Impact of Foreign Direct Investment on Indian Economy

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Abstract

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. In fact, 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. The growth of FDI is tremendous in India it was only 256 crores in 1948 which reached to 147518 crores in 2014. Further, the explosive growth of FDI gives opportunities to Indian industry for technological up gradation, gaining access to global managerial skills and practices, optimizing utilization of human and natural resources and competing internationally with higher efficiency. Most importantly FDI is central for India's integration into global production chains which involves production by MNCs spread across locations all over the world. The present paper has been aimed at to find out the trends and patterns of flow of FDI, to assess the determinants of FDI inflows and to evaluate the impact of FDI on the Economy.

Keywords: *FDI, Economy, Export, MNC, Growth .*

Introduction

Foreign Direct Investment (FDI) in India is the major monetary source for economic development in India. Foreign companies invest directly in fast growing private Indian businesses to take benefits of cheaper wages and changing business environment of India.

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Economic liberalisation started in India in wake of the 1991 economic crisis and since then FDI has steadily increased in India. It were Manmohan Singh and P. V Narasimha Rao who brought FDI in India, which subsequently generated more than one crore jobs. According to the Financial Times, in 2015 India overtook China and the US as the top destination for the Foreign Direct Investment. In first half of the 2015, India attracted investment of $31 billion compared to $28 billion and $27 billion of China and the US respectively.

Routes: There are two routes by which India gets FDI.

- **Automatic Route:** By this route FDI is allowed without prior approval by Government or Reserve Bank of India.
- **Government Route:** Prior approval by government is needed via this route. Foreign Investment Promotion Board is the responsible agency to oversee this route.

Government Initiatives to Attract FDI

The Government of India has amended FDI policy to increase FDI inflow. In 2014, the government increased foreign investment upper limit from 26% to 49% in insurance sector. It also launched Make in India initiative in September 2014 under which FDI policy for 25 sectors was liberalised further. As of April 2015, FDI inflow in India increased by 48% since the launch of "Make in India" initiative. India was ranking 15th in the world in 2013 in terms of FDI inflow, it rose up to 9th position in 2014 while in 2015 India became top destination for foreign direct investment. During 2014–15, India received most of its FDI from Mauritius, Singapore, Netherlands, Japan and the US.

On 25 September 2014, Government of India launched Make in India initiative in which

STATEMENT ON COUNTRY-WISE FDI EQUITY INFLOWS
FROM APRIL 2000 TO MARCH 2016

S.No	Name of the Country	Amount of Foreign Direct Investment Inflows		%age with Inflows
		(In Rs crore)	(In US$ million)	
1	Mauritius	480,363.08	95,909.73	33.24
2	Singapore	256,666.81	45,879.60	15.90
3	United Kingdom	115,591.93	23,108.35	8.01
4	Japan	110,671.35	20,965.96	7.27
5	U.S.A	94,574.89	17,943.35	6.22
6	Netherlands	94,533.14	17,314.46	6.00
7	Germany	44,870.10	8,629.27	2.99
8	Cyprus	42,680.76	8,552.40	2.96
9	France	26,525.03	5,111.48	1.77
10	UAE	21,648.17	4,029.89	1.40
11	Switzerland	16,790.28	3,284.59	1.14
12	Spain	11,547.95	2,208.02	0.77
13	Luxembourg	12,207.40	2,046.01	0.71
14	Italy	9,993.00	1,920.15	0.67
15	HongKong	10,154.12	1,885.73	0.65
16	South Korea	9,390.84	1,797.78	0.62
17	Caymen Islands	7,893.72	1,517.79	0.53
18	China	8,236.91	1,358.46	0.47

policy statement on 25 sectors were released with relaxed norms on each sector. Following are some of major sectors for Foreign Direct Investment.

