

India's Inward FDI: Some Glimpses in the Context of the Debate on Tax Havens

Based on the Ongoing Research on FDI of

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Our Approach in 1991

Statement on Industrial Policy, 1991

- ❖ Foreign investment would bring
 - ✓ ... attendant advantages of technology transfer,
 - ✓ ... marketing expertise,
 - ✓ ... introduction of modern managerial techniques
 - ✓ ...new possibilities for promotion of exports.

... The government will therefore welcome foreign investment which is **in the interest of the country's industrial development.**
- ❖ Decision to approve FDI up to 51% in industries that are
 - ✓ high priority industries,
 - ✓ require **large investments and advanced technology**
- ❖ ... there would be greater emphasis placed on building up our ability **to pay for imports through our own foreign exchange earnings.**

Budget Speech 1991-92 (*final*) stated:

- ❖ After four decades of planning for industrialisation, we have now reached a stage of development where we should welcome, **rather than fear, foreign investment. Our entrepreneurs are second to none.** Our industry has come of age.

Travelled a long way from the 51% Automatic FE in High Priority Industries

- To start with the new Annex III industries of High Priority broadly corresponded to the Appendix I of MRTP/FERA under the ILS. Notable additions were:
 - ❖ Certified high yielding hybrid seeds and synthetic seeds/Certified high yielding plantlets developed through plant tissue culture.
 - ❖ All food processing industries other than milk food, malted foods & flour, but excluding the items reserved for the small scale sector.
 - ❖ All items of packaging for food processing industries excl. the items reserved for the small scale sector.
 - ❖ Hotels and tourism-related industry.
 - ❖ Software industry.
- Now practically all the manufacturing industries (notable exception defence) are open for 100% FE and 100% FE is allowed even in small scale units.
- Caps on are applicable only in some service sectors. (e.g. telecom, banking & insurance)
- Not allowed only in limited areas. (atomic energy, agriculture – excl. floriculture, horticulture, etc.)

Budget Speech 2013-14

My greater worry is the current account deficit (CAD). ... This year, and perhaps next year too, we have to find over USD 75 billion to finance the CAD. There are only three ways before us: FDI, FII or External Commercial Borrowing (ECB). That is why I have been at pains to state over and over again that India, at the present juncture, *does not have the choice between welcoming and spurning foreign investment. If I may be frank, foreign investment is an imperative.* What we can do is to encourage foreign investment that is consistent with our economic objectives.

Reported FDI Inflows and the Major Components

\$ mn.

Year	Equity Inflows#	Reinvested Earnings	Other Capital	Gross Direct Investment	Repatriation / Disinvestment	Ratio of Repatriations to Equity Inflows (%)	Share of Reinvested Earnings in Gross Inflows (%)
1991-92	129			129			
1992-93	315			315			
1993-94	586			586			
1994-95	1,314			1,314			
1995-96	2,144			2,144			
1996-97	2,821			2,821			
1997-98	3,557			3,557			
1998-99	2,462			2,462			
1999-00	2,155			2,155			
2000-01	2,400	1,350	279	4,029	0	0.00	33.51
2001-02	4,095	1,645	390	6,130	5	0.12	26.84
2002-03	2,764	1,833	438	5,035	59	2.13	36.41
2003-04	2,229	1,460	633	4,322	0	0.00	33.78
2004-05	3,778	1,904	369	6,051	65	1.72	31.47
2005-06	6,711	2,760	226	9,697	61	0.91	28.46
2006-07	16,481	5,828	517	22,826	87	0.53	25.53
2007-08	26,864	7,679	300	34,843	116	0.43	22.04
2008-09	32,066	9,030	777	41,873	166	0.52	21.57
2009-10 (P)	27,146	8,668	1,931	37,745	4,637	17.08	22.96
2010-11 (P)	22,250	11,939	658	34,847	7,018	31.54	34.26
2011-12 (P)	35,854	8,205	2,494	46,553	13,598	37.93	17.63

including the equity capital of unincorporated bodies.

Component-wise Distribution of India's Equity Inflows

\$ mn.

Year	Government Approval	RBI Automatic Route#	Acquisition of Shares	Equity Inflows (1) (2)+(3)+(4)	Share of Acquisitions in Equity Inflows(1) (4)/(5) x 100
(1)	(2)	(3)	(4)	(5)	(6)
1991-92	66	63		129	
1992-93	222	93		315	
1993-94	280	306		586	
1994-95	701	613		1,314	
1995-96	1,249	884	11	2,144	0.51
1996-97	1,922	774	125	2,821	4.43
1997-98	2,754	443	360	3,557	10.12
1998-99	1,821	241	400	2,462	16.25
1999-00	1,410	255	490	2,155	22.74
2000-01	1,456	521	362	2,339	15.48
2001-02	2,221	802	881	3,904	22.57
2002-03	919	739	916	2,574	35.59
2003-04	928	534	735	2,197	33.45
2004-05	1,062	1,258	930	3,250	28.62
2005-06	1,862	2,233	2,181	6,276	34.75
2006-07	2,156	7,151	6,278	15,585	40.28
2007-08	2,298	17,127	5,148	24,573	20.95
2008-09	5,400	21,332	4,632	31,364	14.77
2009-10	3,471	18,987	3,148	25,606	12.29
2010-11	1,945	12,994	6,437	21,376	30.11
2011-12	3,046	20,427	11,360	34,833	32.61

