Study of Implications of FDI on Indian Economy

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Communicated In: POSTMODERN OPENINGS JOURNAL, Iasi (International peer reviewed Journal)
Presented In: National conference on Redefining Managerial Practices in 21st Century (MANTHAN-Nov 2011) Amrapali Institute, Haldwani & full paper available online www.ssrn.com

Autobiography of Author

Mr. Srikant Misra has studied Master of Business Administration **(MBA)** from University of Lucknow, Lucknow, and Graduation from affiliated College of Kanpur University, Diploma in Pharmacy (D.Pharm) from Drug Control Department Karnataka affiliated college at Bagalkot and Diploma in Computer Application (DCA) from Lucknow center. Presently Pursuing **PhD in Management** (Research Scholar) from Integral University Lucknow, and having experience about seven years in the Academic profession at university level.

Presently I am the active member of various bodies such as Lucknow management Association (LMA), University News (A journal of Higher Education-AIU), IUP Journal of Higher Education, Journal of Education Planning and Administration (JEPA), Indian Hospital Pharmacist Association (IHPA) and Reader Digest. Attended and organized various conferences, seminars, Workshop at National Level, Approximately ten research papers have been published/ Presented/communicated.

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Abstract

Foreign direct investment (FDI) is always contributing in the positive growth toward the economy of one country due to the investment by another country or country's personnel's. The effectiveness and efficiency of Global economy depends upon the investor's perception, if investment seen with the purpose of long terms investment in the social-economical development then it is said that the investment contributes positively towards global economy, if it is short term for the purpose of making profit then it may be less significant than that long term and disinvestment leads negative effect. The FDI may also be affected due to the governmental trade barriers and policies for the foreign investments and leads to less or more effective toward contribution in economy as well as GDP and GNP of the country.

In this paper, our aim is to point out the negative and positive implications which affect the economic scenario and also measure the level of predominance by the factors for economic contribution of particular country with special reference to India. FDI seen as an important catalyst for economic growth in the developing countries, The main purpose of the study is to investigate the impact of FDI on economic growth in India, from the period of 1990 to 2010.

This article will also be examined current international investment regime and their relation with Indian economy. This article hopes to find a new position for effectiveness and efficiency of Indian economy through integrated global market by FDI.

Key words: Foreign direct Investment (FDI), Indian economy, Economic growth, Economic efficiency & effectiveness.

INTRODUCTION

FDI or Foreign Direct Investment, is Fund flow between the countries in the form of Inflow or outflow by which one can able to gain some benefit from their investment, whereas another can exploit the opportunity to enhance the productivity and find out better position through performance. The potential advantages of the FDI on the host economy are it facilitates the use and exploitation of local raw materials; it introduces modern techniques of management and marketing, it eases the access to new technologies.

Our research article tries to study the growth of FDI on Indian economy, where FDI is considered to be basic input.

During the past 15 years, the importance of FDI in the world economy has increased rapidly. The total stock of FDI increased from 8% of world GDP in 1990 to 26% in 2006. Although the bulk of FDI continues to take place between OECD countries, the increase in FDI has been particularly pronounced in developing countries, largely reflecting the integration of large emerging economies, the so-called BRICs (Brazil, Russia, India and China), into the world economy.

The increase of FDI into developing countries has been spectacular. The share of non-OECD countries in the global stock of inward FDI has risen from 22% in 1990 to 32% in 2005. China is by far the most important non-OECD country as a recipient of FDI, accounting for about one third of FDI in non-OECD countries in 2005. However, FDI inflows also tend to be sizable in many other emerging countries. Indeed, since the mid-1990s, inward FDI has become the main source of external finance for developing countries and is more than twice as large as official development aid.

MNEs tend to have various advantages compared to purely domestic firms that allow them to compete successfully in foreign markets, despite the additional cost of having to coordinate activities across different countries.

Since 1980, foreign direct investment in the United States has grown at a much faster rate than was typical for the preceding 50 years. Foreign investors have become much more visible throughout this country. However, foreign investment in the United States plays virtually the same role that it has since the founding of the Republic.

