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ORIGINAL ARTICLE

THE DETERMINANTS AND IMPACT OF FOREIGN DIRECT INVESTMENT ON ECONOMIC GROWTH IN DEVELOPING COUNTRIES: A STUDY OF INDIA

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Abstract:

The role of FDI in the growth process has been a burning topic of debate in several countries including India. Huge segment of the nation are not much aware about the terminology and role of FDI in employment generation as well as in economic development. The main purpose of the study is to investigate the impact of FDI on economic growth in India.

FDI seen as an important economic catalyst of Indian economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfers.

KEYWORDS:

FDI, GDP, Economic Development, Employment Generation .

1.INTRODUCTION

Foreign direct investment (FDI) plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development. Foreign direct investment, in its classic definition, is defined as a company from one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology, licensing of intellectual property,

In the past decade, FDI has come to play a major role in the internationalization of business. Reacting to changes in technology, growing liberalization of the national regulatory framework governing investment in enterprises, and changes in capital markets profound changes have occurred in the size, scope and methods of FDI. New information technology systems, decline in global communication costs have made management of foreign investments far easier than in the past. The sea change in trade and investment policies and the regulatory environment globally in the past decade, including trade policy and tariff liberalization, easing of restrictions on foreign investment and acquisition in many nations, and the deregulation and privatization of many industries, has probably been been the most significant catalyst for FDI's expanded role.

The most profound effect has been seen in developing countries, where yearly foreign direct investment flows have increased from an average of less than $10 billion in the 1970's to a yearly average of

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less than $20 billion in the 1980's, to explode in the 1990s from $26.7billion in 1990 to $179 billion in 1998 and $208 billion in 1999 and now comprise a large portion of global FDI.. Driven by mergers and acquisitions and internationalization of production in a range of industries, FDI into developed countries last year rose to $636 billion, from $481 billion in 1998 (Source: UNCTAD)

Proponents of foreign investment point out that the exchange of investment flows benefits both the home country (the country from which the investment originates) and the host country (the destination of the investment). Opponents of FDI note that multinational conglomerates are able to wield great power over smaller and weaker economies and can drive out much local competition. The truth lies somewhere in the middle.

For small and medium sized companies, FDI represents an opportunity to become more actively involved in international business activities. In the past 15 years, the classic definition of FDI as noted above has changed considerably. This notion of a change in the classic definition, however, must be kept in the proper context. Very clearly, over 2/3 of direct foreign investment is still made in the form of fixtures, machinery, equipment and buildings. Moreover, larger multinational corporations and conglomerates still make the overwhelming percentage of FDI. But, with the advent of the Internet, the increasing role of technology, loosening of direct investment restrictions in many markets and decreasing communication costs means that newer, non-traditional forms of investment will play an important role in the future. Many governments, especially in industrialized and developed nations, pay very close attention to foreign direct investment because the investment flows into and out of their economies can and does have a significant impact. In the United States, the Bureau of Economic Analysis, a section of the U.S. Department of Commerce, is responsible for collecting economic data about the economy including information about foreign direct investment flows. Monitoring this data is very helpful in trying to determine the impact of such investments on the overall economy, but is especially helpful in evaluating industry segments. State and local governments watch closely because they want to track their foreign investment attraction programs for successful outcomes.

CHANGING SCENARIO FDI IN THE PAST DECADE

As mentioned above, the overwhelming majority of foreign direct investment is made in the form of fixtures, machinery, equipment and buildings. This investment is achieved or accomplished mostly via mergers & acquisitions. In the case of traditional manufacturing, this has been the primary mechanism for investment and it has been heretofore very efficient. Within the past decade, however, there has been a dramatic increase in the number of technology startups and this, together with the rise in prominence of Internet usage, has fostered increasing changes in foreign investment patterns. Many of these high tech startups are very small companies that have grown out of research & development projects often affiliated with major universities and with some government sponsorship. Unlike traditional manufacturers, many of these companies do not require huge manufacturing plants and immense warehouses to store inventory. Another factor to consider is the number of companies whose primary product is an intellectual property right such as a software program or a software-based technology or process. Companies such as these can be housed almost anywhere and therefore making a capital investment in them does not require huge outlays for fixtures, machinery and plants.

In many cases, large companies still play a dominant role in investment activities in small, high tech oriented companies. However, unlike in the past, these larger companies are not necessarily acquiring smaller companies outright. There are several reasons for this, but the most important one is most likely the risk associated with such high tech ventures. In the case of mature industries, the products are well defined. The manufacturer usually wants to get closer to its foreign market or wants to circumvent some trade barrier by making a direct foreign investment. The major risk here is that you do not sell enough of the product that you manufactured. However, you have added additional capacity and in the case of multinational corporations this capacity can be used in a variety of ways.

