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Trendsof FDI Inflow in Indian Economy

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Abstract: *This paper tends to reveal the sectoral trend of FDI inflows in India in two different regimes 1991 - 2000 and 2001-2012.This study further discloses the trend of FDI as well as the major sources of FDI inflows. In this study, the descriptive analysis has been employed for evaluating the sectoral trend of FDI inflows in order to identify the most significant sector contributing largely in growth prospect of India in context of FDI inflow. The results imply that service sector along with telecommunication sector received highest FDI inflows during last decade. Further, it is observed that mostly foreign investors prefer to invest through Mauritius route in India.*
Keywords: *sectoral trend, Mauritius route, trends of FDI, growth prospect*.

I. INTRODUCTION

India's foreign Direct Investment inflows and its sources has been widely discussed and debated in both academics and journals during Pre-post reform period. The conclusion of this discussion shows that FDI inflows stimulate the economic growth of country and further attempt to bridge the gap between saving and investment needs of recipient country (see, for instance, claessens et.al, 2001). Reza, S., and Rashid, M.A, (1987) most of the earlier theories explain that foreign investors prefer to invest FDIs in order to control the assets and further production activities of host country On the other hand the recent literature reveals that foreign investors prefer to invest in service sector along with telecommunication sector only in India. This argument lead to a question- Does the FDI inflows attempt to exploit the market of host country in recent decades?In 1991s, an effective measure has been taken in India in order to pursue the trade and investment reforms. This efficient step led to entrance of substantial FDI inflows in country. However, at the end of decade, the country mildly affected by East Asian currency crisis along with poor industrial environment, which might led to down flow of FDI in India.

In this paper, an attempt has been made to investigate the sectoral trend of FDI inflows and the major sources in terms of investing countries of FDI inflows in India over two period 1991 – 2000 and 2000 - 2012. In this study, a descriptive analysis methodology has been employed to recognize the reasons for heavy growth and down fall in cyclic trend of FDI inflows in India and further attempt has been made to identify the most influential sectors augmenting to growth prospect of Indian economy in context of FDI inflows. Our findings imply that service sector is a successive sector which influence largely the major investors of world may be because of low cost labour force, wide gap between demand and supply of financing facilities. Additionally, Most of the investors prefer Mauritius route for FDI inflows because of capital gain tax exemption and easy incorporation of business there. Our findings also emphasis the role of market size, labour force, infrastructure and youth oriented population in order to get more FDI inflows in India. However, during 1998 and 2008, two sudden crises affected badly the trend of FDI flows in India. Our study helps to determine the growth prospect of FDI flows in different sectors on the basis of two different regimes. Our findings are incorporated with recent body of literature, which clearly highlights the causes of explosive growth of FDI inflows in India such as large market size (Anop, 2010) on account of this some of the studies emphasizes on youth of country which largely influence the FDI inflows in terms of technology innovation.

The rest of the paper framed as: Section 2 provides the perspectives related to investment in India. Section 3 provides previous theoretical studies on FDI investment. In section 4 data sources and methodological is discussed. Section 5 presents the full descriptive analysis related to sectoral trend and sources of FDI inflows in India. Section 6states the result and discussion. Section 7 illustrated the conclusions of FDI inflows.

II. PERSPECTIVES ON FOREIGN INVESTMENT

India has opened the flood gate in year 1991 in context of liberalization in trade and investment policies of the country with a motive to economic development in the country (Jaya Gupta, 2007). During year 1992s, when FIIs were allowed, India passed a treaty namely Double Taxation Avoidance Agreement (DTAA) with Mauritius, which facilitate total exemption from capital-gains tax, quick incorporation (a company is formed in Mauritius within two weeks), total business secrecy and a completely convertible currency. The effect of this treaty was that Mauritius observed as a dominant source of FDI investment in India since two decades. In addition to this, Indian government continuously reformed the investment policies and industrial policies along with offered various liberal investment incentives and tax rebates resultant the FDI inflow increased manifold until year 2012, which measured US $75 Millions in 1991, US $ 47138.73 Millions in 2008to US $25542.84 Millions in year 2012. India is mostpreferred destination for FDI investment because of huge population and large scope of services. In India FDI is attributed in various sectors through registered regional offices. If we analyze the sectoral trend of FDI then find that service sector has been reporting highest FDI inflow, which comprised Financial, Insurance, banking services and others services. Investors preferred to invest in service sector because of low cost wages and wide demand-supply gap in financial services in banking, insurance and telecommunication(M. Ansari and M. Ranga, 2010).

