An Analysis of FDI Flow and Trends in India

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Abstract:

FDI is an important source, a cradle of development and an essential component in the growth strategy of both developed and developing countries and hence the policies are designed and framed in such a mannerso as to stimulate inward FDI. It is a major source of finance from foreign countries which means that countries with meagre amounts of capital can attract finance influx from other wealthier countries. FDI has been one of the crucial player in China's exponential economic growth. It creates a lucrative/profitable situation for both - the host and the home countries. It promotes an open business climate, and helps in building advanced technologies and promotes advanced employee training programs, besides helping Government revenue to multiply. FDI inflow in the last two and a half decades, stimulated by globalization and liberalization of the Indian economy has played a complementary role in bridging the gap and filling the massive lag between domestic investments and saving. It is a preferred source of funds from foreign countries for the simple reason that they are not debt creating and are not volatile thus reducing the associated risk and their returns depend upon the projects financed by the investor, which means that the amount of return is in control of the investor to a certain degree.

Key Words:- FDI, Source, countries, Growth, Economic factors, influx globalization, liberalization.

Introduction

FDI is permitted/allowed under various heads such as through financial collaborations, joint ventures, technical collaborations and through private placements or preferential allotments. Apart from being a propeller of economic growth, it is also a significant source of finance that to non-debtcreating for economic development of India.

The Indian government's favorable policy regime towards FDI that is leading to lenient policy framework alongside rigorous business environment have ensured high flow of foreign capital into the country. The government has taken numerous initiatives in recent years regarding the same.

Definitions

"Foreign Direct investment (FDI) refers to investment in a foreign country where the investor retains control over the investment. Direct investment and management of firms concerned, normally go together."

Definitions of FDI are contained in the **Balance of Payments Manual: Fifth Edition (BPM5)** (Washington D.C., International Monetary Fund, 1993) and the **Detailed Benchmark Definition of Foreign Direct Investment: Third Edition (BD3)** (Paris Organization for Economic Co-operation and Development, 1996).

According to the BPM5, of the IMF, "FDI refers to an investment made to acquire lasting interest in enterprises operating outside the economy of the investor. Further, in cases of FDI, the investor´s purpose is to gain an effective voice in the management of the enterprise. Some degree of equity ownership is almost always considered to be associated with an effective voice in the management of an enterprise; the BPM5 suggests a threshold of 10 per cent of equity ownership to qualify an investor as a foreign direct investor."

According to the BD3,of the OECD, "a direct investment enterprise is an incorporated or unincorporated enterprise in which a single foreign investor either owns 10 per cent or more of the ordinary shares or voting power of an enterprise (unless it can be proven that the 10 per cent ownership does not allow the investor an effective voice in the management) or owns less than 10 per cent of the ordinary shares or voting power of an enterprise, yet still maintains an effective voice in management. An effective voice in management only implies that direct investors are able to influence the management of an enterprise and does not imply that they have absolute control."

According to the Planning Commission of India "FDI is the process whereby residents of one country (home country) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (host country)." (Planning Commission Report 2003).

Components of FDI

As per the IMF definition the components of FDI are:

- Non-cash acquisition of equity, tangible and intangible components (technology fee, brand name, etc.)
- Inter-Company Debt transactions.
- Equity Capital
- Re-Invested Earnings by foreign companies.
- Short-term and Long-term loans.
- Earnings data of indirectly held FDI Enterprises.
- OCB's, trade credits, financial leasing, grants, bonds.
- Investment made by Foreign Venture Capital investors.
- Non-competition fee.
- Control Premium.

Reinvested Earnings: "It comprises the direct investors share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings that are not remitted to the direct investor, such retained profits by affiliates are reinvested." About 1/4th of India's total FDI is through reinvestment of earnings by overseas investors. Reinvested earnings are in essence an equity item, as theyrepresents the undistributed earnings of previous periods, and they belong to the shareholders of the company. Reinvested earnings are shown separately because of their significance and their link to the investment income account. Unlike the other two components, they represent funds that are not transacted directly by foreign direct investors.

Intra-Company Loans:"Intra-Company Debt transactions refer to short or long term borrowing and lending of funds between direct investor (parent enterprise) and affiliate enterprise." This would include debt securities and suppliers' credits. There is no difference between short-term and long-term investment in case of FDI.

Commandments of Foreign Direct Investment

Foreign Direct Investment is influenced by various factors such as:

- **Stable macro-economic policy:**The macro-economic policy of the country should be sound and strong footed. It should be such that, that the companies are able to rely upon the country in which they make an investment regarding the management.

- **An effective government:** Integrity of the host government should be such that, that an investor is able to rely upon its ability to sustain law and order in the country.

- **A large and growing market:** The size of an economy's marketplays a crucial part in deciding whether to invest or not. Companies also take in account the growth capacity of the economy as no company prefers to invest in a market where there is little or no chance to make profits.

- **Freedom of activity in the market:**Companies prefer investing in the economies where there is less competition as that helps them capture a larger part of the market. The degree of government interference with regard toentry and exit of a firm in a country's market are also important for the companies as it decides the companies leverage. Autonomous the market, the more it is preferred as an investment destination.

- **Government intervention:** Government intervention in the affairs of the company should be as less as possible and the profits of private companies should not be a topic of regulation by the government.

