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An Analysis of Foreign Direct Investment Flow And Impact on Indian Economy

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Abstract

Abstract—FDI and trade are often seen as important catalysts for economic growth in the developing countries. FDI is an important vehicle for technology transfer from developed countries to developing countries. Since 1991 the government has focused on liberalization of policies to welcome foreign direct investments. India's economic reforms way back in 1991 has generated strong interest in foreign investors and turning India into one of the favorite destinations for global FDI flows. The FDI inflows grow at about 20 times since the opening up of the economy to foreign investment. Further, the explosive growth of FDI gives opportunities to Indian industry for technological upgradation, gaining access to global managerial skills and practices, optimizing utilization of human and natural resources and competing internationally with higher efficiency. FDI in India has enabled to achieve a certain degree of financial stability; growth and development to sustain and compete in the global economy.

KEYWORDS: FDI Inflow, Economic growth, Financial Market Reforms

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Introduction

Foreign direct investment occurs when individuals or companies in one country purchase ownership of assets in other country. In very simple terms, a company in the United States might purchase the production facility that is used to manufacturer automobiles in China. Foreign Direct Investment (FDI) as an important driver of growth. It is an important source of non debt financial resources for country for economic development. Besides it is a means of achieving technical knowhow and employment generation of employment. However, many are of the view that FDI is a big threat to sovereignty of host and domestic business houses. Midst of debate on pros and cons of FDI, world economy has observed a phenomenal change in volume and pattern of FDI. India emerged as an attractive FDI destination in services but has failed to evolve a manufacturing hub which has greater economic

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benefit. FDI though one of the important sources of financing the economic development, but not is not a solution for poverty eradication, unemployment and other economic ills. India needs a massive investment to achieve the goals of vision 20-20. The major impact during the recessionary period was mainly due to the negative flow of FII in India while the FDI remained moderately unaffected with the global slowdown. Though the liberal policy stance and strong economic fundamentals appear to have driven the steep rise in FDI flows in India over past one decade and sustained their momentum even during the period of global economic crisis (2008-09 and 2009-10),the subsequent moderation in investment flows despite faster recovery from the crisis period appears somewhat inexplicable. Survey of empirical literature and analysis presented in the paper seems to suggest that these divergent trends in FDI flows could be the result of certain institutional factors that dampened the investors'sentiments despite continued strength of economic fundamentals.

Review of literature

Many empirical studies have been undertaken to analyze the trends and determinants of Foreign Direct Investment (FDI) in India, few of them are as follows:

Kumar, R (2014), examined the role of FDI on economic growth in India for the period 1991-2010. In order to study the contribution of FDI on economic growth and the factors influencing the pattern of foreign direct investment in India, two models are fitted. The study also works out the trends and patterns in FDI inflows at sectoral level. Finally, the study shows that FDI significantly contributes to enhancing the economic growth in the country. It is also found that FDI is a very important variable which is influencing the level of economic growth in India. Sapna Hooda (2011) analyzed the impact of FDI on economic growth of Indian economy for the period 1991-92 to 2008-09. She used OLS method for this purpose. The empirical results found that foreign Direct Investment (FDI) is a vital and significant factor influencing the level of growth in Indian economy. Lodhi (2014), discussed the concept of Foreign Direct Investment is now a part of India's economic future but the term remains vague to many, despite the profound effects on the economy. Despite the extensive studies on FDI, there has been little illumination forthcoming and it remains a contentious topic. The paper explores the uneven beginnings of FDI, in India and examines the developments (economic and political) relating to the trends in two sectors: Industry and Infrastructure and sub sector Telecom, to illustrate that. Mathiyazhagan Maathai K. (2005) examined the long-run relationship of Foreign Direct Investment (FDI) with the Gross Output (GO), Export (EX)

