An Empirical Analysis of Determinants of Foreign Direct Investment Inflows From ASEAN to India During 2000 to 2012

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Abstract:

　　Foreign Direct Investment (FDI) equity inflow is important country's economic development. Association of South East Asian Nations (ASEAN) brings 11% of FDI equity flows to India. This by volume is considerably significant. This share is continuously increasing. There are several factors that determine the FDI equity inflows to a country. Empirical evidence proves the importance of gross capital formation, trade position of the country with partners, import and export trade openness, debt position, gross savings and inflation as potential determinants of FDI equity inflows from ASEAN to India. The objective of this paper is to analyses some of the potential determinants of FDI equity inflows from ASEAN to India during the period 2000 to 2012. An econometric model is used to find out the determinants of FDI equity inflows. The time frame for this analysis is 12-year period from January 2000 to January 2012, based on data availability. Majority of the explanatory variables specified in the econometric model found to be significant in attracting FDI while some variables are found to be non-significant in this case.

Key words: Foreign Direct Investment, ASEAN, regression model, trade openness, DCF

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1.0   Introduction

Foreign Direct Investment (FDI) inflow from Association of Southeast Asian Nations popularly known as ASEAN to India is rapidly increasing in recent years. ASEAN-6 consists of Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand, while CLMV comprises Cambodia, Lao PDR, Myanmar and Viet Nam. While in this study we have considered Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam and Myanmar only. India-ASEAN Regional Trade and Investment Area (RTIA) and ASEAN Free Trade Agreement have been formulated to increase the FDI inflows and trade in Asian region. FDI plays a major role in globalization, impacting both the growth of an economy. This also helps in multiplying the profitability of investing companies. FDI equity inflows to a country depend upon multiple factors. In order to attract FDI, countries needs to have a better understanding of FDI as well as factors affecting FDI.

        According to UNCTAD's World Investment Reports (2004, 2005, 2006, 2008), FDI inflows to developing economies is contributing to their economic growth. The initiative by the government of these countries is significant in increasing in the number of FDI activities.   UNCTAD's World Investment Report, describes this rise of developing country transnational corporations as part of a burgeoning shift in the structure of the world economy. The development gains from this trend could increase with appropriate policy responses in both source and recipient countries. India is also a part of this promising shift. The FDI equity inflows from all countries to India increased from 2,347 million US$ in January 2000 to 22,789 million US$ in December 2012, as recorded by the Reserve Bank of India (RBI). The cumulative FDI inflows from all countries in India during this period from January 2000 to December 2012 were 188.47 billion USD (*Department of Industr*

ial Policy and Promotion, Ministry of Commerce and Industry, Government of India).

ASEAN is an important source of FDI inflows for India. FDI equity inflow from ASEAN to India is 10.65 percent amounting 20.06 billion USD during the period January 2000 to December 2012 (*DIPP, Government of India*). The FDI equity inflows from ASEAN to India increased from 144.36 million USD in the year 2000 to 3,150.07 million USD in the year 2012. Year-wise total FDI equity inflow to India from all countries as well as from ASEAN during 2000 to 2012 is presented in Table 1.

Table 1: FDI Equity Inflows
From ASEAN to India (million USD)[1]

Year (January-December)	FDI Equity Inflow from all Countries (million USD)	FDI Equity Inflow from ASEAN (million USD)	FDI Equity Inflow from ASEAN as Percentage of Total FDI inflows (%)
2000	2,347	144	6.2
2001	3,520	42	1.2
2002	3,359	85	2.5
2003	2,079	87	4.2
2004	3,213	73	2.3
2005	4,355	333	7.6
2006	11,120	631	5.7
2007	15,921	1,477	9.3
2008	37,096	3,882	10.5
2009	27,044	3,259	12.1
2010	21,007	2,614	12.4
2011	34,621	4,288	12.4
2012	22,789	3,150	13.8
Cumulative Total	*188,471*	*20,065*	*10.6*

Source: FDI Synopsis on Country ASEAN Country, Table No. 6.1. (C), DIPP, Ministry of Commerce and Industry, Government of India, 31.12.2012.

