CHAPTER II
REVIEW OF LITERATURE

An elaborate framework of the study is given in the Introduction Chapter. As the overall objective of the study is to analyse the Foreign Direct Investment (FDI) in India, a review of concepts, findings and conclusions of the past studies relating to FDI is necessary. This chapter is devoted for this purpose.

Role of FDI
Caves (1971) argued that foreign direct investment occurs mainly in industries characterized by certain market structures in both the lending/home and borrowing/host countries.

Oligopoly with product differentiation normally prevails where corporations make horizontal investments to produce abroad the same line of goods as they produce in the home market. Oligopoly, not necessarily differentiated, in the home market, is typical in industries, which undertake vertical direct investments to produce abroad a raw material or other input to their production process at home. Direct investment tends to involve market conduct that extends the recognition of mutual market dependence - the essence of oligopoly - beyond national boundaries. Likewise, it tends broadly to equalize the rate of return on (equity) capital throughout a given industry in all countries where production actually takes place. This common profit rate may well exceed a
normal or competitive one, however, since persistent oligopoly—national or worldwide—is market by barriers to entry of new firms and perforce, to the inflow of capital.

Direct investment thus does not necessarily tend to equalize rates of return in any country as between industries. With the character and allocative consequences of foreign direct investment identified with the industry, the author proceeded to a simple general equilibrium model that developed the consequences of high international investment coupled with low inter-industry mobility of capital (1).

Aizenman (1992) has analyzed the impact of different exchange rate regimes on domestic and foreign investment in the presence of a short-run Phillips Curve. The results of his study suggest that countries wishing to encourage FDI will benefit from a fixed exchange rate adopted in conjunction with policies that will improve the safety net for unemployment. In other words, these countries will reap the benefits of higher FDI and GNP, while protecting themselves partially against higher employment volatility. On the other hand, a flexible exchange rate stabilizes employment in the presence of real shocks at the cost of reduced expected GNP and investment. As far as monetary shocks are concerned, the study suggests that proper coordination of monetary policies will minimize the shocks and better benefits may occur indirectly by encouraging foreign investment (2).

Given the widespread interest in the Asian tigers with Malaysia itself experiencing sustained growth in real GDP of 8% over the last decade and an analysis of the role-
played by foreign capital in this region. The historical evidence on the role of foreign capital during the early days of modern manufacturing in colonial Malaya has been discussed.

The major empirical analysis relating to modern Malaysia is conducted at three different levels of aggregation. First industries are aggregated into foreign and locally dominated branches on the basis of asset ownership. Secondly, individual industries are studied. Thirdly, there is analysis at the level of the individual firms in the form of a case study of two leading foreign companies operating in Malaysia. The emphasis was made on the linkages with domestic firms via sourcing and sales and to the extent of technology transfer to domestic producers.

The conclusion is that the foreign capital played a positive role in promoting domestic industrialization, through pecuniary linkages, technology transfer and human capital development (3).

Satyanarayana (1995) discussed the role of FDI in achieving economic development in less developed countries. He discussed briefly, in addition, to its benefits and shortcomings. FDI in India and recent trends in FDI for LDCs were discussed in detail. Five suggestions were made to improve the general operating environment and attract more foreign investment. Infrastructure, training and human resource development, development of necessary support industries that provide basic machinery and parts, material inputs, components and testing services to foreign investors, fourthly, better
administration and bureaucracy and lastly by providing better information on investment opportunities in their economies (4).

Balasubramanyam and others commented on the hypothesis developed by Bhagwati [1978] that the volume and efficacy of incoming FDI will vary according to whether a country is following the export promoting [EP] or the import substituting [IS] strategy. According to the hypothesis, the growth enhancing effects of FDI are stronger in countries which pursue an EP policy than in those following an IS one (5).

The analysis undertaken by Walz revealed that in the presence of MNCs, policy-makers have to choose their instruments carefully. Policies leading to an inflow [outflow] of FDI speed up [slow down] the growth process, that is, anything from investment controls for MNCs to specific taxes on profit repatriation of MNCs hurts the international growth process and thereby also consumers in the country B. An important difference between a world with and without FDI becomes obvious. With MNCs, a policy promoting uniformly top quality producers in the low-wage country has a positive growth effect. Without MNCs, this policy leads to a decrease in the growth rate. But there is also a downside to this result. If policy makers cannot discriminate between innovators and imitators accurately, they might well end up supporting the imitators too, thereby reducing the growth rate (6).
This report surveyed the findings and conclusions of OECD work and related studies concerning the role of international investment in globalization and its links with trade and economic development.

International direct investment is increasingly recognized as an engine of economic growth and a powerful force for global integration. The OECD has long been active in analyzing the implications of such forces and in influencing the design of appropriate policies for a global economy. This report summarizes the findings of recent OECD work on the role of international investment in globalization and economic development (7).

At a time of continuing financial crises in Asia, the question of the appropriate policies for recovery and for future sustainable development is paramount. One area of particular importance is the treatment of foreign investors. Foreign direct investment has played a leading role in many of the economies of the region, particularly in export sectors, and has been a vital source of foreign capital during the crises. The four countries reviewed in this study-Indonesia, Malaysia, the Philippines and Thailand (referred to hereinafter as the ASEAN 4), have all to varying degrees welcomed inward investment for its contribution to exports. As a result, although only a small share of total investment or employment in each economy, FDI has been a key factor driving export-led growth in South East Asia.
This study draws on the experience of the ASEAN 4 countries to suggest that a more balanced treatment of foreign investors which allows foreign multi national enterprises to play a greater role in the domestic economy could yield substantial benefits in terms of restoring investor confidence and placing economic development in the ASEAN 4 on a more sustainable basis in the future (8).

Chandra (1999) examined the complexity of China’s FDI policy. Beginning with the size of inflows and their distribution by sector, host region and source country, the paper describes the changing policies and the new types of foreign firms emerging in the recent past. A critical look at official data suggested an exaggeration of the stock of inward FDI and an understatement of FDI outflows, which is often misconstrued as capital flight. The author further discussed the role of FDI in China’s economy in terms of macro economic nature, export structure and import of technology (9).

Bhukta (2000) highlighted the importance of foreign capital in the absence of adequate Gross Domestic Savings as on 1994-95, in order to achieve the desire GDP of 7%. In addition to explaining the forms of foreign capital, the author underlines the shift during the period 1985-1995 from governmental to non-governmental forms of foreign capital in India.

