Foreign Direct Investment

(Creative or Disruptive External Economic Intervention)

1. Introduction

The question people often raise is that: why there is so much controversy about the Foreign Direct Investment? Some vehemently oppose it, yet some passionately support it. The question therefore arise is : what is that which makes people take diametrically opposite views. Is it the belief in the political economic thought? Is it liberal economic thought? Is it because of well carried out economic analysis in a pragmatic way or pure economic way, based on facts and figures plus experience of handling huge foreign direct investment within a sovereign state.

1.1 Definition of FDI

Let us first define what is FDI and how does it takes place. The FDI may be defined in terms of surplus resources with a country, which tries to transfer these surplus funds to other country that can offer better, short and long term, returns. As also one can use FDI lever to acquire a economic foothold in other country either joining as partner with local business person or setting up his/her own business outfit or can acquire stake in the business run by local business firm /person or by acquiring the business firm or investing equity.

1.2 Micro Level

The firm which seeks FDI is that which needs additional resources to expand the business, start the business, or whishes to acquire technology and markets in FDI providing country. Incidentally none of the possibilities stated above is mutually exclusive. There can be one or more than one of the above stated possibilities on both sides. That is countries which are giving funds and those which are receiving funds.

1.3 Macro Level

The above stated is the position with regard to business organizations at micro economic level. But question arises what is the impact at the macro-economic level within FDI giving and receiving countries? Why there is always a policy prescription about extent of FDI to firms/ business person can receive? Often it is stated as FDI cap for different business sectors.

1.4 FDI Cap

FDI Cap means to what is the extent of a firm's capital, the FDI can be sought or the amount could be invested. It is stated in terms percentage of total capital of the firm, which is receiving the funds in a particular business sector or economic sector. The determination of FDI cap for a particular economic or business sector is determined by perceived impact of FDI on business firm/ sector not only in economic terms but also in terms its wider impact on operations and management of business. Here, lots of complexities enter into decision making with regard to FDI cap. This is for two reasons namely; one for economic impact on macro as well micro economic parameters, the other is social, economic and sovereign status parameters.

1.5 Impact of FDI Flow

The impact on macro and micro economic parameters may be defined as overall and specific impact of inward flow and outward flow of funds through FDI. Inward flow raises funds availability at macroeconomic level and therefore, has bearing on exchange value of currency of receiving country and fund transferring country. At microeconomic levels ie., individual firm /sector level, it offers availability or more funds for business operations as also the control over business decision making by the receiving firm/person. The aspects of business decision making is very critical in deciding the extent of FDI solicited by the firm, FDI cap and overall impact of such decisions on the macroeconomic and microeconomic parameters.

1.6 Soft and Hard aspects of FDI

There is also a distinction in the impact between soft aspects of FDI and hard aspects of FDI. Soft is defined in terms of easy to enter and easy to exit in another country/economy. Hard is defined in terms of difficult or easy to enter, but difficult to exit. That a foreign firm can establish its business depending on the policy of a country to allow establishment of foreign business, it could be easy, if governance of economy is smooth and attractive to foreign business operations. But, if such investment is in hardware namely, real estate, equipment, machinery and other infrastructures, it may be difficult to exit. But, if there is only financial stake in a local business is held through FDI, it may be easy to exit. This entry and exit has huge bearing on the FDI receiving country's individual firm as also on the macro-economic parameters. The easy to exit can be regulated by fiscal and monetary of policy of the receiving country. There are enough evidences, wherein such regulatory measures with regard to exit as also entry has been resorted to.

2. The Rationale to Allow FDI and Fixing of FDI Cap for Different Economic Sectors

The rationale to allow FDI has bearing on economic philosophy being followed by a sovereign state. The economic philosophy is often stated as political economy, or political economic philosophy. Two important schools of thought have dominated the discourse on economic philosophy being followed by different countries.

2.1 Prior to WTO

Prior to 1995, when World Trade Organization came into being with a outlined philosophy of liberalization of world economy, wherein a large number of sovereign countries signed this agreement, two dominant school of thoughts prevailed and yet prevails in different part of the world with varying degrees in pronouncement and practice. Those who believed in self reliance, greater role of state in economic matters to ensure economic progress and economic wellbeing of people at large, based on economic philosophy propounded by Marx, considered FDI as direct intervention in their economic decision making and therefore, had no place. The other who believed in market forces to ensure economic well being of people at large, based on whole set of economic thought leaders starting from Marshal, neo-classical thinkers to Keynes and latest economic thought leaders in America and Europe. Accordingly many countries shaped their economic philosophy in alignment or in different degrees of variation, between these two schools of thoughts. The third school of thought was to consider economic conditions, economic endowments within a nation state, by self reliant, decentralized economic decision making and decentralize development, so as to ensure greater democratic rights and economic decision making power to people in a model of self reliant or interdependent model of development at par. This school of thought, though not yet appreciated fully, was propounded by Mahatma Gandhi. Hence the role of FDI was negligible, and if, required depended on ability of sovereign nation to give and take at par, if so required for technological and other reasons. This school of thought was distinct from both- market taking major responsibility and state taking major responsibility of economic well being of people of a nation state.

Both the models, besides, political thoughts, were based on economies of scale methods of large scale production, operations and distribution of resources through state machinery or through market mechanism, which was necessarily possible through capital in the hands of few. In one case it was in the hands of state in another it was in the hands of market, which have proved beyond any doubt, their failure to assure economic wellbeing of people at large, as also these have been exposed to their severe limitations to smooth economic progress, owing to fluctuations and concentration of resources in the hands of a few and making large proportion of population to be workers at various levels. In another case putting lot of economic power in the state machinery, initially ensured basic well being of all, but failed to keep system going owing to political thoughts, atrocities by a few occupying position in state machinery and cadre. So the political economic thought process ranged between socialism and capitalism mainly. Third thought process of decentralized development, power to people for self reliant and or interdependent model of development could not receive as much attention in theory, yet in practice it continues to influence people at various levels. Hence often one finds different views on allowing FDI freely is different in different sovereign states.

2.2 After WTO

WTO has attempted to ensure that market philosophy is accepted by the most part of world, albeit voluntarily through a system of decision by consensus. But at the heart of it is liberalized process of development and allowing market forces to determine the future economic well being of people. Its preamble states that:

> The Director General Mike Moor in his speech on 7th May, 2001 outlined the importance of trade and the importance of the multilateral trading system. According to him***, the trading system has probably done more to boost living standards and lift out of poverty than any government intervention***.

The 17-fold rise in world trade since 1950 has gone hand-in-hand with a 6-fold rise in world output. This has benefitted both developed and developing countries: in both, living standards have risen three-fold; life expectancy in developing countries has risen from 41 to 62 years, infant mortality has more than halved, and the adult literacy rate is up from 40% to 70%.Further he states that studies done by Jeffrey Sachs and Andrew Warner of Harvard University have found that developing countries with open economies grew over six times faster in the 1970s and 1980s than those with closed economies. Yet another study covering data from 80 countries conducting by David Dollar and Aart Kray indicated that the openness boosts economic growth and the income of the poor rise in line with overall growth. According to him, the name of the game in trade policy has been liberalisation. He further states that pro-market reforms has encouraged faster growth, diversification of exports, and more effective participation in the multilateral trading system. He however, warns that trade reforms may not help the countries that: (a) spends all its export revenues on weapons, (b) lacks good governance, (c) have crippling debt overhangs, and (d) lack domestic capacity or infrastructure to take advantage of new market access opportunities. Therefore, he urges that the trade liberalisation must go hand-in-hand with other reforms including domestic reforms. He feels that liberalisation and multilateral trade reduce the tension and also make governments more transparent and gives less scope for corruption.

