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FDI inflows in India: Major impediments

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ABSTRACT

All over the world, FDI is seen as an important source of non-debt inflows, and is increasingly being sought as a vehicle for technology flows, and as a means of building inter-firm linkages in a world in which multinational corporations are primarily operating on the basis of a network of global interconnections. In the current global scenario, it is possible for India to achieve very dynamic growth based upon labor intensive manufacturing that combines the vast supply of Indian labor, including skilled managerial and engineering labor, with foreign capital, technology, and markets. In this paper, an attempt is made to identify the issues and problems associated with India's current foreign direct investment regime, and more importantly the other associated factors responsible for India's unattractiveness as an investment location. Despite India offering a large domestic market, rule of law, low labor costs, and a well working democracy, her performance in attracting FDI flows has been far from satisfactory. A restrictive FDI regime, high import tariffs, exit barriers for firms, stringent labor laws, poor quality infrastructure, centralized decision-making processes, and a very limited scale of export processing zones make India an unattractive investment location.

Key Words : Economic policy reform, FDI, Foreign direct investment, India

India's economic policy reforms have played a crucial role in the performance of the Indian economy since 1991. Among other things, the reforms have involved opening the economy, making it more competitive, getting the government out of the huge morass of regulation, empowering the states to take more responsibility for economic management and thereby creating a kind of competition between the states for foreign investors.

In the backdrop of the East Asian crisis, growth did slow down a little bit, but India has kept growing and has avoided the worst of the crisis. From the narrow financial point of view two things that India did were quite helpful. One, it did keep some limit on the short-term capital inflows and did not go overboard in borrowing short term from abroad. This helped India to avoid the financial reversals of some of its neighbours. Second, it kept the rupee flexible and the depreciation of the rupee definitely helped keep the Indian economy more competitive and kept economic growth going.

It is significant to point out here that India went through a near disaster in 1991 that was, among others causes, based on short-term borrowing. Of course, at that time it was short-term borrowing from the non-resident Indians, (NRIs) but it was the same kind of phenomenon - lots of short-term capital had come in and lots had moved out and created a severe payments crisis. In terms of foreign investment, it is the direct investment that should be actively sought for and doors should be thrown wide open to foreign direct investment. FDI brings huge advantages (new capital, technology,

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