FOREIGN DIRECT INVESTMENT & ECONOMIC GROWTH

(Does Correlation Exists)

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ABSTRACT

Foreign Direct Investment (FDI) is going through spectacular developments during the last two decades. This exceptional growth of FDI around the world made FDI an important and critical element of economic development. In fact, FDI provides a win – win situation to the host and the home countries. FDI now transformed as a modernizing force rather just as a tool to overcome financial crisis. This paper attempted to make on analysis of FDI in India and its impact on economic growth. It also focuses on the determinants and needs of FDI, year-wise analysis, sectoral analysis and sources of FDI. FDI plays an important role in the development process of a country. It has potential for making a contribution to the development through the transfer of financial resources, technology, innovative and improved management techniques along with raising productivity. Developing countries like India need substantial foreign inflows to achieve the required investment to accelerate economic growth and development.

India has been able to attract better FDI's than the developed countries even during the crisis period also. Especially in the recent years the FDI in India has been following a positive growth rate. These investments have been a key driver for accelerating the economic growth. FDI in India has enabled to achieve a certain degree of financial stability, growth and development to sustain and compete in the global economy.

KEYWORDS: FDI, economic growth, Indian Economy.

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INTRODUCTION:

FDI is direct investment into a country by a company production located in another country by buying or by expanding its existing business in the country. Foreign direct investment is one of the measures of growing economic globalization. Investment has always been an issue for the developing economies such as India. The world has been globalizing and all the countries are liberalizing their policies for welcoming investment from countries which are abundant in capital resources. The countries which are developed are focusing on new markets where there is availability of abundant labors, scope for products, and high profits are achieved. Therefore Foreign Direct Investment (FDI) has become a battle ground in the emerging markets.

FDI plays an important role in the development process of a country. It has potential for making a contribution to the development through the transfer of financial resources, technology and innovative and improved management techniques along with raising productivity. Developing countries like India need substantial foreign inflows to achieve the required investment to accelerate economic growth and development. It can act as a catalyst for domestic industrial development. Further, it helps in speeding up economic activity and brings with it other scarce productive factors such as technical knowhow and managerial experience, which are equally essential or economic development.

Many policy makers and academicians contend that foreign direct investment (FDI) can have important positive effects on a host country's development effort. In addition to the direct capital financing it supplies, FDI can be a source of valuable technology and know-how while fostering linkages with local firms, which can help jumpstart an economy. Based on these arguments, industrialized and developing countries have offered incentives to encourage foreign direct investments in their economies.

The objective behind allowing FDI is to complement and supplement domestic investment, for achieving a higher level of economic development and providing opportunities for technological up gradation, as well as access to global managerial skills and practices.

REVIEW OF LITERATURE:

Sarbapriya Ray[i] (2012) in the study "Impact of Foreign Direct Investment on Economic growth in India: A Co integration Analysis" assessed empirically the relationship between FDI and economic growth in India using annual data over the period 1990-91 to 2010-11. The co integration test confirmed that economic growth and foreign direct investment are co integrated, indicating existence of long run equilibrium relationship between two as confirmed by johansen co integration test results.

Dr.P.C.Reddy, A.M Mahaboob Basha, Dr. R.V.S.S Nagabhushana Rao, Dr.M.Vijaya Bhaskar Reddy[ii] (2013) in their study "Impact of Foreign Direct Investment on Indian Economy" made an extensive study and through his study he opined that investment is basic requirement for every nation. Investment in the form of FDI is essential for every nation. There are different types of advantages associated with FDI like investment, employment, Know-how, labour skills, Knowledge, abilities can be transformed from one nation to other nation. FDI makes Economy stronger.

Dr.Raman P[iii] (2015) in his work "Recent Development of FDI in India" made an attempt in enlighting the nature of FDI and the challenges faced by the country due to play in global markets.. In making the capital market global in nature, FDI is directly linked with core national priorities such as raising manufacturing growth to 25% of GDP, Significant job creation and bringing high end technologies into the country.

