

FDI and Its Impact on Overall Growth in India

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Abstract

During the recent years, FDI plays a crucial role in overall development of the country. FDI provides a win-win situation both to the host as well as home country. Sometimes domestically available capital is inadequate for the purpose of overall development of the country. Foreign capital is seen as a way of filling in gaps between domestic savings and investment. India is being looked up by many foreign nations as the scope of investment due to rise in purchasing power, growing consumerism and brand proliferation. The paper has focused on the trends of FDI flow and economy growth in India during 1991 to 2017. India can attract much larger foreign investments than it has done in the past. The study also highlights country wise approvals of FDI inflows to India and the FDI inflows in different sector for the period (1991-2017). The study based on Secondary data which have been collected through reports of the Ministry of Commerce and Industry, Department of Industrial Promotion and Policy, Government of India, Reserve Bank of India, and World Investment Report. This paper makes an in-depth study to analyze the scenario of FDI and its impact on GDP growth. For this purpose empirical data are estimated for the period 1991 to 2017 by applying some useful statistical tools like Unit root Test Johansen, Co integration Test, Granger Causality, Test Time Series Regression. And I conclude that there is strong and positive relationship between FDI on India's GDP.

Key words: FDI, Indian Economy, Growth, GDP.

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I. Introduction

FDI usually represents a long term commitment to host country and contribute significantly to gross fixed capital formation in developing countries. FDI has several advantages such as advancement of technology, generating employment opportunities and promoting overall development of the economy. The growth of foreign direct investment in India was retarded by the introduction of Monopolies and Restrictive Trade Practices Act (MRTP) and Foreign Exchange Regulation Act (FERA) in the beginning of 1970's (Shah & Parikh, 2012). Foreign Direct Investment (FDI) has been one of the most critical factors in the economic health of emerging markets like India. It is the process of establishment of business or carrying out business activities in the host country by a foreign country. The Government of India had undertaken major reforms in the country's FDI policies in 1991. The most recent policies allowed for increasing the FDI limit. Therefore, effective from August 28, 2017, 100% FDI is approved through the direct route in sectors like agriculture and animal husbandry, plantation, mining, petroleum and natural gas. 100% foreign investment is also allowed in services such as selected activities in civil aviation, construction, e-commerce activities and railways. They are welcoming foreign investment in different sectors.

II. Research Methodology

In this paper I have adopted some statistical techniques. This study has collected data through secondary sources. It has used sources such as newspapers, online databases and websites of World Bank, the Reserve Bank of India (RBI), and the Indian Council for Research on International Economic Relation (ICRIER) and so on.

Objective

1. To know the historical growth of FDI inflow into India (Post Liberalization Period).
2. To identify the flow of FDI from across the countries.
3. To analyze the sector wise flow of FDI.
4. To analyze the relationship between FDI and GDP.
5. To point out the policy suggestions.

Role of FDI to promote overall development of India

FDI plays an important role in Indian economic development. FDI is an important and vital component of development strategy in both developed and developing nations and policies are designed in order to stimulate inward flows. Infact, FDI provides a win – win situation to the host and the home countries. Both countries are directly interested in inviting FDI, because they benefit a lot from such type of investment. The “home” countries want to take the advantage of the vast markets opened by industrial growth. On the other hand the “host” countries want to acquire technological and managerial skills and supplement domestic savings and foreign exchange. Moreover, the paucity of all types of resources viz. financial, capital, entrepreneurship, technological know- how, skills and practices, access to markets- abroad- in their economic development, developing nations accepted FDI as a sole visible panacea for all their scarcities. A high level of FDI is viewed as an affirmation country. This is very true in case of various developing countries like India. India is suffering from the scarcity of financial resources and low level of capital formation because it has to majorly depend upon the external sources of Finance. Also the domestic resources are entirely inadequate to carry out development programmes.

Pre-Liberalisation Period

Historically, India had followed an extremely careful and selective approach while formulating FDI policy in view of the governance of „import-substitution strategy“ of industrialisation. The regulatory framework was consolidated through the enactment of Foreign Exchange Regulation Act (FERA), 1973 wherein foreign equity holding in a joint venture was allowed only up to 40 per cent. Subsequently, various exemptions were extended to foreign companies engaged in export oriented businesses and high technology and high priority areas including allowing equity holdings of over 40 per cent. Moreover, drawing from successes of other country experiences in Asia, Government not only established special economic zones (SEZs) but also designed liberal policy and provided incentives for promoting FDI in these zones with a view to promote exports. The announcements of Industrial Policy (1980 and 1982) and Technology Policy (1983) provided for a liberal attitude towards foreign investments in terms of changes in policy directions. The policy was characterised by de-licensing of some of the industrial rules and promotion of Indian manufacturing exports as well as emphasising on modernisation of industries through liberalised imports of capital goods and technology. This was supported by trade liberalisation measures in the form of tariff reduction and shifting of large number of items from import licensing to Open General Licensing (OGL).

