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THE ECONOMIC IMPACT OF FDI IN INDIA

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ABSTRACT: *In the Indian scenario, the New Economic Policy introduced in 1991, along with subsequent doses of liberlisation have heralded a new era in which FDI plays a crucial role in supplementing domestic resources.*

As in many developing countries, India also launched its massive economic reforms in 1991 under the pressure of economic crises. The twin crises were reflected through an unmanageable balance of payments crisis and a socially intolerably high rate of inflation that were building up in the 1980s and climaxed in 1990-91.

In July 2010, Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce circulated a discussion paper on allowing FDI in multi-brand retail. But, on November 24, 2011, the government was forced to put it on hold after it was opposed by various political parties and several state governments.

The major weakness of the Indian economic reforms is that the economy is growing in sustainable way but with 'jobless growth' during the post liberlisation period. The liberlisation policy have generated the employment opportunities but not to the quantum planned.

FDI has created an encouraging effect in both traditional as well as modern formats of retail business in China. Carrefour from France, Tesco from England, Metro from Germany, and Wal-Mart from US have entered the Chinese retail sector and has uplifted the country's economy.

I. INTRODUCTION

There has been a tremendous growth in global Foreign Direct Investment (FDI). In 1980 the total stock of FDI equal only 6.6 percent of world Gross Domestic Product (GDP), while in 2003, the share had increased to 23 percent (UNCTAD 2004). Foreign direct investment (FDI) has become a key battleground for emerging market.

In the Indian scenario, the New Economic Policy (NIP) introduced in 1991, along with subsequent doses of liberlisation have heralded a new era in which FDI plays a crucial role in supplementing domestic resources.

The automatic approvals were restricted to thirty-five industries according to the liberalization of FDI policy announced in July 1991. In January 20, 1997, the government had further liberalized the FDI policy. The list of automatic approvals had been expanded to sixty from thirty-five. Presently, the automatic approval of FDI is almost all the activities/sectors except a few mentioned cases which require approval of the government.

Notwithstanding to the global financial credit squeeze, resulting into the liquidity crunch, India has witnessed the unforeseen increase in the foreign direct investment(FDI), which has shot up by 259 percent to reach at $2.56 billion in 2011 as compared to 2010. As per the official statement issued by the government, during the period of April-September,2011, the foreign direct investment inflows has registered at $17.21 billion, which is the rise of over 137 percent at $7.25 billion, of the same period in the 2010. **(1)**

Foreign Direct Investment(FDI) means investment by non-resident entity/person resident outside India in the capital of the Indian company under Schedule 1 of FEM(Transfer or Issue of Security by a Person Resident Outside India) Regulations 2000. **(2)**

1. *Ila Chaurvedi,(2011),ICTB, Role of FDI on economic development: sector wise analysis*
2. *Dipp manual, definition Chapter 2-1-12 (2011)*

The present study examines the impact of FDI in economic reforms and discusses the current issue of FDI in India. The second chapter briefs the history of FDI, the third chapter enlists the review of literature, the subsequent chapters analyse the FDI inflow in economic reforms, then the current issue of FDI, especially with retail sectors are discussed and finally concluded with suggestions.

II. HISTORY OF FDI IN INDIA

It is well known that from 1951 to 1991, Indian policy-makers stuck to a path of centralized economic planning accompanied by extensive regulatory controls over the economy. The strategy was based on an 'inward-looking import substitution' model of development. This was evident from the design of the country's Second Five-Year Plan (1956-61), which had been heavily influenced by the Soviet model of development. India's economy went through several episodes of economic liberalization in the 1970s and the 1980s under Prime Ministers Indira Gandhi and, later, Rajiv Gandhi. However, these attempts at economic liberalization were halfhearted, self-contradictory, and often self-reversing in parts. **(3)** In contrast, the economic reforms launched in the 1990s (by Prime Minister P V Narasimha Rao and Dr. Manmohan Singh as his Finance Minister) were 'much wider and deeper' **(4)** As in many developing countries, India also launched. its massive economic reforms in 1991 under the pressure of economic crises. The twin crises were reflected through an unmanageable balance of payments crisis and a socially intolerably high rate of inflation that were building up in the 1980s and climaxed in 1990-91.

