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A Study on the Changing Trends in the Flow of FDI

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Abstract

Foreign Direct Investment (FDI) is considered as an engine of economic growth. Foreign investment was normally permitted only in high technology industries in priority areas and in export oriented areas. So the inflow of FDI before 1990's was very low. During early 1990s India suffered from massive balance of payment and foreign exchange crisis, which led Indian Government to opt for liberalized economic policies in 1991. Globalization and liberalisation brings lots of new innovative products to the world, Foreign Direct Investment is the one among this, also there are number of different forms of FDI is available currently. Recently, Government of India allowed FDI in different sectors of Indian economy. Since the adoption of New Industrial Policy (NIP) and on-going reform process, (FDI) inflows have increased substantially. On this background, the paper analyses the sector wise and country wise inflows of FDI during the period 2009-2014. This paper begins by reviewing possible sources of FDI and then provides a comprehensive evaluation of the empirical evidence on sector wise FDI. This study is entirely based on secondary data. It also point out the sector-wise distribution of FDI inflow to know about which has concerned with the chief share. The present study is based on secondary data collected from different sources. The paper concludes that the Government should design the FDI policy in such a way where FDI inflows can be utilized as means of enhancing domestic production, savings and exports through the equitable distribution among states so that they can attract FDI inflows at their own level. As per the study, the sectors that attracted higher inflows were Communication services as per the CAGR and as per the share it is manufacture sector. The Luxernbourg was at highest FDI inflows as per the CAGR and as per the share it is from Mauritius.

Keywords: Foreign Institutional Investors (FII); Foreign Exchange Regulation Act; New Industrial Policy (NIP); Multinational companies

Introduction

India being a resource poor country, particularly in capital resources, was always receptive to foreign investment. The role of foreign direct investment (FDI) in stimulating economic growth is one of the controversial issues in the development literature. The great promise of foreign direct investment (FDI) by multinational corporations is that capital will stimulate dynamic growth. Beyond boosting income and employment, the hope is that manufacturing FDI will bring knowledge that indirectly effect in building skill and technological capacities of local firms, catalysing broad-based economic growth. The part played by foreign direct investment (FDI) in the development process has undergone several changes. In the 1960s, FDI was seen in most countries as a partner in the development endeavours. But the Indian government adopted a restrictive attitude towards foreign capital in late 1960s as local industries started to develop. India adopted a regime that was perceived to be restrictive towards FDI. Explicit curbs on foreign investment were imposed through the introduction of the Foreign Exchange Regulation Act (FERA) in 1973 by restricting foreign ownership of shares in enterprises incorporated in India. At the same time, foreign firms operating in India were subjected to "local content" and "foreign exchange balancing" rules that curbed their freedom of operation. The Industrial Licensing System under the Industries Development and Regulation Act, 1951 and the Monopolies and Restrictive Trade Practices Act, 1969 sought to channelize their activities into high technology and export-oriented production. The limits on foreign shares fostered joint ventures with Indian entrepreneurs. Private savings financed most of India's investment, but by the mid-1980s further growth in private savings was difficult because they were already high level. These policies continued until the policy of creeping liberalisation of the Indian economy was initiated in the 1980s. During the late 1980s India relied increasingly on borrowing from foreign sources. Increased borrowing from foreign sources in the late 1980s, which helped economic growth, led to pressure on the balance of payments. The problem became an exogence in 1990 when Iraq invaded Kuwait, and the price of oil soon doubled. The direct economic impact of the Persian Gulf conflict was exacerbated by domestic social and political developments. In the early 1990s, there was violence over two domestic issues: the reservation of a proportion of public-sector jobs for members of Scheduled Castes and the Hindu-Muslim conflict at Ayodhya. The central government fell in November 1990 and was succeeded by a minority government. The cumulative impact of these events shook international confidence in India's economic viability, and the country found it increasingly difficult to borrow internationally. As a result, India made various agreements with the International Monetary Fund (IMF) and other organizations that included commitments to speed up liberalization. Thus, in the early 1990s, considerable progress was made in loosening government regulations, especially in the area of foreign trade. Many restrictions on private companies were lifted, and new areas were opened to private capital. The stable macroeconomic fundamentals, increasing size of the economy and improving investment climate has attracted multinational corporations to invest in India. An important outcome of economic reform process aimed at opening up the economy and embody globalization in 1991 has led to massive increase in Foreign Direct Investments (FDI) inflows. In fact, FDI policy reform formed part of the first package of industrial reforms in July 1991 and was

