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FDI Flows in Developed and Developing Economies: A Trend Analysis (INDIA VS USA)

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Abstract—*With the development of world economy, FDI plays an important role. The FDI hence provide an opportunity to grow as it multiple investments from limited domestic to international market. But as investment is done to gain more returns, the developed countries have attracted more than developing countries. The reason can be that the developed countries utilize the financial resources more effectively and efficiently than developing countries. Observing the data given by, this paper deals with the trend analysis of FDI inflows and outflows from developed and developing economies and focusing the reasons why the developed countries have major share in FDI inflows and outflows for over four decades (i.e. 1970-2012) and to know why developing countries geared up there FDI flows after 1990 and faced fall in early 2000s. The trend analysis is supported with the deep literature review of papers related to FDI and external factors that affected the FDI flows in the world. The paper is summed up with the reasons of the FDI trend in developed and developing economies. For this we need to compare two nations one a developed and another developing nation and hence we took USA and India.*

1. OBJECTIVES

The objectives of the study are as follows:

- Does movement in FDI inflow and outflow depends on its Developing stage of economy or not? (Main objective)
- Trend analysis of US FDI (both inflow and outflow).
- Trend analysis of India's FDI (both inflow and outflow).
- Reasons of gains and lose periods of both India and USA.
- Reasons of difference between India and USA in FDI (both inflow and outflow).

2. LITRATURE REVIEW

Lot of researchers have studied and researched on FDI in ASIA and Central America but have not compared particularly. We found papers, between developed and developing nations as a whole, sectorial analysis and reasons of FDI in India, US and many more... These are some of the reviews which relates to the topic as well.

Earlier, some researchers analyzed whether the international organizations have impact on the FDI or not. **Mauer and Scaperland (1969)** investigated the key factors of the US FDI during 1952 – 1966. The researchers took into consideration the annual rate of the US FDI in the European Union countries, their GDP, the tariff discrimination, the rate of the involved EU countries, the annual exports from the EEC countries and the annual U.S. exports. The study concluded that from the FDI determinants only the market size is statistically important. The FDI also depends on basic financial condition of country. **Christian and Pagoulatoes (1973)** concluded that the poor development of financial market becomes a major hurdle in collecting funds and utilizing them in manufacturing sector. For this they took the duration of 1962 – 1966 and cross investigated variables like demand deposits, financial resources, GDP, inflows of funds of about 60 countries.

And later also the researchers overview was not changed, **Culem (1988)** also took the variables, tariff barriers, the FDI, the annual rate of GDP growth, labor costs and the nominal interest rate differential and found that the determinants are only responsible for attracting FDI in 1969-1982 despite of the European market size at that time. Other countries also played a major role in US FDI like japan and as of now, japan is one of the major investor in USA. Earlier, **Drake and Caves (1992)** studied the reason why japan invested in USA during 1975-1986.They found that due to increase in promotion and advertising and contribution in research and development. For this researchers took factors like market share of japan in US, foreign exchange rate, the imports in US by japan, FDI, etc.

Whereas in India **Ketkar, (1993)** researched the India's banking sector of pre economic liberalization era (1950-1980) and found thatthe Indian expanding programs in that sector increased both domestic savings and investments. The various

