COMPARATIVE ANALYSIS OF INDIA AND CHINA FDI POLICY AND PERFORMANCES: 1992-2015

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Abstract:

Foreign Direct Investment (FDI)inflows can help host countries development in different ways especially through export competitiveness, generating employment and strengthening the skills base, enhancing technological capabilities and particularly increasing financial resources for development. As a result, developing and underdeveloped countries now widely using FDI as an important source of investment for their sustained economic growth and development. And India and China are no exception from it. Although these two countries have strong similarities with each other in different respect to attract FDI inflows particularly with population and market size but their performance to attracting FDI inflows mismatch severely. While China is able to get huge FDI inflows for a long period, India's performance is not up to mark in this respect although it has improved significantly recently. In this paper an attempt has been made to identify the causes of disparity of India -China FDI performances over time and more importantly find out the factors responsible for India's unattractiveness as an investment location. India's recent policy also analyzed and showed its effects on FDI inflows positively. But India still needs to improve infrastructure facilities significantly, overcome administrative loopholes and slashes corporate tax rate to augment FDI inflows in future.

Keywords: Foreign Direct Investment (FDI), Global Financial Crisis, India, China, and Infrastructure.
JEL Classification: F14, F21, F65, H54

Introduction:

Now-a-days developing countries in the world try to achieve a high rate of economic growth for their socio - economic development. But for the most of the developing countries like India and China, the internal source (savings) is inadequate for their desire rate of economic growth. So, there arises the need of foreign capital for growth. Foreign Direct Investment (FDI) is one of the important sources of foreign capital for these types of countries.[*Seid*(1988); *Srinivasan* (2002)]

FDI is the process whereby resident of one country (the home country) acquire the ownership of assets for the purpose of controlling production, distribution and other activities of a firm in another country (the host country). So, FDI is the movement of capital across national frontiers in a manner that grants the investor control over the acquired assets. Thus, it is distinct from portfolio investment which may cross borders but does not offer such controls.

If the investment is made by a foreign firm in country, known as inflow of FDI whereas investment made overseas is termed as outflow of FDI. FDI include both equity capital, reinvested earnings (retained earnings of FDI companies) and other direct capital (inter corporate debt transactions between related entities).

Foreign investment, particularly FDI has significant advantages over external loans and other forms of financing the resource gap. Beyond providing additional financial resources (when not financed locally), FDI can facilitate the transfer of intangible assets such as technology, skills and management know- how, thus helping to directly boost productivity and economic growth and development; in addition, FDI may secure Foreign market accesses. In short FDI appears to offer a bundle of "good" characteristics ranging from a high degree of stability, financial resource augmentation, and positive productivity effects and perhaps access to foreign markets.

Different countries now compete with each other to win more investment from foreign companies. So, it is important to understand what factors attract FDI. In order to successfully restructure their economies to lure foreign investors and ultimately to get and sustain competitive advantage, policy makers need to better understand what makes a market attractive to foreign companies.

According to USAID (2005) foreign companies can undertake the following four types of FDI:

- Natural- resource seeking FDI – to gain access to a natural resource which is not available in the company's home market.
- Market -seeking FDI – when objective of the foreign company is to get access to new customers, clients and export markets
- Efficiency -seeking FDI- Objective of foreigners is to get access to new technology or competitively priced inputs and labour to reduce the production costs.
- Strategic-seeking FDI- to go after assets in a local economy, such as brands, new technologies, or distribution channels

Literature Survey:

Existing Researches using case studies, surveys and also econometric works on the factors that affect the FDI inflows to a country includes market size, growth prospects, purchasing power, infrastructure facilities, openness, taxes and tariffs, literacy rate, corruption level, labor costs economic and political stability. In order to understand foreign direct investment properly, one must first understand the basic motivations that cause a firm to invest abroad in host country rather than export or outsource production in home country to a national firm (Denisia, V. 2010). Funj (et. al 2000) shows that market size, labour cost, market and institutional reforms affects FDI inflows significantly. According to Basnet and Pradhan (2014) inadequate physical infrastructure is considered one of the constraints of FDI inflows. Cuervo – Cazurra, 2006 and Godinet and Liu,2015 show how corruption level effect the FDI inflows. Fedderke and Romm (2006) show the relationships of lower market size, lower corporate tax rate, lower political risk, proper property rights and global integration with that of the FDI inflows. Dumludag (2009), shows the relationship between FDI inflows and government stability, Corruption level freedom, IPR, political and economic condition of a country. Aw and Tang (2010) studied showed that how important to China accession to the WTO and corruption are important factor for FDI inflows. According to Wenhui Wei (2005), the huge difference of China's and India's FDI inflows has been quite exaggerated. Literature review also suggests that market size (Lall et al, 2003), market growth rates (Jenson,2003), infrastructure (Chantasasawat ,2004), openness (Singh and Jun, 1995) Corruption (Wei, 2003), political stability (Anantaram, 2004) exchange rate (Crowley and Lee, 2003) economic Freedom (Lee, 2005), human capital (Hsiao, 2001) and taxes affect FDI inflows to global market. Different factors affect different county's FDI inflows different ways. India and China's FDI inflows also affect significantly by different factors with different countries. Such as China's lower domestic market and higher international ties with OECD countries significantly affect the FDI inflows from those countries. While India's cheaper labour cost, low country risk and geographical closeness to OECD countries and similar cultural activity affect FDI inflows significantly.

My objective here is to identify the causes for such huge differences of FDI inflows of this two similar but competitive country.

Comparison between India China FDI inflows, outflows and net flows:

FDI inflows to China have surged from almost nil at the start of the reform process in the late 1970's to US$ 40.45 bn in the second half of 1990's (Table-1, Chart I). The surged occur in the early 1990's due to China's continued commitment to reforms and policies to open up the economy to the outside world. By the 1990's, China become the second largest FDI recipient in the world, after the United States, and by for the largest recipient of FDI among developing countries. However, part of China's success in attracting FDI may be exaggerated because of misreporting and round-tripping.Whereas, India's FDI inflows have consistently increased from $ 0.252 bn in1992 to all time high $47,102 bn in 2008 and thereafter a declining trend after Global Financial Crisis and declined to US $ 24.196 in 2012 and later it increased to $45.15 bn in 2014 -2015.

FDI Trends in India:

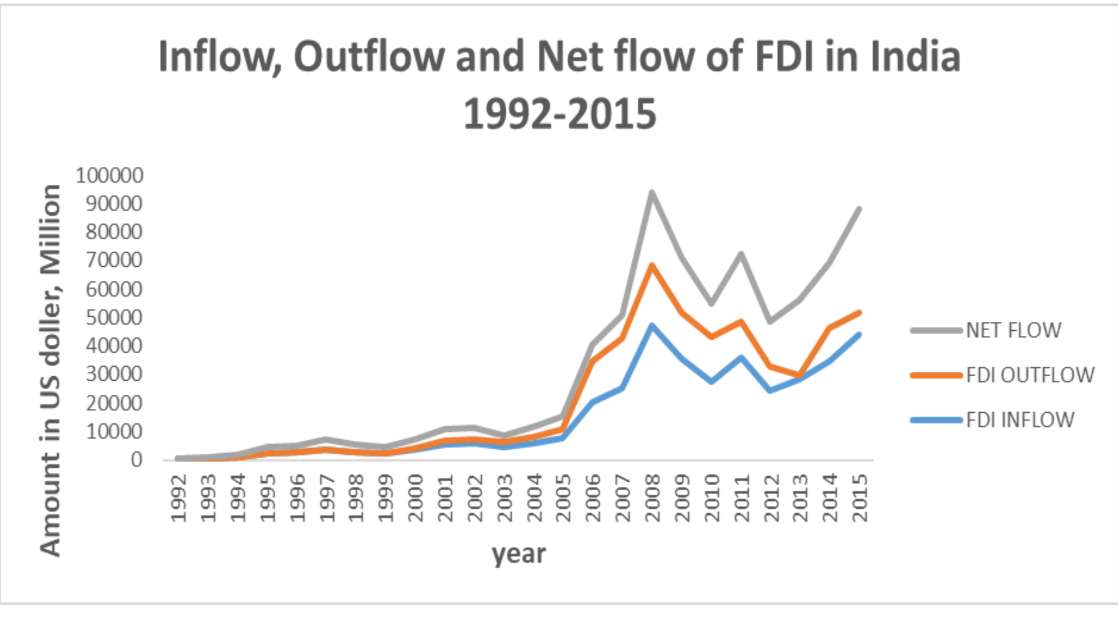
After liberalisation from 1992, India has seen about 200 times rise in FDI inflows from $0.252 bn to about $47bn in 2008 in a time span of 15years. After Global Financial crisis a downward trend was observed and it continued till 2012 when FDI inflows was $24.196. Latter it rose consistently to about $44bn in 2014 but it still below in 2008 level. Over the time FDI outflows also increased from a mere $42 mn in 1992. There was sharp increase of FDI outflows from 2001 and also reached all time high about $ 21.142 bn in 2008. There after there was a declining trend in Outflows also up to 2013. FDI outflow declined more after 2008 and as a result in 2015 net inflows increased all time high to US $36.492 bn.

