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Introduction to Trends and Patterens of FDI Inflows in India

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Abstract: ***One of the most prominent and striking feature of today's globalised world is the exponential growth of FDI in both developed and developing countries. In the last two decades the pace of FDI flows are rising faster than almost all other indicators of economic activity worldwide. Developing countries, in particular, considered FDI as the safest type of external finance as it not only supplement domestic savings, foreign reserves but promotes growth even more through spillovers of technology, skills, increased innovative capacity, and domestic competition. Now a days, FDI has become an instrument of international economic integration.***

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Located in South Asia, India is the 7th largest, and the 2nd most populated country in the world. India has long been known for the diversity of its culture, for the inclusiveness of its people and for the convergence of geography. Today, the world's largest democracy has come to the forefront as a global resource for industry in manufacturing and services. Its pool of technical skills, its base of an English – speaking populace with an increasing disposable income and its burgeoning market has all combined to enable India emerge as a viable partner to global industry. Recently, investment opportunities in India are at a peak.

TRENDS AND PATTERNS OF FDI FLOW IN INDIA

Economic reforms taken by Indian government in 1991 makes the country as one of the prominent performer of global economies by placing the country as the 4th largest and the 2nd fastest growing economy in the world. India also ranks as the 11th largest economy in

terms of industrial output and has the 3rd largest pool of scientific and technical manpower. Continued economic liberalization since 1991 and its overall direction remained the same over the years irrespective of the ruling party moved the economy towards a market – based system from a closed economy characterized by extensive regulation, protectionism, public ownership which leads to pervasive corruption and slow growth from 1950s until 1990s.

In fact, India's economy has been growing at a rate of more than 9% for three running years and has seen a decade of 7 plus per cent growth. The exports in 2008 were $175.7 bn and imports were $287.5 bn. India's export has been consistently rising, covering 81.3% of its imports in 2008, up from 66.2% in 1990-91. Since independence, India's BOP on its current account has been negative. Since 1996-97, its overall BOP has been positive, largely on account of increased FDI and deposits from Non – Resident Indians (NRIs), and commercial borrowings. The fiscal deficit has come down from 4.5 per cent in 2003-04 to 2.7 per cent in 2007-08 and revenue deficit from 3.6 per cent to 1.1 per cent in 2007-08.

As a result, India's foreign exchange reserves shot up 55 per cent in 2007-08 to close at US $309.16 billion – an increase of nearly US $110 billion from US $199.18 billion at the end of 2006-07. Domestic saving ratio to GDP shot up from 29.8% in 2004-05 to 37.7% in 2007-08. For the first time India's GDP crossed one trillion dollars mark in 2007. As a consequence of policy measures (taken way back in 1991) FDI in India has increased manifold since 1991 irrespective of the ruling party over the years, as there is a growing consensus and commitments among political parties to follow liberal foreign investment policy that invite steady flow of FDI in India so that sustained economic growth can be achieved. Further, in order to study the impact of economic reforms and FDI policy on the magnitude of FDI inflows, quantitative information is needed on broad dimensions of FDI and its distribution across sectors and regions.

The actual FDI inflows in India is welcomed under five broad heads: (i) Foreign Investment Promotion Board's (FIPB) discretionary approval route for larger projects, (ii) Reserve Bank of India's (RBI) automatic approval route, (iii) acquisition of shares route (since 1996), (iv) RBI's non – resident Indian (NRI's) scheme, and (v) external commercial borrowings (ADR/GDR) route.

