A STUDY ON DESTINATIONS OF FDI AND PATTERN OF UTILISATION IN INDIA

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ABSTRACT

The study examines empirically the allocation of FDI into select sectors using data collected from secondary data sources like the Department for Promotion of Industry and Internal Trade (DPII), GOI- FDI Newsletter (SIA Newsletter) and Reserve Bank of India – Handbook of Statistics on Indian Economy, RBI Bulletin. The study has used the log-lin panel regression model, Granger Causality and Durbin Watson and Least Square Dummy Variable Model (LSDV) to analyze the concerned objectives. Results show that Maharashtra and New Delhi have the top two positions from 2000 to 2021. The key sectors attracting FDI to the Mumbai-Maharashtra region are services, energy, transportation and telecommunications. Government should modify/change its FDI policy in such a manner that leads to providing equitable investment opportunities across Indian states and ensure that the rising FDI flows do not lead to an increase in regional inequality.

Keywords**:** *FDI, Growth, Heterogeneity, Log-lin panel regression model and Panel Data Analysis*

Introduction

The countries which are developed focus on new markets where there is the availability of abundant labour, scope for products, and high profits are achieved. Therefore Foreign Direct Investment (FDI) has become a battleground in emerging markets. The objective behind allowing FDI is to complement and supplement domestic investment, for achieving a higher level of economic development and providing opportunities for technological up-gradation, as well as access to global managerial skills and practices(Indian Current Affairs, 2010)[1]. Gori (2015)[2] explains that the liberalization phase in the Indian economy has paid rich dividends to the country. Foreign companies are eager to invest in India to take advantage of lower wages, tax exemptions etc. This has generated employment and has helped the economy in upgrading to higher and better technology. A favourable investor-friendly policy regime with a robust business environment has ensured the regular and smoother flow of foreign capital into the country. Countries like 'Mauritius, Singapore and Japan have been the top three countries in India contributing 36.17 per cent, 20.03 per cent and 10.83 per cent of the total FDI Equity Inflows during 2016-17. Other sectors catching up fast are Power and Trading with 8 per cent and 11 per cent share respectively in terms of FDI inflows.

Literature Review

Ramaswamy et al. (2017) analyze the regional productivity across 28 Indian states from 1993 – 2013 for FDI spillover between FDI and economic growth for the developing economies. Using panel data, they observed that factors like research and development, technology import, human capital, and various specifications of FDI have a substantial effect on the regional productivity in India except for the technology gap.

Khachoo & Sharma (2017) observe closely the behaviour of Indian and foreign Manufacturing firms for the research and development (R&D) when the FDI flows in. The authors stress that FDI inflows raise the competition level in the country thereby raising the R&D requirements by both domestic and foreign firms. The study uses Heckman's two-step estimation strategy to analyze this impact from 2000 to 2012. Their results indicate a remarkable increase in the investment budgets of both domestic and foreign firms on R&D and further suggest the opening of the domestic economy for higher FDI. Programs, like Make in India, are working in the direction of bringing transformation into the economy thus making it a global manufacturing hub.

Mora & Singh (2013) examined empirically the role of FDI in manufacturing and its

contribution to trade productivity and fragmentation in ten Asian countries. Their results indicate a positive correlation between exports and imports with FDI. A greater trade fragmentation was observed in imported intermediate goods. However, both exports and intermediate imports have a positive correlation with per capita GDP.

Herzer (2010) suggests positive effects of outward FDI on 50 countries. The study uses a cross-section growth regression approach and system cointegration method to show a positive relationship between FDI and economic growth. The long-run causality shows that increases in GDP and the associated rise in productivity levels of firms help them to make investments abroad thus having positive and significant ripple effects. Various governments have been responding to globalization positively and comprehensively. Significant divergent changes are made in the investment policies to make them adaptable, acceptable and sustainable. This has attracted several researchers across the globe to have a deeper look at the investment policies especially FDI in both developed and developing countries.

Carkovic & Levine (2002), Alfaro (2003), Lyroudi et al. (2004), Sapienza (2009), have been able to establish a positive relationship. Thus, in recent years various governments have been proactive in making profound changes in the investment policies of India and this has helped the country to build and upgrade its industries with more global connect. Government policies since 2014 can be applauded for understanding the global economic landscape well in advance and making deep structural changes in the economy.

