ABSTRACT

FDI is considered to be one of the key aspects in economic growth of any country (developed, underdeveloped and developing) which drives economists and analysts all over the world to study its effects for both short and long term. Foreign Direct Investment not only help in capital acquisition for any economy, it helps in growth of technology, introduction of more efficient management models, generate new jobs for the host country. But there are many factors which determines whether a Multi-National Corporation will invest in any economy or not. In this study, we have tried to study how FDI effects economic growth of any country as well as what factors drives MNCs to invest that economy. FDI Restrictiveness Index is used globally to analyse the willingness of any economy for FDI.

INTRODUCTION

The concept of globalization is still debatable until people gain a firm understanding of how globalization affects human welfare. Since economic growth has become measurement of country welfare from international point of view, people must get a better handle on globalization's effects on economic growth. Globalization covers a wide array of economic activities, including international trade, international migration, and international investment.

International investment is strategic step for country due to lack of capital and technology transfer and it is generally well known as Foreign Direct Investment (FDI). FDI pieces a noteworthy role in the advancement of the nation. In the last 20 years, FDI exhibited noteworthy growth rate in the international economic landscape. Such an unparalleled progress makes FDI a vital factor of development policy in both developed & developing nations. The foreign direct investment (FDI) inflows are often seen as the important catalyst for economic growth in the developing countries. A distinctive characteristic of developing and underdeveloped economies is the fact that these economies do not have the required amount of reserves and income in order to meet the essential level of investment needed to sustain the development of the economy. In such cases, foreign direct investment plays a vital role of bridging the gap between the available resources or funds and the required resources or funds. It plays a significant role in the long-term growth of a nation not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities. They are only two types of FDI which included the horizontal and the vertical all of which heavily contribute to sustaining the economy of countries and bringing stability and also a suitable currency which is not subject to fluctuations. These investments of business are outside their own country that it operates at their own country (domestic country). In horizontal foreign direct investment company wants to take the advantage of international platform by selling their good and services all over the world with the help of globalization and foreign direct investment. It provides platform to companies to showcase their talent and take the advantage of same to increase the wealth of their domestic country. Horizontal foreign direct investment is a traditional model which is followed by Japanese to expand their business. Impact of FDI on the economy can be classified into two types namely direct and indirect. Under the direct impact, it is seen that the FDI inflows create a significant impact of the levels of domestic income, employment, price level, productivity, efficiency and export growth. The indirect impact of FDI can be accounted from the spillover effects of FDI. Spillovers from FDI accounts for the impact of the entry of foreign players in the competitive domestic market resulting in increased productivity and improvements in quality and other business process.

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. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet United Kingdom (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 to use FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. With time and as per economic and political regimes there have been changes in the FDI policy too. The potential advantages of the FDI on the host economy are that it facilitates the use and exploitation of local raw materials and introduces modern techniques of management and marketing. Through FDI investments better quality goods and services become available to domestic customers. The industrial policy of 1965, allowed MNCs to venture through technical collaboration in India. Thereafter, the government adopted a liberal attitude by allowing more frequent equity investment. In the critical phase of Indian economy, the government of India with the help of World Bank and IMF introduced the macro-economic stabilization and structural adjustment program. As a result of these reforms, India opened its doors to FDI inflows and adopted a more liberal foreign policy in order to restore the confidence of foreign investors.

Further, under the new foreign investment policy Government of India constituted FIPB (Foreign Investment Promotion Board) whose main function was to invite and facilitate foreign investment. In India, FDI is considered as a developmental tool, which helps in achieving self-reliance in various sectors and in overall development of the economy. India after liberalizing and globalizing the economy to the outside world in 1991, there was a massive increase in the flow of foreign direct investment. There is a lot of scientific literature elaborating various sides of association between FDI and growth in economic conditions, especially in transition countries. FDI flows into India have grown rapidly since the liberalisation of the policy regimen in the early nineties. Nevertheless, they remain small when measured as a proportion of GDP or total investment. The Indian economy has received a lot of FDI across various sectors for the last 3 decades. However, the majority of the FDI inflows can be seen in the services sector which alone accounts for about one fifth of the total FDI inflows. The other sectors which received significant FDI inflows include construction, automobile, infrastructure, telecommunications, pharmaceuticals, chemicals and power.

