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Role Of FDI In Economic Development Of India

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ABSTRACT

Foreign direct investment plays an important role in the economic development of the country. It helps in transferring of financial resources, technology and innovative and improved management techniques along with raising productivity. An Indian company may receive Foreign Direct Investment either through automatic route or government route. The paper tries to study the need of FDI in India, to exhibit the sector-wise & year-wise analysis of FDI's in India, to rank the sectors based upon highest FDI inflows. The results show that Mauritius is the country that has invested highly in India followed by Singapore, Japan, and USA and so on.

Foreign Direct Investment (FDI) as a strategic component of investment is needed by India for achieving the economic reforms and maintains the pace of growth and development of the economy. The paces of FDI inflows in India initially were low due to regulatory policy framework but there is a sharp rise in investment flows from 2005 towards because of the new policy has broadened. The study tries to find out how FDI seen as an important economic catalyst of Indian economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfers. The main purpose of the study is to investigate the impact of FDI on economic growth in India.

Key words: Foreign Direct Investment, Economy, Gross Domestic Product, Exports, and Foreign Exchange Reserves

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INTRODUCTION

The fast and steadily growing economy of India in majority of its sectors, has made India one of the most famous and popular destinations in the whole world, for Foreign Direct Investment. India's ever-expanding markets, liberalization of trade policies, development in technology and telecommunication, and loosening of diverse foreign investment restrictions, have further collectively made India, the apple of investors' eye, for most productive, profitable, and secure foreign investment.

India’s perception abroad has been changing steadily over the years. This is reflected in the ever growing list of countries that are showing interest to invest in India. Mauritius emerged as the most dominant source of FDI contributing 44 % of the total investment in the country. Singapore was the second dominant source of FDI inflows with 9% of the total inflows. However, USA slipped to third position by contributing 7% of the total inflows. UK occupied fourth position with 5% followed by Netherlands with 4%, Japan with 4%, Cyprus with 4%, Germany with 3%, France with 1%, UAE with 1%.

LITERATURE REVIEW

A considerable amount of research has been done on the working and performance of FDIs in India, by academicians and researchers.

The literature obtained by investigators, in the form of reports of various committees, commissions and working groups established by the Union Government, the research studies, articles of researchers, is briefly reviewed in this part.

Stanley Morgan (2002) has examined in his paper that FIIs have played a very important role in building up India’s Forex Reserves, which have enabled a lot of economic reforms.

Lin et al. (2006) concluded that the investment performance of FIIs high holding stocks is significantly better than that of FIIs low holding stocks. They presented the evidence that FIIs trading behavior has generated better returns and portfolio performance since the stock market’s full liberalization.

Douma, Pallathiatta and Kabir (2006) in their study investigated the impact of foreign institutional investment on the performance of emerging market firms and found that there is positive effect of foreign ownership on firm performance. They also found the impact of foreign investment on the business group affiliation of firms.

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Krishna Prasanna (2008) in his study examined the relationship between foreign institutional investment and firm specific characteristics in terms of ownership structure, financial performance and stock performance.

Sumana Chatterjee (2009) in his dissertation investigated different aspects of FDI at the macroe-conomic level using aggregated data of FDI.

Sapna Hooda (2011) in her dissertation analyzed the trends and patterns of FDI flows at world level.

Sarbapriya Ray (2012) in his study assessed empirically the relationship between Foreign Direct Investment (FDI) and economic growth in India using annual data over the period of 20 years from1990-91 to 2010-2011.

Rahul Dhiman (2012) in his study concluded that FII do have significant impact on the Indian Stock Market but there are other factors like government policies, budgets, bullion market, inflation, economical and political condition etc., also having an impact on the Indian Stock Market.

Arshad Muhammad (2012) attempted to investigate the long-run co-integrating relation among FDI, GDP, Export and Import for Pakistan.

Jose Manuel Durao Barroso, President, European Commission (2013): Europe is India's largest source of foreign direct investment with a stock of 34.4 billion euros and India's investments in Europe is also fast reaching 7 billion euros. There is scope to grow much more. European FDI in India for instance is half the amount of that in China, or a quarter of that in Russia, or a fifth of that in Brazil,"

E & Y Survey (2014): The global survey of E& Y has ranked India as the most attractive investment destination followed by Brazil and China at second and third positions, respectively.

