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Contemporary Issues on Foreign Direct Investment

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ABSTRACT

This paper delineates and discusses the growing number of factors and variables, which constitute the core of foreign direct investment policy instruments. It does so within the new context of the foreign direct investment regime and its requisite policy intervention. The range of factors and variables, their foreign direct investment elasticity's and implications for policy craft as well as the policy dimensions, array of foreign direct investment regulatory, incentive, measures, trade policies and trade-related investment measures are depicted. The relative advantages and disadvantages of policy instruments are viewed through the lens of policy coherence and 'fit' – in spatial sequencing and switching terms – with a country's evolving economic and temporary circumstances and conditions. The need for intense policy research and analysis is emphasised. 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 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. Infect, FDI provides a win – win situation to the host and the home countries. DISCUSSIONS on foreign direct investment are heard as a sort of continuous background music at most seminars and conferences these days on it every other day.

Keywords :

INTRODUCTION

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 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. DISCUSSIONS on foreign direct investment are heard as a sort of continuous background music at most seminars and conferences these days and business newspapers carry articles on it every other day.

The FDI mantra is considered an all-purpose panacea for the ills of the Indian economy and society. It has become routine for our finance ministers to "showcase" India in various international forums — Davos being somewhat of a premier venue — and exhort the global captains of industry and commerce to come to India. Unfortunately there is not much debate, leave alone informed debate, between the academic and other policy-makers about the far-reaching implications of FDI in our economy and, particularly, how it can stifle economic growth. The debate only focuses on the so-called effect on employment and loss of "socialism" — that vanished dogma of the nineteenth century.

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, and entrepreneurship, technological know- how, skills and practices, access to markets- abroad- in their economic development, developing nations accepted FDI as 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.

OBJECTIVES

The study covers the following objectives:

1. To study the trends and patterns of flow of FDI.
2. To assess the determinants of FDI inflows.
3. To evaluate the impact of FDI on the Economy.

FDI AND INDIAN ECONOMY

Developed economies consider FDI as an engine of market access in developing and less

Developed countries vis-à-vis for their own technological progress and in maintaining their own economic growth and development. Developing nations looks at FDI as a source of filling the savings, foreign exchange reserves, revenue, trade deficit, management and technological gaps. FDI is considered as an instrument of international economic integration as it brings a package of assets including capital, technology, managerial skills and capacity and access to foreign markets. The impact of FDI depends on the country's domestic policy and foreign policy.

HYPOTHESES

The study has been taken up for the period 1991-2008 with the following hypotheses:

1. Flow of FDI shows a positive trend over the period 1991-2008.
2. FDI has a positive impact on economic growth of the country.

FDI FLOW IN INDIA

(Amount in Rs. Crores)

Years FDI inflows in India

Years	FDI inflows in India
1991-92	409
1992-93	1094
1993-94	2018
1994-95	4312

1995-96	6916
1996-97	9654
1997-98	13548
1998-99	12343
1999-00	10311
2000-01	10368
2001-02	18486
2002-03	13711
2003-04	11789
2004-05	14653
2005-06	24613
2006-07	70630
2007-08	98664
2008-09	123025

(Source: various issues of SIA Bulletin.)

Economic growth is based on domestic savings

Savings and Investment as per cent of GDP at market prices (in %)

	1996-97	1999-00	2001-02	2002-03	2003-04
Gross Domestic Savings	23.2	24.2	23.4	26.1	28.1
Gross Domestic Investments	24.5	25.3	22.6	24.8	26.3
Savings-Investment Gap	-1.3	-1.1	0.8	1.3	1.8

Source: Economic Survey 2004-2005

Fortunately India's economic growth over the last decade and a half has primarily been driven by savings in the economy, especially by households. Housewives from middle-class homes should be given due credit for this. The Table shows the savings and investment rate in our economy, the gap being met by foreign flows.

We find from the Table that all our investments have come from our own savings in the past decade. The argument pertaining to the need for FDI is based on the following premises.

If we want to grow at 10 per cent and if our capital-output ratio is 3.5, we need investment at 35 per cent and, if our savings rate is 28 per cent, then the gap has to be met by the West.

This is, to start with, spurious since the measurement of the capital-output ratio is not reliable and definitely not applicable to our service sector, which makes up nearly 60 per cent of the economy and is its growth engine. Anyone who has travelled in a taxi in the North will know that there can be passengers to the right side of the driver and the actual capacity of our buses is infinite.

SECTOR WISE RANKING OF FDI INFLOWS

Government must target at attracting specific types of FDI that will be able to generate spillovers effects in the overall economy like investing in human capital, Rv Government should ensure the equitable distribution of inflows among states and must give more freedom to states, so that they can attract inflows at their own level.v The government should provide additional incentives to foreign investors to invest in states where the level of FDI inflows is quite low. v37. RECOMMENDATIONS&D activities, environmental issues, productive capacity, sectors with high income elasticity of demand. Government must exercise strict control over inefficient bureaucracy, red - tapism, and the rampant corruption, so that investor's confidence can be maintained for attracting more FDI inflows to India.v The policy makers should focus more on attracting diverse types of FDI and should design policies where foreign investment can be utilized as means of enhancing domestic production, savings, and exports and also as medium of technological learning and diffusion and also in providing access to the external market.v38. Multinational firms have increased the degree of competition in host-country markets which will force existing inefficient firms to invest more in physical or human capital.v FDI has lead to indirect productivity gains through spillovers.v FDI has provided better access to technologies for the local economy.v The increased flow of FDI in a country has given a major boost to the countrys economy.v39. CONCLUSION Service sector has been the most sought after sector in India for Foreign Direct Investments. India, with its skilled labor and manpower has the potential to overtake China as the most preferred destination for Foreign Investments. Hence measures must be taken in order to ensure that the flow of FDI in our country continues to grow.

