**FDIs have a positive effect on the host economy: Critically discuss this statement in the light of two economies:**

In the words of OECD “Foreign Direct Investment is a key driver of international economic integration. With the right policy framework, FDI can provide financial stability, promote economic development and enhance the well being of societies” (OECD,Benchmark Definition of Foreign Direct Investment,Fourth Edition, 2008).

Developing countries are characterized by low savings and thus they need the savings of other countries to accelerate capital accumulation and growth. FDI can provide short and long run finance to the country while generating the technological spillovers and better management practices (Borensztein et al., 1998; Javorcik, 2004).

The aim of this study is to critically determine the positive effect of FDI on the host economy. The first portion includes the factors that influence FDI in India. It will be then followed by FDI inflow in India from Germany. the impact of FDI on India, benefits getting from FDI and the cost that must be suffered because of FDI. Followed by a conclusion as to how to maximize the benefits of FDI and reduce the negative effects as much as possible.

**Factors influencing FDI**

**Germans FDI in India**

Combining the two specific firm’s datasets on german companies being engaged in India as foreign direct investors. Germany belongs to the most important home countries of FDI, whereas India nay be second only to China when it comes to concerns about offshoring in the home countries of Multi National Enterprises (MNEs).The following content in clearly relevant for both Germany and India:

* Germany plays an important role in India’s efforts to attract FDI and, thereby, promote the process of economic catching up. In the 1990s, Germany ranked first among European direct investors in India.
* India’s share in German FDI stocks is still relatively small; India hosted just three per cent of stocks held in all developing countries in 2006, compared to 13 per cent for China (Deutsche Bundesbank, 2008). But German firms employed more than 120,000 workers in India, accounting for almost eight per cent of German firms’ employment in all developing countries. (Firm Heterogeneity and Choice of Ownership Structure An Empirical Analysis of German FDI in India, Article 4 p83-84 by Gorg, Lauber, Meyer and Nunnenkamp).

Between 1985 to 2004, German’s fdi to India amounted to a cumulative of USD 1.5bn, that was because of the beauracratic hurdles, unsatisfactory infrastructure, and procedural delays inhibiting greater flows of FDI.Even then German enterprises in India have recorded double-digit growth in sales and net income in recent years. Indeed, Indian subsidiaries of German companies outshine their parent companies’ performance on both counts. Moreover, India continues to undergo economic reforms, implying that the outlook for returns on investment remains good. While initial delays and difficulties may dissuade potential investors form entering the country, those who take the leap may be rewarded with substantial benefits.(Deutsche Bank Research,October 2005).

**FDI Inflows in India**

|  |  |  |  |
| --- | --- | --- | --- |
| **Phase 1** | **Phase 2** | **Phase 3** | **Phase 4** |
| **1950-67** | **1968-80** | **1981-90** | **1991 onwards** |
| Resective attitude and cautions welcome | Restrictive attitude | Gradual Liberalization | Open door policy |
| Non Discriminatory  Treatment to FDI | Restriction FDI without technology | Higher foreign equity in export oriented units allowed | Liberalized policy relating to technology collaboration, foreign trade and foreign exchange |
| No restriction on and dividend.Remittance to profit. | Above 40% stake has not allowed, if allowed only in priority area | Procedures for remittance of royalty and technical fees | Encouraging FDI in core and infrastructure Industries |
| Ownership & control with Indians | FDI control by FERA | Liberalized | FERA replaced FEMA |
|  | Discriminating power in sanctioning projects | Fast channel for FDI clearance | Transparent procedures FDI through M&A FDI n services and financial Sectors. |
|  |  |  |  |
|  |  |  |  |

Fig.1 : Major features of fdi during the four phases

Source: Jeromi P.D, 2002

We can see the FDI inflows between 1980-2015 in the table Fig.1. The first stage that is the pre liberalisation stage has a declining or not very stable FDI inflows because of many restrictive and inward looking strategies and policies by Indian Government.Then we see the post liberalisation stage after the 1990s,where the FDI is increasing due many factors, one of the important factors being the LPG. Also because the economy realised the power of FDI.

