Original scientific paper
Received: 27.06.2010

INDIA'S FOREIGN DIRECT INVESTMENT: CURRENT STATUS, ISSUES AND POLICY RECOMMENDATIONS

Mohd. Shamim Ansari
Mukesh Ranga
Bundelkhand University, Jhansi (UP) India
CSJM University, Kanpur (UP) India[1]

Abstract:
Foreign Direct Investment (FDI) as an important driver of growth. It is an important source of non debt financial resources for country for economic development. Besides it is a means of achieving technical know-how and employment generation of employment. However, many are of the view that FDI is a big threat to sovereignty of host and domestic business houses. Faster exploitation of natural resources for profit may deprive host from such resources in long run. Midst of debate on pros and cons of FDI, world economy has observed a phenomenal change in volume and pattern of FDI. There is clearly an intense global competition of FDI. India is not behind this global race of attracting foreign investment. India emerged as an attractive FDI destination in services but has failed to evolve a manufacturing hub which has greater economic benefit. FDI though one of the important sources of financing the economic development, but not is not a solution for poverty eradication, unemployment and other economic ills. India needs a massive investment to achieve the goals of vision 20-20. Policy makers need to ensure transparency and consistency in policy making along with comprehensive long term development strategy.

Key words: Foreign Direct Investment (FDI), analysis of investments in India, flow of FDI, policy recommendation.

INTRODUCTION

Foreign Direct Investment (FDI) is now regarded as an important driver of growth. Emerging Market Economies (EMEs) look upon FDI as one the easiest means to fulfill their financial, technical, employment generation and competitive efficiency requirements. Gradually they also realized that substantial economic growth is inevitable without global integration of business process. This created opportunities for locational advantages and thus facilitated strategic alliances, joint ventures and collaborations over R & D.

---

[1] **Mohd. Shamim Ansari**, PhD., Assistant Professor, Institute of Economics and Finance, Bundelkhand University, Jhansi (UP) India, **Mukesh Ranga**, Ph.D., Professor, Institute of Business Management, CSJM University, Kanpur (UP), India.

The world economy has observed a phenomenal change in volume and pattern of FDI flow from developed nations to EMEs in 1980s and 1990s compared to earlier decades. The hostile attitude of developing nations regarding multinationals investment has become generous during this transition period. FDI was fostered by liberalisation and market-based reforms in EMEs. The financial sector deregulation and reforms in the industrial policy further paved the way for global investments.

There is clearly an intense global competition for FDI. India has emerged as the second most attractive destination for FDI after China and ahead of the US, Russia and Brazil. In view of these facts, the present paper takes stock of current status of FDI in India, aims to find reasons for comparatively lesser flow of FDI and suggest measures to boost flow of FDI to India.

LITERATURE REVIEW

Review of various literatures available on FDI reveals that foreign investment is still a matter of debate. Whether FDI is boom or bane for host countries economic growth and development? Opinions are still divided. FDI has its own advantages and disadvantages. Many scholars argue that through FDI developed nations may try to invade the sovereignty of host country. In order to earn quick profit they may exploit the natural resources at the faster rate and thus leave the host country deprived in the long run. It have been feared that FDI is a big threat to survival of domestic players. Many are of the opinion that basic objective of foreign investments is to earn profits by ignoring the overall social & economic development of the host nation. Thus, through this section an attempt has been made to discuss various issues raised by different scholars on the subject.

It is universally acknowledged that FDI inflow offers many benefits to an economy. UNCTAD (1999) reported that Transnational Corporations (TNCs) can complement local development efforts by (i) increasing financial resources for development; (ii) boost export competiveness; (iii) generate employment and strengthening the skill base; (iv) protecting the environment to fulfill commitment towards social responsibility; and (v) enhancing technological capabilities through transfer, diffusion and generation. However, Te Velde, (1999) has rightly reported that in the absence of pro-active government policies there are risk that TNCs may actually inhibit technological development in a host country. Borensztein, et. al. (1998) reveals that FDI has a net crowding in effect on domestic private and public investment thus advancing overall economics growth. Crowding in effects of FDI varies with regions. There has been strong evidence of crowding-in in Asia and strong net crowding out effect in Latin America (Agosin and Mayer, 2000).

By and large, studies have found a positive links between FDI and growth. However, FDI has comparatively lesser positive links in least developed economies, thereby suggesting existence of "threshold level of development" (Blomstrom and Kokka, 2003 and Blomstrom et. al., 1994). Athreye and Kapur (2001) emphasized that since the contribution of FDI to domestic capital is quite small, growth-led FDI is more likely than FDI-led growth. Dua and Rasheed (1998) indicted that the Industrial production in India had a unidirectional positive Granger-Casual impact on inward FDI flows. They also concluded that economics activity is an important determinant of FDI inflows in India and not vice-versa. Tseng and Zebregs (2002) reported that even in case of China causality between market size/growth and magnitude of FDI holds true.

There is global race for attracting FDI, but how much it would contribute to host country's economics development is to be assessed. Developing countries need to have reached a certain level of educational, technological and infrastructure development before being able to benefit from a foreign presence in their markets. Blomstrom et. al., (1994) have rightly observed that, the host country must be capable of absorbing the new technology manifested in FDI. An additional factor that may prevent a country from reaping the full benefits of FDI is imperfect and underdeveloped financial markets (OECD 2002). India appears to be well placed in terms of reaping benefits because it has relatively well developed financial sector, strong industrial base and critical mass of well educated workers (Rajan et. al., 2008).

