International Journal of Applied Research 2015; 1(7): 770-773

International Journal of Applied Research

ISSN Print: 2394-7500
ISSN Online: 2394-5869
Impact Factor: 5.2
IJAR 2015; 1(7): 770-773
www.allresearchjournal.com
Received: 28-04-15
Accepted: 29-05-2015

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Making "Make in India" a realism: role of FDI

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Abstract

Make in India was launched by Prime Minister, Narendra Modi on 25 September 2014, to encourage companies to manufacture their products in India**.** He has launched this ambitious campaign with an aim to turn the country into a global manufacturing hub. This study focuses on the changes in FDI rate after introduction of Make in India by Modi and growth due to increase in the FDI rate. In August 2014, the Cabinet of India allowed 49% foreign direct investment (FDI) in the defense sector and 100% in railways infrastructure. FDI inflows before and after the "MAKE IN INDIA" campaign were compared using the quantitative data which has been collected from various reports like Reserve Bank of India Database on Indian Economy, database of department of Industrial Policy and Promotion. It has been analyzed that there is high correlation between Industrial Production and FDI inflows. The effect of FDI on economic development ranges from productivity increased to enable greater technology transfer. Authors have also studied the implications for Make in India and realized that tougher task for India is to address competitiveness in non-cost factors. To gain investor confidence and attract high FDI in the future, India would need to fix its poor infrastructure through investment in highways, ports and power plants.

Keywords: FDI, Industrial production, Infrastructure, Make in India.

Introduction

India's economic reforms way back in 1991 has generated strong interest in foreign investors and turning India into one of the favourite destinations for global FDI flows. According to A.T. Kearney, India ranks second in the World in terms of attractiveness for FDI. A.T. Kearney's 2007 Global Services Locations Index ranks India as the most preferred destination in terms of financial attractiveness, people and skills availability and business environment. Foreign direct investment (*FDI*) is a controlling ownership in a business enterprise in one country by an entity based in another country. FDI is defined as the net inflows of investment (inflow minus outflow) to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. FDI usually involves participation in management, joint-venture, transfer of technology and expertise. A foreign direct investment (FDI) is a controlling ownership in a business enterprise in one country by an entity based in another country. Types: Horizontal FDI arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI. Platform FDI Foreign direct investment from a source country into a destination country for the purpose of exporting to a third country. Vertical FDI takes place when a firm through FDI moves upstream or downstream in different value chains i.e., when firms perform value-adding activities stage by stage in a vertical fashion in a host country. FDI Stimulate the economic development of the country in which the investment is made, creating both benefits for local industry and conducive environment for the investors. It creates job and increase employment in the target country. It enables resources transfer and other exchange of knowledge whereby different countries are given access to new skills and technologies. The equipment and facilities provided by the investor can increase the productivity of the workforce in the target country. FDI may be capital intensive from the investors' point of view and therefore sometimes high risk. The rules governing FDI and exchange rate may negatively affect the investing country. Investment in certain areas is banned in foreign markets, meaning that an inviting opportunity may be impossible to pursue.

