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FOREIGN DIRECT INVESTMENT TRENDS AND ISSUES IN INDIA DURING THE LAST DECADE

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ABSTRACT

Compared to most industrializing economies, India followed a reasonably restrictive foreign non-public investment policy till 1991 - relying a lot of on bilateral and multilateral loans with long maturities. Inward foreign direct investment (FDI, or foreign investment, or foreign capital hereafter) was perceived basically as a way of getting industrial technology that was unavailable through licensing agreements and capital goods import. Technology imports were preferred to financial and technical collaborations. Even for technology licensing agreements, there have been restrictions on the rates of royalty payment and technical fees. Development banks mostly met the external financial desires for importing capital equipment. However, foreign investment was permissible in selected industries, subject to variable conditions on setting up joint ventures with domestic partners, native content clauses, export obligations, promotion of local R and D and so on - generally just like those followed in several rapidly industrializing Asian economies.

Keywords: Foreign capital, Profitability, service quality, Foreign Exchange and Regulation Act.

I. INTRODUCTION

Foreign Exchange and Regulation Act (FERA), 1974 stipulated foreign companies to possess equity holding only up to forty per cent, exemptions were at the government's discretion. fixing of branch plants was typically disallowed; foreign subsidiaries were induced to step by step dilute their equity holding to less than forty per cent within the domestic capital market. The law additionally prohibited the utilization of foreign brands, however promoted hybrid domestic brands (Hero-Honda, for instance). However, pragmatism prevailed to confirm stable domestic offer at affordable costs.

Such a restrictive policy is believed to possess delayed domestic technical capability (as reflected within the poor quality of Indian goods); it additionally meant a loss of export chance of labour-intensive manufactures - in distinction to several successful east Asian economies. Moreover, such a policy is claimed to possess inspired 'rent seeking' by domestic partners on foreign technology - with very little efforts to enhance product quality, undertake innovation, and look for export markets [Ahluwalia 1985]. This widespread perception was maybe best illustrated by the passenger car industry that created obsolete (and fuel-inefficient) models of the 1950s at terribly high prices in tiny numbers.

while not denying a number of these arguments and proof, others have shown that the regulation reduced prices of technology imports [Subramaniam 1991], and promoted export of products with comparatively stable technologies wherever domestic companies had the chance of 'learning by doing' by occupation to the big domestic market - as illustrated by successful companies like telephone company (commercial vehicles) and BHEL (heavy electrical equipment) [Lall 1982]. The recent international achievements of some Indian pharmaceutical companies (Cipla, Ranbaxy, Dr Reddy's Laboratories, for instance) is additionally attributed to the restrictive and promotional policies, and therefore the patent laws [Chaudhari 1999] that sought-after to encourage domestic production to reduce drug costs.

FDI Inflows in India in Post Reform Era:

All this changed since 1991. Foreign investment is now seen as a source of scarce capital, technology and social control skills that were needed in an open, competitive, world economy. India wanted to consciously 'benchmark' its policies against those of the quickly growing south-east Asian economies to draw in a larger share of the world FDI inflows. Over the last decade, india not only permissible foreign investment in almost all sectors of the economy (barring agriculture, and, till recently, real estate), however also allowed foreign portfolio investment - therefore practically divorcing foreign investment from the erstwhile technology acquisition effort. Further, laws were modified to produce foreign companies an equivalent standing because the domestic ones.

What are the trends within the quantum and composition of the FDI inflow; and what are their advantages and prices to the economy? This paper seeks to produce a preliminary declare these questions. To do so, we tend to 1st discuss, very in brief, the recent literature on foreign investment and economic development (Section I). the constraints of the available information to check the propositions following from the analytical literature are mentioned in Section II. As a first step in our assessment, Section III describes the trends in FDI within the 1990s. Section IV contains a quick comparison of foreign investment in India and China - a difficulty that has a concerning this policy discussion. based on the available, restricted and preliminary, information, Section V makes an initial assessment of foreign investment by raising some problems for any work. Section VI suggests a additional realistic policy on the premise of the analytical discussion and comparative experience. Section VII concludes by summarizing the study's main findings.