- **Property rights and protection:** Protection of the investor's private property must be taken care of. The possibility that a company's proprietary assets (tangible and intangible) will be stolen must be avoided.

- **Reliable infrastructure:** For investment to yield a sufficient financial return reliable infrastructure is to be promoted. Infrastructure not only includes physical infrastructure but also includes things like insurance and accounting services and competent financial system.

- **Availability FoP:** While the investor bring capital, state of art technology, etc. The quality of the indigenous work force also plays an important part in determining the quality of the product and the accessibility of high quality local raw-materials is also required.

- **A strong local currency:** The local currency must withhold its value. If an investment is initiated in dollars and then the local assets are devalued based on the value of the local currency, foreign investor would lose part or possibly all of original dollar based investment.

- **A favorable tax climate:** Tax incentives are provided to attract initial investments but a company's final investment decision is usually on the grounds of how a country's taxation will affect normal functioning of the firm once the venture has started.

Theoretical Background

According to GraziaLettoGillies (2012), beforeStephen Hymer's theory on direct investment was propoundedin the 1960s, the reasons for FDI flow were explained by neo-classical economists based on macro-economic principles.These theories were in line with the classical theory of trade, according to which the idea behind trade was the variation in the CoP of goods between two countries. Thus, the focus was on the low cost of production as a motive for a firm's foreign activity.

Theories of Foreign Direct Investment

The earlier trade theories were propounded on the basis of the assumption of immobility of capital across borders but it is the movement of capital that has given rise to FDI across the globe. In order to understand the process of capital movement in the form of FDI, several theories have been put forward by economists. In the present study we will analyze the various theories broadly classifying them into FDI theories at Macro Level, Development theories of FDI, FDI theories based on Currency Approaches, FDI theories at Micro Level and Political-Economic theories.

A) Foreign Direct InvestmentTheories at the Macro Level

- **Capital Market Theory (1960):** This is one of the oldest theories of FDI which keeping in line with the classical tradition, gave high importance to interest rate differentials and arbitrage as the explanatory variables for foreign direct investment.

- **Dynamic Macro Economic FDI theory:** According to this theory FDIis a function of TNC strategies in the long term. The decision to investment depends upon the changes in macroeconomic environment. FDI Theory based on Exchange Rates studies the relationship between FDI flows and exchange rates. It propounds that FDI is a way to reduce exchange rate risks.

- **The Gravity Approach to FDI:** This states that FDI flows are massive between countries that are geographically, economically and culturally closer.

- **MacDougall-Kemp Hypothesis (1960's):** It studies foreign investment in a macroeconomic environment assuming a two-country model (investing country and the host country) and also assuming the price of capital to be equal to its marginal productivity. It explains that capital moves freely from a capital abundant country to a country that is scarce in capital and in this way the marginal productivity of capital tends to get equalized. This leads to improvement in efficaciousness of resource usage that leads to a rise in the welfare of the country.

B) Development Theories of Foreign Direct Investment

- **Product Life Cycle Theory of Foreign Investment –Raymond Vernon (1966):** This theory studies the relationship of product life cycle and FDI flows. The theory states that FDI is prominent in two phases i.e. the phases of maturity and decline of a product life cycle. When a product enters the maturity phase, MNC's shift the investment location to other countries that offer the advantage of lower costs of production. By moving the product which is in decline phase in the home country to new markets/developing countries MNC's also increase the survivability of the product. According to Prof. JagadirBhagwati (1998) this theory explains FDI in most cases where there is a shift of investment from one location to another mainly to reduce costs by exploiting foreign factor costs and thus increasing the life-span of the product in a competitive struggle.

- **The Japanese FDI theory by Terumoto Ozawa:** He analyzed the relationship of FDI, competitiveness and economic development. According to him there are 3 phases of development. These are:

  - **I Phase of Economic Growth:** In this phase the country is underdeveloped and the sole motive of foreign investment flows at this stage are mainly to exploit the potential advantage that entail during this phase of growth.
  - **II Phase of Economic Growth:** In this phase there are expanding internal markets and higher standard of living become the reason for attracting new FDI.
  - **III Phase of Economic Growth:** In this phase FDI is boosted due to technological factors and competitiveness of the firm is based solely on its capability to innovate.

- **The Five Stage Theory of John Dunning (1981):** According to this theory the FDI inflow and outflow is based on the 5 stages of economic development of a country and its impact on FDI flows is as follows:

  - **Stage I:**At this stage there is low inflow of FDI, and as domestic companies have no advantages to avail therefore there is no outflow of FDI.
  - **Stage II:**At this stage incoming FDI starts growing due to advantages that can be availed, especially of low labor costs. With rising SoL more MNCs are fascinated to come and invest in the country.
  - **Stage III:** In this phase also the FDI inflows are strong but their nature is gradually changing due to upward trending wages. With domestic companies getting neck to neck with foreign

companies, FDI outflows take off.

- **Stage IV:** Strong FDI outflow seeking to extract the advantages abroad particularly of low labor costs.
- **Stage V:** FDI inflows and outflows are equalized and attain equilibrium.

C) <u>Foreign Direct InvestmentTheories based on Currency Approaches</u>

- **Aliber (1971):** This theory postulates that internationalization of firms can be explained in terms of the relative strengths of different currencies. Firms from country with a strong currency move to a weak-currency nations as in such a situation the stronger currency is financed at a higher rate. Thus, such a firm is able to acquire a larger portion of income generated in the weak-currency country's corporate sector.

