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The Impact of Foreign Direct Investment (FDI) on Indian Economy

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Abstract—*Globalization of any economy means its integration with the world economy. It can be defined as the expansion of economic activities across political boundaries of the nation states. Increasing foreign direct investment can be used as one measure of growing economic globalization. Foreign direct investment plays animportant role in the economic development of the economy by enhancing growth and bringing foreign funds, new technology and skills to the host country. India introduced new economic reforms in July 1991 and adopted LPG (Liberalization, Privatization, and Globalization) Policy. In this policy many restrictions in FDI were reduced, the sectoral caps were raised. FDI was permitted in most of sectors through automatic route, except a few sectors which are of strategic importance.In spite of all measures, FDI inflows in India have remained low in comparison to other emerging economies, especially China, India bagged 7th place in the 2014 Foreign direct investment confidence index (2014 A.T. Kearney foreign direct investment confidence index), a survey conducted by a US consultancy firm A. T. Kearney of more than 300 executives from 28 countries. Main objective of this paper is to find out impact of FDI on Indian Economy since 1991 to till now. In order to find out impact of FDI on Indian economy, Exports, Imports, Employment, National Income of a country and foreign exchange reserves have been taken as dependent variable in the study. For this simple regression and elasticity value have been calculated. Then we conclude that foreign direct investment is an important factor for the economy and it has significant and positive impact on macro variables such as national income, foreign exchange reserves of the country, exports, imports and some extent it is useful for improvement in employment after reforms.*

Keywords: *FDI, Foreign Exchange Reserves, employment, exports, imports, national income and LPG.*

1. INTRODUCTION

Globalization of any economy means its integration with the world economy. It can be defined as the expansion of economic activities across political boundaries of the nation states. Increasing foreign direct investment can be used as one measure of growing economic globalization. Foreign direct investment plays animportant role in the economic development of the economy by enhancing growth and bringing foreign funds, new technology and skills to the host country. India has become the world's third largest economy in terms of purchasing power parity, with gross domestic product of US $ 7277.3 Billion in 2014 ahead of Japan and behind the US and China which hold the top two spots. India's share in world GDP in terms of purchasing power parity was 6.4 percent in 2011 compared with China 14.9 percent and US 17.1 percent (2011 Round of World Bank's international comparison program). At present India enjoys a rating grade of BBB given by Standard & Poor rating Agency. India expects fiscal breach to now be lower and investment to pick up with government big bang reforms (Economic Times of India).

Global FDI inflow's rose by 9 percent to USD 1.45 trillion in 2013. Global FDI will rise to USD 1.6 trillion in 2014, USD 1.75 trillion in 2015 and USD 1.8 trillion in 2016 (UNCTAD Report 2014). FDI inflow's increased in all major economic grouping developed, developing and transition economies.India's FDI inflows has increased 26 percent in 2014 reaching $35 billion, despite macroeconomic uncertainties and financial risks according to an UNCTAD Report. That's much faster than the rest of developing Asia, which saw a growth of about 15 percent across 40 economies.

India is fourth most favoured investment destination in 2014. China has retained its top position as the world's most attractive investment destination followed by the US and Indonesia at second and third place according to the UNCTAD'S World Investment Report 2014. India introduced new economic reforms in July 1991 and adopted LPG (Liberalization, Privatization, and Globalization) Policy. In this policy many restrictions in FDI were reduced, the sectoral caps were raised. FDI was permitted in most of sectors through automatic route, except a few sectors which are of strategic importance. Many new sectors such as mining, banking, telecommunication, highways, construction, airports, hotel and tourism, courier service and management have been opened for FDI. Even Defense sector has opened up to 100 percent for Indian private sector participation with 26 percent FDI, Subject to licensing. FDI has not been permitted in arms and ammunition, atomic energy, railway transport, coal and lignite, mining of iron, manganese, chrome, gypsum, sculpture, gold diamond, copper and zinc. The liberal policies have been accompanied by active courting of foreign investors at the highest level. The international trade policy regime has been considerably liberalized too with removal of quantitative restrictions lowering of peak tariffs to 30 percent and sharp pruning of negative list for imports. The rupee was made convertible on current account and gradually to capital account.

In spite of all measures, FDI inflows in India have remained low in comparison to other emerging economies, especially China, India bagged 7th place in the 2014 Foreign direct investment confidence index (2014 A.T. Kearney foreign direct investment confidence index), a survey conducted by a US consultancy firm A. T. Kearney of more than 300 executives from 28 countries. The 1st, 2nd, 3rd, 4th, 5th and 6th place were bagged by United States, China, Canada, United Kingdom, Brazil and Germany. Similarly in the world investment report of 2014, India ranked 14th among the top 20 global economies receiving the maximum FDI in 2013.

