IJNRD.ORG ISSN : 2456-4184
INTERNATIONAL JOURNAL OF NOVEL RESEARCH AND DEVELOPMENT (IJNRD) | IJNRD.ORG
An International Open Access, Peer-reviewed, Refereed Journal

Role of Foreign Direct Investment in Indian Economy

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ABSTRACT

The Indian economy is one of the fastest-growing economies in the world, attracting significant foreign direct investment (FDI) each year. FDI has contributed to India's financial stability, economic growth, and positive GDP growth rates. As a crucial component of investment, FDI is essential for advancing economic reforms in the country.

The impact of globalization has led India to open its market to foreign investments, and necessary changes in economic policy have facilitated this openness.

This paper aims to study the "Role of Foreign Direct Investment (FDI) in India," focusing on:

- Various trends of FDI inflows in India.
- Country-wise FDI inflows.
- Sector-wise distribution of these investments within the country.

By analyzing these aspects, the paper seeks to provide insights into the role and impact of FDI on India's economic development.

Keywords: Indian Economy, Foreign Direct Investment, Trends

INTRODUCTION

FDI play an essential part in monetary improvement of a country. A nation's innovation level and sectorial advancement is relying on the FDI inflows. It has contributed to the economic growth of various countries. Foreign Investment is required for enhancing production, infrastructural support and technological capabilities of the country. Particularly developing countries which has limited resources and want to increase the industrialization and develop infrastructure facilities, such capital plays very crucial role in these Endeavours. Hence Foreign Direct Investment in the country will result in economic growth of the country. In Indian economy, Foreign Direct Investment is a major monetary source for economic development. Foreign companies can invest directly in private Indian businesses to get the advantages of cheaper wages and changing business environment of India.

Foreign Direct Investment (FDI) is a crucial source of external finance, enabling countries with limited resources to attract capital from wealthier nations. In India, FDI is a significant driver of economic growth and a major source of non-debt external finance.

There are two primary routes for foreign investors to invest in India:

1. **Automatic Route**: Investments through this route do not require prior approval from Indian authorities. Foreign investors can invest in various sectors without needing government authorization. Examples of sectors under the automatic route include:
   - Agriculture
   - Plantation
   - Construction Development
   - Industrial Parks
   - Railway Infrastructure
   - Financial Services
   - Insurance
   - Pension Sector
2. **Government Route**: Investments through this route require prior approval from the Indian government. Examples of sectors requiring government approval include:
   - Print Media
   - Satellites (establishment and operations)
   - Banking (public sector)

FDI regulations in India vary by sector, with different limits and routes applicable. Some sectors permit 100% FDI, meaning that foreign entities can hold complete ownership. For example:

- **Defence**: Up to 49% FDI is allowed under the automatic route, with any investment beyond 49% requiring government approval.
- **Telecom Services**: Up to 49% FDI is allowed under the automatic route, with higher investments needing government approval.

Certain industries have restrictions or prohibitions on FDI, including:

- Cigars, cigarettes, or related tobacco industries
- Lottery, betting, or gambling businesses
- Investments in chit funds
- Nidhi companies
- Trading in Transferable Development Rights (TDRs)

Sensitive sectors such as defence, insurance, and media face additional scrutiny and FDI caps due to concerns over national integrity and security. For instance, the defence sector allows 49% FDI under the automatic route, with higher investments subject to government approval.

REVIEW OF LITERATURE

A review of relevant literature on Foreign Direct Investment (FDI) highlights several key studies:

- **Dasgupta and Bajpai (2004)**: In their study "Multinational Companies and Foreign Direct Investment in China and India," they examined FDI patterns by multinational companies in China and India. Their research aimed to identify ways to attract higher FDI inflows for India through suitable policy frameworks.
- **Saikiab and Goswamia (2012)**: Their study focused on FDI and its relationship with exports in India, particularly in the north-east region. They explored FDI trends and assessed the association between FDI and exports from 1991 to 2011.

- **Marimuthu and Azhar (2012)**: In their research "An Overview of Foreign Direct Investment in India," they analyzed the need for FDI, its sources and determinants. They conducted a year-wise and sector-wise examination of FDI and investigated the reasons behind observed trends.
- **Kadam and Patil (2014)**: Their paper "Effects of FDI on Indian Economy: A Critical Appraisal" assessed the relevance of FDI in India by analyzing inflows and their impact on economic development between 2000 and 2010.
- **Anitha (2012)**: In "Foreign Direct Investment and Economic Growth in India," she explained the significance of FDI for developing and underdeveloped nations, highlighting its role in economic growth.

