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A POST REFORM PERIOD OF FOREIGN DIRECT INVESTMENT INFLOW IN INDIA

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ABSTRACT: Foreign direct investment has played a significant role in the growth and development of Indian economy. Our gross domestic product has been grown four-fold since the year 1991. Foreign direct investment play multidimensional role in the overall development. It may generate benefits through bringing non-debt creating foreign capital resources, technology up-gradation, skill enhancement, new employment, spillovers and allocative efficiency effects. Thus foreign direct investment acts as a catalyst for domestic industrial development and considered to be an important vehicle for economic development. During post liberalization period foreign direct investment has grown at compounded annual growth rate of 24.48% in India. This indicates that liberalization has a positive impact on foreign direct investment inflow in India. This paper document the trend of foreign direct investment inflow in India since 1990s. . Based on the analytical discussion, the study concludes by suggesting a realistic foreign investment policy.
Keywords: economic development, economic reform, foreign direct investment, liberalization.

INTRODUCTION

In today's globalized world the most prominent and striking feature is the exponential growth of foreign direct investment in both developed and developing countries. In particular, in developing countries foreign direct investment is considered as the safest type of external finance as it supplement domestic saving, foreign reserve and promote growth through spillover of technology, increased innovative capacity, skills and domestic competition.

India is the 7th largest and 3rd purchasing power parity country in world. For a long time Indian approach towards foreign direct investment was governed by the multiple objectives of self-reliance, protection of national industry and entrepreneurs, import of select technologies and export promotion. As a part of the Structural Adjustment Program, along with virtually dismantling the industrial regulatory system, India sought to attract foreign direct investment with special favors and persuasion. The expectation of the policy maker was to establish India as an "investor friendly" but expectation remained largely unfulfilled despite the consistent attempts by policy makers to increase the attractiveness of India by further changes in policies that include opening up of industrial sector, raising the hitherto of existing caps on foreign holding and improving investment procedure. But after 2005-2006, official statics started reporting steep increase in FDI inflows.

OBJECTIVE

Objective of the study is to analyze the trend of foreign direct investment in India since 1991.This will enable us to chart out the direction of foreign direct investment in India overtime. Moreover effort has also been made to trace the factors governing the direction of foreign direct investment inflows in India.

HYPOTHESES FORMULATION

Post reform period of 1991 in India shows that there is significant increase in inflow of foreign direct investment, both in terms of approved and actual foreign direct investment inflows in India. Approved foreign direct investment is that foreign direct investment which has to take approval by the government of India. Government of India has prescribed the limit for approved foreign direct investment India while actual

foreign direct investment is the total foreign direct investment coming in India with or without approval. In this regard, we therefore hypothesize that

$H_{0:}$ it is expected that there is no difference in the mean of approved and actual foreign direct investment inflows in India.

$H_{1:}$ it is expected that there is difference in the mean of approved and actual foreign direct investment inflows in India.

RESEARCH METHODOLOGY

This study is based on secondary data. The required data have been collected from department of industrial policy and promotion and bulletin of Reserve Bank of India. It is time series data and relevant data have been collected for the period 1991 to 2015.

One of the tools used for analyzing the overall trend of various phases is compounded annual growth rate (CAGR). The method is used as expression of the secular movement when the series is increasing at regular interval of time. The compounded annual growth is computed by fitting an exponential function to available data. For measuring the compounded annual growth rate of foreign direct investment we have used semi log model of the type:

$Y= ab^t$

Where, a and b are parameter, Y is the foreign direct investment and t is the time period.

Beside estimating the compounded annual growth rate were ever required, we have also estimated simple annual growth rate of the foreign direct investment or any other variable considered during the course of analysis by the formula, $\left(\frac{1}{y} * dy\right)$*100 where dy is the change in the value of the variable during two constructive year and y is original value of variable.

