IMPACT AND INFLUENCE OF FOREIGN INVESTMENT IN INDIA

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Abstract

Foreign direct investment (FDI) policies play a major role in the economic growth of developing countries around the world. Attracting FDI inflows with conductive policies has therefore become a key battleground in the emerging markets. The prospect of new growth opportunities and outsized profits encourages large capital inflows across a range of industry and opportunity types. And this has led to competition among the states in formulating flexible policies and providing incentives to woo private investors to invest more and more. In the light of the above the paper highlights the trend of FDI in India after the economic reforms, sector-wise and country-wise share of FDI, the manner in which FDI has affected the growth of Indian states. Various factors which play a significant role in attracting FDI into a particular state are also examined. Efforts made by the state governments in order to attract maximum FDI are also studied.

Foreign Direct Investment (FDI) in India has been steadily increasing in recent years. According to the Reserve Bank of India, FDI in India reached a record high of US\$61.96 billion in the financial year 2020-2021. The Indian government has implemented policies and initiatives to make the country more attractive to foreign investors, such as simplifying the FDI process and allowing 100% FDI in certain sectors. However, it's important to note that there may be certain restrictions and regulations that foreign investors should be aware of before investing in India. If you're considering investing in India, it's recommended that you consult with a financial advisor or a legal expert familiar with the Indian market.

Objectives of the study

   The study covers the following objectives:

1. To study the trends and patterns of flow of FDI.
2. To assess the determinants of FDI inflows.
3. To evaluate the impact of FDI on the Indian Economy.

In India's FDI inflows have increased 20 times from 2000-01 to 2021-22. According to the Department for Promotion of Industry and Internal Trade (DPIIT), India's cumulative FDI inflow stood at US$ 871.01 billion between April 2000-June 2022; this was mainly due to the government's efforts to improve the ease of doing business and relax FDI norms. The total FDI inflow into India from January to March 2022 stood at US$ 22.03 billion, while the FDI equity inflow for the same period was US$ 15.59 billion. From April 2021-March 2022, India's computer software and hardware industry attracted the highest FDI equity inflow amounting to US$ 14.46 billion, followed by the automobile industry at US$ 6.99 billion, trading at US$ 4.53 billion and construction activities at US$ 3.37 billion. India also had major FDI flows coming from Singapore at US$ 15.87 billion, followed by the US (US$ 10.54 billion), Mauritius (US$ 9.39 billion) and the Netherlands (US$ 4.62 billion). The state that received the highest FDI during this period was Karnataka at US$ 22.07 billion, followed by Maharashtra (US$ 15.43 billion), Delhi (US$ 8.18 billion), Gujarat (US$ 2.70 billion) and Haryana (US$ 2.79 billion). In 2022 (until August 2022) India received 811 Industrial Investment Proposals which were valued at Rs. 352,697 crores (US$ 42.78 billion). Global Capital Flows and Inward FDI for India

