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Foreign Direct Investment in India - Trends and Policies

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Abstract: Foreign Direct Investment is considered an important instrument in the process of economic growth and development in globalizing world. It provides additional sources of capital, latest technology to the host country and create many opportunities for employment. The domestic market becomes more competitive with the entry of FDIs, which leads to an increase in the productivity level of the country. But the distribution of FDI is unequal all over the world. Some countries are ahead while others lag behind in attracting FDI. India is one of the most attractive destinations for foreign direct Investment. Since liberalization when Foreign Direct Investment and Foreign Portfolio Investment were allowed to enter India, our country has grown by manifolds. The present paper is an attempt to show the trends of FDI and FPI in India during the period of 2000-01 to 2012-13. and highlights country wise and sector wise FDI in India and its major policies. The paper also focused on the relation between FDI, FPI and other economic Indicators like GDP and inflation and provides a platform for future research work.

Keyword: FDI, Foreign Investment Inflows, FPI, GDP.

Introduction

There are many economic variables which bring the ups and downs in the growth of an economy. Foreign direct investment is considered an important instrument in the process of economic growth and development in a globalizing world. It is the process where the residents of one country acquires ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country. FDI provides additional sources of capital, technology and good corporate governance to the host country and create many opportunities for employment. It improves the international allocation of capital, particularly if the return on capital is higher in the host country than in the source country. For this reason Government of India have been adopting different steps to promote FDI inflows since 1991 and become one of the most attractive destinations for foreign investment. Since liberalisation, when FDI and FII allowed to enter India, our country has grown by manifolds.

Objectives of the study

The following are the objectives of the present study:

- Trends of foreign investment in India since 2000.
- To discuss the correlation between the major Indian economic indicators and the foreign investment coming into India.
- To highlight current major policies of India about foreign direct investment and to discuss FDI in India country wise and sector wise

Methodology of the study

The present study is based on secondary data, taken from various journals, RBI bulletin and reports of ministry of industries and development.

The statistical tool - correlation coefficient is used to show the relation between foreign direct investment and other economic indicators like GDP, inflation based on CPI and WPI.

Trends and Progress of Foreign Investment in India

The growth pattern of Foreign Investment in India can be ascertained from the table 1, which depicts the trend of Foreign Direct Investment and Foreign Portfolio Investment from 2001-02 to 2012-13.

Table 1: Trend of FDI and FPI in India

US$ million

Year	Foreign Direct investment	Portfolio Investment	Total A+B
2000 – 01	4029	2760	6789
2001-02	6130	2061	8151
2002-03	5035	979	6014
2003-04	4322	11356	15678
2004-05	6051	9315	15366
2005-06	8961	12492	21453
2006-07	22826	7003	29829
2007-08	34835	27271	62106
2008-09	41873	-13855	23983
2009-10	37763	32376	70139
2010-11	34847	31471	66318
2011-12	46556	17409	63965
2012-13	34298	27770	64638

Source: RBI bullitins (2013). Foreign Investment of flows Retrieved from http://www.rbi.org.in/.

Table 1 depicts the trend in Foreign investment inflows to India and it is clear from the table that FDI of India was $4029 million in 2001- 02. The year 2003-04 registered massive foreign investment inflows of $15699 million of which the share of portfolio investment was as high as $11356 million according to RBI, this reflected investors inflows rose further. A distinct change occurred in 2006-07 with the share of FDI surpassing the share of portfolio investment. FDI raised from $8961 million in 2005-06 to $22826 million in 2006-07. This reflected the continued strength of sustained economic activity and positive investment climate. The strength of the corporate performance, positive investor sentiments further liberalisation of foreign direct investment policies in sector such as telecom, retail and expanding promotional efforts by the government also played a greater role in attracting FDI. Portfolio investment also rise due to massive increase in investment by Foreign Institutional Investment. However because of recessions in America, Foreign Institutional investors withdrew a large amount of resources from India in 2008-09 and as a result FPI of India reduced and became $13855 million in 2008-09.But in 2009-10 FDI showed a robust growth of Indian economy and Foreign Investment flows became $70139 million. FDI fell in 2011-12 because of a decline in FII's inflows. Total foreign Investment increased in 2012-13 and showed some improvement in FDI trends.

Country wise FDI Equity inflows in India:

Country wise FDI equity inflows in India is shown in table – 2

Table – 2: Country wise FDI Equity inflows in India

April to Nov. 2014

Rank	Country	Percentage of total Inflows
1	Mauritius	35
2	Singapore	12
3	UK	9
4	Japan	7
5	Netherland	6
6	USA	6
7	Cyprus	3
8	Germany	3
9	France	2
10	Switzerland	1

Source:- Report of ministry of commerce and industry (2014)

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Table 2 depicts that Mauritius have major share in FDI inflows in India. The reason is double tax avoidance agreement (DTAA) with India. The agreement means that any foreign investor has the option of paying tax either in India or in Mauritius. Since the tax rates prevailing in Mauritius are amongst the lowest in the world, many multinational corporations prefer to route their investments to India through Mauritius. India is Asia's major economic power along with China and Japan. Thus Japan is the fourth major trading partner and largest source of FDI after Mauritius, Singapore and U.K.