I.A Brief Analytical Review

Much of the presently held perceptions of foreign investment's role basically take a macroeconomic view: it's a supply of extra external finance (and of risk capital), augmenting fixed investment, potential output and employment.2 Such a positive view gained currency in the main once the crises in Latin America within the early 1980s, more recently in east Asia, once different kinds of capital inflows quickly dried up (or reversed), accentuating the macroeconomic vulnerability of those economies. As against portfolio investment, FDI is also seen as a supply of technology and managerial skills, making tangible (and intangible) assets within the host economy. Foreign companies request not only the domestic market, however also give access to external markets by sourcing factory-made product (and services) from domestic companies. The crux of the policy, therefore, is however the advantages of such investments are distributed between the foreign companies and also the host country, as also between the various factors of production among the host country. In different words, the important question is that the price of foreign capital to the host economy: is it too high, compared to the choice sources of external finance and technology, within the short and therefore the long run?

However, during a economics perspective, a special set of questions is typically asked: What will FDI do to the operating of the domestic markets, and their result on output and productivity growth [Caves 1996]. If, as is commonly the case, the entry of a foreign firm results in the creation of a domestic monopoly, then the advantages of such investment is also restricted, unless accompanied by a sound anti-trust law (or competition policy). Similarly, if FDI flow leads to the displacement of domestic monopolies with the foreign ones, then again, social advantages of such investments is also marginal (if any), as any monopolist, regardless of its origin, would maximize profits either by varying value or output (or both). Moreover, the host government could have considerable problem in implementing domestic laws adequately, as foreign companies usually look for protection below difficult legal structures.3

In industrial organization literature, from a range of analytical views, foreign companies are seen as having firm-specific benefits - together with important market power that they obtain to use in several countries.4 availability and prices of those resources for the host economy depend upon the relative bargaining strength of the foreign companies vis-a-vis the domestic companies (and the host government). whereas the foreign firms' benefits exist their size, control over technology and selling strength worldwide, the host country will use its domestic market, access to low cost labour, location and quality of infrastructure (all of that move to reduce the value of production to service the inter-national market) to discount with the foreign companies.

Thus, a social value profit approach is perhaps a significant technique to assess the potential effects of FDI. If such a read is valid, then what countries should do is maybe not to maximise foreign investment flow per se, however to channel it within the desired directions to maximise long-term returns to the economy. From the development economics perspective, the questions one asks may get even deeper. in a world with unequal resources and technological capabilities (including brand names), however does FDI have an effect on the ownership and control of industrial firms? within the market for industrial technologies that's invariably oligopolistic, will foreign capital flow augment or reduce access to techno-logy and domestic R and D efforts? will foreign capital improve exports (and export capability) from the host country? what's the value of FDI over an extended period; is it essentially less than that of external debt [Helleiner 1989]?5

II. DATA ON FDI AND THEIR LIMITATIONS

To understand however the recent changes in foreign investment policy have influenced the economy, quantitative information is required on broad dimensions of the investment (and its distribution) across industries, regions and by size of projects; firm and industry level production accounts, and audited financial statements. However, such information is scarce. the most simply available (and wide used) information in india are on FDI approvals (contracted), by broad industry group (1-digit ISIC), by country of origin, and by states (regions) of destination. This represents mere intentions of investment. the particular (or realised) foreign investment isn't available by a similar classification, however ac-cording to the administrative and institutional channels of the inflow. Therefore, it's impossible to compare the realised with the intentions, in any significant manner. Apparently, even the involved official agency doesn't appear to know - let alone monitor - however the particular inflows are translated into capital formation, transfer of assets or amendment in social {control} control.

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The actual FDI flow is recorded below 5 broad heads: (i) reserve bank of India's (RBI) automatic approval route for equity holding up to 51 per cent, (ii) Foreign Investment Board's discretionary approval route for larger projects with equity holding larger than 51 per cent, (iii) acquisition of shares route (since 1996), (iv) RBI's non-resident Indian (NRI) schemes, and (v) external commercial borrowings (ADR/GDR route). Reportedly, the Indian definition of FDI differs from that of the imf, as well as of the UN's World Investment Report. IMF's definition includes external commercial borrowings, reinvested earnings and subordinated debt, whereas the world Investment Report excludes external commercial borrowings.7

Ideally, FDI flow should get reflected in (i) capital formation (ii) formation of latest companies and factories, (iii) increase in foreign equity holding within the existing companies, and (iv) mergers and acquisitions of existing companies and factories (or parts of them). However, the availability of information on them depends on their status. we all know little concerning those registered outside the country, and in tax shelters, like Mauritius. for example, Enron's Dabhol power company - the biggest foreign investment project yet - is incorporated in india as a limiteless liability company. however it's a shell company that Enron controls through a minimum of six holding companies registered in various off-shore locations [Mehta 1999].8