NEED OF THE STUDY

To study the trends of FDI inflows in India, identification of country-wise inflows and ascertaining their sector-wise distribution in India.

OBJECTIVES OF STUDY

(i) To study the trends of FDI inflows in India of the last 22 decades.
(ii) To identify the country-wise flow of FDI into India.
(iii) To ascertain the sector-wise distribution of FDI inflows in India.

SCOPE OF STUDY

(i) To evaluate the trends of FDI inflows into India, data have been collected for the period 2000-01 to 2021-22.

(ii) To study the country-wise flow of FDI and it's sector-wise distribution in India, data have been collected for the period 2000-01 to 2021-22.

RESEARCH METHODOLOGY

Data Collection

This study is based on secondary data collected from various reliable sources. The database is constructed by pooling information and data from sources such as the National Statistical Office, the Department of Promotion of Industry and Internal Trade (DPIIT), the Reserve Bank of India (RBI), statisticstimes.com, and others. Additionally, online databases of the Indian economy, along with articles, journals, and newspapers, have been referenced.

Statistical Tool

To evaluate the trend of FDI inflows into India, the study used the Compound Annual Growth Rate (CAGR) and percentage. For analyzing the country-wise flow of FDI and its sector-wise distribution in India, simple percentage calculations were employed for easier understanding.

Data on FDI (April 2000 to 2022)

Table-I. Financial Year-Wise FDI Inflows (Trends)

(A). TOTAL FDI INFLOWS (Equity inflows + Reinvested earnings + Other capital) Amount: US$ in Millions

S. NO.	Financial Year (April - March)	FOREIGN DIRECT INVESTMENT (FDI)					
		Equity		Re-invested earnings +	Other capital	FDI INFLOW INTO INDIA	
		FIPB Route/ RBI's Automatic Route/ Acquisition Route	Equity capital of unincorporated bodies #			Total FDI inflow	%age growth over previous year (in USD terms)
FINANCIAL YEAR 2000-01 TO 2021-22							
1	**2000-01**	2,339	61	1,350	279	**4,029**	-
2	**2001-02**	3,904	191	1,645	390	**6,130**	**(+) 52 %**
3	**2002-03**	2,574	190	1,833	438	**5,035**	**(-) 18 %**
4	**2003-04**	2,197	32	1,460	633	**4,322**	**(-) 14 %**
5	**2004-05**	3,250	528	1,904	369	**6,051**	**(+) 40 %**
6	**2005-06**	5,540	435	2,760	226	**8,961**	**(+) 48 %**
7	**2006-07**	15,585	896	5,828	517	**22,826**	**(+) 155 %**
8	**2007-08**	24,573	2,291	7,679	300	**34,843**	**(+) 53 %**
9	**2008-09**	31,364	702	9,030	777	**41,873**	**(+) 20 %**
10	**2009-10**	25,606	1,540	8,668	1,931	**37,745**	**(-) 10 %**
11	**2010-11**	21,376	874	11,939	658	**34,847**	**(-) 08 %**
12	**2011-12**	34,833	1,022	8,206	2,495	**46,556**	**(+) 34 %**
13	**2012-13**	21,825	1,059	9,880	1,534	**34,298**	**(-) 26%**
14	**2013-14**	24,299	975	8,978	1,794	**36,046**	**(+) 5%**
15	**2014-15**	30,933	978	9,988	3,249	**45,148**	**(+) 25%**
16	**2015-16**	40,001	1,111	10,413	4,034	**55,559**	**(+) 23%**
17	**2016-17**	43,478	1,223	12,343	3,176	**60,220**	**(+) 8%**
18	**2017-18**	44,857	664	12,542	2,911	**60,974**	**(+) 1%**
19	**2018-19**	44,366	689	13,672	3,274	**62,001**	**(+) 2%**
20	**2019-20**	49,977	1,757	14,175	8,482	**74,391**	**(+) 20%**
21	**2020-21**	59,636	1,452	16,935	3,950	**81,973**	**(+) 10%**
22	**2021-22(P)**	58,773	910	19,347	5,805	**84,835**	**(+) 3%**

CAGR= +14.8%

Source: RBI's Bulletin August 2022; (FOREIGN INVESTMENT INFLOWS)
Note: All figures for financial years 2021-22 are provisional.

