Foreign Direct Investment (FDI) in India: An Econometric investigation with respect to Economic Development

Sohanlal Saini  
Assistant Professor  
Department of Commerce  
Government PG College, Ambala Cantt (Haryana)

Abstract

FDI is a natural extension of globalization process that often begins with exports. In the process, countries try to access markets or resources and gradually reduce the cost of production and transaction by expanding overseas manufacturing operations in countries where certain ownership specific advantages can help them to compete globally. Significant uptrend in outward FDI has also been observed in the case of India in recent years. FDI can be said to act as a catalyst for underlying strengths and weaknesses in the host countries’ corporate environments, possibly exacerbating the problems in “Non Governance Zones”, while eliciting the advantages in countries with a more benign business climate and better governance. This paper highlights the effects of Foreign Direct Investment (FDI) with respect to India and its economy. An attempt has been made to provide some insight to these questions through a brief review of the existing evidence on FDI. The role of FDI in economic development is the center of the discussion and is analysed in depth. Both its positive and negative impacts are examined, as well as the channels through which FDI interacts with local economies. The paper then reviews the vast empirical evidence on the determinants of FDI flows, which provides guidance on the pre-conditions that the states need to create to draw out the positive forces of FDI and to prevent its negative effects from harming their economies.

Keywords: Foreign Direct Investment (FDI), Economic Development, Globalization, India, Impact

1 Introduction

The early nineties was a period when the Indian economy faced a severe Balance of Payment crisis. Exports began to experience serious difficulties. The crippling external debts were putting pressure on the economy. In view of all these developments there was a serious threat of the economy defaulting in respect of external payments liability. It was in the light of such adverse situations that the policy makers decided to adopt a more liberal and global approaches thereby, opening its door to FDI inflows in order to restore the confidence of foreign investors. FDI provides a situation where in both the host and the home nations derive some benefit. The home countries want to take the advantage of the vast markets opened by industrial growth. Whereas the host countries get to acquire resources...
ranging from financial, capital, entrepreneurship, technological know-how and managerial skills which assist it in supplementing its domestic savings and foreign exchange. FDI brings better technology and management, access to marketing networks and offers competition, the latter helping Indian companies improve, quite apart from being good for consumers. This efficiency contribution of FDI is much more important”. The last two decades, have seen India open up its economy in a slow but steady fashion to private as well as foreign investment. The foreign investment is governed through the FDI policy which regulates industries open to foreign investment, and also the percentage that can be held by the foreign companies. Globalisation and liberalisation have immensely influenced the Indian economy and have gone a long way in making it a lucrative consumer market. The government in a series of moves has opened up the retail sector slowly to FDI. There were initial reservations towards opening up of retail sector arising from fear of job losses, procurement from international market, competition and loss of entrepreneurial opportunities. To evaluate the impact of international players on domestic markets, in 1997 FDI in cash and carry (wholesale) with 100 percent ownership was allowed. In 2006, 51 percent investment in a single brand retail outlet was permitted. Since then retailing through franchisee route has been explored by several global brands. Discussions were carried out by the government in 2008 to allow 100 percent FDI in single brand and 51 percent in multi brand retailing, but did not succeed due to fierce opposition from its then allies and Left (Communist) party and also from the local trade associations. The push for proposed investment seems to be around creating a supply-chain infrastructure for agriculture to help alleviate the income levels of farmers and reduce wastage of crops which are currently pegged at about 30-40% of total produce.

