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History of FDI in India.

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Introduction

At the time of independence, the attitude towards foreign capital was one of fear and suspicion. This was natural on account of the previous exploitative role played by it in 'draining away' resources from this country. The suspicion and hostility found expression in the Industrial Policy of 1948 which, though recognizing the role of private foreign investment in the country emphasized that its regulation was necessary in the national interest. Because of this attitude expressed in the 1948 resolution, foreign capitalists got dissatisfied and as a result, the flow of imports of ca[ital goods got obstructed. As a result, the prime minister had to give following assurances to the foreign capitalists in 1949:

- No discrimination between foreign and Indian capital. The government o India will not differentiate between the foreign and Indian capital. The implication was that the government would not place any restrictions or impose any conditions on foreign enterprise which were not applicable to similar Indian enterprises.
- Full opportunities to earn profits. The foreign interests operating in India would be permitted to earn profits without subjecting them to undue controls. Only such restrictions would be imposed which also apply to the Indian enterprises.
- Guarantee of compensation. If and when foreign enterprises are compulsorily acquired, compensation will be paid on a fair and equitable basis as already announced in government's statement of policy.

Though the Prime Minister stated that the major interest in ownership and effective control of an undertaking should be in Indian hands, he gave assurance that there would be "no hard and fast rule in this matter."

By a declaration issued on June 2, 1950, the government assured the foreign capitalists that they can remit the he foreign investments made by them in the country after January 1, 1950. in addition, they were also allowed to remit whatever investment of profit and taken place. Despite the above assurances, foreign capital in the requisite quantity did now flow into India during the period of the First plan. The atmosphere of suspicion had not changed substantially. However, the policy statement of the Prime Minister issued in 1949 and continued practically unchanged in the 1956 Industrial Policy Resolution, had opened up immense fields to foreign participation. In addition, the trends towards liberalization grew slowly and gradually more strong and the role of foreign investment grew more and more important.

The government relaxed its policy concerning majority ownership in several cases and granted several tax concessions for foreign personnel. Substantial liberalization was announced in the New Industrial Policy declared by the government on 24th July 1991 and doors of several industries have been opened up for foreign investment. Prior to this policy, foreign capital was generally permitted only in the those industries where Indian capital was scarce and was not normally permitted in those industries which had received government protection or which are of basic and/or strategic importance to the country. The declared policy of the government was to discourage foreign capital in certain inessential 'consumer goods and service industries.

However, this provision was frequently violated as a number of foreign collaborations even in respect of cosmetics, toothpaste, lipstick etc. were allowed by the government. It was also stated that foreign capital should help in promoting experts or substituting imports. The government also laid down that in al those industries where foreign capital investment is allowed, the major interest in ownership and effective control should always be in Indian hands (this condition was also often relaxed).

Research purpose and motivation:-

The purpose is to learn what strategies leaders in emerging market growth have Adopted to attract FDI and evolve and what is lacking on part of the laggards. What Laggards have done and what they have not done. The purpose is to develop a model for Both categories and test the model empirically to substantiate the hypotheses. What are The lessons that laggards can learn from these leaders? The study intends to show a path to the PIN countries and other markets that will emerge in next two decades. A search for the terms ‘China and India’ and ‘Foreign Direct Investment’ on Proquest Online search for dissertations and peer reviewed academic journals returned only six Entries. Of these only three are relevant. Of the three relevant dissertations, first discusses The FDI from Chinese perspective and makes a passing reference to India, the second Discusses the role of overseas Chinese investment, and the third discusses the ASEAN Economies. There are not many studies from the Indian perspective. Anantaram (2004) Research is one study, another study by Wei (2004) focuses on China. Kumar (1989) Study leaves out the Indian reform period. Venkatachalam (2000) study does not compare India and China the way it has been done in this study. This study intends and attempts to Fill these gaps in the literature. Not enough studies exist on India from an Indian perspective. Apart from helping India Lean from leader in FDI attraction this study builds and tests a probable model of growth For emerging markets. PIN (Pakistan, Indonesia, Nigeria) countries can learn from this Experience and tailor make their economic plans to grow at a faster rate.

FDI impacts development in emerging markets:-

There are many studies on benefits of FDI to the emerging markets. There is lack of sufficient internal capital in emerging markets as the governments are devoid of Resources, the private sector does not have enough capital, and the country lacks the Know-how to invest in relatively large projects. The savings in these markets are not enough to create intrinsic economic growth. Therefore, emerging markets need foreign capital for growth. FDI is one of the major sources of foreign capital for these countries [Said (1988); Srinivasan (2002); Jenson (2003)]. Even Government of India (GOI Economic Survey, 2001-02) recognizes the importance of FDI in economic growth.