PLOTTING THE TRENDS OF FDI INFLOWS IN INDIA DURING 2000-01 TO 2021-22 ON A CHART

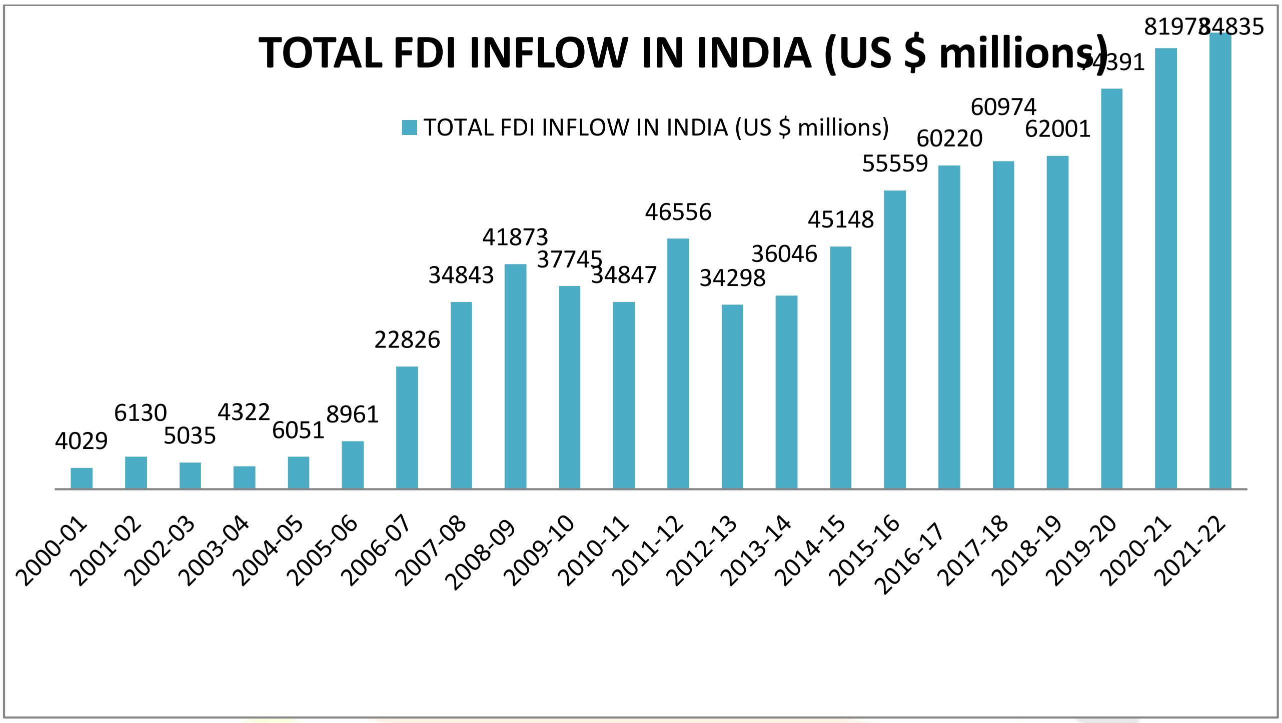


Chart (a)

Note: Researcher's contribution implemented in the chart through the table.

(B). TOTAL FDI EQUITY INFLOWS (excluding amount remitted through RBI's NRI Schemes)

