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SIGNIFICANCE OF FOREIGN DIRECT INVESTMENT IN ASIA: A STUDY OF INDIA AND CHINA

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ABSTRACT

Foreign Direct Investment plays a key role in overall development of an economy. The economic prosperity of the Asian tigers Hongkong, Singapure, Malyasia, Taiwan and South Korea is because of their positive attitude towards the FDI and their out ward looking approach. The present study is an attempt to analysis the significance of FDI in Asia with special reference to India and China. It has been found that the abundance of foreign capital in both south Asian countries i.e. India and China has proved very much helpful to compete with the develop countries at global platform.

Key words: FDI, FPI, WTO, Globalization

INTRODUCTION

In today's world foreign capital has rightly been termed as an 'engine of economic growth' an activator of change and a barometer of economic progress. Globalization is about worldwide systematic interdependence, integration, mobilization and redistribution of resources. So in this era of globalisation, we can see that all economies of the world are highly interdependent. The exchange of goods, services, technologies and ideas are frequently taking place between the various countries and the foreign capital is no exception at all. The strong and sound industrial base of most of American, European and Asian Countries are due to their great understanding regarding the importance of foreign capital and their positive outward looking approach.

Foreign capital provides both opportunities as well challenges. If foreign capital is utilize in proper manner it can be proved bless and if not it can create a burst for the same. In developing countries, foreign capital is considered as a key factor for their overall economic development and most of these developing countries belong to the Asian continent. Economic prosperity of most of the Asian Tigers i.e. South Korea, Hongkong, Singapore, Malaysia, Taiwan, Korea and Thailand are largely attributed to FDI and due to the adoption of outward looking attitude which proved a milestone in their progress and prosperity.

FDI had several advantages over other types of capital flows, in particular its greater stability and the fact that it would not create obligations for the host country, as had been observed in the context of the Asian financial crisis of 1997-1998. FDI can play a key role in improving the capacity of the host country to respond to the opportunities offered by global economic integration. Most of the developing host economies utilize FDI to create their industrial expansion which is a sustainable activity and should be desirable. Foreign capital can be obtained either in the form of concessional assistance and non-concessional, however we are here to discuss the foreign capital only in its two forms i.e. Foreign Direct Investment (FDI); Foreign Institutional Investment (FIIs).

REVIEW OF LITERATURE

The development impact of foreign investment on host of countries has always aroused great deal of controversy. Numerous researchers, financial analysis and economists have done remarkable work in the field of foreign capital. Impact of foreign capital on host countries, and investing countries , trends of foreign financial flows and identifying of foreign capital has been the major areas or research undertaken in the context of foreign capital. The economist like Rosenstein Roden (1961) and Chenery and Strout (1966) in the early 60’s show that foreign capital has a favourable impact on economic efficiency and growth. Chenery and Strout (1966) has also started the external finances could enhance growth prospectus of recipient countries by augmenting domestic availability of investable growth.

Numerous factors have compelled many developing economies to change their earlier version of trade, industrialization and investment policies. For instance India has come with new policies relating to trade, industrialisation and foreign investment. Aitken, Hansen and Harrison (1997) show spill over effects of FDI on exports with the example of Bangladesh where the entry of single Korean multinational in garments exports leads to establishment of a number of domestic export firms creating the country's largest export industry.

In 1913 the primary sector accounted for more than half of FDI flows to developing countries and the manufacturing sector only 10%. In 1990 about 40% of FDI went to manufacturing 50% to services and only 10% to primary sector (Bahaduri 1996; Dutt,1997). Thus foreign capital can lead to higher growth by incorporating new inputs and techniques (Feenstra and Markusen, 1994).

Kathuria (1998) finds that technology spill over from FDI in Indian manufacturing have significant benefits. Wel (1996) uses urban data to show that FDI produced technological spill over in China and explain growth differentials among Chinese urban areas. There are good theoretical reasons to show that the growth consequences of FDI depends on what kind of sector receive FDI and that change in sectoral flows strengthen the positive effects and weaken the negative ones (Dutt, 1997). Thus theoretically speaking the main avenues by which the FDI can affect growth are productivity spill overs, human capital augmentation and technological change.

Goldberg and Klein (1998), identified a clear relation between real exchange rate and FDI from Japan and United States in South East Asian countries (Indonesia, Malaysia, Philippines and Thailand). FDI links the local economy to the export oriented international economy. Openness of both export and import has been shown to be powerful force for growth.

