The Indian government policy towards FDI has changed over time in tune with the changing developmental needs in different phases of development. India opened up the economy in the early nineties following a major crisis of foreign exchange. The response was a slew of domestic and external sector policy measures partly prompted by the immediate needs and partly by the demand of the multilateral organisations. The new policy regime radically pushed forward in favour of a more open and market-oriented economy.

Globalisation and liberalisation of financial markets bring a variety of changes, presenting opportunities as well as risks both in economies and financial systems throughout the world. Globalisation is defined as more integrated financial markets, economies and trade, higher factor mobility, and spectacular change in information technology leading to the spread of knowledge throughout the world.

Developing countries have made their presence felt in the economies of developed nations by receiving a descent amount of FDI in the last three decades. Although India is not the most preferred destination of global FDI, there has been a generous flow of FDI in India since 1991. It has become the 2nd fastest growing economy of the world.

China, India and Brazil are in the top five of the 2010 Foreign Direct Investment (FDI) Confidence Index, prepared by A.T. Kearney and emerging markets with large consumer bases, such as Indonesia and Vietnam, also rank high.

India has substantially increased its list of source countries in the post – liberalisation era. India has signed a number of bilateral and multilateral trade agreements with developed and developing nations. India as the founding member of GATT, WTO and a signatory member of SAFTA is making its presence felt in the economic landscape of globalised economies.
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.

7.1 Findings of the Study

India had grown at an average growth rate of close to 6 percent a year before economic reforms, with some evidence that growth was accelerated and sustained at 8 percent a year in the last two decades. With a population of over 1.2 billion, 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.

The integration of world markets and rapid technological changes led to efficiency gains and growth driven by the lower transaction and information costs. Hence, competition both in the industrialized and developing countries has reached almost the same level. The main findings of the study were presented in the following sub sections.

7.1.1 FDI Trends and integration of Indian economy

✓ India’s GDP share in world GDP was 1.872% in 1970 and later on declined to 1.451% by 2000 and improved rapidly in 2010 to 2.571%.

✓ India has become increasingly integrated with the world economy. The share of exports of goods and services as percentage of India’s GDP was stable at around 6-7% during the period 1980-1990. After that the share is almost doubled for every 10 years.
- India’s share in export and import of commercial services had shown significant improvement. In 1990, the share in world export of commercial services was at 0.559 % and later increased to 1.089 % in 2000 and 3.287% in 2010.

- Export plus import of goods and services as percentage of GDP accounts for 22.9 % during the period 1990 to 2000 and increased to 39.4% during the period 2000-2010.

- The share of world investment received by India remained weak at 1.98 percent in 2010; however, it has been increasing compared to previous years. China and Singapore were the leaders in attracting FDI and accounting for 8.50% and 3.11% of world FDI flows respectively.

- The inward FDI Stock 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$ 197 billion in 2010.

- Indian inward FDI flows surged to a record level of US$ 42.55 billion in 2008 later dropped to US$ 24.64 billion in 2010. It represented 1.98 percent of the world FDI flows and 4.29 percent of the developing economies flows in 2010.

- The share of FDI inflows in GDP had been very small in absolute terms, remaining less than one percent (before 2000, 2003, 2004 and 2005). However the ratio improved dramatically to 3.40 in 2008, which reflected the growth in the domestic economy, improvement in the investment climate as well as the buoyancy in FDI flows.

- The ratio of Inward FDI inflows as percentage of gross fixed capital formation (GFCF) reached to 8.22% where developing countries got 10.17% of its GFCF.

- India received large amount of FDI from Mauritius (42.83 percent of the total FDI inflows) apart from USA (9.24 percent), Singapore (7.51 percent), U.K (5.34 percent), Netherlands (4.07 percent) and Japan (3.54 percent) during the period 2000-01 to 2009-10.
Mauritius was the single biggest foreign direct investor in India - amounting to USD 47,240 million during the period April 2000 to March 2010. The India-Singapore Comprehensive Economic Cooperation Agreement (CECA) signed on June 29, 2005, became effective from August 1, 2005.

FDI in India continues to be local “market seeking” in the first place, its world-market orientation has clearly enhanced in the aftermath of economic reforms.

