TRENDS AND PATTERNS OF FLOW OF FDI IN DEVELOPED COUNTRIES AND DEVELOPING COUNTRIES: A COMPARISON

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ABSTRACT

Foreign direct investment (FDI) in India has played an important role in the development of the Indian economy. It has in lot of ways facilitated India to achieve a certain degree of financial stability, growth and development. The objective of the paper is to analyse the trends of Inflows during 1991-2011(study period) in India and to know about the global scenario and to examine the relationship of liberalised regime pursued by the countries with the level of FDI stock. To empirically test this relationship, Regression analysis was carried out between FDI Restrictiveness Index (FDI Index) and level of FDI stock and the results reveal a significant relationship between this index and the level of FDI stock. This index measures statutory restriction, all discriminatory measures affecting foreign investors, including market, access restrictions and departures from national treatment and gives scores to the respective countries in this endeavour. This study will give more insights about the policy framework to be followed by the countries to increase the flow of FDI inflows especially in the developing countries as for them this is the engine for economic growth.

KEYWORDS: ***discriminatory measures, Investment, Trade, Economic Growth, Restrictiveness index.***

SECTION 1: INTRODUCTION

Foreign direct investment (FDI) in India has played an important role in the development of the Indian economy. It has in lot of ways facilitated India to achieve a certain degree of financial stability, growth and development. This money has endorsed India to focus on the areas that needed a boost and economic attention, and address the various problems that continue to challenge the country. Foreign direct investment is considered to be one of the important measures of increasing economic globalization. Many policy makers and academicians contend that foreign direct investment (FDI) can have important positive effects on a host country's development effort. FDIs are permitted through financial collaborations, through private equity or preferential allotments, by way of capital markets through euro issues, and in joint ventures. FDI is not permitted in the arms, nuclear, railway, coal or mining industries.

The objective behind allowing FDI is to harmonize and complement domestic investment, for achieving a higher level of economic development and providing more opportunities for upgradation of technologies as well as to have an access to global managerial skills and practices. Therefore Foreign Direct Investment (FDI) has become a battle ground in the emerging economies. In addition to the direct capital financing it supplies, FDI can be a source of valuable technical know-how while nurturing the linkages with local firms, which can help the economy on the path of the development. Based on these arguments, industrialized and developing countries have offered incentives to encourage foreign direct investments in their economies. Foreign direct investment (FDI) in India has played a very important role in the growth of the Indian economy even during the time of the recession. FDI in India has facilitated India to achieve a definite degree of growth, development and financial stability. FDI has allowed India to centre on the areas that may have required economic attention and many other challenging issues faced by the Indian economy. There are many factors that have attracted investment in India such as stable economic policies, availability of cheap and quality human resources.

The vast literature on foreign direct investment and multinational corporations has been surveyed many times. For recent surveys see Markusen (1995) and Caves (1996).There is a considerable decrease in the tariff rates on various importable goods. Further, the explosive growth of FDI gives opportunities to Indian industry for technological upgradation, gaining access to global managerial skills and practices, optimizing utilization of human and natural resources and competing internationally with higher efficiency. Most importantly FDI is central for India's integration into global production chains which involves production by MNCs spread across locations all over the world. (Economic Survey 2003-04). The shift of the power centre from the western countries to the Asia sub –continent is yet another reason to take up this study.

Last two decades there has been an impressive growth of FDI in the global landscape. This shows a noticeable change in the expansion strategy of both developed and developing countries which has stirred FDI in many ways. There are number of rewards which are linked with FDI as this is a win- win situation both for home and host countries as they derive payback from open vast global network especially to take advantage of research and development from advance countries, increase foreign exchange, Technology diffusion and knowledge transfer, Managerial skills, increase technical know-how, access to markets, skills and practices etc. It is considered as the main explanation for bridging all the scarcities in new economic liberalised global regime and the only way to integrate with the world economy in the track of growth. The objective of the present paper is to analyse the trends and patterns of FDI in developed and developing countries with special reference to India for the period 1991-2011and to find out whether there exists a significant relationship between OECD FDI Regulatory Index (which is a tool for benchmarking countries measuring reforms and assessing its impact on FDI) and FDI stock.

This period is very important for a many reasons mainly because we opened our doors to MNCs in a liberalised regime. During this period there was a inclusive change in policy frame work and the outlook of developed and developing countries towards FDI owing to its benefits it has in the host country and was also considered as an important source of external finance.

To achieve the objective of the study, this paper is divided into six sections. Section 1 i.e. is the present section gives the insights of nature and flows of FDI scenario in India relating to policy issues and its importance. Section 11 gives brief review of literature, followed by section 111 which gives research objectives, hypothesis, data and methodology. Section 1V entails results and interpretations. Summary is included in Section V, followed by references are covered in last section.

