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FOREIGN DIRECT INVESTMENT
INDIA VIS-À-VIS CHINA

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AFTER the shedding away of restrictive and protectionist policy regime and initiating series of economic reforms, China since 1978 and India since 1991, have increasingly integrated with the global economy. With liberalization, given the labour-abundant, low-cost nature of both economies, Foreign Direct Investment (FDI) funds have been constantly and in ever increasing quantities been flowing into these two countries. This phenomenon has led to both the economies exhibiting remarkably high growth rates. Both have followed different policies and paths like China moving on the path of Export-Promoting manufactures, whereas, India adopting the path of Import-Substituting strategy. China has treaded the path through manufacturing sector, whereas, India is doing it through *high-skilled Information Technology service sector. There are similarities and uniqueness of each w.r.t. size, structure, ownership, modalities, pattern and factors affecting FDI like-investment climate, business environment and the extent of integration with the global economy. Simultaneously, there are various problems and challenges arising out of increasing integration in national and international context.*

Key Words: *Foreign Direct Investment, India, China, Asia, Capital Flows, Structure & Composition.*

Introduction

In the years after the Second World War, global Foreign Direct Investment (FDI) was dominated by the U.S.A., as much of the world recovered from the destruction wrought by the conflict. The U.S.A. accounted for around three-quarters of the FDI (including reinvested profits) between 1945-60. Since that time FDI has spread to become a truly global phenomenon, no longer the exclusive preserve of OECD (Organization for Economic Co-operation & Development) countries. FDI has grown in importance in the global economy with FDI stocks now constituting over 20% of global GDP (Gross Domestic Product). In the last few years, the emerging market countries like China & India have become the most favoured destinations for FDI and investor confidence in these countries has soared. As per the FDI Confidence Index, compiled by A. T. Kearney for 2005, China and India hold the first and second position respectively, whereas U.S.A. has slipped to the third position.

The present paper traces the trends in growth rates in India and China; Concepts of Resource Flows; Policy Regimes towards FDI; Flows and Trends of FDI; Structure, Ownership, Modalities & Sources of FDI; Factors affecting FDI-like Investment Climate, Business Environment & Integration with the Global Economy & Competition, Challenges & Tasks Ahead.

Growth Rates in India and China

Economic globalisation embraces many different forms: Trade, Multinationals, FDI, Short-term Capital Flows, International Flows of Humanity & Technology Diffusion, involving Patent Rights, etc.

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India and China, two big & most populous nations with almost 3 bn. people today, grew disappointingly until the mid-80's, when autarkic policies were followed in India because of the economic ideology followed then and in China because of Communist ideas and political realities. Both countries turned around and embraced globalisation, where growth is described not as a passive "trickle-down" strategy, but as an active "pull-up" strategy. Both shifted to an outward-orientation roughly 2 decades ago and this contributed to their higher growth in the 1980's and 90's. China adopted progressively outward-oriented economic policies in 1978. India also began opening its insular economy in a limited fashion in the 1980's, then more systematically and boldly in the 1990's.

According to World Bank estimates, real income (GDP) grew at an annual average rate of 10% in China and 6% in India during the 2 decades ending in 2000. No country in the world had growth as rapid as China's and fewer than 10 countries-excepting for China, none with poverty rates and population size comparable to India's-had a growth rate exceeding India's during these years.

According to rating agency CRISIL , the Indian economy would grow at 8.3% in 2006-07 as it feels that the growth momentum in India is becoming more broad-based with both consumption and investment emerging as twin growth engines. Agriculture, industry and services sectors are projected to grow at 2.6, 9.2 and 10% respectively. The industry recorded a 10.6% growth during the first five months of this fiscal, reflecting a strong improvement over 8.7% in the corresponding period of 2005-06. The manufacturing grew by a robust 11.1% as against 8.5% in the same month last year. The consumer durable sector recorded the highest growth of 20.2% in August this year. Capital goods sector registered a growth of 14.7%. It reflects a long-term trend of accelerating growth, which has increased from 3.5% during the 1950's-70's to 5.4% in the 1980's and further to 5.9% in the 1990's. The variations in trend growth across sectors have led to a major change in the structure of the economy. The share of services in GDP increased from 27.9% to 50.8% between 1950 and 2002. The increase in the share of industry was from 14.7% to 27.2% and the share of agriculture saw a corresponding decline from 57.4% to 22.0%. As growth in services is much more stable than in agriculture or industry, the rising share of services in GDP implies that growth volatility is also declining over time.

Reforms since the late 80's have lifted its performance significantly and it was largely unaffected (Bhagwati, 2005-06).

Peoples' Republic of China (PRC) has consistently recorded spectacular economic growth with real Per Capita Income more than 5 times higher in 2002 compared to that of 1980 to better than 10% recently. Economic growth accelerated from 8.0% in 2002 to 9.1% in 2003 fueled by strong domestic demand and buoyant foreign trade. While the robust economy reflects substantial reforms associated with W.T.O. accession and the accumulated impact of the proactive policy of the past 6 years, some signs of overheating of investment are causing concern and the government has introduced a range of controls to limit excessive investment in some industries. On the demand side, investment was the main driver, contributing 6.3% to growth, consumption contributed 3.95, but net exports subtracted 1.1% points. A rapid expansion of bank lending, continual FDI inflows and a property market boom were major factors contributing to the investment surge. PRC is now the principal East Asian growth locomotive and a major global economy (Asian Development Outlook, 2004).

