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Research Paper

Foreign Direct Investment in India

Economics

KEYWORDS :

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ABSTRACT

India has emerged as favourable destination of FDI. Its large middle class population has given a big boost to attract the FDI. With the introduction of delicensing and disinvestment many obstacles in the way of FDI inflow have been removed. India has become an attractive FDI destination because of vast population provides a big market to the foreign entrepreneurs and secondly because of its English language skill. This study makes it very clear that FDI has gone unevenly among the states and sectors. Relatively more advanced states are able to attract more FDI than other states of the country. Major portion of FDI has gone to few sectors.

Introduction

Foreign Direct Investment is an investment in a foreign country where investors retain control over the investment. India has advantage in technical manpower, particularly in information technology and has remained favourite destination for FDI. It has better English language skills and English is widely used as the language of business and education in addition, a vast middle class provides a market for consumer goods.

Objectives

a) What has India done till now to attract FDI.
b) Which sectors attracts maximum FDI.
c) Which states attract maximum FDI?
d) Which countries are major source of FDI in India.

Methodology

In this study secondary source of data has been applied. A modest attempt has been made to study various books, journals, research papers and reports. Attempts have been made to make the study from the Indian point of view that combines national level and state level functions and suggests concrete steps in learning from Indian experiences. There is need to study some crucial aspect which will clear some illusion and skepticism relating to real flow of FDI e.g. 'Round Tripping' deserves the special attention here.

Literature Review

Studies have made it clear that market size, measured by GDP, GDP per capita, GNP or GNP per capita has a significant effect on inward FDI. Other key factors include labour costs and high investment return (Ali Shauket and Wei Guo). India's strength is based on knowledge based sectors such as IT and pharmaceutical it's more developed financial markets and more robust private sector (Zhao Renfend).

According to World Investment Report 2003 (UNCTAD2003) FDI has been much less important in deriving India's export growth in IT. FDI accounted for only 3% of India's exports in early 1990s and even today, it is estimated to account for less than 10% of Indian manufacturing exports. The contribution of FDI to India's export was insignificant before 1990s as well (Chandra1994).

The survey results presented by A.T. Kearney (2004) suggest that India is increasingly perceived as an R & D hub for a wide range of industries. It has become common place among foreign investors that India offers a well educated workforce which according to Borensztein et.al. (1998), is essential for FDI to have growth effects.

The Growth of FDI inflows in India

According to Economic Survey of 2007-08 FDI inflows into India accelerated in 2006-07. On a gross basis, FDI inflows into India, after rising to a level of US$ 6.2 billion in 2001-02, fell to US$ 4.5 billion in 2003-04. After a recovery, the proportion has risen to reach US$ 23.0 billion in 2006-07. In spite of the global meltdown, in fiscal year 2007–08, about US$ 32.4 billion as foreign investment had poured into India (IBEF 2009).

It could be observed that there has been a steady build up in the actual FDI inflows in the post-liberalization period (Table 1). Actual inflows have steadily increased from Rs. 3,514.30 million (US $ 143.6 million) in 1991 to Rs. 143,009.40 million (US $ 3,108.9) in 2003.

Table1: Foreign Direct Investment and its share to GDP in India from 1991-2003

year	FDI Inflows	Annual growth rate @	FDI as a % of GDP@
1991	3,514.30		0.62
1992	6,751.80	0.92	1.03
1993	17,877.10	1.65	2.39
1994	32,892.80	0.84	3.83
1995	68,200.30	1.07	6.75
1996	103,892.00	0.52	8.79
1997	164,253.30	0.58	12.00
1998	133,398.40	-0.19	8.76
1999	168,677.90	0.26	9.69
2000	193,417.40	0.15	9.99
2001	192,651.00	0.00	9.16
2002	212,859.70	0.10	9.27
2003	143009.40	-0.33	6.36

