EVALUATING FDI INFLOW IN INDIA DURING THE LIBERALISED ERA

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The adoption of liberal economic policy in India since 1991 has led inter alia to the implementation of an attractive foreign direct investment (FDI) policy. The policy is expected to attract large inflow of FDI into the country. But the question is whether the inflow has turned really large. The greater magnitude of FDI inflow can be interpreted, among other things, in terms of the absolute size of the inflow, stability in the inflow and the size of the inflow in relation to that in some major host countries of Asia, especially the next-door neighbour, China. The present paper examines this particular issue at some length.

I: FDI Policy in the Liberalised Regime

Broadly speaking, the policy helps increase the stake of foreign investors in Indian companies, provides a bigger room for their entry, axes the procedural formalities, provides additive incentives for the import of technology and to the non-resident Indians (NRIs) and in all creates a congenial environment for FDI.

Diluting the provisions of the Foreign Exchange Regulation Act (FERA), the new policy removes the 40 per cent ceiling for foreign equity participation that was existing during the pre-reform period. Moreover, it provides for automatic approval of foreign collaborations in many cases. If a foreign investor wishes to have greater participation in equity than prescribed, the documents are routed through the Foreign Investment Promotion Board (FIPB) that comes under the Industry Ministry of the Indian Government. The FIPB sanctions even 100 per cent equity participation in cases where Indian companies are unable to raise funds or in cases where at least one-half of output is meant for export. It is done also in cases where foreign investor is to bring in proprietary technology. The stake of the foreign investors in the equity capital of the Indian enterprise has been revised upwardly in many areas over the years. Only recently, in January 2004, the stake was raised to 100 per cent in case of oil refining.

The new policy permits FDI also in trading, hotels and tourism-related companies, units of export-processing zones and 100 per cent EOUs, banking and non-banking financial services, with varying degree of foreign equity participation. The non-banking financial services now include credit card business and money changing business. The multilateral financial institutions are allowed to contribute equity to the extent of shortfall in the holdings of the non-resident Indians within the overall permissible limit of 40 per cent in the public sector banks. FDI is allowed also in those areas where the big industrial houses were previously not allowed to invest. The new also

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policy permits opening of branch/liaison offices of foreign company that was prohibited in 1973. The branch office can be set up for conducting research and development, export/import activities and for making available desired technology. An off-shore venture capital company may contribute to entire equity base of a domestic venture capital fund and may also set up a domestic asset management company.

FDI does not always involve investment in cash. A purely technical collaboration involves permission to use patents or trademark and transfer of technology for which the Indian company pays royalty, technical service fees, etc. In case of technology import too, the policy provides for automatic approval if the collaboration agreement involves royalty payment up to US $ 2 million (net of taxes) to be made in a lump-sum amount or up to 5 per cent of domestic sale and 8 per cent of export over a ten-year period from the date of agreement or seven years from the date of commencement of business. As regards hiring of foreign technicians, there is no bar if the RBI guidelines are followed. There is no bar also on the use of foreign brand name.

The policy cuts the procedural delays significantly. Automaticity of approvals is a case in point. Abolition of industrial licensing almost in all cases (except public sector units and those units producing hazardous items) is another example. Foreign Investment Promotion Council has been set up in order to identify the projects within the country that require foreign investment and to target specific country from where FDI can be brought in. In order to foster speedy approvals, the FIPB has been asked to give its decision within a period of 30 days. Again, for speedy implementation of the approved investment, the Government has set up Foreign Investment Implementation Authority.

NRIs get special treatment. They can make direct investment either on repatriable terms or on non-repatriable terms. In case of repatriable investment, their share can go up to 100 per cent of the equity if the project is concerning high-priority industry, housing and real estate development, air-taxi operations, sick unit, 100 per cent export-oriented unit or a unit in export-processing zone and a trading house. On non-repatriable terms, NRIs' participation can go up to 100 per cent of bonus issues in an Indian company if the company is not engaged in agriculture, real estate or plantation. Non-repatriable investment can also flow into proprietary / partnership concerns engaged in industrial, trading and commercial activities.

