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A Research Paper on "Role of Foreign Direct Investment (FDI) in Economic Development of India"

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ABSTRACT

FDI plays an important role in the development process of any country in the world. It can act as a catalyst for domestic industrial development, helps in speeding up economic activity and brings with it other scarce productive factors such as technical knowhow and managerial experience, which are essential for economic development as well as resource mobilization, needed for achieving higher growth and earning potential. Over the years, India has become the second most preferred destination for FDI, next only to China. The economic reforms initiated in 1991 have contributed significantly to the inflow of FDI in India. Liberalization and other related factors have further fueled the inflow of FDI in India. The main purpose of the study is to investigate the impact of FDI on economic growth in India, policy frame work for FDI in India and to identify the role of FDI in various industrial sectors for development of Indian economy.

KEYWORDS: Foreign direct investment, Economic development, Economy and Industry

INTRODUCTION

The foreign direct investment is profitable both to the country receiving investment and the investor. For the investor company FDI offers an exclusive opportunity to enter into the international or global business, new markets and marketing channels, elusive access to new technology and expertise, expansion of company with new or more products or services, and cheaper production facilities. While the host country receives foreign funds for development, transfer of new profitable technology, wealth of expertise and experience and increased job opportunities. FDI is generally defined as "A form of long term international capital movement, made for the purpose of productive activity and accompanied by the intention of managerial control or participation in the management of foreign firm."

Depending on the industry sector and type of business, a foreign direct investment may be an attractive and viable option. Any decision on investing is thus a combination of an assessment of internal resources, competitiveness, and market analysis and market expectations.

FDI AND ECONOMIC DEVELOPMENT

FDI is considered to be the life blood and an important vehicle of for economic development as far as the developing nations are concerned. The important effect of FDI is its contribution to the growth of the economy. FDI has an important impact on country's trade balance, increasing labour standards and skills, transfer of technology and innovative ideas, skills and the general business climate.

INDUSTRIAL SECTORS OF INDIA

India has been a major recipient of FDI Inflows in the majority of sectors. In the liberalization era, India is known to have attracted a quantum amount of FDI especially after the liberalization. In India, FDI opportunities exist in the various telecommunication sectors and other construction projects. The huge size of the market in the power sector in India and high returns on investment are important factors in boosting FDI inflows to power. There are huge opportunities of FDI in power sector in India. Important factors which are conductive to FDI Inflows to Electronics are the availability of low-cost, efficient, and technically skilled workforce, opportunities for the manufacturing of consumer electronic goods and mobile handsets are high given the growing demand in the domestic electronics market, electronics hardware is growing leaps and bounds globally, large-scale manufacturing units of electronics hardware will be set up in the special economic zones with a total exemption of duties and taxes, India has high chances to acquire a size USD 11 billion in terms of contract manufacturing out of USD 500 billion by 2010. Even, Nokia and Elcoteq Network are planning to set up manufacturing operations in India.

POLICY ON FDI

FDI in India is allowed up to 100% under the automatic route in all the sectors except the following, which require prior approval of Government:

- Sectors prohibited for FDI.
- Activities that require industrial license.
- Proposals in which the foreign collaborator has an existing financial/technical collaboration in India in the same field.
- Proposals for acquisition of shares in an existing Indian Company in financial service sector and where SEBI regulations, 1997 is attracted.
- All proposals falling outside notified sectoral policy in which FDI is not permitted.

POLICY INITIATIVES

The Government of India has released a comprehensive FDI policy document effective from April 1, 2010. Furthermore, the government has allowed the Foreign Investment Promotion Board (FIPB), under the Ministry of Commerce and Industry, to clear FDI proposals of up to US$ 258.3 million. In India, there has been a significant shift in the character of global capital flows in recent year. The predominance of private account capital transfer and especially portfolio investment increased considerably.

The importance of FDI received special impetus towards the end of 1992 when the Foreign Institutional Investors (FIIs) such as pension funds, mutual funds, investment trusts, asset management companies, nominee companies and incorporated / institutional portfolio managers were permitted to invest directly in the Indian stock markets. In order to have a flow of FDI, India maintained Double Tax Avoidance Agreements (DTAA) with nearly 70 countries of the world. India has signed 57 (up to 2006) numbers of Bilateral Investments Treaties (BITS). The numbers of BITS are signed with developing countries of Asia 16, the Middle East 9, Africa 4, and Latin America 1 apart from the developed nations 27. India as the founding member of General Agreement on Tariffs and Trade (GATT), World Trade Organization (WTO), a signatory member of South Asian Free Trade Area (SAFTA) and a member of Multilateral Investment Guaranty Agency (MIGA) is making its presence felt in the economic landscape of globalised economies which will help a conducive and healthy atmosphere for foreign investors and thus resulting in substantial amount of FDI inflows in the country. Despite troubles in the world economy, India continued to attract FDI inflows mainly because of the flexible and transparent policies of Government of India.

