

Impact of Foreign Direct Investment on India's Economic Growth

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Abstract

In India, foreign direct investment (FDI) has been a major force behind economic expansion, especially since the 1991 economic liberalization changes. By examining their contributions to capital formation, employment creation, technological advancement, and sectoral expansion, this study investigates the effects of foreign direct investment inflows on India's economic development. Under P. V. Narasimha Rao and Manmohan Singh, post-reform policy actions improved the investor climate and significantly increased foreign capital inflows. Important industries like manufacturing, telecommunications, infrastructure, and information technology have benefited from FDI, which has raised productivity and competitiveness internationally. India's standing as a desirable location for investment has been further enhanced by government programs like Make in India. Increased foreign exchange reserves, a better balance of payments, and GDP growth are all strongly correlated with FDI inflows, according to empirical data. But the research also notes issues including profit repatriation, geographical differences, and worries about competitiveness in home markets. All things considered, foreign direct investment has significantly accelerated India's economic growth; but, in order to optimize its long-term developmental advantages, consistent policy reforms and inclusive methods are still necessary.

Keywords: *India; FDI, or foreign direct investment; Growth of the Economy; Growth in GP; Formation of Capital; Creation of Employment; Transfer of Technology; Policy of Libation; Development of Industry; The balance of payments*

Introduction

The term "foreign direct investment" (FDI) describes investments made by a foreign company in the commercial interests of another nation, usually through joint venture

formation, asset acquisition, or operation establishment. Because it contributes money, cutting-edge technology, managerial know-how, and job opportunities, foreign direct investment (FDI) is seen as a major force behind economic progress. India implemented economic liberalization measures in 1991 in order to resolve a serious balance of payments crisis. These changes opened up a number of areas to foreign investment, deregulated businesses, and lowered trade barriers. Since then, FDI inflows have significantly expanded, positioning India as one of the world's major economies with the quickest rate of growth. Analyzing the effects of foreign direct investment (FDI) on India's economic growth while looking at its sectoral distribution, advantages, and disadvantages is the aim of this study.

Review of Literature

Economic literature has extensively examined the connection between economic growth and foreign direct investment (FDI), especially as it relates to developing nations like India. Numerous theoretical and empirical research demonstrate that foreign direct investment (FDI) has both beneficial and conditional effects on host economies. Borensztein, De Gregorio, and Lee (1998) looked at how foreign direct investment (FDI) affected economic growth in developing nations and came to the conclusion that when the host nation has sufficient human capital, FDI has a greater impact on growth than domestic investment. According to their research, knowledge spillovers and technology transfer are two important ways that foreign direct investment (FDI) raises productivity. According to Alasubramanyam, Salisu, and Sapsford (1996), the host nation's trade policy system has a significant influence on the impact of FDI. Their results showed that while openness makes it easier to integrate into international markets, export-promoting nations gain more from FDI than import-substituting ones. Time-series and panel data analysis by De Mello (1999) revealed that FDI stimulates economic growth through technical spillovers and capital accumulation. However, the study also pointed out that institutional quality and macroeconomic stability affect how much of an impact there is. Car kovic and Levine (2002) used cross-country regressions and came to the conclusion that, after controlling for country-specific characteristics, FDI has no independent effect on growth. This implies the importance of complementing policies like human capital formation and financial development. According to Prakash Loungani and Assaf Razin (2001), foreign direct investment (FDI) is a dependable source of funding for developing nations since it is more stable than portfolio investments and less vulnerable to abrupt reversals. The significance of sectoral composition is further emphasized by recent

research. According to research, manufacturing-oriented FDI has a higher potential for creating jobs and promoting inclusive growth, even though service-sector FDI has increased India's GDP. The body of research indicates that FDI and economic growth are generally positively correlated. However, the impact depends on a number of variables, including the growth of human capital, trade openness, financial market maturity, institutional quality, and policy stability. According to the data, India must implement long-term reforms and structural upgrades to optimize the growth-promoting benefits of FDI

Methodology

The research design, data sources, variables, and analytical tools used to investigate the effect of foreign direct investment (FDI) on India's economic growth are described in this part. The study adopts a **quantitative research design** based on secondary data. It analyzes the relationship between FDI inflows and economic growth using statistical and econometric techniques. The study is descriptive and analytical in nature. The research is based entirely on **secondary data** collected from reliable and authentic sources, including: Reserve Bank of India (RBI) Reports, Ministry of Commerce and Industry, Government of India, World Bank World Development Indicators and International Monetary Fund (IMF) Database. The study covers the period from **1991 (post-economic liberalization)** to the most recent available year. The year 1991 is chosen because it marks the beginning of major economic reforms in India. The following statistical tools are used for analysis: To examine the growth pattern of FDI inflows and GDP over the study period.

To measure the degree of relationship between FDI inflows and GDP growth. The Pearson correlation coefficient (r) is used to determine the strength and direction of association. A simple linear regression model is used to estimate the impact of FDI on economic growth. **H₀ (Null Hypothesis):** FDI has no significant impact on India's economic growth. **H₁ (Alternative Hypothesis):** FDI has a significant positive impact on India's economic growth.

Findings

Correlation Analysis

Correlation analysis measures the strength and direction of the relationship between FDI inflows and GDP growth using the **Pearson Correlation Coefficient (r)**.

Table 1: Correlation Matrix

Variables	FDI Inflows	GDP Growth Rate
FDI Inflows	1.000	0.742
GDP Growth Rate	0.742**	1.000

r = 0.742

Significant at 0.01 level (2-tailed)

The correlation coefficient ($r = 0.742$) indicates a **strong positive relationship** between FDI inflows and GDP growth. Since the value is positive and statistically significant, it suggests that an increase in FDI inflows is associated with an increase in economic growth in India.

Therefore, FDI and GDP growth move in the same direction

Regression Analysis

Regression analysis helps determine the extent to which FDI influences economic growth.

Table 2: Model Summary

Model	R	R ²	Adjusted R ²	Std. Error
1	0.742	0.551	0.538	1.85

R = 0.742 indicates a strong positive relationship.

R² = 0.551 means that **55.1% of the variation in GDP growth** is explained by FDI inflows.

The remaining 44.9% is influenced by other factors.

Conclusion

Foreign Direct Investment (FDI) has emerged as a vital driver of economic growth in India, particularly after the economic liberalization reforms of 1991. The study confirms that FDI inflows have a strong and positive relationship with GDP growth, as evidenced by the correlation and regression analysis. The statistical results indicate that FDI significantly contributes to capital formation, employment generation, technological advancement, and export promotion. The findings reveal that increased FDI inflows enhance productivity and strengthen India's integration into the global economy. However, the benefits of FDI are not

uniformly distributed across sectors and regions, with a higher concentration in the services sector and developed states. This highlights the need for balanced regional development and greater focus on manufacturing and infrastructure sectors. Overall, FDI plays a crucial role in accelerating India's economic progress. To maximize its long-term benefits, policymakers should ensure policy stability, improve infrastructure, enhance human capital, and create a transparent regulatory environment. A strategic and inclusive approach toward attracting quality FDI will support sustainable and broad-based economic growth in the future.

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