IMPACT OF INFLATION ON FDI INFLOWS IN G7 COUNTRIES AND INDIA

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Abstract
Recent invitation by G7 countries to India to attend G7 summit highlights strengthening ties between the developed nations (G7 countries) and the fastest emerging economy in the world (India). In the era of globalization, strengthening relationship between two or more economies results not only economic growth but also economic development. However, there are various factors that play a vital role in the strengthening of such relations such as cultural barrier, economic freedom, democracy, etc. One of such important factor is inflation. Some researchers have concluded that inflation is detriment to the nation's growth while some highlights the importance of inflation in the economy. Hence, it is still unclear about the impact of the inflation on the economy (whether it is developed or developing economies). The paper attempts to study the impact of inflation on FDI inflows in G7 Countries (developed economies) and India (emerging economy) by adopting Correlation technique for the period of 20 years from 2000-2020, the data of which has been gathered from the authorized source such as World Bank. The findings indicate that inflation has positive impact on FDI inflow in G7 countries and India. The finding is important for policy making as well private individuals or company/institutions who are interested in investment or establishing the business in G7 countries and /or India.

Introduction

According to UNCTAD, FDI is defined as an investment done by individuals or enterprises in a country other than one's own and having long-term commitment or interests. For long lasting interests, the investor must possess at least 10% of the voting power in the business established in foreign country. Equity capitals, reinvested earnings and intra-company loans are the 3 main components of FDI. When an investor purchases the share of foreign firm or enterprises, then it is known as equity capitals. When the dividends are not shared among the investors and the profits are reinvested in the business, then it is known as reinvested earnings. When there is short term and long term borrowings and fundings between an investors and its affiliate enterprises, then it is called as intra-company loans. Besides this, there are 3 types of FDI, namely, Horizontal FDI , where an investor invest in the product which are similar or belong to the same industry; Vertical FDI, where investors invest in the supply chain of the same industry, and Conglomerate FDI, where investors invest their money in different industry.

ISSN : *0555-7860*
UGC-CARE Group 1 Journal

In the era of Globalisation, FDI is considered to be the driver of economic growth and development. Due to various benefits that FDI offers such as exposure to modern technical know-how, managerial skills, etc., the host country, by taking into consideration of the comparative advantage (it may be labour intensive or capital intensive product) that it possess, frames such policies in order to boost FDI inflow. Looking from the developed nations' perspective, one of the main motive of their investment in developing countries is the availability of skilled force at low wages as well as huge market size. Thus, FDI is important for both, the host country as well as the country seeking to invest.

The adoption of economic liberalisation policy in 1991 had marked the new beginnings for India as it had connected the former with the world and had provided the exposure to showcase their potentials which has helped India to emerge as a fastest growing economy in the world. India has adopted various measures to boost FDI inflow which resulted in the increment of FDI inflow from Rs.409 Crore (US$ 167 Million) in 1991 to Rs. 442,569 Crore (US$ 59,636 Million) in 2020-21. The extraordinary performance of India at international platform compelled other nations to look at the former for investment, especially G7 countries. The G7 countries is a group of 7 developed economies representing a net wealth of $317 trillion (58% of global net wealth). G-7 countries also represents 46% of GDP (Nominal Value) and more than 32% of Global GDP (Purchasing Power Parity). G7 consist of Canada, France, Germany, Italy, Japan, UK and US. Recent invitation by G7 countries to India to attend G7 summit highlights strengthening ties between the developed nations (G7 countries) and the fastest emerging economy in the world (India). However, this is not the first time that India has received invitation. Earlier, Tony Blair (former Prime Minister of UK) had invited the then Prime Minister, Manmohan Singh to the 31st Gleneagles G-8 Summit in 2005. After this, France had invited India to attend the summit held in 2019. Hence, these frequent invitations highlights G7's increasing interest in India.

As per IMF, inflation is defined as an overall increase in prices or the increase in cost of living in a country over a period of time. The most widely used tool to measure inflation is Consumer Price Index (CPI). There are many researchers which suggest that inflation has a negative impact on the economy in medium as well as long run. Hence, checking inflation and providing tools to control it is the main aim of policy makers of the country.

