FDI In The Era Of Globalization: Some Issues

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INTRODUCTION

With the onset of 1990s, the Indian government realized that the foreign direct investment can spur the economic growth and hence initiated a slew of economic reforms. Moreover, in 2003, the second generation reforms were started to integrate the country's economy with the world economy, through increasing the flow of FDI in the world.

FDI plays a pivotal role in the economic development of the host country and provides a launching pad from where they can they can make further improvements. Any form of investment that earns interest in enterprises and functions outside the domestic territory of an investor can be treated as FDI. For an investment to be classified as an FDI, the parent firm needs to have at least 10% of the ordinary shares of its foreign affiliates.

The present paper is organized into three sections. Section I deals with dimensions and trends of FDI in India since 1990s. Section II discusses the structure of FDI towards the service sector. Lastly, Section III analyses the future prospects of FDI in the wake of the present global turmoil and financial instability.

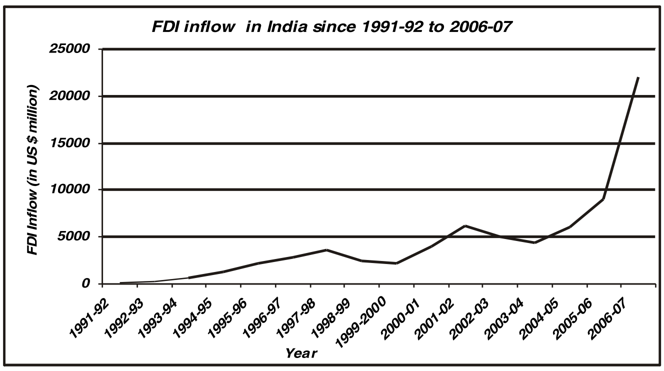
DATABASE

The study is primarily based on the secondary data gathered from reputed published sources like Economic Survey, survey conducted by WIPO (2008-2010), publications of the Centre for Monitoring Indian Economy (CMIE), RBI Bulletin, Department of Industrial Policy and promotion, Statistical outline of India, etc.Moreover, data published in journals, books and newspapers have also been used.

SECTION- I
LIBERALIZATION TRENDS AND PATTERNS OF FDI INFLOWS

There has been a striking shift in capital flows to India, reflecting the growing confidence among international investors with the onset of liberalization of capital account and the initiation of structural reforms during the 1990s. FDI in India stood at a low level of US $ 129 million during 1991-92 and registered a spectacular growth accounting to nearly US $ 22079 million during the financial year 2006-07, which was 2.46 times more than the inflow received during the previous year. "Positive climate, progressive liberalization of the FDI policy regime and simplification of procedures,"[1] are the contributory factors serving as a magnet for Indian FDIs. The accelerated pace of merger and acquisition in sectors like financial services, manufacturing, banking services, information technology and construction are also boosting the FDI inflows. However, the magnitude of FDI inflows received by India is comparatively smaller to countries like China.

Chart 1



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Investments have shown an upward trend with the opening up of door policies during the new economic regime. However, since 1997, downward trends have been registered despite continued liberalization, depicting that the policy liberalization is not the exact reason for this change. During April 2008-09, the total foreign investment stood at USD 2869 million, out of which, USD 3749 million was received as foreign direct investment diluted by negative portfolio investment (outflow) amounting to USD 880 million, leaving the total investment at a modest level.

Table 1: Statement of Foreign Direct Investment (FDI) Inflows from Different Routes To India (1991-92–2006-07)

(US $ Million)

