CHAPTER V

SUMMARY AND CONCLUSIONS

Role of foreign capital in economic development

No country can be self-sufficient today. Even developed countries have to depend on the developing countries for certain purposes and also for marketing their products. Further as specialisation in finance has become worldwide, every investor wants to maximise returns on his investments and minimise the risk. This is applicable both to government investment as well as corporate and private investments. These are days of multi-national corporations that closed economic systems can no longer be realistic. In this situation, flow of capital from one country to another in different forms takes place for several reasons. From the viewpoint of a country, there is a need to execute their plans for economic development. Specifically in the case of India, the need for foreign capital cannot be exaggerated. This could be explained in terms of the following arguments:

a) The availability of funds for execution of plans and achievement of rapid economic development, determine the objective of such plans

b) Domestic investors and managers of funds may not have the required expertise or entrepreneurship in identifying the right and profitable avenues for investment. When foreign capital is allowed to flow, the benefits of the experience of the foreign technicians, finance specialists, production specialists, marketing wizards, etc., are made available to the domestic ventures. This will improve the efficiency of domestic projects, which is directly benefiting the country. On this count foreign capital should be welcomed.
c) One of the basic requirements for achieving rapid economic development is mobilising savings. Savings depend upon income and income depends on the level of economic activity. Hence, any attempt to increase savings should start with attempts for increasing income, which necessitates increasing investment. If the domestic rate of savings and the purpose for which savings is used is unproductive, then efforts should be made to obtain the necessary investment from abroad. This would accelerate economic development leading to income generation and increased savings. Hence, in the process of economic development, foreign capital becomes an essential ingredient.

d) Foreign capital is necessary for one more reason. In every developing country, the economic development requires investment in certain projects relating to infrastructure development, basic industries, etc., which are long gestation projects, low income yielding, but accelerating economic development. No private investment or corporate investment in these projects will come about in the early stage of development either because the investors have no inclination or because the capital market in such a situation is not developed. But the government has to initiate development activities, for which foreign capital becomes essential. Once the 'economic engine' is activated, in due course, the economic development will start taking place. Until then foreign capital is needed.

e) Foreign capital can be in different forms. Countries like India having high rate of savings, but low investment in productive projects, with large human force but with less employment opportunities, have to seek technical know-how and technology available abroad. These can be slightly modified to suit the domestic conditions so that the
production can take place on a large scale, cost can be minimised and employment opportunities can be generated in large scale. Further there are areas like atomic energy, automobile industry, management, marketing and others where the best available talent or technology available abroad can be imported. This will also help to achieve higher levels of economic development.

f) One of the methods of achieving higher levels of development is through mutual co-operation with other countries through bi-lateral or multi-lateral agreements, which provide excellent scope for transfer of technology, etc., between countries. Political wisdom warrants use of such agreements for mutual benefits, which leads to flow of foreign capital from one country to another.

Classification of foreign capital

External capital may be classified and analyzed in several dimensions such as origin, type and conditions. Following the standard classification adopted by the World Bank and OECD, capital flows to developing countries can be decomposed broadly into official flows and private flows. Official flows i.e., Official Development Finance [ODF] as commonly called, include: a] Official grants, b] concessional loans from either bilateral or multilateral sources and c] non-concessional loans from bilateral, multilateral sources, or export credit agencies. Official Development Assistance refers to the sum of official grants and concessional loans.
The different forms of private external finance i.e., all forms of finance not guaranteed by or mediated through the public sector financing, have become increasingly important and are classified broadly as i) Equity forms and ii) Non-equity forms.

**Importance of Foreign Director Investment**

FDI is widely viewed among the major forces as propelling the 'globalization' of the world economy, that is, the increasing specialization of production and trade through global networks of production and distribution, pioneered and operated by multinational enterprises. The importance of FDI could be highlighted through the following arguments:

- FDI is frequently viewed as instrumental in promoting foreign trade, particularly in host countries that maintain relatively open economies, stable macro economic conditions, limited restrictions of foreign exchange transactions and protection for private property rights.
- FDI disperses production technology and know-how from a high-wage source country to one or more lower-wage host countries and hence influences trade patterns.
- FDI provides new jobs or in an economy near full employment, raise real wages, lower the cost of capital at the margin.
- FDI can help finance a chronic deficit or be a conduit for a chronic surplus.
- FDI can penetrate foreign markets to provide access to raw material, technology or cheap labour factor based FDI.
FDI relieves the external debt burden of developing countries, especially in the short term. The non-financial components of FDI package and their long-term effects are often the most important in the development process.

FDI projects can provide greater access to world markets for host country exports.

As the FDI based enterprises enter into competition with the local firms, the latter category of enterprises is forced to improve their technology and the standards of product quality.

The macroeconomic effects of FDI leads to domestic capital formation, balance of payments and taking advantage of external markets for achieving faster growth. The microeconomic effects lead to cost reduction, production quality improvement, and making changes in industrial structure and developing global inter-firm linkages.

FDI also provides a stimulus to competition, innovation, savings and capital formation and through these efforts, to job creation and economic growth.

FDI brings in some intangible assets consisting primarily of intellectual property, which includes technology, brand names, copyrights and human capital.

Government of the countries receiving FDI, gain in terms of increase in their tax-revenues on profits and on royalties which is in the form of fiscal gain.

