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Research Article

Impact of FDI on Economic Growth: A Case Study of Indian Economy

Author (s): Dr. Narendra Singh[1*], Dr. Manita Yadav[2]

[1,2]Assistant Professor Govt. College Mubarikpur, Alwar, Rajasthan, India

Corresponding Author: *Dr. Narendra Singh

Abstract

In all countries, especially developing, foreign direct investment (FDI) plays a very important role, they are even considered as the engine of economic growth and development. Engaged in good conditions, foreign capital can help reduce the gap between capital requirements and national saving, raise skill levels in the host economy, improve market access and contribute to technology transfer and good governance. Foreign investment comes in many forms. In what follows, we will show through theoretical and empirical studies the effect of the investment on economic growth of countries. This study analyzes the relationship between foreign direct investment, Trade openness, Inflation rate and economic growth in Indian economy from 2000-01 to 2022-23 using regression analysis. The results indicated, foreign investment has positive impact on the economic growth of India during study period, which could be a good tool to prioritize the allocation of resources across sectors to promote foreign direct investment. Further results also revealed that trade openness has also positively significant impact on the economy growth of India during study period which could be another important tool for policy makers to boost the economy of India. Based on these results, it is recommended that the governments of these countries implement policies and measures to attract the FDI inflows and the effectively encourages trade-related factors to safeguard and promote economic growth. Additionally, with regard to inflation, it is advisable for these governments to implement measures aimed at curbing and controlling inflation, as rising inflation has adverse effects on economic growth.

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1. Introduction

The global economy has been completely transformed in recent years. It operates in an environment increasingly Entangled as free trade, free movement of capital and goods become hallmarks, where FDI is increasingly qualified as a new way to finance economic growth. In order to increase their investment capacity to positively affect the balance of the balance of payments, make up for the shortfall in national savings, create new opportunities for better jobs with better pay and better conditions work, several countries are trying to make IDE one of the most powerful in the economic development strategy pillars. These countries have a significant production potential, they have everything for the effective take-off of their economy.

These states have focused their actions on the economic and social recovery considering FDI as a by product of economic development, which explains the great importance attached to the attractiveness of foreign investment flows, by implementing a series of measures to make these countries more attractive.FDI is an investment in a business by an investor from another country for which the investor has control over the company purchased. The following advantages of FDI, attracts developing and least developed economies to make FDI friendly policies.

- **As supplement of low domestic savings**

Low capital formation, low savings and low investment are the main characteristics of LDCs and became the barrier in their development goal. The importation of foreign capital helps reduce the shortage of domestic savings through the inflow of capital equipment and raw materials there by raising the marginal rate of capital formation. As chenery (1956) in said in his theory of 'two gap model', that saving gap and foreign gap in the LDCs are fulfilled only by foreign investment.

- **To overcome the deficiency of good infrastructure**

Infrastructure like roads, rails, power projects, communication technology and bridges are very essential to development. Since they require very large investment and have long gestation period, LDCs are unable to undertake them without foreign Aid.

- **To overcome the backward technology**

Technology backwardness is reflected in high average cost of production low productivity of labour and capital. FDI comes with new technology, innovations in product market and increase the efficiency of labour and capital.

- **To best utilization of resources:** FDI is also an effective way to optimum utilization of natural resources which are found under-utilization stages in LDCs.
- **To increase the employment in economy:** FDI has very important feature is that, it increases the skilled employment in the economy.

Trade openness and economic growth are closely associated concepts that have been the subject of extensive research and debate among economists and policymakers. Trade openness refers to a country's willingness and ability to engage in international trade by consenting the flow of goods, services, and capital across its borders. Economic growth, on the other hand, signifies the sustained increase in a nation's real GDP (Gross Domestic Product) over time.
The relationship between trade openness and economic growth can be summarized in several key points:

- **Efficiency and Productivity**

International trade exposures domestic industries to global competition, encouraging them to become more efficient and productive. To remain competitive, firms must innovate, reduce costs, and expand the quality of their goods and services. This improves overall economic productivity, which is an important driver of long-term economic progress.

- **Enlarged Market Access**

Trade openness allows a country's businesses to access larger and more diverse markets. When domestic companies can sell their products and services abroad, they can increase their customer base, leading to amplified sales and profits. This, in turn, contributes to economic growth.