variables like bank deposits, the real investment, return on capital, real domestic demand and many more were responsible in raising the same.The main reason of overall rise in the FDI in the world especially in developing countries between mid-80s and 90s was that most of the countries became open economies from closed economies. **Badar Alam (1999)** investigated FDI trend analysis and found that between the 3 years from 1989-1992 FDI in developed countries fell at faster rate while in developing countries it grew at high rate. But do FDI always has positive impact in the economy **Chandana and Paraptap (2002)** explained the connection between the growth and FDI of India and concluded that though the FDI has an optimistic influence on economy in short run but have a negative result on labor as it lower down the labor cost. The reason could be the introduction of high tech machines replacing labor intensive work which affect India where labor force is in large amount. Not every time the developed country invests as developing countries are also attracted **Banga, (2003)** analysed duration from 1980-81 to 1999-2000 and concluded that the developed countries are attracted with removal of restriction of developing countries whereas the developing countries are attracted by incentives like subsidies, lowering import tax and grants given by the government. And the multinationals will only want to invest where they have full control on labor force **Nayak and Dev (2005)** found same in their research paper of "Low Bargaining Power of Labor Attracts Foreign Direct Investments to India" and this affect the FDI inflow. This can be regulated by government if they introduce loose labor policies for corporate. But sometimes the over regulation by authority can discourage the FDI attraction. **Rammal and Zurbuegg (2006)** investigated in 5 ASEAN between1996-2002 taking factors affecting FDI for same and found the deleterious effect on FDI by regulations on prices, investment and trade. In contrary, other countries have proved that government policies can attract FDI in significant manner for example in china. **Bharathi and Parthipan (2007)** researched in their comparative study on Foreign Direct Investments between India and China the and found that the reason of high difference FDI in China as compared to India is the policies, ristrictions, subsidies given by China for production to the multinationals, whereas India took the idea of SEZs from China to attract FDIs in India by providing liberal taxation policies and improved infrastructure like railways, ports etc. **Jadhav (2012)** studied the major determinants for FDI and found resource availability, political factors, legal factors, market size as determinants. But financial factor as a mojor factor for FDI inflow. For this he took Brazil, Russia, India, South Africa and China and duration from 2000 to 2009.From above papers it is clear about the determinants or factors affecting FDI but the findings of what FDI affects the economic factors was discussed by **Pradeep (2013)** in his paper. He investigated that in developing country like India, the FDI has direct impact on production, income, employment, creation of standard of living and rise in human and money value. The FDI also becomes prominent in countries where there is low rate of domestic savings. **Abhishek Vijaykumar Vyas (2015)** analyzed the FDI inflow in India and took several factors and concluded that the FDI has significantly helped in the growth of various sectors. Drugs & Pharmaceuticals sector and IT sector were the other sectors to which attention was shown by Foreign Direct Investors (FDI). Whereas, **James K. Jackson (2017)** studied that despite of security disturbances (9/11 attacks) and other issues (recession 2008), the FDI in US has not been affected and is a prime destination. Furthermore investments will likely increase as new sectors and firms are developing in the country.

3. RESEARCH METHODOLOGY

The type of research that will be used in this study is **comparative analysis research**. Data like FDI inflow and outflow in Developing and Developed economies, FDI inflow and outflow in USA and India. Sectoral distributions of FDI in both countries are taken in form of graphs and tables. The data is analyzed and the reasons are found for any abnormal gain or loss or the trend. This helps in knowing the difference between the FDI with respect to its development stage.

4. COMAPARITIVE ANALYSIS

First of all we will compare the global data i.e. FDI inflow and outflow in the worldwide according to types of economy. Let us see what trends depict:

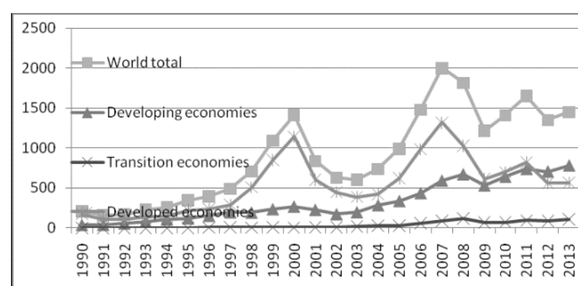

Figure 1: Inward foreign direct investment flows from 1990 to 2013(Dorożyński & Kuna-Marszałek, 2016)

Looking the figures of the trend of FDI inflow between the developing and developed countries we can analyze that

- FDI inflows in developed countries are more than developing countries till 2008 which shows that the investment in developed countries seems to be more profitable or useful for the investors.
- Developing countries also caught growth from 1992 and kept rising after the downfall in 2002-03 and increased more than the developed nations in 2012

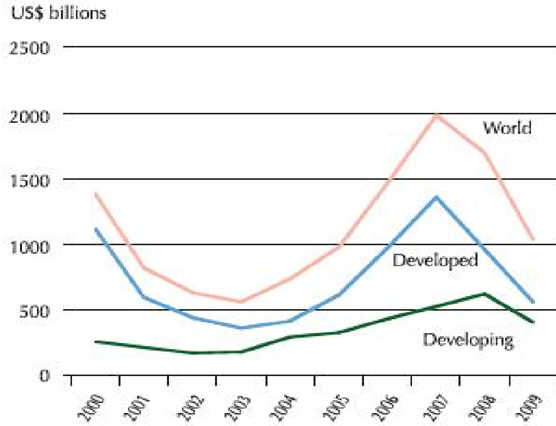

Figure 2: Outward FDI flows in world (GAC, 2018)

