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TRENDS & GROWTH OF FDI IN INDIA

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Abstract
Global FDI flows changed significantly since the outbreak of global financial crisis in 2008, with an uneven pattern across regions and countries. FDI flows to India also moderated during 2009 but unlike trends in other EMEs, flows continued to be sluggish during 2010 despite strong domestic growth ahead of global recovery.
The paper proposes to make a comparative analysis of global trends of FDI and offer a few observations with reference to the same.

Key words: Foreign Direct Investment, Emerging Market Economies, Deceleration.

INTRODUCTION
FDI inflows to India remained sluggish, when global FDI flows to EMEs had recovered in 2010-11, despite sound domestic economic performance ahead of global recovery. The paper gathers evidence through a panel exercise that actual FDI to India during the year 2010-11 fell short of its potential level (reflecting underlying macroeconomic parameters) partly on account of amplification of policy uncertainty as measured through Kauffmann's Index.

FDI inflows to India witnessed significant moderation in 2010-11 while other EMEs in Asia and Latin America received large inflows. This had raised concerns in the wake of widening current account deficit in India beyond the perceived sustainable level of 3.0 per cent of GDP during April-December 2010. This also assumes significance as FDI is generally known to be the most stable component of capital flows needed to finance the current account deficit. Moreover, it adds to investible resources, provides access to advanced technologies, assists in gaining production know-how and promotes exports.

A perusal of India's FDI policy vis-à-vis other major emerging market economies (EMEs) reveals that though India's approach towards foreign investment has been relatively conservative to begin with, it progressively started catching up with the more liberalised policy stance of other EMEs from the early 1990s onwards, inter alia in terms of wider access to different sectors of the economy, ease of starting business, repatriation of dividend and profits and relaxations regarding norms for owning equity. This progressive liberalisation, coupled with considerable improvement in terms of macroeconomic fundamentals, reflected in growing size of FDI flows to the country that increased nearly 5 fold during first decade of the present millennium.

Though the liberal policy stance and strong economic fundamentals appear to have driven the steep rise in FDI flows in India over past one decade and sustained their momentum even during the period of global economic crisis (2008-09 and 2009-10),the subsequent moderation in investment flows despite faster recovery from the crisis period appears somewhat inexplicable. Survey of empirical literature and analysis presented in the paper seems to suggest that these divergent trends in FDI flows could be the result of certain institutional factors that dampened the investors' sentiments despite continued strength of economic fundamentals. Findings of the panel exercise, examining FDI trends in 10 select EMEs over the last 7 year period, suggest that apart from macro fundamentals, institutional factors such as time taken to meet various procedural requirements make significant impact on FDI inflows.

TRENDS IN FDI INFLOWS

Widening growth differential across economies and gradual opening up of capital accounts in the emerging world resulted in a steep rise in cross border investment flows during the past two decades. This section briefly presents the recent trends in global capital flows particularly to emerging economies including India.

1.1 Global Trends in FDI Inflows

During the period subsequent to dotcom burst, there has been an unprecedented rise in the cross-border flows and this exuberance was sustained until the occurrence of global financial crisis in the year 2008-09. Between 2003 and 2007, global FDI flows grew nearly four -fold and flows to EMEs during this period, grew by about three-fold. After reaching a peak of US$ 2.1 trillion in 2007, global FDI flows witnessed significant moderation over the next two years to touch US$ 1.1 trillion in 2009, following the global financial crisis. On the other hand, FDI flows to developing countries increased from US$ 565 billion in 2007 to US$ 630 billion in 2008 before moderating to US$ 478 billion in 2009.

The decline in global FDI during 2009 was mainly attributed to subdued cross border merger and acquisition (M&A) activities and weaker return prospects for foreign affiliates,which adversely impacted equity investments as well as reinvested earnings. According to UNCTAD, decline in M&A activities occurred as the turmoil in stock markets obscured the price signals upon which M&As rely. There was a decline in the number of green field investment cases as well, particularly those related to business and financial services.

From an institutional perspective, FDI by private equity funds declined as their fund raising dropped on the back of investors' risk aversion and the collapse of the leveraged buyout market in tune with the deterioration in credit market conditions. On the other hand, FDI from sovereign wealth funds (SWFs) rose by 15 per cent in 2009. This was apparently due to the revised investment strategy of SWFs - who have been moving away from banking and financial sector towards primary and manufacturing sector, which are less vulnerable to financial market developments as well as focusing more on Asia.

