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Impact of Foreign Direct Investment on Balance of Payments

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ABSTRACT:- FDI in-flows and out-flows have increased dramatically during the last 30 years; with a rapid growth after globalization. The inflow of FDI was significant after 1990s compared to that during1970s and earlier. Emerging economies like China and India have been receiving high amount of FDI after 2010 than what they received earlier.
FDI inflows impact the balance of payments of host countries via strengthening export-orientated and import-substituting economy. Against this background, an attempt is made to find-out the impact of FDI in-flows on balance of payments in terms of current account balances of top-20 FDI recipient countries with special reference to India. The study indicated mixed conclusions. However, FDI inflows helped India to contain negative balance of current account along with positive balance of net invisibles. It is suggested that the counties receiving large amounts of FDI should concentrate on strengthening export-orientated and import-substituting economy to enjoy the fruits of inflow of FDI and consequently acquire core competencies.

Key Words:- Foreign Direct Investment, Current Account Balance, Trade Balance, Net Invisibles, Exports, and Imports,

Acronyms Used: FDI= Foreign Direct Investment, USA=United States of America, UK=United Kingdom, UNCTAD= United Nations Conference on Trade and Development, M&A= Mergers and Acquisitions, US$= United States Dollars.

I. INTRODUCTION

There are a variety of reasons for foreign direct investment (FDI) inflows and outflows. FDI inflows and outflows mostly take place when some firms establish the manufacturing, distribution and servicing facilities in foreign countries, when exporting and licensing strategic alternatives are less attractive.

FDI enables the host countries to improve the positive balance and reduce negative balance of balance of payments through strengthening the country's ability to enhance exports and reduce imports via improving manufacturing sector as well as service sector. Thus, FDI inflows impact the balance of payments of host countries via strengthening the economy. Against this background, an attempt is made to find-out the impact of FDI flows on balance of payment in terms of current account of 20 largest FDI recipient countries with special reference to India.

II. TRENDS IN FDI

FDI flows have increased dramatically during the last 30 years; with a rapid growth after globalization. Developed countries traditionally were providing and receiving lion's share of FDI before globalization. However, the newly industrialized countries like China, India, Brazil and South Africa started increasing their shares in FDI inflows and to some extent in FDI outflows.
The USA was the largest provider as well as recipient of FDI in 2008. The UK was the world's second largest provider of FDI in 2008. Investment in overseas securities accounted for nearly 25% of the UK pension funds' assets under management in 2007. The UK was also a major recipient of FDI and it was the second largest in the world and the largest among European Union countries in 2008. US direct investment abroad was US $ 313.8 billion in 2008, out of which it invested US $ 9.2 billion in India in 2008. US received an investment of US $ 639.1 billion from other countries in 2008. Thus, emerging economies are now receiving high amount of FDI than what they received in 1980s and earlier.

Table-1 provides the largest recipients and providers of FDI in 2015 and 2016. It is observed from this table that the USA was the largest provider and the largest receiver of FDI in 2015 and 2016. This was mostly due to favorable investment climate in the USA. China (including Hong Kong) was the second largest receiver and provider in 2015 and the third largest receiver in 2016 whilst Netherland was the third largest provider (US$174 billion) of FDI in 2016. The UK was the second largest provider in 2016. Surprisingly Ireland was the

fourth largest FDI receiver in 2016 and third largest provider in 2015. Japan was the fourth largest provider of FDI in 2016. Japan, Switzerland and Germany contributed significantly to the out-flow of FDI in 2015 and 2016.

China introduced a joint initiative of Silk Road Economic Belt/ One Belt One Road in 2013 covering and connecting 60 countries, economic groupings and regions involving combined inward FDI stock of nearly US$ 6 trillion and outward FDI flow of US$ 3 trillion.

Singapore, Brazil, India, France, Russian Federation, Australia, Ireland, Canada, Belgium, Mexico, Italy, Luxemburg, Spain and Angola were other largest recipient countries of FDI in 2015 and 2016.

