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Economic Development of India And Role of FDI – *A Vis –A Vis Study*

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ABSTRACT

India's economic policy reforms, adopted at the backdrop of historical economic crises of 1990-91 and some notable changes in global economic set up, have changed the whole structure of Indian economy since 1991. Among other things, the reforms have evolved in opening the economy, making it more competitive, getting the government out of the huge mode of regulation, empowering the states to take more responsibility for economic management and creating a kind of competition among the states for foreign investors.Indian economy had experienced major policy changes in early 1990s. The policy of Liberalization, Privatization and Globalization (LPG) aimed at making the Indian economy a fast growing and globally competitive economy. The series of reforms undertaken with respect to industrial sector, trade as well as financial sector have made the economy more efficient.

The term globalization refers to the integration of economies of the world through uninhibited trade and financial flows, and also through mutual exchange of technology and knowledge.Since July 1991; the Government has consistently pursued the policy of attracting larger volumes of foreign investment to augment the resource availability in infrastructure and other critical areas of the economy. A number of policy measures are being taken to attract both direct and portfolio investment from foreign investor individual, corporate identities and FIIs. The liberalization measures

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embodied in the new economic policy were followed in later years by a series of measures further liberalizing the inward looking policy regime towards FDI. A new foreign investment policy was put in place which stipulated three tiers for approving proposals for FDI viz, (a). RBI's automatic approval system (b). Secretariat for industrial approvals (SIAs) for proposals falling outside the powers delegated to RBI, and (c). Foreign investment promotion board (FIPB), specially created body to invite, negotiate and facilitate FDI.

In the backdrop of the second generation of economic reforms, the present paper : **Role of FDI in Economic Development of India**, studies the trends of FDI Inflow in India and its impact on the economy after the adoption of LPG model. The paper is divided in four sections, viz; Section I- Introduction, Section II-Trends of FDI in Post Reform Era, Section III- Impact of FDI Inflow and Section IV- Conclusion.

INTRODUCTION

FDI has worked as an engine of growth in the past and more in modern era. The outward-oriented growth strategy adopted by the newly industrialized economies of Asia such as Singapore, South Korea, Taiwan and Hong Kong have enabled them to overcome the constraints of least resource developing economies. In India too, FDI has acted as a catalyst for the growth of the economy. FDI contributes in the process of economic development in many ways –

- Procurement of capital goods is feasible with trade.
- It is a means to achieve price stability.
- It generates pressures & pulls for dynamic change.
- Fuller utilization of capacity, exploitation of economies of scale and diversifications is possible.

Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organization. It does not include foreign investment into the stock markets. It is especially important for its potential to transfer knowledge and technology, create jobs, boost overall productivity, enhance competitiveness and entrepreneurship and ultimately eradicate poverty through economic growth and development.

India still suffers from weaknesses and constraints, in terms of policy and regulatory frame work, which restrict the inflows of FDI. Prior to economic reforms

initiated in 1991, FDI in India was discouraged by (a) imposing severer limits on equity holdings by foreigners and (b) restricting FDI to the production of only a few reserved items. The Foreign Exchange Regulation Act (FERA), 1973 has now been replaced by the new legislation known as foreign Exchange Management Act. (FEMA). All foreign investors were virtually driven out from Indian industries by FERA, compared to the earlier regulations FEMA is more liberal and less restrictive.

TREND OF FOREIGN DIRECT INVESTMENT IN INDIA

A .Pre Reform Era

The process of planned economic development in India started with the launching of first five year plan on April1, 1951, although the foreign capital was regarded as effective ingredient of growth, the policy regarding FDI was rather selective. During the first five year plan a free flow of foreign capital was welcome because it was a necessity to ensure the supply of capital goods and technical knowhow (1st Five Year Plan, GOI).Policy toward foreign investment made a U- turn during Third and Fourth Five year plan in view of severe constraints on foreign exchange reserves.

By mid-1980s, the country started opening its economy by inviting foreign investments and liberalising its trade regime. Apart from giving direct incentives to the foreign investors, monetary and fiscal support was also provided to achieve given targets of foreign direct investment. One form of such support was the creation of a tax structure conducive to direct and portfolio investments. Progress toward foreign direct investment in India was rather sluggish during1948-49 to 1989-90.

B .Post Reform Era

India's economic performance in the post reforms period has many positive features. The average growth rate in the ten year period from 1992-93 to 2001-02 was around 6.0 percent. In sharp contrast, growth in the 1990s was accompanied by remarkable external stability despite the East Asian crisis. (Ahluwalia Montek S.2002).

Annual inflow of foreign investment in India is presented in Table 1. It shows the comparative position of FDI and portfolio investment in India. In 2001-02 both these stood at US$ 6130million and US$2021 million respectively.