High tech ventures tend to have longer incubation periods. That is, the product tends to require significant development time. In the case of software and other intellectual property type products, the product is constantly changing even before it hits the marketplace. This makes the investment decision more complicated. When you invest in fixtures and machinery, you know what the real and book value of your investment will be. When you invest in a high tech venture, there is always an element of uncertainty. Unfortunately, the recent spate of dot.com failures is quite illustrative of this point.

Therefore, the expanded role of technology and intellectual propertyhas changed the foreign direct investment playing field. Companies are still motivated to make foreign investments, but because of the vagaries of technology investments, they are now finding new vehicles to accomplish their goals. Consider the following:

Licensing and technology transfer. Licensing and tech transfer have been essential in promoting collaboration between the academic and business communities. Ever since legal hurdles were removed that allowed universities to hold title to research and development done in their labs, licensing agreements have helped turned raw technology into finished products that are viable in competitive marketplaces. With some help from a variety of government agencies in the form of grants for R&D as well as other financial assistance for such things as incubator programs, once timid college researchers are now stepping out and becoming cutting edge entrepreneurs. These strategic alliances have had a serious impact in several high tech industries, including but not limited to: medical and agricultural biotechnology, computer software engineering, telecommunications, advanced materials processing, ceramics, thin materials processing, photonics, digital multimedia production and publishing, optics and imaging and robotics and automation. Industry clusters are now growing up around the university labs where their derivative technologies were first discovered and nurtured. Licensing agreements allow companies to take full advantage of new and exciting technologies while limiting their overall risk to royalty payments until a particular technology is fully developed and thus ready to put new products into the manufacturing pipeline.

IMPORTANCE OF FDI IN GLOBAL ERA

The simple answer is that making a direct foreign investment allows companies to accomplish several tasks:

1.Avoiding foreign government pressure for local production.
2.Circumventing trade barriers, hidden and otherwise.
3.Making the move from domestic export sales to a locally-based national sales office.
4.Capability to increase total production capacity.
5.Opportunities for co-production, joint ventures with local partners, joint marketing arrangements, licensing, etc;

A more complete response might address the issue of global business partnering in very general terms. While it is nice that many business writers like the expression, "think globally, act locally", this often used cliché does not really mean very much to the average business executive in a small and medium sized company. The phrase does have significant connotations for multinational corporations. But for executives in SME's, it is still just another buzzword. The simple explanation for this is the difference in perspective between executives of multinational corporations and small and medium sized companies. Multinational corporations are almost always concerned with worldwide manufacturing capacity and proximity to major markets. Small and medium sized companies tend to be more concerned with selling their products in overseas markets. The advent of the Internet has ushered in a new and very different mindset that tends to focus more on access issues. SME's in particular are now focusing on access to markets, access to expertise and most of all access to technology.

Of course, it is out of question for India to have remained outside the mainstream of the GATT. By virtue of its membership in the GATT, India is automatically entitled to enjoy the benefit of the Most Favoured Nation (MFN) treatment from all the other participating members. Secondly, keeping aloof herself from the GATT, India would have had to undergo bilateral agreements with several countries for improving her trade relations and yet could not have assured the same what could have been yielded through the GATT. Today, even a country like China has been keen on joining the GATT.

In the whole bargaining process of the Uruguay Round, the Indian government, by and large, played merely a spectator's role under the pretext that no clauses of the negotiations are seriously detrimental to the interests of the country. The only consolation is that, there was hardly and option available to us when the country is just wedded to economic liberalisation and the GATT multilateralism is a lesser evil than bilateralism.

OBJECTIVES OF THE RESEARCH:

The objective of research is to discover answers to questions through the application of scientific procedures. The main aim of research is to find out the truth which is hidden and which has not been discovered as yet. Though each study has some specific purpose and objectives, following are the main objective of my research.

1)To measure the Impact of FDI on employment generation.
2)To study the Net Cash Inflow due to Foreign Direct Investment (FDI).

3)To determine the opportunities to India through FDI.
4)To find out the role of FDI in Indian GDP.
5)To study the SWOT analysis of FDI in India.

HYPOTHESIS:

For this research Hypothesis is being drown as FDI will be helpful and beneficiate to the Nation
With the reference of GATT (General Agreement of Trade and Tariff) Nation invite the foreign investor for lending their money in to the Nation
Foreign Direct Investment (FDI) is an important element of Gross Domestic Product (GDP)

Scope and limitations of the research:

Scope: “The relevant information regarding the particular mention area, the population regarding the area, regarding the various elements and about the particular era and about the result can be mentioned as scope of the study”

In view of problem other resources the research area of study will be the India as a nation consisting of 28 states and 07 Union Territories.