Another test named as Paired t test is used to find the difference between the actual and approved foreign direct investment inflows. Paired t test measure whether means from a within subjects test group vary over 2 test condition.

The Formula for a paired t test is mention below:

$$t= \frac{\sum d}{\sqrt{n(\sum d^2)-(\sum d)^2/n-1}}$$

Where, ∑d= sum of differences.

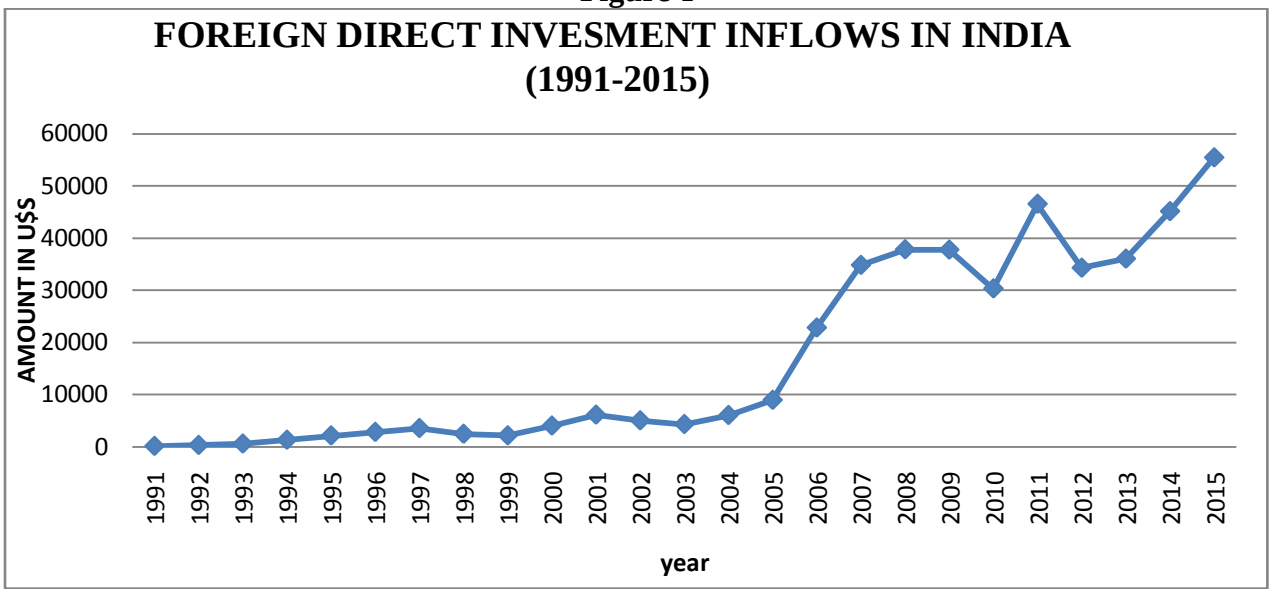
SCOPE AND LIMITATION OF STUDY

The scope of the study is confined to trace the flow of foreign direct investment at all India level for the period of 1991 to 2015.

ANALYSIS ON TREND OF FOREIGN DIRECT INVESTMENT INFLOWS IN INDIA AFTER POST LIBERALIZATION PERIOD:

The broad trend in foreign direct investment inflow in India is depicted in figure-I. From the figure it is evident that there are three distinct phases in India. Phase-1 is from the year 1991 to 2003. Phase-II is short phase and it covers a period 2004 to 2008. This phase is relevant for the growth of foreign direct investment since in this period foreign direct investment increase at abnormal rate because of the special economic zone act (SEZ act, 2005) introduce by government of India. Phase-III (2009 to 2015) is the period of global recession which also impacted India. So figure-I depict that there is decline in the inflow of foreign direct investment. The highest growth rate could be seen in year 2006 with annual growth rate of 154.72 percent. The compounded annual growth rate since 1991 to 2015 is 24.48 percent.

