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Impact of Foreign Direct Investment on Indian Economy

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Abstract: *Foreign direct investment (FDI) is an instrument for economic growth; it strengthens domestic capital, productivity and employment. FDI in India has got an important role in the development of the Indian economy. FDI in India has enabled India to achieve a certain degree of financial stability, growth and development in various ways. It has allowed India to focus on the areas that needed a boost and economic attention, and to address the various problems that continue to challenge the country. India has worked a lot to attract FDI from the world's major investors. FDI is vital in the up gradation of technology, skills and managerial capabilities in various sectors of the economy. With globalization, developing countries, particularly those in Asia, have been witnessing an immense surge of FDI inflows during the past two decades. India with its considerable market potential and a liberalized policy regime has sustained its attraction for foreign investors. This research paper aims to observe the impact of FDI on Indian economy, predominantly after two decades of economic reforms. The paper provides the major policy implications from this analysis. The attraction of foreign direct investments (FDI) is often emphasised as a precondition for a successful economy by most governments of less developed countries. The objective of the paper is to evaluate economic impacts of FDI.*

Keywords: Foreign Direct Investment (FDI), economy, growth.

I. INTRODUCTION

Economic survey 2022-23 India is now the third-largest economy in the world in PPP (Purchasing Power Parity) and fifth position in the world GDP ranking 2023 list.

In the 1990s FDI was the leading source of external financing to the developing countries and it has become a key component of national development strategy foremost of the countries in the world as a means for technology flows and an important source of non-debt inflows for attaining competitive efficiency by creating a meaningful network of global interconnections. FDI provides opportunities to enhance the economic development and opens new opportunities to optimize the earnings by employing the resources.With a strong support of the government, FDI has aided the growth of Indian economy.

India has continually worked hard to attract FDI from the world's major investors. In 1998 and 1999, the Indian government announced various reforms designed to encourage and promote a favorable business environment for the global investors. FDIs are permitted in many ways such as: financial collaborations, through private equity or preferential allotments, by way of capital markets through euro issues, and in joint ventures. FDI is strictly not permitted in the arms, nuclear, railways, coal or mining industries. Various projects have been implemented in areas such as electricity generation, distribution and transmission, as well as the development of roads and highways, providing opportunities for foreign investors.

At present, FDI is allowed in financial services, which includes the growing credit card business. The non-banking financial services sectors are also included in this. Foreign investors can purchase up to 40% of the equity in private banks, provided that these banks must be multilateral financial organizations. Up to 45% of the shares of the companies in the Global Mobile Personal Communication by Satellite Services (GMPCSS) sector can also be purchased.

International Economic Integration has a vital role in Economic Development of a country. Foreign Direct Investment a major instrument of attracting International Economic Integration. It works as a link between investment and saving. Many developing countries are facing the deficit of savings; India is one among them. This problem can be resolved with the help of Foreign Direct Investment. FDI helps in reducing the deficit of BOP. The flow of FDI is a profit making industry and it works as a catalyst for the growth of economy.

The prominent feature of the economic landscape is the movement of international capital in all variety in forms, aspirations and impacts. To face deep economic crisis and to seek after effective ways of recovery, governments are supposed to be more attentive to economic rationale in their decision-making. International capital movement can be distinguished in two types. International borrowing and lending can be seen as intertemporal trade. A country, abundant with capital, exports future consumption at a price of interest rate. Borrowing country imports current consumption at the same price (Krugman, Obstfeld, 1994). The other part of international capital movement takes the form of foreign direct investment. In simple words, foreign investment is international capital flow in which a firm in one country creates or expands a subsidiary in another. It is a measure of foreign ownership of productive assets.

In the years of economic boom, domestic producers in advanced economies are strong enough not to be forced out of business by foreign competitors. The effects of FDI were more positive. Enhanced competition, knowledge and technology spill-over's, financial stability of incoming investors can bring more positive results. Foreign Direct investment acts as a bridge to fulfil the gap between investment and savings.

1.1 Objectives of the Study:

1. To study the importance of FDI in India.
2. To analyse the trends of FDI in the recent past in India after economic reforms.
3. To evaluate the determinants of FDI inflows.
4. To analyse the impact of FDI on the Indian economy.

