Criticality of FDI in Manufacturing

What is the issue?

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- While the FDI flows in the manufacturing sector has already been lacklustre, it is further slowing down now.
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- This is a cause of concern if India needs scale-up its economy and create more jobs for its people.
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What are the status of Foreign direct investment (FDI) in India?

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- **Policy -** FDI limits were eased across sectors in mid-2016 to allow foreign firms to own 49% in a venture through the direct route.
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- Notably, an even greater stake was allowed if the investment venture had access to state-of-the-art technology.
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- However, most of the partnerships that are currently in the pipeline are in the nature of technical collaborations – with little in terms of FDI.
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- **Stats -** Flows into the industrial and manufacturing space have picked up pace in lately, and was estimated to be $17 billion in 2016-17 (double of 2011 level).
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- But despite this, the amount netted by the manufacturing sector was still far less than the capital flow into the service sector (which continues to dominate).
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- Notably, sectors like FMCG (where regulations are relatively less important)

has netted a fair bit of the FDI into well established companies.
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- But more foreign capital is needed in sectors like defence to boost our technical expertise and bring jobs to the skilled and unskilled workers.
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- Insufficient infrastructure, rigid labour laws and an unstable regulatory environment are the probable reasons that hinder manufacturing FDI flows.
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Why is FDI critical for the country?

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- If India is to really scale up its GDP growth and ensure jobs-creation, it is necessary to grow its manufacturing sector.
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- But capital available with local industrialists is limited, which makes it is critical for India to attract more FDI in manufacturing.
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- In this backdrop, multiple sectors have been slacking in attracting the needed FDI to help boost the economy and ensure jobs and progress.
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- **Defence -** Events like our recent DefExpo generating considerable interests among major defence players around the world.
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- But despite this, there hasn't been much it terms of FDI flows into the sector.
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- This poor state of affairs is indeed partly due to the lack of sufficient orders from the government, which is by default the major defence buyer.
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- **Pharmacy -** It is also unfortunate that sectors such as pharmaceuticals aren't attracting the global players despite India's large pool of science graduates.
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- Pharma sector had seen a decline in FDI flow and pulled in less than $1 billion each in FY16 and FY17, lower than the $1.5 billion in FY15.
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- **Automobiles –** In the automobiles sector too, just $1.6 billion came through in FY17 compared with $2.6 billion in FY16.
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- This is despite India's abundantly cheap labor and a big home market.
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What role does FDI play in the Balance of Payment (BoP)?

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- FDI is also an important factor in the “Balance of Payments” (BoP) equation that is critical to ensure the stability of the rupee.
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- Also, of the total capital inflow of $240 billion in the 3 previous financial years, FDI along accounted for 55% - (rest came from debt and portfolio equity).
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- This is a big reversal over the trend in the previous 10 years when FDI accounted for less than 30% of the inflows.
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- However, in the December quarter, FDI flows weakened though economists believe it could be a error.
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- Nevertheless, with the price of crude oil now nudging $70, there is a real chance the basic BoP becoming negative in the FY19.
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Quick Facts:

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Basics:

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- FY – is the abbreviation for “Financial Year” (April 1^{st} - March 31^{st})
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- BoP = “Net FDI Inflow” minus “Current Account Deficit”
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Current Account Defecit (CAD):

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- **CAD =** “Current Account Outflow” minus “Current Account Inflow”
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- **Current Account Outflow =** “Outward remittances by foreign nationals in India” + “Profit Repatriation by Foreign Firms in India” + “Cost of Imports”
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- **Capital Account Inflows =** “Inward remittances by NRIs from abroad” + “Repatriated Profits of Indian Firms Abroad” + “Cost of Exports”.
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Source: Financial Express

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