CHAPTER - 1

INTRODUCTORY BACKGROUND AND THEORETICAL FRAMEWORK OF THE STUDY
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1. INTRODUCTION

Research on FDI is one of the most interesting topics in the area of international business and trade. FDI assumes lot of importance because it can influence many macro economic variables of a host country. It has its impact on employment, prices, exports, imports, exports, BOP, economic growth, competition, production etc.

FDI is now widely perceived as an important resource for expediting the industrial development of developing countries especially India because of the fact that it flows as a bundle of capital, technology, skills and some times even market access. Most of the developing countries, therefore, offer a welcoming attitude to MNEs that are usually associated with FDI. India’s case is a typical in this context. After following a somewhat restrictive policy towards international investment, India liberalized her FDI policy regime considerably since 1991 and this liberalization has been accompanied by changes in the sectoral composition, entry modes and sources of FDI.

The advantages of India as an investment destination rests on strong fundamentals which include a large and growing market, world class scientific, technical and managerial manpower, cost effective and highly skilled labour, abundant natural resources, a large english speaking population and an independent judiciary etc. This is now recognized by a number of global investors who have either already
established a base in India or are in the process of doing so. Ongoing initiatives, such as further simplification of rules and regulations and improvement in infrastructure are expected to provide necessary impetus to increase FDI inflows in future. The inflows of FDI would depend on domestic economic conditions, world economic trends and strategies of global investors. The government, on its part, is fully committed to create strong economic fundamentals and an increasingly proactive FDI policy regime. The positive efforts of the Government to improve the investment climate, including sustained improvement on the infrastructure front, have led to renewed optimism about India as an emerging investment destination.

In case of India, FDI is not a novel phenomenon. The MNCs with their variety of arrangements like FDI technology transfers, JVs and subsidiaries were present even at the time when India attained independence. The IPRs of 1948 and 1956 and subsequent policies have accorded special emphasis on the considerably increasing role of foreign funds in India.

With the changing world scenario during the beginning of the 1990’s, both in economic and political spheres, the Indian economy could not resist itself. Thus, in keeping pace with the outside world, it brought about some major changes in its economic and political system by opening up its economy. Major events like disintegration of USSR, unification of Germany, emergence of EU as a new economic power in the form of industrialized countries, had a great impact on all aspects of the Indian economy.

The GOI came out with a NEP in July 1991 aimed at procedural as well as structural overhaul of the economy, dismantling many of the economic barriers to pave the way for the foreign funds to pour in
mainly to establish the whole infrastructure and set up some new infrastructure that were required in future. The economic policy of 1991 among others aimed to bring about efficient monitoring and globalizing the economy on the capital front to attract maximum foreign capital. In general there are two main forms to bring in international investment into the country. They are FDI and FPI.

'FDI' represent one of the most important instruments through which a national economy can encourage production, know-how imports, increase in employment, infrastructure development, poverty reduction, etc. The benefits achieved through the increase in FDI's have created strong competition in the global market of free capital, all with the aim to attract as many and as diverse FDI as possible. The general trend in the global FDI market is the erasure of geographic borders between developing countries and developed ones as in the recent years, developing countries have not only represented a growing FDI market, but have also been aimed at attracting capital intensive investments, as well as R & D investments.¹

In the last decade after the initiation of the economic reform process, several new industries have emerged on the business horizons which were not heard of in the liberalization period. One such industry is the insurance industry. After opening up of this industry in the year 2000 to private and foreign insurers, its growth and reach has made it a fastest growing industries, not only in India but the world over with an astonishing growth rate. This can be gauged from the fact that the insurance business (measured in the context of first year premium)

¹ UNCTAD, The WIR - 2005. (The Overall Report for 2005 is based on Internationalization and Influx of R & D Investments in the Developing Countries).
registered an impressive growth of 94.96 per cent in 2006-07, surpassing the growth of 47.94 per cent achieved in 2005-06.2

2. REVIEW AND ANALYSIS OF CURRENT AND PAST STUDIES

In the light of the above discussion, this section undertakes a selective review and analyses of both theoretical as well as empirical studies undertaken (in India and in other countries) on FDI in general and FDI in Indian insurance sector in particular. This will facilitate in identifying some of the issues in this area.

Ramesh (1994)3 in a book entitled “Foreign Investment and Technology Transfer in Developing Countries” has tried to look at two important issues facing developing countries. Firstly, how to attract foreign investment and how to benefit from it. The study suggests that the understanding of motives and determinants of foreign investment, solving foreign investor’s problems and keeping the foreign investment policy clear and open, may help promote foreign investment in developing countries.

Wells et al. (1990)4 in a book namely “Marketing a Country: Promotion as a Tool for Attracting Foreign Investment” discusses the investment promotion functions and provides a rationale for successful promotion especially in developing countries. The authors conclude that image building, investor servicing and investment generation are still important. Also, it is proved that investment promotion has statistically significant influence on foreign investment flows.

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3 C, Chitrakar, Ramesh (2004); “Foreign Investment and technology transfer in Developing countries”, Avebury Ashgate Publications.
4 Louis T Wells, Jr and G, Wint Alvin (1990); “Marketing a country: Promotion as a tool for attracting Foreign Investment”, Washington.
Kamlesh (2006)\textsuperscript{5} in the book entitled “Foreign Direct investment: 1947 to 2007” gives a descriptive and analytical study of FDI trends and policies during post independence period. Specifically motives and determinants of FDI (both at sectoral and firm level), FDI Policy- 2006, implications and future outlook are also outlined in this book. The main observation of this study is that motives and determinants of FDI inflows in India differ from sector to sector and from country to country. Therefore, there is a need to have different FDI policies for different sectors. FDI Policies should be dynamic in character so that it keeps on adjusting automatically in response to the changing economic scenario. Also, further liberalization of imports and more privatization was another major suggestion of this study. However, this study is silent as to how transparency and further privatization and liberalization will be brought about.

Niti (2004)\textsuperscript{6} in an edited book on “Foreign Direct Investment”; gives an explanatory and analytical study of FDI trends and policies in the world and in India. This study also gives a comprehensive account of the emerging scenario of international trade and investment under the WTO regime, post-liberalization FDI policy of GOI and its effectiveness in the face of competitions from other Asian Countries, tax incentives to attract FDI inflows into India and further evaluates the FDI Policies of government pursued since the beginning of the economic reforms and charts out future course of action to compete with the world to attract FDI inflows. The main observation of this study is that the simplification and modernization of laws, rules and regulations, elimination of controls and bans, introduction of modern


\textsuperscript{6} Sury, Niti (2004); "Foreign Direct Investment"; New Century Publications, New Delhi.
and professional regulatory systems and other policy reforms result in greater gross domestic investment as well as increasing the flows of FDI.

Sahoo and Wadhwa, (1993)\textsuperscript{7} in the book titled “Foreign Investment Law and Policy in Select Developing Countries” covering twenty developing countries, contains information on different aspects of foreign investment law and policy including types of foreign investment, foreign exchange regulations, technology transfer, investment facilities, authority for approval of foreign Investment and approval procedures, areas offering opportunities for foreign investment and technology transfer, contact points etc.

Colin and Miao\textsuperscript{8} in an edited book entitled “Risk and Foreign Direct Investment” elaborately discussed the risk (as being major determinant) in the FDI and the various approaches to the incorporation of such risk, such as the Capital Assets Pricing Model (CAPM) and the real options approach. The study has clearly identified that the statistics for FDI and the estimates of the country risk shows a clear relationship. Given the range and the level of risk types, the study further identified that there is considerable home country bias in the investment worldwide.

