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# IMPACT OF FDI ON INDIAN ECONOMY: CHALLENGES AND PROSPECTS

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**ABSTRACT :**

*After liberalization of Trade policies in India, there has been a positive GDP growth rate in Indian economy. FDI have helped India to attain a financial stability and economic growth with the help of investments in different sectors. FDI has boosted the economic life of India and on the other hand there are critics who have blamed the government for ousting the domestic inflows. Foreign direct investments helps in developing the economy by generating employment to the unemployed, Generating revenues in the form of tax and incomes, Financial stability to the government, development of infrastructure, backward and forward linkages to the domestic firms for the requirements of raw materials, tools, business infrastructure, and act as support for financial system. Forward and back ward linkages are developed to support the foreign firm with supply of raw and other requirements. It helps in generation of employment and also helps poverty eradication. This paper throws light on the impact of FDI on Indian Scenario.*

**KEYWORDS :** *FDI, Indian Economy, Liberalisation, Technology Transfers.*

## INTRODUCTION :

There are many businesses or individuals who would earn their lively hood through the foreign investments. There are legal and financial consultants who also guide in the early stage of establishment of firm. Foreign investments mean both foreign portfolio investments and foreign direct investments (FDI). FDI brings better technology and management, marketing networks and offers competition, the latter helping Indian companies improve, quite apart from being good for consumers. Alongside opening up of the FDI regime, steps were taken to allow foreign portfolio investments into the Indian stock market through the mechanism of foreign institutional investors. The objective was not only to facilitate non debt creating foreign capital inflows but also to develop the stock market in India, lower the cost of capital for Indian enterprises and indirectly improve corporate governance structures. On their part, large Indian companies have been allowed to raise capital directly from international capital markets through commercial borrowings and depository receipts having underlying Indian equity. Thus the country adopted a two-pronged strategy: one to attract FDI which is associated with multiple attendant benefits of technology, access to export markets, skills, management techniques, etc. and two to encourage portfolio capital flows which ease the financing constraints of Indian enterprises. Foreign technology induction can be encouraged through FDI and through foreign technology collaboration agreements. The sectors which have resources but do not have the required technology acquire foreign technology collaboration through RBI or Government approvals. The total number of approvals recorded for the period of 2000 to 2010 by the RBI, SIA and FIPB is 8080. The RBI has approved 4580 proposal whereas SIA and FIPB have approved 3500. Technical collaborations have put a positive effect on the domestic firms. It helped in establishing technology transfers.

An Indian company may receive Foreign Direct Investment under the two routes as given under:

**Automatic Route:** FDI in sectors /activities to the extent permitted under the automatic route does not require any prior approval either of the Government or the Reserve Bank of India.

**Government Route:** FDI in activities not covered under the automatic route requires prior approval of the Government which is considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, and Ministry of Finance. FDI is not permitted in the following industrial sectors:

Arms and ammunition, Atomic Energy, Railway Transport, Coal and lignite, mining of iron, manganese, chrome, gypsum, sulphur, gold, diamonds, copper, zinc.

Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations).Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

In the overall, inflows of FDI have increased substantially compared to the earlier regime in which the scope for FDI was quite restricted. As a result, the stock of FDI in India jumped from $1.66 bn at the end of 1990, to $17.5 bn by the end of 2000 and further to a little above $164 bn by the end of 2009. The addition during 2004 and 2008 is quite spectacular as the stock increased by nearly $125 bn. There were hints that private equity might have been a major contributing factor to the enhanced inflows. Presently India is contributing about 17% of world total population but the share of GDP to world GDP is 2%. India has been ranked at the second place in global foreign direct investments in 2010. Mauritius is the highest FDI investment in equity inflows with 42% of the total inflow followed by Singapore, USA, UK and Netherlands with 9%, 7%, 5% and 4% respectively.

Service sector is the highest FDI attracting inflows with 21% of the total inflows, followed by computer software and hardware, telecommunication and housing and real estate with 9%, 8%, 7% and 7% inflows respectively. A report released in February 2010 by Leeds University Business School, commissioned by UK Trade & Investment (UKTI), ranks India among the top three countries where British companies can do better business during 2012-14. According to Ernst and Young’s 2010 European Attractiveness Survey, India is ranked as the fourth most attractive foreign direct investment destination in 2010.