The data on FDI and inflation with respect to India and G7 countries has been provided in table 1 and table 2 respectively. As per table 1, since 2000, FDI inflows has shown a downtrend in Canada, US, UK, France, Germany, Italy while FDI inflow in Japan and India has shown an uptrend. Besides this, the data also indicate that FDI inflows in all the countries had decreased sharply in 2008-09 due to global recession. However, only Germany and Italy has shown an increasing trend. These trend are clearly depicted in figure 1. As per table 2, since 2000, inflation in all countries have shown a declining trend except India where inflation rose from 4 % in 2000 to 6.6% in 2020. Also, it can be seen that inflation always remained high for India from 2000 to 2020 as compared to G7 countries. Country wise trend in inflation is depicted in figure 2.

Table 1: Foreign Direct Investment (net inflows, BoP, Current US$ (in Billion)

YEARS/COUNTRY	CANADA	US	UK	FRANCE	GERMANY	ITALY	JAPAN	INDIA
2000	68.3	349.13	164.13	41.39	248.01	13.17	10.69	3.58
2001	28.39	172.5	56.09	50.14	56.95	14.88	4.93	5.13
2002	24.49	111.06	89.76	51.55	51.27	17.24	11.56	5.21
2003	7.01	117.11	36.01	42.35	65.4	19.57	8.77	3.68
2004	1.45	213.64	87.06	35.61	-20.41	20.1	7.53	5.43
2005	25.55	142.34	252.65	85.14	59.84	36.76	5.46	7.27
2006	64.3	298.46	203.64	78.96	87.44	57	-2.4	20.03
2007	120.45	346.61	209.51	83.78	50.85	65.98	21.63	25.23
2008	70.12	341.09	253.45	68	30.95	-9.5	24.62	43.41
2009	20.95	161.08	14.55	18.42	56.7	16.61	12.23	35.58
2010	29.71	264.04	66.73	38.89	86.04	9.93	7.44	27.4
2011	38.34	263.5	27.01	44.21	97.54	34.47	-0.85	36.5
2012	49.37	250.34	46.75	32.94	65.44	0.35	0.54	24
2013	67.03	288.13	54.47	31.59	67.2	19.53	10.65	28.15
2014	64.17	251.86	58.89	5.8	19.49	17.03	19.75	34.58
2015	59.99	511.43	45.33	42.83	62.42	13.3	5.25	44.01
2016	34.2	474.39	324.81	32.8	64.71	25.66	40.95	44.46
2017	25.36	380.82	125.36	35.87	109.51	11.14	18.8	39.97
2018	42.6	214.31	-25.06	77.49	166.87	44.25	25.29	42.12
2019	48.55	302.2	2.24	57.48	71.68	31.19	39.96	50.61
2020	26.56	211.3	31.06	13.24	142.78	-22.09	61.51	64.36

Source: World Bank. https://data.worldbank.org/

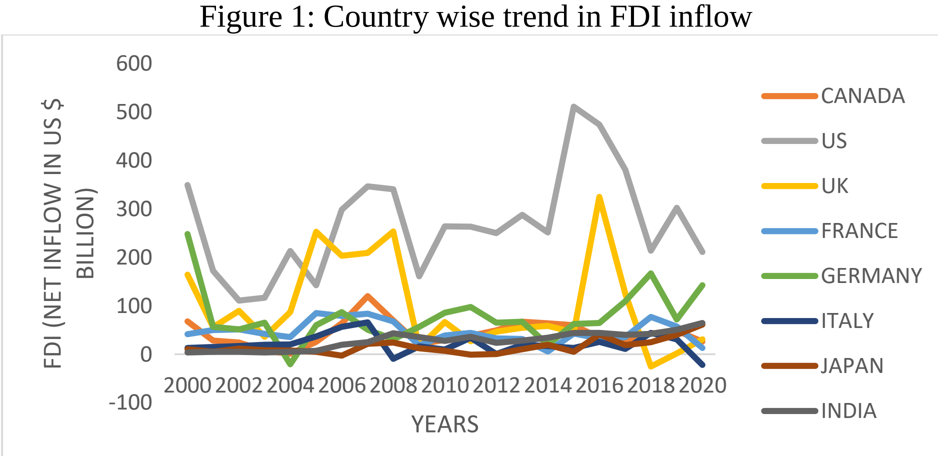
Table 2: Inflation, consumer prices (Annual %)

