

## Foreign Direct Investment in India: Post Liberalization Analysis

Shabi Raza & Ruqayya Alvi

Department of Applied Economics, Shia Post Graduate College, Lucknow (U.P.)-226020 (INDIA)

Corresponding author ; -Ruqayya Alvi

### **Abstract**

*Indian economy has been receiving huge amount of Foreign Direct Investment (FDI) since liberalization and emerged as third most preferred investment destination for foreign investors. Riding waves of reforms and full-scale liberalization were initiated in the 1990s to integrate the Indian economy with the world economy. Foreign investment necessary to supplement domestic capital and secure scientific, technical, industrial knowledge, and capital equipment. The main objective of the paper analysis trend and pattern of FDI Inflows in India Post liberalization. The descriptive design has been used for a study purpose; time series secondary data been used. FDI inflows shows a positive slope and has also significantly shown improvement in Doing Business rank of 77th in 2019 to the position of 63rd in 2020. India in Global Confidence Index has moved down 10 places to rank on 68th position in 2020 as compared to 58th position in 2019.*

**Keywords:** Post Liberalization, Foreign Direct Investment, Doing Business

### **Introduction**

Economic liberalization has led to the opening of some of the world's largest markets, which overcame tremendous business opportunities around the world, including India. In recent years amongst other emerging markets, India has become one of the fastest economies in the world, with the growth rate that shadows most Asian Markets(1). Most recently India in particular, stand to offer(1). India has improved its systems over the past decade, macro-level economic reforms contributed to the higher growth of the 1990s. Relative macroeconomic and political stability, trade liberalization, and further commitments within the World Trade Organization(WTO) comprise one crucial set of ingredients to spur investment and productivity growth.

Government of India (GOI) has committed its efforts to provide a conducive policy environment to the enterprises and also liberalized the investment regime substantially over the last decade. Riding waves of reforms and full-scale liberalization were initiated in the 1990s to integrate the Indian economy with the world economy(2). Private investment by the domestic and foreign investors are being encouraged in almost all the sectors, i.e., agriculture, electricity, health, education, irrigation, water supply, roads, etc. at the central and state levels(3). Higher

investment productivity and deeper integration in the world economy have been the key growth drivers(4).

India has been a host country to FDI since the eighteenth century. Until 1918, British companies were the major players in foreign investment and dominant in FDI over India(5).The first FDI was made in 1767, in the textile industry by Scottish Forbes Gokak Company(6). After World War II, Japanese companies entered the Indian market and enhanced their trade with India, yet the U.K. remained the most dominant investor in India(7). Thus, after getting independence in 1947, the first Prime Minister of India considered a foreign investment necessary to supplement domestic capital and secure scientific, technical, industrial knowledge, and capital equipment.

India offered many incentives and concessions to foreign investors to attract more foreign investment into the country(8). It set up the India Investment Centre in 1961 to promote foreign investment; foreign investors were given guaranteed expropriation and royal treatment during this period. The policies during the decade were accompanied by an increasingly receptive attitude towards FDI and foreign collaborations(9).

India's Investment regime underwent a significant transformation with the New Industrial Policy of July 1991. Beginning in July 1991, the government introduced several changes in the country's regulatory policy package known as widely as the Structure Adjustable Program (SAP)(10). The liberalization of industrial and trade policies during the decade accompanied by an increasingly receptive attitude towards FDI and foreign collaborations.

Further, exceptions from the general ceiling of 40 percent on foreign equity were allowed on the merits of individual investment proposals. Reforms in the 1990s, like a riding wave and full-scale liberalization measures, were initiated to integrate the Indian economy with the world economy(11). Automatic approval of up to 51% of foreign ownership was introduced firstly in 34 sectors. It includes mostly manufacturing industries (such as metallurgical industries, electrical equipment, automobiles, various types of machinery, chemicals, drug and pharmaceuticals, and food processing) and a few services sectors (such as the hotel and tourism industry and packaging services for food processing)(12). In many areas, up to 100 percent of foreign investment on an automatic basis is now allowed.

