BY: D. RAMESH
S. PACKIALAKSHMI

THE PROS AND CONS OF FOREIGN DIRECT INVESTMENT IN INDIA

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 liberalised 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.

Foreign Direct Investment (FDI) refers to the net inflows of investment to acquire a lasting management interest (10 per cent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, other long-term capital, and short-term capital as shown in the balance of payments. It usually involves participation in management, joint ventures, transfer of technology and expertise. There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in a net FDI inflow (positive or negative) and "stock of foreign direct investment," which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares. FDI is one example of international factor movement.

Foreign direct investment refers to investment in a foreign country where the investor retains control over the investment. It typically takes the form of starting a subsidiary, acquiring a stake in an existing firm, or starting a joint venture in the foreign country. In India, as per the rules of liberalisation, FDI comes through five routes. These are: the government (SIA/FIPB), RBI (automatic route), investment by NRIs, acquisition of shares, and equity shares of unincorporated bodies.

To bridge the gap in the flow of funds in the public sector, more participation of the private sector is necessary. For developing countries, foreign capital can be a good source of funds. It may involve equity participation by foreigners as: (i) direct investment, and (ii) portfolio investment.

Definition

Foreign direct investment (FDI) plays an extraordinary and growing role in global business. It can provide an organisation new markets and marketing channels, cheaper production facilities, access to new technology, product skills and financing. For a host country or the foreign firm that receives the investment, it can provide a source of new technologies, capital, processes, products, organisational technologies and management skills, and as such can provide a strong impetus to economic development. Foreign direct investment, in its classic definition, is defined as a company in one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment.

Table I

Foreign Direct Investment: Category-wise

(US$ million)

Item	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Foreign investment, Net (A+B)	**14,492**	**13,000**	**15,528**	**14,753**	**44,957**	**5785**	**50,362**	**42,127**	**39,231**	**46,710**
A. Direct investment of which:	**3137**	**3713**	**3034**	**7693**	**15,401**	**19,816**	**17,966**	**11,834**	**22,061**	**19,819**
(i) In India	4675	5987	8901	22,739	34,236	37,672	33,109	29,029	32,952	26,953
Equity	2387	3714	5915	16,394	26,758	27,863	22,905	15,737	22,833	16,032
Re-invested earnings	1800	1904	2760	5828	7168	9032	8669	13,102	8205	9880
Other capital	488	369	226	517	310	776	1535	191	1914	1041
(ii) Abroad	–1538	–2274	–5867	–15,046	–18,835	–17,855	–15,143	–17,195	–10,892	–7134
Equity	–282	–1637	–3766	–12,604	–14,421	–13,688	–9871	–8048	–3874	–1614
Re-invested earnings	–1176	–248	–1092	–1076	–1084	–1084	–1084	–1569	–1208	–1189
Other capital	–80	–389	–1009	–1366	–3330	–3083	–4188	–7578	–5809	–4331
B. Portfolio investment	**11,355**	**9287**	**12,494**	**7060**	**29,556**	**–14,031**	**32,396**	**30,293**	**17,170**	**26,891**
In India	11,377	9311	12,494	7004	29,394	–13,854	32,376	31,471	17,409	27,770
Abroad	–22	–24	–	56	162	–177	20	–1179	–239	–878

Source: RBI, Annual Reports from 2003-2004 to 2012-2013

In recent years, given the rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology and licensing of intellectual property.

In the past decade, FDI has come to play a major role in the internationalisation of business. Reacting to changes in technology, growing liberalisation of the national regulatory framework governing investment in enterprises and changes in capital markets, profound changes have occurred in the size, scope and methods of FDI. New information technology systems and a decline in global communication costs have made management of foreign investments far easier than in the past. The sea change in trade and investment policies and the regulatory environment globally in the past decade, including trade policy and tariff liberalisation, easing of restrictions on foreign investment and acquisition in many nations, and the deregulation and privatisation of many industries, have probably been the most significant catalysts for FDI's expanded role today.

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:

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

FDI inflows: Category-wise

Table I presents the category-wise direct investment inflows to India, which increased from US$ 3137 million in 2003-04 to US$ 19,819 million in 2012-13. Net portfolio investment flows to India increased from US$ 11,355 million in 2003-04 to US$ 26,891 million in 2012-13. Net foreign investment in India increased from US$ 14,492 million to US$ 46710 million over the same period.