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and Labour Productivity (LPR) in the Indian economyat the sectoral level. He concluded that the advent of FDI has not helped to wield a positive impact on the Indian economy at the sectoral level. Saini (2014), revealed the sectoral trend of FDI inflows in India in two different regimes 1991 - 2000 and 2001-2012.This study further discloses the trend of FDI as well as the major sources of FDI inflows. In this study, the descriptive analysis has been employed for evaluating the sectoral trend of FDI inflows in order to identify the most significant sector contributing largely in growth prospect of India in context of FDI inflow. The results imply that service sector along with telecommunication sector received highest FDI inflows during last decade. Further, it is observed that mostly foreign investors prefer to invest through Mauritius route in India. Khan, A. (2014) evaluated the FDI flows in India through Mergers and Acquisitions, a composite view of effective practices that have been emerged from inbound investors' experience conducting M&As in India. However, a number of successful deals shortlisted based on their size and prominence in the Indian market. Foreign Direct investment is a subject of interest in India. The World Bank is an international financial institution that provides loans to developing countries for capital programme. The countries of the world, particularly developing economies, are rivals to attract foreign capital to boost their domestic rates of investment and also to acquire new technology and managerial skills. Kulwinder Singh (2005) has analyzed FDI flows from 1991-2005. A sectoral analysis in his study reveals that while FDI shows a gradual increase has become a staple of success in India, the progress is hollow. The telecommunication and power sector are the reasons for the success of infrastructure. He finds that in the comparative studies the notion of infrastructure has gone a definitional change. FDI in sectors is held up primarily by telecommunication and power is not evenly distributed.

Objectives

1. To analyze the pattern and direction of FDI flow in India.
2. To analysis the FDI flows in different sectors.
3. To assess the role of FDI on economic growth in India

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Global Trends in FDI Inflows

During the period subsequent to dotcom burst, there has been an unprecedented rise in the cross-border flows and this exuberance was sustained until the occurrence of global financial crisis in the year 2008-09. Between 2003 and 2007, global FDI flows grew nearly four -fold and flows to EMEs during this period, grew by about three-fold. After reaching a peak of US$ 2.1 trillion in 2007, global FDI flows witnessed significant moderation over the next two years to touch US$ 1.1 trillion in 2009, following the global financial crisis. On the other hand, FDI flows to developing countries increased from US$ 565 billion in 2007 to US$ 630 billion in 2008 before moderating to US$ 478 billion in 2009.

Table 1 : Countries with Higher Estimated Level of FDI Inflows than India in 2010

	Amount (US$ billion)				**Variation (Percent)**		
	2007	**2008**	**2009**	**2010 (Estimates)**	**2008**	**2009**	**2010 (Estimates)**
World	**2100.0**	**1770.9**	**1114.2**	**1122.0**	**-15.7**	**-37.1**	**0.7**
Developed Economies	**1444.1**	**1018.3**	**565.9**	**526.6**	**-29.5**	**-44.4**	**-6.9**
United States	266.0	324.6	129.9	186.1	22.0	-60.0	43.3
France	96.2	62.3	59.6	57.4	-35.2	-4.3	-3.7
Belgium	118.4	110.0	33.8	50.5	-7.1	-69.3	49.4
United Kingdom	186.4	91.5	45.7	46.2	-50.9	-50.1	1.1
Germany	76.5	24.4	35.6	34.4	-68.1	45.9	-3.4
Developing Economies	**564.9**	**630.0**	**478.3**	**524.8**	**11.5**	**-24.1**	**9.7**
China	83.5	108.3	95.0	101.0	29.7	-12.3	6.3
Hong Kong	54.3	59.6	48.4	62.6	9.8	-18.8	29.3
Russian Federation	55.1	75.5	38.7	39.7	37.0	-48.7	2.6
Singapore	35.8	10.9	16.8	37.4	-69.6	54.1	122.6
Saudi Arabia	22.8	38.2	35.5	-	67.5	-7.1	-
Brazil	34.6	45.1	25.9	30.2	30.3	-42.6	16.6
India	**25.0**	**40.4**	**34.6**	**23.7**	**61.6**	**-14.4**	**-31.5**

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Source: World Investment Report, 2010 and Global Investment Trends Monitor, UNCTAD.

