FOREIGN DIRECT INVESTMENT AND INDIAN ECONOMY

Trends and Issues

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Abstract

For many years, most developing countries, especially for India, focus on the policies which attract foreign direct investment (FDI) because of its accepted as a tool of technological change in production of goods and due to economic growth. Furthermore, FDI can possibly stimulate economic growth through the international trade channel by augment domestic capital for exports, helping transfer of technology and new products for exports, facilitate entrance to new and large foreign markets, and providing training for the local workforce and improvement technical and management skills. However, FDI may not encourage host economy

because it may lower or replace domestic savings and investment. Moreover, FDI may target primarily the host country's domestic market and thus not increase exports, or it will not help developing the host country's dynamic comparative advantages by focusing exclusively on local economical labor and raw materials. Therefore, an observed analysis of this issue is needed as well for a better understanding of the role of FDI.

INTRODUCTION

There is no doubt that the world is moving toward a single global economy, where national economies are becoming more globally integrated and interconnected. The cornerstones of globalization are economic specialization and international exchange. It is this essential element of globalization which leads us to the natural conclusion that a positive relationship between Foreign Direct Investment (FDI) and growth is not supplementary but a part and bundle of the new order of the world economy. This paper has examine the relationship between FDI and economic growth of Indian economy have lead to the consensus that there is a positive association between the two, provided that receiving country have reached a minimum level of educational, technological and infrastructure development.

Furthermore, FDI can possibly stimulate economic growth through the international trade channel by augmenting domestic capital for exports, helping transfer of technology and new products for exports, facilitating access to new and large foreign markets, and providing training for the local workforce and upgrading technical and management skills. However, FDI may not stimulate host economy because it may lower or replace domestic savings and investment. Moreover, FDI may target primarily the host country's domestic market and thus not increase exports, or it will not help developing the host country's dynamic comparative advantages by focusing solely on local cheap labor and raw materials.

FOREIGN DIRECT INVESTMENT AND INDIAN ECONOMY

One of the most explicit and significant trend in the past two decades has been the fast sustained growth of international business. The world product trade has expended by more than six percent a year since 1950 which is more than 50% faster than growth of output. The phenomenal growth in market interpretation makes it difficult for any country to avoid external impact on its economy. Massive central capital flows in particular can push exchange rates away from levels that accurately reflect competitive relationship among national economic policies or performances diverse in short term.

Beginning with July 1991, the government introduced a number of changes in the country's policies. Among these, and particularly important from the point of attracting Foreign Direct Investment have been de-reservation of many public sector reserved areas, delicensing, doing away with registration under MRTP Act, removing the general ceiling of 40 percent foreign equity under FERA, lifting of restriction on use of foreign brand names in the local market, withdrawal of the restriction on entry in to low technology consumer goods, abandonment of the Phased Manufacturing Programmed (PMP), dilution of the dividend balancing condition and export obligations, liberalization of the terms for import of technology and royalty payments, permission to invest up to 24 percent in small scale units, reduction in tax rates, etc. In the new policy regime, proposals for foreign investment need

 ISBN:978-93-87793-60-6

not necessarily be accomplished by foreign technology agreement. FDI is one of the most dynamic of the increasing international resource flow to developing countries.

PERMITTED ROUTES FOR FDI IN INDIA

Foreign Direct Investment (FDI) involves the ownership and control of a foreign company in a foreign country. In exchange for this ownership, the investing country usually transfers some of its financial, technical, managerial and other resources to the foreign country. FDI in India has come to be recognized as an important source of economic growth. Following permitted routes for FDI in India is:-

(1) Through financial collaboration.
(2) Through joint ventures and technical collaborations.
(3) Through private placement or preferential allotments.
(4) Through capital market via Euro issues.

FORBIDDEN TERRITORIES

FDI is not permitted in the following industrial sectors:-

(a) Arms and ammunition.
(b) Atomic energy.
(c) Railway transport.
(d) Coal and lignite.
(e) Mining of iron, manganese, chrome, gypsum, sulphur, copper and zinc.

FDI INFLOWS INTO INDIA:-

Foreign Direct Investment inflows in India (as percentage of GDP) from 2003 to 2010 show by the table 1:-

Table 1: Comparative Inward FDI

FDI (percent of GDP)

ISBN:978-93-87793-60-6

Country	2003	2004	2005	2006	2007	2008	2009	2010
India	0.7	0.8	0.8	1.9	1.7	1.8	2.0	2.1
China	2.9	2.8	3.4	2.8	2.9	2.1	1.8	1.6
Pakistan	0.6	1.1	2.0	3.4	2.7	2.2	2.1	2.1
Vietnam	3.7	3.5	3.7	6.5	8.7	8.1	7.6	7.4

MAIN SOURCES OF FDI IN INDIA

It is clear that FDI inflows into India have been on the rise. The different source of Foreign Direct Investment (FDI) in India is dividing into two parts i.e. Sector wise FDI and country wise FDI.

