ISBN : 978-81-930365-5-1

Inflation: F.D.I

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- **Abstract:**

Inflation is as common in Indian economy as cold and flu in winter season .It is therefore one of the biggest challenge for an economy like India which is on the path of growth and development , inflation is like a caterpillar that eats away the growing cream of an economy .In this research paper we are going to analysis the inflation and its factors , the challenges that it brings and will also summarize the inflation since independence , particularly the food inflation and examine the demand and supply side factors behind surging food prices . It will further explain the methods of measuring the inflation, the different types of inflation and what factors are responsible for the current high rate of inflation in India.

- **Introduction:**

"Inflation means that your money won't buy as much today as you could yesterday."

In simple terms, inflation can be defined as either a rise in prices or a fall in the value of money. It can be defined as "An increase in the cost of things that are necessary for humans to live and enjoy life or a decrease in the value of money so that it takes more dollars, or yen, or pounds sterling, to buy the same goods and services it did in the past."

Inflation may reduce a country's international competitiveness, by making its exports relatively more expensive, thus impacting on the balance of payments. Moreover, inflation can interact with the tax system to distort borrowing and lending decisions. Firms may have to devote more resources to dealing with the effects of inflation. Macroeconomists, central bankers and policymakers have often emphasized the costs associated with high and variable inflation. Inflation imposes negative externalities on the economy when it interferes with an economy's efficiency.

Generally, policy strategies of the Nigerian government towards foreign investm ents are shaped by two principal objectives of the desire for economic independence and the demand for economic development.

- **Types of Inflation:**

1) **Demand Pull inflation** : In this type of inflation prices increase results from an excess of demand over supply for the economy as a whole demand inflation occurs when the supply cannot expand any more to meet demand that is when critical production factors are being fully utilized also called demand inflation.

ISBN : 978-81-930865-5-1

2) **Cost push inflation:** This type of inflation occurs when general price level rise owing to rising input costs .In general these factors that contribute to cost push inflation rising wages increase in corporate taxes and imported inflation. Imported raw or partly finished goods may become expensive due to rise in international costs or as a result of depreciation of local currency.

3) **Negative effect of inflation :** Negative effect of inflation include an increase in the opportunity cost of the holding money , uncertainty over future inflation which may discourage investment and savings and if inflation is rapid enough ,shortage of goods as consumers begin hoarding out of concern that prices will increase in the future .

4) **Positive effect of inflation:** Positive effect includes ensuring that central banks can adjust real interest rates and encouraging investment in non monetary capital projects. Most economists favour a low and steady rate of inflation as opposed to zero or negative inflation reduces the severity of economic recessions by enabling the labour market to adjust to more quickly in a downturn and reduces the risk that a liquidity trap prevents monetary policy from stabilizing the economy. The task of keeping the rate of inflation low and stable is usually given to monetary authorities.

- **History of inflation in India:**

Inflation is a permanent characteristic of Indian economy .After the second world war there has been a strong inflationary pressure on the economy, because of the high demand and low supply because of the rapid growing of Indian population, rising money incomes, expansion in money supply and liquidity in the country, using volume of black money and continuous rise in demand for goods and services due to rapid economic development.

- **Post war inflation in India:**

The post war period saw the political crisis, partion of the country, social up heals and huge massacres, there was an inflationary trend which has remained repressed during this period. From (1949-69) this phase marks the nationalization of 14commercial banks .This period inherited a strong inflationary pressure because of the world wars and the devaluation of Indian rupee. The situation or the inflation was further aggregated by the Korean War in the year 1950-51 but was stabilized in the coming years because of the bumper agriculture production in the country thus the period experienced a moderate inflation rate during the period. From (1969-1991) This was the period of inflation and economy landing into the balance of payment crisis and forced to adopt for reaching economic reforms covering various sectors of the economy .The four years period ie 1971- 72, 74-75 was the period of hyper inflation in the country with inflation rate touching at 15.25% but government measures brought back the high inflation on track but again in the year 1970 inflation was 9%due to poor agriculture output and crude oil prices .The decade 1980 also experienced the period of inflation compared to the last decade more or less it was approx. 7.5%., but the next decade moved a step further in this direction and rate of inflation in 1990-91was 10%. From (1991-2009) Liberalization of the imports, adoption of the flexible exchange rate system, convertibility of the rupee deregulation of the interest rate, deservation of the public sector, abolition of the industrial licensing and the restrictive provision of the MRTP Act, reduction in fiscal and revenues deficit etc were some of the important reforms introduced since 1990and they have changed the entire Indian economy. Because of the various measures taken during the period, in the initial years the inflation rate was 10%. The second half of the 1990s saw a significant outcome .the average inflation rate during this period declined from 10% in the first half to 5.08%. The factors responsible for this were 1) RBI policy, 2) Cooling of global inflation, 3) Depreciation of rupee slowed down, 4) Large buffer of food grains Inflation after 2009 Inflation rate in India is reported by the ministry of commerce and industry of India. The wholesale price index (WPI) is the main measure of inflation .The WPI measures the price of a representative basket of wholesale goods.