Foreign direct investment (FDI) is a measure of foreign ownership of productive assets, such as factories, mines and land. In other words foreign direct investment (FDI) refers to long term participation by one country to another country. It usually involves participation in management, joint venture, transfer of technology and know-how". Many economists and research scholar have defined FDI. Some of most important definitions are as following:

2. ACCORDING IMF &OCED:-

" FDI reflects the objective of attaining a lasting interest by resident entity in one economy ("Direct investor") in an entity resident in an economy other than that of the investor ("direct investment"). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transactions between the two entities and all subsequent capital transactions between them and amount affiliated enterprises, both incorporated and unincorporated"

According K. Ohno:- "FDI is an international financial flow with the intention of controlling or participating in the management of an enterprise in a foreign country."

According Jeffery P. Graham & Barry Spaulding: - "A Company from one country making a physical investment in building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment."

According Kulwinder Singh: - "FDI is usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depends on the performance of the project financed by the investors. FDI also facilitates international trade and transfer of knowledge, skills and technology".

3. RESEARCH OBJECTIVES OF THE STUDY

(a) To analyze trend and tendency of the foreign direct investment in India.
(b) To find out impact of FDI on Indian Economy.

Research Methodology: The present study is of analytical nature and makes use of secondary data. The relevant secondary data have been collected from various sources i.e. World Investment Reports, Asian Development Bank's Reports, Various Bulletins of Reserve Bank of India, publications from Ministry of Commerce, Govt. of India. It is a time series data and relevant data have been collected for the period 1991 to 2013. In order to find out impact of FDI on Indian Economy, Simple Regression by OLS technique, Elasticity Value have been conducted.

Hypothesis: The study has been taken up for the period 1991 to 2012 with the following hypotheses:

1. Flow of FDI shows a positive trend over period of time (1991to 2013).
2. There is positive impact of FDI on Indian Economy (1991 to 2013).

4. FDI TRENDS IN INDIA

India's share in world FDI has been rising continuously since 2000. The share was only 0.09 percent in 1991 and rose to 3.09 percent in 2009 and 2.74 percent in 2011. India 's share in world FDI was very high in 2009 due to reform in policies, better infrastructure, and more vibrant financial sector. The FDI inflow in India has been increased from Rs. 409 crore in 1991 to Rs. 147518 in 2013. Due to technological up gradation, access to global management skills and practices, optimal utilization of human and natural resources, making Indian industry internationally competitive, opening up, export markets, providing backward forward linkages and access to internationally quality goods and services, Indian government has used many steps to attract more foreign direct investment. The highest amount of FDI was received in the year 2011-12 amounting to Rs. 173947 crore. The highest growth rate of FDI inflows is in the year 2006-07 i.e., 186.9622 percent. The table also found that FDI as a percentage of GDP was less than one until 2005-06 after then it is increasing simultaneous.

Sector-wise classification of FDI is essential to understand better structure and direction of foreign investment in the country. Service sector has been the highest contributor of FDI inflow to India (18%) followed by construction development, townships, housing built-up, infrastructure (11%), telecommunication (6%), Computer software and hardware (6%), and Drugs and Pharmaceutical (5%).

5. IMPACT OF FDI ON INDIAN ECONOMY

Some of following studies are reviewed here with related this study.

Pradeep (2013) in his thesis "Foreign Direct Investment and Industrial development in India" found that Investment or creation of capital, is an important determinant of growth. In combination with other factors of production and technology, investment determines the levels and growth through changes in production and consumption of goods and services.

Deepti (2011) in her book entitled "Foreign Direct Investment in different sectors of Indian Economy" focused on the pros and cons of FDI in India and analyzed it's inflow across various sectors of the economy and suggested measures for increasing FDI and also its judicious use. FDI has worked as an "engine of growth" in the past and in modern era.

M. Gandhi and Dr. G. Prabakaran (2014) in their research article entitled, "Current Scenario of Foreign Direct Investment (FDI) in India found that external resources have played an important role in bridging their saving investment and import-export gaps.**Dr.**

Velu Suresh Kumar and R. Santhi (2014) in their research study entitled "An Analytical Study on Foreign Direct Investment with special reference to industrial development in India" examines the relationship between GDP, Export, FOREX Reserves and FDI by using correlation and regression analyze. According to the results of study, there is relationship between these variables in India significantly. India has become a safe avenue for foreign direct investment in almost all the sectors of the economy. Thus, FDI has helped in boosting our exports by modernizing and diversifying India's industrial structure.

