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Overview of Foreign Investment Policy in India

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Abstract

Foreign investment refers to the investments made by the residents of a country in the financial assets and production process of another country. The foreign investment is necessary for all developing nation as well as developed nation but it may differ from country to country. The developing economies are in a most need of these foreign investments for boosting up the entire development of the nation in productivity of the labour, machinery etc. The foreign investment or foreign capital helps to build up the foreign exchange reserves needed to meet trade deficit or we can say that foreign investment provides a channel through which developing countries gain access to foreign capital which is needed most for the development of the nations in the area of industry, telecom, agriculture, Information Technology etc. The foreign investment also affects on the recipient country like it affects on its factor productivity as well as affects on balance of payments. Foreign investment can come in two forms: foreign direct investment and foreign institutional investment.

Key words : *Foreign investment, financial assets and production process.*

1. INTRODUCTION

Since 1990-91, the Government of India embarked on liberalization and economic reforms with a view of bringing about rapid and substantial economic growth and move towards globalization of the economy. As a part of the reforms process, the Government under its New Industrial Policy revamped its foreign investment policy recognizing the growing importance of foreign direct investment as an instrument of technology transfer, augmentation of foreign exchange reserves and globalization of the Indian economy.

Simultaneously, the Government, for the first time, permitted portfolio investments from abroad by foreign institutional investors in the Indian capital market. The entry of FIIs seems to be a follow up of the recommendation of the Narsimhan Committee Report on Financial System. While recommending their entry, the Committee, however did not elaborate on the objectives of the suggested policy. The committee only suggested that the capital market should be gradually opened up to foreign portfolio investments. From September 14, 1992 with suitable restrictions, Foreign Institutional Investors were permitted to invest in all the securities traded on the primary and secondary markets, including shares, debentures and warrants issued by companies which were listed or were to be listed on the Stock Exchanges in India. While presenting the Budget for 1992-93, the then Finance Minister Dr. Manmohan Singh had announced a proposal to allow reputed foreign investors, such as Pension Funds etc., to invest in Indian capital market.

2. CHANNELS OF FOREIGN INSTITUTIONAL INVESTMENTS IN INDIA

Portfolio investments in India include investments in American Depository Receipts (ADRs)/ Global Depository Receipts (GDRs), Foreign Institutional Investments and investments in offshore funds. Before 1992, only Non-Resident Indians (NRIs) and Overseas Corporate Bodies were allowed to undertake portfolio investments in India.

Thereafter, the Indian stock markets were opened up for direct participation by FIIs. They were allowed to invest in all the securities traded on the primary and the secondary market including the equity and other securities/instruments of companies listed/ to be listed on stock exchanges in India.

3. EVOLUTION OF FOREIGN DIRECT INVESTMENT POLICY

In the 1980s the attitude towards FDI began to change as a part of the strategy of modernization of industry with liberalized imports of capital goods and technology, exposing the Indian industry to foreign competition and assigning a greater role to multinational enterprises in the promotion of manufactured exports. The policy changes adopted in the 1980s covered liberalisation of industrial licensing (approval) rules, a host of incentives and exemption from foreign equity restrictions under FERA to 100 per cent export-oriented units and a degree of flexibility concerning foreign ownership.

After pursuing a restrictive policy towards FDI over the four decades with a varying degree of selectivity, India changed tracks in 1990s and embarked on a broader process of reforms designed to increase her integration with the global economy. The major policy reforms initiated in the post liberalisation period are presented in chronological order in the following section.

4. CHRONOLOGICAL LISTING OF FDI POLICY REFORMS 1991-92

- As against the previous policy of considering all foreign investment on a case by case basis and that too within a normal ceiling of 40 per cent of total equity investment, new policy provides for automatic approval of FDI up to 51 per cent of equity in a specified list of 34 specified high-priority, capital intensive, high technology industries, provided the foreign equity covers the foreign exchange involved in importing capital goods and outflows on account of dividend payments are balanced by export earnings over a period of 7 years from the commencement of production. Foreign technology agreements are also liberalized for the 34 industries with firms left free to negotiate the terms of technology transfer based on their own commercial judgement and without the need for government approval for hiring of foreign technicians and foreign testing of indigenously developed technologies. This is only subject to a registration procedure with the Reserve Bank of India.
- The Foreign Exchange Regulation Act (FERA) was amended to remove a number of constraints earlier applicable to firms with foreign equity operating in India and also to make it easier for Indian businesses to operate abroad.
- India signed the Multilateral Investment Guarantee Agency (MIGA) Convention and became a member of MIGA along with many other developing countries interested in the promotion foreign investment.
- Restrictions placed in March 1991 on sale of foreign exchange for import of capital goods, which were allowed initially only under foreign lines of credit available with financial institutions. Subsequently, in November 1991, this policy was relaxed permitting such imports up to a limited extent against suppliers' credit. Import of capital goods up to a value of Rs. 50 lakhs was also permitted against free foreign exchange and up to a value of Rs. 100 lakhs if the importer could arrange suppliers' credit for 360 days. Import of capital goods would also be allowed (i) against a matching inflow of foreign equity, (ii) against release of

