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ROLE OF FOREIGN DIRECT INVESTMENT IN INDIAN ECONOMY

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ABSTRACT

Since liberalization Foreign Direct Investment (FDI) has become the most important source of foreign capital for emerging market economies (EMEs). FDI can bring the technology advances to the economy and help to increase the production at the national level. The main objective of this study is to examine the role of FDI on country's economic growth. Also this study aimed to analyze the FDI flows in year wise, country wise and sector wise by using the annual data from 1991-92 to 2010-11. This study used correlation test to identify the degree of relationship among the variables like GDP, Inflation and NSE Nifty movement. Regression model also used to check the impact level of FDI on selected macroeconomic variables. The study found that, flow of FDI has a significant impact on GDP and also created a negative impact on inflation.

KEYWORDS: *Role of FDI, Indian Economy, GDP, Inflation, NSE Nifty*

1.INTRODUCTION

Post liberalization was the successful period for the growth of Indian economy. The agriculture sector has faced many revolutions since liberalization. However, 7% of GDP was contributed by the industrial sector per annum. During 1990s, the Indian economy faced a severe crisis, like low per capita income, decline in GDP growth, increasing unemployment, and health & hygiene issue. The outflow of NRIs fund was also huge and the country faced deficit of capital flow.

Capital is the life blood of any business, even for the country too. The capital is required not only in start up, but also required during the life span of the project. To increase the flow of capital economist decided to liberalize the country's policy during 1992-93 in order to attract more foreign cash flows. The initiatives include providing tax benefit, tax holidays and increasing the investment cap in various fields. The effort taken by Government of India has yielded a continuous but steady state increase in cash flows and helped the growth of Indian economy.

The FDI norms were further liberalized during 2012 in civil aviation sector, retail sector and power sector. The FDI cap for various sectors includes tea, media, natural gas and petroleum was also liberalized during that period. India was ranked at third in attracting FDI by transnational corporations during 2013-14. The Government of India continuously works towards increasing the FDI flows through numerous initiatives.

1.1.Government Initiatives:-

The Government of India is now keen in attracting more FDI in construction development sector. The amended policy includes reduction in minimum capitalization and easy of norms to exit from a project. This will lead to increase the FDI flow in this sector and also leads to creation of low cost housing in the country and development of small cities. Added to that, the government has increased the FDI investment in insurance sector from 26% to 49% through FII, FPI, venture capital and nonresident investment.

The foreign investors are gaining their confidence in this new government and the foreign investment is expected to rise up to USD 60 billion in this financial year. This fund may be helpful in meeting the 12th five year plan (2012-17), to fund infrastructure projects like, highways, ports and airways.

2.IMPORTANCES OF THIS STUDY

The role of FDI is predominant and most influencing factor for country economic conditions. The study was undertaken during 1991 to 2010. The period is so important, as give below.

- During 1991, India opened its door for the foreigners/private players and also liberalized its policies.
- The first generation economic reforms were very much successful and the same was led to the initiation of second generation economic reforms.
- This study period was the golden period for the Indian economy; increased competition among FDIs particularly among developed and 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.
- The Indian economist liberalizing the FDI policies to the favour of private players like FDI incentives, removal of trade barriers, bilateral agreements, etc.

The study is more important form the point of different macroeconomic variables like Gross Domestic Product, Inflation and Stock Market Movement. The FDI was one of the main factors in driving the above mentioned macroeconomic variables towards country's economic conditions.

3. OBJECTIVES

- To examine the role of FDI on the growth of country's economic condition.
- To analyze year-wise, country-wise and sector-wise FDI inflows in India during 2006-2012.
- To examine the impact of FDI on GDP, Inflation & NSE Nifty Movement during the period 1991 – 2010.

