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FDI Flows and Investment Policies in India and Select Asian Countries: A Comparative Analysis



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Introduction

Foreign direct investment (FDI) contributes to a country's economic growth and development. It adds to fixed capital formation and has a positive impact on balance of payments without the risk of debt creation or the volatility associated with short term portfolio capital flows. It brings technology, know-how, managerial skills, technology and access to markets. Further, FDI increases the efficiency of local firms and the competitiveness of local markets.

While FDI can bring a wide range of potential benefits, aspects like transfer or spillovers of management, skills, know-how, organizational capabilities and technology are of particular interest to developing countries. At the same time, there is also an increasing recognition that transnational corporations (TNCs) can make a significant contribution to export capabilities.

FDI in Developing Countries

FDI has attracted increasing attention in developing countries

due to the perceived benefits in terms of injection of capital, technology and knowledge. Specifically, a number of factors have led to increased efforts by developing countries to attract FDI inflows:

- Increased recognition by policy makers that the bundle of assets and capabilities encompassed in FDI could contribute directly to growth and development of the national economy;
- Declining trend of other forms of assistance increased reliance on FDI, and various financial crises may have led to a preference for longer term, relatively stable and often tangible flows of direct investment; and
- Governments in developing countries have gained confidence in their ability to maximize the benefits and minimize the liabilities of transnational corporations.

Recent Trends in FDI Flows and FDI in Services

According to UNCTAD's World Investment Report 2005, global

FDI inflows increased to US\$ 648 bn in 2004 from that of US\$ 632 bn in the previous, thus reversing the downward trend in the last few years. The upward swing in FDI inflows was led by developing countries, which registered an overall rise of 40%, whereas FDI inflows to developed countries declined further during 2004. As a result, developing countries accounted for 36% of global FDI inflows in 2004, up from 26% in 2003. Asia and the Pacific, Latin American region and South-east Europe & CIS registered increased FDI inflows during 2004, while FDI flows to the African region remained stable.

In line with the growing importance of services in GDP, the structure of FDI has also shifted towards services. From only one-quarter in the early 1970s and less than 50% in 1990, the share of services in global FDI inflows has risen to 60% in 2002. Between 1990 and 2002, the world's inward stock of services FDI quadrupled from an estimated US\$ 950 billion to over US\$ 4 trillion.

Further, while trade and finance services continue to be major sector, other services sectors such as electricity, telecommunications, water supply and business services (which encompass a diverse group, ranging from real estate to professional services to IT-enabled services) have also emerged as leading FDI recipients in recent years. Health services and education services have also witnessed sharp rise in inward FDI stock. Rapid growth in demand for these services, and privatization and liberalization in many countries have facilitated the surge in services FDI.

of the unfolding new area of knowledge economy, with its large pool of scientific and creative human resources and R&D facilities.

These strong fundamentals are corroborated by recent findings of internationally reputed organizations / institutions such as AT Kearney, PricewaterhouseCoopers', among others, which have attested to the inherent strengths of the economy

India's FDI Performance vis-à-vis Select Asian Economies

While FDI inflows to India has increased in recent years as

Further, FDI in India is yet to play its desired and significant role in overall economic activity in India is evidenced by the fact that the share of inward FDI stock to the country's GDP has been much lower as compared to those in other Asian countries. From 14.9% in the case of Philippines in 2004, Thailand (29.7%), and Malaysia (39.3%), India's indicator at 5.9% pales in comparison. Even in Vietnam, which has emerged as an important FDI recipient among developing countries in recent years, the share of inward FDI stock as a percentage of the country's GDP was as high as 66.3% in 2004.

In countries such as Vietnam and Malaysia, FDI has contributed significantly to total aggregate investment taking place in the economy, with the share of inward FDI as high as 11.3% and 19.1%, respectively, of Gross Fixed Capital Formation (GFCF) during 2004. In Philippines and Thailand also, despite the decline witnessed in 2004, the share of inward FDI flows in total GFCF has been consistently high in the previous years. In comparison, despite the rising trend in inward FDI flows in India, the contribution of FDI in GFCF in the country has been low, ranging from 2.0% in 1992-1997 (annual average) to 3.4% in 2003, albeit a rising trend.

FDI Policy in India and Concerns

Successive simplification and streamlining of the FDI policy has opened up most sectors of the

Trends in FDI Inflows in India and Select Asian Countries (US\$ mn)							
	<i>1992-97 (Annual Average)</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>FDI Inward Stock, 2004</i>
India	1676	2319	3403	3449	4269	5335	38676
Indonesia	3518	-4550	-2977	145	-597	1023	11352
Malaysia	5816	3788	554	3203	2473	4624	46291
Philippines	1343	1345	982	1792	347	469	12685
Thailand	2269	3350	3813	947	1952	1064	48598
Vietnam	1586	1289	1300	1200	1450	1610	29115

Source: World Investment Report 2004 and 2005, UNCTAD

India's FDI Potential

The Indian economy is now well recognized as an attractive destination for investment and a large and growing market for business. India is emerging as a global player in information technology and is in the forefront

compared to other select Asian countries, the stock of FDI inflows for India at US\$ 38.7 bn in 2004, are lower than that for other Asian countries such as Malaysia (US\$ 46.3 bn) and Thailand (US\$ 48.6 bn).

