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Challenges in Indian Economy from FDI Perspective

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Abstract

The foreign direct investment (FDI) difficulties that the Indian economy faces are complicated and should be carefully considered. An outline of the main obstacles to the most effective possible introduction of FDI into India's economy is given in this abstract. The obstacles are many and multidimensional, ranging from complex legal frameworks and bureaucratic barriers to infrastructure scarcity and geopolitical uncertainty. Addressing these issues calls for a calculated strategy that includes targeted infrastructure development, enhanced administrative effectiveness, and policy reforms. Furthermore, intricate solutions are required for problems pertaining to labour regulations, cultural differences, and land acquisition. The Indian economy is resilient despite these obstacles, and taking proactive steps can turn them into chances for long-term, steady growth. A balanced and FDI-friendly climate can be created since the government works to improve regulations and expedite procedures, fostering economic growth and increased global competitiveness.

Keywords: FEMA, Economic Disparity, technology Transfer, Balance of payment

Introduction

India's favourable demographics and steady and clear economic trajectory have made it a popular target for foreign investments throughout the years. It is significant to remember that this increase in FDI was seen in spite of the limitations the Indian government placed on accepting FDI from nations that border India on land. Because it facilitates the development of long-term economic ties with India, government is working hard to create an enhanced business environment with the intention to attract more foreign Investment. FEMA and its regulations are the main sources of regulation for foreign investment in the country. On November 7 2017, Reserve bank of India with the intention of regulating foreign investment published, The Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations 2017 and they keep amending it from time to time. (FDI Policy).

FDI Overview

Foreign Direct Investment is known as FDI. This kind of investment involves a person or company in one nation purchasing the assets or stock of a company operating in another one. This calls for both a long-term stake and some level of control or influence over the overseas company. It provides access to new markets, managerial know-how, technology, and funding. In order to accelerate their economic development, nations frequently try to entice FDI through a variety of incentives and regulations. The host nation obtains access to finance, technology, job creation, and economic development, while the investing nation gains new market prospects and possible returns on investment. By putting in place measures that draw in foreign capital, like tax breaks, infrastructure development, and regulatory changes, governments and legislators play a critical role in fostering an environment that is favourable to FDI[1].

The DPIIT, together with other relevant agencies and ministries, is the primary regulator of FDI in India. The RBI, which has the authority to implement the NDI Rules, is the other major regulator. As of today, FDI in India is governed by FDI policy 2020 and FEMA (Non debt instrument) Rules, 2019.

The definition of an Indian company was expanded to include "a body corporate established or constituted by or under a central or state act, which is incorporated in India" by the DPIIT in Press Note No. 1 of 2022 Series, dated 14 March 2022, earlier this year. The aim of this modification was to present the "corporation" as an Indian organisation in order to facilitate foreign investment in the Life Insurance Corporation (LIC), which was founded as a "corporation" in accordance with the LIC Act, 1956. FDI in LIC is now allowed under the automatic method up to 20 percent as of April 2022[2].

Routes of FDI

Under the FEMA regime, both government approval route as well as automatic route are considered as a valid route of routes. Under the automatic method, up to 100% of FDI or any other limit that may be specified for a sector is allowed without taking any permission. Manufacturing, telephone service, and other financial services are among the industries covered by the 100% automatic route.

Contrary, under the government route, every investment has to be approved by the RBI or the government or both beforehand only. Mineral separation of minerals and ore including titanium, financial service industry (in the cases where it is not fully controlled by the financial service regulator) and the operation and development of satellites are among the industries that fall under the 100% government route. Moreover, investment related to the national security is also made via the government route[3].

Even though government has allowed 100 % FDI is many sectors and thus liberalised the investment policy, but still there are few sectors in which there is a threshold beyond which NRIs cannot invest. This has been done keeping the security and integrity of the nation in the mind. For example, in case of a private sector bank, it can only take foreign investment upto 49% without the approval of government. In case, it exceeds 49% they have to take permission from the government. In this case also, even with the permission of the government, investment cannot increase more than 74%.

1. Kohli, G. (2023) *Snapshot: Foreign investment law and policy in India, Lexology*. Available at: https://www.lexology.com/library/detail.aspx?g=dac69b5f-38bd-49b2-a7e0-c101cf5cdca2#:~:text=Foreign%20investment%20in%20India%20is,to%20foreign%20exchange%20in%20India. (Accessed: 28 December 2023).
2. Pandey, A. (2022) *Recent changes to India's FDI laws - inward/ foreign investment - india, Recent Changes To India's FDI Laws - Inward/ Foreign Investment - India*. Available at: https://www.mondaq.com/india/inward-foreign-investment/1186244/recent-changes-to-indias-fdi-laws (Accessed: 28 December 2023).
3. Anuj, *FDI regulation in India, Legal Service India - Law, Lawyers and Legal Resources*. Available at: https://www.legalserviceindia.com/legal/article-7883-fdi-regulation-in-india.html (Accessed: 28 December 2023).

