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# FOREIGN INVESTMENT AND ITS DEVELOPMENT IN PRE AND POST ECONOMIC REFORM ERA IN INDIA

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**ABSTRACT**

Globalisation can be summarised as opening-up of markets, leading to transfer of capital, technology and people. If globalisation is a progression in the international economic relations, it implies that capital flows are substituting trade flows. These capital transfers work as two way relationship, which implies that the process of globalisation should have gains for both the home country and the host country. With globalisation (WTO) and liberalisation international long-term capital flows in the form of FDI are promoted. Capital is the complementary input to labour, natural resources, infrastructure etc. This leads to international relocation of production. If such flows follow rational allocation, it will lead to global optimum allocation of resources and global economic welfare. This will lead to a visible relationship between socio-economic variables (economic development) such as labour, human resource, infrastructure, openness, market, resources etc and the patterns of FDI flows internationally. This paper tries to analyse the pattern of growth in FDI during the pre and post economic reform era of India. This study is based only on the secondary data which is collected from websites, journals, research papers, magazines and books.



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## INTRODUCTION

Globalisation was never a new phenomenon for India. It was considered to be a prestigious work done and achieved by some of the companies by exporting its products to far-off destinations across the world. But the foreign trade was subject to more tariffs and taxes for importing and exporting of goods. In 1991, India witnessed the major economic reform in the form of liberalisation, privatisation and globalisation (LPG). The need of this major economic reform was because of the Indian economic crisis faced in 1991. It had its roots from 1985 when India started facing BOP deficits. The BOP deficits led India to such a serious position that caused the rupee devaluation. This reform took India to reform itself in respect of its position globally. The other reforms apart from globalisation i.e, liberalisation and privatisation also gave a helping hand to make India visibly competing in the world market.

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Many changes were brought in the trade policies of India like reduction in the rates, tariffs and taxes, focusing on the productivity, promoting foreign investments and much more in the process of making itself a global nation. Since then India is witnessing a tremendous paradigm of growth and development in its foreign trade. India being a developing nation the flow of foreign currency into the domestic economy is an essential ingredient in India going global. The most desirable source of generating foreign currency inflows into the Indian economy can be through Foreign Investment. Foreign Investment being the most buzz word in the present era serves as an economic booster for both the developing countries and also for the developed countries.

**FDI in India before economic reforms:** FDI can be defined as "Investment made outside the economy of the investor to gain long term interests from the enterprises set-up and operating in the host economies". Like that of foreign trade, foreign investment or more commonly referred to as FDI is not a new phenomenon for Indian economy. Though not addressed and portrayed properly the flow of FDI in India started way back from the colonial era with the establishment of the East India Company. Although the trade with the international markets was at a pace in India but there was also an attitude of fear and suspicion towards foreign capital. The only reason for this was the fear of draining away of resources from the country as a result of foreign investments made in India. The first industrial policy of India passed in the year 1948 brought positive insights regarding the government's attitude towards foreign capital. An attempt was made to liberalise the Indian policy towards foreign capital and investment. But it could not be successful and failed to achieve the full fledged FDI operations. After the industrial policy 1948 many other policies were passed having a similar view but those policies succeeded in other aspects of the economy of the country rather than the foreign capital investment. But the industrial policy of 1965, reframed the financial inflow structure by allowing the collaborations of MNCs with India. The significant increase in the operations of foreign investment in India started after the end of the Second World War (Hood and Young, 1979). However, with the establishment of FERA (1973) India could exercise much better control over the foreign investments. During the periods of middle 1980s and beginning of 1990s, India could experience a more liberal policy towards the foreign investment.