Although there are studies on the effect of FDI on the overall performance of India, there is a lack of research that focuses on state-level impact. The variation across these states and territories is huge regarding demography, language, ethnicity and economic conditions. Also, some states have achieved rapid economic growth in recent years, while others have not. In this paper, we ask a simple question whether FDI has benefitted these states over the period? If yes, does this benefit depend on any particular factor or independent of any such factors? Primarily, our results indicate that a state with larger enrollments in engineering, MBBS, and other professional degrees and higher financial assistance benefits more from FDI than the other ones.

Objectives

1. To analyse the sector-wise distribution of FDI in India from 2000 to 2021;
2. To study the State-wise distribution of FDI inflows in India;

Hypotheses

1. H_1: The impact of FDI on selected sectors is positive.
2. H_2: FDI would have a positive impact on domestic employment across all the states of India.

Methodology

The objectives are analyzed with the help of growth rate, percentage to total flows, pictorial representation and appropriate statistical tools like Trend Analysis, Multiple-Regression, Log-lin panel regression model, Granger Causality and Durbin Watson and Least Square Dummy Variable Model (LSDV).

Data and Models

The data collected for the study is from the secondary data sources and the data has been obtained from the following sources like Department for Promotion of Industry and Internal Trade (DPII), GOI- FDI Newsletter (SIA Newsletter) and Reserve Bank of India – Handbook of Statistics on Indian Economy, RBI Bulletin.

Theoretical Framework

A foreign direct investment (FDI) is a purchase of an interest in a company by a company or an investor located outside its borders. To understand the process of capital movement in the form of FDI, several theories have been put forward by economists. In the present study, we will analyze the various theories broadly classifying them into FDI theories at the Macro Level, Development theories of FDI, FDI theories based on Currency Approaches, FDI theories at the Micro Level and Political-Economic theories. In 2020, foreign direct investment tanked globally due to the COVID-

19 pandemic, according to the United Nations Conference on Trade and Development. The total $859 billion global investment compares with $1.5 trillion the previous year.

Chronological Development of FDI in India

India is actively promoting the entrance of foreign players into the market as it has a huge potential for overseas investment. India is believed to be a good investment zone despite political dubiety, cumbersome bureaucratic processes, shortages of power and infrastructural deficiencies. It is among the few markets in the world which have the potential for growth and high earning prospects in practically all areas of business. India's economic growth since independence can be divided into two phases the first phase 1950-80 which was marked by the slow Hindu growth rate of 3.5 per cent per annum in GDP, and the second phase 1980-2005 which was marked by average growth in GDP of 5.6 per cent per annum.

The trenchant increase in India's growth can be attributed to several factors and one of them is the reforms program of 1991 which marked the beginning of the liberalization process in the country. The policy shift from inward-oriented growth strategy to outward-oriented growth strategy was largely guided by the belief that an open trade regime can act as a propeller of higher economic growth. The reforms marked the beginning of the sharp increase in FDI flows into the country. Foreign Investment in India is ruled by the FDI Policy announced by the Government of India (GOI) and is also bound by the provisions of the Foreign Exchange Management Act (FEMA) 1999. Reserve Bank of India on May 3, 2000, issued Notification (No. FEMA 20/2000-RB) which contains the Regulations regarding this matter. This notification document has been amended now and then as the need arises. India now allows 100% foreign direct investment in single-brand retail without Government approval. The regulatory decision reportedly facilitates Apple's desire to open a physical store in the Indian market. Three tiers for approving FDI proposals in the country were introduced:

a. The Reserve Bank's automatic approval system.
b. SIA approvals for proposals within the general.
c. FIPB was specially created to invite, negotiate and facilitate substantial investment.

The sectors now open to FDI are much larger as compared to the earlier policy. There emerged different categories of industries based on the ceiling of foreign equity participation, viz.,

a. FDI < 26 per cent
b. FDI < 50 per cent
c. FDI < 51 per cent
d. FDI < 74 per cent
e. Industries in which up to 100 per cent foreign equity is permitted.

In a nutshell, a positive approach towards foreign collaboration and a departure from the past can be seen through the sweeping changes introduced since 1991. In terms of FDI entry, the prevailing Indian policy is competitively placed keeping in view other major FDI receiving countries in Asia.

