Chapter II

REVIEW OF LITERATURE AND NEED FOR THE STUDY
An attempt has been made in this chapter to review the relevant literature pertaining studies relating to FDI flows and to explain methodology adopted to analyze the trends and pattern of inflow of FDI into India and Karnataka. Besides, it also analyses the impact of FDI flows on income and employment generation India in general and Karnataka economy in particular, simultaneously examining the consequences of the operations of MNC's to the home and host countries. These consequences arise from their trade, employment, production, and their flows of stocks of intellectual capital unmeasured by the capital flows and the stocks of in the BOP.

Most of the currently held perceptions of FDI role take a macro view. Such a positive view gained currency mainly after the South-East Asian crises in the late nineties and the recent Global Financial Crises of 2008's and accordingly the structural importance of FDI has been restored back in comparison to foreign financial flows. The crux of the policy, therefore, is how far the FDI enabled firms will make an impact on employment generation in the host country will be analyzed. Some of the major works are reviewed here to ascertain the research gap.

2.1 REVIEW OF LITERATURE

graphs were used to examine the trend of capital inflow including the FDI over the period of time.

Raghbendra Jha\textsuperscript{2} (2003) has made his study on the recent trends in FDI flows in India. He finds that FDI flows to India have not been commensurate with her economic potential and performance. With FDI becoming a significant component of investment recently, accounting practices in India lagged behind international norms. However, the GOI revised its computation of FDI figures in line with the best international practices, which has led to a substantial improvement in FDI figures. The author however, says that the quality of FDI as manifest in technological spillovers, export performance etc, is more prominent than its quantity.

R.Nagaraj\textsuperscript{3} (2003) in his work titled, “FDI in India in the 1990’s Trends and Issues”, made an attempt to document the trends in foreign direct investment in India in the 1990’s. This paper makes an attempt to provide preliminary answer to the question what are the trends in the quantum and composition of the FDI inflow?. Data have been collected from various sources like Economic survey, Handbook of Industrial policy and statistics, 2001, and RBI’s Handbook of statistics on Indian Economy, 2001. The study revealed that the cumulative approved FDI during the 1991-2000 in dollar terms, touched 67 billion at an average of exchange rate of Rs.40 to a dollar. Mauritius was found emerged the second largest source country during this period. Larger projects with more than Rs. 100 crores account for over two-third of total value of approvals. Evidently, very little of the FDI has gone to augment the exports that are mostly from labour intensive unregistered manufacturing sector. The regional distribution of FDI inflow data revealed that the economically advanced
states had attracted one half of the approved FDI. It was further found that the FDI route representing larger projects requiring the government’s discretionary approval accounts for the bulk of inflow. It is also found that there is gradual increase in the mergers and acquisition in the 1990’s.

Jongsoo park\(^4\) (2004) has tried to build a Korean perspective on FDI in India based on the case study of “Hyundai Motors Industrial Cluster”. He contends that since the launch of reforms Korean companies have invested in joint ventures or Green field projects in automobiles, consumer goods and others. This case study of Hyundai Motor industries set against an exploration of India’s FDI experience from Korean perspective indicates that industrial clusters are playing an important role in economic activity. The key to promoting FDI inflows into India may lie in industries and products that are technology intensive and have the economies of scale and significant domestic content.

Examining India’s experience with capital flows, Ajay shah & Lla Patnaik\(^5\) (2004) discuss India’s policies towards capital flows in the last two decades. They point out that since the early nineties India has implemented policies and aimed at liberalizing trade and deregulating investment decisions. Throughout most of this period India has maintained strong controls on debt flows and has encouraged FDI and Portfolio flows. At the same time the Indian authorities have adopted a pegged nominal exchange rate. According to them, domestic institutional factors have resulted in relatively small FDI and large portfolio flows. They even point out that one of India’s most severe policy dilemma during this period has been related to the tension between capital flows and currency regime. They agree that in spite of the
progress achieved since the reforms were adopted the goal of finding a consistent way to augment investment using current account deficits has remained elusive.

Nagesh kumar⁶ (2005) in his paper, “Liberalization of FDI Flows and Development-Indian Experience in the 1990’s” reviews the Indian experience with FDI and its quality since 1991. This paper summarizes the evaluation of Indian Government policy towards FDI during 1948-2004 and examined the trends and patterns of FDI inflows in India in 1990’s. The author has used only secondary data collected from the UNCTAD world investment database and the sources of Government of India. By using simple percentage and average, the study arrived at the following conclusions. They were:

a) Liberalization process has helped India to diversify its sources of FDI over the 1990’s.

b) Mergers and Acquisition had emerged as an important channel of FDI inflow during late 1990’s.

c) Although FDI inflows into Indian Economy had increased considerably during the 1990’s following the Economic Reforms, India’s share would appear too small especially when compared with other countries in the South Asian region such as china. Further the study has concluded that the changing policy framework has affected the trends and patterns of FDI inflows received by India. Although the magnitude has increased in the absence of policy direction the bulk of FDI has gone into services, software technology and consumer goods industries.