Mathew (1998)\textsuperscript{9} in the book namely “Impact of Foreign Capital on the Indian Economy” has made a detailed study of the impact of foreign investment on indigenous economic structure of the recipient country and the costs and benefits involved in the process. Effects of

\textsuperscript{7} Debroy, B; Sahoo, Wadhwa, R.K (1993); “Foreign Investment Law and Policy in Select Developing Countries”; B. R Publishing Corporation, New Delhi.
\textsuperscript{8} White, Colin and Fan, Miao; “Risk and Foreign Direct Investment”.
\textsuperscript{9} Kurien K, Mathew (1998); “Impact of Foreign Capital on the Indian Economy”; People’s Publishing House, New Delhi.
foreign investment on the volume of domestic product, income, employment, foreign trade and BOP has been also dealt with.

**Dunning (1998)**\(^{10}\) in a book entitled “Globalization, Trade, FDI” describes and analyses the interface between trade, FDI flows and the activities of MNCs, as such is affected by and affects the level and pattern of globalization and in some cases regionalization. Besides this, the author examines the impact of globalization on the competitiveness (viewed from the perspective of both firms and countries) of a variety of regions and countries ranging from the EU and New Zealand to Taiwan and Ghana. This study also offers rich panoply of scholarly studies like changing role of trade and FDI in a globalizing economy and how the economies of the nation state and the economic policies of national government are becoming increasingly intertwined with each other.

**Manoj (1995)**\(^{11}\) in a book on “FDI in India: The Issues Involved” gives some definition of FDI, a brief overview of the changing pattern of FDI (particularly in the 80s and 90s), India’s foreign investment policy, policy on foreign collaborations followed during 80s, comparative assessment of foreign and domestically owned firms operating in India. Also, the issue of the relative export orientation of foreign and domestically owned firms is dealt with. The main recommendation was that as India liberalizes its policies to compete with other Asian countries, it must look at the policies these countries followed to see what it can and cannot do to encourage FDI.

**Singh and Kulkarni (2006)**\(^{12}\) in an edited book on “FDI and Economic Development” have highlighted in detail the increasing role

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10 John, Dunning (1998); “Globalization, Trade, FDI”; Elsevier Science.
11 Pant, Manoj (1995); “FDI in India: The Issues Involved”; Lancer Books.
of FDI in the economic development of a developing country like India. This study also focuses on the impact of globalization on the FDI. The main findings were that total inflow of FDI is short of the expected target, the SEZs should be developed as the most competitive destination for export related FDI in the world and infrastructure development and a strategic and more effective FDI policy by the government to target FDI in areas where the country has dynamic comparative advantage.

**Louis et al. (2001)** in an edited book entitled “Using Tax Incentives to Compete for Foreign Investment: Are They worth the Costs” have thrown the light on the use of various incentives to attract FDI. This original study suggested that non-availability of tax incentives have little effect on the flow of FDI. The governments can safely afford to withdraw incentives unilaterally without fear that this will drive desired foreign investment to other locations. Besides this, they have provided convincing evidence that tax incentives are not at all cost effective.

**Ifzal (2003)** in the Research Project on “Managing FDI In a Globalizing Economic: Asian Experiences” have taken six developing Asian Country (China, India, the Republic of Korea, Malaysia, Thailand and Vietnam) studies on FDI, preceded by a discussion of recent trends and the policy context for FDI and a comparative syntheses of the country studies. This project in the form of book compares and contrasts the countries' experiences in order to inform policy debate and decision making and to help guide ADB’s operations.

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13 Wells, Louis T; Allen, Jr Nancy J; Morisset Jacques and Neda Pirnia (2001); “Using Tax Incentives to Compete for Foreign Investment: Are They worth the Costs”; Washington, World Bank.

Kumar (2002)\textsuperscript{15} in the volume on “Globalization and Quality of FDI” has elaborately analyzed the quality of FDI and the factors that shape it. He argues that the development impact of various forms of FDI depends upon at least three factors namely; the access to new market abroad (especially for manufactured goods), the new knowledge brought in and the contributions to local technological capability building. This study also demonstrates that low-wages are not enough to attract quality investment even in manufacturing operations intended to serve home country markets.

Razin et al. (1999)\textsuperscript{16} in the research paper titled on “An Information Based Model of FDI: The Gains from Trade Revisited” examined the role of FDI in the financial markets of the host country. They argue that in the absence of a well developed domestic market, in which case domestic savings cannot be efficiently channeled into domestic investment, the FDI can play a double role. It provides a vehicle for reviving the domestic market through which domestic savings can be channeled to finance domestic investment and it supplies foreign savings on top of domestic savings to finance domestic investment. The second role provides the traditional gains from trade to the home country. The first role is by no means costless; as the equity market is characterized by asymmetric information, it does not always generate the correct signal about the social rates of return on domestic capital. As a result, Razin et al. argue that there are some welfare losses that offset some or all of the gains stemming from the mere channeling of domestic savings into domestic investment. When a well-developed

\textsuperscript{15} Kumar, Nagesh. K (2000); "Globalization and Quality of FDI"; Oxford University Press, New Delhi.

\textsuperscript{16} Razin, A, Sadka, E. and Yuen, C. W (1999); "An Information- Based Model of Foreign Direct Investment: The Gains from Trade Revisited; NBER Working Paper No. 6884.
domestic credit market exists (through which domestic savings can be channeled into domestic investment even in the absence of an equity market) then the first role played by FDI does not generate any gain. They concluded that when FDI can be levered domestically, the traditional gains from trade associated with the second role of FDI is severely curtailed. As a result, the total net effect of FDI on the welfare of the domestic economy could well be negative.

In a book entitled “Foreign Investment, Transnationals and Developing Countries”; Lall and Streeten (1977) examined in detail the ability of FDI to perform the function of providing capital for at least three reasons. First, direct investment is a relatively expensive source of foreign capital. Second, the actual capital inflow provided by the MNC may not be very large (FDI may be financed by borrowing in the host country). Indeed, MNCs can, through their market power, raise cheap funds and crowd out other socially desirable activities in the host country. Third, the capital contribution of the MNC may take the form of machinery or capitalized intangibles, such as know-how and goodwill. For these reasons, FDI provides little and expensive capital.

Yokova (2004) in his Ph.D thesis on “Foreign Direct Investment and Structural Changes as Factors in Transition: A Study of Central and European Countries” revealed the importance of upgrading of institutional infrastructure as a critical determinant, both for inbound FDI and for the structural transformation of Central and Eastern European economies which is needed, if they are to raise living standard. The evidence suggests that those countries which in May,

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17 Lall, S and Streeten, P. (1977); “Foreign Investment, Transnationals and Developing Countries”; London: Macmillan.

2004, became members of EC have imposed or offered the right incentive structures (or conditions) to FDI; while those offered by the latecomers in the transition process, for example; Romania, Albania and some of the Ex-Soviet Union Satellites, are attracting the least FDI. At the same time, relative to the availability and quality of location-bound resources and capabilities, the upgrading of institutions is likely to offer more incentives to foreign investors in the early stages of their structural transition.

Pradhan (2006) in one of the research paper on “Rise of Service Sector and Outward Foreign Direct Investment from Indian Economy: Trends, Patterns and Determinants” reviewed the recent trends and patterns and tries to identify determinants of such investment. At the firm level, the O-FDI behavior of service sector firms was observed to be non-linearly related to the firm age and size, both relationships following inverted U-shaped curves. Firm’s innovation, export orientation and profitability were also found to be important explanators in the rise of O-FDI at the firm level. The import of capital goods however appeared to have a negative impact on trans-border expansion of service sector firms.

Ningombam, Jayanti (2007) in one of the article entitled “Globalization and FDI in North east India: A Perspective” has made an attempt to highlight the constraints faced by the North East Region (NER) consisting of eight states viz Assam, Auranchal Pradesh, Manipur, Meghlaya, Mizoram, Nagaland, Tripura and Sikkim; focused on the emerging patterns and trends in the inflows of foreign

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20 Ningombam, Jayanti (2007); “Globalization and FDI in North east India: A Perspective”; June, Banking Finance, pp. 15 --18.
investment particularly FDI in North-East in the wake of economic liberalization initiated in 1991. The findings show that the FDI has been concentrated in relatively developed states. According to the author, the NER which is at lower stage of development is characterized by extremely attractive scenario yet investment both domestic and foreign is not North-East friendly due to ‘crowding out theory’ does not work in the region. This article suggested that in the absence of public investment mere opening of the region to the global capital flows will further increase disparities. The reactivation of public investment on the basis of appropriate structure of accountability is, therefore; the need of the hour.