FDI inflows: Country-wise

Table II shows the country-wise break-up of FDI. Mauritius emerged as the most dominant source of inflows with a contribution of US$ 57,645 million (42.29 per cent), followed by Singapore with a contribution of US$ 15,683 million (11.51 per cent) and USA with a contribution of US$ 8759 million (6.43 per cent) during the period 2003-04 to 2012-13. One possible explanation for the dominance of Mauritius in FDI is that India has a Double Taxation Avoidance Agreement (DTAA) with

Table II

Foreign Direct Investment: Country-wise

(US$ million)

Country	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	Total	Per cent share
Mauritius	381	820	1363	3780	9518	10,165	9801	5616	8142	8059	57,645	42.29
USA	297	469	346	706	950	1236	2212	1071	994	478	8759	6.43
Germany	69	143	45	116	486	611	602	163	368	467	3070	2.25
Netherlands	197	196	50	559	601	682	804	1417	1289	1700	7495	5.50
Japan	67	122	86	80	457	266	971	1256	2089	1340	6734	4.94
Singapore	15	64	166	582	2827	3360	2218	1540	3306	1605	15,683	11.51
Korea	22	14	61	68	86	95	159	136	226	224	1091	0.80
UK	157	84	261	1809	508	690	643	538	2760	1022	8472	6.22
UAE	–	–	–	215	226	234	373	188	346	173	1755	1.29
France	34	44	12	100	136	437	283	486	589	547	2668	1.96
Switzerland	5	64	68	57	192	135	96	133	211	268	1229	0.90
Hong Kong	–	–	–	60	106	155	137	209	262	66	995	0.73
Spain	–	–	–	62	48	363	125	183	251	348	1380	1.00
Cyprus	–	–	–	58	570	1211	1623	571	1568	415	6016	4.41
Luxembourg	–	–	–	–	15	23	40	248	89	34	449	0.33
Others	–	–	–	1055	2699	3034	2374	1184	983	1540	12,869	9.44
Total	**1244**	**2020**	**2458**	**9307**	**19,425**	**22,697**	**22,461**	**14,939**	**23,473**	**18,286**	**136,310**	**100.00**

Source: RBI, Annual Reports from 2003-2004 to 2012-2013

this country, under which investors from Mauritius are protected from taxation in India.

FDI inflows: Sector-wise

Table III reveals the sector-wise break-up of FDI inflows in India from the period 2003-04 to 2012-13.

The majority of the inflows during the period 2003-04 to 2012-13 were in manufacture (28.32 per cent), financial services (13.80 per cent), construction (11.31 per cent), business services (6.44 per cent), electricity and other energy generation, distribution and transmission (5.96 per cent) and computer services (5.51 per cent). These facts can be verified from the 'Report of the World Bank on External Financing for Developing Countries'.

FDI in retail

The Indian government feels that FDI in retail will help farmers, create jobs, and benefit consumers by leading to an improved supply chain and lower prices.

Prof. Jagdish Bhagwati, a noted economist, has strongly supported FDI in retail. His argument is that retailers in the unorganised sector may face some problems initially, but after some time, they are bound to gain. He has observed, "The entry of multinational retailers may lower the sales increase for unorganised retailers, but it will not reverse their growth in the near future." (See '*Untenable Critiques of Retail Liberalisation', The Economic Times, October 15, 2012.*) He feels that we have to learn from the Japanese experience.

Prof. Bhagwati has said that the farm sector is going to benefit from FDI in retail. According to him, Indian farmers typically earn a third instead of the international norm of two-thirds of the final price of their produce, either because of wastage or because of exploitation by middlemen. This situation will improve with FDI in the retail sector. The Indian cold chain market has the potential to grow to ₹ 320 billion by 2015 from around ₹ 185 billion in 2010-2011, according to a study.

The pitfalls. Critics of FDI in retail say the move will displace farmers, create unemployment and will leave consumers at the mercy of a powerful cartel known for its tough bargaining power. "The move will distort the existing economic harmony in unorganised retail, dismantle the economic spine of the country, and enrich corporate capital but impoverish India's social capital," said S. Vaidhyasubramaniam, a noted columnist (*'Misplaced Hype over FDI', The New Indian Express, July 25, 2012*).

