Rationalization of FDI Policies and its impact on FDI inflows

Sonal Gupta[1], Dr Teena Bagga[2]
MBA student, Amity Business School, Noida
R-7/133, Raj Nagar, Ghaziabad, Uttar Pradesh, India

Abstract

FDI policy and FDI inflows have always been an important aspect of the Indian economy and the overall growth of our nation. Every year the RBI releases a new FDI policy and every year the government tries to give some relaxation in the limit of investing by the foreign investors. This paper analyses the impact of this ease in the FDI policy on the GDP of the country, ease of doing business ranking. This paper also analyses how the make in India initiative has helped attract FDI inflows right after its launch.

Keywords — *FDI, FDI policy, Foreign Direct Investments, Foreign Investments, Impact of FDI on GDP*

I. INTRODUCTION

For years we've been hearing that India's primary activity is agriculture and how it is the backbone of India; part of which holds true even today. However, majority of the workforce is now shifting towards service sector.

In the financial year 2016, the total share of agriculture in the GDP of the country was 16.5%, whereas, service sector contributed around 45.4% of the total GDP of India. We have seen a shift in sectors like defence, manufacturing, infrastructural growth, etc. making India as one of the leading emerging markets across the globe. India is currently blooming with opportunities, therefore, investors all across the globe see India as one of the top destinations to invest in currently. Here, the role of foreign investments comes into play. Foreign investments are important part of any country. The past decade has seen a huge liberalization of Foreign Direct Investment (FDI) policies in India. Earlier there were several restrictions in railways, transportation sector etc. where foreign companies could not invest after up to a certain limit. These policy norms have been changing every year and now there has been a decrease in the level of restriction in almost every sector. This paper tries to explore the impact of FDI policies on the FDI inflow in India. The impact can be seen in terms of increase or decrease in investment in each sector like manufacturing, agriculture, retail, etc. The paper also tries to explore FDI's impact on the GDP of the country as well.

FDI has two routes through which it can enter in India:

A. *Automatic route*: under this route, the investor doesn't require government's approval in order to invest in India.

B. Government route: there are certain sectors which require government's approval before investing in India. The government has set up a Foreign Investment Promotion Board (FIPB) which regulates the investment through this route.

Foreign companies invest in other country's business to take advantage of cheap resources like cheaper wages, tax benefits etc. therefore; FDI helps both the home country as well as foreign companies in different ways.

Thus, ease in the FDI caps in India means more investment opportunities for foreigners to invest in the country.

II. LITERATURE REVIEW

Vyas, Abhishek Vijaykumar (2015) "An Analytical Study of FDI in India", in his paper, Vyas tried to identify various factors determining FDI inflow and outflow in India and further discussed the FDI policy framework in India. He also tried to explore the reason behind low FDI inflow in India and analysed sector wise inflow. He found that Mauritius and Singapore are the two major investors and Mumbai was the top FDI attractor with approximately 29% of total FDI inflows.

Malhotra, Bhavya (2014) "Foreign Direct Investment: Impact on Indian Economy", the paper revolved around the trends and determinants of FDI inflow in India and its impact on the Indian economy. He analysed the increase in FDI in India post the 1991 reforms with a side by side comparison of GDP growth rates and tried to correlate the two. He further identified various challenges that hinder the FDI growth; among them were factors like low resources, lack of political support, income disparity, federal rules and regulations etc.

Kumari, Nilanjana (2013) "A Study of FDI in India", this paper tried to study the ongoing situation of FDI in retail sector as well as the impact of FDI inflow on the total FDI in India. The research paper also delved into forecasting the inflows till the year 2016. The paper focuses on how important FDI is for the growth of the economy and how multi brand has hindered the growth for FDI in retail sector. It also talks about the downside of FDI and what sectors need to be liberalized for stimulating the FDI inflow in India.

Singh, Dr. Jasbir; Chadha, Ms. Sumita; Sharma, Dr. Anupama (2012), "Role of Foreign Direct Investment in India: An Analytical Study". In this paper the author tried to explore how FDI helps in bridging the gap between saving and investments of a country. He also studied the recent trends in FDI as well as FII in developing countries like India and how FDI and FII help in improving competition which in turn improves the quality and availability of goods to the ultimate consumers. He came to the conclusion that saving rate was less than the investing rate during their study. There was more FDI inflow than FII as it attracted almost 58% of the total investments. Most of the FDI inflow came through equity and had gone to sectors like financing, insurance, real estate etc.

