Historical Review of Approaches to Foreign Investments In India

SHAIL SHAKYA

B.A., LL.B. (Hons.), LL.M. (NLSIU), UGC-NET (Law), Ph.D. (Pursuing), Assistant Professor in Law, Faculty of Law, Dr. Shakuntala Misra National Rehabilitation University, Lucknow

Abstract— Law relating to foreign investments is largely an unexplored context in legal studies. There are however highly significant impacts of policy changes relating to regulation of foreign investments. The present paper attempts to explore the historical evolution of approaches and ideologies to foreign investments in India. It has been highlighted that the present form of foreign investment policy has been achieved through a progressive development. The policies and discussions relating to foreign investments still have the propelling effects of lessons learnt in the past and would continue to impact the object-oriented approach of India in the near times to come. The paper is a strong argument that whatever be the rationale behind a policy statement, due consideration of prevailing economic conditions, level of development and such other similar aspects should always be accounted.

Index Terms- Foreign Investment, FDI, FDI In India, Development of Foreign Investments, Investments & Securities Laws

I. INTRODUCTION

Since the very beginning of investments in India, it has been the policy of Government of India to attract and promote foreign investments in order to supplement domestic capital, technology and skills and to achieve accelerated rates of growth.[1] But it is necessary to understand the situations, perspectives and instances that have prompted the nation to rapidly rationalize policy statement since its very inception before understanding the way such investments are being regulated and monitored. While there could be many reasons for a country to adopt a comprehensive foreign investment policy, let us discuss some of the most highlighted reasons. One of the most promising factors is that developing countries in particular are more open to foreign investments for the reason that prominent MNCs deploy intellectual property, skill & expertise with the foreign investments which accelerates economic development.[2] Other reasons such as growth in GDP or HDI etc. also hold important significance. [3]

Historical background of foreign investments in India can be traced back to establishment of East India Company because of which British capital came to India and entry of Japanese companies after the Second World War.[4] India at that time was an integrated holding of many small states due to which there was no consolidated policy regarding business with foreign enterprises and kings of small kingdoms decided their interests on a case to case basis.[5] Over the period of time, this absence of consensus has been the driving factor for India that all decisions concerning regulation, permission or remittances out of foreign investments is aggressively controlled by Government of India through its consolidated FDI Policy which is published every year. It could therefore be precisely said that contemporary ideology of India on foreign investments is heavily based on learning in the past.

It is said that East India Company became capable of expanding its rule in India because of absence of general consensus and ideology on trade with foreign enterprises among the rulers of small unorganized states in India. This has later served as the biggest lesson for Indian government post-independence to control foreign ownership of domestic capital, enterprises and land property. India progressively developed an object-oriented approach before entering into understandings for foreign investments and attempted to curb all instances where small fragment of likely misuse was perceptive for the policy makers. Lessons of the past are visible in the approach of Indian government even today and the subject of investments is considered an area of activity which is directly connected to sovereignty and integrity of India. There have been many instances when the government has made unexpected changes to the investments policy but enhanced control has always been central to political dialogue and approach of policy makers which shows object-oriented permission to foreign investments in India.

II. EARLY APPROACHES TO FOREIGN INVESTMENTS IN INDIA

There appears a usual question regarding what was the approach of Indian rulers to foreign investment much earlier to the entry of British & Japanese. There are significant evidences of trade much earlier than British came to India. In order to cater domestic needs, a number of handicraft industries produced high quality cotton textiles, silks, jewellery, decorative swords and weapons. There was heavy export of indigo, sugar, pepper etc and Indian rulers wanted only precious metals in exchange. European traders had been dominating the export business while India was exporting textile products in East Africa, Persian Gulf, Malaya and Indonesia which was disturbing Europeans to a great extent. To counter, Europeans established new markets in West Africa & Philippines and their trading companies established production centers in Gujarat & Bengal for indigo and textiles. European activity as such increased the productivity of Indian economy.[6] One of the reasons that foreigners dominated this trade was that religious beliefs inhibited foreign travel and commercial development by Hindus.[7]

The impact of European commerce with India on a competitive basis was in many ways beneficial for the domestic economy. New markets were opened up for exports and the existing ones further deepened. For the limited areas supplying the staples of export, this meant an increase in production and probably also in productivity. An important point to note here is that the essential means of trade was 'exchange' where foreign traders were paid in the form of precious metals.[8] One cannot say with certainty whether the trade during that period was domestically harvested or whether the same was inclined in favor of foreign merchants as charm of possessing foreign goods and articles of luxury was confined to emperors and rich while ordinary were living in ordinary circumstances.[9] It could be therefore said that it was not trade and investment at that point of time rather was greed of living a lavish life by the emperors of India.

