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Role of Foreign Direct Investment in the Growth and Development of Indian Economy

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Abstract:
Foreign direct investment is a powerful tool for economic growth of all sectors of any country for strengthening its domestic capital, productivity and help to tackle with unemployment. This paper has been presented to interpret the significance of FDI in the overall growth of Indian economy. The study also covers the trends of FDI (inflow and outflow) in India after liberalization selecting period from 1990 to Feb2012. The data and information have been collected from the secondary source. India, in recent times, has emerged as a preferred location for many foreign international enterprises due to some factors like high economic growth, fast population growth, a large English speaking population and low cost for workers. In 2011, India's public debt stood at 71.42% of GDP which is highest among the emerging economies. Service sector is the highest invested sector of India with 57.2% of country's GDP, whereas industry and agriculture sector contribute 28.6% and 14.6% respectively. When it comes to employment, agriculture accounts for 52 % of employment, service sector for 34% and industrial sector for 14% but the share of agriculture sector in employment has showed a decrease in recent years. According to "Global Manufacturing Competitiveness Index" by Deloitte Touche Tohmatsu and the US Council on Competitiveness, in 2011, India, was ranked 2nd in the world in term of manufacturing capability. During April-December 2010 period, approximately 50 sub-sectors in India's manufacturing sector grew by 39% achieving the "excellent growth" category. In 2009-2010, India's top five trading partners were United Arab Emirates, China, United States, Saudi Arabia and Germany. India has received 18th rank in world with a 20.4 US $ Bn FDI inflows being 1.36% of world total. Now, the time has come for India to realize its capability as a most preferred and major destination for foreign direct investment. In relation to FDI, the paper finds that service sector, manufacturing sector and power sector etc. are the major sectors contributing to the growth of Indian economy particularly the second decade of liberalization immensely positive.

Keywords: Foreign direct investment, India, GDP, liberalization, privatization.

Introduction: Foreign direct investment is a powerful tool for economic overall growth of all sectors of any country for strengthening its domestic capital, productivity and help to tackle with unemployment. India has been put at 77th place in 2010 list of 'The Best Countries for Business' published by Forbes. In recent times, India has emerged as a preferred location for many foreign international enterprises due to some factors like high economic growth, fast population growth, a large English speaking population and low cost for workers. In 2011, India's public debt stood at 71.42% of GDP which is highest among the emerging economies. Service sector is the highest invested in sector of India with 57.2% of country's GDP, whereas industry and agriculture sector contribute 28.6% and 14.6% respectively. When it comes to employment, agriculture accounts for 52 % of employment, service sector for 34% and industrial sector for 14% but the share of agriculture sector in employment has showed a decrease in recent years. India, in 2011, was ranked 2nd in the world in term of manufacturing capability according to " Global Manufacturing Competitiveness Index" by Deloitte Touché Tohmatsu and the US Council on Competitiveness. During April-December 2010 period, approximately 50 sub-sectors in India's manufacturing sector grew by 39% achieving the “excellent growth” category. In 2009-2010, India’s top five trading partners were United Arab Emirates, China, United States, Saudi Arabia and Germany.

The various sectors attracting FDI in India are: (A) Agriculture, Floriculture, Horticulture, development and production of seeds and planting material, animal husbandry, pissiculture, cultivation of vegetables & Mushroom under controlled conditions and services related to agro and allied sectors , tea sector (including tea plantation), (B) Industry of Mining (mining covering exploration and mining of diamonds & precious stones, gold, silver and minerals), coal & lignite mining for captive consumption by power projects and iron & steel, cement production and other eligible activities permitted under the coal mines (Nationalization Act, 1973), mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities,(C) Manufacturing: Alcohol distillation & brewing, coffee & rubber processing & warehousing, defense production, hazardous chemicals, industrial explosives manufacture, drugs and pharmaceuticals including those involving use of recombinant DNA technology, (D) Power (power including generation), (E) Services (Airports, ground handling services, maintenance and repair organizations, assets, reconstruction companies, banking private & public sector, broadcasting, commodity exchanges, development of townships, housing, built up infrastructure and construction development projects, courier services, credit information companies (CIC), Insurance, Investing companies in infrastructure/services sector, Non-banking finance companies like merchant banking, underwriting, venture capital, housing finance, micro and rural credit, (F) Petroleum and Natural gas sector, refining, print media publishing of newspapers and periodicals, telecommunication, trading, satellite, special economic zones and free trade warehousing zones etc.

