RESEARCH REVIEW JOURNALS
Volume-03
Issue-01
January-2018

ISSN: 2455-3085 (Online)
RESEARCH REVIEW International Journal of Multidisciplinary
www.rrjournals.com [UGC Listed Journal]

Role of Foreign Direct Investment with reference to Economic Reforms

*Prof. Niraj B. Patel

*Faculty of Commerce, M.com. B.Ed., M. Phil, Ph.D, DTP, SLET, Research Scholar,
North Gujarat University, Patan, Gujarat (India)

INTRODUCTION

Indian economy was in deep crisis in 1991 when foreign currency reserves had dwindled to almost $1 billion; inflation had roared to an annual rate of 17 percent; fiscal deficit was very high, foreign investors and NRIs had lost confidence in Indian Economy. With the introduction of economic reforms in 1991, the era of liberalization and globalization of the economy began. Controls began to give way to the policy of deregulation and decontrol. The new economic reform, popularly known as Liberalization, Privatization and Globalization (LPG model) aimed at making the Indian economy a faster growing economy, globally competitive. The series of reforms undertaken with respect to industrial sector, and trade as well as financial sector aimed at making the economy more efficient and competitive. Liberalization and globalization of world economies has opened the doors for foreign investment, transfer of goods, capital and human resources from one country to another country. As a result, the planned economy has been transformed into a market driven economy.

The activities under the purview of the service sector are diverse in nature. The important sub-sectors are trading, transportation, and telecommunication, financial, real estate, IT and IT-enabled services and business services; community, social and personal services come within the ambit of the service industry. Now service sector is the largest and fastest growing sector in India. Following the economic liberalization in India, the service sector has gained prominence in the economy as it accounts for the largest share of GDP, and, also, that the share of this sector in GDP has been growing very rapidly. After recording a growth rate of 5.40 per cent per annum during 19811991, there was further acceleration in GDP growth to 7.70 per cent per annum during 2001-17.

SERVICE SECTOR AND THE INDIAN ECONOMY

The contribution of the Service Sector in India GDP has increased a lot in the last few years. The Service Sector contributed only 4.20 percent to the Indian GDP in 1951-61. Further, the Indian Service Sector's share in the country's GDP has increased from 7.3 percent in 1991-2001 to around 9.5% in 2001-17. It implies that increase in GDP growth rate was possible because of increase in contribution of service sector growth over the periods. The rapid economic growth has entailed a significant structural changes in the Indian economy such that the share of agriculture in the GDP has declined from 10 per cent in 2003-04 to about 5.4 per cent in 2010-17. There has been a sharp increase in the share of services in the GDP from 8.5 per cent to 9.6 per cent in the same period. If the structural composition is examined it can be said that decline in the agriculture has been gained by the service sector.

Table 1: GDP growth rate at constant price (Sectoral Growth)

Year	Agriculture	Industry	Services	GDP
2003-04	10	6	8.5	8.5
2004-05	0	8.5	9.1	7.5
2005-06	5.8	8.1	10.6	9.5
2006-07	4	10.7	11.2	9.7
2007-08	4.9	7.4	10.9	9
2008-09	1.6	2.6	9.7	6.7
2009-10	0.4	8.3	10.1	8
2010-11	5.4	8.2	9.6	8.6
2011-12	5	8	10.6	7.7
2012-13	4.8	7	11.2	8.4
2013-14	6.3	7.3	11.8	8.9
2014-15	6.7	8.6	10.2	7.8
2015-16	5.1	8.9	9.4	7.9
2016-17	5.5	8.3	9.9	8.1

Source: CSO

As per classification of Central Statistical Organization, the services sector includes four broad categories, namely (a) trade, hotels, and restaurants; (b) transport, storage, and communication; (c) financing, insurance, real estate, and business services; and (d) community, social, and personal services. Among these, financing, insurance, real estate and business services; and trade, hotels and restaurants are the largest groups accounting for 16.7 per cent and 16.3 per cent, respectively, of the national GDP at factor cost at current price in 2015-16. The community, social, and personal services category accounts for a 14.4 per cent share, while transport, storage, and communication accounts for a 7.8 per cent share. Construction (which may also be treated as service sector) has a share of 8.2 percent. In developed countries, majority of GDP is contributed by service sector. In developing countries like India, the share of services has been increasing in terms of GDP. Presently about 55% of the GDP is contributed by services sector in India and if the construction is considered, the contribution of services sector in India GDP will be more than 60%.

