THE CRISIS OF FOREIGN DIRECT INVESTMENT IN INDIA

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Abstract :

Foreign Direct Investment (FDI) since 1991 has proved to be game changer for wide segments of Indian industry. FDI has change quality, productivity, and production in areas where it has been allowed. FDI has led to the creation of new activities such as IT-BPO, which was initiated by select foreign companies.

Today, India needs massive investment in the 12th Plan period (2012-2017), to the tune of $1 trillion investment in the infrastructure sector alone. Starting from a baseline of less than $1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010–2012. As per the data, the sectors which attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, US and UK were among the leading sources of FDI. According to Ernst and Young, foreign direct investment in India in 2010 was $44.8 billion, and in 2011 experienced an increase of 13 per cent to $50.8 billion. India has seen an eightfold increase in its FDI in March 2012. (India disallowed Overseas Corporate Bodies (OCB's) to invest in India) On 14 September 2012, Government of India allowed FDI; in aviation upto 49 per cent, in Broadcast sector upto 74 per cent, in multi-brand retail upto 51 per cent and in single-brand retail upto 100 per cent.

Key Words : FDI, GOI.

Introduction :

It is a tragedy that people in any country are hardly consulted before the governments borrow or take loans to slip into debt. Neither have the governments the world over evolved mechanism for this. Investments in Agriculture, Industry, and Services sectors are essential for growth of a country's economy, global governance and for job creation. Foreign Direct

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Investment (FDI) is one such essential holistic desire. No one can deny it. What we fail to realise is the fact that **FDI does not mean a magic wand to bring happiness to all.**

Definition :

Foreign Direct Investment (**FDI**) is direct investment into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is done for many reasons including to take advantage of cheaper wages in the country, special investment privileges such as tax exemptions offered by the country as an incentive to gain tariff-free access to the markets of the country or the region. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the securities of another country such as stocks and bonds.

India is seen as an attractive destination for Foreign Direct Investment Most of the 179 companies surveyed between February and May placed India as their third-favored investment destination — albeit a distant third — after the United States and China. **Not surprisingly, India remained the largest recipient of foreign direct investment in South Asia**. However, **FDI to India is only a fraction of China's $124 billion.** It is also much less than what we could potentially absorb as our requirement given our yawning need for infrastructure finance. While a fresh bout of economic uncertainty and the possibility of lower growth rates in major emerging markets(EMEs) risks undercutting this favorable trend in 2012, UNCTAD expects FDI flows to pick up strength again by 2013. The silver lining is that the increase in FDI flows to India in 2011 came despite the economic slowdown that saw top multinationals turn cautious, hanging on to cash rather than invest. Cash levels for the top 100 Multi National Companies(MCCs) peaked at $1.03 trillion in 2010, an estimated $166 billion above the levels suggested by average pre-crisis cash holdings.

Heightened uncertainty also manifested itself in another form: a rise in the number of known investor-state dispute settlement (ISDS) cases under International Investment Agreements (IIAs), as investors challenged public policies that hit their business prospects.Clearly, challenges of the kind mounted by Telenor and Sistema in the telecom space are not unique to India but part for the course when the economic climate turns adverse.

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UNCTAD proposes some core principles for investment policymaking, guidelines for national investment policies and options for the design and use of IIAs, clubbed as an Investment Policy Framework for Sustainable Development. This is definitely worth consideration. (Refer 01)

Theoretical Background :

With the tripling of the FDI flows to EMEs during the pre-crisis period of the 2000s, India also received large FDI inflows in line with its robust domestic economic performance. The attractiveness of India as a preferred investment destination could be ascertained from the large increase in FDI inflows to India, which rose from around US$ 6 billion in 2001-02 to almost US$ 38 billion in 2008-09.

The significant increase in FDI inflows to India reflected the impact of liberalization of the economy since the early 1990s as well as gradual opening up of the capital account. As part of the capital account liberalization, FDI was gradually allowed in almost all sectors, except a few on grounds of strategic importance, subject to compliance of sector specific rules and regulations.

