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FDI in India

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ABSTRACT

One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economic landscape. This unprecedented growth of global FDI in 1990 around the world make FDI an important and vital component of development strategy in both developed and developing nations and policies are designed in order to stimulate inward flows. Infact, FDI provides a win – win situation to the host and the home countries. Both countries are directly interested in inviting FDI, because they benefit a lot from such type of investment. The 'home' countries want to take the advantage of the vast markets opened by industrial growth. On the other hand the 'host' countries want to acquire technological and managerial skills and supplement domestic savings and foreign exchange. Moreover, the paucity of all types of resources viz. financial, capital, entrepreneurship, technological know- how, skills and practices, access to markets- abroad- in their economic development, developing nations accepted FDI as a sole visible panacea for all their scarcities. Further, the integration of global financial markets paves ways to this explosive growth of FDI around the globe.

KEYWORDS: Introduction, FDI and Indian Economy,FDI Implementation

INTRODUCTION

The historical background of FDI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. However, researchers could not portray the complete history of FDI pouring in India due to lack of abundant and authentic data. Before independence major amount of FDI came from the British companies. British companies setup their units in mining sector and in those sectors that suits their own economic and business interest. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India. Further, after Independence issues relating to foreign capital, operations of MNCs, gained attention of the policy makers. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. The first Prime Minister of India considered foreign investment as "necessary" not only to supplement domestic capital but also to secure scientific, technical, and industrial knowledge and capital equipments. With time and as per economic and political regimes there have been changes in the FDI policy too. The industrial policy of 1965, allowed MNCs to venture through technical collaboration in India. However, the country faced two severe crisis in the form of foreign exchange and financial resource mobilization during the second five year plan (1956 -61).

Therefore, the government adopted a liberal attitude by allowing more frequent equity participation to foreign enterprises, and to accept equity capital in technical collaborations. The government also provides many incentives such as tax concessions, simplification of licensing procedures and de- reserving some industries such as drugs, aluminium, heavy electrical equipments, fertilizers, etc in order to further boost the FDI inflows in the country. This liberal attitude of government towards foreign capital lures investors from other advanced countries like USA, Japan, and Germany, etc. But due to significant outflow of foreign reserves in the form of remittances of dividends, profits, royalties etc, the government has to adopt stringent foreign policy in 1970s. During this period the government adopted a selective and highly restrictive foreign policy as far as foreign capital, type of FDI and ownerships of foreign companies was concerned.

Government setup Foreign Investment Board and enacted Foreign Exchange Regulation Act in order to regulate flow of foreign capital and FDI flow to India. The soaring oil prices continued low exports and deterioration in Balance of Payment position during 1980s forced the government to make necessary changes in the foreign policy. It is during this period the government encourages FDI, allow MNCs to operate in India. Thus, resulting in the partial liberalization of Indian Economy. The government introduces reforms in the industrial sector, aimed at increasing competency, efficiency and growth in industry through a stable, pragmatic and non-discriminatory policy for FDI flow. Infact, in the early nineties, Indian economy faced severe Balance of pyment crisis. Exports began to experience serious difficulties. There was a marked increase in petroleum prices because of the gulf war. The crippling external debts were debilitating the economy. India was left with that much amount of foreign exchange reserves which can finance its three weeks of imports. The out flowing of foreign currency which was deposited by the Indian NRI's gave a further jolt to Indian economy. The overall Balance of Payment reached at Rs.(-) 4471 crores. Inflation reached at its highest level of 13%.

Foreign reserves of the country stood at Rs.11416 crores. The continued political uncertainty in the country during this period adds further to worsen the situation. As a result, India's credit rating fell in the international market for both short- term and longterm borrowing. All these developments put the economy at that time on the verge of default in respect of external payments liability. In this critical face of Indian economy the then finance Minister of India Dr. Manmohan Singh with the help of World Bank and IMF introduced the macro – economic stabilization and structural adjustment program.