1.2 Foreign Direct Investment in India and Economic Growth

The historical background of FDI in India can be traced right from the establishment of East India Company of Britain. British capital came to India during the colonial era. After World War II, Japanese companies entered Indian market and enhanced their trade with India, yet Britain (UK) remained the most dominant investor in India. Further, after the Independence matters relating to foreign capital, operations of MNCs gained attention of the policy makers. Concerning the national interests the policy makers designed the FDI policy as a medium for acquiring advanced technology to mobilize foreign exchange resources. As per economic and political regimes there have been changes in the FDI policy. The industrial policy of 1965, permitted MNCs to venture through technical collaboration in India. Therefore, the government adopted a liberal approach by allowing more frequent equity. In the critical phase of Indian economy the government of India, with the help of World Bank and IMF introduced the macro-economic stabilization and structural adjustment program. As a result of these reforms India opened its door to FDI inflows and adopted a more liberal foreign policy in order to restore the confidence of foreign investors. Further, under the new foreign investment policy Government of India constituted FIPB (Foreign Investment Promotion Board) the main function of that board was to invite and facilitate foreign investment. Starting from a baseline of less than USD 1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010-2012. As per the data, the sectors which attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, USA and UK were among the leading sources of FDI to the country.

According to GYANPRATHA – ACCMAN (Journal of Management, Volume 5Issue 1, 2013) FDI for 2009-10 at US$ 25.88 billion was lower by five per cent from US$ 27.33 billion in the previous fiscal. Foreign direct investment in August dipped by about 60 percent to US$ 34 billion approx., the lowest in 2010 fiscal. Industry department data released showed that in the first two months of 2010-11 fiscal, FDI inflow into India was at an all-time high of $7.78 billion up 77%from $4.4 billion during the corresponding period in the previous year. In 2013, the government relaxed FDI norms in several sectors, including telecom, defence, PSU oil refineries, power exchanges and stock exchanges, among others. Inertial, UK-based Tesco submitted its application to initially invest US$ 110 million to start a supermarket chain in collaboration with Tata Group's Trent. In civil aviation, Malaysia-based Air Asia and Singapore Airlines teamed up with Tata Group to launch two new airline services. Also, Abu Dhabi-based Etihad picked up a 24 per cent stake in Jet Airways that was worth overINR2,000 crore (US$ 319.39 million). India has received total foreign investment of US$ 306.88 billion since 2000 with94 per cent of the amount coming during the last nine years. In the period 1999–2004, India received US$ 19.52 billion of foreign investment. In the period 2004–09, foreign investment in the country touched US$ 114.55 billion, further increasing to US$ 172.82 billion between 2009–September, 2013.During FY 2012–13, India attracted FDI worth US$ 22.42 billion. Tourism, pharmaceuticals, services, chemicals and construction were among the biggest beneficiaries. The January–November period in 2013 witnessed mergers and acquisitions deals worth US$ 26.76 billion in India, according to a survey by tax advisory firm Grant Thornton.

1.3 Need of Foreign Investment in India

India has the scarcity of financial resources and low level of capital formation because it has to depend mainly upon the external sources of finance. Another important factor is that the domestic resources are entirely inadequate to carry out development programmes.

1.4 The Economic Impacts of Foreign Direct Investment in India

FDI was an important source for a developing country's external finance for about 25 years after World War II. Under the veil of command economy Lithuania skipped that period. Around the 1970s the importance of FDI in global level was declined. During the early 1980s it declined in volume further. FDI in developing countries (this includes Latin America, Asia and Central and Eastern Europe) made a comeback in about 1994 (Krugman, Obstfeld, 1996; Han X. Vo, 2004). Eased restrictions on FDI was diminishing lending of commercial banks to developing economies. During this period the composition of external capital underwent a dramatic transformation. Due to the Asian and Russian financial and economic crises, official capital flows in these countries either stagnated or declined. Instead, private capital flows became the major source of external finance for a good number of emerging market economies. Foreign direct investment accounted for only about 30 per cent in early 1980s but in 2000 and next few years over 60 percent of private capital flow was recorded (Carkovic, Levine, 2002).

Amid a sharpening financial and economic crisis, global FDI inflows have made one more significant slide down. This slide was from historic high of $1,979 billion in 2007 to $ 1,697 billion in 2008, a decline of 14%. The slide continued into 2009. Preliminary data suggest that FDI fell a further 44% compared with their level 2008 (World Investment Report, 2009).

However, there is a good chance that foreign direct investments will increase rapidly at the first signs of economic stability. Besides, there is a good chance that the effects of such actions will be very different (depending from countries and firms involved) and not always positive for both investors (core) and host economies.

Theory suggests conflicting predictions concerning the effects of direct foreign investments. Several approaches regarding the effects of FDI exist: Neo-liberal, Keynesian, so called dependency and new dependency schools are among best- known ones.