Determinant factors that are influencing foreign investment in India by foreign investors. There listing is like, the tax structure, special programs and schemes, competition regime, entry and establishment requirements, investment protection, technology transfer, nature al resources, skill levels, incentives, English language, the rule of law, and institutional mechanisms(13). India is undoubtedly an attractive destination for FDI, but there are certain factors, which have prevented it from realizing its true potential. Given that India has a vast and fast-growing consumer market and an ever-increasing middle class, there is every reason to believe that substantial volumes FDI will flow in(14)

## Literature Review

Various government globally responding to globalization and liberalization in a positive and comprehensive. They welcome the foreign investment which can be seen by the positive trend in the foreign investment inflows in various countries especially in developing nations like India and China. This has attracted many researchers to get deeper study of trend in investment globally and country wise.

Das K Bipul (2020), It is found that FDI inflows showed a substantial jump in the 1990's and became more intense since 2001. India's share in world FDI has been increasing over the years. Most of the FDI become automatic route followed by acquisition of existing shares route.

Singh Shikha (2019), India has become one of the most attractive destinations for emerging market economies. Inflows of funds over the years has helped the country in advancement of technology, skill upgradation employment generation, better infrastructure, and management. Thus adding to higher productivity and promoting sustainable and inclusive development.

## Data Methods

The data used for this study are collected from United Nations Conference on Trade and Development (UNCTAD) data Centre. Data to see the trend of FDI inflows at global level and state level collected from Doing Business, World Bank annual report and from the Department of Industrial Policy and Promotion (DIPPs) & Reserve Bank of India.

## Trends of Foreign Direct Investment in India

### Global Trend of Investment in India

### Doing Business in India-World Bank

The World Bank annually conducts a study and publishes a report that provides objective measures of the regulation in business in developed and developing economies. The discussion based on a series of annual reports investigating the regulations that enhance business regulations and property rights protection that can compare across to 190 economies and selected cities at the subnational and regional levels (15). The report considers ten indicators, and they are relatively self-explanatory. These indicators are; dealing with construction permits, starting a business, protecting minority investors, getting electricity, paying taxes, registering property, getting credit, trading across borders, enforcing contracts, and resolving insolvency.

In Doing Business ranking 2020, economies that have several standard regulatory features, including the widespread use of electronic systems, score the highest, including New Zealand, Singapore, and Hong Kong, maintaining the top three positions in Business ranking 2020. It acknowledges the economies that improved after implementing regulatory reforms, including Saudi Arabia, Jordan, Togo, Bahrain, Tajikistan, Pakistan, Kuwait, China, and India (16).

Indian economy regulatory framework has enhanced its attractiveness as a destination for foreign investors after liberalization and among the best performers in Ease of Doing Business

Ranking. There is continuous improvement globally in the rankings of ease of doing business. India has also significantly shown improvement once again from the rank of 77th in 2019 to the position of 63rd in 2020 (16).

**Table: 3.2 Doing Business in India**

S.No.	Indicator	DB 2019 (Rank)	DB 2020 (Rank)	Change in Rank
1.	Ease of Doing Business	132	131	+ 1
2.	Starting a Business	137	136	+1
3.	Dealing with Construction Permits	52	27	+25
4.	Getting Electricity	24	22	+2
5.	Registering Property	166	154	+12
6.	Getting Credit	22	25	-3
7.	Protecting Minority Investors	7	13	-6
8.	Paying Taxes	121	115	+6
9.	Trading Across Border	80	68	+12
10.	Enforcing Contracts	163	163	0
11.	Resolving Insolvency	108	52	+56

Source: Compiled from Ph. D Research Bureau, World's Bank Doing Business Data Base

It can be seen from the above table that India fairs decently and shows tremendous improvement in some areas i.e., registering property, dealing with construction permits, trading across border, and resolving insolvency. But perhaps the truly embarrassing rank is the “Enforcing Contracts” in which India rank a dismal 163 out of 190 countries doesn't shows any improvement from the past year. According the report, it takes 1445 days to enforcing a contract in Mumbai and Delhi and the cost to enforcing that contract is almost two-fifth of the claim. This is a key concern for attracting foreign investors in India as the other corporate economies are doing well i.e. china ranks on 5<sup>th</sup> position in DB2020 Enforcing contract. It takes only 496 days to get the contract and cost of getting contract is 16.2 percent (Economy Profile DB2020)

