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FDI in India- an overview of Changing Paradigm

KEYWORDS

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ABSTRACT *When J L Nehru gave a concept of mixed economy to India nobody has ever think of that one day or other India will march past for capital economy initiatives. Today most of the countries suffer from low level of income and low level of capital accumulation. Actually for a under developed country it is very difficult to live of its own when the whole world is coming near to fulfill the need of world economies. Development in both, the investing countries as well as host countries leads to the flow of foreign direct investment. This research paper talks about the impact of FDI in top most countries in world. This paper analyzes the approval and actual investment flow in different industries which is made to know the impact of FDI in India over a long time period of 15 years! In this paper we will try to find out, Where there is a wave in opposition of FDI now a days, so whether the hypothesis made by different political parties are up to the mark or not. The present study analyses to capture the determents of FDI in India with the results of year 1996 to 2011 that how it is affecting the Indian economy. Government of India has given ascent for FDI in different sectors of economy in indirectly and according the results has been achieved. Very recently the retails sector has also been opened up which generated sufficient controversies. This is the first time when FDI is touching grass root of a social sector. This paper also will try to have an answer whether opening of retails sector will boost the economy positively???*

Introduction-
Today most of the developing countries suffer from low level of income and low level of capital accumulation. The foreign investment and technology accelerate the pace of the economic development of concerned country. In India also we have evidences of the same e.g. Amul. Nobody has ever thought of that one day with the help of FDI it will become the biggest milk brand of Asia.

FDI accelerate the capital formation in the concerned country. The base economics explained by Marshall also defined it a breaking the vicious circle of poverty. " a man is poor because he is poor" the same is appropriately applicable in context of a country- " a country is poor because it is poor"

In the less developed countries the per capita income and rate of saving are very low and hence capital formation is inadequate to give big push to the economy. Hence the domestic resources may be supplemented by foreign investment.

Foreign investment brings capital as well foreign exchange which helps in filling the saving gap and the goal of total development in the developing countries. It is like a farmer who plough backs the small sugarcane root to fertilize again. Well! This ploughing-back results in expansion, modernization and development of undeveloped economies. Interestingly it adds more value to the output of recipient country rather than the return on capital from the foreign investment. In this sense the social returns are greater than the private returns of foreign investment.

The capital inflows from the other country have only two ways- either the debt or the foreign investment. This may consist either portfolio investments or foreign direct investments (FDI). FDI is needed in a country due to many reasons . some of them are as under-

- To Sustain the high level of investment
- To Fills the technological gap
- For exploration of natural resources
- Undertaking of Natural Resources
- Develops the basic infrastructure
- Improves the Balance of Payments Position
- Contributes to the tax revenues of host country

Economists tend to favor the free flow of capital across national borders because it allows capital to seek out the highest rate of return. Unrestricted capital flows may also offer several other advantages, as noted by Feldstein (2000). First, international flows of capital reduce the risk faced by owners of capital by allowing them to diversify their lending and investment. Second, the global integration of capital markets can contribute to the spread of best practices in corporate governance, accounting rules, and legal traditions. Third, the global mobility of capital limits the ability of governments to pursue bad policies.

In addition to these advantages, which in principle apply to all kinds of private capital inflows, Supporters of FDI argue that it brings better management, new technology and sometimes a cheaper finance too. Rates of lending are cheap in countries like china and Malaysia.

The academic arguments in favor of foreign investments are -

- It constitutes a net addition to inevitable resources i host countries and as such raises the growth rate.
- Pattern of growth changes since new and international product are introduced. A well marketing strategy teaches new lesson to improve the human capital.
- Welfare of both- the host as well as deploying country. Helps through MNC's.
- International commerce web moves both ways- horizontally and vertically

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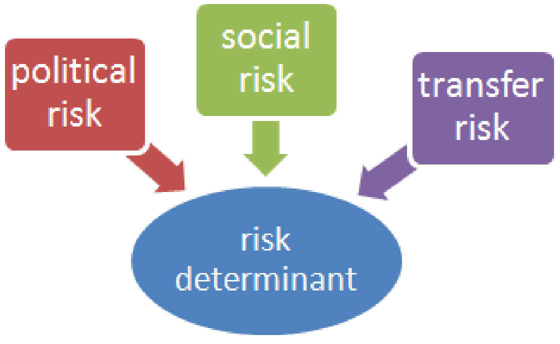
Risk involvement in Foreign capital inflows-

- But if we think that foreign capital inflow have only structural benefits, it may be over said. It contains risk also. The qualitative factors which plays the role of determinant of risk in foreign direct investments are –

T he actual flow of foreign Direct investment in any country is reflected by the degree of risk attached to the country with regards to the relevant investors. Prominent international Institutions and agencies have developed various quantitative indices which give a fair picture of risk involved in investing countries and give guidance to the investor country. Some of the popular Quantitative determinants are-



Evidences of growth through FDI in the world-

Till 1996 , (source- The Hindu, 7th oct., 1996) china was the only country which was hosting FDI. Surprisingly Japan was also out of the list but as per the latest report published by World Bank Hong-Kong (rank- 4 shared with Germany) china (Rank-8), Korea (11), Singapore (17), Japan (20), India (22) in FDI. Do we need more evidences for development indicators? Source – a list by CIA world Fact book.