B. DIPP'S - FINANCIAL YEAR-WISE FDI EQUITY INFLOWS

(As per DIPP'S FDI database - equity capital components only)

S. Nos	Financial Year (April – March)	Amount of FDI Inflows		%age growth over previous year (in terms of US $)
FINANCIAL YEARS 2000-01 to 2015-16		In Rs crores	In US$ million	
1.	2000-01	10,733	2,463	-
2.	2001-02	18,654	4,065	(+) 65 %
3.	2002-03	12,871	2,705	(-) 33 %
4.	2003-04	10,064	2,188	(-) 19 %
5.	2004-05	14,653	3,219	(+) 47 %
6.	2005-06	24,584	5,540	(+) 72 %
7.	2006-07	56,390	12,492	(+)125 %
8.	2007-08	98,642	24,575	(+) 97 %
9.	2008-09	142,829	31,396	(+) 28 %
10.	2009-10	123,120	25,834	(-) 18 %
11.	2010-11	97,320	21,383	(-) 17 %
12.	2011-12 ^	165,146	35,121	(+) 64 %
13.	2012-13	121,907	22,423	(-) 36 %
14.	2013-14 #	147,518	24,299	(+) 8%
15.	2014-15 #	189,107	30,931	(+) 27%
16.	2015-16 #	262,322	40,001	(+) 29%
CUMULATIVE TOTAL (from April, 2000 to March, 2016)		1,495,880	288,635	-

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 (DEPR), Mumbai.
Figures for the years 2013-14 to 2015-16 are provisional subject to reconciliation with RBI.
^ Inflows for the month of March, 2012 are as reported by RBI, consequent to the adjustment made in the figures of March, '11, August, '11 and October, '11.

Major Sectors of FDI

1. **Infrastructure:** 10% of India's GDP is based on construction activity. Indian government has plans to invest $1 trillion on infrastructure from 2012–2017. 40% of this $1 trillion is to be funded by private sector. 100% FDI under automatic route is permitted in construction sector for cities and townships.

2. **Automotive:** FDI in automotive sector was increased by 89% between April 2014 to February 2015. India is 7th largest producer of vehicles in the world with 17.5 million vehicles annually. 100% FDI is permitted in this sector via automatic route. Automobiles shares 7% of the India's GDP.

3. **Pharmaceuticals:** Indian pharmaceutical market is 3rd largest in terms of volume and 13th largest in terms of value. Indian pharma industry is expected to grow at 20% compound annual growth rate from 2015 to 2020. 100% FDI is permitted in this sector.

4. **Service:** FDI in service sector was increased by 46% in 2014–15. Service sector includes banking, insurance, outsourcing, research & development, courier and technology testing. FDI limit in insurance sector was raised from 26% to 49% in 2014.

5. **Railways:** 100% FDI is allowed under automatic route in most of areas of railway like High speed train, railway electrification, passenger terminal, mass rapid transport systems etc. Mumbai-Ahemdabad high speed corridor project is single largest railway project in India, other

being CSTM-Panvel suburban corridor. Foreign investment more than₹90,000 crore (US$13 billion) is expected in these projects.

6. **Chemicals:** Chemical industry of India earned revenue of $155–160 billion in 2013. 100% FDI is allowed in Chemical sector under automatic route. Except Hydrocynic acid, Phosgene, Isocynates and their derivatives, production of all other chemicals is de-licensed in India. India's share in global specialty chemical industry is expected to rise from 2.8% in 2013 to 6–7% in 2023.

7. **Textile:** Textile is one major contributor to India's export. Nearly 11% of India's total export is textile. This sector has attracted about $1647 million from April 2000 to May 2015. 100% FDI is allowed under automatic route. During year 2013–14, FDI in textile sector was increased by 91%. Indian textile industry is expected reach up to $141 billion till 2021.

8. **Airlines:** Foreign investment in a scheduled or regional air transport service or domestic scheduled passenger airline is permitted to 100,with FDI up to 49% permitted under automatic route and beyond 49% through government approval. For airport modernization, 100 % FDI will be allowed for existing airport under automatic route.