Types of Investors

a foreign direct investor may be classified in any sector of the economy and could be any one of the following

- an individual;
- a group of related individuals;
- an incorporated or unincorporated entity;
- a public company or private company;
- a group of related enterprises;
- a government body;
- an estate (law), trust or other social institution; or
- Any combination of the above.

<u>Trends in Global Foreign Direct Investment:</u> Flow of Foreign Direct Investment has grown faster over recent past. Higher flow of Foreign Direct Investment over the world always reflects a better economic environment in the presence of economic reforms and investment-oriented policies. Global flow of foreign direct investment reached at a record level of $ 1,306 billions in the year 2006. Increase in FDI was largely fuelled by cross boarder mergers and acquisitions

(M&As), FDI in 2006 increased by 38% than the previous year. Most of the developing and least developed countries worldwide equally participated in the process of direct investment activities.

1. FDI inflows to Latin American and Caribbean region increased by 11 percent on an average in comparison to previous year.
2. In African region FDI inflows made a record in the year 2006.
3. Flow of FDI to South, East and South East Asia and Oceania maintained an upward trend.
4. Both Turkey and oil rich Gulf States continued to attract maximum FDI inflows.
5. United States Economy, being world's largest economy also attracted larger FDI inflows from Euro Zone and Japan.

Higher inflows of FDI to a country, largely generates employment in the nation. FDI in manufacturing sector creates more employment opportunities than to any other sectors. Countries such as Luxembourg, Hong Kong, China, Suriname, Iceland and Singapore ranked in the top of Inward performance Index Ranking of the UNCTAD. Over recent years most of the countries over the world have made their business environment investment friendly for absorbing global opportunities by attracting more FDI funds to the country.

LITERATURE REVIEW

Singer, 1950; Griffin, 1970; Weisskof, 1972, The main argument of these studies was that FDI flows to Less Developing Countries (LDCs) were mainly directed towards the primary sector, which basically promoted the less market value of this sector. Since these primary products are exported to the developed countries and are processed for import, it receives a lower price for its primary product. This could create a base for the negative impact of FDI flows in the economy.

Rodan (1961), Chenery and Strout (1966), in the early 1960s argued that foreign capital inflows have a favorable effect on the economic efficiency and growth towards the developing countries. It has been explained that FDI could have a favorable short-term effect on growth as it expands the economic activity.

Caves, 1974; Kokko, 1994; Markusen, 1995; Carves, 1996; Sahoo, Mathiyazhagan and Parida 2001, Foreign Direct Investment (FDI) inflow into the core sectors is assumed to play a vital role as a source of capital, management, and technology in countries of transition economies. It implies that FDI can have positive effects on a host economy's development effort.

Barro and Martin, 1999; Helpman and Grossman, 1991, The studies that used the endogenous growth theory challenged this view in explaining the long run growth rate of the economy by using endogenous variables like technology and human capital

Bhagwati, 1994, The local enterprises are able to learn by watching FDI initiative, if the economic framework is appropriate.

Feenstra and Markusen, 1994, FDI is an important vehicle for the transfer of technology and knowledge and it demonstrates that it can have a long run effect on growth by generating increasing return in production via positive externalities and productive spillovers. Thus, FDI can lead to a higher growth by incorporating new inputs and techniques.

Alam (2000) in his comparative study of FDI and economic growth for Indian and Bangladesh economy stressed that though the impact of FDI on growth is more in case of Indian economy yet it is not satisfactory.

Kumar and Pardhan, 2001, Foreign Direct Investment (FDI) has emerged as the most important source of external financial resource for developing countries and has become a significant part of economy in the developing.

Hanson (2001) argues that evidence that FDI generates positive spillovers for host countries is weak.

Lipsey (2002), Takes a more favorable view from reviewing the micro literature which argues that there is evidence of positive effect. He also argues that there is need for more consideration of the different circumstances that obstruct or promote positive spillovers.

