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FOREIGN DIRECT INVESTMENT IN INDIA

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Abstract

Apart from being a critical driver of economic growth, foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. For a country where foreign investments are being made, it also means achieving technical know-how and generating employment.

Foreign Direct Investments (FDIs) have given the Indian economy a tremendous boost. While India needs these investments to maintain a steady rate of economic growth, the government needs to tread with caution and ensure foreign investors do not take control of the Indian economy as a result of its liberalized policies. The country today needs a comprehensive and inclusive development strategy, which will use foreign direct investment to lift India's poor from their current state of deprivation

Introduction

Foreign direct investment, or FDI, is a company's physical investment into building a plant in another country, acquisition of a foreign firm or investment in a joint venture or strategic alliance with a foreign company in its local market. Global foreign investment flows have exceeded $1 trillion in the 21st century -- from $14 billion in the 1970s -- according to the United Nations Conference on Trade and Development. These investments impact the host country and the home country of the investing business. Small businesses experience the effects of FDI by hosting foreign companies in their local markets or by investing internationally.

Advantages of FDI Inflows

Investment of a foreign company can provide new technologies, capital, products, organizational technologies, management skills and potential cooperation and business opportunities for local businesses.

Disadvantages of FDI Inflows

Investment of a foreign company with its new technologies and products has several disadvantages for local businesses. New products arriving at lower prices create competition and force local businesses to lower their prices and reorganize their operations in terms of costs. Local businesses may lose their customers or even their business relations with other companies as they start cooperating with the new foreign one.

Advantages of FDI Outflows

A foreign investment by an indigenous company has positive effects at home. As it concentrates part of its operations abroad, the company may not expand its activities in the local market at the same time, so it leaves more business opportunities and more potential customers for the small businesses that remain. A domestic business that invests overseas may bring new technologies to its home market or may need new business operations with small businesses to complement its activities abroad.

Disadvantages of FDI Outflows

Imagine an multinational company builds a new factory in other country because of lower work force and resource costs and brings new products and techniques back home at low prices. This action sparks stronger competition in the home market for local businesses: Small businesses compete against more effectively operating companies and their products and services that have backups from abroad and may not be sensitive to changes in resource prices and wages in the local market.

The importance of FDI

FDI plays a very important role in the development of an economy due to a number of reasons, some of which are listed below:

- Helps to avoid foreign government pressure for local production.
- Aids in circumventing trade barriers, hidden and otherwise.
- Enables making the move from domestic export sales to a locally-based national sales office.
- Helps in increasing the total production capacity.
- Presents greater opportunities for co-production, joint ventures with local partners, joint marketing arrangements, licensing, etc.

Pros of FDI

In the global economy today, we see many developing countries competing for foreign direct investment. FDI is said to be an important factor for spurring the development of a nation. Let's take a look at some of the advantages of foreign direct investment for a nation.

Integration into the global economy

A developing country, which invites FDI, can gain a greater foothold in the world economy by getting access to a wider global market. Technology advancement. FDI can introduce world-class technology as well as technical knowhow and processes to developing countries. Foreign expertise can be an important factor in upgrading the existing technical processes in a host country. For example, the nuclear deal between India and the United States would lead to transfer of nuclear energy knowhow between the two countries and allow India to upgrade its civilian nuclear facilities.

Increased competition

As FDI brings in advances in technology and processes, it increases the competition in the domestic economy of the developing country that has attracted the FDI. Other companies will also have to improve their processes and products in order to stay competitive in the market. Overall, FDI improves the quality of products and processes in a particular sector. Improved human resources. Employees of a host country in which there is foreign direct investment get exposure to globally-valued skills. The training and skills upgradation can enhance the value of the human resources of the host country.

