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# REGULATION OF FOREIGN INVESTMENTS IN INDIA

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## I. ABSTRACT

Foreign Investments in India has always been a topic of debate and deliberation in academia and industry. The importance of the subject is concurrent with the need of acquisition of new forms of technology, intellectual collaboration, strategic alliances, protection of domestic industry, competition and many other such similar issues. The ideology of regulating foreign investments in India has developed through many stages in a considerable time period. The present paper is a critical insight into the regulatory framework and some of its critical challenges to potential foreign investors. The paper also discusses reasoning and approaches to developing such a regulatory framework. The content offers a wonderful insight into foreign investment's advantages and disadvantages from a developing country's perspective.

Keywords: Foreign Investment, FDI, FDI in India, Regulation of FDI

## II. INTRODUCTION

Regulation of foreign investments and issue/ transfer of securities to a person resident outside India; is such a complex phenomenon that legislative clashes or overlapping that could be well expected considering the nature and scope of the subject. Many minute details which have been unintentionally left over to the concern and disposal of understanding of those interested in framework of foreign investments. While issues may correspond to international measures for domestic protection of shareholders, issues relating to the repatriation of profits and sale proceeds out of India, settlement of disputes through international commercial arbitration and the like, discussion here is limited to the context and background of discussions made so far. There could not be umbrella solutions for all major problems in

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foreign investments. Still, it should be kept in mind that serious discussions motivated to economic development should be convened timely in order to solve issues of prime importance.[2] Many specific issues have been already discussed and this part is dedicated to discuss the general issues in foreign investments when inspected from a 'look through' approach instead of 'look at' approach.

It has been occasionally observed that exchange control laws created by FEMA, 1999 and various pertinent Regulations & Rules under it should be in consonance with the FDI Policy, or there is a risk of the policy coming in conflict with the law and getting overridden consequentially.[3] It is said that the lag between FEMA laws and the FDI Policy which often exists, was usually ignored, and possibly the sectoral policy delineated in FDI Policy has been followed by legal practitioners. There have been numerous cases in India where the concepts of residence and visit to India have been debated in order to remove ambiguity and store clarity to the assessment and regulation.[4] There are many others instances where definitions under FEMA and other regulatory laws have created problems of interpretation & application despite efforts to avoid the same.

Most of the debates outside the legislative framework are concentrated on binding character of bye-laws, executive orders that are generally framed for execution of FDI Policy.[5] It is well settled that foreign investments are being monitored through FEMA and the relevant rules framed thereunder, but considerable doubt still exists in relation to binding character of press notes issued by various sectoral regulators. There is a need of reform to consolidate the regulatory environment which causes uncertainty in the minds and approach of foreign to such a high extent that India lands to criticism of '**unpreferred destination**' for foreign investments owing to complex environment and lack of clarity. Intelligible criteria behind prescribing sector specific caps and investment limits have also been criticized to be based on exploitative approaches that affect the choice selection by foreign investors quite

[2] For Example, FDI Policy has been declaratory of the fact that FEMA provisions shall always prevail in cases of conflict.
[3] Ajay Kr Sharma, *A Critique of Indian FDI Law & Policy*, 2(1) NLUJ Law Review 30 (2013)
[4] See for Example, *Major R P Verma* v. *Union of India*, [1998] 17 SCL 35 (Del); *Reserve Bank of India* v. *Jacqueline Chandani* [1996] 86 COMP CASE 231 (Karnataka) and many others
[5]Amiti Sen, *Ministries have the Right to reject FDI Proposals*, DIPP Clarifies, The Hindu- Businessline, 9 JAN, 2018

considerably. It should however be noted that continuous research and deliberation could only solve such problems.

