India's Investment Environment – May 2008

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I. Introduction

The Government of India is thinking of an even more liberal foreign direct investment (FDI) regime by relaxing the policy in sectors like defence, scrap etc and raising the investment limit for clearance from Cabinet Committee of Economic Affairs (CCEA) to Rs 10bn (US$240mn) from Rs 6bn (US$144mn). The Government is also considering relaxation of the existing procurement and offsets regulations of the Defence Procurement Policy (DPP) of 2006.

II. Expected Changes in FDI Rules

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

i. FDI limits in defence production expected to be raised to 49 percent from existing 26 percent

The Ministry of Defence is contemplating the enhancement of FDI limits in Indian companies engaged in defence production to 49 percent. The current limit as per the Department of Industrial Policy and Promotion (DIPP) Press Note No. 4 is 26 percent. It is expected that the new DPP of 2008 could allow FDI limits to be raised, on a case-to-case basis, to 49 percent.

ii Ministry of Defence expected to change the existing procurement and offsets regulations

The Ministry of Defence is expected to change the existing procurement and offsets regulations of DPP of 2006. The changed policy will govern purchase of military equipments worth US$75bn over the next five years. It will cover the outright purchase of military equipments; transfer of technology to Indian companies for manufacturing equipments in India; and development and manufacture of goods by Indian private and public companies.

The new policy is also expected to increase the direct offset liability at the Ministry of Defence discretion to 50 percent from 30 percent. At present, any defence contract of more than US$73mn will place a direct offset liability of 30 percent on the vendor, making him liable for sourcing defence goods or services of at least 30 percent of the contract value from India. However, it is not expected that the transfer of technology as offsets will be permitted.

The new policy is also expected to allow offset banking. This will facilitate a foreign vendor that generates defence business in India in a particular year to bank that credit and claim it as an offset against a defence contract signed subsequently. However, after a certain time period (which is to be decided) the banked offsets will lapse.

The Ministry of Defence is also considering the setting up of a single window body for handling the growing offsets related workload that will flow from new policy. At present, the Defence Offsets Facilitation Agency (DOFA) handles the offsets related issues.

iii DIPP Press Note 1 of 2005 is expected to scrapped

The Government is expected to scrap DIPP Press Note 1 of 2005, a revised version of Press Note 18 of 1998, which was introduced to protect the interests of Indian companies against overseas investors by preventing foreign companies from changing local partners to suit their own interest. Under the existing Press Note 1, the existing joint venture partners need to get approval of local partners before making new investments in the same area. In 2005, the Government amended Press Note 1 by waiving it for all fresh investments coming into the country from 2005 onwards. Now Government is planning to waive it for all investments with retrospective effect.

Indian business houses are welcoming the scrapping of Press Note 1 but they are of the view that a less stringent condition should be inserted in the regulation which stipulates a minimum waiting time for foreign companies with intentions of making fresh investments in the country. This will give time to Indian companies to get new partners or appropriate technologies.

iv Investment limit for approval from Cabinet Committee of Economic Affairs (CCEA) may be enhanced

The Government is considering the enhancement of the investment limit that requires the approval of CCEA to Rs 10bn (US$240mn) from the existing limit of Rs 6bn (US$144mn). Now the companies will require only Foreign Investment Promotion Board (FIPB) approval for investments up to Rs 10bn. The CCEA clearance will be mandatory only for investments above Rs 10bn. The relaxed rules will also help existing companies which can now pump in additional investments in their Indian operations without seeking Government approval as long as it is within the Rs 10bn limit.

The DIPP is reviewing the Press Note 7 of 1999 in the light of norms related to indirect foreign holdings in sectors where there are FDI caps. Once new rules are implemented, companies like Coca Cola will not be required to go to CCEA for every little investment made by them.

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