IMPACT OF INDIA'S OUTWARD FDI ON HOME AND HOST COUNTRY

Sukanya R*

ABSTRACT

Outward foreign direct investment from India is emerging as a significant aspect of India's international economic integration. Firms from India are incorporating outward foreign direct investment had to compete globally as a part of their corporate strategy to acquire key assets. The study tries to analyse the impact of OFDI on both the home and host country. The results reveal that OFDI has a negative impact on the employment in home country contrastingly OFDI has a positive impact on Exports and Research and development of the home country and with regard to the host country it positively encourages the economic development of the host country by increasing the productivity, exports and benefits the local firms by indirect transfer of technology.

Keywords: Outward Foreign direct Investment, Home country, Host country.

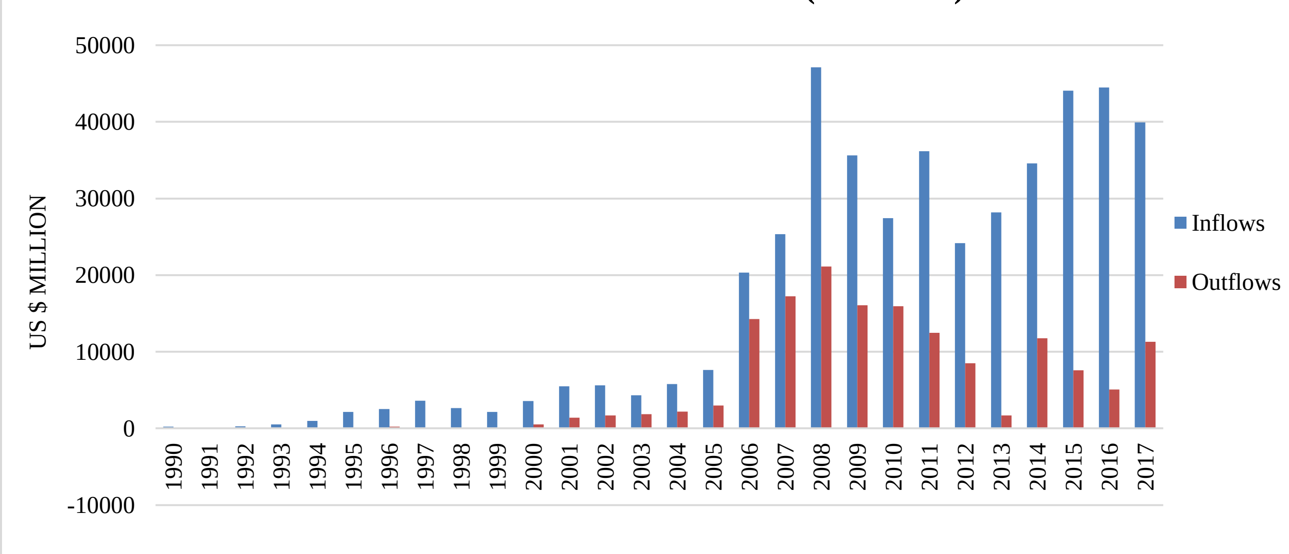
INTRODUCTION

India is considered to be one of the most prominent and largest emerging economies. With the launch of the Globalization and Liberalization policy, India's economy witnessed a major change. As a result, Indian firms apart from competing in the domestic market had to compete globally to sustain the rising competitive environment and stratify for upgrading their technology, accessing new markets, for acquiring assets, obtaining resources, and the need to integrate the firm's operations across the globe. In response to the strategic requirements, Indian firms started overseas investments.

Overseas investments are being undertaken to acquire larger market, resources and strategic assets. Though India's outward investments were there since the 1960s, India started to register steady growth over the past 2 decades, India's Outward Foreign Direct Investment (OFDI) in equity, loans, and guaranteed issue stood at US$ 11.33 billion in 2017-18 according to the data provided by the Reserve Bank of India (RBI).

India’s outward investments have undergone a considerable change in terms of magnitude and in terms of geographical spread and sectoral composition. Since 2005, the Direction and Composition of India‟s OFDI are more towards the developed countries and the investments have increased in the service sector. For example, the UK announced that India has become the third largest source of FDI for them as investments increased by 65% in 2015 leading to over 9,000 new and safeguarded jobs.