Changing Shares of Manufacturing and Services in FDI Equity Inflows

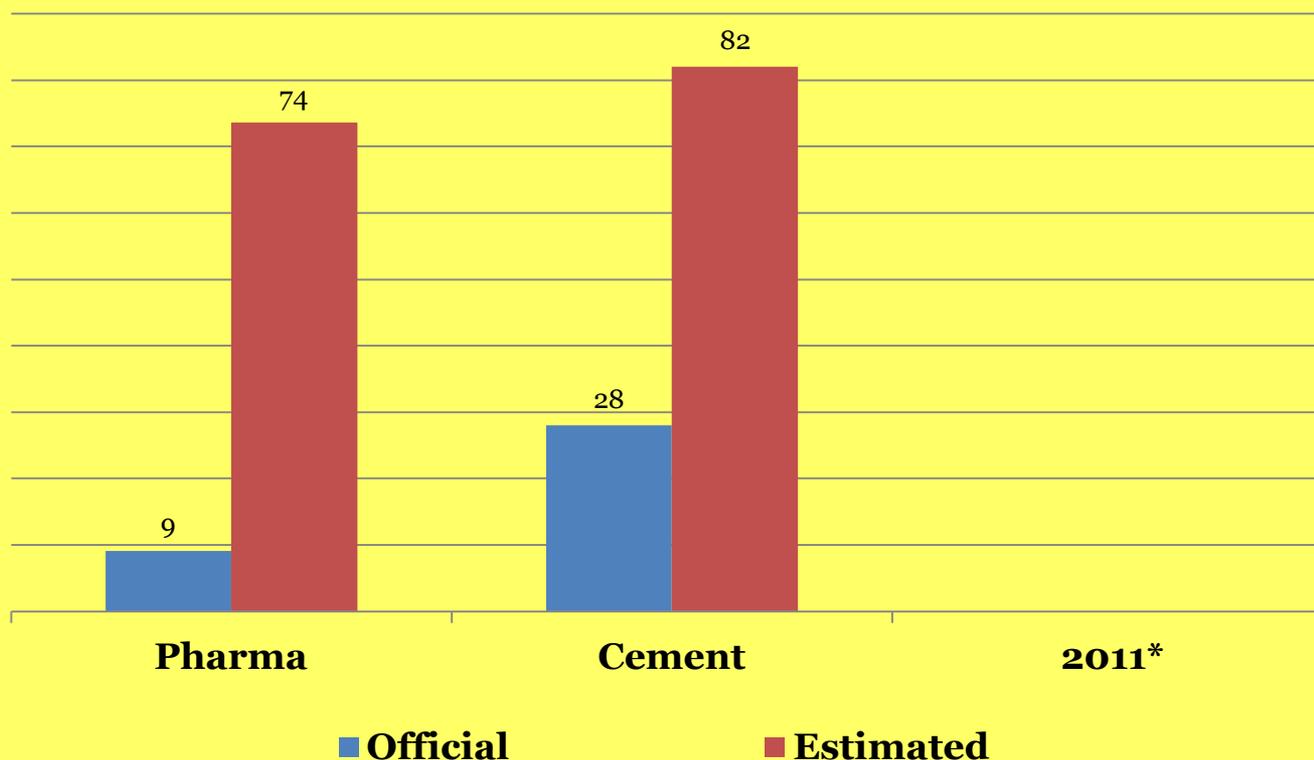
Sector	2000-2005	2006-2009	2010-2012	2000-2012
(1)	(2)	(3)	(4)	(5)
Services	41.92	68.36	46.18	55.95
Manufacturing	38.23	19.03	40.44	30.32
Energy	8.25	6.56	9.57	8.06
Primary	0.70	2.43	0.37	1.37
Miscellaneous	10.90	3.62	3.45	4.29
Total	100.00	100.00	100.00	100.00

Importance of Acquisitions to the increased Share of Manufacturing Sector during 2009-10 -- 2011-12: Some Illustrations

	Name of the FDI Company	Route	Foreign Investor	Amount US\$ mn.
1	Abbott Healthcare Pvt Ltd ^a	RBI Automatic*	Abbott Asia Holdings Ltd	2,397.02
2	Siemens Ltd (foreign equity hiked from 55.18% to 74.71%) ^b	Acquisition	Siemens AG	1,146.04
3	JSW Steel Ltd	RBI Automatic*	JFE Steel Corp	1,060.26
4	Reckitt Benckiser Investments (I) Pvt Ltd ^c	Govt Approval*	Reckitt Benckiser (Singapore) Pte	730.13
5	ABB Ltd (foreign equity hiked from 52.11% to 75.00%) ^d	Acquisition	ABB Asea Brown Boveri Ltd	664.92
6	Luminous Power Technologies Ltd	Acquisition	Schneider Electric South East Asia	271.22
7	Telco Construction Equipment Co Ltd	Acquisition	Hitachi Construction Machinery Co	260.56
8	Essar Steel Ltd	Acquisition	Essar Steel Holdings Ltd	256.47
9	Hospira Healthcare (India) Pvt Ltd ^e	RBI Automatic*	Hospira Pte Ltd	207.62
10	Hospira Healthcare (India) Pvt Ltd ^e	RBI Automatic*	Hospira Pte Ltd	202.84

Share of Acquisitions in Inflows Pharma & Cement Industries

Percentages



* If the inflows into Abbott Healthcare Pvt Ltd (\$2,397 mn.), JSW Steel Ltd (\$1,060 mn.) and Reckitt Benckiser Investments (\$730 mn.) which were not treated as acquisitions in official data, as acquisition-related, the share of acquisitions would jump to **35.46%** of the inflows during the year.

Foreign PE Intermediation & Net Inflows

Foreign Investor	Year	Inflow	Year	Outflow	Net Inflow
Actis (PE)	2006	145	2011	457	
Sequoia (PE)	2006	12	2011	50	
Reckitt Benckiser Investment India Pvt Ltd*	2011	730			
		887		507	380

* Reckitt has already sold some of the acquired brands to Marico for \$120 mn.

