DIRECT FOREIGN INVESTMENTS IN INDIA: POTENTIAL & PERFORMANCE OF FDI INFLOWS FROM UNITED STATES AS STRATEGIC MAJOR INVESTOR

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Abstract
In the recent past the US has emerged as one of the top three important trading partners for India (both in terms of Indian exports to and Imports from US). In terms of both its imports and exports, US play a major role. Over the years, the trade between US and India was very much restricted. This was mainly due to India's proximity towards the former Soviet Union (USSR). Ever since the end of cold war and break up of USSR in 1990-91, a new chapter in trade and investments between India and US started. The trade between US and India has risen sharply in the recent past. This study presents the historical perspective of the trends in FDI inflows in India. In doing so, a detailed descriptive analysis is presented to assess the current trends, patterns of FDI inflows by sector, origin of country and regional comparison. The second part of the study includes constructing FDI potential and performance indices for India and compare with other leading emerging economies for the time period 1970 to 2005. The results reveal that though FDI in India has increased considerably during post reforms period, its position in comparison to other emerging economies is very weak, suggesting that there is still lot of potential for India to compete with its peer group.
JEL Codes:
Keywords: FDI inflows; Potential; Performance; India

1. Introduction: the importance of FDI in India.

The biggest challenge before the Indian government is how to attain a solid economic growth and more importantly how to sustain it. Many economists like Maddison (1998) opine that this can be attained by a massive increase in investments which should result in sustained economic welfare in the years to come. For that, the overall investment levels should be increased substantially from the present levels for the next 15 years.

The table 1 captures the growth rate of investments in some of the emerging economies to achieve an economic growth rate of over 6 to 8%.

In case of India, if it aspires to have a *per capita* income growth of over 6% consistently for the next ten years then the investment level should be increased drastically. Most of the developed nations and also the emerging economies like China, Taiwan, and Mexico have increased their investment levels significantly during the period 1980 - 2005. So if India wants to accelerate its growth then an investment ratio of over 35% is what required. The question is how India can mop up an investment ratio of over 35% and

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sustain it in the years to come. The table 1 captures the growth rate of investments in some of the emerging economies to achieve an economic growth rate of over 6 to 8%.

Table 1. Investment-GDP growth rate in India vis-à-vis other emerging markets. (%)

Country	**Investment Growth: 1980-1990**	**GDP Growth: 1980-1990**	**Investment Growth: 1990-1997**	**GDP Growth: 1990-1997**	**Investment Growth: 1998-2005**	**GDP Growth: 1998-2005**
China	11	10.2	15.5	12.8	16.2	9.7
Malaysia	2.6	5.2	16.0	8.7	0.2	4.3
Indonesia	7.0	6.1	16.3	7.6	5.8	2.3
Thailand	9.4	7.6	10.2	8.4	12.0	3.4
Philippines	-2.1	1.0	3.2	2.3	6.4	4.2
Egypt	2.7	5.0	-1.5	1.3	N.A	N.A
India	**6.5**	**5.8**	**5.3**	**4.6**	**16**	**7.3**

Source: calculated & computed by authors from data collected from World Development Indicators – 2006

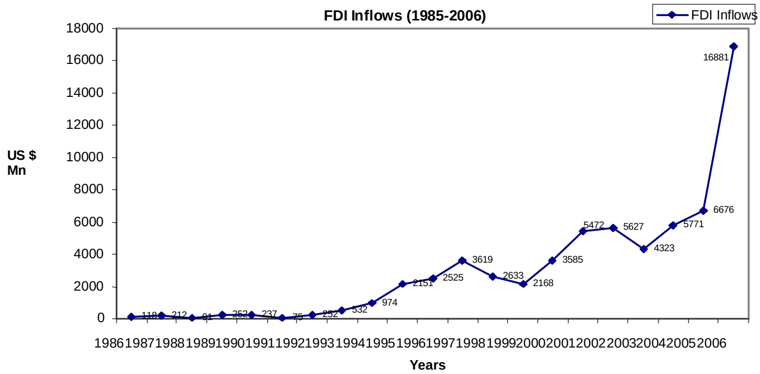
The public sector investments have been declining significantly from 1985 onwards. This is because of the ever-increasing fiscal deficit at both center and states levels, leaving the states with virtually no funds available for any massive investments required in the country. This being so on one hand, on the other hand, the private sector investments seems to be increasing right from 1980. But, this would not suffice the present investment requirements. Therefore, it becomes very important for India to explore the option of attracting more foreign direct investments which can supplement the domestic invest able resources for enabling a higher GDP growth rates. This apart, FDI can be attracted in key infrastructure projects like power, Roads, Housing, etc, which is a genuine need for the country (Qamar, 2003). The FDI also enables the foreign companies to transfer the technology to the host country which can improve its competitiveness globally. Another great advantage through FDI for India is it can generate lot of employment opportunities to the youth. It is a known fact that India has a highest stock of people in the age group of 15 to 30 years and there is also an increasing pressure on the government to provide them the right kind of jobs. Added to this, allowing FDI would also make the services more efficient for the consumers as it would lead to competition and this reduces market concentration of any company in that industry.