RESEARCH METHODLOGY

Objective of the Study

The present study has been undertaken with a conduct empirical analysis of status of FDI in India and made some policy recommendation to boost flow of FDI to India. Thus the objectives of the study can be enumerated as follows:

a) To analyze the pattern and direction of FDI flow in India.
b) To identify factors those are responsible for comparatively lesser flow of FDI.
c) To identify reasons for regional imbalances in terms of flow of FDI.
d) To review FDI policy of India
e) To address various issue and concern relating to FDI.
f) To make policy recommendation to improve the level of FDI.

Nature and Source of Data

The present study is of analytical nature and makes use of secondary data. The relevant secondary data are collected from various publications of Government of India, Reserve Bank of India and World Investment Report 2009 Published by UNCTAD etc.

Period of study and Data Analysis

The reference period is restricted from 2000 to 2009. To have an empirical idea about the status of FDI in India trend analysis has been conducted. For this purpose parameter such as FDI equity inflows country-wise, sector-wise, region-wise and foreign technology approval and transfer from different country to different sector have been taken into consideration. An attempt has also been made to present composition of capital inflows in recent years. Ratios such as Net FDI Flows, FDI as a percentage of GDP, FDI as a percentage of Gross Fixed Capital Formation, FDI as percentage of Gross Fixed Investment and FDI per head are used to present better picture of flow of FDI in the country.

RESULT AND DISCUSSION

FDI is now regarded as one of the key indicators of economic health. Thus, there is a global race to attract foreign funds through this route. India too is not behind in this race. Investors are showing their growing confidence in the immediate and medium term prospects of the Indian economy. This section of the paper aims to conduct an in-depth analysis of pattern and direction of flow of FDI in India.

Status of FDI in India

Various studies have projected India among the top 5 favoured destination for FDI. Cumulative FDI equity inflows has been Rs.5,54,270 crore (1,27,460 Million US$) for the period 1991-2009. This is attributed to contribution from service sector, computer software, telecommunication, real estate etc. India's 83% of cumulative FDI is contributed by nine countries while remaining 17 per cent by rest of the world. Country-wise, FDI inflows to India are dominated by Mauritius (44 percent), followed by the Singapore (9 per cent), United States (8 percent) and UK (4 percent) (Table 1). Countries like Singapore, USA, and UK etc. invest in India mainly in service, power, telecommunication, fuels, electric equipments, food processing sector.

Table 1: Share of top investing countries FDI Equity Inflows

In INR

Rank	Country	2006-07	2007-08	2008-09	2009-10	Cumulative Inflows	%age to total inflows
1	Mauritius	28759	44483	50794	42924	204196	44
2	Singapore	2662	12319	15727	8188	42040	9
3	USA	3861	4377	8220	7577	35536	8
4	UK	8389	4690	3840	1841	34746	5
5	Netherlands	2905	2780	3922	3687	19539	4
6	Cyprus	2666	3385	5983	6419	16468	4
7	Japan	382	336	1889	5197	16421	4
8	Germany	540	2075	2750	2581	12069	3
9	UAE	1174	1039	1133	2824	6830	1
10	France	528	583	2098	1158	6639	1
Total FDI Inflows		**70630**	**98664**	**122919**	**100539**	**493665**	**83%**

Source: Government of India (GOI) (2009). FDI Statistics, Ministry of Commerce & Industry, Department of Industrial Policy and Promotion.

Though India has observed a remarkable rise in the flow of FDI over the last few years, it receives comparatively much lesser FDI than China. Even smaller economies in Asia such as Hong Kong, Mauritius and Singapore are much ahead of India in terms of FDI inflows (UNCTAD, WIR, 2007). This is largely due to India's economic policy of protecting domestic enterprise and its dependence on domestic demand as compared to above mentioned Newly Industrialized Asian Economies.

There is a positive link between FDI and India's growth story. India has been observing a consistent growth in net FDI flow. Ratio of FDI Inflow to Gross Capital Formation has improved from 1.9 per cent during the period 1990-2000 to 9.6 per cent in the year 2008. Similarly ratio of FDI Outflow to Gross Capital Formation also improved from 0.1 per cent during 1999-200 to 4.1 per cent by the year 2008. This seems to be impressive when compared with corresponding data for China, South Asia, Asia and Oceania, Developing Economies and even whole world. Net FDI flow to China is reported to much more than India in absolute term (Table 2 and Table 3).