Prohibited sectors

Apart from the sectors where FDI is permitted till certain extent through automatic approval route or where no permission is required at all. There is another segment in which FDIs are not allowed at all. Some of the Sector in which FDI is prohibited at all are business related to the farm house construction or in real estate business, betting in casinos and gambling, trading in transferable development rights, manufacturing of Tabacco and cigarettes, investment in nidhi companies, lottery business, investment in sectors which are not open for private investments e.g. Atomic energy etc.

Challenges in Indian Economy from FDI perspective

While Foreign Direct Investment (FDI) can bring numerous benefits to an economy, including capital inflows, technology transfer, and job creation, it can also present challenges for the receiving country. Here are some challenges faced by the Indian economy because of FDI:

1. **Dependency on Foreign Capital**- Reliance on foreign investors could arise if capital inflows are mostly provided via FDI. The availability of foreign money may be impacted by shifts in investor mood or fluctuations in the state of the world economy. In cases where India relies significantly on foreign direct investment (FDI), a decrease in FDI inflows globally may have an adverse effect on the country's capital availability for investment and economic expansion. A decrease in foreign direct investment inflows was observed in multiple nations, including India, amid the 2008 global financial crisis. Around 59 billion Indian Rupees would be invested in the petroleum and natural gas sectors even in 2022. Due to significant foreign direct investment in this industry, fluctuations or crises in the price of crude oil have a negative impact on the cost of petroleum and natural gas in India[4].

2. **Risk of Capital Flight**- Due to FDI's mobility, investors are able to remove their capital in reaction to shifts in governmental policy or economic downturns. This may result in capital flight, which would strain the currency stability and balance of payments of the host nation. This may put pressure on India's balance of payments and undermine the rupee's stability. The UK faced a similar problem during the Brexit-related conflict when some international investors moved their money out of the country out of concern for unstable economic conditions.

3. **Creation of Economic Disparity**- It's possible that the host nation does not receive the same share of the advantages of FDI. There's a chance that foreign direct investment (FDI) will disproportionately help some areas or sectors of the economy, widening the economic gap across the nation. For example, if the majority of foreign direct investment goes to urban areas, rural areas might not expand as quickly economically. Due to the majority of foreign direct investment going into the urban sector, many underutilised resources in the rural areas are being wasted. Similar circumstances have befallen China, where substantial regional economic disparities have resulted from the country's recent rapid growth

4. Gaggar, R. *India: Foreign Direct Investment Regulations*, *Global Competition Review*. Available at: https://globalcompetitionreview.com/guide/foreign-direct-investment-regulation-guide/second-edition/article/india#footnote-011 (Accessed: 29 December 2023).

in the economy, which has been centred in a few coastal districts. Although FDI helped to China's prosperity, it also made development more uneven[5].

4. **Threat to local businesses**- Growing international competition can be dangerous for local businesses, especially small and medium-sized ones (SMEs). Local firms may find it difficult to compete with the foreign company's extensive operations and purchasing power. Local retailers opposed Walmart's arrival into India because they were worried about how it would affect their business. Small local businesses' capacity to compete with the size and effectiveness of a multinational retail behemoth has drawn criticism. FDI may pose a serious danger to the government's agenda of increasing the production of goods, as well as the economy.

5. **Environment Concern**- FDI initiatives may give rise to environmental concerns, particularly in industries like manufacturing and mining. Degradation of the environment brought on by poorly managed FDI can have an impact on nearby ecosystems and communities. The UK-based mining company Vedanta Resources has come under fire for social and environmental problems arising from its mining activities in India. The company's actions, according to activists, had a negative impact on the environment and nearby populations. Locals and environmental activists opposed the company's operations in the Niyamgiri Hills, sparking legal disputes and public discussions.

6. **Labour market Impacts**- FDI has an impact on the labour market in the area. Even while it might lead to job opportunities, questions about the nature of the work, job security, and possible displacement of local people might surface. Even though a foreign manufacturing business in India employs a big number of people, it may pay relatively less and provide little job security. Due to subpar working conditions, Amazon and Uber are facing legal action and criticism in India. Foxconn, a significant international company based in Taiwan and a major supplier to Apple, had moral and legal difficulties over employment laws in China. The company's factories came under fire for having subpar working conditions, low pay, and worries about the welfare of the employees; this prompted more scrutiny and demands for change.

7. **Intellectual Property Concerns**- It might be difficult to ensure efficient knowledge transfer from international businesses to local organisations. Inadequate management of technology transfer and intellectual property transfer could prevent the host nation from properly utilising the expertise brought in by international companies. For instance. A foreign technology business sets up business in India, but since it is worried about intellectual property protection, it is reluctant to provide its Indian subsidiary access to its most recent innovations. This can reduce the host nation's capacity for innovation and knowledge transfer. Concerns have been expressed in the pharmaceutical sector regarding multinational pharmaceutical corporations' unwillingness to provide their subsidiaries in

5. [5] Rai, D.K. *FDI flows to India: Recent trends, challenges and way forward*, *Think Tank*. Available at: https://www.delhipolicygroup.org/publication/policy-briefs/fdi-flows-to-india-recent-trends-challenges-and-way-forward-2225.html (Accessed: 27 December 2023).

developing nations with the newest drug manufacturing technologies, which limits local production capacity[6].