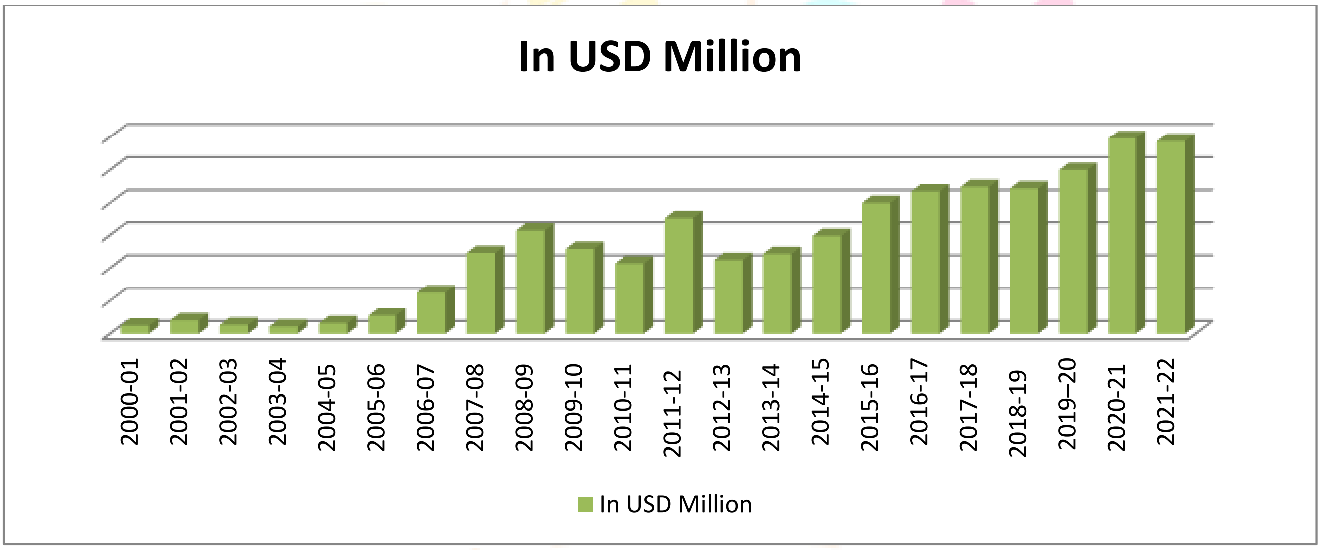
S. No.	Financial Year (April – March)	Amount of FDI Equity inflow		% age growth over previous year (in terms of USD)
FINANCIAL YEAR 2000-01 TO 2021-22		*In INR Crores*	*In USD Million*	
1	2000-01	10,733	2,463	-
2	2001-02	18,654	4,065	(+)65 %
3	2002-03	12,871	2,705	(-)33 %
4	2003-04	10,064	2,188	(-)19 %
5	2004-05	14,653	3,219	(+)47 %
6	2005-06	24,584	5,540	(+)72 %
7	2006-07	56,390	12,492	(+)125 %
8	2007-08	98,642	24,575	(+)97 %
9	2008-09	142,829	31,396	(+)28 %
10	2009-10	123,120	25,834	(-)18 %
11	2010-11	97,320	21,383	(-)17 %
12	2011-12 ^	165,146	35,121	(+)64 %
13	2012-13	121,907	22,423	(-)36 %
14	2013-14	147,518	24,299	(+)8%

15	2014-15	181,682	29,737	(+)22%
16	2015-16	262,322	40,001	(+)35%
17	2016-17	291,696	43,478	(+)9%
18	2017-18	288,889	44,857	(+)3%
19	2018-19	309,867	44,366	(-)1%
20	2019–20	353,558	49,977	(+)13%
21	2020-21	442,569	59,636	(+)19%
22	2021-22	437,188	58,773	(-) 1%

Source: **dipp.nic.in**

Note: *i including amount remitted through RBI's-NRI Schemes (2000-2002).*

ii. FEDAI (Foreign Exchange DealeINR Association of India) conveINRion rate from rupees to US dollar applied, on the basis of monthly average rate provided by RBI (DEPR), Mumbai^ inflow for the month of March, 2012 are as reported by RBI, consequent to the adjustment made in the figures of March, '11, August, '11 and October, '11.



Chart(b)

Note: Researcher's contribution implemented in the chart through the table.

Interpretation (1)

Tables I (A) and I (B) demonstrate the cumulative amount of foreign direct investment (FDI) inflows into India from 2000-01 to 2021-22. Since 2000, the Indian government has implemented significant amendments to FDI policies to enhance the nation's attractiveness as an investment destination. Following the 1991 reforms, FDI inflows into India increased dramatically. However, during the study period (2000-01 to 2021-22), India experienced fluctuations in FDI inflows.

There have been instances of both sudden and gradual decreases in FDI inflows compared to the previous year. For example, during 2001-02 to 2003-04, factors such as the Gujarat earthquakes, the 2001 attacks on the World Trade Center and Indian Parliament, and global economic uncertainties impacted FDI inflows. Similarly, from 2008-09 to 2012-13, the decline in global economic conditions following the 2008 US Subprime Crisis and the 2012-13 Euro Crisis led to reduced investor confidence and a decline in FDI inflows.

