GS FOUNDATION FOR CSE 2024
ECONOMY-18
EXTERNAL SECTOR-2
EXPORT SITUATION; FOREIGN TRADE POLICY, FOREIGN INVESTMENTS (FDIS AND FPIS)

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2. EXPORT SECTOR

- **Current Situation**:

		2022-23 (USD Billion)	**2021-22** (USD Billion)
Merchandize	**Exports**	447.46	422
	Imports	714.24	613.05
Services	**Exports**	322.72	254.53
	Imports	177.94	147.01
Overall Trade (Merchandize + Services)	**Exports**	770.18	676.53
	Imports	892.18	760.06
	Trade Balance	-122.00	-83.53

- **Why does India face such huge trade Deficit**:
  - **Huge Dependency on Fossil fuel imports**
  - **Underperformance in Exports** (India's global export share is only 1.8%, China has 13% share).
    - » Manufacturing sector not well developed.
    - » Less diversification in export basket (10 principle exports account for 78% of total merchandize exports)
  - **Less focus on scientific research and development**
    - » This hinders complex and unique exports.
  - **High cost of logistics** -> Reduces cost competitiveness of Indian products.
  - **Not able to utilize its demographic dividend** due to poor skill levels in the country.

- **Some steps taken to promote exports** and reduce import dependency
  - **Various Schemes** to promote exports.
    - A. **Remission of Duties and Taxes** on Exported Products (RoDTEP) Scheme.
    - B. **Export Promotion in Capital Goods Scheme**
  - **Steps to improve infrastructure.**
    - National Logistic Policy
  - **Focus on Manufacturing sector** - Atmanirbhar Bharat; Various **PLI Schemes**
  - **Increased focus on renewable Energy**

- **Way Forward**:
  - » Focus on growth of manufacturing sector (Initiatives like Atmanirbhar Bharat, Performance linked incentive if effectively implemented will go a long way forward in dealing with these challenges.
  - » **Reduce fuel dependency**: Focus on renewable, biofuels, energy conservation etc.
  - » **Promote ease of doing Business in India**:
    - To attract more investment and production within the country

- Land reforms and labor reforms are two most important focus areas.
- » **Diversify export basket** and **focus on value added exports**
    - For e.g. rather than raw agri products, processed food items can serve more value.
- » **Fast track free Trade** negotiations with EU, Britain etc.
- » **Continued focus on Service sector** like IT.
    - It will be crucial that India's IT sector focuses on emerging technologies, like AI, Machine Learning, ChatGPT etc. so that they will be able to provide next generation services which will be required in future.

3. FOREIGN TRADE POLICY, 2023

- **Example Questions:**
    - » What are the key objectives of India's Foreign Trade Policy, 2023? Highlight some of the challenges to the implementation of this policy. Suggest measures to make this policy more effective in boosting India's exports [15 marks, 250 words]

- **Introduction**:
    - » Foreign Trade Policy (FTP) refers to a set of guidelines, regulations and measures formulated by a government to govern its international trade.
    - » India's new FTP i.e. **Foreign Trade Policy, 2023** has come into force from 1st April 2023.

- This policy is based on continuity of time tested schemes **facilitating exports** as well as a document which is **nimble and responsive** to the requirements of trade.

- **The Key Approach** to the policy is based on these **4 pillars**:
    1. **Incentive to Remission**
    2. **Export Promotion** through collaboration - Exporters, States, Districts, Indian Missions
    3. **Ease of Doing Business, reduction in transaction cost and e-initiatives**.
    4. **Emerging Areas** - E-commerce, Developing Districts as export Hubs and **streamlining SCOMET Policy**.
        - **Note: SCOMET stands for Special, Chemicals Organisms, Materials, Equipment, and Technologies (SCOMET) policy.**

- **Key Aims and Objectives of India's FTP, 2023 are**:
    - » Boost India's **exports to USD 2 trillion by 2030**.
    - » Strengthen India's **export competitiveness**
    - » **Diversify export basket**, **expand** export markets and **promote sustainable exports**.
    - » Focus on promoting exports from small and medium enterprises (SMEs). For this policy envisages support in the form of access to finance and markets.
    - » Provide for several **incentives for exporters**, including duty drawback, export promotion capital goods (EPCG) scheme, and interest subvention schemes.
    - » **Encourage collaboration** between exporters, states, and districts to promote exports.
    - » **Simplify and streamline the process** of exporting goods and services:

- **Focus on emerging areas of export**, such as e-commerce, green technology, and defence and aerospace. These are the areas where India has a competitive advantage, and the policy aims to help businesses take advantage of these opportunities.

