FDI as External Finance in India for Sustained Economic Growth

Bhawna Pandey[1] ● **Sanjeev Kumar Singh**[2]

[1]Department of Economics, Dyal Singh Evening College, University of Delhi
[2]Department of Commerce, DSMNR University, Lucknow

Email Id: b10pandey@gmail.com ● sanjeevsingh2727@gmail.com

Abstract. The world's largest democracy emerges as a global resource for industry in manufacturing and services and in recent days, the investment opportunities in India are at a peak. Rationalize and simplify the process of foreign investments in the country and to put more and more foreign direct investment proposals on automatic route instead of government route where time and energy of the investors is wasted. IMF has branded India as the brightest spot in the global economy. This paper describes the impact of Foreign Direct Investment inflows on the development of the economy. This paper will focus on various macroeconomic variables of India's economy affecting FDI, includes variable like Total Trade, Foreign Exchange Reserve, Development Expenditure, Exchange Rate & Financial Position which help in shaping the level of economic growth & development, and raising the confidence among investors. To have an complete understanding of the nature of inflow during 1991-92 to 2013-14 period taken under study to assess the impact of Macro variable on Indian Economy. This paper focus on the results of Economic Growth Model which reveal that foreign direct investment plays a crucial role in enhancing the level of economic growth in India.

Keywords: Trade, GDP, Foreign exchange reserve, Development expenditure

1 Introduction

Foreign direct investment plays an important role in the development of Developed, developing as well as underdeveloped economies as they are mediums of introduction of advanced technology, skills, increased innovative capacity, and domestic competition. Foreign direct investment is the safest type of external finance as they not only help in enhancing the saving & foreign reserve but also leads to economic and social growth. India has already marked its presence as one of the fastest growing economies of the world. It has been ranked among the top 3 attractive destinations for inbound investments.Every country around the world is encouraging the overseas Investor and their Investment.Increase in foreign direct investment, large amount of capital come in through the safest channel leads to more and more Industries set up leads to expand and diversify the production capacity of an economy & generate Employment. The foreign direct investment is Non- Debt, Non-volatile Investment&Return received on these are generally spent on the host country along with transfer of best practices in corporate governance which leads to economic Development. Foreign direct investment mobilize/Channelize the domestic savings for the financing of projects which essential for economic development and promote International trade.

2. LITERATURE REVIEW

DR. M. SYED IBRAHIM AND A. MUTHUSAMY (2014): Researcher has studied in his paper "Role of foreign direct investment in India's economic development-an analysis" that foreigndirect Investment plays an important role in global business. It can provide afirm with new marketing channels, cheaper production facilities, access to technology transfer, product, skills and financing. With the advent of globalization and strong governmental support, foreign investment has helped the Indian economy grow tremendously. Researcher in this paper attempts to review the importance of foreign direct investments in Indian economy, particularly aftera decade of economic reforms and analyze the role played by the FDI in the economicdevelopment of the country. Further the study is diagnostic and exploratory in nature and makesuse of secondary data. The study finds and concludes that the foreign direct investment inIndia have significantly improved and developed the economy as well.**DR. GULSHAN KUMAR AND NEERJA DHINGRA (2011):**Researcher has studied in his paper "Impact of liberalization on FDI structure in India" that direct investment across national borders is a distinct feature of international economics, which has gained intense attention of all the countries of the world recently. Foreign direct investment (FDI) is deemed to be a growth catalyst since it is usually accompanied by entrepreneurial, managerial and technical skills which are indispensable for economic growth. The period after 1991 is termed as post liberalization period during which not only the quantum of FDI to India escalated but the sectoral composition of FDI also underwent tremendous change**. NAMITA RAJPUT, ANUJ JAIN, AJAY RAJPUT and RAHUL GARG (2012):** Researcher has studied in his paper "Relationship of FDI and growth in India: A diagnostic study" that vvariables so as to have a complete understanding of the nature of inflows during 1991- 2011(study period) to analyze important dimensions of FDI in India impacting economic growth of India. The study also reveals that FDI is a significant factor

2454-342x electronic ISSN

influencing the level of economic growth in India. The results of Economic Growth Model and Foreign Direct Investment Model reveal that FDI plays a crucial role in enhancing the level of economic growth in India. **BHAVYA MALHOTRA (2014):**Researcher has studied in his paper "Foreign direct investment: Impact on Indian economy" that with the initiation of globalization, developing countries, particularly those in Asia, have been witnessing a immense surge of FDI inflows during the past two decades. Researcher aims to examine the impact of FDI on the Indian economy, particularly after two decades of economic reforms, and analyzes the challenges to position itself favourably in the global competition for FDI. The paper provides the major policy implications from this analysis, besides drawing attention on the complexities in interpreting FDI data in India. **MAHANTA DEVAJIT (2012):**Researcher has studied in his paper"Impact of Foreign Direct Investment on Indian economy" that foreign direct investment as a strategic component of investment is needed by India for achieving the economic reforms and maintains the pace of growth and development of the economy. The study tries to find out how FDI seen as an important economic catalyst of Indian economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfers. The main purpose of the study is to investigate the impact of FDI on economic growth in India. **PRAVIN JADHAV (2012) :**Researcher has studied in his paper "Determinants of foreign direct investment in BRICS economies: Analysis of economic, institutional and political factor" that paper explores the role of economic, institutional and political factors in attracting foreign direct investment in BRICS (Brazil, Russia, India, China & South Africa) economy and the comparative weightage of these factors in attracting FDI. The study uses panel data for a period of ten years (2000-2009) in order to examine the significant determinants of FDI in BRICS from a holistic approach. Findings indicate that economics factors are more significant than institutional and political Factors in BRICS economies. The results indicate that market size measured by real GDP is a significant determinates of FDI which implies that most of the investment in BRICS is motivated by market-seeking purpose. Analysis of empirical data also indicates that trade openness, natural resource availability, rule of law and voice and accountability are statistically significant. Coefficients of market size, trade openness are positive which implies that these variables have positive effect on total inward FDI. Natural resource availability has negative effect on total inward FDI, this particular result indicate that FDI is not motivated by resource-seeking purpose in BRICS economies.