Countries/ Years	Canada	United States	United Kingdom	France	Germany	Italy	Japan	India
2000	2.71943996	3.37685727	1.18295624	1.67595989	1.44026819	2.53768532	-0.67657868	4.00943591
2001	2.52512014	2.82617112	1.5323496	1.6347808	1.98385694	2.78516543	-0.7400555	3.77929312
2002	2.25839441	1.58603163	1.52040246	1.92341229	1.42080561	2.46532319	-0.92349403	4.29715204
2003	2.75856321	2.27009497	1.37650039	2.09847219	1.03422777	2.67255553	-0.25654182	3.805859
2004	1.85725872	2.67723669	1.39039757	2.14208965	1.66573341	2.20673661	-0.00857339	3.76725173
2005	2.21355203	3.39274685	2.08913649	1.74586936	1.54690965	1.98529299	-0.28294607	4.24634362

2006	2.0020254	3.2259441	2.45566166	1.6751245	1.57742826	2.09084391	0.24935512	5.79652338
2007	2.13838399	2.85267248	2.38656151	1.48799806	2.2983418	1.82974112	0.06003945	6.37288136
2008	2.37027067	3.8391003	3.52140856	2.81286195	2.62838175	3.34783258	1.38007886	8.34926705
2009	0.2994668	-0.35554627	1.96173174	0.08762048	0.31273763	0.77476813	-1.35283673	10.8823529
2010	1.77687154	1.64004344	2.49265472	1.5311227	1.10380916	1.52551602	-0.72824321	11.9893899
2011	2.91213509	3.15684157	3.85611245	2.11159795	2.07517452	2.78063273	-0.27245562	8.91179336
2012	1.51567823	2.06933727	2.5732348	1.95419532	2.00849092	3.04136333	-0.04406451	9.47899691
2013	0.9382919	1.46483266	2.29166667	0.8637155	1.50472098	1.21999342	0.33503791	10.0178785
2014	1.90663591	1.62222298	1.45112016	0.50775882	0.90679795	0.24104743	2.75922671	6.66565672
2015	1.12524136	0.11862714	0.36804684	0.03751438	0.51442054	0.0387904	0.79527963	4.90697344
2016	1.42875955	1.26158321	1.00841737	0.18333486	0.49174862	-0.09401666	-0.12725884	4.94821634
2017	1.59688413	2.13011	2.55775578	1.03228275	1.50949656	1.22653317	0.4841998	3.32817337
2018	2.26822567	2.4425833	2.2928399	1.85081508	1.73216766	1.13748764	0.9890946	3.93882647
2019	1.94926902	1.81221008	1.7381046	1.10825492	1.44566701	0.61124694	0.46877616	3.72950574
2020	0.71699963	1.2335844	0.9894867	0.47649885	0.50668989	-0.13770757	-0.02499583	6.62343678

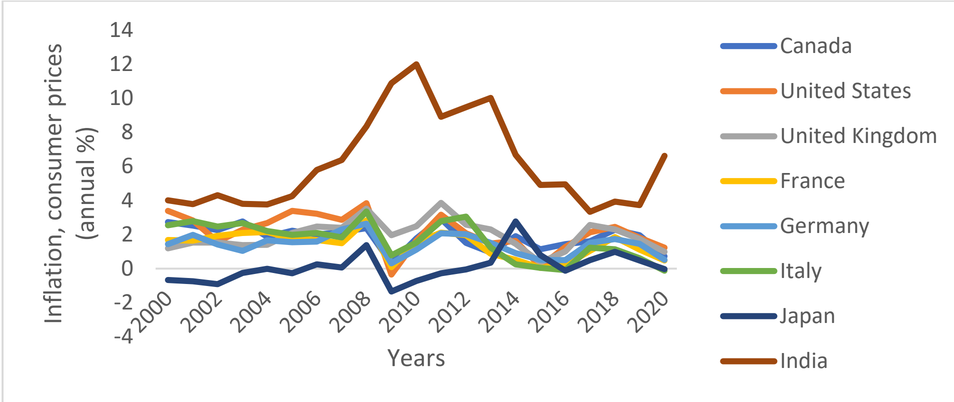
Source: World Bank. https://data.worldbank.org/