The significance of FDI has been stressed due to its nature that FDI brings along with it, superior technology, managerial skills and international marketing channels added to easing the foreign exchange constraints and filling the savings gap, unlike Portfolio
nvestment, which only supplements the domestic savings of the host country. While criticizing the New Economic Policy, which attracted more Portfolio investment (446625% increase) than FDI (776% increase) during the period 1991-95, author disagree to give any credit to NEP for whatsoever increase in FDI, as during this period, most of the countries also experienced this nominal growth that India has witnessed. The increased FDI in India was attributed to debt crisis, world recession and initiation of liberalization policy in the developing regions. A comparison was made between India and China in attracting FDI and the reasons (such as infrastructure facilities, more GDS, more GDP, higher per capita income, stability in the economic and political frontier, legal framework, etc) for China to attract more FDI in comparison to India was highlighted. Finally, the author concluded that the gloomy picture of FDI in this country is actually exaggerated and concluded that if India really wants to use foreign capital for the purpose of economic development, she should first announce a clear cut policy of FDI inflows (10).

Since the inception of economic reforms in 1978, China has experienced almost two decades of rapid growth of foreign direct investment. This growth was particularly impressive in the first half of 1990s. As a result, FDI as a share of total investment has increased rapidly during the past 15 years. The question that arises is how FDI had been utilized efficiently given the poor infrastructure and transition of economic system. This paper presents a preliminary analysis on this issue. It focuses on comparing FDI performance among the China regions. It attempts to investigate the performance of China's foreign direct investment as a factor input, i.e., how efficient FDI as one of the
factor inputs in an economy has been utilized. In the empirical analysis, an input-oriented distance function approach is employed to estimate the technical efficiency of FDI in China's coastal regions over the period 1983-1995.

It is found that FDI performance has gone through an inverted J-shape learning process in the past fifteen years. By 1995, all regions have shown relatively efficient use of foreign capital, i.e., less than 3% of over utilization of FDI. This trend of convergence might be determined by some common factors such as the development of infrastructure, growth of the non-state sector and economic reform. According to official statistical records, over the past decade all regions considered have shown consistent changes in per capita income, the role of the non-state sector and infrastructure development. Per capita FDI among the regions has also recorded the similar growth pattern (11).

To Morisset (2000), to improve the climate for FDI, an econometric analysis indicates that strong economic growth and aggressive trade liberalization can be used to fuel the interest of foreign investors. Similarly, a closer look at the experience of Mali and Mozambique-two countries that have shown a spectacular improvement in their business climate during the 1990s—reveals that the implementation of a few visible actions is essential to attract FDI. Beyond macroeconomic and political stability, those countries focused on a few strategic actions such as:...
Opening the economy through a trade liberalization reform

Launching an attractive privatization programme

Modernizing mining and investment codes

Adopting international agreements related to FDI

Developing a few priority projects that have a multiplier effects on other investment projects and

Mounting an image building effort with the participation of high political figures, including the president

Interestingly, these actions do not differ significantly from those that have been identified behind the success of other small countries with limited natural resources such as Ireland and Singapore about twenty years ago (12)

FDI Flows

Multinationals and international business houses may be interested in seeking a foothold in India but only on their terms and conditions in regard to the choice of sectors, the conditions of their operations and the rights they would like to enjoy. Inflow of foreign investment on a massive scale, which many in our country talk of, can come only on these terms. Based on this, Ghosh (1992) questioned, whether we are prepared politically for a complete turnabout in our policies (13)
Sharan in his study on trends, problems and prospects of Foreign investment in India found that balance of payments effect on the foreign investment has been negative. The Foreign Controlled rupee Companies [FCRCs] earned foreign exchange, but the payments in foreign exchange were larger than the earnings. Moreover, the export performance of FCRCs lagged behind their imports. All this led to a net outflow of foreign exchange straining the balance of payments positions. Thus when the Government has adopted an open economic policy and when foreign investment inflow has shown a definite upward trend, it is of prime significance that measures are taken to check any erosion of foreign exchange reserves on this account (14).

Foreign capital comes in two forms: direct foreign investment (DFI) and foreign portfolio investment (FPI). Sau (1994) presented a simple model to examine the conditions of stability with the inflows of foreign capital. He found that the equilibrium is most likely to be stable if the interest-elasticity of DFI is high and that of FPI is low. The model first characterized the short-run equilibrium of the economy and then scrutinized the stability conditions to see the roles of DFI and FPI therein in order to understand how instability can be caused by the inflow of foreign capital. The experience of India, however, indicates that the situation here is just the reverse that implies the possibility of instability (15).

Sen (1995) addressed the question whether FDI inflows improve the short-run balance of payments or do they require additional foreign exchange funding in the form of foreign borrowings or through depletion of foreign exchange reserves? The answer to
this question is crucial not only for formulating a policy structure for foreign investments but also in determining the position that developing country governments should take with regard to pressure for liberalizing controls on foreign equity (16).

Murugaiah pointed out that India is a country with 100 million strong middle class consumers. At the same time, more than 65% of the population stay in rural areas. Their occupation is agriculture and also to some extent they depend upon rural industry. They are capable of meeting the needs of consumer for consumer goods. But the advent of MNCs into this sector, made the people from all walks of life in the country feel uneasy. Hence, the Government should allow the inflow of FDI, where there is really dearth for capital, know-how, experience, entrepreneurship by making suitable policy decisions to this effect. In other words, the inflow of foreign investment should enable to provide a strong base for economic transformation. This would help the nation, emerge as a strong economic force at global level (17).

Analysing the data with regard to actual FDI flows entered into India, Iqbal remarked that trends and situations have not been encouraging in nature and are against the FDI approvals amounting to Rs 351.5 b, as the actual inflows since the beginning of reforms till the end of 1996, stood at Rs 84.4 b, i.e., an inflow rate of nearly 23.5%. This means that there have been doubts in the minds of the foreign investors with regard to implementation of India's economic liberalization regime. Fear and doubts are on the following counts: 1 Exit policy i.e., necessary changes are inevitable in India's labour laws, 2 Red tapism at the ministerial level, 3 Lack of work culture i.e., sense of

He suggested the following measures to set right the FDI flows in India: 1. FDI must go into infrastructure sector instead of stock market, and hence FDI flows must get preference over foreign institutional investment. 2. Another area where FDI flows must be encouraged is, hi-technology as the sector is unable to buy technology for its growth and development. 3. Special treatments like capital gains, in favour of MNCs have to be modified. 4. MNCs should be allowed to repatriate 40% of this profits earned in India. 5. Local firms should not be allowed to repatriate any volume of profits outside India so that capital does not get drained out. 6. Red tapism must be avoided and necessary monitoring cell should be created for quick clearance of the projects. 7. Administrative machinery at the state level must be geared up to create conducive business environment particularly in those states where potential and opportunities are tremendous with regard to absorption of FDI flows. 8. Procedural norms should be simplified as far as possible. 9. Effective coordination and monitoring by the RBI is a sine-qua-non and 10. Mindset should be changed.

