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This study undertakes a comparative analysis of the foreign direct investment (FDI) flowing from the multinational corporations (MNCs) into China and India over the period 1992 to 2001. On the whole, the yawning gap between China and India in attracting the non-debt creating FDI flows raises some important fundamental questions about its actual FDI potentials. What could be the possible reasons behind China's success in attracting FDI inflows? Has the Chinese FDI been said to take place at least partially, at India's expense? Can India possibly become an FDI destination as attractive as China? Who are the target groups of foreign investors for India? What lessons can India possibly derive from China to attract these investors? An effort is made in this study to answer these questions. We attempt to explore the patterns of FDI inflows by the MNCs into these two countries and analyze their differences. We also examine the prevailing investment climate to account for these differences and finally suggest possible lessons for India.

The study mainly focuses on areas where it is possible for India to attract larger FDI inflows provided appropriate specific and generic MNC-friendly policies are put in place. These are the retail-trade sector, export-oriented manufacturing, the creation of sufficient number of Special Economic Zones of quality and the proactive role of the state governments in aiding the FDI process in conjunction with the Central government and the private sector. On the basis of an extensive examination of the Indian and Chinese data, the paper concludes that India falls short of China in all these respects. This study recommends the Indian government to redesign its policies in each of these directions. Some of the other recommendations include, desirable infrastructure facilities, relaxation of small-scale industry regulations, lower commodity and utility prices, lower indirect taxes, lower import duties on raw materials, fiscal and other fillips to encourage some specific types of investment, incentives for new business promotion, harmonization of government policies and reduction of red-tapism.

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1. Introduction

1.1 Background

The official statistics of foreign direct investment (FDI)¹ inflows in China and India exhibits a remarkable discrepancy that consequently establishes the unmatched superiority of China in attracting FDI inflows. China ventured into the path of liberalization in 1979 by gradually liberalizing and opening up its economy². Removal of restrictions on inward FDI has figured out to be one of the prominent features in the Chinese reforms. China has indeed achieved remarkable success in FDI since it formally opened its door to FDI with the passage of the “Law of People’s Republic of China on Joint Ventures using Chinese and Foreign Investment” in 1979. By virtually having their non-state sector (counterpart of India’s private sector) run on free market principles and setting up large special economic zones, encouraging competition among Chinese provinces to attract FDI, offering substantial tax concessions, permitting the leasing of land and property, introducing government guarantees for investment and special arrangements regarding retention and repatriation of foreign exchange, China has been able to attract significant sums of FDI inflows (Bajpai and Jian, 1996; Bajpai, Jian and

¹ Simply speaking, FDI can be defined as a financial stake a foreign company acquires in a domestic company. FDI is the category of international investment that reflects the objective of a resident entity in one economy (“direct investor” or parent enterprise) obtaining a ‘lasting interest’ and control in an enterprise resident in another economy (“direct investment enterprise”) (International Monetary Fund (IMF) Balance of Payments Manual, Fifth Edition, 1993). The two criteria incorporated in the notion of “lasting interest” are the existence of a long-term relationship between the direct investor and the enterprise and, the significant degree of influence that gives the direct investor an effective voice in the management of the enterprise. An equity capital stake of 10 percent or more of the ordinary shares or voting power in an incorporated enterprise, or its equivalent in an unincorporated enterprise, is normally considered as a threshold for the control. If a shareholding of 10 percent or more is acquired eventually by a non-resident who entered initially through the portfolio route but holds investment aggregating over 10 percent through the purchase of additional shares in subsequent transactions, those additional shares should be regarded as a part of FDI.

² Huang (2002) has classified the FDI regime in China into four distinct phases:
1979-1985 – Permitting FDI
1986-1991 – Selectively encouraging FDI
1992-1996 – Substantial FDI liberalization
1997-2000 – Streamlining FDI approvals and World Trade organization (WTO) agreement.

Sachs, 1997). This has made possible the acceleration of transfer of technology and modern management skills as well as providing foreign exchange (Chunlai, 1997).

China's huge market size with its 1.3 billion consumers, liberalized FDI regulations and improvement of infrastructure and its abundant supply of cheap labor are attractive to foreign firms (Zhang, 2001). While FDI in 1980 was virtually minimal (about 596 million)³, within a span of 21 years, China's annual FDI inflows are way over \$40 billion. As is evident from Table 1, in 2001 China attracted \$46.8 billion in FDI, a 14.9 percent increase over 2000, according to the United Nations Conference on Trade and Development (UNCTAD). Low wages and low labor costs, membership in the World Trade Organization and a rapidly developing domestic consumer market add up to make China a "highly favored" destination for FDI. This foreign investment was distributed over manufacturing, retailing (chain stores) and real estate (apartment buildings) rose 13 percent to \$52.7 billion according to the Ministry of Foreign Trade and Economic Cooperation. The large amount of FDI helped China surpass the United States as the world's top recipient of FDI. Rising foreign investment is helping China to grow at the fastest pace among the world's top 10 economies. In 2002, China's growth accelerated to 8 percent from 7.3 percent in 2001⁴.

India, the only developing country of size and diversity of industrial base comparable to China, has also adopted a similar path of liberalization since 1991, by slowly shedding its FDI restrictions and allowing FDI through automatic route barring a few strategic industries of security concern (Dasgupta 1999). It is important to note that in 1997, India had joined the band of the top ten developing country recipients of FDI flows, whereas China had already acquired prominent positions at least since 1991 (World Bank, 1998).

The government of India is actively pursuing a more open door policy for foreign investment to enhance the potential for India to become an attractive FDI destination (EPW, 2000). For example, the Indian government has decided to allow 100 percent foreign equity in crude oil refining and in e-commerce. In power projects most restrictions have been removed and 100 percent equity participation has been made permissible. The requirement that foreign companies in 22 consumer goods industries had to bring in, within a specified period, foreign exchange through exports to balance their foreign exchange remittances on account of dividends has been done away with (EPWa, 2000). The government of India formed the N.K. Singh Committee on FDI in 2002 (Government of India, 2002) that has made some major recommendations for raising sectoral caps on infrastructure industry and other areas including financial services and real estate for attracting \$8 billion by way of FDI in the Tenth Plan (See Annexure 1).

³ Chen, C., Chang, L. & Zhang, Y (1995), "The Role of Foreign Direct Investment in China's Post-1978 Economic Development", *World Development* 23(4), 691-73.

⁴ http://www.bizasia.com/investment_/f932c/china_reports_record_direct.htm

The FDI inflow has marginally increased to \$3.9 billion in 2001-02. Total FDI inflows in India during 2002 were \$4.43 billion, including American Depository Receipts (ADRs)/ Global Depository Receipts (GDRs) and advance pending issue of shares. FDI inflows net of ADRs/GDRs during 2002 were 8.45 percent higher in rupee terms compared to 2001.

As a part of the ongoing effort to make FDI estimation compliant with the IMF norms, the FDI figure in India, net of American Depository receipts (ADRs) /Global Depository Receipts (GDRs) has risen from about \$3.9 billion in 2001-02 to \$5.4 billion in 2002-03. This is a spurt of about 40 percent indicating a substantial difference in the country's official FDI figures⁵ but still significantly low in comparison to China. Actual FDI inflows from 1991 (when the economic reforms were initiated) till February 2003, amounted to \$32.9 billion against total approvals of \$76.6 billion through government and Reserve Bank of India routes⁶.

Reliance of an economy on FDI can be illustrated through several indices. For example, FDI dependency can be exhibited in terms of the absorption of the cumulative total of FDI over some period. Table 1 provides a synoptic comparative view of FDI inflows in China and India over 1992 to 2001. Indian FDI stands low as compared to China in terms of the accumulated FDI over this time span. While the cumulative FDI that India has received in a decade of liberalization (1992-2001) is a total of \$20.49 billion, the corresponding figure for China is \$364.26 billion, nearly 18 times higher than that of India. The annual FDI inflows of over \$46 billions of China compared with a trivial amount of \$3.4 billion (7.26 percent of Chinese FDI inflow) into India in 2001⁷. China alone attracted over a quarter of total FDI inflows to the developing nations over the decade, thus serving as both an attractive local market and also as an export platform for multinationals. The corresponding figure for India was a mere 1.2 percent.

Apart from the absolute size of FDI, we could also inspect the FDI inflows relative to the size of the economy. The share of FDI inflows in GDP has been also very small for India compared to China. Table 2 gives a picture of FDI as a percentage of GDP for India and China for some selected years over 1997 through 2001. The FDI-GDP ratio

⁵ The enhancement of the FDI data is due to incorporation of more items like earnings reinvested by the MNCs operating in India and intra-corporate debt transactions. Data on reinvested earnings with regard to 3,000 major companies have been included in FDI figures for '02-03. A process to collect the data from a total of over 10,000 companies is on, while this has not been accounted in the 02-03 figures. The areas that still need to be explored for FDI calculations are investment by MNCs for establishment of branch offices, and money flowing to a subsidiary from its parent corporation as grants.
Source: The Economic Times, 2nd May, 2003.

⁶ The Financial Express, 7th June, 2003.

⁷ However, it appears that the gap between these two estimates may be exaggerated owing to technical issues in measurement. Reserve Bank of India (RBI) is presently evaluating some modifications in the way that Indian FDI is measured, which could yield somewhat higher estimates for India. This issue is discussed in Bajpai and Dasgupta (2003).

for India is not only very low in comparison to China, it is very small in absolute terms, remaining less than one over the selected periods. On the whole, the yawning gap between China and India in attracting the non-debt creating FDI flows has indeed been a matter of significant policy concern for India, because in the process India has lost and continues to lose a lot of markets and a lot of FDI to China.

By China's high standards, the financial stake of a foreign company in a Chinese concern must be at least 25 percent to qualify as FDI. Even by these standards, China attracts enormous amounts of FDI. UNCTAD's ranking of countries based on FDI relative to the size of the economy was 121 for India and 61 for China for the period 1988 to 1990. The corresponding figures for 1998-2000 are 119 and 47 respectively. While India has improved marginally, China reveals a huge success in terms of FDI ranking (Nagaraj, 2003). In 2002, the A.T. Kearney survey also found that China outranked the U.S. as the most attractive destination for FDI. The importance of FDI to China is readily apparent.

These discrepancies in the relative FDI attracting capabilities of India and China raise some important fundamental questions about the actual FDI potential of India. Can India possibly become an FDI destination as attractive as China? Who are the target groups of foreign investors that are likely to invest in India? What lessons can India possibly derive from China to attract these investors?

1.2 Objective of the Paper

The existing FDI-gap between India and China in terms of the constituent elements of FDI has been explored in Bajpai and Dasgupta (2003). The paper raised an important point that is usually overlooked in comparing the Indian and Chinese FDI, that is, the expatriate investment is a very small portion of aggregate FDI in India and the expatriate Indians do not form a large segment of the target investors in India, unlike in China.

A substantial portion of the FDI to China comes from overseas Chinese living in an arc of Pacific Rim, especially in Hong Kong, Singapore, Taiwan and Macao. This Chinese diaspora pioneered export-led growth with labor-intensive manufacture (e.g. toys, wigs and textile assembly lines) in Taiwan, Hong Kong and Singapore, and, once wages there rose sharply, they re-located these manufacturing operations to mainland China⁸ when the economy was opening up in the 1980s taking with it the huge volumes

⁸ Chinese government, through a decree passed on 18th August 1990, provides for special rules and regulations to encourage investments by overseas Chinese. The government has thus pursued an active policy to attract investments by the Non-resident Chinese (NRCs). This shows that China has maintained its links with the Chinese abroad, both culturally and economically.
CII News, Confederation of Indian Industry (CII), [Press Releases: January, 2003](http://www.ciionline.org/news/pressrel/2003/Jan/8Jan5.htm+nri+fdi+state+sector+india&hl=en&ie=UTF-8)
<http://216.239.57.100/search?q=cache:kImcg6FdnGMC:www.ciionline.org/news/pressrel/2003/Jan/8Jan5.htm+nri+fdi+state+sector+india&hl=en&ie=UTF-8>.

of FDI that the country is now known for. This possibly explains, at least partially the present Chinese export machinery centering on the manufacture and shipping of light manufactured goods.

The Chinese official statistical database does not provide disaggregated FDI statistics that would directly project the relative contribution by the Non-Resident Chinese (NRC) population in China. However, based on the fact that a large proportion of NRCs residing in Hong Kong, Singapore, Taiwan and Macao make FDI to mainland China, we will make the assumption that, in broad terms, -- any FDI originating from these countries will constitute expatriate FDI and mainland Chinese funds routed through local financial agents - round tripping. While it is very likely that the entire FDI from these economies to China may not be totally from the NRCs, but a very large part of it actually is. Given that we're simply trying, in broad terms, to segregate FDI by NRCs and the multinational corporations⁹ (MNCs), this procedure will enable us to get at least a rough idea of the amount of FDI by the MNCs in China. Accordingly, we have computed the FDI contribution of Hong Kong, Singapore, Taiwan and Macao to mainland China over 1992 to 2001 in Table 3. It is evident that the share of OECD countries and with it the share of MNCs in Chinese FDI inflows has been rising over the 1990s while the share of Singapore, Macao, Taiwan and Hong Kong (supposedly the NRC contribution) is falling. NRC contribution, which was nearly 80.5 percent of the total Chinese inflows in 1992, has gradually decreased over the 1990s, being on an average about 60.5 percent¹⁰ over the decade. But nonetheless, even in 2001, more than 47 percent of FDI inflows to China came from these four countries¹¹.

⁹ An MNC is an enterprise that engages in FDI and that owns or controls value-added activities in more than one country.

¹¹ There is a controversy among economists regarding the volume of expatriate contribution derived from Singapore. They opine that unlike Hong Kong, Macao and Taiwan, FDI from Singapore cannot be claimed to be from expatriate sources because of the substantial MNC activity in Singapore. That is why, we have also calculated the percentage contribution of NRCs to the Chinese FDI excluding Singapore in Table 3. It is interesting to note that while the percentage contribution to FDI excluding Singapore in 1992 was slightly lower (79.37) than that including it, this figure showed significant difference over the decade and in 2001, it was 42.7%, that is much lower than the FDI contribution including Singapore. This implies, one that Singapore's contribution to Chinese FDI inflows increased over the decade and two, there is a need for undertaking a separate study for exploring the actual ratio of expatriate and MNC contribution to Chinese FDI inflows from Singapore. We intend to do that in subsequent research. Right now, we will assume that the contribution to FDI from Hong Kong, Macao, Singapore and Taiwan is an index of NRC participation in Chinese FDI inflows.

