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The role of Foreign Direct Investment on Economic Growth in India

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Introduction

Ratio of Savings and Investment to GDP in India(at current market prices per cent)*

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11 2R	2011-12 1R
1. Gross Domestic Saving	32.4	33.4	34.6	36.8	32.0	33.7	34.0	30.8
2. Gross Domestic Capital Formation	32.8	34.7	35.7	38.1	34.3	36.5	36.8	35.0
3. Saving-Investment Gap (1-2)	-0.4	-1.3	-1.1	-1.3	-2.3	-2.8	-2.8	-4.2

Source: CSO. 1R: 1st Revised Estimate, 2R: 2nd Revised Estimate. * Data on Investment and Savings rates are available up to 2011-12.

In developing and underdeveloped countries Foreign Direct Investment plays a vital role. The need of Foreign Direct Investment in these nations arises due to low level of savings and income in order to meet the needed level of investment required to sustain the growth of the economy. In other words we can say that FDI serves as a link between savings and investment.

India's savings and investment peaked at 36.8% and 38.1% of GDP, respectively, in FY08. In FY13, the overall savings rate dropped to 30.1% of GDP and investment to 34.8% of GDP. The main reason behind this is a fall in savings due to high inflation in India. It has widened the saving-investment gap. So there is a need of external capital.

The gap between Savings and Investment is deficit throughout the period. And it is increasing year by year.

India is facing the problem of deficit savings. This problem can be solved with the help of Foreign Direct Investment. There is a massive increase in the flow of foreign direct investment in India after liberalizing and globalizing the economy in 1991. After this FDI is considered as a developmental tool, which helps in achieving self-reliance in various sectors and in overall development of the economy. For the economic growth in India, FDI is needed in industries like insurance, real estate and business services, because these are the profit making industries.

Review of Literature

As mentioned by Chowdhury and Mavrotas (2005), a large number of empirical studies on the role of FDI in host countries suggest that FDI is an important source of capital, complements domestic private investment, is usually associated with new job opportunities and enhancement of technology transfer and spillover, human capital (knowledge and skill) enhancement, and boosts overall economic growth in host countries.

The reintegration process of developing countries in global economy influences FDI orientation to certain countries or regions causing the reestablish external balance as a consequence for reducing the deficit [Wijeweera, Villano, Dollery, 2010].

De Mello (1997) found that the impact of FDI on economic growth of the host country depends on the degree of efficiency of domestic firms. The long-term of growth rate depends on, the rate of time preference, and productivity of domestic capital and the degree of complementarity between domestic and foreign technologies.

Chakraborty Chandana and Basu Parantap, (2002), "FDI and growth in India: a co integration approach". The study is explored through a structural co integration model with vector error correction mechanism, by a two way link between FDI and long run relationship exists between FDI and GDP, i.e. unit labour cost and import duty in total tax revenue.

In India Gross Domestic product is used as an important variable of economic growth. It shows the potential market size of the Indian Economy. The market size is directly linked with FDI inflows. Due to large market size, India is becoming a favored destination for FDI. India's GDP growth is driven, to a large extent, by the services sector. During 2005-06 and 2007-08 the annual growth rate of GDP was over 9.0 per cent, the performance of services and industry was particularly strong. After the global financial crisis in 2008-09 the Indian economy responded strongly to fiscal and monetary stimulus and achieved a growth rate of 8.6 per cent and 9.3 per cent respectively in 2009-10 and 2010-11. But this recovery was short-lived and the growth rate with growth slowing to 6.2 per cent in 2011-12 and further to 5.0 per cent in 2012-13. The main reason is stagnant industry sector. Within the industry sector, the mining and manufacturing sectors registered negative growth. The another reason for slowing growth is the low growth in the trade, hotels, transport & communications segment of the services sector.

Due to lower household financial savings, corporate savings and greater government dis-savings India is facing the problem of low savings. And this led to a widening of the saving-investment gap in recent years. The overall investment rate slowed to 35.0 per cent in 2011-12 from

the peak of 38.1 per cent in 2007-08. Alongside a fall in investment, latest data indicate that the domestic savings rate has fallen to 30.8 per cent in 2011-12 from 34.0 per cent in 2010-11.

In September 2012 Government of India has announced several economic reform measures to revive growth in the economy by addressing the structural bottlenecks, attempting to restart the investment cycle by boosting the confidence of both domestic and global investors, and outlined steps to increase the financial savings of households.

Actions Taken by Government of India to Attract FDI

A number of actions have been taken by government of India to attract Foreign Investment. For instance, the setting up of the Cabinet Committee on Investment (CCI) under the chairmanship of the Prime Minister to fast track large investment projects has resulted in projects worth over ` 384 thousand crore being cleared (up to August 27, 2013).

Government of India has recently amended its FDI policy by opening entry routes for some sectors like petroleum & natural gas; commodity exchanges; power exchanges; stock exchanges, depositories and clearing corporations; asset reconstruction companies; credit information companies; tea sector including tea plantations; single brand product retail trading; test marketing; telecom services and courier services.

To attract foreign investment in infrastructure sector Indian Government has outlined various initiatives in the Union Budget 2013-14. They are encouragement to Infrastructure Debt Funds, enhancement of credit to infrastructure companies, raising the corpus of Rural Infrastructure Development Fund (RIDF), introduction of investment allowance for new high value investments.

To encourage FDI Government of India has recently issued new gas pricing guidelines introduced deregulation of the sugar sector, signed coal fuel supply agreements, and commenced work on the Delhi-Mumbai Industrial corridor (DMIC). Which cover six states (Uttar Pradesh, NCR of Delhi, Haryana, Rajasthan, Gujarat and Maharashtra). The DMIC aims to ensure the availability of an efficient transportation system within these industrial cities. Land Acquisition, rehabilitation and Resettlement act, 2013

replaced by 120 year old Land Acquisition Act and streamline the process of land acquisition in the country. These reforms have raised FDI limits in a range of sectors. Indian Government has undertaken several economic reform measures since September 2012 to revive growth in the economy by addressing the structural bottlenecks, attempting to restart the investment cycle by boosting the confidence of both domestic and global investors, and outlined steps to increase the financial savings of households. Due to these economic reform measures India was the fourth-largest recipient of FDI in terms of projects in 2012. In terms of value, it accounted for 5.5% of global FDI. India accounts for 9.4% of jobs created by FDI around the world.

Conclusion

In many underdeveloped and developing economies the need of Foreign Direct Investment arises due to low level of saving and investment. High inflation is the main reason of low level of savings in India. There is a huge growth opportunity for Foreign Investors in India due to large size of domestic market. Foreign Direct Investment is considered as a tool for economic development.

Government of India has passed number of reforms to attract Foreign Investment. These reforms include opening entry routes in new sectors for FDI. Foreign investment limits have been raised in number of sectors. India needs to rapidly step up investment in infrastructure sector. Because this sector plays an important role in economic growth. India needs an innovative business models because they bring new avenues of growth to the market. Government of India needs to introduce reforms that help to make it convenient for foreign investors who want to invest in India.

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