FDI flows in India
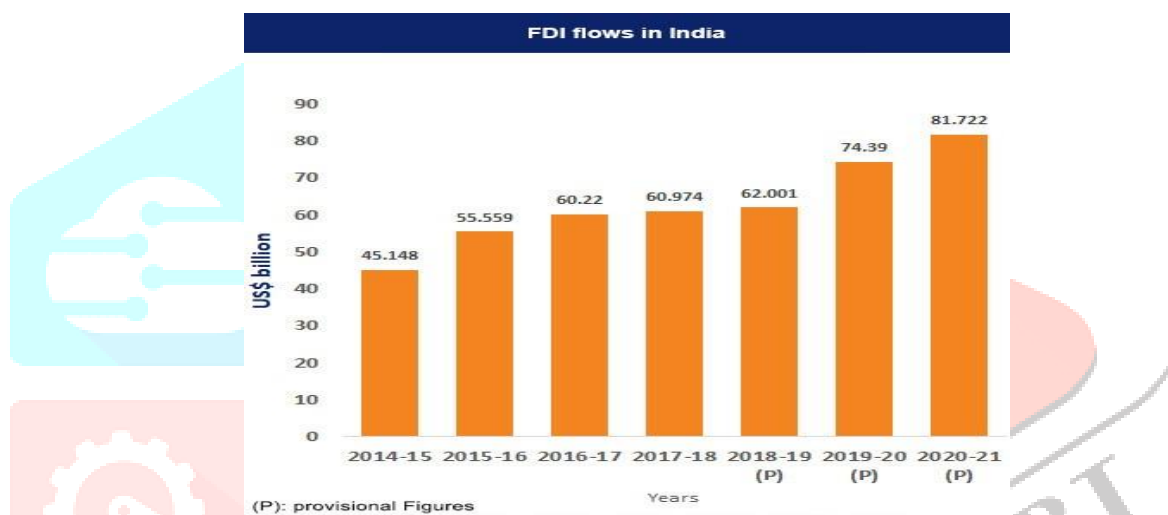
During 2015 to 2019, India received a cumulative FDI inflow to the extent of US$ 173.3 billion and the share of top five investing countries in India stood at 76.7 per cent. Singapore and Mauritius together accounted for more than half of total foreign investment in India with Singapore having the highest share of 27.7 per cent in total cumulative FDI flows (Table 3). Three major sectors viz., 'manufacturing sector', 'communication services' and 'financial services' together accounted for more than 50 per cent share in FDI inflows amounting US$ 89.6 billion during 2015-

2019. (Chart 5.) Despite the Indian government's restrictions on FDI from countries that share land borders with India, such as China, the country received a record FDI inflow of approximately US$84.8 billion in the fiscal year (FY) 2022, including US$7.1 billion in FDI equity inflows in the services sector. In FY 2023, there was a slight drop in FDI due to various factors, including the ongoing conflict between Russia and Ukraine, changes in US monetary policy, and other global uncertainties.

However, according to the 2023 Economic Survey, a rebound in incoming FDI is expected. This can be attributed to the sectoral production-linked incentive (PLI) schemes, growth prospects in tier-2 and tier-3 cities, and new investment facilitation measures like the National Single-Window System (NSWS), which streamlines the approval and clearance process for investors, entrepreneurs, and businesses. Other factors pushing India's growth trajectory forward include high-tech industrial development, market size, and advancements in the digital and technology ecosystem.