As the world economic recovery continued to be uncertain and fragile, global FDI flows remained stagnant at US $ 1.1 trillion in 2010. According to UNCTAD's Global Investment Trends Monitor (released on January 17, 2011), although global FDI flows at aggregate level remained stagnant, they showed an uneven pattern across regions – while it contracted further in advanced economies by about 7 per cent, FDI flows recovered by almost 10 per cent in case of developing economies as a group driven by strong rebound in FDI flows in many countries of Latin America and Asia. Rebound in FDI flows to developing countries has been on the back of improved corporate profitability and some improvement in M&A activities with improved valuations of assets in the stock markets and increased financial capability of potential buyers.

Improved macroeconomic conditions, particularly in the emerging economies, which boosted corporate profits coupled with better stock market valuations and rising business confidence augured well for global FDI prospects. According to UNCTAD, these favourable developments may help translate MNC's record level of cash holdings (estimated to be in the range of US$ 4-5 trillion among developed countries' firms alone) into new investments during 2011. The share of developing countries, which now constitutes over 50 per cent in total FDI inflows, may increase further on the back of strong growth prospects. However, currency volatility, sovereign debt problems and potential protectionist policies may pose some risks to this positive outlook. Nonetheless, according to the Institute of International Finance (January 2011), net FDI flows to EMEs was projected to increase by over 11 per cent in 2011. FDI flows into select countries are given in Table 1.

Table 1 : Countries with Higher Estimated Level of FDI Inflows than India in 2010

	Amount (US$ billion)				Variation (Percent)		
	2007	2008	2009	2010 (Estimates)	2008	2009	2010 (Estimates)
World	**2100.0**	**1770.9**	**1114.2**	**1122.0**	**-15.7**	**-37.1**	**0.7**
Developed Economies	**1444.1**	**1018.3**	**565.9**	**526.6**	**-29.5**	**-44.4**	**-6.9**
United States	266.0	324.6	129.9	186.1	22.0	-60.0	43.3
France	96.2	62.3	59.6	57.4	-35.2	-4.3	-3.7
Belgium	118.4	110.0	33.8	50.5	-7.1	-69.3	49.4
United Kingdom	186.4	91.5	45.7	46.2	-50.9	-50.1	1.1
Germany	76.5	24.4	35.6	34.4	-68.1	45.9	-3.4
Developing Economies	**564.9**	**630.0**	**478.3**	**524.8**	**11.5**	**-24.1**	**9.7**
China	83.5	108.3	95.0	101.0	29.7	-12.3	6.3
Hong Kong	54.3	59.6	48.4	62.6	9.8	-18.8	29.3
Russian Federation	55.1	75.5	38.7	39.7	37.0	-48.7	2.6
Singapore	35.8	10.9	16.8	37.4	-69.6	54.1	122.6
Saudi Arabia	22.8	38.2	35.5	-	67.5	-7.1	-
Brazil	34.6	45.1	25.9	30.2	30.3	-42.6	16.6
India	**25.0**	**40.4**	**34.6**	**23.7**	**61.6**	**-14.4**	**-31.5**

Source: World Investment Report, 2010 and Global Investment Trends Monitor, UNCTAD.

TRENDS IN FDI INFLOWS TO INDIA

With the tripling of the FDI flows to EMEs during the pre-crisis period of the 2000s, India also received large FDI inflows in line with its robust domestic economic performance. The attractiveness of India as a preferred investment destination could be ascertained from the large increase in FDI inflows to India, which rose from around US$ 6 billion in 2001-02 to almost US$ 38 billion in 2008-09. The significant increase in FDI inflows to India reflected the impact of liberalisation of the economy since the early 1990s as well as gradual opening up of the capital account. As part of the capital account liberalisation, FDI was gradually allowed in almost all sectors, except a few on grounds of strategic importance, subject to compliance of sector specific rules and regulations. The large and stable FDI flows also increasingly financed the current account deficit over the period. During the recent global crisis, when there was a significant deceleration in global FDI flows during 2009-10, the decline in FDI flows to India was relatively moderate reflecting robust equity flows on the back of strong rebound in domestic growth ahead of global recovery and steady reinvested earnings (with a share of almost 25 per cent) reflecting better profitability of foreign companies in India. However, when there had been some recovery in global FDI flows, especially driven by flows to Asian EMEs, during 2010-11, gross FDI equity inflows to India witnessed significant moderation. Gross equity FDI flows to India moderated to US$ 20.3 billion during 2010-11 from US$ 27.1 billion in the preceding year.

