



Role of foreign investment in economic development: Trade and pattern of FDI flow in India

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Abstract

Foreign investments have a positive impact of the development of the country. The capital inflows of FDI strangers' infrastructure, productivity, employment opportunities, the trade Network of a country at Global level and also provided financial assistance to that country. The general assertion in financial literature support the construct that FSI is the prime modality for stimulating economic and industrial development in developing nations. This topic, Role of Foreign Investment In Economic Development: Trade And Pattern Of FDI Flow In India. Analyses the impact of foreign investment provides more favorable economic environment for development in India.

Keywords: foreign, growth, development, investment, financial, loan try, economics

Introduction

The flow of capital from one country to another by investing in the assets or buying shares of companies of another country that is foreign investment. One of the most prominent and striking feature of today's globalised world is the exponential growth of FDI in both developed and developing countries. In the last two decades the pace of FDI flows are rising faster than almost all other indicators of economic activity worldwide. Developing countries, in particular, considered FDI as the safest type of external finance as it not only supplement domestic savings, foreign reserves but promotes growth even more through spillovers of technology, skills, increased innovative capacity, and domestic competition. Now days, FDI has become an instrument of international economic integration.

Role of Economic Growth

1. Provides capital
2. Removes Negative BOP
3. Create competitive environment
4. Brings managements skills and Technology
5. Promotes increased employments.

Review literature

Anitha, R (2012) ^[12], in his paper "FDI and economic Growth in India" he talked about the role of FDI in the development of developing and undeveloped countries. FDI is such countries bridges in gap between available financial resources and required financial resources. Rahamam'A. & Chakraborty,S.(2015), they had done empirical research i Bangladesh to analyze the relationship between FDI and gross domestic product, FDI has positive impact on the economic growth as it results in the development, advance technologies came into own country. Singh. J (2012) ^[13] their paper "Role of Foreign Direct Investment in India: "An Analytical Study" they showed that FDI played a major role in attracting International Economic Integration in every economy. Sharma, M. & Sing. S. (2016) in their paper they examined the major features of FDI and impact on Indian economy in pre and post liberalization period. Malhotra. B (2014) ^[14] in her paper she analyzed the

challenges facing by India in positioning itself favorably at global level context to FDI and also examined the impact of FDI on the Indian economy.

Objectives

The study covers the following objectives:

1. To study the trends and patterns of flow of FDI.
2. To assess the determinants of FDI inflows.
3. To evaluate the impact of FDI on the Economy.

Hypothesis

The study has been taken up for the period 1991-2008 with the following hypotheses:

1. Flow of FDI shows a positive trend over the period 1991-2008.
2. FDI has a positive impact on economic growth of the country.

Research methodology

Sources of information: This study is based on secondary data. The data is collected from various sources. The hand book of statistics of Indian economy, publication, journals and internet.

Analysis Method: The collected data are analyzed with the help of linear Regression.

Data Collection

This study is based on secondary data. The required data have been collected from various sources i.e. World Investment Reports, Asian Development Bank's Reports, various Bulletins of Reserve Bank of India, publications from Ministry of Commerce, Govt. of India, Economic and Social Survey of Asia and the Pacific, United Nations, Asian Development Outlook, Country Reports on Economic Policy and Trade Practice-Bureau of Economic and Business Affairs, U.S. Department of State and from websites of World Bank, IMF, WTO, RBI, UNCTAD, EXIM Bank etc.. It is a time series data and the relevant data have been collected for the period 1991 to 2008.

