



## Role of foreign direct investment in Indian economy

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### Abstract

Indian economy experienced major policy changes in 1991. The new economic reform, popularly known as, *Liberalization, Privatization and Globalization* (LPG model) aimed at making the Indian economy as fastest growing economy and globally competitive. The series of reforms undertaken with respect to industrial sector, trade as well In context to India, this implies opening up the economy to foreign direct investment by providing facilities to foreign companies to invest in different fields of economic activity in India, removing constraints and obstacles to the entry of MNCs in India, allowing Indian companies to enter into foreign collaborations and also encouraging them to set up joint ventures abroad; carrying out massive import liberalization programs by switching over from quantitative restrictions to tariffs and import duties, therefore globalization has been identified with the policy reforms of 1991 in India as financial sector aimed at making the economy more efficient, productive and profitable. This research paper explains the role of FDI in Indian Economy.

**Keywords:** Indian economy, gross domestic product, service sector, FDI

### Introduction

Since independence, the performance of Indian economy has been dominated by a regime of multiple controls, restrictive regulations and wide ranging state intervention. Industrial economy of the country was protected by the state and insulated from external competition. As a result of which, India was thrown a long way behind the world of rapid expanding technology. The cumulative effect of these policies started becoming more & more pronounced. By the year 1989-90, the situation on the balance of payment and foreign exchange reserves became precarious and the country was driven to the brink of default. The credibility reached the sinking level that no country was willing to advance or lend to India at any cost. In such circumstances, the government quickly announced a economic policy in 1991 paving way to liberalization, privatization and globalization.

The investment scenario has been buoyant and moving upwards since the initiation of economic reforms. This has become inevitable due to radical as well as structural changes which have taken place world over. So in order to globalize an economy, four vital facets, namely, resources, sophisticated technology, managerial skills, and innovative marketing techniques are required which ultimately ask for liberalization. However, this concept has taken ground very late in India. It was necessary to encourage Indian companies to become global with a view to integrate India with the global market. Since the introduction of economic reforms programme in 1991, India has emerged as a principal host and source in the region. There is a remarkable change in the GDP and GDS. The capital market has become very active and FIIs (Foreign Institutional Investors), Foreign Investment Banks, and Asset Management companies have shown increasing interest in investing in India.

### Liberalization, privatization and globalization policy

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*Liberalization, Privatization and Globalization* (LPG model) aimed at making the Indian economy as fastest growing economy and globally competitive. The series of reforms undertaken with respect to industrial sector, trade as well as financial sector aimed at making the economy more efficient, productive and profitable.

**Liberalization:** Indian economy thus far was known as a controlled economy. Free flow of goods, people and technology was denied and flow was subject to governmental rules and regulations. The concept of liberalization is based on decontrolled thought process and liberal attitude accepting others including their technology, products, services and investment wisdom and wealth.

Now that India was in the process of restructuring her economy, with aspirations of elevating herself from her present desolate position in the world, the need to speed up her economic development was even more imperative. And having witnessed the positive role that Foreign Direct Investment (FDI) has played in the rapid economic growth of most of the Southeast Asian countries and most notably China, India had embarked on an ambitious plan to emulate the successes of her neighbors to the east and is trying to sell herself as a safe and profitable destination for FDI.

In context to India, this implies opening up the economy to foreign direct investment by providing facilities to foreign companies to invest in different fields of economic activity in India, removing constraints and obstacles to the entry of MNCs in India, allowing Indian companies to enter into foreign collaborations and also encouraging them to set up joint ventures abroad; carrying out massive import liberalization programs by switching over from quantitative restrictions to tariffs and import duties, therefore globalization has been identified with the policy reforms of 1991 in India.

**Privatization:** Includes providing opportunities to the private sector to showcase their hidden talent and skills and to invest in the field of business. Earlier due to license raj

there were many hindrances to privatization but with the advent of time and relaxing of norms privatization came into its full bloom.

Privatization permits the people to play freely in the field of economic development. The then Prime Minister Mr. P.V. Narsimha Rao while declaring new policy assured government's positive support to private players. He said, "you operate we willco-operate". PPP Model is also the instrument of national building.