Chary and Gangadhar (2006) in a research paper entitled ‘Foreign Direct Investment: A Study of India and China’ reviewed and analyzed the variations in economic determinants of selected developing Asian economies vis-à-vis FDI between India and China. On the basis of analysis of selected FDI Indicators of China and India, it was inferred that China performed better than India. China’s FDI as inward FDI Stock, FDI as percentage of GFCF and FDI stocks as a percentage of GDP are higher as compared to India during the period 1990 to 2004, making it more attractive for market-seeking FDI. According to them, China has played a successful role in attracting FDI for the benefit of her economy, whereas India is lagging far behind. They concluded that major determinants, why China attracts high flows are: more business-oriented policies, easier FDI procedures, competitive physical infrastructure, flexible labour laws, a better labour climate and better entry-exit procedures for business entities. They further concluded that the reasons why India has low FDI flows are:

21 Chary and Gangadhar (2006); “Foreign Direct Investment: A Study of India and China”.

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bureaucratic tangle for example, anti-FDI lobby, Infrastructural
drawbacks, labour inefficiency and unrest, lesser tax incentives,
procedural disputes, non-implementation of appropriate projects,
political instability, corruption, and red-tapism.

Kwon, Yung-Chul\textsuperscript{22} in a research paper on "Effects of Vertical and Horizontal FDI Projects on a Host Country’s Economy: Trade and Local Linkages" examined the effects of an FDI on a host country’s trade balance and the local-linkages relative to various types of FDI Projects i.e. vertical FDI projects vs. horizontal FDI projects. It was assumed that the effects of FDIs on the host country’s economy are different with regard to a vertical and horizontal FDI projects. Based on 108 FDI projects undertaken by Korean firms, it was found that vertical investment projects have a greater effect on both, the export-creation and import-creation than with horizontal investment projects. Horizontal foreign investment projects, however, have a greater effect than vertical foreign investment projects with respect to local linkages. These findings suggest that the host government’s policy (e.g., incentives or regulations) towards inward FDIs should be differentiated by the types of FDI projects based on different contributions made to the host country’s economy.

In a paper entitled “Global FDI: Changed Scenario in the 90s” Badar Alam (1999)\textsuperscript{23} tried to examine the trend of global FDI flow to different regions of the world especially South Asia (India). He illustrated that between 1989 and 1992, FDI flows to developed world have gone down by more than 50 per cent but FDI flows to developing

\textsuperscript{22} Kwon, Yung-Chul; “Effects of Vertical and Horizontal FDI Projects on a Host Country’s Economy: Trade and Local Linkages”, Foreign Trade Review.

\textsuperscript{23} Iqbal, Badar Alam (1999); “Global FDI: Changed Scenario in the 90s”, Prabandh, April-December.
world did register a faster rate of growth. The major and most vital factor responsible for this rise in FDI flows to developing world has been the initiation of economic reforms in different regions.

Bharathi and Parthipan (2007) in a paper on “A Comparative Study on FDI with Particular Reference to India and China” have made a comparative analysis of the FDI from the various countries and their MNCs into India and China over the period 2001 - 2005. The basic premise of the study was to bridge the long gap between the two countries in attracting non-debt creating FDI flows, which fundamentally looks into their FDI-attracting potentials. The study aimed to bring out the possible factors for China’s success in attracting FDI inflows. It tried to find the reasons for China’s successes and India’s weaknesses to capitalize on opportunities. Thus, an attempt has been made in this study, to explore the pattern of FDI inflows by the corporates into these two countries and their comparisons. The study also analyzed the general investment scenario to justify the differences and finally to take home complimentary and critical observations for our country. The study mainly focused on areas where it is possible for India to attract larger FDI inflows provided appropriate specific and generic MNC-friendly policies are put in place. Thrust has been given to areas like real-estate growth, export-oriented businesses, and the successful Chinese model of SEZs. The study emphasized the synergy of both the Government and private sector in framing and aiding the FDI process. On the basis of an extensive examination of the Indian and Chinese data, this study concludes that India falls short of China in all these respects. This study recommends the Indian government to

redesign its policies in each of these directions. Some of the other recommendations include desirable infrastructure facilities, relaxation of SSI regulations, lower commodity and utility prices, lower indirect taxes, lower import duties on raw materials, fiscal and other fillips to encourage some specific types of investment, incentives for new business promotion, harmonization of government policies and reduction of red-tapism.

Ramamurthy and Subramanian (2007)\textsuperscript{25} in the paper titled “FDI: India Vs. China (A Comparative Analysis - Sector-Wise With a Global Perspective)” stated that India and China are two emerging economies, one with a U - shaped growth and the other with a V - curved one, but both have a long way to go in fulfilling their agendas. According to authors presently, China is ahead of India in mobilizing inflows through FDI, but the scenario is fast changing. The facts and figures also showed a growth trend in FDI inflow in almost all sectors of the growth component. The authors concluded that the key issues which facilitated and attracted FDI inflows into India and probably the issues which make a withdrawal from China, and also the contributory factor of attracting investments in both the countries, needs to be debated upon.

Nalsar and Prasad (2007)\textsuperscript{26} in a paper titled “FDI and the Legal Profession in India” have made an attempt to look at the consequences of allowing FDI and foreign collaboration in the legal services sector in India. Most sectors of the Indian economy are now at least partially open to foreign investment, with certain exceptions. The Indian government continues to prohibit or severely restrict FDI in certain


\textsuperscript{26} Shilpi, Nalsar and Priti Prasad (2007); “FDI and the Legal Profession in India”; Delhi Business Review X Vol. 8, No. 1, January - June.
politically sensitive sectors, such as agriculture, retail trading, railways and real estate. According to them some sectors still require government approval. Within the global economy, the significance of trade in services currently amounts to well over two trillion US dollars, a sixth of total world trade. Thus, in this paper an attempt was made to analyze the whole question from the views of the lawyers.

Pateria (2007) in the paper titled “The Economics of FDI - Incentives” suggested that the use of investment incentives focusing exclusively on foreign firms, although motivated in some cases from a theoretical point of view, is generally not an efficient way to raise national welfare. The main reason is that the strongest theoretical motive for financial subsidies to inward FDI Spillovers of foreign technology and skills to local industry is not an automatic consequence of foreign investment. The potential spillover benefits are realized only if local firms have the ability and motivation to invest in absorbing foreign technologies and skills. To motivate subsidization of foreign investment, it is therefore necessary, at the same time, to support learning and investment in local firms as well.

Mohanty (2007) in a paper on “Examining Challenges of Liberalization in the Context of Poverty and Development” has highlighted that globalization has affected the various economies of the World differently. However, globalization has not worked for many poor countries of the world. According to author, IMF and WTO have mismanaged the process of privatization, liberalization and stabilization that many third world countries now are actually worse off than they

were before. Various factors such as social set up, internal conditions, political stability/instability, formulation and proper implementation of policies etc. by the government greatly affect the FDI inflows and hence economic development of a country. He suggested that in order to increase the economic development, India should follow the example of China. For instance, in the case of China, the cheaper labour rate, open-up of policies have attracted foreign capital & the MNCs have largely invested in the manufacturing firms/units that not only boosted China’s export but also provided the protection to domestic industries. It has not only accelerated the economic development but has made China one of the ‘Economic Giants’ in the World. Whereas in case of India, social diversity, political instability, wrong planning, wrong policies of the government and their improper implementation, bureaucracy, corruption, red tapism, under performance etc. have all resulted in less FDI and hence, the slower pace of economic development as compared to China. To increase the pace of economic growth in India, these trends must be changed.

