Foreign Direct Investment and New Perspectives Importance

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Abstract- **Foreign Direct Investment (FDI) has a very inherent role in the development of any nation especially for underdeveloped and developing countries. By virtue of the fact that these economies do not have the necessary level of reserves and income in order to meet the essential level of investment needed to sustain the growth of the economy. In such an economic scenario, foreign direct investment plays an vital role of bridging the gap between the accessible resources or funds and the requisite resources or funds. It not only leads to long-term growth of a country being a source of capital but also plays an important role for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities. In India, FDI is considered as a developmental tool, which helps in achieving self-reliance in various sectors and in overall development of the economy. India after liberalizing and globalizing the economy to the outside world in 1991, there was a massive increase in the flow of foreign direct investment. This paper analyses FDI inflow into the country during the Post Liberalization period. The paper also attempts to put forth and analyze various set of factors which govern the flow of FDI proposing the causes for low inflow and suggestive remedial steps to increase the flow of FDI in India.**

Index Terms- **Foreign Direct Investment, Pre & Post Liberalization period, FDI Policy**

I. INTRODUCTION

Foreign direct investment (FDI) has been vital in the process of globalization during the past two decades. The rapid increase in FDI by multinational companies since the mid-eighties may be credited to considerable changes in technologies, higher liberalization of trade and investment environment, and deregulation and privatization of markets in many countries including developing countries like India. Capital formation is an important determinant of economic growth. While domestic investments add to the capital stock in an economy, FDI plays a complementary role in overall capital formation and in filling the gap between domestic savings and investment. At the macro-level, FDI is a non-debtcreating source of additional external finances. At the microlevel, FDI is expected to boost output, technology, skill levels, employment and linkages with other sectors and regions of the host economy.

In India FDI inflow made its entry during the year 1991-92 with the aim to bring together the intended investment and the actual savings of the country. To pursue a growth of around 7 percent in the Gross Domestic Product of India, the net capital flows should increase by at least 28 to 30 percent on the whole. But the savings of the country stood only at 24 percent. The gap formed between intended investment and the actual savings of the country was lifted up by portfolio investments by Foreign Institutional Investors, loans by foreign banks and other places, and foreign direct investments. Among these three forms of financial assistance, India prefers as well as possesses the maximum amount of Foreign Direct Investments. Hence FDI is considered as a developmental tool for growth and development of the country. Therefore, this study is undertaken to analyze the flow of FDI into the country identifying the various set of factors which determine the flow of FDI.

II.REVIEW OF LIERATURE

Dr. VB Khandare (2016) did a study to examine the impact of exchange rate on Foreign direct investment in India and China. R. Anitha (2012) analysed FDI inflow into the country during the Post Liberalization period. Further, the trends of FDI inflow into the country were projected for a period of five years from 2010-11 to 2014-15 using Autoregressive Integrated Moving Average (ARIMA) forecasting technique.

Kamaladevi Baskaran (2012) spoke about the global giants' entry to India and their myths and realities. They also showed the status of organised food retailing in India with SWOT Analysis and highlights on farmer's issues towards FDI in multi brand retailing. J. C. Sharmiladevi (2016) attempted to examine the nexus between FDI and economic growth in recent literatures. Dr. Girbal Singh Lodhi (2014) explored the uneven beginnings of FDI, in India and examined the developments (economic and political) relating to the trends in two sectors: Industry and Infrastructure and sub sector Telecom, to illustrate that.

