TOM JACOB "IMPACT OF FOREIGN INVESTMENT FLOWS ON INDIAN ECONOMY IN THE POST LIBERALISATION ERA." THESIS. RESEARCH DEPARTMENT OF COMMERCE ST THOMAS' COLLEGE (AUTONOMOUS), UNIVERSITY OF CALICUT, 2019.

7.2 Suggestions

This study has been proceeding on two broad propositions - which it could prove - that huge amount of foreign investment has reached in India and they produced deep impact on the Indian economy. But now at the end of the study when looking back through a different angle, it can be seen that the foreign investment in India is not so huge as it is projected and appeared. That is despite the apparently huge amount of foreign investment in India, they still form only an average 2 percent of the GDP of the country. Similarly despite the strong back-up of the foreign non debt capital, Indian economy was never in a position to achieve a two digit growth. These two facts not only point out the existence of a wide space for foreign investment in India and the need of its effective use but also throws light on the deficiencies of the policies regarding foreign investment in India especially liberalization which requires some modification and change of approach.

Broadly speaking, liberalization in the context of foreign investment in India must include two things - removal of restrictions and relaxation of policies on the one hand and creation of the conditions necessary for the arrival and effective use of foreign investment on the other. So far what India has been following the former. Now it is necessary for the country to shift her emphasize towards the latter. Just as an individual's liberty is no longer considered as mere absence of restrictions but also creation of the necessary conditions for the fullest development of one's personality, liberalization along with the removal of restrictions should give equal or more importance for the creation of conditions necessary for the arrival and retention of foreign investment in India as well as rectification its defects. Hence as part of this change of approach attention may be given to the following.

So far India has been trying to attract maximum quantity of foreign investment to the country ignoring its qualitative aspects. A foreign investment which is highly vulnerable to volatility and hence highly risky cannot be considered as good quality foreign investment. So also the foreign investment reached so far in India, as they are not from developed countries with solid base, cannot be considered as a good quality foreign investment.

In the India's foreign investment scenario especially in her FDI front, the great economic powers have only a guest role. Their combined contribution is only less than 10 percent. On the other hand the lion's share of FDI in India i.e., more than 60 percent is from Singapore and Mauritius, the two foreign investment dependent countries. Some technical reasons like prevalence of Double Taxation Avoidance Law helped Mauritius to come to the fore front of foreign investment in India. (It is not denying that investment from some companies, which includes some dummy companies also, from these countries are also from the economic powers). The above situation limits the scope of foreign investment in India in two ways. Firstly it limits the scope of the widely claimed benefit of foreign direct investment i.e., technology transfer and secondly make foreign investment in India highly risky and vulnerable to the volatility. That is if those countries which invested in Singapore and Mauritius discontinue their investment in these countries or if a serious outflows take place there it will become a chain action and quite naturally Singapore and Mauritius will withdraw their investments or at least discontinue their investment in India with immediate repercussions and far reaching consequences in India. Under these circumstances it is very necessary for India to attract foreign investment directly from the great economic powers.

The main reason for the arrival of the poor quality of foreign investment to India is the existence of an exaggerated bad image of India outside the country, especially among the great economic powers. It is an undeniable fact that India is still considered as a highly backward undeveloped country inhabited by illiterate, intolerant, uncivilized people with strong anti-foreign sentiments, immersed in large scale corruption, internal conflicts, poor law and order conditions etc. The exaggerated elements of these beliefs and misgivings should be removed through wide propaganda and the facts remaining in them should be eradicated at any cost. Along with this, awareness should be created among the foreign investors about the fundamental strength of the economy, the developments she achieved in all fields, the existence of wide market, skilled man power, vast natural resource, the availability of various schemes of incentives for foreign investment etc. For the realization of this purpose even commercial advertisements may be given as certain African countries do. A fact finding committee may also be appointed to collect first hand facts from foreign countries which repel them from India and erase the unsound bias existing among them about India. In short creation of an image building scheme should form an integral part of liberalization. Besides it should also include steps to remove the existing draw backs of foreign investment in India.

Above all at the micro level it is necessary to ensure the corporate governance of the companies and at the macro level to ensure the credibility of the data of the economy and data analysing institutions like central statistical institutions of the country. Similarly it is also necessary to ensure the strength and credibility of the democratic institutions of the country like the courts to inculcate the faith of the foreign investors in the county and its economy.

