CHAPTER : VI

TRADE EFFECT OF FDI IN INDIA

6.1 INTRODUCTION:

An instrument of economic growth and development, it is asserted that foreign direct investment (FDI) enables a capital deficient and less developed country to build up physical capital. It also creates opportunities of employment and enhances skills of local labourers through various externalities. The history of FDI in India actually lies in the colonial rule. During the colonial rule, investors from Britain did set up their units in India, Britishers mostly attempted to invest in mining sector to meet their own ends and in those sectors that suited their own economic and business interest. The intention was specifically to acquire raw materials from India for their own manufacturing units. On the eve independence India faced a major challenge of mobilising resources in order to launch the economy on the track of development, but the efforts of the government to mobilise resources from within the economy as well as from other countries was not bearing fruit. Further independent India's external trade and performance had also faced severe threats many a times. The most challenging threat was in the year 1991, when widening current account deficits (CAD) and depletion of foreign exchange reserves contributed to loss of investors' confidence in India. This had put the external sector in severe stress.

To find the way out of the growing crisis it had suffered, India initiated economic reforms. Keeping in mind the interests of the nation, the policy makers also initiated a process of liberalising the policies towards FDI as they considered FDI as a medium for acquiring advanced technology. FDI was also regarded as an instrument to mobilize foreign exchange resources and managerial externalities. It was initially believed that FDI inflows besides enhancing the level of foreign exchange reserves in the short run, would revamp the competitiveness of Indian industry. These efforts at attracting inflows have been successful in certain sectors. One such sector is automotive industry1

The automotive industry in India actually seized the attention of the economists and policy makers all over the world. This is because Indian automotive industry has been registering tremendous growth over the years and has cropped up as a one of the leading contributor to India's GDP. Presently almost 7% of India's GDP is contributed by this industry .It also employs almost 19 million people both directly and indirectly2.Contribution of India in global auto industry development is also becoming increasingly important.

In the past two decades many global automobile manufacturers like, Honda Motors, Toyota Motors, Ford Motors, General Motors, Nissan Renault, Volkswagen Group have set up their production units in India. These collaborations in fact have entirely changed the landscape of this sector. Currently, the overall ranking of Indian automobile sector in the world is sixth, notwithstanding the fact that it ranks third in manufacturing of three wheelers, and second in manufacturing of two wheelers. The top five countries in the world that invest in Indian automobile industry are Japan, U.S.A, Netherlands, Italy and Mauritius. These five countries together contribute 71 percent of the FDI inflows in our country.

The question that arises here is whether FDI in automotive sector has been able to alleviate India's Balance of Payment position (BOP)3 or not. How does it compare with overall FDI in India .Number of studies have been conducted which have analysed this aspect of FDI.

[1] The automotive industry is a wide range of companies and organizations involved in the design, development, and manufacture, marketing, and selling of motor vehicles. It is one of the world's most important economic sectors by revenue.

[2] It is estimated that each direct auto job supports at least another five indirect jobs in the community, Autos are built using the goods of many industries, including steel, iron, aluminium, glass, plastics, carpeting , textiles, computer chips, rubber and more. Thus creating multiple jobs simultaneously.

[3] A statement that summarizes an economy's transactions (both visible and invisible items) with the rest of the world for a specified time period.

In one of the first study undertaken in India Prasad, B. (1971) explored the repayment cost of foreign investment in India for two sub period 1956-62 and 1963-67. His analysis deals with direct repayment cost only. According to his study during the 1956 and 1962 the inflow of FDI took place at a rate of Rs.22.7 crores per annum. But of this inflow almost eighty percent of foreign investment was in kind. Therefore only a small portion of capital inflows, Rs.4.6 crores p.a. represented actual inward movement of cash from abroad. Against this inflow, the outflows took place at an average rate of Rs 11.6 crores p.a. Thus the net capital transfer due to FDI during the period mentioned above was negative to the tune of Rs 7 crores p.a. He found that the situation further worsened during 1963-67. Prasad's study however did not consider the import and export on account of FDI.

V. Sharan (1992) in a similar exercise analysed the impact of the performance of MNCs on India's Balance of Payment for the period 1964-70. He studied this impact from two angles: one is the effect of FDI on capital and investment income account and the second is the way these companies (MNCs) generate exports and imports .These effects were studied separately for branches of foreign companies operating in India and the companies incorporated in India but controlled by foreigners.