Table 2: Share of different services in GDP at factor cost (Current prices)

Sector	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
a) Trade, hotels & restaurants	16.1	16.7	17.1	17.1	16.9	16.3
b) Transport, storage & communication	8.4	8.2	8.2	8.0	7.8	7.8
c) Financing, insurance, real estate & business services	14.7	14.5	14.8	15.1	16.1	16.7

d) Community, social & personal services	13.8	13.5	12.8	12.5	13.3	14.4
Construction	7.7	7.9	8.2	8.5	8.5	8.2
Total Services (excluding Construction)	53.0	52.9	52.9	52.7	54.1	55.2
Total Services (including Construction)	60.7	60.8	61.1	61.2	62.6	63.4

Source: Economic Survey, 2010-11

India's emergence as one of the fastest growing economies in the 1990s is largely attributed to the rapid growth of its services sector. The sector grew in this decade at an average of 7.9 percent per annum (Table 1). Consequently, the contribution of services to gross domestic product (GDP) has been more than 60 percent per annum since 2000. The Indian economy has moved from agriculture-based economy to a knowledge-based economy which is primarily represented by the service sector. This growth of the service sector is accompanied by increasing foreign direct investment (FDI) approvals in the services sector.

FDI AND ITS ROLE

According to the definition of IMF, Foreign Direct Investment (FDI) includes equity capital, intercompany debt transactions, short-term and long-term loans, reinvested earnings of foreign companies, financial leasing, trade credits, grants, non-cash acquisition of equity, venture capital by foreign investors, control premium, non-competition fee etc. Foreign Investment through Global Depository Receipts (GDR) /American Deposit Receipts (ADR), Foreign Currency Convertible Bonds (FCCBs) are also treated as Foreign Direct Investment. At the macro- level, FDI is a non-debt-creating source of additional external finances and, at the micro-level, FDI is expected to boost output, technology, skill levels, employment and linkages with other sectors and regions of the host economy. The aim of FDI is to supplement the domestic capital and technology. The FDI is a type of investment that involves the injection of foreign funds into an enterprise that operates in a different country of origin from the investor. The exchange of such investment flows benefits both the home country (the country from which the investment is coming) and the host country (the destination of the investment or receiving country). FDI facilitates international trade and transfer of knowledge, skills and technology. The FDI can play catalytic role in a growing economy like India. The role of Foreign Direct Investment is becoming increasingly significant in the Indian economy. The Foreign Direct Investment is now a part of future of Indian economy. Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ ADRs/FCCBs.

There is a significant change in the sectoral composition of FDI in India since the beginning of the liberalization period. It is revealed that the majority of FDI inflow in the pre-liberalization era was directed to the manufacturing sector and it was quite high-nearly 85 percent of total FDI in 1990. However, with liberalization, the FDI inflows received by services and infrastructure sector have risen amazingly. This has brought the share of manufacturing sector down to 21percent in 2009. Since 1990, the service sector has emerged as a major sector receiving FDI with the share of more than 60 percent of total FDI in 2011.

The growing Indian market, regulatory reforms and availability of skilled work force and democratic government have been important factors in boosting FDI inflows to this sector in India. The inflow of FDI to Service Sector has helped the development of several industries in the service sector of the Indian Economy, such as Financial and Non-financial, Telecommunication, Hotel & Tourism, and so on. FDI Inflows to Service Sector has been phenomenal in the past few years. Since the liberalization of the Indian economy in 1991, the country has experienced a huge increase in the inflow of foreign investments. The flow of FDI in service sector (financial & non-financial only) has increased enormously from Rs.1235 crore in 2003-04 to Rs.15,539 crore in 2010-11. However, the inflow of FDI across sub-sectors has not been uniform and it can be evidenced that there is a bias towards few sectors as compared to others. The service sector in India has tremendous growth potential and, as a result, it attracts huge Foreign Direct Investments. The top five sub-sectors attracting FDI inflows are Services Sector (financial & non-financial), Telecommunication, Computer Software & Hardware, Construction (roads & highways), Housing & Real Estate. Telecommunication sector has massive FDI inflows during 1990-91 to 2016-17. According to the United Nations Conference on Trade and Development (UNCTAD), the foreign direct investment (FDI) flows into India dropped by over 31 per cent

Table 3: FDI inflows in major service sectors (Amount in crore Rs.)

Sector	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Services Sector (Finance & non-financial)	1,235	2,106	1,460	21,047	26,589	28,411	20,776	15,539
Telecommunication	532	588	168	2,155	5,103	11,727	12,338	7,546
Computer Software & Hardware	NA	NA	NA	44,786	5,623	7,329	4,351	3,571
Construction (roads & highways)	NA	NA	NA	4,424	6,989	8,792	13,516	5,077
Housing & Real Estate	NA	NA	NA	2,121	8,749	12,621	13,586	5,149

NA-Not available

Source: Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, GOI

Service sector has ranked among the top ten sectors attracting FDI since 1991. During 2010-11, the highest FDI equity inflows were received by the services sector (financial & non-financial), amounting to 18 per cent of the total FDI inflows, followed by telecommunications (8 per cent), power sectors, housing & real estate, metallurgical industries, construction activities (6% each), computer software & hardware(4%).