Using purchasing power parity (PPP) basis, CHINDIA's (combined economy of China and India) GDP is already 20.31% of the world's, only slightly lower than the US's 20.34% share. In absolute terms, the combined GDP was $3.1 trillion in 2005. But if adjustment for PPP is made, CHINDIA's GDP is already a whopping $12.4 trillion. CLSA, an international securities research firm predicts the projected value of "CHINDIA" economy at $16 trillion on nominal basis by 2020 (Hindustan Times, 2006).

Concepts of Resource Flows

Net resource flows (long-term) are the net resource flows on long-term debt (excluding IMF) +non-debt-creating flows. Non-debt-creating flows are net FDI, Portfolio equity flows and official grants (excluding technical co-operation). Net FDI and portfolio equity flows are treated as private source flows.

According to it, FDI has 3 components-Equity Investment, Reinvested Earnings and short and long term inter-company loans between parent firms and foreign affiliates as shown in the BOP. Portfolio equity flows are the sum of country funds, Depository receipts (American and Global) and direct purchases of shares by foreign investors.

FDI as distinguished from other kinds of international investment is made to establish a lasting interest in or effective management control over an enterprise in another country. As a guideline, IMF suggests that investment should account for at least 10% of voting stock to be counted as FDI. In practice, many countries set a higher threshold.

BOP data on FDI do not include capital raised locally, which has become an important source of financing for investment projects in developing countries. In addition, FDI data capture only cross-border investment flows involving equity participation and thus omit non-equity cross-border transactions such as intra-firm flows of goods and services.

Net private capital flows are calculated as the sum of FDI + portfolio investment flows and bank and trade related lending.

For grants, there is no payment requirement. The memorandum for item Technical Co-operation Grants includes free-standing technical co-operation grants, which are intended to finance the transfer of technical and managerial skills or of technology for the purpose of building up general national capacity without reference to any specific investment projects; and investment related technical co-operation grants, which are provided to strengthen the capacity to execute specific investment projects (Global Development Finance, 2005).

Policy Regime in the context of FDI Flows

Until the mid-1980's, most developing countries worldwide viewed FDI with great wariness. The sheer magnitude of FDI from Multinationals (MNCs) was regarded a threat to host countries, raising concern about MNEs' capacity to influence economic and political affairs. These fears were driven by the colonial experience of many developing countries and by the view that it as a modern form of economic colonialism and exploitation. In addition, the local affiliates of MNEs were frequently suspected of engaging in unfair business practices, such as rigged transfer pricing and private fixing through their links with their parent companies. Consequently, most countries regulate and restrict the economic activities of foreign firms operating within their borders. Such regulations often include limitations on foreign equity ownership, local content requirements, local employment requirements and minimum export requirements to transfer the benefits to the local economy. At the same time, most countries also offer incentives to attract FDI. These often include tax concessions, tax holidays, tax credits accelerated depreciation on plant and machinery and export subsidies and import entitlements. Such incentives aim to attract FDI and channel foreign firms to desired locations, sectors and activities. This "carrot and stick" approach has long been a feature of the regulatory framework governing FDI in host countries.

Both PRC and India comprise that group of countries with historically very restrictive regimes, including outright prohibition, which have opened up during the past quarter century, compared to Malaysia and Thailand, which have always been reasonably open and become progressively more so.

In the PRC, the reform process commenced in 1978. It was further consolidated in the late 1980's and again in 2002 upon accession to the WTO. In India, 1991 is regarded as the key reform year. A range of internal and external factors were typically at work behind these reforms, which included a recognition that outward-oriented economies grew more quickly and that it is possible to achieve "nationalist" objectives in an open economy context. Competitive liberalizations have been a factor.

Both India and China are characterized by dual policy regimes:

1. Both the countries feature quite high levels of decentralized economic policymaking.
2. There are large inter-industry differences in protection and incentives.
3. State-owned enterprises (SOEs) typically receive preferential treatment and,
4. Both offer some sort of fiscal or financial incentives to foreign investors. These vary by sales orientation, technology introduced by the foreign investor, location of investment and other factors.

In recent years, however, FDI restrictions have been substantially reduced as a result of a host of factors-accelerating technological change, emergence of globally integrated production and marketing networks, existence of bilateral investment treaties (BITs), prescriptions from multilateral development banks and positive evidence from developing countries that have opened their doors to FDI (Douglas & Hal, 2004).

The FDI policy in India is characterized by its liberal, transparent and investor-friendly nature. As per the extant policy, FDI upto 100% is allowed on the automatic approval route in most of the activities, except in some cases, where government approval is required. The degree of automaticity has been enhanced. New sectors have been opened to FDI, namely, integrated townships, insurance, defense industry, mass rapid transit system, tea plantations and print media. FDI limits have been raised in certain sectors and removed altogether in certain other sectors. Foreign technology transfer policy also has been liberalized by allowing payment of royalty upto notified limits without restriction on the duration of payment. It permits technology collaborations in all the sectors where FDI is allowed. The government has set up the Foreign Investment Promotion Board (FIPB) to consider FDI proposals requiring government approval. Foreign Investment Implementation Authority (FIIA) was established in the Dept. of Industrial Policy and Promotion, Ministry of Commerce & Industry to facilitate quick translation of FDI approvals into implementation.