It may be mentioned that situation in a good number of developing and least developed countries is similar to what has been described at (a) to (d) above. Precisely for these reasons many of the countries fear the likely impact of liberalization and external market reforms.

Hence, most of sovereign states, who have signed this agreement, are into process of liberalization, albeit external liberalization. Therefore, sovereign states are under pressure of allowing FDI to make globe- a market. The market is viewed as panacea for removal of poverty as part of millennium development goal. Here it may be pertinent to delve on external and internal liberalization. Many of the states who have signed this agreement had different political philosophy and operated varying degree of socialism and liberalism.

These, sovereign states, under the pressure of WTO, caused external liberalization, i.e, by opening domestic market to world economy, whereas, these countries, India included, have failed to liberalize internally by reducing or doing away with various control systems, as a result it has led domestic economies into crony capitalism and corruption at various levels.

Hence, the major rationale of FDI is: *"allowing world market forces to address the problem of economic development, removal of poverty and to achieving the millennium development goal".* How far this rational is justified and acceptable or believable, therefore, is a matter of faith and perception, rather greater economic logic under any political philosophy. Slowly it is inching towards stateless world economy dominated and determined by market forces with least or no interference by the state. In a way attempting to project a withering of state, as projected by Marx, not through empowering of people, or through decentralized development, as envisaged by Mahatma Gandhi, but by market forces, whose, volatility is well known, its ability to remove poverty is seriously questionable.

Having highlighted the rational of FDI, which is very weak and tilted towards those who own greater resources, let us examine how best a sovereign state, even after having committed to WTO voluntarily can effectively tackle the impact of FDI at Macro and Micro levels and how the system of economy propelled through FDI works? Before we deliberate on these aspects, let us first see what is scenario of FDI in the nation states and world economy.

3. Status of FDI in World Economy

The FDI world report for 2013 reveals that the FDI projects numbers have declined in 2012 as compared the years 2011. Extent of decline was 16.38percent from previous year. The total FDI projects in 2012 were 11,789. In contrast to this year, 2011 had shown increase in FDI projects by 8.54 % from the previous year. The decline in number of projects also resulted decline in total capital invested by 33.54 % in 2012. Total capital invested in 2012 in the world economy stood at $ 565 billion. The decline had an impact on creation of employment through FDI. The job creation declined to 28.8% and it was 1.62 million in 2012. The top source country and top destination country is US. The top sector was business and financial services.

3.1 The Decline in FDI by Regions

The decline is mainly due to slow growth of economy in China, which led countries to cut back capital intensive projects. This stated to be the key factor in decline of FDI in the world economy. The decline was not universal for the all the regions of the world. In Africa decline was less than average decline in the world. Africa registered market share of FDI projects to 6 % in 2012 from previous year i.e, 5.54%.Europe registered a decline of 1.6 percent owing debt crisis.

3.2 Asia –Pacific Region

The Asia-Pacific was the leading region in destination of FDI with 3740 projects in 2012. The Australia was the top five destinations in this region. Australia was only the country which registered growth in project numbers with FDI rising by 4.24 percent from previous year. Increase in project number in Mayanmar from 20 to 54 showed strong link between stability and inward flow FDI. Indonesia, Phillipine and Bangladesh also registered increased in inward flow of FDI. The highest was for Bangladesh ie., 66.6 percent in number of projects. Indonesia and Phillipines registered growth in projects by 7.64 and 11.2 percent. Among Bric countries Brazil, Russia, India and China there was sharp decline FDI. It was more than average decline FDI in world.

3.3 EUROPE

In Europe, Ireland and Turkey increased the market share of FDI. The Ireland increased its market share by 3.78% and Turkey by 3.42 percent. The decline in FDI was less than for Europe.

3.4 Middle East a Major Source of FDI

Middle East was a major source of outward flow of FDI. It was only region in to increase the volume of FDI. Arab Emirates led the growth of outbound FDI in 2012 with FDI projects increasing by 25.74 percent. Arab Emirate Enterprises increase the outbound FDI projects by 24.66 percent.

Among source countries Western Europe remains a major source region. Despite the decline Western Europe remain major source of outbound FDI accounting for 43.12 percent of FDI global project in 2012. In Western Europe 43 percent FDI came from within Europe. UK and Germany accounted for 45.45 percent of FDI in Western Europe.

3.5 Top Sectors in FDI Projects

The Business and Financial services and Information and Communication Technology remained top two sectors accounting for 43.68% of total FDI projects in the world in 2012. It has increased by 39.3 percent over the year 2011. Real estate, hotels, tourism and food and beverages had shown an increase in market share. In Bric countries food and beverages counted for one quarter of total FDI. Electronic component and semiconductor, Consumer Electronics and business machines experience decline in project number by 26.07 and 21.21 percent.

4. Share of Received FDI by Countries in the World Economy

The CIA fact book data for the year 2008 shows that there is total stock of $1, 63,600 million accumulated stock of FDI in world. The FDI stock in US, accounts for more than 15 percent of total FDI's world stock*. That in Europe, UK, France, Germany accounted for 7.3, 7.14, and 6.46 percent respectively. In Europe all the three countries put together accounted for more than total US Stock, i.e. 20.90 percent. Thus more than one third of total FDI stock was in US and Europe. China, known as high destination for FDI accounted for 3.5 percent and India 1.1 percent of total FDI stock.

4.1 *FDI Abroad*

Data for Total world FDI abroad are available for 2008. It shows that $16, 22,000 million FDI from the listed countries in abroad. Of the data available for 2012 shows that US accounts for 27.78 percent, In Europe UK, Germany and France accounted for 11.14, 11.03, and 10.37 percent respectively. In Europe all the three countries put together accounts for more than USA i.e, 32.54 percent. China and India accounted for 3.1 and 0.7 percent respectively. The figures for world estimates and figures for respective countries are for two different date's i.e, 2008 and 2012. Therefore, percentage calculated here may not be exact. However, these do reflect the position of respective countries with regard to data at a particular date. As the denominator is common for all the countries, which could be taken as near most to exact position, as far as the relative position of the countries presented above are concerned.

4.2 *The Net FDI*

The Net FDI may be calculated by subtracting inbound from outbound. The Net FDI therefore, if it is in plus i.e. inbound would give picture of net contribution of FDI in the receiving country from the capital invested by other countries, it also represents extent of economic stake other countries have in the economy of receiving countries. It also leaves countries to the extent of exposure of decision with regard to flight of capital invested in the receiving country. Total impact of this flight of capital has, however, could be seen by bringing in the data pertaining to trade surplus and deficit of the country concerned. If the receiving country has trade surplus the impact of flight of capital will be less, but if the country has trade deficit, impact of flight of capital on country's currency and economy would be high.

Table 1: Inbound and Outbound FD Stock
(2008 total World FDI and 2012 figures for countries in %)

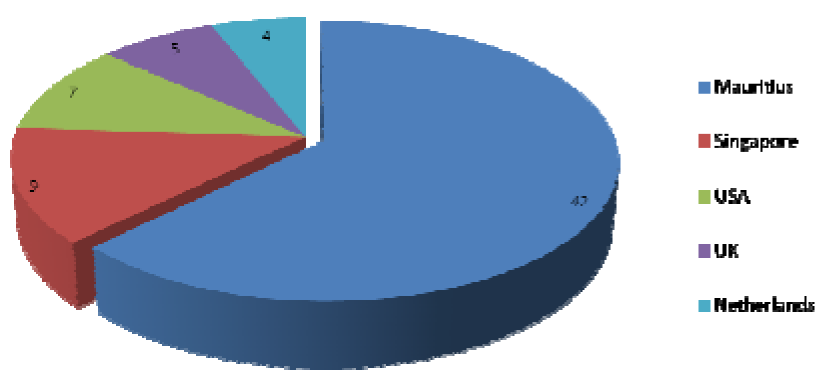
Sl.No.	Name of the Country/Region	Inbound	Out bound	Surplus/ Deficit
1	USA	15	27.78	-12.78
2.	UK	7.14	11.14	-4.0
3.	Germany	6.46	11.03	-5.43
4.	France	7.30	10.37	-3.07
5.	China	3.5	3.1	+0.4
6	India	1.1	0.7	+0.4

The USA has higher stake in economies of other countries as compared to UK, Germany and France. All the three countries put together, as being part of one economic union i.e. Europe, economic stake in other countries is comparable or even slightly less. The net giving countries are China and India. The magnitude is however, very small. The large inflow and outflow of FDI is within America and Europe. There may be several other countries, but for our analysis we have taken above countries as they fall in top five FDI receiving countries.