During the last two decades i.e. during the post-liberalization period, the sector-wise inflows of FDI have undergone a sea change. Figure 1 and 2 show the variation in the sector ranks based on their share in total FDI inflows during 1991-99 and 2000-2011. During 2000-2011, some new sub-sectors like computer software & hardware, construction activities and housing & real estate, power have attracted significant FDIs. Computer software and hardware sectors were not taken independently till the year 2003 and till then it was merged under the head electrical. It was taken separately since 2004. It accounted for major share of 9 percent in the cumulative FDI inflows for the period 2000-11 and ranked the second highest to attract FDI. The e- commerce activities which come under the computer software & hardware also enjoy the permission of 100% FDI under automatic route. FDI in sectors/ activities under automatic route does not require any prior approval either by the Government or the Reserve Bank of India. FDI, under the automatic route, does not require any approval; it only involves intimation to the Reserve Bank. In 2005, the limit of FDI in telecom services was increased from 49 percent to 74 percent. FDI up to 49 percent is permissible under automatic route but FDI in the licensee company! Indian promoters/investment companies including their holding companies shall require approval of Foreign Investment Promotion Board (FIPB), if it has a bearing on the overall ceiling of 74 percent, i.e., the latter case will be through Government route. For the period 1991-99 it added 7 percent, and for the period 2000-11 it added 8 percent

There is a significant increase in the telecom sector in India during the two periods primarily due to the growing demand and participation of private players in this sector.

The Electrical equipment industry, transportation and chemicals managed to be among the top rankers during 1991-99 but these sectors have lost their importance during 2000-2011. 100 percent FDI is allowed under automatic route in the power sector except the atomic energy. The power sector has attracted considerable FDI during the period 1991-99 and accounted for 10 percent share of total FDI inflows during this period. During the period 20002011 there is a considerable decrease in FDI inflows in the power sector to the extent of 5 percent of the total inflow of FDI.

The Housing & real estate and construction industry are among the new sectors attracting large FDI inflows that came under top five sectors in attracting maximum inflows of foreign investment. Housing and real estate sector was opened to FDI in 2005.This sector includes development of township, housing, built-up infrastructure and construction development projects. The government allows FDI up to 100% in this sector under automatic route subject to fulfillment of certain conditions as laid down by the FDI policy of Government of India. Over the last few years the construction industry too attracted considerable FDI. For the period 2000- 2011, both the housing and real estate sector and construction activities received 7 percent (each) of the total FDI inflows.

CONTRIBUTING COUNTRIES OF FDI

The present study shows that Mauritius has been the largest investor in India during 1991-2005 and 20002011. Out of total FDI inflow in India, Mauritius based firms invested 35.55 percent in 1991-2005 and 41.90 percent in 2000-2011. Though USA was in 2nd position with 16.49 percent of total foreign investment in 19912005, its investment came down to 7.36 percent in 20002011. Whereas FDI from Singapur has increased from 3.06 percent (1991-2005) to 9.18 percent during 20002011. Out of total FDI, investment from Cyprus has been increased remarkably from 0.30 percent in 1991-2005 to 3.65 percent in 2005-2011. Again, the investment from South Korea has declined from 2.28 percent in 19912005 to 0.59 percent in 2000-2011. Table 4 shows how the foreign investments are coming to India from different countries. It is important to mention that most of the foreign investments from Mauritius, USA, UK, Germany are coming for service sectors like power, telecommunication, infrastructure etc. The Double Taxation Avoidance Agreement (DTAA) between India and Mauritius facilitates more foreign investment in India from Mauritius than any other countries. India ranked 411 position in terms of FDJ inflows in 2009 (World Investment Report 2011, UNCTAD) after USA, China and UK.

Table 4: Share of top investing countries of FDI in India (% of total inflows)

Country	1991-2005	2016-2017
Mauritius	35.55	41.9
Singapur	3.06	9.18
USA	16.49	7.36
UK	6.6	5.01
Netherlands	6.9	4.35
Japan	6.93	3.99
Cyprus	0.3	3.65
Germany	4.43	2.29
France	2.68	1.74
UAE	0.44	1.47
Switzerland	1.96	1.43
South Korea	2.28	0.59
Italy	1.6	0.72
All other countries	10.78	16.32

Source: CSO

CONCLUSION

The present study concludes that FDI inflows have shown significant growth in the post-liberalization period, specially in service sector. The service sectors like telecommunication, IT & ITeS, insurance and finance are becoming more prominent to attract FDI in India. The government has lifted sectoral caps for FDI since the introduction of LPG model in 1991 in a phased manner. Removal of restrictions on FDI inflows in the service sector like hospital and health, education may also be considered. There is a huge scope of foreign investment in these sectors which in turn, will help the growth of the Indian economy.

REFERENCES

[1] The FDI Policy (2011), Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India (effective from 1t April 2011)

[2] Annual Report (2010-11), Department of Industrial Policy & Promotion, Ministry of Commerce and Industry, Government of India

[3] Critical Issues in India's Service-led Growth (Working Paper No. 171) (2005) by Rashmi Banga, Indian Council for Research on International Economic Relations, New Delhi

[4] FDI in India and its Growth Linkages (2010), National Council of Applied Economic Research, New Delhi

[5] The Service Sector Revolution in India (Research Paper No. 2008/72) by Rubina Verma, September 2008, UNU World Institute for Development, Economics Research (UNU-WIDER), Finland