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Trends and Pattern of FDI in India and Information Technologies (It's) Economic Growth

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Abstract:
FDI has been recognized as an important driver for growth and development. One of the most striking developments during the last two decade is the spectacular growth in the global economic landscape. In the 1960s, FDI was seen in most countries as a partner in the development endeavors. However, the mood turned sharply in the opposite direction from the close of decade when transnational corporations (TNCs), the chief vehicle for FDI , were viewed as agents that were undermining the sovereignty of the nation states. The unprecedented growth of global FDI in 1990 around the world make FDI an important and vital component of development strategy in both developed and developing nations and policies are designed in order to stimulate inward flows. This piece of writing investigates the importance of FDI in Indian IT sectors context. Thus, the present study is an endeavor to discuss the trends and patterns of FDI, its determinants and its impact of FDI on Indian economy.

Keywords: *Foreign direct investment, Information technology*

1. Introduction

The fast-tracked liberalization of the Indian economy introduced in 1991 brought with it a radical shift in the policy towards FDI. In fact, FDI policy development formed part of the first package of industrial reforms in July 1991. Foreign investment would bring attendant advantages of technology relocate, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. The government will therefore welcome foreign investment which is in the interest of the country's industrial development. More recently, the economic survey 2008-09 reiterated that : FDI is believed to be the most attractive type of capital flow for emerging economies as it is expected to bring latest technology and enhance production capabilities of the economy.

2. Objective of the Study

The study covers the following objective:

- To study the trends and patterns of flow of FDI & its impact on growth of Indian IT sector.

3. Research Methodology

This paper is descriptive in nature. Secondary data is used to achieve the objectives of the study which is mainly obtained by various international and national government websites, policy documents, journals, published reports, World Investment Reports, various Bulletins of Reserve Bank of India and from websites of World Bank, IMF, WTO, RBI, UNCTAD, EXIM Bank etc. to analyze the trends and pattern of FDI its economic growth in India. We represent the economic growth rate by using the constant value of Gross Domestic Product (GDP) measured in Indian rupee. This study aims to examine the long-term and causal dynamic relationships between the level of FDI flowing into India and IT sectors growth.

4. Review of Literature

The FDI and its economic growth is evidently identified by the Neo classical growth models. The Neo classical growth model Consider on technological progress and on labour force as exogenous, and thus argue that FDI increases the level of income only while it has no long run growth effect if it does not develop the technology. Long run growth can only be increased through technological and population growth and if FDI positively influences technology, then it will be growth advancing **(Solow 1956).** In addition, **Easterly et al. (1995)** argue that transfer of technology depends on the diffusion process and that can take place through four modes: transfer of new technologies and ideas; high technology imports; foreign technology adoption; and level of human capital. **Yangruni Wu (1999)** emphasize the role of learning process through FDI in the growth of a country. In contrast, **Charkovic and Levine (2002)** claim that FDI creates the crowding out effect on domestic capital and hence the effect of FDI on growth is either insignificant or negative. Hsiao and Hsiao (2006) assert that exports increase FDI by paving the way for FDI by gathering information of the host country that helps to reduce investor's business costs. Also FDI may reduce exports by serving foreign markets through establishment of production facilities there. **Balasubramanyam et. al. (1996)** tested the hypothesis that exports promoting FDI in countries like India give greater benefit than FDI in other sectors. They have used production approach in which FDI is treated as an independent factor input in addition to domestic capital and labour input. As FDI is a source of human capital accumulation and development of new technology for developing countries, it captures such externalities as learning by watching and/or doing and various spillover effects. Once FDI enters a country, some of the previous imports become domestic products. Thus, their output becomes a part of GDP which needs consideration as a part of output or a growth effect of FDI. In their research, real GDP depend on labour, domestic capital stock, foreign capital stock, export, and technical growth through time. **Borensztein et al. (1998)** examine absorptive capacity of recipient country, and is measured by stock of human capital required for technological progress; it takes place through 'capital deepens' associated with new capital goods brought into an economy by FDI. It has been found that the fructification of growth effect of FDI requires adequate infrastructure as a pre-requisite. **Borensztein, et al.,(1998)** found that the effect of FDI on host country growth is dependent on stock of human capital. They conclude from it that flow of advanced technology brought along by FDI can increase the growth rate only by interacting with country's absorptive capacity. They also find FDI to stimulating the total fixed investment more than proportionately. In other words, FDI crowds-in the domestic investment. Though, the results was not robust across specifications. **John Andreas (2004)** in his work "The Effects of FDI Inflows on Host Country Economic Growth" discusses that the potential of FDI inflows to affect host country economic growth. They argues that FDI should have a positive effect on economic growth as a result of technology spillovers and physical capital inflows. Performing both cross – section and panel data analysis on a dataset covering 90 countries during the period 1980 to 2002, the empirical part of the research finds indications that FDI inflows increase economic Growth in developing economies but not in developed economies. A recent study by **Banga (2005)** demonstrates that FDI, trade and technological progress have differential impact on wages and employment. While higher degree of FDI in an industry leads to higher wage rate in that industry, it has no impact on its employment. while On the other hand, higher export intensity of an industry increases employment in the industry but has no effect on its wage rate. Technological growth is found to be labour saving but does not influence the wage rate. **Rajit Kumar Sahoo(2005)** has pointed out that FDI has a direct and indirect impact and on a certain particular sectors of the economy. A study on the impact of FDI on industrialized sector reveals that FDI inflows in chemicals, electrical and electronics shows the direct impact and FDI inflow in drugs and pharmaceutical sectors shows indirect impact (spillover effects). FDI is an essential vehicle for the transfer of technology and knowledge and it demonstrates that it can have a long run effect on growth by generating increasing return in production via positive externalities and productive spillovers. Hence, FDI can lead to a higher growth by incorporating new inputs and techniques. **Nirupam Bajpai and Jeffrey D. Sachs (2006)** on their research "Foreign Direct Investment in India: Issues and Problems", attempted to recognize the issues and problems associated with India's current FDI regime, and more significantly the other associated factors responsible for India's unattractiveness as an investment location. Despite of India offering a large domestic market, rule of law, low labour cost, and a well working democracy, her performance in attracting FDI flows has been far away from satisfactory. The result of the study is that a restricted FDI regime, high import tariff, exit barrier for firms, strict labour laws, poor quality infrastructure, central decision making processes, and a very limited level of export processing zone make India as an unattractive investment location. **Balasubramanyam V.N Sapsford David (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 only a one tenth of that of china. They also discover that India may not require increased FDI because of the structure and composition of India's manufacturing, service sectors and her endowment of human capital. The requirements of management and organizational skills of these industries are much lower than that of labour intensive industries such as in China. 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.

