FDI in India

Policy Update November 2009

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I Introduction

With economies recovering from the effects of the global meltdown, India is targeting annual FDI worth $50 billion by 2012 and doubling of these by 2017. To achieve this objective, the government is taking steps to improve the investment environment at the state level facing prospective overseas investors.

Today, India is ranked very high amongst the emerging market economies of Asia in terms of the magnitude of net capital inflows. However, whether enhanced capital inflows could lead to hardening of the rupee, which, in turn, could shave off export' earnings is a matter for debate. But the government has decided to not restrict capital inflows..

II. Expected changes in FDI rules:-

(i) FDI cap on single-brand retail could go up

The government is once again pushing for foreign investment into the retail sector, albeit in a calibrated manner. In a new strategy being drawn up by the government, FDI in single brand retail could be hiked to 74% from existing 51%.

The government is committed to inviting FDI into the retail market but is going slow as retail is a sensitive issue involving large corporations as well as the general public.

However, there is no move to touch the multi-brand retail segment, where no FDI is allowed. In fact, the approach is to further tighten the norms for multi-brand retail to ensure that there is no back-door entry via the new FDI policy, which relaxes foreign investment into downstream sectors if routed through an Indian owned and controlled holding company.

http://www.financialexpress.com/news/govt-revisits-retail-fdi-cap-on-singlebrand-stores-could-go-up/536345/

(ii) Government may consider FDI in nuclear-power sector

The government will be looking into the possibility of allowing foreign investment into the nuclear power sector. The Prime Minister's Economic Advisory Council (PMEAC) in a recent report had called for allowing entry of reputable private companies into the nuclear power generation sector. However, no final view has been taken yet.

PMEAC had expressed concern at the slow recent pace of additions to power capacity and called for an active plan of action in this regard in the next 15 years, given the country's urgent need for more power. The Committee has recommended allowing entry by private companies on the basis of an appropriate regulatory framework.

At present, FDI in the nuclear power sector is not allowed along with sectors such as multi-brand retail, lottery and gambling. Significantly, the Economic Survey of 2009 also called for allowing FDI into the sector, with a cap of 49 %.

http://www.financialexpress.com/news/commerce-min-weighs-fdi-in-npower-sector/537344/

(iii) Foreign airlines may be allowed to invest in Indian carriers

The government is considering a proposal to allow foreign airlines to pick up a maximum of 49% equity in Indian carriers. It is expected that the proposal, if cleared, will enable the loss-ridden aviation industry to raise funds and thus provide it with a new lease of life.

At present, the government allows 49% FDI into domestic carriers but bars foreign airlines from holding any stake directly or indirectly. Even though a liberal policy is being followed in the aviation sector with foreign investors being allowed to pick up 100% stake in greenfield airports, the government has always adopted a cautious approach towards any proposal seeking entry of foreign carriers into local airlines.

http://www.financialexpress.com/news/centre-to-consider-49-stake-for-foreign-airlines/537839/

(iv) Royalty payments may be liberalised

The government is planning to liberalise the regime relating to the payment of royalties for technology transfers and for the use of trademark and brand name of foreign companies. The move is expected to promote the transfer of state-of-art technology into the country. The government intends to do away with both monetary and procedural restrictions on royalty payments and subject such payments only to exchange control regulations.

At present, royalty payments for technology collaborations are permitted up to a lump sum of $2 million or 5% of domestic sales and 8% of exports under the automatic route. These royalty payments are calculated net of taxes and on the basis of net ex-factory sales price of the product.

Current legislation stipulates that for the use of its trademark and brand name, the foreign collaborator is entitled to the receipt of royalty payments of up to 1% of domestic sales and 2% of exports under the automatic route. Additionally, there are no restrictions on the duration of any of these payments. It is worth noting that these restrictions apply even when the collaboration is in a sector where 100% FDI is otherwise permitted.

http://www.livemint.com/2009/11/09205438/Liberalizing-royalties.html

(vi) Government plans single platform for FDI rules instead of Press Notes

In an attempt to ensure better understanding of FDI related procedures, the government is planning to do away with Press Notes (used in the past two decades for announcing policy changes) and instead have a single platform that specifies overseas investment rules. This would be done by amalgamating provisions of the Press Notes into FDI rules.