SECTION 11: REVIEW OF LITERATURE

The complete literature centered on economies pertaining to empirical findings and Growth and development of any economy in the post liberalization period. Morris Sebastian44 (1999) Morris Sebastian presented 14 case studies of firms in the textiles, paper, light machinery, consumer durables and oil industry in Kenya and South East Asia . This study concluded that the home-grown private corporate sector is the major source of investments. The current system of tariff and narrow export policy are other reasons that have motivated market seeking FDI. Wealth seeking FDI has started to create a substantial portion of FDI from India. Naga Raj R45 (2003) presented the trends in FDI in India in the 1990s and compared them with China. Based on the analytical conversation and comparative experience, the study concluded by suggesting a more realistic foreign investment policy framework is required to expect increased flow of FDI. Nayak D.N (2004) observed that India does not outline very much in the investment plans of Canadian firms due to indifferent attitude of Canadians towards India and lack of information of investment opportunities in India and there was a suggestion that regular publications in this regard will go a long way in increasing the flow of investment in India. Chandan Chakraborty, Peter Nunnenkamp8 (2004) assessed the growth implications of FDI in India by subjecting industry – specific FDI and output data to Granger causality tests within a panel co -integration framework and suggested that FDI is unlikely to work wonders in India if only remaining regulations were relaxed and still more industries opened up for FDI.

Kulwinder Singh38 (2005) critically analyzed fdi in India and concluded that the impact of the reforms in India on the policy environment for FDI presents a mixed picture. Also the industrial reforms have gone far; though they need to be supplemented by more infrastructure reforms o make India a better investment center. Nirupam Bajpai and Jeffrey D. Sachs47 (2006) concluded that a restricted FDI regime, high import tariffs, exit barriers for firms, stringent labor laws, poor quality infrastructure, centralized decision making processes, and a very limited scale of export processing zones make India an Unattractive investment spot. Balasubramanyam V.N Sapsford David (2007) compared the levels of FDI inflows in India and China, and found that FDI in India is one tenth of that of china. According to their findings the country may need much larger volumes of FDI than it currently attracts if it were to attain growth rates in excess of 10 per cent per annum. Finally, they conclude that India is now in a position to implement the FDI Package efficiently and also rely on sources other than FDI for its requirements of capital owing to its potential. Basu P., Nayak N.C, Vani Archana5 (2007) studied the qualitative shift in the FDI inflows in India in – depth in the last fourteen odd years and came on the conclusion that the country is not only cost – effective but also hot target for R&D activities. It was also found that R&D as a significant determining factor for FDI inflows for most of the industries in India. The study also concluded strong negative influence of corporate tax on FDI inflows. A S Shiralashetti and S S Hugar (2009) analyzed the initiatives of The Government of India to attract FDI inflows, to boost the Indian economy since economic liberalization on the basis of different parameters such as year-wise, country-wise, sector-wise and region-wise FDI inflows. The study concluded though FDI inflows into India have raised, yet it is very less compared to some developing countries like China, Russia, Mexico, Brazil and Chile, etc.therefore, there is an urgent need to adopt inventive policies and good corporate Governance practices correlated with international standards, by the Government of India, to attract more and more foreign capital in various sectors of the economy to make India a developed country. Narayan Chandra Pradhan (2011) in his studies observed that although there is governance of manufacturing sector in the East Asian economies, the FDI to India has flown principally to the services sector. This reflects the service led growth of the Indian economy. Dr. P.S. Vohra; Ms. Preeti Sehgal(2011) analyzed the trends and patterns of foreign investment in India and concluded that Indian has proved itself as the Investment attractive country especially in the service sector which provides low employment opportunities. The study asserted that foreign investments assisted the Indian Economic Growth But it assisted only the internal growth not in the external India’s Export level is still low as compare to Import. There are very few comprehensive studies available which analyses the relationship of liberalized regime and the level of FDI Stock, to bridge this gap a modest attempt is done in this direction to empirically test this relationship.

SECTION 111: OBJECTIVES OF THE STUDY

The objective of the present study is to evaluate the trends and flows of FDI in India and developed countries, to have a comparative view. To achieve the objective of the paper, the study has been taken up for the period 1991-2011(post liberalization period).

HYPOTHESIS OF THE STUDY

- FDI flows have shown a marked rise in the study period in both India and developed countries and liberalised regime has shown a positive impact of total inflows of the economy.

- There exist a significant relationship between OECD FDI Regulatory Restrictive Index and the stock of FDI.

RESEARCH METHODOLOGY

DATA COLLECTION

To achieve the objectives of the study secondary data is used which is collected from various sources i.e. World Investment Reports, publications from Ministry of Commerce, Asian Development Bank's Reports, Reserve Bank of India bulletins, Economic and Social Survey of Asia and the Pacific, United Nations, Asian Development Outlook, Country Reports on Economic Policy and Trade Practice-Bureau of Economic and Business Affairs, U.S. Department of State and from websites of World Bank, IMF,OECD, WTO, RBI, UNCTAD, EXIM Bank etc. Time series data and the relevant data have been collected for the period 1991 to 2011.