Gangadhar and Yadagiri reported that there was an increasing trend both in amount of approvals as well as actual inflows. However, the inflows as a percentage of approvals
indicated a declining trend. This is a phenomenon of deceleration of inflows and which attracts the attention of policy makers and administrators for its control and reversal.

Commenting on the destination of FDI, they stated that in the entire period of liberalization, consumer goods sector has attracted more inflows of FDI. The service sector is the next followed by priority sector. The analyst felt that priority should be basic and capital goods and infrastructural development sector rather than consumer goods. Since the development of these sectors will automatically pave the way for development of all other sectors (19).

Based on an empirical analysis of the relation between foreign capital inflows and domestic savings, Mapalad found that foreign capital inflows do not have a significant direct impact, positive or negative, on domestic savings. This result holds good, regardless of whether foreign capital inflows are expressed as an aggregate measure or disaggregated in to direct investment portfolio investment, loans and aid and grants (20).

There are strong reasons to believe that transparency in economic policy-making and in the activities of government institutions is vital in attracting foreign investment. If so, one would expect that countries with more transparent trade and investment regimes will attract more FDI than those that are plagued by the perception of bureaucratic inefficiencies and the existence of corruption and other related problems.
Drabek and Payne evaluated the effects of transparent policy regimes on FDI inflows. In order to do so, they developed a simple econometric model, which they have tested with the help of standard statistical methods. The tests confirm our hypothesis that more transparent policy regimes indeed act as a strong incentive for foreign investors and vice versa.

Non-transparency is a term given in this paper to a set of government policies that increase the risk and uncertainty faced by economic actors and foreign investors. This increase in risk and uncertainty stems from the presence of bribery and corruption, unstable economic policies, weak and poorly enforced property rights, and inefficient government institutions. The empirical analysis shows that the degree of non-transparency is an important factor in a country's attractiveness to foreign investors. High levels of non-transparency can greatly retard the amount of foreign investment that a country might otherwise expect. The simulation exercise presented in the statistical part of this paper reveals that on an average a country could expect a 40 percent increase in FDI from a one point increase in their transparency ranking. Pari passu, non-transparent policies translate into lower levels of FDI and hence lower levels of welfare and efficiency in the host country's economy. A nation that takes steps to increase the degree of transparency in its policies and institutions could expect significant increases in the level of foreign investment into their country. This increased investment translates into more resources, which in turn increases social welfare and economic efficiency (21).
Rao and others (1999) provided a broad picture of the flow of FDI and indicate the possible factors at play in India. For a long time, India's approach towards foreign direct investment was governed by the multiple objectives of self-reliance, protection of national industry and entrepreneurs, import of select technologies and export promotion. As a part of the structural Adjustment Programme, along with virtually dismantling the industrial regulatory system, India sought to attract FDI with special favors and persuasion. While the new regime places heavy emphasis on attracting large amount of FDI, there is very little discussion on the various facets of actual implementation (22).

An important issue in the debate over the desirability of freer capital mobility for developing countries is whether capital flows have significant effects on economic growth. Proponents of capital account liberalization cite the growth-promoting attributes of capital inflows as a key benefit of financial integration for developing countries. Unfortunately, there is little empirical evidence to confirm or refute this claim, except for several studies that establish a positive link between inflows of foreign direct investment (FDI) and economic growth. This paper helps to fill the gap in the literature by investigating the role of private capital flows in the determination of economic growth using panel data for 40 developing countries from 1975-95. Unlike existing empirical work, this paper focuses on the effects of a broad measure of capital flows on economic growth, rather than on a more specific category, such as FDI, and it emphasizes the role played by the domestic financial sector and in the process linking capital flows and growth. This study finds evidence that capital inflows foster higher economic growth, above and beyond any effects on the investment rate, but only for economies where the
banking sector has reached a certain level of development. The results thus suggest that the domestic financial sector plays a pivotal role in ensuring that international capital flows do indeed promote economic growth in developing countries (23).

Eichengreen (2000) discussed how to cope with high capital mobility and how to proceed with capital market liberalization. The author suggests the opening of inward foreign investment early in the process of liberalizing the capital account. As of 1996, 144 of 184 countries surveyed by the IMF had not eased controls on FDI. The author argues that one of the factors contributing to the Korean crisis was the fact that the government had been reluctant to allow inward FDI but that under foreign pressure opened other components of the capital account. In the case of Thailand, even though the lifting of restrictions on inward FDI did not help prevent the crisis, the problem was that the capital account was also opened to portfolio flows without the presence of a strong financial system (24).

Ambatkar concluded that opening the trade sector is crucial for attracting higher doses of FDI from ASIAN. The reason is that foreign owned companies aiming for global competitiveness and international markets mostly go for huge investments outside local boundaries. FDI is now increasingly connected with trading opportunities than local market exploitation. Of course, the presence of state-of-the-art infrastructure is equally important to attract sizeable amount of FDI. According to the author, India needs to expedite the process of improving the overall status of infrastructure for attracting foreign investments (25).
Commenting on the changing patterns of FDI, Nagesh Kumar, concluded that though the magnitudes of inflows have recorded impressive growth, they are still at a small level compared to the country's potential. The policy reforms have enabled the country to widen the sectoral as well as the source country composition of FDI inflows. Bulk of new inflows have come in the energy and services sectors. The relative importance of European countries as source of FDI in India has consistently declined, that of the US and some emerging sources in East Asia has increased steadily. The policy liberalization has not yet helped India improve her share in FDI outflows from major European countries or the US. However, it may have helped to avert a decline in India's share. India seems to have improved her share in Japanese outflows. Liberalization of policies alone may not be enough to win the race. More active negotiations and bargaining with MNEs may often be required. India should use her bargaining advantages such as large domestic markets, abundant supply of trained and low wage labour, vast pool of technical professionals, well developed capital market, etc., more effectively to attract a greater proportion of efficiency-seeking FDI (26).

A Research paper pointed out that the sectoral pattern of FDI inflows is changing during the post-reform period. In pre-reform period, electrical equipments, engineering, industrial machinery, telecommunications, chemicals, etc., were the main areas of foreign investment. But in the post-reform period FDI flows in non-traditional sectors also eg., fuel, power, hotels, tourism, services, trading companies, food processing, etc.,
The paper listed the favourable factors and hurdles to the flow of FDI in India. The favourable factors for foreign investment in India included functioning democracy, well established legal system, potential market, ample natural resources, availability of technical man power, wide acceptance of English as business language and moreover favourable government policy towards FDI. Despite all these favourable factors, India lagged behind in attracting FDI in comparison with East Asian countries particularly China. The factors discouraging FDI inflow in India include bureaucratic decisions, lack of transparency in expediting the foreign investment approvals, corruption, valueless politics, inefficient and indisciplined financial sector, old and outdated labour laws, etc.