As a stark contrast to the Chinese experience, the Indian diaspora did not follow the similar route. This explains their very low investment in India (Guha and Ray, 2002; Bajpai and Dasgupta, 2002). The official statistics on FDI data in India clearly identifies the dichotomy in the source of FDI inflows in terms of expatriate and non-expatriate route that can be assumed to reflect the MNC contribution to the FDI inflows. This can be seen in Table 4¹².

Table 4 reflects the diversity in the sources of FDI data in India over 1991-92 to 2001-02. The actual total FDI in India is composed of those sanctioned by RBI's automatic approval route for equity holding up to 51 percent, those through the discretionary approval route of the Secretariat for Industrial Assistance (SIA)/Foreign Investment Promotion Board (FIPB) for larger projects with equity holding greater than 51 percent, NRI investments and also the acquisition of shares (since 1996). It is evident from the table that over the ten years following liberalization, FDI inflows from NRI sources was on an average, around 13.8 percent as compared to an average of nearly 78 percent from non-NRI sources. Thus, expatriate investment has been a very small portion of aggregate FDI in India, in spite of gradual attempts by the government to simplify the regulations involving investments by the non-resident Indians¹³ (NRIs) into the country and hence the expatriate Indians do not form a large segment of the target investors in India, unlike in China. The proportion of FDI into India flowing from the non-NRI sources has been on an average, steadily rising since 1992, reaching 97 percent in 2001. Also, on an average, FDI inflows into India from non-NRI sources have been around 5.8 times that from NRI sources. This figure is an indication of the growing interest of MNCs in India.

There exist differences in underlying motives for making FDI between the MNCs and the diaspora of the respective countries, although the differences might be fine at times. While the primary motive of the non-resident investors is profit maximization like any other rational investor, including the MNCs, yet there are some distinct factors playing a role in the selection of their respective home-countries as the venue of their investment. This could be the familiarity with the language, culture, socio-economic and political conditions of the country, pre-determined social and economic networking through relations and could even be the nationalistic spirit prevailing in them¹⁴. These

¹² The Government of India also provides another account of FDI inflows in its annual publication of *Economic Survey*. The difference between this account and the one provided by the RBI is that the *Economic Survey* classifies ADR/GDR inflows as FDI while the RBI account records them under foreign portfolio investment.

¹³ Nonresident Indians are defined as those who possess an Indian passport or whose father or paternal grandfather was a citizen of India.

¹⁴ Thus, while there may be several reasons for the non-resident Chinese (NRCs) to invest in China, expatriate characteristics surely would be playing a significant role. However, the expatriate Chinese have a theoretical choice of choosing contract production but they do not; instead they do FDI. Since China's financial market isn't that developed and China lacks proper legal institutions, it can be imagined that the NRCs would be better off making FDI rather than doing contractual production. In the case of FDI, since the Chinese government encourages it very much, they have made the rules and procedures for making FDI

factors together with the standard FDI incentives such as market size, factor cost, infrastructure and institutional endowments determine expatriate FDI into the host country. On the other hand, the MNCs would like to take care of the fundamentals of the host countries comprising the economic, legal and institutional factors that generate the FDI climate for choosing their FDI locations. From this point of view, the real FDI-attracting potential of India and China can best be understood if we consider only the flow of MNC investments in the two countries.

In view of these asymmetries between the constituents of FDI between China and India, a comparison of the overall FDI figures inclusive of the expatriate component may fail to provide a meaningful comparison of FDI between India and China. There is thus a need to disaggregate the FDI statistics between MNC contribution and expatriate participation figures that could produce a more focused and meaningful study of foreign interest in making FDI in the two countries. Also, the sectoral distribution of FDI by the MNCs would give us an insight of the areas preferred by the foreign firms for investment in the respective countries.

Moreover, it logically transpires from the above analysis that the FDI investors in India are predominantly the foreign firms, especially the MNCs. Therefore, to compete with China and other countries in attracting FDI inflows, measures need to be taken to attract increased volume of FDI inflows from the MNCs into India. China, in spite of its socialistic philosophy had opened up to MNC investment long before India, presumably with a view to securing technological expertise for ultimately starting up sophisticated hardware industries of its own (Raj 1985). Until 1991, India relied more on bilateral and multilateral loan agreements with long maturities, and relatively lesser on FDI. FDI was allowed only in designated industries with varying conditionalities imposed upon them regarding the scope and extent of domestic participation in the joint venture agreements such as local content requirements, export obligations, local R & D promotion, etc.

This study makes a comparative analysis of FDI flowing only from the MNCs into India and China over the period 1992 to 2001. Precisely, this research has both the positive and normative dimensions. Under the first, this paper explores the patterns of FDI inflows by the MNCs into the two countries and analyzes the differences. Within the normative view, it examines the prevailing investment climates to account for these differences and finally to seek possible lessons for India. India can attract FDI from the MNCs by creating for itself a conducive investment climate (Bajpai and Sachs, 2000). Perhaps, then, India can possibly withstand Chinese competition in the market for FDI inflows and achieve the benefits that FDI inflows bring in.

The paper is structured as follows. Section 2 traces out certain major characteristics of the volume and sectoral allocation of FDI by the MNCs in India in comparison to that in China and highlights the differences. Section 3 probes into some of the possible explanations behind the differences. This includes some of the recommendations as to whether India needs to implement any major policy reforms

easy and simple. Whereas in contractual production, proper procedures, legal back-up in case there are disputes are necessary.

(overall institutional or sector specific). On the basis of the above analysis, Section 4 reviews the investment climate scenario of India and points out to the possible lessons that the Indian firms and the government could learn from their Chinese counterparts to increase India's FDI-attractiveness for the MNCs vis-à-vis China.

2. FDI by the MNCs in India and China – The Quantitative Dimensions and the Sectoral Allocation Pattern

2.1 Volume of FDI inflows by the MNCs in India and China

India and China, accounting for around 40 percent of the world's population have been attracting the MNCs by their market size and diversity of economy. MNC participation in FDI in India is an old phenomenon that got largely waned out with the Monopolistic and Restrictive Trade practices Act (MRTP) Act and Foreign Exchange Regulation Act (FERA) in the 1970s. However, since liberalization, with the repealing of MRTP and delicensing, more and more MNCs are operating in the Indian economy (see Table 5). Some of them have been attracted to make FDI in India with the opening up of the economy. Many others were already present with minority shareholdings in the joint ventures. A large number of these companies have increased their holdings to 51 percent or more with the liberalization (Dasgupta, 1999). However, MNC participation in Indian FDI stands remarkably low as compared to China. This is evident from the fact that the multinationals from the Western world as well as Japan and some Asian countries have poured in more than \$300 billion¹⁵ into China over the 1990s as compared to around \$15 billion into India¹⁶.

For more than two decades, foreign capital invested by the MNCs have accelerated the development of China's manufacturing industry. Endowed with the world's largest population, China has virtually become the focal point of global corporations who seek cheap labor as well as the potential of reaching the world's largest market of consumers in an environment of policy preferences given by Chinese government to induce FDI inflows¹⁷. In 2002, China surpassed the United States for the

¹⁵ This figure is obtained in Table 3, by adding FDI inflows to China over 1992 to 2001 from Japan, Republic of Korea, Mauritius, Virgin Islands, United Kingdom, Federal Republic of Germany, France, Italy, Netherlands, Sweden, Switzerland, United States, Australia and Canada.

¹⁶ This figure is obtained in Table 4, by subtracting NRI contribution from the total official FDI inflows to India over the 1990s.

¹⁷ Most of the Top 500 MNCs in the world have been investing in China in recent years. For instance, the foreign share in the market of facsimile and video camera reaches 98% and 99% respectively, while the mobile phone 80%, the computer 75%, the car 70%, and the digital program controlled switch 50%. Now there are 8 large enterprises producing large-sealed integrated circuit in the micro-electricity industry in China, 5 of which are Sino-foreign joint venture, and one of which is exclusively invested by foreign capital. among the 5 enterprises jointly owned, only one is dominated by Chinese enterprise while 4 are dominated by foreign enterprises. In the engineering mechanics industry, there are 126 joint ventures, 36% of which are dominated by foreigners, while 47% of which are dominated by Chinese enterprises, and 17% of which are equally owned.

first time as the world's largest foreign investment receiver, with an inflow of foreign capital to the tune of US\$52.7 billion. And the mainland continues to be the favored destination of global corporations in 2003 as well, attracting US\$7.54 billion in the first two months of 2003 that rose from US\$5.88 billion in the first two months of 2002 thus indicating an increase of 28 percent for the same period this year. Contracted foreign investment, a sign of future investment, increased to US\$14.2 billion over the same period in 2003¹⁸.

While foreign investments into China have mainly been from Hong Kong and Taiwan, MNCs from the developed nations have, of late, emerged as significant investors. Even such Latin American countries as Cayman Islands have become key pushers of FDI into China. In 2001, 23 percent of the increase in FDI was by Japanese investors alone (Majumder, 2003).

We have mentioned in the above section that no direct comparison of MNC versus non-resident contribution to FDI inflows between India and China is possible because of lack of a similar database in China that categorically shows the FDI inflows coming from the expatriate sources as distinct from those coming from non-expatriate sources. As such, we have chosen to address this issue in an alternative way. We have selected a number of source countries from across the continents (excluding, Singapore, Hong Kong, Macao and Taiwan) that make significant FDI in both China and India and we have compared their respective FDI contribution in the two countries. These fourteen countries are Japan, Republic of Korea, Mauritius, Virgin Islands, United Kingdom, Federal Republic of Germany, France, Italy, Netherlands, Sweden, Switzerland, United States, Australia and Canada. Tables 6 and 7 show the country-wise FDI inflow in China and India¹⁹ respectively.

Table 8, computed on the basis of the previous two tables reflects a number of facts. First, while the FDI contribution of the aforesaid countries to China during the 1990s was only around 15 percent, that to India was nearly 67 percent. This is an indicator of the greater MNC participation in the FDI inflows of India as compared to China. This corroborates our finding in the last row of Table 4 where on the basis of 1991-2001 FDI data, we show that the participation of MNCs in the Indian FDI inflows over this period was around 77 percent²⁰.

Yifang, N., Wen, G & Xiaobo, W, (2002) "The Opportunities, Threats and Counter-measures of China's Manufacturing Industry Under the Globalization", School of Management, Zhejiang University, Hangzhou, China.

¹⁸ Ministry of Foreign Trade and Economic Cooperation (MOFTEC) website: www.moftec.gov.cn

¹⁹ Although substantial FDI inflows have taken place from Singapore to India over 1992-2000 (\$1858.91 million) and such FDI is rightfully of the MNC variety, yet to maintain parity with the Chinese scenario we have not included it in the MNC contribution to FDI inflows in India.

²⁰ The figures do not match exactly because of differences in the data sources. However the largeness of the two figures indicate a similarity of the results and hence it may be concluded that MNC participation in Indian FDI inflows over the 1990s has been substantial.

Thus, while in terms of percentages to total FDI inflows, country-wise FDI to India exceeds China, yet the individual contribution of these countries to China is much higher than that flowing to India. Looking at the China-India ratio of FDI inflows according to source countries (the last column of Table 8), we find that the FDI inflow to India exceeds China only from Mauritius. The special role of Mauritius here is likely to be the consequence of the special tax treatment accorded in India to investments routed through Mauritius. On an aggregate, FDI inflows to China from the stated source countries are more than three times that to India.

It is to be noted that Chinese FDI data till 1996 comprised 'other' investment elements as well. These 'other' elements include value of equipment supplied by foreign businesses in transactions of compensation trade, processing and assembly and value of equipment supplied in financial leasing transactions. Thus, there is no direct comparability of FDI statistics between China and India till 1996. Moreover, country-wise FDI data for China shows the actual utilization data while the Indian counterpart is available only for the approval statistics. In spite of these differences we have no option but to study the available data in the absence of alternative comparable FDI statistics for India and China. The year-wise approved FDI for India is visibly much less than the actually used FDI in China. Given the wide discrepancy between annual actual and approved FDI in India as disclosed by official reports, one can just imagine the actual FDI that really gets into India from these foreign countries. Thus, the actual MNC participation to FDI in India is much lower as compared to that in China.

We have ranked the fourteen countries making MNC investment in China and India respectively in Table 8. In terms of the country-wise breakup of FDI inflows, the most important FDI-making countries to India are U.S. (23.8 percent), followed by Mauritius (10.2 percent), and U.K. (7.5 percent). The corresponding figures for China are U.S. (rank 1 with 3.8 percent) followed by Japan (3.5 percent) and the Virgin Islands (1.8 percent).

The simple correlation coefficient between the ranks comes out to be around 0.28. This means that there is very little consistency among the relevant ranks of the two countries in terms of source country FDI. While U.S. is the forerunner in FDI in both India and China -- France, Netherlands and Sweden take the eighth, ninth and fourteenth positions in both the host countries. There is lack of consistency in the ranks among the other ten countries, of which some amount of similarity in ranks has been observed for Korea, Germany and Switzerland. Extreme differences are found for Mauritius and Virgin Islands, which have been alleged for round-tripping of FDI in India and China respectively.

Table 9 represents the trend of FDI in developing countries on an approval basis. Overall, there has been a downward trend in FDI approval in all the countries cited in the table from 2000 to 2002, presumably due to the global recession over this period. The major recipients of FDI in the ASEAN are Malaysia, Indonesia and Thailand. In 2002 though, FDI into both Indonesia and Malaysia plunged by 35-40 percent. But what is striking is that FDI approvals in India fell to \$2.3 billion in 2002, the lowest since 1993.

The fall was despite the country being one of the few which sustained its GDP growth amidst the global recession, thus contradicting the economic logic that a country with higher GDP growth should attract more FDI. This fall in FDI in 2002, can be attributed to the slow down in the inflows into the telecommunications and software sectors — in the former to \$235.2 million from \$2,059 million in 2001 and in the latter to \$145.9 million from \$323.2 million.

Paradoxically, though, actual investment by foreign investors in India stayed afloat in 2002, increasing to \$4.4 billion from the \$4.3 billion recorded in 2001. While a decline in FDI approvals mirrors a slump in foreign investors' urge for fresh investments, the surge in actual investments could mean that foreign investors, already doing business in India, were bullish. In other words, the foreign investors who had obtained approvals before this period continued to be positive about implementing their projects.

In China, on the other hand, better GDP growth has become the plank for FDI surge, with investments rising to \$48 billion in the 11 months of 2002 — a 15 percent jump over the corresponding period of 2001. Certain questions emerge at this juncture. Why then did fresh FDI shy away from India in 2002? Did China's FDI growth take place at India's expense? To seek answers to these questions we need to explore the sectoral allocation of India's FDI.

