New FDI Norms in Time of COVID – Good Economics or Geopolitics?*

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There are ample indications to suggest that so far Chinese investments in India have been a help to employment.

The move for capital account liberalisation, which took off in India within a few years of 1991 economic reforms, was followed by large inflows of non-debt creating foreign direct investment (FDI) and portfolio investment.

The steady opening up was responsible for a climate of uncertainty in the financial market with related surges in short-term portfolio investments by foreign institutional investors.

Despite the moderate-to-high growth rates in the domestic economy during the post global crisis years and till 2018, flows of FDI did not pick up as much as did portfolio investments.

As per RBI sources, there were disproportionate flows of portfolio investments, at $244.7 bn on average over the six years ending 2018-19. This contrasts to the much smaller average of $53.3 bn for FDI flows over the same period. Comparing the flows for a single year 2018-19, portfolio inflows at $256.9 bn was nearly four times of FDI flows at $64.8 bn.

The rising inflows as well as the changing composition of capital with financial liberalisation have impacted the Indian economy along predictable lines. Portfolio capital, as expected, initiated volatility in stock markets as well as in markets for real estates, commodity futures and foreign currency. One can observe the synchronized pattern between the rupee rate to US Dollar and the net flows of short term portfolio capital, especially since the short term capital inflows had easier access to the economy.

As for the impact of short term capital inflows on the domestic economy, the related gains/losses for the active agents in markets qualify as capital gains or losses which imparts no immediate change on real activities and output. As for example, we consider a capital gain or loss realised by an agent in the secondary market of stocks and selling a share which was bought in the primary market of Initial Primary Offers (IPOs). The share, was earlier sold by an agent to help real expansion (like a plant in a factory). But the capital gain/loss of the first agent, often based on speculation, is purely financial and distant from the sphere of real activities.A pattern as above reflects the major impact of overseas capital flows currently reaching India, consisting of portfolio capital.

The pattern of deployment, however, remains very different with FDI capital, whether those are for merger and acquisitions or greenfield ventures, since in either form, money invested is necessarily deployed for material activities.

Looking at the non-debt creating capital inflows which currently reach India, one can thus argue that the share directed to productive ventures is miserably small —

standing at around one-fifth on average — of the vast sums hitting the non-productive arena of financial speculation.

Concerns like the ones above bring us to the recent changes in India's FDI policy which went through a major review on April 17.

The government reviewed its FDI policy for "curbing opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic". In terms of the amended FDI rule, "An entity of a country, which shares a land border with India or where the beneficial owner of investment into India is situated in or is a citizen of any such country, can invest only under the Government route."

Moreover, for existing or future FDIs any transfer of 'beneficial ownership' as above, involving a resident of a neighbouring country, the procedure of sanction has to go through the government approval route.

The change is a big departure from the earlier norm of a blanket approval of all FDI except in the prohibited strategic sectors /activities.

By redirecting all investments (existing and new ones) from neighbouring countries sharing land borders to government channels – the final approval may be delayed or not even granted. The change has led China to sharply react by branding the change as a 'discriminatory' act which is opposed to WTO principles.

While rest of the similarly situated countries in South Asia (Pakistan, Bangladesh, Nepal, Bhutan) and SE Asia (Mynamar) don't really contribute much in the way of providing direct investment flows to India, China of late has provided more than $10 bn between January to September 2019, as indicated by the commerce ministry. While the sum remains at not too large a proportion of aggregate FDI inflows to India, one can highlight related aspects which include first, the noticeable jump in China's FDI contribution to India from a mere sum of $371.0 mn on average between 2014 and 2018 to $10.0 bn as mentioned above.

Secondly, the large sums entering as FDI to India from offshore financial hubs like the Cayman Islands at $119 bn and from Mauritius at $588 bn during Jan-September 2019 are, in all probability, not genuine FDI flows to India. Share of the contribution by China would be higher if such figures are taken care of. Third, since the new rules would relate to agencies even from countries having indirect links to the Chinese as investors, the step makes Hong Kong (at $30.7 bn) and even Singapore (if not formally) subject to the new rule .

It is a fact that with the current recession in the global economy, especially under the COVID, direct investment flows will not be abundantly available from many sources. This remains as a hard truth when interest in the real economy remains miniscule compared to speculation-led flows of portfolio capital. As for the current stock of Chinese investments in India, one observes the contribution of tech giants such as Alibaba, Tiktok, Oppo, Xiaomi and Tencent to Paytm, BigBasket , Ola and many more in India.

Contributions as above have been responsible for jobs in those labour-intensive areas of operation as also with the Chinese car manufacturers like Great Wall and MG Motor.

Indications are thus ample to suggest that so far Chinese investments in India have been a help to employment rather than to casino finance of portfolio investments. The recent move by the People's Bank of China to enhance its passive shareholder stake in HDFC by 0.3% which makes it 1.1% may have led the India government to react with the amendments to FDI norms.

But, as pointed out by the CEO, Keki Mistry, the rise in share does not qualify for a takeover of the company or its management, and that PBoC is just one of the existing 2000 FIIs having accounts with the bank.

India's move to amend the FDI policy which corners China in the Indian market for FDI can be viewed, in its face, as a step in geopolitics of keeping pace with US in particular, rather than in good economic strategy which helps the real economy and jobs.

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