CHAPTER 3

TRENDS AND PATTERNS OF INWARD FOREIGN DIRECT INVESTMENT

The Indian Economy opened up in 1991 within the framework of liberal economic reforms. The variations in the policy reforms are reflected in the trends and patterns of inward and outward FDI flows. FDI inflows were stimulated in industry and services benefiting from the many comparative advantages of the country (human resources, emerging markets etc).

The present chapter analyses the trends and patterns of inward FDI flows of India, focusing specially on the period of post liberalisation .The issues that have been studied in this chapter are:

- The nature and extent of Indian economy's integration with the world economy
- The nature of the regional distribution of FDI flows from the global FDI flows
- The comparative standing of FDI among developing countries
- The pattern of originating countries of Indian FDI flows
- The nature of change in the sectoral composition of FDI in India
- The regional distribution of inward FDI in India
- The structure of cross border mergers and acquisitions from India
- The FDI flows as a percentage of GDP and GFCF
- FDI performance v/s potential in India
- Major policy initiatives taken to boost FDI flows

This chapter, divided into three parts, is structured as follows:

- Section 3.1 studies the extent of the Indian economy's integration with the world economy.
- Section 3.2 examines the trends and patterns of inward FDI into India.
- Section 3.3 discusses the findings and conclusions.

SECTION 3.1

INDIA'S INTERNATIONAL TRADE: TOWARDS GLOBAL INTEGRATION

The year 2006 witnessed robust growth in the world economy and vigorous trade expansion. According to data available in (UNCTAD 2007), global GDP growth accelerated to 3.7 percent, the second best performance since 2000. All major regions recorded GDP growth in excess of population growth. Economic growth in the least-developed countries continued to exceed 6 percent for the third year in a row. A large part of the stronger global economy is attributable to the recovery in Europe in early 2006, which turned out to be stronger than expected. The United States economy maintained its overall expansion as weaker domestic demand was balanced by a reduction in the external deficit, mainly due to a faster export growth. In Japan somewhat faster economic growth was achieved despite weaker domestic demand reflected in a widening of its external surplus. China and India continued to report outstandingly high economic and trade growth.

The more favourable investment climate is also reflected in a sharp rise in global foreign direct investment flows in 2006, which approached the record levels of the past. UNCTAD reports that global FDI inflows surged by one-third to US$ 1.23 trillion, the second highest level ever. The high growth of global FDI flows can be attributed partly to increased mergers and acquisitions activity and higher share prices.

INDICATORS OF THE EXTENT OF INTEGRATION OF THE INDIAN ECONOMY IN THE WORLD MARKET FOR GOODS AND SERVICES

Integration of the domestic economy with the world market can be indicated by the extent of international trade in the domestic economy as measured by the share of exports and imports in GDP and in the global economy as measured by the share of country's exports and imports in global exports and imports.

The relevant data are given below in the table:

Table 3.1: Measures of Integration of the Indian Economy with the World Economy (percent total)

Measures of Integration	1994	2004
Share in GDP of Exports of Goods and Services	10	18
Share in GDP of Imports of Goods and Services	10	20
Share in World Merchandise Exports	0.6	0.8
Share in World Merchandise Imports	0.6	1.1
Country Share in World Exports of Commercial Services	0.6	1.9
Country share in World Imports of Commercial Services	0.8	2.0

Sources: World Bank 2006 and WTO, 2005

It is evident from above that India has become increasingly integrated with the world economy. During the period 1990-2004 the share of exports and imports in India's GDP almost doubled, but the increase in India's share in its world merchandise exports was proportionately far less. However, because of the success in the IT service sector, India's share in world exports of commercial services tripled during the same period. This would imply that excluding the services sector, the effect of greater integration is mostly domestic. This is because of rising share of trade in domestic GDP, rather than India's GDP growth, affecting the global GDP growth.

Table 3.2: Share of India in Global GDP and its Growth

Share in Global GDP (percent)		Share in GDP of Low And Middle Income Countries (percent)		Growth Rate of GDP (percent)		Share in Growth of World GDP (percent)		Share in Growth Rate of Low And Middle Income Countries (percent)	
1990	2004	1990	2004	1990	2004	1990	2004	1990	2004
1.46	1.67	7.92	8.23	6.0	6.2	3.58	4.14	12.66	10.63
						(3.12.)	(3.62)	(12.18)	(10.23)

Source: Srinivasan (2006) *pp.7*

Note: Using shares of the two countries in global and low and middle income countries' GDP of 2004 respectively as weights. Figures in parenthesis use corresponding shares in GDP of 1990 as weights.

The share of India in global and low income countries' GDP respectively has increased over time. And India's share of GDP among low and middle income countries is naturally higher than in global GDP and its contribution to GDP growth in low and middle income countries is even higher (table 3.2).

The IMF (2005) recognizes that policy makers in India are actively seeking to strengthen India's global linkages and to accelerate its integration with the world economy. Success in these efforts would increase the role of India in the world economy.

SECTION 3.2

TRENDS AND PATTERNS OF INWARD FDI IN INDIA

The stock of foreign direct investment in India soared from less than US$ 2 billion in 1991, when the country undertook major reforms to open up the economy to world markets, to almost US$ 51 billion in 2006 (table 3.3). Reforms are being done to deregulate FDI restrictions further, e.g., by allowing FDI in retail trade. Policymakers in India as well as external observers attach high expectations to FDI. According to the Minister of Finance, Mr. P. Chidambaram, "FDI worked wonders in China and can do so in India" (Indian Express, November 11, 2005). The Deputy Secretary General of the OECD reckoned at the OECD India Investment Roundtable in 2004 that the improved investment climate has not only resulted in more FDI inflows but also in higher GDP growth (OECD India Investment Roundtable 2004). This implicitly means that higher FDI has caused higher growth[1]. Bajpai and Sachs (2000) advice policymakers in India to throw wide open the doors to FDI which is supposed to bring "huge advantages with little or no downside."

[1] Fischer (2002) makes this assumption explicit when stating that greater openness to FDI would permit a significant increase in growth in India.

