Global Scientific JOURNALS

GSJ: Volume 8, Issue 10, October 2020, Online: ISSN 2320-9186
www.globalscientificjournal.com

IMPACT OF FDI ON INDIAN ECONOMIC GROWTH

Thiththalapitige Natasha Manieshi Fonseka,

Lovely Professional University,

India.

EMAIL - manieshifonseka@gmail.com

Dr. Rajender Singh, Associate Professor, Department of Economics,

Lovely Professional University

India.

EMAL – godarars@gmail.com

© GSJ

ABSTRACT

This research is based on impact of Foreign Direct Investments (FDIs) on economic growth in India. There are certain components which influence the Foreign Direct Investments. It comprises of Trade openness, Inflation rate, Economic stability, Investment policies, rules and regulations adopted, implemented Exchange rates, foreign reserves and Political stability of the country. Further, Foreign Direct Investments succor to amplify trade and it dispense financial aid too. Foreign Direct Investments have ameliorate Balance of Payment problems in Indian economy. The foremost objective of this paper is to analyze the impact of foreign direct investment towards the growth of the Indian economy. Net Foreign Direct Investment inflows and Gross Domestic Product are taken as the variables for the study. Simple Regression and Pearson's correlation methods are used for the study to measure the impact of Foreign Direct Investments towards the Indian Economy. The study is based on Secondary data collected through the World Bank website from 1970 to 2019. According to the Empirical results it reveals that Foreign Direct Investments are significant for the growth of the Indian Economy and the positive association between FDI and GDP.

KEYWORDS

Foreign Direct Investments (FDI), Gross domestic Product (GDP), Balance of Payments, Economic Growth

INTRODUCTION

Foreign Direct Investment (FDI) which called as a non-debt financial capital is known as a most preferable way of capital inflow to any economy. Economic growth is the proliferation production of goods and services over a period of time. GDP is estimated by percentage increase in real gross domestic product. The rate of economic growth means the growth between first and last over a period of time. Usually FDI play a substantial role in proliferating the general capital formation in Indian economy. Moreover, it is a much needed tool for converting the technology and knowledge. Majorly, Foreign Direct Investments (FDIs) give rise to the returns in production through positive externalities towards the sustainable economic growth. (Mengistu and Adams, (2007). However, this is pertinent to most of the developing countries. India is primarily investigated as the most captivating and common destination for Foreign Direct Investments. Indian Foreign Direct Investments had revolted up to 17800 USD Millions by August 2020. There are precise components which determine the Foreign Direct Investments. They are, truncated wage and labor, availability of raw materials, communications systems and FDI policies. Most of the Investors look up for low wage labor in South Asian countries such as India. Therefore low wage labor hypnotize many Foreign Direct Investors. In addition communication skills among workers plays a significant role in tantalizing FDIs. In India since the Literacy rate is higher among the skilled labor lead to fascinate more investors towards India. Moreover, cheap resources and raw materials excite more FDIs. On the other hand ease and alternation in Foreign Direct Investment Policies get more FDIs. Recently, Byju's made a USD 500 worth investment and Cashaa invested USD 5 million for the amplification of crypto market. Further, Government of Singapore offered USD 63.84 million for development of Phoenix Mills and Coralogix invested 30 USD million.

Foreign Direct Investments play a paramount part in proliferating economic growth. FDIs escort new technological refinements which can be embrace to proliferate the production capacity. Moreover, FDIs furnish more capital to the economy too. FDIs lessen the balance of payment problems while proliferating new marketing strategies to economies. In addition, FDI give rise to employment opportunities which further leads to proliferate the economic growth. Moreover FDIs lead to proliferate the normal wage rate of the employees too. Further, FDI facilitates exports of host developing countries too.

Government of India has taken some new steps to boost Foreign Direct Investment in various sectors. Indian Government has altered the Foreign Direct Investment Policy in August 2020 which engrossed on commercial coal mining. Further, it grants 100 permission Foreign Direct Investments in coal mining activities in 2019. However, Government of India has proliferated the Foreign Direct Investment for defense manufacturing. They have proliferated the percentage from 49 to 74 percent. Moreover, Indian Government has altered the Foreign Direct Investment Policy on taking over companies from other nations. However, Non-Residents in India are granted permission to get 100 percent stake from Air India.