III. REVIEW OF LITERATURE

From historically perspective andtraditional body of literature related tosectoraltrends of FDI inflows, Ana Mar (1997)reviewed the recent evidence on the scale of FDI to low-income countries over the period 1970-96 and major factors determining foreign companies' decision to invest in a particular country. The study concludes that large market size, low labor costs and high return in natural resources are amongst the major determinants in decision to invest in low income countries.Laura Alfaro (2003) investigated the effects ofsectoral trend of FDI flows into different sectors of economy such as primary, manufacturing and services on economic growth. He further concluded that FDI inflows into primary sector tends to have a negative effect on growth, whereas FDI inflows in the manufacturing sector has positive one and impact over service sector is ambiguous. In this regards,KulwinderSingh (2005)conducted a study on sectoral trends of FDI flows during 1991-2005 in order to reveal that while FDI shows a gradual increase has become a staple of success in India, the progress is hollow. He further argued that the success of infrastructure depend upon telecommunication and power sector. He finds that in the comparative studies the notion of infrastructure has gone a definitional change. FDI in sectors is held up primarily by telecommunication and power is not evenly distributed. A panel co-integration testhad been conducted on major determinants of FDI such as market size, labor force growth, and infrastructure index and trade openness in South Asia. The results of this study show that FDI has a positive and significant impact on growth for four south Asian countries (Sahoo, 2006).In addition,Jayashree Bose (2007) highlighted in his book the sectoral trend of FDI inflows in India and China. The book provides information on FDI in India and China, emerging issues, globalization, foreign factors, trends and issues in FDI inflows. A comparative study has also been conducted on FDI outflows from India and China. This book also reveals the potential and opportunities in various sectors in India that would surpass FDI inflows in India as compared to China. Jaya Gupta (2007) reviewed the changing sectoral patterns in India due to FDI Inflows since liberalization. She also attempts to examine the impact of policy reform implications on sectoral growth and economic development of India as a whole. Rajan et al. (2008)argued on FDI inflow that India appears to be a suitable location in terms of FDI investment and for reaping huge benefits may be because of well developed financial sector, strong industrial base and large educated worker force. Shiralashetti. A.S and S.S.Huger (2009)conducted a comparative study on country-wise, sector-wise and region-wise, FDI inflows during pre and post liberalization period in India. They found that explosive growth in FDI inflow during post liberalisarion is due to the policy reform and large market size of India.H. Sapna (2011) analyzed the impact of FDI on economic development of Indian economy.Her study reveals that foreign Direct Investment (FDI) is a vital and significant factor influencing the level of growth in Indian economy. She further argues that trade GDP, Research and Development GDP, Financial position, exchange rate, Reserves GDP are the important macroeconomic determinants of FDI Inflows in India. ChaturvediIla (2011)emphasized on sectoral trend of FDI inflows in India. This paper also explore the sector wise distribution of FDI in order to know the dominating sector which has attracted the major share of FDI in India. He also examined in his study that there is high degree of correlation between FDI and Economic Development. M. Ansari and M. Ranga(2010) estimated that India evolved as one of the most favoured destination for investment in the servicesector due to low cost wages and wide demand-supply gap in financial services particularly in banking, insurance and telecommunication. Gradually India has become important centre for back-office processing, call centers, technical support, medical transcriptions, knowledge process outsourcing (KPOs), financial analysis and business processing hub for financial services and insurance claims.

To sum up, the previous studiesreveal the mixed evidence about FDI inflows,Mostly researcher stressed onFDI inflows in service sector of India. However, some of the authors attempt to examine the effect of FDI inflows on GDP and financial position of India.

IV. METHODOLOGY

In this paper, descriptive analysis methodology has been employed to examine the trend of sectoral FDI inflows in India. This study incorporates especially the sources of FDI investment in India and further highlighted the reasons behind lion share of Mauritius route investment in Indian economy since liberalization. However, the FDI inflows analysis has been fragmented in major ten sector of Indian economy, where service sector observed as on priority for investor along with telecommunication sector. The study is basically secondary in nature, for this, data has been collected from various national and international journals, Books such as FDI a contemporary issues by UshaBhati, Department of Industrial Policy & Promotion, Ministry of Commerce and Industry, and finally UNCTAD data base helped a lot for accomplishing the goal of study. Additionally, the effort has been made to get the FDIGR (foreign direct investment growth rate) with assuming previous year as a base year in order to highlight the most successive period for FDI inflows in India. The following formula has been applied for obtaining FDI Growth Rate-

FDI GROWTH RATE = $(P1 - PO)/P0$
P_1= Current year
P_0= Previous year

In this paper the data in concern to trends of FDI inflows has been compiled from last twenty year, which has further been divided into two sub intervals, from year 1991 to 1999 and 2001 to 2012, in order to facilitate the analysis and for getting more constructive results that may expected to be helpful in framing more stable macro economic policy in context of FDI flows in Indian economy. In spite of this to make this study more friendly used graphs and tables to represent the statistical data.