Need and Importance of the Study

India is now considered as the most preferred destination for FDI and FDI is boosting the growth of Indian Economy which shows a large share in the growing GDP of India. FDI is considered to be the most attractive type of capital flow for emerging economies as it brings latest technology and enhance production capabilities of the economy.

The study covers the trends of FDI (inflow and outflow) in India after liberalization period from 1990 to Feb2012. The paper is prepared with the aim of representing growth of FDI in India and its significance in various sectors of Indian economy which will provide a base for policy makers in the future.

Objectives of the Study:

- To study the FDI (inflows and outflows) in India in post liberalization period from 1990 to Feb 2012.
- To analyse the trends and interpret the importance of FDI in Indian economy
- To adjudge the contribution of various sectors in the field of FDI in India.

Methodology of the Study

The study is based on secondary sources of data. The main sources of data are journals, articles, newspapers, online data base of Indian economy, RBI policies and Bulletins, various economic surveys etc. To analyse the data, different statistical tools have been applied with the help of tables, diagrams etc.

Review of Literature

Foreign direct investment (FDI) is generally of two types, outward FDI and inward FDI. Investment made by a country in other countries is outward FDI whereas investment made by other countries in that country is called as inward FDI. In India, Govt. of India formulated and announces the FDI policy. The Department of Industrial policy and promotion, Ministry of Commerce and Industry, Govt. of India issue a "Consolidated FDI Policy Circular" on an half yearly basis on March 31 and September 30 for defining the policy and process in respect of FDI in India. In addition to these circulars, various research papers and reports have been reviewed.

Entrance for Investment in India

According to Foreign Direct Investment (FDI) Department, the investment can be made in shares, mandatorily and fully convertible debentures and mandatorily and fully convertible preference shares of an Indian company by non-residents. FDI scheme approves two ways of FDI (a) Automatic Route, (b) Government Route.

(a) **Automatic Route:** When foreign investor or the Indian company does not require any approval from RBI or Govt. of India, so called investment comes under automatic route.

(b) **Government Route:** Under Govt. route, foreign investor or the Indian company should obtain prior approval of Govt. of India, Ministry of Finance, foreign investment promotion board for investment.

FDI in India (in USD Billion)

Year	Inflows	Outflows
1990	-	-
1991	0.075	-
1992	0.252	-
1993	0.532	-
1994	0.974	0.083
1995	2.145	0.117
1996	2.523	0.239
1997	3.619	0.012
1998	2.633	0.048
1999	2.168	0.079
2000	3.585	0.510
2001	5.472	1.398
2002	5.627	1.679
2003	4.323	1.879
2004	5.771	2.179
2005	7.606	2.978
2006	20.336	14.344
2007	25.483	17.281
2008	43.4	19.257
2009	35.6	15.928
2010	24.6	14.649
2011	20.56	10.95
2012	20.65	11.82

FDI as a Share of GDP in India

Year	Inflows	Outflows
1990	-	-
1991	0.0%	-
1992	0.1%	-
1993	0.2%	-
1994	0.3%	0.0%
1995	0.6%	0.0%

1996	0.7%	0.1%
1997	0.9%	0.0%
1998	0.6%	0.0%
1999	0.5%	0.0%
2000	0.7%	0.1%
2001	1.1%	0.3%
2002	1.1%	0.3%
2003	0.7%	0.3%
2004	0.8%	0.3%
2005	0.9%	0.4%
2006	2.2%	1.6%
2007	2.2%	1.5%
2008	3.4%	1.5%
2009	2.8%	1.3%
2010	1.6%	1.0%
2011	2.0%	0.7%
2012	1.3%	0.4%

Source: OECD International direct investment database, Eurostat IMF OECD/DAF- Investment Division.

