

FDI: A CATALYST IN INDIA'S GROWTH STORY

Prof. Swaha Shome*

Prof. Davinder Suri*

ABSTRACT

Foreign direct investment (FDI) and trade are considered generally to give impetus to economic growth in developing economies. The added advantage with FDI is that the incumbent vulnerabilities associated with external debt do not burden the host nation. FDI promotes use of technology stimulates domestic investment and leads to development in human capital and institutions in the host countries. Moreover once the FDI kick starts economic growth, it induces more multinational companies to enter the host economy. FDI provides knowledge capital to developing making factors of production viz. labor and capital, more productive. Economic growth can be achieved through more investment or through boosting consumption or increasing employment opportunities. India's need for FDI is to grow is undisputed. Since 1990s, India has witnessed a rapid increase in FDI following the liberalization of trade policies for the country. This paper aims to find out the impact of FDI on the above viz. investment, consumption and employment. The aim is to ascertain the path that FDI has taken towards achieving economic growth. Using correlation, the findings substantiated theory wherein the analysis proved the relation between FDI and macroeconomic parameters viz. Economic growth, Investment, Employment and Consumption. FDI has a positive impact on producers, consumers, and on the overall conduct of business in India. FDI has become an essential part of India's growth story in plugging the gap between savings and investment to strengthen the supply side.

Keywords: *Capital Formation, Consumption, Economic Growth, Employment, Foreign Direct Investment (FDI), Investment, Gross Domestic Product (GDP)*

*Faculty (Economics) IBS Mumbai

INTRODUCTION

Foreign direct investment (FDI) is outlay into production activity in a country by a company originating in another country. It entails either buying a company in the host country or by increasing the existing operations of business. According to the Reserve Bank of India, “A *direct investment is defined as incorporated or unincorporated enterprise in which a direct investor, who is a resident in another economy, owns 10% of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated). As such, a company in which 10% or more equity capital is held by a single non-resident investor is defined as a Foreign Direct Investment Company.*” IMF defines FDI as “*The acquisition of at least ten percent of the ordinary shares or voting power in a public or Private enterprise by non-resident investors. Direct investment involves a lasting interest in the management of an enterprise and includes reinvestment of profits*”.

Foreign direct investment is undertaken to extract the benefit of cheaper wages in the host country, to benefit from special investment privileges such as tax exemptions offered by the host country as well as to gain tariff-free access to the markets of the country or the region.

Foreign direct investment (FDI) and trade give impetus to economic growth in developing economies. FDI promotes use of technology, stimulates domestic investment and leads to development in human capital and institutions in the host countries. It can also lead to more international trade wherein production is shifted to countries that have comparative advantage in producing them (Makki S, 1997). FDI is considered to be a fairly long term commitment between the multinational company and the host nation. It is welcomed into developing economies owing to a host of gains including improved management techniques, advanced technologies, easier access to international financial markets. This bodes well for the recipient economies in terms of economic growth and reduced external vulnerability. With respect to the latter current account deficits financed through FDI rather than portfolio investments are certainly more sustainable.

Multinational companies are looking growth and this attracts them to the emerging market economies (EMEs). In particular the attraction is stronger with fast-growing services sectors, the market size and growth rate in the economy. This can be verified by an IMF study which showed that the profitability of investments by US firms in twenty EMEs were higher than the rate of return earned in developed economies.

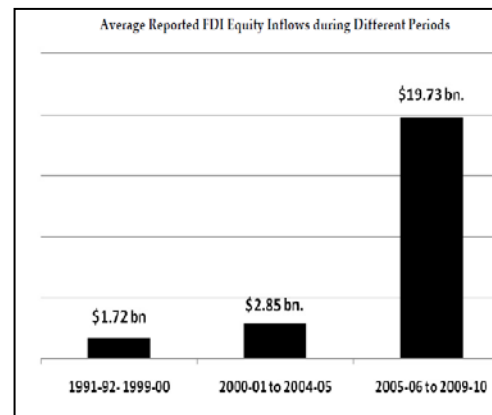
FDI plays an important source of finance for growth developing economies where the financial markets have not developed. These multinational companies are a source of inflow of capital that plugs in the investment savings gap thus promoting growth without controlling consumption. The added advantage with FDI is that the incumbent vulnerabilities associated with external debt do not burden the host nation. Moreover once the FDI kick starts economic growth , it induces more multinational companies to enter the host economy. A strong production sector also gives a fillip to the financial markets to develop and grow giving further liquidity to the host nations' production units. Instead of spending domestic resources on research and development, the domestic companies will now be in a position to access latest technology and management techniques. This initiates a 'spillover process' where domestic firms adapt and implement the imported technology, becoming more productive and enhancing their growth. FDI is generally accompanied development of the financial sector as the mergers and acquisitions attract additional venture capital business. FDI leads to growth in the host economy through benefits of economies of scale, increased cost efficiency, growth in capital stock, technology transfer, skill acquisition and market competition.

