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A STUDY ON FDI TRENDS IN INDIA – AN INTERNATIONAL APPROACH TOWARDS NATION BUILDING

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ABSTRACT

India, the capital deficient country needs more capital from outside the country. Capital is one of the significant elements of factors of production. The industrial development of any country fundamentally depends on the availability of capital. Because of shortage of capital, particularly, underdeveloped and developing countries need more capital for their survival and technology for competing with other countries. Inadequacy of capital is a foremost obstacle for industrial growth of developing nations. The role of Foreign Direct Investment (FDI) is very much a significant in the economic development the country. The amount of FDI, compared to China and other developed countries is quite less. The Indian Government has reviewed policy to attract more FDI and these policy measures boosted the FDI inflows and out flows. But in the recent years, the amount of FDI has been declining. The procedures for FDI approval, environmental clearance, legal aspect, etc., are time consuming. In this paper attempt is made to analyze the direction and impact of FDI on the Indian economy. Global foreign direct investment (FDI) inflows rose 16 per cent in 2011, surpassing the 2005-2007 pre-crisis level for the first time, despite the continuing effects of the global financial and economic crisis of 2008-2009 and the ongoing sovereign debt crises. This increase occurred against a background of higher profits of transnational corporations (TNCs) and relatively high economic growth in developing countries during the year. The study is based on the secondary data and information.

KEYWORDS: Capital, FDI, Global Trends, Collaboration, Policy Framework, Transformation, Environmental.

INTRODUCTION

India Ratings says that the government of India’s recent decision to allow the foreign direct investment (FDI) limit in aviation up to 49% is expected to improve the capital structure of airlines with viable business models. The possible equity infusion would not only de-leverage the sector but also provide funds for long-term growth. However, structural challenges may limit the attractiveness for such foreign investors at least in the medium term. In addition to equity infusion, stronger strategic and operational ties with foreign partners with stronger credit profile, may potentially improve the credit profile of domestic airlines. This may have a beneficial impact on the funding cost of this sector known for its high capital intensity. While the long-term growth potential of the Indian market may draw interest from International Airlines, the continuing structural weakness and regulatory risks may increase the perceived risk in such tie-ups. Other key considerations of prospective joint venture (JV) partners would be the lack of majority equity control in addition to specific board constitution. According to the recent policy, foreign investors in retail JVs would be accountable for setting up back-end infrastructure in a time-bound fashion. While certain aspects of this infrastructure, such as setting up and implementing the agricultural supply chain mechanism may require approvals at the State level, procedural delays may prevent timely implementation. The time-bound implementation of guidelines and sole accountability for the foreign partner may increase the regulatory risks to such JVs. Over a period of time, to the extent that such issues are addressed, the sector would benefit not only in terms of funding but also improved operational aspects. Retailers with majority foreign holdings and having strong operational and legal ties with higher rated foreign partners (higher than the India Country Ceiling assigned by Fitch Ratings) could benefit in terms of ratings.

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.

OBJECTIVES OF THE STUDY

The present study is mainly proposed to examine the following objectives.

- To know the Investment Policy Framework for Sustainable Development.
- To know the extent of inflow and outflow of FDI into India.
- To scrutinize the hit of FDI looking into Global perspective.

LITURATURE REVIEW

It was the insight of Hymer (1960) who by differentiating direct investment from portfolio investment created basis for studies on factors determining the FDI flows. Hymer highlighted certain facts and evidences on the basis of which he concluded that the nature of the direct and portfolio investment differs and therefore same theories cannot be applied to both types of investment. The key feature that Hymer identified for motivation of FDI was the level of control which a firm of home country gets through direct investment in host country. He also stressed upon market imperfections such as the ownership of knowledge not known to rivals, existence of differentiated products giving profit advantage to a firm investing abroad, problems related to licensing the product, etc., for supporting FDI decisions. However, the literature argues that his theory over-emphasised the role of structural market failure and ignored the transaction cost side of market failure (Dunning and Rugman, 1985). Moreover, his theory did not explain the locational and dynamic aspect of FDI.