Figure-I



Analysis of data on foreign direct investment inflows from 1991 to 2015 has revealed three distinct phase. The three phases are respectively as follows:

A. Phase-1 (1991 to 2003)
B. Phase-II (2004 to 2008)
C. Phase-III (2009 to 2015)

During phase-1(1991 to 2003), foreign direct investment has increased consistently and gradually though the rate of increase is fairly low. Foreign exchange management act (FEMA, 1999) was introduced which replaced the foreign exchange regulation act (FERA, 1973). Foreign investment promotion council (FIPC) along with foreign investment promotion board (FIPB) was setup in 1996 to diagnose the project within country. Foreign direct investment was enlarged to 100 percent in export oriented units, banking and non banking financial service, tourism related companies, trading with varying degree of foreign equity participation. Insurance regulatory and development act (IRDA) was passed by parliament in December 1999. By analyzing the first phase of foreign direct investment inflows, conclusion drawn is that there is a need for further liberalization of policy related to capital account convertibility. Since amount of foreign direct investment inflows are not enough to take momentum, outflows of foreign direct investment from domestic companies should also be deregulated more.

Further the second phase (2004 to2008) of post liberalization period launches the special economic zone (SEZ act). Special economic zone was mainly responsible for the foreign direct investment inflow in India. Special economic zone act was introduced with specific intend to provide international competition and Hassel free environment for export. Special economic zone act was perceived as the dominant source of attracting foreign direct investment across the global market. Through special economic zone act many sector of the Indian economy were liberalized to ease the foreign direct investment inflow in the economy. Some of these were manufacturing, drugs and pharmaceutical, hotel and tourism services, infrastructure related marketing, banking, telecom, road, highway port and harbor etc. although analyses of the second phase shows whooping increase in foreign direct investment inflows but there is need for further liberalization in capital account and raising the upper limit of foreign direct investment cap in different sectors.

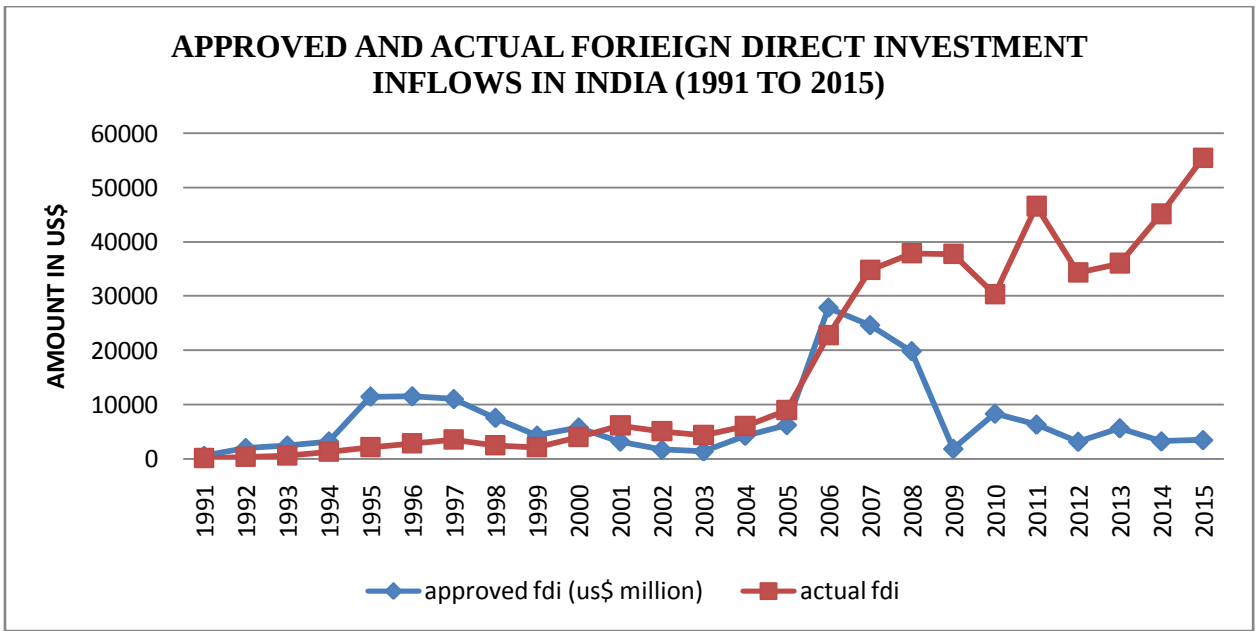
At last the third phase was the period of recession across the world which impacted Indian economy also. To lift the Indian economy out of the serious impact of global recession and to increase the flow of foreign direct investment inflows, major step were taken by the Indian government. One of the major steps taken recently was MAKE IN INDIA program (September 2014). MAKE IN INDIA program is designed to facilitate investment, foster innovation, built best in class manufacturing infrastructure and to protect intellectual property. Policies related to foreign direct investment inflows in MAKE IN INDIA program are as follows:

a) Easing of investment caps and control with high value industrial sector like defense, construction and railway are now open global participation
b) Foreign direct investment cap was raised from 26 percent to 49 percent in defense sector
c) Under automatic route 24 percent portfolio investments permitted in defense sector.
d) For the modernization of our technology on the case to case basis 100 percent Foreign direct investment allowed in defense sector.
e) 100 percent Foreign direct investment under automatic route is permitted in construction, operation and maintenance in specified rail infrastructure project such as:
   a) Sub urban corridor project through PPP
   b) High speed train project
   c) Rolling stock including train sets and locomotive coaches manufacturing and maintenance facilities, electrification, Signaling system, Freight terminal, Passenger terminal.
   d) Basic Infrastructure especially related to railway line/ siding including electrifiable railway line and connectivity's to main railway line.
f) Relaxation in the norms for foreign direct investment in construction development sector for mass rapid transport system.

APPROVED AND ACTUAL FOREIGN DIRECT INVESTMENT INFLOWS IN INDIA

The pattern of approved and actual inflow of foreign direct investment is shown in table-II(A) and figure-II.

FIGURE-II



Comparative analysis has revealed that the gap between actual and approved foreign direct investment has widened especially after 2006. All this depend on various factors namely delay in implementation of project, government clearance, regulatory procedure and non cooperation from the state government etc. under foreign collaboration many long term project get delayed considerably because of absence of proper and insufficient infrastructural support and facilities.

To analyze the difference between the approved and actual foreign direct investment inflow in India paired t test has been used. Paired t test is used to compare the two population mean where you have two samples in which observation in one sample can be paired with observation in the other sample.

Here, paired t test is used to compare the mean of approved and actual foreign direct investment inflow during 1991 to 2015. In this context we have tested the following hypothesis:

H_0= It is expected that there is no difference in the mean of approved and actual foreign direct investment inflow in India.

H_1= It is expected that there is difference in the mean of approved and actual foreign direct investment inflow in India.

The estimated value of paired t statistic between approved and actual foreign direct investment inflows is given in table-III.

Table-III

ESTIMATED VALUE OF THE STATISTIC RELATED TO PAIRED T TEST

Paired Samples Test

	Paired Differences					t	df	Sig. (2-tailed)
				95% Confidence Interval of the Difference				
	Mean	Std. Deviation	Std. Error Mean	Lower	Upper			
Pair 1 approved fdi - actual fdi	-10039.0	18255.12958	3651.026	-17574.4	-2503.69	-2.750	24	.011

SOURCE: Estimate are based on the data regarding actual and approved foreign direct investment inflows taken from **www.dipp.nic.in**

It is evident from the table-III that sig (2 tailed) value in this analysis is .011. This value is less than .05 because of this we can conclude that there is statistically significant difference between the mean of the approved foreign direct investment and actual foreign direct investment inflow. Since our paired sample statistics revealed that the mean of actual foreign direct investment inflow was greater than the mean of the approved foreign direct investment inflows therefore we conclude that actual foreign direct investment inflow was more than the approved foreign direct investment inflow.

