☐ Foreign Direct & Portfolio Investments Flows and Development: A Perspective on Indian Experience (Nagesh Kumar), 2014.

Unit-3, Article-3

Content

1) The Context

- Foreign capital flows have emerged as key channels of global economic integeration all across the world over the past two decades.
- FDI, FPIs (Foreign Portfolio Investments), representing equity and debt flows accompained by management control have become highly visible

and often dominant components of the Foreign capital flows in recent years with the rise in (FIIs). (P-2)

- ## Prospects of FDI flows ~~reps~~

It represent longer-term investments made abroad bringing together with capital & entrepreneurship, technology & managerial know-how and sometimes even mkt access, hence are seen by developing countries as catalysts of development.

- Therefore, most of Developing countries actively seek ~~instruments~~ to attract FDI flows with different policy instruments.
- FPI, in contrast, tend to have limited potential ~~of~~ of contributing to development, if at all, given their short-term and speculative nature.
- They are often seen to be bringing volatility to the financial and exchange rate mkts.
- The number of EMEs are seeking to moderate their volatility through a variety of capital goods.
- India's Globalisation policy (1991) < Inflow / Outflow] → Bidirectional → Competition↑ Competitiveness↑
- This paper summarises the Indian experience in attracting FDI & FPI & reviews the recent trend, pattern & prospects for these flows and developmental ~~aspects~~ impacts.

→ Trends of FDI
→ Conclusion.

~~FPI is similar to F~~
FII (Foreign Institutional Investors) is an investor or group of investors who brings FPIs.

(P-3)

FDI	FPI
→ FDI aims to take control of the company in which investment is made	→ FPI aims to reap profit by investing in shares, bonds of the invested entity without controlling the company
→ Measures on the basis of percentage of shares ~~to~~ own in a company.	→ Same as FDI
	→ It should not exceeding 10% of the total paid up Capital of the company.

→ Both FDI & FPI better than External Commercial Borrowing (or Foreign loans). need to repay the debt

→ In FDI, both ownership and control of the firm is with Investor.	→ FPI defined by IMF, is defined as cross-border transactions ~~and~~ and positions involving debt or equity securities other than those involved in direct investment or reserve assets.
→ FDI means real investment.	→ FPI is monetary or financial investment.
→ Investment in buildings, machineries directly in the company in which he had made investment.	→ FPI doesn't create such productive assets directly.
→ Directly augments employment, output, export etc.	FPI aimed at getting profits from shares, interests from deposits etc.

FII → is when foreign companies make investment in the stock mkt. of a country (financial mkts) (P-5)

- Entry & Exit → easy
- Transfer of funds
- Long/short-term capital (generally short term)
- Increases in capital of the country.

2) Evolution of Policy Regime towards FDI & FPIs in India.

- Indian govt. policy towards FDI has evolved over time in tune with the requirements of the process of development in different phase phases.

→ Started with Import Substitution Industrialisation in order to improve the local capability in the heavy industries.

→ Govt. adopted restrictive attitude towards FDI.

→ 1973 onwards, FERA (Foreign Exchange Regulation Act) of 1973 required all foreign companies operating in India to register under Indian Corporate Legislation with to 40% foreign equity. Exceptions from the general limit of 40% were made only for companies operating in high priority ~~of~~ or high technological sectors.

→ In the 1980s, the attitude towards FDI began to change as a part of the strategy of modernisation of industry with liberalised imports of capital goods & technology, exposing the Indian industry to foreign competition, an assigning a greater role to MNEs in the promotion of manufactured

(P-5)

exports.

- The policy changes adopted in 1980s covered liberalisation of industrial licensing (approval) rules, a host of incentives, a exemption from foreign equity restrictions under FERA to 100% export-oriented units and a degree of flexibility concerning foreign ownership.

→ 1990s → Broader process of reforms designed to increase her integeration with the global economy.

→ More liberal trade policy besides ~~fror~~ reforms of ~~Capital AHEr~~ capital & exchange controls.

→ NIP (New Industrial Policy, 24th July 1991) →

→ In Sept 2012, India allowed FDI in multibrand retail & in civil aviation.

→ Sectoral caps were revised upwards in July 2014 in some sector like telecom to 100%, in insurance to 49%, and in defence equipment beyond 26%. on a case by case basis.

→ FIIs → In Sept 1992, the Indian govt. announced guidelines for investment by FIIs in the Indian Capital Mkt.

→ This liberalisation has led to considerable inflows of portfolio inflows making the country one of the most exposed to ~~portfolio~~ portfolio inflows.

→ In June 2013, FII investments were reclassified as FPI which is subject to their holdings in a Company within 10% of its equity. Any holdings beyond 10% will qualify as FDI.

→ Recognising the importance of outbound investment for competitiveness of enterprises, the policy governing outbound FDI has also been liberalised since 1991.

→ The limits of outward investments have been gradually relaxed and Indian enterprises are now permitted to invest abroad up to 100% of their net worth on automatic basis.