2. Foreign Direct Investment Inflows into India

Till 1991, foreign investments into India were restricted and moderately allowed that to only in few sectors. This was mainly because of the kind of policies which the government of India has adopted over the years, includes, `inward looking strategy'; and dependence of external borrowings which in turn resulted in foreign debts, were preferred to the foreign investments to bridge the gap between domestic savings and the amount of investments required. In 1991 when the government of India started the economic reforms program, FDI had suddenly become important for India which was looked upon as a key component of economic reforms package. The New Industrial Policy of 1991 gave utmost priority to attracting FDI inflows. In the process, the government started opening up of domestic sectors to the private and foreign participation which was earlier reserved only for the public sector. This was followed by slow but significant relaxation of regulatory and entry restrictions on FDI inflows. This led to the substantial increase in the volume of FDI inflows into India.

The FDI inflows into India before 1991 were minimal. The graph 1 shows that the FDI inflows surged post 1991 and reached to a new heights of over 16 US$ billion by 2006. Post reforms, the actual inflows of the FDI had maintained a fluctuating and unsteady trend during the initial period from 1991-92 to 2003-04. They increased from the level of US$ 75 million in 1991-92 to the level of US$ 3581 millions in 2000, before touching all time high US$ 5627 million in 2002. There was however, decline in FDI inflows in the immediate following year falling down to US$ 4323 million. From there on, the FDI inflows rose drastically and reached to over US$ 16 billions in 2006. During the initial phase of reforms from 1991 to 1998 saw continuous increase in the FDI inflows. The total amount of the FDI inflows during the period 1991-92 to 1997-98 had amounted to US$10,866 million. The increase was largely due to the expanded list of industries or sectors which were opened up for foreign equity participation. This followed by relaxation of various rules, regulations and introduction of various policies by the government to promote the FDI inflows. The inflows declined to the level of US$2,462 million in the year 1998-99 and further to US$2,155 million in 1999-2000. The reasons for the declining trend could be attributed to various set of factors, the most important among them being the several restrictions imposed on India by the USA on account of the nuclear test carried out by India at Pokhran, the political instability, the slow down of the Indian economy due to possible mild recession in US and global economy, the poor domestic industrial environment and the unfavorable external economic factors such as the financial crisis of South-East Asia. In 2000-01, the inflows of the FDI into India increased to the level of US$2,400 million. Due to external factors like the terrorist attacks on the Indian Parliament in December 2001, and on World Trade Centre (WTO) in September 2001 brought about a temporary dislocation in the FDI inflows.

Graph – 1: FDI Inflows into India



However, it increased to the level of US$4,095 million in the year 2001-02. This was due to further liberalization in respect of the foreign investment policies. The flow of the FDI decreased to the level of US$2,764 million in 2002-03 and further declined to the level of US$2,229 million in 2003-04. The new UPA government led by Congress party ensured the reforms process keeps moving ahead and further relaxed the rules and regulations saw FDI inflows growing to an all time high of over US$ 16 billions in 2006.

The FDI inflow in India has also gained prominence in relative terms. FDI inflows accounted for 8.7% of gross fixed capital formation in 2006, a significant increase from just about 0.2% in 1980. However, compared with all developing countries which is about 14% and emerging giants like Turkey 23.7%, Brazil 10.5%, Mexico 11.7% in 2006, this share is still slightly on lower side. But, compared with China which is around 8%, it is a remarkable achievement by India.

2. FDI inflows into India: Sector wise and country of origin

The changes in FDI policy adopted by government India saw more than 100 countries contributing to the FDI inflows in the year 2005 as compared to only 29 countries in the year 1991. However, there is an increase in number of countries investing in India since the liberalization but the major share of the FDI inflows came from only a few countries. The five countries which dominated the FDI scene in India were Mauritius, the USA, Japan, Netherlands and the UK. It is important to note that more than 50% of the total FDI inflows into India during the period 1991-2004 came from Mauritius and the USA only. The other five countries Japan, Netherlands, the United Kingdom, Germany and France have collectively accounted for 28.56% of the total FDI inflows into India. A thorough analysis of country wise data on FDI inflows into India shows some interesting trends. The inflows from United States was around 8% of the total inflows in the year 1992-93 has rose to 22% in the year 1999-00, but saw a gradual decline of 10% in the next two years. This was due to the sanctions imposed by the government of US on India because of conducting nuclear test. But after that, the FDI inflows of US steadily increased to around 20% of the total FDI inflows...

