Foreign Investment Inflow And Export Performance Of India Since 1990-91

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Abstract

This study examines the effect of Foreign Investment Inflow on Exports of India beside Export performance of India. The study covers the period from 1990-91 to 2014-15. In a globalizing world, export success can serve as a measure for the competitiveness of a country’s industries and lead to faster growth. Recently, a much optimistic view on the role of foreign investment inflow on export performance in the host country has evolved. The Government of India moved in this direction in 1990-91 which has increased the Foreign Investment inflow into India. Viewing the increasing trend of foreign investment inflows into India, this study explores the impact of foreign investment inflows on the export performance of India. This study finds that the impact of foreign investment inflows on export performance is significantly positive. The study also finds continuously improving export performance during the study period.

Key Words- Foreign Investment Inflow, Export performance

Introduction

Trade is regarded as an engine of growth. Countries engage in international trade for a number of reasons. In modern world development strategies of a country are very closely related to the trade strategies of a country. Industrial development and productive efficiency both depend upon availability of inputs and quality of inputs also matters. Earlier imports were restricted by a large number of developing countries. They adopted import substitution or inward orientation trade policy. The basic belief then was that rapid industrialization is the essential feature of economic growth and that only by domestically producing goods than the imported goods. The failure of inward oriented strategy resulted into the transformation of inward oriented strategy into the outward oriented strategy. By outward oriented strategy is meant a trade strategy that is not biasing incentives in favour of import-competing industries and that provides roughly equal incentives to all exporting activities. There are many reasons why outward-oriented policies can be expected to stimulate growth in the manufacturing sector. These relate to the benefits of expanded market size, the volume of additional resources made possibly by trade, and to the more efficient allocation of existing resources. When outward oriented strategies are pursued, manufacturing production is no longer constrained by domestic market size, as is the case with inward-oriented strategies. Even countries with relatively small domestic markets can establish economically efficient plant sizes and maintain long production runs.

Exports, in particular, are a means to generate the foreign exchange required to finance the import of goods and services; to obtain economies of specialization, scale and scope in production; and to learn from the experience in export markets. In a globalizing world, furthermore, export success can serve as a measure for the competitiveness of a country’s industries. It may be noticed that export success among developing countries has been concentrated only in a few countries. But, the comparative advantage of most of the developing countries still lies traditionally in primary commodities and unskilled labour-intensive manufactures. Transformation from primary and labour intensive exports into higher value-added items requires greater inputs of skill and technology. Developing Countries can attain these objectives in several ways: by improving and deepening the capabilities of domestic enterprises or by attracting Foreign Direct Investment (FDI) into export activities and upgrading these activities over time. These strategies may be complementary or alternatives. In most cases they are found together, but different countries deploy different combinations of domestic enterprise-led and FDI-led export development. Neither strategy is easy (UNCTAD 1999). The Government of India saw in FDI a potential non-debt creating source of finance.
and a bundle of assets, viz., capital, technology, market access (foreign), employment, skills, management techniques, and environment (cleaner practices), which could solve the problems of low income growth, shortfall in savings, investments and exports and unemployment. It was argued that FDI would also help India in the expansion of production and trade and increase opportunities to enhance the benefits that could be drawn from greater integration with the world economy. In other words, FDI would broaden the opportunities for India to participate in international specialization and other gains from trade. Besides FDI, export orientation has also been hailed as an engine of growth. In the above context present study is an attempt to find out the impact of FDI on exports of Indian manufacturing sector. The focus here is on manufacturing oriented exports as manufactured products are more relevant for a developing economy as an indicator of continued long term dynamic growth in exports as well as the whole economy.

Review of Literature

This section deals with the empirical evidence on the role of foreign investment inflow in strengthening the export performance of developing countries. It is pertinent to point out that many studies found that Foreign investment inflow promotes the exports of recipient countries. Balasubramanyam et al. (1996) found the effect of foreign investment inflow on average growth rate for the period 1970-85 for the cross-section of 46 countries as well as the sub-sample of countries that are deemed to pursue export-oriented strategy to be positive and significant but not significant and sometimes negative for the sub-set of countries pursuing inward-oriented strategy. Similar findings have been shown by Athukorala and Chand (2000) and Kohpaiboon (2003, 2006a,b). Aitken et al. (1997) showed the external effect of FDI on export with the example of Bangladesh, where the entry of a single Korean Multinational in garment exports led to the establishment of a number of domestic export firms, creating the country’s largest export industry. Greenway et al. (2004) and Kneller and Pisu (2007) suggested that Multinational Corporations (MNCs), especially export oriented ones, appear to generate positive export spillovers and significantly increase the probability of exporting for domestically-owned firms operating in the same industry. Conversely, Barrios et al. (2003) studied the case of Spain and found no evidence of export spillovers to local firms from the existence of MNCs. Ruane and Sutherland’s (2004) findings through using the case of Ireland agrees with Barrios et al.’s (2003) findings that there appears to be no evidence of export spillovers from MNCs to local firms in Ireland.