The sectoral level of the Indian economy, FDI has helped to raise the output, productivity and employment in some sectors especially in service sector. Indian service sector is generating the proper employment options for skilled worker with high perks. On the other side banking and insurance sector help in providing the strength to the Indian economic condition and develop the foreign exchange system in country. So, we can conclude that FDI is always helps to create employment in the country and also support the small scale industries also and helps country to put an impression on the world wide level through liberalization and globalization.

## FDI Trends and Labour in India

The Indian economy grew at a rate of about five percent per annum during the 1980s. Despite this growth the country faced an acute economic crisis, reflecting some domestic problems but primarily external ones relating to pressure on the balance of payments. Major domestic problems related to inflation, which peaked at 17 percent in 1991, and a central government fiscal deficit that stood at an all time high of 8.4 percent of gross domestic product (GDP). On the external front, foreign exchange reserves continued to fall - plunging to $1.2 billion - just enough to pay for two weeks of imports. The current account deficit widened to almost $8 billion (2.6 percent of GDP).

It was inevitable that these symptoms would result in loss of confidence by international bankers and the debasing of India's credit risk ranking by Moody's. With these problems the International Monetary Fund (IMF) and the World Bank financially supported the country on condition that a Stabilisation and Structural Adjustment economic package was implemented. Faced with such economic difficulties, a new government that took power in June 1991 approached the IMF and World Bank to bail it out. In India, it has been a subject of debate; given these bleak economic conditions India had little choice but to embark on a liberalisation drive while the other point of view is that India could have overcome this situation by adopting tough measures of financial discipline particularly for unplanned expenditure and mobilising resources from within as well as unconditional external financial borrowing.

## FDI and Technology Transfers

There has been significant investment in the manufacture of automobiles and consumer goods, including electronics products, but still the capital equipment and the assembly lines for their production are imported. Little of the design and development work takes place in India. During the fieldwork of a CEC–AMRC study in 2003 on electronics sweatshops in India, researchers tried to find the fabrication and production of electronics chips but not a single instance was found all over India. We found that only local assembly of knocked-down kits in all TNCs and of course there is no question of having indigenous capacity of local companies. So far, FDI in India has not been tantamount to an all-round technological upgrade of Indian design and manufacturing. Some companies assemble personal computers in India; India's share of world hardware manufacturing is less than that of Taiwan, Korea, Malaysia, China, or Singapore, and even lower than Thailand or the Philippines.

There are numerous instances where multinationals have not only displayed a lack of ethics and 'transparency' but have actually broken the law. Violations are neither rare nor exceptional, since all the companies surveyed by the Income Tax authorities in the recent past have shown a tendency to violate the law. Had the violations taken place in some other country, not only would criminal proceedings have been launched but the people responsible for it would have been put behind bars. In the recent past, cases of tax evasion by some Japanese and South Korean firms operating in India have come to the notice of the authorities, highlighting a 'certain intention' on the part of these companies to dupe the Government.

With violations and other means of tax evasion, the loss to the government may amount to Rs 10 billion. Rather than increase the government's ability to solve pressing problems, liberalisation and FDI has actually weakened the government's financial ability to intervene in the areas of education, healthcare, and essential infrastructure.

## Liberalisation, FDI, and labour in India

On the basis of the Annual Survey of Industries it is evident that the growth in organised employment was not significant during the liberalisation period. The 1980s saw a growth of approximately 1.5 percent per annum while that figure declined to less than one percent in the 1990s.

Liberalisation and the consequent inflow of FDI to India have had many consequences for labour standards. Workers face production methods and managerial styles that are not familiar to them and which demand adequate responses from the trade unions. Some of the problems they face are: outsourcing strategies, flexibilisation, and the growing amount of contract labour and temporary work. An important consequence of these trends is a reduction of bargaining power of trade unions .After the liberalisation policies, the process of casualisation and absorption of labour to the informal sector are rising, as has been found by various studies.

With the advent of globalisation and liberalisation, many Indian labour laws were changed or indirectly relaxed to suit employers to attract FDI. Various provincial governments have looked to private domestic and foreign investment for employment generation as well as revenue. The liberalisation measures taken by the Government of India and followed by various provincial governments were reciprocated and many TNCs came to operate in India. Anecdotal evidence suggests that certain provincial governments grant mandatory permission for restructuring, retrenchment, and closure more liberally than earlier. This situation has created a fertile ground for violation of labour rights. Nowadays the most gross violation of labour rights is the violation of International Labour Organisation (ILO) conventions 87 and 98 concerning freedom of association, collective bargaining, the right of workers to form organisations of their own, and to negotiate freely working conditions with employers. This has major complications for the workforce in India where trade unions already have problems facing the new challenges of globalisation. Voluntary retirement schemes with sometimes generous terms acceptable to enterprise level trade unions are also becoming common.