M. Karunakar (2007)\(^29\) in a study on “The Dynamic Facets of Globalized Insurance Industry - Trends and Prospects” looked into the insurance sector in India is at the threshold of widespread growth. With a reportedly annual growth rate of 15-20 per cent and the largest number of life and non-life insurance policies are in force, the potential of the Indian insurance industry is huge. In this paper an attempt has been made to discuss the current state of global insurance industry, the role of regulatory body on this sector, relevance and role of Bancassurance, the emergence of Micro-insurance and growing

opportunities in the globalized insurance Industry.

Mann and Lalit (2007)\textsuperscript{30} in a paper on “India Shining: Investment Destination for Retail Segment” have made an attempt to compare and understand the flow of Foreign Investment in India. A threadbare discussion has been made on factors affecting FDI in Indian Retailing Sector, and factors against the FDI in retail. This paper suggests that, India needs today to lessen the rural – urban divide. This can be done through the help of big pocket entrepreneurs entering the country.

Sahoo (2006)\textsuperscript{31} in the paper namely “Foreign Direct Investment in South Asia: Policy, Trends, Impact and Determinants” concluded that there has been a positive change in policies with regard to FDI with efforts directed more towards bilateral trade agreements and providing investment incentives to foreign investors in all South Asian countries (India, Pakistan, Bangladesh, Sri-lanka and Nepal). However, there are still procedural delays, reserved industries where foreign investors are not allowed to invest and ceilings in many industries/sectors in each of these countries. This study showed that the basic indicators, including infrastructure, in all above five South Asian countries lack adequate infrastructure facilities and governance. Thus, more effective public investment on economic and social infrastructure, along with stable economic policies to create an enabling environment, would attract more foreign direct investment. Analyses of FDI flows to South Asian countries revealed that there has been an increasing trend of FDI into South Asian countries. However, apart from India, the share as well as the absolute volume of FDI inflow to these countries is negligible. An

\textsuperscript{30} Puja Walia Mann and Lalit Asija (2007); “India Shining: Investment Destination for Retail Segment”; Delhi Business Review X Vol. 8, No. 1, January - June.

\textsuperscript{31} Pravakar Sahoo (2006); “Foreign Direct Investment in South Asia: Policy, Trends, Impact and Determinants”; ADB Institute Discussion Paper No. 56, November.
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analysis of FDI inflows to different sectors shows that FDI is largely domestic market oriented in India and Pakistan, whereas it is concentrated in a few export-oriented industries in Sri Lanka and Bangladesh. The results of FDI impact on growth show that FDI has a positive and significant impact on growth for four south Asian countries. Therefore South Asian countries need to improve their domestic investment, exports and infrastructure facilities, along with more foreign investment, to achieve higher growth. Further, FDI has a positive impact on export growth through its positive spillovers for South Asian countries. Though FDI does not affect domestic investment in the current period, it has a positive and significant impact affect over time through dynamic effects.

The results of panel co-integration estimation reveal that FDI and all its potential determinants have a long run equilibrium relationship. According to this study the major determinants of FDI in South Asia are market size, labor force growth, infrastructure index and trade openness. Authors suggested that overall South Asian countries need to maintain growth momentum to improve the market size, frame policies for better use of the abundant labor force, improve infrastructure facilities and follow more open trade policies to attract increased FDI.

Haskel et al. (2007) in a paper on the topic “Does Inward FDI Boost the Productivity of Domestic Firms?” examined the productivity spillovers from FDI to domestic firms and if so, how much should host countries be willing to pay to attract FDI? To examine this issue they used a plant-level panel covering U.K. manufacturing from 1973 through 1992. Consistent with spillovers, they estimated a robust and

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significantly positive correlation between a domestic plant's TFP and
the foreign-affiliate share of activity in that plant's industry. Typical
estimates suggested that a 10-percentage-point increase in foreign
presence in a U.K. industry raises the TFP of that industry's domestic
plants by about 0.5%.

Li and Moshirian (2003) in a paper entitled “International
Investment in Insurance Services in the US” analyzed and discussed the
determinants of FDI in insurance services in the US. This study
demonstrates that solid economic fundamentals in the host countries
are the major factors which attract FDI in insurance services, while the
uncertainty of the international exchange market increases the
investment risk and reduces foreign investors' willingness to invest.
The empirical results of this study indicate that NI, the source countries’
insurance market size and financial development of the host countries
contribute to the expansion of FDI in insurance services, while the
relatively higher wages and higher cost of capital in the host countries
discourage FDI in insurance services. The empirical results also suggest
that FDI in insurance services complement FDI in banking as well as
total trade in insurance services.

Li et al. (2003) in the article on the theme “The determinants of
Intra-Industry Trade (IIT) in Insurance Services” have analyzed and
measured the magnitude and determinants of IIT in insurance services
for the United States. The empirical results of the determinants of IIT
indicate that FDI in insurance services is a significant contributor to the

33 Donghui Li and Fariborz Moshirian (2003); "International Investment in Insurance Services in
the US"; [accessed online at http://www.sciencedirect.com/science? Ob=article URL &
udi=86VGV-4B7D938-1], December.
34 Donghui Li; Fariborz Moshirian and Ah-Boon Sim (2003); “The Determinants of Intra-
Industry Trade in Insurance Services”; The Journal of Risk and Insurance, 2003, Vol. 70, No. 2,
269-287.
volume of trade in insurance services. These empirical findings confirm the new theoretical trade models that, unlike the traditional trade theory that considered trade and FDI in insurance services as substitutes, trade and FDI complement each other and hence multinational insurance companies are contributing to an increase in the volume of trade in insurance services. Furthermore, this study shows that trade intensity between the United States and its trading partners leads to product differentiation in insurance services and hence an increase in consumer welfare.

Pradhan (2007)\textsuperscript{35} in the paper namely "Are the Asian FDI Inflows Co-integrated with the Indian FDI Inflows? Empirical Research Findings" investigated the linkage of FDI inflows between India and four other Asian countries, viz., Japan, Hong Kong, Singapore and Malaysia. The empirical investigation follows annual data of FDI inflows during 1970-71 to 2004-05. The technique employed for the same is co-integration test, which is followed by the unit root test. The empirical results clarify that FDI inflows of four Asian countries along with India, have a unit root at the level data, but found to be stationary at the first difference level. The cointegration test finally confirmed that the FDI inflows of four Asian countries are cointegrated with India's FDI inflows. The implication of this finding is that the FDI inflows of India can be used to predict the FDI inflows of Japan, Singapore, Hong Kong and Malaysia.

In the paper on the theme "Foreign Direct Investment and Growth in India: A Cointegration Approach"; Chandana and Parantap

(2002) explored the two-way link between FDI and growth for India using a structural co-integration model with Vector Error Correction Mechanism. The existence of two co-integrating vectors between GDP, FDI, the unit labour cost and the share of import duty in tax revenue is found, which captures the long run relationship between FDI and GDP. A parsimonious Vector Error Correction Model (VECM) is then estimated to end the short run dynamics of FDI and growth. Their VECM model reveals three important features: (a) GDP in India is not Granger caused by FDI; the causality runs more from GDP to FDI; (b) Trade liberalization policy of the Indian government had some positive short run impact on the FDI inflows and (c) FDI tends to lower the unit labour cost suggesting that FDI in India is labour displacing.

Blomstrom and Kokko (2003) in the paper entitled “Human Capital and Inward FDI” concluded that there is potential for significant 'spillover effects' from FDI into host countries. They identified some limitations of this potential, however, to do with the stock of human capital, the interest in local firms of promoting skills transfer and the competition environment. They proposed that an analysis of the type of FDI flowing to different regions and countries could provide clues to the potential for maximizing the gains to local skills accumulation.