However, UNCTAD (1998) is skeptical about the positive contribution of Foreign investment inflows on manufacturing export performance as it opines that capital and consumption goods not available locally are imported, and profits remitted, thus cutting into the export earnings generated. Ernst et al. (1998) observed that the role of FDI was low in countries where local firms had good capabilities and could undertake subcontracting at low cost to the buyer. The FDI role tended to be larger when local capabilities were weak. Similarly, Mortimore (1998) in case of Latin America found that Foreign investment inflows’ role was high in low – quality segments where wage costs are the main competitive factor; there is little design capability or independent marketing. Wen (2005) conducted a study on China and brings to notice both positive and negative trends in the same country with regard to the role of FDI on export performance. In east China, geographical advantage in export attracts FDI inflow and FDI promotes export. In addition, rise of FDI-GDP ratio increases regional share in industrial value added in east China. These effects contribute positively to regional income growth in east China although there is a direct crowding out effect between FDI and domestic investment (as input) in growth. In contrast, the negative impact of FDI inflow in central China on regional export orientation weakens its contribution to regional income growth.

Objectives

This paper has got twin objective-

1. To examine the performance of Indian manufacturing from 1990-91 to 2015-16.
2. To examine the impact of inward FDI on the total manufacturing exports of India between 1990-91 and 2015-16.

Methodology and Data Sources

The source of data for this study is the Handbook of Statistics on Indian Economy available online on Reserve Bank of India database covering the 25 years period from 1990-91 to 2014-15. The data includes the Inflow of foreign investment inflows into India and Export of India during the study period.

The analytical framework of the study is based to find out impact of Foreign investment inflows (represented by FII) on Export (represented by EXP) linear regression analysis has been conducted.

The linear regression models constructed in this context is following:

\[ \text{EXP} = \alpha + \beta \text{FII} + \epsilon \]

Performance of Indian Manufacturing

To examine the performance of Indian export, the data of last 25 years has been taken. The figure-1 shows the steady growth in export except in few years like in 2009-10 and 2012-13.

Figure 2 shows the Growth of foreign investment inflow. In some year it has increased dramatically and in some year it has declined also like in 2008-09 and in 2013-14.
Figure 3 shows that the direction of line graph is almost same in every year and there is possibility of some kind of correlation between export performance and inflow of foreign investment.

![Graph showing the relationship between export performance and foreign investment inflows](Figure3.png)

**Result and Findings**

**Table 1. Regression Results for EXP = α + βFII + ui**

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficients</th>
<th>Standard Error</th>
<th>t Stat</th>
<th>R square</th>
<th>Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export</td>
<td>1923456</td>
<td>143235</td>
<td>14.653</td>
<td>0.562</td>
<td>25</td>
</tr>
<tr>
<td>Foreign Investment Inflow</td>
<td>18.42672</td>
<td>1.89234</td>
<td>11.763*</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** * = significant at 1% level of significance

The given table 1 shows linear regression results between foreign investment inflows and Exports to estimate impact of foreign investment inflows on Exports. Numbers of observations used in this model are 25. Relationship between Foreign investment inflows and Exports is positive and found to be significant (it is significant at 1 percent level of significance). R-Square (Coefficient of Determination) Value is 0.562, which shows that present model explains 56 percent variation in the dependent variable. These results show that 10 per cent change in foreign Investment Inflow results into only 154 percent change in Exports in the same direction. Our results clearly indicate that Foreign Investment Inflow has affected positively on exports of India. A foreign investment inflow helps the host country to improve its export performance by raising the level of efficiency and the standards of product quality. A foreign investment inflow makes a positive impact on the host country’s export competitiveness.

**Conclusion and Policy Implications**

The findings of this study show that performance of Indian manufacturing has improved during the study period i.e. from 1990-91 to 2014-15. The empirical findings of this study show that inward Foreign investment inflows has significantly contributed to better the export performance of India between 1990-91 and 2014-15.

Balasubramanyam and Sapsford (2006) argued that Foreign investment inflows is not a panacea for the development problem, it is a catalyst in the growth process. It enhances the efficiency of other inputs in the growth process through its well-known role as a supplier of technology and know-how. So, if the Government of India aspires to continue on the export-oriented strategy and
benefit from it in the long run, it needs to concentrate more on domestic efforts to expand manufacturing in line with the foreign investment inflows policy framework.

Also, considering that foreign investment inflows policy of India may not entirely be a choice of the Government of India as it may have to follow IMF and World Bank conditions and much international pressure, a reassessment of the domestic macro-economic policy framework regarding export sector is the requirement of the hour. Most importantly, the Government of India must recognize that foreign investment inflows can only complement domestic efforts to meet development objectives, they alone cannot do wonders.

References