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IMPACT OF FDI AND FII ON INDIAN ECONOMY

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ABSTRACT

The present paper aims to examine the impact of Foreign Direct Investments and Foreign Institutional Investments on the Indian economy. It has established the fact that Foreign Direct Investments has more deep rooted and long term impact on the economy and it proves to be more essential for economic growth of the country. The paper has employed the data from the year 1990-2021 to evaluate the impact of inflow of FDI and FII on the Indian economy. The paper concludes that both FDI and FII are essential for the economy, but FDI is more crucial for the economy and is therefore called as 'engine of growth'.

Keywords: Foreign Direct Investments, Foreign Institutional Investments, economic growth**.**

INTRODUCTION

Since independence, India has paid close attention to the importance of investment in encouraging economic growth. Over the last two decades, India has steadily opened up to foreign investment, particularly following the momentous economic liberalisation of 1991. Foreign investment not only contributes to increased economic activity and jobs but it also promotes the flow of technology into the nation and helps the sector become more competitive (Verma & Saluja, 2018) .Foreign investment finds its way to a country in two ways: foreign direct investment (FDI) and foreign institutional investment (FII). FDI refers to capital inflow from an outside country that is invested in the economy's productive capacity. FDI promotes international trade, transfer of knowledge, skills, and technology. While, FII on the other hand, refers to an investment that is registered in a nation other than the one where the investment is being made (Aggarwal & Solomon, 2017).

FDI inflows are substantially more consistent than FII inflows. Furthermore, FDI not only delivers finance, but also improves management and governance methods as well as in many cases, knowledge transfer. The know-how that is transferred with FDI is usually more important and substantial than the capital itself, whereas FII inflows do not provide such irreplaceable benefits (Sultana & Pardhasaradhi, 2012) **.** The present paper aims to establish the fact that, among the two investments coming in the country namely, foreign direct investment and foreign institutional investment, former is more impactful and deep rooted for the economy of India.

IMPACT OF FDI ON ECONOMY

Foreign Direct Investment (FDI) is an essential instrument for India's economic development. It's a vital element for the global economy itself. FDI inflows assist developing nations in building an open, extensive, and effective policy environment for investment concerns, as well as human and institutional capacity to carry out those policies. Acquiring foreign direct investment seems to have become a significant component of India's economic growth plans. In developing nations, FDI assures a large quantity of domestic capital, production level, and job prospects, which is a crucial step toward the country's economic progress. Thus, it has become a boosting factor to India's economy (Prasad & Sharma, 2012).

In addition to venture and managerial know-how, FDI delivers sophisticated technology, conveys information and skill sets, and offers access to the export market. It makes a considerable quantity of foreign currency accessible to aid in the reduction of the trade deficit. When a foreign business competes with a domestic firm, the domestic firm is compelled to create its own technology, talent, and managerial knowledge. FDI is a crucial way of channelling knowledge transfer and finance, and is hence thought to be a key contributor in promoting emerging nations' economic progress. Furthermore, multinational companies (MNCs) see FDI as a critical tool for reorganizing manufacturing activity across borders in accordance with their business goals and the competitive advantage of host countries (Mishra & Kumar, 2016)**.** As per the Planning Commission FDI is "generally preferred over other kinds of external funding since they are non-debt generating, non-volatile, and their returns are dependent on the success of the projects financed by the investors"(Singh, 2019)

DATA ANALYSIS OF INFLOW OF FDI AND FII ON INDIAN ECONOMY

To evaluate the impact of inflow of FDI and FII on Indian economy it is necessary to make a careful analysis of the data which shows the actual amount of inflow of these two forms of foreign investments.

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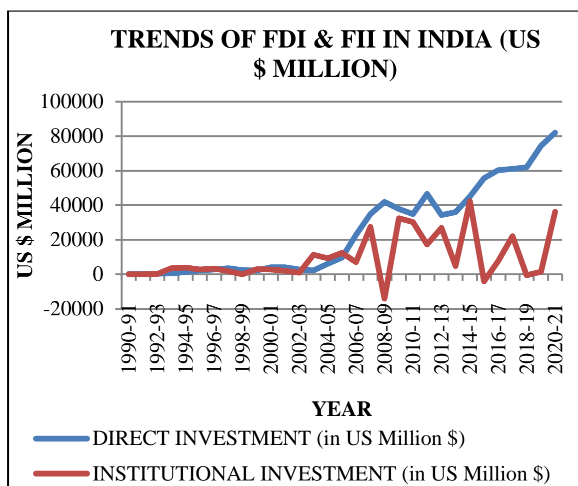

SOURCE: RBI BULLETIN

The data is taken from Reserve Bank of India Bulletin which presents a record from the year 1990 to 2021. The data is presented in millions of USD. The data showed wide fluctuations in the amount of inflows into India through both FDI and FII. However, the fluctuations are more in case of FII. With regard to FDI a huge increase in the inflow is seen in the year 2008-2009 which was US million $41,873 and later, it showed an upward trend since the year 2014-15 when it was US million $ 45,148. It was the highest in the year 2020-2021 which was US million $ 81,973 even though the pandemic situation was prevalent during that time.