Basu (2002), tried to find the short run dynamics of FDI and growth. The study reveals that GDP in India is not Granger caused by FDI; the causality runs more from GDP to FDI and the trade liberalization policy of the Indian government had some positive short run impact on the FDI flow.

Calvo and Robles, 2003, FDI increases the stock of human capital, it stimulates the investment in R&D. foreign inflows could be used for financing current account deficits, finance flows in form of FDI do not generate repayment of principal and interests (as opposed to external debt).

Sahoo and Mathiyazhagan, 2003, There were also few evidences demonstrate that there is a long-run relationship between Gross Domestic Product, FDI and export in India

Arshad, 2008, The role of the foreign direct investment (FDI) has been widely recognized as a economic growth-enhancing factor in the developing countries. The effects of FDI in the host economy are normally believed to be increase in the employment, increase in productivity, and increase in exports and, of course, increased pace of transfer of technology.

WDI indicators 2008, The amount of foreign direct investment increased significantly for developing economies during 1985 to 2000. The share of developing countries in world FDI inflows and outflows has risen from 17.4% in 1985-90 to 26.1% during 1995-2000. For India the amount of FDI inflows increased from $ 0.24 billion in 1990 to $ 55 billion in 2007. *Economist Intelligence Unit 2009*, global survey of 548 companies provided evidence of a link between investing in emerging markets and corporate financial success. Among surveyed companies from developed countries that derive less than 5% of their revenue from activities in emerging markets, only 24% reported their financial performance as being better than that of their peers. By contrast, for developed country companies that derived more than 5% of their revenue from emerging markets, the share reporting better performance than their peers was just under 40%.

METHODOLOGY

The study is descriptive in nature and therefore the information presented is based on secondary data. Secondary information has been collected from various documents such as books, newsletters, reports, magazines, journals, daily newspaper, WWW related to foreign direct Investment (FDI).

Objective

To study 20 years (1990-2010) FDI initiative in Indian context based on secondary data.

DISCUSSION

Global Scenario of FDI

Global flows of foreign direct investment (FDI) have halved in the last two years, Emerging markets have edged ahead of developed markets as the major destination. As higher-growth economies, emerging markets have proven better than developed markets at attracting FDI during the global downturn.

Structural shift in global FDI

The decline in global FDI flows in 2009 was accompanied by a distinct shift in the pattern of FDI. Economic theory tells us that capital should flow from capital-abundant rich countries to capital-scarce poor countries. In practice, that has not been the case as developed countries have consistently attracted the bulk of global FDI flows. High risk in many emerging markets, the benefits of advanced institutions and infrastructure and a superior overall business environment in developed countries have tended to outweigh the attractions of greater market dynamism and lower costs in emerging markets. The share of emerging markets in global FDI has tended to rise during recessions as slumps in M&A have hit the developed world disproportionately. Despite the steadily increasing share in recent years of emerging markets in cross-border M&A, this still remains mainly a developed country phenomenon. In 2008 some 80% of cross-border M&A sales were still in developed states. However, the influence of the M&A factor has been reinforced by other developments which pushed the share of emerging markets in global FDI inflows to a record level in 2009.

However, the relatively weak global recovery and continuing financial sector problems mean that the recovery in FDI will be gradual and we are unlikely to see a new surge in FDI any time soon. According to Economist Intelligence Unit forecasts, global FDI inflows in 2011 will still, in US$ terms, be slightly below the peak reached in 2007.