Comparing the trend between the developing and developed countries we can analyze that

- **Developed countries trend intersects equally with world's investment** which shows that the other type of economies' investment is almost negligible or low till 2008.
- **The developed countries invest more than the developing countries,** reasons could be:

I. High financial capacity
II. Strong Currency value
III. Better literate investors and marketers
IV. Stabilized political environment
V. Less scope in domestic country (for developed nations)

Through these two above graphs we can say the following:

1. **Developed countries have greater control:** As by observing the above graphs we can say that the developed countries have more control on investment in and out in the world as the trends of world's investment and developed countries' investment is same.
2. **Early 2000s recession**: The reason why there is a decline in the FDI inflow and outflow in early 2000s is because of the recession **which mainly affected in developed countries.** The FDI outflow came near **negligible in developing countries** because the recovery and low investment market in developed countries discouraged them to invest out in the market.
3. **Investment in inter developed countries till 1990:** The data also shows that the developed countries invested the money in other developed country rather than developing country till 1990. This also shows that developed countries helped each other more to come at the stage of developed economies.
4. **FDI Inflow and Outflow are interconnected in developing countries:** As after 1992, the developing countries started getting investment and on the other hand, they also started to invest which shows that if the economy gets FDI, they reinvest in some other economy to get better returns for their economy.
5. **FDI outflow after 2005 by developing economies**: The growth of FDI outflow by developing countries geared up after 2005 and that time the growth of FDI inflow also grew. This also justified the fourth point.

5. US FDI TREND ANALYSIS

Now, we will first analyze the US FDI inflows and outflows with major contributing countries in US FDI. We will also analyze the sectorial contribution share in FDI inflow.

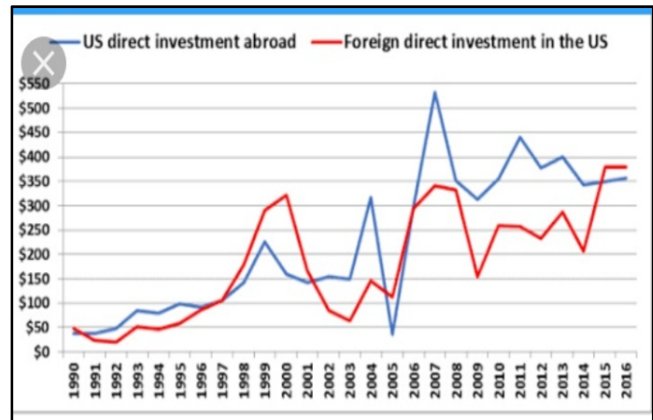

Figure 3 (CRS, 2017)

The FDI inflow and outflow in USA intersects each other many times like in years 1997, 2001, 2006. The graph also shows that sometimes the inflows are greater than the outflows and sometimes less. Some of the observations conclude:

Outflow and Inflow follows same trend: If you observe the graph, whenever the inflows rises or decreases the same happens with the outflows like form year 1990 both rises at same rate but after the1999 both falls

Large decline in outward US FDI flows in 2005:

The profit of the foreign partners of United States-based companies has been increased and this was the major factor behind the large decline in outward US FDI flows in 2005. That decline also reduced the reinvested earnings of foreign affiliates which has been the primary mode on investment by United States. The American Jobs Creation Act of 2004 also contributed to this decline, as it allowed repatriated earnings of United States foreign affiliates to be taxed at a lower rate than the normal one, leading to a one-off fall in reinvested earning.

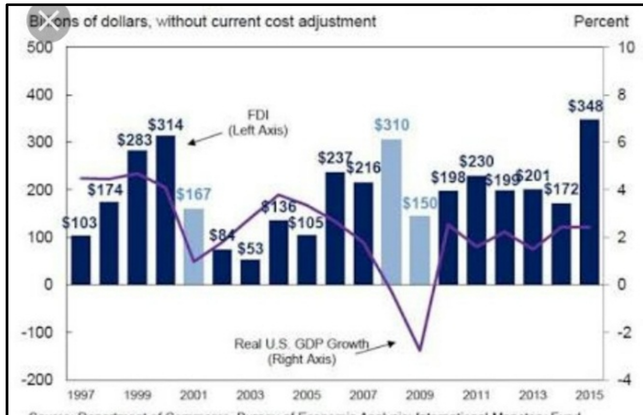

Figure 4: (Taylor, 2016)

