

# Chapter- VI



## SUMMARY AND CONCLUSION

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### 6.1 Summary of the Study

For over four decades after independence India went with import-substitution industrialization (ISI) strategy driven by the Swadeshi ideology infused long before during 1890. Unfortunately, during the period, a low level of income, marginal savings and investment rate, high current account deficit and slow economic growth, etc. continued to be the serious malaises for the economy. However, the surprisingly attractive growth rate of Asian tigers who believed in export-led growth policy compelled our policymakers to shift their reliance from ISI to free trading and investment approach towards economic growth from the early 1990s. However, India has come as a late entrant into the regime of foreign investment-led growth strategy with various positive fundamentals, namely, large unexplored market, abundant source of natural resources, huge human resources, etc. Consequently, within a few years, the country has experienced phenomenal growth in the volume of foreign investment and evident remarkable growth in GDP.

On this purview, the present study makes a unique attempt to measure the impact of foreign investment inflows on the economic growth of India under two approaches i.e. overall and sector-specific treatment of the two variables. The overall approach of analysis documents different findings for different forms of cross border capital and GDP nexus. The gross measurement of the relationship between total inward foreign investment and economic development in the form of GDP in India documents a bi-directional causality in both the long-run and short-run supported by other

econometric test results. Therefore, both the macro-economic variables are found to reinforce each other both in short and long term.

Further, the study examines this relationship in greater perspective by establishing the impact of the binary flow of cross border investments on Indian economic growth separately. This study documents interesting findings for long-run and short-run investigation in regard to the net investment by FII in the form of foreign portfolio investment and the volume of GDP in India. Where in the long-run FII is found to be significantly impacting economic development measured by GDP, in the short-run the reverse case is observed, i.e., the volume of GDP affects the flow of FII. This is due to the fact that even when individually FII investment is quite insignificant, collectively it can generate huge liquidity in the capital market. Consequently, this liquidity provides ample opportunity to firms to raise maximum funds as per their requirement at minimum cost. Finally, through this process the gross value added of the country increases which ultimately compliments GDP growth.

As far as the relationship between the volume of GDP and the inflow of cross border direct investment is concerned, it is observed that there is a long-run bi-directional causal relationship between the variables. This interaction between FDI and GDP is obviously a desirable phenomenon for any country's perspective. Thus, the policymakers are supposed to frame more liberal policy at a furthest level to invite larger volume of FDI into India to instigate the economic development process.

Having undertaken the sector level analysis, the present study is expected to find a distinct space in the economic literatures in India. It makes an endeavor to separately gauge out the impact of sector-wise-decomposed FDI inflows on the growth of three of its economic sectors. The study documents remarkably different findings for different sectors of the economy. Firstly, the study exhibits an unidirectional short-run

and long-run causal relationship between FDI inflow into agriculture sector and the output growth of this sector. The study in this regard reveals that due to poor linkages between agriculture and FDI, the agricultural FDI into India fails to make a positive contribution towards the output growth of this sector.

Unlike the agriculture sector, the study documents the significant bi-directional causality between inward FDI to manufacturing sector and the manufacturing sector's output contribution to GDP for both the long-run as well as short-run. However, the positive impact of manufacturing FDI is not found to be sustaining in the long-run. Perhaps this happens largely because of the incapability of domestic firms to carry competition with foreign firms and their tendency to gradually make a switch over towards service sector.

Similar to the manufacturing sector, the study reveals a bi-directional causality between FDI inflow into service sector and the growth of service sector output for both in short and long-run. It is worthy to mention here that, this sector reasonably attracts a lion's share of the inward FDI that come to India. Besides, service sector contributes most to the GDP among the three sectors. Therefore, this sector draws high degree of attention from both the foreign firms and policymakers ends.

The evidences of the study provide other important corollaries which also contribute to the existing literature. First of all we have noticed that India has witnessed a phenomenal GDP growth after economic liberalization where the average growth rate of GDP almost became double of pre-liberalization period. Furthermore, there has been almost four-fold expansion in the foreign investment inflow through its major two forms, FDI and foreign portfolio investment (FPI). Notably, on an average almost 97 percent of net FPI comes in the form of FII. That is why our study represents FPI by FII. However, considering the issue of absorption of global wave of foreign

investment especially in the form of direct investment, we have shown that developing economies have gradually seized the substantial part of this investment through their policy liberalization, structural transformations, tax heavens etc. India, as a developing country, holds a significant portion, almost 3 percent of global share of FDI. Besides this, we observe another crucial fact that the three Asian countries have grasped much more inward FDI as compared with India. It is also observed that, perhaps due to the interaction of some political and diplomatic factors, a few circumscribed countries like Mauritius and Singapore hold the major portion i.e. about sixty percent of FDI inflows into India.