The FIPB route – represents larger projects which require bulk of inflows and account for government's discretionary approval. Although, the share of FIPB route is declining somewhat as compared to RBI's automatic route and acquisition of existing shares route. Automatic approval route via RBI shows an upward trend of FDI inflows since 1995. This route is meant for smaller sized investment projects. Acquisition of existing shares route and external commercial borrowing route gained prominence (in 1999 and 2003) and shows an upward increasing trend. However, FDI inflows through NRI's route show a sharp declining trend. It is found that India was not able to attract substantial amount of FDI inflow from 1991-99. FDI inflows were US$ 144.45 million in 1991 after that the inflows reached to its peak to US$ 3621.34 million in 1997. Subsequently, these inflows touched a low of US $2205.64 million in 1999 but then shot up in 2001. Except in 2003, which shows a slight decline in FDI inflows, FDI has been picking up since 2004 and rose to an appreciable level of US$ 33029.32 million in 2008. The annual growth rate was 107% in 2008 over 2007, and compound annual growth rate registered was 40% on an annualized basis during 1991-2008. The increase in FDI inflows during 2008 is due to increased economic growth and sustained developmental process of the country which restore foreign investor's confidence in Indian economy despite global economic crisis. However, the pace of FDI inflows in India has definitely been slower than China, Singapore, Russian Federation, and Brazil.

A comparative analysis of FDI approvals and inflows (Chart – 3.7) reveals that there is a huge gap between the amount of FDI approved and its realization into actual disbursements. A difference of almost 40 per cent (Chart – 3.8) is observed between investment committed and actual inflows during the year 2005-06. All this depends on various factors, namely regulatory, procedural, government clearances, lack of sufficient infrastructural facilities, delay in implementation of projects, and non- cooperation from the state government etc.

In fact, many long term projects under foreign collaborations get delayed considerably, or in some cases, they may even be denied in the absence of proper and sufficient infrastructural support and facilities. These are perhaps some reasons that could be attributed to this low ratio of approvals vs. actual inflows.

The major sectors attracting FDI inflows in India have been Services and Electrical & electronics amounting 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. Services exports are the major driving force in promoting exports. Keeping in mind the rising service sector India should open doors to foreign companies in the export – oriented services which could increase the demand of unskilled workers and low skilled services and also increases the wage level in these services.

SOURCES OF FDI IN INDIA

India has broadened the sources of FDI in the period of reforms. There were 120 countries investing in India in 2008 as compared to 15 countries in 1991. Thus the number of countries investing in India increased after reforms. After liberalization of economy Mauritius, South Korea, Malaysia, Cayman Islands and many more countries predominantly appears on the list of major investors apart from U.S., U.K., Germany, Japan, Italy, and France which are not only the major investor now but during the US is the second largest investing country in India. While comparing the investment made by both (Mauritius and US) countries one interesting fact comes up which shows that there is a huge difference (between FDI inflows to India from Mauritius and the US) in the volume of FDI received from Mauritius and the US. FDI inflow from Mauritius is more than double then that from the US. The other major countries are Singapore with a relative share of 7.2% followed by UK, Netherlands, Japan, Germany, Cyprus, France, and Switzerland.

Thus, an analysis of last eighteen years of FDI inflows shows that only five countries accounted for nearly 66% of the total FDI inflows in India. India needs enormous amount of financial resources to carry forward the agenda of transformation (i.e. from a planned economy to an open market), to tackle imbalance in BOP, to accelerate the rate of economic growth and have a sustained economic growth.

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, Ahmedabad and Chennai are also receiving significant amount of FDI inflows.

Mumbai received heavy investment from Mauritius (29%), apart from U.K. (17%), USA (10%), Singapore (9%) and Germany (4%).The key sectors attracting FDI inflows to Mumbai are services (30%), computer software and hardware (12%), power (7%), metallurgical industry (5%) and automobile industry (4%). Mumbai received 1371 numbers of technical collaborations during 1991-2008. Delhi received maximum investment from Mauritius (58%), apart from Japan (10%), Netherlands (9%), and UK (3%).While the key industries attracting FDI inflows to Delhi region are telecommunications (19%), services (18%), housing and real estate (11%), automobile industry (8%) and computer software and hardware (6%). As far as technical collaborations are concerned Delhi received 315 numbers of technical collaborations during 1991- 2008.

Heavy investment in Bangalore came from Mauritius (40%) alone. The other major investing countries in Bangalore are USA (15%), Netherlands (10%), Germany (6%), and UK (5%). Top sectors reported the FDI inflows are computer software and hardware (22%), services (11%), housing and real estate (10%), telecommunications (5%), and fermentation industries (4%). Bangalore received 516 numbers of technical collaborations during 1991-2008. Chennai received FDI inflows from Mauritius (37%), Bermuda (14%), USA (13%), Singapore (9%) and Germany (4%). The key sectors attracting FDI inflows are construction activities (21%), telecommunications (10%), services (10%), computer software and hardware (7%), automobile industry (7%), As far as technical collaborations are concerned, Chennai received 660 numbers of technical collaborations during 1991-2008.