free foreign exchange up to 15 per cent of the cost of import up to a limit of Rs. 100 lakhs where 85 per cent of the cost is financed by external commercial borrowing, (iii) for export-oriented entities against borrowings for a minimum period of two years provided the borrowings are liquidated out of the net foreign exchange earnings of the borrowing unit.

- Earlier prohibition against use of foreign brand name or trademark in goods sold in the domestic market withdrawn.
- Abolished all industrial licensing, irrespective of the level of investment for certain industries related to security and strategic concerns, concerns related to safety and overriding environmental issues, and manufacture of products of a hazardous nature. Certain locational guidelines remain designed to discourage the clustering of industries, particularly the polluting industries in the periphery of major urban centers. Existing industries also free to expand according to their market needs without obtaining prior expansion or capacity clearance from the government.
- Abolition of industrial capacity licensing permits firms to freely manufacture any article in response to market demand (except those subject to compulsory licensing). Phased manufacturing programs which allow for the enforcement of strict local content requirements are abolished.
- Mandatory convertibility clause allowing financial institutions to convert part of their loans into equity if felt necessary by their management is waived.

2013-14

- The sectors in which FDI is prohibited is specified as: retail trading (except single brand product retailing), atomic energy, lottery business, gambling and betting, business of chit fund, Nidhi companies, trading in transferable development rights (TDRs) and activities/ sectors not opened to private sector investment.
- 49 per cent FDI in credit information companies has been allowed.
- FDI up to 29 per cent and FII up to 24 per cent in commodity exchanges, subject to no single investor holding more than 6.5 per cent, have been allowed.
- FDI up to 100 per cent under the automatic route has been allowed both in setting up and in established industrial parks.
- FDI cap in the civil aviation sector, which includes 74 per cent FDI in non- scheduled airlines, chartered airlines and cargo airlines, has been relaxed.
- 100 per cent FDI in maintenance and repair organizations, flying training institutes, technical training institutions, and helicopter services/ seaplane services has been allowed.
- FDI policy in the petroleum and natural gas sector has been rationalized.
- FDI up to 100 per cent (with prior government approval) in mining and mineral separation of titanium-bearing minerals and ores, its value addition, and integrated activities has been allowed.

5. SECTOR SPECIFIC FDI POLICY

While investments are prohibited in some sectors/activities, there are restrictions caps on the investment in certain other sector/activities. The caps in various sector(s)/activity and the channels for the entry of FDI into India are detailed out in Table-1.

Table 1 : Sector Specific FDI Policy

Sector	FDI Cap/Equity	Entry Route
Advertising and Films	100%	Automatic
Air Transport Services	49% FDI 100%	Automatic
Alcohol-Distillation and Brewing	100%	Automatic
Cigars & Cigarettes-Manufacture	100%	FIPB
Commodity Exchanges	49%	FIPB
Construction and Maintenance	100%	Automatic
Credit Information Companies	149%	FIPB
Insurance	26%	Automatic
Coal & Lignite mining for captive consumption by power projects, and iron & steel, cement production and other eligible activities permitted under the Coal Mines (Nationalization) Act, 1973.	100%	Automatic
Development of Townships, Housing, Built-up infrastructure	100%	Automatic
Courier services for carrying packages, parcels and other items which do not come within the ambit of the Indian Post Office Act, 1898.	100%	FIPB
Defence Production	26%	FIPB
Drugs & Pharmaceuticals	100%	Automatic
Industrial Explosives Manufacture	100%	Automatic
Industrial Parks - both setting up and already established Industrial Parks	100%	Automatic
Infrastructure Company in the Securities Market	49%	FIPB
Investing companies in infrastructure / service sector	49% (FDI 26%) (FII 23%)	FIPB
Mining covering exploration and mining of diamonds & precious stones; gold, silver and minerals	100%	Automatic
Research and Development Services excluding basic Research and setting of R&D/academic institutions which would award degrees/diplomas/certificates	100%	Automatic
Satellites – Establishment and Operation	74%	FIPB
Security Agencies in Private Sector	49%	FIPB
Special Economic Zones	100%	Automatic
Storage and Warehouse Services	100%	Automatic
Tea Sector including Tea Plantation	100%	FIPB

Source : Report on Finance Years 2013-14

6. EVOLUTION OF PORTFOLIO INVESTMENT POLICY IN INDIA

India's development strategy was focused on self-reliance and import substitution until the 1980s. Current account deficit was financed mainly through debt flows and official development assistance. There was a general disinclination towards foreign investment or private commercial flows. Since the initiation of the reform process in the early 1990s, however, India's policy stance has changed substantially, with a focus on harnessing the growing global foreign direct investment (FDI) and portfolio flows.

