International Journal of Scientific Research in Engineering and Management (IJSREM)
Volume: 06 Issue: 06 | June - 2022 Impact Factor: 7.185 ISSN: 2582-3930

The Impact of FDI in the Indian Economy

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ABSTRACT

The Indian economy has reached in the orbit of high rate of economic growth. It is being widely acclaimed and considered as an emerging global economic power. The rate of growth recorded during the period 1950-51 to 2020-2021 clearly indicated a tendency of steady upward trend. However, the decade of 80's emerged as a beginning of the high rate of economic growth or at least a dramatic departure from the past growth performance. This tendency had continued in the nineties and further growth stimulus has occurred in the early 21st century.

Foreign direct investment is an investment made by a foreign individual or company in productive capacity of another country. It is the movement of capital across national frontiers in a way that grants the investor control over the acquired asset.

As the third-largest economy in the world in PPP terms, India is a preferred destination for foreign direct investments (FDI). 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 etc. The future of Indian economy is brighter because of its huge human resources, rapidly upcoming service sector, availability of large number of competent professionals, vast market for every product, increasing impact of consumerism, absence of controls and licenses, interest of foreign entrepreneurs in India and existence of four hundred million middle class people. Today, India provides highest returns on FDI than any other country in the world.

(Key Words:- FDI, Liberalized,Stake,Emerging Global Economic Power)

1. 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 (2008). 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 2008-2009. 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.

India faces a burgeoning population and the challenge of reducing social and economic inequality. Even though Poverty remains a serious problem, it has declined considerably since independence, mainly due to the green revolution and economic reforms.

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.

Foreign Direct Investment (FDI) is now regarded as an important driver of growth.
Emerging Market Economies (EMEs) look upon FDI as one the easiest means to fulfill their financial, technical, employment generation and competitive efficiency requirements. Gradually they also realized that substantial economic growth is inevitable without global integration of business process. This created opportunities for locational advantages and thus facilitated strategic alliances, joint ventures and collaborations over R & D.

The world economy has observed a phenomenal change in volume and pattern of FDI flow from developed nations to EMEs in 1980s and 1990s compared to earlier decades. The hostile attitude of developing nations regarding multinationals investment has become generous during this transition period. FDI was fostered by liberalization and market-based reforms in EMEs. The financial sector deregulation and reforms in the industrial policy further paved the way for global investments.

There is clearly an intense global competition for FDI. India has emerged as the Second most attractive destination for FDI after China and ahead of the US, Russia and Brazil. In view of these facts, the present paper takes stock of current status of FDI in India, aims to find reasons for comparatively lesser flow of FDI and suggest measures to boost flow of FDI to India

2.Literature Review

It is universally acknowledged that FDI inflow offers many benefits to an economy. UNCTAD (1999) reported that Transnational Corporations (TNCs) can complement local development efforts by (i) increasing financial resources for development; (ii) boost export competiveness; (iii) generate employment and strengthening the skill base; (iv) protecting the environment to fulfill commitment towards social responsibility; and (v) enhancing technological capabilities through transfer, diffusion and generation. However, Te Velde, (1999) has rightly reported that in the absence of pro-active government policies there are risk that TNCs may actually inhibit technological development in a host country. Borensztein, et. al. (1998) reveals that FDI has a net crowding in effect on domestic private and public investment thus advancing overall economic growth. Crowding in effects of FDI varies with regions. There has been strong evidence of crowding-in in Asia and strong net crowding out effect in Latin America (Agosin and Mayer, 2000).

By and large, studies have found a positive links between FDI and growth. However, FDI has comparatively lesser positive links in least developed economies, thereby suggesting existence of "threshold level of development" (Blomstrom and Kokka, 2003 and Blomstrom et. al., 1994). Athreye and Kapur (2001) emphasized that since the contribution of FDI to domestic capital is quite small, growth-led FDI is more likely than FDI-led growth. Dua and Rasheed (1998) indicted that the Industrial production in India had a unidirectional positive Granger-Casual impact on inward FDI flows. They also concluded that economic activity is an important determinant of FDI inflows in India and not vice-versa. Tseng and Zebregs (2002) reported that even in case of China causality between market size/growth and magnitude of FDI holds true.

