UNIT 2 FOREIGN INVESTMENT

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2.0 OBJECTIVES

After you have studied well this unit, you will be able to:

1. Elaborate the concept of foreign capital.
2. Discuss the role and significance of foreign capital in the development process of an economy
3. Identify the different types and sources of foreign capital.
4. Differentiate between direct investment and portfolio investment.
5. Analyse the process in which MNCs operate and make their contribution
6. Examine their positive and negative role in growth process.
7. Discuss the need to regulate the operations of MNCs

8. Describe the contribution made by foreign institutional investors in the growth process.
9. Analyse the dimensions of Start - Ups programme in India

2.1. INTRODUCTION

As stated earlier in unit 1 flows of goods, invisibles and capital regularly and continuously recur in an economy and make their contribution to the growth process. In that unit we have examined different dimensions of these flows. We proceed further and examine the nature and significance of capital flows in the present unit.

In this unit, you will learn about the capital transfer and economic growth, Sources of foreign capital, multinational corporations and government policy towards foreign capital. You will be further familiarized with the foreign institutional investors, India's overseas investment and start up India.

2. 2. CAPITAL TRANSFER AND ECONOMIC GROWTH

There are four sorts of forex inflows. The most stable, desirable sort is foreign direct investment (FDI). Foreign-owned factories and power stations cannot exit in a panic.

The second most stable inflow is into equities. If foreign investors try to exit en masse in a panic, stock prices and the exchange rate plummet. Equity investors may exit at a steep loss. This was demonstrated in the Asian Financial Crisis and Great Recession.

The third most stable—or second most unstable— inflow is into medium or long-term rupee bonds. Here too, any mass exit will depress the price and exchange rate too. But bonds are far less volatile than stocks, and so carry a much lower exit penalty.

The fourth, worst sort of inflow is dollar- denominated debt, which on maturity is repaid in full without any exit penalty. Long-term dollar debt takes time to mature, and is not so hot. But short-term dollar debt matures very quickly and is the hottest-of- hotflows. Rupee-denominated short-term debt is not quite so bad, since it carries some currency risks (which are, however, limited because of the short maturity).

These facts should guide the strategy of the government and of the RBI. Priority should be given to raising productivity and, thus, reducing the current account deficit. As for inflows, FDI is the best. Inflow into equities is also desirable. Dollar-denominated debt should not be encouraged. Foreign investment in short-term debt, whether in rupees or dollars, must be strongly discouraged. Hot money must not be allowed to make exports uncompetitive.

2.3 FUNCTIONS OF FOREIGN CAPITAL

Foreign capital can perform three gap-filling functions.

1. Savings Gap: The key to the development problem lies in raising the rate of capital formation. Such a raise envisages a much higher level of investment than is warranted by the present level of savings in the EEs. The scope for a sharp rise in domestic savings is limited by the prevailing low level of income, slow rates of growth and rising consumption needs in these economies. The gap between investment requirements and domestic savings can be filled in by foreign capital.

A little simple algebra will show why.

In national income accounting an excess of investment over domestic saving is equivalent to a surplus of imports over exports. The national income equation can be written from the expenditure side as

Income = Consumption + Investment + Exports - Imports

Since saving is equal to income minus consumption, we

$$S = I + X - M$$

Or

$$I - S = M - X$$

A surplus of imports over exports financed by foreign borrowings allows a country to spend more than it produces or to invest more than it serves

The availability of foreign capital increases the availability of total resources in the economy. The increase in total resources helps an EE primarily in two ways:

(i) It influences investment decisions. It makes possible construction of many projects which would not have been possible otherwise. Certain programmes of development can give the optimum results if all the components of the programme are undertaken simultaneously in a phased manner. The availability of foreign capital makes this type of investment possible.

(ii) Establishment of bigger projects and projects with a high investment component open up new opportunities of investment and thus encourage domestic entrepreneurs and savers to supply their services and savings. The addition to the total volume of resources generated thereby exceeds the addition made by foreign resources.

2. Trade Gap or Foreign Exchange Gap

An EE is faced with two structural constraints: (i) a minimum requirement of inputs to sustain a given rate of growth of GNP, and (ii) an actual or potential ceiling on export earnings which are insufficient to finance the required imports.

In either of the above two situations, the availability of foreign exchange can save an economy from the position of an impasse in which it may find otherwise. It may provide place at her disposal high quality factors such as improved machinery, technical know-how and qualified foreign technicians which may have a beneficial effect on her development by, what Harrod called, "fertilising the productivity of common labour".

3. Technological and Management Gap

The EEs do not have access to advanced technology. But they have the *"advantages of latecomers"*. They have not to invent the wheel themselves. Instead they can borrow/receive technology from the developed world and thus improve their resource use and efficiency.

Analogous to technology gap is a gap in management, entrepreneurship and skill. Foreign capital can supply a "package" of needed resources that can be transferred to their local counterparts by means of training programmes and the process of learning by doing.

To sum up, foreign capital touches three sensitive areas, crucial in the development strategy of an EE. However, there is no definite answer in this to the proposition that foreign capital is a

must for growth. "The West has poured $2 trillion into Africa in the past fifty years. Yet, the proportion of Africans living in poverty has risen from 10 per cent in 1970 to 50 percent now.

Check Your Progress 1

1. What is Savings gap
2. What is Foreign exchange gap
3. What is Technology gap

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2. 4 SOURCES OF FOREIGN CAPITAL

We have been getting aid from various multilateral and bilateral external agencies, as also various individual countries. About 60 per cent of the total aid received has been in the form of multilateral aid. About 90 per cent of the total multilateral assistance has come from the World Bank. Bilateral aid has accounted for 40 per cent of the total external assistance; during the past five years, taken together, Japan has led the group of India's bilateral donors having accounted for 22.5 per cent of bilateral aid utilised by India.

2.4.1 Foreign Aid

Countries and multilateral aid agencies are increasingly looking to channel their funding into impact —investing projects that generate some commercial returns with social benefit—by the private sector. The emergent impact economy, centred on input investing, recognised the limitations of traditional government and NGO approaches to development challenges in health-care, water and sanitation, agriculture or infrastructure development.

The concept was introduced by the Rockfeller Foundation around 2007. Presently, it is finding takers even among mainstream investors like J. P. Morgan, City Bank and Deutsche Bank.

Impact of Aid

India's experience with FA has been a mixed one. While on the one hand, FA has helped India raise its productive capacity in all the sectors of the economy, it has also inflicted heavy costs, both direct and indirect.

Nevertheless, compared with many other EEs, India has been relatively successful in avoiding the problems associated with drawing from a multiplicity of aid donors by avoiding the use of a number of domestic agencies for that purpose.

(a) All aid is negotiated through a single department, the Department of Economic Affairs, which keeps account of the recurrent cost and foreign exchange implication of all the country's aid transactions.

(b) Government's control of foreign exchange and financial institutions ensures that the aid pattern does not distort the structure of national plan expenditure.

2. 4.2 External Commercial Borrowings (ECBs)

During the mid-1980s concessional aid to India from varied sources almost reached a plateau, and indeed was on a reverse track. When the foreign exchange shortage began to work as a constraint on India's developmental efforts, India was forced to borrow from private foreign sources, *i.e.,* from the international credit market. Such loans are known as 'external commercial borrowings' (ECBs).

