International Research Journal of Engineering and Technology (IRJET) e-ISSN: 2395 -0056
Volume: 03 Issue: 02 | Feb-2016 www.irjet.net p-ISSN: 2395-0072

A COMPARATIVE STUDY OF FOREIGN INVESTMENT REGULATIONS IN INDIA AND MAJOR WORLD ECONOMIES

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Foreign investment regulation is one of the predominant approaches in protecting domestic industry. Foreign investment regulations differ from country to country and are highly economic specific. The political and economic structures of a country influence foreign investment regulations to a great extent. In a closed economy, where foreign investment is not encouraged, regulations will be stringent and procedures to get foreign investments will be cumbersome. In contrast in an open economy, regulations will be less. In the present era of globalisation and increasing international trade, open economy is preferred by most countries with a significant or trivial difference in the degree of openness. The paper would throw light on the regulatory framework adopted by different countries, with emphasis to the repercussions caused by the foreign investment regulations in India and the ***FDI ceilings*** in various industries. The paper also would highlight on the ***measures adopted by China in improving FDI*** and to what extent India can emulate those measures, since India and China enjoy the same standing according to the BRIC Nations nomenclature.

INTRODUCTION

Foreign Investment Regulations is a way of protecting domestic country. In a closed economy foreign investment is not encouraged and the procedures to get foreign investments approved would be cumbersome. In an open economy regulations will be less, inviting foreigners to invest. During the last several years, the developed countries have been stepping up their pressure to install a multilateral investment agreement that prevents countries from controlling TNC investment activities, and possibly the activities of portfolio investors. The developed countries argue that their free trade and free investment were the main channels through which they became rich and therefore the developing countries should also try to emulate such policies. However, an examination of the historical experiences of a number of today's developed countries the USA, the UK, France, Germany, Finland, Ireland, Japan, Korea, and Taiwan, shows that they have all regulated, often severely, foreign investment when it was in their national interest. Though the US seems to be open to foreign investment, yet it imposes stringent regulations. The amendments in the foreign regulations of China broadened the scope of foreign investments and encouraged investors to put money in different fields. Investment is now encouraged in new technology in agriculture, power transportation, and projects earning foreign exchange through exports. Though liberalisations have been made in Japan in the arena of foreign regulations, there a quite a number of other restrictions that make Japan a difficult place to invest in.

The Indian economy was much of a closed economy till 1991. The Economic policy announced in July 1991 opened the gates for foreign investment in India. Prior to this only 40% foreign investment was allowed in domestic country and that too with prior permission from RBI to invest in that sector. Foreign investors are now allowed to invest in export potential, generation of large scale employment

potential particularly in rural areas, proposals that lead to induction of technology and infusion of capital and social sector projects like hospitals, healthcare and many more. Since 2003 the government has taken drastic measures to relax restrictions on foreign investment but there are many lacunae in the system. Red tapism in the bureaucracy, infrastructure hassles, political turmoil in some states, inconsistency in policies, all affect reforms adversely.

REVIEW OF LITERATURE

Foreign investment regulations differ from country to country and are highly economic specific. The political and economic structures of a country influence foreign investment regulations to a great extent. In a closed economy, where foreign investment is not encouraged, regulations will be stringent and procedures to get foreign investments will be cumbersome. In contrast in an open economy, regulations will be less. In the present era of globalisation and increasing international trade, open economy is preferred by most countries with a significant or trivial difference in the degree of openness.(Han Joon Chang, 2003) The developed countries argue that their free trade and free investment were the main channels through which they became rich and therefore the developing countries should also try to emulate such policies. However, an examination of the historical experiences of a number of today's developed countries the USA, the UK, France, Germany, Finland, Ireland, Japan, Korea, and Taiwan, shows that they have all regulated, often severely, foreign investment when it was in their national interest. This suggests that an investment agreement in the WTO is likely to hamper, rather than help, the development of the developing countries. (Han Joon Chang, March 2003)

