Chapter 3

FDI and Economic Growth: A Glance since 1990

3.1 FDI and Economic Growth in India:

At the time of independence India launched a “socialistic pattern of society” as economic policy with government planning and tight government regulations, permits and controls. Nearly four decades of industry oriented planning, India treaty due importance to the agriculture sector in the 1960s, in resulting to massive food shortages. The consequences of this policy shift as green revolution in the early 1970s. After four decades of government intervention, India face balance of payment crisis in early 1980s. After long delay, economic reforms in India was started on 24 July 1991, economic policy has been recognized by the administration under Prime Minister Narasimha Rao and Finance Minister Manmohan Singh starting in early 1990s, India liberalize the economic policies and starts opening the Indian markets to foreign investment.[1] Foreign policy was introduced for financing balance of payment crisis compared with external borrowing. Foreign direct investment and portfolio investment, positively affect economy in such a way that encourage growth in the post reform period. Foreign investment is permitted in virtually every sector, except those of strategic concern such as defense (opened up recently to a limited extent) and rail transport. Foreign companies are permitted to set up 100 per cent subsidiaries in India.

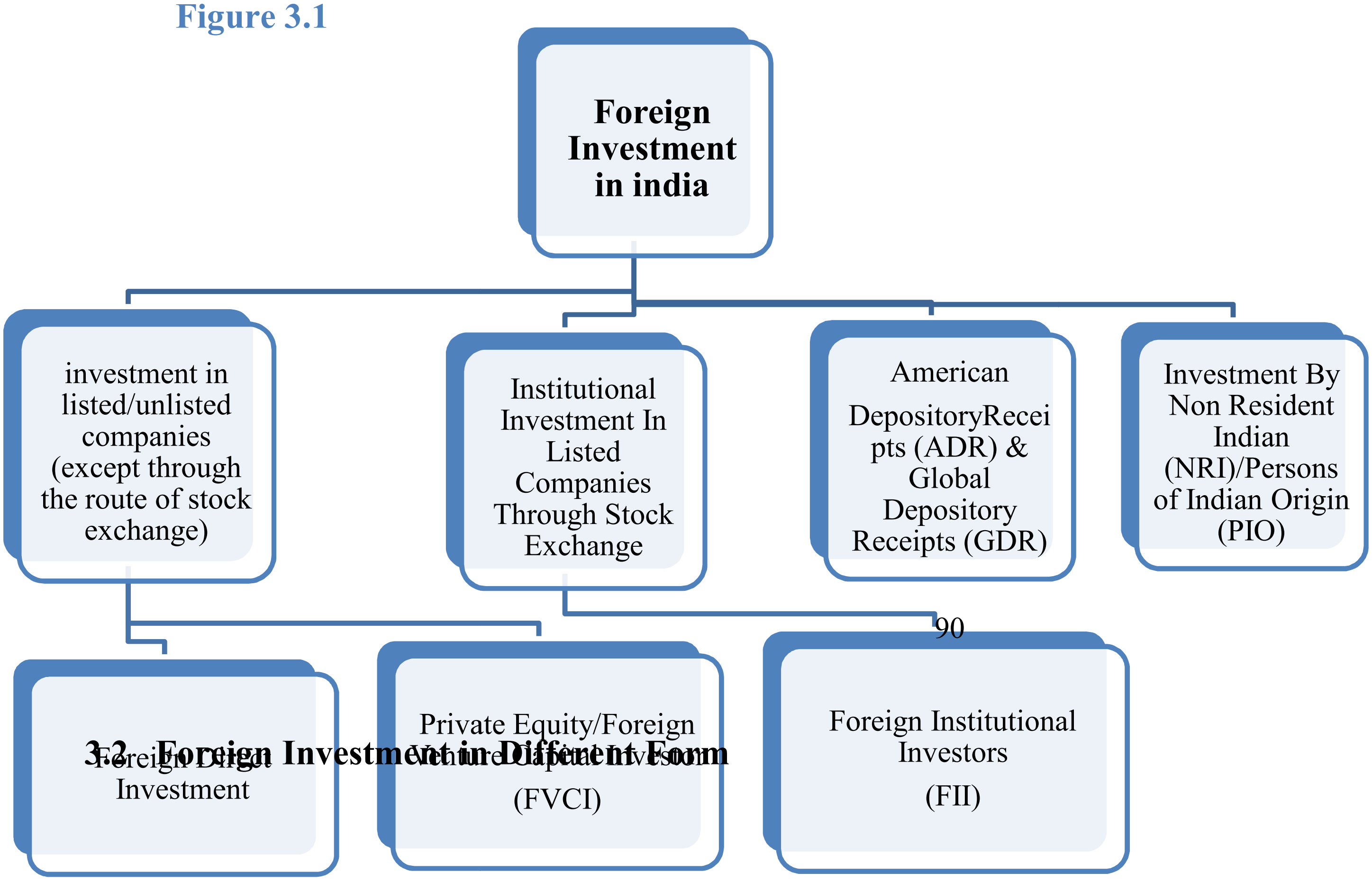
[1] Ram Mohan R. Yallapragada, University of Louisiana at Lafayette madhu r. paruchuri, Tennessee state university “FOREIGN DIRECT INVESTMENT IN INDIA: A LOST OPPORTUNITY”, The Effect of Internet Commerce on The Revenue Base of State and Local Government P. 27