Sectoral Allocation of FDI and Influence on Growth

Foreign Direct Investment does not flow uniformly to all sectors of the Indian Economy. To investigate the influence of FDI on the growth of Indian states for the period 2000-2005, we focus on FDI as a share of SDP (State Domestic Product) as the main explanatory variable. Distribution of the FDI sector-wise is necessary for the Indian market perspective. Which will indicate the sectors which get the highest FDI in India is the highest in growth level. This is stated in the table-1.

Table-1: Sectoral Allocation of FDI (in %)

S. N	Top Ten Sectors	2000-2016	2017	2018	2019	2020	2021	% of Total Cumulative Inflows
1	Service Sectors	11	23	20	22	54	34	16.42
2	Computer Software & Hardware	28	19	29	26	11	23	13.40
3	Telecommunications	8	9	17	14	7	9	7.10
4	Trading	5	10	7	5	16	14	5.70
5	Construction Development	12	20	8	13	1	1	4.92
6	Automobile Industry	8	6	8	8	3	9	4.90
7	Construction Activities	6	6	7	3	2	2	4.66
8	Chemicals (Other Than Fertilizers)	5	3	4	7	2	1	3.49
9	Drugs & Pharmaceuticals	7	3	1	1	3	5	3.40
10	Hotel & Tourism	10	1	1	1	1	3	2.95

Source**:** Department for Promotion of Industry and Internal Trade (DPII), GOI- FDI Newsletter (SIA Newsletter)/ Computed by Authors (C3- C9)

The data is shown in the table-1 is panel nature, where if the log of FDI is regressed on year/ period will give the growth rate of FDI over the period (2004-2010). Moreover, out of cumulative inflows of all 63 sectors from January 2000 to March 2021 (i.e. 530,434 US $ million). Here only the top ten Sectors is shown, where the service sector tops in attracting the highest FDI equity inflows, followed by Computer Software & Hardware, telecommunications and other sectors.

To see the allocation of FDI into different sectors over the period, first, we run a pooled regression of the log of FDI on year, which is equivalent to estimation with neither fixed nor random effects, as given in the following equation. The Eviews 9 output is also shown below.

$LFDI_{it} = ß_1 + ß_2 YEAR_i + u_{it}$

$\widehat{LFDIit} = -657.98 + 0.41\ YEAR_i$

t = (-5.35)*** (5.65)***

SE = (132.16) (0.05)

(F-Statistics = 35.55) *** (R^2 = 0.37)

Here we see that both, the intercept and the regressor are statistically significant at below 5% (***). Since FDI is in logarithmic form (i.e., the model being a log-lin panel regression model), so the slope estimate of 0.412109 corresponds to an approximately 41.21% growth rate in FDI over the years. But this pooled regression assumes that the intercepts are the same for each sector, which could be an inappropriate assumption. Instead, we can estimate a model with cross-section fixed, which is also known as Least Square Dummy Variable Model (LSDV), which will allow us to capture the latent sector-specific heterogeneity, as given in the following equation. Eviews 9 output with effects specification cross-section fixed (dummy variables) is also shown below.

$LFDI_{it} = ß_1 + ß_2 YEAR_i + u_{it}$

$\widehat{LFDIit} = -657.98 + 0.41\ YEAR_i$

t = (-6.53)*** (6.28)***

SE = (112.84) (0.03)

(F-Statistics = 7.85) *** (R^2 = 0.37)

Here also we see that allocation or growth rate of FDI into different sectors over the years, which is positive and statistically significant. We can also see the sector-specific heterogeneity from the table below;

Table-2: Cross-section Specific Heterogeneity

S. No	Sectors	Effect
1	Service Sectors	1.54
2	Computer Software & Hardware	0.56
3	Telecommunications	0.24
4	Trading	-0.65
5	Construction Development	0.23
6	Automobile Industry	-0.26
7	Construction (Infrastructure) Activities	-0.07
8	Chemicals (Other Than Fertilizers)	-0.23
9	Drugs & Pharmaceuticals	0.80
10	Hotel & Tourism	0.23

Source**:** Computed by Authors using Eviews 9

From table-2, we see that heterogeneity in terms of allocation of FDI across different sectors over the years has been captured and this contribution has been obtained to be the highest in the case of Service Sectors, followed by Computer Software & Hardware, Telecommunication, Trading, Construction Development, Drugs & Pharmaceuticals and Hotel & Tourism whereas the same has been obtained to be negative in case of Trading, Automobile Industry, and Chemicals (Other Than Fertilizers).