Table 2. Country wise FDI inflow into India (%)

Country	92-93-	93-94	94-95	95-96	96-97	97-98	98-99	99-00	00-01	01-02	02-03	03-04	04-05
France	3	3	2	4	0	0	0	0	5	3	3	2	2
Germany	8	10	4	7	15	5	6	2	6	3	6	5	6
Hong Kong	1	2	2	7	0	0	0	0	0	0	0	0	0
Italy	0	0	0	0	0	1	6	8	0	0	0	0	0
Japan	9	10	11	4	9	6	12	9	8	5	4	5	5
Mauritius	0	0	0	0	0	30	30	32	44	62	32	26	35
Holland	8	13	5	4	11	5	3	5	4	2	6	14	9
Singapore	1	3	3	4	7	0	0	0	1	2	2	1	3
S. Korea	0	0	0	0	0	11	4	1	1	0	1	2	1
Switzerland	13	6	3	2	0	0	0	0	0	0	2	0	3
UK	2	17	16	5	5	0	0	0	3	2	14	11	4
USA	8	27	23	14	22	23	23	22	17	12	16	20	20
Others	47	10	30	49	31	18	18	21	11	9	14	14	12
Total	100	100	100	100	100	100	100	100	100	100	100	100	100

Source: RBI Annual Report 1999-00 & 2006

Another interesting feature to be noticed is inflows from Mauritius, where the inflows was nil till 1996-97 but suddenly started gaining momentum from there on. By 2001-02 the inflows from Mauritius was about 62%. The FDI inflows into India for the period 1991-2004 saw Mauritius top the list with US$9,000.80 million out of the total FDI inflows. In terms of percentage, it worked out to 34.51% and Mauritius was the first among the top ten countries investing in India. This significant development can be attributed to the investors in this country who might be channeling their investments through this country, which is a tax heaven. If this is the real case, then the India needs to speed up its efforts in making its avoidance of double taxation treaties with different nations more effective.

Before the introduction of economic reforms in the 1990s, FDI inflows were concentrated in the manufacturing activities in India, which was due to the import substituting industrialization programs that encouraged the tariff-jumping investments to capture the protected domestic market. However, the trend clearly changed towards an increase in foreign investments in the territory sector that encompassed mainly the services' activities. These include the Information and Communication Technology (ICT) sector (telecommunications, computer systems, consultancy services), as well as power generation, hotels and tourism (Sadhana & Rahul, 2004). Table 3 presents a detailed break up of the FDI inflows into India during the period 1992-2004. These are classified according to the different sectors or activities.

Table 3. Sector-wise FDI inflows into India (%)

Industry	92-93	93-94	94-95	95-96	96-97	97-98	98-99	99-00	00-01	01-02	02-03	03-04	04-05
Chemical & Allied products	17	10	16	9	15	9	19	8	7	2	3	3	4
Computers	3	2	1	4	3	5	5	6	16	12	23	7	5
Domestic Appliances	6	1	12	0	1	0	0	0	0	0	2	2	3
Electronic Equipments	12	16	6	9	7	22	11	11	15	22	20	14	26
Engineering	25	9	15	18	35	20	21	21	11	8	8	9	9
Finance	1	11	11	19	11	5	9	1	2	1	1	2	8
Food & Dairy products	10	12	7	6	12	4	1	8	4	2	4	3	3
Pharma	1	13	1	4	2	1	1	3	3	2	2	3	3
Services	1	5	11	7	1	11	18	7	12	38	10	15	8
Others	25	21	19	24	14	24	13	35	30	13	27	42	35
Total	100	100	100	100	100	100	100	100	100	100	100	100	100

Source: RBI annual Report – 1999-00 & 2006

The RBI data on FDI inflows into Indian industries reveals that among the major players that have benefited the most include Computers, Electronic & Electrical Equipments, and Service sector. Interestingly, FDI inflows into domestic appliances have evaporated from the year 1997-98, while in Food & dairy products, Finance & banking, chemical & allied products saw a declining trend over the years. While the Pharma sector is witnessed a constant growth rate of 3% on an average in all the years. The chemical & allied products saw a mixed trend of growth over the years but declined at a much greater rate in the recent years. In fact, the early liberalization period, a larger share of the FDI inflows had gone to the chemicals' sector which attracted larger amounts of the FDI inflows from 1991-94 except in the year 1992. Same the case with Finance & banking sector, where it saw an increasing trend till the year 1996-97 and from there on the inflows declined drastically. The sectors like Electronic & Electrical equipments, Service sector; Computers are relatively becoming more of attractive destinations. Here it is worth mentioning that the FDI inflows do not seem to be coming to those industries which have been made more attractive through policy concessions by the government. This is an encouraging sign which is worth appreciation as this means that the FDI inflows into the country are guided more by market and economic conditions rather than the incentives offered by the government.

3. FDI flows in India: A broader picture

The FDI inflows in case of developing nations increased drastically during the period 1995 to 2005. In the case of Asia the FDI inflows have gone up from 14.2% to over 30% during this period, but reduced to 24% in 2005. It may be noticed that the FDI inflow in China during the year 1980, China's FDI stock was a little above 3% and by the end of the year 1999 it raised to over 31%, in relative terms it is an increase of over 25%. However, in 2005, it came down to around 16%. Compared to this, though India seems to have made only marginal progress, it seems to be the beneficiary.