FDI inflows US$ billions				
	2008	**2009**	**2010**	**2011**
World total	**1,718.4**	**1,019.7**	**1,302.5**	**1,519.0**
% change	-17.4	-40.7	27.7	16.6
Developed countries	**894.3**	**488.1**	**619.9**	**734.8**
% change	-33.2	-45.4	27.0	18.5
Emerging markets	**824.1**	**531.6**	**682.6**	**784.2**
% change	11.0	-35.5	28.4	14.9
of which:				
Sub-Saharan Africa	46.4	28.6	36.6	39.0
% change	22.7	-38.3	27.9	6.6
Middle East & North Africa	98.7	62.6	77.0	87.3
% change	25.2	-36.6	23.0	13.4
Developing Asia	331.2	246.4	319.6	372.0
% change	8.2	-25.6	29.7	16.4
Latin America & Caribbean	144.3	88.2	114.0	127.6
% change	12.0	-38.9	29.2	12.0
Eastern Europe	180.6	95.9	122.7	143.1
% change	9.5	-46.9	27.9	16.7
% share developed countries	**52.0**	**47.9**	**47.6**	**48.4**
% share emerging markets	**48.0**	**52.1**	**52.4**	**51.6**
% of GDP				
World	2.9	1.8	2.1	2.4
Developed countries	2.2	1.3	1.6	1.8
Emerging markets	3.9	2.7	3.0	3.1
Source: Economist Intelligence Unit (Sep 2011)				

Indian Scenario of FDI

India's economy is mostly dependent on its large internal market with external trade accounting for just 20% of the country's GDP. Until the liberalization of 1991, India was largely and intentionally isolated from the world markets, to protect its economy and to achieve self-reliance. Foreign trade was subject to import tariffs, export taxes and quantitative restrictions, while foreign direct investment (FDI) was restricted by upper-limit equity participation, restrictions on technology transfer, export obligations and government approvals; these approvals were needed for nearly 60% of new FDI in the industrial sector. The restrictions

ensured that FDI averaged only around US$200 million annually between 1985 and 1991; a large percentage of the capital flows consisted of foreign aid, commercial borrowing and deposits of non-resident Indians. India's exports were stagnant for the first 15 years after independence, due to the predominance of tea, jute and cotton manufactures, demand for which was generally inelastic. Imports in the same period consisted predominantly of machinery, equipment and raw materials, due to nascent industrialization.

Since liberalization, the value of India's international trade has increased sharply. India's major trading partners are the European Union, China, the United States and the United Arab Emirates. The exports during April 2007 were $12.31 billion up by 16% and import were $17.68 billion with an increase of 18.06% over the previous year. In 2006-07, major export commodities included engineering goods, petroleum products, chemicals and pharmaceuticals, gems and jewellery, textiles and garments, agricultural products, iron ore and other minerals. Major import commodities included crude oil and related products, machinery, electronic goods, gold and silver. Its September 2010 exports were reported to have increased 23% year-on-year to US $18.02billion, while its imports were up 26.1% at $27.14billion. At US$13.06billion August's trade gap was the highest in 23 months but the economy is well on the road to cross $200 billion mark in exports for the financial year 2010-11.

India is a founding-member of General Agreement on Tariffs and Trade (GATT) since 1947 and its successor, the WTO. While participating actively in its general council meetings, India has been crucial in voicing the concerns of the developing world. For instance, India has continued its opposition to the inclusion of such matters as labour and environment issues and other *non-tariff barriers* into the WTO policies