Arindam Banik ⁷(2004) try to explain FDI flows to India, china and the Caribbean, he looked FDI flows in an alternative approach based on the concepts of neighborhood and extended neighborhood, rather than on the basis of conventional economic indicators as market size, export intensity, institutions etc. The study shows that the neighborhood concepts are widely applicable in different contexts. There are significant common factors in explain FDI inflows to select regions. While a substation
of FDI inflows may be explained by select economic variables, country specific factors and idiosyncratic component account for more of the investment inflows in Europe, China and India.

Commenting on FDI in India, P.L Beena et al, (2004) agree to the fact that India has come a long way since 1991 as regards the quantum of FDI inflows is concerned, though there is a view that the MNC’s are discouraged from investing in India by bureaucratic hurdles and uncertainty of the economic reforms. However, they feel that very little discussion has taken on the experience of the MNCs and the relationship between their performance and experience with the operating environment and the extent of spillovers in the form of technology transfers. The importance of the former (bureaucratic hurdles) has that the satisfaction of the expectations of the MNCs that are already operating within India is an important precondition for growth of FDI inflow. Transfer of technology and know how on the other hand is at least likely to have an impact on India’s future growth and the quantum of FDI inflow. They argue that to the extent that India’s future growth will depend on the importance of such spillovers can be paramount.

In order to provide foreign investors a latest picture of investment environment in India, Peng Hu (2006) in his study analyses various determinants that influence FDI inflows into India including economic growth, domestic demand, currency stability, government policy and labour force availability against other countries that are attracting FDI Inflows. Analyzing the new findings, it is interesting to note that India has some competitive advantage in attracting FDI inflows, like a large pool of high quality labour force which is an absolute advantage of India against
other developing countries like China and Mexico, to attract FDI inflows. In consequence, this study argues that India is an ideal investment destination for foreign investors.

Mohamed Saqub\textsuperscript{10} (2001), in his paper entitled, "FDI in India: A Cross-Country Performance Analysis", has sought to analyze the performance of FDI in India vis-a-vis other countries. He also discussed the trends in FDI in India for the period from 1991 to 1996. Necessary secondary data have been collected from the various issues of RBI Bulletin, SIA News Letters and World Investment Reports. Simple percentage and averages were used in this study. From the analyses, the study has arrived at the following findings:

1) The increase in FDI was very substantial when compared to the pre-reforms period, but it was not impressive when compared to other Asian countries.

2) While the volumes of FDI inflows into India were much lower compared to other countries, there has been an increase in India's share in total inflows into developing countries.

3) India has had the highest growth rate of FDI almost 60 per cent during 1991-96 among the developing countries like China, Indonesia, Malaysia, Philippines and Thailand.

4) The balance between FDI and licensing has shifted in favor of FDI.

5) Sectoral distribution of FDI stock showed that the manufacturing sector was dominant by retaining 83.4 per cent in 1995.

This paper, however, concluded that the FDI in India has increased but gains have not been maximized.

Krishna and Mitra\textsuperscript{11} also find some evidence of "an increase in the rate of growth of productivity in the years following the reforms." The process of opening up enhanced firm productivity leading to higher levels of growth. It seems likely that
FDI had little direct impact on the growth surge. Simply, there was too little of it to directly increase the capital stock. Even the little FDI that was approved was not all actualized: "In 1992, less than 20 percent of what was approved came in as an actual flow and the trend continued until 1997 with a gradual improvement in the realization rate to around 30 percent but went up over 50 percent for two years in 1999 and 2000 and an impressive 71 percent in 2001." Thus, the effect of FDI on growth was likely through indirect means like technology spillovers, encouraging clustering, and providing an incentive for states to boost their investment climates which also helped attract domestic capital.

Multinational corporations (MNCs) are important employers of labour in the world economy. Employment within MNCs has increased from 45 million (mid-1970s) to 70 million (early 1990s). (See WIR, 1994). Beside their effects on aggregate employment, FDIs have strong influence on domestic employment through types of jobs created, regional distribution of new employment; wage levels, income distribution, and skill transfer. These direct effects are complemented by indirect or spillover effects. Indirect effects take place through movement of trained labour from foreign firms to other sectors as well as through the increase of employment in domestic subcontractors. The integration of FDI into a local economy results often in a deep social change. Movement of labour and links with domestic sub-contractors enable transmission of business culture, which includes corporate values, organisational structures and management practices.

(Mirza, 1998) Despite potentially positive effects of FDI on magnitude, and skill profile of employment in host countries the relationship between FDI and
employment is far from being understood. This relationship is influenced by a plethora of different macro and micro factors, which makes their assessment in a comprehensive manner difficult.

A review of employment effects of FDI by OECD (1995)\(^{14}\) points out that there is 'no general conclusion regarding neither the sign of employment effects nor their magnitude. The broad range of results is a reflection of both the complexities of the analysis and methodological shortcomings, combined with the generally poor data availability in most countries' (p. 140). Yet, high expectations attributed to FDI in CE call for better understanding of its role.

