

FOREIGN DIRECT INVESTMENT IN INDIA: A MACROECONOMIC REVIEW

Hitesh Bhatia*, Ashwini K. Tiwatne**

Abstract *India's Foreign Direct Investment (FDI) has become a focal point of study, as the leading economies of the World, including the United States, China, and the countries of the European Union have started looking inward. Protectionism is gradually replacing facets of Globalization and Free movement of resources. Even in the current times of Global uncertainty, India continues to attract an increasing proportion of World FDI. Considerable reforms have been by the government for creating ease of doing business and attracting multinationals through Make in India initiative. These developments pose significant opportunities and challenges for India's inward FDI. The paper is a modest attempt to study India's inward FDI in terms of volume, source, sector, and regional destination in India.*

Keywords: *FDI, DTAA, Foreign Investment, Department of Industrial Policy and Promotion (DIPP)*

INTRODUCTION

India has been the most attractive emerging market for global investment as per a recent market attractiveness survey conducted by Emerging Market Private Equity Association (EMPEA, 2017). In 2017, India jumped 30 points to rank 100 in the World Bank's Doing Business Ranking annual survey. The IMF, World Bank, and other international agencies have upheld India's position for attracting foreign investment.

Foreign companies prefer investment in fast-growing private Indian businesses to take advantage of cheaper wages and changing business environment of India. At the same time, Foreign Direct Investment (FDI) in India also remains a major monetary source for economic development.

India was forced to undertake a series of economic reforms in 1991. The socialist policies had backfired, global oil shocks had negatively affected Indian imports, and country's own political instability had generated a severe Balance-of-Payment crisis. India went into a debt trap as it borrowed heavily from the rest of the World, including the IMF. It was during this time that the then Prime Ministers, P.V. Narasimha Rao and Dr. Manmohan Singh, architect the new liberalised version of India's economic policies. In addition to boost domestic-private investment, the government went on to invite foreign investment in a big way. This was a complete U turn to its earlier foreign-investment policy of protectionism. However, the results paid. Since 1991, India's GDP has increased multifold from under \$300 billion to nearly \$2.5

trillion, whereas the Real GDP growth rate rose from under 3% to a peak of 9.6% in 2009, and is currently around 7%. FDI in India kept increasing slowly from a bottom of \$74 million to a peak of \$43.40 billion in 2008. Since April 2000, the total FDI inflows have been around \$518,100 million; whereas, for the current financial year from April, 2017 to September, 2017 FDI inflows have shown a record rise of 17% for the corresponding period of 2016 (Department of Industrial Policy and Promotion (DIPP), 2018).

John Chambers, Chairman US-India Strategic Partnership Forum (USISPF, 2018), recently stated that "Steps such as FDI reforms will encourage foreign investors and allow India to realise its dream of becoming one of the world's most powerful economies".

FDI is understood as an investment in lieu of equity ownership by a foreign investor into a host country. The investment either creates new business operations or acquires existing business assets in the host country. The Organization of Economic Cooperation and Development (OECD) defines control as owning 10% or more of the business. FDI, according to the definition published in Consolidated FDI Policy by DIPP (2017), means an investment by non-resident entity/person resident outside India in the capital of an Indian company under Schedule 1 of the Foreign Exchange Management Act, 1999.

FDI is different from Foreign Portfolio Investment (FPI). FPI is a basket of investment opportunities to a foreign investor available under the provisions of SEBI (Foreign Portfolio

* Associate Professor of Economics, School of Business and Law, Vadodara, Gujarat, India. Email: hiteshb@nuv.ac.in

** Navrachana University, Vadodara, Gujarat, India. Email: ash.tiwatne1010@gmail.com

Investors) Regulations, 2014. FPI refers to investment made by foreign investors in Indian securities like equity, bonds, pension funds, mutual fund, etc. Such investments are done with only objective of earning higher returns on investment and have no intentions of creating any ownership of assets and bear the risk of doing business in India. Thus, FPI is also termed as a fair-weather friend. As of January, 2018 nearly 10,000 FPIs were registered with SEBI and listed on National Securities Depository Limited (NSDL, 2018). It is important to note that an individual FPI cannot own more than 10% of paid up capital in a given company; whereas, in a given company, the collective ownership of FPI cannot be over 24% of paid up capital. FDI on the other hand is done with an intention of creating a lasting interest in a business enterprise in a host country. FDI plays a crucial role in creating production capacities and employment opportunities in the host country, as it supplements the gap created by the private-domestic investment and complements the new capital expenditure in the country

FDI POLICY AND REGULATIONS IN INDIA

The Government of India has a comprehensive network to regulate all FDI in India. The FDI policy is transparent, stable, but open to change considering the market and industry requirements. The Government issues a Circular on Consolidated FDI Policy through the DIPP under Ministry of Commerce and Industry, which is an apex body to frame

and implement all FDI policies. All policy changes in FDI circular are notified through Reserve Bank of India (RBI) and Foreign Exchange Management Act (FEMA).