Liberalisation and the inflow of FDI have had somewhat negative effects on the ILO's four core labour standards. It is believed that increasing competition in the automotive sector and demand for better quality, which it was argued implies better labour standards, but they did not improve. Company pressure on productivity created more stress on workers though. The inflow of FDI has introduced new technologies with a generally negative influence on health and safety standards in the assembly plants. TNCs in India normally introduce new technology but ignore corresponding health and safety measures. Now workers have greater exposure to chemicals and fumes. Foreign companies in the automobile sector tend to have a slightly better record on wages than in other industries but have a negative record on the collective process.

Now it is evident that liberalisation and the inflow of FDI have contributed to these negative trends and the situation discussed in the preceding sections. Before liberalisation labour standards were already very poor. Governments do not implement labour laws as they have the opposite priority. TNCs fully exploit the current favourable situation to them by banning independent trade unions in their plants, only allowing sweetheart unions, which certainly negatively affect labour standards. The period of liberalisation shows many unsuccessful attempts by workers and unions in various factories to gain their basic rights and due share in profits, such as the cases of the Maruti–Suzuki workers' struggle during 2001-2002, Honda Seal and Hyundai during 2003-2004. The expected impact on industries originating in India, some of which are now Asian TNCs, is similar to western TNCs in terms of industrial relations and management practices. In indigenous industries workers and trade unions are in retreat or defeat.

## FDI and Information Technology Workers

Information technology linked with FDI has grown very rapidly in the 1990s, mainly in the export market in offshore services for developed countries. Labour turnover is high in this fast growing sector with a young worker age profile. The two to three years after the IT-bubble burst in the US had adverse consequences in India. Anecdotal evidence appearing in economic newspapers indicated widespread prevalence of 'pink-slips' without these reportedly contested under the Industrial Disputes Act (IDA). It is not clear whether the IDA was taken to be inapplicable or whether new informal labour market norms of accepting retrenchment are evolving in this segment. Two studies by CEC on labour rights violations in the IT industry (2001) and Electronics Sweatshops found that in the private sector as well as in the TNCs, workers invariably have to work for more than the stipulated eight hours to complete the quota assigned for the day. So work is performance-based rather than time- based. Indeterminate employment relationships have emerged where short-term contracts, marginal part-time work, in- and out-sourcing, and 'teleworking' is representative of the changing nature of employment. However, employee interaction with top managers is direct and very frequent. Moreover, TNCs prefer to keep the company union free, insisting that worker problems are taken up individually even if the problems are similar in nature.

Despite the hype over the inevitability of FDI and consequential invitations and relaxations, it did not happen as predicted; rather it performed very poorly in India. Total foreign investment has been hovering just around one percent of GDP for the last few years and cannot be said to be making any significant impact. FDI constitutes a little less than half the total, and its impact is thus even lower.

The Indian economy and working class faced more negative impacts than positive. With the beginning of FDI flows into a liberalised India some key characteristics of employment in India have emerged which have been negative. On the employment generation front there has been slow growth in comparison to growth in the labour force and the growth in value added in the economy. This slow growth is more evident in the organised sector, particularly in larger enterprises, and there has been a remarkable rise in casual employment.

On technology transfer and the development of know-how and the infrastructure, the absence of significant investment in the local design and manufacture of advanced electronic components, computer chips, and telecommunications hardware must be seen as a significant failure from labour's viewpoint of this decade of rapid globalisation and the FDI regime. Whatever amount of FDI India has received from the beginning of liberalisation, a detailed analysis of the last few years of FDI indicates that a sizeable portion of this investment has not gone into the creating new productive capacities. Much of the investment has simply gone into takeovers of existing Indian enterprises or towards speculative investments in the Indian stock market. Moreover, other than India's 'hot' IT companies and select TNCs - the vast majority of Indian stocks have not benefited from the highly volatile FDI flows.The FDI regime, with TNCs as its main agents, has implemented a new kind of management where collective initiatives of labour and union have been suppressed successfully.

