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Analysing developments impacting business

FOREIGN DIRECT INVESTMENT IN DEFENCE - INCREASE IN SECTORAL CAP

19 September 2020

Introduction

On 16 May 2020, the government had announced raising the Foreign Direct Investment (FDI) limit in defence manufacturing, under the automatic route, from 49% to 74%.

Subsequent to the announcement, on 17 September 2020, the Department for Promotion of Industry and Internal Trade (DPIIT) has issued Press Note 4 (2020 Series) (PN 4 of 2020) to give effect to the government's decision to raise FDI in the defence sector to 74% under automatic route.

Details of changes introduced

Current Position	Revised Position
FDI limit (100%)	
<ul style="list-style-type: none"> ▪ FDI up to 49% is permitted under the automatic route in an industry requiring industrial license¹. ▪ FDI beyond 49% is permitted under the government route in an industry requiring industrial license, wherever it was likely to result in access to modern technology or for other reasons to be recorded. 	<ul style="list-style-type: none"> ▪ FDI up to 74% is permitted under the automatic route in an industry requiring industrial license. ▪ FDI beyond 74% is permitted under the government route in an industry requiring industrial license, wherever it was likely to result in access to modern technology or for other reasons to be recorded.
Industries not requiring industrial license: Changes in equity pattern / secondary transfers	
<ul style="list-style-type: none"> ▪ Infusion of fresh foreign investment up to 49% in a company not seeking industrial license resulting in (i) 	<ul style="list-style-type: none"> ▪ Infusion of fresh foreign investment up to 49% in a company not seeking industrial license or which already

¹ The list of items requiring compulsory industrial license has been provided schedule I of the Industries (Development and Regulation), Act 1961. The list of defence items requiring compulsory available in press note no 3 (2014 Series) dated 26 June 2014.

<p>change in the ownership pattern; or (ii) transfer of stake by existing investor to new foreign investor, will require government approval.</p>	<p>has government approval for FDI in defence will need to mandatorily submit a declaration with the Ministry of Defence in case of (i) change in equity/shareholding pattern; or (ii) transfer of stake by existing investor to new foreign investor for FDI up to 49%, within 30 days of such change. For FDI beyond 49% in such companies, government approval will be required.</p>
<p>Industrial licensing</p>	
<ul style="list-style-type: none"> ▪ The industrial license applications will be considered by the DPIIT in consultation with Ministry of Defence and Ministry of External Affairs. 	<ul style="list-style-type: none"> ▪ No change in the position.
<p>Security clearance requirement</p>	
<ul style="list-style-type: none"> ▪ Foreign investment in the sector is subject to security clearance² by the Ministry of Home Affairs and as per guidelines of the Ministry of Defence. 	<ul style="list-style-type: none"> ▪ No change in the position.
<p>Self-sufficiency in product design and development</p>	
<ul style="list-style-type: none"> ▪ It has been prescribed that the investee company should be structured to be self-sufficient in the areas of product design and development. The investee/joint venture company along with the manufacturing facility, should also have maintenance and life cycle support facilities for the product being manufactured in India. 	<ul style="list-style-type: none"> ▪ No change in the position.
<p>Discretionary scrutiny powers</p>	
<ul style="list-style-type: none"> ▪ No express discretionary powers provided to the government. 	<ul style="list-style-type: none"> ▪ PN 4 of 2020 prescribes that foreign investment in the defence sector would be subject to scrutiny on the grounds of national security. Further, the government reserves the right to review any foreign investment in the

² Refer <https://fifp.gov.in/Forms/SecurityForm.pdf>

	sector that affects or may affect national security.
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Comments

The above changes introduced by PN 4 of 2020 were expected after the government's announcement in May 2020. While the policy changes have now been announced by issuance of PN 4 of 2020, these changes will have the force of law after amendments to the provisions of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

The objective of the amendments appears to aim at promoting and fostering local manufacturing and reducing the country's reliance on other countries for defence procurements (especially military hardware). Having done so, the government has still retained its critical discretionary powers to scrutinise any defence project in the wake of national security.

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