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EFFECTS OF FOREIGN DIRECT INVESTMENT ON ECONOMIC GROWTH

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Abstract:-Foreign Direct Investment has played a vital role in the Indian economy. FDI has boomed in post-reform era in India. Foreign direct investment (FDI) is always contributing in the positive growth toward the economy of one country due to the investment by another country or country's personnel's. The effectiveness and success of Global economy depends upon the investor's perception. If the investor's want to long term growth then the FDI considered to be a positively growth and the investor's want to short term growth then it has no significance. Aim of this paper is to what is an effect of the FDI on the Indian economy and what relation between GDP is and FDI, which is found through regression analysis.

Keywords: Economic growth, sectoral growth, Economic development, GDP

INTRODUCTION :-

For the developing nationsFDIis considered to be the life blood and an important vehicle of for economic development. The important effect of FDI is that its contribution enhances the growth of the economy. FDI has a vital impact on country's trade balance, increasing labour standards and skills, transfer of technology and innovative ideas, skills and the general business climate. FDI also provides opportunity for technological transfer and up gradation, access to global managerial skills and practices, optimal utilization of human capabilities and natural resources, making industry internationally competitive, opening up export markets, access to international quality goods and services and augmenting employment opportunities. The potentials benefits of FDI have been universally acknowledged worldwide. There is a global race to attract FDI among countries to stimulate economic growth and development. After the liberalization in 1991 Indian market opened up to integrate with the world economy. Since then attracting FDI has been an integral part of India's economic policies. FDI inflow in India has shown tremendous growth in past few years. In the year 2008-09 India attracted USD 83 billion overseas investments and become the second most attractive destination after china. Foreign investment refers to investment by foreign investors in shares, debentures, bonds of Indian companies. Foreign direct investment is made by the foreign investor in order to establish wholly owned companies in other country and to manage them. In this investment participation of foreign investor in the risk capital of an existing or a new undertaking and also participate in the management. Some of the important ways in which FDI can invest in other countries:

a) Incorporation of new company for setting up new projects
b) Incorporation of new companies for taking over operations of existing companies which could be local owned or in turn FDI companies them.
c) Setting up of branches.
d) Capitalization of reserves
e) Can invest in form of share capital, bonds, and debentures.After the economic reforms FDI entered India in all these forms.

OBJECTIVES:

This paper tries to find out the questions to following answers:-

1) To analysis the contribution of FDI to the Indian economy
2) To investigate the effects of FDI to the economy
3) To examine the potentials of FDI and its linkages with other sectors of the economy.

LITERATURE REVIEW:

Foreign Direct Investment (FDI) plays a very important to developing countries. Though foreign direct investment, individuals or corporation obtain partial or total ownership of firms located in another country. But foreign investor should have lasting interest and substantial control over the investment. FDI contribute to growth through several channels. It directly affects growth through being a source of capital formation. As a part of private investment, an increase in FDI will, by itself, contribute to an increase in total investment. An increase in investment directly contributes to growth. A large number of studies have been done in the field of foreign direct investment and economic growth. Some of the major studies are reviewed and discussed below:-

Khawar (2005) examines the impact of contemporaneous foreign direct investment on growth in the period 1970-92 using the method of ordinary least squares (OLS). The study found that foreign direct investment is significant and positively correlated with growth as well as domestic investment. The population growth rate, initial GDP and political instability variables were negatively correlated with growth, which is keeping with the findings in the empirical growth literature. The human capital measure was not significant in the analysis.Hansen and Rand (2005) analyses the casual relationship between FDI and GDP in a sample of 31 developing countries. Using estimators for heterogeneous panel data, they found a unidirectional causality between FDI to GDP ratio implying that FDI causes growth.Bhatia, et al. (2005) examine the relationship between FDI and economic growth for twenty OECD countries over the period 1981-2000 by using econometric methodology and their empirical findings clearly suggest that, FDI does not have statistically significant effect on economic growth for those investigated OECD Countries.AnandVirmani and Susan Collins (2007) find that India will need to broaden its current expansion to provide manufactured goods to the world market and jobs for its large pool of low skilled workers.Kulwinder Singh (2005) has analyzed FDI flows from 1991-2005. A sectoral analysis in his study reveals that while FDI shows a gradual increase has become a staple of success in India, the progress is hollow.Aggarwal (2005) has given the results that FDI to GDP ratio turns out to be negative, though not significant. Pradhan (2002) who estimates a cobb-dougles production function with FDI stocks as additional input variable. They had studied the whole period (1969-1997) and given the results that FDI stocks have no significant impact.Chakraborty and Basu (2002) explore the two-way link between FDI and growth and they find that causality runs more from GDP to growth.According to Kumar (2003:27) linkages with the local economy have remained weak in the software industry where foreign companies are said to operate as export enclaves.Kathuria (2002) shows the different picture that only those domestic firms are benefited from spillovers which have invested in the R$D.