**FDI in pre and post - liberalization period**

The inflow of FDI has not been very significant till 1991, when the policy of liberalization was announced. Until the impact of liberalization in 1992, FDI remained well below US
But since 1993, it started swelling and by 1997 it touched a peak of US $ 3330 m and then slowed down to end up at about US $ 2500 m in 2001.

**Justifications for the Study and Problem Focus**

Foreign Direct Investment has come to stay in India, thanks to liberalization policy. But has the country benefited in the expected way from the policy of liberalization is a question to be answered only after assessing different facets of FDI.

Since the beginning of the 1980’s, there has been an enormous rise in the FDI flows to the developing world. East Asia and Latin America are the major destinations. These economies have undertaken an aggressive policy with regard to economic liberalization, whereas other economies of Eastern Europe, Central Asia, Middle East and North Africa, Sub-Saharan Africa and South Asia have adopted half-hearted economic liberalization regime.

The prevailing trend suggests that South Asia in general and India in particular has failed to attract sufficient FDI flows. India has been lagging far behind in the global race with regard to attracting FDI flows. These trends and situations demand introspection.

Further, there is a need to examine whether the policy options formulated and adopted are in tune with the efforts to improve the flow FDI. Added to this, it is necessary to identify the factors which warrant constant monitoring to make them function favourably to ensure the FDI flow is maintained over a period of time, if not improved. It is also
essential to examine whether the FDI flows move in to the direction, which is desirable from the country's point of view. India has also created agencies to accelerate FDI. How far these agencies have succeeded in their task has to be examined, to decide about their continuance or to revamp them. Another important aspect is to analyse the problems relating to FDI, so that necessary initiatives can be taken to solve them to ensure more smooth inflow of FDI. All these call for an analytical approach to India's experience with FDI inflows since the days of liberalization.

Objectives of the Study

The overall objective of the study is to analyse the Foreign Direct Investment in India. The specific objectives are to

- examine the pattern of FDI inflow
- determine the direction of inflow
- identify the determinants of FDI
- evaluate the government policy and its impact on the inflow of FDI
- assess the role of agencies established to improve the FDI flows in to India, and
- analyse the problems relating to the inflow of FDI

In line with the objectives set for the study, various types of analyses were undertaken and the results of them are summarized hereunder to suggest various methods for improving the flow of FDI in to India.
As regards the pattern of FDI inflows, the FDI had been subjected to a mixed pattern of increasing and decreasing over the period. The slope coefficient was statistically not significant, but the growth coefficient was statistically significant. This implies that over the period, the FDI had been declining at a weak, but increasing rate. This underscored the need for further probing in relation to various other parameters determining FDI inflow.

The analysis of actual FDI inflows as a percentage of FDI approval revealed that, over the period 1980 to 2000-01, it was found that this percentage was declining over the period under reference. This is supported by the quadratic function fitted for the percentage of actual FDI inflow expressed in relation to approved quantum of FDI. The actual inflow of FDI as a percentage of FDI approvals, declined by about $6 m. What is more alarming is that this decline had been taking place at an increasing rate as shown by the positive statistically significant acceleration coefficient. For the purpose of above analysis, data relating to 1990 to 2000-2001 was used, as data relating to earlier years on FDI approvals was not available. Hence, the results could be viewed as an indicator of post-liberalization experience of the country. Added to this, the coefficient of variation of actual FDI inflow as a percentage of FDI approvals revealed that the percentage fluctuated by 20.72 %. Such a wide fluctuation should be taken serious note of. This necessitates review of government policies towards FDI, as otherwise in the years to come, inflow of FDI would go down. This has to be viewed seriously, because, in the context of several other countries like China and South East Asian countries are formulating favourable policies to attract larger inflow of FDI.
Sourcewise FDI was also analysed. FDI inflows have come from various countries. Over a period of about eight years, [from 1993 to 2000] there had been a fall in FDI inflows observed in the case of all countries, especially after 1997. This general pattern indicates that the investors abroad waited for the investment climate to improve after 1997. The reasons for this slow down in FDI inflows should be analysed to reverse the trend.

The countrywise inflow of FDI had been declining over the period, implying that investors abroad had been adopting a 'wait and watch' approach, especially after 1997. Even in the case of Non resident Indians, this tendency is clearly discernable as the percentage of FDI through this channel declined from about 11.78 to 1.60 in 1999, though it picked up marginally in 2000 [4.37 %]. USA is one source, which had been constituting a large percentage of total FDI inflow into India throughout the 90's, but it also slowed down during the decade and finally it ended up at 11.32% by the beginning of the 21st century. All the other countries also reacted in the same way as could be seen from the table. This implies that India had not been focussing on the alarming change in the inflow pattern and devised its policies accordingly. The extent of percentage variation in the inflow of FDI as indicated by the Coefficient of variation, reveals a very dismal picture. The consistency is never experienced in the inflow from any country. The magnitude of variation ranged between 27.72 % in the case of Japan and 213.18 % for UAE. Such a wide variation in inflow necessitates a critical review of our FDI policies and makes suitable changes in them. Added to this, India should study the investors in each country, wherefrom inflows are significant and develop policies
customized to the country concerned. However, this does not mean the policies could be contradictory. Further, the priority of each investing country should be scrutinized closely so as to direct the inflows into the productive channels and re-direct the flows into unproductive channels. Such an exercise has to be undertaken on a yearly basis. This could start right from the stage of approval till the stage of actual receipt and investment. Apart from these, India should undertake vigorous marketing efforts in prospective and potential destinations, by widely promoting the investible opportunities available in India.