REVIEW OF LITERATURE

Gregorio, and Lee, (1998) have examined about how Foreign Direct Investments influence the economic growth. Further Basu, Chakraborty and Reagle (2003) have proven that for 23 developing countries from the year (1978 to 1996) that there is a co integration relationship between Foreign Direct Investment and Gross Domestic Product.

Chowdhury and Mavrotas (2005) proven their results as mixed in the direction of causal relationship between Foreign Direct Investment and economic growth. Moreover Pais in his paper has stated that “Foreign Direct Investment: Impact on Indian Economy” there is a positive impact on Indian economy by Foreign Direct Investments. In addition to that Pradeep (Foreign Direct Investment and industrial Development in India) in the thesis that there is a high coefficient of correlation between Foreign Direct Investments approvals and actual inflows.

Malhotra (2014) inspect the impact of FDI on Indian Economy. Particularly after two decades of economic reforms also analyses the challenges to position itself favorably in the global competition of Foreign Direct Investments.

Silajdzic and Mehic (2015) have figured out that Foreign Direct Investment directly influence the economic growth by subscribing to the fixed capital formation and indirectly subscribing to the knowledge stocks. Moreover, in the traditional framework it implies that the Foreign Direct Investment directly affects the economic growth. Though the Foreign Direct Investment is influencing the economic growth it will affect the shortage of domestic investments and investment shortages also. Further, the study shows that the foreign direct investments have a positive impact towards on economic growth.

Further Alvarado, Iniguez, and Ponce (2017) figured out that Foreign Direct Investment has a positive impact on the product especially in high income countries, however, through this research it showed that in the upper – middle – income countries the effect is uneven and not significant.

Sultana, Kagdiyal, Goyal, Chakkala, Parmar (2019) studied about the impact of FDI on not only Indian growth variables but also on other factors which includes human development index and population. The results of this study was that there is a considerable impact of FDI on HDI, population and Sensex index and some impact on imports and exports too.

NEED OF THE STUDY

The foremost topic of this study is based "Impact of Foreign Direct Investment on Indian Economic Growth." This dispense the empirical results on how FDIs affect the economic growth in India with the help of data from 1970 to 2019. Further, this study helps to find out the factors and role of FDI on proliferating the economic growth.

PROBLEM FORMULATION

The principal problem of this study is to inspect how the Foreign Direct Investments influence the growth of Indian Economy and to figure out the association between foreign direct investments and Gross Domestic Product in Indian Economy.

OBLECTIVES OF THE STUDY

- To study about the factors which influence the Foreign Direct Investment to India
- Role of FDI on Economic Growth
- To investigate the empirical relationship between Foreign Direct Investment and Economic growth in India

RESEARCH METHODOLOGY AND DATA SOURCES

The research data is based on secondary sources. The data is collected from the World Bank Website. The main study period is from 1970 to 2019. There are two variables used to measure the impact. Foreign Direct Investment is taken as the independent variable whilst Gross Domestic Product is taken as the dependent variable. Pearsons correlation is used to figure out the association between Foreign Direct Investments and Gross Domestic Product. However, Simple Regression Model is used to measure the impact of Foreign Direct Investments on Indian Economic Growth. Economic growth is measured by Gross Domestic Product. The simple Regression Model can be mentioned as follows.

$$Y_t = \alpha + \beta X_t + \mu_t$$

$$GDP_t = \alpha + \beta FDI_t + \mu_t$$

Y_t = Dependent Variable (GDP according to this study)

α = Autonomous Variable

β = Regression Coefficient

X_t = Independent Variable (FDI according to this study)

μ_t = Error term

DATA ANALYSIS AND INTERPRETATION

H_0 : There is no statistically significant association between FDI and GDP

H_1 : There is a statistically significant association between FDI and GDP

TABLE 1 - Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.952[a]	.906	.904	2.49834E11	.960

a. Predictors: (Constant), FDI

b. Dependent Variable: GDP

According to the TABLE 1 it shows the value of R square is 0.906, which measures the proportion of the variance in GDP which is predictable from FDI. In other words it means that 90.6 percent of the changes in GDP is because of the changes in FDIs and other 10 percent changes in GDP is due to other variables which are defined in the error term.