## III. KEY DETERMINANTS OF FOREIGN INVESTMENTS POLICY

Apart from the conventional legislative problems for a considerable period of time, necessary attention is also sought by some prime determinants of foreign investment policy in India. Certain factors such as trade openness, exchange rate policies have acted as essential determinants to FDI policy of India for which the researchers concluded that better coherence and integration of such concepts would cause appreciation of the economic conditions of India by investor resident outside.[6] Others have considered the size of the market, political stability, macro-economic environment, access to basic inputs and regulatory frameworks to be the prime factors behind a successful FDI policy of India.[7] Contributing factors such as labor costs, infrastructure facilities and export-import conditionalities of the country have also been considered as a major determinant of FDI in India.[8] The impact of government policies on key issues could not be side-lined for the fact that they operate as indicators for entities which are planning to pursue investments in India and India's evolving jurisprudence among the south Asian countries has done significantly well to attract foreign investment for the domestic economy.[9]

Indian government's stand on liberalizing the foreign investment domain is on a continuous rise particularly after introduction of 'Make in India' scheme that has caused liberalized formerly closed sectors for foreign intervention.[10] The introduction of stringent monitoring system, planned permissions for remittances, control over activities in domestic economy and interlinked sectoral regulation has paved new avenues of positivity among foreign investors

[6] Shiba Shankar, *Examining the determinants of FDI in India*, Journal of Theoretical & Applied Economics, Volume XXIII (2016), No. 2 (2007), Summer, pp. 225-238

[7] Anitha R, *Foreign direct investment and economic growth in India*, International Journal of Marketing, Financial Services & Management Research Vol.1 Issue 8, August 2012, ISSN 2277 3622

[8] Dr. Laxmi Narayan, *Determinants of Foreign Direct Investment in India*, International Journal of Research (IJR), Vol-1, Issue-7, August 2014, ISSN 2348-6848

[9] Jha G M, Agrawal A, Gupta A and Mishra A K, *Determinants of FDI in South Asia*, International Research Journal of Social Sciences, Vol. 2(1), (January 2013), 1-6, ISSN 2319– 3565

[10] For example, Press Release by Ministry of Railways, *FDI in Railways*, 07 April, 2017 available at http://pib.nic.in/newsite/PrintRelease.aspx?relid=160691

as far as India as a preferred destination is concerned.[11] India's diplomatic negotiations with considerable investment potential have also contributed significantly in attracting foreign investments to sectors in need.

There is however disagreement on the ways critical issues in foreign investment are pursued by the legislatures and policy makers. It could be observed that aspects which do not require political dialogue are subject to political scrutiny in India and the underlying area of concern gets overridden. This is the reason that despite several efforts, multi-layered regulatory setup of India has always blocked inflow of FDI. It is important to note here that being a diverse country with multiple opportunities; each issue needs to be tackled in the light of applicable conditions. One such dimension is central policy making without any involvement of states of India. DIPP has left processing of FDI proposals to the concern of independent sectoral regulators, but that alone could not serve the purpose for the reason that state based conditions holds an everlasting impact on utilization of foreign investment and the opinions/ suggestions of states should also be incorporated in central policy making in India.

Another impediment to FDI and a very important determinant in foreign investments is 'measures to prevent losses out of currency mismatch' which has been the core of discussion among Indian regulators when questions of external commercial borrowings (debt route) have come to analysis. There have been suggestions by authors where scrapping the current control system on foreign currency exposure is maintained. It has been said that a better system would be to pursue the challenges on a case-to-case basis.[12] Some considerable updates have already been incorporated in the system such as allowing firms to undertake rupee-denominated ECB, increase in caps of FII investment in rupee-denominated bonds etc. along-with strict prudential norms for banks while lending to unhedged securities by Indian companies. It has also been suggested that information systems (particularly for unlisted companies) should be paid more attention and a consolidated framework to avoid risks of currency exposure should be implemented in order to gain stability and better control.[13] It is

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[11] SEBI Circular No IMD/FPIC/CIR/P/2019/61dated 05 April, 2018 available at https://www.sebi.gov.in/legal/circulars/apr-2018/monitoring-of-foreign-investment-limits-in-listed-indian-companies_38575.html

[12] Ila Patnaik, Ajay Shah &Nirvikar Singh, *Foreign Currency Borrowings by Indian Firms- Towards a new Policy Framework*, India Public Forum, 2015-2016 at p. 178

[13]EmeseKuruc, Bruno Tissot and Philip Turner (BIS), *Looking at Aggregate Currency Mismatches & Beyond*, Paper presented on the occasion of the IFC/ECCBSO/CBRT Conference on "Uses of Central Balance Sheet

also said that in order to boost domestic economy to higher scales, the governments need to identify measures in monitory policies to maintain stable exchange rates.[14]