2 Earlier Studies on the growth impact of FDI in India

In the long run, FDI is positively related to GDP and openness to trade. Furthermore, FDI plays no significant role in the short-run adjustment process of GDP. In an earlier study, Dua and Rashid (1998) report similar results. Kumar and Pradhan (2002) consider the FDI-growth relationship to be Granger neutral in the case of India as the direction of causation was not pronounced. Sahoo and Mathiyazhagan (2002) corroborate what appeared to be the consensus until recently, while the Granger causality and Dickey-Fuller tests presented by Bhat et al. (2004) provide no evidence of causality in either direction. According to Kumar (2003: 27), linkages with the local economy have remained weak even in the software industry where foreign companies are said to operate as “export enclaves.” Bhat et al. (2004) suspect that a lack of local skills has prevented economic spillovers from foreign to local companies. A more differentiated picture is portrayed by Kathuria (2002), who argues that only those domestic firms which invested in R&D, in order to make use of foreign technologies, benefited from spill overs. However, several studies are more in line with the ADB’s (2004: 224) verdict that FDI accounts for a “trivial share” of India’s exports. According to Sharma (2000), FDI had no significant impact on the country’s export performance. Pailwar (2001) argues that India has not been able to attract FDI in export oriented areas. Banga (2003) agrees that FDI has not played a significant role in export promotion, but points out that export effects differ between home countries of foreign investors and between traditional and non-traditional export industries. The survey results presented by ATKearney (2004) suggest that India is increasingly perceived as a R&D hub for a wide range of industries. It has become common place among foreign investors that India offers a well
educated workforce which, according to Borensztein et al. (1998), is essential for FDI to have positive growth effects. Likewise, India compares favorably with China in terms of financial market development (McKinsey Quarterly 2004), which represents another factor favouring positive growth effects of FDI (Alfaro et al. 2001; Choong et al. 2004; Hermes and Lensink 2003). The results find little support for FDI having an exogenous positive effect on economic growth, echoing previous work by Borensztein, De Gregorio, and Lee (1998) and Carkovic and Levine (2002) and Alfaro et al. (2003). The results are robust to the inclusion of other growth determinants, such as human capital measures, domestic financial development, institutional quality, different samples, and conditioning information sets, and the use of lagged values of FDI. A shortcoming of the data set is that, given the limited time frame, I cannot exploit the time variation of the data using statistical techniques such as those followed by Carkovic and Levine (2002) that limits comparisons.

3 Evolution of Foreign Direct Investment (FDI) policy

Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India (‘RBI’) in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time. The Ministry of Commerce and Industry, Government of India is the nodal agency for motorizing and reviewing the FDI policy on continued basis and changes in sectoral policy/sectoral equity cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP). The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board (‘FIPB’) would be required.

The evolution of Indian FDI can broadly be divided into three phases classified on the premises of the initiatives taken to induce foreign investments into the Indian economy:

(a) The first phase, between 1969 and 1991, was marked by the coming into force of the Monopolies and Restrictive Trade Practices Commission (MRTP) in 1969, which imposed restrictions on the size of operations, pricing of products and services of foreign companies. The Foreign Exchange Regulation Act (FERA), enacted in 1973, limited the extent of foreign equity to 40%, though this limit could be raised to 74% for technology-intensive, export-intensive, and core-sector industries. A selective licensing regime was instituted for technology transfer and royalty payments and applicants were subjected to export obligations.

(b) The second phase, between 1991 and 2000, witnessed the liberalisation of the FDI policy, as part of the Government’s economic reforms program. In 1991 as per the ‘Statement on Industrial Policy’, FDI was allowed on the automatic route, up to 51%, in 35 high priority industries. Foreign technical collaboration was also placed under the automatic route, subject to specified limits. In 1996, the automatic approval route for FDI was expanded, from 35 to 111 industries, under four distinct categories (Part A–up to 50%, Part B–up to 51%, Part C–up to 74%, and Part D–up to 100%). A Foreign Investment Promotion Board (FIPB) was constituted to consider cases under the government route.

(c) The third phase, between 2000 till date, has reflected the increasing globalisation of the Indian economy. In the year 2000, a paradigm shift occurred, wherein, except for a negative list, all the remaining activities were placed under the automatic route. Caps were gradually raised in a number of
sectors/activities. Some of the initiatives that were taken during this period were that the insurance and defence sectors were opened up to a cap of 26%, the cap for telecom services was increased from 49% to 74%, FDI was allowed up to 51% in single brand retail. The year 2010 saw the continuation of the rationalisation process and all existing regulations on FDI were consolidated into a single document for ease of reference.