India's comprehensive FDI policy includes specific definitions related to all concepts of FDI, investment routes, the sector-wise permissible limit for foreign investment and other relevant aspects of FDI.

ENTRY ROUTES FOR INVESTMENT

Investments can be made by any non-residents (Except from Bangladesh and Pakistan, where additional approvals from the Government are required) in the equity shares, convertible debentures, and convertible preference shares of an Indian company, through the Automatic Route or the Government Route (DIPP, 2018).

Under Automatic Route, also known as direct route, the non-resident investor or the Indian company does not require any approval from the Government of India for the investment. Investment in any sector where FDI is already approved by a prior notification of DIPP, direct investments can be made to the extent of the percentage of total capital as specified by DIPP. Over a period of time, the Indian Government has increased the number of sectors where in FDI can be routed automatically and prior approval from the Government or any of its offices is not required. In terms of ownership (percentage of total capital) also, most of the sectors under Automatic route can invite up to 100% FDI.

Table 1: List of Sectors under Automatic Route

Sr. No	Sector/Business Activity	FDI Cap
1	Agriculture and Animal Husbandry	100%
2	Plantation Sector	100%
3	Mining and Exploration of metal and non-metal ores	100%
4	Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products, petroleum product pipelines, natural gas/pipelines, LNG Regasification infrastructure, market study and formulation and Petroleum refining in the private sector	100%
5	Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs.	49%
6	Defense	Up to 49%
7	Broadcasting Carriage Services	100%
8	Up-linking of Non-'News & Current Affairs' TV Channels/ Down-linking of TV Channels	100%
9	Civil Aviation – Airports	100%
10	Air Transport Services – (a) Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline (b) Regional Air Transport Service	Up to 49% (Up to 100% for NRIs)
11	Non-Scheduled Air Transport Services	100%
12	Helicopter services/seaplane services requiring DGCA approval	100%
13	Other services under Civil Aviation sector	100%
14	Construction Development: Townships, Housing, Built-up Infrastructure	100%

Sr. No	Sector/Business Activity	FDI Cap
15	Industrial Parks	100%
16	Private Security Agencies	Up to 49%
17	Telecom Services	Up to 49%
18	Trading	100%
19	E-commerce activities	100%
20	Single Brand product retail trading	100%
21	Duty Free Shops	100%
22	Railway Infrastructure	100%
23	Asset Reconstruction Companies	100%
24	Banking- Private Sector	74% Up to 49%
25	Credit Information Companies	100%
26	Infrastructure Company in the Securities Market	49%
27	Insurance	49%
28	Pension Sector	49%
29	Power Exchanges	49%
30	White Label ATM Operations	100%
31	Financial Services activities regulated by financial sector regulators, viz., RBI, SEBI, IRDA, PFRDA, NHB or any other financial sector regulator as may be notified by the Government of India.	100%
32	Pharmaceuticals – Greenfield	100%
33	Pharmaceuticals – Brownfield	Up to 74%

Source: Consolidated FDI Policy Circular of 2017, DIPP

FDI in sectors, or activities not covered under the automatic route or over an above the permitted limit as stated in the Table 1, require prior approval from the Government and, thus, are routed under the Approval Route or Government Route. Only those sectors significant from a national-

security perspective, or in order to protect the interest of domestic producer, are kept under the Government-approval route. Table 2 lists the sectors and permitted limit for FDI cap stated under the Government route.