Cumulative FDI Inflow in India (April 2000 - December 2022) (US$ Million)
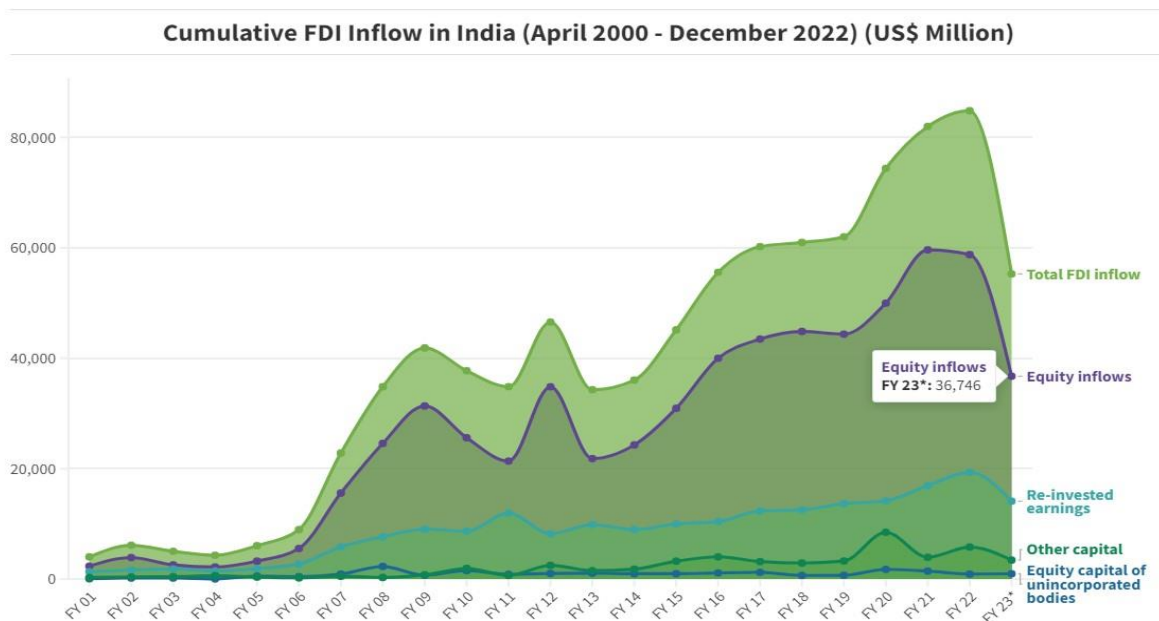
The FDI flows have been measured as FDI inflows to GDP ratio and regressed over a range of explanatory variables. Drawing from the literature review, some of the variables that have been considered to influence the FDI flows are: market size (PPP), trade openness (OPEN), exchange rate (ER), labour participation rate (LABOR), tax revenue to GDP (TAX_GDP), macroeconomic sustainability (GFD_GDP) and capital account openness index (KA_OPEN) of the selected countries. Market size is defined as GDP in purchasing power parity (PPP) terms i.e. GDP per capita based on purchasing power parity (PPP). Trade openness has been defined as sum of current receipts and payments to GDP ratio. Low labour costs and tax rates in a country have a positive impact on FDI (Bayraktar, 2013). The variable considered here is the rate of labour force participation which is described as the proportion of the population of ages 15-64 that is economically active in supplying labour for the production of goods and services during a specified period. FDI would also depend to a significant extent on the exchange rate movements and GDP growth rate of the host economy (Cevis and Camuran, 2007).

Accordingly, GDP growth (GDP_GROWTH) has also been considered as independent variable. Results show that the influence of financial openness (refers to the process of easing capital control) on FDI is far more direct than that of development of the financial market. The improvement of financial openness may significantly increase FDI in the host country. The Chinn-

Ito index, a measure of the country's degree of capital account openness, introduced in Chinn and It (2006) has been considered as an independent variable.

The index (KA_OPEN) is constructed based on a number of binary dummy variables that quantify the tabulation of restrictions on cross-border financial transactions reported in the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER). Higher values of this index imply that the more open the country is to cross-border capital transactions. The value of KA_OPEN index '1' represent that the country is fully open on cross border financial transactions and expect higher FDI inflows.

The fiscal sustainability, captured through Gross Fiscal Deficit (GFD) of central government finances to GDP ratio has also been taken as one of the explanatory variables. The study considered panel fixed effects1 regression model and the equation is as follows:

$$Yit = \beta 1 Xit + \alpha i + uit$$

Where i =1, 2,……n and t = 1, 2,……T αi's   are   individual   unknown intercepts Y_{it} is the Dependent Variable (DV) where i = country and t = time.

X_{it} represents the vector of independent variables, β_1 is the coefficient, u_{it} is the error term. The Hausman test suggests that Panel fixed effect model would be appropriate and Panel fixed effect regression equation was estimated for 10 countries (n=10) and 9 years (T=9) for the period 2010 to 2022.

In this section, we present results of a panel exercise to determine the key factors influencing FDI inflows in the major partner countries which have substantial portion of FDI stock in India. The data set comprises observations for the period from 2009-10 to 2017-22 for these major economies viz., USA, UK, Mauritius, Japan, Netherlands, Germany, Switzerland, Republic of Korea, France and India. The entire dataset has been sourced from the Global Development Finance, published by the World Bank, IMF, the Organisation for Economic Cooperation and Development (OECD) and World Bank database.