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reflected in the Industrial Policy announced in 1991. Amongst other sources; FDI is a major source of private capital in India. The primary reason for alluring FDI is not only the capital it brings in but along with capital it is also an important source of various technologies knows how, better managerial skills, labour training and other externalities which generate increasing return in production.

Need and Importance of the Study

The flow of FDI in Indian service sector is boosting the growth of Indian economy, this sector contributing the large share in the growing GDP of India. This sector attracting a significant portion of total FDI in Indian economy. This contribution of FDI is stimulating the economic growth or not, this knowledge thrust of research scholar creates the interest in conducting this study.

Objective

To study the flow of foreign direct investment country wise and industry wise

Research Methodology

Data collection

This study is based on secondary data. This database is constructed by pooling information and data from various sources. It includes economic survey of India, Reserve bank of India, census, different parliamentary questions, and policy papers amongst many other. Online data base of Indian Economy, journals, articles, newspapers, etc.

Tools

To evaluate the flow of FDI at both the levels i.e. country wise and sector wise the tools that are used to analyze the data are Compound Annual Growth Rate (CAGR) and percentages.

Scope of the study

To investigate the flow of FDI data have been collected for the period 2008 to 2014.

Review of Literature

A good number of studies have investigated on FDI issues. However, the following deserve a special mentioning, since they have gone deepen in to the crux of the FDI issues [1], "Foreign Direct Investment in India: Issues and Problems". In their discussion paper summarized that "India has the resource base, it has the entrepreneurship, has the access to the sea, a vast labor force, it has everything that coastal China has had except the interest of the Government which even today underemphasizes the role of industrial facilities, of infrastructure, of land area, of effective port facilities". "Export Growth in India: Has FDI Played a Role?" in his discussion paper reviews that hypothesizes export as one of the channels through which FDI influences growth [2]. Using annual data for 1970-98 he finds that FDI has no significant impact on export performance and thus on growth. "Foreign Direct Investment and Economic Growth in India: A Production Function Analysis" in their working paper viewed that FDI stock has contributed positively to the national production [3]. The study concludes that the effect of FDI is not significant for the overall period, but during the liberal policy phase FDI plays a significant impact on production of India. "Recent Trends in FDI Flows and Prospects for India", analyses the recent trends in FDI flows in India. He finds that FDI flows to India have not been commensurate with her economic potential and performance.

The GOI revised its computation of FDI figures in line with the best international practices, which has led to a substantial improvement in FDI figures. The quality of FDI as manifest in technological spillovers, export performance etc. is more important than its quantity [4]. "The Differential Impact of Japanese and US FDI on Exports of Indian Manufacturing", found that FDI has not played a significant role in exports of the Indian manufacturing sector in the post reform period and concludes that FDI in India has led to export diversification [5]. "Liberalization, MNC and Productivity of Indian Enterprises", argues in favor of using an unbalanced panel that takes into account the entry and exit of the firms. Firms with better endowments in terms of productivity and technology benefited from liberalization and MNC presence. Firms with large productivity gaps became the victims [6]. "Foreign Direct Investment in India: A Critical Analysis of FDI from 1991-2005", reveals that while FDI shows a gradual increase and has become a staple of success in India, the progress is hollow. He finds that in the comparative studies the notion of infrastructure has gone a definitional change. FDI in sectors is held up primarily by telecommunications and power and is not evenly distributed. "Labor Conflict and Foreign Investments: An Analysis of FDI in India, in their review examined that how labor conflict, credit constraints and indicators of state's economic health affect foreign investment.