Right from 1992, FIIs have been allowed to invest in all securities traded on the primary and secondary markets including shares, debentures and warrants issued by companies which were listed or were to be listed on the Stock Exchanges in India and in schemes floated by domestic mutual funds. The holding of a single FII and of all FIIs, NRIs and OCBs together in any company was initially subject to the limit of 5 per cent and 24 per cent of the company's total issued capital, respectively.

India has been following a cautious and gradual approach to capital account liberalisation in the post-reform period. While virtually all restrictions on foreign non-debt capital inflows into India have been lifted (except for a few sectoral caps), India continues to maintain restrictions on debt inflows, particularly of short maturities, and outward investment. Recognizing that the foreign flows augment the domestic capital stock and thereby higher economic growth and provide other dynamic gains from financial integration, the Committee on Capital Account Convertibility suggested a cautious approach to liberalisation of forex flows.

7. FOREIGN INVESTMENT AND FOREIGN EXCHANGE RATE

After the initiation of the reforms and devaluation of the rupee in 1991, the nominal exchange rate was kept more or less fixed but the RBI kept saying that the exchange rate was market determined, even as it kept buying foreign exchange to keep the rupee from appreciating as foreign inflows began to flood in. After the volatility in the mid-1990s, the RBI said that while the level of the exchange rate was market determined it was intervening in order to lower volatility in the market. The central bank's intervention in the foreign exchange market is presented in Table-2.

Table 2 : RBI's Intervention in the Forex Market

Year	Purchase	Sale	Net Purchases	Outstanding Net Forward Purchases
1995-96	3.6	3.9	-0.3	—
1996-97	11.2	3.4	7.8	—
1997-98	15.1	11.2	3.9	-1.8
1998-99	28.7	26.9	1.8	-0.8
1999-00	24.1	20.8	3.3	-0.7
2000-01	28.2	25.8	2.4	-1.3
2001-02	22.8	15.8	7.0	-0.4
2002-03	30.6	14.9	5.7	2.4
2003-04	55.4	24.9	30.5	1.4
2004-05	31.4	10.6	20.8	0
2005-06	15.2	7.1	8.1	0
2006-07	26.8	0	26.8	0
2007-08	79.7	1.5	78.2	14.7
2008-09	26.6	61.5	-34.9	-2.0
2009-10	24.2	57.4	-31.2	-1.8
2010-11	25.3	59.2	-35.1	-1.9
2011-12	25.8	59.7	-35.2	-2.0
2013-14	27.7	61.2	-36.2	-1.9

Source : Report on Currency and Finance, Various Years 2013-14.

A look at the entire period since 1993-94 when India moved towards the market determined exchange rates reveals that the Indian Rupee has generally depreciated against the dollar during the last 16 years, except during the period 2003 to 2005 and in 2007-08 when rupee appreciated on account of general dollar weakness against major currencies. During 1993-94 to 2013-14, the Indian rupee depreciated against dollar by about 42.65 per cent.

8. CONCLUSION

FIIs were initially allowed to invest only in listed securities of companies. Gradually, they were allowed to invest in unlisted securities, rated government securities, commercial paper and derivatives traded on a recognized stock exchange. From November 1996, any registered FII willing to make 100 per cent investment in debt securities were permitted to do so subject to specific approval from SEBI as a separate category of FIIs or sub-accounts as 100 per cent debt funds. The overall cap on investments in Government securities, both through the normal route and the 100 per cent debt fund route, was revised from US $1 billion to US $3.75 billion in November, 2014.

Moreover, investments were allowed only in debt securities of companies listed or to be listed in stock exchanges. Investments were free from maturity limitations. FII investments were also allowed in dated Government securities from April 1998. Treasury bills, being money market instruments, were originally outside the ambit of such investments, but were included subsequently from May 1998. An overview of the foreign investment policy in India reveals the fact that policy changes were introduced in India not in one go but it was a gradualist one. Even after the completion of nearly two decades, reform measures are still continuing which is an indication of the fact that reforms are never ending and an unfinished business in the agenda of the Government of India.

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