



ORIGINAL RESEARCH PAPER

Economics

FOREIGN INVESTMENT AND ECONOMIC GROWTH IN INDIA

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ABSTRACT

It is widely considered that foreign capital plays a significant role in contributing to economic growth. It stimulates and enhances growth in emerging economies. In developing countries, capital formation directly results in increase in investment and thereby economic growth. When there is capital deficiency in developing economies, foreign capital helps to solve the problem of capital deficiency which in turn boosts economic growth. This paper attempts to find out whether foreign investment is a causative factor that determines economic growth in India. Granger causality test has been used to ascertain the casual relationship between Foreign Direct Investment, net inflows (% of GDP) and GDP growth rate for the years 1993 - 2019. It was found that foreign investment inflows do not cause GDP growth in the study period.

INTRODUCTION:

Economic growth is influenced by FDI in various ways. FDI will result in, increase in the amount of physical capital which is essential for any country. Developing economy will be benefited in many ways by Foreign Direct Investment. Increase in capital will play a greater role in enhancing the productive capacity of the firm. This will help the economy to grow.

Foreign investment through Multinational Corporations can bring about technological advances in the domestic economy. The host country can make use of the technological development to improve the productive efficiency. The MNC's also bring about new managerial skill which will help in improving the productivity and also efficiency of the firm, which boosts the overall economic growth. The flow of capital which bring about new technology will improve innovation. This will make the economy more competitive.

FDI in the home country creates new jobs in the foreign owned enterprises. This is a direct way of improving employment in the host country, where people of the domestic economy can be employed in the foreign owned firm. Ancillary units which supply raw material and also other products to the foreign firm will be established. This creates new jobs in the ancillary firm. It is a well known fact that IT companies (foreign owned) enabled new avenues of employment generation through IT enabled services. FDI not only increases employment opportunities but also through increase in income accelerate consumers spending which results in all round progress of the economy.

FDI helps to have access to international market through global network of Multinational Corporation. Local firms integrated into these networks can enjoy new export avenues, which will increase the foreign exchange reserve of the host country.

The existence of foreign firms (generally owned by multinational corporations) will facilitate the training of workforce in the host country, this will enable the work force to acquire advanced skill set. This will on the one hand accelerate the productivity of the firm and on the other hand enhance the capabilities of work force which will in turn improve the human resource base of the country. FDI will increase the competition in the markets of the host country which will lead to increase in the efficiency of the firm and also benefits the consumers in terms of choice between wide range of goods and services.

In order for FDI to have an impact on economic growth the quality of institutions in the host country is crucial. Political stability, strength of legal institutions and predictability and consistency in governance will accelerate the benefits of FDI

and thereby lead to higher levels of growth. Investment in human capital by the host country will make the benefits of FDI more pronounced and have a positive impact on economic growth. The host countries policies with respect investment incentives and the tax regime which is favourable and stable will help FDI to bring about beneficial effects and raise economic growth.

Review Of Literature:

Ahmed MalumfashiHalliru et al (2021) estimate the impact of economic growth, energy consumption, human capital and bio capacity on carbon emissions in west African countries. The study period was 1979 - 2017. Long-run co integration test was used to find out the relationship between the variables. The paper found the existences of U-shaped and N-shaped patterns between the estimated variables and their impact on carbon emissions. In high carbon emission countries, using panel quantile estimates a N-shaped relationship was found. The paper finds an inverted U-shaped relationship between growth and carbon emissions. Using the panel quantile causality, it was found that FDI, energy consumption etc causes carbon emissions in all the estimated quantiles.

ChandanaChakraborty et al (2008) examine the effect of FDI on output of specific industry in India using panel co integration framework. Granger causality test was applied to assess whether FDI causes output growth. The effect of FDI is not same for all the sectors. In the manufacturing sector it was found that FDI stocks and output are mutually reinforcing. In the primary sector, there is no causal relationship. The results show a transitory effect of FDI in service sector. It was found that through cross - sector spill over's FDI in service sector might have promoted growth in manufacturing sector.

Liton Chandra Voumik et al (2023) the study examines the relationship between energy use, FDI, trade openness, economic growth and urbanization of Australia for the period 1972 - 2021. ARDL approach was used to study the variables. In the long-run and short-run economic growth had a positive and significant impact on energy use. In the long-run, energy use was positively impacted by FDI and trade openness; however urbanization had a negative and significant impact on energy use. When the Zivot-Andrews unit root test was used the variables showed structural breaks for the years 1982, 1993, 1994, 1996 and 2008. Unidirectional causality was found between energy use and trade openness.