There are suggestions that the stiff competition between Dutch & English companies led to a matter of choice for Indian rulers to allow for trade and investments. English through East India Company introduced the product diversification approach in the minds mughal rulers by which they felt elated and fascinated. English traders were neither ruthless nor were aggressive in comparison to their counterparts-the Dutch. They conducted diplomatic negotiations to convince mughal rulers of their intentions of friendship and open trade. The joint-stock company in the name of East India Company was highly organized with a central governance module that helped them in avoiding conflicts of interest, opinions and smooth political dialogue. The policy of 'decentralization' helped them in establishing subsidiaries quite fast and modest interactions with the mughal rulers opened new avenues of intellectual and product exchange between them. Policy of private trade further pushed employees of East India Company to penetrate in Indian market and develop close relations with local merchants and peasants which gave them the award of acceptance among the local communities.[10]

III. THE ERA OF ENGLISH EAST INDIA COMPANY & OTHERS

East India Company was established as a joint-stock company by an Act of English parliament and was granted monopoly to commence trade in East India. Its operations were funded on a voyage-to-voyage basis and shares sold to around 200 investors provided the initial capital to the first voyage- hector that landed near Surat in India. Although the company came to offer resistance to its Dutch competitors, the company soon overthrew its monopoly rights and established itself as an independent colonial power in India evidenced by gaining control over the territory of Bengal. The company was also paying out 8% annual dividends to its investors that had financed over 84 voyages to trade in India.[11] Company's initial investments in India were aimed at establishing factories, giving bribes to mughal rulers for acquiring concessions and trade rights, building architecture and financing export of finished products. The activities of the company were propelled by heavy demand of Indian spices and textiles in British market for which the company worked aggressively in order to earn profit. After establishing the first factor (factory as was then called) on the banks of river Hubli, East India Company started pressing for concessions and sole trade monopoly rights from the rulers.[12]

The company had sought maximum benefits to crown and the citizens of Britain at all expenses of the people of India. The quest for dividends led to administrative and military presence in India in order to gain access to territories and collect revenues. It was also stated by British King's Bench that the corporations do not commit sins and treasons as they had no souls which fired the power of acquisition based on brutality and warfare among the company employees.[13] The royal beneficiaries relied on the company's employees to consolidate economic and political control for them due to which they became agents of the crown in India.[14] The company was intensely protected under the cover of limited liability clause which prevented its employees when being charged for acts not authorized by the company's charter.[15] It could be well thought that the company was to bring prosperity and consumer choices in British markets as the cost of demolition and turmoil in India.

These big lessons later accumulated to India's adoption of closed economy just after gaining independence from the British. Since India had remained victim of aggressive foreign trade and exploitation in the hands of East India Company and the Crown, the central objective post-independence was to secure territory and integrity from both administrative and commercial perspectives. India learnt that foreign merchants and companies must be allowed limited operations in its territory and even if allowed for, the same must be extensively regulated by the government. Since policy of exchange gradually shifted to trade in money and capitalization of domestic production, India had decided to retain territorial controls in its own hands at all points of time and to conduct inquisitive examinations before entry of foreign firms in India. Even after a long period of attaining independence, debates on matters of foreign investments etc. ignite the lessons learned in past and economic development of the host gets a central place in all forms of dialogue.

