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Scenario of FDI in India

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ABSTRACT

The issue of economic prosperity is always linked to massive inflows of FDI into a nation. FDI brings sufficient amount of physical and financial capital to the economy along with technical know-how, skilled personnel, organization experience and a host of other benefits. It has strong technology and productivity spillover effects and would improve the productivity of the economy. New Economic Policy 1991 reflects India's determination to facilitate foreign capital, new technologies, industrial growth and moving towards higher economic growth. The new policy, besides several other measures, greatly increase the role of private sector and an opening up of the economy to a greater external and internal competition. This conducive and enabling environment induces foreign investments that create external resource supplement and thus, aid the economy to grow in an upward direction. However to maintain the full phase operation of foreign investment, India has to offer large diversified market, well organized industrial base, socio-economic infrastructure, abundant scientific and engineering talent, relatively low cost and well trained labour force to the foreign investors. But it can't be denied that in India it has gone unevenly among the states and sectors. Advanced regions have attracted more FDI than other regions of India and major portion has gone to few sectors.

KEYWORDS

Introduction

India's FDI policy clearly reflected the need to supplement foreign capital and technology for rapid economic growth. Foreign capital was preferred in specific areas which bring in new technology and establish joint ventures with Indian partners. Government also granted tax concessions to foreign enterprises and streamlined industrial licensing procedures to accord early approvals for foreign collaborations. It has been widely accepted that protection of domestic industry for a longer period of time resulted into high cost production structure along with poor quality. Foreign direct investment policy announced by the Government of India in July 1991 was regarded as a dramatic departure from the earlier restrictive and discretionary policy towards foreign capital. The FDI policy of 1991 proposed to achieve objective of efficient and competitive world class Indian industry. Foreign investment was seen as a source of scarce resource, technology and managerial and marketing skills.

Existing Definition of FDI in India

FDI statistics in India are monitored and published by two official sources: (a) Reserve Bank of India (RBI), and (b) Secretariat for Industrial Assistance (SIA) in the Ministry of commerce and industry. The finance and external affairs ministries also play their part from time to time.

The RBI presents balance of payment statement in the RBI Bulletin and its Annual Report on monthly an annual basis, respectively. SIA reports FDI inflows on both approval and actual basis in its monthly SIA's Newsletter and SIA Statistics.

In fact, compared to the international standard, the Indian FDI statistics appears to be limited because it includes only one component – foreign equity capital reported on the basis of issue/ transfer of equity or preference shares to foreign direct investors. Some of the principle components that India excludes from the IMF definition while estimating actual FDI inflows are:

- Reinvested earnings by foreign companies (which are part of foreign investor profits that are not distributed to shareholders as dividends and are reinvested in the affiliates in the host country).
- Proceeds of foreign equity listings and foreign subordinated loans to domestic subsidiaries as part of inter-company (short and long-term) debt transactions.
- Overseas commercial borrowings (financial leasing, trade credits, grants, bonds) by foreign direct investors in foreign invested firms.
- Equity well over 20 per cent in the form of American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) held by Foreign Institutional Investors (FIIs).

The FDI accounting procedure in India also omits non-cash acquisition of equity, investment made by foreign venture capital investors, earnings data of indirectly held FDI enterprises, control premium, non-competition fee etc., as per IMF definition, which are normally included in other country statistics. All of these accounts for a massive underestimation of FDI in India and therefore with appropriate adjustment consistent with IMF standards, FDI data in India could be substantially enhanced.

As mentioned above, an especially important component of FDI that is excluded in India constitutes the reinvested earnings, which companies so far have reported on a sporadic and voluntary basis. India has had foreign companies here for decades and many of them have reinvested heavily over the years. If the retained earnings from all these are cumulated, then the current returns on the stock of retained earnings would have to be added to the returns on measured FDI. Added together, these total returns would be high relative to the stock of measured FDI. However, even the flow in recent years can increase since several multinationals have been reinvesting their profits in India and this is not being captured as FDI, a practice China adopts. Citigroup, for example, has reinvested significant earnings in its Indian business over a sustained period--funds that are not captured in the FDI reporting. Its Citibank unit in India has retained earnings of about $350 million was not captured in FDI reporting. The recent reinvestment of more than $ 400 million in India by Citibank alone was not captured in FDI reporting. Similarly, the purchase of around $300 million in non-equity form of direct investment capital by Fiat, the Italian automobile company, to recompense the losses sustained by its Indian subsidiary was also not reflected in Indian FDI figures. Also, Coke and Pepsi have recently invested $1.3 billion in India World Investment Report (2002).