As a result of these reforms India open its door to FDI inflows and adopted a more liberal foreign policy in order to restore the confidence of foreign investors. Further, under the new foreign investment policy Government of India constituted FIPB (Foreign Investment Promotion Board) whose main function was to invite and facilitate foreign investment through single window system from the Prime Minister's Office. The foreign equity cap was raised to 51 percent for the existing companies. Government had allowed the use of foreign brand names for domestically produced products which was restricted earlier. India also became the member of MIGA (Multilateral Investment Guarantee Agency) for protection of foreign investments. Government lifted restrictions on the operations of MNCs by revising the FERA Act 1973. New sectors such as mining, banking, telecommunications, highway construction and management were open to foreign investors as well as to private sector.

FDI AND INIAN ECONOMY

Nations' progress and prosperity is reflected by the pace of its sustained economic growth and development. Investment provides the base and pre-requisite for economic growth and development. Apart from a nation's foreign exchange reserves, exports, government's revenue, financial position, available supply of domestic savings, magnitude and quality of foreign investment is necessary for the well being of a country. Developing nations, in particular, consider FDI as the safest type of international capital flows out of all the available sources of external finance available to them. It is during 1990s that FDI inflows rose

faster than almost all other indicators of economic activity worldwide. According to WTO83, the total world FDI outflows have increased nine – fold during 1982 to 1993, world trade of merchandise and services has only doubled in the same. Since 1990 virtually every country- developed or developing, large or small alike have Sought FDI to facilitate their development process. Thus, a nation can improve its Economic fortunes by adopting liberal policies vis-à-vis by creating conditions conducive to investment as these things positively influence the inputs and determinants of the Investment process. This chapter highlights the role of FDI on economic growth of the Country.

FDI IMPLEMENTATIONS

Institutional infrastructure and development are the main determinants of FDI inflows in the European transition economies. Institutional environment (comprising both institutional strategies and policies of organizations relating to these institutions) plays critical role in reducing the transaction costs of both domestic and cross border business activity.

FDI plays a crucial role in employment generation/ preservation in Central Europe.

It is found that bigger diversity of types of FDI lead to more diverse types o spillovers and skill transfers which proves more favourable for the host economy.

It is also found that apart from market size, exports, infrastructure facilities, institutions, source and destination countries, the concept of neighborhood and extended neighborhood is also gaining importance especially in Europe, China and India.

In industrial countries high labour costs encourage outflows and discourage inflows of FDI. The principle determinants of FDI in these countries are IT – related investments, trade and cross – border mergers and acquisitions.

Studies which underlie the effects of FDI on the host countries economic growth shows that FDI enhance economic growth in developing economies but not in developed economies. It is found that in developing economies FDI and economic growth are mutually supporting. In other words economic growth increases the size of the host country market and strengthens the incentives for market seeking FDI. It is also observed that bidirectional causality exist between FDI and economic growth i.e. growth in GDP attracts FDI and FDI also contributes to an increase in output.

Studies on developing countries of South, East and South East Asia shows that fiscal incentives, low tariffs, BITs (Bilateral Investment Treaties) with developed countries have a profound impact on the inflows of aggregate FDI to developing countries.

Studies on role of FDI in emerging economies shows that general institutional framework, effectiveness of public sector administration and the availability of infrastructural facilities enhance FDI inflows to these nations. FDI also enhance the chances of developing internationally competitive business clusters

It is observed that countries pursuing export – led growth strategies reaps enormous benefits from FDI.

The main determinants of FDI in developing countries are inflation, infrastructural facilities, debts, burden, exchange rate, FDI spillovers, stable political environment etc.

It is found that firms in cluster gain significantly from FDI in their region, within industry and across other industries in the region.

It is also observed that FDI have both short – run and long – run effect on the economy. So, regulatory FDI guidelines must be formulated in order to protect developing economies from the consequences of FDI flows.

CONCLUSIONS

Indeed, India needs a business environment which is conducive to the needs of business. As foreign investors doesn't look for fiscal concessions or special incentives but they are more of a mind in having access to a consolidated document that specified official procedures, rules and regulations, clearance, and opportunities in India. In fact, this can be achieved only if India implements its second generation reforms in totality.

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