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Trend of FDI in India and Its Impact on Economic Growth

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Abstract: ***Foreign investments are the indispensable factors that help in boosting the growth of Indian economy. With the introduction of liberalisation policy under the finance ministry of Dr. Manmohan Singh in 1991 & with further few policy reforms, India has witnessed a change in the flow and direction of foreign direct investment (FDI) into the country. This paper has made an attempt to analyse the trend of FDI flow into the country and to find the relation between FDI, FII and GDP of the country. India has witnessed the increase in the flow of FDI from US $ 4029 million in 2001-01, to US$ 36396 million on 2013. Furthermore India has witnessed a year-on-year (y-o-y) growth of 24.2 per cent in FDI to touch US$ 3.95 billion in April-May 2013 as against US$ 3.18 billion during the same period in 2012. However, the analysis shows that the country is still far behind in comparison to some of the developing countries like China. The continuous upsurge in foreign direct investments (FDI), allowed across the industries and sectors, has proven that foreign investors have faith in the resilience of Indian markets. Furthermore, the study indicates that flow of FDI and GDP are positively correlated with each other and the country's GDP is showing a positive movement with flow of Foreign Direct Investment in India. The flow of FII and FDI also shows the positive correlation with each other.***

Keywords: Foreign Direct Investment, Foreign Institutional Investment, liberalisation, GDP, trade-openness, etc.

1. Introduction

This paper defines foreign direct investment (FDI) as international capital flows in which a firm in one country creates or expands a subsidiary in another. It involves not only a transfer of resource but also the acquisition of control. Since the 1990s, FDI has been a source of economic growth for India, believing that besides needed capital, FDI brings in several benefits. The most important benefit for a developing country like India is that FDI could create more employment. In addition, technology transfer is another benefit for the host countries. When the foreign factories are set up in their countries, they will expose to higher technology production and efficiency in management. So in future, these companies become able to produce goods and services as competitive as foreigners do. Nevertheless, insufficient funds for investment are the main reason to seek FDI. Usually many less-developed countries lack funds for investment, so FDI proves to be an important source of funds for them. Foreign direct Investment is one of the most prominent and striking feature of today's globalised world. In the current globalised world there is 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 spill over of technology, skills, increased innovative capacity, and domestic competition. Nowadays, FDI has become an instrument of international economic integration.

Located in South Asia, India is the 7th largest, and the 2nd most populated country in the world. India has long been known for the diversity of its culture, for the inclusiveness of its people and for the convergence of geography. Today, the world's largest democracy has come to the forefront as a global resource for industry in manufacturing and services. Its pool of technical skills, its base of English – speaking populace with an increasing disposable income and its burgeoning market has all amalgamated to enable India to emerge as a viable partner to global industry. Recently, investment opportunities in India are at its peak.

India's next step for accelerating the Indian Growth is only to make the foreign direct Investment a top priority. As India offers only a hesitant welcome to FDI. It seeks investment in several industries, including manufacturing, construction, telecommunications and financial services, but was hesitant to allow FDI in multi-brand retail. Fortunately India approved FDI in multi brand retail on 7th of December, 2012. The regulatory bodies allow only a minority investment through FDI due to the fear of losing domestic control over management of these projects For example; FDI in insurance companies is permitted up to 49% with restrictions on voting rights to ensure that management control of an insurance firm doesn't shift to a foreign entity. But if we critically analyse the situation then we can say that concern of loss of management control is of much less importance compared to sacrifice of economic growth. Considering the potential of FDI to spur growth, India's ambivalence toward FDI is completely misplaced. If India wants to accelerate growth, it is imperative that the country attracts FDI in large, really large amounts. Growth results from *domestic investment from savings*, from *productivity improvements* and from *foreign investments*. Countries like China that have grown rapidly in recent decades have taken advantage of all three sources of economic growth. India, on the other hand, has tried to achieve growth without much FDI. However, India's approach to growth is like bringing a knife to a gunfight: it's destined to fail relative to other countries' growth strategies, which take advantage of FDI. To transcend from 5-7% growth to 10-12% growth, FDI is essential.

The study of Laura Alfaro of Harvard Business School on FDI and economic growth in April 2003 concluded that it may seem natural to argue that foreign direct investment (FDI) can convey great advantages to host countries, but their study shows that the benefits of FDI vary greatly across sectors by examining the effect of foreign direct investment on growth in the primary, manufacturing, and services sectors. An empirical analysis using cross-country data for the period 1981-1999 suggests that total FDI exerts an ambiguous effect on growth. Foreign direct investments in the primary sector, however, tend to have a negative effect on growth, while investment in manufacturing a positive one. Evidence from the service sector is ambiguous.

2. Routes of FDI in Indian companies

An Indian company may receive Foreign Direct Investment under the two routes as given under:

1) **Automatic Route:** FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.
2) **Government Route:** FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, and Ministry of Finance.