III. THE TRENDS FDI APPROVALS AND ITS COMPOSITION

Approved FDI rose from about Rs 500 crore in 1992 to about Rs 55 thousand crore in 1997 [Economic Survey, 2001-02] (Figure 1). cumulative approved foreign investment throughout 1991and 2000, in dollar terms, is regarding $ 67bn - - at an average rate of exchange of Rs 40 to a dollar. A fifth of it's from the US (Table 1). Mauritius is the second largest source; reportedly a passage for several US based companies, as India contains a tax avoidance treaty with it since 1982. In Asia, South Korea has emerged as a new supply of foreign investment.10 1 / 4 of the approved FDI is for power generation (Table 2), followed by telecommunications (mobile phone firms) at 18.5 per cent, and electrical equipment (mainly software) at 10 per cent. whereas the proportion of projects with investment up to Rs 5 crore is high, their share is a smaller amount than 5 per cent in value. At the other end of the distribution, larger projects with Rs 100 crore and on top of account for over two-thirds of the overall worth of approvals (Table 3). Evidently, little or no of the FDI has gone to enhance exports that are largely from labour-intensive unregistered producing. The economically advanced states of maharashtra, Delhi, Kamataka, tamil nadu and Gujarat have attracted half of the approved foreign investment (Table 4).

Table 5 provides the actual FDI flow as estimated by four different agencies, for 1991 to 2000. IMF's and also the World Investment Report's estimates of the additive flow throughout the 1990s are roughly an equivalent - at concerning $17bn. The Economic Survey estimate is concerning $ 22bn, whereas that by rbi is $17.3bn. The difference between the last 2 estimates is especially on account of ADR/GDR inflows. whereas the Economic Survey classifies them as FDI, rbi records them below foreign portfolio investment.

Table 1: Top 10 Investing Countries in India, 1991-2000

Country/Region	Share (in Per Cent)
US	20.4
Mauritius	11.9
UK	6.4
Japan	4.0
South Korea	3.9
Germany	3.4
Australia	2.7
Malaysia	2.3
France	2.1
Netherlands	1.9

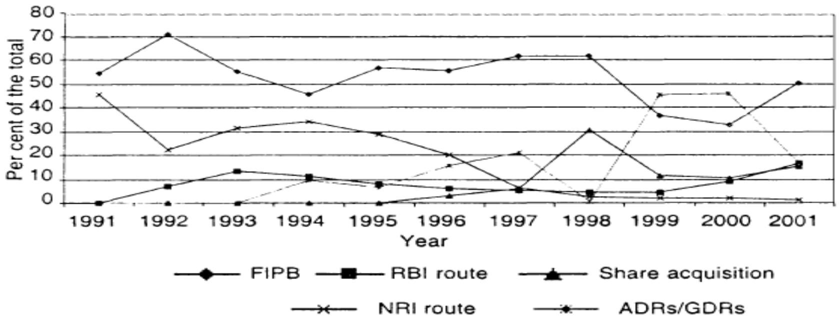

Figure 3: Actual FDI by Different Routes there is an increase in the ratio of the actual-to-approved FDI in the last few years. On average, it is a little over one-third in the 1990s (Figure 1). India's share in world foreign investment increased from 0.5 per cent in 1992, to 2.2 per cent in 1997 (Figure 2).

Figure 3 describes the actual flow by various routes mentioned within the previous section. The FIPB route - representing larger projects requiring the government's discretionary approval - accounts for the bulk of the flow, though its share is somewhat declining. Automatic approval route via run meant for smaller sized investments received modest inflow; and therefore the NRI route's share has declined sharply. Proportion of the flow to acquire shares within the domestic companies, and flotation of ADRs/GDRs have gained in prominence within the last half of the 1990s.

Interpreting the Trends

Though it's impossible to compare the particular with the approved FDI for the reasons mentioned earlier, some broad generalisation will maybe be created based on the available qualitative information. whereas the majority of the approvals is for infra-structure, the particular flow seems to be mostly in registered producing - a lot of precisely, in consumer and automotive industries; little or no of it's gone into capital goods industries. The flow in telecommunication industry is maybe to get licences for mobile phone operations, not for producing equipment. The investments in electrical machinery industry are apparently to line up native offices to supply computer software.

Much of the realized FDI has also are available as totally owned subsidiaries (or branch plants) of their parents abroad. Table 6 provides an illustrative list of such foreign entities. Most of them haven't issued IPOs within the domestic bourses, thus are not quoted firms. Quite contrary to the earlier period, the govt. has so far not insisted on implementing its policy during this respect (more regarding this later).

