THE EFFECT OF FOREIGN DIRECT INVESTMENT DUE TO NEW ECONOMIC POLICY AND ITS IMPACT ON INDIAN ECONOMY

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ABSTRACT

When an investor from a foreign country makes an investment in a business in another country it is known as Foreign Direct Investment (FDI). Foreign Direct Investment plays an important role in the growth and development of any country's economy. After the Gulf war in 1990, the surge in oil prices triggered which imposed a severe strain on the balance of payments in India. The Indian government could not pass the budget in February 1991 at a crucial time. India's economic reforms began with New Economic Policy by finance minister Dr. Manmohan Singh. In 1991 under the Narasimha Rao Government which brought immense investment in the form of foreign direct investment. It is the primary duty of the Competition Commission of India (CCI) to regulate and scrutinize that any sort of companies' recognition is affecting the healthy competition in India. Social justice is a concept of a society in which every human being is treated equal, without any discrimination and the "State" should see that the common man must enjoy the fruits of development in the nation. This paper discusses the effect of foreign direct investment due to the New Economic Policy and its Impact on the Indian economy.

1. INTRODUCTION

The origin of foreign direct investment (FDI) in India can be traced back to 1500 A.D. When the Portuguese set up their first textile unit in Calicut, followed by the British East India Company in 1600 A.D. and the **Dutch East India Company** in 1602 A.D[1]. They came to our country as merchants and later turned industrialists and some of them became rulers. Fierce competition followed between these merchants and industrialists from these countries till 1800 A.D. Finally, **British East India** Company emerged successfully and colonized India. British brought on the Industrial Revolution to India which led to the development of transportation (Railways and Roadways) and communication systems albeit for their benefits [1]. After the Second World War, though the Japanese companies enhanced their trade with India, the U.K. remained the most dominant investor in India. Further, after Independence issues relating to foreign capital, operations of MNCs gained the attention of the policymakers. When **Jawaharlal Nehru** became Prime Minister in 1947, India was miserably poor, hardly literate and unable to feed itself. Nehru was the leading premier personage of India, and his vision of India would shape the country's permanent development and lay the foundations upon which it still builds today. After 1947, Nehru played an important role in shaping the country's education sector. He was aware of the important role scientific research and technology would play in India's growth[2,3]. Rajiv Gandhi came into power in 1984. The country at this time faced a dilemma of an excessive balance of payment crisis following the Gulf War and the downfall of the erstwhile Soviet Union.

2. NEW ECONOMIC POLICY, 1991

The Indian government could not pass the budget in February 1991 at a crucial time and global credit-rating agencies further downgraded India from investment-grade making it impossible to even get short term loans and the government was not in a position to give any commitment to reform the economy[4]. The World Bank and International Monetary Fund also stopped their assistance, leaving the government with no option except mortgaging the country's gold to avoid defaulting on payments. During that time India deposited 47 tons of gold to the Bank of England and 20 tons of gold to the Union Bank of Switzerland which was necessary to manage the budget. During 1990, the surge in oil prices triggered by the **Gulf War** imposed a severe strain on a balance of payments. In 1990, internal political instability, the balance-of-payments

crises quickly ballooned into a crisis of confidence which intensified in 1991 even though oil prices quickly normalized [(5-8)].

Foreign exchange reserves are the deposits of foreign currencies held by the central bank of a country. In 1991, foreign exchange reserves dropped and default on external payments appeared inevitable. Due to the crisis of foreign exchange, the import was restricted, which in turn led to a fall in industrial output. The crisis of severe balance of payment led to India's **economic reforms in 1991**. Narasimha Rao Government recognized the need for a system change, by involving liberalization of government controls, a larger role for the private sector and greater integration with the world economy. In 1991, the government realized the importance of de-licensing and reducing the involvement of the government in economic operations. These liberal ideologies believed in the power of the private sector and thus encouraged a greater involvement of the private sector in all the sectors of the economy initiated groundbreaking economic liberalization reforms. The focus now shifted to Liberalization, Privatization, and Globalization.

3. MAIN OBJECTIVES OF NEW ECONOMIC POLICY, 1991

To plunge the Indian economy into the area of Globalization and to give it a new thrust on market orientation. The New economic policy wanted to permit the international flow of goods, services, capital, human resources, and technology, without any restrictions. It wanted to achieve economic stabilization and to convert the economy into a market economy by removing all kinds of unnecessary restrictions. It intended to move towards a higher economic growth rate and to build sufficient foreign exchange reserves. It intended to bring down the rate of inflation and to remove imbalances in payment. The Government has made some radical changes in its policies bearing on trade, foreign investment exchange rate, industry, fiscal discipline, etc. The various elements, when put together, constitute an economic policy that marks a big departure from what has gone before.