Lei Jiao et al (2024) examine the linkage between natural resources, FDI and economic growth for United States for the year 1990 - 2022. Energy efficiency has been used as a control variable. DF-GLS and Phillips-Peron unit root test have been used. The paper uses Johansen co-integration test for equilibrium & also Bootstrap quantile regression was used for primary estimates. The results show that natural resources are

asymmetric with economic expansion. Economic expansion is positively impacted by natural gas rents. It was found that energy efficiency and FDI stimulate growth across all quantiles.

NajiaSaqib et al (2023), this paper tries to find out the impact of shocks in economic complexity, FDI, environmental technology and renewable energy on carbon emissions in the leading clean-energy investment countries. Panel NARDL method was used for the 1995 – 2020. It was found that positive shocks in economic complexity, FDI etc reduce carbon emission. Negative shocks result in elevated pollution level. In the long-run, it was found that adverse shocks in economic complexity and FDI cause increased pollution.

Rabindra Nepal et al (2021), studied the dynamic linkages between energy use, FDI, economic growth, carbon emissions and trade openness in India from 1978 – 2016. The paper uses a multivariate framework based on the theoretical premise of an Environmental Kuznets Curve. ARDL and VECM Granger Causality test were employed to understand the long – run relationship between the various variables. The results show that there is a co-integration between energy-output-CO2 emissions-FDI in the long-run. It was also found that 1% increase in FDI results 0.013% reduction in energy use. In the long-run output, CO2 emissions and trade openness cause energy use.

Roberto Antoniotti et al (2021), examined the effect of FDI inflows on economic complexities for 117 countries for the period 1995 - 2016. Panel VAR approach and Impulse Response Functions were used. The paper finds accumulation of FDI inflows causes economic complexity. However, the causal effect was found to be very small, and can be only perceived in countries with above-average levels of GDP per capita, tertiary education, tertiarisation or financial development. In developed countries, only Greenfield FDI granger causes economic complexity.

Seefat-E-Rabbi Khan et al (2023), the paper seeks to explain the growth disparities in BRIC countries and 50 other countries, for the period 1980 – 2020. The paper finds that FDI, Gross Capital Formation, Human Capital and Infrastructure are important factors for economic growth. The effect of FDI appears to be conditional on better quality human capital and higher domestic investment in BRIC countries compared to other countries. It was also observed that FDI, human capital and gross capital formation were efficacious in determining the economic growth in BRIC countries.

Timothy Ayomitunde Aderemi et al (2023), studied the effect of FDI inflow on poverty reduction for BRICS, for the period 1990 - 2019. Panel error correction model and Pair wise DumitrescuHurlin Panel Causality tests were used. It was found that in the short run there was a negative and significant relation between FDI inflows and human development. And the reverse relation was found in the long-run. It was also found that FDI inflows have a trickle-down effect on poverty reduction in BRICS countries only in the long run.

METHODOLOGY AND RESULTS:

The paper attempts to find out if there is any causal relationship between FDI inflows and Economic Growth. For this purpose, FDI inflows have been measured using FDI, net inflows (% of GDP). Economic growth is measured using GDP Growth (annual %). The study period is from 1993 to 2019. The data has been obtained from World Development Indicators. Firstly to find out the stationary of each variable unit root test was conducted. GDP growth rate was found to be stationary. FDI net inflows (% of GDP) were found to be stationary at first difference as shows in table – 1.

In the next stage, VAR Granger causality test was used to find out the causal relationship between FDI and Economic

Growth. The results for the VAR Granger Causality test are shown in table – 2. It is clear that there is no causal relationship between FDI inflows and Economic growth since the p – value is greater than 0.05 .Therefore it can be concluded that for the study period 1993 – 2019 there is no causal relationship between FDI inflows (% of GDP) and GDP Growth rate. The table shows that GDP growth rate granger causes FDI net inflows, since the p – value is less than 0.05 .

Table – 1 : Unit Root Test

Variables	ADF unit root test	
	t – statistics	p – value
GDP GRWT	- 4.566	0.0001
FDI	- 5.660	0.0000

Table – 2 : VAR Granger Causality Test

Direction of Causality	Chi – sq	Df	Probability Values
FDI → GDP GRWT	1.9585	2	0.376
GDP GRWT → FDI	6.4218	2	0.040

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