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Impact of Foreign Direct Investment on Indian Economy

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Abstract

With the initiation of globalization, developing countries, particularly those in Asia, have been witnessing a immense surge of FDI inflows during the past two decades. Even though India has been a latecomer to the FDI scene compared to other East Asian countries, its considerable market potential and a liberalized policy regime has sustained its attraction as a favorable destination for foreign investors. This research paper aims to examine the impact of FDI on the Indian economy, particularly after two decades of economic reforms, and analyzes the challenges to position itself favorably in the global competition for FDI. The paper provides the major policy implications from this analysis, besides drawing attention on the complexities in interpreting FDI data in India.

Key Words: minimum 5 words

Introduction

When a firm controls (or have a strong say in) another firm located abroad, e.g. by owing more than 10% of its equity, the former is said "parent enterprise" (or "investor") and the latter "foreign affiliate". For a country, attracting an inflow of FDI strengthen the connection to world trade networks and finance its development path. However, unilateral substantial FDI to a country can make it dependent on the external pressure that foreign owners might exert on it. Foreign investment plays a significant role in development of Indian economy. Many countries provide many incentives for attracting the foreign direct investment (FDI). 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. In the process of economic development foreign capital helps to cover the domestic saving constraint and provide access to the superior technology that promotes efficiency and productivity of the existing production capacity and generate new production opportunity.

Foreign direct investment in India: FDI and Economic Growth

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. 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. 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. Therefore, the government adopted a liberal attitude by allowing more frequent equity.

In the critical face of Indian economy the government of India with the help of World Bank and IMF introduced the macro-economic stabilization and structural adjustment program. 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

Starting from a baseline of less than USD 1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010-2012. As per the data, the sectors which attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, the US and the UK were among the leading sources of FDI to the country.

According to GYANPRATHA – ACCMAN (Journal of Management, Volume 5 Issue 1, 2013) FDI for 2009-10 at US$ 25.88 billion was lower by five per cent from US$ 27.33 billion in the previous fiscal. Foreign direct investment in August dipped by about 60 per cent to approx. US$ 34 billion, the lowest in 2010 fiscal, industry department data released showed. In the first two months of 2010-11 fiscal. FDI inflow into India was at an all-time high of $ 7.78 billion up 77%from $4.4 billion during the corresponding period in the previous year.

In 2013, the government relaxed FDI norms in several sectors, including telecom, defence, PSU oil refineries, power exchanges and stock exchanges, among others. In retail, UK-based Tesco submitted its application to initially invest US$ 110 million to start a supermarket chain in collaboration with Tata Group's Trent. In civil aviation, Malaysia-based Air Asia and Singapore Airlines teamed up with Tata Group to launch two new airline services. Also, Abu Dhabi-based Etihad picked up a 24 per cent stake in Jet Airways that was worth over Rs 2, 000 crore (US$ 319.39 million). India has received total foreign investment of US$ 306.88 billion since 2000 with 94 per cent of the amount coming during the last nine years.

In the period 1999–2004, India received US$ 19.52 billion of foreign investment. In the period 2004–09, foreign investment in the country touched US$ 114.55 billion, further increasing to US$ 172.82 billion between 2009–September, 2013.

During FY 2012–13, India attracted FDI worth US$ 22.42 billion. Tourism, pharmaceuticals, services, chemicals and construction were among the biggest beneficiaries.

The January–November period in 2013 witnessed mergers and acquisitions deals worth US $ 26.76 billion in India, according to a survey by tax advisory firm Grant Thornton.

Objectives

The research paper covers the following objectives:

1. To study the trends and pattern of flow of FDI.
2. To assess the determinants of FDI inflows.
3. To evaluate the impact of FDI on the Indian economy.
4. To know the flow of investment in India

Recent Developments

New Zealand is looking to establish an office in Mumbai to broaden its education footprint in India. It plans to set up an education promotion and market development role within the New Zealand Consulate General, Mumbai. There was an increase of more than 10 per cent in student visas issued to Indian nationals in 2013, making India among the fastest growing student markets for New Zealand.