2.2 Sectoral Allocation of FDI

Increasing number of MNCs, including Fortune 500 companies across the spectrum of banking and financial services, manufacturing, information technology, power, telecommunications and services have been opening up offices in the major Indian metropolitan cities since 1997, entering joint ventures with Indian partners, or starting wholly owned subsidiaries. The presence of so many global giants, including companies from United States, Great Britain, Korea and Japan, indicates the perception that it is important to be present in the Indian market.

Table 10 describes the sectoral distribution of FDI in India over 1992 to 2002 as obtained from RBI data. As is evident from Table 10, electrical, engineering and electronic goods accounted for the major share of FDI flow into India between 1992 and 2002. In 1999-00, these three sectors accounted for a major 32 percent of the total actual FDI flows. FDI was rarely available for infrastructure projects. None of the infrastructure sectors figured in the first 10 major sectors that attracted FDI flows during 1999-00. FDI in the computers and service sectors gained momentum towards the end of the 1990s. FDI in the chemicals, finance, food and dairy products and the pharmaceutical sector have shown a remarkable decline since the mid-1990s. FDI in engineering industries displayed a downward trend, but still could retain an 8 percent share in 2001-02. The service sector attracted the most FDI in 2002 (38 percent of the total FDI, leaving 61 percent for the manufacturing sector). On the whole, it transpires from the table that while FDI in the service sector showed a rising trend, in the manufacturing sector, only electronics and computers could attract significant FDI during 2000-02. On the whole, it is observed that in India, FDI is flowing into areas where skilled labor is a major input.

The SIA data on sectoral allocation of FDI states the approval values although the ranking of FDI inflows are slightly different for the SIA data as compared to the RBI data. One reason could be that the time span varies slightly in the two data sets. Moreover, the sectors not stated explicitly in the RBI data may have been included in the category “others”. In terms of the industries where FDI has come into India, Table 11 shows that the most important sectors are telecom, electrical equipment, including computer software, energy, and the transportation industry²¹. These four sectors accounted for roughly 50 percent of FDI inflows. So far as approval is concerned, electrical equipment including computer software, energy (power and oil refineries) and electronics are the sectors that have attracted highest FDI approval indicating the priorities of development and growth of these sectors in the government. These 4 sectors have also received highest approval technology transfer (Table 12). Inflows as a percentage of approvals were highest in chemicals (excluding fertilizers), followed by transportation, electrical equipment and services²². This in turn shows the relative attractiveness of the different sectors in India to the foreign companies.

Thus, there seems to be a mismatch between the areas where Indian government has been inviting FDI (visible from the approval data) and the sectors which could in reality attract the foreign investors, except for electronic equipment, which too did not quite match in ranking. As mentioned earlier, the inflows into the telecommunications and software sectors in India slowed down in 2001. In 2002, fresh initiative in the telecom sector ebbed because of the completion of bidding for the telecom circles, and computer software lost its glamour post-9/11²³. Also, in information technology (IT), foreign investments flowed mainly through the money market (euro issues) and not via foreign companies. During 2000 and 2001, over 40 percent of the total FDI approved in the country was through euro issues. But in 2002, the share of euro issues declined to 0.7 percent, due mainly to the slump in computer software industry (Majumder, 2003).

It is evident from Table 13 that FDI in manufacturing has maintained the lead position since 1999, the different categories of which are not explicit from the data

²¹ In the 1990s, with software and telecom fever gripping India, FDI flows were largely into these two sectors.

²² FDI in India is gradually entering into the finance and service sectors and will be continuing to do so with the emerging trend of US companies outsourcing their routine services to India.

²³ It has been revealed in the FDI Confidence Index, 2002 by A.T. Kearney, that telecom and utilities investors consider India as their 25th most attractive investment destination. This is probably stimulated by new policies and regulations, including allowing telecom service providers to carry forward losses and unabsorbed depreciation, measures that facilitated the merger of Birla Tata AT&T and BPL Communications in June 2002.

source. It can be presumed that manufacturing includes all low technology as well as technology-intensive production sectors. Real estate has been upgraded from a fifth position in 1999 to a second rank in 2000. The FDI inflows in electric power, gas and water supply has been gradually deteriorating from 1999.

Although infrastructure (electric power, gas, water supply, transport, storage, post & telecom services) has attracted FDI in China as in India; in this way there is similarity between the sectoral FDI between the two countries. But remarkable difference exists in the expanse of the areas of foreign investments in India and China. FDI in China is rather extensive, being diffused over agriculture (farming, forestry, animal husbandry and fishery), mining, manufacturing and significantly into the tertiary sector. Moreover, social-welfare related sectors like education and healthcare and wholesale and retail trade that have not yet been targeted in India as sectors competent for attracting FDI inflows, but these have contributed to FDI in China. Labeled as the cheapest workshop in the world, China attracts FDI mainly into the manufacturing sector, which accounts for over 70 percent of the approvals; the service sector accounts for less than 1 percent of the inflows, which is not so in India. More than 30 percent of the FDI inflows in India were in the services sector over the 1990s (see Table 11). China has, since 1998, stepped up its efforts to encourage foreign investments into technology development and innovation. Several incentives, such as import duty exemption for equipment and technology brought into China by foreign-invested research companies, tax breaks for incomes obtained from transfer of technology, and business tax exemption to foreign enterprises transferring advanced technology, are luring foreign investors to China. Telecommunications in China is yet to be opened up to foreign investors and in computer software India has the lead compared to China.

Sectors with public relevance like media, radio, television etc. have also drawn FDI inflows. Manufacturing and real estate are the two sectors that have attracted the most FDI over the last three years. Some sectors that indicate very small FDI (less than 0.5 percent), have been recorded zero in the table. But what is important is that even these sectors (such as geological prospecting and water conservancy, healthcare, sports & social welfare, education, culture & arts, radio, film & television, and scientific research & polytechnical services) have captured the attention of foreign investors and are capable of attracting higher FDI in the future. It is interesting to note that banking and insurance has not been able to attract even 1 percent of the total FDI inflows in China, primarily due to the lack of reform in China's financial sector.

3. Probing the Causes Behind the Structural Differences in FDI Inflows between India and China

A vital query at this level could be a probe into the limiting factors that have prevented India from attracting FDI inflows in similar magnitudes and diversity as in China. China most certainly attracted large sums of FDI in the manufacturing sector, a significant part of which could definitely be channelized to India had India not been plagued with inadequacies in the prevailing policy environment that directly and

indirectly affected its FDI inflows. India's product reservation for the small-scale industry, stringent labor laws, inability of the firms to exit, if conditions so demanded, (no exit policy), lack of decision-making authority with India's state governments and hence lack of competition among Indian states to attract FDI (as against China's provinces) were some of the key factors why India lost large sums of FDI that could have probably come India's way, but instead went to China. Such restrictions in India virtually assured China's dominance compared with India. With the above factors in play, China was almost assured of facing virtually no competition from India as far as the labor-intensive manufacturing sector was concerned.

Moreover, the fall in FDI in electrical equipment manufacturing in India, especially after the removal of quantitative restrictions, might partly be because of cheap Chinese goods flooding the domestic market. FDI in electrical equipment (excluding computer software) slumped from \$208.8 million in 2000 to \$149.3 million in 2002. Also, the Indian policy-makers failed to design appropriate export-oriented FDI policies to attract foreign investors as was competently achieved in China. Not only in the manufacturing sector, but the service sector in India too requires policy reform. The retail trade industry, which is gradually receiving due importance in China as a sector of potential FDI, has been totally disregarded in India. The role of sub-national government as a catalyst to FDI inflows has also been ignored in India while decentralization of FDI seeking and related powers have given immense incentives to the respective provincial governments in China too induce and sustain FDI inflows within their own jurisdictions. This has led to healthy competition among the different sub-national governments in China to attract FDI inflows. This section will discuss some of these features that could have played their roles in retarding the FDI-attractiveness of India vis-à-vis China.

3.1 FDI in the Retail Sector in India and China

Retailing is one of the biggest private sector industries the world over, with annual sales exceeding \$6 trillion, ahead of financial services (US\$ 5.1 trillion) and engineering (US\$ 3.2 trillion). This sector accounts for about 10 percent of GDP in the western economies and has generated 18 percent shareholder returns between 1994 and 1999 as compared to banks (9 percent) and insurance (15 percent)²⁴. It is also a major employment generator in many economies (16 percent in U.S., 15 percent in Brazil, and 7 percent in China). In the developed countries, the retail industry has developed into a full-fledged industry with more than three-fourths of the total retail trade being handled by the organized sector. Modern formats of retail made their appearances in developing economies such as Thailand, Poland and China²⁵ in the 1990s primarily because of the

²⁴ "The Retail Sector in India", GPS Monograph Series Volume 1, Issue 10, October 2001.

<http://216.239.57.104/search?q=cache:bLfygT2a-rcJ:www.gpservices.net/monograph/Retail.html+retail+sector+fdi+data+india+china&hl=en&ie=UTF-8>

²⁵ In Thailand, seven of the world's top 10 retailers have made significant investments — Carrefour, Casino, Makro, Royal Ahold, Jusco have set up shop in Thailand. In China, three of the top 10 global retailers, have made investments, such as Carrefour, Wal Mart, 7-Eleven.

entry of global retail chains, mainly through FDI. Organized retail trade has also been flourishing in South Asia in recent years (see Table 14). The retail sector is also a contributor to the productivity of an economy as is evident in the U.S. where the annual retail productivity growth reached a stunning 6.3 percent in the period from 1995 through 1999, accounting for nearly 25 percent of the economy wide acceleration in productivity²⁶.

India

Retailing, within India, is a huge industry²⁷, accounting for about 10 percent of GDP and 6.7 percent of employment, while in China, retail accounts for 8 percent of GDP and again around 6 percent of employment⁹. FDI in pure retailing is not permitted in the country, but foreign retailers can operate in India through local franchisees. Dairy Farm is the only foreign retailer with full-fledged operations in India, and it made its entry into the country within a regulatory window during 1993–1995 when the government opened up a window to retail FDI.

The retail trade business in India creates about 6.7 percent of total employment, employing nearly 21 million people²⁸. It amounts to about \$180 billion market and is six times bigger than Thailand and four-five times bigger than that in South Korea and Taiwan. India has one of the highest retail densities in the world, over 12 million²⁹ small, roadside retail operations, employing about twelve million people (almost 15 percent of Indian adults). However, the sector remains fragmented, unorganized³⁰ and small³¹ in unit

²⁶ Johnson, B.C. (2002), "Retail: The Wal-Mart Effect"; The McKinsey Quarterly, 2002 Number 1. (http://www.mckinseyquarterly.com/article_page.asp?tk=406864:1152:20&ar=1152&L2=20&L3=75)

²⁷ Although retail sector is not yet officially considered as an industry in India. In practice, retailing should be officially recognized as an "industry" following which the retail sector could secure easy access to bank finance and also aid substantial growth of organized retail.

²⁸ <http://www.europeanbusinessgroupindia.com/Business%20Prospects.htm#retail>

²⁹ According to a case study in China (Rosling, A. (2002), there are 12 million kirana shops (small individually owned businesses), 96% of which are under 500 square feet with limited stock or choice but convenient local and service-oriented.

³⁰ According to a survey by AT Kearney, only 5% segment of the retail market is organized.

Source:<http://216.239.51.104/search?q=cache:vjPLqr58KUUI:www.indiaonestop.com/retailing.htm+retail+sector+survey+india+fdi&hl=en&ie=UTF-8>

³¹ As much as 96 per cent of the 5 million-plus outlets are smaller than 500 square feet in area. This means that India per capita retailing space is about 2 square feet (compared to 16 square feet in the United States). India's per capita retailing space is thus the lowest in the world.

Source:<http://216.239.51.104/search?q=cache:vjPLqr58KUUI:www.indiaonestop.com/retailing.htm+retail+sector+survey+india+fdi&hl=en&ie=UTF-8>

size no significant presence of large, efficient retailers. Most retail outlets are family-owned and offering limited products and finance facilities. Because of the small size, the retail sector is considered non-viable and is in many instances denied finance facilities by banks. The growth engines of the industry are the grocery and apparel segments. The value added at retailing is quite low due to huge losses resulting from disorganized industry and the presence of a long chain of middlemen.

The late 1990s witnessed a boom in the consumer durable industry, and improved services, and led to rising income levels, changes in life styles, higher demand for better and wider variety of products. These in turn led to increasing economies of scale with the aid of modern supply and distribution of management solutions. This prompted a situation for building an organized retail sector. Organized retailing in India is concentrated in select medium to large cities, and that too, in a limited manner with only one or two reasonably large malls per urban area. Within the retail trade as a whole, taking into account the organized and unorganized sections, barely 3 percent of the stores in the country can be classified as mid-to-large sized units³². However, the retail industry is likely to diversify geographically within the country as the purchasing power of the suburban middle class increases. Already, consumer goods firms such as P&G and Sony are beginning to find that a higher proportion of their demand is being generated by demand-side pull in India's rural areas rather than supply-side push.

But the share of the organized segment with formats like multi brand stores, malls, super stores, franchise agreements and company owned single brand stores is currently estimated to be only 2 percent of the total retailing business in India, compared to 80 percent in the U.S., 40 percent in Thailand, and 20 percent in China, leaving still untapped the large market potential³³. In India, old-fashioned 'kirana' shops dominate the retail sector, while the organized segment comprises up-market departmental stores such as Shopper's Stop, Ebony, Food World, Piramyd etc that basically take off from the western model.

Experience of other countries suggests that FDI in the Indian retail sector could enable the sector to become organized and modern. But, foreign participation in the Indian retail industry is banned since 1997³⁴, except for the cash-and-carry wholesale route³⁵ where wholesalers cannot open retail shops to sell to consumers

³² "Retailing in India"; Euromonitor Emerging Market Report, 1998.

³³ <http://www.europeanbusinessgroupindia.com/Business%20Prospects.htm#retail>

³⁴ Prior to 1997, FDI was allowed in only two retail ventures - Nanz Food Products in 1992 and Spencer and Company Ltd in 1996.

³⁵ Germany's Metro AG was the first foreign company to enter India with a cash-and-carry venture.

directly, 100 percent foreign ownership is permitted, and for franchising. This restriction has constrained the flow of funds and technology into this sector. Presently, global players are entering India, indirectly, via the licensee/local franchisee route, since FDI is not allowed in the retail sector. Dairy Farm is the only foreign retailer with full-fledged operations in India, and it made its entry into the country within a regulatory window (1993 – 1995), when the Indian government opened up a window to retail FDI.

