AN UPDATES OF ISSUES, CHALLENGES AND OPPORTUNITIES IN FDI IN INDIA

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ABSTRACT

In the beginning of liberalization when India was facing the financial crises for meeting the external commitments. At one time during the Prime minister Chandra Sakher government India had to pledge its gold before World Bank to repay the foreign debts as India had only $ 1 billion foreign exchange reserves, at the same time, the immediate external payment was more than $ 25 billion. Therefore India was bound to opt for liberal economic policy for the inflow and outflow of foreign investment and depreciation of Indian rupees by 300% in comparison of dollar from rupees 8 to rupees 28 per dollar. By which the foreign investors started attracted and investing their funds in India as the India had and has potential for the growth and diversification of business, since then the India has made remarkable progress in the field of foreign direct Investment but there are lot many challenges and issues needs to be resolve to promote and attract foreign direct investment. These issues and challenges are as mentioned in the papers are-Restrictive FDI regime, Lack of clear cut and transparent sectoral policies for FDI, High tariff rates by international standards, Lack of decision-making authority with the state governments, Limited scale of export processing zones, No liberalization in exit barriers, Stringent labour laws, Financial sector reforms, High corporate tax rates, Fluctuating Exchange rates, Indecisive Government and political Instability. In this paper we have tried to update the latest and the possible conclusion for the rationalization of foreign direct investment.

Keywords: Challenges and Opportunities, Liberalization, Financial Reforms, Foreign Direct Investment

INTRODUCTION

The scenario in the Indian Economy started to change slowly in the 1980s after liberalization of economy took place by way of economic reforms, which in sum changed the face of the country. Foreign direct investment (FDI) is seen as a strategic component of investment to maintain the pace of growth and development of the economy. It acts as an important economic catalyst of Indian economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfers. Since 1991 the government has focused on liberalization of policies to welcome foreign direct investments. But again, the sector has its own issues, which often poses serious challenges to the industry. In addition to India's poor performance in terms of competitiveness, quality of infrastructure, and skills and productivity of labour, there are several other factors that make India a far less attractive ground for direct investment than the potential she has.[i] The FDI may also affect due to the government trade barriers and policies for the foreign investments and leads to less or more effective towards contribution in economy as well as GDP of the economy.[ii] The developed countries are often in search of new markets where there is scope for products, chances of high profit is attainable and there is availability of abundant labour. While the objective behind allowing FDI is to complement and supplement domestic investment, for achieving a higher level of economic development and providing opportunities for technological upgradation, as well as access to global managerial skills and practices.[iii] While few of the number of challenges are recognized as Restrictive FDI regime, Lack of clear cut and transparent sectoral policies for FDI, High tariff rates by international standards etc. Although it is not debatable and room for doubt that in India FDI has enabled to achieve a certain degree of financial stability; growth and development to sustain and compete in the global economy. But still, if the country is to achieve substantive success, it has to work upon different fronts to reach to the top. Government has also made some, albeit limited, progress in allowing multi-brand retailing, which has so far been prohibited in India.[iv] While on comparison it is worthwhile to note that, in absolute terms China attracted US$ 53,510 million in 2003 whereas India attracted only US$3420 million and during 2004 China attracted US$ 60,600 million, whereas India attracted only 4374 million US$ during the same period. So, India can learn some valuable lessons from its counterpart in order to boost its economy, especially on the FDI front. As the figures above reflect that India attracted only a meagre amount in the year 2003 when compared to China, while in the year

2004 the difference only got widened leaving behind to work upon the current policies and reform to match its counterparts in the international sector.[v]