The economy responds to the reforms in term of revival of the annual rate of GDP growth with some slowdown and fluctuations after 1996-7 and an average of 9.48 percent in the three years from 2005-6 to 2007-8. Then the global financial crisis hit. Then country face a slowdown in economy and the growth rate reach a low level 4.99 percentage. This show that financial crisis hamper the growth till now.

The Indian government differentiates cross-border capital inflow into various categories like foreign direct investment (FDI), foreign institutional investment (FII), non -resident Indian (NRI) and person of Indian origin (PIO) investment in various forms:

Type of Foreign Investment in India

Figure 3.1



3.2 Foreign Investment in Different Form

ADR & GDR

Global Depositary Receipts (GDRs) are negotiable certificates issued by depositary banks which represent ownership of a given number of a company's shares which can be listed and traded independently from the underlying shares. These instruments are typically used by companies from emerging markets and marketed to professional investors only.[2]

American depositary receipt (ADR) and global depositary receipt (GDR) is a simple way for investors to invest in companies whose shares are listed abroad. The ADR or GDR is essentially a certificate issued by a bank that gives the owner rights over a foreign share. It can be listed on a stock exchange and bought and sold just like a normal share. The holder of an ADR or GDR is entitled to all benefits such as dividends and rights issues from the underlying shares. Share holders have no right to vote but some time they can do. ADR is listed in the U.S. A.; GDR is typically listed in London. A depositary receipt where the issuing bank is European will sometimes be called a European Depositary Receipt (EDR).[3]

FDI & FII

FDI (Foreign Direct Investment) is when a foreign company invests in India directly by setting up a wholly owned subsidiary or getting into a joint venture, and conducting their business in India. IBM India is a wholly owned subsidiary of IBM, and is a good example of FDI where a foreign company has set up a subsidiary in India and is conducting its business through that company. FII is when foreign investors invest in the shares of a company that is listed in India or in bonds offered by an Indian company. So, if a foreign investor buys shares in Infosys then that qualifies as FII Investment. It is easy to see why you would prefer FDI to FII investments. FDI investments are more stable because companies like IBM set up offices, hire employees, and

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[2] http://www.londonstockexchange.com/traders-and-brokers/security-types/gdrs/gdrs.htm

[3] file:///C:/Users/Students/Desktop/How%20American%20Depositary%20Receipts%20(ADR)%20

have a long term plan for the country. IBM can’t just pull out a few million dollars from India overnight, which is what FII investors do from time to time and that leads to market crashes.

Meaning of Foreign direct investment (FDI) Foreign Direct Investment (FDI) is a direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

3.3 Foreign Direct Investment in India –Schematic Representation

FDI Regulatory Authority in India

The FDI Policy which is formulated and announced by the Government of India. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India issues a "Consolidated FDI Policy Circular " on an yearly basis on March 31 of each year (since 2010) elaborating the policy and the process in respect of FDI The Foreign Exchange Management Act (FEMA), 1999. FEMA Regulations which prescribe amongst other things the mode of investments i.e. issue or acquisition of shares / convertible debentures and preference shares, manner of receipt of funds, pricing guidelines and reporting of the investments to the Reserve Bank.