Source: Reserve Bank of India, (ECD) Central Office, Mumbai, India

Data given in table-1 shows that the post-reform period has witnessed a rapid increase in actual FDI inflows from Rs. 3,514.30 in 1991 to Rs. 193,417.40 in 2000 then declined to Rs.192, 651.00, in 2001. Unfortunately, the actual inflows were low till 1997, but the situation has shown distinct improvement thereafter Actual flow during 2002 peaked to Rs. 212,859.70 then declined to 143,009.40 in 2003. In a study on FDI, Confederation of Indian Industry has estimated the FDI approvals over the seven year period 1991-98 at $ 55.1 billion while actual inflows have been estimated at $11.9 billion. Thus almost 80 % of the FDI approved between 1991 and 1998 did not fructify and remained only on paper.[1]

Country wise FDI inflows in India

The FDI stock for the period of 1991-1999 from Mauritius is the largest (30.12%) even though the US alone accounted for nearly a quarter (20.19%) of the total FDI inflows. The other top eight countries viz., Japan, UK, Netherlands, Germany, South Korea, Singapore, France and Switzerland collectively shared 35.79 per cent of the total actual FDI inflows to India for a decade.

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Table 2: Share of top investing countries in FDI inflows

Country	1991-1999	% to the Total FDI	2000	% to the Total FDI	2001	% to the Total FDI	2002	% to the Total FDI	2003	% to the Total FDI
Maurititius	124,659.00	30.12	35,686.50	35.36	75,036.10	47.37	72,844.60	45.18	25,859.300	26.95
USA	83,542.30	20.19	17,993.10	17.83	16,541.30	10.44	13,572.00	8.42	19,040.00	19.84
Japan	29,693.70	7.18	9,856.90	9.77	9,965.40	6.29	19,804.60	12.28	4,343.90	4.53
UK	22,279.00	5.38	2,814.80	2.79	12,840.20	8.11	16,988.10	10.54	8,629.00	8.99
Netherlands	21,743.30	5.25	5,468.00	5.42	10,315.50	6.51	7,475.60	4.64	11,618.80	12.11
Germany	23,510.80	5.68	3,714.70	3.68	5,981.30	3.78	6,629.30	4.11	3,625.00	3.78
Korea (South)	20,920.90	5.06	761.70	0.75	203.00	0.13	1,814.40	1.13	1,128.60	1.18
Singapore	12,393.20	2.99	5,015.20	4.97	1,606.60	1.01	2,262.30	1.40	1,680.50	1.75
France	9,638.10	2.33	3,415.80	3.38	5,951.30	3.76	5,301.50	3.29	1,624.50	1.69
Switzerland	7,951.20	1.92	1,872.20	1.86	1,780.20	1.12	2,516.90	1.56	4,289.60	4.47
Total of all countries (in Indian Rupees)	413,806.40	.	100,923.80		158,418.00		161,233.60		95,960.40	
Total of all countries (in US$)	11,489.70		2,347.00		3,520.40		3,359.00		2,079.10	
Source: Ministry of Commerce and SIA										

It implies that these top ten countries accounted for well over 86 per cent of the FDI inflows during the above period. The country-wise annual growth rate of the FDI inflows shows that Mauritius, which was not in the picture till 1992, has the highest growth rate. A lion's share of such investment is represented by the holding companies of Mauritius set up by the US firms. The shares of the total FDI inflows of these top 10 countries have been fluctuating since recent years (Table 2).

State wise Flows of FDI Approvals
Table-3

State wise Flows of FDI Approvals (August 1991 to March 2004)			
States	No of Approvals	Amount (Rs. Crores)	Percent Of total
1.Maharashtra	4,816	51,115	17.5
2.Delhi	2,638	35,251	12.1
3.TamilNadu	2,607	25,072	8.6
4.Karnataka	2,467	24,138	8.3
5.Gujarat	1,204	18,837	6.4
6.Andhra Pradesh	1,226	13,745	4.7
7.West Bengal	670	9,317	3.2
8.Madhya Pradesh	242	9,271	3.2
9.Orissa	140	8,229	2.8
10.Utter Pradesh	798	4,917	1.7
11.Harayana	868	3,870	1.3
12.Rajasthan	341	3,033	1.0
13.Punjab	199	2,434	0.8
14.kerala	325	1,552	0.5
Others	6,951	81,557	27.9
Total	25,482	2,92,358	100.0
Source: Ministry of Commerce and Industry, SIA Newsletter, April 2004			

