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FOREIGN DIRECT INVESTMENT A SIGNIFICANT FACTOR FOR INDIA'S ECONOMIC GROWTH

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Abstract

Foreign Direct Investment (FDI) plays a vital role in a country's economic growth. There are several factors including trade openness, inflation rate, economic stability, investment policies, regulations, exchange rate, foreign reserves and political stability that influence FDI. The inflow of capital from foreign investors helps to strengthen the country's infrastructure, boost productivity, and create jobs. FDI also serves as a platform to acquire cutting-edge technology and access foreign exchange. With foreign exchange reserves, the Reserve Bank of India can intervene in the exchange rate market and control adverse movements to stabilise the exchange rate. Thus, FDI not only provides access to limited resources like fossil fuel and precious metals but also skilled labour, management skills and cutting-edge technologies. It also allows an organisation to reduce its cost of production by accessing cheaper resources or directly sourcing raw materials instead of buying them from third-party suppliers.

Keywords: FDI, Economic Development FDI, Indian Economy, Foreign Investments, Environmental Pollution, GDP, etc.

➢ Introduction

Foreign direct investment (FDI) in India is one of the main sources of finance for India's economic growth. In 1991, the Indian government implemented the economic policy "Liberalisation, Globalisation, and Privatisation (LPG), which has moved our economy in a positive direction. In this regard, various schools of thought argue that FDI inflows into India are shifting the economy in a positive direction. During the past 10 decades, the economy has been moving in a positive direction due to investments through foreign direct investment (FDI), which is essential for the development of every nation. Therefore, it is required that systematic investments be made in the Indian economy in sectors like the agricultural sector, the industrial sector, and the service sector. As per past experience, India is getting huge investments in the service sector, followed by the industry sector and the agriculture sector. Therefore, FDI is the fuel for the engine of economic growth in a nation. According to market experts, those countries that attracted more FDI, became self sufficient with time, while those that got little FDI remained backward or underdeveloped,. It is clearly defined that FDI can provide benefits to the nation in different ways, such as workforce transformation, financial capital flow, knowledge transfer, skills transfer, and technology transfer, which can be brought from country to country. There are various concepts regarding foreign direct investment, are including; 1. **Human Capital:** Labour migration can happen through foreign direct investment, where skilled or highly skilled workforces can move from one nation to another in the world of mutual business. The transfer of human capital from one nation to another facilitates stronger business as knowledge and skills transfer from one nation to another. Since workforces from different nations are quite strong in different knowledge, skills, and talents, these can be shared globally. 2. **Exchange Rate:** The

depreciation and/or appreciation of a currency depend on the exports and imports of that country. An exchange value, sometimes the value of the national currency can increase, while sometimes the value of the host currency can decrease. It depends on market forces. 3. **Gross Domestic Product (GDP):** The GDP of a nation will steadily increase as investments are made through foreign direct investment, facilitating the establishment of novel organisations, industries, and businesses that will increase a country's income. 4. **Exports:** each and every nation should increase its exports, as it must be strong enough in skills, technology, and knowledge, which can be possible by investing in the form of investment. 5. **Per capita income:** per capita income indirectly depends on FDI, which increases industry, which further increases employment, and employment increases the living standards and per capita income of a nation. 6. **Technology:** high-tech products may be viable for investment in the form of foreign direct investment. Not only investments, but also technology can be moved from one nation to another. It allows a nation to become technologically dominant. Today, there is a cutthroat competition among the nations for the apex position. Technological advancement is a significant factor in the growth of a nation, so there is a need for the transfer of technology, which should happen through FDI in every country.

Category of FDI

There are four main types of FDI: horizontal, vertical, conglomerate and platform FDI.