- **The Policy aims to boost India's exports through** a number of **measures:**

  - **Process Re-engineering and Automation** (technology enablement) for facilitating exporters.
  - **Expanding the scope of Town of Export Excellence (TEE)** by including Faridabad, Mirzapur, Moradabad and Varanasi in the existing list of 39 towns listed as Towns of Export Excellence (TEE).
  - **Promoting Exports from districts** by building partnerships with state government and taking forward the **District as Export Hubs initiative** to promote exports at the district level.
  - A **robust export control system** in India would provide **access of dual use High end goods and technologies** to Indian exporters while facilitating exports of controlled items/technologies under **SCOMET** (Special Chemicals, Organisms, Materials, Equipment, and Technologies) from India.
  - **Facilitating E-Commerce Exports** through establishment of e-commerce hubs and other related elements.
    - The consignment wise cap on E-commerce exports through courier has been raised from Rs 5 Lakh to Rs 10 lakh.
    - A comprehensive e-commerce policy addressing export/import ecosystem is planned to be brough soon.
  - **Export Promotion of Capital Goods (EPCG) Scheme** has been rationalized.
    - Prime Minister Mega Integrated Textile Region and Apparel Parks (**PM MITRA) scheme** has been added as an additional scheme eligible to claim benefits under CSP(Common Service Provider) Scheme of Export Promotion capital Goods Scheme(EPCG)
    - **Battery Electric Vehicles (BEV) of all type**s, Vertical Farming equipment, Wastewater Treatment and Recycling, Rainwater harvesting system and Rainwater Filters, and Green Hydrogen are added to Green Technology products – will now be **eligible for reduced Export Obligation requirement under EPCG Scheme.**
  - **Introduction of provisions for merchanting trade**.
    - **Note:** Merchanting trade involves **shipment of goods from one foreign country to another foreign country without touching Indian ports, involving an Indian intermediary**.
  - **Amnesty Scheme** to provide relief to exporters who have been unable to meet their obligations under EPCG and Advance Authorization schemes. This will reduce litigations and foster trust based relationship.

- **Challenges:**

» **Global Economic Uncertainty:** The global economy is facing a number of challenges, including the COVID-19 pandemic, the Russia-Ukraine war, and rising inflation. These challenges could impact India's exports, as they could lead to **lower demand for Indian goods and service**.

» **Competition** from other emerging economies: Countries like China, Vietnam etc are also competing to increase its export base and may become a hurdle in India's achievement of its export targets

» **Domestic challenges** such as infrastructure bottleneck, regulatory hurdles, lack of skilled workforce and high cost of logistics may also become a hindrance to India's exports.

- **Way Forward:**
  - **Increased government support** to exporters in the form of access to finance and market.
  - **Improvement in infrastructure** such as roads, railways, airways etc for easier and faster export of goods and services.
  - **Streamlined regulations** related to customs and taxation.
  - **Increased investment in R&D** for development of innovative products and services fulfilling the global demands.
  - **Promoting Brand India** in global market. This will attract foreign buyers and increase demand for Indian goods and services.
- **Conclusion1:**
  - Overall, the Foreign Trade Policy 2023 is a comprehensive and ambitious document that has the potential to boost India's exports and promote economic growth. Though, it faces some challenges, but with strong political will, and collaboration with various stakeholders, these challenges could be overcome.
- **Conclusion2:**
  - The new FTP is a shift from an incentive based approach and creates an enabling ecosystem for exporters, which is a move in line with India's vision of becoming 'Atmanirbhar' (self reliant).