→ Entered Bilateral Investment Promotion & Protection Agreement (BIPAs) with 82 countries

3) FDI & their Quality.

3.1 Trends in FDI inflows.

- FDI inflows to India have been growing since 1991, but the big break came in 2006 when annual inflows to the country nearly tripled in one year from $ 7.6 billion to $ 20 billion and increased from that level peaking to $ 47 billion in 2008 before declining to $27 billion in 2010 in the wake of GFC but recovering to $ 36.5 billion in 2011. With the slowdown of Indian economy since 2011, however, it declined again and was at $ 28 billion.

2005	→ $ 7.6 billion
2006	→ $ 20 billion
2008	→ $ 47 billion
2010	→ $ 27 billion
2011	→ $ 36.5 billion

- FDI inflows peaked in India, this ratio at 10.8 %, was quite close to that for developing Asia at 10.6 %.
- Afterwards it has declined in the wake of financial crisis indicating the potential for a rise in the future.

4) Investment Climate & Prospects for FDI Inflows.

- Determinants of FDI inflow →
  - i) Mkt size ii) extent of urbanisation, iii) quality of infrastructure iv) Geographical & cultural proximity with major sources of capital, and policy factors e.g, tax rates, investment incentives, performance requirements.

Advantages → India's large population

Disadvantages → Relatively low level of (Y), low level of urbanisation, poor quality of infra

- Relative attractiveness of the country improved with the increase in income growth & mkt size.
- Industrial performance tends to crowd in FDI inflows as well.
- 2006 → Recent rise of FDI inflows because of improving investment climate with the acceleration of growth rate since 2003, the rise

(p.8)

of a sizeable middle class with purchasing power.

- FDI Confidence Index published by AT Kearney, a global consultancy org^n, covering 25 top destinations for FDI.

  India moved up from 6th place in 2003
  to 2nd in 2005.
  3rd in 2010
  2012 → 2nd
  2013 → 5th rank

- Japanese Bank of International ~~Cooper~~ Cooperation (JBIC) as well as in UNCTAD: World Prospects Survey 2013-15, where India ranked as the 3rd most ~~preffe~~ preferred FDI location (UNCTAD, 2013)

- Recent Reforms adopted by the country to allow FDI in ~~multible~~ multibrand retail & civil aviation a large infrastructure projects such as Delhi-Mumbai Industrial corridor are also likely to help in realising its potential for FDI inflows.

4.1) Quality of FDI inflows.

→ Sectoral Composition — [~~Ma~~ Service, Manufacturing.

→ Comparison with China.

→ Sectoral Composition

- If One of the indicators of quality is the sectoral Composition of FDI inflows. It matters whether FDI is going to the modern tech-intensive sector and building productive capabilities or to conventional sectors crowding out domestic investments.

- In terms of the sectoral composition of FDI inflows, there is shift since 1991 in India's case.

- Earlier the bulk of FDI inflows used to be directed to manufacturing especially the high-tech. industries through ~~sect~~ selective policy.

- After Liberalisation, a substantial proportion of FDI inflows has been ~~directed~~ directed to services.

Manufacturing accounted → 40% of inflow
Services → 35% in the post 1991 period.

post 1991 → Food & beverages, transport-equipment, metals & metal products, electricals and electronics, chemical & allied products etc

pre-1991 → Heavy concentration on machinery, chemicals, electricals & transport equipment

- Comparison with China

- In China bulk of FDI inflows have been directed by the govt. policy to manufacturing sector (Export-oriented type) & very little has gone to services.

- Of the FDI in manufacturing in China, 11% has gone in electronics & telecommunication equipment helping it emerge as the leading producer and exporter of these products and helped to make China as a global factory.

5) Impact of FDI on Growth & ~~Development~~ Domestic Investment.

- $\boxed{\text{FDI inflows}} \rightarrow$ ~~Growth rate~~ $\rightarrow \boxed{\text{Capital stock}}$
  $\downarrow$
  Infusion of new tech $\rightarrow \boxed{\text{Economic Growth}}$

- FDI inflows could contribute to growth rate of the host economy by augmenting the capital stock as well as with infusion of new tech. However, high growth rates may also ~~at~~ attract more FDI inflow by enhancing the investment climate in the country.

$\boxed{\text{FDI}} \rightleftarrows \boxed{\text{Growth}}$

- What is the nature of the relationship in India?
- ~~Relat~~ Examining the R/B between FDI on growth.
- Impact of FDI on domestic investment

Inflow of FDI

- Crowding-in domestic investments?
- Crowding-out domestic investments?

→ Quality of FDI Inflow

→ The quality of FDI in India in respect to its impact on growth and on domestic investment is of mixed type and leaves scope for improvement.

- The R/B FDI & Domestic Investment depends on govt. policies.

6) FDI and Export Platform Production

- A number of developing countries have used FDI to exploit the resources of MNEs such as globally recognised brand names, best practices tech, or by increasing integeration with their global production networks, among others for expanding their manufactured export.