V. DATA DESCRIPTION

This section reveals in detail the trends of FDI inflow in India during the period 1991 to 2012. Actually, thislong period has been divided into two short periods as 1991 to 2000 and 2001 to 2012. These periods will assist in explaining the more clear picture of FDI inflow in India. Further, this section divided into some sub-section with a motive to generate some fruitful results which might be helpful in economic development of India. These sub-sections are-

1. Trend of FDI Inflow
2. Sector wise FDI inflow
3. Major source of FDI inflow in India

Table:1Trend and Pattern of FDI in flow In India (1991 to 2000)

Data in US Dollar Millions

YEAR	FDI INFLOW	FDI Growth Rate
1991	75	
1992	252	236%
1993	532	111%
1994	974	83%
1995	2151	121%
1996	2525	17%
1997	3619	43%
1998	2633	-27%
1999	2168	-18%
2000	3587.99	65%

Compiled from UNCTAD"WIR"YEAR 2012.

Table:2 Trend and Pattern of FDI in flow In India (2001 to 2012)

Data in US Dollar Millions

YEAR	FDI INFLOW	FDI Growth Rate
2001	5477.64	53%
2002	5629.67	3%
2003	4321.08	-23%
2004	5777.81	34%
2005	7621.77	32%
2006	20327.76	167%
2007	25349.89	25%
2008	47138.73	86%
2009	35657.25	-24%
2010	21125.45	-41%
2011	36190.4	71%
2012	25542.84	-29%

Source: Compiled from UNCTAD"WIR"YEAR 2012.
Note: Cumulative FDI included equity component, Re-invested earning and other capital.
In this analysis,wecategorized the study into two sub sections in order to explore more constructive results with a motive that this categorization might be helpful in framing the FDI policies for India.

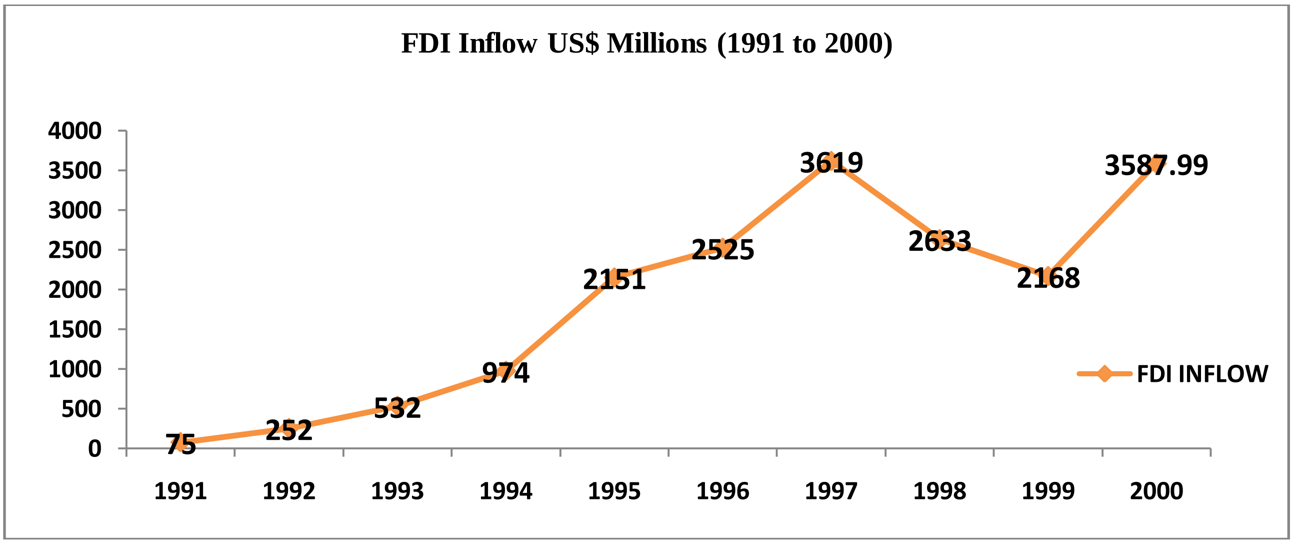

Fig. 1: FDI inflow analysis during the interval 1991 to 2000

From Fig.1, we can interpret that during the early post liberalization period i.e., from 1991 to 1997, FDI inflow continuously increased in India. This upliftment in FDI inflowsmay be due to the entrance of large number of industries or sectors, which were opened up for foreign equity participation. During 1998-99 the FDI reveals the cyclic trend because of several factors put the restriction on FDI inflow in India such as Firstly, the adverse effect 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 (P. sahni, 2012). Fourthly, the decline was due to the political instability and the poor domestic industrial environment.