India's small traders are not equipped to compete with big and powerful ones. They do not have the expertise and the capital to do

Table III

Foreign Direct Investment: Sector-wise

(US$ million)

Sector	2003-04	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	Total	Per cent share
Manufacture	426	3726	4777	5143	4793	9337	6528	38,552	28.32
Construction	172	2551	2237	3516	1599	2634	1319	15,395	11.31
Financial services	69	3850	4430	2206	1353	2603	2760	18,789	13.80
Real estate activities	197	1336	1886	2191	444	340	197	7268	5.33
Electricity and other energy generation, distribution and transmission	90	829	669	1877	1338	1395	1653	8122	5.96
Communication services	–	66	2067	1852	1228	1458	92	7416	5.44
Business services	22	1158	643	1554	569	1590	643	8769	6.44
Miscellaneous services	–	1901	1458	888	509	801	552	6407	4.70
Computer services	166	1035	1647	866	843	736	247	7506	5.51
Restaurants and hotels	67	280	343	671	218	870	3129	5848	4.29
Retail and wholesale trade	5	200	294	536	391	567	551	2723	2.00
Mining	18	461	105	268	592	204	69	1776	1.30
Transport	20	816	401	220	344	410	213	2725	2.00
Trading	–	176	400	198	156	6	140	1158	0.85
Education, research and development	–	156	243	91	56	103	150	848	0.62
Others	213	–	1097	384	506	419	43	2905	2.13
Total	**1465**	**18,541**	**22,697**	**22,461**	**14,939**	**23,473**	**18,286**	**136,117**	**100.00**

Source: RBI, Annual Reports from 2003-2004 to 2012-2013

so; they are not in a position to buy goods at a lower price. The big chains have a capacity to sustain losses for a longer period. They can also undercut prices of goods to eliminate small traders. Also, most labourers in India are semi-skilled. The retail sector is the most appropriate source of livelihood for them. The Indian government is not in a position to provide jobs to all those who may be forced to close their retail shops. Their hardships will mount. However, the government, as in the case of China, may gradually increase FDI in retail *(Gourav Vallabh: 'The FDI Question in Retail', The New Indian Express, August 15, 2011)*.

The right course. India has to learn a few lessons from China. China has achieved phenomenal progress in the manufacturing sector and in transportation infrastructure. The big foreign investors felt that, in their own interest, they should boost the local economy. For instance, Walmart, with more than 350 supermarkets in China, has 15,000 Chinese suppliers. More than 90 per cent of the merchandise it sells in China is made locally. Exports of these products to the US have risen. In China, the small and big retailers had time to adapt to the changing market scenario.

FDI in retail is expected to lead to improvement in the infrastructure in rural India. In the absence of cold storage facilities, India loses around 30 per cent of the fruits and vegetables it produces. There is also loss of 5 to 7 per cent of the food grain output due to this. These losses are very huge and need to be curtailed.

What makes India attractive for FDI

There are a number of reasons why foreign institutions opt to invest in India:

Market size. India has a consumer market of up to 300 million people. Its huge middle class population is a great market for foreign companies and products.

Expectations of further liberalisation of capital movement internationally. India is already fully convertible on the current account and is moving towards full convertibility on the capital account. This makes it a very attractive destination for investment.

Rationalisation of economic policies. The government has rationalised economic policies to make India an attractive destination for investment.

Improvement in domestic financial institutions and banks. The banking system in India has improved dramatically over the last few years, with FIs and banks looking to move towards universal banking.

Good manufacturing and outsourcing hub. India is a relatively cheaper place to conduct business than other countries. With the huge labour availability and access to markets in and around Asia, it becomes very attractive for foreign companies to set up their facilities in the country.

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 low-income economy is the increase in the nation's level of capital stock. A developing nation may increase the amount of capital stock by incentivising 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 favoured, 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 jeopardised 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 globalisation 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. ■

D. Ramesh is assistant professor of humanities at Sree Sowdambika College of Engineering, Virudhunagar District, Tamil Nadu. Mrs S. Packialakshmi is assistant professor of commerce at Devanga Arts College, Virudhunagar District, Tamil Nadu