- **Vertical investment:** It is a type of foreign direct investment (FDI) in which the investor establishes or acquires a business in a country that is not directly related to the investor's core business. For instance, Toyota acquires a car distributor in the USA. There are two types of vertical investments: Forward and Backward vertical investment. Forward vertical investment brings the company closer to a market, for example Toyota acquires a majority stake in a tyre manufacturer or a rubber plantation. Backward vertical investment brings the international integration back to raw materials.
- **Horizontal Investments:** A horizontal direct investment (FDI) is an investment in a foreign country by an investor that carries out the same kind of business activities in that country as it does in the home country. For example, Apple, a US-based company, opens stores in India as a horizontal investment. Coca-Cola, Pepsi, Samsung and HSBC have all expanded internationally as a result of horizontal FDI.
- **Conglomerate Investment**: A conglomerate investment is a foreign direct investment (FDI) made by a business or individual in another country that is not related to their existing business in their home country. In a conglomerate investment, a business obtains an independent business in another country. This type of investment is unusual because it requires two steps to enter a foreign country:
- **Platform FDI:** It is a type of foreign direct investment (FDI) in which a business expands to a foreign country, but the results of the foreign operations are exported to another country. This type of FDI is also known as export-platform FDI. Platform FDI typically takes place in low-cost countries within a free-trade area. For instance, Ford purchased manufacturing facilities in Ireland with the main goal of exporting cars to EU countries.

Review of literature

- According to Tilak Raj and Ashima Pahwa (2018), each country strives to attract a growing amount of FDI, which would then lead to economic growth. The government must focus on a number of issues, including improving the infrastructure, liberalising the FDI policy, maintaining political stability, etc., in order to draw in increasing amounts of foreign investment. In this line, the International Finance Corporation (IFC), the investment arm of the World Bank Group, intends to invest roughly $6 billion in a number of sustainable and renewable energy schemes in India until 2022.

- According to Abidhusain G. Kadiwala's research from 2019, the correlation coefficient between the variables is 0.675, which is positive and can be seen as a good indicator. It was discovered that changes in FDI had an impact on the nation's GDP; hence, an increase in FDI indicated a positive effect on India's GDP. Therefore, in terms of GDP, foreign direct investment is better for the Indian economy.

- According to Dr. Ampu Harikrishnan and Shivani (2018), FDI money can be realised by investing it in worldwide projects, which could result in amounts as high as early as is practical, and that too with regard

to real-time realisation. It was said that more emphasis should be placed on the bureaucracy's development, namely that it should become more responsive. Corruption could be reduced by starting at the base of the economic pyramid.

- Malhotra (2014) examined the difficulties faced by FDI in the country while highlighting the effect of FDI on Indian GDP. Silajdzic and Mehic (2015) stated the positive impact of FDI on economic growth, both directly by subscribing to fixed capital formation and indirectly by subscribing to knowledge stocks. Domestic investments were affected due to FDI.

- While Aitken & Harrison (1999) and Carkovic & Levine (2002) conclude that FDI does not have a significant effect on economic growth, even when the relationship is positive, the effect is very weak, suggesting that there are other factors that influence economic growth besides FDI. For example, a study (Konings (2001)) on the economic growth of Poland from 1993-97 in the context of FDI concluded that FDI did not have a positive effect on economic growth in Poland due to the reverse transfer of management and technical knowhow as well as trade imbalance. Similarly, a study (yi (2008) on economic growth in China from 1997-2008) concluded that FDI can impede economic growth in the short term, whereas human capital and domestic investment as well as domestic credit have positive effects in the short term. However, most literature claims that FDI is an important factor influencing economic growth.
- Gregorio, and Lee (1998) examined the impact of Foreign Direct Investment (FDI) on economic growth. Basu (2003), Chakraborty (2003) and Reagle (2004) found that there is a correlation between FDI and Gross Domestic Product (GDP). Chowdhury (2005) examined the relationship between FDI and economic growth and found positive impacts on the economy. Malhotra (2014), identified the effects of FDI on the Indian economy and analyzed the challenges of FDI. Silajdzic (2015) found that FDI has a positive impact on economic growth by subscribing to fixed capital formation directly and indirectly subscribing to knowledge stocks. Sixthly, domestic investments and investments have been affected by FDI.
- Gregorio and Lee (1998) examined how FDI affects economic expansion.
- Furthermore, Basu, Chakraborty, and Reagle's 2003 analysis found no connection between foreign direct investment (FDI) and GDP.
- In their 2005 study, Chowdhury and Mavrotas looked at the connection between economic expansion and foreign direct investment. They also mentioned how FDI helps an economy flourish in a positive way.

