Internationalisation: FDI and ODI as Key Policies of the Indian Economy[1]

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Internationalisation is a product of globalisation. The process of globalisation brought about changes, such as liberalisation and privatisation, in the former centrally planned economies, which rapidly enhanced internationalisation process in the world. In the last two decades, emerging markets are seen to be the main growth areas in the world, particularly with China and India internationalising at a growing pace. However, given the increasing trends towards protectionism, there is a resurgent and growing interest in the process of internationalisation.

In light of such developments, the issue brief seeks to analyse the process of internationalisation in India through Foreign Direct Investment (FDI) and Overseas Direct Investment (ODI). In doing so, the issue brief would analyse the patterns of both FDI and ODI, since the economic reforms of the 1990s, within the context of policy changes. The main argument is that changes in policy framework have facilitated the process of internationalisation in India.

Towards an Integrative Framework of Internationalisation

The process of internationalisation entails gradual integration of the country to the world economy through trade (exports and imports) as well as investments. The degree of internationalisation depends on the development of production processes, advancement in science and technology, transport and telecommunications, and increased importance of international division of labour, resulting in complex interdependence among states driven by specialisation. Alongside, the process takes place in a given economic and socio-political milieu such as the nature of political and socio-economic fabric or settings and the policy framework that are in place in a country. Therefore, institutional and policy framework is instrumental in internationalisation process of a country.

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The process of change from a centrally planned system to a market economy generates an institutional framework which enables a country to internationalise gradually. Such favourable institutional framework has supported the expansion of multinational enterprises, which have been an important conduit of internationalisation. In India, like in many transitioning economies, the process of internationalisation has been determined by the incremental changes in both regulatory and policy frameworks, particularly post economic reforms, which facilitated the expansion of emerging multinational enterprises (EMNEs).[1] There are two phases/waves of internationalisation visible in India, marked by distinct characteristics: Pre-reform and post reform.

a. *First wave [Pre-Liberalisation (1947-1990)]: Low*

During 1947-1990, India's economic development strategies were guided by an inward-looking development strategy based on the idea of self-reliance and infant-industry policy i.e. stimulating home-grown industrialisation, import-substitution and minimal reliance on international trade. The Import Substitution Industrialisation (ISI) minimised imports by supporting indigenous production and according priority to domestic use in the production. Such trade policy pursuit had a limiting effect on the nature of integration with the world economy. For instance, till late 1980s, ODI from EMNEs of India was concentrated in other developing countries, particularly in the African continent. However, following gradual changes in policies on account of economic reform in the 1990s, the flow of ODI has diversified to include developed countries. Between 1985 and 1995 Indian ODI was insignificant compared to other emerging economies like China, South Africa and Brazil.[2]

During this phase, Indian enterprise, influenced by the inward-looking policy, mainly sought protection from imports and FDI, and depended largely on domestic markets. Policies such as the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 and Foreign Exchange Regulation Act (FERA), 1973 created a restrictive environment for functioning of Indian companies. Nonetheless, a small number of Indian firms were engaged in internationalisation process during this period. For instance, Indian company, Maruti, entered into a joint venture with Japanese company Suzuki in the 1980s. Similarly, the Birla Group of Companies established its first major overseas venture in textiles in Ethiopia as early as 1957. Overall, on account of the restrictive policy framework, the process of internationalisation was low during this phase.

b. *Second Wave [Post –Liberalisation (1990 onwards)]: Moderate to High*

In the last decade of the 20th century, India relinquished its inward-looking strategy and embarked on liberalisation process. One of the basic objectives of reform process was to incrementally integrate the Indian economy with the world. The process ushered in progressive liberalisation of controls and elimination of discretionary licensing for imports and exports. Gradually, effects of the liberalised policies became visible, supported by India's Foreign Trade Policy.

India's Foreign Trade Policy (FTP) particularly since the millennium has attempted to adopt policies to augment India's economy; sustain its economic growth; and to enhance internationalisation process by increasing India's percentage share of global merchandise trade, employment generation and investments. With each FTP, Indian economy has become more internationalised. In terms of trade openness index, India registered an increase during the period 1991-2000. The trade/GDP ratio increased from 17 per cent in 1991 to 27 per cent in 2000.[3] However, investment flows were comparatively modest during the first decade of economic reforms.

The Export and Import Policy or the Exim Policy, as it was referred till 2004, for the period 1992-97 marked a significant milestone in the history of Indian economy. Besides being the first five-year policy, it was for the first time that conscious efforts were made to do away with various protectionist and regulatory policies that were in place. It also set the pace for India to move towards a globally oriented economy.[4] The Exim Policy of 1992 substantially eliminated licensing and discretionary controls on trade and provided impetus to exports. During this period, steps were also taken to promote FDI which included raising the limit of foreign equity holdings from 40 per cent to 51 per cent in priority sectors and establishment of Foreign Investment Promotion Board (FIPB).[5] Similarly, the 'automatic route' of overseas investments was introduced in 1992 and a single window clearance mechanism was put in place by transferring the approvals for ODI from Ministry of Commerce to Reserve Bank of India in 1995.[6]

The FTP (1997-2002) aimed at making India a globally oriented economy by expanding its reach in global markets and promoting technological development. Various policies such as Export Promotion Capital Goods Schemes (EPCG), Advanced License Scheme and 100 per cent foreign equity participation in Export Oriented Units (EOUs) facilitated in achieving such objectives. The introduction of Foreign Exchange Management Act (FEMA) in 2000 expanded the scope of ODI.