4.3 Share of Top Countries FDI Equity Inflows:

The Figure below indicate share of top equity FDI inflow countries.

Share of Top Countries – FDI Equity Inflows
(Cumulative Percentage, between April 2000 to Feb 2011)

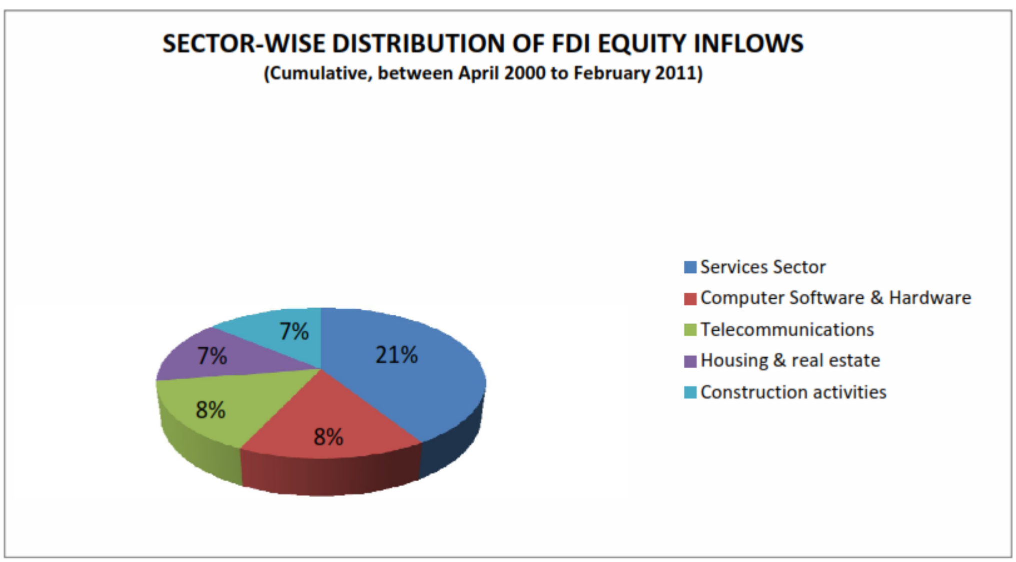


Mauritius is having largest share of equity FDI inflows. This is followed by Singapore, USA, UK and Netherlands. It may be mentioned that Mauritius is a tax haven for equity inflows. Similarly some parts in UK, Singapore, USA and Netherlands are tax havens.* How money travels for FDI is, therefore, an interesting analysis. Any one might ask – is there any link between FDI and tax evasion or unaccounted money flowing through tax havens?

4.4 The Sector-wise Distribution of FDI Equity Inflows

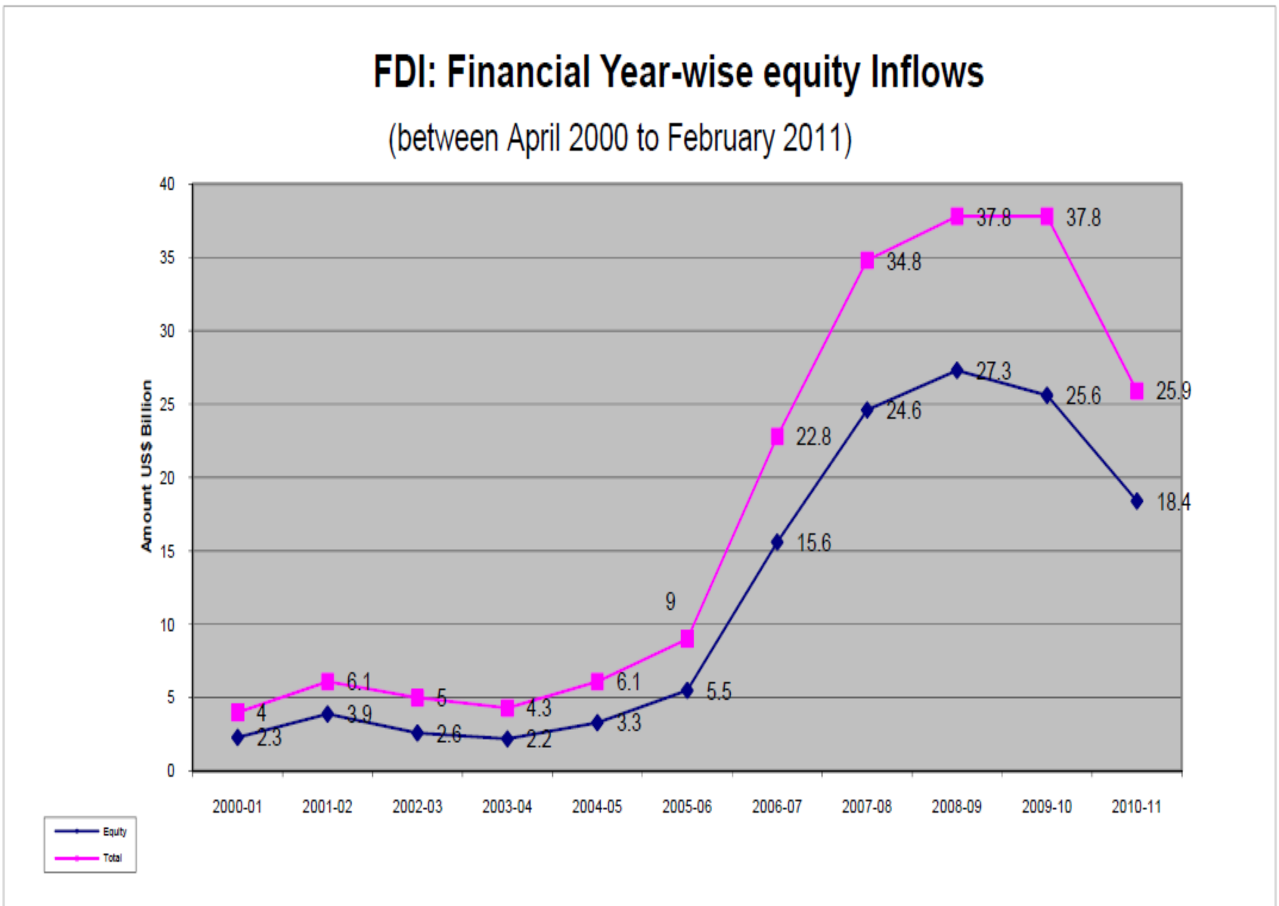
The sector wise distribution of FDI equity inflows is shown in the figure below:

The figure shows, as revealed in FDI inflows in FDI report of 2013 that inflows are mainly in service sector it accounts 21 percent of total inflows. Service sector as stated above is mainly business and financial services sector, ICT sector, housing a real estate including construction activities account for 7% each. If one goes into depth, one would find that real estate investment is basically to facilitate housing service and ICT sectors. Not for construction roads, general housing etc. which we term as hard nature of FDI which cannot be moved easily.