The PRC's initial export orientation was confined to 4 Southern coastal zones. Most of the labour-intensive FDI originated from Hong-Kong-China and later Taipei-China (Diaspora Effect). This FDI co-existed with that going into joint ventures with SOEs, much of it in uneconomic and protected heavy industry. Firms from OECD countries were the dominant investor in these cases. FDI also typically flows into non-tradeables such as real estate and hotels. Meanwhile, another group of foreign investors enters "comparative advantage" sectors (SMEs, Labour-Intensive & export-oriented activities). Often the latter locate in special zones that are free of the regulatory and bureaucratic complexities found elsewhere in the economy.

The domestic welfare implications of different types of FDI are fundamentally important. Therefore, there is not a single "FDI-Model". A major feature of the reform process is the diminished importance of the former type of FDI as the latter becomes progressively more important.

The PRC is an excellent illustration of the political economy proposition that in some circumstances, partial reform is desirable if it can be a precursor to successful countrywide liberalisation. The latter was not politically feasible during the early years of reform. As the coastal zones began to grow at a spectacular rate, they became the model for the rest of the economy to emulate and reform progressively extended to other regions and sectors.

It is crucial to distinguish between formal FDI & trade regimes and their operation in practice. In case of India, power is diffused and under its federal structure, the states wield considerable power. Moreover, while the reforms have been "positive sum game" since growth has accelerated, there have been losers-the bureaucrats, the SOEs sheltered from competition and the unions.

Authoritarian states like the PRC can reform very quickly, once key leadership figures are convinced of the case for change. Democratic states like India move more slowly but reforms may be more durable there. But decentralization is resulting in regional authorities offering a range of incentives. There are dangers of this intra-national competition for FDI also-from governments offering excessively generous incentives.

Flows of FDI have seen a dramatic rise in the last 20 years due to increasing openness of host economies-resulting in growing internationalization of trade and investment. As trade has been liberalized, the old "tariff factory model" of FDI has given way to a new FDI-led, export-oriented paradigm, which is characterized as a switch from "rent-seeking" to "efficiency-seeking FDI".

India is not winning outsourcing work only because it is a low wage economy but also because it is a highly skilled economy. Moreover, India has not tried to make its way as a clone of China or the Southeast Asian Tigers, starting with lower end manufacturing before moving to bigger things. India has started on the upward path in IT, where it has moved rapidly from simple programming to complex design and strategic activity that was once regarded as an American presence. Its ability to match advanced countries at a fraction of the cost of their operations will ensure that outsourcing of highly skilled jobs to India would continue. India has been able to prevent the MNEs from decimating its domestic industries through denial of technology, predatory pricing etc. competition has prompted Indian business to upgrade.

Indian companies have purchased 36 foreign companies recently, while foreign companies bought only 20 Indian companies in the same period.

The Trends in the Inflows of FDI

Relative to world output and exports, FDI outflows have risen tremendously since the early 90's. World FDI outflows increased about 5 times from 1993 to 2000 before falling beginning in 2001, while world trade and output grew at a more modest pace, not even doubling in value between 1990 and 2002.

Economic integration in the past decade has boosted FDI inflows to developing countries-particularly those with improved investment climates. FDI is also increasingly concentrated. The top 8 FDI receiving developing countries accounted for 63% of net FDI inflows in 2004, up from 58% in 1995. Among the countries in developing Asia, the top 10 recipients of FDI inflows in 2002 accounted for 97% of total FDI in the region, with the top 3 recipients alone accounting for 81%, share of PRC being 57.7% and that of India 3.8%. PRC's and India's ratios of FDI to GDP were 3.8% and 0.7% respectively.

FDI inflows into South, East and South-East Asia reached a new high of $165 billion (Rs.742, 500 crores) in 2005, a 19% increase over 2004, according to UNCTAD's World Investment Report 2006.

In South Asia, India received an FDI inflow of $7 billion out of a total of $10 billion. With continuing rapid economic growth in South, East, and South-East Asia, the region has become more attractive to market-seeking FDI. It is a hot spot for transnational corporations, investors in financial services and high technology industries. About two-thirds of the FDI in 2004-05 in South-East and East Asia went to two economies-China ($72 billion) and Hong Kong($ 36 billion). China was the largest recipient of FDI among all developing countries worldwide. India received $6.6 billion. The FDI outflows are $11.3 billion from China compared to $1.4 billion from India. In China, FDI in the manufacturing sector has been shifting towards more advanced technologies. Asian energy companies, in particular those from China and India, have intensified their efforts to acquire oil assets.

FDI inflows in India rose 92% in the first four months of the current financial year, underlining a bullish outlook on economic growth. Manufacturing industries are receiving a significant share of the inflows. FDI inflows of $2.9 billion in the April-July period rose from $1.5 billion in the comparable year-ago period, giving room for the confidence that the target of $12 billion for FDI inflows in 2006-07 would be achieved. In July 2006 alone, FDI inflows jumped 259% to $1.16 billion from $324 million in the corresponding month last year. Foreign investments worth $3 billion are in the pipeline, including some from firms such as German steel maker and Japanese automobile giants Nissan and Mitsubishi. The record growth in investments during the first four months would contribute handsomely to the GDP growth hovering around 8.5-9%. Most of the investments are first mile inflows. So, sustained inflows are bound to come in the medium term as projects get executed (Hindustan Times, 2006).