RESEARCH METHODOLOGY:-

This study is based on secondary data, which is collected from the various resources like economic survey of India various issues and many other like planning commission of India, RBI reports related to various study, Handbook of Statistics on the Indian economy, RBI various issues, Department of Industrial Policy and Promotion (DIPP), Secretariat of Industrial Assistance (SIA), Central Statistical Organization (CSO).

The data is analyzed with the help the SPSS (16.0). And relation between two is find out through the regression analysis, correlation.

DATA ANALYSIS AND INTERPRETATION:-

Data collected from various sources is presented in the following tables. Table 1 shows the amount of FDI and GDP of India in Rs corers' from 2000-2014.

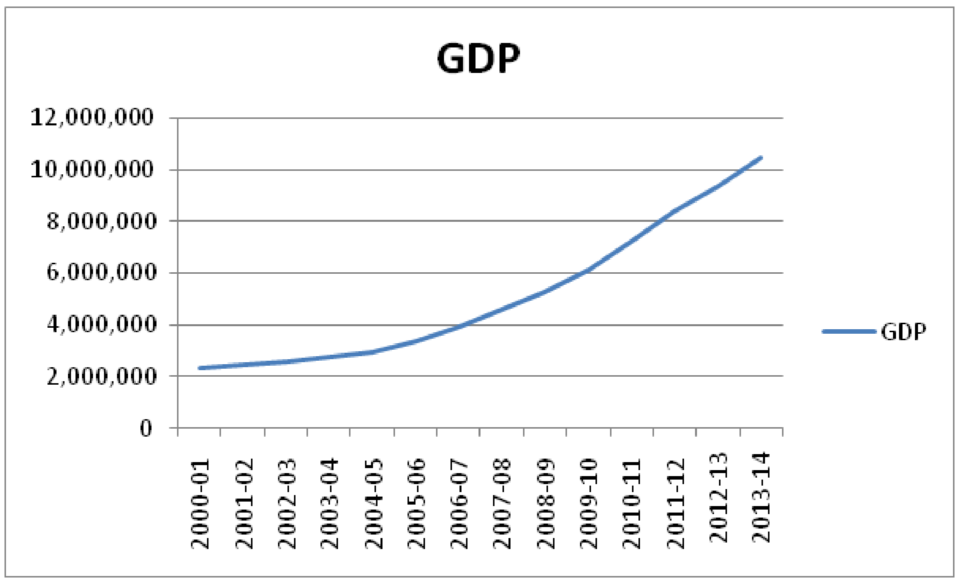
Table 1:-

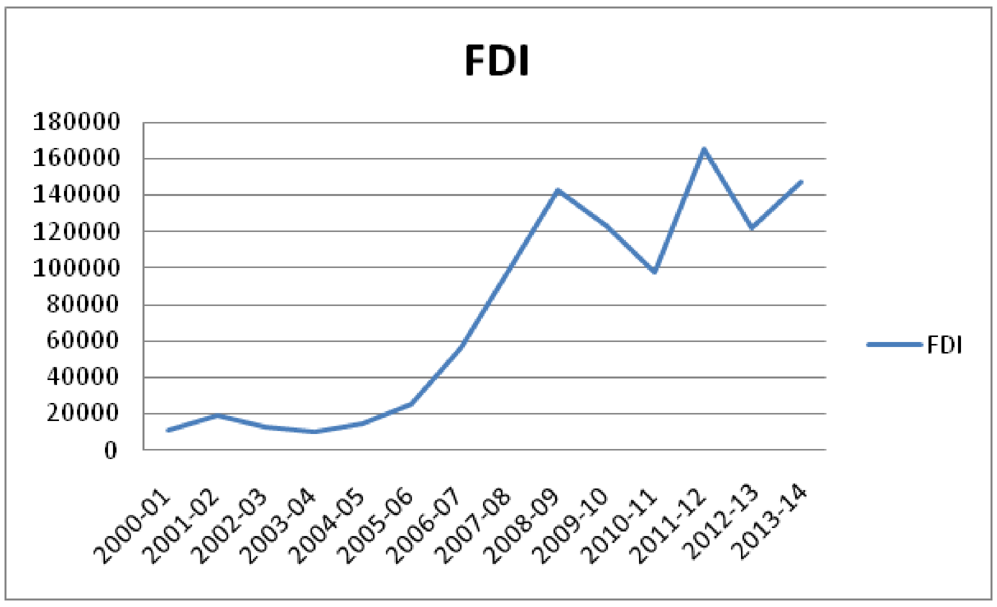
		FDI INLOWS		GDP
S. No	Years	InRsCrores	In US Million $	GDP at Current Price(In RsCrores)
1	2000-01	10733	2,463	2,342,774
2	2001-02	18654	4065	2,472,052
3	2002-03	12871	2,705	2,570,690
4	2003-04	10064	2188	2,777,813
5	2004-05	14653	3,219	2,971,464
6	2005-06	25584	5540	3,390,503
7	2006-07	56390	12,492	3,953,276
8	2007-08	98642	24575	4,582,086
9	2008-09	142,829	31,396	5,303,567
10	2009-10	123,120	25834	6,108,903
11	2010-11	97,320	21,383	7,248,860
12	2011-12	165,146	35121	8,391,691
13	2012-13	121,907	22,423	9,388,876
14	2013-14	147,518	24299	10,472,807