FDI INFLOWS BY SECTOR WISE:

Cumulative FDI inflows reached just over US$60 billion between August 1991 and July 2007. Since 2002, some sectors such as electrical equipment, services, drugs and pharmaceuticals, cement and gypsum products, metallurgical industries have also been doing very well in attracting FDI. The electrical equipment sector and the services sector in particular received the largest shares of total FDI inflows between August 1991 and July 2007. These were followed by the telecommunications, transportation, fuels, and chemicals sector. The Department of Industrial Policy and Promotion has recently modified the classifications of the sectors and data released from August 2007 has been based on the new sect oral classifications. According to that classification, the top performers are the services and computer software & hardware sectors. Clearly, India has attracted significant overseas investment interest in services. It has been the main destination for off-shoring of most services as back-office processes, customer interaction and technical support (UNCTAD, 2007). Indian services have also ventured into other territories such as reading medical X-rays, analyzing equities, and processing insurance claims. According to some reports, however, increasing competition is making it more difficult for Indian firms to attract and keep BPO employees with the necessary skills, leading to increasing wages and other costs. We show the different sectors attracting highest FDI flows in India with the help of table 2.

Table:2 Sectors Attracting highest FDI Flows

(Rs. Crore)

Sectors	2004-05	2005-06	2006-07	2007-08	2008-09
Services	1986	2399	21047	26589	28411
Housing and Real estate	0	171	2121	8749	12621
Telecommunications	570	2776	2155	5103	11727
Construction	696	667	4424	6989	8792
Computer software & Hardware	2441	6172	11786	5623	7329
Automobiles	559	630	1254	2697	5212
Power	241	386	713	3878	4382
Metallurgical Industries	836	654	787	4686	4157
Information & Broadcasting	0	0	0	1290	3492
Chemicals (except fertilizers)	909	1979	930	972	3427
Drugs & pharmaceuticals	1343	760	970	0	0
Grand Total (FDI Equity Flows					

Source: Department of Industrial Policy and Promotion.

FDI INFLOWS BY COUNTRY WISE:

Among countries, Mauritius has been the largest direct investor in India. Firms based in Mauritius invested over US$20 billion in India between August 1991 and July 2007 or over two-fifth of total FDI inflows during that period. The United States (US) is the second largest investor in India. The total capital flows from the US was around US$6 billion between August 1991 and July 2007, which was accounted for 12 percent of the FDI inflows. Most of the US investments were directed to the fuels, telecom, electrical equipment, food processing, and services sectors. The United Kingdom (UK) and the Netherlands are

India's third and fourth largest FDI inflows. The investments from these countries to India are primarily concentrated in the power/energy, telecom, and transportation sectors. Japan was the fourth largest source of cumulative FDI inflows in India between 1991 and 2007, but inflows from Japan to India have decreased during this time period. This is opposite to the general trend. This is particularly interesting because Japan's FDI outflows in 2006 increased by 10 percent to reach a record US$50 billion, the second highest since 1990. The share of Top investing countries FDI inflows (financial year-wise) shown in the table 3.

Table: 3 Share of Top Investing Countries FDI Inflows (Financial year-wise)

Amount Rupees in crore (US $ in million)

Ranks	Country	August 1991 to March 2002	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
1.	Mauritius	27446 (6731)	3766 (788)	2609 (567)	5141 (1129)	11411 (2570)	28759 (6363)	44483 (11096)	50794 (11208)
2.	USA	12248 (3188)	1504 (319)	1658 (360)	3055 (669)	2210 (502)	3861 (856)	4377 (1089)	15727 (3454)
3.	UK	4263 (1106)	1617 (340)	769 (167)	458 (101)	925 (208)	8389 (1878)	4690 (1176)	8002 (1802)
4.	Japan	5099 (1299)	1971 (412)	360 (78)	575 (126)	340 (76)	2905 (644)	12319 (3073)	3840 (864)
5.	Netherlands	3856 (986)	836 (176)	2247 (489)	1217 (267)	1164 (266)	382 (85)	2780 (695)	3922 (883)
6.	Germany	3455 (908)	684 (144)	373 (81)	663 (145)	1345 (303)	540 (120)	3336 (815)	1889 (405)

7.	Singapore	1997 (515)	180 (38)	172 (37)	822 (184)	1218 (275)	2662 (578)	2075 (514)	5983 (1287)
8.	France	1947 (492)	534 (112)	176 (38)	537 (117)	82 (18)	528 (117)	3385 (834)	2750 (629)
9.	South Korea	2189 (594)	188 (39)	110 (24)	157 (35)	269 (60)	321 (71)	583 (145)	2098 (467)
10.	Switzerland	1200 (325)	437 (93)	207 (45)	353 (77)	426 (96)	257 (56)	1009 (248)	1133 (257)
Total FDI Inflows*	92611 (23829)	14932 (3134)	12117 (2634)	17138 (3754)	24613 (4549)	70630 (15726)	70630 (15726)	98664 (24579)	122919 (27309)

Note: * Includes inflows under NRI schemes of RBI, stock swapped and advances pending issue of shares.

Source: Data compiled from Fact Sheet on Foreign Direct Investment

CONCLUSION

In concluding observation, India needs massive investments to sustain high-quality economic growth, particularly in the energy and infrastructure sectors (both physical and social). Policymakers are looking at FDI as the primary source of funds. It is important to keep in mind that FDI on its own is not a panacea for rapid growth and development. What India needs is to put in place a comprehensive development strategy, which includes being open to trade and FDI. This ought to go a long way to fulfilling the ultimate goal of permanently eradicating poverty over the medium and longer-terms.

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