A STUDY ON FDI IN INDIA

By D.Ramachandran*

Dr.V.J.R.Emerlson Moses**

Abstract

Starting from a baseline of less than USD 1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010-2012. As per the data, the sectors which attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, the US and the UK were among the leading sources of FDI. FDI for 2009-10 at USD 25.88 billion was lower by five per cent from USD 27.33 billion in the previous fiscal. Foreign direct investment in August dipped by about 60 per cent to aprox. USD 34 billion, the lowest in 2010 fiscal, industry department data released showed. In the first two months of 2010-11 fiscal, FDI inflow into India was at an all-time high of \$ 7.78 billions up 77% from \$ 4.4 billions during the corresponding period in the previous year. In this study printout that Trends of FDI India and Sector –wise Inflow of FDI.

* Research Scholar, Muthurangam Govt. Arts College, Vellore.

** Assistant Professor, PG & Research Department of Economics, Muthurangam Govt. Arts College, Vellore.

Introduction

Foreign investment refers to the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. It usually involves participation in management, joint-venture, transfer of technology and expertise. There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in a net FDI inflow (positive or negative) and "stock of foreign direct investment", which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares. FDI is one example of international factor movements.

Foreign direct investment (FDI) plays an increasingly important role in the developing world because it has been recognized as a growth enhancing factor in developing countries. Foreign Direct investment (FDI) is now regarded as an important driver of growth. Literature on economic growth showed that there are a number of channels through which FDI permanently affects economic growth. FDI can affect output and income by increasing the stock of capital, increasing the labour force through job creation, and enhancing the human capital through technology and knowledge transfers via labour training, skill acquisition, new management practices and organizational arrangements. It is now well known that most of the developing economies initiated liberalization strategy, the Government of India also announced a series of liberalization measures since 1990's and have liberalized their FDI regimes to attract investment. Foreign Direct Investment will contribute to the process of determining India's position of the next superpower in the east. There is clearly an intense global competition for FDI. India has emerged as the most attractive destination for FDI. Review of various literatures available on FDI reveals that foreign investment is still a matter of debate. Whether FDI is boom or bane for host countries economic growth and development? Opinions are still divided. FDI has its own merits and demerits. Many are of the opinion that basic objective of foreign investments is to earn profits by ignoring the overall social& economic development of the host nation. The external reforms in the 1990's were successful for India. The gains that India experienced include a rise in trade share, strengthening of external accounts, and a less vulnerable economy. He concludes that even with the increases in growth that the economy is still relatively closed..

Data Sources and Methodology

The present study is based primarily on secondary data. This paper covered time series data pertaining to last 19 years that have been used to examine the trend growth and performance of foreign direct investment in India. The data on FDI inflows were taken from various secondary sources such as Indiastat.com.

Trends of FDI India

India has continually sought to attract FDI from the world's major investors. Indian national government announced a number of reforms designed to encourage FDI and present a favorable scenario for investors. The trend of FDI inflow in India has presented in the Table.

Table depicts the cumulative FDI flows in the country. The total inflow of FDI up to January 2011 amounted to Rs. 6,30,336 crore Cumulative amount of FDI inflows from April 2000 to January 2011 were Rs.5,70,105 crore. For the Third quarter from April to January 2011, the flow of FDI accounted to Rs.77,902 crore.

It can be observed from the table that the maximum growth rate recorded in the year 2006-07 with 186.96 percent growth over the previous year amounting Rs.70,630 crore. Owing to 100 percent FDI allowed in many industrial sectors and an automatic approval was accorded. As a result, the highest growth rate of FDI inflows was registered during the year 2006 and 2007 in India. This is the most favored year in respect of FDI inflow. It is also found that during two years i.e. 2002-03 and 2003-04 negative growth rate in FDI was observed representing (29.66percent) and (18.85percent) respectively.

The main reason behind this decrease was due to prohibition of FDI in some sensitive sectors like agriculture, railways, retail industry, real estate etc. however the yearly average of FDI based on the 10 years was amounted to Rs.54,292 crore i.e. accounting for the annual growth of FDI by 36 percent per annum. It can be concluded, from the above analysis, that the FDI growth rate is not constant since 1991, when the indigenous market was opened to the world.

Sector –wise Inflow of FDI

Hotel & Tourism

100% FDI is permissible in the sector on the automatic route.The term hotels include restaurants, beach resorts, and other tourist complexes providing accommodation and/or catering and food facilities to tourists. Tourism related industry include travel agencies, tour operating agencies and tourist transport operating agencies, units providing facilities for cultural, adventure and wild life experience to tourists, surface, air and water transport facilities to tourists, leisure, entertainment, amusement, sports, and health units for tourists and Convention/Seminar units and organizations.

For foreign technology agreements, automatic approval is granted if

i. up to 3% of the capital cost of the project is proposed to be paid for technical and consultancy services including fees for architects, design, supervision, etc.
ii. up to 3% of net turnover is payable for franchising and marketing/publicity support fee, and up to 10% of gross operating profit is payable for management fee, including incentive fee.

Telecommunication:

i. In basic, cellular, value added services and global mobile personal communications by satellite, FDI is limited to 49% subject to licensing and security requirements and adherence by the companies (who are investing and the companies in which investment is being made) to the license conditions for foreign equity cap and lock- in period for transfer and addition of equity and other license provisions.
ii. ISPs with gateways, radio-paging and end-to-end bandwidth, FDI is permitted up to 74% with FDI, beyond 49% requiring Government approval. These services would be subject to licensing and security requirements.
iii. No equity cap is applicable to manufacturing activities.
iv. FDI up to 100% is allowed for the following activities in the telecom sector :
    a. ISPs not providing gateways (both for satellite and submarine cables);

b. Infrastructure Providers providing dark fiber (IP Category 1);

c. Electronic Mail; and

d. Voice Mail

The above would be subject to the following conditions:

e. FDI up to 100% is allowed subject to the condition that such companies would divest 26% of their equity in favor of Indian public in 5 years, if these companies are listed in other parts of the world.

f. The above services would be subject to licensing and security requirements, wherever required.

