

# An assessment of economic impact of FDI on Indian Agriculture

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**Abstract** - Around 2/3<sup>rd</sup> of the world population is dependent on agriculture for its livelihood. As per 2011 Census, In India, 69% of the total population lives in villages and more than 49% of the total working population are dependent on agriculture. The term Agriculture is derived from two Latin words called 'Agri' meaning 'land' and 'Cultura' meaning 'Tillage'. Hence Agriculture means Tilling the Land. Agriculture has a greater role to play in the economic development of a country. Apart from contributing 16% to national income, it provides largest employment opportunity for larger segment of the population. Hence Indian Agriculture is regarded as the "back bone of Indian economy". Agriculture supplies food grains to people. During 2015-16, around 275 million tonnes of food grains was grown in the country, apart from this agriculture supplies fodder to animals, cattle & livestock. Agriculture also supplies raw materials to industries like raw cotton to cotton industry, sugar cane for sugar industry, oil seeds for edible oil industry, jute for jute industry, Wheat for Biscuits industry etc. These industries are known as 'Agro based industries. The prosperity of these agro based industries is directly dependent upon the availability of inputs from the agricultural sector. Apart from that agriculture creates market for the Industrial output like fertilizers, pesticides, tractors. The demand for industrial products depends upon the income of the farmers which in turn depends upon agricultural production. Despite having an important role to play, agricultural sector in India, exists at the subsistence level. To raise the standard of living of the people and to enable them to use the benefits of science and technology, miraculous advances in agriculture, industry, transport, communication, education, health services and other fields, it is almost essential that, capital formation should take place at a higher rate than before, so that the big development projects may be financed properly. When domestic capital available is not sufficient, it must be compensated through other means and FDI is an important source to supplement the capital scarcity faced in the country. This

**paper analyses the economic impact of such FDI on Agricultural sector.**

**Index Terms** - Capital scarcity, Agricultural sector, Domestic supply, Foreign Direct Investment.

## INTRODUCTION

Foreign direct investment works as a means of integrating developing countries into global market as it increases capital available for investment, which is inevitable for economic growth needed to reduce poverty and raising standard of living. Achieving all these goals requires huge capital to be invested. FDI inflows comprises of capital provided by foreign investors, directly or indirectly to enterprises in another economy with an expectation of obtaining profits derived from capital participation in the management of the enterprise in which they invest. The foreign investors acquire ownership assets in the host country firms in proportion to their equity holdings. Foreign direct investment is defined as a process whereby the residents of one country (Home country) acquires ownership of an asset in another country (host country) and such movement of capital involves ownership, control as well as management of the asset in the host country. World Development Report 2000, published by World Bank, states that 1.1 billion people are surviving on less than US \$ 1 a day and around 2.1 billion people are surviving on less than US \$ 2 a day, of whom between two thirds to three quarters live in rural areas of developing countries. Thus, if the war on poverty is to be won, developing countries need to place more importance on agricultural sector (IFAD, 2002). According to International Monetary Fund (IMF), foreign direct investment is defined as "An investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor". The

investor's purpose is to have an effective voice in the management of the enterprise (IMF, 1977). According to IMF and OECD definitions, the acquisition of at least 10% of the ordinary shares or voting power in a public or private enterprise by non-resident investors makes it eligible to be categorized as FDI.

Foreign Direct Investment has three components, namely:

- (a) Equity Capital
- (b) Reinvested earnings and
- (c) Other direct capital in the form of intra-company loans between direct investors (Parent enterprises) and affiliate enterprises.

Based on the nature of foreign investments, FDI may be categorized as horizontal, vertical or conglomerate. A horizontal direct investment is said to take place when the investor establishes the same type the business operation in a foreign country as it operates in its home country. For example: a cell phone service provider based in the United States moving to India to provide the same service. A vertical investment is one under which the investor establishes or acquires a business activity in a foreign country which is different from the investor's main business activity yet in some way supplements its major activity. For example: an automobile manufacturing company may acquire an interest in a foreign company that supplies parts or raw materials required for the company. A conglomerate type of foreign direct investment is one where an investor makes a foreign investment in a business that is unrelated to its existing business in its home country. This is often in the form of a joint venture with a foreign firm already operating in the industry as the investor has no previous experience.

#### ECONOMIC ADVANTAGES OF FDI

Economic prosperity and the relative abundance of capital are necessary pre-requisites for growth and development of any sector, including Agriculture too. Many economies and organisations have accumulation of huge mass of reserve capital seeking profitable use. The primary aim of economic agents being maximization of their economic interests, the opportunity to generate profits available in other countries often entices such entities to make investments in other countries. The chief motive for shifting capital between different region or between

different industries is the expectation of higher rate of return than what is possible in the home country.

