ABSTRACT

Indian economy is the fourth largest economy in the world in terms of purchasing power; it is likely to touch new heights in coming years. The country is one of the G-20 major economies and a member of BRICS. The country because of global economy has been experiencing double-dip recession and economic slowdown. As the infrastructure is the main driver of economic development of country, India needs heavy investment on its infrastructure development. With the current level of current account deficit and fiscal deficit, India needs huge private investment to supplement the public investment in infrastructure development in the 12th five plan period (2012 – 2017). In the 12th five year plan India anticipates 10 percent growth rate and for this purpose drastic steps are to be taken to boost the economic development of the country. As predicted by Goldman Sachs, the Global Investment Bank, by 2035 India would be the third largest economy of the world just after US and China. It will grow to 60% of size of the US economy. This booming economy of today has passed through many phases before it can possibly achieve the predicted milestone of 10% GDP. The conceptual paper tries to understand the reasons for slowdown in FDI and factors affecting the Economic growth.

Key words: Purchasing power, Recession, Deficit, Infrastructure, FDI
1. INTRODUCTION

FDI inflow generally comes as capital bundled with technology, skills and sometimes even market cases. Therefore, they are widely perceived as important resource for expediting the industrial development of the receiving countries. Most developing countries therefore, have a welcoming attitude towards FDI. As a matter of fact, developing countries compete with each other to vie for this coveted Investment; they go all the way to attract such investors. India is considered amongst the developing economies along with countries such as China, Brazil, Russia, South Africa etc. In the Asian continent the biggest beneficiary of FDI is China. India's case is atypical in this context as it followed restrictive policy towards FDI for the first forty years after independence. It was only in 1991 that India liberalized her policy regime considerably. Although sectors like Mining, Banking, Insurance, Telecommunications, Airlines, Construction and Management have been opened up partially in the initial reform process, we need another round of constructive reforms to increase India's FDI inflow. Other roadblocks affecting the growth are corruption, global economic environment, inadequate infrastructure, volatility, macro-economic imbalances etc.

2. OBJECTIVES

The following are the objectives formulated to study the reasons and factors impacting India.
   1. To study the reasons for slowdown of FDI in India
   2. To understand the factors which are affecting the growth of India

3. LITERATURE REVIEW

The aspects of foreign direct investment i.e. political scenario and trends are analyzed by most of the studies by and they are, Bhattacharya (1994), Jain (1994), and Prasad and Chandra (1994), Subramanian, et al, (1996) and Kumar (1998) and (2000). These studies in general highlighted the difference phases in the policies relating to FDI and brought out the significant changes in the composition of FDI in the 1990s. A comprehensive study by Bosworth and Collins (1999) provided evidence on the effect of capital inflows on domestic investment for 58 developing countries during 1978-95. Bosworth and Collins find that an increase of a dollar in capital inflows is associated with an increase in domestic investment of about 50 cents. Studies by Subramaniam, et al. (1996) found that the availability of primary material inputs for manufacturing and the large size of the domestic market for the sale of the manufactured products are the two principal economics determinants of location of FDI inflow. Other two factors that are influenced the FDI are the growth rate of GDP and the level of infrastructure. P.D. Jeromi (2001) in his studies of Foreign Direct Investment in India, Policy, Trend and Impact finds there three reasons for FDI in India viz, Real Sector reforms, Infrastructure development and Privatization. According to global survey conducted by Ernst and Young in June, 2008, India has been rated as the fourth most attractive FDI destination in the world. One of the prime reasons for this the availability of educated and skilled work force, which is the important factor behind attracting the Foreign Investors. Multinationals, today do require such skilled employees to serve to their clientele. Studies like Mark & Moira & FICCI 2002 have revealed success is the key reasons to have FDI in India.
4. METHODOLOGY

The research paper presented here is a conceptual paper the data for which is collected from various secondary resources like research papers, journals, magazines, articles from other databases. In addition to this, various other data sources from RBI, CEIC, Central statistical organization, World Bank and IMF are used.

5. DATA ANALYSIS

From early 1990s FDI inflows had increased after liberalization in investment policies. In late 1990s FDI inflow was at abysmal $1.66 billion and it jumped to $17.5 billion by end of 2000, in a period of 2000-04 it doubled and almost quadrupled during 2004-10. However, after a high of 3.2 percent of GDP in 2008, the inflow of FDI in India along with other emerging markets started declining. The FDI further declined by 32 percent in U.S dollar terms to a stage of 1.5 percent of GDP in 2010, while other developing countries saw a recovery by 10 percent. Based on sectoral reports, FDI in manufacturing improved but services which accounts for 20 percent of inflow was badly impacted in 2010. In 2011, FDI had recovered somewhat because of the some large deals with the most visible M&A deal was the $3.7 billion acquisition of Piramal Healthcare by US-based Abbott Laboratories. Although Inflows in FDI recovered from slump in other countries, India faced unexpected decline in 2010-11 (refer figure 5.1) because of reasons as under:

![Graph showing FDI has not recovered to the pre-crisis level](image)

**Figure 5.1**

1. In 2010, the growth of exports of software and business process services was sluggish, owing to weak demand in advanced economies. Investors were in a “wait and see mode until there was more certainty on the outlook for service sector exports.
2. Due to increasing scrutiny by the Ministry of Environment and Forests on environmental safeguards there has been an increasing delay in some investment projects. Some projects that appeared to have had all necessary clearances were halted, some stopped altogether. Most notably, decisions include the cancellation of a bauxite mine in the Niyamgiri Hills and alumina refinery in Orissa’s Kalahandi District, the scrapping of three hydro-electric projects in the Bhagirathi basin, the withholding of environmental clearance to any other hydro-electric project planned in the Alaknanda and Bhagirathi. Delays of a more temporary nature seem to have hit the construction of the new city of Lavasa in Maharashtra Korean steel venture POSCO and licenses for coal mining.
3. Foreign investors may have been cautioned by recent scandals around the auction of the 2G wireless spectrum, widespread media coverage of alleged cases of corruption, and an enhanced scrutiny of off-shore bank accounts and investments from tax havens. Income tax officials have been deputed to Mauritius, for example, to intensify checks on FDI coming from there, especially into India’s real estate sector.