ECBs are defined to include loans from commercial banks and other financial institutions, suppliers' credits, bonds, FRN and loans from semi- governmental export agencies, IFC (W), DEG Germany, CDC U.K., and Nordic Investment Bank. The major source of ECB, presently, is 'Eurodollar' or 'Eurocurrency' market. The market for dollar (or any other currency) denominated loans located anywhere can be termed as Eurodollar (Eurocurrency) market, and would not be subject to US (the country's) domestic banking regulations like reserve requirements on the liabilities, interest rate restrictions and exchange control restrictions.

More than 90% of the total approvals have taken place under the automatic approval route of the RBI. The bulk of the (75% to 80%) borrowings have been by public sector units like the ONGC, NTPC, BHEL, MUL, etc. The maturities have varied from 3 to 10 years generally and interest charges between 12 and 16 per cent; the spreads have been 0.5-0.75 per cent LIBOR (London inter-bank offer rate, the benchmark rate at which banks loan money to one another).

2. 4.3 Foreign Investment

(a) *Equity Capital:* It is the value of the MNC's investment in shares of an enterprise in a foreign country. An equity capital stake of 10 per cent or more of the ordinary shares or voting power in an incorporated enterprise, or its equivalent in an unincorporated enterprise, is normally considered as a threshold for the control of assets. This category includes both *mergers and acquisitions and 'greenfield investments'* (the creation of new facilities).

(b) *Private Equity:* It has emerged as an important source of FDI in more recent years.

(c) *Reinvested Earnings:* These are the MNC's share of affiliate earnings not distributed as dividends or remitted to the MNC. Such retained profits by affiliates are assumed to be reinvested in the affiliate.

(d) *Other Capital.* It refers to short- or long-term borrowing and lending of funds between the MNC and the affiliate.

Investment and Collaboration: Although foreign investment and collaboration with foreign parties are very closely interrelated, they are not one and the same thing. Foreign investment may take place without foreign collaboration and *vice versa.* Capital participation refers to the foreign partner's stake in the capital of the recipient country's company while technical collaboration refers to such facilities provided by the foreign partner as technical services, licensing, franchise, trade marks and patents (against which he gets lump sum fee or royalty payments for a specified period).

FDI can be Horizontal or Vertical

Horizontal FDI constitutes a situation in which multi-plant firms duplicate roughly the same activities in multiple countries.

Vertical FDI constitutes a situation in which firms locate different stages of production in different countries.

Vertical FDI in turn can be of two types:

(a) *Upstream vertical FDI:* If Peugeot (the French automaker) only assembles cars and does not manufacture components in France, but in the UK, it can be said that Peugeot enters into components manufacturing through FDI.

(b) *Downstream vertical FDI:* If a Volkswagen (the German automaker) does not engage in car distribution in Germany and instead invests in car dealerships in Saudi Arabia (a downstream activity), it can be said that Volkswagen is engaged in "downstream vertical FDI."

Types of FDI

Looked at from the point of view of the investors, the FDI inflows can be classified into three groups:

(i) *Market-seeking:* These are attracted by the size of the local market, which depends on the income of the country and its growth rate.

(ii) *Efficiency-seeking:* In EEs where capital is relatively scarce the marginal efficiency of capital (MEC) tends to be higher than in the developed world where it is abundant. Assuming that interest rates broadly reflect MECs, it follows that lending rates in Western financial centres are below MEC in EEs. Hence, economic efficiency — and commercial logic— dictate that capital should flow from the relatively less-profitable developed world to the relatively more profitable EEs.

(iii) *'Other location' advantages:* These include the technological status of a country, brand name and goodwill enjoyed by the local firms, openness of the economy, trade and macro policies pursued by the government and intellectual property protection granted by the government.

FDI is essentially long-term investment and is associated with investment in capital assets and creating employment while FII is inherently short-term investment linked to the financial market. FDI by its very nature has a high multiplier effect on the economy than FII. Entry and exit decisions invariably take longer for FDI as compared with FII. The nimbleness of FII flows has implications for money supply, forex reserves and interest rates.

Recent Trends in Foreign Investment

Table 2.1: Foreign Investment Inflows

Year	Gross inflows/ Gross Investments	Repatriation/ Disinvestment	Direct Investment to India	FDI by India	Net Foreign Direct Investment	Net Portfolio Investment	Total
	US $ Million	US $ Million	US $	US $	US $ Million	US $ Million	US $

			Million	Million			Million
2000-01	4031	0	4031	759	3272	2590	**5862**
2001-02	6130	5	6125	1391	4734	1952	**6686**
2002-03	5095	59	5036	1819	3217	944	**4161**
2003-04	4322	0	4322	1934	2388	11356	**13744**
2004-05	6052	65	5987	2274	3713	9287	**13000**
2005-06	8962	61	8901	5867	3034	12494	**15528**
2006-07	22826	87	22739	15046	7693	7060	**14753**
2007-08	34844	116	34729	18835	15893	27433	**43326**
2008-09	41903	166	41738	19365	22372	-14030	**8342**
2009-10	37746	4637	33109	15143	17966	32396	**50362**
2010-11	36047	7018	29029	17195	11834	30293	**42127**
2011-12	46552	13599	32952	10892	22061	17170	**39231**
2012-13	34298	7345	26953	7134	19819	26891	**46711**
2013-14	36047	5284	30763	9199	21564	4822	**26386**
2014-15	45147	9864	35283	4031	31251	42205	**73456**
2015-16	55559	10652	44907	8886	36021	-4130	**31891**
2016-17	60220	18005	42215	6603	35612	7612	**43224**
2017-18	60974	21544	39431	9144	30286	22115	**52401**
2018-19	62001	18699	43302	12590	30712	-618	**30094**
2019-20	74390	18384	56006	12993	43013	1403	**44417**
2020-21	81973	27046	54927	10972	43955	36137	**80092**
2021-22	84835	28605	56231	17644	38587	-16777	**21809**

Notes: 1. Data for 2021-22 are provisional.
2. Data on FDI have been revised since 2000-01 with expanded coverage to approach international best practices.
3. Negative (-) sign indicates outflow (except in case of FDI by India).
4. Direct Investment data for 2006-07 include swap of shares of $3.1 billion.
Source: Reserve Bank of India.

Look at Table 2.1, it shows the details of the foreign investment inflows from the year 2000-21 to 2021-22. In the year 2000-21, the total figure was at 5862 US $ Million. After a decade in 2010-11, the figure was 42127 US $ Million. Gradually, it accelerated and in 2020-21 and reached to 80092 US $ Million. In the year 2021-22, due to the negative figure of Portfolio Investment (-16777), the total foreign investment inflows stands at 21809 US $ Million.

Table 2.2: Foreign Direct Investment Flows to India:Country-Wise

(US$ billion)

Countries	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22 (P)**

Singapore	12.2	16.2	14.7	17.4	15.9
US	2.1	3.1	4.1	13.8	10.5
Mauritius	15.9	8.1	8.2	5.6	9.4
Netherlands	2.8	3.9	6.5	2.8	4.6
Switzerland	0.5	0.3	0.2	0.2	4.3
Cayman Islands	1.2	1.0	3.7	2.8	3.8
UK	0.8	1.4	1.3	2.0	1.6
Japan	1.6	3.0	3.2	1.9	1.5
UAE	1.0	0.9	0.3	4.2	1.0
Germany	1.1	0.9	0.5	0.7	0.7
Canada	0.3	0.6	0.2	0.0	0.5
Luxembourg	0.3	0.3	0.3	0.3	0.5
Thailand	0.1	0.1	0.0	0.1	0.5
France	0.5	0.4	1.9	1.3	0.3
Denmark	0.0	0.1	0.0	0.1	0.3
Others	4.2	4.2	4.7	6.3	3.1
Total FDI	44.9	44.4	50	59.6	58.8

P: Provisional.
Note: Includes FDI through approval, automatic and acquisition of existing shares routes.
Source: RBI.

