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## TRENDS IN FDI INFLOWS IN INDIA

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## ABSTRACT

The article discusses the trends in Foreign Direct Investment (FDI) since the initiation of reform process in India i.e. since 1990-91. It starts with the policy of the government towards foreign capital, discusses the advantages and disadvantages of FDI and then finally it analyzes the trends in FDI by using graphical method as well as least squares method.

## KEYWORDS

FDI, Finance.

## INTRODUCTION

Since Independence India started with planned economic development for the overall and balanced development of the country but Indian planners were apprehensive of foreign capital. Foreign capital was looked upon with suspicion. The aim of planning was to achieve a Socialistic pattern of society. Public sector expanded by leaps and bounds and private sector was supposed to play a limited role. Our trade policy was also inward looking. We followed the policy of Import substitution and then slowly moved towards Export promotion.

The push towards liberalization, privatization and globalization in India came in eighties when India faced severe balance of payments crisis. To this crisis fuel was added by oil shocks, which pushed up import bill significantly while exports lagged behind. This led to considerable increase in trade deficits. Remittances from gulf countries also flattened out. The problems multiplied by gulf war in 1990-91. FOREX reserves declined to \$1.1 billion in June 1991, which was hardly sufficient for two weeks of import requirement. During this period government had no option but to take loan from IMF, which comes with its conditionalities. One of the condition was external sector liberalization and relaxing restrictions on international flow of goods, services, technology and capital, which is considered as globalization. Thus we started with giving increasing emphasis to foreign capital. The foreign direct investment was allowed under the new regime in almost all sectors of the economy. The economy was opened up to bring it in tune with the global economy. And changes were effected in industrial and trade policies which were substantially liberalized. In the liberalized atmosphere the change in the attitude of the government was inevitable.

Foreign investments can be of two types direct and Portfolio. The direct foreign investment which is also known as FDI and includes investments from non-Resident Indians and Overseas Corporate Bodies (OCB) These are parts of the government efforts to supplement the domestic resources for the economic development of the country. Now FDI is permitted in all sectors including service sector with some sectoral caps. Even foreign investments are allowed in the SSI sector. Similarly such investments are allowed for trading activities with a cap. There are other modes of FDI like Global Depository Receipts, American Depository Receipts, Foreign Currency Convertible Bonds etc. Although India is endeavouring to catch up with China in attracting foreign capital but it is still way behind it.

## FDI VERSES OTHER FLOWS OF FOREIGN CAPITAL

FDI is defined as a form of long term international capital movement made for the purpose of productive activity and accompanied by the intention of managerial control or should not be confused with portfolio investment which does not seek management control, but is motivated by short term speculative profits.

To quote the --report "FDI flows to developing and transition economies in 1998 declined by about 5% from the peak in 1997, a modest reduction in relation to the effects on other capital flows of the spread of the Asian Financial Crisis to global proportions. FDI flows are generally less volatile than portfolio flows." FDI is considered as superior to other types of flows for following reasons:

- Foreign direct investors have longer term perspective when investing in host country. Hence they are less volatile and easier to sustain even during times of crisis.
- Other types of foreign capital may finance consumption rather than investment in the host country while FDI is used more productively.
- FDI provides more than just capital. Foreign direct investors bring with them internationally available technologies and management know-how

## ADVANTAGES OF FDI

FDI is universally accepted as an essential element for achieving sustainable development. FDI provide a strong stimulus to income growth in host country. Developing countries are strongly advised these days to rely on FDI in order to supplement national savings by capital inflows and thereby promote economic development. FDI has following benefits for the host countries:

1. **Increasing the Level of Investment:** In less developed countries since incomes are low, savings are also very low, therefore, foreign investment can fill the gap between required investment and locally mobilized savings. Local capital markets are often not well developed. Besides access to hard currency needed to purchase investment goods for development purposes may not be locally available. Foreign investment can give a push to domestic investment through both forward and backward linkages
2. **Upgradation of Technology:** FDI normally comes with managerial experience, organizational and technological skills etc. Along with machinery and equipment required foreign direct investors also bring with them advanced technological knowhow. Industries in under developed countries use old and out dated technology and therefore their product will not be competitive in global markets. FDI solves this problem because it comes with advanced technologies.
3. **Improvement in Export Competitiveness:** FDI increases competition in the domestic market and thus domestic companies will have to improve quality and therefore it will promote efficiency. It can help host country improve export competitiveness as well. Export competitiveness will also improve with improvement in technology. Thus it will also lead to increase in exports.
4. **Employment Generation:** Foreign direct investment increases employment opportunities in the country. Foreign investors employ local people in large number of jobs and therefore more and more employment opportunities are created in the economy. In the host country mainly developing countries it also provides training to entrepreneurs in the operation of new businesses.
5. **Resilience Factor:** FDI has proved to be resilient during financial crisis. FDI was significantly stable during currency crisis in South East Asia.
6. **Economic Development of the host country:** FDI through all the above mentioned advantages helps in overall economic development of the country. It increases employment opportunities, increases national and per capita income, increases investment and capital formation and hence accelerates the economic development of the country.
7. **Helps In Improving The Balance Of Payments Situation:** FDI helps in improving Balance of Payments position and increases the FOREX reserves in the host country.

