Chapter 1

1.1 Introduction

The growth of a nation cannot be apart from the role of investment. Investment always considers an important factor for all nation regarding economic growth and development. All long-run growth theories imply that an economy can grow faster by investing more.[1] In this perspective, the investment plays an important role to fill the gap between the ability of the budget / fund in the country with increase the budget for the purpose of financing the economic stability, construction and other government financial activities. In this case, according to the Harrod Domar model, a country's economic growth will be influenced by capital and labor. The capital can play a role in the formation of economic capital, which required to improving a country's economic development. However, all developing nations such as India have not the enough capacity to fund the entire project development by relying on domestic economic resources. Local capital markets are often not well developed. And the other factor is that capital shortage due to the low level of private saving. As a result, it will lead to a saving investment gap in the economy.[2] Thus, they cannot meet the capital requirements for large investment projects. This condition can certainly hamper the country's financial status or economic growth.

1.2 Foreign Direct Investment (FDI) in Developing Countries

[1] . (Ramesh Jangili, 2011, Reserve Bank of India Occasional Papers).

[2] Imam Mukhlis andTimbul (2014), "The Co integration Analysis of the Relationships between Foreign Direct Investment Inflow and Gross Domestic Product in Indonesia", Journal of Economics and Sustainable Development,
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The economic situation of developing countries generally is not good in the provision of domestic capital but has considerable economic potential. The potential consider in the form of abundant natural resources and a high population growth. Both factors can be the economic potential to be a main attraction for investors of other countries to invest their funds in developing countries. Thus the role of multinational corporations (MNCs) in developing countries such as India is very important and full of purely economic interests. Furthermore, the availability of natural resources (raw materials) for industry in developed countries can be provided by the emerging economies. Foreign investment can play a vital role as an external source of capital, management, and technology in India. The Indian government differentiates cross border capital inflow in to various categories like Foreign Direct Investment (FDI), Foreign Institutional Investment (FII,) Non-Resident Indian (NRI) and Person of Indian Origin (PIO) investment. Foreign direct investment is an investment that parent companies build in a foreign nation, it is a direct investment. FDI is also known as a vehicle of transmission of new ideas, human skills, advance technology which reduce the cost of production and make product compete able at national level. Economic development involves the absorption of technological expertise from abroad in way that correspond our theoretical setup. Some evidence of FDI benefits, many enterprises in Hong Kong learned businesses as production workers, serving effectively as apprentices to foreign managers. The local subsequently used this knowledge to establish their own enterprises. In Singapore entry into several leading –edge industries, such as electronics and financial services, depend on substantial foreign investment and expertise. This foreign involvement was actively encouraged by the Singapore government. Foreign investment in china from Hong Kong and in Mexico from United States has been important in facilitating the flow of knowledge about advanced manufacturing techniques. In Mauritius the dramatic growth of garment manufacturing entailed the important of foreign entrepreneurs, who trained and supervised the local workers. These foreigners, from Hong Kong, were attracted by an export processing zone that featured a number of favorable government policies, including low taxes and guaranteed.[3] All countries engage in attract FDI. The success of any nation in attracting FDI is directly related to nation resources, human capital, infrastructure development and the existence of money making investment opportunities low taxes and make friendly law. Foreign Direct Investment (FDI) is an investment made by Multi-National Enterprises (MNEs) or by a non-resident in an enterprise of host (recipient) countries over which they have a control and earn private return. It is important to distinguish between Direct and Indirect Foreign Investment. The indirect investment includes portfolio investment, acquisition of stock of an enterprise, medium-term and long-term loans by financial institutions and intermediaries, and investment in new issues of national loans, bonds and debentures.[4] The direct investment is a long-term equity investment in a foreign company that gives the investor managerial control over the company.

Foreign Direct Investment (FDI) is defining as "an investment that is made to acquire a lasting or long-term interest in an enterprise operating outside of the economy of the investor." The investment is direct because the investor, which could be a foreign person, company or group of entities, is seeking to control, manage, or having significant influence on foreign enterprise

[3] Robet J. Barro and Xavier Sala-i-Martin "economic growth" second edition

[4] Dukhab and Sahoo **"**An Analysis Of The Impact Of Foreign Direct Investment On The Indian Economy**"** Institute for Social and Economic Change, Bangalore
August 2004 p.4.

5 Definitions of FDI are contained in the Balance of Payments Manual: Fifth Edition (BPM5) (Washington, D.C., International Monetary Fund, 1993) and the Detailed Benchmark Definition of Foreign Direct Investment: Third Edition (BD3) (Paris, Organization for Economic Co-operation and Development, 1996).