SIZE AND MAGNITUDE OF INWARD FDI

Table 3.3: FDI Inward Stock (US$ billion)

Year	World	Developing Economies	India
1992-97*	2662.8	694.92	5.4
1998	4168.21	1224.05	14.06
1999	4939.44	1558.68	15.42
2000	5810.18	1707.63	17.51
2001	6210.76	1786.91	20.32
2002	6789.2	1727.49	25.4
2003	8185.38	1978.06	30.82
2004	9570.52	2287.69	38.67
2005	10048.01	2621.61	44.01
2006	11998.83	3155.85	50.68

* Annual average *Source: World Investment Report, 2007*

At the first impression it appears that India is an underperformer in attracting FDI. However, FDI flows are not easy to analyse because they are generally low and fluctuating. Data relating to FDI inflows are underestimated because of their national definition and interpretation. The RBI and SIA, which officially publishes statistics on foreign investment, have, since 1991, only reported the equity component of FDI. And reinvested earnings[2] have not been taken into consideration, though the IMF guidelines estimate that they are a part of FDI inflows. The Indian data on FDI include neither the proceeds of foreign equity listings nor foreign subordinated loans to domestic subsidiaries. Overseas commercial borrowing as well as some depository receipts over 10 percent of the equity coming from the foreign institutional investors are also disregarded (Srivastava, 2003). Hence, there is a lot of scope to bring India's statistics in line with the international standards.

[2] That is the part of foreign investor's profits that are not distributed to share holders as dividends and reinvested in the affiliates in the host country.

At the end of 2006, India's stock of inward FDI amounted to US$50.6 billion which is only 0.4 percent of the world stocks, and 1.6 percent of the investments received by the developing countries. It can be seen, however, that Indian stocks were 2.6 times greater in 2006 than in 1998 (table 3.3). In 2004, India held the 15th slot in terms of inward stock among developing nations. (WIR, 2005)

Table 3.4: Inward FDI Flows (US$ Billion)

Year	World	Developing Economies	India
1992-97*	312.23	114.65	1.67
1998	709.3	189.64	2.63
1999	1098.89	228.46	2.16
2000	1411.36	256.08	3.58
2001	832.56	212.01	5.47
2002	621.99	166.31	5.62
2003	564.07	178.69	4.32
2004	742.13	283.03	5.77
2005	945.79	314.31	6.67
2006	1305.79	379.07	16.88

**Annual Average* *Source: World Investment Report, 2007*

Indian inward FDI flows surged to US$ 6.67 billion in 2005 and US$ 16.88 billion in 2006, which is a record level. It represented 0.7 percent of the world FDI flows and 2.12 percent of the developing economies flows in 2005. However, the ratios improved to 1.29 percent and 4.45 percent in 2006 respectively, which shows marked progress (table 3.4). In 2004, FDI reached a record level of US$ 5.7 billion, and India held the 7th rank among developing countries to attract foreign investors. (WIR, 2005)

Table 3.5: FDI Inflows in selected Asian developing countries (1990-2004) (US$ billion)

Country	1990	2004
China	3.48 (1.72)	60.63 (8.16)
Hong Kong	3.27 (1.62)	34.03 (4.58)
India	0.23 (0.11)	5.77 (0.77)
Indonesia	1.09 (0.54)	1.89 (0.25)
Korea	0.759 (0.37)	8.98 (1.2)
Malaysia	2.61 (1.29)	4.62 (0.62)
Philippines	0.55 (0.27)	0.68 (0.09)
Singapore	5.57 (2.76)	19.82 (2.67)
Srilanka	.043 (0.02)	0.23 (0.03)
Thailand	2.57 (1.27)	5.86 (0.78)
Developing Economies	35.89 (17.80)	283.03 (38.13)
World	201.59	742.13

Source: DIP&P, Ministry of Commerce, 2005

Note: Figures in the parenthesis are % share of the World total

The above table shows that the share of world investment received by India remains weak (0.11 percent in 1990 and 0.8 percent in 2004), however, it is gradually increasing. However, if the distortions in FDI data measurement, as previously mentioned, are taken into consideration, then the actual FDI will be higher than the official figures. If reinvested earnings by foreign firms are added, FDI inflows have to be increased by about US$ 1.8 billion in 2003 and 2004. So, India would have received about US$ 7 billion of FDI in 2004. (RBI bulletin, 2005)

The growing trend in FDI inflows is also pushed by Greenfield investments. The amount of Greenfield investment has risen by 82.8 percent in 2003 with 457 projects, and by 50 percent in 2004 with 685 projects (WIR, 2005). As far as Mergers and Acquisitions by the foreign firms, they amounted to US$ 949 million in 2003 and US$ 1760 million in 2004. (WIR 2005)

INDICATORS OF FDI PERFORMANCE

1. FDI / GDP Ratio

A good indicator of a country's openness to FDI is FDI normalized by the size of the host economy which indicates the attractiveness of an economy to draw FDI. Countries vary in their economic and market size and the size of FDI flows should be assessed relative to the size of host economy.

A country with a ratio of FDI to GDP that is greater than unity is reckoned to have received more FDI than that implied by the size of its economy. It indicates that the country may have a comparative advantage in production or better growth prospects reflecting larger market size for foreign firms. However if the country has the ratio value of less than one may be protectionist and backward or may possess a political and social regime that is not conducive for investments. Overall, FDI-GDP ratio is an index of the prevailing investment climate in the host economy.

Table 3.6 gives a picture of FDI as a percentage of GDP for India for some selected years. The share of FDI inflows in GDP has been very small in absolute terms, remaining less than one (2000, 2003, and 2005). However the ratio improved dramatically (1.85) in 2006, which reflects the growth in the domestic economy, improvement in the investment climate as well as the buoyancy in FDI flows.

