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The Impact and Growth of Foreign Direct Investment (FDI) on Indian Economy

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Abstract

In the Indian economy, foreign direct investment, or FDI, has grown in popularity as a source of funding. It was first implemented in 1991 during the Liberalization, Privatization, and Globalization (LPG) policy. Following the introduction of FDI, the Indian economy opened up to foreign investment inflows across a range of economic sectors. Later in2014, the Indian government introduced the "make in India" campaign and regarded FDI as the most important factor in the growth of the Indian economy. The main goal is to support Indian companies in their globalization. The Indian government has opened up a number of sectors to foreign direct investment, including pension funds, medical devices, insurance, railways, defense, and construction. This article looks at how FDI has grown, reviewed from the perspective of capital movement, and affected the Indian economy. The changes in FDI policy and investment limits in the various sectors of the Indian economy are also highlighted in this paper.
Key words: Infrastructure subsidies, export processing zones, economy, and European Union

1. Introduction

Foreign direct investment (FDI) is the term used to describe a corporation with its headquarters located in another country's majority ownership interest in a business enterprise in another country. The OECD states that a partnership involving foreign direct investment must meet a minimum threshold of 10%. This implies that a minimum of 10% of the voting stock or common shares of the investee company must be owned by foreign investors. Indirect investments like portfolio flows, in which foreign institutions invest in stocks listed on a domestic stock exchange, are very different from foreign direct investments. Traditionally, those who make direct investments have a great deal of power and influence over the business they are investing in. Open economies with skilled labor markets and promising growth

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prospects are more likely to attract foreign direct investment than closed ones. The two most conventional types of FDI are horizontal and vertical. Two new types of FDI are Conglomerate and Platform FDI.

1.1 Horizontal FDI

In this type of FDI, a business expands its inland operations into a new nation. The business operates in the same area, but in a different one.

1.2 Vertical FDI

In this case, a business expands into a new nation by elevating its supply chain. Consequently, the business conducts a range of activities in foreign nations that are all connected to the primary market.

1.3 Conglomerate FDI

Under this type of FDI, a company operates unrelated business ventures in another nation. This kind is uncommon since it involves the difficulty of entering a foreign market and sector.

1.4 Platform FDI

In this instance, a business grows into a second area, but exports its goods to a third.

2. Review of Literature

We are still conducting empirical tests to test the FDI-led growth hypothesis because a consensus on a conclusion has not been reached. There are those who subscribe to the widely accepted nexus and those who do not. For instance, utilizing the dynamic Autoregressive Distributed Lag (ARDL), a recent study (Kalai and Zghidi 2019) on MENA economies discovered a one-way causal relationship between FDI inflow and the economic expansion of MENA economies. The results of the study went a step further and proved that the investigations were moving in tandem over the long run. In a related report, Sokhanvar (2019) tests the same hypothesis for economies within the European Union that receive significant FDI inflows. The results indicate that tourism and foreign direct investment (FDI) are significant drivers of the region's economic growth. The study then used the block exogeneity Wald test and the impulse responses response function to show that the effect of FDI inflow is a mirage because the results show a negative relationship between the variables. The impact of foreign direct investment (FDI), economic growth, and energy consumption on greenhouse gas emissions in emerging economies was examined by Sarkodie and Strezov (2019). The results demonstrated that the only FDI inflow that has a beneficial impact is clean FDI that does not endanger the environment. Using the ARDL method, Sunde (2017) looked into the connection between FDI inflow, exports, and economic growth in South Africa. His findings showed that exports and FDI inflows both contributed to economic expansion. Granter's causality test also reveals a one-way relationship between FDI inflow and economic growth. According to Borensztein et al. (1998), FDI inflow can contribute to economic development, but only if the host nation is able to accept it. Additionally, he stated that foreign direct investment (FDI) inflows would expeditiously boost economic development once a nation hits a certain threshold. Güngör and Ringim (2017), Güngör et al. (2014), Tshepo et al. (2014), and Gungor and Katircioglu (2010) have all completed work along these lines. Nistor's (2014) research verified the link between foreign direct investment and Romania's economic growth. In a panel study involving 65 countries, Tang et al. (2008), Nasrin and Khan (2016), and Almfraji and Almsafir (2013) discovered that foreign direct investment (FDI) inflow is a significant driver of economic growth, supporting the conclusions of Tang et al. (2008), Malikane and Chitambara (2017), and Zghidi et al (2016). In most SAARC countries, Srinivasan et al. (2011) found a bidirectional relationship between FDI and economic growth, with the exception of India, where a one-way connection was found.

