

A Study Of Impact Of Foreign Direct Investment On Growth Of Indian Economy From Year 2008-2017

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Abstract

Since 1991, the regulatory environment for foreign investment has consistently been eased to make it investor-friendly, catapulting India into the position of one of the fastest-growing economies of the world. India has been ranked (9th in terms of FDI inflows for 2016 by UNCTAD) among the top attractive destinations for inbound investments in the world. The potential advantages of the FDI on the host economy are it facilitates the use and exploitation of local raw materials; it introduces modern techniques of management and marketing, it eases the access to new technologies. This paper evaluates impact of Foreign Direct Investment (FDI) on growth of Indian economy and also to identify the factors which influence the flow of Foreign direct investment (FDI) in India. The study tests a hypothesis for a positive relationship between FDI and economic growth in India using a T test for correlation.

INTRODUCTION

Foreign Direct Investment (FDI) has emerged as the most important source of external financial resource for developing countries and has become a significant part of economy (Kumar and Pardhan, 2001), FDI is an investment made by a company or individual in one country in business interest in another country, in the form of either establishing business operations, or acquiring business assets in the other country such as ownership or controlling interest in foreign country. It can provide a firm with new market and marketing channels, cheaper production facilities, access to new technology, product, skill and financing.

Foreign Direct Investment (FDI) in India is a major monetary source for economic development in India. Foreign companies invest directly in fast growing private Indian businesses to take benefit of cheaper wages and changing business environment of India. Economic liberalization started in India in wake of 1991 Economic crises and since then FDI has steadily increased in India. According to the Financial Times, in 2015 India overtook China and the US as the top destination for the foreign direct investment. In the first half of the 2015, India attracted investment of \$31 billion compared to \$28 billion and \$27 billion of China and the US respectively. According to the statistics released by India's Ministry of Commerce and Industry, India has received US\$ 43.48 billion in FDI during the last fiscal year (April 16-March 17), compared to US\$ 40.00 billion that came in the previous financial year.

India is the 3rd largest economy in the world and is the preferred destination for foreign direct investment (FDI). India's recently liberalized policy permit upto 100% FDI stake in ventures. Industrial policy reforms have substantially reduced industrial licensing requirements, removed restrictions on expansion and facilitate easy access to foreign technology and foreign direct investment.

This study investigates the impact of foreign Direct Investments in the economic growth of India

STEPS TAKEN BY GOVERNMENT TO PROMOTE FDI

The Indian Government has taken a number of steps to show its willingness to allow more foreign direct investment in the country.

- In the infrastructure development sector, norms pertaining to area restriction, comfortable exit requirement of minimum capitalization were relaxed. Waiver introduced for area restriction and requirement of minimum capitalization for the companies are ready to commit 30 percent of their investment for affordable housing
- Upper limit of FDI increased from 26 percent to 49 percent in the insurance sector.
- Proposed that 100 percent will be allowed in railway d infrastructure like high-speed train.
- As per the extant FDI policy, foreign investment up to 49% is permitted under the automatic route, foreign investment beyond 49% and upto 100% is permitted through Government approval, wherever it is likely to result in access to modern technology or for other reasons to be recorded.
- India is open to 100 per cent foreign direct investment (FDI) in defense if firms are willing to provide full technology transfer as per the recent statements by Indian officials
- India has announced sweeping relaxations in foreign direct investment (FDI) rules in single-brand retail and other areas besides allowing overseas carriers to acquire as much as 49% of Air India to help speed up its divestment.

