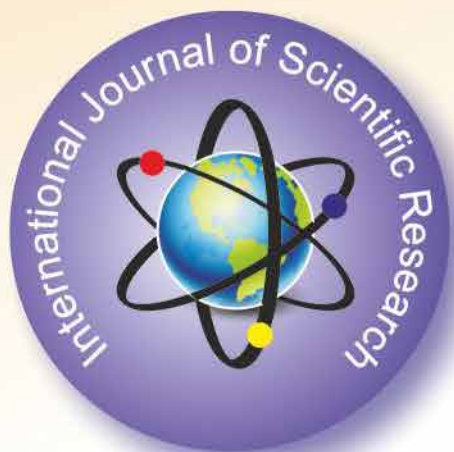


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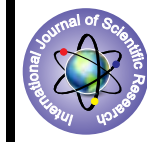
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Foreign Direct Investment in India – An Explanatory Study



Economics

KEYWORDS : liberalization, Capital, Foreign direct investments, Gross Domestic Product.

Dr. K. Madhu Babu

Assistant Professor, Dept. of Economics, Acharya Nagarjuna University, Guntur, Andhra Pradesh

ABSTRACT

Foreign direct investments (FDI) have to play a new role particularly in present days in view of the liberalization measures adopted by the Indian Government. No period in the history of India's industrial development, the Government has attached so much importance to the inflow of foreign capital than that of the present period. Particularly, the less developed countries have had to depend on financial and technical assistance from external sources. In the liberalized environment as economies become increasingly open, and trade between countries expand, financial transactions become global through financing trade of goods and services. Capital is the engine of economic development and this statement is gaining importance in the recent times. The present study is confined to the analysis of inflow of Foreign Direct investment. In this study the inflow of foreign direct investment has been studied for the period 1963-64 to 2009-10. For analytical convenience this period has been divided into two sub periods (1) The pre-liberalization period and (2) post-liberalization period. However, the focus of analysis is mostly on post-liberalization period of 1991-2010. Therefore there is plenty of scope in food processing, agriculture services and agriculture machinery. However, FDI in this sector must be encouraged. Hence, efforts must be made to encourage the inflows of FDI go mostly into the priority sectors of India. If the liberalized policy towards FDI in India is accompanied by these efforts, the country will certainly go a long way in the process of achieving the goal of sustainable economic development in the near future.

I. INTRODUCTION:

Foreign direct investments (FDI) have to play a new role particularly in present days in view of the liberalization measures adopted by the Indian Government. No period in the history of India's industrial development, the Government has attached so much importance to the inflow of foreign capital than that of the present period. Particularly, the less developed countries have had to depend on financial and technical assistance from external sources. In this context, Gait Skell suggests that the efforts of the less developed countries must be supplemented and supported by the developed countries, through financial and technical assistance and multilateral cooperative arrangements. "Without this external assistance, less developed countries cannot realize the dream of rapid economic growth". Generally, the developing countries would be suffering with lack of capital. Low levels of income and hence low levels of saving. But a huge investment is necessary to accelerate economic development. Hence, there is need for foreign capital.

In short foreign capital helps by supplementing the domestic saving to boosting investments. "Foreign investment play dynamic role in the process of economic development in mainly three ways. (1) by supplementing domestic savings (2) by providing foreign exchange for financial vital imports and (3) by introducing advanced technology".

In the liberalized environment as economies become increasingly open, and trade between countries expand, financial transactions become global through financing trade of goods and services. Capital is the engine of economic development and this statement is gaining importance in the recent times. Traditionally, the various sources of capital for developing countries were either the demand for this out put by industrial countries or Foreign aid or loans from foreign banks. FDI is an important factor in the globalization process as it intensifies the interaction between states, regions and firms. Growing international flows of portfolio and direct investment, international trade, information and migration are all parts of this process. The favorable policy framework for FDI is the on

that generally provides economic stability, transparent rules on entry and operations, equitable standards of treatment between domestic and Foreign firms and secures the proper functioning and structure of the markets. In general empirical evidence suggests that policies encouraging domestic investment help to attract domestic investment. FDI contributes to the development process by providing capital, foreign exchange, technology, competition and export market access, while also stimulating domestic innovation and investment. Above all, the inflow of foreign direct investment, if properly directed would bring about upliftment of the economically backward states, thereby achieving the objective of balanced regional development. This

is because the inflow of Foreign direct investments may largely go into the priority sectors of the economy in general and more particularly in to the economically backward states of India. On the recent years many efforts are being made to plan effectively to devise policies that will succeed in encouraging a greater inflow of FDI companies into India and ensuring that it makes the maximum contribution to the Foreign exchange earnings of our Country. In this backdrop the present paper an attempt is made to study the growth and significance of FDI in India.