4 Foreign Direct Investment (FDI) in India

India’s Foreign Direct Investment (FDI) policy has been gradually liberalised to make the market more investor friendly. The results have been encouraging. These days, the country is consistently ranked among the top three global investment destinations by all international bodies, including the World Bank, according to a United Nations (UN) report. For an economy like India which has tremendous potential, FDI has had a positive impact. FDI inflows supplement domestic capital, as well as technology and skills of existing companies. It also helps to establish new companies. All of these contribute to economic growth. In 2013, the government relaxed FDI norms in several sectors, including telecom, defence, PSU oil refineries, power exchanges and stock exchanges, among others. In retail, UK-based Tesco submitted its application to initially invest US$ 110 million to start a supermarket chain in collaboration with Tata Group's Trent. In civil aviation, Malaysia-based Air Asia and Singapore Airlines teamed up with Tata Group to launch two new airline services. Also, Abu Dhabi-based Etihad picked up a 24 per cent stake in Jet Airways that was worth over Rs 2,000 crore (US$ 319.39 million). India has received total foreign investment of US$ 306.88 billion since 2000 with 94 per cent of the amount coming during the last nine years. In the period 1999–2004, India received US$ 19.52 billion of foreign investment. In the period 2004–09, foreign investment in the country touched US$ 114.55 billion, further increasing to US$ 172.82 billion between 2009–September, 2013. During FY 2012–13, India attracted FDI worth US$ 22.42 billion. Tourism, pharmaceuticals, services, chemicals and construction were among the biggest beneficiaries. The January–November period in 2013 witnessed mergers and acquisitions deals worth US $ 26.76 billion in India, according to a survey by tax advisory firm Grant Thornton.

5 Features of the Government of India’s consolidated FDI policy and incentives

The Ministry of Home Affairs has finally given the approval to the proposal of allowing FDI in railways. The Cabinet Committee on Economic Affairs (CCEA) is expected to consider the proposal. Foreign investors can invest only in construction and maintenance of railway projects, and not in operations. India’s Prime Minister Mr Manmohan Singh has sought increased Japanese investment in the country. The two countries are already looking at the possibility of concrete cooperation in areas such as manufacturing and research and development in the electronic industry and energy efficient and energy saving technologies. “I believe there is enormous untapped potential in our business ties,” Mr Singh said following the annual summit level meeting between Japan and India. The presence of Japanese companies in India increased by 16 per cent in 2013. The Andhra Pradesh State Investment Promotion Board has given the approval to six major investment proposals that will have a total investment of Rs 6,500 crore (US$ 1.03 billion). The proposals include those by multinational companies such as PepsiCo, Cadbury, Colgate, Johnson & Johnson, Gerdau Steels and ITC. PepsiCo’s unit will be the largest beverages plant in India with an investment of Rs 1,200 crore (US$ 191.06 million). Similarly, Cadbury is establishing its facility in Sri City with an investment of Rs 2,500 crore (US$ 398.07 million). In an effort to improve capital flows into the country, the Indian
government has allowed 100 per cent FDI under automatic route in storage and warehousing, which includes warehousing of agriculture products with refrigeration. The government has also set up National Centre for Cold Chain Development (NCCD) which will look at standards and protocols for cold chain infrastructure. Based on the recommendations of Foreign Investment Promotion Board (FIPB) made on December 30, 2013, the Indian government has agreed to five FDI proposals amounting to Rs 1133.41 crore (US$ 180.16 million) approximately. On November 13, 2013, it had approved 12 proposals of FDI amounting to Rs 821.63 crore (US$ 130.73 million) approximately. The FIPB has also approved Swedish clothing major Hennes & Mauritz (H&M) AB’s proposal to open 50 stores across India. The investment will be around Rs 720 crore (US$ 114.61 million).

