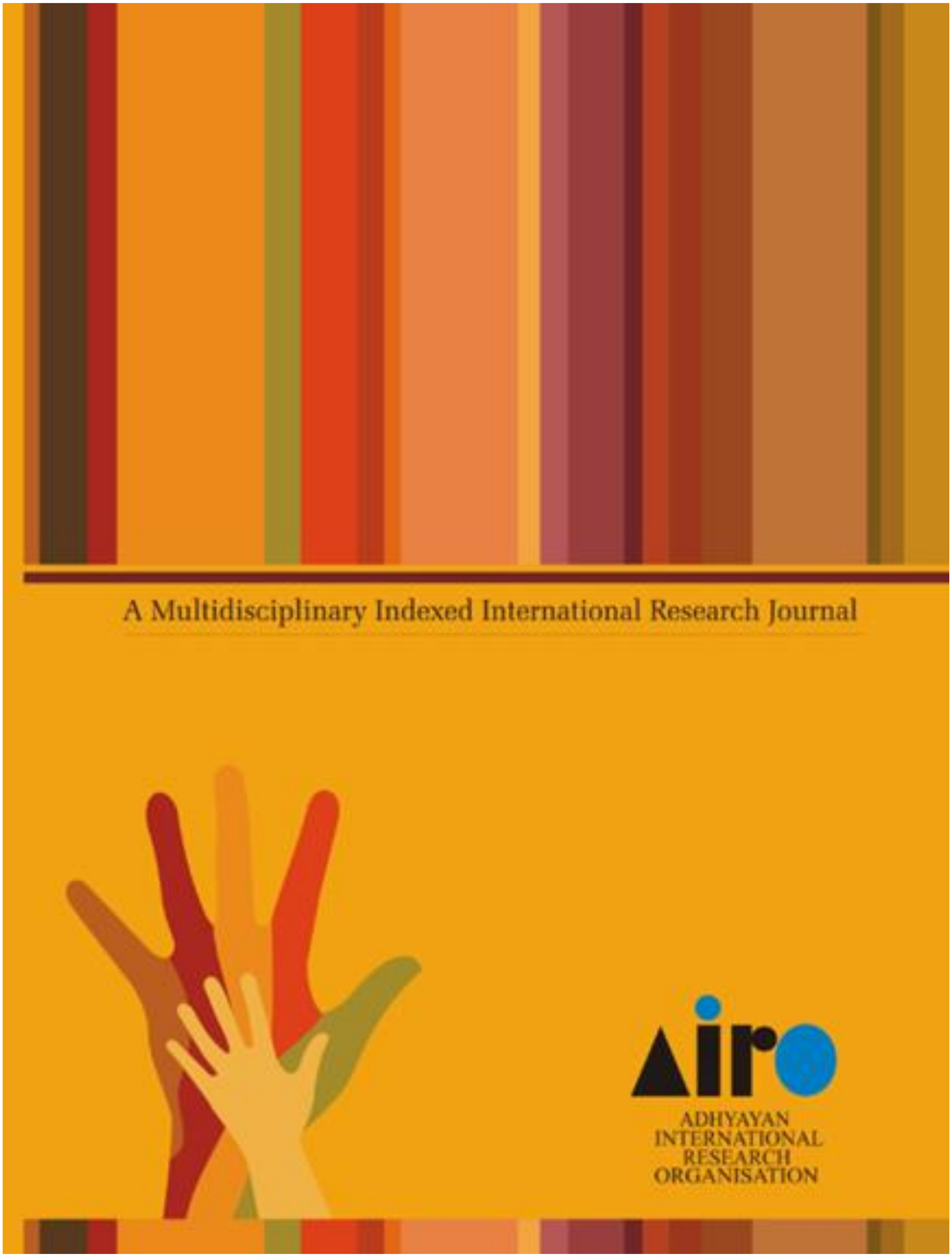
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ANALYSIS OF GROWTH OF FDI IN INDIA