The large and stable FDI flows also increasingly financed the current account deficit over the period. During the recent global crisis, when there was a significant deceleration in global FDI flows during 2009-10, the decline in FDI flows to India was relatively moderate reflecting robust equity flows on the back of strong rebound in domestic growth ahead of global recovery and steady reinvested earnings (with a share of almost 25 per cent) reflecting better profitability of foreign companies in India. However, when there had been some recovery in global FDI flows, especially driven by flows to Asian EMEs, during 2010-11, gross FDI equity inflows to India witnessed significant moderation. Gross equity FDI flows to India moderated to US$ 20.3 billion during 2010-11 from US$ 27.1 billion in the preceding year.

Sectoral perspective shows that, **FDI in India mainly flowed into services sector (with an average share of 41 per cent in the past five years**) followed by manufacturing (around 23 per cent) and mainly routed through Mauritius (with an average share of 43 per cent in the past five years) followed by Singapore (around 11 per cent). However, the share of services declined over the years from almost 57 per cent in 2006-07 to about 30 per cent in

2010-11, while the shares of manufacturing, and 'others' largely comprising 'electricity and other power generation' increased over the same period. Sectoral information on the recent trends in FDI flows to India show that the moderation in gross equity FDI flows during 2010-11 has been mainly driven by sectors such as 'construction, real estate and mining' and services such as 'business and financial services'. **Manufacturing, which has been the largest recipient of FDI in India, has also witnessed some moderation**.

Foreign direct investment and the developing world :

A recent meta-analysis of the effects of foreign direct investment on local firms in developing and transition countries suggests that foreign investment robustly increases local productivity growth. The Commitment to Development Index ranks the "development-friendliness" of rich country investment policies. Foreign Investment in India is announced by Government of India named as FEMA (Foreign Exchange Management Act) **The Indian retail market is estimated to be around $400 billion with more than 12 million retailers employing 40 million people. Ironically, Wal-Mart's turnover is also around $420 billion, but it employs only 2.1 million people**.

If Wal-Mart can achieve the same turnover with hardly a fraction of the workforce employed by the Indian retail sector, how do we expect big retail to create jobs? **It is the Indian retail sector which is a much bigger employer, and big retail will only destroy millions of livelihoods.**What India-Africa needs is systemic reforms that favor 99 percent of people and their pockets and not in favor of one percent of the population supported by multinationals and their hidden pockets in tax havens.

Research :

The data on FDI inflows into the country shows **that foreign investors have shown a keen interest in the Indian economy ever since it has been liberalized**. An increasing trend of flows can be observed since 1991 with the peak of FDI flows being reached in 2008-09. Therefore **the trend gives support to the fact that as and when the government has taken initiatives to open up and liberalize the economy further, the investors have welcomed the initiative and reciprocated by infusing investments into India**.

There are various reasons which work in favour of India and increase the level of interest shown in by foreign organization's some of them being its demographics' with a young population there is a huge consumer base that is to be tapped, the growing middle class, increased urbanization and awareness, rising disposable incomes.

There has been a change in the method of estimation of FDI inflows since 2000-01, prior to this only equity inflows was taken as the FDI inflow figure however post 2000-01 the **RBI has started following the international practice and taken into account other components of FDI inflows namely re-invested earnings and other capital**.

A look at the contribution of various components of FDI reveals that the share of re-invested earnings was rising from 2000 onwards uptil 2005-06 after which it has constantly been declining. The share of equity inflows has risen sharply since 2000-01 when it stood at 59.6 per cent to 74.3 percent in 2010-11

The 12th Plan's draft approach paper of the Planning Commission mentions that "Thus the average investment rate needed during the Twelfth Plan period is estimated to be 38.5 per cent of GDP for the 9.0 per cent growth scenario with 4.5–5.0 average inflation. It would have to rise as much as 41.4 per cent of GDP for the 9.5 per cent growth scenario with 5.0–5.5 rate of inflation" and in terms of investment in infrastructure the same document suggests that "**The total investment in infrastructure would have to be over Rs.45 lakh crore or $ 1 trillion during the 12th Plan period.** Financing this level of investment will require larger outlays from the public sector, but this has to be coupled with a more than proportional rise in private investment".

