FDI in India : Trends and Patterns in Post Liberalization Period

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Abstract:

Foreign Direct investment (FDI) in developing countries and its growing importance in the international field is one of the major changes in the last two decades. This extraordinary growth of global FDI in 1990 around the world made FDI an important and vital component of development strategy in both developed and developing nations. India is a developing nation and second nation after China receiving maximum FDI in the world. The main objective of this paper is to find the trends and pattern of FDI in India since1991. The paper will use a theoretical approach to find the trends of FDI after post liberalization period in different sectors as well.

Keywords: FDI, Growth, Liberalization.

Foreign Direct investment (FDI) in developing nations and its amplifying significance in the international field is one of the dominant changes in the last two decades. This phenomenal growth of global FDI in 1990 around the world made FDI a significant and crucial component of development strategy in both developed and developing nations. The policies are structured in order to modulate inward flows. In reality, FDI provides a win-win situation to both the host and the home countries. Both countries are directly engrossed in inviting FDI, because such type of investment pours numerous benefits into the economies. The 'home' countries want to take the benefit of the expanded markets opened by industrial growth. On the other hand the 'host' countries want to accumulate technological and managerial skills and boost domestic savings and foreign exchange.
The other types of finance from external sources are generally debt creating, volatile and their returns depend on the performance of the projects funded by the investors. Due to the above reasons Foreign Direct Investment (FDI) inflows are suitably chosen over other forms of finance for developing countries. It also supplements international trade and transfer of knowledge, skills and technology. Developing countries have generally given preference to FDI as this is considered more stable and related to growth considerations (Haddad and Harrison, 1992; World Investment Report, 1999). Second, developing countries have been in competition in increasingly wooing FDI. In the 1990s, for example, of all variations to bilateral investment treaties about 95 percent have

been in favour of further liberalizing entry norms for FDI (World Investment Report, 1999). Third, FDI is now viewed as a major source of technology for developing countries in particular (World Investment Report, 1999; Aitken and Harrison, 1999).

The economy gets number of advantages through FDI inflows or presence of multinationals which are otherwise not available in most of the developing economies. First, domestic firms can benefit from the presence of multinationals in the same industry, leading to intra-industry or horizontal spillovers through the movement of workers within industries, demonstration effects, competition effects, and so on. Second, there may be spillovers from multinationals operating in other industries, leading to vertical spillovers. Third, Multinationals lead to improvement in export competitiveness of domestic firms. Fourth, Multinational corporations lead to generation in employment opportunities for domestic labour and improvement in their skill efficiency. Dissemination of technical knowhow is also an important advantage, which multinational firms provide in order to improve the productivity levels. Last but not the least, Increase in financial resources helps in filling the gap between domestic savings and investment, hence lead to economic development.

There are number of channels which lead to technical transfer of knowhow. Creation of new knowledge through investment in research and development is considered as the major source of technical progress and hence growth (Romer 1990).In the case of Newly Industrialised Countries (NICs), technology was found to be an important catalyst in fostering their spectacular growth (Nelson and Pack 1999). Though the effects of FDI to domestic economy through technology transfer are significant yet not automatic (see Te Velde, 1999; also see Blomström and Kokko, 2003 and OECD, 2002, Chapter 5).

Large number of empirical studies has found that there exist strong correlation between FDI and technological development. It has been noticed in various studies that FDI comes out to be a significant medium for overall industrial development of the host country. This in turn is often interpreted as the host country must be capable of absorbing the new technology manifested in FDI (e.g. see Blomström etal.,1994). Also, a further common finding is that when the technological gap between local and foreign enterprises is not very large, and crowding in of FDI and technology transfer is more likely when the level of human capital is higher, maximum technological spillovers from FDI occurs (Borensztein, et al., 1998 and OECD, 2002). As the OECD (2002, Chapter 3) concludes," Apparently, developing countries need to have reached a certain level of educational, technological and infrastructure development before being able to benefit from a foreign presence in their markets. An additional factor that may prevent a country from reaping the full benefits of FDI is imperfect and underdeveloped financial markets (p.69)".

Foreign direct investment is normally described as active role of a foreign investor in the risk capital of an existing or a new undertaking and also having a say in the management. The most common form of FDI flow is through participation in risk capital of the host country's joint stock companies (as per OECD/IMF recommendations). Every now and then foreign direct investment (FDI) is seen as a locomotive to economic growth and development, an assumption that has led many governments around the globe to try to allure

multinationals by providing lucrative financial incentives. International trade or foreign direct investment (FDI) inflow affects a local firm's activities in number of dimensions. Recently the FDI inflows have become important in the development of local firms as well as for the country because of the linkage effects.

