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An Evaluation of Foreign Direct Investment: Impact 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.

KEYWORDS : FDI, Foreign direct Investment in India, FDI impact on Indian Economy, Flow of investment in India through FDI, GDP rate, etc.

Introduction

The Indian economy is the third largest in the world as measured by Purchasing Power Parity, with a gross domestic product of US $3.611 trillion. When measured in USD exchange-rate terms, it is the 10th largest in the world, with a GDP of US $800.8 billion (2006). India is the second fastest growing major economy in the world, with a GDP growth rate of 8.9% at the end of the first quarter of 2006-2007. However, India's huge population results in a per capita income of $3,300 at PPP and $714 at nominal.

The Indian economy is diverse and encompasses agriculture, handicrafts, manufacturing, textile, and a multitude of services. Although two-thirds of the Indian workforce still earns their livelihood directly or indirectly through agriculture, service sector is a growing one and are play an increasingly important role of India's economy. The advent of the digital age, and the large number of young and educated populace fluent in English, is gradually transforming India as an important 'back office' destination for global (multinational) companies for the outsourcing of their customer services and technical support. India is a major exporter of highly talented workforce in software and financial services, and software engineering.

India adopted a socialist-inspired approach for most of its independent history, with strict government control over private sector participation, foreign trade, and foreign direct investment. However, since the early nineties, India has gradually opened up its markets through economic reforms by reducing government controls on foreign investment. The privatization of publicly owned industries and the opening up of some sectors to private and foreign investors has proceeded slowly amid political debate.

FDI up to 100% is allowed under the automatic route in all activities/sectors except the sectors, which will require approval of the Government. The question that begs for an elaboration is that is high growth and inflows of FDI solve structural imbalance of Indian economy and will it succeed in improving the lot of bottom section of the Indian economy, which are living in abysmally poor socio-economic conditions in the countryside. The employment elasticity in the agriculture and industrial sector has gone down in the post-reform period, therefore, the creation of employment opportunities will be a gigantic task for the policy makers. FDI has come in the most capital-intensive sectors; therefore, the required employment opportunities could not be created especially for the manual and the semi skilled labor. High skilled workforce gained substantially. That is why high growth is called urban centric and thus has developed a wedge between the urban and rural economy. There is urgent need to fill this void. The process of Policymaking has matured in the democratic Indian polity since the independence. It is thus predicted that the growing problems will receive mature response and policy will be articulated in such a way to use FDI the way China has used to enhance economic growth while taking more and more investment to industrialize the rural sector of the Indian economy.

Objectives

The research paper covers the following objectives:

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

Foreign Direct Investment in India

India's recently liberalized FDI policy permits up to a 100% FDI stake in ventures. Industrial policy reforms have substantially reduced industrial licensing requirements, removed restrictions on expansion and facilitated easy access to foreign technology and FDI. The upward moving growth curve of the real-estate sector owes some credit to a booming economy and liberalized FDI regime. A number of changes were approved on the FDI policy to remove the cap in most of the sectors. Restrictions will be relaxed in sectors as diverse as civil aviation, construction development, industrial parks, commodity exchanges, petroleum and natural gas, credit-information services, mining and so on. But this still leaves an unfinished agenda of permitting greater foreign investment in politically sensitive areas like insurance and retailing. According to the government's Secretariat for Industrial Assistance, FDI inflows into India reached a record US$19.5bn in fiscal year 2006/07 (April-March). This was more than double the total of US$7.8bn in the previous fiscal year. Between April and September 2007, FDI inflows were US$8.2bn.

There is no doubt about the fact that there has been a worldwide stir about foreign direct investment in India. India's growth rate of 8% certainly owes a lot to foreign equity capital and foreign direct investment. Here are the highlights of the latest trend figures concerned with FDI in India:
* Increase in total FDI: 46.8%

* Rise in foreign equity: 36%

* Reinvested foreign earnings and other capital: $3.2 billion
* Total FDI earnings (inward) in Apr-Jan 2005-06: $5.7 billion
* Total FDI earnings (outward) increase: 2000-01: $757 million 2004-05: $2.4 billion

In the backdrop of this flourishing Indian economy The Associated Chambers of Commerce and Industry of India (ASSOCHAM) has projected India to double its GDP reaching a phenomenal USD 1100 billion from present USD 550 billion by 2010. Why do you think so? Well statistics also say that an average Indian will be growing richer as per capita income rises from USD 600 per annum to USD 1200 per annum by 2010.

Indian Government has a key role to play as far as investment laws are concerned. In this regard it is noteworthy to highlight some of the positive reforms that have brought a positive growth in the Indian economy in terms of GDP growth.

1. Govt. has removed 10% voting limit in banks.
2. Higher ceiling in FDI in airport revamp ventures and real estate investment.
3. Revisit foreign shareholding norms in telecom is welcome change.
4. Removal of unwarranted restrictions on hindrances to foreign investments has exceptionally increased FDI in India.
5. Govt. of India has already allowed FDI up to 51% with prior government approval in the retail trade of "single brand" products.

