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STATEMENT OF THE PROBLEM
OBJECTIVES
HYPOTHESIS (ES)
RESEARCH METHODOLOGY
RESULTS & DISCUSSION
FINDINGS
RECOMMENDATIONS/SUGGESTIONS
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IMPACT OF FOREIGN DIRECT INVESTMENT (FDI) ON INDIAN ECONOMY

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ABSTRACT

Foreign inflows are considered to be an important fuel for any country's economic engine. India has taken several initiatives in terms of government policies, liberal reforms & investor- friendly business environment, to attract foreign direct investment (FDI) into the country. In its recent policy initiatives, the government has allowed FDI in multi-brand retail, power exchanges and boosted FDI cap in single brand retail and broadcasting. FDI in India has grown immensely in the last 5 years due to strong support from government. This growth has in turn helped with the progress of the national economy. Further, the explosive growth of FDI gives opportunities to Indian industry for technological upgradation, gaining access to global managerial skills and practices, optimizing utilization of human and natural resources and competing internationally with higher efficiency. Most importantly, FDI is central for India's integration into global production chains which involves production by MNCs spread across locations all over the world. This research investigates the impact of FDI on Indian economy. It seeks to explain and brief out the concept of FDI with the help of models showing the factors influencing the foreign direct investment in India and depicts the contribution of foreign direct investment to economic growth, problems faced by the MNC at the time of investing in other country, findings and conclusions of research.

KEYWORDS

Indian economy, FDI, MNC.

INTRODUCTION

Foreign direct investment (FDI) – occurs when an entity or investor from one country obtain or acquires the controlling interest in an entity in another country and then operates and manages the entity and its assets as part of the multinational business of the investing entity. FDI plays a multidimensional role in the overall development of the host economies. It may generate benefits through bringing in non-debt-creating foreign capital resources, technological upgrading, skill enhancement, new employment, spill-overs and allocative efficiency effects. While FDI is expected to create positive outcomes, it may also generate negative effects on the host economy. The costs to the host economy can arise from the market power of large firms and their associated ability to generate high profits. Much of the existing empirical evidence suggests that the positive effects offset negatives, thus providing net economic benefits for the host economies. The majority of the population, both urban and rural, is expected to gain, indirectly and differentially, from FDI. While FDI may benefit the economy at both macroeconomic and microeconomic levels, it is equally important to probe whether people in the rural and suburban areas get affected through such benefits. FDI in relatively labour-intensive sectors including food processing, textiles and readymade garments, leather and leather products, and light machine tools, with plants set up in small cities close to rural and suburban areas, would tend to have relatively high employment-generating potential.

Nations' progress and prosperity is reflected by the pace of its sustained economic growth and development. Investment provides the base and pre-requisite for economic growth and development. Apart from a nation's foreign exchange reserves, exports, government's revenue, financial position, available supply of domestic savings, magnitude and quality of foreign investment is necessary for the well being of a country. Developing nations, in particular, consider FDI as the safest type of international capital flows out of all the available sources of external finance available to them.