What Manufacturing Got was Very Little of Non-Acquisition FDI

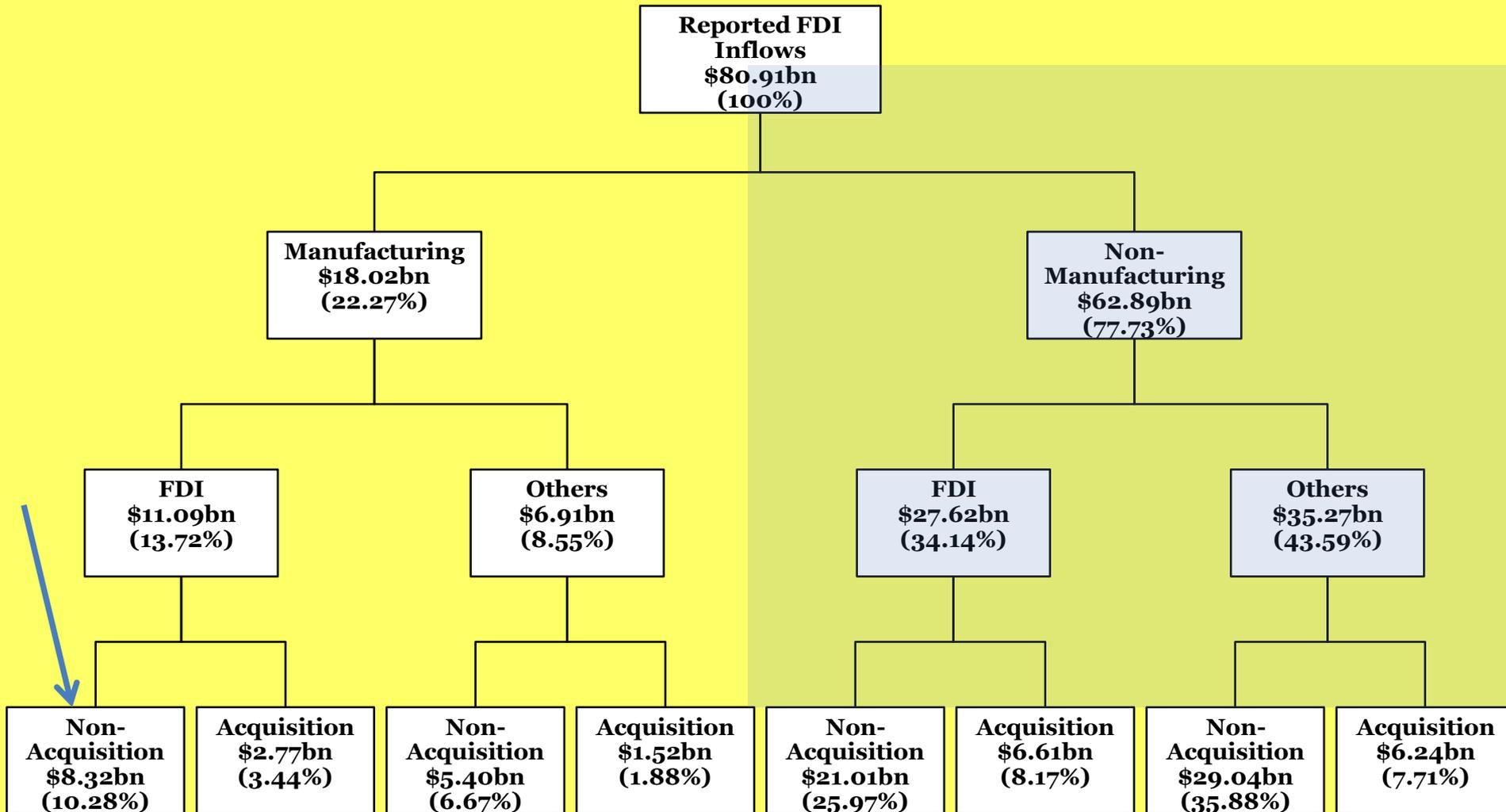
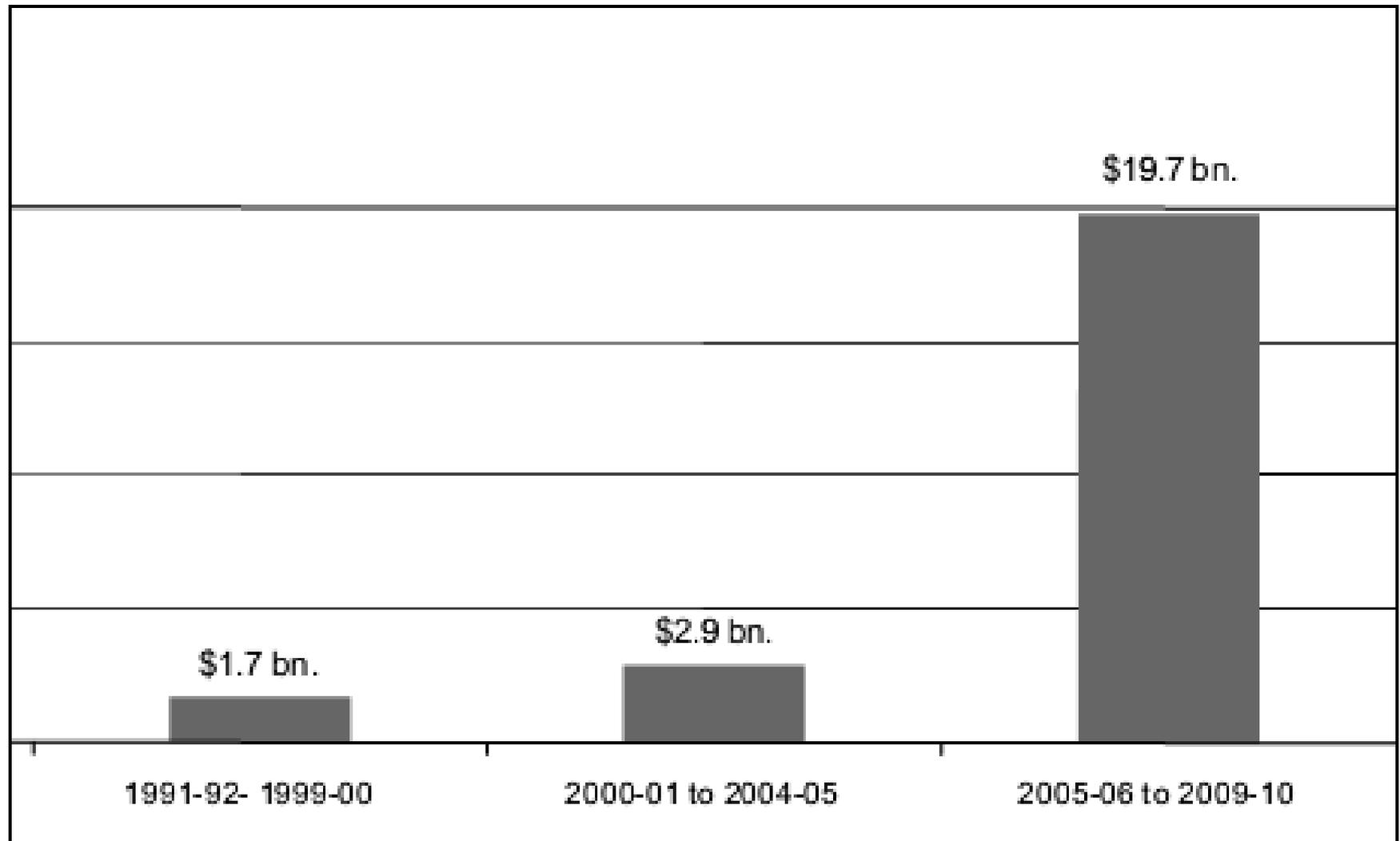