The above graph suffices to study the growth of FDI with respect to its GDP. In late 1990's the growth of GDP was around 4% with increase in FDI inflow with 68% in 1998 and 60% in 1999. But after the early 2000's recession the FDI also fell down with least (64 billion dollars) in 2003. As being a developed economy, the growth rate of GDP never came above 3%, which never affected the FDI growth rate as it increased more than 100% in 2006 and 50% more in 2008 despite of negligible GDP growth. Though it fell by 50% in 2009 when the GDP fell by 3% but it gradually recovered in further years.

By observing the trend of FDI inflow growth with respect to growth of its GDP ,we can say that the above graph concludes that the **growth of GDP does not affect much to the FDI inflow in developed countries** as the growth rate of GDP fluctuates between the minimum values as they are already developed but if the country faces depression, it will ultimately affect the FDI as the investors will then think before taking risk as currency value also depreciates at that time and when it comes to US Dollar, it will ultimately affect the every corner of international investor.

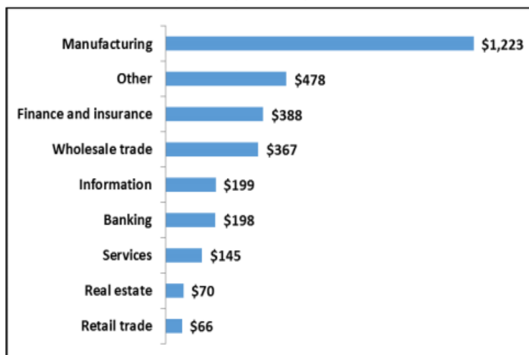

Figure 5

Taking 2015 FDI inflow's data in USA, the manufacturing sector has the maximum share of FDI while finance and insurance have the second maximum share.

The reasons could be as follows:

Manufacturing sector needs larger investment: The manufacturing sector needs to install heavy machineries, workplace, and skilled labor with optimum operating funds to manufacture the goods at smooth rate than other sectors. Hence, the manufacturing sectors have larger share of FDI.

Finance and Insurance: U.S Insurance industry is doing well and it is the largest industry of the world in terms of revenue. The industry is growing at good pace and since 2011, annual revenue of the industry which is known as insurance premiums exceeded by $1.2 trillion mark. Though financial crisis in 2008 had made a negative impact on insurance industry because there was a dip in 2009 after global financial crisis.

The Wholesale Trade sector:

The wholesale trade sector consist of wholesale merchandise, without transformation and rendering services that are incidental to the sale of merchandise. Mostly the merchandise in this sector included the outputs of agriculture, mining and certain other information industries.

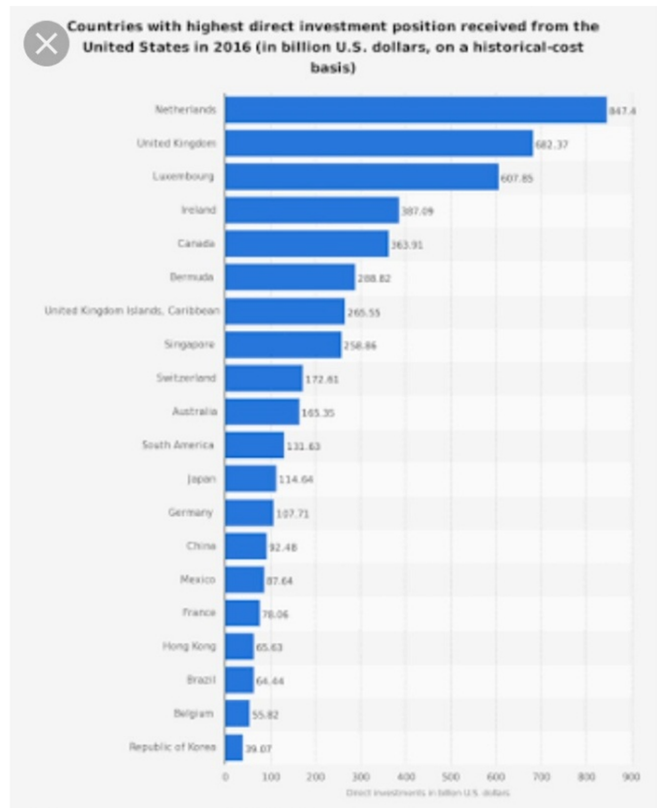

Figure 6-(Statista, 2018)

UK is taking great interest in the American economy. In 2016 UK was the largest investor in American market. The country had invested $555 billion in US and that investment was $ 134 billion more than the second largest investor's amount. Japan was the second largest investor. Canada, India and China has also invested in American economy but those countries total investment was nearly 1% of FDI in US.