India has entered into comprehensive Double Taxation Avoidance Agreements (DTAA) with 79 countries, limited DTAA with 15 countries and other 3 agreement in the form of double taxation relief rules.

India is one of important destinations for acquisition of companies by foreign companies. They invested US $ 276 million in 1995 for M&As and with a highest investment of US $ 10427 million in the year 2008. India increased shopping outside with an investment of US$ 26.421 billion by making 139 deals.

State-wise FDI inflows show that Maharashtra, New Delhi, Karnataka, Gujarat and Tamil Nadu received major investment from foreign investors because of the infrastructural facilities and favourable business environment provided by these states. All these states together accounted for nearly 69.38 percent of inflows during 2000-2010.

Mumbai region is the most attractive destination for foreign investors and followed by New Delhi. Both these destinations gather 55.56% of total investments received in the period of 10 years (i.e.) April 2000 to March 2010.

USA, Germany and Japan are the leaders in providing technological support to new industries through technical collaborations. Electrical equipments (including electronics and software), industrial machinery, chemical and transport industries (including automobiles) have accounted for 49.8% of total technology transfer approvals.
After a short-lived setback in 2009, investment flows from developing countries were back on their upward trend and reached an estimated US$ 210 billion (1.1% of GDP) in 2010.

FDI outflows from the BRIC (Brazil, the Russian Federation, India and China) continue to lead, accounting for more than 60 percent of outward FDI (OFDI) flows from developing countries.

In the last 20 years service sector contribution to the economy has increased due to heavy investment flows into this sector from foreign investors as well as domestic investors. Around 20.82% of total FDI inflows passed into financial and non-financial services sector of India.

Based upon the data given by department of Industrial Policy and Promotion, in India there are sixty two sectors in which FDI inflows are seen but it is found that top ten sectors attract almost seventy percent (70%) of FDI inflows. The cumulative FDI inflows reveal that service sector in India attracts the maximum FDI inflows amounting to Rs. 1,06,992 crores, followed by Computer Software and Hardware amounting to Rs. 44,611 crores. These two sectors collectively attract more than thirty percent (30%) of the total FDI inflows in India. The housing and real estate sector and the construction industry are among the new sectors attracting huge FDI inflows that come under top ten sectors attracting maximum inflows. Thus the sector wise inflows of FDI in India shows a varying trend but acts as a catalyst for growth, quality maintenance and development of Indian Industries to a greater and larger extend. The technology transfer is also seen as one of the major changes apart from the increase in operational efficiency, managerial efficiency, employment opportunities and infrastructure development.

India has developed third largest Telecommunications network in the world. The sector had an average growth rate of 45 per cent during the first decade of this century. High volumes of FDI took place in telecommunication, real estate,
construction, power, automobiles, etc. The rapid development of the telecommunication sector was due to the FDI inflows in form of international players entering the market and transfer of advanced technologies.

- FDI inflows to real estate sector in India have developed the sector. The increased flow of foreign direct investment in the real estate sector in India has helped in the growth, development of urban infrastructure. FDI Inflows to Construction Activities has led to a phenomenal growth in the economic life of the country. India has become one of the most prime destinations in terms of construction activities as well as real estate investment.

- The FDI in Automobile Industry has experienced huge growth in the past few years. The increase in the demand for cars and other vehicles is powered by the increase in the levels of disposable income in India. The options have increased with quality products from foreign car manufacturers. The introduction of tailor made finance schemes, easy repayment schemes has also helped the growth of the automobile sector. The basic advantages provided by India in the automobile sector include, advanced technology, cost-effectiveness, and efficient manpower. Besides, India has a well-developed and competent Auto Ancillary Industry along with automobile testing and R&D centres. The automobile sector of India ranks third in manufacturing of three wheelers and second in manufacturing of two wheelers. Opportunities of FDI in the Automobile Sector in India exist in establishing Engineering Centres, Two Wheeler Segment, Exports, Establishing Research and Development Centres, Heavy truck Segment, Passenger Car Segment etc.

