FOREIGN DIRECT INVESTMENT AND ITS IMPACT ON INDIAN ECONOMY - A CRITICAL ANALYSIS

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ABSTRACT: Developing countries, especially those in Asia, have witnessed an enormous increase in FDI inflows over the past two decades with the initiation of globalization. Despite the fact that India adopted FDI much late as compared to other East Asian countries, India’s potential market and liberalization policy make it a favorite destination for every foreign investor. This research paper aims to examine the impact of FDI on the Indian economy, especially, when economic reforms have taken place and it critically analyzes the challenges of being at a favorable position in the global market relating to FDI and its approach to deal with the competition relating to FDI after introduction of globalization. Additionally, it interprets the complexities of FDI data in India, the paper provides the implementation of major policies of this analysis.

Key Words:...

Introduction

When a company controls (or has a strong say in) another company located abroad, e.g. owing more than 10% of its equity, the former is called "parent company" (or "investor") and the latter is called "foreign affiliate." For a country, attracting an FDI inflow reinforces the connection to global trade networks and finances its path of development. However, a country’s unilateral substantial FDI may make it dependent on the external pressure foreign owners may exert on it. Foreign investment plays a major role in Indian economy development. Many countries offer numerous incentives to attract foreign direct investment (FDI). The need for FDI in any country depends on savings and investment rates. Foreign Direct investment serves as a bridge to bridge the investment-saving gap. Foreign capital helps cover the domestic saving constraint in the process of economic development and provides access to the superior technology that promotes efficiency and productivity of existing production capacity and generates new production opportunities.

FOREIGN DIRECT INVESTMENT IN INDIA

FDI AND ECONOMIC GROWTH

With the establishment of Britain’s East India Company, the historical background of FDI in India can be traced back. During the British colonial era in India, British capital came to India. Japanese firms entered the Indian market after World War II and increased their trade with India, yet U.K. He remained India’s most dominant investor. Furthermore, MNCs operations gained the attention of policy makers after independence issues related to foreign capital.2 Bearing in mind the national interests, the policymakers designed the FDI policy aimed at FDI as a medium for the acquisition of advanced technology and the mobilization of foreign resource. There have also been changes in the FDI policy with time and according to economic and political regimes. 1965’s industrial policy enabled MNCs to venture in India through technical cooperation. Thus, by allowing more frequent equity, the government adopted a liberal attitude. The macro-economic stabilization and structural adjustment program was introduced by the World Bank and the IMF. As a result of these reforms, India is opening its door to FDI inflows and pursuing a more liberal foreign policy to restore foreign investor confidence. In addition, FIPB (Foreign Investment Promotion Board), whose main function was to invite and facilitate foreign investment, was established under India’s new...
foreign investment policy government.3 A recent UNCTAD survey, starting from a baseline of less than USD 1 billion in 1990, projected India as the second most important FDI destination (after China) for transnational corporations in 2010-2012. According to the data, services, telecommunications, construction activities and computer software and hardware were the sectors that attracted higher inflows. Mauritius, Singapore, the United States and the United Kingdom were among the country's leading FDI sources.4 FDI for 2009-10 was down from US$ 27.33 billion in the previous fiscal year by five percent at US$ 25.88 billion.5 Foreign direct investment dropped to approx. 60% in August. Data from the Department of Industry showed US$ 34 billion, the lowest in fiscal 2010. In the first two months of fiscal year 2010-11, FDI inflows into India were up 77 percent from US$ 4.4 billion over the corresponding period of the previous year at an all-time high of US$ 7.78 billion. In 2013, in several sectors, including telecom, defense, PSU oil refiners, power exchanges, and stock exchanges, the government relaxed FDI standards. In retail, in collaboration with Tata Group’s Trent, UK-based Tesco submitted its application to initially invest US$ 110 million to start a supermarket chain. Air Asia and Singapore Airlines, based in Malaysia, have teamed up with Tata Group in civil aviation to launch two new airline services. Etihad, based in Abu Dhabi, also acquired a 24% stake in Jet Airways worth more than Rs 2,000 crore (US$ 319.39 million). Since 2000, India has received a total foreign investment of US$ 306.88 billion, with 94% of the total coming over the last nine years. India received $19.52 billion in foreign investment in the period 1999–2004. Foreign investment in the country touched US$ 114.55 billion in the period 2004–09, up from 2009–September 2013 to US$ 172.82 billion. India attracted US$ 22.42 billion worth of FDI during the 2012–13 fiscal years. Among the biggest beneficiaries were tourism, pharmaceuticals, services, chemicals and construction. According to a survey by tax consultant Grant Thornton, the January - November period in 2013 saw mergers and acquisitions transactions worth US$ 26.76 billion in India.6