The analysis of various facts and figures relating to the volume of sector-wise FDI inflow and sector-wise contribution of GDP leads us to heterogeneous outcomes. One of the crucial facts, that is observed is, a clear trend of switching over of inward FDI from secondary sector to service sector and persistently low and constant level of FDI inflows throughout the considered period in the agricultural. Furthermore, in investigating the sectoral output share in the nation's gross value addition, the study reveals that, since the liberalization contribution of agriculture sector remains almost fixed, around 20 percent. Although, the service sector makes an inclining trend to exert a significant contribution towards GDP and eventually, the manufacturing sector's proportion towards GDP has gradually declined during the period.

## **6.2 Conclusion**

The study finally concludes that cross border investments specifically in the form of FDI inflows, have the potential to boost the Indian economic growth both at the macro level and the sectoral level. As of now, given the size and potential of our economy, FDI inflows should be high enough like other competent developing

countries. However, India's percentage share of world cross border FDI inflows is very minimal. Considering the large and fast growing domestic market with continued policy reforms that improve institutions and environment, there is every reason to believe that substantially mountainous volume of FDI will flow to India which may further expedite the growth process. To sum up, from the sectoral investigation, it can be concluded that, the service sector in India absorbs maximum FDI inflows following manufacturing sector and agricultural sector. The output contribution to GDP is highest for the service sector following the agriculture sector and manufacturing sector respectively. It is important to mention that the manufacturing sector is the lowest contributor to the country's gross value added. However, like the corporate sector, the Government of India has also been focusing more on the highest income contributing service sector rather than the agriculture which is highest in terms of human resource involvement in India. Moreover, most of the recent eminent empirical studies recommend governments for service sector centric policy formulation to attract greater FDI.

On the other side, it is also true that the government recently took handful of policies ( Special Economic Zone, Make-in-India to Made-in-India, Merchandise Export from India Scheme, etc.) to boost up our manufacturing sectors and opened-up 100 percent foreign affiliation in most of the sectors other than security issue aiming at attracting foreign capitals at greater volume. So the economic scholars and development economists are looking forward to seeing the trend and the impact of cross border flow of funds towards sectoral development in the decade (2020-2030) to come.

### **6.3 Contribution of the Study**

The present study perhaps is the first of its kind which establishes the relationship between the volume of inward foreign investment and the volume of GDP under both an overall as well as sector-specific approaches of analysis. This study, using time series data under more advanced time-varying model with autoregressive distributed lag and vector autoregressive specification, is expected to provide a comprehensive understanding on the dynamic relationship between foreign investment in the form of FDI and FII and economic growth. In this study, we justify our econometric (VECM) results by other forecasting results (variance decomposition, impulse response function, etc) and our models are also supported by diagnostic tests and stability test which ensure the robustness of our results.

The study models a comprehensive path of relationship between macro-economic variables and economic development measured by GDP in India. Macro-level analysis evidences that both the forms of foreign investments including gross foreign investment have positive impact on economic growth represented by GDP. Besides this, the force of economic development encouraged all types of foreign investors to materialize their investible funds in large unexplored Indian market. So, the outcome of the study obviously helps policy makers of host country, as well as foreign capital holders at their decision points. On one side, the policy makers can reap maximum benefit from foreign investments by recognizing and practically operationalizing this established path of economic development, and on the other side, the investors get some benefits (tax holidays, enclave type business practices, etc.) from over interest of attracting foreign investment of host country.

From the sector level analysis, this study draws different inferences and distinctly contributes to the existing literature. The evidences regarding agriculture sector can help our policymakers to rethink about the vitality of agriculture sector and its role on overall economic development.

This study has shown alarming situation in Indian manufacturing sector as domestic manufacturers are found to be switching towards service sector; to hold very low portion contributing to total output and to be unable to upgrade them through absorbing foreign capitals. Apart from agriculture and manufacturing sectors the present study sheds some light by giving better understanding of India's service sector which is well organized and structured, updated technology-based with utmost sophistication in operation, minimum pay-back- period etc. To some extent, this information may be helpful to foreign investors who are seeking investment destinations and dimensions.