A UNCTAD survey has projected India as the second most important FDI destination (after China) for transnational corporations, during 2010-2012. On one hand, the prevalent literature body expresses the importance of FDI as a significant source for scaling up production, efficiency, growth and management knowhow while another set of researchers have criticized the inflow of FDIs in the Indian economy and have expressed their concerns over its adverse effects and have termed them as weapons of economic exploitation of the developing countries. Thus, it is very essential to analyse the part of FDIs in the growth of economic condition of India.

LITREATURE SURVEY

According to Nekipelov (2011), economic growth is dynamics of the volume of end goods and facilities formed during a selected stretch unit. There are different concepts of economic growth and ways of measuring it, but the core definition is in terms of growth in the long run industrious size of the economy, typically measured by real growth in Gross Domestic Product (GDP). It is described as the sum of all end goods and services produced in a country over time, without double counting products used in other output. It is a comprehensive measure, covering the production of consumer goods and services, even government services, and investment goods. This production includes that by the country owned companies as well as by production plants located in the country boundaries and owned by foreign companies. As GDP increases, there is a tendency for company profits and interest rates to rise as well. Conversely, as GDP decreases, there is a tendency for company profits and interest rates to also decline. GDP Growth can be measured in terms of demand (total expenditure on goods and services), or supply (total goods and services produced). There are two kind of popular GDP growth in economic study, those are Nominal and Real GDP growth. Nominal GDP is GDP evaluated at current market prices. Therefore, nominal GDP will include all of the changes in market prices that have occurred during the current year due to inflation or deflation. Inflation is defined as a rise in the overall price level, and deflation is defined as a fall in the overall price level. In order to abstract from changes in the overall price level, another measure of GDP called real GDP is often used. Real GDP is GDP evaluated at the market prices of some base year.

Kotrajaras (2010) examined the effect of FDI on the economic growth of 15 East Asian countries. The sample was divided into three groups:

1. High-income group (Hong Kong, Japan, South Korea, Singapore, and Taiwan)
2. Middle-income group (China, India, Indonesia, Malaysia, the Philippines, and Thailand)
3. Low-income group (Cambodia, Laos, Myanmar, and Vietnam).

The study used a fixed effect model and found a positive relationship between FDI and economic growth only in high-income and middle-income countries, which have the appropriate economic factors—well-educated workforce, investment in infrastructure, and trade openness.

Tiwari and Mutascu (2011) investigated the impact of FDI on economic growth in 23 Asian countries using panel data for the period 1986–2008. The study also examined the nonlinearities associated with FDI and exports. The result of this study indicates that FDI and exports enhance the growth process. In addition, labour and capital also play an important role in the growth of Asian countries

Balasubramanyam and Sapsford in their article “Does India need a lot more FDI” compared the levels of FDI inflows in India and China, and found that FDI in India is one tenth of that of china. The paper also concluded that India may not require increased FDI because of the structure and composition of India’s manufacturing, service sectors and her endowments of human capital and the country is in a position to unbundle the FDI package effectively and rely on sources other than FDI for its capital requirements.

Bhattacharyya Jita, Bhattacharyya Mousumi (2012), “Impact of Foreign Direct Investment and Merchandise and Services Trade of the Economic growth in India: an Empirical study”, the study revealed that there was a long term relationship between FDI, merchandise, service trade and economic growth of India. Bi-directional causality is observed between merchandise trade and economic growth, services trade and economic growth. Unidirectional causality is observed from FDI to economic growth and FDI to merchandise trade. A unidirectional causality is also observed from merchandise trade to services trade.

Bajpai and Jeffrey stated attempted the paper on “Foreign Direct Investment in India: Issues and Problems”, to identify the issues and problems associated with India’s current FDI regimes, and also the other associated factors responsible for India’s unattractiveness as an investment location. Despite India offering a large domestic market, rule of law, low labour costs, and a well working democracy, her performance in attracting FDI flows have been far from satisfactory. The conclusion of the study is that a restricted FDI regime, high import tariffs, exit barriers for firms, stringent labour laws, poor quality infrastructure, centralized decision-making processes, and a very limited scale of export processing zones make India an unattractive investment location.