Efforts at the Realignment of FDI Reporting in India with the Global Reporting Practices.

It was felt at the policy level that a revision of the Indian FDI reporting system in line with the international reporting practices, would not only render data precise and comparable, but also substantially improve the FDI inflow figures in global standards

with a refurbished data. With a view to aligning the FDI reporting system in India with the international computation standards and to updating the FDI inflows into the country, the Government of India had, in 2002, set up a joint committee comprising representatives from the Reserve Bank of India (RBI) and the Department of Industrial Policy and Promotion (DIPP), under the Chairmanship of the Secretary of the DIPP, Mr.V. Govindarajan. The Committee submitted the Report in the middle of November 2002.

The objectives of the Committee were to :

- examine the definition of FDI in India
- align the FDI reporting system with the international computation standards
- update the FDI inflows into the country by adopting a broader classification so as to provide a more authentic picture of FDI inflows
- examine whether changes in some of the present laws would be required to bring India's FDI in conformity to the IMF.

This whole exercise seemed to be a mandatory requirement considering that India is also a subscriber to the IMF's Special Data Dissemination Standard (SDDS) established in 1996.

Recommendations and Outcome of the Committee

The Report of the Committee was submitted in November 2002. The RBI-DIPP committee has recommended:

- Collection of data in accordance with the international definition of FDI recommended by the IMF.
- Collection of data on reinvested earnings and other capital (the borrowing and lending transactions of the multinational corporations with their subsidiaries in the country), by overseas investors, which is presently not collected, through a survey by RBI by making the reporting system mandatory for the companies through modification of the Foreign Exchange Management Act (FEMA) and the Industrial Development and Regulation (IDR) Act.
- Collection of data by RBI on external commercial borrowings, suppliers and trade credit between foreign enterprises and investment by unincorporated entities.
- Devising a suitable reporting mechanism by the RBI in order to segregate related entity transactions for inclusion of external commercial borrowings, suppliers credit and trade credit between foreign enterprises and investment by unincorporated entities.
- Collection of data on swaps from existing data with RBI.

In spite of all effort in redefining FDI, no unanimous solution could be reached till January 2003. Some of the contentious issues are the reinvested earnings of foreign companies, inter-company debt transactions, short-term and long-term loans, financial leasing and trade credits. For example, the quantification of "reinvested earnings" poses a big challenge since India has had foreign companies here for decades and many of them have reinvested heavily over the years. Quantifying this would boost the stock of FDI considerably. However, even the flow in recent years would increase since several multinationals have been reinvesting their profits in India and this is not being captured as FDI, a practice China adopts.

There are also differences over the regulation of FDI inflows. While some of the inflows are monitored by the RBI, some are regulated by the Secretariat of Industrial Assistance in the commerce and industry ministry. The finance and external affairs ministries also play their part from time to time. Changes in FEMA would be required to acquire the data on venture capital inflows for FDI computation purposes.

The Steering Committee on FDI set up by the Planning Commission, which presented its report in August 2002, addressed its concern regarding improvement in data coverage on FDI. The National Statistical Commission has recommended conducting periodical surveys on dividends and profits arising out of foreign direct investment and portfolio investment separately. In pursuance of the recommendation, a survey is being launched by the RBI to collect detailed information on FDI that will include reinvested earnings. It is expected that this survey will improve the international compatibility of FDI data in India while providing much more detailed information on FDI flows than currently exists.

Need for Foreign Direct Investment: The need for FDI for a developing country like India can arise on account of following reasons**:-**

a) Domestic capital is inadequate for the purpose of economic growth and it is necessary to invite foreign investment.

b) For the want of experience, domestic capital and entrepreneurship may not flow into certain lines of production. Foreign investment can show the way for domestic investment.

c) There may be potential savings in a developing economy like India but this may come forward only at a higher level of economic activity. It is, therefore, necessary that foreign investment should help in speeding up economic activity in the initial phase of development.

d) It may be difficult to mobilize domestic savings for the financing of projects that are badly needed for economic development. In the early stages of development, the capital market is itself underdeveloped. During the period in which the capital market is in the process of development, foreign investment is essential.

e) FDI brings with it other scarce productive factors, such as technical know-how, business experience and knowledge which are equally essential for economic development.

f) It brings sufficient amount of physical and financial capital to the economy along with technical knowhow, skilled personnel, organization experience and a host of other benefits.

g) It has strong technology and productivity spillover effects and would improve the productivity of the economy.