Reviewing the investment policies over the last 50 years and discuss the trends in FDI in Pakistan, it was reported that despite liberalizing the inward FDI regime, tempering or removal of obstacles to foreign investors, and according liberal incentives, Pakistan has been lacking behind in attracting FDI. This paper attempts to find out the reasons why Pakistan has not been able to attract sufficiently large FDI in spite of liberalization measures.

The analysis identified a number of factors responsible for low FDI in Pakistan. These include the lack of political stability particularly during the last 8 years and unsatisfactory law and order situation particularly in the city of Karachi, the largest industrial and commercial center and the only port of the country. The macroeconomic imbalances and the slowing down of economic activity together with inconsistent economic policies
have also discouraged foreign investors to increase their participation in Pakistan. The slow bureaucratic process, inappropriate business environment and inadequate infrastructure facilities have played their role in discouraging foreign investors to undertake investment initiative in Pakistan. The lack of trained, educated and disciplined labor force, along with complicated and overprotective labor laws, has inhibited business expansion and frightened away productive investment. The cultural and social taboos as well as the quality of life are not conducive to attracting foreign investors to Pakistan. The lack of welcome to foreign investors by government agencies and officials has also been a problem (28).

**IMPACT OF FDI**

The study by Steuer (1973) represented an important contribution to understanding the consequence of inward direct investment for an economy, in this case, the UK. The research started with an aim to investigate the implications of foreign direct investment in the UK for the balance of payments, for the state of technology and for development regions, concentrating on manufacturing industry and leaving aside oil and services. Later, the scope was extended to investigating the operations of multinational firms, including questions of monopoly and concentration, industrial relations, foreign control of subsidiaries and national sovereignty. In the light of the findings, the researchers considered policy options and compared them with the existing UK regulations on inward investment.
The research concluded that the fundamental effect of inward direct investment is on national output and incomes, and it is through these macro-economic changes that the balance of payments is affected. It is the government’s role to maintain internal and external equilibrium through macro-economic policies. To illustrate the macro-economic, micro-economic and potential balance of payments effects of a given foreign direct investment inflow, the author constructed a theoretical model, but one which has operational capabilities, as a simulation exercise shows. On technology, due to complex relationship between FDI and associated technology, the author recommends that each case should be considered on its merits and not subject to general rules. The study found that FDI is concentrated in outlying regions of the UK. This is attributed partly to official policies on local and regional incentives, and partly to economic considerations, such as the supply of labor and low cost land. This distribution has brought benefits to the outlying regions in the form of higher employment as well as raising productivity by increasing the capital employed per worker. It was found that the impact of FDI varies between regions and according to the character of the foreign firm. On the basis of case studies, it is concluded that little disturbance of social patterns seemed likely from foreign investment. The report concluded that concern over the multinational firm and inward investment on the grounds of monopoly power, technology and balance of payments effect were not well found and the research team declared itself to be more favorably disposed to inward direct investment than when it began its work (29).

Kumar (1985) in his work with respect to the Indian experience on cost of technology imports, argues that it will have its short and long run implications for the economic development of the borrowing country. This study covers the direct and indirect costs of
the import of technology on the economy through its implications on the balance of payments, technological environment, industry structure and equity, etc (30)

Most of the issues discussed in the studies by Brash, Safaran, Dean, Stonehill, Stubenisky and John H Dunning (1989) on the impact of outward US direct investment on host economies in the 50s and 60s the authors dismiss most of the popular charges against the welfare effects of inward investment. The authors concluded that in future, more cooperative and harmonized action among the leading home and host countries towards foreign direct investment policy may be required if the current liberal climate towards the globalization of production and markets is to be maintained (31)

Wilkins (1989) discussed a broader theme of the part played by the long-term investment as whole - portfolio and direct - in the country's economic development in 1914. She surveyed American reactions to this activity, the effects on investing countries and the costs and benefits to the US economy. In the crucial 1875-1914 period, it was found that the US grew twice as fast as Britain but at the cost of becoming the world's largest debtor country. No attempt was made to break-up between the portfolio and direct categories of inward investment. Overall, the book provides a thorough case study of how overseas resources helped an important economy to take off and prosper. It will therefore permit comparisons to be made with, say, the contribution of France to the evolution of Germany in 1871 and of Britain to the economic development of Eastern Europe (32)
Based on the results of a field study, conducted in 1987 of Hong Kong firms in the Pearl River delta of Southern China, Thoburn and others (1990) visited some 60 companies and obtained data about their ownership structures, employment, motivation, and locational choice, also their experience with different kinds of contracts and Chinese partners. Providing a useful summary of the impact of the economic reforms, prior to the political problems in 1989, on inward direct investment (33).

The effects of the multinationals activities or direct foreign investment on industrial structures in either the host or home economies were analyzed by Ramstetter and others (1991). Part one sets the issue and a common analytical framework. Part two takes up the cases of two ASEAN countries, Indonesia and Thailand. Part three deals with two newly industrializing countries, namely, Korea and Taiwan. Part four focuses on the two major investing countries, Japan and US. Part five provides perspective views on the role of DFI in the region.

The six country studies are concerned to gauge the degree of impact of DFI on the change in their respective economic structures in terms of such factors as growth rates and composition of GDP, fixed capital formation, generation of employment opportunities, trade structure, consumption patterns, and transfer of technology. However, the analytical methodologies adopted in each chapter vary due to the characteristics as well as the diversity of data availability in the countries concerned (34).
Tayyeb and Azhar (1992) specified and estimated a two-equation simultaneous model of rate of real economic growth and saving ratio using annual time series data on Pakistan for 1959-60 to 1987-88. They explored the answers to two propositions: 1) Net foreign private investment promotes economic growth as measured by annual rate of growth of real GNP and 2) Foreign private investment displaces savings of a country as measured by its national saving to GNP ratio.

They found that both net foreign private investment and disbursements of grants and external loans have a positive impact on the rate of growth of real GNP in Pakistan. In the saving equation, the coefficient estimates for both foreign private investments and disbursements of grants and external loans are negative lending support to the displacement hypothesis, i.e., foreign financial inflows may discourage domestic public and or private saving behavior and resource mobilization efforts. By specifying a simultaneous model of growth of real GNP and Savings, the authors were able to control for a possible simultaneity bias, which many of the earlier single equation studies of growth or savings were susceptible to.