4. FOREIGN INVESTMENT (FDI AND FPI)

1) FOREIGN DIRECT INVESTMENT (FDI)

- Foreign Direct Investment (FDI) is the **investment through capital instruments** by a person who is a resident outside India:
  A. In an unlisted Indian company
  B. In 10% or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company
     » (If the investment comes below 10% subsequently the FDI shall be continued to be classified as FDI. It will not be reclassified as FPI), i.e., **once an FDI, always an FDI**.

- **Key Facts about India's FDI Policy (Remember for Preliminary Exams)**

» **Eligible Investors**
   - **A non-resident entity can invest in India, subject to FDI policy**, except in those sectors/activities which are prohibited.
   - However, a citizen/entity from Bangladesh can only invest under the Government Route.
   - Further, a citizen/entity from Pakistan can invest, only under government route, in sectors/activities other than defence, space, atomic energy, and prohibited sectors for foreign investment.

» **Prohibited Sectors**
   - FDI is prohibited in:
      i. Lottery business including Government/private lottery, online lotteries, etc.
      ii. Gambling and betting including Casinos.
      iii. Chit Funds
      iv. Nidhi Company
      v. Trading in Transferable Development Rights
      vi. Real Estate Businesses and Construction of Farmhouses
         - 'Real Estate Businesses' shall not include development of township, construction of residential/commercial premises, roads or bridges and Real Estate Investment Trust (REITs) registered and regulated by SEBI.
      vii. Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.
      viii. Activities/sectors not open to private investment e.g. Atomic Energy, Railway Operations (other than permitted activities)

A) FDI SITUATION IN INDIA (CURRENTLY)

- **FY23**: $70.97 billion
- **Top Source Countries** (FY23)
   - Singapore ($17.2 billion); Mauritius ($6.13 billion); the US ($6 billion), the UAE ($3.35 billion), the Netherlands ($2.5 billion).
   - Other important source countries include Japan, UK, Cyprus, Cayman Islands, and Germany.
- **Top Five Sectors** to receive FDI
   - **Computer Software ($9.4 billion)**; (Dip from last year)
   - **Service Sector** ($8.7 billion) (Rise from last year)
   - **Trading, Telecommunication, pharma and Chemicals** have also recorded growth in FDI inflow.
- **Statewise FDI reception**:
   - **Maharashtra** received the highest inflows of $14.8 billion during the last fiscal year (though the inflow are down when compared to $15.44 billion) of last year.
   - **Karnataka, Delhi, TN, Haryana, Telangana** and WB also saw a dip in FDI inflow.
   - **Gujarat** saw an increase in FDI to **$4.71 billion** (against $2.7 billion in FY22).
   - **Rajasthan** also saw a positive growth.

- **Why decline in FY23** and **what are FDI threats for future:**
   » Escalation in **geopolitical** stress
   » Enhanced volatility in global financial systems
   » Sharp Price corrections in global stock market

- High magnitude of El-Nino
- Frail Global Demand

B) WHY HAS INDIA EMERGED AS AN ATTRACTIVE DESTINATION OF FDI

- **Liberalization of investment restrictions**
  - In India FDI upto 100% is allowed in non-critical sectors through the automatic route, not requiring clearance from the Ministry of Home Affairs (MHA).
  - Even in strategic sectors like Defence, government has allowed FDI of upto 74% through automatic route and 100% through government route.
  - Consultation activities with representation of different sectors
- **Make in India**, **Atmanirbhar Bharat, PLI** Schemes, **PM GatiShakti** etc.
- **Reforms in Indirect and Direct taxes:**
  - Corporate tax for most companies have been reduced to 25% and for new companies in manufacturing, it has been reduced to 15%
  - GST system has been streamlined, leading to simple tax regime.
- **Increased public capex expenditure** - It is also crowding in private and foreign investment.
- Strengthening of **India's footing in global supply chains**
- **Elimination of Regulatory barriers**
- **Improved Ease of Doing Business**
- **Improved International Relations**