Table 3.6: India's FDI inflows and GDP figures (US$ billion)

Year	FDI	GDP Current	FDI / GDP (%)
1997	3.57	410.91	0.86
2000	3.58	460.19	0.77
2001	5.47	478.29	1.14
2002	5.62	507.91	1.1
2003	4.32	601.86	0.71
2004	5.77	695.84	0.82
2005	6.67	805.73	0.82
2006	16.88	911.81	1.85

Source: World Development Indicators data base, World Bank 2006

2. Inward FDI flows as a percentage of Gross Fixed Capital Formation

A common measure of the relative size of the FDI is the "FDI–Capital Formation Ratio" given by the amount of FDI inflows in one year divided by the total fixed asset investments made by domestic and foreign firms in the same year. This measure can provide a crude measure of the importance of FDI in an economy's capital formation. The share of inward FDI flows as a percentage of GFCF measures the relative weight of FDI in total aggregate investment taking place in the host economy. Total investment includes both public and private sector investment taking place in the host economy. India is at a much lower rank improving from 0.4 in 1992 to a ratio of 3 in 2003 and then showing a marked improvement reaching to a ratio of 9 in 2006 (table 3.7). This implies that FDI is increasingly playing a greater role in the capital formation of the domestic economy which has implications for the growth prospects.

Table 3.7: FDI inflows as percentage of GFCF by host region and economy (1992-2006)

Year	World	Developing Countries	India
1992	3.2	5.1	0.4
1993	4.1	6.5	0.9
1994	4.4	8.2	1.4
1995	5.3	8	2.4
1996	6	9.4	2.9
1997	7.5	11.8	4
1998	11.1	12.9	2.9
1999	16.5	15.8	2.2
2000	20.6	16.2	3.5
2001	12.5	13.7	5.1
2002	9.3	10.4	`5.0
2003	7.5	9.8	3..2
2004	8.5	12.9	3.2
2005	10.4	12.6	3.6
2006	12.6	13.8	8.7

Source: World Investment Report, 2007

3. Inward FDI Performance Index

The inward FDI performance index of the UNCTAD is an instrument to compare the relative performance of countries in attracting FDI inflows. This measure ranks countries by the FDI they receive relative to their economic size[3]. It is the ratio of a country's share in global inward FDI flows to its share in global GDP. An index value greater than one indicates that the country receives more FDI than its relative economic size given by its relative GDP, a value below one suggests that it receives less and a negative value means that foreign investors disinvest in that period. This exercise is intended to provide policy makers with data on some variables that can be quantified for a large number of countries. This index thus captures the influence on FDI of factors other than market size, assuming that other things being equal, size

[3] The inward FDI performance index is shown for a three year period to offset annual fluctuations in the data. The indices cover 140 economies for as much of the period as the data permit; however, some countries could not be ranked in the early years for the lack of data.

is the base line for attracting investment. These other factors can be diverse, ranging from the business climate, economic and political stability, the presence of natural resources, infrastructure, skills and technologies, to opportunities for participation in privatization or the effectiveness of FDI promotion[4].

Table 3.8: Inward FDI Performance Index of some selected countries

Country	1988-1990		1998-2000		2000-2002	
	Rank	Index	Rank	Index	Rank	Index
China	46	1.033	51	1.198	50	1.331
Hong Kong	3	5.292	2	6.033	2	6.508
India	98	0.066	119	0.155	121	0.215
Indonesia	56	0.794	137	-0.570	121	-0.528
Republic of Korea	81	0.369	91	0.587	107	0.330
Malaysia	4	4.355	49	1.248	70	0.923
Pakistan	72	0.493	114	0.216	116	0.278
Philippines	30	1.689	87	0.641	90	0.618
Singapore	1	13.599	7	3.737	6	4.755
Thailand	17	2.562	44	1.375	80	0.753
United States	41	1.115	78	0.805	92	0.589

Source: UNCTAD, World Investment Report, various issues

It is evident that India has an index that is significantly lower than a few other East-Asian economies like Singapore, Malaysia, Philippines, Indonesia, and Republic of Korea. The index value remained consistently much below one although it showed a gradual improvement over subsequent periods (table 3.8). This improvement shows that the policy regime in India must be slowly moving towards a more open economy shedding the protectionist economic policies. However, India also shows deterioration in terms of the ranking of the indices. If India has to compete strongly for more FDI then larger reforms are required at the macro economic front.

[4] The Inward FDI Performance Index methodology is given as:
$IND_i = [(FDI_i) / (FDI_w)] / [(GDP_i) / (GDP_w)]$ where i is the ith country and w is world as given in World Investment Report.

4. Inward FDI potential index

The Inward FDI Potential Index[5] of the UNCTAD is an instrument to compare the relative potentials of different countries in attracting FDI inflows on the basis of the selected variables that capture the host of socio-economic factors apart from market size affecting inward FDI flows.

Table 3.9: Inward FDI Potential Index of some selected countries

Country	1988-1990		1998-2000		2000-2002	
	Rank	Index	Rank	Index	Rank	Index
China	45	0.176	42	0.255	39	0.273
Hong Kong	17	0.355	13	0.426	12	0.413
India	72	0.120	91	0.156	89	0.159
Indonesia	42	0.177	85	0.161	82	0.163
Republic of Korea	20	0.312	17	0.410	18	0.387
Malaysia	38	0.205	32	0.302	32	0.292
Pakistan	92	0.095	129	0.103	128	0.104
Philippines	76	0.110	69	0.193	57	0.212
Singapore	13	0.402	2	0.500	4	0.465
Thailand	40	0.182	53	0.225	54	0.215
United States	1	0.727	1	0.706	1	0.659

Source: UNCTAD, World Investment Report, various issues

Note: The indices are measured on a scale of 0 (minimum potential) to 1 (maximum potential)

Even in the Inward FDI Potential Index India lags behind Singapore, Hong Kong, and Korea among the East Asian countries (table 3.9). The comparative performance of India in the FDI arena is being studied extensively. (Wei, 2000; Srinivasan, 2003; Swamy, 2003; Bajpai and Dasgupta, 2003)

[5] The Inward FDI Potential Index is shown for three year periods to offset annual fluctuations in the data. The index covers 140 economies for the period covered. For the methodology see www.unctad.org

COMPARING PERFORMANCE AND POTENTIAL

Comparing the two indices a four fold matrix can be drawn up of inward FDI performance and potential:

		FDI Performance	
		High	**Low**
FDI Potential	**High**	Front Runners	Below Potential
	Low	Above Potential	Under Performers

- Front Runners: Countries with high FDI potential and performance.
- Above Potential : Countries with low FDI potential but strong FDI performance
- Below Potential : Countries with high FDI potential but low FDI performance
- Under Performers : Countries with both low FDI potential and performance

Based on the following matrix, the results for the years 2000-02 and 2005 are given below. Though FDI in India is showing buoyant trends, it is still ranked as an under performer, when the performance and potential is compared with other countries in the world (Box 3.1 & 3.2). This calls for wider and more meaningful reforms to induce capital flows.