In the liberalization era of the world, India is known to have attracted a quantum amount of Foreign Direct Investment, especially after our liberalization policy 1991. In India, the post-1991 economic reforms have been evolutionary and incremental in nature. Despite the slow pace of implementation of the economic reforms with certain hiccups and delays caused primarily by the compulsions of democratic politics, the performance of the Indian economy under the reforms carried out in last two decades shows a mixed picture of notable achievements and weaknesses.

Finance Minister Pranab Mukerjee met American investors and the business leaders of the corporate world on 29th January 2012 at Chicago and told them that the decision on allowing 51 percent FDI in retail has only been put on hold for now. The Minister also told them that this is how things sometime work in a democracy. Further he said nearly Rs. 2,00,000 crores are awaiting to enter Indian in multi retail sector. **(5)**

III. LITERATURE REVIEW

Several earlier studies on the growth impact of FDI in India are in striking contrast to the currently prevailing euphoria. Some observers doubt that economic reforms went far enough to change the character of FDI in India and, thus, resulted in types of FDI that may have more favorable growth effects. For example,

- Balasubramanyam and Mahambare (2003) as well as Fischer (2002) argue that the reforms implemented so far have not eliminated the distinct anti-export bias of India's trade policy. This may explain why, according to Arabi (2005) and Agarwal (2001), FDI in India has remained domestic market seeking. It is widely believed that the type of FDI and its structural composition matter at least as much for economic growth effects as does the overall volume of inward FDI.
- Agrawal and Shahani (2005) reckon that it is the quality of FDI that matters for a country like India rather than its quantity. **(6)** FDI is often supposed to be of higher quality if it is export oriented, transfers foreign technologies to the host country, and induces economic spillovers benefiting local enterprises and workers (Ender wick 2005).
- Agrawal (2005) estimates a fixed effects model based on pooled data for five South Asian host countries, among which India figures prominently, and the period 1965-1996. The coefficient of the FDI-to-GDP ratio turns out to be negative, though not significant. However, this approach ignores that FDI is endogenous. Moreover, the inclusion of exports as a right hand side variable may bias the coefficient of the FDI variable downwards to the extent that the growth impact of FDI may run through export promotion.

3. *.See, John Harris, 'The state in Retreat? Why has India experienced such Halfhearted Liberalization in the 80s? IDS Bulletin (Institute of Development Studies, Sussex U.K.), Vol. 18, No. 4, 1987.*
4. *Jeffrey D Sachs; Ashutosh Varshney; and Nirupam Bajpai eds., India in the Era of Economic Reforms (New Delhi, Oxford University Press, 1991), p.1.*
5. *Dr. P.M.S. Abdul gaffor – New College, FDI inIndia – Issues and Challenges (2012)*
6. *According to Agrawal and Shahani (2005: 644), "the worst case could be when FDI moves into an economy just to produce for the domestic markets … as its ultimate aim is to… displace the local industry."*

- Most studies accounting for the fact that causation may run both ways tend to find that higher growth leads to more FDI, rather than vice versa.
- Chakraborty and Basu (2002) explore the two-way link between FDI and growth by using a structural co-integration model with vector error correction mechanism. Using aggregate data for 1974-1996, they find that causality runs more from GDP to FDI. In the long run, FDI is positively related to GDP and openness to trade. Furthermore, FDI plays no significant role in the short-run adjustment process of GDP.