Korean South-East Power Company (KOSEP), part of South Korean state-owned power generator Korea Electric Power Corporation, has signed an initial agreement with Jinbhuvish Group, Mumbai, for technical support for its Rs 3, 450-crore (US$ 549.31 million) project in Maharashtra. The 600 megawatt (mw) power plant, which will be set up in Yavatmal district, is expected to be commissioned in 2016.

India and UAE have agreed to promote collaboration in renewable energy, focusing in the areas of wind power and solar energy. A Memorandum of Understanding (MoU) was signed by Dr Farooq Abdullah, Minister of New and Renewable Energy of India and Dr Sultan Ahmed Al Jaber, Minister of State of UAE in Abu Dhabi on January 18, 2014.

Luxury watch brand Jaeger-Le Coultre from Switzerland has filed for a 100 per cent single brand application to enter the Indian retail market. It thus became the first

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luxury company to apply for FDI through this route. Geneva-based Richemont SA that owns the luxury brand filed the application with the Department of Industrial Policy and Promotion (DIPP).

France's Lactalis, the biggest dairy products group in the world, will most likely buy out Hyderabad-based Tirumala Milk Products for US $275–300 million. Lactalis has a yearly turnover of about US $21 billion. Tirumala had a turnover of Rs 1, 424 crore (US$ 226.71 million) for FY 2012–13. The Hyderabad-based company, which was founded in 1998, makes dairy products such as sweets, flavoured milk, curd, ice-cream, etc.

Recent policy initiatives

The Ministry of Home Affairs has finally given the approval to the proposal of allowing FDI in railways. The Cabinet Committee on Economic Affairs (CCEA) is expected to consider the proposal. Foreign investors can invest only in construction and maintenance of railway projects, and not in operations.

India's Prime Minister Mr Manmohan Singh has sought increased Japanese investment in the country. The two countries are already looking at the possibility of concrete cooperation in areas such as manufacturing and research and development in the electronic industry and energy efficient and energy saving technologies. "I believe there is enormous untapped potential in our business ties, " Mr Singh said following the annual summit level meeting between Japan and India. The presence of Japanese companies in India increased by 16 per cent in 2013.

The Andhra Pradesh State Investment Promotion Board has given the approval to six major investment proposals that will have a total investment of Rs 6, 500 crore (US$ 1.03 billion). The proposals include those by multinational companies such as PepsiCo, Cadbury, Colgate, Johnson & Johnson, Gerdau Steels and ITC. PepsiCo's unit will be the largest beverages plant in India with an investment of Rs 1, 200 crore (US$ 191.06 million). Similarly, Cadbury is establishing its facility in Sri City with an investment of Rs 2, 500 crore (US$ 398.07 million).

In an effort to improve capital flows into the country, the Indian government has allowed 100 per cent FDI under automatic route in storage and warehousing, which includes warehousing of agriculture products with refrigeration. The government has also set up National Centre for Cold Chain Development (NCCD) which will look at standards and protocols for cold chain infrastructure.

Based on the recommendations of Foreign Investment Promotion Board (FIPB) made on December 30, 2013, the Indian government has agreed to five FDI proposals amounting to Rs 1133.41 crore (US$ 180.16 million) approximately. On November 13, 2013, it had approved 12 proposals of FDI amounting to Rs 821.63

crore (US$ 130.73 million) approximately. The FIPB has also approved Swedish clothing major Hennes & Mauritz (H&M) AB's proposal to open 50 stores across India. The investment will be around Rs 720 crore (US$ 114.61 million).

Evaluation of FDI and GDP in India during (1991-92 to 2011-2012)
The following table depicts the picture of FDI inflow and its impact on GDP.

FDI inflow, GDP and FDI/GDP ratio in India (1991-92 to 2011-2012) Years	FDI Inflow (in rupees crore)	Growth rate of FDI inflow (%)	GDP	Growth rate of GDP (%)	FDI as a percentage of GDP
1991-92	409	-	1099072	-	0.037213
1992-93	1094	167.4817	1158025	5.363889	0.094471
1993-94	2018	84.46069	1223816	5.681311	0.164894
1994-95	4312	113.6769	1302076	6.394752	0.331163
1995-96	6916	60.38961	1396974	7.288207	0.49507
1996-97	9654	39.58936	1508378	7.974665	0.640025
1997-98	13548	40.33561	1573263	4.301641	0.86114
1998-99	12343	-8.8943	1678410	6.683371	0.735398
1999-00	10311	-16.4628	1786525	6.441513	0.577154
2000-01	12645	22.63602	1864301	4.35348	0.67827
2001-02	19361	53.1119	1972606	5.809416	0.981494
2002-03	14932	-22.8759	2048286	3.836549	0.729
2003-04	12117	-18.8521	2222758	8.517951	0.545134
2004-05	17138	41.43765	2388768	7.468649	0.717441
2005-06	24613	43.61652	3254216	36.22989	0.756342

