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Periodic Research

FDI Trends and its effect on Indian Economy

Abstract

With the onset of reforms to liberalize the Indian economy in July of 1991, a new chapter has dawned for India and her billion plus population. This period of economic transition has had a tremendous impact on the overall economic development of almost all major sectors of the economy especially the services sector. Besides, it also marks the advent of the real integration of the Indian economy into the global economy. India has been attracting foreign direct investment especially during post reforms period. The sectors like telecommunication, construction activities and computer software and hardware have been the major sectors for FDI inflows in India. The Indian economy as a whole, we find that FDI stocks and output are Co-integrated in the long run. FDI is unlikely to work wonders if only remaining regulations were relaxed and still more industries opened up to FDI. Our present focus is on the FDI trends and consequences during the last decade in India. We also study the effects of FDI investment across various sectors during the same period.

Keyword: Economy, FDI, FII, Reforms, Services

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Introduction

Indian economy had experienced major policy changes in early 1990s. The new economic reform, popularly known as, Liberalization, Privatization and Globalization (LPG model) aimed at making the Indian economy as fastest growing economy and globally competitive. The series of reforms undertaken with respect to industrial sector, trade as well as financial sector aimed at making the economy more efficient. With the onset of reforms to liberalize the Indian economy in July of 1991, a new chapter has dawned for India and her billion plus population. This period of economic transition has had a tremendous impact on the overall economic development of almost all major sectors of the economy especially the services sector. Besides, it also marks the advent of the real integration of the Indian economy into the global economy. Indian has been attracting foreign direct investment especially during post reforms period. The sectors like telecommunication, construction activities and computer software and hardware have been the major sectors for Foreign Direct Investment (FDI) inflows in India.

Research Elaborations

Methodology

Our present focus is on the FDI trends and consequences during the last decade across various sectors in India. We also study the flow, distribution and future projections of FDI within India and its effects on Indian economy especially by time of 2008 world crisis using secondary information sources

FDI Inflows in India in Post Reform Era

India's economic reforms way back in 1991 has generated strong interest in foreign investors and turning India into one of the favorite destinations for global FDI flows. According to A.T. Kearney 1, India ranks second in the World in terms of attractiveness for FDI. A.T. Kearney's 2007 Global Services Locations Index ranks India as the most preferred destination in terms of financial attractiveness, people and skills availability and business environment. Similarly, UNCTAD's76 World Investment Report, 2005 considers India the 2nd most attractive destination among the TNCS. The positive perceptions among investors as a result of strong economic fundamentals driven by 18 years of reforms have helped FDI inflows grow significantly in India[1].

Trends and Patterns of FDI flow in the World

Trends in World FDI flows show that developing countries makes their presence felt by receiving a considerable chunk of FDI inflows. Developing economies share in total FDI inflows rose from 26% in 1980 to 40% in 1997.However, the share during 1998 to 2003 fell considerably but rose in 2004, again in 2006 and 2007 it reduces to 29% to 27% due to global economic meltdown. Specifically, developing Asia received 16 %, Latin America and the Caribbean 8.7 %, and Africa 2 %. On the other hand, developed economies show an increasing upward trend of FDI inflows, while developing economies show a downward trend of FDI inflows after 1995[2].

However, India shows a steady pattern of FDI inflows during 1991-2007. The annual growth rate of developed economies was 33%, developing economies was 21% and India was 17% in 2007 over 2006. During 1991-2007 the compound annual growth rate registered by developed economies was 16%, developing economies was merely 2%, and that of India was 41%.

Major sectors attracting FDI

The major sectors attracting FDI inflows in India have been Services and Electrical & Electronics amounting to US$ 30,421millions or 32 % of total FDI. Service sector tops the chart of FDI inflows in 2008 with India emerged as a top destination for FDI in services sector[3]

Distribution of FDI within India

FDI inflows in India are heavily concentrated around two cities, Mumbai (US$ 26899.57 million) and Delhi (US$ 12683.24 million). Bangalore, Ahmadabad and Chennai are also receiving significant amount of FDI inflows. These five cities together account for 69 per cent of total FDI inflows to India. Mumbai and Delhi together received 50 per cent of total FDI inflows to India during 2000 to 2008[4].

2.6 FDI in India dropped in 2010

India has dropped six places in the global trade body's 2010 rankings of highest foreign direct investment (FDI) compared to the 2009 list.

