Foreign Direct Investment

For Prelims: FDI, FPI, Government Initiatives

For Mains: Significance of FDI for Indian Economy, Different Routes and components of FDI, Government's Initiatives

Why in News?

India received the highest annual FDI inflows of USD 84,835 million in FY 21-22, overtaking last year's FDI by USD 2.87 billion.

- In 2021, FDI inflows increased from USD 74,391 million in FY 19-20 to USD 81,973 million in FY 20-21.
- **UNCTAD World Investment Report (WIR) 2022** has **ranked India at 7th rank** among the top 20 host economies for 2021, in terms of FDI.

Who are the Top Recipients?

- **India's Statistics:**
    - India received the highest annual FDI inflows of **USD 84,835 million** in FY 21-22, overtaking last year's FDI by **USD 2.87 billion.**
        - In 2021, FDI inflows **increased from USD 74,391 million in FY 19-20 to USD 81,973 million in FY 20-21.**
    - **Top 5 FDI Sourcing Nation:**
        - **Singapore:** 27.01%
        - **USA**: 17.94%
        - **Mauritius:** 15.98%
        - **Netherland:** 7.86%
        - **Switzerland:** 7.31%
- **Top Sectors:**
    - **Computer Software & Hardware:** 24.60%
    - **Services Sector** (Fin., Banking, Insurance, Non Fin/Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis, Other): 12.13%
    - **Automobile Industry:** 11.89%
    - **Trading:** 7.72%
    - **Construction (Infrastructure) Activities**: **5.52%**
- **Top Destinations:**
    - **Karnataka:** 37.55%
    - **Maharashtra:** 26.26%
    - **Delhi**: 13.93%
    - **Tamil Nadu:** 5.10%
    - **Haryana**: 4.76%
- FDI Equity inflow in **Manufacturing Sectors** have increased by **76% in FY 2021-22** (USD 21.34 billion) compared to previous FY 2020-21 (USD 12.09 billion).

What is Foreign Direct Investment?

- **About:**
  - A **Foreign Direct Investment (FDI)** is an investment made by a **firm or individual in one country into business interests located in another country.**
    - FDI lets an investor **purchase a direct business interest in a foreign country.**
  - Investors can make FDI in a number of ways.
    - Some common ones include establishing a **subsidiary** in another country, **acquiring** or **merging** with an existing foreign company, or **starting a joint venture partnership** with a foreign company.
  - Apart from being a critical driver of economic growth, FDI has been **a major non-debt financial resource for the economic development of India.**
  - It is different from **Foreign Portfolio Investment** **where the foreign entity merely buys stocks and bonds of a company.**
    - FPI **does not provide the investor with control over the business.**
- **Components:**
  - **Equity capital:**
    - It is the foreign direct investor's **purchase of shares of an enterprise** in a country **other than its own.**
  - **Reinvested earnings:**
    - It comprises the **direct investors' share of earnings** not distributed as dividends by affiliates, or earnings not remitted to the direct investor.
      - Such retained profits by affiliates are reinvested.
  - **Intra-company loans:**
    - These refer to **short- or long-term borrowing** and **lending of funds** between direct investors (or enterprises) and affiliate enterprises.
- **Routes of FDI:**
  - **Automatic Route:**
    - In this, the foreign entity **does not require the prior approval of the government or the RBI** (Reserve Bank of India).
    - In India FDI **up to 100% is allowed in non-critical sectors** through the automatic route, **not requiring security clearance** from the Ministry of Home Affairs (MHA).
      - Prior government approval or security clearance from MHA is required for **investments in sensitive sectors** such as defence, media, telecommunication, satellites, private security agencies, civil aviation and mining, **besides any investment from Pakistan and Bangladesh.**
  - **Government Route:**
    - In this, the foreign entity **has to take the approval of the government.**
      - **The Foreign Investment Facilitation Portal (FIFP)** facilitates the single window clearance of applications which are through approval route. It is administered by the **Department for Promotion of Industry and Internal Trade (DPIIT),** Ministry of Commerce and Industry.

What has the Government done to boost FDI?