The Indian Government is quite liberal in respect of dividend repatriation abroad. There is no bar if taxes are paid. However, in case of specified consumer goods, such outflow has to be balanced with export earnings for a period of seven years. Disinvestment too can be made subject to a few RBI formalities.

In all, the Indian Government has created a healthy atmosphere for FDI inflow. It is now a member of the Multilateral Investment Guarantee Agency (MIGA) which has infused confidence among foreign investors against expropriation of assets. What is important is that despite change in government in the country, economic reform process has never been neglected. The Government has rather sped it up. It welcomes foreign investment in sectors of national interest, such as infra-structure, core industries, export-promoting sector and improved-technology sector and is not against FDI in consumer-good sector if it

requires improved technology (Sharan and Mukherji, 2001).

II: Magnitude of the Inflow

The impact of the policy on the size of the inflow can be interpreted in terms of both the approval of the investment and the actual inflow. Table 1 shows that the amount of approved investment during the period of reform has been much larger than in the pre-reform period. As compared to approved investment for Rs. 12.7 billion during the whole of the decade beginning from 1981 (GOI, 1992), the figure of approved investment during August-December 1991 stood at Rs. 4.128 billion. The annual figure of approval rose fast to Rs. 548.914 billion in 1997. But it slumped to Rs. 308.135 billion during 1998 and to Rs. 283.700 billion in 1999. It rose marginally to Rs. 370.400 billion in 2000 but again sagged to Rs. 268.700 billion and to Rs. 111.400 billion respectively in 2001 and 2002.

Table1: Size of FDI

Amount in billions of Rupees

Period	*Approved foreign investment*	*Actual inflow*	*Actual inflow as % of approved amount*
Aug.-Dec. 1991	4.128	2.656*	64.34
1992	38.875	6.912	17.78
1993	88.593	18.620	21.02
1994	141.872	31.122	21.94
1995	320.717	64.853	20.22
1996	361.468	84.484	23.37
1997	548.914	120.357	21.93
1998	308.135	133.204	43.23
1999	283.700	92.599	32.64
2000	370.400	104.412	28.19
2001	268.700	160.710	59.81
2002	111.400	161.344	144.83

Source: *Foreign Investment Promotion Board documents.*

The approvals could not be translated in entirety into the actual inflow. The ratio of actual inflow to approved amount that was as low as 17.8 percent during 1992 improved to over one-fifth in the following years till 1997 and was as large as 43.23 per cent in 1998 but dropped to 32.64 per cent and 28.19 per cent in the following two years. In 2001 and 2002, there was of course revival in this percentage. In 2002, it was the highest at 144.83 per cent.

In fact, approval does not mean immediate follow-up action. Many formalities are required after collaboration agreement is approved. In case of automatic approval, the procedural formalities are not so cumbersome as in case of approvals through FIPB route. In case of approvals through the FIPB route, the files move through different ministries and departments that often work at cross purposes with one other (Joshi and D'souza, 1999). Moreover, red-tapism exists at every step. This is perhaps the reason that the ratio of actual inflow to the approved amount is much lower in case of the approvals through FIPB. And since the FIPB approvals account for a lion's share of the total approved amount, the ratio of actual inflow on the whole is very low (Gupta, 1998). The Foreign Investment Implementation Authority has eased this problem to a great extent. Yet, according to FICCI 2003 survey, 96 per cent of the respondents perceive the procedural delays and red-tapism quite serious (FICCI, 2003).

Again, lack of sufficient infrastructural facilities sometimes comes in the way. In the absence of sufficient infrastructural support, the implementation of the project is delayed considerably or, in some cases, it is even denied. Brahmbhatta et al. (1996) have found this very factor as a significant

one in the Indian case and so they have argued for creation of such facilities for encouraging greater flow of foreign direct investment. The FICCI Survey (2003) finds that 86 per cent of the respondents have praise for telecommunication facilities but deplore the power and road transport system.

