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Evaluation of Foreign Direct Investment in India and China: A Comparative Study

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ABSTRACT

From time immemorial India has attracted the attention of the globe. While, China embarked upon economic reforms in the year 1978, Economic liberalisation was unveiled in India by Dr Manmohan Singh in 1991. Both the countries have pursued diverse policies and strategies under different political regimes. The success story of China is a matter of deliberation amongst policy planners and academicians. China's export-oriented growth has been fuelled by massive FDI inflow. At this point in time an analysis of FDI policy pursued by both nations and there and their success story is significant. This paper analysed the role of policies, planning, infrastructure and the operating environment for mobilizing funds from foreign investors. A comparative evaluation of foreign direct investment policy pursued by both Nations and their respective performance has been attempted in this paper.
Social and economic indicators for both the Nations have been compared. Salient features of India's FDI policy have been briefed. Review of China's FDI policy has been done. Performance of both countries has been evaluated in terms of volume, sources and sectoral distribution of inflows.

Keywords: Foreign Direct Investment, foreign policy framework, economic growth, emerging markets, India Vs China.

INTRODUCTION:

China's great achievement in attracting massive foreign direct investment inflows has won worldwide acclaim. It has aroused lot of interest of academicians, policymakers and researchers. Question arises why India has failed to match China's performance despite being equally endowed with natural and human resources.
Can we Indians (the Laggards) need to learn any lesson from Chinese (the leaders) in attracting more FDI . The study makes an attempt to make comparative assessment of FDI policy regimes and performance for both the nations.
A lot many factors have attributed to China's success in attracting more FDI. These include:

- Decentralized mechanism of economic management functions
- Pursuit of pragmatic policies
- Political support
- Development of sound infrastructure
- Effective implementation of policies
- China has set up special economic zones to provide sound infrastructure and the conducive business environment
- It evolved a decentralised system for FDI approvals by empowering provincial authorities and provided national treatment to foreign investors.
- It further permitted a flexible labour regime in these areas.

- China is a low cost manufacturing hub for variety of products. It has edge in terms of large potential market, stable Political situation and sound investment environment.
- China's growth has been fuelled by high rates of savings, Universal basic education, rapid industrialization and deregulation of labour market for foreign investors.

All these factors together provided Synergy to economic growth. Massive foreign direct investment has generated employment, raised productivity and increased exports of China. China enjoys an edge over India in terms of state ownership of land, its strategic location and proximity to enterprising expatriates. But these favourable factors cannot negate the inherent strength of India to an extent that the gap in performance should be so striking.

Reason for India's under performance:

- Poor policy planning
- Poor implementation of policies
- Lack of political support
- Lack of a Holistic approach
- Attracting export oriented FDI and generating employment in labour intensive industries has not been the key policy objectives.
- Requisite infrastructure and institutional mechanism does not exist in the manufacturing practices.
- Favourable Labour Law reforms could not be introduced due to intransigent attitude of the left parties.

LITERATURE REVIEW:

A review of few important and relevant studies in this area has been made in the study.

Keshava, Dr. S.R., (February 2, 2008) conducted its study on "The Effect of FDI on India and Chinese Economy: A Comparative Analysis". The reference period of this study relates from 1981 to 2004. Relevant statistical techniques, especially regression, have been used in the study along with simple ratios and averages. (R square, F , durbin Watson) The R2 has been significantly high excepting for the BOP variable and the coefficient is statistically significant. Study concluded that India is still far behind China in becoming the attractive FDI destination, for the obvious reason such as power shortage, poor infrastructure, security consideration, absence of an exit policy etc. If India has to reach its target of attractive more FDI for its development, a bold aggressive third generation reforms is the need of the hour. Only then one can expect India to attract FDI to its potential and can become a popular investment destination as China.

Javaid Ahmad Dar Maninder Singh (2003) conducted its study on FDI Inflows in India and China since 2003: A Comparative Analysis . To achieve the research objectives two models, economic growth model and foreign direct investment model were framed and fitted. The first model, economic growth model, depicts the contribution of foreign direct investment to economic growth in India and China. The second model, foreign direct investment model, shows the factors contributing the foreign direct investment in India and China. Total Trade as percentage of GDP, Foreign Exchange Reserves, Financial Position, Research and development expenditure as percentage of GDP, Exchange rate, inflation are the main determinants of FDI inflows in India and China. These macroeconomic variables have a profound impact on the inflows of FDI in India and China.The results of Economic Growth Model and Foreign Direct Investment Model show that FDI plays a crucial role in enhancing the level of economic growth in the country. It helps in increasing the trade in the international market.

