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FDI-Theories and Relation with FDI Restrictive Index

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Abstract

Foreign direct investment plays a key role in developing nations' economic development. Enhancing foreign economic transactions has become more critical than trade. There are a variety of questions for multinational corporations (MNCs) to address if they plan to invest in other countries, such as why do they invest? How are investments made? Where can I spend it? And how big of an opportunity is that? However in the earlier theories of foreign direct investment, certain questions were dealt with. FDI theories were graded according to microeconomic and macroeconomic viewpoints. An attempt has been made in this paper to research key FDI theories and the relationship between the restrictive index of FDI and FDI is studied by the model of bivariate regression. In India, FDI inflows demonstrate a substantial relationship with the FDI restrictive index. It will have to become more liberal to draw more FDI governments.

Keywords: Foreign Direct Investment, Theories of FDI, FDI Restrictive index, Economic Growth, Macro Variables.

1. Introduction

Multinational corporations have a host of issues to answer if they plan to invest in other countries such as Why to make investments? Where to spend? And how much risk is in investment? These questions have, however, been dealt with in the earlier theories of foreign direct investment. The theories of FDI were classified according to microeconomic and macroeconomic perspectives. The theories of macroeconomic FDI emphasize country-specific variables and are more closely associated with trade and international economies, while the theories of microeconomic FDI are firm-specific, agree with the benefits of ownership and internalization, and appear to skew market imperfections towards an integrated economy. FDI's origins are not fully grasped. While several schools of thought are used to explain this phenomenon, there is still no consensus on any dominance or generality theory of FDI. In this paper, an attempt has been made to study the main theories of FDI, and the relation between FDI and

FDI restrictive trade index is analyzed by a bivariate regression model.

2. Review of Literature:

Based on perfectly competitive market assumptions, MacDougall (1958) established his model OKemp (1964) built on this view of MacDougall by suggesting that a two-country model is equal to its marginal output and prices of capital are equivalent.

Hymer(1976) neglected to note that the driving force behind FDI flows is based on the fact that there is an unquestionable quality of excellence in the international market. He was the first to consider the FDI hypothesis from an imperfection perspective.

Caves (1971), As the advantages that are effectively transferred from one unit of a company to another unit of that company, irrespective of whether they are located in one country or more than one country, he formulated an important aspect of this theory.[1-5]

Graham and Krugman (1989), advocated the perception of imperfection by arguing that UK-possessed technical advantages gave them the upper hand to invest in the USA.

Helpman's proposal was enhanced by the innovation of some scholars such as (Yannopoulos, 1990) and (Lipsey, 1990), who emphasized regional integration as the main driver of foreign direct investment.

Kojima (1985), based his proposal on the inability of businesses to compete domestically in Japan, forcing them to look abroad for investment opportunities.

Olusegun Ojo Ebenezer (2015) has taken foreign direct investment (FDI) theories into account and noted the contributions of many academics to the theories of foreign direct investment. He analysed the strength of each theory during the general examination of the literature and it is being strengthened by the various scholars of international trade.[6-14]

3. Objectives:

- 1.To study main theories relating to FDI.
- 2.To study the relation between FDI in India and FDI Restrictive index.

4. Research Methodology

To study the relation between FDI in India and FDI Restrictive index of India correlation and a bivariate regression model is used. As the FDI restrictive index was not available for a few years, so the researcher has calculated missing values by using interpolation and extrapolation techniques.

4.1 FDI Theories

The Industrial Organization Hypothesis

According to this theory, ownership of proprietary resources and specific capabilities such as differentiated goods, proprietary technologies, management expertise, and greater access to capital and market distortions imposed by government confers a competitive advantage on transnational corporations over indigenous companies in the host country and helps them compensate for the disadvantages of operating in a foreign country.

4.2 The Transaction cost approach

R.H. Coase is pioneering the transaction cost method and Williamson (1979) generalizes it. FDI is seen as an organisational solution to the imperfections of TNCs' intermediate products, information, and capital markets. The theory

claims that the external market open to a TNC does not offer an effective environment in which the business can benefit from using its technology, know-how, brand identity, or production processes.

4.3 The Internalization Hypothesis

The theory of internalisation explains why businesses use FDI in preference to exporting and importing from foreign nations. This also clarifies why they would shy away from licencing. Companies substitute some of the business functions with internal procedures, that is, with intra-company transactions, because of the considerable time lags and transaction costs associated with market acquisitions and sales.

4.4 The Location Hypothesis

The theory explained the success of FDI among countries based on a country's national wealth, such as its endowment of natural resources, labour availability, and size of the local market, infrastructure, and government policy to these national resources.

4.5 The Eclectic Theory

The theory argues that FDI is the result of companies that want to exploit in foreign locations (L) with special (income-generating) ownership advantages (O), which they cannot do profitably except by internalization (I). Dunning further transformed the possession of proprietary resources and technologies into asset-based ownership benefits that are realised from imperfections in the systemic market and transaction-based ownership benefits that are realised from imperfections in transactions.