CHART 1

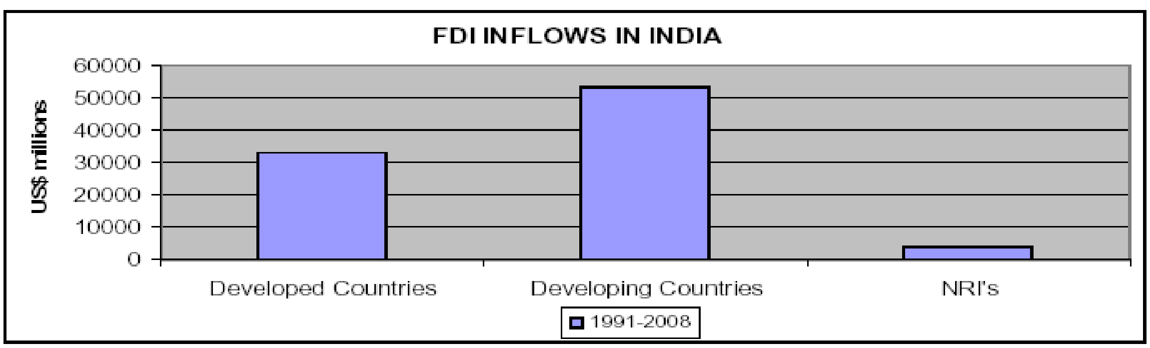
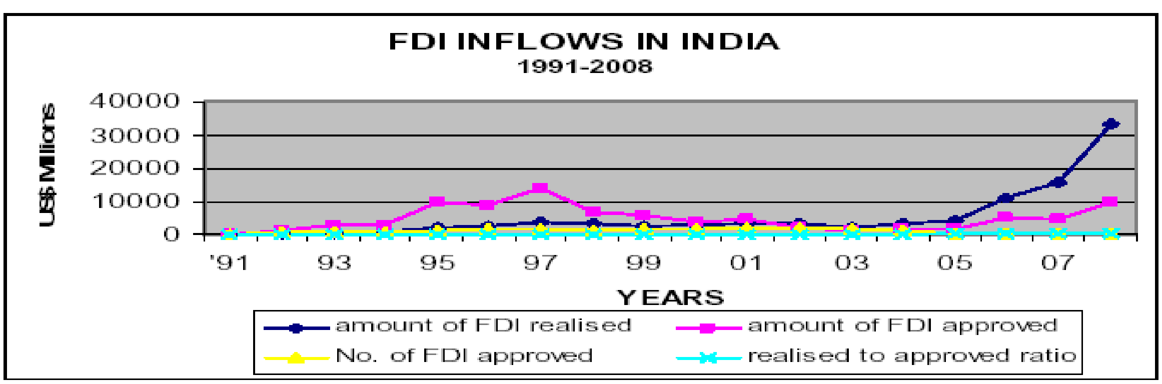


CHART 2



Sources: compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI

TABLE 1.3: PROVIDES A LIST OF COUNTRIES THAT ARE THE LEADING FOREIGN DIRECT INVESTORS FOR INDIA

Country	Approx. percentage of FDI inflows	Approx. inflows in million US dollars
Mauritius	42	50164
Singapore	9	11275
USA	7	8914
UK	5	6158
Netherlands	4	4968

As the table shows, within 2000 and 2010 India has attracted FDI worth 178 billion dollars. Majority of the foreign direct investment comes through Mauritius as it enjoys several tax advantages, which works well for the international investors.

OBJECTIVES

The study covers the following objectives:
1. To study the trends and patterns of flow of FDI.
2. To assess the determinants of FDI inflows.
3. To evaluate the impact of FDI on the Economy.

HYPOTHESES

The study has been taken up for the period 1991-2008 with the following hypotheses:
1. Flow of FDI shows a positive trend over the period 1991-2008.
2. FDI has a positive impact on economic growth of the country.
Developed economies consider FDI as an engine of market access in developing and less developed countries vis-à-vis for their own technological progress and in maintaining their own economic growth and development. Developing nations looks at FDI as a source of filling the savings, foreign exchange reserves, revenue, trade deficit, management and technological gaps. FDI is considered as an instrument of international economic integration as it brings a package of assets including capital, technology, managerial skills and capacity and access to foreign markets. The impact of FDI depends on the country's domestic policy and foreign policy. As a result, FDI has a wide range of impact on the country's economic policy. In order to study the impact of foreign direct investment on economic growth, two models were framed and fitted. The foreign direct investment model shows the factors influencing the foreign direct investment in India. The economic growth model depicts the contribution of foreign direct investment to zEconomic growth.

MODEL BUILDING

Further, to study the impact of foreign direct investment on economic growth, two models were framed and fitted. The foreign direct investment model shows the factors influencing the foreign direct investment in India. The economic growth model depicts the contribution of foreign direct investment to economic growth. The two model equations are expressed below:
1) FDI = f [TRADEGDP, RESGDP, R&DGDP, FIN. Position, EXR.]
2) GDPG = f [FDIG]
Where,

FDI	=	Foreign Direct Investment;
GDP	=	Gross Domestic Product
FIN. Position	=	Financial Position
TRADEGDP	=	Total Trade as percentage of GDP.
RESGDP	=	Foreign Exchange Reserves as percentage of GDP;
R&DGDP	=	Research & development expenditure as percentage of GDP;
FIN. Position	=	Ratio of external debts to exports;
EXR	=	Exchange rate;
GDPG	=	level of Economic Growth;
FDIG	=	Foreign Direct Investment Growth.

