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[Foreign Investment]

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INTRODUCTION

A Foreign investment policy is any government regulation or law that encourages or discourages foreign investment in the local economy, e.g. currency exchange limits. Foreign capital implies funds that are raised from foreign investors for investment purposes in development projects in a host country.

Foreign investment helps: -

1. To reduce shortage of domestic savings through the inflow of capital equipment and raw materials thereby raising the marginal rate of capital formation.
2. It overcomes not only capital deficiency but also technological backwardness.
3. It also helps in industrializing the economy.
4. It creates more employment.
5. It helps in minimizing the inflationary pressures by increasing supply of goods.

Foreign capital is advanced to the developing countries mainly after observing the opportunities and evaluating the credibility of the recipient country.

Foreign investment with special reference to developing countries

Foreign capital enters a country in the form of private capital and / or public capital.

Private foreign capital may take the form of

1. Direct investment
2. Indirect investment.

Direct Investment means that the concerns of the investing country exercise control over the assets created in the capital importing country by means of that investment.

It may take many forms:

• The formation in the capital importing country of a subsidiary of a company of the investing country,

• The formation of a concern in which a company of the investing country has a majority holding;

• The formation in the capital importing country of a company financed exclusively by the present concern situated in the investing country;

• Setting up a corporation in the investing country for the specific purpose of operating in the other concerns; or the creation of fixed assets in the other country by the nationals of the investing country.

Such companies or concerns are known as Transnational Corporations (TNCs) or Multinational Corporations (MNCs).

Indirect Investment better known as 'portfolio' or 'rentier' investment consists mainly of the holdings of transferable securities (issued or guaranteed by the government of the capital importing country), shares or debentures by the nationals of some other country. Such holdings do not amount to a right to control the company. The share3 holders are entitled to dividend only. In recent years, multilateral indirect investments have been evolved. The nationals of a country purchase the bonds of the World Bank floated for financing a particular project in some LDCS.

Public Foreign Capital may consist of:

1. 'Bilateral hard loans' i.e., giving of loans by the British Government in pounds sterling to the Indian Government;
2. 'Bilateral soft loans' i.e., sale of food grains and other farm products to India by the United States.
3. 'Multilateral loans' i.e., contributions to the Aid India Club, the Colombo Plan, etc., by the member countries. Under this category are also included loans made available by the various agencies of the United Nations like IBRD, IFC, IDA, SUNFED, UNDP, etc.
4. Inter-governmental grants.

Foreign capital refers to public foreign capital on hard and soft terms, in cash or kind, and intergovernmental grants.

In INDIA Foreign investment was introduced in 1991 under Foreign Exchange Management Act (FEMA), driven by then finance minister Manmohan Singh. India disallowed overseas corporate bodies (OCB) to invest in India and imposes cap on equity holding by foreign investors in various sectors, current FDI in aviation and insurance sectors is limited to a maximum of 49%.

In 2012 UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010–2012.The sectors that attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, US and UK were among the leading sources of FDI. Nine from 10 largest foreign companies investing in India (from April 2000- January 2011) are based in Mauritius. In 2015, India emerged as top FDI destination surpassing China and the US. India attracted FDI of $31 billion compared to $28 billion and $27 billions of China and the US respectively.

India received
$63 billion in FDI in 2015. India also allowed 100% FDI in many sectors on 2016.

MULTINATIONAL CORPORATIONS AND LDCs

A multinational corporation(MNC)is a company, firm, or enterprise with its headquarters in a developed country such a United States, Britain, Germany, Japan etc. and also operates in other countries, both developed and developing. They are spread not only in LDCS of Asia, Africa and Latin America, but also on the continents of Europe, Australia, New Zealand and South America. They are engaged in mining, tea, rubber, coffee and cocoa plantations, oil extraction and refining, manufacturing for home production and exports, etc. Their Operations also include such services as banking insurance, shipping, hotels and so on. MNCs dominate not only global investment but also international production, trade, finance and technology. Thus MNCS come in various shapes and sizes, perform distinctive functions differently and their individual impact on the environment.

MNCS are also known as:

- Transnational Corporations (TNCS),
- International company
- Global Corporations

Transnational corporations (TNCs) are incorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates. A parent enterprise is defined as an enterprise that controls assets of other entities in countries other than its home country, usually by owning a certain equity capital stake.
An international company is an organization that has business operations in several markets across the globe.

The company may have its headquarters in one central location, but it has subsidiary offices in each of the countries it operates in.
A global corporation is generally referred to as a multinational corporation (MNC). An MNC is a company that operates in two or more countries, leveraging the global environment to approach varying markets in attaining revenue generation.