K S Chalapathi Rao, Professor, ISID- New Delhi (2016): Most of the FDI coming into India through Mauritius, Singapore and Cyprus are actually from the U.S. or from India-related investors. The Mauritius route is used for availing tax benefits and for ensuring anonymity. FDI from Mauritius is however sector-agnostic unlike FDI from countries like Japan, Germany and France, which are mostly in manufacturing related sectors. The Singapore route is used mostly by Indian entities with a regional office there.

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OBJECTIVES OF THE STUDY

- To discuss the FDI policy framework in India.
- To discuss the role of FDI in different sectors
- To understand the need for FDI in India.
- To discuss policy initiatives taken by Indian Govt. for FDI

FDI IN INFRASTRUCTURE

The number of FDI projects in the Infrastructure sector grew by 90% in 2011 in India. The sector contributed 4% to the total number of FDI projects and 9% to the total jobs created. Development in the country's infrastructure is poised to accelerate as the Government of India (GOI) plans to double its infrastructure spending from US$ 500 billion to US$1 trillion during FY2012–17. The GOI is aggressively focusing on minimizing India's infrastructure deficit and would like to generate investor interest in the sector. The GOI allows investors full access to most infrastructure sectors, including: roads and highways; ports and harbors; power plans and airports. To increase infrastructure's attractiveness further, the GOI has extended tax holiday periods, and facilitated the creation of public-private partnership (PPP) projects. Drawn by the various opportunities available in the sector, a number of private players, including foreign players, have started participating in building the infrastructure sector. International players, such as Toyo Engineering, Jacobs H&G, Tecnimont and Aker Solutions, are already investing substantially in the country's infrastructure space. However, land acquisition and environmental clearance issues, along with persistently high inflation and interest rates, hamper new investments projects, especially their timely completion. Furthermore, India's regulatory environment can periodically block the injections of foreign money into the sector.

FDI IN AUTOMOTIVE SECTOR

The automotive sector in India attracted 78 FDI deals during 2011, an increase of 28% in comparison to the same period in 2010. Although the sector made up 8% of total FDI projects in India, it created most jobs (16%). India is now the world's seventh-largest passenger vehicle (PV) manufacturer, and the second-largest medium and heavy commercial vehicles (MHCV) and 2-wheelers market. The GOI created the Auto Policy 2002 to attract FDI to establish the country as a manufacturing and export base. The policy provides automatic

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approval of foreign equity investment of up to 100% for the manufacture of automobiles and auto components. India's automotive sector has five key manufacturing hubs — Chennai (Tamil Nadu), Pune (Maharashtra), National Capital Region (NCR), Pantnagar (Uttarakhand) and Sanand (Gujarat). These states have provided incentives to attract investment, including tax breaks, facilitated access to land and guaranteed access to energy. To further promote automotive exports, the GOI has created the Focus Market Scheme (FMS), which provides manufacturers with cash incentives of up to 5% for export of vehicles. Investors find India an appealing destination for automotive manufacturing given its skilled technical labor force, low-cost supplier base and strong domestic demand. Furthermore, they increasingly see India as a base to manufacture and export cars, bringing in competition with Thailand, the current automotive manufacturing destination of Asia. According to our survey, investors believe that improvement in the quality of products and increased focus on R&D will enhance the position of Indian auto-component players in the global automotive supply chain.

FDI IN FINANCIAL SERVICES

In 2011, the number of projects in the Indian financial services sector increased by 21%, whereas the value of FDI projects increased by 75%. Despite a high growth potential, FDI in the industry remains low compared with other rapidly developing economies, due to capital account convertibility, capital lock-ins and numerous regulations. About 22% of the financial services companies surveyed said that capital convertibility is the main concern faced by investors and 21% believed that capital lock-ins are a key challenge in the sector. However, the demand for a wide array of financial services products, ranging from credit to insurance, is growing. Currently, only 47% of the Indian population has access to banking facilities, while only 15% of the total insurable populations have life insurance coverage. This is a tiny portion of the giant Indian market, underlining the domestic growth potential in the sector. Industry experts anticipate India will become the world's third-largest banking market by 2025 and the third-largest life insurance market by 2015. India's vast potential in financial services, and particularly in insurance, will increasingly attract investors as the GOI relaxes restrictions on investment. According to our survey, 38% of financial services companies believe that relaxing Insurance Regulatory and Development Authority (IRDA) caps on marketing commissions will attract more foreign participation in the sector, while 26% feel that it will be made more attractive by relaxing FDI caps.

