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FOREIGN DIRECT INVESTMENT IN INDIA AND CHINA: A COMPARATIVE STUDY

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INTRODUCTION

Foreign direct investment (FDI) in India is an important element of free market, liberalisation and globalization. The channels through which FDI inflows influence the growth and performance of companies in developing countries is an important factor. FDl enables the recipient developing countries to achieve accelerated economic growth with favourable consequences for employment, improvement in efficiency in operations and productivity resulting in economic betterment and increasing levels of earnings and income. Theories of FDI suggest that firm size, profitability, trade, interest rates, economy and inflation wield significant influence in attracting FDI.

In 1991, when India liberalized its policy towards foreign investment, there was a positive response from capital exporting countries. The liberalisation of government policies that restrict foreign, direct investment (FDI) is a recent phenomenon, although Liberalisation of FDl policies offers opportunities for firms as well as threats. If FDl (and trade) liberalisation results in faster growing national economies, then firms face larger, faster-growing markets domestically. The significance of FDI is rising heavily due to its all round contributions to the growth of economy. FDl to developing countries is also the leading source of external financing.

The rise in FDI volume is accompanied by a marked change in its composition. Foreign Direct Investment (FDI) is considered to be the lifeblood and an important vehicle for economic development as far as the developing nations are concerned. The important effect of FDI is its contribution to the growth of the economy.

FDI has an impact on country's trade balance, increasing labour standards and skills, transfer of new technology and innovative ideas, improving infrastructure, skills and the general business climate. FDI also provides opportunity for technological transfer and up gradation, access to global managerial skills and practices, optimal utilization of human capabilities and natural resources, making industry internationally competitive, opening up export markets, providing backward and forward linkages and access to international quality goods and services and augmenting employment opportunities.

Before coming out with a statement of the problem, it is required to survey the existing recent literature on Foreign Direct Investment (FDI) to find the research gap. Therefore, a selective survey of literature is given here. Jacques Morissets's (2000) survey on 29 African countries reveals that, comparative locational advantages, political stability and economic environment are the prime factors for attracting more FDI. Markusen, James and others (2000) investigated the impact of FDI in services on host country firms. The study proved that liberalization of policies and its impact on income and welfare of the country is positively correlated. Choudary (2001) examined the politico- economic and legal framework of FDI in China. Reasons for the increase in inflow of FDI to China have also been highlighted in the study. Morisset and Lumenga (2002) examined the cross-country variations in administrative costs faced by investors by studying 32 developing countries. The study came out with a positive relationship of low level of corruption, quality governance, trade and finance reforms and high inflow of FDI. Linda, Tuan and Chyav (2002), empirically examined dimensions and major factors in governing FDI- friendly environment by studying sample firms operating in Guangdong province of China. The study observed macroeconomic environment with favorable institutional changes as the prime factor to attract more FDI. By using some econometric models, Sahoo and Mathiayazhagan (2002) tested the role of FDI in the economic growth of India through export promotion and found that the growth of economy is positively influenced by the export, but not by the aggregate FDI inflows. UNCTAD (2002, Chapter 2) advocates the necessity of a promotion agency with a strong administrative capacity, and abundant resources to woo the foreign investors. Pradeep and Pravakar (2003) in their study evaluated the implications of China's accession to the WTO in terms of its impact on the country's exports and foreign investment flows. The study accepted the relation of economic growth of China with WTO accession, and the study left some Chinese challenges for India. Ravi and Xiaboo (2004) have examined regional inequality in China due to deployment of more FDI to a particular region and cautioned the Chinese government regarding the increasing favourism towards coastal regions in its foreign investment strategy. Casar and others (2004), conducted a study on 22 industrial and 50 developing countries to know the link between FDI flows through Greenfield projects and M&As, and the study concluded that expansion of M&As is indeed followed by an increase in Greenfield FDI In another study, Luo (2004) examined the relationship between unbalanced regional growth and development of the Chinese economy. The study claims infrastructural development in the region is the main reason for flow of FDI to only coastal regions of China. Kumar (2005) in his study traced the reasons for increasing the investment by knowledge-based MNCs in the software of India. The study concluded that locational advantage is one reason which attracts knowledge-based industries. Whereas, in the study of Duilian (2005), the reasons for shifting of FDI in China from market-seeking to efficiency seeking have been traced out.

