FDI INFLOWS IN INDIA

Dr. K. Shobha

Absract

Policy regime is one of the key factors driving investment flows to a country. Apart from underlying macro fundamentals, ability of a nation to attract foreign investment essentially depends upon its policy regime - whether it promotes or restrains the foreign investment flows. There has been a sea change in India's approach to foreign investment from the early 1990s when it began structural economic reforms encompassing almost all the sectors of the economy. During the Pre-Liberalisation Period, India had followed an extremely cautious and selective approach while formulating FDI policy in view of the dominance of "import-substitution strategy" of industrialisation. With the objective of becoming "self reliant", there was a dual nature of policy intention – FDI through foreign collaboration was welcomed in the areas of high technology and high priorities to build national capability and discouraged in low technology areas to protect and nurture domestic industries. The regulatory framework was consolidated through the enactment of Foreign Exchange Regulation Act (FERA), 1973 wherein foreign equity holding in a joint venture was allowed only up to 40 per cent. Subsequently, various exemptions were extended to foreign companies engaged in export oriented businesses and high technology and high priority areas including allowing equity holdings of over 40 per cent. Moreover, drawing from successes of other country experiences in Asia, Government not only established special economic zones (SEZs) but also designed liberal policy and provided incentives for promoting FDI in these zones with a view to promote exports. As India continued to be highly protective, these measures did not add substantially to export competitiveness. Recognising these limitations, partial liberalisation in the trade and investment policy was introduced in the 1980s with the objective of enhancing export competitiveness, modernisation and marketing of exports through Trans-Technology Policy (1983) provided for a liberal attitude towards foreign investments in terms of changes in policy directions. The policy was characterised by de-licensing of some of the industrial rules and promotion of Indian

manufacturing exports as well as emphasising on modernisation of industries through liberalised imports of capital goods and technology. This was supported by trade liberalisation measures in the form of tariff reduction and shifting of large number of items from import licensing to Open General Licensing (OGL). During the Post-Liberalisation Period a major shift occurred when India embarked upon economic liberalisation and reforms program in 1991 aiming to raise its growth potential and integrating with the world economy. Industrial policy reforms gradually removed restrictions on investment projects and business expansion on the one hand and allowed increased access to foreign technology and funding on the other. A series of measures that were directed towards liberalizing foreign investment included: (i) introduction of dual route of approval of FDI – RBI‟ s automatic route and Government‟ s approval (SIA/FIPB) route, (ii) automatic permission for technology agreements in high priority industries and removal of restriction of FDI in low technology areas as well as liberalisation of technology imports, (iii) permission to Non-resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) to invest up to 100 per cent in high priorities sectors, (iv) hike in the foreign equity participation limits to 51 per cent for existing companies and liberalisation of the use of foreign "brands name" and (v) signing the Convention of Multilateral Investment Guarantee Agency (MIGA) for protection of foreign investments. These efforts were boosted by the enactment of Foreign Exchange Management Act (FEMA), 1999 [that replaced the Foreign Exchange Regulation Act (FERA), 1973] which was less stringent. This along with the sequential financial sector reforms paved way for greater capital account liberalisation in India. Investment proposals falling under the automatic route and matters related to FEMA are dealt with by RBI, while the Government handles investment through approval route and issues that relate to FDI policy per se through its three institutions, viz., the Foreign Investment Promotion Board (FIPB), the Secretariat for Industrial Assistance (SIA) and the Foreign Investment Implementation Authority (FIIA). FDI under the automatic route does not require any prior approval either by the Government or the Reserve Bank. The investors are only required to notify the concerned regional office of the RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issuance of shares to foreign investors. Under the approval route, the proposals are considered in a time-bound and transparent manner by the FIPB. Approvals of composite proposals involving foreign investment/ foreign technical collaboration are also granted on the recommendations of the FIPB(RBI,2011).