IV. POST-INDEPENDENCE APPROACH TO FOREIGN INVESTMENTS IN INDIA

Till 1991, the government of Independent India exercised heavy control over industrial activity and the time period is popularly called as 'License Raj' by analysts. India adopted the policy of closed economy where support and other inputs from abroad were highly discouraged and domestic resources were being utilized for manufacturing activity. Government exercised control over establishment of new units or enterprises entering to new chain of productions.[16]
Foreign inputs were subjected to heavy controls and high fees in order to encourage domestic industrialization and reduce foreign ownership of Indian enterprises.[17] Financing business operations from the market was controlled and government was the maker of the market.[18] Prior to reforms, import or acquisition of foreign technology was also nearly impossible and unprofitable due to reservations to domestic producer and strict licensing norms implemented in the wake of protecting sovereignty of India. The economic development during this time was intensely slow and most of the occasions witnessed scarcity of either of the resources forcing the governments to invest heavily on troubled sectors so that they can be restored to operation efficiency.[19] The Indian Economic Index was getting worse day after day till the time Republic of India landed to its balance of payments crisis in 1990s.

The years 1990-91 are considered to be among the toughest days for Indian economy from the balance of payments point of view, where the crisis rose to unmanageable proportions which were promoted by the later 1980s themselves. Although the crisis erupted in 1990s, it was flourishing since a long time. The primary reasons for the crisis have been suggested as post-independence development strategy, complex industrial licensing norms and substantial public ownership of heavy industry. In the late 1980s, current account deficits of India were on continuous rise and the Reserve Bank of India was responding partially to the situation. Consequential run-ups in international oil markets and events in the Middle East in 1990 were economic shocks that provided momentum to the rising crisis.[20]

The year 1991 marked a key transition in India's foreign investment policy whereby the government decided to encourage stable non-debt creating long term capital flows as a major source of funds for supplementing domestic savings. Government introduced first foreign investment policy which was articulated in 'New Industrial Policy' announced on July 24, 1991 whereby entry barriers for private players were removed and several withdrawals to MRTP Act, 1969 were made that was hindering industrial investments.[21] The industrial policy also allowed foreign investment in 35 priority sectors and removed various procedural controls to the inflow of FDI. This policy was however reflective of the lessons learned in past and the government capped foreign ownership of capital to 51% of the enterprise capital. This point of time is considered as beginning of foreign investments in India and the formulation of policy was also object-oriented whereby responding to the currency crisis and balance of payments was primary objective for the government and the decisions also appeared appealing to the community.

V. LATER DEVELOPMENTS IN APPROACH TO FOREIGN INVESTMENTS IN INDIA

It is however important to mention here that this was not the first time that India had revised its industrial policy.[22] Although an Industrial Policy was formulated soon after independence in 1947, the Industrial Policy-1948 did not become a reality. Industrial Policy, 1948 was based on formulating a participatory model for the private and public players and introduction of the idea that market making should be left over to the market itself. It was not formalized due to the fact that government was interested in regulating the private to a nearer extent rather than attempting to balance the private-public dialogue. Later, Industrial Policy Resolution-1956 which was immensely based on socialist model of market economy was also put forward for consideration but government appointed Dutt Committee to evaluate the recommendation of resolution and nothing material could be done till modification which was attempted in 1977. Further on the lines, the strategy of Industrial Policy of 1977 was promulgated which was fundamentally based on implementation of Foreign Exchange Regulation Act (FERA) which was sought to be allowed for the categorized sectors in the national interest as per the opinion of government of India. Policy of 1977 is said to create confusion by preparing a comprehensive list of 800+ items in small scale sector for which the policy was designed. Later, Industrial Policy-1980 made provision for the development of industry in backward areas and attain economic federalism and to respond to the energy crisis of 1980. Last policy prior to 1991 established promotion of competition among the domestic players and encouraged extensive industrial activity.[23]

Over a long period of time, India has witnessed mixed experiences of colonialism, capitalism, attempts to socialism, liberalism and concentrated federalism. There has always been need to foster economic development by enhanced foreign collaboration, exchange of skill and technology, adoption of effective regulatory methods and political adjustments to avoid conflicts of interest. Be it any cause or concern, interests of domestic market, machinery and people has dominated all policy formulations in independent India. Conservatism has also guided major policy reforms and the reasons that usher are purely historical in nature. India has been to catastrophes quite few times and immediate government action that responded to them holds promoting and progressive nature. India has slowly adopted a modest view to foreign investments as it is not just about money all the time. Investments in the terms of technology, human resource and capital have together contributed to change the dynamics of foreign investment in India over a period of time.