The New Economic Policy permitted the private sector to expand by removing the barriers to entry and the restrictions on the growth of firms. Greater role of the private sector was emphasized to utilize fully the capacities, to absorb modern technology and to improve

productivity. Without obtaining prior permission from the Foreign Investment Promotion Board (FIPB) a foreign investing company is entitled to acquire the shares of an Indian company. If the acquisition of shares directly or indirectly results in the acquisition of a company listed on the stock exchange, it would require the approval of the Security Exchange Board of India.

The Indian retail industry has seen tremendous growth in the past ten years. The growth has been so phenomenal that many big players in India (like the Tata group, Reliance, and Mahindra) have entered this segment. This kind of growth is mainly attributed to the increase in the buying power of the end consumer who now has more expendable money at their disposal. India has seen the emergence of nuclear family structure (deviating from the traditional joint family structure) with an increase in double-income in households. People have now exposure to foreign trends and many travel frequently to other developed countries. With the Government policies also encouraging women to contribute to the development of the country during the 80s and 90s, India has seen a significant rise in the working population. Hence the demand, as well as expenditure on luxury items, has seen an unprecedented increase. Many of the current youth are brand conscious and are willing to spend more on imported branded goods. Supporting the trend, the Government policies have also been inclined towards globalization and Indian has slowly opened its doors to foreign companies for investment and to set up factories. The real estate has also benefited with the advent of foreign companies setting up factories in India with Government allocating **special economic zones (SEZs)** for such purposes where both local people and the investing companies have benefitted. This has led to settlements of people and urbanization of many cities and towns at an accelerated pace.

4. FOREIGN DIRECT INVESTMENT, (FDI)

Foreign direct investment (FDI) refers to the net inflows of investment of equity capital, other long-term capital, and short term capital. It includes the participation in management, joint venture, transfer of technology and expertise.

FDI was introduced in the year 1991 under Foreign Exchange Management Act (FEMA), by then finance minister Dr. Manmohan Singh. All these measures were launched in the year 1991 and since then, further liberalization has been introduced every year with each new

budget. The New Industrial Policy, 1991 has led to a free inflow of foreign direct investment (FDI) along with modern cutting edge technology, which increased the importance of the private sector in the Indian economy considerably.

5. FOREIGN COMPANIES IN INDIA:

As per the Companies Act, 1956, under section 591, foreign companies are those companies that are incorporated outside India but establish a place of business within India. As of 31.3.2014,

SR.NO	COUNTRY OF INCORPORATION	NUMBER OF COMPANIES
1	USA	451
2	Singapore	284
3	United Kingdom	252
4	Japan	201
5	Germany	150
6	Hong Kong	99
7	France	94
8	Republic of Korea	105
9	Australia	20
10	Netherland	67
11	Italy	64
12	Malaysia	49
13	Switzerland	54
14	Spain	51
15	China	41
16	Canada	49
17	UAE	49
18	Thailand	32
19	Belgium	31
20	Others	1,097

Total		3,240

Table – 1: Distribution of Foreign Companies defined under Section 591 of the Act 1956 by their country of incorporation as on 31.3.2014 [11, 12].

the number of foreign companies that are reported to have a place of business in the country was 3,240[9-11]. Table – 1: shows the trend of the growth of foreign companies in India. It shows the distribution of foreign companies by their country of incorporation defined under Section 591 of the Companies Act, 1956. It is observed that out of 3240 total foreign companies as on 31 March 2014 and 451 are US companies [11, 12]. Followed by the US, 284 companies are from Singapore and 252 from the U.K. Among the total number of Foreign companies, Japan, Germany, Hong Kong, Korea, France, and the Netherland also have a major share in India. It is clear that foreign companies attracted to India from all over the world and their number also increasing which is clear from this Table-1.