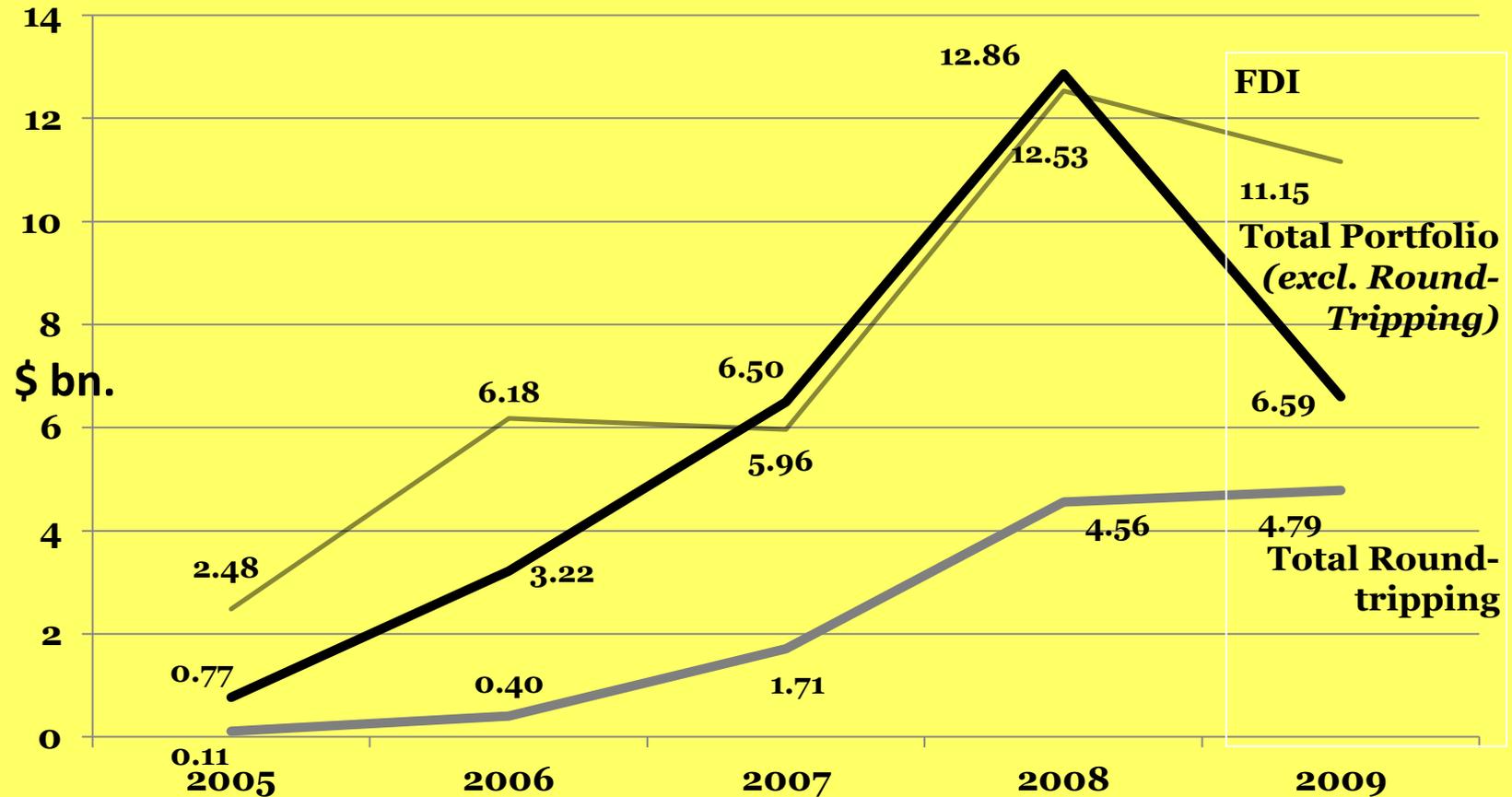
Chart 1: Annual Average Reported FDI Equity Inflows during Different Periods