TRENDS AND PATTERNS OF FDI FLOW AT SECTORAL LEVEL

INFRASTRUCTURE SECTOR

FDI up to 49% is allowed for investing companies in infrastructure/ services sector (except telecom sector) through FIPB route. The infrastructure sector constitutes Power, Non-conventional energy, Petroleum and natural gas, Telecommunication, Air Transport, Ports, Construction activities and (including roads and highways), real estate. The infrastructure sector accounted for 28.62% of total FDI inflows from 2000 to 2008. Initially the inflows were low but there is a sharp rise in investment flow from 2005 onwards (Chart – 3.13). Telecommunication received the highest percentage (8.05%) followed by construction activities (6.15%), real estate (5.78%), and power (3.16%). The major investment comes from Mauritius (56.30%) and Singapore (8.54%). In order to attract the investment, New Delhi (23.2%) and Mumbai (20.47%) enjoy the top two positions in India.

Infrastructure sector received 2528 numbers of foreign collaborations with an equity participation of US$ 111.0 bn; 41.15% of the total investment. Out of 2528 foreign collaborations 633 were technical and 2795 are financial collaborations during 1991- 2008. The top Indian companies which received FDI inflows in Infrastructure sector during 2000 to 2008 are IDEA, Cellule Ltd, Bhaik Infotel P.Ltd, Dabhol Power Company Ltd, Aircel Ltd, Relogistics Infrastructure P.Ltd.

India has encouraged FDI in infrastructure sector from the very initiation of its economic reforms, but the demand for it is still not being fulfilled. In fact, investment is heavily concentrated in consumer durables sector rather than in long – term investment projects such as power generation, maintaining roads, water management and on modernizing the basic infrastructure. Maitra41 (2003) reveals that the shortage of power is estimated at about 10% of the total electrical energy and approximately 20% of peak capacity requirement.

However, insufficient and poor conditions of India's infrastructure are the major factors to the slowdown in growth which reduces the trust and enthusiasm for FDI from investors and economic growth of the country. Further, insufficient power supply, inadequate and unmaintained roads, an over- burdened railway system, severely congested urban areas, may continue to plague the Indian economy in the coming years.

SERVICES SECTOR

Services sector puts the economy on a proper glide path. It is among the main drivers of sustained economic growth and development by contributing 55% to GDP. There is a continuously increasing trend of FDI inflows in services sector with a steep rise in the inflows from 2005 onwards. Service sector received an investment of US$ 19.2 bn which is 19.34% of the total FDI inflows from 1991-2008 from FIPB/SIA, acquisition of existing shares and RBI's automatic routes only. However, this amount does not include FDI inflows received through acquisition route prior to Jan. 2000. Among the subsectors of services sectors, financial services attract 10.25% of total FDI inflows followed by banking services (2.22%), insurance (1.60%) and non- financial services (1.62%) respectively. Outsourcing, banking, financial, information technology oriented services make intensive use of human capital. FDI would be much more efficient and result oriented in these services vis- a-vis services which make intensive use of semi- skilled and unskilled labour.

In India, FDI inflows in services sector are heavily concentrated around two major cities- Mumbai (33.77%) and Delhi (16.14%). Mauritius top the chart by investing 42.52% in services sector followed by UK (14.66%), Singapore (11.18%). The total number of approvals for services sector (financial non-financial) have been of the order of 1626 (5.78% of the total approvals) with an equity participation of US$ 8.7 bn, 10.28% of the total investment. Services sector ranks 3rd in the list of sectors in terms of cumulative FDI approved from August 1991 to Dec 2008. Out of 1626 numbers of foreign collaborations, 77 are technical and 1549 are financial in nature. Majority of collaborations in technology transfers are from USA (30) and UK (8).the leading Indian companies which received FDI inflows in services sector are: Cairn (I) Ltd, DSP Merrill Lynch Ltd, AAA Global Ventures Pvt. Ltd., Kappa Industries Ltd, Citi Financial Consumer Finance (I) Ltd, Blue Dart

Express Ltd, Vyasa Bank Ltd, CRISIL Ltd, Associates India Holding Co. Pvt. Ltd, Housing Development Finance Corp. Ltd.