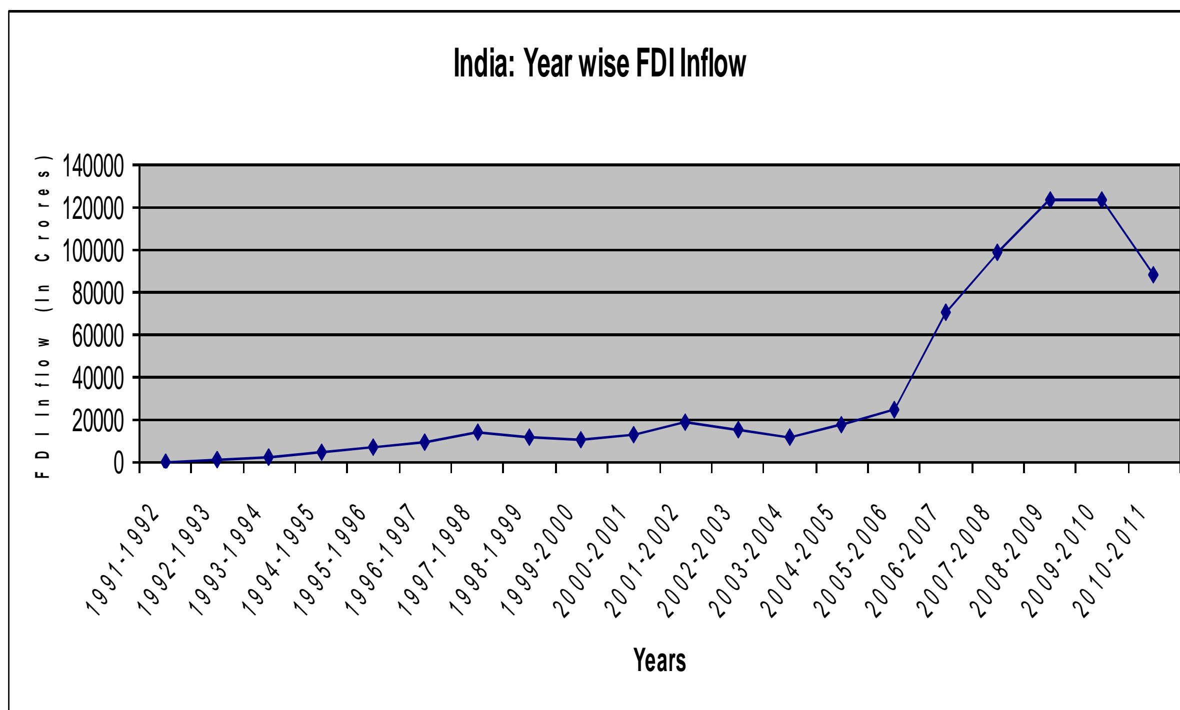
The following data and graphical presentation related to FDI being able to represent the status of FDI in India for the period of 1991-2011

Foreign direct investment in India

INDIA: FINANCIAL YEAR-WISE FDI EQUITY INFLOWS

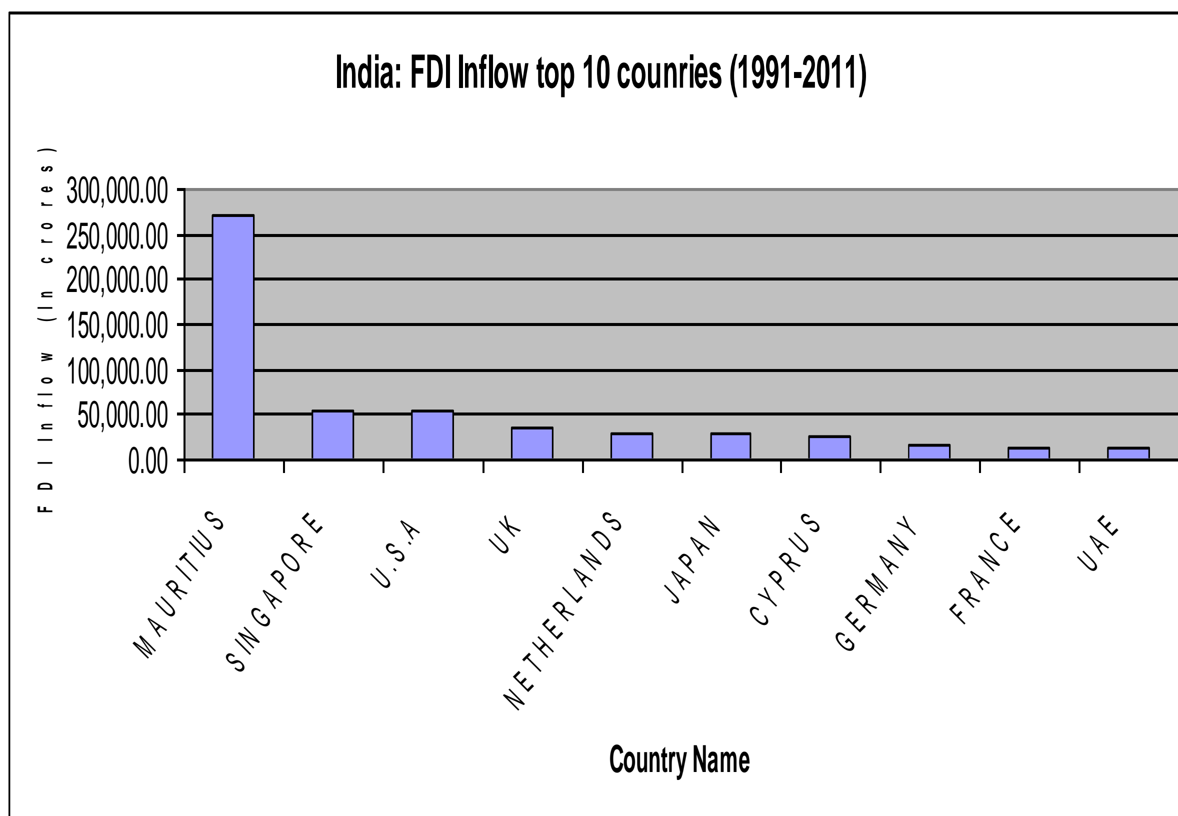
(Source: DIPP'S FDI data 1991-2011)