MNCs from economic, organizational and motivational viewpoints.

The economic definition lays emphasis on the size, geographical spread and extent of foreign involvement of an MNC. According to this definition, a typical multinational company is one with net sales of 100 million dollars to several thousand million dollars having direct foreign investment in manufacturing usually accounting for at least 15 to 20 per cent of the company's total investment. Direct foreign investment means at least 25 per cent participation in the share capital of the foreign enterprise.
The organizational definition stresses on some organizational aspects of an MNC, besides the economic ones. In this respect a truly MNC is that which: -
(a) acts as an Organisation maximizing one overall objective for all its units,
(b) treats the whole world (or the parts open to it) as its operational area
(c) is able to coordinate all its functions in any way necessary for achieving (a) and (b).

The motivational definition highlights corporate philosophy and motivation in laying down criteria for multi-nationality. Thus, 'True' multi-nationality is generally indicated by a lack of nationalism, or a concern with the firm as a whole rather than with any of its constituent units or any country of its operation." On this basis, firms are distinguished between ethnocentric (home-oriented), polycentric (host-oriented) and geocentric (world-oriented), on the basis of attitudes revealed by their executives.

MNCs in general are very large firms with widespread operations which are clearly international in character and have more than five foreign subsidiaries or more than 15 per cent of total sales produced abroad, and acting in a cohesive manner to achieve maximum-profits or growth.

Features of Multinational Corporations (MNCs):

(i) Huge Assets and Turnover:

Because of operations on a global basis, MNCs have huge physical and financial assets. In fact, in terms of assets and turnover, many MNCs are bigger than national economies of several countries.

(ii) International Operations Through a Network of Branches:

MNCs have production and marketing operations in several countries; operating through a network of branches, subsidiaries and affiliates in host countries.

(iii) Unity of Control:

MNCs control business activities of their branches in foreign countries through head office located in the home country. Managements of branches operate within the policy framework of the parent corporation.

(iv) Mergers and Acquisitions:

MNCs are powerful economic entities. They keep on adding to their economic power through constant mergers and acquisitions of companies, in host countries.

(v) Advanced and Sophisticated Technology:

Generally, a MNC has at its command advanced and sophisticated technology. It employs capital intensive technology in manufacturing and marketing.

(vi) Professional Management:
A MNC employs professionally trained managers to handle huge funds, advanced technology and international business operations.
(vii)Aggressive Advertising and Marketing:
MNCs spend huge sums of money on advertising and marketing to secure international business. This is, perhaps, the biggest strategy of success of MNCs. Because of this strategy, they are able to sell whatever products/services, they produce/generate.
(viii) Better Quality of Products:
A MNC has to compete on the world level. It, therefore, has to pay special attention to the quality of its products.

Advantages of MNCs at a glance from the Viewpoint of Host Country:

1. Employment Generation
2. Automatic Inflow of Foreign Capital
3. Proper Use of Idle Resources
4. Improvement in Balance of Payment Position
5. Technical Development
6. Managerial Development
7. End of Local Monopolies
8. Improvement in Standard of Living
9. Promotion of international brotherhood and culture

Limitations of MNCs at a glance from the Viewpoint of Host Country:

1. Danger for domestic Industries.
2. Repatriation of profits (sending profits to home country).
3. No Benefit to poor people and Exploitation of the poor working class people.

4. Danger to Independence of the host country in the long run of the host country through political interference.
5. Disregard of the National Interests of the Host Country.
6. Exploitation of Natural Resources.
7. Selfish Promotion of Alien Culture.

Role of Public and Private Foreign capital in Economic Development

Public foreign capital is more important for accelerating economic development than private foreign capital. The financial needs of LDCs are so great that private foreign investment can only partially solve the problem of financing. For one thing, it has nothing to do with social expenditures in such spheres as education, public health, medical programmes, technical training and research, etc. Such schemes though indirectly contributing to economic efficiency and productivity of the economy in the long-run yield no direct returns, and could, therefore, be financed with the help of grants received from advanced countries. Further, private foreign investment presupposes the existence of basic public services in LDCS. But investment in them requires large sums and risks which private capital is unable to undertake. So investment in low-yielding and slow-yielding projects could be possible only on the basis of foreign capital. Therefore, much cannot be expected of private foreign investment.