Anitha, R., "Foreign Direct Investment and Economic Growth in India", In this paper, the author aims to analyze the FDI inflow in India post the Liberalization period and studying the various factors that affect the flow of FDI in the Indian economy. She additionally projects the trends in FDI for a period of five year beginning 2010-2011 to 2014-2015 with the help of Autoregressive Integrated Moving Average (ARIMA) forecasting technique. Lastly, the author does a comparative study of the FDI inflow in India with that in other developing economies. The results of this study suggest that the large market of the Indian economy, the abundance of skilled labour and natural resources as well as the respectable economic policy all contribute to the increase in the FDI inflow in the country.

III. OBJECTIVES OF THE STUDY

The objectives of this paper are as follows:

- Analysing the change in the FDI inflows due to liberalization.
- Finding the correlation between increase in FDI caps and GDP growth of the country, if any.
- Finding the impact of liberalization of FDI policy on the World Bank's 'ease of doing business' rank of India.

IV. RESEARCH METHODOLOGY

This paper was prepared with the help of secondary data from reliable sources such as websites of Reserve Bank of India (RBI), India Brand Equity Foundation (IBEF), World Bank, Make in India, Department of Industrial Policy and Promotion (DIPP), and others. After analysing all the aspects, descriptive study was adopted for the paper.
Also statistical tools like excel and SPSS were used for analysing data and generating correlation.

Liberalisation of the FDI Policy

Over the past 5-6 years, the Indian Government has given entry to foreign investments in many sectors. Each year has seen an increase in the FDI cap in one or more sectors. The major reason for increasing the cap has been to increase the flow of Foreign investments, that is, to attract more inflow of capital from abroad so as to see a growth in the economy, as, increase in the injection of capital, would lead to an increase in the production of goods and services, employment, infrastructure development, competition, etc. which would in turn increase the GDP of our country and hence would help in the growth of the overall economy
According to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report, 2016 India is ranked at number 10 in terms of attracting FDI into the country. China is ranked first followed by Hong Kong and US. India's 10th ranking is actually a pretty good number which makes it one of the top 10 countries attracting highest FDI, according to the report.

Following is an year on year comparison in each sector which analyses the ease in FDI caps. The data has been taken from RBI's official website:

A. Defence Sector

Till 2014, the defence sector had a cap of 26% that too under the government approval route. From 2015 the limit increased to 49% under the automatic route. This means that after 49% the companies would need government approval to invest.

B. Broadcasting Sector

Only last year the FDI limit has been raised to 100% in the broadcasting carriage services sector. Before that the limit was 74% from 2013-16 and before that it was even less, that is, 26%. However in broadcasting cable networks, the limit is 100% which was increased only last year from 49% earlier.

C. Print Media

The cap has been 26% that too under the government approval, since the last 6 years in the print media sector.

D. Civil Aviation

The limit for civil aviation on air transport service is now 100% which has increased last year from 49% since the past 5 years. In civil aviation non-scheduled air transport services is now 100% which has increased from 74%, also government approval was required beyond 49%

E. Satellite

In 2016 the limit increased to 100% from 74% which had remained constant in the past 5 years.

F. Telecom Services

The limit was increased to 100% in 2014. Before that the limit had been 74% constantly for 4 years.

G. Single Brand Retailing

The limit in this sector was increased to 100% in 2012, which is automatic till 49% and after that from government approval. Before that it was 51% that too from government approval.

H. Asset Reconstruction Companies

The limit was increased to 100% in 2014 but only 49% can be entered through automatic route, more than that would need government approval. In 2013, it was raised to 74% from 49% in the last three years.

I. Credit Information Companies

In 2016 the cap increased 100% which was earlier 74%, since 2014. Before that it was 49% which required government approval as well.

J. Insurance

The limit in this sector has recently been increased in the year 2015, which also requires government approval beyond 26% till 49%. Before that the limit had been 26%.

Following is the sector wise breakup of the FDI inflow of April 2016- December 2016.

Table I : Sector Wise FDI Inflow in Year 2016

Sector	Amount of FDI Inflows (In US$ millions)	%age of Total Inflows
SERVICES SECTOR	7,552.69	21.07
TELECOMMUNICATIONS	5,539.00	15.45
INFORMATION & BROADCASTING	1,286.11	3.59
HOTEL & TOURISM	706.74	1.97
DRUGS & PHARMACEUTICALS	687.08	1.92
FOOD PROCESSING INDUSTRIES	663.23	1.85
RETAIL TRADING	398.13	1.11
OTHERS	19,011.34	53.04
Grand Total	35,844.32	100

(*Source*: Department of Industrial Policy and Promotion)

From the above information, it can be gathered that the sector to receive the highest FDI inflows was service sector, followed by Telecommunications and then Information and broadcasting. Now that we have seen the liberalized FDI policy in the past 6 years, Let us now analyse its impact on various aspects.

