Role of FDI in Economic Development of India

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Abstract – India's economic policy reforms, taken in the sense of historic economic failures in 1990-1991 and some remarkable shifts in the global economic system, have changed the overall structure of the Indian economy since 1991. The reforms developed to free up the market, make it more efficient, bring the government out of its vast mode of control, encourage the Member States to take greater responsibility for the management of economic relations and to establish a kind of rivalry between countries for external investors. Liberalization, Privatization and Globalization (LPG) policies were designed to transform the Indian economy into a quickly expanding and internationally competitive economy. The series of reforms in the industrial, trade and financial sectors also rendered the economy more productive.

In July 1991, the Government has continuously followed the strategy of attracting more international investment to increase the availability of capital in infrastructure and other vital fields of the economy. The idea of globalization implies the integrating of the world economies through uninhibited trade and financial flows and through reciprocal transfers of technology and information. Several policy initiatives are being introduced to lure international funds, company names, and FIIs to direct and portfolio investment. In later years, the liberalization initiatives found in the new economic strategy were accompanied by a set of measures to further liberalize the domestic political structure against FDI. A new foreign investment policy was developed that stipulated the acceptance of FDI proposals by three thirds (a). Automatic approval framework of RBI (b). Industrial Approval Secretariat (SIAs) for projects outside the jurisdiction assigned to RBI, and (c). Board for Foreign Investment Promotion (FIPB), an organization formed to invite, negotiate and promote FDI.

Key Words: Role of FDI in Economic Development of India, Studies FDI Inflow patterns in India and its economic effects since the LPG model was implemented. Section I-Introduction, Section II-Trends of the FDI in the Post Reform Period, Section III- Effect of the FDI Inflow and Section IV- Conclusion The paper consists of four parts.

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INTRODUCTION

FDI has been acting as a development driver in the past and more in recent days. The newly industrialized Asian economies such as Singapore, South Korea, Taiwan and Hong Kong have adopted an outward-looking growth strategy which enables them to overcome the limitations of the least resource-developing economies. In India too, FDI has become a driver for economic development. FDI leads in several respects to the mechanism of global growth –

The acquisition of capital products with exchange is possible.

It is a method of maintaining market stability.

It creates complex transition forces and pulls.

It is possible to allow maximum use of capacity, leverage economies of scale and diversification.

International direct investment is investment in domestic structures, infrastructure and organizations with foreign properties. Foreign funding is not allowed on capital exchanges. It is particularly essential for its ability to move information and technologies, build employment, improve production overall, increase competitiveness and entrepreneurship and eventually end poverty by means of economic growth and development.

India continues to suffer from political and regulatory weaknesses and constraints that limit FDI inflows. Before economic reforms started in 1991, the FDI was discouraged in India from enforcing (a) extreme restrictions on foreign capital holdings and (b) by limiting the FDI to only a few reserved products. The Foreign Exchange Control Act (FERA) of 1973 was substituted by the current law referred to as the Devises Management Act. There was a mistake (FEMA). In contrast to earlier FEMA rules, all international investors were

practically forced out by FERA from Indian industries.

RESEARCH METHODS:

A.   Pre Reform Era

The phase of economic development in India began with the launch on 1April 1951 of the first five-year plan, although foreign capital was considered to be an important growth component, FDI policy was very selective. Free movement of foreign capital was welcome during the first cinque-year plan, which involved the provision of capital goods and technological skills (1st Five Year Plan, GOI). Foreign policy took a turn in the 3rd and 4th Five Year Plan with extreme foreign exchange reserve restrictions.

By the mid-1980s, the country began to expand its economy by attracting international investment and liberalizing its trading regime. In addition to supplying international investors with direct benefits, monetary and fiscal assistance was also given to fulfill such foreign direct investment goals. The establishment of a fiscal system conducive to direct and portfolio investments was a type of such assistance. Progress against foreign direct investment in India in 1948-49 to 1989-90 was very late.