Literature Review

Dunning (2004) [1, 10] in his study "Institutional Reform, FDI and European Transition Economics" studied the significance of institutional infrastructure and development as a determinant of FDI inflows into the European Transition Economies. The study examines the critical role of the institutional environment (comprising both institutions and the strategies and policies of organizations relating to these institutions) in reducing the transaction costs of both domestic and cross border business activity. By setting up an analytical framework the study identifies the determinants of FDI, and how these had changed over recent years. Sunday *et al.* (2004) [8, 11], in their work "Explaining FDI Inflows to India, China and the Caribbean: An Extended Neighborhood Approach" find out that FDI flows are generally believed to be influenced by economic indicators like market size, export intensity, institutions, etc., irrespective of the source and destination countries. Klaus (2003) in his paper "Foreign Direct investment in Emerging Economies" focuses on the impact of FDI on host economies and on policy and managerial implications arising from this (potential) impact. The study finds out that as emerging economies integrate into the global economies international trade and investment will continue to accelerate. MNEs will continue to act as pivotal interface between domestic and international markets and their relative importance may even increase further. Boon (2001) [13] in his study, "Foreign Direct Investment and Economic Growth" investigates the casual relationship between FDI and economic growth. The findings of this thesis are that bidirectional causality exist, between FDI and economic growth in Malaysia i.e. while growth in GDP attracts FDI, FDI also contributes to an increase in output. FDI has played a key role in the diversification of the Malaysian economy, as a result of which the economy is no longer precariously dependent on a few primarily commodities, with the manufacturing sector as the main engine of growth. The study by Dua and Rashid (1998) [2] for the Indian economy does not support the unidirectional causality from FDI to Index of Industrial Production (IIP), wherein is taken as the proxy for GDP. In fact, this study used the monthly data for IIP and GDP, which may include seasonal component in its variation and hence it is required to de-seasonalise the data. Alam (2000) [3] in his comparative study of FDI and economic growth for Indian and Bangladesh economy stressed that though the impact of FDI on growth is more in case of Indian economy yet it is not satisfactory. Sharma (2000) [4] used a multiple regression technique to evaluate the role of FDI on the export performance in the Indian economy. The study concluded that FDI does not have a statistically significant role in the export promotion in Indian Economy. This result is also confirmed by the study of Pailwar (2001) [5] and the study also argues that the foreign firms are more interested in the large Indian market rather than aiming for the global market. By using a vector error correction model (VECM), Chakra borty and Basu (2002) [6] tried to find the short run dynamics of FDI and growth. The study reveals that GDP in India is not Granger caused by FDI; the causality runs more from GDP to FDI and the trade liberalization policy of the Indian government had some positive short run impact on the FDI flow. The study by Sahoo and Mathiyazhagan (2003) [7] also support the view that FDI in India is not able to enhance the growth of the economy.

Objectives of study

1. To find out the effect of FDI on economic development after launch of "Make in India" campaign.
2. To study about the role of FDI inflows and its contribution in increasing output.

Research Methodology: The study is based on secondary data. The required data has been collected from various sources i.e. research papers, various Bulletins Of Reserve Bank Of India, Publications from Ministry Of Commerce, Govt. Of India that are available on internet.

Manufacturing led transformation approaches

To achieve a manufacturing led transformation, India would need to undertake a structured and planned approach across three levels:

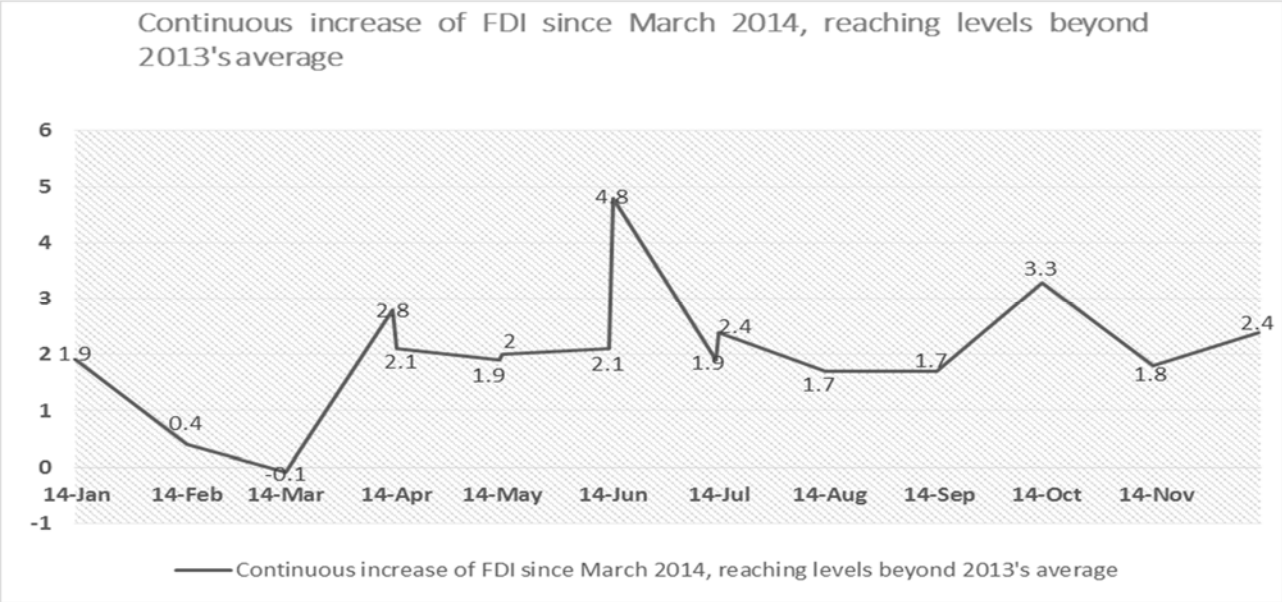
1. **Revive manufacturing:** The right infrastructure not only ensures an effective supply chain and key inputs feeding into the manufacturing process but also creates a seamless link across production hubs and end markets both domestic and global.