Look at table 2.2, it shows the country-wise details of the Foreign Direct Investment Flows to India. In the year 2021-22 highest inflows were received from Singapore (15.9 US$ billion) followed by US (10.5 US $ billion), Mauritius (9.4 US$ billion), Netherlands (4.6 US$ billion), Switzerland (4.3 US$ billion), Cayman Islands (3.8 US$ billion), UK (1.6 US$ billion), Japan (1.5 US$ billion) and UAE (1.0 US$ billion).

Table 2.3: Foreign Direct Investment Flows to India:Industry-Wise

(US$ billion)

Industries	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22 (P)**
Manufacturing	9.0	9.6	9.6	9.3	16.3
Computer Services	3.4	3.7	5.1	23.8	9.0
Communication Services	9.1	6.5	7.8	2.9	6.4
Retail & Wholesale Trade	4.6	4.9	5.1	3.9	5.1

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Financial Services	4.6	7.2	5.7	3.5	4.7
Education, Research & Development	0.4	0.9	0.8	1.3	3.6
Transport	2.5	1.2	2.4	7.9	3.3
Construction	2.8	2.3	2.0	1.8	3.2
Business services	3.3	2.8	3.8	1.8	2.5
Electricity and other energy Generation, Distribution & Transmission	2.8	2.6	2.8	1.3	2.2
Miscellaneous Services	0.9	1.4	1.1	0.9	1.0
Restaurants and Hotels	0.5	0.8	2.7	0.3	0.7
Mining	0.1	0.3	0.3	0.2	0.4
Real Estate Activities	0.5	0.2	0.6	0.4	0.1
Trading	0.0	0.0	0.0	0.0	0.0
Others	0.3	0.1	0.2	0.2	0.4
Total FDI	44.9	44.4	50	59.6	58.8

P: *Provisional.*
Note: *Includes FDI through approval, automatic and acquisition of existing shares routes.*
Source: *RBI.*

Look at table 2.3, it shows the industry-wise details of the Foreign Direct Investment Flows to India. In the year 2021-22 highest inflows were received by manufacturing sector (16.3 US$ billion) followed by computer services (9.0) Communication Services (6.4), Retail & Wholesale Trade (5.1), Financial Services (4.7), Education, Research & Development (3.6), Transport (3.3), Construction (3.2), Business services (2.5), Electricity and other energy Generation, Distribution & Transmission (2.2) and Miscellaneous Services (1.0).

Need to Regulate Capital Inflows

The global financial integration and free flow of capital does improve the resource allocation and hence growth prospects but can also be a source of macroeconomic instability. Occasional restrictions on capital inflows may therefore be necessary. This is not inconsistent with the overall objective of liberalisation/financial globalisation and stability. While the pace of global flows may moderate in the coming years, India as one of the fastest growing economies will keep attracting foreign capital and will remain vulnerable to unpredictable capital inflows and outflows. In this scenario, the broad policy thrust should be to strengthen the domestic institutions, develop deep and efficient financial markets and improve risk management practices to raise the capacity of the economy to deal with capital flows.

2.6 MULTINATIONAL CORPORATIONS

An MNC is one which undertakes FDI, *i.e.,* it owns or controls income generation assets in more than one country, and in so doing produces goods or services outside its country of origin,

i.e., engages in international production. The MNCs are multiprocess, multi-product and multi-national composite enterprises.

These are also known as Transnational Corporations, (TNCs), although there are certain fundamental differences between the two. The most important difference is that an MNC, wherever it is, is controlled from its national headquarters with globally standardised operating procedures laid down in a universally *applicable policy* manual. A TNC, on the other hand, favours foreign semi- autonomous units with only reports and income repatriation flowing back to base.

New Phase of Operations by MNCs

Operations of MNCs have been changing over the past two decades, and this change has become a dominant pattern of their behaviour during the past decade. Instead of making mega-sized investments in host economies, MNCs have been sub-contracting various parts of the value chains by establishing joint ventures with local enterprises in a number of countries, thus establishing global value chains (GVCs). This fragmentation of production has twin advantages for these conglomerates. They are able to diversify their risk by collaborating with local enterprises, especially in the emerging economies, but perhaps more importantly, they are able to pick the more dynamic enterprises in their partner countries to improve their overall bottom lines.

Advantages of GVCs have been seen in India's neighbourhood. South-East Asian countries have long been involved in these GVCs that were first triggered when Japanese firms moved away from their home country in search of more cost-efficient locations. In the past decade, firms located in China have brought these countries closer in the production networks, a phenomenon that has also contributed to deepening of economic integration within the South Asian region. The growing share of trade in intermediate goods in the total non-fuel trade between these countries provides the evidence of greater regional integration.

2.6.1 Significance of Multinational Corporations

The retreat of socialism, and failure of aid as an instrument of economic development, there has been a greater realisation of the capacity of MNCs to deliver an efficient package of practices. In the 1970s MNCs were characterised by alarmists as something of an evil monster—almost *like muggers on a dusk night waiting to pounce on the innocent passerby.* MNCs were seen as pariahs, not saviours— objects of harm, not instruments for good. These attitudes have changed in the last few years. Today they constitute a powerful force in the world economy. They are being increasingly credited with dramatic and industry transforming innovations that are taking place today faster and faster.

Table 2.4: Potential Benefits from MNC Operations

Impact Area	Potential Benefits
• Imitation	Adoption of new production methods. Adoption of new management practices.
• Skills acquisition	Increased productivity of complementary labour. Tacit knowledge.
• Competition	Reduction in X-inefficiency. Faster adoption of new

	technology.
• Capital	Provision of scarce capital resources — Internally generated — Externally generated (privileged access to global capital markets)
• Technology	Provision of sophisticated technology and other technology not available in the host country.
• Exports and balance of payments	Access to superior global distribution and marketing systems. —MNCs may increase exports and create positive balance of payments effects
• Diversification	MNCs command technology and skills required for diversification of the industrial base and for the creation of backward and forward linkages. — Based on the host countries factor endowement.

The Case for Multinational Corporations

The case for MNCs revolves around the potential benefits that an EE can hope to get from MNC operations. These benefits are summarised in Table 2.4 above.

A recent study on the subject concludes that in today's world of global capitalism foreign investment is the only instrument that can reduce the inequalities between nations.

The Case Against Multinational Corporations in actual operations, in the past half a-century or so, the experience of EEs with MNCs has been none- too-happy. Main points of criticism can be summarised as in Table 2.5.

Table 23.5: Actual Impact of MNC Operations

• Capital	Insignificant net inflow — The MNCs raise most of the investment capital in domestic capital market, pre-empt scarce local capital resources and crowd out domestic borrowers.
• Remittances	Large dividend remittances Large technical payments Progressive fall of foreign participation in corporate capital formation.
• Technology	Transitory reluctance followed by increased inflow May be costly 'over-import' Problems with advanced technology and updating Problems with technical support
• Export	Export performance on par with domestic companies Higher import propensity than domestic companies Some import substitution but negative BOP effects.
• Diversification	MNCs do contribute: reallocation in favour of manufacturing and technology-intensive sectors.