In another similar study covering a period between 1982 to 1988, V.Sharan excluded the branches of foreign companies as they lost their significance with the enactment of FERA.He concentrated on FCRCs (Foreign controlled rupee company) functioning in India. He found that during this period there was excess of inflows over outflows during this period to the tune of Rs. 425 crores. He also found that dividend accounted for almost 48 p.c of the total outflows. The same scenario prevails in case of trade account. He found that the imports exceeded exports to the tune of Rs.406 crores .This clearly points towards high net outflows. Thus adversely affecting BOP of the country.

In another such study, Chandrasekhar and Ghosh (2010) found that the net outflows of foreign exchange on account of the operation of FDICs in India, has sharply increased, between 2002-03 and 2006-07. They found that this holds true even if these figures are normalised with the total income earned by these firms, with net earnings moving from a positive 3.4 per cent in 2001- 02 to a negative 9.1 per cent in 2006-07. They found that, foreign capital inflows into joint ventures are in the nature of large one-time flows for establishing an enterprise accompanied by smaller 'in effect' inflows on account of retention of part of the profits due to the foreign partner, which are not paid out as dividends. They found that, much of the expansion of the foreign firms occur on the basis of borrowing from the domestic market. Further, the increase in the fixed assets, sales and profits of the foreign companies, increases outflows on account of imports and expenditures like royalties that are tied to sales volumes. They concluded that, unless export revenues increase significantly and bring in additional foreign exchange revenues; net inflows that are positive in the beginning, will soon turn negative.

Chaisrisawatsuk and Chaisrisawatuk (2007) investigated Bi directional effects between international trade and foreign investment. They observed different aspects of international trade in separate models to observe the linkages between trade and FDI inflows. They found, complementary relation between international trade (either measured by exports or imports) and FDI inflows. They observed FDI have feedback effects with exports of not only the home and the host countries but also on those of other trading partners. They also observed similar linkages between FDI inflows and imports. While identifying the relationship between international trade and investment. They suggested policy harmonisation by the governments to further benefit from globalisation, which implies more coordination between trade and investment agencies at home and host countries. They also emphasised the need for multilateral agreements covering both trade and investment amongst countries.

In a similar study Jaykumar et al (2014) also elucidated the existence of a link between Foreign Direct Investment (FDI) and exports and imports in India. They found that the liberalization policy of the government automatically helped increase the FDI inflows into India. Their study has provided statistically significant evidence of positive linkage between FDI and trade along with other explanatory variables. FDI inflows have feedback effects with exports and imports of the trading partners and also of the other trading partners. They stressed that FDI induced by trade expansion also improve social welfare. They suggested that it is important for both the public and private sectors to realize the complementarity between trade and FDI, and respond accordingly.

On a different note Mathew, J. (2013) found that FDI inflows into India during 1991-92 were only $ 129 million; it gradually increased and reached $ 6130 million during 2001-02. He found that although the inflow fluctuated during first part of 2000s, the year 2006-07 witnessed 154 percent hike in inflow which is treated as the highest in the last two decades. However, during the global recession once again the inflow was negatively affected leading to negative growth during 2009-10 and 2010-11. The Indian economy regained confidence of the foreign investors during 2011-12 attracting $49007 million. The huge sum of FDI inflow is contributing significantly in reducing the deficit in India's current account and maintaining surplus in overall balance of payment account.

It is evident that these studies are indecisive about the impact of FDI on India's BOP. While some of the studies have pointed towards favourable effects of FDI, others have mentioned disadvantageous effects of FDI on BOP of India and trade intensity of different sectors of the economy. The empirical evidence on correlation between FDI and BOP is ambiguous, although in theory FDI is believed to have several positive effects on the BOP position of the host country .Further studies regarding the impact of FDI in automotive industry on India's BOP is also lacking. It is in this context that the study makes an attempt to analyse the effect of FDI on India's BOP in general and FDI in automotive sector in particular. Rest of the study is subdivided into following sections. In section two the explains the methodology of the study and sources of data are explained in section three the findings are presented and in the last section the conclusion are drawn.

6.2 TIME PERIOD OF PRESENT STUDY :

For the present study a period between 1991 to 2012 has been considered. The long stretch of the time period facilitates to study BOP effect of FDI in Indian economy in general and automotive industry in particular .This also enables us to capture in detail the impact of various factors including policy changes implemented over the period of time on FDI inflows in India. Further, the two sub periods i.e. 1991-2000 and 2001-2012 have been considered to understand and compare the impact FDI on India's BOP from a wider perspective in these two periods.