### 3.4.2 Global Competitive Index

The Global Competitiveness Index (GCI), which maps the competitiveness landscape of around 141 economies including developed and developing economies through 103 indicators organized in 12 pillars was launched in 1979.(Economic Times, Oct 9,2019) The report shows the competitiveness index of those countries which integrate into their economic policies focusing or emphasizing on infrastructure, skills, research and development.

India in GCI has moved down 10 places to rank on 68<sup>th</sup> position in 2020 as compared to 58<sup>th</sup> position in 2019 which is among the worst -performing in BRICS nations in recent years. India's

position to 68th place may look dramatic, but the decline in the country's competitiveness score is relatively small (GCI,2020).India ranks high in terms of macroeconomic stability and market size, while its financial sector is relatively deep and stable despite the high delinquency rate, which contributes to weakening the soundness of its banking system.

The WEF study also showed, India is ranked also high in terms of corporate governance at 15th place, while globally for shareholder governance it is ranked second. In terms of the market size, it ranked third, while it has got the same rank for renewable energy regulation (GCI,2020).India, on par with several advanced economies and which is well ahead of most emerging economies also punches above its development status when it comes to innovation.

In some of the basic enablers of competitiveness in case of India, these positive metrics contrast with major shortcomings, the life expectancy ranking where India ranked 109<sup>th</sup> out of the total 141 countries and flagging limited ICT (Information, Communications and Technology) adoption, poor health etc, is one of the shortcomings which reducing the ranking significantly below the South Asian Average.

India needs to grow its skills base, while focus is to be imposed on its market efficiency which is undermined by a lack of trade openness and lack of worker rights protection in labour market. It also to emphasized on participation of female as the ratio of female workers to male workers in India is 0.27(World Bank,2019).

### **3.4.3. Foreign Direct Investment Confidence Index**

According A.T.Kearney Foreign Direct Investment Confidence Index 2020, a regular assessment of senior executive sentiment as world's largest companies, that attract the most investment. United States remains the top-ranked destination by foreign investors and retained the top place on index for the eight year in row. (FDICI,2020). A T Kearney notes that this year marks the second time in the history of 22 years of the indexing that the developed countries captures the top five position in consecutively attracting foreign investment through their market polices. India, after coming at 16<sup>th</sup> position in 2019 and made its place in top 25 countries, it has dropped out of Kearney's 2020 FDI Confidence Index. It stood on a decent spot on the 25-country index in 2018,2017 and 2016 at the 11<sup>th</sup>, 8<sup>th</sup> and 9<sup>th</sup> position respectively. The only emerging markets that have made it on the index this year are China 8<sup>th</sup> , Brazil 22<sup>nd</sup> and The United Arab Emirates 19<sup>th</sup> Position in FDI Confidence Index.

## Growth of FDI Inflows in India

### 3.5.1. Trend of FDI Inflow in India

Economic reforms taken by Indian government in 1991 makes country as one of the prominent performers of global economies. FDI because of policy measures (taken way back in 1991). FDI in India as increased manifold since 1991 irrespective of the ruling party over the years, as there is a growing consensus and commitments among political parties follow liberal foreign investment policy that invite steady flow of FDI in India so that sustained economic growth can be achieved.

It can be clearly seen from the figure 3.1 below that, FDI inflows before 1991 was less than \$ 1 billion. The trend line shows a slow increase in upward direction after year 1992, more than a double increase to exceed \$ 2 billion in year 1995. Since than there the trend line in respect of FDI inflows shows a positive slope, but after 2005, the reported statistics shows a steep increase in inflows from \$ 20 billion to nearly \$ 47 billion.