TRENDS IN FDI IN INDIA

Since 1990s, India has witnessed a rapid increase in FDI following the liberalization of trade policies for the country. The FDI inflow which was around an average of \$ 33 million during 1975-79 and \$ 105 million during 1980-89, increased to a record level of \$1741 million during 1990s .Since then, FDI inflows has grown at a much faster rate reaching the peak level of \$ 3.62 billion in 1997. It slowed down in 1998 and 1999 but increased rapidly again in 1999-2001. The following table shows the trends in FDI for India.

FDI FLOWS INTO INDIA		
Year	FDI flows	% age growth over previous year
2001	4029	(+) 52 %
2002	5,035	(-) 18 %
2003	4,322	(-) 14 %
2004	6,051	(+) 40 %
2005	8,961	(+) 48 %
2006	22,826	(+) 146 %
2007	34,835	(+) 53 %
2008	41,874	(+) 20 %
2009	37,745	(-) 08 %
2010	34,847	(+) 34 %

Source: Fact sheet on FDI in India 2000 - 2012



This rapid growth in FDI inflows were a direct result of the liberalization process which involved relaxing the restrictions on foreign ownership in existing sectors and opening up of many new sectors such as banking, insurance, telecommunications, mining, construction and management of roads and highways, airlines, and defence equipment. One key factor that encouraged this trend was the size of the domestic markets. According to A.T. Kearney, India ranks second in the world in terms of an attractive destination for FDI. The 2007 Global Services Location index ranks India as the most preferred destination in terms of skills availability, financial attractiveness and overall business environment. UNCTAD's World Investment Report 2005 considers India as the most attractive destination among the transnational corporations. The above mentioned factors have caused the FDI inflows to increase by almost twenty times since the beginning of reform in 1991.

During the first five months of the financial year 2010-11, amount of FDI was registered at US\$8.89 million. By August it had increased by another \$1.3 billion. The countries which have contributed to the FDI growth have increased in number from fifteen in 1991 to more than 120 in 2009. Mauritius alone contributes about 40%. The other major countries are USA, Singapore, UK, Netherlands, Japan, Germany, Cypress, France and Switzerland. In fact in the past five

years, 66% of the FDI have come from five countries, Mauritius, USA, Singapore, UK, and Netherlands. The following table shows the different sources of FDI for India in the past few years.

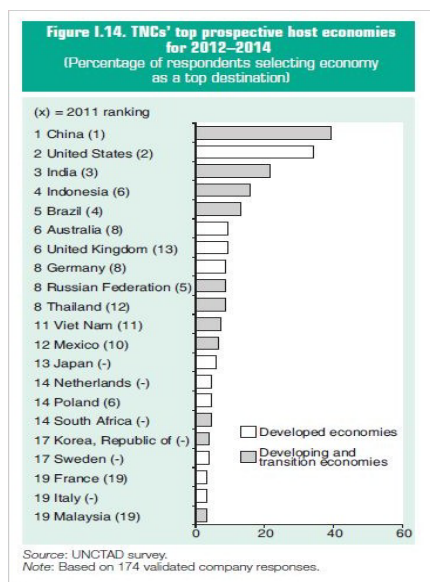
Ranks	Country	Amount Rupees in crores (US\$ in million)				
		2009-10 (April-March)	2010-11 (April-March)	2011-12 (for April 2011)	Cumulative Inflows (April '00 - April '11)	%age to total Inflows (In terms of US \$)
1.	MAURITIUS	49,633 (10,376)	31,855 (6,987)	4,332 (976)	247,092 (55,203)	42 %
2.	SINGAPORE	11,295 (2,379)	7,730 (1,705)	5,214 (1,175)	58,090 (13,070)	10 %
3.	U.S.A.	9,230 (1,943)	5,353 (1,170)	356 (80)	42,898 (9,529)	7 %
4.	U.K.	3,094 (657)	3,434 (755)	19 (4)	29,451 (6,643)	5 %
5.	NETHERLANDS	4,283 (899)	5,501 (1,213)	172 (39)	25,799 (5,739)	4 %
6.	JAPAN	5,670 (1,183)	7,063 (1,562)	1,043 (235)	25,001 (5,511)	4 %
7.	CYPRUS	7,728 (1,627)	4,171 (913)	754 (170)	22,702 (4,982)	4 %
8.	GERMANY	2,980 (626)	908 (200)	231 (52)	13,607 (3,051)	2 %
9.	FRANCE	1,437 (303)	3,349 (734)	977 (220)	11,244 (2,484)	2 %
10.	U.A.E.	3,017 (629)	1,569 (341)	91 (21)	8,683 (1,910)	1 %
TOTAL FDI INFLOWS *		123,120 (25,834)	88,520 (19,427)	13,846 (3,121)	594,569 (132,837)	-

Note: (i) *Includes inflows under NRI Schemes of RBI.

(ii) Cumulative country-wise FDI equity inflows (from April 2000 to April 2011) – Annex-'A'.