Sapna Hooda (2011) analyzed the impact of FDI on economic growth of Indian economy for the period 1991-92 to 2008-09. She used OLS method for this purpose. The empirical results found that foreign direct investment (FDI) is a vital and significant factor influencing the level of growth in Indian economy.

This paper attempts to measure the macro economic impact of foreign direct investment on six national economic indicators

(a) Impact on national income
(b) Impact on foreign exchange reserves
(c) Impact on Employment
(d) Impact on BOP
(e) Impact on Exports
(f) Impact on Imports

In order to calculate above FDI has been taken as independent variable and the above-mentioned six economic indicators have been taken as dependent variables. Accordingly, there are six regression equations.

6. IMPACT OF FDI ON NNP

It can be inferred from the table 1 foreign direct investments has positive impact on national income after reform and it is statistically significant. So it can be drown that enhancement of national income depend on foreign direct investment. Therefore, there is, need to increase foreign direct investment for economic growth in the country.

Table 1: IMPACT OF FDI ON NNP (1991-2013)

Dependent variable: l_NNP				
	coefficient	**std. error**	**t-ratio**	**p-value**
Const	17032.30	1230.51	13.84	0.00
FDI	19.45	1.85	10.53	0.00
R-squared	0.84			
F(1, 21)	110.95	P-value(F)		7.74E-10

7. ELASTICITY OF FDI IN ENHANCEMENT OF NNP

Table 2 describes that foreign direct investment in inelastic for enhancement of national income which shows that there are many other factors which impact national income then it. The result shows that inelastic demand is statistically significant at 1% level.

Table 2: Elasticity of FDI in respect of National Income

Dependent variable: l_NNP				
	coefficient	**std. error**	**t-ratio**	**p-value**
const	8.97	0.10	90.55	0.00
l_FDI	0.22	0.02	11.55	0.00
R-squared	0.86	Adjusted R-squared	0.86	
F(1, 21)	133.37	P-value(F)	0.00	

8. IMPACT OF FDI IN FER

The conclusion can be drown from the table 3 that role of foreign direct investment is positive in respect to increase foreign reserve and it is too statistically significant.

Table 3: IMPACT OF FOREIGN DIRECT INVESTMENT ON FOREIGN EXCHANGE RESERVE

Dependent variable: l_FER				
	coefficient	**std. error**	**t-ratio**	**p-value**
const	1362.32	506.09	2.69	0.01
FDI	9.86	0.76	12.98	0.00
R-squared	0.89			
F(1, 21)	168.46	P-value(F)	0.00	

The coefficient of determination is good in this model, which shows FDI determines power is good in respect of forex reserve. So foreign direct investment is good for enhancement of forex reserve after reform.

9. ELASTICITY OF FDI IN FER

The table 4 shows that elasticity value of FDI is 0.75, which is inelastic, but it is near to unitary elastic, which shows that FDI is a key factor, which determine the forex reserve. This elasticity also statistically significant. Coefficient of determination is too also very high which shows FDI determine forex reserve.

Table 4: ELASTICITY OF FDI IN ENHANCEMENT OF FOREX RESERVE

Dependent variable: l_FER				
	Coefficient	std. error	t-ratio	p-value
Const	4.19	0.27	15.60	0.00
l_FDI	0.75	0.05	14.50	0.00
R-squared	0.91			
F(1, 21)	210.22	P-value(F)	0.00	

10. IMPACT OF FDI IN EMPLOYMENT

It can be drown from the table 5 that foreign direct investment has no role for enhancement of employment although this ordinary least square method is not appropriate for estimation of employment through foreign direct investment.

Table 5: IMPACT OF FOREIGN DIRECT INVESTMENT FOR ENHANCEMENT OF EMPLOYMENT (1991-2011)

Model : OLS, using observations 1991-2011 (T = 21)				
Dependent variable: Employment				
	coefficient	std. error	t-ratio	p-value
const	272.91	1.75	155.82	0.00
FDI	0.00	0.00	1.43	0.17
R-squared	0.10			
F(1, 19)	2.05	P-value(F)		0.17

11. ELASTICITY OF FDI IN EMPLOYMENT

It is clear from the table 6 that foreign direct investment also play a statistically significant and positive role for improvement in employment but it is too small as show in the table it about perfectly inelastic. The role of foreign direct investment role is small but positive for improvement in the employment.