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ABSTRACT

India's economic policy reforms, adopted at the backdrop of historical economic crises of 1990-91 and some notable changes in global economic set up, have changed the whole structure of Indian economy since 1991. Among other things, the reforms have evolved in opening the economy, making it more competitive, getting the government out of the huge mode of regulation, empowering the states to take more responsibility for economic management and creating a kind of competition among the states for foreign investors.Indian economy had experienced major policy changes in early 1990s. The policy of Liberalization, Privatization and Globalization (LPG) aimed at making the Indian economy a fast growing and globally competitive economy. The series of reforms undertaken with respect to industrial sector, trade as well as financial sector have made the economy more efficient. The term globalization refers to the integration of economies of the world through uninhibited trade and financial flows, and also through mutual exchange of technology and knowledge. Since July 1991; the Government has consistently pursued the policy of attracting larger volumes of foreign investment to augment the resource availability in infrastructure and other critical areas of the economy. A number of policy measures are being taken to attract both direct and portfolio investment from foreign investor individual, corporate identities and FIIs. The liberalization measures embodied in the new economic policy were followed in later years by a series of measures further liberalizing the inward looking policy regime towards FDI.

KEYWORDS: *Foreign direct investment, Indian economy, Globalization, transfer technology, economic growth.*

INTRODUCTION

FDI may be defined as an investment involving a lasting interest and control by an investor who is a resident of another economy, other than that of the host economy. In the simple sense, FDI implied that the investor has a significant degree of influence on the management. Foreign Direct Investments are investments made by residents of one economy with the objective of establishing a lasting interest in a company located in another economy (host economy).FDI refersto the purchase by the citizens of one country of non-financial assets in another country. Foreign direct investment involves the acquisition or establishment of a firm, company or enterprise in a country outside of the registered corporate home country. FDI in real estate involves acquisition of land or building across all commercial, residential and retail segments. Any construction activity is also included in FDI.FDI can be categorized into three components: equity capital, reinvested earnings and intra-company loans. *Equity capital* comprises of the shares of companies in countries foreign to that of the investor. *Reinvested earnings* include the earnings not distributed to shareholders but reinvested into the company. *Intracompany loans* relate to financial transactions between a parent company and its affiliates (UNCTAD 2006).

There is now a considerable literature on the impact of foreign direct investment (FDI) and growth. The contribution of this paper is to take the effect of volatility of FDI flows on growth into account. Using a variety of econometric techniques, we find that while FDI as such has (the expected) positive effect on growth, volatility of such flows has a negative effect. There are a number of reasons why volatility of FDI inflows may be negatively associated with growth. A first possibility is that volatility itself has a negative effect on growth. The recent endogenous growth literature on FDI provides some arguments why this might be so. This literature shows that FDI positively affects growth by decreasing the costs of R&D through stimulating innovation. If FDI inflows are uncertain, costs of R&D are uncertain, which negatively affects incentives to innovate. It may then be the case that volatility of FDI undermines investment, and thus has an adverse effect on growth. A second possibility might be that the volatility of FDI flows is a proxy for economic or political uncertainty; FDI volatility may reflect underlying uncertainty (political and economic) in a country.

Lensink and Morrissey (2000) and Guillaumont and Chavet (1999) suggest that economic uncertainty is an important determinant of both growth and the productivity of investment. By ‘economic uncertainty’ they refer to the tendency of some developing countries to be particularly vulnerable to shocks that have the immediate effect of reducing income and, if recurrent, tend to reduce growth (or constrain the ability of an economy to reach its steady state growth rate). These shocks may be external, such as terms of trade shocks or financial crises induced by the volatility of capital flows, or ‘acts of nature’, such as severe drought or floods. While FDI tends to be less volatile than other private flows, it is possible that sudden changes in the volume of FDI inflows can have a de-stabilising impact on the economy.

