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FOREIGN DIRECT INVESTMENT IN INDIA: A CROSS-COUNTRY PERFORMANCE ANALYSIS*

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I. Introduction

The world economy has witnessed a remarkable expansion of Foreign Direct Investment (FDI) since the early 1980s. In the post World War II period, through the 1970s, international trade grew more rapidly than FDI, and thus international trade was by far the most important international economic activity. The situation changed dramatically in the middle of the 1980s, when world FDI started to increase sharply. Indeed, for the period from the early 1980s through the mid-1990s the rate of growth of FDI was significantly higher, compared to international trade. Although major investors as well as recipients have been developed countries, developing countries in Asia have also become large recipients of FDI.

The role of foreign investment in Indian economy has grown since liberalisation in 1991. This growing foreign presence has sparked a debate on the role of foreign investment. The critics expressing concern and alarm about the behaviour of foreign firms. The apprehension is that foreign firms will behave in ways that reduce employment, worsen the trade deficit, or inhibit technological progress. They worry that too large a foreign presence may compromise national sovereignty or threaten national security. The defenders of foreign investment argue usually proceeding from a general presumption in

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favour of free markets. However, this debate is primarily based on anecdotes and a priori judgements, rather than on systematic analysis of the data.

This paper seeks to analyse performance of FDI in India *vis-a-vis* other countries competing to attract FDI inflow. A useful way to assess the growing role of foreign investment in Indian economy is to compare the behaviour of foreign firms in India with that of other countries, who have long had substantial foreign presence. These countries have also developed faster than India. It is arguable that India is simply becoming more normal, like other nations, as a host as well as a home for multinational firms.

International comparisons of FDI are difficult because of data scarcity and because of existence of noncomparables. However, we have tried to analyse the performance of US investment in selected developing countries *vis-a-vis* India. The countries selected are such that they are characterised by a long presence of FDI in their economy. The FDI has played a very important role in their industrial development and, these countries are potential competitors of India for receiving FDI.

The analysis is based on data collected by US Bureau of Economic Analysis on foreign affiliates and reported in Survey of Current Business. Our period of analysis of US FDI data is upto 1996, which could seem a little outdated. There were two reasons to restrict our analysis till 1996. Firstly, we presume that Asian currency crisis would have altered the normal behaviour of US FDI after 1996 and secondly, the format of Survey of Current Business has changed after 1996 and we can not cover as many variables.

Section II of the paper reviews current issues regarding FDI. Section III analyses the performance of US investment in selected countries, while Section IV will discuss current trends in FDI, Section V concludes the paper.

II. Review of Current Issues in Indian Context

There is a prolific literature on the importance of foreign resources in general and Foreign Direct Investment (FDI) in

particular, in economic development. Among the sources of private capital *viz.* FDI, debt and portfolio investment, FDI is the most desirable.

There are good reasons to believe that FDI is preferred to other type of flows. One convincing argument is that FDI consists of a package of capital, technology and market access which tends to go to those manufacturing sectors which enjoy actual or potential comparative advantage. On the other hand, official flows and even commercial loans are often tied with social overheads and sectors which do not enjoy comparative advantage. In those manufacturing sectors which enjoy comparative advantage, the inflow of FDI would give rise to economies of scale and higher productivity and create linkage effects. Moreover, there are a number of financial advantages of FDI over the other types of flows for the recipient developing countries. For FDI, repayment is required only if the productive activity is profit making and repayment can to a large extent be regulated through tax policies and legislations. Incentives can be created to encourage reinvestment to minimise repatriation of profits. There is also a closer match between the maturing structures of earnings and repayments. For other types of flows, it is often the case of using short-term loans to finance long-term projects.

Technology

One of the most important contributions that the recipient countries expect from FDI is technology transfer. The liberalisation in most of developing world has made technology even more important as countries are trying to achieve and maintaining international levels of competitiveness. Obtaining technology from abroad is now seen primarily as a means to accumulating internal technological capacity building. Since the 1980s there has been an increasing multiplicity of technology transfer channels reflected in "new forms of investments" i.e. joint ventures, production sharing, subcontracting, franchising and buy, operate and transfer. Owing to the proliferation of sources from which technology can be secured, better bargaining skills by purchasing entities and the marked trend towards global trade liberalisation, the current focus is on taking advantage of

opportunities for complementing local technological capability building with technology attained with investments flows or other conduits for technology transfer. Extent of technology transfer by MNCs would be determined by different international business modes through which MNCs operate. Thus, while there could be a direct transfer of technology in a joint venture, wholly owned subsidiaries would transfer technology indirectly through work-force mobility.

Some objections raised regarding technology inflow are that MNCs do not pass on the appropriate technology. It has been argued that market prices determine the techniques that MNCs will use. This is no different from the behaviour of a domestic company. If an economy is protectionist, allowing for little competition, there will be no incentive for domestic or foreign firms to search for an appropriate technology. For e.g. if the regulatory framework is lax, all firms will be lax about applying environmental safety measures. Host country policies therefore, turn out to be pivotal.

India has followed a selective policy in attracting FDI. Through the late sixties and the seventies, there was an effort made to unbundle foreign technology and financing. Whenever possible, technology was to be acquired directly through licensing contracts rather than as part of a package deal involving both technology and foreign capital. In this manner it was hoped that Indian firms would acquire only necessary foreign technology and in such a way that domestic ownership of the firms would be promoted. Even if a firm was in an industry eligible for technology purchase, its application could be rejected on the basis of the cost of the technology, availability of local substitutes, the technology's appropriateness, or the impact that the technology's import would have on local R& D capabilities. In the eighties the policies were liberalised and controls on technology licensing agreements were relaxed. In the nineties, technology policy was liberalised further and equity participation by foreign firms was encouraged to a greater extent.

India has recognised, increasingly since 1991, that to benefit from the phenomena of globalisation, technology import has an

important role to play. The policy redirection reflects a broad realisation that global economic forces cannot be ignored or resisted, and indeed must be accommodated.

