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# Trends of Foreign Direct Investment in India

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## ABSTRACT

This research paper aims to explore the rutted beginnings of foreign Direct Investment and analyzes the trend and need of FDI in the Indian Economy. This paper also aims to study the change in the volume of inflow of FDI in India during pre and post reform period (1991). The data has been accrued through secondary sources like the DIPP, official publications of the Government, ET bureau, UNCTAD, RBI Bulletin etc. To analyze the difference in inflow of FDI in pre and post reform period, paired dependent "t" test has been applied. The top twenty sectors attracting the maximum FDI equity inflow has been assessed in the paper and the top ten countries of the world who are investing in India in terms of outward flow of foreign investment for the time period 2000 to 2015 has been assessed respectively. The prevailing paradox, that India wouldn't reap from FDI for a very long time, and thus for sustainable development India should aim to grow on the back of Domestic Market has been mentioned in this paper.

***Key Words:*** *Foreign Direct Investment, Foreign Institutional Investment, Gross Domestic Product, Balance of Payments.*

## INTRODUCTION:

Beginning its trade long back in the Bronze Age as the Indus Valley civilization with Egypt and Mesopotamia, India experienced structured and systematic inflow of foreign capital during the British colonial era. The foreign investors have identified India as one of the most potential destinations for foreign investment and with the advent of globalization howsoever there is an immense upwelling of foreign investments in India since the past three decades. Foreign Investment, which may mean investment or reinvestment of income or new equity capital, may be categorized into two hues, the Foreign Direct Investment (FDI) and the Foreign Portfolio Investment (FII). The FDI is the injection of foreign funds or capital inflow from abroad into an enterprise that is operating in some other country of origin through acquisition of a local company or founding of a new operating site. Namely Foreign Direct Investments are classified with regard to their inward and outward direction of flow.'A cross border investment made by a direct investor in direct enterprise both residing and stationing in different countries' (IMF, 2002). The FDI plays key role in the economic growth and development of a nation and strengthens the global networks of trade where a nation enticing an FDI inflow finances its path of development. Howsoever in the process the foreign capital recovers domestic saving constrictions stipulating a gate to superior technological knowhow which enhances the yield of the existing production capacity and proficiently boosts new production prospects.

With the emergence of Globalization and liberalization developing countries including India and China have witnessed a upsurge of inflow of FDI during the past 3 decades respectively. . Foreign Direct Investment in India is a major foundation of no debt monetary resource for the economic development of the country. India has always been identified to be an extremely salient destination for foreign investment and the investors ungrudgingly look forward to taking advantage of the Indian Market, the fairly lower labor wages and all the special investment dispensations. Foreign capital has kept flowing into the country principally because of vigorous business environment and constructive government policy administrations in India. Vivid measures have been taken in due course of time to ease the norms for inflow of foreign capital in various sectors like defense, telecom, Public Sector oil refineries etc.

**Review of Literature :**

Several studies carried out to identify the role of Foreign Direct Investment in different economies could not but avoid the fact that study of its general routes, patterns and directions are severely important likewise. A study conducted by **Honnakeri and Kumar (2015)** divulge the expected growth of Indian Retail due to the advent of FDI as to three time 660 billion USD in 2015.The paper discusses the absence and the must have FDI inflow in the Indian retail as to increase the productivity and the strategically moves the government is planning to take for the same. **Khurana and Sharma (2013)** distinctly discuss about FDI inflows in different sectors of the Indian Economy including its problems and suggested recommendations. Agriultural sector according to them is the heart of Indian Economy and FDI should be way more indulged in this sector henceforth. **Devajit in 2012** steered a study to ascertain the impact of foreign direct investment in the Indian Economy and concluded emphasizing the advent of FDI in the economy s a component of sustained growth. A study conduced in the Vietnam economy by **Chien and Zhang (2012)** conclusively dalt with the positive relationship of FDI and GDP more importantly proving to have a better impact in the places having healthier socio economic stability. A focused study carried out by **Agarwal (2011)** reveal the multiplier effect of FDI on the growth of both China and India howsoever China's growth being ominously more than that of India. A significant mention of the study carried out by **Kumar and Karthika (2010)** can be made in light of their findings about the role of FDI in the economy as a whole especially in developing countries is definitely positive. According to **Gyanpratha- Accman (2010)**, FDI in India for the year 2010 was lower by 5% from that of 2009 which was reason for a previous dip of 60% in the early fiscal. In 2013 the foreign direct investment norms were generally relaxed by the government in sectors like defense, telecom etc which also resulted in significant inflow of FDI henceforth. A study conducted by Dunning John in 2004 critically investigates the institutional environment as a major determinant for FDI in an economy and also shows importance of changing role of FDI over series of time.