The FDI inflows to India was about 0.7% of its GDP in 1980 and in 1999 it stood at 3.6%, an increase of just below 3%. This improved further to over 5% by 2005. This looks impressive but when compared to what happened in China, the only other economy which of the size of India, over performance becomes minimal. China during that particular period was able to attract FDI of over 16%. The Asian economies stood highest in this head as these regions invests in other countries a sum equivalent to about 13.6% of their GDP. The developing economies too have in doing so.

Table 4. FDI inflows & outflows Stock as percentage of GDP

FDI Inflows Stock as Percentage of GDP						
Host Economies	**1980**	**1985**	**1990**	**1995**	**1999**	**2005**
Developing Economies	10.2	14.1	13.4	15.6	28.0	26.65
Asia	14.2	17.4	15.4	17.3	30.2	23.82
China	3.1	3.4	7.0	19.6	30.9	16.05
India	0.7	0.5	0.6	1.7	3.6	5.65
FDI Outflows Stock as Percentage of GDP						
Host Economies	**1980**	**1985**	**1990**	**1995**	**1999**	**2005**
Developing Economies	0.9	1.6	2.6	4.8	10.1	12.72
Asia	0.7	1.0	2.7	5.7	13.6	13.43
China	NA	NA	0.7	2.3	2.5	2.34
India	0.1	0.1	00	0.1	0.2	1.19

Source: compiled from UNCTAD – WIR 2001 & 2006

With FDI inflows worth more than 3.4 US billions, India receives only a little out of the total FDI inflows from the developing economies. In terms of growth there has been a remarkable increase in FDI inflows since 1994. The growth during this period was termed to be dramatic ones. Though FDI inflows to India have increased by leaps and bounds in the recent past but when compared with Chinese growth of more than US$ 80 billions in 2006, India's growth of US$ 16 billion is still lower. The only point of cheer is that FDI inflows to India as percentage of FDI inflows to Asia has gone up from 2.8% in the year 1995 to over 6.5% in the year 2006.

Table 5. FDI inflows into India: key indicators

FDI Inflows (Mn US Dollars)					
Host Economies	**1989-1994**	**1995**	**1999**	**2003**	**2006**
Developing Economies	59578	113338	222010	178699	379070
Asia	37659	75293	99728	115330	259773
China	13951	35849	40319	53505	69468
India	394	2144	2154	4323	16881
FDI inflows: Relative Share of India (%)					
Host Economies	**1989-1994**	**1995**	**1999**	**2003**	**2006**
Share of India in Developing Economies	0.6	1.9	0.9	2.42	4.45
Share of India in Asia	1.0	2.8	2.2	3.75	6.5
Share of China in Developing Economies	23.4	31.6	18.2	29.94	18.3
Share of China in Asia	37	47.6	40.4	46.4	26.8

Source UNCTAD – WIR: 2001, 2003 & 2006

Table 6. FDI outflows into India: key indicators

FDI Outflows (Mn US Dollars)					
Host Economies	**1989-1994**	**1995**	**1999**	**2003**	**2006**
Developing Economies	24925	48987	57978	39742	122936
Asia	20335	31149	35421	18980	83557
China	2154	2000	1775	-152	11306
India	19	119	79	1325	1364
FDI Outflows: Relative Share of India (%)					
Host Economies	**1989-1994**	**1995**	**1999**	**2003**	**2006**
Share of India in Developing Economies	0.0	0.0	0.0	3.33	1.11
Share of India in Asia	0.1	0.4	0.2	6.98	1.63
Share of China in Developing Economies	8.6	4.1	3.1	-0.38	9.2
Share of China in Asia	10.6	6.4	5.0	-0.33	13.53

Source UNCTAD – WIR: 2001, 2003 & 2006

FDI Inflows from United States: Strategic Major Investor

US are the largest trading partner of India. However, India is a relatively minor trading partner for the US (Indian trade with the US as a percentage of total US trade). In the recent past the US has emerged as one of the top three important trading partners for India (both in terms of Indian exports to and Imports from US). In terms of both its imports and exports, US play a major role. Over the years, the trade between US and India was very much restricted. This was mainly due to India's proximity towards the former Soviet Union (USSR). Ever since the end of cold war and break up of USSR in 1990-91, a new chapter in trade and investments between India and US started. The trade between US and India has risen sharply in the recent past. The table 7 show the trade between India and US from 1999 to 2003.

The major advantage for the US is the vast market size of India. This is mainly due to huge population which generates lot of demand for various goods and services. In 2003, the total US exports to India was around $ 5 billion and imports from India were worth $ 13.1 billion. This is an increase of 22% and 11% when compared to the previous year (2002).