Generally, the study is expected to offer some useful insights to the policymakers and financial regulators which are expected to have utmost usefulness in formulating coherent economic policy including FDI policy.

A comprehensive examination like this which encompasses both the macro-economic and sectoral level analysis would help the government agencies in designing sector-specific as well as general policies which would further encourage more inward foreign capitals into the economy.

At the same time, the fact-figure analysis of the study is expected to extend the literature by providing different critical issues relating to foreign investment and domestic investment which will help the academicians, research scholars and some



other users to build a comprehensive understanding and develop a strong perception on the subject.

#### **6.4 Policy Implication and Recommendation**

The study clearly observes the government's principal concentration over the manufacturing and service sectors across the liberalization period. It is quite true that without sufficient development of agriculture and manufacturing sector the sustainability of service-led growth is highly questionable. This is mainly due to the fact that the demand at large for services comes from the agricultural and manufacturing sectors and the service sector itself can't generate its own demand in long-run (Sen, 2011). Moreover, the service sector growth in India is largely led by hi-tech labour and outsourcing and for these services, the demand is mostly coming from abroad and hence, the sector becomes vulnerable to external shocks (Sen, 2011). Apart from this, since independence, the employment generating potential of service sector is found to be the least among the three sectors (Gordon and Gupta, 2003). Some recently published data show that this sector absorbs only around 30 percent of the total work force in the country in the year 2018 (ILOSTAT database, Published by International Labour Organization).

Therefore, besides service sector policy implications, the Government of India should also formulate effective policies to revitalize other economic sectors. It is noteworthy that though this study finds the potential of Indian manufacturing sector to absorb FDI and contribute towards economic growth, it strongly recommends the policy makers to rethink on improving spill-over effect of manufacturing FDI within the sector to ensure sustainable growth of the sector.

In fact, the government report depicts that almost two-thirds of the total work force in India is engaged directly or indirectly in agricultural sector. Surprisingly, this large volume of the population only contributes about 16 percent of total value added in the economy (Economic Survey Report 2017-18, GOI). Fortunately, having one of the world's largest plain agricultural land surface, with maximum skilled and unskilled workforces accompanied by plenty of rivers flowing across the country (India is called as Riverine Land) and tropical equi-temperate climate, etc, the sector reasonably bears the huge potentiality to make greater contribution to gross value added in the national economy.

Thus, the viability of agricultural sector to generate favorable impact from FDI still remains a matter of high concern for the policymakers of India. The government should continuously encourage FDI in the primary sector with necessary policy measures that can improve the vitality of the sector. Although, the Govt. of India has, however, recently made a move towards the decision as the Department of Agricultural cooperation and Farmers Welfare, GOI, has proposed a new integrated program for envisaging integrated use of Space and Geospatial Tools for mapping, monitoring, and management of agriculture, which is labeled as National Programme on use of Space Technology for Agriculture (NPSTA). Again, very recently the government has framed a roadmap by 'NITI Aayog' for radical reforms in agricultural sector and doubling cultivators' income by 2022 focusing on seven parameters of growth of agriculture. The government should properly execute these policies which could encourage foreign investors to invest in this sector.

In a nutshell, it is clearly evidenced that post-liberalization era of FDI policy mainly concentrated on manufacturing and service sector whereas agriculture sector was grossly neglected. Notably, the consequences are evidenced in facts and figures

disclosed by World Bank for the year 2016 which show that the mean productivity of cereal per hectare in India was 2993 Kilograms (kg) where as world average was 3967 kg. and the neighboring developing countries are comparatively high productive. The mean production of crops per hectare in Korean republic (6795 kg), China (6029 kg), Indonesia (5406 kg), Bangladesh (4629 kg), Sri Lanka (3897 kg) and even Pakistan (3064 kg) are all higher than that of India. This productivity gap is glaring if compared to that of the developed European Union and North America, for example, in Netherland 8384 kg per hectare, in Ireland 8223 kg per hectare, in USA 7318 kg per hectare, in Austria 7245 kg per hector, in Germany 7182 kg per hectare and so on.

There is obviously ample opportunity to enhance productivity domestically but this study recommends concentration on cross border capital especially in the form of direct investment through collaboration with the high productive nations.