Given the task of large scale restructuring in these economies, there is a need to examine whether FDI is contributing to preservation and generation of new employment and how much the structure of employment is affected. Under 'real socialism', excessive employment or 'labour hoarding' was an endemic part of the economy of shortage,

Kornai, (1986)\(^{15}\) Factor markets were as much affected by shortages as final product markets and the rational response of the enterprises was to hoard. It was the volume of production, not profit, which was maximized. With 'soft budget', this maximization was not subject to financial but too real constraints (ibid.)\(^{16}\). At the outset of economic transition it was obvious that it will be impossible to maintain levels of employment from socialist period. Hence, the slowdown of employment reduction and protection of employment has become one of the main objectives of economic policy. Active labour market policies had positive micro results but they could not substitute for new job creation by private sector. Among employment-
enhancing measures, privatization contracts signed with investors (foreign in particular) had some effects.

(Lavigne, 1999)\textsuperscript{17} Those included guarantees for maintaining a specified level of employment for a period of time in exchange for either lower price or additional incentives. In particular, this policy played crucial role in East German privatization, but it proved to be insufficient (Brucker\textsuperscript{18} 1997, chapter 5). Contracts with foreign investors, which guaranteed maintenance of specific employment levels, were adopted also in countries like Poland and Estonia. However, these direct policies could not be sufficient without employment generation in private domestic sector.

Most studies Hill and Athukorala\textsuperscript{19}1998 have shown that FDI’s social and distributional impact on the host country has been generally favorable in developing countries of various regions. Apart from bringing in a package of highly productive resources into the host economy there have been a visible positive impact on the creation of jobs not only in those sectors attracting FDI inflows but also in the supportive domestic industries.

Nagesh Kumar\textsuperscript{20} (2000) has made an exploratory attempt to examine the patterns of MNC related mergers and acquisitions in India in the nineties with the help of an exclusive data base. He finds that the liberalization of FDI policy framework since the early nineties has led the MNC’s to increasingly use the Merger & Acquisition route to enter and strengthen their presence in the country. In the recent years, two fifths of all FDI inflows took the form of M&A’s compared to virtually all of FDI in flows coming from Greenfield ventures earlier. The deals relating to MNC’s are predominantly horizontal rather than vertical in nature. In terms of
developmental implications he finds that FDI inflows in the form of M&A’s are of an inferior quality compared to Greenfield investments. These findings, therefore, emphasize the need for adopting a comprehensive and competitive policy framework in India.

Jonathan Haskel\textsuperscript{21} (2004) and others in their study try to find out whether there are any productive spillovers from FDI to the domestic firms and, if so how much should the host countries be willing to pay to attract FDI to other countries. Using plant level panel covering U.K. manufacturing from 1973 to 1992 they estimate a positive correlation between domestic plant’s TFP (Total Factor Productivity) and the foreign affiliates, share of activity is that plant’s industry. Typical estimates suggest that a 10 percent point increase in foreign presence in the U.K. Industry raises the TFP of that industry’s domestic plant by about 0.5 percent. These estimates are used to calculate the job value of these spillovers. These calculated values appear to be less than per job incentives that the Government has granted in some cases.

Mohan Guruswamy sharma\textsuperscript{22} discuss the retail industry in India in their study on FDI in the retail sector. They focus on the “labour displacing” effect on employment due to FDI in the retail sector are not fully applicable to the retailing sector and the chief task of the Government in India is still provide and not create so called efficiencies of scale by creating superfluous(redundancies).

Bary Rose Worth\textsuperscript{23}, Anand Virmans and Susan Collins- (2007) study empirically India’s economic growth experience during 1960-2004, focusing on the post 1973 acceleration, The analysis focuses on the unusual dimensions of India’s
experience: The concentration of growth in the service production and the modest level of human and physical capital accumulation, they find that India will need to broaden its current expansion to provide manufactured goods to the world market and jobs for its large pool of low skilled labour force, increased public saving as well as rise in foreign investment, particularly FDI could improve the rising household saving and support the increased investment necessary to sustain rapid overall growth.

The Japan Bank for International Cooperation (2002) made a study on Key FDI related issues, following were the findings. The inflows of global FDI have increased with cross border mergers and acquisitions among OECD countries triggered by policy initiatives like implementation of E.U’s single market program and the creation of NAFTA, ASEAN and South Asia began cross border mergers and acquisitions after their financial crises. Also in the 1990’s the US emerged as the world’s largest recipient of FDI, while China led the race of attracting FDI inflows. The study also finds that FDI tend to “crowd in” domestic investment as the creation of complementary activities outweighs the displacement of the domestic competitors and that “spillover” effects of FDI. On the productivity growth of the local firms do not occur automatically. The magnitude of these spillovers depends on various home country and firm level characteristics like relative and absolute absorption capacities of Individual host countries and firms. The study concludes by stating that host countries government policies should attach greater importance to the stability and predictability of the local business environment in which foreign trade occurs.
N.S. Siddharthan and K. Lal (2004) analyze the impact of FDI spillovers on the productivity of the Indian enterprises for the post liberalization years 1993-2000. This study argues in favour of using an unbalanced panel that takes into account the entry and exit of the firms, further it also advocates the estimation of separate firm level cross section equations for each year to analyze the possible changes in the values of the spillover time. The results show the presence of significant spillover effects from FDI. During the initial years of liberalization the spillover effects were modest, but increased sharply later on. Firms with better endowments in terms of productivity and technology benefited from liberalization and MNC presence. Firms with large productivity gaps become the victims.