Bhavya Malhotra (2014) examined the impact of FDI on the Indian economy, particularly after two decades of economic reforms, and analyze the challenges to position itself favourably in the global competition for FDI. Shalini Aggarwal et.al. (2012) tried to study the need of FDI in India, to exhibit the sector-wise & year-wise analysis of FDI's in India, to rank the sectors based upon highest FDI inflows Foreign direct investment plays an important role in the economic development of the country. Abhishek Vijaykumar Vyas (2015) presented a study that focused on the trends of FDI Flow in India during 2000-01 to 2014-15 (up to June, 2015). The study also highlighted country wise approvals of FDI inflows to India and the FDI inflows in different sector for the period April 2000 to June 2015. Deepti Goel (2014) studied the issues related to FDI in retail sector in India. and concluded that India is the third largest emerging market economy in the world. Peng Hu (2006) analyses various determinants that influence FDI inflows in India which include economic growth, domestic demand, currency stability, government policy and labour force availability against other countries that are attracting FDI inflows. Analyzing the new findings, it is observed that India has some competitive advantages in attracting FDI inflows, like a large pool of high quality labour force which is an absolute advantage of India against other developing countries like China and Mexico. Chandana Chakraborty and Peter Nunnenkamp (2008) said that booming foreign direct investment in post-reform India is widely believed to promote economic growth. Chew Ging Lee (2009) has pointed out that GDP per capita has a positive effect on FDI inflows in the long run. Krishna Chaitanya Vadlamannatia, Artur Tamazianb and Lokanandha Reddy Iralac (2009) analyses about the determinants of FDI in Asian economies. The determinants are analyzed under four heads, viz. economic and policy factors, socioeconomic factors, institutional factors and political factors. The findings in the baseline models show that poor socioeconomic conditions and labour-related issues are the major determinants. Shiralashetti.A.S and S.S.Huger (2009) have made a comparison of FDI inflows during pre and post liberalization period, country-wise, sector-wise and regionwise. Subash Sasidharan and Vinish Kathuria (2011) examine the relationship between FDI and R&D of the domestic firms in the post-liberalization regime.

OBJECTIVES

- This study is based on the following objectives-
- To compare FDI inflow during the post & pre liberalization period
- To identify the factors influencing the flow of FDI in India.
- To identify the hindrances relating to inflow of FDI and to make suitable suggestions for attracting more FDI inflow to India.

III. METHODOLOGY

SOURCES OF DATA COLLECTION

The study is based on published sources of data collected from various sources. The data was extracted from the following sources:

Handbook of Statistics on the Indian economy, RBI, various issues

Economic Survey, Government of India, various issues

Department of Industrial Policy and Promotion (DIPP)

Secretariat of Industrial Assistance (SIA)

Central Statistical Organization (CSO)

PERIOD OF STUDY

The magnitude of FDI inflows is analyzed during the Pre and Post Liberalization period, hence the study is undertaken for a period of 35 years from 1980-81 to 2015-16. The factors which influence the flow of FDI into the country is analyzed during the Post Liberalization period i.e., from 1991 to 2016.

FDI INFLOWS DURING PRE & POST LIBERALIZATION PERIOD IN INDIA

The first objective on which the study is made is to analyze the magnitude of FDI inflows in India. In this context, the period of study from 1980-81 to 2015-16 is divided into two phases, Phase I is the Pre-Liberalization period, that is, FDI inflows from 1980-81 to 1990-91 are taken into account. The Phase II is the Post-Liberalization period from 1991-92 to 2015-16. The annual and compounded growth rates during the Pre and Post Liberalization period are calculated to find out the magnitude of FDI inflows into the economy during the periods.

Table1 shows the Annual Growth Rate (AGR) of FDI inflows for each and every year and Compounded Annual Growth Rate (CAGR) during the pre and post liberalization period. The Annual Growth Rate is calculated by using the formula:

AGR = (X2- X1)/ X1

Where, X1 = first value of variable X

X2 = second value of variable X

Further, Compounded Annual Growth Rate (CAGR) for the Pre liberalization and Post Liberalization period is calculated by using the formula:

CAGR (t0, tn) = (V(tn)/V(t0))1/tn- to -1

Where, V (t0): start value, V (tn): finish value, tn t0: number of years

TABLE 1: VOLUME OF FDI INFLOWS DURING PRE & POST LIBERALIZATION PERIOD (AMOUNT IN US $ MILLION)

