International Journal of Engineering Technology Science and Research
IJETSR
www.ijetsr.com
ISSN 2394 – 3386
Volume 5, Issue 1
January 2018

Foreign Direct Investment (FDI) in India

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ABSTRACT:
FOREIGN DIRECT INVESTMENT(FDI). has been an important component of capital flows in financial globalization. Though the vast literature lacks consensus on the benefits of financial globalization, FDI is believed to be one of the most important channels through which financial globalization benefits an economy. FDI is also the least volatile form of capital flows making countries less vulnerable to sudden stops or reversals of flows. FDI provides a situation where in both the host and the home nation is benefited. The home countries want to take the advantages of the vast markets opened for industrial growth and the hosts countries acquire resources like finance, capital labor and incentives provided by home nations which help in supplementing home savings and earn foreign exchange. Thus, all countries seek to attract FDI given their importance with a view to reaping benefits for competitiveness,economic performance, growth and development. FDI from developing countries like India have become remarkable. This phenomenon (i.e. FDI) in the developing country's firms has succeeded in global market places and has elevated their positions from being domestic market players to global market players.

FDI IN INDIA- NEED, IMPACTS AND POLICIES

"FDI is a responsibility for Indians & an opportunity for the world. My definition of FDI for people of India is 'First Develop India'.

-Narendra Modi

Introduction:

Foreign Direct Investment is the major monetary source for economic development in India. Foreign companies invest directly in the fast growing Indian businesses to take benefits of cheaper wages and changing business environment of India. The 3rd phase of the Indian economy i.e. the economic liberalization policy in 1981 has steadily increased the growth of FDI in India. It was Manmohan Singh and P.V Narsimha Rao who brought FDI in India which generated more than 1cr. Jobs. In 20015, India overtook China and US as the top destination for FDI.in the 1st half of 2015, India attracted investment of $31billion compared to $28 billion and $27billion of China and US resp.

KEY WORDS : Liberalization, portfolio investment, Make in India.

<u>What is FDI- DEFINITION</u>

'A foreign direct investment (FDI) is an investment in the form of a controlling ownership in a business in one country by an entity based in another country. It is thus distinguished from a foreign portfolio investment by a notion of direct control'

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The above definition implies the following points to be noted:

- FDI involves participation in management, joint-venture, transfer of technology and expertise.
- The investment may be made either by buying a company in the target country or by expanding the operations of an existing business in that country.
- Direct investment excludes investment through purchase of shares.
- FDI can be financed through loans obtained in the host country, payments in exchange for equity (patents, technology, machinery etc.), and other methods

NOTE:

Foreign direct investment is distinguished from foreign portfolio investment, a passive investment in the securities of another country such as public stocks and bonds, by the element of "control".

EMERGENCE OF FDI- HISTORY

The reasons behind Foreign Direct Investment and Multinational Corporations were explained by neoclassical economics based on macro-economic principles. These theories were based on the classical theory of trade in which the motive behind trade was a result of the difference in the costs of production of goods between two countries, focusing on the low cost of production as a motive for a firm's foreign activity.

NEOCLASSICAL ECONOMICS:

Neoclassical theory is an approach to economics focusing on the determination of goods, outputs, and income distributions in market through supply and demand. This determination is often mediated through hypothesized maximization of utility by income-constrained individuals and of profits by firms facing production costs and employing available information and factors of production, in accordance with rational choice theory. Neoclassical economics dominates microeconomics, and together with Keynesian economics forms the neoclassical synthesis which dominates mainstream economics at present.

NEED FOR FDI IN INDIA

SCENARIO OF INDIAN ECONOMY BEFORE LIBERALIZATION

- Before liberalization in 1991, the government attempted to close the Indian economy to the outside world.
- The Indian currency was inconvertible and high tariffs and import licensing prevented foreign goods reaching the Indian markets.
- The license raj often led to absurd restrictions- up to 80 agencies had to be satisfied before a firm could be granted a license to produce and the state would decide what was produced, how much , at what price and what sources of capital were used.
- India needed to rely internal markets for development, not international trade.
- Government emphasized on agriculture than industrialization.

SCENARIO OF INDIAN ECONOMY POST LIBERALIZATION

- The reforms progressed furthest in the areas of opening up to foreign investment .
- Liberalization has done away with the license raj and ended many public monopolies, allowing automatic approval of FDI in many sectors.
- Government's goals were reducing the fiscal deficit, privatization of public sector and increasing investment in infrastructure.
- Government emphasizes more on industrialization than agriculture.