- Kumar and Pradhan (2002) consider the FDI-growth relationship to be Granger neutral in the case of India as the direction of causation was not pronounced. Similar qualifications apply to Pradhan (2002) who estimates a Cobb-Douglas production function with FDI stocks as additional input variable. FDI stocks have no significant impact when considering the whole period of observation (1969-1997).
- Sahoo and Mathiyazhagan (2002) corroborate what appeared to be the consensus until recently, while the Granger causality and Dickey-Fuller tests presented by Bhat et al. (2004) provide no evidence of causality in either direction.
- Several explanations have been offered for the at best weak impact of FDI on growth in India. The Asian Development Bank refers to concerns in India "about the apparently limited linkages between MNEs and local firms" (ADB 2004: 228). According to Kumar (2003: 27), linkages with the local economy have remained weak even in the software industry where foreign companies are said to operate as "export enclaves." Bhat et al. (2004) suspect that a lack of local skills has prevented economic spillovers from foreign to local companies.
- Nagesh Kumar (2001) analyses the role of infrastructure availability in determining the attractiveness of countries for FDI inflows for export orientation of MNC production. **(7)**
- Anand Virmani and Susan Collins (2007) studied empirically India's economic growth experience during 1960-2004 focusing on the post 1973 acceleration. The analysis focuses on the unusual dimensions of India's experience. They find that India will need to broaden its current expansion to provide manufactured goods to the world market and jobs for its large pool of low skilled workers. **(8)**
- Nagesh kumar and Alka chandha (2009), analysed empirically India's outward foreign direct investment in steel industry in a Chinese comparative perspective through Industrial and Corporate Change. **(9)**
- Singhal Aravid, Indian Retail (2011), With a contribution of 14 percent to the National GDP and employing 7 percent of the total workforce (only agriculture employs more) in the country, the retail industry is definitely one of the pillars of the Indian economy **(10)**

IV. ANALYSIS OF FDI INFLOW WITH ECONOMIC REFORMS

In order to assess the role of FDI on economic reforms, a model was used. The estimation results of the model is supported and further analysed by using the relevant econometric techniques viz. Coefficient of determination, standard error, f- ratio, t- statistics, D-W Statistics etc. In the foreign direct investment model, the main determinants of FDI inflows to India are assessed. The study identified the following macroeconomic variables: TRADEGDP, R&DGDP, FIN. Position, EXR, and ReservesGDP as the main determinants of FDI inflows into India. And the relation of these variables with FDI is specified and analysed with the following equation.

FDI = f [TRADEGDP, RESGDP, R&DGDP, FIN. Position, EXR.]

In order to study the role of FDI on Indian economy it is imperative to assess the trend pattern of all the variables used in the determinant analysis. It is observed that FDI inflows into India shows a steady trend in early nineties but shows a sharp increase after 2005, though it had fluctuated a bit in early 2000. However, Gross domestic product shows an increasing trend pattern since 1991-92 to 2007-08. Another variable i.e. TRADEGDP (Percentage of total trade with GDP) maintained a steady trend pattern till 2001-02, after that it shows a sustainable and continuous increasing pattern during the last decade. RESGDP, (percentage of foreign exchange reserves with GDP) is another explanatory variable which shows low trend pattern till 2000-01 but gained momentum after 2001-02 and shows an increasing trend. In addition to these trend patterns of the variables the study also used the multiple regression analysis to further explain the variations in FDI inflows into India due to the variations caused by these explanatory variables. The Other variables are R&DGDP (Percentage of expenditure of R&D with GDP), FIN. Position (Ratio of external debts to exports) and EXR (Exchange Rates).

7. *Nagesh Kumar (2001), role of infrastructure availability….*
8. *Anand Virmani and Susan Collins (2007), India's economic growth experience during 1960-2004*
9. *Nagesh Kumar and Alka Chadha, July 2009. (Oxford),*
10. *Singhal Aravid, Indian Retail (2011); The road ahead, Retailbiz, www.etretail.com*

The following table extracted from the various issues of SIA (Secretariat for Industrial Assistance) Bulletins for the data FDI inflow and Foreign Exchange Rates and the remaining economic factors such as GDP at factor cost, Total trade, Foreign Exchange Reserves, Expenditure on R&D, Exports and Debts are extracted from the various issues of RBI Bulletins for the period of the past two decades, i.e., from the financial year 1991-92 to 2008-09.