Table-1: FDI Inflows and Outflows- Top 20 FDI Receiving and Providing Countries in 2015 and 2016 (Billions of US Dollars)

Country	Inflows		Outflows	
Country	**2015**	**2016**	**2015**	**2016**
USA	348	291	303	299
UK	33	254	-	-
China	136	134	128	183
Hong Kong, China	174	108	72	62
Netherlands	69	92	138	174
Japan	-	-	129	145
Germany	-	-	93	35
Switzerland	-	-	104	31
Republic of Korea	-	-	24	27
Singapore	71	62	31	24
Brazil	64	59	-	-
Australia	19	48	-	-
India	44	44	-	-
Russian Federation	38	12	27	27
Canada	42	34	67	66
Belgium	21	33	30	18
Italy	19	29	20	23
France	47	28	44	57
Luxemburg	16	27	55	32
Mexico	33	27	-	-
Ireland	22	188	166	45
Sweden	6	20	15	23
Spain	12	19	44	42
Angola	16	14	-	-
Finland	-	-	-16	23
Tiwan-China	-	-	15	18

Source: UNCTAD Investment Report 2017

http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf).

Switzerland, Russian Federation, Germany, Singapore, Republic of Korea, Canada, Belgium, Italy, France, Luxemburg, Ireland, Sweden, Spain, and Taiwan China were other largest providers of FDI in 2015 and 2016. Surprisingly, India which was one of the largest recipient countries of FDI, could not find a place in the list of top of top-20 FDI providing countries.

The balance of payments takes into account the export and import of both the visible and invisible items. In other words, it takes into consideration, the export and import of goods of all kinds including consumer goods, consumer durables, fast moving consumer goods, capital goods, machinery, technical equipment and services like banking, insurance, tourism, transportation etc. and payment of salaries, benefits, interests, dividends etc.

Thus, balance of payments is a much wider term as compared to balance of trade. Balance of trade deals with exports and imports of merchandise. Balance of payments presents an account of comprehensive economic and financial transactions of a country with the rest the globe.

III. CURRENT ACCOUNT

The Current account includes merchandise exports and imports. Current account contains credits and debits. Credits of current account include: merchandise exports (money income from sale of goods) and invisible exports (income from services). Invisible exports consists of transport services insurance services, foreign tourist services and other services sold abroad and/or to foreigners and income received on loans and investment abroad.

Debits of current account include: merchandise imports, payments for goods purchased from foreign countries, and invisible imports (payments to services received from foreign countries). Invisible imports consists of transport services, insurance services, tourism abroad and other services purchased from foreign countries and payments on loans and investments of foreigners in our country.

The two major items of current account are merchandise exports and imports and invisible exports and imports. Merchandise exports include the sale of goods to foreign countries. Most of these transactions are on credit basis. All these transactions give rise to monetary claims on foreign importing companies. These claims are credits. Contrary to these transactions, merchandise imports include purchase of goods from foreign countries. Debit entries are made for these transactions as they rise to foreign exchange claims on the home country. These claims are debits.

Balance of current account of advanced economies was negative during the period 2002 to 2010.Similarly, Latin American and Caribbean countries and Sub-Sahara African Countries (with minor deviations) suffer from negative balances. The reason for the negative balance was due to excess of merchandise and/or invisible imports over merchandise exports.

However, it is interesting to note that the current account balance of the Euro area, newly industrialized economies, developing economies and Middle East and North-African countries was positive during the period 2002 to 2010. It was also estimated that they would enjoy positive balances in 2011 and 2015. The reason for the positive balance was due to excess of merchandise and/or invisible exports over merchandise imports. As far as individual countries are concerned, the USA was suffering from negative current account balance due to excessive imports over exports and Japan was enjoying surplus balance on current accounts during the period due to excessive exports over imports.