K. Effect of Liberalised FDI Policy on Total FDI inflows

FDI flows basically record the value of cross border transactions which are related to direct investments, during a given period of time. An outward flow represents the transactions that increase the investments that the domestic investors have in the foreign country through the purchases of equity or reinvestment of their earnings. Similarly, an inward inflow means the investments that have been made by foreign investors in the domestic country's company. FDI tries to create stable and long-lasting links between economies. Below is the table which shows the total FDI inflows from the year 2010 to 2017 and also indicates the total increase (decrease) percentage from the previous year.

Table II : FDI Inflows

Year	Inflow (US $) in Billions	% Increase (Decrease)
2009-2010	37.7	(-) 10%
2010-2011	34.8	(-) 8%
2011-2012	46.5	34%
2012-2013	34.3	(-) 26%
2013-2014	36	5%
2014-2015	45.1	25%
2015-2016	55.5	23%
2016-2017	60	8%

(*Source*: Department of Industrial Policy and Promotion)

From the above data, following conclusions can be drawn:

1. In the year 2009-10, the total FDI inflow stood at $37.7 Billion, which was actually a 10% decrease from the previous year's inflow, according to the DIPP's website. According to some UN analysts, the reason for this decrease was that during that time there was a lot of negative publicity for the then upcoming commonwealth games. Investors were fretting to invest in India because of its bad image worldwide regarding the mismanagement of commonwealth games.
2. Year 2010-11 also showed a decrease in the total investments however it was a 2% less decrease from last year. The reason behind this could also be same since there was no major change in the FDI caps as well as the bad image of India due to the malfunction in preparation for the commonwealth games.
3. Year 2011-12 saw a tremendous increase in the total inflow of FDI up to a great 34%. One of the major reasons for this growth could be the ease in FDI limit in the Single Brand Retailing sector which was 51% earlier and increased to 100% but under government route.
4. Year 2012-13 again saw a dip in the investments. The FDI decreased to as low as $34.3 billion which is actually 26% decrease in inflow from the previous year's $46.5 billion. This could be due to strictness in doing business in India.

5. Year 2013-14 marked the beginning of Mr. Narendra Modi's tenure as the Prime Minister of India. With the launch of many initiatives like 'make In India' as well as his business trips abroad across many countries, he tried to lift the picture of FDI inflow in India. Although many initiatives were taken still its effects on the FDI growth would take at least 3-4 years. In 2013-14 however the total investments were $36 billion which was a 5% increase from last year's $34.3 billion.

6. Year 2014-15 again saw a tremendous growth in investments. The total FDI in this year were US$45.1 billion which were 25% more than previous year. In this year, caps in the telecom sector increased from 74% to 100%. The FDI limit of asset reconstruction companies also increased from 74% to 100% and the FDI limit in credit information companies increased from 49% to 74%.

7. In the year 2015-16 total investments further grew to US $55.5 billion which was again a growth of 23% from the previous year. The major sectors in which the FDI limit increased were defence manufacturing, where the limit increased from 26% to 49% and insurance sector where the earlier limit was also 26% and now it is 49%. Due to the increase in FDI limit of both these sectors, there has been a huge investment in both these sectors. According to open government website, https://community.data.gov.in, the total equity inflow in telecom sector from April 2015 till February 2016 was US$ 1.2 billion.

8. In the year 2016-17, the total FDI inflow was US $ 60 billion, which was an increase of 8% from the previous year. The ease in FDI limits has been in sectors like broadcasting carriage services which went up from 74% to 100%, broadcasting cable networks which went from 49% to 100%; civil aviation in air transport services which went up from 49% to a full 100%, civil aviation for non-scheduled air transport services whose limit has increased from 74% to 100%. There has also been an increase in satellite establishment sector which went up from 74% to 100%. The credit information companies also saw an increase of 100% from earlier 74%.

To sum up, year 2016 has seen a great ease in FDI limits, including in around every sector, under the automatic route. Therefore, due to the ease in limits, there has been a drastic increase in the FDI inflows which led to a total of US $60 billion inflows in the year 2016.

