"FDI and its Impact on Indian Economy"

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Abstract

FDI is a form of long term international capital movement, made for the purpose of productive activity and accompanied by the intention of managerial control or participation in the management of foreign firm. The role of FDI in the up-gradation of technology, skills and managerial capabilities is well accepted additional investment over and above investment possible with the available domestic resources helps in providing much needed employment opportunities.

Foreign Direct investment in India is a crucial factor for the economic growth. The pre economic liberalization period was challenge for the Indian economy to grow because there were many constraints to overcome. The draconian act like FERA causes many companies to withdraw from the India market. Even for the giants like Coca Cola were not able to survive in the market, as the economy was isolated. But the post liberalization period was very fruitful for the India economy to head with a swift pace. Now India is moving along very nicely with around 9% GDP rate. In this research paper the trend of FDI equity inflow has been analyzed and the future trend has been depicted.

Keywords: FDI, GDP, Territorial Marketing, Tariff, M&A, Foreign Affiliate.

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. Foreign investment plays a significant role in development of any economy as like India. Need of FDI depends on saving and investment rate in any country. Foreign Direct investment acts as a bridge to fulfill the gap between investment and saving.

Foreign direct investment (FDI) has two forms: outward FDIs and inward FDIs inflows. Infact, 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. Further, the integration of global financial markets paves ways to this explosive growth of FDI around the globe.

Key factors attracting FDI

Inflow of Foreign Direct Investments increases with the **attractiveness** of the country, due to the following factors in different proportions depending on the industry and the country:

- Large GDP and market potential;
- Advanced know-how;
- Skilled work-force;
- Low labor cost and wages;
- Low taxation;
- Lower environmental protection;
- High tariff protection;
- Favorable laws and public incentives;

History of FDI in India

FDI was introduced in 1991 under Foreign Exchange Management Act (FEMA) RBI has issued

Notification No. FEMA 20/2000-RB dated 3rd May 2000, driven by Finance Minister Mr. Manmohan Singh.

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. 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.

Infact, in the early nineties, Indian economy faced severe Balance of payment crisis. Exports began to experience serious difficulties. The continued political uncertainty in the country during this period adds further to worsen the situation. As a result, India's credit rating fell in the international market for both short- term and long term borrowing. In this critical face of Indian economy the then finance Minister of India Dr. Manmohan Singh with the help of World Bank and IMF introduced the macro – economic stabilization and structural adjustment programm. As a result of these reforms India open its door to FDI inflows and adopted a more liberal foreign policy in order to restore the confidence of foreign investors. Further, under the new foreign investment policy Government of India constituted FIPB (Foreign Investment Promotion Board) whose main function was to invite and facilitate foreign investment through single window system from the Prime Minister's Office.

Literature Review

Singer, 1950; Griffin, 1970; Weisskof, 1972, the main argument of these studies was that FDI flows to Less Developing Countries (LDCs) were mainly directed towards the primary sector, which basically promoted the less market value of this sector. Since these primary products are exported to the developed countries and are processed for import, it receives a lower price for its primary product. This could create a base for the negative impact of FDI flows in the economy. **Rodan (1961), Chenery and Strout (1966),** in the early 1960s argued that foreign capital inflows have a favorable effect on the economic efficiency and growth towards the developing countries. It has been explained that FDI could have a favorable short-term effect on growth as it expands the economic activity.

Caves, 1974; Kokko, 1994; Markusen, 1995; Carves, 1996; Sahoo, Mathiyazhagan and Parida 2001, Foreign Direct Investment (FDI) inflow into the core sectors is assumed to play a vital role as a source of capital, management, and technology in countries of transition economies. It implies that FDI can have positive effects on a host economy's development effort.

Barro and Martin, 1999; Helpman and Grossman, 1991, The studies that used the endogenous growth theory challenged this view in explaining the long run growth rate of the economy by using endogenous variables like technology and human capital.

Bhagwati, 1994, The local enterprises are able to learn by watching FDI initiative, if the economic framework is appropriate.

Feenstra and Markusen, 1994, FDI is an important vehicle for the transfer of technology and knowledge and it demonstrates that it can have a long run effect on growth by generating increasing return in production via positive externalities and productive spillovers. Thus, FDI can lead to a higher growth by incorporating new inputs and techniques.

Alam (2000) in his comparative study of FDI and economic growth for Indian and Bangladesh economy stressed that though the impact of FDI on growth is more in case of Indian economy yet it is not satisfactory.

Kumar and Pardhan, 2001, Foreign Direct Investment (FDI) has emerged as the most important source of external financial resource for developing countries and has become a significant part of economy in the developing.

Hanson (2001) argues that evidence that FDI generates positive spillovers for host countries is weak. 6

Lipsey (2002), Takes a more favorable view from reviewing the micro literature which argues that there is evidence of positive effect. He also argues that there is need for more consideration of the different circumstances that obstruct or promote positive spillovers.

Basu (2002), tried to find the short run dynamics of FDI and growth. The study reveals that GDP in India is not Granger caused by FDI; the causality runs more from GDP to FDI and the trade liberalization policy of the Indian government had some positive short run impact on the FDI flow.

Calvo and Robles, 2003, FDI increases the stock of human capital, it stimulates the investment in R&D. foreign inflows could be used for financing current account deficits, finance flows in form of FDI do not generate repayment of principal and interests (as opposed to external debt).

Sahoo and Mathiyazhagan, 2003, There were also few evidences demonstrate that there is a long-run relationship between Gross Domestic Product, FDI and export in India **Arshad, 2008,** The role of the foreign direct investment (FDI) has been widely recognized as a economic growth-enhancing factor in the developing countries. The effects of FDI in the host economy are normally believed to be increase in the employment, increase in productivity, and increase in exports and, of course, increased pace of transfer of technology.