Objectives

a) What has India done till now to attract FDI.
b) Which sectors attract 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 scepticism 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.

FDI INFLOWS

Table.1 YEAR WISE FDI INFLOWS

A. As per international best practices (Amount US$ million)

Year	FDI FLOWS	% age growth over previous year (in US$ 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	34,843	+53%
2008-09	4,1873	+20%
2009-10(P)(+)	37,745	-10%
2010-11(P)(+)	34,847	-8%
2011-12(P)	46,556	+34%
2012-13(P)	36,860	-21%
2013-14(P)(Apr-Dec-2013	24,824	-
CUMULATIVE TOTAL (Apr,2000 – Dec,2013)	314,902	

Source:
1. RBI's Bulletin February, 2014 dt. 11.02.2014 (Table No. 34 – FOREIGN INVESTMENT INFLOWS).
2. Inflows under the acquisition of shares in March, 2011, August, 2011 & October, 2011, include net FDI on account of transfer of participating interest from Reliance Industries Ltd. to BP Exploration (Alpha).
3. RBI had included Swap of Shares of US$ 3.1 billion under equity components during December 2006.
4. Monthly data on components of FDI as per expended coverage are not available. These data, therefore, are not comparable with FDI data for previous years.
5. Figures updated by RBI up to December, 2013.
(P) All figures are provisional
"+" Data in respect of 'Re-invested earnings' & 'Other capital' for the years 2009- 10, 2010-11, 2012-13 & 2013-14 are estimated as average of previous two years.

Table.1 shows the FDI trend which is increasing from 2000-01 to 2001-02 then decreasing for the year 2002-03 and2003-04 after that it is increasing till 2008-09 with 4,1873 US$ million. Provisional figure for 2012-13 and 1013-14(Apr-Dec-2013) is 36,860 and 24,824 US$ million respectively.

Table. 1.2 YEAR WISE FDI INFLOWS

B. DIPP'S Financial Year Wise Equity Inflows

Year	In Rs crores	(in US$ million)	%age growth over previous year (in terms of US $)
2000-01	10733	2463	-
2001-02	18654	4065	(+) 65 %
2002-03	12871	2705	(-) 33 %
2003-04	10064	2188	(-) 19 %
2004-05	14653	3219	(+) 47 %
2005-06	24584	5540	(+) 72 %
2006-07	56390	12492	(+)125 %
2007-08	98642	24575	(+) 97 %
2008-09	142829	31396	(+) 28 %
2009-10(#)	123120	25834	(-) 18 %
2010-11(#)	97320	21383	(-) 17 %
2011-12(#)^	165146	35121	(+) 64 %
2012-13(#)	121907	22423	(-) 36 %
2013-14(P)(Apr-Dec-2013	99813	16560	
CUMULATIVE TOTAL (Apr,2000 – Dec,2013)	996726	209964	

Source:
1. including amount remitted through RBI's-NRI Schemes (2000-2002).
2. FEDAI (Foreign Exchange Dealers Association of India) conversion rate from rupees to US dollar applied, on the basis of monthly average rate provided by RBI (DEPR), Mumbai.
Figures for the years 2009-10, 2010-11, 2011-12 & 2012-13 (from April, 2012 to September, 2012) are provisional subject to reconciliation with RBI.
^ Inflows for the month of March, 2012 are as reported by RBI, consequent to the adjustment made in the figures of March, '11, August, '11 and October, '11.

Table. 2 Share of top investing countries in FDI inflows (from Apr,2000 to December,2013)

	Name of the country	(In US$million)	Percentage with total FDI Inflows (+)
1	Mauritius	77,343.83	36.86
2	Singapore	22,665.60	10.80
3	UK	20,696.70	9.86
4	Japan	15,359.83	7.32
5	USA	11,743.94	5.60
6	Netherland	10,561.07	5.03
7	Cyprus	7,269.16	3.46
8	Germany	6,137.80	2.92
9	France	3,839.64	1.83
10	UAE	2,645.38	1.26

'+' Percentage of inflows worked out in terms of US$ & the above amount of inflows received through FIPB/SIA route, RBI's automatic route & acquisition of existing shares only.

