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Challenges in India's Foreign Investment Policies

BANOTH VAMSHI[1]

ABSTRACT

The world market became a local market after many nations, including India, liberalized their trade laws in 1991, and the inflow of foreign investment increased significantly. In this way, the idea of foreign investment has evolved. Foreign investment is the majority owner of a company in another nation by an investor based in that country. Further, FECA, 1947, and FERA, 1973, relating to foreign investments, were initially adopted in India. Later, these laws were repealed and replaced by new laws known as FEMA, 1999, and Foreign Contribution (Regulation) Act, 2010, as well as other related laws like the Securities Contracts (Regulation) Act, 1956, and Companies Act, 2013. To develop new laws that are advantageous to the nation and desirable to foreign investors, as well as change current laws, is necessary. Foreign investment can be viewed as a benefit for both developing and underdeveloped nations since it attracts capital to businesses, which in turn helps the economy of the nation by covering the funding gap. Additionally, the received foreign investment not only provides capital but also makes high-level technology and an increase in job prospects possible. Both countries receive benefits in exchange for foreign investment, including the capital, resources, markets, etc. However, many challenges with foreign investment in India, including a restrictive FDI framework, high import tariffs, and centralised decision-making.

Keywords*: Foreign investment, Company, Capital, Technology, Import tariffs.*

I. INTRODUCTION

During 1991, India faced serious financial crisis due to the implementation of nationalization of banks which provided debt as well as equity capital to private firms. To overcome from the financial crisis, the policy of foreign investment was allowed through the new economic reform LPG Policy i.e., Liberalization, Privatization, modernization. This led to the gradual growth of economic development, financial stability which helped to overcome the crisis. With the introduction of foreign investment in India, the Government of India introduced new laws known as Foreign Exchange Management Act (FEMA), 1999 to manage foreign investments. For better development and economic growth on par with other countries, India permitted

[1] Author is a LL.M. Student at Osmania University, India.

foreign investment in various sectors like power, health, education, media, airport, telecom etc. through either modes such as foreign direct investment or foreign portfolio investment scheme.

(A) Foreign investment

Foreign investment is investing the capital in a country by a company located in another country, either directly i.e., by buying a company in the host country or by expanding operations of an existing business in the host country or by indirectly like buying Stocks and shares in that country.

Evolution of Foreign Investment in India

In the First phase (1947 - 1969) The Government of India enacted a law known as Foreign Exchange Control Act (FECA), 1947 and a limited foreign investment was allowed. In the Second phase (1969 - 1991) India introduced the nationalization of banks policy and adopted new laws in line with the changing times such as Monopolies and Restrictive Trade Practices Act (MRTP), 1969 and the Foreign Exchange Regulation Act (FERA) in 1973 by repealing its previous act. During the third phase (1991- 2000) The Government of India introduced the LPG policy i.e., Liberalization, Privatization and Modernization. FERA was replaced by Foreign Exchange Management Act (FEMA), 1999. During this phase serious Asian crisis had occurred whereby the value of Indian Rupee had drastically come down in the world market. Foreign Investment was highly encouraged to overcome such crisis. Foreign Investment Promotional Board (FIPB) was constituted to consider issues regarding FDI. Further, the Fourth phase (2000-2007) The Government permitted to invest in various sectors/activities which lead to increase in foreign capital which further helped India to achieve a high growth rate.

In the Fifth phase (2007 - 2010) World Economies hit by severe recession but India remained resistant with the savings policy. The rate of foreign investment has been heavily declined due to the recession. During the Sixth phase (2011-2013) Global economies began recovering from recession but India witnessed a slow growth of foreign investments. Currency depreciation, high inflation etc. are major concerns after the world recession. India introduced the policy of foreign investment into the Retail sector. In the Seventh phase (2013-2015) The Indian government made new programmes such as 'MAKE IN INDIA' which was inaugurated by the Prime Minister Narendra Modi on 25th September, 2014. Its main aim is to facilitate investment, enhance skill development and protect intellectual property.

(B) Modes of Foreign Investment

Foreign Investment can be invested by Foreign Companies, Non-Residents of India (NRI), Persons of Indian Origin (PIO) etc. Foreign Investment can be invested into an existing company or into a new company, formed either by incorporating or by unincorporating as follows

By incorporating a company under the Companies Act, 1956

a) A wholly owned subsidiary or company.

b) Joint venture company - existing company or new company with domestic partner.

