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Justification Behind Foreign Direct Investment (Fdi) In Indian Economy: A Re-Look

KEYWORDS: FDI, Foreign Capital, Capital Formation, Foreign Exchange Reserve

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ABSTRACT *According to IMF FDI is defined as "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor. The investors' purpose being to have an effective voice in the management of the enterprise." Developing countries like India are generally capital-scarce due to lower levels of income. It plays a vital role in development of an economy. FDI acts as a bridge to fill the gap between investment and saving. Positive fundamentals combined with fast growing markets have made India an attractive destination for foreign investors.*

The present endeavour is an attempt to assess the present FDI status and sector-wise FDI attractiveness with effects of FDI including hindrances and concern.

Introduction
"Foreign direct investment is the category of international investment in which an enterprise resident in one country (the direct investor) acquire an interest of at least 10% in an enterprise resident in another country(the direct investment enterprise)" (UNCTAD, 2010). What makes FDI different from foreign portfolio investment is the use of transferred capital in the host country. FDI means that foreign investors either invest into an existing company or established a new company (i.e. factory, branch) in a host country. Since FDI is a form of physical investment, it is expected to have effects on the current account balance, capital formation, employment, productivity, economic growth, and development.

In other way FDI is the investment of foreign capital by foreign investors in the business of another country (called home country) with the primary objective of acquiring effective controlling interest in the business. The Organisation of Economic Cooperation and Development (OECD) define control as owning 10% or more of the business. In the corporation form of business, controlling power (policy and decision making) is vested with the Board of Directors are appointed by the shareholders exercising their voting rights.

So, direct investment requires investment of capital in equity shares sufficient to acquire controlling of voting rights. Acquiring controlling interest means acquiring the right to appoint a majority of the directors or to control the management or policy decisions. Many countries have, however, set the minimum threshold limit of share holding at a level higher than 10% as set by OECD.

Objectives of the Study:
The following objectives have been set for the study:

1. To asses the present status of FDI in India
2. To know the Major Impediments and Concern over FDI in India

Entry Route of FDI in India:
Under FDI scheme investments can be made by non-residents in the shares/convertible debentures of an Indian company, under the following routes:

Automatic Route: Under this route FDI is allowed without prior approval either of the Government or The RBI. The investors are only required to notify the concerned regional office of the RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issuance of shares to foreign investors

Government Route: under this route, FDI approval is made by three institutions, viz., the Foreign Investment Promotional Board (FIPB), the Secretariat for Industrial Assistance (SIA) and the Foreign Investment Implementation Authority (FIIA).

Why Foreign Capital?
Capital is a critical component in any economic activity. It is equally critically important for any country for its various programmes of economic development. The need for capital of a country is met primarily out of domestic earning surplus i.e., domestic savings. But a country has to depend on external capital when domestic savings fall short of optimistically designed need for capital in planned development programmes. This is particularly important in a developing country like India. Developing countries do have huge deficit of investible funds needed for various planned developmental programmes. So, a developing country like India has got either of the two options i) to invite foreign capital for immediate developmental programmes, and ii) to sacrifice developmental programmes or delaying them to be met out of domestic savings in the distant future. Studies revealed that the apprehended loss of management control in FDI route under first option is of less than the sacrifice or delay in enjoying the fruits of developments under second option.

Gross Domestic Product (GDP) is the parameter of economic performance of a country. With the opening up of economy in the early '90s India could come out of the eclipse of Hindu Rate of Growth (around 3-4% of GDP). Gradually over time growth rate in India currently hovers around 7-8%. To pursue a growth of around 7% of GDP, the net capital flows in India should increase by at least 28 to 30%. But the domestic savings stood only at 24 percent. The gap puts pressure and pushes the demand for foreign capital. Studies revealed that economic growth in India by an increasing inflow of FDI is more via 'stimulating

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technological progresses than by 'increasing total capital accumulation'.

Why is FDI?

FDI being non-debt nature does not involve any termed payment obligations; rather, repayment is linked to profitability. On the other hand, FDI is preferred to Foreign Portfolio Investment (FPI) since the former investment type is, as stated above, less volatile than FPI in which the invested capital can be taken away by the investor with a simple mouse-click such that this capital is less effective for utilization in the economic development programmes. For capital to be gainfully utilised in economic development, it must be characterised with longevity and stability which are available in FDI. Another reason for FDI-preference may be the scope to shift the investment risk from domestic investors to foreign investors. Foreign investors are attracted to follow this route for the wider scope they get to diversify their investment portfolio at international level; internationally diversified investment portfolio may embrace lesser risk and thereby better return.