Quality

Literature suggests that different rates of growth across countries can be explained more by qualitative differences in investments than quantitative differences. The government policies are responsible for these productivity differentials created by trade distortions and financial repression imposed on the economy. Trade distortions manifest themselves in a set of relative prices that deviate substantially from relative world prices. Foreign Direct Investment in an economy with highly distorted policies is likely to generate net losses to the economy. In India even though the level of protection has been curtailed, it continues to be high. Tariffs have been lowered substantially, but they are still among the highest in the world. Similarly quantitative trade restrictions remain important in India. It is argued that most of the costs of foreign investments are associated with the exploitation of protected domestic markets. MNCs have been and are still attracted to highly protected domestic markets in developing countries. Highly protected domestic markets allow such companies not to build plants large enough to exploit economies of scale and not to choose technology appropriate to the factor endowment of the host country and yet make high profits.[1] High protective barriers will attract 'tariff hopping' FDI, which empirical studies suggest has a smaller growth impact than that under more competitive conditions. Behind the wall of protection offered by the protected domestic market, foreign firms can form non-competitive oligopolies.

FDI in the consumer goods sector, is one of the most controversial issues in the post-reform period.[2] It has been argued that MNCs engaged in such sectors dump obsolete technology in India, invest in low technology consumer product markets with no

1 See H. Hughes (1995)

2 See World Bank, CEM (1996)

benefit to the country, focus on unproductive areas like marketing or trading rather than manufacturing and exploit India's large domestic market without contributing to exports. Some points need to be made in this context. Firstly, if consumer goods are luxury products, then they would be considered so when produced by both foreign firms and domestic firms. The issue then is one of taxing the sector appropriately.[3] Secondly, higher tariffs in the consumer goods industry in fact attract FDI. Lowering tariffs, and eliminating import licensing restrictions on consumer goods would reduce excess rents that are likely to be realised in a non-competitive market. While it is true that at present FDI in consumer goods is targeted for the domestic market, allowing investment more freely in this sector would in fact improve the efficiency of both domestic and foreign producers and induce them to produce for the export market. What is perhaps neglected in this debate is the fact that relaxing restrictions in the consumer goods sector would (through more competition, better management and superior technology) raise productivity, reduce costs, and improve the quality and range of products available to consumers.[4]

Policy makers in India have strongly advocated sector selectivity for the entry of FDI. Thus it is felt that foreign investment should be primarily invited in the core sectors with emphasis on infrastructure and be discouraged in consumer durables and non-durables sectors. Such selectivity would not have been warranted if appropriate policy packages had been adopted in the beginning. Infrastructure is an area where FDI is a pressing need. While statistics on approved FDI reveal that the intended investment accounted for almost half of the total approved investment in the infrastructure sector, there are several reasons why investment has not been realised so far.[5] Infrastructure sectors are highly regulated and involve complex and multilevel interface between the private investor and various government agencies. Since investments are being inducted into a regulated sector,

3 See T. N. Srinivasan (1995)

4 See Sengupta *et. el.*

5 Ahluwalia and Little (1998)

investors have had several problems. The power sector is a case that has been faced with problems even though it was thrown open to private investors as early as 1992. One such problem has been tariff fixation. Some of the earlier projects drew public criticism on the ground that their tariffs were too high. However, these tariffs were being compared with the average cost of generation of all plants in the public sector. Secondly, since private investors are solely dependent on the State Electricity Boards (SEBs) for selling generated electricity, given the financial health of the SEBs there is a perceived risk of non-payment of electricity. Private investors have therefore tried to seek credit enhancement through government guarantees for the payment obligations of SEBs. While State Governments are willing to provide guarantees, their lack of creditworthiness has led investors to seek sovereign counter-guarantees from the Central Government. Thirdly, the inadequacy of the existing infrastructure situation itself is an impediment to the starting of new projects. Thus interruption in fuel supply arrangements is a major source of risk for investors. Given the large amount of investments and the risks that are associated with this particular sector - it is necessary to create the pre-conditions to attract private. These include - public acceptance of the need for private investment in infrastructure, a structure of tariffs which can assure remunerative returns for investors, clarity of government policy and transparency of procedures and establishment of independent regulatory agencies charged with ensuring fair treatment for private investors.

Ports is another area where private investment is needed. However, policy for private investment was announced only in 1997. While major ports will remain in the public sector, it is proposed to encourage privatisation of individual activities. However international experience suggests that it is relatively easier to attract private investment into ports since there are attractive returns to be made and there is no payments risk and relatively little market risk.

Trade

The relationship between exports and FDI has not been unequivocally established by economic theory. It needs to be judged

on a case by case basis. However in recent years, there has been an increase in export-oriented investments by MNCs to take advantage of the lower costs of labour. The fall in trade barriers have made it possible for MNCs to locate part of their production in selected countries in Asia and Latin America. Overtime, this process has shifted from the more developed countries to the less developed ones. It appears that TNC activities are gradually being restructured in Asia, with export-oriented labour-intensive manufacturing activity gradually shifting from the more advanced of the developing countries in the region to the less advanced ones. Overtime, the flying geese pattern of development that has taken place in Japan, Korea, Malaysia can be replicated in India. As labour costs have risen in the more advanced Asian countries it is likely that some export-oriented FDI will be transferred to India. For instance in the late 1980s and early 1990s shares of foreign affiliates in exports were as high as 57 per cent in Malaysia, 92 per cent in Singapore, 24 per cent in Hong Kong, and 17 per cent in Taiwan in the manufacturing sector.[6] This not only applies to small economies with limited domestic markets but also to larger economies, as the recent experience of China shows. High export propensities have been particularly visible in the textiles and apparel sector and in the electrical and electronic sector.