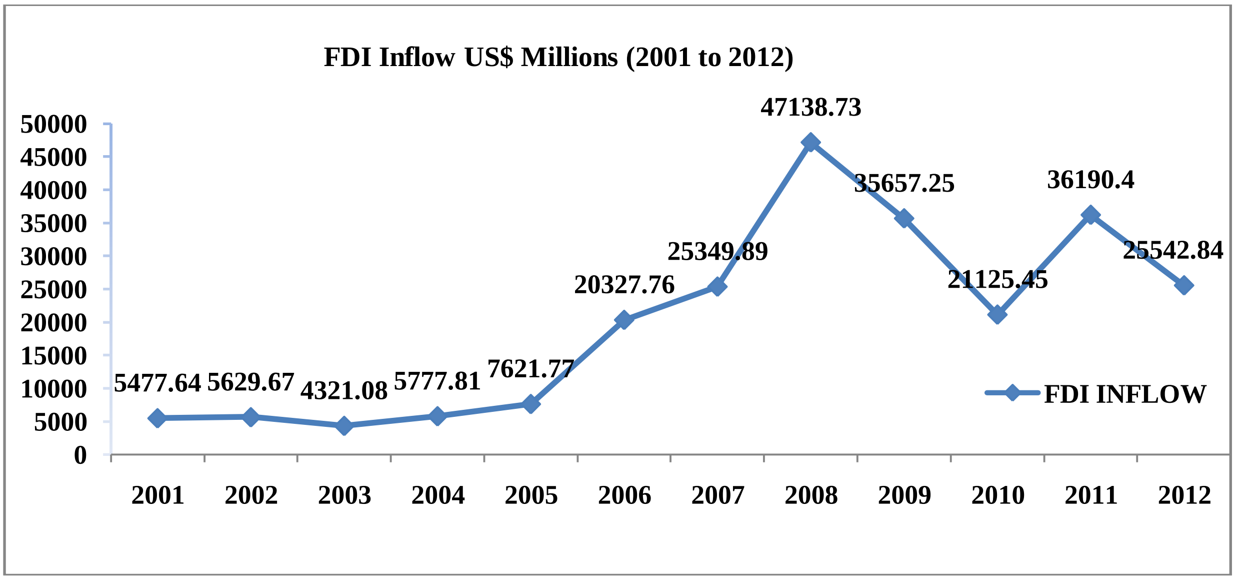

Fig. 2: FDI inflow analysis during the interval 2001 to 2012

From Fig. 2, we can interpret that during second interval 2000 to 2012, the FDI inflow trendreveals the explosive FDI growth in India. In this period the government initiated the major reforms in FDI policies and further large market size (Shiralashetti. A.S and S.S. Huger 2009) motivated the foreign investors such as Mauritius route, USA, Singapore and Others Confidently to invest in India through FIPB and Automatic routes for reaping huge benefits.In year 2008, India received highest FDI inflow that may be because of relatively well developed financial sector, strong industrial base and critical mass of well educated workers (Rajan et. al., 2008).During the third quarter of Financial Year 2008, the US financial crisis badly affected the stock market through out the world. This sudden crisis created a turbulent situation. However, India was least affected country but the slight impact also revealed over FDI inflow into India, which tends to reduce the level of FDI inflow in year 2009 and 2010. During year 2011, India expected to overcome by the adverse effect of financial crisis and succeed to invite substantial inflows again but in year 2012 the FDI inflow framework again moved downward.

Table:3Sectoral distribution of FDI Inflow in Indian Economy

SECTORS	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	Cumulative FDI (from April, 2000 to March, 2012)	Sector-wise Cumulative percentage of FDI Inflow
SERVICE SECTOR(Financial &Non-Financial)	4664	6615	6116	4170	3296	5216	32351	27%
TELE-COMMUNICATION(radio paging, cellular mobile, basic telephone services)	478	1261	2558	2539	1665	1997	12552	11%
CONSTRUCTION ACTIVITY(Including Roads &Highways)	985	1743	2028	2852	1103	2796	11433	10%
COMPUTER SOFTWARE	2614	1410	1677	872	780	796	11205	10%