FDI POLICY IN INDIA

FDI as defined in Dictionary of Economics is investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new site. To put in simple words, FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy. Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India ('RBI') in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time. The Ministry of Commerce and Industry, Government of India is the nodal agency for motoring and reviewing the FDI policy on continued basis and changes in sectoral policy/ sectoral equity cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP).The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board ('FIPB') would be required.

FOREIGN DIRECT INVESTMENT IN INDIA

Pre Reform Era: The process of planned economic development in India started with the launching of first five year plan on April1, 1951, although the foreign capital was regarded as effective ingredient of growth, the policy regarding FDI was rather selective. During the first five year plan a free flow of foreign capital was welcome because it was a necessity to ensure the supply of capital goods and technical knowhow (1 st Five Year Plan, GOI).Policy toward foreign investment made a U- turn during Third and Fourth Five year plan in view of severe constraints on foreign exchange reserves. By mid-1980s, the country started opening its economy by inviting foreign investments and liberalising its trade regime. Apart from giving direct incentives to the foreign investors, monetary and fiscal support was also provided to achieve given targets of foreign direct investment. One form of such support was the creation of a tax structure conducive to direct and portfolio investments. Progress toward foreign direct investment in India was rather sluggish during1948-49 to 1989-90.

Post Reform Era: India's economic performance in the post reforms period has many positive features. The average growth rate in the ten year period from 1992-93 to 2001-02 was around 6.0 percent. In sharp contrast, growth in the 1990s was accompanied by remarkable external stability despite the East Asian crisis. (AhluwaliaMontek S.2002). Annual inflow of foreign investment in India is presented in Table 1. It shows the comparative position of FDI and portfolio investment in India. In 2001-02 both these stood at US$ 6130million and US$2021 million respectively.

Table 1: Trends in Foreign Investment Flows in to India

YEAR	FDI	Portfolio investment	Total Investment Inflows
1999-00	2155	3026	5181
2000-01	3270	2590	5680
2001-02	6130	2021	8151
2002-03	5035	979	6014
2003-04	4322	11377	15699
2004-05	3712	9291	13003
2005-06	3769	12492	16261
2006-07	7693	6947	14640
2007-08	15891	27434	43325
2008-09	22343	-14032	8311
2009-10	17965	32396	50361
2010-11	11305	30292	41597
2011-12	22006	17171	39177
2012-13	19819	26891	46710
2013-14	21564	4822	26385
2014-15	32628	40934	73562

During 2007-08 both FDI and Portfolio investment stood at US$ 15891 million and US$ 27434 million respectively. Year 2008-09 witnessed historic economic recession in the world and in India too. BSE sensex decreased sharply and recorded below 10,000 from the highest level of 21,000. As a result portfolio investment witnessed outflow and it was US$ - 14032 million in 2008-09.Pace of growth of inflow of FDI and portfolio investment showed almost similar trends during 1999-00 to 2014-15. Higher trends were witnessed up to 2007-08. The sharp decline in portfolio investment during 2008-09 was the result of global meltdown. Portfolio inflow was – US$ 14032 million, however, net FDI inflows was US$ 22343 million. Gross FDI inflows during the 2008-09 were US$ 8311 million. Provisional data for 2014-15 shows FDI inflow at US$32628 million and Portfolio Investment at US$40934 million. The trends in FDI are being presented as growth model in the following manner.

