INDIA'S FOREIGN DIRECT INVESTMENT INFLOWS: A POLICY ASSESSMENT

*Jasmine Kaur**

ABSTRACT

Foreign Direct Investment (FDI) is vital for economic development of a developing nation. This paper traces India's approach towards FDI. Just after independence, India granted national treatment to foreign investors, however, soon government started becoming apprehensive about foreign investments especially in key sectors due to the outflow of remittances of profits, dividends etc. India enacted Foreign Exchange Regulation Act (FERA) in 1973 to regulate foreign exchange. Still, India was witnessing severe debt crisis in 1980s, which resulted in complete economic overhaul through Liberalisation Privatisation Globalisation policy of 1991. With this, FERA was replaced by comparatively less stringent Foreign Exchange Management Act, 1999 (FEMA). The latter established two FDI routes: automatic and approval. Foreign Investment Promotion Board (FIPB) was established to look into these routes. This paper discusses the impact of economic measures taken post-liberalization to promote foreign investments. It also highlights the shift brought in by FDI Policy 2015, abolition of FIPB and recent changes in FDI in different sectors. The paper concludes with recommendations to the Government to reduce tax rates, improve infrastructure, and eliminate corruption and red tapism, in order to further boost foreign investment.

* Assistant Professor of Economics, Rajiv Gandhi National University of Law, Punjab, Patiala.

Foreign Direct Investment holds great significance in the economic development of less developing nations. Owing to the paucity of domestic capital, Less Developing Countries rely on the foreign capital to supplement its own scarce domestic capital for initiating and sustaining the level of economic development. Foreign Direct Investment (FDI) contributes positively to the stimulation of economic development by the transfer of capital, advanced technology, efficiency, knowledge, etc. to the host nations. The major determinants of FDI are size of the market, economic stability, political factors, policy structure, level of human capital, etc.

Owing to the significance of FDI in the process of economic development, the Government of India have been reforming economic policies to attract foreign direct investment inflows.

After independence, India developed a strategy of import substitution for the development of local industries. A Policy of Protectionism was adopted in order to protect its own industries. The Government of India had undertaken investment in infrastructure for the overall development of industrial sector. The attitude towards foreign capital was not encouraging. The industrial policy of 1948 focused on the regulation of foreign investment for the protection of national interest. As a result, the flow of foreign capital was very limited. During 1949, the foreign investors were assured ‘national treatment’, no restrictions on the remittances of profits and repatriation of capital and fair and equitable compensation to investors in the event of nationalisation of the undertaking.[1] A number of initiatives and concessions were extended to the investors to attract Foreign Direct Investment. As a result, Multinational Corporations started showing real interest in investing in India during late 1950s and 1960s. However, the local firms were unable to compete with the foreign firms. On the other hand, the outflow of remittances of profits, dividends, etc. had increased sharply. These factors led the government to adopt a more opposed attitude towards Foreign Direct Investment. FDI was not permitted in trading activities, banking and financial institutions, industries of strategic importance, etc. It was stated that foreign capital should aim at export promotion and the majority of ownership and control will be in Indian hands. A number of restrictions were imposed on FDI proposals which were not accompanied by transfer of technology and were seeking more than 40 per cent foreign ownership.[2]

During 1972, the Government of India permitted fully owned subsidiaries of foreign companies with a condition that they undertake to export 100 per cent of their output. Further, Foreign Exchange Regulation Act (FERA) was enacted in 1973 and came into force on January 1, 1974. The objective of FERA was to regulate the foreign exchange dealings, the trade of currency and bullion, transactions indirectly affecting foreign exchange and for the conservation and proper utilisation of foreign exchange resources of the nation. Under Section 29 of FERA, the foreign companies with foreign equity of not more than 40 per cent were required to register themselves under Indian corporate legislation. However there

---

[1] Biswajit Dhar, *State Regulation of Foreign Private Capital in India*, ISID Working Paper No. 006, 1988, Institute for Studies in Industrial Development.

