Volume : 1 | Issue : 7 | July 2012 ISSN - 2250-1991

Research Paper Economics

Impact of Foreign Direct Investments on Indian Economy: A Study

*Dr. Swapan Kumar Roy

* Ph.D.Assistant Professor In Commerce,Bethuadahari College, P.O. Bethuadahari, Dist. Nadia

ABSTRACT

It is needless to mention that our country is advancing rapidly in all respects. The rapidity of such advancement in different fields has been due to economic reforms adopted by the government from time to time. Economic reforms/liberalization in India signifies a shift from socialistic economy to a market economy. It means greater reliance on market forces. The main motto was to obtain maximum benefits for maximum people. In India, the reform process started in July 1991. At that time, the country was in severe foreign exchange crisis. Such a situation activated the then government to adopt economic reforms. Since then i.e. 1991, successive governments have been taking initiatives in order to reap the benefits of economic reforms. The economic reforms in goods and service tax, industrial and trade policy, foreign direct investment (FDI), agriculture, financial sector, social sector development in health and education hastened the pace of economic growth and eradication of poverty. FDI is deemed to be the lifeblood of economic development of a country like India. Under the liberalization process, FDI enabled India to achieve financial growth, stability and financial development. Foreign direct investments have come in various sectors. The inflows of FDI helped our country in widening up the job opportunities, improving higher standard of living, and also in establishing better infrastructure. It has also been criticized. Foreign investments in some sectors yielded a negative impact on the country's economy also. In this backdrop, an attempt has been made to assess/examine the impact of FDI on the country's economic development during post-economic reforms period.

Key Words: Economic Reforms, FDI, Financial Development, Market Economy and Socialistic Economy

Economic reforms in India are a much talked about subject today. Economic policy reforms were initiated in India in 1991. Since then, these reforms have been playing an important role in the performance of the Indian economy. Foreign direct investment is an important component of economic reforms in India. India has liberalized her policies and strategies in order to invite foreign direct investment. It has accelerated the economic growth of the country. As a result, India has been rapidly changing from a restrictive regime to a liberal one. Some restrictions have been imposed in some sectors keeping in view of our country's interest. The objective of the Government is to create a conducive atmosphere of attracting FDI in our country.

Objectives of the Study

The objectives of the study are:

1. To give an idea about the definitional and conceptual aspect of "Foreign Direct Investment";
2. To find out the reasons of inviting FDI in India;
3. To throw light on the policies and strategies adopted by the Government of India with regard to FDI;
4. To assess/examine the impact of FDI on Indian economy;
5. To make concluding remarks.

Methodology

The entire gamut of discussion has been made on secondary sources. Different books, journals, periodicals, Government reports and related websites have been consulted in order to enrich the study.

Review of Existing Literature

R Naga Raj (2003) in his article " Foreign Direct Investment in India in the 1990s: Trends and Issues" highlights the trends in FDI in India in the 1990s. B. S. Bodla and Usha Bhati (2004) in their article discussed the emerging scenarios of FDI. Nirupam Bajpai and Jeffrey D. Sachs (2006) in their paper " FDI in India: Issues and Problems" made an attempt to identify the issues and problems associated with India's current FDI regimes. K. Muthalagu and K. Vijayarani (2006) in their article titled "FDI in India" stated that the FDI inflows had encouraged infusions of new technologies and management practices in India. Badar Alam Iqbal and Munir Hassan (2006) in their paper put stress on sectoral pattern, role of government and FDI policy. Tanmay Kumar Nandi and Ritankar Sahu (2007) in their article titled "Foreign Direct Investment in India with special emphasis on Retail Trade" discussed the need of FDI in retail sector and they argued in favour of FDI in retail sector. Ms. Sapna Hooda (2011), in her thesis title "A Study of FDI and Indian Economy" elaborately highlighted the 'Trends and patterns of FDI inflows' and 'FDI and Indian economy'.

Economic Reforms: The Background

Reform is necessary for creating an investment-oriented climate. "Reform' means a change for the better as a result of correcting abuses and this in the sense of economic reform is to bring a change in the economy. Economic reforms in India generally mean changes introduced in the development of economy of the country with a view to obtaining maximum benefits for maximum people. The new economic reform popularly known as "Liberalization, Privatization and Globalization"(LPG) aimed at making the Indian economy as fastest growing economy and globally competitive. The economic reforms put emphasis on the open market economic policies. It aims at accelerating the pace of economic growth and eradication of poverty. In 1991, the Government of India signaled a systematic shift to a more open economy with greater reliance upon market forces, a larger role for the private sector including foreign investment, and restructuring of the role of the government.