Very few studies have focused on India‟s OFDI. Most of them have looked into the trend, pattern of India‟s OFDI (Athreye, 2005; Kumar N. , 1995; Nagaraj, 2006; Nayyar, 2008; Ramamurti, 2009; Dige Pedersen, 2008; De Beule, 2012; Buckley P. J., 2007; Kumar N. , Internationalization of Indian Enterprises: Patterns, Strategies, Ownership Advantages, and Implications., 2008) and the locational determinants of India‟s OFDI (Buckley P. F., 2012; Das K. &., 2015; Jain, 2015;Nunnenkamp, 2012; Pradhan J. , Emerging multinationals: A comparison of Chinese and Indian outward foreign direct investment., 2011). Similarly, recent works of (Chittoor, 2009; Deng, 2012) have focused on examining the role of firm-specific factors on overseas investment by Indian firms (Bhaumik, 2010; Chittoor, 2009; Gaur, 2014; Pradhan J., 2004).



India's FDI Inflows and Outflows (1990-2017)

Year	1990-93	1994-97	1998-2002	2003-2006	2007-2010	2011-2014	2015-2017

Inflows (US $ Million)	532	3619	5629.7	20327.8	27417.1	34582.1	39916.1
Outflows (US $ Million)	0.4	113	1678	14285	15947.4	11783.5	11304.4

Although the macroeconomic environment was not considered as a part of location advantage during the 1970s, Dunning, (2009) revealed the importance of the macroeconomic environment by describing the location pattern, structure and activities of multinational firms over the last 20 years. Recent studies (Augier, 2007; Cavusgil, 2015; Child, 2005; Gerschewski, 2015; Kylaheiko, 2011) (Tseng et al., 2007, etc.) have been concerned about unveiling the role of firm-specific factors on explaining the OFDI activities, (Bhasin, 2013; Das K. C., 2013; Estrin, 2016; Globerman, 1999; Hoang, 2015; Huang, 2017; Kalotay, 2010; Stoian C. , 2013; Stoian C. &., 2016). Later on (Tolentino, 2010; Boateng, 2011; Kyrkilis, 2003; Kueh, 2010; Wei, 2010) have underlined and highlighted the macroeconomic environment from the perspective of home-country location advantage explaining the current trend of OFDI.