Several surveys have been undertaken in recent years to evaluate the role of FDI in this sector. McKinsey India has undertaken such surveys either with its parent body, McKinsey Global Institute (in 2001) or in collaboration with CII (in 2003). Such studies advocate that reforms in the retail sector by way of allowing FDI can improve productivity by 2.5 percent and annual output by 12 percent, creating eight million jobs. Further, it is being argued that once productivity levels rise, huge capital inflows by foreign investors will follow in upstream activities once FDI is allowed. Also, the report felt that at present consumers were ‘deprived of price advantage, choice and variety’ and hence enhanced competition would benefit them.

According to A T Kearney, Global Retail Development Index, 2002, India ranks 4th among 30 emergent markets (see Table 15). This ranking of the emerging countries has been made according to three factors: economic and political risk, level of retail saturation and difference between GDP and retail growth time pressure. While country risk and market saturation were given 40 percentage weightage each, the time pressure was give 20 percent.

The study observes that India possesses the strength of one billion residents and a retail market that is forecast to grow at 30 percent compounded annual rate over the next five years, according to the projections of A T Kearney. In spite of the significant promise for new retailers in India, the study points out that the country is plagued with the limitations of complex tax structure, restrictions on foreign direct investment and heavy regulation.

Among legal and political constraints in India, the index factored heavy regulation of FDI in this sector, complex bureaucratic clearance process, a large number of taxes on organized retail and archaic laws leading to poor availability and high costs of real estate. Current norms do not allow majority shareholding by foreign investors in retail industry.

FDI in retailing could theoretically offer consumers with better deals in choice, price, quality, and variety³⁶, new opportunities for farmers and food processors, better employment opportunities, higher tax collection and an overall development stimulus for

³⁶ FDI in retail industry could create competition through the entry of MNCs that reduces prices, encourages product and service innovation, and generates enhanced customer experience.

the economy. It is also a major driver for urban and real estate development. Thus, the retail sector has the long-term potential of productivity gains leading to larger income and employment opportunities by stimulating agricultural growth and consumer demand. In spite of acknowledging these long-term merits of FDI in retail, the Indian government has repeatedly dissuaded from lifting its ban on the FDI in the retail sector on economic and political considerations, which is retained even in the Report of the Steering Group on FDI, Planning Commission in August 2002³⁷.

Under existing norms, the FDI in wholesale cash-and-carry forward is permitted, but not in retail trading. However, foreign retail chains are making an appearance as franchisees. Marks & Spencer, the UK's leading retail chain, and Shoprite, South Africa's largest grocery chain supermarket have come in as franchisees. While foreign retailers are eyeing India, awaiting for some clear direction in policy from the government, few of them – if any – are likely to commit large sums of money as investment, as has been identified by the McKinsey study³⁸, given that the purchasing power of the Indian middle class is lower than China's.

China

By contrast, the McKinsey Report documents that China began to liberalize retailing a decade ago but with severe restrictions. FDI in retailing was permitted in this sector in 1992 although it was restricted to a few major cities and provincial capitals including Beijing, Shanghai and Guangzhou and the SEZs. Modern, organized retailing formats made their appearance in China largely on account of the foreign investment in its retail sector. About 40 foreign retailers have secured approval since 1992 attracting \$22 billion (i.e., 3.6 percent of total FDI). Some well-known foreign retail corporations that have established themselves in the Chinese market include Nike, Wal-Mart, Carrefour, 7-Eleven, and Giordano. These retailers, amongst others, account for some of the 10 percent of total merchandise that is sold through supermarket format in China, but it has taken China's market a significantly long ten years to evolve to the present level. By 1997, 16 retail joint ventures had been signed in China, contracting an investment of

³⁷ The Report of the Steering Group on FDI, Planning Commission in August 2002 acknowledged that FDI in food retailing would lead to more efficient supply chain management systems that could reduce the price paid by consumers and price received by farmers. Thus both consumers and producers could be benefited and also a profitable avenue for FDI could be generated for the industry. But at the same time it retained the ban on FDI in the retail sector. The decision was taken in view of the possible unfavorable effect on the traditional retailers, employment scenario and the opportunities to the nascent Indian players in the retail sector. The idea is that FDI in retail will at best penetrate into metros and larger cities. Since investments will cater to a niche market (catering barely to 1 per cent of the population in select metros) it gives a lie to the argument that allowing FDI will benefit a sizeable number of consumers. Moreover, the Indian experience of organized retail segment that has modeled itself on the western retail strategies so far does not suggest any of these benefits to consumers at large. There is also the short-term possibility of loss of income by the small family-run counter stores and small traders in direct competition with the new entrants.

³⁸ "India" The Growth Imperative"; McKinsey Global Institute Report Retail Section and related exhibits (<http://www.mckinsey.com/knowledge/mgi/reports/pdfs/india/Retail.pdf>, <http://www.mckinsey.com/knowledge/mgi/reports/pdfs/india/retail-ppt.pdf>)

U.S. \$ 1.2 billion³⁹. However, China, just like India, has a large number of small corner stores as part of the retail sector, 9 million to be precise and most of them unorganized⁴⁰.

Although up until now, foreign ownership was restricted in 49 percent of joint venture with a local partner, with the latter holding majority stake, the current restrictions on FDI would be waned out within 5 years as condition of WTO entry. The study by Rosling (Rosling, A. (2002) has shown that the growth of retailing in China since the permission of FDI in this sector in 1992 has improved the quality of experience, choice and prices for the Chinese shoppers, catalyzed the growth of traditional retailers and raised the employment in retailing. Also, the majority of the leading retail outlets are Chinese-owned.

Recommendations for India

Distribution service and retail trade occupies a prominent place in the economy of a country for its potential to kick-start the process of economic development. The retail industry, nurtured properly, can benefit everyone connected with it like suppliers/manufacturers, government and workforce. The experience of China and other developing countries shows that liberalizing FDI inflows into the retail sector generates macro economic and micro economic advantages for the country. So the policy choice for India is to choose between the two alternative scenarios. Either it has to protect the existing fragmented and unorganized wholesale and retail systems or it can change policies to encourage modern retailing to generate advantages for consumers, farmers and the food-processing industry.

But, merely by allowing FDIs in this sector will not bring in investments, unless the FDI policies make it attractive for MNCs to pump in capital to fuel growth along with systems, expertise and know how that will also shorten the learning process in India. To what extent MNCs will bring their capital to the retail sector will depend on how far the government can formulate good overall economic policies thus creating the conditions for a conducive business environment. The government would need to deal with complementary areas such as labor policy, infrastructure development, fiscal management, land reforms, etc. To be more specific, the government need to rewrite the real estate laws, restructure the tax regime⁴¹, remove bottlenecks in the supply chain⁴², do away with the constraints on

³⁹ See McKinsey Report.

⁴⁰ Chan, W., Perez, J., Perkins, A. & shu, M. (1997), "China's retail markets are evolving more quickly than companies anticipate"; The McKinsey Quarterly, 1997 Number 2.

(http://www.mckinseyquarterly.com/article_page.asp?tk=406864:220:37&ar=220&L2=37&L3=97)

⁴¹ For example, the government can adopt a uniform sales tax rate across states, and time, introduce Value-Added Taxation (VAT) and also eliminate octroi wherever it is levied. It should also enforce tax collection from small retailers.

⁴² Removal of bottlenecks in the supply chain could improve the efficiency level in retailing. It could also increase the availability of products and reduce product costs.

processing, manufacturing and distribution by relaxing the small scale industry (SSI) reservations⁴³, access and develop new skills, streamline licensing process for retailing⁴⁴ and invest significantly in infrastructure. It is only through these means that it will realize the aforementioned benefits of FDI in its retailing sector, amongst others, viz. employment growth; improved supply chain, inventory and logistics management; productivity enhancements; and backward integration into increased manufacturing⁴⁵. This idea has also been supported in a study by McKinsey that showed that if retail sector and complementary reforms are fully implemented in India by 2010, productivity of large retail chains in India has the potential to touch 90 percent of U.S. levels, dramatically up from the current 20 percent⁴⁶.

3.2 Export-orientation in FDI in India and China

It is well-recognized that export-oriented FDI is an important means of expanding manufactured exports for developing countries, as it helps improve the quality and competitiveness of manufacturing industries. It is well documented that in the 1970s and 1980s, FDI played a crucial role in the rapid export growth achieved by East Asia's newly industrialized economies.

China

China has been successful in attracting huge export oriented FDI inflows in recent years. The significant role played by the foreign funded enterprises demonstrate the export-orientation of FDI in China. Table 16 shows that over the late 1990s till 2001. The share of foreign funded enterprises in Chinese exports has consistently remained over 40 percent during this period and has exceeded 50 percent in 2001. China has pushed up the MNC share in exports from 17 percent in 1991 to over 45 percent in 1999 to around 50 percent in 2001 as compared to a mere 3 percent of exports by MNC affiliates in India.

⁴³ Relaxation of the SSI reservation will allow small-scale firms to increase scale and become far more productive and competitive.

⁴⁴ State governments should make all licenses and permits for retail available through a single agency, at least at the city level. Providing one-time licenses for multiple stores in a chain will ease the bureaucratic hurdle experienced by modern retailers.

⁴⁵ Refer to the paper "How Foreign Investment Affects Host Countries" by Magnus Blomstrom and Ari Kokko, both of the Stockholm School of Economics, for further details and explanation.

⁴⁶ Di Lodovico, A.M., Lewis, W.W., Palmade, V. & Sankhe, S. (2001), "India – From emerging to surging"; The McKinsey Quarterly, 2001 Number 4.
http://www.mckinseyquarterly.com/article_page.asp?L2=37&L3=97&tk=406864:1117:37&ar=1117&pageenum=1

China invited foreign direct investors to provide the capital and the expertise to achieve export competitiveness in a wide range of sectors, including electronics, apparel, plastic toys, stuffed animals, ceramics, and many other labor-intensive sectors. In each sector, the key was to link foreign investor capital and expertise with a large and low-cost Chinese labor force. The foreign investors brought in the product design, specialized machine tools and capital goods, key intermediate products, and knowledge of world marketing channels. The Chinese assured these foreign investors certain key conditions for profitability, such as low taxes, reliable infrastructure, physical security, adequate power, decent logistics for the import and export of goods, and so forth.

Table 17 exhibits the official breakup of Chinese exports into primary and manufacturing commodities over the 1990s through 2001. It is remarkable to note that Chinese official export data does not give any category of service in its data-base. This confirms that the contribution of services in China's exports is negligible. We observe that the manufactured exports as a percentage of total exports have always demonstrated a rising trend reaching around 90 percent in 2001. Within the manufacturing exports, about 57 percent was by the chemicals, light & textile industrial products, machinery and transport equipment, minerals and metallurgical products, rubber products etc. over 1991-2001 (see Table 18). Presumably, a substantial percentage of these exports especially in the mechanical and electrical products sector was contributed by the MNCs⁴⁷.

India

Focus of FDI in India is mainly on sectors such as infrastructure, power, capital goods and food processing, all of which do not fall under export-oriented units. Only one-fourth of total approvals were directed towards major exporting sectors like textiles, chemicals & pharmaceuticals, leather goods, transport, metallurgical industries and food processing industries. Of India's export basket of software products and services, gems and jewelry, minerals, and agricultural products, FDI is allowed only in software products. India needs a larger export market for manufactured goods where FDI could flow in. For example, the handicraft sector has consistently made the largest contribution to exports over the 1990s. But since this sector falls under the reserved small-scale category, FDI is practically non-existent in this area.

Recommendations for India

Perhaps with the opening up of the small-scale industries, MNCs could be attracted and export-oriented FDI could get a significant boost. Also, comparing Table 18 (machinery and transport equipment) with Table 19 (engineering), we observe that India lags very much behind China in the export of machinery and electronics goods. This can

⁴⁷ It is documented that in the export of mechanical and electrical products, the share of foreign-invested firms rose from 43.7 per cent in 1996 to 52.4 per cent in 1999.

be mitigated if India adopts competent measures to attract FDI from the MNCs in these capital-intensive industries.

3.3 SEZs in India and China

Export-oriented industries can be fostered through the creation of different types of special economic zones. Virtually all of the East and South-east Asian countries have utilized export-processing zones (EPZs) or other special economic zones (SEZs) to help attract foreign investment and to initiate the process of manufacturing export-led growth. These zones have attempted to carve out a geographical zone in which export-businesses can conduct profitable export-oriented activities, exempt from costly regulations, tax laws, and labor standards that apply more generally within the country. More generally, the relatively successful industrial policies have had a few common characteristics. First, they have aimed to promote exports, rather than to protect the domestic market; second, they have provided subsidies on the basis of successful performance (for example, the growth of exports) rather than to cover losses; and third, they have been temporary rather than permanent subsidies (for example, a five-year tax holiday for new export firms).

China

At the center of China's strategy to attract investors' and to develop China as a major platform for labor-intensive manufacturing exports were the SEZs in which favorable export conditions were assured. The urban export-oriented enterprises in China were encouraged by the designation of a growing number of SEZs, coastal⁴⁸ open cities and economic and technological development zones, all designed to encourage manufacturing exports. These SEZs, along China's coastline, were designed to give foreign investors and domestic enterprises favorable conditions for rapid export promotion. All key aspects of the export environment were secured. Exporters, for example, were allowed to import intermediate products and capital goods duty free. They were given generous tax holidays. The exporters were assured decent physical infrastructure, often through the provision of land, power, physical security, and transport to the ports, within specially created industrial parks. China has demonstrated through its own experience that creation of SEZs attract substantial FDI for the export sector.

⁴⁸ In the early years of the reforms beginning in 1979, China began coastal development policy, resulting a marked shift in term so of producing for export. Coastal, urban-based industry can serve both the internal market and the international market, and can more readily make logistical links with foreign suppliers and customers than can interior-based enterprises. New export-oriented units are therefore heavily concentrated on the coast. Manufacturers in interior regions can of course service the domestic market, particularly in consumer goods such as processed foods, but the potential for rapid growth based on the internal market tends to be more limited than the growth based on exports to the world market.

⁴⁹ The eight EPZs in India have contributed a meager Rs85.52bn in exports (4.3% of country's exports) in 2001. That one of the reason for failure was the poor quality of infrastructure and other facilities is evident from the fact that the government invests only Rs170mn annually in the seven of the government-owned EOUs.

In 1980, the Chinese authorities set up Shenzhen SEZ, the first of its kind in the country. Today, China has five SEZs. Of these, four — Shenzhen, Xiamen, Shantou and Zhuhai — were established 20 years back and the fifth, Hainan, was set up in 1988. All the five SEZs had unique locations. Shenzhen (near Hong Kong), Shantou (a major home of overseas Chinese) and Zhuhai (near Macao) are in the Guangdong province. The other SEZ, Xiamen, in the Fujian province, is nearer Taiwan. The last was set up in the Hainan Islands in 1988 promoting the island to the Province status. Setting up these zones close to internationally reputed commercial destinations was basically for easier access to foreign investments, modern technology and managerial expertise. The strategic locations of these SEZs perhaps explain the alacrity FDI by the expatriate Chinese since the 1980s.

