# Foreign Direct Investment: Impact on Economic Growth and Import

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## Abstract

Foreign Direct Investment is described as an investment by a firm into another another firm located abroad by owning more than 10% of its equity, the former being said "parent enterprise" (or "investor") and the latter "foreign affiliate". Foreign Direct Investment plays an important role by strengthening the infrastructure, increasing productivity and creating employment opportunities in host country. The objectives of research paper are to analyse the trends of Foreign Direct Investment Inflow in Indian Economy, its impact on the growth rate and imports of the country. Secondary Data has been obtained from the website of Reserve Bank of India, Department of Industrial Policy & Promotion. The research involves uses of Descriptive Analysis of Secondary Data, Augmented Dickey-Fuller Test to check the stationarity of data, Co-integration Test to analyse any long term relationship between Inward Foreign Direct Investment & Gross Domestic Product and Inward Foreign Direct Investment and Imports. The research concludes that there is positive relationship between Economic Growth and Foreign Direct Investment Inflows. No long run relationship has been found between Foreign Direct Investment and Import which denotes that FDI has no significant impact on imports of principal commodities.

Keywords: Foreign Direct Investment, Economic Growth, GDP, Imports.

## Introduction

Investment in a country by individuals and organisations from other countries is an important aspect of international finance. The flow of international finance can be in the form of Foreign Direct Investment or Portfolio Investment. Foreign Direct Investment involves purchase of asset in rest of the world with having control over that asset while in the latter investment there is no control over that asset by the investor.

The investment climate in India has improved considerably after the economic liberalisation of policies initiated in 1991 with the goal of making economy more market and service oriented, and expanding the role of private and foreign investment. Development economists have long argued that countries pursuing externally oriented development strategies are more likely to achieve higher rate of economic growth than those The investment climate in India has improved considerably after the economic that are internally focussed. A number of studies have analysed the relationship between inward FDI and economic growth. A generally accepted conclusion is that FDI has played a significant role in growth and development of host countries because FDI represents "The transmission to the host country of a package of capital, managerial and technical skills". (Johnson,1972,p.2). India has obtained the position of 11 in FDI Confidence Index. This index is an annual survey which tracks the impact of political, economic and regulatory changes of FDI intentions and preferences of CEOs, CFOs and other top executives of Global 1000 companies.

## Recent Policy Initiatives of FDI Inflow in India

The government of India has amended FDI policy to increase the inflow of FDI. In 2014, the government increased foreign investment upper limit from 26% to 49% in insurance sector. It also launched Make in India initiative in 2014 under which FDI policy for 25 sectors was liberalised further. In April 2015, FDI inflow recorded a growth of 48% since the launch of Make In India initiative ("FDI up 48% since 'Make in India' campaign launch." The Economic Times, 14 July 2015). According to data published by DIPP, India received US$ 64375 million in 2018-19 which has been highest since last many years. India is considered to be a hub for FDI investment because of availability of abundant resources, cheap labour, huge market and easily accessible entry norms. The table below shows the FDI limits in different sectors of Indian economy. According to the data published by Department for Promotion of Industry and Internal Trade (DIPP) total FDI inflows during the first quarter of Financial Year 2019-20 has been US$ 21310 Million which is 28% higher than the FDI received in first quarter of 2018-19. The highest FDI inflow for 2019-20 first quarter has been from Mauritius and the sector that recorded top most FDI recipient was Service Sector. In August 2019, Union Cabinet approved by the Prime Minister Shri Narendra Modi has approved the proposal for Review of Foreign Direct Investment on various sectors. The impact of FDI Policy Reforms would lead to making India a more attractive FDI destination, leading to benefits of increased investments, employment and growth.

## Objectives

The objectives of the research paper are-

1. Analysis of Trend of Foreign Direct Investment (FDI) inflows in India.
2. Analysis of Impact of FDI on Economic Growth.
3. Analysis of Impact of FDI on Imports in India.