All of today's developed countries had imposed strict regulation of foreign investment when they were net recipients of foreign investment. *(Kicking Away the Ladder*, 2002, Anthem Press) The exact strategies that were used varied across countries, ranging from the very welcoming strategy of Ireland to the very restrictive strategy of Finland, Japan, Korea, and the 19th-century USA in certain sectors (especially finance and navigation). In other words, there was no "one-size-fits-all" model of foreign investment regulation. However, one commonality between them is that they took a *strategic* approach, rather than a uniformly welcoming or uniformly restrictive one, to the issue of foreign investment regulation. This meant that different sectors could be subject to different policies even at the same point in time. For example, while welcoming and subsidising FDI in labour-intensive manufacturing sectors, Korea and Taiwan in the 1960s and the 1970s strictly restricted FDI in other industries. Also, over time, with changes in their economic structure and external conditions, their policy stances changed. For example, Korea had a relatively open policy towards FDI in the car industry, but when it decided in the mid-1970s to develop its own car industry, it started putting heavy restrictions on FDI in the industry. (Public Law 81-774) The amendments in the foreign regulations of China broadened the scope of foreign investments and encouraged investors to put money in different fields. Investment is now encouraged in new technology in agriculture, power transportation, and projects earning foreign exchange through exports.(Chuang Peck Ming, 2004)

The UK, France, and Germany did not have to control foreign investment until the Second World War, as they were capital-exporting countries before that. However, when they were faced with the challenge of upsurge in American investment after the Second World War, they used a number of formal and informal mechanisms to ensure that their national interests are not hurt. Formal mechanisms included foreign exchange control and regulations against foreign investment in sensitive sectors like defence or cultural industries. (Nicholas Carr, 2003). At the informal level, they

used mechanisms like the SOEs, restrictions on take-over, and "undertakings" and "voluntary restrictions" by TNCs in order to restrict foreign investment and impose performance requirements. Though liberalisations have been made in Japan in the arena of foreign regulations, there a quite a number of other restrictions that make Japan a difficult place to invest in. (Nicholas Carr, 2004)

OBJECTIVES OF THE STUDY

- To study the regulatory framework adopted by different countries
- To determine the repercussions caused by the foreign investment regulations in India and the FDI ceilings in various industries.
- To understand the measures adopted by China in improving FDI and to what extent India can emulate those measures.

SCOPE OF THE STUDY

All of today's developed countries had imposed strict regulation of foreign investment when they were net recipients of foreign investment. The developed countries argue that their free trade and free investment were the main channels through which they became rich and therefore the developing countries should also try to emulate such policies. However, an examination of the historical experiences of a number of today's developed countries the USA, the UK, France, Germany, Finland, Ireland, Japan, Korea, and Taiwan, shows that they have all regulated, often severely, foreign investment when it was in their national interest. The exact strategies that were used varied across countries, ranging from the very welcoming (but not *laissez-faire* and increasingly selective over time) strategy of Ireland to the very restrictive strategy of Finland, Japan, Korea, and the 19th-century USA in certain sectors (especially finance and navigation). In other words, there was no "one-size-fits-all" model of foreign investment regulation. However, one commonality between them is that they took a *strategic* approach, rather than a uniformly welcoming or uniformly restrictive one, to the issue of foreign investment regulation. This meant that different sectors could be subject to different policies even at the same point in time. For example, while welcoming and subsidising FDI in labour-intensive manufacturing sectors, Korea and Taiwan in the 1960s and the 1970s strictly restricted FDI in other industries. Also, over time, with changes in their economic structure and external conditions, their policy stances changed. For example, Korea had a relatively open policy towards FDI in the car industry, but when it decided in the mid-1970s to develop its own car industry, it started putting heavy restrictions on FDI in the industry. Thus it has become extremely important to review the foreign regulations of various nations and contrast and compare the significant differences in the FDI ceiling.

STATEMENT OF THE PROBLEM

In light of the past lessons, we can say that the current proposals made by the developed countries in the WTO in relation to foreign investment regulation are highly problematic. Historical experiences show that a strategic and flexible approach is essential if countries are to use foreign investment in a way that is compatible with their long-term development. By restricting such policy freedom, the developed country proposal is going to damage the development prospect of the developing countries. Especially, the principle of "national treatment" that some countries emphasise is lethal to development. At one level, national treatment sounds fair, given that it is calling for a "level playing field". However, the principle of "level playing field" should be complemented by that of "comparable players. And history tells us that the policy-makers of successful countries understood this when they

designed their policies towards foreign investment. Thus it has become extremely important to review the foreign regulations of various nations and contrast and compare the significant differences in the FDI ceiling.

LIMITATIONS OF THE STUDY

1. Time constraint posed a serious limitation to conduct an elaborate research.
2. Foreign regulations are subject to constant review in all nations.
3. Foreign investment regulations have become sector specific in majority of the nations that makes the study too complex.