Liberalization measures taken overtime facilitated the removal of restricted foreign investment inflow which has enhanced the path for foreign direct investment inflow in India. The initial impact of Economic crisis held in 2007-2008 in the different part of the world make developing countries as a great destination for foreign direct investment inflow. In developing countries, India becomes the most fruitful destination for the foreign direct investment inflows. This removal of restriction and crises of 2007 in world enhances the flow of foreign direct investment which impacted the economic growth of Indian economy. However the impacts of financial crisis spread to different economies of the world the flow of foreign direct investment become uneven during the terminal year of analysis despite this temporary setback regarding the flow of foreign direct investment yet the overall actual inflows was higher than approved foreign direct investment.

Further enhancing the actual foreign direct investment inflows in country the next level of reform and policies will need to address a broad range of issue. This issue includes improving infrastructure, revisiting

the land acquisition law, reforming the labor law, streamlining the process for obtaining environmental clearance and policies related to sector wise foreign direct investment inflow in India.

CONCLUSION AND POLICY SUGGESTION

Analysis on data of foreign direct investment inflows from 1991 to 2015 has revealed three distinct phases. Phase-I was the period of introduction of foreign exchange management act (FEMA ACT,1999) which replaces the foreign exchange regulation act (FERA ,1973). Foreign investment promotion council (FIPC) along with foreign investment promotion board (FIPB) was setup in 1996 to diagnose the project within country. During this phase foreign direct investment was enlarged to 100 percent in export oriented units, banking and non banking financial service, tourism related companies, trading with varying degree of foreign equity participation. Insurance regulatory and development act (IRDA) was passed by parliament in December 1999.

Phase-II of post liberalization period launches the special economic zone act (SEZ ACT, 2005). Special economic zone act was the main responsible for the foreign direct investment inflows in India. Special economic zone act was introduce with specific intend to provide international competition and hassel free environment for export. Special economic zone act was perceived has the dominant source of attracting foreign direct investment across the global market. Through special economic zone act many sector of Indian economy were liberalized in foreign direct investment inflow in greater extent. Some of these were manufacturing, drugs and pharmaceutical, hotel and tourism service, infrastructure relating marketing, banking, telecom, road, highway port and harbor etc.

At last the third phase was the period of recession across the world which impacted Indian economy also. To lift the Indian economy out of the serious impact of global recession and to increase the flow of foreign direct investment inflows, major step were taken by Indian government. One of the major steps taken recently was MAKE IN INDIA program (September 2014). MAKE IN INDIA program is designed to facilitate investment, foster innovation, built best in class manufacturing infrastructure and to protect intellectual property. Policies related to foreign direct investment inflows in MAKE IN INDIA program are as follows:

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   d) Basic Infrastructure especially related to railway line/ siding including electrifiable railway line and connectivity's to main railway line.
f) Relaxation in the norms for foreign direct investment in construction development sector for mass rapid transport system.

Further analyzing the pattern of the approved and actual inflow of foreign direct investment reveals that financial crisis of 2007 in world has impacted the growth of Indian economy and flow of foreign direct

investment become uneven during the terminal year of analysis. Despite this setback regarding the flow of foreign direct investment yet the overall actual inflows was higher than approved foreign direct investment.

Finally, government must target at attracting specific type of foreign direct investment that will able to generate spillover effect in overall economy like investing in human capital, research and development activities, environmental issue, productive capacity, sector with high income elasticity of demand. Policy maker should focus more on attracting diverse type of foreign direct investment and should design policies where foreign investor can be utilized as means of enhancing domestic production, saving, exports and also as medium of technological learning and diffusion for providing access to external market.

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