Several studies have focused on theoretical positive impact of FDI on growth. However there are only few empirical studies of this part. Both micro and macro studies have generally been conducted to study the relationship between FDI and its economic growth. Micro studies find no positive evidence to support the thesis that FDI positively contributes to growth. Macro studies, have, thrown up some evidence to show that FDI positively affects economic growth under certain conditions.

A number of studies have analyzed the relationship between FDI inflows and its economic growth, the issue is far away from settled in view of the mixed finding reached. Most of these studies have usually adopted standard growth accounting framework for analyzing the effect of FDI inflows on growth of national income along with other factors of production. Our study will strive to highlight the nexus between FDI and economic growth in India under co integration framework

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.

5. Advantages of FDI

(1) Growth in Economy: Due to foreign companies entering into retail sector, new infrastructure will be built thereby bolstering the jagging real estate sector. In turn, banking sector will also grow as the funds needed to build infrastructure will be provided by banks.

(2) Job Opportunities: It has been estimated according to government, that approximately ten million jobs will be created mostly in retail and real estate sectors.

(3) Benefits to Farmers: In the retailing business, the intermediaries have dominated the interface between the manufacturers or producers and the consumers. Hence the farmers and manufacturers lose their actual share of profit margin, as the lion's share is eaten up by the middlemen.

This issue can be resolved by FD1, as farmers might get contract farming, where they will be able to supply an organised retailer based upon demand and will get paid handsomely for that and they need not run in search of buyers.

(4) Benefits to consumers: Consumers will get variety of good quality products at low prices compared to market rates and will be able to choose from various international brands at one place.

(5) Lack of Infrastructure: This has been one of the common issues in the retailing chain in India for years, which has led to the process of an incompetent market mechanism. To cite an example, inspite of India being one of the largest producers of fruits and vegetables, lack of proper cold storage facility significantly affects the selling of these perishable items and also in huge losses. Allowing FDI might help India have better logistics and storage technologies resulting in avoiding wastage. Due to FDI foreign companies will invest around $ 100 million in India. Thereby, infrastructure facilities, refrigeration technology, transportation sector will get a boost.

(6) Cheaper Production facilities: FDI will assure operations in production cycle and distribution. Due to economies of operation, production facilities will be available at a cheaper rate and thus resulting in availability of variety products to the ultimate consumers at a reasonable and cheaper price.

(7) Availability of new technology: FDI allows transfer of skills and technology from abroad and develops the infrastructure of the domestic country. Greater managerial talent will flow in from other countries. Domestic consumer will get the benefit of getting great variety and quality products at all price points.

(8) Long term cash liquidity: FDI will render necessary capital for establishing organised retail chain stores. It is a long term investment because the physical capital in the domestic company is not easily liquidated.

