

AN ANALYSIS OF FOREIGN DIRECT INVESTMENT INFLOWS IN INDIA**Dr.V. Balakrishnan**

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Abstract

Foreign Direct Investment (FDI) plays an important role in the long term economic development of the 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. It is a key foreign exchange earner and provides employment to majority of Country's technical workforce. Having identified FDI as a major thriving force for economic development, a study on the sectors which attract the maximum inflows becomes absolutely essential.

Keywords: inflows, Foreign Direct Investment, Foreign Investment Promotion Board.

Introduction

The FDI policy must also be suitably flexible, with long-term objectives and with minimal mid-course policy changes in order that foreign investors' confidence is enhanced. There is a need based, fast track, time-bound, clearance of approvals and mechanisms for speedy implementation. The main objective of the study is to make a critical analysis of trends in FDI inflows in India and its impact and to offer feasible suggestions to improve the quality of FDI in India. The study is mainly based on secondary data .The secondary data were obtained from sources like Balance of payments Manual [BPM5] and statistics provided by Secretariat of Industrial assistance, Department of Industrial policy and promotion .Related websites were also browsed for better understanding. The study covers the period of 15 years between 1992-2006 segmented as three phases 1992-1996, 1997-2001 and 2002-2006. For FDI proposals in sectors / activities requiring prior government approval, the Foreign Investment Promotion Board (FIPB) acts as a single window clearance authority. RBI has granted general permission under Foreign Exchange Management Act (FEMA) in respect of proposals approved by the Government. Indian companies getting foreign investment approval through FIPB route do not

require any further clearance from RBI for the purpose of receiving inward remittance and issue of shares to the foreign investors.

Such companies are, however, required to notify the Regional Office concerned of the RBI of receipt of inward remittances within 30 days of such receipt and to file the required documents with the concerned Regional Offices of the RBI within 30 days after issue of shares to the foreign investors.

Types of Foreign Direct Investments

The following are the types of FDI in India:

1. Automatic route

The investment route of FDI inflows does not require the prior approval of government is called automatic route.

2. FIPB route

The investment route of FDI inflows which require the approval of Foreign Investment Promotion Board (FIPB) set up by the Government of India in the year 1991 is called FIPB route. There are other modes of FDI inflows in India namely investment in Global depository receipts (GDR), American depository receipts (ADRO, Foreign Currency Convertible bonds (FCCB), investment in preference shares, reinvested earnings and other capital. RBI's reporting format takes into account equity capital only .Hence analysis of trends in FDI in India includes equity components only.

The following table shows FDI inflows in India over a period of 15 years from 1992-2006 covering three phases.

Table -1 Trends in FDI Inflows in India Through Automatic and FIPB Route
(Rupees in Millions)

Phases	Year	Automatic Route (a)		FIPB Route (b)		Other Capital (c)		Total FDI inflows (a) +(b)+ (c)
		Amount in Rs. Millions	% to Total	Amount in Rs. Millions	% to Total	Amount in Rs. Millions	% to Total	
I	1992	475.1	6.87	4906.9	70.99	1530	22.14	6912
	1993	2411	12.95	10414.4	55.93	5794.2	31.12	18619.6
	1994	3625.8	11.65	16043.9	51.55	11452.6	36.8	31122.3
	1995	5301.6	8.17	39673.6	61.17	19878.4	30.66	64853.6
	1996	6196	7.08	57667.9	65.89	23658.6	27.03	87521.9
II	1997	8677.2	6.68	101283.8	77.97	19936.6	15.35	1,29897.6
	1998	6106.6	4.60	82397.4	62.10	44188.3	33.30	132,692.3
	1999	7608.3	7.48	61894.5	60.88	32164.3	31.64	1,01,667.1
	2000	16974.7	13.74	63368.0	51.29	43194.6	34.97	1,23537.3
	2001	32410.7	19.29	96386.2	57.38	38980.6	23.33	1,67,977.5
III	2002	39030.4	21.45	69580.1	38.24	73345.1	40.31	1,81,955.6
	2003	23399.6	20.14	42955.8	36.97	49816.3	42.89	1,16,171.7
	2004	54221.1	31.40	48516.9	28.10	69917.2	40.5	1,72,665.2
	2005	68686.6	35.60	49728.4	25.76	74575.9	38.64	192,990.9
	2006	321758.3	63.89	69683.2	13.84	1,12,130.6	22.27	5,03,572.1