In their study on FDI and its economic effects in India, Chandana Chakraborty and Peter Nunnekemp (2006) assess the growth implications of FDI in India by subjecting industry specific FDI and output to causality tests. Their study is based on the promise that the composition and type of FDI has changed in India since 1991 which has led to high expectations that FDI may vary widely across sectors. FDI stocks and output are mutually reinforcing in the manufacturing sector. They also find only transitory effects of FDI on output in the services sector which attracted the bulk of FDI in the post-reform period. These differences in the FDI growth relationship suggest that FDI is unlikely to work wonders in India if only remaining regulations were relaxed and more Industries opened up to FDI.

Sebastain Morris (2004) has discussed the determinants of FDI over the regions of a large economy like India and developed a framework drawn from the advantage concept of Kindleberger and from location theories noted in regional
science. He argues that it is the regions with metropolitan cities, which have an advantage in ‘headquartering’ the country operation of MNC’s in India, and therefore, attract the bulk of FDI. Even more than the quantum of FDI, the employment effects and the spill over effects are large for such regions. He finds that Gujarat has been particularly handicapped in not having a large and metropolitan city unlike the southern states which have Bangalore and Hyderabad and Chennai. He concludes by suggesting that there are vast gains to be made by attracting FDI especially in services, high-tech, and skilled labour seeking industries because than the resulting operations are more externally oriented and the investments arise from competing firms.

Prof. Subramanya and prof. Bhuma 28 (2006) in their paper “Studying outward FDI by India”, find that government expenses and labour outflows have significant elasticity with respect to remittances. They say that the level of overseas investments is closely related to the comfort level of the investors. Tangible data collection and validation support the hypothesis that, when outward FDI becomes a reality, significant skilled personnel from the country get employed in the venture and thus contributes towards the remittances. They contend that government expenditure to promote the tertiary education and increasing the pool of skilled man power and the number of people emerging has a direct bearing on the remittances.

In a different study Rashmi Bang 29 (2004) has analysed the impact of Japanese and U.S FDI on the productivity growth. She has examined the impact of Japanese and US FDI on total factor productivity growth of the firms in the Indian automobile, electrical and chemical industries in the post reform period. The results
show that the domestic firms have witnessed both efficiency growth and technological progress in the electrical and chemical industries in the reform period. This has positively impacted on the productivity and employment generation in these sectors.

FDI in fact did have a significant impact, as reported by Topalova\textsuperscript{30} (2007) \textquotedblleft The impact of trade reforms appears to be magnified as foreign direct investment was allowed or restrictive licensing requirements were removed, a finding that is robust across all specifications and measures of productivity. The increase in productivity from a 10 percent reduction in tariffs in a firm, operating in an industry that saw no change in FDI rules was 0.63 percent. The same reduction in tariffs was associated with a 2.3 percent increase in productivity for firm, for which FDI was fully liberalized during this time period.	extquotedblright \ Taken together, the small amount of FDI and Topalova's findings suggest that the clustering, competition, and spillover effects of FDI are boosting growth in terms of income and employment generation in India.

Chakravorty\textsuperscript{31} acknowledges the diminished role of the government, but argues that it is \textquotedblleft a more enlarged state in terms of promoting selected metropolitan regions for receiving investment, especially foreign direct investment (FDI)\textquotedblright

Sachs\textsuperscript{32} et al. argue that liberalizing reform is vital to where FDI flows, \textquotedblleft there are major differences across states in the area of policy reform. A few of the Indian States have been more reform-oriented, such as Maharashtra, Karnataka, Gujarat, Tamil Nadu and Andhra Pradesh.\textquotedblright

Ahuwalia\textsuperscript{33} notes that the \textquotedblleft investment climate varies widely across states, and these differences are reflected in a disproportional share of investment, especially
foreign investment, being concentrated in what are seen as the more investor-friendly states to the disadvantage of other states.” Sachs et al suggest a causal mechanism in “the role of private investment” that “has acquired a great deal of significance. States are now in competition with one another to attract private investment, both in terms of domestic and foreign.

Roa and Singh point out that “the regional concentration of FDI is less of a concern if labour mobility is sufficient to ensure that workers can go where new jobs are created.” However, Topalova points out that Indian labor mobility is relatively low, “less than 0.5 percent of the population in rural and 4 percent of the population in urban areas moved for reasons of economic consideration (or employment).” The differential flow of foreign investment creates the possibility of “Two Indias” unless more governments pursue policies that attract FDI. State governments should induce foreign private investors to invest in backward regions of the state and help generate more income and employment opportunities in the backward regions.