&HARDWARE								
HOUSING &REAL ESTATE	467	2179	2801	2935	1227	731	11113	9%
CHEMICAL (OTHER THAN FERTILIZERS)	205	229	749	366	398	7252	9844	8%
DRUGS & PHERMACEUTICALS	n.a.	n.a.	n.a.	213	209	3232	9195	8%
POWER and Oil Refinery	157	967	985	1272	1272	1652	7299	6%
AUTOMOBILE INDUSTRY	276	675	1152	1236	1299	923	6758	6%
METALLURGICAL INDUSTRY	173	1177	961	407	1098	1786	6041	5%
TOTAL	10019	16256	19027	16862	12347	26381	117791	100%

Data in US Dollar Millions
Source: DIPP, Federal Ministry of Commerce & Industry, Government of India
[1]**Note:** Cumulative sector-wise FDI equity inflows only.

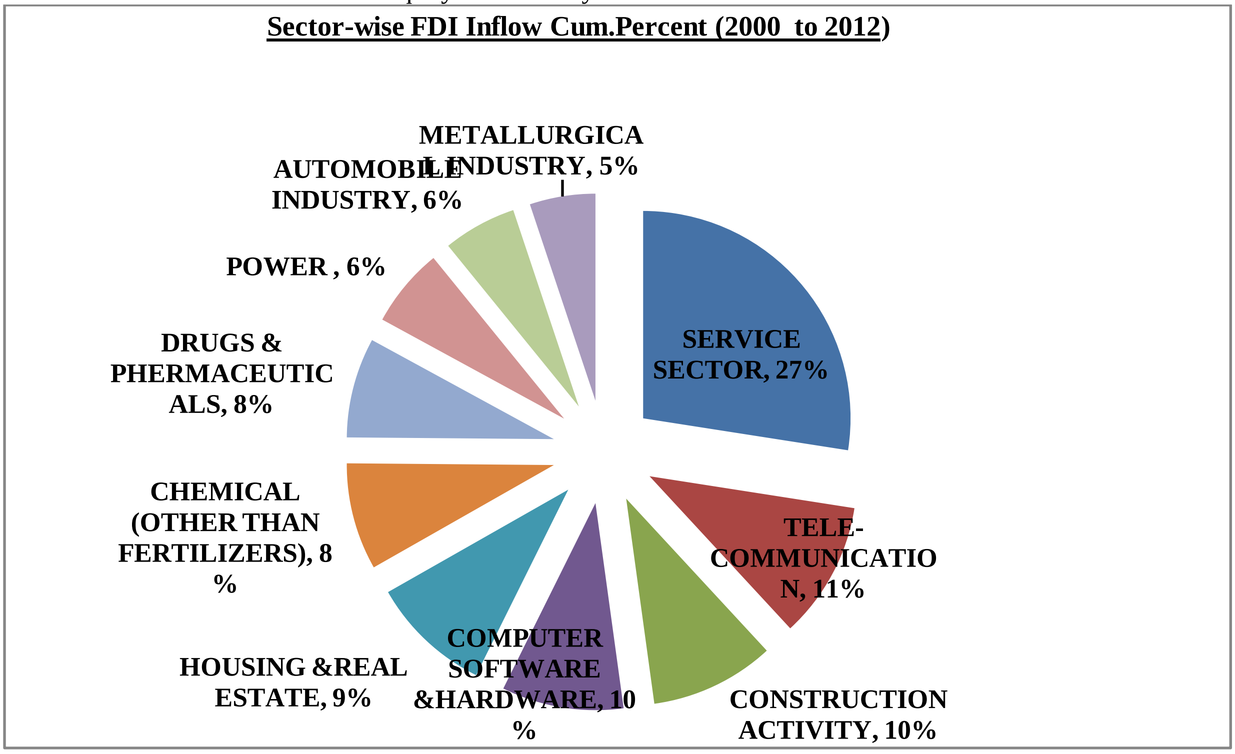

Fig. 3: Sector-wise FDI inflow (2000 to 2012)

From Fig.3, we can interpret that in India about 58% cumulative FDI has been emerged in particularly four sectors; Services sector, Telecommunications sector, Construction activities, Computer software and Hardware and remaining received by rest of economy during 2000 to 2012. Among all, Service sector remained on top priority for investment in India on account of low cost of labour force and wide gap between demand and supply of financial services (M. Ansari and M. Ranga 2010). During FY 2009-10 the real state sector achieved second highest FDI inflow after service sector. Interestingly, the chemical sector moved on first position with highest FDI inflows in FY 2011-12, which was even more than the investment hosted in service sector during FY 2011-2012.