Box 3.1: Matrix of Inward FDI Performance and Potential (2000-2002)

	High Performance	Low Performance
	Front Runners	**Below Potential**
High Potential	Bahamas, Belgium and Luxembourg, Botswana, Brazil, Brunei, Darussalam, Bulgaria, Canada, Chile, China, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Dominican Republic, Estonia, Finland, France, Germany, Guyana, Hong Kong (China), Hungary, Ireland, Israel, Jordan, Latvia, Lithuania, Malaysia, Malta, Mexico, Mongolia, Netherlands, New Zealand, Panama, Poland, Portugal, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Trinidad and Tobago, United Kingdom and Vietnam.	Australia, Austria, Bahrain, Belarus, Egypt, Greece, Iceland, Islamic Republic of Iran, Italy, Japan, Kuwait, Lebanon, Libyan Arab Jamahiriya, Norway, Oman, Philippines, Qatar, Republic of Korea, Russian Federation, Saudi Arabia, South Africa, Taiwan Province of China, Thailand, United Arab Emirates and United States.
	Above-Potential	**Under-Performers**
Low Potential	Albania, Angola, Armenia, Azerbaijan, Bolivia, Colombia, Ecuador, Gambia, Georgia, Honduras, Jamaica, Kazakhstan, Mali, Morocco, Mozambique, Namibia, Nicaragua, Republic of Congo, Republic of Moldova, Sudan, TFYR Macedonia, Togo, Tunisia, Uganda and United Republic of Tanzania.	Algeria, Argentina, Bangladesh, Benin, Burkina Faso, Cameroon, Cote d'Ivoire, Democratic Republic of Congo, El Salvador, Ethiopia, Gabon, Ghana, Guatemala, Guinea, Haiti, **INDIA**, Indonesia, Kenya, Kyrgyzstan, Madagascar, Malawi, Myanmar, Nepal, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Romania, Rwanda, Senegal, Sierra Leone, Sri Lanka, Suriname, Syrian Arab Republic, Tajikistan, Turkey, Ukraine, Uruguay, Uzbekistan, Venezuela, Yemen, Zambia and Zimbabwe.

Source: UNCTAD.

Box 3.2: Matrix of Inward FDI Performance and Potential (2005)

	High Performance	Low Performance
	Front Runners	**Below Potential**
High Potential	Azerbaijan, Bahamas, Bahrain, Belgium, Botswana, Brunei Darussalam, Bulgaria, Chile, China, Croatia, Cyprus, Czech Republic, Dominican Republic, Estonia, Hong Kong (China), Hungary, Iceland, Israel, Jordan, Kazakhstan, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Netherlands, Panama, Poland, Portugal, Qatar, Singapore, Slovakia, Thailand, Trinidad and Tobago, Ukraine, United Arab Emirates and United Kingdom	Algeria, Argentina, Australia, Austria, Belarus, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Islamic Republic of Iran, Italy, Japan, Kuwait, Libyan Arab Jamahiriya, Mexico, New Zealand, Norway, Oman, Republic of Korea, Russian Federation, Saudi Arabia, Slovenia, Spain, Sweden, Switzerland, Taiwan Province of China, Tunisia, Turkey, United States and Venezuela.
	Above-Potential	**Under-Performers**
Low Potential	Albania, Angola, Armenia, Colombia, Congo, Costa Rica, Ecuador, Egypt, Ethiopia, Gabon, Gambia, Georgia, Guyana, Honduras, Jamaica, Kyrgyzstan, Lebanon, Mali, Mongolia, Morocco, Mozambique, Namibia, Nicaragua, Republic of Moldova, Romania, Sierra Leone, Sudan, Suriname, Tajikistan, Uganda, United Republic of Tanzania, Uruguay, Vietnam and Zambia.	Bangladesh, Benin, Bolivia, Burkina Faso, Cameroon, Democratic Republic of Congo, Côte d'Ivoire, El Salvador, Ghana, Guatemala, Guinea, Haiti, **INDIA**, Indonesia, Kenya, TFYR of Macedonia, Madagascar, Malawi, Myanmar, Nepal, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Philippines, Rwanda, Senegal, South Africa, Sri Lanka, Syrian Arab Republic, Togo, Uzbekistan, Yemen and Zimbabwe.

Source: UNCTAD.

Following are some of the reasons that can explain the low levels of inward FDI flows registered until recently:

- Being a developing country with a low GDP per capita, many illiterate people and poor social and economic infrastructures, India could not attract FDI.
- India implemented, after its independence an inward looking strategy including planning, nationalization, an import substitution policy, where tax structure was complex and FDI was conditionally tolerated for internal needs and minority shares.

- If some measures of de-licensing were taken in 1985-86, it was mainly in 1991 that India opened up to foreign investment, parallel with liberalisation of the economy. Private and foreign firms were permitted to invest in activities previously reserved for the public sector. FDI was allowed not only for the domestic market but also for exports, investment ceilings were raised; policy environment and procedures were simplified and streamlined[6]. This was beneficial for the Indian economy. However, India began to emerge with inertia.

[6] Until 1992 all the foreign investors in India and the repatriation of foreign capital required prior approval of the government, and the Foreign Exchange Regulation Act rarely allowed foreign majority holdings.