Table-3: Actual Differential Intercept Values of Ten Sectors

S. No	Sectors	Effect
1	Service Sectors	-770.65
2	Computer Software & Hardware	-770.26
3	Telecommunications	-769.24
4	Trading	-768.26
5	Construction Development	-769.25
6	Automobile Industry	-768.27
7	Construction (Infrastructure) Activities	-768.25
8	Chemicals (Other Than Fertilizers)	-768.25
9	Drugs & Pharmaceuticals	-769.29
10	Hotel & Tourism	-769.89

Source**:** Computed by Authors using Eviews 9

From table-3, we also see actual differential intercept values of ten sectors over the years has been captured and this contribution has been obtained to be the highest in the case of Service Sectors, followed by Computer Software & Hardware, Telecommunication, Trading, Construction Development, Automobile Industry, Construction (Infrastructure) Activities, Chemicals (Other Than Fertilizers), Drugs & Pharmaceuticals and Hotel & Tourism.

Next, we go into for random effects (cross-section) model, which is sometimes also known as the error component model. Under the random-effects model, the intercept for each cross-sectional unit is assumed to arise from a common intercept, which is the same for all cross-sectional units and over time, plus a random variable that varies over cross-section but is constant over time, as given in the following equation. The Eviews 9 output with effects specification cross-section random and idiosyncratic random is shown below;

$LFDI_{it} = ß_1 + ß_2\ YEAR_i + \varepsilon_i + u_{it}$ or $LFDI_{it} = ß_1 + ß_2\ YEAR_i + w_{it}$

$\widehat{LFDIit} = -657.98 + 0.41\ YEAR_i + w_{it}$

t = (-6.53)*** (6.28)***

SE = (112.84) (0.03)

(F-Statistics = 7.85) *** (R^2 = 0.37)

F-Statistics = 41.44***) (Weighted R^2 = 0.40), (Un-weighted R^2 = 0.38)

Simultaneously, it is also worth determining that whether fixed effects are necessary or not, as shown in Eviews 9 output below;

Table-4: Redundant Fixed Effects Tests

Effects Test	Statistic	d.f.
Cross-section F	3.29***	(8,85)
Cross-section Chi-square	27.06***	8

Source**:** Computed by Authors Using Eviews 9

A redundant fixed effects test has been employed to see whether fixed effects are necessary or not, each in both χ^2 and F-test versions, restricting cross-section fixed effects to zero. From the above output, we see that cross-section fixed effects restrictions are not supported by data meaning thereby that a pooled sample could not be employed. Next, we see whether fixed effect model is preferred over random effect model or not, using the Hausman test, as shown below in Eviews 9 output;

Table-5: Correlated Random Effects – Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f
Cross-section random	0.00***	(1)

Source: Computed by Authors Using Eviews 9

From the output of Table-5, we see that the Hausman test is not significant. Therefore, it can be concluded that through random effect model is preferred over the fixed-effect model but there is no significant difference between them, which is shown in the cross-section random effects test comparisons of the Correlated Random Effects – Hausman Test.

Table-6: Cross-section random effects test Comparisons

Variable	Fixed	Random	Var(Diff.)	Prob
LFDI	0.36	0.36	-0.00	NA

Source**:** Computed by Authors Using Eviews 9

This means that heterogeneity in terms of the allocation growth rate of FDI into different sectors over the years could be arising from two legs (Table-6). One is the common intercept, which is constant over cross-section and overtime periods. This invariably emerges out of a low level of development in the economy encompassing all the sectors, bureaucratic delays and widespread corruption, which could not attract a considerable amount of FDI, resulting in an initial negative growth rate. The other is the random variable, which is constant over time but varies over cross-section, which is invariably government policy regarding FDI across different sectors. Now, we can compare three models, such as Pooled OLS Model, Fixed Effect (LSDV) model and Random Effect Model (Error Component Model) in a tabular form, as given below.

Table-7: Coefficient (t-ratio) [Standard Error] Values of Both the Variables

Dependent Variable: LFDI			
	Coefficient (t-ratio) [Standard Error]		
Independent Variable			
Year	0.36 (5.57)*** [0.05]	0.36 (6.27)*** [0.06]	0.36 (6.51)*** [0.06]
Observations	54		
R^2	0.33	0.52	0.40

Source**:** Computed by Authors Using Eviews 9 *(***Significant at 1%)*

The table-7 explains that the coefficient of the fixed effect model is 36 in 2019, 2020 and 2021 but the level of significance is different.

