Extra Mileage In Foreign Investment in Resurging India

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Introduction

The impact of globalization on Indian economy is understood to be the support factor for the programmed growth and development taking place today. It will be further improving as and when necessary steps are taken to gain extra mileage as regards the level of foreign investment receipts is concerned. This is multi-dimensional in character and need of the hour in Indian Industry. The Government Policy, Bankers Attitude, Institutional Arrangement, Market Response, Productivity Rate, Absenteeism, Adaptability of Trade Unions and a host of other factors contribute to the existing conditions in foreign investments in India. This paper is an attempt on such conditions and relevant remedial measures for desired results.

1990s witnessed a tremendous increase in the mobility of international capital. Cross-country trends in capital flows reveal that private capital flows now dominate with official capital flows reduced to a trickle. Until the early 1990s, the main source of external financing across the developing world was official development assistance (ODA) provided by the governments of high-income countries. These assistance stimulated a keen interest in understanding the nature and economic effects of capital flows as well as the appropriate policy responses to safeguard against financial instability While the impact of 'aid' flows was relatively well researched and understood, the impact of private capital flows is still ambiguous and controversial. For e.g., the type of capital inflows, direct or portfolio investment appears to make a critical difference in impact.

Foreign direct investment is proven to have well-known positive effect through technology spillovers and stable investments tied to plant and equipment, but portfolio capital is associated more closely with volatility and its capacity to be triggered by both domestic as well as exogenous factors, making it extremely difficult to manage and control. Moreover, the impact of private capital flows varies vastly across countries, time, the stage of financial and economic development as well as economic policies, underlining the need for individual country studies to enable comparisons and stylized representations.

Capital flows affect a wide range of economic variables such as exchange rates, interest rates, foreign exchange reserves, domestic monetary conditions and the financial system. Some commonly observed effects of capital inflows that have been documented in recent studies.

- Exchange rate appreciation, stock market and real estate boom, reserve accumulation, monetary expansion as well as effects on production and consumption.

These issues are significant for India, which has witnessed a swing from official aid flows towards private capital flows in the early 1990s. Both the international trend towards private resource transfers and the changing profile of India's capital account merit a close examination of implications of this transition. This context motivates the aim of this paper. It attempts to highlight in the first chapter the impact of lpg in Indian economy in the second chapter liberalization of capital account is dealt .in the third chapter the need and significance is discussed- in the fourth chapter current trend in fii is discussed. And challenges Indian economy-future prospects of fii- role of govt-response by beneficiaries are discussed in the following chapters and finally the concluding discussion takes place.

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Impact of LPG on Indian Economy

The Government approved sweeping reforms in FDI with a first step towards partially opening retail markets to foreign investors. It will now allow 51 per cent FDI in single brand products in the retail sector. Besides retail, other sector are being opened:

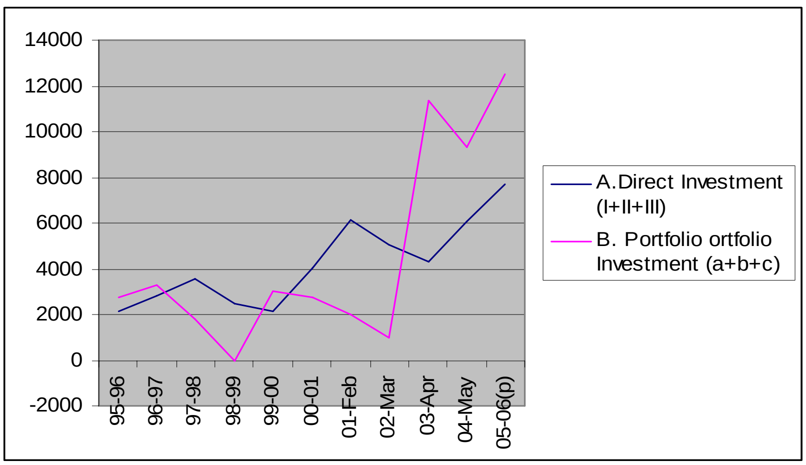
- 100 per cent allowed in new sectors such as power trading, processing and warehousing of coffee and rubber.
- FDI limit raised to 100 percent under automatic route in mining of diamonds and precious stones, development of new airports, cash and carry wholesale trading and export trading, laying of natural gas pipelines, petroleum infrastructure, captive mining of coal and lignite.
- Subject to other regulations, 100 percent FDI is allowed in distillation and brewing of potable alcohol, industrial explosives and hazardous chemicals.
- Indian investor allowed transferring shares in an existing company to foreign investors.
- Limit for telecom services firms raised to 74 per cent from 49 per cent
- Insurance (upto 26%); development of integrated townships (upto 100%); defense industry (upto 26%);tea plantation (upto 100% subject to divestment of 26% within five years to FDI); enhancement of FDI limits in private sector banking up to 74%, allowing FDI up to 100% under the automatic route for most manufacturing activities in SEZs; opening up B2B e-commerce; Internet Service Providers (ISPs) without Gateways; electronic mail and voice mail to 100% foreign investment subject to 26% divestment condition; etc. The Department has also strengthened investment facilitation measures through Foreign Investment Implementation Authority (FIIA).
- Non Resident Indian Scheme the general policy and facilities for foreign direct investment as available to foreign investors/ Companies are fully applicable to NRIs as well. In addition, Government has extended some concessions specially for NRIs and overseas corporate bodies having more than 60% stake by NRIs
- . Throwing Open Industries Reserved For The Public Sector to Private Participation. Now there are only three industries reserved for the public sector
- . Abolition of the (MRTP) Act, which necessitated prior approval for capacity expansion
- . The removal of quantitative restrictions on imports.
- . The reduction of the peak customs tariff from over 300 per cent prior to the 30 per cent rate that applies now.168 International Research Journal of Finance and Economics - Issue 5 (2006)
- . Severe restrictions on short-term debt and allowing external commercial borrowings based on external debt sustainability.
- . Wide-ranging financial sector reforms in the banking, capital markets, and insurance sectors, including the deregulation of interest rates, strong regulation and supervisory systems, and the introduction of foreign/private sector competition. Relevant data are given in table and graph in the following pages.

Liberalization of Capital Account Convertibility norms:

The committee on Capital Account Convertibility, with Dr.S.S.Tarapore as Chairman, submitted its Report in May 1997 The committee recommended three crucial preconditions viz., fiscal consolidation, a mandated inflation target and above all, strengthening of the financial system and also a reduction in Gross Fiscal Deficit / Gross Domestic Product ratio from 4.5 per cent to 3.5 per cent in 1999-2000 and a mandated rate of inflation for the period 1997-98 to 1999-2000 at an average of 3 to 5 per cent. The recommendations were to reduce gross NPAs of banks as a percentage of total advances from 13.7 per cent in 1996-97 to 9 per cent by 1998-99 and to 5 per cent by 1999-2000, and the average effective CRR from 9.3 as of April 1997 to 3 per cent by 1999-2000.

FOREIGN INVESTMENT FLOWS IN INDIA Source-Reserve Bank Bulletin,April-2006 US $ MILLION											
ITEMS	95-96	96-97	97-98	98-99	99-00	00-01	01-02	02-03	03-04	04-05	05-06(p)
1	2	3	4	5	6	7	8	9	10	11	12
A.Direct Investment (I+II+III)	2144	2821	3557	2462	2155	4029	6130	5035	4322	6051	7722
I. Equity (a+b+c+d+e)	2144	2821	3557	2462	2155	2400	4095	2764	2229	3778	5820
a. Government (SIA/FIPB)	1249	1922	2754	1821	1410	1456	2221	919	928	1062	1126
b. RBI	169	135	202	179	171	454	767	739	534	1258	2233
c. NRI	715	639	241	62	84	67	35	-	-	-	-
d. Acquisition of shares *	11	125	360	400	490	362	881	916	735	930	2181
e. Equity capital of unincorporated bodies #						61	191	190	32	528	280
II. Reinvested earnings $ ..						1350	1645	1833	1460	1094	1676
III. Other capital $$.						279	390	438	633	369	226
B. Portfolio ortfolio Investment (a+b+c)	2748	3312	1828	-61	3026	2760	2021	979	11377	9315	12492
a. GDRs/ADRs ##	683	1366	645	270	768	831	477	600	459	613	2552
b. FIIs**	2009	1926	979	-390	2135	1847	1505	377	10918	8686	0026
c. Offshore funds and others	56	20	204	59	123	82	39	2	-	16	14

Trend In International Investment



Challenges in Indian Economy:

There are, undoubtedly, many challenges for the Indian economy, but it is useful to focus on a few of these: the "usual suspects", the eyes of analysts that track the developments in the Indian economy.