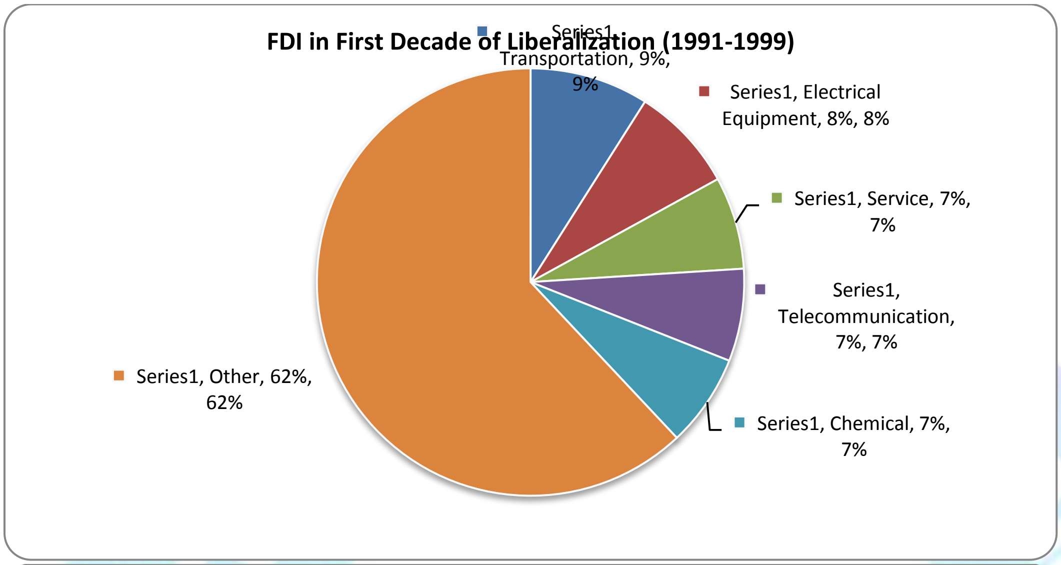
The trend of FDI inflows and outflows in India is having an increasing rate. Starting from a baseline of less than $1 billion in 1990, and now according to a recent UNCTAD survey, India is considered as the second most important FDI destination for transactional corporations during 2010-Feb2012. India has received 18th rank in world with a 20.4 US $ Bn FDI inflows being 1.36% of world total (Source: Economist Intelligence Unit).

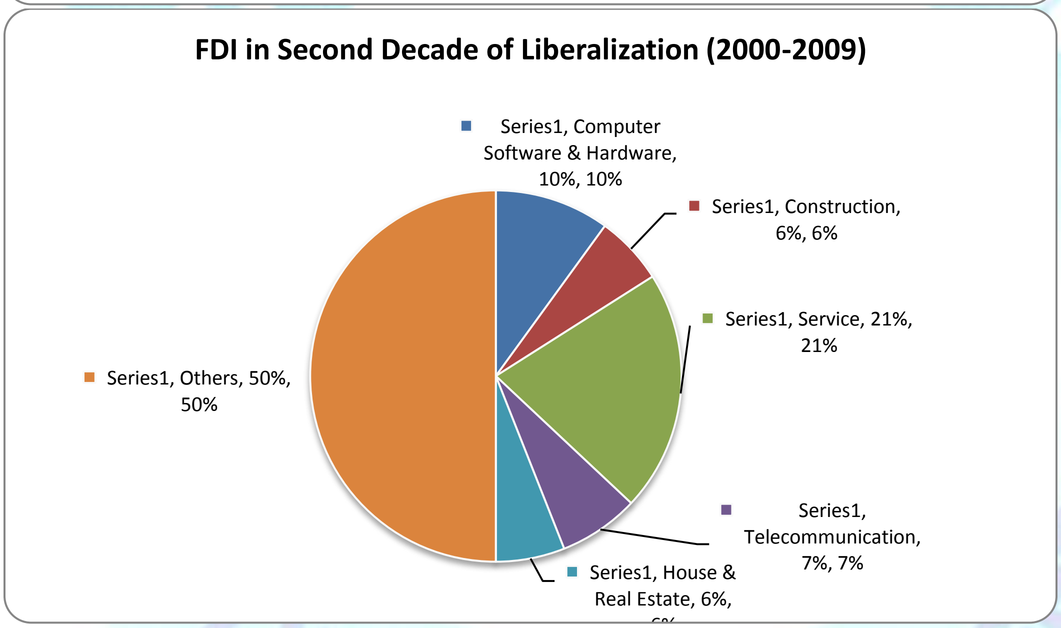
County wise Cumulative FDI Inflows

Name of Country	Cumulative FDI Inflows, Aug. 1991 to July 2007 (US $ Millions)	Share of FDI inflows, August 1991 to July 2007 (percent)
Mauritius	20,808	41.9
US	6,215	12.0
UK	3,979	8.0
Netherlands	2,789	5.6
Japan	2,585	5.1
All others	13,297	27.4
Total	49,673	100

Source: GOI (2007)

Sector-wise FDI





Source: RBI Manual 2010

Industry and Service Sector:

India has one of the world's fastest growing automobile industries Tata Nano the world's cheapest car. Industry accounts for 28% of GDP.