Foreign investment is now identified as a mine of scarce capital, technology and managerial skills that were observed to be necessary in an open, competitive and world economy. The Government of India saw FDI as a potential non-debt creating source of finance and a bundle of assets, *viz.,* capital, technology, market access (foreign), employment, skills, management techniques, and environment (cleaner practices), which could solve the issues of low income growth, shortfall in savings, investments and exports and unemployment . One of the dominating arguments in favour of FDI suggests that FDI would also support India in the growth of production and trade and increase opportunities to increase the benefits that could be drawn from greater integration with the world economy. In nutshell, FDI would broaden the opportunities for India to participate in international specialization and other gains from trade. Besides FDI, export orientation has also been hailed as an engine of growth.

In the Newly Industrialized Economies' (NIEs: Singapore, Hong Kong and Tai- wan) successful economic development has been attributed to these economies' success in pursuing an export led growth strategy (Kohpaiboon, 2007) and an increased participation of foreign investors in Asia. In case of India, adoption of New Economic Policy was importantly the part of the IMF and World Bank condition that the Government of India must resort to macro-economic reforms and structural adjustments in order to be bailed out from the severe economic crisis in 1990-91(UNCTAD 1999). Consequently, in mid-1991 the Government of India resorted to full-fledged macro-economic reforms and structural adjustments with the New Economic Policy.

Despite the fact that there are gist voices of dissent echoing the familiar concerns with enhanced foreign participation in the economy, the new initiatives have had a favorable reception. Indeed, the often heard lament is that FDI inflows are low with respect to the size of the economy, it is only 5 per cent of gross domestic capital formation, Also these actual inflows are much less than approvals (around 21 percent of approvals amounting to $54 million between the years 1991-98). Alternatively, China resorted to the policy of liberalisation in mid 80s has achieved much of the economic development by the end of this century. The varying composition of the Chinese and Indian diaspora, in fact, provides one reason for the differences in the volume of FDI the two countries have allured as being shown in the table provided below:

Table 1.1 : Realized FDI in India and China (in US $ billion)

Period	China	India
1979-90	20.6	1.5
1991	4.4	0.1
1992	11.0	0.1
1993	27.5	0.3
1994	33.8	0.6
1995	73.3	1.3
1996	41.7	2.1
1997	45.3	2.8
1998	45.5	3.6
1999	40.4	2.5
2000	42.1	2.2
2001	48.8	2.3
2002	55.0	3.9
2003	53.5	2.1
2004	60.6	3.2
2005	60.3	4.6
2006	63.0	11.12
2007	74.8	15.9
2008	92.4	37.1
2009	98.9	27.0
2010	NA	21.0
2011	NA	27.8
2012	NA	22.8

Note: Financial year for India is from April-March

Source: China - PRC Ministry of Foreign Trade and Economic Cooperation

India - 1979-90 World Bank database, 1991 onwards Economic Survey.

Ministry of Commerce of the People's Republic of China.

China is a country who receives maximum FDI in the world because of the policy regime and investment friendly environment for foreign investors. India is at the second rank in terms of a destination which has attracted maximum foreign investment in the recent past. The above table shows there are huge gaps between foreign investment in India and China. The argument behind the high investment in China is chiefly from the residents of East Asian countries including Hong Kong**.** This may be so, but there is no reason to dismiss diaspora investments as inferior to those from other sources, a sort of quasi-FDI, as one commentator puts it (Wei, S 1999). Up to the extent the diaspora does bring in knowhow and technology, they do make a input to the growth process.

The openness of China has offered chance to enhance their trade and investment and shift their business interests to the mother country to take gain of relatively low cost labour and land. India have long opted for the portfolio spread of investments principally bank deposits, the sudden withdrawals of such investments was one of the dominating reasons for the economic crisis India experienced in 1991. From the above table 1.1, it is evident that FDI inflows in India were comparatively low as compared to China. In 1991, China was almost receiving 44 times more FDI in terms of US $ as compared to India. Though by the end of last century, the gap has been shortened by 19 times as compared to India. The flows of investment received by India were not sufficient for the formation of capital and economic development of the nation. After more than a decade, the first and second-generation reforms have created conducive and boosting surroundings for foreign investment in India. Half of FDI inflows to the developing world, propelled largely by an increase in registered Greenfield projects, are accounted by India and China. The FDI inflows have increased in India in the last decade. All these efforts have made India the second desired destination in the world for foreign investment after China.