REGIONAL (COUNTRY WISE) DISTRIBUTION OF FDI

Table 3.10: Share of top investing countries' FDI inflows in Rs. Crores (US$ million)

Ranks	Country	Aug '91– Mar '02	Apr '02– Mar '03	Apr '03– Mar '04	Apr '04– Mar '05	Apr '05– Oct '06	Cumulative Inflows (Aug '91– Oct '05)	Percentage with inflow
1.	Mauritius	27,446 (6,632)	3,766 (788)	2,609 (567)	5,141 (1,127)	5,033 (1,144)	43,995 (10,358)	35.95
2.	U.S.A.	12,248 (3,188)	1,504 (319)	1,658 (360)	3,055 (668)	1,498 (340)	19,963 (4,876)	16.31
3.	Japan	5,099 (1,299)	1,971 (412)	360 (78)	575 (126)	410 (93)	8,416 (2,008)	6.88
4.	Netherlands	3,856 (986)	836 (176)	2,247 (489)	1,217 (267)	70 (39)	8,325 (1,956)	6.80
5.	U.K.	4,263 (1,106)	1,617 (340)	769 (167)	458 (101)	845 (192)	7,952 (1,906)	6.50
6.	Germany	3,455 (908)	684 (144)	373 (81)	663 (145)	170 (39)	5,346 (1,317)	4.37
7.	Singapore	1,997 (515)	180 (38)	172 (37)	822 (184)	660 (150)	3,829 (925)	3.13
8.	France	1,947 (492)	534 (112)	176 (38)	537 (117)	36 (8)	3,229 (768)	2.64
9.	South Korea	2,189 (594)	188 (39)	110 (24)	157 (35)	251 (57)	2,894 (749)	2.37
10.	Switzerland	1,200 (325)	437 (93)	207 (45)	353 (77)	171 (39)	2,367 (579)	1.93
Total FDI inflows *		92,611 (23,829)	14,932 (3,134)	12,117 (2,634)	17,138 (3,754)	11,397 (2,590)	1,48,195 (35,942)	

** Includes inflows under RBI NRI Schemes, stock swapped and advances pending issue of shares.*

Source: DIP&P, Ministry of Commerce,2005

FDI inflows show a skewed pattern in terms of their originating destinations. Between 1991 and 2005, investments of 10 countries accounted for 80 percent of FDI, the main investor countries being Mauritius, the USA, the Netherlands, Japan, and the United Kingdom. According to the data relating to the period 1991-2005, Mauritius has been the biggest source of FDI. This could be because of common cultural patterns in both the countries and also close political and bilateral ties. Mauritius has low rates of taxation and an agreement with India on double tax avoidance regime. For these reasons, some MNCs set up companies in Mauritius before going to India. Investments from Mauritius take place both in the public[7] and private[8] sector.

Apart from Mauritius, the US is another important investor in India. It contributed about 16 percent of total IFDI between 1991 and 2005. The reason could be that both countries have close relations. The US is the largest trading partner of India and a broad Indian community lives in it. Far behind the USA, Japan (7 percent of FDI inflows received by India), Netherlands (7 percent), U.K. (6.5 percent) are significant investors. Germany follows (4 percent), then Singapore (3 percent), France (3 percent), South Korea (2 percent) and Switzerland (2 percent). The European Union's FDI is higher than that from the US. FDI from Netherlands, United Kingdom, Germany and France registered between 1991 and 2005 accounts for 20 percent of the total (table 3.10).

[7] For instance, it is the case of Life Insurance Corporation, New India Assurance, State Bank of India International, Bank of Baroda, Indian Oil Corporation and so on

[8] It is the case, notably, of Infosys, Ajanta Pharma, Apollo Tyres, Pentafour, Arvind Mills, Ashok Leyland and so on.

Table 3.11: Statement on RBI's regional office-wise (with states covered) FDI equity inflows[1] (April '00–Feb '08)

Ranks	RBI's - Regional Office[2]	State covered	% with FDI inflows (in Rs. terms)
1.	Mumbai	Maharashtra, Dadra & Nagar Haveli, Daman & Diu	29.51
2.	New Delhi	Delhi, Part of UP and Haryana	20.27
3.	Bangalore	Karnataka	7.15
4.	Chennai	Tamil Nadu, Pondicherry	5.80
5.	Hyderabad	Andhra Pradesh	4.25
6.	Ahmedabad	Gujarat	3.78
7.	Kolkata	West Bengal, Sikkim, Andaman & Nicobar Islands	1.45
8.	Chandigarh	Chandigarh, Punjab, Haryana, Himachal Pradesh	0.77
9.	Panaji	Goa	0.44
10.	Kochi	Kerala, Lakshadweep	0.23
11.	Bhopal	Madhya Pradesh, Chattisgarh	0.20
12.	Bhubaneshwar	Orissa	0.17
13.	Jaipur	Rajasthan	0.15
14.	Kanpur	Uttar Pradesh, Uttranchal	0.03
15.	Guwahati	Assam, Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Tripura	0.02
16.	Patna	Bihar, Jharkhand	0.00
17.	RBI's regions not indicated[3]		25.78

Source: DIP&P, Ministry of Commerce, 2008

[1] *Includes equity capital components' only.*

[2] *The Region-wise FDI inflows are classified as per RBI's - Region-wise inflows, furnished by RBI, Mumbai.*

[3] *Represents inflows through acquisition of existing shares by transfer from residents. For this, Region-wise information is not provided by Reserve Bank of India.*

The regional distribution of FDI inflows in the above table shows highly concentrated patterns. Eight regional offices received around more than 70 percent of Indian FDI inflows. Mumbai, New Delhi and their surroundings include almost the half of the FDI received by India since 2000. The areas of Bangalore and Chennai with almost 7 percent and 6 percent each respectively lag behind. Then there are places surrounding Hyderabad (4 percent) and Ahmedabad (4 percent).

Most software companies are in Mumbai and Bangalore where the Indian Industry originally developed, but they are also developing quickly in Delhi and its surroundings as well as in Andhra Pradesh and Tamil Nadu .As to the main poles of competitiveness, they are mainly concentrated in the South on the axis of Madras and Bangalore, and around Delhi and Mumbai.

