

## **Role of Foreign Direct Investment (FDI) in the Growth of Indian Agricultural Sector: A Post Reform Study**

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### **Abstract**

The need for economic development is self raised as an automatic consequence of the globalization. Although many countries have achieved significant increases in income in last few years, there still exist great international inequalities in the level of income. In India, agriculture is an important sector of the economy and accounts for almost 19% of its gross domestic product (GDP). Agriculture forms the backbone of rural India. Since economic reforms initiated in 1991, Government of India has taken many programs to magnetize FDI inflows, to improve the Indian economy. The lower level of income in India can be basically attributed to the prominence of agricultural sector as the means of livelihood. Moreover, the agricultural sector in India unlike developed nations exists at the subsistence level, engaging very large chunk of population. To raise the standard of living of the people and to enable them to use the fruits of scientific and technological, miraculous advances in agriculture, industry, transport, communication, education, health services and other fields, it is almost essential that, capital formation should take place at a higher rate than before, so that the big development projects may be financed properly so that income receives a good boost up. This paper endeavors to analyze the efforts and policies of Indian Government to attract FDI to the Agricultural and its impact on the same.

**Keywords:** Globalization, FDI, Economic Development, Agriculture.

**INTRODUCTION**

FDI has been shown to play an important role in promoting economic growth, raising a country's technological level, and creating new employment in developing countries. It has also been shown that FDI works as a means of integrating developing countries into the global market place and increasing the capital available for investment, thus leading to increased economic growth needed to reduce poverty and raise living standards. According to the World Bank's World Development Report, in 2000 over 1.1 billion people were subsisting on less than US\$1 a day and around 2.1 billion people on less than US\$2 a day of whom between two thirds to three-quarters live in rural areas of developing nations. Thus, if the war on poverty is to be won, developing countries need to place more emphasis on the agricultural sector (Mangisoni, 2006; IFAD, 2002).

Economic development remains an urgent global need and for rapid economic development, the central problem is capital formation not only in industrial sector, but also in the agricultural sector. FDI flows comprise capital provided by foreign investors, directly or indirectly to enterprises in another economy with an expectation of obtaining profits derived from the capital participation in the management of the enterprise in which they invest. The foreign investors acquire ownership of assets in the host country firms in proportion to their equity holdings. This is the empirical definition of FDI adopted by many countries to distinguish it from portfolio flows. According to International Monetary Fund (IMF), FDI is defined as "an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor" The investor's purpose is to have an effective voice in the management of the enterprise (IMF, 1977).

The effects of FDI in the host economy are usually believed to be increase in the employment, augment in the productivity, boost in export and amplified pace of transfer of technology. It facilitates the utilization and exploitation of local raw materials, introduces modern techniques of management and marketing, and eases the access to new technologies, foreign inflows can be used for financing current account deficits also. As noted by the World Bank (2002), several recent studies concluded that FDI can promote the economic development of the host country by promoting productivity growth and export. However, the exact relationship between foreign multinational corporations and their host countries varies considerably between countries and among industries. The characteristics of the host country and the policy environment are important determinants of net benefit of FDI.

**FDI IN INDIAN AGRICULTURE**

FDI in Indian Agricultural sector is no doubt a necessity, however, any increase in equity stake of the foreign investors in existing joint ventures or purchase of a share of equity by them in domestic firms would not automatically change the orientation of the firm. That is, "the aim of FDI investors would be to benefit from the profit earned in the Indian market. As a result, in such cases FDI inflows need not be accompanied

by any substantial increase in exports, whether such investment leads to modernization of domestic capacity or not". Therefore, it is a challenge for a developing country like India to channelize its capital inflow through FDI into a potential source of productivity gain for domestic firms especially into agriculture.