IMPORTANCE OF THE STUDY

It is apparent from the above discussion that FDI is a predominant and vital factor in influencing the contemporary process of global economic development. The study attempts to analyze the important dimensions of FDI in India. The study works out the trends and patterns, main determinants and investment flows to India. The study also examines the role of FDI on economic growth in India for the period 1991-2008. The period under study is important for a variety of reasons. First of all, it was during July 1991 India opened its doors to private sector and liberalized its economy. Secondly, the experiences of South-East Asian countries by liberalizing their economies in 1980s became stars of economic growth and development in early 1990s. Thirdly, India's experience with its first generation economic reforms and the country's economic growth performance were considered safe havens for FDI which led to second generation of economic reforms in India in first decade of this century. Fourthly, there is a considerable change in the attitude of both the developing and developed countries towards FDI. They both consider FDI as the most suitable form of external finance. Fifthly, increase in competition for FDI inflows particularly among the developing nations. The shift of the power center from the western countries to the Asia sub – continent is yet another reason to take up this study. FDI incentives, removal of restrictions, bilateral and regional investment agreements among the Asian countries and emergence of Asia as an economic powerhouse (with China and India emerging as the two most promising economies of the world) develops new economics in the world of industrialized nations. The study is important from the view point of the macro-economic variables included in the study as no other study has included the explanatory variables which are included in this study.

LIMITATIONS OF THE STUDY

All the economic / scientific studies are faced with various limitations and this study is no exception to the phenomena. The various limitations of the study are:
1. At various stages, the basic objective of the study is suffered due to inadequacy of time series data from related agencies. There has also been a problem of sufficient homogenous data from different sources. For example, the time series used for different variables, the averages are used at certain occasions. Therefore, the trends, growth rates and estimated regression coefficients may deviate from the true ones.
2. The assumption that FDI was the only cause for development of Indian economy in the post liberalized period is debatable. No proper methods were available to segregate the effect of FDI to support the validity of this assumption.
3. Time and money.

TABLE 1.1: SHOWING FDI INFLOWS, GDP, TRADE, FOREIGN RES.& RES. DEV. EXP. (*Amounts in Rs. Crores)*

Years	FDI inflows in India	GDP	Total Trade	Foreign Exchange Reserves	Research & Development Expenditure
1991-1992	409	1099072	91892	23850	8363.31
1992-1993	1094	1158025	117063	30744	8526.18
1993-1994	2018	1223816	142852	60420	9408.79
1994-1995	4312	1302076	172645	79781	9340.94
1995-1996	6916	1396974	229031	74384	9656.11
1996-1997	9654	1508378	257737	94932	10662.41
1997-1998	13548	1573263	284276	115905	11921.83
1998-1999	12343	1678410	318084	138005	12967.51
1999-2000	10311	1786525	374797	165913	14397.6
2000-2001	10368	1864301	434444	197204	15683.37
2001-2002	18486	1972606	454218	264036	16007.14
2002-2003	13711	2048286	552343	361470	16353.72
2003-2004	11789	2222758	652475	490129	17575.41
2004-2005	14653	2388768	876405	619116	19991.64
2005-2006	24613	2616101	1116827	676387	22963.91
2006-2007	70630	2871120	1412285	868222	24821.63
2007-2008	98664	3129717	1668176	1237985	27213
2008-2009	142829	3339375	2072438	1283865	28914.51

Source: various issues of SIA Bulletin & RBI Bulletin

TABLE 1.2: SHOWING FINANCIAL POSITION AND EXCHANGE RATES (*amount in Rs. Crores)*

Years	Exports	Debt	Exchange Rates
1991-1992	44041	252910	24.5
1992-1993	53688	280746	30.6
1993-1994	69751	290418	31.4
1994-1995	82674	311685	31.4
1995-1996	106353	320728	33.4
1996-1997	118817	335827	35.5
1997-1998	130100	369682	37.2
1998-1999	139752	411297	42.1
1999-2000	159561	428550	43.3
2000-2001	203571	472625	45.7
2001-2002	209018	482328	47.7
2002-2003	255137	498804	48.4
2003-2004	293367	491078	45.9
2004-2005	375340	581802	44.9
2005-2006	456418	616144	44.3
2006-2007	571779	746918	42.3
2007-2008	655864	897955	40.2
2008-2009	766935	1169575	45.9

Source: various issues of SIA Bulletin.

1. FOREIGN DIRECT INVESTMENT (FDI): It refers to foreign direct investment. Economic growth has a profound effect on the domestic market, as countries with expanding domestic markets should attract higher levels of FDI inflows.

