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A COMPARATIVE STUDY OF FDI IN INDIA & CHINA*

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Abstract

India and China have experienced rapid economic growth in recent years. The growth, in part, is attributed to the adoption of liberal trade policies by each country in 1990's, and the consequent surge in the flows of foreign capital to both these countries. China and India, as the two largest developing countries in the world, have been both enjoying fast economic growth since the 1990s. China seems to be performing better. In 1975, China was at par with India in GDP, yet 33% lower in its GDP per capita ($146 versus $220). But over the years China developed more rapidly than India and surpassed India in terms of GDP per capita in 1984. Now, after 36 years there is a huge difference. China is much ahead from India and has left Japan behind to become the 2nd largest economy in the world. China's GDP and GDP per capita are almost 3 times than those of India's.

Introduction: A simple definition for common understanding can be understood as "Foreign direct investment (FDI) refers to long term participation by country A into country B. It usually involves participation in management, joint-venture, transfer of technology and expertise". Different organizations define FDI differently and the most accepted one is that given by IMF (International Monetary Fund).

IMF defines FDI as "The acquisition of at least 10% percent of the ordinary shares or voting power and effective voice management in a public or private enterprise by non-resident investors in another country and comprises those entities in the host country that are subsidiaries (>50% ownership); associates (<=50% ownership) or branches (wholly or jointly-owned, unincorporated enterprises) of the parent,". Direct investment involves a lasting interest in the management of an enterprise and includes reinvestment of profits".

A simple definition would be –"an investor based in country acquires an asset in another country with the intent to manage that asset". (OECD,2000).

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More than two third of the FDI activities (one third as trade between affiliates of the same TNC and another one third a TNC and another enterprise) are involving Trans National Corporations, hereinafter referred to as TNCs.

Today, the world is witnessing the significant impact of globalization which has completely redefined the way in which business used to be done. One of the key results of globalization is that there has been a tremendous growth in global FDI. This dramatic development has taken place simultaneously with a substantial growth in international trade. The term 'Global Village' was coined to indicate that the distance is no longer a constraint and the trade boundaries have become blurred. FDI is an important factor in the globalization process as it intensifies the interaction between states, regions and firms. Growing international flows of portfolio and direct investment, international trade are all parts of this process. Globalization offers an unprecedented opportunity for developing countries to achieve faster economic growth through trade and investment. In the period 1970s, international trade grew more rapidly than FDI, and thus international trade was by far than most other important international economic activities. This situation changed dramatically in the middle of the 1980s, when world FDI started to increase sharply. In this period, the world FDI has increased its importance by transferring technologies and establishing marketing and procuring networks for efficient production and sales internationally (Shujiro Urata, 1998). The large increase in the volume of FDI during the past two decades provides a strong incentive for research on this phenomenon.

After the global financial crisis, the status and importance of Asian economies have increased a lot because of their more than expected resilience to financial crisis. Asian economies are expanding rapidly and their growing clout can be felt from the fact that out of top 5 economies of the world (in terms of GDP by PPP) 3 are Asian. Asia, with the exception of Japan, South Korea, Hong Kong and Singapore, is currently undergoing rapid growth and industrialization spearheaded by China and India - the two fastest growing major economies in the world.

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Who are foreign direct investors?

foreign direct investor is an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated or unincorporated enterprises which has a direct investment enterprise – that is, a subsidiary, associate or branch – operating in a country other than the country or countries of residence of the foreign direct investor or investors.

Why Does FDI Matter?

Why does foreign direct investment matter to Economic development?

There are several reasons that foreign direct investment has a significant impact on Economic growth; this impact is magnified in a growing economy. In particular, foreign direct investment (FDI) impacts five variables –: Domestic Investment, Technology, Employment generation and labour skills the Environment and Export competitive.

The Rationale for increasing FDI

Foreign Direct Investment (FDI) flows are usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. FDI also facilitates International trade and transfer of knowledge, skills and technology. In a world of increased competition and rapid technological change, their complimentary and catalytic role can be very valuable.

India ranked 100 and China ranked 78 out of 190 countries in the list of Ease of doing Business according to the report co- published by World Bank and the International finance corporation.