4.5 *The Year-wise FDI Inflows*

The year wise FDI inflows given in figure below indicates that FDI flows significantly increased from the years 2005-6 and tapered in 2009-10 and 2010-11 the figures for 2012 also show a decline as stated above. All this seems to be attributed general slowing down of world economy and particularly in USA, Europe and even China and India. Thus FDI has acted as further dampening the growth of economy. The above analysis leads us to two important features of FDI namely, it could be out of unaccounted money in respective countries and flows through tax heavens, secondly it is not a growth stimulator at the time of slowing of domestic economy and rather it accentuates the downturn of economy.



It may be further mentioned that FDI is also not a major source of stimulator of domestic economy, as sector wise distribution of FDI shows that it in mainly services sector and modern ICT sector. Both sectors' growth depends on growth of Agriculture, Manufacturing and Technology Development related to: (i) Agriculture production, processing and distribution, (ii) Manufacturing (iii) technology enabling the transportation of goods and merchandize- which, besides transport, deals with roads and other related infrastructures. All these pertain to hard nature/ aspect of FDI, which cannot be easily moved, but has a long term revenue prospects, however, it is also subject to policy change owing to change in governments of receiving countries.

Nation's economic growth is basically caused by Agriculture, Manufacturing, and Technology advancement to facilitate these and host of non-formal sector activities, through manufacturing of technology products. However, the magnitude of FDI compared to any countries domestic economy is very small and also it is employed in services sector; it cannot, therefore, be stimulator of growth of the domestic economy. It can at best claim benefit from growing domestic economy through claiming a rent on capital, which may be disproportionate to its contribution, as also can significantly contribute to source country by pushing their technology, goods and services. In fact hidden aspects of FDI is, besides employing idle capital, it is for stimulating the slowing consumption of their domestic goods, merchandise and services through finding market in other countries. The problem becomes accentuated when such capital employment takes place in developing economies, in particular, where international trade balance is in deficit. Although case for inflow of FDI is always made by arguing that it helps to creating hard nature/aspect of capital investment. But historical evidence speaks otherwise. Historical evidences points out towards greater distortion of domestic economic policies through high sounding words, higher amount of lobbying for finding markets for their goods, merchandise and services in developing economies. In fact FDI flow in business has seriously impacted the domestic services sector, in particular banking and insurance sectors, where all sorts' ethical or unethical means are employed to enhance the profit margin and higher rating to garner higher equity resources. No wonder there is a strong resistance for FDI in retail in Indian economy.

5. FDI Policy in India – Has Passed through Three Stages

5.1 The First Stage

FDI was viewed, as an important input in domestic economy to acquire resources and technology to strengthen domestic economy's manufacturing and technology sectors. This was expected to export enhancement, besides helping increase the Gross Domestic Product of the economy. This phase is stated, by present day policy analyst in India, as "cautious approach" or Self Reliant Approach. To quote:

"India had followed an extremely cautious and selective approach while formulating FDI policy in view of the dominance of 'import-substitution strategy' of industrialization. With the objective of becoming 'self reliant', there was a dual nature of policy intention – FDI through foreign collaboration was welcomed in the areas of high technology and high priorities to build national capability and discouraged in low technology areas to protect and nurture domestic industries. The regulatory framework was consolidated through the enactment of Foreign Exchange Regulation Act (FERA), 1973 wherein foreign equity holding in a joint venture was allowed only up to 40 per cent."

5.2 The Second Stage

Was when lot of pressures was build both by external actors and internal industry people to open the domestic economy, ostensibly for export promotion? Fact of matter was that lot of lobbying was done by America and UK for opening the domestic economy. I was doing research in Bombay University around seventies when a large number of liberal and free trade economic thinkers used to visit Departments of Economics in Indian Universities, so was also in Bombay university, and strongly pitch for free trade and removing protection. They side tracked the issue of stages of development of Indian economy by drawing parallel with American economy, when it flowed protection of several kinds. Under pressure of thoughts and domestic industrial magnates, though initial objected to opening of economy owing to lack level playing field in international trade, but they accepted opening of economy under the hope and perception that it will help export growth as also liberalize the economy internally. In this second phase, lot of policy modification and reforms took place to facilitate opening of Indian economy to world market, though in a selective way. This phase is stated as modifications and reforms in FDI policy. To quote:

"Subsequently, various exemptions were extended to foreign companies engaged in export oriented businesses and high technology and high priority areas including allowing equity holdings of over 40 per cent. Moreover, drawing from successes of other country experiences in Asia, Government not only established special economic zones (SEZs) but also designed liberal policy and provided incentives for promoting FDI in these zones with a view to promote exports. As India continued to be highly protective, these measures did not add substantially to export competitiveness. Recognising these limitations, partial liberalisation in the trade and investment policy was introduced in the 1980s with the objective of enhancing export competitiveness, modernisation and marketing of exports through Trans-national Corporations (TNCs). The announcements of Industrial Policy (1980 and 1982) and Technology Policy (1983) provided for a liberal attitude towards foreign investments in terms of changes in policy directions. The policy was characterised by de-licensing of some of the industrial rules and promotion of Indian manufacturing exports as well as emphasising on modernisation of industries through liberalised imports of capital goods and technology. This was supported by trade liberalisation measures in the form of tariff reduction and shifting of large number of items from import licensing to Open General Licensing (OGL)."

5.3 Third Stage

Is marked policy of liberalization – success of market forces The third stage started as early as 1990 when world economic thinkers strongly advocated for new economic world order and finally culminated as World Trade Organization, 1995 at Doha round. In India the beginning was made in 1990s, when Narsihmah Roa was Prime Minister and Dr. Manmohan Singh was finance minister and India was facing the problem foreign exchange. It may be recalled that India also borrowed from IMF to tie up their foreign exchange problem during the Prime Ministership of Mrs. Indira Gandhi, but India paid back the loan amount and never asked for second tranche, as she believed in political philosophy of self reliant and removal of poverty through growth of domestic economy. But with Narsimah Roa as PM and Dr.Manmohan singh as FM, who had worked in IMF and was, therefore, wedded to the philosophy of liberalization the process of opening of domestic economy was started. While doing so they threw overboard the policy of selective liberalization for the benefit of growth of Indian economy through agriculture, industry and manufacturing. They also agreed to sign and committed India to the philosophy and logic of WTO as market forces as panacea to remove the poverty in 1995. Story of Doha round and participation of India in discussions in WTO is a story of story of progressive liberalization, with some resistance and give in, without gaining much from the external liberalization, as also without any attempt to open up domestic economy internally. The third stage is stated as phase of liberatlization to quote:

> "shift occurred when India embarked upon economic liberalisation and reforms program in 1991 aiming to raise its growth potential and integrating with the world economy. Industrial policy reforms gradually removed restrictions on investment projects and business expansion on the one hand and allowed increased access to foreign technology and funding on the other. A series of measures that were directed towards liberalizing foreign investment included: (i) introduction of dual route of approval of FDI – RBI's automatic route and Government's approval (SIA/FIPB) route, (ii) automatic permission for technology agreements in high priority industries and removal of restriction of FDI in low technology areas as well as liberalisation of technology imports, (iii) permission to Non-resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) to invest up to 100 per cent in high priorities sectors, (iv)

hike in the foreign equity participation limits to 51 per cent for existing companies and liberalisation of the use of foreign 'brands name' and (v) signing the Convention of Multilateral Investment Guarantee Agency (MIGA) for protection of foreign investments. These efforts were boosted by the enactment of Foreign Exchange Management Act (FEMA), 1999 [that replaced the Foreign Exchange Regulation Act (FERA), 1973] which was less stringent. This along with the sequential financial sector reforms paved way for greater capital account liberalisation in India."