Table 2: FDI Overview of Select Years

(Annual Average)

					Million Dollar	**As a percentage of Gross Capital Formation**			
FDI Flows	1990 -2000	2005	2006	2007	2008	**1990 - 2000**	**2006**	**2007**	**2008**
India									
Inward	1705	7606	20336	25127	41554	1.9	6.9	6.5	9.6
Outward	110	2978	14344	17281	17685	0.1	4.8	4.5	4.1
Net FDI Inflow	**1595**	**4628**	**5992**	**7846**	**23869**				
China									
Inward	30104	72406	72715	83521	108312	11.9	6.4	6	6.0
Outward	2195	12261	21160	22469	52150	0.9	1.9	1.6	2.9
Net FDI Inflow	**27909**	**60145**	**51555**	**61052**	**56162**				
Pakistan									
Inward	463	2201	4273	5590	5438	5.1	16.4	18.3	18.3
Outward	5	44	109	99	46	0.1	0.4	0.3	0.2
Net FDI Inflow	**458**	**2157**	**4164**	**5491**	**5392**				
South Asia									
Inward	2578	14352	27758	33982	50669	1.9	6.7	6.4	8.5
Outward	176	3515	14871	17758	18182	0.1	3.6	3.4	3.1
Net FDI Inflow	**2402**	**10837**	**12887**	**16224**	**32487**				
Asia and Oceania									
Inward	76763	213999	283402	332682	388709	8.5	11.4	11	10.7
Outward	37829	84424	144492	223130	220194	4.2	5.8	7.4	6.1
Net FDI Inflow	**38934**	**129575**	**138910**	**109552**	**168515**				
Developing Economies									

Inward	130778	329328	433764	529344	620733	9.9	13	12.9	12.5
Outward	52929	122707	215282	285486	292710	4.1	6.5	7.1	6.1
Net FDI Inflow	**77849**	**206621**	**218482**	**243858**	**328023**				
World									
Inward	492674	973329	1461074	1978838	1697353	8.2	13.5	16.6	12.8
Outward	492528	878988	1396916	2146522	1857734	8.3	13.0	18.0	14.6
Net FDI Inflow	**146**	**94341**	**64158**	**-167684**	**-160381**				

Source: UNCTAD, World Investment Report 2009; Net FDI Inflow= Inward FDI flow Minus Outward FDI Flow.

Table 3: FDI Stock of Select Years

(Annual Average)

					Million Dollar	**As a Percentage of GDP**			
FDI Stock	**1990-2000**	**2005**	**2006**	**2007**	**2008**	**1990-2000**	**2006**	**2007**	**2008**
India									
Inward	1657	5641	17517	105429	123288	0.5	3.7	9.2	9.9
Outward	124	495	1859	44080	61765	-	0.4	3.9	5.0
Net FDI Stock	**1533**	**5146**	**15658**	**61349**	**61523**				
China									
Inward	20691	101098	193348	327087	378083	5.1	16.2	9.7	8.7
Outward	4455	17768	27768	95799	147949	1.1	2.3	2.8	3.4
Net FDI Stock	**16236**	**83330**	**165580**	**231288**	**230134**				
Pakistan									
Inward	1892	5408	6919	25621	31059	4.8	9.7	17.8	20.9
Outward	245	266	489	1238	1284	0.6	0.7	0.9	0.9
Net FDI Stock	**1647**	**5142**	**6430**	**24383**	**29775**				
South Asia									
Inward	6795	15320	31003	159799	186105	1.3	4.3	9.4	9.8
Outward	422	826	3075	47156	65297	0.1	0.4	2.8	3.5
Net FDI Stock	**6373**	**14494**	**27928**	**112643**	**120808**				
Asia and Oceania									
Inward	358412	578098	1079436	2843929	2583855	16.1	25.4	29.3	22.8
Outward	67710	210533	613815	1771086	1697259	3.3	14.8	18.6	15.3

Net FDI Stock	**290702**	**367565**	**465621**	**1072843**	**886596**				
Developing Economies									
Inward	529593	852489	1736167	4393354	4275982	13.8	25.1	29.3	24.7
Outward	145179	329927	862358	2360772	2356649	4.1	12.9	16.5	14.0
Net FDI Stock	**384414**	**522562**	**873809**	**2032582**	**1919333**				
World									
Inward	1942207	2915311	5757360	15660498	14909289	9.1	18.1	29.1	25.0
Outward	1785584	2941724	6069882	16226586	16205663	8.5	19.3	29.8	27.3
Net FDI Flow	**156623**	**-26413**	**-312522**	**-566088**	**-1296374**				

Source: UNCTAD, World Investment Report 2009

FDI stock of India has also registered a consistent growth over the period of study. Net FDI stock for the period 1990-2000 was 1533 Million US$ which rose to 61523 Million US$. However, net FDI stock of China is about 4 time than that of India. India's inward FDI stock to GDP ratio improved from 0.5 per cent for the 1990-2000 to 9.9 per cent by the year 2008. Similarly, ratio of outward FDI Stock to GDP for the corresponding period has registered a consistent rise and was at the level of 5 per cent in the year 2008 (Table 3).