Liu et al. (2001) in his paper "An Empirical Investigation of the Causal Relationship between Trade and economic Growth in China" evaluated the causal relationship between foreign direct investment and trade in China for the period 1984-1998. It was concluded that the growth of China imports causes the growth in inward FDI from home country, which in turn causes the growth of exports from China to home country.

Wang, Grarce Miao (2001) examined the impact of FDI inflows on 12 Asian economies: Bangladesh, China, Hong Kong, India, Indonesia, Korea, Malaysia, Pakistan, Philippines, Singapore, Thailand and Taiwan during the period 1987-97 and found that FDI in manufacturing sector has a significant and positive impact on economic growth in the host economies.

Shalini Sharma and Ruchi Sharma in their research paper "Globalization, FDI and Development" (2003) developed two alternative econometric models to examine the extent of relationship between Foreign Direct Investment inflows and GDP. The study used the data of 29 countries and provided an empirical base to the hypothesis that, FDI is related directly to development as measured by income. However their study had a limitation. Their paper could not give evidence to show how the rates of growth of GDP and FDI are related.

Rao, K.S.C., Murthy M.R. and Ranganathan, K.V.K, (2005) in their paper on "Foreign Direct Investment in Post Liberalisation Period-An Overview", discussed the role played by liberalization policies in shaping patterns of foreign direct investment inflows and analysed the structural transformation of the economy during the different phases of government policy on FDI regime. It was shown that infrastructure sector and technology & skill intensive industries attracted maximum investment.

Aizenmana, J. and Noy, L. (2006),in their paper "FDI and Trade -Two-way linkages?", found complementarities between FDI and trade at the macro-economic level because of spillovers between firms within industries and also between industries within the manufacturing sector. Further Linkages between FDI flows and trade were stronger in developing than in industrialized countries.

Mohnot, R. (2007) in his study on "Changing pattern of Foreign Direct Investment (FDI) in Asian Region: Issues, Motives and Strategies for Economic Development" evaluated the changing pattern of FDI in the Asian region. A foremost change over the past few decades has been that Governments of countries of Asian Region have become more positive towards FDI and liberalised their FDI regime accordingly. These countries have realised that Government policies can influence the effect of FDI inflows on economic growth and development. Asian countries have regarded FDI as contributory to their development strategies.

OBJECTIVES OF THE STUDY:

- To examine the factors have attributed to China's success in attracting more FDI.
- To examine the factors have attributed to India's under performance.
- To analyse and compare the trends of FDI inflow in India and China.
- To compare policy regimes of India and China.
- To compare Sectoral distribution of FDI inflows in India and China.
- To compare sources of FDI for both nations.

METHODOLOGY OF THE STUDY:

Exploratory research has been conducted here in this research paper. Information has been collected from various secondary sources like (Department Of Industrial Policy Promotion) to study the potentiality of both China and India in attracting Foreign Direct Investment and comparing the policy structure of both nations and thus to justify the above mentioned objectives.

INDIA CHINA COMPARISON:

When China initiated economic reforms in 1978, its growth rate, per capita income, and other key social and economic indicators were more or less comparable with India. However during the last 40 years, China has stolen a march over India and thereby creating a significant gap. Both nations are fastest growing developing economies and are endowed with world's largest pool of skilled human resources.

Different political regimes:

Both nations have different political regimes. India is a democratic country while China is a communist country. However, China is quick to discard ideological dogmas in favour of pragmatic economic strategies for adjusting itself to market economy.

Difference in policy design:

China initiated reforms much ahead of India in 1978. India's switch over to liberalisation policy was crisis driven, arising out of balance of payment problem China's reforms have been gradual, sequential, incremental, consistent, well managed, well planned and directed. China is much more aggressive and better focused in pursuit of objectives and much more pragmatic in policy design.