[2] Nagesh Kumar, *Liberalisation and Changing Patterns of Foreign Direct Investments: Has India's Relative Attractiveness as a Host of FDI Improved?*, 33 ECONOMIC AND POLITICAL WEEKLY 1321-1329 (1998).

were certain exemptions under certain conditions. For example- Foreign equity up to 74 per cent was allowed if they were engaged in core sector as mentioned in Industrial licensing policy 1973, manufacturing activities requiring modern and sophisticated technology, predominantly export-oriented industries.[3]

India's failure to increase the volume and proportion of manufacturing exports was seen towards the end of 1970s. The reasons behind low export levels were technological obsolescence, high cost, low product quality, etc. As a result, the Government of India emphasised on the liberalised imports of capital goods and technical know-how for exposing the domestic industries to foreign competition. During 1980s, a number of liberalisation measures were undertaken such as relaxation of industrial licensing rules, exemptions from foreign equity restrictions under FERA to 100 per cent export-oriented units. Foreign collaboration and joint ventures were welcomed. The total number of collaboration agreements approved per year rose from 242 during 1967-79 to 744 during 1980-88.[4] During 1990-92, India experienced an external debt crisis which brought about an introduction to new economic policy. The adverse effects of Gulf war were seen on Indian economy. There had been an increase in Petroleum, Oil and Lubricant (POL) imports, reduction of remittances from non-resident Indians in the afflicted countries, fractional loss of export markets in West Asia. All of these led to a rise in the current account deficit upto 3.2 per cent of Gross Domestic Product in 1991. Due to the dried up lending activities of commercial banks after the debt crisis

---

[3] Sudip Chaudhuri, *FERA: Appearance and Reality*, 14 ECONOMIC AND POLITICAL WEEKLY 734-744 (1979).

[4] V.N Balasubramanyam. & Vidya Mahambare, *Foreign Direct Investment in India*, Working Paper 2003/001, Lancaster University Management School.

and growing competition for foreign resources, a more liberal new economic policy was initiated to attract foreign capital. Several measures were undertaken to create a conducive economic environment for encouraging the private domestic and foreign investment. The FDI inflows were encouraged into export-oriented, high tech manufacturing sectors.[5]

The Liberalisation Privatisation Globalisation policy of 1991 encompassed abolition of industrial licensing, dilution of the role of private sector, further relaxation towards foreign investment and technology, removal of Monopolistic and Restrictive Trade Practices (MRTP) Act and mandatory convertibility clause. It also included liberalisation measures such as rise in the foreign equity participation up to 51 per cent for existing companies and freedom for the use of foreign brand name, introduction of dual route system i.e. automatic and approval route; establishment of Foreign Investment Promotion Board (FIPB) for the screening of FDI applications under approval route, approving the FDI automatic permission for technology agreements in high priority industries, etc. Later on Foreign Exchange Regulation Act was replaced by comparatively less stringent Foreign Exchange Management Act, 1999.[6] The economic reforms have been successful in increasing the level of foreign trade and foreign exchange reserves along with the inflow of sophisticated technology and skilled human capital. The amount of FDI inflows rose 34 times during 1991-2010. There was a rapid increase in

[5] Pami Dua & Aneesa I. Rashid, *Foreign Direct Investment and Economic Activity in India*, 33 INDIAN ECONOMIC REVIEW 153-168 (1998).
[6] Abhishek Vijaykumar Vyas, *An Analytical Study of FDI in India (2000-15)*, 5 INTERNATIONAL JOURNAL OF SCIENTIFIC AND RESEARCH PUBLICATIONS 1-30 (2015).

FDI inflows from 1991-2000, but it came down to 8 per cent from 2000-2010.[7]

The scope for Foreign Direct Investment has increased gradually since 1991. It not only covers industrial sector but also services sector. The Steering group on Foreign Direct Investment was constituted by Planning Commission in August, 2001 to provide suggestions for increasing the FDI inflows which was necessary for achieving the growth targets of Tenth Five Year Plan. The committee suggested that State should consider enacting legislation relating to special investment covering infrastructure. It could lay out labour laws, rules and procedures for infrastructural investment. It also suggested setting up of investment facilitation fund to provide assistance to the needy states.[8]

Since then, a number of liberalisation measures have been undertaken for a sharp increase in FDI inflows. The Foreign Direct Investment policy is reviewed on an ongoing basis. The general caps on FDI in different sectors have been raised. The 'Make in India' initiative was launched in September, 2014 to transform Indian economy into a manufacturing hub. It targets twenty five sectors of the economy including automobile, food processing, railways, pharmaceuticals, textiles, mining, etc. It seeks to encourage both domestic and foreign companies to undertake the manufacturing process within India. It aims to raise the contribution of manufacturing sector to 25 per cent of Gross Domestic

---

[7] Mohammad Iftekhar Khan & Amit Banerji, *A Study of Drivers, Impact, and Pattern of Foreign Direct Investment in India*, 48 THE JOURNAL OF DEVELOPING AREAS 327-348 (2014).

