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FDI in India: Opportunities and Options

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Abstract:- *Economic parameters clearly indicate that the global economy is on recovery mode. However some economics stress on exit in euro-zone countries. It is widely conceived that European crisis is not going to have as adverse an effect on other countries like the 2008 – 2009 crisis. Global financial meltdown in 2008 had highlighted the weakness of growth model of the developed world. As well it underlined the importance of emerging markets in the world development matrix.*

Keywords*:* FDI, Inflow, Trend, Capital Market, Opportunities

Introduction:

India has got a unique position in this bandwagon. It includes the opportunities to attract foreign direct investment (FDI) into Indian a big way. It is due to the fact the multinational corporations (MNCs) have been re-writing their strategic planning and emerging markets are on their radar. India can be their preferred destination. The logic looks convincing but a lot of roadblocks exist there, which can hamper India's promising growth story.

Therefore, efforts should and must be directed to plug these holes because it will change the destiny of India which is set to become economic power in near future. The present state of world economy is on recovery path but the recovery is fragile. Even though the consensus is that recovery in the US and Europe will be slow and gradual.

In Europe there are some countries like Greece, Portugal, Spain and Italy which are having large debt burdens and are experiencing some stress. In certain quarters it is believed that there are risks of the developed world too slipping into a second recession. Hedge fund manager James Chinos has the views that China's property market is a bubble that may burst in late 2011. This is the economic environment under which world economy is crossing.

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The situation in India is entirely different. The Indian economy is the eleventh largest economy in the world by the nominal value and the fourth largest by purchasing power parity (PPP). In the 1990s; following economic reform from the socialist- inspired economy of post – independence India, the country began to experience rapid economic growth, as markets opened for international competition and investment.

In the 21st century, India is an emerging economic power with vast human and natural resources, and a huge knowledge base. Economists predict that by 2020 India will be among the leading economies of the world. But it requires huge resources to attain this development ambition. For instance, India's needs $1 trillion infrastructure spending during the 12th plan (2012-17), according to the planning Commission.

Even though India's domestic saving rate is estimated to 34% in 2009- 10 and to reach 36% by 2011- 12, but due to its massive development needs, the role of FDI in the faster development of the economy cannot be overlooked. The major advantages of FDI in India have been in terms of.

- Increased capital flow
- Improved technology
- Management expertise
- Access to international markets

FDI in India has increased over the years due to the efforts that have been made by the Indian government. The increased flow of FDI into India has given a major boost to the country's economy and so measures must be taken in order to ensure that the flow of FDI into India continues to grow. The major sectors of the Indian economy that have benefited from FDI into India are:

Financial sector (banking and non-banking)

- Insurance
- Telecommunication
- Hospitality and tourism
- Pharmaceuticals

Software and Information Technology

The experience of China in attracting large scale FDI is well documented and it has achieved near double digit growth rate. Its increasing openness to FDI has contributed to its growth performance. Most of the factors explaining China's success have also been important in attracting FDI to other countries: market size, labour costs, quality of infrastructure and govt. policies. For instance, FDI inflows into China reached a record $92.4 billion in 2008,

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whereas FDI inflows into India is estimated to $25.89 billion in 2009-10.

The sudden change in the external environment that started around mid-September 2008 led to an adverse situation characterized by global liquidity squeeze and increased risk aversion on the part of international investors. In India, there were large capital outflows by portfolio investors in the third quarter of 2008-09. While FDI flows exhibited resilience, access to ECBs and trade credits were rendered somewhat difficult.

Under this situation, the main objective of the article is to examine the opportunities and policy options which India can take to attract FDI in a large scale in the current global economic environment.

Trends

India has been a key beneficiary of the improvements in sentiments towards emerging markets and this is reflected in large FDI inflows into India. The trends are:

Year –wise:

FDI inflows into India surged from $ 9 billion in 2005-06 to $27 billion in 2008-09 and 26 billion in 2009-10. FDI inflows marginally lowered in 2009-10 due to the impact of financial crisis. Table below gives a picture of India's performance in attracting FDI.

Table: FDI inflows into India

Year	Amount ($billion)
2003-4.1	4.32
2004-05	6.05
2005-06	8.96
2006-07	22.83
2007-08	34.36
2008-09	27.30
2009-10	25.89

Source: Department of Industrial Policy and Promotion

FDI inflows have surged in India despite the global meltdown and their medium to long-term prospects remain promising. MNCs in many manufacturing and service industries, ranging from steel and automotives to retail, have speeded up their market entry and expansion in India. The overall trend in Asian countries like India abolishing existing FDI ceiling or raising some of them to change policies and legislation to become more favourable to FDI led to further opening of the markets.

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Global FDI inflows were expected to fall from $1.7 trillion to below $ 1.2 trillion in 2009, according to the World Investment Report. It said a recovery up to the level of $1.4 trillion could be made in 2010, which would then gain momentum in 2011 to reach the $ 1.8 trillion levels. The US, along with India, China, Brazil and Russia are likely to lead the future FDI recovery.

Country –wise:

Cumulative FDI inflows into India (April 2000 to December 2009), the most important are Mauritius (44%), followed by Singapore (9%) and USA (8%). The importance of Mauritius as a source of FDI is nearly half of FDI in India. The special role of Mauritius is likely to be the consequences of the special tax treatment accorded in India to investments.

Sector –wise:

The largest portion of FDI is destined for service sector which took up 22% of total FDI inflows into India. Next is Computer software and hardware at 9%, followed by Telecommunication at 8%. This suggests that the main attraction of MNCS is in domestic-led growth sectors.

Geographical- distribution:

FDI pattern in India shows a great disparity among regions. Western region (Maharashtra, Dadra and Nagar Haveli, Daman and Diu) took up nearly 36% of FDI to India, while Northern region (Delhi, part of UP and Haryana) took up 19% and Karnataka attracted nearly 6%.