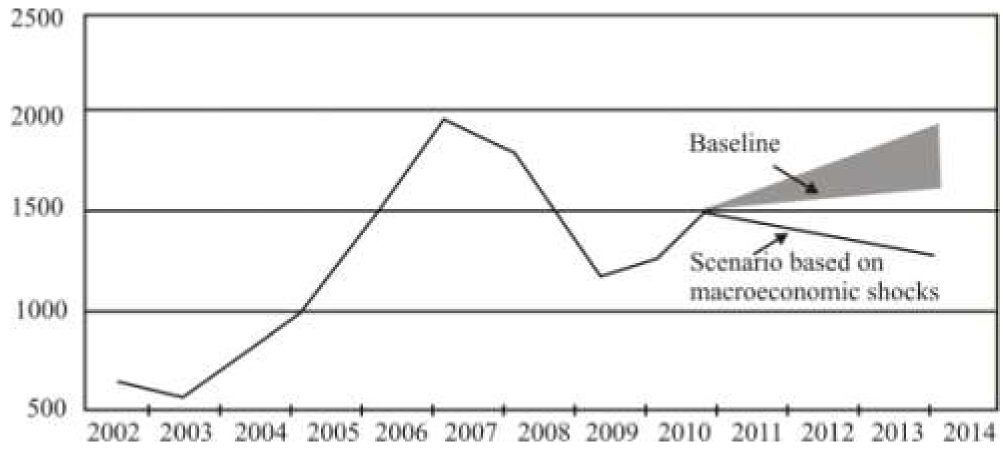
Later, Caves (1971) expanded upon Hymer's theory of direct investment and embedded it in the industrial organization literature. By differentiating horizontal and vertical FDI, he identified factors such as possession of superior knowledge or information, motives to avoid uncertainty in a market characterized by a few suppliers and objective of creating entry barriers, etc., as being responsible for rising FDI flows. With the rising presence of multinational enterprises in the global economy, the view on FDI was expanded with the internationalization theories of FDI that stressed on transaction costs (Dunning and Rugman, 1985; Horaguchi nad Toyne, 1990). The internationalization theory of FDI identified accumulation and internalisation of knowledge as the motivation for FDI, which bypasses intermediate product markets in knowledge (Tolentino, 2001).

The theorists such as Horst (1972), who stressed upon locational determinants of FDI, identified prevalence of natural resources as an important factor for FDI inflow. Wheeler and Mody (1992) identified ergodic and non-ergodic systems that determine the location of FDI. The ergodic system focussed on classical variables such as geographical features, labor costs, transport costs and market size as factors determining the FDI flows. Various empirical studies still rely on these variables to determine potential for FDI flows. The non-ergodic system focussed on externalities that emerge from investment in firms experiencing agglomeration economies, in other words, indicating the clustering effects of FDI. The studies such as Venables (1996), Potter et al (2002) explained spatial patterns of FDI in terms of these factors.

The research work of Dunning (1973, 1981) provided a comprehensive analysis of FDI based on ownership, location and the internationalization (OLI) paradigm. His eclectic theory of FDI highlighted various benefits emerging from FDI: the ownership-specific advantages which comprise access to spare capacity, economies of joint supply, greater access to markets and knowledge, diversification of risk, technology and trademarks, firm size; the location-specific advantages consisting of distribution of inputs and markets, costs of labor, materials and transport costs, government intervention and policies, commercial and legal infrastructure, etc.; internalization-specific advantages covering reduction in search, negotiation and monitoring costs, tariff avoidance, etc. The critics of eclectic theory of FDI have regarded it as a taxomony rather than a theory of FDI (Ietto-Gillies, 1992) as it covered a range of theories and employs a large number of variables. It has also been criticised for reformulation over time to incorporate new ideas and to reflect contemporary trends in FDI. The prior version of his theory ignored the role of strategy in determining the FDI flows. The role of strategic motivations, which was first analysed by Knickerbocker (1973), were extended by Acocella (1992). As per these strategic theories, the reasons behind strategic alliances included economies of scale, the reduction of risk and access to knowledge and expertise (Inkpen, 2001). The strategic alliances highlight the motivation for mergers and acquisitions taking place in the current era of M&A boom.