RESEARCH METHODOLOGY

- Nature of Data: Secondary Data
- Target Population: Developed and Developing World Economies
- Research Design: Descriptive Research Design
- Tool for Analysis: Case study

ANALYSIS AND INTERPRETATION

Case on Foreign Investment Regulations in major economies : A virtual framework

The increase in the number of economies liberalizing trade and investment has led to a significant change in the flow and stock of FDI. Developing nations have emerged as a favourable destination for investment through liberalization of their economies. The developing countries are opening up industries to foreign nations. India has seen growth due to foreign investment in sectors like infrastructure, IT, computer hardware, drugs and pharmaceuticals and food processing. The Japanese automobile industry in the US, the Korean electronic goods industry in India and global business process outsourcing investments in India, are all examples of the change in the pattern of flow of FDI. The US in contrast to its strong support for foreign investment liberalisation today, when it was a capital-importing country, the USA had all kinds of provision to ensure that foreigners invest in the country but do not control its economy. For example, the US federal government had restrictions on foreigners' ownership in agricultural land, mining, and logging. It discriminated foreign firms in banking and insurance, while prohibiting foreign investment in coastal shipping. It demanded that all directors of national banks have to be American citizens, while depriving foreign shareholders of voting rights in the case of federally-chartered banks. It also prohibited the employment foreign workers, thus implicitly disadvantaging foreign investors that wanted to import skilled labour from their home countries. Though the US seems to be open to foreign investment, yet it imposes stringent regulations. At the state level, there were even more restrictions. In addition to restrictions on land ownership, many states taxed foreign companies more heavily and some even refused them legal protection. Much state legislation in the financial sector was even more discriminatory. Some states imposed more strict capital base requirements on foreign financial institutions, and some even totally banned entry into certain financial industries (e.g., New York state laws banning foreign bank entry).

Foreigners are not allowed to invest in agricultural land, mining and logging and coastal shipping. The federal government condoned such laws and refused to take action against state governments even when there were pressures from foreign investors and governments to do so. The US ensures that foreigners invest in their economy but take care they do not control their economy. All mergers and acquisitions are investigated by the government with the help of the committee on foreign investment in the United States. New York bans the entry of foreigners in some sections of financial services.

The UK, France, and Germany did not have to control foreign investment until the Second World War, as they were capital-exporting countries before that. However, when they were faced with the challenge of upsurge in American investment after the Second World War, they used a number of formal and informal mechanisms to ensure that their national interests are not hurt. Formal mechanisms included foreign exchange control and regulations against foreign investment in sensitive sectors like defence or cultural industries. At the informal level, they used mechanisms like the SOEs, restrictions on take-over, and “undertakings” and “voluntary restrictions”.

Foreign direct investment in China can be made in Joint Sino foreign ventures, cooperative businesses, exclusively foreign owned enterprises and cooperative exploitation. Investment is now encouraged in new technology in agriculture, power transportation and projects earning exchange through exports. Encouragement is given to invest in traditional industries and labour intensive projects. China liberalized the norms for foreign investment at various levels in fields like commerce, foreign trade, finance, insurance, transportation, international freight agencies, law service, tourism, advertising, medical care and health, accounting, assets evaluation, education, leasehold, engineering design, consultation and real estate. Finland and Ireland are arguably among the most impressive cases of industrial transformation in the second half of the 20th century in Europe. However, their respective policies towards foreign investment could not have been more different, at least until Finland’s accession to the EU in 1993 – Finland basically blocking any significant foreign investment, while Ireland aggressively seeking it out.

Finland built its economic miracle under arguably one of the world’s most restrictive policy regimes vis-à-vis foreign investors, while Ireland benefited from actively courting and working with TNCs. The second is that, however “liberal” a country may be towards foreign investment, a targeted and performance-oriented approach works better than a hands-off approach, which is recommended by the developed countries today. Even in the case of Ireland, a combination of carrots and sticks has been used vis-à-vis the foreign investors since the early days, and it was only when it got the balance between the two right that the country started to truly benefit from FDI.