FDI oriented export LED growth:

China has relied heavily on FDI for accelerating economic growth. On the other hand, India has underestimated role of export-oriented industries in the growth. China follows FDI oriented and export led growth. Thus China has replicated the growth pattern of East Asian economies. Its growth has been labour-intensive, whereas, India is predominantly in the service sector

COMPARISON OF POLICY REGIMES:

Policy regime india:

❖ **Pre Liberalisation Period**

During this period the policies were mainly inward looking and focused on import substitution. Thus the policy framework remained restrictive and selective. The Policy was mainly an arm and leg to Foreign Exchange Regulation Act (FERA) with the only objective of earning and conserving foreign exchange. the role of foreign direct investment inflow as a medium for accelerating economic growth was never envisaged.

❖ **Post Reform Period**

India initiated liberalisation reforms since 1991 in the wake of foreign exchange crisis. Since 1991, entry of foreign investors have been eased progressively. Mechanism of approval of FDI inflow has been made simpler by introducing two routes namely:-

1) Automatic Route
2) Foreign Investment Promotion Board Route.

Approvals under Foreign Investor Promotion Board Route are centralised. Thus there exists centralised structure of authority in economic decision-making. Promotional activities are centralised with DIPP (Department of Industrial Policy and Promotion). Local and provincial authorities have not been authorised with the powers to approve foreign direct investment inflow. Though approvals are easy to obtain but procedures for facilitations by various government departments, local authorities and organisations are not investor friendly.

❖ Few export processing zones EPZs were set up between 1965 and 1995.
❖ The policy for setting up special economic zones was announced in 2000 but Special Economic Zone Act was enacted five years later in 2005.

Critical Appraisal Of Policy Regime:

1. Policies Implementation has been tardy because of lack of well planned and well designed strategies.
2. We have inefficient and corruptbureaucracy in the system.
3. The policy is more based upon press notes and executive notifications and is not backed by statute.It does not create confidence among investors about stability of policy.
4. The FDI policy mainly stress on reviewing percentage is on equity caps.
5. Export processing zones EPZs were too small and to few to make any impact on exports. They failed to attract any funds from foreign investors due to infrastructural and locationaldeficiencies . Despite availability of sound financial system& cheap labor, comparative cost advantage in the industrial sector could not be explored through export-oriented foreign direct investment inflows for lack of sound infrastructure. Moreover transaction costs are very higher.
6. The political debate on the issue of special economic zone had been so vigorous and prolonged that the main purpose of setting up these zones was diluted to a large extent.Acquisition of land has become a prickly issue due to violent protests. Rather than being signal of economic development and Employment generation special economic zones are perceived to be anti poor and anti farmer.
7. India has emerged as IT hub for the global market and is a rising power in softwaredesign and services.India is successful in achieving export orientation and attracting foreign direct investment inflow in the IT sector. This has been facilitated byavailability of requisite infrastructure in terms of software technology parks,adopting proactive liberal policy and skilled labour .India can be proud of excellence it has achieved in the IT sector but it has little meaning for millions of unskilled and semi skilled unemployed persons as it benefitsonly the highly educated class.
8. Labour laws continues to be inflexible due to lack of political consensus on labour laws. Most of manufacturing jobs are in the unorganised sector which employs 40% of the total labour available. Wages in this sector are very low.
9. The FDI policy does not offer any special incentives to woo foreign investors. On the contrary to it , corporate income tax rate for foreign corporates is very higher. Investment by non resident Indians have been very less.This is due to risk averse nature of NRIs since most of them are professionals.

Policy Regime China:

China's FDI policy has been a vital part of it Strategies for economic development and growth.

1. In China the foreign direct investment inflow policy is transparent and is embedded in the statute. Thus it has created confidence among investors about continuity and stability.
2. The policy objectives have been clearly spelt out.These are export promotion , access to modern technology , access to international market and Employment generation. The policy thrust is on attracting export-oriented foreign direct investment inflow in the labour intensive industries.
3. Requisite export platform has been divided by a variety of zones set up likespecial economic zones, Economic and technological development zones, FreeTradeZones and ExportProcessingZones.
4. Foreign investors have been wooed by offering excellent incentives.
5. Special Privileged policies have been crafted by differentiating thetaxreturn and the duration of incentives on the basis of the location of enterprise, technological content, duration of operations, manufacturing sector and export intensity of the organisation. Tax rate for the units located in the notified zones are differentiated.Foreign investors have been granted super national treatment throughfiscal benefits.
6. A distinctive feature of China's FDI policy is that considerable autonomy is being enjoyed by provincial and local authorities in economic decision making. They can also negotiate incentives beyond what is permitted by Chinese government. It has resulted in quick clearance of FDI proposals. Provincial and local governments can directly undertake promotional activities and attract foreign investment.
7. Facilitation at local level is done in an investor friendly manner.
8. For the purpose of scrutiny of FDI proposals, Industries are classified into four categories encouraged, permitted, restricted and prohibited. This has insured diversion of inflows into the sectors holding national priority. Dangerous, polluting and wasteful processes fall in prohibited list. Banned category include broadcasting Industries, Industries reserved for state Enterprises, traditional Handicrafts, wildlife, defence industry, casinos, news media and traditional medicine. After China's entry into WTO in 2001Telecom services, banking, insurance and retail business have partially been opened to foreign investment.