5.4 Automatic Route

Investment proposals falling under the automatic route and matters related to FEMA are dealt with by RBI, while the Government handles investment through approval route and issues that relate to FDI policy per se through its three institutions, viz., the Foreign Investment Promotion Board (FIPB), the Secretariat for Industrial Assistance (SIA) and the Foreign Investment Implementation Authority (FIIA).

FDI under the automatic route does not require any prior approval either by the Government or the Reserve Bank. The investors are only required to notify the concerned regional office of the RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issuance of shares to foreign investors. Under the approval route, the proposals are considered in a time-bound and transparent manner by the FIPB. Approvals of composite proposals involving foreign investment/ foreign technical collaboration are also granted on the recommendations of the FIPB.

6. Current FDI Policy in Terms of Sector Specific Limits

Current FDI policy in terms of sector specific limits has been summarized as below:

Tabular representations of the key changes proposed under the FDI Limits are as follows:

Sector/Activity	Before the proposal		After the proposal	
	% of FDI/ Equity	Entry Route	% of FDI/ Equity	Entry Route
Defense Sector	26%	Government Route	No Change	Higher limits of foreign investment in "stateof-the-art" manufacturing would be considered by the CCS
Insurance Sector	26%	Automatic Route	49%	Automatic Route
Telecom Services	74%	Automatic up to 49% Government route beyond 49% and up to 74%	100%	Automatic up to 49% Government route beyond 49% and up to 100%
Tea Plantation	100%	Government Route	100%	Automatic up to 49% Government route beyond 49% and up to 100%
Asset Reconstruction Company	74% of paid-up capital of ARC (FDI+FII)	Government Route	100%	Automatic up to 49% Government route beyond 49% and up to 100%
Petroleum & Natural Gas	49%	Government Route	49%	Automatic Route
Commodity Exchanges	49% (FDI & FII) + [Investment by Registered FII under Portfolio Investment Scheme (PIS) will be limited to 23% and Investment under FDI Scheme limited to 26%]	Government Route (For FDI)	49%	Automatic Route
Power Exchanges	49% (FDI &FII) FDI limit of 26	Government Route (For	49%	Automatic Route

	per cent and an FII limit of 23 per cent of the paidup capital	FDI)		
Stock Exchanges/ Clearing Corporations	49% (FDI &FII) FDI limit of 26 per cent and an FII limit of 23 per cent of the paid-up capital	Government Route(For FDI)	49%	Automatic Route
Credit Information Companies	49% (FDI & FII)	Government Route	74%	Automatic Route
Courier Services	100%	Government Route	100%	Automatic Route
Single Brand product retail trading	100%	Government Route	100%	Automatic up to 49% Government route beyond 49% and up to 100%

6.1 Rules and Regulations

This is subjected to following rules and regulations:

FDI Caps: Foreign Direct Investment (FDI) in India is subject to certain Rules and Regulations and is subject to predefined limits ('Limits') in various sectors which range from 20% to 100%. There are also some sectors in which FDI is prohibited. The FDI Limits are reviewed by the Government from time to time and as and when the need is felt and FDI is allowed in new sectors where the limits of investment in the existing sectors are modified accordingly. In order to revise the FDI Limits to attract more foreign investment in India, the Union Government constituted a committee named, Arvind Mayaram Committee headed by the Economic Affairs Secretary. On Tuesday, 16th July, 2013, the Government approved the recommendations given by the Arvind Mayaram Committee to increase FDI limits in 12 sectors out of the proposed 20 sectors, including crucial ones such as defense and telecom.

Some of the important changes made in the Existing FDI Limits are provided below:

- FDI Limit in Telecom Sector is increased from 74 per cent to 100 percent, out of which up to 49 per cent will be allowed under automatic route and the remaining through Foreign Investment

Promotion Board (FIPB) approval. A similar dispensation would be allowed for asset reconstruction companies and tea plantations.

- FDI in 4 sectors i.e. gas refineries, commodity exchanges, power trading and stock exchanges have been allowed via the automatic route. In case of PSU oil refineries, commodity exchanges, power exchanges, stock exchanges and clearing corporations, FDI will be allowed up to 49 per cent under automatic route as against current routing of the investment through FIPB.
- FDI in single brand retail is to be allowed up to 49 percent under the automatic route and beyond that shall be through FIPB.
- In credit information firms, 74 per cent FDI under automatic route will be allowed.
- In respect of courier services, FDI of up to 100 per cent will be allowed under automatic route. Earlier, similar amount of investment was allowed through FIPB route.
- FDI cap in defense sector remained unchanged at 26%, however higher limits of foreign investment in state-of-the-art manufacturing would be considered by the Cabinet Committee on Security (CCS). Technically, the decision leaves it open for CCS to even allow 100% foreign investment in what the defence ministry will define as "state-of-the-art" segments with safeguards built in to ensure that the technology and equipment are not shared with other countries.
- In the contentious insurance sector, it was decided to raise the sectoral FDI cap from 26 per cent to 49 per cent under automatic route under which companies investing do not require prior government approval. A Bill to raise FDI cap in this sector is pending in the Rajya Sabha.

Some of the sectors in which FDI limits were expected to be increased but did not were, civil aviation, airport, media, multi-brand retail and brownfield (existing firms) pharmaceuticals.

Recent announcement has also allowed FDI in multi brand retail; however, final decision is left to the states of India. Two states rules by BJP and AAP have withdrawn FDI in multi brands, after allowing it.

6.2 Domestic Economic and Foreign Investors Interest – Conflict of Vision

How has policy influenced the FDI inflow in India and to which sector? This question is important as magnitude and sector choice by investors and sector need of sovereign state are crucial for ensuring best use of foreign resources for the benefit of domestic economy and also for investors , if not in short term in long term certainly. Incentives and encouragement for foreign investors in the desired sector of domestic economy, is therefore an economic intelligent decision, rather than generic and faith ordained economic decisions. On this crucial issue, there is likely to be conflict of visions and assessment of need between domestic economic requirement and foreign investors. Foreign investors would always like to choose sectors which are safe and secured; offer good assured return, offer possibility of easy withdrawal of the capital. The safe & secured sectors choice may directly result into market distortion, as these sectors are already doing well and hardly need outside resources for their operation and expansion. Any FDI intervention in these sectors would cause ruffles in existing market, although one might argue that it will ensure competition. That, it is stated to, finally result into efficiency and gains to consumers. This, in our view, is very poor logic and poor substitute for better regulation and management of these sectors, particularly through foreign investors, whereas as local investors might have been restricted the entry, owing to ill informed policy decisions or simply continuing with the old practice of controlled system. In our view, this generic approach and faith ordained decisions lack the economic intelligent decisions in the larger interest of domestic economy.

FDI policy of India, as outlined above, seems to have moved from economic intelligence in domestic interest to slowly generic and finally the faith ordained decisions leading to serve the interest of foreign investors. This could be owing to desperate need for seeking FDI as also to meet fiscal and challenges of current account deficits. It may be mentioned that there was greater lobbying by free trade economist like Jagdish Bhagwati and many American and European economist to influence policy decisions through lectures in various Chambers of Commerce and visits to those who mattered in economic decisions in the government. In our view, any economic decision taken under desperation or pressure is bound to be poor economic decision, as far as the domestic economy is concerned.

First stage- there was a clear focus on the need for FDI in manufacturing and technology sector. Slowly policy started responding to need of foreign investors by way of relaxing certain rules and FDI caps and in general rather than incentivizing the relaxation and FDI caps in domestically needed sectors. The third stage- was more to respond to philosophy of liberalization, without clearly examining the likely impact of this liberalization. Having stated that, it may be important to examine how has this liberalization helped the domestic economy in practice?

