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Liberalization and Sectoral Growth of FDI in India

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Abstract

FDI refers to capital inflows from abroad that are invested in or to enhance the production capacity of the economy.FDI page an important role in the long term development of a country not only as a source of capital but also for a enhancing competitiveness of the domestic economic trough transfer of technology strengthening infrastructure, rising productivity and generating new employment opportunities. In India FDI is considered as a developmental tool, which helps in achieving self reliance in various sectors an in overall development in the economic. Despite globalization, the essential role of foreign direct investment (FDI) in economic development has not changed. However, many mechanisms and dynamics of FDI-assisted development have changed: there is greater variation in the kinds of FDI, the benefits each offers, and the manner in which each interacts with the host economy. The main purpose of the study is to investigate the impact of FDI on economic growth in India, from the period of 1991 to 2011.

Key words: Foreign direct investment, Indian economy, Globalization, transfer technology, Economic growth.

I. INTRODUCTION

Foreign direct investment (FDI) in India has played an important role in the development of the Indian economy. It has in lot of ways facilitated India to achieve a certain degree of financial stability, growth and development.

It is the objective of the Government of India to attract and promote foreign direct investment in order to supplement domestic capital, technology and skills, for accelerated economic growth. Foreign direct investment (FDI) and trade are often seen as important catalysts for economic growth in the developing countries. FDI is an important vehicle of technology transfer from developed countries to developing countries**.** There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in a *net* FDI *inflow* (positive or negative) and "stock of foreign direct investment", which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares**.**FDI is one example of international factor movement. An investment abroad, usually where the company being invested in is controlled by the foreign corporation. The simplest explanation of FDI would be a direct investment by a corporation in a commercial venture in another country. A key to separating this action from involvement in other venture in foreign country is that the business enterprise operates completely outside the economy of the corporation's home country. The rapid expansion in FDI by multinational enterprises since the mid-eighties may be attributed to significant changes in technologies, greater liberalization of trade and investment regimes, and deregulation and privatization of markets in many countries including developing countries like India. FDI is not permitted in the arms, nuclear, railway, coal or mining industries. The objective behind allowing FDI is to harmonize and complement domestic investment, for achieving a higher level of economic development and providing more opportunities for up gradation of technologies as well as to have an access to global managerial skills and practices.

II. OBJECTIVES:

The study covers the following objectives:

- To study the trends and pattern of flow of FDI during post liberalization period
- To analyze the FDI flows in different sectors.
- To evaluate the impact of FDI on the Indian economy.
- To know the flow of investment in India

III. FDI POLICY IN INDIA:

FDI as defined in Dictionary of Economics is investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new site. To put in simple words, FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy. Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India ('RBI') in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time. The Ministry of Commerce and Industry, Government of India is the nodal agency for motoring and reviewing the FDI policy on continued basis and changes in scrotal policy/ spectral equity cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP).The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board ('FIPB') would be required.

IV. REVIEW OF THE LITERATURE:

Bhagabati J.N (1978) in his study "Anatomy and Consequences of Exchange control regimes" analised the impact of FDI on International trade. He concluded that countries actively pursuing export led growth strategy can reap enormous benefit from FDI. Aitken, et al. (1997) showed the external effect of FDI on export with example of Bangladesh, where the entry of a single Korean Multinational in garment exports led to the establishment of a number of domestic export firms, creating the country's largest export industry. Balasubramanyam.V.N and Vidya Mahambre (2003) concluded that FDI is a very good means for the transfer of technology and knowhow to the developing countries. Laura Alfaro (2003) finds that FDI flows into the different sectors of the economy (namely primary, manufacturing, and services) exert different effects on economic growth. FDI inflows into the primary sector tend to have a negative effect on growth, whereas FDI inflows in the manufacturing sector a positive one John Adreas(2004) in his work"The effect of FDI inflows on Host country Economic growth" Discussed the potential of FDI inflow to affect Host country economic grouth. The paer argues that FDI shoud have a positive effect on economic growth as result of technology spillover and physicals capital inflows, Chandana Chakraborty and Peter Nunnenkamp (2004) intheir study "Economic Reforms, FDI and Its Economic Effects in India" assess the growth implications of FDI in India by subjecting industry- specific FDI and output data to Granger Causality test within a panel co-integration framework. It turns outs that the growth effect of FDI very widely accros sectors. Chandana Chakraborty and Peter Nunnenkamp (2008) said that booming foreign direct investment in post-reform India is widely believed to promote economic growth. Chew Ging Lee (2009) has pointed out that GDP per capita has a positive effect on FDI inflows in the long run. A S Shiralashetti and S S Hugar (2009) analyzed the initiatives of The Government of India to attract FDI inflows, to boost the Indian economy since economic liberalization on the basis of different parameters such as year-wise, country-wise, sector-wise and region-wise FDI inflows. The study concluded though FDI inflows into India have raised, yet it is very less compared to some developing countries like China, Russia, Mexico, Brazil and Chile, etc.