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FDI IN TECHNOLOGY

The technology sector in India has a major impact on the Indian economy. The industry has grown from US$4 billion in 1998 to more than US$80 billion in 2011, employing directly and indirectly more than 10 million people. Riding on the services outsourcing wave, domestic and international companies have leveraged India's value proposition to enhance their competitiveness in the global market. Key government initiatives, such as setting up of tax free zones, Software Technology Parks of India (STPI) and Special Economic Zones (SEZ), have given strong impetus to the export of IT services. These zones exempt companies from a variety of taxes while setting and running in the initial years of operations. The technology sector in India received US$6,197 million through FDI in 2011, showing an increase of 46% from the previous year. The investment has created 153 projects with an estimated 41,607 jobs in the industry. Five principle sectors in the IT industry, namely online businesses, IT services, IT-enabled services and software and hardware merchandise received most of the investments. Compelling cost advantage coupled with available skilled force has driven this spectacular growth. India's domestic IT demand is growing fast and is expected to surpass US$90 billion in next decade. Technology is integrating with the conventional ways of doing business; a lot of business transactions are happening online. India's burgeoning economy needs more hardware, software and other IT services. Many Tier II and Tier III cities have the potential to support the growth expansion of the IT industry, along with providing the cost advantage compared with that in Tier I cities. Although many low-cost delivery destinations, such as China, Philippines and Vietnam, are emerging, India's leadership position cannot be challenged. Its benefit of long term cost competitiveness, supply of highly trained engineers and its expertise in processes and quality will continue to foster its growth.

FDI IN RETAIL

Growing urban Indian population has been driving organized retail in India. In addition, shift in the preference for branded products; convenient spending through debit/credit cards; and greater propensity to spend act as drivers for the sector. However, investors' confidence was dampened because of the GOI's decision to put FDI in multi-brand retail policy on hold. Investors, in 2011, were anxiously waiting for the liberalization of the Indian retail sector, allowing big box retailers to come in and set up shop. Not only did this plan portend the

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creation of 10 million jobs in India, it also offered a way to alleviate supply bottlenecks and food price inflation. But only days after introducing the plan, political squabbles forced its retraction. This has damaged the GOI's credibility to foreign investors to a certain extent, who may decide to look elsewhere in the coming year. The decision is a big disappointment for players such as Wal-Mart Stores Inc. and Tesco plc, which were planning to make major investments in the country. The GOI, however, did not back down from allowing 100% foreign investment in single brand retail from the current 51%. This will help some of the well- known apparel single- brand firms that are keen on entry into India.

FDI IN CONSUMER PRODUCTS (CP)

The number of projects in the CP sector grew by 31% in 2011. The sector made up 10% of total FDI projects in India and created over 28,400 jobs. Investors in consumer products are interested in accessing India's rapidly growing middle class, which is increasingly able to afford consumer products. In particular, investors have observed growth in the packaged food and beverages sector. India's large population and rapid economic growth position it to become the fifth largest country in terms of consumption by 2025. The strong demand of the rising middle class is only part of this story; in fact, an emerging rural consumer base is also increasingly able to purchase consumer products. The specific requirements of the consumer products market in India have forced companies to innovate, adapting to the needs of Indian consumers, with diversified products portfolios. However, inflation is catching up with companies' cost structures and has resulted in rapidly rising input, packaging and fuel costs. This, in turn, has squeezed profit margins while forcing prices upward. Consumer products are likely to witness continued demand driven by healthy disposable income growth and lower absolute spends on FMCG products. Although companies may some face margin pressure due to high raw material prices, rural markets will remain a big opportunity.

FDI IN CLEANTECH

India continues to be one of the preferred destinations for cleantech investments. According to the November 2011 edition of Ernst & Young's Renewable energy country attractiveness indices, India ranked as the fourth most attractive country (after China, the US and Germany) out of 40 countries. Investors see potential in the sector, given the current Indian power generation deficit of 10.3%. The GOI has taken a number of initiatives to promote the sector.

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Its National Action Plan on Climate Change (NAPCC) stipulates a minimum renewable energy purchase target of 5% of total grid purchase, increasing by 1% each year for 10 years. Furthermore, the sector has been opened to foreign players, allowing investors to spend in renewable power generation on a build-own-operate basis in India. The Indian clean tech sector looks promising to investors. The market's concern over future energy price rises is expected to boost interest in power-saving technologies. This will likely support the country's goal of 15% of green electricity by 2020.