6.3 FDI in Practice

The period of April, 2000 to October, 2013 shows accumulated FDI to the tune of US $309,012 Million. If we exclude NRI and other flows it stands at US $205,885. (see Fact Sheet below):

FACT SHEET ON FOREIGN DIRECT INVESTMENT (FDI)
From APRIL, 2000 to OCTOBER, 2013

(up dated up to October, 2013)

I. CUMULATIVE FDI FLOWS INTO INDIA (2000-2013):

A. TOTAL FDI INFLOWS (from April, 2000 to October, 2013):

1.	**CUMULATIVE AMOUNT OF FDI INFLOWS** (Equity inflows + 'Re-invested earnings' +'Other capital') *	-	**US$ 309,012 million**
2.	**CUMULATIVE AMOUNT OF FDI EQUITY INFLOWS** (**excluding,** amount remitted through RBI's-+NRI Schemes)	Rs. 971,350 crore	**US$ 205,885 million**

Note: * Data on 'Re-invested earnings' & 'Other capital', are the estimates on an average basis, based upon data for the previous two years, published by RBI in monthly bulletin dated: 10.12.2012.

FDI inflows during the latest financial years 2013-14 stand at US $18,934 million and FDI equity flows at US $ 12,603. Thus major part (66.56 %) of FDI flow is of soft nature/aspect and can be easily moved out.

B. FDI INFLOWS DURING FINANCIAL YEAR 2013-14 (from April, 2013 to October, 2013):

1.	**TOTAL FDI INFLOWS INTO INDIA** (Equity inflows + 'Re-invested earnings' + 'Other capital') (as per RBI's Monthly bulletin dated: 10.12.2013).	-	**US$ 18,934 million**
2.	**FDI EQUITY INFLOWS**	Rs. 74,971 crore	**US$ 12,603 million**

The FDI inflow has declined by 15% over the last year. And last year it declined by 7% over its previous year. Thus in spite of all the measures FDI inflow is not growing.

Countries which contributed most to Equity FDI inflows over the period 2012-13 and till October, 2013 is Mauritius with 37% share followed by Singapore 11%. UK, Japan, USA accounted for 9, 7and 6 percents respectively. Other countries which contributed FDI inflows were Netherland, Cyprus, Germany, France and UAE with 4, 3, 2,and 1 percents respectively See Table below:

D. **SHARE OF TOP INVESTING COUNTRIES FDI EQUITY INFLOWS *(Financial years):***

Amount Rupees in crores (US$ in million)

Ranks	Country	2011-12 (April - March)	2012-13 (April – March)	2013-14 (April- October, 2013)	Cumulative Inflows (April '00 - October '13)	%age to total Inflows (in terms of US $)
1.	MAURITIUS	46,710 **(9,942)**	51,654 **(9,497)**	18,453 **(3,099)**	359,578 **(76,765)**	**37 %**
2.	SINGAPORE	24,712 **(5,257)**	12,594 **(2,308)**	16,462 **(2,865)**	106,644 **(22,325)**	**11 %**
3.	U.K.	36,428 **(7,874)**	5,797 **(1,080)**	12,016 **(1,893)**	92,475 **(19,442)**	**9 %**
4.	JAPAN	14,089 **(2,972)**	12,243 **(2,237)**	2,756 **(460)**	72,851 **(15,011)**	**7 %**
5.	U.S.A.	5,347 **(1,115)**	3,033 **(557)**	3,125 **(535)**	54,048 **(11,656)**	**6 %**
6.	NETHERLANDS	6,698 **(1,409)**	10,054 **(1,856)**	6,536 **(1,085)**	48,914 **(10,050)**	**5 %**
7.	CYPRUS	7,722 **(1,587)**	2,658 **(490)**	1,922 **(317)**	34,250 **(7,207)**	**4 %**
8.	GERMANY	7,452 **(1,622)**	4,684 **(860)**	3,458 **(614)**	28,971 **(6,094)**	**3 %**
9	FRANCE	3,110 **(663)**	3,487 **(646)**	1,021 **(173)**	17,885 **(3,746)**	**2 %**
10.	U.A.E.	1,728 **(353)**	987 **(180)**	1,184 **(194)**	12,491 **(2,616)**	**1 %**
TOTAL FDI INFLOWS FROM ALL COUNTRIES *		**165,146 (35,121)**	**121,907 (22,423)**	**74,971 (12,603)**	**971,883 (206,006)**	-

**Includes inflows under NRI Schemes of RBI.*

Note: (i) Cumulative country-wise FDI equity inflows (from April, 2000 to October, 2013) are at – Annex-'A'.

(ii) %age worked out in US$ terms & FDI inflows received through FIPB/SIA+ RBI's Automatic Route + acquisition of existing shares only.

6.4 *Sector-wise FDI Equity Inflows*

The Sector wise FDI equity inflows show that it is service sector which has attracted the highest FDI equity inflows. Within Service sector, it is financial services, banking, insurance, Non-banking Finances, outsourcing etc. has attracted highest equity inflows. This sector accounted for 19% of total equity inflows. This, in our view, is most safe & secured sector with assured rate of return. This has higher possibility of volatility as there can be flight capital affecting value of local currency and domestic market international trade. It contribution to domestic economy in terms industry, infrastructure, manufacturing and technology is minimal. Besides it is in stake form where financial decision namely landing etc can be influence; it can be more tilted towards multinational establishments. The second important sector is construction. It accounted for 11 percent. This is followed by Tele Communications, Computer Software and hardware, Drugs and pharmaceuticals each accounting for 6% each of the total equity FDI inflows. Chemical other than fertilizers accounted for 5% and Automobile, Power and metallurgical each accounted of 4% each. The hotel and tourism industry accounted for 3 percent of total equity FDI. Please table below:

6.5 *Input–Output Matrix*

An input output matrix of investment in these sectors and contribution to domestic economy in terms of industrial, manufacturing and agriculture equipment and implement, power generation equipment and implement would surely show that its impact has been minimal. The avowed objective of FDI need to promote exports and generate high rate of growth in key economic sectors and finally leading to removal of poverty through market forces, is therefore, seriously debatable. Before we enter into this debate, let us see the impact/status of export, import and balance of trade and current account position after the liberalization.

F. SECTORS ATTRACTING HIGHEST FDI EQUITY INFLOWS:

Amount in Rs. crores (US$ in million)

Ranks	Sector	2011-12 (April - March)	2012-13 (April-March)	2013-14 (April-October, 2013)	Cumulative Inflows (April '00-October'13)	% age to total Inflows (In terms of US$)
1.	SERVICES SECTOR **	24,656 **(5,216)**	26,306 **(4,833)**	7,920 **(1,360)**	180,195 **(38,595)**	19 %
2.	CONSTRUCTION DEVELOPMENT: TOWNSHIPS, HOUSING, BUILT-UP INFRASTRUCTURE	15,236 **(3,141)**	7,248 **(1,332)**	4,244 **(699)**	105,293 **(22,779)**	11 %
3.	TELECOMMUNICATIONS (radio paging, cellular mobile, basic telephone services)	9,012 **(1,997)**	1,654 **(304)**	197 **(33)**	58,929 **(12,889)**	6 %
4.	COMPUTER SOFTWARE & HARDWARE	3,804 **(796)**	2,656 **(486)**	2,935 **(488)**	55,709 **(12,179)**	6 %
5.	DRUGS & PHARMACEUTICALS	14,605 **(3,232)**	6,011 **(1,123)**	5,956 **(1,082)**	54,836 **(11,400)**	6 %
6.	CHEMICALS (OTHER THAN FERTILIZERS)	18,422 **(4,041)**	1,596 **(292)**	2,560 **(433)**	43,056 **(9,314)**	5 %
7.	AUTOMOBILE INDUSTRY	4,347 **(923)**	8,384 **(1,537)**	4,495 **(784)**	43,665 **(9,079)**	4 %
8.	POWER	7,678 **(1,652)**	2,923 **(536)**	1,890 **(320)**	38,027 **(8,155)**	4 %
9.	METALLURGICAL INDUSTRIES	8,348 **(1,786)**	7,878 **(1,466)**	1,438 **(245)**	36,252 **(7,752)**	4 %
10	HOTEL & TOURISM	4,754 **(993)**	17,777 **(3,259)**	983 **(169)**	34,243 **(6,800)**	3 %

*Note: (i)** Services sector includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis*
(ii) Cumulative Sector- wise FDI equity inflows (from April, 2000 to October, 2013) are at - Annex-'B'.
(iii) FDI Sectoral data has been revalidated / reconciled in line with the RBI, which reflects minor changes in the FDI figures (increase/decrease) as compared to the earlier published sectoral data.