## IV. ANALYSIS OF RISKS IN FOREIGN INVESTMENTS

A greater participation by foreign investors in a developing economy such as that of India also involved exposure of Indian markets to systemic risks and other risks that may arise out of contagion. It is observed that due to volatility of investment markets, a high dependence on foreign investments would put the domestic markets at the risk of accumulated failure. Such failures may arise out of uncontrolled exchange of detrimental information without having any substance. It is therefore important that the developing economies focus more on supplementing their domestic economy by acquisition of capital, skill and technology from outside and also to focus through strategic measures on ownership and interference of such investors in entities owned domestically. Integration of market economies and regulatory setup further aggravates the risk which if remains uncontrolled or unmonitored would be a significant exposure to uncounted risk of demolition or failure.

It has been observed in experiences that foreign owned entities also resort to exploitative and exclusionary practices in order to establish their firm presence in domestic markets. It cause huge blow to the domestic market and may also cause their ultimate dismissal from competition. While the objective of promoting foreign investment should be do grow economically, measures to combat instances of misuse of economic power, concentration among foreign entities and exclusive dealing should be addressed nationally as trade and exploitation can’t go together. Adopting specific measures in managing competition holds importance not just to provide incentives and rewards to domestic entities but to keep a check on activities pursued by foreign investors and their conglomerates in domestic economy. There must be strict & time-bound redressal of disputes if any, as competitive concerns come together with trade objectives.

FDI is not an unmixed blessing as a number of adverse effects on host countries are identified with it.[15] It is a misnomer that FDI invariably provides capital to Indian enterprises. FDI as it

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Data Offices’ information”, organised by the Irving Fisher Committee on Central Bank Statistics (IFC), the European Committee of Central Balance Sheet Data Offices (ECCBSO) and the Central Bank of the Republic of Turkey (CBRT), Özdere-İzmir, 26 September 2016

[14]AimaAzhar, Naeem Ullah & Qaisar Ali Malik, *Effect of Exchange Rate Volatility on FDI in SAARC Countries*, Middle East Journal of Scientific Research, 23 (2): 350-356, 2015 ISSN 1990-9233 at p. 350

is being measured now can be categorized into three major types. First, in a liberalized policy environment, RFDI which is associated with capital and the expected attributes of technology, management skills, etc., would have little interest to finance domestic entrepreneurs or to transfer advanced technologies to them unless they are bound in some subordinate relationship. It will indeed be naïve to expect RFDI, especially the market seeking type, to facilitate the emergence of local competitors. Far from that, it will be inclined to not only displace existing entrepreneurs but also to inhibit the emergence of newer ones. In the process, national champions, lead firms and start-ups nurtured though various types of incentives by developing countries like India could end up as constituents of global corporations. The investors can also be differentiated according to their motives: natural resource seeking, efficiency seeking, market seeking and strategic asset seeking. The remaining two types of investors can bring in capital but would more often than not have very little to contribute in terms of technology. Foreign financial investors, the second main type of FDI, would play the financing role. But, the downside risks are large capital outflows and loss of control over domestic enterprises when RFDI investors provide the exit route to them. The third main form of FDI, i.e. inflows on account of domestic entrepreneurs could be return of flight capital and/or disguised portfolio investment/borrowings.[16]

## V. INDIA'S EXPERIENCE WITH EXPOSURE TO FOREIGN INVESTMENTS

India however has moved to advanced stages of policy formulation to attract and retain foreign investment in various sectors of economic activity. There have been measures implemented not only to liberalize the sectors for enhanced acquisition of technology and know-how but has also opened up domestic promotion of foreign investors. Key initiatives in the recent past have been aimed at attaining accelerated rates of growth with intensive homework on policy requirements and system of regulation. Several key steps as have been discussed above remain in continuous elaboration and discussion by government agencies to ensure that a threat and risk-free environment is created for collaborated commercial activity in India.