The following arguments are advanced for foreign capital in LDCS:

1. To Supplement Domestic Savings.

LDCs are characterized as 'capital-poor or 'low-saving and lowinvesting economies. There is not only an extremely small capital stock but current rate of capital formation is also very low. On an average, gross investment is only 5 to 6 per cent of gross national income in these economies, whereas in advanced countries it is about 15 to 20 per cent. Such a low rate of savings is hardly enough to provide for a rapidly growing population at the rate of 2 to 2.5 per cent per annum, let alone invest in new capital projects. In fact, at the existing rate of savings, they can hardly cover depreciation of capital and even replace existing capital equipment. Efforts to mobilize domestic savings through taxation and public borrowings are barely sufficient to raise the current rate of capital formation via investment. Rather these measures lead to reduction in consumption standards, and unbearable hardships on the people. The importation of foreign capital helps reduces the shortage of domestic savings through the inflow of capital equipment and raw materials thereby raising the marginal rate of capital formation.

2. To Overcome Deficiency of Technological Backwardness.
Besides, low-saving and low-investment imply capital deficiency, and along with it, LDCS suffer from technological backwardness. Technological backwardness is reflected in high average cost of production and low productivity of labour and capital due to unskilled labour and obsolete capital equipment. Above all, it is reflected in high capital-output ratio. Foreign capital overcomes not only capital deficiency but also technological backwardness. It brings sufficient physical and financial capital along with technical know-how, skilled personnel, organizational experience, market information, advanced production techniques, innovations in products, etc. It also trains local labour in new skills. All this accelerates economic development.

3. To Overcome Deficiency of Overhead Capital.
LDCs woefully lack in economic overhead capital which directly facilitates more investment. The rails, roads, canals, and power projects provide the necessary infrastructure for development.

But since they require very large capital investment and have long gestation periods, such countries are unable to undertake them without foreign capital.

4. To Establish Basic and Key Industries.
Similarly, LDCs are not in a position to start basic and key industries by themselves. It is again through foreign capital that they can establish steel, machine tools, heavy electricals, and chemical plants, etc. Moreover, the use of foreign capital in one industry may encourage local enterprise by reducing costs in other industries which may lead to chain expansion of other related industries. Thus foreign capital helps in industrializing the economy.

5. To Exploit New Areas and Natural Resources.
Private enterprise in LDCs is reluctant to undertake risky ventures, like the exploitation of untapped natural resources and the exploitation of new areas. Foreign capital assumes all risks and losses that go with the pioneering stage. Thus it opens up inaccessible areas, taps new resources, and helps in augmenting the natural resources of the country, and removing regional imbalances.

6. To Obtain Social Benefits.
Creation of the country’s infrastructure, the establishment of new industries, the tapping of new resources, the opening of new areas, all tend to increase employment opportunity within the economy. In other words, the importation of capital creates more employment in the urban sector. This leads to the migration of surplus labour from the rural to the urban sector. The pressure of population on land is reduced and disguised unemployment may disappear. This is the social gain from capital.

7. To Raise the Standard of Living.
Foreign capital tends to raise the levels of national productivity, income and employment, which, in turn, lead to higher real wages for labour, lower prices for consumers and rise in their standard of living. When with the inflow of foreign capital, local labour becomes skilled, its marginal productivity is increased, thereby raising total real wages of labour. Secondly, when new industries are started by importing Superior know-how, management, machines and equipment, larger quantities of new and quality products are available to consumers at lower prices.

8. To Increase State Revenues.
When private foreign investors invest in various industries LDCS, they get profits and royalties. The government of the capital-receiving country levies taxes on such profits and royalties which increase their revenues.

9. To Reduce Inflationary Pressures.
The appearance of inflationary pressures is inevitable in a developing country because of the existence of the disequilibrium between demand and supply of domestic products, following the initiation of a large public investment programme. The latter has the impact of rapidly increasing the demand for goods and services relative to their supplies. This leads to inflationary pressures which become strong due to the existence of structural rigidities that inhibit the expansion of food and other consumer goods. Foreign capital helps minimize such inflationary pressures when food and other essential consumer goods through foreign capital raises the levels of consumption which, in turn, enhance the productive efficiency of the community.

10. To Solve the Problem of Balance of Payments.

Foreign capital overcomes the balance of a payments difficulties experienced by an LDCs in the process of development. To accelerate the rate of development it needs to import capital goods, components, raw materials, technical know-how, etc. Besides, its import requirement of food grains increases rapidly with population pressures. But its exports to developed countries are either stagnant or have a tendency to decline. The gap between imports and exports leads to the balance of payments difficulties. It is through foreign capital that an under-developed country can meet all its import requirements, and at the same time, avoid the balance of payments difficulties. Further, there is the need for additional foreign exchange for servicing external debt. This accentuates the balance of payments problems which can again be remedied by importing capital.