Table 2: List of Sectors under Government Route

Sr. No	Sector/Business Activity	FDI Cap	Government Approval
1	Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities	100%	100%
2	Defense	100%	Beyond 49%
3	Terrestrial Broadcasting FM(FM Radio)	49%	49%
4	Up-linking of 'News & Current Affairs' TV Channels	49%	49%
5	Publishing of newspaper and periodicals dealing with news and current affairs	26%	26%
6	Publication of Indian editions of foreign magazines dealing with news and current affairs	26%	26%
7	Publishing/printing of scientific and technical magazines/specialty journals/periodicals	100%	100%
8	Publication of facsimile edition of foreign newspapers	100%	100%
9	Air Transport Services - (a) Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline (b) Regional Air Transport Service	100%	Beyond 49%
10	Satellites- establishment and operation	100%	100%
11	Private Security Agencies	74%	Beyond 49% and up to 74%
12	Telecom Services	100%	Beyond 49%

Sr. No	Sector/Business Activity	FDI Cap	Government Approval
13	Multi Brand Retail Trading	51%	51%
14	Banking- Private Sector	74%	Beyond 49% and up to 74%.
15	Banking- Public Sector	20%	20%
16	Pharmaceuticals – Brownfield	100%	Beyond 74%

Source: Consolidated FDI Policy Circular of 2017, DIPP

However, over a period of time, many such sectors have been shifted to Automatic route. This is done with an intention to liberalize flow of FDI in India. Recently, in May 2017, the Government abolished the Foreign Investment Promotion Board (FIPB) which was a front desk for processing and clearing all FDI proposals under the Government route. FIPB was an inter-ministerial body comprising representatives from several relevant ministries like Commerce, Finance, External Affairs, among others. FIPB used to further coordinate with the respective ministries, departments and State Governments under which the proposed FDI was to

be made. However, in order to smoothen the flow of FDI and remove bureaucratic hurdles, FIPB has been abolished. DIPP has now introduced the Foreign Investment Facilitation Portal (FIFP), a new online single-window interface to clear all FDI proposals under Approval or Government route. FIFP will be one point contact for the investors with the Government. All FDI applications will be processed online by the concerned ministry or department or a competent authority as per standard operating procedure laid by DIPP (FIFP, 2018).

Table 3: Sector wise Competent Authority to Approve FDI under Government Route

Sr. No	Sector/Business Activity	Competent Authority/Ministry/Department
1	Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities	Department of Atomic Energy, Atomic Energy Regulatory Board
2	Defense	Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, Ministry of Defense and Ministry of External Affairs.
3	Terrestrial Broadcasting FM (FM Radio)	Ministry of Information & Broadcasting
4	Up-linking of 'News & Current Affairs' TV Channels	Ministry of Information & Broadcasting
5	Publishing of newspaper and periodicals dealing with news and current affairs	Ministry of Information & Broadcasting
6	Publication of Indian editions of foreign magazines dealing with news and current affairs	Ministry of Information & Broadcasting
7	Publishing/printing of scientific and technical magazines/specialty journals/periodicals	Ministry of Information and Broadcasting
8	Publication of facsimile edition of foreign newspapers	Ministry of Information and Broadcasting
9	Air Transport Services - (a) Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline (b) Regional Air Transport Service	Ministry of Civil Aviation.
10	Satellites- establishment and operation	Department of Space/ISRO
11	Private Security Agencies	State Government
12	Telecom Services	Department of Telecommunications (DoT)
13	Single Brand product retail trading	Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion
14	Multi Brand Retail Trading	State Governments/Union Territories
15	Banking- Private Sector	Reserve Bank of India
16	Banking- Public Sector	Reserve Bank of India
17	Pharmaceuticals – Brownfield	Ministry of Health and Family Welfare, Department of Pharmaceuticals or any other regulatory Agency/Development as notified by Central Government

Source: - Consolidated FDI Policy Circular of 2017, DIPP

All procedural guidelines to be followed for applying FDI and reviewing the proposal by a competent authority are made available on the official website of FIFP. In case of any dispute or where competent authority is not able to review the proposal, DIPP shall approach the Cabinet Committee on Economic Affairs (CCEA).

SECTOR-SPECIFIC CONDITIONS ON FDI

In its thrust towards liberalizing FDI inflow in India and giving a boost to Make in India initiative, the Government of India has increased the frequency of reviewing its Sector-

Specific Conditions on FDI. The DIPP circular on FDI Policy framework was earlier amended annually, but is now witnessing changes twice a year. The circular states the sector-specific cap or limit on FDI approvals with the minimum being 26% to a maximum of 100%. As stated earlier, the sector-specific FDI policies are based on the importance of the given sector in economic development, protection for domestic investors, need for competition in the sector, matter of national security and confidentiality among others. Keeping such considerations in view following is the list of sectors where FDI is completely prohibited in India. Any foreign investor is not allowed to apply or invest a single dollar in these sectors.