Following Table gives the changes in FDI flows, portfolio investment flows & bank related lendings for India and China during 1990 and 2004.

Table 1: Global Private Financial Flows

(Figures in US $ mn.)

Country	FDI		Portfolio Investment Flows				Bank & Trade Related Lending	
			Equity		Bonds			
	1990	2004	1990	2004	1990	2004	1990	2004
China	3,487	54,936	-48	3,690	0	10,923	4,668	4,280
India	237	5,335	147	3,722	0	8,835	1,459	-40

Source: World Development Indicators, 2006.

In both the countries, FDI inflow has shown remarkable growth. In India, portfolio investment is becoming more important source than FDI, whereas in China, FDI is a multiple of portfolio investment.

FDI seen from any perspective- whether as % of total capital inflows, or as % of GDP, is very small in India as compared to China, but seen individually and given the fact that India opened up much later than China, the growth in India is remarkable.

FDI inflows in India (US $ mn.) accumulate to 32,690.7 being 144.4 in 1991, 2873.0 in 2000, and 3753.4 in 2004. The percentage increases in 2002, 2003 and 2004 are 10.49, 32.82 and 48.63 respectively.

Table 2: Comparative Statistics

Investment	PRC	India
FDI as % of total capital flows: 1990-1996	93	15
FDI as % of total capital flows: 1997-2002	93	38
Total cumulative FDI inflow, 1990-2002($bn.)	425.0	24.3
Total FDI stock, 1990 ($ bn.)	24.8	1.7
Total FDI stock, 2002 ($bn.)	447.9	25.8
Outflow/Inflow FDI stock 1990 (%)	10.1	16.8
Outflow/Inflow FDI stock 2002 (%)	7.9	9.7
Total FDI stock as % of GDP, 1990	7.0	0.5
Total FDI stock as % of GDP,2002	36.2	5.1
FDI as % of GDP, 1990-2000 (annual average)	4.1	0.4

Source: Asian Development Review, Vol.21, No.1, 2004.

Top 5 investing countries in India's FDI inflows are: Mauritius(35%), US(17%), Netherlands(7%), Japan(7%), U.K.(6%) and others(28%).

Sectors attracting highest FDI inflows are: Electrical Equipments (including computer software& electronics)(15%); Transportation Industry(11%); Telecommunications(10%); Fuels (power & oil refineries) (10%); Services (financial & non-financial)(8%); Chemicals(other than fertilizers) (6%); Food Processing Industries (4%); Drugs & Pharmaceuticals(3%); Metallurgical Industries(2%); Consultancy Services(2%), [SIA Newsletter, 2004].

Table 3: Year-Wise FDI Inflows (Equity + Additional Components of FDI)

(Amount US $ mn.)

Year (April-March)	Equity	Reinvested Earning	Other Capital	Total FDI Inflows	Portfolio Investment including GDR/ADR, FIIs & Offshore Funds
2000-01	2,400	1,350	279	4,029	2,760
2001-02	4,095	1,645	390	6,130	2,021
2002-03	2,764	1,833	438	5,035	979
2003-04	2,387	1,798	488	4,673	11,377
2004-05 (upto Jan.)	2,821	1,362	50	4,233	4,919
Total(1991-Jan.2005)	**29,250**	**7,988**	**1,645**	**39,583**	**40,548**

Source: RBI Bulletin April 2005 (Table No. 46)

In India, portfolio investment is as important as FDI. Reinvested earnings also form a considerable part although main source is equity.

Structure, Ownership, Pattern, Modalities & Sources of FDI

Ownership Structures & Foreign Presence

In PRC manufacturing sector, importance of once dominant SOE sector has been rapidly diminishing and its share of industrial output declined from 49% in 1994 to just 18% in 2001; whereas over this period, shares of the non-SOE domestic sector rose from 38 to 53% and of foreign firms from13 to 28%, which has been the source of the country's economic dynamism since the late 1980's. Among the latter, firms from Hong-Kong China, Macao, Taipei china account for 40-45% of the total. There has been some, but limited privatization of SOEs.

In India, foreign shares declined prior to liberalisation, from around 30% of industrial output in the early 1970's to about 255 in 1990's because of the restrictions placed on foreign firms by the overall regulatory framework. Post-liberalisation, this trend is slowly reversing. For listed companies on the Indian Stock exchange, the share of foreign firms in manufacturing output has risen gradually from 9.5% in 1990 to 9.3% in 1995 and 12.8% in 2000; more sharply in newly opened service industries. The foreign presence in India's manufactured exports is miniscule, especially compared to East Asian norms.

Flows and pattern of FDI

Round-Tripping: although the PRC was the world's largest FDI recipient in 2002, the principal uncertainty relates to "round-tripping" i.e. the PRC investments are being channeled through HK China and returning as "foreign" investment to secure the greater privileges and security that foreign investors typically receive. As the PRC reforms progress, however, and the gap between the commercial environment in HK China and adjourning Southern regions narrows, it appears to be a diminishing proportion of total inflows.

