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FOREIGN DIRECT INVESTMENT IN INDIAN SERVICE SECTOR

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ABSTRACT

India's inward investment regime went through a series of changes since economic reforms were ushered in two decades back. The expectation of the policy makers was that an "investor friendly" regime will help India establish itself as a preferred destination of foreign investors. These expectations remained largely unfulfilled despite the consistent attempts by the policy makers to increase the attractiveness of India by further changes in policies that included opening up of individual sectors, raising the hitherto existing caps on foreign holding and improving investment procedures. But after 2005 – 06, official statistics started reporting steep increases in FDI inflows. This paper is an attempt to explain this divergence from the earlier trend.

KEYWORDS: *Regime, Investor Friendly, Foreign Holding.*

INTRODUCTION

One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economic landscape. This unprecedented growth of global FDI in 1990 around the world make FDI an important and vital component of development strategy in both developed and developing nations and policies are designed in order to stimulate inward flows. In fact, FDI provides a win – win situation to the host and the home countries. Both countries are directly interested in inviting FDI, because they benefit a lot from such type of investment. The 'home' countries want to take the advantage of the vast markets opened by industrial growth. On

the other hand the 'host' countries want to acquire technological and managerial skills and supplement domestic savings and foreign exchange. Moreover, the paucity of all types of resources viz. financial, capital, entrepreneurship, technological know- how, skills and practices, access to markets- abroad- in their economic development, developing nations accepted FDI as a sole visible panacea for all their scarcities. Further, the integration of global financial markets paves ways to this explosive growth of FDI around the globe.

HISTORICAL BACKGROUND

The historical background of FDI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. However, researchers could not portray the complete history of FDI pouring in India due to lack of abundant and authentic data. Before independence major amount of FDI came from the British companies. British companies setup their units in mining sector and in those sectors that suits their own economic and business interest.

After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India. Further, after Independence issues relating to foreign capital, operations of MNCs, gained attention of the policy makers. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. The first Prime Minister of India considered foreign investment as "necessary" not only to supplement domestic capital but also to secure scientific, technical, and industrial knowledge and capital equipments. With time and as per economic and political regimes there have been changes in the FDI policy too.

The industrial policy of 1965, allowed MNCs to venture through technical collaboration in India. However, the country faced two severe crisis in the form of foreign exchange and financial resource mobilization during the second five year plan (1956 -61).

Therefore, the government adopted a liberal attitude by allowing more frequent equity participation to foreign enterprises, and to accept equity capital in technical collaborations. The government also provides many incentives such as tax concessions, simplification of licensing procedures and de- reserving some industries such as drugs, aluminium, heavy electrical equipments, fertilizers, etc in order to further boost the FDI inflows in the country. This liberal attitude of government towards foreign capital lures investors from other advanced countries like USA, Japan, and Germany, etc. But due to significant outflow of foreign reserves in the form of remittances of dividends, profits, royalties etc, the government has to adopt stringent foreign policy in 1970s. During this period the government adopted a selective and highly restrictive foreign policy as far as foreign capital, type of FDI and ownerships of foreign companies was concerned.

Government setup Foreign Investment Board and enacted Foreign Exchange Regulation Act in order to regulate flow of foreign capital and FDI flow to India. The soaring oil prices continued low exports and deterioration in Balance of Payment position during 1980s forced the government to make necessary changes in the foreign policy. It is during this period the government encourages FDI, allow MNCs to operate in India. Thus, resulting in the partial liberalization of Indian Economy, the government introduces reforms in the industrial sector,

aimed at increasing competency, efficiency and growth in industry through a stable, pragmatic and non-discriminatory policy for FDI flow.

OBJECTIVES

1) To study the FDI inflows in Indian Service Sector from 1991-2011.
2) To explore the Service Sector wise distribution of FDI inflows
3) To rank the sectors based upon highest FDI inflows.
4) To study the relationship between service sector growth and India economy.

RESEARCH METHODOLOGY

The study is based on secondary sources of data. The main source of data are various Economic Surveys of India and Ministry of Commerce and Industry data, RBI bulletin, online data base of Indian Economy, journals, articles, news papers, etc.

SERVICES SECTOR CONTRIBUTION TO THE INDIAN ECONOMY

The Services Sector contributes the most to the Indian GDP. The Sector of Services in India has the biggest share in the country's GDP for it accounts for around 53.8% in 2005. The contribution of the Services Sector in India GDP has increased a lot in the last few years. The Services Sector contributed only 15% to the Indian GDP in 1950. Further the Indian Services Sector's share in the country's GDP has increased from 43.695 in 1990- 1991 to around 51.16% in 1998- 1999. This shows that the Services Sector in India accounts for over half of the country's GDP. Real estate and business services, community services (public administration and defense) and other services. This sector provides services of final consumption nature as well as intermediate nature, the latter accounting for a major share. Substantial parts of services such as transport and communications are in the form of intermediate inputs for production of other goods and services

IMPORTANCE OF THE STUDY

It is apparent from the above discussion that FDI is a predominant and vital factor in influencing the contemporary process of global economic development. The study attempts to analyze the important dimensions of FDI in India. The study works out the trends and patterns, main determinants and investment flows to India. The study also examines the role of FDI on economic growth in India for the period 1991-2008. The period under study is important for a variety of reasons. First of all, it was during July 1991 India opened its doors to private sector and liberalized its economy. Secondly, the experiences of South-East Asian countries by liberalizing their economies in 1980s became stars of economic growth and development in early 1990s. Thirdly, India’s experience with its first generation economic reforms and the country’s economic growth performance were considered safe havens for FDI which led to second generation of economic reforms in India in first decade of this century. Fourthly, there is a considerable change in the attitude of both the developing and developed countries towards FDI. They both consider FDI as the most suitable form of external finance. Fifthly, increase in competition for FDI inflows particularly among the developing nations.