Table 4: FDI Inflows: As per international best practices

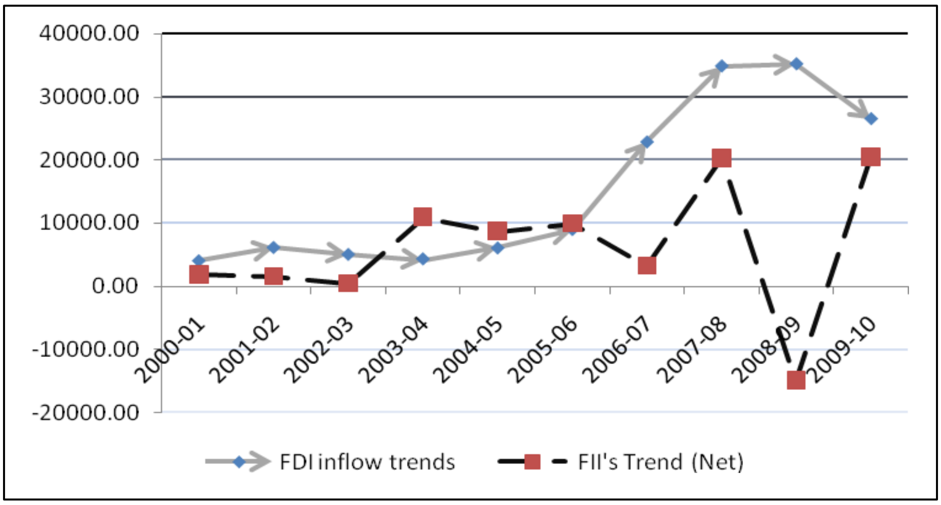
S. No		**FOREIGN DIRECT INVEST**				***Amount in US Million $***		
		Equity						
	Financial Year	**FIPB Route**	**Quantity Capital of Unincor-porated bodies**	**Rein-vested earnings**	**Other Capital**	**Total FDI Inflows**	**%age growth over previous year**	**Investment by FII's (Net)**
A	**1991-2000**	**15,483**	**-**	**-**	**-**	**15483**	**-**	**-**
B	**2001-2009**							
1	2000-01	2339	61	1350	279	**4029**		1847
2	2001-02	3904	191	1645	390	**6130**	(+) 52%	1505
3	2002-03	2574	190	1833	428	**5035**	(-)18%	377
4	2003-04	2197	32	1460	633	**4322**	(-)14%	10918
5	2004-05	3250	528	1904	369	**6051**	(+)40%	8686
6	2005-06	5540	438	2760	226	**8961**	(+)48%	9926
7	2006-07	15585	896	5828	517	**22826**	(+)155%	3225

8	2007-08	24573	2291	7679	292	**34835**	(+)53%	20328
9	2008-09	27329	666	6428	757	**35180**	(+)01%	-15017
10	2009-10	20734	770	3831	1169	**26506**	(-)25%	20518
Sub Total		**108025**	**6060**	**34718**	**5070**	**153875**		**62313**
Cumulative Total(A+B)		**123508**	**6060**	**34718**	**5070**	**168358**		

Source: Government of India (GOI) (2009). FDI Statistics, Ministry of Commerce & Industry, Department of Industrial Policy and Promotion.

FIPB Route has been the most important source of FDI inflow for India and has been reported at cumulative 1,23,508 Million US$ since 1991. For the period 1991-2000 and 2001-2009 FDI inflows though this FIPB route was 15,483 Million US$ and 1,08,025 US Million $ respectively which is seven time than previous decade. However, due to liberalization in economic policy of the government other routes of FDI are also becoming popular. For the corresponding period FDI inflow of reinvested earning has been 34,718 Million US$, which is about one-fifth of the total FDI inflow so far. This may be attributed to government initiatives of providing special tax benefits and other facilities for reinvestment of earnings. Trends of FDI and FII in India have been cyclical for the period under study (Diagram 1). For the financial year 2008-09 FDI growth was only 1% while for the financial year 2009-10 FDI growth was negative i.e. (-25%) due to global financial crisis followed by world wide recession (Table 4). Global financial crisis led to excess pressure on international liquidity which was responsible for FII's movement to south. Gradually FII are gaining confidence in Indian economy with economic recovery world wide.

Diagram 1: Trend of FDI inflows and FII in India



Source: Government of India (GOI) (2009). FDI Statistics, Ministry of Commerce & Industry, Department of Industrial Policy and Promotion.

Sector-wise FDI inflows

Sector-wise classification of FDI is essential to understand better structure and direction of foreign investment in the country.

Service sector has been the highest contributor of FDI inflow to India (22%) followed by compute software and hardware (9%), telecommunication (8%), housing and real estate (8%), construction activities and power (7%), (Table 5).

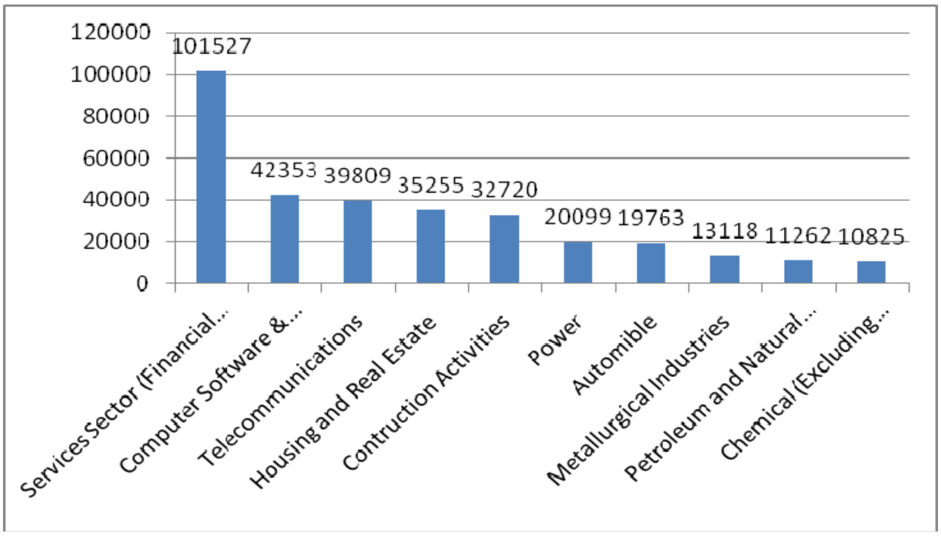
Net inward FDI into India remained buoyant during April-June of 2009-10 as manufacturing sector continued to attract most part of FDI (19.2 per cent), followed by real estate activities (15.6 per cent) and financial services (15.4 per cent). This trend reversal could be attributed to relatively better macroeconomic performance of India during 2008-09, continuing liberalisation measures to attract FDI and positive sentiments of global investors about the growth potential of EMEs, including India.