L. FDI and GDP Growth in India

According to International Monetary Fund (IMF), "GDP measures the monetary value of final goods and services—that is, those that are bought by the final user—produced in a country in a given period of time (say a quarter or a year). It counts all of the output generated within the borders of a country. GDP is composed of goods and services produced for sale in the market, and also include some nonmarket production, such as defence or education services provided by the government. An alternative concept, gross national product, or GNP, counts all the output of the residents of a country." As we have discussed earlier, FDI of a country helps attract more employment, production, overall development, therefore it in turn helps in increasing the GDP of a country. Let us take a look at the year wise GDP of India.

Table III : Year wise GDP of India

Year	GDP (in current trillion US$)	Absolute Change	% Change	Real GDP growth at market prices in percent
2010	1.66	-	-	10.3
2011	1.82	0.17	9.1	5.5
2012	1.83	0.01	03	5.6
2013	1.86	0.03	1.6	6.6
2014	2.03	0.18	8.7	7.2
2015	2.09	0.06	2.6	7.6
2016	2.45	0.36	14.7	7

(*Source*: World Bank)

The above data shows the GDP of India in trillion US$, the absolute change and the percentage change.

Following observations can be made from the above data:

1. The actual GDP in US$ has been growing every year even if the growth is as low as 0.3% (in year 2012).
2. The real GDP growth which is calculated at market prices has also seen a consistent increase every year as well; except from year 2010 to 2011 where the GDP fell to almost half from 10.3% to 5.5%.one of the reasons for this yearly growth in FDI could be the increased FDI limits each year in almost every sector.

Previously, a connection was established between FDI limits and inflows, now let us try to relate what impact FDI inflows have on the GDP of India.

For this purpose, we use excel for correlation analysis.

Table IV : FDI Inflow and GDP comparison

Year	FDI Inflow (US $) in Billions	GDP (US $) in Billions
2010	37.70	1656.50
2011	34.80	1822.90
2012	46.50	1828.10
2013	34.30	1857.20
2014	36.00	2033.50
2015	45.10	2088.80
2016	55.50	2450.00

(*Source*: World Bank)

In excel, after applying the formula for Pearson's Rank correlation, the result was following:

$$R= 0.739$$

R gives the coefficient of correlation. The value of R lies between -1 to 1. A higher value is represented by a strong correlation. R = 0 means there exists no relation between the two variables.

In the above case the value of R is pretty good which means that there is a strong relation between the two variables, that is, FDI inflows and GDP of our country.

M. FDI and its impact on ease of doing business ranking

Every year, the World Bank releases a report on 'Ease of Doing Business' which comprises of 10 aspects which help in knowing how easy it is to set up a business in a country. The Bank ranks 190 countries, better the rank means better regulations to set up business in that country. This helps the companies in knowing where to invest and which country has easy and better regulations regarding setting up a business in a country as well as doing business there.

A country's ranking on the index is based on the average of 10 sub-indices:

1. Dealing with construction permits
2. Getting electricity
3. Registering property
4. Getting credit
5. Protecting minority investors
6. Paying taxes
7. Trading across borders
8. Enforcing contracts
9. Resolving insolvency

The doing business report also focuses on following datasets:

1. Distance to frontier
2. Entrepreneurship
3. Good practices
4. Transparency in Business Regulation.

For example, say, Canada is ranked at number 17 on the sub index "starting up a business". Now, Canada only needs 1 procedure to start up a business and it takes approximately 5 days to complete. The cost of which is 0.4% of the Gross National Income per capita. There is also no minimum capital requirement. As opposed to this, Chad is ranked 184 (out of 185 countries). In this African country, 9 procedures are required to start up a business which takes around 60 days to finish. The cost, also, is 200% of the Gross National Income per capita. The minimum capital requirement of this country is approximately 300% of the Gross National Income per capita.

However, having fewer and easier regulations doesn't always mean a higher ranking. Protecting the rights of investors, creditors; upgrading credit registries and properties may mean that there is a need of more regulation.

The doing business report also has a downside to it. The World Bank does not include any economic conditions of a country like poverty, employment rate, corruption, etc. it also does not cover all the regulatory requirements like financial market, environment, or intellectual property regulations, relevant for private sector are not considered.

According to the latest ranking released by the World Bank in 2017, India stood at 130 out of the total 190 countries whose reports are published on the website.

Now, let us examine the year wise ranking of India starting from the year 2010, the year from where all of our data collection has started.

Following is the table compiled from the World Bank's Ease of doing business showing India's rank.