FDI Inflows during Pre-Liberalization Period			FDI Inflows during Post-Liberalization Period		
Year	Amount	Annual Growth Rate (AGR) %	Year	Amount	Annual Growth Rate (AGR)
1980-81	8	-	1991-92	129	-
1981-82	10	25.00	1992-93	315	144.18
1982-83	60	500.00	1993-94	586	86.03
1983-84	60	-	1994-95	1314	55.40
1984-85	60	-	1995-96	2144	63.16
1985-86	160	166.67	1996-97	2821	31.57
1986-87	196	22.50	1997-98	3557	26.09
1987-88	190	-3.06	1998-99	2462	-30.78
1988-89	267	40.52	1999-00	2155	-12.46
1989-90	330	23.60	2000-01	4029	89.96
1990-91	97	-70.60	2001-02	6130	52.14
			2002-03	5035	-17.86
			2003-04	4322	-14.16
			2004-05	6051	40.04
			2005-06	8961	48.09
			2006-07	22826	154.72
			2007-08	34843	52.61
			2008-09	41873	20.00
			2009-10	37745	-10.00
			2010-11	34847	-08.00
			2011-12	46556	34.00
			2012-13	34298	26.00
			2013-14	36046	05.00
			2014-15	44291	23.00
CAGR		25.46 %	CAG		34.73

CHART 1: FDI INFLOWS DURING PRE LIBERALIZATION PERIOD

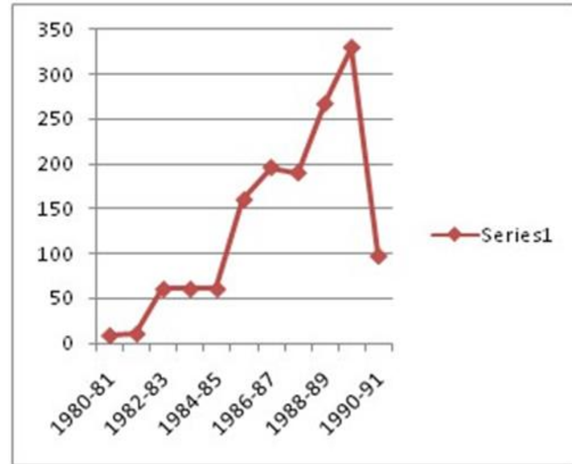
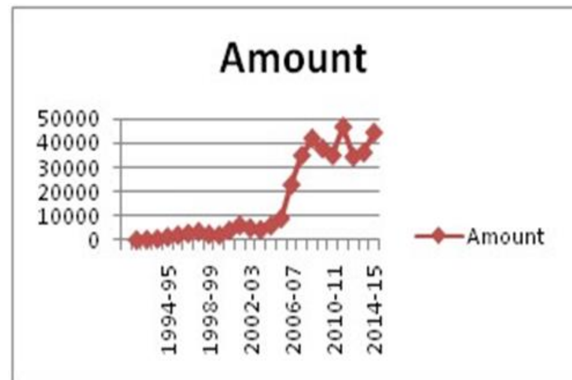


CHART 2: FDI INFLOWS DURING POST LIBERALIZATION PERIOD



The above table and chart shows that FDI inflow into India before 1991 was minimal with the Compounded Annual Growth Rate showing only 25.46 percent. During this period, foreign investments into India were restricted and allowed moderately in few sectors. This is mainly because of the kind of policies which the government of India has adopted over the years which includes inward looking strategy and dependence of external borrowings, In turn the borrowings resulted in foreign debts, which were preferred to the foreign investments to bridge the gap between domestic

savings and the amount of investments required. In 1991, when the government of India started the economic reforms program, FDI had suddenly become important for India which was looked upon as a key component of economic reforms package. The New Industrial Policy of 1991 gave utmost priority in attracting FDI inflows. In this process, the government started opening up of domestic sectors to the private and foreign participation which was earlier reserved only for the public sector. This was followed by slow but with significant relaxation of regulatory and entry restrictions on FDI inflows. Later substantial increase in the volume of FDI inflows into India was observed during the Post Liberalization period.

During the initial phase of post liberalization period i.e., from 1991 to 1998, there was continuous increase in the FDI inflows. The total amount of the FDI inflows during the period 1991-92 to 1997-98 had amounted to US$10,868 million. The increase was largely due to the expanded list of industries or sectors which were opened up for foreign equity participation. This was followed by relaxation of various rules, regulations and introduction of various policies by the government to promote the FDI inflows. FDI inflows declined to the level of US$2,462 million in the year 1998-99 and further to US$2,155 million in 1999-2000. The reasons for the declining trend of FDI inflows were due to various set of factors. Firstly, the most important factor was the several restrictions imposed on India by the USA on account of the nuclear test carried out by India at Pokhran. The second factor was the slowdown of the Indian economy due to the mild recession in US and global economy. The third one was about unfavorable external economic factors such as the financial crisis of South-East Asia. Fourthly, the decline was due to the political instability and the poor domestic industrial environment.