V. RESEARCH METHDOLOGY

The study is based on secondary data. The required data has been collected from various sources i.e. World Investment Reports, Asian Development Bank`s Reports, Various Bulletins Of Reserve Bank Of India, Publications from Ministry Of Commerce, Govt. Of India that are available on internet. It is a time series data and relevant data have been collected for the period of 1991 – 2011.The study is limited to a sample of investing countries e.g. Mauritius, Singapore, USA etc. And sectors like service sector, computer hardware and software, telecommunication etc. Which had attracted larger inflow of FDI from different countries. The study has been taken up for the period 1991 – 2011 with the following hypotheses:

- Flow of FDI shows a positive trend over the period 1991 – 2011.
- FDI has a positive impact on economic growth of the country.

VI. IMPORTANCE OF THE STUDY:

The study attempts to analyze the important dimensions of FDI in India. The study works out on the pattern and trends of the main determinants and dimensions of investment flow in India. The study also examines the role of FDI on economic growth in India for the period 1991 – 2011. The period of study is important because:

- July, 1991, India opened is doors to private sector and liberalized it economy.
- Experience of South – East Asian countries by liberalizing their economies in 1980s became stars of the economic growth and development in 1990s
- India experience with its first generation economic reform and the country`s economic growth and performance were considered safe heavens for FDI which led to second generation of economic reform in India in first decade of century.
- There is a considerable change in the attitude of both developing and developed countries towards FDI. They both considered FDI as most suitable form of external finance
- Increase in competition for FDI inflows particularly among developing nations.
- Current issues related to FDI in Retail sector (Multi brand retail)

VII. ANALYSIS AND FINDINGS:

Government of India has decided to allow 26% FDI and 23% FII investment in commodity Exchange, subject to the provision that no single entity will hold more than 5% stake.

- Although India`s share in global FDI has increased considerably, but the pace of FDI inflows has been slower than China, Singapore, Brazil and Russia
- Due to continued economic liberalization since 1991, India has seen a decade of 7 plus percent of economic growth. In fact, India`s economy has been growing more than 9 percent for three consecutive years since 2007 which make country make a proficient performer among global economies
- At present India is the 4th largest and 2nd fastest growing economy in the world. It is the 11th largest economy in terms of industrial output and has the 3rd largest pool of scientific and technical manpower.
- There has been a generous flow of FDI in India since 1991 and its overall direction also reminded the same over the years irrespective of the ruling party.
- India has considerably decreased its fiscal deficit form 4.3% in 2002-03 to 2.7% in 2007- 08 and 1.15 in year 2009-11.
- FDI plays a crucial role in enhancing the economic growth and development of the country. Moreover, FDI as a strategic component of investment is needed by India for achieving the objectives of its second generation of economic reforms and maintaining the pace of growth and development of the economy.

TABLE 1: VOLUME OF FDI INFLOWS DURING POST LIBERALIZATION PERIOD
AMOUNT IN US $ MILLION)

Year	**Amount**	**Annual Growth Rate (AGR)**
1991-92	129	-
1992-93	315	144.18
1993-94	586	86.03
1994-95	1314	55.40
1995-96	2144	63.16
1996-97	2821	31.57
1997-98	3557	26.09
1998-99	2462	-30.78
1999-00	2155	-12.46
2000-01	4029	86.96
2001-02	6130	52.14
2002-03	5035	-17.86
2003-04	4322	-14.16
2004-05	6051	40.04
2005-06	8961	48.09
2006-07	22826	154.72
2007-08	34835	52.61
2008-09	35180	0.99
2009-10	37182	95.69
CAGR	**34.73%**	

Source: SIA, Newsletter, various issues

During the initial phase of post liberalization period i.e., from 1991 to 1998, there was continuous increase in the FDI inflows. The total amount of the FDI inflows during the period 1991-92 to 1997-98 had amounted toUS$10,868 million. The increase was largely due to the expanded list of industries or sectors which were opened up for foreign equity participation. This was followed by relaxation of various rules, regulations and introduction of various policies by the government to promote the FDI inflows. FDI inflows declined to the level of US$2,462 million in the year 1998-99 and further to US$2,155 million in 1999-2000. The reasons for the declining trend of FDI inflows were due to various set of factors. Firstly, the most important factor was the several restrictions imposed on India by the USA on account of the nuclear test carried out by India at Pokhran. The second factor was the slowdown of the Indian economy due to the mild recession in US and global economy. The third one was about unfavorable external economic factors such as the financial crisis of South-East Asia. Fourthly, the decline was due to the political instability and the poor domestic industrial environment. In 2002-03, FDI inflows were declined to US$ 5035. They were also reduced to US$ 4322 during 2003-04. This fall in flow of FDI into the country was due to the Global economic recession. Then, from 2004-05 onwards, there has been steady increase in the flow of FDI into the country with highest annual growth rate which has reached 154.72 percent during 2006-07. Further, the table shows that the compounded annual growth rate (CAGR) which was 25.46 percent during Pre liberalization has increased to 34.73 percent during the Post liberalization period. This shows the openness of the Government in liberalizing and globalizing the economy to the outside world through relaxation of regulatory and entry restrictions on FDI inflows.