(iii) %age worked out in US\$ terms & FDI inflows received through FIPB/SIA+ RBI's Automatic Route+ acquisition of existing shares only.

Source: Economic Survey



The following table shows the sectoral difference in FDI in the past few years. As visible, the maximum inflow has been in services sector.

Ranks	Sector	Amount in Rs. crores (US\$ in million)					% age to total inflows (In terms of US\$)
		2009-10 (April-March)	2010-11 (April-March)	2011-12 (for April 2011)	Cumulative Inflows (April '00 - April '11)		
1.	SERVICES SECTOR (financial & non-financial)	20,776 (4,353)	15,539 (3,403)	2,922 (658)	123,706 (27,668)	21 %	
2.	COMPUTER SOFTWARE & HARDWARE	4,351 (919)	3,571 (784)	425 (96)	48,135 (10,821)	8 %	
3.	TELECOMMUNICATIONS (radio paging, cellular mobile, basic telephone services)	12,338 (2,554)	7,546 (1,665)	205 (46)	48,313 (10,611)	8 %	
4.	HOUSING & REAL ESTATE	13,586 (2,844)	5,149 (1,127)	167 (38)	43,288 (9,655)	7 %	
5.	CONSTRUCTION ACTIVITIES (including roads & highways)	13,516 (2,862)	5,077 (1,125)	1,381 (311)	42,160 (9,491)	7 %	
6.	AUTOMOBILE INDUSTRY	5,754 (1,208)	6,008 (1,331)	1,182 (266)	28,037 (6,199)	5 %	
7.	POWER	6,908 (1,437)	5,709 (1,252)	1,136 (256)	27,848 (6,156)	5 %	
8.	METALLURGICAL INDUSTRIES	1,935 (407)	5,055 (1,105)	229 (52)	18,724 (4,286)	3 %	
9.	PETROLEUM & NATURAL GAS	1,328 (272)	2,621 (574)	28 (6)	13,763 (3,159)	2 %	
10.	CHEMICALS (other than fertilizers)	1,707 (362)	1,810 (398)	152 (34)	13,234 (2,927)	2 %	

Source: Economic Survey

LITERATURE REVIEW

According to UNCTAD (1999), the Transnational Corporations (TNCs) can complement local development initiatives by

(i) increasing financial resources for development

(ii) boost export competitiveness;

(iii) generate employment and strengthening the skill base;

(iv) protecting the environment to fulfil commitment towards social responsibility; and

(v) enhancing technological capabilities through transfer, diffusion and generation.

The relation between FDI and growth has drawn the attention of many researchers. Empirically, the positive impact on economic growth of a host nation on account of receiving FDI has been established by many empirical studies (Veugelers, 1991; Barrell and Pain, 1996; Grosse and Trevino, 1996; Taylor and Sarno, 1999; Trevino et al., 2002). Cross sectional data of a sample of 66 developing countries over three decades, shows that FDI promotes investment in the presence of other macroeconomic variables being favourable (Makki S, 1997). Another study also based on FDI flows from industrial countries to 69 developing countries over the last two decades found that FDI contributes to economic growth only when a sufficient absorptive capability of the advanced technologies is available in the host nation (Borenszteina and Lee, 1997). Alfaro, based on cross-country data for the period 1981-1999, found that within sectors in the host nation FDI has a positive effect on the manufacturing sector with the aim to study the benefits of FDI on growth in the primary, manufacturing, and services sectors. According to empirical analysis based on data on FDI and consumption in Romania, it found that these two variables induce each other and Romania was looking for FDI to promote investment and not consumption (Simona-Gabriela and Cristina).

Chadee and Schlichting (1997) discuss some aspects of foreign direct investment in the Asia-Pacific Region and conclude that FDI has made a positive contribution to all the economies in that region. Hsiao and Shen(2003) examine the same relationship between FDI and growth through data on 84 countries during the period of 30 years from 1970 to 1999, Lee (2005) strongly support that foreign direct investment along with trade liberalization is a strong driver

for economic development. Hansen and Rand (2006) in their paper titled ‘On the Causal Links Between FDI and Growth in Developing Countries’ also provide a positive linkage between FDI and economic growth, but this is dependent on the host country’s labour policies and availability of skilled labour. Baharumshah and Thanoon (2006) by using dynamic panel models demonstrated the positive contribution of FDI on the growth of East Asian countries. Zhang (2001) analyzed the data from 11 countries in East Asia and Latin America to provide evidence that FDI promotes economic growth in countries which follow a liberalized trade regime, and have a workforce with higher job skills and education. According to Ram and Zhang (2002), FDI provides a host country which is underdeveloped a ready access to the world markets and allows the host country to participate in the globalization process.

Basu, Chakraborty and Reagle (2003) analyzed a group of 23 developing countries from Asia, Africa, Europe and Latin America and found the causal relationship between GDP growth and FDI to run both ways in more open economies, and in only one direction—from GDP growth to FDI in relatively protected economies. This result has been also found by Trevino and Upadhyaya (2003) in their study of five developing countries in Asia. They found that the positive impact of FDI on economic growth is greater in more open economies.