FDI and its connection with human capital have gained lots of attention. Inward foreign direction has favourably affected the economic growth of the country through its interaction human resources and capital. Thomas (2016) said that Economic sustainability of host countries in regards to the national output and gross national product. Contribution of FDI in economic growth of the country is more than the domestic investment. According to researchers, manpower is directly related to growth of the country’s economy. As per the sample of American countries, country must have economic stability, human capital resources and there should be liberalization in the market for significant positive impact of FDI on economic growth of the country. As per the sample data of 84 countries during the period 1970 to1999, it is found that FDI directly or indirectly affects the economic growth of the country through its interaction with manpower.

METHODOLOGY

1. **Data Collection**
   The required data have been collected from various sources i.e. World Investment Reports, various Bulletins of Reserve Bank of India, publications from Ministry of Commerce, Govt. of India, websites of World Bank, RBI and UNCTAD etc.
2. **Model Building**
   Two equations used here are
   I. FDI = f (TRADEGDP, RESGDP, R&DGDP, FIN. Position, EXR)
   II. GDPG = f(FDIG)

   Where,
   FIN. Position= Financial Position
   TRADEGDP= Total Trade as percentage of GDP.
   RESGDP= Foreign Exchange Reserves as proportion of GDP.
   R&DGDP= Research & development expenditure as proportion of GDP.
   EXR= Exchange rate
   GDPG= level of Economic Growth
   FDIG= Foreign Direct Investment Growth

   Regression analysis was carried out using relevant econometric techniques. Simple regression was operated to measure the influence of FDI flows on economic growth (proxied by GDP growth) in India. Further, multi-regression analysis was used to identify the major variables which have impact on foreign direct investment. Relevant econometric tests such as coefficient of determination R^2, Standard error of coefficient and F- ratio were carried out in order to assess the relative significance, desirability and reliability of model estimation parameters. The general purpose of multiple regressions is to learn more about the relationship between several independent or predictor variables and a dependent or criterion.

ANALYSIS

FDI = f (TRADEGDP, RESGDP, R&DGDP, FIN. Position, EXR)

Variable	**Coefficient**	**Standard Error**	**t-Statistic**
Constant	26.25	.126	207
Trade GDP	11.79	7.7	1.5
Reserves GDP	1.5	3.6	.41
Exchange Rate	7.06	9.9	72
Financial Health	15.1	35	.45
R&D GDP	-582.14	702	.83

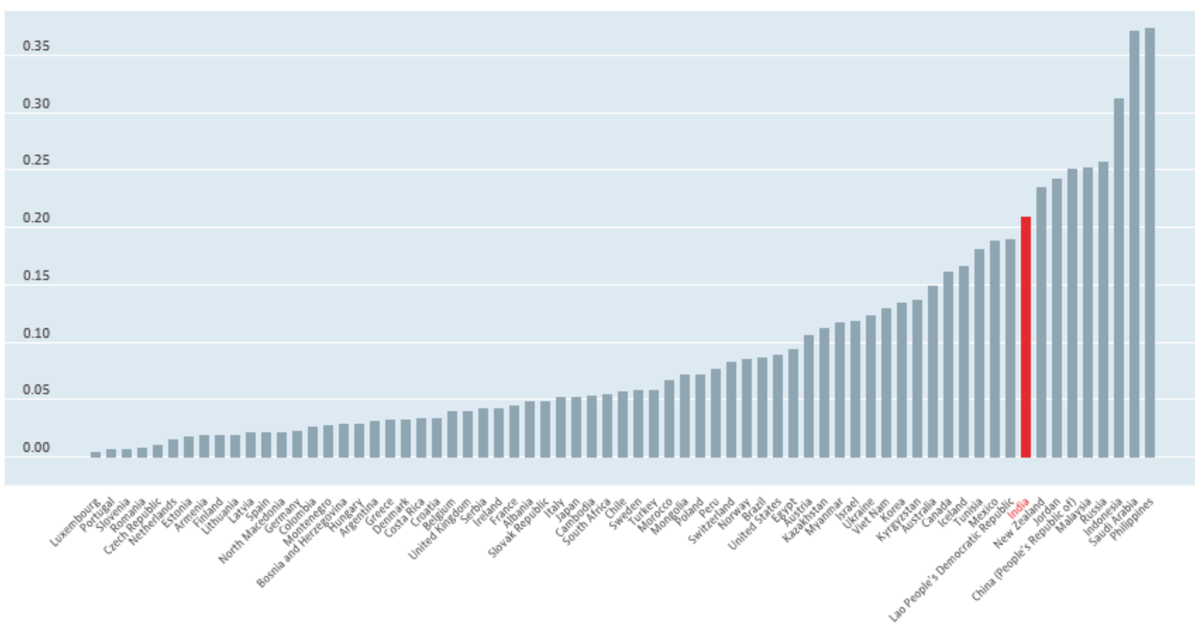
$R^2 = 0.623$
Adjusted $R^2 = 0.466$ F-ratio=7.74