ADVANTAGES OF FOREIGN DIRECT INVESTMENT IN INDIA

- **Promotion of investment in key areas** such as infrastructure development as a result of which there will be more production of capital goods. For example, investment in power generation can generate more electric power which will enable the growth of more industries.
- **To get access to new technologies** which were not adopted in the country till now. Example is the recent development in the communication system. The launching of the satellites with the help of other countries has enabled the growth of communication system in the country. Nokia has come to India for promoting India's communication system.
- **Increase in capital inflow** especially in the key and the core sectors. We have a shortage of capital not only in the form of money but also in the form of material. FDI's bridge this gap by which there will be speedy economic growth in the country.
- **Increase in exports:** The creation of economic zones and promotion of 100% export oriented units by many underdeveloped countries for attracting FDI has helped them in increasing their export from other countries. There is a change in the composition of exports and direction of exports with the presence of FDI.
- **Increase in Government revenue:** The revenue earned by the government is estimated to be increased by about 25-30 million dollars. This increased revenue would provide a huge boost and greatly contribute to the country's quest to become economic powerhouse.
- **Promotion of employment opportunities:** The advent of FDI especially in the service sector and the change in the advertising and marketing technologies due to FDI provides more scope for employment opportunities.
- **Promotion of financial services:-**
Foreign direct investment (FDI) strengthens financial services of the country by not only entering banking industry but also by extending other activities such as merchant banking, portfolio investment etc. which has resulted in the promotion of more new companies. It has also helped the capital market in the country.
- **Development of backward areas:** Industrial centres have been developed in far reaching and backward areas with the help of FDI. Examples are Hyundai and Ford car units started at Sriperumbudur and Maraimalai nagar in India.

FDI Limits In India

SECTOR	LIMIT	ENTRY ROUTE
Agriculture and Animal Husbandry -Floriculture, Horticulture, Apiculture and Cultivation of Vegetables & -mushrooms under controlled conditions. -Development and production of seeds and plantation material -Animal husbandry (including dog breeding), pisciculture and aquaculture. -Service related to agro and allied sectors.	100%	Automatic
Plantation sector including tea, Coffee, Rubber, Cardamom Palm oil and Olive oil plantation	100%	Automatic
Mining Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities.	100%	Automatic
Petroleum and Natural gas Petroleum refining by Public Sector Undertaking (PSU) without any disinvestment or dilution of domestic equity in the existing PSU's.	49%	Automatic
Petroleum and Natural gas Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products etc.	100%	Automatic

Defence	100%	Automatic up to 49% Above 49% under Government route (for access to modern technology)
Broadcasting Carriage Services	100%	Automatic up to 49% Above 49% Government route
Print Media (Nnews and Current affairs) Publishing of newspaper and periodicals Publication of Indian editions of foreign magazines	26%	Government
Print Media Publishing/printing of scientific and technical magazines/specialty journals/ periodical subject to compliance with legal framework as applicable and guidelines issued in this regard from time to time by Ministry of Information and Broadcasting. Publication of facsimile edition of foreign newspaper.	100%	Government
Civil Aviation –Air Transport Services Scheduled Air Transport Services/ Domestic Scheduled Passenger Airline. Regional Air Transport Service	100%	Automatic up to 49 % . Above 49% under government route.
Airports(Greenfield projects)	100%	Automatic
Airports (Existing projects)	100%	Automatic up to 74% Government route beyond 74%
Construction Development Townships, Housing, Built- up Infrastructure.	100%	Automatic
Industrial Parks New and Existing	100%	Automatic
Satellites- establishment and Operation, subject to the sectoral guidelines of Department of Space/ISRO	100%	Automatic
Private Security Agencies	74%	Automatic up to 49%, Government route beyond 49% and up to 74%
Telecom Services	100%	Automatic up to 49% Government route beyond 49%
E-commerce activities E-commerce entities would engage only in Business to Business (B2B) e-commerce and not in Business to Consumer (B2C) e-commerce.	100%	Automatic
Single Brand product retail trading Local sourcing norms will be relaxed up to three years and a relaxed sourcing regime for another five years for entities undertaking Single Brand Retail Trading of products having state of the art and cutting edge technology.	100%	Automatic up to 49% Government route beyond 49%
Multi Brand Retail Trading	51%	Government
Railway Infrastructure Construction , operation and maintenance of railway infrastructure	100%	Automatic
Banking- Private Sector	74%	Automatic up to 49% Government route beyond 49% (upto 74%)
Banking- Public Sector	20%	Government
Infrastructure Company in the Securities Market [in compliance with SEBI Regulations	49%	Automatic
Insurance -Insurance Company -Insurance Brokers	49%	Automatic

-Third party administrator -Surveyors and Loss Assessors -Other Insurance Intermediaries		
Power Exchanges	49%	Automatic
Pension Sector	49%	Automatic
Credit Information Companies (CIC)	100%	Automatic
Pharmaceuticals	100%	Automatic
Financial service activities regulated by RBI, SEBI, IDRA or any other regulator.	100%	Automatic
Asset Reconstruction Companies	100%	Automatic