3. OBJECTIVES OF STUDY

This study is considering the macroeconomic variables like foreign exchange reserves, total trade, financial position, Development expenditure, exchange rate. The present study tries to include these above said variables in assessing the determinants and impact of FDI in India at the macro – level from 1991-92 to 2013-14. This study documents the trends and patterns of FDI Indian level from 1991-92 to 2013-14. In order to appreciate the importance of foreign direct investment for the Indian economy, it would be pertinent to examine the changes in the global FDI flows and the place of investment within India. Thus, the present study is an effort to discuss and assess the role and impact of the FDI in the economic development of a country.

4. DATA COLLECTION

This study is based on secondary data. The required data have been collected from various sources various Bulletins of Reserve Bank of India, publications from Ministry of Commerce, Govt. of India, Economic Survey etc.

5. MODEL

Model is framed to study the impact of foreign direct investment on economic growth. The FDI model represents the factors affecting the FDI in India. The model equations are expressed as: FDI = f [TRAGDP, RESGDP, DEVEXPGDP, FINPOS, EXRAT]

FDI	:	Foreign Direct Investment
GDP	:	Gross Domestic Product
$TRAGDP_t$	:	Total Trade as percentage of GDP
$RESGDP_t$	:	Foreign Exchange Reserves as percentage of GDP.
$DEVEXPGDP_t$	:	Development expenditure as percentage of GDP.
$FINPOS_t$	:	Ratio of external debts to exports
$EXRAT_t$	:	Exchange rate

Multiple Regression analysiswas carried out using relevant econometric techniques. Multiple regression analysis was used to identify the major variables which have impact on foreign direct investment. Econometric tests such as coefficient of determination R^2, Standard error of coefficients, T-Statistics and F- ratio were carried out in order to assess the relative significance, desirability and reliability of model estimation parameters. Macroeconomic indicators of an economy are considered as the major pull factors of FDI inflows to a country. After thorough analysis of the different combination of the variables, the present study includes the following macroeconomic indicators: Total trade, Financial position, Foreign Exchange Reserves, Development expenditure and Exchange rate.FDI inflow is considered as the function of these said macroeconomic indicators:

$$\mathbf{FDI_t = a + b_1TRAGDP_t + b_2RESGDP_t + b_3\,DEVEXPGDP_t + b_4\,FINPOS_t + b_5EXRAT_t + e}$$

Total Trade: Total trade implies sum of total exports and total imports. International trade is the exchange of capital, goods & services across International Border or territories, which could involve the activities of government and individual. In most of the countries it shows the significant share of Gross Domestic Product.

Gross Domestic Product: The OECD defines GDP as " an aggregate measure of production equal to the sum of the gross value added of all resident, institutional units engaged in production (plus any taxes and minus any subsidies, on product not included in the value of their outputs)". GDP by industry can also measure the relative contribution of an industry sector. This is possible because GDP is a measure of 'Value added' rather than sales" it add each firm's value added (the value of its output minus the value of goods that are used up in producing it). Gross Domestic Product is a monetary of the value of all final goods and services produced in the period (quarterly or yearly).

Foreign Exchange Reserves: Foreign exchange reserve is asset held by the central Bank or other monetary authority, usually in various reserve currencies and used to back its liabilities. Foreign Exchange Reserves are called reserve assets in the Balance of Payments and are located in the Capital Account. Hence they are usually an important apart of the international investment position of a country. The reserve is labeled as reserve asset under assets by functional category. In terms of financial asset classification, the reserve asset are classified as Gold bullion, Unallocated gold accounts, Special Drawing rights, Currency reserve position in the IMF, Interbank position, other transferable deposits, other deposits, debt securities, Loans, equity (listed and unlisted), investment Fund share and financial derivatives, such as Forward Contracts and Options.

Development Expenditure: All expenditure that promotes economic growth and development are termed as development expenditure. Expenditure on infrastructure development, Public enterprise or development of agriculture increase productive capacity in the economy and bring income to the Government.