4.6 FDI Restriction Index

Originally established in 2003, the FDI Index is maintained jointly by the OECD Investment Division and the OECD Department of Economics as one component of the revised 2008 OECD Product Market Regulation Indicator (PMR) which sets out the priorities of the Going for Growth Policy (Golub, Stephen (2003) and Wöfl, A., I. Wanner, T, Kozluk, G. Nicoletti (2009). The 2010 update upgraded the FDI Index's sector-by-sector coverage, a move in which delegates expressed concern. Non-banking and insurance services (under finance), as well as media services (TV and radio broadcasting, as well as print and other media), were introduced to cover sub-sectors. Manufacturing (five sub-sectors), energy

(generation and distribution), distribution (retail and wholesale) and transport (added international/domestic breakdown for air and road transport) are subject to greater detail. Overall, the improved sector coverage and finer subsector specifics boost the comparability of findings across countries, as restrictions in certain sectors/subsectors may be more severe in certain groups of countries (BlankaKalinova, Angel Palerm and Stephen Thomsen, 2010) The FDI Restrictiveness Index includes four types of measures: I foreign ownership limitations, (ii)

criteria for screening and prior approval, (iii) guidelines for key employees and (IV) other restrictions on the activity of foreign enterprises. For any measure in any sector, the highest score is 1 (the measure completely limits foreign investment in the sector) and the lowest score is 0 (the sector does not have any regulatory impediments to FDI). By adding the scores for all four forms of measures, the score for each sector is obtained with the restriction that their sum is also capped at a value of 1.

Table I-1: Scoring of restrictions 2010 of FDI index

Foreign equity limits	Scores
1.Start-ups and acquisitions	
No foreign equity allowed	1
<i>Foreign equity < 50% of total equity</i>	0.5
<i>Foreign equity > 50% but < 100% of total equity</i>	0.25
<i>Acquisitions No foreign equity allowed</i>	0.5
<i>Foreign equity < 50% of total equity</i>	0.25
<i>Foreign equity > 50% but < 100% of total equity</i>	0.125
2. Screening and approval 1	
Approval required for new FDI/acquisitions of < USD 100mn or if corresponding to < 50% of total equity	0.2
Approval required for new FDI/acquisitions above USD100mn Or if corresponding to > 50% of total equity	0.1
Notification with a discretionary element	0.025
3.Restrictions on key foreign personnel	
directors Foreign key personnel, not per	0.1
Economic needs test for employment of foreign key personnel	2/0.05
Time-bound limit on the employment of foreign key personnel	2/ 0.025
Nationality/residence requirements for board of directors, Majority must be nationals	0.075
At least one must be national	0.02
4. Other restrictions Establishment of branches not allowed	
local incorporation required	0.05
Reciprocity requirement	0.1
Restrictions on profit/capital repatriation	1-0.1
Access to local finance	0.05
Acquisition of land for business purposes	3/ 0.1
Land ownership not permitted but leases possible	0.05 - 0.01
TOTAL	Up to 1

Source: OECD Working Papers on International Investment 2010/03

Table.2: FDI Inflow and FDI Restrictive index

Years	FDI inflows in India	FDI Restrictive index
1991-92	129	0.540
1992-93	315	0.526
1993-94	586	0.513
1994-95	1314	0.499
1995-96	2144	0.486
1996-97	2821	0.473
1997-98	3557	0.480
1998-99	2462	0.470
1999-00	2155	0.450
2000-01	4031	0.422
2001-02	6130	0.393
2002-03	5095	0.366
2003-04	4322	0.418
2004-05	6052	0.350
2005-06	8962	0.282
2006-07	22826	0.248
2007-08	34844	0.232
2008-09	41903	0.229
2009-10	37746	0.283
2010-11	36047	0.284
2011-12	46552	0.272
2012-13	34298	0.257
2013-14	36047	0.255
2014-15	45147	0.241
2015-16	55559	0.214
2016-17	60220	0.214
2017-18	60974	0.209
2018-19	62001	0.206

Source: World Bank - World Bank national accounts data, and OECD National Accounts data.

FDI restrictive index of few years was available, so its values are interpolated and extrapolated by different techniques of interpolation and extrapolation to know the correlation and cause and effect relationship between them. The results are;
 As p value=0.000 and r=-0.886, it shows that their correlation is significant and there is a high degree

of negative correlation between FDI and FDI restrictive index.

The relation between FDI and FDI restrictive index is significant

$$FDI = 79180.484 - 164026.138 \text{ FDI RESTRICTIVE INDEX}$$

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients Beta	t	Sig.
		B	Std. Error			
1	(Constant)	79180.484	6397.006		12.378	.000
	fdi restrictive index	-164026.138	17132.257	-.886	-9.574	.000
a. Dependent Variable: FDI						

It shows that as India reduces restrictions on trade, FDI inflow increases in the country. So to attract more FDI government should have to become more liberal.

Conclusions

It has been observed that India's FDI inflows are impressive in absolute figures, but India's share is far from satisfactory compared to global flows. Since India is a latecomer in opening up its economy, compared to other developing countries, it is unable to attract enough FDI. This is essentially connected to its socio-economic system and strategies taken after independence. India needs Foreign Direct Investment as a strategic investment component for its sustainable economic growth and growth through job creation, expansion of established manufacturing industries, education, and research and development, etc. The FDI policy should be structured by the government in such a way that FDI inflows can be used to increase domestic production, savings and exports through fair distribution between states to attract FDI inflows at their level. FDI will help to increase demand, manufacturing, and export at the Indian sector level.

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