

# FDI and Sustainable development: Lessons to Draw for India

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## ABSTRACT

*The past half a century has been marked with an unprecedented expansion of international trade. The share of international trade in world GDP has raised from 5.5 percent in 1950 to 20.5 percent in 2006 and further estimated to rise up to 55% in 2038. The resultant complex linkages between trade, environment and development are all set to redefine future economic leadership. Important amongst others is the Economics that is emerging from the relationship between trade opening and the environment. Though, there is now no debate on opening trade for higher growth, its environmental impact has often remained a point of great debate in all global fora.*

*Developing countries have increasingly come to see FDI as a source of economic and sustainable development, income growth and employment. Countries have liberalised their FDI regimes and pursued other policies of attracting investment. India too has shown remarkable growth and development in terms of International Trade, Globalisation, health care services and technology, etc. It has addressed the issue of how to best pursue domestic policies to maximise the benefits of foreign presence in the domestic economy. This paper attempts primarily to shed light on the second issue, by focusing on the overall effect of FDI on economic growth. The paper does not solely focus on the positive effects but it also addresses the potential*

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*drawbacks such as the deterioration of the environmental impact of increase in FDI, especially in the extractive and heavy industries, the social consequences of an accelerated commercialisation in developing countries, the effects on competition in national markets and the risk that countries, especially transforming economies, may experience a loss of political sovereignty.*

*Actions taken—or not taken—in the years ahead will have a profound bearing on the future course of human development. The world lacks neither the financial resources nor the technological capabilities to act. What is missing is a sense of urgency, human solidarity and collective interest.*

**Keywords:** Foreign Trade, Carbon Dioxide Emissions, Foreign Direct Investment, Sustainable Development, Globalization  
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## Introduction

The past half a century has been marked with an unprecedented expansion of international trade. The share of international trade in world GDP has been raised from 5.5 percent in 1950 to 20.5 percent in 2006 and further estimated to rise up to 55% in 2038. The resultant complex linkages between trade, environment and development are all set to redefine future economic leadership. Important amongst others is the Economics that is emerging from the relationship between trade opening and the environment. Though, there is now no debate on opening trade for higher growth, its environmental impact has often remained a point of great debate in all global fora.

Developing countries have increasingly come to see FDI as a source of economic and sustainable development, income growth and employment. Countries have liberalised their FDI regimes and pursued other policies of attracting investment. India too has shown remarkable growth and development in terms of International Trade, Globalisation, health care services and technology, etc. It has addressed the issue of how to best pursue domestic policies to maximise the benefits of foreign presence in the domestic economy. This paper attempts primarily to shed light on the second issue, by focusing on the overall effect of FDI on economic

growth. The paper does not solely focus on the positive effects but it also addresses the potential drawbacks such as the deterioration of the environmental impact of FDI, especially in the extractive and heavy industries, the social consequences of an accelerated commercialisation in developing countries, the effects on competition in national markets and the risk that countries, especially transforming economies, may experience a loss of political sovereignty.

The positive benefits of FDI to the receiving host country are manifold and include capital, skill, technology transfer, market access and export promotion. The actual impact on the environment, however, may be larger because CO<sub>2</sub> emission is one of the many pollutants generated by economic activities. With India having emerged as the fourth highest in the global ranking of CO<sub>2</sub> emissions by turn of this century.

### **Theoretical Framework**

Economic growth in developing countries depends on many factors, including internal economic conditions, as well as such external factors as FDI, portfolio investment and foreign aid. All of these external factors depend on internal economic policies, such as institutional and macroeconomic reforms designed to stabilize the economy. Since there is a marked trend towards better policy among poor countries, the climate for effective aid is improving (Burnside and Dollar, 2000).

According to (Magdoff 1976) the Third World progressive – breaking down obsolete structures and building ‘productive forces’ denounce the negative effects as the exploitative tendencies of the ‘northern capitalists’ search for new markets, new sources of cheap labour/inputs, which ultimately leads to a distorted social, political and economic environment. The ‘Dependency theorists’ in a similar contention saw MNC investment as ‘growth hinderants’ by draining away the domestically usable surplus, stifling local entrepreneurial capacity and distorting the entire pattern of growth as per (Bhagwati and Brecher, 1980, 1981; Grieco, 1986).

