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Foreign Direct Investment and Its Impact on Indian Economy

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Abstract

Globalization means so many things to so many process of globalization is exchange of ideas. It is starting point of globalization. For the rapid development of the Indian economy Foreign Direct Investment as a strategic component of investment is needed by India. FDI is seen as a means to supplement domestic investment for achieving a higher level of economic growth and development. FDI benefits domestic industry as well as the Indian consumers by providing opportunities for technological up gradation, access to global managerial skills and practices opening up export market, providing backward and forward linkages and access to international quality goods and services.

Keywords:FDI, International monetary fund, LPG (Liberalisation, Privatisation, and Globlization), and Political imperatives.*

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1. INTRODUCTION

Indian has been attracting foreign direct investment for a long period. The sectors like telecommunications, construction activities and computer software and hardware have been the major sectors for FDI inflows in India. According to AT Kearney report India sits in 3rd place on the FDI Confidence Index globally. European and North American investors place it 3rd, while Asia-Pacific investors' rank it 4th. India is the top location for nonfinancial services investment and also scores highly in heavy industries, light industries and financial services. Even, during economic crisis, looming largely on the other economics. FDI to India soared from US $500mn in its Chennai plant, Nissan Renault planning to manufacture ultra-low-cost cr with its local partner Bajaj Auto, French tyre maker Michelin's to invest US$874mn in its first Indian manufacturing facility. All these developments are helping in getting FDI inflows into the country.1

2. FOREIGN INVESTMENT: NEW STRATEGY OF FASTER GROWTH

The last three decades have witnessed a dramatic worldwide increase in foreign investment, accompanied by a marked change in the attitude of most developing countries towards foreign direct investment (FDI). Foreign Direct investment is considered to be the life blood for economic development as far as the developing nations are concerned, foreign direct investment has the potential to generate employment, raise productivity, transfer skills and technology, enhance exports and contribute to the long term economic development of the world developing countries. FDI is a zero sum game in which a count can attract FDI only of the expense of another country. Additional FDI is likely to take place when new investment opportunities emerge in countries opening up to the world.

What is FDI?

FDI is the outcome of the mutual interests of multinational firms and host countries. According to the international monetary fund (IMF,), FDI is defined as investment that is made to acquire a listing interest in an enterprise operating in an economy other than that of the investor, the investor purpose being to have an effective voice is the management of the enterprise". FDI has become one of the council areas for the growth of Indian economy since she initiated her economic reforms on the LPG (Liberalization, Privatization and Globalization) strategies in 1991.

Determinants of FDI

To understand the scale and direction of FDI flows, it is necessary to identify their major determinants. Factors influencing the destination of investment, i.e. the host country determinants are explained below. The relative importance of FDI determinants varies not only between countries but also between different types of FDI. Traditionally, the determinants of FDI include the following.

1. **Size of the Market:** Large developing countries like India provide substantial markets where the consumer's demand for certain goods for exceeds the available supplies. This demand potential is a big draw for many foreign owned enterprises. This establishes a presence in the market and provides important insights into the ways of doing business and possible opportunities in the country.

2. **Political Stability:** In India, the institutions of Government are still evolving and there are unsettled political questions. Companies are unwilling to contribute large amount of capital into an environment where some of the basic political questions have not yet been resolved.
3. **Macroeconomic Environment:** Instability in the level of prices and exchange rate enhance of the level of uncertainly, making business planning difficult. This increases the perceived risk of making investments and therefore adversely affects the flow of FDI.
4. **Legal and Regulatory Framework:** The transition to a market economy entails the establishment of a legal and regulatory frame work that is compatible with private sector activities and the operation of foreign owned companies.
5. **Access to Basic Inputs:** Many developing countries have large reserves of skilled and semi-skilled workers that are available for employment at wages significantly lower than developed countries. This provides an opportunity for foreign firms to make investments in these countries to cater to the export market.

The motivation and determinants of FDI differ among countries and across economic sectors. 2

3. India as an Investment Destination

FDI is seen as a means to supplement domestic investment for achieving a higher level of economic growth and development. FDI benefits domestic industry as well as the Indian consumers by providing opportunities for technological upgradation, access to global managerial skills and practices, optional utilization of human and natural resources, making Indian industry internationally competitive, opening up export markets, providing backward and forward linkages and access to international quality goods and services. Towards this end, the FDI policy has been constantly reviewed and necessary steps have been taken to make India a most favorable destination for FDI.

There are several goods reasons for investing in India.

1. Third largest reserve of skilled manpower in the world.
2. Large and diversified infrastructure spread across the country.
3. Package of fiscal incentives for foreign investors.
4. Large and rapidly growing consumer market.
5. Democratic government with independent judiciary.
6. Developed commercial banking network of over 63,000 branches supported by a number of national and state level financial institutions.
7. Large capital market consisting of 23 stock exchanges with over 9400 listed companies.
8. Easy access to market of Bangladesh, Bhutan, Maldives, Nepal, Pakistan and Sri Lank.