Years(1991-2011)	**1991-92**	**1992-93**	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**
FDI Inflow (in crores)	408	1094	2018	4312	6916	9654	13548	12343	10311	12646	19361	14932	12117	17138	24613	70630	98664	123025	123378	88520



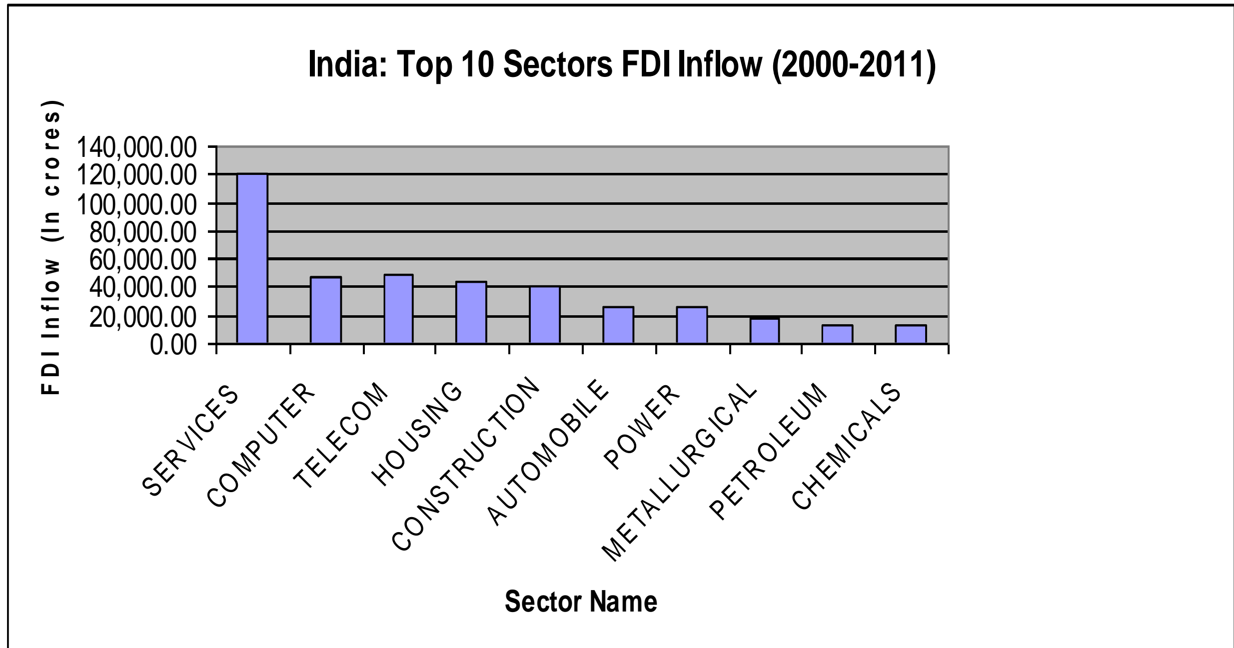
INDIA: SHARE OF TOP 10 INVESTING COUNTRIES FDI INFLOWS (Source: DIPP'S FDI Data 2005 & 2011)