About 40 per cent of the flow appears to have been used for acquiring existing industrial assets, and their management} control (Table 7 (i)); and, there seems to be a gradual increase in such merger and acquisitions within the 1990s (Table 7 (ii)). Further, Table 8 provides an illustrative list of plants(and divisions)o f Indian controlled companies acquired by foreign companies within the 1990s. this can be additionally evident from the actual fact that foreign companies appear to use a bigger proportion of their total funds for such acquisition than for capital formation, compared to Indian owned companies within the non-public corporate sector, the ratio of mounted capital formation to total uses of funds by foreign companies is below that by the domestic firms [Nagaraj 1997].

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Table 3: Distribution of FDI by Size of Investment, 1991-97

Investment (Rs Crore)	No of FDI Approvals		Quantum of FDI Approved	
	Number	Share (in Per Cent)	Amount	Share (in Per Cent)
0-1	3040	49.2	919.4	0.9
1-5	1686	27.3	3800.8	3.6
5-25	906	14.7	10046.0	9.5
25-50	212	3.4	7503.5	7.1
50-100	128	2.1	8828.4	8.4
100-500	173	2.8	38699.0	36.6
Over 500	38	0.6	35992.4	34.0

Table 4: Top Five Destinations of Approved FDI among the Indian States

State	No of Financial Collaborations Approved	Approved FDI ($ Million)	Share (in Per Cent)
Maharashtra	2015	11135.9	16.9
Delhi	1226	9226.7	13.1
Karnataka	1078	5247.1	8.1
Tamil Nadu	1223	5073.8	7.7
Gujarat	458	3129.6	4.5
State not indicated	3119	19476.4	27.9

Source: Handbooko f Industrial Policy and Statistics,2 001.

IV. A COMPARISON OF FDI IN INDIA AND CHINA

Though the actual FDI flow in india within the 1990s increased significantly over the past, it's modest compared to several Asian economies (Figure 4); and, it pales into insignificance compared to China (Figure 5).12,s3 UNCTAD's ranking of countries in terms of foreign investment (relative to the size of the economy) for the period 1998-2000 is 119 for india, and 47 for China. The ranking a decade ago was 121 and 61 respectively (The new york Times, August 28, 2002). It shows that even at the beginning of the reforms, China's ranking was way before india's; China affected up within the ranking much faster than India did within the 1990s.

These statistics are widely seen as an proof of the failure of India's reforms, since greater flow of foreign capital in China is believed to be mostly responsible for its exceptional growth and export performance. As this perception is way discussed within the current policy discourse, we examine the quality of the Indian and therefore the Chinese estimates, and also the proof on the role of FDI on economic performance in the recent years.

according to ifc (2002), india doesn't follow the standard imf definition because it excludes (i) external industrial borrowings, that's ADRs/GDRs, (ii) reinvested profits and (iii) subordinated debt.14 ifc is maybe right, however only partially. As noted earlier, the Economic Survey estimates include external industrial borrowings, however not the remaining 2 things. Thus, notwithstanding the estimation of FDI within the Indian statistics, there's very little doubt that foreign investment flow in india is negligible as compared to China.

However, it's well recognised that a large share of the investment flow in China represents 'round tripping' - recycling of the domestic saving via hong kong to require advantage of tax, tariffs and different benefits offered to non-resident Chinese. this is estimated to be within the range of 40-50 per cent of the total FDI (IFC, global financial Report, 2002).

Further, about a quarter of the inflow in China is invested in real estate [Tseng and Zebregs 2002]. Some of the Chinese coastal cities have attracted considerable speculative capital in this sector in the 1990s after the collapse of the property prices in Hong Kong. It is widely accepted, especially after the east Asian financial crisis, that

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foreign investment in real estate is inherently problematic, as this sector can easily give rise to financial bubbles, with potentially adverse macroeconomic consequences of the remaining, only a small fraction has gone into large-scale manufacturing that can potentially augment domestic capability and exports. In fact, FDI from the advanced economies that could bring in newer technology and managerial practices are limited, as the Chinese still seem to have a fairly strict regulation on such inflows. Reportedly, in 31 industries China does not allow wholly foreign owned enterprises; and in 32 others, Chinese partners must hold majority share holding.15

Based on the foregoing, the International Finance Corporation's study of business environment, in fact, places India marginally ahead of China - from the viewpoint of foreign investors [IFC 2002]. The study also found that the quantum of FDI inflow in China and India, as proportions of their respective GDP, is roughly comparable. Thus, t he widely held view of China's ability to attract enormous foreign capital needs to be taken with considerable circumspection.

