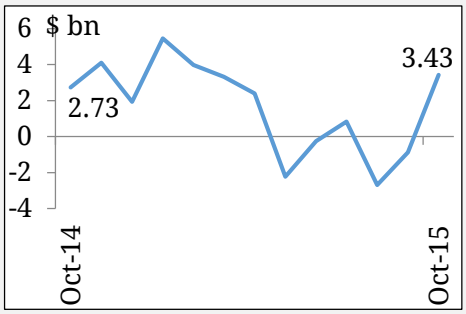
Increase in U.S.-India goods trade, 12-month rolling average, per U.S. Census.

+27.0%



Increase in FDI, 12-month rolling average, per DIPP.

-51.3%



Increase in FII, 12-month rolling average, per NSDL.

It is rare, though certainly not unprecedented, for a sitting government to announce simultaneously the opening of multiple sectors. Past examples over the last 20 years where the Indian government revised the foreign equity rules in multiple sectors at once include:

- **Press Note 1 of 1999**: Roads, ports, bridges;
- **Press Note 7 of 2000**: Business-to-business (B2B) e-commerce, refining, electricity generation and distribution;
- **Press Note 4 of 2001**: Pharmaceuticals, airports, defense, construction, hotels, couriers, transport, Internet service providers, banking;
- **Press Note 1 of 2004**: Scientific and technical journals, petroleum marketing, petroleum exploration and development;
- **Press Note 4 of 2006**: Cash and carry, power trading, alcohol production, hazardous chemicals production, airports, B2B e-commerce, mining, pipelines;
- **Press Note 4 of 2008**: Airports and maintenance, ground handling services, air transportation;
- **Press Notes 4, 5, 6, 7, 8 of 2012** (issued simultaneously): Retail, airlines, satellite television, power exchanges;
- **Press Note 6 of 2013:** Tea plantations, petroleum refining, defense, courier services, telecom, single-brand retail, test marketing, asset reconstruction companies, commodity exchanges, credit information companies, power exchanges.

Separate from the impact of the Bihar election, a dangerous narrative was reemerging that seemed to indicate a reduced interest in pursuing economic reforms (as it did a decade earlier)—the feeling that India's new growth floor was 7 percent and that India was already the world's top investment destination. This engendered a fear that politicians may feel less inclined to spend political capital on pursuing tough reforms. But the November 10 announcement clearly strikes down this narrative, though the timing of the announcement indicates that the Modi government does prefer to take reform steps when it is not facing an election.

The full details of these reforms will be released soon. The Modi government, like the Manmohan Singh government that preceded it, has shown an ability to insert "poison pills" into FDI reforms in the past (e.g., the "control" issue in insurance). Hopefully the detailed rules, when issued, will fall on the side of openness and clarity.

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