A Comparison of FDI in India and China

India and China have experienced rapid economic growth in recent years. The growth, in part, is attributed to the adoption of liberal trade policies by each country in 1990's, and the consequent surge in the flows of foreign capital to both these countries. China and India, as the two largest developing countries in the world, have been both enjoying fast economic growth since the 1990s. China seems to be performing better. In 1975, China was at par with India in GDP, yet

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33% lower in its GDP per capita ($146 versus $220). But over the years China developed more rapidly than India and surpassed India in terms of GDP per capita in 1984. Now, after 26 years there is a huge difference. China is much ahead from India and has left Japan behind to become the 2nd largest economy in the world. China's GDP and GDP per capita are almost 3 times than those of India's.

What's more phenomenal, however, is the difference in their FDI performance. China has been able to attract more FDI than India, both in terms of net inflow and as % of GDP, from the beginning. Over the past decade, China has established itself as the top recipient of foreign direct investment (FDI) among developing countries. The World Prospectus Survey 2010-2012, released by the United Nations Conference on Trade and Development (UNCTAD), showed that China has once again retained title of the world's most important FDI destination. India, meanwhile, overtook the United States to claim the survey's second spot as the U.S. economy continues to struggle. As has already been discussed China has been receiving substantial FDI compared to India. Although prior to 1980s India received higher FDI than China but because of the liberalization policy adopted by China in 1978, turned the tables in favour of China. Since late eighties and throughout nineties China has been in forefront of the developing world in terms of FDI inflows and hence economic development. So, there is need to investigate the reasons how china has grown more rapidly than India by utilizing FDI.

Given this dichotomy in the economic status of these countries, it would be interesting to know what the effect of FDI on their growth is. The role of foreign direct investment (FDI) in the growth process has for long been a topic of intense debate. Although this debate has provided rich insights into the relationship between FDI and growth.

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From the stand point view of inter-sectoral economic growth[1]:

China is a fast industrializing country whereas India seems to be entering the post-industrial phase without having industrialized. We need to reverse the trend by stimulating industrialization, especially since it creates more jobs and has greater multiplier effects on the economy. This calls for far greater investments in infrastructure especially since civil projects such as dams, canals and building construction require not only large amounts of material such as steel and cement, but they will also employ large number of least skilled workers. The controlled growth of this segment of our population poses our greatest economic challenge and gainful employment is its only solution. Quite clearly government must spend less on itself and more for the people. Chinese GDP was lower than that of India in absolute terms in 1978 but caught up with India in the very next year. The size of Chinese economy (in 1991) now was 1.47 times that of India. In 2008, the size of Chinese economy now is 3.58 times that of India.

It is clear indicates from the table given below that China has almost doubled the growth rate within the ten years' period ever since it put itself on the economic reformation. Reformation measures that are initiated by China on Macro Economic level (globalization and liberalization) and desired volume of inward FDI flows have brought a great change on the economic growth unlike India which accounts for negligible marginal growth rate.

Growth rate; %	China	India
Pre-reform period(10years)	5.5	5.7
Post-reform period(10years)	10.1	5.9

[1] Himachalapathy. R, "A Comparative analysis of FDI in India and China", International Journal of Business and Management Vol. 6, No. 10; October 2011

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A Comparative Study:

It's true both countries have transformed themselves after they embarked on the path of economical reform. But the transformations were entirely different. In 1980, the sectoral breakup of China's economy was as follows; Agriculture 30%, Industry 49% and Services sector 21% as table given shows, over the next 20 years until 2003, the share of Agriculture fell while Industry and Service sector grew. Especially remarkable was the growth of Industry from 1990 to 2003, it grew from 42% to 53%.

The Indian sectoral picture makes for a study in contrast, while the share of Agriculture fell from over 40% to 23% from 1980 to 2003 it was not the Industry that took this share; instead the Service sector become dominant sector contributing over half of India's income. This is a sharp contrast with China where over half the present income accrues from Industry.

Though the actual FDI inflow in India in the 1990s increased significantly over the past, it is modest compared to many Asian economies; and, it pales into insignificance in comparison to China. UNCTAD's ranking[2] of countries in terms of foreign investment (relative to the size of the economy) for the period 1998-2000 is 119 for India and 47 for China. The ranking a decade ago was 121 and 61 respectively. It shows that even at the start of the reforms, China's ranking was way ahead of India's; China moved up in the ranking much faster than India did in the 1990s.