Evaluation of FDI and GDP in India during (1991-92 to 2016-2017)

The following table depicts the picture of FDI inflow and its impact on GDP

Table-1

Years {BY-(2004-05) till 2013-14}	FDI Inflow (in rupees crore)	Growth rate of FDI inflow (%)	GDP (in rupees crore)	Growth rate of GDP (%)	FDI as apercentage of GDP
1991-92	409	-	1099072	-	0.0372
1992-93	1094	167.48	1158025	5.36	0.0945
1993-94	2018	84.46	1223816	5.68	0.1649
1994-95	4312	113.68	1302076	6.39	0.3312
1995-96	6916	60.39	1396976	7.29	0.4951
1996-97	9654	39.59	1508378	7.97	0.6400
1997-98	13548	40.34	1573263	4.30	0.8611
1998-99	12343	-8.89	1678410	6.68	0.7354
1999-00	10311	-16.46	1786525	6.44	0.5772
2000-01	10733	4.09	1864301	4.35	0.5757
2001-02	18654	73.80	1972606	5.81	0.9457
2002-03	12871	-31.00	2048286	3.84	0.6284
2003-04	10064	-21.81	2222758	8.52	0.4528
2004-05	14653	45.60	2388768	7.47	0.6134
2005-06	24584	67.77	3254216	36.23	0.7555

2006-07	56390	129.38	3566011	9.58	1.5813
2007-08	98642	74.93	3898958	9.34	2.5300
2008-09	142829	44.80	4162509	6.76	3.4313
2009-10	123120	-13.80	4493743	7.96	2.7398
2010-11	97320	-20.96	4918533	9.45	1.9786
2011-12	165146	69.69	5247530	6.69	3.1471
2012-13	121907	-26.18	5482111	4.47	2.2237
2013-14	147518	21.01	5741791	4.74	2.5692
2014-15 (BY-2011-12)	189107	27	10522686	7.5	1.7971
2015-16	262322	29	11357529	8.0	2.3096
2016-17	291696	9	12165481	7.1	2.3977

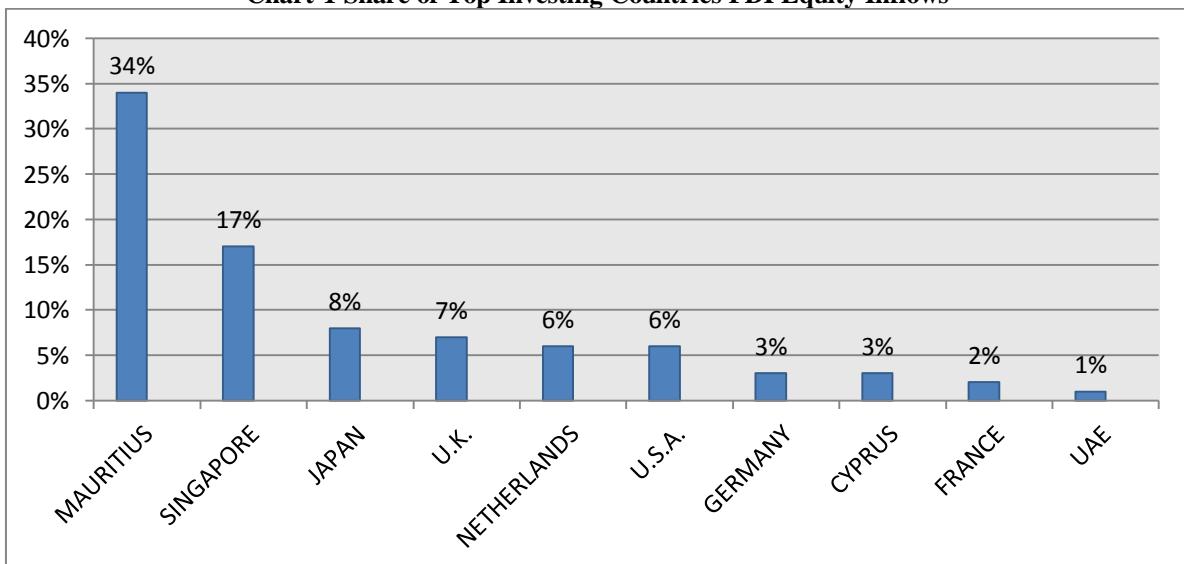
Source: compiled & computed from the various issues of Economic Survey, RBI Bulletin, Ministry of Commerce

