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Role of Foreign Direct Investment in Accelerating Economic Growth of India

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ABSTRACT

Apart from being a critical driver of economic growth, foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of cheaper wages, special investment privileges like tax exemptions and others. For a country where foreign investments are being made, it also means achieving technical know-how and generation of employment. The continuous inflow of FDI in India, which is now allowed across several industries, clearly shows the faith that overseas investors have in the country's economy. The Indian government's policy regime and a robust business environment have ensured that foreign capital keep flowing into the country. The Government of India has taken many initiatives in recent years such as relaxing FDI norms across sectors such as defen, Public Sector Units oil refineries, telecom, power exchanges and stock exchanges, among others. This research articles aims to examine the impact of FDI on the Indian economy and contribution of FDI in different sectors. The present study is not only confined to evaluate the impact of FDI on gross domestic product but also to analyse the trend of FDI in India. The study has focused on the trends of FDI flow in India during 2000–2001 to 2014–2015 (up to June, 2015). It is mainly based on secondary source of information, and the relevant secondary data have been collected from various publications of Government of India, Reserve Bank of India, UNACTD's World Investment Report (2015) published by United Nations different journals, FDI fact sheets and others. During the liberalised era, India has attracted huge quantum of funds in the form of FDI; while the performance of FDI has been impressive and satisfactory, on several other fronts, it has been inadequate also.

KEYWORDS: Foreign direct investment, Economic growth, Sectoral analysis, Indian economy, Gross domestic product, Equity, Portfolio investment

INTRODUCTION

Foreign investment is an investment in an enterprise by a non-resident irrespective of whether this involves new equity capital or reinvestment of earnings. Foreign investment is of two kinds: (i) foreign direct investment (FDI) and (ii) foreign portfolio investment. FDI is defined under the Dictionary of Economics as investment in a foreign country through the acquisition of a local company or the establishment thereof an operation on a new site. Nations' progress and prosperity are reflected by the pace of its sustained economic growth and development. Investment provides the base and prerequisite for economic growth and development. Apart from a nation's foreign exchange reserve, exports, government's revenue, financial position, available supply of domestic savings, magnitude and quality of foreign investment re necessary for the well-being of a country. The developing nations, in particular, consider FDI as the safest type of international capital flows out of all the

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available sources of external finance available to them. It was during the 1990s that FDI inflows rose faster than almost all other indicators of economic activity worldwide. The 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. The developing nations look at FDI as a source of filling the savings, foreign exchange reserves, revenue, trade deficit, management and technological gaps.

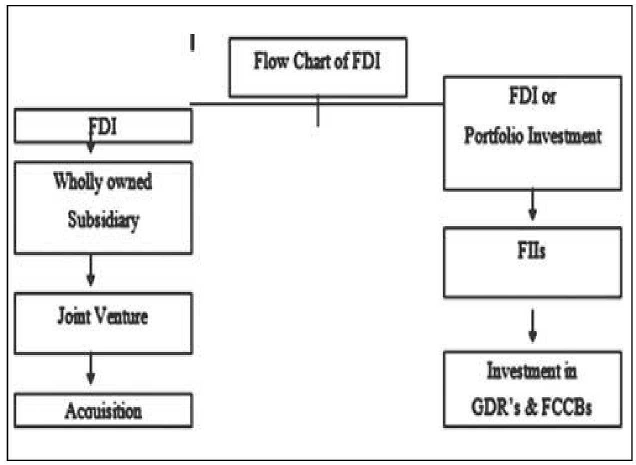
FDI policies play a major role in the economic growth of developing countries around the world. Investment opportunities in India have increased many folds. Economic liberalisation took place in wake of 1991 economic crisis and after that FDI progressively increased in India. With the initiation of new economic policy in 1991, which led to reforms process, India has witnessed a change in the flow and direction of FDI into the country. This is mainly because of the removal of restrictive and regulated practices.