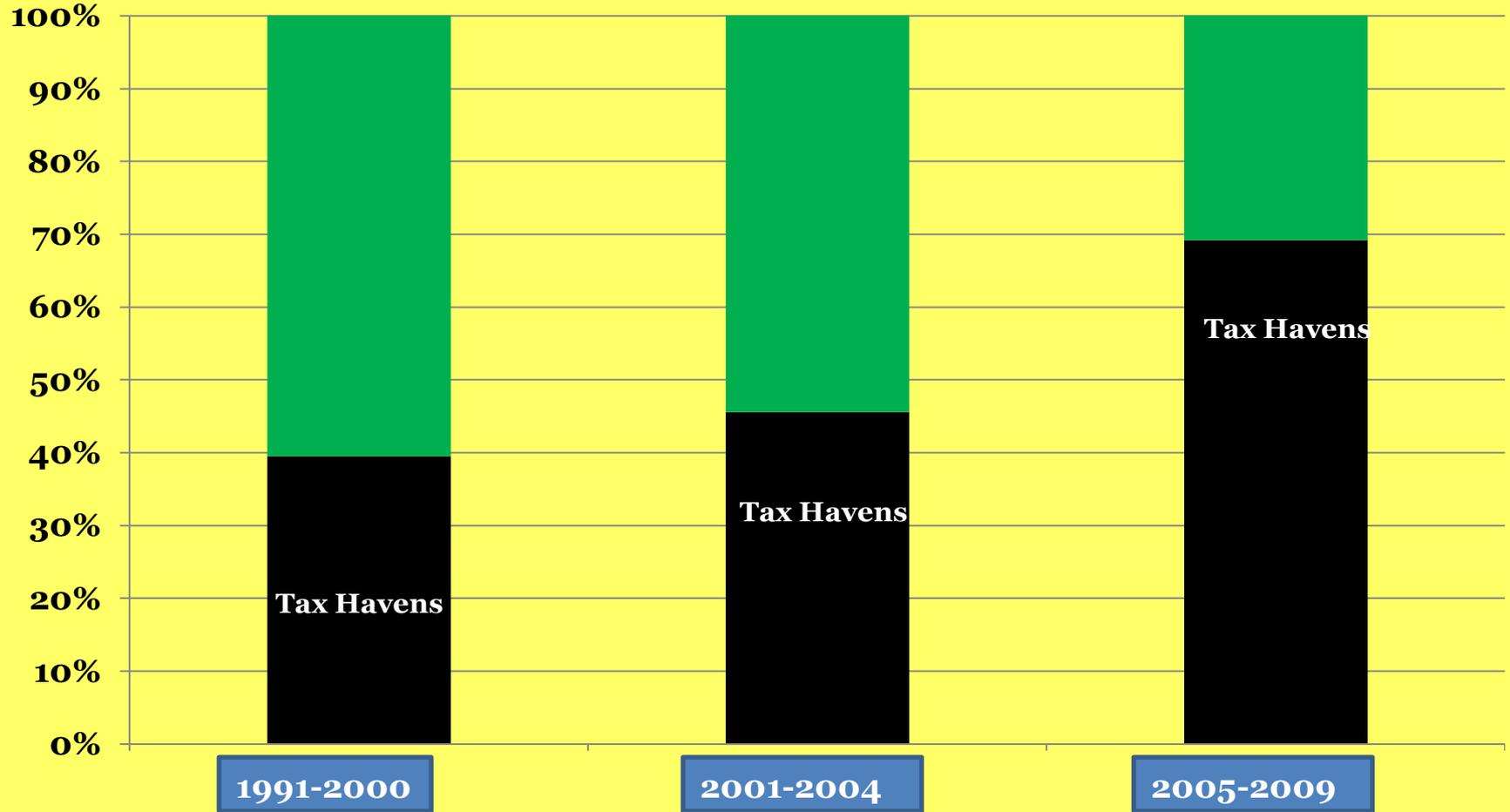
Relative Shares of Different Types of Investors in the Top FDI Inflows (Sep. 2004 to Dec. 2009)

Percentages					
Year	Realistic FDI	Portfolio Investments (incl. PE/VC/HF)	Round- tripping	Others	Total
(1)	(2)	(3)	(4)	(5)	(6)
2004 (Sep-Dec.)	53.38	34.02	1.68	10.92	100.00
2005	73.36	22.13	3.30	1.20	100.00
2006	62.97	27.30	4.10	5.63	100.00
2007	42.03	40.41	12.07	5.49	100.00
2008	41.76	35.66	15.19	7.39	100.00
2009	49.00	25.87	21.03	4.10	100.00
Total	47.85	32.14	14.32	5.69	100.00