ITEM	1991 -92	1992 -93	1993 -94	1994 -95	1995 -96	1996 -97	1997 -98	1998 -99	1999 -2000	2000 -01	2001 -02	2002 -03	2003 -04	2004 -05	2005 -06	2006- 07
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	XIII	XIV	XV	XVI	XVII
DIRECT INVESTMENT(I+II+III)	129	315	586	1314	2144	2821	3557	2462	2155	4029	6130	5035	4322	6051	8961	22079
I.Equity(a+b+c+d+e)	129	315	586	1314	2144	2821	3557	2462	2155	2400	4095	2764	2229	3778	5975	16482
a. Government	66	222	280	701	1249	1922	2754	1821	1410	1456	2221	919	928	1062	1126	2156
(SIA/FIPB)	-	42	89	171	169	135	202	179	171	454	767	739	534	1258	2233	7151
b.RBI	63	51	217	442	715	639	241	62	84	67	35	-	-	-	-	-
c. NRI	-	-	-	-	11	125	360	400	490	362	881	916	735	930	2181	6278++
d.Acquisition of shares e. Equity capital of Unincorporated Bodies#	-	-	-	-	-	-	-	-	-	61	191	190	32	528	435	897
II. Reinvested earnings+	-	-	-	-	-	-	-	-	-	1350	1645	1833	1460	1904	2760	5091
III. Other Capital	-	-	-	-	-	-	-	-	-	279	390	438	633	369	226	506

Source: RBI Bulletin, Government of India, Mumbai, (Various Issues) (Date of Publishing: Feb. 13, 2008)
Figures for Equity capital of Unincorporated Bodies for 2006-07 are estimated.
+Date for 2006-07 is estimated as average previous two years.
++Date pertain to inter company debt transactions of FDI entities.

SECTION- II
SECTORS ATTRACTING HIGHEST FDI INFLOW

Since the last two decades, service sector has substantially expanded, occupying a significant position in national economies. Presently, service sectors like telecom, IT enabled services, electricity, insurance, air transport are playing a prominent role and "will be around 58%, on par with a mid level developed country by the year 2010[2]". The Indian Sectors attracting highest FDI inflows are numerous like electrical equipments, transportation industries, telecommunication, fuels, cement and gypsum products, metallurgical industries, chemicals, and drugs and pharmaceuticals.

GLOBAL TRENDS IN FDI INFLOWS IN SERVICE SECTOR

The global setback in FDI prospects can be witnessed at various levels in almost every sector. However, the service sector seems to have been less affected i.e. overall, 27% of the companies in this sector (as against 33% in WIPS 2007-09),are still willing to increase their investment (by more than 30%) over the next three years, while this percentage is only 17% for manufacturing, registering a 12% decrease as in comparison to the previous year.
During 1990s, India grew rapidly mainly because of the presence of the service sector. Presently, India registers 1.4% of global exports in services and 0.7% in the goods. According to UNCTAD (2004), the share of the service sector in total FDI inflows to India was merely 10.5% during 1990 to 1994 but increased to 28.3% during 1995-99. If we talk about Australia, it accounted for 52% during 1995-99 to 36.2% during 2000-02, whereas in case of Mexico, the share of FDI increased from 28% during 1990-94 to 64% during 2000-02. Switzerland witnessed higher FDI inflows during 1990-94 followed by France and U.S.A.

FACTORS AFFECTING SERVICES SECTOR FDI AND POLICY IMPLICATIONS

Conventionally defined, service sector includes electricity, gas, water, communication, construction, wholesale and retail trade, hotels and restaurants, transport and storage and communications, finance and insurance, business administration, defence, health, social papers. The factors which have contributed towards the global economic activity were income growth in developing countries and changing investment and trade policies towards the sector.