The above table shows the FDI inflow in India from the year 1991-92 to 2016-17(post-liberalization period). The table states that India had showed a large amount of FDI inflow. It showed that FDI inflow has been increased by more than 210 times during the study period because the FDI Inflow has been increased from Rs. 409 crore in 1991-92 to Rs.29169 crore in 2016-2017. Due to technological up gradation, access to global managerial skills and practices, optimal utilization of human and natural resources, making Indian industry internationally competitive, opening up export markets, providing backward forward linkages and access to international quality goods and services the Indian Government has used many steps to attract more FDI. The highest amount of FDI was received in the year 2016-17, amounting to Rs.291696 crore. The highest growth rate of FDI inflow is in the year 2006-07 i.e., 129.36. %. SO in all the foreign investment have been on rise in India. The source for annual time series data for GDP and FDI inflows for the period 1991-2017 data is the World Bank and DIPP. Therefore the chosen time period allows us to take into consideration the impact of FDI inflows on GDP in post reform (1991 onwards).

Top Investing Countries

The Below Chart-1 shows the countries having the highest FDI in India. Chart-1 shows that the MAURITIUS country has the highest foreign investor in India with 34%. After Singapore, Japan and U.K. invest the highest FDI in India with 17% ,8%, and 7% respectively. Netherlands also gets 5th position with 6% FDI in India.

Chart-1 Share of Top Investing Countries FDI Equity Inflows



Source: FDI Fact Sheet June 2017

India ranks among the top 10 host economies for FDI, according to the United Nations Conference on Trade and Development (UNCTAD) 2018 World Investment Report.

FDI inflows are welcomed currently in 63 sectors as compared to 16 sectors in 1991. Table-2 shows the service sector has the highest FDI inflow attracting 18% share, followed by computer software & hardware, construction development, & telecommunications. FDI equity inflows to the services sector grew by 15.0% during 2017-18. It has been possible because the Government has undertaken a number of reforms to ensure that India remains an increasingly attractive investment destination, which includes announcement of National Intellectual Property Rights (IPR) policy, implementation of GST, reforms for ease of doing business. This was brought about in the Economic Survey 2017-18 tabled by the Union Minister for Finance and Corporate Affairs, Arun Jaitley in Parliament.

Table-2 Sectors Attracting Highest FDI Inflows in India

Sector	Amount Rupees in crores (US\$ in million)				
	2015-16 (April – March)	2016-17 (April – March)	2017-18 (April,17– June,17)	Cumulative Inflows (April, 00 - June, 17)	% age to total Inflows (In terms of US\$)
Services Sector	45,415 (6,889)	58,214 (8,684)	12,134 (1,883)	328,702 (61,359)	18 %
Computer Software & Hardware	38,351 (5,904)	24,605 (3,652)	8,480 (1,316)	145,269 (25,985)	8 %
Construction Development: Townships, Housing, Built-Up Infrastructure	727 (113)	703 (105)	1,616 (251)	116,255 (24,544)	7 %
Telecommunications (Radio Paging, Cellular Mobile, Basic Telephone Services)	8,637 (1,324)	37,435 (5,564)	565 (88)	130,729 (24,034)	7 %
Automobile Industry	16,437 (2,527)	10,824 (1,609)	4,613 (716)	96,831 (17,390)	5 %
Drugs & Pharmaceuticals	4,975 (754)	5,723 (857)	1,811 (281)	77,631 (14,988)	4 %
Trading	25,244 (3,845)	15,721 (2,338)	4,955 (769)	89,513 (14,979)	4 %
Chemicals (Other Than Fertilizers)	9,664 (1,470)	9,397 (1,393)	4,381 (679)	73,333 (13,972)	4 %
Power	5,662 (869)	7,473 (1,113)	1,139 (177)	61,226 (11,766)	3 %
Hotel & Tourism	8,761 (1,333)	6,140 (916)	2,152 (334)	58,001 (10,477)	3 %