Distribution of FDI within India

Distribution of FDI is a very much important concept in India, from which we can know which state gets how much of FDI. Moreover, the distribution of FDI can show the regional disparity in India. This is stated in table-8.

Table-8: Percentage of State-wise Total FDI Equity Inflows

		Total FDI Equity inflows(In %)	Growth Rate of FDI in Percent		
S.N	State Name	2019-2021	2019	2020	2021
1	Gujarat	29.60	8.00	36.00	8.00
2	Maharashtra	27.98	29.00	27.00	31.00
3	Karnataka	14.27	22.00	13.00	16.00
4	Delhi	11.23	23.00	9.00	15.00
5	Tamil Nadu	3.98	5.00	3.00	8.00
6	Jharkhand	3.13	1.00	4.00	1.00
7	Haryana	2.89	4.00	2.00	7.00
8	Telangana	2.20	3.00	2.00	4.00
9	Punjab	0.88	0.00	0.00	7.00
10	Uttar Pradesh	0.79	0.00	1.00	1.00
11	West Bengal	0.73	1.00	1.00	0.00
12	Rajasthan	0.55	1.00	0.00	1.00
13	Andhra Pradesh	0.34	1.00	0.00	0.00
14	Madhya Pradesh	0.34	0.00	0.00	0.00
15	Kerala	0.32	0.00	0.00	0.00
16	Goa	0.09	0.00	0.00	0.00
17	Pondicherry	0.07	1.00	0.00	1.00
18	Bihar	0.06	1.00	0.00	0.00
19	Orissa	0.04	0.00	0.00	0.00
20	Himachal Pradesh	0.03	0.00	0.00	0.00
21	Uttarakhand	0.02	0.00	2.00	0.00

22	Assam	0.02	0.00	0.00	0.00
23	Chandigarh	0.02	0.00	0.00	0.00
24	D and N Haveli and D & Diu	0.01	1.00	0.00	1.00
25	Arunachal Pradesh	0.01	1.00	1.00	1.00
26	Tripura	0.00	1.00	1.00	1.00
27	J. and Kashmir	0.00	1.00	2.00	1.00
28	Ladakh	0.00	1.00	2.00	1.00
29	Chhattisgarh	0.00	1.00	1.00	1.00
	Total	100.00			

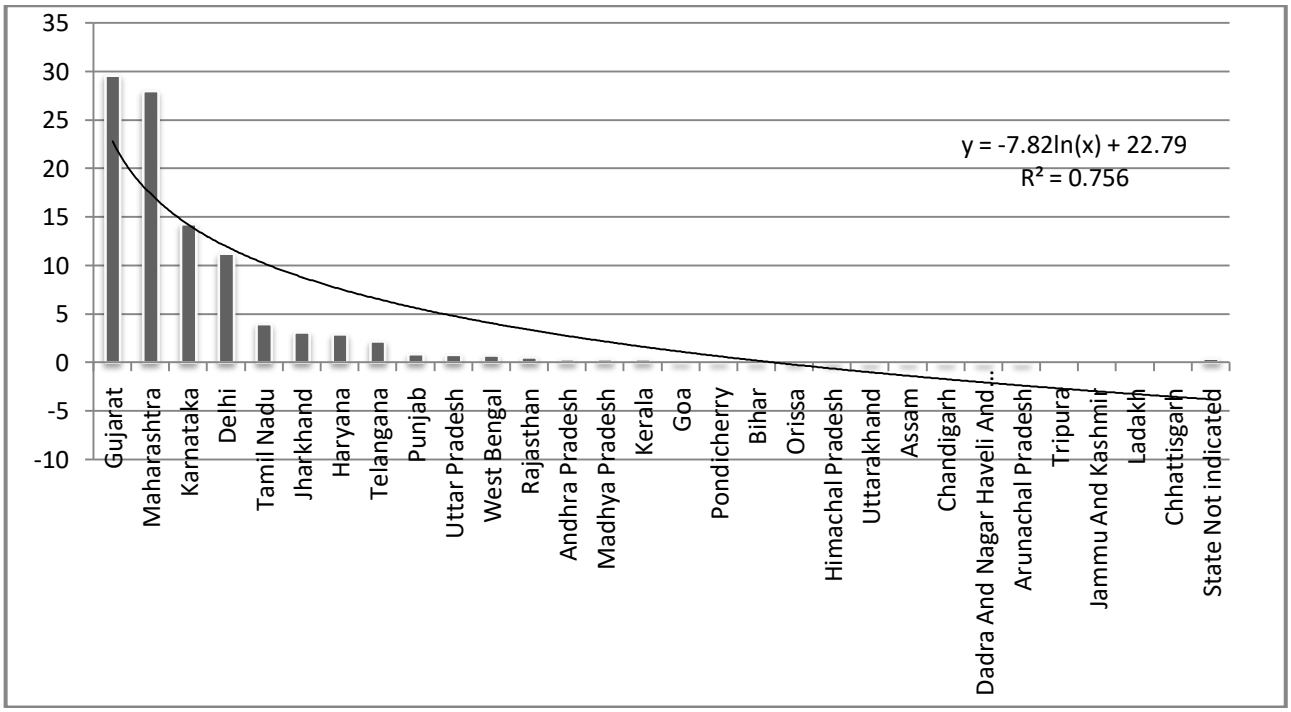
Source: Department for Promotion of Industry and Internal Trade (DPII), GOI- FDI Fact Sheet/ Computed by Authors (C3)