2.1 Foreign Direct Investments in India

Under the Foreign Exchange Management Act (FEMA), former Finance Minister Manmohan Singh introduced Foreign Direct Investment (FDI) in 1991. India plans to cap foreign equity holdings in a number of industries in the upcoming years. Currently, FDI in the aviation and insurance sectors is limited to a maximum of 49%. India is the second most popular FDI destination for multinational corporations, after China, according to a 2012 UNCTAD survey project on FDI, which was carried out after two decades of FDI introduction. Major sources of FDI inflows now include services, telecommunications, construction activities, and computer software and hardware. The top FDI investors in India were the United States, the United Kingdom, Singapore, Mauritius, and the United States. Furthermore, India became the most preferred FDI destination in 2015, surpassing both China and the US. In the first half of 2015, India received $31 billion in foreign direct investment (FDI), while China and the US received $28 and $27 billion, respectively. India ranked ninth among countries receiving foreign direct investment in 2019, with inflows of 51 billion dollars, up from 42 billion dollars in 2018, according to UNCTAD's World Investment Report-2020. Once more, India's economy came in at number twelve out of the world's twenty host economies in 2020.

2.2 Make in India Initiative Concerning FDI

The goal of the Made in India initiative is to include India in the world's supply chain. The main goal is to support Indian companies in their globalization. India's economy has been opened up considerably in a number of areas, including construction, insurance, railroads, and defense. Pension funds and medical devices have seen an increase in Foreign Direct Investment (FDI). That was a smart investment. India currently has one of the most accessible economies globally. The Indian government has put in place several policies targeted at significantly raising the Ease of Doing Business in order to achieve this. Its goal is to simplify regulations in order to create an environment where businesses can prosper. It has successfully merged and integrated divisions through the use of technology. With 14 services integrated into it, the eBiz portal serves as a one-stop shop for obtaining clearances from various government agencies.

2.3 Types of Foreign Direct Investors

A Foreign Direct Investor may be listed as any of the following in any field of the economy.

- An individual;
- A group of related individuals;
- An incorporated or unincorporated entity;
- A public company or private company;
- A group of related enterprises;
- A government body;
- A will, a trust, or another social institution;
- Any combination of the above.

An enterprise's voting power can be acquired by a foreign direct investor in:

- Subsidiary company
- Associated enterprise
- Merged or acquired Company
- Joint venture based Company

Incentives for foreign direct investment can take the following forms:

- Low corporate and personal income tax rates
- Tax holidays
- Tax breaks
- Tariffs with Preferential Treatment

- Areas of special economic significance
- Export Processing Zones (EPZs)
- Bonded Storage Facilities
- Financial incentives for investment
- Loan insurance or soft loans
- Subsidies for property or free land
- Grants for relocation and expatriation
- Subsidies for job preparation and work
- Infrastructure support
- Research and development assistance

2.4 Foreign Direct Investment (FDI) Policy

Policy for foreign direct investment is renowned for being open, accommodating, and liberal toward investors. The current policy allows FDI up to 100% on the automatic approval path in the majority of sectors / operations. A consolidated FDI Policy circular is accessible to the public on the Department of Industrial Policy & Promotion's website (http://dipp.nic.in), where the FDI Policy is available.

2.5 Foreign Investment Facilitation Portal (FIFP)

The new online single point of contact for investors in India who wish to encourage foreign direct investment is the Foreign Investment Facilitation Portal (FIFP). This portal is managed by the Department of Industrial Policy and Promotion (DIPP) of the Ministry of Commerce and Industry. Applications that are undergoing the approval process will be easier to process through a single window thanks to this platform. After receiving the FDI application, the administrative Ministry/Department will handle it in line with the Standard Operation Procedure (SOP) that this department supplied on June 29, 2017, as well as any subsequent amendments.