**OBJECTIVES:**

- To assess the trends of FDI inflow in India.
- To evaluate the sector-wise and country-wise inflow of FDI in India.
- To calculate share of FDI inflow in India's GDP.
- To estimate the percentage share of India's FDI in Global FDI inflows.
- To assess the growth of FDI inflow in India during pre and post economic reforms (1991).

**Trends of FDI Inflow in India:**

Before even the advent of globalization in the modern world, India was subjected to foreign capital by Portugal, Netherland, UK and France in the 16th century and after, the British Colonial era strengthened their hold, they predominantly became the overriding investors in India. Policy makers after 1947 paid due attention to the purpose of inflow of foreign capital in the economy and in 1965 the multinational corporations were allowed to venture through technical partnership in India. FDI inflow in India in 1972 was estimated to be 17.79 million US Dollars which grew by more than 100% in the next year(37.91 million) in 1973 and even accounted for a negative growth rate in 1983 (-92%) from 72 million to 5.64 million USD. India during her 70's was facing social political and economic turmoil, with the influx of Bangladeshi refugees and Indo Pak war in 1971.The foreign investors had lost faith in the stability of the economy and the numbers reduced from 51.11 million USD in 1976 to 18 million USD in 1978,which was a year of established of the new UPA government. Henceforth the growth of FDI inflow percentages raised by 160% in 1979 and until 1982 when the inflow reduced by 92%. The 1980's in the history of the Indian economy was a period of bulk foreign capital inflow with a growth rate in FDI inflow of 451%,109% and 80% in three consecutive years 1985,1986 and 1987.Until 1989 the inflow of FDI was 252 million USD which had a slight downturn in 1990 and was 236 million USD (6% decrease) but this was accompanied by a sharp decrease in 1991 (75 million USD).The period from 1989 onwards was subjected to massive economic, social and political turmoil and the Indian Economy had to undergo reforms to stabilize the nation. Initially investors had lost faith in the economy but after the policy implications the inflow of FDI increased and was projected to be 2151 million USD in 1995 which was 58% of the Indian GDP.FDI dipped in the years 2009 and 2010 by 24% and 23% due to the world global economic crisis but again increased to 36190 million USD (31%) in 2011.According to the recent study in United Nations cooperation of trade and Development, India is one of the ideal destinations for Foreign Investment, may it be direct or institutional .