- The increased FDI Inflows to Metallurgical Industries in India have helped to bring in the latest technology to the industries. Further the increased FDI Inflows to Metallurgical Industries in India have led to the development, expansion, and growth of the industries. All this has helped in improving the quality of the products of the metallurgical industries in India.
The increased FDI Inflows to Chemicals industry in India has helped in the growth and development of the sector. The increased flow of foreign direct investment in the chemicals industry in India has helped in the development, expansion, and growth of the industry. This has improved the competitiveness of domestic industry in producing the quality products.

The benefits of reduced cost of capital were mostly confined to the largest Indian firms. In a certain sense, these developments have given large firms a competitive advantage and handicapped smaller firms who have been unable to break through the home bias of foreign investors.

Earlier, many developing countries or least developed countries are depending on IDA assistance to meet its foreign exchange requirements. At present many countries are looking at foreign investment flows to balance their fiscal needs.

7.1.2 Trade trends

USA and UK rapidly lost their competitiveness in merchandise exports during the first decade of this century. Their share in world merchandise exports dropped from 12.11% and 4.42% in 2000 to 8.29% and 3.01% in 2010. Developing countries like China and India improved their stake from 3.86% and 0.66% in 2000 to 9.64% and 1.44% to 2010.

Due to liberalisation policies of India, Imports also increased in the same way of exports. India’s weighted average of import duties of all commodities came down from 77.2% in 1991-92 to 7% in 2009-10.

Mauritius was the largest investor with 42.83% share in total FDI inflows in to India and Cyprus with 3.37% occupy’s 7th position. The reason behind the huge investment is advantageous double taxation treaty for investors. However the trade with these countries were nominal and doesn’t influence investments in any way.
Singapore is the second largest investor in India. India has trade surplus with this country. Merchandised exports to Singapore accounts for 4.17% of total trade in 2010-11 improved from 1.97% in 2000-01. Merchandised imports fell down from 2.90% to 1.90% in the same period. Singapore is an emerging financial hub and trading hub of south East Asia and south Asia regions.

USA and Japan were second and third largest investors in the period 1991-2000 and later occupied with 3rd and 6th positions in the period 2000-2010.

India’s trade with USA is very high compared to its investments in percentage of investment and total trade. Exports to USA were peaked at $ 25.6 billion while imports from USA are at $ 18.5 billion. India has huge trade surplus with this country. However, the trade gap is reducing which should be analysed further for proper action to improve exports.

UK is fourth largest investor and has a long track record with India in terms of trade and investment. India’s trade with UK has a phenomenal change (i.e.) trade deficit to trade surplus. Latest trends revealed that investment from UK accounts for 2.79% in 2010-11 and India’s merchandise exports accounted for 2.82% and imports account for 1.45% only.

Netherlands’ trade with India is encouraging. Netherlands’ FDI has displayed a study increase ignoring subprime crisis and it is fifth largest investor. India has trade surplus with Netherlands for the last decade. The exports had been increasing steadily and consistently from 1.98% in 2000-01 to 3.04% in 2010-11 of total merchandise exports. The imports were maintained with no much variation from 0.87% in 2000-01 to 0.51% in 2010-11.

Japan has invested selectively in India. India has a trade deficit with Japan. Since 2003-04, trade deficit has increased drastically. Increased import of electronic goods and automobile components has resulted higher trade deficit.

Germany’s investments were volatile in absolute terms but had a decreasing trend in terms of total FDI inflows. The merchandise exports were almost
halved in the decade from 4.28% in the year 2000-01 to 2.65% in the year 2010-11. The imports trend has been consistent over the years with a steady movement throughout the decade.

✓ The FDI from France is highly volatile but is decreasing over the years steadily with exception to the year 2010-11. The exports have been decreasing steadily over the years but the decrease is meagre. The imports were more or less at a consistent level starting from 1.27% in the year 2000-01 to 1% in the year 2010-11.

✓ South Korea is one of the newly industrialised countries and maintains its lead in electronic goods selling across the globe apart from automobiles, shipbuilding etc. India is a huge market for Korean companies and consistently has been investing in selected fields. Investments from Korea were at around 0.5% of total FDI inflows whereas trade is at around 2.5%. India’s trade with South Korea has a deficit. And deficit is ever increasing.