3. Objective of the Study

1. To analyse the trend of FDI in India.
2. To analyse the relationship between FDI and FII in India.
3. To analyse the relationship between FDI and economic growth.

4. Research Methodology

The above objectives have been studied through the use secondary data. The secondary data has been collected from, various secondary sources such as published reports RBI, Department of Industry Policy and Promotion, World Bank, IMF etc. The data collected has been analysed through tables & graphs. The linear correlation analysis has been done to understand the relationship between foreign direct investment flow, GDP and foreign institutional investment flows in India.

5. Data Analysis

The total FDI inflow in India from 2000 to June-2014 is US$ 335020 and cumulative FDI equity inflow is US$ 224817 million. The FDI in the India has shown a good growth after 2004.

Total FDI inflow from April 2000- June 2014

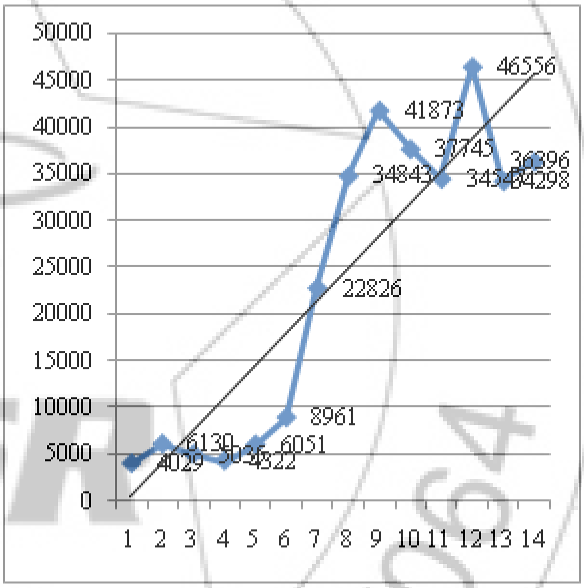
1. Cumulative FDI inflow = US $335020 million
2. Cumulative FDI equity inflow = US$ 224817 million

FDI Inflow Year wise

Year	*Total FDI (US $ Million)*	*Percentage growth over previous year*	*Investment by FII (US $ Million)*
2000-01	4029	-------	1847
2001-02	6130	52 %	1505
2002-03	5035	(-) 18%	377
2003-04	4322	(-) 14%	10918
2004-05	6051	40%	8686
2005-06	8961	48%	9926
2006-07	22826	146%	3325
2007-08	34843	53%	20328
2008-09	41873	20%	-15017
2009-10	37745	(-)10%	29048
2010-11	34547	(-)8%	24422
2011-12	46556	34%	16812
2012-13	34298	(-)26%	27582
2013-14	36396	6%	5010
2014-15*	8011	--------	

Source: Department of industrial policy and Promotion: FDI statistic table-1

5.1 Karl Pearson's coefficient correlation for Total FDI in India and Investment by FIIs in India for the period 2001 to 2014 for the data given in table 1 is 0.330705. This analysis is showing that the two variables have a weak positive correlation between them. But it is quite evident from the data that increase in FDI in India is leading to increase in investments by FII because of its positive effect on the economic development of a country.



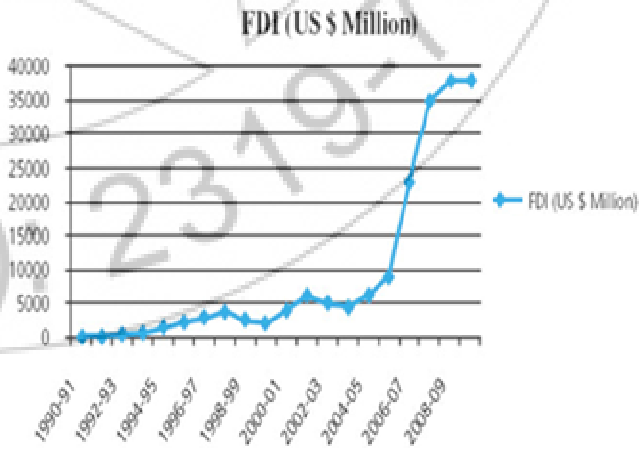


Figure 1: Trends in Foreign Direct Investment Inflows in India 1990-91 to 2009-10

5.2 The trend Analysis of the FDI data from 2001 to 2014 shows that there is always a positive average trend of FDI in India but if we deeply analyse the data, FDI flow in India has increased in the recent years only starting from 2009 to 2014. The Indian economy has started attracting a good amount of FDI after 2004. Before 2004 the FDI flow was lying between US$ 4029 to US$4322, which was just a stagnant trend for FDI. The significant increase in FDI inflows in India reflected the impact of liberalization of the economy since the early 1990s as well as gradual opening up of the capital account. As part of the capital account liberalization, FDI in India was allowed almost in all the sectors of the economy except a few on the basis of strategic importance and subject to the rule and regulations for that sectors. From the above data we can analyse that during the period of current global financial crisis, there was a significant decrease in the flow of FDI in most of the countries in 2008-2010 but this decline of FDI in India was relatively moderate reflecting robust equity flows on the back of strong rebound in domestic growth ahead of Global recovery and steady reinvested earnings reflecting better profitability of foreign companies in India.

