FOREIGN DIECT INVESTMENTS INFLOW

FOR ECONOMIC DEVELOPMENT, A STRATEGIC MOVE AND IT'S CHALLENGES FOR INDIA.

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Abstract:

Foreign Direct Investment inflows play a predominant role in the economic development developing countries like India. Lots of efforts are made by the country through liberalized strategy to attract Foreign Direct Investments. India has withdrawn the restrictions on Foreign Direct Investments in order to enhance capital flow for developing sectors in the country. Recently the retail sector has also been made open for FDI inflow to the extent of 50% in multi brand outlets. The service sector of India is attracting highest amount of FDI in India. It is estimated that service sector alone is attracting 21% of total FDI inflow. India the second largest country in consumer market and 10th largest country in the world in consistent economic growth and 4th largest economy in terms of purchase power parity and the tenth most industrialized country in the world. The growth of Indian economy can be noticed after 1994 when it has adopted liberalized policy for FDI inflow. There are many opportunities and also challenges of FDI inflow for Indian Economy.

Key words: Foreign Direct Investments, liberalization strategy, challenges and opportunities.

Introduction:

In today's globalized economy not only goods and services are moving across the borders of the country, even the investments are moving. When the investments go out of the home country to foreign country it is known as investment outflows and when it moves from foreign country to home country it is known as investment inflows. The foreign investments are expected even by developed countries. Most of the developed countries require foreign capital inflows for modernization and further development of technology.

Foreign capital plays an important role in the process of economic development of a country at the initial stage of development. To what extent it is to be invited depends upon the type of economy. If it is a closed economy welcoming of foreign capital is limited. If it is a open economy role of foreign capital is high. Since, the underdeveloped countries are having a lack of capital; certainly the foreign capital will help to shape the economy.

Foreign investments consist of two types, mainly Portfolio Investment and Foreign Direct Investment. In case of Portfolio Investment the foreign investors may be individuals or institutions prefer to hold shares or stock for some times to have capital gains. But in case of Foreign Direct Investments the investor is interested to have control over the investing company, participate in management and affairs of the company. This research paper is aimed to discuss the role of FDI in developing countries like India and the strategies implemented by India in attracting FDI inflow, its opportunities and challenges.

Objectives of the Research Paper: This paper aims at the following objectives.

1. To study the importance of FDI in Developing country like India.
2. To study the strategies implemented by India in attracting the FDI inflows.
3. To study the FDI inflows in India.
4. To study the effect of FDI inflow on major economic indicators like GDP, Capital formation and Employment generation.
5. To study the challenges before India in managing the FDI inflows.

Methodology: For the present study the data are gathered through secondary sources such as Reserve Bank of India Bulletin, Economic and business magazines, websites etc. Based on the data collected through secondary sources , the analysis were carried out by using appropriate statistical tools such as Time series Analysis and Karl Pearson co-efficient of correlation.

What is Foreign Direct Investment: Generally speaking FDI refers to capital inflows from abroad that invest in the production capacity of the economy and are "usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. FDI also facilitates international trade and transfer of knowledge, skills and technology. United Nations Conference on Trade and Development (UNCTAD) in it's World Information Report-2009 defines Foreign direct investment (FDI) as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy.

Why Foreign Direct Investment is necessary for India? : The Foreign Direct Investment is preferred by developing countries like India due to its unique characters. They are;

1. FDI is non Debt capital: Any foreign capital inflow other than FDI is in the form of loans and advances. This create debt burden on the economy as this capital has to be paid back after specific time interval with interest irrespective of economic condition of the country.
2. Non fluctuating Capital: FDI is invested in the form of fixed assets in the country. Hence this capital remains in the economy for long period. Therefore risk of fluctuation of capital is not there.
3. FDI is the Investors risk: The country need not bother about the repay of capital and the returns for capital. Since the investor himself takes the risk. If the performance of the sector in which FDI is made is good the investor would earn huge returns, if not losis the returns. The government need not worry about it.
4. FDI investor is interested in Management affairs of Host Company in which he has invested funds: because of personal interest in getting good returns the foreign investors bring advanced technology to enhance the efficiency of host company. The technological transparency leads to economic growth in the country.
5. FDI creates economic growth : the capital inflow in the country generates industrial growth which in turn generates employment opportunities. This increases the standard of living of people.