6. FOREIGN DIRECT INVESTMENT INFLOW IN INDIA [12-15]:

The Foreign Direct Investment flow information in India during the last 22 years is provided in Table - 2. Data reveals that during the 22 years period a total of US $ 401.8 billion dollars was invested in India in the form of Foreign investment, out of which the US $ 244.1 billion (60.8 %) was in the form of FDI and $ 1.57.7 billion (39.2 %) was in the form of Portfolio Investment. Segregated data reveals that FDI flows remained subdued during 1991-92 to 1994-95 and in this period portfolio investment accounted for a larger share, but in the period 1995-96 to 2002 -03 FDI flows picked up and they accounted for quite a significant share and from 1997-98 to 1998-99, FDI becomes dominant. During the year 2008-09, the portfolio investment became negative as of $ 13,855 due to the economic crisis. In 2009-10, we could find a record of Total foreign investment of $ 70,139 million with a portfolio investment of $ 32,376 million. In 2012-13 total investment was $ 53,844 million with FDI of $ 26,953 million.

7. THE RETAIL GIANTS IN THE WORLD:

The main foreign retail giants are Wal-Mart (U.S.), Tesco (U.K), Carrefour (France) and Metro (Germany). All these retail giants opened their hypermarkets which is a large store that combines a traditional discount store and supermarket. These hypermarkets attracted many countries as they provide food and general merchandise at low prices and under one roof. Among these, Wal-Mart and Carrefour are the two largest retailers in the world and pioneers in the globalization of the retail industry. Carrefour first opened its hypermarket in mainland China in the year 1995, and Wal-Mart followed in 1996. By 2010, Carrefour operated 157 stores and Wal-Mart 178 stores. India is one of the developing countries in the world that has a major share of FDI for the past 28 years not, in retails. Walmart entered in India as a joint venture with Bharti in hopes of achieving a liberalization of the Indian market and partnership ended in 2013 [(16)]. Wal-Mart is a multi-brand retailer and its policies and regulation for doing business in India, is still not very favorable and clear. Wal-Mart could not invest in multi-brand due to the new FDI policy in India.

YEAR	FOREIGN DIRECT INVESTMENT	PORTFOLIO INVESTMENT	TOTAL
1991-92	129	4	133
1992-93	315	244	559
1993-94	586	3,567	4,153
1994-95	1,314	3,824	5,138
1995-96	2,144	2,748	4,892
1996-97	2,821	3,312	6,133
1997-98	3,557	1,828	5,385
1998-99	2,462	-61	2,401
1999-20	2,155	3,026	5,181
2000-01	4,029	2,760	6,789
2001-02	6,130	2,021	8,151
2002-03	5,035	979	6,014
2003-04	4,322	11,377	15,699
2004-05	6,051	9,315	15,366
2005-06	8,961	12,492	21,453
2006-07	22,826	7,003	29,829
2007-08	34,835	27,271	62,106
2008-09	37,838	-13,855	23,983
2009-10	37,763	32,376	70,139
2010-11	27,829	30,292	58,121
2011-12	32,957	17,171	50,126
2012-13	26,953	26,891	53,844
Total (1991-92 To 2011-12)	2,44,107 (60.8)	1,57,694 (39.2)	4,01,801 (100.0)

Table2: Foreign directory Investment Inflow in India US $ million.

Source: RBI Bulletin, Handbook of Statistics on Indian Economy.

7.1. FDI Policy in Retail:

(a). Single Brand product retail trading.

(b). Multi Brand product retail trading.

7.1.a. Single Brand Retail Trading:

FDI in Single-brand retail trading up to 49% was permitted under the automatic route, beyond that government approval was required. Single brand retail refers to the company which itself owns or runs a single brand as a retailer like Sony, LG, Nokia, IBM, etc. and runs a shop selling only a single brand. The cabinet has approved 100% FDI in single brand retail trading subject to certain following conditions:

The product sold should be a single brand only. The product sold should be the same brand internationally.

The single brand covers the product which is branded during manufacturing. Applications should be processed by DIPP (Department of Industrial Policy Promotion) first and then by FIPB (Foreign Investment Promotion Board) for government approval.

7.1.b. Multi-brand retail trading:

Multi-brand retail refers to the stores where multiple brands belonging to various manufacturers are sold. These refer to various chains of retailers like wall mart, Mobile store, Big Bazaar, etc. Multi-brand retailing was not permitted until 2011. In 2012, the government of India allowed 51% in this sector but with certain conditions: The foreign investor must bring a minimum amount of US dollar 100 million for investment. Govt. possess the first right of procurement on agricultural products. Fresh agricultural products may be unbranded. At least 30% of the products purchased must be from MSME.

8. HUMAN RESOURCE AND THE REVENUE TO THE HOST COUNTRY:

The foreign company educates and trains the local human resources and bridging the gap between education and employability. It plays an important role in enhancing the productivity of the employees. The technological transfer of the foreign company brings economic growth

in the country. It is a wonderful option for developing nations to improve economic growth and revenue by FDI.