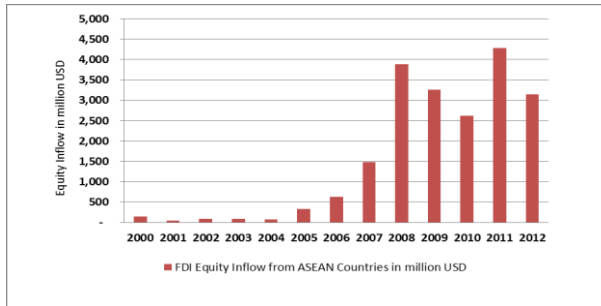Figure 1 shows, the total FDI equity inflows to India from ASEAN to India during 2000 to 2012.

Figure 1: Total FDI Equity Inflow from ASEAN

Table 2 presents FDI inflow from ASEAN to India during 2000 to 2012.

Table 2: FDI Inflow to India from ASEAN to India (In million USD)[2]

Sl. No.	Country	2000-2005 Jan.-Dec.	2006 Jan.-Dec.	2007 Jan.-Dec.	2008 Jan.-Dec.	2009 Jan.-Dec.	2010 Jan.-Dec.	2011 Jan.-Dec.	2012 Jan.-Dec.	% of Total FDI 2000-2012
1	Indonesia	24.17	0.37	3.34	6.06	138.30	433.06	0.41	4.58	3.04
2	Malaysia	93.89	6.56	5.09	100.27	38.65	43.98	20.83	211.77	2.60
3	Philippines	0.43	0.09	0.15	0.01	0.22	0.34	1.75	24.97	0.14
4	Singapore	619.54	620.66	1455.72	3,763.49	3,059.54	2,121.32	4,255.09	2897.20	93.66
5	Thailand	25.87	2.83	12.34	3.06	22.34	15.33	10.29	11.55	0.52
6	Vietnam	0.10	0.02	0.00	0.00	0.01	0.00	0.01	0.00	0.00
7	Myanmar	0.05	0.18	0.00	8.73	0.00	0.00	0.00	0.00	0.04
	Grand Total	764.05	630.71	1,476.64	3,881.62	3,259.06	2,614.03	4,288.39	3,150.07	100

Source: FDI Synopsis on Country ASEAN Country, Table No. 6.1. (C), DIPP, Ministry of Commerce and Industry, Government of India, 31.12.2012.

Amongst the ASEAN, India receives highest FDI inflows from Singapore followed by Indonesia, Malaysia, Thailand and Philippines. Other ASEAN partners have limited share.

2.0   Review of Literature:

In recent time, FDI flow from regional integration is important. The importance of regional integration is felt as it creates integration not only among themselves but also among other nations in the world in terms of trade and FDI flows. One of the objective of formation of ASEAN was to boost up inter –regional

trade and investment (Kreinin et al. 2008). Indo-ASEAN trade and investment ties are nothing different from the above-mentioned (Karmakar, 2005). FDI is an important source to generate savings required for investment hence economic growth. Asian countries in recent years have become important destinations for receiving FDI from the rest of the world especially America and Europe. The economic growth of many Asian nations such as India, China, Taiwan, Malaysia, Thailand, Indonesia and etc. is depended upon this factor. FDI brings economic growth by augmenting investment, by promoting technological efficiency, developing knowledge, skills, training and etc. [Vadlamannati et al. (2009), Pradhan (2006), Li and Liu (2005), Okamoto and Sjobolm (2005), Hermes and Lensink (2003), Zhang and Felmingham (2002), De Mello (1999), Borensztein et al. (1998), Balasubramanyam et al. (1996;), Chao and Yu (1994), Grossman and Helpman, (1991)].

Dunning (2004) laid emphasis on the significance of institutional infrastructure and development as a determinant of FDI inflows. The empirical study conducted by Iyre et al. (2004) pointed out economic indicators such as market size, export intensity, institutions, etc. as important factors of FDI. Chen Kun Ming et.al. (2004) highlighted the significance of exchange rate and its volatility as important determinants of FDI. FDI inflows is country specific and depending upon technological conditions, institutional efficiency and policy environment are either significant or non-significant (Bhat et al. 2004).