RECENT DEVELOPMENTS

New Zealand is basically planning to set up a Mumbai office with the intention to expand its business relating to provide international education to the Indian students. It is in the process of establishing relationship with the New Zealand Consulate General, Mumbai, with the objectives to promote education and market development. They are issuing student visa to Indian students for providing education in New Zealand in 2013 which has been increased by more than 10 percent, now, New Zealand has become fast growing student market. Korean South-East Power Company (KOSEP), which is a part of South Korea's state-owned power generator Korea Electric Power Corporation, has entered into an initial technical support agreement with Jinhuvish Group, Mumbai, for Rs 3, 450-crore (US$ 549.31 million) project located in Maharashtra. It has been expected that the 600 megawatt (mw) power plant will be established in 2016, which is going to be set up in Yavatmal district. India and UAE have entered into an agreement to promote renewable energy collaboration, which focuses on wind and solar energy. Dr Farooq Abdullah, Minister of New and Renewable Energy of India, and Dr Sultan Ahmed Al Jaber, Minister of State of the UAE in Abu Dhabi, signed a Memorandum of Understanding (MoU) dated on 18 January 2014. Swiss luxury watch brand Jaeger-LeCoultre has made an application to enter the Indian retail market for a 100% single-brand application. By this route, it has become the first luxury company to make an application for FDI. The application was submitted to the Department of Industrial Policy and Promotion (DIPP) by Richemont SA, Geneva, which has owned the luxury brand France’s Lactalis, which is the world’s largest group of dairy products, with the object to purchase Tirumala Milk Products based in Hyderabad for US$ 275–300 million. Lactalis has an annual turnover of approximately $21 billion.Tirumala's turnover for FY 2012–13 was Rs 1, 424 crore (US$ 226.71 million). Founded in 1998, the Hyderabad Company manufactures dairy products such as sweets, flavored milk, curd, icecream, etc.7

RECENT POLICY INITIATIVES

The Ministry of Home Affairs granted the proposal for permitting FDI on the railways. The proposal is expected to be considered by the Cabinet Economic Affairs Committee (CCEA). Only Foreign investors can

3 ibid
5 GYANPRATHA – ACCMAN (Journal of Management, Volume 5 Issue 1, 2013)
7 Ms. Sapna hooda (2011) a study of FDI and Indian Economy;Doctor of philosophy from national institute of technology(deemed university) Haryana.
invest in railway project for construction and maintenance, not in operations. India’s Prime Minister, Mr Manmohan Singh, has made an increment for the country’s Japanese investment. In case of manufacturing and research and development in the electronic industry and energy-efficient and energy-saving technologies, the two countries are in the consideration relating to the possibility of concrete cooperation. “I think our business ties have enormous untapped potential,” Mr Singh pointed out after the Japan-India annual summit level meeting. Japanese companies’ presence in India extended in 2013 by 16 percent. The Andhra Pradesh State Investment Promotion State Investment Promotion Board has approved six major investment proposals that will total Rs 6,500 crore (US$ 1.03 billion) investment. The proposals make an inclusion for those who are from multinationals like PepsiCo, Cadbury, Colgate, Johnson & Johnson, Gerdau Steels and ITC. PepsiCo’s unit will be treated India’s largest drink plant with Rs 1, 200 crore (US$ 191.06 million) investment. Again, after making investment of Rs 2, 500 crore (US$ 398.07 million), Cadbury has constituted its facility in Sri City. In order to improve capital flows into the country, the Indian government has been given permission of 100% FDI under automatic storage and warehousing route, it has included refrigerated warehousing of agricultural products. The government has also constituted a National Center for Cold Chain Development (NCCD) to examine cold chain infrastructure standards and protocols. The Foreign Investment Promotion Board (FIPB) recommended on 30 December 2013, the Indian government approximately agreed to five FDI proposals of Rs 1133.41 (US$ 180.16 million). It also makes an approval of approximately 12 FDI proposals which amounts to Rs 821.63 crore (US$ 130.73 million) on November 13, 2013. The FIPB also makes an approval to the proposal by Swedish major clothing Hennes & Mauritz (H&M) AB to open 50 stores throughout India. The investment is about Rs 720 crore (US$ 114.61 million).