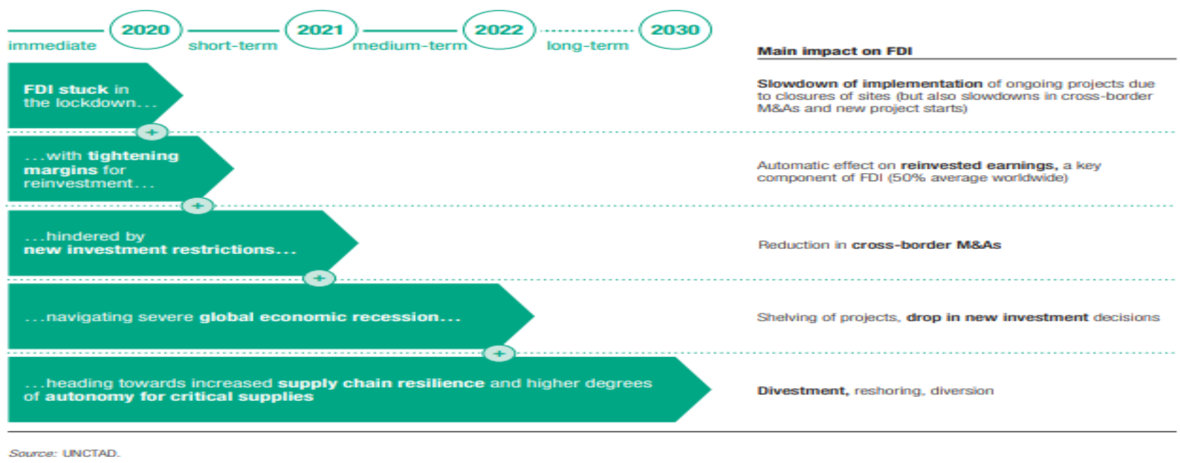
2.6 Recent Initiatives Taken by Government

In order to establish a mobile and IT display product manufacturing unit in December 2020, Samsung Display Noida Private Limited has agreed to receive special incentives from the Uttar Pradesh government. As part of the Central Government's initiative to support the manufacturing of semiconductors and electronic components, Samsung will also get a financial incentive worth Rs. 460 crore (US$ 62.61 million) (SPECS).Through this project, Uttar Pradesh would be able to attract more foreign direct investment (FDI) and establish itself as a global export hub. The Union Cabinet authorized changes to the Direct-to-Home (DTH) service guidelines in December 2020, allowing 100% foreign direct investment in the DTH broadcasting services sector. A bill to raise foreign direct investment (FDI) in the insurance industry from 49% to 74% was approved by the parliament in March 2021. The State Minister for Defense, Mr. Shripad Naik, declared in March 2021 that 44 Indian companies, including PSUs, had received FDI approvals for collaborative defense development with foreign entities.

2.7 Impact of Crisis (Covid-19) on FDI

FDI has already been impacted by the COVID-19 crisis, and there may be long-term effects. The quick and simultaneous interaction of supply-side and demand-side shocks, along with policy reactions to the global crisis, is setting off a cascade of effects on foreign direct investment. The impact will be particularly strong in 2020, when the total effect of all transmission mechanisms is at its highest. Immediate effects: FDI is inhibited. Construction sites, manufacturing plants, and commercial establishments are closing to prevent the virus from spreading. As a result, investment project implementation experiences sudden delays. Certain investment expenses, like project fixed running costs, are still incurred, but others are entirely stopped. Announcements about greenfield projects are also delayed. In a similar vein, a number of mergers and acquisitions (M&A) have been temporarily halted. Similar to green field initiatives, M&A deals are typically long-term investments in overseas markets. However, the completion of previously announced mergers and acquisitions has been postponed, which could result in cancellations. Authorities in the US and Europe have verified that some of the biggest proposed mergers in the world—Amazon's acquisition of Deliveroo in the UK and Boeing's acquisition of Embraer in Brazil—are taking longer than expected to receive approval. Financial markets have discounted the stock of businesses that have been the subject of takeover offers or that have experienced delays in receiving regulatory approval for a merger.

Figure 2.1 The Impact of COVID-19 on FDI



2.8 Government Future Plan On FDI

A report by the CII and EY predicts that by 2025, India will draw FDI worth US$ 120–160 billion annually. The GDP of the nation has grown by 6.8% during the past ten years, while FDI has increased by 1.8%. India was ranked third by the investors in terms of attractiveness; 25% of them reported having made investments exceeding US$ 500 billion, and 80% planned to make investments there in the next two to three years.

2.9 FDI Limits In Different Sectors In India-2020

India's Foreign Direct Investment (FDI) strategy has experienced significant alterations and revisions in the past few years. Additionally, FDI may enter through the government or automatic channels. Approval is not necessary for foreign entities before they can proceed along the automatic route. The Government road requires prior approval.

