

Role of FDI in the process of Economic Development

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Abstract

FDI is commonly referred to as investment which is made to acquire long term interest in enterprises operating outside of the economy of the investor. FDI has played a very important role in the development of the Indian economy. It has facilitated to achieve a certain degree of financial stability, helps in increasing employment and also in promoting international trade, growth and development. Foreign Direct Investment is one of the main sources to supplement domestic capital and also bring in the latest technology and managerial abilities. After 1991 economic reforms, all the restrictions which were earlier in place on these investments were removed.

As a result, the volume of foreign direct investment has significantly increased. Moreover, the composition and type of FDI have also changed. This has stimulated high hopes that FDI may serve as a catalyst to higher economic growth. From time to time government of India has taken a number of steps to boost FDI inflow into the country. One of such recent step is "Make in India" initiative launched by Prime Minister Mr. Narendra Modi in September 2014. This initiative was launched with the objective of liberalizing the FDI norms and improving ease of doing business in the country.

Keywords: FDI, Initiative, Incentives, Economic reforms, Economic development.

Introduction

Economic development is an important objective of economic policy of India. But deficiency of capital is mostly responsible for slow economic growth. There is a relative shortage of capital, goods and technical knowhow. There is a large deficit in our balance of payment. To overcome these difficulties, the government has to arrange external finance. Accordingly, India has obtained huge amount of external debt during planning period. The foreign aid can enter India in various forms such as direct entrepreneurial investment, foreign collaboration, inter-governmental loans, investment by non-residential Indians, loans from international institutions like IBRD, IMF, IDA, IFC, ADB etc. RBI's study reveals that the foreign assistance comes in the form of loans and grants, but lions share has come as loans under external assistance programme from friendly countries.

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Foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions etc. For a country where foreign investment is being made, it also means achieving technical knowhow and generating employment. The Indian government's favorable policy regime and robust business environment have ensured that foreign capital keeps flowing into country. The Government has taken many initiatives in recent years such as relaxing FDI norms across sectors such as defiance, PSU oil refineries, telecom, power exchange, and stock exchanges among others.

FDI refers to capital inflows from the rest of the world sector which are invested in the production capacity of the economy. FDI also facilitates international trade and transfer of knowledge, skills and technology. FDI is an investment in a business by an investor from another country for which the foreign investor has control over the company purchased. The multi-national company may make a direct investment by creating a new foreign enterprise which is called a green field investment, or by the acquisition of a foreign firm, either called an acquisition or brown field investment.

The objectives of present study are primarily to understand the impact of FDI on Indian economy and its advantages and difficulties. The following objectives describe the necessity of the study.

- 1) To understand the meaning of foreign direct investment (FDI).
- 2) To find out the advantages of FDI to economy.
- 3) To describe the disadvantages of FDI to economy.
- 4) To explain the need of FDI in India
- 5) To know the difficulties & challenges of FDI
- 6) To draw the conclusion.

Research Methodology

The study is descriptive in nature and is completely based on secondary data. For the study purpose secondary data i.e. reference books, recently published journals, magazines, articles and newspapers have been collected, analyzed and conclusion has been drawn. The search for this paper has been done using the online databases; inline journals and material available on various websites have been scanned.

Review of Literature

FDI is an important tool for economic growth of the country. FDI stands for Foreign Direct Investment, a component of a country's national financial accounts. Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organizations. FDI also offers

some advantages for foreign countries.⁸ For starters, FDI offers a source of external capital and increased revenue. It can be a tremendous source of external capital for a developing country, which can lead to economic development.

In the context of FDI,⁸ advantages and disadvantages are often a matter of perspective. FDI may provide some great advantages for the MNE but not for the foreign country where the investment is made. FDI in India has a significant role in the economic growth and development of India.² FDI also plays an important role in the long-term development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities. FDI as a strategic component of investment is needed by India for its sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries, short and long-term project in the field of healthcare, education, research and development.¹

Meaning of Foreign direct Investment (FDI):

According to the international monetary fund, FDI is defined as “Investment that is made to acquire lasting interest in an enterprise operation in an economy other than that of. The investor’s purpose is to have an effective voice in the management of enterprise”. According to the IMF and OECD FDI is direct investment that reflects the aim of obtaining a lasting interest by resident entity of one economy (direct investor) in an enterprise that is resident in another economy (the direct enterprise). Foreign direct investment is a particular type of foreign capital as opposed to domestic investment. The Organization of Economic Cooperation and Development defines control as owning 10% or more of the business. Businesses that make foreign direct investment are often called Multinational corporations (MNCs) or Multinational enterprises (MNEs).

Need of Foreign direct investment in India:

India is suffering from the scarcity of financial resources and low level of capital formation because it has to majority depended upon the external sources of finance. Also, the domestic resources are entirely inadequate to carry out development programme. FDI stands for Foreign Direct Investment, a component of a country’s national financial accounts. Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organizations. FDI plays a major role in developing countries like India. They act as a long-term source of capital as well as a source of advanced and developed technologies. The investors also bring along best global practices of management. As large amount of capital comes in through this investment, more and more industries are set up.

Results and Discussion

Foreign direct investment is an investment made by an organization/entity in one country in an industrial/business

activity in another country. FDI can take place in the form of establishing new business operations from scratch or acquiring existing business asset in the other country. FDI includes mergers and acquisitions, building new facilities, expansion of existing production capacity etc. FDI usually involves control/participation in management, joint venture, management expertise and technology transfer. It excludes investment through purchase of securities or portfolio foreign investment, a passive investment in the securities of another country e.g. shares and bonds.

