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India: Investment Climate and FDI Inflows

Abstract. The favorable investment climate is fundamental to the modernization of the economy through foreign investments. In the article, the characteristic of the investment climate in India is given in five areas.
Keywords: investment climate, competitiveness factors of the country, restrictions on foreign direct investment, property rights protection, tax and administrative incentives for investors.

The investment climate in India is considered in five areas: factors of competitiveness, openness of the economy, protection of the basic interests of foreign investors, the business environment, policy incentives. Sections on the inflow of foreign direct investment (FDI) and measures to improve the investment climate are also included.

1. Factors of competitiveness

Factors of competitiveness can be divided into two groups: advanced, evaluated in points exceeding the rating of competitiveness of the country as a whole; and problematic, which are below the common country assessment. Table 1 provides advanced and problematic factors of competitiveness of India according to the Global Competitiveness Report of the World Economic Forum.

Table 1

India in the Global Competitiveness ranking

Global Competitiveness Index 2014–2015		Factor and its score
Rank (out of 144)	Score (1-7)	
71	4,2	*Advanced factors:* Health and primary education — 5,4 Market size — 6,3 Financial market development — 4,3
		Problematic factors: Technological readiness — 2,7 Innovation — 3,5 Labor market efficiency — 3,8

Source: The Global Competitiveness Report 2014–2015. World Economic Forum, Geneva, 2014, p. 212.

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The table shows that the market size is the most powerful advanced factor, which is 1.5 times higher than the country-wide score (of 6.3 and 4.2, respectively). It is the size of the market to the greatest extent attracting foreign direct investment in India. To a lesser extent a positive impact on the investment attractiveness of the country have progress in the health and primary education, as well as in the development of the financial market.

The most problematic factor was technological readiness, assessment of which is more than 1.5 times below the common country assessment. The technological readiness includes such parameters as the availability of new technologies, technology absorption at the firm level, FDI and technology transfer, and indicators of Internet use. This situation suggests that in India there are certain barriers that reduce a country's attractiveness to FDI in the field of high and advanced technologies.

2. The openness of the economy to FDI

In India FDI is prohibited in the following areas: lottery business, gambling and betting, business of chit fund, nidhi company, trading in transferable development rights, activities/sectors not open to private investment e.g. atomic energy and railway transport, real estate business, or construction of farm houses; manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or tobacco substitutes.

Sectors where prior approval of Government is required:

- Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities.
- Pharmaceuticals (brownfield).
- Defence.
- Print media.
- Broadcasting.
- Tea sector.
- Satellites — establishment and operation.
- Banking — public sector.
- Multi Brand Product retailing.
- Security Agencies in Private Sector.[1]

The FDI Regulatory Restrictiveness Index), as calculated by the OECD, allows to estimate the level of legislative restrictions on foreign capital in the investment sector. In 2014, the index of India was equal to 0.26, which indicates approximately the average degree of closeness of the economy. In Asia, several countries have a higher measure of restrictions on FDI: Myanmar — 0.36, Indonesia — 0.34, Saudi Arabia — 0.34, Jordan — 0.30.[2]

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[1] Key to India Investment. By ASA & Associates LLP, chartered accountants, in collaboration with Corporate Catalist (India). April 2015, p. 48.

[2] http://www.oecd.org/investment/fdiindex.htm

3. Protection of the basic interests of foreign investors

Protection of property rights

Several cities, including the metropolitan cities of Delhi, Calcutta, Mumbai, and Chennai have grown according to a master plan registered with the central government's Ministry of Urban Development. Property rights are generally well-enforced in such places, and district magistrates — normally senior local government officials — notify land and property registrations. Banks and financial institutions will provide mortgages and liens against such registered property. In other urban areas, and in areas where illegal settlements have been built up, titling remains unclear.