Parminder Singh[iv] (2015) in his work " Impact of Foreign Direct Investment in Indian Economy" analysed how FDI is showing its impact on economic Development of India. He analysed the need of FDI in India, Sector wise and country wise analysis of FDI in India and ranked sectors based on highest FDI inflows in his work. The major findings of his study are Mauritius is the country which has invested highly in India and there has been tremendous increase in FDI flows in India during the years 2010-2015.

Vanita Tripathi, Ritika Seth, Varun Bhandari[v] (2015) in their study "Foreign Direct Investment and Macro Economic Factors : Evidence from the Indian economy" made an attempt to find out the existence of relationship between FDI and Six macro economic factors- Exchange rate, Inflation, GDP, Interest rate, Trade oppeness and S&P CNX 500 equity index using monthly and quaterly data for period starting from July 1997-December 2011. The results show a significant correlation between FDI & all macro economic variables (Except for Exchange rate).

AN OVERALL VIEW:

The historical background of FDI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. However, researchers could not portray the complete history of FDI pouring in India due to lack of abundant and authentic data. Before independence major amount of FDI came from the British companies. British companies setup their units in mining sector and in those sectors that

suits their own economic and business interest. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India. Further, after Independence issues relating to foreign capital, operations of MNCs, gained attention of the policy makers. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. The first Prime Minister of India considered foreign investment as “necessary” not only to supplement domestic capital but also to secure scientific, technical, and industrial knowledge and capital equipments. With time and as per economic and political regimes there have been changes in the FDI policy too. The industrial policy of 1956, allowed MNCs to venture through technical collaboration in India. The government also provides many incentives such as tax concessions, simplification of licensing procedures and de-reserving some industries such as drugs, aluminum, heavy electrical equipments, fertilizers, etc in order to further boost the FDI inflows in the country. This liberal attitude of government towards foreign capital lures investors from other advanced countries like USA, Japan, and Germany, etc. During this period the government adopted a selective and highly restrictive foreign policy as far as foreign capital, type of FDI and ownerships of foreign companies was concerned. Government setup Foreign Investment Promotion Board(FIPB) and enacted Foreign Exchange Regulation Act in order to regulate flow of foreign capital and FDI flow to India. The soaring oil prices continued low exports and deterioration in Balance of Payment position during 1980s forced the government to make necessary changes in the foreign policy. It is during this period the government encourages FDI, allow MNCs to operate in India. Thus, resulting in the partial liberalization of Indian Economy. The government introduces reforms in the industrial

sector, aimed at increasing competency, efficiency and growth in industry through a stable, pragmatic and non-discriminatory policy for FDI flow.

FDI IN INDIA

The last decade of the 20th century witnessed a drastic increase in foreign direct investment (FDI), accompanied by a marked change in the attitude of most developing countries towards inward investment. FDI flows have grown in importance relative to other forms of international capital flows, and the resulting production has increased as a share of world output. Naturally, the attitude towards foreign capital was one of fears and sufficient, an account of the previous bitter experience draining away of the resources from the country, once better known as the golden birds.

Foreign Direct Investment (FDI) in India has played an important role in the development of the Indian economy during the recession. FDI in India has – in a lot of ways – enabled India to achieve a certain degree of financial stability, growth and development. This money has allowed India to focus on the areas that may have needed economic attention and address various problems that continue to challenge the country. The factors that attracted investment in India are stable economic policies, availability of cheap and quality human resources, and opportunities of new unexplored markets. Mostly FDI are flowing in service sector and manufacturing sector recorded very low investments. The investments in service sector will enhance the benefit of flow of funds to the home country. Presently India is contributing about 17.84 % of world total population but the share of GDP to world GDP is 3.33%. India has replaced China as top destination for foreign direct investment by attracting $63 billion worth FDI projects in 2015

According to the fact sheet on foreign direct investment (from April 2000 to March 2016). Mauritius is the highest FDI investment in equity inflows with 33% of the total inflow followed by Singapore, UK, Japan, USA and Netherlands with 16%, 8%, 7%, 6% and 6% respectively. Service sector is the highest FDI attracting inflows with 18% of the total inflows, followed by construction development, computer software and hardware, telecommunication and automobile industry with 8%, 7%, 6% and 5% inflows respectively.