Table 3.12: Sectoral Analysis of FDI Inflows

Ranks	Sector	Amount of FDI Inflows					
		Apr '02– Mar '03	Apr '03– Mar '04	Apr '04– Mar '05	Apr '05– Dec '06	Cumulative Inflows (Aug '91– Dec '05)	Percentage with inflow
1.	Electrical Equipments (incl. computer software & electronics)	3,075 (644)	2,449 (532)	3,281 (721)	3,796 (841)	21,006 (4, 886)	16.50
2.	Transportation Industry	2,173 (455)	1,417 (308)	815 (179)	830 (187)	13,162 (3,143)	10.34
3.	Services Sector (financial & non-financial)	1,551 (326)	1,235 (269)	2,106 (469)	2,035 (462)	12,274 (2,972)	9.64
4.	Telecommunications (radio paging, cellular mobile, basic telephone services)	1,058 (223)	532 (116)	588 (129)	886 (198)	12,199 (2,890)	9.58
5.	Fuels (Power + Oil Refinery)	551 (118)	521 (113)	759 (166)	150 (34)	10,711 (2,521)	8.41
6.	Chemicals (non-fertilizers)	611 (129)	94 (20)	909 (198)	856 (194)	7,456 (1,890)	5.86
7.	Food Processing Industries	177 (37)	511 (111)	174 (38)	158 (36)	4,678 (1,173)	3.67
8.	Drugs & Pharmaceuticals	192 (40)	502 (109)	1,343 (292)	499 (114)	4,051 (949)	3.18
9.	Cement and Gypsum Products	101 (21)	44 (10)	1 (0)	1,970 (452)	3,231 (747)	2.54
10.	Metallurgical Industries	222 (47)	146 (32)	881 (192)	560 (126)	2,695 (627)	2.12

Source: DIP&P, Ministry of Commerce, 2008

Between 1991 and 2005, most of the FDI received by India was mainly in manufacturing. Notably sectors such as electrical equipment (including computer software and electronics) received 17 percent of FDI inflows, transportation industry (11 percent), telecommunications (10 percent), fuels (9 percent) and chemicals (6 percent). Services accounted for 10 percent (table 3.12). In recent years some sectors such as electrical equipment, services, drugs and pharmaceuticals, cement and gypsum products, metallurgical industries have shown impressive results.

Since 2002, services hold the third rank in attracting FDI. Business services (IT, software, financing, insurance, real estate, etc) are gathering momentum. India is the main destination for off-shoring of most services as back office processes, customer interaction and technical support, R&Ds[9] (WIR, 2005). According to the data provided by OCO consulting (2005), India is by far the country which attracted the greatest number of projects in IT and software. Since 2002 of 1913 projects observed, it attracted 519[10], which is 27 percent.

Table 3.13: Changes in FDI Stocks[a] and Output Growth[b] in Major Sectors ('87–'04)

	1987-1991	1991-1995	1995-2000	2000-2004
All Sectors				
FDI	1.26	2.07	6.39	N.A.
Output	6	6.4	5.9	6.3
Primary Sector				
FDI	1.35	1.65	1.17	N.A.
Output	5	3.6	2.7	2.6
Manufacturing Sector				
FDI	1.24	2.05	2.03	N.A.
Output	5.6	9.8	5	6.6
Services Sector				
FDI	1.41	3.14	56.06	N.A.
Output	6.8	7.1	7.9	7.8

a Ratio final over initial year of the respective period

b Annual growth rate of GDP and contribution to GDP respectively in constant prices

c Includes electricity, gas and water

Source: UNCTAD 2000; Central Statistical Organisation; Reserve Bank of India (Database on Indian Economy).

[9] Among them we find, abstracting, and indexing, call centers, data entry and processing, electronic publishing, mailing list management, secretarial services, technical writing, telemarketing, web site design, interpretation of medical scans, flight reservations and so on. (WIR, 2005)

[10] Among them are notably investments by Microsoft, Oracle, Syntel, SAP and Cybernet Software Systems.

FDI and Output trends for major sectors are given in table 3.13. Output growth showed a declining trend in the primary sector despite the relatively strong increase in FDI during 1991-'95. The manufacturing sector experienced temporary growth acceleration after reforms in 1991 when FDI stocks doubled. However, output growth in manufacturing weakened between 1995-'00, even though the FDI stocks continued to rise. Patterns within the manufacturing sector are too diverse to reveal a clear picture of the links between FDI and output growth.

The services sector reported relatively high output growth even before the FDI boom started. Increasing FDI stocks since the mid-nineties were matched with higher output growth. These results could imply that FDI was attracted to the service sector by its favourable growth performance and at the same time was a stimulus to a better performance (table 3.13).

Survey data compiled by the RBI (various issues) on the FDI companies indicate that in addition to the increased significance and changing composition of FDI, the type and character of FDI has changed in several respects since the reform program of 1991.

Table 3.14: FDI Characteristics ('90–'91, '02–'03)

	Export % of prod.	Exports / Imports	Imports of Capital Goods (% of total imports)	Imports of Raw materials, Stores & Spares (% of indigenous)	Royalty Payments (% of prod.)	R&D (% of prod.)	Salaries (% of prod.)	Memorandum	
								Companies No.	Val of prod. (all industries= 100)
1990-1991									
All industries	9.3	1.3	9	20	0.11	0.09	9	300	100
Tea plantations	13.7	95.7	18.4	0.5	0	0	17	24	6.3
Textiles	16.4	3.5	19.5	18.7	0	0.04	14.4	6	2
Rubber products	11.2	1.7	7.2	12.8	0.01	0	7.9	4	3.5
Chemicals	9.5	1.2	2.9	23.3	0.02	0.06	2	63	29.3
Engg.	7	0.8	12.3	26.6	0.24	0.14	9.5	126	38.7
Trade	16.3	2.1	61.6	0.3	0	0.05	7.4	8	0.7
2002-2003									
All industries	14.8	1.3	7.7	20.6	0.26	0.38	8.3	490	100
Tea plantations	22.4	49.3	9.8	1.5	0	0.05	37.2	10	1

Food products	8.9	2.9	5.1	4.6	0.01	0.09	5.6	16	3.3
Rubber / Plastic products	16.4	1.9	16.2	18.8	0	0.21	5	11	2
Chemicals	11.8	0.9	3.4	23.6	0.28	0.39	5.7	76	28.2
Engg.	11.1	0.9	9.2	22.7	0.49	0.65	8.7	153	26.3
Machinery & tools	13.5	1	3.4	23.8	0.27	0.68	9.5	85	8.5
Elect. & Mech.	11.4	0.8	6.7	30.4	0.25	0.47	7.5	33	5.9
Transport equipment	9.2	1	16.9	18.6	0.76	0.72	8.8	35	11.9
Computer & related act.	12.7	5	74.8	0	0.05	0.77	31.8	23	4.4
Trade	19.9	1.4	1	0.5	0.01	1.8	9.3	20	1.2

Source: Reserve Bank of India (Database on Indian Economy)

Facts and figures point to an increased world market orientation of FDI. Exports accounted for almost 15 percent of production by all FDI companies surveyed in 2002-'03, compared to less than 10 percent in 1990-91. Accordingly, FDI in India continues to be motivated by serving local markets in the first place. However there is a rise in the export orientation of the Indian companies which may have favourable effects on India's economic development. The increasing export orientation of FDI appears to be due to two factors:

a. The emergence of new industries that attracted FDI (notably computer and related activities).
b. Rising shares of exports in the production of industries in which FDI has a longer tradition (such as tea plantations, rubber products, and engineering).