- **Kenneth Froot and Jeremy Stein's theory (1989):** This theory is about the strength of the currency. According to this theory the depreciation of a currency lowers the wealth of the domestic residents. Thus, making the assets of the domestic firmscheaper for the foreign firms to acquire.

- **Richard Caves theory (1988):** It puts forth channels through which exchange rates influences FDI:

  - The costs incurred and revenue earned of a firmare clout by the changes in exchange rate. If the domestic currency depreciates, the import bill will increase, causing a taper effect on the net income. But,if alongside depreciation exports increase the net income will rise.
  - Capital gains are accelerated by exchange rate changes causing an effect on FDI. Temporary depreciation in the value of currency, leads to capital gains once the currency is appreciated. Thus, in order to gain, foreign capital flows in.

D) <u>Foreign Direct InvestmentTheories at Micro Level</u>

- **Stephen Hymer's Theory of Imperfect Markets (1960):** This theory states that most of the FDI comes from oligopolistic industries. The imperfections in the market provide certain advantages to MNC's over their competitors and also compensates for the additional cost of setting up a business in an unfamiliar environment. The access of knowledge empowers the firm to develop unique marketing skills, refined organizational and management set-up and ameliorate processing. It is the firm specific advantages over its competitors that help MNC's to maximize their gains in the host nations despite the drawbacks. The imperfect market prevents rival firms from availing technological advantages, thus hampering their competitive ability and therefore, MNC's reap profits.
- **Buckley and Casson's (1991) Theory of Internalization:** It states that foreign investment is the result ofa firm's decision to internalize a knowledgeof a superior value i.e. keeping the knowledge bound within the boundaries of the firm to maintain the competitive advantage. If a firm decides to externalize it's know-how by permitting a foreign firm to utilize it, then the firm does not make any FDI. But if it wishes to internalize, then the firm must invest abroad in production infrastructure. The internalization benefits which are evident in the cost-free intra-firm transfer of technology or any other knowledge, allures a firm to go international.
- **The Hymer-Kindleberger Theory (1969):** It states that compensating advantages encourage a foreign owned firm tomake investments in the host country. These advantages enable the MNC's to compete on equal footing with indigenous firms. This however doesn't suffice for FDI since the firm can yet choose to license the technology to an indigenous producer or can export the product to host country. Therefore, certain conditions need to be met for FDI to take place and they are:

  i) The advantage should be internally transferable i.e. it should be of such a nature that it could be exploited by a subsidiary of the firm without incurring any extra cost.

  ii) It should be more profitable for the foreign firm to utilize the advantages by itself than to license it to a domestic producer.

  iii) Product export to the host country should be expensive due to controls like taxes or transport cost barriers.

- **F.T Knickerbocker's Theory of Oligopolistic Reaction and Multinational Enterprise:** It studied the relationship of FDI and rivalry in oligopolistic industries. This industry is characterized by interdependency and therefore imitative behavior among firms is common, this emulative behavior characterizes FDI.
- **Hood and Young's Location-specific Theory (1979):** The theory states that for the production to be established in a particular country certain advantages need to be provided like labor at a cheap cost, abundancy of raw material, etc.
- **The Eclectic Theory or OLI Paradigm of John Dunning (1988):** It is one of the most popular theories of FDI. The theory states that when a firm enjoys 3 types of advantages – Ownership, Localization and Internalization it goes for FDI.

i) **O – Ownership Advantages:** To operate in foreign markets firm must possess firm specific advantages which are not accessible to their competitors. The firm specific advantages are knowledge capital, economies of scale and monopolistic advantages.

ii) **L – Localization Advantages:** The localization advantages could besaving transport cost by producing close to consumers, obtaining cheap inputs, jumping trade barriers, etc. The firm can experience the O advantages in a country proffering L advantages by arms-length transactions such as export/license/franchise.

iii) **I – Internalization Advantages:** FDI can come in the form of arms-length transactions when it enjoys the O and L advantages. But these have harsh limitations i.e. trade barriers, transaction costs, etc. Therefore the internalization route is more attractive. By choosing among joint venture or fully owned subsidiary in a foreign country, MNC can fully exploit its O and L advantages.

Thus according to OLI theory when firm enjoys only the O and L advantages i.e. the ownership and localization advantages, it results in arms-length business deals. It is only when the firm enjoys all the three advantages i.e. ownership, localization and internalization, FDI takes place.

E) Political-Economic Theories

- **Fetehi-Sedah and Saflzedah(1989):** The politico-economic theory is based on political risk. Political stability in the host countries helps in attracting FDI.
- **Tallman (1988):** Political unrest in the home country promotes investment in foreign countries.
- **Schneider and Frey (1985):** This theory states that factors underlying the economic determinantsare quiet well developed than those involvingpolitical determinants of FDI. The political factors play only a complimentary role in influencing foreign investment.

Types of Foreign Direct Investment

A) According to UNCTAD (World Investment Report 2004), FDI can be classified into the following types:

- **Market-Seeking FDI:** It is the form of investment which seeks to access domestic/regional market. It moves to countries where per capita income and size of the market is large. It is mainly export oriented FDI.
- **Resource/Asset Seeking FDI:** It is the form of investment which seeks to exploit the resources like raw materials, cheap labor, technology, brand name, etc. in the host nations.
- **Efficiency Seeking FDI:** It is the form of investment which aims at specializing and dividing production line to reap the benefits of the competitive advantage of different locations, economies of scale and scope.