TABLE 6: ELASTICITY OF FOREIGN DIRECT INVESTMENT FOR EMPLOYMENT (1991-2011)

Dependent variable: l_Employment				
	Coefficient	std. error	t-ratio	p-value
const	5.59	0.01	414.86	0.00
l_FDI	0.01	0.00	2.30	0.03
R-squared	0.22			

12. IMPACT OF FDI ON BOP

It is clear from the table 7 that foreign direct investment also play a statistically significant and positive role improvement in BOP.

Table 7: IMPACT OF FDI ON BOP (1991-2013)

Dependent variable: BOP				
	coefficient	std. error	t-ratio	p-value
const	497.07	249.04	1.996	0.06
FDI	0.02	0.37	0.006	0.95
R-squared	0.0002			
F(1, 21)	0.0043	P-value(F)		0.95

13. ELASTICITY OF FDI IN BOP

It is clear from the table 8 that foreign direct investment also play a statistically significant and positive role for improvement in BOP but it is too small as show in the table it about perfectly inelastic. The role of foreign direct investment role is small but positive for improvement in the employment.

TABLE 8: ELASTICITY OF FOREIGN DIRECT INVESTMENT FOR BOP

Dependent variable: BOP				
	Coefficient	std. error	t-ratio	p-value
const	1.6	1.6	0.10	0.33
l_FDI	0.61	0.31	1.98	0.06
R-squared	0.16			

14. IMPACT OF FDI ON EXPORTS

It can be drawn from table that role of foreign direct investment is positive in respect to increase exports and it is too statistically significant at 5 percent level.

Table 9: IMPACT OF FDI ON EXPORTS (1991-2013)

Dependent variable: l_EXPORTS				
	coefficient	std. error	t-ratio	p-value
const	1036.25	535.98	1.93	0.067
FDI	7.939	0.7865	10.09	2.70E-09
R-squared	0.84			
F(1, 21)	101.89	P-value(F)		2.7E-09

15. ELASTICITY OF FDI IN EXPORTS

It is clear from the table 10 that foreign direct investment also play a statistically significant and positive role for improvement in exports but it is too small as show in the table it about perfectly inelastic. The role of foreign direct investment role is small but positive for improvement in the exports.

TABLE 10: ELASTICITY OF FOREIGN DIRECT INVESTMENT FOR EXPORTS

Dependent variable: l_EXPORTS				
	coefficient	**std. error**	**t-ratio**	**p-value**
const	4.764	0.2515	18.94	3.04E-14
l_FDI	0.61	0.047	13.01	3.21E-11
R-squared	0.89	Adjusted R-squared	0.89	
F(1, 21)	169.29	P-value(F)	3.21E-11	

16. IMPACT OF FDI ON IMPORTS

It is clear from table 11 that FDI has a positive impact on the imports of a country. Investment inflows shows that $R^2 = 0.85$. It shows that 85 percent variation in imports due FDI.

Table 11: IMPACT OF FDI ON IMPORTS (1991-2013)

Dependent variable: Imports				
	coefficient	**std. error**	**t-ratio**	**P value**
const	965.93	840.19	1.149	0.2638
FDI	13.15	1.23	10.66	1.06342E-09
R-squared	0.84			
F(1, 21)	113.70	P-value(F)		1.06342E-09

17. ELASTICITY OF FDI IN IMPORTS

It is clear from the table 12 that foreign direct investment also play a statistically significant at 5 percent level and positive role for improvement in imports but it is too small as show in the table it about perfectly inelastic. The role of foreign direct investment role is small but positive for improvement in the imports.

TABLE 12: ELASTICITY OF FOREIGN DIRECT INVESTMENT FOR IMPORTS

Dependent variable: l_IMPORTS				
	coefficient	**std. error**	**t-ratio**	**p-value**
const	**4.6338**	**0.2822**	**16.4201**	**4.49E-13**
l_FDI	0.690	0.052	13.07	2.96E-11
R-squared	0.90	Adjusted R-squared	0.89	
F(1, 21)	170.823	P-value(F)	2.96E-11	

18. CONCLUSION

It is concluded that foreign direct investment is an important factor for the economy and it has significant and positive impact on macro variables such as national income, foreign exchange rate, exports, imports and forex reserve of the country and some extend it is useful for improvement in employment after reform.

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