NEED FOR THE STUDY:

As India is a developing country, capital has been one of the scare resources that are usually required for economic development. Capital is limited and there are many issues such as Health, poverty, employment, education, research and development, technology obsolesce, global competition. The flow of FDI in India from across the world will help in acquiring the funds at cheaper cost, better technology, employment generation, and upgraded technology transfer, scope for more trade, linkages and spillovers to domestic firms. The above arguments are advanced in favor of foreign capital and these reasons made me study FDI and its impact on economic development of India.

OBJECTIVES:

The study covers the following objectives:

1. To examine the trends and composition of FDI.
2. To assess the impact of FDI on Indian economy.
3. To examine the factors which drives FDI flows into India.

4. To evaluate the impact of Government policies on FDI flows to India.
5. To suggest measures for strengthening economy through FDI flows.

SCOPE:

This paper tries to examine the role of FDI on economic growth in India for the period 2000-01 to 2015-2016. The period under study is important for a variety of reasons. First study aimed at post liberalization period. Secondly, the experiences of South-East Asian countries and its impact on flow of FDI into India.

HYPOTHESES:

1. Flow of FDI shows positive trend
2. FDI has positive impact on growth of economy

DATA COLLECTION:

The study is based on secondary data. The required data collected from various sources i.e. world investment reports, bulletins of RBI, Publications of Ministry of commerce, Country reports on economic policy and trade practices and from websites of world bank, IMF, WTO,RBI, EXIM banks etc.

DETERMINANTS OF FDI:

The determinant varies from one country to another due their unique characteristics and opportunities for the potential investors. In specific the determinants of FDI in India are:

STABLE POLICIES: India stable economic and socio policies have attracted investors across border. Investors prefer countries which stable economic policies.

ECONOMIC FACTORS: Different economic factors encourage inward FDI. These include interest loans, tax breaks, grants, subsidies and the removal of restrictions and limitation. The

government of India has given many tax exemption and subsidies to the foreign investors who would help in developing the economy.

CHEAP AND SKILLED LABOR: There is abundant labor available in India in terms of skilled and unskilled human resources. Foreign investors will to take advantage of the difference in the cost of labor as we have cheap and skilled labors.

BASIC INFRASTRUCTURE: India though is a developing country, it has developed special economic zone where there have focused to build required infrastructure such as roads, effective transportation and registered carrier departure worldwide, Information and communication network/technology, powers, financial institutions, and legal system and other basic amenities which are must for the success of the business. A sound legal system and modern infrastructure supports an efficient distribution of goods and services in the host country.

UNEXPLORED MARKETS: In India there is large scope for the investors because there is a large section of markets have not explored or unutilized. In India there is enormous potential customer market with large middle class income group who would be target group for new markets.

AVAILABILITY OF NATURAL RESOURCES: As we that India has large volume of natural resources such as coal, iron ore, Natural gas etc. If natural resources are available they can be used in production process or for extraction of mines by the foreign investors.

SUSTAINING A HIGH LEVEL OF INVESTMENT: As all the under-developed and the developing countries want to industrialize and develop themselves, therefore it becomes necessary to raise the level to investment substantially. Due to poverty and low GDP the saving are low. Therefore there is a need to fill the gap between income and savings through foreign direct investments.

TECHNOLOGICAL GAP: In Indian scenario we need technical assistance from foreign source for provision if expert services, training of Indian personnel and educational, research and training institutions in the industry. It only comes through private foreign investment or foreign collaborations.

EXPLOITATION OF NATURAL RESOURCES: in India we have abundant natural resources such as coal, iron and steel but to extract the resources we require foreign collaboration.

DEVELOPMENT OF BASIC ECONOMIC INFRASTRUCTURE: In the recent years foreign financial institutions and government of advanced countries have made substantial capital available to the under developed countries. FDI will help in developing the infrastructure by establishing firm's different parts of the country.