In 2002-03, FDI inflows were declined to US$ 5035. They were also reduced to US$ 4322 during 2003-04. This fall in flow of FDI into the country was due to the Global economic recession. Then, from 2004-05 onwards, there has been steady increase in the flow of FDI into the country with highest annual growth rate which has reached 154.72 percent during 2006-07. Further, the table shows that the compounded annual growth rate (CAGR) which was 25.46 percent during Pre liberalization has increased to 34.73 percent during the Post liberalization period. This shows the openness of the Government in liberalizing and globalizing the economy to the outside world through relaxation of regulatory and entry restrictions on FDI inflows.

Thus, on analyzing FDI inflows into the country over a period of 30 years it is observed that the compounded annual growth rate (CAGR) is 25.46 percent during 1980-81 to 199091 i.e., during the pre liberalization period. On comparison with the post liberalization period, it is found that the annual compounded growth rate has excavated to 34.73 percent showing the relaxation of regulatory and entry restrictions on FDI inflows in the economy. This shows that the importance of FDI into the country is realized by the Government during the Post liberalization period. In this period, steady increase of FDI inflow was observed from 1991-92 to 2009-10 except the period from 1998-99 to 1999-00 and again the period from 2002- 03 to 2003-04.

PROBLEMS FOR LOW FDI FLOW TO INDIA:
India, the largest democratic country with the second largest population in the world, with rule of law and a highly educated English speaking work force, the country is considered as a safe haven for foreign investors. Yet, India seems to be suffering from a host of self-imposed restrictions and problems regarding opening its markets completely too global investors by implementing full scale economic reforms. Some of the major impediments for India's poor performance in the area of FDI are: political instability, poor infrastructure, confusing tax and tariff policies, Draconian labor laws, well entrenched corruption and governmental regulations.

LACK OF ADEQUATE INFRASTRUCTURE:
It is cited as a major hurdle for FDI inflows into India. This bottleneck in the form of poor infrastructure discourages foreign investors in investing in India. India's age old and biggest infrastructure problem is the supply of electricity. Power cuts are considered as a common problem and many industries are forced to close their business.

STRINGENT LABOR LAWS:
Large firms in India are not allowed to retrench or layoff any workers, or close down the unit without the permission of the state government. These laws

protect the workers and thwart legitimate attempts to restructure business. To retrench unnecessary workers, firms require approval from both employees and state governmentsapproval that is rarely given. Further, Trade Unions extort huge sums from companies through over-generous voluntary retirement schemes.

CORRUPTION:

Corruption is found in nearly every public service, from defense to distribution of subsidized food to the poor people, to the generation and transmission of electric power. Kumar (2000) observes that a combination of legal hurdles, lack of institutional reforms, bureaucratic decisionmaking and the allegations of corruption at the top have turned foreign investors away from India. Vital (2001) states that corruption and misuse of public office for private gain are capable of paralyzing a country's development and diverting its precious resources from public needs of the entire nation. Corruption is against the poor people because it snatches away food from the mouths of the poor. If corruption levels in India come down to those of Scandinavian countries, India's GDP growth will increase by 1.5 per cent and FDI will grow by 12 per cent (Vittal, 2001).

LACK OF DECISION MAKING AUTHORITY WITH THE STATE GOVERNMENTS: The reform process of liberalizing the economy is concentrated mainly in the Centre and the State Governments are not given much power. In most key infrastructure areas, the central government remains in control. Brazil, China, and Russia are examples where regional governments take the lead in pushing reforms and prompting further actions by the central government.

LIMITED SCALE OF EXPORT PROCESSING ZONES:

India's export processing zones have lacked dynamism because of several reasons, such as their relatively limited scale; the Government's general ambivalence about attracting FDI; the unclear and changing incentive packages attached to the zones; and the power of the central government in the regulation of the zones. India which established its first Export Processing Zone (EPZ) in 1965 has failed to develop the zones when compared to China which took initiative for establishment only in 1980.

HIGH CORPORATE TAX RATES:

Corporate tax rates in East Asia are generally in the range of 15 to 30 percent, compared with a rate of 48 percent for foreign companies in India. High corporate tax rate is definitely a major disincentive to foreign corporate investment in India.