In the year 2017 (6<sup>th</sup> December), the Government of India signed a Memorandum of Understanding (MOU) with Italy on food and forestry development policy. As of now, given the volume and potential of the nation, such types of MOUs or in other wards, foreign capitals in agriculture are very minimal. That is why Government may encourage agricultural sector making more investment under MOU with high productive nations ensuring agricultural research & development, development of rural infrastructure, strengthening supply chain, spreading irrigation, establishing sufficient warehousing, expansion of bio-fuels, provides crop insurance opportunity and aranging agricultural education for all farmers, etc.. This productivity is highly associated with technological equipment, know-how, well-spreaded irrigation system, research & development set-up, advanced agriculture kits like hi-yielding seeds, fertilizers, environment friendly pesticides, etc and proper education related to agriculture. It is a serious concern that due to inadequate knowledge and education

there takes place severe misuse and bad use of fertilizers, pesticides and other kits that heavily deteriorate soil quality and badly degrade environment that leads to threatening the achievement of sustainable development. Moreover, the government can also promote FDI in the manufacturing sector, including industries like advanced agricultural equipment, fertilizers, pesticides etc. which has a deeper forward linkage with the rural economy to supplement the agricultural growth. The government has to frame integrated policies with foreign capitals to include the greater community of small and marginal cultivators into the fold of mechanized farming which will answer the plight of Indian farmers and ensconce overall future development.

The government should work on building long-term investors confidence in the country. In this regard, the study recommends the policymakers to focus more on framing Greenfield FDI policy which provides more substantial and huge volume of investment in this country. Besides, this type of investment creates large scale of employment.

For the overall development of the economy, the government should frame policy like Corporate Social Responsibility (CSR) for MNEs so that government can take care of proper utilization of natural resources, up-gradation of human resources and environmental issues.

The empirical investigation documents that there exists a bidirectional causal relationship between foreign investment and economic development in this country. Therefore, the government is advised to exercise strict control over inefficient bureaucracy and red tapeism for absorbing maximum foreign capitals.

The authorities should ensure quality of foreign investment rather quantity. More productive investment is welcomed. Under the consumption centric foreign

investment, investment in education, health, research and development are welcome as this investment may help sustainable development.

Flexible labour laws in the service sector may be the one major reason for huge development in this sector. In line with the service sector, the government should rethink about the flexible labour laws practices all other sectors especially in the manufacturing sector.

### **6.5 Limitation of the Study and Scope of Further Research**

In this section, the study attempts to foster an understanding of the impact of cross border foreign capital of overall economic development in context India under a macro-level as well as sector level analysis. Further research may either eliminate some of the limitations or expand the scope of this investigation.

The study has introduced a step-by-step analysis of impact of foreign investment on economic development from aggregate level foreign capital inflows to basic three sector levels and makes a significant contribution to the existing literature. But, microeconomic dimensions specifically industry level and even company level analyses of the impact of foreign investment assume greater importance. This is because when a firm plans to invest in a subsidiary in a particular industry, consideration of comparative advantage in the industry or firm gains the highest priority. Therefore, the study may be further extended to industry level and even company level analysis. More inclusive findings may insist the policymakers for channelizing foreign capitals properly to exploit the highest benefit from it.

The study does not consider the impact of foreign direct investment inflows on Indian economic wellbeing from its strategic viewpoint, i.e., whether all types of foreign

direct investments (horizontal, backward vertical and forward vertical) exerts equal impact on economic development or not. If it is not so, then it is important to know which type would generate positive impact. Moreover, another study may be conducted in comparing the relative importance of Greenfield investment and Brownfield investment in context of Indian economy.

There is no denying the fact that a large number of variables could have the potential to exert significant influence on GDP volume. But, our study concentrates solely on impact of foreign investment on volume of national output measured by GDP at macro-level and sector-level. Further study could attempt to measure the impact of foreign investment on GDP through affecting export, index of industrial production (IIP), consumer price index (CPI), exchange rate, etc.

Besides, further study may empirically test the relationship at both the macro level and sector level by employing other sophisticated econometric techniques and introducing new model with another perspective like considering the potential structural shocks in the time series.

The study may further be extended to cross country analysis taking developed countries or neighboring countries with quite similar economic set-up to produce comparative results that would bring important lessons on comparative policy related strengths and flows to the country's economic policymakers. Moreover, our study focuses on the impact of foreign investment on economic development in the post-liberalization period and incorporates some valid conclusions in the existing literature. Further study may introduce a comparative analysis of this relationship between pre- and post-liberalisation periods in order to highlight differences in trends, practices and policies in this perspective.