Domains emerge from these areas requiring significant change to revive domestic manufacturing:

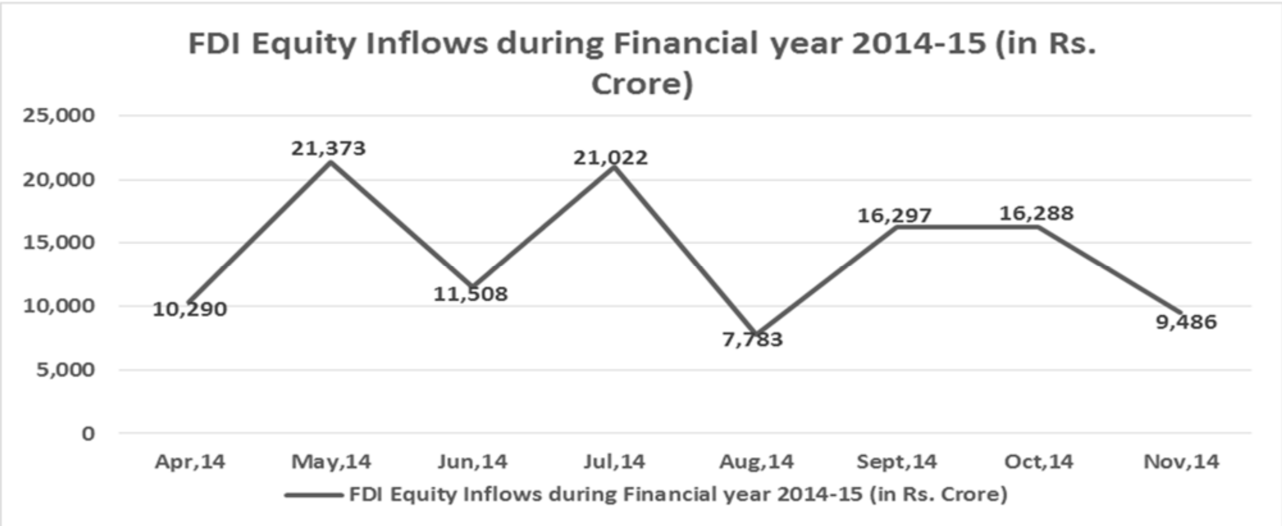
- ✓ Financial environment
- ✓ Land acquisition
- ✓ Administrative environment
- ✓ Legal & regulatory environment

2. **Gain global competitive advantage:** building an export ecosystem and developing an infrastructure which support export growth and attracting more investments
3. **Claim global leadership:**- sustaining and expanding competitiveness, changing mindset