Top Investing Countries' FDI Equity Inflow into India (US$ Million)					
Country	FY 2021 (April-March)	FY 2022 (April-March)	FY 2023 (April-December)	Cumulative equity inflow (April, 2000–December, 2022)	Percentage share
Mauritius	5,639	9,392	4,731	1,62,473	26%
Singapore	17,419	15,878	13,077	1,44,044	23%
USA	13,823	10,549	4,957	59,108	9%
Netherland	2,789	4,620	2,157	43,417	7%
Japan	1,950	1,494	1,430	38,373	6%
UK	2,116	1,657	1,608	33,746	5%
UAE	4,203	1,032	3,101	15,326	2%
Cayman Island	2,799	3,818	624	14,776	2%
Germany	667	728	350	13,941	2%
Cyprus	386	233	1,154	12,521	2%

It is apparent from the above discussion that FDI is a predominant and vital factor in influencing the contemporary process of global economic development. The study attempts to analyze the important dimensions of FDI in India. The study works out the trends and patterns, main determinants and investment flows to India. The study also examines the role of FDI on economic growth in India for the period 2008-2022. The period under study is important for a variety of reasons. First of all, it was during July 1991 India opened its doors to private sector and liberalized its economy.

Secondly, the experiences of South-East Asian countries by liberalizing their economies in 1980s became stars of economic growth and development in early 1990s. Thirdly, India's experience with its first-generation economic reforms and the country's economic growth performance were considered safe havens for FDI which led to second generation of economic reforms in India in first decade of this century. Fourthly, there is a considerable change in the attitude of both the developing and developed countries towards FDI. They both consider FDI as the most suitable form of external finance. Fifthly, increase in competition for FDI inflows particularly among the 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. FDI incentives, removal of restrictions, bilateral and regional investment agreements among the Asian countries and emergence of Asia as an economic powerhouse (with China and India emerging as the two most promising economies of the world) develops new economics in the world of industrialized nations. The study is important from the view point of the macroeconomic variables included in the study as no other study has included the explanatory variables which are included in this study. The study is appropriate in understanding inflows during 2008- 2022.

MOST ATTRACTIVE LOCATION OF GLOBAL FDI

It is a well-known fact that due to infrastructural facilities, less bureaucratic structure and conducive business environment China tops the chart of major emerging destination of global FDI inflows. The other most preferred destinations of global FDI flows apart from China are Brazil, Mexico, Russia, and India. The annual growth rate registered by China was 15%, Brazil was 84%, Mexico was 28%, Russia was 62%, and India was 17% in 2007 over 2006. During 19912007 the compound annual growth rate registered by China was 20%, Brazil was 24%, Mexico was 11%, Russia was 41% (from 1994), and India was 41%. India's FDI need is stood at US$ 15 bn per year in order to make the country on a 9% growth trajectory (as projected by the Finance Minister of India in the current Budget74). Such massive FDI is needed by India in order to achieve the objectives of its second-generation economic reforms and to maintain the present growth rate of the economy. Although, India's share in world FDI inflows has increased from 0.3% to 1.3% (Chart-3.2 & Table – 3.2) from 1990-95 to 2007.

Though, this is not an attractive share when it is compared with China and other major emerging destinations of global FDI inflows. reveals that during the period under review FDI inflow in India has increased from 11% to 69%. But when it is compared with China, India's FDI inflows stand nowhere. India Foreign Direct Investment data reached an all-time high of 4.3 % in Sep 2020 and a record low 0.4 % in Jun 2020 and when it is compared with rest of the major emerging destinations of global FDI India is found at the bottom of the ladder India Foreign Direct Investment (FDI) registered a growth equal to 0.9 % of the country's Nominal GDP in Dec 2022, compared with a growth equal to 1.1 % in the previous quarter.

