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India's Recent FDI Reforms: An Analysis, and Possible Trends

India's regulations for foreign direct investment (FDI) in various sectors have been relaxed in November 2015 and June 2016. This paper argues that, while India has seen a surge of FDI inflows over the last two years (not always in sectors where the regulations were relaxed), the rising global uncertainties and the Indian economy's structural issues may hinder potential inflows of FDI in the medium-term.

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Foreign investment plays a key role in plugging the gap between domestic demand and supply of capital for businesses in most emerging economies like India which offer comparatively higher returns on investment. Given India's economic growth and the employment challenges it faces today, the need to attract foreign capital has increased with time across various sectors. India's foreign direct investment (FDI) regulations have thus been periodically liberalised from the 1990s through successive phased reforms. The latest round of FDI reforms was announced recently with Prime Minister Narendra Modi mentioning that these reforms have now made India the most open economy in the world in terms of FDI norms. I try to briefly analyse the reforms, focusing on the relevant sectors and the resulting impetus received by the economy through foreign funds.

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While development has been a key agenda of the present Indian Government since it took office about two years ago, reforms on various fronts have been expected and FDI is one of them. The government has tried to improve the overall business environment, and the prime minister has promoted Brand India in various forums within India and abroad through several initiatives. Initiatives like “Make in India” and “Start-up India”, coupled with initiatives to ease the process of clearances and inspection by government officials, have been instrumental to improve India’s rank in the world to 130 in respect of doing business indicators. On the FDI reforms front, specific sectors targeted by the government include defence, construction development, insurance, pensions, broadcasting, tea, coffee, rubber, cardamom, palm oil and olive oil tree plantations, single brand retail trading, limited liability partnerships, civil aviation, credit information companies, satellites- establishment/operation and asset reconstruction companies.[2]

In India, FDI regulations allow foreign capital through either of two modes: first, the automatic route i.e. without approval from the government or the Reserve Bank of India. This holds good for a number of sectors as updated by the FDI policy of the Indian Government from time to time. Secondly, FDI is allowed through government approvals by the Foreign Investment Promotion Board (FIPB) of the Department of Economic Affairs, Ministry of Finance. Till date, sectors considered sensitive for national security purposes like defence have had controls on foreign investment, and required government approval for foreign ownership beyond a specified level.

Most FDI into an economy is either market-seeking or resource-seeking in its scope or both. In the Indian context, FDI has targeted the domestic market and produced for the foreign markets as well. The two most-recent FDI reforms were announced in November 2015 and in late June 2016. In the 2015 reforms, the key elements included: allowing 49% FDI in defence under the automatic route, a departure from the previously-allowed route of government approvals; doing away with conditions like bringing in a maximum of US$5million in six months and building on a maximum area of 20,000 sq. meters in construction development under the construction sector; relaxing 30% sourcing norms for high-tech segments under single brand retail; allowing 100% FDI under automatic route for plantations like coffee, rubber, cardamom, palm oil and olive oil; allowing 100% FDI in limited liability

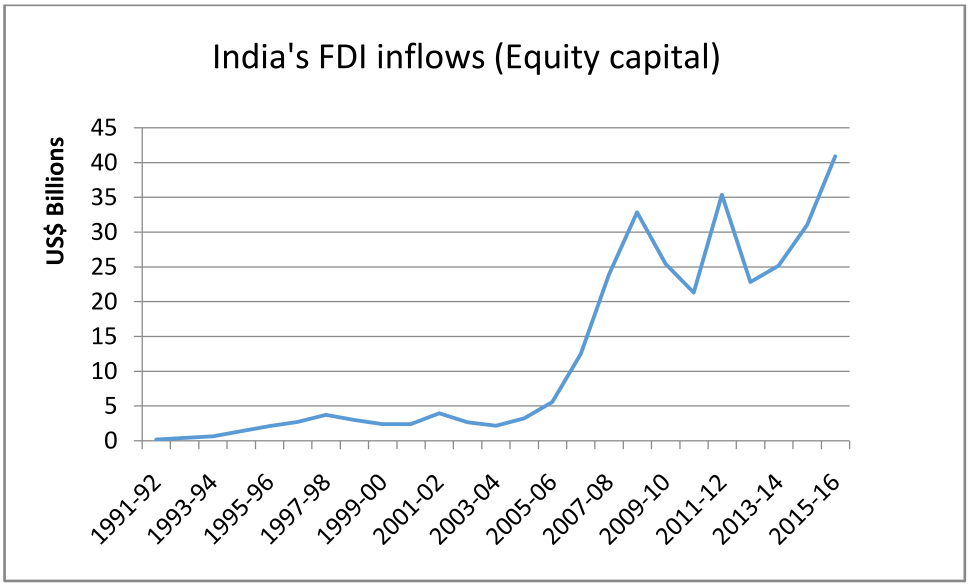
[2] See “Major impetus to job creation and infrastructure: Radical changes in FDI Policy Regime, Most Sectors on automatic route for FDI” Prime Minister’s Office, Govt. of India http://pib.nic.in/newsite/PrintRelease.aspx?relid=146338