India has also experienced both sudden and gradual increases in FDI inflows at various times. For example:

- **2006-07**: There was a dramatic surge of more than 100 percent in FDI inflows, following positive amendments to FDI policies. The procedures were simplified, capital limits were increased to 100 percent, and many restrictions were lifted, which had a particularly positive impact on sectors like civil aviation.
- **2007-08**: The Indian government organized promotional events such as Destination India and enhanced the user-friendliness of the Department of Industrial Policy & Promotion (DIPP) website. These measures, which included providing answers to investment-related queries, were aimed at attracting more investments.
- **2014**: After a prolonged period of decline in global economic conditions from 2008-09 to 2012-13, FDI inflows into India began to recover. This recovery was attributed to new government policies and initiatives like Make in India, Start-up India, Skill India, the development of smart cities, and improvements in the business environment to facilitate ease of doing business.
- **2017**: Further changes to FDI policies were introduced, which proved effective in reducing bureaucratic hurdles. These changes made the FDI approval process more rational, swift, and investor-friendly.
- India's FDI equity inflows have experienced a decline in recent years, reaching their lowest level in 2018-19, primarily due to a sharp decrease in foreign investments in sectors such as telecom, power, and pharmaceuticals. Contributing factors to this decline include recent economic challenges like demonetization, the implementation of GST, job crises, poor consumer demand, the farmer crisis, and the burden of non-performing assets (NPAs).
- Despite these challenges, the new government has addressed some of these issues by alleviating 87 FDI rules across 21 sectors over the past three years. Notably, it has opened up traditionally conservative sectors like railways and defense to foreign direct investment.
- Overall, while there have been fluctuations in FDI inflows, the trend have generally been on the rise, especially after 2012-13. This upward trend is reflected in a positive Compound Annual Growth Rate (CAGR) of 14.8 percent for FDI inflows, aligning with the broader global economic trends.

Interpretation (2)

FDI consists of three components: Equity Capital, Reinvested Earnings, and Other Capital. The Other Capital component includes amounts remitted through the RBI's NRI schemes.

- **Table I(A)**: Shows the cumulative amount of FDI inflows (including Equity Capital, Reinvested Earnings, and Other Capital) as US$ 848,663 million. This figure represents a positive growth of 3% in the financial year 2021-22 compared to the previous financial year 2020-21.
- **Table I(B)**: Shows the cumulative amount of FDI equity inflows (excluding the amounts remitted through RBI's NRI schemes) as US$ 588,528 million. This figure indicates a negative growth of 1%.

This comparison suggests that the RBI's NRI schemes contribute significantly to the total FDI inflows in India. Without considering these remittances, the growth rate of FDI inflows shifts from a positive 3% to a negative 1%, highlighting the substantial impact of these schemes on overall FDI figures.

Table II. Share of Top Investing Countries' FDI Equity Inflows (Financial Years): Amount: Rupees in Crores (US$ in Millions)

Ranks	*Country*	Amt. in Rupees Crores/ Amt. in USD Million	*Cumulative inflow* *(April, 00 – September, 22*	*%age to total inflow* *(in terms of USD)*
1	Mauritius	Rupees Crores	9,33,295	
		USD Million	**(161,061)**	26%
2	Singapore	Rupees Crores	9,35,357	
		USD Million	**(140,988)**	23%
3	U.S.A.	Rupees Crores	3,77,569	
		USD Million	**(56,753)**	9%
4	Netherland	Rupees Crores	2,77,387	
		USD Million	**(43,022)**	7%
5	Japan	Rupees Crores	2,31,010	
		USD Million	**(38,126)**	6%
6	United Kingdom	Rupees Crores	1,85,115	
		USD Million	**(32,821)**	5%
7	UAE	Rupees Crores	1,03,684	
		USD Million	**(15,180)**	2%

8	Cayman Islands	Rupees Crores	1,03,521	2%
		USD Million	**(14,735)**	
9	Germany	Rupees Crores	81,023	2%
		USD Million	**(13,813)**	
10	Cyprus	Rupees Crores	68,517	2%
		USD Million	**(12,131)**	
TOTAL FDI EQUITY INFLOW FROM ALL COUNTRIES *		Rupees Crores	38,21,824	-
		USD Million	**(615,317)**	

Source: dipp.nic.in

* Includes inflows under NRI Schemes of RBI.

Note: (i) Percentage worked out in terms of US$ & FDI inflows received through FIPB/SIA+ RBI's Automatic Route + acquisition of existing shares only.(ii) Figures are provisional.

Interpretation

From the above table, it can be observed that among the top ten countries investing in India over the last 22 years, Mauritius and Singapore rank first and second, respectively. Together, they have contributed approximately 49 percent of the total FDI inflows during this period.