Overall imports increased by the same order as exports, leaving the ratio of exports to imports constant. However, import of capital goods still account for a minor share in overall imports, though this share still varies widely across industries. As a consequence, the extent to which India may benefit from technology transfers embodied in imports of capital goods seems to be limited. On the other hand, concerns that rising imports by FDI companies would crowd out local suppliers seem to be unfounded. The ratio of imported to indigenous supplies of raw material, stores and spares is more or less constant[11] when comparing this indicator for all surveyed FDI companies in 1990-'91 and 2002-'03.

Another major change in FDI characteristics concerns its technological sophistication. This has two aspects. First, rising payments of royalties suggest that FDI companies have increasingly transferred foreign technologies which may support India's industrial upgrading. In 1990-'91, such transfers were largely confined to FDI in engineering. They still figure most prominently in this area, with transport equipment standing out with the highest ratio of royalties to production by far. However, other industries notably the chemical industry has also drawn increasingly on technologies available abroad. The second aspect relates to R&D undertaken by

[11] In addition, FDI in financial services gained considerably in importance. By contrast, FDI stocks in services such as electricity and water distribution, trade, and transport and storage continued to be of minor importance.

FDI companies in India. Measured as a percentage of production, local R&D has gained in significance by still more than transfers of foreign technology. This applies to all industries for which the data is available. Yet local R&D is concentrated in exactly the same industries, namely chemical and engineering which stand out in terms of transfers of foreign technology. This strongly suggests that transfers of foreign technology and local R&D represent complementary means for industrial upgrading, rather than the former substituting the latter (table 3.14).

EXPLAINING INDIAN INWARD FDI

Liberalisation has been combined with globalization, thus benefiting from the international context of deregulation, lower transport costs, and rapid expansion of internet. Growing international division of labour and fragmentation of MNCs has also proved beneficial. Since 2000 India has kept pace with some other more conspicuous developing counties such as the Asian dragons, Brazil and China.

- India is becoming an attractive location for global business on account to its buoyant economy, its increasing consumption market, infrastructure growth and cost efficiency. According to experts and MNC managers, India is ranked just behind China and behind or on equal terms with U.S (WIR, 2005)[12] This trend was again recently confirmed by AT Kearney's FDI Confidence Index[13]
- Though literacy and education rates are comparatively at a lower level, however, when human resources are normalized by population size, this factor does not remain a deterrent. Indeed, Indian skills in research, product design, and customization of services, are acknowledged. India has one of

[12] .In response from experts, China is the favourite destination (85percent), followed by the US (55percent), and India (42 percent). In the responses from MNCs China comes first (87percent), followed by India (51 percent), and the US (51 percent).
[13] This index tracks investor confidence among global executives to determine their order of preference.

the largest pools of scientists, engineers, and technicians in the world, particularly in information technology, with competitive wage levels when compared to those of industrial countries and the use of English in business and technical and managerial education.

- In the eighties some foreign companies such as Texas Instruments, (semiconductor design) and Astra-Zeneca biopharmaceuticals were pioneers in research activity in India. They were followed in the nineties by groups such as Motorola (telecommunication software), Microsoft (computer operating systems), ST Microelectronics (semiconductor design), Daimler-Benz (avionics system), and Pfizer (biometrics). Nowadays more than 100 MNCs[14] run research activities in India and their number is growing fast.
- The availability of qualified workers, the existence of internationally reputed R&D institutes (Indian Institute of Technology, Indian Institute of Science, Indian Institute of Chemical Technologies, Center for Drug and Research etc), and the emergence of many Indian firms as service providers or as partners[15] contributed to attract MNCS in India to perform R&D.
- On account of its cost advantages, India is nowadays the third destination for R&D, just behind China and the US (WIR, 2005). It also benefits from the fact that the kind of R&D that is suited for expansion in developing countries is not very different from that which may be kept at home. (WIR, 2005).
- Being the second most populous country in the world, India is also attractive for "market seeking" FDI. Half of the population is under 25 years of age. India's consumer market is growing quickly with an average of 12 percent a year. Living standards are rising, a vibrant middle class estimated to be 300

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[14] For e.g. we can quote General Electric, Intel, Casio, Hewlett-packard, IBM, Lucent, Boeing, ZTE, Huawei, Flextronics, or pharmaceutical companies such as Eli Lily, Glaxo Smithkline, Novartis, Sanofi-Aventis.

[15] Indian software companies like TCS, Wipro, and Infosys have alliances with Ericsson, Nokia, and IBM.

million with spending power is emerging in cities and infrastructure needs are tremendous.

- India is a more and more active partner in regional arrangements and agreements such as ASEAN[16], Gulf Cooperation council, BIMSTEC[17], South Asia Free Trade Area, Indian Ocean Rim Association for regional Cooperation and SAARC[18]. Since 2000 India has signed, many bilateral investment and trade agreements as well as double taxation treaties with increasing number of countries that stimulated exports and investments (elimination of quotas, reduction of customs duties)[19].
- FDI is now freely allowed in many sectors[20] with automatic approval[21], freedom of location and choice of technology. Imports and exports, repatriation of profits, dividends and capital are also free[22]. Also IPRs are guaranteed.
- Since November 2005, FDI is allowed up to 100 percent in most activities under the automatic route[23].
- The government also aims to attract foreign investments by setting up Special Economic Zones[24], Science Parks and Free Trade and Warehousing Zones[25]. The Indian Investment Commission is charged with the responsibility of wooing investors[26]. Foreign investment is particularly sought after in power generation, telecommunications, ports, roads, petroleum exploration and processing and mining. A ten year tax holiday is offered to

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16. Cambodia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam, Myanmar
17 Including since 1997, Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation and Bhutan and Nepal since 2004.
18 South Asian Association for Regional Cooperation
19 Such a trend was reinforced by the end of textiles and clothing quotas (UNCTAD 2005)
20 Sectoral ceilings remain in some activities
21 Initially FDI approval relied on matching exports and dividend repatriation. In July 1991, this approval became automatic in 34 industries designated high priority, up to an equity limit of 51 percent.
22 Recently foreign equity ceilings in aviation services, private banks, non news print publications and the petroleum industry have been adjusted.
23 Without any prior approval
24 For e.g. export oriented units and units in export processing zones benefit of tax holiday (100 percent) for 5 years.
25 In free trade warehousing zones, FDI is permitted up to 100 percent.
26 The Foreign Investment Promotion Board is a one stop service center and facilitator for FDI.

companies engaged exclusively in scientific R&D with commercial applications.