II. OBJECTIVES:

The objectives of the present study are

- 1) To examine trends in Foreign direct investment in India and
- 2) To analyse the FDI companies into priority and non-priority sector wise inflow of FDI into India.

III. METHODOLOGY:

The present study is confined to the analysis of inflow of Foreign Direct investment. In this study the inflow of foreign direct investment has been studied for the period 1963-64 to 2009-10. For analytical convenience this period has been divided into two sub periods (1) The pre-liberalization period and (2) post-liberalization period. However, the focus of analysis is mostly on post-liberalization period of 1991-2010. In order to study the growth of the inflow of foreign direct investments, linear growth rates have been calculated for both pre-liberalization and post-liberalization periods under consideration. Simple techniques of percentages have also been employed.

IV. SOURCES OF DATA:

The present study is based primarily on secondary data. The data for this work are taken from a variety of sources. The publication of secretariat for Industrial Assistance (SIA) of Ministry of Industry, Government of India is a main source of information for data on FDI flows, country – wise break up and sector – wise break up. Data are also taken from CME, www. Indiatat.com and Reserve Bank of India (RBI) Bulletins.

V. NET IN FLOW OF FOREIGN DIRECT INVESTMENTS IN INDIA

The inflow of foreign direct investments during the pre and post-liberalization period 1963-64-1980-81 & 1991-2010 are presented in table – 1.

TABLE – 1

Net Inflow of Foreign Direct Investment (1963-64 to 1979-80 & 1991-92 to 2009-2010)
(Rs. in crore)

Pre - Liberalization Period		Post - Liberalization Period	
Year	FDI Amount	Year	FDI Amount
1963-64	22.4	1991-92	409

1964-65	44.10	1992-93	1094
1965-66	15.20	1993-94	2018
1966-67	24.40	1994-95	4312
1967-68	23.40	1995-96	6916
1968-69	25.30	1996-97	9654
1969-70	21.90	1997-98	13548
1970-71	34.00	1998-99	12343
1971-72	43.10	1999-00	10311
1972-73	28.40	2000-01	12645
1973-74	48.70	2001-02	19361
1974-75	69.90	2002-03	14848
1975-76	-8.10	2003-04	11945
1976-77	-26.80	2004-05	17138
1977-78	-17.80	2005-06	24584
1978-79	-23.70	2006-07	56390
1979-80	68.50	2007-08	98642
1980-81	68.80	2008-09	123025
--	--	2009-10	123120

Source: 1) Various Issues of RBI Bulletins, Mumbai, 2) www.indiastat.com.

As can be seen from the table, there are wider fluctuations in the net flow of foreign direct investments. While foreign direct investment was about Rs. 22.4 crores in 1963-64, this investment got doubled in the following year (1964-65) and again there was a drastic fall of the foreign direct investments to Rs. 15.20 Crores in the following year (1965-66). In the subsequent years though the foreign direct investment was more or less moving around Rs. 23.40 crores, it went up to Rs. 34.0 crores by 1970-71. In the pre - liberalization period a maximum inflow of foreign direct investment was noticed in the year 1974-75. However, the FDI recorded a negative inflow from 1975-76 to 1978-79. Interestingly, a positive amount of Rs. 68.5 Crores of FDI was recorded in the following year (1979-80). Thus, the table reveals wider fluctuations in the inflow of foreign direct investment during the pre - liberalization period.

The data relating to the new inflow of foreign direct investment for the post-liberalization period are also shown in the same table, as can be seen from the table the net inflow of foreign direct investment has increased steadily from Rs. 409.0 crore to Rs.123120 crore. There is a continuous increase in the foreign in the foreign direct investment during this period. This is mainly attributable to the liberalization policies adopted by the Government.

The linear growth rates have been worked out for the inflow of Foreign Direct Investment periods and are given in table - 2.

„ Table - 2 Linear Growth Rates of Foreign Direct Investments

Pre-liberalization period 1963-64 to 1980-81	Post-liberalization period 1991-92 to 2009-10
-0.0534 (-0.8578)	0.0161* (11.0574)

Figures in brackets indicate t - values. * Significant at 1 percent level.

