

Radical Liberalization of the Foreign Direct Investment (FDI) Regime in India

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Abstract
Apart from being a critical driver of economic growth, foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of an underdeveloped country like India. The main advantage of this form of assistance is that generally the foreign investor also brings with him new technology, better management and organization, superior marketing and cheaper finance. Whereas foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. The Indian government's favorable policy regime and robust business environment investment have ensured that foreign capital keeps flowing into the country in order to supplement domestic capital, technology and skills. The government has taken many initiatives in recent years such as relaxing FDI norms across sectors such as defense, PSU oil refineries, telecom, power exchanges pharmaceuticals, and stock exchanges, among others. Coordinated and concerted efforts have been made by the Indian government to provide impetus to the ''Make in India'' initiative for accelerated economic growth. This paper aims to examine the various FDI reforms that the Indian government has undertaken in the recent past and its effects on the respective sectors.
Keywords: Foreign Capital, Foreign Direct Investment, Foreign Investor, FDI Inflows, Greenfield and Brownfield Projects, Automatic and Government Approval Route

INTRODUCTION

India has become the tenth largest recipient of foreign direct investment (FDI) in 2015 in the world, grossing $ 44 billion following a series of reforms by the government, as per the latest World Investment Report 2015 released by the United Nations Conference on Trade and Development (UNCTAD). According to the report, the country has been listed in top three preferred investment destination for multinational enterprises, just behind China and the US owing to the new liberalization steps enacted since the inauguration of the new government. Among the investment promotion agencies, India is the sixth most preferred investment destination, one rank above last years. In terms of Greenfield investments, India received $63.44 billion in foreign investment commitment, more than $ 59.4 billion for China.

Indian government has again unleashed what it termed a ''radical liberalization'' of the Foreign Direct Investment (FDI) regime- a second wave of FDI reforms, by allowing 100 percent inflows (complete foreign ownership) in Civil Aviation, teleports, DTH, mobile TV and food processing sectors (Single Brand Retail) while easing FDI norms in defense Animal Husbandry Policy and pharmaceuticals Sector and putting more sectors on automatic route.

Some important measures announced for promoting foreign investment in the post-reform period (i.e. from 1991 onwards) are highlighted in the table below:

Table 1: FDI Policy Highlights (1991-2016)

August 1991:	• FDI up to 51% opened up in 47 high priority sectors, including software (with 34 sectors under automatic route), with a condition that capital goods imports to be financed by foreign equity. Export trading firms, hotels and tourism businesses also allowed 51% FDI. • Foreign investment promotion Board set up in the PMO to vet FDI proposals, with a Finance Minister –headed panel decided on investments up to INR 300 crore and a cabinet committee on foreign investment taking a call on FDI over INR 300 crore.
April 1992	FDI in software also put on Automatic Route
May 1992	Use of Foreign brand names allowed
June 1992	Dividend balancing norms for FDI-backed firms, linking dividend payments to export income, scrapped for all but consumer goods firms
October 1994	FDI in Pharma up to 51% put on automatic approval route, except for recombinant DNA technologies
1996	Foreign Investment Promotion Board (FIPB) transferred to the Department of Industrial Policy and Promotions (DIPP) approvals up to INR 600 crore by industry ministry, cabinet committee nods over INR 600 crore.
November 1996	Condition linking import of capital goods to foreign equity investments scrapped
October 1998	49% FDI allowed in mobile telephony by satellite
January 1999	FDI in construction of Highways, toll roads and ports raised from 74% to 100%.
March 2000	Eases norms for 100% FDI in NBFC's
October 2000	26% FDI in Insurance Sector
May 2001	• 100% FDI in drug manufacturing and pharma, airports, hotel, tourism • 26% FDI in defense • 74% in select activities of telecom sector • 49% FDI in Banking Sector
January 2004	100% FDI in petroleum product marketing, oil exploration, petroleum production and natural gas pipelines
March 2004	74% FDI in Private Banks
March 2005	100% FDI in Townships
November 2005	• 74% FDI in Telecom Sector • 20% FDI in Radio Broadcasting
February 2006	51% FDI in Single Brand Retail
March 2006	74% FDI in Telecom Sector
March 2008	• 100% FDI in Airports • 74% FDI in Non-Scheduled Air Transport Services
January 2009	• 100% FDI in Fax Publication of Foreign Newspapers • 26% FDI in publication of Indian versions of Foreign Publication
November 2011	100% FDI in brownfield pharmaceutical projects (earlier only in Greenfield)
January 2012	FDI in Single Brand Retail raised from 51% to 100%
September 2012	• 51% FDI in Multi-brand Retail • 49% FDI in Aviation Companies • 49% FDI in Power Exchanges • 74% FDI in teleports, mobile TV
August 2014	• 49% FDI in Defense Sector • 100% FDI in some aspects of Rail Infrastructure
March, April 2015	• 49% FDI in Insurance Sector • 49% FDI in Pension Sector
June 20, 2016	• **100% FDI in trading including through e-commerce** • **Amendments to FDI in Defense Sector Policy** • **100% FDI in teleports, DTH, mobile TV** • **100% FDI in Brownfield Aviation projects** • **74% FDI in Private Security Agencies** • **Amendments to FDI in Animal Husbandry Policy** • **Relaxing of FDI norms in Single Brand Retail**