- Foreign enterprises while setting up export-oriented production bases created 23 million jobs by 2003 making China a global factory.

- Unlike China & other East Asian countries, India has not been able to ~~export~~ exploit the potential of FDI for export-oriented production.

- The bulk of FDI inflow in India are mkt-seeking ~~comp~~ coming for tapping the domestic

(p.10)

mkt with the share of foreign affiliate in exports around 10 %.

- Therefore, the quality of FDI inflow in respect of export orientation is ~~poo~~ relatively poor. ~~as com~~ compared to other East Asian Economies

- The Role of host country policies in exploiting the potential of FDI for export-oriented prodn.

- China ~~a~~ succeeded in expanding manufactured exports with help of MNEs affiliates, regulatory stipulate that wholly owned foreign enterprises must undertake to export more than 50 % of their output.

- India has not imposed export obligations on MNE affiliates except for those entering the products ~~in~~ reserved for SMEs.

- India's experience is very similar to Thailand that has emerged as the major auto hub of ~~Southeast A~~ Southeast Asia.

7) R&D and other knowledge based Activities and Local tech. Capabilities.

- A comparison of R&D intensity of foreign firms in India and ~~in~~ in other countries has not been possible due to lack of data.

- Within the country, foreign ~~for~~ firms appear to be spending more on R&D activity than in India than local firms.

- The quality of technology transfer is superior in the case of a sole venture than in the ~~case~~ case of a joint venture, from the host country point of view, the latter may have more desirable externalities in terms of local learning and diffusion of the knowledge transferred.

8) FDI inflow and their impact.

	Net FDI	~~Net~~ Net FPI	Total
2000-01	3270	2590	5860
2003-04	2388	11377	13765
2007-08	15891	27434	43325
2008-09	22343	-14032	8311
2012-13	19819	26891	46710

FII

- One may argue that FII inflows help a country to build foreign exchange reserves but it also enhance the volatility.

- Therefore, Developing countries such as India should rely for their foreign resource needs more on FDI inflows rather than FIIs.

- A number of emerging economies such as Brazil South Korea and Indonesia have recently imposed Capital controls to moderate their volatility.

8) India as an Emerging source of FDI ~~out~~ outflows

- The major turnaround in their outflows came in 2006 when ~~of~~ outflows increased ~~from~~ to \$ 14 billion ~~to~~ ~~20~~ and peaked to nearly \$ 20 Billion in 2007 before declining to around \$ 15 Billion in subsequent year ~~is~~ in the wake of GFC.

- The big break came with Indian enterprises using their outward investment to acquire larger companies in the advanced economies ~~as a part of their~~.

- Past few years have seen several multi-billion dollars aquisitions of western firm by Indian companies including Tata Steel - Corus, Tata-Motors - Jaguar / Land Rover etc..

- During 2012-13, outward FDI Flows declined dramatically as Indian companies struggled with slowdown of Indian economy.

- A recent analysis of India's outflow FDI flows among the emerging mkts has shown that the relative scale of India's outward ~~flows~~ FDI was quite significant.

		FDI outflow.
2005	-	2985 (Million USD)
2006	—	14285 "
2007	—	19594 "
2013	-	~~1679~~ 1679 "

continues to exercise a major influence on the magnitude of FDI inflows by acting as a signaling device for foreign investors about the growth prospects for the potential ~~host~~ host economy.

- Paying attention to improve macroeconomic ~~perf~~ condition of the economy (investment climate, growth rate, industrial performance etc)
- In order to exploit the potential of MNEs / FDI inflows by host countrys, the govt. should focus ~~of~~ on phased manufacturing programmes, export performance requirements and domestic ownership requirements.
- Maximise the crowding-in domestic investments and minimise the crowding-out Domestic I.
- Careful & deep observation of policies experience of South Asian countries such as Malaysia, Korea, China & Thailand.
- Export-oriented FDI minimises the possibilities of ~~cro~~ crowding-out of domestic investment.
- FDI inflow in newer areas where local capabilities ~~of~~ do not exists.
- Maximize gains from global is in diffusion of knowledge brought in foreign enterprises.
- Vertical inter-firm linkages with domestic enterprises.

- ~~Emt Stro~~ The Govt. should also focus on the employing proactive measures.

- Investments made by govt. in building local capabilities for higher edn and training in technical disciplines, centers of excellence & ~~am~~ in other aspects of national ~~un~~ innovation systems have substantial favourable externalities.

- CAD (Current Account Deficit). (policy)
- Export competitiveness should be strengthen.
- Strategic import substitution
- (Attention should be paid to very large and fast growing imports of ~~ed~~ electronics, non-electrical machinery, and defence equipment, among others that provide opportunities for strategic import substitution.

- Effort needs to be ~~need~~ made to start domestic manufacture of these products leveraging India's large domestic mkt size and by targeting large ~~units~~ manufacturing facilities MNEs to set up local manufacturing facilities.

- Strategic import substitution will also lead to a more balanced structural change by creating more manufacturing jobs which is critical for poverty reduction.