Table-2 depicts top 20 countries with largest surplus in current account balance in 2017. It is clear from this table that Germany enjoyed highest amount of current account balance followed by Japan and China (including Hong Kong) despite outflow of FDI. China (including Hong Kong) which was one of the largest recipient of FDI, enjoyed

Table-2: Top 20 countries with the largest surplus in Current Account Balance in 2017 (Estimated)

.Rank	Country	Current Account Balance (million US dollars)
1	Germany	296,600
2	Japan	195,400
3	China	164,900
4	Netherlands	80,880
5	Taiwan	80,110
6	South Korea	78,460
7	Switzerland	63,210
8	Singapore	60,990
9	Italy	56,070
10	Thailand	49,280
11	Ireland	41,880
12	Russia	40,250

.Rank	Country	Current Account Balance (million US dollars)
13	Denmark	24,600
14	Spain	21,700
15	Norway	20,340
16	Iran	18,400
17	Saudi Arabia	18,230
18	United Arab Emirates	17,630
19	Sweden	17,010
20	Macau	15,160

Source: https://en.wikipedia.org/wiki/List_of_countries_by_current_account_balance

largest surplus in current account balance in 2017 despite FDI outflows. In fact, FDI inflows were more than outflows in case of China (including Hong Kong) in 2015. However, China's (including Hong Kong) FDI outflows were slightly in excess of FDI inflows in 2016. Netherlands enjoyed surplus in its current account in 2017 despite the outflow of FDI to the tune of US$174 billion in 2016. It does mean that the countries having surplus in current account enjoy surplus of foreign exchange as the amount of their exports was in excess of imports in that year.

It is also evident that some of the largest recipients of FDI like Ireland, China, and Netherlands secured a place among the top 20 countries with surplus in current account balance.

However, some of the largest FDI recipient countries like, the USA, Australia, Russian Federation, Canada, France, India, Luxemburg, Mexico, and Angola couldn't find a place in the top 20 countries that enjoyed surplus in their current accounts in 2017. This situation might be due to their inability to get the advantage of FDI inflows in the short-run. It is also observed that some countries which were not the largest recipient countries of FDI could find a place in the top-20 countries with largest surplus in current account balance. They include: Taiwan, Denmark, Thailand, Saudi Arabia, United Arab Emirates, and Macau.

Table-3 depicts top 20 countries with largest deficit in current account balance in 2017. It is observed from this table that the USA experienced largest deficit in current account balance in 2017 followed by the UK, India, Canada, Turkey, France, Australia, and Argentina.

Table-3: Top 20 countries with the largest deficit in Current Account Balance in 2017 (Estimated)

Rank	Country	Current Account Balance (million US dollars)
1	United States	-466,200
2	United Kingdom	-106,700
3	India	-57,200
4	Canada	-49,260
5	Turkey	-47,100
6	France	-36,770
7	Australia	-32,270
8	Argentina	-30,790
9	Algeria	-21,940
10	Mexico	-18,830
11	Indonesia	-17,290
12	Egypt	-15,380
13	Lebanon	-12,880
14	Pakistan	-12,440
15	Colombia	-10,360

Rank	Country	Current Account Balance (million US dollars)
16	Brazil	-9,762
17	Oman	-8,557
18	South Africa	-7,912
19	Romania	-7,298
20	Ethiopia	-6,551

Source: https://en.wikipedia.org/wiki/List_of_countries_by_current_account_balance

It is also clear from Table-1 and Table-3 that the USA, the UK, Canada, Australia, India, Mexico, Brazil and France, were among the top-20 countries suffering from deficit in current account balance, despite the fact that they were among the 20 largest FDI recipient countries. This scenario might be due to the fact that some of these countries like the USA, Canada, France and Luxemburg were also in the list of top 20 FDI outflow countries.