Table 5: Sectors attracting highest FDI Equity Inflows

Ranks	**Sector**	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**%age to total inflows (in terms of rupees)**
1	Services Sector (Financial and Non Financial)	21047	26589	28411	17074	22
2	Computer Software & Hardware	11786	5623	7329	2857	9
3	Telecommunications	2155	5103	11727	11442	8
4	Housing and Real Estate	2121	8749	12621	11472	8
5	Construction Activities	4424	6989	8792	10543	7
6	Power	713	3875	4382	6088	4
7	Automobile	1254	2697	5212	4696	4
8	Metallurgical Industries	7866	4686	4157	1613	3
9	Petroleum and Natural Gas	401	5729	1931	1085	2
10	Chemical (Excluding Fertilizers	930	920	3427	1258	2

Source: Government of India (GOI) (2009). FDI Statistics, Ministry of Commerce & Industry, Department of Industrial Policy and Promotion.

Diagram 2: Sector wise cumulative inflows (1990-91 to 2009-10)



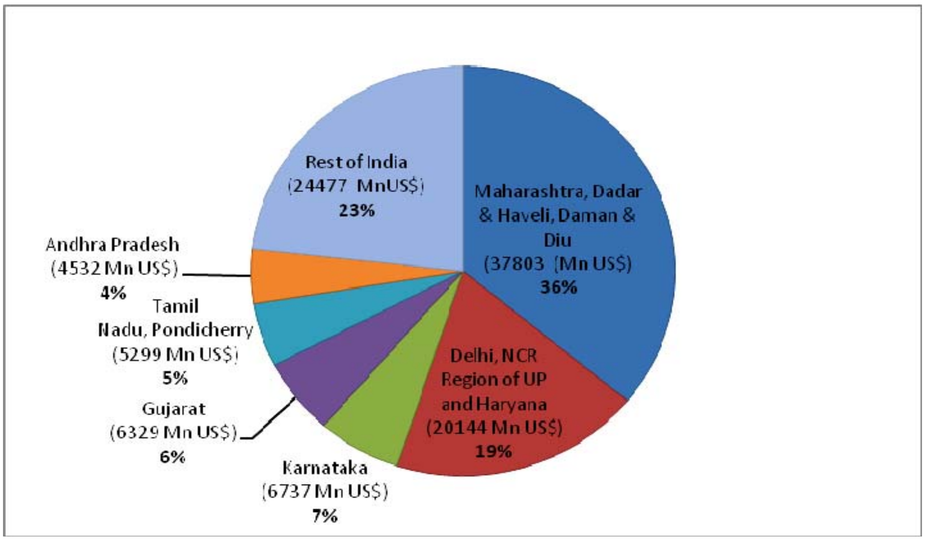
Source: Government of India (GOI) (2009). FDI Statistics, Ministry of Commerce & Industry, Department of Industrial Policy and Promotion.

India evolved as one of the most favoured destination for investment in the service sector due to low cost wages and wide demand-supply gap in financial services particularly in banking, insurance and telecommunication. Gradually India has become important centre for back-office processing, call centers, technical support, medical transcriptions, knowledge process outsourcing (KPOs), financial analysis and business processing hub for financial services and insurance claims. However due to increased completion, rising wages and other costs has caused Indian firms to face tough times.

Geographical Distribution of FDI inflows

Balanced geographical distribution of FDI inflows could have been instrumental in achieving sustainable growth. However, there seems to wide concentration of FDI inflows around Mumbai Region (36%) followed by New Delhi Region (19%), Karnataka (6%), Gujarat (6 %), Tamil Nadu (5%) and Andhra Pradesh (4%), (Diagram 3). It is alarming that these regions receive 77% of FDI equity inflow while rest of India accounts for only 23%. Lack of proper initiative from the various state governments is responsible for wide disparities of foreign investments. These states are also backward in terms of skilled manpower and infrastructure.

Diagram 3: Geographical Distribution of FDI Inflows: April 2000 to December 2009 (Cumulative)



Foreign Technology Transfers

Cumulative foreign technology transfer so far has been 8,080 during the period 1991 to 2009. USA contributes 1832 technical collaboration followed by Germany 1,115, Japan 879, U.K. 874, Italy 488 and other counties 2,892 (Diagram 4). 52% of foreign technology transfer to India is concentrated to five sectors only while 48% to other sectors (Diagram 5). Five states Maharashtra, Tamil Nadu, Gujarat, Karnataka and Haryana have the credit of 45% of the technology transfers to India (Diagram 6).