TRADING SECTOR

Trading sector received 1.67% of the total FDI inflows from 1991-2008. Trading (wholesale cash and carry) received highest percentage (84.25%) of total FDI inflow to this sector from 2000-2008 followed by trading (for exports) with 9.04%, e-commerce with (2.38%). Trading sector shows a trailing investment pattern upto 2005 but there is an exponential rise in inflows from 2006 onwards (Chart – 3.15). Further, major investment inflows came from Mauritius (24.69%), Japan (14.81%), and Cayman Island (14.60%) respectively from 2000-2008. Investment in India is heavily concentrated in three cities viz. Mumbai (40.76%), Bangalore (15.97%), and New Delhi (12.05%). As far as technology transfers are concerned, total numbers of 20 technical and 1111 financial collaborations have been approved for Trading sector from 1991-2008. Maximum numbers of technology transfers are approved from USA (5), Japan (3) and Netherlands. The top five Indian companies which received FDI inflows are Multi Commodity Exchanges of India Ltd, Anchor Electricals, Multi Commodity Exchanges of India Ltd, Metro Cash and Carry India Pvt. Ltd, Essilor India Pvt. Ltd.

CONSULTANCY SECTOR

Consultancy Sector received US$ 1.1 bn which is 1.14% of total inflows received from 2000-2008 through FIPB/SIA route, acquisition of existing shares and RBI's automatic route. Management services received an investment of US$ 737.6 million, marketing US$138.65 million and Design and Engineering services constitute an investment of US$ 110.43.

Major share of investment in consultancy services comes from Mauritius with 37.2%, USA (25.47%) and Netherlands 6.63% respectively. FDI inflows in consultancy sector registered a continuous increasing trend of FDI inflows from 2005 onwards (Chart- 3.16). Further, in India Mumbai (38.76%) and New Delhi (13.01%) received major percentages of FDI inflow for consultancy sector from 2000-2008. Total numbers of technology transfers in consultancy services are 125, out of which 40 technical collaborations are approved with USA, 21 with UK, and 14 with Germany from 1991-2008.

EDUCATION SECTOR

FDI up to 100% is allowed in education sector under the automatic route. Education sector received US$ 308.28 million of FDI inflow from 2004-2008. Education sector shows a steep rise in FDI inflows from 2005 onwards. Heavy investment in education sector came from Mauritius with 87.95%, followed by Netherlands (3.76%), USA (2.93%) respectively.

In India, Bangalore received 80.14% of total FDI inflow followed by Delhi (6.45%), Mumbai (5.58%) respectively. As far as technology transfer and financial collaborations are concerned, total number of 2 technical and 112 financial collaboration are approved for education sector. Out of 2 technical collaborations, USA and Japan begged one each during 1991-2008. Further, India is endowed with a large pool of skilled people with secondary and tertiary level of education. India with this level of education attracts foreign firms in science, R & D, and high technology products and services. The endowment of science, engineering, and technology oriented people facilitate the spillovers of technology and know – how. Moreover, the medium of instruction at these education levels is English – the lingua franca of business. India with this added advantage benefits in attracting foreign firms in education sector.

HOUSING AND REAL ESTATE SECTOR

Housing and Real Estate sector accounts US$ 4.7 bn of FDI inflows which is 5.78% of the total inflows received through FIPB/SIA route, acquisition of existing shares and RBI's automatic route during 2000 – 2008. There is an exponential rise in the amount of FDI inflows to this sector after 2005.