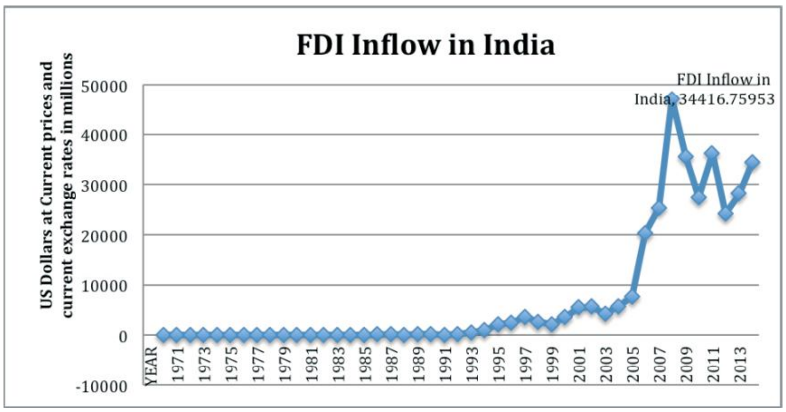



**Figure 1: FDI inflow in India (1970 to 2014)**

**Source: Compiled from UNCTAD, 2016.**

**Country-wise FDI equity inflows in India:**

The coverage of globalization of a country's economy is by and large evaluated from its trade and investment relations, especially the volume and growth of trade from one country to another. Exports help the firms to achieve greater effectiveness in production. The Top Ten investing countries in FDI inflow are Mauritius, Singapore, UK, Japan, Netherland, USA, Germany, Cyprus, France and Switzerland

**Table 1: country wise (top 10) FDI equity inflows in India**

| Ranks | Country | Cumulative Inflows (2000-2015) | Percentage to total inflows (in terms of USD) |
|---|---|---|---|
| 1. | MAURITIUS | 89,644.04 | 34.74% |
| 2. | SINGAPORE | 35,860.84 | 13.90% |
| 3. | U.K | 22,329.12 | 8.65% |
| 4. | JAPAN | 18,811.08 | 7.29% |
| 5. | NETHERLAND | 15,323.43 | 5.94% |
| 6. | U.S.A | 14,377.97 | 5.57% |
| 7. | GERMANY | 8,197.45 | 3.18% |
| 8. | CYPRUS | 8,139.55 | 3.15% |
| 9. | FRANCE | 4,651.30 | 1.80% |
| 10. | SWITZERLAND | 3,138.47 | 1.22% |
| Total FDI Inflows from all countries | | 2,20,473.25 | |

Source: FDI Statistics, Department of Industrial Policy& Promotion, Ministry of Commerce& Industry

Mauritius has always been the top investing country in India and India has also been often called upon as the Mauritius route. This is a historical relationship which is shared by both for over ten years majorly because of a special tax treaty between India and Mauritius which confirms capital gains can only be taxed in Mauritius. Amitabh Kant the CEO of Niti Ayog, in his report to India times in December 2015 has identified a huge surge in FDI inflows in India specially financed by countries like Mauritius and Singapore largely because the present government has opened up vast sectors. However very recently Singapore has taken the top most position of Mauritius in terms of investment in the year 2015 with an equity investment of more than twenty four thousand rupees crores. The major reasons identified is the DTAA (Double Taxation avoidance agreement)

Incorporating the LOB (limit-of Benefit) clause of India with Singapore which has given a breathe of fresh air to the foreign investors in Singapore. Further India's relationship with U.K in terms of trade is commendable as India has emerged to be the third largest source of FDI in U.K and U.K is one of the big investors in India as well. On the hand Japan being a capital rich nation has invested all over east Aisa including countries like Korea, Taiwan, Hong Kong and even the trade king China. India for Japan is an absolute haven destination where it still holds an upper hand.

**Sector-wise FDI equity inflows in India:**

The sectorial distinction of FDI inflows from the year 2000 to 2015 reveal that the highest FDI inflow magnetizing service sector entices 17% with a cumulative inflow of 43,350 million USD. The construction sector also accounts for 9.34% of FDI inflow as in 2015.Among the top ten the lowest foreign investment has been experienced by metallurgical industries (3.36%) whereas chemicals, power and trading account for joint 4.1%, 3.81% and 3.47% of total inflows. Computer software and telecommunications have attracted a cumulative FDI of 17,575 and 17,453 USD millions as of from April '000 to June '15 respectively. Automobile industry and Pharmaceuticals have been attracting 5.22% and 5.17% of FDI inflows securing fifth and sixth rank in the lot. Hotels and tourism though not being one of the top ten sectors to attract FDI has a significant amount of investment (3.15 %) including petroleum and natural gas with 6575 million USD (Cumulative '00-'15) accounting for 2.55% of total investments. The rest like information broadcasting, electrical equipment's, construction or infrastructure activities, industrial machinery etc have accounted for 1% in average of total foreign investment inflow.

