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A Critical Study on the Significance of FDI in Flows in Indian Context

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Abstract*:* *The Foreign Direct Investment (FDI) is cogitated as an imperative factor contributing to economic growth because it brings capital for investment as well as new technologies from abroad to expand the production capabilities of the economy. That is why, countries seek to increase FDI inflows for their economies and in order to do that they change their foreign investment policies on regular basis. The GoI (Government of India) also adopted the same pattern. But when India suffered from a "balance of payment (bop) crisis" in the year 1991, because of its heavy reliance on external debts, the then Indian Finance Minister Dr. M. Singh had initiated new liberalization policies that brought the country out of the crisis. Thus, the main concern of this work is to critically analyse significance of FDI inflows for the growth of Indian economy. To do so, the work will use qualitative method of research which will descriptive and exploratory in nature*

Keywords: FDI inflows, Indian economy, growth rate, positive linkage

I. INTRODUCTION

Although different economists and organizations have defined Foreign Direct Investment differently, the definition given by OECD is the globally recognized one. OECD described FDI as "*a category of cross-border investment made by a resident entity in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor*" (Chalapati and Dhar, 2011).

It means there exist a proportional linking between the FDI inflows and economic development. Furthermore, FDI improves an economies' trade balance, labour skills and values, human and natural resource utilisation, industry competitiveness, export markets, open the doors to transnational quality goods and services, and create employment possibilities. And because of these pretexts, FDI is an imperative economic development tool, especially for developing and emerging economies (Ghosh, 2005).That is why, countries seek to increase FDI inflows for their economies and in order to do that they change their foreign investment policies on regular basis. The GoI (Government of India) also adopted the same pattern. Therefore, the main concern of this work is to critically analyse the significance ofinflows of FDIfor the growth of Indian economy.

II. LITERATURE REVIEW

Generally, it is widely accepted that FDI is a major contributing factor for economic growth. But nevertheless, it has its own harmful effects too. But on the whole, studies have resulted a propositional linkage between FDI and economic development. In fact, it is evident that if FDI policy is framed meticulously, it can work as a contributing factor to boost the economic growth or else, it may worsen the condition of the host country.

According to Te Velde (2001), due to the lack of pro-active government measures, transnational countries (TNCs) may potentially stifle technological growth in their host nations. Though Borensztein, et.al. (1998) in their research claimed that FDI has a total "***crowding-in effect***" on local, public, and private investments, accelerating total economic growth.

Blomström and Kokko (2001) have pointed out that the recipienteconomy must be proficient to engross the innovative technology fetched in by FDI. It means that developing countries must have achieved a specific standard in terms of education, technological knowledge and infrastructural development in order to attract FDI.

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Sultana et.al. (2019) examined the effect of FDI as India's progress pointers along with additional aspects of HDI (Human Development Index) and populace. As per their findings, FDI exerts an influential effect on the populous, HDI, imports and exports, and Sensex Index.

Furthermore, **Alvarado, et.al. (2017)** discovered that "FDI has a favourable influence" on the product, particularly in high-income economies.Though the study revealed that the effect is unequal and not substantial in upper-middle-income countries.

Chowdhury and Mavrotas (2005)concluded in their research that there exists an underlying connection "between FDI and economic growth". Furthermore, Pais claims in his study "***Foreign Direct Investment: Impact on Indian Economy***" that FDI has a favourable effect on the country's economy. Additionally, Pradeep's thesis workon "***Foreign Direct Investment and Industrial Development in India***" has approved that actual FDI inflows and economic growth are suggestively correlated (Fonseka and Singh, 2020).

Contrary to this, **Dua, P., and Rashid, A. I. (1998)** explored the relationship between FDI and production growth in the post-reform period. The analysis was conducted using monthly data (1992 to 1998) for FDI endorsements and actual FDI flows from 1994. According to the findings of empirical analysis, there is a bidirectional causation "between FDI endorsements and the IIP (Index of Industrial Production)", as well as a widespread connection between FDI inflows and the IIP and vice-versa. "*IIP granger*", on the other hand, is a reason ofactual FDI inflows, while IIP is not a cause of actual inflow of FDI. Finally, thisresearch suggests that while higher economic advancement (as assessed by IIP) leads to increased FDI inflows, the influence of FDI on progress is unclear. Approvals for FDI don't automatically result in higher levels of industrial production except they are interpreted into actual flows.

Objective of the Study

To assess the significance of FDI inflowsfor the growth ofIndian economy .

Hypothesis

The economic growth of Indian economy is a result of Foreign Direct Investment Inflows in the country.

III. RESEARCH METHODOLOGY

The research has usedqualitative method of research which is descriptive and exploratory in nature and grounded on secondary sources of data. The secondary source of data has been collected from publications of different governments and private agencies, like the handbook on Indian Economy published by the Indian Public Finance Statistics, RBI's reports, National Industry Survey Report, Economic and statistical report, "***Central Government's Secretariat of Industrial assistance"*** (SIA), "***Ministry of Commerce***", and the DIPP.Other necessary data related to study is also collected from International Monetary Fund, UNCTAD Reports, and OECD.