Sector attracting highest FDI Equity inflows:

It would be interesting to see in which sectors foreign investors show comparatively greater interest. The maximum inflows of FDI has been in Service sector accounting 18 percent in total FDI inflows, followed by Construction activities (10 percent), Telecommunications (7 percent), computer software and hardware (6 percent), Drugs and Pharmaceuticals (5 percent), Automobile Industry (5 percent), chemicals (4 percent) and Hotel and Tourism (3 percent). Over the 66 percent of the total FDI have accessed by above ten sectors. The top ten sectorwise curative inflows FDI in India have been shown in Table 3, given below:

Table – 3: Sector wise FDI equity inflows in India

April – Nov. 2014

Rank	Sector	Percentage of total Inflows
1	Service Sector	18
2	Construction	10
3	Telecommunication	7
4	Computer software & Hardware	6
5	Drugs and Pharmaceuticals	5
6	Automobile Industry	5
7	Chemicals	4
8	Power	4
9	Metallurgical Industry	4
10	Hotel and Tourism	3

Source: Report of ministry of commerce and industry (2014).

What make India attractive for FDI

- Market size – Consumer market of up to 300 million people – India has the largest middle class population in the world, which possess great potential for companies to market.
- Rationalization of economic policies
- Improvement in domestic financial Institutions and banks help a lot in attractive FDI.
- Good manufacturing and outsourcing Hub-India is a relatively cheaper place to conduct business than other countries. With the huge labour availability and its access to markets in Asia, it becomes very attractive for foreign companies to set up shoe in this country.

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Correlation between FDI and major economic variables:

Table-4: depicts the correlation between FDI and other economic variables – GDP, rate of inflation based on CPI and WPI.

Table 4: Annual growth rates of GDP, WPI, CPI and FDI in India (in percentage)

Year	GDP	WPI	CPI	FDI
2000-01	4.1	7.1	4.3	31
2001-02	5.3	3.6	4.1	.20
2002-03	3.8	3.4	3.8	-26
2003-04	7.9	5.5	3.9	161
2004-05	7	6.5	4.2	-2
2005-06	9.4	3.7	6.8	39.6
2006-07	9.5	6.5	6.2	39.2
2007-08	9.3	4.8	9.1	108
2008-09	6.7	8	12.3	-61
2009-10	8.9	3.6	10.5	192
2010-11	6.6	9.6	8.4	-13
2011-12	4.4	8.8	10.2	-15
2012-13	4.7	7.5	9.5	23

Source: CSO report released on 29 May, 2014.

Correlation between FDI and GDP = 0.29
Correlation between FDI and inflation rate based on WPI = -0.25
Correlation between FDI and inflation rate based on CPI = -o.64.

After calculating the correlation coefficient between FDI and Macro economic variables, it is found that there is positive and moderate correlation between FDI and GDP and negative and moderate correlation between FDI and rate of inflation based on WPI and highly negative correlation between FDI and rate of inflation based on CPI.

FDI Policies in India

After liberalisation government of India introduced dual route of approval of FDI –

RBI's automatic route and Government approval route FDI under automatic route does not require any prior approval either by the government or the Reserve Bank. The investor are required to give notice to the concerned regional office of the RBI under the approval route application are considered by the foreign investment Promotion Board (FIPB). Approval from cabinet committee on security is required for more than 49% FDI in defence. It is noted that citizen from Bangladesh and Pakistan can invest only under the government route and Pakistan cannot invest in defence space atomic energy and sectors prohibited for foreign investment.

Sector where Foreign Direct Investment is Prohibited:-

1) Chit funds.
2) Lottery business.
3) Gambling.
4) Nidhi company
5) Trading in transferable Development Rights (TDRS).
6) Manufacturing of cigars, cigarette and tobacco.
7) Real estate business other than Construction.
8) Automic energy and Railway Transport other than Construction, operation.
9) Service like legal, book keeping, accounting and auditing.

Areas where FDI is Permitted to some extent :

1) Cable Networks (49%).
2) Print Media dealing with news and current affairs (26%).
3) Broadcasting content services (26%) .
4) Air transparent services – scheduled (49%) , non-scheduled air transport (74%).
5) Satellites – establishment and operation (74%).
6) Private security agencies (49%).
7) Private Sector Banking (74%).
8) Public Sector Banking (20%).
9) Commodity exchange (49%).
10) Credit information companies (74%).
11) Infrastructure companies in securities market (49%).
12) Insurance and sub-activities (26%).
13) Power exchange (49%).
14) Defence (49%).

Recent policy Measures:

Recent policy measures of government of India are followings :

1) 100% FDI allowed in telecom sector.
2) 100% FDI in single brand retail.
3) Government has removed restriction in tea plantation sector.
4) Government raised the limit of FDI in India in credit information up to 74 % and 100% in asset reconstruction Companies.
5) In defence sector FDI limit from 26% to raised 49% under Government approval route. Foreign Portfolio Investment raised up to 24%. FDI beyond 49 percent is also allowed on a case to case basis with the approval of cabinet Committee on security.
6) 100% FDI allowed in construction, operation and maintenance of specified activities of Railway sector under automatic route.
7) Special Dispensation have been envisaged for NRI investment in construction development, Air transport services and FDI from Nepal and Bhutan is allowed in Indian rupees.

Conclusion and scope for future research

An analysis of the trends in FDI in India from 2001 – 13 shows that India has generally attracted higher FDI inflows, especially in service sector with its robust economic growth and the contribution of Mauritius and Singapore in FDI inflows is highest. The trend shows some ups and down in FDI in India due to the changes in India's macroeconomic environment. The result shows that there is positive correlation between FDI and GDP in India and negative correlation FDI and inflation. Future studies in this area can focus on more number of macro-economic variables like balance of trade, exchange rate, current and capital account deficit and can show the relation of these variables with foreign investment flows.

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