Research Journal of Management Sciences ISSN 2319–1171
Vol. **1(2),** 29-31, September **(2012)** *Res. J. Management Sci.*

Short Communication

Impact of Foreign Direct Investment on Indian economy

Mahanta Devajit
Vice President, 3A-Oberon Apartment, 6-Lamb Road, Ambari, Guwahati, Assam, INDIA

Available online at: www.isca.in
Received 11th September 2012, revised 14th September 2012, accepted 17th September 2012

Abstract

Foreign direct investment (FDI) as a strategic component of investment is needed by India for achieving the economic reforms and maintains the pace of growth and development of the economy. The paces of FDI inflows in India initially were low due to regulatory policy framework but there is a sharp rise in investment flows from 2005 towards because of the new policy has broadened.

The study tries to find out how FDI seen as an important economic catalyst of Indian economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfers. The main purpose of the study is to investigate the impact of FDI on economic growth in India.

Keywords: Economic growth, FIPB, foreign direct investment, inflow,

Introduction

Foreign Direct Investment (FDI) is fund flow between the countries in the form of inflow or outflow by which one can able to gain some benefit from their investment whereas another can exploit the opportunity to enhance the productivity and find out better position through performance. The effectiveness and efficiency depends upon the investors perception, if investment with the purpose of long term then it is contributes positively towards economy on the other hand if it is for short term for the purpose of making profit then it may be less significant. Depending on the industry sector and type of business, a foreign direct investment may be an attractive and viable option. Any decision on investing is thus a combination of an assessment of internal resources, competitiveness, and market analysis and market expectations.

The FDI may also affect due to the government trade barriers and policies for the foreign investments and leads to less or more effective towards contribution in economy as well as GDP of the economy. The studies try to find out the implications which affect the economic scenario and also measure the level of predominance by the factors for economic contribution to India.

Contextual Background

After independence in India 1947, FDI gained attention of the policy makers for acquiring advanced technology and to mobilize foreign exchange resources. In order to boost the FDI inflows in the country Indian government allowing frequent equity participation to foreign enterprises apart from provides many incentives such as tax concessions, simplification of licensing procedures and de-reserving some industries like drugs, fertilizers, aluminum etc. But due to significant outflow of foreign reserve in the form of remittances of dividends, profits, royalties etc in 1973 government of India set up Foreign Investment Board and enacted Foreign Exchange Regulation Act in order to regulate flow of FDI to India. Further Government of India set up Foreign Investment Promotion Board (FIPB) for processing of FDI proposals in India. The Board is the apex inter-ministerial body of the Central Government that deals with proposals relating to FDI into India for projects or sectors that do not qualify for automatic approval by the Reserve Bank of India (RBI) or are outside the parameters of the existing FDI policy.

It could be observed that there has been a steady build up in the actual FDI inflows in the pre-liberalization period in table-1. But measures introduced by the government to liberalize provisions relating to FDI in 1991 increased FDI Rs.2705 crores in 1990 to Rs.123378 crores in 2010. The list of investing countries to India reached to 150 in 2010 as compared to 29 countries in 1991. Nevertless, still a lion's share of FDI comes from only a few countries.

Table-1
FDI inflows in India (from 1948-2010)

Amount of FDI	Mid 1948	March 1964	March 1974	March 1980	March 1990	March 2000	March 2010
In crores	256	565.5	916	933.2	2705	18486	123378

Table-2
Share of top ten investing countries in FDI inflows (Financial year wise)

Ranks	Country	2008-09 (April-March)	2009-10 (April-March)	2010-11 (April-March)	Cumulative inflows (from Apr-2000 to March-2011)	Percent of total Inflow (in Rupees)
1	Mauritius	508993.1	496333.7	318547.8	2427607.2	42
2	Singapore	157266.7	112948.2	77296.6	528762.9	9
3	U.S.A.	80017.8	92304.3	53526.7	425422.4	7
4	U.K.	38404.1	30941.5	34342	294326.8	5
5	Netherlands	39215	42826.7	55012.3	256268.9	4
6	Japan	18885.6	56704	70629.8	239579.2	4
7	Cyprus	59828.3	77275.8	41706.7	219479.4	4
8	Germany	27497.3	29800.4	9078.8	133761.8	2
9	France	20980.5	14368.3	33486.3	102673.1	1
10	U.A.E	11333.3	30168.2	15691.8	85921.8	-
Total FDI Inflows		**1230248.8**	**1231196.4**	**885193.7**	**5807223.3**	-

Table-2 shows the actual investment flows of top ten countries during the period of 2008-09 to 2010-11. The FDI stock for this period from Mauritius is the largest 42 percent. The other top nine countries are Singapore, USA, UK, Netherlands, Japan, Cyprus, Germany, France and UAE. It implies that these top ten countries accounted for well over 78 percent of the FDI inflows during the above period. The Mauritius which was not in the picture till 1992 has the highest growth rate because such investment is represented by the holding companies of Mauritius set up by the US firms. The reason behind the US companies have routed through Mauritius is the tax treaty between Mauritius and India stipulates a dividend tax of five percent while the treaty between Indian and US stipulated a dividend tax of 15 percent.

The 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[1].

Review of Literature: This section reviews the empirical studies on the relation between FDI and economic activities in India. One school of thought argued that FDI has a negative impact on the growth of India because FDI flows mainly towards the primary sector which basically promoted the less market value[2]. However another school of thought argued that FDI inflow into the core sectors is assumed to play a vital role as a source of capital, management and technology in countries transaction economies[3].