Since the authors found that the saving is positively affected by marginal changes in real interest rate, they suggested that an optimal policy may be there to encourage foreign investment for its favorable impact on growth. At the same time, rationalize the domestic credit structure and interest rate policy to mitigate foreign private investment's negative impact on saving and resource mobilization effort.
Eduardo, Gregorlo and Lee tested the effect of foreign direct investment (FDI) on economic growth in a cross-country regression framework, utilizing data on FDI flows from industrial countries to 69 developing countries over the last two decades. They suggested that FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investment. However, the higher productivity of FDI holds only when the host country has a minimum threshold stock of human capital. In addition, FDI has the effect of increasing total investment in the economy more than one for one, which suggests the predominance of complementarity's effects with domestic firms (36).

Sjölin and Maxwell (1995) conducted a thorough assessment of FDI's impact under diverse macroeconomic conditions. The first part of the research examined FDI flows to 46 developing countries to test whether the flows are autonomous or accommodating relative to both the current account and other capital flows. Using Granger-causality test, the research found that requirements to surrender export proceeds and the special exchange rates for some capital account transactions reduce the probability that FDI is independent. The more liberal a country's foreign exchange system, the more likely that FDI is independent or exogenous. The research also found that FDI is associated with a larger increase in capital formation when it is independent than when it is Granger-caused by other capital flows.

The second part of the research compared the effects of FDI inflows to a group of 6 East Asian Economies and a control group of 11 other developing economies. It
estimated the contemporaneous and lagged effects of FDI in East Asia on capital formation, national saving, imports, exports, and economic growth in a five equation macroeconomic model. Dynamic simulations indicated that even though FDI increases domestic investment, the positive direct and indirect (through accelerated growth) effects of FDI on national saving actually lead to improvement in the current account in the long run. An increase in FDI from zero to 10% of GNP worsens the current account from –0.6% to –6.4% of GNP in the short run, but improves the current account by 7.6% of GNP in the long run.

This analysis found that both the nature and the effects of FDI flows vary significantly between different regions of the developing world. Outside East Asia, FDI has not increased aggregate domestic investment or economic growth. When the countries in the control group attracted more FDI inflows, national saving, domestic investment, and the rate of economic growth all declined. Financial sector and foreign exchange distortions were pinpointed as the key variables accounting for the differential impacts of FDI in the two country groups.

Thus the research showed that FDI is not always associated with increased domestic investment. The explanation for the disparate effects lies in the different macroeconomic environments in the two groups of countries. Greater trade and financial distortions reduce the efficiency of all forms of investment, including FDI. Indeed, at some point such distortions turn the positive effects of FDI on investment and economic growth into negative effect (37).
Pfeffermann and others (1995) focused on the effects of FDI on capital flight. First question of this study examined was whether FDI inflows similarly facilitate capital flight from developing countries? The second question the study examined is which of these two factors (First, over all investment climate and second, Favourable treatment of non resident investment in the form of differential taxation, investment or exchange rate guarantees, priority over resident claims in the event of a financial crisis, etc) is the dominant cause of capital flight as well as FDI inflows.

The study relied mainly on data from the World Bank and the International Monetary Fund. It used recent World Bank estimates for seven different capital flight measures for developing countries in six regions and for all developing countries. And it computed FDI data confirming to the World Bank’s country groupings from the IMF’s balance of payments statistics. The estimation method was contemporaneous correlation and principal component analysis.

The study found, first, that FDI inflows are always associated with a reduction in capital flight. Second, a capital flight is caused primarily by general economic mismanagement rather than by favorable treatment of foreign capital and third, a broader measure of capital flight is more appropriate than a narrower one (38).

Kobrin (1997) contributed a methodology on testing the impact of foreign direct investment on the developing countries. It statistically tests the interrelationship
between foreign direct investment, industrialization and social change in the developing countries. The analysis is at first conducted at macro level for a cross section of 51 developing countries. This is then complemented with comparative micro level case studies on Mexico and Venezuela. The author used factor analysis to reduce a long list of variables identifying social change to three principal factors: the role differentiation, mobility and social organization. This paves the way for a statistical verification of the interrelationship between foreign direct investments, industrialization, and social change using cross-sectional correlation and regression techniques. The results of the exercise show that there is a strong relationship between industrialization and social change and that foreign direct investment intensifies this relationship, although in itself it has no effects on either industrialization or social modernization.

"Could the effect of foreign direct investment on social change be stronger in the case of manufacturing investment than in the case of extractive investment?" the micro case studies, which attempt to analyse this issue, show that Mexico ranks much below Venezuela on the indicators of social modernization that the author employs. This despite the fact the Mexico ranks above Venezuela on the industrialization scale. Moreover, much of foreign direct investment in Mexico is in the manufacturing sector whereas it is concentrated in the extractive sector in Venezuela. Author ascribes this finding to the very dissimilar paths of industrialization the two countries followed, indigenous orientation in the case of Mexico and exogenously based orientation in the case of Venezuela. The author finally argued that one should suspend judgement on
the issue of the impact of manufacturing foreign direct investment on social change until adequate data is available to mount a statistical test (39)

Overview of recent literature dealing with the relationship between foreign direct investment and the environment was studied. Four key aspects of the FDI-environment relationships have dominated much of the research efforts to date. They are Environmental effects of Private International Finance, Environmental effects of FDI-based technology Development and Diffusion, Impact of Environmental Standards on Investment Decisions by the Firm and Environmental Effects of International competition for FDI.

It is concluded that FDI is an increasingly important engine for sustainable development in many countries. However, the potential environmental consequences for the other two elements of privately supported capital flows (portfolio investment and debt) as well as ODA, also need to be considered when examining these consequences.

Empirical evidence concerning the sign and the significance of the technology effects of increased FDI is rather limited. However, it is possible that the environmental performance of firms in many countries will be positively influenced by better access to foreign technologies associated with FDI as well as by the increased exposure to foreign demand patterns that increased FDI implies (40).
Studying the effect of volatility of FDI flows on growth into account. Using a variety of econometric techniques, Lensink and Morrissey concluded that FDI has a positive effect on growth whereas volatility of FDI has a negative impact. There is a suggestion that it is not the volatility of FDI per se that retards growth but that such volatility captures the growth-retarding effects of unobserved variables. The relationship between FDI and growth, and the volatility of FDI, may be related to the sector concentration. For example, FDI in resource extraction, and its impact on growth, may be less sensitive to economic uncertainty than investment in manufacturing or production of primary commodities. Unfortunately, we do not have data that disaggregates FDI by sector (41).