The locational advantage of these SEZs attracted foreign investors that spurred FDI in China — with Hong Kong accounting for about 60 percent of the total inflows. Initially, the majority of foreign investors were NRCs from Hong Kong who were engaged in trading. Later, MNCs started investing in technology-oriented sectors even as China liberalized its foreign investment policy further to attract modern technology. The Guangdong province, which has the largest number of SEZs, became the most attractive foreign investment destination. In 2001, over 25 percent of China's FDI flowed into Guangdong.

These SEZs, along China's coastline, were designed to give foreign investors and domestic enterprises favorable conditions for rapid export promotion. The SEZs were given extra-territorial rights to function as a foreign land for all financial purposes, despite being a part of the country. All key aspects of the export environment were secured. Exporters, for example, were allowed to import intermediate products and capital goods duty free. They were given generous tax holidays. Another important aspect was the attention paid to infrastructure. The exporters were assured decent physical infrastructure, often through the provision of land, power, physical security, and transport to the ports, within specially created industrial parks. The quality of infrastructure ensures that there is no stoppage of work, no delays and no loss due to bottlenecks. All the SEZs, which China has developed, are on virgin land where there was no trade or commerce earlier.

This has helped in devising the right quantum of infrastructure required to sustain a defined quantum of population. This ensures that there is no unnecessary load on the infrastructure, as the population grows unbounded. These special areas also received various kinds of favorable tax and regulatory treatment, such as tax holidays, and duty-free access to imported inputs and capital goods needed for export production. Thus, the SEZs and other special areas were akin to the EPZs that had been used in other parts of Asia as of their initial export-led growth. Most joint ventures and wholly owned foreign companies operating in China qualify for corporate tax holidays and reductions because they are engaged in production, are located in a special incentive zone or are technologically advanced or export oriented.

The Chinese SEZs are very large in magnitude, and in addition to export processing they promote activities such as commerce, tourism, housing, agriculture and

industrial production. These zones are in direct competition with each other at both the domestic and the international level. They are typically marked by minimum bureaucracy, good infrastructure, generous tax holidays for manufacturing units, unlimited duty free imports of raw, intermediate and final goods as well as capital goods.

India

India also had similar models of EPZ and Export Oriented Units (EOU). EPZs are located at various places including Cochin, Falta (near Calcutta), Kandla, Chennai, Noida, Santacruz (Mumbai), Vishakhapatnam and Surat. A unit could be set up in these zones subject to availability of space. Incentives provided to attract investment in these areas were 'zero import duty', a 'special 10-year income tax rebate' and other incentives.

But these eight special zones failed to achieve the export targets⁴⁹. There are several reasons for the failure of India's EPZs. We discuss some of them later in this section. In April 2000, the government of India introduced a new SEZ scheme. The scheme allowed for converting some of the existing EPZs into SEZs to provide an internationally competitive and hassle free environment⁵⁰ for export production and also to attract export-oriented FDI. The Export/Import Policy of 2000 (chapter 9 para 30) defined the SEZ as a specifically delineated, duty free enclave deemed to be foreign territory for the purpose of trade operations and duties and tariffs. Units may be set up in SEZ for manufacture of goods and rendering of services. All the import/export operations of the SEZ units will be on self-certification basis. The units in these zones have to be a net foreign exchange earner but they shall not be subjected to any pre-determined value addition or minimum export performance requirements.

The setting up of an SEZ unit was made open to any private, public, joint sector or state government. There would be no customs and excise duties, automatic approval for all items barring select ones on the negative list. Up to 75 percent of the earnings of the company units in SEZs could be retained in foreign exchange. The infrastructure and management in these zones were envisaged to be provided by the private promoters to ensure quality and the proper pricing of services. The units within SEZs are planned to be declared as public utility services so that sudden strikes are not permissible. All supplies going into the SEZs from the domestic markets will be duty-free, whereas in reverse the domestic sector will have to pay the equivalent amount of taxes as applicable in similar imports.

Units operating in these zones have full flexibility of operations and can import duty free capital goods and raw material. The movement of goods to and fro between ports and SEZ are unrestricted. The Government has converted EPZs located at Kandla

⁵⁰ SEZs are areas where export production can take place free from plethora of rules and regulations governing imports and exports. The objective is to bypass the bureaucratic hurdles, high tax levels and the inherent problem of poor infrastructure.

and Surat (Gujarat), Cochin (Kerala), Santa Cruz (Mumbai-Maharashtra), Falta (West Bengal), Madras (Tamil Nadu), Visakhapatnam (Andhra Pradesh) and Noida (Uttar Pradesh) into operational SEZs. SEZs are approved for establishment at Kanpur and Bhadohi (Uttar Pradesh), Indore (Madhya Pradesh), Kulpi (West Bengal), Paradeep and Gopalpur (Orissa), Dahej, and Mundra (Gujarat), Dronagiri (Andhra Pradesh), Kakinara (Kerala) and Nanguneri (Tamil Nadu).

India versus China

India, like China, is also offering a host of incentives to boost FDI at the SEZs such as duty-free imports, tax holidays, freedom from customs procedures, etc. In the Exim Policy 2002-07 as well as in the 2002 Budget, a comprehensive policy package was drawn up for attracting foreign investments in SEZs involving fiscal concessions, export incentives etc., for both the SEZ developers as well as the SEZ units. Units operating in these trade zones will be provided with additional incentives and given more flexibility in their operations, such as flexible labor laws. Not only will the government provide them the necessary infrastructure but they would be able to import raw materials duty-free and would also be able to access those from the domestic tariff area (DTA) without payment of terminal excise duty. Within the SEZ, no permission would be required for inter-unit sales or transfer of goods.

The share of SEZs in total exports in 2001 was 10.5 percent in China, whereas the corresponding figure for India in 2001-2002 was 4.4 percent (Majumder, S. (2003). Hence, the question that remains is whether the generous offering of incentives is by itself enough to ensure greater investment flows. In other words, merely switching from EPZs to SEZs, without undertaking the required structural changes, can success of SEZs be guaranteed. EPZs and SEZs are different in size — while the former is an industrial estate, the latter is an industrial township. In China, each SEZ is well over 1,000 hectares, the minimum recommended area. In India, the EPZs converted into SEZs are not even a third of the recommended size. Among the converted SEZs, the one in Noida is the largest but extends only 310 hectares. The Santa Cruz Electronics Export Processing Zone (SEEPZ), the first SEZ in India, is only 93 hectares.

Another ingredient of infrastructure is the availability of power at competitive rate. Apart from cheap power (the price of power is around 4 to 6 cents per unit), there is no power failure in China, as in India. Moreover, the concept of minimum demand (minimum amount paid whether or not power is used) for power is nonexistent in China, as in India. Also, bank interest is less than 4 percent in China as against about 14 percent in India⁵¹.

Commensurate with their size, the scope of SEZs are much wider and their linkages with the domestic economy stronger. SEZs provide supportive infrastructure

⁵¹ Business Line, September 16, 2002
<http://216.239.51.104/search?q=cache:cn0l84bxgncJ:www.thehindubusinessline.com/bline/2002/09/16/stories/2002091600160900.htm+export+oriented+FDI+india+china&hl=en&ie=UTF-8>

such as housing, ports, roads and telecommunication and, as a result, have a wider industrial base. Compared to EPZs, SEZs give more in terms of exports, industrial growth, investments, both domestic and foreign, and employment generation. Hence, undertaking the required structural changes in terms of supportive infrastructure becomes mandatory to ensure success of SEZs. The conversion of EPZs into SEZs can be successful if SEZs are carved out with the recommended size and dedicated infrastructure to provide uninterrupted power supply, for instance. With such small areas of SEZs in India, the requisite infrastructure and services required of an SEZ cannot be created nor multiple economic activities.

Decentralization of decision-making authority was also a major reason for SEZ success in China. Provincial and local authorities were made partners and stakeholders, by delegating to them powers to approve foreign investment. The SEZ authorities in China can approve foreign investment proposals up to \$30 million. In India, until recently, only State governments are allowed to set up SEZs⁵² and the powers for foreign investment approvals are vested with the Development Commissioners, who are the representatives of the Central Government.

The flexible labor laws with the hire-and-fire policy in SEZs has been one of the biggest attractions for foreign investors in China. The new labor law consists of 107 articles, but none of these is more than one paragraph. All jobs are on contract basis, which stand terminated upon the expiry of the terms, which can be fixed/flexible or for a specific job. In contrast, the labor laws in India are extremely stringent and the Industrial Disputes Act, 1947 does not allow companies with 100 or more employees to retrench labor without seeking prior permission from the concerned state government, which is very hard to come by.

In China, the major responsibility for the SEZs rests with local and provincial governments, whereas in India, the responsibilities remain heavily with Delhi. Under those circumstances, many state governments were actually averse to the idea of EPZs in their state. It should be noted, however, that since the year 2000, India has begun to put in place SEZs, similar to those in China, and the federal and state governments are engaged in the process of attempting to reform critical issues, such as labor laws, land laws, and the federal government has also been pruning the long list of items on the small-scale product reservation list.

India too experimented with special zones, mainly EPZs, but one has to say that India's approach, at least until the early to mid 1990s to export zones, as engines for attracting foreign investors, has been one of relative neglect rather than support. While China's five main special economic zones (Shenzen, Zhuhai, Santou, Xiamen, Hainan) proved to be very successful in attracting FDI, boosting exports and creating large-scale employment, India's main export processing zones, or EPZs (Kandla, Santacruz, Noida, Madras, Cochin and Falta), managed to do very little, both in absolute levels and as a

⁵² As per the 2000 EXIM policy of India, SEZs can be set-up by private sector, joint sector as well.

proportion of total Indian exports. India's EPZs have not performed as well as China's SEZs for many reasons, including:

1. limited scale and overcrowding of units in the EPZs
2. insufficient logistical links with ports and airports
3. poor infrastructure in areas surrounding the zones (e.g. unpaved roads and poor physical security)
4. government ambivalence and red-tape regarding inward FDI
5. unclear incentive packages governing inward investment, and
6. lack of interest and authority of state and local governments, and the private sector, compared with the central government, in the design, set-up, and functioning of the zones.

Recommendations for India

The SEZs in India could be fostered as SEZs investment-friendly areas so as to increase the inflow of FDI into high technology and manufacturing activities. They could create manufacturing facilities that would serve as supply partners to renowned global firms, whose brand names and global reach will give relatively easy access to world markets for parts and products made in Indian SEZs. This would require excellence in cost, quality and an ability to provide in-time delivery. SEZs should aim to provide modern physical infrastructure and the firms operating therein could help benefit from India's skilled workforce. These Zones must operate on a new set of industrial, trade, tariff and labor policies that would make investment in these zones competitive with those in China or other competing nations in Asia.

The policies and procedures for investment and various clearances must be simplified and made as transparent as possible. The success of these zones would depend on their coastal location, world-class infrastructure in high-speed highways, access to suppliers, housing, education, health, transport (air and sea), water, power, information technology and telecommunications. The central government should function in conjunction with the subnational governments and the private sector in the development of the SEZs.

3.4 Sub-national Government and FDI in India and China

Globalization has created incentives for decentralization of governmental relations in a way that allows local governments to play an active developmental role. Brazil, China and Russia are examples where regional governments have taken the lead in pushing reforms and prompting further actions by the Central Government. In Brazil, Sao Paulo and Minas Gerais were the reform leaders at the regional level. The coastal provinces in China are the fastest growing regions of China and are also leaders of China's reform process. In Russia, reform leaders in Nizhny Novgorod and in the far-east were the major spurs to reforms at the Central level (Bajpai and Sachs, 2000).

India

As mentioned previously, in India, while the State governments are allowed to set up the SEZs, the powers for foreign investment approvals are vested with the Development Commissioners, who are the representatives of the Central Government. Table 20 shows the export performances and the corresponding ranks of these SEZs over 2000 through 2003. We observe that while SEEPZ and Noida consistently maintain their first and second positions respectively, the other six SEZs have been vacillating in their export performance over the specified period. Tables 21 and 22 show that there is indeed a strong association between the performance of SEZs in terms of exports and FDI of the states where these SEZs were located. The FDI potential as perceived by foreign investors in six of these seven states where these were located (Kerala did not figure) were among the top nine states in India in 2001 (Table 21). Barring Kerala, the other six states were among the top 10 states securing FDI approvals in 2001 (Table 22).

China

One of the achievements of the sub-national governments has been in the area of attracting FDI as in China where the provincial and local authorities are vested with power to approve foreign investment up to a certain level. Table 23 shows the export performance and the FDI of the three Chinese provinces with SEZs. Although the percentage share of exports has been falling for each of these provinces (signifying the strengthening of other regions like Beijing, Tianjin, Liaoning, etc. as competing trade regions), yet Guangdong maintains the lead followed by Fujian and Hainan. The same order has been maintained for the FDIs. We have already noted that Guangdong had three SEZs. Perhaps the largeness in the number of SEZs in Guangdong explains its export performance over the other two provinces with SEZs.

Recommendations for India

Economic policy making authority has been concentrated at the central government level in India. It is essential that this authority be devolved to the states such that the private sector can function more freely in all the states. This process has started in bits and pieces and some states have attached a high priority to attracting FDI. However different state tax regimes, procedures and customs make doing business more complex.

The state governments should play a proactive role in attracting the MNCs to India. The major role that the state governments in India could play in the FDI arena is to provide an appropriate investor-friendly environment to the MNCs who are interested in making FDI in the respective states. Apart from providing incentives for SEZs in the state jurisdictions the state governments also need to review and redefine the legislations within the states' ambit like the land laws and certain labor laws that entail hire and fire policies.

Improvement of infrastructure at the state level and wider awareness of the state in the potential FDI-source countries seem to be significant factors for India. For example, according to a 2003 estimate, there were around 50 Japanese companies in Tamil Nadu, either wholly owned or as joint ventures. These companies are mainly in auto components, biotechnology and the apparel industry. But because of lack of Japanese awareness about the state of Tamil Nadu's potential, Japanese investment into Tamil Nadu has been just three percent of the total FDI in India⁵⁵.

4. Investment Climate

Since the initiation of economic reforms by the Indian government in 1991 (ten years after China's open door policy), attracting FDI has been an important area. The United Front Government had targeted FDI of \$10 billion by 1997 but, even as late as 2003, less than half of the target has been achieved. A pre-condition to FDI inflows is the creation and sustenance of a well-designed business environment. The new institutional economics literature with its emphasis on transaction costs have focused on the creation of an appropriate business environment or "investment climate" for the benefits of FDI⁵⁶ to be realized by a developing economy (Fields and Pfeffermann, 2003).