FDI Inward Stock as Percentage of GDP							
	1985	1990	1995	2000	2002	2003	2004
India	0.3	0.5	1.6	3.8	5.2	5.4	5.9
Indonesia	28.2	34.0	25.0	40.4	33.3	27.5	4.4
Malaysia	23.3	23.4	32.3	58.5	59.5	57.2	39.3
Philippines	8.5	7.4	8.1	17.1	14.5	14.5	14.9
Thailand	5.1	9.7	10.5	24.5	27.7	25.8	29.7
Vietnam	1.1	4.0	27.8	48.2	50.2	50.6	66.3

Source: World Investment Report 2004 and 2005, UNCTAD

economy to foreign investments, with the result that India has one of the most liberal investment policies in Asia. FDI is now allowed under the automatic route in all activities, subject to

With this perspective, some of the issues that would be required to be addressed in India's endeavour to attracting increasing volumes of FDI in the years to come would include FDI

warehouses, export trading), real estate (except for integrated township development) and a few other sectors deemed sensitive by the government. There also are limits to foreign ownership in a host of sectors like telecom, banking, advertising, airports, and insurance etc. Although there are some restrictions for FDI in other Asian countries, the list does not appear to be as exhaustive as in India. In Malaysia, for instance, investment restrictions exist only in a few specific parts/components industries. In the retail trading sector, foreigners can acquire upto 70% equity in local companies as long as the 30% minimum condition is met.

Further, while the findings of many reputed international organizations/institutions attest to the inherent strength of the Indian economy and corroborate the potential of India in the global investment scenario, concerns expressed by them about the investment climate and related issues would need to be addressed/examined. These concerns include issues such as bureaucracy and political instability, weak/inadequate infrastructure and concerns about intellectual property rights, heterogeneous nature of the Indian markets, business regulations.

In addition, the World Bank's FDI Investment Climate Surveys have highlighted that, while India fares relatively well as compared

FDI Inflows in Select Asian Countries							
<i>(as percentage of GFCF)</i>							
	1992-97 (Annual Average)	1999	2000	2001	2002	2003	2004
India	2.0	2.2	2.3	3.2	3.0	3.2	3.4
Indonesia	6.4	-6.6	-13.9	-9.7	0.4	-1.3	1.9
Malaysia	18.0	22.5	16.4	2.5	14.5	10.8	19.1
Philippines	8.5	11.9	8.4	6.9	13.3	2.6	3.3
Thailand	4.1	23.8	12.4	14.4	3.3	5.7	2.5
Vietnam	34.5	20.1	15.0	13.6	11.0	11.6	11.3

Source: World Investment Report 2004 and 2005, UNCTAD

few exceptions that require government approval. Most manufacturing sectors are now opened up to FDI upto 100% under the automatic route. Further, in a number of infrastructure and services sectors, 100% FDI under the automatic route has been allowed.

caps/restrictions, and concerns expressed by International Organizations.

In India, FDI is restricted in agriculture including plantations (except tea plantations), retail sector (except cash and carry wholesale trading, bulk imports with sales through custom bonded

to select Asian countries (as Indonesia, Malaysia and Philippines), with respect to important determinants such as policy, courts, crime and labour skills, efforts will need to be directed to address issues such as corruption, tax administration, management time, average days to clear customs, finance, and infrastructure (electricity), critical areas where India's trails behind the other Asian countries.

Current Imperatives

Identifying key issues/concerns with a view to discerning policy parameters to foster increased FDI inflows, while also ensuring that FDI inflows is conducive to sustainable development, is an imperative for a developing country like India. This assumes added importance with the FDI environment expected to become increasingly competitive.

World Bank's *Doing Business in 2006*

The low ranking of India among the Asian countries in the World Bank's *Doing Business in 2006* calls for urgent measures to streamline procedures with a view to reducing/addressing specific impediments identified by the report. According to the report, India ranked 116th in the Ease-of-Doing-Business ranking, far behind its Asian counterparts

such as Thailand (20th) followed by Malaysia (21st). Even Vietnam and Philippines were placed ahead of India, at 99 and 113, respectively.

Although India has made progress in some areas for improving the business climate, the most striking feature for India is that it ranks lower than its Asian peers in most of the categories. It takes 11 procedures, 71 days and costs 61.7% of income per capita to start a business in India, as compared to 8 procedures, 33 days and 6.1% of income per capita to start a business in Thailand, and 9 procedures, 30 days and 20.9% of income per capita in Malaysia. Hence, India ranks 90th on the ease of starting a business as compared to 57th and 29th for Malaysia and Thailand, respectively. According to the report, India needs to seriously address the entry procedures for new firms to set up a business. Cumbersome entry procedures push entrepreneurs into the informal economy, where businesses pay no taxes and many of the benefits that regulation are supposed to provide are missing.

Prospects for Global FDI Flows

As observed by UNCTAD, while prospects for global FDI are expected to be positive both in the short term and the medium

term, countries will intensify their efforts to attract FDI and will compete fiercely for it, and investment targeting will become an important tool for attracting FDI on a worldwide scale. Further, potential investors on their part will become increasingly selective in choosing investment destinations. As competition for FDI requires increased human and financial resources, developing countries in particular would need to formulate their policies and their investment promotion strategies carefully.

The contents of the publication are based on information available with Export-Import Bank of India and primary desk research through published information of various agencies. Due care has been taken to ensure that the information provided in the publication is correct. However, Export-Import Bank of India accepts no responsibility for the authenticity, accuracy or completeness of such information.

Note: Indian Rupees are referred in crore and lakhs:

1 crore : 10 million
1 lakh : 100 thousand

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