MAJOR ISSUES AND CHALLENGES

History has witnessed that the concern of allowing unrestrained FDI flows in the retail sector has never been free from controversies and simultaneously has been an issue for unsuccessful deliberation ever since the advent of FDI in India.[vi] Where on one hand there has been a strong outcry for the unrestricted flow of FDI in the retail trading by an overwhelming number of both domestic as well as foreign corporate retail giants; to the contrary, the critics of unrestrained FDI have always fiercely retorted by highlighting the adverse impact, the FDI in the retail trading will have on the unorganized retail trade, which is the source of employment to an enormous amount of the population of India. The antagonists of FDI in retail sector oppose the same on various grounds, like, that the entry of large global retailers such as Wal-Mart would kill local shops and millions of jobs, since the unorganized retail sector employs an enormous percentage of Indian population after the agriculture sector; secondly that the global retailers would conspire and exercise monopolistic power to raise prices and monopolistic (big buying) power to reduce the prices received by the supply. It is of no doubt that India has a huge domestic market and a fast growing one. Thus, this makes the Indian economy a food market to invest and with continued reforms that improve institutions and economic policies a conclusive conducive for private investment and economic growth can be created which in turn will significantly increase FDI follow to India in high volumes. Here are some of the major issues, listed below:

i. Restrictive FDI Regime

The FDI regime in India is still quite restrictive. As a consequence, with regard to cross-border ventures, India ranks 57 in the GCR 1999. Foreign ownership of between 51 and 100 percent of equity still requires a long procedure of governmental approval baring few sectors. In our view, there does not seem to be any justification for continuing with this rule. This rule should be scrapped in favour of automatic approval for 100 % foreign ownership except on a small list of sectors that may continue to require government authorization. The banking sector, for example, would be an area where India would like to negotiate reciprocal investment rights. Besides, the government also needs to ease the restrictions on FDI outflows by non-financial Indian enterprises so as to allow these enterprises to enter into joint ventures and FDI arrangements in other countries. Further deregulation of FDI in industry and simplification of FDI procedures in infrastructure is called for.

ii. Lack of Clear Cut and Transparent Sectoral Policies for FDI

Expeditious translation of approved FDI into actual investment would require more transparent sectoral policies, and a drastic reduction in time-consuming red-tapism and unauthorised delays by the governmental officials.

iii. High Tariff Rates by International Standards

India's tariff rates are still among the highest in the world, and continue to block India's attractiveness as an export platform for labour-intensive manufacturing production. On tariffs and quotas, India is ranked 52 in the 1999 GCR, and on average tariff rate, India is ranked 59 out of 59 countries being ranked. Much greater openness is required which among other things would include further reductions of tariff rates to averages in East Asia (between zero and 20 percent). Most importantly, tariff rates on imported capital goods used for export, and on imported inputs into export production, should be duty free, as has been true for decades in the successful exporting countries of East Asia.

iv. Lack of Decision-making Authority with the State Governments

The reform process so far has mainly concentrated at the central level. India has yet to free up its state governments sufficiently so that they can add much greater dynamism to the reforms. In most key infrastructure areas, the central government remains in control or at least with veto over state actions. Greater freedom to the states will help foster greater competition among themselves. The state governments in India need to be viewed as potential agents of rapid and salutary change. Brazil, China, and Russia are examples where regional governments take the lead in pushing reforms and prompting further actions by the central government. In Brazil, it is Sao Paulo and Minais Gerais which are the reform leaders at the regional level; in China, it is the coastal provinces, and the provinces farthest from ICOQM.

The FDI Confidence Index 2007, an annual report from consultancy firm A.T. Kearney has ranked India at second place, a position it has held since 2005. The report notes: India retains second place in the Index, a position it has held since displacing the US in 2005. India continues to attract investors in the high value-added services industries, particularly financial services and information technology. Three quarters of respondents who are 'highly likely' to invest in India over the next few years are from outside Asia."[vii]

WHY INDIA LAGS AS A FDI DESTINATION FOR MANUFACTURING?