Textile manufacturing is the second largest sector of employment after agriculture and accounts for 20% of manufacturing output, providing employment to over 20 million people. After freeing the industry from a number of limitations, primarily financial, during 2004-05, total investment amounted to 27 Billion dollars. By 2012 it is expected to reach at 38 billion, creating an additional sector of more than 17 million jobs.

Service sector contributes the biggest share in the country's GDP. In 2009, seven Indian firms were listed among the top 15 technology outsourcing companies in world.

Mining is an important segment to Indian economy. India produces 79 different minerals.

The above stated two sectors (industry and service) currently are contributing the most to Indian GDP. In 2009, service sector contributed 69.78 of total % of FDI inflows.

Agriculture Sector:

India is able to achieve second rank worldwide in farm output despite a steady decline of its share in GDP. Agriculture and allied sectors like forestry, floriculture, horticulture, animal husbandry, development and production of seeds and planting material and fishing accounted for 15.7% of GDP in 2009-10, employment 52.1% of total work force. India's inland water resources including rivers, canals, ponds, lakes and marine resources comprising the east and west coasts of Indian Ocean and gulfs and bays provide employment to nearly 6 million people in fisheries sector in India.

Besides, India is the largest producer in the world of milk, jute and pulses. In 2008, India had the world's second largest cattle population with 175 million animals in 2008. Indian States, Uttar Pradesh, Haryana, Punjab, Madhya Pradesh, Maharashtra are the key agricultural contributing States of India.

FDI Equity Inflows on the basis of Region
(January 2000 to July 2007)

Rank	RBI Regional Office	States Covered	FDI Inflows (US $ in Millions)	Share of total (percent)
1	Mumbai	Maharashtra, Dadra & Haveli, Daman & Diu	9,594.6	24.64
2	New Delhi	Delhi, Parts of UP and Haryana	9,194.2	23.55
3	Bangalore	Karnataka	2,824.2	7.21
4	Chennai	Tamil Nadu, Pondicherry	2,774.7	7.17
5	Hyderabad	Andhra Pradesh	1,509.8	3.88
6	Ahmadabad	Gujarat	1,092.9	2.85
7-16	All others		11,838.1	30.49
Total			38,828.5	

Source: GOI (2007)

Energy and Power Sector:

In 2009, total FDI inflow in energy sector was 2137.60 $ mn in India. India was the fourth largest producer of electricity and oil products and the fourth largest importer of coal and crude-oil in the world. Coal and oil together accounts 66% the energy consumption of India. India's oil reserves meet 25% of country's domestic oil demand. In 2010, India imported about 70% of its crude oil requirements. Oil and natural gas fields are located offshore at Mumbai High, Krishna Godavari Basin and the Cauvery Delta, and onshore largely in States of Assam, Gujarat and Rajasthan. India is the fourth largest consumer of oil in the world. The petroleum industry in India mostly consists of public sector companies such as oil and Natural Gas Corporation (ONGC), Hindustan Petroleum Corporation Limited (HPCL) and Indian Oil Corporation Limited.

Major Private Indian companies in oil sector such as Reliance Industries Limited (RIL) which operates the world's largest oil refining complex. India meets most of the domestic energy demand through its coal reserves. India's dwindling uranium reserves stagnated the growth of nuclear energy in country for many years. However, the India-US nuclear deal has paved the way for India to import uranium from other countries.

Manufacturing: Major segments of manufacturing sector are automobile industry, electrical equipment, metallurgical industries and chemical etc. FDI stocks and production are reinforcing the domestic manufacturing sector. India gets second rank in the world in terms of manufacturing capabilities, according to the "2010 Global manufacturing index" by Deloitte Touché Tohmatsu and US Council of Competitiveness. During April-December 2010 period, approximately 50 sub-sectors in India's domestic manufacturing sector grew by 39%, achieving "the excellent growth" category. Industries such as utility vehicles, crude oil, power transformers, energy meters, alcoholic beverages and textiles machinery have registered around 10-20% growth.