Significance of FDI inflows in Indian Context

FDI Inflows after 1991

Willem, B. and Urjit, P. (1992) conducted an analysis which revealed that if corrective actions are not implemented, India may be faced with the prospect of fiscal insolvency. During the Gulf crisis in 1990, mounting fiscal deficits, along with a sharp increase in oil prices, emphasized on prices and the exchange rate. This fueled predictions about an imminent depreciation of the currency. Non-Resident Indians (NRI) suffered from a loss of faith in the government's capability to handle the economy as a direct result of the political turmoil that occurred in 1990. The drop in confidence, along with the anticipation of a depreciation of the rupee, led to the removal of deposits in Indian banks by non-resident Indians and the extraction of money by other foreign investors. The foreign exchange reserve fell to a level that was lower than the amount necessary to cover the cost of imports for two weeks. The possibility of India defaulting on its short-term foreign loans loomed, which resulted in a reduction of the country's credit rating by three points.

The government solicited aid from both the "***World Bank***" and the "***International Monetary Fund (IMF)",*** and at the same time, it began to implement structural changes. The "macroeconomic and balance of payment crisis" was resolved thru debt reduction and restricted tax reforms, the removal of control system on productive development and on imports (other than consumer products initially), decrease in import tariffs, creation of a surroundings that was less unfavorable

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for attracting foreign investment, prudent leadership of movements in the exchange rate while enabling market forces to play a substantial role in the perseverance of the exchange rate, and creation of a surroundings that was less unfavorable for attracting foreign capital. Initially The primary focus of the changes being made (domestic and foreign).

FDI Inflows after 1991

In the years 1990-1991, India struggled mightily to overcome a variety of economic challenges. The large deficit in the balance of commerce with other countries was widening further. Since 1987–1988, it has been growing at such a quick scale that by the time 1990–1991 came to a close, the amount of this deficit balance had become Rs 10,644 crore. New credit was denied by the Indian central bank, and the country's foreign exchange reserves cut down to a small level that India could hardly afford to pay for its imports for three weeks' worth of goods. India's vow to implement urgently required economic changes was a prerequisite for receiving the international rescue package. The key deciding reason was a bop crisis that occurred in 1991 and brought the country to the brink of bankruptcy; in order to save the Indian economy from the crisis and gain a bailout from the international monetary fund, gold was sent to London as collateral.

As a form of compensatory financial facility, the government of India was required to borrow a substantial amount of money from the International Monetary Fund during the years 1990 and 1991. Even though they had put up 46 tons of gold as collateral for a short-term foreign loan from the Bank of England, they still needed the money. While this was going on, India was also experiencing high levels of inflation, which reached a rate of 12% in the year 1991. The factors that contributed to this inflation were an upsurge in the quantity of monetized discrepancy in the budget, a surge in the cost of imports, and a reduction in the rate of currency exchange and administered price. The primary factor that contributed to this inflation was an upsurge in the price at which agrarian products were purchased for delivery. As a result, the economy was suffering from a trade imbalance in addition to a fiscal deficit.

The post-liberalization period had a number of significant effects, the most significant of which were the opening of the economy, which made it more competitive, the release of the government from the enormous morass of regulation, the empowerment of the states to take on a greater responsibility for economic management, and the creation of a sort of competition among the states for foreign investors.

Since 1991, the GoI has implemented a wide range of economic reforms in the country in an effort to address the persistent macroeconomic imbalance that exists inside the country. The following is an outline of how the government packaged the reforms it introduced:

i. In order to liberalize the government's industrial policy and to attract foreign investment through the privatization of existing companies and the elimination of the license system, we must first liberalize the government's industrial policy.

ii. The implementation of an automatic approval process for foreign direct investment was made available across a wide range of industries.

iii. To make the country's trade policy more open to imports and exports to facilitate the acquisition of the essential raw materials for the manufacture of goods suitable for export and the expansion of the industrial sector. In addition, lowering the amount of import tariffs charged on a number of different products.

iv. The devaluation of the Indian rupee, in addition to a gradual transition toward a system with a floating currency rate.

v. To accept a large amount of foreign debt from the IMF and the WB in order to revitalize the state of thecountry's economy and to implement structural adjustment in the state of the country's economy as a prerequisite for receiving such debt.

vi. To make changes to the country's banking system as well as the way taxes are structured.

vii. To build a market economy by removing and/or limiting influence from the government in investment activities.

viii. The monopoly that had been held by the public sector over a number of different businesses was broken.

viii. to stimulate private sector investment in large-scale enterprises by providing incentives to do so.

Since 1991–1992, a number of significant steps toward enacting these reforms have been taken, and they have been funded by a variety of government budgets. Indian economy has been able to expand at a quicker rate as a result of economic liberalization. India is currently widely recognized as having one of the most important economies in Asia. Over the course of recent history, there has been a rise in the quantity of money invested from abroad in India. In recent years, India has been home to the headquarters of a significant number of global corporations. The fact that India's GDP (gross domestic product) is growing at a higher rate per person is evidence of the country's overall progress. India has

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quickly become amongst the world's largest exporters of services, software, and items related to information technology. There are a number of Indian businesses that are recognized all over the world, including Wipro, TCS, HCL Technologies, and Tech Mahindra.

Consequently, the new economic policy of "liberalization, privatization, and globalization" has facilitated the economy by increasing the growth rate from approximately 5.5 percent to approximately 7.5 percent over the course of the last two decades. This has occurred over the course of the last twenty years. As a result, it has alleviated a significant portion of the suffering that was prevalent in India at the beginning of the 1990s.

IV. CONCLUSION

To summarize, Indian economy's FDI policy has been steadily liberalizedtomake the environment more investor-friendly.The results have been positive. As per the UN Report, Indian economy is unceasingly ranked as the third global investment targets by all IOs, including WB. FDI has had a promising impact on the Indian economy. It also assists in the development of innovativeindustries. All of these factors contribute to India's economic progress.

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