table -1: fdi inflows, outflows and net flows of india:1992-2015 (in us$ million)

Year	FDI Inflow	FDI Outflow	FDI Net flow	Growth rate of FDI Net Flow
1992	252	24	228	0
1993	532	0	532	133.33
1994	974	82	892	67.67
1995	2,151	119	2,032	127.80
1996	2,525	240	2,285	12.45
1997	3,619	113	3,506	53.44
1998	2,633	47	2,586	-26.24
1999	2,168	80	2,088	-19.26
2000	3,588	514	3,074	47.22
2001	5,478	1,397	4,080	32.73
2002	5,630	1,678	3,952	-3.14
2003	4,321	1,876	2,445	-38.13
2004	5,788	2,175	3,602	47.32
2005	7,622	2,985	4,636	28.73
2006	20,328	14,285	6,043	30.32
2007	25,350	17,234	8,116	34.30
2008	47,102	21,142	25,960	219.86
2009	35,634	16,058	19,576	-24.59
2010	27,417	15,947	11,470	-41.41
2011	36,190	12,456	23,734	106.92
2012	24,196	8,486	15,710	-33.81
2013	28,199	1,679	26,521	68.82
2014	34,582	11,783	22,799	-14.03
2015	44,064	7,572	36,492	60.06

Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics)

figure: 1: fdi inflows, outflows and net flows of India; 1992-2015



FDI Trend in China:

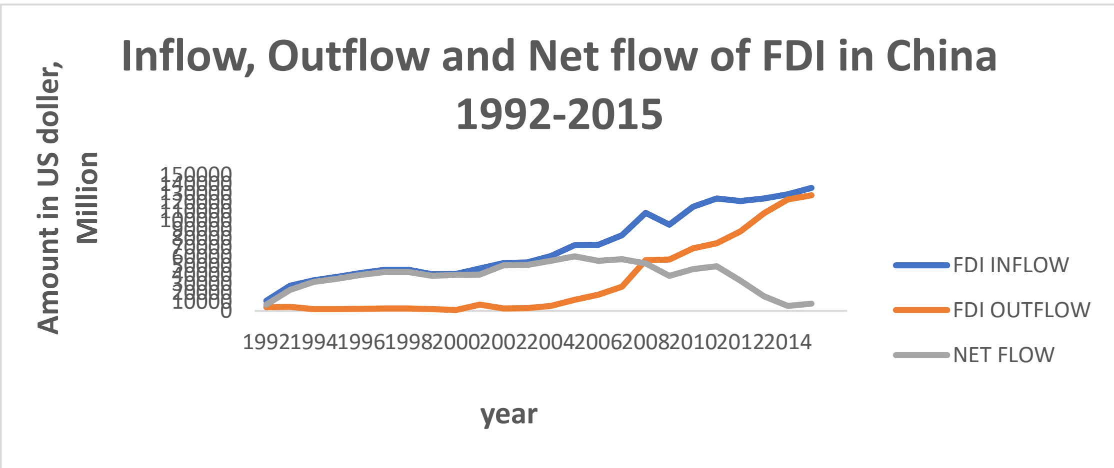
On the other hand, China FDI inflows rose about only 10 times from US$ 11 billion in 1992 to US$ 108 billion in 2008. Although there was a declining trend latter but not as much in India. But contrast to India, China out flows increased more rapidly compare to India and as a result FDI net inflows is much lower compare to India. China's FDI outflows increased more than 30 times from $ 4 billion in 1992 to $ 127 billion in 2005. Consequently, there was a significant decreasing trends in net FDI inflows to China. One important change in China's FDI behaviour was that it now becomes a home country in respect of FDI from earlier Host country (Table 2 and Figure 2).