As can be seen from the table the growth rate during the pre-liberalization period is observed to be -0.0534, which is not found to be statistically significant, while the growth rate in the post-liberalization period is worked out to be positive (0.0161) and is also statistically significant at 1 percent level.

Net Inflow of Foreign Direct Investment by Country-Wise

S.No.	Country	1991-2002	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	Cumulative inflow
1.	Mauritius	27466 (29.65)	3766 (25.22)	2609 (21.53)	15414 (8.99)	11441 (16.2)	28759 (40.72)	44483 (45.09)	50899 (41.37)	49633 (40.31)	200629 (30.5)

If we compare the inflow of foreign direct investments during the pre-liberalization period and the post-liberalization period, one can easily notice that there is tremendous increase in the inflow of foreign direct investments during the post-liberalization period. This only reveals that liberalization policies adopted by the Government of India since 1986 have paved the way for attracting the foreign direct investment substantially into India.

VI. FOREIGN DIRECT INVESTMENT (FDI) / GROSS DOMESTIC PRODUCT

(GDP): FDI/GDP Ratio:

A good indicator of a country's openness to FDI is FDI normalized by the size of the host economy which indicates the attractiveness of an economy to draw FDI. A country with a ratio of FDI to GDP that is greater than unity is reckoned to have received more FDI than that implied by the size of its economy. It indicates that the country may have a comparative advantage in production or better growth prospects reflecting larger market size for foreign firms. However if the country has the ratio value of less than one may be protectionist and backward or may possess a political and social regime that is not conducive for investments. Overall, FDI, GDP ratio is an index of the prevailing investment climate in the host economy.

Table - 3: India's FDI inflow as percentage of GDP (Rs. in crores)

Year	FDI	FDI/GDP %
2001	12645	0.6
2002	19361	0.85
2003	14848	0.6
2004	11945	0.43
2005	17138	0.54
2006	24584	0.69
2007	56390	1.37
2008	98642	2.09
2009	123025	2.31
2010	123120	1.98

Source: 1) World Development indicators data base-World Bank - 2008 2) www.indiastat.com .

Table - 3 reveals of FDI as a percentage of GDP for India under the period of study years. The share of FDI inflows in GDP has been very small in absolute terms, remaining less than one (2001 to 2006). However the ratio improved dramatically (1.37) in 2007, which reflects the growth in the domestic economy, improvement in the investment climate as well as the buoyancy in FDI flows. FDI inflows in India, in general, show an increasing trend during the post - reform period.

VII. COUNTRY - WISE FOREIGN DIRECT INVESTMENT:

It is of interest now to analyse the inflow of foreign direct investments from various countries into India for the period under consideration 1991- to 2009-10. However, this analysis is confined to post-liberalization period (i.e. 1991-2010). It is also proposed to confine this analysis to ten major investing countries of the world which are as follows: 1) Mauritius, 2) US, 3) Netherlands, 4) Japan, 5) UK, 6) Germany, 7) Singapore, 8) France, 9) South Korea and Switzerland. Percentage rates have been calculated to study the trends in country-wise foreign direct investment. The data relating to the country-wise inflow of foreign direct investment during the post-liberalization period along with the percentages are presented in table - 4.

Table - 4

2.	U.S.	12248 (13.22)	1504 (10.07)	1658 (13.68)	30553 (17.8)	2210 (3.13)	3861 (5.48)	4377 (4.44)	8002 (6.50)	9230 (7.5)	58233 (8.86)
3.	Netherlands	3856 (4.16)	836 (5.59)	2247 (18.54)	12168 (7.1)	340 (0.48)	2905 (4.11)	2780 (2.82)	3922 (3.19)	4283 (3.48)	26398 (4.02)
4.	Japan	5099 (5.50)	1971 (13.19)	360 (2.97)	5751.9 (3.36)	925 (1.31)	382 (0.54)	3336 (3.38)	1889 (1.53)	5670 (4.6)	17953.9 (2.73)
5.	U.K.	4263 (4.60)	1617 (10.82)	769 (6.34)	4583.5 (2.67)	1164 (1.65)	8389 (11.88)	4690 (4.75)	3840 (3.12)	3094 (2.51)	25760.5 (3.92)
6.	Germany	3455 (3.43)	684 (4.58)	373 (3.07)	6631.9 (3.87)	1345 (1.9)	540 (0.76)	2075 (2.10)	2750 (2.23)	2980 (2.42)	16321.9 (2.45)
7.	Singapore	1997 (2.15)	180 (1.20)	172 (1.41)	8217.3 (4.79)	1218 (1.72)	2662 (3.77)	12319 (12.49)	15727 (12.78)	11295 (9.17)	51438.3 (7.8)
8.	France	1947 (2.10)	534 (3.57)	176 (1.45)	5367.8 (3.13)	82 (0.12)	528 (0.75)	583 (0.59)	2098 (1.70)	1437 (1.17)	10095.8 (1.54)
9.	South Korea	2189 (2.36)	188 (1.25)	110 (0.90)	219 (0.31)	1174 (1.66)	1039 (1.05)	1133 (0.92)	3017 (2.45)	-	6582 (1.0)
10.	Switzerland	1200 (1.29)	437 (2.92)	207 (1.70)	-	310 (0.44)	266 (0.38)	3385 (3.43)	5983 (4.86)	7728 (6.23)	17672 (2.62)
	Total FDI inflows	92611	14932	12117	171379	70630	70630	98664	123025	123120	657448