4. REVIEW OF LITERATURE

FDI plays an important role in the consistent growth of a country through technological transfer, employment opportunity, development in infrastructure, etc. India ranked as second largest recipient of FDI across the world during the year 2008. But there was a slip in terms of amount of FDI inflows during 2012 & 2013. Hence, the rank secured by Indian was slipped down from 3rd to 7th rank in the year 2012. Experts said that, the slip was due to uncertainty in economic policy and slow down in the country's economy. Even though there has been increased flow of FDI into the country during the post liberalization period, the global share of FDI in India is very less when it is compared to other developing countries, Anitha.R (2012). One of the reasons for higher degree of fluctuation in the FDI flow is due to the fact that, India entered into a Double Taxation Avoidance Agreement (DTAA) with Mauritius, Kali Ram Gola *et al.* (2013). The trend movement of GDP was influenced by the movement of FDI, Naik Parth Pradipbhai (2013). He also proved that, FDI has a significant impact on Indian economy. Venkata Suresh.B & Ramakrishna.K (2013) concluded that, the sectoral level output, productivity and export was less due to the low flow of FDI into India both at the macro level as well as at the sectoral level. Dukhabandhu Sahoo & Maathai K. Mathiyazhagan (2003) suggested that, it is advisable to open up the export-oriented sectors so that a higher growth of the economy can be achieved through the growth of these sectors. Though FDI flows have gone up since 2008, yet it is very less compared with China, Russia, Brazil, etc. It is suggested to work on more innovative policies, corporate governance practices to attract more FDI flows on par with other developing country, said by Shiralashetti.A.S & Hugar.S.S. (2009).

5.METHODOLOGY

Descriptive research is used in this study to figure out the FDI inflows in country wise and sector wise during 2006-2010. The secondary data during 1991 – 2010 were collected from its authorized websites like Department of Industrial Policy & Promotion, Government of India, Ministry of Commerce & Industry, National Stock Exchange (NSE) and The World Bank. The collected data were analyzed by using descriptive statistics, correlation & regression, to study the trends on FDI inflows and to examine the impact of FDI on Indian economy

6.LIMITATIONS

- Since the selected sample size for country wise and sector wise is small when compared to total population, this study cannot be generalized.
- The projection of FDI flows in future may not be calculated exactly, as this may vary with respect to time horizon.

7.ANALYSIS

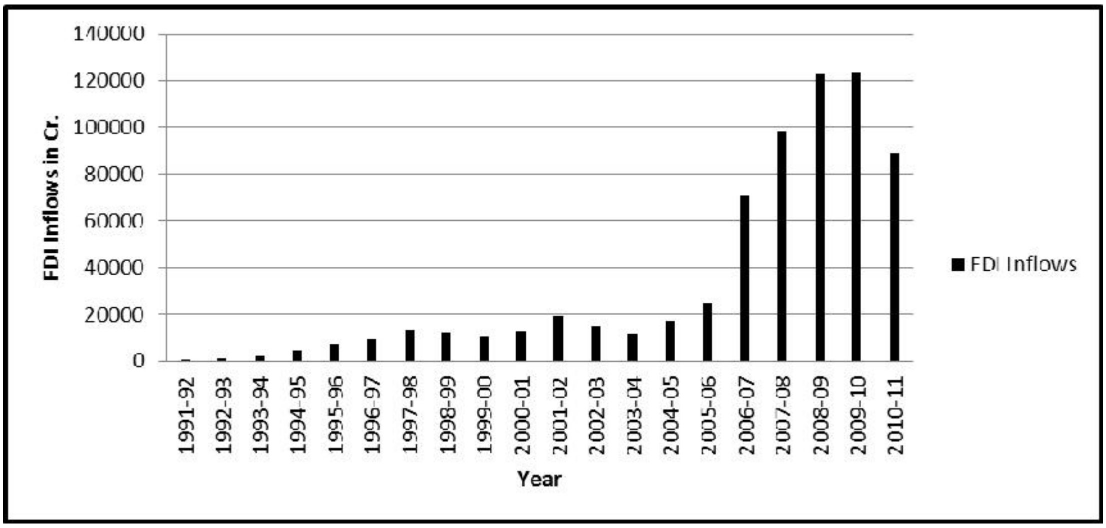
7.1.FDI Inflows since liberalization:-

The year wise FDI inflows from 1991 – 2010 were collected from its authorized websites and the data were tabulated below.