WDI indicators 2008, The amount of foreign direct investment increased significantly for developing economies during 1985 to 2000. The share of developing countries in world FDI inflows and outflows has risen from 17.4% in 1985-90 to 26.1% during 1995-2000. For India the amount of FDI inflows increased from $ 0.24 billion in 1990 to $ 55 billion in 2007. Economist Intelligence Unit 2009, global survey of 548 companies provided evidence of a link between investing in emerging markets and corporate financial success. Among surveyed companies from developed countries that derive less than 5% of their revenue from activities in emerging markets, only 24% reported their financial performance as being better than that of their peers. By contrast, for developed country companies that derived more than 5% of their revenue from emerging markets, the share reporting better performance than their peers was just under 40%.

Research methodology

For achieving the purpose of the study, data has been collected from the secondary sources over a period of 2000-2015. The data is collected mainly from several websites, annual reports, World Bank reports, research reports, fact sheet on foreign direct investment, press notes of government of India, FDI database etc. Statistical tool percentage is used to analyze the data.

Objectives

We are presenting the objectives of this study which are here-in-under:

1. To know the trend of FDI inflows in India.

2. To Study the pattern of FDI inflows in different sectors of India.

3. To study the Impact of FDI on Indian economy.

4. To study the challenges and improvement areas.

Analysis and interpretation

To achieve the objectives of this study we make an analysis on the basis of collected data. The results on the basis of secondary data are following as under:

Table 1. FDI Inflows in India (Amount US$ in Millions)

Financial year (April- March)	Total FDI inflow	Percentage growth over previous year
2000-2001	4029	-------
2001-2002	6130	+52
2002-2003	5035	-18
2003-2004	4322	14
2004-2005	6051	+40
2005-2006	8961	+48
2006-2007	22826	+146
2007-2008	34843	+53
2008-2009	41873	+20
2009-2010	37745	-10
2010-2011	34847	-08
2011-2012	46556	+34
2012-2013	34298	-26
2013-2014	36,046	+5
2014-2015	44291	+23
2015-16 (P) (Apr - June 2015)	12362	
CUMULATIVE TOTAL (from April, 2000 to June, 2015)	**380,215**	**-------**

Table 1 presents the inflows of FDI for the period of 2000-2013. The results show that there is large fluctuation in the pattern of FDI inflows. In the year of 2001-2002, there is a positive increase in the value of FDI inflows due to various reasons such as heavy demand of Indian consumers, liberalized government policy, communications facilities but after this period the value of FDI is decreased. The value of FDI is increased from the period of 2004 to 2008 but after this value of FDI is decreased due to decline in the money value of rupees.

Table 2. Sectors Attracting Highest FDI Equity Inflows (Amount in Rs. Crores)

S.No.	Sector	Amount of FDI (In crores)	%Age Of Total Inflows
1.	Services Sector	205,532.20	17.19
2.	Construction Development: Townships, Housing, Built-Up Infrastructure And Construction-Development Projects	113,139.4	9.68
3.	Telecommunications.	84,091.83	6.86
4.	Computer Software & Hardware	73,234.77	6.04
5.	Drugs & Pharmaceuticals	65,281.56	5.28
6.	Automobile Industry	63,990.57	4.98
7.	Chemicals (Other Than Fertilizers)	49,310.42	4.16
8.	Power	46,640.34	3.85
9.	Miscellaneous Industries	44,060.46	3.72
10.	Metallurgical Industries	41,146.85	3.44

Conclusion

India's Foreign Direct Investment (FDI) policy has been gradually liberalised to make the market more investor friendly. The results have been encouraging. These days, the country is consistently ranked among the top three global investment destinations by all international bodies, including the World Bank, according to a United Nations (UN) report. For Indian economy which has tremendous potential, FDI has had a positive impact. FDI inflow supplements domestic capital, as well as technology and skills of existing companies. It also helps to establish new companies. All of these contribute to economic growth of the Indian Economy.

Current Challenges and Improvement Areas

India is definitely a lucrative place for FDI, but there are certainly some challenges and areas for improvement still present. Until, these areas are honed to perfection, India will not become the number one place for FDI. India is focusing on maximizing political and social stability along with a regulatory environment. In spite of the obvious advantages of FDIs, there are quite a few challenges facing larger FDIs in India, such as:

• Resource challenge: India is known to have huge amounts of resources. There is manpower and significant availability of fixed and working capital. At the same time, there are some underexploited or unexploited resources. The Foreign Direct Investment: Impact on Indian

Economy 23 resources are well available in the rural as well as the urban areas. The focus is to increase infrastructure 10 years down the line, for which the requirement will be an amount of about US$ 150 billion. This is the first step to overcome challenges facing larger FDI.

• Equity challenge: India is definitely developing in a much faster pace now than before but in spite of that it can be identified that developments have taken place unevenly. This means that while the more urban areas have been tapped, the poorer sections are inadequately exploited. To get the complete picture of growth, it is essential to make sure that the rural section has more or less the same amount of development as the urbanized ones. Thus, fostering social equality and at the same time, a balanced economic growth.

• Political Challenge: The support of the political structure has to be there towards the investing countries abroad. This can be worked out when foreign investors put forward their persuasion for increasing FDI capital in various sectors like banking, and insurance. So, there has to be a common ground between the Parliament and the Foreign countries investing in India. This would increase the reforms in the FDI area of the country.

• Federal Challenge: Very important among the major challenges facing larger FDI, is the need to speed up the implementation of policies, rules, and regulations. The vital part is to keep the implementation of policies in all the states of India at par. Thus, asking for equal speed in policy implementation among the states in India is important.

• India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing larger FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.

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