Yet again, in a federal structure of administration, the State Governments have to co-operate with the coming up of the project. But in many cases, it is found that the required response from the State Governments has been absent (Bhattacharya, 1994).

To be more precise about the absolute size of the actual inflow, Table 1 shows that it grew from Rs. 6.912 billion in 1992 to Rs. 133.204 billion in 1998 but then it contracted all of a sudden to Rs. 92.599 billion in 1999. However, the following years witnessed some improvement. The size of the actual flow gradually reached Rs. 131.344 billion during 2002. It is a positive sign that the actual inflow of FDI into India in 2001 and 2002 has been on a marginal increase despite a global downtrend in the global FDI inflow by 40.9 per cent and 21.0 per cent respectively during these two years (United Nations, 2003). It is because the foreign investors rate India as among the top six destinations in the developing world (Kearney). To be more precise, 82 per cent of the respondents of FICCI Survey 2003 perceive opportunities for greater FDI in their own industry / sector (FICCI, 2003). The foreign expatriates (90 per cent of the respondents of FICCI Survey 2003) find India safe and secure (FICCI, 2003).

III: Instability in the Flow

It is evident from Table 1 that the annual growth rate of the FDI inflow has been highly erratic. This type of instability is not good from the viewpoint of economic planning. The planned outlay normally has some amount of foreign exchange component. If the inflow of foreign exchange in any form is unstable, planning of the outlay becomes a quite difficult task. The planners are compelled to follow a stop-and-go policy that adversely impacts growth rate of the economy. The study of instability has been made by the United Nations agency in case of the inflow of foreign portfolio investment in select countries (United Nations, 1998). The instability index of the FDI inflow exclusively in case of India vis-à-vis some major recipient of FDI in Asia has been computed by the author (Sharan, 2004). The findings presented in summary form in Table 2 reveal that the inflow of FDI in India is more unstable than that in China, Hong Kong, Singapore, Thailand and People's Republic of Korea, although it is more stable than in Taiwan.

Table 2: Instability Index of FDI among Select East and South-East Asian Developing Countries: 1993-2001

Country	FDI
India	0.179142
China (Mainland)	0.041625
Hong Kong	0.144760
Singapore	0.136830
Taiwan	0.381149
Thailand	0.126017
People's Rep. Of Korea	0.072495

Source: Sharan, Vyuptakesh (forthcoming), "A Note on Instability in Foreign Exchange

EARNINGS IN INDIA".

Thus it can be inferred that the liberal FDI policy in India has failed to contribute to

stable growth in the FDI inflow.

IV: FDI Flow in a Comparative Perspective

The absolute size of the FDI inflow in India might have grown in the wake of the liberal policy, but it is not enough. It should be treated as large only if it is comparable with other major FDI recipients of the emerging market economies in this region of the globe. It is worth analysing whether the FDI inflow in India has any comparability with that in some other countries of Asia where openness or liberal economic policies exists.

Table 3: Annual Average FDI Inflow in Select Asian Countries

Billions of US $

Country	1992-1997	1998-2002
India	1.6	2.8
China	29.8	44.8
Singapore	6.6	10.4
Indonesia	3.6	(-) 2.5
Malaysia	4.5	2.8
Thailand	2.2	4.4

Source: United Nations, World Investment Report, New York and Geneva, various issues.

Statistics in Table 3 show that the annual average of the FDI flow into India during 1992-97 was US $ 1.6 billion compared to US $ 29.8 billion in China, US $ 6.6 billion in Singapore, US $ 3.6 billion in Indonesia, US $ 4.5 billion in Malaysia and US $ 2.2 billion in Thailand during the same period (United Nations, 1998). Again, during 1998-2002, the annual average FDI inflow in India stood at US $ 2.794 billion compared to US $ 44.778 billion in China, US $ 10.381 billion in Singapore, and US $ 4.363 billion in Thailand during the same period. It was US $ 2.831 billion in Malaysia being marginally higher than in India. It was only Indonesia in the sample that witnessed disinvestments to the tune of US $ 2.491 billion annually during 1998-2002 (United Nations, 2003).