In his study on human capital formation and FDI in developing countries, Koji Lyamoto argued that the complex linkages between the activities of the MNC’s and the policies of host developing countries. The literature indicates that a high level human capital is one of the key ingredients for attracting FDI as well as for the host countries to get maximum benefits from these activities. He finds that one way to improve human capital formation and attract more FDI is to provide a strong incentive for MNC’s and investment promotion agencies to participate in formal education and vocational training for workers employed with domestic firms.
In addition FDI promotion activities can target high value added MNC’s that are more likely to bring new skills and knowledge to the economy that can be tapped by the domestic firms? They can in turn generate more employment opportunities in the host country.

FDI and gender equity, Elissa Braum\textsuperscript{37} (2006) presents a review of research and policy on the links between foreign private investment and development. This work provides broad and consistent evidence for the argument that growth leads to FDI rather than FDI leading to growth. The work also under scores the importance of economic policy context for gaining development benefits from FDI. Besides keeping the production costs low to attract more qualitative FDI, countries must also have adequate domestic capacities to benefit from FDI. These capacities are related to economic growth including high level of investment, infrastructure and human capital. Looked from a gender perspective, FDI in female intensive industries has had a greater impact on women’s work and development. She finds that there is likely to be some short term improvement in women’s income as FDI expands but the trajectory of women’s wages is less promising. These findings are constituted with those that indicate trade and FDI have done little to narrow the gender wage gap.

Rajesh Narula and S. Lall\textsuperscript{38} (2006), in their edited volume, find that understanding the factors that led to an optimization of the benefits from FDI for the host country. Despite the diversity of the countries covered and methodology used, the chapters in this volume point to a basic paradox, “with weak local capabilities, Industrialization has to be more dependent on FDI. However, FDI can’t drive industrial growth without local capabilities”. The studies here do not support the view
that FDI is a sine qua non for economic development. They unmistakably show that market forces cannot substitute for the role of the government and argue in favour of a pro-active industrial policy. Thus FDI per se does not provide growth opportunities unless the domestic industrial sector exists which has the necessary technological capacity to benefit from the externalities from MNC activity.

Stephen Howes, et al edited a volume on state level reforms in India. Although the book is primarily on India it has some comparative studies from Great Britain and Australia too. The book argues that state governments in India, a country with a federal structure, play an extremely important role in the provision of social services such as education and health, and basic infrastructure such as power, roads and irrigation. Since the second half of the nineties, a wave of reforms has sweeping India at the state level. While cynics may counter that talk about reforms has outpaced action, the number of state governments which have donned the reform mantle is striking, and number of new reform initiatives is growing rapidly. So far, there has been no source book to document and analyze this remarkable phenomenon which, in many ways, is changing the face of India. The book discusses a wide variety of topics related to fiscal and governance reform from a range of perspectives-political, bureaucratic and academic, Indian and foreign, state and national.

Pradip Baijal in "privatization: Compulsions and Options for Economic Reform" argues that privatization is an evocative subject even in the developed economies. In a developing economy like India, with its tradition of successful and pervasive public intervention, it generates unique mind-blocks. Its implementation therefore, according to the author, requires persistent, persuasive zeal. However, the
compulsions of ensuring higher levels of efficiency and productivity require a complete restructuring of the economic environment. Low levels of public savings, inadequate competition and low export orientation are barriers which need to be transcended. Privatization and liberalization of the licensing regime for FDI are two initiatives which can meet the objectives of efficiency enhancement, domestic and foreign resource mobilization and incremental capital outlays. The pace of privatization has quickened since 2000. The adoption of a strategic partner, along with transfer of management control, as opposed to market sale of shares in small lots, has enhanced the value received by the government through disinvestments. It also ensures that these assets are put to productive use in the most optimum time frame and with the maximum benefit. While it is too early to quantify such benefits, there is sufficient anecdotal evidence of significant welfare gains for employee, institutional investors and the economy, along with the quantifiable gains for government, from the additional resources freed by the sale of public sector enterprises.

Abdul Aziz edited a book on Karnataka with reference to industrialization, socio-economic externalities and state policy that gives an overarching view of industrialization in Karnataka. The book is a collection of field-based research papers originally presented in a seminar, spells out the socio-economic implications of massive industrial investment that is expected to flow into an iron ore based economy of a district in Karnataka. The main focus of the papers prepared by economists, sociologists and political scientists is on an assessment of the extent of pressure that is likely to build up on the basic infrastructure, municipal services, land and manpower
resources and eco-system, as also the consequences this will have on the social and economic life of the people of the region. The book argues that while the investment activity of such a magnitude will initiate industrial and economic growth, and help develop material and human resources in the region, the pumping in of such huge amounts of money will also cause some major adverse effects on the society, economy and polity unless timely steps are taken to minimize them. People and their organizations, and non-governmental organizations to minimize the negative investments in a particular sector and in particular region lead to various other problems that need to be addressed.

