FOREIGN DIRECT INVESTMENT FOR INDIAN RUPEE APPRECIATION– A LESSON AT THE RIGHT TIME

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ABSTRACT

BACKGROUND
The copious inflow of foreign currencies particularly in the form of foreign investment is a major reason for the appreciation of rupee. The foreign exchange reserve of the country stood at $261 billion in October 2007 which is $62 billion more than that in March 2007. Negative Impact includes Reduced Export earning, Job losses in the Export sector, Retardation of Export performance, Increase in imports, Threat of import substitution, Losing export market to competing countries, Reduced return on overseas investment, Reduced value of remittance by NRIs, Minimised investment in India by Persons of Indian Origin. Positive Impact includes Reduced external debt, Reduced oil cost, Inflation control, Attractive overseas investment and Reduced cost of imported machinery and raw material. The Government of India announced packages worth Rs. 5200 crore to cushion the impact of the appreciation of the Rupee. Government also raised the annual limits of Market Stabilisation Scheme (MSS) to Rs. 2.5 lakh crore. This money would be used by RBI for intervention to stabilise the currency value.

KEYWORDS
FDI, Negative Impact, Positive Impact and Government Interventions.


BACKGROUND
The Indian Rupee has been appreciating steadily against the major foreign currencies. This appreciation has been more pronounced against the US Dollar and the British Pound Sterling. The Indian Rupee appreciated by more than 15 percent against the US Dollar between October 2006 and October 2007. In the export front, 76 percent of invoicing is done in US Dollars. Business models and strategies, which have been designed, based on the assumption of an ever-depreciating Rupee have been hit hard by this sudden turn of events. However, there are also some positive effects of this development. This paper deals with the major reason for Rupee appreciation, the negative and positive impact of the rupee appreciation, measures taken by the Indian Government and suggestions to minimise the effect of this phenomenon.

Major Reason
The copious inflow of foreign currencies particularly in the form of foreign investment is a major reason for the appreciation of rupee. According to the Report on Foreign Exchange Reserves published by the Reserve bank of India in July 2007, the nation has accumulated $192 billion over a period of sixteen years from March 1991 to March 2007. Foreign direct investment (FDI) accounts for $57 billion, Foreign Institutional Investment (FII) for $52 billion, NRI deposits $29 billion, external assistance $14 billion, and external commercial borrowing accounts for $38 billion. The foreign exchange reserve of the country stood at $261 billion in October 2007 which is $62 billion more than that in March 2007.

It is well known that much of this increase is due to relatively large inflow of FII. This has resulted in the unprecedented appreciation of the Indian Rupee against the major foreign currencies.

Negative Impact
The Appreciation of the Rupee has resulted in the following Negative Consequences-
1. Reduced Export earning.
4. Increase in imports.
5. Threat of import substitution.
6. Losing export market to competing countries.
7. Reduced return on overseas investment.
8. Reduced value of remittance by NRIs.
9. Minimised investment in India by Persons of Indian origin.

Reduced Export Earning
The earnings of the exporters in terms of Indian Rupee have come down. Every dollar earned today is giving Rs. 6 less than what was earned a year ago. Every 10 paisa appreciation in Rupee negates the effect of one Dollar increase in the international price. Various export sectors have reported loss as a result of this development. According to a report by FIEO (Federation of Indian Exporters Association), the export during the current fiscal year would only be $140 billion compared to the target of $160 billion. The industries, which have been hard hit by this development, are Textiles, Leather, Handicrafts, Engineering Goods, Software Outsourcing, Sports Goods, Marine and Agro-based products and Tourism and Hotel Industry.

Job losses in the Export Sector
As the profit margin gets squeezed, the export companies find it difficult to continue their operations. Sectors that are labour intensive are the worst affected and have witnessed closing down of many units. Government of India estimates that 20 lakh workers would face unemployment. However, FIEO has
reported that 5 million jobs were lost by the end of November 2007. 8 million jobs were lost in the export intensive industries during 2007-08. This is shown in the following table.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Job Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engineering</td>
<td>16,00,000</td>
</tr>
<tr>
<td>Handicrafts</td>
<td>8,00,000</td>
</tr>
<tr>
<td>Leather</td>
<td>7,00,000</td>
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<tr>
<td>Textile</td>
<td>6,00,000</td>
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<tr>
<td>Sports goods</td>
<td>2,00,000</td>
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Engineering Export Promotion Council (EEPC) estimates on the basis of a survey that one percent appreciation in the value of Rupee renders 1, 60, 000 workers jobless. More than lakh workers have lost their jobs in the sports goods clusters in Ludhiana, Panipat and Jalandhar. The textile units in Tirupur are incurring a loss of Rs. 50 crore a month since April 2007 leading to severe job loss.

Retardation of Export Performance
The rate of growth of export has declined after a spectacular growth for five successive years. The exports slumped by 17 percent during the first quarter of the fiscal year 2007 – 08 as compared to the same period in the previous year. Exports were 36 percent lower than the $7.5 billion target set for the same period. According to a report by TEA (Tirupur Exporters Association), its exports may experience a negative growth of 15 percent as against the targeted positive growth of 20 percent. Export promotion Council of Handicrafts has estimated that the export of handicrafts would decrease by 15 percent in 2007–08 compared to the previous year. This sector was steadily growing at the rate of 17 percent in the previous years.