Foreign Direct Investment in India

Policy of the Government of India towards foreign direct investment has been to attract inflow of FDI to supplement domestic capital for rapid industrialization. However, the country could not attract significant amounts of FDI before economic liberalization in 1991 due to the consequences of socialistic pattern of society that was in force in the country.

These liberalizations announced and implemented by the Government of India during and after 1991 resulted in increase in foreign direct investment inflows into India. Table-4 depicts foreign direct investment inflows into India during 2000-01 to 2017-18. It is observed from this table that FDI inflow into India increased from US$4,029 million in 2000-01 to US$41,873 million in 2008-09 and to US$ 60,082 million in 2016-17 with fluctuations. Thus FDI inflows into India increased by nearly 15 fold during the last 16 years i.e., 2000-01 to 2016-17.

Table -4: FDI Flows into India

Year	Amount in millions of US $
2000-01	4,029
2001-02	6,130
2002-03	5,035
2003-04	4,322
2004-05	6,051
2005-06	8,961
2006-07	22,826
2007-08	34,843
2008-09	41,873
2009-10	37,745
2010-11	34,847
2011-12	46,556
2012-13	34,298
2013-14	36,046
2014-15(P)	45,148
2015-16(P)	55,559
2016-17(P)	60,082
2017-18)P) (Up to September 2017)	33,749
Total	518,100

Note: P= Provisional
Source: http://dipp.nic.in/sites/default/files/FDI_FactSheet_Updated_September2017.pdf

India's Balance of Payment Position on Current Account

Table-5 depicts India's balance of payments on current account from 1979-80 to 2016-17.

The negative balance of trade of India increased from Rs.3,374 crores in 1979-80 to Rs. 16,934 crores in 1990-91. Balance of net invisibles declined from Rs.3,140 crores to (-)Rs. 435 crores during the same period. This trend resulted in increase in the negative balance of balance of payments from Rs.254 crores to Rs. 17,369 crores during the same period.

The economic liberalisations in India helped the country to reduce the negative balance of trade from Rs. 16,934 crores in 1990-91 to Rs.6,495 crores in 1991-92. In addition, the increased net invisibles to Rs.4,258 crores in 1991-92 brought down the negative balance of balance of payments from Rs.17,369 crores to Rs. 2,237 crores in 1991-92.

The negative trade balance increased at a galloping rate from Rs.17,238 crores in 1992-93 to Rs. 49,758 crores in 2001-02. But the positive balance of net invisibles increased from Rs.4,474 crores in 1992-93 to Rs. 50,833 crores in 2001-02. It was surprising to note that the negative balance of balance of payments of Rs. 12,764 crores in 1992-93 turned into positive balance of Rs. 1,075 crores in 2001-02. Thus higher growth of positive balance of net invisibles than that of negative balance of trade during the period could contain the negative balance of balance of payments and turned it in to positive balance. However, negative position of balance of trade augmented to Rs.111.928 in 2004-05. But the positive balance of net invisibles increased up to Rs. 125,328 crores in 2004-05. Thus, higher growth of net invisibles than that of negative balance of trade resulted in positive balance of balance of payments of Rs. 13,400 crores in 2004-05. Increase in positive balance of net invisibles during this period was mostly due to growth in remittances of Non-Resident Indians consequent up on increase in jobs in information technology sector in various foreign countries.

The growth of negative trade balance has been rampant and increased up to Rs. 547,500 crores in 2008-09. However, positive balance of net invisibles also increased phenomenally to Rs. 419,800 crores in 2008-09. But higher growth of negative trade balance compared to that of net invisibles resulted in negative balance of payments to the tune of Rs. 127,700 crores in 2008-09

Trade balance has been negative and increased from Rs.547,500 crores in 2008-09 to Rs.1064,500 crores in 2012-13, but declined to Rs 754,452 crores in 2016-17. But, net invisible has been positive and increased from Rs. 419,800 crores to Rs. 651,646 crores during the same period. Positive balance on net invisibles was highest in 2014-15 during the period. However, balance on current account has been negative and fluctuated during the period. Positive balance of net invisibles except in 190-91 helped to contain negative balance on current account. In fact, negative balance of trade account was much higher than that of current account.

