International Journal of Business Management
Available at www.ijbm.co.in
ISSN No.:2349-3402
Vol. 1(2), 2014

Foreign direct investment and Indian economy

Dr. Harish Kumari[1]

Abstract

The Foreign Direct Investment means "cross border investment made by a resident in one economy in an enterprise in another economy, with the objective of establishing a lasting interest in the investee economy. Foreign direct investment (FDI) in India has played an important role in the development of the Indian economy. FDI in India has, in a lot of ways, enabled India to achieve a certain degree of financial stability, growth and development. This money has allowed India to focus on the areas that may have needed economic attention and address the various problems that continue to challenge the country. This paper throws a light on macro view of FDI in India, FDI reforms in India, challenges in FDI and current position of FDI in India.

1. Principal, Khalsa College (Asr.) of Tech. & Buss. Studies, Mohali.

Introduction

The Foreign Direct Investment means "cross border investment made by a resident in one economy in an enterprise in another economy, with the objective of establishing a lasting interest in the investee economy.FDI is also described as "investment into the business of a country by a company in another country". Mostly the investment is into production by either buying a company in the target country or by expanding operations of an existing business in that country". Such investments can take place for many reasons, including to take advantage of cheaper wages, special investment privileges (e.g. tax exemptions) offered by the country .India, the largest democracy in the world, with its consistent growth/performance and abundant skilled manpower provides enormous opportunities for investment, both domestic and foreign. Foreign direct investment (FDI) in India has played an important role in the development of the Indian economy. FDI in India has, in a lot of ways, enabled India to achieve a certain degree of financial stability, growth and development. This money has allowed India to focus on the areas that may have needed economic attention and address the various problems that continue to challenge the country. India has continually sought to attract FDI from the world's major investors. In 1998 and 1999 the Indian national government announced a number of reforms designed to encourage FDI and present a favorable scenario to investors.

FDI investments are permitted through financial collaborations, through private equity or preferential allotments, by way of capital markets through Euro issues, and in joint ventures.

Objective of the Study

The objective of the paper is to provide an overview of need ,importance, position, and challenges in FDI in India.

Review of Literature

There are many empirical studies on the relation between FDI and economic activities in India. One school of thought argued that FDI has a negative impact on the growth of India because FDI flows mainly towards the primary sector which basically promoted the less market value. However another school of thought argued that FDI inflow into the core sectors is assumed to play a vital role as a source of capital, management and technology. 'Singh J.' conducted a research on "Economic Reforms and Foreign Direct Investment in India: Policy, Trends and Patterns" in the year „2010‟. The main objective of his research was in the context of increasing competition among nations and sub national entities to attract Foreign Direct Investment (FDI). For this research he used tables and graphs as a data analysis tool. From the present paper he tried to analyze the emerging trends and patterns of FDI inflows into India in response to various policy measures announced by the Government of India since mid-1980 and later. The empirical analysis tends to suggest that the FDI inflows, in general, show an increasing trend during the post-reform period. Furthermore, country-wise comparison of FDI inflow also indicates that FDI inflow into India has increased considerably in comparison to other developing economies in the recent years. Thus, the study indicates that the FDI inflows into India responded positively to the liberalization measures introduced in the early 1990s. 'Singh, Shikha' conducted a research on "Foreign Direct Investment (FDI) and Growth of States of India" in the year „2009‟. The main objective of her research was to analyze the growth of Indian states in context of FDI inflow and to study the factors contributing to the flow of FDI in a particular state. For this research she used correlation as a data analysis tool. From this study she concluded that foreign direct investment (FDI) policies play a major role in the economic growth of developing countries around the world. Attracting FDI inflows with conducive policies has, therefore, become a key battleground in the emerging markets. The prospect of new growth opportunities and outsized profits encourages large capital inflows across a range of industry and opportunity types. And this has led to competition among the states in formulating flexible policies and providing incentives to woo private investors to invest more and more. In the light of the above the paper highlights the trend of FDI in India after the economic reforms, sector-wise and country-wise share of FDI, the manner in which FDI has affected the growth of Indian states. Various factors, which play a significant role in attracting FDI into a particular state are also examined. Efforts made by the state governments in order to attract maximum FDI are also studied.

Why Is FDI Important?

FDI is a major source of external finance which means that countries with limited amounts of capital can receive finance beyond national borders from wealthier countries. Exports and FDI have been the two key ingredients in China's rapid economic growth. According to the World Bank, FDI and small business growth are the two critical elements in developing the private sector in lower-income economies and reducing poverty.

Historical Background in India

* India adopted pro-FDI approach since 1990's.
* Successive governments from that time realized the importance of FDI & they were too pro-FDI.
* Recent reforms such as FDI in retail, insurance, civil aviation, etc. are welcome steps & will surely help to improve these sectors in the coming years.
* India has been focusing more on FDI these days so that it can decrease the pressure of current acoount Deficit.

