FDI in India

Policy Update February 2010

Table of Contents

I. Introduction

With high growth expected in the Indian economy and weak recovery in developed economies, global investors are bullish on India. This is not only because of strong domestic demand but also due to cost effective production.

In a bid to give further fillip to FDI, the government has decided to consolidate the foreign investment policy, notified so far through 177 Press Notes by the Department of Industrial Policy and Promotion (DIPP) and various circulars by Reserve Bank of India, into a single regulatory framework.

The consolidated framework is aimed at providing greater clarity on existing rules to foreign investors, but will not alter the current FDI norms or sector specific caps.

II. Expected changes in FDI rules

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

1. Commodities broking door opened to FDI

The government is planning to allow full FDI in commodities broking business by adding it to the eligible list of activities of non-banking finance companies (NBFCs) with 100 percent FDI. 100 percent FDI is allowed in stock broking and forex broking through the automatic route.

Allowing FDI in commodity broking business is expected to bring about a big change in the business. It will give access to international best practices, high quality products and bring about a shift from a trading oriented business to knowledge based business. The change is expected to transform the commodity broking business completely just the way entry by foreign institutional investors changed the equity markets.

http://mobilepaper.timesofindia.com/mobile.aspx?article=yes&pageid=9&sectid=edid=&edlabel=ETBG&mydateHid=03-03-2010&pubname=Economic+Times+-+Bangalore&edname=&articleid=Ar00901&publabel=ET

2. Government plans to ease FDI norms for exchanges

The government is planning to raise the cap on FDI by any single investor from the existing 5 percent. However, the overall cap on FDI for these bourses would remain

49 percent. This will allow foreign investors in India's stock and commodity exchanges to raise their stakes.

The move is expected to give a fillip to India's underdeveloped exchange business and will lead to more meaningful competition among bourses resulting in efficiency of operations and better investor services. The move could also pave the way for the setting up of more exchanges in the country.
Millions of potential investors are yet to enter the equity market, as the present system is not attractive enough, even though Indian stock exchanges have trading volumes benchmarked against the biggest bourses in the world.

http://www.financialexpress.com/news/govt-plans-to-ease-fdi-norms-for-exchanges/574695/

3. Government plans to check FDI policy loopholes

The government is planning to expand the reach of the Foreign Exchange Management Act (FEMA) to encompass more instruments such as partly paid shares and convertible warrants issued to foreign investors.

The companies issuing these instruments would require RBI approval under the automatic route for selling these to foreign investors. The changes are being contemplated to prevent a possible breach of existing FDI regulations by overseas investors.

The government feels that since holders of partly paid shares get voting rights in Indian companies and can potentially gain control, they need to be governed by FEMA. Currently, these instruments are neither part of FDI - as the current policy does not have a concept of partly or totally paid shares - nor are these governed by FEMA.

The inclusion of these two instruments in the ambit of FEMA would empower RBI to scrutinise these companies and their FDI levels. Since these will also be considered as FDI, their issuers will have to ensure they do not breach sectoral caps.

Simultaneously, the government plans to make an exception for the banking sector by keeping them out of the purview of FDI regulations announced in February last year.

http://www.financialexpress.com/news/cabinet-to-take-up-fdi-policy-loopholes-today/578177/

III. News & Views

1. Economic Survey for liberal FDI regime

The Economic Survey 2009-10 made out a strong case for adopting a liberal FDI regime for services like health insurance, rural banking and higher education, as FDI inflows could boost trade in services. Other sectors that raked in a significant chunk of FDI during 2009-10 were telecom, housing and real estate, and construction.

Expediting auction of high speed third generation telecom technology, removing 10-year disinvestment clause regarding FDI in insurance and liberalising foreign investment in the animation sector are also the key suggestions of the Survey.

The Survey also calls for encouraging venture capital in services and exemption of ECBs from the withholding tax for financing export-related activities and overseas acquisitions.

http://www.thehindu.com/2010/02/26/stories/2010022662591700.htm

2. Welcoming FDI reforms

The government's recent decision to authorise the Cabinet Committee on Economic Affairs (CCEA) to vet and approve only proposals involving total foreign equity inflow exceeding Rs 1,200 crore (Approx. $250 million), rather than proposals with a total project cost of over Rs 600 crore (Approx. $125 million), is being hailed as a welcome step as the move is expected to expedite FDI approvals. However, projects with foreign equity inflow of and below Rs 1,200 crore and recommended by the FIPB, would still need the finance minister's approval.

It has been argued that a host of attendant factors can result in uncertainties and routine hold-ups for FDI. This too needs to change through transparent rules, time bound procedures and a business like approach to vetting.

Further, dispensing with the requirement that a foreign entity obtain a no-objection certificate from its Indian partner for going it alone or tying up with other partners in the same area of business is also being debated. It is being argued that it makes no policy sense for domestic players in tie-ups to draw rents from existing arrangements or stall fresh investments.

All this is welcome, but India still falls short of an ideal policy that would welcome FDI in all sectors save a specified few, obviating the need for case-by-case approval. It is being argued that with our relatively well-developed corporate sector, a sound legal framework, huge economic potential and attractive FDI destinations, removing opacity in FDI approvals would pay rich dividends.

http://economictimes.indiatimes.com/opinion/editorial/Welcome-FDI-reform/articleshow/5574590.cms

3. Bring in greater clarity in the FDI policy

It is being claimed that the large magnitude of capital inflows clearly demonstrates the inherent attractiveness of doing business in India but *Doing Business 2010* does not paint a very pretty picture ranking India at 133 in terms of ease of doing business.

The government's recent policy initiatives in the form of the new direct tax code, goods and service tax regime, the Companies Bill, e-filings, introduction of the limited liability partnership regime etc are being appreciated and will help to improve the perceived investment environment.

The decision to consolidate the existing FDI policy is also being seen as a welcome step and experts hope that government will use this as an opportunity to throw light on certain issues faced by investors.

Though different sectoral caps can be justified by the sensitivity of these sectors, sector specific policy announcements over the years have resulted in certain inconsistencies in computing foreign equity shares across sectors. The issue is further complicated by Press Note 2 (of 2009) which seeks to clarify the computations of indirect FDI in Indian firms. It is being argued that the consolidated FDI policy irons out the inconsistencies in computing the sectoral ceilings.

http://www.livemint.com/2010/02/07233209/Bring-in-greater-clarity-in-th.html

4. US ask India to raise FDI ceiling in defence

To provide more opportunities for US companies interested in defence sales in India, the US is urging India to raise the cap on equity held by foreign defence firms from 26 per cent to 49 per cent.

US firms have bagged almost all the major contracts worth more than $10 billion pertaining to the Indian armed forces.

http://www.business-standard.com/india/news/us-asks-india-to-raise-fdi-cap-in-defence-to-49/86828/on

5. India, Latvia ink pact to promote investments

India and Latvia signed a Bilateral Investment Promotion and Protection Agreement aimed at boosting bilateral investment and technology flows between the two countries, by creating favourable conditions for investors.

The agreement includes full repatriability of investment and returns, protection against expropriation and a mutually acceptable definition of 'investment'. The pact also provides for national treatment of investments on a post-establishment basis as well as most favoured national treatment to investments and investors on a post-establishment basis.

It provides for an elaborate dispute resolution mechanism to settle disputes between an investor and the host Government relating to investments.

http://www.thehindubusinessline.com/2010/02/19/stories/2010021952641700.htm

Disclaimer: This information has been collected through secondary research and CUTS C-CIER is not responsible for any errors in the same.