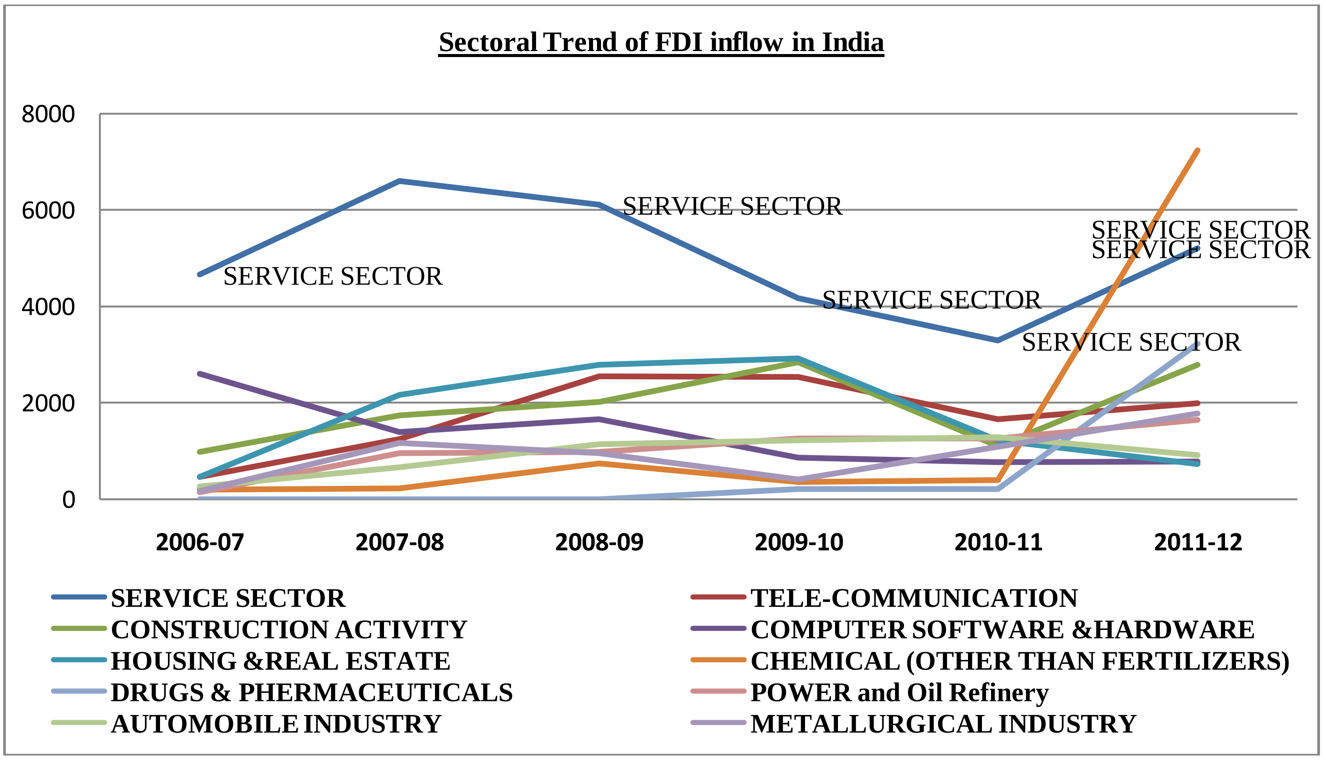

Fig. 4:Sectoral Trend of FDI inflow in India

In above Fig. 4, we can interpret that FDI investment in Service sector of India remained on first priority for foreign investors during last six financial years. However, this trend is not on upward direction but reveals the highest growth than other sectors of Indian economy. In year 2011-12, chemical sector has beaten the service sectors FDI inflows and marked highest FDI. Moreover, some of the sectors such as Telecommunication, construction related activities registered a significant growth that might be due to availability of large work force or due to huge population prompt to increase the opportunities in construction activities in India.

Table:4Major FDI investing countries in India

Data in US Dollar Millions

Country	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	Cumulative FDI Inflow from year 2006-07 to 2011-12	Cumulative percentage of FDI Inflow
MAURITIUS	6363	11096	11208	10376	6987	9942	55972	37%
SINGAPORE	578	3073	3454	2379	1705	5257	16446	11%
U.K.	41	1176	864	657	755	9257	12750	8%
JAPAN	85	815	405	1183	1562	2972	7022	5%
U.S.A.	198	1089	1802	1943	1170	1115	7317	5%
NEITHERLAND	644	695	883	899	1213	1409	5743	4%
GERMANY	120	514	629	626	200	1622	3711	2%
FRANCE	117	145	467	303	734	663	2429	2%
CYPRUS	58	834	1287	1627	913	1587	6306	4%
UAE	260	258	257	629	341	353	2098	1%
OTHERS	4028	4880	10140	5212	3847	2327	30434	20%
TOTAL	12492	24575	31396	25834	19427	36504	150228	100%

Source: DIPP, Federal Ministry of Commerce & Industry, Government of India.
Note: Cumulative country-wise FDI equity inflows only.