Foreign trade also increased although its share in world exports remains low – 0.8 percent for merchandise exports (ranked 30) and 1.7 percent for services trade in 2004 (rank 16). In 2004 exports grew by 30 percent for merchandises to reach US$ 75.5 billion[27] and by about 70 percent for commercial services to reach US$ 39.5 billion (WTO, 2005).

Since the end of nineties the dynamism of services and high tech sectors have contributed to modernize the Indian economy and to boost international trade and investments. Policies implemented have been decisive to support information and communication technology industries as well as the pharmaceutical and biotechnology sector. Thus India became well known all around the world for its services and software activities. Between the beginning of nineties and 2005, computing and information technology services registered an annual growth rate of 8-9 percent. In 2005 it accounted for 5 percent of Indian GDP. Such dynamism created many jobs, gave confidence to entrepreneurs and attracted many MNCs which started to outsource their business process to India.

ECONOMIC REFORMS – SOME MILESTONES

Following are some of the measures taken by the government to boost the inflows of FDI in the country:

[27] Gems and Jewellery, engineering goods, petroleum products, ores and minerals, and chemicals and related products were key drivers of Indian exports.

1. Abolition of industrial licensing, except in few 'strategic' sectors.
2. Foreign Direct Investment up to 100 percent allowed in most sectors under the "Automatic Route"
3. Rationalization of both indirect and direct tax structure.
4. Portfolio investments by foreign institutional investors allowed in both equity and debt markets.
5. Rupee made fully convertible on trade account.
6. Removal of quantitative restrictions on imports.
7. Financial sector reforms and decontrol of interest rates.
8. The Fiscal Responsibility and Budget Management (FRBM) Act enacted in 2003

Box 3.3: Various incentive schemes for attracting FDI

Central Government Investment Incentives	• 100 percent profit deduction for developing, maintaining and operating infrastructure facilities. • Tax exemption of 100 percent on export profits for 10 years. • Deduction in respect of certain inter-corporate dividends to the extent of dividend declared. • Various capital subsidy schemes and fiscal incentives for expansion in the north eastern region. • Tax deduction of 100 percent on profits for 5 years and 50 percent for the next two years for undertakings in the special economic zones.
State Government Investment Incentives	• Single window approval system for setting up industrial units. • Electricity duty, registration fee, and stamp duty exemptions. • Reservation of plots for NRIs, EOUs and foreign investment projects. • Rebate on land costs, tax concessions and octroi refunds • Interest rate and fixed capital subsidy.

Box 3.4: Liberalisation of FDI policy

Pre 1991	1991	1997	2000	Post 2000
Allowed selectively up to 40 percent	Up to 51 percent under "Automatic Route" for 35 priority sectors	Up to 74 / 51 / 50 in 111 sectors under "Automatic Route", 100 percent in some sectors	Up to 100 percent under 'Automatic Route' in all sectors except a small negative list	More sectors opened, equity cap raised, conditions relaxed, foreign exchange management

Source: Compiled from Media Reports

SECTION 3.3

FINDINGS AND CONCLUSIONS

This chapter has examined the growth patterns and changing nature of Indian inward Foreign Direct Investment, with an emphasis on the post liberalization period, since FDI, along with trade, has been an important mechanism which has brought about a greater integration of the Indian economy with the world economy. The changing patterns reflect the growing investor confidence in the country.

India is growing at an average growth rate of close to 6 percent a year since 1980, with some evidence that growth is accelerating and can be sustained at 8 percent a year in the coming decades. With population of 1.1 billion in 2003, India presents a huge and fast growing domestic market for a range of goods and services, and thus export opportunities for producers in the rest of the world. Large and growing market opportunities in India are widely seen, as evidenced by the large flows of foreign direct investment, attractive both for production for the domestic market, and also to use exports to the rest of the World.

Inward FDI has boomed in post-reform India. The Indian government policy towards FDI has changed over time in tune with the changing needs in different phases of development. The changing policy framework has affected the trends and patterns of FDI inflows received by the country. At the same time, the composition and type of FDI has changed considerably. Even though manufacturing industries have attracted rising FDI, the services sector accounted for a steeply rising share of FDI stocks in India since the mid-nineties. Thus, although the magnitude of FDI inflows has increased, in the absence of policy direction the bulk of them have gone into services and soft technology consumer goods industries bringing the share of manufacturing and technology intensive among them down. In terms of investing countries, it can be noted that there is a high degree of concentration with more than 50 percent of the investment coming from Mauritius, U.S and Japan. Also, while FDI in India continues to be local "market seeking" in the first place, its world-market orientation has clearly increased in the aftermath of economic reforms. Thus while the growth of FDI inflows to India seem to be fairly satisfactory; India's share in the global FDI regime is still minuscule. This calls for further liberalisation of norms for investment by present and prospective investors. It underlines the need for efficient and adequate infrastructure, availability of skilled and semiskilled labour force, business friendly public administration and moderate tax rates.

Opening up the Indian economy and the resulting FDI flows have really created new opportunities for India's development and boosted the performances of local firms as well as the globalization of some of them. Such a trend has undeniably raised Indian's stature among developing countries.

However, the potential of the country to catch up the levels of the leading economies in the coming decades, often touched on, is not quite guaranteed. India has an extremely hard job to perpetuate its advantages, to achieve further productivity gains and to ensure that all segments of its population participate in the income growth.

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