It has given rise to a recent debate about the comparative attractiveness of the PRC and India to foreign investors. PRC appears to dwarf India, owing to its earlier reforms and faster economic growth, as its recorded FDI inflows are about 20 times greater than India's in recent years. But making adjustments for the facts that 20% of the PRC's FDI is still thought to be round-tripping and PRC's economy is about double that of India's, the reported difference in inflows becomes perhaps 3:1 in terms of FDI/GDP ratio. Since the PRC's investment rate (relative to GDP) is at least one-third higher than India's, the FDI/GDI ratio for the to countries is about 2:1.

Changing Sectoral Composition of FDI Flows: Prior to the 1980's, most FDI in developing countries was in extractive industries and import-substituting (IS) manufacturing. The first major compositional shift was within manufacturing from IS to export-oriented manufacturing, commencing in the late 1960's, but accelerating from the 1980's. a more recent shift has been toward services. By 2000, about half the total stock of FDI in developing countries was in services, more than double the figure in 1990. Principal factors accounting for this trend are-the rising share of services in practically all countries, the increasingly tradeable nature of many service outputs and liberalised entry into many service industries previously closed to foreign business.

In PRC, FDI began entering the banking and foreign and domestic trade sectors in the 1990's. With its WTO accession, insurance, telecommunications and other sectors are being progressively opened.

Liberalisation in India has resulted in India in sharp decline in the earlier dominance of manufacturing in FDI inflows, from 85 to 48% of the total. Most of the increase has gone into services. There is also a more even distribution of FDI across sub-sectors.

Changing Modalities of Capital Flows: FDI has been the major source of capital flowing into the PRC, dwarfing portfolio investment owing to the semi-closed capital account, including restrictions on foreigners trading shares on the domestic stock market. Moreover, the nature of FDI is also changing. In India, the major compositional shift was the type of FDI. During the restrictive era, virtually all the FDI was "green field" by government dictate; now about 40% is Mergers & Acquisitions.

Varying Major Sources of FDI across countries: Europe, Japan and US are typically the major investors. But in some cases, much smaller, but very open, proximate and historically connected economies are major players in much larger economies. Thus, HK China is the largest investor in the PRC, given its traditionally important (though declining) role in connecting that country to the global economy. The round-tripping phenomenon is also a factor. A major foreign investor in India is Mauritius, where in addition to historical connections, special tax privileges have played a key role.

There is demonstrated evidence that well-managed FDI contributes to growth, regardless of its origins; international competition for FDI is more intense. There is a greater diversity of sources as compared to earlier periods of American and European domination, and even quite low-income countries are investing abroad.

The Commercial Environment: The large variations in the foreign presence amongst different economies are explained fundamentally by the attractiveness of the host economies to FDI. This in turn reflects the rate of economic growth in each and the ease of entry for foreign investors. A number of factors determine this-Three I's (incentives, infrastructure and institutions) which include proxies for human capital, quality of physical infrastructure, institutional quality and country risk and financial development. As economies open up, governments have to make the transition from protectionist/regulatory regimes to a new emphasis on promotion and efficiency. Thus, there needs to be more effective industrial extension, Research & Development (R&D) and other support schemes, better physical infrastructure, legal reforms, improved education and administrative reforms and simplifications. Broader still are the issues of country risk and policy predictability. Hence, countries' performance according to a range of "competitiveness" variables listed earlier is central to both to attracting FDI and to economic progress.

Moreover, domestic investors are invariably the key players in any economy and they weigh heavily in MNEs' international location decisions.

The PRC's human capital base is comparatively strong, with near universal literacy and segments of technical excellence. It is also increasingly able to tap into a very large international diaspora. It has R&D strengths, some military related, or present owing to the past emphasis on heavy industry. It is rapidly opening up to foreign trade and investment. Its commercial institutions have been historically weak and the country continues to score poorly in international comparisons of corruption and protection of property rights. But institutional quality is improving quickly, especially in regions most connected to the international economy. Physical infrastructure is being upgraded rapidly although its quality spatially is very uneven.

The 1991, reforms and their aftermath have begun to transform India's commercial Environment, but the unfinished agenda is large and complex. Its human capital and R&D base has pockets of international excellence, most notably in Information Technology (IT) and in some defense related heavy industry. Until recently and in contrast to much of East Asia, its educational priorities resulted in centers of international quality alongside quite high levels of illiteracy. It also differed from East Asia until recently in that its inward-looking strategy meant that it was unable to exploit its human capital strengths in the global economy. Thus, in contrast to the PRC, its major intrusion into the international IT industry has been via services rather than manufacturing. Its commercial environment is broadly predictable and the legal system cumbersome but independent. Economic policy making is dispersed and decentralized. A large diaspora facilitates its connection with the international economy.

Government policies are important to maximize the benefit of foreign presence. As trade and regulatory barriers come down, FDI motives typically shift from "rent-seeking" to "efficiency-seeking", i.e. as the rents associated with a highly interventionist regime diminish, MNEs assess potential investment locations on the grounds of costs and efficiency. Host country policy priorities therefore need to adjust accordingly from dispensing rents and patronage to providing high quality institutions and infrastructure, which, of course, also benefits domestic investors. The faster the reform process, the faster this policy reorientation need to proceed.