Defining "Foreign Direct Investment"

Any investment flowing from one country into another is foreign investment. A simple and commonly used definition says financial investment by which a person or an entity acquires a lasting interest in, and a degree of influence over, the management of a business enterprise in a foreign country is foreign investment. Foreign investment is of 2 kinds – (a) Foreign direct Investment and (b) Foreign Portfolio Investment. Foreign direct investment is an investment of foreign assets into domestic structures, equipment and organizations. It does not include foreign investment into the stock markets. It is a type of investment that involves the injection of foreign funds into an enterprise that operates in a different country of origin from the investor. It is defined as a company from one country making a physical investment into building a factory in another country.

Foreign Direct Investment: Types
FDI can be categorized into 3 components. They are equity capital, reinvested earnings and intra-company loans. Equity capital comprises of the shares of companies in foreign countries to that of the investor. Reinvested earnings include the earnings not distributed to the shareholders but reinvested into the company. Intra-company loans relate to financial transactions between a parent company and its affiliates. (UNCTAD 2006). FDI flows can be classified as inflows (capital flows into the host country) and outflows (capital flows out of the home economy).

Foreign Direct Investment: Why it is needed
FDI has been gaining importance in our country because of the following reasons:

1. It helps in the economic development of that country where the investment is being made;
2. It can bring capital to an economy;
3. It helps the countries when they face economic hardship;
4. It results in job creation and employment;
5. It provides domestic countries with an exchange of skill sets, information and expertise;
6. It provides domestic countries with improved productivity levels;
7. It provides the benefits of reduced cost through the realization of scale economies, and coordination advantages, especially for integrated supply chains;
8. It can provide a firm with new markets, marketing channels and access to new technologies.

Policy and Strategy of Foreign Direct Investment in India: A Bird's Eye View
The Government of India adopts a number of policies and strategies to attract and promote productive FDI in activities that significantly contributes to industrialization and socio-economic development. FDI supplements domestic capital and technology. FDI is freely permitted in almost all sectors. Under the FDI Scheme, investments can be made by non-residents in the shares/convertible debentures/preference shares of an Indian company through 2 routes:

a. Automatic Route: Under this route, the foreign investor or the Indian company does not require any approval from the RBI or Government of India for the investment. FDI is permitted, under this route, up to 100% subject to sectorial caps as stipulated in the Consolidated FDI policy of India.
b. Government Route: Under this route, prior approval of the Government of India, Ministry of Finance, and Foreign Investment Promotion Board (FIPB) is required.

A non-resident entity (other than a citizen of Pakistan or an entity incorporated in Pakistan) can invest in India, subject to the FDI policy. A citizen of Bangladesh or an entity incorporated in Bangladesh can invest in India under the FDI policy, only under the Government route.

In India, FDI policy allows for investment only in case of the following form of investments:
- Through financial alliance
- Through joint schemes and technical alliance
- Through capital markets, via Euro Issues
- Through private placements or preferential allotments

Foreign companies can make investments or operate their business in a number of ways as given below:
- Liaison /Representative Office
- Project office
- Branch Office
- 100% wholly owned subsidy
- Joint venture company

According to FDI policy, different sectors have different FDI limits. These have been shown hereunder in a tabular form.

Sector	Investment Cap
Petroleum Refining (Private Sector)	100%
Power	100%
Hotel & Tourism	100%
Advertising	100%
SEZs	100%
Drug & Pharmaceuticals	100%
Films	100%
Pollution Control & Management	100%
Electricity	100%
Non Banking Financial Companies	100%
Agriculture Sector including seeds, plantation, horticulture and cultivation of vegetables	100%
E-Commerce	100%
Information Technology	100%
Food Processing	100%
Construction development	100%
Telecommunication	74%
Private Banking	74%
Airport	74%
Nuclear Energy	74%
Asset Reconstruction Companies	49%
Domestic Airlines	49%
Insurance	26%
Print Media (for newspapers and current events)	26%

FDI is prohibited in the following activities/sectors:

1. Retail Trading (except single brand product retailing)
2. Gambling
3. Betting
4. Lottery
5. Chit fund
6. Nidhi company
7. Trading in Transferable Development Rights (TDRs)
8. Real estate Business or Construction of Farm Houses
9. Manufacturing of Cigars, cheroots, cigarillos, and cigarettes, of tobacco or of tobacco substitutes.