US exports mainly include, chemicals, computers and aircraft equipment items. While its major imports include manufactures mineral items like processed diamonds, clothing apparel and jewelry items. The increasing economic and trade relationship between India and US in the recent past helped in increasing US investments into India. The US FDI outflows into India have surpassed FDI outflows from the UK. It is observed that the foreign investments from US into India have increased recently as the US companies were enthused by the opening up of the Indian economy in the early 1990.

Table 7. US-India trade (1999 – 2004)($ Mn)

Sl. No.	Items	1999	2000	2001	2002	2003	2004
01	Office machines and automated data processing machines	175	218	367	349	371	506
02	Transport equipment	454	424	312	394	331	365
03	Electrical machines, appliances and parts	214	213	264	311	306	345
	Total US Exports	**3545**	**3707**	**3663**	**3764**	**4098**	**4986**
04	Non metallic mineral manufacturers	2062	2499	2768	2180	2931	2962
05	Article of apparel and clothing	1642	1646	2002	1934	2064	2156
06	Textile Yarns and fabrics	1642	988	1119	1050	1260	1424
	Total US Imports	**8225**	**9083**	**10686**	**9738**	**11818**	**13053**

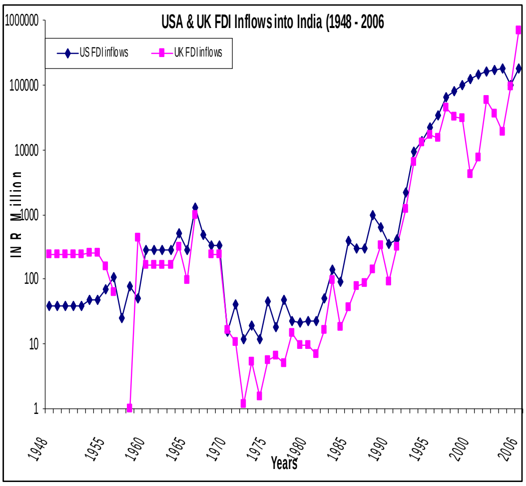
Source: Morrison W & Kronstadt A, “India-U.S. Economic Relations” CRS Reports for Congress, USA, 2003 & 2004

The graph 2 captures the FDI inflows of US and UK into India from 1948 to 2007. The graph shows that from post independence period to 1970, FDI from UK occupied a dominant share in the total FDI inflows of India. For a brief period from 1971 to 1985 the FDI inflows from US started overtaking UK. After the liberalization of the Indian economy in 1991, the FDI inflows from UK also surged overtaking the US for a brief period in early 1990s. The total cumulative stock of US FDI from 1949 to 2002 is larger than that of UK. The Graph – 3 shows the total collaborations that US, UK and German firms had with local companies in India from 1951 to 2001.

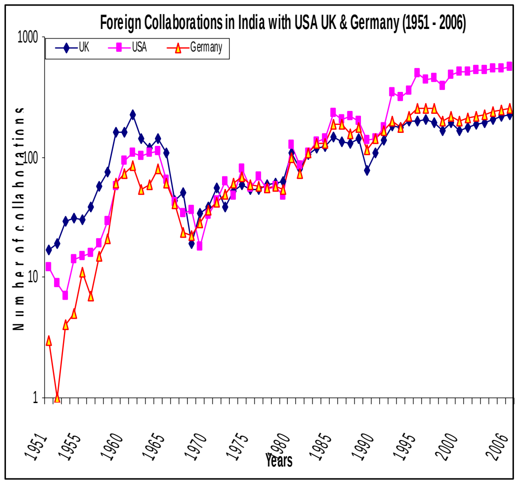
The graph 3 points out some interesting trends. From 1951 to 1967 the foreign collaborations with UK firms were higher. From 1968 to 1980 the number of collaborations of UK, German and US companies were very low. The collaborations with UK firms also reduced substantially during this period. However, things began to change from 1981 onwards as the trend of number of foreign collaborations started to increase. The collaborations with US firms increased significantly from 1985 onwards. On the other hand, during the same period, the collaborations with UK firms declined and the German collaborations increased.

The pace picked up from 1991 as number of foreign collaborations increased by drastically. This was because of the government lifting various foreign investment and collaboration restrictions. German and UK collaborations too increased but when compared to US, these were very low in number. This apart, the impressive economic performance of Indian economy in the recent past also played an important role in attracting US companies into India. The government of India data on FDI into India reveals that US is the second largest source of FDI after Mauritius. By the end of 2004, the US FDI inflows into India have crossed $ 345 million.

Graph 2



Graph 3



Source: www.rbi.org; authors' calculations

4. India vs. Other Emerging Economics: Potential & Performance Indices

In this section, we look at the comparative picture of India versus other fast emerging economies in terms of performance and potential of FDI from 1970 to 2005. We have selected eight most emerging economies that have attracted large chunk of FDI amongst total developing economies. They include: Argentina, Brazil, Chile, China, Mexico, South Africa, South Korea and Turkey In the recent years, the emerging economies experienced exceptional growth in terms of attracting FDI inflows post 1990. We present the comparative analysis using FDI Potential & Performance Indices using Frias, Iglesias & Vazquez (2005) method.