In the above table 2 it is clear that these top ten countries constitute almost 85 % of total FDI in India and Mauritius has a lion share followed by Singapore, UK, Japan, USA etc. A lion's share of such investment is represented by the holding companies of Mauritius set up by the US firms. It means that the investment flowing from the tax havens is mainly the investment of the multinational corporations headquartered in other countries. It is because, first, the US companies have positioned their funds in Mauritius, which they like to invest elsewhere. Secondly, it should be noted that Mauritius based investments are nothing but US investments. They are routed through Mauritius because of tax advantages. The tax advantage emanates from the double tax avoidance agreement that India has with that country. This agreement means that any foreign investor has the option of paying tax either in India or in Mauritius. Since the tax rates prevailed in Mauritius are amongst the lowest in the world. Many multinational corporations prefer to route their investments to India through Mauritius.

Table. 3 FDI inflow in the top 10 sector

	Sector*	(In US$ million)	Percentage with total FDI Inflows (+)
1	Service sector	38,824.09	18.50
2	Construction Development: Township, housing, built-up infrastructure, and construction-Development projects	22,994.20	10.96
3	Telecommunication	12,937.85	6.17
4	Computer Software & hardware	12,231.38	5.83
5	Drugs & Pharmaceuticals	11,583.69	5.52
6	Chemicals (other than fertilizers)	9370.99	4.47
7	Automobile industry	9165.93	4.37
8	Power	8383.52	4.00
9	Metallurgical Industries	7806.64	3.72
10	Hotel & Tourism	6910.18	3.29

* Services sector includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis
FDI inflows data re-classified, as per segregation of data from April 2000 onwards.
'+' Percentage of inflows worked out in terms of US$ & the above amount of inflows received through FIPB/SIA route RBI's automatic route & acquisition of existing shares only.
- FDI Sectoral data has been revalidated / reconciled in line with the RBI, which reflects minor changes in the FDI figures (increase/decrease) as compared to the earlier published sectoral data.

In the above table 3 it is clear that service sector has attracted major portion of FDI inflow in India. These 10 sectors absorb almost 67 % of FDI inflow in India. FDI inflows are more in the consumer durable goods and automotive industries. Capital goods sector has more or less been bypassed by the FDI. This clearly points out the tendency of foreign investment to exploit the pent up domestic demand for consumer durable goods. India's large size of domestic market seems to have been the major attraction for foreign firms. India may have an advantage in technical manpower, particularly in information technology.

Table 4
STATEMENT ON RBI'S REGIONAL OFFICES (WITH STATE COVERED) RECEIVED FDI EQUITY INFLOWS1 (from April, 2000 to December, 2013):

S. No.	RBI's Regional Office2	State Covered	Cumulative Inflows(Apr '00-Dec'13)	Percentage to total FDI Inflows
1	Mumbai	Maharashtra, Dadra & Nagarhaveli, Daman & Diu	308,575	31
2	New Delhi	Delhi, Part of UP & Haryana	184,019	19
3	Chennai	Tamil Nadu , Pondicherry	62,070	6
4	Bangalore	Karnataka	57,543	6
5	Ahmadabad	Gujarat	43,207	5
6	Hyderabad	Andhra Pradesh	39,872	4

1 Includes 'equity capital components' only.
2 The Region-wise FDI inflows are classified as per RBI's – Regional Office received FDI inflows, furnished by RBI, Mumbai.

The above table 4 shows that FDI is unevenly distributed among the different region of India. Mumbai has attracted major portion of FDI in India followed by New Delhi, Chennai, Bangalore, Ahmedabad and Hyderabad. It shows that the states which are relatively advanced are able to attract major portion of FDI hence FDI has favoured only relatively better-off states. There is a need to alter the flow of FDI in relatively less well-off states.

Now it is possible to give main gist of this study:
- India has adopted a narrow definition of FDI which excludes many components which are reinvested earning by foreign companies, proceeds of foreign equity listing and foreign subordinated loans to domestic subsidiaries as a part of inter-company debt transactions, overseas commercial borrowings and equity well over 20% in the form of American Depository Receipts held by Foreign Institutional Investors (FIIs).

- India has grown because of its human capital, size of the market, rate of growth of market, political stability.

Conclusion
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 in India 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. Poor infrastructure is found to be the most important constraint for construction and engineering industries. 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.
4) More incentives should be given to the efficient low cost firms so that they may encourage to produce globally competitive goods.
5) Efforts should be made to control the inflation so that consumption may not be effected badly.
6) Environmental quality must be improved.
7) Govt. must try to increase the trade with neighbours.
8) There should be check on monopolies and groups and competition must spread there.
9) Govt. should liberalize the financial markets

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