United Nations Conference on Trade and Development (UNCTAD) published its World Investment Report for 2012 which outlined that FDI in 2011 exceeded pre-economic crisis levels. More importantly, the report ranked India as the **3rd most preferred economy for FDI after China and US.**

The comprehensive study surveyed more than 179 companies and it emerged that the top 3 most favourable hosts for FDI remained constant in 2011 as compared to the previous year. India's rank remained unchanged at 3rd overall and 2nd amongst all Developing and Transition Economies, only after China. India is expected to remain in that position for next 3 years.

Sectors Attracting Highest FDI in India (Amount in Crore)

S. No.	*Sector*	*April 2000-2014*	*Percentage (%)*
1	Service Sector	189,991	18
2	Construction and development	110,234	11
3	Telecommunication	78573	7
4	Computer software and hardware	60503	6
5	Pharmaceuticals	60101	5
6	Automobile Industry	48879	4
7	Chemical except fertilizers	45826	4
8	Power	44245	4
9	Metallurgical Industries	38943	4
10	Hotel and Tourism	37767	3

Source: Department of industrial policy and Promotion: FDI statistic

5.3 IF we look into the current data of FDI in India in different sectors, the Services sector is attracting maximum funds of 18% of total FDI amounting to 189,991 crore followed by construction and development with 18% share amounting to 110,234 crore. The other sectors like Telecommunication, pharmaceuticals, computer software and hardware, automobile industry and hotel and tourism are also attracting a good share of FDI in India.

As for as the service sector is concerned according to the economic survey of India, India has the second fastest growing services sector in the world with a compound annual growth rate at 9 per cent, just below China's 10.9 per cent, during 2001 to 2012.Among the world's top 15 countries in terms of GDP, India ranked 10th in terms of overall GDP and 12th in terms of services GDP in 2012. Thus this reason can be attributable to the highest share of FDI to Service sector as India has the second fastest growing services sector with CAGR at 9 per cent, just below China's 10.9 per cent, during the last 11-year period from 2001 to 2012.

5.4 FDI and GDP of India

Foreign direct Investment and Gross domestic product are the major determinant of the economy of any country. FDI affects the GDP of a country directly and hence they are positively correlated. But the FDI in a country is not the only economic factor on which causes the GDP to increase or Decrease there are so many quantitative and qualitative economic and non economic variables which influences the GDP of a country.

Year	*GDP- Real growth rate (%)*	*Equity inflows in Million (US$)*
2000-2001	5.5	2908
2001-2002	6	4222
2002-2003	4.3	3134
2003-2004	4.3	2776
2004-2005	8.3	2549
2005-2006	6.2	5546
2006-2007	8.4	6081
2007-2008	9.2	9277
2008-2009	9	18708
2009-2010	8.4	17604

Karl Pearson's coefficient of correlation for the above data from 2000 to 2010 is 0.65 (i,e r = 0.65)

From the statistical analysis it is quite clear that the above data of GDP growth rate and Equity inflows in India through GDP are positively correlated with each other. Thus any increase in FDI inflow leads to increase in the growth rate of GDP. But as we can see that both variables are not perfectly correlated and GDP growth rate is showing too many fluctuations. So we can say that they have moderate positive correlation between them. And further we can say that there are too many other factors that have impact on Indian GDP. The other factors may include interest rate, employment rate, inflation rate etc.

6. Findings

1. The Flow of FDI in India is showing a positive trend and is a very positive signal for Indian Economy.
2. The Indian Economy is one of the most favourable investment destination for most of the developed and developing countries.
3. The Inflow of FDI and FII in India has positive relationship between each other.
4. The FDI is significantly contributing in the economic development of India as it has the positive correlation coefficient of 0.6 with Indian GDP.
5. Service sector of India is the second fastest growing services sector with CAGR at 9 per cent, just below China's 10.9 per cent, during the last 11-year period from

2001 to 2012 and thats why the Indian service sector shares maximum share of the total FDI In India.

7. Future Scope

This Study can be extended by finding the various determinants of FDI in India and how we can use that determinants for increasing the flow of Foreign Direct investment in India.

8. Conclusion

The FDI trend in Indian Economy is moving in upward direction that too with the good speed. On the basis of above analysis it is quite evident to say that Indian economy is one of the most promising investment destination for most of the developed and developing nations. And we should grab this opportunity by liberalising the rule and regulations for FDI in India. But one question that is striking my mind is that in spite of having good inflow of FDI in India just after the recession period. Why we are not able to attract more FDI. As the growth rate of FDI in India for the period of 2010 to 2014 is not much attractive. So we need to find some factors that are causing slowdown of FDI inflow in Indian Economy.

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