Palit and Nawani (2007) in the research paper on “Technological Capability as a Determinant of FDI Inflows: Evidence from Developing Asia and India” made an attempt to explain the

38 Amitendu, Palit and Shounkie, Nawani (2007); “Technological Capability as a Determinant of FDI Inflows: Evidence from Developing Asia and India”; ICRIER, Working Paper No.193, April.
Introductory Background and Framework of the Study

country-wise variations in the pattern of FDI flows to developing Asian economies by empirically identifying location specific features influencing such flows. The paper argues that some countries in the region, which have developed long term sources of comparative advantages in the form of superior technological capabilities and supporting infrastructure, have consistently attracted greater volumes of export-oriented FDI. These attributes are also crucial for explaining the steady improvement in FDI flows to India. The paper suggests that with production processes becoming increasingly complex and technology-intensive, developing countries like India, must devote greater attention to the development of R&D and frontier technologies, failing which, they might lose out in the race for FDI.

Bajpai and Sachs (2000)\textsuperscript{39} in the paper entitled “FDI in India: Issues and Problems” have attempted to identify the issues and problems associated with India’s current FDI regime and more importantly the other associated factors responsible for India’s unattractiveness as an investment location. Despite India offering a large domestic market, rule of law, low labor costs, and a well working democracy, her performance in attracting FDI flows has been far from satisfactory. This study observed that a restrictive FDI regime, high import tariffs, exit barriers for firms, stringent labor laws, poor quality infrastructure, centralized decision-making processes, and a very limited scale of EPZs make India an unattractive investment location.

Bloodgood (2007)\textsuperscript{40} in a project report on “Competitive Conditions for Foreign Direct Investment in India” examined FDI in

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\textsuperscript{40} Laura Bloodgood (2007); “Competitive Conditions for Foreign Direct Investment in India”; Cornell University, Key Workplace Documents Federal Publications.
India (country-wise and industry-wise), in the context of its economic and regulatory environment. This study also discusses specific investment activities of multinational companies in India, representing a wide range of countries and industries. To illustrate the driving forces behind these trends, the study also discusses the investment climate in India, Indian government incentives to foreign investors, particularly SEZs, the Indian regulatory environment as it affects investment, and the effect of India's global, regional, and BTAs on investment from the US and other countries. Finally, the study presents two case studies. The first one examines global FDI in India's automobile industry and the second one analyzes the effects of India's 2005 Patent law on FDI in the pharmaceutical industry.

In a detailed study by Nayak and Dev (2005) on the topic "Low Bargaining Power of Labour Attracts FDI to India" has looked into the question that whether there exists any nexus between the bargaining power of labor and the flow of FDI? because in the present era of economic liberalization due to disempowerment of labor—numerical decline of the organized workforce, weakening of trade unions and the consequent decline in the bargaining power of labor have become quite visible. This study suggests that notwithstanding low and declining capital-output ratio and high labor efficiency as the obvious determinants of increasing FDI flow, the Indian scenario suggests that FDI flows to the destinations where workers have a low and declining bargaining power.

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Banga (2006) in one of the empirical paper on "The export-diversifying impact of Japanese and US FDI in the Indian Manufacturing Sector" highlighted the export-diversifying impact of FDI in a developing country. According to him, FDI may lead to export diversification in the host country if it positively affects the export intensity of industries that have a low share in world exports. Indirectly, FDI may encourage export diversification through spillover effects: that is, the presence of FDI in an industry may increase the export intensity of domestic firms. The empirical results for the Indian economy in the post-liberalization period show that FDI from the US has led to diversification of India and its exports, both directly and indirectly. However, Japanese FDI has had no significant impact on India and its exports.

In one of the paper namely “Impact of Trade Liberalization on Foreign Direct Investment in Indian Industries” by Bishwanath and Banga, undertook analyses at three levels and the results arrived at different levels indicate that trade liberalization has had a favourable effect on FDI flows in India. It was also found that the regions having greater extent of international trade are able to attract greater amount of FDI. They concluded that although liberalization has led to a substantial increase in intra-industry trade, much of the intra-industry being horizontal in nature in India is not found to have a strong favourable effect on FDI.

In one of the study on “Performance Differentials between Indian and FDI Companies in India: Some Explanations” by Denis (2005), it was found that FDI companies outplayed Indian companies in performance and also that the differences between the two widened over the years. Using literature on the relationship between conduct and performance, and expected outcome of policy changes—the observed performance differentials were explained in terms of R&D intensity, advertising intensity, vertical integration, salaries and wages intensity, export intensity, and import intensity. It was found that all of them, except import intensity does influence profit margin of Indian companies. However, salaries and wages and export intensity had negative influence. In contrast to this, only advertisement and salaries, and wages intensity were found to negatively influence profit margin of FDI companies and vertical integration had positive influence.

Research paper entitled “Foreign Capital Inflows into India: Determinants and Management” by Soumyen (2005) provides a comprehensive review of the issues relating to external capital flows into India during the post-liberalization period. It then delineates the major policy issues arising out of the various concerns. The paper illustrates the differential impact of different types of capital inflows through an extension of standard Mundel-Fleming Analysis. The conclusions are: (1) an increase in FPI causes currency appreciation and contraction in output and (2) an increase in FDI may lead to a rise in income if the direct plus indirect (crowding in) effects are strong enough. This contrasts with the Standard Mundell-Fleming model.

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45 Sikdar, Soumyen (2006); “Foreign Capital Inflows into India: Determinants and Management”; INRM Policy brief No. 4, ADB.
where additional capital inflow is always contractionary because it leads to a fall in net exports through currency appreciation.

Qian et al. (2002)\textsuperscript{46} in a research paper entitled "Determinants of foreign direct investment across China" have analyzed the spatial and temporal variation in FDI among China's 30 provinces from 1986 to 1998. After examining changes in importance of FDI determinants through time, they found that the cumulative FDI relative to cumulative domestic investment has a negative impact on the new FDI. It was suggested that provincial officials have to improve the investment environment; otherwise, MNCs may choose to invest in provinces with fewer FDI competitors. However, it explains the FDI distribution in the coastal provinces better than it does for Central and Western provinces.

Mathiyazhagan (2005)\textsuperscript{47} in one of research paper namely "Impact of FDI on Indian Economy: A Sectoral Level Analysis" examined the long-run relationship of FDI with the Gross Output (GO), Export (EX) and Labour Productivity (LPR) in the Indian economy at the sectoral level by using the annual data from 1990-91 to 2000-01. The study uses the Panel Co-integration (PCONT) Test and the results demonstrate that the flow of FDI into the sectors has helped to raise the output, labour productivity and export in some sectors but a better role of FDI at the sectoral level is still expected. Results also reveal that there is no significant co-integrating relationship among the variables like FDI, GO, EX and LPR in core sectors of the economy. This implies that when there is an increase in the output, export or labour productivity of the sectors it is not due to the advent of FDI. Thus, it was concluded that

\textsuperscript{46} Sun, Qian, Tong, Wilson, and Yu, Qiao (2002); "Determinants of Foreign Direct Investment Across China"; Journal of International Money and Finance 21, pp.79-113.

\textsuperscript{47} Mathiyazhagan, Maathai K. (2005); "Impact of FDI on Indian Economy: A Sectoral Level Analysis"; ISAS Working Paper, No.6, November, 17, Singapore.
the advent of FDI has not helped to yield a positive impact on the Indian economy at the sectoral level. Thus, the major suggestion of this study was that in the eve of India's plan for further opening up of the economy, it is advisable to open up the export oriented sectors so that a higher growth of the economy could be achieved through the growth of these sectors.