There are special economic zones which have been developed by government for improvising the industrial growth.

IMPROVEMENT IN THE BALANCE OF PAYMENTS POSITION: The inflow FDI will help in improving the balance of payment. Firms which feel that the goods produced in India will have a low cost, will produce the goods and export the same to other country. This helps in increasing the exports.

FOREIGN FIRM'S HELPS IN INCREASING THE COMPETITION: Foreign firms have always come up with better technology, process, and innovations comparing with the domestic firms. They develop a completion in which the domestic firms will perform better it survive in the market.

TRENDS AND COMPOSITIONS OF FDI IN INDIA:

The 1990's saw a radical transformation in the nature of FDI into India. After liberalization policy announced by the government of India the flow of FDI into our country increased. During the last 10 years India has attracted more than US $ 40 billion of foreign investment and out of which 55% constitute FDI and rest with the composition of FPI's, FII's,NRI's, ADR/GDR's etc.,.

Table- I

Flow of FDI into India (2000-2016)

S.No	Year	FDI flows in US millions(x)	GDP growth rate(y)	XY	X2	Y2
1	2000-2001	4,029	3.8	15310.2	16232841	14.44
2	2001-2002	6,130	4.8	29424	37576900	23.04
3	2002-2003	5,035	3.8	19133	25351225	14.44
4	2003-2004	4,322	7.9	34143.8	18679684	62.41
5	2004-2005	6,051	7.9	47802.9	36614601	62.41
6	2005-2006	8,961	9.3	83337.3	80299521	86.49
7	2006-2007	22,826	9.3	212281.8	521026276	86.49
8	2007-2008	34,843	9.8	341461.4	1214034649	96.04
9	2008-2009	41,873	3.9	163304.7	1753348129	15.21
10	2009-2010	37,745	8.5	320832.5	1424685025	72.25
11	2010-2011	34,847	10.3	358924.1	1214313409	106.09
12	2011-2012	46,556	6.6	307269.6	2167461136	43.56
13	2012-2013	34,298	5.1	174919.8	1176352804	26.01
14	2013-2014	36,046	6.9	248717.4	1299314116	47.61
15	2014-2015	45,148	7.3	329580.4	2038341904	53.29
16	2015-2016	55,457	7.9	438110.3	3075478849	62.41
	$\sum$	424,167	113.1	3124553.2	16099111069	872.19

http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG

$$r = \frac{n(\Sigma xy) - (\Sigma x)(\Sigma y)}{\sqrt{[n\Sigma x^2 - (\Sigma x)^2][n\Sigma y^2 - (\Sigma y)^2]}}$$

r = 0.21245

From the above table it is understood that India attracted highest FDI in the year 2015-16. The FDI flows witnessed down trend in the years 2002-03,2003-04,2009-10,2010-11and 2012-13. Correlation coefficient(r) for the above period is positive that indicates there exist positive relation between FDI & Economic development. But the "r" value is less than 1 so we can interpret that both FDI and economic development are partially correlated.

FINDINGS:

1. FDI is seeing a spectacular growth in the last two decades.
2. India is able to attract more FDI in the year 2015-16.
3. Stable economic policies, Cheap labour, abundant natural resources, huge market are few reasons for being India as hot destination for FDI.
4. FDI and economic development are positively correlated. This indicates FDI has its impact on economic development of the country.

SUGGESTION:

FDI is modernizing force to overcome financial crisis and to improve economic development of a country. India been a developing country there is a great need to attract more FDI for its transformation. For welcoming more FDI, India furthermore has to liberalize its policies towards FDI and it need to redefine economic factors.

CONCLUSION:

I finally conclude that there exist positive correlation between foreign direct investment and economic development. But for a country's economic development along with FDI there are other factors viz.. Gross Domestic production, capital formation, conditions of foreign trade, Natural resources, corruption, political freedom, Human resource etc., will also contribute.

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