In the comparative study of FDI and economic growth for Indian and Canada found that India does not figure very much in the investment plans of Canadian firms due to lack of information of investment opportunities in India. To come forward and enhancing Canadian FDI in India he suggested highlighted opportunities in India through publishing newsletter[4].

Despite India offering a large domestic market and low labour costs due to restricted FDI regime, high imports tariffs, exit barriers for firms, stringent labour laws, poor quality infrastructure, centralized decision making processes and a very limited scale of export processing zones make India an unattractive investment location[5]. However there have different views in this context[6]. The new economic liberalization policy in 1991 the FDI inflow in India in-depth in the last fourteen years makes the country progress in both quantity and the way India attracted FDI. The study also finds out that R&D as a significant determining factor for FDI inflows for most of the industries in India. According to 2005, United Nations Conference on Trade and Development report on world investment prospects India has been ranked at the third place in global foreign direct investments in 2009 and will continue to remain among the top five attractive destinations for international investors 2010-11[7].

To sum up, it can be said that government should simplifying and relaxing entry barriers for business activities and providing investor friendly laws and tax system for foreign investors. Somewhere, a restriction related to the track record of Sub-Accounts is also to be made on the investors who withdraw money out of the Indian stock market who have invested with the help of participatory notes. We have to modernize and also have to save our culture. Similarly the laws should be such that it protects domestic investors and also promote trade in country through FDI.

Policy Initiatives

The Government of India has released a comprehensive FDI policy document effective from April 1, 2010. Furthermore, the government has allowed the Foreign Investment Promotion Board (FIPB), under the Ministry of Commerce and Industry, to clear FDI proposals of up to US$ 258.3 million. Earlier all project proposals that involved investment of above US$ 129.2 million were put up before the Cabinet Committee of Economic

Affairs (CCEA) for approval. The relaxation would expedite FDI inflow.

During April 2010, Mauritius invested US$ 568 million in India, followed by Singapore which invested US $434 million and Japan that invested US $327 million according to latest data released by DIPP. It shows that there has been a significant shift in the character of global capital flows to the India in recent years in that the predominance of private account capital transfer and especially portfolio investment increased considerably.

The importance of FDI received special impetus towards the end of 1992 when the Foreign Institutional Investors (FIIs) such as pension funds, mutual funds, investment trusts, asset management companies, nominee companies and incorporated / institutional portfolio managers were permitted to invest directly in the Indian stock markets. In order to attract portfolio investments which prefer liquidity, it has been advocated to develop the Indian stock markets. The foreign portfolio investment not only do they expand the demand base of the stock market, but also stabilize the market through investor diversification.

In order to have a flow of FDI, India maintained Double Tax Avoidance Agreements (DTAA) with nearly 70 countries of the world. India has signed 57 (up to 2006) numbers of Bilateral Investments Treaties (BITS). The numbers of BITS are signed with developing countries of Asia 16, the Middle East 9, Africa 4, and Latin America 1 apart from the developed nations 27. India as the founding member of General Agreement on Tariffs and Trade (GATT), World Trade Organization (WTO), a signatory member of South Asian Free Trade Area (SAFTA) and a member of Multilateral Investment Guaranty Agency (MIGA) is making its presence felt in the economic landscape of globalised economies which will help a conducive and healthy atmosphere for foreign investors and thus resulting in substantial amount of FDI inflows in the country.

State wise FDI inflows show that Maharashtra, Delhi, Karnataka, Gujarat and Tamil Nadu together accounted more 75 percent of inflows during 2000-2010 because of the infrastructural facilities and favourable business environment provided by these states. Despite troubles in the world economy, India continued to attract FDI inflows mainly because Government of India open-up with flexible investment regimes and policies prove to be the horde for the foreign investors in finding the investment opportunities in the country.

Conclusion

Foreign Direct Investment (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 (R & D) etc.

Government should design the FDI policy such a way where FDI inflow can be utilized as means of enhancing domestic production, savings and exports through the equitable distribution among states by providing much freedom to states, so that they can attract FDI inflows at their own level. FDI can help to raise the output, productivity and export at the sectoral level of the Indian economy. However, it can observed the result of sectoral level output, productivity and export is minimal due to the low flow of FDI into India both at the macro level as well as at the sectoral level. Therefore for further opening up of the Indian economy, it is advisable to open up the export oriented sectors and higher growth of the economy could be achieved through the growth of these sectors.

References

1. Ministry of Finance, *Report of the economic survey*, Government of India, New Delhi **(2003-04)**
2. Weisskof T.E., The impact of foreign capital inflow on domestic savings in underdeveloped countries, *Journal of International Economics*, **2,** 25-38 (**1972**)
3. Sahoo D. Mathiyazhagan M.K. and Parida P., Is Foreign Direct Investment an engine of growth? Evidence from the Chinese economy, *Savings and Development*, **4**, 419-439 (**2002**)
4. Nayak D.N., Canadian Foreign Direct Investment in India: Some observations, *Political Economy Journal of India*, **8**, 51-56 (**1999**)
5. Srivastava S., What is the true level of FDI flows to India?, *Economic and Political Weekly*, **19**, 1201-1209 (**2003**)
6. Basu P., Nayak N.C. and Vani A., Foreign Direct Investment in India: Emerging Horizon, *Indian Economic review*, **25,** 255-266, (**2007**)
7. Weisskof T.E., The impact of foreign capital inflow on domestic savings in underdeveloped countries, *Journal of International Economics*, **2**, 25-38 (**1972**)