The deficit in the current account balance increased from Rs 13,639 crores in 2000-01 to Rs. 106,806 crores in 2016-17. Inflow of FDI helped in containing the negative balance along with increase in the positive balance on invisibles.

Table-5: Balance of Payments of India on Current Account (in Crores of Rupees)

Year	*Trade Balance*	*Net Invisibles*	*Balance of Payments on Current Account*
1979-80	–3374	+3140	–254
1980-81	–5967	+4310	–1657
1981-82	–6121	+3804	–2317
1982-83	–5776	+3480	–296
1983-84	–5871	+3609	–2262
1984-85	–6721	+3869	–2852
1985-86	–9586	+3630	–5956
1986-87	–9354	+3524	–5830
1987-88	–9296	+3003	–6293
1988-89	–13555	+1975	–11580
1989-90	–12413	+1025	–11388
1990-91	–16934	–435	–17369
1991-92	–6495	+4258	–2237
1992-93	–17238	+4474	–12764

1993-94	–12723	+9087	–3636
1994-95	–28420	+17837	–10583
1995-96	–38061	+18454	–19607
1996-97	–52559	+36720	–15839
1997-98	–60751	+36196	–24555
1998-99	–51825	+33305	–18580
1999-00	–69883	+47538	–22345
2000-01	–56287	+42648	–13639
2001-02	–49758	+50833	+1075
2002-03	–47037	+74,954	+27,917
2003-04	–67,997	+114466	+46469
2004-05	–111,928	+125,328	+13,400
2005-06	–184,300	+170,620	–13,680
2008-09	-547,500	+419,800	-127,700
2009-10	-559,900	+380,300	-179,600
2010-11	-580,500	+360,800	-219,700
2011-12	-912,100	+536,200	-375,900
2012-13	-1064,500	+584,800	-479,700
2013-14	-884,500	+697,709	-186,791
2014-15	-840,641	+722,549	-118,092
2015-16	-849,531	+705,769	-143,762
2016-17	-754,452	+651,646	-106,806

Source: **Calculated from *Economic Survey,* Government of India 2006-07 and www.rbi.org**

Reasons for Deficit Balance on Current Account

The data presented in Table-5 reveal that Indian economy has been facing the problem of heavy deficits in the current account of balance of payments mostly due to deficit in trade account. The problem has been acute since 1979-80. Reasons for galloping negative balance of balance of payments are:

- Liberalization of imports particularly from 1985.
- Higher growth rate of imports than that of exports.
- The Gulf War in 1990-91 significantly resulted in increase in imports during that period.
- Heavy imports of capital goods due to the fast growth of the economy during 2005-06.
- Heavy imports of consumer durable goods from other countries due to price differences during 2005-06 to 2012-13.
- Increase in FDI contributed to some extent to reduce the negative balance of payments position along with net invisibles.

IV. CONCLUSION:

FDI inflows helped the USA, the UK, Canada, Australia, India, Mexico, Brazil and France, to be in the list of top-20 FDI recipient countries, but failed to help in finding a place in the list top-20 countries with surplus in current account balance. However, some countries like the USA, the UK, Canada, Australia, India, Mexico, Brazil and France, were among the countries suffering from deficit in current account balance, despite the fact that they were among the 20 largest FDI recipient countries.

FDI inflows into India augmented by 15 times during 2001 to 2016-17. Yet the deficit of trade account increased by 7.83 times during the same period. It is felt that though the inflow of FDI could not result in positive current account balance, it contributed to the reduction in adverse balance along with positive balance of net invisibles. Therefore, it is suggested that the countries receiving large amounts of FDI should concentrate on strengthening export-orientated and import-substituting economy to enjoy the fruits of inflow of FDI and consequently acquire core competencies.

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