FDI promotes local sourcing of goods

Foreign direct investment (FDI) is an important source of capital for developing countries such as India that suffers from lack of sufficient domestic savings to meet the investment needs of the fast growing economy. FDI is not only a key driver of investment, but it also provides an opportunity for local small and medium enterprises to supply raw materials and intermediate goods to the large FDI recipient companies. This is evident from the data published in an article on 'Changing Dynamics of Foreign Direct Investment in India'. The article appeared in the January 2022 bulletin of Reserve Bank of India (RBI). The article documents the evolution of FDI into the country since independence.

The article points out that FDI stock into India more than doubled to Rs. 566 crore in 1964 from Rs. 256 crore in 1948 and increased further to Rs. 916 crore in March 1974. In 1961, Government of India issued a list of industries where foreign investments have been allowed, taking into account the shortage in capacity in relation to the plan targets.

As India opened investment in a slew of manufacturing sectors, there was a sharp jump in the share of manufacturing in the FDI stock to more than 40% from around 20% at the time of independence. Specifically, India received foreign capital in consumer, intermediate and capital goods sectors. In 1968, Indian government established the Foreign Investment Board to deal with all cases involving foreign investment or collaboration with up to 40% foreign equity and a Cabinet Committee was formed to screen those with more than 40% foreign ownership.

Post 1991 reforms

India opened its economy in a big way by abolishing license raj in most sectors, inviting private investment in many sectors that were reserved for government until then, liberalizing exchange rate controls and making Indian rupee fully convertible in the current account.

India abolished industrial licensing system in all industries other than strategic or environmentally sensitive industries and introduced automatic approval of 51% FDI in 34 high priority industries. Government also waived the technology transfer condition for FDI and set up Foreign Investment Promotion Board (FIPB) to promote FDI inflows. Private companies, including those owned by foreign shareholders were allowed to invest in sectors such as mining, banking, telecommunications, highways construction and management.

These reforms attracted foreign capital and FDI inflows to India grew from USD 2.0 billion in 1998-99 to more than USD 26.7 billion just before the global financial crisis in 2008. This crisis undermined economic growth momentum and also reduced inflow of FDI to India till 2013-14.

Further liberalization since 2015

With an objective to promote Make in India, Government of India relaxed FDI regulations in 15 major sectors which include agriculture, civil aviation, construction, defence, manufacturing and mining in 2015.

During 2015-2019, more than 50% of FDI inflows went to three major sectors, viz., 'manufacturing sector', 'communication services' and 'financial services'.

FDI companies procure locally

According to this article, around 75% of the FDI into India went to domestic subsidiaries of foreign companies. Indian market is the major source of revenue for these domestic subsidiaries of foreign companies. These domestic subsidiaries of global firms derived more 69% of their revenue from the Indian market, while earning the balance 31% revenue from exports.

More significantly, these local subsidiaries of global companies met 61% of their overall procurement from domestic market and depended on imports for the remaining 38.8% of the procurement. Their dependence on imports declined from 42.9% in 2012 to 38.8% by 2019. This shows that global firms operating in India are sourcing more and more raw materials and intermediate goods locally, instead of relying on imports.

Notifications

PIB

Digital platform of NSWS simplifies approval for investors

[Press Information Bureau (pib.gov.in)]

Minister aims USD 650 billion goods and services exports in FY22

[Press Information Bureau (pib.gov.in)]

MSME units capable of constituting a complete supply chain

Press Information Bureau (pib.gov.in)

DGFT

Clarification regarding SIMS

pc 38 dt 19-01-22_.pdf (dgft.gov.in)