2006-07	70630	186.9622	3566011	9.581263	1.980644
2007-08	98664	39.69135	3898958	9.336679	2.530522
2008-09	122919	24.58343	4162509	6.759524	2.953003
2009-10	123378	0.373417	4493743	7.957556	2.745551
2010-11		88502		-28.2676	
2011-12		173947		96.5458	
Total		577002		42598695	

The above table shows the FDI inflow and GDP in India from the year 1991-92 to 2011-2012(post-liberalization period). The table states that India had showed a large amount of FDI inflow. It showed that FDI inflow has been increased by more than 210 times during the study period because the FDI Inflow has been increased from Rs. 409 crore in 1991-92 to Rs. 173947 crore in 20011-2012. Due to technological up gradation, access to global managerial skills and practices, optimal utilization of human and natural resources, making Indian industry internationally competitive, opening up export markets, providing backward forward linkages and access to international quality goods and services the Indian Government has used many steps to attract more FDI. The highest amount of FDI was received in the year 2011-2012, amounting to Rs. 173947crore. The highest growth rate of FDI inflow is in the year 2006-07 i.e., 186.9622 percent. The table also shows that FDI as a percentage of GDP was less than one until 2005-06 after then it is increasing year after year.

Future Outlook

India is estimated to require around US $ 1 trillion during the 12th Five-Year Plan period (2012–17), to fund infrastructure in sectors such as roads, airports and ports. The government is in the process of liberalizing FDI norms in construction activities and railways, which could bring in investments to meet the target.

The government is also relaxing FDI norms in other sectors for foreign investors to invest. FDI in multi-brand retail has been allowed up to 51 per cent. The minimum requirement for the FDI is US$ 100 million, of which at least 50 per cent must be invested in 'backend infrastructure' within three years following the initiation of the FDI. FDI limit in single-brand retail has been increased to 100 per cent; 49 per cent will be under the automatic route and the rest through the FIPB route.

A Brief Review of The Literature:

Agarwal and Khan conducted the study on "Impact of FDI on GDP: A Comparative Study of China and India", the study found that 1% increase in FDI would result in 0.07%increase in GDP of China and 0.02% increase in GDP of India. We also found that China's growth is more affected by FDI, than India's growth [1].

Kumar and Karthika found out in their study on "Sectoral Performance through Inflows of Foreign Direct Investment (FDI)", that Foreign Direct Investment has a major role to play in the economic development of the host country. Most of the countries have been making use of foreign investment and foreign technology to accelerate the place of their economic growth. FDI ensures a huge amount of domestic capital, production level and employment opportunities in the developing countries, which a major step towards the economic growth of the country [2].

Balasubramanyam and Sapsford stated in their article "Does India need a lot more FDI" compared the levels of FDI inflows in India and China, and found that FDI in India is one tenth of that of china. The paper also concluded that India may not require increased FDI because of the structure and composition of India's manufacturing, service sectors and her endowments of human capital and the country is in a position to unbundle the FDI package effectively and rely on sources other than FDI for its capital requirements [6].

Bajpai and Jeffrey stated attempted the paper on "Foreign Direct Investment in India: Issues and Problems", to identify the issues and problems associated with India's current FDI regimes, and also the other associated factors responsible for India's unattractiveness as an investment location. Despite India offering a large domestic market, rule of law, low labour costs, and a well working democracy, her performance in attracting FDI flows have been far from satisfactory. The conclusion of the study is that a restricted FDI regime, high import tariffs, exit barriers for firms, stringent labor laws, poor quality infrastructure, centralized decision making processes, and a verylimited scale of export processing zones make India an unattractive investment location [7].

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 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.

1. **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.

2. **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.

3. **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.

4. 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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