- **Resource Allocation**

Trade allows countries to specify in producing goods and services that they are moderately more efficient at, based on their available resources and technological competences. This specialization leads to a more efficient allocation of resources, as nations can concentration on what they do best. As a result, resources are not wasted on producing items that could be more efficiently produced elsewhere.

- **Foreign Direct Investment (FDI)**

Trade openness often attracts foreign direct investment, which can carry in new capital, technology, and expertise. Foreign companies invest in domestic markets, forming jobs, shifting knowledge, and inspiring economic activity. FDI can be a significant driver of economic growth, particularly in developing countries.

- **Diversification and Risk Reduction**

Relying solely on the domestic market can expose an economy to greater economic risks and fluctuations. Trade allows countries to diversify their sources of revenue and reduce dependence on a single market or sector. This diversification can enhance economic stability and resilience in times of economic uncertainty.

- **Consumer Benefits**

Trade can lead to lower prices and a wider diversity of goods and services for consumers. Improved competition from imported products can result in cost savings for households, improving their standard of living and overall well-being.

In conclusion, while trade openness can be an influential driver of economic growth, it is not a one-size-fits-all solution. A well-designed trade policy that takes into account the specific circumstances and desires of a country is essential. Furthermore, addressing the potential challenges associated with trade, such as income inequality and environmental concerns, is crucial for ensuring that the benefits of trade are distributed equitably and sustainably. Inflation and economic growth are two critical macroeconomic concepts that are interconnected but can also influence each other in complex ways. Inflation is the sustained increase in the general price level of goods and services in an economy over a period of time. It is typically measured using an inflation rate, which indicates the percentage change in prices compared to a base year. Traditionally, economists have described a trade-off between inflation and economic growth known as the Phillips Curve. This theory suggests that there is an inverse relationship between inflation and unemployment in the short run. When inflation is high, unemployment tends to be low, and vice versa. However, this trade-off is generally seen as

a short-term phenomenon and tends to break down over the long term. In the long run, there is no clear evidence of a direct trade-off between inflation and economic growth. In fact, moderate inflation is often seen as a sign of a healthy economy. It can indicate that consumer demand is strong, and businesses are able to raise prices, which can lead to increased profitability and investment. While moderate inflation may have a positive impact on growth, high and unpredictable inflation can harm an economy. It erodes the purchasing power of money, leading to uncertainty and discouraging saving and investment. High inflation can also distort price signals, making it difficult for businesses and consumers to make informed decisions. Inflation can impact investment decisions. If inflation is expected to be high, businesses may be hesitant to invest in long-term projects, as the real return on investment may be reduced. This can slow down economic growth. In conclusion, the relationship between inflation and economic growth is multifaceted. While moderate inflation can be conducive to economic growth, high and unpredictable inflation can have detrimental effects. Managing inflation through appropriate monetary policies is essential for promoting long-term economic growth while maintaining price stability. Balancing these objectives is a key challenge for policymakers in many economies.

1.2. Indian economy and Foreign Direct investment policy

At the initial stages of its independency of Indian economy followed the policy of closed economy. Main motive behind that policy was that protection could be provided to new born domestic industries from the high technology foreign industries. India adopted a regime that was perceived to be restrictive towards FDI. Explicit curbs on foreign investment were imposed through the introduction of the Foreign Exchange Regulation Act (FERA) in 1973 by restricting foreign ownership of shares in enterprises incorporated in India. When Indian faced the problem of foreign exchange and huge crisis in the economy during 90's, then India adopted new economic policy of globalization and welcomes the foreign investment in the Indian economy. After, the 90's Indian foreign investment policy is becoming more liberal as time passes. The fast-tracked liberalization of the Indian economy introduced in 1991 brought with it a radical shift in the policy towards FDI. In fact, FDI policy reform formed part of the first package of industrial reforms in July 1991 and was reflected in the Industrial Policy announced in 1991. Foreign investment would bring associated advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. The government will therefore welcome foreign investment which is in the interest of the country's industrial development. Now, India follows an FDI-friendly regime that is quite comparable to that adopted by most countries.