What Strategies did India adopted in the past for attracting FDI? What Strategies are planned under 'Make in India'

The major reforms that lead to increase FDI in flow in India are

1. Liberalization Policy: The economic reforms programme initiated by the Indian government in 1991 aimed at rapid and substantial integration of the Indian economy with the global economy in a harmonized manner. Accordingly, the industrial policy in the post-reforms period mainly aimed at de-licensing, privatization, and FDI promotion, which was coupled with trade liberalisation in the manufacturing sector. To attract FDI, the policy regime for FDI was liberalised considerably. The first step in this direction was the grant of automatic approval, or exemption from case by case approval, for equity investment of up to 51 per cent and foreign technology agreements in identified high priority industries. Gradually, FDI has been permitted

in almost all industries. Not only has the restrictions on foreign equity investments gone down, several incentives to encourage FDI in manufacturing sector have also been undertaken e.g., tax incentives, tax holidays, etc. Also, to protect the interest of foreign partner and ensure proper treatment and facilitate business operations of foreign firms, India has signed a number of bilateral investment treaties (BITs). India has also become a member of MIGA (Multilateral Investment Guarantee Agency). Along with the efforts to improve FDI flows, trade has been encouraged to a large extent

2. Privatization Policy: The privatization policy adopted by India lead to the growth of private industries. The new Industrial policy announced in 1991 abolished industrial licensing and created considerable scope for the growth of the private sector. The need of capital for emergence of private giant industries started demanding huge capital. This lead to the flow of foreign capital in the form of FDI. Many cross-border acquisitions and mergers are noticed in India after the privatization policy.
3. Globalization: India underwent globalization due to new economic policy. When the privatization policy was introduced the economy began growing. The private sector started growing but the existing capital availability was not sufficient to meet the demand of economic growth. Hence welcoming the foreign capital was the need of the hour. Then freedom was given to the entry of private capital in the country. This lead to the emergence of Foreign Direct Investments and Portfolio Investments in the country.
4. Investor Friendly Investment Policies: The investor friendly foreign investment policies of government of India such as easy procedures, investment caps enhancement, favorable policies etc. have started attracting the foreign investors. Therefore India stood in the second rank next to China in attracting FDI

FDI inflow in India: The FDI inflow in India is showing positive trend. The time series analysis is made with help of statistical equation. Y= a + bx. The Table No.1 and Diagram No.1 explains the trends of FDI in India from 1991 to 2010

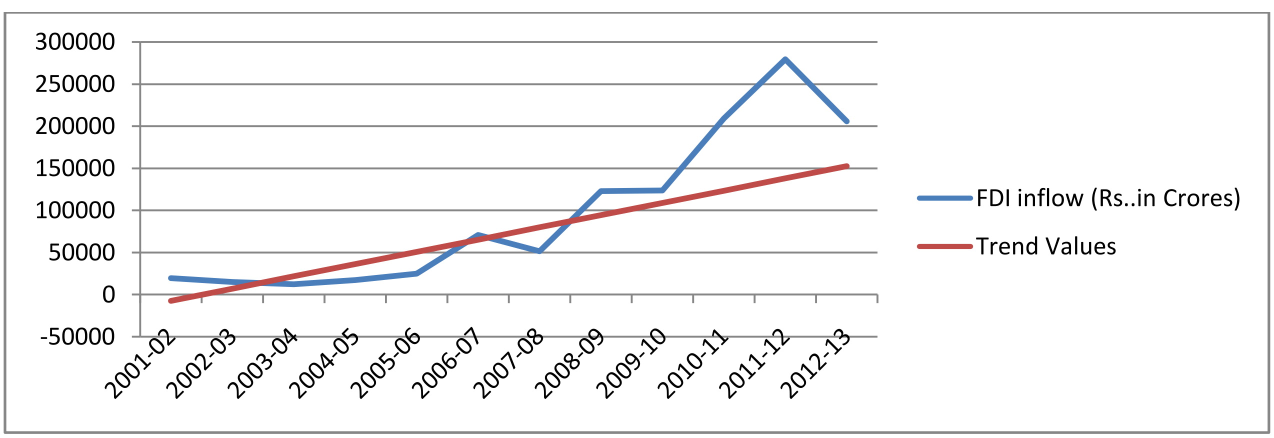
Table-1
Trend Analysis of FDI inflow in India From 2001 to 2010