Destinationwise analysis of FDI was undertaken to discern the direction in which the FDI inflows had been moving in India. For this purpose, the inflow of FDI into various sectors was analysed. It was found that the finance sector experienced increasing inflows of FDI from 1992-93, which slowed down in 1996-97, increased in 1998-99 and then remained a low priority for investors as evidenced by poor inflows in 1999-2000 and 2000-2001. On the other hand, the Engineering sector could attract FDI in increasing quantity from 1992-93 which reached a peak of US $ 730 m in 1996-97 and remain hovering around US $ 300 m since then. Electronics and equipments sector revealed a similar pattern but the inflow had been subjected to greater variation as revealed by a higher coefficient of variation [93.08 per cent]. Chemical and allied sector is also one of the beneficiaries of FDI inflows and this sector had the second consistent inflows next to Pharmaceuticals sector. Services sector displayed a dormant picture atleast till 1993-94 and then slowly picked up to join the race, but became active after 1997-98. Food and dairy sector remained relatively passive throughout the period.
under reference though there was an occasional peak in 1996-97. Pharmaceutical sector remained the least active in terms of inflow of FDI, as, since 1992-93, its inflow never crossed US $ 62 m. As a result the consistency of the FDI inflows in to this sector remained very high compared to the other sectors. Computers sector had fluctuating FDI inflows, recording less than US $ 60 m till 1996 -97 and then doubling to end up with a peak of US $ 306 m in 2000 - 2001. The extent of variation in FDI inflows in to this sector is very high as is indicated by the coefficient of variation [102 per cent] All the other sectors put together also do not present a significantly different inflow pattern. Hence, the inter-year FDI inflow pattern revealed a mixed picture that no specific sector had any significant and consistent FDI inflows.

The inter-sectoral comparison of inflow of FDI was undertaken to identify the sectoral preference of the investors over the study period. Engineering, Electronics and equipments and Chemical and allied services sector together accounted for nearly 54 per cent of total FDI inflow in 1992-93. But in 1993-94, except the Electronics and equipments sector, the other two received lesser percentage of inflow. On the other hand, Finance, Services, Food & Dairy and Pharmaceutical sectors recorded significant improvement in FDI inflows during 1993-94. They received more than 40 per cent of the total inflows during that year. In 1994-95, the finance sector received marginally lesser percentage of inflows compared to 1993-94, but engineering, Chemical and allied services, sector experienced increased inflows of FDI. The year 1995-96 was more favourable towards finance, engineering and electronics and equipments sectors, while the other sectors recorded poor inflows. In 1996-97, engineering sector alone
registered almost doubling of inflows [35.5 per cent] in FDI compared to 1995-96. Apart from this, the chemical and allied and food and dairy sectors alone recorded improvement in inflows. The year 1997-98 witnessed a reversal in the trend observed in 1996-97, as there was nearly 16 per cent decline in inflows recorded by the Engineering sector, but an appreciable increase in inflows was reported by electronics and equipments sector. Service sector once again became popular with nearly 11 per cent of FDI inflows, and marginal increase in inflows was witnessed by computers sector. The erratic fluctuations in inflows of FDI in to the different sectors continued in 1998-99. This is supported by the increase in inflows found with Finance, Engineering, Chemical and allied services and services sectors, which together received more than 56 per cent of the total FDI inflow during that year. The year 1999-2000 was a shock for almost all the sectors, though only Food and Dairy sector improved upon its previous performance of FDI inflows. Services, computers and electronic equipments sectors had some positive increase in their inflows of FDI in 2000-01 while the other sector had nothing spectacular to discuss about.

Destination-wise analysis of FDI inflows revealed that no sector preference was discernable over the study period. The reasons for such an erratic inflow pattern into various sectors have to be analysed and based on that, necessary modifications in policies are to be brought about.
Determinants of FDI inflows

One of the important objectives of this study is to identify the determinants of FDI inflows. In this context, the following determinants were selected: Gross Domestic Product [GDP], Coal Production [CLPRDN], Number of telephone lines [TELE], Exports [EXP], Imports [IMP], Number of commercial vehicles registered [a proxy for infrastructural development] [COMMVHL], population [proxy for potential market size] [POP], foreign exchange reserve [EXRSR] and industrial disputes [IDIS]. Each one of these determinants was selected for the justifications explained in the Chapter on Methodology.

The variables included in the regression equation explained nearly 97 per cent of the variations in the FDI inflows \( R^2 = 0.968 \). The F value also is found statistically significant \( F = 33.6453 \) implying that the equation is fit for drawing inferences.

Among the determinants included in the equation, Gross Domestic Product, Number of telephone lines, Exports, Imports, Number of commercial vehicles registered and number of industrial disputes were found to be statistically significant. The other determinants were not statistically significant.