Over the past 23 years (from April 2000 to March 2023), the total foreign direct investment (FDI) inflow into the country amounted to $919 billion. Notably, during the last 9 years (from April 2014 to March 2023), the cumulative FDI inflow reached $595.25 billion, accounting for approximately 65% of the total FDI inflow over the entire 23-year period.In the fiscal year 2014-15, India attracted a relatively modest FDI inflow of $45.15 billion. However, this figure witnessed a steady increase, reaching $60.22 billion in 2016-17 and eventually achieving a record-breaking annual FDI inflow of $83.57 billion during the fiscal year 2021-22.For the fiscal year 2022-23, the total FDI inflow in India stands at $70.97 billion, with FDI equity inflows specifically amounting to $46.03 billion. Analysing the sources of FDI equity inflows in India during the fiscal year 2022-23, the top five contributing countries are Mauritius (26%), Singapore (23%), the USA (9%), the Netherlands (7%), and Japan (6%).In terms of sectors, the top five recipients of FDI equity inflows during the fiscal year 2022-23 are the Services Sector (comprising Financial Services, Banking, Insurance, Non-Financial Businesses, Outsourcing, Research and Development, Courier Services, Technology Testing and Analysis, and others) at 16%, Computer Software and Hardware at 15%, Trading at 6%, Telecommunications at 6%, and the Automobile Industry at 5%.Finally, breaking down the regional distribution of FDI equity inflows, the top five states in India during the fiscal year 2022-23 that attracted the highest FDI equity inflows are Maharashtra (29%), Karnataka (24%), Gujarat (17%), Delhi (13%), and Tamil Nadu (5%).

1.3. International Trade in India

International trade plays a significant role in India's economy. India has a long history of engaging in trade with other nations, dating back thousands of years. Today, it is one of the world's largest economies and a major player in the global trade arena. India has pursued a policy of economic liberalization and trade liberalization since the early 1990s. Reforms and policy changes have aimed at reducing trade barriers, improving the ease of doing business, and attracting foreign investment.

India used to be a protectionist state for a long time, but the country has become progressively more open to international trade. Currently trade represents 45.3% of the country's GDP. The country mainly exports petroleum oils (13.7%), diamonds (6.3%), medicaments (4.3%), articles of jewellery (2.7%), and rice (2.4%), while it imports petroleum oils (18.7%), gold (9.8%), diamonds (4.6%), coal and similar solid fuels (4.5%), petroleum gas and other gaseous hydrocarbons (4.2%). According to IMF Foreign Trade Forecasts, the volume of exports of goods and services increased by 3.9% in 2022 and is expected to further increase in 2023, reaching at 4.9%, while the volume of imports of goods and services increased by 10.1% in 2022 and is expected to increase by 7.2% in 2023.

India conducts trade with countries around the world, but some of its major trading partners include the United States, China, the United Arab Emirates, Saudi Arabia, and the European Union. India has also been actively engaging in trade agreements with various countries and regional blocs to expand its trade networks. India exports a wide range of products and services, including software and IT services, pharmaceuticals, textiles, chemicals, agricultural products, and machinery. IT services, in particular, have been a major driver of India's export growth, with the country often referred to as the "IT outsourcing hub of the world."India imports various goods and services, such as crude oil, machinery, electronics, chemicals, and gold. Crude oil

imports are a significant component of India's import bill, as the country relies heavily on oil for its energy needs. In addition to goods, India has a strong presence in the global services market, particularly in IT and business process outsourcing (BPO) services. The country is known for its skilled workforce and expertise in software development and IT services, making it a preferred destination for outsourcing. India is a member of various regional and bilateral trade agreements, including the South Asian Association for Regional Cooperation (SAARC), the Asia-Pacific Trade Agreement (APTA), and the ASEAN-India Free Trade Area. India has also been negotiating trade agreements with countries like the United States and the European Union. Although, India faces several challenges in international trade, including trade imbalances, infrastructure deficiencies, bureaucratic red tape, and issues related to intellectual property rights. Addressing these challenges is crucial for India to fully leverage its trade potential.

In summary, international trade is a crucial component of India's economy, contributing significantly to its growth and development. The country has made efforts to liberalize its trade policies and attract foreign investment, but it also faces challenges that need to be addressed to further enhance its position in the global trade landscape.