SECTION IV: ANALYSIS AND INTERPRETATIONS OF RESULTS

FDI is as an engine of capital, technology, managerial skills, technological progress & capacity, access to foreign markets and in maintaining economic growth and development for developing countries, where as for developed countries it is considered as a tool for accessing the market of emerging economies. It is also considered as tool of filling the savings, foreign exchange reserves, revenue, trade deficit, management and technological gaps. Its impact on economic growth depends on country's domestic policy and foreign policy.

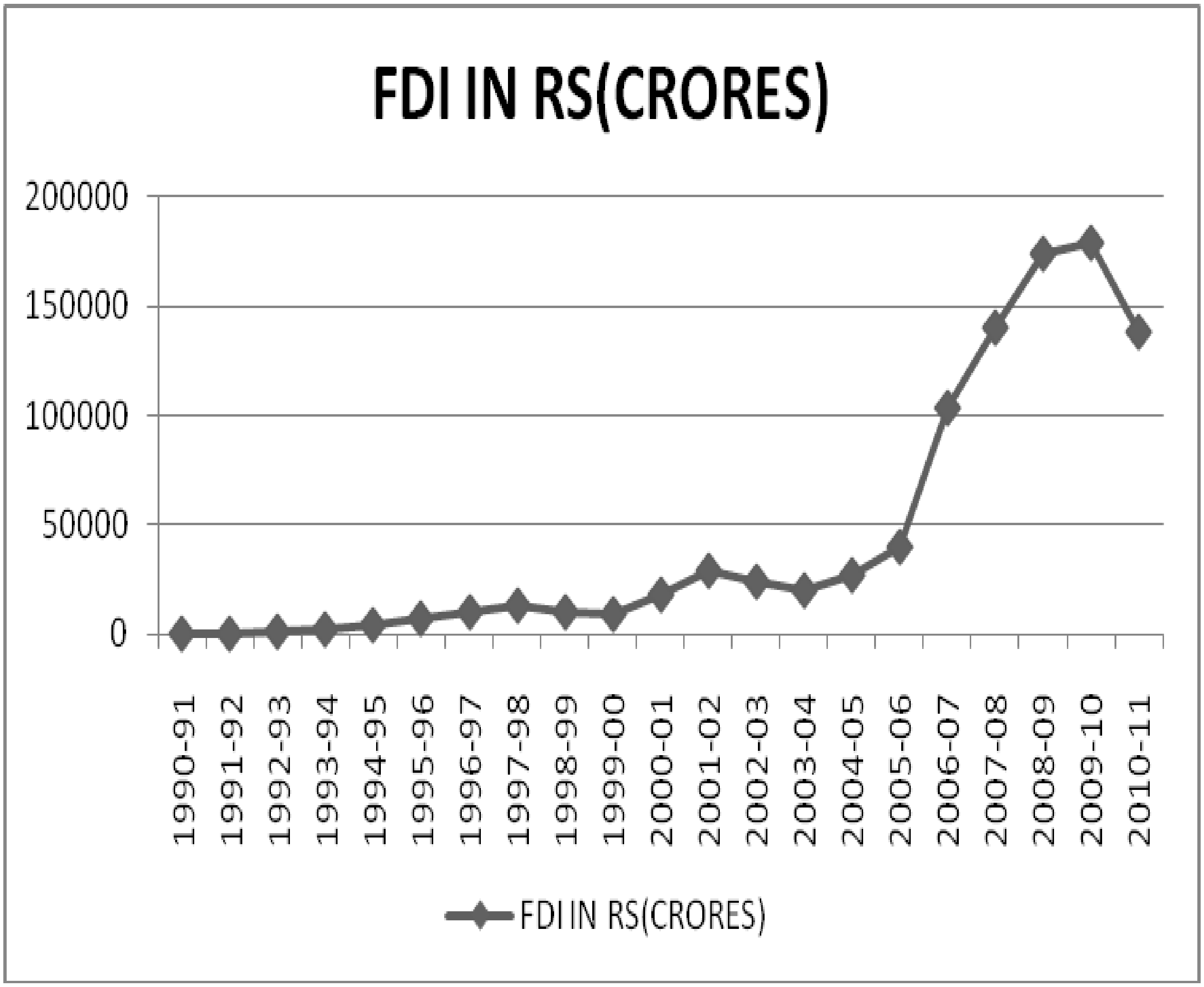
TRENDS AND PATTERNS OF FOREIGN DIRECT INVESTMENT (FDI):