RECENT SIGNIFICANT FDI ANNOUNCEMENTS/INVESTMENTS IN INDIA

- Based on the recommendations of Foreign Investment Promotion Board (FIPB), the Government has approved 18 proposals of FDI amounting to approximately INR 5,000 crore (US$ 770 million).
- American military manufacturer Lockheed Martin plans to produce F-16 Fighters in an assembly line based in India taking advantage of the new liberalized FDI conditions announced by the Government.
- Apple Inc is aiming to open its first stores in India and might eventually start manufacturing in the country under new foreign investment rules for retailers outlined June, 2016.
- The Indian government, during the 2014-15 fiscal year, announced that it would allow FDI worth US$ 14.65 billion into the railways infrastructure. Some of the most expensive and largest railway projects will be carried out under these investments.
- During the next three years, ADAMA Agrochemicals, an Israeli firm, has set its targets to spend US$ 50 million in India. The company plans to enhance R&D and manufacturing facilities in India to grow at a better rate than the current industry growth rate.
- Germany-based ThyssenKrupp group is aiming to double its revenue from India to US$ 1 billion in next three-four years while the group's elevator unit, ThyssenKrupp Elevator, plans to invest EUR 44 million (US$ 50.5 million) to set up a manufacturing plant in Chakan, Pune.

- Dalian Wanda Group, one of China's largest real estate firms, has planned to invest US$ 10 billion in India in the next 10 years which will be used to construct retail properties and industrial townships.

Table 2: FDI EQUITY INFLOWS from FINANCIAL YEARS 2000-01 to 2015-16

Sr. No.	Financial Years from 2000-01 to 2015-16	Amount of FDI inflows (In US$ million)	%age growth over previous year (in terms of US $)
1.	2000-01	2,463	-
2.	2001-02	4,065	(+)65
3	2002-03	2,705	(-)33
4.	2003-04	2,088	(-)19
5.	2004-05	3,219	(+)47
6.	2005-06	5,540	(+)72
7.	2006-07	12,469	(+)125
8.	2007-08	24,575	(+)97
9.	2008-09	31,679	(+)28
10.	2009-10	25,834	(-)18
11.	2010-11	21,313	(-)17
12.	2011-12	35,432	(+)64
13.	2012-13	22,423	(-)36
14.	2013-14	24,299	(+)8
15.	2014-15	30,931	(+)27
16.	2015-16	40,001	(+)39
CUMULATIVE TOTAL (from April, 2000 to March, 2016)		288,635	-

Source: FDI Statistics, Department of Industrial Policy and Promotion, Government of India, Ministry of Commerce and Industry;
Website: http://dipp.nic.in/English/Publications/FDI_Statistics/FDI_Statistics.aspx

NEW FOREIGN DIRECT INVESTMENT (FDI) POLICY REFORMS IN PHARMACEUTICALS, DEFENCE, CIVIL AVIATION AND SINGLE BRAND RETAIL SECTORS

The changes in the policy include 100 percent FDI approval route for trading, including through e-commerce, in respect of food products manufactured and produced in India. To attract investment in the **defense sector**, the government has removed the condition of ''state-of-the-art'' technology, besides permitting foreign investment in manufacturing of small arms and ammunitions.

The government also permitted 100 percent FDI through automatic routed in broadcasting carriage services like teleports, direct-to-home and mobile TV.

In a significant reform, the government allowed 100 percent FDI in airlines and relaxed norms for overseas investment in Brownfield airports (Table 3). In private security agencies, FDI limit was raised to 74 percent from 49 percent earlier.