FDI is attracted to economies for reasons more than market size. These include the general wage level, level of education, institutional environment, tax laws, and overall macroeconomic and political environment. All these factors impact the profitability of the multinational companies. FDI has a positive relation to institutional quality, physical infrastructure, import tariffs, macroeconomic stability, and political stability (Wei, 1997; Mallampally and Sauvart, 1999; Trevino et al., 2002; Biswas, 2002), and negative relation with corporate taxes (Wei, 1997; Gastanaga et al., 1998; Hsiao, 2001).

To examine the link between FDI and economic growth in India, Chakraborty and Basu (2002) suggest that GDP in India is not caused by FDI, but the other way around i.e. FDI is a result of higher growth rates. Empirical research for relation between FDI and investment in India has been till date ambiguous with Fry (1993) and Dhar and Roy (1996) finding a negative relationship between FDI and domestic investment. Kathuria (1998, 2000) suggests that the indirect gains from FDI depend upon the local companies’ ability to learn new technologies by investing in research and development. Spill over is most commonly observed in high-tech domestic industries. FDI has been responsible for some positive technological spillovers from

R&D expenditure of multinational firms in India, and it is likely that business practices introduced by multinational firms can improve the international competitiveness of domestic firms (Kaur S, 2005).

Contrary inferences have been met by Herzer et al (2007). He has argued that with 28 developing countries data there exists an ambiguous relationship between FDI and growth. Merican (2009) tested the impact of FDI and Gross Domestic Investment on growth in case of four Asian countries, and showed that FDI is superior to Domestic Investment for growth only in two countries. Karimi and Yusop (2009) studied the Malaysia's growth-FDI relationship. According to the authors, there are many factors that determine whether FDI promotes or hinders economic growth. Wijeweera et al. (2010) did a panel study of 45 countries between 1997 and 2004 and showed that FDI improves growth only if skilled labour exists in the economy. Review of various literatures available on FDI reveals that foreign investment is still a debatable issue. Whether FDI is boom or bane for host countries economic growth and development cannot be answered unambiguously. Opinions are still divided. FDI has its own advantages and disadvantages. Many researchers argue that through FDI, the developed nations may try to jeopardise the sovereignty of host country. TeVelde, (1999) has reported that there is a risk of multinationals inhibiting growth process unless the host government is proactive in ensuring that there is long run impact of FDI on growth and development. Borensztein, et. al. (1998) reveals that FDI might have a crowding out effect on domestic private and public investment which might affect long term economic growth. Empirical evidence exists for strong net crowding out effect in Latin America (Agosin and Mayer, 2000).

The above issues raised by the researchers have led to a strong contention on the need and benefit of FDI in a country. This paper seeks to examine the same in the context of India.

ROLE OF FDI AS AN ENGINE OF GROWTH

Economic growth is a function of the resources a country is endowed with. The higher the amount and the quality of the resources, the more is growth in an economy. Hence growth can emanate from: (1) Natural resources: plentiful supply of natural complemented by skilled people to exploit the opportunities, (2) Capital: Increased investment means more production therefore more growth, (3) Rate of savings: provide fund for investment which leads to more growth in the future and (4) Technological progress: will increase the potential to grow as technology enables higher output hence growth.

Growth models developed by Harrod (1939) and Domar (1946) state that capital formation is important for growth through raised standard of living. Solow (1956) further clarified that it is increased labour productivity that is a result of capital formation that leads to economic growth. Some recent theories (Lucas (1988), Rebelo (1991) and Romer (1986; 1990)) broaden the definition of capital to include knowledge capital gained through research and development to explain growth along with other variables.

FDI plays a role in capital formation bringing in new technology and knowledge along with capital. It has been empirically proven that FDI is an important source of economic growth and development (Bajpai and Sachs, 2000). FDI provide new knowledge and add to domestic investment thus enhancing economic growth in developing country. Rodan (1961) and Chenery and Strout (1966) found that FDI had a positive relation with productivity and growth in developing countries. This was corroborated by Barro and Sala-i-Martin, (1997) and Helpman and Grossman (1991) who found that FDI has long term positive influence on growth through technology and knowledge transfers. Even UNCTAD, while analyzing investment policy reviews, found that FDI benefits host nations through employment generation, wages, and linkages with local firms, increases in technology intensive exports, range of new products and services, etc.

Mainly previous studies show that FDI contributes to growth through capital formation and technology transfer (Blomstrom et al. 1996 and Borensztein et al. 1995) compounded by knowledge growth due to labor training and skill building (Mello, 1999). Hence FDI link to economic growth is through investment ushering in productivity spillovers for the host economy consequently leading to higher growth. The idea is that FDI provides knowledge capital to developing making factors of production viz. labor and capital, more productive. The idea that FDI improves growth and per capita growth has been substantiated various studies (Caves, 1974; Lipsey, 1999; Globerman, 1979 and Blomstrom and Persson, 1983). Overall literature has found positive impact of FDI on economic growth of host nation, but the impact varies from country to country and depending on country conditions.