RETAIL- ADVANTAGES

The entry of large global retailers such as Wv Foreign Players would displace the unorganized retailers because of their superior financial strengths. v18. FDI IN RETAIL-DRAWBACKS Increase in real estate prices and marginalize domestic entrepreneursval-Mart would kill local shops and millions of jobs. Trading for wholesale received highest percentage (84.25%) of total FDI inflow followed by trading (for exports) with 9.04%, e-commerce with (2.38%) during 2006-08 2008.v Total numbers of 20 technical and 1111 financial collaborations have been approved since 2005.v This sector shows an exponential rise in inflows from 2006 onwards.v19. TRADING SECTOR Out of the 125 technology transfers, 40 technical collaborations are approved with USA, 21 with UK, and 14 with Germany.v Mumbai (38.76%) and New Delhi (13.01%) received major percentages of inflow .v Consultancy Sector received US$ 1.1 bn which is 1.14% of total inflows received since 2008.v20. CONSULTANCY SECTOR

India with the added advantage of having large pool of skilled people with secondary and tertiary level of education attracts foreign firms in science, Rv 100% FDI is allowed in education sector.v21. EDUCATION SECTOR & D, and high technology products and services. Out of the total technology transfers ,9 technical and 223 financial collaborations have been approved till December 2008v In India Delhi, Mumbai, and Hyderabad receives maximum amount (viz. US$ 1245.61, 1000.5, and 943.22 billion) of investment.v The amount of FDI till Dec. 2008 is US$ 4.9 billion which is 6.15% of the total inflows received.v22. CONSTRUCTION SECTOR In India Mumbai, New Delhi and Ahmedabad received major chunks of investment i.e. 36.98%, 26.63% and 9.47%).v It ranks 5th in the list of sectors in terms of cumulative FDI approved from August 1991 to Dec 2008.v FDI inflows during Jan 2005 to Dec. 2009 are US$ 3.2 billion which is 4.09% of the total inflows received.v23. AUTOMOBILE INDUSTRY Among Indian locations Mumbai received 22.44% of investment followed by Bangalore (10.8%), and Chennai (9.90%).v Also it received US$ 8.9 billion which constitute 11.43% of the total FDI inflows during the period during 2005-2007.v This industry fetched 3636 numbers of foreign collaborations out of which, 125 are technical and 3511 are financial in nature.v24. COMPUTER HARDWARE AND SOFTWARE New Delhi attracts highest percentage (32.58%) of FDI inflows after 2005.v Out of cumulative FDI inflows, this Sector received an inflow of US$ 8.2 billion, which is 8.4% of the total FDI inflows during last few years.v Telecommunication sector ranks 2nd in the list of sectors in terms of cumulative FDI.v25. TELECOMMUNICATION SECTOR

LIMITATION OF FDI

Foreign direct investment may be very advantageous to the host country that is the country which receives the investment flows in terms of helping the country progress economically and financially. However, foreign direct investment can remain beneficial only when the governments of the host countries put in needed regulations so as to prevent the country from being exploited and used as a profit generating machine for such corporate giants. The past has given many examples of how foreign direct investment can also at times be detrimental to the economy of a country, some examples of which are highlighted below:

Political Lobbying: In the past, there have been many instances in which MNCs have resorted to political lobbying in order to get certain policies and laws implemented in their favor. At times, these MNCs are so large that their revenues even exceeded the Gross Domestic Product (GDP) of some smaller nations and compel or threaten them to pass judgments and policies in their favor.

Exploitation of Resources: Exploitation of natural resources of a host country is not an very uncommon phenomenon in the case of FDI. MNCs of other countries have been known to indiscriminately exploit the resources of hosts countries in order to get short run gains and profits and have even chosen to ignore the sustainability factors associated with the local communities and local habitat, very much like what happened in the 17th century colonialism.

Threaten Small Scale Industries: MNCs have large economic and pricing power due to their large sizes. They do not have much problem with regards to financial capital and can hence resort to using advertising which is a costly affair. Also, these companies are global players who have their operations spread across countries and have effective supply chains which enable them to have economies of scale which smaller players in the domestic market of the host country cannot compete with. All this results in the MNC having cheaper products and more visibility due to the higher amounts of advertising and have been known to push out smaller industries out of business.

Technology: Although, the MNCs have access to new and cutting edge technology, they do not transfer the latest technology to the host country with a fear that their home country may loose its competitive advantage, hence the maximum potential of the host economy cannot be achieved as a result of old technology transferred.

CONCLUSIONS

- 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 favorable for the host economy.
- In industrial countries high lab our 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 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 FDIto 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
- 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.

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