India's post-reform economic success has several optimistic characteristics. In the 10-year cycle from 1992-93 to 2001-02, the average growth rate was around 6.0%. In stark contrast, development in the 1990s, amid the East Asian crisis, contributed to unprecedented external stability. There was a mistake (Ahluwalia Montek S.2002).

Table 1 presents the annual inflow of foreign investment into India. It demonstrates the FDI's comparative role and the investment portfolio in India. In 2001-02, which contributed to US$6130 million and US $ 2021 million.

Table 1: Trends in Foreign Investment Flows in to India (In US$ million)

YEAR	FDI	Portfolio Investment	Total Investment Inflows
1999-00	2155	3026	5181
2000-01	3270	2590	5680
2001-02	6130	2021	8151
2002-03	5035	979	6014
2003-04	4322	11377	15699
2004-05	3712	9291	13003
2005-06	3769	12492	16261
2006-07	7693	6947	14640
2007-08	15891	27434	43325
2008-09	22343	-14032	8311
2009-10	17965	32396	50361
2010-11	11305	30292	41597
2011-12	22006	17171	39177
2012-13	19819	26891	46710
2013-14	21564	4822	26385
2014-15	32628	40934	73562

Both FDI and portfolio contributions contributed to US$15891 million and US$27434 million respectively throughout 2007-08. 2008-09 saw historical economic crisis in the world as well as in India. From the maximum level of 21000, BSE Sensex decreased sharply and registered below 10,000. This culminated in fund investment outflows, amounting to US$ -14032 million in 2008-09. During 1999-00 to 2014-15, development in the FDI inflows and investment in portfolios displayed nearly equal patterns. Higher patterns have been observed before 2007-During 2008/09, the rapid fall in portfolio investment was the product of the financial collapse. Portfolio inflows were – US$ 14032 million but net FDI inflows contributed to US$ 22343 million. In 2008-09, the Total FDI inflows amounted to US$ 8,311 million. For 2014-15, preliminary statistics suggest FDI inflows of 32628 million US dollars and portfolio expenditure of 40934 million US dollars. The patterns in FDI are viewed in the following way as a growth model.

According to the FDI inflow data in India from 1999-00 to 2014-15 (Table 1), the value is calculated in the model.

Dependent Variable: log (TOTAL INVESTMENT INFLOWS)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	8.469187	0.242434	34.93401	0.0000
T	0.159552	0.025072	6.363784	0.0000

R-squared	0.743109	Mean dependent var	9.825381
Adjusted R-squared	0.724759	S.D. dependent var	0.881192
S.E. of regression	0.462303	Akaike info criterion	1.411277
Sum squared resid	2.992141	Schwarz criterion	1.507851
Log likelihood	-9.290219	Hannan-Quinn criter.	1.416223
F-statistic	40.49775	Durbin-Watson stat	3.135457
Prob(F-statistic)	0.000018	Growth rate	44.39%

The value of r (growth rate) is therefore equivalent to 44.39%. This results in a constant proportional or relative shift in the overall FDI inflow at r (growth rate) for a given absolute change in time.

Residual graph:
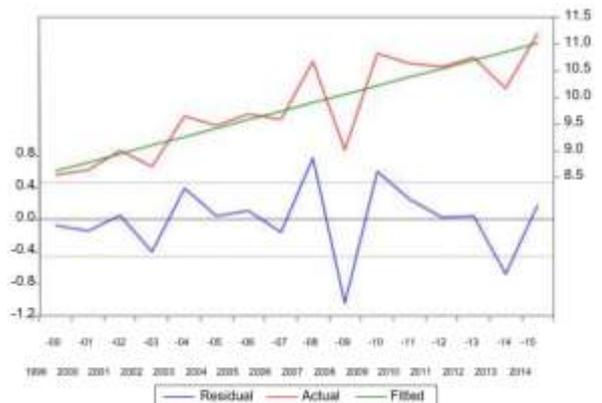
We find no serial correlation, no heteroscedasticity, normally distributed residual and no auto

correlation. All findings thus indicate that this model is appropriate.