Gross Domestic Product represents the productive capacity of the economy. It reflects both the size of the domestic market and the purchasing power of the citizens. A positive relationship between GDP and FDI implies that FDI flows in to an economy with
a sufficiently large host country market to accommodate the increase in local supply.

From the equation it is clear that GDP is statistically significant. It implies that a unit increase in GDP would lead to 0.016 unit increase in FDI. The positive relationship between GDP and FDI has to be read in conjunction with India's objective to achieve a higher growth rate.

Coal production is taken as a proxy for mineral resources in the country. This determinant was not statistically significant in the above function.

Number of telephone lines, taken as a proxy for improvement in standard of living of the people, was positively related to FDI inflows. This implies that with improvement in standard of living, the demand for improved communication facilities would go up. This in turn would open up opportunities for multinational corporations to invest in the development of telecommunication sector. The statistically significant coefficient of this variable \( t = 1.96941 \) indicate, that for every unit increase in number of telephones, the FDI inflows would go up by 0.17 unit. This is very much justified by the governmental action to privatize the telecommunication sector. This could be expected to give a boost to the inflow of FDI in to India. Further with the improvement in communication facilities in the country, the access to remote markets would become possible, which would enlarge the business opportunities. This again would have favourable impact on the inflow of FDI.
Exports have an inverse relationship with the FDI inflows. This is because, as the level of nation's exports increases, it has the effect of altering local labour market and driving domestic wages towards world levels. So FDI becomes less profitable. Hence, the exports would decline with an increase in inflow of FDI. This is also very much supported by the increasing wage levels in the private sector units in the Indian economy. As regards the public sector and government employees, the Government had announced the Pay commission causing a hefty hike in wages and salary. This is very much conformed by the negative sign in the regression equation shown above. The co-efficient of exports was also statistically significant. With every unit addition to exports, the FDI inflows would decline by 0.02 units.

As regards imports, they are directly related to inflow of FDI. This is very much in consistence with the findings of the previous studies. The past studies have concluded that FDI flows into those countries that are importing goods from abroad. Import substitution argument also explains the reasons for inflow of FDI. FDI credits vertically integrated production units and so increases the amount of trade. Given the oligopolistic structure of markets and international integration, imports and the level of FDI are always complementary. In the case of India, with the liberalization, entry of multinational corporations has facilitated inflow of modern technology. As a result imports have gone up along with the increase in inflow of FDI.

The coefficient of imports in the above regression equation was statistically significant. One unit increase in imports leads to 0.059 unit increase in imports.
There exists a very close relationship between infrastructural development and inflow of FDI. This is because, the infrastructure should improve to attract foreign manufacturers. With lower wages and greater profit potential, there exists a positive relationship between FDI inflows and the level of development of the country’s infrastructure. In the above regression equation, the number of commercial vehicles registered was taken as a proxy for infrastructural development. This variable was found to be statistically significant as could be seen from the equation. With every unit addition to number of commercial vehicles registered, the FDI inflows would go up by about 0.45 units.

In reality, a number of automobile manufacturers like Ford, Hyundai, General motors and others in the passenger car segment and Suzuki, Kawasaki and others in the two wheeler segment have brought in a revolution in these segments and consumers have a very wide choice. The increasing sale of heavy vehicles reported, also indicate the improvement in infrastructural development. At the national and state level, higher allocations are made towards development of roads. Development of roads is also taking place on ‘Build Operate and Transfer’ [BOT] basis. This augur well for India, as increasingly number of multinational corporations is entering in to this segment of infrastructure.

Population is considered as a measure of potential market size of the host country. A larger population would increase the projected profit from foreign investment. Hence, FDI inflows have a direct relationship with the size of population. But in the regression
equation fitted, population was not statistically significant. Foreign exchange reserve was also not statistically significant in the above equation.

Industrial disputes in a country reflect the level of manufacturing in the industrial sector. With larger number of industrial disputes, the production of the industrial sector is bound to be low. This would bring down the profit expectations. As a result number of industrial disputes adversely affect the inflow of FDI. In Indian experience, the increasing disturbance in the industrial scene has a dampening effect on the inflow of FDI. Hence, a negative sign associated with the coefficient of industrial dispute in the regression equation is very much consistent. In the above equation, industrial disputes turned out to be statistically significant. The coefficient indicated that with every unit increase in industrial disputes, the inflow of FDI would go down by 0.537 units.

The impact of FDI inflows on various macro aggregates was also analysed to ascertain whether the inflows had any beneficial effect on the economy. The macro aggregates selected were employment, Gross domestic savings, Net national product, personal disposable income and enrolment in schools.