Daigram 4: Country-Wise foreign technology approvals

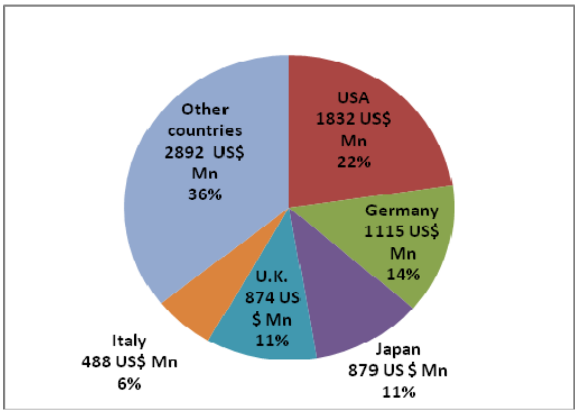


Diagram 5: Sector –wise foreign technology transfer approvals

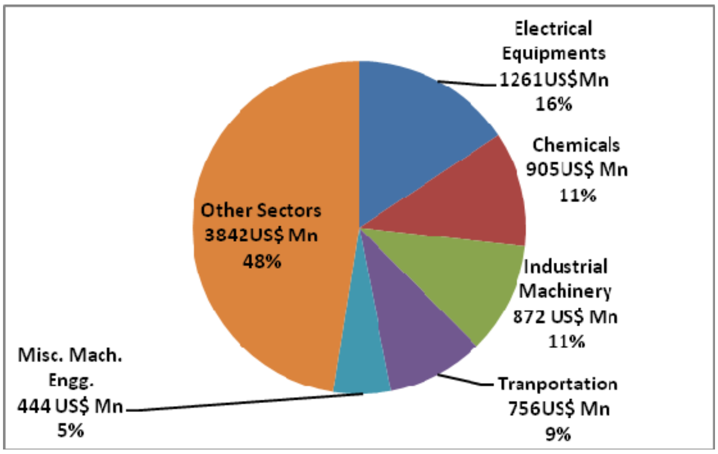
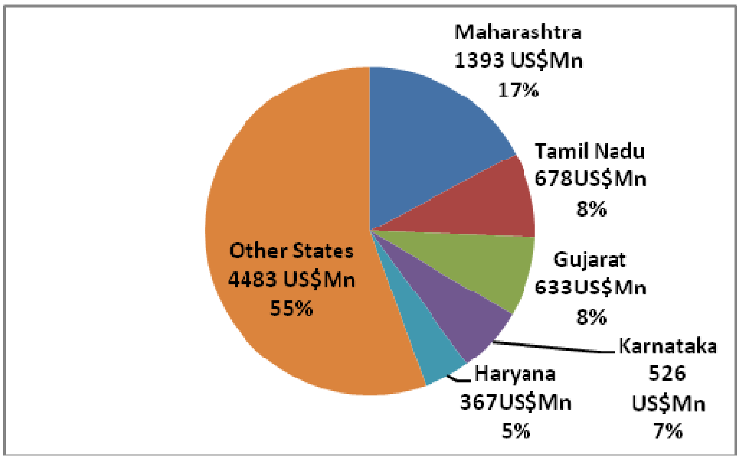


Diagram 6: Geographical Distribution of foreign Technology Transfer



Maharashtra Region attracts FDI in energy, transportation, services, telecommunication and electrical equipment. Delhi and NCR attracts FDI inflows in telecommunications, transportation, electrical equipment (including software) and services. While Haryana emerged as a preferred destination for electrical equipment, transportation and food processing, Tamil Nadu has been successful in attracting FDI in automotive related and auto components sector. Andhra Pradesh and Karnataka emerged as a popular destination for software, computer hardware and telecommunication. India's rural areas such as Orissa has also been successful in attracting FDI in securing large Greenfields FDI projects in bauxite, mining, aluminum and automotive facilities.

Review of FDI's Policy

The Government of India (GoI) has been selective in opening various sectors for FDI. Gradually different sectors were opened for investment in FDI with varying rates of sectoral caps. GoI is trying best to introduce simple and transparent FDI policy. The policy seems to reduce regional disparities, protect the interest of small retailers and health hazard of its citizens due to foreign investment. The area which are of strategic importance are not opened for FDI under automatic route.

However, the GoI has taken number of measures to boost FDI inflow. Besides, allowing FDI in new sectors, the need of multiple approvals from government and regulatory agencies that exists in certain sector has been given up. FDI upto 100 per cert is allowed under automatic route in most sectors and no approval is required either from government or RBI. Investors are only required to notify within 30 days to concerned regional RBI office. In some sector such as air transportation services there is cap of 49% (no restriction for NRI investment), and FDI in insurance sector though under automatic route there is a cap of 49%. FDI is not permitted in retail trade (except single brand product with a cap of 51% only), lottery, gambling and atomic energy is not permitted.

The government has also broadened list of sector for automatic route. In the New Industrial Policy, all industrial undertakings are exempt from licensing except for Atomic Energy, Railway transport, distillation and brewing of alcoholic drinks, cigars and cigarettes, manufactured tobacco substitutes, Industrial explosives hazardous, chemicals, drugs and pharmaceuticals and those reserved for the small scale sector (Annexure I and II of Manual on FDI in India, 2003).