The effects of FDI in the host economy are usually believed to be increase in the employment, augment in the productivity, boost in export and amplified pace of transfer of technology. It facilitates the utilization and exploitation of local raw materials, introduces modern techniques of management and marketing, and eases the access to new technologies, foreign inflows can be used for financing current account deficits also. As noted by the World Bank (2002), several recent studies concluded that FDI can promote the economic development of the host country by promoting productivity growth and export. However, the exact relationship between foreign multinational corporations and their host countries varies considerably between countries and among industries. The characteristics of the host country and the policy environment are important determinants of net benefit of FDI.

#### INDIAN AGRICULTURE AND FOREIGN INVESTMENT

FDI in Indian Agricultural sector is no doubt a necessity, however, any increase in equity stake of the foreign investors in existing joint ventures or purchase of a share of equity by them in domestic firms would not automatically change the orientation of the firm. That is, "the aim of FDI investors would be to benefit from the profit earned in the Indian market. As, a result, in such cases FDI inflows need not be accompanied by any substantial increase in exports, whether such investment leads to modernization of domestic capacity or not". Therefore, it is a challenge for a developing country like India to channelize its capital inflow through FDI into a potential source of productivity gain for domestic firms especially into agriculture. FDI is one of the most important means of arranging finance for the economy of any country. Government of India is relentlessly working towards making agriculture a promising investment sector for global players. The agriculture sector witnessed a steady decline in growth rate from 7.9 per cent in 2010-11 to 3.6 per cent in 2011-12 and further to 1.9 percent in 2012-13. In order to improve the graving situation, Government of India should focus on providing subsidies to small farmers as subsidies in India are too low when

compared to countries to Canada, Japan and USA. With the Food Security Act passing in parliament, the need for more investments in the agricultural sector of India is only bound to increase. Already the increments are being felt as in 12th five year plan (2012-17), FDI inflows of Rs 875 crore in 2012-13, and Rs 70 crore up to June in current (financial) year 2013-14, have been received in agriculture sector.

It is quite evident that Agricultural investment is essential for promoting agricultural growth thus reducing poverty and hunger and promoting environmental sustainability. Agricultural investment can be categorized as public or private and foreign or domestic. Studies have shown that there has been a favourable impact of foreign investment on economic development of any country. Indian economy needs to invest around 35 to 40 per cent of GDP to grow by 7 to 8 per cent a year. National savings are not able to manage this and therefore foreign investments have to cope up with this investment-savings gap. This has already been recognized and successive governments have attempted to attract and facilitate foreign investments in varied sectors of Indian economy.

The FDI in India resulted to \$31.5 billion in 2011, \$27.3 billion in 2012 and \$28 billion in 2013. According to a United Nations report, FDI flows into India grew 17 per cent in 2013 despite unexpected capital outflows in the middle of the year. It also said foreign direct investment across the world rose to levels not seen since the start of the global economic crisis in 2008. The data on FDI inflows into the country shows that foreign investors have shown a keen interest in the Indian economy ever since it has been liberalized. An increasing trend of flows can be observed since 1991 with the peak of FDI flows being reached in 2008-09. Therefore the trend gives support to the fact that as and when the government has taken initiatives to open up and liberalize the economy further, the investors have welcomed the initiative and reciprocated by infusing investments into India.

#### STATUS OF FDI IN INDIAN AGRICULTURE

FDI promotion, facilitation and approval in India is regulated by The Department of Industrial Policy & Promotion established in 1995 and reconstituted in 2000. According to the circulars issued in 2011, FDI

up to 100% is permitted, under the automatic route, subject to certain conditions mentioned in Consolidated FDI Policy, in the following agricultural activities:

##### 1. Agriculture & Animal Husbandry

- a. Floriculture, Horticulture, and 100% Automatic Cultivation of Vegetables & Mushrooms under controlled conditions;
- b. Development and production of Seeds and planting material;
- c. Animal Husbandry (including breeding of dogs), Pisciculture, Aquaculture under controlled conditions; and
- d. Services related to agro and allied sectors

Other conditions: For companies dealing with development of transgenic seeds/vegetables, the following conditions apply:

1. When dealing with genetically modified seeds or planting material the company shall comply with safety requirements in accordance with laws enacted under the Environment (Protection) Act on the genetically modified organisms.
2. Any import of genetically modified materials if required shall be subject to the conditions laid down vide Notifications issued under Foreign Trade (Development and Regulation) Act, 1992.
3. The company shall comply with any other Law, Regulation or Policy governing genetically modified material in force from time to time.
4. Undertaking of business activities involving the use of genetically engineered cells and material shall be subject to the receipt of approval from Genetic Engineering Approval Committee (GEAC) and Review Committee on Genetic Manipulation (RCGM).
5. Import of materials shall be in accordance with National Seeds Policy.
6. The term “under controlled conditions” covers the following:
  - a. ‘Cultivation under controlled conditions’ for the categories of Floriculture, Horticulture, Cultivation of vegetables and Mushrooms is the practice of cultivation wherein rainfall, temperature, solar radiation, air humidity and culture medium are controlled artificially. Control in these parameters may

be effected through protected cultivation under green houses, net houses, poly houses or any other improved infrastructure facilities where microclimatic conditions are regulated anthropogenically.