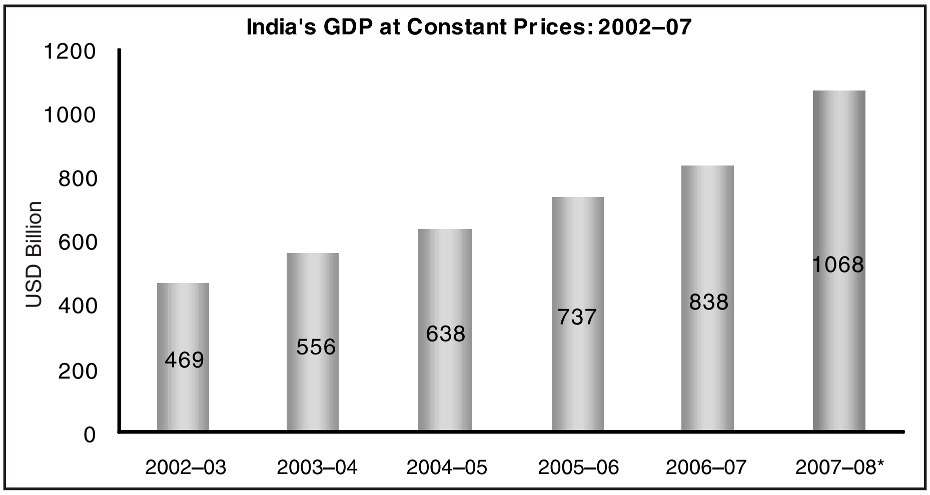
1. INCOME GROWTH

As the demand for services increased with rising income level, FDI also accelerated to meet the growing demand. However, in Africa, share of the service sector in FDI has lagged behind to positively contribute to GDP due to numerous reasons, whereas in case of China, policies towards services FDI has helped it to contribute towards GDP.

Table 2 : Average share of services in FDI flows and in GDP (%)

Services share in	FDI	GDP
Asia NIEs	69	65
China	31	41
India	55	52
Other Asian Countries	43	45
Europe and Central Asia	65	60
Latin America and the Caribbean	65	59
Africa	29	52
Memo Item High Income OECD	69	72

Chart No. 2



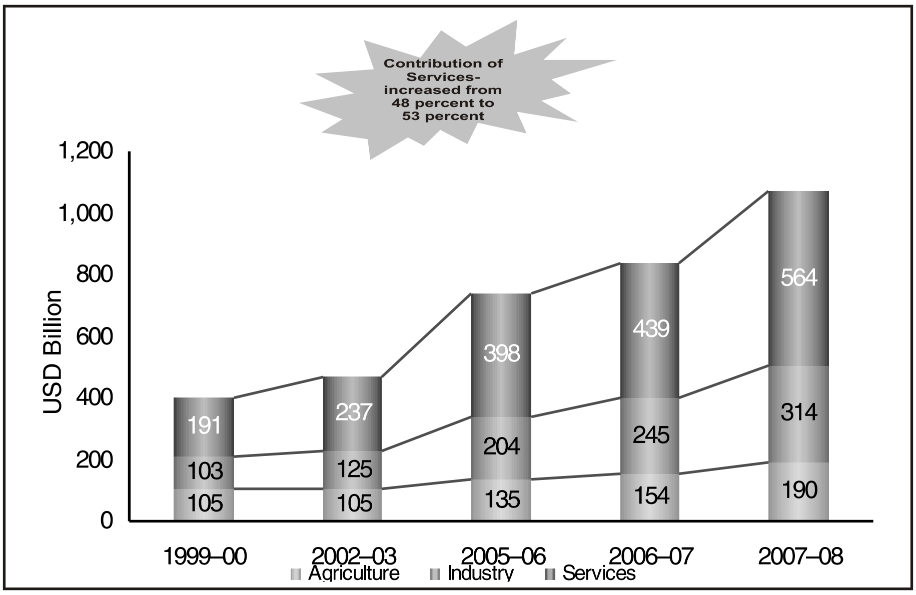
*Revised estimates
Source: MOSPI Statistics, R.B.I.

Table No. 3

	GDP Growth	Forex	FII Flow	FDI	Per Capita	Inflation
1990	4.9 percent	< USD 1 billion	USD 1 million (1993)	USD 97 million	USD 390	9 percent
2008*	9.0 percent	USD 310.7 billion as on June 13, 2008	USD 16.1 billion in 2007–08	USD 25 billion in 2007–08	USD 740	11.91 percent as on July 17, 2008

*Annualized data used to show comparison with 1990.
Sources: Times of India, , RBI, RBI, DIPP, Indian Budget, Rediff, The Economic Times

Chart . 3



2. INVESTMENT AND TRADE POLICY

Another major factor contributing towards the flow of FDI in services sector is the considerable progress of investment and trade policies, opening up of the services' sector to foreign participation. Governments' policies regarding the FDI in services have been influenced by considerations of national security and independence, consumer protection and ensuring the provision of public goods.