- The Government of India has taken many initiatives in recent years such as relaxing **FDI norms** across sectors such as defence, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others.
- **'Make in India**' and **'Atmanirbhar Bharat'** campaigns coupled with strengthening of **India's footing in global supply chains** have given momentum to FDI inflows over the past few years.
- Launch of Schemes attracting investments, such as, **National technical Textile Mission, Production Linked Incentive Scheme**, **Pradhan Mantri Kisan SAMPADA Yojana**, etc.
- The first wave of the **Covid-19 pandemic** prompted around 1,000 companies to shift their base out of China, with nearly 300 of them being in the areas of medical and electronic devices, mobiles and textiles.
  - For India, **companies like Lava International** with over 600 employees clarified its intention to shift its base to India from China.
- Higher FDI inflows have been possible due to the **liberal and attractive policy regime** for the

investors, **a good business climate and reduced regulatory framework.**

How can India Retain this Growth?

- **Government policies/decisions** are of crucial importance in creating a conducive environment for global investors. **The disruptions induced by the pandemic** have given opportunities for India to expand its global footprints.
    - The government is striving to **strengthen the FDI environment through an array of policy** initiatives and reforms at all levels.
    - This also has to be complemented by a **sound** trade policy **to boost exports** further, encourage **inclusive development**, and **incentivise R&D** (research & development) to make our **industry globally competitive.**
- **FDIs have more potential** to facilitate the growth of the Indian economy than Foreign Portfolio Investment (FPI).
    - It should be ensured that India remains an attractive, safe, predictable destination for serious, long term investors.
        - **A level playing field is necessary** if we want continued foreign investments. Sneaking loyalty towards local players should be avoided.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Q. Consider the following: (2021)

1. Foreign currency convertible bonds
2. Foreign institutional investment with certain conditions
3. Global depository receipts
4. Non-resident external deposits

Which of the above can be included in Foreign Direct Investments?

(a) 1, 2 and 3
(b) 3 only
(c) 2 and 4
(d) 1 and 4

Ans: (a)

Explanation:

- Foreign Investment means any investment made by a person resident outside India on a repatriable basis in capital instruments of an Indian company or to the capital of an LLP.
    - Foreign Direct Investment (FDI) is the investment through capital instruments by a person resident outside India (a) in an unlisted Indian company; or (b) in 10% or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company.
    - Foreign Portfolio Investment is any investment made by a person resident outside India in capital instruments where such investment is (a) less than 10% of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company or (b) less than 10% of the paid-up value of each series of capital instruments of a listed Indian company.
- Foreign investment is recognized as FDI only if the investment is made in equity shares, fully and mandatorily convertible preference shares and fully and mandatorily convertible debentures only. FDI policy does not permit issuance of any optionally convertible security.
- Foreign Currency Convertible Bonds (FCCBs) are foreign currency convertible Bonds invested in Indian company. Since these bonds are convertible in to equity shares over a period of time as provided in the instrument, therefore they are covered under FDI policy and inward remittances received by the Indian company vide issuance of FCCBs are treated as FDI and counted towards FDI. Hence, 1 is correct.
- Foreign Institutional Investor (FII) is not FDI in general as FIIs can invest up to a maximum of 10 per cent of the total paid-up capital, however, if FII invest in convertible debenture then it is counted as FDI subject to certain limitations. Hence, 2 is correct.

- Indian companies can raise foreign currency resources abroad through the issue of American Depository Receipt (ADR)/Global Depository Receipts (GDRs) in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India thereunder from time to time. Therefore, bonds cannot be FDI but Convertible Bond/Debenture could be converted to Equity and included under FDI. Hence, 3 is correct.
    - DRs are basically foreign investment in the form of equity shares issued outside India by a Depository Bank, on behalf of an Indian company which is covered under the FDI policy.
- Non-resident external deposits or are not treated as FDI as banks can route these deposit for loans. NRIs can invest in shares on recognized stock exchanges under portfolio investment route. The investment can be repatriable or non-repatriable, but the maximum limit of investment is 10% of paid-up capital of the relevant company. Hence, 4 is not correct.
- Therefore, option (a) is the correct answer.

Source: PIB