(9) Conducive for the country's economic growth : FDI will create a competition among the global investors, which will ultimately guarantee better and lower prices, thereby benefiting people in all sections of the society. The market growth and expansion will increase. It will step-up retail employment. It will ensure better managerial techniques and success. Higher wages will be paid by the international companies. Urban consumers will be exposed to international lifestyles.

(10) FDI opens up a new avenue for Franchising: Restrictions on FDI are regarded as trade barriers as they traverse direct market access to foreign firms. Retail giants who are very keen in looking for entry into foreign markets look for other available alternatives. These restrictions on the global retailers regarding the inflow of FDI, leads them towards getting the market entry through franchises. Thus, countries which offer promising market potentialities for retail growth offer substantial growth in the franchising sector also.

(11) According to the Indian Government's condition, foreign companies have to source a minimum of 30% of their goods from Indian micro and small industries. This will encourage the domestic manufacturing by creating a big effect for employment and technology up gradation and income generation.

(12) Countries like China, Indonesia and Thailand have 100% FD1 in retail. Reports show that these countries have experienced high growth in agro processing industry, refrigeration technology and infrastructure.

(13) Foreign countries will also create a supply chain management in the Indian market. This will result in avoidance of food wastage and perishables.

6. Disadvantages of FDI

(1) Limited Employment Generation It is said that FDI might provide employment opportunities, but it is argued that it cannot provide employment opportunities to semi-illiterate people. This argument gains more importance because in India, large number of semi-illiterate people is present.

(2) Fear of lowering of prices There is a fear that allowing FD1 in retail would result in lowering of prices, as FDI will bring in good technology, supply chain etc. If prices are lowered, then it will lower the margin of unorganised players also. As a result of this, the unorganised market will be affected. This in turn will have an impact on the employment opportunities provided by the unorganised market.

(3) FDI in retail will drain out the country's share of revenue to foreign countries, which may cause negative impact on India's economy.

(4) Fears that domestic organised retail sector might not be competitive enough to tackle international players might not only resulting in loss of market share for them but in closure of their units.

(5) There is a possibility of small business owners and workers from other functional areas, as lot of people are involved in unorganised retail business, may lose their jobs.

(6) Small retailers and other 'Kirana Stores' may close down.

(7) Supermarkets will establish their monopoly in the Indian market. Due to supermarkets fine tuning and higher accessibility they will be able to buy goods at lower prices and therefore will be able to sell at lower prices to consumers. This will result in closing of many small retailers.
(8) Though Government has stipulated that 30% procurement should be from Indian sources, this may get diluted over the years. The remaining 70% procurement from cheaper countries will make the people run towards that stuff and the 30% supply from Indian small industries will have their own death, unable to compete with low price Chinese goods**.**

7. An Over View of FDI in India

The historical background of FDI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. After Second World War, Japanese companies entered Indian market and enhanced their
Trade with India, yet U.K. remained the most dominant investor in India.

Government setup Foreign Investment Board and enacted Foreign Exchange Regulation Act in order to regulate flow of foreign capital and FDI flow to India. The soaring oil prices continued low exports and deterioration in Balance of Payment position during 1980s forced the government to make necessary changes in the foreign policy. Thus, resulting in the partial liberalization of Indian Economy. The government introduces reforms in the industrial sector, aimed at increasing competency, efficiency and growth in industry through a stable, pragmatic and non-discriminatory policy for FDI flow.

In this critical face of Indian economy the government of India with the help of World Bank and
IMF introduced the macro – economic stabilization and structural adjustment program. As a result of these reforms India open its door to FDI inflows and adopted a more liberal foreign policy in order to restore the confidence of foreign investors. Further, under the new foreign investment policy Government of India constituted FIPB (Foreign Investment Promotion Board) whose main function was to invite and facilitate foreign investment through single window system from the Prime Minister’s Office. The foreign equity cap was raised to 51 percent for the existing companies. Government had allowed the use of foreign brand names for domestically produced products which was restricted earlier. India also became the member of MIGA(Multilateral Investment Guarantee Agency) for protection of foreign investments.

8. Conclusion

FDI plays an significant role in the long-term development of a country not only as a basis of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising production and generating new employment opportunities. India emerges as the fifth largest recipient of foreign direct investment across the world and second largest among all other developing countries (World Investment Report 2010). The enormous market size, availability of highly skilled human resources, sound economic policy, abundant and diversified natural resources all these factors enable India to attract FDI. Further, it was found that even if there has been increased flow of FDI into the country during the post liberalization era, the global share of FDI in India is very less when it is compared to other developing countries. The study also reveals that FDI is a significant factor influencing the level of economic growth in India. 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 country. It also contributes to the GDP and foreign exchange reserves of the country. Therefore, there is an urgent need to adopt innovative policies and good corporate governance practices on par with international values, by Indian government, to attract more and more foreign capital in various sectors of the economy to make India a developed economy.

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