Source: RBI, (Fed) Central Office, Mumbai

Note :

1. Figures of FDI inflows include equity capital components only.
2. Inflows through GDR, ADR, FCCB against FDI approvals have had been included.
3. FDI inflows through acquisition of existing shares and investments in RBI's various NRI schemes, have been included made the category 'other capitals'.

From table -1, the statistical results of Total FDI inflows are shown as under:

Mean	=135477.1
Standard deviation	= 117552.32
Co efficient of variation	= 86.77 per cent.
Compound growth rate	= 22.83 per cent.

The value of standard deviation is 117552.32 and co efficient of variation is 86.77 per cent. It reveals greater variation in FDI inflows from 1992-2006, over a period of 15 years. The value of compound growth rate is 22.83 per cent which shows that the growth over 15 years is noteworthy. The reasons for the growth from 1992-2006 is studies as under:

FDI Inflows Through Automatic Route

FDI inflows which do not require the prior approval of the government are brought under automatic route. To analyse the trends in FDI inflows through automatic route and its percentage to total FDI inflows during the year from 1992-2006.

Table -2 FDI inflows through automatic route and percentage to total FDI inflows

Phase	Year	Automatic Route		Total FDI inflows (Rupees in Millions)
		Rupees in Millions	Percentage to Total	
I	1992	475.1	6.87	6912
	1993	2411	12.95	18619.6
	1994	3625.8	11.65	31122.3
	1995	5301.6	8.17	64853.6
	1996	6196	7.08	87521.9
II	1997	8677.2	6.68	1,29897.6
	1998	6106.6	4.60	132,692.3
	1999	7608.3	7.48	1,01,667.1
	2000	16974.7	13.74	1,23537.3
	2001	32410.7	19.29	1,67,977.5
III	2002	39030.4	21.45	1,81,955.6
	2003	23399.6	20.14	1,16,171.7
	2004	54221.1	31.40	1,72,665.2
	2005	68686.6	35.60	192,990.9
	2006	321758.3	63.89	5,03,572.1

Source :RBI, (FED) Central Office, Mumbai.

Table -2 reveals that during the I phase, FDI inflows through automatic route has increased from Rs 475.1 millions in the year 1992 to Rs 6196 millions in the year 1996. Though the increase in FDI inflows through the Automatic route during the I phase is nearly 13 fold, its percentage to total FDI inflows increased marginally from 6.87 per cent to 7.08 per cent during the I phase. FDI inflows through automatic route was 6.87 per cent of total FDI inflows in the year 1992 which increased to 12.95 per cent of total FDI inflows in the year 1993. Thereafter the % of FDI inflows through automatic route to total FDI inflows declined to 11.65 per cent in the year 1994, 8.17 per cent in the year 1995, 7.08 per cent in the year 1996. The reason for initial increase in FDI inflows through automatic route in the I phase from 6.87 per cent in the year 1992 to 12.95 per cent in the year 1993 could be attributed to permitting FDI inflows in respect of new ventures and to limit FDI inflows up to 51 per cent of equity cap.

During the II phase, FDI inflows through automatic route grew from Rs 5677.2 millions to Rs 32410.7 millions amounting to nearly 5.7 times growth which is comparatively less than the I phase which had a growth of 13 fold. The percentage of FDI inflows through automatic route to total FDI inflows during the II phase was 6.68 per cent during the year 1997, which fell to 4.60 per cent in the year 1998. Hence per cent of FDI inflows through automatic route to total FDI inflows increased from 4.6 per cent in the year 1998 to 7.48 per cent in the year 1999, 13.74 per cent in the year 2000, 19.24 per cent in the year 2001.