**Table 2: Sector- wise FDI Equity Inflows in India**

| S.No | Sector | Amount of FDI Inflow, Cumulative (in USD Millions) | Percentage of Total Inflows |
|---|---|---|---|
| 1. | Service Sector | 43,350 | 16.80 |
| 2. | Construction Development | 24,097.91 | 9.34 |
| 3. | Computer Software &Hardware | 17,575.15 | 6.81 |
| 4. | Telecommunications | 17452.60 | 6.81 |
| 5. | Automobile Industry | 13,476.99 | 5.22 |
| 6. | Drugs& Pharmaceutical | 13,335.88 | 5.17 |
| 7. | Chemicals | 10,588.22 | 4.10 |
| 8. | Power | 9,828.08 | 3.81 |
| 9. | Trading | 8,957.62 | 3.81 |
| 10. | Metallurgical Industries | 8,679.72 | 3.47 |
| 11. | Hotel &Tourism | 8,140.10 | 3.15 |
| 12. | Petroleum& Natural Gas | 6,575.97 | 2.55 |
| 13. | Food Processing Industries | 6,429.15 | 2.49 |
| 14. | Miscellaneous Mechanical & Engineering Industries | 4,053.72 | 1.57 |
| 15. | Information & Broadcasting including Print Media | 4,050.58 | 1.57 |
| 16. | Electrical Equipments | 4029.43 | 1.56 |
| 17. | Infrastructure Activities | 4,010.10 | 1.55 |
| 18. | Industrial Machinery | 3,747.02 | 1.45 |
| 19. | Non-conventional Energy | 3,714.83 | 1.44 |
| 20. | Hospital & Diagnostic Centers | 3,133.81 | 1.21 |

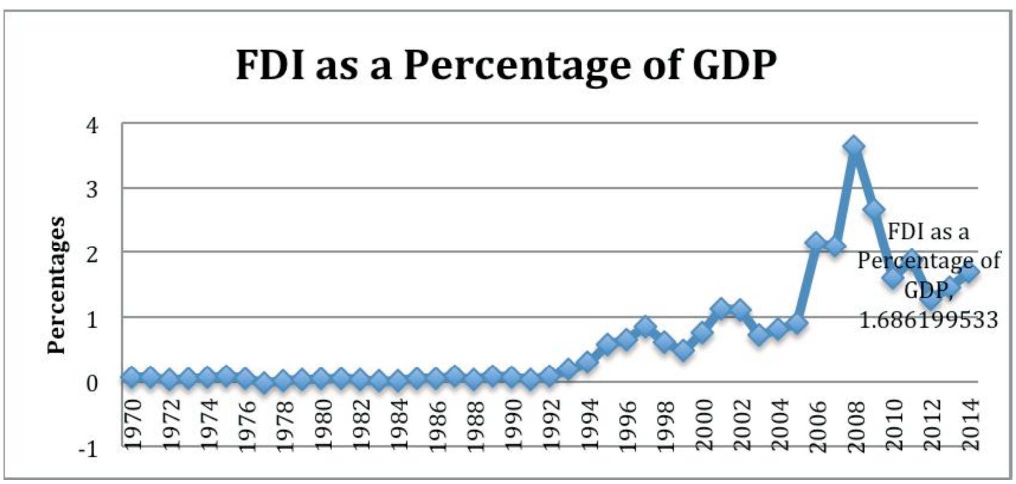
Source: FDI Statistics, Department of Industrial Policy& Promotion, Ministry of Commerce& Industry

Indian government has always tried to make maximum investments flow into the manufacturing sector but the service sector endures to attract the maximum FDI. The Department of Industrial Policy and Promotions data confirms the maximum investments made in financial , banking ,insurance, R&D courier, technology analysis as main constituents of the service attracting a handsome amount of FDI. Followed with glory, construction and development, computer software, telecommunications, automobile industry etc have attracted capital and specially the foreign direct investment reforms have enabled successful exposure and strength for the country in world global scenario. Inflow of FDI, which is a critical driver of economic growth are ensured in these sectors which in turn are the deliberate efforts of the nation to boost growth and development in the economy. The countries investing in India in different sectors are taking due advantage of favorable policy regimes and vigorous business environment. The relaxation of FDI norms in sectors such as telecom, power exchange, stock exchange, defense, public sector units oil refineries etc has in turn made sure of the continuous flow of FDI into the economy. India has moved up by 16 positions in the world global Index of most competitive nations in the year 2015 holding the 55th position currently.