One of the negative drawbacks of foreign investment in India is the uneven development of the various sectors of the Indian economy. Attractions of certain sectors and unattractiveness of certain others, the existence of restrictions to invest in certain sectors etc. are the main causes for these sectorial imbalances. Hence while restricting foreign investment in certain sectors, government should take positive steps to encourage investment in the neglected and backward sectors by way of tax holidays, tax concessions etc. for the investments in these sectors.

As in the case of sectoral concentration of foreign investment, concentration of foreign investment in certain regions of the country like Mumbai, New Delhi causes regional imbalances leading to the neglect of some backward regions. Here also government may take some positive steps to encourage investments in backward and neglected regions through the already mentioned schemes like tax holidays, tax concessions etc. Moreover it is high time to discourage or even to ban further foreign investments in congested areas like Bombay, New Delhi etc. by levying extra taxes and the like for the investments in these areas. In short positive liberalization must involve positive discrimination of sectors and regions for foreign investment in India.

Again, so far foreign investment has been looked at as a means for economic growth of the country. There should be a change in this approach. Instead, economic growth should also be used as a means for attracting foreign investment and retaining it in India in order to control the volatility of foreign investment to a certain extent. Foreign investment policy in India is based on a false belief that liberalization will be sufficient to attract foreign investment to the country. But the study revealed that it is not liberalization but economic growth in the case of FDI and in the case of FPI economic growth and stock return, are the determining factors for foreign investment in India. Hence in the foreign investment agenda top priority should be given for economic growth especially improvement in the IIP. Therefore the policy makers should consider enhancing the index of industrial production, the measuring rod of economic growth, by offering incentives and attractive benefits for the lagging industries in the economy because IIP being the indicator of the strength of the fundamentals of the economy has a magnetic power to attract foreign investments to the country.

It is a universal truth that foreign investment brings volatility - the uncertainties of foreign investment to the host economies. Though not in a big scale foreign investment in India also especially FPI exhibited volatility. Therefore all attempts in the direction of foreign investment must have built in safety valves to contain the risk of foreign investments especially volatility. Foreign investment in the capital market has now become the dictatorship of the FIIs. This dominance of the FIIs in the capital market is one of the main reasons for the capital market volatility in India. Because of their organizational strength, huge fund and power at their disposal the FIIs now direct the movements of the capital market as they desire through techniques like hedging.

Again, the extreme dependence of the FIIs on proxies leads to some sort of absentee investorship system and the denial of certain expected benefits of foreign institutional investment emerging from their superior knowhow related to the capital market. There are several occasions like those scandals related to Harshad Metha, Saytham Computers etc when the FIIs were are also emotionally and imprudently carried over just like the domestic investors. The only solution to these is to minimize the influences of FIIs in the capital market. It may be possible by encouraging and permitting foreign individual investors directly to invest in the Indian capital market. That is the dictatorship of the FIIs can be checked to a very great extent by further encouraging and liberalizing the entry of foreign individual investors, who are less organized and less powerful when compared to the FIIs, in the Indian capital market. Since the investment behavior of foreign individual investors will be entirely different from that of the FIIs it will become a check and balance of the investment behavior of the FIIs. Besides, stringent legislations are also necessary to control the FIIs along with the routine measures like lock in period, fixing of limits for the purchase of shares by the FIIs etc.

This study on the impact of foreign investment in India will remain incomplete unless an attempt is made to answer whether FDI or FPI has made more positive impact to the Indian economy and hence more suitable and to be encouraged in India. Generally speaking the two have distinct features, advantages and disadvantages and hence both are quite different in each other. Similarly their individual contributions to the positive impact of foreign investment in India are also indistinguishable and unidentifiable. For example it is seen that both came to India mainly attracted by her economic growth; both played almost equal contributions to the capital account and thereby played almost equal role in maintaining a fovourable balance of payments : both in the long run contributed significantly to the forex reserves, exchange rate and economic growth and both exhibited negative impact on economy by way of inflation. It is only with regard to volatility that both exhibited a clear distinction i.e., FPI is found more volatile. Therefore for the proper development of the country simultaneous operation of both is recommended. However a little more emphasize may be given for foreign portfolio investment (FPI) not because of its superior role over foreign direct investment (FDI) in impacting the Indian economy but because of certain characteristics of FDI are not suitable for the country. Though the permanent nature of FDI is a positive side of the FDI it necessitates the existence of foreign investment in the country for a long period whether we like or not. Long period of the foreign investment in the country in effect is long period of foreign presence in the country. People who have bitter experience of foreign rule may find it difficult to digest this. In this sense FDI may adversely affect the morale of the people and even their patriotism to a certain extent. Another widely claimed advantage of FDI is that it will help the transfer of technology to the country. This merit exists only in theory. It may not be wise to think that a foreign company will transfer technology to India just because it is permitted to invest in India. If they are willing to transfer their technology, during the present stage of the developed communication system, it is easy for us to absorb them even directly from foreign countries. Again opening of our economy to foreign investors like the multinationals gives an opportunity for the politicians for continuous agitations which will adversely affect future flows of foreign investment to India and even result in the deterioration of the relations with our benefactor countries. These problems when combined with the generally agreed demerits of FDI - drain of the national wealth, unhealthy competitions and destruction of native industries, loss of employment etc. - make it comparatively an unsuitable form of foreign investment in India.