The book on vision 2025 for Karnataka edited by D. Jeevan Kumar and Susheela Subrahmanya deals with the strategies and action plans for sustainable development of Karnataka by 2025. The book makes a pre-assumption that sustainable development is the path that Karnataka has to adopt in order to ensure development by 2025. Hence, the book needs to be located in the discourse on ‘sustainable development’. Sustainable development is not a fixed state, but a process of continuous change in which the exploitation of resources, the direction of investments, the orientation of technological development and institutional change are all in harmony, and hence both cannot and future potential to meet human needs and aspirations. Karnataka undoubtedly is one of the most progressive states in India. Under an enlightened leadership, the state is shifting to e-governance, building public-private partnerships in key sectors, and is utilizing bio-technology and genetic engineering to modernize agriculture and promote rural development. For Karnataka to develop on a sustainable basis, it needs a vision based on the assumption that
development should meet the needs of present, without limiting the ability of future
generations to meet their own needs.

Another book on Karnataka edited by M.V.Srinivasa Gowda and D.T.Nanje
Gowda deals with various issues of economic development of Karnataka. The book
covers wide variety of issues in a broad manner that are relevant to the state of
Karnataka. Dealing with trends and dimensions in the development of the state’s
economy in terms of the overall and sectoral SDP as well as in terms of changes in
demography is linked with human development.

Veeramani and Bishwanath Goldar in their paper on productivity analyses
the influence of investment climate on total factor productivity in the registered
manufacturing sectors across the major Indian states. They conclude that a market
friendly investment climate is important for achieving higher levels of productivity.
They further argue that robust, unaffected by the choice of the investment climate
indicator. A market friendly investment climate, however does not mean that the
regulatory function of the Government should be done away with. Government,
according to them, should regulate and this regulation is crucial to address market
failures and to protect social interests, but the policies and practices of the
Governments should be transparent and designed without distorting the incentives of
the firms to invest and grow. However the authors fail to look at the history of
productivity as they concentrate only on post-reforms period.

The paper by B.B.Bhattacharya, N.R.Bhanumurthy, Sabyasachi Kar and
S. Sakthivel on “Forecasting State Domestic Product and Inflation: Macro economic
model of AP, Karnataka and UP” analyses using econometric models of the SDP of
Andhara Predesh, Karnataka and Uttar Pradesh. They argue that at present, states in India make their own assessments regarding economic growth for their planning and budgeting purpose. These assessments are mostly derived, according to the authors, from judgements rather than serious econometric modeling. The regional econometric model developed in these papers forecasts growth rates of the aggregate and sectoral GSDP for the three states. The paper looks at the medium-run trends and characteristics of the economy of each state, taking into consideration the structural changes in the Indian economy during the period. However, the paper does not directly address the disinvestments issue by looking at the state of Karnataka.

In Howes, et al, edited volume looks at the role of state government in the post-reform period. It is argued that the number of state governments that donned the reform mantle is increasing rapidly in the post-reform period. The book counter the argument that the talk about reforms has outpaced the action. It is argued the state governments were able to play a crucial role in the industrial development due to the space provided by the federal structure of the Indian constitution. Also, the healthy competition among the states in order to attract investment and industries to their own states has further boosted the prospects of the industrial development in India. It concludes by studying various aspects of the fiscal and government reform challenges facing the Indian states.

Paul (2000) in his article on ‘the industrial investments and the state governments looks at the role of the states in pursuing economic reforms. He argues that in order to ensure the economic reforms succeed, states must not only focus on attracting projects, but also on monitoring their implementation. Moreover, all the
state governments are vying with each other to attract industrial investments. However, Paul laments at the lack of data available on the rate of implementation of projects. In this backdrop, Paul records the progress of implementation of investment proposals in Karnataka and suggests methods for creating an enabling environment for industrial growth.

Jaya Gupta48 (2007) in his paper made an attempt to review the change in sectoral trends in India due to FDI Inflows since liberalization. This paper also examines the changed policy implications on sectoral growth and economic development of India as a whole.

Jayashree Bose49 (2007) in his book studied the sectoral experiences faced by India and China in connection with FDI inflows. This book provides information on FDI in India and China, emerging issues, globalization, foreign factors, trends and issues in FDI inflows, FDI inflows in selected sectors. A comparative study has also been conducted on FDI outflows from India and China. This book also revealed the potential and opportunities in various sectors in India that would surpass FDI inflows in India as compared to China.

Feinberg & Majumdar50 (2001) found that Liberalization of FDI policies offers opportunities for firms as well as threats. If FDI (and trade) liberalization results in faster growing national economies, then firms face larger, faster-growing markets domestically.

Krishnamoorthy,51 et al.(2005) compared the trends in FDI flows in India and China during the post-reform. He found that though, there has been a clear rising trend in FDI flows during the post-reform period, the growth of FDI was not in
commensurate with China. Never the less, he found that FDI during this period went to high priority and high technology sectors.