Differing Behaviour of FDI, Portfolio and Round-tripping Investments in 2009



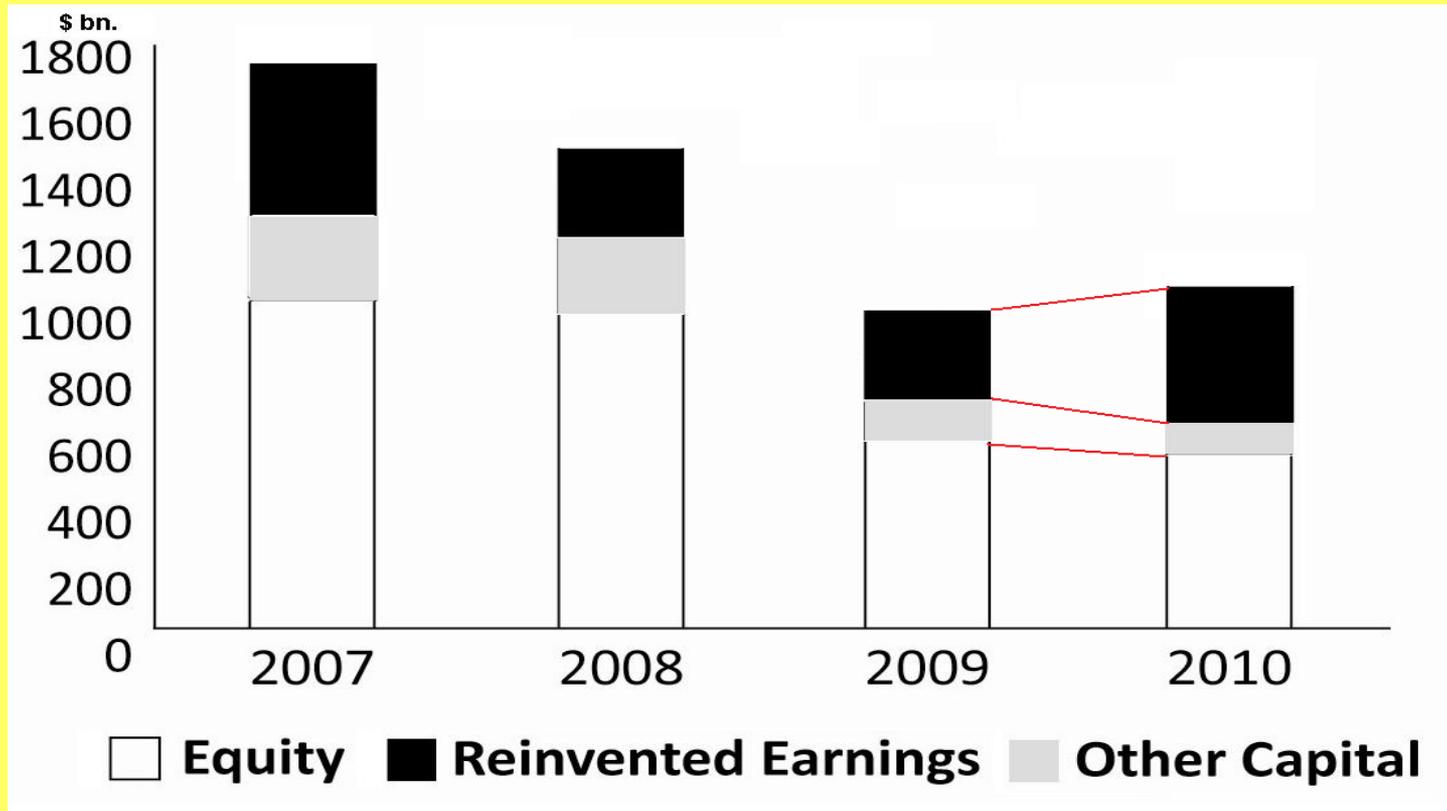
Increasing Share of Tax Havens



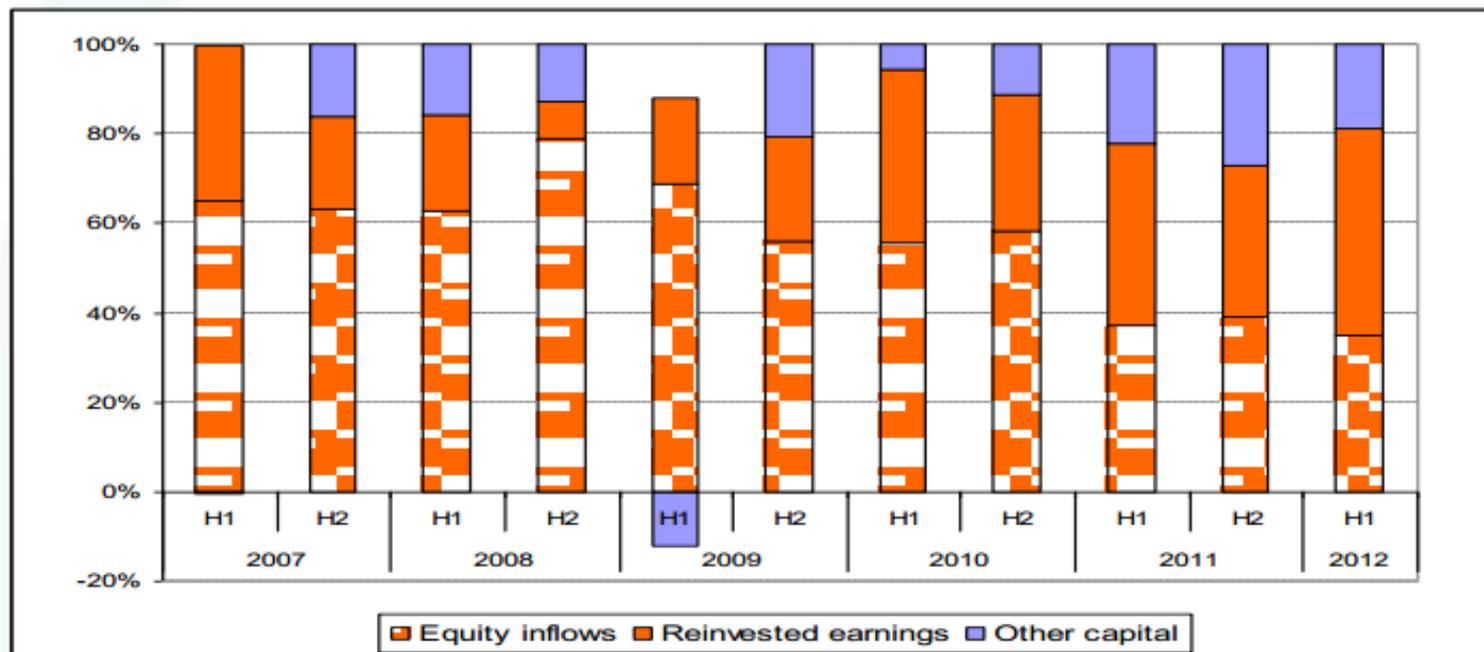
Fall in Inflows During 2010

Sectors which experienced a fall in inflows	FDI Inflows (Rs. Cr.)		Fall in 2010		Share in Total Fall (%)
	2009	2010	Amount (Rs. Cr.)	%	
1. Housing, Real Estate Devt & Constn	27,705	13,902	13,803	49.8	27.3
2. Services Sector	27,656	16,911	10,744	38.9	21.2
3. Agriculture Services	5,878	230	5,648	96.1	11.2
4. Telecommunications	12,444	6,918	5,526	44.4	10.9
5. Electrical Equipments	3,808	506	3,302	86.7	6.5