Table 4 :Trends and patterns of F.D.I. inflows in Indian Service Sector

(Amount in million)

Year	Telecommunica-tions	Consultancy Services	Financial/Non-Financial	Hotel &Tourism	Trading	Total Services	Total FDI Inflows
1991	0.0	0.0	0.3	0.0	0.0	0.3	2656.3
1992	0.0	0.0	48.3	7.4	1.9	57.7	6912.0
1993	16.6	0.0	1214.9	2.9	55.0	1289.4	18619.6
1994	140.2	0.0	943.1	533.0	240.9	1857.1	34196.6
1995	1274.5	0.0	11014.9	219.1	3320.1	15828.5	69351.5
1996	7529.8	0.0	10106.9	444.3	650.7	18731.7	103970.0
1997	11850.0	0.0	5411.4	1031.9	945.1	19238.4	164258.0
1998	17410.2	5.8	7679.8	399.5	520.0	26015.3	133399.0
1999	2155.6	214.2	4023.8	405.4	980.6	7779.5	168678.0
2000	6855.4	209.0	1861.5	524.0	1239.8	10689.7	193417.0
2001	42671.0	2922.9	8202.2	471.5	2204.4	56472.1	192652.0
2002	9090.7	1003.0	15431.4	2237.9	1824.2	29587.2	212860.0
2003	7272.6	2480.3	13904.0	2594.2	831.5	27082.6	143011.0
2004	6087.84	11843.5	11455.83	1527.23	682.16	31596.56	172657.5
2005	9639.13	1627.16	31445.14	2799.59	1257.67	46768.69	192990.9

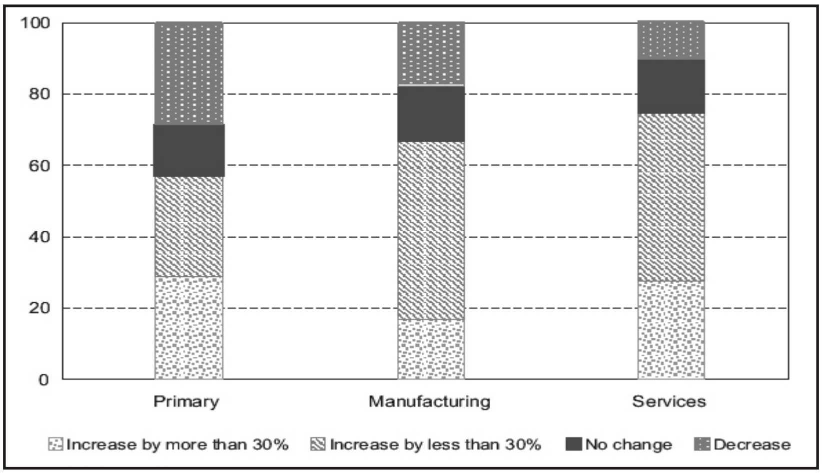
Table 4 gives a bird eye view regarding the year wise FDI Inflows in the Service Sector starting from the year 1991 to 2005. It is found that there has been an almost uniform trend among the entire service sector. The telecommunication sector occupies a major chunk of FDI inflows, accounting for 7% share out of total FDI inflows, and it is limited to 49% subject to licensing and security requirement. Companies in the service sector, especially in infrastructure industries such as telecommunication, transport, electricity, gas and water were eager to expand their FDI over the subsequent years. We have found that growth in FDI flows are heaviest in consultancy services, financial and non-financial services; hotel and tourism and telecommunications and trading consultancy services recorded a highest growth of 11.90% during the study period. It has been seen that FDI in Financial and Non-financial services, hotels and tourism and telecommunications and trade recorded a growth rate of 60.5%, 46.8%, 43.9% and 32.0% p.a. respectively.

