Are foreign direct investments at an ebb?

Posted at: 16/08/2018

Debate rages, but a look at 5-year patterns shows there is little cause for concern. Focus on an 8% GDP growth is all that matters

- A heated debate is now on, with the government claiming that total Foreign Direct Investment flows scaled a new record in FY18.
- Detractors argue that, on FDI as a proportion of GDP, NDA is yet to match the UPA's achievements in 2008.
- UPA-2 started off on a high note and fell victim to 'policy paralysis' at the end of its tenure.
- FDI inflows and witnessed a bounceback in FDI in its final year.
- The NDA, seen as business friendly, flagged off with 20% plus FDI growth rates in its first two years.
- But despite implementing reforms such as the GST, it has had to contend with slumping FDI flows lately.

So what really drives FDI?

Economic, not political

- FDI flows into India seem to track its economic fortunes more closely than its political fortunes.
- In the last ten years, strong GDP growth prints in India have inevitably been followed by an upsurge in FDI.
- The largest annual jump in FDI till date, from $7.6 billion in 2005 to $20.3 billion in 2006 came about after India improved its GDP growth from 7.8% to 9.3% in 2005.
- Given the lumpy nature of FDI, evaluating these flows on five-year averages makes more sense than dissecting annual growth rates.

From an average of $5 billion a year from 1998 to 2002, the annual flow vaulted to $12 billion in 2002-2007, climbed further to $34 billion in 2007-2012 and stood at $38 billion in the latest five years to 2017.

Punching below weight

- The larger an economy and the size of its consumer market, the more interested foreign investors are likely to be to set up shop in it.
- This makes it important to evaluate FDI flows into a country as a proportion of its GDP.
- According to the World Bank, FDI as a proportion of India's GDP hovered at 1-2% for many years before shooting up to 3.6% in the immediate aftermath of the global financial crisis in 2008, probably driven by the impression that India was 'decoupled' from the crisis.

- Globally, FDI flows average 2.4% of GDP. Clearly, India continues to punch below its weight on FDI, given its size and prospects.

FDI flows into countries depend not just on local economic prospects, but also on the total capital that global investors are willing deploy overseas in any given year. This pool is decided by global financial market conditions.

Share of pool

- World Bank data tells us that after a stellar show in 2008 when India managed to grab 3.2% of the global FDI pool, its share fell steadily to 1.5% in 2012. That was incidentally the year in which GDP growth hit a nadir of 5.5%.
- Since then, India's share of the global FDI pool has charted a smart recovery, getting back to 2.8% by 2017.

This suggests that the slump in India's FDI flows in the last couple of years was driven more by the shrinking global FDI pool than by domestic factors.

Overall, for FDI to keep flooding into India, it needs to maintain a single-minded focus on sustaining 8%-plus growth. The political dispensation doesn't matter that much.

The Hindu