One of the justifications given for liberalization was, that it would encourage inflow of FDI and in turn generate employment opportunities. To examine whether this had happened in Indian experience after liberalization, a simple regression was fitted taking employment as a dependent variable and FDI inflows as independent variable. The result presented in the table given above indicate that over the period [since 1991],
employment had been increasing as evidenced by positive regression coefficient 
[+ 0.000899] This implies that for every unit increase in FDI, employment would go up 
by about 0.0009 unit

As regards domestic savings, this is an important macro aggregate as it lays down the 
basis for supply of funds for investment. An economy like China experienced a very 
high rate of domestic savings [above 40 per cent], consequent to the opening up of the 
economy. This in turn provided a strong foundation for attracting more FDI inflows.
India with about 23 per cent of domestic savings should improve its level of savings to 
reap the benefits of inflow of FDI. Even the existing level of inflow of FDI has benefited
Gross domestic savings in India. This is because, with the entry of multinational 
corporations, the wages and salary structure has gone up. With more income, the 
savings capacity of the economy has also gone up. This is substantiated by the 
equation stated in the table above. The statistically significant coefficient implies that for 
every unit increase in FDI inflows, the Gross domestic saving would increase by about 
0.0011 unit

FDI inflows have a positive impact on Net National Product [or National income]. This is 
because, infrastructural development and better utilisation of available resources take 
place with the liberalization of the economy. Consequently, the output in the economy 
also grows, contributing to national income. Since liberalization, a positive impact on 
national income is observed with increasing FDI inflows. The regression equation 
shown in the table supports this. The statistically significant regression coefficient
implies that for every unit addition to FDI inflows, the national income goes up by 288.0852 units.

Personal disposable income reflects the purchasing power of the people. Larger this component of income, greater would be the demand for goods and services and savings potential. Consequent to liberalization, the earnings potential of skilled and trained work force have gone up, as is evident from the direction of FDI flows to electronics industry and services sector. With huge population size, the increase in Personal disposable income has a salutary effect on further inflow of FDI. From the table given above, it could be understood that with a unit increase in FDI inflows, the personal disposable income would go up by 379.3096 units. The statistically significant coefficient implies that since liberalization, continued inflow of FDI has improved the personal disposable income.

The impact of inflow of FDI on enrolment in school was taken to indicate the extent of trained man power required by the country after liberalization. This is because, India is a most favoured destination of the foreign investors, because of the availability of cheap labour. The multinational corporations seek trained manpower for their operations. So unless education and training opportunities are improved, soon preference for India for investment may be lost. So enrolment in school was taken for analysis.

Enrolment in school also has a statistically significant relationship with inflow of FDI. This is clear from the regression equation contained in Table IV.7. The coefficient
implies that for every unit of increase in FDI inflows, the enrolment goes up by 5.85 units.

Government policies relating to FDI were discussed at length. These policies clearly indicated gradual liberalization of rules, regulations and procedures to accelerate the inflows of FDI into India. Revision of these policies was based on the experiences and outcomes of policy implementation.

As regards the functioning of institutions established for the purpose of improving the inflows of FDI into India, a detailed analysis of the functions of each of these channels of FDI inflows was made. It revealed that the existence of a number of channels only creates confusion and integration of the functions of various agencies must be made to facilitate smooth inflows of FDI.

The problems of FDI inflows were discussed elaborately in the last Chapter. Specifically the following problems emerged as important: Colonial mind set of policy makers, lack of market orientation, problems relating to investment, remittance management, bargaining for better gains from the entry of multinational corporations, infrastructural inadequacy, political instability, poor labour market conditions, hesitation due to provisions of intellectual property rights, existence of very cumbersome labour laws and difficulties in co-ordinating with various agencies.
Suggestions

Based on the above discussion, suggestions for FDI related issues are given below.

India should use her bargaining advantages such as large domestic markets, abundant supply of trained and low wage labour, vast pool of technical professionals, well-developed capital market, etc., more effectively to attract a greater proportion of efficiency-seeking FDI.

FDI into India is more likely to take the form of joint ventures and other so called 'non-equity' forms. As indigenous businesses have gathered strength over the period of sheltered growth in the 80's, FDI entry into India would rarely be without an active Indian collaborator. FDI's role in manufactured exports is likely to be small. In contrast, international, subcontracting by foreign firms could play a major role in manufactured export growth. This is an aspect that has attracted little attention in terms of policy and given the wide diversification of the economy, the low cost of manpower, availability of a wide variety of skills and large excess capacities, is vitally important for Indian manufacturing.

A careful sequencing of appropriate policies therefore is important in mitigating the risk associated with capital inflows. Successful policy responses used monetary policy in the early stages of the inflow period. However, as inflows persisted and the costs associated with the different types of stabilization were realized, countries began to rely
on nominal exchange rate flexibility. In several cases, the costs of the real exchange rate appreciation were mitigated by the imposition of capital controls to moderate the volume of inflows and lengthen their maturities. This is an important policy outcome, because the short maturity of debt was identified as main determinant of the volatility and reversals of capital flows in the Mexican and Asian crises.

Strategies for tackling common hurdles

Different Indian states have different cultures, languages, food habits, political parties and levels of infrastructure. Therefore, an investor needs to evaluate the state carefully before developing a strategy for investment. Some of the hurdles at the state level are as follows:


Strategies to overcome

The reasons for such a trend persisting are:

If we analyze data with regard to actual FDI flows entered into India, then it is very clear that trends and situations have not been encouraging in nature and are against the FDI approvals amounting to Rs. 351.5 b, the actual inflows since the beginning of reforms till the end of 1996, stood at Rs. 84 4 b, i.e, an inflow rate of nearly 23.5% This means that there have been doubts in the minds of the foreign investors with regard to implementation of India's economic liberalization regime. Fear and doubts are on the following counts: 1. Exit policy i.e., necessary changes are inevitable in India's labour laws, 2. Red tapism at the ministerial level; 3 Lack of work culture i.e., sense of dedication towards job; 4. Lack of single window clearance with regard to approvals; 5. Lack of required infrastructure at the state level, 6 Liberalization of capital market, 7 Lack of rule based approach, 8. Lack of special treatment with regard to capital gains tax, and 9. Lack of level playing field.