- India's ranking has dropped to 14th place in 2010 from 8th position in 2009. India attracted FDI worth $25 billion last year, much lower than the inflows of $36 billion seen in 2009.
- FDI to South Asia declined to $32 billion, reflecting a 31 percent slide in inflows to India and a 14 percent drop in flows to Pakistan. But inflows to Bangladesh increased by nearly 30 percent to $913 million.
- While inflows to India slowed down, FDI in China has increased in 2010[5].

Global foreign direct investment

The United Nations Conference on Trade and Development reported that there was no significant growth of Global FDI in 2010. In 2010 was $1,122 billion and in 2009 was $1,114 billion. The figure was 25 percent below the pre- crisis average between 2005 & 2007.

Indian FDI projections

United Nations Conference on Trade and Development

(UNCTAD) survey projection on FDI

Starting from a baseline of less than $1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010–2012. Services, telecommunication, construction activities, computer software and hardware were attracted higher inflows. Mauritius, Singapore, the US and the UK were among the leading sources of FDI. According to Ernst and Young, foreign direct investment in India in 2010 was $44.8 billion, and in 2011 experienced an increase of 25% to $50.8 billion. The world's largest retailer Wal-Mart has termed India's decision to allow 51% FDI in multi-brand retail as a "first important step" and said it will study the finer details of the new policy to determine the impact on its ability to do business in India. However this decision of the government is currently under suspension due to opposition from multiple political quarters.

FDI in India to rise 66% to $80 billion in two years

A leading global investment bank has forecast a 66.6 per cent jump in foreign direct investment (FDI) in India. Though India still does not rank highly as an FDI destination, the country is likely to receive FDI of $80 billion in the next 12-24 month as compared with $48 billion in the last two-year period. Morgan Stanley noted that 20 per cent of the firms covered in the survey have plans to invest in India over the coming 12-24 months. As per the survey, India still does not rank highly as an FDI destination amongst global investors due to infrastructure concerns and thus India isn't considered as a top FDI destination. Morgan Stanley anticipates that India could attract FDI worth as much as US$ 80 billion in next 1-2 years while KPMG officials believe that FDI in 2011-12 may cross the US$ 35 billion mark[6].

Economic Survey 2012

The total foreign direct investment flows into major infrastructure sectors during April-December 2011 were up 23.6 percent from a year ago. The power sector was the biggest gainer (43.6 percent of FDI), followed by non-conventional energy (33.8 percent) and telecommunications (49.9 percent). In order to boost economic growth in the country, the Planning Commission has projected an investment of Rs 45 lakh crores (about $1 trillion) during the Twelfth Plan (2012-17) [7] .

Current Foreign Direct Investment

FDI inflows rose by 36 per cent to US$ 23.69 billion during January-October 2011, while the cumulative amount of FDI equity inflows from April 2000 to October 2011 stood at US$ 226.05 billion, according to the latest data released by the Department of Industrial Policy and Promotion (DIPP).

- The services (including financial and non-financial) sectors attracted highest FDI equity inflows during April-October 2011-12 at US$ 3.43 billion.
- India received maximum FDI from countries like Mauritius, Singapore, and the US at US$ 61.2 billion, US$ 15.2 billion and US$ 10 billion, respectively, during April 2000-October 2011.
- According to the weekly statistical supplement of the Reserve Bank of India (RBI), India's foreign exchange reserves (forex) stood at US$ 291.07 billion for the week ended February 7, 2014[8] .

Market Conditions

Table 1.1
FDI Growth Rate of Indian Market

	Respondents		
Factors	High	Medium	Low
Profitability	16	61	23
Level of Competition	62	31	7
Ease of market penetration	22	56	22
Growth Rate	87	13	0

Source: FICCI Foreign Direct Investment survey, December 2010

Foreign direct investors have shown a lot of confidence in the healthy growth rate of the Indian market with 87 percent of the responding companies rating growth rate of Indian market to be 'high[9]'. It can be observed in table 1.1

Affect of global crisis on Indian operations & Future outlook

The economic and financial crisis of 2008 created uncertainty across the world. Although the maximum impact of the crisis was felt in the western countries, even emerging market economies like India saw a few percentage points being shaved off their growth in the ensuing period. The responses received show that slowdown of the Indian economy in 2009 had an adverse affect on Indian operations of about 60 percent of the surveyed firms. Most of the investors said that they had to face a decline in demand, profitability and sales[10].