As an unincorporated entity

a) Liaison Office – Liaison office provides information to the domestic customers about the company, their objectives and it is restricted to deal with commercial, trading and industrial activity. It acts as a link between the foreign company and the local company.

b) Project Office – These offices are established for an adhoc purpose relating to a particular project for a temporary period.

c) Branch Office – Foreign Companies which are not incorporated in India can establish a branch office with the approval of RBI for the purpose of manufacturing and trading activities.

II. Types of Foreign Investment

Foreign Investment is of two types –

(A) Foreign Direct Investment

Foreign direct investment (FDI) is an investment made directly into the business of a country by an individual or company of another country, either by buying a company in the former country or by expanding operations of an existing business in that country.

Routes of FDI

An Indian company may receive Foreign Direct Investment under two routes as given under

a) Automatic Route FDI in various sectors is permitted under automatic route through Foreign Equity, ranging from 24%, 50%, 51%, 74% upto 100% which is allowed depending on the category of Industries and does not require any prior approval either of the Government or the Reserve Bank of India.

b) Government Route Foreign Direct Investment (FDI) in activities not covered under the automatic route requires prior approval of the Government of India which is considered by the Foreign Investment Promotion Board (FIPB), Ministry of Finance.

(B) Foreign Portfolio Investment Scheme

Foreign Institutional Investor (FII) was replaced with the Foreign Portfolio Investment (FPI). Foreign Portfolio Investment enables Non-Residents of India (NRI), Overseas Corporate Bodies (OCB) to invest in shares of Indian companies and can deal with Securities, shares, stocks, bonds and debentures. Foreign Portfolio Scheme is governed by SEBI (Foreign Portfolio Investors) Regulations, 2014.

(C) Laws regulating Foreign Investment

Some of the laws regulating Foreign Investment are

1. Foreign Exchange Management Act (FEMA), 1999

2. Foreign Contribution (Regulation) Act, 2010

3. Foreign trade (Development and regulation) Act, 1992

4. Foreign Direct Investment (FDI) Policy

Other allied laws

5. Securities Contracts (Regulation) Act, 1956

6. Securities and Exchange Board of India (SEBI) Act, 1992

7. Depositories Act, 1996

8. Companies Act, 2013

9. Competition Act, 2002

10. Micro, Small and Medium Enterprise Development Act, 2006

1. Foreign Exchange Management Act (FEMA), 1999 -

Foreign Exchange Management Act, 1999 came into force on 29th December, 1999 by replacing its previous act 'Foreign Exchange Regulation Act (FERA), 1973.' Its main objective is to facilitate external trade and payments which promotes development and maintenance of foreign exchange market in India. This act has liberalized rules and regulations than the previous act.

2. Foreign Contribution (Regulation) Act, 2010-

Foreign contribution (Regulation) Act, 2010 was enacted on 26th September, 2010 by replacing its previous law Foreign Contribution (Regulation) Act, 1976. Its main aim is to regulate the acceptance and utilization of foreign contribution or foreign hospitality donated by certain individuals or associations or companies and to prohibit acceptance and utilisation of foreign contribution or foreign hospitality for any activities which are detrimental to the national interest. The act also envisaged the list of certain individuals who are prohibited from accepting such contribution.

3. **Foreign trade (Development and regulation) Act, 1992**

Foreign Trade (Development and Regulation) [FT(D&R)] Act, 1992 was formed which aims to regulate and provide development of foreign trade by facilitating imports and exports of the country, the preceding acts were Imports and Exports (Control) Act, 1947 and the Foreign Trade (Development and Regulation) Ordinance, 1992 which are repealed. This act provides and regulates export and import policies of the country.

4. **Foreign Direct Investment (FDI) Policy**

The Department of Industrial Policy and Promotion (DIPP), Government of India issues consolidated FDI policy, first issued on 2005 and later on 2010, 2013, 2014, 2015 respectively. The main objective of this policy is to attract and promote foreign direct investment in order to supplement domestic capital, technology and skills, for accelerated economic growth.