The solution for this include:

In order to attract more FDI flows in actual terms, the government should undertake the following measures: 1. FDI must go into infrastructure sector instead of stock market, and hence FDI flows must get preference over foreign institutional investment 2. Another area where FDI flows must be encouraged is hi-technology as the sector is unable to buy technology for its growth and development 3. Special treatments like capital gains, in favour of MNCs have to be modified 4. MNCs should be allowed to
repatriate 40% of their profits earned in India. Local firms should not be allowed to repatriate any volume of profits outside India so that capital does not get drained out.

6. Red tape must be avoided and necessary monitoring cell should be created for quick clearance of the projects. 7. Administrative machinery at the state level must be geared up to create conducive business environment particularly in those states where potential and opportunities are tremendous with regard to absorption of FDI flows.

8. Procedural norms should be simplified as far as possible. 9. Effective coordination and monitoring by the RBI is a sine-qua-non. 10. Mindset should be changed.

Although India has done well in terms of attracting FDI, the potential has not been fully exploited. Greater attention to the following factors is required to improve the locational attraction of India for foreign investors.

**Stability**

It is the important element in the corporate appraisal of a country's FDI policy, as FDI involves a long-term commitment. Unless the corporate body is sure that the present policy will continue for sometime, it is not in a position to take a decision. Unfortunately, the record with respect to stability is rather poor. Policy relating to foreign investment in the power sector is a classic case where policies and procedures have been in a state of flux for a long time. So is the case of a telecommunication sector. This has resulted in a 'wait and watch' attitude on the part of some foreign investors, either because they are not absolutely sure of the future or because of the expectation of securing a better
policy package in the succeeding period. Recent developments, including a fairly large number of FDI proposals by the FIPB, may have further dampening impact.

**Transparency**

It has been observed that while the FIPB system provides a great degree of flexibility, there is scope for introducing further transparency in the system. Lack of transparency leads to unnecessary delays in the approval and execution of the projects.

**Simplification in the approval system**

Currently, there are several agencies, which are involved in FDI approval system. Though the domain of each agency is more or less defined, the very fact that there is more than one agency for granting approvals causes confusion in the minds of prospective investors. Multiplicity of routes of approval creates confusion, which could be simplified and reduced to only Automatic Approval [AA] and FIPB routes. Ideally, the FIPB route should continue itself to special and mega-projects while other proposals should be channelized through AA route. It may be desirable to raise the ceiling of 51% on equity holding for projects under the AA route, because the current restriction does not appear to serve any useful purpose.
Importance of a negative list

There is need to consider a change over from the positive list approach to a negative list approach for expanding the areas for FDI. It has been seen in many countries that laying down clearly the areas where foreign investment is not permitted – adds to transparency in the policy.

System Issues

At the systemic level, bureaucracy is still perceived to be a major area of concern. The unchanged mindset and an antiquated legal and procedural system generate enormous delays. Progress is slow with approvals for land acquisition and environmental issues may delay start-ups substantially. There are essentially three solutions – all are to be sought simultaneously. First, extensive and intensive orientation programmes are to be organised, especially for lower and middle level functionaries. Second, since the workload is bound to get reduced in organisations whose regulatory powers are being taken away, large-scale redeployment of staff has to be done. This is necessary because so long as the officials are there, they will try not to lose their powers in some ways or other. Thirdly a major revision of the central/state level laws and regulations will have to be undertaken.
Centre-State Interface

There is virtually no cooperation between the states and the central government in terms of FDI approvals and subsequent follow ups. Once the approval for FDI is given by the central government to the foreign investor, he has to approach the state level agencies for project implementation. These relate to approvals for acquisition of land, clearance for water, power connections, sales tax number, etc. Some laws [e.g.,] the Urban Land Ceiling Act, the Industrial Disputes Act, the Sick Industries Companies Act (SICA), the Packaging control regulations order and the Lube and Grease control order have also been identified as major hurdles for implementation of larger FDI projects. Lack of cooperation between the centre and the states has also affected the marketing of reforms in the domestic market.

Environmental clearance

The issue of environmental clearance needs further analysis. As the environmental standards prescribed in many developed countries for many technologies are vigorous and stringent, there appears to be low risks in granting automatic approval to such technologies either by the Central Government or state government.
India's trade regime with high tariff rates and complicated customs administration has not only affected foreign trade but also inflows of foreign investment. Though over the last four years the customs duties have been brought down, the average tariff level is still quite high. The average collection rate, which is a better indicator of the protection level as it takes into account various tax exemptions, was 47% in 1990-91, 44% in 1991-92, 37% in 1992-93 and approximately 30% in 1993-94. This rate is even now too high and introduces both an anti export bias as well as perpetuates an unacceptable level of inefficiency in the domestic production system. While it is true that the government is heavily dependent upon import duties for revenue realization, this should not be a problem if the base of imports increases due to both rise in GDP and lowered tariffs. For example, if the customs duties are reduced by one third on an average, revenue neutrality will be maintained if value of imports increases by the same proportions. Most econometric studies on India's imports suggest an import elasticity value between 1 and 1.5. Since there are reasons to believe that these values are underestimates, it can be argued that there is hardly any possibility of any revenue loss due to customs duty reduction if the licensing and foreign exchange control regime concerning imports are also concurrently liberalized.