III phase visualized a tremendous growth in FDI inflows through automatic route from Rs 39030.4 millions in the year 2002 to Rs 321758.3 millions in the year 2006 which accounts to over 8 times growth. The percentage of FDI inflows through automatic route to total FDI inflows was 21.45 per cent in the year 2002 which fell to 20.14 per cent in the year 2003. Thereafter it rose to 31.40 per cent in the year 2004, 35.6 per cent in the year 2005 and 63.89 per cent in the year 2006. The initial fall and steady rise during the III phase could be attributed to the move of the government to encourage FDI inflows through automatic route over FIPB route.

FDI Inflows Through FIPB Route

FDI inflows which require the prior approval of the Government of India are brought under FIPB route. The trends in FDI inflows through FIPB route and its percentage to total FDI inflows during the year from 1992-2006

Table -3 FDI Inflows Through FIPB Route and % to Total FDI Inflows

Phase	Year	Automatic Route		Total FDI inflows (Rupees in Millions)
		Rupees in Millions	Percentage to Total	
I	1992	4906.9	70.99	6912
	1993	10414.4	55.93	18619.6
	1994	16043.9	51.55	31122.3
	1995	39673.6	61.17	64853.6
	1996	57667.9	65.89	87521.9
II	1997	101283.8	77.97	1,29897.6
	1998	82397.4	62.10	132,692.3
	1999	61894.5	60.88	1,01,667.1
	2000	63368.0	51.29	1,23537.3
	2001	96386.2	57.38	1,67,977.5
III	2002	69580.1	38.24	1,81,955.6
	2003	42955.8	36.97	1,16,171.7
	2004	48516.9	28.10	1,72,665.2
	2005	49728.4	25.76	192,990.9
	2006	69683.2	13.84	5,03,572.1

Source RBI (FED) Central Office, Mumbai.

The reason for the fall in FDI inflows through FIPB route in the I phase could be attributed to permitting FDI inflows in respect of new ventures and to limit FDI inflows upto 51 per cent of equity cap. Being the I phase of introduction, FIPB also met with technical flaws in implementing the FDI policy and hence decided to resort to conservative move in respect of admitting FDI inflows.

During the II phase, FDI inflows through FIPB route fell from Rs.101283.8 millions to Rs. 96386.2 millions. The percentage of FDI inflows through FIPB route to total FDI inflows during the II phase was 77.97 per cent during the year 1997, which fell to 62.10 per cent in the year 1998. The slow down in the pace of FDI inflows through automatic route could be attributed to change in the government at the centre during the year 1999, when BJP came to power.

Thereafter BJP government resisted in permitting FDI inflows through government route restricting the inflow to automatic route. Hence per cent of FDI inflows through FIPB route to total FDI inflows further decreased to 60.88 per cent in the year 1999, 51.29 per cent in the year 2000, 57.38 per cent in the year 2001.

III phase visualized a steep fall in FDI inflows through FIPB route from Rs. 69580.1 millions in the year 2002 to Rs. 42955.8 millions in the year 2003, Rs. 48516.9 millions in the year 2004, Rs. 49728.4 millions in the year 2005 and rose to Rs. 69683.2 millions in the year 2006. The percentage of FDI inflows through FIPB route to total FDI inflows was 38.24 per cent in the year 2002 which

fell to 36.97 per cent in the year 2003, 28.10 per cent in the year 2004, 25.76 per cent in the year 2005 and 13.84 per cent in the year 2006.

The steep fall during the III phase in respect of FDI inflows through automatic route could be attributed to the move of the government to encourage FDI inflows through automatic route over FIPB route.

From table 2 and 3, statistical results of FDI inflows through automatic route and FIPB route are depicted in Table 4.