Table 1: Trends in Foreign Investment Flows in to India (In US$ million)

YEAR	FDI	Portfolio investment	Total Investment Inflows
1999-00	2155	3026	5181
2000-01	3270	2590	5680
2001-02	6130	2021	8151
2002-03	5035	979	6014
2003-04	4322	11377	15699
2004-05	3712	9291	13003
2005-06	3769	12492	16261
2006-07	7693	6947	14640
2007-08	15891	27434	43325
2008-09	22343	-14032	8311
2009-10	17965	32396	50361
2010-11	11305	30292	41597
2011-12	22006	17171	39177
2012-13	19819	26891	46710
2013-14	21564	4822	26385
2014-15	32628	40934	73562

Source – RBI, Bulletin, November 2015, Table No. 34, www.rbi.org.in

During 2007-08 both FDI and Portfolio investment stood at US$ 15891 million and US$ 27434 million respectively. Year 2008-09 witnessed historic economic recession in the world and in India too. BSE sensex decreased sharply and recorded below 10,000 from the highest level of 21,000. As a result portfolio investment witnessed outflow and it was US$ - 14032 million in 2008-09.Pace of growth of inflow of FDI and portfolio investment showed almost similar trends during 1999-00 to 2014-15. Higher trends were witnessed up to 2007-

08. The sharp decline in portfolio investment during 2008-09 was the result of global meltdown. Portfolio inflow was – US$ 14032 million, however, net FDI inflows was US$ 22343 million. Gross FDI inflows during the 2008-09 were US$ 8311 million. Provisional data for 2014-15 shows FDI inflow at US$32628 million and Portfolio Investment at US$40934 million. The trends in FDI are being presented as growth model in the following manner.

$$Total\ FDI\ Inflow_t = y_0 (1 + r)^t$$

$$\log(Total\ FDI\ Inflow)_t = \log y_0 + t \log(1 + r)$$

$$\log(Total\ FDI\ Inflow)_t = \beta_1 + \beta_2 t + \varepsilon_t$$

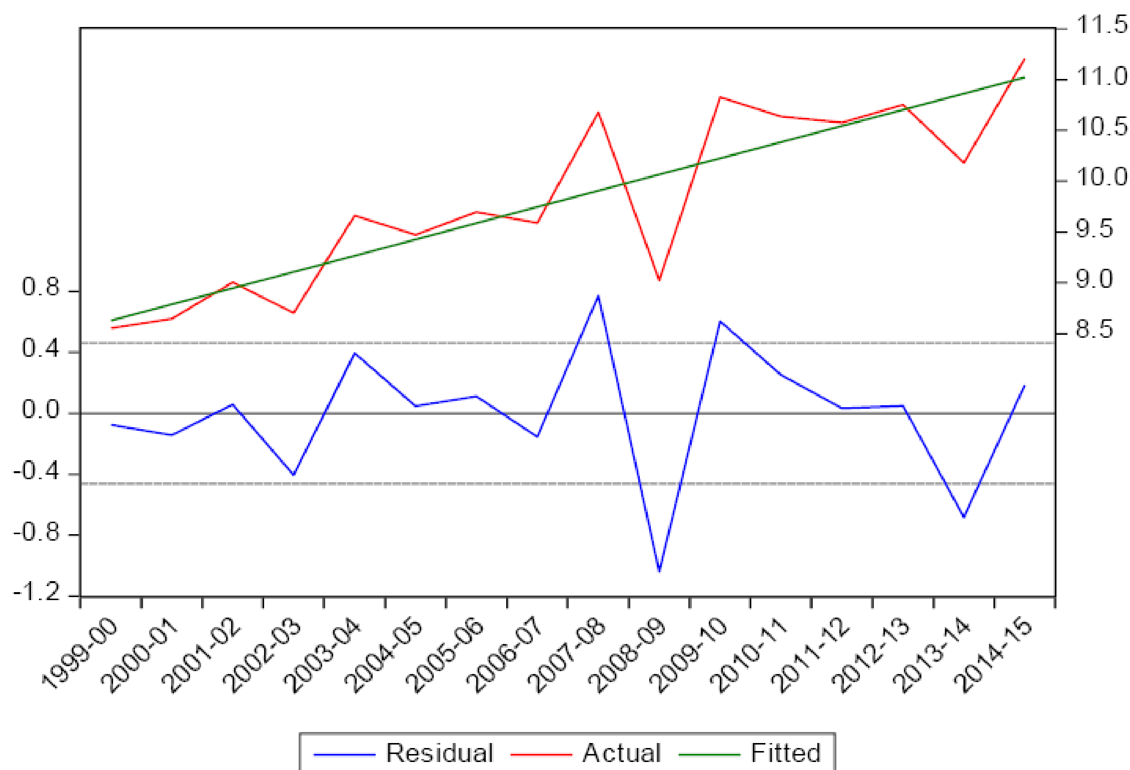
As per time series data on FDI inflow in India during 1999-00 to 2014-15 (Table 1), the value in the model can be put as

Dependent Variable: log (TOTAL INVESTMENT INFLOWS)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	8.469187	0.242434	34.93401	0.0000
T	0.159552	0.025072	6.363784	0.0000
R-squared	0.743109	Mean dependent var		9.825381
Adjusted R-squared	0.724759	S.D. dependent var		0.881192
S.E. of regression	0.462303	Akaike info criterion		1.411277
Sum squared resid	2.992141	Schwarz criterion		1.507851
Log likelihood	-9.290219	Hannan-Quinn criter.		1.416223
F-statistic	40.49775	Durbin-Watson stat		3.135457
Prob(F-statistic)	0.000018	Growth rate		44.39%

Thus, the value of r (growth rate) is equal to 44.39 per cent. This means that the r (growth rate) measures the constant proportional or relative change in total FDI inflow for a given absolute change in time.