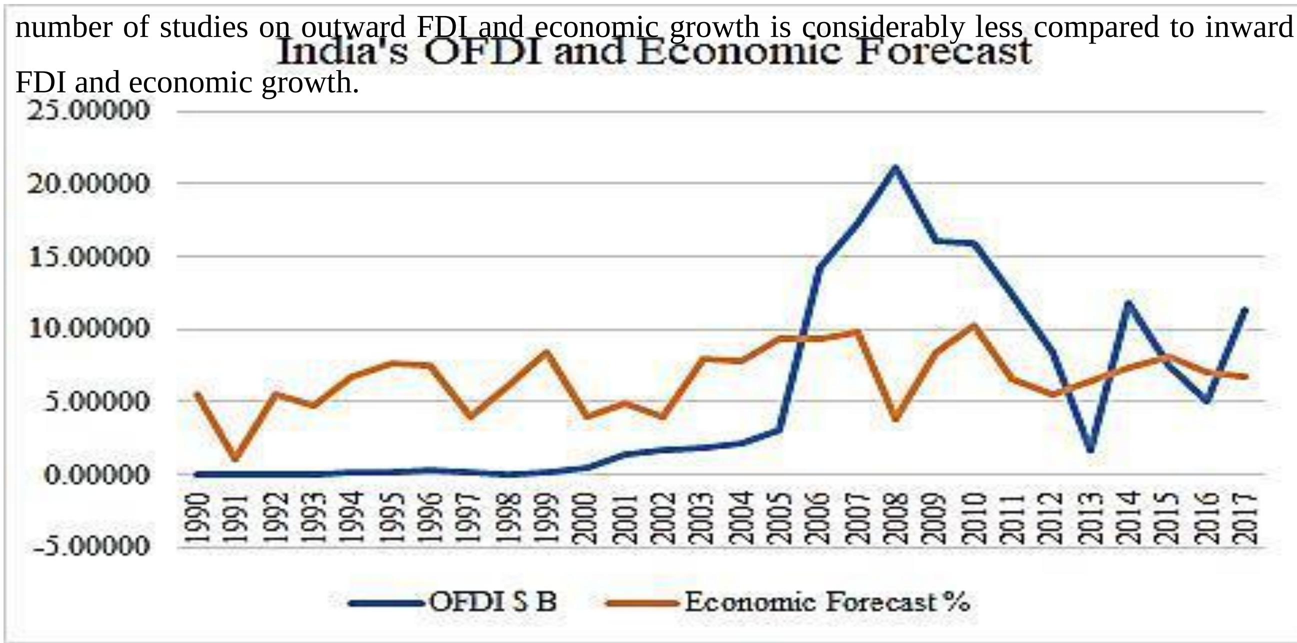
REVIEW OF LITERATURE

IMPACT OF FDI ON THE HOME AND HOST ECONOMY

Home Country

In the modern era of globalization, it is important for the companies to set up their entities in the locations beyond the geographical location of the country previously operating from. The best way of establishing their entities is through the expansion strategy of foreign direct investment. By using this approach, the entities will have direct control over the assets owned by them in other geographical locations including their equipment, offices, and buildings in the foreign locations.

Outward Foreign Direct Investment (OFDI) is seen as a new channel for development an it is evident that the growing OFDI increases a country's investment competitiveness, crucial for long-term, sustainable growth. Impact of inward FDI on economic growth is the main focus for the existing studies (Borensztein E. D.-W., 1998; Chakraborty, 2002; Hansen, 2006) as inward FDI has a positive impact on the economic growth in developed and developing economies. The number of studies on outward FDI and economic growth is considerably less compared to inward FDI and economic growth.



There is also an argument that OFDI reduces the domestic investment, production and employment opportunities in the home country which affects the economic growth among the developing economies (Al-sadiq, 2013; Waqar Ameer et.al., 2017). Some studies have observed that the OFDI reduces the country's rate of domestic investment, while on the other hand others have found that OFDI stimulates the domestic investment with a positive impact on productivity and employment (Navaretti G. B., 2006) innovation (Masso J. R., 2013) in the home country it provides exposure to new markets, import of technology, intellectual capital, upgrade production processes, boost competitiveness, augment managerial skills, and access distribution networks are benefits to the economy as a whole. For example, Chinese OFDI overtook inward FDI in 2016 which made the 6th largest OFDI Stock (Perea, 2017) - Global investment Competitiveness Report 2017/2018) in spite of its Economic (GDP) growth at 6.8% in both 2015 and 2016, Industry production at 6.2% (2015) and 6% (2016), capital investment at 45.4% (2015) and 44.26% (2016), and unemployment rate at 4.05% (2015) and 4.02% (2016). with an increase in the economic globalization of 7.86% from 2015 to 2016.

Yet other studies have observed to have no significant impact among the developed and developing economies (Hsu, 2011; Ito, 2000). Meanwhile, (Elia, 2009) found that OFDI has a negative impact on the demand of the home country"s less skilled workers and also for skilled workers when FDI is directed to developed countries. According to (Stevens G. V., 1992) OFDI is a substitute for domestic production when the multinational firms relocate their production facilities abroad, it reduces domestic output, employment, and economic growth as well. On the other hand (Desai, Foreign Direct Investment and the Domestic Capital Stock. , 2005) says that OFDI is complementary to domestic investment, whereas (Hejazi, 2003) says that the impact of OFDI varies according to the investment partner.

(Herzer D., 2011; Herzer D., 2008) analysed (2008) the relationship between outward FDI and Economic Growth as the previous studies had examined the firm and industry level effects (domestic investment, productivity) of outward FDI and found that Outward FDI is positively associated with the increase in economic growth it is both a consequence of economic growth as well as a cause for an increase in economic growth among the developed economies. Using an Asymmetric ARDL model (Ali, 2018) studied the relationship between OFDI and economic growth and found that the results obtained are more superior and efficient for policy making and also suggest that OFDI is beneficial to the country by assessing the advanced innovation and technology among the developed and developing economies.