In Foreign Direct Investment Model, it is found that all variables are statistically significant. Further the results of Foreign Direct Investment Model show that TradeGDP, R&DGDP, Financial Position, exchange rate and ReservesGDP (RESGDP) are the important macroeconomic determinants of FDI inflows in India. R&DGDP shows the unexpected negative sign instead of positive sign and exchange rate shows positive sign instead of expected negative sign. In other words, all variables included in the foreign direct investment model shows their predicted signs except the two variables (i.e. Exchange rate & R&DGDP) which deviate from their respective predicted signs. The reason for this deviation might be due to the appreciation of Indian Rupee in the international market and low expenditure on R&D activities in the activities in the country.

It is observed from the regression results that among the positive determinants, FDI inflows into India are more elastic to FIN.position than to TradeGDP and ReservesGDP. It is also observable that FDI inflows are more sensitive to R&DGDP than to exchange rate as the elasticity coefficient between FDI and exchange rate.

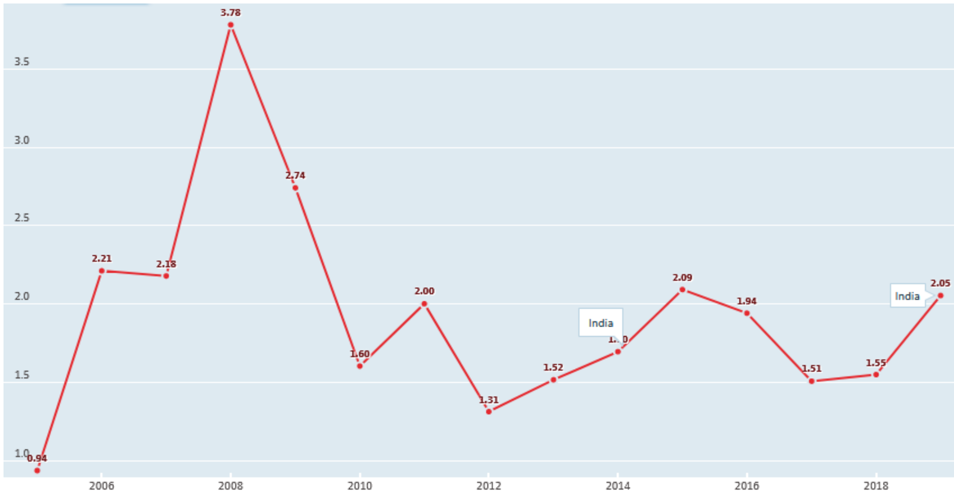
The coefficient of determination, i.e. the value of R^2 explains 95.6% level of economic growth by foreign direct investment in India. The F-statistics value also explains the significant relationship between the economic growth and FDI inflows in India. Thus, the conclusions of the economic growth model show that FDI is a vital and central factor swaying the level of growth in India.