Source: 1) Foreign Direct Investment – A Fact Sheet – Economic & Political Weekly, January, 6-2007, P.07. 2) www.indiastat.com

Note: Figures in brackets are percentages to totals.

As can be seen from the table, it is evident that Mauritius emerged as one of the largest foreign investors in India. In India FDI equity inflow has been Rs. 123120 crores in 2009-10. India's 79.84 percent of FDI is contributed by ten countries while remaining 20.16 percent by rest of the world in 2009-10. Country-wise FDI inflows to India are dominated by Mauritius (40.31 percent) followed by the Singapore (9.17 percent), United States (7.5 percent) and Netherlands (3.48 percent). The net inflow of Foreign direct investment from France accounted for Rs. 534 crores in 2002-03 and finally increased to Rs. 1437 crores (1.17 percent) by 2009-10. In respect of Germany the Foreign direct investments accounted for Rs. 684 crores in 2002-03 and this went steadily increasing from year to year and ultimately accounted for Rs. 2980 crores (2.42 percent) by 2009-10. It is interesting to observe that the net inflow of foreign direct investment from Switzerland has also increased steadily from Rs. 437 crores (1.25 percent) in 2002-03 to Rs. 7728 crores (6.23 percent) in 2009-10. As regards foreign direct investment net inflow in concerned, it recorded an inflow of Rs. 92611 crores in 1991-2002 and experienced a steady increase in the inflow which went up to Rs. 657448 crores by 2009-10. It can also be inferred from this analysis that more liberal attitude of the Government towards the foreign direct investment seems to be the major reason for substantial increase of foreign investments.

VIII. FOREIGN DIRECT INVESTMENT INTO PRIORITY AND NON - PRIORITY SECTORS:

It is generally believed that the impact of FDI in a developing economy would be more effective, if the inflow of FDI goes mostly into the priority sector rather into the non-priority sector. An exercise is made to trace the inflow of FDI into priority and non-priority sectors with a particular reference to the pre-liberalization period and post liberalization period. For analytical convenience, it is proposed to take 1987-90 as representing the pre-liberalization period and 2005-2010 as representing the post-liberalization period. In this exercise the priority sector includes electricity, textiles, chemicals, non-metallic mineral products, metals and metal products, machinery, transport equipment and mining, while the non-priority sector includes services, food and beverages, irrigation and other industries. The data relating to the inflow of foreign direct investments into priority sector and non-priority sectors for the pre-liberalization period (1987-1990) and post liberalization period (2007 to 2010) are presented in table – 6.

Table – 6
Break – up of FDI into priority and non-priority sectors in India (1987-90 – 2005-10)

SL. No.	Industry	1987-90 Rs. Cr	Relative Share (%)	2007-10 Rs. Cr	Relative Share (%)
Priority Sector					
1.	Textiles	356	4.88	6724	0.5
2.	Chemicals	2532	34.76	6054	10.3
3.	Non-Material mineral products			11803	0.8
4.	Metals & metal products	470	6.95	10778	4.3
5.	Machinery	1107	15.19	24961	1.7
6.	Transport Equipment	899	12.34	16722	1.1
7.	Mining	27	0.3	67,200	4.6
8.	Electricity	1,024	14.06	4,29,358	29.1
	Sub – Total	6415	88.08	7,72,096	52.4
Non - Priority Sector					
9.	Service	178	2.445	573065	38.8
10.	Food and beverages	525	7.20	9337	0.7
11.	Irrigation	-	-	1,16,328	7.9
12.	Other Industries	165	2.26	4,329	0.3
	Sub-total (ii)	868	11.92	7,03,459	47.6
	Total	7233	100.00	14,75,555	100.0

Source: 1) CMIE – 2010. 2) RBI Bulletin 2011.

