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Role of FDI in Indian Economic Growth

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INTRODUCTION

One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economic landscape. This unprecedented growth of global FDI in 1990 around the world make FDI an important and vital component of development strategy in both developed and developing nations and policies are designed in order to stimulate inward flows. Infact, FDI provides a win – win situation to the host and the home countries. Both countries are directly interested in inviting FDI, because they benefit a lot from such type of investment. The 'home' countries want to take the advantage of the vast markets opened by industrial growth. On the other hand the 'host' countries want to acquire technological and managerial skills and supplement domestic savings and foreign exchange. Moreover, the paucity of all types of resources viz. financial, capital, entrepreneurship, technological know- how, skills and practices, access to markets- abroad- in their economic development, developing nations accepted FDI as a sole visible panacea for all their scarcities. Further, the integration of global financial markets paves ways to this explosive growth of FDI around the globe

AN OVERALL VIEW

The historical background of FDI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. However, researchers could not portray the complete history of FDI pouring in India due to lack of abundant and authentic data. Before independence major amount of FDI came from the British companies. British companies setup their units in mining sector and in those sectors that suits their own economic and business interest. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India. Further, after Independence issues relating to foreign capital, operations of MNCs, gained attention of the policy makers. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. The first Prime Minister of India considered foreign investment as "necessary" not only to supplement domestic capital but also to secure scientific, technical, and industrial knowledge and capital equipments. With time and as per economic and political regimes there have been changes in the FDI policy too.

The industrial policy of 1965, allowed MNCs to venture through technical collaboration in India. However, the country faced two severe crisis in the form of foreign exchange and financial resource mobilization during the second five year plan (1956 -61). Therefore, the government adopted a liberal attitude by allowing more frequent equity participation to foreign enterprises, and to accept equity capital in technical collaborations. The government also provides many incentives such as tax concessions, simplification of licensing procedures and de- reserving some industries such as drugs, aluminium, heavy electrical equipments, fertilizers, etc in order to further boost the FDI inflows in the country. This liberal attitude of government towards foreign capital lures investors from other advanced countries like USA, Japan, and Germany, etc. But due to significant outflow of foreign reserves in the form of remittances of dividends, profits, royalties etc, the government has to adopt stringent foreign policy in 1970s. During this period the government adopted a selective and highly restrictive foreign policy as far as foreign capital, type of FDI and ownerships of foreign companies was concerned. Government setup Foreign Investment Board and enacted Foreign

Exchange Regulation Act in order to regulate flow of foreign capital and FDI flow to India. The soaring oil prices continued low exports and deterioration in Balance of Payment position during

1980s forced the government to make necessary changes in the foreign policy. It is during this period the government encourages FDI, allow MNCs to operate in India. Thus, resulting in the partial liberalization of Indian Economy. The government introduces reforms in the industrial sector, aimed at increasing competency, efficiency and growth in industry through a stable, pragmatic and non-discriminatory policy for FDI flow. Infact, in the early nineties, Indian economy faced severe Balance of payment crisis. Exports began to experience serious difficulties. There was a marked increase in petroleum prices because of the gulf war. The crippling external debts were debilitating the economy. India was left with that much amount of foreign exchange reserves which can finance its three weeks of imports. The out flowing of foreign currency which was deposited by the Indian NRI's gave a further jolt to Indian economy. The overall Balance of Payment reached at Rs.(-) 4471 crores. Inflation reached at its highest level of 13%.

Foreign reserves of the country stood at Rs.11416 crores. The continued political uncertainty in the country during this period adds further to worsen the situation. As a result, India's credit rating fell in the international market for both short- term and long- term borrowing. All these developments put the economy at that time on the verge of default in respect of external payments liability. In this critical face of Indian economy the then finance Minister of India Dr. Manmohan Singh with the help of World Bank and IMF introduced the macro – economic stabilization and structural adjustment programm. As a result of these reforms India open its door to FDI inflows and adopted a more liberal foreign policy in order to restore the confidence of foreign investors.

Further, under the new foreign investment policy Government of India constituted FIPB (Foreign Investment Promotion Board) whose main function was to invite and facilitate foreign investment through single window system from the Prime Minister's Office. The foreign equity cap was raised to 51 percent for the existing companies. Government had allowed the use of foreign brand names for domestically produced products which was restricted earlier. India also became the member of MIGA (Multilateral Investment Guarantee Agency) for protection of foreign investments. Government lifted restrictions on the operations of MNCs by revising the FERA Act 1973. New sectors such as mining, banking, telecommunications, highway construction and management were open to foreign investors as well as to private sector.

OBJECTIVES

The study covers the following objectives:

1. To study the trends and patterns of flow of FDI.
2. To assess the determinants of FDI inflows.
3. To evaluate the impact of FDI on the Economy.

IMPORTANCE OF THE STUDY

It is apparent from the above discussion that FDI is a predominant and vital factor in influencing the contemporary process of global economic development. The study attempts to analyze the important dimensions of FDI in India. The study works out the trends and patterns, main determinants and investment flows to India. The study also examines the role of FDI on economic growth in India for the period 1991-2008. The period under study is important for a variety of reasons. First of all, it was during July 1991 India opened its doors to private sector and liberalized its economy. Secondly, the experiences of South-East Asian countries by liberalizing their economies in 1980s became stars of economic growth and development in early 1990s. Thirdly, India's experience with its first generation economic reforms and the country's economic growth performance were considered safe havens for FDI which led to second generation of economic reforms in India in first decade of this century. Fourthly, there is a considerable change in the attitude of both the developing and developed countries towards FDI. They both consider FDI as the most suitable form of external finance. Fifthly, increase in competition for FDI inflows particularly among the developing nations.

