SOME IMPLICATIONS OF FDI IN INDIA
IN THE POST-LIBERALISATION PERIOD

Ph. D Thesis (Abstract)

Submitted by
KABITA NATH

Under the supervision of
PROFESSOR BYASDEB DASGUPTA

Department of Economics
University of Kalyani
Kalyani – 741235

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and Peridy, 2010), attracting more MNEs and domestic firms and thus creates second round backward linkage effect and so on. With the help of proper Government policies, this process will continue and increase host country’s national income and welfare (Haaland and Wooton, 1999). On the contrary, the opponents of FDI argue that ownership specific advantages of MNEs may be transformed into monopoly power when competing domestic firms cannot compete with advanced, large and cost-effective foreign firms. With the help of improved technical and managerial knowledge, better access to finance and more competitive power in world market, MNEs crowd out domestic firms in the same industry. Larger growth effects are visible only when MNEs and domestic firms are producing complementary final and intermediary goods (Alfaro et al., 2006). Another argument in favour of FDI is that it raises wages, employment and working conditions. It is well accepted that MNEs are paying higher wages (Brown et al, 2003) sometimes for reducing labour turnover or sometimes for attracting high quality job applicants. But the effect of FDI on employment generation is not very conclusive. FDI in primary or labour intensive manufacturing industries may create some new employment opportunities. But, as technologies brought by MNEs are generally labour saving and prone to skilled labour, wages and employment for skilled labour experience an increase (Feenstra and Hanson, 1997; Arnal and Hijzen, 2008).

Keeping an eye on the beneficial effects of FDI on the host country, foreign investment is encouraged in growth-centric neoliberal policy in India. It is believed that FDI inflow is the most important driver of economic growth through higher private investment, employment generation, technological up-gradation and export promotion.

The objectives of the present research work are the following:

1. To analyse the effects of FDI on economic growth.
2. To evaluate the role of FDI inflows in increasing total investment.
3. To review the role of FDI in employment generation.

In the backdrop of the above objectives the principal hypotheses of the present work are indicated as follows:

1. FDI inflows increased economic growth rate in India.
2. FDI inflows in India meant addition to total gross domestic investment.
3. FDI inflows in India had positive impact of employment generation in India since 1991.
Abstract

In comparison to other emerging countries like China, Malaysia, Indonesia and Thailand, India is a latecomer in respect of neo-liberal economic reforms. For a long forty years after Independence, Indian economy remained state-driven with planning for modern economic development as the central force guiding this modern economic development. As a first step in industrial reforms in July, 1991, Indian government agreed that foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities of promotion of exports. By 2000, the government was quite confident about positive role of FDI in enhancing the production base of host country and ensuring rapid output and export growth. Starting from 1991 and accelerating since 2000, India has liberalised the economy towards greater reliance on market forces, active participation of private enterprises including foreign investment and curtailing the role of government. Further, the euphoria was created since 1991 that without foreign capital economic growth and hence, economic development would become almost next to impossible!

It is held in the mainstream economic arguments that the FDI inflows in the emerging economies like India would raise investment, bring in new technology, generate employment and enhance exports and thereby would swell the foreign exchange reserves of the country. Theoretically, FDI contributes to economic growth of host country mainly through two channels - by introducing new and advanced technology and by capital formation in capital-scarce developing countries. As domestic firms are better acquainted with local markets and political and social conditions, the Multinational Enterprises (henceforth, MNEs) should possess specific ownership advantages in terms of advanced technology, management skills, marketing strategies, transaction cost minimizing and other intangible advantages to compensate the advantages enjoyed by domestic firms. Primarily with the help of this knowledge capital, MNEs are able to operate profitably in multiple economies (Markusen, 2002). The horizontal spill-over takes place through demonstration effect or reverse engineering, labour turnover and competition (Gorg and Strobl, 2002). The vertical technology spill-over occurs through both forward and backward linkages by directly transferring knowledge through workers’ training/technical assistance, by demanding and supplying high quality intermediate products and on-time delivery and by providing after sales services (Iyer, 2009; Javorcik, 2004). Intermediate production expansion gives rise to a decrease in the price of the downstream industry creating a forward linkage effect (Uttama
We have used in this work for our purpose secondary data to test the above hypotheses. They include data from the Reserve Bank of India, Government of India (Economic Survey, Planning Commission), Department of Industrial Policy and Promotion (DIPP), Secretariat of Industrial Assistance (SIA), Annual Survey of Industries (ASI), World Investment Report etc.