It is not denying that foreign portfolio investment has no demerits. Of course it has serious draw backs like volatility but one need not fear that foreign investors will remain volatile always for no reasons. If the country can achieve strength in the fundamentals of the economy, especially economic growth and good return, foreign investors will cling to the economy. Moreover what the developing countries like India needs is not merely non debt capital but also liquid non debt capital. Foreign investment made in the capital market is more liquid than the investment made under FDI. Some of the already mentioned findings of the study like those related to foreign exchange reserves, exchange rate stability etc also argue for FPI in contrast to FDI.

The above preference advocated in favour of FPI is in no way a criticism of the more or less equal importance being given in India to both FDI and FPI or a recommendation of the reversal or discontinuance of the policy related to FDI in India. What is advocated here is only a little preference for FPI which should not be at the expense of the FDI.

7.3 Conclusion

By way of conclusion it is possible to say that foreign investment so far has not make any damaging impact on Indian economy. Instead it positively impacted the economy in manifold ways - from solving the balance of payments problem, increasing foreign exchange reserves, strengthening the exchange rate, reducing the debt service ratio and directly and indirectly boosting the economic growth. Foreign investment in the Indian capital market also achieved the target - it helped to increase the stock price, to develop and modernise the capital market and thereby facilitated wealth creation, domestic saving etc. and all these were achieved without seriously operating its much dreaded feature - volatility. Thus except in the case of inflation and volatility foreign investment showed positive and significant impacts on the Indian economy. Therefore it is concluded that foreign investment has a positive impact on the Indian economy.

However neither the main finding of the study - positive impact of the foreign investment of the Indian economy - nor the suggestions made here for its betterment are in no way a glorification or a recommendation of its permanency in India. One should not be tempted to reach eternal conclusion regarding foreign investment in India. He or she should bear in mind that the credit for the wonderful performance of foreign investment in India is not exclusively the credit of foreign investment alone. On the other hand they belong to the favourable conditions which have been existing in India during the days of foreign investment in the post liberalization period. Throughout the period under study, inflation has been moderate - never been two digit and inflation causing factors are almost dormant - the oil price was in a declining trend (except very recently), the country received moderate rain fall throughout the period, the country was free from internal and external conflicts and above all we have great economists at the helm of affairs who were always been keen to keep inflation under control mainly with the interest rate as a weapon ignoring the clamour for interest rate cut by the public. But tomorrow if troubles shoot up in a cluster in Indian economy by way of or as a result of inflation, exchange rate rise etc. either because of unprecedented crude oil price or because of a severe drought or flood or internal or external conflict or the occupancy of some populist economists at the helm of affairs, foreign investment will become a foe to the economy and will make a series of damaging impacts on the economy starting from intensification of inflation and volatility.

Therefore it may be concluded that by far the impact of foreign investment on the India economy is positive but such generalization and prediction about foreign investment in India is possible only on the condition which precede all laws in economics - other things remain the same - that is if exchange rate and economic growth are stable, inflation is under control etc. It is also important to point that the positive impacts of foreign investment on Indian economy can last long only if similar or strenuous efforts are made to retain the foreign investment reached India than to attract them to India. If so foreign investment will be an asset and very beneficial for the Indian economy. Otherwise it will not only be adverse but will be detrimental for her economy. Therefore it is also imperative for the country to tame foreign investment through rigorous and continuous restrictive policies, bearing in mind that foreign investment is like the transplantation of an alien body in a human body. Just as a human body must be prepared in advance to accept a foreign body, India must regularly prepare her economy to accept foreign investment and just as a human body which received a foreign body requires continuous monitoring, so also once foreign investment began to function in Indian economy it must be continuously monitored. Because in an economy ridden with high inflation, high interest rate, high exchange rate volatility etc. foreign investment will be highly inflammable as it will add fuel to the existing inflationary conditions and even ruin the host economies like that of India. Thus foreign investment contains seeds of destruction as well as seeds of construction. In an inflation driven economy the seed of destruction will grow fast and annihilate the whole economy. On the contrary in an economy with minor inflation its seeds of construction will take roots and bear abundant fruits.