	There may be preemption of growth opportunities and substitution of domestic capital in several promising areas Increased foreign influence in key sectors.

In a partial response to the above propositions it may be stated that many of the old myths are no longer valid. Present-day Third World Governments are not exactly powerless like those of yesteryears, nor are the modern MNCs mere' white profiteers who would turn into predators, unscrupulous, insensitive and interventionist. They are not like large trading firms of the 19th century, such as the East India Company[1] or the Royal African Company which "were like dinosaurs, large in bulk but small in brain, feeding on the lush vegetations of the new worlds". They have transformed themselves into modem MNCs which acknowledge their responsibility to the concerns and interests of the host countries and basically operate on the basis of mutuality of interests of both. MNCs are increasingly losing the sense of loyalty to their home country to provide employment. They are in search of bases where they can produce their products most competitively. The chosen model of growth is being defined as 'micro-multinational', *i.e.,* a company that from its very inception is based in a developed country but maintains a less-costly skill workforce abroad. The slogans *'Thinkglobal, act local'* and *'multidomestic'* are a working reality with most multinationals today. In fact, in present times international capital has no loyalty towards any nationality. MNCs realise they cannot be oriented toward the state of their origin. They have to be the citizens of the country they are in. If they are not, they do not succeed.

In view of these, there has been a perceptible change in the attitude of the EEs towards the MNCs.

2.6.2 Regulation of Multinational Corporations

In view of the fact that MNCs do possess a potential that can be gainfully exploited, most of the EEs have chosen to regulate their activities rather than to dispense with them altogether—an effort to separate the gold from the dross.

(i) Threat of nationalisation is an effective tool of regulation. Although nationalisation should be resorted to only in the extreme situations, the very fact that it can be exercised makes the corporations act in a disciplined manner.

(ii) The Government may allow collaboration in certain selected industries or certain selected regions where the operation of MNC is felt highly suitable. Similarly, the government may deny permission in specific cases.

(iii) MNCs may be allowed to invest for specific periods. Thus, after a certain period of time restrictions may be imposed on foreign holdings, or there may be provision for gradual disinvestment.

(iv) A multi-tax system may be followed by the Government. The MNCs may be taxed at a higher rate.

(v) The host country may lay down certain export criteria.

(vi) Large domestic market can be used as sweetener, if not a bait, to get new technologies in areas such as agriculture, bio-technology, infrastructure and export-oriented industries. These areas would be of more lasting benefits to host country than soaps, detergents or fried

chicken.

(vii) MNCs may be asked to carry out a minimum fixed share of their total research and development activities within the host countries.

2.7. GOVERNMENT POLICY TOWARDS FOREIGN CAPITAL

Foreign investment in India is subject to the same Industrial Policy as all other business ventures, plus some additional policies and rules specially governing foreign collaborations.

Beginning with the First Plan in 1951, five distinct phases can be marked:

• *First phase* lasted till 1965. As the domestic base of 'created' assets, *viz.,* technology, skills, entrepreneurship was quite limited. The policy was characterised by a liberal attitude towards foreign capital. Many concessions and incentives were given to foreign capital participation in the industrial development of the country.

- In the *second phase,* beginning with the mid- 1960s, the liberal attitude of the State yielded place to strict controls and the broad policy was to restrict the area of operation of foreign capital.
- In the *third phase,* beginning towards the end of the decade of 1970s, the policy was marked by a certain liberalisation. The changes eased the restrictions on FDI inflows.
- *Fourth phase,* beginning with the adoption of economic reforms programme since July 1991, has adopted a liberal attitude towards foreign capital and has aimed at attracting a free flow of direct foreign investment.
- *Fifth phase.* In late 2012 the RBI softened its stand on foreign direct investments that have in-built options, settling for a one-year lock-in on such investments as opposed to three years it wanted earlier. The compromise solution will help government put in place a policy that should address concerns of potential overseas investors, and end the uncertainty over the investment proposals that the RBI had refused to clear.

2.7. 1. New Economic Policy and 1991-2022 Policy Changes

The New Industrial Policy, 1991 can be described as a minor revolution as far as decisions concerning foreign investment and foreign technology agreements are concerned.

The various changes in the policy can be broadly classified into four categories:

1. *Choice of Product.* The number of products in which foreign investment is freely permitted has been significantly increased.
2. *Choice of Market.* The foreign investors are now free to compete with the domestic producers in the Indian market.
3. *Choice of Ownership Structure.* In most cases, the foreign investor is free to own a majority share in equity.
4. *Simplification of Procedures.*

India has opened two routes for FDI inflows. First, the RBI route (or the Bombay route). This is transparent in the sense that the guidelines are clear. If projects satisfy the guidelines, the approvals are practically automatic.

FDI proposals which fall under the automatic route are listed in Annexure III of the industires list; it consists of 42 industries.

The second route is the FIPB route (or the Delhi route). Foreigners are welcome to make proposals that

do not fit into the first category. Such proposals are considered case by case, in all manufacturing activities in Special Economic Zones except those subject to licensing, or public sector monopoly. The Government has also set up Foreign Investment Implementation Authority (FIIA), independent of the Foreign Investment Promotion Board (FIPB), to act as a single point interface between the investor and government agencies.

Centre approves New Definition of 'Control' in FDI

The government has changed the definition of 'control' in the context of foreign direct investment (FDI) policy. The new definition will empower the shareholders' agreement or voting agreements and will be with prospective effect.

Control will be defined as "the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholder agreements or voting agreements. This was done in order to bring parity with the definitions that are given under the guidelines of Securities and Exchange Board of India and Companies Bill 2012.

Further, the government has allowed 100 per cent FDI in contract manufacturing and in coal mining and related activities such as washery, handling and separation. This easing of restrictions on foreign investment, which sends a positive signal to the international community, should be seen as a continuation of the measures to prop up the economy.

2.7.2 2018 Reforms Push

In early January 2018 the government unveiled a fresh round of liberalisation of the foreign direct investment (FDI) policy.

These changes are pointers to the fact that, lately, the Government is keen to attract more of foreign investment. It seems it has come to be believed that:

(i) It is better to allow equity than to go out to borrow. For one thing, dividend remittance on equity will start only when the unit starts producing.

(ii) Capital is generally never repatriated. Profit also is normally re-invested. The company meanwhile makes a substantial contribution to GNP and domestic market becomes competitive.

(iii) Direct foreign investment brings technology. This technology spills over into other sectors which supply components and inputs.

Also when FDI firms produce cheaper and better capital goods or intermediate products, the competitiveness of sectors which use these improves. The competitive edge will spur development and accelerate the growth process. And, above all, the following message seems to have been clearly driven home to us: *"The piper playing his tune on past borrowings can only be paid without an external drain of capital from the economy if the nation is successful in attracting a new flow of investment."*

2.7.3 Suggestions

(i) State infrastructure is a major constraint and things can worsen if quick action is not taken to match the quality and size of all infrastructure components. For examples; transport,

communication and energy, comparable with that in other countries competing for the same capital.