Figure 3.1 Annual FDI Inflow Trend in India

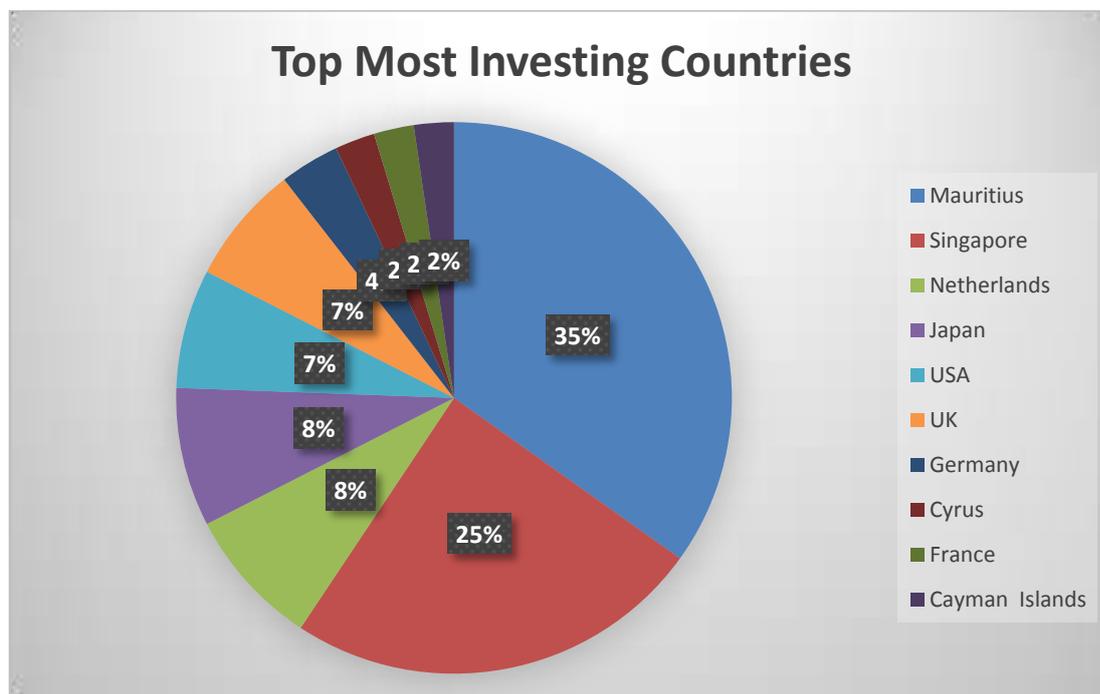
Source: Compiled from World Bank Database

Then after the trend line of FDI inflows found to be quiet volatile, it decreased from a peak in 2008 to nearly \$ 28 billion in 2010 and again increased around \$ 35 billion in 2011. This volatility is due to global financial crisis that took place in year 2007 which affected the whole world economy and affected Indian Economy (RBI Bulletin 2020).

On the general basis, FDI inflows have almost consistently increased since 1991 as economy opened for foreign investment through liberalization-privatization-globalization policy implemented by the Indian government under the supervision of finance minister Dr. Manmohan Singh. It is considerably noticeable by analyzing the trend line given in figure 3.1 that there is continuous growth in investment inflows by foreign investors in India after the country has revised its foreign investment policies.

### 3.5.2 Top investing Countries in India

Figure 3.2 Top most Investing Countries (Cumulative percent 2017 to March,2020)



Source: Reserve Bank of India (RBI) Bulletin and Department for promotion of Industry and Internal Trade (DPIIT)

The above figure 3.2 shows the percentage of FDI inflows from different countries cumulative from 2017 to March,2020. In terms of topmost investing countries Mauritius and Singapore remains rivals in acquiring the top positions from the past consecutive years. Mauritius tops the list (35 percent) followed by Singapore (21 percent), the Netherlands (7 percent) along with Japan (7 percent), USA (6 percent) and UK (6 Percent) with the rest four countries reporting share below 4 percent.