India is rapidly growing as a worldwide manufacturing hub with a huge number of companies changing manufacturing base to country. The Govt. has defined the news "Consolidated Foreign Direct Investment Policy" which came into effect from April, 2010.

Retail: By allowing FDI in retail trade, India will significantly flourish in terms of quality standards and consumer expectation, since the inflow of FDI in retail sector is bound to pull up the quality standards and cost competitiveness of Indian procedures in all segments. The international brands such as Wal-Mart, Carrefour, Metro, IKEA share the view and insist on a clear path towards 100% opening up in near future. Informed opinion is also supporting FDI in retail. According to a recent study by apex Chamber of Commerce (Assocham), 90% the customers are for FDI in retail.

Infrastructure:

India has the world's third largest road network. Indian railway is the fourth largest rail in the world. India has a national teledensity rate of 74.15% with 926.53 million telephone subscribers in Dec. 2011 in India. Infrastructure includes segments like housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure.

FDI in pension fund management companies will increase the volume of assets that can be invested in infrastructure. India needs approximately one trillion dollars for infrastructure investment in 12th Plan (2012-2017). If pension funds are diverted to infrastructure projects, they bring long-term income stream, stability, low default rates and social benefits. Only 12% of working population in India is covered by some form of retirement benefit. The population above 60 yrs. of age by 2030 will approach 200 million.

Sector- wise FDI inflows in 2009

Sector	Inflows (US $ mn)	Share of (%) Total
(1) Service Sector (total)	18,871.6	69.78
• Housing, real Estate & construction	5,658.40	20.82
• Telecommunication	2,557.65	9.50
• Agriculture	1,307.37	4.84
• Information & Broadcasting (including print media)	782.77	2.90
• Computer software	688.30	2.55
(2) Manufacturing (total)	5,791.21	21.41
• Automobile industry	1,338.38	4.94
• Electrical Equipments	787.56	2.91
• Metallurgical Industries	470.73	1.74
• Chemical (other than fertilizer)	451.36	1.69
(3) Energy	2,137.60	7.90
(4) Others	243.73	0.91
Total	**27,044.14**	**100**

Source: Based on data available in SIA newsletter, January 2010.

FDI Trend in India

During January-April, 2011, FDI into India declined by a percent to $ 6.51 bn. In September and October 2011, the inflows were down by 16.5% and 50% year on year respectively. But, in November 2011, FDI into India went up by 56% to $ 2.53 bn, indicating an improvement in investor sentiment. Sectors which attracted the maximum funds include services, construction, power, computer, telecommunication, real estate etc. Figures for the first three quarters of 2011 are as:

	Inflow	Outflow (in USD million)
Quarter I 2011	4,874	4,297
Quarter 2 2011	13,335	5,404
Quarter 3 2011	7,248	2,898

Source: OECD international direct investment database, eurostat IMF.

Forecast of FDI for 2012 in India

	Year 2012
Inward direct investment (US $ billion)	60
Inward direct Investment (% of GDP)	2.3
Inward direct Investment (% of gross fixed investment)	5.7
Outward direct investment (US $ in billions)	35.0
Net foreign direct investment (US $ billion)	25.0
Stock of foreign direct investment (US $ billion)	301.2
Stock of foreign direct investment per head (US $)	254
Stock of foreign direct investment (% of GDP)	11.4
Share of world inward direct investment flows (%)	4.24
Share of world inward direct investment stock (%)	1.57

Source: Economist Intelligence Unit (EIU)

The figures above show that India is now considered the best destination for FDI. Second decade of liberalization has showed a tremendous increasing trend. The development is to have a positive effect on rupee in foreign exchange market. It will further strengthens the Indian economy.

Findings

- FDI is an important factor for the growth of Indian economy.
- Major sectors contributing in FDI in India are service sector, manufacturing sector and power sector etc.
- Trend of FDI in second decade of liberalisation is immensely positive.
- If the growth continues, India will soon become the first most preferred destination for FDI.

Conclusion

Capital investment and human resources are the pivots of development of a country. FDI takes better technology, more employment and growth for economy with it. In the post liberalization age, India is able to achieve a huge amount of FDI in a variety of sectors, India's workforce of scientists, researchers, engineers, English-speaking people and democratic regime make it an attractive destination for FDI. And the trend of FDI in second decade of liberalization is greatly satisfactory. The crucial test for India is to move the FDI to a consistent upward trend.

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