Year	FDI inflow (Rs..in Crores)	Trend Values	De-trend Values
2001-02	19361	-7414.78	26775.78
2002-03	14932	7114.805	7817.195
2003-04	12117	21644.39	-9527.39
2004-05	17138	36173.97	-19036
2005-06	24613	50703.55	-26090.6
2006-07	70630	65233.14	5396.863
2007-08	51244	79762.72	-28518.7
2008-09	122919	94292.30	28626.7
2009-10	123378	108821.90	14556.11
2010-11	209082	123351.47	85730.53
2011-12	279366	137881.05	141484.95
2012-13	205548	152410.64	53137.36

Source: FDI Statistics www.dipp.gov.in. Trend values and de-trend values calculated by the researcher.

From the Table No.1, the trend values are calculated with the help of Time Series equations **Y= a + bx**. Accordingly the Value of **a = - 21944.361 and value of b= 14529.583.** Value of **a** shows constant growth in the FDI inflow where as value of **b** shows the rate of growth pertaining to time values **x**. a + b shows the linear growth of FDI inflows. De-trend values shows the deviation of actual FDI inflows from the linear trend values of FDI inflows

Diagram No.2.Trend Analysis of FDI inflows from 2001-02 to 2009-10



In the above diagram the straight line shows the growth character of FDI inflow. As the line slopes upward from left to right shows growth trends. The actual FDI inflow is plotted on trend line which in some year below the trend line and in some year above the trend line. But in total it shows positive growth in FDI inflows. It means the strategies adopted have successfully attracted FDI.

What is Impact of FDI on Economic Indicators?: The FDI inflow lead to increase in the Gross Domestic Product, Capital Formation and Employment generation. The gross domestic product is the major indicator of economic growth. It is developing at an increasing rate in India The gross domestic product (GDP) is one the primary indicators used to gauge the health of a country's economy. It represents the total money value of all goods and services produced over a specific time period. According to the data released for the year 2006-2007, India's GDP grew at an impressive 9.2 per cent. Table-2 explains the Growth of economic indicators:

Table.2:
Table showing the GDP, Gross Capital formation and employment generation in India

Year	GDP at factor cost (Rs.in crores)	Gross capital formation (Rs.in Crores)	Employment Generation (in millions)
1990-91	515032	291611	36
1991-92	594168	246099	37
1992-93	681517	269647	36
1993-94	792150	286305	37
1994-95	925239	349266	37
1995-96	1083289	375888	37
1996-97	1260710	374006	39
1997-98	1401934	419378	40
1998-99	1616082	419885	40
1999-00	1786525	506244	41
2000-01	1925017	488658	42
2001-02	2097726	474448	41
2002-03	2261415	555287	41

2003-04	2538171	665625	40
2004-05	2877701	795642	39
2005-06	3402316	950102	41
2006-07	3941865	1053323	41
2007-08	3896636	1622226	39
2008-09	4158676	1931380	38
2009-10	4516071	2363132	39
2010-11	4918533	2841457	41
2011-12	5247530	3200633	45
2012-13	5482111	3521399	45

Source: RBI Handbook 2013-14

Diagrams showing the growth of GDP, Capital Formation and Employment generations.