Table V : Year wise 'Ease of Doing Business' rank of India

Year	Rank
2010	133
2011	134
2012	132
2013	132
2014	134
2015	142
2016	130

(*Source*: World Bank)

According to the table, India has stepped up on the Ranking Table in the year 2016 as compared to the preceding years. Interestingly, India also was a recipient of 60 billion US$ FDI in the year 2016 which again is a record figure. It could mean that Ease of doing business rank does have an impact on the FDI inflows. Year 2015 had the worst ranking in the past 6 years, i.e. 142.

In the beginning talked about how ease in the FDI limit could affect the Ease of doing business rank, so let's try to establish a relation there as well.

Table VI : Ease of Doing Business Rank and FDI Inflow

Year	Rank	Inflow (US $) in Billions
2010	133	37.7
2011	134	34.8
2012	132	46.5
2013	132	34.3
2014	134	36
2015	142	45.1
2016	130	55.5

(*Source*: World Bank)

Now, let us try to find out the correlation between doing business rank and FDI inflow using statistical methods,

For this, Pearson's coefficient of correlation was calculated using MS Excel,

Again, using this formula we get,

$$R = -0.10$$

The above value of r means that there is a negative correlation between the ranking and the FDI inflows, which is what the study was trying to establish in the first place. The following result can be interpreted as,

As the ease of doing business ranking increases, the FDI inflows decreases, and vice versa. It means that investors look at the doing business ranking before investing in any nation, and a lower ranking does increase the FDI inflows of our country.

N. FDI and the 'Make in India' initiative

The Make in India is an initiative which was launched by our Prime Minister, Mr. Narendra Modi, in September 2014 as part of a wider set of nation-building initiatives. This initiative was started to turn India into a global manufacturing hub. In 2013, the over hyped emerging markets bubble had burst and India's growth rate had fallen very low, therefore it was high time that the situation needed to be handled somehow and the Make in India initiative did exactly that. There was a worldwide debate among the investors arguing whether India was a risk or an opportunity. At that time India had been on the brink of economic failure. According to the Make in India's website "Make in India was launched against the backdrop of this crisis, and quickly became a rallying cry for India's innumerable stakeholders and partners. It was a powerful, galvanizing call to action to India's citizens and business leaders, and an invitation to potential partners and investors around the world. But, Make in India is much more than an inspiring slogan. It represents a comprehensive and unprecedented overhaul of outdated processes and policies. Most importantly, it represents a complete change of the Government's mindset – a shift from issuing authority to business partner, in keeping with Prime Minister's tenet of 'Minimum Government, Maximum Governance'". In December, 2014, a workshop called "Make in India – Sectoral perspective & initiatives" was conducted the aim of which was to prepare an action plan for 1-5 years to boost the investments in around 20 sectors.

The ministry also involved the World Bank group to help them identify the areas of improvement in line with World Bank's 'doing business' methodology, which could boost India's ranking which currently is 130 in terms of Ease of doing business. Various sectors have opened up for investments like Defence, Railways, Space, etc. Also, the regulatory policies have been relaxed to facilitate investments and ease of doing business.

Let's take a look at the FDI inflows from the year 2014, when the Make in India initiative was launched:

Table VII : FDI Inflow from 2010 onwards

Year	Inflow (US $) in Billions
2009-2010	37.7
2010-2011	34.8
2011-2012	46.5
2012-2013	34.3
2013-2014	36
2014-2015	45.1
2015-2016	55.5
2016-2017	60

(*Source*: Department of Industrial Policy and Promotion)

Looking at the above table, we can see that in the year 2013, the FDI inflow was USD 36 Billion, which shot up to USD 45.1 Billion, the year of launch of make in India, and there has been a constant growth in the FDI inflows, ever since. Thus, it can be inferred that Make in India did have an impact on the FDI inflow as there had been low FDI growth in the years before that.

V. CONCLUSION

Foreign investments have a deep impact on the economy of a fast growing country like India, and they have helped in achieving growth, developing the infrastructure, market and many other aspects of our country.

FDI has an impact in many areas and is one of the key factors in the growth of the nation. A relation was established between FDI and GDP of our country as well as its effect on the ease of doing business ranking. The recent launch of the Make in India initiative has helped in attracting the FDI even more. The FDI has increased considerably due to this; as much as 23-25% in the year 2014 and 2015, right after the launch of Make in India.

India is one of the emerging markets in the world, along with countries like China, Japan, and Brazil etc. However, in comparison to China; India is still far behind in attracting the investors. China has been the top priority of investors with approximately US$136 billion investments in the year 2015, while India only received an inflow of US$ 45 billion. This shows that India needs to buckle up and perhaps ease the FDI policy further or make the business requirements easier to increase the investments further.

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