Report of the Committee on FDI, 2002

Committee on Foreign Direct investment (chairman, N.K. Singh), which submitted its report in September 2002 to the Prime Minister, recommended that the ban on FDI in Retail trade should not be lifted. In other sectors including oil marketing petroleum location banking and financial services and real estate, the committee suggested rising of FDI limit to 100%. The committee pointed out that it was not desirable to lift the ban on retail trade at present as the sector was dispersed, wide spread, labour intensive and disorganized. The main reason stated by the committee for the low level of FDI (US$406 billion per annum) was the absence of a credible regulator of frame work in several sectors.

The committee made the following major recommendations:

1. Enactment of a new low on FDI granting national treatment to foreign firms and removing the enforce directorate as their supervision body.
2. Making investment in most sectors automatic removing it from the discretionary ambit of the foreign investment promotion board (FIPB) even while empowering it and the foreign investment implementation authority to carry out as many cleanness as possible such as registration for exist and direct payments.
3. Replacing the present permission approach Vis-à-vis FDI to a proactive promotion.
4. Allowing up to 40% investment in insurance and airlines including FDI by foreign airlines.
5. Formatting up to 100% FDI is petroleum refining, oil marketing, diamond mining, petroleum exploration, cool washery, airports banking and investing companies radio aging adv and trade.
6. Putting all proposals except lactations and housing on automatic route
7. Allowing foreign investment @ 49% for plantations and allow 100% FDI in real state.3

The Need for FDI

While on the one hand the Indian economy in the eighties seemed to be doing quite well, one the other hand there were certain long-term structural weaknesses which led to a major crisis by 1991 when the country was on the urge of defaulting (of its foreign debts) It is the crisis which brought home to the country the immediate compulsion of bringing about structural adjustment and economic reform as conditions of IMF-WB teams to tide over it. There were three sets of problems which had gathered strength in the Indian economy over time and which needed FDI through urgent reform there are:

i. Emergence of Structural Bottlenecks: The import substitution industrialization strategy based on heavy protection to indigenous industries was very effective in deeping and widening India's industrial base and giving the economy a lot of freedom from foreign dependence however, overtime, the excessive protection through import restrictions started leading to in efficiency and technological backwardness in Indian industry which favored FDI into Indian industry.

ii. Rapid Globalization: In today's context of rapid globalization pursuing excessively autarchic policies in search of autonomy may, through fall or strategies of productivity levels, destroy precisely that autonomy and push the country towards peripheraliation. Thus, weakness of Indian economy relate to the continuation of the inward oriented development path followed by India since independence India failed to make a timely shift from the export pessimism inherent in the first three plans.

Political Imperatives: This problem was related to the manner in which the Indian state structure and democratic framework evolved. More and more sections of the population emerged which made strong, government were increasingly unable either to meet these demands fully or diffuse the glamour for them.

Sources of FDI: The list of investing countries to India reached to maximum number of 120 in 2008 as compared to 15 in 1991. Although, India's receiving FDI inflows from a number of sources but large percentage of FDI inflows is invested with few major countries. Mauritius is the major investing country in India during 1991-2008. Nearly 40 per cent of FDI inflows came from Mauritius alone. The other major investing countries are USA, Singapore, UK, Netherlands, Japan, Germany, Cyprus, France and Switzerland. An analysis of last eighteen years of FDI inflows in the country shows that nearly 66 percent of FDI inflows came from only five countries viz. Maritius, USA, Sinagpore, UK and Netherlands.

Mauritius and United states are the two major countries holding first and the second position in the investor's list of FDI in India. While comparing the investment made by both countries, one interesting fact comes up which shows that there is huge difference in the volume of FDI received from Mauritius and the US. It is found that FDI inflows Mauritius are more than double from that of US.

Top 10 FDI investing countries in India are Mauritius, Singapore, United States, UK, Netherlands, Japan, Cyprus, Germany, France and UAE.

Table No. 1: 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)	Cumulatie inflows (From Apr 2000 to March 2011)	Percent of total Inflow (In Rupees)
1	Mauritius	508993.1	406333.7	318547.8	2427607.2	42
2	Singapore	157266.7	112948.2	77296.6	528762.9	9
3	U.S.A.	80017.8	92304.2	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	1026731.1	1
10	U.A.E.	11333.3	30168.2	15691.8	85921.8	-
Total F.D.I. Inflows		12320248.8	1231196.4	885193.7	5807223.3	-

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 investments locatins.6

4. Summary and Conclusion

Foreign direct investment 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 health care, education, research and development etc.

Government should design the FDI policy such a way where FDI inflow can be utilized as means of enhancing domestic production. FDI provides the financial resources for investment in the host country and thereby augments the domestic saving efforts.

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