FDI FROM GLOBAL PERSPECTIVE

A resurgence in economic uncertainty and the possibility of lower growth rates in major emerging markets risks undercutting this favourable trend in 2012. The United Nations Conference on Trade and Development (UNCTAD) predicts the growth rate of FDI will slow in 2012, with flows leveling off at about $1.6 trillion, the midpoint of a range (figure 1). Leading indicators are suggestive of this trend, with the value of both cross-border mergers and acquisitions (M&As) and greenfield investments retreating in the first five months of 2012. Weak levels of M&A announcements also suggest sluggish FDI flows in the later part of the year.



Source: UNCTAD, *World Investment Report* 2012

Figure 1: Global FDI flow 2002-2011 and projection 2012-2014 (Billions of dollars)

UNCTAD projections for the medium term based on macroeconomic fundamentals continue to show FDI flows increasing at a moderate but steady pace, reaching $1.8 trillion and $1.9 trillion in 2013 and 2014, respectively, barring any macroeconomic shocks. Investor uncertainty about the course of economic events for this period is still high. Results from UNCTAD's World Investment Prospects Survey (WIPS), which polls TNC executives on their investment plans, reveal that while respondents who are pessimistic about the global investment climate for 2012 outnumber those who are optimistic by 10 percentage points, the largest single group of respondents - roughly half - are either neutral or undecided. Responses for the medium term, after 2012, paint a gradually more optimistic picture. When asked about their planned future FDI expenditures, more than half of respondents foresee an increase between 2012 and 2014, compared with 2011 levels.

FDI flows to developed countries grew robustly in 2011, reaching $748 billion, up 21 per cent from 2010. Nevertheless, the level of their inflows was still a quarter below the level of the pre-crisis three-year average. Despite this increase, developing and transition economies together continued to account for more than half of global FDI (45 per cent and 6 per cent, respectively) for the year as their combined inflows reached a new record high, rising 12 per cent to $777 billion (table 1). Reaching high level of global FDI flows during the economic and financial crisis it speaks to the economic dynamism and strong role of these countries in future FDI flows that they maintained this share as developed economies rebounded in 2011.

Table 1: FDI flows by Region 2009-2011 (Billions of dollars and per cent)

Region	**FDI inflows**			**FDI outflows**		
	2009	**2010**	**2011**	**2009**	**2010**	**2011**
World	**1197.8**	**1309.0**	**1524.4**	**1175.1**	**1451.4**	**1694.4**
Developed Economies	606.2	618.6	747.9	857.8	989.6	1237.5
Developing Economies	519.2	616.7	684.4	268.5	400.1	383.8
Africa	52.6	43.1	42.7	3.2	7.0	3.5
East and South-East Asia	206.6	294.1	335.5	176.6	243.0	239.9
South Asia	42.4	31.7	38.9	16.4	13.6	15.2
West Asia	66.3	58.2	48.7	17.9	16.4	25.4
Latin America and the Caribbean	149.4	187.4	217.0	54.3	119.9	99.7
Transition Economies	72.4	73.8	92.2	48.8	61.6	73.1
Structurally Weak, Vulnerable and Small Economies*	**45.2**	**42.2**	**46.7**	**5.0**	**11.5**	**9.2**
LCDs	18.3	16.9	15.0	1.1	3.1	3.3
LLDCs	28.0	28.2	34.8	4.0	9.3	6.5
SIDS	4.4	4.2	4.1	0.3	0.3	0.6
Memorandum: % Share in World FDI flows						
Developed Economies	50.6	47.3	49.1	73.0	68.2	73.0
Developing Economies	43.3	47.1	44.9	22.8	27.6	22.6
Africa	4.4	3.3	2.8	0.3	0.5	0.2
East and South-East Asia	17.2	22.5	22.0	15.0	16.7	14.2
South Asia	3.5	2.4	2.6	1.4	0.9	0.9
West Asia	5.5	4.4	3.2	1.5	1.1	1.5
Latin America and the Caribbean	12.5	14.3	14.2	4.6	8.3	5.9
Transition Economies	6.0	5.6	6.0	4.2	4.2	4.3
Structurally Weak, Vulnerable and Small Economies*	3.8	3.2	3.1	0.4	0.8	0.5
LDCs	1.5	1.3	1.0	0.1	0.2	0.2
LLDCs	2.3	2.2	2.3	0.3	0.6	0.4
SIDS	0.4	0.3	0.3	0.0	0.0	0.0