6.3 METHODOLOGY AND SOURCES OF DATA :

Foreign Direct Investment influences the balance of payment position of a country in two different ways Firstly through the finance (capital) flows association with it i.e. equity flowing into the country v/s dividend, royalty, and technical fees etc. flowing out of the country. In addition to this trade account effect of its operation i.e. the exports it generates v/s imports it uses in its production process are also taken into account. The first one can be treated as direct BOP effect and the latter along with the direct effect can be treated as the overall effect.

Thus:

Direct effect of Foreign Direct Investment on Balance of Payment = Equity Inflow- outflow on account of Dividend, Royalty, Technical fees Payment and Travelling &other Expenses.

Overall Effect of Foreign Direct Investment on Balance of Payment = (Direct Effect) + (Export-Import) facilitated by foreign investments

The balance of payment implication of foreign investment in automotive sector in India and in other sectors in general has been calculated by keeping in view the following:

Inflow of funds on account of annual increase in share capital and commission received.

Outflow of funds on account of royalty, technical & professional fees dividend remittance, and travelling & other expenses.

Imports and exports involvement by individual firms.

Data published by CMIE Prowess is the principal source of data for the present study. CMIE provides data of the financial performance of Indian companies .Basically it provides the annual reports of individual companies. It presents several well formatted analytical tabulations that include ratio analysis, funds –flow analysis, benchmark and peer comparisons. Data have also been taken from the data base of ACMA the nodal agency for the Indian Auto Component Industry. It represents 700 companies, which contributes more than 85% of the total auto component output in the organised sector. The surveys done by the RBI have also been considered for collecting data. These surveyed data are published in the monthly bulletin of RBI. By comparing the inflows and outflows of FDI during different years an attempt has been made to capture the BOP implication of FDI on Indian Automotive industry.

6.4 COVERAGE OF THE COMPANIES :

For the present study inflows and outflows of around 65 major automotive companies and the inflows and outflows of other FDI companies in India, for two different periods vis a vis 1991-00 and 2001-13have been attempted. The description for other FDI companies are provided in the subsequent table ,comparing the inflows and outflows of other FDI companies for mentioned period, the trade implication of FDI on Indian economy was found. This also enabled a comparison between the trade intensity of other FDI and trade intensity of FDI in automotive companies in India.

TABLE- 6.1: NUMBER OF FDI COMPANIES COVERED

Period Covered	Number of FDI Companies* covered
1991-94	275
1994-95	241
1995-96	268
1997-99	321
1999-00	334
2000-01	465
2001-03	490
2003-04	508
2004-06	501
2006-08	502
2008-11	745

Sources: RBI monthly bulletin (various issues)

*** Average No. of Companies.**

6.5 FINDINGS :

The results of the BOP effect of foreign direct investment in automotive industry in India is presented in the following table, in context of the methodology mentioned above. To understand the impact of the inflow of foreign direct investment from a wider angle the direct and the overall effect of foreign direct investment on trade of Indian Automotive industry during two sub periods are shown separately.

TABLE-6.2: BALANCE OF PAYMENT IMPLICATION OF FOREIGN DIRECT INVESTMENT IN AUTOMOTIVE INDUSTRY IN INDIA

(In Rs. Crores)

Period	Net inflow (Direct effect)	Net Inflow (Overall effect)	India's CAD BOP Deficit	1 as a % of 3	2 as a % of 3
	(1)	(2)	(3)	(4)	(5)
1991-2000	34130.6	146586.8	-1179560	2.89	12.42
2001-2013	58905.05	1786932.45	-14352030	0.41	12.45

Source: Compiled from Appendix- 3.

As shown above in case of automotive industry the direct effect, shows that during the period from 1991-2000 there was excess of inflows over outflows to the tune Rs 34130.6. Thus the direct balance of payment effect was positive. In other words the foreign direct investment in automotive sector contributed to reduce around 2.89 percent of India's current account deficit during this period. With further liberalisation in FDI related approach by the government ,the sector witnessed an excess of inflows over outflows to the tune of 58905.05, in the period 2001-2012 and due to this India's current account deficit(CAD) came down to 0.41 percent. When we take into consideration the overall effect of BOP during the first half of the study period it was positive at 146586.6 millions .It contributed to ease Current account deficit by 12.42 percent. During second sub period it contributed by 12.45 percent, to ease India's Current account deficit. Although the inflows were considerably higher during this period.

One of the reasons for this favourable impact is high export Intensity of automotive industry: As shown in the Tab. 2 the trade intensity of exports of automotive industry is higher than its imports. This indicates towards the fact that the growth performance of automotive industry in terms of exports has been satisfactory.