FDI IN INDIA-

The evolution of Indian FDI can broadly be divided into three phases classified on the Premises of the initiatives taken to induce foreign investments into Indian economy:

(a) First Phase ;

The first phase, between 1969 and 1991, was marked by the coming into force of the Monopolies and Restrictive Trade Practices Commission (MRTP) in 1969, which imposed restrictions on the size of operations, pricing of products and services of foreign companies. The Foreign Exchange Regulation Act (FERA), enacted in 1973, limited the extent of foreign equity to 40%, though this limit could be raised to 74%

India's Experience with FDI: Role of a Game Changer for technology-intensive, export-intensive, and core-sector industries. A selective licensing regime was instituted for technology transfer and royalty payments and applicants were subjected to export obligations.

(b) Second Phase:

The second phase, between 1991 and 2000, witnessed the liberalization of the FDI policy, as part of the Government's economic reforms program. In 1991 as per the „Statement on Industrial Policy", FDI was allowed on the automatic route, up to 51%,in 35 high priority industries. Foreign technical collaboration was also placed under the automatic route, subject to specified limits. In 1996, the automatic approval route for FDI was expanded, from 35 to 111 industries, under four distinct categories (Part A –up to 50%, Part B–up to 51%, Part C–up to 74%, and Part D-up to 100%). A Foreign Investment Promotion Board (FIPB) was constituted to consider cases under the government route.

(c) Third Phase:

The third phase, between 2000 till date, has reflected the increasing globalisation of the Indian economy. In the year 2000, a paradigm shift occurred, wherein, except for a negative list, all the remaining activities were placed under the automatic route. Caps were gradually raised in a number of sectors/activities. Some of the initiatives that were taken during this period were that the insurance and defense sectors were opened up to a cap of 26%, the cap for telecom services was increased from 49% to 74% , FDI was allowed up to 51% in single brand retail. The year 2010 saw the continuation of the rationalization process and all existing regulations on FDI were consolidated into a single document for ease of reference. (Source- economic survey 2007-08)

Trend and impact of FDI on Indian GDP- (from phase II to till date)

Impact of foreign capital inflows on the growth of the Indian economy. Data has been taken from the statistical hand book on Indian Economy published Reserve bank of India. The reference period for this study has been taken for 1992-1993 to 2011-2012.Different researchers have studied the impact of foreign capital inflows on the economy of host country. Few studies have focused on the Net Foreign Direct investment and Foreign portfolio investment as well as External aids. This table is self explanatory as we took the 19 observations over the period of 19 years. When the new economic as well as foreign policy was introduced to supplement the low level of domestic investment.

Year	Net Foreign Direct Investment (Rs in Bill)	Net Portfolio Investment (Rs in Bill)	GDP At Factor Cost at Constant Price	
1993-1994	18.38	111.88		
1994-1995	41.26	120.07		
1995-1996	71.72	91.92		

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Year	Net Foreign Direct Investment (Rs in Bill)	Net Portfolio Investment (Rs in Bill)	GDP At Factor Cost at Constant Price	
1996-1997	100.15	117.58		
1997-1998	132.2	67.94		
1998-1999	130.58	2.57		
1999-2000	9.338	131.12		
2000-2001	149.24	111.20	23427.72	
2001-2002	226.3	92.90		
2002-2003	155.94	45.04		
2003-2004	109.44	518.98		
2004-2005	167.45	413.12		
2005-2006	134.25	553.57		
2006-2007	349.10	318.81		
2007-2008	637.76	1106.19		
2008-2009	1001	650		
2009-2010	860	154		
2010-2011	429	1394		
2011-2012	1032	856	52025.14	

Source- economic survey 2011-12.