The aim of economic liberalization and reforms program to raise its growth potential and integrating with the world economy. Economic reforms made revolutionary changes in industrial licensing by removing restrictions on investment projects and business expansion and allowed increasing access to foreign technology and funding on the other. a series of measures that directly liberalizing foreign investment includes: - (i) Introduction of dual route of approval of FDI- RBI automatic route and Government approval (SIA/FIPB) route, (ii) automatic permission for technology agreements in high priority industries and removal of restriction of FDI in low technology areas as well as liberalization of technology imports, (iii) permission to Non-resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) to invest up to 100 per cent in high priorities sectors.

3.3.1 Government policy on Foreign Direct Investment

India has among the most liberal and transparent policies on FDI among the emerging economies. In retail sectors 100% allow in single brand retail and up to 51% allowed in multi-brand retail. FDI up to 100% is allowed under the automatic route in all activities/sectors except the following which require prior approval of the government:

- Manufacture of cigars & cigarettes of tobacco and manufactured tobacco substitutes;

- Manufacture of electronic aerospace and defense equipment : all type
- Manufacture of items exclusively reserved for all sectors with more than 24% FDI;
- Proposal in which the foreign collaborator has an existing financial/technical collaboration in India in the same field;
- All proposal outside notified sectoral policy/caps;

Government amended the policy on single brand retail trading (condition applied):

- The foreign investor being the owner of the brand.
- Mandatory sourcing of at least 30% of the value of the product sold having to be done from Indian "small industries/villages and cottage industries", artisan and craftsmen applicable in respect of proposals involving FDI beyond 51%.

Governments permit FDI up to 51% in multi-brand retail trading under the government route:

- Minimum FDI of US $100 million, of which at least 50% to be invested in back- end infrastructure.
- Mandatory sourcing of a minimum of 30% from Indian small industries with a total investment in plant and machinery not exceeding US $ one million.
- Government having the first right of procurement of agriculture products

- State government having the right to decide whether and where a multi- brand retailer, with FDI, is permitted to establish its sales outlets within the state.

Prohibited sectors

The extant policy does not permit FDI in the following cases:

- Gambling and betting including casinos etc.
- Lottery business including government/private lottery, online lotteries, etc.
- Business of chit fund
- Atomic energy
- Nidhi company
- Trading in transferable development rights (TDRs)
- Real estate business or construction of farm houses
- Manufacturing of cigars, cheroots cigarillos and cigarettes, of tobacco or of tobacco substitutes
- Activities/ sectors not opened to private sectors investment including atomic energy and railway transport (other than mass rapid transport systems)

3.3.2 Entry Routes for FDI Investments in India

Under the Foreign Direct Investments (FDI) Scheme, investments can be made in shares, mandatorily and fully convertible debentures and mandatorily and fully convertible preference shares of an Indian company by non-residents through two routes:

- **Automatic Route:** FDI in sectors/activities to the extent permitted under automatic route does not require any prior approval by the government or RBI. The investors are only required to notify the regional office concerned of RBI within 30 days of receipt of inward remittances and file the required document with that office within 30 days of issue of shares to foreign investors.
- **Government Route:** Under the Government Route, the foreign investor or the Indian company should obtain prior approval of the Government of India (Foreign Investment Promotion Board (FIPB), Department of Economic Affairs (DEA), Ministry of Finance or Department of Industrial Policy & Promotion, as the case may be) for the investment.[4]

Table No. 3.1

There are two types of Entry Route of Foreign Direct Investment in India.
Year-Wise / Route-Wise FDI Equity Inflows from August 1991 to December 2009

(Amount in Rupees million)

INFLOWS OF FOREIGN DIRECT INVESTMENT IN THE FOLLOWING ROUTES			
Year (Jan – Dec.	**I** ***Govt. approval Route***	**II** ***Automatic Route***	**Cumulative** Total **I+ II**