Table 6:

Illustrative List of Foreign Firms Not Listed in the Domestic Stock Market

Product Group	Foreign Firms
Automobiles and allied products	GM, Ford, Mercedes Benz, Honda, Hyundai, Fiat, Toyota, Volvo, Yamaha, Cummins, Goodyear
Food and beverages	Coca-cola, Cadbury Schweppes, Kellogg, Heinz, Seagram, Hiram Waker, United Distillers, Perfitti, Wrigley, KFC, McDonalds
Consumer durable goods	Daewoo, Samsung, Sony, General Electric, LG Electronics, Black and Decker, Kimberley Clark
Personal care products	Revlon, L'Oreal, Cussons, Unilevers

Thus, the quantum of FDI inflow into China, and its positive effect on the economy are perhaps overstated. Without getting into simplistic comparisons, what we need to appreciate from the Chinese experience is perhaps how to take advantage of the openness to investment and trade, to expand domestic capability and get access to external markets for its labour intensive manufactures

V. A PRELIMINARY ASSESSMENT FOCUS ON DOMESTIC MARKET

As noted earlier, India's seemingly large (and growing) domestic market is maybe the main attraction for foreign companies. for example, international soft drinks producers and fast food chains that were unknown a decade ago have acquired a visible presence within the metropolitan cities, though their quantitative significance could yet be marginal. These companies have brought with them the oligopolistic market structures and firm rivalries that are evident within the developed economies. whereas such market structures could have some desirable properties, if they lead to tacit collusion to bar new entry, then it should not be a positive development within the long run.

Similarly, almost all major international automobile companies have set up assembly and producing facilities in varying extent. the same probably holds true for washing machines, refrigerators, and entertainment electronics. Such large-scale entry of companies has resulted in increased value and non-price competition, resulting in a greater choice and quality improvement - a desirable outcome for consumers.

Initially, there have been considerable apprehensions that international companies with their superior technology, marketing skills and financial strength would wipe out domestic companies (and brand names) in several of those industries. To some extent this has indeed happened - within the aerated drink market, for

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example. the same is partly true within the automotive industry as well: fiat gradually acquired Premier auto (its erstwhile licensee); hindustan Motors (an erstwhile gm licensee) has largely become a sub-contractor for gm and Ford, producing engines and trans-mission equipment.

But many technologically strong and financially sound domes-tic firms seem to have withstood the growing competition - at least so far. In some cases, domestic firms have severed their ties with their foreign collaborators to assert their managerial independence after some years Of association, though such cases are only a few.17 Further, contrary to many early apprehensions, bulk of the domestic firms (and brand names) have not been displaced from the market. Dominant domestic firms have sought to protect their market shares by expanding capacity and distribution networks, contributing, among other factors, to the boom in fixed investment in registered manufacturing in the 1990s [Nagaraj 2002].

Problems with Infrastructure Investment

Foreign investment in power generation that attracted the largest approved FDI was predicated on securing a high and assured rate of return on invested capital - modeled after Enron's DPC. It was the first of its kind, offering exchange rate guaranteed

Table 7 (i): Share of M and A as in FDI Inflows in India

Year	FDI Inflow ($ Million)	M and A Fund ($ Million)	Share of M and A Fund in FDI Inflow (Per Cent)
1997	3200	1300	40.6
1998	2900	1000	34.5
1999 (Jan-Mar)	1400	2800	39.4

Table 7 (ii): Foreign Firms Related M and A in India

Year	Mergers	Acquisitions	Total
1993-94	4	9	13
1994-95	-	7	7
1995-96	-	12	12
1996-97	2	46	48
1997-98	4	61	65
1998-99	2	30	32
1999-2000 (Up to Jan 2000)	5	74	79
Total	17	239	256

16 per cent rate of return on investment on power purchase by the Maharashtra State Electricity Board. The agreement was not based on competitive bidding, violating many established norms of investment planning for a project of that size and scope. This was apparently done in the early years of the reforms to signal India's eagerness to invite foreign investment.

Most of these power projects did not fructify, as they were based on unrealistic assumptions regarding the profitability and the market size. Moreover, as the Enron's Indian saga unraveled, most foreign firms discovered the state governments' inability to ensure the guaranteed return, hence cancelled their investment plans. The speed and secrecy, with which the Enron project was launched, ignoring the checks and balances in public decision-making, invoked considerable debate in the press, parliament and academia. In retrospect, many of the criticisms seem valid, denting foreign investment's popular image (and the credibility of its exponents).

However, there are probably other reasons as well. Much of the projected demand for power that formed the basis for inviting such a large FDI in this sector was apparently inflated.20 After the industrial slow down since the mid- 1990s, the demand-supply gap was found to be relatively modest [Nagaraj 2002].