Empirical research highlights FDI inflows to human capital, technological transfer, institutional capability, bureaucratic efficiency, infrastructure, market integration, liberalization, economic and political stability and economic growth [UNCTAD (1999), Borensztein et al. (1998), Xu (2000), Olofsdotter (1998), Bengoa and Sanchez-Robles (2003), Durham (2004), Bende-Nabende et al. (2003), Mohapatra (2014)].

Coming back to the case of FDI inflows to India, one important point to be noted here that, over time along with the increase of FDI inflows into India actual outward FDI from India also increased significantly. Prior to the year 2004-05 both inward and outward FDI were increasing at a slow rate, but both types of FDI started increasing at a higher rate from the year 2004-05. The volume of outward FDI is increasing significantly to catch up with inward FDI into India, despite the fact that Indian firms started investing abroad only recently. Thus, India is not only considered as a destination for FDI but is also identified as a source of FDI for other countries. India receives FDI from a number of countries. Developed countries with their comparative advantages in technology and possession of huge capital stocks are expected to be a bigger source of FDI, but developing countries are slowly beginning to invest more in India.

The literature on FDI explains cross-country variations in FDI inflows in terms of country-specific characteristics encouraging or discouraging such flows. These can be broadly classified into *economic* factors impacting returns from investment e.g. host country market size, exchange rate stability, degree of openness of the economy, investment potential, country's debt position etc., host country *policies* for instance, outward-orientation, tax rates, investment incentives and *institutional* factors influencing investor outlooks such as, political stability, ease of doing business, cultural differences from home countries, language. While all these factors, individually and/or collectively, influence inward FDI, it is important to determine which of these are more significant in explaining the ability of some economies to consistently attract more FDI over time [Singh and Jun (1995), Caves (1996), and Blonigen (2005)].

The existing empirical literature on determinants of FDI into developing countries has not devoted adequate attention to country-specific features that constitute sources of dynamic

comparative advantages for attracting FDI. In this regard, exchange rate stability, investment potential, national debt, degree of openness can be key factors. It is well known that all these factors not only leads to productivity gains, but also production efficiency and higher returns on investment. Developing economies that have successfully made themselves attractive destinations for FDI are taking care of the above-mentioned.

Empirical research on FDI in India has mostly focused on the impact of FDI upon macroeconomic fundamentals. The limited literature on host-country determinants of FDI inflows points to such FDI that are essentially domestic market-oriented (Banga 2003, Guha and Ray, 2004). India also appears to enjoy the advantage of low wage costs (Guha and Ray, 2004; Gupta and Mehra, 1995). However, there is hardly any empirical analyses that describe economic strengths have influenced inward FDI in India. A close look at the likely impact of these factors on FDI inflows becomes essential with India emerging as a leading recipient of FDI.

GDP of a country is an indicator of the size of the market. A growing and potential market with substantial size ensures economies of scale and gives opportunities to the investors for investment. Foreign investors get attracted towards a country with stable or accelerating growth of output. Similarly, the fluctuation of exchange rate plays a vital role for the firms making investment abroad. With the fluctuation the firms prefers to reinvest or repatriate the earnings, change the location to other markets, or goes for mergers and acquisitions or consolidation for maximization of benefits. The depreciation of currency increases the ability of the foreign firms in comparison to local firms as it helps in doing more activities with less foreign exchange.

In this paper, we have attempted to empirically identify role of GDP, capital formation, trade position, gross savings, trade openness, inflation, exchange rate stability, debt, GDP

per capita in explaining the pattern of FDI inflows from ASEAN to India.

1.2 Objective:

The objective of this paper is to find out the determinants of FDI equity inflows from selected ASEAN countries to India during 2000 to 2012.