Japaneseinvestment was different from all other countries because research and development activity of Japanese industries was unique. US policies are such that those policies attract high-performance firms and high- value production stages to United States from any of the industry.

Luxembourg– In Europe, Luxembourg is the leading investment fund center and it has ranked second in the world after US. The reason for this is a highly tuned legal and regulatory framework that combines rigorous investor protection with an unequalled degree of flexibility in fund design, a flexibility that allows products to be tailored to the needs of a specific market or client group. The availability of a wide range of specialized service providers enables fund promoters to subcontract non-core activities and hence benefit from economies of scale.

6. INDIA'S FDI TREND ANALYSIS

Now, we will first analyze the India's FDI inflows and outflows with major contributing countries in India's FDI. We will also analyze the sectorial contribution share in FDI inflow.

Factors that attract foreign direct investment in India

The most lucrative factor for foreign investors is the liberalization of Indian economy. Prior to 1991, Indian government has protectionist economy. The post reform period after 1991 has strengthened the base of Indian economy. The expectations of foreign investors also increased who were trying to invest in the different industrial sectors of India. The Indian economy was on a progressive track towards liberalization and it made India a lucrative market to invest. India was looking to reinforce the confidence of the investors in the market.

High growth rate after the economic liberalization

The growth rate after liberalization was dependent on Gross Domestic Product. The GDP of India was growing because the country was getting investment in different sectors. The investors were looking after the GDP of India because it was providing standard measure to determine the potential in India market for investments.

Lower inflation rate as a determinant of foreign investment

The cost of capital was increasing in the Indian market because there was a constant growth in the inflation rate. The increased valuation in the Indian market has signified the economic growth which attracted foreign investment in the developing countries.

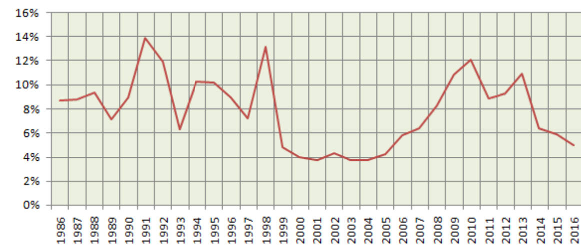

Figure 7: (Econ, 2014)

Trade openness

The Indian market showed an openness of the country towards foreign trade. There was integration of regional sectors in India and this integration leads to more FDI flows in the country. The Indian policy makers have took a step to liberalize the trade policies which was appreciated by the investors. The pace of globalization and modernization for the openness of trade made the economy close to various modern technology.

Figure 8 (Econ, 2014)

Foreign exchange reserve

Whether the country has the ability to sustain itself during the time of adversity has been determined by the foreign exchange reserves of the country. The monetary base is also dependent on foreign exchange reserves hold by the country. If a country has large sum of reserves than it is a lucrative option for the investors. The inflow of the foreign reserves has also increased the FDI inflow in India and the country's resources such as manpower and infrastructure can also be utilized.

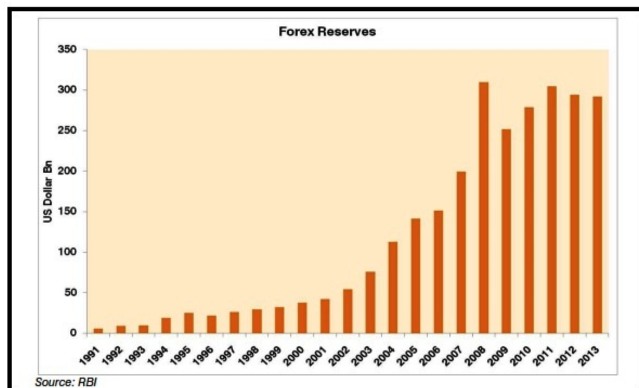

Figure 9- (RBI, 2015)

The main reasons why countries like **Singapore and Mauritius** topped the list of FDI inflows in India is because of tax benefits they receive while investing here. Because of Double Taxation Avoidance Agreement (DTAA), this agreement makes a country an attractive investment destination by providing relief on dual taxation. Such relief is provided by exempting income earned abroad from tax in the resident country or providing credit to the extent taxes have already been paid abroad. Double taxation is the levying of tax by two or more jurisdictions on the same declared income (in the case of income taxes), asset (in the case of capital taxes), or financial transaction (in the case of sales taxes).