Whether foreign direct investment is assuming a dimension which can threaten Indian industry was examined by Ganesh (1997). Data on FDI approvals in the post liberalization period have been compared with data on capital formation by local industry during the same period. From an analysis of the current level of dominance by foreign firms, the likely impact of fresh FDI has been analyzed and assessed at the sectoral level. The findings are likely to have relevance at least over the next five years.

The thrust is on whether there is a basis for the fear that foreign firms will gradually wipe out indigenous industry, some other issues related to FDI is also examined. These include trends in technical collaboration approvals compared with FDI, sectoral levels of exports and trade balance and dividend outgo compared with know-how and royalty payments (42).
Borensztein and Lee reported that results of their study suggest that the beneficial effects on growth of FDI come through higher efficiency rather than simply from higher capital accumulation. This leads to the possibility of testing the effect of FDI on the rate of total factor productivity growth in recipient countries. It might be interesting to explore the effects of FDI on the level of human capital (43).

Rana and others (1988) developed a simultaneous equation system to examine the effect of foreign capital on growth of a sample of nine (Burma, China, India, Korea, Nepal, Philippines, Singapore, Sri Lanka, and Thailand) Asian developing countries. This is because integrating the growth rate and the saving rate in a single model yields results, which are richer than those reported for single equation models. Despite the limitations of data, the two-equation model performed rather well. Mean square errors of the equations were low and most of the coefficients had the correct signs and were statistically significant.

The major finding was that foreign capital flows have made a positive contribution to the growth of Asian developing countries. While foreign direct investment has contributed to growth both by augmenting resources available for capital formation and by improving investment efficiency, foreign aid has contributed only by aiding in capital formation. The evidence implies that it has tended to reduce investment efficiency. This finding suggests that aid may have been used to finance projects, which were unnecessarily capital intensive. It may have also introduced inappropriate technology. The other major finding was that export performance, growth of the labour force and domestic
saving rate have also contributed favorably to growth. In relative terms, foreign private investment and export performance have contributed more than aid. The analysis showed that based on relative productivity, Asian developing countries should attempt to attract foreign private investment, improve their export performance and rely relatively less on aid (44).

Sun (1998) investigated the macroeconomic impact of FDI flows into China during the period 1979-96. FDI has significantly promoted economic growth in China by contributing to domestic capital formation, increasing exports, and creating new employment. In addition, FDI flows to China have tended to improve the productive efficiency of resource allocation of the Chinese domestic sectors by transferring technology, promoting exports, and facilitating inter-regional and inter-sectoral flows of labor and capital. However, FDI flows to China have had also some negative side effects by (a) worsening of environmental pollution, (b) exacerbating inter-regional economic disparities as a result of the uneven distribution of FDI, (c) transfer pricing, and (d) encouraging round-tripping of the capital of Chinese domestic firms (whereby firms sent money out of China in order to bring it back in as FDI and take advantage of the various fiscal and other incentives offered by the government) (45).

The results of the study undertaken by Borensztein and Lee suggested that FDI is in fact an important vehicle for the transfer of technology, contributing to growth in larger measure than domestic investments. There is a complementary effect between FDI and human capital, that is, the contribution of FDI to economic growth is enhanced by
its interaction with the level of human capital in the host country. However, the results imply that FDI is more productive than domestic investment only when the host country has a minimum threshold stock of human capital.

The study also investigated the effect of FDI on domestic investment. In principle, this effect could have either sign by competing in the product and financial market. MNCs may displace domestic firms, conversely, FDI may support the expansion of domestic firms by complementarity in production or by increasing productivity through the spillover of advanced technology (46).

The study tests the hypothesis of increasing returns due to FDI for the five Latin American economies (Brazil, Mexico, Venezuela, Chile, and Colombia) that absorbed most of the FDI in the region in the period 1970-91. The finding suggests that both directions of causality depend on the recipient economy’s trade regime, ranging from import substitution to export promotion. Both open-economy performance variables (e.g., terms of trade, foreign debt, and so on) and domestic policy variables are shown to affect FDI and growth in the long run (47).

With the objective of making an overall assessment of the contribution of foreign direct investment (FDI) to the economic transformation of the three Baltic states since their independence in 1991-1992, the OECD conference concluded that foreign direct investment has played a determining role in the economic progress of the Baltic States towards market-based economies and their integration into the global economy.
Liberalization of trade and investment together with sound macro-economic policy were the best investment incentives that could have been provided to foreign investors. In the future, openness to FDI as well as efforts to remove regulatory and administrative barriers and constraints, should continue to be pursued to achieve a de facto as well as a de jure hospitable business environment (48).

DETERMINANTS OF FDI

Tsai (1991) while assessing the demand and supply side determinants for Taiwan, has pointed out the difficulty of using regression techniques for time-series data for a single country. Using a simultaneous equation model to incorporate the demand and supply side determinants resulted in differences in the level of aggregation and led to difficulties in reconciling demand and supply side variables. In an alternative approach, he incorporated three dummy variables to represent the policy changes in Taiwan and tested whether demand side determinants in Taiwan are more attractive than in other countries. Using the logarithm of variables, the results estimate by ordinary least squares, showed that FDI in Taiwan is probably supply side determined (49).

Agarwal and others (1991) undertaken an empirical analysis of the determinant of FDI in LDCs using data on German FDI with the objective identifying policy changes and modifications likely to introduce an increased level of FDI inflows into LDCs. It was argued that the financial issues, such as sovereign risk, on FDI flows need to be considered in the context of the debt crisis. Some conclusions are also drawn with
respect to the impact of the Single European Market and Eastern Europe on the flow of FDI to the LDCs

The study compared and contrasted the determinants and patterns of German FDI with the investment behavior of other major FDI source countries, particularly the US, UK and Japan. The empirical analysis is based upon extensive financial data on sectoral linkages reported to the Deutsche Bundesbank and the Bundesministerium für Wirtschaft (Ministry of Economic Affairs) together with comparative data from the UNCTC and IMF. The author distinguished explicitly between the aggregate response of FDI to macro economic factors and micro economic explanations of the behavior of multinational enterprises. Such a methodological distinction therefore recognizes that stocks and flows of FDI are the aggregate outcome of heterogeneous firm level activity.