The Indian government policy towards FDI during the pre-globalisation era may be classified under four different phases:

- The Phase of Cautious and Selective Attitude towards FDI (1948-1967)
- The Phase of Restrictive Attitude towards FDI (1968-1979)
- The Phase of Semi-Liberalization (1980-1990)
- Trends of FDI Inflows during Pre-reform Period: Before 1991

The policy adopted during the 1950s acknowledged foreign investment should to be essentially encouraged for the industrial development of the country. The first Prime Minister of India, Jawaharlal Nehru in April 6, 1949 took the official position on foreign investment. According to his view the foreign capital was an important supplement to domestic savings for facilitating national economic and technological progress. During this period, government also granted tax concessions to various foreign enterprises and set up the Indian Investment Centre in 1961 to promote foreign investment in India. In 1970's the policy of India regarding foreign capital investment restricted the establishment of foreign companies. The main motive of this restrictive policy was to protect the growth of the Indian industries and also to reduce the challenges and competitions of the domestic products. The restrictions were exercised through the establishment of Monopolies and Restrictive Trade Practices (MRTP) Act, 1969, Industrial Licensing Policy of 1970, Patent Act, 1970 and other measures like nationalisation of banks. The restriction in flow of foreign investment in India was further increased by the enactment of Foreign Exchange Regulation Act (FERA) in 1973. FERA made mandatory for all the foreign companies operating in India to register under the Indian Corporate Legislation. Although there were some exceptions to the export oriented units but they were also obliged to export a minimum part of their turnover. The 1980's were found to be a turning point in the policy of foreign investment in India. The policies were made more liberal and the important reform made was the abolition of the restrictions imposed by the FERA on the foreign companies. The Industrial Policy Statement of 1980 focussed on promoting competition in the domestic market, technological up gradation and modernisation. The policy encouraged foreign investment in high-technology areas. Restrictions exercised by FERA on foreign equity to 100 percent export oriented units were liberalised which was an attraction for the foreign collaborations and foreign companies to set up their business units in India.

**Table 1. Trends in Net FDI Inflows to India: 1980-1990**

(Values in US$ Millions)

| Year | Fdi flows net | Present change over previous year |
|---|---|---|
| 1980 | 79 | - |
| 1981 | 92 | 13 |
| 1982 | 72 | -20 |
| 1983 | 6 | -66 |
| 1984 | 19 | 13 |
| 1985 | 106 | 87 |
| 1986 | 118 | 12 |
| 1987 | 212 | 94 |
| 1988 | 91 | -121 |
| 1989 | 252 | 161 |
| 1990 | 237 | -15 |

Source: UNCTADSTAT, World Development Indicators, World Bank, Last updated on 08 November, 2017.

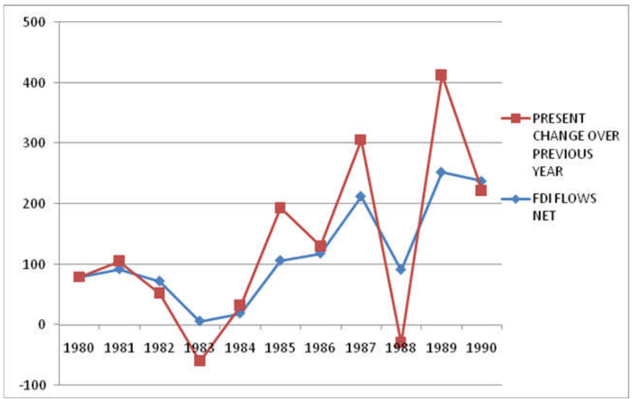


**Figure 1.**

After independence the cautious FDI policy was resulted in a low level of FDI inflow in India. The amount of FDI increased from US$ 79 million in 1980 to reach a peak level US $ 252 million in 1989 thereafter it declined to US $ 237 million in 1990 (Table 1). The overall FDI inflow during 1980 to 1990 was fluctuating. The increase in FDI from 1980 to 1990 is about three times and the CAGR is 12% during the same period of time.