## Challenges of FDI to India

In spite of the obvious advantages of FDIs, there are quite a few challenges/problems facing larger FDIs in India. So in order to solve these, few root cause of the problems along with the feasible solutions are given below, such as:

**Resource challenge**: India is known to have huge amounts of resources. There is manpower and significant availability of fixed and working capital. At the same time, there are some underexploited or unexploited resources. The resources are well available in the rural as well as the urban areas. The focus is to increase infrastructure 10 years down the line, for which the requirement will be an amount of about US$ 150 billion. This is the first step to overcome challenges facing larger FDI.

**Equity challenge:** India is definitely developing in a much faster pace now than before but in spite of that it can be identified that developments have taken place unevenly. This means that while the more urban areas have been tapped, the poorer sections are inadequately exploited. To get the complete picture of growth, it is essential to make sure that the rural section has more or less the same amount of development as the urbanized ones. Thus, fostering social equality and at the same time, a balanced economic growth.

**Political Challenge:** The support of the political structure has to be there towards the investing countries abroad. This can be worked out when foreign investors put forward their persuasion for increasing FDI capital in various sectors like banking, and insurance. So, there has to be a common ground between the Parliament and the Foreign countries investing in India. This would increase the reforms in the FDI area of the country.

**Federal Challenge:** Very important among the major challenges facing larger FDI is the need to speed up the implementation of policies, rules, and regulations. The vital part is to keep the implementation of policies in all the states of India at par. Thus, asking for equal speed in policy implementation among the states in India is important. India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing larger FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.

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**Table-1: Doing Business in India**

| S.No | | Rank |
|---|---|---|
| 1. | Ease of doing business | 134 |
| 2. | Starting a business | 179 |
| 3. | Dealing with construction permits | 182 |
| 4. | Getting electricity | 111 |
| 5. | Registering property | 92 |
| 6. | Getting credit | 28 |
| 7. | Protecting investors | 34 |
| 8. | Paying taxes | 158 |
| 9. | Trading across borders | 132 |
| 10. | Enforcing contracts | 186 |
| 11. | Resolving insolvency | 121 |

The table above indicates that India is performing well only on two indicators, namely, getting credit and protecting investors. India's performance on three indicators, namely, starting a business, dealing with construction permits and enforcing contracts shows a dismal picture of the investment climate in India. Another report "Global Competitiveness Report" published annually by "World Economic Forum" ranks 148 economies on their competitiveness with respect to indicators like infrastructure, institutions, macro-economic stability, innovation etc. India's overall rank for 2013-14 on the Global Competitiveness Index was 60. The most problematic factors for doing business identified in the report are inadequate supply of infrastructure, corruption, inefficient government bureaucracy, policy instability, tax regulation and restrictive labour regulations.

## Prospects& Future Outlook

India is estimated to require around US$ 1 trillion during the 12th Five-Year Plan period (2012–17), to fund infrastructure in sectors such as roads, airports and ports. The government is in the process of liberalising FDI norms in construction activities and railways, which could bring in investments to meet the target. The government is also relaxing FDI norms in other sectors for foreign investors to invest. FDI in multi-brand retail has been allowed up to 51 per cent. The minimum requirement for the FDI is US$ 100 million, of which at least 50 per cent must be invested in 'backend infrastructure' within three years following the initiation of the FDI. FDI limit in single-brand retail has been increased to 100 per cent; 49 per cent will be under the automatic route and the rest through the (Foreign Investment Promotion Board) FIPB route. Except that, amendments in Indian FDI policy recently opened a no. of key business sectors to increased foreign investment & in several instances, eliminated the need for foreign investors to obtain approval from the Indian Govt. before investing. These changes had a profound influence on FDI trends in India. Ultimately the current regime and the future policies that are declared to be adopted soon shall bring up "GOOD DAYS" for FDI in India as well.

## CONCLUSION

India's main competitive advantage lies in its lower labour costs and remunerative domestic markets. But India is fast losing its competitive advantage to countries like Indonesia and Vietnam as investors are shifting FDI away from known growth engines towards these new emerging economies. No doubt Indian government has implemented several reform measures in order to attract greater FDI but there are several studies which have highlighted India's weak spots. One such report is "Doing Business 2014", an annual report co-published by the World Bank and International Finance Corporation that brings out the differences in business regulations and their implementation across economies. This study covers 189 countries, ranking them on 11 indicators. These indicators reflect the quality of the investment climate in a country and better performance on these indicators is frequently associated with greater inflows of FDI.

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