Construction of Indices

The FDI performance and potential indices measure the performance and potential of a country in terms of attracting FDI inflows using different set of macroeconomic and policy factors which are important to foreign investors. Taken together, these two indices show how countries are performing in attracting FDI inflows relative to their potential. The FDI performance index includes the values of average FDI inflows into the country for the study period. While the FDI Potential index is constructed as the unweighted average of nine variables.

Table 8. Indicators under Potential & Performance Indices

FDI POTENTIAL INDEX	
Variables	**Indicators**
Market Growth	GDP Growth Rate
Economic Development	Percapita GDP in PPP (US$ Constant)
Human Capital	Secondary School Enrollment Ratio
Legal System & Protection of Property	Property & Legal Rights
Trade Openness	Imports + Exports / GDP
Financial Openness	Capital Account Convertibility Index [Dr. Chinn & Dr. Ito (NBER, USA)]
Business & Labour Regulations	Economic Freedom Index (Business & Labour Regulation Scores)
Access to Money Constraints	Economic Freedom Index (Availability of Credit Scores)
Infrastructure	Telephone Lines per 1000 inhabitants
FDI PERFORMANCE INDEX	
Variables	**Indicators**
FDI Inflows	FDI Inflows in US$ Millions
FDI Inflows controlling for Size of the country	Per capita FDI Inflows (US$)
Relative Position of FDI against competitors	Share of FDI Inflows of i_{th} country / FDI Inflows of sample countries(9)

In the first step, we identify the appropriate indicators under each head (potential & performance). The selection of the indicator was done to best represent the macro economic and socio economic fundamentals and policy aspect of reforms carried out in terms of attracting FDI inflows. In the next step, the values under each indicator were converted into an index, namely individual indicator indices. For this purpose, the paper used the methodology of Physical Quality of Life Index (PQLI). Accordingly, the worst and best values of each indicator during the period of 1970 to 2006 were identified. For each indicator the performance of each indicator in each year was put on a 0 to 1.00 scale where, 0 represents an absolutely defined worst performance and 1.00 represents an absolutely defined best performance and to aid the calculations, one unit point was added to the best values of the indicators[2]. Thus,

$$\text{Indicator scores} = \frac{1}{\mathrm{m_i}}\frac{1}{n_i}\sum_{j_i}^{m_i}\sum_{t_i}^{n_i}\left(\frac{\text{Actual value j - Minimum value jit}}{\text{Maximum value j Minimum value j}}*100\right)$$

Where, *Indicator scores* is a value of *j*-th variable of *i*-th country (India) in time *t*, *n* stands for the number of the years and *m* for the number of variables. One main advantage of such transformation is that it allows the reform index to be measured over the same scale. This is an easy method to find out the performance of the Reforms, as an increase in the value of an indicator index would necessarily mean improvement in the economic reforms process and vice versa. Once the indicator indices are formed, the

[2] The best & worst values are defined in such a way that all the indexes could become unidirectional, i.e. an increase in value of an index would necessarily mean improvement in the fiscal performance of the state.

comprehensive Composite Index is then calculated as a simple average of the indicator indices.

FDI Potential Index: 1970 – 2005

The overall potential of India in comparison with other emerging economies is relatively poor. The overall rank of India during the 1970 was 7th and fluctuated between 7th and 8th till 1980. From then on, consistently, the rank of India was 9th. On the other hand, India' closest neighbor, China stood 9th in position in 1970, leapfrogged to number 5th rank by 2005. Similarly, Chile, which stood at 5th position in 1970, improved its position to 2nd by 2005.

The performance of India on Market Growth indicator was reasonably good expecting the period 2000 in which it stood in 8th position. But, the biggest disadvantage of India was its lower per capita GDP, which was lowest amongst all the emerging economies. This is due to very high population, which reduced the per capita GDP values for India. Similarly, the performance of India in Human Capital was also poor. It always stood in the last position in comparison to other emerging economies, where as countries like Brazil, which stood in 5th position improved significantly to stand in 1st position by 2005.

One of the greatest improvements which India witnessed during the post reforms period is protection of property rights. India stood 8th in position consistently during the period 1970 to 1990. But from 1995 onwards, things began to change and its rank improved to 3rd position. On the contrary, the Business and Labour Regulation in India was significantly better than other emerging economies from 1970 to 1990 period. But post reforms period, the scores though slightly improved, but the ranking went down. This is not because of poor performance, but rather it is due to drastic improvement in terms of performance by other emerging economies.

The trade and financial openness portray mixed picture, while trade openness position of India though improved very slightly, the scores almost remained the same, but in case of financial openness, its position slipped down during the post reforms period. This is again not due to policy reforms, but rather due to considerable improvement by its competitors. For example Chile and Brazil shared 8th position respectively during 1970 stand at 1st and 2nd positions respectively in 2005.