The statistics are widely seen as an evidence of the failure of India's reforms, since greater inflow of foreign capital in China is believed to be largely responsible for its exceptional growth and export performance. As this perception is much discussed in the current policy discourse, we examine the quality of the Indian and the Chinese estimates, and the evidence on the role of FDI on economic performance in the recent years.

[2] Nagraj R, "Foreign Direct Investment in India in the 1990s Trends and Issues", Economic and Political Weekly April 26, 2003

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China and India are emerging as the most important economic driving forces in the world. The two Asian giants have 40% of the global labour force and 18% of the world economy in terms of purchasing power parity (PPP). During the last two decades, both economies have been growing twice as fast as the rest of the world, putting them among the fastest-growing economies worldwide. It is predicted that in two decades, China will become the number-one economy ahead of the United States, while India will surpass Japan to rank third in the world.

Due to the economic reforms pursued by the two governments, foreign direct investment (FDI) has gradually blossomed in both China and India. Kearney's 2005 FDI Confidence Index, China maintained its position as the most attractive FDI destination globally for a fourth year in a row, with India in second place, rising from fifteenth in 2002. Despite India's dramatic FDI gains in the last decade, it still lags far behind China. Between 1988 and 2004 (Table 1), the India's annual average share of global FDI was less than 1%, compared with China's 7% (13% in 1994). In terms of the FDI Performance Index in 2004 (Table 2), China ranked 45th, while India was far behind at 112th (UNCTAD, 2005).

These differences raise interesting questions for both the young economists of academia and policymakers as to why the two countries have performed differently in attracting inward FDI. What is determining the FDI flows into the two countries? Are the determinants the same or different? Will both countries continue an increasing trend of receiving FDI? Can India catch up with China?

Buckley (2002) pointed out that India along with China might be a focus for the current research agenda in the sphere of international business. Lardy (2003) noted, "In terms of their participation in the international economy it would be difficult to envision two more contrasting cases than China and India" Indeed, China and India present an interesting case for comparison. Both countries (especially China) have received considerable increasing attention for years.

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It is widely recognized that FDI has been one of the major driving forces behind industrial upgrading and economic growth in the Asian newly industrialized economies (NIEs). FDI as an economic growth agent is more effective in outward export-oriented countries than in inward import-substituting countries. As is well known, China and India have different development strategies and policies. An outward export-led regime is pursued in China, while an inward import-substituting regime is conducted in India.

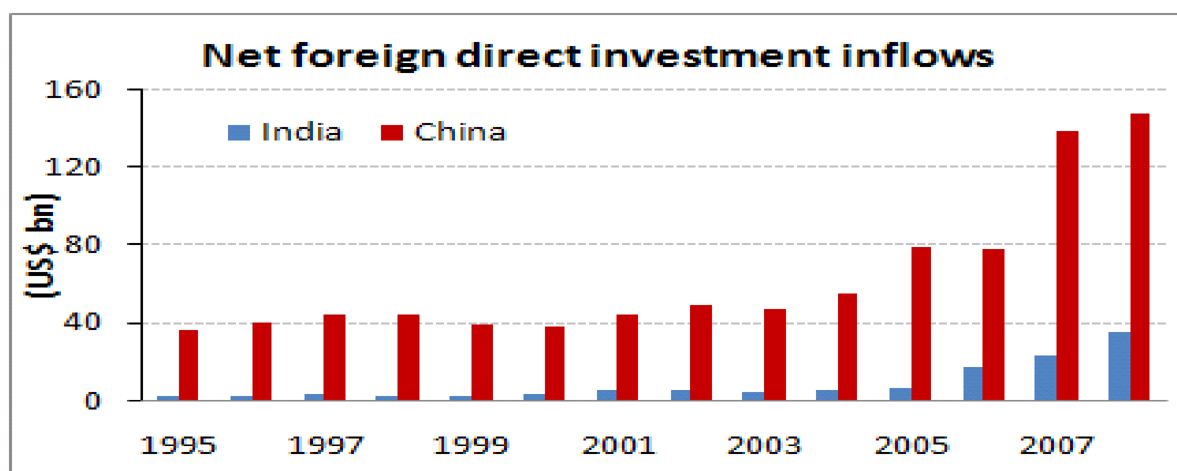

Table-1 Inward FDI in China and India 1970–2004 (U.S. $ Million) [3]