PERFORMANCE COMPARISON:

- **FDI Inflows**

A comparison of China's performance during 1991- 2016 and that of India for the same period has been done in the terms of FDI inflows.

Years	FDI (in US$ Millions)		Years	FDI (in US$ Millions)	
	India	China		India	China
1991	75	4366.34	2004	5778	60630
1992	252	11007.51	2005	7622	72406
1993	532	27514.95	2006	20328	72715
1994	974	33766.5	2007	25350	83521
1995	2151	37520.53	2008	47102	108312
1996	2525	41725.52	2009	35634	95000
1997	3619	45257.04	2010	27417	114734
1998	2633	45462.75	2011	36190	123985
1999	2168	40318.71	2012	24196	121080
2000	3588	40714.81	2013	28199	123911
2001	5478	46877.59	2014	34582	128500
2002	5630	52742.86	2015	44064	135610
2003	4321	53504.7	2016	44486	133700

Inflows to China during 1991 to 2016 have been manifold times than India. China has succeeded in attracting higher investment due to preferential policies and better infrastructure. Aggressive pursuit of investor's non resident Chinese from Hong Kong Taiwan and Macau have contributed handsomely. Inflows to Indian increased during 2006. This had possibly been due to high GDP growth rate which seem to have changed the investors perception about India as an investment destination. Moreover infrastructure sectors like real estate sector had begun attracting investment since 2000 when it was opened up. Some analyst feel that FDI inflows to China cannot be taken at face value since a part of FDI reported from Hong Kong is in fact capital originating from Mainland China disguised as foreign investment for taking advantage of tax, tariffs and other benefits according to the foreign investors. This is known as round tripped investment. One estimate is that it is around

15% of total investment. The 'round tripped capital' is 'False foreign investment'. If 'false foreign investments' are excluded from the realized value of FDI, China would be an underachiever in relation to its market potential and infrastructure. But in any case, FDI inflows to China still remain much higher than India.

Sources of FDI:
Share of top 10 investing countries in inflows to India for the period APRIL 2000 TO JUNE 2018 and for China for the year 2017 is given in following tables:

Country wise FDI equity inflows- india from April 2000 to June 2018

S.No.	Name of the Country	Amount of FDI inflows in US dollar million	%age share in total FDI inflows
1	Mauritius	129072.55	33.13
2	Singapore	73289.32	18.81
3	Japan	28159.95	7.23
4	United Kingdom	26086.15	6.7
5	Netherlands	24318.15	6.24
6	USA	22765.19	5.84
7	Germany	10990.47	2.82
8	Cyprus	9612.05	2.47
9	France	6297.9	1.62
10	UAE	5840.75	1.5

Country Wise FDI Equtyinflows- China Year 2017

S.No.	Name of the Country	%age share in total FDI inflows (Year 2017)
1	Hong Kong	75.5
2	Singapore	3.7
3	Taiwan	3.6
4	South Korea	2.8
5	Japan	2.5
6	USA	2.4
7	Netherlands	1.7
8	Germany	1.2
9	UK	1.1
10	Denmark	0.8

It can be seen that Hong Kong and Singapore have been the major source of inflows for China. As of 2017 their respective share in inflows was 75.5 and 3.7 % . China's opening up accompanied by Low wage rates, preferential policies and setting up of special economic zones SEZs and economic and technological development zone ETDZs facilitated relocation of export oriented labor-intensive Enterprises by expatriates. Taiwan and South Korea happen to be other two major investor countries.
For India, Mauritius, Singapore and Japan are the major investing countries accounting for 33.13, 18.81and 27.23 percent of total inflows respectively. However investment from Mauritius originates from various countries for availing the tax benefits some. Indian companies have reportedly invested Indian funds through Mauritius to take the advantage of tax benefits admissible under Double Taxation Avoidance Agreement (DTAA). Notably USA, Japan, Singapore and Germany are common to both the countries as a major investor.