Changed perception about India after the Crisis

A mixed response was received with respect to the change in perception about India as an investment destination post crisis. While 49 percent did think more positively about India post the global crisis, a slightly higher proportion - 51 percent - of respondents said that the crisis did not lead to any particular change in their perception and they continue to attach the same level of importance to India as they did in pre crisis days[11] .

Challenges and welcoming factors before India

At last, since economies that enjoy relatively higher rate of growth succeed in attracting a bigger chunk of foreign investment, which, in turn, is expected to accelerate their growth, it is fair to expect that India would have a larger share of FDI in the coming decades. The challenge before India is to disentangle the effects of FDI by taking measures to maximize positive spillovers and minimize the negative effects. While welcoming FDI, priority should be given to investment in industries that have wide spillover effects in technology transfer, manpower training, and employment generation and industries that benefit mass consumption rather than increasing conspicuous consumption or consumption by small group of privileged elite[12].

FDI by sector and industry

FDI inflows and outflows slumped in all three sectors (primary, manufacturing and services) in 2009. The global economic and financial crisis continued to dampen FDI flows not only in industries sensitive to business cycles – such as chemicals and the automobile industry – but also in those that were relatively resilient in 2008, such as pharmaceuticals and food and beverage products. In 2009, only a handful of industries generated higher investments via cross-border M&A s than in the previous year; these included electrical and electronic equipment, electricity services and construction. Telecommunication services also continued to expand, protected by resilient demand and a slightly lower internationalization than in other industries (e.g. in the United States, FDI in the information industry, which includes telecommunications, rose by 41 per cent in 2009 compared to 2008.

It is observed from the table 1.2 that services sector, Telecom, software, Housing and Real estate and construction have witnessed more than 5% increment of FDI during 2000 and 2012. Remaining all the sectors has achieved less than 5% increment of FDI. It is observed that the sectors who have given support by the government have got good share of FDI inflow.

Table 1.2
Statement On Sector-Wise FDI Equity Inflows From April, 2000 To December, 2013

S.No.	Sector	Amount Of FDI Inflows		%Age With Total FDI Inflows (+)
		(In Rs Crore)	(In US $ Million)	
1	Services Sector*	181,621.94	38,824.09	18.5
2	CONSTRUCTION DEVELOPMENT: Townships, Housing, Built-Up Infrastructure And Construction-Development Projects	106,637.46	22,994.20	10.96
3	Telecommunications	59,234.48	12,937.85	6.17
4	Computer Software & Hardware	56,036.91	12,231.38	5.83
5	Drugs & Pharmaceuticals	55,985.48	11,583.69	5.52
6	Chemicals (Other Than Fertilizers)	43,411.45	9,370.99	4.47
7	Automobile Industry	44,205.89	9,165.93	4.37
8	Power	39,458.61	8,383.52	4
9	Metallurgical Industries	36,591.62	7,806.64	3.72
10	Hotel & Tourism	34,925.76	6,910.18	3.29
11	Petroleum & Natural Gas B14	25,471.73	5,491.29	2.62
12	Food Processing Industries	30,576.43	5,273.60	2.51
13	Trading	20,954.68	4,339.64	2.07
14	Information & Broadcasting (Including Print Media)	17,764.60	3,666.67	1.75
15	Electrical Equipments	15,371.89	3,299.66	1.57