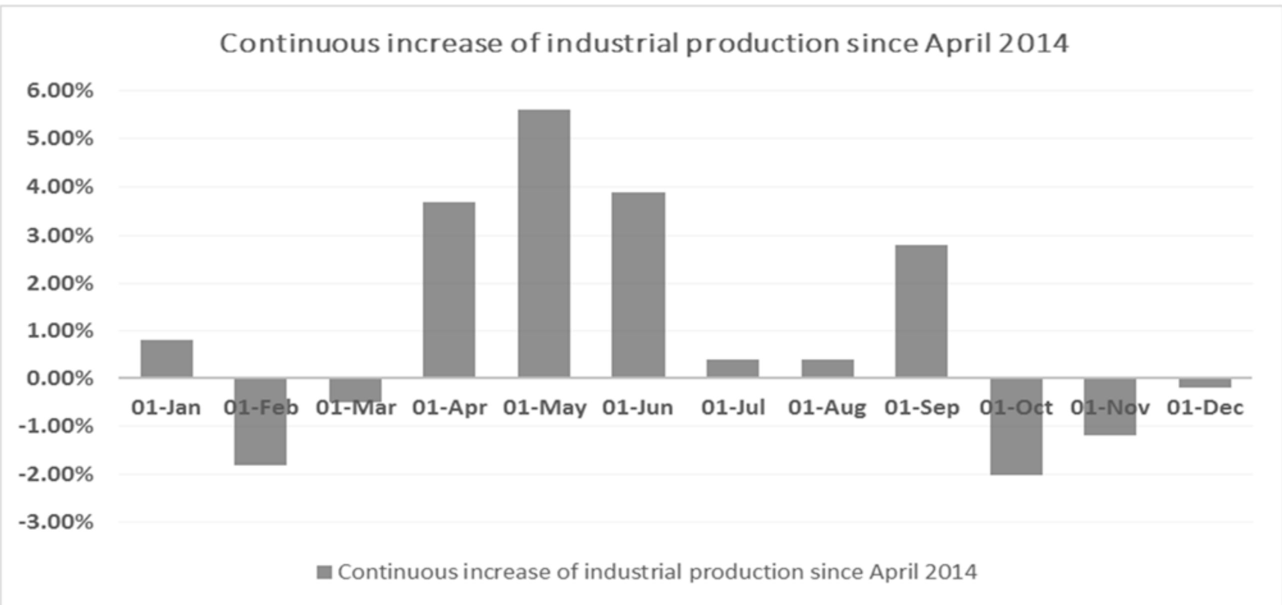
FDI since March 2013



FDI Equity Inflows during Financial year 2014-15 (in Rs. Crore)



Continuous increase of industrial production since April 2014



Suggestions for Increased Flow of FDI into the Country

Flexible labor law needed: China gets maximum FDI in the manufacturing sector, which has helped the country become the manufacturing hub of the world. In India the manufacturing sector can grow if infrastructure facilities are improved and labour reform stake place. The country should take initiatives to adopt more flexible labour laws. Relook at sectoral caps: Though the Government has hiked the sectoral cap for FDI over the years, it is time to revisit issues pertaining to limits in such sectors as coalmining, insurance, real estate, and retail trade, apart from the small-scale sector. Government should allow more investment into the country under automatic route. Reforms like bringing more sectors under the automatic route, increasing the FDI cap and simplifying the procedural delays has to be initiated. There is need to improve SEZs in terms of their size, road and port connectivity, assured power supply and decentralized decision-making. Geographical disparities of FDI should be removed: The issues of geographical disparities of FDI in India need to address on priority. Many states are making serious efforts to simplify regulations for setting up and operating the industrial units. Promote Greenfield projects: India's volume of FDI has increased largely dueto Merger and Acquisitions (M&As) rather than large Greenfields projects. M&As not necessarily imply infusion of new capital into a country if it is through reinvested earnings and intra company loans. Business friendly environment must be created on priority to attract large Greenfields projects. Develop debt market: India has a well developed equity market but does not have a well developed debt market. Steps should be taken to improve the depth and liquidity of debt market as many companies may prefer leveraged investment rather than investing their own cash. Education sector should be opened to FDI: India has a huge pool of working population. However, due to poor quality primary education and higher education, there is still an acute shortage of talent. FDI in Education Sector is lesser than one percent. By giving the status of primary and higher education in the country, FDI in this sector must be encouraged. Strengthen research and development in the country: India should consciously work towards attracting greater FDI into R&D as a means of strengthening the country's technological prowess and competitiveness.

Conclusion: FDI plays an important role in the long-term development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities.It has been analyzed that there is high correlation between Industrial Production and FDI inflows. The effect of FDI on economic development ranges from productivity increased to enable greater technology transfer.

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