Foreign Direct Investment: % of Nominal GDP: Quarterly: India

SOURCE: WWW.CEICDATA.COM | CEIC Data
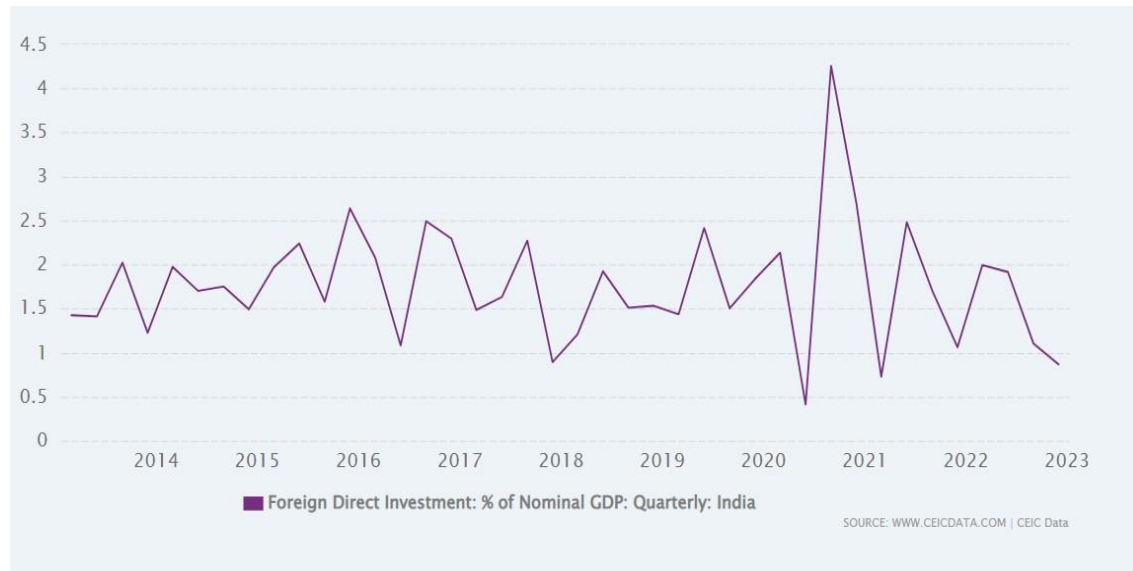
Review of Literature

Iyare Sunday O, Bhaumik Pradip K, Banik Arindam28 (2004), in their work
"Explaining FDI Inflows to India, China and the Caribbean: An Extended Neighborhood
Approach" find out that FDI flows are generally believed to be influenced by economic indicators like market size, export intensity, institutions, etc, irrespective of the source and destination countries. This paper looks at FDI inflows in an alternative approach based on the concepts of neighborhood and extended neighborhood. The study shows that the neighborhood concepts are widely applicable in different contexts particularly for China and India, and partly in the case of the Caribbean. There are significant common factors in explaining FDI inflows in select regions. While a substantial fraction of FDI inflows may be explained by select economic variables, country – specific factors and the idiosyncratic component account for more of the investment inflows in Europe, China, and India.

Sharma Rajesh Kumar67 (2006) in his article "FDI in Higher Education: Official Vision Needs Corrections", examines the issues and financial compulsions presented in the consultation paper prepared by the Commerce Ministry, which is marked by Shoddy arguments, perverse logic and forced conclusions. This article raises four issues which need critical attention: the objectives of higher education, its contextual relevance, the prevailing financial situation and the viability of alternatives to FDI. The conclusion of the article is that higher education needs long – term objectives and a broad vision in tune with the projected future of the country and the world. Higher education will require an investment of Rs. 20,000 to 25,000 crores over the next five or more years to expand capacity and improve access. For such a huge amount the paper argues, we can look to F Nayak D.N46 (2004) in his paper "Canadian Foreign Direct Investment in India.