With the tripling of the FDI flows to EMEs during the pre-crisis period of the 2000s, India also received large FDI inflows in line with its robust domestic economic performance. The attractiveness of India as a preferred investment destination could be ascertained from the large increase in FDI inflows to India, which rose from around US$ 6 billion in 2001-02 to almost US$ 38 billion in 2008-09. The significant increase in FDI inflows to India reflected the impact of liberalisation of the economy since the early 1990s as well as gradual opening up of the capital account. As part of the capital account liberalisation, FDI was gradually allowed in almost all sectors, except a few on grounds of strategic importance, subject to compliance of sector specific rules and regulations. The large and stable FDI flows also increasingly financed the current account deficit over the period. During the recent global crisis, when there was a significant deceleration in global FDI flows during 2009-10, the decline in FDI flows to India was relatively moderate reflecting robust equity flows on the back of strong rebound in domestic growth ahead of global recovery and steady reinvested earnings (with a share of almost 25 per cent) reflecting better profitability of foreign companies in India. However, when there had been some recovery in global FDI flows, especially driven by flows to Asian EMEs, during 2010-11, gross FDI equity inflows to India witnessed significant moderation. Gross equity FDI flows to India moderated to US$ 20.3 billion during 2010-11 from US$ 27.1 billion in the preceding year.

Trends in FDI Inflows to India

Table 2: Equity FDI Inflows to India

(Percent)

Sectors	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**
Sectoral shares (Percent)					
Manufactures	17.6	19.2	21.0	22.9	32.1
Services	56.9	41.2	45.1	32.8	30.1
Construction, Real estate and mining	15.5	22.4	18.6	26.6	17.6
Others	9.9	17.2	15.2	17.7	20.1

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Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Equity Inflows (US$ billion)					
Manufactures	1.6	3.7	4.8	5.1	4.8
Services	5.3	8.0	10.2	7.4	4.5
Construction, Real estate and mining	1.4	4.3	4.2	6.0	2.6
Others	0.9	3.3	3.4	4.0	3.0
Total Equity FDI	**9.3**	**19.4**	**22.7**	**22.5**	**14.9**

From a sectoral perspective, FDI in India mainly flowed into services sector (with an average share of 41 per cent in the past five years) followed by manufacturing (around 23 per cent) and mainly routed through Mauritius (with an average share of 43 per cent in the past five years) followed by Singapore (around 11 per cent). However, the share of services declined over the years from almost 57 per cent in 2006-07 to about 30 per cent in 2010-11, while the shares of manufacturing, and 'others' largely comprising 'electricity and other power generation' increased over the same period. Sectoral information on the recent trends in FDI flows to India show that the moderation in gross equity FDI flows during 2010-11 has been mainly driven by sectors such as 'construction, real estate and mining' and services such as 'business and financial services'. Manufacturing, which has been the largest recipient of FDI in India, has also witnessed some moderation (Table 2).

Advantages of FDI

1. Increase economic growth due to different international products
2. Employment will increase
3. Billion dollars will be invested in Indian market
4. Spread of import and export business in different countries
5. Agriculture related people will get good price of their goods

Disadvantages of FDI

1. Will affect 50 million merchants in India
2. Profit distribution, investment ratios are not fixed

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3. An economically backward class person suffers from price raise
4. Retailer faces loss in business
5. Market places are situated too far which increases traveling expenses
6. Workers safety and policies are not mentioned clearly
7. Inflation may be increased
8. Again India become slaves because of FDI in retail sector

Findings and conclusions

An analysis of the recent trends in FDI flows at the global level as well as across regions/countries suggests that India has generally attracted higher FDI flows in line with its robust domestic economic performance and gradual liberalization of the FDI policy as part of the cautious capital account liberalization process. Even during the recent global crisis, FDI inflows to India did not show as much moderation as was the case at the global level as well as in other EMEs. However, when the global FDI flows to EMEs recovered during 2010-11, FDI flows to India remained sluggish despite relatively better domestic economic performance ahead of global recovery

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