2.2 Relevance of the study

The rational of the present lies on the fact that non of the reviewed studies focused on in and employment generation due to FDI flows in the state of Karnataka to say that the study mainly emphazes on the proper utilization of the foreign private capital in core sectors to augment the rapid economic growth and employment generation in the state of Karnataka. In this context FDI is seen to complement scarce domestic financial resources. It is also expected to help modernize production by upgrading technical know-how, while increasing domestic productivity and improving international competitiveness.

The following are the needs for FDI in developing countries like India to achieve the twin objectives of income and employment generation & optimum utilization of natural resources:

- **Scarcity of resources**: In view of the scarcity of capital resources due to inadequate capital formation in the country, the foreign capital is urgently needed to support various investment projects.

- **The technological gap**: Considering the gap in technological knowledge prevailing in a developing country like India, the FDI is badly needed to update the traditional technology of production for attaining international competitiveness.

- **Initial risk**: The underdeveloped countries are facing the lack of flow of domestic capital at the initial stage of a project due to lack of experience and expertise the high initial risk of investment can augment flow of domestic capital to the desired direction.

- **Building infrastructure**: The developmental programmes of the underdeveloped country depend much on building infrastructural facilities which require huge investment. Foreign private capital can
provide necessary support towards building such infrastructural facilities in the country.

➢ **Associated assistance**: FDI brings with it other factors like technical knowledge, R&D facilities, business experience, skill over effects, etc. Which are considered equally important for economic development.

➢ **BOP Support**: FDI plays a vital role in the area of international trade promotion activities. In order to meet the balance of payments crises arising from the huge import requirements for importing technical know-how, capital goods, and other maintenance imports in the initial part of development process of a developing country like India, the inflows of FDI stock can offer a temporary solution to the problem.

Elaborating the need for FDI in India the Economic Survey 2003\(^3\) maintains:  
“FDI directly impacts on output growth in India by augmenting the available invertible capital. However, a far more important impact of FDI is through externalities leading to high efficiency and productivity. FDI typically serves to increase competition in markets, bring new technology into India and foster skill acquisition amongst domestic labour. FDI by international corporations is also central to the process of India being utilized as a platform for global production chains, which would pave the way for strong exports growth.”

FDI should also facilitate integration into the world market, domestic participation in globalized production patterns, and creation of forward and backward linkages with the domestic economy. In so doing, it will have a multiplier effect on the whole economy and could thus be a key element in spurring growth in employment generation. As a result, the role of FDI based enterprises as investors and contributors to employment has growth in importance, but it can lead to uncontrolled competition between countries and even between states with in the same country in terms of offering fiscal incentives to attract investment. In fact it is happening in
India, among the states of Maharastra, Delhi, Karnataka, Gujarat and Tamil Nadu respectively.

FDI is theorized to boost growth in the recipient country via two channels. The more obvious premise is that FDI directly adds to the capital-stock of the recipient country, thereby allowing a more optimal production of goods and services. Thus, the result of the relative inputs of labor and capital is maximized. The other channel is FDI's ability to shape the domestic economy by encouraging clustering, creating competition-driven productivity gains, and exposing local firms to foreign technology and best business practices. When states actively seek FDI, they take steps to improve the investment climate, which helps local firms.

Structure of FDI and its effects on income & employment with the opening of the Indian economy, FDI has become an important mechanism of their integration into world Economy.

Ajaga and Nunnenkamp\textsuperscript{54} (2008) investigated the long-run relationships between inward FDI and economic outcomes in terms of value added and employment at the level of US states. Multi National Enterprises (MNE) employment has a direct and indirect impact on domestic employment: FDI often generates new employment (direct employment is higher in green filed (investments) and creates jobs (indirectly) through forward and backward linkages with domestic firms estimates for a number of developing countries indicate that FDI has a multiplier effect on domestic employment. Aaron, c\textsuperscript{55} (1999)

FDI in India thought of as a composite bundle of capital stocks, know-how, and technology, and hence its impact on growth and employment is expected to be
manifold and vary a great deal between technologically advanced and developing country like India. The ultimate impact of FDI on output growth in the recipient economy depends on the scope for efficiency spillovers to domestic firms, by which FDI leads to increasing returns in domestic production, and increases in the value-added content of FDI related production activities. A number of studies have shown that MNEs pay higher wages than domestic firms even after controlling for firm and worker characteristics Lipsey (2002) Further more, the presence of multinationals sometimes generates wage spillovers: wages tend to be higher in industries and in provinces that have a higher foreign presence Lipsey and Sjoholm56 (2001).

Since second generation reforms started in India in 2000, country emerges as an alternative FDI destination in the world of development economy. FDI has considered a major factor in promoting sustainable development in developing countries like India. FDI has the potential to generate employment, both in urban and suburban areas, raise productivity, transfer skills and technically increased the national income of the country in general and State Domestic Net Product (SDNP) of Karnataka’s economy in particular.

Greenfield investments are key promoters of income and employment opportunities in the country, direct investment in new facilities or the expansion of existing facilities. Greenfield investments are the primary target of a host nation’s promotional efforts because they create new production capacity and jobs, transfer technology and know-how and can lead to linkages, to the global marketplace.