Challenges for FDI in India and its impact on Economy: -

There are several challenges faced by the economy because of FDI, but the fact that a nation cannot survive without FDI cannot be neglected. Recently, there is a decline in the FDI in India which has a serious impact on the economy as well. In comparison to 2021-22, there is a decline of 16% in the FDI in India that has resulted in a loss of $13.5 billion[7]. Some of the challenges faced by FDI in India are:

1. **Infrastructure deficiency-** one of the challenges faced by investors are lack of infrastructure facilities especially in rural areas. That is also a reason for economic disparities which is faced by the nation. All though government is taking initiatives to improve the infrastructure facilities in the rural areas, still there is a long way to go.
2. **Complex Tax laws-** Another Challenge faced by investors in FDI in India is complex nature of tax regimes. The complex tax structure, including issues related to transfer pricing, can be a concern for foreign investors. Companies faces difficulties in tax compliance, leading to legal disputes and potential financial losses. Complex nature of tax regimes also sometimes gives the opportunity to find loopholes, as was seen in the case of Vodafone[8].
3. **Inefficiency of CCI-** A significant part of the investing operations is played by CCI. On the other hand, CCI has not been entirely effective in halting anti-competitive actions and preventing the misuse of dominant positions. It has a significant negative influence on the economy, as demonstrated by the Flipkart controversy, which prompted the US President to sign a Presidential Proclamation removing India off the list of developing nations eligible to receive preferential treatment under the US Generalised System of Preferences (GSP). According to the Proclamation, India's inability to "provide equitable and reasonable access to its markets" was the grounds for the termination”[9].

Way Forward: -

As was previously said, there are drawbacks to foreign direct investment (FDI) for the economy, yet FDI is still necessary. To address this issue, some possible actions include looking into insurance mechanisms to handle political risks and shield foreign investors from unforeseen circumstances, as well as increasing technology transfer programmes. Promote technology transfer agreements between domestic companies and foreign investors. This can improve domestic industries' technological prowess and fortify anti-corruption safeguards in FDI procedures. Enforcing anti-corruption legislation and putting in place strong

6. Khan, M.S. *FDI and Indian economy-: Issues, challenges and prospects in India*, *FDI AND INDIAN ECONOMY-: Issues, Challenges and Prospects in India*. Available at: https://journals.indexcopernicus.com/api/file/viewByFileId/627973.pdf (Accessed: 26 December 2023).
7. Bakshi, I. (2023) *India’s rise is the big story. so, where’s the FDI? The Indian Express*. Available at: https://indianexpress.com/article/opinion/columns/indias-rise-is-the-big-story-so-wheres-the-fdi-8965716/ (Accessed: 28 December 2023).
8. Abhirami, A.B. (2021) *Vodafone case analysis*, *TaxGuru*. Available at: https://taxguru.in/income-tax/vodafone-case-analysis.html (Accessed: 28 December 2023).
9. Nandakumar, A. (2019) *Anti-trust and e-commerce: Impact of the 2018 FDI policy review*, *IndiaCorpLaw*. Available at: https://indiacorplaw.in/2019/06/anti-trust-e-commerce-impact-2018-fdi-policy-review.html (Accessed: 26 December 2023).

anti-corruption measures will help create a transparent and equitable business climate and enable the implementation of skill development initiatives that meet the needs of FDI-attracting businesses. This guarantees that local labour can strategically select important areas for FDI promotion based on national development goals and economic priorities, and guarantee that local labour can contribute to foreign-invested projects in an efficient manner. Paying focus on industries that support sustainable growth, technological transfer, and job creation. To ensure that foreign investors engage in sustainable business practises, environmental restrictions should be strengthened and properly enforced. Regularly audit and evaluate how FDI projects affect the environment, and urge foreign investors to get involved in the community by solving social issues and recognising cultural sensitivities. Put corporate social responsibility (CSR) programmes into action to help your community. Provide procedures for routine assessments and audits of the effects of foreign direct investment on the economy. This involves evaluations of the transfer of technology, the creation of jobs, and compliance with regulations.

Conclusion:

In summary, the Indian economy greatly benefits from foreign direct investment (FDI), but FDI also comes with a number of drawbacks that call for careful thought and strategic management. These obstacles, which range from bureaucratic roadblocks and regulatory complexity to insufficient infrastructure and geopolitical unpredictability, highlight the necessity of a sophisticated strategy to promote a conducive investment climate. Policymakers must strive tirelessly to improve administrative effectiveness, simplify regulatory frameworks, and give investors a stable and predictable environment in order to meet these difficulties. The Indian economy is clearly resilient and appealing to international investors despite these obstacles. The government can foster an atmosphere that promotes long-term foreign direct investment inflows by enacting reforms and improving policies. To overcome these obstacles and promote a flourishing FDI landscape, the public and private sectors must work together strategically and continue to improve the ease of doing business. India can benefit from foreign direct investment (FDI) by managing the related challenges and gaining access to markets, technology, and skilled labour, in addition to financial inflows. By taking on these obstacles head-on, the Indian economy can maintain its standing as a desirable location for international capital, supporting long-term economic expansion and advancement.