They find that labor unrest is the most important factor in determining the effect of foreign investment. Their results indicate that labor unrest has a strong negative effect on foreign investment and also labor unrest is endogenous across Indian states [7]. "Foreign Direct Investment in India's Retail Sector: More Bad than Good?" Discusses the retail industry in India in their study on FDI in the retail sector. They focus on the "labor displacing" effect on employment due to FDI in the retail sector. The primary task of the Government in India is still to provide livelihood and not create so called efficiencies of scale by creating redundancies [8]. "The Unequal Effects of Liberalization: Evidence from Dismantling the License Raj in India. Centre for Economic Policy Research" in their discussion paper opined that They show that more trade or FDI is associated to positive growth effects in regions and sectors that are initially close to the technological frontier. This is primarily due to higher absorptive capacities of these regions or sectors and their engagement in R&D when foreign competitors enter the market.

Although there are studies on effect of FDI on overall performance of India, there is lack of research which focuses on countrywise and sector wise FDI, which are discussed in the present article [9]. "Economic Reforms, FDI and its Economic Effects in India", assess the growth implication of FDI in India. They find that the growth effects of FDI vary widely across sectors and only transitory effects of FDI on output in the services sector which attracted the bulk of FDI in the post-reform period [10]. "India's Suitability for Foreign Direct Investment", analyses various determinants that influence FDI inflows to India. Analyzing the new findings it is interesting to note that India has some competitive advantage in attracting FDI inflows, like a large pool of high quality labor force. In consequence this study argues that India is an ideal investment destination for foreign investors [11]. "FDI and Globalization in India", finds that the FDI from the Indian firms were principally addressed to the developing countries and Russia, however, the share of the industrialized countries was on the rise and the manufacturing and non-financial sectors accounted for the bulk of it [12].

Foreign direct investment (FDI) and growth of states of india VISION 2020 - Managerial Strategies and Challenge", stated in their study that foreign direct investment (FDI) policies play a major role in the economic growth of developing countries around the world. Attracting FDI inflows with conductive policies has therefore become a key battleground in the emerging markets. The paper highlighted the trend of FDI in India after the sector-wise economic reforms [13]. Sectoral performance through inflows of foreign direct investment (FDI) found out in their study that Foreign Direct Investment has a major role to play in the economic development of the host country. Most of the countries have been making use of foreign investment and foreign technology to accelerate the pace of their economic growth. FDI ensures a huge amount of domestic capital, production level and employment opportunities in the developing countries, which a major step towards the economic growth of the country [14]. "Impact of FDI on GDP: A comparative study of China and India," in their the study found that 1% increase in FDI would result in 0.07%increase in GDP of China and 0.02% increase in GDP of India. We also found that China's growth is more affected by FDI, than India's growth [15]. "Impact of foreign direct investments on indian economy", conducted the study to find out the impact of foreign direct investments on Indian economy and concluded that Foreign Direct Investment (FDI) as a strategic component of investment is needed by India for its sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries, short and long term project in the field of healthcare, education, research and development also clarified that subject to the sectorial foreign holding cap, companies will now need prior permission from Reserve bank of India (RBI) for an overall FII holding of beyond 24 per cent. After RBI permission, the companies can allow FIIs to hold more than 24 per cent after the approval for the same by their boards and shareholders. This study investigates the growth in foreign direct investment country wise and industry-wise.

Data Analysis and Discussions

Table 1 displays the FDI inflows from different countries. To indentify and examine the growth of FDI inflow Compound Annual Growth Rate has been estimated for the period of 7 years i.e from 2008- 2014. The above table shows that the annual compound growth rate of Total Foreign Investment in different countries have not been equally successful in attracting FDI. There is considerable variation in the dataset. The Compound Annual Growth rate of FDI inflow ranges from minimum of -19.53% to maximum of 65.28%. The highest FDI annual compound growth was 65.28% witnessed from Luxembourg country and the lowest FDI annual compound growth was -19.53% witnessed from United Kingdom country. According to above table analysis it reveals that ten countries showed positive CAGR in terms of FDI flow, and they are Singapore, Japan, Netherlands, Germany, UAE, France, Switzerland, Spain, South Korea and Luxernbourg. At the same time, countries like Mauritius, U.S.A., Cyprus, United Kingdom, Hong Kong SAR and Others have witnessed with negative CAGR.