Balasubramanyam V.N Sapsford David4 (2007) in their article "Does India need a lot more FDI" compares the levels of FDI inflows in India and China, and found that FDI in India is one tenth of that of china. The paper also finds that India may not require increased FDI because of the structure and composition of India's manufacturing, service sectors and her endowments of human capital. The requirements of managerial and organizational skills of these industries are much lower than that of labor intensive industries such as those in China. Also, India has a large pool of well – Trained engineers and scientists capable of adapting and restructuring imported know – how to suit local factor and product market condition all of these factors promote effective spillovers of technology and know- how from foreign firms to locally own firms. The optimum level of FDI, which generates substantial spillovers, enhances learning on the job, and contributes to the growth of

productivity, is likely to be much lower in India than in other developing countries including China. The country may need much larger volumes of FDI than it currently attracts if it were to attain growth rates in excess of 10 per cent per annum. Finally, they conclude that the country is now in a position to unbundle the FDI package effectively and rely on sources other than FDI for its requirements of capital.

Hypotheses

   The study has been taken up with the following hypotheses:

1. Flow of FDI shows a positive trend
2. FDI has a positive impact on economic growth of the country.

DATA COLLECTION

 This study is based on secondary data. The required data have been collected from various sources i.e. World Investment Reports, Asian Development Bank's Reports, various

Bulletins of Reserve Bank of India, publications from Ministry of Commerce,

Govt. of India, Economic and Social Survey of Asia and the Pacific, United Nations,

Asian Development Outlook, Country Reports on Economic Policy and Trade Practice- Bureau of Economic and Business Affairs, U.S. Department of State and from websites of World Bank, IMF, WTO, RBI, UNCTAD, EXIM Bank etc.. It is a time series data and the relevant data have been collected.

Data Analysis

In order to analyses the collected data, the following mathematical tools were used. To work out the trend analyses the following formula is used:

a.)   Trend Analysis i.e. $\hat{y} = a + b x$ where $\hat{y}$ = predicted value of the dependent variable a = y – axis intercept, b = slope of the regression line (or the rate of change in y for a given change in x),   x = independent variable (which is time in this case).

b.)   Annual Growth rate is worked out by using the following formula:
         AGR = (X2- X1)/ X1 where X1 = first value of variable X
                     X2 = second value of variable X

c.)   Compound Annual Growth Rate is worked out by using the following formula: CAGR (t0, tn) = (V(tn)/V(t0))1/tn – t0 -1

where
V (t0): start value, V (tn): finish value, tn − t0: number of years.

   In order to analyses the collected data, various statistical and mathematical tools were used.
Further, to study the impact of foreign direct investment on economic growth, two models were framed and fitted. The foreign direct investment model shows the factors influencing the foreign direct investment in India. The economic growth model depicts the contribution of foreign direct investment to economic growth. The two model equations are expressed below:

1 FDI = f [TRADEGDP, RESGDP, R&DGDP, FIN. Position, EXR.]
2 GDPG = f [FDIG]

where,
FDI= Foreign Direct Investment
GDP = Gross Domestic Product
FIN. Position = Financial Position
TRADEGDP= Total Trade as percentage of GDP.
RESGDP= Foreign Exchange Reserves as percentage of GDP.
R&DGDP= Research & development expenditure as percentage of GDP.
FIN. Position = Ratio of external debts to exports
EXR= Exchange rate
GDPG = level of Economic Growth
FDIG = Foreign Direct Investment Growth

Regression analysis (Simple & Multiple Regression) was carried out using relevant econometric techniques. Simple regression method was used to measure the impact of FDI flows on economic growth (proxied by GDP growth) in India. Further, multiple regression analysis was used to identify the major variables which have impact on foreign direct investment. Relevant econometric tests such as coefficient of determination R^2, Durbin – Watson [D-W] statistic, Standard error of coefficients, T Statistics and F- ratio were carried out in order to assess the relative significance, desirability and reliability of model estimation parameters.