- b. In case of Animal Husbandry, scope of the term ‘under controlled conditions’ includes –
- Rearing of animals under intensive farming systems with stall-feeding. Intensive farming system will require climate systems (ventilation, temperature/ humidity management), health care and nutrition, herd registering/pedigree recording, use of machinery, waste management systems.
  - Poultry breeding farms and hatcheries where microclimate is controlled through advanced technologies like incubators, ventilation systems etc.
- c. In the case of pisciculture and aquaculture, ‘under controlled conditions’ includes –
- Aquariums
  - Hatcheries where eggs are artificially fertilized and fry are hatched and incubated in an enclosed environment with artificial climate control.

## 2. Tea Plantation

- Tea sector including tea plantations
- Other conditions:
  - (a) Compulsory divestment of 26% equity of the company in favour of an Indian partner/Indian public within a period of 5 years.
  - (b) Prior approval of the State Government concerned in case of any future land use change.

Although India is traditionally an agro based and agro dependent economy, average per hectare yield is lower than the global yield. This is due to lack of finance with the farmers. Banks and financial institutions do not play an impactful role in financing the agricultural sector and hence the sector is severely suffering from lack of finance. Even the foreign investors do not find the agricultural sector of India an attractive one and the share of agriculture in the total FDI in India is negligible. The recent data shows that agriculture accounted for only about 0.8 per cent of the total FDI inflows into India.

## Measures to improve FDI in Indian Agriculture:

The government has taken several steps to revitalise agriculture sector and improve the conditions of farming community on sustainable basis by increasing investment, improving farm practices, rural infrastructure, delivery of credit, technology and other inputs. Some of the major initiatives taken by the

### Government of India include:

The Government of India plans to set up two spice parks at Sitarganj and Sahaspur in Uttrakhand with the help of Spice Board of India, said Mr Anand Sharma, Union Minister for Commerce and Industry, Government of India. It has also opened fifth spice park at Mattupetty Sivaganga in Tamil Nadu (TN) for processing turmeric and chilli.

- The government has allowed 100 per cent FDI under the automatic route in storage and warehousing including cold storages. 100 per cent FDI is also permitted for development of seeds.
- The Cabinet Committee on Economic Affairs (CCEA) has approved the implementation of the National Mission on Oilseeds and Oil Palm (NMOOP) during the 12th Plan with financial allocation of Rs 3507 crore (US\$ 559.51 million). This would help in enhancing production of oilseeds by 6.58 MT and also bring additional area of 125,000 hectares under oil palm cultivation.
- The government has launched an initiative to spend US\$ 65.1 million to promote 60,000 pulses villages in rain fed areas for increasing crop productivity and strengthening market linkages.
- The Government of India has set a target of 259 MT of food grains production in 2013-14. It is implementing various crop development programmes/ schemes for achieving production targets of various crops.
- The total outlay of Rs 27,049 crore (US\$ 4.31 billion) is proposed for the Ministry of Agriculture. The government has allocated US\$ 145.8 billion for agriculture credit, an increase of US\$ 26.04 billion compared to FY13.
- Allocation to the Rashtriya Krishi Vikas Yojana (RKVY) has been increased to US\$ 2.1 billion, an increase of about nine per cent from the previous fiscal.

- The National Bank for Agriculture and Rural development (NABARD) has opened a lending window to private sector for creation of warehouse space and also to set up cold storages and cold chains.
- Unique Organics plans to set up an integrated herbal tea processing facility in West Bengal with total outlay estimated at Rs 500 crore (US\$ 79.73 million). Further, a mobile application named TRA Tocklai on Android and IOS platforms has also been launched by Tea Research Association (TRA) in India. The application includes all research and development (R&D) work done in the past 100 years.
- The Technology Mission on Coconut (TMOC) has cleared 14 projects with an outlay of Rs 19.25 crore (US\$ 3.06 million) and a subsidy of Rs 2.86 crore (US\$ 456,044.92). Under the project component 'Processing and Product Diversification', proposals from 10 coconut processing units have been sanctioned assistance.

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## CONCLUSION

Lower productivity in India is attributed to limited income and sources of credit. FDI plays a significant role in increasing productivity by offsetting the investment and technological gap. Therefore, Indian policy makers should revamp their efforts to attract FDI in agricultural sector. It should be done with a caution so that Indian farmers, who carry out agricultural activities at the subsistence level, will not, however, suffer on account of any FDI initiatives of the government.

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