Finally, the successful introduction of competition may have a negative short-term effect on the host countries’ employment rates, but in the longer term this trend should be reversed by the stronger economic growth stemming from more competitive markets. This accentuates a general need

for labour market flexibility, and it may present national authorities with difficult policy choices.

The groundbreaking research by the prestigious Globalization and Economic Policy Centre (GEP) at the University of Nottingham Malaysia Campus shows that the flow of money from overseas cannot sustain a nation's economic growth and that policy-makers should consider tightening the lax environmental regulations that have encouraged much foreign investment.

The worldwide shift in the economic frame with the turn of the century in the garb of the LPG (Liberalization, Privatization and Globalization) once again emphatically brought back the FDI Centre stage in the vertical process of economic development overlooking the horizontal expansion. Keeping in line with the worldwide opening of markets, the New Industrial Policy statement (1991, NIPS) of India had a free attitude towards foreign collaborations, both technical as well as financial and a more open door policy towards direct foreign investments (DFIs). Studies have revealed FDI has been a major engine for the rapid economic growth of many South East Asian countries, but the success of these economies has been achieved at the expense of the environment. But, according to Lee, 2008 many academicians believe that a number of South East Asian nations have been misled into accepting that increased pollution is a price worth paying for the future well-being of their economies.

By and large, studies have found a positive links between FDI and growth. However, FDI has comparatively lesser positive links in least developed economies, thereby suggesting existence of “threshold level of development” (Blomstrom and Kokka, 2003 and Blomstrom et al., 1994). Athreye and Kapur (2001) emphasized that since the contribution of FDI to domestic capital is quite small, growth-led FDI is more likely than FDI-led growth.

Foreign Direct Investment (FDI) as an important driver of growth. It is an important source of non-debt financial resources for country for economic development. Besides it is a means of achieving technical know how and employment generation of employment. However, many are of the view that FDI is a big threat to sovereignty of host and domestic business houses. Faster exploitation of natural resources for profit may deprive host from such resources in long run. Rapid growth may exhaust

all resources and create environmental problems for generations to come. Midst of debate on pros and cons of FDI, world economy has observed a phenomenal change in volume and pattern of FDI. There is clearly an intense global competition of FDI. India is not behind this global race of attracting foreign investment. India emerged as an attractive FDI destination in services but has failed to evolve a manufacturing hub which has greater economic benefit. FDI though one of the important sources of financing the economic development, but is not a solution for poverty eradication, unemployment and other economic ills. India needs a massive investment to achieve the goals of vision 20-20. Policy makers need to ensure transparency and consistency in policy making alongwith comprehensive long term development strategy. In the light of the above the issue of Indian trade future in global market becomes a new area of concern.

Over the past few years, “Sustainable Development” (SD) has emerged as the latest development catchphrase. A wide range of nongovernmental as well as governmental organizations have embraced it as the new paradigm of development. A review of the literature that has sprung up around the concept of Sustainable Development indicates, however, a lack of consistency in its interpretation. More important, while the all-encompassing nature of the concept gives it political strength, its current formulation by the mainstream of Sustainable Development thinking contains significant weaknesses. These include an incomplete perception of the problems of poverty and environmental degradation, and confusion about the role of economic growth and about the concepts of sustainability and participation.

As per Defra (2009) Sustainable Development is categorized as consumption and production, climate change and energy, natural resource protection and enhancement and finally creating sustainable communities. The world will take another decade to understand the above and make changes to safeguard our environment for future. The impact has to be studied in both short run and long run time frame.

## **Objectives and Methodology**

In lieu of the above stated research and data review the current exercise enhances further on the effect of FDI over our countries sustainable development.

Hence the objectives of the study have been identified as follows:

1. To measure the growth rates of FDI inflows in India and other developing countries.
2. To measure the development profile of these countries.
3. To ascertain the relationship between FDI inflows, growth and pollution in these countries.