1.3   Methodology:

We have analyzed the potential determinants of FDI equity inflows from ASEAN to India using an econometric model used by UNCTAD to determine the determinants of FDI to various countries in 1993. The FDI model used is as given below:

1.3.1   FDI Model:

$$FDI_t = \beta_0 + \beta_1 GCF_t + \beta_2\, TR_{A\,t} + \beta_3\, TR_{I\,t} + \beta_4\, I_{A\,t} + \beta_5\, E_{A\,t} + \beta_6\, S_t + \beta_7\, Debt_t + \beta_8\, OP_t + \beta_9\, Inf_t + \beta_{10}\, GDP_t + \beta_{11}\, Ex_t + \beta_{12}\, PER_{GDP} + \sigma$$

FDI_t = Inflows of FDI in year t
GCF_t = Gross capital formation in year t
$TR_{A\,t}$ = India's trade with ASEAN in year t
$TR_{I\,t}$ = India's trade position in year t
$I_{A\,t}$ = Imports from ASEAN in year t
$E_{A\,t}$ = Exports to ASEAN in year t
S_t = Gross savings of India in year t
$Debt_t$ = Debt position of India in year t
OP_t = Trade openness of India in year t
Inf_t = Inflation in India in year t
GDP_t = GDP growth of India in year t
Ex_t = Exchange rate of India in year t
PER_{GDP} = Per capita growth rate of India in year t
σ = random error.
β_0 = Constant
β_1, β_2, β_3, β_4, β_5, β_6, β_7, β_8, β_9, β_{10}, β_{11} and β_{12} are coefficient of various determinants of FDI inflows such as GCF_t, $TR_{A\,t}$, $TR_{I\,t}$,

$I_{A\ t}$, $E_{A\ t}$, S_t, Debt $_t$, OP $_t$, Inf $_t$, GDP $_t$, Ex $_t$ and PER $_{GDP}$ respectively. The significance of these coefficients has been analyzed with the help of regression analysis.

1.3.2 Assumptions:

We have assumed all the above mentioned variables as main determinants of FDI equity inflows from ASEAN to India. The following assumptions about the variables have been considered.

i. There exist a positive relationship between GDP growth and FDI equity inflows;

ii. Gross Capital Formation (I) attracts foreign investors to increase their operation;

iii. Trade openness of an economy attracts more FDI equity inflows;

iv. The level of indebtedness (DEBT) of a country is negatively related to FDI inflows;

v. Trade positions of the country (exports and imports) with the ASEAN is an important determinant of FDI inflows;

vi. Overall trade position (imports and exports) of the country have a positive influence on FDI;

vii. Gross savings of the country positively influence the FDI inflows;

viii. Inflation of the country negatively influence the FDI flows

ix. The fluctuation in exchange rate (XR) is negatively related to FDI inflows,

x. Per capita growth of GDP positively influences the FDI flows.

1.4 Data:

The summary data used for this analysis are presented in Table 3.1 to 3.3. These data have been compiled from Country Data of

India from World Bank (2013) and all the data used in the analysis belongs to time period 2000 to 2012.

Table 3.1: Data used in the Analysis

Year	FDI (% of GDP)	Gross Capital Formation (% of GDP)	Trade with ASEAN (% of GDP)	Total Trade of India (% of GDP)	Import from ASEAN (% of GDP)
	FDI	GCF	TR_A	TR_I	I_A
2000-01	0.0303	24.11	1.48	19.95	0.87
2001-02	0.0085	25.57	1.59	19.28	0.89
2002-03	0.0162	24.97	1.86	21.78	0.98
2003-04	0.0141	26.14	2.14	22.96	1.20
2004-05	0.0101	32.45	2.43	27.31	1.26
2005-06	0.0399	34.28	2.55	30.24	1.30
2006-07	0.0665	35.87	3.24	32.89	1.91
2007-08	0.1192	38.03	3.16	33.49	1.83
2008-09	0.3171	35.53	3.70	39.95	2.14
2009-10	0.2387	36.30	3.22	34.21	1.89
2010-11	0.1530	36.53	3.29	36.34	1.79
2011-12	0.2281	36.39	4.20	42.30	2.24
2012-13	0.1695	34.70	4.08	42.56	2.31

Source: Country Data *of India, World Bank, 2013.*
(Downloaded from World Bank website on 27.09.2014)

Table 3.2: Data used in the Analysis
(Continued)