Post liberalisation, India has been beneficial by the foreign investors in the light f FDI, also at the same time it had many obstacles, example; its rigid and obsolete FDI policies.Many economic changes has been taken place by the Indian Government to cope up with the rest of the world. FDI brings industrial developments with the advancement of technology, expert management, boost in exports. All these have been possible due to the new ammendments made by the FERA on the FDI policy.(International Journal of Innovative Research and Development, impact of fdi on Indian economy, by mamta sharma , Dr. Satinderpal Singh, Volume 5 issue 2, 2016,p-2)

.(file:///C:/Users/myiph/AppData/Local/Packages/Microsoft.MicrosoftEdge\_8wekyb3d8bbwe/TempState/Downloads/86085-150723-1-SM.pdf)

**Impact of FDI in India**

The studies on FDI and economic growth in India are very limited. A recent study by Banga (2005) demonstrates that FDI, trade and technological progress have differential impact on wages and employment. While higher extent of FDI in an industry leads to higher wage rate in the industry, it has no impact on its employment. On the other hand, higher export intensity of an industry increases employment in the industry but has no effect on its wage rate. Technological progress is found to be labour saving but does not influence the wage rate. Further, the results show that domestic innovation in terms of research and development intensity has been labour utilizing in nature but import of technology has unfavourably affected employment in India (Working paper, IMPACT OF LIBERALISATION ON WAGES AND EMPLOYMENT IN INDIAN MANUFACTURING INDUSTRIES,Rashmi Banga, February 2005,p8-11)

**Effects of FDI on on the host country**

The are various ways in which the entry or an existence of a foreign firm can affect the host country. Some of them are:

* **Relegate Effect:** Relegate effect of fdi is the transpose or the misplace effect gained by single power or the monopoly power by the foreign firms. The econometric test by Argosin and Mayer(2000) says that out of the 39 economies, 19 resulted as same as before with no changes, but 10 economies were relegated (Kumar and Pradhan,2002).

The effects of relegation is not same in any two economies.as every economy experience a diiferent type of FDI.Some countries will experience the in-relegation as they are the markets that attracts national markets, so it will be hard to compete wth the foreign markets. At the same time countries that attracts exports, experiences relegation comparitively (Bhalla and Ramu, 2005).

Economies experience the out-relegation when the domestic firms are wiped by the the foreign firms giving a higher level of expertise. Also when they have a better capitalization than the domestic firms.So that results in loss of satisfaction and a lot of government arbitration to help the domestic firms (Bhalla and ramu 2005).

* **Trade Deficit Effects:** There exist a two-way relationship between fdi and imports. As more and more fdi inflows from the home country, more will be imports from the home country to the host country.This results in increasing dependancy of the host country on the home country. This may be due many factors, for example if the foreign investors wants to supply the raw materials or the semi-finished goods to the host country from the home country. The host country suffer from trade deficits as the export rate goes higher. (Chaisrisawatsuk S. and Chaisrisawatsuk W, 2007).
* **Surplus Recovery:** When foreign firms invests in host countries, their first motive is maximization of profit with the aim of minimizing the cost by getting cheap labour resources, expertise, cheap raw materials and mineral deposits, that benefits the investing firms to earn more profit, which actually results in huge outflow of capital from the host country to the home country leaving the host country in negative effects in the balance of payment.(Billet 1991)
* **Double header direction:** FDI can result in heading two ways in a developing economy, which has a developed sector undertaken by the MNEs and the underdeveloped sector undertaken by the local firms. This two way direction create a hindrance in the economic development of the host economy. As the developed economy involves capital intensive technology and the underdeveloped parts involves more of labour intensive technology.(Bulte et al, 2003).
* **Environmental Impact :** FDI has some pessimistic impact on the host country in the light of environmental factors. Different countries have different environment regulatory system,some may have strict whether some may be lesser strict just to increase the inflows of fdi. In order to compete with other countries the host country may attempt to loosen thei regulatory framework hampering their own environment (Gray 2002).

**Conclusion**

Summing up all the above facts, we can conclude that India can be beneficial from the FDI if it uses its advantages like skilled but low waged labor, large demography, large domestic market, technical expertise, abundance of natural resources and so on. The major FDI investors in India are US, UK, Germany, France, Singapore, Netherlands, Switzerland, Japan and Mauritius. FDI is a remedy for economic illness of a country. FDI give a major support in boosting the economic development of a country. In India FDI policy permits FDI upto 100 percent from foreign investors without prior approval in most of the sector including the service sectors. As India gears up for the competition in the international market, foreign investors also see a good scope in maximizing their profit and minimizing their cost if investing in India.