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THEREFORE, INIDA NEEDED FDI FOR REASONS SUCH AS;

- Sustaining high level of investment for development
- Fulfill the technological gap
- Exploitation of natural resources
- Development of economic infrastructure

TYPES OF FDI IN INDIA

- **NRI DEPOSITS**:
- It is the form of capital flowing into India which are made in profitable foreign currency accounts.
- **PORTFOLIO FLOW OF CAPITAL:**
- Portfolio flows of capital are made by institutional foreign investors that make investments in India's debt and stock markets.
- **INVESTMENTS MADE IN COMMERCIAL BANKS:**
- his refers to investments made by foreign banks in India.
- **PRIVATE FOREIGN INVESTMENT:**
- It refers to investors either setting up a branch or a subsidary in the host country.
- **FOREIGN AIDS:**
- It refers to all official grants and concessional loans in currencies which are broadly aimed at transferring resources from developed countries to less developed nations on development grounds.

IMPACTS OF FDI IN INDIA

After independence in India 1947, FDI gained attention of many policy makers for acquiring advanced technology and to mobilize foreign exchange resources. In order to boost FDI inflows in the country, Indian government started allowing foreign enterprises to invest in equity market and started providing many incentives such as tax concessions, simplification of licensing procedures and de-reserving some industries like drugs, fertilizers etc. But due to significant flow of foreign reserves in form of remittances of dividends, profits, royalties etc. in 1993, the government of India set up Foreign Investment Promotion Board(FIPB) in order to regulate flow of FDI in India. The board is the apex inter-ministerial body of the government that deals with proposals relating to FDI into India for projects or sectors that do not qualify for automatic approval by RBI or are above the parameters of the existing FDI policy.

It could be observed that there has been a steady build up in the actual FDI inflows in the pre-liberalization period in table-1 .But measures introduced by the government to liberalize

Provisions relating to FDI in 1991 increased FDI Rs.2705 cr. in 1990 to Rs.123378 cr. in 2010. The list of investing countries to India reached to 150 in 2010 as compared to 29 countries in 1991.

Amount of FDI	Mid 1948	March 1964	March 1974	March 1980	March 1990	March 2000	March 2010	March 2013-2017
In cr.	256	565.5	916	933.2	2705	18486	123378	4020000

The top 5 countries that have remarkably invested in the Indian sub-continent are:

RANKS	**COUNTRY**
1	MAURITIUS
2	SINGAPORE
3	U.S.A
4	U.K
5	NETHERLANDS

The growth of FDI gives opportunities to Indian industry for technological up gradation, gaining access to global managerial skills and practices, optimizing utilization of human and natural resources and competing internationally with higher efficiency.Despite India offering a large domestic market and low labor costs due to restricted FDI regime, high imports tariffs, exit barriers for firms, stringent labor laws, poor quality infrastructure, centralized decision making processes and a very limited scale of export processing zones make India an unattractive investment location.Since the economic liberalization policy in 1991, the FDI inflow in India in-depth in the last few decades makes the country progress in both quantity and the way it has attracted FDI. It can be said that government should keep simplifying and relaxing entry barriers for business activities and providing investor friendly laws and tax system for foreign investors. At the same time, a restriction related to the track record of Sub-Accounts is also to be made on the investors who withdraw money out of the Indian stock market who have invested with the help of participatory notes. We have to modernize and also have to save our culture. Similarly the laws should be such that it protects domestic investors and also promote trade in country through FDI.

GOVERNMENT INITIAVTIVES IN FDI

The Government of India has amended several policies to increase the flow of FDI in India in the year 2014. It has launched Make in India initiative in September 2014 under which FDI policy for 25 sectors was liberalized. For e.g. The government has increased the upper limit from 29% to 49% in insurance sector.

MAKE IN INDIA-2014

The major objective behind the initiative is to focus on job creation and skill enhancement in 25 sectors of the economy. The initiative also aims at high quality standards and minimizing the impact on the environment. It hopes to attract capital and technological investment in India.

A few sectors covered under make in Initiative are automobiles and its components, aviation, biotechnology, chemicals, construction, defence manufacturing, electrical machinery and systems, food processing, oil and gas, tourism etc.

As per the new govt. policy 100% FDI is permitted in the 25 sectors of make in India campaign except for space-74%, defence-49%, and news media-26%.

