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A Study On The Role Of Foreign Direct Investment (FDI) In Economic Growth

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Abstract

Ever since the economic reforms and the open door policy of 1978, China has experienced a dramatic industrialization. The Chinese government, heavily influenced by Communist values, recognized the need to open up to international trade and become more of a capitalistic country. Hence, reduced trade barriers followed with the economic reform, which has made foreign direct investment increase rapidly. The country made a desired commitment by entering the World Trade Organization, WTO in 2001. The expected consequences were a more rapid development of industries and increasing competition, because of even fewer restrictions on foreign investment. There are a lot of reasons for writing this thesis about China. The country is today an economic giant with a growth in real GDP of on average nine percent per year since 1981 and exceeding 10 percent in recent years. If this growth rate persists, the World Bank is expecting China to become the largest economy in the world in the near future. China has developed clear policies to enhance an export processing type of FDI and has therefore set up several economic zones for foreign investors. For China, this becomes a clear advantage when it comes to attracting FDI, and according to the UN Conference on Trade and Development, China surpassed the United States as the world's largest recipient of FDI for the first time in 2002. Foreign direct investment (FDI) policies play a major role in the economic growth of developing countries around the world. Attracting FDI inflows with conductive policies has therefore become a key battleground in the emerging markets. The prospect of new growth opportunities and outsized profits encourages large capital inflows across a range of industry and opportunity types. And this has led to competition among the states in formulating flexible policies and providing incentives to woo private investors to invest more and more.

Keywords: Economic, Growth, Development, FDI, States

Introduction

Today, in the era of globalization and liberalization, FDI is looked upon by the countries (both developed and developing) as an engine for raising the economic growth and development. As per the available studies and researches FDI envelops with it many advantages. They are: • new capital inflow and technology, • increased competitiveness • transfer of knowledge and skills, • increase in overall productivity, managerial efficiency, • creates more employment opportunities. All these are very useful tools for an all round development and future of any country. FDI engulfs with it the process of dynamism which is a very important component for the economic development and growth of a country. India has emerged as a major recipient of FDI in South Asia after China. Though we cannot compare the FDI inflows in China to that of India, as China is much ahead of us and we have to still burn midnight oil to get maximum FDI in our country. Indian economy is moving, it will sooner transform from a developing country to a developed country. And this road to transformation will need huge amount of resources (both financial and managerial). Under this transformation process, Foreign Direct Investment remains the most convenient and effective option for financial resources in India. Hence, Foreign Direct Investment can be defined as a financial process of incoming of capital from a country outside the political boundaries of a nation. This capital inflow which increases the production capacity of various sectors of the economy is termed as Foreign Direct Investment. According to the Planning Commission, FDI is "usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. FDI also facilitates international trade and transfer of knowledge, skills and technology." It is the duty of the government of a country to formulate, implement and administer the FDI policies. To a large extent the size and amount of FDI inflows in any country depends upon its macroeconomic policies.

Initially, India followed a restrictive FDI policy before the economic reforms. But after the economic reforms it has liberalized the FDI policy regime. Hence, the economic reforms of 1991 have worked actively in the process of getting FDI inflows in India. Further in 1995 with the introduction of disinvestment in the public sector industries and encouragement to privatization followed by liberalization of the FDI policies, increased the total amount of FDI inflow in India. From the available data it appears that most of the FDI in India has gone to the richer states and a meager or nothing is left for the poorer states.

The growth and boost in productivity of the Indian states from 2000 to 2006 is very much attributed to FDI inflows. Some of the states in India which have witnessed a massive upsurge in FDI inflows include Delhi (US$ 6,780 million), Maharashtra (US$ 5,650.1 million), Karnataka (US$ 1,876.1 million), and Tamil Nadu (US$ 1,876.1 million). Other states which are in the receipt of FDI Inflows in India include West Bengal, Gujarat, Haryana, Andhra Pradesh, Kerala, and Uttar Pradesh. (With reference to the website of Business Maps of India) States like Jharkhand and Bihar have not attracted enough FDI when compared with other states. The main reason can be the Naxalite activities in state or the level of corruption into the working system and insecure social atmosphere. Moreover, it is the perception of governance in these states which hinders foreign inflow of funds. The governance in these states is not much concerned about the development of the state, concern is more on filling and keeping packed once own pocket.

Objectives

- To analyze the growth of Indian states in context of FDI inflow.
- To study the factors contributing to the flow of FDI in a particular state.

Review of Literature

- **Singh J. (2010),** In the context of increasing competition among nations and subnational entities to attract Foreign Direct Investment (FDI), the present paper tries to analyze the emerging trends and patterns of FDI inflows into India in response to various policy measures announced by the Government of India since mid-1980 and later. The empirical analysis tends to suggest that the FDI inflows, in general, show an increasing trend during the post-reform period. Furthermore, country-wise comparison of FDI inflow also indicates that FDI inflow into India has increased considerably in comparison to other developing economies in the recent years. Thus, the study indicates that the FDI inflows into India responded positively to the liberalization measures introduced in the early 1990s.
- **John W. (2010),** This study found that foreign Invested Enterprises (FIEs), enterprises account for over 50% of China's exports and 60% of China's imports. Their share in Chinese GDP has been over 20% in the last two years, but they employ only 3% of the workforce, since their average labor productivity exceeds that of Non-FIEs by around 9:1. Their production is more heavily for export rather than the domestic market because FIEs provide access to both distribution systems abroad and product design for export markets. China's FIEs may have contributed over 40% of China's economic growth in 2003 and 2004, and without this inward FDI, China's overall GDP growth rate could have been around 3.4 percentage points lower.
- **Singh, Shikha (2009),** This study stated that foreign direct investment (FDI) policies play a major role in the economic growth of developing countries around the world. Attracting FDI inflows with conductive policies has therefore become a key battleground in the emerging markets. The prospect of new growth opportunities and outsized profits encourages large capital inflows across a range of industry and opportunity types. And this has led to competition among the states in formulating flexible policies and providing incentives to woo private investors to invest more and more. In the light of the above the paper highlights the trend of FDI in India after the economic reforms, sector-wise and country-wise share of FDI, the manner in which FDI has effected the growth of Indian states. Various factors which play a significant role in attracting FDI into a particular state are also examined. Efforts made by the state governments in order to attract maximum FDI are also studied.