partnerships; allowing 49% FDI under automatic route in civil aviation for regional air transport service etc.

Some of the most significant reforms announced in June 2016 include: allowing 100% FDI under the government approval route for trading including through e-commerce in respect of food products manufactured or produced in India; allowing foreign investment beyond 49% through the government approval route on the explicit condition of access to modern defence technology; allowing 100% FDI for teleports, cable networks, mobile TV in broadcasting carriage services through the automatic route; allowing 74% FDI in brownfield pharmaceuticals automatically with additional FDI allowed through government approvals; allowing 100% FDI through automatic route in brownfield airport projects; revision of FDI limit from 49% under government approval route to 49% through the automatic route in private security agencies; allowing 100% FDI through automatic route in animal husbandry; relaxing local sourcing norms in single brand retail up to three years and a further relaxed sourcing regime for five years.

If we look at the inflow of aggregate FDI as equities, one notices a definite increase in FDI equity inflows into India after 2012-13.

Figure 1: FDI inflows as equity capital into India from 1991-92 till 2015-16



Source: statistics collated by the author from Indiastat.com

Note: Figures converted from Indian Rupee to US$, using official annual exchange rates provided by the World Bank. Figures from 1991-92 are from August to March, data for 2013-14 to 2015-16 are provisional.

From Figure 1, the increase in FDI flows after 2012-13 in some ways mirrors the increase India experienced in 2005-06. However, there is a difference. In 2005-06 the global economic outlook was reasonably better (since the effects of the financial crisis were still to hit the global economy) than it is currently. Hence, India's attractiveness as a destination for FDI is evident, and more recently, India has thus moved from the fifth most attractive destination to the most attractive FDI destination between 2014 and 2015.[3]

In looking at the FDI inflows every month over the last financial year, one does not necessarily notice a secular growth in FDI inflows every month. However, in aggregate terms, India's FDI inflows have grown.

Table 1: FDI Inflows into India April 2014-March 2016 (US$ Mn)

Month-year	FDI inflow (US$ Mn)
Apr-15	3,605
May-15	3,850
Jun-15	2,054
Jul-15	2,007
Aug-15	2,220
Sep-15	2,897
Oct-15	5,242
Nov-15	2,934
Dec-15	4,635
Jan-16	4,975
Feb-16	3,117
Mar-16	2,466

Source: Ministry of Statistics and Program Implementation Quarterly fact sheet on FDI from April 2000 till March 2016

3 See India attractiveness survey, http://www.ey.com/IN/en/Issues/Business-environment/EY-india-attractiveness-survey-2015

From the above figures in Table 1 we note that FDI equity inflows do not show any increasing trend consistently. There have been months where FDI inflows have been above four billion US dollars and there have been months where the FDI inflows have barely been over two billion US dollars. However, in November 2015 (when the reforms were announced) one does not notice a big increase in FDI inflows. The following two months saw high FDI inflows but so did October 2015 (just before the announcements). Hence, statistics do not show any distinct shift in FDI inflow trends in response to the November 2015 announcements. The response to the most recent announcement in June is yet to be observed.

Table 2 below shows the sectors which have received maximum FDI inflows.