ANALYSIS AND INTERPRETATION

Country – Wise FDI Inflows- Top 10 Countries (From 2007- 2010) (Amount Rupees in Crores)

Rank	Country	2007-08 (April-March)	2008-09 (April-March)	2009-10 (April-March)	(for April 2010)	Cumulative Inflows (April ’00 to April ’10)	% age to Total Inflow
1	Mauritius	44483	50794	49633	2528	213434	43
2	Singapore	12319	15727	11295	1933	47080	09
3	USA	4377	8002	9230	404	37593	07
4	UK	4690	3840	3094	265	26263	05
5	Netherlands	2780	3922	4283	312	20438	04
6	Japan	3336	1889	5670	1455	18350	04
7	Cyprus	3385	5983	7728	123	17900	04
8	Germany	2075	2750	2980	102	12571	03
9	France	583	2098	1437	184	7102	01
10	UAE	1039	1133	3017	31	7054	01
	Total FDI Inflows	**98664**	**123025**	**123378**	**9854**	**526357**	**83%**

Source: Government of India (GOI) (2009) . FDI statistics. Ministry of Commerce & Industry, Department of Industrial Policy and Promotion

India's 83% of cumulative FDI is contributed by nine countries while remaining 17 per cent by rest of the world. The analysis of country wise inflows of FDI in India indicates that during 2007-2010, the total amount of Rs 526537 of FDI was received from 113 countries including NRI investments.

India's perception abroad has been changing steadily over the years. This is reflected in the ever growing list of countries that are showing interest to invest in India. Mauritius emerged as the most dominant source of FDI contributing 44 % of the total investment in the country. Singapore was the second dominant source of FDI inflows with 9% of the total inflows. However, USA slipped to third position by contributing 7% of the total inflows. They maintained continuous increasing trend under the period of study. UK occupied fourth position with 5%followed by Netherlands with 4%, Japan with 4%, Cyprus with

4%, Germany with 3%, France with 1%, UAE with 1%.

It has been observed that some of the countries like Israel, Thailand, Hong Kong, South Africa and Oman increased their share gradually during the period under study. It is also interesting to note that some of the new countries such as Hungary, Nepal, Virgin Islands, and Yemen are making significant investments in India.

Sector wise FDI inflow in India (Rupees in Crores)

Sector	2007-08 (April -March)	2008-09 (April -March)	2009-10 (April-March)	2010-11 (for April '10)	Cumulative Inflows (April '00 - April '10)	% age to Total Inflows (In terms of US$)
Services Sector	26,589	28,411	20,958	1,581	106,992	**21%**
Computer Software	5,623	7,329	4,350	765	44,611	**9%**
Telecommunications (radio paging, cellular mobile, basic telephone services)	5,103	11,727	12,338	1,914	42,620	**8%**
Housing & Real	8,749	12,621	13,586	246	37,615	**7%**
Construction	6,989	8,792	13,544	345	36,066	**7%**
Power	3,875	4,382	6,908	547	21,466	**4%**
Automobile Industry	2,697	5,212	5,609	187	20,864	**4%**
Metallurgical	4,686	4,157	1,935	404	13,845	**3%**
Petroleum & Natural	5,729	1,931	1,328	522	12,026	**2%**
Chemicals (other than Fertilizers)	920	3,427	1,707	115	11,390	**2%**

FDI and Economic Development:-

FDI is considered to be the life blood and an important vehicle of for economic development as far as the developing nations are concerned. The important effect of FDI is its contribution to the growth of the economy.

FDI has an important impact on country's trade balance, increasing labour standards and skills, transfer of technology and innovative ideas, skills and the general business climate. FDI also provides opportunity for technological transfer and up gradation, access to global managerial skills and practices, optimal utilization of human capabilities and natural resources, making industry internationally competitive, opening up export markets, access to international quality goods and services and augmenting employment opportunities.

FDI and GDP FC

Year	FDI (Rs. Crores)
2000-01	12645
2001-02	19361
2002-03	14932
2003-04	12117
2004-05	17138
2005-06	14613
2006-07	70630
2007-08	98664
2008-09	85700

The reliance on FDI is rising heavily due to its all-round contributions to the growth of the economy. FDI to developing countries since 1990's is the leading source of external financing. The rise in FDI volume is accompanied by marked change in its composition.

CONCLUSION:-

Foreign Direct Investment (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 (R & D) etc. Government should design the FDI policy such a way where FDI inflow can be utilized as means of enhancing domestic production, savings and exports through the equitable distribution among states by providing much freedom to states, so that they can attract FDI inflows at their own level. FDI can help to raise the output, productivity and export at the sectoral level of the Indian economy. However, it can observed the result of sectoral level output, productivity and export is minimal due to the low flow of FDI into India both at the macro level as well as at the sectoral level. Therefore for further opening up of the Indian economy, it is advisable to open up the export oriented sectors and higher growth of the economy could be achieved through the growth of these sectors

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