- First, the poor state of the physical infrastructure, both in terms of quantity and quality is considered to be most critical hindrance for India's progress by many. The most important issue here is regulatory framework and overall investment climate, which are being addressed by the Government. Technological developments and rapid enhancement of domestic construction capabilities should aid the process of speedy and efficient implementation.
- Second, fiscal consolidation still remains a matter of concern, especially in the eyes of the rating agencies.
- Third, and perhaps the most challenging issue relates to development of agriculture. While over 60 per cent of the workforce is dependent on agriculture, the GDP growth

generated from agriculture is only marginally above the rate of growth of the population, which is not adequate to ensure rapid poverty reduction.

- Fourth, delivery of essential public services such as education and health to large parts of our population is a major institutional challenge.

Future Prospects of Foreign Institutional Investments:

Some of the areas for future prospects are listed here under:

- Sustaining the growth momentum and achieving an annual average growth of 9-10 % in the next five years.
- Simplifying procedures and relaxing entry barriers for business activities and Providing investor friendly laws and tax system.
- Checking the growth of population; India is the second highest populated country in the world after China. However in terms of density India exceeds China, as India's land area is almost half of China's total land. Due to a high population growth, GNI per capita remains very poor. It was only $ 2880 in 2003 (World Bank figures).
- Boosting agricultural growth through diversification and development of agro processing.
- Expanding industry fast, by at least 10% per year to integrate not only the surplus labour in agriculture but also the unprecedented number of women and teenagers joining the labour force every year.
- Developing world-class infrastructure for sustaining growth in all the sectors of the economy
- Allowing foreign investment in more areas.
- Effecting fiscal consolidation and eliminating the revenue deficit through revenue enhancement and expenditure management.
- Some regard globalization as the spread of western culture and influence at the expense of local culture. Protecting domestic culture is also a challenge.
- Global corporations are responsible for global warming, the depletion of natural resources, and the production of harmful chemicals and the destruction of organic agriculture.
- The government should reduce its budget deficit through proper pricing mechanisms and better direction of subsidies. It should develop infrastructure with what Finance Minister P Chidambaram International Research Journal of Finance and Economics - Issue 5 (2006) 171 of India called “ruthless efficiency” and reduce bureaucracy by streamlining government procedures to make them more transparent and effective.
- Empowering the population through universal education and health care, India must maximize the benefits of its youthful demographics and turn itself into the knowledge hub of the world through the application of information and communications technology (ICT) in all aspects of Indian life although, the government is committed to furthering economic reforms and developing basic infrastructure to improve lives of the rural poor and boost economic performance. Government had reduced its controls on foreign trade and investment in some areas and has indicated more liberalization in civil aviation, telecom and insurance sector in the future.

Conclusions

Narasimham Committee (1998) has recently given a road map for further reform of banking sector, and a number of recommendations on prudential norms have been announced in the latest policy statement on Monetary and Credit Policy. Fiscal adjustment has been undertaken and a very significant measure is that the system of automatic monetization of the fiscal deficit has been replaced by a system of Ways and Means Advances. In brief, reform in the external sector was meshed with reform in other related sectors and within the external sector reform, capital flows were managed keeping in view the needs of efficiency and stability. There was a fairly smooth movement from an administered exchange rate system to a market-determined exchange rate. Reserve Bank attempts to ensure that volatility and speculative elements are curbed through both direct and indirect measures.

All the above meant to impress upon the position of 'Advantage India' as regards foreign investment is concerned in a resurging economy based on the pragmatic policy approach and concerted support extended by both the RBI and the Government of India.

Indeed, it is high time for further strengthening the channels and utilization of funds that flow from international agencies for the sole benefit of the Indian economy as a whole.

References

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