Table III. Sectors Attracting Highest FDI Equity Inflows:
Amount: Rupees in Crores (US$ in Millions)

SHARE OF TOP 10 SECTOR-WISE FDI EQUITY INFLOW FROM APRIL 2000 TO September 2022

S.No	Sector	Amount of FDI inflow		%age of Total inflow
		(In INR crore)	(In USD million)	
1	SERVICES SECTOR (Fin., Banking, Insurance, Non Fin/Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis, Other)	5,94,897.2110	98,356.2143	15.9846
2	COMPUTER SOFTWARE & HARDWARE	6,27,190.2720	91,799.1549	14.9190
3	TELECOMMUNICATIONS	2,32,367.0572	39,025.2632	6.3423
4	TRADING	2,54,751.9398	38,020.8151	6.1791
5	AUTOMOBILE INDUSTRY	2,14,684.6010	33,774.1535	5.4889
6	CONSTRUCTION (INFRASTRUCTURE) ACTIVITIES	1,98,531.5995	28,959.2898	4.7064

7	CONSTRUCTION DEVELOPMENT: Townships, housing, built-up infrastructure and construction-development projects	1,28,235.4099	26,237.7649	4.2641
8	CHEMICALS (OTHER THAN FERTILIZERS)	1,22,256.5124	20,759.4814	3.3738
9	DRUGS & PHARMACEUTICALS	1,14,834.7499	20,104.2863	3.2673
10	METALLURGICAL INDUSTRIES	1,01,999.1483	17,094.0075	2.7781

Interpretation

Among the top ten sectors attracting the most FDI inflows, the service sector has received the highest investments, constituting nearly 15 percent of the total investments from these countries over the last 22 years. This is followed by the Computer Hardware & Software sector with 14 percent and the Telecommunication sector with 6 percent.

The service sector has been the fastest-growing sector in the Indian economy for an extended period. Various components within this sector—such as trade, financing, hotels, insurance, transport and communication, real estate and business services, and social and personal services—collectively account for more than 60 percent of India’s GDP. This substantial contribution highlights the sector's strong appeal to foreign investors.

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There was notable growth in FDI inflows from 2013 to 2016 following a sharp decline of -36% in 2012-13. This period saw India attracting a significant amount of FDI. However, in recent years, FDI equity inflows have experienced a decline, hitting their lowest level in 2021-22. This decline is attributed to a steep fall in foreign investments in key sectors such as telecom, power, and pharmaceuticals.

Findings Pertaining to Objective 2

Mauritius and Singapore have been the top two countries investing directly in India, together constituting around 49 percent of the total FDI inflows from the top ten investing countries over the last 22 years.

Findings Pertaining to Objective 3

Among the top ten sectors attracting the most FDI inflows, the service sector ranks first, receiving 15 percent of the total inflows over the last 22 years. This is followed by the Computer Hardware & Software sector with 14 percent and the Telecommunication sector with 6 percent.

CONCLUSION

Trends in FDI inflows represent relative changes, showing percentage growth compared to the previous year. These trends may not always reflect the absolute numbers of foreign direct investment flowing into the economy. Various factors contribute to the variations in FDI trends, including:

1. **Economic Factors**: Economic growth, market size, resource availability, return on investment, and inflation.
2. **Institutional Factors**: Government regulations, tax policies, and foreign exchange rates.
3. **Political Factors**: Political stability and the overall investment climate.

These factors can significantly impact FDI inflows, causing fluctuations in trends from year to year. Understanding these influences helps in interpreting the trends and planning strategies to attract and sustain foreign investment.

RECOMMENDATIONS

According to previous studies, India has been successful in attracting significant amounts of FDI primarily since the post-reform period starting in July 1991. However, it still lags behind many other developing nations relative to its size in terms of FDI inflows. To address this, it is recommended that India shift its focus towards long-term development rather than short-term growth.

In the context of FDI, the government is advised to:

1. **Further Liberalize Policies**: Make foreign direct investment policies more liberal and investment-friendly.
2. **Diversify Investment Sources**: Expand beyond relying on a few countries and seek multiple investment opportunities.
3. **Explore New Sectors**: Identify and promote sectors where foreign investors can enter through the automatic route.
4. **Formulate Favorable Policies**: Develop policies that are favorable for investments across various sectors, not just the service sector.

These measures could help attract a more diverse range of investments and support sustained economic growth.

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