Trends in FDI inflow to India

With the tripling of the FDI flows to EMEs during the pre-crisis period of the 2000s, India also received large FDI inflows in line with its robust domestic economic performance. The attractiveness of India as a preferred investment destination could be ascertained from the large increase in FDI inflows to India, which rose from around US$ 6 billion in 2001-02 to almost US$ 38 billion in 2008-09. The significant increase in FDI inflows to India reflected the impact of liberalisation of the economy since the early 1990s as well as gradual opening up of the capital account. As part of the capital account liberalisation, FDI was gradually allowed in almost all sectors, except a few on grounds of strategic importance, subject to compliance of sector specific rules and regulations. The large and stable FDI flows also increasingly financed the current account deficit over the period. During the recent global crisis, when there was a significant deceleration in global FDI flows during 2009-10, the decline in FDI flows to India was relatively moderate reflecting robust equity flows on the back of strong rebound in domestic growth ahead ofglobal recovery and steady reinvested earnings (with a share of almost 25 per cent) reflecting better profitability of foreign companies in India. However, when there had been some recovery in global FDI flows, especially driven by flows to Asian EMEs, during 2010-11, gross FDI equity inflows to India witnessed significant moderation. Gross equity FDI flows to India moderated to US$ 20.3 billion during 2010-11 from US$ 27.1 billion in the preceding year (RBI, 2011).

From July 1991 the new economic reforms was implemented. So the present study analyses the trends of FDI, its determinants and impact on the Indian economy from 1991. The hypothesis tested was that FDI has an impact on the economic growth of the country. The study is based on the secondary data. The required data have been collected from hand Book of Indian Economy, RBI. Being a time series,it was collected for the period 1991 to 2011. Inorder to analyse the data, trend analysis and step-wise regression analysis were used.

Using regression, linear, compound and exponential growth of direct investment inflows were analysed. Based on the results it can be inferred that during the post reform period FDI has grown to 8666.08 level in rupee terms and 1899 in dollar terms. Compound growth indicates an increase in direct investment inflows to 32% in rupee terms and 28% in dollar terms. Exponential growth indicates an increase in direct investment inflows to 28% in rupee term and

53% in dollar terms. Over all the FDI inflows increased over the period of time but with fluctuations during the post reform period.

YEAR	FDI	FINANCIAL POSITION	EXCHANGE RATES	GDP AT FACTOR COST	TRADE GDP	EXCHANGE RESERVES	FRGDP
1991-92	326	574.2499	24.4737	594168	15.46576	23850	4.014016
1992-93	1713	522.9184	30.6488	681517	17.1768	**30744**	4.511113
1993-94	13026	416.3615	31.3655	792150	18.0335	**60420**	7.627343
1994-95	16133	377.0044	31.3986	925239	18.65948	**79780**	8.622637
1995-96	16364	301.5685	33.4498	1083289	21.14223	74384	6.866496
1996-97	21773	282.642	35.4999	1260710	20.44378	**94932**	7.530043
1997-98	20014	284.1509	37.1648	1401934	20.27748	**115905**	8.267508
1998-99	10101	294.3026	42.0706	1616082	19.68248	**138005**	8.53948
1999-00	22450	268.58	43.3327	1786526	20.97915	**165913**	9.286907
2000-01	31015	232.1672	45.6844	1925017	22.56831	**197204**	10.24427

Table-1

Macro – Economic Indicators

2001-02	38874	230.7591	47.6919	2097726	21.65286	**264036**	12.58677
2002-03	29105	195.5041	48.3953	2261415	24.42467	**361470**	15.98424
2003-04	72139	168.8872	45.9516	2538170	25.70649	**490129**	19.31033
2004-05	69042	156.2066	44.9315	2971464	29.49401	**619116**	20.83539
2005-06	94981	135.9548	44.2735	3389621	32.94843	**676387**	19.95465
2006-07	135080	131.4147	45.2849	3952241	35.73379	**868222**	21.96784
2007-08	249921	136.8105	40.2410	4581422	36.41173	**1237965**	27.02141
2008-09	110123	135.8451	45.9170	5282086	41.9378	**1283865**	24.30602
2009-10	332575	139.4499	47.4166	6133230	36.02131	**1259665**	20.53836
2010-11	281897	118.0257	45.5768	7306990	37.81022	**1361013**	18.62618

FDI- Foreign Direct Investment, GDP- Gross Domestic Product, FRGDP- Foreign Reserves to Gross Domestic Product

There was a decline in FDI for five years. Since the year 1999, the financial position, which is the ratio of external debts to exports, declined constantly showing an upward trend in development. On an average the exchange rate was around 45-48 US dollars. Since 1991, GDP was constantly increasing. From 1998-99 onwards trade GDP showed an increase except for a decline in 2009-2010. Exchange reserves increased sharply. After 2007-08, FRGDP started declining. FDI inflows were increasing but not on an increasing trend.