[4] Secretariat for Industrial Assistance, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, Government of India New Delhi, Investing In India, Foreign Direct Investment- policy & procedure p. 13 to 74

	(FIPB,SIA)		
1991 (Aug-Dec)	1,911.8	-	1,911.8
1992	4,906.9	475.1	5,382.00
1993	10,414.4	2411.0	12,825.40
1994	16,043.9	3625.8	19,669.70
1995	39,673.6	5301.6	44,975.20
1996	57,667.0	6196.3	63,863.30
1997	101,283.8	8677.2	109,961.00
1998	82,397.4	6106.6	88,504.00
1999	61,894.5	7608.3	69,502.80
2000	63,368.0	16974.7	80,342.70
2001	96,386.2	32410.7	128,796.90
2002	69,580.1	39030.4	108,610.50
2003	42,955.8	23399.6	66,355.40
2004	48,516.9	54221.1	102,738.00
2005	49,728.4	68686.6	118,415.00
2006	69,683.2	321758.3	391,441.50
2007	107,872.9	361000.6	468,873.50
2008	135588	1004680.8	1,140,268.80

2009 (Jan.- Dec.)	229,715.8	919849.0	1,149,564.80
TOTAL (as on 31.12.09)	1,289,588.60	2882413.7	4,172,002.30

Source: RBI, (FED) Central Office, Mumbai
Note: Since 2003, inflows included under the heading RBI's Automatic Route.

The above table shows the investment by automatic route and approval route. The table reveals that from 1991 to 2004 most of FDI inflow receiving by govt. approval route. But after 2005 sequence has been changed and then flow of FDI is increasing by automatic route because at this time government increase caps of many sectors by automatic route.

3.4 Caps on FDI Inflow in Different Sectors: Government liberalizes FDI limits in 12 sectors, including telecom, defense and others. The Manmohan government liberalizes FDI limits with big hike in Foreign Direct Investment caps.[5] The government has changed FDI limits in many sectors including telecom and defence. The government cleared 100% FDI in telecom sectors and also raises FDI in defence from 26% to 49%. But there are some condition applies with big hikes in Foreign Direct Investment caps. 49% will only be allowed with state of the art technology transfer. FDI limits in different sectors increase such as asset reconstruction from 74% to 100%, petroleum refining 49%, insurance sectors FDI cap from 26% to 49% under automatic route under which companies do not require prior government approval. A bill to raise FDI cap in the sectors is pending in the Rajya Sabha. Civil aviation and media sectors have been left untouched. FDI in 4 others sectors- gas refineries, commodity exchanges, power trading and stock exchange have been allowed via the automatic route. It was decided to allow 49% FDI in single brand retail under the automatic route and beyond through the Foreign Investment

[5] (India Today Online New Delhi, July 16, 2013)

Promotion Board (FIPB). In case of PSU oil refineries, commodity bourses, power exchange, stock exchange and clearing corporations, FDI will be allowed up to 49% under automatic route as against current routing of the investment through FIPB. In basic and cellular services, FDI was raised to 100% from current 74%. Of this, up to 49% will be allowed under automatic route and the remaining through FIPB approval FDI of up to 100% was allowed in courier services under automatic route. In credit information firms 74% FDI under automatic route would be allowed. FDI has been falling steadily in the past few years 2011-12. Foreign investment falls because value of rupees goes down. But the major concern is unstable policies and political uncertainty in the country.[6]

Table No. 3.2

Increase in FDI Caps in Different Sectors

Table 3.3: sector specific limits of foreign investment			
Sectors	**FDI Cap/Equity**	**Entry Route**	**Others Condition**
A. Agriculture 1. Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture, Aquaculture, Cultivation of vegetables & mushrooms and services related to agro and allied sectors. 2. Tea sector, including plantation	100% 100%	Automatic FIPB	