Literature review*:*

- Why firms engage in FDI? Hymer (1959) was the first one to explore this Phenomenon in his doctoral dissertation and stated ‘FDI as a means of transferring Tangible and intangible assets to organize international production.’ Market failure theory (Vernables, 2004) states that firms organize international production to avoid market Failure that might arise from licensing to a third party.
- (Knickerbocker, 1973) states that firms invade each other’s home market to fight and create an oligopolistic market. Vernon’s Product Life-cycle theory states that as product And markets mature, firms move production overseas to appropriate balance rent from the Declining phase in the product life cycle. Resource Based View (Werner felt, 1984)

Stresses on the fact that firms have specific resources that are unique and provide Advantage to them and firms go to foreign markets to benefit from these advantageous Resource positions. Dunning's Eclectic Paradigm theory (1996) of 'OLI'- Ownership, Location, and Internalization states three TNC motives or a combination of these motives to conduct foreign investment. Firms have ownership of specific advantages which they Want to exploit in other markets, locations have specific advantage that TNC want to Exploit, internalization is preferred by TNC over third party licensing to avoid 'spillover'. Caves' Vertical vs. Horizontal FDI theory states that firms either undertake FDI to Seek efficiency in their global supply value chain or make FDI to enter horizontally to Explore new markets.

Testimony from leaders in the race: China- The more evolved emerging market:
China's achievements and comparison with India demonstrate the success of the congenial business climate adopted by China. In 1978 China ($163.6 b) was behind India ($168.0) in GDP. Chinese government initiated reforms in 1978 and carried them forward in 1992. Deng Xiao Pang, the father of Chinese reforms created an industrial revolution in a communist China. China followed an 'export-import' oriented growth pattern as Opposed to an Indian 'import-substitution' pattern. Chinese government made structural Changes in the economy, provided strategic infrastructure in form of SEZ's, and took Strategic policy initiatives to provide freedom, openness in trade, attracted diaspora from Hong Kong to invest in Shenzhen and other neighboring areas, and made flexible labor Laws to attract efficient labor in the manufacturing sector. All these factors attracted TNC's to set up manufacturing units in the SEZ's and export the produce to different parts of the globe. Modern China has an FDI stock of $600 billion which contributes Almost one-third of current Chinese GDP.

Structural changes made in the economy can be demonstrated though the Development of Shanghai and its modern infrastructure. Shanghai was a backward small Place some fifteen years back. The government initiated the change process that brought about significant improvements. Modern Shanghai attracts 180 million people, has a GDP of $110 billion, has a life expectancy of 80 years, and has attained a growth rate of 10% for last ten years. Tallest Asian building Oriental Pearl Tower measuring 468 meters is located in Shanghai. Jingmao Mansion is the fourth largest building in the world.

Shanghai World Financial Centre to be completed in 2009 might be the tallest building in The world. Shanghai has one of the most extensive bus system having 1000 lines. Shanghai Metro, subway, and elevated light rail have five lines which will increase to Eight by 2010. Hongqiao and Pudong International airport attract the highest traffic in the World. Trans rapid train system is growing fast and Shanghai Maglev train system covers 30 kilometer trip in 7.21 minutes reaching a speed of 431 km/hour, highest in the world. Donghai Bridge is the longest cross-sea bridge in the world measuring 32.5 miles Connecting Shanghai to the Yangshan islands.

Comparing Shanghai with India it seems strange that the achievements of the city are Bigger than the country India. Shanghai received $60 b in FDI as opposed to $58 b for India. India's foreign trade was 30% less than Shanghai's $241 b in 2005, Shanghai World's largest port handled 443 million tones cargo against 423 million tones handled by 12 ports of India. Coastal areas of Pearl River Delta, Yangzi River Delta, and Beijing Gulf were developed to create a platform for growth by TNC's as foreign firms do not want to invest in capital intensive projects long gestation period and makes investor a Hostage of fortune (Guha and Ray, 2000), three out of five busiest ports in the world are in Shanghai. Shanghai Yangshen deep water port is the busiest port of the world and Handles 443 million tones of cargo. As a result of these structural changes made 430/500 TNC’s (220 only out of 500 for India), and 40,000 foreign invested companies have Opened office in Shanghai.