FDI is not only 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, but also a major monetary source for economic development of India. India's recorded gross domestic product (GDP) growth throughout the last decade has lifted millions out of poverty and made the country a favoured destination for FDI. A recent UNCTAD survey projected India as the second-most important FDI destination after China for transnational corporations during 2010–2015. Services, telecommunication, construction activities, computer software and hardware and automobile are the major sectors which attracted higher inflows of FDI in India. Countries like Mauritius, Singapore, the United States and the United Kingdom were among the leading sources of FDI in India. According to Financial Times, in 2015 India overtook China and the United States as top destination for FDI of $31 billion compared to $27 billion, respectively. India also jumped 16 notches to 55 among 140 countries in the world.

Routes of Foreign Investment Inflow

The inflow of foreign investment happens through various routes:

1. **Equity (government, Reserve Bank of India RBI, Non-Resident Indian NRI, acquisition, shares, equity capital of unincorporated bodies), re-invested earning, other capitals.**



2. **Portfolio investment Global Dipository Receipt (GDR/Alternative Dispute Resolution ADR, Foreign Institutional Investors FIIs, offshore funds etc.)**

S.No.	Investment	Indirect Investment
I.	Equity	
	(a) Government (Security Industry Association SIA/ Foreign Investment Promotion Board FIPB)	(i) GDRs/ADRs
	(b) RBI	
	(c) NRI	
	(d) Acquisition of shares	
	(e) Equity capital of unincorporated bodies	
II.	Reinvest dearing	(ii) FIIs
III.	Other capital	(iii) Offshore finds and others

REVIEW OF LITERATURE

Researchers have carried out various studies on the FDI in respect of some sectors, states and country-wise. Banik *et al.* (2004), in their work explained FDI inflows to India. China and the Caribbean find out that FDI flows are generally believed to be influenced by economic indicators like market size, export intensity, institutions and others, irrespective of the source and destination countries. This paper looks at FDI inflows as an alternative approach based on the concepts of neighbourhood and extended neighbourhood. The study shows that the neighbourhood concepts are widely applicable in different contexts particularly for China and India, and partly in the case of the Caribbean. There are significant common factors in explaining FDI inflows in select regions.

Andersen and Hainaut (2004) in their paper 'Foreign direct investment and employment in the industrial countries' pointed out the evidence regarding a possible relationship between FDI and employment, in particular between outflows and employment in the source countries in response to outflows. They also found that high labour costs encouraged outflows and discouraged inflows, and such effect can be reinforced by exchange rate movements.

Sharma (2006) raised four issues in his article 'FDI in higher education: official vision needs corrections', which need critical attention; those are: the objectives of higher education, its contextual relevance, the prevailing financial situation and the viability of alternatives to FDI. The conclusion of the article is that higher education needs long-term objectives and a broad vision in tune with the projected future of the country and the world. The higher education will require an investment of 20,000–25,000crore over the next five or more years to expand capacity and improve access. For such a huge amount the paper argues, we can look to FDI.

Kumar and Karthika (2010) found in their study on 'Sectoral Performance through Inflows of Foreign Direct Investment (FDI)' that the FDI has a major role to play in the economic development of the host country. Most of the countries have been making use of the foreign investment and the foreign technology to accelerate the place of their economic growth. It ensures a huge amount of domestic capital, production level and employment opportunities in the developing countries, which is a major step towards the economic growth of the country.

Devajit (2012) reported the impact of FDI on Indian economy and concluded that FDI as a strategic component of investment is needed by India for its sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries, short- and long-term project in the field of healthcare, education, research and development. Inadequacy of FDI would create many hindrances in the developmental process of the country. It is a potent weapon of economic development especially in the current global context and bridging the financial gap between the quantum of funds needed to sustain a level of growth and the domestic availability of funds (Yameen and Ahmad, 2014).