The inflow of FDI shows a positive and upward trend and it is seen to have a huge impact on the growth of Indian economy during these years. FDI is seen as a source of filling foreign exchange reserves, trade deficits, revenue, management, and technical gaps in economies like India. It is viewed as a tool for international economic integration since it brings a package of assets including capital, technological competence, and market access. As a result, FDI has a wide influence on economic policy of the nation. India is already a thriving economy that is often regarded as a leader among emerging economies with enormous development potential. Foreign companies invest in India to take advantage of cheaper wages and special investment benefits such as tax exemptions. India's regulatory environment for foreign investment has improved substantially since 1991, making it one of the top ten most attractive inbound investment destinations (Verma & Saluja, 2018). FDI affects the growth directly through capital formation, strengthening infrastructure, increasing productivity and generating employment opportunities (Joo & Mir, 2014).

Foreign capital continues to come into India due to the Indian government's favourable policy regime. In recent years, the government has taken a number of steps, including loosening FDI restrictions in areas of defence, PSU, oil refineries, telecom and stock exchanges. The Indian government has taken a number of initiatives so far, to increase FDI inflows into the nation which include easing scrutiny on some foreign direct investments from countries that share border with India, plans to change FDI policy in the insurance sector, enabling FDI up to 20% in India's LIC, and the implementation of measures such as PM Gati Shakti, single window clearance, and GIS-mapped land bank etc (IBEF, 2022) . If India succeeds to boost the FDI to GDP ratio to between 3% to 4% range by 2025, it is expected that the country will attract US$120 billion to US$160 billion in FDI annually. This might help India's GDP growth rate return to the 7 %- 8% range. The aforesaid growth will be boosted by recent structural changes, increased FDI limits in various sector, and the Indian government's Atmanirbhar Bharat agenda (Kapadia, 2020).

On the other hand FII has shown wide fluctuations as it has increased in the year 2007-08 up to 27,434 US million $, but later decreased drastically in the year 2008-09. Then it recovered a little bit but again declined in the year 2011-12. It was negative in the year 2015-16 with 4130 US million $ and in the year 2018-19 with 618 US million $, it again showed a decline. In the year 2020-21 it showed an upward trend but as per the recent data of the year 2021-22 it was found to be declining again due to the extreme withdrawal by foreign institutional investors. FII is shown to have both negative and positive impact on the economy of the country. But, if we consider the impact in the long run we can clearly understand that FII does not have a deep rooted effect on the economy with regard to its positive influence is concerned. The capital flows of FIIs are sometimes considered as a double-edged sword. On the one hand, FII investment increases market efficiency and lowers the cost of capital in emerging economies that are in the process of liberalisation. Policymakers and experts, on the other hand, think that FII trades worsen volatility in the host country's stock markets. FIIs are attracted to invest not only by domestic and global economic conditions, but also by short-term expectations, which are largely formed by what is known as 'market sentiment.' These short-term expectations in return create a level of speculation and significant mobility in FII capital flows, causing volatility in the host country's stock market. Volatility is a sign of a high liquid market and is defined as the degree of price variation between share prices over a certain period. Though some volatility is useful since it reveals changing values across economic activity and makes resource allocation easier, yet the volatility caused by FIIs' flow of funds is harmful to stock markets and investors. Volatility has a negative influence on investors' choices about effective resource allocation and, as a result, on stock market investment. Because of the growing uncertainty in stock markets, investors are hesitant to hold certain stocks. As a result, investors seek a greater risk premium to

compensate the extra risk caused by market volatility. All of this leads to a rise in the cost of capital, which decreases physical investment and has a negative impact on economic growth (Joo & Mir, 2014). A similar situation has arisen recently wherein the overseas investors have pulled out a net Rs 1.14 lakh crore from the Indian market so far this year and foreign portfolio investors have taken back equities worth Rs 48,268 crore. To this the finance minister of India, Nirmala Sitharaman responded that it is the inflow of Foreign Direct Investment (FDI) that should be measured to determine the economy's strength as it stays in the nation and creates employment and opportunities, rather than the outflow of Foreign Institute Investors (FIIs). She also applauded the retail investors who have helped the stock market in absorbing the shock of massive outflows over the last few months (The Indian Express, 2022) .

CONCLUSION

Thus, it can be said that FDI is more essential for growth of any economy as compared to FII as it has a more deep rooted effect on the growth of country's economy. There are many reasons which make FDI a more suitable and acceptable form of investment for India also as FDI has shown to be a country's "engine of growth" whereas FII is also crucial as it accounts for a major percentage of stock market investment in India. But, the inflow and outflow of FIIs are entirely dependent on the market's return and sentiment. Their investment inflows boost stock market indices, while their exits push market indices down, leading in massive changes in the stock market of the host nation, resulting in volatility. Because it generates a frantic situation in the market, stock market volatility is a source of severe concern for investors in general and policymakers in particular.

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