Merits/Demerits of Foreign Direct Investment
Merits of FDI in India
Attracting foreign direct investment has become an integral part of the economic development strategies for India. FDI ensures a huge amount of domestic capital, production level, and employment opportunities in the developing countries, which is a major step towards the economic growth of the country. The effects of FDI are by and large transformative. The incorporation of a range of well-composed and relevant policies will boost up the profit ratio from Foreign Direct Investment higher. Some of the biggest advantages of FDI enjoyed by India have been listed as under: Economic growth- This is one of the major sectors, which is enormously benefited from foreign direct investment. A remarkable inflow of FDI in various industrial units in India has boosted the economy of country.

Demerits of FDI in India
FDI has been a booming factor that has bolstered the economic life of India, but on the other hand it is also being blamed for ousting domestic inflows. FDI is also claimed to have lowered few regulatory standards in terms of investment patterns: The disadvantages of foreign direct investment occur mostly in case of matters related to operation, distribution of the profits made on the investment and the personnel. One of the most indirect disadvantages of foreign direct investment is that the economically backward section of the host country is always inconvenienced when the stream of foreign direct investment is negatively affected.

The FDI Boom in India
* India is now the third most favored destination for Foreign Direct Investment (FDI), behind China and the USA, according to an AT Kearney survey that tracked investor confidence among global executives to decide their order of preferences.
* India's share of global FDI flows rose from 1.8 per cent in 1996 to 2.2 percent in 1997.
* FDI in India in 1997-98 was lower at U.S.$ 5,025 million compared to U.S.$ 6,008 million in 1996-97 because of a decline in portfolio investment. Although foreign direct investment (FDI) increased by 18.6 per cent from U.S.$ 2,696 million in 1996-97 to U.S.$ 3,197 million in 1997- 1998.
* International developments continue to attract capital flows into India in 1998-99 as well.
* Mauritius, as in the previous two years, was the dominant source of FDI inflows in 1997- 98. U.S.A. and S. Korea were, respectively, the second and third largest sources of FDI.
* S. Korea increased its flow of investment in India from a meager U.S.$ 6.3 million in 1996-97 (0.2 per cent of total FDI) to U.S.$ 333.1 million in 1997-98 (10.4 per cent share).
* There has been a sharp rise in the number of FDIs approved in 2004.
* During the first seven months of 2004, between January and July, Rs. 5,220 crore worth of FDI was approved.
* Almost a third share of the investment in India is by NRI.
* According to the latest Reserve Bank of India figures, outflows through various NRI deposits schemes amounted to $903 million since May 2004, as against net inflows of $1.2 billion in the corresponding period last year.

Figure. 1

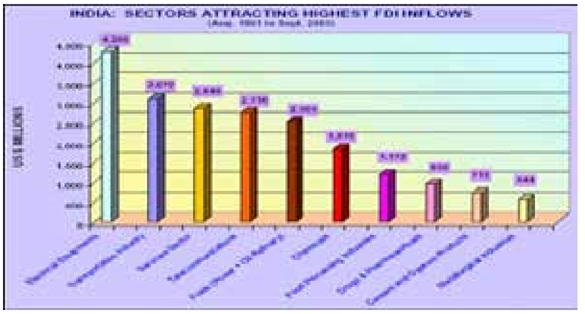
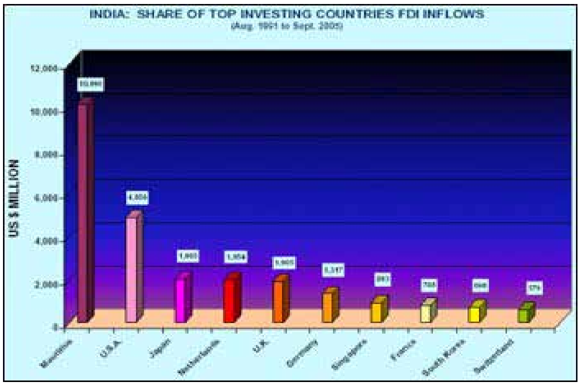


Figure 2



Basis of Comparison	China	India
Total population	1272 billion	1033 billion
Savings rate	50 per cent	26 per cent
Labour force	757 billion	451 billion
Annual GDP	US $ 1159 billion	478 US $ billion
Share of agriculture in GDP	15 per cent	27 per cent
Share of industry in GDP	52 per cent	27 per cent
Share of service sector in GDP	33 per cent	48 per cent
Rail routes	56.7 thousand sq kms	62.5 thousand sq kms
Motor vehicles per 1000 people	8	7
R& D expenditure	0.1 % of GNP	0.6 % of GNP
Internet host	0.6 per 10000 people	0.8 per 10000 people
Education expenditure	2.3 per cent of GNP	3.2 per cent of GNP
Female adult literacy	85 per cent	45 per cent
Undernourished people	9 per cent of the total population	23 per cent of the total population

A recent international agency report has explained that the Indian economy will become one of the worlds largest by 2050 A.D. With a GDP growth rate of 8 per cent since 2003 starting with a rebound in the Indian agriculture initially but now followed with a boom in production and service sectors similar to that of China.

If a comparative analysis of the Indian and Chinese economy is done some interesting comparison emerges through India lags behind China in so many areas and a lot needs to be done, if India has to catch up with China. The comparative analyses were discussed above table.

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

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