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Impact of FDI on Indian Economy: A Critical Analysis

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ABSTRACT: FDI flows records the data of cross border transactions related to direct investments during the given period of time (usually a quarter or a year). FDI inflows means investment made by foreigners in the domestic companies and FDI outflows are the investments made in the external economies. FDI inflows trigger the economic growth of a country. In view of the fact that many developing countries are experiencing lack of monetary funds, low level of technology and skills. FDI is an essential factor for sustainable development and poverty alleviation. Expansion of economy with FDI flows is a good indicator of economic growth as it increases the job opportunities and hence creates employment. United Nations Conference on Trade and Development (UNCTAD) said in its report that India notches to rank no. 9 in terms of FDI received in 2016, at the time global FDI falls.

KEYWORDS: FDI, Inflows, Economy, Growth and Increase.

I. INTRODUCTION

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. On this line, it has been argued that FDI can bring the technological diffusion to the sectors through knowledge spillover and enhances a faster rate of growth of output via increased labour productivity in India. There were also few evidences demonstrate that there is a long-run relationship between Gross Domestic Product, FDI and export in India. In fact, many countries like India have offered incentives to encourage FDI to their economies. India is also opened up its economy and allowed MNEs in the core sectors such as Power and Fuels, Electrical Equipments, Transport, Chemicals, Food Processing, Metallurgical, Drugs and Pharmaceuticals, Textiles, and Industrial Machinery as a part of reform process started in the beginning of 1990s. In this context, it is imperative to assess the impact of FDI inflows in to these core sectors in India. It is also motivated by recent political developments in India following the opening of sectors like insurance and telecommunication with increased financial gap for the private players. In particular, the left parties, who are main coalition partner of the present government in India is not in favor of increased financial gap to the private players in the sectors of insurance and telecommunication and also disinvestment of public enterprises. An empirical analysis could offer a basis for the further opening up the economy if FDI inflows into the core sectors set a positive spillover in the economy in India.

FDI flows records the data of cross border transactions related to direct investments during the given period of time (usually a quarter or a year). FDI inflows means investment made by foreigners in the domestic companies and FDI outflows are the investments made in the external economies. FDI inflows trigger the economic growth of a country. In view of the fact that many developing countries are experiencing lack of monetary funds, low level of technology and skills. FDI is an essential factor for sustainable development and poverty alleviation. Expansion of economy with FDI flows is a good indicator of economic growth as it increases the job opportunities and hence creates employment. United Nations Conference on Trade and Development (UNCTAD) said in its report that India notches to rank no. 9 in terms of FDI received in 2016, at the time global FDI falls.

The dimensions of the FDI flows into India could be explained in terms of its growth and size, sources and sectoral compositions. The growth of FDI inflows in India was not significant until 1991 due to the regulatory policy framework. However, under the new policy regime, it is expected to assume a much larger role in catalyzing Indian economic development. It could be observed that there has been a steady build up in the actual FDI inflows in the post-liberalization period. Actual inflows have steadily increased from Rs. 3,514.30 million (US \$ 143.6 million) in 1991 to Rs. 143,009.40 million (US \$ 3,108.9) in 2003. This results in an annual average growth rate close to 6 per cent. However, the pace of FDI inflows to India has definitely been slower than some of the smaller developing countries like Indonesia, Thailand, Malaysia and Vietnam. In fact, India has registered a declining trend of FDI inflows and the FDI- GDP ratio especially in 1998 and 2003 could be attributed to many factors, including the US sanctions imposed in the aftermath of the nuclear tests, the East Asian melt-down and the perceived Swadesh image of the Bharatiya Janatha

Party, which was ruling government during this period in India. It is also important to note that the financial collaboration has out numbered the technical collaboration over the years.

The analyses of the origin of FDI inflows to India show that the new policy has broadened the source of FDI into India. There were 86 countries in 2000 which increased to 106 countries in 2003 as compared to 29 countries in 1991 whose FDI was approved by the Indian Government. Thus, the number of countries investing in India has increased during the period of reform. Nevertheless, still a lion's share of FDI comes from only a few countries. The country-wise annual growth rate of the FDI inflows shows that Mauritius, which was not in the picture till 1992, has the highest growth rate. A lion's share of such investment is represented by the holding companies of Mauritius set up by the US firms. It means that the investment flowing from the tax havens is mainly the investment of the multinational corporations headquartered in other countries. Now an important question arises as to why the US companies have routed their investment through Mauritius, which they like to invest elsewhere. Secondly, because the tax treaty between Mauritius and India stipulates a dividend tax of five per cent, while the treaty between Indian and the US stipulated a dividend tax of 15 per cent (World Bank, 1999). On the other hand, the shares of the total FDI inflows of these top 10 countries have been fluctuating since recent years.