6. Power	7,977	5,512	2,466	30.9	4.9
7. Information & Broadcasting	3,706	1,881	1,825	49.2	3.6
8. Consultancy Services	2,023	1,163	861	42.5	1.7
9. Automobile Industry	6,587	5,747	839	12.7	1.7
10. Trading	3,242	2,532	709	21.9	1.4
11. Others	13,250	8,333	4,917	37.1	9.7
Total fall in respect of sectors experiencing decline	1,14,275	63,637	50,639	44.3	100.0
Total Inflows	1,30,980	96,015	34,965		

FDI Inflows by Component: 2007-2010



The share of quarterly FDI inflow components for selected countries, ^a
 2007 H1 - 2012 H2
 (Billions of US dollars)

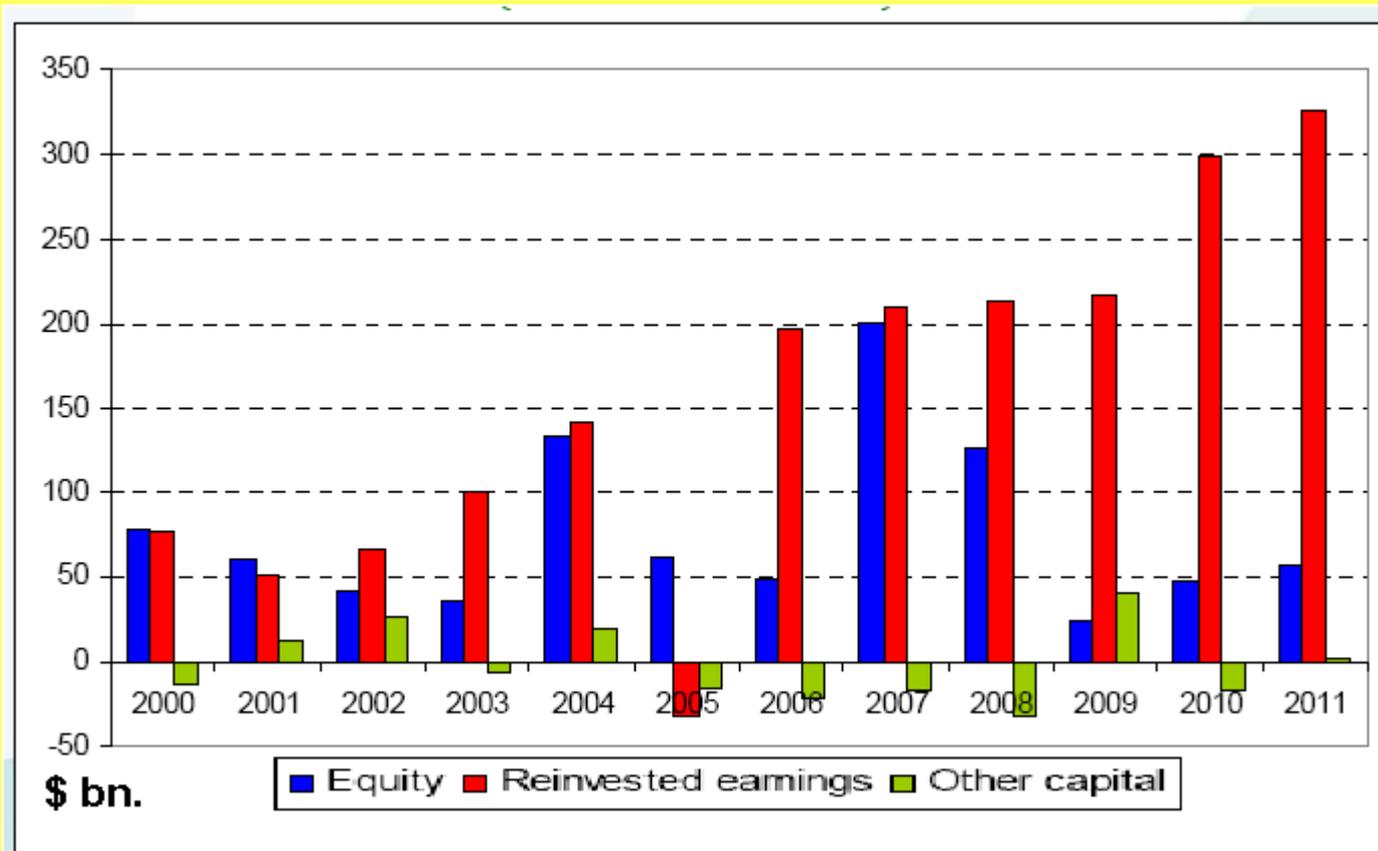


Source: UNCTAD.