The study shall rest on the following Hypotheses:

1. Growing FDI inflows in the developing countries have resulted in better development and sustainable growth.
2. Growing FDI inflows in developing and developed countries have resulted in the increase of environmental pollution.

The paper is based on secondary data pertaining to countries collected from various sources such as Annual Reports of various countries, Central Statistical Organization, Economic & Political Weekly Research foundation, Reserve Bank of India/State Bank of India publications, Innovation Report, Human Development Report, World Bank data and The World Investment Report 2012.

The levels of growth are taken as proxy to GDP growth rates and the levels of development to GDP Per Capita of chosen countries. In order to measure the development profile of countries HDI is taken as additional variable so as to reflect the currently popular connotation of Human Resource Development as being an important indicator of development process. The variable chosen to reflect the environmental pollution are CO<sub>2</sub> emissions and decadal rate of growth of CO<sub>2</sub> emissions. In order to establish the degree and nature of relationship among all the determinants simple Correlation Coefficients have been calculated.

### **Trend of FDI in India**

During the first few decades, India's policy towards FDI or any foreign capital remained highly restrictive, as a part of its stringent licensing rules, tariffs, import-substitution policy and various other rules and regulations.

The abolition on patent rights on certain products in industry also severely curtailed Intellectual Property Rights, due to which FDI was opposed for

preferential technical collaboration agreements. In 1980's some softening on FDI approval was accepted and finally sustained liberalization in 1991.

FDI is now permitted up to 51% ownership and 100 % on a case-by-case basis in some priority areas like pharmaceuticals, airports, hotels etc. Technology Policy is also reformed for greater recognition to IPR procedures to further simplify the flow of FDI.

“New generation” investment policies place inclusive growth and sustainable development at the heart of efforts to attract and benefit from investment. This leads to specific investment policy challenges at the national and international levels. At the national level, these include integrating investment policy into development strategy, incorporating sustainable development objectives in investment policy and ensuring investment policy relevance and effectiveness. At the international level, there is a need to strengthen the development dimension of international investment agreements (IIAs), balance the rights and obligations of States and investors, and manage the systemic complexity of the IIA regime.

#### Sustainable Development: Increasing Recognition

It is also a matter of concern for any developing economy like India and with its image as Emerging Market Economies (EME's) all the above mentioned agreements on FDI must ensure that they do not interfere in the countries development but should focus on the environmental and positive social impact of investment. The progressive policies in terms of macroeconomic fundamentals increased the FDI inflows nearly 5 fold from first decade to the present millennium.

This paper has been organized in the following manner: 1. Global FDI inflows and FDI inflows in India 2. Growth profiles of countries mentioned 3. Environmental pollution in these countries 4. Inter relationship between FDI and growth.

### **Analysis**

On the basis of Table 1, we can see that there has been remarkable increase of 5.6% in FDI inflows of India and also of the transforming economies.

**Table 1:** FDI Inflows: Statement of FDI Inflows of Developing, Transforming & Developed Countries

Economy	2004	2005	2006	2007	2008	2009	2010	2011
Developed	414186	613089	972762	1358628	1019648	606212	618586	747860
Transforming	30308	30948	54548	90866	114361	72386	73755	92163
Developing	290397	229292	433764	529344	620733	519225	616661	684399
India	6051	8961	20328	25506	43406	35596	24159	31554

Source: UNCTAD, FDI/TNC database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).(Rs in billions)

The developed economies have experienced a downfall in some of the years but then again regained momentum in last 2 years because of the aftermaths of Recession.

The basic aim of these countries is to transform their economies from export based to domestic demand driven economies thereby resulting in greater international resilience to external economic crisis.

**Table 2:** Annual Average Growth Rate of GDP (in %)

Type	2004	2005	2006	2007	2008	2009	2010	2011
Developing Economies	7.2	6.7	7.1	7.3	6	3.8	7.5	6.2
Transforming Economies	7.3	6.5	7.2	8.2	7.8	7.1	7.9	7.8
Developed Economies	2.9	2.3	2.8	2.5	2	2.6	3.2	2.6
India	8.5	8.8	9.2	9.7	6.2	6.6	10.6	7.2

Source: UNDP Report 2012.

