

# AN ECONOMIC ANALYSIS OF FDI IN INDIA

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## ABSTRACT

Foreign Direct Investment (FDI) broadly encompasses any long-term investments by an entity that is not a resident of the host country. Typically, the investment is over a long duration of time and the idea is to make an initial investment and then subsequently keep investing to leverage the host country's advantages which could be in the form of access to better (and cheaper) resources, access to a consumer market or access to talent specific to the host country - which results in the enhancement of efficiency. This long-term relationship benefits both the investor as well as the host country. The investor benefits in getting higher returns for his investment than he would have gotten for the same investment in his country and the host country can benefit by the increased know how or technology transfer to it's workers, increased pressure on it's domestic industry to compete with the foreign entity thus making the industry improve as a whole or by having a demonstration effect on other entities thinking about investing in the host country.

## INTRODUCTION

Nowadays the issue of foreign direct investments is being paid more attention, both national and international level. There are many theoretical papers that examine foreign direct investments (FDI)'s issues, and main research on the motivations underlying FDI were developed by J. Dunning, S. Hymer or R.Vernon. Economists believe that FDI is an important element of economic development in all countries, especially in the developing ones. The conclusion reached after several empirical studies on the relationship between FD and economic development is that the effects of FDI are complex. From a macro perspective, they are often regarded as generators of employment, high productivity, competitiveness, and technology spillovers. Especially for the least developed countries, FDI means higher exports, access to international markets and international currencies, being an important source of financing, substituting bank loans.

## HISTORICAL TRENDS IN FDI IN INDIA

Starting with the market reforms initiated in 1991, India gradually opened up its economy to FDI in a wide range of sectors. The "licence-raj" system was dismantled in almost all the industries. The infrastructure sector which was in dire need of capital welcomed foreign equity. FDI was especially encouraged in ports, highways, oil and gas industries, power generation and telecommunication. Consumer goods and service sector which was once completely off-limits for foreign equity was also gradually opened up. The reserve bank of India set up an automatic approval system which allowed investments in slabs of 50, 51 or 74% depending on the priority of the industry,

as defined by the government. The foreign investment limits were slowly raised and some sectors saw the limits raised to 100%.

## **BEGINNING OF FDI**

Those who support FDI claim that the country which accepts FDI will **benefit economically**; increased job opportunities, higher standards of living and better infra structure are some of the positive that flows from FDI. A visible impact of FDI on the growing economy is that it gets a **quick supply of money**.

To back their claim they site the example of “**The Asian Tiger**” economies such as China, South Korea, Singapore and the Philippines that benefited from FDI in to their economy. In the case of China FDI has really been a better step for improving the economy. Chinese economy has welcomed FDI since 1970 and the investment rose to a whopping \$274.6 billion in 2010 (according to UNCTAD).

There are positives that India can benefit from by more FDI flows. Farmers tend to get higher prices for their products by direct purchase by these retail houses. Middlemen are notorious for keeping the prices given to farmers low. Big retail companies will find direct purchasing profitable thus farmers will get a better deal for their products. Consumers also stands to gain as prices will go down due to direct purchase and competition.

## **ROLE OF FDI**

The importance of FDI extends beyond the financial capital that flows into the Country. In addition, FDI inflows can be a tool for bringing knowledge, managerial skills And capability, product design, quality characteristics, brand names, channels for international marketing of products, etc. and consequent integration into global Production chains, which are the foundation of a successful exports strategy (BlomStrom, Kokko and Zejan, 1994; Borensztein, De Gregorio and Lee, 1998; De Mello, 1999; United Nations Conference on Trade and Development (UNCTAD) 1999; Lall, 2000; Organization for Economic Cooperation and Development (OECD) 2002, Lipsey, 1999). FDI could benefit both the domestic industry as well as the consumer, by providing Opportunities for technological transfer and upgradation, access to global managerial Skills and practices, optimal utilization of human capabilities and natural resources, Making industry internationally competitive, opening up export markets, providing backward and forward linkages and access to international quality goods and services and augmenting employment opportunities. For all these reasons, FDI is regarded as an important vehicle for economic development particularly for developing economies. FDI flows 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. In a world of increased competition and rapid technological Change, their complimentary and catalytic role can be very valuable.