Thus, on analyzing FDI inflows into the country over a period of 30 years it is observed that the compounded annual growth rate (CAGR) is 25.46 percent during 1980-81 to 1990-91 i.e., during the pre liberalization period. On comparison with the post liberalization period, it is found that the annual compounded growth rate has excavated to 34.73 percent showing the relaxation of regulatory and entry restrictions on FDI inflows in the economy. This shows that the importance of FDI into the country is realized by the Government during the Post liberalization period. In this period of 19 years, steady increase of FDI inflow was observed from 1991-92 to 2009-10 except the period from 1998-99 to 1999-00 and again the period from 2002-03 to 2003-04.

Table-2 MAJOR SOURCES OF FDI IN INDIA

Mauritius	USA	Singapore	U.K	Netherlands	Japan	Germany	Cyprus	France	Switzerland
39.9	88.8	7.2	6.1	4.1	3.4	2.9	2.1	1.5	1.1

Sources: complied & commuted from the various issues of economic survey, RBI Bulletin, Ministry of Commerce
FDI is now regarded as one of the key indicator of economic growth. In table -2 the major source of FDI in India are Mauritius ,USA, Singapore, U.K, Netherlands, Japan, Germany, Cyprus, France, Switzerland

Table-3 FDI Inflows in India – Sectoral Analysis of Top 10 Sectors (Rupees in Crores):

Sectors	2007-8	2008-9	2009-10	2010-11	Cumulativein flows	%of total inflows In terms of US $
Services sector Financial & non – financial)	26589	28411	20958	1581	106992	21%
Computer softwere & hardware	5623	7329	4350	765	44611	9%
Tele-Communi-	5103	11727	12338	1914	42620	8%
Housing & real state	8749	12621	13586	246	37615	7%
Construction Activity	6989	8792	13544	345	36066	6 %
Power	3875	4382	6908	547	21466	4%
Automobile industry	2697	5212	5609	187	20860	4%
Matallugical Industry	4686	4157	1935	404	13845	3%
Petroleum & Natural gas	5729	1931	1328	522	12026	2%
Chemicals	920	3437	1707	115	11390	2%

(Sources- government of india-2009, ministry of finance, FDI Statistics, department of industry policy & formation)

Table -4, Ranking Of Sector Wise FDI Inflows in India since April 2000- Dec 2011: Rank of Sector–wise FDI Inflows

Industrial sectors	Rank
Service sector	1
Computer hardware & software	2
Telecommunication	3
Housing and real state	4
Construction	5
Power	6
Automobile industry	7
Metallurgical industry	8
Petroleum and natural gas	9
Chemicals	10

Sources: Fact Sheets on FDI, DIPP

In Table -3 FDI inflows maximum in service sector, nearly 21% and minimum 2% in the chemical sector of total inflows in terms of US $ among 10 sectors and Table 4 shows the rank of sector wise FDI inflows

VII. CONCLUSION:

FDI is as an engine of capital, technology, managerial skills, technological progress & capacity, access to foreign markets and in maintaining economic growth and development for developing countries, where as for developed countries it is considered as a tool for accessing the market of emerging economies. There is a clear indication from the data that foreign investors showed keen interest in Indian economy because of liberalized regime pursued and followed by Indian economy. This may be due to the low flow of FDI into India both at the macro level as well as at the sartorial level. It implies that the spirit in which the economy has been liberalized and exposed to the world economy at the late eighties and early nineties has not been achieved after so many years. This calls for a judicious policy decision towards FDI at the sartorial level. A large number of changes that were introduced in the country`s regulatory economic policies heralded the liberalization era of the FDI policy regime in India and brought about a structural breakthrough in the volume of the FDI inflows into the economy maintained a fluctuating and unsteady trend during the study period. It might be interest to note that more than 50 per cent of the total FDI inflows received in India come from Mauritius, Singapore and the USA. The main reason for higher levels of investment from Mauritius was that the fact that India entered into a double taxation avoidance agreement (DTAA) with Mauritius were protected from taxation in India. Among the different sectors, the service sector had received the larger proportion followed by computer software and hardware sector and then telecommunication sector. The process of economic reforms which was initiated in July 1991 to liberalize and globalize the economy had gradually opened up many sectors of its economy for the foreign investors. It might be of interest to note that more than 50% of the total FDI inflows received by India during the period from 1991-2010 came from Mauritius and the USA. Among the different sectors, the electrical and equipment had received the larger proportion followed by service sector and telecommunication sector. Net FDI in India was valued at $ 7693 million in the 2006–07 Indian fiscal years and nearly doubled, to $ 15401 million, in the 2007–08 fiscal years. Investors are showing their growing confidence in the immediate and medium term prospects of Indian Economy. FDI off course might be one of the important sources of financing the economic development. Policy makers need to ensure transparency and consistency in policy making along with comprehensive long term development strategy.

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