[6] India Today Online New Delhi, July 16, 2013

3.Defence production	26%-49%	FIPB	State of the art of technology transfer
4. Hazardous chemicals & isocyanates 5. Industrial explosives-manufacture 6. Drugs and Pharmaceuticals 7. Power including generation (except Atomic energy); transmission, distribution and power trading.	100% 100% 100% 100%	Automatic Automatic Automatic Automatic	
(FDI is not permitted for generation, transmission & distribution of electricity produced in atomic power plant/atomic energy since private investment in this activity is prohibited and reserved for public sector.)			
D. Services 1. Civil aviation (Greenfield projects and Existing projects)	100%	Automatic	
2. Asset Reconstruction companies	49%-100%	Up to 49% by Automatic while 100% FIPB	
3. Banking (private) sectors	74% (FDI+FII). FII not to exceed 49%	Automatic	

4. NBFCs : underwriting, portfolio management services, investment advisory services, financial consultancy, stock broking, asset management, venture capital, custodian, factoring, leasing and finance, housing finance, forex broking, etc.	100%	Automatic	s.t. minimum capitalization norms
5. Broadcasting a. FM Radio b. Cable network; c. Direct to home; d. Hardware facilities such as up-linking, HUB. e. Up- linking a news and current affairs TV Channel	 20% 49% 100%	FIPB	
6. Commodity Exchange	49% (FDI+FII) (FDI 26% FII 23%)	FIPB	
7. Insurance	26%-49%	Automatic	Clearance from IRDA
8. Petroleum and natural gas: a. Refining	49% (PSUs). 100% (private companies)	FIPB (for PSUs).Automatic (private)	
9. Print Media a. Publishing of newspaper and periodicals dealing with news and current affairs b. Publishing of scientific	26% 100%		S.t. guidelines by Ministry of Information & Broadcastin

magazines/speciality journals/periodicals			
10. courier service	100%	Automatic	
11. Telecommunications a. Basic and cellular, unified access services, national/international long-distance, V-SAT, public mobile	74%-100% FDI,FII,NRI, FCCBs, ADRs/GDRs,)	Automatic Up to 49% And FIPB beyond 49%	

Sectors where FDI is prohibited

1. Atomic Energy;
2. Lottery Business including Government / private lottery, online lotteries etc;
3. Gambling and Betting including casinos etc.;
4. Business of chit fund;
5. Nidhi Company,
6. Trading in Transferable Development Rights (TDRs);
7. Activities/sector not opened to private sector investment;
8. Agriculture (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms etc. under controlled conditions and services related to agro and allied sectors) and Plantations (Other than Tea Plantations);
9. Real estate business, or construction of farm houses;

Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

Source: Foreign Direct investment (FDI) statistical table from Reserve Bank of India (RBI)

Note: foreign investment through automatic route does not require govt. permission to invest while through approval route, prior government permission is requiring for investment. Some change which occurs by the department of industrial policy and promotion are mention Govt. raises FDI limits in 12 sectors;

Above table present the recent changes in FDI caps in different sectors and remove the approval route from a number of sectors.

3.5 FDI Inflow and Economic Growth in India: - There are many factors which affect the growth rate of any country. FDI is also considering as a foreign investment in the country. FDI increase the productive capacity of an economy by investing long term equity investment. Due to the 1980s balance of payment crisis, growth rate decline by 5.36 during the period 1992 -93. In 1991 Indian government introduced economic reforms and open market for foreign investor and removing licensing from some selected sectors. It influenced the growth of Indian economy. Between 2000–01 and 2007–08, India's real GDP growth averaged 7.3 per cent per annum. In 2005-06 FDI inflow is 394.57 Rs. billion and the growth rate of this period was 9.48 due to this record level India became the third largest economy. Growth rate have recently been around 9 per cent and sometimes in excess of 9 per cent, except for the period since 2008–09. In that year, GDP growth fell to 6.7 per cent due to the global financial crisis. This table show that when FDI inflow increases growth rates also increase. During 2012-13 FDI inflow (-5.32%) decline as well as growth rate (4.99%) decline. While India continued to be the second fastest growing economy in the world after China, (F.M.) P.Chidambaram (2014).