China is today the largest FDI destination. But the paradox is that its investment climate is not liberal in all directions. For example, China's FDI policy is still relatively restricted in terms of FDI forms, foreign ownership shares, access to certain activities and performance requirements. China's laws and regulations unambiguously stipulate that foreign investors can choose from among three different forms to invest in China — contractual joint ventures; equity joint ventures; and wholly foreign-owned enterprises. A comprehensive study by the OECD titled *China in the World Economy* in 2002 has said that despite China's continued priority of luring FDI with advanced technology, there

⁵⁵ "More room for Japanese investment in TN", Business line, March 19, 2003.

⁵⁶ The need for growth in FDI inflows in the developing countries made by the MNCs has assumed significant importance in recent years as a potential source of economic growth and development (Sachs and Bajpai, 2000; De Mello and Luiz, 2000). It is also viewed as a source of private investment inflows that could be used as a mechanism for alleviating poverty (Fields and Pfeffermann, 2003). Apart from the traditional argument that FDI accelerates economic growth by raising the capital stock of recipient countries, there is also the recent hypothesis that views FDI inflows as a channel of technology transfer through technological diffusion (Markusen, 1995). Access to advanced technologies lead to knowledge spillovers in via imitation, competition, linkages and training (Kinoshita, 1998; Sjöholm, 1999; Saggi 2000).

remain restrictions on the organizational forms of FDI entry⁵⁷. There are 31 industries that do not allow the establishment of wholly foreign-owned enterprises, and 32 sectors in which the Chinese partners must hold majority share-holdings or a dominant position⁵⁸.

In stark contrast to China, FDI in India is freely allowed in all sectors, including the services sector, save where the notified sectoral policy does not permit FDI beyond a ceiling. FDI for virtually all items/activities could be brought in through the automatic route under the power vested with the RBI and, for the remaining items/activities, through Government approvals. Again, as India is a founder member of the erstwhile and its successor WTO, its investment policies cannot be WTO-incompatible in terms of offering special and discriminatory treatment to foreign investors, as is the case with China, which became a WTO member only recently.

Though the policy atmosphere in China for attracting FDI is more stringent relative to that in India, what is it that still makes China the darling of foreign investors, enabling it to gain FDI in unmatched volume year after year? Basic features that help attract FDI to China, besides a stable political structure, include lower commodity and utility prices, lower indirect taxes (14 percent as against 25-30 per cent in India), lower import duties on raw materials (13 percent as against 24 percent), higher labor productivity (1.6 to five times in different segments) and low capital investment requirements⁵⁹.

⁵⁷ China's current FDI policy is still relatively restricted in terms of FDI forms, foreign ownership shares, access to certain activities and performance requirements. China's laws and regulations unambiguously stipulate that foreign investors can choose from among three different forms to invest in China — contractual joint ventures; equity joint ventures; and wholly foreign-owned enterprises. China's industrial guidance on FDI has four categories — encouraged (agricultural new technologies, new or advanced technologies which can improve the quality of products, conserve energy and raw materials etc and so forth); permitted (FDI that is not under the categories of encouraged, restricted and prohibited); restricted; and prohibited.

⁵⁸ Industries where Chinese partners must have majority shares include coal-mining, design and manufacture of civil aero planes, construction and management of oil and gas delivery pipelines, as well as oil depots and oil wharves, printing and publishing, development and production of grain, cotton and oilseeds, domestic commerce, foreign trade, medical institutions and repairs, designing and manufacturing of special, high-performance ships, and ships at or above 35,000 tonnes.

⁵⁹ Nair, G.K. (2003), "Does the economy really need FDI?" Business Line, Jan. 12. <http://216.239.51.104/search?q=cache:V5eW56h1TYIJ:www.thehindubusinessline.com/bline/2003/01/13/stories/2003011300951300.htm+state+government+india+fdi&hl=en&ie=UTF-8>

Efforts to improve investment climate in China have been augmented since 1998 when it stepped up its efforts to encourage foreign investments in technology development and innovation and initiated a transformation from low to hi-tech industries. Several tax incentives have been offered to lure foreign investors. Equipment (and related technology), components and spares brought into China by the foreign invested research and development (R&D) centers are exempt from import duty. Besides, China still extensively uses fiscal and other fillips to encourage some specific types of investment — for instance, export-oriented and technologically advanced FDI — and to guide the flows into certain targeted regions and industries.

Foreign enterprises transferring advanced technology to China are exempt from both business and income taxes. Foreign invested firms that increase their technology funding by more than 10 percent over the previous year are eligible to deduct 50 percent of the funds actually spent on technological development from their income-tax dues. Further, the technology, equipment and components imported by foreign investors for upgrading enterprises considered high-priority by the state are exempt from import duty. No such incentives are offered in India. On the contrary, the policy-makers impose obligations on foreign firms even for transfer of technology.

Corporate tax rates are much higher in India (Table 24). This is a constraint that needs to be addressed by India in order to attract FDI. India lacks adequate incentives for new business promotion, which is in place in China. For example, China offers super-national treatment to foreign firms through reduced or exempted taxes. Furthermore, there is a lack of harmonization of government policies in India.

China attracts foreign investors not only by projecting its inherent strengths but also by creating a congenial economic atmosphere. The setting up of SEZs, where business is regulated by an independent authority, has been one of the major reasons for China's FDI successes. High priority to improve its power infrastructure, which was in shambles a decade ago, also helped. At present, China's power generating capacity is thrice India's, and its power tariff, only half as much. While roads and railways are more extensively built in India, the number of ports as well as sea freight is very small in India. Also, the spread of telecommunications (in terms of people per telephone and internet connections), which has become an indispensable part of globalization is remarkably limited in India (Table 24).

Indisputably, China has overtaken India in almost all measures of economic growth and, in particular, as a recent CII-McKinsey report said, it has completely "outdone" India in manufacturing. As the study concedes, during the 1990s, China's manufacturing industrial sector grew at 12.3 percent. *Per contra*, India's grew at 5.1 percent and, as a consequence, China's manufacturing sector is much larger than India's in terms of contribution to GDP per capita share (\$1,322 vs \$381, purchasing power parity (PPP) adjusted), share of GDP (35 percent vs 16 percent) and to employment (95 million vs 45 million). China today has emerged as a major manufacturing base for the world in several products and has captured a large share of world trade in different products. It accounts for 29 percent of world trade in bicycles, 28 percent in toys, 25

percent in footwear and 20 percent in ready-made garments. In contrast, India's share of world trade is 2.2 per cent in bicycles, 0.2 percent in toys; 1.7 percent in footwear and 3.8 percent in garments.

The inescapable impression one gets about China is that its growth was fuelled not only by investment (both domestic due to high savings and FDI in directed areas and sectors by the State) but also by a phenomenal growth in labor productivity, a due stress on exports, robust domestic demand fed by low prices and with quality consciousness being the byword of companies. The McKinsey study states that China's manufacturing sector productivity is 1.6 times that of India and, in some sectors, as much as five times.

Global integration means development of borderless production to cater to the needs of both the domestic and export markets. In its decade of liberalization, India has failed to provide a competitive manufacturing base to MNCs -- neither for their export efforts nor to meet the needs of the large middle-class market. Attention has been paid largely to the development of the services sector, software in particular. Foreign enterprises have, therefore, hardly made any effort to use India as their production base for exporting to other countries. India shows the advantages of a vast labor force with a skilled engineering and scientific community. It also shows, however, deficiency in both the hard infrastructure, such as roads, ports, and power, as well as the soft infrastructure of public administration, labor market practices, and financial market depth. From the FDI point of view, an option worth considering would be to open up its service sector more boldly, even by throwing open its retail sector to FDI.

The CII-McKinsey study, supported by the DIPP, notes that subsidies, marginal pricing and poor cost accounting drive lower domestic prices in China. But it hastens to note that lower domestic prices are based on sustainable economic factors. The factors for lower prices include lower indirect taxes, lower import duties, higher labor productivity, lower capital costs and lower margins. Citing a case, the report said the Chinese price for a three-blade, 48-inch ceiling fan is 32 percent lower than the Indian price. Lower indirect taxes in China account for almost half (14.5 percent of the Indian price) of the total price difference. Higher labor productivity further decreases prices by 5 percent, while lower raw material prices in China account for another 4 percent and lower capital costs for 2.5 percent of the Indian retail price. The remainder of the price difference of close to seven percent of the retail price is the result of such other factors as margins, capital productivity and difference in specifications between the Indian and the Chinese product, e.g. the use of steel rather than aluminum blades in Chinese fans.

The study found the average incidence of import duties in China is 17 percent, and the trade-weighted average about 13 percent — almost half of India's trade-weighted level of 24 percent. Import duties on several key raw materials, such as plastics and aluminum, are much higher in India than in China. Higher import duties on raw materials result in higher prices of inputs, as most domestic players resort to import parity pricing. China has a flat 17 percent VAT rate (about 14 percent of the retail price), while India's indirect taxes range from 25 percent to 30 percent of the retail price for most manufactured products.

In view of the inherent cost and factor advantages that China enjoys to an exceptional degree, it is small wonder that, of the total FDI of \$38 billion China received in 2000, \$27 billion went to the manufacturing sector. On the other hand, India received only \$2.4 billion in FDI, of which the manufacturing sector received a little less than \$2 billion. FDI has also played a key role in boosting Chinese exports, and foreign-invested companies accounted for almost 50 percent of China's exports in 2000.

It is widely claimed that China's competitiveness is because of low wages. This is true when compared to those in Japan or the US — where it is 25 times more. But vis-à-vis India, the wages are not that low — at \$1,000 per annum on an average, it is only slightly lower than that in India. But with much higher labor productivity, China enjoys the low-wage windfall. While China and other Asian countries were going the whole hog to attract FDI, India seemed to be in no hurry to remove the impediments. For instance, over a decade back, more than 800 items were reserved for the small-scale sector, allowing only 24 percent FDI. Paradoxically though, the small-scale sector continues to be the platform, contributing to over 60 percent of India's exports. In China, foreign-funded firms contribute nearly 47 percent of the nation's exports.

Since 1991, India's FDI policy has merely involved tinkering with foreign equity holding in the manufacturing sector and negating the changes in the global pattern of FDI flow. In the latter half of the 1990s, over 80 percent of global FDI flows were related to mergers and acquisitions (M&As), with little going to greenfield investments. In India, from 1999 to 2001 (up to November), acquisition of equity accounted for a mere 12 percent of the FDI. Privatization delays and restrictive rules have choked M&A activity.

Several factors contributed to China's number one position in attracting FDI, including its market size, continued economic growth, stable political situation, sound investment environment, WTO membership, etc. A survey undertaken by CII in June 2003 of some leading Indian companies (the sectors surveyed include stainless steel, information technology, banking, pharmaceuticals and consumer goods) in China to understand the growing relationship between industry in India and China. The good side of doing business in China, according to all sectors surveyed is that the Chinese government welcomes FDI and does not seek too much documentation for companies setting up ventures in China. Next, is the high level of decentralization between the provinces and the center in terms of attracting FDI. Infrastructure and communication facilities in China are as good as in any developed country. Most provinces do not need any central clearance when the FDI amount is not very high. Also, licenses for setting up shop or even trade come fast. Most companies get their approvals in less than six months. Over 60 percent of the companies get the work done in under six months while the remaining get in under one year⁶⁰.

⁶⁰ However, the flip side of for doing business with China include problems of language, lack of clarity regarding certain domestic regulations, complexity in legal machinery for the foreigner to comprehend and implement, red tapism, lack of right talent for all jobs and lack of proper protection for intellectual property rights.

Thus, it is time that India should learn from China and improve its economic environment for attracting higher volume of investment flows on an enduring basis for long-term development by launching its second-generation of reform without any further loss of time. Accordingly, a more attractive package to lure MNCs needs to be put in place. The Indian government through its 'single window system' relating to foreign investments already aims to cut down bureaucratic hurdles. The gradual relaxation of rules has definitely encouraged more inflow of FDI. Coca Cola was able to get permission for a 100 percent wholly owned subsidiary in a week and Motorola received clearance in flat 2 days. Other Companies included Daimler-Benz, Procter & Gamble and Whirlpool. India has an edge over China vis-à-vis managerial skills, a large English-speaking population, and highly educated workforce, especially in critically short supply areas- medicine, engineering and software, low wages /salaries, which are often 10-30 percent of similar type of jobs in the west and a well-established legal system. Nevertheless, providing competitive fiscal incentives, opening up of more sectors to FDI, promoting SEZs for expanding export-oriented FDI and improving physical, and financial infrastructure are imperative in order for India to begin attracting large sums of FDI on a sustained basis.

Table 1
FDI Inflows to Developing Countries by Host Region, 1992-2001

(US \$million)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Cumulative total	Average FDI over 1992-2001
India	233	574	973	2144	2426	3619	2633	2168	2319	3403	18292	
China	11007	27515	33787	35849	40180	44237	43751	40319	40772	46846	364263	
FDI in India as a percent of Chinese FDI Inflow	2.17	2.09	2.88	5.98	6.04	8.18	6.02	5.38	5.69	7.26		4.69
Developing Countries	51108	72528	95582	105511	129813	191022	187611	225140	237894	204801		
Share of India in Developing countries	0.46	0.79	1.02	2.03	1.87	1.89	1.40	0.96	0.97	1.66		1.19
Share of China in Developing Countries	21.54	37.94	35.35	33.98	30.95	23.16	23.32	17.91	17.14	22.87		25.48

Source: World Investment Report, United Nations, various issues.

Note: The relevant average figures have been computed by taking the geometric mean of the respective data.

Table 2
FDI inflows and GDP figures in India and China, selected years

	1997	2000	2001
India – FDI (\$ billion)	3.6	2.3	3.4
India – GDP (current \$ billion)	409.7	457.0	477.6
India – FDI/GDP (%)	0.88	0.51	0.71
China – FDI (\$ billion)	44.2	40.8	46.9
China – GDP (current \$ billion)	898.2	1100.0	1200.0
China – FDI/GDP (%)	4.9	3.7	3.9

Source: World Development Indicators database, April 2002, World Bank

Table 3
Countrywise FDI (and other) Actually Used in China, 1992-2002
(US \$million)

	1992	1993	1994	1995	1996
Total FDI (& other)	11291.62	27770.87	33945.84	37805.69	421351.60
Hong Kong	7706.12	17444.93	19822.68	20185.11	201851.60
Macao	202.82	587.56	509.44	439.82	606.28
Singapore	125.93	491.80	1179.61	1860.61	2247.16
Taiwan	1053.35	3139.13	3391.34	3165.16	3482.02
Total	9088.22	21663.46	24903.07	25650.70	208187.06
FDI by the MNCs	2203.40	6107.41	9042.77	17620.58	213164.54
% of total FDI (& other) (including Singapore)	80.49	78.00	74.35	67.85	49.41
% to total FDI (& other) (excluding Singapore)	79.37	76.24	69.89	62.93	48.87

Source: China Statistical Yearbook, various issues.