Foreign investors operating under the automatic route are allowed the same rights as a citizen for the purchase of immovable property in India in connection with an approved business activity. However, a registered sale deed does not confer title ownership and is merely a record of the sales transaction. It only confers presumptive ownership, which can still be disputed. Actual title is established through a chain of historical transfer documents that originate from the land's original established owner. Accordingly, before purchasing land, buyers should examine all the link documents that establish title from the original owner. Many owners, particularly in urban areas, do not have access to the necessary chain of documents. This increases uncertainty and risks in land transactions.

India is a party to the Berne Convention, UNESCO, and the World Intellectual Property Organization (WIPO). In 2012, India amended its copyright laws and signed WIPO's Beijing Treaty on the Protection of Audiovisual Performances. However, the copyright law still contains several broad exceptions for personal use and fair dealing, and has weak protection against unlawful circumvention of technological protection measures.[3]

The procedure of expropriation and compensation

Article 31 (1) of the Constitution of India assures protection against deprivation of property except by "authority of law". Clause 2 of Article 31, informs of the state's power to acquire property for "public purpose," provided "due compensation" is given to the affected party.

With regard to FDI an important role in the implementation of investment protection issues play bilateral investment treaties (BITs). Often seen as a response against expropriations, BITs guarantee 'minimum standard' of protection for foreign investments in the territory of developing countries, i.e., not less than similar protection afforded to their own nationals.[4]

UNCTAD points out that there can be three broad categories of expropriations: (1) direct expropriations include nationalizations and/or outright physical seizure

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[3] US Department of State. 2015 Investment Climate Statement: India, May 2015, p. 14–16.

[4] R. Rajesh Babu. Constitutional Right to Property in Changing Times: The Indian Experience. www.icl-journal.com, vol. 6 2/2012, p. 234, 216.

of the property; (2) indirect expropriations which permanently destroy the economic value of the investment or deprive the owner of its ability to manage, use or control its property in a meaningful way; and (3) regulatory measures, i e, acts taken by states in the exercise of their right to protect public interest, which may have the same effects as an indirect expropriation.

India's BITs provide that expropriation of investment is not allowed except for public purposes in a non-discriminatory manner and on payment of fair and equitable compensation. It may be pointed out that the definition of investment holds the key to the determination of expropriation. Thus, in countries that have a more precise definition of investment, claims of expropriations may be far fewer as compared to that of India.[5]

Dispute Settlement

In an attempt to align its adjudication of commercial contract disputes with the rest of the world, India enacted the Arbitration and Conciliation Act based on the United Nations Commission on International Trade Law model. Judgments of foreign courts are enforceable under multilateral conventions like the Geneva Convention. The government established the International Center for Alternative Dispute Resolution (ICADR) as an autonomous organization under the Ministry of Law and Justice to promote the settlement of domestic and international disputes through alternate dispute resolution.[6]

Conversion and Transfer Policies

The Rupee (INR) is fully convertible only in current account transactions. Capital account transactions are open to foreign investors, though subject to various clearances. NRI investment in real estate, remittance of proceeds from the sale of assets, remittance of proceeds from the sale of shares may be subject to approval by the Reserve Bank of India (RBI) or Foreign Investment Promotion Board.

Foreign institutional investors may transfer funds from Rupee to foreign currency accounts and back at market exchange rates. They may also repatriate capital, capital gains, dividends, interest income, and some kinds of compensation without RBI approval. The RBI also authorizes automatic approval to Indian industry for payments associated with foreign collaboration agreements, royalties, and lump sum fees for technology transfer, and payments for the use of trademarks and brand names. Royalties and lump sum payments are taxed at 10 percent.

Remittances are permitted on all investments and profits earned by foreign companies in India once taxes have been paid. Certain sectors are subject to special conditions, including construction, development projects, and defense. Profits and

[5] Biswajit Dhar, Reji Joseph, T C James. India's Bilateral Investment Agreements. Time to Review. Economic & Political Weekly. December 29, 2012 vol. XLVII, no 52, p. 117.