SECTOR WISE FDI FLOWS IN INDIAN ECONOMY-(1991 TO 2012)

	1991- 2000	2000-10	2010-11	2010-11	2011-12	Growth
				(Apr.-Dec.)	Apr.-Dec.)	(%)
Food products	707.4	1237.3	246.9	170.7	190.8	11.8
Fermentation industries	24.0	770.1	57.7	18.0	53.2	195.0
Textiles	241.8	828.6	129.8	74.8	94.0	25.6
Wood products	0.0	18.8	1.6	1.1	11.6	1002.9
Paper	250.5	716.9	44.0	30.8	341.7	1008.6
Leather	33.5	42.6	9.3	0.4	5.6	1360.5
Chemicals	1480.9	4446.1	734.0	589.6	4001.7	578.7
Rubber, plastic & petroleum products	90.3	2953.6	573.6	555.0	323.6	-41.7
Non-metallic minerals	261.1	2263.6	657.3	623.3	207.7	-66.7
Metals and metal products	186.2	3143.2	1098.1	964.4	1495.3	55.0
Machinery and equipment	2043.1	15670.4	1846.7	1447.6	3279.0	126.5
Transport equipments	0.0	4603.2	1286.1	1048.0	609.6	-41.8
Other manufacturing	1761.6	5705.6	1495.3	1249.7	706.2	-43.5
Mining (including mining services)	0.0	730.9	79.5	75.9	136.6	80.0
Power*	1038.9	5220.9	1464.4	1072.0	1729.4	61.3
Telecommunication	1089.4	8915.9	1664.5	1326.7	1988.7	49.9
Total	16699.6	110289.3	19426.9	16039.2	24187.8	50.8

Source: Office of the Economic Adviser, DIPP.
Note: Total excludes inflows to the services sector and other non-resident Indian (NRI) schemes.

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The actual growth in FDI inflows in India-

Financial Year	As per International Practices*	Growth	FDI Equity Inflows#	Growth
2003-04	4.32	- 14%	2.19	- 19%
2004-05	6.05	+ 40%	3.22	+ 47%
2005-06	8.96	+ 48%	5.54	+ 72%
2006-07	22.83	+ 146%	12.49	+ 125%
2007-08	34.84	+ 53%	24.58	+ 97%
2008-09 (P)	41.87	+ 20%	27.33	+ 11%
2009-10 (P)	37.75	-10%	25.83	-5%
2010-11 (P)	32.90	-13%	19.43	-25%
2011-12	35.35		24.19	-
(April-Dec.)				
Apr. 2000-	240.06		157.97	
Dec. 2011				

Source: Office of the Economic Adviser, DIPP.
Note: * As per Reserve Bank of India (RBI) estimates.# As per DIPP estimates(crores)

POLICY CHANGES IN FDI IN THE YEAR 2011-

- 'Circular 1 of 2011', effective from 1.4.2011 contained a number of significant policy changes, including: (i) pricing of convertible instruments upfront, on the basis of a conversion formula, instead of price (ii) inclusion of fresh items for issue of shares against non-cash considerations, including import of capital goods/ machinery/ equipment and pre-operative/ pre-incorporation expenses (iii) removal of the condition of prior approval in case of existing joint ventures/technical collaborations in the 'same field" (iv) simplification and rationalization of guidelines relating to down-stream investments and (v) development and production of seeds and planting material, without the stipulation of having to do so under 'controlled conditions'.

- Effective May 20, 2011, Government allowed FDI, in Limited Liability Partnerships, subject to specified conditions.
- 'Circular 2 of 2011', effective from 1.10.2011, further simplified FDI and included: (i) exemption of construction-development activities in the education sector and in old-age homes, from the general conditionalities in the construction-development sector (ii) inclusion of 'apiculture', under controlled conditions, under the agricultural activities permitted for FDI (iii) inclusion of 'basic and applied R&D on bio-technology pharmaceutical sciences/life sciences', as an 'industrial activity', under industrial parks (iv) notification of the revised limit of 26% for foreign investment in Terrestrial Broadcasting/ FM radio (v) liberalization of conversion of imported capital goods/machinery and pre-operative/pre-incorporation expenses to equity instruments and (vi) introduction of provisions on 'pledging of shares' and opening of non-interest bearing escrow accounts, subject to specified conditions.
- Effective November 8, 2011, (to be reviewed after six months) Government reviewed the extant policy on FDI and decided that FDI, up to 100%, would be permitted for Brownfield investments (i.e. investments in existing companies), in the pharmaceuticals sector, under the Government approval route.
- Effective January 10, 2012, Government liberalized
- the extant policy on FDI in single brand retail trading, in which FDI, up to 51% was permitted, subject to specified conditions, by allowing FDI, up to 100%, under the Government route, subject to the additional condition that, in respect of proposals involving FDI beyond 51%, mandatory sourcing of at least 30% of the value of products sold would have to be done from Indian 'small industries/ village and cottage industries, artisans and craftsmen'.

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