C) NEED OF FDI IN INDIA

- **Lack of Domestic Resources:**
  - Neither the government, nor the private sector in India has enough resources to fulfill India's infrastructure and industrial needs. For e.g. infrastructure sector alone needs more than 1 trillion dollars over the next few years. COVID-19 crisis has further deteriorated the situation.
- **Diffusion of new Technology:**
  - FDI, along with it brings in new technology which is very important for the growth and advancement of India.
- **Virtuous Cycle of Investment:**
  - High FDI in any country gives confidence to other investors and creates a virtuous circle of more investments. So, increasing FDI will also increase private investments which has gone stagnant over the years.
- **Other advantages associated with FDI**
  - **Economic Growth:** More Investment leads to more growth which in turn leads to higher incomes, more employment etc.
  - **Improved performance of governments at state level:** Increases competition among states to attract FDI -> promotes good/efficient business practices among the states
  - **Provides opportunity to government to focus more on social sector**

D) MAIN PROBLEMS THAT ARE RESTRICTING FDI INFLOWS IN THE COUNTRY

- **Complex and rigid Labour Laws**
- **Significant Delay in Land Acquisition** due to slow environmental clearance and difficult Land Acquisition Act.
- **Bureaucratic Red Tapism and Corruption** still dissuades foreign investors from investing in the country

- **Regulatory framework also needs simplification** as it is still too complex for many investors.
- **Regulatory Certainty** is something the investors crave the most.
  - Frequent rule changes, including retrospective changes worry the investors.

E) PROBLEMS ASSOCIATED WITH INCREASED FDI DEPENDENCY

1. **Volatile Investments:** Unreliable in the long term
   - FDI tend to switch to countries where there is more profit, cheap labor and cheap land.
2. **Diffusion of technology is limited :**
   - It is in the interest of foreign firm to withhold profitable technology. Thus generally diffusion of new technology is very less.
   - Moreover, in a developing country like India, where the state of both physical and human capital is not yet on a par with advanced countries, the diffusion also becomes difficult.
3. **Job Creation Not very effective due to FDI ->** FDI is mostly coming in service sector or capital intensive sector.
   - Despite the central government's push to boost manufacturing sector through 'Make in India' and various PLI initiatives, FDI's continue to chase bets in the services sector.
     - For e.g. in FY23, the highest FDI came in sectors like IT, Services etc.
   - Further, the bulk of FDI in manufacturing is not greenfield.

4. **Regional inequities are perpetuated** -> Most FDI come in already industrialized regions.
   - For e.g. Maharashtra, Karnataka, Gujarat and Delhi - collectively accounted for 83% of the FDI between Oct 2019 and March 2022. .
   - This further leads to metro - non metro divide and inequitable distribution of opportunities throughout the country.

F) WAY FORWARD & CONCLUSION

- **Promote Ease of Doing Business in Manufacturing sector**:
  - » Fast track the implementation of labor reforms
  - » Last mile infrastructure issue has to improve.

- **Deal with problems faced by foreign players in setting up large capacities (large factories)**

- **Focus on other impending downside risks** like
  - » Carbon Border Adjustment Mechanism (CBAM), for which carbon content reporting is mandatory from 1st oct 2023.
  - » Polarization risks arising out of the prevailing geopolitical situation reflected in the possible adoption of trade-restrictive measures.

- **Conclusion:**
  - While India has achieved a healthy growth in FDI, to sustain it we need to ensure sound trade policy, inclusive development, implementation of labor codes etc.

2) FOREIGN PORTFOLIO INVESTMENT (FPI)

- **Example Question:**
  - » What is Foreign Portfolio investment? How does it contribute in economic development of a country? Is India becoming immune to volatility associated with FPIs? Give reasons [15 marks, 250 words]

- **Introduction**
  - » Foreign Portfolio Investment (FPI) is any investment made by a person resident outside India in capital instruments where such investment is
    - ▫ Less than 10 percent of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company or

Gyan	**Fully diluted basis** means the total number of shares that would be outstanding if all possible sources of conversion are exercised. For e.g. if the company had issued 100 shares as on today. However, there are debentures that are yet to be converted into shares. If it happens say the total number of shares may go up to 1500. The 10% calculation is to be made against 1500 which is called total number of shares on fully diluted basis.