Note: Chinese FDI data till 1996 comprised 'other' investment elements as well. These 'other' elements include value of equipment supplied by foreign businesses in transactions of compensation trade, processing and assembly and value of equipment supplied in financial leasing transactions.

FDI by the MNCs includes the FDI inflows in China from US, UK, major European countries and Japan but excludes FDI inflows from Hong Kong, Macao, Singapore and Taiwan.

Table 3 (contd.)
Countrywise FDI Actually Used in China, 1992-2002
(US \$million)

	1997	1998	1999	2000	2001
Total FDI	45257.04	45462.75	40318.71	40714.81	46877.59
Hong Kong	20632.00	18508.36	16363.05	15499.98	16717.30
Macao	394.55	421.57	308.64	347.28	321.12
Singapore	2606.96	3403.97	2642.49	2172.20	2143.55
Taiwan	3289.39	2915.21	2598.70	2296.58	2979.94
Total	26922.90	25249.11	21912.88	20316.04	22161.91
FDI by the MNCs	18334.14	20213.64	18405.83	20398.77	24715.68
% of total FDI (including Singapore)	59.49	55.54	54.35	49.90	47.28
% to total FDI (excluding Singapore)	53.73	48.05	47.80	44.56	42.70

Source: China Statistical Yearbook, various issues.

Note: Chinese FDI data till 1996 comprised 'other' investment elements as well. These 'other' elements include value of equipment supplied by foreign businesses in transactions of compensation trade, processing and assembly and value of equipment supplied in financial leasing transactions.

FDI by the MNCs includes the FDI inflows in China from US, UK, major European countries and Japan but excludes FDI inflows from Hong Kong, Macao, Singapore and Taiwan.

Table 4
Foreign Investment Inflows in India (1991-92 – 2000-01)
(US \$ million)

	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-2001 P	Average
A. Direct Investment	130	320	590	1310	2140	2820	3560	1660	2160	2340	1703
a. RBI automatic route		40	90	170	170	140	200	180	1410	1460	428.89
b. SIA/FIPB route	70	220	280	700	1250	1920	2750	1020	170	450	883
c. Acquisition of shares					10	130	360	400	490	360	291.67
d. NRI	60	60	220	440	710	630	250	60	90	70	259
d/A (%)	46.15	18.75	37.29	33.59	33.18	22.34	7.02	3.61	4.17	2.99	13.81
a+b+c	70	260	370	870	1430	2190	3310	1600	2070	2270	1444
(a+b+c)/A (%)	53.85	81.25	62.71	66.41	66.82	77.66	92.98	96.39	95.83	97.01	77.56

Source: Constructed from Reserve Bank of India, *Report on Currency and Finance*, various issues and RBI Annual Report, various issues.

Note: 'P' indicates 'provisional' data

The average for the first four rows have been computed using arithmetic mean and that of the fifth row has been calculated with the help of geometric mean.

Table 5
Some MNCs operating in India

Infrastructure	Consumer Durables	Consumer Non-durables	Services	Others
Alcatel	Aiwa	3M	ABN Amro	ABB
Alstom	Akai	Avon	Alliance Capital	Caltex
AT&T	Bosch	Bayer	American Express	Castrol
BT	Canon	Cargill	Arthur Henderson	Compaq
Bell Canada	Casio	Coca-Cola	ANZ	Cummins
Bechtel	Electrolux	Colgate	Bank of America	Daewoo
British Gas	Ericsson	Henkel	BCG	Daimler Chrysler
Cogentrix	Gillette	Hoechst	Citicorp	Du Pont
Deutsche Telecom	Hoover	ICI	Deutsche Bank	Fiat
Enron	LG	IDV	Dresdner Bank	Ford
Fujitsu	Levi Strauss	Johnson & Johnson	HSBC	General Motors
General Electric	Matsushita	Kellog	ING Barings	Hewlett Packard
Hutchison	Nokia	Nestle	Jardine Fleming	Honda
Itochu	Philips	Novartis	KPMG	Hyundai
Mission Energy	Samsung	PepsiCo	McKinsey & Co.	IBM
Mitsubishi	Sansui	Procter & Gamble	Merrill Lynch	Microsoft
Motorola	Sanyo	Revlon	Morgan Stanley	Mobil
Nynex	Sony	Reckitt & Colman	Standard Chartered	Oracle
Shell	Timex	Sara Lee	UBS	Siemens
Sumitomo	Whirlpool	Seagram		Suzuki
Telstra	Xerox	Smithkline Beecham		Toyota
Total		Unilever		Volvo
US West				

Table 6
Countrywise FDI (and other) Actually Used in China, 1992-2001
(US \$million)

	1992	1993	1994	1995	1996
Total FDI (& other)	11291.62	27770.87	33945.84	37805.69	421351.60
Hong Kong	7706.12	17444.93	19822.68	20185.11	201851.60
Macao	202.82	587.56	509.44	439.82	606.28
Singapore	125.93	491.80	1179.61	1860.61	2247.16
Taiwan	1053.35	3139.13	3391.34	3165.16	3482.02
Total	9088.22	21663.46	24903.07	25650.70	208187.06
% of total FDI (& other)	80.49	78.00	74.35	67.85	49.41
Japan	748.27	1361.37	2086.16	3212.47	3692.14
Korea, Republic	120.25	381.49	726.12	1047.10	1504.16
Mauritius	0.11	0.19	1.19	1.0010	0.22
Virgin Islands	4.00	13.92	128.27	303.76	537.61
UK	38.50	220.51	688.84	915.20	1301.93
Federal Republic of Germany	91.28	62.48	264.12	390.53	518.87
France	46.92	141.51	193.40	287.02	424.65
Italy	26.66	99.89	206.16	270.20	169.44
Netherlands	28.41	84.00	111.05	114.11	125.17
Sweden	10.01	22.91	24.18	24.04	56.69
Switzerland	29.44	46.88	71.60	79.38	214.41
US	519.44	2067.85	2490.80	3083.73	3444.17
Australia	35.05	110.34	188.26	232.99	194.06
Canada	59.07	136.88	216.05	257.04	337.97

Source: China Statistical Yearbook, various issues.

Note: Chinese FDI data till 1996 comprised 'other' investment elements as well. These 'other' elements include value of equipment supplied by foreign businesses in transactions of compensation trade, processing and assembly and value of equipment supplied in financial leasing transactions.

Table 6 (contd.)
Countrywise FDI Actually Used in China, 1992-2001
(US \$million)

	1997	1998	1999	2000	2001
Total FDI	45257.04	45462.75	40318.71	40714.81	46877.59
Hong Kong	20632.00	18508.36	16363.05	15499.98	16717.30
Macao	394.55	421.57	308.64	347.28	321.12
Singapore	2606.41	3403.97	2642.49	2172.20	2143.55
Taiwan	3289.39	2915.21	2598.70	2296.58	2979.94
Total	26922.90	25249.11	21912.88	20316.04	22161.91
% of total FDI	59.49	55.54	54.35	49.90	47.28
Japan	4326.47	3400.36	2973.08	2915.85	4348.42
Korea, Republic	2142.38	1803.20	1274.73	1489.61	2151.78
Mauritius	45.86	100.50	170.25	264.79	305.63
Virgin Islands	1717.17	4031.34	2658.96	3832.89	5042.34
UK	1857.56	1174.86	1044.49	1164.05	1051.66
Federal Republic of Germany	992.63	736.73	1373.26	1041.49	1212.92
France	474.65	714.89	884.29	853.16	532.46
Italy	215.04	274.57	187.44	209.51	219.98
Netherlands	413.80	718.82	541.68	789.48	776.11
Sweden	42.84	133.42	155.80	159.24	84.39
Switzerland	215.67	228.82	247.09	194.03	205.44
US	3239.15	3898.44	4215.86	4383.89	4433.42
Australia	313.74	271.97	263.31	308.88	335.60
Canada	344.12	316.52	314.42	279.78	441.30

Source: China Statistical Yearbook, various issues.

Table 7
Countrywise FDI Approval in India, 1992-2000
(US \$million)

	1992	1993	1994	1995	1996
Annual Re-dollar exchange rate (\$1=Rs. ...)	30.649	31.366	31.399	33.45	35.5
Total FDI	1268.41	2824.50	4518.36	9597.96	10182.20
Hong Kong	18.62	28.04	52.48	121.72	143.07
Macao					
Singapore	19.65	21.28	84.56	79.37	279.17
Taiwan	5.87	3.19	3.25	1.16	21.93
Japan	199.10	82.07	127.68	452.69	419.23
Korea, Republic	12.86	9.35	34.03	93.93	907.30
Mauritius	0	40.52	170.30	540.63	657.47
Virgin Islands	0.17	1.47	1.16	1.95	10.55
UK	38.39	198.54	413.76	515.95	429.46
Federal Republic of Germany	28.15	56.09	181.33	400.45	433.21
France	9.67	41.16	28.58	125.67	470.90
Italy	29.16	37.41	124.51	137.62	39.12
Netherlands	31.58	102.55	65.91	288.93	295.41
Sweden	15.79	0.20	3.71	150.15	150.15
Switzerland	225.05	136.07	15.38	92.52	45.00
US	401.81	1103.70	1110.89	2108.93	1987.15
Australia	25.33	9.42	123.71	449.69	235.05
Canada	0.25	8.69	13.40	410.60	55.36

Source: <http://www.economywatch.com/database/foreigninvestment2.htm>

Note: Annual Re-dollar exchange rate is quoted from Economic Survey of India 2001-02, Government of India, p. S-76.

The annual FDI inflow data to India from Macao is not available presumably because of the absence of FDI inflows.

Table 7 (contd.)
Countrywise FDI Approval in India, 1992-2000
(US \$million)

	1997	1998	1999	2000 *
Annual Re-dollar exchange rate (\$1=Rs. ...)	37.165	42.071	43.333	45.684
Total FDI	14769.63	7324.17	6546.17	34.18
Hong Kong	69.57	56.58	10.19	6.95
Macao				
Singapore	86.04	204.87	177.08	15.41
Taiwan	0.36	0.85	1.72	1.12
Japan	512.94	304.92	296.04	37.36
Korea, Republic	526.30	87.56	842.07	5.61
Mauritius	2705.74	752.52	877.63	105.05
Virgin Islands	4.93	2.33	6.67	0
UK	1208.32	760.82	683.78	42.77
Federal Republic of Germany	580.07	202.93	263.76	35.32
France	191.96	122.07	334.30	3.66
Italy	321.54	66.16	406.04	1.8
Netherlands	234.24	117.96	145.90	14.76
Sweden	29.33	51.21	63.22	16.35
Switzerland	132.83	67.75	67.20	10.86
US	2705.74	3225.46	821.99	165.38
Australia	116.15	626.97	149.76	5.17
Canada	103.39	75.03	8.50	18.47

Source: <http://www.economywatch.com/database/foreigninvestment2.htm>

Note: * upto 03/31/2000

Note: Annual Re-dollar exchange rate is quoted from Economic Survey of India 2001-02, Government of India, p. S-76.

The annual FDI inflow data to India from Macao is not available presumably because of the absence of FDI inflows.

Table 8
Country-wise Average FDI Inflow in India and China, 1992-2000
(US \$million)

	China	Rank	India	Rank	China: Times Larger
Total FDI	78213.21		6340.62		12.33
Total FDI from these countries	11664.52		4270.07		2.73
Percent Country-wise FDI to total FDI	14.91		67.34		
Japan	2746.24	2	270.23	5	10.16
Korea, Republic	1165.45	5	279.89	4	4.16
Mauritius	64.90	15	649.98	2	0.10
Virgin Islands	1469.77	4	3.25	15	452.24
UK	933.99	6	476.87	3	1.96
Federal Republic of Germany	607.93	7	242.37	6	2.51
France	446.72	8	147.55	8	3.03
Italy	184.32	12	129.26	10	1.43
Netherlands	325.17	9	144.14	9	2.26
Sweden	69.90	14	53.35	14	1.31
Switzerland	147.48	13	88.07	12	1.68
US	3038.15	1	1514.56	1	2.01
Australia	213.18	11	193.47	7	1.10
Canada	251.32	10	77.08	13	3.26

Source: Computed from China Statistical Yearbook, various issues and <http://www.economywatch.com/database/foreigninvestment2.htm>

Table 9
FDI Approval Trend in Major Asian Countries

(US \$ million)

Country	2000	2001	2002
China	62,379.0	69,194.0	48,010.0
Malaysia	5223.2	4,975.6	2,948.5
Thailand	2,813.0	3,941.0	NA
Indonesia	15,423.0	15,043.0	9,744.1
Singapore	4,198.8	3,688.8	3,932.4
South Korea	15,697.0	11,870.0	NA
Taiwan	7,608.0	5,129.0	NA
India	8,613.8	5,972.2	2,320.8

Source: Majumder, S. (2003), "Why FDI is welling up behind the Wall?" Business Line, June 19. <http://216.239.39.104/search?q=cache:gVJlpx-DN94J:www.thehindubusinessline.com/bline/2003/06/19/stories/2003061900070800.htm+banking+insurance+fdi+india+china&hl=en&ie=UTF-8>

Table 10
Sectoral Distribution of FDI in India

(Percentage of total)

Sector/ Industry	1992- 93	1993- 94	1994- 95	1995- 96	1996- 97	1997- 98	1998- 99	1999- 2000	2000- 01	2001- 02 P
1.Chemicals & Allied Products	17	18	16	9	15	9	19	8	7	2
2.Engineer- ing	25	8	15	18	35	20	21	21	14	8
3.Domestic Appliances	6	1	12	0	1	2	0	0	0	0
4.Electro- nics & Electrical Equipment	12	14	6	9	7	22	11	11	11	22
5.Food & Dairy Products	10	11	7	6	12	4	1	8	4	2
6.Com- puters	3	2	1	4	3	5	5	6	16	12
7.Pharma- ceuticals	1	12	1	4	2	1	1	3	3	2
8.Others	25	19	19	24	14	22	13	35	30	13
Manufac- turing (1-8)	98	85	78	74	88	84	73	92	86	61
Finance	1	10	11	19	11	5	9	1	2	1
Services	1	5	11	7	1	11	18	7	12	38
Total	100	100	100	100	100	100	100	100	100	100

P: Provisional

Source: Computed on the basis of RBI Annual Reports, various issues.