FOREIGN DIRECT INVESTMENT POLICY SINCE 1991:

FDI policy of the government of India has been gradually liberalized. As early as in the year 1948 and 1956 (two industrial policy resolutions) government policy clearly reflected the need to supplement foreign capital and technology for rapid economic growth. Government also granted tax concessions to foreign enterprises and streamlined industrial licensing procedures to accord early approvals for foreign collaborations. In the case of 100 per cent export of output, foreigners were allowed to establish industrial units. It needs to be noted here that under the Foreign Exchange Regulation Act (FERA) 1974 only up to 40 per cent of the equity holding of the foreign firms were permitted. It needs to be pointed out here that the restrictions have been flouted frequently and relaxations were also granted. This process has culminated into gradual liberalization of government policy towards foreign capital.

Foreign direct investment policy announced by the government of India in July 1991 was regarded as a dramatic departure from the earlier restrictive and discretionary policy towards foreign capital. The major feature of policy regarding foreign investment up to 51 per cent of equity holding was too permitted. Automatic approvals were also allowed to foreign investment up to 51 per cent equity in 34 industries as well as to foreign technology agreements in high priority industries. The Foreign Investment Promotion Board (FIPB) was set up to speedily process applications for approvals of the cases which were not covered under the automatic route. Laws were amended to provide foreign firms the equivalent status as the domestic ones. FDI up to 100 per cent is allowed under automatic route for all sectors/activities except activities that attract industrial licensing, The only sectors/activities where FDI is not permitted are agriculture and plantations excluding tea plantations, real estate business (excluding development of townships, housing, built up infrastructure and construction development projects-NRI/OCB investment is allowed for the real estate business), retail trade, lottery, security services and atomic energy. Government has simplified procedure, rules and regulations on a regular basis since 199. Attempt is made through FDI policy to make India the hub of global FDI in world level economic activities.

RANKING OF SECTOR WISE FDI INFLOWS IN INDIA SINCE APRIL 2000- DEC 2010
Table 1

Industrial Sector Rank	Rank
Service Sector	1
Computer Hardware & Software	2
Telecommunication	3
Housing and Real Estate	4
Construction Activities	5
Power	6
Automobile Industry	7
Metallurgical Industry	8
Petroleum and Natural Gas	9
Chemicals	10

[Source Fact Sheets on FDI, DIPP]

TRENDS OF FOREIGN DIRECT INVESTMENT IN INDIA SINCE 1991:

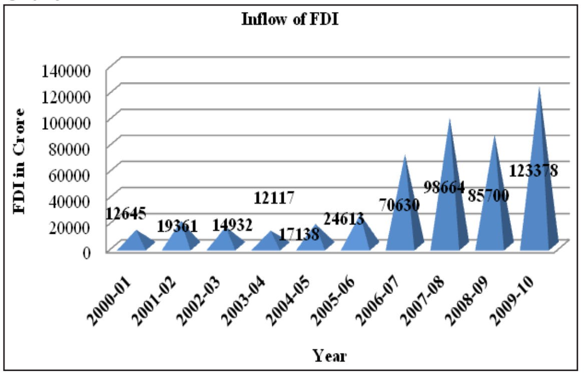
To examine the impact of recent FDI policy changes on the economy, quantitative information is required on the numerous dimensions. The most easily available information with regard to FDI is FDI approvals, approved amount and inflows across industries and regions/state wise. The number of FDI approvals, amount approved and actual inflows in rupee terms since 2001 to 2010 year wise and cumulative are presented in Table 2.

The sources of FDI usually affect the nature of economic outcomes. Therefore, it is important to analyze the most important source countries from where FDI is pouring in India. The Table 2 shows the flow of FDI in India from the year 2001 to 2010 where flow of FDI represent that during the time span flow of FDI is increasing because of government liberalization and thus many industrial sector such as real estate, infrastructure, service, telecommunication and many more get huge fund in the form of foreign currency and shows huge amount of potential to attract foreign investment from various countries in the world.

Table 2
YEAR WISE INFLOW OF FDI

Year	FDI (Crores)
2000-01	12645
2001-02	19361
2002-03	14932
2003-04	12117
2004-05	17138
2005-06	24613
2006-07	70630
2007-08	98664
2008-09	85700
2009-10	123378

Chart 1



CONCLUSIONS:

Indian economy has reached in the orbit of high rate of economic growth. India is being widely commended and recognized as an emerging global economic power. FDI inflows have been increased in the post-reform period and India now seems to be quite attractive place for such kind of investments. In quantitative terms, India's global share of FDI is still very low. However, the FDI still is shying away from the most important sectors and regions where it is direly needed. FDI as a strategic component of investment is needed by India for its sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries, short and long term project in the field of healthcare, education, etc. FDI can help to raise the output, productivity and export at the sectoral level of the Indian economy. However, it can observed the result of sectoral level output, productivity and export is minimal due to the low flow of FDI into India both at the macro level as well as at the sectoral level. Therefore for further opening up of the Indian economy, it is advisable to open up the export oriented sectors and higher growth of the economy could be achieved through the growth of these sectors.

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