Year	Export from ASEAN (% of GDP)	Adjusted savings: gross savings (% of GNI)	Central government debt, total (% of GDP)	Official exchange rate (LCU per US$, period average)	Trade Openness
	E_A	S	Debt	Ex	OP
2000-01	0.61	25.26	54.1	44.94	1.27
2001-02	0.70	27.07	58.0	47.19	1.40
2002-03	0.88	26.59	61.5	48.61	1.22
2003-04	0.94	28.46	61.1	46.58	1.24
2004-05	1.17	32.98	61.5	45.32	1.21
2005-06	1.25	33.90	61.2	44.10	1.12
2006-07	1.33	35.24	59.1	45.31	1.07
2007-08	1.33	36.76	56.5	41.35	1.10
2008-09	1.56	34.06	56.1	43.51	0.85
2009-10	1.33	34.10	54.3	48.41	1.00
2010-11	1.50	34.52	50.6	45.73	0.95
2011-12	1.95	32.67	43.7	46.67	0.77
2012-13	1.78	30.68	49.7	53.44	0.72

Table 3.3: Data used in the Analysis (Continued)

Year	Inflation, consumer prices (annual %)	GDP per capita growth (annual %)	GDP growth (annual %)
	Inf	PER_{GDP}	GDP
2000-01	4.01	2.12	3.84
2001-02	3.68	3.12	4.82
2002-03	4.39	2.15	3.80
2003-04	3.81	6.18	7.86
2004-05	3.77	6.29	7.92
2005-06	4.25	7.68	9.28
2006-07	6.15	7.72	9.26
2007-08	6.37	8.30	9.80
2008-09	8.35	2.51	3.89
2009-10	10.88	7.07	8.48
2010-11	11.99	8.84	10.26
2011-12	8.86	5.28	6.64
2012-13	9.31	3.42	4.74

Source: Country Data *of India, World Bank, 2013.*
(Downloaded from World Bank website on 27.09.2014)

1.4.1 Explanation of Variables Used:

Gross Capital Formation: Gross capital formation (formerly gross domestic investment) consists of outlays on additions to the fixed assets of the economy plus net changes in the level of inventories. Fixed assets include land improvements (fences, ditches, drains, and so on); plant, machinery, and equipment purchases; and the construction of roads, railways, and the like, including schools, offices, hospitals, private residential dwellings, and commercial and industrial buildings. Inventories are stocks of goods held by firms to meet temporary or unexpected fluctuations in production or sales, and "work in progress." According to the 1993 SNA, net acquisitions of valuables are also considered capital formation.

Exports and Imports in goods and services: Export and import position of a country are important from the point of view of balance of payment position. A favorable balance of payment position creates conducive atmosphere for foreign investors from the point of view of foreign trade policy whereas

a highly unfavorable balance of payment position hinder FDI. Here the export of goods, services and income is the sum of goods (merchandise) exports, exports of (nonfactor) services and income (factor) receipts. Data are in current U.S. dollars. Similarly, import of goods, services and income is the sum of goods (merchandise) imports, imports of (nonfactor) services and income (factor) payments. Data used are in current U.S. dollars.

Trade: Total trade of the country determines the likelihood of going for foreign investment by any nation. Here the trade is the sum of exports and imports of goods and services measured as a share of gross domestic product. Data used are in current U.S. dollars.

Trade openness: Trade openness determines the degree of liberalization process in the economy. Trade openness is measured by the sum of imports and exports to the total GDP of the country. Data used are in current U.S. dollars.

Official exchange rate (LCU per US$, period average): Official exchange rate refers to the exchange rate determined by national authorities or to the rate determined in the legally sanctioned exchange market. It is calculated as an annual average based on monthly averages (local currency units relative to the U.S. dollar).

GDP growth (annual %): Annual percentage growth rate of GDP at market prices based on constant local currency. Aggregates are based on constant 2005 U.S. dollars. GDP is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources.

Gross savings: Gross savings are the difference between gross national income and public and private consumption, plus net current transfers.

Central government debt, total (% of GDP): Debt is the entire stock of direct government fixed-term contractual obligations to others outstanding on a particular date. It includes domestic and foreign liabilities such as currency and money deposits, securities other than shares, and loans. It is the gross amount of government liabilities reduced by the amount of equity and financial derivatives held by the government. Because debt is a stock rather than a flow, it is measured as of a given date, usually the last day of the fiscal year.

GDP per capita (annual% growth rate): Annual percentage growth rate of GDP per capita based on constant local currency. Aggregates are based on constant 2005 U.S. dollars. GDP per capita is gross domestic product divided by midyear population. GDP at purchaser's prices is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources.