Total FDI inflows (actual) experienced an unprecedented growth in the decade 1991-2000. In absolute measure, it jumped more than 58 times from Rs. 3.29 billion in the year 1991-92 to Rs. 184.04 billion in the year 2000-01. Within this decade annualised growth rate of FDI over the previous year was nearly 100% (in 1992-93 it was over 200%) against that for the earlier period. But in last two years, i.e., 1998-99 and 1999-2000 FDI inflows experienced negative growth rate. It improved for a very short period and again followed somewhat sluggish growth for the earlier part of the next decade with a minimum of Rs. 198.3 billion for the year 2003-04 but regained its position particularly after 2006 and continued till 2009.

While real GDP growth rate is always positive (though it fluctuates between 3.88% and 9.57%) the FDI growth rate experienced negative results for several years. In 2006-07 FDI growth rate is quite high at 144.05% and GDP growth rate is also highest in this year at 9.57%. But in 1992-93 and 1994-95 while FDI growth rates are more than 100%, GDP growth rate is only at 5.36% and 6.39% respectively. On the other hand, during 2009-10 and 2010-11 negative FDI growth rate is accompanied with GDP growth at 8.59% and 9.32% respectively. The correlation coefficient between real FDI and real GDP growth rate is -0.148, which is not only small but even negative.

A close look towards FDI inflows in different sectors reveals a bias in favour of the services sector (financial and non-financial banking and insurance, outsourcing and research and development) which almost tripled its share from 6.30% to 18.19%, securing the highest rank in the last decade. Liberalisation policy taken by the government and opening up more industries channelized FDI inflows in services sector and a steep fall in the share of manufacturing sector. FDI is nominal in India’s leading export sectors, such as gems and jewellery, pharmaceuticals, textiles and marine products. Handicraft sector is one of the largest contributors to exports over the 1990s. But since this sector is reserved under small scale category, FDI is practically non-existent in this sector (Bajpai and Dasgupta, 2004). With the help of the large pool of unskilled population India has an excellent scope to invest in manufacturing sector. In fact, manufacturing sector is only option to generate employment for growing labour force in India. FDI in services sector creates jobs for only limited skilled
labour. Moreover, manufacturing sector has the maximum linkage effect. The overemphasis on FDI inflows by policy makers and corresponding policy changes increased the volume of FDI in the services sector, while much-needed net investment (domestic as well as foreign) in manufacturing sector is still neglected. As more and more sectors are being liberalised the focus on investment in core sectors has faded away. FDI remained concentrated in few sectors of the Indian economy, most of which are generating different modern services as economic activities and one is not sure till the date how much positive externality these FDI-infested sectors do render on other (non-services) sectors of the economy?

The role of FDI in generating investment should be analysed from the qualitative perspective focusing on the nature of FDI, some of which may be detrimental. DIPP/SIA approval route was the major route among all routes of equity capital occupying more than 50% share during the first decade of liberalisation. But as more and more sectors are being declared under the automatic route, the government approval route gradually lost its significance. The completely opposite trend is visible in case of automatic approval route. These two routes jointly occupy more than 60% share throughout the period and sometimes nearly 80% as in 2009-10 and 2012-13. Despite Government's various efforts to encourage NRIs to invest by simplifying the regulations time to time, FDI through this route remained quite nominal vis-a-vis the other routes. The notable feature of different route-wise distribution of FDI is the increasing share of acquisition route in the total FDI inflows which increased leaps and bounds during few years after its inclusion in 1995-96. Increasing importance of acquisition of shares in total equity is a bit of concern as it does not refer to any fresh investment but only the transfer of ownership of an existing domestic company or increase in the importance of foreign firms (partially of course) in the concerned domestic company.

Among different components of FDI another confusing element is reinvested earnings, the share of which was more than 30% for the first half of 2000s after its inclusion in 2000. Reinvested earnings represented the difference between the profit of a foreign company and its distributed dividend. Therefore, it is regarded as undistributed profit. According to UNCTAD (1997), retained or reinvested earnings should not be considered as new infusion of capital rather as domestic savings on the basis of resident principal and in the absence of transfer from abroad. Acquisition of shares together with reinvested earnings occupied round about 50% of total FDI inflows for a long period starting from 2002-03 to 2006-07. For next three consecutive years the accumulated share of these two components remained low between 31% and 36% after which it showed an upward trend. The impacts of such a high
share of these two components on capital formation in the host country require an in-depth analysis to know whether such impacts are positive or negative on domestic gross fixed capital formation.