(ii) Attention need be paid to restructuring education, training and skills. The process must begin at the level of primary education upwards with emphasis on absorption of appropriate skills and through upgradation.

(iii) India should promote quality standards. The present mindset favouring cheapness at the cost of quality needs a change.

(iv) The existing framework of legislation and practices related to industrial action should be reorganised so as to make it conducive to the promotion of productivity-oriented measures.

(v) The operating environment need to be made 'investor-friendly'. For this purpose, following suggestions can be made:

- At the entry level, there are two alternative routes *viz.,* the Automatic Approval Route (AA) of RBI and the Foreign Investment Promotion Board (FIPB). The policy framework should be liberalised to make the AA route more effective. An increased share of the AA route in the FDI approvals will concurrently reduce the pressures on the FIPB system.

During the last couple of years, much of the FDI was directed to the real estate sector, with comparatively little going into manufacturing or services.

- The efficiency of the state-level frontline bureaucracy is absolutely critical to keep up investor's confidence to prevent cost and time overruns which. This should be prevented, otherwise will have adverse effect not only on individual investors but also on the economy as a whole.

  We are at the bottom of the Brie league on three key parameters: absence of corruption, order and security and access to civil justice.

  Our poor ranking is a contributory factor for the dwindling funds flow into India in recent. On the face of it, this is bad news. If our image as a country where there is little respect for the rule of law gains currency, it is only a matter of time before this trend gets entrenched. And that is bad news for a country that despite the high domestic savings rate, desperately needs foreign capital to meet its huge infrastructure requirements.

(vi) We need more clarity on foreign ownership. There are far too many grey areas—sectoral limits, automatic route, FIPB, direct/indirect preference capital, convertible debt—that have unnecessarily complicated the foreign investment regime. We need quickly to move to 100% FDI policy regime in non-strategic sectors. It would check bureaucratic/political discretion and, thereby, impart more predictability in administrative outcome. Likewise, for award of contracts and projects, we need to have more sound bid documents particularly in terms of eligibility conditions and better evaluation of bids. Courts, too, need to be more circumspect in staying proceedings when unsuccessful bidders allege lacunae in bidding process or appraisal mechanism after participating in the bidding under the very terms.

(vii) We need to be tough with MNCs. But the real way to be tough with MNCs is to make the domestic market a ruthlessly competitive place by doing away with discretionary FDI approvals. Otherwise, corporates would be back at the old game of maximising gains by taking advantage of opportunities to politically manage the market place.

India has entered into Bilateral Investment and Protection Agreement with a number of countries. This agreement provides protection to private investment from abroad in India.

(viii) A last word, direct foreign investment may actually be harmful to the recipient country if the economy is highly protected and foreign investment takes place behind high tariff walls. This type of investment is generally referred to as the *'tariff jumping'* variety of foreign investment, whose primary objective is to take advantage of the protected markets in the host country. The longer the government shields its home market with tariffs the more will the foreigner come in to exploit that protected market, and more acute will be the conflict between him and the domestic entrepreneur. In view of this, an appropriate policy framework must respond to two conflicting objectives. First, the need to liberalise rules governing such investment in view of the growing integration of the world economy. The Second, the need to ensure that such investment has positive effects on the country's economy and does not lead to negative welfare effects. We do not need a 'rent- a-womb' type of investment.

Keep it Simple

Define a negative list where foreign investment is unwanted, lift caps on the rest.

The government should formulate a small, negative list of activities like the media where it desires little or no foreign investment. Even countries like the US rope off some activities from foreign funding. In all other sectors, it should allow full foreign investment, without limits. That and a transparent, rule-based regime will encourage overseas investors to enter India and do business with confidence.

We need to take a lesson from China. China is presented as the mightiest example of the virtues of international 'coupling'. During late 2007, China made a 180-degree turn and substantially cut down on its globalisation thrust. It eliminated tax breaks for foreign investments, limited merger deals, withdrawn many of the support schemes for export-oriented enterprises and clamped down on foreign investment in many sectors. These measures came in the wake of an increasing concern that the country was falling into the hands of powerful MNCs that left little for its people. With the new measures, China intends to use foreign investment rather than be used by foreign investors. India is also sailing in the same boat and should draft its policy accordingly.

India has much to offer the foreign investor. It must ensure that the benefits also flow the other way round.

A Question of Control

FDI Policy Defines 'Control' Narrowly

An entity is said to control another if it can appoint a majority of its directors. It does not consider indirect control *via* shareholder agreements & quasi-equity instruments.

This Allows Foreign Cos to Avoid Curbs

Foreign owned or controlled Indian entities are considered foreign companies

They face same restrictions on downstream investments as any other foreign company

They cannot invest in prohibited sensitive sectors

A foreign investor can exercise indirect control over an Indian company to get around

restrictions.

Indian companies having foreign stakes will now face a much closer scrutiny of their management and decision-making structures as the government decides to tighten the rules to determine who controls them.

As brought out clearly in a recent Supreme Court Judgement (Vodafone case), it is important to have clear tax laws incorporated in the treaties and in the laws so as to avoid conflicting views. Foreign investors should know where they stand. It also helps the tax administration in enforcing the provisions of the existing laws.

2.8. FOREIGN INSTITUTIONAL INVESTORS

Foreign institutional investors (Fils), described as *New Bulls* on Indian bourses, include pension funds, mutual funds, asset management companies, investment trusts, nominee companies and corporate or institutional portfolio managers, university funds, endowments, foundations and charitable trusts.

FII inflows are divided into two groups, (/) Regular sources, and *(ii)* others. Regular sources refer to global emerging market and Asia funds. The other category includes global funds. Wedge funds and sector-specific and sovereign wealth funds.

These can directly invest money raised from clients (firms, individuals and pension funds) or through sub accounts created for those who are not eligible to invest directly. The most popular channel for investment till 2007 was the (PN). A PN is a contract note where the funds accrue from overseas investors but the transactions are *via* the proprietory accounts of registered Fils. (In case of both PNs and subaccounts, the regulators do not have knowledge of the source of the money).

At present, over 9,000 Fils are registered in India; they operate sub-accounts; such accounts typically belong to large overseas wealth funds. Fils contribute an estimated 80% of the equity volume in India.

Benefits

Since their entry into Indian markets in the early 1990s, FIIs have invested cumulatively about $ 450 billion. Their annual level of operations on both the purchase and sale sides account for just 7.5 per cent of the turnover on our exchanges but their operations decisively impact the movement in stock prices. Fils bring with them certain advantages that help markets to save on time as the learning process is quicker, (i) They have deep pockets and can invest in large numbers as institutions, which other domestic entities may not be willing to do. (ii) They have considerable knowledge on global markets and developments taking place that would add a lot of value to the Indian markets too. Their global research teams provide valuable advice on world developments, (tn) They bring in the global best practices to the floor which help to strengthen the system.

Limitations

It is time we take a close look at this development. There are two aspects to it: *One,* its macro impact on overall policy framework; and *two,* its micro impacts on capital market, individual shareholdes, etc.

Macro Impact

Capital inflows in the form of portfolio investment have two negative, mutually reinforcing, effects.