Inflation, Consumer prices (annual %): Inflation as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly. The Laspeyres formula is generally used.

1.5   Result of the Analysis:

A regression analysis was carried out with the data presented in Table-3. In this analysis, we have considered FDI as dependent variable and all others variables (assumed determinants) as independent variables. The summary result of the regressions is presented in Table-4. Some of the explanatory variables specified in the econometric functions found to be significant elements in attracting FDI inflows.

Table 4: Result of Regression Analysis

RESULTS (2000 to 2012)					
Dependent Variable (Y)	Independent Variable (X)	Coefficients	R^2	t-Statistics	Significance
FDI	GCF	5.90	0.60	4.03	+Ve
FDI	Trade (ASEAN)	3.18	0.72	5.26	+Ve
FDI	Trade (INDIA)	4.10	0.78	6.20	+Ve
FDI	Import (ASEAN)	3.23	0.77	6.10	+Ve
FDI	Export (ASEAN)	2.93	0.61	4.14	+Ve
FDI	Gross Savings	6.59	0.38	2.59	+Ve
FDI	Debt	-8.62	0.46	-3.04	+Ve
FDI	Trade Openness	-5.51	0.73	-5.45	+Ve
FDI	Inflation	2.71	0.84	7.59	+Ve
FDI	GDP Growth	0.46	0.02	0.46	-Ve
FDI	GDP Per Capita	0.48	0.04	0.67	-Ve
FDI	Exchange Rate	-0.15	0.00	-0.02	-Ve

The above results explain about 95 % of the variation. Summary results are presented below:

i. The coefficient +5.90 implies that variable GCF is a significant determinant of FDI equity inflows. Here R^2 value 0.60 and t –Statistics 4.03 are significant.

ii. Trade of India with ASEAN having a coefficient of +3.18 is significant determinant of FDI inflows. The R^2 value 0.72 and t –Statistics 5.26 values are also significant.

iii. The coefficient of +4.10 also implies that India's trade (exports and imports) is significant determinant of FDI equity inflows. Here R^2 value 0.78 and t –Statistics 6.20 are significant.

iv. Imports of India from ASEAN having a coefficient of +3.23 is significant determinant of FDI inflows. The R^2 value 0.77 and t –Statistics 6.10 values are also significant.

v. Exports of India to ASEAN having a coefficient of +2.93 is significant determinant of FDI inflows. The R^2 value 0.61 and t –Statistics 4.14 values are also significant.

vi. India's debt position with a coefficient of − 8.62 and R^2 value + 0.46 and t –Statistics of -3.04 turns out to be a significant determinant of FDI equity inflows.

vii. Gross savings of India with a coefficient of +6.59 is significant determinant of FDI inflows. The R^2 value 0.38 and t –Statistics 2.59 values are also significant.

viii.   Trade openness with a co-efficient of -5.51 and R^2 value 0.73 and t –Statistics -5.45 turns out to be a significant determinant of FDI equity inflows.

  ix.   Inflation with a co-efficient of +2.71 and R^2 value 0.84 and t –Statistics +7.59 turns out to be a significant determinant of FDI equity inflows.

   x.   The coefficient of -0.15 with a low R^2 value of 0.00 and t-statistic of -0.02 for exchange rate implies it to be a non-significant determinant of FDI equity inflows.

  xi.   GDP growth with a coefficient of + 0.46 and R^2 value + 0.02 and t –Statistics of +0.46 turns out to be a non-significant determinant of FDI equity inflows.

 xii.   GDP per capita growth with a coefficient of + 0.48 and R^2 value + 0.04 and t –Statistics of +0.67 turns out to be a non-significant determinant of FDI equity inflows.

1.6   Conclusion:

The above analysis shows that gross capital formation, India's trade with ASEAN, trade openness, total trade of India, exports and imports from ASEAN, gross savings, debt and inflations are some of the selected variables that are significant determinants of FDI equity inflows from ASEAN to India during the period 2000-2012. However selected variables such as GDP growth, GDP per capita growth and exchange rate are found to be non-significant determinants in this case.

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