6 FDI inflows to accelerate the pace of economic development

Economic development is an all-encompassing concept. It centers on economic and social progress, but also entails many different aspects that are not easily quantified, such as political freedom, social justice, and environmental soundness. Without a doubt, all these matters combine to contribute to an overall high standard of living. However, empirical evidence has amply demonstrated that all these varied elements of economic development correlate with economic growth. That is, as a general rule, countries with faster economic growth have more rapid improvement in health and education outcomes, progressively freer political system, increasingly more equitable distribution of wealth, and enhanced capacity for environmental management. Therefore, while economic growth does not bring about automatically other aspects of social, institutional and It is seen that every nation world over is the race of attracting more FDI inflows to accelerate the pace of economic progress India’s case is no different as in order to achieve and sustain a healthy rate of growth India would require huge investments which cannot be financed locally therefore the government needs to look at alternate avenues of building up investments, FDI in this context is a very useful mechanism. Recent reports have also suggested that greater FDI inflows must be encouraged to meet capital requirements. Aside from using FDIs as investment channel and a method to reduce operating costs, many companies and organizations are now looking at FDI as a way to internationalize. FDI should be looked upon as a means of industrialisation and development. The Benefits of FDI Inflows can be broadly identified as:

• Bridging the financial gap between the quantum of funds needed to sustain a level of growth and the domestic availability of funds
• Technology transfer coupled with knowledge diffusion that leads to improvement in productivity. It can, thus, fasten the rate of technological progress through a ‘contagion’ effect that permeates domestic firms
• The transfer of better organizational and management practices through the linkages between the investing foreign company and local companies.

It is well accepted that India’s rising growth would require a simultaneous expansion of its infrastructure facilities to support it. The Government of India has been frequently taking initiatives to liberalize and incentivize its foreign direct investment policies to attract investments however the recent decision to suspend FDI in retail as well as hold all other FDI decisions could dampen the international investor’s confidence, as the initial announcement and then the rollback of the initiative might be interpreted as a sign of political instability in taking key policy decisions. In today’s global scenario when investors might be looking at alternate avenues, to invest their money there are only a few nations across the world that provide opportunities to foreign companies, with a highly potential
market and a low cost manufacturing opportunity and India is one of them. Most significant source of external resource flows to developing countries over the years and has become a significant part of capital formation in these countries, despite their share in global distribution of FDI continuing to remain small or even declining. The effects of FDI in the host economy are usually believed to be increase in the employment, augment in the productivity, boost in exports and amplified pace of transfer of technology. It facilitates the utilization and exploitation of local raw materials, introduces modern techniques of management and marketing, eases the access to new technologies, foreign inflows can be used for financing current account deficits, finance flows in form of FDI do not generate repayment of principal and interests (as opposed to external debt) and increases the stock of human capital via on the job training. In the context of the new theory of Economic Growth, FDI is considered as an engine of growth of mainstream economies. As noted by the World Bank (2002), several recent studies concluded that FDI can promote the economic development of the host Country by promoting productivity growth and export. However, the exact relationship between foreign multinational corporations and their host countries varies considerably between countries and among industries. The characteristics of the host country and the policy environment are important determinants of net benefit of FDI. In view of the above discussion, this discussion provides rich insight into the relationship between FDI and Growth. Therefore, this paper is an attempt to analyse the causal relationship between Foreign Direct Investment (FDI) and economic growth in India.

The Reserve Bank of India today released on its website, data related to Finances of Non-Government Non-Financial (NGNF) Foreign Direct Investment (FDI) Companies, 2011-12 based on audited annual accounts of select 766 companies which closed their accounts during April 2011 and March 2012. The study includes 715 companies covered in the regular studies on finances of non-government non-financial (NGNF) public/private limited companies for the year 2011-12 published earlier and 51 additional FDI companies. It provides a comparative picture over the three-year period 2009-10 to 2011-12. ‘Explanatory notes’ on data are given at the end.

7 Determining India’s Economic Trajectory w.r.t Foreign Direct Investment

Growth in the Indian economy has slowed and inflation has risen in the last several months. What have been the primary triggers for this slowdown?

