

INDIA, FDI AND THE GLOBAL ECONOMY - A NOTE

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The title² suggested that the intellectual context for the exploration of this subject is the globalised world economy that also happens to be in a crisis. To attract foreign investment, nation states have to grow fast, have good governance, and have other attributes of successful competitive economies. It is also sometimes believed that lower regulation leads to more FDI. However, many countries which attract a great deal of FDI also regulate its use. China is a prime example.

Arguably the most important factor in the relative ability to attract FDI for a jurisdiction over the long term is the rate of growth of the economy. Other things being equal the faster the overall growth rate of the economy, the faster will be the growth of FDI. So the important question for this conference is how fast the Indian economy is likely to grow relative to other countries. It will be seen, however, that this question is more complex as the causation can run both ways: the faster the growth of FDI, the faster the growth of the economy.

Further, not only globalization is an issue here but so is the current world crisis. The question is how India will cope with globalization and the economic crisis simultaneously.

We are living through extraordinary times. During the first twelve years of the new millennium an unusual event has taken place - developing countries have expanded much faster than the developed countries. Five developed countries (US, UK, France, Germany and Japan) achieved an average growth rate of only 1.50 per cent between 2000 and 2012. This compares with the corresponding growth rate of five emerging countries (India, China, Brazil, South Africa and Russia) of nearly 6 per cent. India and China, the two most populous countries have done particularly well. India achieved average annual growth rates of over 7 per cent in the first twelve years of the new millennium while the corresponding growth rate of the United States was a third of that number. China similarly had a stellar growth performance.

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² This note is based on the lecture I gave recently at a conference with an intriguing title, "India as Global Investment Destination: How Attractive?", organized by Sri Guru Gobind Singh College of Commerce, University of Delhi at Hotel Shangri La, New Delhi. In writing this paper, expert research assistance from Amandeep Kaur at Panjab University is gratefully acknowledged. The usual caveat applies.

Other non-BRICS countries such as Colombia, Thailand, Indonesia, Malaysia, and Mexico have also performed much better than rich countries. Indeed on the basis of this data, one might argue that the so - called global crisis has affected only the advanced economies while the leading developing economy countries have enjoyed a great leap forward rather than crisis during the first decade of the new millennium.

The excellent performance of the developing countries is one of the most encouraging features of the current crisis. It is not only desirable in itself, but their faster growth rate also helps the world economy. It is estimated that eight leading developing economies together make a major contribution to world GDP growth. This is a far cry from the situation at the end of World War II when developing countries constituted a very small part of world production.

The superior performance of developing countries, as in the current crisis, is a new departure. Not too long ago, it used to be an article of faith among scholars that in a global economic and financial crisis, it is periphery countries which suffer a prolonged slow-down or worse while the centre takes care of itself. The story in the present crisis seems to be quite the opposite. Why should this be so? An important related issue is whether the good performance of the periphery can be sustained.

Here there are conflicting voices from unexpected quarters. The IMF suggests that the improvement in the position of the periphery during this crisis is their growing ability over the past two decades to absorb shocks. The organization went on to observe, “Developing countries’ improved performance is explained by both good policies and lower incidence of external and domestic shocks” (IMF, 2012). On the other hand, Yilmaz Akyuz, chief economist of the South Centre in Geneva, a developing country think tank argues that the good performance of the southern countries during the crisis has been largely due to favorable external factors e.g. commodity price rises, increases in capital flows (including remittances) (IMF, 2012). However, it is also the case that developing countries learned and internalized the lessons from their previous experiences with the global crises. They improved their macroeconomic management of the economy markedly, paid close attention to the current account balance, and accumulated reserves to be in a position to run counter-cyclical monetary and fiscal policies during times of crisis.

Returning to the issue of FDI, while appreciating the many virtues of FDI, developing countries should keep these merits in perspective. FDI can, for example, compete against domestic industry and cause it harm rather than improve it. Uncontrolled FDI flows can

cause macroeconomic financial fragility. Last but not least, it should not be forgotten that FDI is normally only a small part of total national investment.

The conference brochure has also raised important questions concerning the rate of growth of the Indian economy. The brochure suggests that the Indian growth rate is “floundering”. It is indeed true that the average growth rate has fallen from 9.5 per cent in 2006 to about 6 per cent in 2012. However, similar falls have been reported by the other leading emerging economies. China’s growth rate has fallen from 12.7 per cent in the year 2006 to 7.9 per cent in the year 2012, Brazil’s rate has declined from 4 per cent in 2006 to 2 per cent in 2012, while that of South Africa fell from 5.6 per cent to 2.7 per cent.

The changes in growth rates in rich countries, because of the economic downturn, have been even more negative. The average growth rates recorded during 2006-2012 ranged from 0.47 per cent per annum in Japan, 1.06 per cent in the US, 0.40 per cent in UK and 1.51 per cent in Germany. The “floundering” Indian growth rate still looks quite healthy in comparison. However, this correction to Indian public perception of economic decline is not to encourage complacency. Rather, it is to agree with much recent research that suggests that neither India nor China, nor India and China together can be the locomotive to pull the world economy out of its worst post 1930s economic downturn. This task can only be done by the US and Euro zone economies when they manage to lift themselves out of their current malaise.

The question of how much FDI India needs or can attract is secondary to these complex issues related to growth and crisis in the world economy and how India can forge ahead in this difficult global climate with or without FDI.

References

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