Foreign Direct Investment: Its impact on Indian economy
Over the years, FDI inflow in the country is increasing. However, India has the tremendous potential for absorbing greater flow of FDI in the coming years. Serious efforts are being made to attract greater inflow of FDI in the country by taking several actions both on policy and implementation front. FDI is recognized as an important driver of growth in the country. It complements and supplements domestic investment. It plays a pivotal role in the development of India's economy. It is an integral part of the global economic system. It helps in the transfer of technology, raise the level of production, develop the infrastructure and generate opportunities for employment in the country.

FDI inflows in India have tremendously impacted India's economy. Year-wise FDI inflows in India have been shown in Table-1.

Table-1
FDI Inflows in India (In rupees crore)

Year	Amount of FDI Inflows
1992-1993	408
1993-1994	1094
1994-1995	2018
1995-1996	6916
1996-1997	9654
1997-1998	13548
1998-1999	12343
1999-2000	10311
2000-2001	12645
2001-2002	19361
2002-2003	14932
2003-2004	12117
2004-2005	17138
2005-2006	24613
2006-2007	70630
2007-2008	98664
2008-2009	123025

Source: Various Issues of SIA Bulletin & www.dipp.nic.in

Table-1
manifests the fluctuating trend of FDI inflows in India. FDI inflows to India have been growing at a high rate for the last few years i.e. during the period from 2004-05 to 2008-09. The FDI inflows in India during the year 2008-09 were INR 123025 crore as against INR 408 crore in 1992-93. FDI enabled India to achieve a certain degree of financial growth, stability and financial development. So it may be said that FDI is an engine of growth of our country's economy. It is a booster to the country's economy.

The liberalization and deregulation of the Indian economy have attracted FDI in India and as a result a large amounts of FDI are coming from different countries. This has been exhibited in Table-2.

Table-2
Share of Top Investing countries FDI inflows (Amount Rupees in Crore)

(April to March)

Country	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Mauritius	3766	2609	5141	11411	28759	44483	50794	49633	31855
U.S.A.	1504	1658	3055	2210	3861	4377	8002	9230	5353
Japan	1971	360	575	925	382	3336	1889	5670	7063
Netherlands	836	2247	1217	340	2905	2780	3922	4283	5501
U.K.	1617	769	458	1164	8389	4690	3840	3094	3434
Germany	684	373	663	1345	540	2075	2750	2980	908
Singapore	180	172	822	1218	2662	12319	15727	11295	7730
France	534	176	537	82	528	583	2098	1437	3349
South Korea	188	110	157	269	-	-	-	-	-
Switzerland	437	207	353	426	257	-	-	-	-
Cyprus	-	-	-	-	266	3385	5983	7728	4171
U.A.E.	-	-	-	-	-	1039	1133	3017	1569

Source: www.dipp.nic.in

From the above Table-2, it is observed that Mauritius, U.S.A., Japan, Netherlands, U.K., Germany, Singapore, France, South Korea, Switzerland, Cyprus and U.A.E. are playing an important role for the growth of Indian economy through providing FDI in our country. Out of the countries mentioned above, Mauritius had been the biggest source of FDI in India (if FDIs are aggregated during the period from 2002-03 to 2010-11 as compared to other top investing countries). Most of the top investing countries like to send FDI to India because the country has large and growing middle class population, majority of the workers are educated and can speak good English, and the wages are also low. A potentially huge market capable of yielding much higher returns than in other countries has been a major attraction for foreign investors. India's abundant and diversified natural resources, its sound economic policy, liberal government policy environment, scope for well-developed rural development infrastructure, and opportunities for getting skilled managerial personnel make it a proper destination for foreign direct investments.

FDI in different sectors during the period from 2002-03 to 2010-11 has been displayed in Table-3.