MAJOR SECTORS ATTRACTING FDI IN INDIA

During 2014–15, India received most of its FDI from Mauritius, Singapore, Netherlands, Japan and the US. On 25 September 2014, Government of India launched Make in Indiainitiative in which policy statement on 25 sectors were released with relaxed norms on each sector.Following are some of major sectors for Foreign Direct Investment.

Infrastructure

10% of India's GDP is based on construction activity. Indian government has plans to invest $1 trillion on infrastructure from 2012–2017. 40% of this $1 trillion is to be funded by private sector. 100% FDI under automatic route is permitted in construction sector for cities and townships.

Automotive

FDI in automotive sector was increased by 89% between April 2014 to February 2015. India is 7th largest producer of vehicles in the world with 17.5 million vehicles annually. 100% FDI is permitted in this sector via automatic route. Automobiles shares 7% of the India's GDP.

Manufacturing

India is making progress turning itself into a magnet for manufacturers, the aim being to increase the share of manufacturing in India’s GDP from a stagnant 15-16% since 1980 to 25% by 2022 and creates an additional 100 million jobs. Electronics contributes to India's success in manufacturing but some challenges remain with foreign direct investment.

Pharmaceuticals

Indian pharmaceutical market is 3rd largest in terms of volume and 13th largest in terms of value. Indian Pharma industry is expected to grow at 20% compound annual growth rate from 2015 to 2020.100% FDI is permitted in this sector.

Service

FDI in service sector was increased by 46% in 2014–15.It is US $ 1.88Bl in 2017. Service sector includes banking, insurance, outsourcing, research & development, courier and technology testing. FDI limit in insurance sector was raised from 26% to 49% in 2014.

Railways

100% FDI is allowed under automatic route in most of areas of railway, other than the operations, like High speed train, railway electrification, passenger terminal, mass rapid transport systems etc. Mumbai-Ahemdabad high speed corridor project is single largest railway project in India, other being CSTM-Panvel suburban corridor. Foreign investment more than ₹90,000 cr. (US$14 billion) is expected in these projects.

Chemicals

Chemical industry of India earned revenue of $155–160 billion in 2013. 100% FDI is allowed in Chemical sector under automatic route. Except Hydrocyanic acid, Phosgene, Isocynates and their derivatives, production of all other chemicals is de-licensed in India. India's share in global specialty chemical industry is expected to rise from 2.8% in 2013 to 6–7% in 2023.

Textile

Textile is one major contributor to India's export. Nearly 11% of India's total export is textile. This sector has attracted about $1647 million from April 2000 to May 2015. 100% FDI is allowed under automatic route. During year 2013–14, FDI in textile sector was increased by 91%.Indian textile industry is expected reach up to $141 billion till 2021.

Airlines

Foreigner investment in a scheduled or regional air transport service or domestic scheduled passenger airline is permitted to 100,with FDI up to 49% permitted under automatic route and beyond 49% through good existing airport under automatic route.

CONCLUSION

Many developing countries desire increased inflows of foreign direct investment as it brings the potential of technological innovation. However, studies have shown a host country must reach a certain level of development in education and infrastructure sectors in able to truly capture any potential benefits foreign direct investment might bring. If a country already has sufficient funds in terms of per capita income, as well as an established financial market, foreign direct investment has the potential to influence positive economic growth. Pre-determined financial efficiency combined with an educated labor force are the two main measures of whether or not foreign direct investment will have a positive impact on economic growth within a country.Statistics have shown that although there is a long run, positive but marginal, impact of foreign direct investment in India, the long run growth of foreign direct investment impact on CO_2 is even larger. It has been hypothesized that the impact on environment may be larger as CO_2 emission is an air pollutant that is typically generated through economic activities, By the turn of this century, India had been named as the 4th highest in global ranking of CO_2 emission.

India, as well as many developing countries, have been experiencing rapid economic development once adopting more liberal economic policies. Since 1991, India has sought to increase foreign direct investment interest within their country by instilling liberal trade and investment policies. Since making these policy changes India has seen an increase in GDP growth rates at 7% annually. However, since the surge in foreign direct investment inflow, pollution emission and resource depletion has been increasing at alarming rates due to greater economic activity (such as the cement, transportation and paper industries). There is potential for regulation of industrial pollution to increase with further economic development due to the creation of developed public institutions capable of regulating environment depletion. However, until then these public sectors and institutions can be implemented, India will continue to experience increased resource depletion and pollution emissions with increases of foreign direct investment.

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