It refers to foreign direct investment. Economic growth has a profound effect on the domestic market as countries with expanding domestic markets should attract higher levels of FDI inflows. There is a clear indication from the data that foreign investors showed keen interest in Indian economy because of liberalised regime pursued and followed by Indian economy. There was a constant upsurge in FDI equity flows reaching the peak in 2008-09, showing a decline in 2010 and 2011 and showing slight signs of recovery in January 2012 taking the cumulative equity inflows of FDI to a record level of 243055 US Dollars. (Figure 1, Table 1).This trend proves that India is now considered a good investment centre which is evidenced from their infusion of investment in Indian economy. There are a number of factors contributing to this contemporary trend with special reference to being its demographics' with a young population there is a huge consumer base that is to be tapped, the growing middle class, increased urbanization and awareness, rising disposable incomes see figure 1 and table 1 . There is fall in the investment in the year 2010-11, for this many global factors are responsible but it will recover very quickly owing to the advantages FDI can give to the emerging economies like India. Now this is showing a clear sign of recovery showing positive global scenario. After a dismal performance in 2010-11, foreign direct investments into India are back on track. "During April and May 2011, FDI flows were up 77 percent from the previous year to $7.8 billion, breaking with the poor performance of last year. This is also corroborated by rising mergers and acquisitions of Indian companies by foreign companies at $23.3 billion in the first half of 2011-12. The government is finally taking steps to relax FDI norms for multi-brand retail. The Committee of Secretaries has recently recommended up to 51 percent foreign investment in the sector and a commitment of at least $100 million investments. If this relaxation in norms finally becomes policy, retailing giants like Wal-Mart and CarreFour will enter this market. When large investments pour in, the general climate for inflows improves”. (http://www.firstpost.com).

TABLE 1

YEARS	FDI IN RS(CRORES)
1990-91	174
1991-92	316
1992-93	965
1993-94	1838
1994-95	4126
1995-96	7172
1996-97	10015
1997-98	13220
1998-99	10358
1999-00	9338
2000-01	18406
2001-02	29235
2002-03	24367
2003-04	19860
2004-05	27188
2005-06	39674
2006-07	103367
2007-08	140180
2008-09	173741
2009-10	179059
2010-11	138462

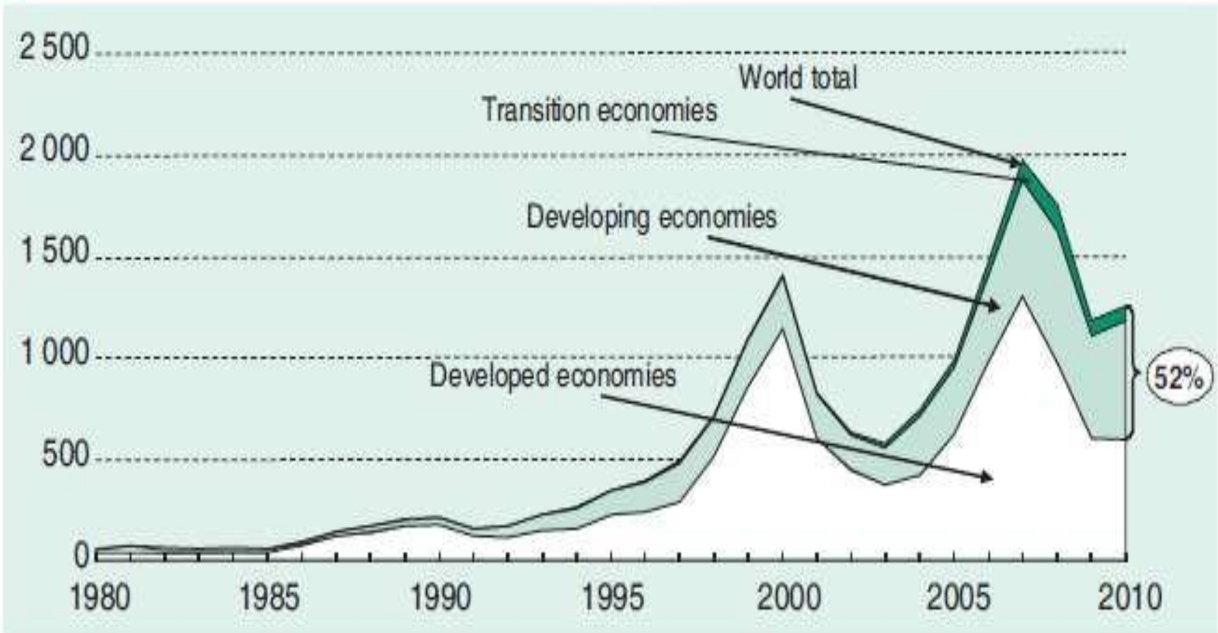
Source:Dipp.nic.in



EVALUATION OF GLOBAL FDI

There is a moderate rise in FDI flows to $1.24 trillion in 2010 which is below 15 per cent below their pre-crisis average. There was an unprecedented rise in FDI of developing and transition economies together attracted more than half of global FDI flows. There was a record level of Outward FDI to these economies reaching at a record level mainly to South. On the contrary there was a continuous fall in FDI inflows to developed countries. Emerging economies emerged as a major recipient of both FDI and as outward investors in 2010. There has been a shift in international production and consumption trends to emerging economies. TNCs are increasingly investing in both efficiency- and market-seeking projects in these emerging economies because of this reason. More than half of global FDI inflows in 2010 were absorbed by these countries. There was also a strong rise in FDI outflows from developing and transition economies, by 21 per cent as is seen in the following figure

