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THE EVOLUTION OF FDI POLICY IN INDIA

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ABSTRACT

India has had a fluctuating policy towards attracting FDI since 1948.Its initial favorable attitude to foreign investment was followed by a more restrictive phase and then, an effort to attract foreign investment in a more aggressive and welcoming manner.[1]

The evolution of FDI policy in India can be categorized into four phases

- The first phase (1948-66)-Cautious welcome policy
- The second phase (1969 -1991)-Selective and Restrictive policy and then Partial liberalization policy
- The third phase (1991-2000)- Liberalization and open door policy
- The fourth phase (2000 –till date)-increasing globalization of Indian economy.[2]

KEYWORDS: FDI, Foreign Investment, Industrial Policy

INTRODUCTION

The First Phase (1948 -1969)

It comprised of a cautious reception of foreign investment with a view that it will accelerate the industrialization of the country as outlined in the Industrial Policy Statement of 1948..To protect the national interest, India ensured that regulation, ownership and effective control remained in its hand. Emphasis was placed on the establishment of heavy industry in the second five-year plan and in 1961 a list of industries where foreign investment was welcomed was issued by the government of India in the third five-year plan. This comprised of industries that were earlier reserved for PSU's like drugs, aluminum, heavy electrical equipment, fertilizer etc. Foreign firms were encouraged to invest in these industries and they were given a lot of benefits like extensive concessions and tax advantages to attract multinational oil companies.[3]

The Second Phase (1969-1991)

In order to protect domestic skills and capabilities from competition, infant industry protection was taken up. Outflow of foreign exchange had increased immensely because of payment of dividend, royalties, technical fee abroad for the FDI provided and technology imported. Thus the government felt the need to impose restrictions on the process of foreign collaboration approvals and adopted a more restrictive attitude towards FDI. Thus in order to deal with cases in which foreign investment or collaboration was up to 40 percent foreign equity and above a new agency FIB

[1] Pravakar Sahoo, Geethanjali Nataraj, Ranjan Kumar Dash, Foreign Direct Investment in South Asia: Policy, Impact, Determinants and Challenge, p.41,(26TH Ed., 2014)
[2] Usha Bhati 'Foreign Direct Investment: Contemporary Issues', Deep and Deep Publications, (1st Ed.2006)
[3] Supra Note 141

(Foreign Investment Board) was established in the year 1968 and further screening was done by a cabinet committee.[4]

Then in the year 1969 the Monopolies and Restrictive Trade Practices Commission (MRTP) was established and it imposed various restrictions on the size of operations, pricing of products and services of foreign companies. In the year 1969 the first legislation to competition was enacted i.e. Monopolies and Restrictive Trade Practices Act which was passed in the year 1969.It was an Act to prevent the concentration of economic power in hands of few, to control monopolies, to prohibit monopolistic and restrictive trade practices.[5]

There were more liberal FDI policies towards transfer of technology but the foreign collaboration renewals were more restricted. In the year 1973 Foreign Exchange Regulation Act (FERA) was enacted. The foreign companies operating in India were to register themselves as Indian companies and there was a limit for foreign equity in such companies. The act limited the extent of foreign equity for Indian companies up to 40percent, however the limit could be raised to 74percent for companies in high technology, export manufacturing, tea plantation or high –priority companies, thus for such companies there was some relaxation and also if such companies did not exceed the licensed capacity and they did not undertake any expansion or diversification activities they were exempted to take permission from RBI to carry on business. All the fresh inflows of foreign exchange were directed to the sectors which were technology –intensive such as electrical appliances, machinery and machined tools, chemical and allied products etc. For the transfer of technology and payment of royalties a selective licensing regime was instituted and the applicants were subjected to export obligations. Between 1974 and 1980 FDI stock rise was only Rs.163 million. Hence due to the reorganization in the pattern of FDI there was increase in overall FDI.[6]Coca Cola was asked to move out of the country in the year 1977 and therefore a reversal of government policy was seen.[7] The oil crisis took place in the late 1970's which resulted in the slowdown of the manufacturing exports. The period from 1980 onwards saw the trend of partial liberalization policy. Since the Indian goods suffered from technology that was old and the quality of product was also inferior the government made the policy liberal for import of technology and capital goods, the government reduced import restrictions and tariff, and encouraged the MNCs to set up units of exports in India. The policy statements of 1980 and 1982 brought out the liberalized policies for 100percent export –oriented units, industrial licensing rules were liberal for them, they were given a host of incentives, and were exempted from foreign equity restrictions under FERA. It was decided to set up more EPZ to attract MNE's to set up export –oriented units.The trade policies also became liberal. The imports of raw material and capital goods was also liberalized by slowly expanding the items listed in the Open General License (OGL).Between the period of 1984 and 1985, 150 items and 200 types of capital goods were made part of the list of OGL. Tariffs on import of capital goods were also abolished.