Whether or not MNCs would contribute to exports has been an issue of concern in India. The need for MNCs to participate actively in exports was realised in the 1980s when they were encouraged to set up export oriented units. A number of other incentives were given to MNCs to export their output. It has been found that sectors with higher foreign dominance (as measured by their market share) had a higher export orientation and a more favourable trade balance as compared with other groups. Thus the export propensity of firms in sectors where MNCs had a market share of more than 67 per cent was 11.6 per cent.[7] It has also been estimated that there is a positive and significant relationship between the level of foreign ownership and exports in India.[8]

6 UNCTAD World Investment Report (1995)

7 Ganesh (1997)

8 Majumdar and Chhibber (1997)

Whether or not MNCs would undertake exports would depend on the sectors that FDI is flowing into. The sectoral distribution of FDI shows that a large proportion of investment is intended for the non-tradable sector. Thus infrastructure accounted for 48.4 per cent of FDI. Inflow of FDI into export oriented sectors was only 8 per cent. These included textiles computer software, leather goods and tourism. The food and agro products sector accounted for another 8 per cent. The textile sector accounted for 21 per cent of India's exports in 1996-97 but the amount of intended FDI in this sector was only 1.6 per cent. This is because of several reasons. The garment industry is based on a system of de-centralised production which owes its existence partly to the existence of labour legislation and the lack of an effective exit policy, as well as the reservation of garment and hosiery production for the small scale sector. While de-centralised production has its own advantages, like cheap labour and flexibility in production, the production system is getting to be a constraint for MNC operations. Other labour-intensive export oriented industries like leather goods and gems and jewelry for similar reasons have not been able to attract adequate FDI.

Labour market rigidities are a serious impediment to FDI inflows into labour intensive sectors. The labour market inflexibility has limited India's ability to attract significant FDI in labour intensive manufacturing exports. In fact reforms in the labour market will not only improve productivity and lower costs, for domestic producers but will also attract FDI. With the phasing out of the Multi Fibre Agreement, it is important that Indian industry be prepared for a much more competitive environment, both at home as well as in foreign markets.

Given the fact that India has a large pool of skilled manpower indicated by the high number of scientists and engineers, it is likely to have a comparative advantage in certain high-skill intensive sectors, e.g. software. There is evidence that FDI into the computer software sector is highly export-oriented.[9] This has been possible because of a low cost highly skilled English speaking professionals. It should

9 See World Bank CEM (1996)

be mentioned that high level skills have been generated through a policy of human resource development where there has been a relative emphasis on high-level versus low-level skills.[10]

Deficiencies in transport, ports, power and telecommunications are a major bottleneck for any expansion in production activity both for the domestic market and for exports. Availability and quality of infrastructure services are among the most important determinants of export-oriented FDI flows because of their impact on cost competitiveness. FDI, in this sector is therefore crucial. The intricacies of working out a policy framework for the infrastructure industry that ensures efficiency and concomitantly encourages FDI is proving to be a challenge for many developing countries India included.

Employment

In developing countries the major concern is that economic liberalisation - motivated by a desire to benefit from the growth of world trade and investment flows - will generate high transitional unemployment and cause an increase in inequality. Job losses in uncompetitive industries occur immediately while job creation in competitive new industries may be held back by the inability of the financial system to meet the need of enterprises for investment funds, by bottlenecks in essential infrastructure such as power and transportation, and by shortages of skilled labour. In addition to these basic difficulties, the problem can be compounded by policy errors accompanying the liberalisation process such as overshooting in terms of macroeconomic stabilisation and inappropriate monetary and exchange rate policies that generate a debt crisis. The experience of Chile in the early 1980s illustrates the severe effects of overshooting in terms of stabilisation policy. Output contracted by 23 per cent in 1982-93 and unemployment remained above 24 per cent for five years. Similarly, the Mexican crisis of 1994-95 illustrated the devastating effects of wrong monetary and exchange rate policies.

10 UNCTAD (1996)

The principal mechanism of creating employment is through sustained rapid economic growth which could be attained through FDI. While unemployment has reduced substantially to 2 to 3 per cent in Singapore, Hong Kong, Taiwan and Korea, large reductions in unemployment have also been observed in countries like Thailand and Indonesia. Exports of labour intensive products have had a major impact on employment and earnings. This is true even in a large country like China. The main impact of foreign firms is to raise efficiency in the first round. The immediate employment effects of greater competitiveness may lead to job losses in a given firm, but lower prices and rising income lead to market expansion. In an overall, general equilibrium context, therefore, employment should increase.

One form of FDI that is increasingly contributing to employment is FDI by Small and Medium Enterprises (SMEs) into Small and Medium Enterprises. Although the labour-capital ratio varies from country to country and from industry to industry, SMEs tend to be more labour intensive than large firms. In particular FDI in SMEs in developing countries has the potential to create local indigenous employment and also contribute to exports. In economies such as Japan, Korea, Singapore and Taiwan, SMEs typically contribute substantially to output and moreover, include a dynamic, fast growing group of enterprises that play an important role in growth. FDI in SMEs in Vietnam, Mynamar and Philippines have played an important role. While in terms of value, small package FDI does not figure substantially (10 per cent of total FDI in Vietnam, 5 per cent in Philippines and 10 per cent in Mynamar) but in terms of numbers FDI accounts for a noticeable proportion of all FDI projects ranging from 15 per cent and 12 per cent in Vietnam and Mynamar to over 60 per cent in the Philippines.[11]

In India, FDI by SMEs in SMEs could contribute significantly to the growth process. As internationalisation and globalisation gains momentum in India, SMEs like other firms would face increasing competitive pressures with implications for their survival and growth.

11 UNCTAD (1998)

However, a number of changes are required in order to attract FDI into SMEs. Firstly, SMEs are defined in terms of a ceiling on investment in plant and machinery. This inhibits the growth of potentially dynamic firms. Second, about 800 products are reserved for exclusive production in the small sector. The reservation policy has also hampered the growth of small scale sector. Reforms in the small scale sector are needed in order to maximise gains from FDI into this sector.