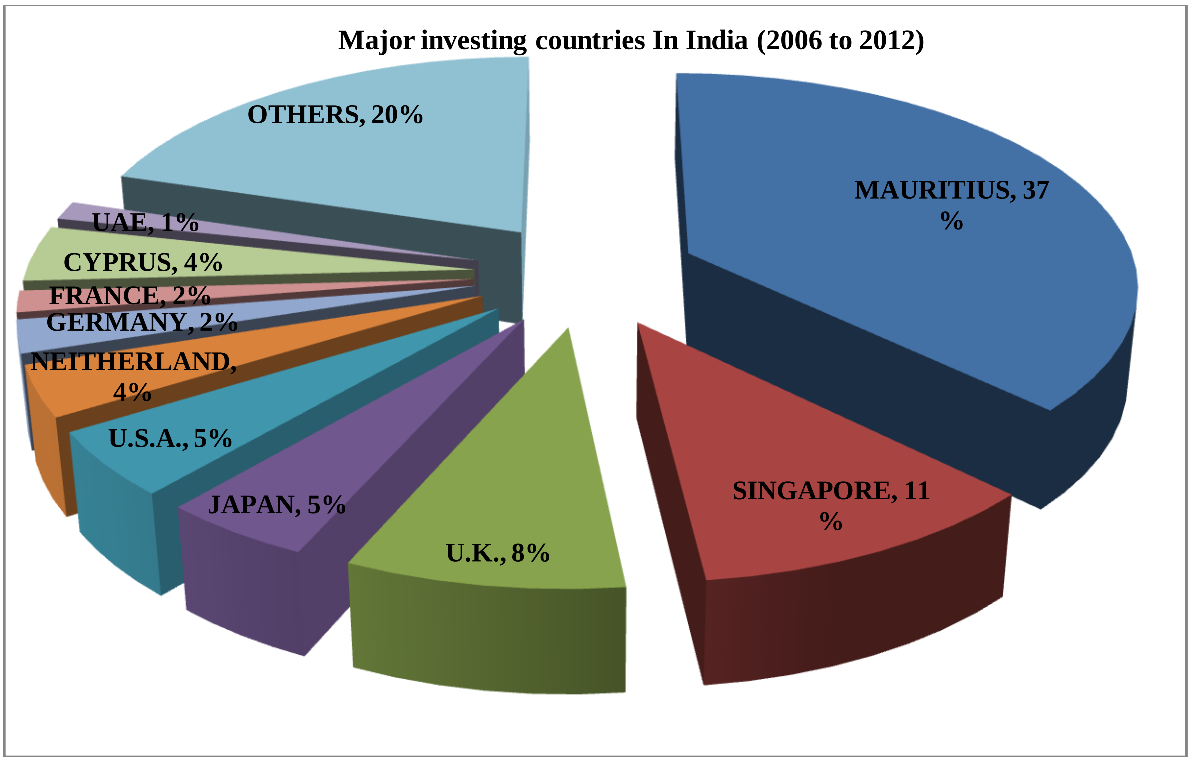

Fig.5 Major investing countries In India (2006 to 2012)

From fig.5, we can interpret that India's 70% of cumulative FDI inflow is contributed by six countries while remaining 30 % contributed by rest of the world. The country specific FDI inflow analysis indicates that during 2006 to 2012, India receivedUS $150228 Millions FDI inflow around 136 countries of the world. In regards of this, Mauritius has contributed largely and further recognized as a most dominant source of FDI investment in the country because of favorable Double Taxation Avoidance Agreement (DTAA) between the two countries (P. Sahni, 2012).Singapore remained on second dominant source of FDI inflows with 11% of the total inflows whereas, UK slipped to third position by contributing 8% oftotal inflows. In India the availability of mass bi-lingual labour force and favorable economic policies implication always attract maximum FDI inflows(Jaya Gupta, 2007).