✓ India’s trade with Switzerland also has huge deficit and ever increasing. Imports from Switzerland accounted for 6.15% of total imports in 2010-11, whereas exports accounted for only 0.29% of total exports from India. Switzerland’s investments were not consistent with its trade.

✓ Canada’s trade with India was in the range of 0.55% to 1.03% whereas investments from Canada were at very low in the range of 0.05% to 0.25% in the period of 2000-01 to 2010-1.

✓ UAE is in an important trading partner for India. Total trade accounts for 10% of the total trade of India. India has trade surplus with UAE. Investments from UAE have increased gradually.
7.1.3 Empirical Findings

- A study on Determinants of the FDI inflows was conducted through multivariate analysis by considering the influencing parameters (i.e.) Change in GDP (ΔGDP), trade openness (TRADE_OPEN), Average wage of employee (AVG_WAGE), inflation (INFL), Gross fixed capital formation (GFCF), per capita net domestic product growth rate (NDPpcgro), country risk factor (Cont_Risk) and lagged FDI inflows by one year (AGGL) during the period of 1990-91 to 2009-10. The findings of the empirical study on determinants of inward FDI were consistent with the apriori relationships.

- GFCF, NDPpcgro, Cont_Risk and AGGL have positive correlation with FDI inflows whereas Change in GDP (ΔGDP), TRADE_OPEN, AVG_WAGE and INFL has negative correlation. In reduced models, Change in GDP has shifted to positive correlation with FDI. However, AVG_WAGE also changed its stand on reduced models.

- As per Country risk is concerned higher the rating means less risk. Hence positive FDI is expected. Regarding AVG_WAGE is concerned, higher the wages influences FDI negatively. Higher the Gross fixed capital formation leads positively to higher FDI flows. Similarly larger growth rate of per capita net domestic product is able to attract larger positive FDI flows. Lagged FDI flows also influences positively. Higher Inflation negatively influences FDI inflows.

- The empirical tests conducted on India in post economic reforms suggest that in India’s GDP granger cause FDI inflows. Increase in GDP leads to bring more FDI. And FDI inflows does not granger cause GDP in India which means there is no causality relationship from FDI to GDP. GDP is not depending on FDI and it is independent of FDI.

- India has been attracting foreign direct investment from different countries and it has been increasing over the last two decades. The linkage between Inward FDI and other economic parameters of different countries (i.e.) RGDP (the
ratio of real home country GDP to real host country’s GDP lagged by one year), REX (real host country’s exports to the home country), RIM (real host country’s imports from the home country), REER (REER exchange rate), GEOD (geographic distance between the host country and the home country) were established through panel data analysis.

- As specified, RGDP (the ratio of real home country GDP to real host country’s GDP lagged by one year) has a negative correlation with FDI in all tested models. Variables such as Exports and Imports of India have a positive correlation with FDI inflows from that country. In case of REER exchange rate, negative correlation with FDI occurred instead of expected positive correlation. Variable GEOD (geographic distance between the host country and the home country) has omitted due to multicollinearity.

- A granger causality test was conducted to understand the relationship between FDI inflows in to India and Merchandised Exports of India. As per the test results, Merchandised Exports of India does not granger cause FDI. Increase in merchandised exports does not influence FDI inflows. And FDI inflows into India does granger cause Merchandised Exports immediately (i.e.) lagged by one year. But later on there is no granger causality relation between merchandised exports of India and FDI inflows in to India.

Apart from the specific findings given above, it was also observed that GDP size is an important factor affecting FDI in general; however, in India this important traditional variable has decreased in its importance over the years. At the same time, cost differences between locations, spillovers from increased competition on the domestic turf, the ease of doing business and the availability of skills have become more important.

1.12 Suggestions

- Growth in FDI inflows to India seems to be fairly satisfactory but India’s share in the global FDI is still minuscule. This calls for further liberalisation of norms for investment by policy makers. It underlines the need for efficient and
adequate infrastructure, availability of skilled and semiskilled labour force, business friendly public administration and moderate tax rates.