LIMITATIONS OF THE STUDY

All the economic / scientific studies are faced with various limitations and this study is no exception to the phenomena. The various limitations of the study are:

1. At various stages, the basic objective of the study is suffered due to inadequacy of time series data from related agencies. There has also been a problem of sufficient homogenous data from different sources. For example, the time series used for different variables, the averages are used at certain occasions. Therefore, the trends, growth rates and estimated regression coefficients may deviate from the true ones.

2. The assumption that FDI was the only cause for development of Indian economy in the post liberalized period is debatable. No proper methods were available to segregate the effect of FDI to support the validity of this assumption.

3. Above all, since it is a Ph.D. project and the research was faced with the problem of various resources like time and money.

CHALLENGES

The opportunities in this fast-growing, employment-oriented, FDI attracting sector, with vast export-potential are striking. However, the challenges are also many:

- One of the challenges in this area is to retain India's competitiveness in those sectors where it has already made a mark such as IT and Telecommunications. Their deeper and broader use in the domestic sectors would also have a dramatic potential to increase the efficiency and productivity of other goods and services.

- The second challenge lies in making inroads into some traditional areas such as tourism and shipping where other countries have already established themselves, but where the potential for India is nevertheless very high.

- The third challenge is in making forays into globally traded services in still niche areas for India, such as financial services, health care, education, accountancy, and other business services where India has a large domestic market and has also shown recent signs of making a dent in the international market, but only a very small part of the full potential has been tapped.

TRENDS AND PATTERNS OF FDI FLOW IN INDIA

Economic reforms taken by Indian government in 1991 makes the country as one of the prominent performer of global economies by placing the country as the 4th largest and the 2nd fastest growing economy in the world. India also ranks as the 11th largest economy in terms of industrial output and has the 3rd largest pool of scientific and technical manpower. Continued economic liberalization since 1991 and its overall direction remained the same over the years irrespective of the ruling party moved the economy towards a market – based system from a closed economy characterized by extensive regulation, protectionism, public ownership which leads to pervasive corruption and slow growth from 1950s until 1990s.

In fact, India's economy has been growing at a rate of more than 9% for three running years and has seen a decade of 7 plus per cent growth. The exports in 2008 were $175.7 bn and

imports were $287.5 bn. India's export has been consistently rising, covering 81.3% of its imports in 2008, up from 66.2% in 1990-91. Since independence,

India's BOP on its current account has been negative. Since 1996-97, its overall BOP has been positive, largely on account of increased FDI and deposits from Non – Resident

Indians (NRIs), and commercial borrowings. The fiscal deficit has come down from 4.5 per cent in 2003-04 to 2.7 per cent in 2007-08 and revenue deficit from 3.6 per cent to 1.1 per cent in 2007-08.

Table 2 *Sector-wise FDI Inflows (Rupees in Crores)*

Sector	2007-08 (April-March)	2008-09 (April-March)	2009-10 (April-March)	2010-11 (for April '10)	Cumulative Inflows (April '00 - April '10)	% age to Total Inflows (In terms of US$)
Services Sector (financial & non-financial)	26,589	28,411	20,958	1,581	106,992	21 %
Computer Software & Hardware	5,623	7,329	4,350	765	44,611	9 %
Telecommunications (radio paging, cellular mobile, basic telephone services)	5,103	11,727	12,338	1,914	42,620	8 %
Housing & Real Estate	8,749	12,621	13,586	246	37,615	7 %
Construction Activities (including roads & highways)	6,989	8,792	13,544	345	36,066	7 %
Power	3,875	4,382	6,908	547	21,466	4 %
Automobile Industry	2,697	5,212	5,609	187	20,864	4 %
Metallurgical Industries	4,686	4,157	1,935	404	13,845	3 %
Petroleum & Natural Gas	5,729	1,931	1,328	522	12,026	2 %
Chemicals (other than fertilizers)	920	3,427	1,707	115	11,390	2 %