7. Impact of FDI Policy

It takes time for a policy to record its impact in practice. Though policy changes started in late 20th and early 21st century, its impact could be seen from the following table:

Since the 2007-08 India is having trade deficit continosly. So is current account balance rising from US $ (million) 15.73 to 38.97. Between these years it reached to 78.15 US $(Million) in 2011. This has lead to weakening of exchange value of Indian Rupee. This situation makes us to conclude that FDI policy during the third Phase, besides being adopted under desperation to seek foreign investment, has ben based on poor economic intellegence. It is based on generic and faith ordained approach of liberalziation. In our view it has caused greater market distortions and adversly afftected the growth and development of Indian economy. This kind of FDI policy, particularly allowing it single, multi brand retail and in defence production coupled with market access for non-agriculture products is likely to futher disrupt economy and seriously affect the domestic production in formal and non-formal manufacturing sectors and it would lead to greater unemployment of domestic resources and people in India. These inferences are valid for similarly placed economies and those following similar policy prescription with regard to FDI and liberalziation.

Table 6.2 : Balance of Payments : Summary (US$ million)

Sl. No.	Item	2007-08	2008-09	2009-10	2010-11[PR]	2011-12[P]	2011-12 H1 (April-Sept. 2011)[PR]	2012-13 H1 (April-Sept. 2012)[P]
1	2	3	4	5	6	7	8	9
I	**Current Account**							
1	Exports	166,162	189,001	182,442	256,159	309,774	158,202	146,549
2	Imports	257,629	308,520	300,644	383,481	499,533	247,739	237,221
3	Trade Balance	-91,467	-119,519	-118,203	-127,322	-189,759	-89,537	-90,672
4	Invisibles (net)	75,731	91,604	80,022	79,269	111,604	53,103	51,699
	A Non-factor Services	38,853	53,916	36,016	44,081	64,098	30,409	29,572
	B Income	-5,068	-7,110	-8,038	-17,952	-15,988	-7,587	-10,510
	C Transfers	41,945	44,798	52,045	53,140	63,494	30,281	32,637
5	Goods and Services Balance	-52,614	-65,603	-82,187	-83,241	-125,661	-59,128	-61,100
6	Current Account Balance	-15,737	-27,914	-38,181	-48,053	-78,155	-36,433	-38,973
II	**Capital Account**							
	Capital Account Balance	106,585	7,395	51,634	63,740	67,755	43,490	39,989
	i. External Assistance (net)	2,114	2,439	2,890	4,941	2,296	640	15
	ii. External Commercial Borrowings (net)	22,609	7,861	2,000	12,160	10,344	8,388	1,726
	iii. Short-term debt	15,930	-1,985	7,558	12,034	6,668	5,940	9,511
	iv Banking Capital (net)] of which:	11,759	-3,245	2,083	4,962	16,226	19,714	14,899
	Non-Resident Deposits (net)	179	4,290	2,922	3,238	11,918	3,937	9,397
	v Foreign Investment (net) of which:	43,326	8,342	50,362	42,127	39,231	17,087	18,608
	A FDI (net)	15,893	22,372	17,966	11,834	22,061	15,741	12,812
	B Portfolio (net)	27,433	-14,030	32,396	30,293	17,170	1,346	5,796
	vi Other Flows (net)	10,847	-6,016	-13,259	-12,484	-7,008	-8,278	-4,769
III	**Errors and Omission**	1,316	440	-12	-2,636	-2,432	-1,338	-653
IV	**Overall Balance**	92,164	-20,080	13,441	13,050	-12,831	5,719	363
V	**Reserves change [increase (-) / decrease (+)]**	**-92,164**	**20,080**	**-13,441**	**-13,050**	**12,831**	**-5,719**	**-363**

Source : RBI. PR : Partially Revised. P : Preliminary.

7.1 FDI Policy and Its Impact - Trade Surplus Asian Economies – South Korea and China

Let us also examine where FDI policy has significantly contributed to domestic economy and export growth lead to favourable balance of trade.

7.1.1 China

FDI inflows in India are ofter campared with FDI inflows in China FDI inflow in China are more than three time that of India. FDI policy in China has passed through three stages. First was cautious approach with clear focus on seeking techonology and industrial production though Special Economic Zone. Second stage incentivising the FDI for selctive sectors in manufacturing through joint ventures mostly foucs on manufacturing industry. In the third stage promoting FDI through domestic Industrial development objectives. To quote:

- "Encouragement to FDI has been an integral part of the China's economic reform process. It has gradually opened up its economy for foreign businesses and has attracted large amount of direct foreign investment.
- Government policies were characterised by setting new regulations to permit joint ventures using foreign capital and setting up Special Economic Zones (SEZs) and Open Cities.The concept of SEZs was extended to fourteen more coastal cities in 1984.Favorable regulations and provisions were used to encourage FDI inflow, especially export-oriented joint ventures and joint ventures using advanced technologies in 1986.
- Foreign joint ventures were provided with preferential tax treatment, the freedom to import inputs such as materials and equipment, the right to retain and swap foreign exchange with each other, and simpler licensing procedures in 1986. Additional tax benefits were offered to export-oriented joint ventures and those employing advanced technology.
- Priority was given to FDI in the agriculture, energy, transportation, telecommunications, basic raw materials, and high-technology industries, and FDI projects which could take advantage of the rich natural resources and relatively low labour costs in the central and northwest regions.
- China's policies toward FDI have experienced roughly three stages: gradual and limited opening, active promoting through preferential treatment, and promoting FDI in accordance with domestic industrial objectives. These changes in policy priorities inevitably affected the pattern of FDI inflows in China."

7.1.2 South Korea

South Korea followed different approach in attracting foreign investment. It went for developing technology through reverse engineering with loan funds from foreign investors. Through this process they could build international brands like Samsung, Hundai and LG. The approach loan funding helped them carry out their own decisions in the interest of Korean economy.

When I had opportunity visit Korea in late seventies and late mid eighties, I had observed clear thrust on development of National industrial sector particularly Pohang Steel Plant, and Hundai shipyard manufacturing facilities. There was short of national fervor for development. There was expansion of education by operating instutions for more than two shifts and allowed limited number of teachers to help the expansion by offering them almost double pay for working second or third shifts.