As result economic reforms and various initiatives of the government, India has received total FDI of US\$ 180,034million from the year 1990-91 to 2009-10. The FDI inflows have shown a rising trend owing to the sincere programs of structural liberalization and open marketer forms. The rise in flows of FDI till 1997 was not only the result of the liberalization policy but also due to the sharp expansion in the global scale of FDI outflows during the 1990s. Another causal factor may have been the recovery of the Latin American economies, which had begun to emerge from the 'Debt Crisis' of the 1980s. Then after during 1998-99 and 1999-00 there was decline in FDI inflow which was due to the decline in industrial growth rate in the economy and also due to the result of the 'East Asian Financial Crisis'. But again in the next year, foreign investment started to bounce back. During 2002-03 and 2003-04, again there was fall in flow of foreign direct investment which was due to the cast of Global Recession on the Indian economy. The FDI Equity inflows during the five years 2005-06 to 2009-10 showed a massive increase of more than seven times than those of the previous year's 1991-92 to 1999-00 and 2000-01 to 2004-05. This increase was due to the revised FDI Policy in March 2005.

### **NEED FOR THE STUDY**

In India, agriculture is an important sector of the Indian economy and accounts for almost 19% of Indian gross domestic products (GDP). Agriculture is the main stay of the Indian economy as it forms the backbone of rural India which engages more than 70% of total Indian population. The Ministry of Agriculture, the Ministry of Rural Infrastructure, and the Planning Commission of India are the main governing bodies that define the future role of agriculture in India and it aims at developing agricultural sector of India.

Agricultural sector of India is highly fragmented and unorganized. Given the various changes like virtual collapse of rural credit in organized sector, especially for small and marginal farmers, continuous increase of input cost and stagnant crop price, profit potential of agricultural sector has declined substantially. Farmers are still kept on tenterhook, not knowing how to manage their economy, except to play it by years (Gupta, 2005).

If production is good then there is glut and prices fall. When there is crop failure farmers hardly get any compensation in terms of higher price. For instance West Bengal is an eastern province of India and is the most densely populated among the provinces and paddy is the principal crop here involving millions of rural people for their livelihood. Profitability in paddy cultivation gradually came down to only 13% in 2007 and has further come down to 10% in 2011 as per the report of the commission

for Agricultural Costs and Prices (Choudhury S, 2011). This case is valid throughout the agricultural sector of India. Farmers toil hard just to earn their mere livelihood. Newspapers are rampant with the news of farmers' suicides across the nation. It is in the wake of this deplorable condition of Indian rural lot belonging to the vulnerable agricultural sector that present paper entitled "Role of FDI in the Growth of Indian Agricultural Sector in the Post Reform Period", assumes importance.

### **REVIEW OF LITERATURE**

There has been tremendous research work in the area of impact of FDI on the economy of developing nations of the world and especially their agricultural sector. Some of the relevant research works which highlight the viewpoint of the present paper are as under:

Bala subramanyam (1996) tested the hypothesis that exports promoting (EP) FDI in countries like India confer greater benefit than FDI in other sectors. They have used production function approach in which FDI is treated as an independent factor input in addition to domestic capital and labour. As FDI is a source of human capital accumulation and development of new technology for developing countries, FDI captures such externalities as learning by watching and/or doing and various spillover effects. Exports are also used as an additional factor.

Hsiao and Hsiao (2006) assert that exports increase FDI by paving the way for FDI by gathering information of the host country that helps to reduce investors' transaction costs. Also FDI may reduce exports by serving foreign markets through establishment of production facilities there.

Rais Ahmad (2009) in his edited book titled "WTO and Indian Agriculture" deals with the multi-faceted dimensions of Indian agriculture and our relationship with WTO and the impact of FDI through various bilateral agreements between India and other member nations of WTO. The positive and negative aspects of WTO regulations starting with the Uruguay round agreement and extending up to the present day have been brought up very clearly in his reputed work. It also dealt with great clarity, the various implications of farm exports and imports for the well-being of farmers as well as the Indian economy as a whole.