1. Portfolio investors may become the ultimate arbiters of national macro-economic policy to the determinant of economically vulnerable groups. Fils account for 45% of the free float. Investors' veto power is expressed through the mechanism of portfolio reallocation. An economic crisis that threatens portfolio investors is likely to induce assistance from foreign governments and/or multilateral institutions. Those providing assistance may do so with the provision that they be given substantive influence over policy making.
2. Under floating exchange rates, a withdrawal of portfolio investment may trigger a nominal and real depreciation of the domestic currency. This may be because the government may not have forex reserves sufficient to stabilise the currency value. In such circumstances, problems of increased risk potential and constrained autonomy may be mutually reinforcing as measures undertaken to stem the crisis may further constrain autonomy.
3. Foreign investors have been found to break free of investment caps imposed by the RBI. To counter one such move the RBI, asked custodian bank to ensure foreign investor holding dues not exceed the cap.

Micro Impact

Among these the following may be noted:

1. It cannot be said with certainty how long Fils will hold on to their investments, that is, when they will sell for profit and repatriate the earnings in foreign currency. Worldwide they are branded as notoriously fickle investors; the slightest whiff of danger and they are gone.
2. Foreigners currently have a bigger stake in the biggest companies listed on the BSE than that of Indians, minus all promoters, foreign or Indian. FII investment in financial assets has exceeded foreign direct investment under liberalisation. This type of foreign investment is making little difference to the real economy.
3. With increasing equity acquisition, Fils are unlikely to remain passive investors for long. (Fils now own about one-fourth of Indian equities.) They are allowed to acquire any amount of a company's equity—against 10 per cent in South Korea and Taiwan—enough to pressurise or dislodge controlling interests of most companies. The predators may, in the first instance, replace domestic components with imported ones, as is happening in consumer electronics. Import dependence will increase with a decline in domestic capability.
4. There is no knowing how much of the FII inflow represents the return of capital outflow of the past two decades. (The illegal outflow from India, unofficially estimated and generally accepted, was of the order of $ 1.5 billion a year.) Less certain is the impact of the financial flows on the real economy.

Suggestions

With little bit of deftness, the government can ensure that the entry of Fils will continue to benefit foreigners, but not at the cost of Indians. It could, for example, charge Fils a hefty fee for getting registered in India. And it could insist on having tax laws which would treat foreigners at par with Indians; no better, and no worse. The Mauritius route should be brought under tax network. Above all, the government will have to move fast to improve the functioning of stock markets and the regulatory system which can curb undesirable speculation and ensure an orderly functioning of the markets during crisis situation. It is very necessary that we take steps to ensure that our entire financial system does not sway with every whim and fancy of Fils as it is starting to do now.

The real 800-pound gorilla in the room is financial globalization. Financial globalization is the consequence of the naive extension of the belief that if finance was essential for economic growth, lots of it would ensure faster growth. After three decades of the pursuit of financial globalization, global economies are left with too much finance, too much debt and the prospect of too little growth. Dani Rodrik, in a recent commentary, elaborates more on the harmful consequences of financial globalization and reckons that the answer lies in striking the right balance between the real economy and finance.

Financial globalization has left policymakers in the developing world with few meaningful options. Few years ago, Rodrik coined the phrase, "inescapable tri-lemma" to make the argument that deep economic integration, democratic politics and nation-states are incompatible. One of the three has to give. He might as well have replaced "deep economic integration" with "financial globalization" because that is what he had in mind when he coined the phrase. The "inescapable trilemma" has reduced the well-known "impossible trinity" in economics to one of impossible policy autonomy. That is, countries cannot have independent monetary policy in a world of unrestricted capital flows regardless of whether they have fixed or floating exchange rates. Therefore, given the reality of financial globalization, market-distorting responses from emerging policymakers may well be inevitable. However, the real worry is that even these second-best options may not be available to them.

Check your Progress 2

1. State two sources of external assistance.

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2.What are external commercial borrowings?

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3. What do you mean by foreign direct investment ?

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2.9. INDIA’S OVERSEAS INVESTMENTS

A large number of Indian companies have been reaching out for overseas destinations in order to access high-growth markets, technology and knowledge, attain economies of size and scale of operations, to tap global natural resource banks and leverage international brand names for their own brand building. India's overseas investments have taken the form of wholly-owned subsidiaries (WOS) and Joint Ventures (JVs).

Joint ventures (JVs) include commercial and industrial enterprises in which two or more parties from two or more countries share the responsibility for operation by providing risk capital, goodwill, know-how and management, natural resources, and access to national markets in an agreed manner. Controlling partner is one who is the major decisionmaker in the JV.

Government Policy

The Indian policy framework has been highly supportive of direct investment abroad.

Growth and Nature

FDI emanating from India has been growing by leaps and bounds over the past 10 years, and has often been close to $ 20 billion a year of late. The gap between inbound and outbound FDI has been narrowing, although India continues to be a net importer of capital because of its current account deficit. Four phases with respect to sectors, magnitudes, entry modes and destination can be differentiated.

In the *first phase* until 1990, largely Indian companies operated small operations as joint ventures in poorer countries in Asia and Africa seeking markets based on adapted and scaled down technologies in relatively low technology sectors. The entry mode was green field.

The *second phase* began with the onset of reforms. With greater freedom to invest abroad, Indian companies made outward investments in other countries to support their exports with local presence. Hence, they began to be concentrated in developed and developing countries where the markets for Indian products and services existed. These investments were concentrated by select industries such as pharmaceuticals and IT software in which Indian companies developed some cost effective processes. The entry mode was largely green field.

The *third phase* in the evolution of Indian enterprises has been ushered in by the Tata-Tetlay deal in 2000. Hence, it is largely directed at acquiring strategic assets such as brand names and global footprints, established marketing networks, access to customers, or access to clients, or technology, or to secure access to raw materials. The scales and magnitudes involved are large and the entry mode is acquisition.

In the *current phase,* post-2005, overseas investment began to slow down. During the last couple of years these have picked up some small momentum despite the government liberalizing policy.

Potential Sectors

A recent study on the subject identifies the following sectors in which India can make a mark.

(i) *Agricultural products:* In products like tea, basmati rice, alphonso mangoes, Nagpur oranges and even staple cotton and gold the Indian origin can provide extra value and make the products and brands desirable. This could be a good platform given that the world is moving towards organic and natural products. Of course, much needs to be done in farming and packaging to make this a reality.

(ii) *Food and fashion:* India has strong associations in these areas in the developed world. In food, India has a wide range of sweetmeats to add to the already familiar tandoori chicken,

Hyderabadi biryani and spicy samosas. In fashion, Indian fabrics and colours give it a distinct edge. These products, suitably adapted to local tastes and branded, could be made to reach a larger consumer group.

(iii) *Hospitality:* Hotels and restaurants provide India an opportunity to leverage its traditional values of warmth and friendliness to serve a larger world. Most Indians subscribe to the concept of "Atithi Devo Bhava" (Guest is God).

(iv) *Entertainment:* Whether it is movies or soaps, entertainment in India has developed a distinct character and DNA. In an increasingly stressful world where people are seeking to escape all the time, the "nonsensical and masala mix" Bollywood and "melodramatic" television serials provide alternative entertainment to the more serious and thought-provoking Western celluloid. India's rich story-telling culture adds to this.

(v) *Spirituality:* India can formally brand and sell it in the form of yoga, ayurveda, homeopathy, vaastu and so on. India has a rich heritage of holistic arts and sciences that intrigues and interests many in the world.