The foregoing paragraphs are identifying FDI, Trade openness and inflation as major determinants of economic growth of countries.

1.4. Objective of the Study

- Trends and patterns of GDP Growth, FDI inflows, Trade openness, Inflation rates in Indian Economy.
- To analyze the impact assessment of FDI, Trade openness and Inflation rates in the Economic Growth of India.

2. Review of Literature

There have been numerous studies, which try to explain the relationship between the foreign direct investment, Trade openness, Inflation rate and economic growth of an economy. Some literature reviews are given below:

Nwaogu and Ryan (2015) conducted research to investigate the impact of foreign direct investment (FDI), foreign aid, and remittances on the economic growth of 53 African countries and 34 Latin American and Caribbean countries. Their findings revealed that, in the case of Latin America and the Caribbean, foreign aid and remittances influenced growth when analyzed separately, whereas remittances had an impact when analyzed together with other factors. Additionally, their results emphasized the significance of spatial interdependence in both regions. On another study conducted by Agrawal (2015) also identified the connection between foreign direct investment (FDI) and economic growth within the five BRICS economies during the period spanning 1989 to 2012. Agrawal's findings indicated that foreign direct investment and economic growth exhibited co-integration at the panel level, implying the presence of a long-term equilibrium relationship between these variables. Meanwhile, Tang (2015) investigated the effects of foreign capital flows on the economic growth of the European Union (EU) throughout the years 1987 to 2012. Surprisingly, the study revealed that the increased foreign direct investment (FDI) and portfolio investment (FPI) stimulated by the European Monetary Union (EMU) did not contribute significantly to economic growth. This unexpected lack of impact from FDI was particularly noteworthy, given the potential benefits associated with foreign direct investment. In a separate study, Sun and Anwar (2016) employed panel data encompassing six Chinese manufacturing sectors during the years 2005 to 2007. Their research aimed to explore the relationship between foreign presence, domestic sales, and export intensity among local firms. They discovered that in China's pharmaceutical industry, domestic sales and exports complemented each other, while in the textile, transportation equipment, beverage, communication equipment, and general equipment manufacturing sectors, domestic sales and exports acted as substitutes. Another research conducted by Wiredu et al. (2020) conducted investigated the connection between openness to trade and foreign direct investment (FDI) on the economic growth of a group of four West African countries: Côte d'Ivoire, Ghana, Nigeria, and Senegal. They analyzed data spanning the years 1998 to 2017 and utilized static panel regression techniques to assess the causal relationship among several variables, including FDI, trade openness, investment, and inflation, in relation to economic growth, as measured by Gross Domestic Product (GDP). The findings derived from their statistical analysis indicate that the combined effect of trade openness indeed exerts a positive and significant influence on the economic growth of Côte d'Ivoire, Ghana, Nigeria, and Senegal. On more study by Mallick and Behera (2020)investigated the long-run equilibrium relationship between economic growth and trade openness in India during the period 1960–2018 using the asymmetric error-correction model with threshold co integration. To evaluate the robustness impact of trade openness on economic growth under different regimes, we divide the full sample period into two sub-periods, i.e., pre-trade reforms period 1960–1990, and post-trade reforms period 1991–2018. The results of study indeed confirmed the evidence of asymmetric co integration between economic growth and trade openness in India during the period under evaluation and over the different sub-periods. Further, another research by Oppong-Baah et al., (2022) explored the role of trade openness, inflation, investment, real exchange rate and investment on the economic growth of Ghana and Nigeria using panel data covering the period from 1998 to 2017. The findings reveal that, under the random effects model, both trade openness and the real exchange rate have a positive and statistically significant impact on economic growth. Conversely, inflation and investment show no significant influence on economic growth when estimated using random effect models.

3. Research Methodology

3.1. Research Design and Data source

The study is empirical in nature. Further, required data has been collected from the World Bank database. GDP at Constant price 2015 has been taken as proxy of economic growth and Foreign direct investment net inflows (Bop, current US$) has been taken as proxy for the foreign investment in India. Further Trade (% of

GDP) has been taken as proxy for degree of trade openness and inflation rate (CPI) has been considered as inflation of country.