The project should not be located within 25 kilometers of a city with a population of more than one million as per 1991 Population Census. The Government has substantially liberalised the procedures for obtaining an Industrial License. The application in form IL-FC should be filed with the SIA. Approvals normally granted within 6-8 weeks. An Industrial undertaking exempted from licensing needs only to file information in the Industrial Entrepreneurs Memorandum (IEM) with the SIA, which will issue an acknowledgement. No further approvals are required.

Given the federal structure of India, states are also partners in the economic reforms of the country. So many states are simplifying the rules and procedures for setting up and operating the industrial units. Single Window System is now in existence in most of the states for granting approval to set up industrial units. Moreover, with a view to attract foreign investors in their states, many of them are offering incentive packages in the form of various tax concessions, capital and interest subsidies, reduced power tariff, land at low cost etc.

Foreign Investment through GDRs/ADRs, Foreign Currency Convertible Bonds (FCCBs) are treated as FDI. Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ADRs/FCCBs. These are not subject to any ceilings on investment. An applicant company seeking Government's approval in this regard should have a consistent track record for good performance (financial or otherwise) for a minimum period of 3 years. This condition can be relaxed for infrastructure projects such as power generation, telecommunication, petroleum exploration and refining, ports, airports and roads. There is no restriction on the number of GDRs/ADRs/FCCBs to be floated by a company or a group of companies in a financial year.

The Reserve Bank of India, through its regional offices, accords automatic approval to all industries for foreign technology collaboration agreements subject to (i) the lump sum payments not exceeding US $ 2 Million; (ii) royalty payable being limited to 5 per cent for domestic sales and 8 per cent for exports, subject to a total payment of 8 per cent on sales over a 10 year period; and (iii) the period for payment of royalty not exceeding 7 years from the date of commencement of commercial production, or 10 years from the date of agreement, whichever is earlier

FDI issues and Policy Recommendation

- India is striving hard to achieve a growth rate of 10%. Improving the level of productivity can be instrumental in achieving this target as growth rate is positively related to rates of return. The available data on FDI reveals that India's volume of FDI has increase largely due to Merger and Acquisitions (M&As) rather than large Greenfields projects. M&As not necessarily imply infusion of new capital into a country if it is through reinvested earnings and intra-company loans. Business friendly environment must be created on priority to attract large Greenfields projects. Regulations should be simplified so that realization ratio is improved (Percentage of FDI approvals to actual flows). To maximize the benefits of FDI persistently India should also focus on developing human capital and technology.
- India has failed to evolve as inward FDI manufacturing destination which is sweetest of all sources of FDI. Manufacturing investment has potentiality to develop ancillary industries also. There is a wide spread under employment in agriculture. Manufacturing sector has greater scope of low end, labour intensive manufacturing jobs for unskilled population when compared with service sector. It is widely reported in large number of studies that India lags behind in terms of business environment (ranked 72 of 82 countries by EIU, 2007) which is not conducive for doing business. These factors are acute labour market rigidities, lack of world class ports, airports, road and on an average 6-7 hours of power cuts. Other problems are that of norms of registering property, protection of investors, excessive bureaucracy, lack of rationale tax structure, competition rules and time taken in enforcing contracts (1420 days with a cost average cost of two-fifth of claim).
- The issues of geographical disparities of FDI in India need to address on priority. India is a federal country consisting of States and Union Territories. States are also partners in the economic reforms. Many states are making serious efforts to simplify regulations for setting up and operating the industrial units. In order to attract foreign investors in their states, many of them are offering packages in the form of tax rebates, capital and interest subsidies, reduced power tariff, etc. However, efforts by many state governments are still not encouraging. Even the state like West Bengal which was once called Manchester of India attracts only 1.2% of FDI inflow in the country. West Bengal, Bihar, Jharkhand, Chhattisgarh are endowed with rich minerals but due to lack of proper initiatives by governments of these states, they fail to attract FDI.India is striving hard to achieve a growth rate of 10%. Improving the level of productivity can be instrumental in achieving this target as growth rate is positively related to rates of return. The available data on FDI reveals that India's volume of FDI has increase largely due to Merger and Acquisitions (M&As) rather than large Greenfields projects. M&As not necessarily imply infusion of new capital into a country if it is through reinvested earnings and intracompany loans. Business friendly

environment must be created on priority to attract large Greenfields projects. Regulations should be simplified so that realization ratio is improved (Percentage of FDI approvals to actual flows). To maximize the benefits of FDI persistently India should also focus on developing human capital and technology.