Foreign Direct Investment (FDI)

Any investment from an individual or firm that is located in a foreign country into a country is called Foreign Direct Investment.

- Generally, FDI is when a foreign entity acquires ownership or controlling stake in the shares of a company in one country, or establishes businesses there.
- It is different from foreign portfolio investment where the foreign entity merely buys equity shares of a company.
- In FDI, the foreign entity has a say in the day-to-day operations of the company.
- FDI is not just the inflow of money, but also the inflow of technology, knowledge, skills and expertise/know-how.
- It is a major source of non-debt financial resources for the economic development of a country.
- FDI generally takes place in an economy which has the prospect of growth and also a skilled workforce.
- FDI has developed radically as a major form of international capital transfer since the last many years.
- The advantages of FDI are not evenly distributed. It depends on the host country's systems and infrastructure.
- The determinants of FDI in host countries are:
  - Policy framework
  - Rules with respect to entry and operations/functioning (mergers/acquisitions and competition)
  - Political, economic and social stability
  - Treatment standards of foreign affiliates
  - International agreements
  - Trade policy (tariff and non-tariff barriers)
  - Privatisation policy

FDI in India

The investment climate in India has improved tremendously since 1991 when the government opened up the economy and initiated the LPG strategies.

- The improvement in this regard is commonly attributed to the easing of FDI norms.
- Many sectors have opened up for foreign investment partially or wholly since the economic liberalization of the country.
- Currently, India ranks in the list of the top 100 countries in ease of doing business.
- In 2019, India was among the top ten receivers of FDI, totalling $49 billion inflows, as per a UN report. This is a 16% increase from 2018.

- In February 2020, the DPIIT notifies policy to allow 100% FDI in insurance intermediaries.
- In April 2020, the DPIIT came out with a new rule, which stated that the entity of nay company that shares a land border with India or where the beneficial owner of investment into India is situated in or is a citizen of such a country can invest only under the Government route. In other words, such entities can only invest following the approval of the Government of India
- In early 2020, the government decided to sell a 100% stake in the national airline's Air India. Find more about this in the video below:

FDI Routes in India

There are three routes through which FDI flows into India. They are described in the following table:

Category 1	Category 2	Category 3
100% FDI permitted through Automatic Route	Up to 100% FDI permitted through Government Route	Up to 100% FDI permitted through Automatic + Government Route

Automatic Route FDI

In the automatic route, the foreign entity does not require the prior approval of the government or the RBI.

Examples:

- Medical devices: up to 100%
- Thermal power: up to 100%
- Services under Civil Aviation Services such as Maintenance & Repair Organizations
- Insurance: up to 49%
- Infrastructure company in the securities market: up to 49%
- Ports and shipping
- Railway infrastructure
- Pension: up to 49%
- Power exchanges: up to 49%
- Petroleum Refining (By PSUs): up to 49%

Government Route FDI

Under the **government route**, the foreign entity should compulsorily take the approval of the government. It should file an application through the Foreign Investment Facilitation Portal, which facilitates single-window clearance. This application is then forwarded to the respective ministry or department, which then approves or rejects the application after consultation with the DPIIT.

Examples:

- Broadcasting Content Services: 49%
- Banking & Public sector: 20%
- Food Products Retail Trading: 100%
- Core Investment Company: 100%
- Multi-Brand Retail Trading: 51%
- Mining & Minerals separations of titanium bearing minerals and ores: 100%
- Print Media (publications/printing of scientific and technical magazines/speciality journals/periodicals and a facsimile edition of foreign newspapers): 100%
- Satellite (Establishment and operations): 100%
- Print Media (publishing of newspaper, periodicals and Indian editions of foreign magazines dealing with news & current affairs): 26%

Sectors where FDI is prohibited

There are some sectors where any FDI is completely prohibited. They are:

- Agricultural or Plantation Activities (although there are many exceptions like horticulture, fisheries, tea plantations, Pisciculture, animal husbandry, etc.)
- Atomic Energy Generation
- Nidhi Company
- Lotteries (online, private, government, etc.)
- Investment in Chit Funds
- Trading in TDR's
- Any Gambling or Betting businesses
- Cigars, Cigarettes, or any related tobacco industry
- Housing and Real Estate (except townships, commercial projects, etc.)

Conclusion

The impact of FDI can vary depending on the factors such as the host country's institutional capacity, regulatory environment, and level of economic development. Countries must have a well-designed investment policy that balances the benefits and risks associated with FDI. These policies should be aimed at maximizing the benefits for the country's economies while minimizing external costs. FDI has the potential to be a valuable investment plan for economic development. However, governments must adhere to several rules and regulations and make sure FDI is compatible with the nation's development goals.

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