There is global race for attracting FDI, but how much it would contribute to host country's economic development is to be assessed. Developing countries need to have reached a certain level of educational, technological and infrastructure development before being able to benefit from a foreign presence in their markets. Blomstrom et. al., (1994) have rightly observed that, the host country must be capable of absorbing the new technology manifested in FDI. An additional factor that may prevent a country from reaping the full benefits of FDI is imperfect and underdeveloped financial markets (OECD 2002). India appears to be well placed in terms of reaping benefits because it has relatively well developed financial sector, strong industrial base and critical mass of well educated workers (Rajan et. al., 2008).

3. Foreign direct investment in India

As the third-largest economy in the world in PPP terms, India is a preferred destination for foreign direct investments (FDI); India has strengths in information technology and other important areas such as auto components, apparels, chemicals, pharmaceuticals, jewellery and so on. Although India has always held promise for global investors, but its rigid FDI policies was a significant hindrance in this context. However, as a result of a series of ambitious and positive economic reforms aimed at deregulating the economy and stimulating foreign investment, India has positioned (projected) itself as one of the front-runners in Asia Pacific Region. India has a large pool of skilled managerial and technical expertise. The size of the middle-class population at 300 million exceeds the population of both the US and the EU, and represents a powerful consumer market.

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 2008/09 (April-March). This was more than double the total of US$7.8bn in the previous fiscal year. Between April and September 2009, 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.

The GDP investments will likewise increase from current 5% to 35% by 2010. No wonder India has tremendous potential to attract USD 50 billion FDI in the next 5 years. With so much of visibility of MNCs, JVs, foreign investors etc it is little contradictory to say that the current flow of foreign direct investment India has been only 0.8% of GDP, compared to other nations of south-east Asia like Malaysia and Thailand with a FDI flow of 3% of GDP. Hence with more liberalization and opening of other sectors of the economy like the latest relaxation in FDI policies in real estate or direct foreign investment in real estate India etc, FDI will increase by at least 1.6% of GDP in the next 5 years.

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.

4 . Impact of FDI on Indian Economy

Liberalization of trade policies during the last one and half decade has led India to become an investment friendly country. Foreign direct investment (FDI) in this country assumed critical importance in the context of this liberalization. Though India is the tenth most industrialized country in the world, it is well known that it is mainly agro-based with around 70% population engaged in the farm sector. However, in the initial stage of liberalization, FDI was centered on the urban manufacturing sectors because of its civic infrastructure, labour availability, flexible taxation mechanism etc. The success story of FDI in these sectors is known to us.

For a long time there were efforts for FDI in the retail sector so that the trader can reap the benefit of FDI. Retail trade contributes around 10-11% of India's GDP and currently employs over 4 crores of people. Recently, a great debate has cropped up against the government plans for FDI in the Indian retail sector. FDI in retail is fundamentally different from that in manufacturing. FDI in manufacturing basically enhances the productive employment in most cases; but FDI in retail trade may create job losses and displacement of traditional supply chain. One of the main features of rural India is disguised unemployment. Farmers, evicted from the agricultural sector, engage in small retail trades for livelihood. The main fear of FDI in retail trade is that it will certainly disrupt the livelihood of the poor people engaged in this trade. The opening of big markets or foreign-sponsored departmental outlets will not necessarily absorb them; rather they may try to establish the monopoly power in the country. However, so many positive factors are also there in favor of FDI in Indian retail service.