Important of the Study

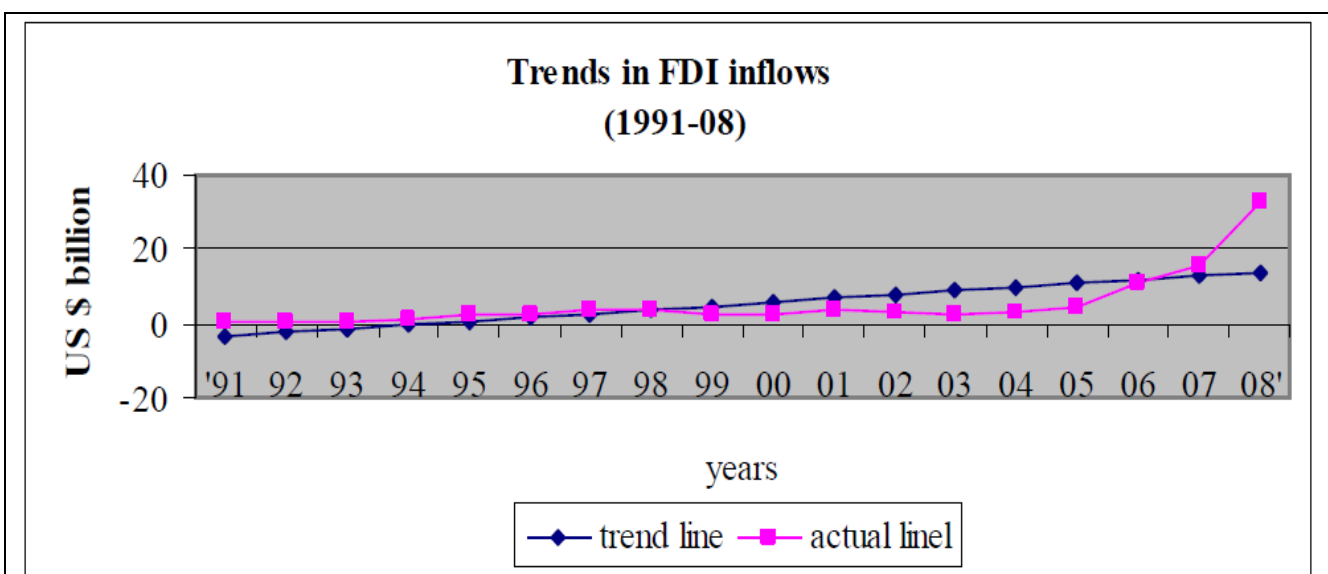
It is apparent from the above discussion that FDI is a predominant and vital factor in influencing the contemporary process of global economic development. The study attempts to analyze the important dimensions of FDI in India. The study works out the trends and patterns, main determinants and investment flows to India. The study also examines the role of FDI on economic growth in India for the period 1991-2008. The period under study is important for a variety of reasons. First of all, it was during July 1991 India opened its doors to private sector and liberalized its economy. Secondly, the experiences of South-East Asian countries by liberalizing their economies in 1980s became stars of economic growth and development in early 1990s. Thirdly, India's experience with its first generation economic reforms and the country's economic growth performance were considered safe havens for FDI which led to second generation of economic reforms in India in first decade of this century. Fourthly, there is a considerable change in the attitude of both the developing and developed countries towards FDI. They both consider FDI as the most suitable form of external finance. Fifthly, increase in competition for FDI inflows particularly among the developing nations.

The shift of the power center from the western countries to the Asia sub -continent is yet another reason to take up this study. FDI incentives, removal of restrictions, bilateral and regional investment agreements among the Asian countries and emergence of Asia as an economic powerhouse (with China and India emerging as the two most promising economies of the world) develops new economics in the world of industrialized nations. The study is important from the view point of the macroeconomic variables included in the study as no other study has included the explanatory variables which are included in this study. The study is appropriate in understanding inflows during 1991-2008.

Trends and patterns of FDI flow in India

Economic reforms taken by Indian government in 1991 makes the country as one of the prominent performer of