Other allied laws

5. **Securities Contracts (Regulation) Act, 1956**

Securities Contracts (Regulation) Act, 1956 was framed to prevent undesirable transactions and regulate the securities. It was amended and introduced a new bill known as Securities Contracts (Regulation) Amendments Bill, 2005. Its main proposal is to amend the definition of "Securities" which covers all types of transactions in securities debt such as both Asset Backed Securities and Residential Mortgaged-Backed securities.

6. **Securities and Exchange Board of India (SEBI) Act, 1992**

Securities and Exchange Board of India (SEBI) was initially formed on 12th April, 1988 as non-statutory body. In 1992, it was revised as a statutory body. Securities and Exchange Board of India (SEBI) is the 1st Statutory Body in India to establish its own tribunal i.e. Securities Appellate Tribunal for resolving its problems. The Supreme Court is the appeal court to this tribunal. Its objective is to safeguard the interests of investors in securities, to regulate and to promote the development in the security markets. The SEBI Board was formed to provide speedy justice.

Decisive steps taken by SEBI for ensuring healthy Security Market

SEBI has adopted various measures to ensure healthy security market. Some of them were

a. **Control on Stock-Brokers and Sub-Brokers** - To have control over Stock-brokers and Sub-brokers a legislation has been made called 'Securities and Exchange Board of India (Stock-brokers and Sub-brokers) Regulation, 1992.' Under this act, it is mandatory to each and every stock-broker and sub-brokers to get register.

b. **Insider Trading** - SEBI (Insider Trading) Regulation, 1992 was enacted to prevent malpractices such as falsification of share prices by companies and its employees. This act aims to ensure safety to the security holders and also promotes investments.

c. **Control on Mutual Funds** - SEBI (Mutual Funds) Regulation, 1993 was enacted to have control over mutual funds of both government and private sector.

7. **Depositories Act, 1996:** Depositories Act was formed after issuing two ordinances on 21st September, 1995 and 7th January, 1996 respectively, the latter was ratified by both the houses thereby forming Depositories Act, 1996. Its main objective is to improve and modernize the markets and to provide regulation of depositories in securities. A depository is an organization which holds securities (like shares, bonds, government securities, mutual funds etc.) of investors in electronic form. This can be attained only through DEMATERIALISATION (DE-MAT) which means paper-less transaction i.e. through electronic mode which helps to maintain transparency, adequate information and accuracy in stock exchange markets.

There are two sorts of depositories in India at present which are registered with SEBI –

- National Securities Depository Limited (NSDL)
- Central Depository Services India Limited (CDSL)

8. **Companies Act, 2013** - Companies act has been enacted inspired by the Bubbles Act, 1720 of England. Joint Stock Companies Act, 1860 has been formed primarily and replaced by Companies Act, 1866, 1882, 1913, 1956, 2013. Companies Act, 2013 defines 'Foreign Company' and various procedures under Chapter-XXII – "Companies Incorporated Outside India."

9. **Competition Act, 2002 -** Monopolies and Restrictive Trade Practices Act, 1969 has become obsolete for the changing times and has been replaced with Competition Act, 2002. Its aim is to provide, keeping in view of the economic development of the country, is to provide for the establishment of competition commission, prevent practices which

having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India. Competition Act, 2002 protects the interests of Micro, small and Medium Enterprises and their operating conditions from the abuse of market power.

10. Micro, Small and Medium Enterprise Development Act, 2006

Micro, Small and Medium Enterprise Development Act, 2006 was enacted for the first time on 16th June, 2006 and came into force on 2nd October, 2006. Its aim is to promote Finance and credit, Technology, Infrastructure, Marketing to the produced goods, Skill development and training and enhance the competitiveness of micro, small and medium enterprises.

III. Incentives to the Foreign Investors

a) Investment allowance (additional depreciation) at the rate of 15% to manufacturing companies that invest more than INR 1 billion in plant and machinery.

b) Areas based incentives like unit set-up in North-East region, Jammu & Kashmir, Himachal Pradesh and Uttarakhand.

c) Export incentives like duty exemption, remission scheme, market schemes etc.

d) Sector specific incentives in electronics.

e) Incentives available to units which were set-up in the areas of Special Economic Zones (SEZ).