Foreign Direct Investment (FDI) as a strategic component of investment is needed by India for its sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries, short and long term project in the field of healthcare, education, research and development (R & D) etc.
Government should design the FDI policy such a way where FDI inflow can be utilized as means of enhancing domestic production, savings and exports through the equitable distribution among states by providing much freedom to states, so that they can attract FDI inflows at their own level. FDI can help to raise the output, productivity and export at the sectoral level of the Indian economy. However, it can observed the result of sectoral level output, productivity and export is minimal due to the low flow of FDI into India both at the macro level as well as at the sectoral level. Therefore for further opening up of the
Indian economy, it is advisable to open up the export oriented sectors and higher growth of the economy could be achieved through the growth of these sectors.

5. Foreign Direct Investment - Concept & Policy

Foreign direct investment is an investment made by a foreign individual or company in productive capacity of another country. It is the movement of capital across national frontiers in a way that grants the investor control over the acquired asset.

5.1 Types of FDI:

There are two types of FDI:

* **Greenfield investment:** It is the direct investment in new facilities or the expansion of existing facilities. It is the principal mode of investing in developing countries like India.
* **Mergers and Acquisition:** It occurs when a transfer of existing assets from local firms takes place.

6 . Forbidden Territories:

FDI is not permitted in the following industrial sectors:

* Arms and ammunition.
* Atomic Energy.
* Railway Transport.
* Coal and lignite.
* Mining of iron, manganese, chrome, gypsum, sulphur, gold, diamonds, copper, zinc.

7. Investment in India:

Government of India accepts the key role of Foreign Direct Investment (FDI) in economic development not only as an addition to domestic capital but also as an important source of technology and global best practices. The Government of India has put in place a liberal and Transparent FDI policy.

FDI up to 100% is allowed under the automatic route in most sectors/activities. FDI policy in India is reckoned to be among the most liberal in emerging economies. FDI Policy permits FDI up to 100 % from foreign/NRI investor without prior approval in most of the sectors including the services sector under automatic route. FDI in sectors/activities under automatic route does not require any prior approval either by the Government or the RBI.

8. Foreign Direct Investment Policy

Foreign direct investment (FDI) has become an integral part of national development strategies for almost all the nations globally. Its global popularity and positive output in augmenting of domestic capital, productivity and employment; has made it an indispensable tool for initiating economic growth for countries.

India is evolving as one of the 'most favored destination' for FDI in Asia and the Pacific. It has displaced US as the second-most favored destination for FDI in the world after China according to an AT Kearney's FDI Confidence Index. India attracted more than three times foreign investment at US$ 7.96 billion during the first half of 2007-08 fiscal, as against US$ 2.38 billion during the subsequent period of 2006-07.

FDI in India has contributed effectively to the overall growth of the economy in the recent times. FDI inflow has an impact on India's transfer of new technology and innovative ideas; improving infrastructure, thus makes a competitive business environment.

FDI policy is reviewed on an ongoing basis and measures for its further liberalization are taken. Change in sectoral policy/sectoral equity cap is notified from time to time through Press Notes by the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy announcement by SIA are subsequently notified by RBI under FEMA. All Press Notes are available at the website of Department of Industrial Policy & Promotion.

FDI Policy permits FDI up to 100 % from foreign/NRI investor without prior approval in most of the sectors including the services sector under automatic route. FDI in sectors/activities under automatic route does not require any prior approval either by the Government or the RBI. The investors are required to notify the Regional office concerned of RBI of receipt of inward remittances within 30 days of such receipt and will have to file the required documents with that office within 30 days after issue of shares to foreign investors.

9 . Proposals requiring Govt's approval:

Application for proposals requiring prior Government's approval should be submitted to FIPB in FC-IL form. Plain paper applications carrying all relevant details are also accepted. No fee is payable. The following information should form part of the proposals submitted to FIPB: -
Whether the applicant has had or has any previous/existing financial/ technical collaboration or trade mark agreement in India in the same or allied field for which approval has been sought; and If so, details thereof and the justification for proposing the new venture/ technical collaboration (including trademarks).