	China			India		
YEAR	**FDI Inflow US $ mn**	**Year-on-Year growth rate**	**Share of World FDI (%)**	**FDI Inflow US $ million**	**Year-on-Year growth rate**	**Share of World FDI (%)**
1970-1980	0	-	-	455	-	-
1981-1986	1021	-	-	69	-	-
1987	2314	-	-	212	-	-

[3] **Zheng Peng,** "A Comparison of FDI Determinants in China and India", **Thunderbird International Business Review** Vol. 51, No. 3 May/June 2009

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1988	3194	0.38	2	91	-0.57	0
1989	3393	0.06	2	252	1.77	0
1990	3487	0.03	2	162	-0.36	0
1991	4366	0.25	3	141	-0.13	0
1992	11156	1.56	6	151	0.07	0
1993	27515	1.47	12	273	0.81	0
1994	33787	0.23	13	620	1.27	0
1995	37500	0.11	11	1750	1.82	1
1996	40180	0.07	11	2525	0.44	1
1997	44237	0.10	9	3619	0.43	1
1998	43751	-0.01	6	2633	-0.27	0
1999	40319	-0.08	4	2168	-0.18	0
2000	40772	0.01	3	2319	0.07	0
2001	46846	0.15	6	3403	0.47	1
2002	52743	0.13	8	3449	0.01	1
2003	53505	0.01	9	4269	0.24	1
2004	60630	0.13	10	5335	0.25	1
TOTAL	**550716**		**7.35(avg.)**	**33441**		**0.47(avg.)**

Table-2 Inward FDI Performance Index

	1990	1995	2000	2001	2002	2003	2004
CHINA	46	14	52	57	50	42	45
INDIA	98	110	120	121	121	118	112

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Above graph and statistics both show that China is much more effective in attracting and exploiting FDI as a driving force for its economic growth than is India. From 1981 to 2004, China received a cumulative FDI of U.S. $550.7 billion, which is15 times higher than the U.S. $33.4 billion that India received (Table 1 and Figure 1). FDI stock in 2004 as a percentage of gross domestic product (GDP) is 15% in China compared with 6% in India (Table 3). Table 4 shows that in 2002–2004, China attracted U.S. $166.88 billion FDI, which is equivalent to 30% of the FDI inflows to all developing countries and 8% of the global total, compared with the U.S. $13.05 billion received by India, which is only 2% of the total for developing countries and less than 1% of the global total. FDI as a percentage of gross fixed capital formation (GFCF) over this period in China averaged 9%, compared with just 3% in India.

Although there are many similarities between the two countries from historical, social, and economic perspectives, China has left India far behind in attracting FDI. Why have China and India performed so differently? A.T. Kearney (2001) pointed out that bureaucracy, corruption, poor infrastructure, rigid labour laws and regulations, red tape, the sluggish pace of economic reforms, and the Indian government's role in the economy were the major reasons behind the lower FDI flows into India. A.T. Kearney (2004) further argued that FDI favours China over India for its larger market size, easier access to export markets, more preferential policies, and better physical infrastructure and macro-economic climate in terms of its much wider and deeper economic reforms. UNCTAD (2003) considered the reasons from three aspects basic determinants, development strategies and policies, and overseas networks.

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TABLE-3 FDI Stocks in China and India 1990–2004 [4]

	CHINA			INDIA		
	1990	**2000**	**2004**	**1990**	**2000**	**2004**
FDI stocks (millions of dollars)	20691	193348	245467	1657	17517	38676
Percent of GDP (%)	5.8	17.9	14.9	0.5	3.7	5.9
Percent of developing economies (%)	5.68	11.15	11.03	0.46	1.01	1.74
Percent of world (%)	1.17	3.34	2.76	0.09	0.30	0.43

Table-4 FDI in China and India 2002–2004

	CHINA			INDIA		
	2002	**2003**	**2004**	**2002**	**2003**	**2004**
FDI inflows (millions of dollars)	52743	53505	60630	3449	4269	5335
Percent of GFCF (%)	10.4	8.6	8.2	3.0	3.2	3.4
Percent of developing economies (%)	33.91	32.17	26.00	2.22	2.57	2.29