The analysis of sector-wise FDI inflows shows that electrical equipments, transportation, telecommunication, power and fuels, service, chemicals, food processing, drugs and pharmaceuticals, metallurgical, textile and industrial machinery sectors attracted more FDI, which together accounted for more than 73 per cent of total FDI inflows during 1991-1999. Among these core sectors, transportation industry accounted for 12.45 per cent followed by electrical equipments including IT and electronics with 9.76 per cent, and service and telecommunication sector with 9.77 per cent and 9.76 per cent respectively of the total investment. It is important to note that though food-processing sector attracted less FDI inflows, it recorded a significant share (5.72 per cent) in attracting total FDI inflows in India. The share of the FDI inflows to the top sectors is not very encouraging barring electrical equipments, telecommunications and power and fuels sectors in recent years.

II. REVIEW OF LITERATURE

Review of selected literature is an essential part of every study process. It helps us to examine and evaluate what has been said earlier on the subject.

Ray (2012) to study the impact of FDI on economic growth in India, using the co-integration approach. The period taken in study was from 1990-91 to 2010-11. Least Square Method suggested that there is positive relationship between foreign direct investment(FDI)investment and GDP and vice versa. The unit root test results showed that both FDI and economic growth were found to be integrated. Granger causality test revealed the presence of uni-directional causality, which ran from economic growth to FDI. Also, VEC(error correction estimate) confirmed the long run relationship between FDI and GDP.

Anitha, R. (2012). In his paper "Foreign Direct Investment and Economic Growth in India" he talked about the role of FDI in the development of developing and underdeveloped countries. FDI in such countries bridges the gap between available financial resources and required financial resources. In his paper he analyzed the trends of FDI inflows in the country from 2010 to 2015. He mentioned the reasons for the poor performance of India in attracting FDI inflows such as political instability, poor infrastructure, tariff laws, labour laws etc. in his study he concluded that global share of FDI in India is very less as compared to other developing countries even after increased in the flow of FDI. To improve this situation govt. has to adopt innovative policies and good corporate governance practices to attract more & more foreign capital.

Singh, J., et.al. (2012). In their paper "Role of Foreign Direct Investment in India: An Analytical Study" they showed that FDI played a major role in attracting International Economic Integration in every economy. Main sectors where investments were flowing more were: real estate & business, insurance sector etc. The objective of the study was to know the amount of foreign investments required for growth and analyzing its trend. There are two routes of FDI inflows i.e. automatic route (liberalized route) and government route (or approval route). They also talked about the main determinants of FDI (a) in host country were policy framework, international agreements, trade policies, rules regarding entry & operations etc. (b) economic determinants such as market size, market structure, labour, technology etc. in their study they found that saving rate is very low and route of investment inflows were FDI & FIIs both. The highest amount 6878 billion dollars in India came from Mauritius. They concluded that India should welcome foreign investments as it is favorable for Indian Economy and also helped govt. in achieving their goals such as favourable BOP, removal of poverty, economic development etc.

Rahaman, A. & Chakraborty, S. (2015) They had done empirical research in Bangladesh to analyze the relationship between foreign direct investments and gross domestic product. FDI is an important medium for accelerating economic growth. FDI had positive impact on the economic growth as it results in HR development, advance technologies came into own country. They used secondary data for analyzing the trend in GDP. The upward Trend was shown during the period 1987-2011. They concluded that inflows of foreign investments in the Bangladesh (as a developing country) is very low and to improve this situation govt. had to take steps i.e. develop skills of labours, develop infrastructure and remove power shortage problem, investment friendly framework etc.

Sharma, M. & Singh, S. (2016) In their paper they examined the major features of FDI and its impact on Indian economy in pre and post liberalization period. They explained the attitude of Indian govt. towards foreign investments from 1950 in 4 phases. Attitude changed a lot from restrictive to open door policy when FERA replaced FEMA. Indian trade turned to new heights after the Second World War. They also talked about economic factors that affect the growth and development of Indian Economy such as GDP, Currency, Stock Market, and Foreign Exchange Reserve etc. After 1990, India realized the power and importance of foreign investments as it was a source of external private finance. They suggested the main sectors where there were opportunities of foreign investments like service sectors, construction & development sector etc.