Table 2.1 Sector-wise FDI limit in India

Sectors	**Percentage of FDI**
Agriculture & Animal Husbandry	100
Plantation Sector	100
Mining(Coal & Lignite)	100
Petroleum and natural gas (public sector undertakings refining petroleum)	49
Natural gas and petroleum (Oil and natural gas field exploration, facilities related to petroleum product and natural gas marketing, natural gas and petroleum product marketing, etc.)	100
Defence Manufacturing	100
Broadcasting	100
Terrestrial Broadcasting FM (FM Radio) Up-linking of ‘News & Current Affairs' TV Channels Broadcasting Content Services:	49
Newspapers and periodicals concerned with news and current events are published in the print media. Publication of Indian editions of international news and current affairs journals.	26
Print Media: Publishing/printing of scientific and technical magazines/specialty journals/periodicals, subject to adherence to the relevant legal structure and guidelines provided by the Ministry of Information and Broadcasting from time to time.	100
Print Media:(Publication of facsimile edition of foreign newspapers)	100
Airport Greenfield and Existing Projects in Civil Aviation	100

Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline • Regional Air Transport Service Civil Aviation – Air Transport Services (Foreign Airlines are barred from Investing in Air India)	100% Automatic up to 49% Above 49% under Government route 100% Automatic for NRIs
• Non-Scheduled Air Transport Service in Civil Aviation • DGCA approval is required for helicopter and seaplane services. • Security clearance and sectoral legislation apply to ground handling services. • Companies that provide maintenance and repair services; flying training institutes; and professional training institutes	100
Townships, housing, and built-up infrastructure are all examples of construction growth.	100
Industrial Parks (new & existing)	100
Establishment and maintenance of satellites, subject to Department of Space/ISRO sectoral guidelines	100
Private Security Agencies	Automatic upto 49% 74% above 49% upto 74% under government route
Telecom Services	Automatic up to 49% 100% Above 49% under Government route
Cash & Carry Wholesale Trading	100% Automatic
E-commerce activities (B2B e-commerce companies will not participate in B2C e-commerce.)	100% Automatic
Retail sales of a single brand	Automatic up to 49% 100% Above 49% under Government route
Retailing of several brands	51% Government
Shops that offer duty-free goods	100% Automatic
Infrastructure for Railways	100% Automatic
Asset Reconstruction Companies	100% Automatic
Banking- Private Sector	Automatic up to 49% Above 49% & up to 74% under Government route
Banking- Public Sector	20% Government
Credit Information Companies (CIC)	100% Automatic
Infrastructure Company in the Securities Market	49% Automatic
Insurance	49% Automatic
Pension ector	49% Automatic
Power Exchanges	49% Automatic
White Label ATM Operations	100% Automatic
RBI, SEBI, IRDA, or any other regulator regulates financial services activities.	100% Automatic
Pharmaceuticals (Green Field)	100% Automatic

Pharmaceuticals(Brown Field)	Automatic up to 74% 100% Above 74% under Government route
India's food products are processed or produced there. Food products manufactured or produced in India are traded, including through e-commerce.	100% Government

Source: RBI Annual Reports.

According to the above table, a total of 25 major sectors have been identified as targets for foreign direct investment (FDI). The highest priority FDI sectors are agriculture, asset reconstruction, courier services, education, medical devices, the pharmacy industry, railway infrastructure, and single brand retail. The sectors with the highest priority are credit rating and information, private banks, and defense, insurance and related activities, multibrand, civil aviation, pensions, and power, which are ranked third.

Table 2.2 Foreign Direct Investment Flows to India: Country-wise (US $ billion)

S.No.	Counrtry	2018-19	2019-20	2020-21	2021-22	2022-23(P)
1	Singapore	16.2	14.7	17.4	15.9	17.2
2	Mauritius	8.1	8.2	5.6	9.4	6.1
3	US	3.1	4.1	13.8	10.5	6
4	UAE	0.9	0.3	4.2	1	3.4
5	Netherlands	3.9	6.5	2.8	4.6	2.5
6	Japan	3	3.2	1.9	1.5	1.8
7	UK	1.4	1.3	2	1.6	1.7
8	Cyprus	0.3	0.9	0.4	0.2	1.3
9	Canada	0.6	0.2	0	0.5	0.8
10	Cayman Islands	1	3.7	2.8	3.8	0.8
11	Germany	0.9	0.5	0.7	0.7	0.5
12	Luxembourg	0.3	0.3	0.3	0.5	0.5
13	Switzerland	0.3	0.2	0.2	4.3	0.4
14	France	0.4	1.9	1.3	0.3	0.4
15	South Korea	1	0.8	0.4	0.3	0.3
16	Others	3.1	3.2	5.7	3.4	2.3
17	Total	44.5	50	59.5	58.5	46

Source: RBI Annual Reports. P: Provisional.
Note: Includes FDI through SIA/FIPB and RBI routes only.