Proposals for FDI beyond 49% shall be considered by FIPB on case to case basis.

The major share of FDI went to the service sector, representing 21% of the total FDI inflow amounting to Rs.1,18,923 crores, followed by Computer software and hardware (8%) and telecommunication sector (8%) which occupied the second and third positions in attracting the FDI accounting for Rs.47,340 crores and Rs.46,746 crores respectively while Petroleum & Natural Gas and Chemicals sector registered only three and two percent of total FDI inflows into India. Service sector, computer software telecommunication sectors observing major portion of FDI investment and around 40 percent, and intern these sectors creating optimum level of income and employment in the country. Liberalization of FDI policy frame work impacted a lot towards positive trends in FDI flows in the country.

Table – India's Foreign Direct Investment (FDI) Inflows as Percentage of GDP (Rs. In Crores)

Year	Amount of FDI Inflows	YOY Growth	% of GDP
1991-92	409		0.06
1992-93	1094	167.5	0.15
1993-94	2018	84.46	0.23
1994-95	4312	113.7	0.42
1995-96	6916	60.39	0.58
1996-97	9654	39.59	0.7
1997-98	13548	40.34	0.89

1998-99	12343	-8.89	0.7
1999-00	10311	-16.5	0.53
2000-01	12645	22.64	0.6
2001-02	19361	53.11	0.85
2002-03	14848	-23.3	0.6
2003-04	11945	-19.6	0.43
2004-05	17138	43.47	0.54
2005-06	24584	43.45	0.69
2006-07	56390	129.4	1.37
2007-08	98642	74.93	2.09
2008-09	123025	24.72	2.31
2009-10	123120	0.077	1.98
2010-11	77902	-29	-
CGR	28.08	-	-
CV	1.32	-	-

Source: www.indiastat.com

Conclusion and Policy Recommendations

It is evident from the study, that FDI inflows in India increased sharply in the post-reform period. The trend of FDI has been positive in India and world too in the post-reform period. FDI can complement local development by boosting export competitiveness, employment generation, strengthening skills, and enhanced financial resources for development. Now a day's investment environment in India has become much friendlier than previous decades. Infrastructure is being developed and FDI policy is being liberalized to improve the situation. However, a lot is to be done if we want to emerge as one of the major export oriented manufacturing hub. FDI might be one of the important sources of financing the economic development. However, one should not forget that FDI alone is not a solution for poverty eradication, unemployment and other economics issues.

Policy makers need to ensure transparency and consistency in policy making along with comprehensive development strategy to achieve the long term goals. The Major findings of the study are as follows:

1. India is striving hard to achieve a growth rate of ten percent. The available data on FDI reveals that India's volume of FDI has increase a largely due to merger and acquisitions

rather than large green fields projects. To maximize the benefits of FDI persistently, India should also focus on developing human capital and technology.

2. Indian economy is largely an agrarian economy. Therefore there is plenty of scope in food processing agriculture services and agriculture machinery. However FDI in this sector must be encouraged.
3. India has a huge pool of working population. However, due to poor quality primary and higher education, there is still an acute shortage of talent. This factor has negative repercussion on domestic and foreign business. FDI in education is still low. Therefore there is need to encouraged FDI in this sector. However, appropriate measure must be taken to ensure quality. The issues of commercialization of education and regional gap have to be addressed on priority basis.
4. It is observed that there is a major reduction in FDI in the sectors such as computer software and hardware and metallurgical industries from 25.1% to 3.5% and 26.6% to 1.7% during 2005-06 to 2009-10 respectively. FDI in this sector should be encouraged.
5. It is also observed that the sectors such as housing, real-estate and construction shows major chunk of FDI inflows, on the contrary power sector is not showing the reasonable proportion of boost in FDI in 2009-10. Therefore steps in this direction are essential to boost the FDI in power sector also.
6. Though service sector is one of the fastest growing and major sources of mobilizing FDI to India, today large part of population still do not have bank accounts, insurance of any kind, underinsurance etc. Therefore there is urgent need to address such problems to making service sector more competitive.
7. In order to improve technological competitiveness of India, FDI into research and development should be promoted. Special package can be also instrumental in mobilizing FDI in research and development.

References

- Agosin and Mayer, (2000): Fireign Investment in Developing Countries: Does it Crowd in Domestic Investment? Discussion paper no; 146, United Nations Conference on Trade and Development (UNCTAD), 2000 Palais des Nations Geneva, Switzerland.
- Basvarajappa & Chandrasekar (2001): Technological innovation and economic development choices and challenges for India, Economic and Political Weekly, 36 (34), 3238-3245.
- D.N. (2001): Basis of China's competitiveness. Economic and Political Weekly, 36 (7), 524-525.
- M. Shamim Ansari, M.Ranga (2010): India's Foreign Direct Investment: Current Status Issues and Policy Recommendations, UTMS Journal of Economics, Vol.1, No.2 pp. 1-16, 2010.
- Rajan R S, Rongala S and Ramya Ghosh (2008): "Attracting Foreign Investment to India", Unpublished Paper, April, George Mason University, Virginia, USA.
- Singh lakhwinder (2007): "India's Economic Growth and the Role of Foreign Direct Investment", MPRA Working Paper No. 6427.
- UNCTAD World Investment Report 2010; http://www.unctad.org/fdistatistics.
- Virmani, arvind. (2003). India's external reforms: modest globalization, significant gains. Economic and Political weekly, 38 (32), 3373-3390.