There have, of course, been differences in the approach to FDI among different countries in relation to timing, speed of liberalisation, modalities of capital inflows and particular benefits sought from FDI. In PRC, there is the transition from planned to market economy and progress towards a unified policy regime. In India, the challenge is to build on the earlier reforms and to become more "East-Asian" in its labour-intensive export trajectory.

Factors Affecting FDI- Investment Climate, Business Environment &Integration with the Global Economy

Investment Climate

The table includes World Bank sponsored firm-level investment climate surveys covering more than 50,000 firms in 63 developing countries for 2001-05. A good investment climate requires government policies that provide an environment for firms and entrepreneurs to increase productivity, create jobs and contribute to growth and poverty reductions. The goal is to create a better investment climate that benefits society as a whole, not just firms. Here the governments face four primary challenges-(i) restraining corruption by public officials, firms and other interest groups, (ii) establishing credibility by maintaining economic and political stability and restraining arbitrary behaviour by the key agencies of the state, (iii) fostering public trust and legitimacy through open and participatory policy making, transparency and equity, (iv) ensuring that government policies realistically effect current conditions and continue to adopt to changing economic and business conditions. The indicators of investment climate as shown in the table cover 8 dimensions. The figures for China are for the year2002 and for India 2003.

Table 4: Investment Climate

Indicators	China	India
Policy Uncertainty: Major Constraint	32.9	20.9
Corruption: Major Constraint	27.3	37.4
Courts: Major Constraint		
Lack of Confidence in Courts to Uphold Property Rights	17.5	29.4
Crime: Major Constraint	20.0	15.6
Regulation & Tax Administration		
Tax Rates as major Constraint	36.8	27.9
Time Dealing With Officials as % of Management Time	12.6	15.3
Average Time to Clear Customs-days	7.9	6.7
Finance: Major Constraint	**22.3**	**19.2**
Electricity: Major Constraint	**29.7**	**28.9**
Labour: Major Constraint		
Skills	30.7	12.5
Regulation	20.7	16.7

Source: 2006 World Development Indicators, World Bank.

India fares poorly vis-à-vis China w.r.t. corruption, lack of confidence in courts upholding property rights and time taken to deal with officials, but china fares poorly w.r.t. policy uncertainty, crime, tax rates, finance, availability of skills of average workers and labour regulations.

Business Environment

The table presents key indicators for the year 2005 on the environment for doing business, identifying regulations that enhance or constrain business investment, productivity and growth.

Table 5: Business Environment

Indicators	PRC	India
Starting A Business		
No. of Procedures	13	11
Time Required (Days)	48	71
Cost % of Per Capita Income	13.6	61.7
Registering Property		
No. of Procedures	3	6
Time Required (Days)	32	67
Dealing with Licenses		
No. of Procedures to build a Warehouse	30	20
Time Required (Days)	363	270
Hiring & Firing Workers		
Rigidity of Employment Index: 0(less rigid) to 100(more rigid)	30	62
Enforcing Contracts		
No. of Procedures	25	40
Time Required (Days)	241	425
Protecting Investors		
Disclosure Index:0(less disclosure) to 10(more disclosure)	10	7
Closing a Business:		
Time to Resolve Insolvency (years)	2.4	10.0

Source: 2006 World Development Indicators, World Bank.

Whereas china fares poorly vis-à-vis India w.r.t. number of procedures required for starting a business, India fares poorly w.r.t. both time required (number of days) and cost (% of Per Capita Income). Again, India fares poorly both w.r.t. number of procedures regarding registering of property and China scores less w.r.t. dealing with licenses both in number of procedures and time required (days).

India fares very poorly w.r.t. hiring and firing of workers-rigidity of employment index being more than double that of China. Both fare very poorly vis-à-vis USA.

Integration with the Global economy

The table represents standardized measures of the size of trade and capital flows relative to GDP. The numerators on trade and private capital flows are based on gross flows that capture the two way flow of goods, services and capital. Gross flows are better measure of integration because they show the total value of financial transactions during a given period. Trade in services is an increasingly important element of global integration. The difference between the growth of real trade in goods and services and the growth of GDP helps to identify economies that have integrated with the global economy by liberalizing trade, lowering barriers to foreign investment and harnessing their abundant labour to gain a competitive advantage in labour-intensive manufacture and services.

The table includes net inflows and outflows of FDI, based on BOP data reported by the IMF. FDI may be understated in many developing countries. Some countries fail to report reinvested earnings and the definition of long-term loans differs among countries. Underreporting is more so when investors are attempting to avoid controls on capital and foreign exchange or high taxes on investment income.

Table 6: Integration with the Global Economy

Indicators	PRC	India
Merchandise Trade (% of GDP)		
1990	32.5	13.1
2004	59.8	25.0
Trade in Services (%of GDP)		
1990	2.9	3.4
2004	7.0	8.2
Growth in Real Trade less Growth in Real GDP (%age Points)		
1990-2004	5.7	6.8
Gross Private Capital Flows (% of GDP)		
1990	2.5	0.8
2004	10.0	5.9
Foreign Direct Investment (% of GDP)		
Net Inflows:		
1990	1.0	0.1
2004	2.8	0.8
Net Outflows:		
1990	0.2	0.0
2004	0.1	0.2

Source: 2006 World Development Indicators, World Bank

China is more integrated with global economy than India, which is reflected in merchandise trade as %age of GDP, which is more than double that of India; whereas trade in services as %age of GDP, India's share is higher. Gross private capital flows stand at 10% of GDP at 2.8% for net inflows for China, but only 0.8% for India.