INDECISIVE GOVERNMENT AND POLITICAL INSTABILITY:

There were too many anomalies on the government side during past two decades and they are still affecting the direct inflow of FDI in India such as mismanagement and oppression by the different company, which affect the image of the country and also deject the prospective investor, who are very much conscious about safety and constant return on their investment.

IV. SUGGESTIONS FOR INCREASED FLOW OF FDI INTO THE COUNTRY

FLEXIBLE LABOUR LAWS NEEDED:

China gets maximum FDI in the manufacturing sector, which has helped the country become the manufacturing hub of the world. In India the manufacturing sector can grow if infrastructure facilities are improved and labor reforms take place. The country should take initiatives to adopt more flexible labor laws.

RE LOOK AT SECTORAL CAPS:

Though the Government has hiked the sectoral cap for FDI over the years, it is time to revisit issues pertaining to limits in such sectors as coal mining, insurance, real estate, and retail trade, apart from the small-scale sector. Government should allow more investment into the country under automatic route. Reforms like bringing more sectors under the automatic route, increasing the FDI cap and simplifying the procedural delays has to be initiated. There is need to improve SEZs in terms of their size, road and port connectivity, assured power supply and decentralized decision-making.

GEOGRAPHICAL DISPARITIES OF FDI SHOULD BE REMOVED:

The issues of geographical disparities of FDI in India need to address on priority. Many states are making serious efforts to simplify regulations for setting up and operating the industrial units. However, efforts by many state governments are still not encouraging. Even the state like West Bengal which was once called Manchester of India attracts only 1.2% of FDI inflow in the country. West Bengal, Bihar, Jharkhand, Chhattisgarh are endowed with rich minerals but due to lack of proper initiatives by governments of these states, they fail to attract FDI.

PROMOTE GREENFIELD PROJECTS:
India's volume of FDI has increased largely due to Merger and Acquisitions (M&As) rather than large Greenfields projects. M&As not necessarily imply infusion of new capital into a country if it is through reinvested earnings and intra company loans. Business friendly environment must be created on priority to attract large Greenfields projects. Regulations should be simplified so that realization ratio is improved (Percentage of FDI approvals to actual flows). To maximize the benefits of FDI persistently, India should also focus on developing human capital and technology.

DEVELOP DEBT MARKET:
India has a well developed equity market but does not have a well developed debt market. Steps should be taken to improve the depth and liquidity of debt market as many companies may prefer leveraged investment rather than investing their own cash. Therefore it is said that countries with well-developed financial markets tend to benefits significantly from FDI inflows.

EDUCATION SECTOR SHOULD BE OPENED TO FDI:
India has a huge pool of working population. However, due to poor quality primary education and higher education, there is still an acute shortage of talent. FDI in Education Sector is lesser than one percent. By giving the status of primary and higher education in the country, FDI in this sector must be encouraged. However, appropriate measure must be taken to ensure quality education. The issues of commercialization of education, regional gap and structural gap have to be addressed on priority.

STRENGTHEN RESEARCH AND DEVELOPMENT IN THE COUNTRY:
India should consciously work towards attracting greater FDI into R&D as a means of strengthening the country's technological prowess and competitiveness.

V. CONCLUSION

FDI plays an important role in the long-term development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities. India emerges as the fifth largest recipient of foreign direct investment across the globe and second largest among all other developing countries (World Investment Report 2010). The huge market size, availability of highly skilled human resources, sound economic policy, abundant and diversified natural resources all these factors enable India to attract FDI. Further, it was found that even though there has been increased flow of FDI into the country during the post liberalization period, the global share of FDI in India is very less when it is compared to other developing countries. Lack of proper infrastructure, instable government and political environment, high corporate tax rates and limited export processing zones are considered to be the major problems for low FDI into the country. To overcome this situation, the Government should revise the sectoral cap and bring more sectors under the automatic route. Further, India should sign the agreement of Double Taxation treaties with other countries in order to increase bilateral trade. Therefore, there is an urgent need to adopt innovative policies and good corporate governance practices on par with international standards, by the Government of India, to attract more and more foreign capital in various sectors of the economy to make India a developed economy.

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