All these imply that foreign investment is a not blank cheque received by the Indian economy and hence it should not be allowed to ride through the Indian economy unbridled. Moreover it contains a warning as well as a reminder that extreme dependence on foreign investment will be another gamble for Indian economy. Because like monsoon we are uncertain about its arrival, the quantity and longevity of its shower on the horizon of the Indian economy as foreign investment need not to abide by our dictates. Similarly though we are aware of the volatility of foreign investment which is usually associated with the outflow of foreign investment, we are not aware of another face of foreign investment, perhaps a more ugly and dangerous one i.e., volatility related to inflow of foreign investment. As long as the compelling force - sovereign power - is inoperative behind foreign investment, neither India nor any other country can shape their economy anticipating foreign investment. Therefore we must learn to grow ourselves, produce in India itself (make in India) the maximum, export the maximum and import the minimum, control inflation etc. anticipating the likely days when the foreign investment flows change their direction or the sources of foreign investment become dry.

The legitimacy and worldwide acceptance and growth of foreign investment owe to the idea of globalization and the expectancy of the birth of a global village which still remains a mirage. As long as the grip of nationalism and sovereignty of nations remain strong, one must be sceptic about foreign investment because in a world scenario where mutual rivalries between nations and power blocs as an economic blockade. It is likely to become a political weapon to be used as a form of economic sanction to canvas other countries to the power blocs or to destroy the enemies. It is true that all types of foreign investments are not investments directly made by a county in another country. Yet the relation between the countries has a crucial role in foreign investment flows between those countries. In other words foreign investment is an extension of the political relations between the nations. One day if the relation between the two nations deteriorate an outflow of foreign investment will definitely take place. India's bitter experience followed by the Pokhran nuclear explosion is a living testimony. The Pokhran nuclear explosion irritated the US and it initiated economic sanction against India which was followed by huge outflows of foreign investments especially investments from the capital market. The recent deterioration of the relation between USA and China and the consequent sharp fall in China's foreign investments from the USA further testifies this. In this way foreign investment forces India to maintain good relations, whether it likes or dislikes, with the investing countries here not only to attract further foreign investments from them but also to retain the investments she has already received from them. In this respect way foreign investment is a limitation on India and its sovereignty. All these again point out to the fact that India must be vigilant and cautious about the likelihood disappearance of the greeneries of her economy created by the foreign investment as future alone can prove whether these are bubbles or pebbles.

This study is winding up incidentally at a time when the fear of a global trade war is looming large and threatening to swallow the trade dispositions of the world. For this very reason it is not possible to conclude this study by signalling a bright future for foreign investment not only in India but else where. It is doubtful whether the ardent advocates of foreign investment are now so optimistic and enthusiastic about it as they had been a few years back. The world trade war, in the unfortunate event of its occurrence, will not be fought only with tariff but with all forms of weapons and among them foreign investment will definitely be a fierce weapon, perhaps more destructive in nature than the tariff weapon. It will become not only a weapon but also a victim of the war because world trade war will develop into a world economic recession which will witness massive foreign investment withdrawal shuffling the economies of the foreign investment linked countries like India. In short the present world scenario pauses certain ominous question marks on the future of the foreign investment everywhere as it does on the future of the global economic order.

7.4 Scope for Further Research

Foreign investment in India especially since globalization is an ever-growing and expanding phenomenon with far reaching implications and impacts. This fact essentially demands and necessitates new and wider research in this area. It is presumed that some of the limitations of this study, especially those in the nature of serious omissions may open up new avenues for research. For example as pointed out above a study of the impact of foreign investment on Indian economy employing comparative method offers wide scope for further research. That is studies related to the impact of foreign investment on Indian economy may be made by making the following comparisons:-

a.) comparison between the impact of foreign investment on pre liberalization and post liberalization Indian economy,

b.) comparison between the impact of foreign investment on Indian economy and on another developing country's economy,

c.) comparison between developing countries which receive and which do not receive foreign investment,

d.) comparison between the impacts of foreign investment on different sectors of the Indian economy,

e.) comparison between the individual contribution and impact of FDI and FPI in the Indian economy etc.

Such comparisons may again pave the way for more research areas and thereby enlarge the frontiers of the subject.