global economies by placing the country as the 4th largest and the 2nd fastest growing economy in the world. India also ranks as the 11th largest economy in terms of industrial output and has the 3rd largest pool of scientific and technical manpower. Continued economic liberalization since 1991 and its overall direction remained the same over the years irrespective of the ruling party moved the economy towards a market - based system from a closed economy characterized by extensive regulation, protectionism, public ownership which leads to pervasive corruption and slow growth from 1950s until 1990s. In fact, India's economy has been growing at a rate of more than 9% for three running years and has seen a decade of 7 plus per cent growth. The exports in 2008 were \$175.7 bn and imports were \$287.5 bn. India's export has been consistently rising, covering 81.3% of its imports in 2008, up from 66.2% in 1990-91. Since independence, India's BOP on its current account has been negative. Since 1996-97, its overall BOP has been positive, largely on account of increased FDI and deposits from Non - Resident Indians (NRIs), and commercial borrowings. The fiscal deficit has come down from 4.5 per cent in 2003-04 to 2.7 per cent in 2007-08 and revenue deficit from 3.6 per cent to 1.1 per cent in 2007-08. As a result, India's foreign exchange reserves shot up 55 per cent in 2007-08 to close at US \$309.16 billion - an increase of nearly US \$110 billion from US \$199.18 billion at the end of 2006-07. Domestic saving ratio to GDP shot up from 29.8% in 2004-05 to 37.7% in 2007-08. For the first time India's GDP crossed one trillion dollars mark in 2007. As a consequence of policy measures (taken way back in 1991) FDI in India has increased manifold since 1991 irrespective of the ruling party over the years, as there is a growing consensus and commitments among political parties to follow liberal foreign investment policy that invite steady flow of FDI in India so that sustained economic growth can be achieved. Further, in order to study the impact of economic reforms and FDI policy on the magnitude of FDI inflows, quantitative information is needed on broad dimensions of FDI and its distribution across sectors and regions.



Source: compiled & computed from the various issues of Economic Survey, RBI Bulletin, Ministry of Commerce

Chart 1

The actual FDI inflows in India is welcomed under five broad heads: (i) Foreign Investment Promotion Board's (FIPB) discretionary approval route for larger projects, (ii) Reserve Bank of India's (RBI) automatic approval route, (iii) acquisition of shares route (since 1996), (iv) RBI's non-resident Indian (NRI's) scheme, and (v) external commercial

borrowings (ADR/GDR) route. An analysis of the last eighteen years of trends in FDI inflows (Chart-1 and Chart-2) shows that there has been a steady flow of FDI in the country up to 2004, but there is an exponential rise in the FDI inflows from 2005 onwards.