© GSJ

TABLE 2 - ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.880E25	1	2.880E25	461.340	.000[a]
	Residual	2.996E24	48	6.242E22		
	Total	3.179E25	49			

a. Predictors: (Constant), FDI

b. Dependent Variable: GDP

According to the TABLE 2, Test results the P value is 0.000. However, the α value is 0.05. Therefore, the null hypothesis will be rejected. In other words the test results shows that there is a significant linear association between Foreign Direct Investments and Gross Domestic Product.

TABLE 3 – Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	2.302E11	4.260E10		5.405	.000		
	FDI	47.083	2.192	.952	21.479	.000	1.000	1.000

a. Dependent Variable: GDP

Since the VIF value is less than 10 multi co linearity does not exist.

$$Y_t = \alpha + \beta X_t + \mu_t$$

$$GDP_t = 2.302 + 47.083\, FDI_t + \mu_t$$

According to the above TABLE 3 change in 1 USD Billion in FDI will change the GDP by 47.083 USD Billion. Since the FDI and GDP is having a positive correlation an increase in 1 USD Billion will increase the GDP by 47.083 USD Billion.

TABLE 4 – Correlations

		GDP	FDI
GDP	Pearson Correlation	1	.952**
	Sig. (2-tailed)		.000
	N	50	50
FDI	Pearson Correlation	.952**	1
	Sig. (2-tailed)	.000	
	N	50	50

TABLE 4 – Correlations

		GDP	FDI
GDP	Pearson Correlation	1	.952**
	Sig. (2-tailed)		.000
	N	50	50
FDI	Pearson Correlation	.952**	1
	Sig. (2-tailed)	.000	
	N	50	50

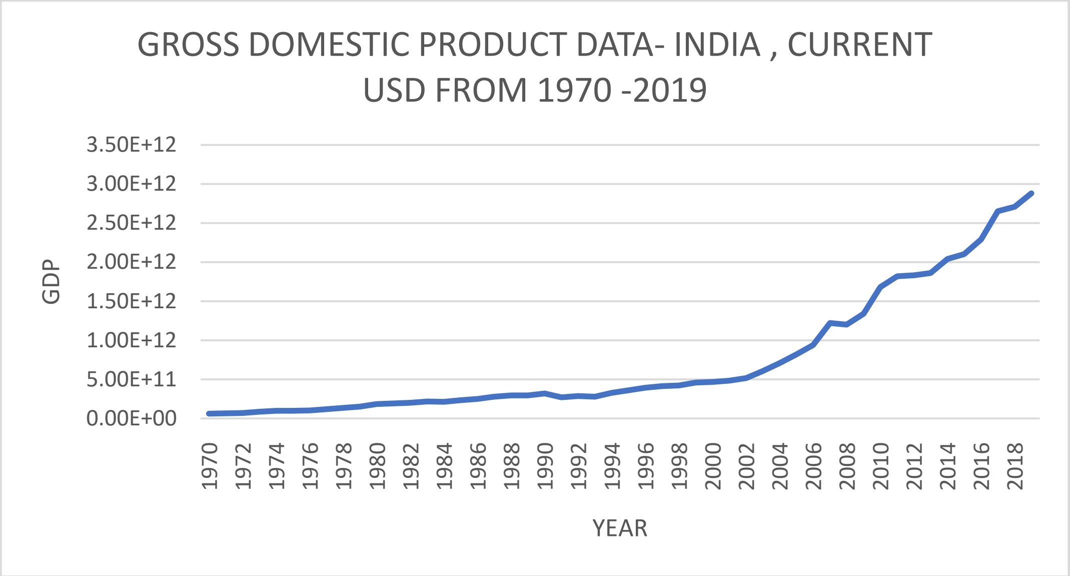
**. Correlation is significant at the 0.01 level (2-tailed).