    - ▫ Less than 10 percent of the paid-up value of each series of capital instruments of a listed Indian company
  - » **Note:**
    - ▫ FPI reflect capital gain but doesn't lead to lasting interest in the company.
    - ▫ FPI includes investment in stocks, bonds (government or corporate), infrastructure securities etc.
  - » Since FPI is easily withdrawable/cashable, it is also called **hot money** and is considered less stable when compared to FDI.

- **Type of FPIs:** In India, FPIs include Foreign Institutional Investment (FII) and Qualified Foreign Investment (QFI).
  1. **Foreign Institutional Investment**
     - It involves foreign institutional investors going for FPI.
     - **Only institutional investors** like investment companies, investment funds etc are allowed to invest in Indian stock market directly. These investors have to get a license from SEBI.

  2. **Qualified Foreign Investment (QFI)**
     - The concept of QFI was introduced in 2000, which allowed individual foreign investor to invest in Indian stock market **without a sub-account** in FII.
     - However, they have to open a Demat account and Trade Account with the depository participant in India.
     - A QFI can be individual, group or an association.
     - QFI should satisfy following conditions.
       - i. QFI should be resident in a foreign country that is compliant with the standards of Financial Action Task Force.
       - ii. QFI must be a signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding (MMoU).

- **Note: According to Regulations by SEBI**
    i. **Investments in unlisted companies** are treated as **FDI.**
        - FPIs are not allowed to invest in unlisted shares and investment in unlisted entities will be treated as FDI.
    ii. Any equity which is less than or equal to 10% of capital in a company is portfolio investment. While investment above 10% of capital in a company will be counted as Foreign Direct Investment.
    iii. **Investment by a FPI** cannot exceed 10% of the paid up capital of the Indian company.
    iv. **All FPI** taken together can't acquire more than 24 percent of the paid-up capital of an Indian Company.
    v. **Investment by NRIs** will not be considered FPI.

- **Advantages of FPI**
    i. **For investor**
        - **Portfolio diversification**
        - **Easy access to international credit**
            - If investor holds FPI they can access credit in the foreign country. Ability to get credit on favorable terms and quickly can determine the business expansion opportunities for the investor.
        - **More Liquid and thus less risky**

    ii. **For Domestic Economy**
        - **More capital to country's capital market** will lead to more development of capital market thereby resulting in more capital flowing into the real economy thereby leading to overall development of the country.
        - **Diverse Investment, large scale investments**
            - FIIs are big and hence they have the capacity to make large scale investment.
        - **Strengthening of domestic currency**

- **Limitations of FPI**
    i. **For Investors**
        - **Lack of control** over business
    ii. **For domestic country**
        - Easy liquidity of investments comes with **vulnerability for economy**.
            - E.g. East Asia crisis of late 1990s.
        - Sudden withdrawal also leads to beating up of the domestic currency.
        - **Chances of round tripping of funds**
            - Sometimes, round tripped capital is re-invested in the Indian Stock markets using the FPI route.

- **Situation in FY23**:
    - As per annual report of SEBI released in Aug 2023, **FPIs pulled out Rs 37,632 crore** from Indian equities during FY23. This is a decline in outflow of **73.1%** as compared to FY22.
        - **Why the recent outflow**:
            - **Rise in Inflation worldwide** led to tightening of monetary policies among all major economies.

        - **Global uncertainty** due to geopolitics of Europe have also led to withdrawals.
        - **COVID-19** resurgence in China has also added to negative sentiments

- **But**, the **stock markets haven't fallen much** and are trading near its highest ever.
    - This is because DII flows are compensating the FII outflows. They invested a **total of Rs 2.55 lakh crore** during the fiscal year.
        - DIIs now own a record 15% of the BSE-500 shares, just 3.3% points below the share of FPIs, which has now declined to nine-year lows.
        - This highlights India's economic resilience and attractiveness to local investors.

- **In conclusion**, India's economy continues to recover and expand. With supportive regulatory measures from SEBI and other market regulations, India's financial markets are poised for a promising future, attracting both domestic and international investments.