The regulation for foreign licensing collaboration was made less restrictive. Tax rates on royalties was decreased. The policy on foreign equity participation had become flexible and exclusions from general ceiling of 40percent on foreign equity were allowed after going into the merits of individual investment proposals. The outward remittance of royalty, technical fee, and dividend had become liberal. In 1988 a 'fast channel' was set up for speeding up clearances of FDI

[4] Supra Note 141

[5] The Preamble, Monopolies and Restrictive Trade Practices Act,1969

[6] Discussion Paper on 'FDI Policy — Rationale,and Relevance of Caps', Department of Industrial Policy & Promotion (23 June,2011), p.2 available at http://dipp.nic.in/english/Discuss_paper/DiscussionPaper_relevance_23June2011.doc (last visited on October 1,2014), (last visited on September1,2014)

[7] Coca Cola History, Coca cola, available at http://www.coca-colaindia.com/products/coca-cola.html (last visited on November1,2014)

proposals from major investing countries. Thus in the 1980s, important policy changes took place to enhance international competitiveness of Indian companies. Therefore India followed a cautious and selective approach while framing FDI policy in the pre-liberalized period. With the aim of becoming 'self-reliant' there was dual nature of policy intention –Foreign Direct Investment through foreign collaboration was encouraged in the areas of high technology and high prices to build the capacity of the nation and discouraged in low technology areas to safeguard and support domestic industries. The policy of FDI before 1991 was characterized by de-licensing of some industrial norms, promotion of Indian manufacturing exports and emphasis was laid on the modernization of the industries through liberalized imports of capital goods and technology. This was supported by the measures for trade liberalization in the form of tariff reduction and shifting of large number of items from import licensing to OGL.[8]

The Third Phase (1991- 2000)

The year 1991 was marked by major economic reforms by the Indian government. The liberalization; globalization and privatization policies were introduced. The period from 1990-1992 saw several crisis in the balance of payment, political instability and increase in India 's external debt. The result of this was that India's credit rating in both long-term and short –term borrowing lowered. India had great difficulty in borrowing from the international markets and there was outflow of foreign currency deposits kept in India by Non-Resident Indians (NRIs).There was virtual stoppage of the remittance from the Indian workers in the Gulf due to the rise in prices of petroleum. India's external payment liability kept increasing. Therefore there was a need to tide over the crisis. The third phase of the evolution witnessed a friendly FDI policy, as part of the Government's economic reforms program.[9] Under the Statement on Industrial Policy' of 1991, FDI was allowed up to fifty one percent in 35 high priority industries on the automatic route. Foreign technical alliance was also placed under the automatic route but they were subject to specified norms. Trading companies which were chiefly involved in export activities were also permitted fifty one percent foreign equity. For the 100percent export –oriented projects and companies in EPZs a fresh package was established.[10] The automatic approval route for FDI was expanded In the year 1996, from thirty five to hundred and eleven industries, under four distinct categories (Part A–up to fifty percent, Part B–up to fifty-one percent, Part C–up to seventy-four percent, and Part D-up to hundred percent). Restrictions were imposed on the foreign companies starting new joint-ventures utilizing the same technology as an existing joint venture.[11] A Foreign Investment Promotion Board (FIPB) was established in order to consider cases of foreign investment that were under the government route.