Global prospective: The UNCTAD World Investment Report (WIR) 2012, in its analysis of the global trends in foreign direct investment (FDI) inflows, has continued to report India as the third most attractive location for FDI for 2012-2014. According to report, India accounted for more than four fifths the FDI in South Asian in 2011. The financial year 2011 survey of the Japan Bank for International Cooperation, conducted that India as the second most promising country for overseas business operation in the medium term. The 2012 A.T. Kearney Confidence Index Rates India second in term of Future Prospect for FDI Inflows, After China, followed by Brazil, U.S.A., Germany Australia, Singapore, U.K., Indonesia, South Africa and Russia

Table No. 3.3

Growth Rate of FDI Inflow, GDP in %, and FDI as a Ratio of GDP in India

(1991-92 to 2012-13)

Financial Year wise	Growth rate of FDI inflow (in %)	Growth rate of GDP (in %)	FDI as a percentage of GDP
1991-92	-	-	0.000231
1992-93	205.38	5.36	0.000670
1993-94	90.47	5.68	0.001207
1994-95	124.48	6.39	0.002547
1995-96	73.82	7.29	0.004127
1996-97	39.64	7.97	0.005338
1997-98	32.00	4.30	0.006755
1998-99	-21.65	6.68	0.004961
1999-00	-9.85	8.00	0.004141
2000-01	97.11	4.15	0.007837
2001-02	58.83	5.39	0.011812
2002-03	-16.55	3.88	0.009490
2003-04	-18.72	7.97	0.007144
2004-05	35.89	7.05	0.009069
2005-06	46.42	9.48	0.012129
2006-07	160.16	9.57	0.028800
2007-08	35.82	9.32	0.035780
2008-09	36.78	6.72	0.045856

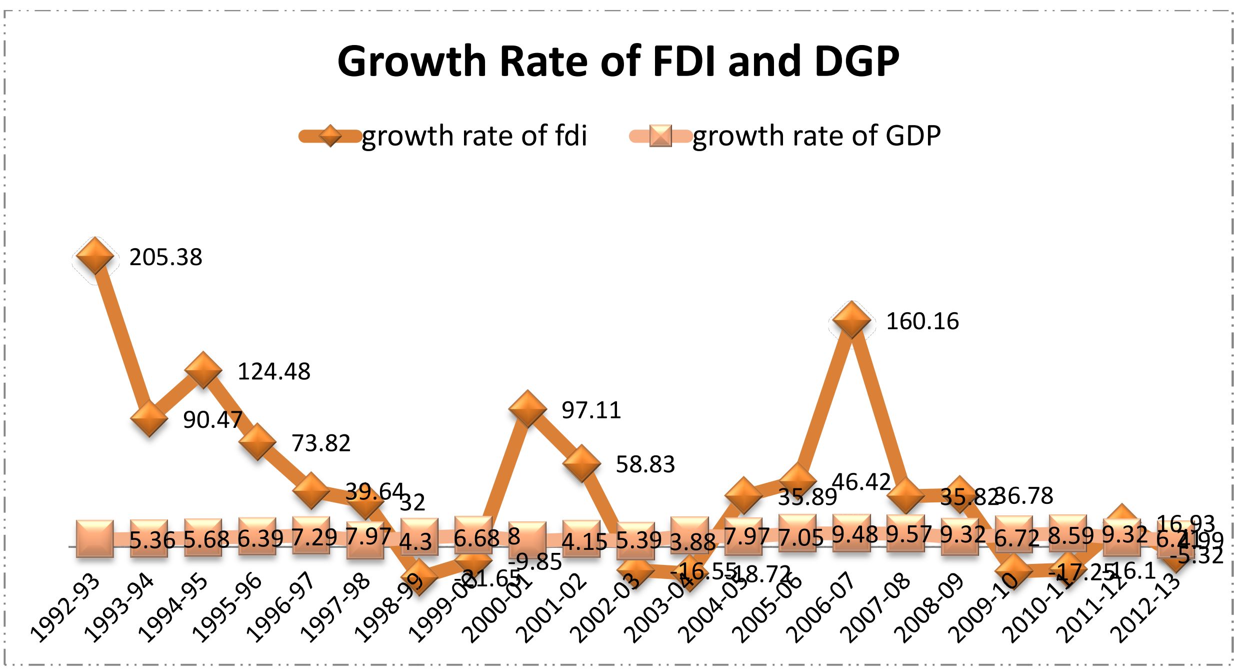
2009-10	-17.25	8.59	0.034942
2010-11	-16.10	9.32	0.026818
2011-12	16.93	6.21	0.029525
2012-13	-5.32	4.99	0.026625

Source: Reserve Bank of India Handbook Statistic of Indian Economy (Self Computed)

Data for 2010-11, 2011-12 and 2012-13 are Provisional

Note: (-) Ne sign shows that decrease in FDI inflow in a particular year.