Total FDI equity flow in India from various sectors was USD 2378.68 million in 2000-01, USD 4027.69 million in 2001-02, USD 2704.34 million in 2002-03, USD 2187.85 million in 2003-04, USD 3218.69 million in 2004-05, USD 5539.72 million in 2005-06, USD 12491.77 million in 2006-07, USD 24575.43 million 2007-08, USD 31395.97 in 2008-09, USD 25834.41 million in 2009-10, USD 21383.05 million in 2010-11, USD 35120.08 million in 2011-12, USD 22423.58 million in 2012-13, USD 24299.33 million in 2013-14, USD 30930.05 million in 2014-15, USD 40000.98 million in 2015-16 and USD 43478.27 million in 2016-2017 respectively. There was a decline in growth of total FDI Inflow of 36.15% during 2012-13 over 2011-12 in India. There was a growth of total FDI equity inflow of 8.37% during 2013-14 over 2012-13 in India. There was a growth of total FDI equity inflow 27.29% during 2015-16 over 2014-15 in India. There was a growth of total FDI equity inflow of 8.69% during 2016-17 over 2015-16 in India.

Government Initiatives: Government of India is planning to consider 100% FDI in Insurance intermediaries in India to give a boost to the sector and attracting more funds. In September 2017, the Government of India asked the States to focus on strengthening single window clearance system for fast-tracking approval processes. In January 2018 Government of India allowed foreign airlines to invest in Air India up to 49% with Government approval. No Government approval will be required for FDI up to an extent of 100% in real estate Broking services. The Ministry of Commerce and Industry, Government of India has eased the approval mechanism for FDI proposals by doing away with the approval of Department of Revenue and mandating clearance of all proposals requiring approval within 10 weeks after the receipt of application.

The Government of India is in talks with stakeholders to further ease foreign direct investment in defense under the automatic route to 51% from the current 49%, in order to give a boost to the make in India initiative and generate employment. In January 2018, Government of India allowed 100% FDI in single brand retail through automatic route. In order to provide clarity to the e-commerce sector, the Government has issued guidelines for foreign investment in the sector.

100% FDI under automatic route is permitted in the marketplace model of E-commerce. 100% FDI allowed in

Asset Reconstruction Companies under the automatic route. FDI limit for Private Security Agencies rose to 74%. 100% FDI under automatic route is permitted in Brownfield Airport projects. Foreign airlines would continue to be allowed to investment in capital of Indian companies operating scheduled and non-scheduled air transport services up to the limit of 49% of their paid-up capital. FDI limit of 100% (49% under automatic route, beyond 49% government route) for defense sector is made applicable to Manufacturing of Small Arms and Ammunitions covered under Arms Act 1959.

Advantages of FDI: In the context of FDI, advantages and disadvantages are often a matter of perspective. FDI may provide some great advantages for the MNE but not for the foreign country where the investment is made. On the other hand, sometimes the deal can work out better for the foreign country depending upon how the investment pans out. Ideally, there should be numerous advantages for both the MNE and the foreign country, which is often a developing country. It is no denying the fact that external debt funds have helped in meeting the shortage of capital, overcoming foreign exchange difficulty, easing the pressure on balance of payments and diversifying industrial economy of India.

There are merits of FDI: 1) It provides local economic benefits in multiple locations. 2) It makes international trade easier to complete. 3) Foreign income can increase. 4) It improves human resources. 5) It allows your money to work harder for you. 6) It provides a foreign company with needed experience. 7) It creates new opportunities for workers. 8) Access to markets and resources and 9) Reduces cost of production. FDI also offers some advantages for foreign countries. For starters, FDI offers a source of external capital and increased revenue. It can be a tremendous source of external capital for a developing country which can lead to economic development.

Disadvantages of FDI: Along these plus points, there are minus points also which are more serious. "External Debt Trap" has created several problems which need immediate attention which are 1) It stops domestic investment from happening. 2) It is not without risk. 3) It can be more expensive. 4) It can affect currency exchange rates. 5) It can lead to exploitation. 6) It has been observed that the foreigners do not exploit the natural resources with any foresighted attitude. 7) FDI is not an unmixed blessing. Sometimes it has slowed down the pace of economic growth. 8) the quantum of FDI obtained every year becomes uncertain and 9) Indian economy has to incur heavy cost of foreign investment.

Conclusion

Considering all above discussion, the question is "Should India do away with external debt?". Its long history in India indicates "a record of ruthless exploitation, economic domination and political subjugation." All these evils must be carefully guarded against the interest of the nation at

large. It is needless to say that no country can afford to depend on foreign aid for an indefinite period. Aid should increasingly take the form of united rather than tied aid. It should be linked with the development programme in order to ensure its optimum utilization. Indian situation calls for uncommitted loans for maintenance imports, development-imports and for putting the existing industrial capacity of the country into the fullest possible swing.

However, it is essential that a country should harness and develop its own technology and energy resources. What is necessary is larger investment in human resources, export industries, import substitution industries and research and development. FDI should be used as medicine, rather than a daily diet. FDI in Indian has a significant role in the economic growth and development of India. FDI also plays an important role in the long-term development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities.

FDI as a strategic component of investment is needed by India for its sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries, short and long-term project in the field of healthcare, education, research and development. And the main conclusion is – considering advantages, disadvantages and need of FDI provide a foundation for the decision-making process. Every key point must be carefully considered before completing a transaction. That way the best possible outcome can be achieved for everyone involved in the investment.

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