Heavy investment i.e. 61.96% came from Mauritius. In terms of most attractive locations in India New Delhi and Mumbai with 34.7% and 29.8% shares are on the first and second positions. The total numbers of foreign collaborations in Housing and Real Estate sector is 18 with an equity participation of US$1.0 bn during 1991-2008. Maximum numbers of foreign collaborations in Housing and Real Estate sector is with Mauritius (7), Singapore (2), and U.K (2). The top five Indian companies which received maximum FDI inflows in this sector are: Emaar MGF Land P. Ltd, Emaar MGF Land P. Ltd, Shivaji Marg Properities, Shyamaraju & Company (India) Pvt. Ltd, and India Bulls Infrastructure Development.

CONSTRUCTION ACTIVITIES SECTOR

Construction activities Sector includes construction development projects viz. housing, commercial premises, resorts, educational institutions, recreational facilities, city and regional level infrastructure, township. The amount of FDI in construction activities during Jan 2000 to Dec. 2008 is US$ 4.9 bn which is 6.15% of the total inflows received through FIPB/SIA route, acquisition of existing shares and RBI's automatic route. The construction activities sector shows a steep rise in FDI inflows from 2005 onwards. Major investment in construction activities is received from Mauritius which is accounted nearly 58.61% of total FDI inflows during 2000-2008. In India Delhi, Mumbai, and Hyderabad receives maximum amount (viz. US$ 1245.61, 1000.5, and 943.22 bn) of investment. As far as technology transfers are concerned, total numbers of 9 technical and 223 numbers of

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financial collaborations have been approved for construction activities, which accounts for 0.11% of the total collaborations approved during August 1991 to December 2008.

Maximum numbers of technical collaborations are approved with France (3) and USA (2). The top five Indian companies' which received FDI inflows in this sector are: W.S Electric Ltd, Carmen Builders & Construction Pvt. Ltd, Caitlin Builders & Developers Pvt. Ltd, W.S. Electric Ltd, and PVP Ventures Pvt. Ltd.

AUTOMOBILE INDUSTRY

Automobile Industry Sector comprises Passenger cars, auto ancillaries etc. FDI inflows in the automobile Industry sector, during Jan 2000 to Dec. 2008 is US$ 3.2 bn which is 4.09% of the total inflows received through FIPB/SIA route, acquisition of existing shares and RBI' automatic route. The trends in automobile sector show that there is a continuous increase of investment in this sector after 2005 onwards. Major investment came from Japan (27.59%), Italy (14.66%), USA (13.88%) followed by Mauritius (7.77%) and Netherlands (6.91%). In India Mumbai, New Delhi and Ahmedabad received major chunks of investment i.e. 36.98%, 26.63% and 9.47%). The total numbers of approvals for automobile industry have been of the order of 1611 with an equity participation of US$ 6.1 bn, which is 7.01% of the total investment.

Automobile industry sector ranks 5th in the list of sectors in terms of cumulative FDI approved from August 1991 to Dec 2008. Out of 1611 numbers of foreign collaborations approved 734 are technical and 877 are financial in nature.

Highest numbers of technical collaborations with Japan in automobile Industry. Major Indian companies which received highest percentage of FDI inflows in automobile industry are Escorts Yamaha Motor Ltd, Yamaha Motors India Pvt. Ltd, Punjab Tractors Ltd., Yamaha Motor Escorts Ltd, Endurance Technologies P. Ltd, General Motors India Ltd, and Fiat India Automobile P. Ltd.

COMPUTER SOFTWARE AND HARDWARE SECTOR

Computer Software and Hardware sector received US$ 8.9 bn which constitute 11.43% of the total FDI inflows during the period Jan 2000 to Dec 2007. Computer Software and Hardware sector shows a continuous increasing trend of FDI inflows .Mauritius with an investment of US$ 4789 bn remained at the top among the investing countries in India in this Sector. Other major investing countries in this sector are USA (12.88%), Singapore (10.07%) etc. Among Indian locations Mumbai received 22.44% of investment followed by Bangalore (10.8%), and Chennai (9.90%).

Computer Software and Hardware industry fetched 3636 numbers of foreign collaborations. Out of 3636, 125 are technical and 3511 are financial in nature with an equity participation of US$ 3.0bn. Major technological transfers come from USA (43.2%) and Japan (10.4%). The top Indian companies which received FDI inflows in this sector are: I Fliex Solutions Ltd, I Flex Solutions ltd, Tata Consultancy Services Ltd, Infrasoft Technologies Ltd, Mphasis BFL Ltd, I-Flex Solutions Ltd, Digital Global Soft Ltd, India Bulls Financials Services P. Ltd, IFLEX Solutions Ltd, Unitech Reality Projects Ltd.