**Share of FDI in India's GDP:**

The foreign direct investment has increased in due course of time and as a percentage of GDP it had significantly expanded. The significant changes in growth has been identified majorly after the reform period in 1992 and the percentages have snooted up until 2008 after which it has ominously decreased. Foreign investment plays a very important role to bridge the gap between savings and investment and finance the development activities in the country, but for a nation to sustain its development the growth of the domestic industries is as important as strident development. But the role of the foreign investors in the India Economy has been massive as to their trust in the economic stability of the nation and to reap the social, political and economic advantages altogether.

**Figure 2: FDI inflow as a percentage of GDP in India**

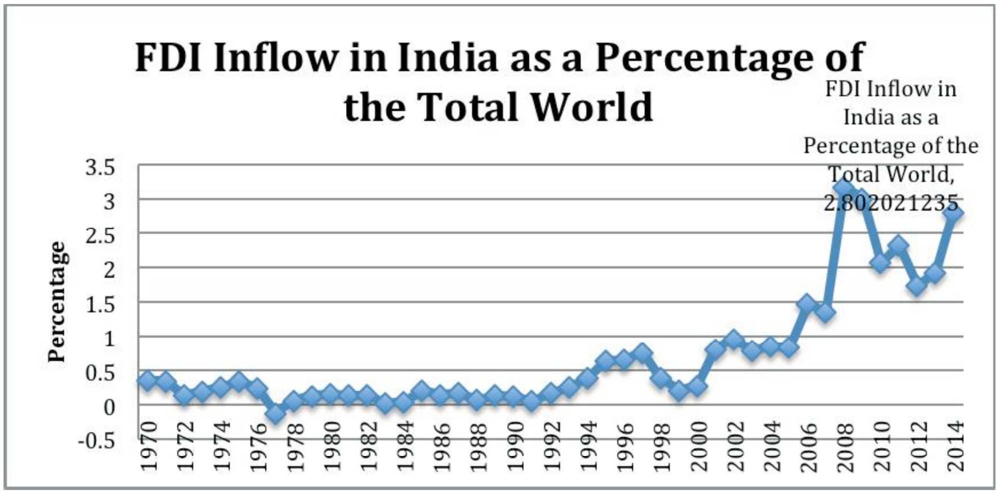



Source: Compiled from UNCTAD, 2016

**India's share in the global FDI inflows:**

India been prominently denoted as the world's largest democracy is the global resource for industry in manufacturing and services. With comparative advantages to all the resources and cheap factors of production, the emerging developing countries reap good returns to investment bestowing substantial bearing in the global economy. The recent scope of investment in India has reached its all-time peak with the increased internationalization of goods and services and liberalization of trade in the global world. India's share in the global FDI inflows has been increasing in due course of time from .3% to 2.8% from 1970 to 2014, especially after the reforms of 1991 the percentage share of FDI inflows in India has increased form .04% further to .95% in 2002 and 2.8% in 2014 respectively (Unctad,2016).

**Figure 3: Percentage share of FDI inflow in the global FDI inflows**




Source: Compiled from UNCTAD, 2016

Figure 3 reveals that during the period of review FDI inflow as a percentage of the total world inflow has undergone a significant increase in due course of time. But yet the major budding international destinations of the worlds like China, Brazil and Russia have way more FDI inflow as the accounted percentage of the total world inflow

**FDI inflows in India: An Assessment of Pre and after liberalization period (1991)**

Table 3 shows the inflow of FDI from 1970 to 2014 and the period divided into two sections; namely before and after liberalization period to understand the difference in the volume with regard to the adjusted time period. The above test reveals there is a significant difference in inflow of foreign Direct Investment before and after the reform period in the Indian Economy. There are several factors influencing the inflow of foreign investment in the economy one of which and a major is the economic reforms.