M. Sankara Reddi, M. Ramesh and M. Chandrayya (2009) in their work have highlighted that WTO is receiving the deepest indulgence of everyone, as it is affecting the major sectors of Indian economy and agriculture in particular. A major concern growing with the increasing impact of WTO is, as to how the small and marginal farmers who dominate the Indian agriculture, depend heavily on agriculture for their livelihood, have small marketable surplus and operate under heavy constraints to be competitive in a subsidized agricultural production and trade regime, could benefit from WTO. The concern more often swings to the other side that the spreading tentacle of WTO with reduced tariff regime and increased access to Indian

market for the products from subsidized agriculture could severely damage the agriculture based livelihood of majority of Indian farmers. The challenge to policy makers is how to protect Indian agriculture from the impending WTO threat, enhance the competitiveness of Indian farming and make farming a viable and self sustaining enterprise to improve and ensure livelihood security of the farmers. A strategy to address this challenge shall necessarily involve re-orientation and injection of market linked dynamism in Indian agricultural Research and Development(R&D), strengthening of supportive institutions to serve the resource poor farmers, and steering fast the change with appropriate policies and trained human ware.

P. Arunachalam (2009)in his paper asserts that why agriculture has attracted a lot of attention in WTO from politicians, bureaucrats, academicians, business persons, critics in India and abroad since past two decades? The simple reason according to him is, that this is the only organization at the world level where you could see a clear cut differences exist between developing countries and developed countries. He argues that the root cause of distortion of international trade in agriculture has been the massive domestic subsidies given by the industrialized countries to their agricultural sector over many years. This in turn led to excessive production and it's dumping in international markets as well as import restrictions to keep out developing countries' agricultural products from their domestic markets. Hence, the starting point for the establishment of a fair agricultural trade regime has to be the reduction of domestic production subsidies given by industrialized countries, reduction in the volume of subsidized exports and minimum market access opportunities for agricultural produces world-wide. He suggests that India has a uniquely important contribution to make at this point to restart the round. This is to show some further flexibility on agriculture but not to the extent of opening India's huge agricultural subsistence economy to global competition. But by moving where you can to allow other limited but real market access, including in some difficult commodity areas.

V.Balasubramanian discusses the negative and positive benefits of India as WTO member through his paper "WTO and Indian Agriculture Insight, Implications and imperatives". He notices some problems of Indian farmers. Firstly the governments of developed countries spend huge amounts on agricultural subsidies. This has resulted in the decline of prices of agricultural commodities in the world market. The policies of the Indian Government have compelled the farmers of the country to compete with cheaper foreign agricultural commodities when they have to spend more and more for ever increasing cost of agricultural inputs such as seeds, fertilizers, pesticides, electricity, etc. Increasing cost of inputs, decline in growth rates and lower prices of outputs have adversely affected the farmers and it has accelerated the indebtedness, desperation, destitution and starvation to a vast majority of rural people particularly the small and marginal farmers and tenant cultivators in India. He says two major factors are responsible for the present downfall of Indian agriculture. First, the government has substantially reduced the development expenditure in agriculture sector owing to its eagerness to reduce the fiscal deficit. Secondly, import liberalization has contributed in a big way for the reduction in prices of agricultural

products. Having failed to get remunerative prices for their products, many farmers have curtailed their farm operations which in turn have increased unemployment among the agricultural workers. Thus import liberalization is a major cause for the existing plight of poor farmers.

The literature review given above highlights the major issues related to the long-term and immediate effects of FDI on India and specifically its agriculture, being the member of WTO. They also highlight the need of Indian policy makers' initiatives to safeguard the interests of weaker sections of the not so developed Indian economy against the stiff competition from the better equipped and highly developed signatories of WTO. Moreover, Interests of countries like India are being subdued on the continuous basis to safeguard the interests of the powerful and highly privileged nations.