However, During Asian financial crisis Korea had to change its policy to suit the IMF conditions it set up certain institutions for promotion of FDI and providing tax incentives for manufacturing units. In general approach has been seeking FDI in the sector needed for busting domestic economy and exports. To Quote:

- "The Korean government maintained distinctive foreign investment policies giving preference to loans over direct investment to supplement its low level of domestic savings during the early stage of industrialisation. Korea's heavy reliance on foreign borrowing to finance its investment requirements is in sharp contrast to other countries.
- The Korean Government had emphasised the need to enhance absorptive capacity as well as the indigenisation of foreign technology through **reverse engineering** at the outset of industrialisation while restricting both FDI and foreign licensing. This facilitated Korean firms to assimilate imported technology, which eventually led to emergence of global brands like Samsung, Hyundai, and LG.
- The Korean government pursued liberalised FDI policy regime in the aftermath of the Asian financial crisis in 1997-98 to fulfil the conditionality of the International Monetary Fund (IMF) in exchange for standby credit.
- Several new institutions came into being in Korea immediately after the crisis. Invest Korea is Korea's national investment promotion agency mandated to offer one-stop service as a means of attracting foreign direct investment, while the Office of the Investment Ombudsman was established to provide investment after-care services to foreign-invested companies in Korea. These are affiliated to the Korea Trade Investment Promotion Agency.

Korea enacted a new foreign investment promotion act in 1998 to provide foreign investors incentives which include tax exemptions and reductions, financial support for employment and training, cash grants for R&D projects, and exemptions or reductions of leasing costs for land for factory and business operations for a specified period”

7.1.3 Malaysia

Malaysia rather followed strict Foreign Investment Policy. It focused on regulation and directing it to manufacturing activities and regulating equity through export performance. To quote:

- “The Malaysian FDI regime is tightly regulated in that all foreign manufacturing activity must be licensed regardless of the nature of their business.
- Until 1998, foreign equity share limits were made conditional on performance and conditions set forth by the industrial policy of the time.
- In the past, the size of foreign equity share allowed for investment in the manufacturing sector hinged on the share of the products exported in order to support the country's export-oriented industrial policy.
- FDI projects that export at least 80 per cent of production or production involving advanced technology are promoted by the state and no equity conditions are imposed. Following the crisis in 1997-98, the restriction was abolished as the country was in need of FDI.”

The FDI policy followed by China, Korea and Malaysia was distinct from the FDI policy followed by India in terms of focus and concern for domestic industrial and manufacturing sector. These countries made FDI policy focus to clearly promote manufacturing and encouraging joint ventures and setting up industries oriented towards exports promotion. This helped these countries to acquire favorable balance of trade and stability of their domestic currency, owing to hard nature/aspect of FDI, it was not easy to exit. We wish to term this approach economic intelligent decision i.e., “based on economic intelligent decision making in the larger interest domestic economy as also long term interest of investors.” Investor in manufacturing would think several times before withdrawing the capital. Return on such investment may be relatively slow and less, but it will be for a long term owing to restricted market fluctuations.

8. FDI Theories/Research Studies

8.1 The Supply Side

In FDI research studies and theory formulation mainly looked into FDI from supply side of FDI. Business of host country attempted to seek higher rate of return (under neo-classical framework), taking advantage of knowledge, economies of scale, market expansion and control over business of receiving countries for strategic reasons and so on. A great deal of analysis of factors responsible for capital flow has been done by Hymer (1960) who worked on motivation of investor to exercise control of home country firm through direct investment on receiving country. He also studied several factors and stressed on market imperfections and structural failures. Dunning and Rugman (1985) argued on over emphasis on role of structural market failures while underlying the transaction cost side of market failure. Hymer's theory also did not explain the dynamic and location aspects of FDI flow. Caves(1971), Dunning Rugman, 1985, Horaguchi and Toyne (1990) further expanded the Hymer work by introducing internationalization theory of FDI flow. In the literature of supply side of FDI Wheeler and Mody (1992) identified ergodic and non-ergodic factors determining international FDI flow. Ergodic factors pertain to geographic location, labor cost, transport cost and market size and non-ergoci factors pertain to externalities resulting from investment through agglomeration and clustering in other words economies and control arising out of investment. Dunning further provided analysis of FDI flow based on location, ownership and internationalization (OLI) paradigm. Dunning eclectic theory highlighted the benefit emerging from access to spare capacity, economies of joint supply and greater market access, diversification of risk, technology and trademarks, firm size, distribution of inputs and markets, costs of labor, material and transport cost, government intervention and policies, commercial and legal infrastructures and so on. The work of Knickerbocker (1972) and Acocella (1992) added role of strategic motivation in FDI flow in the form M&A.

8.2 The Demand Side

The demand side studies, identifying the pull factors World Bank (1995), make sort of case for why host country should attract FDI. Similarly studies by Blomstrome and Kokko (1998), Markusan and Vanables (1999) spell out the gains from FDI in the form of competition and efficiency effect, effect of backward and forward linkages, technological effects, accumulation of knowledge capital, stable flow of funds and with no-debt servicing obligation attached, greater external market discipline on macroeconomic policy, broadening and national capital market and so on.

All these statements sounds good in theory, but in practice it does not answer problem often faced by receiving country owing to domestic market distortions, domestic production derangements and flight of capital resulting into financial market volatility, speculation effect owing to nature of FDI capital flow and sectors to which the FDI employed. Similarly UNCTC(1991) also spell seven policy instruments to attract FDI. These seven instruments mainly focus on convertibility of foreign exchange and remittance of earning, price control measures, performance requirement, sector specific limitations, incentives and rules and procedures that facilitate entry. The World Bank report (2010) on regulation of FDI highlights the obstacles arising out of: red tape, lengthy procedures and obsolete laws that create further barriers to FDI. Several empirical studies have also been conducted by employing econometric model of factors determining flow of FDI in emerging economies. There is a book on Flight of Capital highlighting breakout nations attracting FDI. This has in fact been proved wrong. As good number of them talk about sentiments and faith ordained liberalization without going into hard core economic issues pertaining to domestic economic growth and market disruption caused by FDI, if not employed selectively and effectively.

9. Conclusion

All supply side and demand side studies focus on promotion of FDI flow from the point of view of investors and again from the point of investors to smoothen the flow. None of the above studies, in a true sense, examined the role of FDI in receiving countries from macro-micro points of view as well as costs arising out of domestic market disruption, if the FDI is not selectively directed to enhance the capacity of domestic economy to produce and enhance employment. If it is not selectively employed, the economic and social cost may be enormous and the gain from export may be less. Finally it may result into problems of balance of payment and international debt owing to trade gap and decline in exchange value of domestic country's currency. India of 2014 is a case in sight. If FDI is applied selectively, it may add to national wealth, stable rate of return to foreign investors and over all development of domestic and world economy. But it is a wishful thinking, as there is always a conflict of visions and interests. Dominant economies do score over the developing economies in this conflict, if the leadership of the country does not exercise economic intelligence and they are guided by faith in liberalization, irrespective of gain or loss to domestic economy.

The high rate of equity FDI, the high proportion of investment in service sector, particularly banking and insurance and high rate of flow from tax heavens, without commensurate growth in agriculture, manufacturing, technology advancement and R&D, would hardly lead to global development and removal of poverty through market forces in liberalized world economy, as is being claimed by WTO in its preamble.

Present downturn of world economy and economies of developing countries can best be explained by economic decisions based on faith ordained liberalization than hard economic analysis.

It is further stated that in domestic economy, FDI has very little role in stimulating the growth and development, owing to small size of resources as compared to vast domestic economy, but has occupied disproportionate importance at the cost of diverting attention from key factors that cause growth and development, irrespective of availability of funds from outside. It has also disrupted manufacturing sector and confused the domestic entrepreneurs. The lure to get technology and know-how in modern sectors through FDI has in fact proved to be a mirage. No country, firm and individual will share and give technology which is needed by receiving country to enhance production capacity in core economic sectors; it will give technology to suit market access of their products. Therefore, new policy of FDI by India and for that matter by developing countries should focus on expansion of their production capacity, R&D and export growth through comparative advantage in world economy. Policy has to be based on hard core economic analysis. Countries should not allow external economic intervention unleashing the disruptive market forces, owing to faith in liberalization or under the pressure of WTO.

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