Impact, Challenges and Tasks Ahead

Signs of economic overheating in China included the extraordinary investment growth rate, rising prices of raw materials and shortages in some sectors (e.g. oil, electricity and coal). Power consumption increased rapidly and 21 out of 31 provinces suffered blackouts in 2003. Concerns focused on the possible over investment industries such as steel, automobile manufacturing, aluminium and cement as well as the rapid rise in bank lending, particularly in real estate. Concerned at patches of economic overheating and unbalanced socio-economic development, the government has taken steps to control credit expansion and is emphasizing a more balanced approach, with help for rural areas. But the country faces many challenges- including a weak banking system, state enterprise reform, job creation and poverty reduction.

In India, GDP is growing steadily, the markets are buoyant and the B.O.P. position is comfortable. A recent IMF study suggests that growth acceleration in the services sector is explained by high income elasticity of demand, user industry demand and rising exports, in addition to reforms and the technological advances. Industry also recorded robust growth, which was broad-based among capital, consumer and intermediate goods. However, the large fiscal deficit, short-term and reversible nature of foreign exchange inflows, poor quality of infrastructure and slow growth of employment are concerns as are the poor performance in human development and growing intra-regional disparities.

Supporters of FDI contend that foreign investors introduce a package of highly productive resources into the host economy, including production and process technology, managerial expertise, accounting and auditing standards and knowledge of international markets. The challenge for the host economy is to benefit from the MNE presence and appropriate some of the increased income accruing from the resultant productivity growth. The large literature on FDI impacts suggests that host economies benefits are quite uneven, both across and within countries. This suggests that host country policies are an important factor in the distribution of these benefits –like commercial environment, institutional quality and supply-side capacities. Other things being equal, a larger presence is associated with faster economic growth and technology spill-overs within countries, from foreign to domestic firms.

Also, there are positive "crowding-in" effects of FDI like, positive technology and trade effects together with various dynamic externalities such as clusterings and negative "crowding-out" effects like-anti-competitive impacts (e.g. displacement of domestic firms or investment) bidding scarce resources (e.g. skilled labour, credit) away from domestic firms or squeezing out domestic supply networks as new foreign entrants bring with them integrated upstream and downstream supply chains.

It is now increasingly accepted that the distinguishing characteristics of FDI are its stability and ease of service relative to commercial debt or portfolio investment as well as its inclusion of non-financial assets in production and sale processes. Aside from increasing output and income, potential benefits to host countries include-access to superior technology, increased competition reducing domestic prices, increased domestic investment and export market access.

Terms of Trade Effects

As China's investment rate eases from its current high level, FDI flows may abate. Instead, Chinese firms and households may seek to expand their portfolios and direct investment abroad. While world as a whole may gain, but some developing countries may suffer from Chinese competition for scarce international capital. An alternative view is that the increased FDI going to China will complement flows to the rest of the region and indeed outward FDI from China to other economies will expand further (Asian Development Outlook,2005).

As trade integration proceeds, more competition with Chinese goods from labour abundant countries may reduce the demand for their products, thereby reducing their prices and resulting in adverse terms of trade effects. These will have significant impact on the sectoral composition of output and on income distribution within, as well as, across countries. Given China's abundance of less-skilled labour, its emergence could raise worldwide returns to capital and skilled labour, while lowering relative rewards for unskilled labour. Consequently, some sectors or groups in certain countries could be highly vulnerable to increased competition from China. China's integration may affect the incentives for factor accumulation and productivity growth, not only in China but also in other countries, through terms of trade effects and increased competitive pressures (World Economic Outlook, 2004).

Employment Effects

The employment effects of FDI are not decisively proved and show a mixed trend. Moreover, wages are more likely to rise only for a small portion of the labour-force employed by the foreign investor. By creating a favoured local group, this can lead to greater income-disparity within the host country. Overtime, however, and given a conducive policy environment, linkages and leakages emerge.

Social Impact-Poverty

The critics of globalization (trade and FDI) agree that whereas it may be economically benign in the sense of increasing the pie of national economic growth, it is socially malign and cause of many social ills like-accentuation of poverty in both rich and poor countries, MNCs seeking profits by exploitation of labour, erosion of unionization and other labour rights and the deterioration of the environment.

Bhagwati,J. (2005) suggests that the host countries have to devise institutions to deal with the downslides as and when they arise, maximal speed is not necessarily the optimal speed , so cautious adjustment is needed, supplementary policies are needed to accelerate the pace at which the social agendas are advanced. Both China and India have radically reduced poverty by pulling large number of poor into gainful employment. According to Asian Development Bank (ADB), poverty declined from an estimated 28% in 1978 to 9% in 1998 in China. Official Indian estimates report that poverty fell from 51% in 1977-78 to 26% in 1999-2000. So, globalisation in terms of trade and FDI, helps, not harms, the cause of poverty reduction in poor countries.