Table: 2: FDI Inflows, Outflows and Net flows of China :1992-2015
(In US $ million)

Year	FDI Inflows	FDI out flows	FDI net Flows	Growth rate of FDI net flows
1992	11,008	4,000	7008	0
1993	27,515	4,400	23,115	229.84
1994	33,767	2,000	31,767	37.43
1995	37,521	2,000	35,521	11.82
1996	41,726	2,114	39,612	11.52
1997	45,257	2,562	42,695	7.78
1998	45,463	2,634	42,829	0.31
1999	40,319	1,774	38,544	-10.00
2000	40,715	916	39,799	3.26
2001	46,878	6,885	39,992	0.48
2002	52,743	2,518	50,224	25.59
2003	53,505	2,855	50,650	0.85
2004	60,630	5,498	55,132	8.85
2005	72,406	12,261	60,145	9.09
2006	72,715	17,634	55,081	-8.42
2007	83,521	26,506	57,015	3.51
2008	10,8312	55,907	52,405	-8.09
2009	95,000	56,529	38,471	-26.59
2010	11,4734	68,811	45,923	19.37
2011	12,3985	74,654	49,331	7.42
2012	12,1080	87,804	33,276	-32.55
2013	12,3911	1,07,844	16,067	-51.72
2014	12,8500	123,120	5,380	-66.52
2015	1,35610	127,560	8,050	49.63

Source: UNCTAD, FDI/MN database (www.unctad.org/fdistatistics)

Figure: 2: FDI Inflows, Outflows and Net flows of China; 1992-2015



The Net FDI Growth pattern of India and China shown in Fig.3 and Fig.4. Overtime annual growth rate of India's net FDI inflows is, or less positive, whereas annual growth rate of China's net FDI inflows shows almost negative pattern. Particularly after GFC this pattern is highly significant. Which indicates that India was able to attract more FDI compare to China from foreigners after GFC.

Fig 3: Annual Growth Rate of Net FDI inflows in India

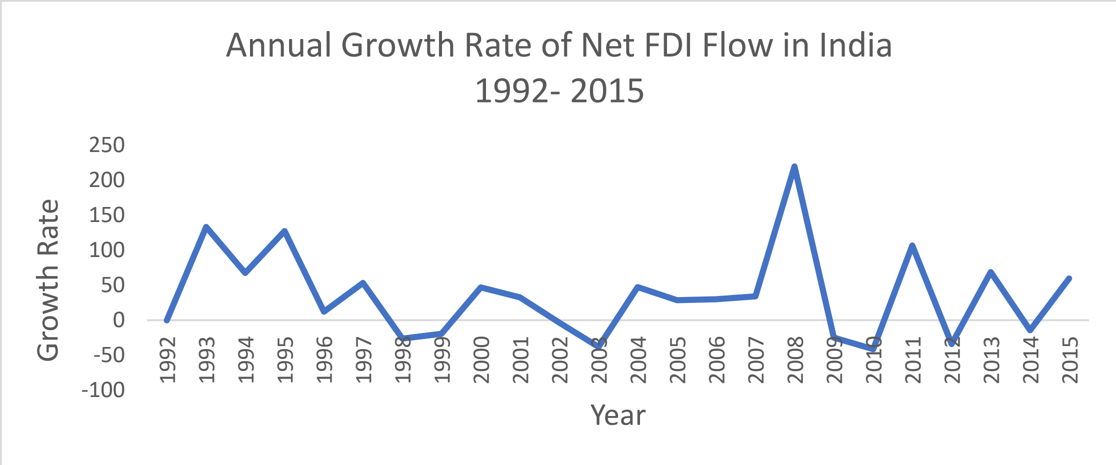
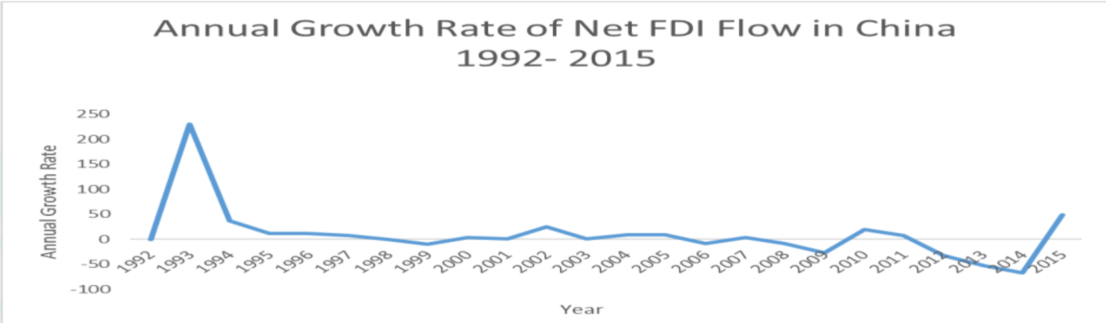