PROHIBITED SECTORS FOR FOREIGN DIRECT INVESTMENTS

1. Lottery including Government or private lottery, online lotteries etc.
2. Gambling, betting including casinos etc. Foreign technology collaboration, including licensing for franchise, trademark or brand name, is also prohibited for lottery, gambling and betting activities,
3. Chit funds
4. Nidhi companies
5. Real estate business or construction of farm houses- This shall not include construction of townships, residential or commercial premises, roads, bridges and Real Estate Investment Trusts registered with SEBI.
6. Cigar, cigarillos and cigarette manufacture
7. Sectors not open to private investments such as
 - Atomic Energy
 - Railway operations (other than permitted activities).

REVIEW OF LITERATURE

FDI is an important vehicle for the transfer of technology and knowledge and it can have a long run effect on growth by generating increasing return in production via positive externalities and productive spillovers. Thus, FDI can lead to a higher growth by incorporating new inputs and techniques. (Feenstra and Markusen, (1994)).

FDI helps domestic firms to achieve higher productivity as per findings of study by Lipsey (2002) and Alfro (2003) found in his study that . FDI flows into the different sectors of the economy (namely primary, manufacturing, and services) exert different effects on economy. Balasubramanyam.V.N and VidyaMahambre (2003) concluded that FDI is a very good means for the transfer of technology and knowhow to the developing countries. Sahoo and Mathiyazhagan, (2003) found a few evidences that demonstrate that there is a long-run relationship between Gross Domestic Product, FDI and export in India

DrMaathai K. Mathiyazhagan (2005) in his study tried to examine the long run relationship of FDI with gross output, export and labour productivity in the economy at the sectoral level. The researcher found that results demonstrate that the flow of FDI into the sector has helped to raise the output, labour productivity and export.

ChandanaChakraborty and Peter Nunnenkamp (2008) observed that booming foreign direct investment in post-reform India is widely believed to promote economic growth. Arshad, (2008), found that role of the foreign direct investment (FDI) has been widely recognized as an economic growth-enhancing factor in the developing countries resulting in increase in employment, productivity, exports and, pace of transfer of technology.

Satyanarayan, G., P.N. SampangiRamaiah and G. Raju (2011) made an attempt to analyze the impact of globalization on FDI flows in some Indian states viz. Maharashtra, Delhi, Karnataka, Gujarat and Tamil Nadu and found that there was a positive impact of globalization on foreign direct investment

Safiudin, Syed Khaja and S.S. Shreenivasa Murthy (2011), in their study of sector-wise FDI inflows in India and its impact on Indian industries found that FDI worked as a catalyst of growth, quality maintenance and development of Indian Industries to a greater extent.

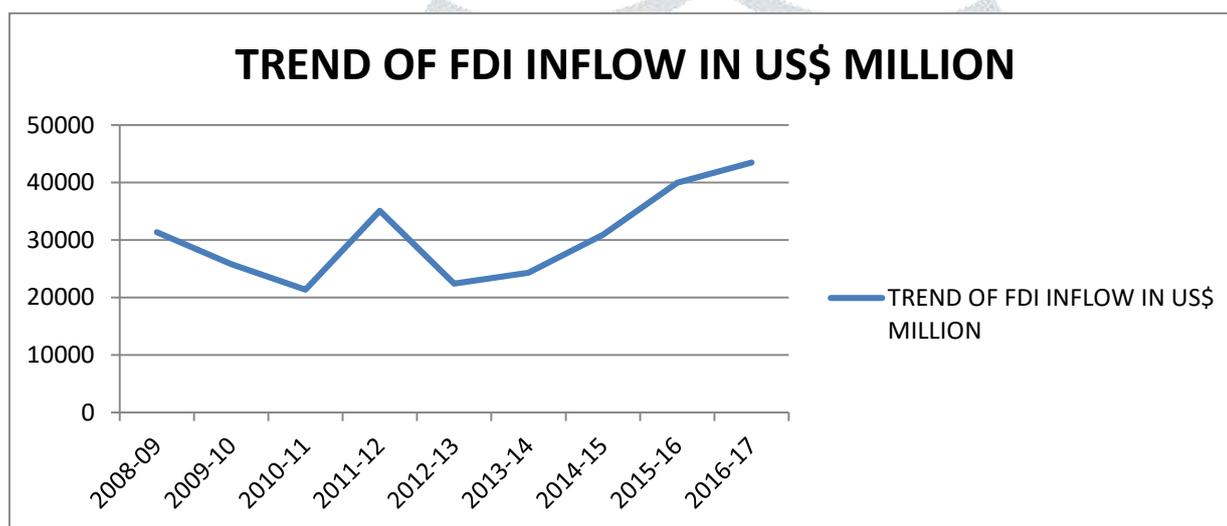
R. Jayaraj and Sumeet Gupta (2011) examined the interrelationship between FDI and GDP by using grangercausality in India and found that FDI did not Granger cause GDP but interestingly GDP has Granger cause on FDI. A positive correlation between FDI and GDP was found by Vinay Kumar (2012) , BhavyaMalhotra (2014) and Zafar, S.M.Tariq & Waleed Hemdatt (2016) in separate studies.