(vi) *Mass marketing:* It is a big weapon to enter the global markets. In the past 70 years after Independence, India's philosophy of balancing socialism with capitalism has provoked marketers to think of value with volume and urban with rural. Thus, the average Indian business mind has developed the core competence of creating products and mixes to reach the less privileged. The Nano, the sachet and products with cheaper ingredients are examples of this expertise. Brand India can leverage this to move a step ahead of traditional global marketing giants in the less developed world.

(vii) *Education:* There is something powerful in the traditional *gurukul* system of education that can be re-engineered to suit contemporary times to open a new "school" of education.

Clearly, there is much that Brand India can explore beyond IT and business outsourcing for the world to look towards it as a global business powerhouse. However, remember that the opportunities are accompanied by challenges.

Suggestions

For successful operation of JVs it would be essential to consider different aspects of these ventures when promoters from India submit their proposals to the government.

1. Line of activities chosen for this purpose, the country in which such ventures are sought to be established and the foreign collaborators identified along with such important details as their growth ratings, reputation, capacities for investment, etc.
2. Government-to-government understanding about the conditionalities that such ventures should respect in the creation of both implementation and operation of these ventures.
3. Feasibility studies and project reports prepared for this purpose detailing all important aspects of these enterprises.
4. Political and economic climate in the country of operation so that at any stage the ventures do not come under a cloud of uncertainty.
5. Preference should be given to export of Indian capital goods and also the initial requirements of other inputs while emphasis would remain on exploitation of local raw materials and marketing products in the local markets at the first instance and then exporting to India and other countries. Exporting to India becomes relevant in cases where such products are in short supply, on the one hand, and are much costlier in the case of imports

from other countries, on the other.

6. It appears that adhocism and so-called 'on- merit' considerations still rule the roost, spelling undesirable uncertainties which affect the degree of confidence of Indian entrepreneurs seeking to sail in foreign waters.

Taking a cue from China, which backs its enterprises hunting for raw materials, the Indian government is throwing its weight behind its companies. The government has directed its missions across the globe to provide vital inputs to the PSUs eyeing acquisitions overseas. Further in a major policy shift the government has formulated a plan, wherein it will assist Indian corporate sector to acquire companies oversees, especially in South East Asia, eastern Europe and Africa.

In terms of policy, the quest for financial stability has a couple of implications. *First,* central banks need to use macro-prudential norms (things like getting banks to build capital buffers during a business upswing) to ensure that the financial system is in good fettle. *Second,* they need to have a set of tools at their disposal to smooth out the impact of a server jolt to the financial system. Mere rate cuts, for instance, turned out to be far from adequate in restoring some degree of order to the American and European inter-bank markets. The Fed and the European Central Bank had to resort to the untested quantitative easing, which has now become part of central banks' standard toolkit. The use of some of these tools (massive liquidity infusion, for instance) could seem to work against the objective of price stability and confuse the markets. It is the job of a central bank to make sure that its policy actions are interpreted correctly.

2.10. START-UP INDIA

Under the purview of Make in India, the government has introduced the initiative of Start-up India with the ambition to set forth:

"Inspiration and strength to the younger generation of India which is talented and intends to do new things for humanity as well as the nation".

This initiative directs towards creating a platform where the promising entrepreneurs achieve the ability to establish themselves smoothly into the market and receive funding support as well as incentives in the fields which deal with law and simplification of the whole business of start up.

The consolidated policy of FDI has come into effect from August 2017. This is for the first time that start ups have been included amongst the policies of FDI. According to the rules, startups have been given the ability to raise up to complete 100% of funds from Foreign Venture Capital Investor (FVCI). Earlier, they could only issue equity or instruments linked to equity or debt instruments to FVCI against the receipt of foreign payment but now, a start up can issue convertible notes to the foreign investors. By this, the startup company can issue the corroboration receipt of money which was initially taken as debt as now to an asset which is repayable at the recourse of the holder. Or allows conversion into equity shares of the start up company, within the time limit of five years. The year starts on the date of the issue of the convertible note. So basically, the balance of loan taken can automatically be converted to such number of equity shares at that particular moment which is usually after the valuation of a funding ground that takes place later on. This entire task is aimed at providing the investors a friendly environment who are foreign contenders and in turn it is expected to attract more FDI. The FDI will consequently provide more job opportunities and boost our economic development.

The policy has also intended to simplify the denotation of 'venture capital funds' simply as the funds which are registered under the Securities and Exchange Board of India or SEBI (Venture Capital Funds) Regulations 1996. Earlier the foreign contenders had to maintain a 51% stake in the respective company where they invest but now, start ups have been permitted to take forward losses till the extent where the promoters have the capacity to retain their holding in the venture or company.

Intent and Objectives of Policy

The main aim of the consolidated policy is to ensure more ease at doing business in India and to provide with a friendly atmosphere to the foreign investor in order to pull more FDI in the country. However, the policy specifically mentions two objectives:

1. Upgrade and attract foreign direct investment so as to supplement domestic capital, skills and technology to direct acceleration towards the wholesome economic growth of the country. The document also states the difference between this from portfolio investment which is dependent upon–lasting interest (in form of a resident) than merely as an investor in the venture.
2. To issue a regular circular which talks about the consolidated policies of FDI in form of press releases/notes, regulations, clarifications, etc. so as to maintain transparency and predictability. Thus, it becomes easier for the foreign company to comprehend the rules.

Benefits of the Policy

Firstly, due to investment by foreign companies in our start ups, new and better technology is carried along with the capital resources that they provide us. This leads to innovative products with increase deficiency which gives more choices to the consumer in the Indian market. Thus, the consumer can evaluate the opportunity cost of the products and purchase them accordingly. *Secondly,* better production leads to increase in the Gross Domestic Product (GDP) of the nation. GDP is the market value of all final services and commodities within a nation during a particular period of time. It measures the total income of everybody in the economy (Fig. 2.2).

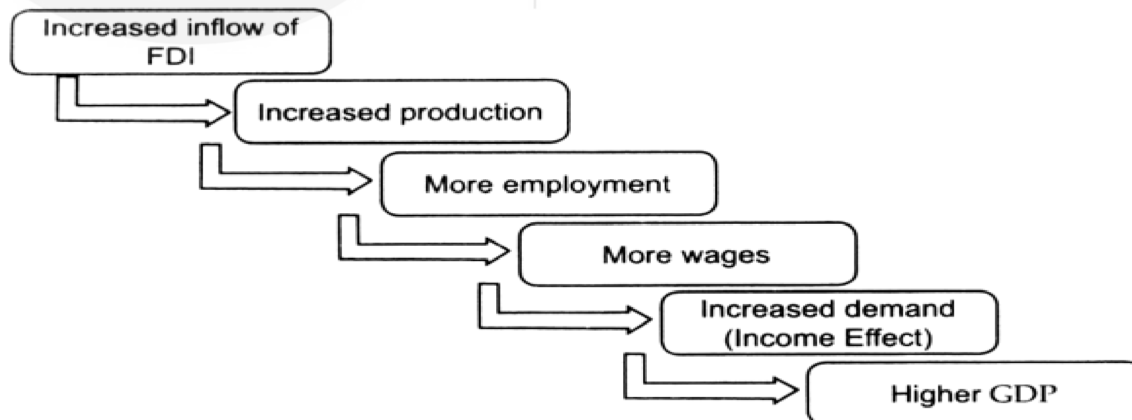

Fig. 2.3: Increase in the Gross Domestic Product (GDP) of the Nation

Thirdly, more inflow of FDI gives the opportunity to the Indian rupee to rise in the market as shown in the Figure 2.4.