B) Caves (1971) classified FDI into 3 types:

- **Horizontal FDI:** Horizontal FDI is investment in the same industry abroad as the MNC operates in at home.
- **Vertical FDI:** Vertical FDI is investing in an industry that is an input provider for a firm's domestic operations or initiating FDI in an industry abroad that markets the products of the firm's domestic operations. It takes two forms:
  - **Backward vertical FDI:** It is the investment in an industry abroad that is the supplier of inputs for a firm's domestic production processes.
  - **Forward vertical FDI:** It is investment abroad to acquire distribution outlets to sell output directly to customers.
- **Conglomerate FDI:** When Multinational Corporations undertake investments which are both horizontal and vertical in nature it is known as Conglomerate FDI.

C) Another popular classification of FDI is:

- **Green Field Investments:**"Green-field investment is a form of investment in the equity capital of a company abroad for the sake of management of the company or investment abroad through opening of new branches."
- **Mergers and Acquisitions:** M&A is an outright purchase of an existing company abroad or an amalgamation with an existing foreign company.
- **Brown Field Investment:**The term 'brown-field' investment is used to denote a combination of green-field investment and M&A's. "It is found in cases when a firm acquires another firm and after the acquisition, it completely replaces the plant and equipment, labor and product line."

D) Imad A. Moosa (2002) classifies FDI into the following based on the perspective of the host nation:

- **Import Substituting FDI:** FDI which leads to shift of production of any good that was previously imported by the host country. This is mainly driven by the extent of the market of the host country.
- **Export Increasing FDI:** FDI which is sought to enable a country to access resources which would help in increasing the export potential of the host country.
- **Government initiated FDI:** FDI which is attracted by the incentives offered by the host country Government, which seeks to overcome its BoP deficit by attracting FDI.

Determinants of FDI

Multi-National Corporations which undertake FDI are highly influenced by three key factors while choosing the destination of their investment – Returns, Risk and Feasibility. There are several factors that affect the above three dimensions of decision making in a positive or negative way and they can be broadly classified as Supply factors, Demand factors, Economic factors, Socio-Political factors, Institutional factors and Infrastructural factors.

A)Supply Factors

- **Production costs:**Low labor costs, cheap land prices, tax rates, etc. encourage the companies to invest in foreign countries in order to avail these benefits and reduce their production costs.
- **Logistics:**When the cost of transportation from the domestic country to any foreign market is substantially high then firms prefer FDI as that is cheaper.
- **Natural resources:**Production facilities of the companies are located close to the source of critical inputs for easy and cheap availability of resources.
- **Availability of quality natural resources at low cost:** The high quality of human resources availability at low cost leads to higher level of productivity in monetary terms and thus the cost of per unit value

addition is low. India, South Korea, Malaysia, China attract FDI as cost of operation in these countries is relatively less.

- **Access to key technology:**To have access to existing state of art technology rather than developing technologies firms indulge in FDI.

B)Demand Factors

- **Customer Access:** In order to increase the demand for their products or services certain business firms particularly fast food, service oriented and retail outlets locate their operations close to customers.
- **Marketing advantages:** These advantages include, lower marketing costs, improved customer services, etc. in host country.
- **Exploitation of competitive advantages:** Companies that have competitive advantages of trade mark, brand name, technology etc., indulge into FDI to exploit its competitive advantages i.e. to extract upon the brand name in foreign markets.
- **Customer mobility:** The companies which have few customers prefer the FDI strategy. For example ancillary units locate their production facilities in those international areas where their parent companies locate their production facilities.

C)Economic factors: The economic determinants of FDI influence its feasibility, profitability and stability of future cash flows. And the economic variables influencing FDI are GDP, GDP growth rate, availability of high quality factor inputs, production and labor costs, inflation, interest rates, policy with respect to remittances and economic stability.

D)Socio-Political factors: The socio-political factors have a great influence on the growth potential and stability of an economy and therefore are a fundamental determinant of FDI. The socio-political factors influencing FDI are demographics, education, social and political stability, Centre-state congruency and transparency.

E)Institutional factors: Strong institutions like bureaucracy, legal, financial, etc. are important for a sound economy. The institutional factors that have an influence on FDI flow are degree of trade openness, legal and accounting framework, financial system, tax climate, bureaucracy and international agreements.

F)Infrastructure factors: Infrastructure is the key determinant of FDI as it has a direct influence on an economy's productivity. Good infrastructure makes an economy attractive for investors as it ensures reliable financial returns. The key infrastructures from the point of FDI are transportation, telecommunication, power, ports, insurance and accounting services, competent financial system etc.

FDI flows into a nation are largely guided by the factors elaborated above. But when it comes to regional flows within a nation like in the case of India there are certain determinants which have a crucial impact like the market size, availability of skilled manpower, physical infrastructure, policy framework and entrepreneurs perception of business environment.

Advantages of Foreign Direct Investment

Advantages of FDI can be studied in terms of various segments of the society who are benefited by flow of FDI. These are as follows:

- **Domestic Labor:** Due to the increase in productivity domestic labor tends to get better and increased wages. There might also be proliferation of the employment opportunities, as has been happening in China.