Currently, FDI-related guidelines are scattered over more than 175 Press Notes released between 1991 and 2009. Often foreign investment guidelines prescribed by the new press notes modify the old ones.. But since the Press Notes are spread over various years, investors get confused very often.

http://www.financialexpress.com/news/govt-plans-single-platform-for-fdi-rules-to-do-away-with-press-notes/541950/

(vii) RBI is going to audit foreign banks

The Reserve Bank of India (RBI) is going to run a detailed assessment of the risk management capabilities of all foreign banks operating in India and evaluate transparency maintained by these in their financial affairs. The move is aimed at ensuring that these do not pose any systemic risk to the banking sector. Till this process is completed, foreign banks are unlikely to be allowed to open more branches in India.

Coming in the aftermath of the financial crisis, the audit perhaps reflects concerns over an unduly large presence of foreign banks creating risks for Indian financial markets.

http://economictimes.indiatimes.com/News/News-By-Industry/Banking/Finance/Banking/RBI-to-audit-foreign-banks-ops-before-allowing-new-branches/articleshow/5197873.cms

III. News & Views

(i) Domestic players raise concern over liberalisation of payment of royalties

The government's plans for liberalising the payment of royalties for technology transfers and the use of trademark and brand names of foreign companies are being welcomed as a positive step which would enable the country to benefit from the entry of modern technology. However, the domestic players are arguing that a free hand to decide royalty

payments may result in foreign companies demanding exorbitant amounts and tilt the balance in their favour. Though a somewhat valid concern, it is worth noting that even under current regulation, royalty payments over the prescribed limits can be made. A suggestion being made is that undue advantage to foreign parties can be prevented through a post facto reporting mechanism to disclose and justify the formula for arriving at the magnitude of royalty payments.

It is also being argued that the proposed change will provide an opportunity to the domestic companies to have access to updated technology. Sectors such as pharmaceuticals and healthcare, automobiles, infrastructure, aviation and telephony, all of which are technology-intensive, will now only stand to gain. From a social perspective, access to the latest technology will help increase India's production and efficiency, improve its overall economic health, and strengthen its position as a global research and development hub, as well as improve the environment for innovation.

http://www.livemint.com/2009/11/09205438/Liberalizing-royalties.html

(ii) India looking for agreement on investment protection among SAARC countries

The government is considering the need for putting in place an *Agreement on Promotion and Protection of Investment* for better regional integration and cooperation among SAARC nations.

India is expected to notify the agreed tariff reduction schedules for the Non Least Developing Countries (NLDCs) of SAARC in order to give required impetus to greater export opportunities for all its SAARC neighbours. At the same time India is expecting NLDCs to also review their negative lists with respect to Least Developed Countries (LDCs) of SAARC.

http://beta.thehindu.com/news/cities/Delhi/article53217.ece
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(iii) Government to overhaul foreign investment regime

The government has embarked on a major overhaul of its foreign investment policy matrix to remove inconsistencies that lead to regulatory arbitrage. The government has directed the finance ministry, RBI and markets regulator SEBI to integrate the legal and regulatory regimes for foreign capital inflows.

All legal, regulatory and taxation regimes with respect to foreign investments are under review. One objective of the exercise is to disallow foreign investors from evading rules by pitting one regulator against one another.

The idea is to create an efficient policy regime for capital flows free from constraints, but not prone to easy abuse.

http://www.financialexpress.com/news/govt-to-overhaul-foreign-investment-regime/545387/

(iv) Onus on states to check FDI violations in retail

The central government has put the onus of monitoring any violation by companies that have been allowed FDI in the retail sector on state governments. It has directed them to create a suitable mechanism to hold periodic scrutiny against violation of Foreign Exchange Management Act (FEMA).

The move comes after it was found that some foreign retail companies or joint ventures, which had permission to undertake only cash & carry wholesale trading, were violating the rules. They were apparently selling directly for personal consumption, which is prohibited. It was also noticed that companies that were allowed to operate single-brand retail outlets sold multiple brands in violation of permission.

http://www.business-standard.com/india/storypage.php?autono=377552

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