RESULTS:

As value addition in FDI rises, the beneficial effect of FDI is expected to be greater. In 2008-09, the FDI influx and hence the development of the economy experienced a downturn as a consequence of the global slowdown, however the Indian economy saw a rapid rebound in 2009-10. The global economic crisis has impacted India's economy and GDP development in 2008-09 was modest to 6.8%, compared to an average of 9.5% during the last three years. The effect of the global slowdown on industry particularly the manufacturing sector, was amplified. However, fiscal and monetary policy actions boosted the economy, which contributed to the GDP growth rebound to 8,0% for 2009-10 and 8,9% for the first half of 2010-11 (Economic Survey, 2010-11).

In general, FDI inflows have a positive effect on India's GDP growth. Table 2 indicates that, in spite of certain extreme variations, FDI inflows rose from 1999-00 to 2013-14. During the same era, GDP has risen by around three times. The association between GDP development and FDI influx is quantitatively shown by an econometric model.

Table 2: Trends of Growth Rate of GDP and FDI Inflow

Year	FDI Inflow		GDP at factor cost	
	Rs. crore	% change	Rs. crore	% change
1999-00	22450	122.2552	2023130	12.1855762
2000-01	10733	-52.1915	2177413	7.62595582
2001-02	18654	73.80043	2355845	8.19467873
2002-03	12871	-31.0014	2536327	7.66103033
2003-04	10064	-21.8087	2841503	12.0322025
2004-05	14653	45.59817	3242209	14.1019031
2005-06	24584	67.77452	3693369	13.9152041
2006-07	56390	129.3768	4294706	16.2815305
2007-08	98642	74.92818	4987090	16.1218021
2008-09	142829	44.79532	5630063	12.8927491
2009-10	123120	-13.799	6477827	15.0578066
2010-11	97320	-20.9552	7784115	20.1655277
2011-12	165146	69.69379	8832012	13.4619928
2012-13	121907	-26.1823	9988540	13.0947286
2013-14	147518	21.00864	11345056	13.5807235

Dependent Variable: log(GDP)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	10.13587	0.687454	14.74407	0.0000
log (FDI INFLOW)	0.483097	0.063880	7.562546	0.0000
R-squared	0.814794	Mean dependent var		15.31011
Adjusted R-squared	0.800547	S.D. dependent var		0.580129
S.E. of regression	0.259086	Akaike info criterion		0.260254
Sum squared resid	0.872633	Schwarz criterion		0.354660
Log likelihood	0.048098	Hannan-Quinn criter.		0.259248
F-statistic	57.19210	Durbin-Watson stat		0.755999
Prob(F-statistic)	0.000004			

The log linear OLS model shows that GDP will certainly grow with the growth in FDI inflow. The above results confirm theoretic expectations. Since the value of R^2 and R^2 almost the same, the model is fitted.

CONCLUSION

As India achieves its desired targets, as set out in the 12th Five-Year Plan, our economy needs to be solid, dynamic and the outcome of growth equally shared. The effects of the economic reforms of the second century can only be understood if sufficient improvements to administrative apparatus and institutions, both central and federal, were introduced to encourage FDI influx.

India's economic reforms also helped crack the Hindu growth trend of 3.5 per cent and step towards higher economic growth. Rising FDI inflow has been one of the key successes of the post-reform era, but its advantages have not extended uniformly throughout the entire economy and are high. The FDI inflow pattern as predicted by the semi-log linear model suggests a gradual rise in FDI inflows in the years to come. If used wisely and with help of infrastructural development, this inflow may contribute to rapid economic growth in the region.

Thus, while attracting FDI may be a significant factor for growth, it can be inferred that this is not a goal in itself. The best policy will be to build a country-wide climate for equal FDI inflows and at the same time establish effective internal macro-economic and structural policies.

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RBI Bulletin 2015.

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