The Post 1991 Phase

After July 1991, the country has opened up its door for foreign investment as most other developing countries have done but probably a little belatedly. The phobia of flag following trade was excessively dominant in India and there were some regulatory measures such as ceiling on equity, entry barriers to certain industries, export obligations, phased domestic manufacturing programme, ceiling on royalty and other payments etc. have lead to less foreign investment and consequently less economic growth. Following a restrictive policy towards FDI over the four decades with a varying degree of selectivity, India changed its tracks in 1990s and embarked on a broader process of reforms structured. Relaxation of controls over FDI constituted a significant plank of the wide ranging economic reforms introduced in 1991 is shown in table 1.2.

Table 1.2: Major economic Reforms in INDIA

Prior to 1991	Post 1991(Reforms)
a) Industrial licensing reserved several industries for the public sector.	a) Abolished with a few exceptions.
b) MRTP act restricting corporate investment.	b) Relaxed.
c) Imports subject to quotas and tariffs.	c) Removal of quotas and substantial lowering of tariffs.
d) Restrictions on FDI, foreign equity discouraged.	d) Many sectors opened up to FDI, automatic approval of foreign equity up to 51% in many sectors.
e) Control over foreign exchange.	e) Largely liberalized current account, although restrictions on capital account remain.
f) Ban on foreign portfolio investment	f) Relaxed rules.

g)Severe restrictions on the timing and pricing of capital issues	g) Substantial capital market reforms.
h) Interest rate ceilings, subsidized lending.	h) Ceilings largely removed, subsidized lending reduced.
i) Access to foreign technology restricted	i) Policies relating to technology relaxed.

During that time period, the three significant reforms done by the Indian Government were abolition of the licensing requirements governing domestic investment, reduction in tariffs on imports and recreation of controls over FDI. The most important changes in the foreign investment regime included automatic endorsement of FDI up to 51 percent of equity ownership by foreign firms in a group of 34 technology concentrated industries, a case by case deliberation of applications for foreign equity ownership up to 75 percent in nine sectors, generally relating to infrastructure, and the streamlining of procedures relating to approval of investment applications in general. Relaxation of controls over the extent of foreign ownership of equity signals a foremost disappearance from the earlier regime, although foreign ownership of equity over and above 50 per cent was subject to the requirement that the investors should balance all outgoings of foreign exchange on account of their operations with export earnings over a seven year period. The reform package as a whole heralded a removal from the former deregulated regime (Kathuria 2000).

Although the increased foreign participation in the economy created strong voices of divergence echoing the recognizable concerns , yet the new initiatives have had a sympathetic retort. By the end of this century, the FDI inflows almost augmented by 20 times as it was in 1991 as shown in the table provided below. Total FDI inflows in India from 1991-2000 are shown below in figure 1.1:

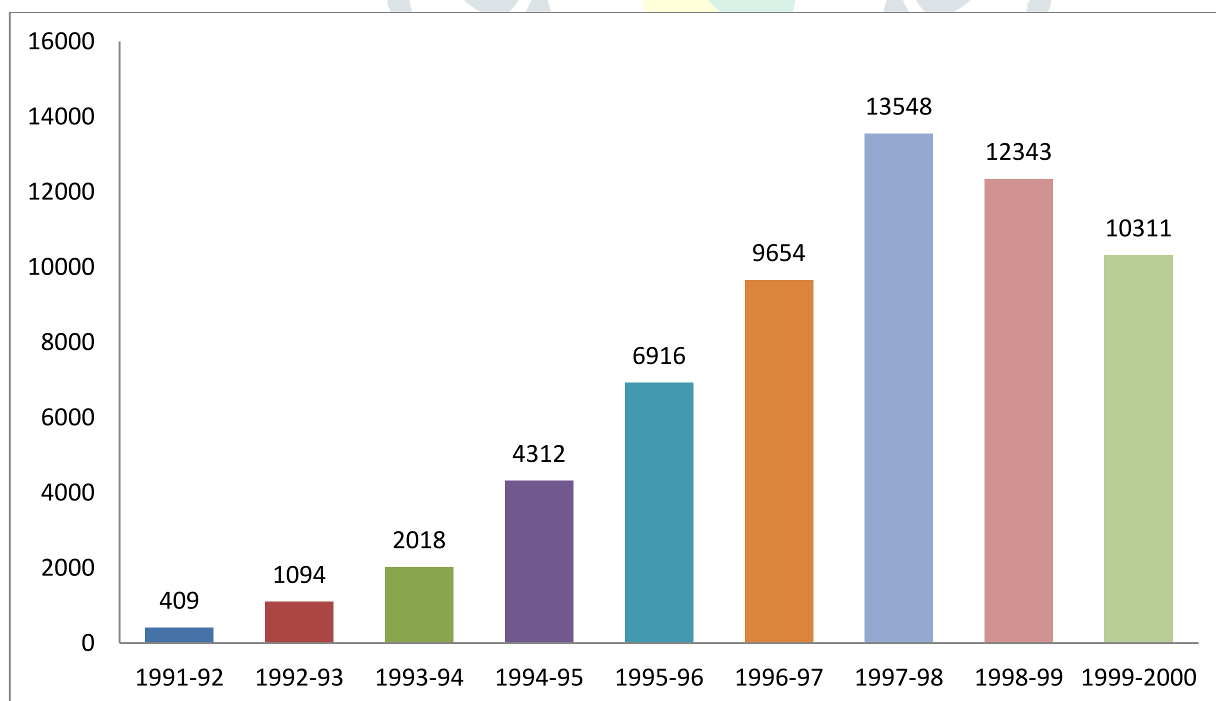

Figure 1.1:India's FDI Inflows since 1991-2000

Source: Various issues of SIA Bulletin

India has brought about a paradigm shift in its policy during the post liberalisation period by gradually removing restrictions on FDI inflow. During the period 1991 to March 2004, there has been impressive increase in the amount of Foreign Direct Investment approvals. The post-liberalisation era has also witnessed a shift of foreign ownership from minority to majority foreign ownership.

The liberalization policy has consistently helped in increasing the FDI inflow into India. The increased inflows of FDI into the Indian economy have led to the extension of cross-border production by multinational enterprises and their networks of closely connected firms in India. Another initiative of Government of India to smoothen the foreign investment and expansion of foreign trade in the form of a board known as Foreign Investment Promotion Board (FIPB). The constitution of FIPB has lead to increase in FDI inflows in the country. It is evident from the figure 1.2 that FDI inflows have increased almost 19 times in the year 2012-13 than it was in the year 2000-01. The amount of FDI inflows were decreased in the year 2002-04. But after 2005 the amount of FDI inflows has shown incredible growth. During the global recession period, India remained one of the favorite destinations of foreign investment. It reveals that foreign investors are now finding India as the most striking destination for investment.