POLICY RECOMMENDATIONS

The fact that India receives FDI inflows far below its potential is not denied. The Indian government has taken several steps to simplify and transparent FDI policies, increased FDI limits in various sectors, opened up many new sectors for FDI, and put many sectors on the automatic route of approval. Despite all this, India is receiving much less FDI compared to China and Brazil’s developing economies. India is likely to lose its comparative advantage to the newly emerging low-cost economies of Indonesia, Vietnam and the Philippines in lower labor costs and large domestic markets. If some reform measures are not implemented quickly, it is likely that the form of reality will soon take shape. Indeed, India ranks 60 out of 148 countries in the Global Competitive Report 2013-14, well below other developing economies such as Malaysia (rank 24), China (rank 29), Thailand (rank 37), Indonesia (rank 38), Turkey (rank 44), South Africa (rank 53), Mexico (rank 55), Brazil (rank 56) and the Philippines (rank 59).

It is high time; therefore, that India learned some lessons from other countries and started reforms in the second generation. Labor reforms; the liberalization of FDI policies in sectors such as retail, insurance, airports and the media; the introduction of Goods Sales Tax to avoid multiple taxes; the reduction of corporate tax rates; the reduction of bureaucratic hurdles; and the simplification of regulatory procedures and the development of world-class infrastructure. India can expect to attract larger FDI flows in the years to come only by implementing these reforms.8

FUTURE OUTLOOK

India is estimated to require around $1 trillion in funding for infrastructure in sectors such as roads, airports and ports during the 12th Five-Year Plan Period (2012-17). The government is in the process of liberalizing FDI standards in construction and railway activities, which could result in investment to achieve the goal. The government also relaxes FDI standards for foreign investors to invest in other sectors. Up to 51 percent of FDI was allowed in multi-brand retail. The FDI’s minimum requirement is US$100 million, of which at least 50% must be invested in ‘backend infrastructure’ within three years of the FDI’s launch.9

CURRENT CHALLENGES

Indeed, India is one of the profitable place for FDI, but some challenges and areas for improvement has remained untouched. Until these areas are upgraded perfectly, India has become FDI’s number one

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8 “Analysis of inflows of Foreign Direct Investment in India-Problems and Challenges” by Priyanka Bedi and Ekta Kharbanda; Global journal of Finance and management vol6,no-7(2014),pp-675-684
9 Indian Economic Review, Vol. XXXXII, No.2
place. India, with its regulatory environment, focuses on that political and social stability should be maximized. Despite of having the obvious advantages of FDIs, large FDIs in India faces few challenges, such as:

**RESOURCE CHALLENGE**

It is known that India has large amounts of resources. Fixed and working capital is made for manpower and significant availability. Similarly, some resources are in the concept of underexploited or unexploited. In rural as well as urban areas, the resources are easily available. The focus is to increase infrastructure 10 years down the line, for this reason there is requirement of approximately US$ 150 billion. This is the initial step towards addressing the challenges faced by larger FDI.  

**EQUITY CHALLENGE**

India is developing at higher pace now than before, but it can still be seen that developments have occurred unevenly. This means that the poorer sections are insufficiently exploited while the more urban areas have been tapped. It is important to ensure that the rural section has more or less the same amount of development as the urbanized ones in order to get the complete growth. Similarly, it is promoting social equality and balancing economic growth at the same time.  

**POLITICAL CHALLENGE**

The political structure has become supportive towards the foreign investing countries. This can be done by making their persuasion by foreign investors in order to increase FDI capital in several sectors such as banking and insurance. There must be a common ground between Parliament and foreign countries which is investing in India. This would increase the country's FDI area reforms.  

**FEDERAL CHALLENGE**

The need to make improvement for the implementation of policies, rules and regulations which is very important among the major draw backs facing by larger FDI. The vital part is to balance parallel policy implementation in all Indian states. It is therefore important to call for equal speed in the establishment of policies among the states in India.  

**WEAK INFRASTRUCTURE**

Bottlenecks in infrastructure has become major cause of concern in India. India is not opposed to other markets which are emerging in terms of ports, roads, skills sets, education, etc, in case of competition. Even after six decades of planned economic development, India is facing challenges relating to poor transport connections, inadequate power supply, poor roads, frequent power cuts, ports delays, water and sewerage problems, etc. A study made by the Indian Chambers of Commerce and Industry Federation in 2013 revealed that Indian companies lose up to Rs. 40,000 every day due to power shortages; and that 61 percent of companies suffer more than 10 percent production loss due to power cuts.  