TABLE-6.3: TRADE INTENSITY OF EXPORTS AND IMPORTS OF AUTOMOTIVE INDUSTRY IN INDIA

(In Rs. Crores)

Period	Exports earnings	Total Sales	Imports	2 as a % of 3	4 as a % of 3
1991-00	428233.5	3290271	312879.1	13.01	9.50
2001-12	3291324.3	20573331	1423559.6	15.99	6.91

Sources: Compiled from Appendix- 2.

Based on the analysis it is evident from Table 6.3 that the percentage of exports in the total sales of automotive company is more in comparison to its imports. For the period 1991 to 2000 the p.c of export in the total sales was 13 p.c it increased to almost 16 p.c for the period 2001-2013 which is a positive sign. The p.c of import for the period 1991-2000 was 9.5 p.c this came down to 6.9 p.c .This is again a very positive sign as it indicates that most of the inputs requirements of the automotive industry are catered to indigenously by the component industry. It is also possible that lower rate of dividend repatriation has been responsible for the favourable impact of FDI in automotive industry,

TABLE-6.4: DIVIDEND REPATRIATION OF AUTOMOTIVE COMPANIES

(in Rs.crore).

Period	Dividend repatriation	Total Outflows	2 as a % of 3
1991-00	4360.1	32490.1	13.4
2000-12	45750.2	426317.3	10.73

Sources: Compiled from Appendix- 2 and 3.

Dividend repatriation is another important component affecting the Balance of Payment position. It is evident that the Dividend Repatriation of automotive industry was 13.4 p.c of the total payment during the first part of the reform period, which came down by 2 p.c to 11p.c during the second sub period. Decreased dividend repatriation as a percentage of total outflows is one of the important reasons explaining the positive effect of FDI on Automotive industry and favourable trade intensity of this sector. In the next section, we will analyze the trade intensity of other foreign direct investment companies in India for the period 1991 to 2013. This helps us to understand how other FDI companies have influenced India's BOP position. In addition we will understand that whether, the trade intensity of FDI in automotive sector is better in performance as compared to other FDI companies.

TABLE- 6.5: BALANCE OF PAYMENT IMPLICATION OF FOREIGN DIRECT INVESTMENT IN INDIA.

(in Rs. Crores)

Period	**Net Inflow (Direct Effect)**	**Net Inflow (Overall effect)**	**India's C.A.D**	**1 as % of 3**	**2 as % of 3**
	(1)	**(2)**	**(3)**	**(4)**	**(5)**
1991-00	-7601.28	-29,696.4	-1347450	0.564	2.20
2001-12	-47556.8	-249609	-5912010	0.804	4.22

Sources: compiled from Appendix-5.

When we look at the direct effect during the period from 1991-00 there was excess of outflows over inflow to the tune of Rs 7601.28, in other words the BOP effect was negative. Foreign direct investment contributed about 0.564 percent to India's current account deficit during the above mentioned period. It needs to be mentioned here that during this period

Indian government adopted a liberal policy with respect to foreign capital. During the second sub-period 2001-11(as inflows of other FDI companies are available until2010-11, therefore CAD fig. has been adjusted) the excess of outflows over inflows maintained an increasing trend and reached to the level Rs. 47556.8 crore. It needs to be mentioned here that during this period Indian government adopted a liberal policy with respect to foreign capital. During the second sub period foreign investment contributed nearly 0.80 percent to India's current account deficit directly an increase of about 0.24 percent.

When we consider the overall effect it shows that during 1991-00 the overall trade effect was negative to the tune of Rs.29696.4 crore. The Foreign direct investment contributed up to 2.2 percent to India's CAD during this period. During the second sub period the overall trade effect of foreign direct investment was negative to the tune of Rs.249609.9.Foreign direct investment contributed to 4.22 percent to India's C.A.D during this period .An increase by 2 percent. Thus from 1991 to 2011 the BOP implication of foreign direct investment was negative not only on direct account but also on the overall account. One of the important reasons for this condition is that the exports generated by FDI lagged behind the value of imports necessitated by them. This fact is shown in the subsequent table.

TABLE-6.6: EXPORT AND IMPORT INTENSITY OF OTHER FDI COMPANIES IN INDIA

(In Rs. crores)

Period	Exports	*Total sales	Imports	2 as a% of 3	4as a% of 3
1991-01	3,03,637.67	3828183	325732.9	0.07	0.08
2001-13	4,17,732.44	34024483	6,22,754	0.0122	0.0018

Sources: Complied from Appendix- 4 & 7.