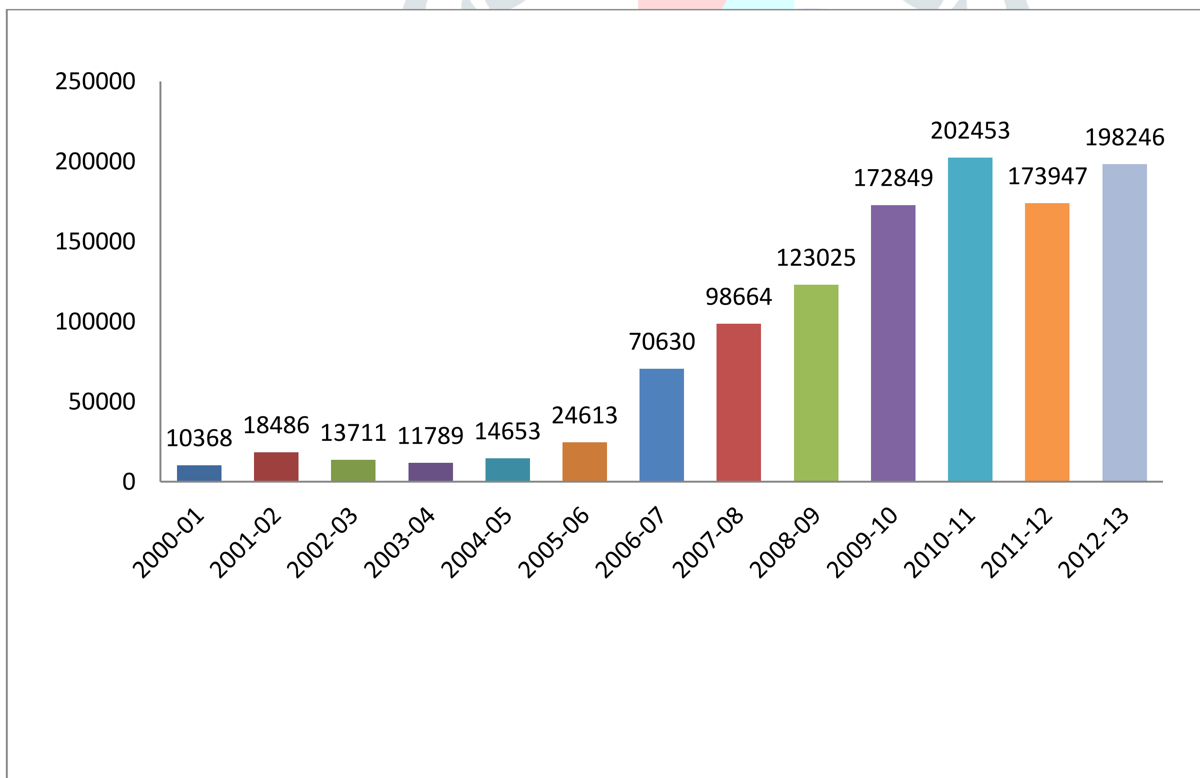

Figure 1.2: FDI inflows in India from 2001-2013

Source: Various issues of SIA Bulletin

There has been an impressive increase in the amount of Foreign Direct Investment approvals but actual inflows against these approvals have been small. FDI approvals too have shown a declining tendency during the period 2000-01 to 2003-04. Hence, there is an urgent need to make efforts to identify the causes for decline in FDI approvals as also for slow realization of commitments. It has been observed that the preference of foreign firms has been more in favour of portfolio investment which has been of volatile nature. This is not a healthy trend. Moreover, Foreign Direct Investment is more dependable than portfolio investment. NRIs too have contributed a very small proportion of FDI inflows. Another disquieting trend observed during the post-liberalisation period is that the share of India in direct foreign investment is very low when compared with other developing countries like China, Brazil, Mexico, Hong Kong, Singapore, etc. This indicates that India has not been able to benefit from foreign direct investment despite the red carpet spread by it for the foreign investors. In order to further improve its economic environment for foreign entrepreneurs, the government announced a revised FDI policy in March 2005. As per this new policy initiative, the decision to allow FDI up to 100 per cent foreign equity under the automatic route in townships, housing, built-up infrastructure and construction-development projects was made. The year 2005 also witnessed the enactment of the Special Economic Zones Act, which opened further avenues for the involvement of foreign firms in the Indian economy.

Table 1.4:**India's FDI Inflows and its Growth since 2000-2012**

Year	FDI Inflows(US $ mn)	% age of growth over previous year (in US $ million terms)
2000-01	4,029	-
2001-02	6,130	(+)52 %
2002-03	5,035	(-)18%
2003-04	4,322	(-)14%
2004-05	6,051	(+)40%
2005-06	8,961	(+)48%
2006-07	22,826	(+)146%
2007-08	34,835	(+)53%
2008-09	41,874	(+)20%
2009-10	37,745	(-)08%
2010-11	34,847	(+)34%
2011-12	46,847	-
Cumulative Inflow Since April 2000-March 2012	2,53,502	-

Source: RBI Bulletin May 2012 date 10.05.2012 (Table no 44 FOREIGN INVESTMENT INFLOWS)

Table 1.4 shows the FDI inflows from the year 2000 to 2012 in US $ Millions. It exhibits the fact that the percentage growth of FDI was highest in the year 2006-07 which is 146 percent. This is majorly because of the reason that GDP was also high during this period. The percentage growth of FDI was lowest in the year 2009-10, which is just 8 percent. The reason behind the lowest growth in the decade was because of global recession. Most of the countries were facing economic crisis. Due to the risk caught up in the investment, they are not paying attention in foreign direct investment in most of the developing economies.

To sum up, it is presumed that FDI acts as panacea for the developing countries. Developing economies are always in lack of domestic finance, So FDI act as a non debt creating source of finance for the long term economic development of the economy. Government of India has also seen it as a magic concoction to all its economic problems which had arisen in the year 1991.

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