Opportunities:-

In the past India's performance in attracting FDI was lackluster/ dismal. But the situation has been changing. A number of opportunities within and outside the Indian economy have emerged as well as global economic environment has been changing in India's favour. These reasons are:

Demographic favour

India is a young country, wherein 50% of population is below the age of 25 years. It will also enjoy a very favourable demographic momentum for another three decades. This will impact not only its economic growth prospects, but also savings and investment behavior, according to Deutsch Bank research. The U.N. report underlines the dividend which India will get from its demography. It states that the working- age population in India would shoot up by 240 million over the next two decades, equivalent to four times the total population of the U.K. The demographic developments in the BRIC (Brazil, Russia, India and China) over the next 10, 20, 30 years will vary greatly.

The report further adds that in terms of demographic transition model. India is at the beginning of stage three (decline fertility, population growth) Brazil and China are at stage four (low mortality and fertility, population trending towards stability), while Russia is already at stage five (sub-replacement rate fertility, declining population).

In addition, India's domestic savings rate is far higher compared to international. Its saving rate has removed up from 24% to 36% in the span of 5-6 years. So India can find its investments through domestic sources. Its investment stands at nearly 38% of GDP, which is in turn driving its growth. Unlike US, which funds its growth from borrowings, India's growth is a result of savings-led investment.

Big market:

India is expected to grow by 8.75% in 2010 and 8.5% in 2011, driven by a strong domestic demand. The demand will strengthen as the labour- market improves, and investment is expected to be boosted by strong profitability, rising business confidence and favourable financing conditions.

A large domestic market with low market penetration levels across industry segments looks much attractive and convincing to MNCs. The use and sale of items ranging from consumer durables and FMCG products to automobiles are on the rise. There is a sufficiently large space, particularly in the rural and semi- urban markets that is still vacant and is waiting to be tapped.

It is race against time when it comes to the Indian market for many MNCs as they go about launching new products tailored to suit the specific requirements of the Indian consumer. Take the auto industry as an example. Developing a compact

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car specifically for the Indian market is a project that has engaged some of the largest global auto players. Such investments in 'Made for India' products will rise in the future.

Legal and democratic system:

India is the largest democratic country in the world and its transparent and honest election process is on par with any democratic country of the world. However, Indian democracy has huge fault lines: caste politics, demand for more States, agitation for regional employment, tribal uprising and so on.

As far as its legal system is concerned, it is independent and any dispute can be solved in the Court of Law. It allows for equal treatment of foreign companies at par with Indian companies. There is no discrimination against foreign companies once they register in India. India also has fairly standard accounting procedures that are in line with the internationally accepted norms. It also ensures investors' rights including protection of any form of intellectual property rights (IPRs).

Policy environment:

India's policy regime is now geared to flexible and market – friendly. Government swiftly acts according to the needs of economy and world economic environment. For instance, government is seriously considering to open the retail sector in multi- brands for FDI and to increase the limit for FDI in defence production.

Hurdles:-

The four major constraints which appear to play a prominent role in influencing FDI inflows into India are:

- Lack of policy initiatives
- Inadequate infrastructure
- Rigidities in labour laws
- High fiscal deficit

Policy options

Even though FDI inflows into India have picked up steam, India is still not in the big league. It needs to take some policy initiatives to streamline FDI regime to make it easily comprehensive to foreign investors. There are

- Macro-economic corporate governance has a significant effect on inward FDI flows. It suggests that India should shape its policy in this area to maximize such flows.

- The policy framework needs to be simplified and defined for the medium to long term, rather than have a situation where the govt. moves back and forth on decisions. Inconsistency in interpretation of rules and regulations by different authorities needs to be addressed. For instance, the government needs to clear the confusion that was created by the press notes 2, 3 and 4 issued in Feb.' 09. Sect oral caps and other restrictions need to be eased where greater liberalization will not threaten national security but will benefit the country in terms of more jobs, more capacity and reduced dependence.

According to Quigley Jim, the following measures can boost FDI inflows into India:

Continue the process of liberalizing the investment norms into sectors that are still closed to FDI, such as retail and insurance.

- Encourage even greater trade openness, which is important to improve absorption of capital inflows in the short run and to develop force earnings capacity that while enable appropriate return on invested capital.
- Move towards convertibility of country's capital account to facilitate smoother flow of foreign capital into and out of the country.
- Push ahead with financial sector reforms already under way to enhance India's role a major hub for global finance.
- Reform land and labour policies to enable industrial development.
- Speedy reform in education sector to provide access for skill development to broaden the participation in India's growth.
- Embrace innovate technologies and strengthen intellectual property protection in India through convergence with international standards.

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Conclusions:-

It appears that world economy is on the road of recovery but the growth is uneven. The crisis has highlighted the weaknesses of developed world and emerging economies. Therefore, the excessive dependence of the developing economies on the US is being shortened by a number of measures including, for instance, foreign Central Banks across the globe have been diversifying their foreign exchange reserve away from the dollar. The US Federal Reserve Board indicates that foreign official holdings- essentially, Central bank holdings in US treasury bonds have dipped by $58 billion, to $2674 billion in February 2010 from $2732 billion in November 2009. The world economic crisis has also highlighted the strength of the Indian economy which emerged as second fastest economy in the world. It has provided India a number of opportunities including to attract FDI in a large proportion. Clearly, MNCs are searching new green pastures and India is very well on their radar. They cannot ignore India's potential as investment destination, market, etc. Therefore, FDI inflows into India has been picking up in recent years. In the meantime we should not forget missing links in this mission. Accordingly, policy options, which are needed to take, have been listed.

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