4. Some analysts also cite concerns about high inflation, and large fiscal deficits which constrain fiscal space to deal with the economic slowdown. Apart from the above reasons some other possible reasons could be sluggish growth of developed countries, a clamp down on tax evasion and general concerns regarding the prospects of Indian economy.

5.1 Global economic environment

Christine Lagarde of the IMF had warned at the second half of 2011 that the global economy has entered a “Dangerous phase” mainly due to concerns of fiscal sustainability of high income countries like Europe leading to increasing risk aversion around the globe. Hardening credit constraints and risk aversion has transferred financial sector difficulties to the real economy, and economic growth has slowed, including in major emerging markets, most notably being China and India.

5.2 Capital flows to developing countries weakened sharply due to market turmoil

The emerging-market equity funds concluded 2011 with about $48 billion in net outflows, compared with a net inflow of $97 billion in 2010. Investors withdrew substantial sums from developing-country markets in the second half of the year. In the second half of 2011 gross capital flows to developing countries plunged to $170 billion, only 55 percent of the $309 billion received during the corresponding period of 2010. Most of the decline was in bond and equity issuance. In contrast, syndicated bank loans held up well, averaging about $15 billion per month, slightly higher than the $14.5 billion in flows received during the same period of 2010.

5.3 Major factors affecting Economic growth of India

a. Disinflation: There would be an output gap resulting from lower aggregate demand, i.e. actual output would fall below potential. This reduction of capacity utilization would mean lower pricing power for companies, and therefore downward pressure on core inflation.

b. Rely on domestic growth: Declining stock markets, capital inflows and slowdown in investment which was witnessed in 2011 may be due structural problems: overexposure of banks to power projects, imbalances in revenue-expenditure of some state electricity boards, mining scandals especially in Orissa and Karnataka, alleged corruption in granting licenses in telecom sector. In order to improve investment climate and strengthening domestic growth drivers’ major structural reforms need to be introduced.
c. High volatility of capital inflows: Due to uncertainty in health of the global economy, volatility of portfolio could be high. Investors may be averse to invest because of poor perception of global financial systems. On the other hand, global liquidity remains unusually high with little prospect of monetary policy tightening in major developed countries in 2012. High liquidity could lead to sudden FII surges in emerging markets. To prevent unwanted volatility of the rupee RBI has been demonstrating its ability to react quickly to short-term capital flows and its reserves remain sufficient.

d. Reducing macroeconomic imbalances: In a country like India where average growth has been around 7 percent things can be changed by lowering borrowing, rationalizing public spending and supporting private investment through lower interest rates. Further, structural reforms can be done to improve the business climate.

6. CONCLUSIONS

Increasingly growing economy of India in most of its sectors, has made India one of the most well-known and preferred destinations in the world, for FDI. India has been expanding and the immense development is seen increasingly in areas like technology and telecommunications, making it secure foreign investment. India has noticeably emerged out as the second most attractive destination in the world, after China, for profitable FDI in sectors like infrastructure, technology, telecom or hospitality. Countries like US, UK, Mauritius, Singapore, and many others are eying for further investments in India. However, there are some bottlenecks like Infrastructure, corruption, taxation system and bureaucratic hurdles which are impacting the flow of FDI and growth of the economy.

Indian Prime Minister has touted an ambitious target for the 12th five year plan, which will run from 2012-2013 to 2017-2018. The most eye catching figure in this plan is the proposed investment in the infrastructure sector, a whopping 45,000 billion rupees or 1 trillion USD, double of that in 11th five year plan. The prime minister’s office is hoping that through double investment targets, real GDP growth can be sustained at an average of 10% per year between 2012-2013 and 2017-2018. However it is very unlikely, an average read GDP growth forecast for the period comes in only marginally lower than the 11th five year plan period of around 7% per annum. While this is below the government’s target, the forecast is a good one and highlights India’s attractiveness. But going by the trends that are shaping the near future, growth will not reach double figures due to the country’s strained fiscal situation. India’s public debt levels are very high at around 80% of GDP. This will constrain the fiscal budget, however, if spending is not reduced, interest rates on government debt will be pushed higher and this will constrain access to loans. In order to unlock the targeted double-digit growth, it is imperative that the private sector plays a crucial role. With financing constrained in the domestic project finance market and deep-rooted obstacles damaging the business environment, the private sector’s ability to push growth this high is limited. During the 12th Five-Year Plan, the government is targeting 50% of investment (equal to US$500bn) to come from the private sector. It seems that while India remains an attractive market for infrastructure investors – driven by the strong fundamentals of economic and population growth – this target is a particularly ambitious one.
REFERENCES