## TYPES OF FDI

- Inward Foreign Direct Investment: This refers to long term capital inflows into a Country other than aid, portfolio investment or a repayable debt.
- Outward Foreign Direct Investment: This refers to a long term capital outflow from a country other than aid, portfolio investment or a repayable debt. It is done by an entity outside the host country in the home country.
- Horizontal Foreign Direct Investment: This refers to a multi-plant firm producing the same line of goods from plants located in different countries
- Vertical Foreign Direct Investment: If the production process is divided into upstream (parts and components) and downstream (assembly) stages, and only the latter stage is transferred abroad, then the newly established assembly plant's demand for parts and components can be met by export from home-country suppliers. This is what Lipsey and Weiss (1981, 1984) and other researchers describe as "Vertical FDI", whose aim is to exploit scale economies at different stages of production arising from vertically integrated production relationships.
- Greenfield Foreign Direct Investment: Greenfield FDI is a form of investment where the MNC constructs new facilities in the host country.
- Brownfield Foreign Direct Investment: Brownfield FDI implies that the MNC or an affiliate of the MNC merges with or acquires an already existing firm in the host country resulting in a new MNC affiliate.

## SIGNIFICANCE OF FDI IN INDIA

When our then p.m.mr.Chandrashekhar announced about his plans to allow fdi in India, it opened a Pandora's Box for us. it was then in 1991.Since then,our economy has been growing manifolds.Since 1991, our economy is growing so rapidly that all the so called 'super powers" are keen on building strong relationship with our country. India was a country rich in resources, but the problem was their optimum utilisation.FDI has solved this problem. As a result, all the retail biggies are attracted towards India. India is giving tough competition to all developed countries, including china. so, wait for the day when our economy would be one of the strongest in the world and by then, probably you would get your answer as to" WHAT IS THE SIGNIFICANCE OF FDI for India"

## OBJECTIVES OF THE STUDY

In order to appreciate the importance FDI flows for the Indian economy, it would be pertinent to examine the changes in the global FDI flows and the place of India within. In this respect the following issues shall be studied with respect to inward flows to and outward flows from India:

- The nature and extent of Indian economy's integration with the world economy
- The nature of the regional distribution of FDI flows from the global FDI flows
- The comparative standing of FDI among developing countries
- The pattern of originating and destination countries of Indian FDI flows

- The nature of change in the sectoral composition of FDI in India
- The regional distribution of inward FDI in India
- The structure of cross border mergers and acquisitions from India
- The FDI flows as a percentage of GDP and GFCF
- FDI performance v/s potential in India
- Major policy initiatives taken to boost FDI flows

Why do firms go abroad? Why do they choose to invest in a specific location? These are some of the questions that have plagued scholars since the advent of interest in FDI. The origins of the theoretical literature on the determinants of FDI are to be found in Stephen Hymer's (1960) doctoral dissertation. His thesis, briefly put, is that firms go abroad to exploit the rents inherent in monopoly over advantages they possess and FDI is their mode of operations. The advantages firms possess include patented technology, team specific managerial skills, marketing skills, and brand names. All other methods of exploiting these advantages in external markets, such as licensing agreements and exports are inferior to FDI because the market for knowledge or advantages possessed by firms tends to be imperfect. In other words they do not permit firms to exercise control over operations essential for retaining and fully exploiting the advantages they own. Hymer's insights form the basis of other explanations such as transactions costs and internationalization theories, most of which in essence, argue that firms internalize operations, forge backward and forward linkages in order to bypass the market with all its operations.

## CONCLUSION

It is widely known that capital flows into developing economies like India have risen sharply in nineties and has, therefore, become a self propelling and dynamic actor in the accelerated growth of the economies. This study focuses on FDI as a vector of Indian globalization. Recently not only did India become a more frequent destination for FDI, but also many Indian firms have started investing abroad in a big way. Thus we find a surge in both inward and outward FDI flows. Structure of Foreign Direct Investments into and from India. It traces the development of India's economic policy regarding FDI and the resulting changes in both inflows and outflows. The expansion of FDI into and from India has been accompanied by a rapid economic growth and an increasing openness to the rest of the world. It is equally important to understand why India has become one of the important beneficiaries of FDI in the world and what drives the more recent progress of India's outward FDI.

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