ROLE OF DIFFERENT COUNTRIES IN FDI FOR INDIA

Europe: Europe is India's largest source of foreign direct investment with a stock of 34.4 billion euros and India's investments in Europe is also fast reaching 7 billion euros. There is scope to grow much more. European FDI in India for instance is half the amount of that in China, or a quarter of that in Russia, or a fifth of that in Brazil. Foreign direct investment with a stock of 34.4 b The European Union is India's first partner in terms of trade and investment - in 2010 the European Union imported over 40 billion Euros worth of goods and services from India. Europe is also one of India's major partners in the field of economic and development cooperation, particularly in the areas of education and social actions. India has one of the highest potentials for the effective use of renewable energy and it is already the fifth largest producer of wind power; Europe has a large know-how in the green economy and we are developing a low-carbon economic strategy.

Mauritius and Singapore: Singapore, Mauritius, the Netherlands and the US account for the major share of FDI inflows into India. Out of FDI equity inflows of $24.8 billion during 2015-16 (April-November), more than 60% came from two geographically small countries—Singapore and Mauritius. These inflows need perhaps to be examined more closely to determine whether they constitute actual investment or are diversions from other sources to avail of tax benefits under the Double Tax Avoidance Agreement that these countries have with India.. Mauritius has regained the position as top source of foreign direct investment (FDI) into India by pushing Singapore to the second slot in 2014-15. Mauritius accounted for about 29 per cent of the country's total FDI inflows last fiscal. In 2013- 14, Singapore had replaced Mauritius as the top source of FDI into India. According to the Department of Industrial Policy and Promotion, FDI inflows under the approval route (which requires prior government permission) increased by 87% during 2014-15 with an inflow of $2.22 billion.

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More than 90% of FDI was through the automatic route. Also in 2014-15, foreign institutional investment rose by an unprecedented 717% to $40.92 billion.

China: On top of this, there is around 60 billion dollars of remittance Indian send back to India annually. Which is highest in the world, even more then Chinese. This also shows Indian consider India as their long term save investment zone. This is important to note that more Indians see India as a safe destination for their investment as compare to Chinese considering investing back into China. Infect more and more millineries in China are taking out their wealth from China which is actually more than the total FDI china is getting now.

The Chinese government has restricted the currency too much, there's nothing left for Chinese to buy in China and returns are very low that's why they're trying to get it out. But the government has serious restrictions in place and this remains a problem. They should float the RMB properly. India isn't perfect but its international money flows are better than China's. USA and other Countries U.S. was the world's largest recipient of FDI from OECD (Organization for Economic Co-operation and Development) countries. France, Greece, Iceland, Poland, Slovak Republic, Switzerland and Turkey also have a positive record in FDI investments.

GOVERNMENT INITIATIVE- BUDGET 2016-17

Budget 2016-17 has proposed several reforms in Foreign Direct Investment (FDI) Policy in areas of insurance and pensions, asset reconstruction companies and stock exchanges, such as easier governing and fund raising norms, clarification of tax related matters and higher FDI limits.

1. Residency Permit Policy: In order to make India a more attractive foreign investment destination, the Ministry of Finance is planning to introduce the residency permit policy, which will allow key executives of foreign companies making investments worth US$ 2 billion or more in India, to avail various facilities such as special package on upscale housing, residency permits allowing long stay in the country, and cheap rates for utilities.

2. Construction Development Sector: The Government of India has amended the FDI policy regarding Construction Development Sector. The amended policy includes easing of area restriction norms, reduction of minimum capitalization and easy exit from project. Further, in order to provide boost to low cost affordable housing, it has indicated that conditions of area restriction and minimum capitalization will not apply to cases committing

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30 per cent of the project cost towards affordable housing.

3. Relaxed foreign direct investment (FDI) policy in 15 sectors: The Government of India has recently relaxed foreign direct investment (FDI) policy in 15 sectors, such as raising the foreign investment limit for some sectors, easing the conditions for others and putting many on the automatic route for approval. The sectors that benefited from the relaxation include defence, real estate, private banking, defence, civil aviation, single brand retail and news broadcasting. The new rules provide for easier exit from investment in the construction sector while foreign investment limit in defence and airlines was allowed up to 49 per cent through the automatic route. Banks were allowed fungible FDI investment up to 74 per cent, which means that FII investment in private banks can rise to this limit. The Government of India recently relaxed the FDI policy norms for Non-Resident Indians (NRIs). Under this, the non-reparable investments made by the Persons of Indian Origin (PIOs), Overseas Citizens of India (OCI) and NRIs will be treated as domestic investments and will not be subject to FDI caps.