The FTP (2004-09) introduced a new scheme, called the Free Trade and Warehousing Zone (FTWZs), to create trade-related infrastructure to facilitate import and export of goods and services with freedom to make trade transactions in convertible currencies. For the development and establishment of these zones, 100 per cent FDI as well as other benefits as applicable for units in Special Economic Zones (SEZs) were allowed. The present FTP for the period 2015-2020, announced on April 1, 2015, focuses on supporting both manufacturing and services exports and improving the 'Ease of Doing Business'. To give a thrust to foreign investments in the manufacturing sector and make it more digital friendly, it also initiated 'Make in India' and 'Digital India' programmes. Major relaxations such as enhancing the limit of ODI under automatic route[7] from 200 per cent to 300 per cent of net worth and further to 400 per cent encouraged investments from Indian companies.

Some significant changes made in the FDI policy regime in recent times have helped to ensure that India remains an increasingly attractive investment destination. For instance, to attract higher levels of FDI, the government has put in place a liberal FDI policy under which FDI up to 100%, is permitted through automatic route in most sectors/ activities.[8] Data analysis reveals that FDI has increased over the years, indicating that such policies have been effective.

Total FDI into India, since April, 2000 including equity inflows, reinvested earnings and other capital stood at US$ 546,452 million (mn) (April 2000- March 2018). The period 2006-09 saw largest inflow of FDI and the year 2006-7 recorded a 155% growth over previous year. Thereafter, FDI inflows saw slight fluctuations till about 2012-13 and again saw an upward trend from the period 2013-14 onwards. The slowdown can be attributed to the Global Economic Crisis as well as restrictive regulatory framework leading to procedural delays, complex rules related to land acquisition and legal and environmental requirements. However, such regulatory policies have been liberalised through passage of Goods and Services Tax (GST) Bill and Land Acquisition Bill. During the period from April 2017-March 2018, total FDI stood at US$ 61,963 mn.[9] As far as direction of investment is concerned, the highest FDI Equity Inflows has been from Mauritius followed by Singapore, Japan and UK for the period 2000-2018.[10]

As far as sectoral composition of FDI is concerned, the sector attracting the highest FDI equity inflows is services sector for the period 2000-2018.[11] This is followed by computer hardware and software; telecommunications[12]; construction development[13]; automobile industry; trading; drugs and pharmaceuticals.[14]

Similarly, ODI from India has also witnessed a considerable change not only in terms of magnitude but also in terms of geographical spread and sectoral composition. Since the latter half of the 20th century, ODI has emerged as an important strategy for cross-border expansion of business enterprises of India. ODI has increased from US$ 999 mn in 2001-02 to US$ 37,766 mn in 2016-17.[15] In terms of direction, a shift from largely traditional countries like Russia, the US and the UK in early 2000s to resource rich countries like Australia, Sudan and UAE during mid-2000s is visible. However, by 2011-12, India's ODI came to be largely directed into countries providing tax benefits like Mauritius, Singapore, British Virgin Islands and the Netherlands. In terms of sectoral composition, Indian overseas investment has been primarily dominated by manufacturing sector, followed by services, wholesale, retail trade, transport, storage, agriculture, and construction. However, share of manufacturing over the years has declined from 59.8 per cent in 2003-04 to 40.4 per cent by 2009-10 and further to 27 per cent in 2017-18 (April-December).[16]

Many Indian companies have taken advantage of the liberalised policy environment to hone their entrepreneurial abilities and face competition in global market. Exports from India have been growing for the last several years, and concomitantly there has been a very strong trend of outward foreign direct investment (ODI) and international merger and acquisition (M&A) activity by Indian companies. Since late 1990s, many Indian IT firms such as Tata Consultancy Services, Infosys and WIPRO established overseas offices in developed countries. Infact, the Tata Group of Companies has become one of the largest manufacturers in Europe, particularly the UK. Tata Motors acquisition of Jaguar and Land Rover worth $2.3 billion in 2008 is indicative of expansion of Indian companies.[17] In more recent years, Indian firms have started to enhance investments in Eastern and Central Europe. For instance, at least 20 development centres have been set up in countries such as Poland, Romania, Bulgaria, Hungary, Austria and Ireland in the last one year. [18] In 2017, Infosys added a new facility in Karlovac in Croatia and Wipro set up a specialised automotive centre of excellence in Timisoara, Romania.[19]

Conclusion

Over the past two decades, India has emerged as important player in the global economic landscape. Since the economic reforms of 1990s, FDI as well as ODI have witnessed considerable changes. These changes can be attributed to the reforms introduced through various policies. In terms of FDI, the Indian government has made policy changes to ensure that India remains an increasingly attractive investment destination. To attract higher levels of FDI, the government has put in place a liberal FDI policy under which 100% FDI is permitted through automatic route in most sectors/ activities, including civil aviation, railways, construction, and telecom. In this direction, 'Make in India' Initiative has been launched in 2014 with the aim to attract more FDI into the country. Similarly, ODI patterns have not only changed in terms of magnitude but also in terms of geographical spread and sectoral composition, facilitated by policy changes.