- **Consumers:**Consumers of a product may gain through reduced product prices if foreign investment helps in cost cutting in a particular industry. They may also benefit from better quality products or new products if the investment is product ameliorating or product-innovating.

- **Governments:**Fiscal revenue of the government might increase by the increase in production and foreign trade resulting from foreign capital.

- **External Economies:**Numerous indirect gains are created through foreign capital by the way of external economies. For instance, domestic investment can be stimulated in other sectors if foreign investment is used for the development of infrastructure.

- **Balance of Payments and Forex:**BoP and foreign exchange reserves position of several countries changed remarkably due to the increase in the flow of FDI. During Seventh Plan (1985-90) the debt creating flows as a percentage of total flows in the BoP of India averaged as much as 97 per cent but declined to less than 20 per cent by mid 1990's.

Limitations of Foreign Direct Investment

Poor absorptive capacity of the host country is the main cause of failure of FDI as the catalyst of growth.Given the market power of the MNC's and their proprietary assets such as superior technology, appeal of brand names and aggressive marketing technique their entry has a deteriorating effect on the domestic enterprises. The large outflow of foreign capital on account of imports, dividend payments, technical fee, royalty and transfer pricing may deteriorate the BoP in host country. Some of these limitations are as follows:

- **Hindrance to Domestic Investment:** FDI can sometimes hinder domestic investment as it leads to shift of focus of resources elsewhere other than the home country.
- **Political Changes:** FDI is very risky as the political situations in other countries can change anytime. Also, most of the risk factors that are associated to it are extremely high.
- **Influence on Exchange Rates:** FDI can have detrimental effects one country in the process of benefitting another by the way of exchange rates fluctuations.
- **Higher Costs:** Sometimes it is very imperative to prepare sufficient funds to set up operations in a foreign land as sometimes export of goodsis cheaper than investing in foreign countries.
- **Economic Non-Viability:** FDI can sometimes be very risky or economically non-viable considering the fact that it may be capital-intensive for an investor.
- **Expropriation:** Government's power to control property and assets of the entity is known as expropriation and it can be caused due to political changes.
- **Negative Impact on the Country's Investment:** Country making investment abroad may be affected by the rules that govern foreign exchange rates and direct investments. It is sometimes impossible to pursue an inviting opportunity as FDI isbanned in some foreign markets.
- **Modern-Day Economic Colonialism:** Many third-world countries, mainly those with history of colonialism, worry that FDI which exposes and makes them vulnerable to foreign companies' exploitations would lead to some kind of modern day economic colonialism.

Statement of the Problem

Government of India (GoI) undertook various policy initiatives in recognition of the importance of Foreign Investment in accelerating economic growth of the country. India has encouraged FDI in almost all the economic activities in an attempt to rapidly shift from a restrictive regime to a liberalized economy.

Over the years, FDI has helped the Indian economy grow and FDI inflow in the country is increasing. Moreover, India has tremendous potential for absorbing greater flow of FDI in the coming years and this paves way to study the trends in FDI flows in India with respect to year-wise flows and country-wise flows. Furthermore, there has been tremendous progress in the various sectors of Indian economy due to inflows of foreign capital, which paves way for study of sector-wise flows of FDI, thus an evaluation of India's FDI flows has been done.

Moreover, to study the impact of FDI (positive or negative) on various variables, a Multiple Regression Model is applied on variables such as GDP, Access to Electricity in Urban areas, Average time to clear exports through customs, etc. to understand the impact of FDI on major Indian economy variables to know whether the flow of FDI is good for the economy or not. Also, to understand the cause and effect relationship between FDI and GDP, a Granger Causality Model is used, so as to know whether FDI causes increase in GDP or is it higher GDP that causes FDI inflows.

Review of Literature

Ana Margarida Fernandes (1997) studied the extent of FDI to low-income countries over the period 1970-96 and also dwelled upon the factors determining foreign companies' decision to invest in a particular nation. Her study concluded that high return in natural resources, large market size and low labor costs are amongst the major determinants in influencing the decision to invest in countries with low income.

Aneesa I. Rashid and PamiDua (1998)in their paper used Granger causality tests and innovation accounting analysis. They opine that FDI flows respond to the level of industrial production i.e. the areas with a better industrial setup respond better to FDI inflow.

Pradumna B. Rana and J. Malcolm Dowling, Jr (1999) undertook a brief survey of foreign capital inflows to the Asian developing economies and assessed the role of foreign capital in Asian economic growth during 1970-1988. Using simultaneous equation model it was found that except for the effect of official flows on savings, the impact of foreign capital and exports on growth and saving rate has been both positive and favorable.

Agrawal L. (2000)analysis of the impact of FDI on South Asian economies, found that a manifold increase in the investment by national investors had an impact on FDI flows in South Asia, suggesting that there exist complementarity and linkage effects between foreign and national investment. FDI inflows had a negative impact on growth rate of GDP prior to 1980, mildly positive for the early 80's and over the late eighties and early nineties it was strongly positive. Hence more open economies benefit to a larger extent from FDI.