Diagram 2: Growth of GDP in India since 1991

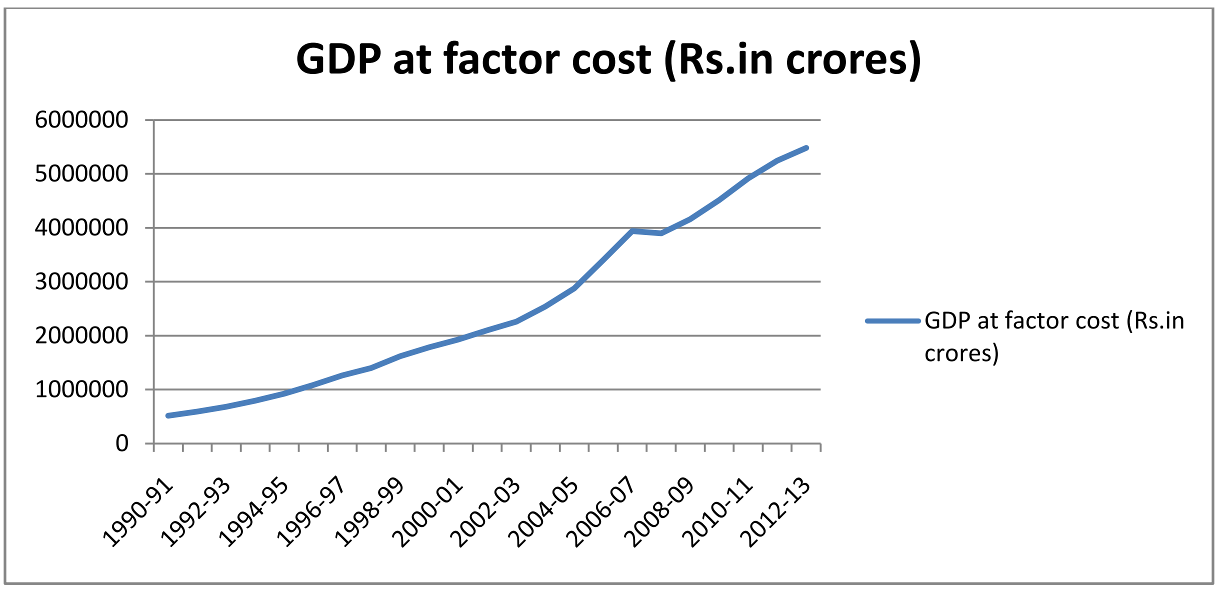


Diagram-3 : Growth of Goss Capital Formation in India

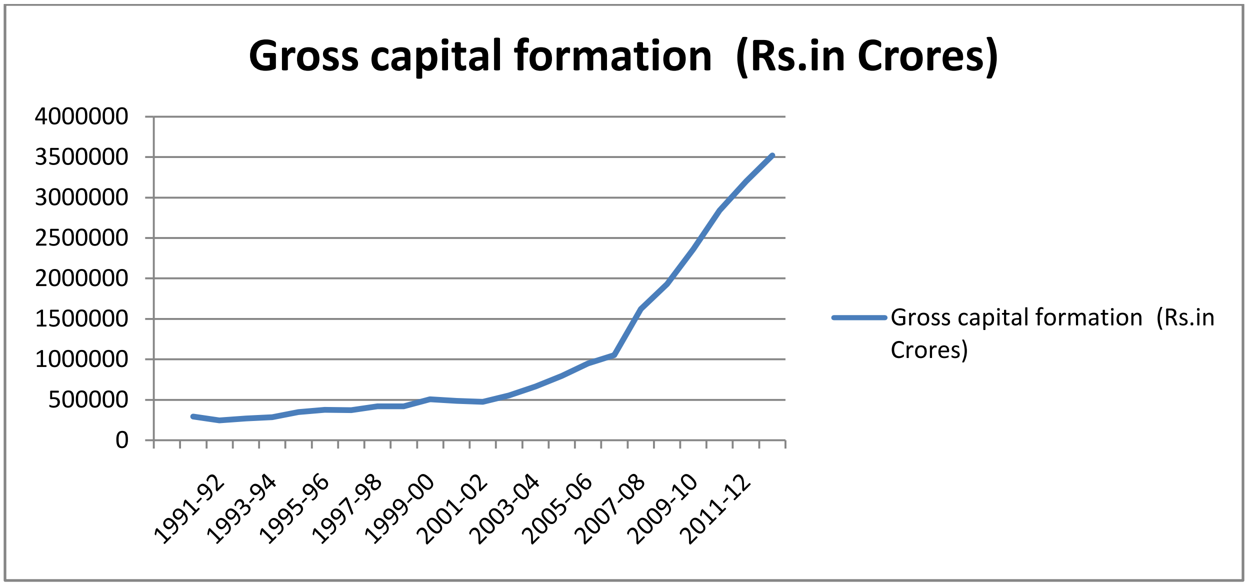
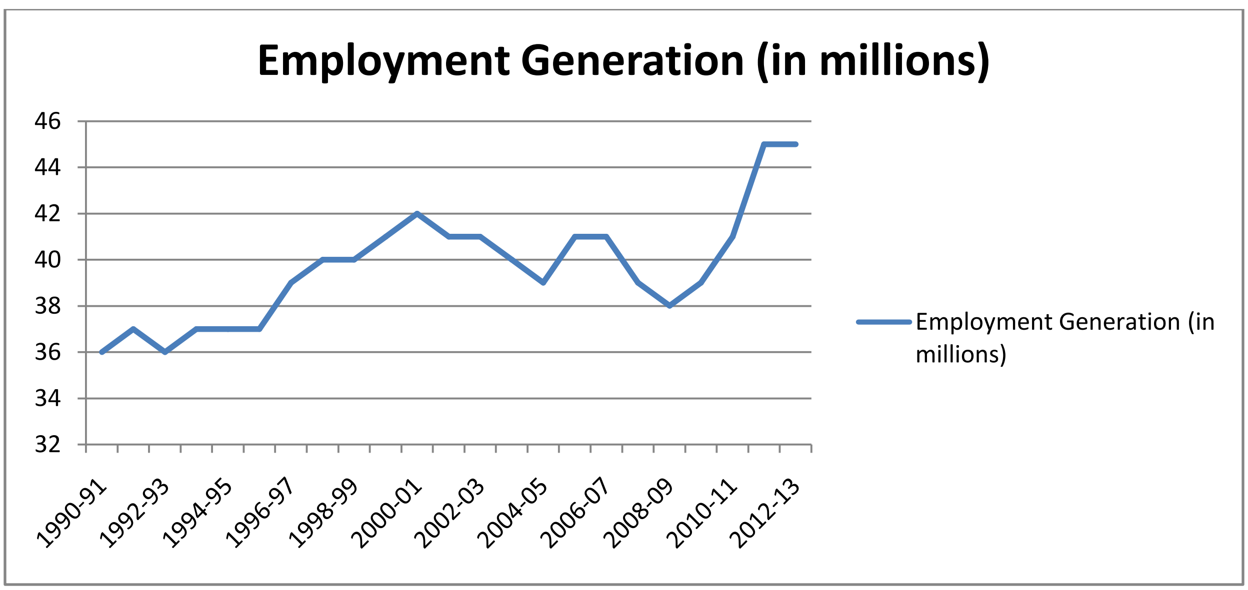


Diagram-4: Growth of Employment Generation



The impact of FDI on These economic indicators is studied with the help of Karl Pearson's Co-efficient of correlations. The following tables exhibit the of Karl Pearson's Tests Results.

Result Sheet1: Test Result of FDI on GDP

		Foreign Direct Investment	Gross Domestic Product at constant price
Foreign Direct Investment	Pearson Correlation	1	0.904
	Sig. (2-tailed)		.000
	N	12	12
Gross Domestic Product	Pearson Correlation	0.904	1
	Sig. (2-tailed)	.000	
	N	12	12

Result Sheet-2

Impact of FDI on Capital Formation

		Foreign Direct Investment	Capital Formation
Foreign Direct Investment	Pearson Correlation	1	0.891
	Sig. (2-tailed)		0.00
	N	12	12
Capital Formation	Pearson Correlation	0.891	1
	Sig. (2-tailed)	0.00	
	N	12	12