2. GROSS DOMESTIC PRODUCT (GDP): Gross Domestic Product is used as one of the independent variable. GDP can be estimated with the help of either (a) Current prices or (b) constant prices. If domestic product is estimated on the basis of market prices, it is known as GDP at current prices. On the other hand, if it is calculated on the basis of base year prices prevailing at some point of time, it is known as GDP at constant prices. In fact, in a dynamic economy, prices are quite sensitive due to the fluctuations in the domestic as well as international market. In order to isolate the fluctuations, the estimates of domestic product at current prices need to be converted into the domestic product at constant prices. Any increase in domestic product that takes place on account of increase in prices cannot be called as the real increase in GDP. Real GDP is estimated by converting the GDP at current prices into GDP at constant prices, with a fixed base year. In this context, a GDP deflator is used to convert the GDP at current prices to GDP at constant prices. The present study uses GDP at factor cost (GDPFC) with constant prices as one of the explanatory variable to the FDI inflows into India for the aggregate analysis.

Gross Domestic Product at Factor cost (GDPFC) as the macroeconomic variable of the Indian economy is one of the pull factors of FDI inflows into India at national level. It is conventionally accepted as realistic indicator of the market size and the level of output. There is direct relationship between the market size and FDI inflows. If market size of an economy is large than it will attract higher FDI inflows and vice versa i.e. an economy with higher GDPFC will attract more FDI inflows. The relevant data on GDPFC have been collected from the various issues of Reserve bank of India (RBI) bulletin and Economic Survey of India.

3. TOTAL TRADE (TRADEGDP): It refers to the total trade as percentage of GDP. Total trade implies sum of total exports and total imports. Trade, another explanatory variable in the study also affects the economic growth of the country. The values of exports and imports are taken at constant prices. The relationship between trade, FDI and growth is well known. FDI and trade are engines of growth as technological diffusion through international trade and inward FDI stimulates economic growth. Knowledge and technological spillovers (between firms, within industries and between industries etc.) contributes to growth via increasing productivity level. Economic growth, whether in the form of export promoting or import substituting strategy, can significantly affect trade flows. Export led growth leads to expansion of exports, which in turn promote economic growth by expanding the market size for developing countries.

4. FOREIGN EXCHANGE RSERVES (RESGDP): RESGDP represents Foreign Exchange Reserves as percentage of GDP. India's foreign exchange reserves comprise foreign currency assets (FCA), gold, special drawing rights (SDR) and Reserve Tranche Position (RTP) in the International Monetary Fund. The emerging economic giants, the BRIC (Brazil, Russian Federation, India, and China) countries, hold the largest foreign exchange reserves globally and India is among the top 10 nations in the world in terms of foreign exchange reserves. India is also the world's 10th largest gold holding country (Economic Survey 2009-10)17. Stock of foreign exchange reserves shows a country's financial strength.

5. RESEARCH & DEVELOPMENT EXPENDIYURE (R&DGDP): It refers to the research and development expenditure as percentage of GDP. India has large pool of human resources and human capital is known as the prime mover of economic activity.

6. FINANCIAL POSITION (FIN. Position): FIN. Position stands for Financial Position. Financial Position is the ratio of external debts to exports. It is a strong indicator of the soundness of any economy. It shows that external debts are covered from the exports earning of a country.

7. EXCHANGE RATES (EXR): It refers to the exchange rate variable. Exchange rate is a key determinant of international finance as the world economies are globalised ones.

8. GROSS DOMESTIC PRODUCT GROWTH (GDPG): It refers to the growth rate of gross domestic product. Economic growth rate have an effect on the domestic market, such that countries with expanding domestic markets should attract higher levels of FDI. India is the 2nd fastest growing economy among the emerging nations of the world. It has the third largest GDP in the continent of Asia. Since 1991, India has emerged as one of the wealthiest economies in the developing world. During this period, the economy has grown constantly and this has been accompanied by increase in life expectancy, literacy rates, and food security. It is also the world most populous democracy. The Indian middle class is large and growing; wages are low; many workers are well educated and speak English. All these factors lure foreign investors to India.

India is also a major exporter of highly – skilled workers in software and financial services and provide an important 'back office destination' for global outsourcing of customer services and technical support. The Indian market is widely diverse. The country has 17 official languages, 6 major religion and ethnic diversity. Thus, tastes and preferences differ greatly among sections of consumers.