K. H. Zhang (2001) provided estimates of a model of the FDI augmented production function approach for China on the basis of cross section and panel data for the period 1986-1997. The data was collected from 28 provinces and cross section estimations were conducted for two sub-periods i.e. 1986-91 and 1992-97. The conclusions drawn were: inward FDI flows have had a positive impact on China's economic performance, the effect of FDI on economic performance is clearly larger in 1992-97 than in 1986-91, the effect of FDI on growth is indeed numerically larger in the coastal region than the inland region and lastly FDI seems to have been the engine of China's economic growth.

Balasubramanyam V. N. and VidyaMahambre (2003)in their paper concluded that FDI is a very good mechanism for the transfer of technology and its knowhow from developed to the developing nations.

Laura Alfaro (2003)in her paper statedthat FDI flow into the various sectors of the economy – primary, secondary and tertiary, exerts different effects on economic growth. FDI inflows into the primary sector creates a negative effect on growth, whereas FDI inflows in the secondary sector (manufacturing) a positive one. Evidence from the foreign investments in the tertiary sector is quiet ambiguous according to this researcher.

Sebastin Morris (2004)studiesthe determinants of FDI w.r.t. the regions of a large economy like India in his paper. He argues that, for all forms of investments it is the regions of metropolitan cities that attract the bulk of FDI.

Peng Hu (2006)in his paper analyzed economic growth, currency stability, government policy, labor force availability, etc. as determinants that influence FDI flow in India. It is also observed that India has certain competitive advantages in attracting FDI inflows, like a large pool of high quality labor force which is an absolute advantage for India compared to any other developing nation like China and Mexico.

K. S. ChalapatiRao and M. R. Murthy (2006) in their study said that states in the western and southern regions attracted maximum portion of the approved FDI. Also according to their study most of the FDI went into the manufacturing sector and this manufacturing FDI would not flow to the relatively backward states except in case of extractive activities and natural topographical reason.

VaniArchana et al. (2007)in their study opined R&D as a significant determinant for FDI in India. Also the software industry is showing intensive R&D activity. Both panel data as well as Seemingly Unrelated Regression Model suggest that higher unit costs and tax, act as deterrent to FDI flow in India and R&D expenditure positively influences flow of FDI.

NingombamJayanti (2007)in her studyhighlights the constraints faced by the north east region of the country consisting of the Eight Sister States – Assam, Arunachal Pradesh, Nagaland, Tripura, Manipur, Meghalaya, Mizoram and Sikkim. The study is focused on the emerging trends in the inflows of FDI in North-East. The findings show that the FDI has been concentrated in developed states. According to the author, these sister states are at lower stage of development but are yet characterized by extremely attractive scenario for investment, but yet investment (domestic and foreign) is not North-East friendly due to "crowding out theory".

A. S. Shiralashetti and S. S. Huger (2009)made a comparison of FDI inflows during pre and post liberalization period in India – country, sector and region-wise. They also found that explosive growth in FDI inflow during post liberalization is due to the policy reform and large market size of India.

R. Anitha (2012)studied the determinants of FDI flow in India in her paper using multivariate regression and Durbin-Watson test, for the period 1980-2010. The study concluded that GDP, Coal Production, Wages paid, Electricity Generated, Deficit in BoP, Inflation, Trade openness are the determinants of FDI flow in India. The paper also analyzed the problems of FDI flow in India and suggested ways to increase FDI flow into the country.

Scope of the Study

- The study helps to analyze the trends of FDI in India for the time period 2000-2017, and thus covers year-wise, country-wise and sector-wise inflows in India.
- The study also outlines the impact of FDI on various aspects/variables of the Indian economy like Labor Force Participation, Unemployment, Inflation, Electricity Consumption, etc.
- The study explains the relationship between FDI and GDP.

Objectives of the Study

- **Objective 1** – To analyze the year-wise trends of FDI inflows in India from 1990-91 to 2016-17 and make future projections of the same for the time period 2017-18 to 2021-22.
- **Objective 2 –** To study country-wise FDI inflow to India from various countries during the time period 2000-2017 and to state the reasons for major portion of FDI being contributed from few countries.
- **Objective 3** – To study the state-wise FDI distribution with respect to RBI's region-wise FDI inflows from 2000-2017 and to identify the reasons behind heavy FDI flow to certain states and low FDI to others and to suggest remedial measures for the same.
- **Objective 4** – To study the sector-wise distribution of FDI and the reasons behind the high inflow of FDI to certain sectors.
- **Objective 5 –** To study the relationship between FDI and GDP.

- **Objective 6 –** To study the relationship of FDI withGDP, Access to Electricity in Urban areas, Average time to clear export through customs, Labor Force Participation Rate, Unemployment and Inflation in India.

Data and Methodology

(A) Sources

The data collected for the study is from the secondary data sources and the data has been obtained from the following sources:

- Department of Industrial Policy and Promotion (DIPP) [Ministry of Commerce and Industry, Government of India] – Factsheets on FDI.
- Reserve Bank of India – Handbook of Statistics on Indian Economy, RBI Bulletin.
- Securities and Exchange Board of India (SEBI) – Annual Reports.
- Secretariat for Industrial Assistance, Department of Industrial Policy & Promotion (DIPP) [Ministry of Commerce & Industry, Government of India] – Newsletter.
- United Nations Conference on Trade and Development (UNCTAD).
- World Bank – Databank of World Development Indicators.

(B) Methodology

The objectives are analyzed with the help of growth rate, percentage to total flows, pictorial representation and appropriate statistical tools like Trend Analysis, Multiple-Regression, Granger Causality and Durbin Watson.