Benefits of FDI

1. Gross domestic product:

The endogenous growth theories support strongly the role of FDI in promoting economic growth in host countries. FDI is viewed as a way to transfer knowledge, promote learning by doing, bring in technology spill-over, and human capital growth.

Shan et al. (1998), Alam (2001), Hasen and Rand (2003) etc. have evaluated positive impact of FDI on growth.

2 Gross fixed capital formation:

The capital formation is the creation of productive assets that expand an economy's capacity to product goods and services. Private savings facilitate capital formation by allowing resources to be diverted to corporate investment rather than individual consumption (Scott, 2003). Due to establishment of backward and forward linkages with local industries, it can also encourage domestic investment.

Foreign firms can undertake projects for which domestic investor do not have the capacities to carry out or which are considered too risky for host country firms. In such cases, FDI also serves to stimulate domestic investment by further boosting the total country investment and plays significant role in the formation of gross fixed capital of the host country.

3 Employment opportunities:

FDI plays a major role in creation of employment. The basic mechanism for FDI to generate employment in the recipient countries are: i) Foreign subsidiaries employ people in their domestic operations, ii) Through backward and forward linkages, employment is created in enterprises that are suppliers, sub-contractors, or service providers to them and iii) with the expansion of FDI in related industries, employment is also generated in different sectors of the economy (Sun, 2002)

4 Export :

There is a strong and positive relation between FDI and export volume. Since exporting involves high degree of risk and uncertainty, foreign firm with higher profitability due to greater access to financial resources, do better on export front. This is because export oriented companies tend to form micro-level linkages with domestic firms in the form of sourcing and partnerships. Their objective is to exploit the low cost infrastructure and cheap labour skill available locally for export purposes. In addition to knowledge spill overs to local suppliers, export-oriented foreign firms also cause information spill overs to purely domestic firms to enter into export market (Chopra, 2003)

5 Foreign exchange reserve:

Foreign Exchange Reserve is the sum total of a country's gold holdings and convertible foreign currencies held in its banks, plus special drawing rights (SDR) and exchange reserve balances with the IMF. Foreign investment causes certain advantages like technology transfer, marketing expertise, introduction of modern managerial techniques and thus creating immense possibilities of increased foreign exchange reserves in the country concerned. Foreign investors are generally considered to be better placed to tap international market than their local counterparts because of their massive asses to the formation and marketing networks of their parent enterprises which facilitates their efforts to increase foreign exchange reserves in the host country (Chopra).

6 Spill over effects:

FDI inflows create spill over effects on Indian economy through product quality improvement arising out of triggered competitiveness, through intellectual properties like knowledge, skill, experience, technological know-how, etc. Existing domestic employees of the get enriched with the advanced knowledge and skills.

7 Comparative advantages:

The inflow of FDI helps exploit the comparative advantage through each country concentrating only on production and generation of those products and services in which the respective country is more efficient than the corresponding other country.

8 Best Governance:

Through FDI –relationship the host firm gets scope for learning best governance practices business practices, foreign country rules and laws, etc.

9 Scope for wider choice:

Consumers in a FDI-rich country get a wider choice in selecting a product for buying.

Present Status of FDI:

The following information about FDI may give us an idea about its present status:

1. Monthly Foreign Direct Investment in India (RBI): June 2015:1749 USD Million, July 2015: 1943 USD Million, October 2015:5035 USD Million, November 2015: 2701 USD Million, Highest in February 2008:5670 USD Million and Lowest in February 2014(-60) USD Million.
2. As per Financial Times News paper a ranking of top destinations for green field investment measured by estimated capital expenditure in the first half of 2015 shows India at number one, having attracted roughly billion more than the United States.
3. Singapore was the top investing country during April, 2015 to June, 2015 with 23,320 Crores Rupees (3673 USD Million) of FDI followed by Mauritius, Netherlands, USA, Germany.