In a paper entitled, "Foreign Investments - Evidences from South and East Asian Economies"; Juan Pinero et al (2007) examined whether FDI inflows in South and East Asian economies posses any barriers which are deterring to attract FDI of their actual potential? If so, what are those various set of barriers? These questions are addressed in this study using cross section time series data for 17 South and East Asian economies from 1996 to 2005. They coined the term 'quality of FDI' which is a function of higher per capita FDI inflows, lower volatility in FDI inflows and higher bilateral investment treaties between the host country and rest of the world. They tested this against the possible set of barriers, including, socio-economic, labour, policy and institutional barriers using pooled regression analysis. Their overall empirical evidence suggests that all the possible set of barriers have a negative effect in stimulating the 'quality of FDI'. There is an urgent need for South and East Asian economies to address these set of barriers which are acting as stumbling block in not allowing to attract FDI of their actual potential.

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48 Chousa, Juan Pinero; Vadlamannati, Krishna Chaitna; Aristidis, Bitzenis P. & Tamazian, Aristidis (2007); "Foreign Investments - Evidences from South & East Asian Economies"; University of Santiago Decompostela, Spain.
Juan Pineiro et al. (2008)\textsuperscript{49} in the paper namely “Does Growth and Quality of Capital markets Drive Foreign Capital? - The Case of Cross-Border M and As” examined the interrelationship between firm level FDI in the form of cross border M and As and capital markets growth and quality. They addressed this question using panel data of cross border M and As for nine emerging economies. The study period goes from 1987 to 2006. They found that the stock market variables, viz., capitalization and value addition encourage the number of deals and value of cross border M and As. However, the association with regulatory and financial reforms is much stronger and robust. After interacting both the stock market variables with financial and regulatory reforms variables, they found coefficients proved to be higher than other variables, suggesting that higher reforms in capital markets could increase firm level FDI. Moreover, the results are found to be extremely robust when they replaced stock market variables with squared values of the same, reiterating the fact that larger is the growth, greater is the inflow of firm level FDI in the form of cross border M and As.

Prasada and Satyanarayana (2007)\textsuperscript{50} in a research paper on “the Rising Trends of the Insurance Industry in India” focused on the changing scenario of the insurance industry, its challenges and the strategies to offset the current challenges of the Indian insurance industry. Their study showed that the success of the insurance industry depends upon meeting the rising expectations of the consumers, who are the real kings in the liberalized insurance market. Their study


\textsuperscript{50} Rao, S.S Prasade & Chary, T. Satyanaryana (2007); “The Rising Trends of Indian Insurance Industry”.

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concluded that Life insurance products, have to compete with saving and mutual funds; hence should offer various dimensions of risk, return and flexibility, so that they can be linked to stock market indices, inflation, etc making them more competitive and appropriate for risk/return appetite of different investors, as at present there are no such products.

Banga, (2003)\textsuperscript{51} in a paper entitled “Impact of Government Policies and Investment Agreements on FDI Inflows” has first analysed aggregate FDI inflows to fifteen developing countries of South, East and South East Asia for the period 1980-81 to 1999-2000. Separate analyses are then undertaken for FDI from developed and developing countries. The results based on random effects model show that fiscal incentives do not have any significant impact on aggregate FDI, but removal of restrictions attracts aggregate FDI. However, FDI from developed and developing countries are attracted to different selective policies. While lowering of restrictions attract FDI from developed countries, fiscal incentives and lower tariffs attract FDI from developing countries. Interestingly, BITs, which emphasize non-discriminatory treatment of FDI, are found to have a significant impact on aggregate FDI. But it is BITs with developed countries rather than developing countries that are found to have a significant impact on FDI inflows to developing countries.

Chaitanya (2005)\textsuperscript{52} in a research a paper entitled “Liberalization, Privatization and Globalization of Insurance Sector in India” studied the general scenario of Indian insurance sector. The author emphasized that insurance sector was thrown open to private players to strengthen

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the forces of competition and high growth rate over 20 percent and over 18 percent respectively in life insurance and non-life sector was only due to reforms in this sector. The main observations of his study were that the biggest challenge before this industry is the turbulence market place and excess competition on many fronts.

Rao (2006) in a written article on “Insurance: Issues and Challenges” has studied the Indian insurance sector in general. Author emphasized that during the last five years, the Indian insurance industry has undergone dramatic changes. According to the author, there is enormous scope and potential for the insurance industry to provide health insurance in India. The General insurers have to come out with innovative products in the personal lines if they are to expand business. Some of the untapped areas include long term health policy, and professional liability insurance annuities and pensions related products to meet the growing needs of the ageing population. This comprehensive study further pointed out the following issues and challenges:

a. Due to demographic change in India, companies have to provide products and services with what is available in advanced countries;

b. Matching Asset-liability;

c. Falling interest rates would pose a great challenge to the shortfall between pay - outs and expected returns from investments. The industry has to develop advanced skills in this area including the use of modeling techniques;

d. To put in place basic infrastructure before de-tariffied regime is affected. This would include upgrading underwriting skills of the underwriters, using IT systems, ways and means to protect the policyholders, scientific and adequate pricing of covers, etc.

e. For outsourcing purposes managing relationship with external vendor

The author suggested that the industry needs to focus on building their capability and capacity and this will be fulfilled only when the expertise is developed in the areas of underwriting, asset/liability management, investments, strategic management, actuarial expertise and IT. It was also suggested that providing insurance to low income households by minimizing transaction cost will be a key challenge before this industry.

In an article on the topic entitled “Indian Insurance Industry-Overview” by the Editorial team of Yojana,\textsuperscript{54} has presented an overall position of Indian insurance industry in the post-liberalization period by analyzing the parameters like insurance penetration, insurance premium, insurance density, customer satisfaction and investment in infrastructure and social sector. This article emphasized that overall this industry witnessed the beneficial effects of competition in the insurance sector in the post liberalisation period. In this period, life insurance is growing faster as compared to non-life on the one hand and on the other customer service is one of the important areas that witnessed the most significant change. This article concluded that, best international practices in service and operational efficiency through use of latest technologies, need based selling and professional advice to the

\textsuperscript{54} Indian Insurance Industry- Overview (2006); Yojana- A Development Monthly (English) with inputs from Conference on Insurance organized by FICCI, April, pp. 10 - 16.
customer through trained sales force and advisors, is bound to make a significant impact in the Indian insurance industry.

Lipson (2001) in a note on “GATS and Trade in Health Insurance Services” provides a background on the treatment of health insurance services by the GATS of the WTO and explains the relevance of current GATS negotiations for health insurance trade. It reviews some of the issues addressed in current GATS negotiations and their potential implications for market access commitments covering health insurance. It concludes by reviewing the opportunities, risks and challenges presented by GATS for national policies and regulations affecting health insurance. Further, this study points out that the entry of foreign suppliers makes it more urgent for countries to create an effective regulatory framework and build capacity to enforce those regulations, for the health insurance sector. Until such a system is in place, it could be harmful for developing countries to make full binding commitments in the health insurance sub-sector under GATS financial services schedules.

Joshi (2003) in one of the article namely “Insurance Sector Reforms in India: the Emerging Scenario” has pointed out that the insurance industry in India today has a few enigmatic features. It is very old and yet it is new. Insurance traces its origin in the ancient Aryan period and has reinvented itself in the year 2000. This study also explains that it has awe-inspiring history besides setting itself on a fast track for awesome growth in the first decade of the new millennium. This study further elaborately explained how insurance sector reforms

55 Debra J. Lipson (2001); “GATS and Trade in Health Insurance Services”, Background Note for WHO Commission on Macroeconomics and Health; Working Group, June 4, Geneva, Switzerland.

56 Joshi, N. N (2003); “Insurance Sector Reforms in India: the Emerging scenario”.
have changed the face of Indian insurance sector. This article concludes that reforms in insurance sector had a favourable impact on this sector.