Limitations of the Study

- The study mainly considers the data pertaining to only 17 years i.e. from 2000-01 to 2016-17.
- The Granger Causality Test has been done for time period 1990-91 to 2016-17 considering the time lag factor.
- RBI has re-segregated FDI data classification in 2000 so all India data is authentic post 2000 and comparison between pre-2000 and post-2000 is statistically not feasible.
- The amount of data available being limited the results obtained is more of indicative nature.

Foreign Investment in India – An Overview

India is actively promoting the entrance of foreign players into the market as it has a huge potential for overseas investment. India is believed to be a good investment zone despite political dubiety, cumbersome bureaucratic processes, shortages of power and infrastructural deficiencies. It is among the few markets in the world which have the potential for growth and high earning prospects in practically all areas of business.

India's economic growth since independence can be divided into two phases the first phase 1950-80 which was marked by the slow Hindu growth rate of 3.5 per cent per annum in GDP, and the second phase 1980-2005 which was marked by average growth in GDP of 5.6 per cent per annum. The trenchant increase in India's growth can be attributed to several factors and one of it is the reforms program of 1991 which marked the beginning of the liberalization process in the country. The policy shift from inward oriented growth strategy to outward oriented growth strategy was largely guided by the belief that an open trade regime can act as a propeller of higher economic growth. The reforms marked the beginning of sharp increase in FDI flows into the country.

Foreign Investment in India is ruled by the FDI Policy announced by the Government of India (GoI) and is also bound by the provisions of the Foreign Exchange Management Act (FEMA) 1999. Reserve Bank of India on May 3, 2000 issued Notification (No. FEMA 20/2000-RB) which contains the Regulations in regard to this matter. This notification document has been amended now and then as the need arises.

Eligibility for Investing in India: Based on the FDI Policy of the Government of India, a person, not a resident of India (other than a citizen of Pakistan or Bangladesh) or an organization incorporated outside India, (other than an organization incorporated in Pakistan or Bangladesh) can invest in India.

India's Policy towards Foreign Capital: The Changing Scenario

Changes in policy framework of India's FDI policy are studied in four phases. Each policy reflects government's particular response to foreign exchange crisis in respective periods. The point of emphasis is the BoP crisis in shaping countries attitude and policy towards foreign investment.

Foreign Exchange Regulation Act (FERA) 1973

FERA Act served as a route for implementing the national policy on foreign private investment in India. The FERA enabled the RBI to regulate or execute direct control on the activities of foreign companies and foreign citizens in India. A foreign company was defined as one which was not formed in India, or in which non-resident partners held interests of more than 40 per cent, or any branch of such an organization.

The trading, commercial and industrial activities in India, of persons living abroad, foreign citizens in India and foreign companies, were regulated by FERA. They had to obtain permit for carrying activities in India. This permission was to be taken from the Reserve Bank of India.

Phase 3: 1980-1990: The Period of "Partial Liberalization"

In the wake of India's failure to boost its manufactured exports and in the backdrop of the second oil crisis, the FOREX position began to deteriorate in the early 80's. The eighties, thus include selective efforts to attract FDI especially, in high technology areas and exports. Many restrictions on the large houses and FERA companies were removed; thus the 80's were in a way, the forerunners of the liberalization policy of the 90's.

Factors which Discouraged Foreign Investment in India Prior to 1991

Direct foreign investment in India, was adversely affected by the following factors:

- The scope of private investment - domestic and foreign was limited as the public sector was assigned a dominant position in most sectors.
- There was a preference for foreign government sources whenever public sector needed foreign investment.
- Government policy towards foreign capital was very selective – more towards high technology industries and priority areas.
- Foreign equity was normally subject to a ceiling of 40 per cent.
- Stringent laws like FERA discouraged foreign investment.
- Tax laws and procedures were quiet complex. Also the corporate taxation was abnormally high.

These factors either limited the scope of FDI or discouraged foreign investment in India.

Phase 4: 1991 onwards: The Period of "Liberalization and Open Door Policy"

New policy i.e. The Industrial Policy Statement of July 24, 1991, has liberalized the Indian policy towards foreign investment and technology. The new policy has given opportunities for promoting foreign investment in India.

Features of Initiatives under the "New Policy" include the following:

- Three tiers for approving FDI proposals in the country were introduced:

  a) The Reserve Bank's automatic approval system.

  b) SIA approvals for proposals within the general.

c) FIPB specially created to invite, negotiate and facilitate substantial investment.

- The sectors now open to FDI are much larger as compared to earlier policy. There emerged different categories of industries on the basis of ceiling of foreign equity participation, viz.,

  a) FDI < 26 per cent

  b) FDI < 50 per cent

  c) FDI < 51 per cent

  d) FDI < 74 per cent

  e) Industries in which up to 100 per cent foreign equity is permitted.