Source: UNCTAD, *World Investment Report* 2012

* Without double counting.

Rising FDI to developing countries was driven by a 10 per cent increase in Asia and a 16 per cent increase in Latin America and the Caribbean. FDI to the transition economies increased by 25 per cent to $92 billion. Flows to Africa, in contrast, continued their downward trend for a third consecutive year, but the decline was marginal. The poorest countries remained in FDI recession, with flows to the least developed countries (LDCs) retreating 11 per cent to $15 billion. Indications suggest that developing and transition economies will continue to keep up with the pace of growth in global FDI in the medium term. TNC executives responding to this year's WIPS ranked 6 developing and transition economies among their top 10 prospective destinations for the period ending in 2014, with Indonesia rising two places to enter the top five destinations for the first time.

The growth of FDI inflows in 2012 will be moderate in all three groups developed, developing and transition economies (table 2). In developing regions, Africa is noteworthy as inflows are expected to recover. Growth in FDI is expected to be temperate in Asia (including East and South-East Asia, South Asia and West Asia) and Latin America. FDI flows to transition economies are expected to grow further in 2012 and exceed the 2007 peak in 2014.

Table 2: Summary of Econometric Results of Medium-term Baseline Scenarios of FDI flows by Region (Billions of dollars)

Host Region	Averages					Projections		
	2005-07	2009-11	2009	2010	2011	2012	2013	2014
Global FDI Flows	**1473**	**1344**	**1198**	**1309**	**1524**	**1495-1965**	**1630-1925**	**1700-2110**
Development Countries	**972**	**658**	**606**	**619**	**748**	**735-825**	**810-940**	**840-1020**
European Union	646	365	357	318	421	410-450	430-510	440-550
North America	253	218	165	221	268	255-285	280-310	290-340
Developing Countries	**443**	**607**	**519**	**617**	**684**	**670-760**	**720-855**	**755-930**
Africa	40	46	53	43	43	55-65	70-85	75-100
Latin America and the Caribbean	116	185	149	187	217	195-225	215-265	200-250
Asia	286	374	315	384	423	420-470	440-520	460-570
Transition Economies	**59**	**79**	**72**	**74**	**92**	**90-110**	**100-130**	**110-150**

Source: UNCTAD, *World Investment Report* 2012

UNCTAD'S INVESTMENT POLICY FRAMEWORK FOR SUSTAINABLE DEVELOPMENT

A New Generation of Investment Policies Emerges: Cross-border investment policy is made in a political and economic context that, at the global and regional levels, has been buffeted in recent years by a series of crises in finance, food security and the environment, and that faces persistent global imbalances and social challenges, especially with regard to poverty alleviation. These crises and challenges are having profound effects on the way policy is shaped at the global level. First, current crises have accentuated a longer-term shift in economic weight from developed countries to emerging markets. Second, the financial crisis in particular has boosted the role of governments in the economy, in both the developed and the developing world. Third, the nature of the challenges, which no country can address in isolation, makes better international coordination imperative. And fourth, the global political and economic context and the challenges that need to be addressed - with social and environmental concerns taking centre stage - are leading policymakers to reflect on an emerging new development paradigm that places inclusive and sustainable development goals on the same footing as economic growth. At a time of such persistent crises and pressing social and environmental challenges, mobilizing investment and ensuring that it contributes to sustainable development objectives is a priority for all countries.