ANALYSING OF FDI INFLOW WITH ECONOMIC INDICATORS IN INDIA DURING 1991-2009. (Rs. in Crores)

YEARS	FDI INLOW	GDP (FC)	TOTAL TRADE	FORE. EXCH. RESERVES	EXPENDITURE ON R&D	EXPORTS	DEBT.	EXCHANGE RATES
1991-92	409	1099072	91892	23850	8363.31	44041	252910	24.5
1992-93	1094	1158025	117063	30744	8526.18	53688	280746	30.6
1993-94	2018	1223816	142852	60420	9408.79	69751	290418	31.4
1994-95	4312	1302076	172645	79781	9340.94	82674	311685	31.4
1995-96	6916	1396974	229031	74384	9656.11	106353	320728	33.4
1996-97	9654	1508378	257737	94932	10662.41	118817	335827	35.5
1997-98	13548	1573263	284276	115905	11921.83	130100	369682	37.2
1998-99	12343	1678410	318084	138005	12967.51	139752	411297	42.1
1999-00	10311	1786525	374797	165913	14397.6	159561	428550	43.3
2000-01	10368	1864301	434444	197204	15683.37	203571	472625	45.7
2001-02	18486	1972606	454218	264036	16007.14	209018	482328	47.7
2002-03	13711	2222758	552343	361470	16353.72	255137	498804	48.4
2003-04	11789	2616101	652475	490129	17575.41	293367	491078	45.9
2004-05	14653	2388768	876405	619116	19991.64	375340	581802	44.9
2005-06	24613	2616101	1116827	676387	22963.91	456418	616144	44.3
2006-07	70630	2871120	1412285	868222	24821.63	571779	746918	42.3
2007-08	98664	3129717	1668176	1237985	27613	655864	897955	40.2
2008-09	123025	3339375	2072438	1283865	NA	766935 (P)	1169575	45.9

Source: Various issues of SIA Bulletins and Various issues of RBI Bulletins

FDI MODEL FOR ECONOMIC REFORMS

VARIBALES	COEFFICIENT	STANDARD ERROR	t. STATISTICS
CONSTANT	26.25	0.126	207 *
TRADE GDP	11.79	7.9	1.5 *
RESERVE GDP	1.44	3.8	0.41
EXCHANGE RATE	7.06	9.9	0.72**
FINANCIAL POSTION	15.2	35	0.45
R&D GDP	-582.14	704	0.83**

*** is Significant at 0.10 level and ** is Significant at 0.25 level**

R^2 = 0.623 Adjusted R^2 = 0.466

D W Statistics = 0.98 F – Ratio = 7.74

It is observed from the results that the elasticity coefficient between FDI & TRADEGDP is 11.79 which imply that one percent increase in Trade GDP causes 11.79 percentage increase in FDI inflows in India. The TRADEGDP shows that the predicted positive sign. Hence, Trade GDP positively influences the flow of FDI into India. Further, it is seen from the analysis that another important promotional factor of FDI inflows to the country is RESGDP. The positive sign of RESGDP is in accordance with the predicted sign. The elasticity coefficient between RESGDP and FDI inflows is 1.44. It implies that one percent increase in RESGDP causes 1.44 percentage increases in FDI inflows into India.

The other factor which shows the predicted positive sign is FIN. Position (financial position). The elasticity coefficient between financial position and FDI is 15.2 percent which shows that one percent increase in financial position causes 15.2 percent of FDI inflows to the country. India prefers FDI inflows in export led strategy to boost its exports. Further, the analysis shows that the trend pattern of external debt to exports (i.e. FIN. Position) has been decreasing continuously since 1991-92, indicating towards a strong economy. This positive indication is a good fortune to the Indian economy as it helps in attracting foreign investors to the country. One remarkable fact observed from the regression results reveal that R&DGDP shows a negative relationship with FDI inflows into India. The results show that the elasticity coefficient between FDI and R&D GDP is -582.14. This implies that a percentage increase in R&DGDP causes nearly 582 percent reductions in the FDI inflows. This may be attributed to the low level of R&D activities in the country.

V. CURRENT ISSUE OF FDI

The recent glamour about opening up of retail sector to FDI becomes a very sensitive issue with arguments to support both sides of the debate, for and against. As per present regulations FDI is not permitted in multi-brand retail trade in India. But, there is a strong speculation that the government of India will allow FDI in multi brand retail after the election, to the five states in March 2012. There are three questions to be answered to explain the latest issue, "FDI in Indian Retail reform".

1. Why India has remained closed to FDI in retail sector after liberalisation?
2. Why India is proposing for FDI in retail now?
3. Why India is facing problem in implementing the FDI in retail?