### **THE NORMS FOR THE FDI IN INDIAN AGRICULTURE SECTOR**

In India, agriculture is an important sector of the Indian economy and accounts for almost 19% of Indian gross domestic products (GDP). Agriculture is the main stay of the Indian economy as it forms the backbone of rural India which inhabitants more than 70% of total Indian population and supports their families which and thin. The Ministry of Agriculture, the Ministry of Rural Infrastructure, and the Planning Commission of India are the main governing bodies that define the future role of agriculture in India and it aims at developing agricultural sector of India. No FDI / NRI / OCB are allowed in the Indian Agriculture sector. Only in Tea sector 100% FDI is allowed, including plantations of tea. This requires Government of India approvals. Further, it requires compulsory divestment of 26% equity in favor of the Indian partner or Indian public within a maximum period of five years. This also requires approval from the concerned state government in case of change in use of land for such activities. And this holds true for any fresh investments in the above-mentioned sector.

The FDI Inflows to Agriculture Services are allowed up to 100% and allowed through the automatic route covering horticulture, floriculture, development of seeds, animal husbandry, pisciculture, aqua culture, cultivation of vegetables, mushroom and services related to agro and allied sectors. Only in Tea sector, 100% FDI is allowed, including, plantations of tea.

### **FDI in Indian agriculture sector and the latest developments are as follows:**

- 100% foreign direct investment (FDI) allowed through the automatic route covering horticulture, floriculture, development of seeds, animal husbandry, pisciculture, aqua culture, cultivation of vegetables, mushroom and services related to agro and allied sectors
- Farm credit target of 225,000 crore for 2007-08 was set with an addition of 50 lakh new farmers to the banking system

- 35 projects have been completed in 2006-07 and additional irrigation potential of 900,000 hectares to be created and training of farmers arranged.
- A pilot programme for delivering subsidy directly to farmers has been arranged.
- Loan facilitation through Agricultural Insurance and NABARD has also been facilitated.
- Corpus of Rural Infrastructure Development Fund to be raised.

#### **Sectors which Witnessed Growth Owing to FDI Inflows to Agriculture**

- Irrigation
- Roads
- Housing
- Water Supply
- Electrification
- Telecommunication Connectivity

#### **Impact of FDI Inflows to Agriculture Services on Rural Infrastructure**

- To connect 66,800 habitations with population over 1000 with all weather roads.
- To construct 1, 46,000Km of new rural roads.
- To upgrade and modernize 1, 94,000 Km of existing rural roads.
- Total investment of 1, 74,000 crore envisaged under "Bharat Nirman", investment on rural roads estimated to be at 48,000 crore.
- To provide corpus of 8000 crore to Rural Infrastructure Development Fund (RIDF).

#### **FDI Inflows to Fertilizers Industry in India**

Indian Government has allowed foreign direct investment in the fertilizers industry of the country. Foreign Direct Investment (FDI) in fertilizers in India is allowed up to 100% under the automatic route in India. The total amount of FDI Inflows to Fertilizers industry in India was US\$ 78.22 million between August 1991 and December 2005. The total percentage of FDI Inflows to Fertilizers industry in India stood at 0.26% out of the total foreign direct investment in the country during August 1991 to December 2010.

The various advantages that has emerged as the result of the FDI Inflows to Fertilizers industry in India are –

1. Growth and expansion of fertilizer industry in India.
2. Use of improved technology in the fertilizer industry.
3. Quality of fertilizers has improved significantly.

#### **FDI in the Indian Agricultural Machinery Sector**

The FDI inflow and the subsequent development of the Indian agricultural sector is predicted to have a significant positive impact on the 700-million strong rural population, living in about 600,000 small villages of India. The total quantum of foreign direct investment in the Indian agricultural machinery was above US \$ 185.50 million during the period from August 1991 to December 2010. FDI inflows into

agricultural machinery of India have resulted in the steady rise of the Indian agriculture industry in recent years. The Indian agriculture sector enjoys 100% FDI through the automatic route.