Kapoor (2003)\textsuperscript{57} in the article entitled "Issues and Challenges facing the Insurance Industry" remarks that Indian insurance industry has opened wide opportunities for service and infrastructure sectors. The author stated that the some of the major challenges that have to be addressed for channelising growth of insurance sector are product innovation, distribution network, investment management, customer service and education. He further pointed out that the competition will result in the market to grow beyond current rates and offer additional consumer choice through the introduction of new products, services and price options. This article further suggests that development of industry code of conduct, contributing to a common catastrophe reserve fund and chalking out agreement to settle claims to the benefit of consumer can be expected with concentrated efforts from all the players. These steps go in the long way for smooth functioning of this industry.

Joshi (2003)\textsuperscript{58} in an article on, "Changing Mindset of professional Agents in the Emerging Insurance Scenario in India" has examined that the insurance industry in India is currently undergoing a major change with the induction of competition. The industry is at the threshold of a revolutionary change of environment which will have a significant impact on its various constituents like suppliers, sellers, service providers and consumer of insurance products and services. This study suggests that it would be desirable that this revolutionary change

\textsuperscript{57}Kapoor, T. (2003); "Issues and Challenges Facing the Insurance Industry".
\textsuperscript{58}Joshi, N. N (2003); "Changing Mindset of Professionals Agents in the Emerging Insurance Scenario in India".
process is harnessed effectively to serve sharing benefits of insurance companies and agents together.

In the paper "Popular Attitudes, Globalization and Risk"; Noland (2004) has tried to throw light on the issue of popular opposition to globalization. According to the author this may be interpreted as xenophobia or hostility to market economics and signal country risk, including the degree of security risk—the possibility that local staff or facilities could be subject to discriminatory treatment, harassment, or attack. This paper integrates the few global attitudes data into a series of economic models on FDI, sovereign ratings, and local entrepreneurship and finds that some responses correlate with economic variables of interest, conveying information beyond what can be explained through standard models. This paper concluded that more tolerant countries attract more FDI, obtain better ratings, and exhibit more entrepreneurship.

Ivar and Espen (2004) in a study on "Determinants of Foreign Direct Investment in Services" used industry level FDI data from 57 countries 1989-2000, to examine the host country determinants of FDI flows in services as a whole and in the major service industries. Consistent with the observation that many services are non-tradable, they found that service FDI is market-seeking and unaffected by trade openness. Producer services are important in binding together vertically disintegrated chains of production, accordingly they found a strong correlation between FDI in manufacturing and FDI in finance and transport.

60 Kolstad, Ivar and Vllanger, Espen (2004); "Determinants of Foreign Direct Investment in Services"; Chr Michelsen Institute, Working Paper No. 2, Norway.
Bordo and Meissner (2007) in a study on “Foreign Capital and Economic Growth in the First Era of Globalization” explored the association between economic growth and participation in the international capital market. In standard growth regressions, they found mixed evidence of any association between economic growth and foreign capital inflows. Taking a balance sheet perspective on crises and exploring other determinants of debt crises and currency crises including the currency composition of debt, debt intolerance and the role of political institutions, they argued that the set of countries that gained the least from capital flows in terms of growth outcomes in this period were those that had currency crises, foreign currency exposure on their national balance sheets, poorly developed financial markets and presidential political systems. They further suggested that countries with credible commitments and sound fiscal and financial policies avoided major financial crises and achieved higher per capita incomes by the end of the period despite the potential of facing sudden stops of capital inflows, major current account reversals and currency crises that accompanied international capital markets free of capital controls.

Tapen (2002) in the paper “Privatization of the Insurance Market in India: From the British Raj to Monopoly Raj to Swaraj” has given a detailed account of the institution of insurance in India since British period to the insurance liberalization period. According to the author after the independence, the industry was state-owned monopoly and during liberalization process of 1991. Nothing has happened to the

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62 Sinha, Tapen (2002); “Privatization of the Insurance Market in India: From the British Raj to Monopoly Raj to Swaraj”; CRIS Discussion Paper Series, Centre for Risk & Insurance Studies, University of Nottingham, UK.
institutional structure of insurance and it remained a monopoly. Only in 1999, a new legislation came into effect signaling a change in the insurance industry structure. The author suggested that too many regulations kill the incentive for the new insurers and too relaxed regulations may induce failure and fraud that led to nationalization. Besides this, he observed that the openness of the market did not mean a takeover by foreign companies even in a decade. Thus, according to him, it is unlikely that the same will happen in India, especially when the foreign insurers cannot have a majority shareholding in any company.

In a study on the “Foreign Direct Investment and Trade in Health Services: A Review of the Literature”; Richard (2004) has highlighted the scope of trade in health services with a review of past studies. According to the author, the FDI has been noted as perhaps the most critical area for trade negotiation because of the birth of GATS which aims to further liberalize trade in services. This paper provides the first comprehensive and systematic review of evidence concerning FDI and health services. Further, the following three issues have been explored in depth: (i) the extent to which a national health system is commercialized per se is of more significance than whether investment in it is foreign or domestic; (ii) the national regulatory environment and its ‘strength’ will significantly determine the economic and health impact of FDI, the effectiveness of safeguard measures and the stability of GATS commitments and (iii) any negotiations will depend upon parties having a common understanding of what is being negotiated, and the interpretation of key definitions is thus critical. The overall

63 Smith, Richard D. (2004); “Foreign Direct Investment and Trade in Health Services: A Review of the Literature”, Health Economics, Law and Ethics Group, School of Medicine, Health Policy and Practice, University of East Anglia, Norwich, UK.
Conclusion of the study was that countries should take a step back and first think through the risks and benefits of commercialization of their health sector rather than being sidetracked in to considering the level of foreign investment.

In view of the changing scenario of competition in the life insurance sector, Sinha (2007) in the paper “Premium Income of Life Insurance Industry: A Total Productivity Approach” compares 13 life insurance companies for the financial years 2002-03, 2003-04 and 2004-05 in respect of technical efficiency and changes in total factor productivity. For the purpose of computation of technical efficiency and TFP, the net premium income of the observed life insurance companies has been taken as the output, and equity capital and the number of agents of insurance industries have been taken as the inputs. The results suggest that all the life insurers exhibit positive TFP growth during the period.

3. RESEARCH GAP

From the foregoing detailed review and analysis of literature, it is been observed that although plethora of literature on different facts, dimensions and aspects of FDI in India is available, yet there is dearth of literature especially dealing with the inflow of FDI in all its manifestations and the forms in the Indian insurance sector. As a matter of fact, since the insurance sector is a newly emerging industry arresting the attention of the scholars, academicians, government, corporates, economists, researches alike. Hence, very few write ups appeared scantly covering all the aspects of the Indian insurance sector particularly the process of FDI in this sector. Therefore, an endeavour is

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made in this proposed study to examine the aspects dealing with the inflows of FDI and their impact on the efficiency and effectiveness on the insurance sector. Furthermore, this study would examine the issue of increasing the FDI equity limit to 49 per cent and its implications on this sector.

4. SCOPE OF THE STUDY

FDI is not a new for Indian economy but after liberalization its role has changed significantly. Earlier the amount of FDI was low confronting to some selected sectors but now the inflow of FDI has grown exponentially and almost in all the sectors of the economy. The proposed study is, therefore, directed towards examining the different dimensions of FDI in the Indian economy since liberalization process. This study also takes up the case study of insurance sector to assess the inflow of FDI in this particular sector in the post reforms period i.e., from January, 2000 onwards. The proposed study also deals with the factors effecting FDI in insurance sector and implications of increasing FDI cap to 49 per cent in this sector.