Table 2: Top sectors receiving FDI in India (US$ Mn)

Sectors	2012-13 April-March	2013-14 April-March	2014-15 April-March	2015-16 April-March
Service Sector	4,833	2,225	4,443	6,889
Construction development	1,332	1,226	769	113
Computer Software & Hardware	486	1,126	2,296	5,904
Telecommunications (radio paging, cellular mobile, basic telephone services)	304	1,307	2,895	1,324
Automobiles	1,537	1,517	2,726	2,527
Drugs and Pharmaceuticals	1,123	1,279	1,498	754
Chemicals (other than fertilizers)	1,596	878	763	1,470
Trading	718	1,343	2,728	3,845

Source: Ministry of Statistics and Program Implementation Quarterly fact sheet on FDI from April 2000 till March 2016

The sectors which have seen greater investments after the present government came to power and after the FDI reform announcements were made are automobiles, trading, computer software and hardware. Incidentally, the construction sector where norms were relaxed inNovember 2015 has seen a reduction in FDI inflows. A large build-up of inventory in the housing sector by various real estate developers, and stagnation in prices may be responsible for this reduction in FDI flows to this sector. Possibilities of easier loans for buying property may not be realised very soon in the wake of rising inflation in the last two months which makes rate cuts unlikely.

The FDI reforms in the civil aviation sector may appear significant, but these are merely changes that lay down a few more ground rules. While the earlier norms allowed FDI in air transport service, domestic scheduled passenger airlines and regional air transport service upto 49% only; the new norms allow foreign investment beyond 49% but only through government approval. Traditional problems in obtaining government clearances may plague possibilities of FDI flows into this sector.

The 100% FDI through government approval in trading of food products manufactured in India may see a greater entry of foreign brands already present in India in various other segments of the food industry. This may help in checking inflationary pressures on food products which have been a problem in India but would not necessarily result in any growth in farmers' incomes. FDI in this sector may increase in the short- to medium-term.

The announcement of FDI in defence has attracted attention from politicians from various camps but the fact that any foreign investment greater than 49% would require government approval continues to guard the sector's security concerns in a big way. In the pharmaceutical industry, the relaxation of norms has not resulted in greater inflows in the recent past. The discomfiture of the world pharmaceutical industry about the Indian position on intellectual property rights may explain this. The trading sector has experienced a surge in foreign investments in the last few years. The relaxations on sourcing requirements for high-tech products may result in greater investments and opening up of other international brand retail stores. Although there are no immediate signs of high foreign investments in plantations, the same may be expected in the medium-term given the export potential.

The announcement of reforms has had immediate positive effects on the Indian stock markets which were facing downward pressures resulting from the announcement of the RBI Governor Raghuram Rajan that he would step down after his current term. There are, however, a few reasons why the FDI liberalisation may not necessarily result in as much inflows of foreign funds as it should, even though various international agencies have named India as the number one FDI destination. The reasons mostly stem from global uncertainties as well as India's domestic structural issues which need attention from the legislators.

On the domestic front, India's labour laws, such as the Factories Act and the Industrial Disputes Act, continue to remain a concern for the investors in the manufacturing sector and militate against growth and development of the organised manufacturing sector which is the main source of stable, longer-term employment. Contract enforceability problems continue to harm investor interests, as enforcing contracts could easily take more than three years in India. Considering the international conditions, global demand may continue to be low, and the increase in uncertainties resulting from Brexit (without immediate clarity on how the exit negotiations will span out) would impact global capital flows; investments into India may not pick up in a way it otherwise could have.

Downturns in global trade in the recent past would need to be watched carefully; the resulting impact on India's trade would be crucial. As of May 2016, Indian exports have been falling consistently every month for the last eighteen months. Hence, external demand may not be relied upon to generate return on investments. Investors would thus need to rely on Indian domestic demand which has facilitated India's GDP growth in the recent past. In the near future, with increased salaries of government employees because of the implementation of the Seventh Pay Commission recommendations, an increase in domestic demand may be expected, which would be inflationary if not matched with growth in supplies. Thereby, while there are some encouraging signs especially on the domestic front for India through the relaxation of FDI norms, a few other domestic as well as international uncertainties may erode the potential growth of FDI flows into India. Hence, while there are silver linings facilitating FDI inflows, the imminent concerns of international investors may affect FDI flows into India in the near- to medium-term.

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