Graphs and Line Plots



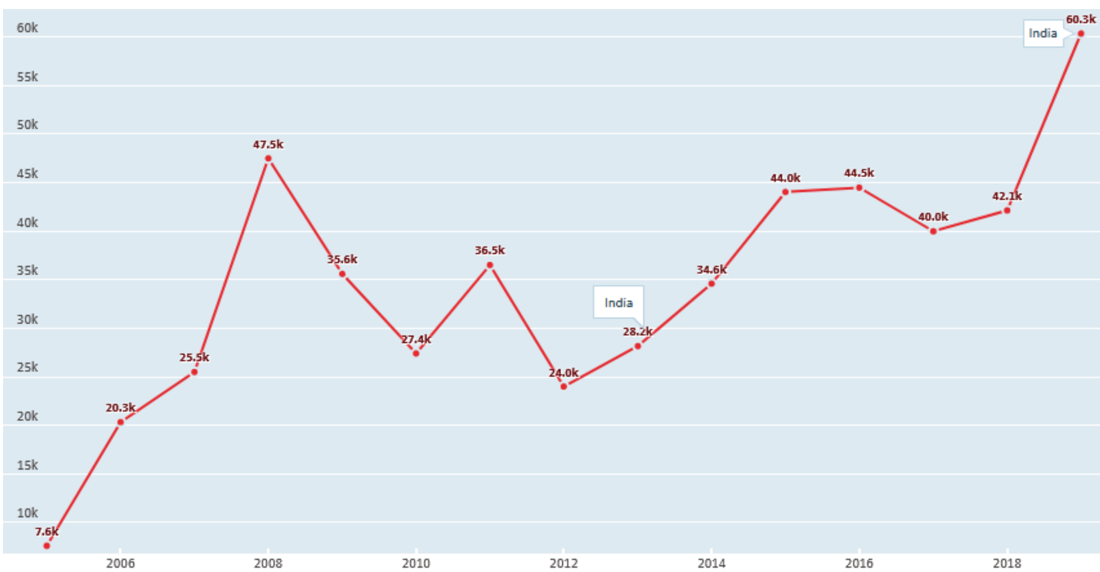
Fig(i): FDI Restrictiveness Index

FDI restrictiveness is an OECD index gauging the restrictiveness of a country's foreign direct investment (FDI) rules by looking at four main types of restrictions: foreign equity restrictions; discriminatory screening or approval mechanisms; restrictions on key foreign personnel and operational restrictions.



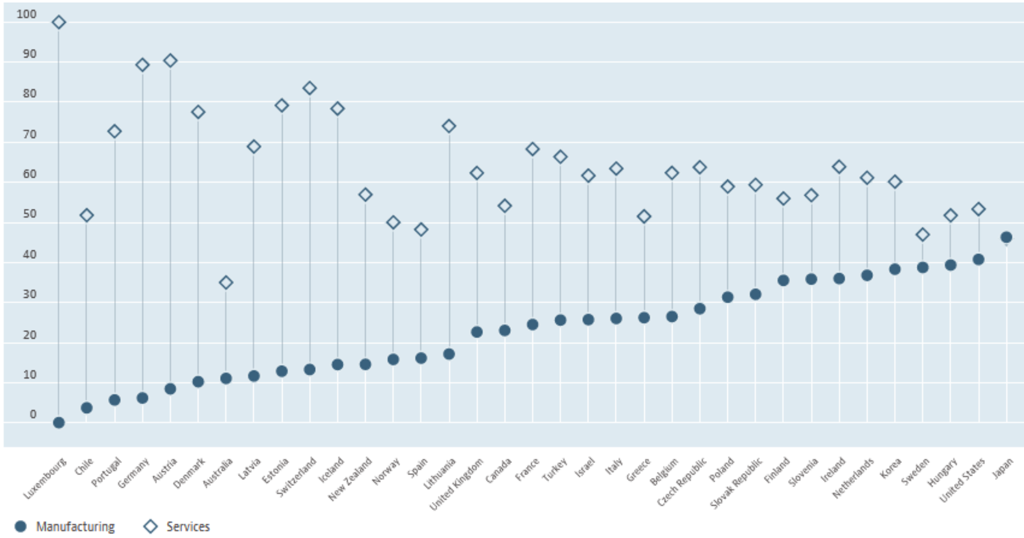
Fig(ii): % growth in FDI year after year

It is evident from the above line plot that highest FDI growth India saw was in 2008, that may be due to introduction of new policies by government (increased market share for foreign companies).