The analyses of the origin of FDI inflows to India show that the new policy has broadened the source of FDI into India. There were 29 countries in 1991 which increased to 147 countries in 2015 whose FDI was approved by the Indian government. As per FDI Statistics, GOI, 2015, cumulative

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inflows (April 2000-June 2015) shows Mauritius has been the largest investor in India. Firms based in Mauritius invested 89644 USD Million in India during this period or about 35 % of total FDI inflows during the period. One of the major reasons behind India's FDI attractiveness to Mauritius is the Double Taxation Avoidance Agreement (DTAA) between them. The Singapore is the second largest investor in India. The total capital flows from the Singapore was around 35861 USD Million that registered for 14% of the FDI inflows. The United Kingdom (9%) and Japan (7%) are India's third and fourth highest FDI suppliers, followed by Netherlands and USA (both 6%), Germany and Cyprus (both 3%), France (2%) and Switzerland (1%).

The analysis of sector wise FDI inflows shows that Service Sector, Construction Development: (Township, Housing, Built-up Infrastructure and Construction-Development Projects), Computer Software & Hardware, Telecommunications, Automobile industry, Drugs& Pharmaceuticals, Chemical (other than Fertilizers), Power, Metallurgical Industries and Hotel & Tourism Sector attracted more FDI, that together accounted for 65% (approx)of total FDI inflows during April 2000 to January 2015. April 2000 to January 2015) inflows into India shows that Service Sector registered the highest attracting sector amounting to 42101.98 USD Millions (17.32%) followed by Construction Development (9.88%), Telecommunications (6.99%), Computer Software & Hardware (5.81%), Drugs& Pharmaceuticals (5.29%), Automobile industry (4.88%), Chemical (other than Fertilizers) (4.21%), Power (3.91%), Metallurgical Industries (3.49%) and Hotel & Tourism Sector (3.20%).

FDI in Retail Sector is around 14-15% of GDP. 100% FDI is allowed in single brand retail but FDI in Multi-brand is yet a strong debatable issue. The government is yet to take any decision to implement FDI in multi-brand retail. The current foreign investment policy permits 51% FDI in multi-brand retail, but the present government is not supportive of bringing any investment in this sector (Economic Times, 12 August, 2015).

Major Impediments and Concern:

The major deterrents to larger flows of FDI are weak infrastructure, complicated tax structures, stringent and rigid labour laws, unstable political situation, sluggish legal system, slow reform process, time consuming processing system, etc.

Infrastructural bottlenecks continue to be a major cause of concern in India. Even after six decades of planned economic development, India suffers from poor transport links, inadequate power supply, poor roads, and frequent power cuts, delays in ports, water and sewerage problems and so on. As per world competitiveness Index for 2013-14, India ranked 85 out of 148 countries for its infrastructure, much behind china which ranked 48.

While enacting legislations to allow FDI inflow, various restrictive conditions are included which are repulsive in nature.

The taxation policies in India remain inherently complex despite the fact that government has taken several steps to simplify and redesign it.

India is well acclaimed for her democratic system of governance. Trade unionism, though a democratic right providing protection to the workers and employees, does not appear to be a welcoming feature to the investors because they view it in terms of the loss. Legal system also takes too long a time in disposing litigation.

FDI cannot be all virtuous; rather there is some sting of viciousness ingrained in it, which would affect the interests of the people of the present generation as well as of the future. It creates a cause of concern like fear of getting hijacked in controlling business, fear of losing national sovereignty and economic independence, unmatched competition between small domestic businesses and FDI-dominated large business houses, pricing monopoly and hostile take-over, doubt over expected percolation of business gains to the employees etc.

Conclusion

Some impacts, like knowledge acquisition, technology and international image can not be measured quantitatively. It takes considerable time before these variables affect growth. Some challenges regarding federal, equity, environmental and international competition etc are to be overcome for gainful utilisations of FDI.

No doubt India government has implemented several reform measures in order to greater FDI but there are several studies have highlighted India's weak spots. One such report is "Doing Business 2015", an annual report published by the World Bank. 'Ease of doing business' is one important internal environmental factor. As per 'Ease of doing business' India ranked 142nd with a score of 53.97 out of 189 countries (USA-7th with score of 81.98, China-90th with score of 62.58); The highest score of 88.27 goes to Singapore.

Bureaucracy, red tapism and corruption are the hindrances to attract FDI in India.

Both gains and loss are involved with FDI. The policy of encouragement of massive FDI inflow into India and the incentive structure for the same needs to be re-looked in the interest of self-sustained economic development and sustainable development.

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