Indeed, the dynamism unleashed through incremental liberalisation of the Indian economy has spurred FDI and ODI flows. It has encouraged foreign investors to invest in India as well as instil a sense of confidence among Indian companies to invest outside. In Indian context, policy changes have facilitated the process of internationalisation. However, a liberal regulatory and institutional framework has also made India more vulnerable to externalities or external

shocks. For instance, Indian rupee has depreciated to reach a low of 74 against US dollar in October on account of the effects of external factors. [20] Therefore, there is a need to adopt a cautious approach to safeguard against such externalities and prevent capital outflows.

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Disclaimer: The views expressed are that of the Researcher and not of the Council.

Endnotes

[1] In the Indian context, joint ventures (JV) and wholly owned subsidiaries (WOS) has been the two recognised channels of internationalisation.

[2] Divya Chaudhary, Priyanka Tomar and Pallavi Joshi , "Deconstructing Indian Overseas Foreign Direct Investments: Historical and Contemporary Trends", OXFAM Discussion Paper, March 2018,

[3] Amita Batra (2013), *Regional Economic Integration in South Asia: Trapped in Conflict?,* Oxon: Routledge.

[4] Institute of Chartered Accountant, India (2008), Handbook of Foreign Trade Policy and Guide to Export and Import, Agra: Sahitya Bhawan Publications.

http://nbaindia.org/uploaded/Biodiversityindia/Legal/6.%20Import%20and%20Export%20(Control)%20Act,%201947.pdf (accessed on December 19, 2016)

[5] Rashmi Banga and Abhijit Das (2012), *Twenty Years of India's Liberalization: experiences and Lessons*, Geneva: UNCTAD.

[6] Harun R. Khan, "Outward Indian FDI –Recent Trends and Emerging Issues", https://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/OV27022012.pdf (accessed on August 1, 2018)

[7] There are two routes for ODI: Automatic and Approval Route. Under the Automatic Route, an Indian Party does not require any prior approval from the Reserve Bank for making overseas direct investments in a JV/WOS abroad while the Approval route require prior approval of the Reserve Bank.

[8]The sectors that are getting 100 per cent FDI include food products (manufactured/produced in India), **civil aviation, railways, construction, telecom, retail**, and b**roadcasting**

[9] Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce, "Quarterly Factsheet on FDI: From April 2000 to March 2018". http://dipp.nic.in/sites/default/files/FDI_FactSheet_29June2018.pdf (accessed on August 1, 2018)

[10] Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce, "Quarterly Factsheet on FDI: From April 2000 to March 2018". http://dipp.nic.in/sites/default/files/FDI_FactSheet_29June2018.pdf (accessed on August 1, 2018)

[11]This include services such as financial, banking, insurance, business process outsourcing, R&D, logistics and Tech. Testing and Analysis.

[12] This includes radio paging, cellular mobile and basic telephone services.

[13] This includes townships, housing and built-up infrastructure.

[14] Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce, "Quarterly Factsheet on FDI: From April 2000 to March 2018". http://dipp.nic.in/sites/default/files/FDI_FactSheet_29June2018.pdf (accessed on August 1, 2018)

[15] Data from EXIM Bank and Department of Economic Affairs (DEA)

[16] "Outward Direct Investment from India: Trends, Objectives and Policy Perspectives", Occasional Paper no. 165, May 2014, EXIM Bank; and Department of Economic Affairs.

https://www.eximbankindia.in/Assets/Dynamic/PDF/Publication-Resources/ResearchPapers/5file.pdf (accessed on December 20, 2016)

[17] "Tata Motors completes acquisition of Jaguar Land Rover", June 2, 2008, https://www.tatamotors.com/press/tata-motors-completes-acquisition-of-jaguar-land-rover/ (accessed on August 2, 2018)

[18] The sectors include engineering, digital services, software solutions for auto clients, robotic, business analytics and cloud.

[19] Shilpa Phadnis and Avik Das, "IT companies invest more in Europe for business and tech talent", May 31, 2018, https://timesofindia.indiatimes.com/business/india-business/it-companies-invest-more-in-europe-for-business-tech-talent/articleshow/63552609.cms (accessed on August 2, 2018)

[20] These factors include US fed rates hike, rising crude oil prices, negative global investors' sentiments towards emerging markets and India's widening current account deficit.