III. US FDI in India: A Performance Evaluation

Traditionally, India has never been a favourite destination for the US foreign investors. However, US has always been an important foreign investor in India, more so after liberalisation. In the following section, we have tried to analyse the performance of US FDI in India *vis-a-vis* other selected developing countries on selected parameters i.e., return on investment, trade intensity, employment intensity and local R&D.

Rate of Return and FDI

Profit is the main motive of any firm. Since there is a lot of competition among host countries to invite FDI, multinationals look for the most profitable site for their investment.

Although a crude indicator, we have used net income earned (net of taxes) as a measure of profitability. Net income includes dividends, royalties, interest, other income etc. Thus, strictly speaking, it is not pofitability but return on foreign investment. Three indicators to calculate rate of return have been used i.e. net income earned as a percentage of sales, assets and FDI stock on historical basis (Table 1).

Table 1: Rate of Return on US FDI: Countrywise

	Net income/sales		Net income/assets		Net income/FDI stock	
	1995	**1996**	**1995**	**1996**	**1995**	**1996**
Argentina	5.02	5.12	3.57	3.80	10.40	13.28
Brazil	11.38	7.32	10.58	6.83	20.28	14.29
Chile	13.01	11.48	8.04	5.71	17.52	13.77
Mexico	8.27	9.79	8.56	10.41	30.14	35.28
China	**6.41**	**8.34**	**4.84**	**6.78**	**17.22**	**24.67**
India	**5.22**	**1.82**	**6.23**	**1.56**	**15.84**	**5.10**
Indonesia	17.56	17.68	9.56	9.49	23.90	24.73
Malaysia	9.37	8.55	8.68	7.77	32.29	26.79
Phillipines	8.41	8.08	7.76	6.61	24.13	19.98
Thailand	7.50	4.58	5.71	4.58	25.40	20.31
All Countries	**6.23**	**6.07**	**4.50**	**4.39**	**18.18**	**17.38**

Source: Tabulated from the US Survey of Current Business data.

Our results show that rate of return on US FDI in India is lowest compared with selected countries in 1995 and 1996. It is noteworthy that the rate of return on investment is reducing substantially since liberalisation. In 1991, the rate of return on US FDI stock in India was 16.4 percent (reported in an earlier study by the author), which was second highest in similar group of countries. This has declined to 15.84 per cent in 1995 to 5.1 per cent in 1996. However the rate of return in other countries is either constant or has increased in this period. Does it imply that liberalisation of Indian economy has given impetus to competition among MNCs as well as from domestic industry? This can be explained by arguing that India has a stronger industrial base compared to other countries but because of protection and distortion in industrial policies the local as well as foreign firms were reaping above normal profits. The liberalisation has created a competition among MNCs as well as with local firms, and now generating normal profits. This argument is reinforced by

the fact that reinvestment of income by multinationals in India is among the highest in selected group of countries along with new equity investments. One does not expect this kind of trend if decline in profits is because of other non-economic reasons.

In the sectoral analysis (Table 2), return on investment in manufacturing came down from 18.8 per cent in1995 to 10.64 per cent in 1996, which has brought India from second highest profitable market for US FDI to second lowest in selected group of countries. Chemicals, metals and Industrial machinery gave the highest return of 30.37 per cent, 17.39 and 17.45 per cent respectively in 1996. This could be due to complex nature of these industries and probably because it takes some time for new companies to come in to compete. Services is another sector which has given high returns of 24 per cent to US FDI but compared to China it is very low where return on US FDI in services is 47.14 per cent.

Interestingly, food and products have a negative return on US FDI in India as well as in China. There is also negative reinvestment in this sector but simultaneously fresh equity is coming in this sector. This could be due to newness of this sector and companies must be spending substantial amount on marketing and establishing their presence. The fresh equity might be coming from the new companies. But the similar behaviour in China is puzzling since they opened their economy for FDI quite sometime ago.

FDI and Employment

Much of the popular debate over the economic effects of FDI has focussed on its alleged impact on employment. The critics argue that FDI brings in relatively more capital intensive and labour displacing technology in a labour abundant country. This creates unemployment in the developing countries. The other related argument is that foreign owners tend to obtain more of their production input from abroad than local companies, resulting in reduced demand for the products of domestic suppliers, and both cost the host country jobs and worsen trade balance.

We tried to analyse the capital intensity of US FDI across the selected countries (assets divided by number of employees). We

Table 2: Income Earned on FDI at Historical Cost Basis (net income/FDI) 1995

(Per cent)

	all industries	Petro-leum	manu-fng.	food & prodts	chem & prdts	prim & fab met	indl.mach & eqp	elec & troneqp	tpt. eqp	Other Mfg.	Whole-sale	Fin (excdpot, insur, real est)	Service	other ind
Argentina	10.91	21.22	14.05	21.57	10.80	4.55	16.67	7.41	-6.38	18.32	8.47	4.15	11.05	-11.72
Brazil	15.03	8.88	16.87	30.06	17.14	18.79	13.15		28.35		3.52	15.51	29.79	12.02
Maxico	9.39	3.28	8.67	4.13	19.37	15.14		2.69	-1.55		5.27	10.28	0.55	9.04
Australia	11.38	20.85	13.76	16.93	10.72	7.06	14.23	16.84	20.29	14.80	10.92	8.05	14.04	2.62
China	**7.23**	**-14.20**	**17.10**	**-9.09**	**-5.71**	**0.86**		**52.53**		**-12.63**	**12.89**	**18.94**	**1375.00**	**10.67**
Hong Kong	19.63	11.45	22.91	0.00	19.54	23.53	0.00	36.75	26.32	15.82	16.60	16.62	19.42	45.22
India	**11.95**	**-15.38**	**18.80**	**-8.51**	**29.25**	**4.17**	**33.10**	**5.00**	**0.00**	**-8.82**	**-4.65**	**-3.05**	**29.63**	**0.00**
Indonesia	23.20	26.43	6.92	15.79	14.10	22.22	16.67	5.41			18.18	6.75	32.56	
Malaysia	26.03	66.82	19.50		17.42		-30.94	16.07		25.00	21.03	3.09	36.72	
Phillipines	19.97	11.04	25.70	32.57	35.50		16.67	12.36			26.23	9.61		
Thailand	19.22	16.45	22.36	7.44	15.41	19.48		12.50	0.00		15.55	18.75	2.70	4.63
All Countries	**12.50**	**13.16**	**14.07**	**15.50**	**14.04**	**11.94**	**14.35**	**16.23**	**10.88**	**14.58**	**13.39**	**11.26**	**13.92**	**7.06**

Source: Tabulated from the US Survey of Current Business data.