(A) Advantages of Foreign Investment

i. Foreign Investment helps in economic development of the host country.

ii. It facilitates exchange of resources between the countries, such as superior technological resources to the developing and under-developed countries whereas human resource and market to the developed countries.

iii. It provides employment to the youth, and country like India is benefitted the most as 25% of world’s youth are located in India.

iv. It also helps in increasing the generation of income through the taxes levied on the foreign investments.

(B) Disadvantages of Foreign Investment

i. National Wealth and integrity of the country is at risk due to extreme liberalization of foreign investment in high risk prone sectors like defence, arms and ammunition, mining etc.

ii. Ownership may be lost by the domestic partners with the domination of the foreign investors

iii. Foreign policies which were adopted were not appropriate to the working class in the invested country.

iv. Due to extreme liberalisation of foreign policy, the Micro, Small and Medium Enterprises (MSMEs) face severe competition from the MNC's.

IV. CHALLENGES TO THE NEW GOVERNMENTS

India is the largest democratic country having second largest population in the world. Even though India is having abundant natural and human resources, yet some of the major challenges faced by the new governments were- political instability, poor infrastructure, confusing tax and tariff policies, inadequate basic amenities, stringent labor laws, limited export processing zones, corruption and delay in governmental procedures and regulations etc.

1. **PROPER EMPLOYMENT:** Though foreign investment creates a considerable number of jobs, creation of suitable employment based on eligibility, qualification to younger generation is always a bit difficult challenge, as India possesses 25% of the world's younger generation (aged between 14-28 years) with better qualifications.

2. **LACK OF ADEQUATE INFRASTRUCTURE:** India is having very poor infrastructure when compared to other developing countries which discourages foreign investors in investing in India. India's biggest infrastructure problem is the supply of electricity, Plant & machinery etc. Power cuts are considered as most common problem and many industries are forced to shut down their business.

3. **CORRUPTION**: Corruption is found nearly in each and every public office, from pillar to post. Lack of institutional reforms, delay in bureaucratic decision-making and the allegations of corruption are the top reasons that turned foreign investors away from India. Corruption and misuse of power are the main obstacles for the country's development.

4. **LACK OF DECISION-MAKING AUTHORITY WITH THE STATE GOVERNMENTS:** In India, flow of Foreign Investment was regulated and controlled by Central Government and the State Governments have no active role to play. Even though if the State Government plays an active role and tries to have an agreement with foreign investors, it

must take prior approval from the Central Government. America, Brazil, China, and Russia are examples where state governments are the active decision makers.

5. POLITICAL INSTABILITY: During past decade India observed coalition government which led to political instability. Political instability is an obstruction to make laws as the governments go on changing, the laws and regulations made by previous governments or yet to be made which are about to be approved, will always have been a fresh review, relook in the laws which makes an inordinate delay to approve and implement the laws.

According to the survey conducted by FICCI (Federation of Indian Chambers of Commerce and Industry) on foreign Investment in the year 2010, the three main challenges pointed out were

6. DELAY IN PROCEDURES: The delay in procedures such as registration, documents, granting of Government approval will take more than 6 months which may turn foreign investors away from investing in India.

7. HIGH CORPORATE TAX RATES: High corporate taxes were collected from the foreign companies in India. Foreign investments in LLP's (Limited Liability Partnership) were made to pay 30% of tax which makes foreign investors unwilling to invest.

8. STRINGENT LABOUR LAWS: Large firms in India are not allowed to retrench or layoff any workers, or close down the unit without the permission of the state government. These laws protect the workers. To retrench delinquent workers, firms require approval from both employees and state government.

Measures taken and suggestions to overcome the challenges -

The Government has implemented certain policies and programmes to overcome the aforesaid challenges and to enhance foreign investment which are as follows

1. DEVELOPING SKILLED HUMAN RESOURCE: Skilled human resource is necessary in yielding efficient results. In India abundant human resource is available but lacks skill or has low skill. For improving skill development welfare programmes must be implemented by the government which aims to promote skilled labour. Some of the programmes implemented to develop skilled human resources are - i) Prime Minister's National Council on Skill development (NCSD), ii) National Skill Development Coordination Board (NSDCB), iii) National Skill Development Cooperation (NSDC). These programmes contribute to skilled labour to certain extent, however there is need for further implementation of such programmes exhaustively which could reach common people.