In Single Brand Retail Trading, the mandatory local sourcing norm for foreign firms will not be applicable up to three years from commencement of the business i.e. opening of the first store for entities undertaking single brand retail trading of products have state of the art and cutting edge technology and where local sourcing is not possible. After completion of the exemption period, the foreign company in the next five years will have to meet the domestic sourcing norm at an annualized average rate of 30 percent. Thereafter, they have to comply with the norm on an annual basis.

The DIPP also notified the changes in **pharmaceuticals**, in which government has allowed FDI up to 74 percent through automatic route and beyond that under government approval. The government has also relaxed the norms in **animal husbandry sector.**

Table3: FDI Reforms in Defense, Civil Aviation, Single-Brand Retail and Pharmaceuticals Sectors to induce more Investments

Aviation	**Defense**	**Retail**	**Pharmaceuticals**	**FDI continues to be prohibited in**
- 100% FDI under Automatic Route in brownfield Airports (where funds are pumped into an existing airport) has been permitted - Earlier it was 74% for this category	- 100 percent FDI and some amendments in the Defense Sector - Earlier, FDI beyond 49% was permitted through approval route in cases of modern and ''state-of-the-art'' technology	*Single Brand Retail*: - Local Sourcing Norms eased for three years - A relaxed sourcing regime introduced for five years	- It has been decided to permit upto 74% FDI under automatic route in Brownfield projects ; approval route beyond 74%	- Lottery - Gambling - Atomic Energy - Real Estate Investments Trust - Railway Operations

1) FDI REFORM IN CIVIL AVIATION SECTOR

Opening up investments in the civil aviation sector, the government allowed overseas entrepreneurs, other than airlines, to bring in up to 100 percent foreign direct investment (FDI) to set up an airline in India. However, foreign airlines will be permitted to invest only up to 49 percent in the airline.

This means that although equity holdings of foreign airlines is still limited to 49 percent , a foreign airline can join hands with its sovereign fund or private investor and set up a 100 percent foreign-owned airline in India. Thus, with this move, the foreign carriers would no longer have to look for an Indian partner to set up a domestic airline and could join hands with private investors abroad.

At present, foreign investment in a scheduled or regional air transport service or domestic scheduled passenger airline is permitted up to 49 percent.

The government has decided to raise the FDI limit in the Civil Aviation Sector to 100 percent, with FDI up to 49 percent permitted under the automatic route and beyond 49 percent through government.

Therefore to give a fillip to airport modernization, 100 percent FDI will be allowed for existing airports under the automatic route. Currently, while this is allowed for Greenfield airport projects, FDI beyond 74 percent in existing airports requires government approval.

100 percent FDI is now allowed in the following Civil Aviation areas:

- Airports
- Airlines
- Ground Handling
- Flying Training Institutes &
- Maintenance, repair and Overhaul (MRO) units

Foreign Airlines in India

Foreign airlines, at present, own stake in Jet Airways, Vistara and Air Asia India. In 2013, Jet Airways sold a 24 percent stake to Etihad Airways. Vistara is a joint venture between Tata Sons (51 %) and Singapore Airlines (49%). Air Asia Bhd owns a 49 percent stake in Air Asia India and Tata Sons 51 percent.

Conclusion

Thus the decision to liberalize FDI regime for brownfield airports has been welcomed by all as it will not only allow long-term capital inflows but will also help India in modernizing airport infrastructure in next 10-15 years. The move would put to rest the controversies around ownership and effective control and foreign airlines could now focus on the customers and competition rather than wasting time on legal and regulatory issues.

2) RELAXED NORMS IN THE DEFENCE SECTOR

The government has allowed 100 percent FDI and some amendments in the Defense Sector. The decision to liberalize conditions governing 100 percent FDI in Defense Sector could result in at least some foreign entities setting up subsidiaries in India.

Following are the relaxed norms in the Defense Sector

- Earlier, FDI beyond 49 percent was permitted through approval route in cases of access to modern and ‘’state-of-the-art’’ technology. But now the demand for ‘’state-of-the-art’’ technology has been removed by the government for permitting 100 percent FDI in the Defense Sector as it was affecting the ease of doing business.
- The new condition is that the companies wanting to invest 100 percent FDI and open a subsidiary only needs to bring in ‘modern’ technology.
- The new rule is – 49 percent FDI in Defense under the Automatic Route. Foreign investment beyond that would be permitted through government approval route in cases resulting in ‘’modern’’ technology.
- The FDI limit for the defense sector has been made applicable to manufacturing of small arms and ammunition covered under the Arms Act, 1959.

Conclusion

Thus the new policy will be a significant step forward in ensuring OEM (Original Equipment Manufacturer) subsidiary driven manufacturing plans take off. It will result in greater comfort for OEMs to establish high technology manufacturing driven subsidiaries.