Against this background, a new generation of foreign investment policies is emerging, with governments pursuing a broader and more intricate development policy agenda, while building or maintaining a generally favourable investment climate. This new generation of investment policies has been in the making for some time and is reflected in the dichotomy in policy directions over the last few years - with simultaneous moves to further liberalize investment regimes and promote foreign investment, on the one hand, and to regulate investment in pursuit of public policy objectives, on the other. It reflects the recognition that liberalization, if it is to generate sustainable development outcomes, has to be accompanied -

if not preceded - by the establishment of proper regulatory and institutional frameworks. "New generation" investment policies place inclusive growth and sustainable development at the heart of efforts to attract and benefit from investment. Although these concepts are not new in and by themselves, to date they have not been systematically integrated in mainstream investment policy making. New generation" investment policies aim to operationalize sustainable development in concrete measures and mechanisms at the national and international levels, and at the level of policymaking and implementation.

- Broadly, 'new generation' investment policies strive to:
- Create synergies with wider economic development goals or industrial policies, and achieve seamless integration in development strategies;
- Foster responsible investor behaviour and incorporate principles of CSR;
- Ensure policy effectiveness in their design and implementation and in the institutional environment within which they operate.

New Generation Investment Policies and Challenges: Three broad aspects of 'new generation' foreign investment policies translate into specific investment policy challenges at the national and international levels (tables 3 and 4). The critical issues like, the core principles for investment policymaking for sustainable development and share of top investing countries FDI equity inflows (Financial Years) respectively (table 5 and 6).

Table 3: National Investment Policy Challenges

Integrating Investment Policy in Development Strategy	• Channeling investment to areas key for the build-up of production capacity and international competitiveness. • Ensuring coherence with the host of policy areas geared towards overall development objectives.
Incorporating Sustainable Development Objectives in Investment Policy	• Maximizing positive and minimizing negative impacts of investment. • Fostering responsible investor behavior.
Ensuring Investment Policy Relevance and Effectiveness	• Building stronger institutions to implement investment policy. • Measuring the sustainable development impact of investment.

Source: UNCTAD, *World Investment Report* 2012

Table 4: International Investment Policy Challenges

Strengthening the Development Dimension of IIAs	• Safeguarding policy space for sustainable development needs. • Making investment promotion provisions more concrete and consistent with sustainable development objectives.
Balancing Rights and Obligations of States and Investors	• Reflecting investor responsibilities in IIAs. • Learning from and building on CSR principles.
Managing the Systemic Complexity of the IIA regime	• Dealing with gaps, overlaps and inconsistencies in IIA coverage and content and resolving institutional and dispute settlement issues. • Ensuring effective interaction and coherence with other public policies (e.g. climate change, labour) and system (e.g. trading, financial).

Source: UNCTAD, *World Investment Report* 2012

Table 5: Core Principles for Investment Policymaking for Sustainable Development

Sl. No.	Area	Core Principles
1	**Investment for Sustainable Development**	The overarching objective of investment policymaking is to promote investment for inclusive growth and sustainable development.
2	**Policy Coherence**	Investment policies should be grounded in a country's overall development strategy. All policies that impact on investment should be coherent and synergetic at both the national and international levels.
3	**Public Governance and Institutions**	Investment policies should be developed involving all stakeholders, and embedded in an institutional framework based on the rule of law that adheres to high standards of public governance and ensures predictable, efficient and transparent procedures for investors.
4	**Dynamic Policy Making**	Investment policies should be regularly reviewed for effectiveness and relevance and adapted to changing development dynamics.
5	**Balanced Rights and Obligations**	Investment policies should be balanced in setting out rights and obligations of States and investors in the interest of development for all.
6	**Right to Regulate**	Each country has the sovereign right to establish entry and operational conditions for foreign investment, subject to international commitments, in the interest of the public good and to minimize potential negative effects.
7	**Openness to Investment**	In line with each country's development strategy, investment policy should establish open, stable and predictable entry conditions for investment.
8	**Investment Protection and Treatment**	Investment policies should provide adequate protection to established investors. The treatment of established investors should be non-discriminatory.
9	**Investment Promotion and Facilitation**	Policies for investment promotion and facilitation should be aligned with sustainable development goals and designed to minimize the risk of harmful competition for investment.
10	**Corporate Governance and Responsibility**	Investment policies should promote and facilitate the adoption of and compliance with best international practices of corporate social responsibility and good corporate governance.
11	**International Cooperation**	The international community should cooperate to address shared investment-for-development policy challenges, particularly in least developed countries. Collective efforts should also be made to avoid investment protectionism.