According to ADB Millennium Development Goals (MDGs): Progress in Asia and the Pacific (2006) report, the Asian and Pacific region as a whole is on track to achieve most MDGs, but progress in many individual countries is slow and unsatisfactory as the absolute size of social and economic deprivation remains enormous. Two-thirds of Asians or a total of 1.5 billion people are still without access to basic sanitation. The region is also home to roughly three times as many underweight children and people living on less than $1 a day as sub-Saharan Africa and Latin America combined. The gaps within countries can be as stark as between countries even in places that have seen spectacular development such as China and India. In 1990, 28% of the developing world's population lived in extreme poverty. By 2002, the proportion decreased to 19% with much of Asia showing the most significant progress. The proportion of people living on less than $1 a day, decreased from 39.4% to 31.2% in Southern Asia and from 33.0% to 14.1% in Eastern Asia (Hindustan Times, 2006).

James Wolfensohn remarked – "in the next 25 years, out of 8 billion people, 6.8 billion will live in the developing world". Unless there is an equitable and broader distribution of income, you will have poverty, which will be created and expanded resulting from lack of infrastructure and government apathy leading to despondency and despair. Private sector investments into manufacturing or infrastructure get limited to smaller geographical spreads due to a perception of higher risks and the government is unable to put up investments as revenue collections are poor. But he suggests that a direct linkage should be established between profits and environmental and social objectives. Investment in development is a business protection and sustainability cost and this belief will channel resources from private enterprises towards a holistic development of people and nations. Apart from the huge humanitarian effort, it also protects and sustains their markets of the future (Hindustan Times, 2006).

Problems and Challenges

India faces many challenges like-limited technology transfer; development of a favoured class reaping benefits; growing consumerism; allowing manufacture of products like coke, pepsi, fast food joints, toothpaste, cosmetics etc., where little technological advancement is there; liberal tax breaks and other incentives; some computer companies like Intel sucking technology out of India and exploiting intellectual capital; giving preferential treatment in allocation of scarce resources like land and round-the-clock electricity supply; creation of a digital divide in the country; uneven regional development and infrastructural facilities; absence of any significant investment in the local design and manufacture of advanced electronic equipment, computer chips or telecommunication hardware; much of investment going into taking over existing Indian enterprises (M&As) rather than creating new productive capacity (Greenfield Investment) or towards speculative investment in the Indian stock market. Even 100% subsidiaries are allowed in non-technical areas. Moreover, these are being financed by Indian banks and financial institutions; large-scale tax-evasion, unethical practices (Enron Debacle).

R&D: A study conducted by the National Institute of Science, Technology and Development Studies (NISTADS) says that between 1990 and 2002, 266 patents were filed in the US Patent and Trademark Office (USPTO), by companies for research done in India. Most are for high-tech products that have a huge market in the US. The cost of research in India is one-tenth of the cost in the US. Therefore, these companies have set up their R&D centres in India. The West is deriving financial gains from our scientific know-how (Hindustan Times, 2006). The interest of foreign companies in Indian research saw an exponential rise after 1999, when India implemented a new TRIPS-consistent IPR regime (World Investment Report,2005).

Security Concerns: In India, the National Security Council has proposed to impose security related restrictions and screening of FDI proposals, especially from Pakistan, Bangladesh, China, HK and Macau, Afghanistan, Taiwan and North Korea. FDI from tax havens such as Mauritius must be subject to full disclosures of actual and beneficial ownership. Some sensitive and strategic sectors are identified like-seaports, airports, aviation, telecommunications, internet services and shipping Hindustan Times, 2006).

Energy Consumption and Carbon Emission: According to a Price waterhouse coopers Report, titled "The World in 2050", the rapid growth of emerging economies like China and India could pose a serious long-term impact on global energy consumption and carbon emission. The carbon emission from these two countries will more than double by 2050 causing serious threat to global warming. India's share of global carbon emission will increase from current 4.4% to 6.7% in 2025 and further to 11.4% by 2050. Similarly, China's share will increase from 17.3% now to 24.3% in 2025 and to 24.8% in 2050. On the other hand, the report says that developed countries-particularly the US and Japan-will significantly reduce its share of global carbon emission by adopting clean technology, fuel efficient vehicles and developing renewable sources of energy. Currently, the US is the country with the largest carbon emission in the world, with 22.9% of the global share followed by China and Japan at 17.3% and 4.9% respectively. The US's share is projected to come down by 16.5% by 2025 and further down to 14.5% by 2050. Japan's share is expected to fall to 3.9% by 2025 and 2.7% by 2050 (Hindustan Times, 2006).

Protectionism

A real problem now lies in the protectionism, which seems to be plaguing some of the leading rich countries like US and France, e.g. the fears about outsourcing resulting in curtailed employment in their home countries. Those very countries, which were outright supporting liberalization and free trade, are protecting their agriculture with high subsidies.

Conclusion

FDI has grown in importance in the global economy with FDI stocks now contributing over 20% of global GDP. In the last few years, the emerging market countries such as China and India have become the most favoured destinations for FDI and investor confidence in these countries has soared. But, this has also given rise to various problems and challenges as well. The agenda for future lies in devising appropriate policy framework to deal with problems of equitable distribution of growing size of GDP, removing regional imbalances, eradicating poverty, meeting infrastuctural constraints, competition amongst themselves, security concerns, taking measures to prevent over-heating or downslides, to meet growing resilience of developed countries, coping with environmental challenges etc. and thus moving towards sustained development.

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