Table 2a: Income Earned on FDI Stock at Historical Cost Basis (net income/FDI)

(Per cent)

	All industries	Petro-leum	Manu-fng.	Food & prodts	Chem & prdts	Prim & fab met	Indl.mach & eqp	Elec & troneqp	Tpt. eqp	Other Mfg.	Whole-sale	Fin (excdpot, insur, real est)	Service
Argentina	11.19	20.05	14.88	17.87	13.48	5.29	28.57		8.70		1.47	7.49	7.25
Brazil	14.31	17.20	14.57	36.80	16.61	5.97	8.44	-29.10	21.58	17.02	2.17	12.86	22.62
Mexico	14.38	-1.19	14.24	3.71	26.57			14.05	9.34	18.15	7.99	22.49	9.93
China	**14.78**	**4.72**	**21.50**	**-8.06**	**4.78**	**-0.82**	**44.64**	**0.00**			**25.21**	**5.22**	**47.37**
India	**7.76**	**-5.17**	**10.64**	**-9.52**	**30.37**	**17.39**	**17.45**	**-24.24**	**-37.04**	**-28.57**	**12.50**	**-2.09**	**24.14**
Indonesia	25.43	33.66	9.32	19.05	8.16	35.71	16.67	12.68			29.41	7.22	11.54
Malaysia	23.47	50.12	20.02	0.00	13.37	15.79	0.00	16.86		0.00	24.22	6.24	12.50
Phillipines	15.69	2.10	23.17	35.24	30.94	31.03	25.00	10.58		14.29	26.69	6.85	
Thailand	16.85	16.84	14.61	11.93	18.90	21.74	0.00	0.00	0.00	17.43	13.95	20.69	0.00
All Countries	**11.85**	**15.69**	**12.62**	**14.63**	**13.19**	**9.54**	**14.42**	**13.34**	**9.40**	**12.02**	**12.19**	**11.28**	**10.02**

Source: Tabulated from the US Survey of Current Business data.

found that US FDI is most labour intensive in India among the selected countries (Table 3). Although capital intensity of US FDI is increasing, which is a normal process of development be it MNCs or local firms, but it still remains lowest among the group. It shows that US FDI recognises and is attracted by the cheap labour in India.

Table 3: US Affiliates: Wages and Capital Intensity

	US $ employee/annum		Capital Intensity	
	1995	**1996**	**1995**	**1996**
Argentina	25362	26888	238	259
Brazil	22959	26575	162	189
Chile	16829	18333	330	355
Mexico	11729	12399	80	92
China	**5645**	**5986**	**89**	**94**
India	**5339**	**6050**	**48**	**74**
Indonesia	12793	12700	292	327
Malaysia	8729	9299	110	127
Phillipines	7434	8208	80	105
Thailand	8619	9359	168	181
All Countries	**32783**	**33348**	**385**	**404**

Source: Tabulated from the US Survey of Current Business data.

Another related issue is quality of employment measured by the emoluments paid to employees. The emoluments (annual salary per person) paid by US Affiliates is among lowest in India in the group. However, it has been increasing constantly and in 1996 it surpassed average emoluments paid by US firms in China.

FDI and Trade Balance

Related to the question of the employment effects of foreign ownership is that of trade balance effects. Trade associated with FDI

is a very important activity for any host country because MNCs have a marketing network which can create exports for the host country. It is also alleged that foreign owned firms have a higher propensity to source abroad than do their domestically owned counterparts and that results in worsening trade deficit.

The intra-firm trade of US affiliates in India is lowest compared with selected countries. The import intensity of US affiliates in India from the US was 5.42 per cent of sales. It has risen from 2.86 per cent in 1991. The export intensity of US affiliates remains around one per cent of sales.

Table 4: US FDI Trade Intensity: Countrywise

	Imports intra-firm		Exports intra-firm	
	1995	**1996**	**1995**	**1996**
Argentina	6.46	5.17	0.54	0.64
Brazil	7.00	6.81	4.53	4.10
Chile	5.34	6.53	7.04	0.00
Mexico	27.97	29.49	31.77	33.37
China	**15.05**	**14.64**	**5.44**	**9.18**
India	**4.33**	**5.42**	**0.90**	**1.08**
Indonesia	2.02	4.46	11.96	5.29
Malaysia	17.72	16.44	0.00	25.23
Phillipines	11.05	11.67	6.61	9.27
Thailand	8.72	7.60	4.24	0.00
All Countries	**8.71**	**8.72**	**7.28**	**7.29**

Source: Tabulated from the US Survey of Current Business data.

This could be because they found a huge protected domestic market more profitable than exports and/or Indian industrial policies did not allow them to grow enough to exploit economies of scale and compete in international market.

We should note that even where foreign firms appear to have higher import intensity, their expansion need not have a negative effect on the trade balance. The FDI in greenfield plants that foreign firms add to an industry's capacity may not purchase as much from domestic suppliers as do existing facilities, they may displace imports rather than domestic production and thus reduce overall imports in the industry. Also FDI gives access to external market which might increase exports and help trade balance.

FDI and R&D

One of the potential benefit of FDI is spillovers of technology from the foreign firms. A concern that has been raised in India is that FDI might instead tend to reduce such favourable spillovers. The argument runs as follows; valuable externalities arise from the complex intellectual activities undertaken by firms, especially R&D. Since FDI comes with a higher technology than exist with local firms there will not be any incentive for local firms to do any R&D because the chances to succeed will be very low. Further, firms like to keep their sophisticated activities near the headquarter. When a firm with foreign headquarter acquires or displaces an Indian firm in the Indian market, it is therefore likely to shift the sophisticated activities abroad. Thus the benefits of proximity to these activities are lost.