The Indian economy recovered well after the global financial crisis due to a fiscal stimulus package and also many social programs like the Mahatma Gandhi National Rural Employment Guarantee Act. These activities created employment and demand that resulted in 9% GDP growth in 2010. However, GDP expansion for 2011 is now expected to be 7.0%, not the forecasted 8.5%. Several major factors are responsible for this slowdown, including the continuous rise of inflation, a tight monetary policy, a series of corruption scandals, policy paralysis on crucial reforms, and a lack of infrastructure development. Tight monetary policy for the thirteenth consecutive quarter has increased the cost of capital and affected credit flows to the commercial sector, slowing down overall investment activity. However, monetary policy has not been effective in containing India’s inflation, as this inflation is primarily a supply-side phenomenon due to a deficiency in infrastructure and bottlenecks in supply chains. Furthermore, a lack of investor confidence and positive business sentiment has
led to declining FDI inflows over the last three quarters, adding pressure on new and ongoing investment.

➤ What effect could the retail FDI decision have on the domestic economy and for foreign companies doing business in India?

Should it have gone into effect, the multi-brand retailing decision would have impacted different stakeholders widely. The scale economies of organized retailing would likely have offered consumers a wider variety of products at lower prices, with safeguards like quality control and checking for counterfeit products, including infringed American goods. Organized retailers would also have to buy products directly from Indian farmers and producers, paving the way for better price realization. The provision of 50% FDI from the United States and elsewhere in back-end infrastructure for storage, logistics, and better extension services would substantially reduce wastage in India’s farm produce, which is one of the highest in the world. The provision of 30% sourcing from Indian SMEs (small and medium enterprises) would have helped expand capacity, improve quality, and get exposure to international supply chains, making them internally competitive over time. Countering these positive aspects, however, the initial impact of multi-brand retailers entering India’s market is expected to have a negative impact on the over 12 million unorganized shops and countless kirana (mom-and-pop) stores, as they lack the financial muscle to challenge major retailers in terms of variety, quality, packaging, and other offers.

➤ What kind of impact has India’s slower economic growth had on trade and economic relations with the United States and other partners like China and Europe? If this trend continues over the next year, what can outside observers expect?

India’s economic slowdown may certainly affect the country’s external sectors, including the country’s bilateral trade with the United States. China’s cost of domestic production is rising, and many investors, including some from the United States, are looking to India as an alternative destination. As many foreign investors look to tap into India’s domestic market, capital inflows could decrease. In fact, if the downturn continues, there may be more outflows of capital from India than inflows to India. India is a major buyer of American products, particularly high-value and technology-intensive products in sectors such as defence, and a slowdown in the Indian economy would likely affect trade between the two countries.

➤ What are the political implications of India’s economic slowdown?

If the slowdown continues and reduces resource mobilization, it would jeopardize the effective implementation of the Indian government’s grand social programs such as the right to education and the new food security bill. Regarding the latter, in December 2011, India’s cabinet cleared a bill to provide food at highly subsidized rates to 60% of the population, amounting to roughly $6 billion per year. These mandatory programs require a tremendous amount of resources at a growing rate and are only possible if economic growth continues. If not, the government’s fiscal deficit will breach its limits and, along with increasing the current account deficit, will create undesirable effects for the Indian economy. India’s twin...
deficits will use up both domestic savings and foreign savings to manage the economy and will lead to high inflation, the crowding out of private investment, high interest rates, and difficulties in managing monetary policy. India has experience with deficits leading to a balance-of-payment crisis, as occurred in 1991. Growth is necessary for the government to meet the socioeconomic infrastructure requirements for a majority of the population. Lagging investor confidence and an economic slowdown in manufacturing and industry would disappoint the aspirations of millions of young people searching for jobs. With a median age of 25 years, India has a young population compared to other Asian countries like Japan and China, which need to deal with an aging population. Now India must sustain its growth and create jobs to reap the rewards of its population dividend.

What are the primary issues for the Indian economy at this moment? What are the major hurdles to making India’s growth more inclusive and sustainable?