The important role of FDI in an economy has been visible through the specific indicators such as gross domestic product, gross fixed capital formation, employment and consumption. Each of these macro – indicators have been strongly affected by the FDI inflow in the past decade.

OBJECTIVE OF PAPER

India is a developing in need of FDI to grow. India's savings rate is close to 30 percent which is an envious sum for most economies as these savings finance investment which further fuels economic growth. Currently India needs nearly USD 320 bn. Over the next ten years to build infrastructure for which savings are insufficient hence the need for FDI. Does FDI promote growth in India? Economic growth can be achieved through more investment or through boosting consumption or increasing employment opportunities.

India's need for FDI is to grow is undisputed. This paper aims to find out the impact of FDI on the above viz. investment, consumption and employment. The aim is to ascertain the path that FDI has taken towards achieving economic growth.

DATA AND METHODOLOGY

In order to examine the impact of the FDI on investment, employment and consumption, correlation has been done. Annual data has been used for analysis for the period 1999 to 2011. Data for FDI, Investment and Consumption has been collected from RBI's website and employment data is from Labour Bureau, Government of India, Annual Survey of Industries Scheme

The results show a high degree of correlation at significant levels between FDI and Investment, FDI and employment and also FDI and Consumption.

GDP AND FDI IN INDIA

The economic rationale for host countries to attract FDI is the belief that foreign investment through technology transfers and spillovers encourage growth and development of the country. A correlation between FDI and GDP for India in the period under study reveals a positive strong correlation thus confirming that FDI has encouraged growth in India.

		gdp	fdi
gdp	Pearson Correlation	1	.862(**)
	Sig. (2-tailed)		.000
	N	12	12
fdi	Pearson Correlation	.862(**)	1
	Sig. (2-tailed)	.000	
	N	12	12

Investment and FDI in India

Capital formation is essential for economic growth and FDI plays a vital role in capital formation process in the host nation by filling the gap between domestic savings and investment besides being a non-debt-creating source of additional external finances. At firm level FDI boosts output, technology, skill levels, employment and connections with other sectors and regions of the host nation. India has gained from FDI since the mid nineteen eighties with the multinational companies bringing with them substantial modifications in technologies, liberalization of trade and investment regimes, and deregulation and privatisation of markets. FDI has played a major role in change in India's stance from import substitution to market and export oriented policies.

Impact of FDI on Investment in India

FDI FLOWS (MN. DOLLARS) AND AS A PERCENTAGE OF GROSS FIXED CAPITAL FORMATION								
Year	India		China		Pakistan		South Asia	
2005	-							
2007	17 818	5.5	76213	6.6	4021	16.1	25681	5.8
2009	35 596	8.2	95000	4.3	2338	8.1	42370	7.3
2010	24 159	4.4	114734	4.4	2022	7.5	31746	4.5
2011	31 554	6.4	123985	3.7	1327	5.3	38942	5.5

FDI STOCK (MN. DOLLARS) AND AS A PERCENTAGE OF GROSS FIXED CAPITAL FORMATION								
	India		China		Pakistan		South Asia	
1995	5641	1.5	101098	13.4	5408	7.5	15320	2.5
2009	171218	12.7	473083	9.4	17673	11.3	225739	11.2
2010	204692	11.9	587817	10.2	19828	11.4	266641	10.8
2011	201724	10.4	711802	10.1	21876	10.5	270890	9.6

Source: World investment report, 2012, UNCTAD

The above tables show the relation of FDI to gross fixed capital formation in the Asia region. The figures above give a picture of FDI flows and stock and also their contribution to gross fixed capital formation. It appears from the data that although the FDI flows as a percentage to GDCF

in India was the least in 2007. Over the years, as a percentage of GDCF, FDI flows make a highest contribution in India of 6.4 percent and China is lagging far behind at 3.7 percent. Even when contribution of FDI stock to GDCF is compared India emerges higher than China and also South Asia average. The correlation between FDI and Investment in India has been attempted below.

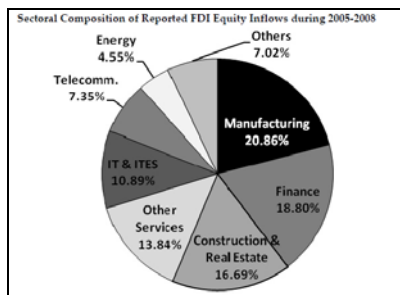
Correlations

		GDCF	FDI
GDCF	Pearson Correlation	1	.950**
	Sig. (2-tailed)		.000
	N	20	20
FDI	Pearson Correlation	.950**	1
	Sig. (2-tailed)	.000	
	N	20	20

** . Correlation is significant at the 0.01 level (2-tailed).

FDI and unemployment:

FDI has emerged as an important sensitive issue in the growth of developing countries. It is seen as a transfer of both tangible and intangible assets which include not just the capital flow but the technology, managerial skills and marketing expertise. The traditional argument in favour of FDI is that it provides greater employment opportunities in the host country. This positive impact is not only on the sectors which attract the FDI but also on a range of supporting industries as well.