How far this argument is correct is a question of empirical exercise and would be country specific. The empirical work done for Europe shows the only new multinationals have a high headquarter effect. The experienced multinationals tend to place R&D activities in all major markets.

Generally, R&D tends to be a 'head quarter function'. At affiliate level, it is very minimal, mostly of adaptive nature. The R&D intensity of US majority owned companies in India is 0.46 per cent (Table 5). It is highest in Asian countries. US companies in China have only 0.29 per cent of R&D intensity. There could be two possible explanations for high R&D intensity in India. Firstly, availability of cheap scientists and engineers is an incentive for carrying R&D in India and secondly, since R&D at the affiliate level is of adaptive

nature and US FDI seems to be more domestic oriented compared to other countries, it will require more adaptation of technologies for local conditions.

Table 5: R&D Intensity of US

	R&D/Sale (1995)	R&D/Sale (1996)
All Countries	**0.74**	**0.76**
Argentina	0.18	0.25
Brazil	0.62	0.98
Chile	0.21	0.08
China	**0.24**	**0.29**
India	**0.30**	**0.46**
Indonesia	0.10	0.06
Malaysia	0.15	0.14
Phillipines	0.37	0.20
Thailand	0.04	0.04

Source: Tabulated from the US Survey of Current Business.

IV. Policy Reforms and FDI Trends

The treatment of FDI sometimes seems to suggest that a wholesale takeover of Indian assets is occurring. However the statistics indicate that the role of FDI, although growing, but still very modest. FDI constitute only 1.08 per cent of India's GDP in 1995 and 3.75 per cent of industrial sector. The share of FDI in foreign corporate liabilities has grown from 19.1 per cent in 1991 to 24.1 per cent in 1995. There is a surge in FDI that began in 1991 and is continuing, but it is still very modest to cause any worry.

The Liberalisation of FDI

In 1991 India embarked on a major policy reform programme. The policy package announced in the Statement on Industrial Policy

in 1991 deregulated the economy in a substantial manner so as to promote the growth of a more efficient and competitive industrial economy. Industrial licensing was abolished barring a few cases, quantitative restrictions on imports were reduced and tariff levels were lowered significantly. The balance of payments crises induced policymakers to make tangible changes in the FDI policy. These changes were also welcome since they were a crucial part of the reform process. FDI is now permitted virtually in every sector of the economy. While majority foreign investment (upto 51 per cent) is freely allowed in most sectors, foreign equity upto 100 per cent is encouraged in export oriented units, power sector and electronics and software technology parks. FDI proposals do not necessarily have to be accompanied by technology transfer agreements. A Foreign Investment Promotion Board (FIPB) has been set up to provide single window clearance to invite and facilitate investments. India has become a signatory to the Convention of the Multilateral Investment Guarantee Agency (MIGA) for protection of foreign investments. The FERA Act has been amended and restrictions placed on foreign companies by the FERA have been lifted. Companies with more than 40 per cent of equity are now treated on par with domestic companies. New sectors such as mining, banking, telecommunications, highway construction and management have been thrown open to both domestic private and foreign investors. MNCs are also allowed to have an equity participation in small scale enterprises upto a limit of 24 per cent. They are also allowed to manufacture items exclusively reserved for production in the small scale sector provided they undertake to export 75 per cent of their output.

Post Reform Trends

The inflows since the liberalisation of policy show a dramatic jump as shown in Table 6. Approvals of FDI inflows are far greater than actual inflows, indicating that approvals have been slow in materialising into actual inflows. In 1996, while actual inflows were $ 2.6 billion, approved FDI stood at $ 10.3 billion.

Table 6: Actual and Approved FDI in Post Reform Period

	Actual Inflow of FDI ($ Billion)	Approved FDI ($ Billion)	Proportion of Actual Inflow (Per cent)
1991	0.1	0.2	87.6
1992	0.3	1.1	23.4
1993	0.6	2.5	23.1
1994	0.9	4.1	23.3
1995	2.0	9.2	22.1
1996	2.4	10.3	23.3
1997	3.4	15.7	22.0

Source: SIA Newsletter

While the increase in FDI is very substantial when compared to the pre-reform period, it does not compare very favourably, when compared with other countries in Asia. In 1996, China attracted $ 42.3 billion FDI, Indonesia $ 8.0 billion, Malaysia $ 5.3 billion and Thailand $ 2.4 billion. While the volume of FDI inflows into India are much lower compared to other countries, there has been an increase in India's share in total inflows into developing countries. A noticeable feature is that while China, Malaysia, Philippines, Thailand and Vietnam's shares have been falling, only India and Indonesia have had consistently rising shares. Yet another aspect is the fact that of the countries selected for our comparison, India has had the highest growth rate of almost 60 per cent during 1991-96. (Table 7)

Table 7: FDI Inflows to Developing Countries

($ Million)

	Developing Countries	China	India	Indonesia	Malaysia	Phillipines
1991	41696	4366	155	1482	3998	544
1992	49625	11156	233	1777	5183	228
1993	73045	27515	574	2004	5006	1238
1994	90462	33787	1314	2109	4342	1591
1995	96330	35849	1929	4348	4132	1478
1996	128741	42300	2587	7968	5300	1408
Growth Rate (Per cent) (1991-96)	20.7	46.0	59.9	32.4	4.8	17.2

Source: World Investment Report (1997)

Table 7a: Share in FDI Inflows to Developing Countries

(Per cent)

	China	India	Indonesia	Malaysia	Phillipines	Thailand
1991	10.5	0.4	3.6	9.6	1.3	4.8
1992	22.5	0.5	3.6	10.4	0.5	4.3
1993	37.7	0.8	2.7	6.9	1.7	2.4
1994	37.3	1.5	2.3	4.8	1.8	1.5
1995	37.2	2.0	4.5	4.3	1.5	2.1
1996	32.9	2.0	6.2	4.1	1.1	1.9