V: India vis-a-vis China

Let us concentrate on the issue of the FDI flow in India vis-à-vis in China because disparity between these two countries is very large. China opened a sizeable segment of its economy to foreign investors as far back as in 1978 and since then there is a continuous effort of the Government to pursue liberal policy and to provide incentives to attract foreign capital. In India, on the other hand, large-scale openness was adopted only since mid-1991. During the earlier decades, even if the Indian Government made efforts to attract FDI, the policy was only a short-phased one and more importantly, it was under the broad framework of an inward-looking policy. To be more precise, the Indian Government tried to attract foreign investment in the wake of the foreign exchange crisis of the late 1950s, but it turned to be more selective in 1968 when specific areas were delineated where financial collaborations or only technical collaborations could be permitted. In 1973, Foreign Exchange Regulation Act was amended to have a sizeable curb on the inflow of FDI. During mid-1980s, the policy turned a bit liberal but the curbs continued to be there.

In China too, the high-growth phase from the viewpoint of FDI inflow began since 1992, the year coinciding approximately with the open-door agenda of the Indian Government. Table 4 presents a comparative view of the FDI inflow into the two countries on an annual basis since 1992.

Table 4: FDI Inflow in India and China

Billions of US $

Year	*India*	*China*	*Col. 2 as % of Col. 3*
1992	0.233	11.200	3.50
1993	0.550	27.515	2.00
1994	0.973	33.787	2.88
1995	2.144	35.849	5.98
1996	2.426	40.180	6.04
1997	3.619	44.237	8.18
1998	2.633	43.751	6.02
1999	2.168	40.319	5.38
2000	2.319	40.772	5.69
2001	3.403	46.846	7.26
2002	3.449	52.700	6.54

Source: United Nations, World Investment Report, New York and Geneva, various issues.

It is evident from the above statistics that India has lagged far behind China in attracting FDI. FDI inflow in India has remained limited to barely 6 - 8 per cent of that in China during 1995-2002. Greater FDI inflow in China may be attributed, apart from the liberal policy, to the creation of special economic zones (SEZs) on a wide scale and provision of various facilities to such zones. The SEZs are very successful in China. They account not only for a lion's share of export but also for FDI. Their success is positively related to the inflow of FDI that is in quite contrast with the performance of export-processing zones in India (Kundra and Sharan, 1999). Moreover, the necessary power for approval of FDI in China has been delegated to certain provinces that has certainly helped the inflow of FDI (ESCAP, 1998).

However, when one probes deep into this issue, it is evident that the figures of FDI in China are not entirely represented by fresh inflow. Around 40 to 50 per cent of the amount represents "round tripping" that is recycling of domestic savings via Hong Kong to take advantage of tax and other benefits offered to non-resident Chinese (IFC, 2000). About another one-fourth of the amount stands directed to the real estate, and not to the manufacturing sector, due to collapse of real estate prices in Hong Kong during late 1990s (Tseng and Zebregs, 2000). In other words, disparity in FDI inflow between the two countries is lower than it is evident from the statistics.

There is disparity in the very approach towards FDI in the two countries. The inflow is large in. China because it has been favouring an FDI-dependent approach, whereas India treats FDI as complementary to the domestic investment and puts desired weight to the development of domestic industrial sector as a long-term development strategy. This is the reason that there is hardly any Chinese firm operating on a global scale and marketing globally any product produced by its domestic unit. On the contrary, there are many such firms in India that operate on a global scale. It is true that the Chinese products have flooded the foreign markets but they are produced by the foreign firms operating in China (Huang and Khanna, 2003). China may have a large FDI inflow and a high growth rate at present but that may not continue for a long period if the empirical study of Carkovic and Levine (2002) showing lack of definite relationship between larger inflow of FDI and a higher growth rate is really to be believed. India's lagging behind China in attracting FDI does not matter much.

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