FDI in India

Policy Update October 2009

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I Introduction

Even in the midst of the global financial crisis with its dampening impact on FDI flows, FDI into India has boomed with cumulative FDI since 2000 crossing the $ 100-billion milestone in July this year. This is testimony to India's increasing profile as a safe and sound investment destination. Capital flows into India this year are expected to be six times the figure for the previous year because of higher equity investment and FDI, and a revival in External Commercial Borrowings (ECB) by Indian companies. India is estimated to receive net capital flows of $57.3 billion in 2009-10, up from $9.1 billion in 2008-09. India is also now being recognised as a major reformer in policymaking and regulatory processes targeted towards global financial and economic stability

II. Expected changes in FDI rules:-

The following changes in FDI rules are expected in the near future:

(i) The automatic route for FDI is under review

Looking at the growing concerns over national security, the government is going to prune the automatic routes available to foreign investors pumping funds into various sectors. To initiate the process, explosives and chemicals will be withdrawn from the automatic route. In the next stage, a more comprehensive security screening for sectors such as refineries, civil aviation, defence production, power and real estate may be introduced.

The government is also committed to comprehensive security screening through a proposed umbrella law that would arm it with powers to scrutinise and act against foreign investors found to be working against national interests.

http://economictimes.indiatimes.com/News/Economy/Policy/Security-cloud-over-FDI-route/articleshow/5104137.cms

(ii) Foreign players in coal mining are going to be allowed

For the first time, the Government is going to allow foreign players to start mining coal in India. The world's biggest coal miner, state-owned Coal India Ltd (CIL), will select joint venture (JV) partners for reviving its 18 abandoned mines. Production in each of these underground mines will be controlled by the private partner, which will have the right to buy 50% of the coal extracted at a predetermined price. The private mine operators, however, will not be allowed to sell the coal outside India.

http://www.livemint.com/2009/10/08005350/Unique-tender-by-Coal-India-fo.html

(iii) Foreign investment norms to cover limited liability partnerships (LLPs)

The government is working to bring LLPs within the scope of FDI guidelines. This move is expected to facilitate the inflow of overseas capital through a corporate structure that has recently been allowed in India. LLPs combine the features of partnerships and limited liability companies and are supposed to constitute the preferred corporate structure for services sector globally, particularly tax-accounting and law firms.

Bringing LLPs within the FDI ambit will facilitate the establishment of cross-border LLPs through which entrepreneurs in India can start business ventures with foreign investors. Since an LLP partner is not liable for the wrongdoings of other partners, entrepreneurs who do not know each other will be willing to come together and start a business. Nearly 250 LLPs have been registered in India since April 2009, when the LLP Act came into force.

http://economictimes.indiatimes.com/News/Economy/Policy/FDI-norms-to-cover-ltd-liability-partnerships/articleshow/5107742.cms

(iv) No FDI in multi-brand retail

The government is planning to clarify that FDI in multi-brand retail is no-go territory. Indian retailers were expecting that the new rules announced earlier this year would allow them to bring in overseas partners and capital. The government wants to ensure that the liberalised FDI policy does not lead to the unintended opening up of multi-product retail which is closed to foreign investment now.

The ministry will also try and clarify how the revised FDI policy will apply to the banking sector. One of the solutions being considered is to exempt banks from the new way of computing foreign investment based on ownership and control of the investing company.

The government, however, is unlikely to exempt defence production, where 26% FDI is allowed, from the purview of the liberalised FDI policy, considering the safeguards already in place.

http://economictimes.indiatimes.com/News/Economy/Finance/Govt-plans-to-say-no-to-FDI-in-multi-brand-retail/articleshow/5166292.cms

III. News & Views

(i) Regulators should announce policy on dual listings

It is being debated that government should reflect on all aspects of dual listing and come out with a policy stance on the issue. It is not very useful to link it immediately to convertibility of rupee. The issue of dual listing of MTN (South Africa based multinational mobile telecommunication company) to maintain its identity in the merged company appears to have been the deal-breaker during the tough negotiations that lasted over four months.

http://economictimes.indiatimes.com/News/Economy/Policy/CEA-suggests-considering-all-aspects-of-dual-listing/articleshow/5112356.cms

(ii) Develop a comprehensive law for FDI

The government's proposal to enact a law defining security clearance procedures for FDI proposals is being considered as a welcome step. It is being argued that it would put an end to arbitrary decisions based on the country of origin. Denying a company access on the basis of the country of its origin is grossly unfair, not just to the company in question but often to the consumers who may derive some benefit from the products and services that the particular company would offer.

It is also being argued that when the government is planning to enact an FDI law, it should cover all aspects of foreign investment. The practice of regulating FDI through executive orders should be replaced with a comprehensive law. The press notes should ideally be incorporated into law. The argument is that the entire objective of enacting a law should be to reduce policy flip-flops and arbitrary decision- making.

http://economictimes.indiatimes.com/Opinion/Editorial/Legally-by-all-means/articleshow/5087920.cms

(iii) The inflows from foreign institutional investors (FIIs) have been rising.

The appetite for emerging market stocks has increased and foreign capital inflows are growing rapidly but the problem is that much of these are taking the form of portfolio investments and not FDI that is long term in nature.

The Government of India is concerned that once the economy rebounds to a sustainable growth trajectory, and the interest rates rise, India will become even more attractive destination for FII investments. But the government does not want any pressure on the rupee due to growing foreign capital inflows.

The challenge before India is to direct these investments into long term or direct channels. FDI inflows will definitely go up but the balance between FII and FDI inflows is not yet right. The government has to deal with this issue next year.

http://www.livemint.com/2009/10/23004718/The-FIIFDI-balance-in-India-i.html

(iv) Agricultural reforms needed to attract investments

According to the US Chamber of Commerce, India should push through agriculture reforms and strengthen intellectual property protection to encourage increased US investments in the agriculture and food processing industries.

The US companies have the technology to address issues relating to the development of agriculture in India. But while small and medium Indian company investments in the US have increased more than 80 per cent since 2007, the US companies are investing elsewhere and not in India. The US and India should collaborate on policies and technologies that foster a stronger trade relationship.

www.blonnet.com/2009/10/31/stories/2009103150102200.htm

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