**Globalization:** The term globalization refers to the integration of economies of the world through uninhibited trade and financial flows, as also through mutual exchange of technology and knowledge. Ideally, it also contains free inter-country movement of labor. The process of globalization not only includes opening up of world trade, development of advanced means of communication, internationalization of financial markets, growing importance of MNCs, population migrations and more generally increased mobility of persons, goods, capital, data and ideas but also infections, diseases and pollution.

The whole world is one unit and the concept of globalization is based on the theory of global village phenomenon which amounts to free flow of information and other resources. The concept is based on a boundary-less world.

Foreign investment plays a significant role in development of any economy as like India. Many countries provide many incentives for attracting the foreign direct investment (FDI). Need of FDI depends on saving and investment rate in any country. Foreign Direct investment act as a bridge to fulfill the gap between investment and saving. In the process of economic development foreign capital helps to cover the domestic saving constraint and provide access to the superior technology that promote efficiency and productivity of the existing production capacity and generate new production opportunity.

#### Objective of the study

1. To study the significance of FDI for India
2. To Analysis the trends of FDI in developing country like India after economic reforms.
3. To study the impact of FDI.

#### Research Methodology

The research paper is based Secondary data. The Required data and Information have been collected from Annual Reports of Central Government Offices. The RBI Annual Reports and Various Websites relevant to topics.

#### Current scenario of Indian economy

Indian economy is moving very fast form developing stage to developed one. We are premier democratic country of the world with a very sound financial system, well governed by various autonomous institutions and agencies working under the reign of Government of India.

India is projected to see a faster growth of 7.5 per cent this fiscal, on the back of higher savings and investment rates, even as most of the Asia-Pacific economies are likely to expand at a slower pace, as per a United Nations (UN) report. "We expect it to expand by about 7.5 per cent in 2012-13," Nagesh Kumar, Chief Economist, United Nations Economic and Social Commission for Asia and the Pacific (ESCAP).

Meanwhile, India continues its ascent as a top destination for private clean energy investment, according to a research report released by The Pew Charitable Trusts. "Clean energy investment, excluding research and development, has grown by 600 per cent since 2004," according to Phyllis Cuttino, Director, Pew's Clean Energy Program. India's clean energy sector continued to flourish in 2011, with private investment increasing 54 per cent to US\$ 10.2 billion, placing the country at sixth position among the G-20 nations.

#### Segregation of Indian Economy

The economy of India is segregated into three sectors, namely;

**Primary sector:** Where the economic activity depends mainly on exploitation of natural resources then that activity comes under the primary sector. Agriculture and agriculture related activities are the primary sectors of economy. The Primary sector of the economy is the change of natural resources into primary products. Most products from this sector provide raw materials for other industries. The share of primary sector has decreased from the past four decades. In 1970 the share of the sector was 50% which has reduced to 29% in 1995 and is now further reduced to 25%. Major businesses in this sector are agriculture, agri-business, fishing, and forestry, all mining and quarrying industries.

#### Agriculture

Agriculture in India is the major sector of its economy. Almost two-thirds of the total work-force earns their livelihood though farming and other allied sectors like forestry, logging and fishing which account 18% of the GDP. These sectors provide employment to 60% of the country's total population. About 43% of the country's total geographical area is used for agricultural purposes. After independence additional areas were brought under cultivation and new methods, practices and techniques of irrigation and farming were introduced by the government. The "Green Revolution" and "Operation Flood" in the country have made India self sufficient in producing food grains and milk. Among other things, the government also tried to decrease the dependence on monsoons. Better seeds, use of fertilizer, education of farmers and provision of agricultural credit and subsidies are reasons for increase in agricultural productivity. Today, India is the major producer of milk, cashew nuts, coconuts, tea, ginger, turmeric and black pepper in the whole world. It is the second largest producer of wheat, sugar, groundnut and inland fish. It is the third largest producer of tobacco and rice. India accounts for 10 per cent of the world fruit production with first rank in the production of banana and sapota (Sapodilla). Agriculture in India is the responsibility of the states rather than the central government. States like Punjab, Haryana, Uttar Pradesh, Andhra Pradesh, Tamil Nadu, Karnataka and West Bengal are major producers of food grains in India. Himachal Pradesh and Jammu and Kashmir are famous for fruit production. Tea is produced in the high altitudes of Assam, Darjeeling in West Bengal, Tripura, Ooty in Tamil Nadu, Himachal Pradesh and Kerala. Kerala is also the largest producer of natural rubber and spices in India. Rajasthan is among the major producers of edible oils in India and second largest producer of oil seeds. Even though there has been a steady decline in its share in the GDP,

agriculture still remains the largest economic sector and plays a crucial role in the socio-economic development of the country.