## Review of Literature

The following researches have been studied in order to gain knowledge on Foreign Direct Investment and to achieve the objectives of this paper.

1. Agnihotri An. & Arora Sh. (2019), examined the linkages between Outward FDI and Domestic Economic Growth. The paper involved studying whether Outward FDI is linked to production or it is regarded as withdrawl of domestic capital and its positive and negative impact on GDP of country. The study concluded that there is no linkage between Outward FDI and Domestic Economic Growth.
2. Nagpal A. & Jain, M. (2019) made a study on relationship between Make in India and FDI. The study concluded that FDI inflows have swelled since the unveiling of Make in India programme. The study discovered the relationship between FDI inflows and Index of Industrial Production. Also, a negative and significant association between FDI Restrictive Index and Manufacturing Value Added growth rate has been observed in context to India.
3. Malhotra B.,(2014) made study on impact of FDI on Indian Economy. The study concluded that FDI has had a positive impact on Indian Economy.
4. Gorg, Holger; Greenaway,David (2003) made a study on Do domestic firms really benefit from FDI? The paper concluded that FDI is a key driver for economic growth and economic development.
5. Buckley,Peter J.; Clegg Jeremy; Wang,Chengqi; Goss,Adam R. (2002) made a study on FDI and Economic Growth and Regional Differences. The reults showed that FDI favours growth in economically stronger provinces and the full benefits are received when local markets are at its strongest.
6. Jayakumar, A.; L., Kannan; G., Anbalagan made a study on Impact of FDI, Imports and Exports. The study concluded positive linkage between FDI, Exports, Imports.

## Research Methodology

The research involves use of secondary sources of data. The data has been obtained from the publications of Reserve Bank of India and the publications of Department for Promotion of Industry and Internal Trade (DIPP). The study involves uses of Descriptive Analysis, Augmented Dickey-Fuller Test to check the stationarity of data, Co-integration Test to analyse any long term relationship between Inward FDI & GDP and Inward FDI and Imports. Finally Regression is used to see impact of FDI Inflow on GDP and Import. Secondary Data for FDI Inflow, GDP and Imports of Principal Commodities has been taken from 2012-13 to 2018-19. The Secondary Data for analysis of distribution of FDI Inflow in all states of India and their contribution towards GDP has been taken from 2014-15 to 2018-19.