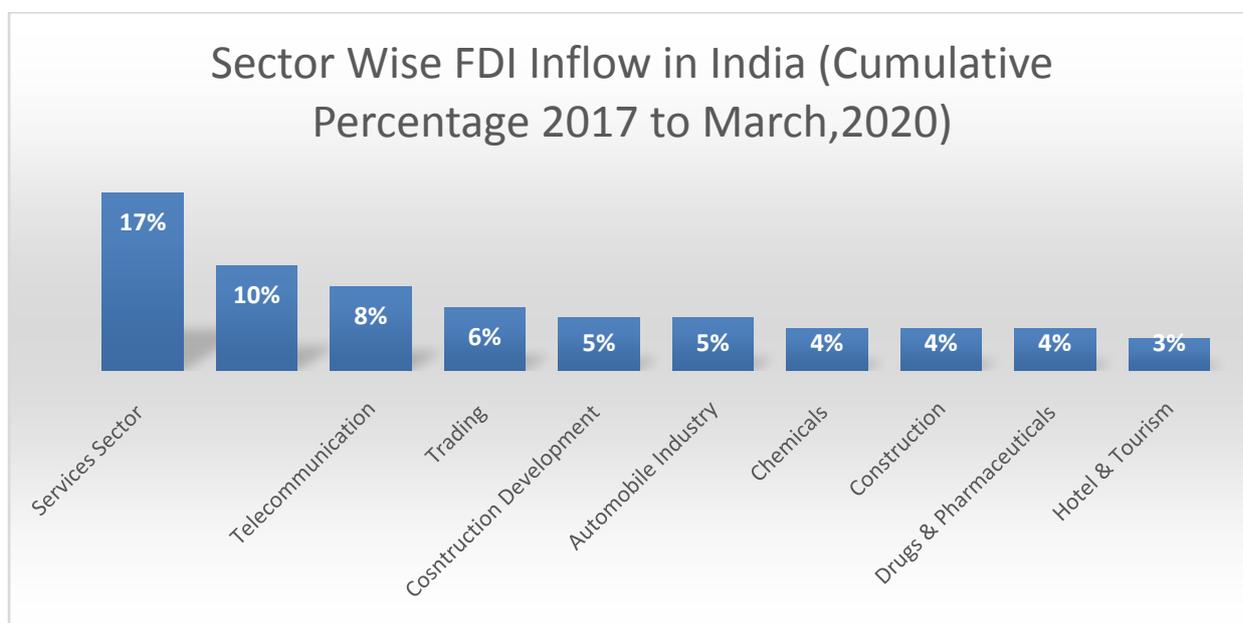
The inflow of FDI from Mauritius and Singapore registered a phenomenal increase in recent years. One of the possible reasons behind this is the treaty signed between India and Mauritius after 22 years which agreed on Processing Industries, Transportation Industries Drugs & Pharmaceuticals, Cement & Gypsum Products and Metallurgical Industries (Das B K, 2020).

Secondly, Singapore has been able to outpace Mauritius by acquiring the top position for two consecutive years i.e., 2018 to 2019. With its ease of doing business policies, simplified tax regime and large number of private investors (Economic Times, May29,2020).

### Sector wise FDI Inflow in India

The figure 3.3 shows FDI entering in India through different sectors. The data presented in form bar graph given in the figure explains the percentage of total FDI inflows in different sector from year 2017 to March,2020. Service sector accounting US \$ 82,003 million with 17 percent, Computer Hardware and Software sector accounting US \$ 44,911 million with 10 percent.