[4] **Zheng Peng,** "A Comparison of FDI Determinants in China and India", **Thunderbird International Business Review** Vol. 51, No. 3 May/June 2009

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Percent of world (%)	7.37	8.46	9.35	0.48	0.67	0.82

China has a bigger domestic market and has achieved higher GDP, per capita GDP, and GDP growth than India, making China more attractive, especially for market-seeking (horizontal) FDI. In 2004, China's GDP was U.S. $1,506 billion, more than twice the U.S. $581 billion achieved by India. China's per capita GDP was U.S. $1,161, double India's U.S. $538. As mentioned earlier, China achieved higher GDP growth at 9% compared to 6% in India. With better regional and international export networks, China provides a better platform for exporting and thus attracts more export-oriented FDI. Statistics show that the share of total Chinese exports generated by foreign investment enterprises (FIEs) operating in China rose to 50% in 2001 (while FIEs' export share in India was only 3%) from 45% in 1999, 13% in 1990, and less than 1% in the early 1980s. As a result of its much higher investment (eight times that of India), China's physical infrastructure has improved significantly and is ahead of that of India. China has more airports and hotels; longer and higher-quality highways, railways, and waterways, better telecommunications services, and a greater power supply than India. With higher adult literacy (95% compared to 68% in India) and education rates, China has a richer, better-skilled with higher productivity labour force. China's lower direct and indirect taxes, import duties, raw material prices and capital costs make China a more favourable destination than India for resources-seeking and efficiency- seeking (vertical) FDI.

With respect to attitudes, policies, and procedures, China has more business-oriented FDI preferential policies and quicker and easier procedures for FDI entry and exit than India, while India's bureaucratic systems create major obstacles for FDI inflows. As mentioned above, the two countries conduct different development strategies and policies. While India long pursued an inward-oriented and import-substitution policy and strongly relied on domestic firms and

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resources, China created more opportunities for the investors to access regional and international export markets by following the East Asian outward and export-oriented model.

China has much stronger overseas Chinese networks than India. The lion's share (50.6% from 1992 to 2004) of Chinese inward FDI was from overseas Chinese in Hong Kong, Macau, and Taiwan. By contrast, the overseas Indian community has not been a major contributor to India's inward FDI.

With respect to India's seemingly lagging performance, it is argued that China's reforms were a decade earlier than those of India. China pursued its economic reforms and opening-up policies from 1979 (FDI was banned in China before 1979; see Table 1), but India only began its economic reforms and liberalization in 1991 (though India never banned FDI; see Table 1 for India's FDI in the 1970s). It is also argued that Indian FDI is understated because its FDI measuring system does not follow international standards. According to international guidelines (based on the recommendations from the International Monetary Fund [IMF]), FDI flows are the sum of three basic components: equity capital, reinvested earnings, and intercompany loans. But Indian FDI statistics exclude reinvested earnings, intercompany loans, and overseas commercial borrowings. It is also argued that China overstated its results by accounting "round-tripping" FDI from Hong Kong, which might account for the disparity between China and India (in fact, India has the same problem of accounting "round-tripping" FDI from Mauritius). The World Bank (2002) estimated the scale of round-tripping to be as high as a quarter, while the International Finance Corporation (IFC; 2002) estimate is even higher, at 40 to 50% of total FDI. However, although aligning India's FDI with international standards and excluding round-tripping from China's FDI might narrow the gap between the two countries, Indian FDI would still trail China's several-fold.

Conclusion Remarks: It is argued that China's reforms were a decade earlier than those of India. Although china is a socialist economy, China pursued its economic reforms and opening-

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up policies from 1979 and starts attracting Foreign Direct Investment (FDI)but India only began its economic reforms and liberalization in 1991.

Second thing is that in India there is more corruption in bureaucracy and politicians, poor infrastructure, red tape etc. as compare to china. There should be policies which promote Foreign Direct Investment-: like good infrastructure, single window clearance. And it should also be focuses on generating more employment for Indian labourers and using raw material produced in India. So that it can help in both way in growth of National Income and reduce Poverty and unemployment.

So that India should not develop only in terms of growth of GDP but also in terms of standard of living of whole masses of the country and then surpass the China.

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