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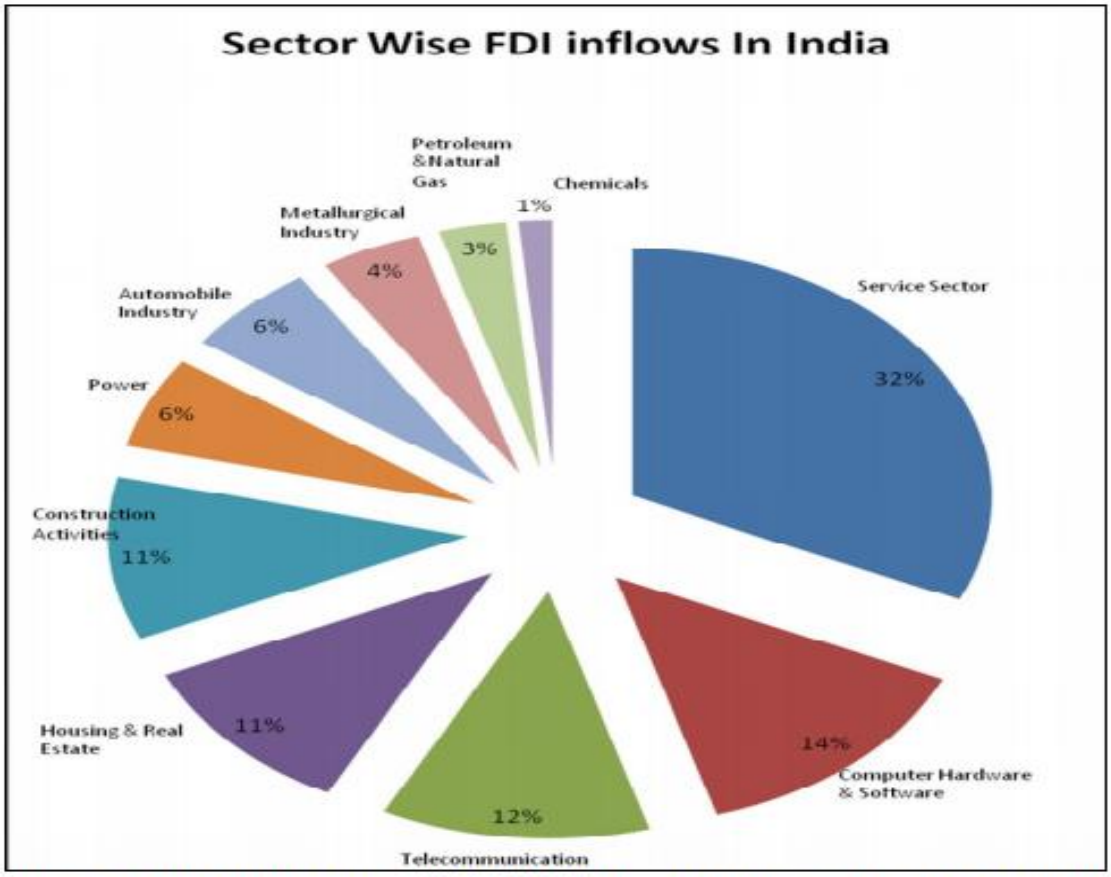
Table 3 *Rank of Sector–wise FDI Inflows*

Industrial Sector	Rank
Service Sector	1
Computer Hardware & Software	2
Telecommunication	3
Housing and Real Estate	4
Construction Activities	5
Power	6
Automobile Industry	7
Metallurgical Industry	8
Petroleum and Natural Gas	9
Chemicals	10

Source *Fact Sheets on FDI, DIPP*

DATA ANALYSIS



Graph Showing Top Ten Sectors attracting FDI Inflows in India since April 2000- Dec 2010

The sectorial analysis of FDI in India show that maximum FDI has taken place in service sector including IT, Telecommunication, Travel etc.

The rapid growth telecommunication was due to FDI inflow in form of international player entering the market the growth rate of Indian telecommunication industry is of 45% and its heist in the world.

The increased flow of real state sector in India has help in growth development and expanssino of these sectors

The basic advantage provided by India in automobile sector include advanced technology, cost of effectiveness and efficient man power.

Based upon the data given by department of Industrial Policy and Promotion, in India there are sixty two (62)sectors in which FDI inflows are seen but it is found that top ten sectors attract almost seventy percent (70%) of FDI inflows. The cumulative FDI inflows from the above results reveals that service sector in India attracts the maximum FDI inflows amounting to Rs. 106992 crores, followed by Computer Software and Hardware amounting to Rs. 44611 crores. These two sectors collectively attract more than thirty percent (30%) of the total FDI inflows in India. The housing and real estate sector and the construction industry are among the new sectors attracting huge FDI inflows that come under top ten sectors attracting maximum FDI inflows.

CONCLUSION

- FDI has gained momentum in the economic landscape of world economies in the last three decades. It had outpaced almost all other economic indicators of economic transactions worldwide.

- FDI is considered as the safest type of external finance both by the developed and developing nations. So, there is growing competition among the countries in receiving maximum inward FDI.

- Trends in world FDI inflows shows that maximum percentage of global FDI is vested with the developed nation. But in the last two decades, developing countries by receiving 40% of global FDI in 1997 as against 26% in 1980 make waves in the economics of developed nations.

- Among developing nations of the world, the emerging economies of the Asian continent are receiving maximum share (16%) of FDI inflows as against other emerging countries of Latin America (8.7%) and Africa (2%).

- In the last two decades, India has significantly increased its share of world FDI from 0.7% in 1996 to 1.3% in 2007.

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