Source: UNCTAD, *World Investment Report* 2012

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. FDI flows of top investing countries are given in the below mentioned table-6.

Table 6: Share of Top Investing Countries FDI Equity Inflows (Financial Years)

Ranks	Country	2008-09	2009-10	2010-11	Cumulative Inflows	% age to total Inflows (in US $)
I	Mauritius	50899 (11229)	49633 (10376)	31855 (6987)	242761 (54227)	42
II	Singapore	15727 (3454)	11295 (2379)	7730 (1705)	52876 (11895)	09
III	U.S.A	8002 (1802)	9230 (1943)	5253 (1170)	42542 (9449)	07
IV	UK	3840 (864)	3094 (657)	3434 (755)	29433 (6639)	05
V	Netherlands	3922 (883)	4283 (899)	5501 (1213)	25627 (5700)	04
VI	Japan	1889 (405)	5670 (1183)	7063 (1562)	23958 (5276)	04
VII	Cyprus	5983 (1287)	7728 (1627)	4171 (913)	21948 (4812)	04
VIII	Germany	2750 (629)	2980 (626)	808 (200)	13376 (2999)	02
IX	France	2098 (467)	1437 (303)	3349 (734)	10267 (2264)	02
X	U.A.E.	1133 (257)	3017 (629)	1569 (341)	8592 (1890)	01
TOTAL FDI INFLOW*		**123025 (27331)**	**123120 (25834)**	**88520 (19427)**	**58722 (129716)**	**--**

Source: RBI Bulletin May 2011, 11-05-2011 (Table No. 44 FDI Inflow)

Note: i. Includes inflows under NRI Schemes of RBI. ii. Cumulative country-wise FDI equity inflows (from April 2000 to February 2011) – Annexure – 'A'. iii. Percentage worked out in US $ terms & FDI inflows received through FIPB/SIA+RBI's Automatic Route + acquisition of existing shares only.

FDI IN DEVELOPING COUNTRIES

In the case of developing countries the domestic capital is insufficient hence it is unavoidable to invite foreign funds. Most of the developing nations of the world are mainly depending on foreign capital for the development of their industrial development. They get foreign capital in the form of Foreign Direct Investment, Foreign Collaboration, Inter-government loans, and loans obtained from international institutions and commercial barrowings. In July 1991by confirming the need of the foreign capital, the Indian Government adopted the new economic policy. Till 1991, the growth of FDI inflows was not large but after the implementation of the new economic policy in 1991, it has been playing an important role in the economic development. The available data show that, the inflow of FDI into India has been increased from US $ 4029 million in 2000-01 to US $ 37838 million and registered a declining trend in recent years. India, the capital deficient country needs more capital from outside the country. The role of Foreign Direct Investment is very much a significant in the economic development the country. By December 2010, India attracted FDI equity inflows of US $ 2,014 million. According to the data released by the Department of Industrial Policy and Promotion (DIPP), the cumulative FDI equity inflows stood at 186.79 billion US dollar from April 2000 to December 2010.

The amount of FDI, compared to China and other developed countries is quite less, but it has helped in economic transformation of India. The Indian Government has reviewed policy to attract more FDI and these policy measures boosted the FDI inflows and out flows. But in the recent years, the amount of FDI has been declining. The percentage growth over previous years has shown a negative sign. The inflows of FDI increased in the last decade and inspired the performance of the industries in India and it has new opportunities in India. Both India and China are fast developing economies of the world and enjoy the strong economic growth rate. But, India is under performer as for as FDI is concerned if compared with China. The procedures for FDI approval, environmental clearance, legal aspect, etc., are time consuming. The FDI inflow is being hampered due to the political uncertainty at the central and state as well. The reforms in infrastructure need to be quickened, mergers and acquisition process must be rationalized. Above and beyond all these, India is suffering from problem of corruption to attract more FDI.