3.2. Modeling Criterion

To analyze the role of FDI in the economic growth of India. The following econometric equation has been introduced: -

$$Y = \alpha + \beta_1 FDI + \beta_2 Trade + \beta_3 Inf + \mu$$

Y denotes the GDP at constant price (US$ 2015) and FDI denotes the Foreign Direct Investment (Bop current US$), Trade defines the Trade (% GDP) and Inf denotes inflation rate in Consumer Price Index. In this model, μ is the error term.

3.3 Techniques of Analysis

To fulfill the first objective of this study, tabulation and graphical representation has been used, as these are most suitable techniques to represent any dataset. Further, to fulfill the principle objective of this study, OLS (Ordinary Least Square Method) has been employed.

4. Results and Discussion

4.1. Trends and Patterns of FDI, Trade openness, Inflation and Economic Growth in India from 2000-01 to 2022-23.

In the developing countries like India, there is need of Huge Capital investment and high technology to fulfill the increasing needs of the people, which are increasing as per economy's growth. Lack of capital is the main feature of these economies. Therefore, to fulfill the gap between the domestic savings and investment, foreign investment is a great tool for these economies. In this section of the study the patterns of FDI, Trade openness, inflation and GDP growth have been analyzed

Table: 4.1.1. Trends and Patterns of Economic Growth in India During 2000-2022

Years	GDP at constant US$	GDP growth (annual %)
2000	800534474756.83	3.840991157
2001	839151987750.04	4.823966264
2002	871073122272.89	3.803975321
2003	939542792614.37	7.860381476
2004	1013982172523.95	7.922936613
2005	1094324346478.24	7.923430621
2006	1182534905529.44	8.060732573
2007	1273126717721.70	7.660815065
2008	1312424295413.01	3.08669806
2009	1415605634536.13	7.861888833
2010	1535897922371.19	8.497584702
2011	1616399170582.72	5.241315001
2012	1704596193129.56	5.456388753
2013	1813453519729.32	6.386106401
2014	1947834553053.75	7.410227605
2015	2103588347241.77	7.996253786
2016	2277267027690.13	8.256305502
2017	2432016053695.66	6.795383419
2018	2588974754487.17	6.453851345
2019	2689205279517.88	3.871436941
2020	2532396288465.75	-5.83105322
2021	2761585190297.21	9.050277908
2022	2954977663032.88	7.002951544

Source: *World Development Indicators, 2023*

Table 4.1.1 indicates the trends and patterns of economic growth of FDI for the period of 2000 to 2022. The result shows that there is large fluctuation in pattern of FDI inflows. In the year, 2001 to 2010 there is a positive increase in the GDP growth it is highest in the year 2021 due to various reasons such as heavy demand of Indian consumers, liberalized government policies but after this period, value of GDP is declined.

Table: 4.1.2. Trends and Patterns of FDI inflow in India During 2000-2022

Years	Foreign direct investment, net inflows (BoP, current US$)	Foreign direct investment, net inflows (% of GDP)	FDI Growth (Annual %)
2000	3584217307	0.765212649	
2001	5128093562	1.056378305	43.07429271
2002	5208967106	1.011571805	1.577068431
2003	3681984671	0.605889255	-29.31449563
2004	5429250990	0.765601405	47.45447019
2005	7269407226	0.88610072	33.89337202
2006	20029119267	2.130168425	175.5261694
2007	25227740887	2.07339403	25.95531811
2008	43406277076	3.620523209	72.05772515
2009	35581372930	2.651590332	-18.02712574
2010	27396885034	1.635034111	-23.00217002
2011	36498654598	2.002063463	33.22191393
2012	23995685014	1.312934538	-34.25597387
2013	28153031270	1.516276477	17.32539102
2014	34576643694	1.695659598	22.81677011
2015	44009492130	2.092115227	27.28098343
2016	44458571546	1.937364119	1.020414903
2017	39966091359	1.507315832	-10.10486849
2018	42117450737	1.558214839	5.382961669
2019	50610647354	1.784826349	20.16550496
2020	64362364994	2.409135951	27.17159009
2021	44727277563	1.419775276	-30.50709438
2022	49915506925	1.474569618	11.59969854

Source: *World Development Indicators, 2023*

Table 4.1.2 shows the trends and patterns of FDI inflow in India during the period 2000 to 2022.the results shows that there is large fluctuation in the pattern of FDI inflows. In the year 2000 to 2002, there is a positive increase in the value of FDI inflows. The value of FDI is highest in the year 2006. However, after this its fluctuation.