Table 4 Statistical Results of FDI Inflows Through Automatic Route and FIPB Route

Phases	Route	Mean	Standard deviation	Co-efficient of variation (percentage)	Compound growth rate percentage
I	Automatic	3601.8	2281.20	63.35	80.83
	FIPB	25741.16	22228.27	86.35	87.11
II	Automatic	14355.5	10939.18	76.20	44.16
	FIPB	81,065.98	18207.18	22.46	-
III	Automatic	101419.2	124,326.0	122.58	69.82
	FIPB	56092.88	12620.29	22.50	1.5

During the III phase, mean of FDI inflows through automatic route and FIPB route is Rs.101419.2 millions and Rs56092.88 millions respectively. It reveals that the mean FDI inflows through automatic route are more than FIPB route during the III phase unlike I and II phase. The standard deviation of FDI inflows through automatic route and FIPB route during the I phase is 2281.2 and 22228.27 respectively. It reveals that the mean FDI inflows through FIPB route are nearly 7 times more than automatic route.

The co efficient of variation for FDI inflows through automatic route and FIPB route during the I phase is 63.35 per cent and 86.35 per cent respectively. It shows that the standard deviation is high and there is greater variation in the value of FDI inflows during the I phase.

The compound growth rate of FDI inflows through automatic route and FIPB route during the I phase is 80.83 per cent and 87.11 per cent. The growth over the I phase is noteworthy.

During the II phase, mean of FDI inflows through automatic route and FIPB route is Rs.14355.5 millions and Rs81065.98 millions respectively. It reveals that the mean FDI inflows through FIPB route are nearly 5.6 times more than automatic route. The standard deviation of FDI inflows through automatic route and FIPB route during the II phase is 10939.18 and 18207.18 respectively. The co efficient of variation for FDI inflows through automatic route and FIPB route during the II phase is 76.20 per cent and 22.46 per cent respectively. It shows that the standard

deviation is high and there is greater variation in the value of FDI inflows during the II phase.

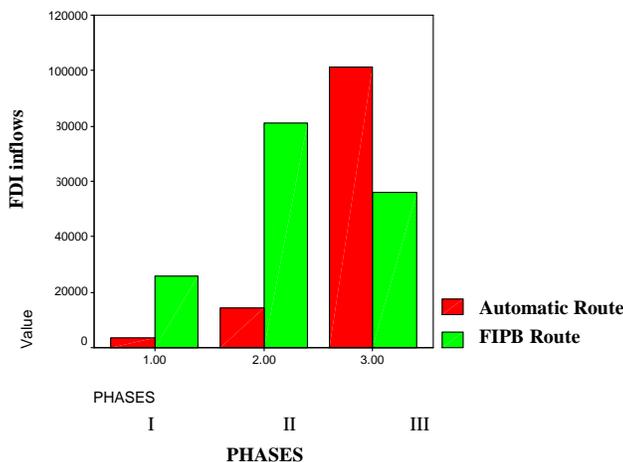
The compound growth rate of FDI inflows through automatic route during the I phase is 44.16 per cent. The growth over the II phase through automatic route is noteworthy. The compound growth rate of FDI inflows through FIPB route shows a negative result. Hence it is not taken into account for analysis. During the III phase, mean of FDI inflows through automatic route and FIPB route is Rs.101419.2 millions and Rs56092.88 millions respectively. It reveals that the mean FDI inflows through automatic route is more than FIPB route during the III phase unlike I and II phase.

The standard deviation of FDI inflows through automatic route and FIPB route during the III phase is 1,24,326 and 12,620.29 respectively .

The co-efficient of variation for FDI inflows through automatic route and FIPB route during the III phase is 122.58 per cent and 22.50 per cent respectively. It shows that the standard deviation is high and there is greater variation in the value of FDI inflows through automatic route when compared to FIPB route.

The compound growth rate of FDI inflows through automatic route during the I phase is 69.82 per cent. The growth over the III phase through automatic route is noteworthy. The compound growth rate of FDI inflows through FIPB route is only 1.5 per cent which shows only a marginal rise.

Graph showing mean FDI inflows through automatic route and FIPB route during the 3 phases



In the above figure, X axis denotes phases and y axis denotes FDI inflows. During the I phase mean of FDI inflows through automatic route and FIPB route is Rs.3601.8 millions and Rs 25741.16 millions respectively. It reveals that the mean FDI inflows through FIPB route is nearly 7 times more than automatic route.