**Table 2. Fdi flow in india: approval vs actualduring 1980-90 (us $ million)**

(Values in US$ Millions)

| YEAR | APPROVAL | ACTUAL | % GROWTH (ACTUAL) |
|---|---|---|---|
| 1980 | 11.2 | 79 | |
| 1981 | 12.5 | 92 | 16.5 |
| 1982 | 66.2 | 72 | -21.7 |
| 1983 | 61 | 6 | -91.7 |
| 1984 | 99.4 | 19 | 216.7 |
| 1985 | 102.9 | 106 | 457.9 |
| 1986 | 84.9 | 118 | 11.3 |
| 1987 | 83.1 | 212 | 79.7 |
| 1988 | 172.3 | 91 | -57.1 |
| 1989 | 195.2 | 252 | 176.9 |
| 1990 | 73.3 | 237 | -6 |

Source: UNCTADSTAT, World Development Indicators, World Bank, Last updated on 08 November, 2017.

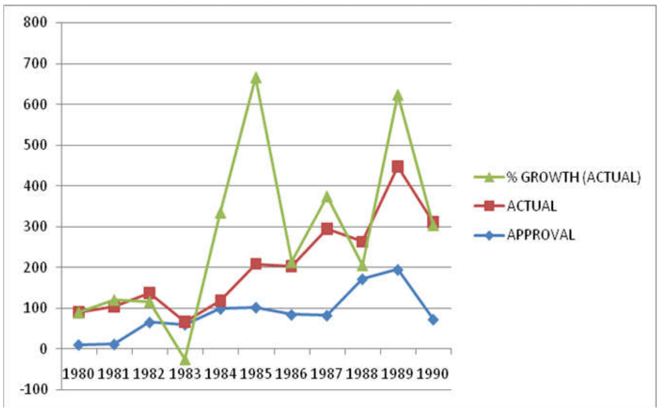


**Figure 2**

From the above study of the flows of FDI during the pre-globalisation era there has been a very slow growth as compared to other economies.

**FDI in India after economic reforms:** In the year 1991 the economic reforms were made in India which made the flow of FDI more liberalised. The economic reform of 1991 constituted of three major things viz., Liberalisation, Privatisation and Globalisation. All the three reforms made the flow of FDI easier in India. The liberalisation of Industrial Policy in 1991made way for foreign direct investment through various measures. Some of the important measures are:

- First was the automatic approval route which was applicable to all proposals where the proposed items of manufacture activity did not require an industrial license and was not reserved for the small scale sector.
- The Foreign Investment Promotion Board (FIPB) was set up as the nodal, single window agency for all matters relating to FDI, with a view to promote FDI into India, [i] by undertaking investment promotion activities, [ii] facilitating foreign investment, [iii] purposeful negotiation/discussion with potential investors, [iv] early clearance of proposals, and [v] reviewing policy and putting in place appropriate institutional arrangements, transparent rules and procedures and guidelines for investment promotion and approvals.
- The Secretariat for Industrial Assistance (SIA), Ministry of Commerce & Industry, provides a single window service for entrepreneurial assistance, investor facilitation, receiving and processing all applications, assisting entrepreneurs and investors in setting up projects (including liaison with other organisations and state governments) and in monitoring the implementation of projects.
- Foreign Investment Implementation Authority (FIIA) provides a pro-active one stop after service care to foreign investors by helping them obtain necessary approvals, sort out operational problems and meet with various government agencies to find solution to their problems.
- In order to invite foreign investment in high priority industries, requiring large investments and advanced technology, it was decided to provide approval for foreign direct investment upto 51 percent foreign equity in such industries (Statement on Industrial Policy, 1991).
- Additional liberalisation measures included amendment of the FERA to remove the general ceiling of 40% on foreign ownership in FDI projects; the ban on the use of foreign brand names in the domestic market was lifted; the dividend balancing condition was withdrawn for all foreign investment approvals except for 22 industries in the consumer goods sector; export obligations were relaxed; the terms of technology and royalty agreements were liberalised; and the sectors reserved for the SSI were opened up for foreign investments up to 24% of equity ownership.