Lucas (1990), has analyzed the issue by examining the question of why capital does not flow from rich to poor countries and critically explored some candidate answers that arc based on human capital and capital market imperfections. With regard to human capital, he shows that the rich -— country's optimal policy is to retard capital flows so as to maintain real wages at artificially low levels in the poor country. As far as capital market imperfections are concerned, Lucas's paper analyzes a borrowing contract between poor and rich countries. In this paper, the focus is on linkages and on the rational behavior of different for investors in the face of reform.

Feinberg and Majumdar (2001), found that liberalization of FDI policies offers opportunities for firms as well as threats. If FDI (and trade) liberalization results in faster growing national economies, then firms face larger, faster-growing markets domestically.

Jaya Gupta made an attempt to review the change in sectoral trends in India due to FDI Inflows since liberalization. This paper also examines the changed policy implications on sectoral growth and economic development of India as a whole. Jayashree Bose (2007) studied the sectoral experiences faced by India and China in connection with FDI inflows. This book provides information on FDI in India and China, emerging issues, globalization, foreign factors, trends and issues in FDI inflows. A comparative study has also been conducted on FDI outflows from India and China. The study also revealed the potential and opportunities in various sectors in India that would surpass FDI inflows, in India as compared to China.

Fung (2005) in his study analyzed current development of China's foreign trade and investment, and their related issues. It found a positive relationship between exports of China and performance of foreign funded enterprises. At the end, the study noted some challenges and opportunities before China in the trade and investment field. The Chinese related study of Ali and Guo (2005) identified that political instability, unsatisfactory trade policies, improper implementation of regulations as the major obstacles in foreign firms' decisions to invest in China. Lim (2005) in his work observed the growth performance of China and India. While analyzing challenges of development in India, the study identifies certain areas such as infrastructure, humanresource development, politics, policy reformations where mutual learning is needed. China Annual Economic Report (2009) reveals that since 2006, China's FDI policy has shifted from export-led growth to quality investment supporting domestic led growth. As a result, China has been changing its attitude of inviting quantity based FDI to quality based FDI. Ram Mohan, Toma and Roe (2009) have listed the strengths and weaknesses of India and China. They reported certain benefits available for India, such as the young force for the manufacturing sector etc.

STATEMENT OF THE PROBLEM

International flow of capital is not a new phenomenon. Foreign Direct Investment (hereafter, FDI) is generally viewed as an engine for global development and transfer of technology. In order to avail the benefits of FDI through MNCs, the developing countries, including India and China have started modifying foreign - related Trade and Investment Laws in favour of the prospective investors. Foreign Direct Investment is defined as, "an investment involving a long- term 'relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (foreign direct enterprise or affiliate enterprise or foreign enterprise. ". FDI implies that the investor exerts a degree of influence on the management of the enterprise resident in the other economy. A Foreign direct invest or may also have an effective voice in the management of another business entity by means of acquiring other than an equity stake. For example, through franchising, licensing, turnkey arrangements, sub-contracting. FDI occurs mainly in two forms: namely, Greenfield investment and Mergers & Acquisitions. The former involves the establishment of a new enterprise. On the other hand, the latter is related to the acquisition of existing firms. Since Greenfield form of FDI is backed by many advantages, there is although competition among developing countries to turn more FDl to their respective countries through the green fleidmode.