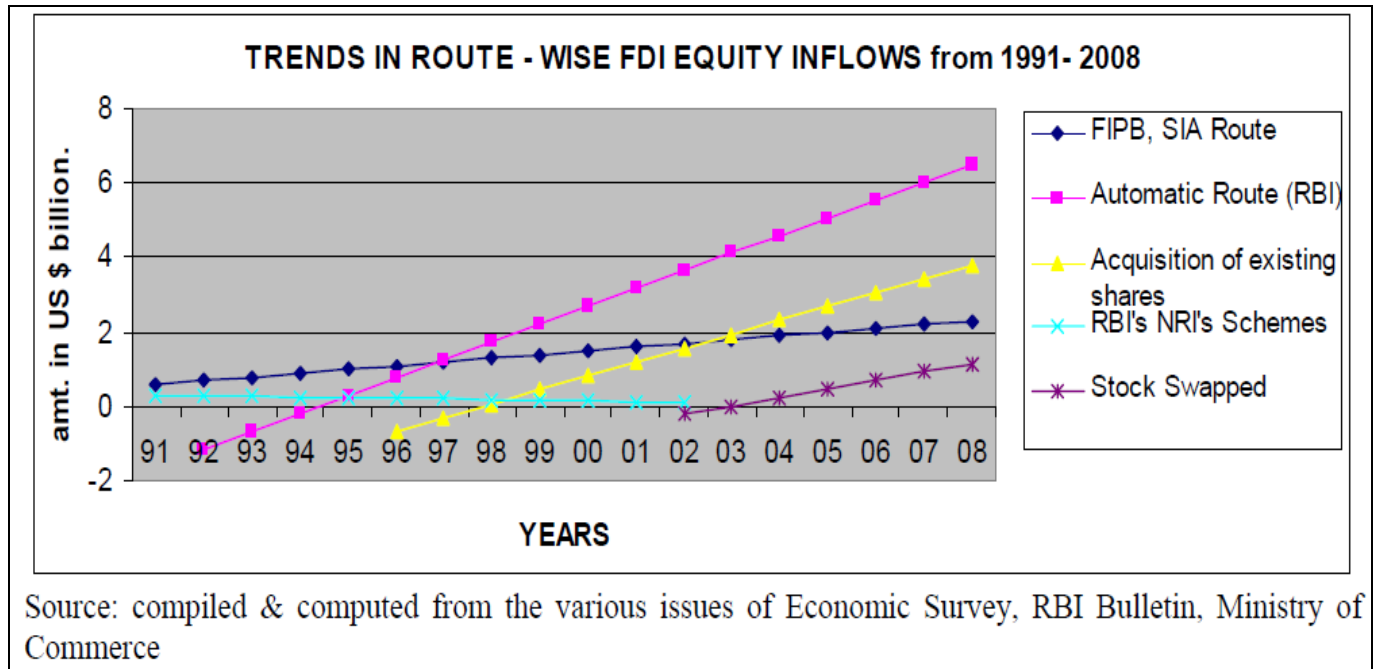
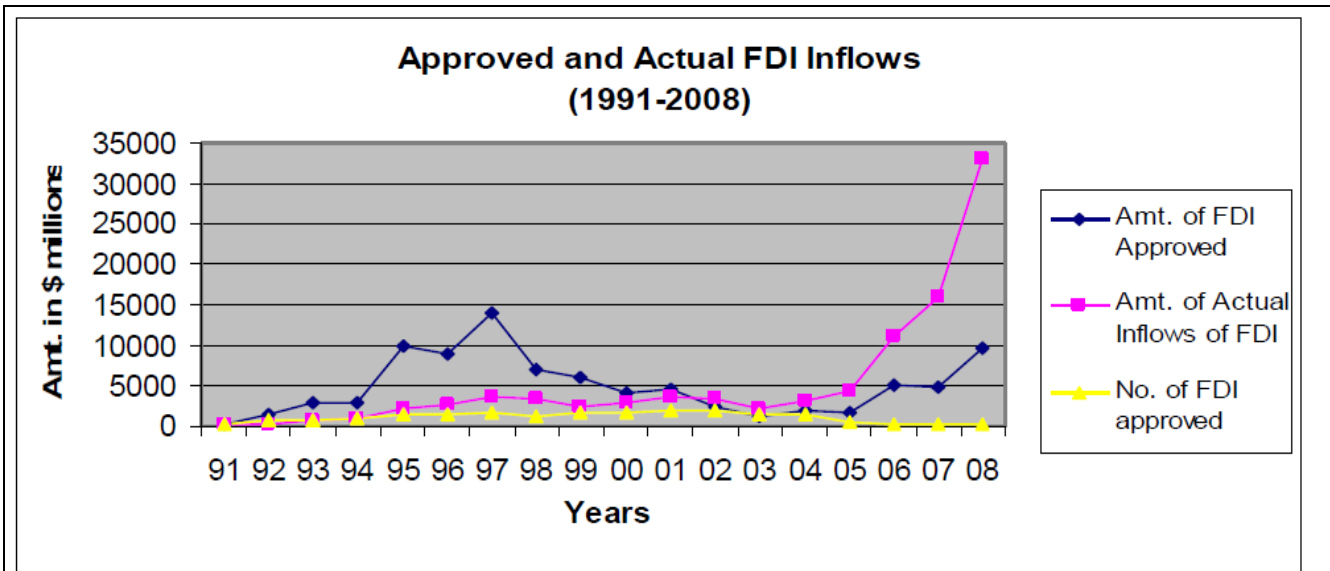