Figure 3.3 Sector Wise FDI Inflow in India

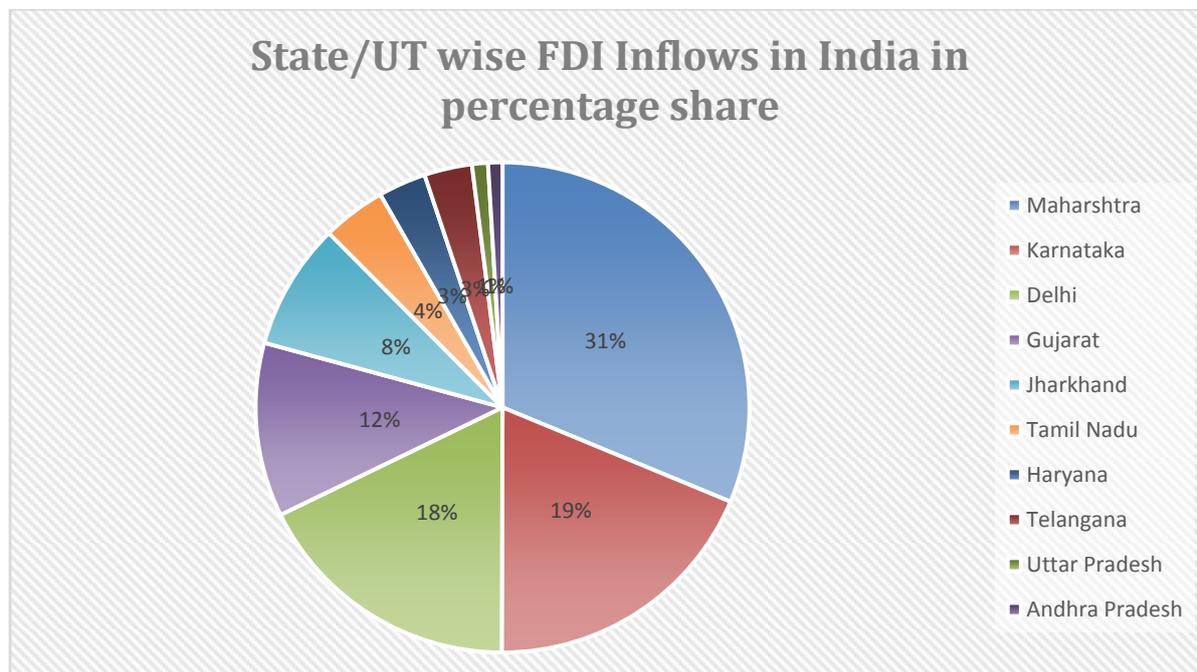


After Service Sector and Computer Hardware and Software Sector, Telecommunication and Trading sector jointly account for 14 percent share of FDI Inflows. Rest all the sector other than Construction Development and Automobile Industry which account remarkable percentage share (5 percent), accounts with below 5 percent of FDI inflows in India.

### 3.5.4 Region wise or State wise FDI Inflows in India

The figure 3.4 shows the region wise or state/UTs wise FDI inflows as classified by Reserve Bank of India cumulative inflow from October 19 to March 2020 in US \$ Million. The states which occupies the top positions in attracting foreign investors are Maharashtra (31 percent ) with US \$ 7263, Karnataka (18 percent ) with US \$ 4289 followed by Delhi (17 percent ) with US \$ 3973 (DPIIT,2020).

Figure 3.4 State/UT wise FDI Inflows in India in percentage share (US\$ million)



There is a wide region wise disparity can be seen in attracting foreign investment inflows among the different regions or states by analyzing the above figure. One of the major reasons behind this disparity are developed infrastructure of the states, secondly, speedy approvals and processing, thirdly, easy process or procedure of land acquisition, fourthly, preference and concessions given on electricity supply to foreign companies and lastly, other concessions and policies encouragement implemented by state governments(Shrestha Saroj,2016).

### Conclusion

A vibrant private sector that invests, creates jobs, and improves productivity is center to promote growth and expanding opportunities for poor people. The volume of FDI in India is relatively low as comparing to its neighboring nation i.e., China. If China with its newfound faith in capitalism can embrace and attract substantial volumes of FDI, why can't India, which is blessed with western institutions and capitalist organization? This impassioned advocacy of increased flows of FDI into India based on the well-worn arguments that FDI is a rich source of technology and know-how and capital to boot economic growth. But the deficiencies in India's Investment Climate pose critical constraints on Private sector investment and performance, particularly industrial competitiveness. The most important issue is to implement proper policy making by the government to reduce the implication of the constraints which reducing the FDI inflow in India.

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