Table: 01 Year-wise FDI Inflows in India

Period	FDI Inflows Rs. in Crore	Growth Percentage
1991-92	408	-
1992-93	1,094	168.1
1993-94	2,018	84.5
1994-95	4,312	113.7
1995-96	6,916	60.4
1996-97	9,654	39.6
1997-98	13,548	40.3
1998-99	12,343	-8.9
1999-00	10,311	-16.5
2000-01	12,645	22.6
2001-02	19,361	53.1
2002-03	14,932	-22.9
2003-04	12,117	-18.9
2004-05	17,138	41.4
2005-06	24,613	43.6
2006-07	70,630	187.0
2007-08	98,664	39.7
2008-09	122,919	24.6
2009-10	123,377	0.4
2010-11	88,520	-28.3

Chart 01: Year-wise FDI Inflows in India



The above table shows the FDI inflows in India during the year 1991 to 2010. There exist a positive upwards trend during the calculated period. The FDI flows had a high movement after 2006 and it reached the highest level in the year 2009. The year on year growth rate of FDI inflows was higher during the period 2006 and the lowestrate was in 2009, because of the occurrence of the global recession & economic slowdown in India. The highest rate of FDI inflows during the period 2006-07 was made in sectors like real estate, construction activities, services sector, telecommunications and electrical equipments.

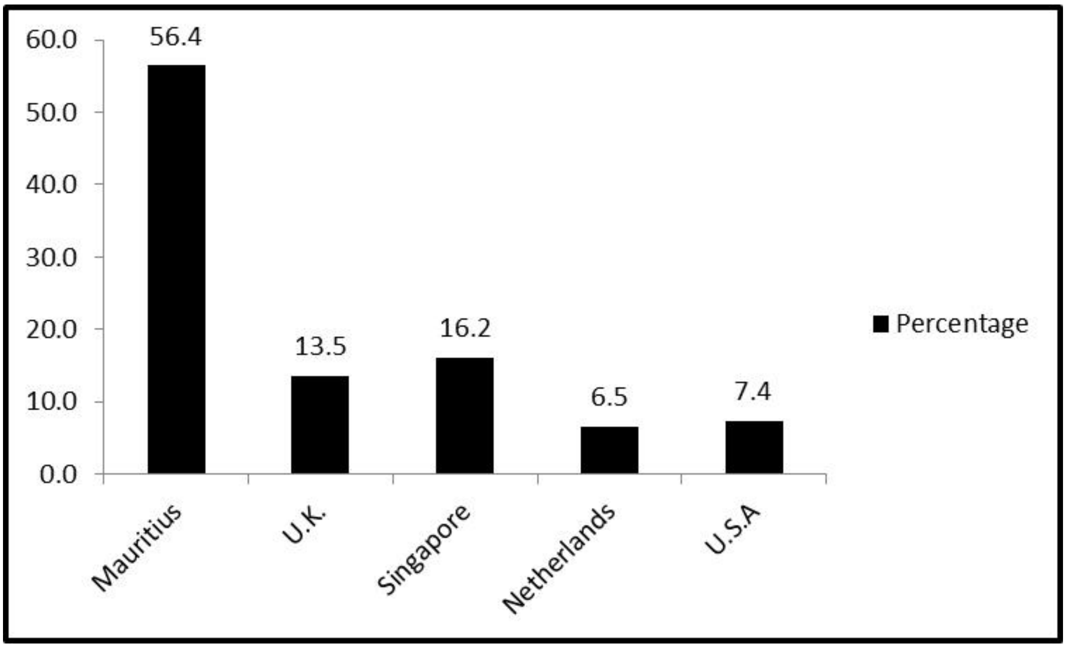
7.2.Country wise FDI Inflows:-

The overall FDI inflows during the period were segregated according to country wise and the top 5 countries contribution are listed below.