A close scrutiny of foreign direct investments from Singapore and Mauritius is needed as both the nations accounted for large share of FDI. A detailed examination is needed to find out if they constitute actual investments or whether they are diversions from other sources to avail tax benefits under the Double Taxation Avoidance Agreement (DTAA) that India has with these two countries.

Japanese FDI into India has mainly been in automobile, electrical equipment, telecommunications, chemical and pharmaceutical sectors. But officials pointed out that sectors are diversifying as India is undertaking economic reforms and GST will further boost Japanese investments here.

The total number of Japanese companies registered in India as of Oct 2016 is 1,305, with an increase of 76 companies (6% growth) as compared to 1,229 in October 2015. The total number of Japanese business establishments in India is 4,590, with an increase of 173 establishments (3% growth) as compared to 4,417 in October 2015. In the retail sector, top Japanese brand MUJI have opened stores in Delhi and Mumbai, officials said, adding, Japanese run restaurants have also seen a rise in Indian metro.

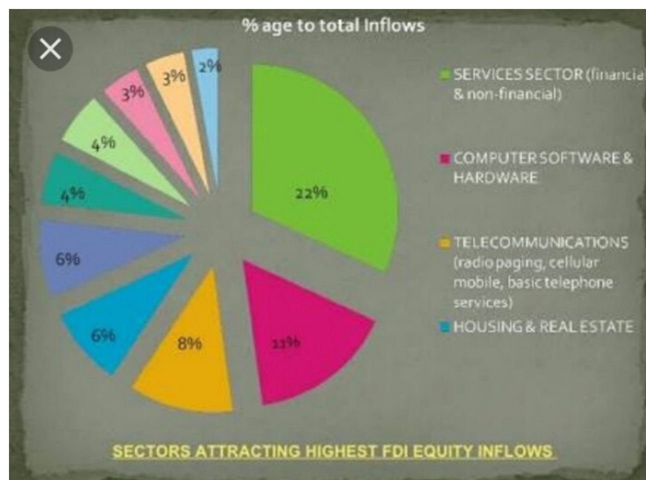

Figure 10

7. CONCLUSION

After studying the whole data the following points can be concluded:

FDI flows don't depend on its developing stage of economy: If we compare the FDI flow between USA and India, it cannot be compared as USA has very high FDI growth as compared to India, with 44.6 billion dollars in India in 2016 by 479.4 billion dollars in USA. This time USA is in 1st position for FDI inflow in the world while India is at 9th but China is 3rd and Brazil is 7th which are developing countries.

Other reasons are that it depends on the following aspects:

Political factors play a major role in FDI flows: Another finding is that the political (which include the laws regarding the investment for domestic as well as foreign investor) have a major impact on FDI flows. The reason is because of DTAA, India receives so much FDI amount from Singapore and Mauritius. The political stability in Luxemburg made the country as tax heaven and many investors invest in that country as it has risk free financial market and it made them to reinvest that money in USA.

FDI does not follow GDP growth rate every time for developed countries: After studying the US FDI growth where it still grew even after fall of GDP growth proves that it does not have any country as they are developed.

Resources in a country: whether a developed or developing, if the country has adequate resources whether human or financial, the investors are ready to invest on you. Like China receives the FDI because of large manufacturing sector at low cost because of abundant resources and low tax which attracts investors to invest there for production sector. On the other hand, investors invest in countries like USA, UK because of high financial stability and of developed sectors like technological, services, insurance, etc.

Foreign exchange rate/ Currency value: It also depends on the exchange rate, it is not necessary that every developed country has strong currency value like 10 Chilean pesos is equal to 1 INR. So, it depends on currency as weak currency value can suffice there investment need in lesser amount than country with strong currency value whether developing or developed like Kuwait (a developing country).

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