Fig 4: Annual Growth Rate of Net FDI flow in China



From Fig. 5A to 5C net inflow of FDI in China and India for different periods are depicted. In Fig. 5A show that net inflow of FDI in China increases at a decreasing rate up to 2007and latter decline. After 2011, there is a sharp decline in net FDI in flows and as a result absolute figure decline. Contrast to it for India net FDI inflows continuously increase at a increasing rate and accelerate its growth rate continuously after 2007 and it continued till 2015. In fig. 5C it is clear the net inflow of FDI in India crosses Chinas figure after 2012.

Fig 5 A: FDI net inflows of India and China

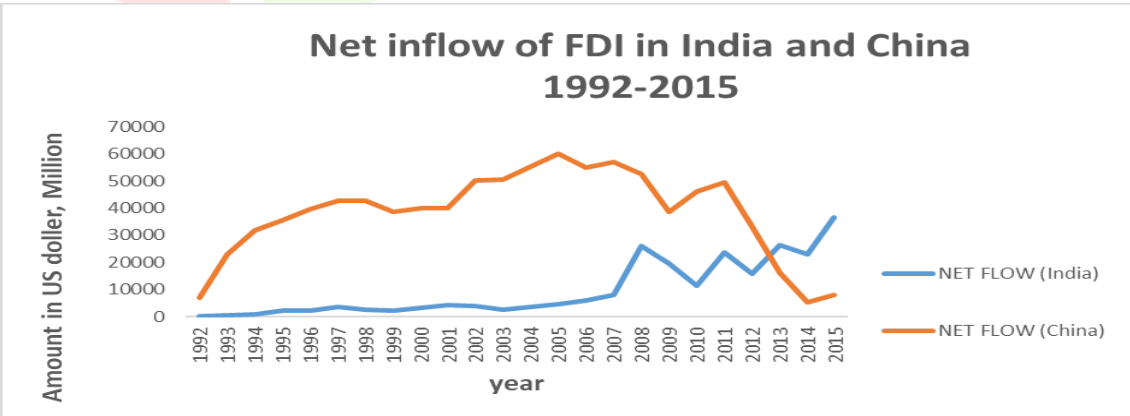


Fig 5 B: FDI net inflows of India and China

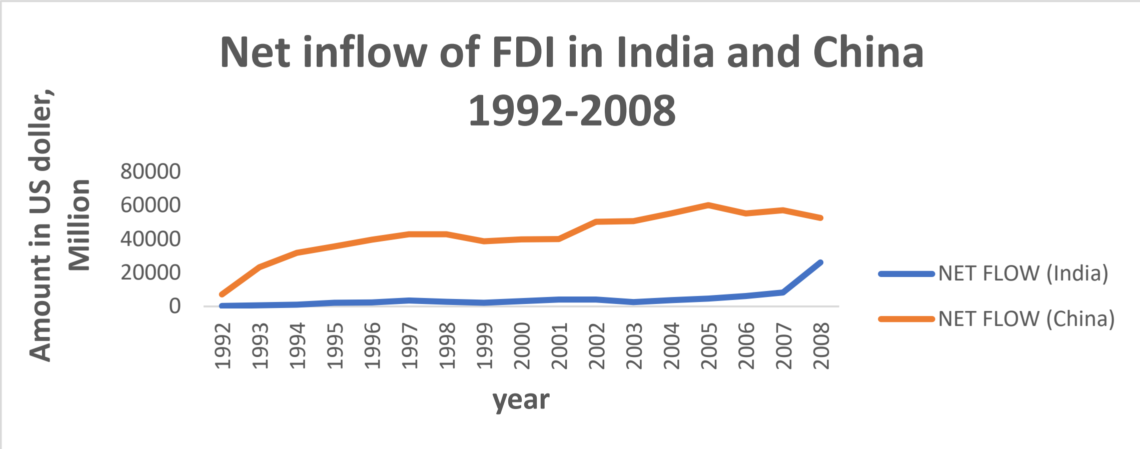
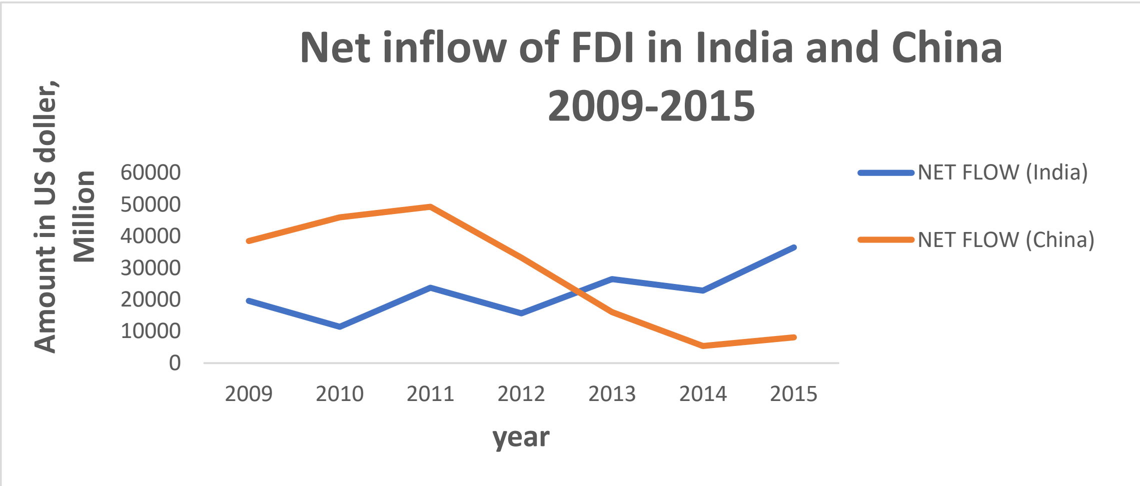


Fig 5 C: FDI net inflows of India and China



China's Success Story:

Important factors explaining China's success in attracting FDI is market size, labor cost, quality of infrastructure and govt policy but China's exceptional economic growth performance has resulted primarily of its increasing openness to foreign direct investment. FDI inflow in China contributed productivity growth through higher investment with FDI resulting effects on job creation and dynamic export sector. An increasing openness of China's economy to FDI and market-oriented reforms for attracting FDI has been a key pillar of China's high economic growth and dramatic transformation. In terms of sectoral distribution, in China most of the FDI inflow is associated towards labor -intensive manufacturing sector which implies that an important motivation of for foreign companies was to take the advantage of China's cheap labor. Equity, cooperative joint venture companies, joint venture companies and wholly foreign- owned enterprises have been the main forms of absorbing of FDI inflows into China. In China two types of FDI flows can be considered Domestic- market oriented FDI inflows is mostly motivated by the size and growth of the market of the host country. On the other hand, Export- oriented FDI inflows mainly looks for cost competitiveness. Economic structure, Liberalization and preferential policies, and cultural and legal environment are the three grouped most important factors which influencing FDI in China. Empirical studies confirm that provinces in China with more developed in infrastructure have tended to receive more FDI. The reduction of barriers to FDI and policies to improve the investment environment have played a key role in attracting FDI to China. Initially, laws and regulations tended to be too restrictive and legal problems were encountered.