Azhar and Marimuthu (2012) attempted to make an analysis of FDI in India and its impact on growth. It also focuses on the determinants and needs of FDI, year-wise analysis of FDI, sectoral analysis and sources of FDI and reasons. One of the economic aspects of globalisation is the fact that increasing investments in the form of FDI. In the recent times, because of the global recession most of the countries have not been able to pull investments. India has been able to attract better FDI's than the developed countries even during the crisis period also. Especially in the recent years, the FDI in India has been following a positive growth rate. Since 1991, the government has focused on liberalisation of policies to welcome FDI. These investments have been a key driver for accelerating the economic growth through technology transfer, employment generation, and improved access to managerial expertise, global capital, product markets and distribution network. FDI in India has enabled to achieve a certain degree of financial stability; growth and development to sustain and compete in the global economy.

Yameen and Ahmad (2015) observed that Indian economy has tremendous potential, and FDI has positive impact on GDP. It is suggested in their study that attention should be given towards agriculture sector reform, labour sector reform, financial reform, industrial restructuring and others.

Naik (2015) explored that the highest amount of FDI during 2000–2014 – US $41,307 million (18%) has gone to the service sector, and that FDI has a positive impact on the economic growth of the country.

OBJECTIVES OF THE STUDY

This paper covers the following objectives:

1. To study the trends and pattern of flow of FDI in India during 2001 to 2014–2015 (up to June 2015).
2. To analyse the sector-wise role of FDI in India.
3. To evaluate impact of FDI on GDP of India.

RESEARCH METHODOLOGY

This study is based on secondary data. The required data have been collected from various sources for example different websites and reports of RBI, United Nations Conference on Trade and Development UNCATD report, 2015 on FDI and various journals. It is time series data, and the relevant data have been collected for period 2000–2015.

TREND AND PATTERN OF FDI FLOW INTO INDIA

Table 1 shows that the total amount of FDI inflows in India during the last 15 years that is 2000–2015 and the cumulative amount of FDI equity inflow from 2000 to 2015 stood 1,293,836 crore rupees. The FDI inflow from 2000 to 2001 that is 10,733 crore rupees and in 2001–2002, it was 18,654crore rupees. It shows the good result in the FDI inflows in India. There was little

Table 1: FDI equity inflows in year-wise (2001–2015)

S.No.	Financial Year From April 2001–June 2015	Amount of FDI Inflows		% Growth Over Previous Years (in Terms of US $)
		Rs. (Crores)	US $ (Million)	
1.	2000–2001	10,733	2,463	–
2.	2001–2002	18,654	4,065	(+) 65%
3.	2002–2003	12,871	2,705	(-) 33%
4.	2003–2004	10,064	2,188	(-) 19%
5.	2004–2005	14,653	3,219	(+) 47%
6.	2005–2006	24,584	5,540	(+) 72%
7.	2006–2007	56,390	12,492	(+)125%
8.	2007–2008	98,642	24,575	(+) 97%
9.	2008–2009	142,829	31,396	(+) 28%
10.	2009–2010	123,120	25,834	(-) 18%
11.	2010–2011	97,320	21,383	(-) 17%
12.	2011–2012	165,146	35,121	(+) 64%
13.	2012–2013	121,907	22,423	(-) 36%
14.	2013–2014	147,518	24,299	(+) 8%
15.	2014–2015	189,107	30,931	(+) 27%
16.	2015–2016	60,298	9,508	
Cumulative total (from April, 2000 to June, 2015)		1,293,836	258,142	–

Source: RBI Bulletin July, 2015 dt.10.08.2015.

bit ups and downs in FDI inflows up to 2005–2006, but after that great hike in the year 2007–08 that is 98,642 crore rupees as compare to earlier years. In 2008–2009, there was a huge investment in FDI in 142,829 crore rupees. But then, there was a downfall in the inflow of FDI in two consecutive years 2009–2010 and 2010–2011, with figures 123,120 and 97,320, respectively. This is analysed from the table that the FDI was the second highest of last 15 years that is 165,146. In the year 2012–2013 and 2013–2014, the FDI inflow fluctuated from 121,907 to 147,618, respectively. In the last financial year that is 2014–2015, the amount of FDI inflow was 189,107, which is the highest FDI inflow in last 15 years. Recently in the month of June 2015, there was inflow of 60,298 crore rupees.

