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Global Meltdown (Recession): India Vs rest of the world will U. S. economic slowdown? See an upturn (Some reflections)

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INTRODUCTION

Foreign investment can be defined as the acquisition of assets by governments, institutions, or individuals in one country of assets in another. Foreign investment covers both direct investment as well as portfolio investment and includes public authorities, private firms, and individuals. Direct investment is often referred to as Foreign Direct Investment (FDI). FDI inflows have increased in importance since the 1990s, becoming the single most significant component of total capital flows to developing countries. At a time when the world economy is facing the worst credit freeze in several decades, India Inc. continues to be a favorite FDI destination. The FDI figures for January, 2009 bring a renewed hope that India is back on the radar of global investors once again.

External capital flows Vs India’s position

External capital flows to developing countries including India have undergone fundamental changes during the past three decades. More recently, rapid liberalization of financial markets and privatization of economic activity in the developing countries have influenced them. The private sector has become the principal borrower in international capital markets and recipient of other private financial flows. Not long ago, India's position has been somewhat marginal in international business discussions. Since 1991, India's economic policies have become more oriented towards globalization, liberalization, and privatization. From then onwards, certainly there was far more foreign interest in India what with the entry of German, Korean, Japanese, and American car manufacturers and others than what it was before. However, for sustaining this interest, the corporate governance in India should be, in certain respects at least, more familiar and transparent like the one in the West, than what exists in East Asian countries. Apart from the sheer size of its population, next only to Japan, India has Asia's second largest middle class. India has some unique advantages, besides its size, which could help attract FDI to the manufacturing sector. However, stock market and corporate scams besides the recent economic slowdown have led to a large-scale skepticism among the stakeholders.

FDI not only adds to external financial resources for development but is also more stable than other types of flows. It is typically based on a longer-term view of the market, the growth potential, and the structural characteristics of recipient countries. FDI is generally preferred by the host country over portfolio management. FDI and the policies concerning it have a preponderant role as engines of growth because of the diffusion of technology. FDI can contribute to technological up gradation in two ways:

- If it embodies a higher level of technology than domestic investment, it makes a direct contribution by raising the overall technological level of the host country.

- It can also make an indirect contribution through positive externalities, which benefit local enterprises.

Nevertheless, India had been a comparative outsider in international economic and business affairs and remained so for a very long period. Consequently, it had featured less in the strategic horizons of Western and East Asian corporations, though this had changed subsequently.

US economic slowdown and its impact on India

The US economic slowdown might just be seeing an upturn. With it, the positive contagion could be impacting India too. There are reasons for sharing this optimism. There are people with a viewpoint that the US economy has not hit the bottom yet. However, there is some evidence now that some segments of the financial sector have reached the bottom. Perhaps an upturn also might be seen in the next five to six months. If we take the markets for example, right now the movements of the major indices like S&P and Dow Jones in the middle of March, 2009 seem to have stabilized for various reasons and this is always a leading indicator. Experts opine that it is an indicator that the bottom, at least in the financial segment seems to have reached.

Now, let us see the impact of the proposed $1 trillion bond issue to revive the American economy. It has already impacted on the long term interest rates. This will soon have an impact on those segments of the economy that are very sensitive to long term interest rates such as investment and so on. Again, this is being seen as a sign that once again the bottom is there and that the light at the end of the tunnel is faintly visible. Some people believe that the package is going to have an impact because there are doubts in some quarters that it is creating money in thin air. Right now due to excess capacity etc., initially if the US economy is stimulated, it won’t translate itself into inflationary pressure. But once the economy reaches its capacity, then, inflation might be in unless the unwinding of the huge money thrown into the economy is taken back someway or other.

There is reason for Americans to be optimistic at this point of time as there is a method to this madness. There are not indiscriminately or unthinkingly throwing away money. We can repose confidence in both the group of people who are in charge of economic decision making in the US as well as its President who have a deeper understanding of the economics. Moreover, they are not committed to any ideology, which is a positive sign. However, we have to see whether this will result in more investments coming into India and where we can place our optimism or the lack of it. FDI inflows into India have not slowed down that much. Foreign Institutional Investors (FIIs) have pulled out significantly last year. That reflects in the current crisis circumstances. If all the packages work, then the concerns of the FIIs having to pull back their funds from elsewhere would be addressed somewhat. So, we need to be worried about the fact that India’s growth slowdown started before the financial crisis in US and the nine per cent growth rate that India had for three years in a row was indeed running into capacity and major supply constraints. It would not have been sustained and hence reduction in growth was inevitable. We have to remember that FIIs are fickle and volatile and so India should be obviously focusing on FDI than FII, and more so in the current scenario. FDI is considerably less volatile than portfolio investments. Whether before the financial crisis or after that, it is a given, as the reaction time needed to pull out in portfolio investments and the cost of doing so is less than in the case of FDIs. Also, FDI comes with longer term consideration and short term factors affect FIIs more.

India is still a favorite FDI destination!

At a time when the world economy is facing the worst credit freeze in several decades, India Inc. continues to be a favorite FDI destination. India attracted \$2.7-billion FDI in January, up 58.8% from what it was a year ago and stayed as a favorite destination for cross-border investments. It is an indication of the confidence that the rest of the world has in India as stated by Ajay Shankar, Secretary in the Department of Industrial Policy and Promotion. FDI inflows for April-January aggregated to \$23.8 billion and are expected to cross in this fiscal the target of \$25 billion set last year. Though the government set a target of \$35-billion FDI for 2008-09, it looked rather ambitious. Up to September this fiscal, the monthly inflows were in excess of \$2 billion. However, the following three months saw a sharp dip in the overseas investments. The FDI figures for January, 2009 bring a renewed hope that India is back on the radar of global investors once again.

Concluding Remarks

What does all this mean for India Inc.? Better corporate governance and everything! The loyalty of a typical Indian investor is far greater than his counterparts in the USA or Britain. However, our companies must not make the mistake of taking such loyalty as a given. To nurture and strengthen this loyalty, companies need to give a clear-cut signal that the words 'your company' have real meaning. That requires well functioning Boards, greater disclosure, better management practices, and a more open, interactive and dynamic corporate governance environment. Shareholders' and creditors' support are vital for the survival, growth, and competitiveness of

India's companies. Implementation of corporate governance is dependent upon laying down explicit codes such as those of CII and Central Vigilance Commissioner, which enterprises and organizations are supposed to observe.

India is going to provide great economic opportunities for the rest of the world. When the developed economies will experience a growth plateau, the stimulus for growth in world economy is going to come only from certain regions. India and China are the two large countries which will offer part of this stimulus. India's reforms, therefore, will be dictated by requirements for cross-border investment, which is critical for economic development. Recent stock market and corporate scams have led to a large-scale skepticism among the stakeholders. Pundits allege that the corporate image of India Inc., if not watchful, will be adversely affected due to poor corporate governance especially when it is emerging as one of the fastest growing economies of the world. This is the opportune time for India Inc. to promote corporate fairness, transparency, and accountability that may be perceived as a constructive mechanism that sanitizes the business environment by straightening the prevailing as well as the potential corporate misconduct.

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