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[15] United Nations, *The Development Dimension of FDI: Policy and Rule-Making Perspectives*, New Yok and Geneva, 2003

[16] Chalapati Rao KS and Biswajit Dhar, *India's Recent Inward Foreign Direct Investment: An Assessment*, MPRA Paper No. 88992, posted 17 September 2018, available by retrieval at: https://mpra.ub.uni-muenchen.de/88992/1/MPRA_paper_88992.pdf

The conventional wisdom that FDI is a key factor in sustained economic growth may provide an incomplete picture. Also, the arguments put forth by the environmentalists against the very concept of privatization of the atmospheric commons (you can't sell what you don't own) that allows the market and corporate actors (many of whom are the world's biggest polluters) to determine the pace and development of the 'carbon market'; cannot be overlooked. Investing abroad inevitably carries increased political and economic risks, particularly when an investment involves large sunk costs or a long-term commitment of capital. Overall policy trends during the crisis in India have so far been mostly favorable to FDI, both nationally and internationally. However, in some countries a more restrictive FDI approach has emerged. There is also growing evidence of 'covert' protectionism.[17]

Apart from various positive aspects that might have been mingled with a comprehensive foreign investment policy of countries such as India, there are certain attached disadvantages that are observed domestically. For example, some of the products produced in cottage and village industries and also under small scale industries of India have been alleged to have disappeared from the market due to the onslaught of the products coming from FDIs.[18] Foreign direct investments contribute to pollution problem in the country. The developed countries have shifted some of their pollution-borne industries to the developing countries. The major victim is automobile industry. Most of these are shifted to developing countries and thus they have escaped pollution.[19] Similarly, Foreign Direct Investments are one of the reasons for exchange crisis at times. During the year 2000, the Southeast Asian countries experienced currency crisis because of the presence of FDl. With inflation contributed by them, exports have dwindled resulting in heavy fall in the value of domestic currency. As a result of this, the FDIs started withdrawing their capital leading to an exchange crisis. Thus, too much dependence on FDls will create exchange crisis.[20] And above all, in all the countries where the FDls have made an inroad, there has been a cultural shock experienced by the local people, adopting a different culture alien to the country. The domestic culture

[17] Jasmeet Kaur, *FDI and Sustainable Development: Lessons to Draw for India*, Annual Research Journal of SCMS, Pune, Vol. 1, Jan. 2013–Jan. 2014, pp. 56-68

[18] M. Ghoshal &Shipli Saxena, *Role of FDI in Indian Small Scale Industries*, International Journal of Management, IT & Technology, Vol. 2 Issue 5, 2012

[19] Joysri Acharya, *FDI, Growth and The Environment: Evidence From India on Co2 Emission During the Last Two Decades*, Journal of Economic Development, Volume 34, Number 1, 2009

[20] Tushar K Mahanti, *High Dependence on FDI may Hamper Growth of India Inc*, Economic Times, 13 April 2009

either disappears or suffers a setback. This is felt in the family structure, social setup and erosion in the value system of the people. Importance given to human relations, hither to suffers a setback with the hi-fi style of living.[21]

## VI. CONCLUSION

There shall always be a difference of opinion in relation to utility and problems of FDI among the developing and developed nations and therefore there could not be a unanimous opinion regarding appropriateness of foreign investments for a select country. American experience reflects that European entities are aiming to focus investments in Mexico to establish a production base to meet supply requirements of US markets. Asian experience has largely focused on supplementing the domestic capital by establishing joint ventures so that better acquisition of technology could be done. European experience is based on creating new trade gateways across emerging economies and doing businesses with them.[22]

In summary, this paper has concentrated on developing deep understanding on various facets involved in foreign investments and allied activities done in a domestic economy. It is imperative for the learner to understand that investments for any country, is not just an abstract concept but is political ideology which has many objectives to pursue. It should be kept in mind that political dialogue and deliberation across countries has been based on their respective objectives and therefore a universal consensus for laws relating to investments and securities was impossible to realize. In a developing economy such as India, the problems are not just related to operational mechanisms but to various other segments and the issues are so intermingled with each other that, policy formulation for one issue would cause significant impact on several others thereby putting the entire framework to analysis and criticism.

[21] Arjun Bhardwaj, Joerg Dietz and Paul W. Beamish, *Host Country Cultural Influences on Foreign Direct Investment*, *Management International Review*, Vol. 47, No. 1 (2007), pp. 29-50

[22] Mariusz Omelańczuk, *Export Platform FDI as a Concept for Growth – Selected Global Experiences*, Entrepreneurial Business and Economics Review, 1(1), pp. 91-102