3) PHARMACEUTICAL SECTOR

The Union government has decided to allow 100 percent FDI under the automatic route in Greenfield pharmaceutical projects and under government approval in existing companies, or Brownfield pharma. FDI under the automatic route in Brownfield pharmaceutical firms would be 74 per cent.

Enhanced Investment through Mergers and Acquisitions

According to some analysts, with 100 percent Foreign Direct Investment (FDI) in pharma, mergers and acquisitions (M&A) by multinationals are likely to intensify in the sector, which is thus expected to attract a sizeable amount of foreign funds.

The new norms will enable enhanced investments in the form of M&A Activities form MNC companies, which believe in the growth potential of the domestic pharma industry.

For private companies, this will allow promoters to monetize part of their shareholding easily should they choose to do so. The Foreign Investment Promotion Board (FIPB) process used to add to timelines; deals will now close much quicker.

4) FDI IN THE RETAIL SECTOR

Amongst the changes announced, the move to allow FDI in retailing of food products manufactured or produced in India is perhaps the most significant owing to the chronic problems faced by the food processing sector in India- cases of farmers failing to receive fair price for their produce and lack of adequate back-end infrastructure that resulted in produce not reaching markets for consumption.

The government has allowed 100 percent FDI in trading of food products, including through e-commerce, to boost food processing sector in the country. 100 percent of FDI would be allowed through the FIPB route in marketing of food products produced and manufactured in India.

Retailing has been permitted for this segment in brick-and-mortar and e-commerce formats. It is a departure from the current policy stance where differential e-commerce in the B to C space is generally subject to greater restrictions in the retail space as compared to the brick and mortar operations. This would encourage investments both in the front-end through the brick and mortar players and back-end infrastructure by the e-commerce players.

The food processing sector attracted USK 5,286.66 million FDI during April 2012 to December 2015 period. The Investment has been expected to benefit foreign retail giants such as Walmart and Tesco.

CONCLUDING REMARKS

Foreign investment is considered crucial for India, which needs around USD 1 trillion for overhauling its infrastructure sectors such as ports, airports and highways to boost growth. This would require support from FDI flows.

Significant changes have been made in the FDI policy regime in the recent times to ensure that India remains increasingly attractive and investor friendly thereby promoting the ease of doing business. Owing to the previous reforms in FDI taken by the government the FDI in the country has touch an all-time high of USD40 billion in 2015-16.

With a backdrop of Britain's exit from the European Union, a strong inflow of foreign investments will help improve the country's balance of payment situation and strengthen rupee value against global currencies, especially the US dollar.

The central governments sweeping reforms in Foreign Direct Investment have been severely criticized by the opposition parties on the grounds that the reforms would affect India's independent foreign policy and would be highly dangerous to allow 100 percent FDI in Defense Sector. According to some, 100 percent FDI in Pharmaceutical and agriculture will kill the Indian Brands. But one must not forget that domestic players do not have to fear the foreign competition as they are globally robust enough to take them globally. In fact the entry of global partners will help our home grown brands prosper as they have already been modernized, adapted competition and improved quality.

New reforms in FDI will lead to greater inflow of foreign investments and encourage domestic players in sectors such as manufacturing with cutting-edge technology, defense, aviation, food processing and retail. Thus if these reforms are implemented correctly, then it will not only help improve India's overall market sentiment but will also boost the overall economy of the country.

GLOSSARY OF DEFINITIONS

1) AUTOMATIC ROUTE: Under this route no Central Government permission is required.
2) FOREIGN DIRECT INVESTMENT: It means investment by non-resident entity/person resident outside India in the capital of an Indian company under Schedule 1 of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India)
3) GOVERNMENT ROUTE: Under this route applications are considered by the Foreign Investment Promotion Board (FIPB). Approval from Cabinet Committee on Security is required for more than 49% FDI in defense. The proposals involving investments of more than INR 30 billion are considered by Cabinet committee on economic affairs.
   The Indian company receiving FDI either under the automatic route or the government route is required to comply with provisions of the FDI policy including reporting the FDI and issue of shares to the Reserve Bank of India.
4) GREENFIELD INVESTMENT: It means building a completely new factory or business. It is the best of its kind as it creates new jobs. Google, Microsoft, Facebook, Amazon have all set up new establishments in India.
5) BROWNFIELD INVESTMENT: It means buying an existing business and to grow it. It helps in getting new technology and business innovation. Examples: Vodafone bought Hutch; Groupon bought Crazeal.

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