To sum up the effects of economic reforms it can be given in three points in terms of LPG. Liberalisation process made the legal formalities; licensing system and various other rules were reformed making it easy for foreign companies to set up their branches in India. Privatisation attracted foreign currency as the restriction on the investment in companies was also allowed to private parties. On the other way, the flow of foreign investment required collaboration of various foreign countries with India not only in terms of MNCs and TNCs but also in terms of trade and commerce. Globalisation led India to be a business partner in various trade and non-trade transactions.

**Hghlights of changes in fdi policy (1991 to 2016)**

**1991**

**July:** New industrial policy of NarasimhaRao government as part of the Union Budget presented by Manmohan Singh, which led to a substantive opening up of the Indian economy.
August: FDI up to 51 per cent opened up in 47 high-priority sectors, including software (with 34 sectors under automatic route), with a condition that capital goods imports be financed by foreign equity. Export trading firms, hotels and tourism businesses also allowed 51 per cent FDI. Foreign Investment Promotion Board (FIPB) set up in the PMO to vet FDI proposals, with a Finance Minister-headed panel deciding on investments taking a call on FDI over Rs 300 crore.

**1992**

**April:** FDI in software also put on automatic route.

**May:** Use of foreign brand names allowed.

**June:** Dividend balancing norms for FDI-backed firms, linking dividend payments to export income, scrapped for all but consumer goods firms.

**1994**

**October:** FDI in Pharmacy up to 51 per cent put on automatic approval route, except for recombinant DNA technologies.

**1996**

FIPB transferred to Department of Industrial Policy and Promotion (DIPP); approvals up to Rs. 600 crore by Industry Minister, Cabinet Committee for nods over Rs. 600 crore.
November: Condition linking import of capital goods to foreign equity investments scrapped.

**1998**

**October:** 49 per cent FDI allowed in mobile telephony by satellite.

**1999**

**January:** FDI in construction of highways, toll roads and ports raised from 74 per cent to 100 per cent. March: Timeline for considering FDI proposals slashed from six weeks to 30 days.

**2000**

**March:** Eases norms for 100 per cent FDI in NBFCs.
October: 26 per cent FDI in insurance sector.

**2001**

**May:** 100 percent FDI in drug manufacturing and pharmacy, airports, hotel, tourisms, 26 per cent FDI in defence, 74 per cent in select activities of telecom sector, 49 per cent FDI in banking sector.

**2004**

**January:** 100 per cent FDI in petroleum product marketing, oil exploration, petroleum production and natural gas pipelines.

**March:** 74 per cent FDI in private banks.

**2005**

**March:** 100 per cent FDI in townships.

**November:** 74 per cent FDI in telecom, 20 per cent FDI in radio broadcasting.

**2006**

**February:** 51 per cent FDI in single brand retail.

**March:** 74 per cent FDI in telecom.

**2008**

**March:** 100 per cent FDI in airports, 74 per cent FDI in non-scheduled air transport services.

**2009**

**January:** 100 per cent FDI in fax publication of foreign newspapers, 26 per cent FDI in publication of Indian versions of foreign publications.

**2011**

**November:** 100 per cent FDI in Brownfield pharmaceutical projects (earlier only in Greenfield).

**2012**

**January:** 100 per cent FDI in single brand retail.

**September:** 52 per cent FDI in multi-brand retail. 49 per cent FDI in aviation companies, power exchanges. 74 per cent FDI in teleports, mobile TV.