It was during this phase that the Foreign Exchange Regulation Act of 1973 was amended as a part of the ongoing process of liberalization and restrictions that were imposed on the foreign companies by FERA were lifted. These relaxations had a positive impact resulting in increased Foreign Exchange reserves, growth in foreign trade etc. In 1999 the Foreign Exchange Management Act was passed and it amended the law relating to foreign exchange with the objective to assist external trade and promote the development and growth of foreign exchange market in India. The scope of outward

[8] Supra note 141
[9] Supra note 5
[10] Statement on Industrial Policy, Ministry of Industry, Government of India (July 24, 1991),available at http://dipp.nic.in/English/Policies/Industrial_policy_statement.pdf (last visited on October 21,2014)
[11] Press Note No. 18(1998 Series), Department of Industrial Policy & Promotion, Ministry of Industry, Government of India, available at http://dipp.nic.in/English/policy/changes/press18.htm (last visited on October 21,2014)

FDI, however, expanded significantly after the introduction of the FEMA which became effective in June, 2000.[12]

The Fourth Phase (2000 -Till Date)

The phase began with global optimism. There was increased globalization of the economy of India within the frame work of FEMA, 1999. A paradigm shift occurred in the year 2000, in which besides the negative list all the activities that were left were placed under the automatic route[13]. In various sectors/activities Caps were eventually raised. The sector of NBFC was placed on the automatic route.[14] The sectors of defense and insurance were opened up to a cap of 26percent (Press Notes 10 of 2000, 4 of 2001 and 2 of 2002).[15] The cap was increased from forty nine percent to seventy four percent for the sector of telecom services (Press Note 5 of 2005).[16] fifty one percent FDI was allowed in single brand retail under the government approval route (Press Note 3 of 2006).[17] In the year 2009 an important change took place, the differentiation between 'ownership' and 'control' was established for the motive of calculating the total foreign investment-direct and indirect-in an Indian company (Press Note 2 of 2009).[18] Indian companies which had FDI, owned and controlled by the residents of India were allowed downstream investments without government approval (Press Notes 2 and 4 of 2009).[19] Limits that were placed on payment of royalty were removed (Press Note 8 of 2009).[20] The rationalization process continued in the year 2010. All existing norms on FDI were to be consolidated into a single document for easy reference (Circular 1 of 2010)[21]. Issue of shares against non-cash considerations (in respect of import of capital goods/ machinery/ equipment and pre-operative/ pre-incorporation expenses) was allowed.[22]The requirement of approval of the Government for establishment of new joint ventures in the 'same field' was also done away with and as a result consequence of this, non-resident companies were allowed to have 100percent owned subsidiaries in India. Government has allowed FDI in Limited Liability Partnerships (Press Note 1 of 2011).[23]In 2012 FDI up to 100 percent was

[12] Supra note 5

[13] Press Note 2 of 2000, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry Government of India, available at http://dipp.nic.in/English/policy/changes/press2_00.htm (last visited on September 25,2014)

[14] Press Note 2 of 2001, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry Government of India, available at http://dipp.nic.in/English/policy/changes/press2_01.htm (last visited on October 3,2014)

[15] Press Notes 10 of 2000, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry Government of India, available at http://dipp.nic.in/English/policy/changes/press10_00.htm (last visited on October 3,2014)

[16] Press Note 5 of 2005, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry Government of India, available at http://dipp.nic.in/English/policy/changes/pn5_2005.pdf (last visited on October 1,2014)

[17] Press Note 3 of 2006, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry Government of India, available at http://dipp.nic.in/English/policy/changes/pn3_2006.pdf (last visited on October 23,2014)

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[19] Press Notes 4 of 2009, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry Government of India, available at http://dipp.nic.in/English/policy/changes/pn2_2009.pdf (last visited on October 25,2014)

[20] Press Note 8 of 2009, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry Government of India, available at http://dipp.nic.in/English/policy/changes/pn8_2009.pdf (last visited on October 25,2014)

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allowed in single brand retail trade under government approval route subject to certain conditions.[24] FDI up to fifty one percent was allowed in multi brand retail trade under government approval route subject to certain conditions.[25]Then in the year 2013, FDI was allowed in SBRT at 49percent under automatic route. [26]

However the present ruling party BJP had vehemently opposed FDI in Multi Brand Retail Trade in the parliament. The **BJP manifesto says no to FDI in multi-brand retail**. The change in the government may have implications on the future of FDI in retail sector in India.[27]

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