In table-8, it is stated that among states, Gujarat received the highest FDI at 29.60 per cent of the total equity inflows. Maharashtra and Karnataka had the second and third highest flow at 27.98 per cent and 14.27 per cent, respectively. India has attracted the highest ever total FDI (foreign direct investment) inflow of $81.72 billion during the financial year 2020-21, recording a 10 per cent rise on a year-on-year basis. Gujarat has bagged the top spot in terms of the highest FDI for the fourth consecutive year now. With a 29.60 per cent share, Gujarat received a total FDI of $30.23 billion in 2020-21.

Moreover, the growth rate of FDI in Percent has also been shown in table-8, where Gujarat and Maharashtra have been the top performers in terms of the growth rate of FDI, with the majority of FDI inflows within India being heavily concentrated around these two major States. Karnataka, Delhi, Tamil Nadu and Jharkhand are also drawing significant shares of FDI inflows. For statistical purposes, India's Department of Industrial Policy and Promotion (DIPP) divides the country into 16 regional offices. The top 6 regions account for more than two-thirds of all FDI inflows to India from 2019 to 2021.

States those which are in top receiving of FDI are very less in numbers and those which are getting less FDI are in more numbers of States. That is stated in the following figures.

Figure-1: State-wise % FDI Equity Inflows from 2019 to 2021



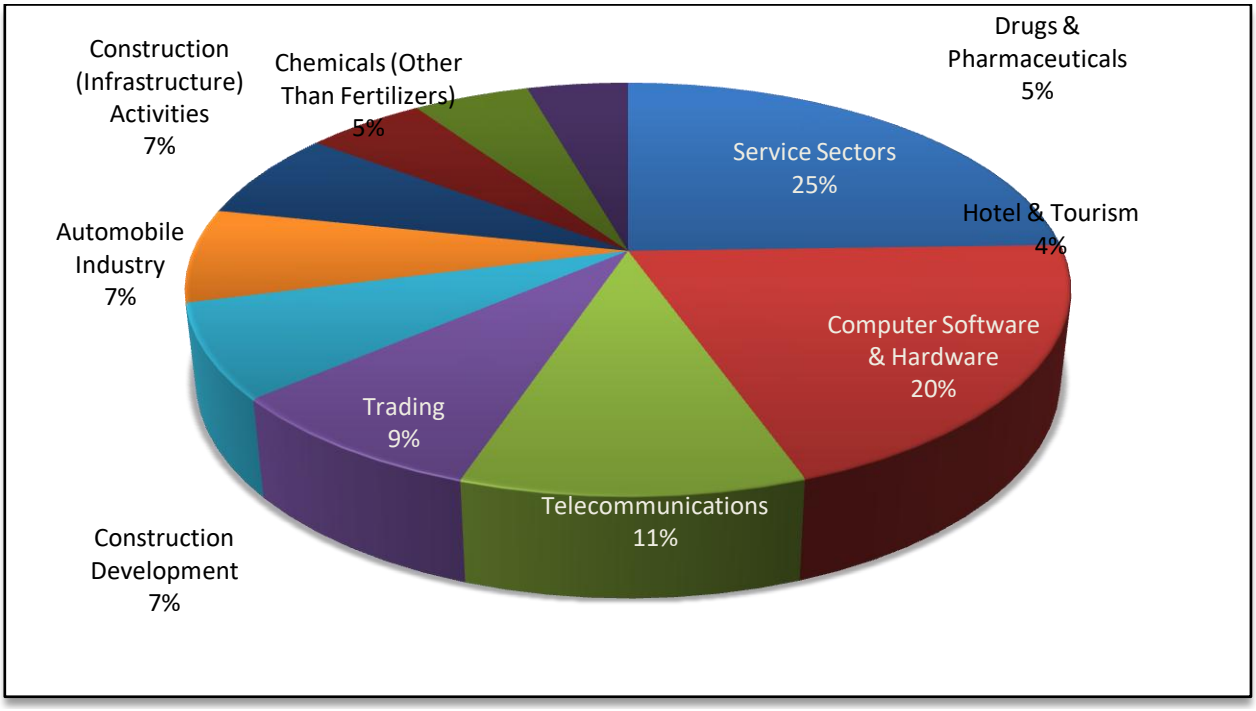
Source: Computed by Author using Excel

FDI equity inflow regarding the distribution of it is highest in the States like Gujarat, Maharastra, and Karnataka. These States are getting approximately more than half of the total FDI. Whereas, Delhi, TN, Jharkhand, Haryana, and Telangana are getting a little bit very low level of FDI. However, the remaining States are getting the very minute level of FDI. Here it is visible that Gujarat and Maharastra, these two States are alone getting around two-third of the total FDI. This scenario shows that foreign countries are being attracted towards FDI in Gujarat and Maharastra is very high. Hence, it can be said that the employability in these States may be very high.

Results and Discussion

Region-wise, economically advanced states have attracted lion's share of FDI inflows in India. This leads to an increase in regional inequality among Indian states. The more efficient states received fewer FDI flows. It points towards non-economic forces in an operation that influences FDI flows and regional development (Murthy and Sinha, 2014). Government should modify/change its FDI policy in such a manner that leads to providing equitable investment opportunities across Indian states and ensure that the rising FDI flows do not lead to an increase in regional inequality (Sinha, ed. 2017).