Table-3
Sectors Attracting Highest FDI Inflows (Amount Rupees in Crore)

(April to March)

Sector	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Electrical Equipment (including computer software & electronic)	3075	2449	3281	6499	-	-	-	-	-
Transportation Industry	2173	1417	815	983	-	-	-	-	-
Service Sector (Financial & non-financial)	1551	1235	2106	2565	21047	26589	28411	20958	15539
Telecommunications (Radio paging, cellular mobile, basic telephone service)	1058	532	588	3023	2155	5103	11727	12338	7546
Fuels	551	521	759	416	-	-	-	-	-
Chemicals (other than fertilizers)	611	94	909	1979	930	920	3427	1707	1810

Food Processing Industries	177	511	174	183	-	-	-	-	-
Drugs & Pharmaceutical	192	502	1343	760	970	-	-	-	-
Cement & Gypsum Products	101	44	01	1970	-	-	-	-	-
Metallurgical Industries	222	146	881	681	7866	4686	4157	1935	5055
Computer Software and hardware	-	-	-	-	11786	5623	7329	4350	3571
Construction Activities (including roads and high ways)	-	-	-	-	4424	6989	8792	13544	5077
Housing & Real Housing Estate	-	-	-	-	2121	8749	12621	13586	5149
Automobile Industry	-	-	-	-	1254	2697	5212	5609	6008
Power	-	-	-	-	713	3875	4382	6908	5709
Petroleum & Natural Gas	-	-	-	-	-	5729	1931	1328	2621

Source: www.dipp.nic.in

The analysis of the Table-3 reveals that the sectors that attracted high FDI inflows in India were service sector, telecommunication, computer software and Hardware, construction activities, housing and real housing estate, automobile industry etc. During the period from 2002-03 to 2005-06, the sector 'Electrical Equipment' attracted high FDI inflows. In 2006-07 and onwards, the scenario changed. The 'Service sector' attracted major FDI inflows as compared to other sectors mentioned in Table-3. So FDI is considered to be a development tool that can help in achieving self-reliance in various sectors of the economy. The increasing trend (in different sectors) of FDI inflows has been possible because of the announcement of Industrial Policy in 1991. Government of India made several changes in the economic policy of the country and provided a galore of opportunities to the foreign players into the market. As a result, the sectors having received FDI are expanding, developing and flourishing. This results in stabilizing our economy. FDI inflows have led to transfer of technology, generation of new opportunities for employment and infrastructure development.

Conclusion

FDI inflows in India are, no doubt, an outcome of free market, liberalization and globalization. It has been recognized by the Indian government as one of the strategic and vital segment for accelerating the pace of economic emancipation and economic development. It is deemed to be lifeblood of economic development especially for the developing and underdeveloped countries. It is a driving force of globalization. It plays a pivotal role in the long-term development of a country. It enhances competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new job opportunities. The standard of living of the general public of the host country could be improved as a result of the FDI made in a country. FDI in India has increased over a period of time due to the sincere efforts taken by the Government of India. To develop the country's economy, steps should be taken to make sure that the flow of FDI in India continues to grow. Government-level policies are needed to enable FDI inflows and maximize their returns for both investors and recipient countries. On the flip side, some apprehend that the high scale investment by another country may cut down many domestic jobs. Opponents of FDI note that multinational conglomerates are able to wield great power over smaller and weaker economies and can drive out much local competition. So FDI should be invited but not at the cost of immersing our interests.

REFERENCES

1.Economic Survey, 2009-10 & 2010-11, Ministry of Finance, Government of India, New Delhi | 2.Frontline, March 25, 2002 | 3.Mainstream, February 11, 2006 | 4.Yojana, October, 2004, April, 2006 and July, 2006 | 5.Economic & Political Weekly, March 6, 2010 (Vol-XLV, No-10), May 29, 2010 (Vol-XLV, No-22), April, 2, 2011, (Vol-XLVI, No-14) | 6.The Hindu Survey of Indian Industry, 2003, 2005 and 2006 | 7.The Economic Times, 16-1-2011 | 8.www.dipp.nic.in | 9.www.indiafdiwatch.org | 10. www.economywatch.com | 11.www.isid.org.in | 12.www.economics.about.com | 13.www.unctad.org | 14.www.fdiindia.in | 15.www.rbi.org