Two oft-noted problems that are often highlighted in India have been the poor state of the country's infrastructure as well as the acute labour market rigidities. Any trip outside urban areas highlights the problem of bad infrastructure in India. To start with roads, they are best described as shoddy and are strewn with potholes and these are roads that are described as "national highways". Most of these highways are two-lane roads at best though there is the construction of the Golden Quadrilateral, a four to six lane highway linking major cities in India going on. However, the Quadrilateral does not link much of India. This is not to say that infrastructure in urban areas is any good. Urban infrastructure in the country remains woeful. The fact is that they are terrible in absolute terms and not just in comparison to any Western city. The other problem is power. It is very common for towns and villages to face daily blackouts averaging more than 8 hours a day. The other infrastructure issues are the ports, airports; both which are either too small or bad when compared to world-class ports or airports.[viii] Problem of employment in rural area is not adequately solved. Most of the population of India is lived with unemployment in rural region. FDI favours only urban regions for the investment and neglect rural & backward regions.[ix]

A series of measures that were directed towards liberalizing foreign investment included:[x] (i) introduction of dual route of approval of FDI – RBI"s automatic route and Governments approval (SIA/FIPB) route, (ii) automatic permission for technology agreements in high priority industries and removal of restriction of FDI in low technology areas as well as liberalisation of technology imports, (iii) permission to Non-resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) to invest up to 100 per cent in high priorities sectors, (iv) hike in the foreign equity participation limits to 51 per cent for existing companies and liberalisation of the use of foreign „brands name‟ and (v) signing the Convention of Multilateral Investment Guarantee Agency (MIGA) for protection of foreign investments. These efforts were boosted by the enactment of Foreign Exchange Management Act (FEMA), 1999 [that replaced the Foreign Exchange Regulation Act (FERA), 1973] which was less stringent. This along with the sequential financial sector reforms paved way for greater capital account liberalisation in India.

IMPACT OF FDI ON INDIAN ECONOMY

India is a land of retail democracy – hundreds of thousands of weekly haats and bazaars are located across the length and the breadth of the country by people`s own self organizational capacities. Our streets are bazaars – lively, vibrant, safe and the source of livelihood for millions. In a country with large number of people, and high levels of poverty, the existing model of retail democracy is the most appropriate in terms of economic viability.
FDI in retail has always been opposed by a large section of Indian society and polity. Parties across the political spectrum have demanded a roll back of the decision. The government, however, has insisted that this executive decision does not require any parliamentary sanction.

The Indian retail sector is the second largest employer in India after agriculture, employing over 4 crore (40 million) persons as per the latest National Sample Survey (NSS) 2009- 10. Most of these are small unorganised or self-employed retailers, who are unable to find gainful employment in other sectors of the economy.

Despite the hype over the high GDP growth in India, NSS 2009- 10 has confirmed the trend of jobless growth in the country. Total employment growth has slowed down from an annual rate of around 2.7% during 2000-2005 to only 0.8% during 2005- 2010. Growth in non-agricultural employment fell from 4.65% to 2.53%. Among all the workers at the national level, about 51% were ‘self-employed’, about 33.5% were ‘casual labour’ and only 15.6% were ‘regular wage/salaried’ employees.

In this backdrop, the entry of MNC supermarket and hypermarket chains would cause severe displacement of the small and unorganised retailers. The sample survey of unorganised retailers done by the ICRIER in 2008 estimated the average size of an unorganised outlet to be around 217 sq.ft, excluding the pushcarts and kiosks operated by the hawkers[xi]. The total annual business of unorganized retail in India was estimated in the ICRIER report to be $ 408.8 billion in 2006-07 and the total number of traditional retail outlets as 13 million (1.3 crore). The average total business per store per year for an Indian unorganised retail store therefore comes to around $31446 (Rs. 15 lakh). The survey found an average retail outlet employing 2 to 3 persons.[xii]

The average size of a Walmart supermarket in the US is 108000 sq.ft employing around 225 persons. In 2010, Walmart sold $405 billion amount of goods through its 9800 odd outlets 5 located across 28 countries, employing around 2.1 million (21 lakhs) persons. This implies that one Walmart supermarket can displace over 1300 Indian small retail stores and thereby render around 3900 persons jobless. The employment created against this in that supermarket will be 214 (or maximum 225, which is the average in the US). Clearly, there will be severe job losses if giant MNC supermarkets are allowed entry into the Indian market.