Macro View of FDI

* It has been proposed that in long run FDI is never useful because of the diminishing returns to capital over time.
* But it is also true that FDI increases the production & efficiency. So actually it contributed to increasing returns to capital.
* According to the economic theories, there are four main channels of technological spillovers (indirect effect of FDI) from FDI to the host country (the country in which FDI comes):- 1) Learning by doing 2) Competition 3) Labour Skills 4) Linkage.
* Any FDI provides for more new investment opportunities for local firms and increase their profitability through the provision of machinery, technology, training, managerial skill, and finance.
* FDI also indirectly increases the local demand for local inputs such as labour and suppliers create local demand of domestically produced goods and services. This increases domestic investment (DI). So there is complementary relationship between FDI & DI.
* FDI integrates local domestic markets with international ones & provides easy access to international markets for domestic business.
* In a way it can be said that FDI contributes to improving the host economy's export and competitiveness and volume by (1) augmenting domestic capital for exports (2)helping transfer of technology and new products for exports (3) facilitating access to new and large foreign markets (4) providing training for the local workforce and upgrading technical and management skills.

FDI Reforms in India: a Brief Summary

* Till 1990 all the FDI norms were meant to meet domestic requirements.

* It was the Balance of Payment (BoP) crisis of 1991 that triggered for allowing FDI in India.
* Provision of the Foreign Exchange Regulation Act (FERA) were diluted to a great extent in this period.
⇒ India was heavily dependent on foreign exchange in the form of debts in 1970s & 1980s. But the 1991 crisis saw allowing a way to foreign exchange but which was non-debt-creating & long term in nature.
* FDI policy is now reviewed on a regular basis.
* FDI can enter most sectors or activities under the Automatic Approval Route, except for a few sectors where there are additional restrictions on FDI such as equity caps, disinvestment conditions and lock-in periods on investment. Such restrictions are present because of the sectoral needs, security and strategic concerns and in the interest of domestic investment.

Recent FDI Reforms
* Recent years have witnessed a slowdown in investment because of financial crisis, policy paralysis, and deterioration of business environment.
* Various economic problems in India led to the sharp fall in the business confidence in India.
* Because of this various sectors have been made open under FDI equity to regain the confidence of both domestic and foreign investors.

Major FDI Reforms since September 2012

* Allowing 100% FDI ownership in single brand retail trading and upto 51% FDI in multi brand retail.
* Allowing foreign airlines upto 49% FDI.
* Increasing FDI equity from 49% to 74% in certain broadcasting sectors.
* Allow up to 49% FDI in power exchanges.
* Increasing FDI limit from 26% to 49% in insurance sector.
* Allowing 49% FDI in several sectors such as petroleum and natural gas, commodity and stock exchanges, power exchanges, asset reconstruction, single brand retail and telecommunications. Foreign investment up to 49% in these industries may be made under the automatic route which does not require approval from the RBI or the Indian government
* Sectors such as asset reconstruction and telecommunications are eligible for 100% FDI upon approval by the FIPB.
* The defence sector will also be eligible for greater FDI under the recent changes. For present it is 26%. But 100 equity is also allowed if the project are likely to result in access to modern and state of the art technology.
* Increase in pension sector have been proposed and await parliamentary approval.
Implications of Recent Changes in FDI Norms
* It will increase the efficiency of the concerned sector.
* All the results of the current changes can be seen only in the future.

* It will increase overall Indian economy.
* It will facilitate better insurance products, technological capabilities, awareness efforts and expertise and skills in underwriting, actuarial, claims management and data standardization to India.

Challenges In FDI

* FDI inflow has increased in India in the past 20 years but it still lags behind (quantitatively) countries like China, Singapore or Brazil.
* FDI inflow to India is concentrated in a few sectors only.
* FDI has been seen to come in some states only.
* Various problems that are in the way of FDI flow to India:

Infrastructure bottlenecks 2) rigid and complicated labour laws 3) lack of coordination between the centre and states 4) FDI caps/ceiling in many sectors where 100% FDI equity is not allowed for feasible investment projects and 5) difficult bureaucratic controls and procedures to get the necessary clearances and approvals. First time investors in India are always skeptical about whether projects will progress from screening to operation.

Necessary Reforms That Must Come In FDI

* A better environment for infrastructure development with an appropriate institutional framework such as a dispute resolution mechanism, independent regulatory authority and special investment law.
* A uniform labour code after an independent review and proper consultation with stakeholders.
* Proper design and planning of SEZs including local level solutions for land acquisition and sector-specific policies with incentives to attract FDI into SEZs
* Proper infrastructure connectivity to SEZs and allowing the private sector to provide infrastructure services to SEZs.
* Increasing FDI caps in sectors with FDI potential and allowing more sectors under the automatic route.
* Revisiting outdated laws, controls, regulatory systems, ad government monopolies affecting the investment environment.
* Encouraging non-governmental facilitation services for foreign investors.
* Further trade reforms and reforms in public services to attract foreign investment.