Strategic infrastructure of China can be demonstrated with the Shenzhen SEZ creation and development. The 1979 reforms created four SEZ’s. The first SEZ was in Shenzhen. Shenzhen used to be small village and a fishing area (70,000 residents, 325 sq Miles area) but due to the reforms initiated over the last twenty five years it is one the Most modern places in the world. Modern Shenzhen has 7 million population, area of 2020 kilometers, produces $40 billion in GDP, has 120,000 foreign TNC’s in active Operation, and is the sixth largest port in the world. Shenzhen is the only city in China that has a land port, sea port, airports, and stock exchange of its own. As a result of SEZ’s China’s global trade exceeded $1 trillion in 2004. Exports from SEZ’s account for 35% of GDP. Merchandise exports have grown by 15% during 1989-2005. Strategic policy initiatives taken by Chinese government were providing economic freedom and creating openness during the period 1978-2005. Government intervention reduced over time and in 2005 85% of the manufacturing was outside non-state sector. Government allowed joint ventures between diaspora and local residents, gave incentives, tax holidays, promoted exports, and wages were kept low due to allowing free Competition. Lease and ownership rights were provided to foreigners. Tax exemption on Importing machinery, free movement of goods between SEZ designated areas, rebates on Export duty, liberal entry and exit policies were adopted. Foreign currency transactions Were allowed in SEZ designated areas. Stock market was created and trading was allowed in foreign shares (B type). Decentralization was conducted and provincial governments Were given powers to negotiate contracts. Visa norms and zoning laws were simplified for foreigners. Foreign firms could form Wholly Foreign Owned Enterprise (WFOE) in China from 1986 onwards. Bilateral tax treaty has also helped in attracting investment.

Cheng and Kwan, (2000) found that there is a positive relation between SEZ and regional income in attracting FDI to China. River boat transportation and ‘industrial clusters’ Helped in reducing infrastructural bottlenecks and reducing costs. Share of foreign affiliates increased from 9% in 1989 to more than 50% in 2005. Therefore, freedom and openness adopted by China had an impact on FDI inflows into the country.

Chinese diaspora which is 50 million people living in Honk Kong, Taiwan, Macau, Singapore (Wei, 2004) was attracted by the government by formulating preferential favorable policies in the SEZ’s. Policies such as giving three years tax holidays and reduced rates after that period attracted Diaspora. Hong Kong and Taiwan based manufacturers shifted to Shenzhen due to tax benefits given, proximity and cultural Affinity with China. Diaspora tycoons like Gordon Wu and others contributed Significantly to the Chinese growth. ‘Guanxi networks’ helped in building a loose connection between the Diaspora community and the local manufactures (Cheung, 2004). It is estimated that 70% of initial investment came from Diaspora Chinese (Zhang, 2001).

Chinese Diaspora essentially is considered more entrepreneurial and wealthy than Indian Diaspora (Ramamurti, 2004). Had these Diaspora Chinese not invested in China, it would Have been a totally different story in China today (Ramamurti, 2004). Flexible labor Laws were created in 1979 and ‘iron-rice bowl’ system of guaranteed Employment was discontinued. Labor housing was freed and free movement of labor in Economic zones were permitted. Initially 20 million people were unemployed but with the Growth in industrial activity unemployment rate dropped. High performing workers were Rewarded suitably and a merit-based system was introduced.

How laggards can benefit from leaders?

Based on the Indian FDI model and findings from Chinese FDI model policy Recommendations are made for creating a Congenial Business Climate in emerging market India. India has to leverage the ‘endurance seeking’ FDI behavior of the TNC’s to attract ‘linear FDI’.

India has to make structural changes in the economy. It has to duplicate success stories in the structural changes it has adopted till now. Metro Rail (DMRC) in Delhi & Expressway Network (Golden Quadrilateral) has to be created at all metro towns and roads linking these towns. Metro is a necessity in the entire NCR in Delhi Metropolitan area. Mumbai, Calcutta, Chennai, Bangalore, Hyderabad, and Poona should have Metro Network. Expressways have to connect all parts of the country. In the telecommunications Field, mobile telephony has been highly successful in India and its penetration should Continue to benefit farmers and rural poor people. Indian railway is a highly inefficient Organization that needs to be privatized like Chinese railway was done. Trailing Indian States of Bihar, Madhya Pradesh, Orissa, Uttaranchal, Uttar Pradesh, Chhattisgarh, and Jharkhand -BIMAOR UT UP CHA JA (sick, get up and conquer)- ‘the seven up’ have to Experience this conducive business climate growth.