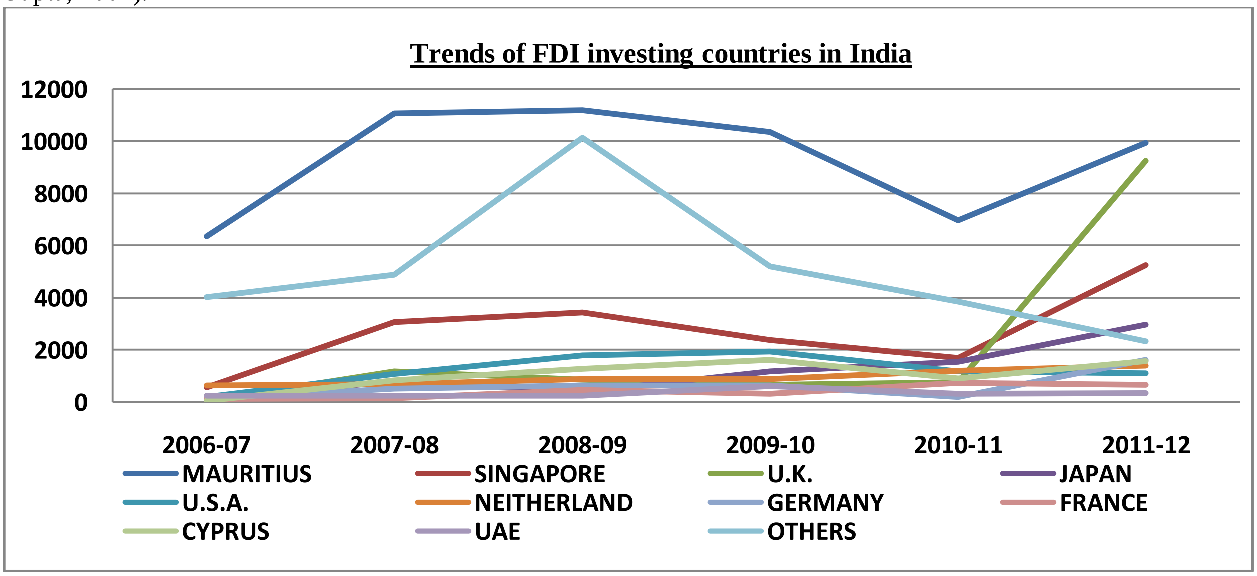

Fig.6, Trends of FDI investing countries in India

In above fig.6, we can interpret that Mauritius is on peak in terms of FDI inflows in India after year 2006. However, from FY 2008-09 onwards, the inflows reveals down ward trend might be due to US financial crisis, which affected unfavorable through out world economy resultant the investors begun to retain their investment in order to smooth rotation of funds in their own economy. Secondly,the Singapore and than U.K. also contributed substantial amount of FDI flows in India since FY 2006-07. In FY 2006-07 and 2010-11, FDI inflows reduced to least in India.

VI. RESULTS AND DISCUSSION

Our study indicates that second interval 2000 to 2012 recognized far better than first interval 1991 to 2000 in terms of FDI inflows.However,from 2005 onwards,India received highest FDI inflows reason being emergence as rapid growing economy, availability of vast immobile natural resources,low cost of skilled labour forceand more liberalized service sector policy. In India about 136 countries contributed the FDI investment. Among all, the Mauritius evaluated as most dominant source of FDI inflows contributing 37% of the total investment in the country because of favorable Double Taxation Avoidance Agreement(DTAA) which facilitated total exemption from capital-gains tax and quick incorporationof company in Mauritius (within two weeks). Afterwards, Singapore and USA occupied second and third position in India in terms of FDI inflow because these countries contributed the large amount of FDI inflows in various sectors of Indian economy for year 2006. Approximately, 63 sectors are such in Indian economy where FDI inflows entertained. I observed that Service sector along with telecommunication sector accounted approx 38% FDI inflows in Indian economy because of low cost wages and wide demand-supply gap in financial services in banking, insurance and telecommunication. In addition to this, India emerged as a center of back-office processing, call centers, technical support, knowledge process outsourcing (KPOs).However, South-East Asia crisis during 1998 -99 and US financial crisis in 2008 both adversely affected the FDI inflow in India .

VII. CONCLUSION

There is a global race for attracting FDI in all developed and developing countries of the world. Although, the developing countries need to modify the level of educational, technological and infrastructure background to promote the FDI. However, India has observed a remarkable growth in the flow of FDI over the last one decade may be because of large market size in terms of GDP and GNI, tax incentives and availability of high quality multilingual work force.One of the significant reasons to invest in India is the youth of this country who are brand loyal and more conscious about taste and preference. In India some of the sectors such as Service sector, Telecommunication sectors are most preferred in terms of Foreign investment and Mauritius and Singapore are such countries which revealed full confidence in India concerning to FDI inflow. However, India receives comparatively much lesser FDI than China and other smaller economies in Asia. To achieve the highest Foreign investment India need to develop such an attractive investment avenues and need to framed liberal economic policies and required to develop the level of Infrastructure in India.

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