[6] US Department of State. 2015 Investment Climate Statement: India, May 2015, p. 10.

dividend remittances as current account transactions are permitted without RBI approval following payment of a dividend distribution tax.[7]

4. The business environment

Ease of doing business is the rating of the World Bank, assessing the conditions of the business environment for local small and medium enterprises in 189 countries around the world. If the host country provides to foreign investors the national regime of their activities, this rating can be used directly as one of the sections of the assessment of the investment climate for FDI. In the case of other modes (such as most favored nation) similar estimates can be performed with some reservations. Given the rate of liberalization and increasing economic openness pursued by the government of India in recent years, these rankings can be used as one of the areas of assessment of the investment climate for FDI in this country.

Table 2

India in the ranking of ease of doing business

Factors	Rank (1–189)	Score (0–100)
General Index 2015	142	53,97
Starting a business	158	68,42
Dealing with construction permits	184	30,89
Getting electricity	137	63,06
Registering property	121	60,40
Getting credit	36	65,00
Protecting minority investors	7	72,50
Paying taxes	156	55,53
Trading across borders	126	65,47
Enforcing contracts	186	25,81
Resolving insolvency	137	32,60

Source: Doing Business 2015: Going Beyond Efficiency. World Bank Group Flagship Report, p. 192.

From table 2 it is seen that with two factors India ranks high in the ranking: the protection of minority investors — 7th place, lending — 36th place. Also with two factors the country's places are low: enforcing contracts — 186th place, obtaining construction permits — 184th place. As a whole, i.e. as a General Index, India ranks in the middle of the second half of the rating, which indicates the relatively modest role of business environment in ensuring favorable investment climate in the country.

[7] US Department of State. 2015 Investment Climate Statement: India, May 2015, p.8–9.

5. Incentives policy

Investment promotion agency. The national investment promotion Agency Invest India was established in December 2009. *Invest India* has been set up as a not-for-profit joint venture between Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry, Government of India; Federation of Indian Chambers of Commerce & Industry (FICCI); and State Governments of India.

The stated mission of the Agency is "promoting foreign investments in India in a focused, comprehensive and a structured manner while acting as the first reference point to provide quality input and support services to foreign investors."

Range of services the Agency covers pre-investment, investment and subsequent stages, and includes:

1. Pre-investment services: fact capsules on industry and competitive landscape, information on incentives and subsidies & policy elucidation; industry opportunity assessment and market validation; investment risk assessment — political, legal and economic; information/data support for business plans — cost estimation; advise on arranging finances, human capital and other resources; location assessment inputs; inputs on legal system, regulatory landscape, taxation; clarification on FDI policies/Foreign Exchange rules.
2. Investment services: professional support for documentation work, advise about entry routes to India/FDI procedures, corporate and industry introductions, applicability of industrial licenses and compliances, clarification on policies and eligibility for incentives, land/site procurement and site visits, JV and strategic partner search.
3. Subsequent services: support and advisory services for expansion of operations, mitigating hassles in operating business due to unlawful interventions, tackling delays in getting licenses, company incorporation, etc., handling grievance with public entities and government departments, advocating policy changes affecting business/industry.[8]

As a rule, the presence of such Agency indicates on serious efforts by the country to attract FDI. Wide range and consistency of services provided by *Invest India*, undoubtedly has a positive impact on the investment climate in the country. This influence is to reduce the number of errors of an investor when entering an unfamiliar market, the formation of adequate representations of the investor about the risks and business conditions, the volume of the market and the level of costs. It is important that on many issues not only technical, but also organizational support is available.