A review of literature on the topic shows that in most economies, FDI has had a direct influence on employment. Nunnenkamp, Bremont and Walrich(2002) highlight that FDI contributed to employment in Mexico. Federico and Alfredo showed the effect of outward FDI on domestic

employment growth between 1996 and 2001. In general the literature survey shows that multinational enterprises boosts wages in host economies. Lipsey (2002) show Multinational employees pay a higher wage than domestic firms. FDI generates employment through backward and forward linkages. Studies for a number of developing economies indicate that there is a multiplier effect created on domestic employment. Aaron (1999) estimated that FDI in developing countries created 2 million direct jobs and 41.6 million internal jobs in 1997.

There are primarily three ways by which FDI can impact the labour market

- Wages are normally higher in industries which have international presence.

It has been seen that foreign firms pay more than domestic firms in developing economies. An explanation for this phenomenon is the efficiency wages hypotheses which suggest that if work effort depends on the wage level, a profit maximising firm would wish to pay higher. This proposition that foreign firms pay more has been tested by many with unambiguous results. Driffield finds that foreign firms pay seven % higher in UK due to productivity differences. This brings us to the second impact of FDI on the labour markets.

- FDI enhances the productivity of the workers .

Ramachandran and Shah (1998) argue that added value per worker is 59 % higher in wholly owned foreign enterprises in Kenya. Harrison (1996) analyzed difference in productivity of labour between domestic and foreign owned enterprises and found that the latter was much higher.

- FDI allows transfer of technology

It is observed that foreign technology gets diffused into the domestic industry as employees especially at higher levels move from foreign firms to domestic firms. In South Korea significant technology transfer was by Bloom (1992) when senior managers left multinationals to join domestic companies.

In the Indian economy, the labour market has an unique feature in that it is dualistic by nature. There is a simultaneous existence of a large unorganised sector along with an organised sector.

To analyze the employment impact of FDI Pradhan, J.P., V. Abraham and M.K. Sahoo (2004) has estimated employment elasticity of value added in foreign and domestic enterprises across 11 industries in Indian manufacturing. In 2001-2002 the foreign enterprises had reportedly 5 percent higher employment

elasticity than domestic enterprises in the total manufacturing. In the case of individual industries foreign firms have shown superior employment elasticity in 5 industries whereas domestic firms have higher employment elasticity in 4 industries. Thus this findings suggests that when output grow the employment growth is much faster in foreign enterprises than in their domestic counterparts.

Following the above argument, we can show a significant positive correlation between employment and FDI for the period under study. The following table shows the correlation results.

Correlations

		FDI	ALLEMPL
FDI	Pearson Correlation	1	.941**
	Sig. (2-tailed)		.000
	N	8	8
ALLEMPL	Pearson Correlation	.941**	1
	Sig. (2-tailed)	.000	
	N	8	8

** . Correlation is significant at the 0.01 level (2-tailed).

Consumption and FDI in India

Economic growth can also be stimulated through consumption and FDI can increase consumption expenditure in the host country which adds to the GDP. This is termed as demand led growth. FDI influencing the output through investment expenditure is supply side growth. The demand-led growth theory seems to be better adapted than the growth model based on the production function to the situation of less developed countries (Gore C., 2007). The increase in output capacity is a response to increase in demand which is in complete contrast to the classical growth theories. The demand led growth theory has also been studied by Setterfield (2002) and Blecker (2002). Hence it can be said that either the economic growth is a result of demand which leads to development of production capacities through investment or economic growth explained by aggregate demand level and income distribution between salaries and profits (Gabriela M and Cristina J.). Consumption growth may also bring an increase in imports. This can upset the current account balance where the FDI is needed to fund the deficit. This is witnessed in medium income countries where the current account deficit is financed by external savings (FDI) which

fuels consumption more than adding to gross domestic capital formation (Bresser-Pereira and Gala, 2008).

In India the fear of achieving only demand side growth is unfounded as FDI has impact not only on sales but also on capacity expansion, employment and achieving efficiencies which are parameters of supply side growth. The Indian consumption boom is backed by rise in income levels, lifestyles, taste & habits reflecting in strong consumerism with preference for superior quality and branded products, vast domestic market with a very competitive manufacturing base (CII report).

The relation between FDI and economic growth of the host country has been researched and answers to this question have been varying from country to country with China witnessing large FDI inflows and high growth, Korea growing quickly without much foreign capital while Latin American countries are open to FDI but have witnessed slow growth. In general, the relationship between FDI and growth seems to depend on country-specific factors. FDI can enhance consumption or investment (Kaur S., 2005).