IMPACT ON VARIOUS GROUPS

i. Unorganized retailers in the vicinity of organized retailers experienced a decline in their volume of business and profit in the initial years after the entry of large, organized retailers.
ii. There was decline in employment in the North and West regions which, however, also weakens over the time.

iii. Overall consumer spending has increased with the entry of the organized retail and it has definitely gained from organized retail on multiple counts.

iv. Unorganized retailers have significant competitive strengths that include consumer goodwill, credit sales, amenability to bargaining, ability to sell loose items, convenient timings, and home delivery.

v. Famers benefit significantly from the option of direct sales to organized retailers. Profit realization is 60% higher than their proceeds from sales to organized retailers as that against of mandi.[xiii]

vi. Modern retail would displace a large number of jobs.

vii. Global retail chains would adopt predatory pricing tactics to wipe out domestic competition (small retailers).

viii. Once global retail chains are established, they would be in a position to dictate prices for both buying wholesale, and selling retail products.

ix. Retailing itself cannot boost GDP. The growth in manufacturing sector needs to be increased.[xiv]

SUGGESTIONS AND RECOMMENDATIONS

After an extensive research, the authors would like to put forward he following suggestions for the FDI sector in India: -

i. Encourage formulation of private codes of conduct by organized retail for dealing with small suppliers. These may then be incorporated into enforceable legislation. This was also one of the recommendations of the Murli Manohar Committee on FDI in retail.

ii. Government must target at attracting specific types of FDI that are able to generate spill overs effects in the overall economy. This could be achieved by investing in human capital, R&D activities, environmental issues, dynamic products, productive capacity, infrastructure and sectors with high income elasticity of demand.[xv]

iii. Government must pay attention to the emerging Asian continent as the new economic power – house of business transaction and try to boost the trade within this region through bilateral, multilateral agreements and also concludes FTAs with the emerging economic Asian giants.

iv. Simplification of the licensing and permit regime for organized retail and move towards a nationwide uniform licensing regime in the states to facilitate modern retail.[xvi]

v. Focus should not just be on the absolute amount of gross FDI inflows but also the type.[xvii] More specifically, while India has experienced an infusion of FDI inflows in recent times, a large portion of the new inflows have been in the form of M&As.[xviii]

vi. It is also suggested that the Indian government must promote research an development to maintain fine economic growth under FDI. Maximum preference should be given to the development of human resources. Try to stabilize the political environment. FDI should use as means of controlling inflation and deflation, upgrading the education system, ensuring personal security of the citizens.[xix]

CONCLUSION

The path of economy growth and development certainly navigate with the help of FDI. India is an over populated country; infrastructure facility is not much developed therefore supply term is became week and inflation is occurred. Transition of a economy from Agriculture sector to Industrial sector and from Industrial sector to services sector is an evolutionary process. This is how an economy can achieve inclusiveness, expansiveness and excellent growth of economy. India's FDI policy has progressively evolved into more and more liberal and further opening up of the service sector which has been most preferred sector for FDI will help realize India its true potential of economic growth on world's arena. Furthermore, the realization of India's FDI potentials will also depend on the ability of its leaders to improve the FDI climate and take advantage of the new global interest in the affairs of the region by implementing sound macroeconomic policies, enforcing the rule of law, reducing risks of policy reversals, and improving the provision of infrastructure. In addition, while foreign direct investment does have positive net benefits for the economy as a whole, empirical research has not established that such benefits remain unambiguously positive when tax and financial incentives are offered as inducements. FDI would lead to a more comprehensive integration of India into the worldwide market and, as such, it is imperative for the government to promote this sector for the overall economic development and social welfare of the country. If done in the right manner, it can prove to be a boon and not a curse. India has been one of the developing countries and has managed to show a positive GDP growth even during the recession period. It has comparatively performed well, then the average growth rate of world GDP. According to UNCTAD in its World Investment Report 2010 "If the situation continues to improve, India is likely to be among the most promising investor-home countries in 2010-12 as well as the third highest economy for FDI in 2010-12". While it is to be noted that India has well established political government and has stable economy which is very positive indicators for someone thinking about investing in India. It has very large population which serves to be large consumer base. Thus, this acts as a bonus point for India. Hence FDI if properly regulated can be a boon for the Indian economy.

ENDNOTES

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