Net Foreign Exchange Inflow

For long it has been control that foreign companies bring in limited internet resources within the host economy, as they usually take a large surplus out of the country as dividends and royalties [Chandra 1991]. This, to some extent, is probably true of what happened in India within the early 1990s, although it should be hard to substantiate. one of the earliest changes in the foreign investment rules when the reforms was to remove the restriction on the foreign equity holding in the existing foreign companies - reversing the policy initiatives of the earlier period. Foreign companies were fast to seize the opportunity to issue large equity to themselves at a fraction of the market prices (when the stock market was booming). This meant, in principle, a substantial FDI flow in the book of accounts throughout 1991-94, however essentially it had been simply a book transfer without any fresh capital flow. With a larger proportion of equity control by the parent companies, it's now possible for them to require out an ever-larger share of surplus in perpetuity.21 Table 10 provides an illustrative list of the foreign companies that followed such a practice, and their gains because of the discount on the problem price of the fresh equity.

It only goes to show however sensitive foreign companies are about the managerial} control. within the absence of suitable regulations, they'd like to retain an absolute control that will not be desirable for the host country. However, it's often argued that majority equity holding is necessary for international companies to be assured enough to bring in the latest technology that could potentially have positive spillover within the host economy. This view seems suspect. there's some proof to show it's not the majority control, however the market structure that determines innovation and also the introduction of recent technology. Mani (1983), in an exceedingly case study, showed that within the 1970s when the world's leading companies dominated the Indian automotive tyre industry, it was the new Indian entrants like Apollo and Vikrant Tyres that introduced innovations, and not the incumbent companies. faced with such a threat, foreign companies quickly followed suit to protect their market shares.

Technology Spillovers

As noted earlier, one of the arguments in favour of FDI is the potential positive externality of technology into the host economy. However, in reality, the process may not be that simple. We have seen, that foreign investment does not necessarily lead to fixed capital formation; moreover, technical spillovers depend on the extent of value addition that is carried out in the host economy. For instance, assembly operations or production of simple consumer products is likely to have marginal externality.

For instance, most automobile firms - barring Hyundai and to a less extent Ford – have essentially set up minimal facility to assemble and paint their imported CKD kits, leading to a proliferation of firms and models with modest rise in domestic production and technological capability.

In other durable goods industries too, foreign firms have acquired dormant domestic firms and/or resorted to contract manufacturing with the existing firms rather than set up green field plants.24 While these may be efficient strategies for the firms concerned, the social benefit of such arrangements may remain modest. Our contention is consistent with Richard Caves's observation:

While productivity spillovers from foreign subsidiaries to local firms are apparently widespread, they are neither ubiquitous nor independent of firms' market ambient structure. Spillovers may be a justification for LDC government policies to encourage flow of foreign direct investment. Justification is likely to be conditional on the country's state of development and the structure of particular industries in which foreign subsidiaries might alight [Caves 1999: 17].

Decline in Competition

FDI, in principle, brings in greater market discipline on the incumbent firms by increasing competition. But, as we have seen, foreign firms often acquired dominant positions by taking over domestic firms (and brands). This, again, is best illustrated by Coca Cola's acquisition of the dominant domestic competitor, Thums Up; and Hindustan Lever's-Indian subsidiary of Unilever - acquisition of its largest domestic rival, and the second largest firm in the industry, TOMCO, and the largest cosmetics firm, Lakme.

In principle, in a well functioning market economy such acquisitions would have attracted the provisions of the competition law. But they went unchallenged in India as the MRTP Act - the anti-trust law - was practically abolished as part of the economic reforms. Further, the government ignored the public and academic criticisms of such acquisitions, as it was keen to signal a positive outlook towards FDI. Thus, our examples show, the widely held view of foreign investment per se leading to greater competition needs to be taken with caution.

Foreign Exchange Earnings

One of the common apprehensions against foreign investment is the net drain of foreign exchange in the host countries. Many countries seek to overcome this problem by imposing foreign exchange neutrality clauses. Reportedly even the UK applied such a clause while permitting Japanese automotive firms in the early years of conservative reforms in late 1970s and the early 1980s. Many states in the US apply conditions of job creation while offering incentives for Japanese automotive firms. Though we do not have data to examine net foreign exchange outgo on account of foreign firms that came into India in the 1990s, the government, reportedly, has been lax in enforcing this clause or has diluted it.25 This could be a serious matter, especially with many automotive firms that have set up are largely limited assembly plants.