2. PROTECTION OF MICRO, SMALL AND MEDIUM INDUSTRIES: Government had taken measures to protect the interests of micro, small and medium industries by assuring 30% purchase of the finished manufactured products which are sourced from Indian micro, small and medium industries. The Government of India also enacted a law called MICRO, SMALL AND MEDIUM ENTERPRISES, 2006 which promotes Finance and credit, Technology, Infrastructure, Marketing, Skill development and training and enhance the competitiveness of micro, small and medium enterprises.

Other programmes launched by Government in support of Micro, Small, and Medium Enterprises are National Manufacturing Policy, National Manufacturing Competitiveness Programmes. Further the percentage of source can be increased for protection of the local industries and also the issue can be included in the upcoming Five-Year Plan as one of the objectives.

3. PREVENTIVE MEASURES OF CORRUPTION: Prevention of corruption results in efficiency and speedy economic growth and thereby leads to country's development and improving its share in the world market. Therefore, the Lokpal and Lokayuktas Act, 2013 was enacted to prevent corruption and to provide fair investigation and prosecution in cases of corruption,

4. DECISION-MAKING POWER TO STATE GOVERNMENTS: Power of decision making must be granted to State Governments so that the State Government can adopt various initiatives which will make use of natural resources properly. West Bengal, Bihar, Jharkhand, Chhattisgarh etc. are blessed with abundant forest resource, rich minerals such as diamonds, gold, coal mines etc., but due to lack of proper initiatives these states fails to attract more Foreign Investment.

5. INCREASE IN SECTORAL CAPS: Government permitted foreign investments in various sectors such as real estate, coal mining and retail trade through automatic route which increased sectoral capital as well as technological improvisation. Government could allow more foreign investment into various sectors.

6. STRENGTHEN RESEARCH AND DEVELOPMENT IN THE COUNTRY: India should attract more Foreign Investment into Research and Development which strengthens and protects the country interests.

7. FLEXIBLE LABOUR LAWS NEEDED: China receives maximum Foreign Investment from manufacturing sector, which made the country as manufacturing hub. In India the manufacturing sector could be developed, if infrastructure facilities such as Power supply, Plant & Machinery were improved. To improve these facilities in manufacturing sectors, there is need to make changes in stringent labour laws.

V. Need for changes in existing laws and for emergence of new laws

India liberalized many laws for the changing times to enhance more Foreign Investment ratio. Existing laws are efficient to some extent to attract foreign investments to the country which made India stand in the global market but when compared with other developing countries like China, Malaysia, Singapore our inflow of Foreign Investment is low. To meet the present day challenges there is a need to change in existing laws to make India as No. 1 in the global market. Laws about to be made in future as well as changes in existing laws must be in compliance with the following recommendations to attain better inflow of foreign investment. Some of the Recommendations made by FICCI to Government for increase of Foreign Investment in India

1. Rationalization of the tax structure

2. Simplification of procedures for flow of funds

3. Modernization of government systems and reduction in bureaucracy

4. Improvement in infrastructure facilities

5. Flexible labour laws

6. Liberalization of employment visa rules

Other Recommendations

1. Political Stability
2. Investment in Education Sector
3. Increasing the Export Processing Zones

VI. Conclusion

Foreign Investment plays a predominant role in long-term development of a country. Foreign Investment not only enhances capital but also provides technological transfer, strengthens infrastructure and generates new employment opportunities. India emerges as the fifth largest recipient of foreign direct investment across the globe and second largest among other developing countries and ranks as third largest economy in terms of Purchasing Power Parity. The huge market size, good economic policies amended from time to time, availability of skilled human resources, abundant natural resources, all these factors enable India to attract more and more Foreign Investment.

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Further, it was found from the trends that even though there has been increased flow of Foreign investment, the global share of Foreign Investment contributed by India is very less when compared with other developing countries like China, Singapore, Malaysia. Lack of proper infrastructure, instable government, corruption, high corporate tax rates are considered to be the major problems for low Foreign Investments into the country. To overcome this situation, the Government should adopt better laws and bring more sectors under the automatic route. Therefore, there is an urgent need to adopt innovative policies and laws for good corporate governance for the changing times by the Indian Government to attract more and more foreign capital in various sectors of the economy to make India as No. 1 in the global economy.

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