^a Countries included are: Armenia, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, Chile, Czech Republic, Denmark, Estonia, Georgia, Germany, Guatemala, Honduras, Hong Kong (China), Hungary, Indonesia, Ireland, Israel, Japan, Kazakhstan, Latvia, Lithuania, Luxembourg, Mexico, Mongolia, Montenegro, Namibia, Netherlands, New Zealand, Norway, Panama, Peru, Philippines, Portugal, Republic of Korea, Republic of Moldova, Serbia, Slovakia, Sweden, Switzerland, Thailand, The FYR of Macedonia, Uganda, United Kingdom, United States, Uruguay and the Bolivarian Republic of Venezuela for which quarterly data on FDI by component are available.

FDI outflows from USA

- by components: 2000–2011



Share of Different Sectors in Global FDI Stock

Percentages

Sector	Developed Countries			Developing Countries			World *		
	1990	2002	2010	1990	2002	2010	1990	2002	2010
Primary	9.94	5.86	6.73	6.67	7.02	7.54	9.36	6.09	7.12
Manufacturing	40.58	31.61	24.70	45.08	36.37	24.44	41.37	33.13	24.61
Services	48.91	61.76	63.60	47.22	53.26	66.91	48.61	59.19	64.42
Unspecified #	0.57	0.76	4.97	1.04	3.35	1.11	0.66	1.58	3.84
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

* Includes Eastern Europe/Transition economies.

Comparative Performance of India and China in World FDI Inflows, Greenfield Investments and M&As

\$ bn.

Year	FDI Inflows			Value of Greenfield Investments			Value of M&As		
	World	China	India	World	China	India	World	China	India
2000	1,4005,41	40,715	3,588				905,214	37,316	1,064
2001	8276,17	46,878	5,478				429,374	2,042	683
2002	6279,75	52,743	5,630				248,446	15,953	542
2003	5869,56	53,505	4,321	801,828	154,785	20,711	182,874	4,039	693
2004	7443,29	60,630	5,778	751,646	133,209	37,738	227,221	4,689	1,034
2005	9807,27	72,406	7,622	754,910	93,917	30,240	462,253	7,207	526
2006	1,4633,51	72,715	20,328	989,581	127,325	86,147	625,320	11,298	4,424
2007	1,9755,37	83,521	25,506	1,015,738	110,419	54,002	1,022,725	9,332	4,405
2008	1,7907,06	108,312	43,406	1,634,445	130,518	80,588	706,543	5,375	10,427
2009	1,1978,24	95,000	35,596	1,051,581	116,765	57,170	249,732	10,898	6,049
2010	1,3090,01	114,734	24,159	904,572	98,406	51,956	344,029	6,306	5,550
2011	1,5244,22	123,985	31,554	904267	100,696	58,273	525,881	11,176	12,577
<i>Sub-Total 2003 -- 2011</i>	<i>11,572,854</i>	<i>784,808</i>	<i>198,269</i>	<i>8,808,568</i>	<i>1,066,043</i>	<i>476,827</i>	<i>4,346,578</i>	<i>70,320</i>	<i>45,685</i>
<i>Share in World Total (%)</i>		6.78	1.71		12.10	5.41		1.62	1.05

PM's Group

- ...Technology transfer is considered to be one of the most important benefits of permitting FDI into a country. In India, however, in attracting the FDI the emphasis appears to be substantially on the amount of FDI flows.
- ... during the process of liberalization and globalization ... the trade and **FDI policies were not adequately leveraged** to strengthen manufacturing or manage substantial transfer of technology as the countries (Korea, Taiwan, Singapore, Hong Kong, Thailand, Malaysia, Indonesia and China) had done.
- It appeared as though Government policy pendulum may have swung from one extreme of excessive controls to the other of abandonment or minimizing the role of the State in so far as the mfg. sector is concerned.
- ... technologies (acquired through FDI, purchases and M&As), quite often, are not the state of art technologies but are at least one or two generations behind what is available elsewhere in the world. Purchase of technology is increasingly becoming costly and in view of liberal FDI policies, companies from abroad are reluctant to part with technology even for purchasing.

PM's Group...

- ...The multinational companies are also permitted to open 100 percent owned subsidiaries in India. In other words, in those areas the technology would continue to remain with the multinational companies themselves.
- ... (technology) spillover effects do take place but not only that such spillover takes long time for the benefits to percolate, ..., it ensures that the technology gap keeps widening. The technology standing of India in the World ... clearly shows that even if some spillover benefits have been there, they have not been significant enough to take India to the upper bracket in the technology standing index.
- In particular, many of the technologies in the fields of defence, aerospace, IT, atomic energy and other high technology areas are not available either through the liberalized FDI route or for buying them outright.
- ... there is clearly a need **to have a relook at our FDI policy** in terms of the technological benefits the country needs to derive.

Authority for Advance Rulings (Income Tax)

While upholding a foreign investor's claim of non-liability of Tax on the sale of shares held in an Indian company, the AAR said in 2010 that:

Though it looks odd that the Indian tax authorities are not in a position to levy the capital gains tax on the transfer of shares in an Indian company, this is an inevitable effect of the peculiar provision in India-Mauritius DTAA, the Circular issued by CBDT and the law laid down by Supreme Court in Azadi Bachao case.

Whether the policy considerations underlying the crucial Treaty provisions and the spirit of the Circular issued by the CBDT would still be relevant and expedient in the present day fiscal scenario is a debatable point and it is not for us to express any view in this behalf.