Power and electricity reform is another area where India needs to take immediate Steps. Power sector has given -26% returns on government equity employed in SEBs (Economic Survey, 2006). Removing subsidy on power, privatization of power Distribution companies and SEBs is long overdue. Precedent is already there from the Privatization of Delhi power board (DVB) as another success story that has to be emulated in all other state capitals. Free rural power scheme (RGGVY) should be shelved As it might have several implementation problems, instead private companies should be Allowed tax holidays on providing power to rural poor.

India needs $300 b in infrastructure development. Infrastructure development Should be undertaken by using foreign exchange reserves & PSU offloading. India has Reserves of more than $150 billion in foreign exchange. These reserves should be utilized In developing the infrastructure. Offloading public sector equity will provide funds for Developing infrastructure. Government has to focus in social areas of providing health And education instead of conducting direct business.

India has to overcome the current service sector myopia. Service sector growth Should be supported with manufacturing growth as Indian population of 1.1 billion People cannot be employed in service sector alone and majority of the population from Bihar cannot be converted in computer literate call center executives. Much hyped Indian IT sector constitutes less than 2% of Indian GDP. Sam Pitroda recently commented that IT and BPO create only 3, 00,000 jobs against 10 million required. 79.9% of Indian Population earns less than $2 a day (Mehta and Shah, 2002) and services sector alone will Solve their problems. India needs manufacturing boom to move idling labor force of (67% employed in agriculture producing 22% of GDP) from agriculture.

India has to diversify from developing service sector based ‘core competence’ (Hamel and Prahalad, 1990) being currently followed to developing ‘dynamic Capabilities’ (Eisenhardt,

2000) to augment current services growth with manufacturing Growth. Manufacturing is the answer to employ India's growing population that will Exceed 1.5 billion by 2050 (IMF, 2005) and make India the most populous country in the World. China is catching up fast with service sector growth (40.26% in 2005) and its Manufacturing model of Shenzhen is maturing into service model of Shanghai. Similarly, India has to move to manufacturing to compete with China. Even in R&D, that is thought Of as an Indian stronghold, China filed for 943 US patents as opposed to 495 filed by Indian investors in 2004-05 (Economic Times, April, 30, 2006).

Paradigm shift in Indian manufacturing is required. India has to move towards Skill-neutral mass manufacturing. As Chinese working age population ages by 2015 and Burden on the economy increases, India has an opportunity due to its 'demographic Dividend', having the highest young working population in the world. Despite Manufacturing growth of 9% in last three years, the number of jobs in manufacturing Remains the same as 1991, at 48 million, which is one third of China's manufacturing Labor force (The Economic Times, July, 7th, 2006). Current manufacturing pattern has Created a 'job-less growth'. Backward 'seven-up' states do not have majority of educated People so a skill neutral 'mass-manufacturing' will help employ large number of Unemployed youth. Coastal areas in Bihar such as Gopalpur might be an ideal place for Setting up large manufacturing units that can be 'export-oriented' to feed large US west Coast market.

Conclusion:

Economic reforms in India have deregulated the economy and stimulated domestic and foreign investment, taking India firmly into the forefront of investment destinations. The Government, keen to promote FDI in the country, has radically simplified and rationalized policies, procedures and regulatory aspects. Foreign direct investment is welcome in almost all sectors; expect those strategic concerns (defence and atomic energy).

Since the initiation of the economic liberalisation process in 1991, sectors such as automobiles, chemicals, food processing, oil and natural gas, petro-chemicals, power, services, and telecommunications have attracted considerable investments. Today, in the changed investment climate, India offers exciting business opportunities in virtually every sector of the economy. Telecom, electrical equipment (including computer software) energy and transportation sector have attracted the highest FDI.

Despite its market size and potential, India has yet to convert considerable favourable investor sentiment into substantial net flows of FDI. Overall, India remains high on corporate investor radar screens, and is widely perceived to offer ample opportunities for investment. The market size and potential give India a definite advantage over most other comparable investment destinations.

India's investment profile, however, is also conditioned by factors that affect the flow of FDI, which are bureaucratic delays, wide spread corruption, poor infrastructure facilities pro-labour laws, political risk and weak intellectual property regime. A perceived slowdown in the process of reforms generates doubts about the market's long-term potential. To capitalize on its potential for FDI, would seem that India needs to accelerate efforts to institutionalize government efficiency and advance the implementation of promised reforms. Other strategic efforts should include focusing the market on India's relatively higher rates of return on existing investments and long-term potential, addressing the issue of transforming the country into a viable export platform and encouraging strategic alliances with foreign investors. In short, this means accelerating India's integration with the global economy.

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