- 8. **Revenue to the Government:** FDI also increases the government’s tax revenues also because profits generated by the foreign companies contribute to corporate tax revenue.
- 9. **Benefits to the consumers:** Finally consumers also gain through increased availability of world class consumer goods at competitive prices.

**DISADVANTAGES OF FDI**

- 1. Crowding out of domestic industry may take place.
- 2. It has been observed that the contribution by foreign firms to government tax revenue will be very negligible because of liberal tax concession given to in order to attract them.
- 3. They are responsible for creating dualistic socio economic structure in under developed countries. They also increase inequalities in income in the economy. They create a class of highly paid executives. They also create imbalance between rural and urban areas.
- 4. In long run they may lead to outflow of Foreign Exchange Reserves in the form of repatriation of profits and dividends by the investors.
- 5. They exploit natural resources and cause environmental damage.

**TRENDS IN FDI AND FPI SINCE THE REFORM PROCESS IN INDIA**

As per the UNCTAD’s World Investment Report 2010 India is projected as to become second most attractive destination for FDI by 2010-12. The projection is based on the survey conducted among Trans National Corporations. As per the new FDI policy of the Government of India FDI upto 100% is permitted under automatic route in large number of sectors. Table 1 shows inflows of FDI in US\$ millions from 1990-91 onwards.

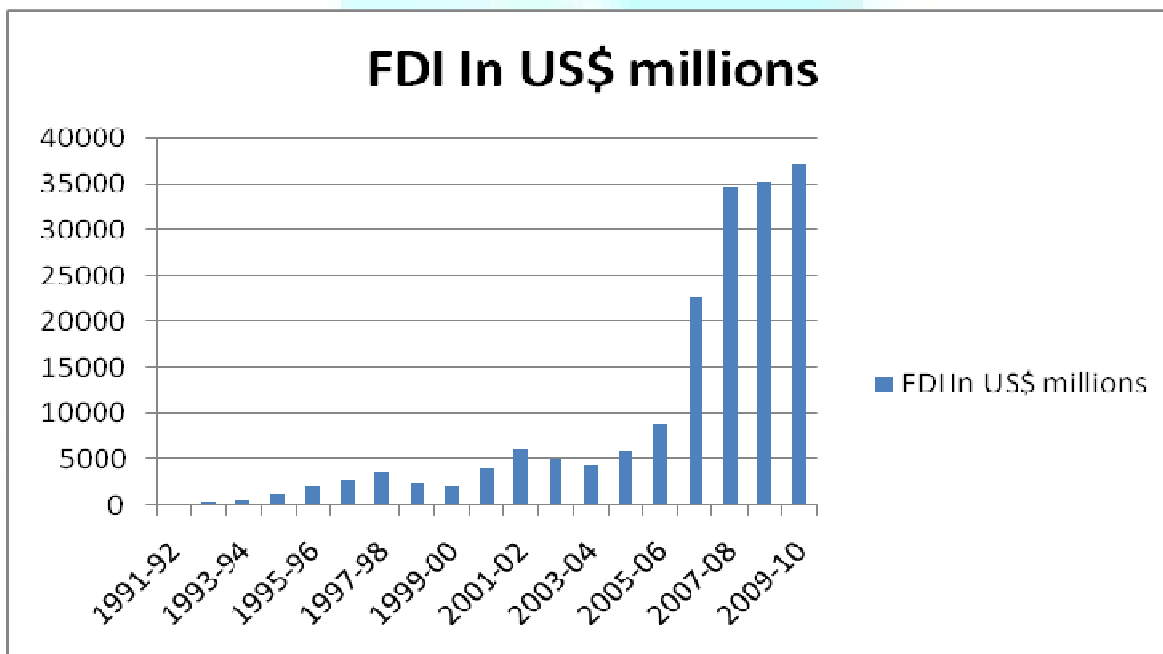
The table shows that FDI inflows are increasing by leaps and bounds in the country. Starting with just 129 million dollars in the 1991-92 it increased to 37182 million dollars by 2009-10. The increase is approximately 28723.26% in period of 20 years. This is remarkable indeed.