Table 5: Expected Changes in Investment by Industry, 2008-2010
(Percent of responses to UNCTAD survey)

Sector/Industry	Decrease	No change	Increase of less than 30%	Increase of more than 30%
Primary	29	14	29	29
Manufacturing	18	15	50	17
Food products, beverages and tobacco	15	0	69	15
Textiles, clothing and leather	0	75	25	0
Wood and wood products	9	18	64	9
Chemicals, pertrochemicals, plastics and rubber	24	21	38	17
Metals and non-metallic products	29	0	43	29
Electrical and electronic equipment	30	15	55	0
Professional equipment goods	5	15	45	35
Motor vehicles	13	13	53	20
Other manufacturing	0	25	75	0
Services	11	15	47	27
Electricity, gas and water	17	8	50	25
Construction	0	50	33	17
Trade	6	13	50	31
Transport	23	15	38	23
Telecommunications	20	0	40	40
Business and other services	0	14	57	29
Total	**16**	**15**	**48**	**21**
Memorandum item:				
Infrastructure	20	10	43	27

Source : WIPS 2008-2010

Chart : 4 Expected changes in FDI expenditure, by sector 2008-2010
(Percent of responses to the UNCTAD survey)



Source : WIPS 2008-2010

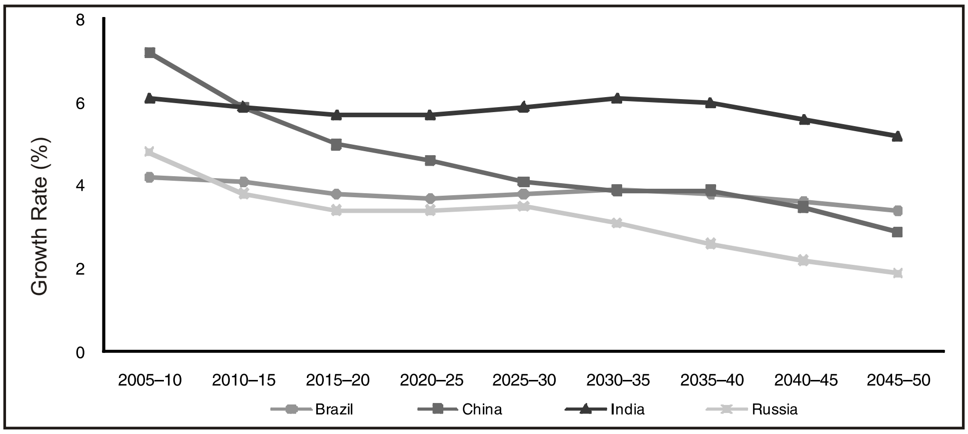
SECTION III
IMPACT OF ECONOMIC DOWNTURN ON FDI PROSPECTS

Foreign direct investment had fallen during the year 2000 and 2002, but thereafter, they witnessed a steady growth, with a remarkable acceleration during the last two years. During 2007, inflows reached a historic high amounting to more than $1.8 trillion, and it can be attributed to a perceptible rise in cross border M&As, which reached $1.6 trillion (UNCTAD, 2008).

The companies cut short their investment in the year 2008 as well as in 2009 (9%) due to the financial crisis which emerged during mid 2007 and the gloomy forecasts about the world economic outlook, as predicted by the survey conducted by WIPS (2008-10).

The countries witnessed a slowdown during the year 2008-09 as forecasted by the International Monetary Fund (IMF), the organization for economic cooperation and development (OECD), the World Bank and UNCTAD. The following chart portrays the projected GDP growth of the selected upcoming economies.