Data regarding the growth rate (%) of different countries from 2018–19 to 2022–2023 are shown in the table that is provided. With growth rates over the specified years of 16.2%, 14.7%, 17.4%, 15.9%, and 17.2%, respectively, Singapore tops the pack. The growth rate of Mauritius varies, reaching a maximum of 9.4% in 2021–22, 8.1% in 2018–19, and then marginally declining to 6.1% in 2022–23. The US grew significantly between 2020 and 2021, going from 3.1% to 13.8%, and then stabilizing at 6% in 2022–2023. The UAE experienced a similar rise, beginning at 0.9% and reaching 4.2% in 2020–21 before leveling off at 3.4% in 2022–23. Switzerland's growth rate was notable for having jumped from 0.2% in 2019–20 to 4.3% in 2021–2022 before declining to 0.4% in 2022–2023. All things considered, some nations oversaw steady growth rates over time, while others saw swings, which was understandable given the diverse economic environments and national policy choices that each country faces. At the bottom of each year's table is the overall growth rate for all countries, which gives a broad picture of the trends in global economic growth over the given time frame.

Table 2.3 Industry-Wise Foreign Direct Investment Flows in India (US$ Billion)

S.No.	Sector	2018-19	2019-20	2020-21	2021-22	2022-23
1	Manufacturing	9.6	9.6	9.3	16.3	11.3
2	Financial Services	7.2	5.7	3.5	4.7	6.8
3	Computer Services	3.7	5.1	23.8	9	5.6
4	Retail & Wholesale Trade	4.9	5.1	3.9	5.1	5.3
5	Communication Services	6.5	7.8	2.9	6.4	4.5
6	Electricity and Other Energy Generation, Distribution & Transmission	2.6	2.8	1.3	2.2	3.3
7	Business Services	2.8	3.8	1.8	2.5	2
8	Education, Research & Development	0.9	0.8	1.3	3.6	1.9
9	Transport	1.2	2.4	7.9	3.3	1.7
10	Construction	2.3	2	1.8	3.2	1.4
11	Miscellaneous Services	1.4	1.1	0.9	1	1.2

12	Restaurants and Hotels	0.8	2.7	0.3	0.7	0.2
13	Mining	0.3	0.3	0.2	0.4	0.2
14	Real Estate Activities	0.2	0.6	0.4	0.1	0.1
15	Trading	0	0	0	0	0
16	Others	0.1	0.2	0.2	0.4	0.5
17	Total	44.5	50	59.5	58.9	46

Source: RBI Annual Reports. P: Provisional.
Note: Includes FDI through SIA/FIPB and RBI routes only.

The table presented presents data on multiple sectors from 2018–19 to 2022–2023; the performance of each sector is shown for these five years. Among the many industries covered by the sectors are Manufacturing, Financial Services, Computer Services, Retail & Wholesale Trade, and Communication Services. The performance of each sector is shown as numerical values for each fiscal year. For example, the Manufacturing sector's value started at 9.6 in 2018–19, increased to 16.3 in 2021–2022; however, in 2022–2023 it fell to 11.3. Similarly, Financial Services started at 7.2, fluctuated over the years, and ended at 6.8 in 2022-23. Notably, some sectors experienced significant fluctuations, such as Computer Services peaking at 23.8 in 2020-21 before declining, while others, like Real Estate Activities, maintained relatively stable values throughout the period. The last row of the table represents the total value across all sectors for each respective year, offering an overview of the overall economic performance across the five-year period.