Table 10. FDI Potential Index: India

Years	Total Score	Final Rank
1970	0.29	7
1975	0.37	8
1980	0.42	7
1985	0.43	8
1990	0.37	7
1995	0.31	8
2000	0.31	9
2005	0.27	9

Source: Computed & Compiled by author.
Note: The final scores for each indicator range between 0 – 1

Similarly, India's position also declined considerably in terms of access to Money, in which its position was 3rd in 1970 came down to 7th in 2005. While countries like China and South Africa which stood in 9th and 5th positions respectively improved their positions to 3rd and 1st positions by 2005. Again, the pace of reforms in other emerging economies has outpaced the relatively slow reforms process adopted by India. Finally, in terms of infrastructure, India's position is very poor as it slipped from already lowest position (8th rank in 1970) to further lowest point of 9th in 2005. On the other hand, China is a success story in terms of building state of art infrastructure facilities. It was the lowest amongst all the emerging economies in 1970 with 9th position, now stands at 3rd position in 2005.

FDI Performance Index: 1970 -2005

The FDI performance index is represented by the scores given to all emerging economies based on the FDI performance displayed during the 1970 - 2005 period. The table 11 gives the FDI Performance scores and rank for India.

Table 11. FDI Performance Index: India

Years	Final Score	Final Rank
1970	0.08	7
1975	0.05	6
1980	0.03	5
1985	0.26	8
1990	0.07	8
1995	0.02	8
2000	0.05	7
2005	0.02	9

Source: Computed & Compiled by author

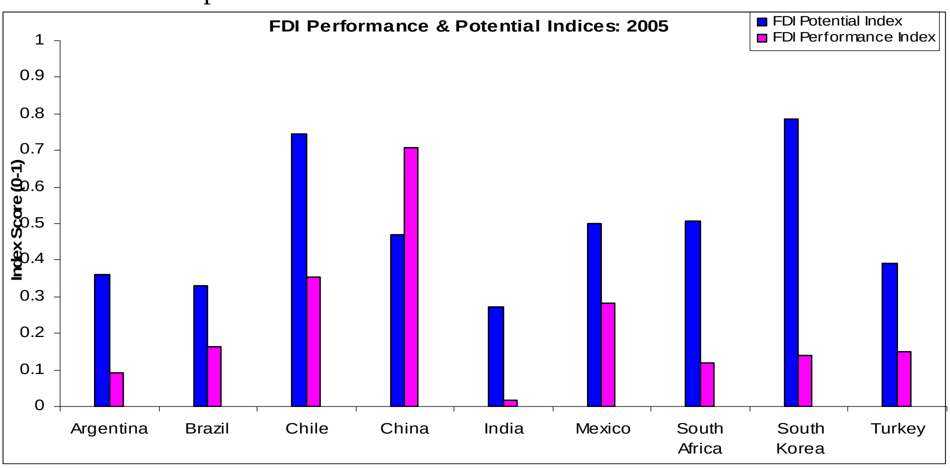
In all the three components, the scores of India are considerably lower than its counterparts for large number of time periods In terms of per capita FDI inflows, which controls for the size of the economy; we find that India's position is 9th in 2005. The actual FDI Inflows to GDP saw India gaining 7th position and the share of FDI inflows to emerging economies share stood at last position. Though FDI inflows in India increased slowly during the post reforms period, in comparison to other emerging economies like China, Brazil, Mexico and Chile, it is very low. This is the only reason though we see FDI inflows increasing, but in comparison to its rivals, its position is decimal. On the other hand, China stands out as one of the greatest success stories of attracting FDI as it stood 9th in position in 1970. By 2005, its position surged to 1st position. Even in terms of it share in leading emerging economies FDI inflows it stood 1st in 2005 in comparison to 9th position in 1970.

The potential was at all time high during the mid-1980s. This declined during the post reforms period. The same is the case with performance index also. In mid-1980s the performance was at all time high. But, reading between the lines suggest that though reforms brought in growth and huge FDI inflows into the country, its rivals positions improved better than that of India. For example, the case of China shows that the second generation reforms in 1992 initiated by Deng Xiaoping led to massive increase in FDI inflows into China. The policy changes include drastic reforms in terms of relaxation of entry regulations and providing various tax and non tax incentives for foreign firms.

The graph 4 captures the latest position (2005) of all the emerging economies including India. Both indices show that only China has outperformed all other countries in terms of FDI Performance. In terms of Chile and South Korea, the potential is very high, but the performance is lower given very high potential to attract FDI.