9. FOREIGN DIRECT INVESTMENT GROWTH (FDIG): In the last two decade world has witnessed unprecedented growth of FDI. This growth of FDI provides new avenues of economic expansion especially, to the developing countries. India due to its huge market size, diversity, cheap labour and large human capital received substantial amount of FDI inflows during 1991-2008. India received cumulative FDI inflows of Rs. 577108 crore during 1991 to march 2010. It received FDI inflows of Rs. 492303 crore during 2000 to march 2010 as compared to Rs. 84806 crore during 1991 to march 99.

During 1994-95, FDI registered a 110% growth over the previous year and a 184% age growth in 2007-08 over 2006-07. FDI as a percentage of gross total investment increased to 7.4% in 2008 as against 2.6% in 2005. This increased level of FDI contributes towards increased foreign reserves. The steady increase in foreign reserves provides a shield against external debt. The growth in FDI also provides adequate security against any possible currency crisis or monetary instability. It also helps in boosting the exports of the country. It enhances economic growth by increasing the financial position of the country. The growth in FDI contributes toward the sound performance of each sector (especially, services, industry, manufacturing etc.) which ultimately leads to the overall robust performance of the Indian economy.

MODEL-1: *FOREIGN DIRECT INVESTMENT MODEL*

FDI = f [TRADEGDP, R&DGDP, EXR, RESGDP, FIN. Position]

TABLE 1.3

Variable	Coefficient	Standard Error	t- Statistic
Constant	26.25	.126	207*
TradeGDP	11.79	7.9	1.5*
ReservesGDP	1.44	3.8	.41
Exchange rate	7.06	9.9	.72**
Financial health	15.2	35	.45
R&DGDP	-582.14	704	.83**

R2 = 0.623 Adjusted R2= 0.466

D-W Statistic =.98, F-ratio = 7.74

Note: * = Significant at 0.25, 0.10 levels; ** = Significant at 0.25 level.

In Foreign Direct Investment Model, it is found that all variables are statistically significant. Further the results of Foreign Direct Investment Model shows that TradeGDP, R&DGDP, Financial Position (FIN.Position), exchange rate (EXR), and ReservesGDP (RESGDP) are the important macroeconomic determinants of FDI inflows in India. The regression results of shows that TradeGDP, ReservesGDP, Financial Position, exchange rate are the pull factors for FDI inflows in the country whereas R&DGDP acts as the deterrent force in attracting FDI flows in the country. As the regression results reveal that R&DGDP exchange rate does not portray their respective predicted signs. However, R&DGDP shows the unexpected negative sign instead of positive sign and exchange rate shows positive sign instead of expected negative sign. In other words, all variables included in the foreign direct investment model shows their predicted signs except the two variables (i.e. Exchange rate & R&DGDP) which deviate from their respective predicted signs. The reason for this deviation is due to the appreciation of Indian Rupee in the international market and low expenditure on R&D activities in the activities in the country.

MODEL-2: *ECONOMIC GROWTH MODEL*

GDPG = f [FDIG]

TABLE 1.4

Variable	Coefficient	Standard Error	t- Statistic
Constant	.060322925	0.00007393156391	815.92
FDIG	0.039174416	.020661633	1.8959

R2= 0.959 Adjusted R2= 0.956

D-W Statistic = 1.0128, F-ratio = 28.076

Note: * = Significant at 1%

In the Economic Growth Model (Table – 4.10), estimated coefficient on foreign direct investment has a positive relationship with Gross Domestic Product growth (GDPG). It is revealed from the analysis that FDI is a significant factor influencing the level of economic growth in India. The coefficient of determination, i.e. the value of R2 explains 95.6% level of economic growth by foreign direct investment in India. The F-statistics value also explains the significant relationship between the level of economic growth and FDI inflows in India. D-W statistic value is found 1.0128 which confirms that there is no autocorrelation problem in the analysis. Thus, the findings of the economic growth model show that FDI is a vital and significant factor influencing the level of growth in India.