Figure-2: Cumulative within Total FDI (from 2000 to 2021) (in US$ million)



Source: Computed by Author using Excel

Figure-2 shows the Cumulative Total FDI (from January 2000 to March 2021) (in US$ million). The total of these ten Sectors of FDI inflow is 2145989.66 US$ million. The highest carries are Service sector which is 25%, followed by Computer Software & Hardware 20%, Telecommunications 11%, Trading 9% and so on. The tenth position is Hotel & Tourism 4%.

a) Maharastra and New Delhi top all the lists taking the top two positions throughout from 2000 to 2021. The key sectors attracting FDI to the Mumbai-Maharashtra region are services, energy, transportation and telecommunications. Delhi attracts FDI inflows in sectors like transportation, telecommunications, electrical equipment (including software sector) and services. All these sectors have huge growth potential and thus attract more FDI. Next followed by Ahmedabad, Bangalore and Chennai but recently in 2016-17 Chennai took up the 3rd position in the list outpacing Ahmedabad and Bangalore.

b) Among the share of top ten sectors contributing to the FDI inflows in India, the

Services sector has the major share, comprising Financial, Banking, Insurance, Non-Financial Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis attracted around 17.71 per cent of the total FDI equity inflow into India from 2000 to 2017.

Conclusion

Indian economy is possessed with greater foreign participation as is evident continuously rising FDI. These trends are expected to continue given the liberal trade policies and efficacious regulatory regime. The cautious and at the same time liberal investment policies ensure that the country would continue to attract large chunks of foreign investments and continue to outpace other developing and developed economies. It is only the positive thinking that might be protecting us even if we might have been in the case, assessed by others differently. But for Indians the attitude we have while donating or providing things to others also play a very important role. We think good intentions bring good outcomes. "As you sow so you reap". Here, if money is the seed been sowed, and expecting reap is something different, might be using our innocence or trapping our attitudes or playing mind games like our ancient Kauravas, we may be thrown off into a pit. So one must take care regarding the pros and cons of utilizing the FDI facility in our country

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