Understanding the determinants of FDI is important for analyzing capital flows and the industrial organization of multinational firms. Most empirical studies of FDI, however, have focused on case studies of non tax factors in overseas investment decisions or on discerning reduced-form relationships between some measure of FDI and variables relating to non tax and aspects of the investment decision. In this paper, the authors examine the effects of taxation on FDI using previously unexplored (for this purpose) panel data on FDI by subsidiaries of US multinational firms collected by Compustat's geographic segment file project. These firm-level data contain information on new capital investment overseas, which enable us to measure tax influences on FDI more
precisely and allow us to focus on structural models of subsidiaries' investment decisions. Our empirical results cast significant doubt on the simplest notion that "taxes don't matter" for US firms' FDI decisions. Tax parameters influence FDI in precisely the ways indicated by neoclassical models. The results also lend support to the application of the "tax capitalization" model to the study of dividend repatriation and foreign direct investment decision (51).

Abul Shamsuddin (1994) studied empirically the determinants of FDI using cross-section data for 36 developing countries. In particular, the study is directed to address the questions as to why do some less developed countries appear to be more successful in attracting private FDI than other LDCs? In other words, the study attempts to examine the economic determinants of private foreign direct investment by using a single-equation econometric model for 36 LDCs for the year 1983. The market size of host country as measured by per capita GDP is found to be the most important factor in attracting FDI. The other important variables, which influence FDI, are found to be the cost factor (such as wage cost) and the investment climate in the host country (represented by such variables as per capita debt). The inflow of per capita public aid and economic stability, proxy by the volatility of prices, are other important factors affecting the flow of FDI. While larger market size and increased inflow of public aid attract FDI, the higher wage cost, poor investment climate and economic instability in the host countries reduce the inflow of FDI. The model used to obtain these results is found to be structurally stable across countries (52).
Using 20 years of international data, Ferns and others established the importance of a number of determinants of foreign direct investment. They find that GDP, imports, exports, infrastructure and political risk are significant influences on the decision of multinational corporations to invest abroad. The results from this analysis will allow a better understanding of foreign investment in a transitional economy such as Guyana.

Imports  Founded on Mundell's 1957 work, FDI should, ultimately, flow into those countries that are importing goods from abroad. The concept of import substitution has long been a theory used to explain international capital flows. Helmberger and Schmitz [1970] as well as Dunning and Normal [1983] contended that FDI credits vertically integrated production units and therefore, increases the amount of trade. Hymer [1970, 1972], Kindleberger [1970], Vernon [1966] and Caves [1971] argued that, given the oligopolistic structure of markets and international integration, imports and the level of FDI are complementary. There is a positive relationship.

Exports  As the level of nation's export increases, it has the effect of altering local labour market and driving domestic wages towards world levels. This, in turn, makes FDI less profitable as the advantage of lower wages evaporates. Based on these observations, one might hypothesize a negative relationship between exports and FDI.

There is, however, an alternative possibility. Some countries may have higher exports because of some unique access to foreign markets. If a low wage country has access to a trading group, one might expect that country to draw significant level of FDI as
countries outside the trading group attempt to sell within the countries of the group, thus having positive relationship

Infrastructure Vernor [1966] has suggested that, for production to move abroad, the host nation must provide adequate infrastructure. However, a less developed nation is likely to mean lower wages and, hence, greater profit potential. Hence, there is a positive relationship between FDI and the level of development of the country's infrastructure.

Gross domestic product It captures the productive capacity of an economy. It reflects both the size of the domestic market and the purchasing power of the citizens. A positive relationship between this variable and FDI would be consistent with Kindleberger who argues that foreign investment requires a sufficiently large host country market to accommodate the increase in local supply. Bajo-Rubio and Sosvilla-Rivero [1994] find a positive long run relationship between GDP and FDI.

Population Population is a measure of the potential market size of the host country. A smaller population will reduce projected profit from foreign investment as potentially low wages should be more rapidly driven to world levels. The model to be specified might enter this variable as a direct measure of population, in which case, we would expect a positive relationship between population and FDI. Culem [1988] reports a positive impact of population on foreign investment within developed countries.
Political risk: Larimo [1995], finds evidence supporting a behavioural model of the multinational corporation. The hypothesis is for a negative relationship between political risk and FDI, suggesting an inverse relationship between political risk and the level of FDI.

The findings of this study indicated that a country’s participation in international trade has a positive influence on its capital inflows. Greater levels of imports and export potential enhance a nation’s attractiveness for FDI. The degree of infrastructure development has an overwhelming impact on the process of foreign investment. The existence of adequate distribution and communication network encourages capital investment by multinational corporations (53).

The data from a recent ESCAP (1995), UN publication are instructive in regard to the sources of DFI, sectors attracting DFI and the factors determining DFI flows. By examining the available evidence that the government of India and the state government have a long way to go in regard to raising the level of DFI inflows and fine tuning the sectoral composition, it insisted the need to put in place a set of appropriate policies (54).

Graham (1995) surveyed the theoretical and empirical literature on the determinants of FDI and the economic consequences of FDI for both host (recipient) and home (investor) countries. He concluded, inter alia, that FDI could have both positive and negative economic effects on host countries. Positive effects come about largely...
through the transfer of technology and other intangible assets, leading to productivity increases and improvements in the efficiency of resource allocation. Negative effects can arise from the market power of large foreign firms (Multinational Corporations) and their associated ability to generate very high profits or from domestic political interference by multinational corporations. Empirical research, however, suggests that the evidence of negative effects from FDI is inconclusive, while the evidence of positive effects is overwhelming (55).

Aitken and others (1996) investigated the relationship between wages and FDI in Mexico, Venezuela and the US. Higher levels of FDI are associated with higher wages. However, in Mexico and Venezuela FDI is associated with higher wages only for affiliates, suggesting an absence of wage spillovers (56).

Nishat and Aqueel identified various demand-side determinants of direct foreign investment in Pakistan during 1961 – 1994. The model selected by them, with nine macro-level determinants, has 94 per cent explanatory power. The variables are: total direct foreign investment, GDP, general index of share prices, coal production, proxy for mineral resources, value added in wholesale and retail trade, value added in transport and communications, employment in mining and manufacturing, number of industrial disputes, ratio of exports to GDP, number of telephone lines, length of roads in kms, primary education enrolment (57).
Anwar concluded that economic liberalization has emerged as a fruitful policy track being pursued by so many developing countries as it attracts invaluable foreign capital and technology in the form of FDI. There are several determinants of FDI in the context of low income emerging economies. They quite often work as a set of variables, sometimes with almost equal weights and at times with varying emphasis. The policymaker cannot afford to focus on just few variables and neglect some others. The competitive dimension of an emerging economy cannot be divorced from range of the determinants of FDI (58).