16	Cement And Gypsum Products	13,367.30	2,879.95	1.37
17	Non-Conventional Energy	14,621.15	2,879.84	1.37
18	Industrial Machinery	13,276.33	2,677.02	1.28
19	Miscellaneous Mechanical & Engineering Industries	12,120.35	2,588.09	1.23
20	Construction (Infrastructure) Activities	11,295.96	2,352.64	1.12
21	Consultancy Services	10,684.15	2,256.72	1.08
22	Hospital & Diagnostic Centres	10,876.24	2,191.91	1.04
23	Fermentation Industries	9,909.83	1,901.87	0.91
24	Agriculture Services	8,204.05	1,674.98	0.8
25	Ports	6,717.38	1,635.08	0.78
26	Rubber Goods	7,457.11	1,397.77	0.67
27	Textiles (Including Dyed,Printed)	6,464.37	1,352.92	0.64
28	Electronics	6,018.81	1,297.59	0.62
29	Sea Transport	5,575.28	1,208.03	0.58
30	Mining	4,392.80	1,002.59	0.48
31	Prime Mover (Other Than Electrical Generators)	5,046.76	996.08	0.47
32	Education	4,686.52	915.78	0.44
33	Paper And Pulp (Including Paper Products)	4,209.19	891.08	0.42
34	Medical And Surgical Appliances	3,723.75	741.8	0.35
35	Soaps, Cosmetics & Toilet Preparations	3,609.16	713.3	0.34
36	Machine Tools	3,258.35	670.35	0.32
37	Ceramics	2,913.65	633.79	0.3
38	Air Transport (Including Air Freight)	2,268.16	489.06	0.23
39	Diamond,Gold Ornaments	2,064.56	433.15	0.21
40	Glass	2,170.74	428.23	0.2
41	Railway Related Components	2,135.35	420.86	0.2
42	Vegetable Oils And Vanaspati	1,974.44	397.95	0.19
43	Printing Of Books (Including Litho Printing Industry)	1,854.65	369.11	0.18
44	Agricultural Machinery	1,665.16	338.17	0.16
45	Fertilizers	1,537.89	318.52	0.15
46	Commercial, Office & Household Equipments	1,264.20	268.01	0.13
47	Earth-Moving Machinery	873.83	191.59	0.09
48	Leather,Leather Goods And Pickers	556.81	112.64	0.05
49	Tea And Coffee (Processing & Warehousing Coffee & Rubber)	476.96	105.02	0.05
50	Scientific Instruments	548.15	103.71	0.05
51	Retail Trading (Single Brand)	472.34	97.6	0.05
52	Timber Products	433.45	85.23	0.04
53	Industrial Instruments	310.56	67.06	0.03
54	Photographic Raw Film And Paper	269.26	66.54	0.03
55	Boilers And Steam Generating Plants	306.75	62	0.03
56	Sugar	252.35	53.43	0.03
57	Coal Production	119.19	27.73	0.01
58	Dye-Stuffs	87.32	19.5	0.01
59	Glue And Gelatin	72.22	14.83	0.01
60	Mathematical,Surveying And Drawing Instruments	39.8	7.98	0
61	Defence Industries	24.36	4.94	0
62	Coir	10.62	2.21	0
63	Miscellaneous Industries	37,725.92	8,218.11	3.92
	Sub-Total	996,192.42	209,841.70	100
64	RBI'S- NRI Schemes (2000-2002)	533.06	121.33	
	Grand Total	996,725.48	209,963.03	

Sources: Department of Industrial Policy and Promotion

Findings

The study finds that there is a positive relationship between direct investment and economic growth. Also it is found that economic growth granger cause, FDI in case of India in the post liberalization phase. During 1992-93, several additional measures were taken by the government to encourage investment flows: foreign direct investment, portfolio investment, NRI investment and deposit and investment in global depository receipts.

Indian economy has reached in the orbit of high rate of economic growth. She is being widely acclaimed and recognized as an emerging global economic power. The rate of growth recorded during the period 1950-51 to 2004-05 clearly showed a tendency of steady upward trend. However, the decade of eighties emerged as a beginning of the high rate of economic growth or at least a dramatic departure from the past growth performance. This tendency had continued in the 1990s and further growth stimulus has occurred in the early 21st century.FDI inflows to India remained sluggish, when global FDI flows to EMEs had recovered in 2010-11, despite sound domestic economic performance ahead of global recovery.

Conclusions

An analysis of the recent trends in FDI flows at the global level as well as across regions/countries suggests that India has generally attracted higher FDI flows in line with its robust domestic economic performance and gradual liberalization of the FDI policy as part of the cautious capital account liberalization process.

Inward FDI has boomed in post-reform India. At the same time, the composition and type of FDI has changed considerably. The services sector accounted for a steeply rising share of FDI stocks in India since the mid-1990s. The Indian economy as a whole, we find that FDI stocks and output are Co-integrated in the long sprint FDI is unlikely to work wonders if only remaining regulations were relaxed and still more industries opened up to FDI.

Suggestions

- Indian infrastructures must be developed to capture more FDIs.
- Present reforms for FDI must be continued for the desired economic growth.
- It is advised to government that service charges should be reduced to encourage FDI and allied foreign investments.
- It is better to give special benefits for investments in India to NRIs as they can more reliance on Indian economy to grab the attention of world.
- Government can encourage FDI investors to park their funds in sectors like cultivation, energy, communication, infrastructure and other important sectors.

References

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