Table: 02 Country Wise FDI Inflows in India

Country Name	Amount of FDI (USD in Millions)							
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	% of Cumulative Inflows
Mauritius	6,363	11,096	11,229	10,376	6,987	9,942	9,497	56.4
U.K.	1,878	1,176	864	657	755	9,257	1,080	13.5
Singapore	578	3,073	3,454	2,379	1,705	5,257	2,308	16.2
Netherlands	644	695	883	899	1,213	1,409	1,856	6.5
U.S.A	856	1,089	1,802	1,943	1,170	1,115	557	7.4

Chart: 02 Country Wise FDI Inflows in India



The above table shows the country wise FDI inflows in India contributed by top 5 countries. Mauritius stood in the first position in terms of amount of FDI inflows in India during the study period. Among the top 5 investment countries, the investment made by UK declined from 2006 to 2009, and later there exist a sudden increase in FDI inflows.

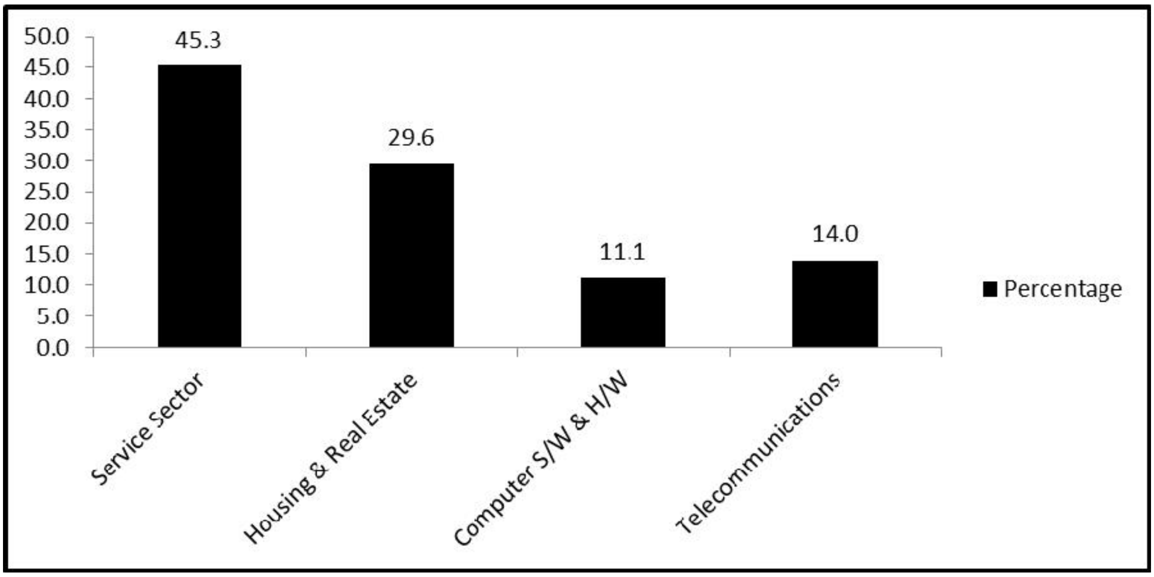
7.3.Sector wise FDI Inflows:-

The overall FDI inflows during the period were segregated according to its investment made in different sectors and the top 4 sectors are listed below.

Table: 03 Sector Wise FDI Inflows in India

No	Country Name	Amount of FDI (USD in Millions)							
		2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	% of Cumulative Inflows
1	Service Sector	4,664	6,615	6,138	4,176	3,296	5,216	4,833	45.3
2	Housing, Real Estate & Construction	1,452	3,922	4,829	5,787	2,330	3,141	1,332	29.6
3	Computer Software & Hardware	2,614	1,410	1,617	872	780	796	486	11.1
4	Telecommunications	478	1,261	2,558	2,539	1,665	1,997	304	14.0

Chart: 03 Sector Wise FDI Inflows in India



The above table shows the sector wise FDI inflows in India during the study period. Out of the total FDI inflows from 2006-2012, the service sector enjoyed the lion share of 45% of cumulative FDI inflows when compared to all other sectors. This signifies the importance of the service sector in the development of Indian economy. Further, it also reveals that the FDI inflow was highest in Service Sector during the period 2007-08 and the lowest was in telecommunications sector in 2012-13.