The figure shows trends of FDI inflow and GDP growth in India from 1992-93 to 2012-13. **Figure 3.2**



FDI as a % of GDP Figure 3.3

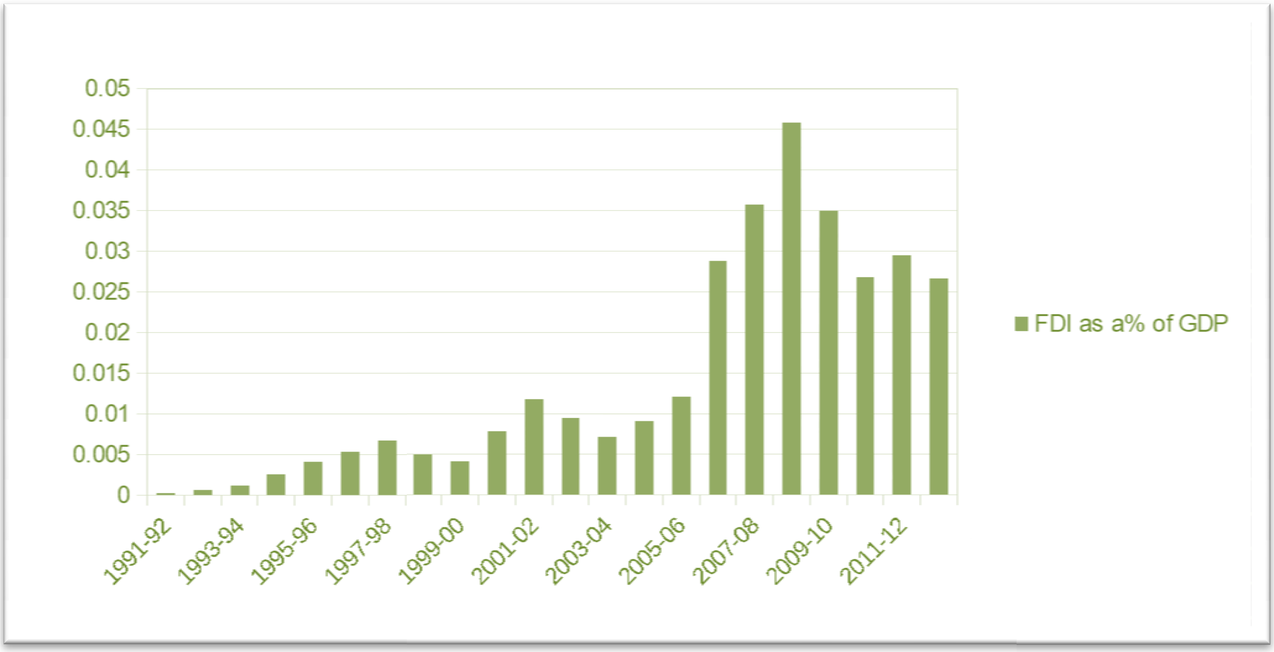


Figure 2 show that fluctuation of FDI growth rate and GDP growth rate. At the starting stage of economic reforms growth rate of FDI is very high because government liberalizes policy regarding foreign investment in economy. After that FDI inflow increasing with a decreasing rate and the growth rate of GDP increase with the flow of FDI. Growth rate of GDP in 2006-07 is higher with higher FDI inflow. In 2008 due to global financial crisis growth rate of GDP decline by 4.99% and FDI decline by -5.32%.

Figure 3 show that FDI contribution to GDP growth, reflect that how much it affect the growth rate of an economy.