Source: FDI Fact Sheet June 2017

During this period 2017-18, 25 sectors also including services activities and covering 100 areas of FDI policy have undergone reforms. FDI policy provisions were radically overhauled across sectors such as construction development, broadcasting, retail trading, air transport, insurance and pension. At present, more than 90% of FDI inflows are through automatic route. After the successful implementation of the e-filing and online processing of FDI application by the Foreign Investment Promotion Board (FIPB), the Government announced to phase out the FIPB in the Union Budget 2017-18. Recently, on 10th January 2018, Union Cabinet approved amendments in FDI policy allowing 100% FDI under automatic route for Single Brand Retail Trading. Foreign airlines also have been allowed to invest up to 49% in Air India.

Hypothesis

For the regression analysis, GDP is the dependent variable whereas FDI is the independent variable. The basic model to find out the impact of FDI on GDP is

$$GDP = f (FDI)$$

Testing the null hypothesis that FDI has no impact on GDP.

Table-3

Name of the Test	Objective
Unit root Test	To check stationarity in the data
Johansen Co integration Test	To check long run relationship
Granger Causality Test	To determine the direction of causality
Time Series Regression	To determine the impact of FDI on GDP

While the first three tests are done using EVIEWS software, the linear regression is done using STATA.

Checking stationarity in the data

As the first step of empirical analysis, it is essential to check the stationarity in the data of the variables before we can examine the impact. The null hypothesis for the test is that there is a unit root and the time series is non stationary. On the other hand, the alternative hypothesis is that the series is stationary. The results of Phillips-Perron (PP) and Augmented Dickey Fuller (ADF) unit root tests have been presented in table below.

Table 4: Augmented Dickey-Fuller and Phillips–Perron Unit Root Test Statistics.

Series	(PP) t statistic	PP at 1% Level	PP at 5% Level	(ADF) t statistic	ADF at 1% Level	ADF at 5% Level
GDP	19.3563	-3.6267	-2.9458	-13.7263	-3.6267	-2.9458
ΔGDP	-10.2849	-3.6394*	-2.9511*	-5.5716*	-3.6537*	-2.9571*
FDI	-1.6337	-3.6267	-2.9458	-3.6267	-3.6267	-2.9458
ΔFDI	-5.9220	-3.6329*	-2.9484*	-3.1971*	-3.6463*	-2.9540*

Note: A variable is stationary when the Phillips–Perron (PP) and ADF t-statistics is greater than the critical values and non-stationary when t-statistics is less than the critical value.

The results of unit root test in table above confirm that both the variables are non-stationary at level. Therefore this means we cannot reject the null hypothesis. The variables become stationary after first differencing to investigate long-run relationship among them. The null hypothesis of existence of unit root or non-stationarity in the data can be rejected at first difference.

Co-integration test

Johansen co-integration test shows the long run association between the variables. When the variables are co-integrated, they have long run equilibrium relationship. When the dependent and independent variables are non-stationary at level, it means that the variables are co-integrated. The results are shown in table 3 below.

Table-5 Johansen Co-integration Test (Trace and Max Value stat). Results for GDP and FDI

Maximum Ranks	Trace Statistic	5% Critical Value	P-Value	Max Statistic	5% Critical Value	P-Value
0	28.7537	15.4947	0.0003*	25.8236*	14.2646	0.0005*
1	2.93008	3.84146	0.0869*	2.93008*	3.84146	0.0869*

Johansen test relies on maximum likelihood method and on two statistics: Eigen value statistic and the maximum statistic. When the rank is zero it means there is no co-integration relationship and if the rank is one it means there is one co-integration equation and so on. The above results of Johansen co-integration test imply that there is co-integration between the two variables. The results of both trace and max statistic suggests that there is a long run association between FDI and GDP.

Granger causality test

Next, attempting to estimate the causality from FDI to GDP and vice versa. Applying Granger causality to check the robustness of the results and detect the nature of the causal relationship between FDI and GDP. The results are presented below.

Table-6

Equation	Chi2	Prob
GDP to FDI	2.85864	0.0403*
FDI to GDP	3.04565	0.0320*

The above table presents the results of Granger causality test. Based on the p-values, both the null hypotheses that FDI does not Granger Cause GDP and GDP does not Granger Cause FDI can be rejected. It implies bidirectional causality. The reverse causality holds in light of the fact that FDI Granger causes GDP and vice versa. The results indicate that if the FDI inflow increases, economic growth will enhance in the form of increased GDP. On the other hand, increase in GDP will foster more FDI inflow.