➢ Methodology

The information for the research paper has been extracted from secondary data such as articles related to foreign direct investment (FDI) from newspapers, journals, textbooks, internet and other sources.

➢ Objectives

- To study the role of FDI in accelerating the economic growth
- To analysis the significance of FDI in the Indian economy

FDI not only provides skilled labour, management skills and cutting-edge technologies but also access to limited resources like fossil fuel and precious metals. It allows an organisation to reduce its cost of production by accessing cheaper resources or directly sourcing raw materials instead of buying them from third-party suppliers which rejuvenate the growth of economy.

Table-1-FDI inflow and economic growth in India

Year	GDP (In Billion US$)	Growth	Total FDI (In Billion $)	%age growth over previous year (in US$ terms)
2012	1,823.05	5.24%	46.56	(+) 34 %
2013	1,827.64	5.46%	34.30	(-) 26%
2014	1,856.72	6.39%	36,046	(+) 5%
2015	2,039.13	7.41%	45.15	(+) 25%
2016	2,103.59	8.00%	55.56	(+) 23%
2017	2,294.80	8.26%	60.22	(+) 8%
2018	2,651.47	6.80%	61.74	(+) 1%
2019	2,702.93	6.45%	62.01	(+) 2%
2020	2,831.55	3.74%	74.40	(+) 20%
2021	2,667.69	-6.60%	82.03	(+) 10%
2022	3,176.30	8.68%	84.84	(+) 3%
2023	3368.40	7.0%	52.34	(-)37%

(Source: Department of promotion of Industry & internal trade-2023)

From the above table-1 show the relationship of the FDI, GDP and economic growth. During the period of 2011-2023, the gross domestic product increased overtime. In 2012, the GDP accounted of worth US$ 1823.05 billion, increase US$ 2039.13 billion in 20154 and US$3368.40 billion in 2023. Whereas, the FDI was US$46.56 billion in 2012 and remained fluctuation till 2015 and steadily increased up to US$84.84 billion in 2022 but decreased in 2023 i.e. US$ 52.34 billion due to COVID-19. Even in 2021, GDP growth rate remained negative by -6.60% which is the highly affected by the pandemic, however, FDI did not decreased. During the pandemic period FDI and GDP increased significantly. Thus, FDI and GDP have the positive relation i.e. GDP increased along with the foreign direct investment.

How FDI accelerate the economic growth

Here are some of the ways in which foreign direct investment (FDI) works in favor of the recipient country:

i) **Providing finance & technology**: Beneficiaries of FDI provide their businesses with access to the latest financial instruments, technologies and operating practices from around the world. As time goes by, the newer, improved technologies and processes become available in the local economy resulting in increased efficiency and effectiveness in the industry.

ii) **Higher employment and economic growth:** This is one of the primary reasons why a country, particularly a developing country, seeks to attract foreign direct investment (FDI). Higher FDI helps to boost the manufacturing and services sectors, which in turn create jobs and help to reduce the unemployment rate among the educated young people, as well as among the unskilled and skilled labour. Higher employment leads to higher incomes, which in turn give the population more purchasing power, which in turn boosts the economy.

iii) **Stimulation of economic development:** FDI provides foreign capital and higher income for a country construction of factories utilises at least local labour, raw materials and equipment. Once the construction is completed, the factory employs some local workers and also uses local raw materials.

iv) **Human resource development:** Human capital refers to the skills and competencies of the labor force. The skills acquired and improved through education and experience increase the education and the human capital of a country. Once human capital is developed, it is mobile and can be trained in other companies.

v) **Inflows of capital** are especially important for countries that have limited domestic resources and have limited access to global capital markets.

vi) **Developing backward areas**: FDI helps to transform backward areas into industrial centres in a country. This helps to improve the social economy in the area. An example of this is the Hyundai unit in the state of Tamil Nadu, India.