**Table 3: Paired t-test to reveal changes in FDI before and after liberalization period (1991)**

**Paired Samples Test**

| | | Paired Differences | | | | | t | df | Sig. (2-tailed) |
|---|---|---|---|---|---|---|---|---|---|
| | | Mean | Std. Deviation | Std. Error Mean | 95% Confidence Interval of the Difference | | | | |
| | | | | | Lower | Upper | | | |
| Pair 1 | VAR00001 - VAR00002 | -13179.76813 | 14327.66466 | 3054.66837 | -19532.29876 | -6827.23750 | 4.315 | 21 | .000 |

During pre-liberalization period the compound annual growth rate (CAGR) increased by 19% whereas during post liberalization period the CAGR of FDI increased by 25% and since 1991 the FDI inflows in India have increased more than 165 times indicating the positive impact of liberalization on the FDI inflows (Akhtar, 2013). The major reason catering to the conclusion is the relaxation of policy regimes towards international trade and support of investments by capital exporting countries. India in the post liberalization period has definably gone through corrective measure of deregulation reducing government control, greater privatization and lower taxes in order to allow more foreign capital in the country. Thus the international players have had more scope to enter the Indian Economy after moderation of norms giving us signs of significant change in inflow of FDI in the pre and post liberalization period. The result of carefully removing unnecessary bureaucratic controls and restrictions on Foreign investors and integrating India with the world's economy was the significant rise in the inflow of foreign Direct Investment in the nation.

**CONCLUSION:**

The Foreign Direct Investment in the Indian economy has shown a dynamic approach and change especially after the first and second phase reforms. Foreign capital is an effective tool to bridge the gap between savings and investment in a nation like India where rapid growth and development is extremely crucial. The developmental theory given by Arthur Lewis clearly enunciates the need of rapid development and investment created by surplus capital which definitely generates employment in the economy. For fleet investment, bridging the gap between investment and savings and to create effective employment the inflow of foreign direct Investment plays an important role. After the Economic reforms of 1991,India has been undergoing a path of sharp growth and development where all the statistics have pointed out at India as the fastest growing economy of the world producing enough industrial output to put it self to 11th rank in the global forum. The Indian exports and imports have apparently increased and a significant change in the current account deficit have been noticed with the increase in flow of foreign capital in the Indian Economy. The balance of payments deficit has decreased with the due course of time as a percentage of the Gross Domestic product. Thanks to inflow of foreign investments, exports in certain sectors have surged up impacting the balance of trade in the economy positively. Exports of services plays a very crucial position and certain sectorial exports of services especially have began their run right after the reforms and strategically during the second phase of reforms like telecommunication, construction etc. Particularly after India adopted the economic reforms in 1991 to finance the Balance of Payments crisis, Globalization laid path to Indian growth and stabilization. During 2002 the current account deficit had been noted to be 1.39% of GDP which in due course increased to 4.8% of GDP again showing a significant decrease in 2014, accounted for 1.5% of GDP. The inflow of FDI had been fruitfully categorizing India to be a nation having positive capital accounts with a reduced fiscal deficit of 3.5% of GDP. Indian foreign exchange has increased from 1.6 billion USD in 1991 to 326 billion USD in 2015.

Now the important question, Is the Boon greater than the Curse? According to Amitabh Kant (January 2016), the much lenient and relaxing norms with regard to the advent of FDI in the economy will definitely increase the inflow of foreign capital but the country in the long run should not grow at the back of FDI .The domestic market should be boosted and the government should create the positive environment. He further asserted that make for India is absurd and India should visualize the global markets, its scale and size as done by China

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