Journal of Advances and Scholarly Researches in Allied Education

Vol. VII, Issue No. XIV, April-2014, ISSN 2230-7540

A STUDY ON THE CONTRIBUTION OF FDI TO ECONOMIC GROWTH

AN INTERNATIONALLY INDEXED PEER REVIEWED & REFEREED JOURNAL

www.ignited.in

Journal of Advances and Scholarly Researches in Allied Education
Vol. VII, Issue No. XIV, April-2014, ISSN 2230-7540

A Study on the Contribution of FDI to Economic Growth

Suman Devi

Research Scholar of Swami Vivekananda University

Abstract – FDI may be defined as an investment involving a lasting interest and control by an investor who is a resident of another economy, other than that of the host economy. In the simple sense, FDI implied that the investor has a significant degree of influence on the management. Foreign Direct Investments are investments made by residents of one economy with the objective of establishing a lasting interest in a company located in another economy (host economy).

----------X----------

INTRODUCTION

FDI refers to the purchase by the citizens of one country of non-financial assets in another country. Foreign direct investment involves the acquisition or establishment of a firm, company or enterprise in a country outside of the registered corporate home country. FDI in real estate involves acquisition of land or building across all commercial, residential and retail segments. Any construction activity is also included in FDI.

The contribution of FDI to economic growth has been debated quite extensively in the literature. The 'traditional' argument is that an inflow of FDI improves economic growth by increasing the capital stock, whereas recent literature points to the role of FDI as a channel of international technology transfer. There is growing evidence that FDI enhances technological change through technological diffusion, for example because multinational firms are concentrated in industries with a high ratio of R&D relative to sales and a large share of technical and professional workers (Markusen, 1995).

Multinational corporations are probably among the most technologically advanced firms in the world. Moreover, FDI not only contributes to imports of more efficient foreign technologies, but also generate technological spillovers for local firms. In this approach, technological change plays a pivotal role in economic growth and FDI by multinational corporations is one of the major channels in providing developing countries (LDCs) with access to advanced technologies. The knowledge spillovers may take place via imitation, competition, linkages and/ or training (Kinoshita, 1998; Sjoholm, 1999). Although it is in practice rather difficult to distinguish between these four channels, the underlying theory differs.

The *imitation* channel is based on the view that domestic firms may become more productive by imitating the more advanced technologies or managerial practices of foreign firms (the more so the greater the technology gap). In the absence of FDI, acquiring the necessary information for adopting new technologies is too costly for local firms. Thus, FDI lowers the cost of technology adoption and may expand the set of technologies available to local firms.

The *competition* channel emphasizes that the entrance of foreign firms intensifies competition in the domestic market, encouraging domestic firms to become more efficient by upgrading their technology base. The *linkages* channel stresses that foreign firms may transfer new technology to domestic firms through transactions with these firms. By purchasing raw materials or intermediate goods a strong buyer-seller relationship may develop that gives rise to technical assistance or training from the foreign firm to the domestic firm.

Finally, the *training* channel arises if the introduction of new technologies requires an upgrading of domestically available human capital. New technologies can only be adopted when the labor force is able to work with them. The entrance of foreign firms may give an incentive to domestic firms to train their own employees. If labor moves from a multinational to a local firm (through labor turnover), the physical movement of workers causes knowledge to move between firms.

Empirical evidence that FDI generates positive spillovers for local firms is mixed. Some studies find positive spillover effects, some find no effects and some even conclude that there are negative effects. This does not necessarily imply that FDI is not beneficial for growth (for a survey of FDI and growth

in LDCs, De Mello and Luiz. 1997). It may be that the spillovers are of a different nature.

Aitken *et al* (1997), for instance, point to the importance of the entry of multinationals for reducing entry costs of other potential exporters. Moreover, FDI may also contribute to growth by means of an increase in capital flows and the capital stock.

Some recent studies have argued that the contribution of FDI to growth is strongly dependent on the circumstances in recipient countries.

Balasubramanyam *et al* (1996) find that the effect on growth is stronger in countries with a policy of export promotion than in countries that pursue a policy of import substitution. In a very influential paper, Borensztein *et a*l (1998) suggest that the effectiveness of FDI depends on the stock of human capital in the host country. Only in countries where human capital is above a certain threshold does FDI positively contribute to growth.

Borensztein *et al* (1998) develop a growth model in which technical progress, a determinant of growth, is represented through the variety of capital goods available. Technical progress is itself determined by FDI as foreign firms encourage adoption of new technologies and increase the production of capital goods, hence increase variety.

Thus, FDI leads to growth via technology spillovers that increase factor productivity. Certain host country conditions are necessary to ensure the spillover effects. In particular, human capital (an educated labour force) is necessary for new technology and management skills to be absorbed. Where the issue is addressed, empirical studies consistently find a negative effect of uncertainty (measured in various ways) on investment.

