

TRENDS AND POLICIES OF FDI INFLOWS IN INDIAN STATES

K.V. Bhanu Murthy¹ & Manoj Kumar Sinha²

Foreign Direct Investment (FDI) plays an important role in the long-term economic development of a country. The growth of FDI depends upon international economic conditions and policies along with the potential of an economy to absorb FDI. This paper has laid out the overall policy framework for facilitating FDI inflows in India and study the overall trend in FDI inflows over a period from 1990-91 to 2008-09. While, it is important to study the overall growth of FDI. It is also important to analyse the regional distribution of FDI amongst Indian states. The state level policies are responsible for encouraging FDI flows on a regional basis. Therefore, this paper also examines the state level policy for FDI.

The paper finds that for fifteen years period from 1990-91 to 2004-05, FDI remained below one percentage of GDP. Thereafter it has grown sharply. One anomalous finding is that during the phase of global recession overall FDI inflows grew substantially. The state level policies resulted in differential FDI inflows while some states are gainers other have been losers.

Keywords: *Foreign Direct Investment, Gross Domestic Products, State Domestic Products, Growth Rate.*

INTRODUCTION

Foreign Direct Investment (FDI) plays an important role in the long-term economic development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities. FDI also has an important role in enhancing exports. India sees FDI as a developmental tool.

India made appropriate changes in its policy since 1991 for attraction of FDI. The sweeping changes in the policy introduced since 1991 mark a radical departure from the

¹ Head, Department of Commerce, Delhi School of Economics, University of Delhi, Delhi 110007, e-mail: bhanumurthykv@yahoo.com

² PGDAV(D) College, University of Delhi, Nehru Nagar, New Delhi- 110065, mkdsesinha@yahoo.co.in.

past and reflect a positive approach towards foreign capital. The changes provide freedom to foreign investors to enter into Indian industry. In terms of openness to FDI entry, the prevailing Indian policy is favourably placed in terms of competitiveness with other major FDI receiving countries in world. Since 1991, Indian states have been also making appropriate changes in their respective industrial policy in order to attract more and more foreign investment. So, States are now busy wooing foreign investors to invest and in this regard, provide investor companies with a vast range of incentives. For each state these incentives vary across industries, depending upon the scale of production, location of unit, export orientation and a host of other factors.

Objectives of the Study:

1. To undertake a brief study of trends and policies of FDI in India.
2. To study policy of FDI in Indian states.
3. To study pattern of state-wise distribution of FDI in India.

Structure of the Study:

This paper is laid out in six sections. Section I discusses the data and methodology of the study. Section II is about trend of FDI inflow in India. Section III is about FDI policy of India. Section IV explains about FDI policies of Indian States. Section V presents the trends of FDI distribution in Indian states. The final Section VI gives summary and conclusions.

Section I: Data and Methodology

The required data for the analysis is collected from published sources. Data on centre-wise (or state-wise) FDI has been taken from SIA Newsletter- various monthly and annual issues. These data are maintained by Department of Industrial Policy and Promotion, Ministry of Industry and Commerce, Government of India (<http://dipp.gov.in/>). Data on State Domestic Products (SDP) has been taken from reports/publications of Central Statistical Organisation (CSO). CSO is maintained by Ministry of Statistical and Programme Implementation, Government of India (http://mospi.nic.in/mospi_cso_rept_pubn.htm). SDP data has been maintained state-wise. For comparing to FDI, SDP data has been converted to centre-wise. The methodology involved a number of empirical exercises: employing line graph, mathematical, statistical and econometric tools for analyzing policy implications on the

trends of distribution in Indian states.

A line graph shows overall trend of FDI inflows in India for periods 1990-91 to 2008-09. The correlation coefficient is estimated between FDI and GDP of India for period 1990-91 to 2008-09. The growth equation measures extent to which time factor influences FDI inflows in India. Time factor represents general factors that influence FDI. This enables measurement of Rate of Growth (RoG), through time-series analysis during 1990-91 to 2008-09. Rate of growth is measured for India over time. R-bar square measures the influence of time on FDI and p-value represents the level of significance. The growth equation is

$$FDI = e^{a+bT}$$

Taking log of both sides and adding error term

$$\log(FDI) = a + bT + u_i; \text{ 'b' represents annual exponential growth rate.}$$

This growth equation is also used to measure rate of growth, Rbar Square, and p-value of FDI inflows in Indian states during 1991 to 2008.

Section II: Trends of FDI in India

With the liberalization and structural reforms of Indian economy since 1991, there has been a marked shift in the magnitude of foreign capital flows to India during the 1990s and 2000s, reflecting the growing confidence among international investors. There has been a manifold increase of FDI inflow in India since 1991. The amount of FDI inflows was mere Rs.174 crore during 1990-91 and these FDI inflows have reached to Rs. 161481 crore during 2008-09. This is more than 500 times increase in the FDI inflows into from 1991-92 to 2008-09. The line graph of FDI inflows in India has also been drawn for the said periods. The line graph also shows the trend and pattern of FDI inflows in India. This line shows that how FDI inflows in India have reached to Rs 161481 crore in 2008-09. There are three stages of FDI inflows in India since 1991:

1st Stage- Slow Growth Period (Period: 1991 to 1997): During these periods, FDI inflows continued upward but FDI growth rate was low. Reasons for this trend may be:

- New Industrial Policy, 1991 focuses on openness, structural reforms, and liberalisations for foreign investment.

- WTO: TRIMs, GATS and TRIPS & Upward trend of global FDI flows.
- Cautious approaches towards opening of Indian economy.

Table 1: FDI as Percentage of GDP of India

Year	GDP (₹ Crore)	FDI (₹ Crore)	FDI as % of GDP	Correlation Coefficient
1990-91	569624	174	0.03	0.91
1991-92	654729	316	0.05	
1992-93	752591	965	0.13	
1993-94	865805	1838	0.21	
1994-95	1015764	4126	0.41	
1995-96	1191813	7172	0.60	
1996-97	1378617	10015	0.73	
1997-98	1527158	13220	0.87	
1998-99	1751199	10358	0.59	
1999-00	1952036	9338	0.48	
2000-01	2102314	18406	0.88	
2001-02	2278952	29235	1.28	
2002-03	2454561	24367	0.99	
2003-04	2754620	19860	0.72	
2004-05	3149407	27188	0.86	
2005-06	3586743	39674	1.11	
2006-07	4129173	103367	2.50	
2007-08	4723400	138276	2.93	
2008-09	5321753	161481	3.03	

Source: RBI Handbook of Statistics, 2009

Figure 1: Trends of FDI inflows in India During 1990-91 to 2008-09