The consolidated FDI policy in India, 201057 mainly aims at removal of rigid regulatory barriers to facilitate the FDI investment prospects in terms of more FDI
inflows in core sectors which will enable the FDI based industries to create more productive employment opportunities in the country. India sought to make its foreign investment regulations more accessible to investors by consolidating regulations relating to FDI and cross-border capital flows.

2.3 Statement of the problem

The study has shown that FDI is not a panacea for economic growth and employment creation. A country needs stable and productive investment inflows to ensure sustainable growth and employment creation. The question is how and to what extent a country can influence or steer investors' decisions to receive investment which promotes production and employment. In an increasingly globalized world a country can influence FDI only to a limited extent. Nevertheless, the State should ensure to consolidate the locational advantage of a country by creating a sound macro economic frame work and by sustained public investment in physical and human infrastructure. The State could also have a more proactive role in promoting productive investment in promising productive employment activities and in discouraging volatile short-term investment through a mix of regulations and incentives. To attract more FDI, we will have to think in terms of new areas into which we may channel these investments. But more than this the serious stumbling block in attracting FDI into India is the fact that our bureaucratic machinery continues to be sluggish. Data released by the World Bank show that in terms of the bureaucratic efficiency for "doing business," (Economic Survey of India (2010-11))\textsuperscript{58} India ranks as low as 134th in the world. Clearly, this is one area with scope for improvement. If we can make our Bureaucratic administrative machinery more
efficient the benefits for the economy will be enormous in terms improvement in investment and employment opportunities in the country.

According to the World Bank: India country overview 2008\textsuperscript{59} India’s labour regulations—among the most restrictive and complex in the world have constrained the growth of the formal manufacturing sector where these laws have their widest application. Better designed labor regulations can attract more labor-intensive investment and create jobs for India’s unemployed millions and those trapped in poor quality jobs. Given the country’s momentum of growth, the window of opportunity must not be lost for improving the job prospects for the 80 million new entrants who are expected to join the work force over the next decade.

In order to understand the link between FDI and employment, it is crucial to understand what attracts FDI to a country. The economic determinants of FDI have been classified by standard FDI theories as market-, resource- and efficiency-seeking. The main considerations of market-seeking investors are market size and per capita income, market growth potential, including access to regional and global markets, country-specific consumer preferences; and the structure of the markets. Generally, market seeking investment is horizontal. It means that a large part of the production chains is based within the country implying important backward and forward linkages and technological spillovers.

While the 2008 level was the second highest in history, FDI flows began gradually declining over the course of that year. In the first half 2009, FDI flows fell at an accelerated rate. This trend affected the economic growth and employment prospects in the country during the melt down period.

FDI into India has declined by 9 percent to touch $6.51 billion during January-April 2011 over the same period last year, according to the industry ministry data. In January-April 2010, the country received FDI worth $7.14 billion. According to experts, the government should further streamline FDI policies and make the environment more investment-friendly to attract investments. The sectors that attracted FDI include services (financial and non-financial), telecommunications, housing and real estate, construction activities and power, the data said. FDI inflows into India were $19.42 billion for 2010-2011.

Increasing inter-regional FDI has become an effective vehicle for industrial upgrading in the South Asia region, in general and India in particular in providing opportunities to countries at different stages of development. UNCTAD\(^6\) (2009). Inflows from developed countries contracted the most, while inter-regional FDI gained ground. UNCTAD’s World Investment Prospects Survey 2010–2012,\(^6\) indicates renewed business optimism over the medium term. TNCs’ intentions to pursue foreign expansion are stronger for 2011 and 2012. The recovery of FDI is likely to be led by cross-border Merger and Acquisitions (M&As). Restructuring in a number of industries, as well as the privatization of companies rescued during the global turmoil, will further create cross-border M&A opportunities for TNCs. The
survey also confirms that the share of the manufacturing sector in FDI will continue to decline relative to the primary and services sectors.

Already the mood on India was not very positive given that various infrastructure and industrial projects had come up against green hurdles erected by the ministry of environment and forest. This badly impacted in terms of investment and employment creation activities in the country. A new balance has to be found between foreign investment and domestic investments.

The global financial and economic recovery remains fragile, threatened by emerging risks, constraints in public investment, uncertainty about financial regulatory reforms the limited access to credit, the volatility of the stock and foreign exchange markets and other factors. UNCTAD\textsuperscript{62}, (2010) the recovery to remain on track, private investment is crucial for stimulating growth and employment. FDI has a major role to play in terms investment promotion and employment generation in the country.

In spite of the efforts by the government of Karnataka to attract FDI investments in key sectors like Infrastructure, Steel, Cement, Power and others, it fail to attract optimum FDI investments compare to other states due to global meltdown and other factors. The objective behind allowing FDI is to complement and supplement domestic investment, for achieving a higher level of economic development and providing opportunities for technological upgradation, as well as access to global managerial skills and practice.
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