Investment incentives. At the present time India provides a 10-year tax holiday for knowledge-based startups. Many states also use local tax incentives to attract investment, and these benefits vary by state and by sector. The government allows

[8] Invest India. Guiding Your Investments. NATIONAL INVESTMENT PROMOTION & FACILITATION AGENCY. Год издания не указан, p. 2, 4.

for 100 percent FDI in research and development, through the automatic route.[9] In a broader context it can be noted that since 1991, India has implemented a number of significant measures to attract FDI:

- The abolition of industrial licensing, privatization of the public sector, and the opening of many sectors, with 100% foreign equity, for foreign participation.
- The revamping of the Foreign Exchange Regulation Act into the Foreign Exchange Management Act in 1999 to facilitate foreign-exchange management in the capital account.
- The introduction of an automatic approval channel for 100% foreign equity in priority sectors and automatic permission for high-technology agreements or technological collaborations in priority sectors.
- The abolition of high local-content requirements, dividend balancing requirements, and export obligation conditions.
- The establishment of major institutions to promote and facilitate FDI inflows, such as the Foreign Investment Promotion Board (FIPB), Foreign Investment Implementation Authority (FIIA), and Secretariat for Industrial Assistance (SIA).
- The signing of many bilateral investment and double tax avoidance agreements (currently with more than 70 countries) to benefit and assure foreign investors.
- Fiscal incentives such as tax subsidies and concessions offered by both central and state governments to foreign investment.
- Reforms at the state government level, and the establishment of institutions to help implement FDI projects.
- The opening of major sectors with huge potential, such as multi-brand retail, civil aviation, defense, railway, insurance, banking, and pension to foreign investors in recent years, with plans to open up many more sectors in the near future.[10]

These measures deeply affect the structure of the Indian economy and significantly improve the investment climate for FDI.

Bilateral investment agreements. As of July 2012, India had concluded 82 bilateral investment treaties (BIT). Of these, 72 agreements are currently in force. The Government of India circulated a new model BIT in April 2015 for two weeks of public comment. A number of provisions have been introduced to protect the sovereign from investment disputes. Foreign investors will not have access to bilateral investment treaties, if the contracts they have entered into with local investors or the government provide exclusively for legal recourse in India.[11]

Special economic zones (SEZs). India has a number of SEZs located around its coastline, including Gujarat (Northwest), Mumbai (West coast), Noida (Delhi), Kolkata (Bay

[9] US Department of State. 2015 Investment Climate Statement: India, May 2015, p. 12–13.

[10] Pravakar Sahoo. Making India an Attractive Investment Destination: Analyzing FDI Policy and Challenges. The National Bureau of Asian Research, December 2014, p. 6.

[11] US Department of State. 2015 Investment Climate Statement: India, May 2015, p. 25.

of Bengal), Chennai (East Coast) and Visakhapatnam (Southeast Coast). All of these are sited close to significant ports with excellent shipping and rail infrastructure.[12]

Enterprises operating on the territory of SEZ have a number of tax and customs privileges. In particular, they are exempt from paying profit tax (in full — for a period of 5 years from the date of declaration of profit, in the amount of 50% during the next 5 years), federal sales tax, taxes on services, taxes on dividends and from various kinds of taxes and fees at the state level. In SEZ the opening of branches of Indian banks is allowed — with preferential performance standards. It facilitates companies located in the area to get access to financial resources. In SEZ duty-free importation of goods from abroad and from Indian territory is in force, and many of the procedures of exports of goods by resident companies are simplified. Enterprises located in free zones do not require a license to import.[13]

5. FDI inflows

In the period of 2007–2012, FDI inflows to India had amounted to 326.1 billion, the number of projects involving FDI got close to 5000. Western Europe had 38,6% of the inflow and 40,5% of the projects. The U. S. share amounted respectively to 19,7% and 30,2%, Japan's share made 10% and 10,4%. In 2012, India accounted for 5,5 per cent of total inflows in the world, 6,3% of projects and 9,4% of employment within this tributary. By number of projects India took the 4th place in the world, behind only USA, China and the UK. These data show a relatively favorable investment climate of the country, appreciated by investors.[14]

Table 3

FDI in India by activities

	Project numbers (% share)		Jobs created (% share)		Capital investment (% share)	
	2007–2012	2012	2007–2012	2012	2007–2012	2012
Services*	52,2	61,3	31,7	38,6	23,6	37,1
Manufacturing*	31,2	24,3	50,2	41,5	61,9	47,4
Retail, construction, recycling and extraction	9,9	7,8	15,0	16,8	11,4	12,4
Strategic functions***	6,7	6,6	3,1	3,1	3,1	3,1

*Services includes Sales, Marketing & support; Business services;
Design, Development & testing; Maintenance & servicing; Customer contact center; Technical support center; Shared services center; TMT internet infrastructure
**Manufacturing includes Industrial activity; Logistics, distribution & transportation; and Electricity
***Strategic functions include Education & training; Research & development; and Headquarters
Source: EY's attractiveness survey: India 2014, p. 13.

