

Chapter 1

Regional Economic Imbalances: Business and Foreign Direct Investment in India

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ABSTRACT

*The importance of inflow of Foreign Direct Investment (FDI) in economic development of India is widely known, analyzed and well accepted in the post-liberalization era. But such inflows have created regional disparities within India owing to their concentration in select geographical locations (states) only. This should be brought into socio-economic discourses and policy formulation and as such, this chapter is an attempt to understand the linkage between FDI and regional economic growth of India. The chapter is divided into three parts. **Part-1** presents phases of evolution of FDI policies that made an impact on the business condition in India post independence, **Part-2** presents economic condition of various states and also discusses the FDI inflows to these states since 1991. **In Part-3**, some policy measures has been suggested to remove this anomaly in our development process so as to make economic development with FDI more stable and inclusive.*

1.0 INTRODUCTION

In economic theory and academic discussion, FDI has a positive relationship with economic growth has been validated. Post 1950, MNC and international trade increased dramatically in all continents and India being no exception invited foreign capital in various forms and sizes. Post 1991, India witnessed significant amount of FDI inflows in few of its States and Union Territories and consequently showed better growth prospects. It also raised issues like regional disparity and economic imbalance among the

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states because of FDI accumulation in few states. An attempt has been made in the present chapter to understand this relationship. The chapter is divided in three parts where Part I is an overview of FDI policies post, Part II, discusses the economic condition of various States and then an attempt has been made to understand the relationship between FDI and regional economic development. The policy measures have been discussed in Part-3 of the paper.

1.1 Evolution of FDI Policies in India since Independence

After independence, the FDI policy of India can broadly be classified in four phases where each phase characterized with changing attitude of respective governments towards foreign capital and its role in economic development. The first Phase or Phase I can be back tracked from 1948 to 1966. Under this period India adopted the policy of welcoming foreign capital but with caution. The second phase was the period 1966-1979 where in this period the policy stance of India towards FDI was hardened. The period 1980-1990 was the beginning of the adoption of the policy of liberalization of the economy albeit partially. Post 1991, government of India completely changes its policy towards FDI, recognizes the role of FDI in the overall growth of the economy and consequently making the policies more liberal and welcoming.

(Phase-I): The Period of “Cautious welcome policy” ¹(1948-66) -After independence India adopted a cautious approach towards foreign capital. This approach was based on the experience India had with the foreign companies before independence. The sizeable presence of British capital in pre-independence India had done little to promote development, its large presence in extractive industries, plantations, shipping, banking and insurance were geared to promoting colonial interests. The Industrial Policy Resolution (IPR) 1948 recognized that participation of foreign capital and enterprise particularly as regard to the industrial techniques and technical know-how would be helpful in achieving the objective of rapid industrialization. However it was also emphasized that foreign capital should be properly regulated. But in IPR 1956, import substitution policy followed with a view to build local capabilities was adopted and in order to promote technological development, technology imports and foreign investment in high technology areas were allowed. In 1963-64, the Government of India decided to give the ‘letter of intent’ to foreign companies to proceed with their capital projects, instead of making the company finds an Indian partner. In 1965 certain tax concession was made for Non-Resident Account.

(Phase II): The Period of “Selective and restrictive policy” (1967-79) - After having shown openness and receptivity towards foreign capital, policy regime became further selective and restrictive during the period of 1968-79. Under the IPR 1970, the large industrial houses and foreign enterprises were permitted to enter in the ‘core and ‘heavy investment’ sectors except industries reserved for the public sector. But in 1973 the Foreign Exchange Regulation Act was amended and branches of foreign companies in India and Indian Joint Stock Companies in which non-resident interest was more than 40% were expected to bring down their non –resident share holding to 40% within a period of 2 years. However, basic and core industries and export oriented industry engaged in manufacturing activities needing sophisticated technology were allowed to carry on business with non-resident interest with permission from RBI. As a result many multinationals such as IBM and Coca Cola closed down their operations in India whereas other companies followed statutory requirement and likes of Unilever diversified their production base in order to fulfill export obligations as required under FERA in return for retaining majority equity ownership. During the period 1967-79, the total number of collaboration agreements reached an all-time low of just 242 (Kumar 1994). There were further relaxations in the rules pertaining to encourage non-resident investment. But in a major policy shift by the government in 1977, foreign

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