Important factors in FDI Inflows to Agricultural Machinery and various aspects of the agrarian sector and rural sector in India that have a positive impact besides the above mentioned criteria on FDI Inflows to Agricultural Machinery are as follows:

1. Loan facilitation through Agricultural Insurance Institutions and NABARD has been extended.
2. Corpus of Rural Infrastructure Development Fund to be raised.
3. 66,800 habitations with population over 1000 are to be connected with all weather roads.

Indian economy has been heavily geared towards the service sector that contributes 56% of our GDP. The service sector's contribution to the increase in GDP over the last 5 years has been 63.9%. Having high contribution from services is an attribute that is characteristic of developed economies. In China, manufacturing accounts for a significant share of GDP, whereas in India, manufacturing contributes a mere 23.1% of the GDP. If India has to grow at 8 to 10% economic growth rate our agricultural sector has to expand. For that to happen there is a need for reforms in our agricultural sector. The Department of Industrial Policy and Promotion (DIPP) has issued a circular. According to the circular by DIPP animal husbandry pisci culture, aquaculture under controlled conditions and services related to agro and allied sectors have also been provided with 100 per cent FDI along with the tea sector. The new rules have been implemented from April 1, 2011.

DIPP has imposed certain conditions for companies dealing with growth of transgenic seeds and vegetables. While dealing with genetically modified seeds or planting material the company is expected to comply with safety requirements in accordance with laws enacted under the Environment (Protection) Act on the genetically modified organisms, any import of genetically modified materials, if required, shall be subject to the conditions laid down vide Notifications issued under Foreign Trade (Development and Regulation) Act, 1992. Further undertaking of business activities involving the use of genetically engineered cells and material shall be subject to the approvals from Genetic Engineering Approval Committee (GEAC) and Review Committee on Genetic Manipulation (RCGM). The circular also states the term "under controlled conditions". As per the defined term, the "under controlled conditions" for the categories of floriculture, horticulture, cultivation of vegetables and mushrooms is the practice of cultivation wherein rainfall, temperature, solar radiation, air humidity and culture medium are controlled artificially. Control in these parameters may be affected through protected cultivation under green houses, net houses, poly houses or any other improved infrastructure facilities where microclimatic conditions are regulated anthropogenically.



In addition in case of animal husbandry, the term under controlled conditions includes, rearing of animals under intensive farming systems with stall-feeding. Intensive farming system will require climate systems (ventilation, temperature/humidity management), health care and nutrition, herd registering/pedigree recording, use of machinery, waste management systems. Poultry breeding farms and hatcheries where microclimate is controlled through advanced technologies like incubators, ventilation systems etc. In the case of pisci culture and aquaculture, it includes aquariums hatcheries where eggs are artificially fertilized and they are hatched and incubated in an enclosed environment with artificial climate control. In addition to these provisions various other measures has been made to ensure steady development of agricultural sector in a streamlined manner.

## **CONCLUSION**

Limited development and lesser adoption of new production technologies essential for improving productivity by the poor in India are mostly low due to limited income and sources of credit. FDI plays a significant role in increasing productivity by offsetting the investment and technological gap. In recent years, India is losing its attraction as FDI destination. From a position of 8th rank in 2009 India has fallen to 14th position as country attracting largest FDI, according to “World Investment Report 2011” by United Nations Conference on Trade and Development (UNCTAD). Developing countries like China, Hong Kong, Singapore, Thailand, Taiwan, Malaysia etc. are attracting a higher FDI inflow than India. A number of studies and reports highlight the weakness of India as a falling FDI destination. In the latest study from World Bank “Ease of Doing Business in India 2011” India is ranked as 134 out of 183 countries. Thus Indian policy makers should revamp their efforts to attract FDI in agricultural sector. Moreover, it should be done with a caution so that Indian farmers who are operating at the subsistence level do not suffer on account of this initiative of the government.

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