Table 4: List of Sectors/Activities Where FDI is Prohibited

Sr. No	Sector/Activity
1	Lottery Business including Government/private lottery, online lotteries, etc.
2	Gambling and Betting including casinos etc.
3	Chit funds and Nidhi company
4	Construction of Farm
5	Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
6	Activities/sectors not open to private-sector investment, e.g., (I) Atomic Energy and (II) Railway operations

Source: - Consolidated FDI Policy Circular of 2017, DIPP

Apart from the sectors listed in Table 4, all other sectors are open for foreign investment subject to investment cap fixed in terms of the percentage of total capital. The sector-wise permitted limit or cap is listed in Tables 1 and 2. Chapter 5 of FDI policy circular clearly indicates these limits and other relevant details.

FDI STATISTICS

FDI inflow in India reached to a record high of \$60.1 billion in the FY 2016-17. In May 2017, the Ministry of Industry and

Commerce acknowledge the efforts of central government towards easing the rules for inviting foreign investors in India. A total of 87 rules sectors related to FDI spreading across 21 were eased by March 2017. The press release by the Ministry stated that the country has now become the top-most attractive destination for foreign investment (PIB, 2017). Some major sectors like Rail Infrastructure, Defense, Retail, Pension, and others were liberalized.

Table 5: Inflow and Outflow of FDI (US \$ Million)

Year	FDI (Inflow)	AAGR	FDI (Outflow)	AAGR	Net FDI	AAGR
2000-01	4029		759		3272	
2001-02	6130	52%	1391	83%	4734	45%
2002-03	5035	-18%	1819	31%	3217	-32%
2003-04	4322	-14%	1934	6%	2388	-26%
2004-05	6051	40%	2274	18%	3713	55%
2005-06	8961	48%	5867	158%	3034	-18%
2006-07	22826	155%	15046	156%	7693	154%
2007-08	34843	53%	18835	25%	15893	107%
2008-09	41873	20%	19365	3%	22372	41%
2009-10	37745	-10%	15143	-22%	17966	-20%
2010-11	34847	-8%	17195	14%	11834	-34%
2011-12	46556	34%	10892	-37%	22061	86%

2012-13	34298	-26%	7134	-35%	19819	-10%
2013-14	36046	5%	9199	29%	21564	9%
2014-15	45148	25%	4031	-56%	31251	45%
2015-16	55559	23%	8886	120%	36021	15%
2016-17	60082	8%	6603	-26%	35612	-1%
2017-18*	33749	-44%				

*From April to September, 2017 Source DIPP

Source: - Handbook of Statistics on Indian Economy, 2017, RBI

During the three years of NDA government rule between 2014-15 and 2016-17, the FDI inflow has witnessed a rise of over 50%. The net effect of FDI also remains very positive during the same period. Even for the current financial year, over \$30 billion worth of FDI has already flowed into the country. India is poised to surpass the \$60 billion benchmark

of FY 2016-17 this year. Though the experts believe that the government needs to further liberalize sectors like pharmaceutical, civil aviation, and few others to take a great leap in FDI inflow. The Swiss-based CARE rating has already stated that India attracts only 2-3% of the total world FDI inflows. India's share is low compared to Brazil (4%) and Hong Kong (5%) (CARE, 2017).

Table 6: Share of Top Investing Countries in India

Rank	Country	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18*	Total (\$ Mill)	2000-2017
1	Mauritius	30.32	48.18	23.13	33.10	23.55	39.98	45.22	68,877	34.68
2	Singapore	16.03	11.71	28.49	24.71	38.60	22.14	20.88	47,989	24.16
3	Japan	9.06	11.35	8.18	7.64	7.37	11.97	3.75	17,284	8.70
4	UK	24.01	5.48	15.31	5.30	2.53	3.77	1.18	16,296	8.21
5	Netherlands	4.30	9.42	10.80	12.60	7.45	8.56	7.67	16,926	8.52
6	USA	3.40	2.83	3.84	6.69	11.82	6.05	5.23	12,200	6.14
7	Germany	4.95	4.36	4.94	4.12	2.78	2.72	3.68	7,634	3.84
8	Cyprus	4.84	2.49	2.65	2.16	1.43	1.54	0.88	4,557	2.29
9	France	2.02	3.28	1.45	2.33	1.69	1.56	1.20	3,766	1.90
10	UAE	1.08	0.91	1.21	1.35	2.78	1.72	0.97	3,060	1.54

* from April, 2017 to September , 2017

Source: FDI Fact Sheet, DIPP, September, 2017

Mauritius by far remains the top source of FDI investment in India, followed by Singapore and others. From 2000 to 2017, about 34.6% FDI came to India from Mauritius alone. Nearly 24% came from Singapore and about 2.29% came from Cyprus islands which is just a tiny mark on the World map. It is interesting to note that these countries and a few others are also known as tax heavens (Oxfam, 2017).