Loss of Bargaining Power in the Technology Market

It is well accepted that dominant international firms have substantial market power, and many developed countries widely intervene in the technology market to protect and promote interests of their firms.27 Indian policy, after the reforms, practically ceased to intervene in the technology market, significantly weakening domestic firms' bargaining position. With the increasing role of financial collaborations, foreign technical agreements as a source of technology have steadily

Table 9: An Illustrative List of Foreign Firms Moving to De-List from Domestic Bourses

Sl No	Company	Acquirer's Current Holding (Per Cent)	Offer Price (Rs)	Post-offer Holding (Per Cent)
1	Cabot	60	100	92
2	Cadbury	51	500	90
3	Carrier Aircon	51	100	86
4	Centak Chemicals	75	200	93
5	Hoganas	51	100	85
6	Otis	69	280	79
7	Philips	51	105	83
8	Reckitt & Colman	51	250	Yet to open
9	Sandvik	73	850	89

dwindled in the 1990s - both in absolute and relative terms (Figure6) [Economic Survey,2 001-02]. Evidently, foreign firms do not want to part with their technology, as they can now come into India without a domestic partner.

Considering their superior financial and technical strengths, many foreign firms in the capital goods industry seem to have wrested managerial control in the existing joint ventures in the 1990s. For example, Caterpillar bought out Birla's stake in their joint venture manufacturing earthmoving equipment although the firm was doing well in the market. Many automotive firms started as joint ventures, but gradually foreign partners increased their financial stake by buying out domestic partners, as Indian partners were unable to bring in the resources to make up for the losses in the early years of the firms' operations. This happened at a time when the domestic interest rates were higher than the international rates. Foreign partners found it an inexpensive way to acquire a greater managerial control, especially as the currency was steadily depreciating.

For instance, Honda bought out the Sriram group, and Ford acquired Mahindras's stake in their joint venture car projects. However, more recently, there are instances of the converse, where Indian firms have bought out their foreigner partners; for instance TVS Motors and Suzuki, Kinetic motors and Honda. and LML and Piaggio. But such instances seem far fewer.

Arguably, the above examples illustrate the virtues of a market driven process for corporate control that is best left to it. Such a benign view may not necessarily favour developing countries and their consumers in the long run. For instance, the demise of Spanish automotive firms with its integration in the European Union, and the lack of technological and market dynamism in the Brazilian auto industry- despite substantial investment and output growth- probably suggests that strategic intervention to support domestic firms and industry are not in compatible with securing dynamic comparative advantage and export competitiveness.

In sum, while the entry of foreign firms has increased competition and improved the variety and quality of consumer goods, there are some disturbing signals. Foreign investment in infra-structure is a failure. Gradual loss of managerial control in many industrial firms, decline in competition in some industries, extinction of some leading domestic brand names and limited improvement in domestic production capability seem to be signs of concern.

VI. TOWARDS A REALISTIC FDI POLICY

It is widely believed that India has not done enough of policy reforms to attract substantially more foreign investment. More-over, it is not the financial incentives but the lack of adequate infrastructure, bureaucratic delays and above all, the rigid industrial labour laws that have come in the way of attracting ore investments[Sachs and Bajpai2 001]. This view seems to have many l imitations. For instance, there is no evidence of a positive association between the extent of market oriented reforms and FDI inflows across developing economies [Easterly 2001]. Moreover, as discussed earlier, greater foreign investment in flow does not necessarily mean faster output and export growth. What, then, should guide India's foreign investment policy?

If history i s any guide, foreign investment in infrastructure is potentially problematic. Latin America witnessed a wave of foreign infrastructure investment from the US in the 1930s, only to leave with the bitter experience of nationalizations in a couple of decades. It bears repetition that infrastructure is inherently capital intensive with long gestation lags, and low (but stable) returns over a long period. Market failures are ubiquitous in these industries, with considerable network economies necessarily inviting wide and deep state intervention. In a world consisting of politically independent nations with a growing number of democracies, the pricing of infrastructure is bound to be a political decision. Foreign firms with short pay back periods invariably find it hard to stay on, as it conflicts with the goals of developing economies caught in an increasingly uncertain world economy.28

There are also perhaps some India specific factors for the relatively small foreign capital inflow. It seems worth reiterating that India is still largely an agrarian economy, with land productivity being a third of China's, where the average disposable income after meeting food and clothing (wage goods) requirement is still relatively small. P rice-income-ratio of most consumer goods that foreign firms usually sell is high by domestic standards, accentuated perhaps by cultural factors and regional heterogeneity of markets[Financial Times, April 25, 2002]. In infrastructure industries, the rupee cost of electricity supply by foreign firms seems high. Given India's fairly diversified industrial capability, and low labour costs, foreign firms may not have a cost advantage over the domestic producers- especially with the currency depreciating in nominal terms. T his is perhaps best illustrated, again, by the Enron's DPC. With imported capital goods and fuel, and high operating cost duet o international norms of costing, Enron's cost of production was found to be higher than the comparable new plants using domestic capital equipment [Morris 1996].