Causes of India's low FDI Inflows:

Analyzing the FDI inflows to India it shows that compare to China its performance was not to the expected level, even though the government follows liberal FDI policy over time. The causes for low FDI inflows during this period are as follows:

I) Foreign investors in India must deal with more regulation and more bureaucracies than other emerging market like China.

II) The average time for obtains approvals is far longer in India than China.

III) India did not open much economic activities to the foreign player as compared to other developing nations except liberalizing trade and foreign investment.

IV) Despite starting much ahead of China, the SEZ movement in India has not picked up (Srinivason, 2003).

V) The sea ports are underdeveloped and underutilized.

VI) FDI regime has been restrictive and not welcoming as is evident in higher tariffs and taxes.

VII)Fiscal deficits, subsidies and corruptions have affected Real Gross Domestic Capital Formation (RGDCF)

VIII)India lays behind China in terms of attracting FDI inflows in the country because India is not skilled enough to adopt the technological advancement at a fast pace.

IX) Stringent labour laws act as a constraint for FDI inflows.

X) China offered investment opportunities much before than India and there by attracted more FDI inflows in that country.

XI) While China has usurped the state role in granting approvals, India democratically adheres to the principle of state rights inherent to federalism.

XII) Large section of population in India lies below poverty line.

XIII) India's per capita income is less compared to China

XIV) Literacy rate in India is low compare to China

India -China FDI comparison from 1991-2003:

FDI inflows to China grew from US $3.5 billion in 1990 to US$ 40 billion. Those for India it it rose from US$0.4 billion toUS$3.45 billion during the same period. China attracted more than fifteen times more FDI inflows than India in 2002.
FDI has contributed to the rapid growth of China's merchandise export. In some hi-tech industries such as electronics circuits and mobile phones the share of foreign affiliates in exports was over 90 percent while India has been much less important in driving export growth except in except in information technology. FDI in Indian manufacturing has been and remains domestic market-seeking.
China's total and per capita GDP are higher than India's, making it more attracting market seeking FDI. Besides, China has literacy and education rates making it more attracting for efficiency-seeking investors. Moreover, it has more natural resource endowments. In addition, China's physical infrastructure is more competitive, particularly in the coastal areas (CUTS, 2003 Marubeni Corporation Economic Research Institute (2002), But, India may have an advantage in technical manpower, particularly in information technology and has better English speaking man power.

In ICT, China has become a key Centre for hardware design and manufacturing by such companies as ACER, Enccsson, Generan Electric Hitachi Semiconductors Hundai, Intel, LG electronics, Microsoft, Motorola, Nokia, Philips, Samsung Electronics, Sony and many more but India on the Other hand, specializes in It services, call centers, business back-office operations and R&D.

Rapid growth in China has increased the local demand for consumers durables and nondurables, such as home appliances, electronics equipment, automobiles, housing and leisure. this rapid growth in local demand as well as competitive - ness environment and infrastructure have attracted many market-seeking investors. It has also encouraged the growth of many local indigenous firms that support manufacturing.

Other determinants related to FDI attitudes, policies and procedures also explain why China does better in attracting FDI. China has "more business- oriented" and more FDI-friendly policies than India (AT Kearney, 2001). China's FDI procedures are easier, and decisions can be taken quickly. China has also more flexible labour laws, a better labour climate and better entry and exit procedures for business. China is more attractive tan India in the macroeconomic environment, market opportunities and policy towards FDI whereas India scored better on the political environment, taxes and financing (EIU 2003a).

FDI policy in India after Global Financial crisis-2008

Significant changes have been made in the FD\I policy regime after the global financial crisis 2008 to ensures that India remains increasingly attractive and investors friendly. some of the main changes have been as follows:

I) In February, 2009 incorporates the twin concepts of "ownership" and "control" as a central principle in India's FDI regime. This ensured application of simple, homogenous and uniform norms for as also to clarify the need for obtaining government/ FIPB approval (or, Otherwise) for foreign investment into Indian companies.

II) Increase government oversight was also brought in over the transfer of ownership or control in sensitive sectors to non-resident entities,

III) All payments for royalty, lump sum fee for transfer of technology and use of trademarks/ brand names, were brought under the automatic route, without the need for government approval.