During the II phase, mean of FDI inflows through automatic route and FIPB route is Rs.14355.5 millions and Rs.81065.98 millions respectively. It reveals that the mean FDI inflows through FIPB route is nearly 5.6 times more than automatic route.

During the III phase, mean of FDI inflows through automatic route and FIPB route is Rs.101419.2 millions and Rs.56092.88 millions respectively. It reveals that the mean FDI inflows through automatic route are more than FIPB route during the III phase unlike I and II phase.

Correlation Between FDI Inflows Through Automatic Route and FIPB Route

Having learnt the modes of FDI inflows and the trend in FDI inflows from 1992-2006, it becomes noteworthy to study if there is any correlation between FDI inflows through automatic route and FDI inflows through FIPB route.

Table-5 FDI Inflows Through Automatic Route and FIPB Route
(Rupees in Million)

Year	FDI inflows	
	Automatic Route	FIPB route
1992	475.1	4906.9
1993	2411	10414.4
1994	3625.8	16043.9
1995	5301.6	39673.6
1996	6196	57667.9
1997	8677.2	101283.8
1998	6106.6	82397.4
1999	7608.3	61894.5
2000	16974.7	63368.0
2001	32410.7	96386.2
2002	39030.4	69580.1
2003	23399.6	42955.8
2004	54221.1	48516.9
2005	68686.6	49728.4
2006	321758.3	69683.2

Source: RBI (FED) Central Office Mumbai

For table 5, the value of coefficient of correlation, $r = 0.199$. It shows that there is a positive correlation between FDI inflows through automatic route and FDI inflows through FIPB route. Since the value of coefficient of correlation is less than 0.5, the degree of correlation is not significant.

Correlation between FDI inflows and Foreign exchange reserves of RBI

FDI denotes direct investment relationship established when the direct investor from one country has acquired 10 percent or more of the ordinary shares

or voting power of an enterprise in another country resulting in a lasting interest or existence of a long-term relationship between the direct investor and the direct investment enterprise, and a significant degree of influence exercised by the investor on the management of the enterprise.

The quantity of foreign exchange reserves can change as a central bank implements monetary policy. Foreign exchange reserves are important indicators of ability to repay foreign debt and for currency defense, and are used to determine credit ratings of nations. FOREX reserves allow RBI to purchase the issued currency, exchanging its assets to reduce its liability. The purpose of reserves is to allow central banks an additional means to stabilise the issued currency from excessive volatility, and protect the monetary system. Large reserves are often seen as strength, as it indicates the backing a currency has. Low or falling reserves may be indicative of an imminent bank run on the currency or default, such as in a currency crisis. Hence it is studied to find if there is any correlation between FDI inflows in India and the amount of FOREX reserves maintained by RBI.

Table 6 FDI Inflows in India and FOREX Reserves (Rupees in Million)

Year	FDI inflows in India	FOREX Reserves
1998	132692.3	12653.4
1999	101667.1	14959.5
2000	123537.3	18589.5
2001	1.67977.5	22969.0
2002	181955.6	33405.8
2003	1166171.7	45559.1
2004	172665.2	57544.9
2005	192990.9	65090.9
2006	503,572.1	78593.1

Source: www. rbidocs.org.in.

Forex reserves include foreign currency assets, gold, SDR, and reserve position in IMF. From table 6 the result of co- efficient of correlation, $r = 0.725$. It shows that there is high degree of positive correlation between FDI inflows and FOREX reserves in India.

CONCLUSION

An analysis of trends in FDI inflows shows that the growth in FDI inflows were slack during the second phase when compared to the first and third phase. Also the contribution of FDI inflows through automatic route increased manifold over 15 years when compared to FDI inflows through PIPB route over the three phases. The study reveals a high degree of positive correlation between FDI

inflows in India and Dollar- Rupee exchange rate and FDI inflows in India and FOREX reserves of RBI.

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