Regression analysis

Developing the linear regression model to study the impact of FDI on GDP.

Table-7

GDP	Coef	t-value	P-value	R2
FDI	3437.45*	5.37	0.000	0.4514
Cons	3.32476*	7.34	0.000	

Note: Superscripts “*” denote 1% and 5% significance

The table above gives the regression results between GDP and FDI. The results reveal that an increase in FDI will increase GDP and validates FDI led-growth hypothesis. The coefficients show that for a, one percent increase in FDI there will be a statistically significant increase in GDP. The null hypothesis stating that FDI has no impact on GDP can be rejected at 1% and 5% level of significance. Positive relationship between FDI and GDP.

SUGGESTIONS FOR INCREASED FLOW OF FDI INTO THE COUNTRY:-

1. **Flexible labour laws needed:** China gets maximum FDI in the manufacturing sector, which has helped the country become the manufacturing hub of the world. In India the manufacturing sector can grow if infrastructure facilities are improved and labour reforms take place. The country should take initiatives to adopt more flexible labour laws.
2. **Re look at sectoral caps:** Though the Government has hiked the sectoral cap for FDI over the years, it is time to revisit issues pertaining to limits in such sectors as coal mining, insurance, real estate, and retail trade, apart from the small-scale sector.
3. **Geographical disparities of FDI should be removed:** The issues of geographical disparities of FDI in India need to address on priority. Many states are making serious efforts to simplify regulations for setting up and operating the industrial units. However, efforts by many state governments are still not encouraging. Even the state like West Bengal which was once called Manchester of India attracts only 1% of FDI inflow in the country. West Bengal, Bihar, Jharkhand, Chhattisgarh are endowed with rich minerals but due to lack of proper initiatives by governments of these states, they fail to attract FDI.
4. **Promote Greenfield projects:** India’s volume of FDI has increased largely due to Merger and Acquisitions (M&As) rather than large Greenfields projects. M&A’s not necessarily imply infusion of new capital into a country if it is through reinvested earnings and intra company loans. Business friendly environment must be created on priority to attract large Greenfields projects. Regulations should be simplified so that realization ratio is improved (Percentage of FDI approvals to actual flows). To maximize the benefits of FDI persistently, India should also focus on developing human capital and technology.
5. **Develop debt market:** India has a well developed equity market but does not have a well developed debt market. Steps should be taken to improve the depth and liquidity of debt market as many companies may prefer leveraged investment rather than investing their own cash. Therefore it is said that countries with well-developed financial markets tend to benefits significantly from FDI inflows.
6. **Education sector should be opened to FDI:** India has a huge pool of working population. However, due to poor quality primary education and higher education, there is still an acute shortage of talent. FDI in Education Sector is lesser than one percent. By giving the status of primary and higher education in the country, FDI in this sector must be encouraged. However, appropriate measure must be taken to ensure quality education. The issues of commercialization of education, regional gap and structural gap have to be addressed on priority.

III. Conclusion

FDI inflows have assumed a huge role in the development and advancement of an economy, especially in India. GDP of India has been growing four-crease since 1991. A large number of changes were introduced in the country after LPG era after 1991. India brought about a structural breakthrough in the volume of the FDI inflows into the economy maintained a fluctuating and unsteady trend during reform period. It might be interest to note that more than 50 per cent of the total FDI inflows received in India come from Mauritius, Singapore and the USA. The main reason for higher levels of investment from Mauritius was that the fact that India entered into a double taxation avoidance agreement (DTAA) with Mauritius were protected from taxation in India. Among the different sectors, the service sector had received the larger proportion followed by computer software and hardware sector and then telecommunication sector. The results of co integration analysis in this article reveal that there is a long-run relationship between FDI inflows and GDP. Granger causality tests find reverse causality relationship. Regression results imply that FDI has a positive and significant impact on GDP. The fact that India’s limit as a host country in drawing FDI took off in the post reform period supports the findings. However the quantum of FDI inflows in respect to its size has been low when compared with other developing nations. Fundamental explanations behind these low FDI inflows have been identified with the

venture atmosphere, poor foundation, remote conversion scale variance and business help. The results of empirical analysis in this article reveal that FDI has a significant and positive relationship with GDP. It can be inferred that FDI is important for socio-economic development for India.

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