In order to boost FDI inflow in India post-1991 liberalization, India had signed a series of agreements with over 80 countries of the World (PIB, 2016). One important agreement was DTAA, Double Tax Avoidance Agreement. Whereby any capital gains arising from the sale of shares are taxable in the country of residence of the shareholder and not in the country of residence of the company, whose shares are being sold. For example, a company investing in India via Mauritius, if sells its shares in India, it has no tax liability in India. Further, as there is no capital gains tax in Mauritius, the investor avoids paying taxes at both the ends. Similarly,

in case of Singapore, the investors are entitled to a lower rate of tax withholding in India, 15% on interest income that would otherwise be between 20% and 40% under regular domestic tax laws (Gosh, 2015).

However, these agreements were misused for round tripping of funds and laundering money (PIB, 2016). In its pursuit to cap money laundering and curb creation of black money, the government of India in May 2016 amended the India–Mauritius tax treaty. A source-based taxation has been introduced on capital gains arising from selling of shares acquired from 1 April 2017 onwards. Though the tax cap has been fixed at 50% of the domestic tax rate of India, this limit is applicable till 31 March 2019; thereafter, all transactions will be subject to full domestic tax rate. However, there will be no retrospective tax on the investments made before 1 April 2017. A grandfathering clause has been put and these will not be subject to any capital gains tax in India.

Table 7: Sector Attracting Highest FDI in India

Ranks	Sector	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18 *	Total (\$ Mill)	2000-2017
1	Service sector	21.94	31.86	17.87	22.67	24.42	31.95	15.81	35,207	24.3
2	Telecommunications	8.4	2	10.5	14.77	4.69	20.47	32.97	19,475	13.5
3	Computer Software and Hardware	3.35	3.2	9.04	11.71	20.93	13.44	16.5	17,305	12
4	Construction Development - Township, Housing, Built-up Infrastructure	13.21	8.78	9.85	3.92	0.4	0.39	1.97	7,049	4.87
5	Automobile Industry	3.88	10.13	12.18	13.91	8.96	5.92	6.69	12,074	8.34
6	Trading	0	0	10.78	13.92	13.63	8.6	7.87	11,707	8.08
7	Drugs and Pharmaceuticals	13.59	7.4	10.27	7.64	2.67	3.15	4.68	9,606	6.63
8	Chemicals (other than fertilizers)	17	1.93	7.05	3.89	5.21	5.13	4.86	9,733	6.72
9	Power	6.95	3.53	8.56	3.61	3.08	4.1	3.86	6,655	4.59
10	Infrastructure Activities	0	0	0	0	15.99	6.85	4.79	7,255	5.01
11	Metallurgical Industries	7.51	9.67	0	0	0	0	0	3,252	2.25
12	Hotel and Tourism	4.18	21.49	3.9	3.96	0		0	5,515	3.81

** Services sector includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis

* from April, 2000 to September, 2017

Source: FDI Fact Sheet, DIPP, September, 2017

The services sector is the key driver of India's economic growth. The sector contributed around 53.8% of its Gross Value Added in 2016-17 and employed 28.6% of the total population. Net services exports from India reached \$67.5 billion in 2016-17 (Industry: Services, 2018).

Thus, not surprisingly Service sector received maximum FDI, an average of 24% since April, 2000, followed by Telecommunications at 13% and Computer software and hardware at 12%.

CONCLUSION

FDI is a major source of non-debt financial resource for any economy. The economic growth gets a boost with FDI. Foreign companies intend to invest in India to take advantage on several accounts. Low-cost production, ease to export, access to a large and growing market are among others. India's demography, richness in minerals and other resources, growing disposable income, diversified socioeconomic culture are major drivers in attracting FDI. The present government's initiatives towards ease of doing business, tax reforms, controlling tax evasions and money laundering, single-window clearance to all FDI proposals under the Government route, hard selling India in other countries, and overall approach towards foreign investment as to complement domestic investment have proved productive. In spite of amending DTAA with Mauritius and

other countries from 1st April 2017 and increasing regulatory compliances for smooth functioning of business in India, India will continue to remain one of the top destinations for FDI.

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