Source: World Investment Report (1997)

There has also been a change in the organisational form of FDI inflows in the post 1991 period. With liberalisation, the policy barriers that were neutralising the internalisation advantages to foreign investors have been removed. Hence, a greater proportion of technology collaborations takes place through internal or FDI mode. Thus, in the 1970s the proportion of foreign collaborations that were internalised through FDI in total approvals has gone up from just 11 per cent to 25 per cent in the 1980s, and still further to 59 per cent in the 1990s.[12] Liberalisation has shifted the balance between FDI and licensing in favour of FDI. Thus foreign investors have shown a preference for technology collaborations with equity participation rather than a purely technological agreements. Further, with relaxation on the extent of equity participation in certain high priority industries and in trading companies engaged primarily in exports, majority of the foreign collaborations through the FDI route have been in the 50 to 100 per cent foreign ownership range. Thus during August 1991 and May 1997, 56 per cent of the total number of foreign collaborations had an equity ownership of more the 50 per cent.[13] Another noticeable feature is that with liberalisation the importance of joint venture mode of operations has declined.

Since liberalisation, there has also been a change in sectoral patterns of FDI inflows. The government policy pursued in the period prior to 1991 restricted FDI to technology intensive branches of manufacturing industry. Hence, 85 per cent of FDI stock in 1990 was in manufacturing, plantations and services accounted for 9.5 per cent and 5 per cent share of FDI stock respectively in 1990. The stock data on FDI upto 1995 reveals a slight shift away from manufacturing in favour of services. Thus in 1995 manufacturing accounted for 83.4 per cent while services accounted for 8.7 per cent of total FDI stock. (Table 8)

However stock data does take into account past flows and to that extent the shift away from manufacturing may have been more

12 See SIA Newsletter

13 See N. Kumar (1998)

Table 8: Sectoral Distribution of FDI

(Million Rupees)

	Industry Group	FDI Stock as in March 1980		FDI Stock as in March 1990		FDI Stock in March 1995	
		Value	Per cent	Value	Per cent	Value	Per cent
I	Plantations and horticulture	385	4.1	2560	9.5	44900	4.8
II	Mining	78	0.8	80	0.3	2400	0.3
III	Petroleum and Power	368	3.9	30	0.1	27400	2.9
IV	**Manufacturing**	**8116**	**86.9**	**22980**	**84.9**	**785200**	**83.4**
	Food and beverages	391	4.2	1620	6	68700	7.3
	Textiles	320	3.4	920	3.4	37000	3.9
	Machinery and machine tools	710	7.6	3540	13.1	106200	11.3
	Transport equipment	515	5.5	2820	10.4	98700	10.5
	Metal and metal Products	1187	12.7	1410	5.2	43700	4.6
	Electrical and electronics	975	10.4	2950	10.9	102100	10.8
	Chemicals and allied products	3018	32.3	7690	28.4	208700	22.2
	Miscellaneous manufacturing	1000	10.7	2030	7.5	1201	0.1
V	**Services**	**385**	**4.1**	**1400**	**4.2**	**81700**	**8.7**
	Telecommunications	0	0	0	0	na	na
	Finance and Banking	na	na	na	na	na	na
	Hotels and tourism	na	na	na	na	na	na
	Air and sea transport	na	na	na	na	na	na
	Consultancy	na	na	na	na	na	na
	Other services	na	na	na	na	na	na
	Total	**9332**	**100.0**	**27050**	**100.0**	**941600**	**100.0**

Sources: *Kumar 1998*

RBI Bulletin, April, 1998

SIA Newsletter, April, 1998

pronounced than the data suggests. Data on approvals for FDI from 1991 to March 1998 show that while manufacturing accounted for only 38.4 per cent services accounted for 28 per cent and power and petroleum accounted for 29.2 per cent. (Table 9) Among the

manufacturing sub-sectors, FDI approvals for the 1990s are more evenly distributed between food and beverages, transport equipment, metals and metal products, electricals and electronics, chemicals and allied products and miscellaneous manufacturing unlike a very heavy concentration in relatively technology intensive sectors, viz., machinery, chemicals, electricals and transport equipment upto 1990.

Table 9: Sectoral Distribution of FDI

Industry Group	Approvals 1991-98 Value	Per cent
Plantations and horticulture	5129	0.3
Mining	15624	1.0
Petroleum and power	463633	29.2
Manufacturing	**609741**	**38.4**
Food and beverages	79282	5.0
Textiles	26168	1.6
Machinery and machine tools	36637	2.3
Transport equipment	74779	4.7
Metal and metal Products	75267	4.7
Electrical and electronics	83613	5.3
Chemicals and allied products	119003	7.5
Miscellaneous manufacturing	114992	7.2
Services	**443827**	**28.0**
Telecommunications	307253	19.4
Finance and Banking	68885	4.3
Hotels and tourism	30144	1.9
Air and sea transport	24900	1.6
Consultancy	12645	0.8
Other services	48751	3.1
Total	**1586705**	100.0

Sources: Kumar 1998
RBI Bulletin, April, 1998
SIA Newsletter, April, 1998

Table 9a: Foreign Direct Investment Inflows - Industrywise

($ Million)

Source	1994-95	1995-96	1996-97
Engineering	131.6	251.9	730.2
Chemicals and Allied Products	141.2	126.7	303.8
Food and Dairy Products	60.9	85.0	237.5
Finance	97.7	270.0	217.0
Electronics and Electrical Equipment	56.4	129.6	153.6
Computers	10.2	52.1	58.7
Pharmaceuticals	10.1	54.8	47.6
Services	93.4	100.4	15.2
Domestic Appliances	108.3	0.5	15.1
Others	162.2	347.0	278.3
Total*	**872.0**	**1418.0**	**2057.0**

* Total exclude NRI inflows since their industrywise breakup is not available.

