The brick and mortar of FDI 2.0

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"List or trade in India should be used as a strategic policy tool to enable Indians to become shareholders in MNCs."

Foreign Direct Investment (FDI 1.0) has been welcome in India irrespective of whether or not its equity structure includes Indian public shareholding. However, the world has undergone a structural change with the emergence of Internet Multinational Companies (MNCs) such as Microsoft, Google, Facebook and Twitter that are based on 'winner-takes-all' platform business models. These firms are characterised essentially by inequitable dynamics, since they distribute most gains to themselves vis-à-vis their host countries. This situation demands a policy response.

Perhaps this is one of the reasons why China banned Internet MNCs. This led to China creating nine out of the 20 global Internet leaders. China strategically deploys a quid pro quo policy. MNC firms are mandated to transfer technology, share patents and enter into 50:50 joint ventures with Chinese partners in return for market access. Given our political system, India will obviously need to follow a new FDI 2.0 policy to achieve more desirable outcomes.

Rather than accepting the 'winner MNC takes it all' as fait accompli, FDI 2.0 should harmonise interests of all stakeholders including Indian consumers, the government and investors. FDI 2.0 could deploy 'List or Trade in India' as a strategic policy tool to enable Indian citizens become shareholders in MNCs such as Google, Facebook, Samsung, Huawei and others, thus capturing the 'upside' they create for their platforms and companies. This is equitable to all, since Indian consumers contribute to the market value of MNCs.

In 1978, the Indian government adopted a policy that required equity dilution by 100% foreign-owned companies. This led to the 'Listing of MNCs', and many of which then provided handsome returns to both MNCs and Indian shareholders. It is estimated now that listing Indian subsidiaries of MNCs alone could add as much as ₹50 lakh crore to equity market capitalisation. This could make capital markets deeper and valuations more reasonable. 'List or Trade MNCs in India' could become a potent extension to 'Make in India' to disseminate prosperity. In contrast to 1978, the proposals we present here are based on incentives, more capital market-friendly and in line with the practices followed by Mexico, China, Bangladesh and other countries.

A road map for India

India could implement the following set of proposals: Proposal 1 (List in India): Majority (more than 51%) foreign-owned Indian-listed MNCs could be eligible to domestic company tax rate whereas unlisted MNC subsidiaries could be subjected to a higher tax rate. Many countries such as Bangladesh, Vietnam and Thailand have used tax incentives to attract listing by MNCs.

Mexico is most successful in attracting cross listings. For example, AB InBev, Coca-Cola, Walmart and Citigroup are listed in Mexico. To ensure the success of this proposal, the government will need to reconsider the present policy of allowing 100% MNC-owned subsidiaries to compete with their listed Indian counterparts that erodes the value accruing to Indian shareholders.

Proposal 1, by itself, will not achieve the objective of increasing Indian participation in the fair value of Internet MNCs. This is because of complex issues in revenue booking that result in low profits in Indian subsidiaries. Hence, there is a need for additional initiative by way of proposal 2 to enable Indian investor participation in the ownership of parent MNCs' shares.

Proposal 2 ('Trade in India' i.e. U.S. dollar-denominated parent MNC Shares to be 'Admitted for Trading' on Indian bourses]: In this proposal, Indian investors could buy shares of parent MNCs (where global profits and value get consolidated). This can be permitted within the $250,000 Liberalised Remittance Scheme (LRS) limit. Indian bourses could admit only S&P 500 stocks. The Mexican Stock Exchange allows trading of international shares listed in other stock exchanges. India could replicate such models.

Mirroring Mexico

For successful implementation of Proposal 2, the Indian government may need to facilitate following measures: Permit Indian bourses to implement international trading system on the lines of Mexico.

Parent MNCs in S&P 500 with business interests in India could be mandated to facilitate trading of their shares in India. MNCs would readily agree as it does not envisage listing in India.

For taxation purposes, no distinction should be made between transactions in comparable domestic and foreign securities.

LRS implementation for buying foreign stocks in GIFT City/NSE/BSE could be simplified and work as single click functionality.

Educate Indian investors about the value of diversification of their portfolio in international stocks for achieving better risk adjusted returns.

The government could facilitate access to ultra-low cost (<=0.04%) S&P 500 Index Funds such as Admiral Shares (VFIAX) and ETFs using Indian e-KYC. Indian MFs charge fees from 0.54% to 2%. They are at least 13 times more expensive.