TELECOMMUNICATIONS SECTOR

Telecommunications Sector comprises Telecommunications, Radio Paging, and Cellular Mobile/Basic Telephone Services etc. India received cumulative FDI inflows of US$ 100.4 bn during 1991-2008. Out of this, Telecommunications Sector received an inflow of US$ 8.2 bn, which is 8.4% of the total FDI inflows during August 1991 to December 2008. There has been a steady flow of FDI in telecommunications from 1991 to 2005, but there is an exponential rise in FDI inflows after 2005 . Mauritius with 82.22% of investment remains on the top among the investing countries in this sector. Other investing countries in the telecom sector are Russia (5.41%) and USA (2%). New Delhi attracts highest percentage (32.58%) of FDI inflows during Jan 2000 to Dec 2008. The total numbers of approvals for telecommunications Industry have been of the order of 1099 with an equity participation of US$ 13.3 bn, 14.34% of the total investment. Telecommunication sector ranks 2nd in the list of sectors in terms of cumulative FDI approved from August 1991 to Dec 2008.

INTERNATIONAL INVESTMENT AGREEMENTS

India is the founding member of GATT (General Agreement on Trade and Tariffs). India is also a signatory member of South Asian Free Trade Agreement (SAFTA). India has signed BITs (Bilateral Investment Treaties) with both developed and developing nations. India has concluded 57 numbers (upto 2006) of BITs, out of which 27 are with developed nations and majority of them, are with developing countries of Asia (16), the Middle East (9), Africa (4), and Latin America (1). India also maintains double tax avoidance agreements (tax treaties) with 70 countries (upto 2006). Apart from BITs and tax treaties India is the member of many FTAs (Free Trade Area, nearly 17 in numbers, upto 2006)).

3.8 CONCLUSIONS

The above analysis of Trends and Patterns of FDI inflows reveals the following facts:-

FDI has gained momentum in the economic landscape of world economies in the last three decades. It had outpaced almost all other economic indicators of economic transactions worldwide. FDI is considered as the safest type of external finance both by the developed and developing nations. So, there is growing competition among the countries in receiving maximum inward FDI. Trends in world FDI inflows shows that maximum percentage of global FDI is vested with the developed nation. But in the last two decades, developing countries by receiving 40% of global FDI in 1997 as against 26% in 1980 make waves in the economics of developed nations. Among developing nations of the world, the emerging economies of the Asian continent are receiving maximum share (16%) of FDI inflows as against other emerging countries of Latin America (8.7%) and Africa (2%).In the last two decades, India has significantly increased its share of world FDI from 0.7% in 1996 to 1.3% in 2007. China is the major recipient of global FDI flows among the emerging economies of the world. It is also the most preferred destination of global FDI flow. India is at 5th position in the category of most attractive location of global FDI.It is found that FDI flows to India have increased from 11% in 1991-99 to 69% in2000-2007.In the South, East and South-East Asia block India is at 3rd place after China andSingapore in receiving FDI inflows.India is the major recipient of FDI inflows in South-Asia region. It constitutes 75% of total FDI inflows to this region.In order to have a generous flow of FDI, India has maintained Double Tax Avoidance Agreements (DTAA) with nearly 70 countries of the world.India is the signatory member of south Asian Free Trade Agreement (SAFTA).

Apart from SAFTA, India is also the member of many (of nearly 17) Free Trade. Agreements (FTAs).It is found that China's share is 21.7% and India's share is miniscule (i.e. 2.8%) among the emerging economies of the world in the present decade.India has considerably decreased its fiscal deficit from 4.5 percent in 2003-04 to 2.7 percent in 2007-08 and revenue deficit from 3.6 percent to 1.1 percent in 2007-08. India has received increased NRI's deposits and commercial borrowings largely because of its rate of economic growth and stability in the political environment of the country.

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