CONTRIBUTION OF FDI IN INDIA'S DIFFERENT SECTOR

Table 2 shows the ranking of top 10 sectors on the basis of their total inflow of FDI from the year 2000 to 2015. Only quantity of FDI is not important, but it is more important that where this amount is invested. If FDI is coming into heavy industries, basic capital goods, infrastructure, agriculture, development and many more, certainly it would increase the production and growth of Indian economy, and this sector have great impact on growth of the economy. If it is going to more non-priority industries, where profit is high, there will be an increase in the consumption but not capital formation. This shows that service sector (financial and non-financial service) has the highest FDI equity inflow

Table 2: Sector-wise FDI equity inflow (April 2000–June 2015)

Ranks	Sector	Amount in Rs. Crores (Million US $)				% to Total Inflows in Terms of US$
		2013–2014 (April–March)	2014–2015 (April–March)	2015–2016 (April–March)	(Cumulative Inflows (April–March)	
1.	Service sector	13,294 (2,225)	19,963 (3,253)	4,036 (636)	209,578 (43,350)	17
2.	Construction development: townships, housing, built-up infrastructure	7,508 (1,226)	4,582 (758)	216 (34)	113,355 (24,098)	9
3.	Computer software & hardware	6,896 (1,126)	13,564 (2,200)	16,245 (2,556)	89,481 (17,575)	7
4.	Telecommunications (radio, pager, cellular mobile, basic telephone)	7,987 (1,307)	17,372 (2,895)	2,517 (395)	86,609 (17,453)	7
5.	Automobile industry	9,027 (1,517)	15,794 (2,570)	6,914 (1,094	70,906 (13,477)	5
6.	Drugs and pharmaceuticals	7,191 (1,279)	9,211 (1,523)	1,370 (215)	66,562 (13,336)	5
7.	Chemicals (other than fertilisers)	4,738 (878)	4,077 (669)	1,598 (251)	50,909 (10,588)	4
8.	Power	6,519 (1,066)	3,985 (657)	1,717 (271)	48,357 (9,828)	4
9.	Trading	8,191 (1,343)	16,962 (2,761)	5,679 (897)	49,479 (8,958)	4
10.	Metallurgical industries	3,436 (568)	2,897 (472)	845 (133)	41,992 (8,680)	3

Source: FDI Statistics, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, GOI (2015).

17%. The foreign investor is interested in mainly financial services because of its profit generating advantage. The service sector is followed by construction development, computer software and hardware, telecommunication, automobile industry sector having 9%, 7% and 5%, respectively. Other sectors like drugs and pharmaceuticals carry 5%, and chemicals, power and trading industries carries 4% FDI inflow each, whereas the least is of metallurgical industries 3%.

FDI AND ECONOMIC GROWTH

India has been the most important recipient of FDI in the greater part of its different sectors. It also plays an important role in the development of a country. FDI is considered to be the life blood and an important vehicle for economic development, as far as the developing nations are concerned. The important effect of FDI is its contribution to the growth of the economy. FDI has an important impact on country's trade balance,

