

RELATIONSHIP BETWEEN FDI, EXPORT AND ECONOMIC GROWTH IN INDIA: EVIDENCE FROM TODA AND YAMAMOTO APPROACH

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Abstract

Understanding the relationship between Gross Domestic Product (GDP), export and Foreign Direct Investment (FDI) is inevitable for better formulation and implementation of policy decisions aimed at economic growth. This paper aims at understanding recent economic policies of the Government of India, which are oriented towards a more liberal approach, especially meant for promoting export and for attracting foreign capital. The existing debate over the relationship between these factors (i.e., GDP, FDI & export) and the curiosity about the nature of this relationship after the policy change in the 1990s motivated this study to investigate the causal relationship between these variables. The present study investigates the causal relationship between GDP, FDI and export by employing quarterly time series data from 1996Q1 to 2017Q2. As most of the previous studies are constrained by the issue of spurious regression due to stationarity problem, this study applies a modified Granger Causality test (1969) proposed by Toda and Yamamoto (1995) within Vector Autoregressive (VAR) framework as an attempt to solve the stationarity issues. The empirical evidence showed a bidirectional causality running between GDP and export and failed to find any relationship between FDI and GDP.

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Furthermore, VAR residual serial correlation LM test and the inverse root of AR characteristic polynomial confirms the stability of an augmented VAR model and non-existence of serial correlation. Based on the result, the study suggests that there should be more liberal policies to improve the FDI flow and to facilitate sustainable export-oriented growth.

Keywords: FDI, export, economic growth, causality, Toda & Yamamoto.

JEL Classification: F2, F13, F43, F63, P4.