5. OBJECTIVES OF THE STUDY

FDI has been and continues to be a subject of great interest. Historically, it has left a profound and indelible mark in the economic and social organization of our country. In the light of the research gap, this proposed study is designed to cover the following objectives:

i. To make study with regard to the introductory background including the significance and utility of FDI in the developing economies like India.
ii. To examine and assess the various aspects pertaining to the performance of FDI in India vis-à-vis sector-wise, country-wise, region-wise and year-wise in the pre and post-economic liberalization era.

iii. To find out whether there exists any relationship between FDI, economic reforms and economic growth in India.

iv. To appraise inflow of FDI in the insurance sector in the post liberalization period i.e. January, 2000 onwards.

v. To highlight the future prospects of FDI inflow in the insurance sector and critically examine the implications of increasing FDI from 26 percent to 49 per cent in this sector.

vi. And finally to come out with summary and findings of the study to offer some pragmatic suggestions for increasing FDI inflows in India to benefit the whole economy in general and insurance sector in particular.

6. HYPOTHESES OF THE STUDY

In the light of research gap and the objectives of the study, researcher would like to look into detail at the following research questions:

• Whether FDI Climate in India has improved in the post liberalization era or not?

• Whether the pattern of FDI has undergone a significant change since economic liberalization in India or not?

• Whether the performance of Indian Insurance Sector has improved because of the increasing FDI inflows?
Besides these research questions, the researcher would like to test following hypotheses empirically and present its results for various policy implications on India:

**H₀ 1:** The Null hypothesis is that there exists no significant relationship between economic growth and FDI inflows in India.

**H₀ 2:** The Null hypothesis is that economic reforms make no significant positive impact on FDI attractiveness in India.

**H₀ 3:** The Null Hypothesis is that the interactive effect of reforms and economic growth has not any positive impact on FDI attractiveness.

Rejection of any of the above hypotheses will automatically make to accept the alternative hypothesis (H₁) in each case.

**7. RESEARCH METHODOLOGY**

In the light of the objectives and the hypotheses formulated, an attempt has been made in the present study to analyze the growth pattern of FDI in India since liberalization taking Indian insurance sector as the major case study.

Methodology is a way of systematically solving the research problems. It may be understood as a science of studying how research problem is solved scientifically. In this context, the methodology that has been used in the study is as follows:

i. **Selection of Sample**

For the purpose of analyzing general trends and patterns of FDI in the pre and post liberalization period, data has been taken from January, 1991 to March, 2008. While for the purpose of using Probit Model and three-Stage Least Square Method, data has been taken for the period of 1975 to 2006.
For the purpose of analyzing different determinants and parameters of FDI in insurance sector in India, this study has been divided into two periods: pre-reforms period (i.e. before - 2000) and post-reforms period (2000 - onwards). For this purpose, data on FDI was taken from January 2000 to March 2008, as FDI was allowed only in the year 2000 in this sector.

ii. Sources of Information

The statistical data can be collected from the primary sources as well as secondary sources. The primary sources include data collected directly from the person concerned or indirectly through questionnaires, enquiries etc. The secondary sources include published and unpublished data collected from different organizations, institutes, agencies and government offices. The data used for this study is extensively based on the secondary sources only. The data used has been collected form the Ministry of Finance, the Ministry of Commerce and Industry and FDI Data Cell, DIPP, New Delhi. Consolidated figures from RBI Annual Reports, Economic Surveys, Budget Reports, Press releases of DIPP, IRDA Annual Reports have been gathered for first hand references. Reputed Journals like Delhi Business Review, The Journal of Risk and Insurance, The Indian Journal of Commerce, Gitam Journal of Management, The Foreign Trade Review have been also used for collecting relevant literature. Various News letters from CII, FICCI, CMIE, SIA, Indian Development Report, World Investment Report and business magazines such as business world, business today, business India, Yojana, The Economic and Political Weekly etc. and Newspapers like Business Standard, The Times of India, Economic Times, Financial Express, the Hindustan Times, The Business Line (online edition) and
the Hindu have been made extensive use-of for up-to-date information and referencing purposes.

Some International level reports of IMF and the World Bank, IFC, World Development Report, UNCTAD’s World Investment Report, Swiss Re, Sigma Reports dealing with different dimensions of FDI vis-à-vis Indian insurance sector have been also used.

Mostly, numerical data for analysis and interpretation has been extracted from various WIRs, Swiss Re Sigma Reports, IRDA Annual Reports, Economic Surveys, SIA Newletters, RBI Bulletin and RBI’s various Annual Report. Besides above sources, up to date data was manually collected from FDI data cell, DIPP, Ministry of Commerce and Industry, New Delhi.

iii. Data Compilation and Tabulation

For the present study, information and relevant data has been collected from secondary sources mentioned above. After this, data related to FDI inflows and various parameters of insurance have been checked for its reliability and consistency. Then, this data have been tabulated as per the tabulation plan and then processed both through computer and manually. Thereafter, information has been interpreted by using different statistical tools and techniques to get results of the study.

iv. Statistical Tools and Techniques

For the purpose of statistical analysis, different explanatory and analytical techniques have been used which are based on the existing standard literature. For the interpretation of data various statistical tools have been used according to the requirement and suitability. The statistical methods like annual growth rate, f-stats, regressions
equations, probit model and three stage least square method have been used in this study. In addition, researcher has used Vadlamannati's (2007) comprehensive Economic Reform Index (ERI) for India to critically analyze the impact of economic reforms on FDI inflows and economic growth simultaneously. Besides this, simple statistical methods like arithmetic mean and percentage is also used to interpret the data correctly.

8. LIMITATIONS OF THE STUDY

During the compilation of the present thesis work, researcher found and faced a number of difficulties. Some of them are as under:

i. Although enough of data on FDI was available with RBI, DIPP, Ministry of Commerce and Industry, UNCTAD but there was no consistency and similarity in the data.

ii. FDI in the post-liberalization period was easily and up-to-date available but consistent and continuous FDI data on pre-liberalization period was difficult to found as no organization has made efforts to compile it till date.

iii. Since FDI in Indian insurance sector was allowed only in the year 2000. Therefore, there was dearth of detailed FDI data availability on this sector. Only source of data was FDI Data Cell, DIPP, New Delhi. In addition, there was inconsistency in the year-wise data on insurance premiums, insurance density and insurance penetration in the pre-liberalization period of this sector.

iv. Besides above, sample available for statistical analysis of FDI in insurance sector was too short (i.e merely 8 years from January, 2000 to December, 2007) to measure the trend and pattern of FDI in this sector. Therefore, showing empirically the impact of FDI in
Indian insurance sector was not possible through empirical testing. It would have given spurious results as sample available was only for 8 years which should be at least 30 plus.

Lastly, it is important to note that missing data do not necessarily mean that the information does not exist in the country or outside. Rather, it may indicate that researcher did not find any information in the sources used for this study.

9. STRUCTURE OF THE THESIS

After taking objectives and hypothesis into consideration, the researcher has divided this study into five systematic and logical chapters. These are:

Chapter 1 : Introductory Background and Theoretical Framework of Study
Chapter 2 : FDI: A Conceptual Approach
Chapter 3 : Growth Pattern of FDI in India: A Pre and Post Economic Liberalization Analysis
Chapter 4 : Post Liberalization Evaluation of Indian insurance Sector and Inflow of FDI: A Case Study
Chapter 5 : Conclusions, Recommendations and Suggestions

10. NEED AND SIGNIFICANCE OF THE STUDY

As it is clear from the review and analyses of past and current studies that a number of studies have looked at the trends and impact of FDI in Indian economy. However, none of the studies till now has been undertaken to examine the impact of economic reforms on FDI attractiveness and FDI inflows in India. Besides, this study is novel as it analyses the pattern, potential drivers and implications of FDI in the
Indian insurance sector. Moreover, this study proposes a theoretical model to increase the equity cap from the present 26 per cent to 49 per cent which is the need of the present market conditions. Therefore, it is in this perspective that the need of this study is felt.

In the next chapter, the researcher has made an attempt to explain all concepts and fundamentals related to FDI in India. This exercise may prove helpful in accurate interpretation of different concepts and variables used in the present study. In this way, it may further assist in correct and accurate analysis and interpretation of results of this study.