Figure I.3. FDI inflows, global and by group of economies, 1980–2010
(Billions of dollars)

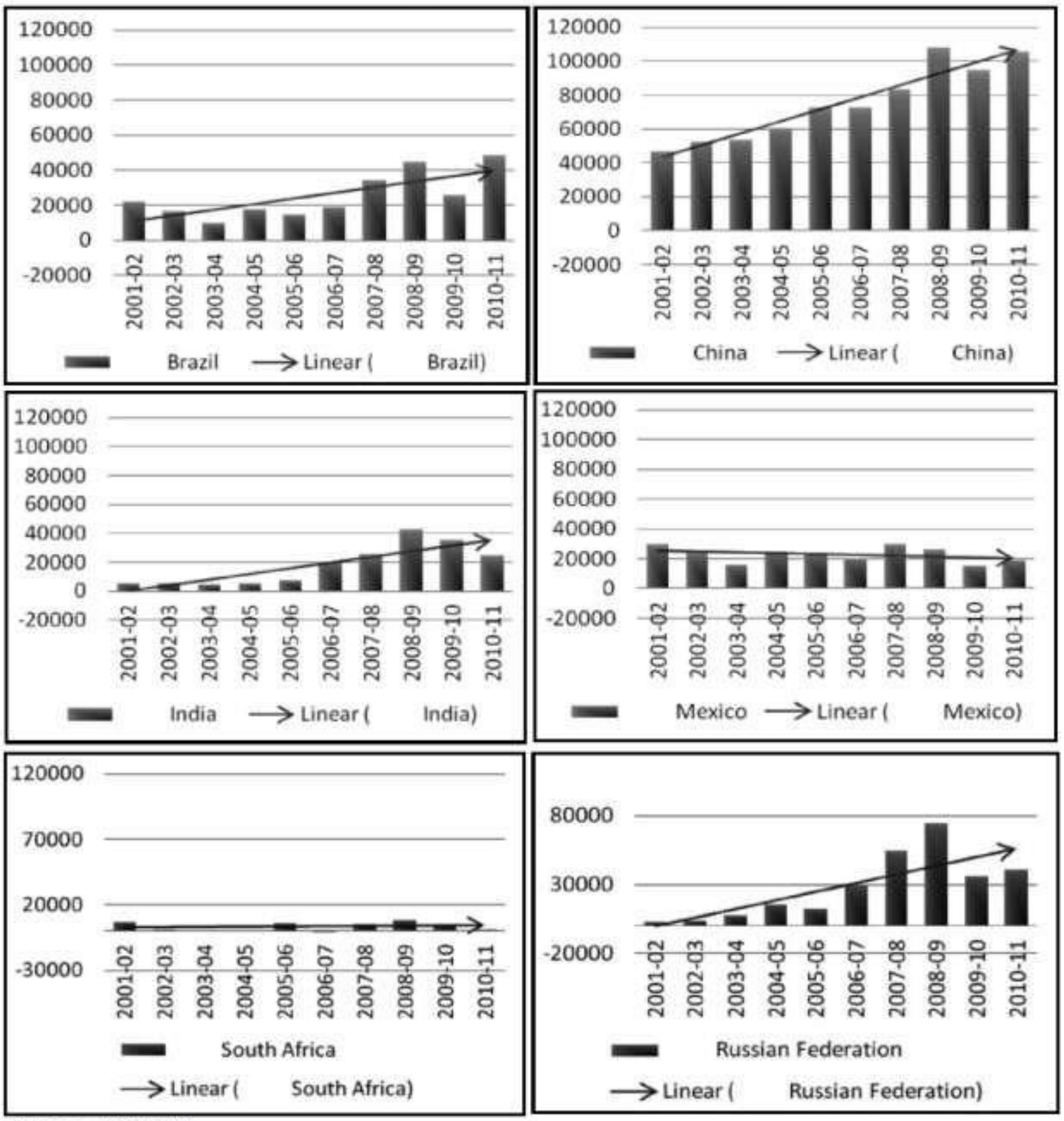


Source: UNCTAD, based on annex table I.1 and the FDI/TNC database (www.unctad.org/fdistatistics).