***. Correlation is significant at the 0.05 level (2-tailed).**

Result Sheet-3

Impact of FDI on Employment Generation

		Foreign Direct Investment	Employment
Foreign Direct Investment	Pearson Correlation	1	0.611
	Sig. (2-tailed)		.033
	N	12	12
Employment	Pearson Correlation	0.611	1
	Sig. (2-tailed)	0.033	
	N	12	12

Result Sheet1: Test Result of FDI on GDP

		Foreign Direct Investment	Gross Domestic Product at constant price
Foreign Direct Investment	Pearson Correlation	1	0.904
	Sig. (2-tailed)		.000
	N	12	12
Gross Domestic Product	Pearson Correlation	0.904	1
	Sig. (2-tailed)	.000	
	N	12	12

Result Sheet-2

Impact of FDI on Capital Formation

		Foreign Direct Investment	Capital Formation
Foreign Direct Investment	Pearson Correlation	1	0.891
	Sig. (2-tailed)		0.00
	N	12	12
Capital Formation	Pearson Correlation	0.891	1
	Sig. (2-tailed)	0.00	
	N	12	12

***. Correlation is significant at the 0.05 level (2-tailed).**

By analyzing the above result sheet it can be interpreted that one unit of FDI generate 0.904 unit of GDP it means there is high level of Positive correlation. On the other hand one unit of FDI can generate 0.891 unit of capital formation. There is high degree of positive correlation. In case of employment generation one unit of FDI inflow can only generate 0.611 unit of employment. There is moderate positive correlation. Because more capital inflow leads to introduction of advanced technology which some extent reduce unskilled workforce but in long run enhances skilled workforce.

What are the Challenges of FDI inflow for Indian Economy: The major challenges of FDI inflow are:

1. Managing the economic sectors from foreign controls: The invested FDI if withdrawn at once leads to collapse of economic system. The returns earned by foreign investors if taken back to their home countries may lead to out flow of resources. These are danger signs. Hence country has to manage these issues with sound economic policies.
2. Protecting the Cultural norms against foreign invasion: The foreign capital will not come alone, it comes along with its corporate and social work culture. This may not be sustained by Indian employees. Hence checking cultural differences is major challenge.
3. Too much dependency on foreign resources may prove ganged during war.
4. Economic crisis may lead to slow down FDI inflow and disinvestment of funds. This will collapse economic system.
5. Foreign Investors may rule the industrial growth in the country.

Findings:

1. The trend in the FDI inflow is mainly influenced by government policy and good industrial climate in India. The sound strategies may attract good amount of FDI inflow.
2. FDI inflow is showing positive growth trend. It has recorded the highest FDI inflow during 2008-09.
3. The FDI inflow has brought the growth in the economic environment of India. There is high degree of positive correlation between the FDI inflow and growth of GDP. It shows that Indian GDP is much induced by Foreign Direct Investments.
4. There is high degree of positive correlation of FDI inflow with Gross capital formation in India.
5. The employment generation in India is also having positive correlation. As per the analysis it is found that one unit of FDI capital inflow is creating 0.534 unit of employment generation. There is low degree of correlation between FDI inflow and employment generation as compared to GDP growth and Gross capital formation. The reason would be most of the FDI inflows in India are found in high technology sectors where skilled man power is required. In most of the cases foreign employees are used to reduce the cost and increase benefit. In course of time the Indian man power would cope up with the system. On the other hand the FDI inflow is inducing high technology where man power requirement is low. Ijn general the FDI inflow has brought positive growth in employment generation in India.

6. **Conclusions:** The inflow of FDI in any developing country like India has the positive bearing on the economic growth. The vicious circle of capital formation problems can be solved only from external force that is FDI inflows. It is because of this reason the developing countries frame attracting policies to increase foreign direct investments. As FDI has no any burden on the government relating to tax payments and forming loan burdens, the government will always be favorable towards the FDI. But only the sound policies relating to management of foreign funds can protect country against misappropriation of funds.

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