Chart: 5 : Projected GDP Growth Rates for Select Upcoming Economics



Source : AT Kearney, BRIC Report

Table 6 : GDP growth rates and prospects by region, 2006-2010

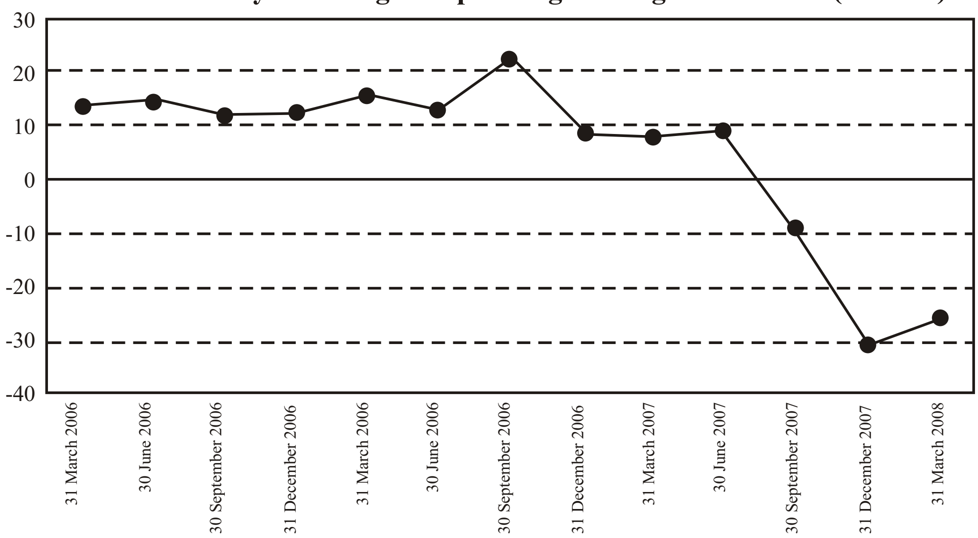
		Annual growth rate of GDP (%)				
Source	Region/economy	2006	2007	2008[a]	2009[a]	2010[a]
IMF[b]	World	5.1	5.0	4.1	3.9	--
	of which:					
	Advanced economies	3.0	2.7	1.7	1.4	--
	United States	2.9	2.2	1.3	0.8	--
	Euro area	2.8	2.6	1.7	1.2	--
	Japan	2.4	2.1	1.5	1.5	--
	Developing and emerging economics	7.9	8.0	6.9	6.7	
	Developing Asia	9.9	9.7	8.4	8.4	--
World Bank	World	5.4	5.4	4.3	4.5	4.8
	of which:					
	High-income countries	3.0	2.6	1.6	2.0	2.5
	Developing countries	7.6	7.8	6.5	6.4	6.4
OECD	OECD countries	3.1	2.7	1.8	1.7	--

Source : IMF, 2008, World Bank, 2008 and OECD, 2008

[a] 'Projected'

[b] According to IMF categorization (July 2008)

Chart: 6 Year-on-year change in operating earnings of S&P 500 (Percent)



Source : S & P's Index service

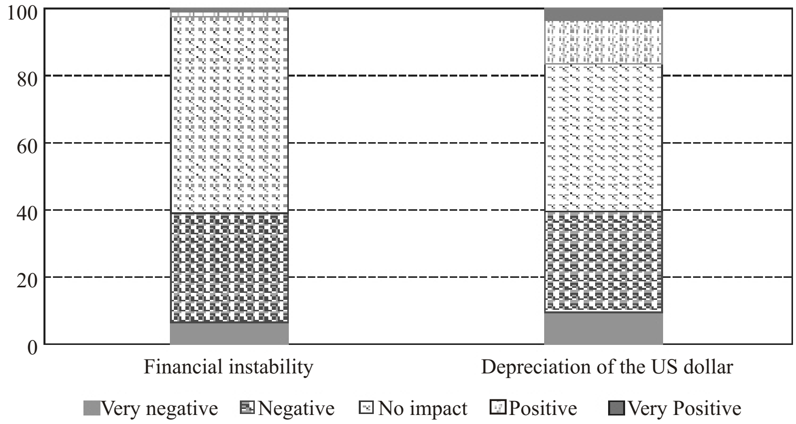
Response to WIPS 2008 -10 point to a negative, limited impact of the economic downturn. Approximately, 40% of the companies have a very negative impact on the FDI plans. However, a majority of firms have not been affected by the present turmoil.

Almost 20% of the respondents declared that the depreciation of the dollar had a positive impact. Companies other than those from the United States may take the advantage of the declining investment and acquisition costs due to their lower value of the dollar for acquiring business in United States. U.S. companies are expecting a positive impact of the dollar's weakness on their FDI plans, which may increase the competitiveness of their products and boost not only exports, but also their investments in logistics and distribution networks abroad for sustaining their increased sales.