IMPACT OF FDI ONECONOMIC GROWTH

Foreign direct investment (FDI) has played an important role in the process of globalization during the past two decades. The rapid expansion in FDI by multinational enterprises since the mid-eighties may be attributed to significant changes in technologies, greater liberalization of trade and investment regimes, and deregulation and privatization of markets in many countries including developing countries like India. Capital formation is an important determinant of economic growth. While domestic investments add to the capital stock in an economy, FDI plays a complementary role in overall capital formation and in filling the gap between domestic savings and investment. At the macro-level, FDI is a non-debt-creating source of additionalexternal finances. At the micro-level, FDI is expected to boost output, technology, skill levels, employment and linkages with other sectors and regions of the host economy. In India FDI inflow made its entry during the year 1991-92 with the aim to bring together the intended investment and the actual savings of the country. To pursue a growth of around 7 percent in the Gross Domestic Product of India, the net capital flows should increase by at least 28 to 30 percent on the whole. But the savings of the country stood only at 24 percent. The gap formed between intended investment and the actual savings of the country was lifted up by portfolio investments by Foreign Institutional Investors, loans by foreign banks and other places, and foreign direct investments. Among these three forms of financial assistance, India prefers as well as possesses the maximum amount of Foreign Direct Investments. Hence FDI is considered as a developmental tool for growth and development of the country. Therefore, this study is undertaken to analyze the flow of FDI into the country identifying the various set of factors which determine the flow of FDI.

Table 2: Trends of Growth Rate of GDP and FDI Inflow

Year	FDI Inflow		GDP at factor cost	
	Rs. crore	% change	Rs. crore	% change
1999-00	22450	122.2552	2023130	12.1855762
2000-01	10733	-52.1915	2177413	7.62595582
2001-02	18654	73.80043	2355845	8.19467873
2002-03	12871	-31.0014	2536327	7.66103033
2003-04	10064	-21.8087	2841503	12.0322025
2004-05	14653	45.59817	3242209	14.1019031
2005-06	24584	67.77452	3693369	13.9152041
2006-07	56390	129.3768	4294706	16.2815305
2007-08	98642	74.92818	4987090	16.1218021
2008-09	142829	44.79532	5630063	12.8927491
2009-10	123120	-13.799	6477827	15.0578066
2010-11	97320	-20.9552	7784115	20.1655277
2011-12	165146	69.69379	8832012	13.4619928
2012-13	121907	-26.1823	9988540	13.0947286
2013-14	147518	21.00864	11345056	13.5807235

Table 2 reveals that FDI inflow increased during 1999-00 to 2013-14 despite some serious fluctuations. GDP has increased by about three times during the same period. An econometric model is being put forward to quantitatively prove the relationship between GDP growth and FDI inflow.The positive impact of FDI is likely to be higher as value addition under FDI increases. In 2008-09 the FDI inflow and consequently the growth of the economy witnessed a downfall due to the global recession however the Indian economy witnessed a swift recovery in 2009-10. The global economic slowdown had affected the Indian economy and GDP growth moderated to 6.8% in 2008-09 compared to an average of 9.5% in the preceding three years. The impact of global slowdown was more intense on industry, particularly the manufacturing sector. The fiscal and monetary policy interventions, however, provided the stimulus to the economy, leading to a recovery in the GDP growth to 8.0% in 2009-10 and 8.9% in the first half of 2010-11(Economic Survey, 2010-11). In general terms, FDI inflow has a positive impact on the growth of GDP in India.

CONCLUSION

If India has to achieve its desired goals as laid down in the twelfth Five Year Plan then our economy has to be strong and vibrant and the result of development equitably shared. The results of second generation economic reforms would be realised only if suitable changes in institutional apparatus and organisations are implemented both at the Central and State levels for attracting FDI inflows. The economic reforms in India have been instrumental in breaking the Hindu rate of growth of 3.5 per cent and moving towards faster economic growth. Increase in FDI inflow has been one of the major achievements in the post reforms period, however its benefits have not been interstate and intra state variations evenly spread across the entire economy and there are large. The trend of FDI inflow as projected by the semi log linear model shows a steady increase in FDI inflow in the coming years. This inflow if used judiciously and support by infrastructural development could have the way for fast economic growth in the country. Thus, it can be concluded that although attracting FDI can be an important factor for development, however, it is not an end in itself. The right strategy would be to create a favourable environment throughout the country for equitable FDI inflow and simultaneously develop sound domestic macro-economic and structural policies.

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