7.4.Relationship among the selected variables:-

The variables selected for this study are FDI inflows, GDP, Inflation and NSE Nifty movement during the period 1991-2010. The relevant data were collected from its authorized website and inter relationship among the variables were tested by using the Pearson Correlation test and furnished below.

Table: 04 Correlation Matrix

	FDI	GDP	Inflation	NSE Nifty
FDI	1	0.91	0.11	0.17
GDP	-	1	0.04	0.31
Inflation	-	-	1	-0.02
NSE Nifty	-	-	-	1

The annual average GDP has the highest level of positive correlation with the FDI inflows during the study period. This confirms that, the movement of country's GDP is in line with the movement of FDI inflows. There exist a negative correlation between inflation and NSE Nifty movement. The degree of relationship between FDI inflows and Inflation/NSE Nifty rate are having lowest positive correlation and its neglected due to its meager.

7.5.Impact of FDI inflows on GDP:-

In order to test the impact of FDI inflows on country's annual average GDP, the regression model was used and the result of the regression is given below.

Table 05: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.91	0.83	0.82	1.79855 E11

Table 06: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.86 E24	1	2.86 E24	88.49	0.00
	Residual	5.82 E23	18	3.23 E22		
	Total	3.44 E24	19			

Table 07: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.53 E11	5.19 E10		6.80	.00
	FDI	9291762.71	987743.82	0.91	9.40	.00

From the model summary it is understood that, the value of R square is greater than 0.5 and hence the regression model has a valid outcome. There exists a significant impact on GDP due to FDI inflow in India since the significance value is less than 0.05. Approximately 83% of FDI inflows had a significant impact on GDP during the study period.

7.6.Impact of FDI inflows on Inflation

In order to test the impact of FDI inflows on country's annual average inflation, the regression model was used and the result of the regression is given below.

Table 08: Regression between FDI & Inflation

Model		Sum of Squares	df	Mean Square	F	Sig.	R Square
1	Regression	2.62	1	2.62	0.21	0.65	0.02
	Residual	224.92	18	12.49			
	Total	227.55	19				

The above table shows the regression output (ANOVA) and R square value derived from the model summary. The ANOVA and the R square value did not support the existence of significance impact of FDI inflows on country's average annual inflation since the significance value is greater than 0.05. Hence, it is concluded that, the FDI inflows has no significant impact on inflation.

7.7. Impact of FDI inflows on NSE Nifty:-

In order to test the impact of FDI inflows on NSE Nifty movement, the regression model was used and the result of the regression is given below. The average daily return of NSE Nifty movement was considered as data for calculation.

Table 09: Regression between FDI & NSE Nifty

Model		Sum of Squares	df	Mean Square	F	Sig.	R Square
1	Regression	344660.65	1	344660.65	0.52	0.48	0.03
	Residual	1.19 E7	18	663295.61			
	Total	1.23 E7	19				

The above table shows the outcome of ANOVA and R square value derived from the model summary. The significance value is greater than 0.05, hence the FDI inflow has no significant impact on NSE Nifty movement. The R square value has not met the standard requirement of 0.5 and hence it is concluded that, the FDI inflow has not created a significant impact on NSE Nifty movement.

8.CONCLUSION

FDI plays an important role in country's long term development. It gives plenty of opportunities like employment, technology up gradation, infrastructure development, optimization of human capital, etc. Many researchers have identified that, the country's market size, economic policy, interest rate, business environment, etc. are the factors influence the flow of FDI. Even though, there exist an increasing trend of FDI flows in India since liberalization, the level of investment at India is not equal to the global competition, *(i.e)* developing countries like China, the Republic of Korea and Taiwan. The lacuna in attracting the FDI investments are, lack of proper infrastructure, instability in government policies, high corporate tax & limited export processing zones. The present study examined the role of FDI on country's economic condition and also examined the FDI inflows on sector wise and country wise. The study revealed that, the movement of GDP is similar to the movement of FDI inflows in India. However, the inflation rate has a negative impact on FDI inflows. It shows that, the macroeconomic instability in terms of inflation has also the influencing factor for the flow of FDI. Finally the study concludes that, the FDI has a significant impact on economic growth in India.

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