It is expected that Greenfield investments add new investments, improve production capacity and create new employment opportunities vis-a-vis the M&A type investment. Though Greenfield FDI, measured as equity inflows excluding acquisition, holds more than 80% of total FDI prior to 2000, its importance drastically fell due to the revised system of FDI accounting. For the rest of the period, i.e., after 2000, it is more than 60% only for three years (2007-08 to 2009-10). For a long period of seven years (from 2000-01 to 2006-07) this is less than 50%. The bottlenecks of FDI in India is characterized as time-taking procedures to implement new investment; dominance of services sector over capital intensive, employment-generating manufacturing sector; unprecedented growth in mergers and acquisition and reinvested earnings which have little effect in additional investment and negligible presence of Greenfield investment in total FDI.

During the regime of globalisation and privatisation, with their emphasis on growth as the primary objective and employment generation as a trickle-down effect FDI is welcomed in almost all sectors in course of time. Liberalisation proponents blame restrictive labour laws that create inflexibility in Indian labour market for insufficient growth of employment. Banga (2005) identifies rigid labour laws in the Indian organised sector as a major obstacle to FDI. FDI inflows in export sector require relaxed labour laws, higher education and training of labour in India. Whyman and Baimbridge (2006) identified government, trade unions and monopsonistic employers as market distorting agents which restrict free operation of market forces to ensure full employment of all resources and social optimal welfare. The critiques of flexible labour regime opine in general that different notions of flexibility itself deter the possibility of new employment generation, especially in case of functional flexibility where multi-skilling and re-training of existing workers reduce the scope of fresh recruitment. Wage process flexibility leads to casualisation and contractualisation of jobs which is widely practised all over the world (Sen and Dasgupta, 2009). In fact, flexibility in labour market and social welfare arrangements are interactive and mutually dependent (Sengenberger, 2002). While neoliberal flexibility ensures adjustments with quantitative and qualitative changes in demand for labour, labour market regulation is essential for worker's co-operation and involvement in well-functioning production process. In India though there was no major change in the existing laws many policy measures were taken as a step towards flexible
labour market which is referred by Nagaraj (2007) as 'reform by stealth' by administrative means to dilute the strength of laws that seem to have contributed to the weakening of the bargaining power of trade unions, permitting employers a greater freedom in their industrial relations practices. Disinvestment of public sector, removal of licensing and tariffs, de-reservation of SSIs are few major steps to encourage private investors including foreign investors.

Due to the journey of the Indian economy towards the neo-liberal regime, in the multinational companies, which invested in India after 1991, most of the labourers are engaging contractual labourers mostly in general, not the permanent labourers; and rarely these companies paid any heed to the existing labour laws – especially the one pertaining to the Contract Labour. MNCs are taking the advantage of loopholes of legal laws and the conflicts between central and state regulations and are flouting them with the necessary support from the oppressive and in general anti-labour Indian state apparatus. The contribution of FDI on creating quality jobs with more security and better living standard is yet to be proved. So, the question remains how much labour-friendly the FDI inflows in India are?

So it can be said that the FDI inflows in India during the post-liberalization period cannot be claimed as the panacea for economic ills afflicting the Indian economy and society like sustainable high growth and development, accelerating domestic investment and reducing high rate of Keynesian involuntary unemployment in the formal segment of the Indian economy. Finally, we can assert that the FDI policies cannot be treated in isolation but should be analyzed as part of the present neo-liberal policy regime in India given the unique compulsion of India as the largest liberal political democracy in the world.


*: SIA Newsletter (various issues), Secretariat for Industrial Assistance, DIPP, Government of India.


Press Notes:

DIPP: Press notes: 1991 (P.N. no. 10, 11, 11(Annex III)); 1992 (P.N. no. 5, 12); 1997 (P.N.no. 2, 3(Annex)); 1998 (P.N.no. 2); 1999 (P.N. no. 1); 2000 (P.N. No. 9, 10); 2001 (P.N. no. 4); 2004 (P.N. no. 1, 2); 2005 (P.N. no. 2,5,6); 2006 (P.N. no. 1, 3); 2009 (P.N.no. 1); 2012 (P.N.no. 1).


Websites:

http://marutisuzukiworkersunion.wordpress.com

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