The above Table 2 shows the total amount of FDI inflows in India during 2008-2014 and it clearly reveals that, FDI inflow during the period 2008-2009 has been increased from. US $19425 Million to US $22697 Million. From the year 2008-2014, the highest share of FDI has been maintained by Mauritius and the lowest share of FDI has been maintained by Luxenbourg except in the year 2011 and 2014. During the study period of seven years Singapore contributed as the second highest share of FDI Inflow in India except in the year 2010. From the year 2008-2010 others enjoyed third place in FDI attraction receiving 13.89%, 13.37% and 10.57% of total FDI respectively. In the year 2011 and 2013 the third place is occupied by Netherlands contributing 9.49% and 9.30%. In the year 2012 and 2014 Japan occupied by third place contributing 8.90% and 11.18%.

In India there are many sectors attracting FDI inflow. India is welcoming sector wise FDI as a part of its reform policies. Among them top sectors attracted high rate of FDI. Inflow in 2008-2014 is given in the above table and the data has been analyzed by using Compound Annual Growth Rate.

It is examined in the above table that, the Compound Annual Growth Rate of FDI ranged between -52.22% to 52.33%. It has been observed from the above analysis that the FDI trends have witnessed the negative Compound Annual Growth Rate in many of the sectors. The above results in Table 3 clearly indicate that there was a highest FDI flow in communication services and lowest in cease of trading industry witnessed with a Compound Annual Growth Rate of 52.33% and -52.22% respectively.

Table 4 provides the descriptive statistics of the major industries used in the analysis and it shows the share of industries in the total flow of FDI. The table reports the sectorial-wise inflow of FDI to India for the period from 2008 to 2014, it reveals that FDI inflow to Manufacture Industry, Construction Industries and Financial Services sector were ranging between 6% to 40%. During this period FDI inflow to sectors namely Real Estate Activities, Communication Services, Business Services, Miscellaneous Services, Computer Services, Restaurants and Hotel Industries, Retail and Whole sale Industries, Mining industries and Transport Industries accounts for one to ten percentage only. While in to the other sectors like trading and Education, Research and Development the FDI inflows were less than one percentage. It indicates that FDI inflows have increased continuously within a span of 7 years in case of manufacturing sector except in the year 2013. The trend shows that after the economic reforms were carried out FDI was heavily concentrated in manufacturing activities, which was due to the import substitution principle. During the study period trend of FDI in Manufacture sector was highest with 39.78% in the year 2012 and FDI in trading industry was lowest with 0.01% in the year 2014.

Foreign Direct Investment Flows to India During the Study Period 2008-2014: Country -Wise								
(US $ million)								
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	CAGR(%)
Country								
Mauritius	9,518	10,165	9,801	5,616	8,142	8,059	3,695	-12.64
Singapore	2,827	3,360	2,218	1,540	3,306	1,605	4,415	6.58
U.S.A	950	1,236	2,212	1,071	994	478	617	-5.98
Cyprus	570	1,211	1,623	571	1,568	415	546	-0.61
Japan	457	266	971	1,256	2,089	1,340	1,795	21.58
Netherlands	601	682	804	1,417	1,289	1,700	1,157	9.81
United Kingdom	508	690	643	538	2,760	1,022	111	-19.53
Germany	486	611	602	163	368	467	650	4.24
UAE	226	234	373	188	346	173	239	0.8
France	136	437	283	486	589	547	229	7.73
Switzerland	192	135	96	133	211	268	356	9.22
Hong Kong SAR	106	155	137	209	262	66	85	-3.1
Spain	48	363	125	183	251	348	181	20.88
South Korea	86	95	159	136	226	224	189	11.91
Luxembourg	15	23	40	248	89	34	539	65.28
Others	2,699	3,034	2374	1184	983	1540	1,249	-10.42

Source: Reserve Bank of India, Annual Reports

Table 1: FDI inflows from different countries.