A survey made by Price Water Coopers (2008) shows a decline in its *Confidence Index* of Company leaders worldwide.

Eventually, the *"Info World Economic Climate Index"* slowed down in the second quarter of 2008 below its long term average, representing a six year low (CESifo, 2008).

Chart: 7. Impacts of the financial crisis and dollar depreciation on FDI Prospects, 2008-09 (Percent of responses to the UNCTAD survey)



Source : WIPS 2008-2010

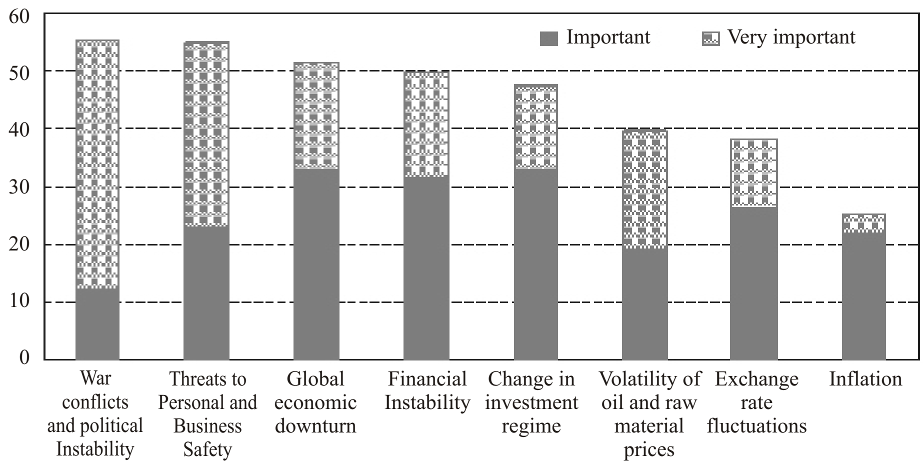
SURVEY ABOUT IMPORTANCE OF RISK FACTORS FOR FDI DECISIONS (WIPS 2008-2010)

With a view to gain better insight regarding the FDI plans, WIPS surveyed the perceptions of company's executives and found the following results. Executives believed that the world seems to have entered into a period of high and multidimensional uncertainty and gave the following responses.

- Companies engaged in the primary sector were more concerned about the geo-political instability, business and personal safety as well as happenings in the investment regimes.
- Geopolitical risks (wars, conflicts and political instability) are generally perceived to pose the greatest risk for companies' investments in the medium term. Out of the total respondents, 43% considered geopolitical risks as "very important" and 12 as "important".
- Nearly 32% of the respondents ranked threats regarding personal and business safety as "very important".
- 51% of the respondents ranked the risk of major economic downturn and financial instability as either "important" or "very important." which reflects the high degree of uncertainty about the outlook regarding economic conditions
- Regarding the negative changes in the country's investment regimes, 48% of the respondents treated it as "important "or "very important".
- The volatility of oil prices has been ranked as an "important" or very important issue by only 40% of the business executives of the company.
- Finally, only 3% of the respondent companies considered inflation and 12% considered changes in exchange

rates as "very important risks". For instance, a decline in the exchange rate of currency such as the United States dollar may have contradictory effects on FDI inflows.

Chart:8 Importance of risk factors for FDI decisions, 2008-09
(Percent of responses to the UNCTAD survey)



Source : WIPS 2008-2010

CONCLUDING OBSERVATIONS

Due to the global economic recession and the consequent shrinking of the developed economies of North America, Western Europe and Japan during 2009, the inflows of foreign direct investment (FDI) came down, as did the investments in shares. The terror attack on Mumbai, India's financial and commercial capital also exacerbated the downtrend in the short run. However, there is a reason to be optimistic about the medium-term future. The economy started reviving by around the end of 2009, and India has started attracting foreign investment again. Despite the slowdown, India remains one of the fastest growing economies in the world with a large internal market, making it an attractive destination for FDI as well as for foreign institutional investors (FIIs).

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