Positive Impact of FDI on Indian Economy

1. **Economic Development Stimulation:** Foreign direct investment can stimulate the target country's economic development, creating a more conducive environment for you as the investor and benefits for the local industry.

2. **Easy International Trade:** Commonly, a country has its own import tariff, and this is one of the reasons why trading with it is quite difficult. Also, there are industries that usually require their presence in the international markets to ensure their sales and goals will be completely met. With FDI, all these will be made easier.

3. **Employment and Economic Boost:** Foreign direct investment creates new jobs, as investors build new companies in the target country, create new opportunities. This leads to an increase in income and more buying power to the people, which in turn leads to an economic boost.

4. **Development of Human Capital Resources:** One big advantage brought about by FDI is the development of human capital resources, which is also often understated as it is not immediately apparent. Human capital is the competence and knowledge of those able to perform labor, more known to us as the workforce. The attributes gained by training and sharing experience would increase the education and overall human capital of a country. Its resource is not a tangible asset that is owned by companies, but instead something that is on loan. With this in mind, a country with FDI can benefit greatly by developing its human resources while maintaining ownership.

5. **Tax Incentives:** Parent enterprises would also provide foreign direct investment to get additional expertise, technology and products. As the foreign investor, you can receive tax incentives that will be highly useful in your selected field of business.

6. **Resource Transfer:** Foreign direct investment will allow resource transfer and

other exchanges of knowledge, where various countries are given access to new technologies and skills.

7. **Reduced Disparity between Revenues and Costs:** Foreign direct investment can reduce the disparity between revenues and costs. With such, countries will be able to make sure that production costs will be the same and can be sold easily.

8. **Increased Productivity:** The facilities and equipment provided by foreign investors can increase a workforce's productivity in the target country.

9. **Increment in Income:** Another big advantage of foreign direct investment is the increase of the target country's income. With more jobs and higher wages, the national income normally increases. As a result, economic growth is spurred. Take note that larger corporations would usually offer higher salary levels than what you would normally find in the target country, which can lead to increment in income.

Negative Impact of FDI on Indian Economy

1. **Hindrance to Domestic Investment:** As it focuses its resources elsewhere other than the investor's home country, foreign direct investment can sometimes hinder domestic investment.

2. **Risk from Political Changes:** Because political issues in other countries can instantly change, foreign direct investment is very risky. Plus, most of the risk factors that you are going to experience are extremely high.

3. **Negative Influence on Exchange Rates:** Foreign direct investments can occasionally affect exchange rates to the advantage of one country and the detriment of another.

4. **Higher Costs:** If you invest in some foreign countries, you might notice that it is more expensive than when you export goods. So, it is very imperative to prepare sufficient money to set up your operations.

5. **Economic Non-Viability:** Considering that foreign direct investments may be capital-intensive from the point of view of the investor, it can sometimes be very risky or economically non-viable.

6. **Expropriation:** Remember that political changes can also lead to expropriation, which is a scenario where the government will have control over your property and assets.

7. **Negative Impact on the Country's Investment:** The rules that govern foreign exchange rates and direct investments might negatively have an impact on the investing country. Investment may be banned in some foreign markets, which means that it is impossible to pursue an inviting opportunity.

8. **Modern-Day Economic Colonialism:** Many third-world countries, or at least those with history of colonialism, worry that foreign direct investment would result in some kind of modern day economic colonialism, which exposes host countries and leave them vulnerable to foreign companies' exploitations.

Conclusion

Investing into another country's economy, buying into a foreign company or otherwise expanding your business abroad can be extremely financially rewarding and might provide you with the boost needed to jump to a new level of success. However, foreign direct investment also carries risks, and it is highly important for you to evaluate the economic climate thoroughly before doing it. Also, it is essential to hire a financial expert who is accustomed to working internationally, as he can give you a clear view of the prevailing economic landscape in your target country. He can even help you monitor market stability and predict future growth.

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