*** Note :** Total Sales Figure of FDI Companies in Appendix-7.

As mentioned earlier one of the reasons for this unfavourable impact on India's BOP is the low export intensity of foreign controlled firms: the numbers indicate is that in the period when FDI inflows into India have been rising rapidly, the export intensity of FDICs is showing a declining trend .Although percentage of imports in total sales of FDICs is showing a declining trend however it has not helped much in reducing CAD. It can be concluded that the low export intensity of FDI firms has not contributed positively to reduce its current account deficit. Another reason of unfavourable BOP effect of FDI firms is very high rate of dividend repatriation .This is shown in the next table

TAB-6.7: OUTFLOWS ON ACCOUNT OF DIVIDEND REPATRIATION OF FOREIGN DIRECT INVESTMENT COMPANIES

(in Rs. crores)

Period	Dividend repatriation	Total outflow	2 as a % of 3
1991-00	2108	4010.31	52.56
2001-11	44059.25	154757.25	28.46

Source: compiled from Appendix -4.

Dividend Repatriation: As is shown in the table , dividend repatriation because of foreign investment was almost 50 percent of the total outflow during the period 1991-2000, however during the second half of the period under review dividend repatriation has come down considerably which is 28.46 percent of the total outflow. However it still forms a very high p.c of total outflows. Another factor which has been considered responsible for this state of affair is higher Cost of Technology Transfer increase in stock of useful knowledge and its proper function is considered as the backbone of modern economic growth. However the BOP impact of FDI also got distorted because of increased outflow on account of higher royalty charges for importing technology. As is evident from the table import of trans-border scientific and technological cooperation is consuming much of the resources of the Indian government.

TABLE 6.8 ROYALTY PAYMENTS AS A PERCENTAGE OF TOTAL OUTFLOWS OF OTHER FDI COMPANIES

Period	Royalty Payment	Total Outflow	2 as a % of 3
1991-00	758.47	4010.31	18.91
2001-11	105617.45	154757.25	68.24

Source: compiled from Appendix - 4.

It is evident from the above table that Royalty payment as a p.c of total outflow has increased manifold over the years, starting from 1991-00 until the year 2011.This points out towards the fact that Indian industries are giving lots of weightage to innovation and research centric activities. Most of these technical knowhow are imported from abroad. Royalty payment which was 19 p.c of total outflows had increased to a whopping 68.24 p.c of total outflows in the second sub period i.e. 2001- 11.This factor is one of the reasons of unfavourable effect of overall FDI on India’s BOP position.

6.6 CONCLUSION :

The unprecedented growth of global FDI since 1990 around the world because of the profound institutional changes incorporated by various emerging market countries, propelled by the successive globalisation waves of the 1980s and 1990s, has given impetus to the curiosity to find out its impact on the BOP of the Indian economy.FDI is considered as an important and vital component of development strategy in both developed and developing nations.

It is asserted that foreign direct investment (FDI) enables a capital deficient and less developed country to build up physical capital along with creating opportunities of employment and enhancing skills of local labourers through various externalities .India also attained the benefits of FDI that had flowed into its economy in various sectors. Of late, the automotive industry in India has actually seized the attention of the economists and policy makers all over the world. This sector has most of the time witnessed an excess of FDI inflows over outflows. This industry has been registering tremendous growth rate around 7p.c over the years and has cropped up as a contributor to India's GDP.

The foreign direct investment in automotive sector contributed to reduce, India's current account deficit

(CAD) by 2.89 and 0.41 p.c during the period between 1991 to 2000 and 2001 to 2012, respectively. One of the reasons of favourable effect of FDI in automotive industry on BOP is its excellent performance in export front. Based on the analysis of the data it is proved that export intensity of automotive industry is better as compared to its import intensity. In addition the dividend repatriation of this sector is regulated and controlled which has played an impressive role in exerting positive influence on the BOP of India .On the other had the study found that the impact of other FD companies on India's BOP has not been positive for the period considered.

The overall foreign direct investment , which has been responsible for 2.21 p.c of India's current account deficit between 1991-2000 , contributed to 4.01 p.c to India's CAD during 2001-2012.Amongst the various reasons , poor export intensity is one of the major causes followed by high rate of dividend and royalty payments. All these evidences, point towards the fact that in comparison to other sectors of the economy, FDI in automotive sector of India has performed better. It can be concluded from the study that FDI in automotive sector has helped to alleviate India's BOP problem hence FDI in this sector is highly recommended.