MisbahNousheen (2013) used co-integration analysis and found that there is long-term relationship between FDI and GDP variable

DATA ANALYSIS & INTERPRETATION**Table 1.FDI INFLOW TREND IN INDIA DURING THE YEAR 2008-17**

Sr.No	Financial Year (April-March)	Amount of FDI inflow (IN US\$ MILLION)
1	2008-09	31,396
2	2009-10	25,834
3	2010-11	21,383
4	2011-12	35,121
5	2012-13	22,423
6	2013-14	24,299
7	2014-15	30,931
8	2015-16	40,001
9	2016-17	43,478

Compiled from : <https://rbi.org.in/Scripts/PublicationsView.aspx?id=17931>

**Chart 1.0- Trend of FDI inflow during the period 2008-17**

As is indicated in the table, the FDI Trend in India, the overall trend of FDI inflow is fluctuating during the study period. There was around US\$ 31,396 million invested by the foreign investors during 2008-09. But there was fall in the FDI inflow 2009-10 and 2010-11. This was because of the subprime crises in US. In 2011 there was again rise in the FDI inflow of US\$ 35121 million followed by fall in inflow in the year 2012-13 and 2013-14. But in the year 2014-15, the FDI inflow again rises and continues to rises till the year 2016-17 with an inflow of US\$ 43,478 million due to the boost in the Indian Economy.

There was a significant rise (+9%) as compared to last financial year. Cumulative FDI inflow received during the period 2000-2017 were US\$ 332112 million as per the above table. During the year 2008-09, investment into India grew 28% but declined during the subsequent two years from 2009-10 and 2010-11. India once again experienced a surge in investment growing 64% in 2011-12. Although there was another dip of 36% in the year 2012-13, the government was confident that the trend will be reversed. The subsequent years was again very good where investment inflow gained 8% during year 2013-14, followed by an increase of 29% during year 2015-16, and with an increase of 9% during year 2016-17. The services sector (financial and non-financial services) had attracted FDI worth USD 4.39 billion during 2017. Mauritius, Singapore, the US, UK, Netherlands, Japan, Germany and the UAE, among other countries, are the major investors in India.

Table. 5:- SECTORS ATTRACTING HIGHEST FDI EQUITY INFLOWS:-

Amount in Rs. Crores(US\$ in Million)