TABLE: 1

Foreign Direct Investment in India					
Year	Foreign Direct investment		Year	Foreign Direct investment	
	US \$ million	Annual Rate of growth		US \$ million	Annual Rate of growth
1991-92	129		2001-02	6130	52.1469
1992-93	315	144.186	2002-03	5035	-17.863
1993-94	586	86.0318	2003-04	4322	-14.161
1994-95	1314	124.232	2004-05	6051	40.0046
1995-96	2144	63.1659	2005-06	8961	48.0912
1996-97	2821	31.5765	2006-07	22826	154.726
1997-98	3557	26.09	2007-08	34835	52.6111
1998-99	2462	-30.784	2008-09	35180	0.99038
1999-00	2155	-12.47	2009-10	37182	5.69073
2000-01	4029	86.9606			

Source: RBI Website- [www.rbi.org.in](http://www.rbi.org.in)

The following diagram shows increase in FDI over the years.



The diagram clearly shows the increase in FDI in India after the reform process. The average annual rate of growth of FDI is around 46.7%. This is remarkable indeed.

**LEAST SQUARES ANALYSIS OF FDI AND FPI**

The results of linear trend for FDI as dependent variable and time as independent variable are given below:

R	R Square	Adjusted R Square	Std. Error of the Estimate
.801	.642	.622	7707.533

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta	B	Std. Error
Time	1697.336	298.885	.801	5.679	.000
(Constant)	-8815.479	3580.391		-2.462	.024

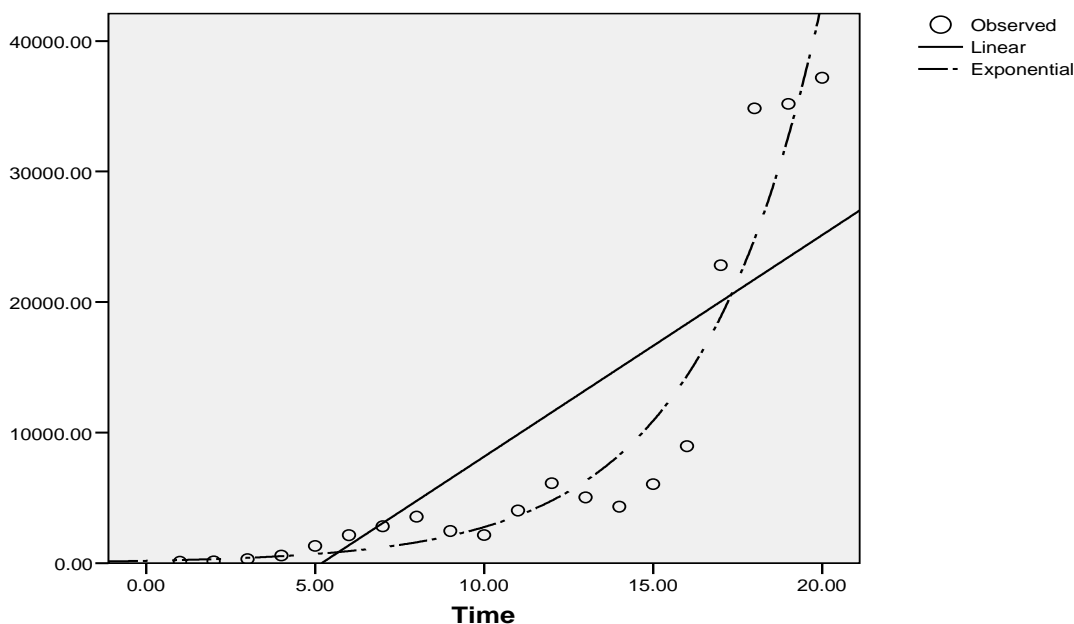
For linear trend  $R^2$  is only 0.642 and adjusted  $R^2$  is 0.622 almost equal. The results of exponential trend are given below:

R	R Square	Adjusted R Square	Std. Error of the Estimate
.950	.902	.897	.550

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta	B	Std. Error
Time	.275	.021	.950	12.878	.000
(Constant)	177.511	45.330		3.916	.001

For exponential trend  $R^2$  is good it is 0.902 and adjusted  $R^2$  is 0.897. This suggests that FDI is growing exponentially during this period. The diagram given below also shows that exponential curve is good fit for the data.

**FDI**



In the diagram the dotted curve is exponential fit it is closer to observed values which are circles. It implies that FDI inflow is growing exponentially in the country.

**CONCLUSION**

Thus to conclude we can say that India is the most attractive destination for Foreign Direct Investors. The reasons are many and the most important are a wide market and low labor costs. Increasing FDI has helped the country in solving the problem of deficits in the balance of payments. It has also lead to increase in the growth rate of the economy. Now India is one of the fastest growing economy, next only to China. It has also helped in technological up gradation in the country. Our exports are also increasing by leaps and bounds and the composition of exports is also changing.

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