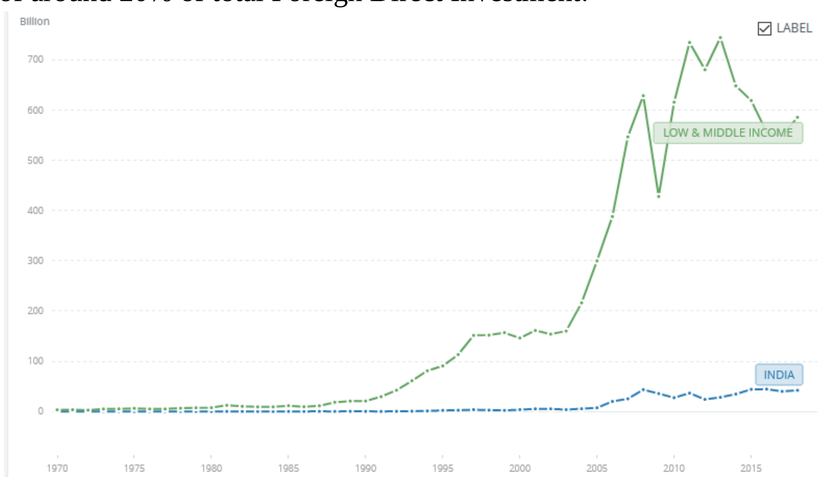
Fig(iii): FDI amount in US Million Dollars year after year

The above graph is in correspondence with fig(ii) which shows major spike in inward flow of investment in India in year 2008. The downfall after 2008 is due to global financial crisis which world faced and strong recovery started in 2012. India further made changes in its FDI policies under Modi's governance in 2015-16 but the results were seen only after 2018.

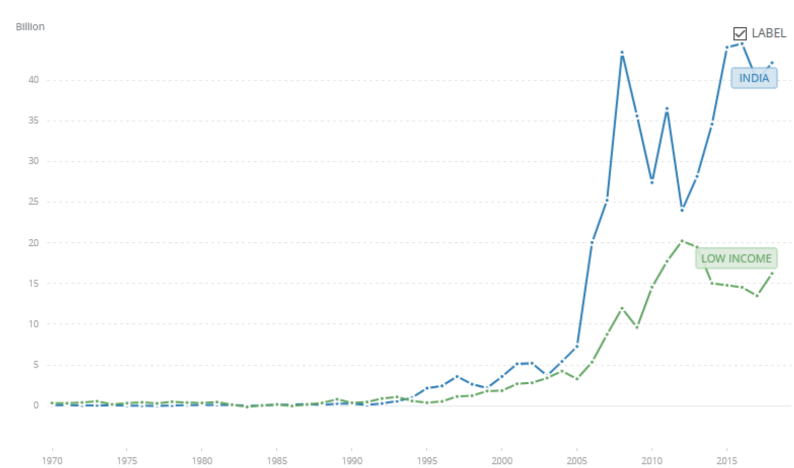


Fig(iv): % Contribution of countries in Manufacturing and Service Sector

The above plot shows the distribution of various countries in manufacturing and service sector of India. We can clearly see here, the contribution in service sector is significantly larger than manufacturing sector as stated in this study earlier; service sector alone comprises of around 20% of total Foreign Direct Investment.



Fig(v): Comparison of Inward FDI



Fig(vi): Comparison of Inward FDI

CONCLUSION

The study concludes a constructive influence of FDI inflow on the GDP. This would be beneficial for policy makers to design strategies to target GDP based on the inflow of FDI. This study needs to be further developed taking into account other control variables which impacts GDP. This model describes the overall impact of FDI on GDP, however the sector wise impact needs to be further analysed before drawing any conclusion. FDI is necessary for new job creation, expansion of existing manufacturing industries and development of the new one. Indeed, it is also needed in the healthcare, education, R&D, infrastructure, retailing and in long- term financial projects.

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KEYNOTE DEFINATIONS

1. **Exchange Reserve:** Foreign exchange reserves are cash and other reserve assets held by a central bank or other monetary authority that are primarily available to balance payments of the country, influence the foreign exchange rate of its currency, and to maintain confidence in financial markets.
2. **FDI:** A foreign direct investment is an investment in the form of a governing possession in a business in one country by an unit based in different country.
3. **Financial Position:** The financial condition of a business, which is derived by examining and comparing the information in its financial statements. This typically means calculating a number of financial ratios from the presented information, examining results on a trend line, and comparing results to those of other entities in the same industry.
4. **GDP:** Gross domestic product is a financial gauge of the market worth of all the end goods and services provided in a specific time.
5. **Regression:** Regression analysis is a set of arithmetical processes for estimating the associations among a dependent variable and 1 or more autonomous variables. Multi linear regression represents multiple dependent variables.