A review of State-wise Flow of FDI Approvals reveals (in table-3) that Maharashtra tops the list with Rs. 51,115 crores (17.5 %), followed by Delhi Rs. 35,251 crores (12.1 %), Tamil Nadu Rs. 25,072 crores (8.6 %), Karnatka Rs. 24,138 crores (8.3 %), Gujarat Rs.18,837 crores (6.4 %), Andhra Pradesh Rs. 13,745 crores (4.7 %), West Bengal Rs. 9,317 crores (3.2 %) and Madhya Pradesh Rs.9,271 crores (3.2 %). These eight states taken together account for 64 % of total investment approvals. Utter Pradesh accounted for barely 1.7 % and Bihar and Jharkhand together accounted for 0.3 % of total FDI approvals. There is a need to alter the flow of FDI in relatively less well-off states.

Sectors Attracting Highest FDI Approvals with actual Inflows:
Among the core sectors, transportation industry accounted for 12.45 per cent followed by electrical equipments including IT and electronics with 9.76 per cent, and service and telecommunication sector with 9.77 per cent and 9.76 per cent respectively of the total investment. The share of the FDI inflows to the top sectors is not very encouraging baring electrical equipments, telecommunications and power and fuels sectors in recent years (Table 4). Furthermore, there is a gradual increase in the mergers and acquisitions during the 1990s which show a tendency of FDI inflows to acquire existing industrial assets and managerial control without actually engaging in new productive activities (Nagraj, 2006).

Table 4: Top Sectors attracting highest FDI inflows in India

Sector	FDI stock (1991-1999)	% of FDI stock (1991-1999)	2000-2003	% of FDI stock 2000-2003	FDI stock (1991-2003)	% of FDI stock (1991-2003)
Electrical Equipments (Including IT ad Electronics)	46,424.75	11.22	78,033.98	15.12	124,469.95	13.38
Transportation Industry	51,520.67	12.45	62,376.65	12.08	113,897.32	12.25
Telecommunications	40,376.82	9.76	65,890.19	12.76	106,267.01	11.43
Power and Fuels	36,433.77	8.80	60,747.11	11.77	97,180.88	10.45
Service sector (Financial and Non Financial)	40,443.49	9.77	39,398.72	7.63	79,842.21	8.58
Food Processing Industries	23,676.92	5.72	17,627.75	3.41	41,304.67	4.44
Drugs and pharmaceuticals	8,221.75	1.99	11,465.47	2.22	19,687.22	2.12

Metallurgical Industries	6,333.34	1.53	5,711.86	1.11	12,045.20	1.30
Textiles	8,293.49	2.00	3,323.44	0.64	11,616.93	1.25
Industrial Machinery	3,627.90	0.88	2,719.95	0.53	6,347.85	0.68
Total FDI Inflows in Indian Rupees	413,806.40	73.76	516,215.80	70.57	93,022.20	71.99
Total FDI Inflows in US Dollar)	11,489.70	-	-	-	22,795.20	-
Source: Ministry of Commerce and Industry, Annual Report 2003- 04.						

Conclusion

On the basis of above discussion, we conclude that there is need to attract FDI in the Indian economy. The market is still very much dependent on the bureaucracy and decisions are quite slow. Relatively advanced states are able to attract larger quantity of FDI because, they possess basic infrastructure facilities. There is need of improving the basic infrastructure of backward states by giving stress on both quantity and quality. Law, rules, regulations relating to infrastructure are sometimes missing or unclear e.g. the power sector is beset with multiple problems such as State monopoly, bankruptcy and weak regulators.

Suggestions

1) Government should invest more on skill education. Education system must inculcate the entrepreneurship so that the potential of abundant people may be utilized in a proper direction.
2) Red-tap and bureaucratic corruption must be eradicated so that the gap between approval and actual FDI can be bridged.
3) Effort should be made to invest on the quantity and quality of infrastructure so that better road connectivity and uninterrupted power supply may be realized to some extent.

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