The most pressing issue for the Indian economy now is to improve competitiveness across all sectors. If India desires to be an economic power, it needs to reduce trade and transaction costs, improve governance, and carry out institutional reforms for effective law enforcement. A serious problem that might halt the Indian economy’s growth is the country’s infrastructure bottleneck. Lack of high-quality physical and social infrastructures have led to high costs in trade and transaction costs, thereby lowering India’s economic competitiveness. The planning commission has estimated that the infrastructure sector requires investment of up to $1 trillion in the 12th Five Year Plan (2012–17), but it may be difficult to raise such funds. The service sector, which was the driver of growth for the last two decades, has also showed signs of a slowdown in the last few quarters. Decreased output in the industrial sector, along with low demand for India’s services in the United States and Europe, has resulted in a slowdown for services exports as well. Given the current situation, particularly the European debt crisis and the overall slowdown in developed countries, a moderation in exports in general, and trade in services in particular, is expected.

8 Trends in FDI Inflows & Outflows to India

India continued to be the dominant recipient of FDI inflows to South and South-West Asia in 2012. However, inflows to the country dropped by significant 29% in 2012, which is a much bigger decline than the average for all developing economies (-4%) and Asia-Pacific developing countries (-7%). The economy of India experienced its slowest growth in a decade in 2012, and also struggled with risks related to high inflation. In addition to the overall economic situation, a research study conducted by the Reserve Bank of India on FDI flows into the country notes that complex policies and cumbersome procedures could have dampened FDI flows. In September 2012, the Government allowed FDI in multi-brand retailing under certain conditions. With the conditions governing multi-brand retail relaxed, foreign retailers are allowed to invest in cities with less than one million inhabitants. They are also given five years to reach the requirement of sourcing 30% of products from small Indian firms. Also, government approval is no longer needed for up to 49% FDI in single-brand retail or petroleum refining. India has also relaxed its rules for FDI in aviation and television broadcasting and 100% foreign ownership in telecommunication companies has been approved (India,
Department of Industrial Policy and Promotion, 2012 and 2013). The tripling of the FDI flows to EMEs during the pre-crisis period of the 2000s, India also received large FDI inflows in line with its robust domestic economic performance. The attractiveness of India as a preferred investment destination could be ascertained from the large increase in FDI inflows to India, which rose from around US$ 6 billion in 2001-02 to almost US$ 38 billion in 2008-09. The significant increase in FDI inflows to India reflected the impact of liberalisation of the economy since the early 1990s as well as gradual opening up of the capital account. As part of the capital account liberalisation, FDI was gradually allowed in almost all sectors, except a few on grounds of strategic importance, subject to
compliance of sector specific rules and regulations. The large and stable FDI flows also increasingly financed the current account deficit over the period. During the recent global crisis, when there was a significant deceleration in global FDI flows during 2009-10, the decline in FDI flows to India was relatively moderate reflecting robust equity flows on the back of strong rebound in domestic growth ahead of global recovery and steady reinvested earnings (with a share of almost 25 per cent) reflecting better profitability of foreign companies in India. However, when there had been some recovery in global FDI flows, especially driven by flows to Asian EMEs, during 2010-11, gross FDI equity inflows to India witnessed significant moderation. Gross equity FDI flows to India moderated to US$ 20.3 billion during 2010-11 from US$ 27.1 billion in the preceding year.

9 Major Hurdles for the Indian government to attract foreign investors for making India’s growth more inclusive and sustainable

The post-liberalization period has been remarkable for FDI in India. It has created a conducive environment for foreign investment by abolishing industrial licensing, establishing institutions, lifting FDI equity ceilings, shifting more sectors to the automatic route, providing incentives, and liberalizing foreign exchange regulations. Consequently, FDI inflows, negligible before 1991, have increased substantially. FDI in India is still concentrated in a few sectors and states. Factors that hinder FDI inflows include:

- Infrastructure bottlenecks, rigid and complicated labour laws, lack of coordination between the states and the central government, lack of reforms at the state level, FDI equity caps in many potential sectors, and delays in getting multiple clearances and approvals. The most pressing issue for the Indian economy now is to improve competitiveness across all sectors. If India desires to be an economic power, it needs to reduce trade and transaction costs, improve governance, and carry out institutional reforms for effective law enforcement.