From a theoretical viewpoint, OFDI varies from one country to another depending on their motives for overseas investment. Similarly, the impact of OFDI on the home country may occur through financial and product markets. If the FDI outflows complement the home economy through backwards-forward linkages then OFDI complements the domestic economy. The FDI outflows may have a positive (Lipsey R. E., 2004; Herzer D., 2011) negative (Feldstein, 1995; Andersen(deceased), 1998) or a neutral impact on the home economies domestic investment, employment. Therefore, it is necessary to identify the overall impact of FDI outflows on the home economy.

Host Country

Foreign direct investment (FDI) influences the host country economic growth through the transfer of new technologies, know-how, the formation of the human resources, integration in global markets, increase of competition, and firms‟ development and reorganization. Studies consider that FDI generates economic growth in the host country though there is evidence that FDI is also a source of negative effects for the host country. Authors have suggested that foreign capital when effectively allocated generates economic growth and is the most effective way to achieve economic growth (Lee, 2004; Balasubramanyam, 1996). FDI can affect economic growth through the transfer of technology and know-how, and this impact can be positive and/or negative.

FDI is a means to improve countries economic growth depends on the implementation of more advanced technology through multinationals in developing economies (Frindlay, 1978; Saggi, 2002; Hermes, 2003) as the multinational firms are more often regarded as more developed and a major source of technology dispersion, and world spending on research and development (R&D) due to its presence in various parts of the world (Borensztein E. D.-W., 1998; Ford, 2008). Transfer of technology improves the host firms performance and also contributes to the growth of GDP (Varamini, 2007; Lim, 2001) and reduces the firms R&D cost as it receives these technologies and makes the firms more competitive (Berthelemy, 2000). The main benefits brought by multinationals are new products and new production processes (Blomstrom M. a., 1998).

FDI affects the host country economic growth in the formation of the human resources or labour force positively as it improves the knowledge of the labour force by providing training through the introduction of new methods, production, management practices (De Mello, 1999), Know-how, and also highly skilled workers (Zhang, 2001). As a result, it increases the productive capacity based on the training obtained (Ozturk, 2007). Similarly, another harmful impact to the host country economy is the instability of FDI Inflows i.e. sudden and high capital inflow. Which results in an increase of inflation, difficulty in the predicting these flows, and it may destabilize the country's economic development leading to difficulty in implementation of economic policies desired by local authorities (Sen, 1998; Vissak, 2005).

Another negative consequence of FDI in the host country is a decline in the local authorities‟ autonomy (Duttaray, 2008), as the large multinationals gain control over assets and employment, it empowers them to influence the political and economic decisions of the host country authorities (Zhang, 2001). It is also observed that multinational companies in order to gain control over their operations pressurise the local authorities to make policies that are more favourable to their firms than to the host country economic growth. Due to the size of multinationals and their influence on localeconomies, their strategic decisions cause significant changes in the host country, and the independent strategies of local authorities‟ could be contrary to the desired national policies (OECD,2002). In this way, multinationals cause distortions in the host country policies to benefit foreign investors (Ram, 2002). It is also reported that multinationals encourage the permanence of the existing economic situation and FDI is seen as a way for the developed countries to gain control developing countries (Zhang, 2001; Loungani, 2001).

OFDI has enhanced with respect to growth, exports, productivity (Zhao, 2010; Liu H. &., 2011), efficiency (Navaretti G. B., 2006; Kumar N. , 2008; Pradhan J. P., 2007; Pradhan J. P., 2008; Chopra & Sachdeva, 2014; Hsu, 2011; Tsuchiya, 2015) employment (Das K. C., 2013) innovation(Masso J. R., 2013) and know-how in particular with advanced home economies. The geographic distance has a negative impact on Indian overseas investments (Al-Sadig, 2013; Mishra & Kumar,2016; De Beule, 2012). Ahmad, Draz, & Yang (2015) Found that outward investment from ASEAN nations is negatively associated with economic growth. Due to the variation in the amount of investment among the high and low income countries it is clearly evident that they negatively impact the demand for the low skilled workers in the parent countries and also reveals a high demand for the high skilled workers in the parent country, this result seems to be evident by the studies of (Alfaro, L., & Charlton, A. , 2007; Elia, 2009).