6. Data Analysis

	Mean	Std. Deviation	N
FDI	690.10	800.28	23
Trade GDP	31.63	23.32	23
Reserve GDP	15.93	11.12	23
Development expenditure GDP	11.90	5.27	23
Financial Position	1.195	.573	23
Exchange Rate	42.33	8.30	23

Correlation Matrix

Particular		FDI	Trade GDP	Reserve GDP	Development expenditure GDP	Financial Position	Exchange Rate
Pearson Correlation	FDI	1.000	.964	.901	.935	.670	.670
	Trade GDP	.964	1.000	.912	.981	.770	.770
	Reserve GDP	.901	.912	1.000	.887	.746	.746
	Development expenditure GDP	.935	.981	.887	1.000	.822	.822
	Financial Position	.615	.626	.879	.585	.618	.618
	Exchange Rate	.670	.770	.746	.822	1.000	1.000
Sig. (1-tailed)	FDI	.	.000	.000	.000	.000	.000
	Trade GDP	.000	.	.000	.000	.000	.000
	Reserve GDP	.000	.000	.	.000	.000	.000
	Development expenditure GDP	.000	.000	.000	.	.000	.000
	Financial Position	.001	.001	.000	.002	.001	.001
	Exchange Rate	.000	.000	.000	.000	.	.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.987[a]	.974	.966	147.05

a. Predictors: (Constant), exchange rate, fin position, tradegdp, development expenditure gdp, resgdp

Coefficients[a]

Model		Un-standardized Coefficients		t	Sig.	Co linearity Statistics Tolerance
		B	Std. Error			
1	(Constant)	950.186	275.420	3.450	.003	
	Trade GDP	19.540	8.883	2.200	.042	.023
	Reserve GDP	209.244	48.145	4.346	.000	.003
	Development expenditure GDP	-228.485	71.056	-3.216	.005	.007
	Financial Position	-2223.456	542.629	-4.098	.001	.010
	Exchange Rate	27.572	13.926	1.980	.064	.073

A value of 0.987 indicate good level of prediction. R^2 which is the proportion of variance in the dependent variable that can be explained by the independent variable. In this case Independent variable explains 97.4% of the variability of our dependent variable, FDI. The elasticity coefficient between Reserve GDP and FDI inflows is 209.244 which implies that one percent increase in Reserve GDP causes 209.244 percentage increase in FDI inflows.In Foreign Direct Investment Model, it is found that all variables are statistically significant. Further the results of Foreign Direct Investment Model shows that TradeGDP ($TRAGDP_t$), Development Expenditure ($DEVEXPGDP_t$), Financial Position ($FINPOS_t$), ReservesGDP ($RESGDP_t$) and Exchange rate ($EXRAT_t$), are the important macroeconomic determinants of FDI inflows in India. The regression results of shows that TradeGDP, ReservesGDP and Exchange rate are the pull factors for FDI inflows in the country whereas Development Exp. GDP & Financial Position acts as the deterrent force in attracting FDI flows in the country. As the regression results reveal that Development Exp.GDP, Financial Position & Exchange Rate does not portray their respective predicted signs. However, Development Exp.GDP& Financial Position shows the unexpected negative sign instead of positive sign and exchange rate shows positive sign instead of expected negative sign. All variables included in the foreign direct investment model shows their predicted signs except the two variables (i.e. Development Exp.GDP& Financial Position) which deviate from their respective predicted signs. The reason for this deviation is may be due to the appreciation of Indian Rupee in the international market and low expenditure on Developmental activities in the country. Financial Position is negative due to showing the increasing trend of Debt.

7. CONCLUSIONS

Thus from the analysis, it was found that FDI as the safest and external finance is needed in India for sustained economic growth and Development. FDI will not only benefit the consumer in terms of better Quality and Price but also have the positive effect on employment generation, expansion of existing manufacturing industries and development of emerging the new one. Need of foreign direct investment in developing countries like India for safe & stable forms of international capital flows from the long-term perspective. Foreign Investments brings productive factors and provide access and transfer of advanced technologies, improved management practices & foster the economic activity for economic development. Further establish backward and forward linkages with the rest of the economy.

8. REFERENCES

Syed,M., Ibrahim. &Muthusamy,A. (2014).Role of Foreign Direct Investment in India's economic development- An analysis. Journal of International Relations and Foreign Policy,2(2), 101-113.

Kumar,G.,&Dhingra,N. (2011). Impact of liberalization on FDI structure in India. International journal of economics and research, 2(2), 80-94.

Rajput,N., Jain,A., Rajput,A., &Garg,R. (2012). Relationship of FDI and Growth in India: A diagnostic study. Asian journal of management research, 2(2), 797-813.

Jadhav,P. (2012). Determinants of foreign direct investment in BRICS economies: Analysis of economic, institutional and political factor. Procedia - Social and Behavioral Sciences – Journal- ELSEVIER, 37, 5-14.

Malhotra,B. (2014). Foreign Direct Investment: Impact on Indian Economy. Global Journal of Business Management and Information Technology,4 (1),17-23.

Devajit,M. (2012). Impact of Foreign Direct Investment on Indian economy. Research Journal of Management Sciences, 1(2), 29-31.

www.wikipedia.org

www.rbi.org

www.worldbank.org