Chart 2

Further, the actual inflows of FDI through various routes in India are described in (Chart- 2). The FIPB route - represents larger projects which require bulk of inflows and account for government's discretionary approval. Although, the share of FIPB route is declining somewhat as compared to RBI's automatic route and acquisition of existing shares route. Automatic approval route via RBI shows an upward trend of FDI inflows since 1995. This route is meant for smaller sized investment projects. Acquisition of existing shares route and external commercial borrowing route gained prominence (in 1999 and 2003) and shows an upward increasing trend. However, FDI inflows through NRI's route show a sharp declining trend. It is found that India was not able to attract substantial amount of FDI inflow from 1991-99. FDI inflows were US\$ 144.45 million in 1991 after that the inflows reached to its peak to US\$ 3621.34 million in 1997. Subsequently, these inflows touched a low of US \$2205.64 million in 1999 but then shot up in 2001. Except in 2003, which shows a slight decline in FDI inflows, FDI has been picking up since 2004 and rose to an appreciable level of US\$ 33029.32 million in 2008.

The annual growth rate was 107% in 2008 over 2007, and compound annual growth rate registered was 40% on an annualized basis during 1991-2008. The increase in FDI inflows during 2008 is due to increased economic growth and sustained developmental process of the country which restore foreign investor's confidence in Indian economy despite global economic crisis. However, the pace of FDI inflows in India has definitely been slower than China, Singapore, Russian Federation, and Brazil.

A comparative analysis of FDI approvals and inflows (Chart - 3) reveals that there is a huge gap between the amount of FDI approved and its realization into actual disbursements. A difference of almost 40 per cent (Chart -4) is observed between investment committed and actual inflows during the year 2005-06. All this depends on various factors, namely regulatory, procedural, government clearances, lack of sufficient infrastructural facilities, delay in implementation of projects, and non- cooperation from the state government etc.

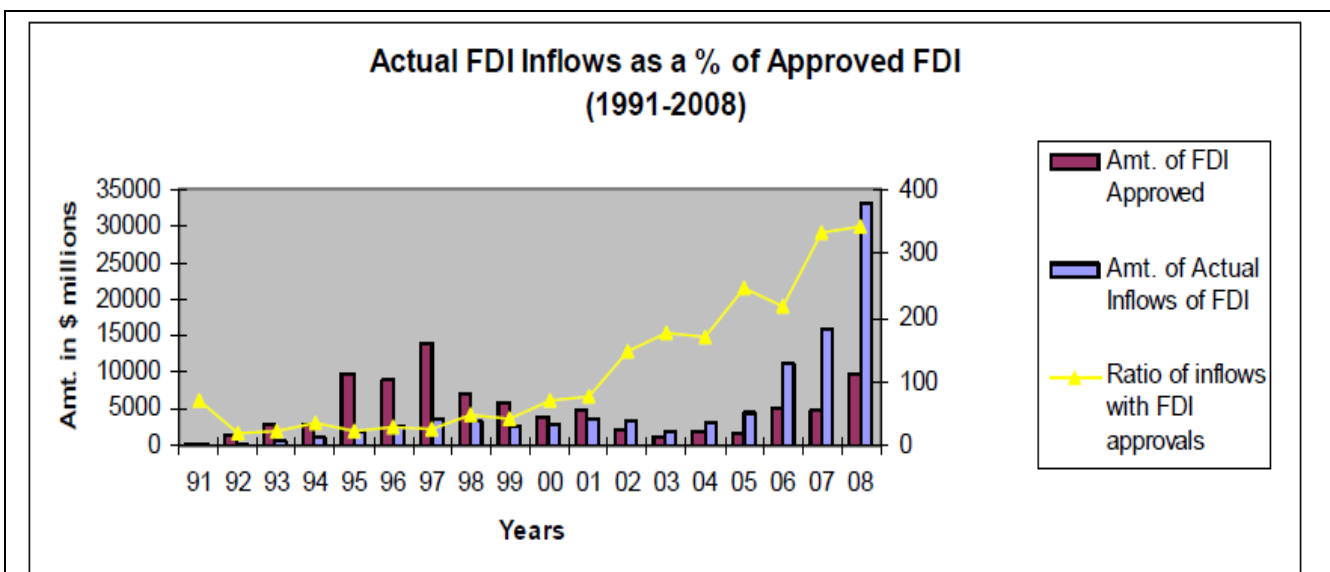


Source: compiled & computed from the various issues of Economic Survey, RBI Bulletin, Ministry of Commerce