For Proposal 2, one important issue that needs to be addressed pertains to U.S. Estate taxes. For Indian citizens, U.S. estate taxes @40% apply above portfolio value of $60,000.

To mitigate this burden, the National Securities Depository Limited (NSDL) could design a sovereign trust for holding parent MNC stocks. The NSDL could then issue BharatShares to retail investors. Nominees of the government of India would get voting rights in parent MNCs. In addition, the government could make available a 'Fully Disclosed Model' for holding foreign stocks in line with our NSDL/Central Depository Services Ltd (CDSL) system. The prevalent 'Omnibus model' carries the risk of U.S broker default because investors' shares are held in the U.S. broker's name. For this reason, it could also lead to higher tax liabilities in India.

Summing up, increasing Indian equity ownership of MNCs would offer diversification benefits and make Indians more prosperous. Wealth distribution through mutual funds would create a virtuous cycle of innovative ideas, entrepreneurship, employment, consumption, higher taxes, social and physical infrastructure for the benefit of Indian society. MNCs would earn the goodwill of Indian consumers while expanding their investor base. In other words, this is a win-win for all stakeholders.

Foreign direct investment-FDI

What is it?

- It is an investment made by a group with the intention of establishing permanent interests in the business or corporation of a country.
- Foreign direct investment is a major driver of economic growth and an important source of non-debt finance for economic development in the country.
- FDI brings new capital, new technology and employment opportunities in the domestic economy.

Benefit

- With more foreign investment, insurance companies will expand and new offices will also open. This will create more jobs, which will boost employment in the country.
- Due to this, new brokers will also come, who will be able to tell the market better about insurance.
- Due to the presence of more companies, competition can also occur in them, due to which the products will become cheaper.
- Every company would like to attract more and more people to it, due to which products will not only become cheaper, but will also improve their quality.

Loss

- Loss to the common public - FDI causes the maximum damage to the livelihood of the unskilled workers. The higher the FDI limit, the more unskilled workers will be hurt.
- Big companies will provide jobs to the skilled people, but will not give jobs to the skilled people.
- Small companies will also be acquired, which will make it very difficult for skilled people to get jobs.
- Companies will lure customers by selling cheaper goods, which small companies will not be able to compete with, which may also threaten their survival.
- Large foreign companies may take over the market by acquiring existing companies.

FDI in April-June quarter

- Foreign direct investment (FDI) in the country grew by 28 percent to reach $ 16.33 billion in the first quarter of the current financial year. This information has been given in the government data.
- The country received FDI of $ 12.75 billion in the same quarter of FY 2018-19.
- According to data from the Ministry of Commerce and Industry, FDI inflow was $ 2.80 billion in services sector, $ 2.24 billion in computer software and hardware, $ 4.22 billion in telecommunications and $ 1.13 billion in business in the first quarter of this financial year.
- During this period, the highest FDI of $ 5.33 billion was received by Singapore. It was followed by Mauritius with $ 4.67 billion, Netherlands with $ 1.45 billion and Japan with $ 472 million. The government has recently relaxed FDI norms in some areas.
- Recently, the Union Cabinet approved relaxation in FDI rules in several sectors including single brand retail.
- The central government has also approved 100% FDI (production of goods by a company to another company under its brand or level) in coal mining activities and contract manufacturing.
- In an effort to promote Digital India campaign of Prime Minister Narendra Modi's the cabinet approved 26% FDI in digital media platforms. It was previously only for print media in the country.

Expected Questions (Prelims Exams)

1. Government of India is considering preparation of FDI 2.0. Consider the statements that prepare the road map for FDI 2.0: -

1. The government needs to allow 100% multinational subsidiaries to compete with their listed (Indian counterparts).
2. Britain, has been the most successful in attracting Cross listings, learning from which India can make a good roadmap.
3. A fully disclosed model can be provided to hold foreign stock.

Which of the statements given above is / are correct?

(a) 1 and 2 (b) 2 only

(c) 1 and 3 (d) 3 only

Expected Questions (Mains Exams)

Q. 'To attract a new form of FDI in India, policy and structural changes have to be brought and global examples will have to be adopted.' To what extent do you agree with this statement? Discuss **(250 Words)**

Note: Answer of Prelims Expected Question given on 3 Oct., is 1 (c).