In response to globalization, investment from foreign countries is coming for both India arid China. However, as per United Nations Conference on Trade and Development World Investment Report 2009, China has attracted nearly threefold higher FDI than India. Annual FDI inflow to China increased from US 2.7 billion dollar to US 108.31 billion dollar for the period from 1984 to 2008. As a percentage of global FDI inflows, China received, on an average, 5.65% during last decade (1998-2008), against India's 0.98 %. However, the international financial decline has also influenced direct investment in China. FDI in China still increased, but much more slowly in 2008 than in previous years. According to the Ministry of Commerce of PRC, the actual direct investment of China reached US $92.4 billion in 2008, a growth of 23.6% compared to the previous year

(China Annual Economic Report 2009, p.7). Therefore, it is necessary to analyse the reasons for changes in inflow of FDI to China and India systematically. As a result of higher FDI inflows, studies shows that FDI companies contribute more for total industrial output, exports, access to market and in turn, GDP and economic development. The present study will throws light on the reasons for high inflow of FDI to China and slow inflow of FDI to India. Through this study, it is planned to trace the reasons for bypassing of FDI from India. The analysis is being made at the macro level.

OBJECTIVES OF THE STUDY

Our study would try to:

- Present a comparative analysis of Foreign Direct Investment(FDI) in India and China,
- Identify reasons for high inflow of FDI to China and slow inflow of FDI to India,
- Trace the reasons for bypassing of FDI from India and
- Suggest ways for improvement in the atmosphere of FDI in India.

IMPORTANCE OF THE STUDY

Since 2006, China's FDI policy has shifted from export-led growth to quality investment supporting domestic led growth. This can be observed from the newly introduced and explicit "buy Chinese" policy in order to ensure the use of Chinese products. In a move to create a tax neutral FDI policy, the new Corporate Income Tax law (CIT), which came into force from 1st January 2008, removed many of the preferential treatments foreign companies previously enjoyed, creating a more equal environment. The new economic policy of China in this regard led to an increased nationalism and protectionism of domestic industry. Therefore, China decided to shift its policy of attracting foreign investment form "quantity to quality" and push its industry up the value chain (China Annual Economic Report, 2009). Both India and China are giants on the world stage, in terms of market size, population, etc. Both India and China are comparable and compatible. Hence, growing trade between them, together with other types of economic co-operation would certainly make them as the world's superpower in the years to come. These two largest emerging economies are ranked as number one and number three respectively as the most preferred FDI locations (UNCTAD's World Investment Prospects Survey-20 10-11). Their strong performance, even during the global financial crisis and recession, has reshaped the landscape of FDI flows to the region, as well as to the world at large.

As a result of comparison of Foreign Direct Investment (FDI) in India and China, it will be possible to identify reasons for high inflow of FDI to China and slow inflow of FDI in India. Consequently, the reasons for bypassing of FDI from India could be traced out which will pave the ways to improve the atmosphere of FDI in India. Hence, the proposed study is of too much importance in the present scenario of globalization of markets.

HYPOTHESIS

Our study would be based on the following Hypothesis:

1. Economic environment with favourable institutional changes is the prime factor to attract more FDI.
2. There is a positive relationship between low level of corruption, quality governance, trade and finance reforms and high inflow of FDI.
3. The overseas Chinese are more entrepreneurial in nature than Non Resident Indians (NRIs).

RESEARCH METHODOLOGY

The study is based on Secondary data and the facts and figure will be collected from various sources such as fact sheets of FDI, Department of Industrial Policy and Promotion(DIPP),Ministry of Commerce and Industry, Government of India, China Annual Economic Reports of different years, official website of People's Republic of China (www.fdi.gov.cn) and World Investment Reports of UNCTAD.

We will take help of relevant materials, facts and figures published in different

- Books
- Journals and Magazines
- Newspaper and Economic Dailies
- Reports
- Websites etc.

The present study will cover the experience of India after initiations of new economic policies i.e from 2000 to 2013 in case of China, the study will cover the period after its accession into World Trade Organization(WTO) i.e from 2001 to 2013 .The study is obviously analytical in nature and hence, with the help of collected data and application of suitable mathematical / statistical tools and techniques like:

- Ratio and Proportion

- Percentage
- Trend Analysis
- Mean and Standard Deviation
- Analysis & Variable
- Chi-square test
- Factor Analysis etc.

Comparative analysis will be made and results will be specifically interpreted.

The study would mainly focus on to trace the reasons for bypassing of Foreign Direct Investment (FDI) from India. The analysis will be made at the macro level. The study will present some lessons for India regarding attracting FDI which could be learnt from China.

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