## Data Analysis

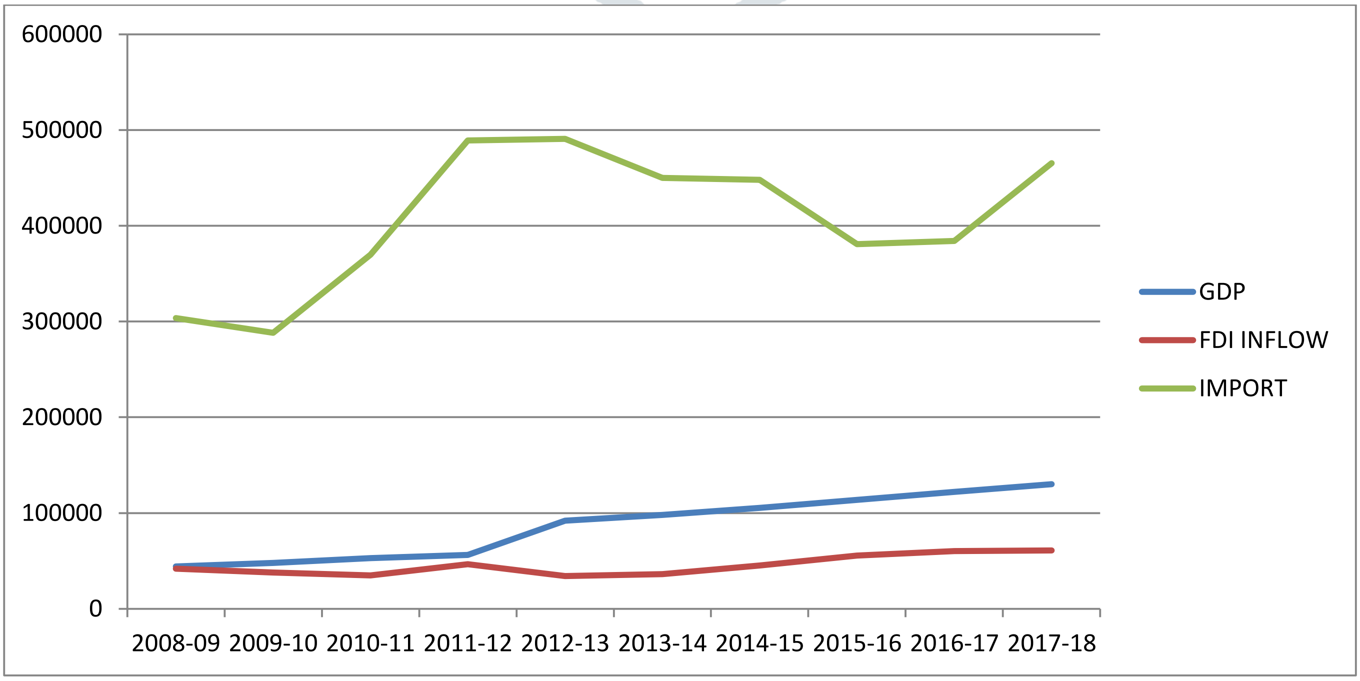
Table 1 represents the Trend Analysis of Gross Domestic Product, Foreign Direct Investment and Employment from 2009-10 to 2018-19.The data for GDP upto 2011-12 has been taken considering base year as 2004-05 thereafter base year is 2011-12.

Table 1. Trend in GDP, FDI Inflows and Import

| Year | GDP (₹ Billion) | FDI Inflow (US$ Million) | FDI Inflow (US$ Million) |
|---|---|---|---|
| 2008-09 | 44163.50 | 41873 | 303696.3 |
| 2009-10 | 47908.47 | 37745 | 288372.9 |
| 2010-11 | 52823.86 | 34847 | 369769.1 |
| 2011-12 | 56330.50 | 46556 | 489319.5 |
| 2012-13 | 92130.17 | 34298 | 490736.6 |
| 2013-14 | 98013.70 | 36046 | 450213.6 |
| 2014-15 | 105276.74 | 45148 | 448033.4 |
| 2015-16 | 113861.45 | 55559 | 381007.8 |
| 2016-17 | 121960.06 | 60220 | 384357.0 |
| 2017-18 | 130108.43 | 60974 | 465581.0 |

*Source: GDP & Imports- rbi.org.in ; FDI Inflows- dipp.gov.in

Graph 1: Trend of GDP, FDI Inflow and Imports



Note- GDP (₹ Billion), FDI Inflow (US$ Million), FDI Inflow (US$ Million)

The Line graph represents linear relationship between Foreign Direct Investment Inflow & Gross Domestic Product whereas no relationship can be seen between Foreign Direct Investment Inflow & Imports.

Table 2. Descriptive Analysis

| Parameter | GDP (₹ Billion) | FDI Inflow (US$ Million) | Imports (US$ Million) |
|---|---|---|---|
| Mean | 86257.69 | 45326.60 | 407108.7 |
| Median | 95071.94 | 43510.50 | 416195.2 |
| Maximum | 130108.4 | 60974.00 | 490736.6 |
| Minimum | 44163.50 | 34298.00 | 288372.9 |
| Std. Dev. | 32913.98 | 10327.36 | 73097.78 |
| Skewness | -0.116918 | 0.472041 | -0.411546 |
| Kurtosis | 1.410473 | 1.712986 | 1.852178 |
| | | | |
| Jarque-Bera | 1.075532 | 1.061539 | 0.831240 |
| Probability | 0.584052 | 0.588152 | 0.659931 |
| | | | |
| Sum | 862576.9 | 453266.0 | 4071087 |
| Sum Sq. Dev. | 9.75E+09 | 9.60E+08 | 4.81E+10 |
| Observations | 10 | 10 | 10 |