The shift of the power center from the western countries to the Asia sub – continent is yet another reason to take up this study. FDI incentives, removal of restrictions, bilateral and regional investment agreements among the Asian countries and emergence of Asia as an economic powerhouse (with China and India emerging as the two most promising economies of the world) develops new economics in the world of industralised nations.

TRENDS AND PATTERNS OF FDI FLOW IN INDIA

Economic reforms taken by Indian government in 1991 makes the country as one of the prominent performer of global economies by placing the country as the 4th largest and the 2nd fastest growing economy in the world. India also ranks as the 11th largest economy in terms of industrial output and has the 3rd largest pool of scientific and technical manpower. Continued economic liberalization since 1991 and its overall direction remained the same over the years irrespective of the ruling party moved the economy towards a market – based system from a closed economy characterized by extensive regulation, protectionism, public ownership which leads to pervasive corruption and slow growth from 1950s until 1990s.

In fact, India's economy has been growing at a rate of more than 9% for three running years and has seen a decade of 7 plus per cent growth. The exports in 2008 were
$175.7 bn and imports were $287.5 bn. India's export has been consistently rising, covering 81.3% of its imports in 2008, up from 66.2% in 1990-91. Since independence, India's BOP on its current account has been negative. Since 1996-97, its overall BOP has been positive, largely on account of increased FDI and deposits from Non – Resident
Indians (NRIs), and commercial borrowings. The fiscal deficit has come down from 4.5 per cent in 2003-04 to 2.7 per cent in 2007-08 and revenue deficit from 3.6 per cent to 1.1 per cent in 2007-08.

. As a result, India's foreign exchange reserves shot up 55 per cent in 2007-08 to close at US $309.16 billion – an increase of nearly US $110 billion from US $199.18 billion at the end of 2006-07. Domestic saving ratio to GDP shot up from 29.8% in 2004-05 to 37.7% in 2007-08. For the first time India's GDP crossed one trillion dollars mark in 2007. As a consequence of policy measures (taken way back in 1991) FDI in India has increased manifold since 1991 irrespective of the ruling party over the years, as there is a growing consensus and commitments among political parties to follow liberal foreign investment policy that invite steady flow of FDI in India so that sustained economic growth can be achieved. Further, in order to study the impact of economic reforms and FDI policy on the magnitude of FDI inflows, quantitative information is needed on broad dimensions of FDI and its distribution across sectors and regions. The actual FDI inflows in India is welcomed under five broad heads: (i) Foreign Investment Promotion Board's (FIPB) discretionary approval route for larger projects, (ii) Reserve Bank of India's (RBI) automatic approval route, (iii) acquisition of shares route (since 1996), (iv) RBI's non – resident Indian (NRI's) scheme, and (v) external commercial borrowings (ADR/GDR) route..

FDI AND INDIAN ECONOMY

Developed economies consider FDI as an engine of market access in developing and less developed countries vis-à-vis for their own technological progress and in maintaining their own economic growth and development. Developing nations looks at FDI as a source of filling the savings, foreign exchange reserves, revenue, trade deficit, management and technological gaps. FDI is considered as an instrument of international economic integration as it brings a package of assets including capital, technology, managerial skills and capacity and access to foreign markets. The impact of FDI depends on the country's domestic policy and foreign policy. As a result FDI has a wide range of impact on the country's economic policy. In order to study the impact of foreign direct investment on economic growth, two models were framed and fitted The foreign direct investment model shows the factors influencing the foreign direct investment in India. The economic growth model depicts the contribution of foreign direct investment to economic growth.

ROLE OF FDI ON ECONOMIC GROWTH

In the foreign direct investment model the main determinants of FDI inflows to India are assessed. The study identified the following macroeconomic variables: Trade GDP, R&DGDP, FIN Position, EXR, and Reserves GDP as the main determinants of FDI inflows into India. In order to study the role of FDI on Indian economy it is imperative to assess the trend pattern of all the variables used in the determinant analysis. It is observed that FDI inflows into India shows a steady trend in early nineties but shows a sharp increase after 2005, though it had fluctuated a bit in early 2000. However, Gross domestic product shows an increasing trend pattern since 1991-92 to 2010-11and further steady and again increasing trend upto 2014. Another variable i.e. Trade GDP maintained a steady trend pattern upto 2001-02, after that it shows a continuous increasing pattern upto 2008-09. Reserves GDP, another explanatory variable shows low trend pattern upto 2000-01 but gained momentum after 2001-02 and shows an increasing trend. In addition to these trend patterns of the variables the study also used the multiple regression analysis to further explain the variations in FDI inflows into India due to the variations caused by these explanatory variables.

CONCLUSIONS:

1. FDI is a significant factor influencing the level of economic growth in India.
2. FDI plays a crucial role in enhancing the level of economic growth in the country
3. FDI is a significant factor influencing the level of economic growth in India. It provides a sound base for economic growth and development by enhancing the financial position of the country
4. FDI contributes to the GDP and foreign exchange reserves of the country.

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