Table 3: FDI inflow and GDP in India from 1991–92 to 2011–2012

FDI Inflow, GDP and FDI/GDP Ratio in India (1991–92 to 2014–2015)	FDI Inflow (in Rupees Crore)	Growth Rate of FDI in Flow (%)	GDP	Growth Rate of GDP (%)	FDI as a Percentage of GDP
1991–1992	409	–	10,99,072	–	0.037
1992–1993	1,094	167.48	11,58,025	5.36	0.094
1993–1994	2,018	84.46	12,23,816	5.68	0.165
1994–1995	4,312	113.67	13,02,076	6.39	0.331
1995–1996	6,916	60.39	13,96,974	7.29	0.49
1996–1997	9,654	39.59	15,08,378	7.97	0.640
1997–1998	13,548	40.33	15,73,263	4.30	0.861
1998–1999	12,343	-8.89	16,78,410	6.68	0.735
1999–2000	10,311	-16.46	17,86,525	6.44	0.57
2000–2001	12,645	22.64	18,64,301	4.35	0.68
2001–2002	19,361	53.11	19,72,606	5.81	0.981
2002–2003	14,932	-22.87	20,48,286	3.84	0.729
2003–2004	12,117	-18.85	22,22,758	8.52	0.545
2004–2005	17,138	41.44	23,88,768	7.47	0.717
2005–2006	24,613	43.62	32,54,216	36.23	0.756
2006–2007	70,630	186.96	35,66,011	9.58	1.980
2007–2008	98,664	39.69	38,98,958	9.34	2.53
2008–2009	122,919	24.58	41,62,509	6.76	2.953
2009–2010	123,378	0.373	44,93,743	7.96	2.746
2010–2011	97,320	-21.12	48,77,842	7.87	1.995
2011–2012	165,146	69.69	52,02,514	5.78	3.174
2012–2013	121,907	26.18	55,03,476	4.33	2.215
2013–2014	147,518	21.08	57,41,791	4.9	2.569
2014–2015	189,107	28.19	60,23,138	5.9	3.13

Source: RBI's Bulletin (2015).

increasing labour standards and skills, transfer of technology and innovative ideas, skills and the general business climate. FDI also provides opportunity for technological transfer and upgradation, access to global managerial skills and practices, optimal utilisation of human capabilities and natural resources, making industry internationally competitive, opening up export markets, access to international quality goods and services and augmenting employment opportunities.

Table 3 shows the FDI inflow and GDP in India from the year 1991–1992 to 2014–2015 (post-liberalisation period). The data in Table 3 reveals that the FDI inflows in India have been increased at a higher rate from Rs. 409 crores in the year 1991–1992 to Rs. 189,107 crores in the year 2014–2015. While, the growth rate of FDI inflows indicates sometimes fluctuating situation and sometimes negative situation. These fluctuations may be because of the instability of the government, political invasion, lack of will and policies of the present government. The highest growth rate was recorded in the year 2006–2007 that is 186.96% and the lowest in the year 2009–2010 that is 0.37%. The above table also shows that during the period under review that is 24years, in these years, 6 years have shown negative growth of FDI inflows. The growth rate of GDP has been recorded between 3.84% (lowest) in the year 2002–2003 and 9.58% (highest) in the year 2006–2007. The FDI as percentage of GDP was recorded 0.037% in the year 1991–1992, which has increased to 3.13% in the year 2014–2015. It shows a continuous rise in FDI as percentage of GDP.

CONCLUSION

FDI plays an important role in the long-term development of a country not only as a source of capital, but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities. The findings indicate that the results of FDI have been encouraging. India emerges as the fifth largest recipient of FDI across the globe and the second largest among all other developing countries (World Investment Report, 2010). The huge market size, availability of highly skilled human resources, sound economic policy, abundant and diversified natural resources all these factors enable India to attract FDI. It has also been noted that there has been increased flow of FDI into the country after liberalisation of the economy. Indian economy has a tremendous potential, and FDI had a positive impact on GDP. The FDI inflow not only supplements domestic capital, but also technology, skills of existing companies. Further, it was found that even though there has been increased flow of FDI into the country during the post-liberalisation period, the global share of FDI in India is very less when it is compared to other developing countries. Lack of proper infrastructure, unstable government and political environment, high corporate tax rates and limited export processing zones are considered to be the major problems for low FDI into the country. To overcome this situation, the government should revise the sectoral cap and bring more sectors under the automatic route.

There is an urgent need to adopt innovative policies and good corporate governance practices on par with the international standards, by the Government of India, to attract more and more foreign capital in various sectors of the economy to make India a developed economy.

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