At the same time, Hyundai's large investment with consciously built-in high domestic content secured through economies of scale has succeeded in producing a small car that seems competitive both in price and quality. Reportedly, Hyundai proposes to use its Indian plant as a global hub for its small car [The Economic Times, J anuary2 , 2003]. Thus, the key to increasing FDI inflow seems to lie in industries (and products) with relatively high technology that have large economies of scale, with substantial domestic content.

However, the foregoing reasoning still does not explain why foreign investment does not come to use cheap labour and skills for export of labour intensive manufactures -as it has happened in China. We are inclined to believe that the foreign investment policy lacks a clear focus. Unlike China, India has not invested in export infrastructure. In fact, as is widely accepted now, the share of infrastructure in fixed capital formation has declined sharply for nearly one and half decade now [Nagaraj 1997].

VII. SUMMARY AND CONCLUSION

Ending its long held restrictive foreign investment policy in 1991, india sought to compete with the successful Asian economies to get a larger share of the world's FDI. cumulative approved foreign investment since then is about$ 67bn, however the realized amount is about a third of it - the ratio roughly com-parable to China's. whereas the foreign investment flow represents a substantialju mp over the 1980s, it's mode st compared to several rapidly growing Asian economies, and miniscule com-pared to China. whereas the bulk of the approved FDI is for infrastructure, the realized investment is {largely|is essentially|is basically} in manufacture of consumer durable goods and also the automotive industry seeking India's seemingly large and growing domestic market. Foreign investment in telecom and software industries has also been important. Approved FDI has mostly gone to a few developed states- the same as its concentration within the southern coastal provinces in China. a large a part of the foreign investment seems to represent a gradual increase in foreign companies' equity holding (hence managerial control)i n the present firms, and acquisition of industrial assets (and brand names).

China's ability to attract a phenomenal amount of foreign investment could be a puzzle for several. A bout4 0-50 % of China's FDI represents it s domestics saving re cycled as foreign investment via Hong Kong to require advantage of economic incentives – popularly called the "round tripping". A nother2 5 per cent or so, seems to represent investment in real estate by overseas Chinese that's potentially problematic, as such investments may simply produce to property bubbles. so the quantum of foreign investment from the advanced economies that would improve domestic production capability is perhaps not very different from that in india, in relation to its domestic output. Contrary to the favored belief, China's foreign investment regime is alleged to be additional restrictive than India's. Therefore, what india should be concerned regarding isn't most the absolute quantum of the flow, but how effectively it uses its external openness to enhance the domestic capability, and access foreign markets for its labour intensive manufactures For a careful economic analysis of the effects of foreign investment, considerable detailed statistical information is needed - each at the aggregate and at the firm or industry level. In their absence, much of our analysis is indicative in nature, raising questions for further enquiry

As the 1990s' experiences hows, quite contrary to the popular perception, the size of India's domestic market is comparatively small, given the low levels of per capita income. when meeting the requirements of food and consumer goods (wage goods), financial gain left for outlay on product that the majority foreign companies offer seems small; their price-income ratio too high for Indian consumers. Therefore, several of them seem to be creating efforts to indigenise production to reduce prices and secure economies of scale. in this method, several foreign companies are discovering the potential of low price of producing for exports.

Much of the approved FDI in infrastructure id not fructify, because the rupee cost of electricity supply by foreign companies is much too high for Indian consumers. This seems true for 2 reasons: one, costs of goods like electricity are wide subsidised, and can't be increased while not inviting public opposition; second, raw material and capital equipment. Foreign investment in consumer goods industries has increased domestic competition, leading to greater selection and quality improvement. whereas FDI flow displaced some domestic companies (and brand names), the majority of them have - at least yet - largely been able to withstand the competition by creating large capital investment, and in expanding distribution networks.

However, in industrial goods there have probably been sizable acquisitions of domestic companies (and factories) whose details aren't known. There are many instances of foreign companies gradually acquiring controlling interests, edging out domestic partners. whether or not these firm-level changes get reflected in industrial efficiency within the aggregate - as several expected - is a moot point.

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