Source: RBI

V. Concluding Remarks

While FDI into India has increased in recent years, gains from FDI have not been maximised. The mismatch between sector selectivity advocated by Indian policy makers and choice of sectors by MNCs is arising in response to prevailing policy induced distortions. Thus, while investment in infra-structure is a pressing need, foreign investors have had to deal with serious problems which arise when private sector projects are to be phased into a highly regulated infrastructure sector. On the other hand, the consumer goods sector has infact attracted foreign investment due to high protection accorded to this sector. Investment into export-oriented labour intensive industries has not been forth-coming due

to labour market rigidities and the decentralised production structure which owes its existence partly to the inflexibility of the labour market. India's large pool of skilled manpower is attracting FDI into skill-intensive and capital intensive sectors e.g. computer software and telecommunications rather than into labour intensive sectors.

The ill effects of FDI can in fact be treated by addressing the underlying distortions. A more open trade regime, public sector reforms, flexible labour markets, and increase in literacy rates are channels through which India could benefit most from FDI. Uninhibited domestic market competition would lead to greater efficiency gains. In particular, because of the large size of India's markets, unless they are subject to international competition, domestic producers will have little incentive to improve their efficiency and produce for exports, which may delay India's integration into the world market and the associated welfare improvements.

Despite the distinct advantage of FDI over other types of flows, there are certain apprehensions about the impact of FDI on economic growth and dependence on foreign resources. However, if one looks at overall impact of FDI across the countries, it seems that the crucial factor explaining the impact is not so much the country of origin and types of FDI, but the differences in development strategies and domestic economic environment of the host country.

The experiences of countries suggest that the following factors are important in determining the impact of FDI on host countries.

Development strategy, export-oriented industrialisation or import substitution seems to be crucial. A country adopting export-oriented strategy has a less protected domestic economic environment so that foreign firms are forced to use resources in the most appropriate way in order to maintain a high degree of international competitiveness.

To obtain the maximum benefits from FDI, the host country must implement policies to maximise the linkage effects created by

foreign firms. This is to ensure a full integration of local firms into the foreign investment sector in the course of time so as to prevent the formation of a foreign enclave leading to an increasing degree of foreign dependency.

While FDI benefits the host country through increase in output growth, technology transfer, employment and exports, the extent to which such gains can be maximized would depend on the efficient functioning of markets. The policy tools to ensure contestability of markets include trade policy, FDI policy, regulatory policy with respect to domestic economic activity and competition policy.

ANNEXURE

Performance of US MOFA - 1995

	Incom/ sal	incom/ Asst	inv/ asst	invin/ sals	R&D/ Sale	EXP to AFF	IMP fr aff	per empl.$	cap int emp
All Countries	**6.42**	**4.49**	**1.71**	**2.44**	**0.74**	**10.12**	**8.05**	**33710**	**71.791**
Argentina	5.71	5.23	0.76	0.82	0.18	7.65	0.68	29754	0.454
Brazil	11.47	10.82	1.17	1.24	0.62	7.06	4.09	23467	1.804
Chile	12.47	8.30	1.54	2.31	0.21	5.36	8.07	17676	0.618
China	**6.02**	**4.64**	**0.20**	**0.26**	**0.24**	**16.59**	**7.30**	**5296**	**1.322**
India	**5.34**	**5.90**	**0.99**	**0.90**	**0.30**	**5.34**	**1.68**	**4696**	**0.321**
Indonesia	17.88	10.63	0.18	0.30	0.10	2.06	12.64	12820	1.145
Malaysia	9.97	9.58	0.62	0.63	0.15	18.33	21.46	8689	1.628
Phillipines	8.10	8.38	1.24	1.20	0.37	13.62	7.56	7575	0.800
Thailand	6.81	6.55	1.38	1.43	0.04	9.49	4.67	8642	1.506

Performance of US MOFA - 1996

	Incom/ sal	incom/ Asst	invin/ sals	R&D/ Sale	R&D/ SalG	EXP to AFF	IMP fr aff	per empl.$	cap int emp
All countries	**6.17**	**4.35**	**2.26**	**0.76**	**0.90**	**10.07**	**8.06**	**34526**	**428**
Argentina	5.42	4.88	1.54	0.25	0.30	6.08	0.78	29494	241
Brazil	6.89	6.50	1.54	0.98	1.07	7.29	4.10	27306	186
Chile	11.46	6.16	2.24	0.08	0.10	5.89	5.99	19622	358
China	**8.88**	**7.43**	**0.23**	**0.29**	**0.31**	**15.74**	**11.90**	**6096**	**91**
India	**2.36**	**2.08**	**1.59**	**0.46**	**0.50**	**7.99**	**1.95**	**5440**	**88**
Indonesia	18.04	10.79	0.46	0.06	0.06	4.70	5.63	12385	318
Malaysia	8.98	8.94	1.00	0.14	0.16	16.68	26.15	9132	118
Phillipines	8.32	7.98	1.14	0.20	0.22	14.41	11.02	8379	110
Thailand	5.27	5.22	1.45	0.04	0.04	10.75	3.69	9313	173

Source: Tabulated from the US Survey of Current Business.

Actual Flows of FDI

($ Million)

	NRI Investment	Total FDI	Proportion of NRI Investment (Per cent)
1981	0.2	12.6	1.2
1982	11.8	66.4	17.7
1983	6.4	61.3	10.5
1984	12.9	99.4	13.0
1985	15.4	101.9	15.1
1986	6.3	84.8	7.4
1987	16.0	83.1	19.3
1988	12.1	172.3	7.0
1989	13.1	195.2	6.7
1990	3.0	73.3	4.1
1991	70.5	154.5	45.6
1992	57.8	260.5	22.2
1993	183.8	585.9	31.4
1994	356.5	950.4	37.5
1995	607.7	1964.5	30.9
1996	582.0	2382.3	24.4
1997	286.3	3314.7	8.6

Source: India Investment Centre

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