Like the USA in the 19th century, the three largest East Asian economies have tried to use foreign capital under national management as much as they can, and consequently have used extensive controls on foreign investment in terms of ownership, entry, and performance requirement, throughout their developmental period. Especially Japan and Korea (until recently) relied very little on FDI, while even Taiwan, the most FDI-friendly among the three countries, was below international average in its reliance on FDI. IMF statistics show that Japanese FDI is much lower compared to other

major economies. Their approach was decidedly "strategic" in the sense that, depending on the role of the particular sectors in the overall developmental plan of the time, they applied very liberal policies in certain sectors (e.g., labour-intensive industries established in free trade zones in Korea and Taiwan) while being very restrictive in others. It goes without saying that therefore the same industry could be, and have been, subject to relatively liberal treatments at some point but became subject to more strict regulations (and vice versa), depending on the changes in the external environment, the country's stage of development, and the development of the indigenous firms in the industries concerned. Especially the experience of Korea and Taiwan, which provided extensive financial incentives to TNCs investing in their countries while imposing extensive performance requirements, show that FDI bring the most benefit when carrots are combined with sticks, rather than when either carrots or sticks alone are used. At present Japan is concentrating on getting foreign direct investment and the government is taking measures to liberalize more regulations.

Foreign investment regulations differ from country to country and are highly economic specific. The political and economic structures of a country influence foreign investment regulations to a great extent. In a closed economy, where foreign investment is not encouraged, regulations will be stringent and procedures to get foreign investments will be cumbersome. In contrast in an open economy, regulations will be less. In the present era of globalisation and increasing international trade, open economy is preferred by most countries with a significant or trivial difference in the degree of openness.

FINDINGS

1. Foreign investment regulations differ from country to country and are highly economic specific.
2. Though the US seems to be open to foreign investment, yet it imposes stringent regulations.
3. After the Second World War, UK, France, Germany used a number of formal and informal mechanisms to ensure that their national interests are not hurt. Formal mechanisms included foreign exchange control and regulations against foreign investment in sensitive sectors like defence or cultural industries.
4. China liberalized the norms for foreign investment at various levels in fields like commerce, foreign trade, finance, insurance, transportation, international freight agencies, law service, tourism, advertising, medical care and health, accounting, assets evaluation, education, leasehold, engineering design, consultation and real estate.
5. Finland and Ireland are arguably among the most impressive cases of industrial transformation in the second half of the 20th century in Europe.
6. Japan and Korea (until recently) relied very little on FDI, while even Taiwan, the most FDI-friendly among the three countries, was below international average in its reliance on FDI. IMF statistics show that Japanese FDI is much lower compared to other major economies.

RECOMMENDATIONS AND SUGGESTIONS

1. The major world economies should take a strategic approach, rather than a uniformly welcoming or uniformly restrictive one, to the issue of foreign investment regulation. This means that different sectors could be subject to different policies even at the same point in time.

2. Foreign investment regulations should differ from country to country and should be highly economic specific. The political and economic structures of a country influence foreign investment regulations to a great extent.

3. The experience of Korea and Taiwan, which provided extensive financial incentives to TNCs investing in their countries while imposing extensive performance requirements, show that FDI bring the most benefit when carrots are combined with sticks, rather than when either carrots or sticks alone are used.

4. The amendments in the foreign regulations of China broadened the scope of foreign investments and encouraged investors to put money in different fields. The same model can be emulated by India since India and China enjoy the same standing according to the BRIC Nations nomenclature.

5. At present Japan should concentrate on getting foreign direct investment and the government should take measures to liberalize more regulations

6. In the present era of globalisation and increasing international trade, open economy should be preferred with a significant or trivial difference in the degree of openness.

7. Red tapism in the bureaucracy, infrastructure hassles, political turmoil in some states, inconsistency in policies, all affect reforms in India adversely. Thus efforts have to be made to eradicate such evils at the grass root level.

CONCLUSION

Foreign investment regulations differ from country to country and are highly economic specific. The political and economic structures of a country influence foreign investment regulations to a great extent. In a closed economy, where foreign investment is not encouraged, regulations will be stringent and procedures to get foreign investments will be cumbersome. In contrast in an open economy, regulations will be less. Historical experiences show that a strategic and flexible approach is essential if countries are to use foreign investment in a way that is compatible with their long-term development. By restricting such policy freedom, the developed country proposal is going to damage the development prospect of the developing countries. In the present era of globalisation and increasing international trade, open economy is preferred by most countries with a significant or trivial difference in the degree of openness. The amendments in the foreign regulations of China

broadened the scope of foreign investments and encouraged investors to put money in different fields. The same model can be emulated by India since India and China enjoy the same standing according to the BRIC Nations nomenclature.

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