Services FDI subdued Sectoral patterns. FDI in services, which accounted for the bulk of the decline in FDI flows due to the crisis, continued on its downward path in 2010. There was a fall in the share of FDI inflows in this sector. All the main service industries (business services, finance, transport and communications and utilities) fell but at different speeds. The declining trend was sharpest in the financial industry. There is strong interaction of domestic industrial policies with the FDI policy nationally and internationally .The challenge is to manage this interaction so that the two policies work together for development of the economy i.e. between building stronger domestic productive capacity on the one hand and avoiding investment and trade protectionism on the other.

The moderate recovery of FDI flows in 2010 revealed an uneven pattern among components and modes of FDI. Cross-border mergers and acquisitions (M&As) rebounded gradually, yet green field projects – which still account for the majority of FDI – fell in number and value. Increased profits of foreign affiliates, especially in developing countries, boosted reinvested earnings – one of the three components of FDI flows – while uncertainties surrounding global currency markets and European sovereign debt resulted in negative intra-company loans and lower levels of equity investment – the other two components of FDI flows. While FDI by private equity firms regained momentum, that from sovereign wealth funds (SWFs) fell considerably in 2010.FDI inward stock rose by 7 per cent in 2010, reaching $19 trillion, on the back of improved performance of global capital markets, higher profitability, and healthy economic growth in developing countries. Majority of FDI – fell in number and value. Increased profits of foreign affiliates, especially in developing countries, boosted reinvested earnings – one of the three components of FDI flows – while uncertainties surrounding global currency markets and European sovereign debt resulted in negative intra-company loans and lower levels of equity investment – the other two components of FDI flows. While FDI by private equity firms regained momentum, that from sovereign wealth funds (SWFs) fell considerably in 2010(http://www.unctad-docs.org).

FDI trends in various EME's (Emerging Market Economies) in US $ Millions



Source: UNCTAD

- To analyse and test the hypothesis of relationship between OECD Regulatory Restrictiveness Index and FDI stock let us first define OECD FDI Regulatory Restrictiveness Index

  OECD FDI Regulatory Restrictiveness Index, A tool for benchmarking countries, measuring reform and assessing its impact. FDI Index measure, statutory restriction, all discriminatory measures affecting foreign investors, including market, access restrictions and departures from national treatment. It does not cover , degree of implementation, Institutional quality .It takes into accounts four types of restrictions namely Sectoral equity limits, Screening restrictions on key personnel: managers, directors and other restrictions: land, reciprocity, capital repatriation, branches, etc. These are weighted in the following ways each restriction is given a score based on an assessment of its importance. Aggregate score is weighted average of sectoral scores

FDI INDEX: DATA & COVERAGE

□ OECD countries: information based on reservations under the OECD Code of Liberalisation of Capital Movements and the National Treatment Instrument

□ Countries adhering to the OECD Declaration on International Investment and Multinational Enterprises • Argentina, Brazil, Egypt, Latvia, Lithuania, Morocco, Peru, Romania •

OTHER COUNTRIES CURRENTLY REQUESTING ADHERENCE

□ Other non-OECD countries (China, India, Indonesia, Russia, Saudi Arabia, South Africa, Ukraine), based on OECD Investment Policy Reviews, national sources, GATS and other international agreements, APEC

SECTORS

□ Agriculture,forestry, fishing

□ Mining & quarrying

□ Manufacturing (5 sub-sectors)

□ Electricity (generation, distribution)

□ Construction

□ Distribution (wholesale, retail)

□ Transport (surface, water, air)

□ Hotels & restaurants

□ Information & communication (fixed & mobile telecoms, broadcasting, other media)

□ Financial services (banking, insurance, other finance)

□ Professional services (accounting & auditing, legal, architecture, engineering)