vii) **Developing a Competitive Market:** Foreign direct investment (FDI) facilitates the entry of foreign companies into the domestic market, which helps to create a competitive environment. FDI also helps to break up domestic monopolies. A healthy competitive environment encourages companies to continually improve their processes and products, thus promoting innovation. Consumers also benefit from a wider variety of products at competitive prices.

viii) **Increase in exports**: The 100% export oriented units and economic zones have helped FDI investors to increase their exports.

ix) **Exchange rate stability:** constantly inflows of foreign exchange into a country help the Central bank maintain a comfortable foreign exchange reserve stability of exchange rates.

❖ **Significance of FDI to accelerate economy growth in India**

Foreign direct investment (FDI) accelerates economic growth in the following ways:

i. **Foreign direct investment (FDI) supports the export of host developing countries:** FDI boosts exports. Foreign companies, with their global marketing networks and marketing data, are well-positioned to leverage these advantages to support developing countries' exports.

ii. **Foreign direct investment (FDI) brings more jobs:** Foreign enterprises create jobs by employing the people of developing countries. If it weren't for this investment, many developing countries wouldn't have jobs. Moreover, these jobs are likely to be in higher skill sectors. FDI creates direct jobs but it also creates indirect jobs through back and forth linkages.

iii. **Foreign direct investment (FDI) leads to higher wages:** FDI also promotes higher wages. Relatively higher skilled jobs would receive higher wages.

iv. **Foreign direct investment (FDI) creates a competitive environment in the host country:** The entry of foreign firms into the domestic market creates an environment where domestic firms are forced to

compete with foreign firms in the domestic market, resulting in increased efficiency and quality of products and services. Consumers may have more options.

v. **FDI provides Capital:** Foreign Direct Investment (FDI) is expected to provide the capital that developing countries need. Developing countries need more investment in order to meet their national income growth targets. Since developing countries do not usually have sufficient savings, they need to supplement their savings with foreign savings. They can do this either through external borrowing or by allowing and promoting FDI. Foreign direct investment is an efficient way to provide this additional capital. However, it comes with its share of risks.

vi. **Foreign direct investment (FDI) eliminates the balance of payments constraint:** FDI provides a 'flow of foreign exchange resources' and eliminates balance of payment constraints. Many developing countries face balance of payments (BoP) deficits because of their foreign exchange demand, which is usually much higher than what they can earn. Foreign direct investment (FDI) inflows remove this constraint. One of the key advantages of FDI compared to external borrowings from a balance of payments perspective is that a loan creates a fixed liability. Governments or corporations need to repay a loan, and the resulting international debt (debt) of the government or the corporation is a 'balance of payments' liability. With a loan, the government or corporation has to repay the loan, along with interest, over a specified period of time. In contrast, with FDI, there is no such thing as a fixed liability. Instead, the foreign investor will generate sufficient resources to fund outflows on the basis of activity generated by FDI, and the risk will be borne by the foreign investor.

vii. **Foreign direct investment (FDI) provides technology, management and marketing skills:** FDI brings with it critical assets that are either absent or limited in developing countries: technology, management, and marketing skills. Without these, development cannot occur. This is perhaps the single most important benefit that FDI brings. It's more important than attracting capital, which may come from the global capital markets and governments.

➢ Conclusion

Through transfers, foreign direct investment plays an important role in the country's overall economic growth through development of technology, strengthening of infrastructure, improvement of productivity, creation of new productivity employment opportunities. There are many factors that make India attract foreign direct investment. These factors include huge market size, sound economic policies and availability of quality products. After the introduction of the new economic policy in 1991, the inflow of foreign direct investment into India increased. However, India's global share of foreign direct investment is very small compared to other developing countries due to lack of proper infrastructure, unstable political environment, high corporate tax rate, challenging environment, labor laws, lack of decision-making authority, and export processing zone restrictions. These factors are believed to contribute to the low level of inward foreign direct investment. Therefore, Indian government should take innovative measures to attract more foreign investment in various fields of economy.

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