Sectoral Distribution of FDI:
Data on sectoral distribution of inflow to China is available only for year 2017. For the purposes of comparison sectoral inflows for ten major recipient sectors for India for the period 2000-2018 and for China for the year 2017 have been considered.

Sector-Wise FDI Equtyinflows- India from April 2000 to June 2018

S.No.	Sector	Amount of FDI inflows in US dollar million	%age share in total FDI inflows
1	Services Sector	68617.41	17.61
2	Computer Software And Hardware	32830.14	8.27
3	Telecommunication	31751.18	8.15
4	Construction Development	24865.36	6.38
5	Trading	20183.68	5.18
6	Automobile industry	19290.59	4.95
7	Drugs and Pharmaceutical	15828.75	4.06
8	Chemical (other than fertilizers)	15387.24	3.95
9	Power	14179.12	3.64
10	Construction (infrastructure) Activities	13109.05	3.36

Sector-Wise FDI Equtyinflows- China (Year 2017)

S.No.	Main Invested Sectors	%age share in total FDI inflows (Year 2017)
1	Leasing and Business Service	33.5
2	Manufacturing	14.8
3	Wholesale and Retail Trade	10.7
4	Hightech Sector	9.5
5	Real Estate	7.8
6	Financial Intermediation	7.6
7	Service to Households	2.8
8	Construction	2.2
9	Scientific, Research and Technical Services	2.2
10	Culture, Sport, Entertainment	2.0

It can be seen that, 17.61% of inflows to India during this period have gone into services sector. It is followed by 8.27 Percentage share in computer software and Hardware sector. In case of China, 33.5% have gone into leasing and business service and 14.8 % into manufacturing followed by 10.7% into wholesale and retail trade.

CONCLUSION:

Appropriate policy interventions and China being a hub of labour intensive exports have facilitated massive FDI inflows into China. There had been clarity of policy objectives. On the other hand, in India policies remain ad hoc, ambivalent, compartmentalised and sector specific. Requisite IT infrastructure also did not exist. The policies did not have objective clarity. Besides Indian Diasporas are mainly professionals while Chinese expatriates are steeped higher into businesses. India has failed to fully tap the potential of Non Resident Indians. China’s reforms had been well planned and well managed. It has followed gradualist and sequential approach in undertaking reforms. On the other hand, reform measures in India have been half hearted. Further India is faced with the problem of poor infrastructure. Corruption is endemic in the political system. Thus due to fundamental differences between two Nations, Chinese experience may not hold any lessons for India.
China’s success proved that introducing one set of reforms paved way for another. On the other hand, India

initiated economic reforms in 1991 in the wake of foreign exchange crisis. India was forced to introduce liberalisation policy reform as a solution to balance of payment crisis at the time when no other alternative was left. Large and expanding market for export was a wonderful opportunity that could have been capitalised. India seems to have lost this opportunity. China on the other hand realised the significance of its market.

It is observed that India and China have inherent differences in terms of financial architecture labour Markets and land pricing therefore a comparison of FDI policy is not valid, nor can those adopted by China be replicated in India.

India and China have many similar favourable structural factors that are important determinants of FDI these include market size, abundant labour and a large Indian expatriates. There is no reason why India may not become an attractive destination for FDI. It has property rights and independent law enforcement machinery. Its financial system is far more developed than China. Its manpower has excellent managerial capability. India's political stability, entrenched democracy, relatively effective financial system ,deepening international economic integration and improving environment for infrastructural development should augur well for future. In some ways India is far better placed than China in so far as its economic structure and institution in arrangement are concerned.

A durable growth rate sustained has positively impacted upon investors perception leading to sharp increase in inflows during 2006 and 2007.Thus it is clear it may not be difficult for India to replicate China'ssuccess in mass manufacturing exports if requisite IT infrastructure is provided for export oriented FDI.

India need to build confidence among investors. .Thus we need to think big plan well and implement fast.

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