- The locational strategies chosen by firms are likely to be highly contextual and would vary according to industry specific characteristics, the motives for FDI, and the functions being performed by MNC subsidiaries. The government should recognise that the location specific advantages are sought by investors. Over all, India needs to maintain the growth momentum and to make better use of their abundant labour forces and it has to follow more open trade policies for attracting FDI.

- The actions of the government need to focus on controlling inflation at reasonable levels, enhancing per capita income and ensuring the investments turned into gross fixed capital assets which lead to attract more FDI into India.

- The government needs to give focussed attention to the upgrading and reconfiguring of their own unique location bound advantages with specific reasons, both actual and potential. For example Mumbai region and the national capital region accounts for 55.56% of total investments received during the last 10 years. Hence, regional initiatives need to be designed carefully to ensure the benefits spread across all the regions and sectors.

- It is possible that government regulations and policies may deter some forms of FDI, particularly where they affect ownership. Thus the Government needs to assess the benefits of such interventions against the costs of creating impediments to FDI.

- Policy makers have to maintain the same level playing field for both foreign investors and domestic investors while formulating policy measures.

- The measures must be initiated by policy makers to create specific location advantages in areas and sectors which have not been able to attract more FDI. This will help reduce the disparities in development across regions and sectors.
India has registered trade deficit with countries like Korea, Japan etc. out of the selected countries for this analysis. It was observed that electronic and automobile components were imported from these countries to India. Hence concerted effort must be made by the policy makers to improve the performance of these industries to reduce the trade deficit.

India has a positive trade with countries like USA, UAE but the trade gap is gradually reducing. India was unable to maintain the same share of exports to USA out of its total exports over the last decade. Since USA is a very important market, India should initiate steps to improve its share without losing to other developing countries.

Even though India is having double taxation treaties with countries such as Mauritius, Cyprus etc., there is a gradual decline in FDI flows from those countries since 2008-09. Hence, the Indian government has to revisit the policy of double taxation treaty entered with Mauritius two decades ago.

Government of India must not change policies too frequently and has to maintain policy framework for at least considerable time period. This will enable the foreign investors to plan their strategy well in advance and it also gives them some sense of certainty. Any modification in tax system must be prospective in nature and it should not indulge in taxing retrospectively.

1.13 Contribution of the Study

Facts and empirical results evidenced in this study show that the motives for inward FDI are changing. “Efficiency seeking” investment is gaining more importance as compared to “market seeking” both for domestic as well as foreign investors. Productivity in the economy has emerged as a very important factor which attracts more vertical FDI as compared to horizontal FDI. Growing competition and economic spillovers from increased FDI inflows along with cost advantage due to productivity gains have induced more FDI outflows which are also vertical in nature. Thus inward FDI has emerged as major contributing and important factor influencing outward FDI flows from India.
As it was observed from the study most of the research work done by considering macro economic factors including GDP (Real & Nominal), Exchange rate, Exports, Imports, Trade Balance, Balance of payments, Openness of Economy, and Interest rates etc. Only a few studies have analysed thoroughly the effects of Socio-political factors on FDI inflows. The present study has included the variables like change in GDP ($\Delta$GDP), average wage of worker ($AVG_{WAGE}$), and NDP per capita growth rate ($NDP_{pcgro}$) for understanding the impact of these on FDI inflows.

Causality relationship between FDI inflows and GDP was established in Indian contest by using Indian currency units which is unique feature of this study. Similarly causality relationship was examined between FDI inflows and India’s merchandised exports.

Panel data analysis was done between country wise FDI inflows and India’s external trade with respective country along with other parameters to estimate future FDI inflows into India. This application is new and has given substantial evidence of relation between tested macro variables.

Detailed analysis of each country’s inward FDI, exports, imports and total trade was done and ratio analysis was used to establish the relation among these variables for better interpretation.

1.14 Scope for Further Research

An interesting topic for further research would be to analyse how foreign direct investment in India is affected by factor endowments such as knowledge capital, in order to better explain the driving forces of FDI. It would also be very pertinent to study the impact of FDI inflows on various macro and micro economic variables like M3, Gross fiscal deficit and govt policies on subsidies. Another interesting research avenue would be to undertake an analysis on possible economic turmoil like ASEAN economic crisis, subprime crisis etc.

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