Source: UNCTAD World Investment Report 2022
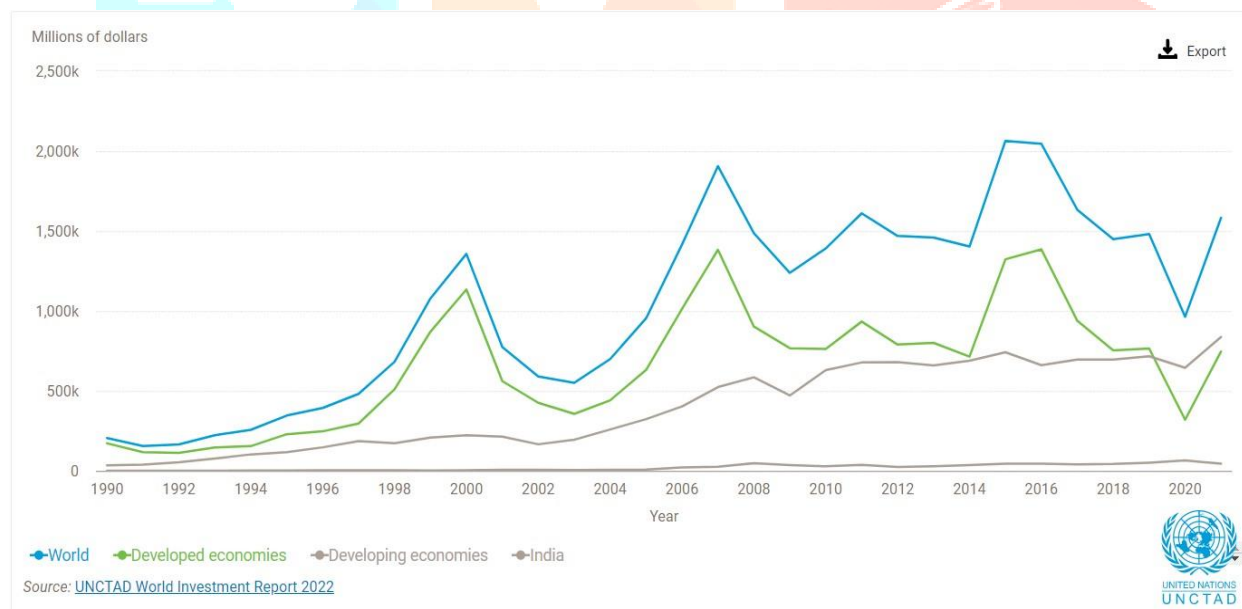
EMERGING ECONOMIES OF THE WORLD

Emerging Market Countries	Revised GDP PPP Int$, Billions	CAGR 10 Year Rate %, 2012-2022	Share of Global GDP %	Share of Global GDP Growth %, 2012-2022	Revised GDP Per Capita Int$	Government Debt to Revised GDP %
Brazil	4,287.6	0.4%	2.5%	0.4%	19,910	66.2%
Chile	606.4	2.6%	0.4%	0.3%	31,502	30.3%
China	31,555.1	6.2%	18.5%	31.7%	21,785	62.4%
Colombia	1,081.2	3.1%	0.6%	0.6%	20,989	45.9%
Czech Republic	501.9	2.2%	0.3%	0.2%	46,743	36.2%
Egypt	2,010.2	4.2%	1.2%	1.5%	18,936	59.8%
Greece	422.6	0.5%	0.2%	0.0%	40,963	139.9%
Hungary	421.8	3.4%	0.2%	0.3%	43,913	60.7%
India	15,820.4	5.5%	9.3%	14.6%	11,247	52.3%
Indonesia	4,810.9	4.2%	2.8%	3.6%	17,235	29.1%
Korea, Rep.	2,880.0	2.6%	1.7%	1.5%	56,108	44.1%
Kuwait	289.8	0.2%	0.2%	0.0%	66,169	5.2%
Malaysia	1,305.3	4.1%	0.8%	1.0%	39,339	51.2%
Mexico	3,377.3	1.3%	2.0%	0.9%	25,670	41.9%
Peru	661.7	2.8%	0.4%	0.4%	19,645	22.8%
Philippines	1,389.6	4.9%	0.8%	1.2%	12,351	42.3%
Poland	1,691.5	3.6%	1.0%	1.1%	44,820	39.8%
Qatar	318.8	2.1%	0.2%	0.1%	106,990	38.3%
Saudi Arabia	2,441.2	2.2%	1.4%	1.0%	68,105	17.6%
South Africa	1,174.5	1.8%	0.7%	0.4%	19,331	46.7%
Taiwan	1,551.2	3.3%	0.9%	1.0%	64,937	19.7%
Thailand	1,835.4	1.8%	1.1%	0.7%	26,190	42.0%
Turkey	3,695.0	5.3%	2.2%	3.3%	43,185	28.6%
United Arab Emirates	844.9	2.9%	0.5%	0.5%	83,801	25.5%
Emerging Markets Totals / Averages:	84,974.5	N/A	49.8%	66.3%	39,578*	43.7%*