A perusal of India's FDI policy and 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 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 7: Equity FDI Inflows to India

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**

Source: World Investment Report, 2011 and Global Investment trends Monitor, UNITAD

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 7). 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 7).

CONCLUSION

An analysis of the recent trends in FDI flows at the global level as well as across regions/countries suggests that India has generally attracted higher FDI flows in line with its robust domestic economic performance and gradual liberalization of the FDI policy as part of the cautious capital account liberalization process. Even during the recent global crisis, FDI inflows to India did not show as much moderation as was the case at the global level as well as in other EMEs. However, when the global FDI flows to EMEs recovered during 2010-11, FDI flows to India remained sluggish despite relatively better domestic economic performance ahead of global recovery. This has raised questions especially in the backdrop of the widening of the current account deficit beyond the sustainable level of about 3 per cent. In order to analyze the factors behind such moderation, an empirical exercise was undertaken which did suggest the role of institutional factors (Government's to implement quality policy regime) in causing the slowdown in FDI inflows to India despite robustness of macroeconomic variables.

A comparison of actual FDI flows to India and the potential level worked out on the basis of underlying macroeconomic fundamentals showed that actual FDI which has generally tracked the potential level till 2009-10, fell short of its potential by about 25 per cent during 2010-11. Further, counter factual scenario attempted to segregate economic and non-economic factors seemed to suggest that this large divergence between actual and potential during 2010-11 was partly on account of rise in policy uncertainty. Against this backdrop, it is pertinent to highlight the number of measures announced by the Government of India on April 1, 2011 to further liberalise the FDI policy to promote FDI inflows to India. These measures include;

1. Allowing issuance of equity shares against non-cash transactions such as import of capital goods under the approval route.
2. Removal of the condition of prior approval in case of existing joint ventures/technical collaborations in the 'same field'.
3. Providing the flexibility to companies to prescribe a conversion formula subject to FEMA/SEBI guidelines instead of specifying the price of convertible instruments upfront.
4. Simplifying the procedures for classification of companies into two categories – 'companies owned or controlled by foreign investors' and 'companies owned and controlled by Indian residents'.
5. Allowing FDI in the development and production of seeds and planting material without the stipulation of 'under controlled conditions'.

These above measures are expected to boost India's image as a preferred investment destination and attract FDI inflows to India in the near future. Apart from the role of institutional factors, as compared to other EMEs, there are also certain sectors including agriculture where FDI is not allowed, while the sectoral caps in some sectors such as insurance and media are relatively low compared to the global patterns. In this context, it may be noted that the caps and restrictions are based on domestic considerations and there is no uniform standards that fits all countries. However, as the economy integrates further with the global economy and domestic economic and political conditions permit, there may be a need to relook at the sectoral caps (especially in insurance) and restrictions on FDI flows (especially in multi-brand retail). Further, given the international experience, it is argued that FDI in retail would help in reaping the benefits of organized supply chains and reduction in wastage in terms of better prices to both farmers and consumers. The main apprehensions in India, however, are that FDI in retail would expose the domestic retailers – especially the small family managed outlets - to unfair competition and thereby eventually leading to large-scale exit of domestic retailers and hence significant job losses. A balanced and objective view needs to be taken in this regard. Another important sector is the generation, transmission and distribution of electricity produced in atomic power, where FDI is not permitted at present, may merit a revisit. In this context, it may be noted that electricity distribution services is a preferred sector for FDI. Similarly, the demands for raising the present FDI limits of 26 per cent in the insurance sector may be reviewed taking into account the changing demographic patterns as well as the role of insurance companies in supplying the required long term finance in the economy.

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