Residual graph:



We found that there is no serially correlation, no hetero scadasticy, residual is normally distributed and no auto correlation in residual. Thus all result shows that this model is fitted.

IMPACT OF FDI ONECONOMIC GROWTH

The positive impact of FDI is likely to be higher as value addition under FDI increases. In 2008-09 the FDI inflow and consequently the growth of the economy witnessed a downfall due to the global recession however the Indian economy witnessed a swift recovery in 2009-10. The global economic slowdown had affected the Indian economy and GDP growth moderated to 6.8% in 2008-09 compared to an average of 9.5% in the preceding three years. The impact of global slowdown was more intense on industry, particularly the manufacturing sector. The fiscal and monetary policy interventions, however, provided the stimulus to the economy, leading to a recovery in the GDP growth to 8.0% in 2009-10 and 8.9% in the first half of 2010-11(Economic Survey, 2010-11).

In general terms, FDI inflow has a positive impact on the growth of GDP in India. Table 2 reveals that FDI inflow increased during 1999-00 to 2013-14 despite

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some serious fluctuations. GDP has increased by about three times during the same period. An econometric model is being put forward to quantitatively prove the relationship between GDP growth and FDI inflow.

Table 2: Trends of Growth Rate of GDP and FDI Inflow

Year	FDI Inflow		GDP at factor cost	
	Rs. crore	% change	Rs. crore	% change
1999-00	22450	122.2552	2023130	12.1855762
2000-01	10733	-52.1915	2177413	7.62595582
2001-02	18654	73.80043	2355845	8.19467873
2002-03	12871	-31.0014	2536327	7.66103033
2003-04	10064	-21.8087	2841503	12.0322025
2004-05	14653	45.59817	3242209	14.1019031
2005-06	24584	67.77452	3693369	13.9152041
2006-07	56390	129.3768	4294706	16.2815305
2007-08	98642	74.92818	4987090	16.1218021
2008-09	142829	44.79532	5630063	12.8927491
2009-10	123120	-13.799	6477827	15.0578066
2010-11	97320	-20.9552	7784115	20.1655277
2011-12	165146	69.69379	8832012	13.4619928
2012-13	121907	-26.1823	9988540	13.0947286
2013-14	147518	21.00864	11345056	13.5807235

Source: (i) RBI, (ii) SIA, Newsletter & Economic Survey 2014-15

$$\log GDP = \beta_1 + \beta_2(\log FDI\ Inflow)$$

Dependent Variable: log(GDP)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	10.13587	0.687454	14.74407	0.0000
log(FDI INFLOW)	0.483097	0.063880	7.562546	0.0000

R-squared	0.814794	Mean dependent var	15.31011
Adjusted R-squared	0.800547	S.D. dependent var	0.580129
S.E. of regression	0.259086	Akaike info criterion	0.260254
Sum squared resid	0.872633	Schwarz criterion	0.354660
Log likelihood	0.048098	Hannan-Quinn criter.	0.259248
F-statistic	57.19210	Durbin-Watson stat	0.755999
Prob(F-statistic)	0.000004		

The log linear OLS model shows that GDP will certainly grow with the growth in FDI inflow. The above results confirm theoretic expectations. Since the value of R^2 and $\bar{R}^2$ are almost the same, the model is fitted.

CONCLUSION

If India has to achieve its desired goals as laid down in the twelfth Five Year Plan then our economy has to be strong and vibrant and the result of development equitably shared. The results of second generation economic reforms would be realized only if suitable changes in institutional apparatus and organisations are implemented both at the Central and State levels for attracting FDI inflows.

The economic reforms in India have been instrumental in breaking the Hindu rate of growth of 3.5 per cent and moving towards faster economic growth. Increase in FDI inflow has been one of the major achievements in the post reforms period, however its benefits have not been interstate and intra state variations evenly spread across the entire economy and there are large. The trend of FDI inflow as projected by the semi log linear model shows a steady increase in FDI inflow in the coming years. This inflow if used judiciously and support by infrastructural development could have the way for fast economic growth in the country.

Thus, it can be concluded that although attracting FDI can be an important factor for development, however, it is not an end in itself. The right strategy would be to create a favourable environment throughout the country for equitable FDI inflow and simultaneously develop sound domestic macro-economic and structural policies.

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