Country's Name	MAURITIUS	SINGAPORE	U.S.A	UK	NETHERLANDS	JAPAN
FDI inflow (in crores)	270,206.72	54,873.29	54,790.24	33,695.68	29,482.89	29,056.92
Country's Name	CYPRUS	GERMANY	FRANCE	UAE		
FDI inflow (in crores)	25,572.96	16,831.18	12,214.31	13,888.33		



INDIA: TOP 10 SECTORS ATTRACTING HIGHEST FDI INFLOWS
(Source: DIPP'S FDI data 2000-2011)

Sectors	SERVICES	COMPUTER	TELECOM	HOUSING	CONSTRUCTION
FDI Inflow (In crores)	120,771.06	47,700.06	48,220.49	43,191.56	40,770.04
Sectors	AUTOMOBILE	POWER	METALLURGICAL	PETROLEUM	CHEMICALS
FDI Inflow (In crores)	26,830.59	26,712.28	18,494.54	13,734.87	13,077.58



Findings

it is find that the growth of FDI in India is not severely effected due to economic slowdown/recession. It is slightly affected, during the slowdown period of 2007-2009; generally there are boom in the FDI and initiated investment trust over India by other countries to conciliate the loss of his own country due to recession.

As the fourth-largest economy in the world in PPP terms, India is a preferred destination for foreign direct investments (FDI); India has strengths in telecommunication, information technology and other significant areas such as auto components, chemicals, apparels, pharmaceuticals, and jewellery. Till 2010-11, services sector attracted 54.93 per cent of India's total FDI as cumulative basis. Despite a surge in foreign investments, rigid FDI policies resulted in a significant hindrance. However, due to some positive economic reforms aimed at deregulating the economy and stimulating foreign investment, India has positioned itself as one of the front-runners of the rapidly growing Asia Pacific Region. India has a large pool of skilled managerial and technical expertise. The size of the middle-class population stands at 300 million and represents a growing consumer market.

During 2000-11, the country attracted $178 billion as FDI. The inordinately high investment from Mauritius is due to routing of international funds through the country given significant tax advantages; double taxation is avoided due to a tax treaty between India and Mauritius, and Mauritius is a capital gains tax haven, effectively creating a zero-taxation FDI channel.

India's recently liberalized FDI policy (2005) allows up to a 100% FDI stake in ventures. Industrial policy reforms have substantially reduced industrial licensing requirements, removed restrictions on expansion and facilitated easy access to foreign technology and foreign direct investment FDI. The upward moving growth curve of the real-estate sector owes some credit to a booming economy and liberalized FDI regime. In March 2005, the government amended the

rules to allow 100 per cent FDI in the construction sector, including built-up infrastructure and construction development projects comprising housing, commercial premises, hospitals, educational institutions, recreational facilities, and city- and regional-level infrastructure.

Conclusions:

The positive effects of inward FDI for workers in host economies suggest that FDI-friendly policies could be a useful component of an integrated policy framework for development. When designing policies to promote FDI, policy-makers should take into account that these may not only affect the volume of inward FDI, but also its composition and, as a result, its corresponding benefits. The OECD Policy Framework for Investment provides a useful starting point. For a start, removing specific regulatory obstacles to inward FDI could be important.