Chart 3

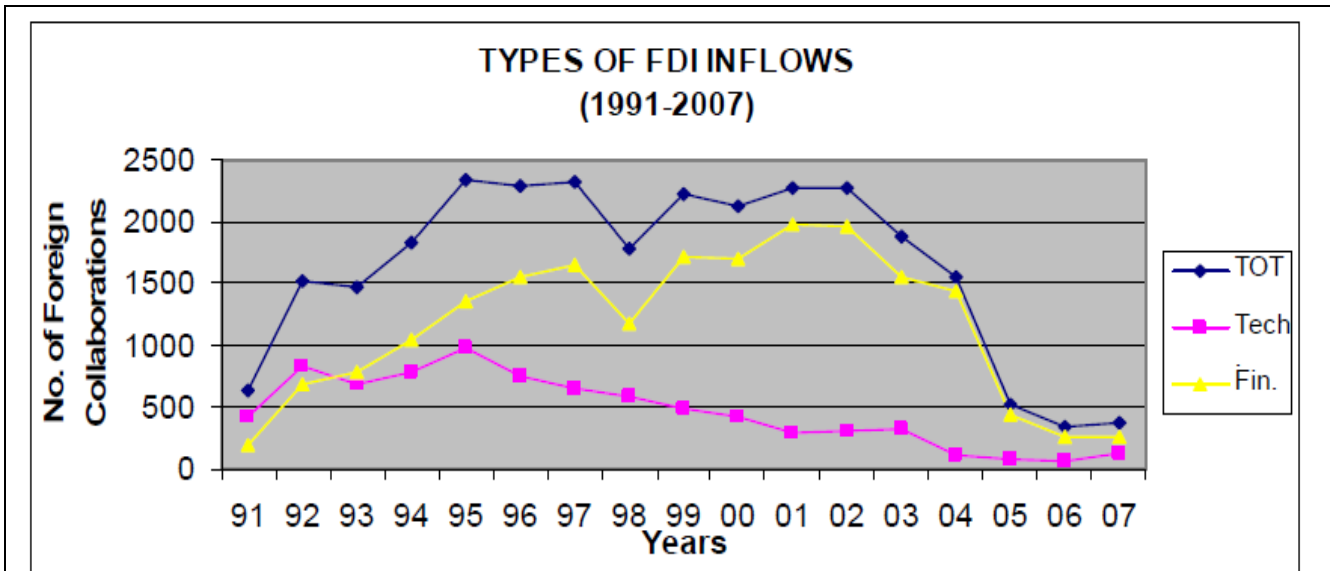
Infect, many long term projects under foreign collaborations get delayed considerably, or in some cases, they may even be denied in the absence of proper and sufficient

infrastructural support and facilities. These are perhaps some reasons that could be attributed to this low ratio of approvals vs. actual inflows.



Source: compiled & computed from the various issues of Economic Survey, RBI Bulletin, Ministry of Commerce