- Mauritius contributes about 44% of FDI inflow in the country. Such a high level of FDI contributed by a low tax country like Mauritius indicates that all is not well. Mauritius have agreement with India on avoidance of double taxation. There are likely chances that many MNCs may be first dummy companies in Mauritius before investing in India. This is not good for financial stability of the country and is also a reason for loss to state exchequers.
- FDI can be instrumental in developing rural economy. There is abundance opportunity in Greenfield Projects. But the issue of land acquisition and steps taken to protect local interests by the various state governments are not encouraging. MOU Arecelor-Mittal controversy is one of the best examples of such disputes.
- India has a huge pool of working population. However, due to poor quality primary education and higher there is still an acute shortage of talent. This factor has negative repercussion on domestic and foreign business. FDI in Education Sector is less than 1%. Given the status of primary and higher education in the country, FDI in this sector must be encouraged. However, appropriate measure must be taken to ensure quality. The issues of commercialization of education, regional gap and structural gap have to be addressed on priority.
- Indian economy is largely agriculture based. There is plenty of scope in food processing, agriculture services and agriculture machinery. FDI in this sector should be encouraged. The issue of food security, interest of small farmers and marginal farmers need cannot be ignored for the shake of mobilization of foreign funds for development.
- India has a well developed equity market but does not have a well developed debt market. Steps should be taken to improve the depth and liquidity of debt market as many companies may prefer leveraged investment rather than investing their own cash. Looking for debt funds in their own country invites exchange rate risk.
- In order to improve technological competitiveness of India, FDI into R&D should be promoted. Various issues pending relating to Intellectual Property Rights, Copy Rights and Patents need to be addressed on priority. Special package can be also instrumental in mobilizing FDI in R&D.
- Though service sector is one of the major sources of mobilizing FDI to India, plenty of scope exists. Still we find the financial inclusion is missing. Large part of population still doesn't have bank accounts, insurance of any kind, underinsurance etc. These problems could be addressed by making service sector more competitive. Removal of sectoral cap in insurance is still awaited.

CONCLUSION

FDI can complement local development by boosting export competitiveness, employment generation and strengthening skills, transfer-diffusion-generation of technology and enhanced financial resources for development. According to report Global Competitive Index (2007-08) published by World Economic Forum (WEF), India is has been ranked at 48 out of 131 countries. It is worth noting that India is ranked poorer than economies of Asia with which India competes i.e. China (34th rank), Taiwan & Singapore (14th rank) and Thailand (28th rank). India is attracting a low level of FDI largely due to poor business environment prevailing in the country. The investment climate in India has become much friendlier today than previous decades. Infrastructure is being developed and FDI policy is being liberalized to improve the situation. However, a lot is to be done if we want to emerge as one of the major export oriented manufacturing hub.

Investors are showing their growing confidence in the immediate and medium term prospects of Indian Economy. FDI off course might be one of the important sources of financing the economic development. However, one should not forget that FDI alone is not a solution for poverty eradication, unemployment and other economic ills. India needs a massive investment to achieve the goals of vision 20-20. Policy makers need to ensure transparency and consistency in policy making along with comprehensive long term development strategy.

REFERENCES

Asher, M.G. (2007). "India's Rising Role in Asia", http://www.spp.nus.edu.sg/wp/wp0701b.pdf

Athreye, S. and S. Kapur (2001). "Private Foreign Investment in India: Pain or Panacea?" The World Economy, 24, pp.399-424.

Agosin, M. and R. Mayer (2000). "Foreign investment in Developing Countries: Does it Crowd in Domestic Investment?" Discussion Paper No.146, UNCTAD, Geneva.

Blomström, M. and A. Kokko (2003). "The Economics of Foreign Direct Investment Incentives", Working Paper No.9489, NBER.

Borensztein, E., J. De Gregorio and J. Lee (1995). "How does Foreign Direct Investment Affect Growth", Journal of International Economics, 45, pp.115-135.

Blomström, M., R. Lipsey and M. Zejan (1994). "Host Country Competition and Technology Transfer by Multinationals", Weltwirtschaftliches Archiv, 130, pp.521-533.

Daisuke, H. (2008). "Japan's Outward FDI in the Era of Globalization", in R.S. Rajan, R. Kumar and N. Vargill, eds. (2008) "New Dimensions of Economic Globalization: Surge of Outward FDI from Asia", World Scientific Press, Chapter 4.

Dua, P. and A.I. Rasheed (1998). "Foreign Direct Investment and Economic Activity in India", Indian Economic Review, 33, pp.153-168.

Foreign Direct Investment Policy (2006), department of Industrial policy and promotion, Ministry of Commerce and Industry, Government of India.

Government of India (GOI) (2009). FDI Statistics, Ministry of Commerce & Industry, Department of Industrial Policy and Promotion.

Government of India (GOI) (2007). FDI Statistics, Ministry of Commerce & Industry, Department of Industrial Policy and Promotion.

Government of India (GOI), (2006). Foreign Direct Investment Policy, Ministry of Commerce and Industry, Department of Industrial Policy and Promotion.

Organisation of Economic Cooperation and Development (OECD) (2002). Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs, Paris: OECD, Chapters 1 and 3.

Rajan, R.S., R. Kumar and N. Vargill, eds. (2008) "New Dimensions of Economic Globalization: Surge of Outward FDI from Asia", World Scientific Press.

Ramkishen S. Rajana, Sunil Rongalab and Ramya Ghoshc,(2008), "Attracting Foreign Direct Investment FDI) to India",World Scientific Press.

Tseng, W. and H. Zebregs (2002). "Foreign Direct Investment in China: Some Lessons for Other Countries", Policy Discussion Paper No.02/3, IMF.

The Economist Intelligence Unit (EIU) (2007). World Investment Prospects to 2011, EIU, London.

Te Velde, D.W. (2001). Policies Towards Foreign Direct Investment in Developing Countries: Emerging Issues and Outstanding Issues, London: Overseas Development Institute.

UNCTAD, World Investment Report 2009; http://www.unctad.org/fdistatistics/ www.unctad.org/wir

UNCTAD (1999). World Investment Report 1999, New York and Geneva: Oxford University Press.

World Economic Forum (2007). Global Competitiveness Index 2007-08, World Economic Forum, Davos.