Figure 1: Country wise trend in FDI inflow



Source: World Bank. https://data.worldbank.org/

Figure 2: Country wise trend in inflation



Source: World Bank. https://data.worldbank.org/

Literature Review

There are various factors that play a pivotal role in boosting FDI inflow such as agglomeration effect, cultural closeness, capital city advantage, skilled labour abundance (Murugesan & Poovendhan, 2016), quality of institution (Bissoon O., 2012), infrastructure facilities, macroeconomic stabilities and growth prospects (Vinit & Agrawal, 2011), GDP, total labour force and IIP (Singh et al.,2012), transnational attributes and market size (Pillai & Rao, 2013), openness, foreign exchange reserves, GDP and long-term debts (Kaur & Sharma, 2013), etc. However, one of such important factors that play a pivotal role in determining FDI is inflation. Many studies suggest that there is negative impact of inflation on FDI (ibid); (Workneh, A. M. , 2014) while an increase in FDI inflow leads to decrease in inflation (Siddiqui & Aumeboonsuke, 2014). Also, Comparative studies have suggested that inflation and other variables are influencing more inward FDI in one host country as compared to other host country (Dar & Singh, 2014) while some studies suggest that inflation is the main driver of FDI inflow in the host country (Parashar S., 2015); (Goel & Walia, 2017) . Also some studies indicate that inflation has no significant effect on inward FDI (Alshamsi & Azam, 2015). There are also some studies that provide mixed result on the effect of inflation on FDI inflow (Sajilan et al., 2019).

Data And Methodology

The study consider secondary data on FDI inflow and Inflation for G7 countries (developed countries) and India (developing country) from the authorised source like World Bank. The period of the study is of 20 years from 2000 to 2020. By using correlation technique, the study aims to examine the impact of inflation on FDI inflow in G7 countries and India. For FDI inflow, the study uses indicator in terms of Net inflow (BoP, Current US$) while for inflation, Consumer prices in terms of Annual percentage has been taken.

Emperical Results

Table 3 provide the correlation results of the selected data set and have found that inflation has positive impact on FDI inflow in India and overall G7 economies. However, country wise data indicate that coefficients of correlation is positive for Canada, United Kingdom, Italy, Japan, France and India indicating that increase in inflation leads to increase in FDI inflow while it is negative in case of United States and Germany, indicating that increase in inflation leads to decrease in FDI inflow.

Table 3: Result of Correlation

COUNTRIES	CORRELATION OEFFICIENTS
Canada	0.072893006
United States	-0.114155094
United Kingdom	0.079420608
Germany	-0.080978291
Italy	0.043176083
Japan	0.222039554
France	0.536246146
Overall G7	0.27761344
India	0.248291689

Conclusion

The study aims to examine the impact of inflation on FDI inflow in developed economies (G7 countries) and developing country (India) for the period from 2000-2020. The data on FDI indicate that FDI inflow in India and Japan has shown an increasing trend while FDI inflow in others countries included in the study shows decreasing trend. With respect to inflation, all developed countries have shown a declining trend while Indian economy shows an increasing trend. Also, Inflation rate is highest in all the years undertaken for study. The study adopted correlation technique and result indicated that there is a positive correlation between inflation and FDI for countries like Canada, United Kingdom, Italy, Japan, France and India while there exist a negative correlation between both variables for United States and Germany. The scope of the study is limited to inflation only. However, there can be many factors that might affect FDI inflow in the host country which needs more attention.

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