Table 2: Equity FDI Inflows to India(Percent)					
Sectors	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**
Sectoral shares (Percent)					
Manufactures	17.6	19.2	21.0	22.9	32.1
Services	56.9	41.2	45.1	32.8	30.1
Construction, Real estate and mining	15.5	22.4	18.6	26.6	17.6
Others	9.9	17.2	15.2	17.7	20.1
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Equity Inflows (US$ billion)					
Manufactures	1.6	3.7	4.8	5.1	4.8
Services	5.3	8.0	10.2	7.4	4.5
Construction, Real estate and mining	1.4	4.3	4.2	6.0	2.6
Others	0.9	3.3	3.4	4.0	3.0
Total Equity FDI	**9.3**	**19.4**	**22.7**	**22.5**	**14.9**

From a sectoral perspective, FDI in India mainly flowed into services sector (with an average share of 41 per cent in the past five years) followed by manufacturing (around 23 per cent) and mainly routed through Mauritius (with an average share of 43 per cent in the past five years) followed by Singapore (around 11 per cent). However, the share of services declined over the years from almost 57 per cent in 2006-07 to about 30 per cent in 2010-11, while the shares of manufacturing, and ‘others’ largely comprising ‘electricity and other power generation’ increased over the same period (Table 2). Sectoral information on the recent trends in FDI flows to India show that the moderation in gross equity FDI flows during 2010-11 has been mainly driven by sectors such as ‘construction, real estate and mining’ and services such as ‘business and financial services’. Manufacturing, which has been the largest recipient of FDI in India, has also witnessed some moderation (Table 2).

SECTION 2: FDI POLICY FRAMEWORK

Policy regime is one of the key factors driving investment flows to a country. Apart from underlying macro fundamentals, ability of a nation to attract foreign investment essentially depends upon its policy regime - whether it promotes or restrains the foreign investment flows. This section undertakes a review of India’s FDI policy framework and makes a comparison of India’s policy vis-à-vis that of select EMEs

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CROSS-COUNTRY COMPARISON OF FDI POLICIES – WHERE DOES INDIA STAND?

A true comparison of the policies could be attempted if the varied policies across countries could be reduced to a common comparable index or a measure. Therefore, with a view to examine and analyse 'where does India stand' vis-a-vis other countries at the current juncture in terms of FDI policy framework, the present section draws largely from the results of a survey of 87 economies undertaken by the World Bank in 2009 and published in its latest publication titled 'Investing Across Borders'.

The survey has considered four indicators, viz., 'Investing across Borders', 'Starting a Foreign Business', 'Accessing Industrial Land', and 'Arbitrating Commercial Disputes' to provide assessment about FDI climate in a particular country. **Investing across Borders**indicator measures the degree to which domestic laws allow foreign companies to establish or acquire local firms.**Starting foreign business** indicator record the time, procedures, and regulations involved in establishing a local subsidiary of a foreign company. **Accessing industrial land** indicator evaluates legal options for foreign companies seeking to lease or buy land in a host economy, the availability of information about land plots, and the steps involved in leasing land. **Arbitrating commercial disputes** indicator assesses the strength of legal frameworks for alternative dispute resolution, rules for arbitration, and the extent to which the judiciary supports and facilitates arbitration. India's relative position in terms of these four parameters vis-à-vis major 15 emerging economies, which compete with India in attracting foreign investment, is set out in Tables 5A and 5B.

FOLLOWING KEY OBSERVATIONS COULD BE MADE FROM THIS COMPARISON

- A comparative analysis among the select countries reveals that countries such as Argentina, Brazil, Chile and the Russian Federation have sectoral caps higher than those of India implying that their FDI policy is more liberal.
- The sectoral caps are lower in China than in India in most of the sectors barring agriculture and forestry and insurance. A noteworthy aspect is that China permits 100 per cent FDI in agriculture while completely prohibits FDI in media. In India, on the other hand, foreign ownership is allowed up to 100 per cent in sectors like 'mining, oil and gas', electricity and 'healthcare and waste management'.