RESEARCH GAP

Existing studies on India's FDI have only analysed the role of Inward FDI. Few studies have been undertaken outward investments from service sector with respect to the factors influencing investment and very few published studies with respect to firm-specific advantages to the firm from IT Industry as they have created a global presence and brand image. Outward FDI is an emerging phenomenon, therefore, it is important to analyse the changing structure and pattern of outflows from India. Existing studies on India's OFDI are majorly on determinants and impact with specific variables of the home country. Previously reviewed papers have taken into consideration only the approved amount of investments and not the actual amount of investments. Studies are not been taken on the impact and determinants of India's OFDI into the developing and developed countries and also to find out the direction of India's FDI outflows into sectors and economies.

RESEARCH QUESTION

1. What are the determinants or the motivating factors of India's OFDI?
2. What is the impact of India's OFDI with respect to the specific variables and also the overall economic growth from the perspectives of both home country and host country?
3. What are the trend and pattern of flow of outward foreign direct investment from India to the country and to the Sector?

NEED / PURPOSE/ SIGNIFICANCE OF THE STUDY

Though India's outward investments were there since the 1960s, India started registering a steady growth of 11304.4 US $ Million in 2017 from 6.0 US $ Million in 1990, after the implementation of the globalization policies in the 1990s. India has registered a steady increase over the past 2 decades as most of the firms have started adopting internationalization through FDI as a strategic policy, to remain competitive and expand their global outreach. the

Earlier, India's investments were majorly directed towards developing countries with similar or lower levels of economic development, a form of 'South-South' cooperation. The composition of the outflows has also changed post-1991. Currently, OFDI has been undertaken in newer host countries, including large numbers of developed countries, signalling a changing profile of India's external economic engagement.

Outward Foreign direct investment from developing economies like India pose several questions with regard to the motives for the outward Investment. While India's outward investments are motivated by the strategic assets and wider reach of markets (or new markets), whereas generally it is assumed as resource seeking as the motive for investment in developing countries. With the firms using different strategies to expand their global reach, there is a significant need to investigate the market-seeking as a motive for investment in a developing country.

With firms applying new strategies to expand their global footprints, this study seeks to investigate the significance of market-seeking even in the developing country group. The significance of this research is in linking the motives of India’s OFDI, drawn from the theoretical literature to the host country economic determinants across different groups of countries and to examine the Impact on the home country as well as the host country with the help of empirical data.

The study explores the implications of OFDI and thus supplement the existing literature by identifying significant host country factors across developed and developing countries, the changing patterns of India’s OFDI, and the relation of OFDI with exports. The study attempts to identify the economic factors that determine the choice of host country location along with the changing patterns of India’s OFDI, and its relationship with exports, another channel of internationalization. The present study aims to analyse the changing patterns of OFDI from India.

STATEMENT OF PROBLEM

Most of the studies are being conducted with respect to the determinants of Outward FDI majorly in developed countries, and existing studies with regard to the impact of OFDI are being studied considering few specific variables like employment. As India’s Outward Investment has started registering an increase, it is important to study the relation between OFDI and economic growth. This study analyses the determinants of India’s OFDI; examine the impact of India's OFDI with respect to the specific variables and also the overall economic growth from the perspectives of both home country and the host country, empirically drawing upon the link between the established in the theoretical framework. The review of the literature has identified economic determinants based on the motives of OFDI as factors determining the location of OFDI. Market-seeking, resource-seeking, efficiency-seeking, and strategic assets seeking are the motives for OFDI. Therefore, it is important to analyse the changing structure and pattern of India’s Outward Foreign Direct Investment.

In a globalised business environment, overseas investment is inevitable on account of a country's policy on outsourcing, emphasis on on-shore presence, protectionism, etc. India's foreign exchange reserves has supported the relaxation of capital controls including Unlimited capital Outflows for OFDI and it has a significant impact on the sustainability of India's external debt profile and Current Account Deficit (CAD). India being a Current Account Deficit economy ensures that the capital outflows from the country needs to be closely monitored. Surplus finance is required to maintain a comfortable level of India's foreign exchange reserves for financing India's growing CAD. Another important factor that warrants close monitoring of capital outflows is implication for domestic investment. It needs to be ensured that overseas investment by Indian companies do not crowd-out domestic investments. Even though both domestic capital formation and overseas FDI investments have increased concomitantly in recent years, potential implications of rising trend in outward FDI for domestic investment, growth and employment needs to be examined against the benefits that domestic companies derive elsewhere in terms of expanded market base, backward and forward vertical integration and cheap skilled labour. Hence, the Indian companies have to balance the need for domestic business expansion with the compulsions of overseas investments.