(IMF, 1993). FDI is the process by which the resident of one country acquires the production, distribution and productive activities of a firm in another country (IMF). The BPM5 suggests a threshold of 10 per cent of equity ownership to qualify an investor as a foreign direct investor. According to the BD3 of the OECD, a direct investment enterprise is an incorporated or unincorporated enterprise in which a single foreign investor either owns 10 per cent or more of the ordinary shares or voting power of an enterprise.[5]

India's economy is growing very rapidly since 1991 with some fluctuations. Foreign capital flow is considers to be the most accessible route for economic growth whereby investment is regarded as the engine of growth. Romer (1986) and Lucas (1988) provide a more convincing and rigorous theoretical basis for the positive relation between international trade and long run economic growth and development. According to new theory of endogenous economic growth postulates that lowering trade barriers will speed up the rate of economic growth and development in the long run by allowing developing nations to absorb the advanced technology with a lower degree of openness, increasing the benefits that flow from research and development (R & D), promoting larger economies of scale in production, efficient use of domestic resources, increasing specialization and efficiency in the production of intermediate inputs, introduce new products and services.

These are the ways by which foreign investment can stimulates economic growth and development. According to new endogenous growth theory lower trade barriers can stimulates

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growth in the long run. Edwards (1993) and Pack (1994) point out, openness lead to faster growth.[6]

1.3 Present Status of FDI in India

In the era of globalization, FDI has become an important source of private external finance for developing countries. As we know India is a developing country it also require huge amount capital such as foreign investment for economic growth perspective. After 1991 economic reforms, the government of India has liberalized the FDI regime in about a dozen sectors, including telecom, power etc. and have also relaxed investment norms in multiband retailing. At present time, India allows 100 percent FDI in single brand retail and up to 51 percent in multi-brand segment. Foreign Investment provides a great impetus for growth to Indian economy. The cabinet has recently approved proposals raising FDI caps in several sectors and permitting higher limits in others after approval from the Foreign Investment Promotion Board. More sectors brought in under the automatic route which requires only notification to the RBI. The enactment of a contemporary Companies Bill would also attract FDI. Various survey and industry experts have revealed that India is amongst the top destination for investment across the globe. All countries attracts FDI by using various strategy for the strengthen of their economy. The Foreign Direct Investment in India continuously increases day by day. During 2012-13, India attracted FDI 1465.82 in Rs. billion.[7] Among BRICS India stood at fourth position above South Africa, in terms of FDI inflow. Hotels and tourism, pharmaceuticals, services, chemical and construction received the highest amount of FDI[8]. During 2000-13 Service sectors is attracting highest FDI inflow 31.13%. India Receive highest FDI inflow through Mauritius (43.78%). Because India

[6] Dominick Salvatore "International Economics" Eight Edition p.370
[7] Reserve Bank of India Handbook Statistic of Indian Economy
[8] Department of Industrial Policy & Promotion

have Double Tax Avoidance Agreement (DATT) with Mauritius. But recently Singapore replace Mauritius by 72,986.60 to 1,70,403.39 Rs. Billion (Jan-Mar 2014). Infect Mauritius use as a route by other countries.

1.4 Significance of the Study

The present study is about Impact of FDI on Economic Growth in India during 1991-92 to 2012-13. In this study the researcher uses variables such as GDP and FDI. The present study tries to find out, that FDI is supporting for economic growth or not. Policy regarding FDI in India liberalized after economic reforms 1991. After reforms a flow of foreign investment in Indian economy has been started. The researcher is interested to empirically check the Impact of FDI on GDP Growth in India. The study also explores the sectors in which FDI is dominating and explores the different countries, which investing in India. I study some selected articles and news papers about Foreign Direct Investment (FDI). FDI is a burning issue at present time all over the world. In India it also considered as a source of external finance and it affect the growth of Indian economy. Thus it is important to find out the effect of FDI on Economic Growth of India. Because this is the time of globalization and every country compete to each other to improve its investment policy. Indian government further liberalized its policy regarding FDI caps in different sectors in India (The Economic Time 2014). Thus it became most important to know that FDI impact on growth is positive or not. There are lot of review which is controversial to take relationship between FDI and Economic Growth in India. On behalf of this topic, I select objectives:

1.5 Objectives of the Study

Specifically, the main objectives are:

- To examine the impact of FDI on the economic growth in Indian prospective.
- To explore the sectors wise FDI inflow and country wise FDI inflow in India.

1.6 Hypothesis of the Research

Ho: There is no relationship between FDI and Economic Growth in India.

Ho: GDP does not cause FDI.

1.7 Limitations of the Study

The present study base on the aggregate data. Consisting of yearly time series data hence it will not capture micro level impact on variables. There are many variables which effect the economic growth of the country but there is only FDI which show the effect of foreign investment on economic growth in India

1.8 Organization of the Study

The content of the present study on impact of Foreign Direct Investment (FDI) on Economic Growth of India has been organized in to six chapters.

1. The first chapter presents a brief introduction focusing on significance of the study, objective of the study, and limitation of the study.
2. The second chapter presents a brief review of literature, and found a problem with the theoretical and empirical gap if there is, with the purpose putting the present work in right perspective.

3. The third chapter introduces the FDI and Economic Growth: A Glance since 1990, FDI caps on different sectors, country wise distribution of FDI and sectors wise distribution of FDI.
4. The fourth chapters describe the theoretical framework consisting of time series econometrics techniques such as unit root test, granger causality test and regression model and data source and description. Empirical result based on time series data has been presented in chapter fifth.
5. The fifth chapter including conclusion and reconditions.

Finally, the study presents the bibliography and relevant appendix of the dissertation respectively.