This wholesale price index is divided into three groups.

1) Primary index: 20% of total weight,
2) Fuel and power: 49%
3) Manufactured products: 65%
4) Food articles: 14.3%
5) Metals and alloys: 10.8%
6) Machinery and tools: 8.9%
7) Textiles: 7.3%
8) Transport, equipment & parts: 5.2%

The Consumer Price Index (CPI) is a statistical estimate constructed using the prices of a sample of representative items whose prices are collected periodically. Sub-indexes and sub-sub-indexes are computed for different categories and sub-categories of goods and services, being combined to produce the overall index with weights reflecting their shares in the total of the consumer expenditures covered by the index. It is one of several price indices calculated by most national statistical agencies. The annual percentage change in a CPI is used as a measure of inflation. A CPI can be used to index (i.e., adjust for the effect of inflation) the real value of wages, salaries, pensions for regulating prices and for deflating monetary magnitudes to show changes in real values.

- **Impact relationship between fdi antit's determinants factors:**

There are so many determinants of FDI in the economy as suggested by existing literature available on this issue. There is need to know the expected relation between FDI and these determinants before doing empirical investigation regarding relationship of FDI and some variables taken in this study so as to find main determinants of FDI in India.

(i) **Market Size:** Market size which is measured in terms of GDPis expected to have positive relationship with FDI. Countries having more GDPgrowth rate can attract more FDI inflows. Market oriented FDI aims to set up enterprises to supply goods and services to the local market. This kind of FDI may be undertaken to exploit new markets. The market size of host countries is very important location factor for market oriented FDI. there is a positive effect of FDI and market size, if market size is large so it attract more capital inflow and vice-versa or spill-over effect is more in case of large market size it attract large capital inflow

 ISBN : 978-81-930865-5-1

(vii) Openness: openness is measured by proportion of export plus imports over GDP at market price. There is positive relationship between trade openness and FDI, if trade openness is high, it attract high capital inflow thereby high spill-over effect and vice-versa.

(viii) Government Regulations: This consists of rules and regulations governing the entry and operations of foreign investors. FDI cannot take place unless it is allowed to enter in a country. Its potential relevance is evident when policy changes sharply in the direction of more or less openness. It should be noted, however that policy changes in the direction of openness differ in an important way from those in the direction of restriction. Open policies are basically intended to induce FDI while restrictive policies such as sweeping nationalization of foreign affiliates, can effectively close the door to FDI.

(x) Tax Policies: Fiscal policies determine general tax levels, including corporate and personnel tax rates and thereby influence inward FDI. Other things being equal a country with lower tax rates should stand a greater chance of attracting FDI project than a country with higher rates. It is difficult to ascertain how much influence it can have on the total inflows of FDI.

(xi) Inflation: Low inflation rate is considered to be a sign of internal economic stability in the host country. High inflation rate indicates incapability of the government to balance its budget and failure of the central bank to conduct appropriate monetary policy. Changes in inflation rates of the domestic or foreign country are anticipated to alter the net returns and optimal investment decisions of the MNEs. It is expected to give negative impact on FDI. high inflation no FDI , less inflation, more FDI.

(xii) Industrial Organization: Industrial organization theory states that firm specific advantages, competition capabilities, managerial skills and practice etc. are some of the crucial points for industrial organization to survive. The relative advantages to TNCs in terms of these points make FDI to flow to a country of their choice.

(xiii) The Level of External Indebtedness: The level of external indebtedness means the net external assistance to India in the form of loans. It is expected to have a negative impact on FDI inflows. The level of indebtedness shows the burden of repayment and debt servicing on the economy, thus making the country less attractive for foreign investors.

(xiv) Foreign Exchange Rate: It is the rate at which one currency may be converted into another. In other words it is the relative strength of the domestic country in relation to the foreign country. high foreign exchange rate lead towards the high FDI and vice versa, but it has negative impact on economy of India.

- **Conclusion:**

This research article basically shows the different determinants factors, which either positive related with FDI or negative along with the spillover effect. This article found some determinants factors having positive impact on FDI mean that attract FDI from host country to home country. whereas some factors having negative impact on

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FDI means that don't attract FDI from host country to home country. Some factors have a neutral impact on FDI. In that case they only attract more FDI if high spill-over effect be there, means some additional benefits if having with FDI if capital inflow from host country to home country.

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