Besides, there are problems at the ports. The most commonly mentioned problems are extensive delays of three weeks or more in the ports, plus the hassle and corruption in dealing with Indian customs.
Corporate Tax Rates

India's corporate tax rates are also perceived to be higher than the corresponding rates in some other Asian countries. There is some empirical evidence to show a negative correlation between tax rates and FDI flows. Though it is extremely difficult to calculate effective tax rates and make a cross-country comparison the nominal tax rates can be easily benchmarked. Since at the time of initial locational choice, investors will be influenced prima facie by data which are easily available and comparable, it is obvious that the Indian corporate tax structure needs to be suitably modified to make it more transparent and bring down the differential between the nominal and effective tax rates.

Rupee convertibility

Issues regarding convertibility are often referred to in the context of FDI flows. It is argued that the convertibility of the rupee will provide necessary psychological support to the foreign investor regarding the safety of his capital in terms of complete freedom to remit not only his earnings in the form of dividends, royalties and management fees, but also his capital. Besides, it is believed that convertibility also helps the foreign investor to plan his global investments without the apprehensions of delays and sometimes refused of or reduction in the volume of repatriation. However, studies show that though foreign investors would welcome such a move, lack of capital account convertibility has not acted as a deterrent to foreign investment into India due to long
term market commitment of the investors. The overall investment climate is held to be a more significant determinant of FDI.

**IPR Issues**

Although the protection of intellectual property rights is not found to be one of the main determinants of FDI in several studies in several countries, it is certain that stronger protection is likely to boost the flow of FDI to some industries, such as pharmaceuticals, agro-chemicals and micro electronics. Intellectual property protection is also crucial for new products. A study by International Finance Corporation on 'Intellectual Property Protection - FDI and Technology transfer', came to the conclusion that IPR regime affects investment flows except in high technology sectors where the impact is greater on technology flows. The study also concluded that India is perceived to have one of the weakest IPR regimes by foreign investors.

**Protection of FDI & Related issues**

Although India has become a member of Multilateral Investment Guarantee Agency [MIGA], it has so far not concluded bilateral agreements for settlement of investment disputes with the important FDI supplying countries. The issue of amending the present Indian Arbitration Act 1940 has to be sorted out to provide an internationally acceptable legal framework for settlement of commercial disputes expeditiously and effectively. At
the same time, it is also necessary to have more and more avoidance of Double taxation Agreements, as studies show that these have a positive effect on FDI inflows.

Financial Sector Reforms

The need for financial sector reforms has also been highlighted, especially by Japanese investors. The specific requests included liberalization of banking activities, development and stabilization of the call market and removal of loan obligations to priority sector. It is well known that not much progress has been made in this sector, though the need for it is recognized by all, including the government.

Marketing of India as FDI location

Since India for all practical purposes followed a fairly restrictive FDI policy for more than two decades, it can be presumed that both the quantity and quality of information on 'doing business in India' were at a sub-optimal level at the beginning of the reform process. Many investors feel that India is still fairly unknown as a FDI location. To bridge this gap, it is necessary to take steps for promoting India as an attractive investment destination. In the past, official and semi-official delegations went to various countries while private sector firms had gone for road shows for their GDR / Euro Issues, but still a lot more needs to be done. In other words, a plan is to be developed for effective marketing of India. The first element of this plan is to provide information on tap to any potential investor. Audio-visual packages must be developed which
should be continuously updated. If need be, the service of private foreign agencies may be utilized.

The industry and trade associations like the FICCI, ASSOCHAM, CII, FIEO AND PHD Chambers of Commerce, too, can play a greater role in helping foreign prospective investors. One of the major problems faced by foreign investors is identification of the right Indian partner for joint ventures, etc. Although these associations provide help in such matters, a more systematized national approach by delineating responsibilities for each body needs to be developed with the combined support of these apex associations. There is a need to compile and publish periodically the latest information with regard to the opportunities available in various states and the policy package of incentives offered by the state governments to foreign investors. Since the Indian High Commissions and Embassies are the first links that can be established by any foreign investor in respect of India, their role in attracting FDI is critical.

Beyond the FDI policy regime

It is necessary to appreciate that the FDI policy per se is only one of the concerns of the foreign investors. The FDI policy determines the ease of accessing the domestic market and the terms and conditions of entry. But the other policy viability, the progress of project implementation and successful business operations. An investor, therefore, cannot concern himself with only what the new industrial policy provides but he must evaluate the entire spectrum of rules, regulations and operating conditions once he is in
Consequently, issues like law and order conditions, labour policy, etc., become as important as the FDI policy itself.

**FDI - Export Linkage**

Further, no purpose will be served by attempting a linkage between FDI and export promotion through the policy framework. It is quite clear that some firms, in fact the majority, are contemplating coming to India to take advantage of the burgeoning domestic market. Whether a firm will use its foreign investment to service a domestic market or its global operations is a part of its strategic decisions and it is better left to them. It is definitely possible to influence the decision making by appropriately redefining the policy and building in an incentive package for its export orientation, but that would need a fairly drastic restructuring of the present policy framework.