III. METHODOLOGY

The method used in this paper is descriptive-evaluative method. The study is mainly review based. It is purely supported by secondary source of data, i.e. books, journals, papers and articles and internet.

IV. RESULTS AND DISCUSSION

Trend of FDI flows in India:

The historical background of FDI in India can be traced back with the establishment of East India Company of Britain Perceptions of foreign investors towards India changed quite distinctly due to the change in the policy regime. Inflows of FDI have increased substantially compared to the earlier regime in which the scope for FDI was quite restricted ,with adoption of liberalization policy. Caps on FDI shareholding are now applied only to a few sectors .FDI of up to 100 %,74%,51% has been allowed by Government of India in almost all the sectors. From a less than \$ 1 billion in the early 1990s, FDI inflows received have crossed 36 billion \$ in FY 2013-14.The resultant increase in the stock of FDI was staggering, from \$1.7 billion at the end of 1990, FDI stock went up to \$17.5billion by the end of 2000 and close to \$300 bn by the end of FY 2014.

Foreign Direct Investment (FDI) has been a major non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges like tax exemptions, etc. For a country where foreign investment is being made, it also means achieving technical know-how and generating employment. The Indian Government's favourable policy regime and robust business environment has ensured that foreign capital keeps flowing into the country. The Government has taken many initiatives in recent years such as relaxing FDI norms across sectors such as defence, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others.

Market size:

According to Department for Promotion of Industry and Internal Trade (DPIIT), FDI equity inflow in India stood at US\$ 469.99 billion during April 2000 and March 2020, indicating that Government's effort to improve ease of doing business and relaxing FDI norms has yield results. FDI equity inflow in India stood at US\$ 49.97 billion in 2019-20. Data for 2019-20 indicates that service sector attracted the highest FDI equity inflow of US\$ 7.85 billion, followed by computer software and hardware at US\$ 7.67 billion, telecommunications sector at US\$ 4.44 billion, and trading at US\$ 4.57 billion. During 2019-20, India received the maximum FDI equity inflow from Singapore (US\$ 14.67 billion), followed by Mauritius (US\$ 8.24 billion), Netherlands (US\$ 6.50 billion), USA (US\$ 4.22 billion) and Japan (US\$ 3.22 billion).

Investments:

Some of the significant FDI announcements made recently are as follows:

- On August 21, 2020, the Government of Singapore announced investment of Rs 450 crore (US\$ 63.84 million) in the qualified institutional placement (QIP) offering of mall developer Phoenix Mills Ltd.

- On August 14, 2020, Israel-based Coralogix, provider of machine-learning based log analytics and monitoring solution, announced a strategic expansion into India with a commitment to invest over US\$ 30 million in the next five years.
- Between April 23 and July 16, 2020, Jio Platforms Ltd. sold 25.24 per cent stake worth Rs 1.52 trillion (US\$ 21.57 billion) to various global investors from separate deals involving Facebook, Silver Lake, Vista, General Atlantic, Mubadala, Abu Dhabi Investment Authority (ADIA), TPG Capital, L. Catterton, Public Investment Fund (PIF), Intel Capital, Qualcomm Ventures and Google. This is the largest continuous fundraise by any company in the world.
- In May 2020, Philips, Dutch health tech and consumer electronics company, announced its plan to invest Rs 250-300 crore (US\$ 35.47-42.56 million) to boost its manufacturing and R&D facilities in India.
- In January 2020, Amazon India announced investment of US\$ 1 billion for digitising small and medium businesses and creating one million jobs by 2025.
- In January 2020, Mastercard announced its plans to invest up to US\$ 1 billion in India over the next five years to double its research and development effort in the Indian market.
- In October 2019, French oil and gas giant, Total S.A., acquired 37.4 per cent stake in Adani Gas Ltd for Rs 5,662 crore (US\$ 810 million), making it the largest FDI in India's city gas distribution (CGD) sector.
- In August 2019, Reliance Industries (RIL) announced one of India's biggest FDI deals with Saudi Aramco to buy a 20 per cent stake in Reliance's oil-to-chemicals (OTC) business at an enterprise value of US\$ 75 billion.

Government Initiatives:

In May 2020, Government increased FDI in defence manufacturing under the automatic route from 49 per cent to 74 per cent. In April 2020, Government amended existing consolidated FDI policy for restricting opportunistic takeovers or acquisition of Indian companies from neighboring nations. In March 2020, Government permitted non-resident Indians (NRIs) to acquire up to 100 per cent stake in Air India. In December 2019, Government permitted 26 per cent FDI in digital sectors. In August 2019, Government permitted 100 per cent FDI under the automatic route in coal mining for open sale. In Union Budget 2019-20, the Government of India proposed opening FDI in aviation, media (animation, AVGC) and insurance sectors in consultation with all stakeholders. 100 per cent FDI is permitted in insurance intermediaries. As of February 2019, the Government of India has been working on a road map to achieve its goal of US\$ 100 billion worth of FDI inflow.