FINDINGS

It is observed from the results of above analysis that TradeGDP, ReservesGDP, Exchange rate, FIN. Position, R&DGDP and FDIG are the main determinants of FDI inflows to the country. In other words, these macroeconomic variables have a profound impact on the inflows of FDI in India. The results of foreign Direct Investment Model reveal that TradeGDP, ReservesGDP, and FIN. Position variables exhibit a positive relationship with FDI while R&DGDP and Exchange rate variables exhibit a negative relationship with FDI inflows. Hence, TradeGDP, ReservesGDP, and FIN. Position variables are the pull factors for FDI inflows to the country and R&DGDP and Exchange rate are deterrent forces for FDI inflows into the country. Thus, it is concluded that the above analysis is successful in identifying those variables, which are important in attracting FDI inflows to the country. The study also reveals that FDI is a significant factor influencing the level of economic growth in India. The results of Economic Growth Model and Foreign Direct Investment Model show that FDI plays a crucial role in enhancing the level of economic growth in the country. It helps in increasing the trade in the international market. However, it has failed in raising the R&D and in stabilizing the exchange rates of the economy.0

The positive sign of exchange rate variables depicts the appreciation of Indian Rupee in the international market. This appreciation in the value of Indian Rupee provides an opportunity to the policy makers to attract FDI inflows in Greenfield projects rather than attracting FDI inflows in Brownfield projects.

Further, the above analysis helps in identifying the major determinants of FDI in country. FDI plays a significant role in enhancing the level of economic growth of the country. This analysis also helps the future aspirants of research scholars to identify the main determinants of FDI at sectoral level because FDI is also a sector – specific activity of foreign firms' vis-à-vis an aggregate activity at national level. Finally, the study observes that FDI is a significant factor influencing the level of economic growth in India. It provides a sound base for economic growth and development by enhancing the financial position of the country. It also contributes to the GDP and foreign exchange reserves of the country.

Thus, we can say Impact of FDI on Indian economy are:-

1. Creates employment opportunity for domestic country.
2. Good relation between two countries.
3. Modern technology.
4. Inflow of foreign funds in Indian economy.
5. To provides the goods and services at best suitable price.
6. It creates the competition among the domestic company and MNC in this way domestic co can increase their efficiency.
7. Indian company get chance to work professional body.
8. Indian company get chance to work with world market Leader Company.
9. Backward area can be developed.
10. Creating good capital market in India.
11. Government earns in the form of licenses fees, registration fees, taxes which is spend for public expenditure.

Problem facing by the MNC's at the time of investing (FDI) in other country

1. Communication problem
2. They will have to find new supplier and distributors.
3. Political problem: for e.g. if any Pakistan company want to invest in Indian market of course they will face problem or difficulty compare to other country
4. Taxation policy of country
5. Exchange rate of home country

CONCLUSIONS

The above review confirms/highlights the following facts:-

- Institutional infrastructure and development are the main determinants of FDI inflows in the European transition economies. Institutional environment (comprising both institutional strategies and policies of organizations relating to these institutions) plays critical role in reducing the transaction costs of both domestic and cross border business activity.
- FDI plays a crucial role in employment generation/ preservation in Central Europe.
- It is found that bigger diversity of types of FDI lead to more diverse types of spillovers and skill transfers which proves more favorable for the host economy.
- It is also found that apart from market size, exports, infrastructure facilities, institutions, source and destination countries, the concept of neighborhood and extended neighborhood is also gaining importance especially in Europe, China and India.
- In industrial countries high labour costs encourage outflows and discourage inflows of FDI. The principle determinants of FDI in these countries are IT – related investments, trade and cross – border mergers and acquisitions. Studies which underlie the effects of FDI on the host countries economic growth shows that FDI enhance economic growth in developing economies but not in developed economies.
- It is found that in developing economies FDI and economic growth are mutually supporting. In other words economic growth increases the size of the host country market and strengthens the incentives for market seeking FDI.
- It is also observed that bidirectional causality exist between FDI and economic growth i.e. growth in GDP attracts
- FDI and FDI also contribute to an increase in output.
- Studies on role of FDI in emerging economies shows that general institutional framework, effectiveness of public sector administration and the availability of infrastructural facilities enhance FDI inflows to these nations. FDI also enhance the chances of developing internationally competitive business clusters
- It is observed that countries pursuing export – led growth strategies reaps enormous benefits from FDI.
- The main determinants of FDI in developing countries are inflation, infrastructural facilities, debts, burden, exchange rate, FDI spillovers, stable political environment etc.
- It is found that firms in cluster gain significantly from FDI in their region, within industry and across other industries in the region.
- It is also observed that FDI have both short – run and long – run effect on the economy. So, regulatory FDI guidelines must be formulated in order to protect developing economies from the consequences of FDI flows.

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