Indian growth is primarily driven by private consumption demand i.e. spending on food, clothing, rent, education, vacations and all other activities. It sums up close to almost 60 percent of Gross Domestic Product (GDP). Consumption growth has been sustained at 8 percent till now. Slow down in investment and government expenditure has been bolstered by consumption to enable India to grow at respectable rate. With FDI flowing in India leading to job opportunities and higher wages and profits, consumption has seen the steady growth to sustain India's growth rate.

Correlations

		FDI	CONSN
FDI	Pearson Correlation	1	.897**
	Sig. (2-tailed)		.000
	N	20	20
CONSN	Pearson Correlation	.897**	1
	Sig. (2-tailed)	.000	
	N	20	20

** . Correlation is significant at the 0.01 level (2-tailed).

CONCLUSION

Given the rapid growth of the global economy, international flows of foreign investment have become a major catalyst in the growth and development of the host economies. FDI has had a positive impact on producers, consumers, and the overall conduct of business in India. The positive role played by FDI in developing countries in general and India in particular has been well established in the preceding sections. Contribution made by FDI in India's capital formation, employment generation and consumption expenditure bolstering has been underscored.

The relation of FDI and economic growth in India offering low cost production and large market and India gaining through non debt external funds with technology, capital transfer and opportunity to exploit demographic dividend has been well established. In India, data confirms that FDI flows move towards economic growth through the routes of capital formation, consumption expenditure and employment generation. FDI has become an essential part of India's growth story in plugging the gap between savings and investment to strengthen the supply side.

It is now up to investment policy formulation of the Indian government to ensure that the interests of Indian producers and consumers are protected.

Bibliography

1. Aaron, C. (1999), "The contribution of FDI to poverty alleviation," Washington, DC: Foreign Investment Advisory Service.
2. Baharumshah, A., & Thanoon, M. (2006). Foreign capital flows and economic growth in EastAsian countries, *China Economic Review*, 17, 70-83. <http://dx.doi.org/10.1016/j.chieco.2005.09.001>.
3. Bajpai and Sachs, 2000, 'Foreign Direct Investment in India: How Can \$10 Billion of Annual Inflows be Realized?', Centre for International Development, (Harvard University)
4. Barrell, R. and N. Pain (1996), "Domestic Institution, Agglomeration and Foreign Direct investment in Europe," *European Economic Review*, 43, pp. 29-45.
5. Barro, Robert J & Sala-i-Martin, Xavier, 1997. " Technological Diffusion, Convergence, and Growth," *Journal of Economic Growth*, Springer, vol. 2(1), pages 1-26, March

6. Basu, P., C. Chakraborty, and D. Reagle (2003), "Liberalization, FDI, and Growth in Developing Countries: A Panel Cointegration Approach," *Economic Inquiry*, 41, pp. 510-516.
7. Biswas, R. (2002), "Determinants of Foreign Direct Investment," *Review of Development Economics*, 6 (3), pp. 492-504
8. Bloom, M. (1992), "Technological Change in the Korean Electronics Industry. OECD,
9. Borensztein, Greorio, De and Lee. (1998). How Does Foreign Direct Investment Affect Growth?, *Journal of*
10. Borenszteina and Lee, 1997, 'How does foreign direct investment affect economic growth?',
11. Bosworth, B.P. and S. M. Collins (1999), "Capital Flows to Developing Economies: Implications for Saving and Investment," *Brookings Papers on Economic Activity*, no. 1, pp. 143-169.
12. Bresser-Pereira Luiz Carlos, Gala Paulo (2008), Foreign savings, insufficiency of demand, and low growth, *Journal of Post Keynesian Economics*, vol 30, no 3 315, spring 2008
13. Chadee and Schlichting. (1997). Foreign Direct Investment in the Asia-Pacific Region: Overview of Recent Trends and Patterns. *Asia Pacific Journal of Marketing and Logistics*, 9, 3-15.
14. Chakraborty, C., & Basu, P. (2002). Foreign direct investment and growth in India: A co integration approach, *Applied Economics*, 34, 1061–1073. <http://dx.doi.org/10.1080/00036840110074079>.
15. Chakraborty, C., and Nunnenkamp, P. (2008). Economic Reforms, FDI, and Economic Growth in India: A Sector Level Analysis. *World Development*, 36, 1192–1212. <http://dx.doi.org/10.1016/j.worlddev.2007.06.014>.
16. Chen, E. K.Y. (1992). Changing Pattern of Financial Flows in the Asia-Pacific Region and Policy Re-sponses., *Asian Development Review*, 10, 46-85.
17. Domar, E., 1946, "Capital Expansion, Rate of Growth and Employment," *Econometrica* 14, 137-47.