The existence of spillover efficiency benefits to host country economies from inward foreign direct investment (FDI) are well documented in the literature, particularly for economically developed host economies. The determinants of the size and scope of the spillover benefits have also been studied, but they are not as clearly and consistently documented as the existence and magnitude of the relevant externalities. Yet, a good understanding of the determinants of the nature and magnitude of FDI efficiency spillovers is of crucial importance to policymakers. To review and synthesize the available literature focusing on the determinants of efficiency spillovers from inward FDI, a theoretical framework for understanding the underlying "supply" and "demand" forces determining the scope and magnitude of FDI spillovers to host economies was developed. The findings suggests that the competitiveness of host country markets, proxied e.g. by the openness to imports, and the technical capability of local firms are among the most important determinants of spillover benefits. Both of these characteristics can be influenced by host country policy. However, it is difficult to
provide unequivocal policy advice on the basis of these findings, since some of the policies that maximize the potential spillovers from a given "pool" of appropriable technology (such as technology transfer requirements or active competition policies) may actually reduce the attractiveness of the host country to some foreign investors (59).

Mallampally and Sauvant argued that FDI policy frameworks are only one determinant of the location of investment among host countries. Countries must also pay attention to other factors that influence investors' locational decisions. Equally important, with FDI policy frameworks becoming more similar, countries interested in encouraging investment inflows are focusing on measures that facilitate business. These include investment promotion, investment incentives, after-investment services, improvements in amenities, and measures that reduce the 'hassle' costs of doing business. While by no means new, these measures have proliferated and are becoming more sophisticated, targeting individual investors and investments in particular industries.

The most important determinants for the location of FDI are economic considerations, which came into full play once an enabling FDI policy framework is in place. They may be divided into three groups: those related to the availability of location-bound resources or assets; those related to the size of markets for goods and services, and those related to cost advantages in production. Although many of the factors that attract investment to particular locations—such as abundant natural resources, large host country markets; or low-cost, flexible labour—remain important, their relative importance is
changing as transnational corporations, within the context of a globalization and liberalizing world economy, increasingly pursue new strategies to enhance this competitiveness (60).

Based on findings, Carmela and Francisco pointed out that the variables that can best explain the bilateral FDI flows within the OECD are on the one hand, the technological superiority of the investor vis-à-vis the host and, on the other, the relative abundance of physical capital, the endowments of human capital, transport infrastructure, and the size of the host countries, which clearly act as a factor of attraction for FDI (61).

OTHERS

Almost all the governments of less developed countries (LDCs) provide fiscal incentives in the belief that these encourage a higher level of direct foreign investment. This study found no support for the belief by the governments of most of the lesser developed countries that the provision of fiscal incentives is necessary to attract direct foreign investment and that the greater the generosity of these incentive programmes, the greater would be the level of such investment. What mattered was the presence of natural resources and a proven record of economic performance. The provision of incentives could not compensate for the absence of either of these two factors. The study is a cross-sectional one of 27 LDCs for the period 1965-73 (62).
Ghosh (1991) discussed the emergence of blocs in foreign investments, similar to those in world trade. Further, this aspect is of particular interest to those developing countries, including India, which have made attracting foreign investment a major plank of recent policy initiatives. It is concluded that the clustering of developing countries with respect to FDI is close to, but not identical with the clustering of these countries with respect to international trade in goods and services (63).

Commenting on the facts and issues relating to FDI in India, Bhattacharyya and Palaha concluded that to attract more investment from foreign companies in the future, it will be important to focus on small and medium sized business and selected services sector. Attracting small and medium enterprise, however, will require a greater and better targeted marketing effort. The reason for seeking investment from the service sector is that there are a large number of companies in the USA and other countries with superior capabilities in the fields of medicine, medical services, the environment, leisure, software, design and business services. Investment in these sectors would add vitality to domestic business and the domestic market. Further, investment in the service sector could be expected to have a ripple effect on the manufacturing industries.

Further, though India has a large number of free trade zones and 100% export oriented units providing similar benefits, their functioning is hampered by location-specific or infrastructural problems. These schemes require greater attention of the policy makers in India.
In terms of the policy areas, simplification of the entry routes, raising of equity ceiling, introduction of negative list, simplification of the operating systems and procedures, IPR legislation and comprehensive dispute settlement system are critical. The most important point is India should be viewed as a country that is adhering to the policy of reforms (64).

This is the first study in foreign direct investment in Nepal. Till 1988, there were only 58 foreign projects, mostly from India, with a total value of investments of under $100 million. In view of the tiny universe, this study covered the bulk of foreign investors in Nepal. It provided useful and interesting data on various aspects of their operations and perceptions of the host economy and compares Nepalese FDI policies with other South Asian Countries. The author makes no attempt to assess independently the various factors that affect FDI (65).

Steven (1995) discussed the global strategy of Japanese multinational corporations and the resulting changes in global trade and investment flows. The author entertained the old idea that the international trade and FDI are detrimental to the development of less developed countries (66).

The extent of multinational activity and the share of world trade accounted for by multinational enterprises have risen steadily over the past two decades. This has led to renewed interest within Europe in the impact of multinational enterprises on employment, investment and trade and the structure of economic growth. The authors
(Barrell and others, 1997) discussed the factors behind the continued growth of foreign direct investment and its wider consequences on home and host economies. They reported the evidence on the impact of production relocation on the export performance of a number of OECD economies, and investigate the extent to which technology transfer from foreign-owned firms has affected the rate of technical progress within the German and UK economies. The acquisition of firm-specific knowledge-based assets is found to be an important factor behind the growth of FDI, suggesting that such investments are likely to be an important channel for the diffusion of ideas and technologies (67).

Aitken and others (1997) tested the hypothesis that multinational companies (MNCs) act as export catalysts using panel data for 1986-90 for 2104 Mexican manufacturing plants following Mexico’s trade liberalization in 1985. A two-stage profit model is used. The probability that a domestic plant exports is positively correlated with proximity to MNC affiliates, even when other factors such as overall industrial activity, capital city proximity, and so on, are controlled for. Export propensity is uncorrelated with the concentration of exporters generally. This suggests that export spillovers are restricted to MNC activity, with affiliates being a natural conduit for information about foreign markets and technology, and so on (68).

Sajal and Ono (1998) focused on the effect of FDI on the host country’s welfare via two channels, employment promotion and price change, and considered the host country’s optimal policies to attract FDI. The authors developed a partial equilibrium model of
foreign direct investment in which identical foreign firms locate themselves in a host country to compete in an oligopolistic market for a non-tradable commodity. The host country, assumed to be small in the market for FDI, makes use of two instruments, viz., a profit tax and a local content requirement, to compete for FDI in the international market. They further assumed the existence of unemployment in the host country. The structure of optimal instruments and their relationship to the number, and the relative efficiency levels, of the domestic firms, are established (69).
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CHAPTER III

METHODOLOGY