Share of Foreign Direct Investment Flows to India During the Study Period 2008-2014: Country -Wise (US $ million)							
	2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**
Country							
Mauritius	9518(49)	10165(44.79)	9801(43.64)	5616(13.59)	8142(34.69)	8059(44.07)	3695(23.02)
Singapore	2827((14.55)	3360(14.80)	2218(9.87)	1540(10.31)	3306(14.08)	1605(8.78)	4415(27.50)
U.S.A	950(4.89)	1236(5.47)	2212(9.85)	1071(7.17)	994(4.23)	478(2.61)	617(3.84)
Cyprus	570(2.93)	1211(5.34)	1623(7.23)	571(3.82)	1568(6.68)	415(2.27)	546(3.40)
Japan	457(2.35)	266(1.17)	971(4.32)	1256(8.41)	2089(8.90)	1340(7.33)	1795(11.18)
Netherlands	601(3.09)	682(3)	804(3.58)	1417(9,49)	1289(5.49)	1700(9.30)	1157(7.20)
United Kingdom	508(2.62)	690(3.04)	643(2.86)	538(3.60)	2760(11.76)	1022(5.59)	111(0.69)
Germany	486(2.50)	611(2.69)	602(2.68)	163(1.09)	368(1.57)	467(2.55)	650(4.05)
UAE	226(1.16)	234(1.03)	373(1.66)	188(1.28)	346(1.47)	173(0.95)	239(1.49)
France	136(0.70)	437(1.93)	283(1.26)	486(3.25)	589(2.51)	547(2.99)	229(1.43)
Switzerland	192(0.99)	135(0.59)	96(0.43)	133(0.89)	211(0.90)	268(1.47)	356(2.22)
Hong Kong SAR	106(0.55)	155(0.68)	137(0.61)	209(1.40)	262(1.12)	66(0.36)	85(0.53)
Spain	48(0.25)	363(1.60)	125(0.56)	183(1.22)	251(1.07)	348(1.90)	181(1.13)
South Korea	86(0.44)	95(0.42)	159(0.71)	136(0.91)	226(0.96)	224(1.22)	189(1.18)
Luxembourg	15(0.08)	23(0.10)	40(0.18)	248(1.66)	89(0.38)	34(0.19)	539(3.36)
Others	2699(13.89)	3034(13.37)	2374(10.57)	1184(7.93)	983(4.19)	1540(8.42)	1249(7.78)
Total FDI	19425(100)	22697(100)	22461(100)	14939(100)	23473(100)	18286(100)	16054(100)

Source: Reserve Bank of India , Annual Reports

Table 2: FDI inflows in India during 2008-2014.

Industry	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**	**CAGR (%)**
							(US $ million)	
Manufacture	3,726	4,777	5,143	4,793	9,337	6,528	6,381	7.99
Construction	2,551	2,237	3,516	1,599	2,634	1,319	1,276	-9.42
Financial Services	3,850	4,430	2,206	1,353	2,603	2,760	1,026	-17.21
Real Estate Activities	1,336	1,886	2,191	444	340	197	201	-23.71
Electricity and other Energy Generation, Distribution & Transmission	829	669	1,877	1,338	1,395	1,653	1,284	6.45
Communication Services	66	2,067	1,852	1,228	1,458	92	1,256	52.33
Business Services	1,158	643	1,554	569	1,590	643	521	-10.78
Miscellaneous Services	1,901	1,458	888	509	801	552	941	-9.56
Computer Services	1,035	1,647	866	843	736	247	934	-1.46
Restaurants and Hotels	280	343	671	218	870	3,129	361	3.7
Retail and Wholesale Trade	200	294	536	391	567	551	1,139	28.21
Mining	461	105	268	592	204	69	24	-34.44
Transport	816	401	220	344	410	213	311	-12.87
Trading	176	400	198	156	6	140	1	-52.22
Education, Research and Development	156	243	91	56	103	150	107	-5.24
others	884	1,097	384	506	419	43	293	-14.59

Source: Reserve Bank of India, Annual Reports

Table 3: Foreign Direct Investment Flows to India during the Study Period 2008-2014: Sector -Wise.