IMPACT OF FDI ON INDIA

India is becoming an attractive location for global business on account to its buoyant economy, its increasing consumption market, and its needs in infrastructure and in the engineering sector. To date, India is becoming a favorite destination for foreign enterprises. According to experts and TNCs managers, it is just ranked behind China and behind or on equal terms with USA (WIR, 2005); this trend was again recently confirmed by AT Kearney's FDI Confidence Index (IBEF, 2006). TNCs invest in India to improve competitiveness and profits by means of cutting costs and to take a step in the Indian market. India has many comparative advantages for TNCs.

Though low literacy and education rates could suggest that labour is not skilled enough, it is not the case when human resources are normalized by the population size. Indeed, Indian skills in research, product design, and customization of services are acknowledged. India is one of the largest pools of scientists, engineers, technicians in the world, more particularly in information technology, with competitive wage levels when compared to those of industrial countries and the use of English in business and in technical and managerial education.

The contribution of Indians of the Diaspora to human resources is noteworthy. Until the end of the 1990's, this Diaspora was still rather resented for its success abroad; but it is no more the case. The government sees it as a potential source of skills, of entrepreneurship, of knowledge and of capital. It is even creating conducive conditions to favour its return: the idea is to turn the original "brain drain" into "brain gain". As a result, more and more Indians expatriated in industrial countries (mainly in United States and United Kingdom) start to come back to work in foreign affiliates or local companies; some of them creating their own business. Furthermore, these last years, qualified workers went less abroad, seeing their country as a land of opportunity.

SIGNIFICANCE OF THE STUDY

Foreign capital played an important role in the early stages of industrialization of most of the advanced countries of today like, the countries of Europe (including the Russia) and North America. Though the problems of development of developing countries of today are not very much similar to those faced by the advanced countries in the past ,there is a general view that foreign capital , if properly directed and utilized , can assist the development of the developing countries.

Borenstein and others (1995) tested the effects of FDI on economic growth in across –country regression framework, utilizing data on FDI flows from industrial countries to 69 developing countries over two decades. Their results suggest the following conclusions:

I. FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investments.

II. For FDI to produce higher productivity than domestic investment, the host country must have a minimum threshold stock of human capital.

III. FDI has the effect of increasing total investment in the economy more than proportionately which suggests the predominance of complementary effects with domestic firms.

More recent studies have focused on such factors as technological status, brand name, openness of the economy, macro trade policies of the government and intellectual property protection. Some of these variables are country specific rather than pertaining to a specific region or a State within a country. Keeping

the above in mind the present study will focus on the trends and behavior (i.e. flow, growth and volatility of FDI) of FDI in India since 1991.

OBJECTIVES OF THE STUDY

The present study will be conducted:

1. To analyze the extent and flow of FDI in India
2. To analyze the growth of FDI in India since the reform period and its regional distribution.
3. To analyze the volatility of FDI with respect to its determinants growth

SOURCE OF DATA

The present study would be based on secondary data. The secondary data is collected through the bulletins and reports of Ministry of Commerce and Industry, Center for Monitoring Indian Economy, RBI website, statistical abstracts, Economic survey of India (various issues), Magazines and Newspapers etc. Apart from above data would be collected from various journals, newspaper and internet websites.

SCOPE OF STUDY

The study would be covering the pattern of FDI since economic reforms. It include various sectors of economy of India to study the various aspect of FDI such as Power and fuel, Telecommunication, Service Sector, Chemicals (other than fertilizers), Food processing, Transport, Metallurgical Industry, Electricity Equipments (including software), Textiles, Paper and paper products and Industrial Machinery.

REFERENCES

- Arindam Banerajee (2005), “India as an FDI Destination”. Portfolio Organizer pp. 21-32.
- Basu, Partha Naryana and Vani Archana, “Determinants of foreign direct Investment in India”: An Industry- Wise Analysis”
- Agrawal,Pradeep (2000), “Economic impact of FDI in South Asia,” Indira Gandhi Institute of Development Research ,Mumbai.
- Aitken, B., G.H. Hansen and A.E. Harrison (1997), “Spillovers, Foreign Investment , and Export Behaviour ,” *journal of International Economics* ,43, 103-32.
- Bayineni Srinivasulu (2005), “Foreign Direct Investment: The Best Driver for Economic Growth”. The ICFIA Journal of Indutrial Economics, pp. 68-76.
- Bodla B. S. and Usha Bhatia (2004), “FDI; Emerging Scenario” Yojana, pp. 21-27.
- Bahaduri, A. (1996), *Implications of Globalisation for Macro-economic Theory and Policy*, Centre for Economic Studies and Planning , Jawaharlal Nehru University ,New Delhi ,India.
- Bailliu, Jeanine ,N. (2000), “ Foreign capital flows financial development and economic growth in developing countries ,” Working Paper ,Bank of Canada. Gttp://netech.mlcac.uk.
- Bajpai , Nirupam and Jeffery, D. Sachs (1997), “India’s economic reforms : Some lessons from East Asia ,” *journal of international Trade and Economic Development* ,6/7 July.
- Bornschier, V. (1980), “Multinational Corporations and Economic Growth: A Cross National Test of the Decapitalisation Thesis,” *journal of Development Economics* , 7, 191-210.