Applications can also be submitted with Indian Missions abroad who will forward them to the Department of Economic Affairs for further processing. Foreign investment proposals received in the DEA are placed before the Foreign Investment Promotion Board (FIPB) within 15 days of receipt. The decision of the Government in all cases is usually conveyed by the DEA within 30 days.

10 . FDI Prohibited:

FDI is not permissible in Gambling and Betting, or Lottery Business, Business of chit fund, Nidhi Company, Housing and Real Estate business, Trading in Transferable Development Rights (TDRs), Retail Trading, Atomic Energy Agricultural or plantation activities or Agriculture (excluding Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture and Cultivation of Vegetables, Mushrooms etc. under controlled conditions and services related to agro and allied sectors) and Plantations(other than Tea plantations)

11 . Conclusion:

It is generally said that future is always uncertain. This saying is correct to some extent. But at the same time it is also said that exceptions are always there. This exception is about India's certain higher rate of growth in the coming future. The future of Indian economy is brighter because of its huge human resources, rapidly upcoming service sector, availability of large number of competent professionals, vast market for every product, increasing impact of consumerism, absence of controls and licenses, interest of foreign entrepreneurs in India and existence of four hundred million middle class people. Even today, India is producing largest number of billionaires in a year, take over by Indian multinationals is amazing, the craze of Indians to go abroad is rapidly diminishing, and the Rupee is becoming stronger and stronger in relation to Dollar. India's say in the international diplomacy and political affairs has now become meaningful, thousands of foreigners are working as executives in India, packages are becoming lucrative and competitive and annual rate of growth is highest after China. This present picture gives some reflections of the future. But this is all in the absolute sense and not in the relative terms. A country can only grow if the Govt. policies allow more participation and is able to attract more and more foreign direct investment in India. Today, India provides highest returns on FDI than any other country in the world. India is poised for further growth in manufacturing, infrastructure, automobiles, auto components, food processing sectors, real estate development etc. In this context it is also worth mentioning that savings rate has also increased from 23% to 31% over the last year to this year. India's continuing ambivalence on FDI, as a result, exacts a heavy toll on the economy. Undoubtedly, India is ceding billions of dollars of FDI to its neighbours each year. While China achieved actual FDI inflows of around $45.3 billion in 1997, India settled for a mere $3.2 billion. India therefore stands to win in the next few years.

The growth rate of the Indian economy has been very high in the post reforms era. And hence India has become the cynosure of investment by foreign Multinational enterprises. The relationship between FDI and other macro Economic variables like growth rate, export, employment and productivity has been found to vary. It has been found that to gain a positive impact of technology Spillovers via FDI the host country should achieve a basic minimum human Capital threshold. Studies exist both in support and against the positive impact of FDI in the Indian economy. It is self conclusive that the growth of FDI in India is Growth resultant and not growth stimulant. The positive impact of FDI has been felt in the high technology sectors like telecommunication and IT. The success Story of the telecom sector is a real confidence booster in this regard. It is clearly visible that the MNEs are more interested in exploiting the Indian markets rather Than investing in capital goods.

The retail sector is one of the fastest growing sectors of India. It also employs a huge proportion of the population. Hence any measure regarding this sector such as approval of FDI in the Indian retail sector will have a gigantic impact on Indian economy. FDI in the Indian retail sector will work wonders in terms of controlling inflation, creating new jobs and increasing the efficiency and productivity of the Indian economy. But many believe that it may lead to wide scale unemployment, drainage of capital from the Indian economy and social inequity. Hence FDI in India’s retail sector should be accompanied by stringent Policy measures on the part of the government so that the majority of the population can benefit from the positive spillover effects of FDI. Government should encourage FDI in the manufacturing sector along with the retail sector to compensate for the loss of jobs that will be created due to the advent of FDI in retail. Government should also build social infrastructure to enhance the human capital formation so that the positive spillover effects of FDI are greatly felt.

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