- All the securities traded on primary and secondary markets were made open for investment for the Foreign Institutional Investors.
- India also became part of the Multilateral Investment Agency in 1994.
- To ensure that approvals for foreign investment were quickly translated into actual investment inflows, Foreign Investment Implementation Authority (FIIA) was established in 1999 within the Ministry of Industry.
- The government also permitted SEBI registered domestic fund managers to manage foreign funds for investment in the Indian capital market through portfolio investment route.
- Indian companies would be free to access the ADR/GDR markets through an automatic route without prior approval of the Ministry of Finance.
- Foreign equity stake in domestic private insurance companies was permitted by the Insurance Regulatory and Development Act (IRDA) that was passed in 1999.
- With increased liberalization, as at the end of 2007, equity caps on FDI existed only in limited sectors.
- **Foreign Exchange Management Act (FEMA) 1999:** The Foreign Exchange Management Act (1999) or in short FEMA has been established as a replacement for earlier Foreign Exchange Regulation Act (FERA). FEMA came into act on the 1st of June, 2000. FEMA was thus formulated in order to be in line with the policies of pro-liberalization of the Indian government. Among the various objectives, to combine all the laws that relate to foreign exchange is the most important reason behind the formulation of Foreign Exchange Management Act (FEMA). Further, it aims to promote foreign payments and trade in the country. The act is also applicable to all the economic units owned or controlled by a person who is resident of India irrespective of the fact that whether the fir is within or outside Indian borders.

In a nutshell, a positive approach towards foreign collaboration and a departure from the past can be seen through the sweeping changes introduced since 1991. In terms of FDI entry, the prevailing Indian policy is competitively placed keeping in view other major FDI receiving countries in Asia.

SUMMARY OF FINDINGS, POLICY INITIATIVES AND CONCLUSION

Summary of Findings

- ❖ The overall FDI inflows received by India since the liberalization era has increased and has shown a drastically increasing trend from 2006 but witnessed a decline in the latter years due to the Global economic crisis. The forecasted trend values for 2017-18 to 2021-22 indicates a positive rise in the total FDIInflows to India in the future. And the forecasted value of FDI in the year 2021-22 is Rs.245198.17 Crore.

- Largest inflows of FDI over the period 2000-01 to 2016-17 have been received from Mauritius, its share being as high as 32.78%. Singapore is second with a share of 17.62% followed by Japan with a share of 7.96% and the tenth position is occupied by U.A.E. with 1.46%.

- Mumbai and New Delhi tops all the lists taking the top two positions throughout from 2000 to 2017. The key sectors attracting FDI to the Mumbai-Maharashtra region are services, energy, transportation and telecommunications. Delhi attracts FDI inflows in sectors like transportation, telecommunications, electrical equipment (including software sector) and services. All these sectors have huge potential for growth and thus attract more FDI. Next followed by Ahmedabad, Bangalore and Chennai but recently in 2016-17 Chennai took up the 3rd position in the list outpacing Ahmedabad and Bangalore.

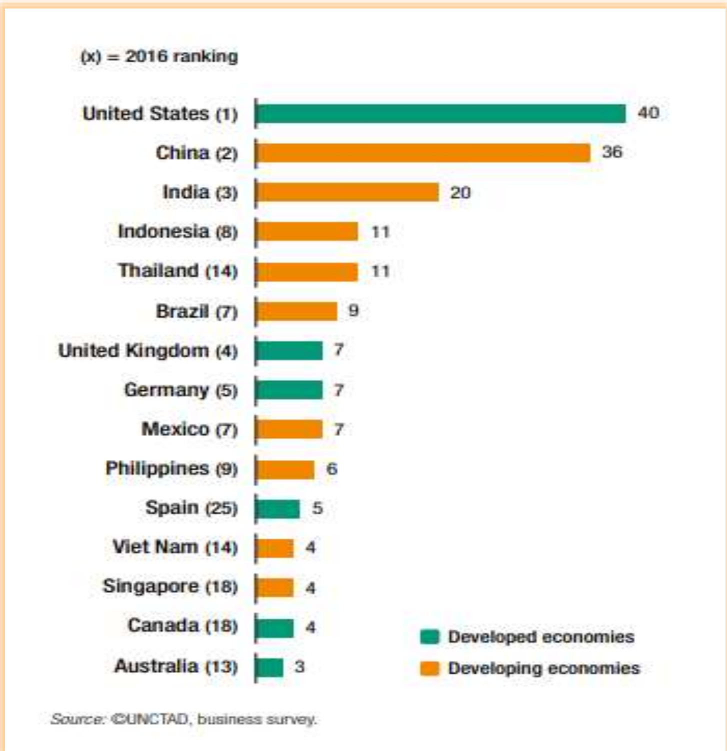
- Among the share of top ten sectors contributing to the FDI inflows in India, Services sector has the major share, comprising Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis which attracted around 17.71 per cent of the total FDI equity inflow intoIndia from 2000 to 2017.

- The Granger Causality test gave the evidence that GDP does not affect FDI Inflows. However, FDI Inflows do affect GDP of India.

Conclusion

According to the World Investment Report 2017**,** India will be the second-most popular destination for FDI Inflows globally over the next two years. This is animprovement over the projection made in World Investment Prospects Survey 2015-16 and 2016-17, which ranked India ninth and third in the list respectively.

Graph 5.1 –Top 15 Host Countries 2016



In the ranking of the top priority host economies for FDI 2016, U.S.A. is at the top of the list, followed by China, India, Indonesia and Thailand.

Indian economy is possessed with greater foreign participation as is evident in continuously rising FDI. These trends are expected to continue given the liberal trade policies and efficacious regulatory regime. The cautious and at the same time liberal investment policies ensure that the country would continue to attract large chunks of foreign investments and continue to outpace other developing and developed economies.

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