The position of India is decimal in terms of FDI Performance, though the potential index shows lot of promise to attract FDI inflows. In fact a close comparative picture of FDI Potential between India and some countries like Argentina, Brazil and Turkey show that though they all are ahead of India, the gap is very low. But when compared to the performance, India stands last. Another interesting point worth noting is no country excepting China's performance has outperformed its own potential. China's performance index shows that it has overtaken the potential index by at least more than 30%. The other country which stands behind China in these terms is Mexico and Chile

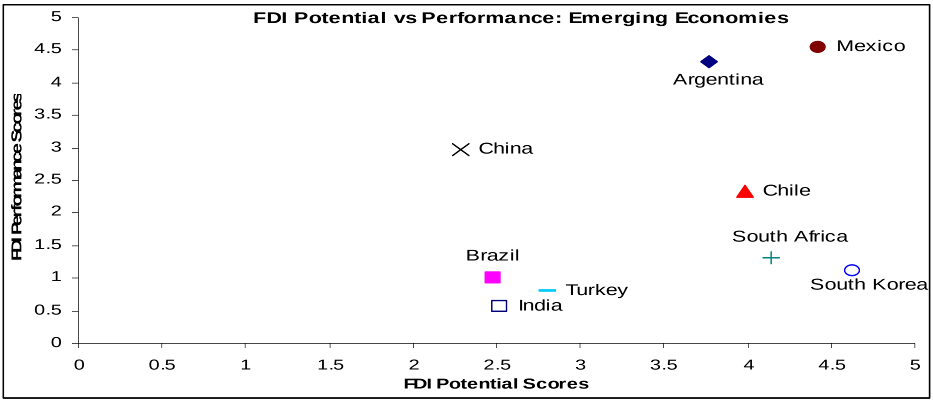
Graph 4. FDI Performance and Potential Indices 2005



Comparing Positions

It is useful to compare the scores of all these emerging economies based on these two indices to know whether the countries under consideration are performing adequately or otherwise. By taking into account both these indices, we formulate FDI Performance and Potential indices matrix.

Graph 5: FDI Potential Vs performance: Emerging economics (1970 – 2005)



Source: authors own calculations

This matrix divides the countries under four heads namely, a. Front Runners; b. Above Potential; c. Below Potential and d. Under Performers. The countries with higher performance, i.e. the score of above 3 points by performance and high potential, the score of above 3 points for potentiality are considered as Front Runners category. Countries with high performance and low potential are categorized under above potential league. Countries with low performance and high potential are considered for below potential category and finally, countries with low performance and low potential are brought under performers' category. The scatter graph shows the scores in potential and performance indices in which we can observe the relationship that exists between both. These scores are the sum values from 1970 to 2005. The countries which fall under first category include Argentina and Mexico. Countries with low potential and high performance include only China. While, Chile, South Africa and South Korea come under below potentials, while Brazil, India and Turkey are in under performer category.

6. Conclusion and Suggestions

Some of the few important reasons why India is unable to compete with its counterparts in terms of attracting huge FDI Inflows are because there are still considerable bottlenecks, which still remain. The government report 2003 addresses reasons for inadequate performance of India in the area of FDI. The identification of causes draws extensively on investor perception surveys carried out by major global consultancy firms Boston Consultancy Group. Six major constraints are mentioned:

Image and Attitude: There is a perception among investors that foreign businesses are still treated with suspicion and distrust in India. This is however, slowly phasing out from the minds of foreign investors as India is potentially becoming the hub of emerging economies in terms of growth and huge market opportunities.

Domestic Policy: While the FDI policy is quite straightforward and getting increasingly liberalized for most sectors, once an investor establishes his presence, national treatment means that this investor is subject to domestic regulations, which are perceived as being excessive.

Approvals & Procedures: Although approval for investment is given quite readily, actual setting up requires a long series of further approvals from central, state and local authorities. This introduces substantial implementation lags. There is however some forward movement in this as the government of India abolished FIPB route and merged this with RBI's direct approvals route. This saves lot of time for foreign investors of some sector to initiate the business after the project being approved.

Quality of infrastructure:

Foreign investors are concerned about a number of problems with the infrastructure sector – in particular, electricity and transport. Irregular and undependable supply is further complication for foreign investors.

Obstacles at Center – State level: When it comes to actual investment the practices of state (and often lower levels) governments become important. The state government practices in issues such as land records, utility (power, water etc.) connections, providing clearances of various sorts make an important difference in the time it takes to get a plant up and running. Differences in state practices in such matters partly explain the disproportionate flow of FDI to some states in the peninsular region of India. In addition, there are some fiscal barriers to unimpeded flow of goods and services within the country, although the level of such barriers has come down in recent times.

Delays in legal process: Despite a highly structured legal system, dispute settlement and contract enforcement are time consuming activities in India. However, there is a general perception amongst foreign investors that India as a product is not able to market itself as an FDI destination. An attitudinal mindset change towards FDI is necessary. This may seems to be simple but practically it is very difficult to change. Changing the foreign perception on India and making India as FDI destination is a challenging task. When it comes to the case of China, it does better than India in terms of basic economic determinants like Strong economic fundamentals, literacy levels & skilled labor, excellent infrastructure facilities, focused FDI policy framework, flexible labor laws and liberal entry exit barriers for business firms and relatively good market opportunities and better FDI policy.

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