The answer for the **first question** is "The Indian retail sector is highly fragmented with 97 per cent of its business being run by the unorganized retailers. The organized retail however is at a very nascent stage. The sector is the largest source of employment after agriculture and has deep penetration into rural India generating more than 10 per cent of India's GDP". **(11)**. The answer for the **second question** is "On 8 June, 2009, the Parliamentary Standing Committee on Commerce, in its 90th Report, on 'Foreign and Domestic Investment in Retail Sector', had made an in-depth study on the subject and identified a number of issues related to FDI in the retail sector. A number of concerns were expressed with regard to partial opening of the retail sector for FDI. Another concern is that the Indian retail sector, particularly organized retail, is still under-developed and in a nascent stage and that, therefore, it is important that the domestic retail sector is allowed to grow and consolidate first, before opening this sector to foreign investors." The answer for the **last question** is "In July 2010, Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce circulated a discussion paper **(12)** on allowing FDI in multi-brand retail. But, on November 24, 2011 the government was forced to put it on hold after it was opposed by various political parties and several state governments, including those ruled by the BJP, stating that they would not allow global retailers to open shops. Retailing is subject to required state license. The discussion paper doesn't suggest any upper limit on FDI in multi-brand retail. If implemented, it would open the doors for global retail giants to enter and establish their footprints on the retail landscape of India."

VI. SUCCESSFUL STORY OF CHINA WITH "FDI IN THE RETAIL SECTOR"

China is the world's largest FDI recipient, and has used it deftly to increase its exports. It started off with an FDI investment of $19 billion in 1990, and reached $300 billion in 1999. Forty retailers now have a secured approval in the Chinese market. FDI has created an encouraging effect in both traditional as well as modern formats of retail business in China.

11. India's Retail Sector (Dec 21, 2010) http://www.cci.in/pdf/surveys_reports/indias_retail_sector.pdf
12. Discussion Paper on FDI in Multi Brand Retail Trading, http://dipp.nic.in/DiscussionPapers/DP_FDI_Multi-BrandRetailTrading_06July2010.pdf

Impact of FDI in China				
	Traditional	**Supermarket**	**Convenience**	**Hypermarket**
1996	**19,20,604**	**13,079**	**-**	**-**
2001	**25,65,028**	**1,52,194**	**18,091**	**593**

Source: http://www.going-global.com/ (2012)

Carrefour from France, Tesco from England, Metro from Germany, and Wal-Mart from US have entered the Chinese retail sector and has uplifted the country's economy. Initially during 1992, China allowed FDI only in a few selected cities and also restricted the ownership by 26 percent. Later on as the exports of the country progressively increased, by 2002, the Government increased the FDI cap to 49 percent. China continues to hit new records. More than 28 million people and approximately 10 percent of Chinas total population are working in companies funded with FDI.

VII. CONCLUSION

India has the most liberal and transparent policies on FDI among the emerging economies. India has been a major recipient of FDI Inflows in the majority of sectors. There has been an abnormal upsurge in the economic developments of the country. In the liberalization era, India is known to have attracted a quantum amount of Foreign Direct Investment, especially after the liberalization.

The performance of FDI has been impressive on some fronts, satisfactory on several other fronts, and inadequate in certain respects. India has to still launch deeper reforms in various areas to get the best results.

The major weakness of the Indian economic reforms is that the economy is growing in sustainable way but with '**jobless growth**' during the post liberlisation period. The liberlisation policy have generated the employment opportunity but not to the quantum required.

To increase the effectiveness of economic reforms, the required policy measures must be simultaneously extended from central to state governments and also below to the third tier of local governments. For this purpose, in 12th five year plan, the new areas of economic forms are to be concentrated. The following are the ten recommended areas of special focus in the second generation of economic reforms that integrates the global financial markets, which paves way to the explosive growth of FDI around the globe.

1. Political Reforms for Good Governance;
2. Re-engineering the Role of the government;
3. Administrative and Legal Reforms;
4. Strategic Management of the Economy with a focus on knowledge based HRD Activities;
5. Fiscal Prudence;
6. Agricultural Sector Reforms;
7. Industrial Restructuring;
8. Labor Sector Reforms;
9. Foreign Trade and Outward Investment Policies;
10. Financial Sector Reforms.

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