World Economics has combined 24 countries to represent the Emerging Markets. Overall these countries account for 50% of Global GDP and 66% of global GDP growth in the past 10 years (2012-2022).

The Emerging Markets are home to over 4.3 billion people with an average life expectancy of 75 years and a current median age of 34 against a global average of 30.

FINDINGS AND RECOMMENDATIONS

It is observed from the results of above analysis that Trade GDP, Reserves GDP, Exchange rate, FIN. Position, R&DGDP and FDIG are the main determinants of FDI inflows to the country. In other words, these macroeconomic variables have a profound impact on the inflows of FDI in India. The results of foreign Direct Investment Model reveal that Trade GDP, Reserves GDP, and FIN. Position variables exhibit a positive relationship with FDI while R&DGDP and Exchange rate variables exhibit a negative relationship with FDI inflows. Hence, Trade GDP, Reserves GDP, and FIN. Position variables are the pull factors for FDI inflows to the country and R&DGDP and Exchange rate are deterrent forces for FDI inflows into the country. Thus, it is concluded that the above analysis is successful in identifying those variables which are important in attracting FDI inflows to the country. The study also reveals that FDI is a significant factor influencing the level of economic growth in India. The results of Economic Growth Model and Foreign Direct Investment Model show that FDI plays a crucial role in enhancing the level of economic growth in the country. It helps in increasing

the trade in the international market. However, it has failed in raising the R&D and in stabilizing the exchange rates of the economy.

The positive sign of exchange rate variables depicts the appreciation of Indian Rupee in the international market. This appreciation in the value of Indian Rupee provides an opportunity to the policy makers to attract FDI inflows in Greenfield projects rather than attracting FDI inflows in Brownfield projects.

Further, the above analysis helps in identifying the major determinants of FDI in the country. FDI plays a significant role in enhancing the level of economic growth of the country. This analysis also helps the future aspirants of research scholars to identify the main determinants of FDI at sectoral level because FDI is also a sector – specific activity of foreign firms vis-à-vis an aggregate activity at national level.

Finally, the study observes that FDI is a significant factor influencing the level of economic growth in India. It provides a sound base for economic growth and development by enhancing the financial position of the country. It also contributes to the GDP and foreign exchange reserves of the country.

CONCLUSION

Indeed, India needs a business environment which is conducive to the needs of business. As foreign investors don't look for fiscal concessions or special incentives but they are more of a mind in having access to a consolidated document that specified official procedures, rules and regulations, clearance, and opportunities in India. In fact, this can be achieved only if India implements its second-generation reforms in totality and in right direction. Then no doubt the thirdgeneration economic reforms make India not only favorable FDI destination in the world but also set an example to the rest of the world by achieving what is predicted by Goldman Sachs23,24 (in 2003, 2007) that from 2007 to 2020, India's GDP per capita in US$ terms will quadruple and the Indian economy will overtake France and Italy by 2020, Germany, UK and Russia by 2025, Japan by 2035 and US by 2043.

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