OBJECTIVES OF THE STUDY

1. To analyse the impact of various OFDI policies.
2. To precisely examine the flow of Outward FDI from India into Developed and Developing countries and sectors for the period of 2011-18.
3. To analyse the determinants of India's Outward Foreign Direct Investment.
4. To examine the causality relationship of India's FDI outflows and economic growth for a period of 1995 -2017
5. To examine the impact of India's FDI outflows and Economic Growth in both the home country and in the host country.

METHODOLOGY

The methodology of the Study

The study is based on secondary data of India's outflow of foreign direct investment to different countries. To facilitate the analysis, the countries will be grouped into developed and developing based on the categorization followed in the 'World Investment Report', a publication by the United Nations Conference on Trade and Development (UNCTAD) on global FDI.

Data Sources

Secondary data for the analysis has been collected from the Reserve Bank of India (RBI): data on Overseas Investment, RBI publications, RBI reports, Export-Import Bank publication (2014) and (2017), data from the Ministry of Finance (1991-2018), World Bank's World Development Indicators, UNCTAD, and other published sources.

To analyse market-seeking (market size), resource-seeking, strategic asset-seeking motives and policy variables, a panel data approach has been adopted. The dependent variable in the study is the amount of OFDI outflow. The independent variables are the market-seeking, policy variables, resource and strategic asset-seeking variables in the host country.

Period of Study

The direction of India's OFDI is studied from 1990-2018, comparing it with pre-1991 data. The year 1991 has been selected as the Government of India had introduced the Liberalization, Privatization and Globalization policy in that year. Subsequently, with policy changes, OFDI from India registered a considerable increase. The study analyses the host country determinants are empirically tested by taking the data of annual foreign direct investment outflow during 2001-13.

The geographical and sector level analysis has been performed by dividing the host countries into two groups, developed and developing, based on the categorization followed in the UNCTAD World Investment Report internationally and also across broad geographical regions during 2011 - 2018 due to the non-availability of time series data of India's OFDI in host countries for a longer duration. Moreover, for many host countries, the data for independent variables is not available. Thus, such countries could not be considered for panel data analysis.

1. Impact and the causality relationship of OFDI are from 1995-2017.
2. Sector Wise and Country Wise analysis are from 2011-2018.

Tools used in the Study

Granger Causality test - Granger causality is a way to investigate causality between two variables in a time series. It is the ratio of the variance of the model before and after the addition of the new time series. The advantage of Granger causality is that it allows a researcher to pinpoint directional influences of regions on another without any *a priori* hypothesis regarding which regions are involved in particular subnetworks (Mohapatra, 2016;Waqar Ameer et.al., 2017; Herzer D., 2011). Testing the data for unit root is necessary as a first step. The concept of Stationarity is important for accurate estimations as well. Variables are considered to be stationary at 1st difference under Levin, Lin & Chu t, Breitung t-stat, ADF, PP and I'm, Pesaran and Shin. The results for Exports, Gross Capital Formation, Expense, imports, Inflation, OFDI, Research and Development, Trade openness, Unemployment Rate and Real Effective Exchange Rate are Stationary at 1st Difference.

Johansen Cointegration Test - Cointegration test will be applied to check the cointegration relationship. Cointegration test represents the relationships among the variables. As long as there is a cointegration relationship between variables, the error correction model can be derived from the autoregressive distributed lag model. And each equation in the VAR model is an autoregressive distributed lag model; therefore, it can be considered that the VEC model is a VAR model with cointegration constraints. Because there is a cointegration relationship in the VEC model, when there is a large range of short-term dynamic fluctuation, VEC expressions can restrict long-term behaviour of the endogenous variables and be convergent to their cointegration relation (Kueh, 2010; Herzer 2011).