Table 2.4 States/UTs Attracting Highest FDI Equity Inflows (US $ billion)

Sr.No.	**State Name**	**2020-21**	**2021-22**	**2022-23**	**Cumulative FDI equity inflow**
1	ANDHRA PRADESH	85.85	224.96	284.22	595.04
2	ARUNACHAL PRADESH	4.95	-	-	4.95
3	ASSAM	11.19	4.4	2.09	17.69
4	BIHAR	45.08	116.47	47.37	208.93
5	CHANDIGARH	10.03	51.37	13.46	74.87
6	CHHATTISGARH	0	0.98	2.37	3.36

7	Dadra and Nagar Haveli and Daman and Diu	5.03	142.07	17.56	164.67
8	DELHI	5,471.05	8,189.35	7,534.15	21,194.55
9	GOA	16.33	37.12	11.73	65.18
10	GUJARAT	21,890.17	2,705.52	4,713.87	29,309.56
11	HARYANA	1,697.01	2,798.48	2,599.57	7,095.06
12	HIMACHAL PRADESH	10.92	137.99	34.04	182.95
13	JAMMU AND KASHMIR	0.21	0.15	0.72	1.07
14	JHARKHAND	792.06	6.43	5.62	804.11
15	KARNATAKA	7,670.49	22,071.94	10,429.37	40,171.80
16	KERALA	212.27	347.77	164.54	724.58
17	LADAKH	0.03	0.14	0.06	0.22
18	MADHYA PRADESH	206.63	208.53	39.04	454.2
19	MAHARASHTRA	16,169.79	15,438.63	14,806.39	46,414.81
20	MANIPUR	-	-	0	0
21	MEGHALAYA	-	1.1	-	1.1
22	NAGALAND	-	0.01	-	0.01
23	ODISHA	19.76	95.33	31.63	146.71
24	PUDUCHERRY	58.21	0.19	4.44	62.85
25	PUNJAB	644.46	127.01	93.55	865.02
26	RAJASTHAN	272.22	707.09	909.81	1,889.12
27	TAMIL NADU	2,323.46	3,003.16	2,168.96	7,495.58
28	TELANGANA	1,155.49	1,606.89	1,302.57	4,064.96
29	TRIPURA	0.43	0.13	-	0.56
30	UTTAR PRADESH	421.79	216.97	419.72	1,058.48
31	UTTARAKHAND	5.3	103.99	2.88	112.18
32	WEST BENGAL	415.37	427.77	394.28	1,237.42

33	State Not Indicated	19.93	1.32	-	21.25
Total:		59,635.54	58,773.27	46,034.05	1,64,442.86

Reinvested earnings, other capital, equity capital of unincorporated bodies, and equity inflow make up the total inflow of foreign direct investment. Details broken down by sector, state, and country are only kept for the equity portion of FDI inflows. Together with cumulative numbers, the table shows the Foreign Direct Investment (FDI) equity inflows for each of India's states and union territories for the fiscal years 2020–21, 2021–22, and 2022–23. Leading FDI destinations are Maharashtra, Gujarat, and Karnataka. Maharashtra has drawn the largest total FDI of 46,414.81 billion, followed by Gujarat with 29,309.56 billion and Karnataka with 40,171.80 billion. These states' varied industries—such as manufacturing, information technology, and services—contribute considerably to the FDI inflow. With significant FDI inflows of $21,194.55 billion, mostly from the real estate and services sectors, Delhi also stands out. But while some states, like Manipur and Arunachal Pradesh, see little FDI activity, other states, like Rajasthan and Bihar, see significant growth, suggesting that different regions have different levels of economic development and investment attractiveness. Despite variations in the performance of individual states, India remains a desirable destination for foreign investment, as evidenced by the cumulative FDI of 1,64,442.86 billion for all states and Union Territories.

3. Conclusion

FDI has significantly aided India's overall economic development in recent years. Foreign direct investment (FDI) inflows impact India's capacity to adopt innovative ideas and new technologies, enhance infrastructure, and create a more competitive market environment. Many people consider India to have one of the most liberal FDI strategies in the developing world. Under the automatic path, foreign direct investment (FDI) of up to 100% is allowed in most industries, including the services sector, without the need for prior approval. The government or the RBI do not need to give prior approval for FDI in certain sectors or activities due to automatic direction. The Indian economy is priority India ranks well even among the developing countries in the top 12 countries with the highest total GDP, according to an international comparison of the services sector. Simultaneously, the computer hardware and software, as well as the telecommunications market, are exploding. For FDI inflows in the former, the growth of software technology parks, regulatory reforms by the Indian government, the expanding Indian market, and the availability of skilled labor were all important factors. At the same time, the government's liberal policies provide for easy market access for telecom equipment and a rational regulatory structure for providing Indian consumers with low-cost telecom services. Marily driven by the service sector. Its gross domestic product is growing at a rate of 55.2%.

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