The economies have shown remarkable economic performance, measured in terms of growth of gross domestic product (GDP). Increasing sectoral specialization and competitive advantage in many economies perhaps contributes to these economies' phenomenal GDP growth rate. The growth and development of manufacturing industries and the presence of global corporations are thought to be facilitating the emergence of a service-dominated economy. Transforming Economies are showing special

growth levels since these are the ones adapting to changing global market conditions and liberalization.

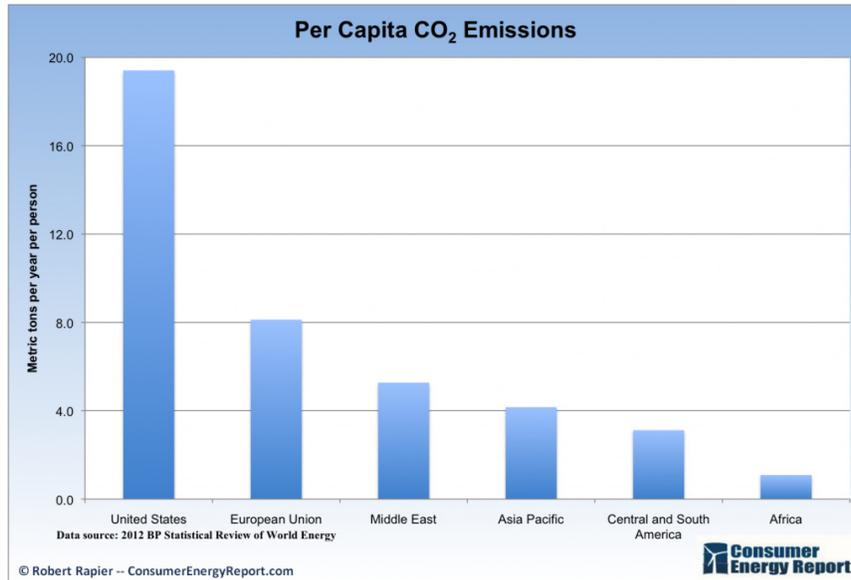


Figure 1: Environmental Pollution CO<sub>2</sub> Emissions

Developing countries seek the same modern conveniences—dishwashers, televisions, computers, and cars—enjoyed by the developed world and which are currently powered mostly by fossil fuels. We can imagine that they can improve their standard of living without increasing their fossil fuel consumption, but what do we have to point to in order to show that it can be done?

The Report addresses some of the critical issues. While acknowledging the threat posed by rising emissions from major developing countries, the northern governments have to initiate the deepest and earliest cuts. The report points out those rich countries carry overwhelming historic responsibility for the problem, have far deeper carbon footprints, and have the financial and technological capabilities to act. Scenarios for future emissions reinforce the scale of the challenge ahead. On current trends, CO<sub>2</sub> emissions are projected to increase by 50% to 2030—an outcome that would make dangerous climate change inevitable. “The bottom line is that the global energy system is out of alignment with the

ecological systems that sustain our planet,” commented Mr. Watkins, adding: “realignment will take a fundamental shift in regulation, market incentives, and international cooperation.”

**Table 3:** Correlation Between FDI, Economic Growth and Pollution

<i>Indicators</i>	<i>Correlation-Coefficient</i>	<i>Significance</i>
FDI & Growth	-0.32	Moderate degree of negative correlation
Growth & Pollution	0.597	Moderate degree of positive correlation
FDI & Pollution	0.988	High degree of positive correlation
FDI & GDP Growth	-0.234	Moderate degree of negative correlation

## Conclusion

The table above clearly reveals that FDI inflows in absolute as well as growth terms do not have positive relationship with growth indicators. Similar results have been confirmed by other studies that no robust relationship between FDI and income growth is established (Busse et al., 2006). They argue that countries need a sound business environment in the form of good government regulations to be able to benefit from FDI.