Sectors	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	Cumulative Inflow (April, 00-March 17)	% to total inflow
Service Sector	24,074(5,270)	20,766(4,353)	15,539(3,403)	24,656(5,216)	26,306(4,833)	13,294(2,225)	27,369(4,443)	45,415(6,889)	58,214(8,684)	316,568(59,476)	18%
Computer software & Hardware	7,329(1,677)	4,351(919)	3,571(784)	3,804(796)	2,656(486)	6,896(1,126)	14,162(2,296)	38,351(5,304)	24,605(3,625)	136,789(24,669)	7%
Construction Development	8,792(2,028)	13,516(2,862)	7,552(1,665)	15,236(3,141)	7,248(1,332)	7,508(1,226)	4,652(769)	727(113)	703(105)	114,639(24,293)	7%
Telecommunication	11,727(2,558)	12,338(2,554)	7,546(1,665)	9,012(1,997)	1,654(304)	7,987(1,307)	17,372(2,895)	8,637(1,324)	37,435(5,564)	130,164(23,946)	7%
Automobile industry	5,212(1,152)	5,754(1,208)	6,008(1,331)	4,347(923)	8,384(1,537)	9,027(1,517)	16,760(2,726)	16,437(2,527)	10,824(1,609)	92,218(16,674)	5%
Drugs & Pharmaceuticals	NA	NA	NA	NA	6,011(1,123)	7,191(1,279)	9,052(1,498)	4,975(754)	5,723(857)	75,820(14,707)	4%
Trading	NA	NA	NA	NA	NA	NA	16,755(2,728)	25,244(3,845)	15,721(2,338)	84,557(14,211)	4%
Chemicals (other than fertilizers)	3,427(749)	1,707(362)	1,810(398)	1,522(327)	1,596(292)	4,738(878)	4,658(763)	9,664(1,470)	9,397(1,393)	68,592(13,293)	4%
Power	4,382(985)	6,908(437)	5,709(1,252)	1,136(256)	2,923(536)	6,519(1,066)	4,296(707)	5,662(869)	7,473(1,113)	60,087(11,589)	3%
Metallurgical Industry	4,157(961)	1,935(407)	5,055(1,105)	8,348(1,786)	7,878(1,466)	3,436(568)	2,196(359)	2,982(456)	9,647(1,440)	53,074(10,331)	3%

Source- RBI's FDI Factsheets

Ranking of Sector wise FDI inflows in India:-

Industrial Sector	Rank
Service Sector	1
Computer Software and Hardware	2
Construction Development	3
Telecommunication	4
Automobile industry	5

Drugs and Pharmaceuticals	6
Trading	7
Chemicals (other than fertilizers)	8
Power	9
Metallurgical industry	10

The Sector wise Analysis of FDI Inflow in India reveals that maximum FDI has taken place in the **service sector** including the telecommunication, information technology, travel and many others. The service sector has topped the list with US\$ 59,476 million (18 percent). The service sector is followed by the computer hardware and software in terms of FDI with US\$ 24,669 million (7 percent), Construction Development sector with US\$ 24,293 million (7 percent), Telecommunication sector with US\$ 23,946 million (7 percent), Automobile Industry with US\$ 16,674 million (5 percent), Drugs and Pharmaceuticals sector with US \$ 14,707 million (4 percent), Trading sector with US \$ 14,221 million (4 percent), Chemicals with US\$ 13,293 million (4 percent), Power sector with US\$ 11,589 million (3 percent) and Metallurgical industry with US\$ 10,331 million (3 percent). The top ten sectors have collectively accounted to 62 percent (US\$ 213,189 million) of the total FDI during the period from 2000-17. Other than above top ten sectors are Aviation, Biotechnology, Defence manufacturing, Electrical machinery, Food processing, Leather industry, Media and entertainment, Textiles and Garments, Tourism and Hospitality etc which contribute 38 percent of the total FDI inflow into India.

HYPOTHESIS OF THE STUDY

- Null Hypothesis (H_0): $\rho=0$ - There is no significant relationship between FDI and GDP.
- Alternative Hypothesis (H_1): $\rho \neq 0$ - There is significant relationship between FDI and GDP.

The hypothesis is tested by a t-test of correlation at 5% significance level.

Karl Pearson co-relation(r) is found to be + **0.19**. It means that there is a positive co-relation between the FDI and GDP. And T value is **0.511**

$T <$ Critical value 2.262 at 5 % significance level. Hence the research hypothesis that there is positive correlation is rejected.

CONCLUSION

The study observes that there is a positive relationship between FDI and economic growth in India but it is not statistically significant. FDI can provide a sound base for economic growth and development by enhancing the financial position of any country. India can improve its economic performance and can achieve its target of double digit growth rate by creating conditions conducive to investment. The Indian economy is one of the most promising investment destinations for most of the developed and developing nations and ensuring ease of doing business would attract more FDI and can fuel the growth of the economy in a faster pace.

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