CONCLUDING REMARKS

It is well said that opportunities are the best teachers. The proposition holds truth in light of historic insight to the development and integration of foreign investment in Indian economy. It is also true to say that actions of the present have a bit of the past. India is a rapidly developing economy and there is still much scope for the nation to explore. It should continue researching the best possible models in order to incentivize economic development with foreign collaboration at various levels. Intellectual exchange in terms of technology transfer is newest of the breed and government action to promote scholar and academic exchange under the broad array of 'foreign investment' would further drive the economy to new heights.

REFERENCES

[1] Statement of Intent & Objectives, Chapter 1, Consolidated FDI Policy Statement, 2017, para 1.1.1

[2] Manuel R. Agosin & Ricardo Mayer, *Foreign Investments in Developing Countries: Does it crowd in Domestic Investment*, UNCTAD/OSG/DP/146 at p.1

[3] Laura Alfaro & Jasmina Chauvin, *Foreign Direct Investment, Finance and Economic Development*, Encyclopedia for International Economics & Trade

[4] Bhavya Malhotra, *Foreign Direct Investment-Impact on Indian Economy*, Global Journal of Business Management & Information Technology, ISSN 2278-3679, Vol 4, No 1 (2014), pp. 17-23

[5] For instance, William Hawkins successfully convinced Jahangir for setting up a factory at Surat by offering wealth, presents & assurance for enhanced security to the king.

[6] T. Rayachaudhari, *European Commercial Activity & Organisation of India's Commerce & Industrial Production* 1500-1750 cited in B. N Ganguli (*ed*), *Readings in Indian Economic History*, Asia Publishing House, London, 1964, p. 55

[7] The Moghul Economy & Society, Class Structure and Economic Growth: India & Pakistan since the Moghuls Maddison (1971)

[8] Meera Nanda, *European Travel Accounts During the reigns of Shahjahan & Aurangzeb*, Kurukshetra, 1994, p. 59

[9] W. H. Moreland, *From Akbar to Aurangzeb*, New Delhi, 1994, p. 58

[10] Chaitanya Kansal & Ors, *English East India Company: Analysing the Company's Strategic Choices through the lens of Modern Strategy Theory*, IIM-B, Tejas

[11] Emily Erikson, *Between Monopoly & Free Trade- The English East India Company*: 1600-157

[12] Binda Preet Sahani, *A Legal Analysis of British East India Company*, Acta Juridica Hungaria, 54, No 4, pp. 317-330 (2013)

[13] *Case of Sutton's Hospital*, (1612) 77 ER 960, 973

[14] Charter of 1600: *The Law relating to India and East India Company*, London, 1841

[15] *The Case of Thomas Skinner, Merchant* v. *East India Company*, (1666) 6 State Trials, 710 (H.L.)

[16] Industries Development & Regulation Act, 1951

[17] Few foreign companies were allowed to hold nearly 40% equities in Indian companies.

[18] Government through Controller of Capital Issues (CCI) decided the quantum and price of equity issues.

[19] PL Beena, Laveesh Bhandari, Sumon Bhaumik, Subir Gokarn and Anjali Tandon, *Foreign Direct Investment in India*, Investment Strategies in Emerging Markets

[20] Valerie Cerra & Shweta Chaman Saxena, *What Caused the 1991 Currency Crisis in India?*, IMF Working Paper Series, WP/00/57, October, 2000

[21] *Statement on Industrial Policy*, July 24, 1991, para 1.25 cited in *Handbook of Industrial Policy & Statistics* 2006-2007, Office of Economic Adviser, Ministry of Commerce & Industry, Government of India, at p.6

[22] Jesus Felipe, Utsav Kumar & Arnelyn Abdon, *Exports, Capabilities and Industrial Policy in India*, Working Paper No 638, Levy Economics Institute, Bard College, November, 2010.

[23] Dr. Rabita Thakur, Rozika Gupta & Rajesh Singh, *Changing Face of India's Industrial Policies: A Look*, International Journal of Scientific and Research Publications, Volume 2, Issue 12, December- 2012.