**2014**

**August:** 49 per cent FDI in defence sector, 100 per cent FDI in some aspects of rail infrastructure.

**2015**

**March, April:** 49 per cent FDI in insurance, pension sectors.

**2016**

**June:** 100 per cent FDI in trading including through e-commerce, amendments to FDI in defence sector policy, 100 per cent FDI in teleports, DTH, mobile TV, 100 per cent FDI in Brownfield aviation projects, 74 per cent. Note: Source: Collected from various sources such as Economic Survey (Various Issues), Handbook of Statistics on Indian Economy (Various Issues), Journals, Books, Working Papers, etc

**Table 3. Trends in Net FDI Inflows to India: 1980-1990**

(Values in US$ Millions)

| Year | FDI flows net | Present change over previous year |
|---|---|---|
| 1991 | 75 | - |
| 1992 | 252 | 177 |
| 1993 | 532 | 280 |
| 1994 | 974 | 442 |
| 1995 | 2151 | 1177 |
| 1996 | 2525 | 374 |
| 1997 | 3619 | 1094 |
| 1998 | 2633 | -986 |
| 1999 | 2168 | -465 |
| 2000 | 3588 | 1420 |
| 2001 | 5478 | 1890 |
| 2002 | 5630 | 152 |
| 2003 | 4321 | -1309 |
| 2004 | 5778 | 1457 |
| 2005 | 7622 | 1844 |
| 2006 | 20328 | 12706 |
| 2007 | 25350 | 5022 |
| 2008 | 47102 | 21753 |
| 2009 | 35634 | -11468 |
| 2010 | 27417 | -8217 |
| 2011 | 36190 | 8773 |
| 2012 | 24196 | -11995 |
| 2013 | 28199 | 4004 |
| 2014 | 34582 | 6383 |
| 2015 | 44064 | 9482 |
| 2016 | 44486 | 421 |

Source: UNCTADSTAT, World Development Indicators, World Bank, Last updated on 08 November, 2017.

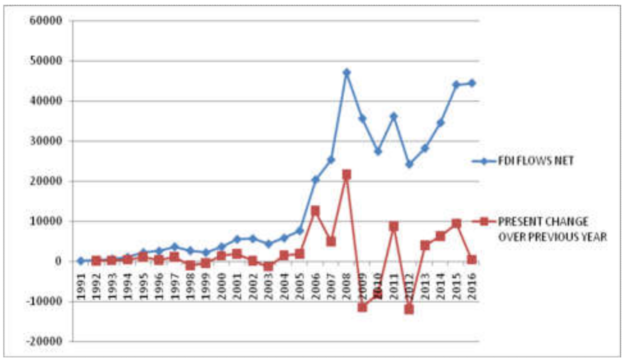


**Figure 3**

The post reform periods have been a boom for the FDI inflows to India. It can be seen that there has been a steady although slow growth in the inflows of FDI. The amount of FDI increased from US$ 75 million in 1991 to reach a peak level US $ 47102 million in 2008 thereafter it declined to US $ 35634 million in 2009 and it can be seen that from the year 2012 there is a steady growth (Table 2). The overall FDI inflow during 1991 to 2016 has both upward and downward trend but it has a satisfactory growth. The CAGR during the same period comes to 29%.

**Conclusion**

This paper studies briefly the inflows of FDI in to India in the pre and post reform periods. It has been seen that India has sustained successfully in the FDI market during its development period. The data collected from the sources shows on an average the upward trend of FDI inflow in India. Comparing the inflows of FDI in the pre reform period and post reform period, the inflows were facilitated by the government's policies towards FDI during the post reform period. Since 1991 the government has focused on liberalization of policies to welcome foreign direct investments. These investments have been a key driver for accelerating the economic growth through technology transfer, employment generation, and improved access to managerial expertise, global capital, product markets and distribution network. FDI in India has enabled to achieve a certain degree of financial stability; growth and development to sustain and compete in the global economy. According to UNCTAD in its World Investment Report 2010 "If the situation continues to improve, India is likely to be among the most promising investor-home countries in 2010-12 as well as the third highest economy for FDI in 2010-12". India has all the variables such as fine infrastructure, potential markets, abundant labour, availability of natural resources, and at last the economic and trades policies which has been favouring FDI. India is now rated as the second-most favoured destination for FDI in the world after China, but it is expected that in future India would out beet china as it has a large proportion of young population with one of the fastest growing economies.

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