Cons of FDI

One of the measurements of economic development in a lowincome economy is the increase in the nation's level of capital stock. A developing nation may increase the amount of capital stock by incentivizing and encouraging capital inflows, and this is generally done through the attraction of FDI. It has been widely discussed and upheld that amongst various forms and modes of capital inflows, FDIs are favored, because of their long-term durability and commitment to a host country's economy. FDIs are less susceptible to short-term changes in market conditions, which ensures a certain level of continuity and stability in the money flow. However, many developing economies have tried to restrict, and even resist, foreign investments because of nationalist sentiments and concerns over foreign economic and political influence. One pertinent reason for this sentiment is that many developing countries, or at least countries with a history of colonialism, fear that foreign direct investment may result in a form of modern day economic colonialism, exposing host countries and leaving them and their resources vulnerable to the exploitations of the foreign company. While FDIs may increase the aggregate demand of the host economy in the short run, via productivity improvements and technology transfers, critics have also raised concerns over their supposed benefits. This theory follows the rationale that the long run balance of payments position of the host economy is jeopardized with the investor outlay. Once the initial investment starts to turn profitable, it is inevitable that capital will return to the country it originated from. To sum up, FDIs have created tremendous opportunities for India's development and helped to boost the performance of local firms as well as the globalization of some of them. This has undeniably raised India's stature among developing countries. India needs massive investments to sustain high-quality economic growth, particularly in the energy and infrastructure sectors. Policymakers are looking at FDI as the primary source of funds. It is important to keep in mind that FDI on its own is not a panacea for rapid growth and development. What India needs is to put in place a comprehensive development strategy, which includes being open to trade and FDI. This should go a long way in fulfilling the ultimate goal of permanently eradicating poverty.

Indian Scenario

In the case of India, FDI inflows have risen rapidly, from $24 billion in 2012 to $44.2 billion in 2015 — a seven-year high. This increase is also fairly broad-based. It is not just the e-commerce (trading) sector that has received more inflows; other sectors such as computer software and hardware, construction, services, autos and the telecom sectors also account for a large share of the increase.

Interestingly, even though China continues to attract larger FDI inflows than India in absolute terms, India has started to close the gap, when FDI is measured as a share of GDP. FDI inflows into China have moderated to 2.3 per cent of GDP in 2015, from 2.6 per cent in 2014. During the same period, FDI inflows into India rose to 2.1 per cent from 1.7 per cent.

India has already marked its presence as one of the fastest growing economies of the world. It has replaced china from most favored FDI destination in 2015. Since 1991, the regulatory environment in terms of foreign investment has been consistently eased to make it investor-friendly.

Apart from being a critical driver of economic growth, foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. For a country where foreign investments are being made, it also means achieving technical know-how and generating employment.

The Indian government's favorable policy regime and robust business environment have ensured that foreign capital keeps flowing into the country. The government has taken many initiatives in recent years such as relaxing FDI norms across sectors such as defense, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others.

Recent Policy Measures

- Government eases FDI norms in 15 major sectors.
- Townships, shopping complexes & business centres – all allow up to 100% FDI under the auto route. Conditions on minimum capitalisation& floor area restrictions have now been removed for the construction development sector.
- India's defence sector now allows consolidated FDI up to 49% under the automatic route. FDI beyond 49% will now be considered by the Foreign Investment Promotion Board. Govt approval route will be required only when FDI results in a change of ownership pattern.
- Private sector banks now allow consolidated FDI up to 74%.
- Up to 100% FDI is now allowed in coffee/rubber/cardamom/palm oil & olive oil plantations via the automatic route.
- 100% FDI is now allowed via the auto route in duty free shops located and operated in the customs bonded areas.
- Manufacturers can now sell their products through wholesale and/or retail, including through e-commerce without Government Approval.
- Foreign Equity caps have now been increased for establishment & operation of satellites, credit information companies, non-scheduled air transport & ground handling services from 74% to 100%.
- 100% FDI allowed in medical devices
- FDI cap increased in insurance & sub-activities from 26% to 49%

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- FDI up to 49% has been permitted in the Pension Sector.
- Construction, operation and maintenance of specified activities of Railway sector opened to 100% foreign direct investment under automatic route.
- FDI policy on Construction Development sector has been liberalized by relaxing the norms pertaining to minimum area, minimum capitalization and repatriation of funds or exit from the project. To encourage investment in affordable housing, projects committing 30 percent of the total project cost for low cost affordable housing have been exempted from minimum area and capitalisation norms.
- Investment by NRIs under Schedule 4 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations will be deemed to be domestic investment at par with the investment made by residents.
- Composite caps on foreign investments introduced to bring uniformity and simplicity is brought across the sectors in FDI policy.
- 100% FDI allowed in White Label ATM Operations.

Conclusion

Rising FDI inflows can have significant positive effects on an economy. For an investment-starved economy such as India's, they can provide the requisite financial capital while ensuring a stable source of financing the current account deficit. From a real-economy perspective, greenfield FDI inflows can boost growth prospects through job creation, buttressing investments and by enabling higher productivity and competitiveness.

Remember that we live in an increasingly globalized economy, so foreign direct investment will become a more accessible option for you when it comes to business. However, you should weigh down its advantages and disadvantages first to know if it is the best road to take.

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