Table – 2

Growth of FDI

Method	**Growth Rate**	**t value**	**R^2**
Linear			
Direct Investment Inflows (Rs.)	8666.08	6.445*	0.698
Direct Investment Inflows (in $)	1899.398	6.304*	0.688
Compound			
Direct Investment Inflows (Rs.)	1.323	47.827*	0.909
Direct Investment Inflows (in $)	1.288	50.222*	0.900
Exponential			
Direct Investment Inflows (Rs.)	0.280	13.370*	0.909
Direct Investment Inflows (in $)	0.530	12.695*	0.900

*Significant at 1%

Model Building

To analyse the impact of FDI on economic growth two models were framed. FDI model shows the factors influencing the FDI and economic growth model reveals the growth of the economy due to FDI. The present study uses GDP at factor cost as one of the variables to the FDI inflows. Total trade as percentage of GDP, which includes total exports and total imports. Foreign exchange reserves as a percentage of GDP which includes foreign reserves which comprises of foreign currency assets, gold, special drawings rights and reserve tranche position. Financial position is the ratio of external debts to exports. External debts refer to total amount of external debts. Exchange rate includes the average of U.S dollar.

FDI = f(Total trade as percentage of GDP, foreign exchange reserves as percentage of GDP,Financial position -ratio of external debts to exports,exchange rate)

GDPG= f(foreign direct investment growth)

In FDI model variables like Total trade as percentage of GDP and Financial position -ratio of external debts to exports, were pull factors for FDI inflows in the country. However other variables like foreign exchange reserves as percentage of GDP, exchange rate were insignificant and did not contribute to FDI inflows. If trade GDP increases by 1 percent the FDI inflows increases by 0.9 percent. Similarly if financial position increases by 1 percent then the FDI increases by 0.02 percent. About 85% of the variation in FDI was due to the above two factors. Durbin Watson statistics value was 1.219, which confirms that there is no auto correlation. F statistic value reveals the significant relationship between FDI and the selected variables.

Table-2

Regression Co-efficients

Independent variable	Co-efficients	Standard error	t	Significance
Constant	-23.749	4.897	-4.849	.000
Trade GDP	0.949	0.123	7.748	.000
Financial position	0.017	0.008	2.207	.041

R2 = 87%; R2 (adj.) = 85%; F* =56.939; Durbin Watson=1.219

Exchange rate was insignificant due to Euro zone crisis, drop in growth, high current deficit, declining capital inflows, slow export growth, high imports, high international oil prices, foreign institutional investment flow declined, all these have strained rupee exchange rate. Foreign exchange reserves as a percentage of GDP though positive yet it was insignificant which was contrary to the earlier study by Ajay Rajput et.al (2012), where the foreign reserve GDP brought about an increase in FDI inflows. But foreign reserves as a percentage of GDP showed a fluctuating trend. This is partly due to the intervention by the RBI to stem the slide of rupee against US dollar.

Economic Growth Model

In the economic growth model the estimated coefficient on FDI had a positive impact on GDP growth. About 85% variation in GDP growth was due to FDI.

Table-3

Regression Co-efficients

Independent variable	Co-efficients	Standard error	t	Significance
Constant	1.527E6	131886.230	11.580	0.000
FDI	18.419	1.726	10.672	0.000

R2 = 86%; R2 (adj.) = 85%; F* =113.896; Durbin Watson=0.746

The F value (113.896) indicates a significant relationship between the level of economic growth and FDI. An increase in 1 percent FDI will lead to an 18 percent increase in GDP growth. Durbin Watson's value 0.746 shows that there is no autocorrelation.

Conclusion

FDI inflows in India had a greater impact on the Indian economy but the flow of FDI is low when compared to China. Inspite of the complicated procedure on FDI inflows in China yet it remained a favourite destination for the foreign investors. Reasons for the less FDI flow were the regional differences in the development of physical infrastructure and procedural delays. Efforts should be undertaken by the Government to ease the stringent rules avoid red tapism and give importance to green field investment rather than the brown field investments.

Reference

- Handbook of Statistics on the Indian Economy,www.rbi.org.in
- Foreign Direct Investment Flows to India,Division of International Trade and Finance of the Department of Economic and Policy Research, Reserve Bank of India,www.rbi.org.in
- Namita Rajput, Anuj Jain, Ajay Rajput, Rahul Garg (2012),Relationship of FDI and growth in India: A diagnostic study,ASIAN JOURNAL OF MANAGEMENT RESEARCH,797,Volume 2, Issue 2 pp. 797-813.