Chart 4

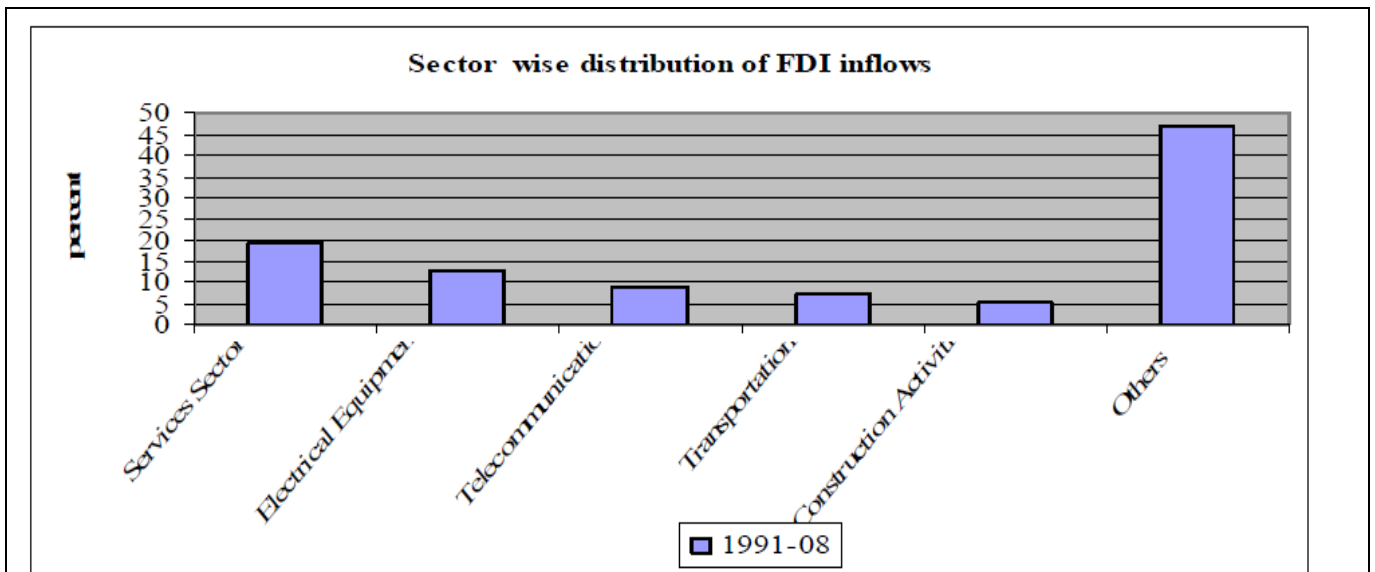


Source: compiled & computed from the various issues of Economic Survey, RBI Bulletin, Ministry of Commerce

Chart 5

Although, total number of foreign collaborations has increased since 1991. It is evident from (Chart - 5) that financial collaborations have gradually outnumbered the technical collaborations which indicate that investors are

more interested in financial collaborations rather than technical ones. The increase in financial collaboration could be because of the relaxation given by government in the investment norms for financial collaborations.



Source: compiled & computed from the various issues of Economic Survey, RBI Bulletin, Ministry of Commerce

Chart 6

The major sectors (Chart- 6) attracting FDI inflows in India have been Services and Electrical & electronics amounting US\$ 30,421 millions or 32% of total FDI. Service sector tops the chart of FDI inflows in 2008 with India emerged as a top destination for FDI in services sector. Services exports are the major driving force in promoting exports. Keeping in mind the rising service sector India should open doors to foreign companies in the export - oriented services which could increase the demand of unskilled workers and low skilled services and also increases the wage level in these services. Data in (Chart- 2.10) reveal that the top 5 sectors

in aggregate for FDI inflows constitute US\$ 50,479 million during August 1991 to Dec. 2008 which accounts for 53.2% of total FDI inflow. Out of this, nearly 40.8% of FDI inflows are in high priority areas like Services, Electrical Equipments, Telecommunication, etc.

Conclusion

Above analysis shows, foreign direct investment has a significant impact on the economic growth of the country and also FDI has a major contribution in it. Each country tries to bring more and more FDI in their country which will

later bring economic growth of the country. Finally, it may be concluded that developing countries has make their presence felt in the economics of developed nations by receiving a descent amount of FDI in the last three decades. Although India is not the most preferred destination of global FDI, but there has been a generous flow of FDI in India since 1991. It has become the 2nd fastest growing economy of the world. India has substantially increased its list of source countries in the post - liberalization era. India has signed a number of bilateral and multilateral trade agreements with developed and developing nations. India as the founding member of GATT, WTO, a signatory member of SAFTA and a member of MIGA is making its presence felt in the economic landscape of globalised economies. The economic reform process started in 1991 helps in creating a conducive and healthy atmosphere for foreign investors and thus, resulting in substantial amount of FDI inflows in the country.

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