4. Insurance: The government has also raised FDI cap in insurance from 26 per cent to 49 per cent through a notification issued by the DIPP. The limit is composite in nature as it includes foreign investment in the form of foreign portfolio investment, foreign institutional investment, qualified foreign investment, foreign venture capital investment, and non-resident investment. The Cabinet Committee on Economic Affairs (CCEA) has raised the threshold for foreign direct investment requiring its approval to Rs 3,000 crore (US$ 440.15 million) from the present Rs 1,200 crore (US$ 176.06 million). This decision is expected to expedite the approval process and result in increased foreign investment inflow. India's cabinet cleared a proposal which allows 100 per cent FDI in railway infrastructure, excluding operations. Though the initiative does not allow foreign firms to operate trains, it allows them to invest in areas such as creating the network and supplying trains for bullet trains etc.

5. Most Favoured Nation (MFN): Treatment to 15 countries India is likely to grant most favoured nation (MFN) treatment to 15 countries that are in talks regarding an agreement on the Regional Comprehensive Economic Partnership (RCEP), which would result in significant easing of investment rules for these countries. The Government of India plans to further simplify rules for Foreign Direct Investment (FDI) such as increasing FDI investment limits in sectors and include more sectors in the automatic approval route, to attract more investments in the country.

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6. FDI in defence production: FDI in defence production is now allowed up to 49 percent through FIPB route. In some hi-tech defence production it could up to 100 percent on case by case basis. More recently thee budget opened up multi brand retail on food items up to 100 percent FDI. Usually 70 percent of multi brand retail business would over is on food items. This will go a long way in improving the lot of rural India and farmers as exploitation by middle men will get phased out.

7. Abolition of FIPB: Finance Minister in his budget 2017-18 announced abolishing FIPB saying 90%of the foreign investment approvals are via automatic route and only 10% go to the board. Currently, FIPB offers single window clearance for applications on FDI in India that are under the approval route.

PROBLEMS IN FDI AND SUGGESTIONS

Problems: Physical infrastructure is the biggest hurdle that India currently faces, to the extent that regional differences in infrastructure concentrate FDI to only a few specific regions. While many of the issues that plague India in the aspects of telecommunications, highways and ports have been identified and remedied, the slow development of railways, water and sanitation continue to deter major investors. Federal legislation is another perverse impediment for India .Local authorities in India are not part of the approval process and the large bureaucratic structure of the central government is often perceived as a breeding ground for corruption. Foreign investment is seen as a slow and inefficient way of doing business, especially in a paperwork system that is shrouded in red tape.

Suggestions: The government should allow free foreign investment except in critical areas of national interest and sensitive sectors such as the media. Sectoral FDI caps , varying between 49% and 74% across sectors as diverse as insurance, defence projects and banking, have only led to a policy mess, opening up a profitable market for Indian businessman to become a passive partner of overseas companies wanting to set up shop in India as holders of economic interest owned by the foreign party. Removing caps and allowing majority control by foreign partners in sectors such as insurance is the way to go. The government should provide additional incentives to foreign investors to invest in states where the level of FDI inflows is quite low. Government should ensure the equitable distribution of inflows among low. States must give more freedom to states, so that they can attract inflows at Government must target at attracting specific types of FDI their own level that will be able to generate spillovers

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effects in the overall economy like investing in human capital, R&D activities, environmental issues, productive capacity, sectors with high income elasticity of demand. The policy makers should focus more on attracting diverse types of FDI. and should design policies where foreign investment can be utilized as means of enhancing domestic production, savings, and exports and also as medium of technological learning and diffusion and also in providing access to the Government must exercise strict control over inefficient external market.

CONCLUSION

No doubt, FDI plays a crucial role in enhancing the economic growth and development of the country. Moreover, FDI as a strategic component of investment is needed by India for achieving the objectives of its second generation of economic reforms and maintaining this pace of growth and development of the economy. Hence FDI is a significant factor which influences the level of economic growth in India. It provides a sound base for economic growth and development by enhancing the financial position of the country. It also contributes to the GDP and foreign exchange reserves of the country. MNCs should be allowed to set up in such a manner that they help increase the standard of living of our country instead of sole profit making.

Though the government plays an active role in investment promotion "the investment decisions of investors are based on the macroeconomic policy framework , investment climate in the host country , investment policies of the transnational corporations and other commercial considerations. To boost investment environment and attract foreign investments the government had brought in FDI related reforms and liberalized several major sectors.

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