Besides, the magnitude of export oriented FDI attracted by a country is determined more by structural advantages than by incentives offered. Kumar [1994] in an empirical study analyzing the inter-country pattern of export oriented FDI made by United States MNCs found the extent of export oriented FDI investment attracted by a country to be determined by wage levels, industrial capability and infrastructure of EPZs. The Government policy towards FDI [eg., incentives and performance obligations] or the overall international orientation of the economy did not affect it significantly.
Role of states

This brings the state level policies and procedure firmly in the picture. The Indian policy, the states provide the location, the infrastructure and the operating environs. They also extend, increasingly these days, a host of incentives to attract investment, irrespective of their origin. State governments and their agencies are responsible for the numerous clearances, approvals and operating procedures. It has been found that to set up a power sector project, 42 statutory clearances and approvals are required from various central and state agencies. No nodal agency will be able to sort out such massive regulatory requirements, because no agency will be likely to delegate its powers to another agency. Therefore, the legal regime also needs to be simplified.

Like infrastructure, General law and order situation in some states has been identified as an important factor for promoting FDI because as an important factor for promoting FDI. Many states have lost out in the race for FDI because of bad law and order situation leading to lack of investor friendly environment. It is this whole package of laws, systems and procedures and not the FDI policy alone, which is considered by any farsighted investor. And this is where India seems to lose out to other competing countries.
A suggested strategy

It has become imperative on the part of the governments of developing regions to initiate and implement a strategy based on the following points:

1. create more productive and purposeful economic and business environment
2. policies should be rule based and not individual based
3. climate of mutual trust and help must be created among the vital facets namely - government, industry and commerce
4. utilization of loans and grants must be made more effective and on the higher side
5. credit worthiness of the nations and creation of a forum for negotiations either bilateral or multilateral must be made out
6. time limit in regard to completion of projects must be adhered to
7. cost awareness must be created to policy makers and policy implementators

Removal of barriers to infuse further inflow of foreign investment

An emerging market such as India, which makes a policy decision to open the markets for foreign institutional investors, has two important objectives in mind. First, the influx of foreign capital is expected to promote the level of investment. Second, better productivity and growth is expected to stem out of the increased investment of capital. The achievement of the second objective requires that the resources be efficiently allocated.
While the policy has been concentrating on creating an enabling environment for foreign investment, not much has been specifically done towards ensuring optimal allocation of resources.

Direct barriers in the form of differential regulation and tax structures have to be largely dismantled in India, which are still prevalent and restrict inflows.

Indirect barriers that restrict the ability of the global investor to assess and value stocks, are prevalent in most emerging markets. Diverse practices in accounting and reporting system can be cited as the most common indirect barrier confronting the global investors.

Lack of timely and reliable data on the performance of the economy and the market is another such barrier. Given that many of these markets are embryonic in nature, historical data on performances of companies is hard to come by. It would therefore need a higher order skill to access and assimilate relevant information, in an emerging market like India.

Apart from these, investment inflows are also influenced by barriers that are particular to the markets. Lack of depth and liquidity in the markets, problems of trading, clearing, settlement and registration, also pose typical problems.
Based on the above discussion, the following steps are to be taken:

The Government should get over excessive preoccupation with channelising FDI flows into certain pre-conceived priority investment for foreign as well as domestic enterprises.

Under WTO dispensation, domestic and foreign investment would have to be brought within a non-discriminatory framework.

Like China, India should allow 100% foreign investment in specified zones.

Effective competition policy absolutely essential.

Labour and financial sector should be further liberalized.

Privatisation proceeds should be speeded up.

Financial sector should build strong financial structure and reduce high levels of non-performing assets.

The government should provide more sops to exporting community so that they are in a position to bring in the foreign exchange.
More double taxation treaties should be signed so as to improve bilateral trades. The government should stress on traditional industries for tapping their export potential.

Seven Steps to attract Investment

The Government may have an important role to play in creative conditions that are required to attract FDI. Long-term foreign investment can be attracted by cultivating a healthy macro and micro economic environment. This implies domestic investment in human capital, creation of distortion-free domestic markets, commitment to a strong regime of investors encouraging growth of markets for corporate control, allowing free purchase of companies in both public and private sectors where assets are underutilized and non-performing, not to speak of repealing legislation that constraints labour mobility and closure of companies.

Since India's economic reforms have been rather slow compared to many other developing countries, large FDI inflows are not attracted. We have severe infrastructure bottlenecks, lengthy legal framework causing delays and involving cumbersome process and unremunerative tariff pricing.

India has a large market and it has liberalized rules for FDI inflows. But what is relevant is making investing and disinvesting in India hassle-free and creating a market economy environment for doing business in India. Towards this the following steps are necessary.
Make disinvesting as easy as investing

Make investing by foreigners as easy as by domestic investors

Make investing by investors subject to no approval except a 15 days limit of single window environment protection clearance.

Make markets for all inputs including labour and output more free, limiting government intervention to the absolute minimum.

Allow financial market to integrate.

De-link bureaucratic and political processes from both domestic investment and FDI and

Dismantle laws and legal processes that delay decisions involving business and financial transaction.