Neo-liberals defend foreign direct investment and explain how it is beneficial for developing country as it contributes to development. They advocate free flow of capital by saying that it ensures economic efficiency; allows capital to seek the highest return across the borders; fastens economic growth as the free flow of capital reduces investors risk enabling them to diversify their investment better.

Pro-FDI economists affirm that the result of FDI is limited ability of host government to implement bad policies. If the government inclines to do so. Moreover, foreign flow of capital might spread the best practices of corporate governance, accounting rules, and legal traditions to less developed countries (LDCs) (Ciburiene&Zaharieva, 2006).

Some more arguments used by supporters of FDI are that it, firstly, enables technology transfer in the form of capital inputs, which could not be achieved by trade (Brock, Urbonavicius, 2008). Secondly, through FDI a competition is likely to be encouraged in domestic input markets. Thirdly, FDI contributes to human capital development as foreigners engage in employee training. In addition, profits from corporate taxes may be used to encourage host country's development e.g. investing in infrastructure. In addition, sometimes the investment from a core country encourages domestic investment as well (Bernatonyte, Normantiene, 2009).

In World Investment Report (1999) by IMF a number of ways are stated in which FDI encourages development. FDI brings in financial resources, which are scarce in receiving country, generates new jobs, increases exports by raising efficiency and enhancing marketing opportunities, increases the availability and reduces the costs of public utilities, consumption goods and investment goods.

In favour of foreign direct investment, there is one more argument which has some practical grounds. FDI has an advantage over other investments such as portfolio or loans as it has been proved to be more resilient in times of economic crisis. During the financial crisis of 1997-98 it was stable compared with other types of investments especially short-term, which were subject to large reversals. The same was apparent during Mexico crisis and Latin American debt crisis of 1980 (Loungani, Razin, 2001). On the other hand, latest events show that during recent crisis some large transnational companies, e.g. American car producers who were broadly settled in European Union (Spain, Poland, England), are closing European factories paying little attention on huge negative economic and social distortions.

Neo-liberals would say that countries should open up and let the market to work freely; that all the efforts should be concentrated on attracting FDI because it means development of the country; that every country should welcome FDI because it will improve economic conditions and increase potential of the receiving country's development (Sabonienė 2009). Implementation of this kind of purely Neo-liberal pro-foreign direct investment policy seems to be the only approach recognized by Lithuanian authorities. At least in theory.

Meanwhile admitting the benefits of FDI many economists have reasonable doubts whether it happens every time in every country. They strongly disagree that one size fits all. A particular, more cautious approach is the characteristic of the representatives of the so-called Keynesian school.

Keynesians argue that if FDI brings benefits in one country it does not necessarily mean that the same will happen in another. Many things depend on the prevailing conditions in the receiving country. The effects should differ not only across countries but also within countries at different time as conditions change (Lipsey, Pourvis& Courant, 1994; Epstein, 1999; Sims & Lake, 2000; Han X.Vo, 2004, Buoziute-Rafanaviciene, Pundziene, Turauskas, L. 2009).

Advocates of Keynesian approach believe that there are always market failures, free market itself cannot ensure efficiency. Firstly, Insufficient or incorrect information can lead to the attraction of insufficient or wrong kind of investment. Secondly, sometimes interests of investors diverge from the interest of receiving economy. Hence government regulations must be in place.

Increased competition may be beneficial for the host economy, but not always. International corporations which enter the country may push out potentially more productive local business as they are yet incapable to compete. In that case many jobs might be lost instead of generating new jobs. Therefore as Loungani &Razin (2001) and Kazlauskaite & Buciuniene (2008), advocate, government protection of local activities is needed.

While attracting FDI, governments can use tax cuts, subsidies and many other means. If decided to slow down the volume of incoming foreign capital, governments most commonly use institutional barriers of FDI: ownership restrictions, rate of return restrictions, project approval requirements, trade and financial restrictions etc. China has been proved as a very rational decision maker in attracting FDI when economic rationale suggested they should; and hampering the flow of foreign capital when positive effects approached the apex (Blakman and Wu, 1998).

However, often it is difficult for a developing country to manage foreign investment to their advantage as there is a large asymmetry in bargaining power between core countries investors on the one hand and host governments - especially those from countries that are poor, lack scarce natural resources and small - on the other (Han X. Vo, 2004).

The countries which do not clearly understand all the effects that FDI can bring to their economies sometimes engage in such actions which ultimately can actually hamper growth. Epstein (1999) claims that countries trying to attract investment by subsidies and tax breaks can lead to substantial reduction of government revenues which could otherwise be used to invest in education and infrastructure what ultimately creates attractive environment to FDI itself, fastens economic growth and increases total welfare. Such environment may be even more important than tax breaks. Finally, the country finds itself in a situation when it is not attractive to FDI though their actions should have attracted it.