### Fishing

Fish breeding has increased almost five times since India got independence and is a prime industry in coastal regions. The economic zone of India runs up to Indian ocean (370 Km) covering an area more than 2 million square kilometers. Approximately 4.5 million ton catches are expected from that area. India has about 14000 Km<sup>2</sup> brackish water for aquaculture, out of which 600 Km<sup>2</sup> were being farmed in early 1990s; about 16,000 Km<sup>2</sup> of freshwater lakes, ponds and swamps; and nearly 64,000 kilometers of rivers and streams.

### Mining

Mining is the term used for the extraction of useful material from the treatment of ore, vein or coal seam. Materials obtained from extraction may be base metals, precious metals, iron, uranium, coal, diamonds, limestone, oil shale, rock salt and potash. Any material obtained from agriculture or cultured in laboratory requires to be mined.

**Secondary Sector:** When the main activity involves manufacturing then it is the secondary sector. All industrial production where physical goods are produced come under the secondary sector. The secondary sector of the economy includes those economic sectors that create a finished usable product and hence depend on primary sector industries for the raw materials. This sector includes Mining, manufacturing and construction. The secondary sector contributes 24% of the share in Indian economy.

### Industry

India's industrial sector accounts for 27.6% of the GDP and gives employment to 17% of the total workforce. Though agriculture is the foremost occupation of the majority of the people, the government had always laid stress on the industrial development of the country. Thus policies and strategies were framed to give a boost to India's industry. The government aims at achieving self-sufficiency in production and protection from foreign competition. Since independence, India is marching ahead to become a diverse industrial base. Today India holds some key industries in the sectors like steel, engineering and machine tools, electronics, petrochemicals, textiles and software. Importance has also been given to improve the infrastructure of the country. The government has liberalized its industrial policy thereby attracting huge foreign direct investment. If on one hand several multinational companies opened their offices in India, on the other hand many Indian companies started their operations in foreign countries.

### Construction

The process of building or assembling of infrastructure is known as a term commonly used in architecture and civil engineering- "construction". Construction job is all about multitasking and needs the services from project manager, construction manager, design engineer, construction engineer and project architect. The construction industry in India is an important indicator of development as it creates investment opportunities across various related sectors. The construction industry has contributed an estimated ₹ 3, 84, 282 crore (at constant prices) to national GDP in 2010-11 (a

share of around 8 per cent). The sector is labour intensive and, including indirect jobs, provides employment to more than 35 million people. These initiatives have resulted in more private ownership of build-operate transfer (BOT), build-operate-own-transfer (BOOT), and build-operate-lease-transfer (BOLT) projects. FDI is allowed upto 100 per cent under the automatic route in townships, housing, built-up infrastructure, and construction of development projects (which include housing, commercial premises, educational institutions, and recreational facilities). Construction services have been brought under the ambit of services tax since the year 2004. However, certain infrastructure projects like dams, roads, bridges, railways, and airports and projects awarded by Government/ local bodies are exempt from services tax. Construction service providers have been allowed to avail of Central value added tax (CENVAT) credit on capital goods, inputs, and input services since 2004.

**Tertiary or Service Sector:** When the activity involves providing intangible goods like *services* then this is part of the tertiary sector. Financial services, management consultancy, telephony and IT are examples of service sector. The share of services in India's GDP at factor cost increased rapidly from 30.5 per cent in 1950-51 to 55.2 per cent in 2009-10. If construction is also included, then the share increases to 63.4 per cent in 2009-10. The ranking up of the overall growth rate (compound annual growth rate) CAGR of the Indian economy from 7 per cent in the 1990s to 8.6 per cent during the period 2004-05 to 2009-10 was to a large measure due to the acceleration of the growth rate (CAGR) in the services sector from 7.5 per cent in the 1990s to 10.3 per cent in 2004-05 to 2009-10. The services sector growth was significantly faster than the 6.6 per cent for the combined agriculture and industry sectors annual output growth during the same period. In 2009-10, services growth was 10.1 per cent and in 2010-11 (advance Estimates—AE) it was 9.6 per cent. India's services GDP growth has been continuously above overall GDP growth, pulling up the latter since 1997- 98. It has also been more stable.