Conclusion

In the 1990's Foreign Direct Investment became the major source of private capital flows to developing economies. Due to the sudden disappearance of commercial bank lending in 1980's many developing nations started to offer various fiscal and financial incentives to foreign firms. It is widely believed that the extent to which FDI can affect output growth is not limited to the capital it supplies. Instead, FDI is thought of as composite bundle of capital stocks, technology know how, better managerial skills, labor training and other externalities that benefit output in several ways. Prior to early 1990's India used to have restrictive and regulated market for foreign capital. During this period, there were various obstacles (red tapes) and procedures for approval of foreign collaborations. However in early 90's, India faced extreme foreign exchange and balance of payments crisis which forced policy makers to opt for liberal policy regime. New Industrial Policy (NIP) in 1991 dissolved industrial licensing and market became less regulated. Due to the adoption of liberalization policies by India since 1990's the FDI inflows have increased consistently.

FDI in India is a key driver of economic growth and economic development of India. Most governments regard attracting it as a priority, particularly in developing and transitional economies. It is given such emphasis not just because it boosts capital formation but because of its potential to enhance the quality of the capital stock. The reason for this is that in general multinationals are assumed to bring with them best practice or, as a minimum, better practice technology and management. FDI in India to various sectors can attain sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries. In this piece of

Industry	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
							(US $ million)
Manufacture	3726(19.18)	4777(21.05)	5143(22.90)	4793(32.08)	9337(39.78)	6528(35.70)	6381(39.75)
Construction	2551(13.13)	2237(9.86)	3516(15.65)	1599(10.70)	2634(11.22)	1319(7.21)	1276(7.95)
Financial Services	3850(19.82)	4430(19.52)	2206(9.82)	1353(9.06)	2603(11.09)	2760(15.09)	1026(6.39)
Real Estate Activities	1336(6.88)	1886(8.31)	2191(9.75)	444(2.97)	340(1.45)	197(1.08)	201(1.25)
Electricity and other Energy Generation, Distribution and Transmission	829(4.27)	669(2.95)	1877(8.36)	1338(8.96)	1395(5.94)	1653(9.04)	1284(8)
Communication Services	66(0.34)	2067(9.11)	1852(8.25)	1228(8.22)	1458(6.21)	92(0.50)	1256(7.82)
Business Services	1158(5.96)	643(2.83)	1554(6.92)	569(3.81)	1590(6.77)	643(3.52)	521(3.25)
Miscellaneous Services	1901(9.79)	1458(6.42)	888(3.95)	509(3.41)	801(3.41)	552(3.02)	941(5.86)
Computer Services	1035(4.56)	1647(7.26)	866(3.86)	843(5.64)	736(3.14)	247(1.35)	934(5.82)
Restaurants and Hotels	280(1.44)	343(1.51)	671(2.99)	218(1.46)	870(3.71)	3129(17.11)	361(2.25)
Retail and Wholesale Trade	200(1.03)	294(1.30)	536(2.39)	391(2.62)	567(2.42)	551(3.01)	1139(7.09)
Mining	461(2.37)	105(0.46)	268(1.19)	592(3.96)	204(0.87)	69(0.38)	24(0.15)
Transport	816(4.20)	401(1.77)	220(0.98)	344(2.30)	410(1.75)	213(1.16)	311(1.94)
Trading	176(0.91)	400(1.76)	198(0.88)	156(1.04)	6(0.03)	140(0.77)	1(0.01)
Education, Research and Development	156(0.80)	243(1.07)	91(0.41)	56(0.37)	103(0.44)	150(0.82)	107(0.67)
others	884(4.55)	1097(4.83)	384(1.71)	506(3.39)	419(1.79)	43(0.24)	293(1.83)
Total FDI	19425(100)	22697(100)	22461(100)	14939(100)	23473(100)	18286(100)	16054(100)

Source: Reserve Bank of India, Annual Reports

Table 4: Share of Foreign Direct Investment Flows To India During The Study Period 2008-2014: Sector -Wise.

research, Using data country wise and sector wise for the period 2008-2014 we find that At country level, it is found that the Luxembourg was at highest FDI inflows as per the CAGR and as per the share it is from Mauritius. As per the study, the sectors that attracted higher inflows were Communication services as per the CAGR and as per the share it is manufacture sector. The other sectors in Indian economy the Foreign Direct Investors interest was, in fact has been quite poor.

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