□ Real estate

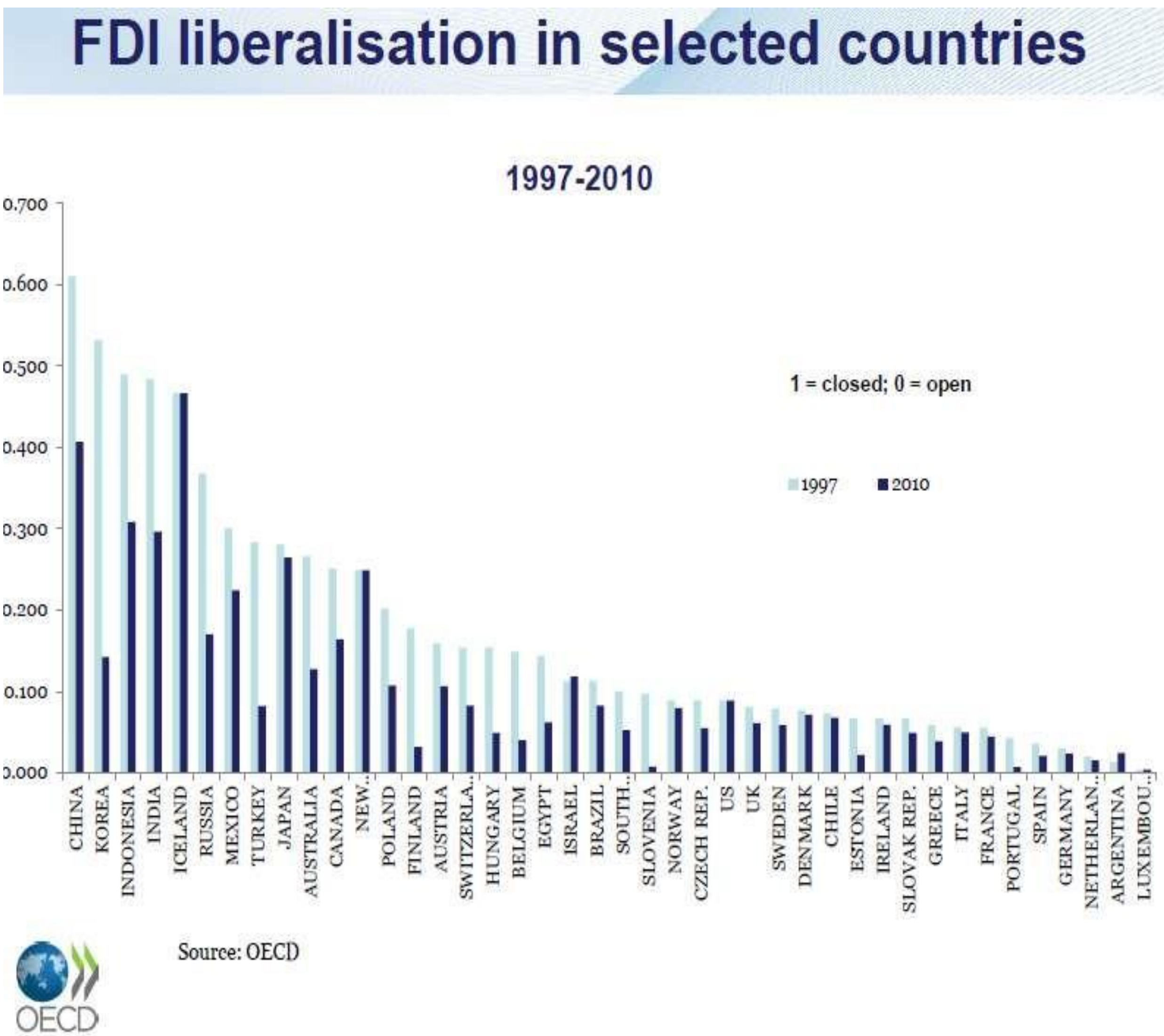
THIS INDEX HELPS IN MEASURING

□ Relative FDI restrictiveness of each country

□ changes in restrictiveness over time

□ A country's performance in attracting FDI for a given level of restrictiveness

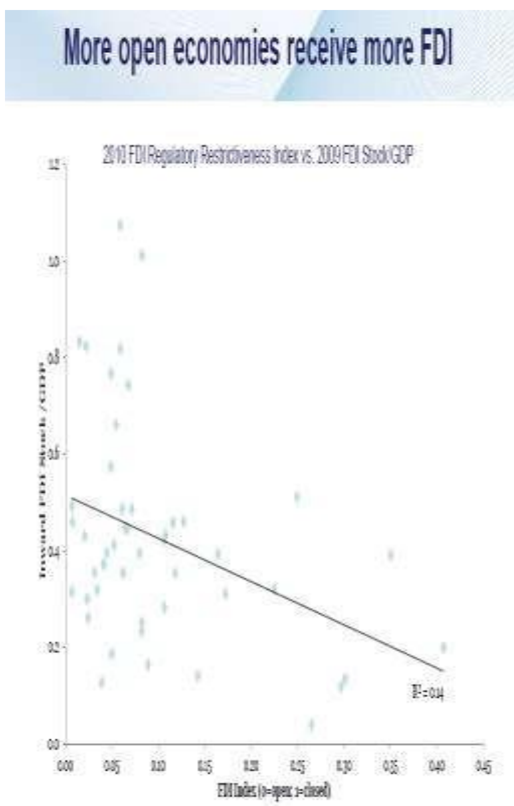
□ the effect of FDI liberalisation on FDI inflows.