Findings :

It is observed that a mad race has begun for **attracting more FDI inflows, to accelerate the pace of economic progress in the global economy** India's case is no different as in order to achieve and sustain a healthy rate of growth. **India would require huge investments which cannot be financed locally therefore the government needs to look at alternate avenues of building up investments**, FDI in this context is a very useful mechanism. Recent reports have also suggested that **greater FDI inflows must be encouraged to meet capital requirements.** Aside from using FDIs as investment channel and a method to reduce operating costs, many companies and organizations are now looking at FDI as a way to **internationalize**. **<u>FDI should be looked upon as a means of industrialization and development.</u>**

The Benefits of FDI Inflows can be broadly identified as :

1. Bridging the financial gap between the quantum of funds needed to sustain a level of growth and the domestic availability of funds
2. Technology transfer coupled with knowledge diffusion that leads to improvement in productivity.

It can, thus, fasten the rate of technological progress through a 'contagion' effect that permeates domestic firms The transfer of better organizational and management practices through the linkages between the investing foreign company and local companies. Some of these benefits have been seen in the cases of automobile and the telecom industry. Moreover it can be seen that a promotion and growth in one industry simultaneously fuels the growth in its interconnected sectors as well. It is well accepted that India's rising growth would require a simultaneous expansion of its infrastructure facilities to support it. **The Government of India has been frequently taking initiatives to liberalize and incentivize its foreign direct investment policies to attract investments however the recent decision to suspend FDI in retail as well as hold all other** FDI decisions could dampen the international investor's confidence, as the initial announcement and then the rollback of the initiative might be interpreted as a sign of political instability in taking key policy decisions In today's global scenario when investors might be looking at alternate avenues, to invest their money there are only a few nations across the world that **provide opportunities to foreign companies, with a highly potential market and a low cost manufacturing opportunity and India is one of them**. FDI in retail would have been an opportunity to attract inflow of funds which would have resulted in major benefits for the Indian economy:

1. Agriculture :

Organized retailing would have led to a complete overhauling of the existing agricultural supply chain. It would have led to bypassing of various intermediaries thereby reducing costs. Investments made by them would have helped in creating back end infrastructure like warehousing and distribution centers, transport and cold storage facilities. It would have created both direct as well as indirect employment at various levels.

All these would have resulted in enhanced farmer's realizations, improved quality of products and reduction in consumer price.

2. Growth in allied industries :

The inflow of funds into retailing would have simultaneously led to the growth of allied industries as happened in the case of automobiles, which led to the growth of auto components sector. Likewise FDI in retail would assist growth in supplier industries such as food-processing and textiles. Moreover, growing demand for retail space, construction of real estate would have also taken place.

3. Increase in Employment Opportunities :

The growth in a number of allied industries would also result in the growth of employment opportunities across sectors. Both direct and indirect labour would be required to support the industrial and operational machinery that would have been formed as a result of opening up of sectors

4. Government Revenues :

Another significant advantage of organized retailing is its contribution to government revenues. Organized retailers, by virtue of their being corporate entities need to file tax returns periodically whereas in the unorganized sectors there have been leakages in the collection of central and state taxes.

India needs among many other infrastructure facilities, infrastructure in retail as well as those for food and perishable products. Opening of FDI in retail would have led to the creation of such farm infrastructure. This apart mining and manufacturing sectors also require huge investments and **FDI can supplement domestic efforts significantly.**

There is also an urgent need for India to augment the investment absorption capacity. Moreover it has to be understood that India is competing for foreign

investments with other emerging economies and so far a comparative analysis suggest that India has not been a large recipient of FDI (Refer 02).

Suggestions :

FDI is important tool/mechanism, but it is not, one solution to all problems. The government's thinking that FDI in retail will help solve the crisis in the agriculture sector is misplaced. Most people in rural India depend on their local retailers. The retail business in the rural and semi-urban areas is based on credit where farmers pay whenever they get the money. Crores of people are in the retail business. FDI in retail will make most of them jobless.

Conclusion :

Moribund Agriculture, Moderate Industry and increasing Service sector are the major players and stakeholders, which will together with technology and science, would decide the fate of India Finally it is "**We the people of India**" with the **squeezed pockets because of rising inflation** will decides the **future of .FDI which is only a market driver having no power to pay off a country's loans or generate more increased jobs**

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