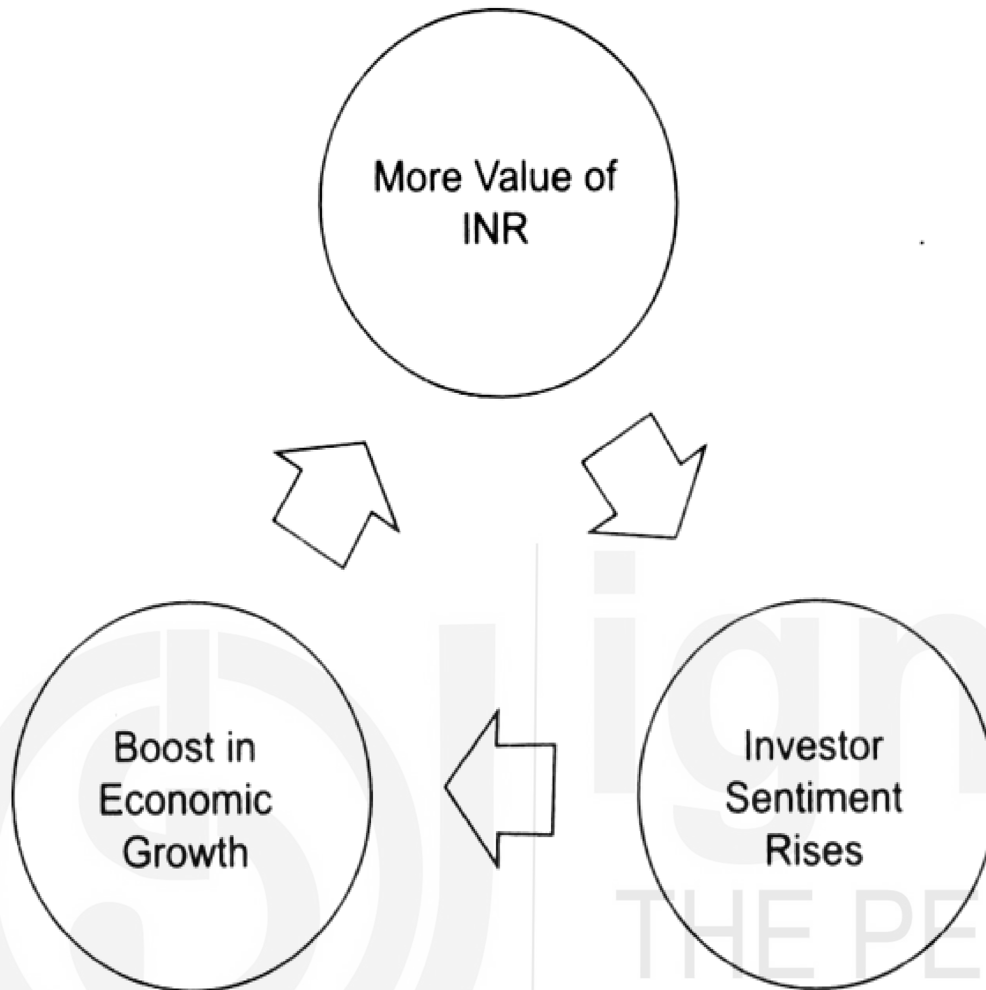

Fig. 2.4: Appreciation of the Indian Rupee

The investors invest in the market with a belief that they will get good returns through their investment on the Indian Rupee. There is a purchase of corporate and government bonds and these bonds are bought against the foreign currency. Consequently, all of this results in an increase in the INR. Thus, FDI indirectly results in the *appreciation of the Indian Rupee.*

How can implementation be made more effective

First and foremost, the government should focus upon providing a better infrastructure. Our one of the biggest issues as to why do the foreign investors hesitate to invest into the start up industries or factories is due to the lack of adequate supply of electricity because the already built business ventures have enough finance to avoid this error of lack of electricity. A start up just cannot work without electric supply and power cuts are one of the major cruxes of problem as to why there is less investment, especially in the rural areas. *Secondly,* a decrease in the rate of *corruption* would lead to better investment as well as start up opportunities. It is easier for a start up to sustain with FDI in a nation such as Singapore or Hong Kong because of the less corruption rate as compared to India. *Thirdly,* although corporate tax rates avoid unnecessary liberty to the foreign investors but high corporate tax rate can be a major disincentive to the foreign corporate investment. This is why it is difficult to invest in a start up which is based in UAE and easier for a start up based in Europe. *Lastly,* there has to be uniformity in the policies.

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Investors necessarily take less interest to invest in such a place where there is political instability because one government may favor one policy and once the government changes, the new one may bring a policy completely opposite of the one existing. Hence, if there is more evenness then it becomes less risky for the investor to invest.

Check your Progress 3

1. Distinguish between foreign direct investment and foreign portfolio investment.

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2. What was the RBI Route for FDI inflows?

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3. What are floating exchange rates ?

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2.11. LET US SUM UP

International capital relations have been promoted globally to derive advantages of international division of labour. Different countries possess different resource endowments and hence differing efficiencies in different activities. International division of labour accumulates these comparative advantages so as to produce goods and services at a lower cost. Lower cost of production makes it possible to offer these goods at lower prices all over the globe, there by widening the market. Thus, both producers and consumers gain. International supply chains are set up. This involves the flows of capital across nations. Multinational corporations and foreign institutional investors undertake this task , and promote welfare globally.

2. 12. Terminal Questions

1. There is a view which emphasises that the efficiency of foreign aid flow may be jeopardised if the aid is tied, whether to projects or to maintenance imports". Do you agree? Justify your answer.
2. "Is it true that the Indian economy is such that domestic savings alone may not be sufficient for planned investment, and an import of foreign capital is needed for that purpose"? Elaborate your arguments.
3. "An open foreign trade policy and an open external sector have created more problems for domestic economy than it has solved". Do you agree? Justify your answer.
4. "The new foreign investment policy can be described as a minor revolution as far as decisions concerning foreign capital are concerned". Elaborate. What has been the impact of the new policy? Discuss with example.

5. Examine the need for foreign capital in the Indian economy and discuss critically the Government policy on foreign direct investment.
6. "Foreign direct investment is not an unmixed blessing". Comment.
7. Review the reforms in the trade, exchange rate and foreign investment policies after the 1991 crisis. What has been the impact of these reforms on trade and foreign investment flows?
8. Discuss the trend and pattern of FDI inflow to India since 1991. Do you agree with the view that if India were to shed its inhibitions about FDI and follow in the footsteps of China, we would be in a position to realise our full potential. Explain.

2.13. KEY WORDS

ECBs: Loans contracted from private sources in international capital market.

External assistance: Loans contracted from govts of other countries or from international institutions.

Foreign direct investment: Investments by foreigners in production sector of the host country.

Foreign portfolio investment: Amount of foreign exchange spent by foreigners on purchase of equity in host country.

MNCs: Those corporates who operate in more than one country and cultivate economic interests.

Single-brand retail: 100% FDI now through automatic route. Norms for 30% sourcing from India eased.

Real estate: Broking services can get 100% FDI without seeking government nod.

Security clearance: FDI from "countries of concern" under automatic route to be processed by industry department, not by home ministry.

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