How FDI is calculated?

Foreign direct investment can be defined, according to national accounting principles, as the net investment inflow that is necessary for acquiring long term management interest in an organization that is operating in a different country. Long term management interest can be calculated as at least 10% of the voting stock of a company.

It is the aggregate of equity capital and other long term and short term capital that are reflected in the balance of payments. A foreign direct investor normally takes part in the following areas of an organization's operations:

- management
- technology transfer
- joint ventures
- expertise transfer

There are two major types of FDI – inward FDI and outward FDI. Together these values are used to calculate the stock of foreign direct investment and the net FDI inflow. Direct investment, however, does not include buying shares. FDI can be cited as an example of international factor movement.

Union Government FDI Measures

The Union Government has allowed 100 percent FDI in cash and carry wholesale trade sector apart from the single brand retail market. It has also opted to allow 51% FDI in the multi brand retail segment. However, this will be implemented in accordance to certain predetermined conditions. At present, it is trying to come to a consensus on this matter with the various state governments.

FDI Equity Inflows from 2000-2012				
S. Nos	Financial Year (April – March)	Amount of FDI Inflows		%age growth over previous year (in terms of US $)
FINANCIAL YEARS 2000-2012		In ` crores	In US$ million	
1	2000-01	10733	2463	-

2	2001-02	18654	4065	(+) 65 %
3	2002-03	12871	2705	(-) 33 %
4	2003-04	10064	2188	(-) 19 %
5	2004-05	14653	3219	(+) 47 %
6	2005-06	24584	5540	(+) 72 %
7	2006-07	56390	12492	(+)125 %
8	2007-08	98642	24575	(+) 97 %
9	2008-09 ‘*’	142829	31396	(+) 28 %
10	2009-10 #	123120	25834	(-) 18 %
11	2010-11 #	97320	21383	(-) 17 %
12	2011-12 #	165146	35121	(+) 64 %
13	2012-13 #	121907	22423	(-) 36 %
CUMULATIVE TOTAL (from April 2000 to April 2013)		909536	195725	-

Note:

(i) including amount remitted through RBI‟s-NRI Schemes (2000-2002).

(ii) FEDAI (Foreign Exchange Dealers Association of India) conversion rate from rupees to US dollar applied, on the basis of monthly average rate provided by RBI (DEAP), Mumbai.

(iii) Variation in equity inflows reported in above Table II-A & II-B for 2006-07, 2007-08, 2008-09, 2009-10 & 2010-11 is due to difference in reporting of inflows by RBI in their monthly report to DIPP & monthly RBI bulletin.

(IV) Figures for the years 2009-10, 2010-11 & 2011-12 are provisional subject to reconciliation with RBI.

(V) An additional amount of US$ 4,035 million pertaining to the year 2008-09, since reported by RBI, has been included in FDI data base from February 2012

Key Statistics

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.**Conclusion**

FDI as a strategic component of investment isneeded by India for its sustained economic growthand development through creation of jobs,expansion of existing manufacturing industries,short and long term project in the field ofhealthcare, education, Research andDevelopment (R&D), etc. Government shoulddesign the FDI policy such a way where FDI inflowcan be utilized as means of enhancing domesticproduction, savings and exports through theequitable distribution among states by providingmuch freedom to states, so that they can attractFDI inflows at their own level. FDI can help toraise the output, productivity and export at thesectoral level of the Indian economy

References

Ramkishen S. Rajan, Sunil Rongala and Ramya Ghosh, “Attracting Foreign Direct Investment (FDI) to India”, April 2008.

Banco de España (2002) "The Spanish Balance of Payments 2001”, 1st edition, Madrid.

Available in: http://www.bde.es/.

World Economic Forum “Global Competitiveness report 2011-12: Country profile Highlights”, 2011-12.

Falzoni, Anna M. (2000) “Statistics on Foreign Direct Investment and Multinational

Corporations: a Survey”, University of Bergamo, Centro de Studi Luca d’Agliano and

CESPRI.

IMF (International Monetary Fund) 1993, Balance of Payments Manual 5th Edition, Washington DC.

IMF (International Monetary Fund) 1995, Balance of Payments Compilation Guide, 1st Edition, Washington DC.

IMF (International Monetary Fund) 2001, Balance of Payments Statistics Yearbook, Washington DC.

IMF (International Monetary Fund) 2001, International Finance Statistics Yearbook, Washington, DC.

http://www.schwabfound.org/en/initiatives/gcp/CountryStudies/index.htm

Lipsey, Robert E. (2001) "Foreign Direct Investment and the operations of multinational firms: concepts, history, and data", Working paper 8665, National Bureau of Economic Research, Cambridge (USA).