Table 11
FDI Approval and Inflows for the leading Sectors in India over August. 1991 to October. 2002

(US \$ million)

Sector	Amount of FDI Approved	Percentage of Total FDI approved	Amount of FDI inflows	Percentage of total FDI inflows (Ranks)	Inflows as percent of approvals
Energy					
(i) Power	11.86	15.4			
(ii) Oil Refinery	9.06	12.0			
Total (i+ii)	20.92	27.4	1.81	10.4 (3)	9.7
Telecommunications (Radio Paging, Cellular mobile, Basic Telephone Services)	15.19	19.9	2.26	12.9 (2)	16.5
Electrical Equipment (including computer software & electronics)	7.03	9.8	2.49	13.9 (1)	34.1
Transportation Industry	5.51	7.4	1.98	10.8 (4)	37.2
Services Sector (Financial & Non-financial)	4.93	6.5	1.57	8.3 (5)	32.4
Metallurgical Industries	4.25	5.5	0.25	1.4 (9)	6.4
Chemicals (excluding fertilizers)	3.68	4.5	1.32	6.7 (6)	37.7
Food Processing Industries	2.71	3.3	0.79	4.0 (7)	30.8
Hotel & Tourism	1.38	1.7	0.14	0.8 (10)	11.1
Textiles	1.01	1.2	0.29	1.5 (8)	30.6

Source: SIA (FDI Data Cell), Department of Industrial Policy & Promotion (DIPP), Ministry of Commerce & Industry.

Table 12
Sectors attracting highest FDI approvals with FDI inflows in India over August. 1991 to October. 2002

(US \$ million)

Sector	No. of Technical Collaborations (TC) Approved	Percentage with Total TC Approved
Electrical Equipment (including computer software & electronics)	1174	16.4
Industrial Machinery	832	11.6
Chemicals (excluding fertilizers)	813	11.3
Transportation Industry	604	8.4
Metallurgical Industries	355	4.9

Source : SIA (FDI Data Cell), Department of Industrial Policy & Promotion Ministry of Commerce & industry.

Table 13
Sectoral Distribution of Actually Used FDI in China

(Percentage of total)

Sector/ Industry	1999 (Rank)	2000 (Rank)	2001 (Rank)
Agriculture	2	2	2
Mining & Quarrying	1	1	2
Manufacturing	56 (1)	63 (1)	66 (1)
Electric Power, Gas, Water Production & Supply	9 (2)	6 (3)	5 (4)
Construction	2	2	2
Geological Prospecting & Water Conservancy	0	0	0
Transport, Storage, Post & Telecom Services	4 (4)	3	2
Wholesale & Retail Trade & Catering Services	2	2	3 (5)
Banking & Insurance	0	0	0
Real Estate Management	3 (5)	11 (2)	11 (2)
Social Services	6 (3)	5 (4)	6 (3)
Healthcare, Sports & Social Welfare	0	0	0
Education, Culture & Arts, Radio, Film & Television	0	0	0
Scientific Research & Polytechnical Services	0	0	0
Other Sectors	2	4 (5)	2
National Total	100	100	100

Note: Figures have been rounded to the nearest whole number. 0 percentage implies percentages less than 0.5. When the individual percentages fall short of the national total, it signifies that this discrepancy is the rounding-up error attributable to the rounding up at each sectoral level.

Source: Computed on the basis of Chinese Statistical Yearbook, various issues.

Table 14
Organized Retailing in South Asian Countries

Country	Organized Retailing (%)	Traditional Retailing (%)
Malaysia	50	50
Thailand	40	60
Phillipines	35	65
Indonesia	25	75
South Korea	15	85
China	20	80
India	2	98

Source: http://216.239.37.104/search?q=cache:VFtRRf4AK_kJ:www.directories-today.com/i_retailing.htm+retail+fdi+india+china+post-liberalization&hl=en&start=1&ie=UTF-8

Table 15**Ranking of Emerging Economies according to the Potential of the Growth of Retail Sector**

Country	Rank	Score (%)
China	1	72
Slovak Republic	2	68
Hungary	2	68
Russia	2	68
Morocco	3	67
Vietnam	4	63
India	4	63

Source: A T Kearney, Global Retail Development Index, 2002, compiled from India First Foundation, November 2002

http://www.indiafirstfoundation.org/archives/news/02/november/b&enews_m.htm#b&e8

Table 16**Value of Export Goods of Foreign Funded Enterprises in China from 1998 through 2001**

(\$100 million)

Year	Value of Export Goods of Foreign Funded Enterprises (a)	Total Value of Exports (b)	a as percent of b
1998	809.6189	1837.09	44.07
1999	886.2766	1949.31	45.47
2000	1194.4121	2492.03	47.93
2001	1332.3506	2661.55	50.06

Source: Computed on the basis of Chinese Statistical Yearbook, various issues.

Table 17**Value of Exports of Commodities in China over 1991 to 2001 (Customs Statistics)**

(\$100 million)

Year	Primary Goods	Manufactured Goods	Total Value of Exports	Manufactured Exports as a Percent of Total exports
1991	161.45	556.98	718.43	77.53
1992	170.04	679.36	849.40	79.98
1993	166.66	750.78	917.44	81.83
1994	197.08	1012.98	1210.06	83.71
1995	214.85	1272.95	1487.80	85.56
1996	219.25	1291.23	1510.48	85.49
1997	239.53	1588.39	1827.92	86.90
1998	204.89	1632.20	1837.09	88.85
1999	199.41	1749.90	1949.31	89.77
2000	254.60	2237.43	2492.03	89.78
2001	263.53	2398.02	2661.55	90.10

Source: China Statistical Yearbook, various issues.

Table 18
Value of Manufacturing Exports by Categories in China over 1991 to 2001 (Customs Statistics)
(\$100 million)

Year	Manufactured Goods	Chemicals & Related Products	Light & Textile Industrial Products, Rubber Products, Minerals Metalurgical Products	Machinery & Transport Equipment	Miscellaneous Products	Products not Other-wise Stated
1991	556.98	38.18	144.56	71.49	166.20	136.55
1992	679.36	43.48	161.35	132.19	342.34	
1993	750.78	46.23	163.92	152.82	387.81	
1994	1012.98	62.36	232.18	218.95	499.37	0.12
1995	1272.95	90.94	322.40	314.07	545.48	0.06
1996	1291.23	88.77	284.98	353.12	564.24	0.12
1997	1588.39	102.27	344.32	437.09	704.67	0.04
1998	1632.20	103.21	324.77	502.17	702.00	0.05
1999	1749.90	103.73	332.62	588.36	725.10	0.09
2000	2237.43	120.98	425.46	826.00	862.78	2.21
2001	2398.02	133.54	438.23	949.18	871.23	5.84
1991-2001	15170.22	933.69	3174.79	4545.44	6371.22	145.08

Source: China Statistical Yearbook, various issues.

Table 19
Exports of India over 1991-92 to 2001-02
(\$ million)

Commodity	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-20	2000-01	2001-02
I. Primary Products	4132.2	3873.5	4915.7	5214.4	7256.9	8035.1	7687.3	6927.9	6524.2	7126.2	7065.2
II. Manufactured Goods	13148.4	14038.8	16656.7	20404.4	23747.0	24613.4	26546.6	25791.5	29714.4	34335.2	33127.8
1. Leather and Manufactures	1268.8	1277.5	1299.5	1610.6	1752.2	1605.8	1656.7	1660.7	1590.2	1944.4	1905.5
2. Chemicals and Allied Products	1479.3	1228.7	1477.8	1955.5	2359	2690.3	3169.9	2906.2	3409	4034.1	4039.7
a) Drugs, Pharmaceutical and Fine Chemicals	628.8	529.3	640.7	800.1	1019	1223	1458.2	1487	1668.5	1917	2044.6
b) Others	850.5	699.3	837.1	1155.4	1340	1467.3	1711.7	1419.2	1740.5	2117.2	1995.1
3. Plastic and Linoleum Products	112.1	149.4	335.9	478.3	585.4	539.4	514.3	471.7	603.8	915.2	970.7
4. Rubber, Glass, Paints, Enamels and Products	269.8	395.5	523.6	619.1	642	670.7	696.8	613.5	679.6	936.5	974
5. Engineering Goods	2253.1	2480.8	3038.1	3508	4391	4962.7	5336.2	4463.9	5152.1	6818.6	6873.4
6. Readymade Garments	2199.2	2393	2586.2	3281.9	3675.6	3753.3	3876.2	4364.9	4765.1	5568.9	4987.4
7. Textile Yarn, Fabrics, Made-ups, etc.,	1804.6	1900.9	2140.2	3044.6	3523	4056.8	4355.3	3724.7	4188.7	4888.5	4416.8
a) Cotton Yarn, Fabrics, Made-ups, etc.,	1299.3	1350.5	1537.1	2233.8	2576.6	3121.7	3264.3	2771.9	3089.6	3460.7	3031
b) Natural Silk Yarn, Fabrics, Made-ups, etc.,	142	138.6	127.2	136.2	133.2	128.8	176.4	178.2	237.7	306.9	274.6
c) Others	363.2	411.8	475.9	674.6	813.2	806.3	914.6	774.6	861.4	1120.9	1111.2
8. Jute Manufactures	158.5	122.6	124	150.6	185.7	155.4	186.8	138.2	125.7	151.2	127.9
9. Coir and Manufactures	28.5	31.2	41.4	55	62.9	61	68.6	75.2	46.1	48.3	61.6
10. Handicrafts	3386.9	3783.1	4768.1	5328.2	6129.2	5664.7	6282	6971.7	8669.6	8492.4	8222.9
a) Gems and Jewellery	2738.2	3071.7	3995.8	4500.4	5274.8	4752.7	5345.5	5929.3	7502.3	7384	7305.7
b) Carpets (Handmade excl. Silk)	407.4	434.8	453.8	441.5	420.4	436.3	410.6	409.3	498.6	446.9	369.3
c) Works of Art (excl. Floor Coverings)	241.5	276.6	318.5	386.3	433.9	475.7	525.9	633.1	668.6	661.5	547.9
11. Sports Goods	31.5	35	44.5	65.8	73.7	78.1	80.8	73.2	67	64.6	68.2
12. Others	156.1	241.1	277.4	306.8	367.4	375.2	322.9	327.4	417.6	472.3	479.7
III. Petroleum Products	414.7	476.2	397.8	416.9	453.7	481.8	352.8	89.4	38.9	1869.7	2085.9
IV. Others	170.1	148.7	268.1	294.8	583.4	339.4	419.8	409.9	544.9	1229.2	1547.8
Total Exports	17865.4	18537.2	22238.3	26330.5	31794.9	33469.7	35006.4	33218.7	36822.4	44560.3	43826.7

Table 20
Export Performance of the Functional SEZs in India over 2000 to 2003

Zone	State	2000-01 (%)	Rank	2001-02 (%)	Rank	2002-03 (%)	Rank
Kandla	Gujarat	6.17	4	5.18	5	7.25	4
SEEPZ	Maharashtra	60.73	1	56.86	1	60.49	1
Cochin	Kerala	3.56	6	2.81	7	2.69	8
Surat	Gujarat	0.73	8	3.39	6	2.79	7
Noida	Uttar Pradesh	12.09	2	10.67	2	9.96	2
Madras	Tamil Nadu	8.08	3	8.30	4	8.18	3
Visakhapatnam	Andhra Pradesh	2.56	7	2.73	8	3.55	6
Falta	West Bengal	6.08	5	10.05	3	5.10	5
Total		100		100		100	

Source: <http://www.sezindia.nic.in/sez2.asp>

Table 21
Ranks of Indian States as Perceived by Foreign Investors, 2001

State	Ranking
Maharashtra	1
Karnataka	2
Andhra Pradesh	3
TamilNadu	4
Gujarat	5
Haryana	6
MadhyaPradesh	7
WestBengal	8
Uttar Pradesh	9

Source: FICCI FDI Survey, 2002

<http://216.239.39.100/search?q=cache:zpynUZWgiQYC:www.ficci.com/ficci/FDI2002highlights.htm+ficci+fdi+survey&hl=en&ie=UTF-8>

Table 22
Ranks of Indian States according to FDI Approvals, 2001

State	Ranking according to FDI Approvals
Maharashtra	1
Delhi	2
Tamil Nadu	3
Karnataka	4
Gujarat	5
Andhra Pradesh	6
Madhya Pradesh	7
West Bengal	8
Orissa	9
Uttar Pradesh	10
Haryana	11

Source: FICCI FDI Survey, 2002

<http://216.239.39.100/search?q=cache:zpynUZWgiQYC:www.ficci.com/ficci/FDI2002highlights.htm+ficci+fdi+survey&hl=en&ie=UTF-8>

Table 23
Export and FDI Performance of Chinese Provinces with SEZs over 1998 to 2001
(Percentage of total)

	1998		1999		2000		2001	
	Export	FDI	Export	FDI	Export	FDI	Export	FDI
Fujian	5.42		5.31	9.98	5.18	8.43	5.23	8.36
Guangdong	41.14		39.85	28.91	36.88	27.71	35.85	27.71
Hainan	0.42		0.38	1.20	0.32	1.06	0.30	1.00

Source: Computed from China Statistical Yearbook, various issues.

Note: Export data refer to the total value of Export by Location of China's Foreign Trade Managing Units. FDI refers to the actually used FDI.

Table 24
Comparative Statistics of India and China (2000)

NO	DESCRIPTION	CHINA	INDIA
1	Population (billion)	1.276	1.029
2	Urban Population (%)	37	33
3	GDP (Billion \$)	1121	440
4	Per capita income (\$)	990	440
5	Exports (billion \$)	250	44.1
6	Inflation (%)	1.3	4.0
7	Savings (% of GDP)	39	22
8	Labor Laws	More flexible	Less flexible
9	Corporate Tax (%)	15	36.75
10	Double Taxation	No	Yes
11	Value Added Tax (VAT)	Yes	No
12	Power Generation (billion KW)	1,166	417
13	Electricity Tariff (\$/100KW)	4.3 (Rs 1.97/unit)	7.53 (Rs 3.80/unit)
14	Sea Freight (million tonnes)	922.37 (17 ports)	251.73 (12 ports)
15	Roads (million km)	1.7	3.0
16	Railways (thousand km)	68.0	81.5
17	People per telephone	12	46
18	Percent FDIs from non residents	65	10
19	Forex Reserves (billion \$)	312	67
20	Internet Connections (millions)	35	3

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