[8] Government of India, Report of the Steering Group on Foreign Direct Investment, 2002, Planning Commission

Product by 2025. It further aims at creation of employment opportunities, promote innovation and encourage skill development.[9]

As per the consolidated FDI Policy 2015, the percentage of FDI cap is allowed up to 100 per cent under automatic route in agriculture, mining and exploration of metal and non-metal ores, exploration activities of oil and natural gas, greenfield airport projects, construction development projects, etc. subject to applicable laws and conditionalities.[10] Mostly the sectors are open for 100 per cent FDI under Automatic Route. In order to improve the procedural efficiency for seeking clearance on FDI proposals, the Cabinet approved the proposal to abolish FIPB in May, 2017. At present, the individual ministries are responsible for evaluating FDI proposals under the approval route. On August 28, 2019, the Union Cabinet has decided to relax the stringent condition of local sourcing for single-brand retail sector. It has permitted 100 per cent FDI in coal mining and contract manufacturing through automatic route to ensure that India remains investor friendly destination.[11]

Foreign Direct Investment has played a significant role in providing capital, skills and technological know-how to Indian economy. The FDI flows from the developed nations are more likely to exploit cheap Indian labour for improving efficiency. On the other hand, FDI from developing nations are attracted on account of growing Indian market. The liberalisation measures have played an important role in attracting FDI

---

[9] www.makeinindia.com

[10] Government of India, Consolidated FDI Policy, 2015, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry

[11] Government of India, Press Information Bureau, 2019

flows into different sectors and thereby to facilitate economic growth. Soon after 1991, the number of countries investing in India rose from 29 in 1991 to 106 in 2003. The major portion of FDI came from Mauritius, the largest investor.[12] The trend of India's total FDI Inflows from 1990-91 till 2017-18 is shown in Table 1.

Table 1: India's Foreign Direct Investment Inflows

S.No.	Financial Year	India's Total FDI Inflows (US $ million)
1.	1990-91	97
2.	1991-92	129
3.	1992-93	315
4.	1993-94	586
5.	1994-95	1,314
6.	1995-96	2,144
7.	1996-97	2,821
8.	1997-98	3,557
9.	1998-99	2,462
10.	1999-00	2,155
11.	2000-01	4,029
12.	2001-02	6,130

[12] Mathiyazhagan, M.K., "Impact of Foreign Direct Investment on Indian Economy Sectoral Level Analysis" ISAS, 2005, Working Paper No. 6.

13.	2002-03	5,035
14.	2003-04	4,322
15.	2004-05	6,051
16.	2005-06	8.961
17.	2006-07	22,826
18.	2007-08	34,835
19.	2008-09	41,873
20.	2009-10	37,745
21.	2010-11	34,847
22.	2011-12	46,556
23.	2012-13	34,298
24.	2013-14	36,046
25.	2014-15	44,291
26.	2015-16	55,559
27.	2016-17	60,220
28.	2017-18	60,974

Source: Reserve Bank of India Bulletin (2018)

The trend of FDI inflows has been impressive over time. The FDI inflows have increased from US $ 97 million in 1990-91 to US $ 60,974 in 2017-18.

Though India is receiving higher amount of FDI flows, but it's rank is lower in competitiveness index and it continues to rank among the most corrupt nations in the world. There are a number of challenges facing FDI inward i.e. lack of infrastructure, procedural delays, high taxes, implementation issues, etc. The Government of India should further open up to International platform through reduction in tax rates, corruption, improvement in infrastructure, liberalisation of labour laws, elimination of red tapism and cumbersome bureaucracy. The government should address implementation issues that arise for foreign investors. In sum, India has the potential to attract greater Foreign Direct Investment. The government should undertake policies in the interest of both domestic and foreign investors.