Authors, who argue that developing countries should try to attract FDI, agree, that rather than doing so by giving away the candy store in the form of subsidies and tax breaks, developing country governments should mobilize resources for 'infrastructure and labour resources' that will complement the economic structures and needs of the particular developing country. They should make efforts to inform the world of these resources and opportunities to attract different investors, both local and foreign. Governments should bargain with TNCs to ensure that these investments contribute to the long term and dynamic benefit of the developing country.

Finally, not all types of FDIs equally contribute to the development of local economy. As it is stated in World Investment Report 1999, "Greenfield investment are likely to encourage development most while mergers and acquisitions (M&A), that entail a simple change of ownership can be of dubious value". The same idea is underlined in the works of Xan X.Vo (2004), Loungani &Razin (2001), Snieska (2008) and many other authors.

In the last two decades more FDI has entered in the form of mergers and acquisitions of domestically owned firms by foreign-owned firms. Most FDI that come to Lithuania have a form of M&A too.

Xan X.Vo (2004) presents the principles of so-called "dependency" school which cannot be left aside. Representatives of that approach argue that FDI benefits the core industrial economies at the expense of the peripheral underdeveloped countries. As a result FDI can be contributing to increasing world inequality instead of giving positive externalities of FDI.

According to the dependency school, in the long-run, FDI tends to hamper economic growth and development of recipient economies. Although underdeveloped countries lack capital and industrial technology, they often are rich in natural resources and inexpensive labour. While income or wealth is created in the host country, it does not lead to an accumulation of wealth that would benefit the host economy. On the contrary, this wealth is transferred to the core countries. As a consequence, the core stands to benefit from this structural dichotomy of the host economy because the foreign sector (i.e. the sector associated with FDI) does not benefit the rest of the host country because of lack of integration. Therefore, as the argument of Han X. Vo (2004) runs, there are cases when it is in the interest of the core countries to keep the periphery underdeveloped and dependent on the core.

Some economists (Lipsey, Purvis and Courant, 1994; Krugman, Obstfeld, 1997) argue that a distinctive feature of foreign direct investment is that it involves not only a transfer of resources but also the acquisition of control. In some cases the extension of control is the essential purpose of incoming foreign capital. This associates a necessity to screen foreign investments on economic as well as military grounds.

All cases mentioned above proved that incoming FDI needs more thorough examination and decisions about policy towards FDI should not be simply straightforward. Greenfield foreign direct investment really can contribute to development of host economy (Snieska, 2008). However, some control over them is essential in order to ensure that a country will benefit. M&A investment can not contribute to the development but hampers the economic growth of the particular country.

The developing countries should focus on improving the investment climate for all kinds of capital, domestic as well as foreign (Epstein, 1999, Loungani, Razin, 2001, Blomstrom, 2002). Effective investment packages should be part of countries industrial policy and be available on equal terms to all investors (Martinkus, Lukasevicius, 2008). The idea of attracting foreign direct investors as a special effort lies behind the economic rationale.

II. CONCLUSION AND SUGGESTIONS

Foreign investment flows are supplementing the scarce domestic investments in developing countries particularly in India. But foreign investor does not adopt 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. The highest amount of FDI has gone to financing sector, insurance sector, and real estate and Business services. It is a serious matter in context of foreign direct investment objectives. Main reason of this shifting is high risk and low profit in concern sectors. Because the FDI is associated with various types of risks which are expected to provide various linkages in the development of Indian economy. But there is an upward trend in the flows of foreign investment. The government 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 favourable for Indian economy and enable it to achieve rapid economic development, removal of poverty, internal personal disparity in the development and making the Balance of Payment favourable.

India's Foreign Direct Investment (FDI) policy has been liberalised to make the market more investor friendly. The results have been encouraging. In recent years, the country is consistently ranked among the top three global investment destinations by all international bodies, including the World Bank, and United Nations(UN) report. Indian economy which has tremendous potential, has had a positive impact of FDI. FDI inflow enhances domestic capital, as well as technology and skills of existing companies. It also helps for the establishment of new companies. These things contribute to economic growth of the Indian Economy.

The effects of FDI can be positive and negative as well. They depend upon the type of FDI, sector, scale, duration, location of business, density of local firms in the sector and many other secondary aspects. Attractive terms to investors should be seen as part of a country's overall industrial policy and made available on equal terms to all investors, foreign as well as domestic.

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