H_0 : There is no correlation between GDP and FDI

H_1 : There is a correlation between GDP and FDI

According to the TABLE 4 the value is 0.05. However, the P value is 0.00. Therefore the null hypothesis will be rejected, which means that there is an association between GDP and FDI. According to the correlation results it depicts that there is a positive correlation between GDP and FDI. Moreover, the degree of association between the variables are very high. Therefore GDP and FDI are having a high positive correlation. Whenever FDI is increases the GDP will also rise. Whenever the FDI is decreases the GDP will also fall.

FIGURE 1 SOURCE: WORLD BANK



According to the FIGURE 1 it shows the values of Gross Domestic Product India from 1970 to 2019 with Current US Dollars. The data shows a rise in GDP from 1970 to 2019 with fluctuations.

FIGURE 2 SOURCE: WORLD BANK

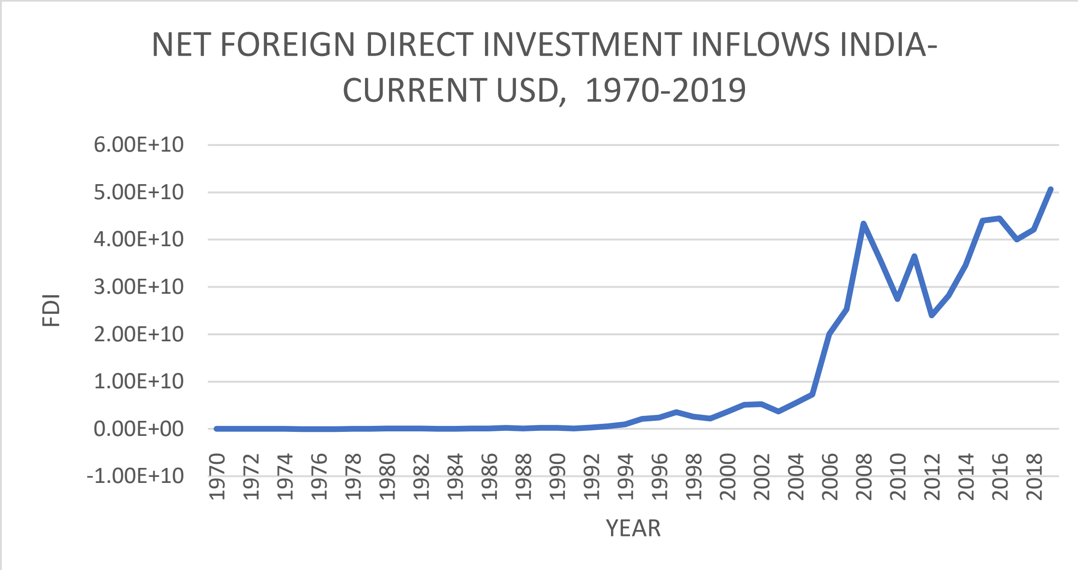


FIGURE 2 shows the data about net foreign direct investment inflows in India from 1970- 2019 which are represented in Current US Dollars.

At first the net FDI inflows were stagnant and then it shows an increase with fluctuations between 2006 to 2016 and afterwards a rise from 2016 to 2019.

© GSJ

CONCLUSION

Foreign Direct Investments is an investment done from one nation to another nation with many different expectations. Foreign Direct Investments plays a significant part of Indian Economic Growth. Foreign Direct Investments have both positive and negative impacts towards an economy. Most of the times it proliferate the economic growth. FDIs proliferate the employment opportunities, it reduces imbalances between balances of payment problems. It helps to strengthen the local currency with the help of foreign reserves too. However, there are many negative impacts as well. Foreign Direct Investments lead to lessen the domestic competition among the domestic producers. On the other hand Foreign Direct Investments are focused on the growth aspect of the country and it do not consider the developmental aspect of the country. According to the empirical analysis it directly showed that there is a significant impact on Gross Domestic Production by Foreign Direct Investments in India. In the simple regression analysis it has proven that nearly 90 percent of the changes in Gross Domestic Product is due to the changes in Foreign Direct Investments. In addition, by the correlation analysis it had shown that Foreign Direct Investments and Gross Domestic Product have a positive correlation between each other. However, concerning about the FDI policy, India amended it in August 2020. Since India had refurnished the Foreign Direct Investment policy in the coming years there is a trend that India is going to be the most attractive market for FDI investors .This has been proven by a EMPEA survey (Emerging Market Private Equity Association) Further, according to a UBS report annual Foreign Direct Investment will be increased up to by 75 US Dollar Billion after next five years. Moreover, India is trying to achieve more than this target by next two years of time.