18. Encarnation D. J. and L. T. Wells, Jr. (1986), "Evaluating Foreign Investment," in T. H. Moran et al. Investing in Development: New Roles for Foreign Capital? Washington, DC: Overseas Development Council.
19. Federico and Alfredo (2007) Outward FDI and Local Employment Growth in Italy. Bank of Italy, Economic Research Department Temi di discussione (Economic Working Papers 613).
20. file:///C:/Documents%20and%20Settings/dsuri/My%20Documents/Downloads/STATIST ICS.htm
21. Gastanaga, V.M., J. B. Nugent, and B. Pashamova (1998), "Host Country Reforms and FDI Inflows: How Much Difference Do they Make?" World Development, 26, pp. 1299-1314.
22. Gore Charles (2007), Which Growth Theory is Good for the Poor?, The European Journal of Development Research, Volume 19, No. 1
23. Harrod, R. F., 1939, "An Essay in Dynamic Theory," Economic Journal 49, 14-33.
24. Herzer .D , 2008, In search of FDI-led growth in developing countries: The way forward Economic Modelling
25. Hsiao, C., 2001, "Efficient Estimation of Dynamic Panel Data Models with ah Application to the Analysis of Foreign Direct Investment in Developing Countries," Paper Presented at the 2001 Far Eastern Econometric Society Meeting, Kobe, Japan.
26. <http://dx.doi.org/10.1108/eb010288>.
27. http://planningcommission.nic.in/data/datatable/0904/comp_data0904.pdf
28. http://planningcommission.nic.in/data/datatable/0904/comp_data0904.pdf
29. <http://www.adbi.org/discussion-paper/2006/11/28/2066.fdi.south.asia.policy.trends/impact.and.determinants.of.fdi/>
30. <http://www.adbi.org/discussion-paper/2006/11/28/2066.fdi.south.asia.policy.trends/impact.and.determinants.of.fdi/>
31. <http://www.bis.org/publ/cgfs22buba1.pdf>
32. <http://www.bis.org/publ/cgfs22buba1.pdf>

33. International Economics, 45, 115-135. [http://dx.doi.org/10.1016/S0022-1996\(97\)00033-0](http://dx.doi.org/10.1016/S0022-1996(97)00033-0).
34. International Monetary Fund, Research Department, Elsevier Science B.V., PAPER
35. Lipsey, R. E., 2002, Home and Host Country Effects of FDI. Cambridge, MA: National Bureau of Economic Research. (NBER Working Paper 9293).
36. Lucas R, 1988, On the mechanics of economic development, Journal of Monetary Development 22, 3 – 42
37. Mallampally, P. and K. P. Sauvant, 1999, "Foreign Direct Investment in Developing Countries," Finance and Development, 36 (1), p. 36
38. P Nunnenkamp – 2007 FDI in Mexico: an empirical assessment of empirical effects, hawk.ethz.ch/serviceengine/Files/ISN/101056/.../kap1328.pdf
39. Pradhan, J.P., V. Abraham and M.K. Sahoo, 2004, The 'Employment' Impact 'Foreign Direct Investment and Labour: The Case of Indian Manufacturing', Labour & Development, 10(1), pp. 58–79.]
40. Ramachandran, Tyler Biggs and Manju Kedia Shah, 1998, "Enterprise Growth in the Manufacturing Sector: Is Africa Really Different?" Working Paper, Regional Program on Enterprise Development, The World Bank,
41. Rebelo, Sergio (1991), 'Long run policy analysis and long run growth', Journal of Political Economy 99 (3): 500.
42. Romer P, 1994, 'The Origins of Endogenous Growth', The Journal of Economic Perspectives, Vol. 8, No. 1. pp. 3-22.
43. Setterfield Mark (2003), Supply and Demand in the Theory of Long-run Growth: introduction to a symposium on demand-led growth, Review of Political Economy, Volume 15, issue 1, January 2003
44. Shiva S. Makki, 1997, Impact of Foreign Direct Investment and Trade on Economic Growth, Journal of Economic Literature Classification numbers: F10, F21, O1, O40
45. Simona-Gabriela and Cristina, The vicious circle of FDI and consumption in Romania
46. Solow R, 1956, 'A Contribution to the Theory of Economic Growth', The Quarterly Journal of Economics, Vol. 70, No. 1. pp. 65-94.

47. Taylor, M.P. and L. Sarno, 1999, "Capital flows to Developing Countries: Long and Short-term Determinants," *World Bank Economic Review*, 11, pp. 451-470.
48. Trevino, Len, J., J. D. Daniels, H. Arbelaez, and K. P. Upadhyaya (2002), "Market Reform and Foreign Direct Investment in Latin America: Evidence from an Error Correction Model," *International Trade Journal*, 16 (4), pp. 367-392.
- Trevino, Len J. and K. P. Upadhyaya (2003), "Foreign aid, FDI and Economic Growth: Evidence from Asian Countries," *Transnational Corporations*, 12 (2), pp. 119-135.
- Veugelers, Reinhilde , 1991, "Locational Determinants and Rankings of Host Countries: An Empirical Assessment," *Kyklos*, 44 (3), pp. 363-382.
49. Zhang.K , 'Does foreign direct investment promote economic growth? Evidence from East Asia and Latin America', *Contemporary Economic Policy* Volume 19, Issue 2