DR. SYED ZAHID PERWAIZ
Faculty of Commerce
Karim City College, Jsr.
Class: B.Com Sem - III
Subject: Planning and Economic Development.(PED)-6-
Topic: Role of Foreign Direct Investment in Economic Growth

Role of Foreign Direct Investment in Economic Growth

Foreign Direct Investment helps in accelerating the rate of economic growth as follows:

i). FDI provides Capital:

Foreign Direct Investment is expected to bring needed capital to developing countries. The developing countries need higher investment to achieve increased targets of growth in national income. Since they cannot normally have adequate savings, there is a need to supplement savings of these countries from foreign savings. This can be done either through external borrowings or through permitting and encouraging Foreign Direct Investment. Foreign Direct Investment is an effective source of this additional capital and comes with its own risks.

ii). FDI removes Balance of Payments Constraint:

FDI provides 'inflow of foreign exchange resource and removes the constraints on balance of payment. It can be seen that a large number of developing countries suffer from balance of payments deficits for their demand for foreign exchange which is normally far in excess of their ability to earn. FDI inflows by providing foreign exchange resources remove the constraint of developing countries seeking higher growth rates.

FDI has a distinct advantage over the external borrowings considered from the balance of payments point of view. Loan creates fixed liability. The governments or corporations have to repay. The resulting international debt of the government and the corporation parts a fixed liability on balance of payments.This means that they have to repay loans along with interest over a specific period. In the context of FDI this fixed liability is not there. The foreign investor is expected to generate adequate resources to finance outflows on account of the activity generated by the FDI. The foreign investor will also bear the risk.

iii). FDI brings Technology, Management and Marketing Skills:

FDI brings along with it assets which are crucially either missing or scarce in developing countries. These assets are technology and management and marketing skills without which development cannot take place. This is the most important advantage of FDI. This advantage is more important than bringing capital, which perhaps can be had from the international capital markets and the governments.

iv). FDI promotes Exports of Host Developing Country:

Foreign direct investment promotes exports. Foreign enterprises with their global network of marketing, possessing marketing information are in a unique position to exploit these strengths to promote the exports of developing countries.

v). FDI provides Increased Employment:

Foreign enterprises by employing the nationals of developing countries provide employment. In the absence of this investment, these employment opportunities would not have been available to many developing countries.

Further, these employment opportunities are expected to be in relatively higher skill areas. FDI not only creates direct employment opportunities but also through backward and forward linkages, it is able generate indirect employment opportunities as well.

vi). FDI results in Higher Wages:

FDI also promotes higher wages. Relatively higher skilled jobs would receive higher wages.

vii). FDI generates Competitive Environment in Host Country:

Entry of foreign enterprises in domestic market creates a competitive environment compelling national enterprises to compete with the foreign enterprises operating in the domestic market. This leads to higher efficiency and better products and services. The Consumer may have a wider choice.