FACTORS DETERMINING THE AMOUNT OF FOREIGN INVESTMENT FLOWING FOR ECONOMIC DEVELOPMENT

The amount of foreign investment flowing to LDCs, however, depends upon a number of factors:

1. Availability of Funds.

Developed countries should have enough surplus capital to export. These does not appear to be an excess of surplus in such countries. With the exception of the United States, there are very few countries that can spare so much capital as to bring it up to 10-15 billion dollars annually, required by LDCs. Some of the developed countries like Canada and Australia themselves borrow from the United States and Great Britain to finance their development projects. However, a genuine effort on the part of rich countries to mop surplus capital can meet the requirements of LDCs.

2. Capacity to Absorb Capital.
LDCS should get as much as they could usually invest; Absorptive capacity Covers all the ways in which the ability to plan and execute development projects, to change the structure of the economy, and to reallocate resources is circumscribed by lack of crucial factors, by institutional problems or by unsuitable Organization. The structure of the economy along with the utilization of its existing capacity will have an important bearing on a country's absorptive capacity. The amount of capital that can be utilized by an LDCs is determined by the availability of complementary resources. It will remain unutilized if complementary resources are not available. Inadequacy of overhead facilities like power, transport, etc., in LDCS keep the capacity to absorb foreign capital low. The other factors which keep the absorptive capacity for productive investment low are the lack of efficient entrepreneurship, administrative and institutional bottlenecks, the lack of trained personnel, the lack of geographic and occupational mobility, and the small size of the domestic market.

The capacity to absorb resources for productive investment is high if the following conditions are met:

- unutilized capacity of some kind
- opportunities for improvements in technology
- a well-construed development plan
- some domestic financial resources
- public and business administrators capable of executing projects expeditiously and efficiently
- a strong and united government having the support of the masses
- a fluid and flexible society already undergoing cultural change and willing to shift from agricultural to industrial occupations
- a high level of literacy

• effective system of education
• a technology-minded and development-minded public

3. Availability of Resources.
If an LDC has little adequately developed human and natural resources it will act as an impediment to the effective use of foreign capital. It will be all the more difficult for such a country to utilize the available foreign capital if it lacks in human and natural resources. But the latter should not act as limits to economic development.

4. Capacity of the Recipient Country to Repay Loans.
This is a very pertinent problem. For the burden of servicing loans acts as a barrier to the borrowing of large funds by LDCs. This, in itself, can be attributed to their extreme poverty. The capacity for repayment, however, hinges on their capacity to export and their ability to augment their foreign exchange resources. In the short run, the capacity to repay is dictated by the foreign exchange impact or investment undertaken, whether it be export-increasing or import decreasing. Overtime, the only determinant of the capacity to repay is the loans contribution to productivity of the economy as a whole, and the capacities of the system to skin off the necessary portion of that productivity in taxes or pricing, and reallocate resources so as to transfer debt service abroad. The requirement for payment is that the fiscal system raise the necessary funds and the transformation occur to shift resources into export-increasing or import-decreasing lines. If loans flow in a steady and increasing stream then for very long periods with liberal terms of repayment, the problem of repayment is easy. For, in a very long period, the borrowing countries would have raised their outputs to such an extent as to permit net repayment.

But prudence demands that loans should be tied to self-liquidating works, while grant should be made available for specific social overheads, such as research, education, public health, and community development.

5. The Will and Effort to Develop.
Perhaps the most important factor is the will and the effort on the part of the recipient country to develop. Capital received from abroad does not fructify, unless it is desired and paralleled by an effort on the part of the recipient country. As Nurkse aptly says, "Capital is made at home." The role of foreign capital is to act as an effective agent for the mobilization of a country’s will.

SUMMARY

Foreign capital can enter the country in the form of:
- Direct Investment: means the concerns of the investing country exercise de facto control over the assets created in the capital importing country by means of that investment. E.g. MNC’s
- Indirect Investment: better known as portfolio investment consists mainly of the holding of transferable securities or guaranteed by the govt. of the capital importing country. Such holdings do not amount to right to control the company. E.g. shares, debenture, bonds etc.

Foreign capital helps in movement of technical know-how and advancements and proves to be of great dynamism. The inflow of foreign capital is indispensable for accelerating economic development. It helps in industrialization, in building up economic overhead capital, and in creating larger employment opportunities. Foreign capital not only brings money and machines but also technical know-how. It opens up inaccessible areas and exploits untapped and new resources. Risks and losses in the pioneering stage also go with foreign capital. Further, it encourages local enterprise to collaborate with foreign experience. It removes the balance of payments problem and minimizes the inflationary pressures. Foreign capital helps in modernizing society and strengthens both the private and public sectors. Foreign capital is thus indispensable for the economic development of LDCS.