- The service sector, which was the driver of growth for the last two decades, has also showed signs of a slowdown in the last few quarters. Decreased output in the industrial sector, along with low demand for India’s services in the United States and Europe, has resulted in a slowdown for services exports as well. Given the current situation, particularly the European debt crisis and the overall slowdown in developed countries, a moderation in exports in general, and trade in services in particular, is expected.

- India also faces internal problems, such as widespread poverty, corruption, and poor governance. Market reforms over the last two decades have created opportunities for the private sector to grow, resulting in a high growth rate, but they have also produced high inequality in India. Growing inequality and a high poverty rate (more than 30% of the population) are the biggest challenges to sustained economic growth, and if not addressed properly, will create disharmony.

10 Analytical Discussion

The study of FDI in India concludes that India should welcome FDI as it has huge benefits for the Indian economy. FDI participation always brings prosperity for any emerging country. Various benefits which India can entice by liberalising FDI are use of advanced technology, expertise, better
infrastructural developments, widened product basket, improving standard of living, uplifting the brand quality, improving competitiveness, better foreign relations, boosting exports, and providing India with a global platform. The debated views of FDI in multi brand have certainly hindered the flow in retailing. However, the government has tried to encounter all the obstructions and ease the investment norms for foreign investors. FDI though being beneficial and having an increasing trend always brings huge threat for domestic and small scale companies and retailers. Investment in general education and other generic human capital is of the utmost importance in creating an enabling environment for FDI. Achieving a certain minimum level of educational attainment is paramount to a country’s ability both to attract FDI and to maximise the human capital spill overs from foreign enterprise presence. Developing countries, emerging economies and countries in transition have come increasingly to see FDI as a source of economic development and modernisation, income growth and employment. Countries have liberalised their FDI regimes and pursued other policies to attract investment. As countries develop and approach industrialised nation status, inward FDI contributes to their further integration into the global economy by engendering and boosting foreign trade. Apparently, several factors are at play. They include the development and strengthening of international networks of related enterprises and an increasing importance of foreign subsidiaries in MNEs’ strategies for distribution, sales and marketing. In both cases, this leads to an important policy conclusion, namely that a developing country’s ability to attract FDI is influenced significantly by the entrant’s subsequent access to engage in importing and exporting activities. This, in turn, implies that would-be host countries should consider a policy of openness to international trade as central in their strategies to benefit from FDI, and that, by restricting imports from developing countries, home countries effectively curtail these countries’ ability to attract foreign direct investment. The study Foreign Direct Investment for Development attempts primarily to shed light on the second issue, by focusing on the overall effect of FDI on macroeconomic growth and other welfare-enhancing processes, and on the channels through which these benefits take effect.

11 Conclusion

FDI plays an important role in the transmission of capital and technology across home and host countries. Benefits from FDI inflows are expected to be positive, although not automatic. A facilitating policy regime with minimal interventions may be ideal to maximise the benefits of FDI inflows. The debate on its pros and cons has not yet been settled and is likely to continue. It is not possible to reach a decisive value judgement on whether FDI is good or bad for the developing country/host economy. It may or may not have the desired and expected growth-enhancing impact on the host economy. Even more difficult is the question of whether it brings about equity along with growth effects. FDI might enter a labour-abundant country with capital-intensive technologies; however, if the labour laws are not flexible, this would have a relatively small impact on employment generation. On the other hand, the entry of FDI in labour intensive firms would have a positive impact on equity and poverty reduction if the FDI-enabled firms choose to locate close to suburban/rural areas. The overall benefits of FDI for developing country economies are well documented. Given the appropriate host-country policies and a basic level of development, a preponderance of studies shows that FDI triggers technology spill overs, assists human capital formation, contributes to international trade integration, helps create a more competitive business environment and enhances enterprise development. All of these contribute to higher economic growth, which is the most potent tool for
alleviating poverty in developing countries. Moreover, beyond the strictly economic benefits, FDI may help improve environmental and social conditions in the host country by, for example, transferring “cleaner” technologies and leading to more socially responsible corporate policies.

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