This research paper shows that the conventional wisdom that FDI is a key factor in sustained economic growth may provide an incomplete picture. Also the arguments put forth by the environmentalists against the very concept of privatization of the atmospheric commons (you can't sell what you don't own) that allows the market and corporate actors (many of whom are the world's biggest polluters) to determine the pace and development of the 'carbon market'; cannot be overlooked. The neoliberal economic paradigm on which carbon trading is based is fatally flawed and rewards polluters by bestowing tradable property rights on them in an arbitrary, unequal fashion. Carbon Trading is worse as trading in emissions effectively creates a commodity literally out of thin air; unlike markets that trade in tangible commodities, this one trades in the absence of something no one wants: greenhouse gases in the atmosphere. Pollution rights promote rent-seeking rather than purposive action to reduce emissions through material or energy saving and reducing fossil

fuel dependence. Worse, they inhibit serious innovation and structural change while rewarding superficial, paltry “end-of-pipe” solutions.

Governments have created this network to promote and protect foreign investment. These agreements respond to investors’ requests, and provide a valuable tool to attract desirable inward FDI. Investing abroad inevitably carries increased political and economic risks, particularly when an investment involves large sunk costs or a long-term commitment of capital. As outward FDI from Asia turns increasingly toward developing countries with less stable legal and judicial frameworks, the risks associated with foreign investment increases in India. And in an era of capital shortage, investment destinations will compete to obtain the most desirable investment projects.

Overall policy trends during the crisis in India have so far been mostly favorable to FDI, both nationally and internationally. However, in some countries a more restrictive FDI approach has emerged. There is also growing evidence of “covert” protectionism.

An analysis of the recent trends in FDI flows at the global level as well as across regions/countries suggests that India has generally attracted higher FDI flows in line with its robust domestic economic performance and gradual liberalization of the FDI policy as part of the cautious capital account liberalization process. Even during the recent global crisis, FDI inflows to India did not show as much moderation as was the case at the global level as well as in other EMEs. However, when the global FDI flows to EMEs recovered during 2010-11, FDI flows to India remained sluggish despite relatively better domestic economic performance ahead of global recovery. This has raised questions especially in the backdrop of the widening of the current account deficit beyond the sustainable level of about 3 percent.

In Table 3 it is clearly showing that there exists a negative relationship between FDI and GDP growth levels as well as very high positive correlation between FDI and CO<sub>2</sub> emissions which proves the first hypothesis true that increasing FDI inflows are actually a bane. The world lacks neither the financial resources nor the technological capabilities to act. What is missing is a sense of urgency, human solidarity and collective interest. Today, the geopolitics of climate is profoundly affected by the

convergence of the diverse crises currently sweeping the world and this current framing is in total failure.

Against this backdrop, it is pertinent to highlight the number of measures announced by the Government of India on April 1, 2011 to further liberalize the FDI policy to promote FDI inflows to India. These measures, inter alia included:

- (i) allowing issuance of equity shares against non-cash transactions such as import of capital goods under the approval route,
- (ii) removal of the condition of prior approval in case of existing joint ventures/technical collaborations in the 'same field',
- (iii) providing the flexibility to companies to prescribe a conversion formula subject to FEMA/SEBI guidelines instead of specifying the price of convertible instruments upfront,
- (iv) simplifying the procedures for classification of companies into two categories – 'companies owned or controlled by foreign investors' and 'companies owned and controlled by Indian residents' and
- (v) allowing FDI in the development and production of seeds and planting material without the stipulation of 'under controlled conditions'.

These measures are expected to boost India's image as a preferred investment destination and attract FDI inflows to India in the near future.

If action is not taken to curb global carbon emissions, climate change could cost between 5 and 20 percent of the annual global gross domestic product, according to a British government report. In comparison, it would take 1 percent of GDP to lessen the most damaging effects of climate change, the report says. Actions taken—or not taken—in the years ahead will have a profound bearing on the future course of human development. The world lacks neither the financial resources nor the technological capabilities to act. What is missing is a sense of urgency, human solidarity and collective interest.

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