Table: 1
Depicts FDI inflows and its impact on GDP

YEAR	FDI (in rupee billions)	FDI Growth Rate (in %)	GDP (in rupee billions)	GDP Growth Rate (in %)	FDI as percentage of GDP
2002-03	200.98	-	25306.63	-	0.794
2003-04	628.42	212.68	28379.00	12.14	2.214
2004-05	580.57	7.61	32422.09	14.25	1.791
2005-06	687.82	18.47	36933.69	13.92	1.862
2006-07	667.91	2.89	42947.06	16.28	1.555
2007-08	1743.95	161.11	49870.90	16.12	3.497
2008-09	350.61	79.9	56300.63	12.89	0.623
2009-10	2399.51	584.38	64778.28	15.06	3.704
2010-11	1934.82	19.37	77841.16	20.17	2.486
2011-12	1887.38	2.45	87363.29	12.23	2.160
2012-13	2546.53	34.92	99440.13	13.82	2.561
2013-14	1596.5	37.31	112335.22	12.97	1.421
2014-15	4490.72	181.29	124451.28	10.79	3.608
2015-16	2085.79	53.55	136820.35	9.94	1.524
2016-17	2893.94	38.75	151837.05	10.98	1.906

Source: Handbook of Statistics on the Indian Economy

The FDI inflows in India have increased at a higher rate from Rs. 200.98 billions in the year 2002-03 to Rs. 2893.94 billions in the year 2016-17. The highest growth rate was recorded in the year 2009-10 i.e. 584.38% and lower

in the year 2011-12 i.e. 2.45%. Increased in growth rate of GDP has been recorded between 12.14% in the year 2003-04 and 20.17% in the year 2010-11. GDP starts falling reach to its minimum growth rate (since 2002) with 9.94% in 2015-16 and then increased in 2016-17 with rate 10.98%. The FDI as percentage of GDP was recorded between 0.794% in the year 2002-03, which has increased to 3.704% in the year 2009-10. It shows a continuous rise in FDI as percentage of GDP but after financial year 2009-10 it takes a drop & reached at 1.421% in 2013-14. The FDI as percentage of GDP in year 2016-17 was 1.906%.

Table: 2
Trend Analysis of FDI

YEAR	FDI	Trend Analysis Base Year 2002-03 (in %)
2002-2003	200.98	100
2003-04	628.42	312.68
2004-05	580.57	288.87
2005-06	687.82	342.23
2006-07	667.91	332.33
2007-08	1743.95	867.72
2008-09	350.61	174.45
2009-10	2399.51	1193.90
2010-11	1934.82	962.69

Source: Handbook of Statistics on the Indian Economy

The trend of foreign investment inflows over the period of time by taking 2002-03 as base year. Above table shows trend percentage of foreign investments goes on increasing with more or less % and reached 867.72%. But in 2008-09 drop in investment was seen. Thereafter India again enjoys investments made in their country. Trend percentage of investments in financial year 2016-17 was 1439.91%.

IV. CONCLUSION

It can be observed from the above analysis that at the sectoral level of the Indian economy, FDI has helped to raise the output, productivity and export in some sectors. It implies that the spirit in which the economy has been liberalized and exposed to the world economy at the late eighties and early nineties has not been achieved after so many years. This calls for a judicious policy decision towards FDI at the sectoral level. Therefore, in the eve of India's plan for further opening up of the economy, it is advisable to open up the export oriented sectors and a higher growth of the economy could be achieved through the growth of these sectors. The various researches carried out to study the impact of FDI on Indian economy reveals that FDI, no doubt, has a positive impact on Indian economy. It has been helpful in the country's economic growth, measured by various indicators such as GDP, GNP, increase in forex reserves, high paying jobs. Hence we need to frame FDI-friendly policies in the country, as has been rightly practiced by Government of India. However, a proper targeting has to be made by the policy makers, regarding attracting that type of FDI, which can generate additional jobs in the country without replacing the old ones, which can provide for import substitution and export enhancement. Above analysis shows, foreign direct investment has a significant impact on the economic growth of the country and also FDI has a major contribution in it.

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