There are two types of implications i.e. positive and negative as per following:

Positive Implications

1. FDI provides capital which is usually missing in the target country-Long term capital is suitable for economic development.
2. Foreign investors are able to finance their investments projects better and often cheaper
3. Foreign corporations create new workplaces
4. FDI bring new technologies that are usually not available in the target country-There is empirical evidence that there are spill-over effects as the new technologies usually spread beyond the foreign corporations
5. Foreign corporations provide better access to foreign markets-Ex. Foreign corporations can provide useful contacts even for their domestic subcontractors
6. Foreign corporations bring new know-how and managerial skills into the target country-Again, there is a spill-over effects – as people leave the corporations they leave with the knowledge and know-how they accumulated

7. Foreign corporations can help to change the economic structure of the target country- With a good economic strategy governments can attract companies from promising and innovative sectors
8. "Crowding in" effect-The foreign corporations often bring additional investors into the target country (ex. their usual subcontractors)
9. Foreign corporations improve the business environment of the target country-Ethical business or rules of conduct
10. Foreign corporations bring new "clean" technologies that help to improve the environmental conditions
11. Foreign corporations usually help increase the level of wages in the target economy
12. Foreign corporations usually have a positive effects on the trade balance

Negative Implications

1. Foreign corporations may buy a local company in order to shut it down (and gain monopoly for example)
2. "Crowding out" effect- We can see this effect if the foreign corporations target the domestic market and domestic corporations are not able to compete with these corporations
3. Foreign corporations may cut working positions (privatization deals or M&A transactions)
4. Foreign corporations have a tendency to use their usual suppliers which can lead to increased imports (no problem if the production is export driven)
5. Repatriation of the profits can be stressful on the balance of payments

6. The high growth of wages in foreign corporations can influence a similar growth in the domestic corporations which are not able to cover this growth with the growth of productivity- The result is the decreasing competitiveness of domestic companies
7. Missing tax revenues- If the foreign corporations receive tax holidays or similar provisions
8. The emergence of a dual economy- The economy will contain a developed foreign sector and an underdeveloped domestic sector
9. Possible environmental damage
10. "Incentive tourism"

The United States welcomes foreign investment and seeks to accord foreign investors the same fair, equitable, and nondiscriminatory treatment given to American investors. U.S. investment policy is governed by the following principles.

<u>National Treatment:</u> Foreign investors from different countries should be granted equal treatment. (Becomes as **Most-Favored-Nation**)

<u>Protection of Investor Rights in Accord With International Legal Principles and Multilateral Conventions</u>: Any benefit of investment or agreement of an investor's financial, physical, and intellectual property rights should be done for a public purpose, in a nondiscriminatory fashion under due process of law without violating previous contractual arrangements, and accompanied by prompt, adequate, and effective compensation.

Multilaterally, the United States has worked actively to promote and implement these principles. For example, in 1976 and 1984, the United States sought and achieved two decisions by the **Organization for Economic Cooperation and Development (OECD)**, consisting of understandings among OECD members on national treatment, investment incentives and disincentives, guidelines for multinational enterprises, liberalization of capital flows, and the

right of establishment for foreign (including U.S.) investors. The U.S. Government now is pursuing an initiative in the current Uruguay Round of multilateral trade negotiations to reduce foreign government restrictions on investment in the form of trade-related investment measures and to ensure high international standards of protection for intellectual property, such as copyrights, trademarks, and patents.

A number of changes were approved on the FDI policy to remove the caps in most sectors. Fields which require relaxation in FDI restrictions include civil aviation, construction development, industrial parks, petroleum and natural gas, commodity exchanges, credit-information services and mining. But this still leaves an unfinished agenda of permitting greater foreign investment in politically sensitive areas such as insurance and retailing. The total FDI equity inflow into India in 2009-10 stood at ₹123,378 crore, a growth of 25% in rupee terms over the previous period.

India has also been suggested to participate in FDI initiative globally to promote and facilitate the policies related to FDI for capital gain and more attraction toward Indian economy, by which increase the efficiency and effectiveness in term of FDI.

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