REFERENCES

Borensztein, E., De Gregorio, J., and J.-W. Lee, (1998)., "How does foreign Direct Investments affect economic growth?", Journal of International Economics, Vol. 45: pp. 115- pp.135.

Chowdhury and Mavrotas (2005)., "FDI and Growth: A causal Relationship", JOUR.

Malhotra, B., (2014)., Foreign Direct Investment : Impact on Indian Economy, Global journal of business management and information technology Vol. 4 (1) pp. 17- pp.23.

Silajdzic, S., and Mehic E., (2015)., "Knowledge Spillovers, Absorptive Capacities and the impact of Foreign Direct Investment on economic growth: Empirical Evidence from Transition Economies.", Procedia- Social and Behavioral Sciences, Vol. 195, pp. 614- pp.623.

Zhang, K., (2001)., "Does foreign direct investment promote economic growth? Evidence from East Asia and Latin America.." , Contemporary Economic Policy, Vol.19 (2), pp. 175- pp.185.

Zhang, K. (2001a)., "How does foreign direct investment affect economic growth in China?", Economics of Transition, Vol. 9(3), pp. 679-pp.6

Zhang, K. (2001)., "Does foreign direct investment promote economic growth? Evidence from East Asia and Latin America", Contemporary Economic Policy, Vol.19 (2), pp. 175- pp.185.

Alfaro, L, Kalemli- Ozcan, S and Sayek, S. (2009), "Foreign Direct Investment, productivity and financial development.", The World Economy Vol. 32(1), pp. 111-pp.135.

Alvardo, R., Iniguez, M., & Ponce, P. (2017)., "Foreign direct Investment and economy growth in Latin America.", Economic Analysis and Policy, Vol .56, pp. 176-pp.187.

Basu , Chakraborty, (2002)., "Foreign Direct Investment and Growth in India: A Cointergration Approach", Applied Economics, Vol. 34(9 pp.1061-pp.73.

Borensztein, E, De Gregorio, J., and J.-W. Lee, (1998)., "How does foreign Direct Investments affect economic growth? ", Journal of International Economics, Vol. 45., pp.115-pp.135.

De Mello, L. (1999)., "Foreign Direct Investment in developing countries and growth: a selective survey.", Journal of Developmental Studies , Vol. 34(1), pp. 1 – pp. 34.

Fadhil, M.A., & Almsafir , M.K. (2015)., "The Role of Foreign Direct Investment inflows in Economic Growth in Malaysia (Time Series: 1975-2010).", Procedia Economics and Finance, Vol. 23 , pp.1558- pp.1566.

Hansen and Rand (2006)., "On the Causal Links between FDI and Growth in Developing Countries.", The World Economy, Vol. 29, pp. 1- pp.94.

© GSJ

Nair – Reichert , U. and Reinhold, D. (2001)., "Causality tests for cross country panels: a new look on Foreign Direct Investment and economic growth in developing countries.", Oxford Bulletin of Economics and Statistics , Vol. 63, pp. 153- pp..171.

Nistor, P., (2014).," Foreign Direct Investment and Economic growth, the case of Romania", Procedia Economics and Finance, Vol 15, pp. 577-pp.582.

Sultana M, Kagdiyal V, Goyal V. Chakkala S, Parmar R. (2019)., Journal of critical Reviews, Vol 6, (6), pp. 115- pp.119.

www.worldbank.org, GDP data on Indian Economy, 16/10/2020.

www.worldbank.org, Net FDI inflows to India, 16/10/2020

© GSJ