Source: Researcher Analysis from RBI Data- rbi.org.in and DIPP data- dipp.gov.in

Table 1 shows us the raw data which has been used to draw parameters. The Gross Domestic Product at Constant Prices, Foreign Direct Investment Inflows and Import of Principal Commodities for a period of 2008-09 to 2017-18 has been taken. The descriptive statistics reveal that the average value of Gross Domestic Product for the mentioned period is ₹ 86257.69 Billion. The highest value that the GDP attained in the given period is ₹ 130108.4 Billion.

Similarly, the average Foreign Direct Investment Inflow value is US$ 45326.60 Million. The range over which FDI varies is US$ 26676 Million. This indicates the range within which the values of FDI fluctuates. The data for FDI is positively skewed. Skewness denotes the symmetrical distribution of data.

The average value of imports for the given period is US$ 407108.7 Million. The data values are negatively skewed. The range over which Import varies is US$ 202363.7 Million. This is obtained as difference between highest and lowest values.

Table 3. ADF test to check the stationarity of the variables

| Intercept | | | | | | |
|---|---|---|---|---|---|---|
| | Level | | First Difference | | Second Difference | |
| ADF | T-Stat. | Prob. | T-Stat. | Prob. | T-Stat. | Prob. |
| | | | | | | |
| GDP | -.343188 | 0.8809 | -3.181598 | 0.0601 | -4.110941 | 0.0217 |
| FDI | -.535463 | 0.8397 | -3.012022 | 0.0754 | -3.881839 | 0.0283 |
| Import | -3.754532 | 0.0284 | -2.136151 | 0.2380 | -2.380637 | 0.1797 |

Source: Researcher analysis from RBI data- rbi.org.in and DIPP data- dipp.gov.in

The above table checks the stationarity of data. GDP and FDI are stationary at Level, First Difference and Second Difference. Import data is stationary at Level and First Difference but not stationary at Second Difference.

Table 4. Co-integration Test 1

| Gross Domestic Product & Foreign Direct Investment | | | | |
|---|---|---|---|---|
| No. of CE(s) | Eigenvalue | Statistic | Critical Value | Probability |
| None | 0.653207 | 15.74273 | 15.49471 | 0.0459 |
| At Most 1 | 0.596998 | 7.270501 | 3.841466 | 0.0070 |

Source: Researcher Analysis from RBI and DIPP data

Table 5. Co-integration Test 2

| Foreign Direct Investment & Import | | | | |
|---|---|---|---|---|
| No. of CE(s) | Eigenvalue | Statistic | Critical Value | Probability |
| None | 0.804086 | 13.86152 | 15.49471 | 0.0868 |
| At Most 1 | 0.097523 | 0.820901 | 3.841466 | 0.3649 |

Source: Researcher Analysis from RBI and DIPP data

In the Table 4, the trace statistic is more than the critical value thus the analysis documents long run relationship between Gross Domestic Product and Foreign Direct Investment. In Table 5 the trace statistic value is less than the critical value thus the analysis documents no long run relationship between Foreign Direct Investment and Import.

## Conclusion

The study provides that there is positive relationship between Economic Growth and Foreign Direct Investment Inflows. These days, the country is consistently ranked among top three global investment destinations by International Bodies, including the World Bank, according to a United Nations report. No long run relationship has been found between Foreign Direct Investment and Imports. FDI both at initial investment and operational phases can influence import of a country. The relationship between FDI and Import can be positive or negative. If FDI is concentrated in import substituting industries, then it is expected to affect imports negatively because the goods that were imported earlier are now being produced in host country by foreign investors. No long run relationship between FDI and Import denotes that FDI has no significant impact on imports of principal commodities.

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