The most important reason why India, looks to attract FDI is, FDI boosts the manufacturing and the services sectors which creates jobs and helps reduce unemployment among the educated youth. The employment of both skilled and unskilled younger generations boosts the economy of the country. FDI transforms the backward area into industrial sectors.

The product goods from FDI are not meant for domestic consumption alone but many of these product goods have global markets. The creation of Export Oriented goods boost the exports from other countries.

The inflow of capital is particularly beneficial for countries with limited domestic resources, as well as for nations with restricted opportunities to raise funds in global capital markets.

ADVANTAGES OF FOREIGN INVESTMENT AND CREATION OF COMPETITIVE MARKET

FDI takes place when an investor from another country invests in a business in a manner wherein, he gains control over the company purchased. By facilitating the entry of foreign organizations into the domestic marketplace, FDI helps create a competitive environment, as well as break domestic monopolies. A healthy competitive environment pushes firms to continuously enhance their processes and product offerings, thereby fostering innovation. Consumers also gain access to a wider range of competitively priced products.

The economic survey 2008-09 retired that the FDI is considered to be the most attractive type of capital flow for emerging economies as it expected to bring the latest technology and enhance production capabilities of the economy. In India, FDI provides a stable inflow of funds, access to international markets, export growth, transfer of technology skills and improve the balance of payments.

The foreign investment leads to imports of capital goods, and raw materials. Further, when the FDI companies introduced high technology in the host country, the Indian firms also need high technology which competes with foreign firms. It is concluded that there is a positive impact

of the foreign direct investment on the economic growth of the Indian economy and it creates a competitive market globally.

9. NEGATIVES OF FDI:

9.1. Exploitation and Draining of Money:

Globalization increases employment opportunities especially in developing countries due to the rapid increase in foreign investment. The unemployment in the developing countries leads to exploitation of workers by multinational corporations. The foreign companies are basically deployed to earn profits from native customers through foreign direct investment. Therefore, the net amount earned by a foreign company is transferred to the parent nation. But the foreign direct investment is basically deployed to earn profits from the native customers. The net profit amount earned is transferred to the parent nation. In addition, human resources are forced to work for long hours without morale. In addition, the laborers are forced to work for long hours with the absence of health insurance.

9.2. Loss of Business for Local Companies:

The retail traders in India are enraged at the entry of FDI companies that will be cancerous to their growth. The small local businesses will inevitably be wiped out by large multinational companies (FDI), in a form of imperialist capitalism and it will put them out of competition and affect their trade adversely. The destruction of local businesses leads to the loss of local culture and the rise of a singular anonymous corporate culture. The local business is forced to wind up after some time because they do not have the required financial muscle. It is an unfortunate situation as the country can never develop a local industrial base.

Foreign direct investment (FDI) brings ample opportunity to the lower class people for employment. Big businesses will destroy local economics by displacing many people affiliated with small businesses such as shopkeepers, small retailers, Kirana store owners, hawkers, vendors, and workers. These people will suffer a large loss due to Giant retailers and Supermarkets like Wal-Mart, Tesco, Carrefour, etc. will displace small retailers. Loss of business of local enterprises because of the entry of Multinational Corporates. Thus the local people who are doing small business cannot compete with them in terms of advancement in

technology and most important capital thus many wipes out from the race or becomes a niche player.

But multinational Corporations predict that a total of 2 million jobs can be created when they infiltrate India's economy. In India, there are 200 million people whose jobs depend on the retail sector. The intervention of big business will destroy through forcing small businesses to close and killing local economies, which result in the replacement of the Socialistic pattern of the mixed economy by the market economy.

10. CONCLUSION:

FDI plays an important role to increase the level of **economic growth** in India. It also contributes to the **GDP growth and to increase the foreign exchange reserves** of the country. In India, retail sectors were a small family-owned business in the form of general stores catering to the needs of the small sector of consumers. So, it is a gradual step for the Central Government to introduce foreign direct investment (FDI) in the retail sector by multi-brand retailing not a single brand retailing. A healthy discussion must be held by the Government of India with a **panel committee members** representing at various levels such as rural, semi-urban, urban, corporation and metropolitan of all the industries like retailers, farmers to analyses the impact of FDI and to understand its outcome rather than creating fear in the minds of retailers, farmers and MSME's. The calling of such representatives is to get their opinion and for healthy discussion with a questionnaire.

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