The following are the main observations industry – wise break up of the data foreign direct investments in the pre-liberalization period revealed that chemical industry recorded an inflow of Rs. 2,532 crores, accounting for 34.76 percent in the total investment, followed by industrial machinery claiming 15.19 percent, transport equipment industry absorbing 12.34 percent in total investment. The inflow of foreign direct investment into metals and metal products was Rs. 470 crores and it worked out to 6.45 percent in the total investment. While the foreign direct investment in electricity amounted to Rs. 1,024 crores, thereby claiming 14.06 percent of the total investment. As can be seen from the table during the pre-liberalization period the mining industry could attract very low FDI i.e., Rs. 27 crores, there by claiming only 0.3 percent in the total investment.

Thus, it can be observed that all the industries in the priority sector taken together could as high as 88.08 percent of the foreign direct investments during the pre-liberalization period, leaving just 11.02 inflows into the non-priority sector. During the post-liberalization period the foreign direct investment in electricity recorded an inflow of Rs.4,29,358 crores, claiming

29.1% in total investment followed by chemical industries explaining 10.3 percent in total investments. The inflow of foreign direct investments into textiles industries has come down to 0.5 percent in total investment, while the inflow of foreign direct investment in the mining claimed 4.6 percent in total investment and the metals and products explained 4.3 percent in total investment. The inflow of foreign direct investment in the industrial machinery accounted for 1.7 percent in the total investment while the inflow of foreign direct investment in the transport equipment industries absorbed 1.1 per cent in the total investment; the non-metallic mineral products explained only 0.8 percent in total investment.

Thus, it can be observed from the above analysis that the priority sector during the post-liberalization period could absorb just 52.40 percent in the total investment, there by allowing 47.60 percent of investment to the non-priority sector. It is observed that while the priority sector attracted 88.08 percent of the total investments during the pre-liberalization period, it could attract only 52.40 percent during the post-liberalization period. This does not augur well for the Indian economy.

X. CONCLUSION:

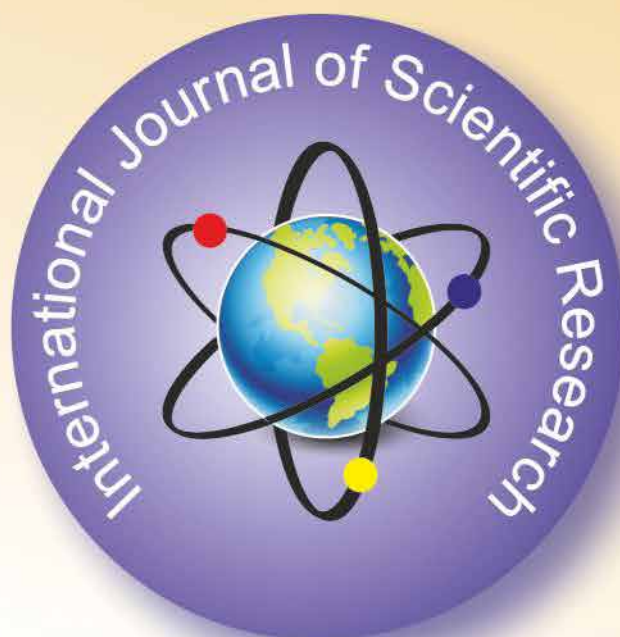
The liberalized policy towards foreign direct investments in India is a welcoming trend in the recent years. It is evident from the study that FDI inflows in India increased sharply in the post-

reform period. The trend of FDI has been positive in India and world too in the post-reform period. FDI 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 economic issues.

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 increased a largely due to merger and acquisitions rather than large greenfields projects. To maximize the benefits of FDI persistently, India should also focus on developing human capital and technology. 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. Hence, efforts must be made to encourage the inflows of FDI go mostly into the priority sectors of India. If the liberalized policy towards FDI in India is accompanied by these efforts, the country will certainly go a long way in the process of achieving the goal of sustainable economic development in the near future.

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