Table 5A: Investing Across Borders – Sector wise Caps – 2009

Country	Mining, oil and gas	Agriculture and forestry	Light manufacturing	Telecommunications	Electricity	Banking	Insurance	Transportation	Media	Construction, tourism and retail	Health care and waste management
Argentina	100	100	100	100	100	100	100	79.6	30	100	100
Brazil	100	100	100	100	100	100	100	68	30	100	50
Chile	100	100	100	100	100	100	100	100	100	100	100
China	75	100	75	49	85.4	62.5	50	49	0	83.3	85

India	**100**	**50**	**81.5**	**74**	**100**	**87**	**26**	**59.6**	**63**	**83.7**	**100**
Indonesia	97.5	72	68.8	57	95	99	80	49	5	85	82.5
Korea,	100	100	100	49	85.4	100	100	79.6	39.5	100	100
Malaysia	70	85	100	39.5	30	49	49	100	65	90	65
Mexico	50	49	100	74.5	0	100	49	54.4	24.5	100	100

- India positioned well vis-a-vis comparable counterparts in the select countries in terms of the indicator ‘starting a foreign business’. In 2009, starting a foreign business took around 46 days with 16 procedures in India as compared with 99 days with 18 procedures in China and 166 days with 17 procedures in Brazil (Table 5 B).
- In terms of another key indicator, viz., ‘accessing industrial land’ India’s position is mixed. While the ranking in terms of indices based on lease rights and ownership rights is quite high, the time to lease private and public land is one of the highest among select countries at 90 days and 295 days, respectively. In China, it takes 59 days to lease private land and 129 days to lease public land. This also has important bearing on the investment decisions by foreign companies.
- In terms of the indicator ‘arbitrating commercial disputes’ India is on par with Brazil and the Russian Federation. Although, the strength of laws index is fairly good, the extent of judicial assistance index is moderate.

Table 5B: Investing Across Borders – Key Indicators 2009

Country	**Starting a Foreign Business**			**Accessing Industrial Land**						**Arbitrating Commercial Disputes**	
	Time (days)	**Procedures (number)**	**Ease of establishment index (0 = min, 100 = max)**	**Strength of lease rights index (0 = min,100 = max)**	**Strength of ownership rights index (0 = min,100 = max)**	**Access to land information index (0 =min, 100 = max)**	**Availability of land, information, index (0 min, 100 = max)**	**Time to lease private land (days)**	**Time to leas e public land (days)**	**Strength of laws index (0 = min, 100 = max)**	**Ease of process index (0 = min, 00 = max)**	**Extent of judicial assistance index (0 =min, 100 = max)**
Argentina	50	18	65	79.3	100	44.4	85	48	112	63.5	72.2	55.1
Brazil	166	17	62.5	85.7	100	33.3	75	66	180	84.9	45.7	57.2
China	99	18	63.7	96.4	n/a	50	52.5	59	129	94.9	76.1	60.2
India	**46**	**16**	**76.3**	**92.9**	**87.5**	**15.8**	**85**	**90**	**295**	**88.5**	**67.6**	**53.4**

Korea,	17	11	71.1	85.7	100	68.4	70	10	53	94.9	81.9	70.2
Malaysia	14	11	60.5	78.5	87.5	23.1	85	96	355	94.9	81.8	66.7

CONCLUSION

Thus, a review of FDI policies in India and across major EMEs suggests that though India's policy stance in terms of access to different sectors of the economy, repatriation of dividend and norms for owning equity are comparable to that of other EMEs, policy in terms of qualitative parameters such as 'time to lease private land', 'access to land information' and 'Extent of Judicial assistance' are relatively more conservative. Since time taken to set up a project adds to the cost and affect competitiveness, an otherwise fairly liberal policy regime may turn out to be less competitive or economically unviable owing to procedural delays. Thus, latter may affect the cross border flow of investible funds. But an assessment of precise impact of these qualitative parameters on the flow of FDI is an empirical question.

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