Source:- Planning commission of India

It is clear from the table that there is constant increase in GDP and FDI through the years. Increase in GDP cause an increase in FDI. And this increase is also shown in the graph which is drawn separately for GDP and FDI. The line of GDP is clearly showing a increasing trend with the FDI.Here it is showed that GDP is growing continuously.

But graph of FDI is increasing continuously up to 2009 which after that shows a zigzig variations.





Correlation Value:-

The value of Karl Pearson correlation(r) is found to be +.874. It means that there is high degree positive correlation between the FDI and Economic Development (GDP). This is shown in table 2.

Table 2 :-Correlation between FDI and GDP

		FDI	GDP
Pearson Correlation	FDI	1.000	.874
	GDP	.874	1.000
Sig. (1-tailed)	FDI	.	.000
	GDP	.000	.
N	FDI	14	14
	GDP	14	14

Relation between FDI and GDP:-

R2 =0.764 F (1, 12) =3121.496, D-W =0.890
* Significant at 5% level of significance

Coefficientsa

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.091E6	615336.337		3.398	.005
	FDI	40.849	6.553	.874	6.233	.000

a. Dependent Variable: GDP

R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics R Square Change	F Change	df1	df2	Sig. F Change	Durbin-Watson
.874[a]	.764	.744	1,395,845.794 94	.764	38.855	1	12	.000	.890

a. Predictors: (Constant), FDI

b. Dependent Variable: GDP

$$Y_i = b_0 + b_1\ (ses_i) + e_I$$

The above regression results supports the fact that the relationshipbetween Foreign Direct Investment (FDI) andGross Domestic Product year-wise is significant and positiveas shown by the student's t-values attached to it. The R2 ishighly significance which shows that year-wise data of 'FDI'is an important factor and explains 99.7 % of variations in thedetermination of changes in Gross Domestic Product (GDP)year-wise. Besides, F-value is statistically highly significantwhich reveals a positive relationship between the variables ofthe whole result. D-W statistics is significant and it indicatesthe absence of auto-correlation among the residuals.From the above analysis, we can conclude that the ForeignDirect Investment (FDI) is significant and has positive relationshipon the determination of Gross Domestic Product(GDP) year-wise in India for the study period of 2001-014.

CONCLUSION

Foreign Direct Investment (FDI) is considered as important part of investment is needed by India for its continuous economic growth and development through employment opportunities, expansion of existing industries, short and long term project in the sector.FDI inflow should be used as a means of enhancing domestic production, savings and exports through the equitable distribution among states by providing much freedom to states, so that they can attract FDI inflows at their own level. FDI can help to raise the output, productivity and export at the sectoral level of the Indian economy. However, it can observed the result of sectoral level output, productivity and export is minimal due to the low flow of FDI into India both at the macro level as well as at the sectoral level. Therefore for further opening up of the Indian economy, it is advisable to open up the export oriented sectors and higher growth of the economy could be achieved through the growth of these sectors. Thus in short we can say that FDI shows a tremendous growth in the Indian economy and the maximum FDI inflow in service sector. Due to FDI inflows in India economic growth, technological up gradation, per capita income, employment generation also increases. The positive effects of inward FDI in host country suggest that FDI-friendly policies could be a valuable component of an integrated policy framework for development. When designing policies to promote FDI, policy-makers should take into account that these may not only affect the volume of inward FDI, but also its composition and, as a result, its corresponding benefits.

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