Losing Export Market to Competing Countries
Rupee appreciation has increased the dollar price of Indian goods in the global market. Hence, the Indian exporters are losing to their counterparts from countries such as China, Pakistan, Bangladesh, Indonesia, Cambodia and Vietnam. Because the currencies of these countries are not appreciating at such a high rate as that at which the Indian Rupee is appreciating, the exports from these countries have become attractive in price terms. Pakisthani Rupee and Bangladeshi Taka have fallen against Euro and Pound Sterling while remaining stable against the US dollar.

Increase in imports
The appreciation of Rupee has made imports cheaper. As a result, import of capital goods as well as consumer goods has seen a steady rise. This may further affect the balance of trade of the country and does not add to the strength of the economy in the long run.

Threat of import substitution
Companies, which cater to the domestic demand, are also affected as a consequence of Rupee appreciation. The imported products have become cheaper than the domestically manufactured products. Industries, which are affected by this phenomenon, are chemicals, textiles, standardised auto components and tyres.

Reduced return on overseas investment
The repatriation of profits earned through overseas investment in Rupee terms has decreased substantially. Returns from the overseas stock markets in the form of dividends and the interest accrued through overseas debt instruments have also decreased.

Reduced value of remittance by NRIs
The realisation of the remittance by the non-resident Indians has seen significant erosion as a result of Rupee appreciations. This would result in decrease in the disposable income and in reduced spending. Such an eventuality would have a dampening effect on the economy.

Minimised Investment in India by PIOs (Persons of Indian Origin)
People of Indian origin who are living abroad have been heavily investing in India in various avenues such as the stock market and real estate. However, the appreciation of the Rupee has affected this, as the quantum of investment in Rupee terms has been decreasing.

Increased Cost of Stay in Indian Cities
The amount of money to be spent in dollar terms for staying in Indian cities has increased significantly. Hence, Indians living abroad think twice before making their usual trips to the country.

Positive Impact
The Appreciation of Rupee has its Own Positive Consequences as Well. They are:
1. Reduced external debt.
2. Reduced oil cost.
3. Inflation control.
4. Attractive overseas investment.
5. Reduced cost of imported machinery and raw material.

Reduced external debt
The country has an external debt burden amounting to $142.65 billion. A ten percent appreciation of the Rupee would reduce it to a Rupee equivalent of $128.39 billion. A similar effect is experienced on the interest being paid on this external debt. It works to the advantage of the Indian economy when it comes to external debt and servicing the external debt.

Reduced Oil Cost
The oil price has been skyrocketing in the past two years. The appreciation of the Rupee, to a large extent, has counteracted the steep rise in the oil price. As our oil contracts are made in Dollar terms, the amount paid in Rupee terms has been significantly lesser. It is also estimated that for every one Rupee appreciation against the Dollar, the cost of crude oil decreases by 2 percent.

Inflation Control
As the Rupee value increases, it enhances the inflation control measures of the Government. The oil bill is one of the important factors causing inflation. Hence, any slower growth on oil cost results in curtailed inflation. Also the earnings from export and overseas investment gets reduced. This has led to reduction in the disposable income available for consumption. These factors have been helpful in controlling inflation.
Attractive Overseas Investment
Overseas acquisition has become attractive, as lesser amount of Rupees need to be spent for the same. Companies such as Mahindra and Mahindra, Godrej and Biocon are optimistic about this opportunity, which is a result of Rupee appreciation.

Reduced Cost of Imported Machinery and Raw Material
The cost of imports in rupee terms becomes lesser. Companies, which are importing their raw materials, stand to gain out of this. As this results in reduced cost of raw material, the profitability of these companies improves. Also companies, which are importing the capital goods, would pay lesser amount of Rupees.

Government Interventions
The Government of India has announced packages worth Rs. 5200 crore to cushion the impact of the appreciation of the Rupee. Government has also raised the annual limits of Market Stabilisation Scheme (MSS) to Rs. 2.5 lakh crore. This money would be used by RBI for intervention to stabilise the currency value. Reserve Bank of India has decreased the pre and post-shipment credit by two percent. The interest rates on Duty Entitlement Passbook scheme (DEPS) has been increased by 2-3 percent. Increasing the duty drawback rate, reducing the ECGC (Export Guarantee Credit Corporation) premia rate and service tax exemption/refund for export of ten services are the other measures taken by the Government to minimise the adverse impact of Rupee appreciation on the export sector. However, the exporters claim that while the Rupee has appreciated by more than 10 percent, the concessions by the Government accounts for less than four percent.

Suggestions
The measures taken by the Government are expected to be effective only in the short run. However, to overcome the effect of the appreciation of Rupee, the following longterm steps should be taken:
1. Exporters need to concentrate on value addition. This would help them to charge a premium on their products. In order to ensure success in the long run, attention must be paid to design innovativeness, cost minimisation, logistics and cost of capital.
2. To offset the rising domestic interest rates, exporters must be allowed to use their export earnings to raise external credit at cheaper rates.
3. Market development outside the United States needs to be undertaken. Also invoicing in other currencies such as Euro and Yen should be done.
4. As the small and medium enterprises, which contribute to 60 percent of the country's export in value terms, are not familiar with practices such as hedging, they need to be educated on such practices to protect themselves from the effects of currency movement.
5. Calculated measures of restrictions should be taken with respect to any Foreign Institutional Investment that does not contribute to meaningful and steady growth of the economy.

CONCLUSION
The unexpected appreciation of Rupee poses serious challenges to the Indian economy. However, it has also sensitised the planners and the strategists to the problems that may arise from an unexpected quarter. It has highlighted the relative merits and demerits of an unbridled exposure to the global system. It has also reinforced the need for the development of a system to handle such serious problems in the short run as well as in the long run.

REFERENCES