12 http://www.india-briefing.com. August 5, 2013.

13 http://www.ved.gov.ru/exportcountries/in/about_in/laws_ved_in/special_area_in/

14 EY's attractiveness survey: India 2014, p. 13.

In terms of types of activities (see table 3) services have the largest number of projects. Thus, in 2012, this activity by the number of FDI projects was more than two times higher than the manufacturing industry. However, on average, in 2012 the project in manufacturing industry created 349 jobs and had cost $ 81 million. For comparison: the project in services created 129 jobs and brought in 25,1 million of foreign investment. Therefore, from the point of view of socio-economic effects to address the problem of employment and development of more capital-intensive technologies the manufacturing industry is very important.

In terms of sectors the largest number of projects for 2007–2012 (21,6%) were implemented in TMT sector (software, IT services, communications, semiconductors, and electronic components). Investment in TMT is driven by the sector's strong outsourcing potential, the emergence of cloud and tele-services, increasing digitization in media and rising technology demand from a number of customer segments, such as government, corporate and consumer. In general, we can say that India has achieved significant gains in TMT due to the rapid development of this sector niches and skillful use of the international division of labour.

The industrial sector is on the second place (16,6%) by number of projects (Industrial machinery, equipment and tools, textiles, rubber, business machines and equipment, engines and turbines, space and defense, wood products, and paper, printing and packaging). Within the sector heavy machinery and equipment (57,7%) and textiles (17,9%) have become the largest recipients of FDI. The sector has significant potential, but its development is constrained by bottlenecks in infrastructure, as well as some outdated labor and factory laws. Business services (business services, leisure and entertainment) is the third leading sector. It accounted for 11,4% of all FDI projects. The main driving force behind investments in this sector in India is growing young and well-educated English-speaking population.[15]

7. Measures to improve investment climate

According to survey of 502 respondents conducted by Ernst&Young, the key to improving the investment climate in India according to the respondents are 13 areas (see table 4).

Improving the investment climate in these areas involves solution of extensive complex problems. For example, in the field of infrastructure the government has initiated development of several major projects, such as the creation of a freight rail corridor in Mumbai, expressway to Delhi and the project of improving the road pavement in Chennai. In the future, infrastructure development will be focused on optimization of costs and energy efficiency.

In area "improve the effectiveness of the rule of law" task of reducing the level of corruption is urgent. The government has proposed a draft law on the prevention of

[15] EY's attractiveness survey: India 2014, p. 16–17.

bribery of foreign public officials and officials of international organizations. Similar measures exist in other areas.[16]

Table 4

Improving the investment climate in India

Areas	%
Develop infrastructure	42,0
Improve the effectiveness of the rule of law	42,0
Reduce bureaucracy	31,8
Increase the transparency of business regulation	18,6
Increase consistency in regulatory policy	11,0
Lighten companies' legal and fiscal obligations	8,7
Ease land acquisition and licensing	9,9
Improve labor laws	12,2
Improve labor skills	11,6
Facilitate access to capital	8,0
Improve overall taxation system	21,8
Ease FDI limits	12,8
Stimulate R&D and innovation	9,7

Source: EY's attractiveness survey: India 2014, p. 48.

Implementation of complex of measures on improvement of investment climate is the most important condition for preserving the country's competitiveness in attracting FDI. India ranks high among recipients of FDI, but the level of competition for foreign investment is high as well.

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[16] EY's attractiveness survey: India 2014, p. 48, 50.

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