Although the primary sector (mainly agriculture) is the dominant employer followed by the services sector, the share of services has been increasing over the years while that of primary sector has been decreasing. In 2007-08 compared to 2004-05, though the trend was similar, the fall in employment in primary sector was less (at -1.1 per cent) with a small commensurate rise in employment in the other two sectors, which was again almost equally divided between the other two sectors. The four fast-growing broad service categories are:

1. Financing, Insurance, Real estate and Business services.
2. Transport, Storage, and Communication. The latter overtook the former in 2009-10 with a high growth of 15 per cent.
3. Growth of Trade, Hotels and Restaurants, slowed in 2008-09 and has recovered moderately in 2009-10.

**Foreign Direct and Indirect:** Investment FDI stands for Foreign Direct Investment, a component of a country's national financial accounts. Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organizations. The FDI can take any route or form to enter into any nation. The three principal forms

of FDI in India are joint ventures, acquisition of assets in a country and Greenfield ventures. According to the international monetary fund, FDI is defined as “Investment that is made to acquire lasting interest in an enterprise operating in an economy other than that of investor. The investor’s purpose is being to have an effective voice in the management of enterprise.” Foreign indirect investment as portfolio investment, Portfolio investment does not seek management control, but it motivated by profit. Portfolio investment occurs when individual investors invest, mostly through stockbrokers in stocks of foreign companies in foreign land in search of profit opportunities. Foreign investment comes in host country in through various route and many forms. Rather than attracting as much FDI as possible host country governments would be well advised to focus their efforts in inviting the “right” kind of FDI. Among all various routes the two main routes are: 1. Foreign Direct investment (FDI) and 2. Foreign indirect investment (FIIs) The Inflow of Foreign Investment Comes Through Various Routes. viz 1. Equity (Government, RBI, NRI, Acquisition, shares, Equity capital of unincorporated bodies); Reinvested earning; other capital. 2. Portfolio investment (GDR/ADR, FIIs, OFF shore funds and others)

**Inflow of Foreign Investment in India:** In India foreign capital comes from private individual and institutional investors on commercial terms in the form of Euro-issues comprising, external commercial borrowings, portfolio investments by non-resident of India’s, overseas corporate bodies and investments by foreign financial institutions.

**Need of Foreign Investment in India:** India is suffering from the scarcity of financial resources and low level of capital formation because it has to majorly depend upon the external sources of Finance. Also the domestic resources are entirely inadequate to carry out development programmes. Foreign investments have played a pivotal role in India to supplement the low level of domestic investment. The flows of foreign investments in India takes the form of direct investment and portfolio investment which are non-debt creating flows in nature. The FDI flows in India took a new turn with announcement of New Economic Policy in 1991. The FDI allowed in priority sectors for the development of industries.

**Table 1**

2010	\$27.40B	1.64%
2009	\$35.58B	2.65%
2008	\$43.41B	3.62%
2007	\$25.23B	2.07%
2006	\$20.03B	2.13%
2005	\$7.27B	0.89%
2004	\$5.43B	0.77%
2003	\$3.68B	0.61%
2002	\$5.21B	1.01%
2001	\$5.13B	1.06%

From Table 1.1 it is evident that the Foreign Direct Investment of India was 1.06% of GDP in 2001 and in 2010 it was 1.64%. There are various facilities given to the investors for FDI,

**Conclusion**

On the basis of study we draw conclusion that Various sectors of India received FDI. Foreign investment flows are

supplementing the scare domestic investments in developing countries particularly in India. But foreign investor never adopts environment friendly technique to maximize their profit. These investments met the financial requirement for building up the basic and essential infrastructure industries of priority sector. We should provide the better environment for attracting the foreign investment through direct as well as indirect methods. We should welcome inflow of foreign investment in such way that it should be convenient and favorable for Indian economy and enable us to achieve our cherished goal like rapid economic development, removal of poverty, internal personal disparity in the development and making our Balance of Payment favorable.

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