Table: 4.1.3. Trends and patterns of Trade openness and Inflation in India During 2000-2022

Years	Trade (% of GDP)	Growth rate in Trade (%GDP)	Inflation, consumer prices (annual %)
2000	26.90092291		4.00943591
2001	25.99325475	-3.374115303	3.779293122
2002	29.50866294	13.52430935	4.297152039
2003	30.59243613	3.672728921	3.805858995
2004	37.50381406	22.59178673	3.767251735
2005	42.00166962	11.99306169	4.24634362
2006	45.7244805	8.86348309	5.796523376
2007	45.68626868	-0.083569718	6.372881356
2008	53.36822044	16.81457467	8.349267049
2009	46.27286964	-13.29508599	10.88235294
2010	49.2552065	6.445108932	11.98938992
2011	55.62388001	12.92994989	8.911793365
2012	55.79372172	0.305339548	9.478996914
2013	53.84413195	-3.494281634	10.01787847
2014	48.92218575	-9.141100472	6.665656719
2015	41.92291387	-14.30694842	4.906973441
2016	40.08248571	-4.390029182	4.948216341
2017	40.74249695	1.646632512	3.328173375
2018	43.61696933	7.05521898	3.938826467
2019	39.90540353	-8.50945368	3.729505735
2020	37.80412536	-5.265648216	6.623436776
2021	45.6676832	20.80079295	5.131407472
2022	49.37309406	8.113857753	6.699034141

Source: *World Development Indicators, 2023*

Table 4.1.3 shows the trade openness in India during the period 2000 to 2022. If we see trade openness, in the year 2000, it was 4% and it is highest in the year 2010 that is 11%.

4.2. Impact Assessment of Trade openness, FDI, Inflation and Economic Growth

The following Table 4.2. Depicted the results of regression analysis to determine the role of Trade openness, FDI, Inflation and Economic Growth:

Table: 4.2 Results of Regression Analysis

Variables	Coefficient	Std. Error	t-value	P>|t|	[95% conf. Interval	
Ln_FDI	0.4344713	.0554425	7.84	0.000	0.3184288	0.5505139
LN_TRADE	0.1352002	.3104808	1.44	0.168	-0.5146436	0.785044
LN_INFLATION	-0.3597222	.1348433	-2.67	0.015	-0.6419525	-0.0774919
Cons	17.87225	.9642199	18.54	0.000	15.85411	19.89038
R-Square		0.8576				
Adj. R-Square		0.8352				

Source: *Author's Computation Using STATA 12*

The result of regression analysis indicated that adjusted R-square value is 0.8352 which signifies that the explanatory variables; FDI, Trade openness and inflation effects variation of GDP in India with 83.52 % during the study period. Further coefficient of variable defines that one percent increase in the FDI inflows, upsurges the GDP of India with the 0.4344713 %, which means that there is positive and significant association between the FDI inflows and GDP growth of India. One percent increase in trade openness boosts the growth of GDP with 0.1352002 %, which defines that there is positive association between the trade openness and GDP growth in India. One percent increase in inflation rate decreases the GDP growth with 0.3597222 %, it signifies that there is negative association between inflation rate and economic growth of India.

5. Conclusion and policy implications:

There is found a positive relation between the FDI and economic growth in India to various sectors can attain sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries. Results of our analysis are consistent with the previous studies on the FDI-EG relation have largely proved that FDI exerts positive effects on the host country's economic growth. Government should provide the infrastructure and less formalities work to MNCs, which helps them to work on projects fast. It makes a quick impact on the economic growth. But Indian economy has slow with the use of FDI and takes very much time to utilize this opportunity. Single window system for the investment formalities helps to attract the more FDI. Further researches may explore the influencing

factors works to increase the utilization of foreign investment in Indian economy. The degree of trade openness significantly improves the growth of Indian economy. Therefore, government should promote the exports of goods and services. There is need to watch out the situation of inflation rates in our country.

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