IV) On 31st March, 2010 major exercise under taken by the government has been the consolidation/ integration of all existing regulations on FDI, contained in FEMA, RBI circulars, various Press Notes etc. into one consolidated document, so as to reflect current regulatory framework. It would ensure that all information on FDI policy is available at one place, which is expected to lead simplification of the policy, greater clarity and understanding of foreign investment rules among foreign investors and sectoral regulations, as also to bring in greater predictability o policy.

V) Lastly, the government has now initiated stakeholder consultations, by inviting suggestions on various aspects of FDI policy, including sectoral policy.

India's FDI Policy:1990-2015

Investment climate in India has improved since the opening up of the economy in 1991. This is primarily attributed to ease in FDI rules in India. India today is a part of the top 100 clubs on Ease of Doing Business (EoDB).

Prior to 2014, India was unsuccessful in attracting FDI commensurate with India's capital requirements. Unsatisfactory performance of FDI prior 2014 was due to policy paralysis, presence of multiple sectors under the Government route and low FDI caps across sectors. India's FDI problems were compounded by the fact that other nations were engaging competitive liberalisation and offering highly attracting FDI policies to foreign investors. In 2014-15, FDI inflows in India stood at a mere Us$ 45.15. The low FDI inflows in the years prior to 2014 was reflective of an unimaginative and rigid approach towards policy making. So, there was a growing necessity for a liberal and investor friendly FDI, regime to remove policy bottlenecks, augment domestic capital formation through increased inflow of FDI, promote industrial development, bring international best practices and latest technologies to India and generate employment across sectors. And lastly, the Indian Government has initiated a transparent, predictable and investment friendly FDI policy through which FDI permitted in almost all sectors via automatic route. India continues to open up its different sectors to global investors for FDI by raising its limit, removing previous regulatory barriers for attracting increased FDI and hi-tech solutions, in addition to developing infrastructure, improving business environment, building robust and predictable taxation regime and nurturing international relations. Since2014, India's Govt. has pushed through different FDI reforms with the objective of making India a more attractive investment destination. In 2014, the FDI limits for most of the sectors were raised to 100% through automatic route. And India now becomes most open economy for FDI.

The Indian Govt. is committed to make India unattractive destination for FDI inflows. The continuous liberalisation of the FDI regime in India has significantly boosted India's image at the global level. India has now become a preferred destination for FDI Inflows. The central Govt. is engaged in the review of the FDI policy on an ongoing basis, with a view to attract larger volumes of FDI to the country. It engages in frequent and intensive consultations with stakeholders including apex industry associations and representatives of corporate across sectors.

The intent of these consultations and Govt. reforms is to make the FDI policy more investor friendly and ensure India remains an attractive and investor friendly destination for FDI inflows.

India's latest FDI policy. thumbs up by following Stakeholders/ investors.

"Climate for doing business in India is positive"	Frans Van Houten Philips, CEO of Royal Philips.
"India and the US should now aim at taking bilateral ties to its "full potential" where both countries will need to manage their political imperatives to "unleash greater trade and investment"	Nisha Biswal, president of the US- India Business Council (USIBC)
"Will surpass $ 10 billion investment for India"	Masayoshi Son, Founder & CEO of Soft bank.
"India is probably the only place where entrepreneurial energy is able to scale up. Not just start."	Satya Nadela, Microsoft
"Growth prospect intact, India is a big opportunity.''	Anuj Ranjan, Managing partner, Brookfield

Source: Department for Promotion of Industry and international Trade.

Conclusions:

Continuous market oriented and investor friendly FDI reforms since 2014 makes India a more attractive investment destination. And India is now able to get more net FDI inflows compare to China. But in terms of Gross FDI inflows it is far behind compare to China. This is because India's infrastructure facility is not sufficient particularly in respect of sea ports, it has also high corporate tax rates and stringent labour laws. Besides, there is high level of corruption, administrative loopholes and SEZ movement has not developed. So, India still needs to improve infrastructure facility, overcome administrative loopholes, slashes corporate tax rates and have to greater connect with overseas Indian to augment FDI inflows sufficiently. One important thing regarding China FDI is that net FDI inflows becomes negative recently, which means that outflows is greater than inflows and we have to search for this aspect in future.

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