ANALYSIS OF THE STUDY

The impact of OFDI is analysed using macroeconomic time series data. Time series data may be non-stationary which means that the series contain permanent stochastic trend which continues over a period of time. therefore there is a required to analyse whether the concerned time series data are stationary or not. Stationarity of the data is being tested using Im, Pesaran and Shin test, Phillips and Perron test, Augmented Dickey-Fuller test at the 1st difference and found that the data is stationary.

To test the relationship between FDI and Economic growth Granger causality test is being used and found that the series is stationary at the 1st difference and 2nd difference (Labour force, Expense, Unemployment rate, Gross capital formation, Imports, Inflation, Trade openness, Research and Development, REER, Exports).

Johansen Cointegration test is used to examine the long run relationship between OFDI and economic growth, the results reveal that there is a significant cointegration between OFDI, GDP, Expense, Exports, Gross Capital Formation, Trade openness, Unemployment Rate, Economic Forecast No significant relationship between OFDI, REER, Imports, Inflation, Labour Force, Research and Development.

RESULTS

First ADF, PP and Im, Pesaran and Shin are applied to examine the stationarity of the data, based on the null hypothesis of unit root against the alternative hypothesis of no unit root. The results given in Table 1 shows that all the series are stationary except labour force. All the series are stationary at first differenced; (1) as the null hypotheses of unit roots. .This analysis shows that no data series is stationary at first difference; therefore, these variables may contain long-run relationship among them. Keeping this view, we apply the Johansen cointegration approach to find a long run relation.

Johansen Cointegration test results are given in Table 3 and 4. Table 3 shows the results of Trace statistics and Table 4 shows the results of Maximum Eigen Statistics. The cointegration test results in Table 3 reveal that the variables are stationary at first difference that is they are I (1) series integrated of one order. Trace and Maximum Eigen Statistics show the number of Vector(s) containing long-run relations, and the null hypothesis is rejected at 5% level of significance. Therefore, the results of both trace and max-Eigen statistics confirm that one cointegration vector exists in the model. It means long run relationship prevails among the variables.

The Causal link between OFDI and economic growth is estimated through ADF, PP, Im Pesaran and Shin approaches. As already explained, al the variables are integrated at first order and lag length of the variable one. The results of causality are presented in Table 5 reveal that OFDI has a relationship with Exports of the country, R&D Expenditure, and the Unemployment rate as the null hypothesis is rejected at 5% level of significance. To conclude, this study has found that there exists a bidirectional causal association between domestic investment and foreign direct investment whereas domestic investment causes economic growth and economic growth causes foreign direct investment.

CONCLUSION

This study examines the impact of India's OFDI and economic growth for the period of 1990 – 2017. As India's OFDI registered steady growth in the past 2 decades. Stationarity of the data is being tested using ADF, PP, Im Pesaran and Shin unit root test and results are stationary at first differenced which shows that all the variables are integrated at first order, that is, $I(1)$. Johansen cointegration approach is applied to examine the relationship and Granger causality approach is exercised to evaluate causal linkages between OFDI, Exports, R&D Expenditure, and Unemployment.

The Results reveal that foreign production has a negative impact on the employment in home country contrastingly OFDI has a positive impact on Exports and Research and development (De Beule, 2012)of the home country. Domestic Investment increases Outward FDI and combines the production process to decrease the cost of manufacturing (Desai, 2005). The Findings from the study reveal that OFDI has both a positive and negative impact on the host country. It positively encourages the economic development of the host country by increasing the productivity (Hsu 2011),exports and benefits the local firms by indirect transfer of technology. As a result, the local firms were able to compete more successfully in exports by using the technology or management techniques used by the multinationals (Blomstrom M., 1991).

Therefore policy makers instead of focusing on the standalone increase in FDI inflow should focus on both FDI inflow and outflow. Policies should be directed to attract and retain FDI inflow even during the crisis rather than managing or taking corrective measures on the macroeconomic policies during the crisis period. EMEs should also incentivize the domestic firms investing abroad for technologies and synergies as FDI outflow also enhance growth-related activities. Various incentives including tax benefits or subsidies should be promoted by the government in order to foster the foreign direct investment and hence domestic investment.

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