A regression was carried out on 2009 FDI STOCK AND 2010 FDI INDEX ,the relationship was found significant i.e. the economies which are more open receive more FDI investments and vice versa,

	2010 FDI INDEX	**FDI/STOCK 2009**
Argentina	0.025	0.261
Australia	0.128	0.461
Austria	0.106	0.422
Brazil	0.083	0.251
Canada	0.164	0.393
Chile	0.068	0.743
China	0.407	0.200
Czech Republic	0.055	0.661
Denmark	0.072	0.485
Egypt	0.062	0.354
Estonia	0.022	0.823
Finland	0.032	0.355
France	0.045	0.396
Germany	0.023	0.300
Greece	0.039	0.128
Hungary	0.049	0.766
India	0.297	0.119
Indonesia	0.308	0.135
Ireland	0.059	1.074
Israel	0.118	0.354
Italy	0.050	0.186
Japan	0.265	0.039
Korea	0.143	0.141

Latvia	0.065	0.448
Lithuania	0.041	0.372
Mexico	0.225	0.320
Morocco	0.067	0.446
Netherlands	0.015	0.832
New Zealand	0.249	0.512
Norway	0.080	0.395
Peru	0.107	0.283
Poland	0.108	0.432
Portugal	0.007	0.493



Romania	0.008	0.459
Russia	0.195	0.310
Saudi Arabia	0.350	0.392
Slovakia	0.049	0.574
Slovenia	0.007	0.314
South Africa	0.052	0.412
Spain	0.021	0.430
Sweden	0.059	0.817
Switzerland	0.083	1.012
Turkey	0.082	0.233
Ukraine	0.116	0.458
UK	0.061	0.487
US	0.089	0.164

Dependent Variable: FDIINDEX2010

Method: Least Squares

Date: 04/02/12 Time: 17:17

Sample (adjusted): 5 48

Included observations: 44 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FDISTOCK2009	-0.163488	0.059614	-2.742422	0.0089
C	0.175245	0.029185	6.004631	0.0000
R-squared	0.151873	Mean dependent var		0.104682

Adjusted R-squared	0.131679	S.D. dependent var	0.098047
S.E. of regression	0.091364	Akaike info criterion	-1.903542
Sum squared resid	0.350590	Schwarz criterion	-1.822442
Log likelihood	43.87791	F-statistic	7.520880
Durbin-Watson stat	1.680366	Prob(F-statistic)	0.008925

Dependent Variable: FDISTOCK2009

Method: Least Squares

Date: 04/02/12 Time: 17:34

Sample (adjusted): 5 48

Included observations: 44 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FDIINDEX2010	-0.928954	0.338735	-2.742422	0.0089
C	0.528858	0.048325	10.94371	0.0000

R-squared	0.151873	Mean dependent var	0.431614
Adjusted R-squared	0.131679	S.D. dependent var	0.233716
S.E. of regression	0.217786	Akaike info criterion	-0.166222
Sum squared resid	1.992085	Schwarz criterion	-0.085122
Log likelihood	5.656880	F-statistic	7.520880
Durbin-Watson stat	1.892709	Prob(F-statistic)	0.008925

The regression results are displayed below once taking FDI as dependent and another regression equation by taking fdi index as dependent, both show significant relationship of the two equations, clearly showing if economy is more open with less of restrictions the inflow of FDI will be more and vice-versa. This leads to the acceptance of the hypothesis that there is a significant relationship between Regulatory Restrictive Index and the level of FDI stock.

SECTION V: SUMMARY AND CONCLUSION

FDI is as an engine of capital, technology, managerial skills, technological progress & capacity, access to foreign markets and in maintaining economic growth and development for developing countries, where as for developed countries it is considered as a tool for accessing the market of emerging economies. There is a clear indication from the data that foreign investors showed keen interest in Indian economy because of liberalised regime pursued and followed by Indian economy. There was a constant upsurge in FDI equity flows reaching the peak in 2008-09, showing a decline in 2010 and 2011 and showing slight signs of recovery in January 2012 taking the cumulative equity inflows of FDI to a record level of 243055 US Dollars. There are a number of factors contributing to this contemporary trend with special reference to being its demographics' with a young population there is a huge consumer base that is to be tapped, the growing middle class, increased urbanization and awareness, rising disposable incomes There is fall in the investment in the year 2010-11, for this many global factors are responsible but it will recover very quickly owing to the advantages FDI can give to the emerging economies like India. India is now opening its policies even more to attract the foreign investment inflows .When large investments pour in, the general climate for inflows improves". There is a moderate rise in FDI flows (global view) to $1.24 trillion in 2010 which is below 15 per cent below their pre-crisis average. There was an unprecedented rise in FDI of developing and transition economies together attracted more than half of global FDI flows. There was a record level of Outward FDI to these economies reaching at a record level mainly to South. Emerging economies emerged as a major recipient of both FDI and as outward investors in 2010.There has been a shift in international production and consumption trends to emerging economies. TNCs are increasingly investing in both efficiency- and market-seeking projects in these emerging economies. There is strong interaction of domestic industrial policies with the FDI policy nationally and internationally .To empirically test the relationship of liberalised regime represented by OECD FDI Regulatory Restrictiveness Index and the level of FDI Stock regression (OLS) was carried out. Regression results show significant relationship of the equations, clearly showing if economy is more open with less of restrictions the inflow of FDI will be more and vice-versa.

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