**COMPLICATED TAX STRUCTURE**

Stability along with transparency in the tax regime, clarity in tax legislation, can have most effective investment in any country. Indian tax policies remain complex despite the fact that various steps have been taken by the government to make it simple and redesign it. India has witnessed number of tax disputes over international transactions involving large MNCs in current years. In 2011-12, 30 corporations consist of the BSE Sensex had USD 7 billion dogged in tax law suits, according to a report. Again, while corporate tax rates in most nations varies from 15% to 25%, in India foreign firms are taxed at 40% it also includes tax holidays for qualified tax payers, the corporate tax rate for foreign companies is 25 percent in China. India's indirect tax regime is also very complex, imposing multiple taxes such as central sales tax, VAT, service tax, central  

11 ibid  
12 ibid  
13 ibid  
14"Analysis of inflows of Foreign Direct Investment in India-Problems and Challenges" by Priyanka Bedi and Ekta Kharbanda; Global journal of Finance and management vol 6, no 7 (2014), pp 675-684
excise duty, grants etc. and calling for a number of compliances to increase the burden on businesses. In addition, tax rates across the countries are not uniform; it is increasing the complexity of taxpayers.15

RESTRICTIVE LABOR LAWS
India is known around the world for its strict, rigid labor laws and over-regulated labor market. Over the following years, the Indian government has presented an enactment to wide range of legislation for protection labor interests covering various aspects such as wage fixing and revision, worker health and safety, wage payment methods, payment of compensation in the event of an industrial accident, social security provision such as provident funds, gratuity, insurance, etc. Because of these laws, the Indian economy has become inflexible. These laws contain complex rules on overtime and impose financial obligation upon retribution of the worker on the employer.16

CORRUPTION, REGULATION
India also needs to focus on reduction of poverty, liberalization of trade, and liberalization of banking and insurance. Challenges faced by larger FDIs are not restricted to those mentioned above, as trade relations with foreign investors will always bring new investment challenges. Bureaucracy, red tapestry and corruption are problems that India suffers from. Obtaining licenses, approvals and permits takes long time. It takes a company 67 days to obtain electricity connection, 16 days to obtain clearances and export goods from India, 182 days to deal with building permits and 1420 days to constitute contracts, according to the doing business report. As compared to a few days in most developed and developing markets, it takes 4 to 8 weeks for a new company to make registration in India. The FDI approvals are held pending for months many times, which makes the investor to drop out. As far as FDI policies are concerned, although the government has taken several liberalization measures, FDI regulations remain restrictive as compared to many other nations. India has been subject to sector caps ranging from 20% to 100% in opening sectors for FDI and FDI in India. The 2013 OECD-prepared and published FDI Regulatory Restrictiveness Index ranked India 6th out of 58 countries (indicate restrictive FDI policies). Once again, there is corruption at great level in India; licenses, clearances, and contracts are given on bribes, not on merit basis. Uncertain government policies and frequent changes in them, inefficient administration, overlapping jurisdictions, excessive governance increases transaction costs for businesses that make India a less preferred place.17

The aggregate FDI inflow, which in 2005 amounted to US$ 6051 million, increased to US$ 37745 million in 2010. FDI inflows increased over the base year 2005 at a high growth rate of 158.60 in 2008. After analyzing FDI’s aggregate inflow behavior, it is concluded that FDI’s inflow has increased with a high rate of growth between 2005 and 2008. The FDI inflow in India as shown in Table 2 shows that in 2015 they have risen to US$ 44291 million compared to US$ 34847 million in 2011. FDI inflows declined in 2013 and 2014 compared to the 2011 year.

Despite all these measures, India’s FDI inflows remained low compared to other emerging economies, particularly China. India took fifth place in the 2013 Foreign Direct Investment Confidence Index, a survey carried out by a US consultancy firm A.T. Kearney with over 300 executives from 28 countries. U.S., China, Brazil and Canada respectively bagged the 1st, 2nd, 3rd and 4th place. Similarly, India ranked 15th among the top twenty host economies in 2012 in the 2013 World Investment Report. As the most attractive destination, emerging economies such as China, Brazil, Hong Kong, and Mexico surpassed India. While China and Brazil remain the main competitors, some new countries, namely Indonesia, Vietnam, Mexico, South Africa, the Philippines and Myanmar, are competing hard for India.18

CONCLUSION
India’s FDI policy has been gradually liberalized to make the market friendlier to investors. The findings were encouraging. According to a United Nations (UN) report, the country is consistently ranked by all international bodies, including the World Bank, among the top three global investment destinations. FDI has had a positive impact on an Indian economy that has tremendous potential. Inflow of FDI supplements domestic capital, as well as existing companies’ technology and skills. It also helps to set up new businesses. All of these contribute to the Indian economy’s economic growth.

15 ibid
16 ibid
17 ibid
18 FDI in India by Anil Duggar published in Journal of Internet Banking and Commerce (2017)