Bornstein et al*. (1998)* opined that it has become common place among foreign investors that India offers a well-educated workforce which is essential for FDI to have positive growth effects. Aggrwal (2000) analysed economic impacts of FDI in South-East Asian countries India, Pakistan, Bangladesh, Sri Lanka and Nepal and found that FDI inflow was associated with a manifold increase in the investment by national investors and linkage between foreign and national investment. The impact of FDI inflow on growth rate of GDP is found to be negative prior to 1980, mildly positive for early eighties and strongly positive over the late eighties and early nineties. FDI is more likely to be beneficial in the more open economies.

Wang 2001 examined the impact of FDI inflows on 12 Asian economies Bangladesh, China, Hongkong, India, Indonesia, Korea, Malaysia, Philippines, Singapore, Thailand and Taiwan during the period 1987-97 and found that FDI in manufacturing sector has a significant and positive impact on economic growth in the host economies.

According to world investment report 2003 (UNCTAD) foreign investors regards both India and China as a hub for relocation of labour intensive activities. In China about two third of FDI flows flow in to a diverse range of manufacturing industries. Sahoo (2006) works on 'foreign direct investment in South Asia: policy, trends, impact and determinants'. He said that the FDI environment has undergone a sea change in South Asian countries during the 1990s, and more so in recent years. With their liberalized approach to FDI and constant changes in the FDI policy framework, it is certain that South Asia has become an important destination for investment.

Kabir (2007) revealed that FDI can provide the necessary tools for Bangladesh to progress further and realize higher growth by utilizing all its resources. Kok and Ersoy (2009) many developing and least developed countries (LDCs) suffer seriously from lack of adequate and advanced technology. Attracting FDI occupies paramount importance in their policy making. They recognize FDI a useful means to increase their production, economic activity; generate employment and raise the social welfare of the host country. Ahmad and Tanin (2010), a large inflow of FDI can add to foreign exchange and investment resources in a host economy but it may deter the development of local firms or create exchange rate problems.
Other literature (Aykut and Rath, 2004; Bhatt and Aykut, 2005; Aykut and Goldstein, 2007; Goldstein, 2007 has come to recognize the growing incidents of developing country firms undertaking FDI activities in fellow developing countries. This has led to a much faster growth rate of south-south FDI flows as compared to the rate at which FDI has flown from developed countries to developing countries in the 1990s. The studies of Ahearne et al. (2003), McKibbin & Woo (2003), Chantasasawat et al. (2004), Eichengreen et al. (2004), Mercereau (2005) and Ahearne et al. (2006) concentrate on the effect of China on its neighbors or other Asian economies in terms of either natural resources, labor cost, and human capital), which is the resultant of economic reforms, affect expected profitability of foreign investment. Alfaro et al. (2001), Choong et al. (2004) and Hermes and Lensink

(2003) concluded that India compares favourably with China in terms of financial market development, which represents another factor favouring positive growth effects of FDI.

It is clear from the above discussion that the foreign capital particularly FDI can induce economic activities and growth in various ways. However, Singer (1950) argues that FDI has a detrimental effect on developing countries and leads to uneven global development. This is based on the premise that FDI mainly goes to primary sectors in developing countries. However Singer modifies his views by focussing on differences between countries rather than commodities. Hausmemn and Fernandez Arias (2000), points to reason a high share of FDI in total capital inflows may be a sign of host country's weakness rather its strength. Moreover, the debate whether the foreign capital is beneficial or not for host country depends upon country to country and situation to situation

Managing Capital Flow in Asia: An Overview

Initially, most inflows were in the form official lending, followed by commercial bank lending with government guarantees, but more recently the composition has shifted towards a wider varieties of private sources, often without government guarantees. Private to private flow now constitute most external capital flows the bulk in in the form of foreign direct investment (FDI), which also provides transfer of technology and management skills, enhanced access to external markets, and improved competitiveness and efficiency. The most remarkable growth in the past few years however has been in foreign portfolio investment (FPI) flows. Flows of FPI also contribute to the development of domestic capital market but FPI are more volatile than FDI as shown by the Asian crisis of 1997.

India v/s China

India and China are two of the world's most ancient civilisations. In post-colonial era mutual relations suffered a setback due to political and boundary disputes. In contemporary times they have re-emerged as leading techno-economic nations. It is high time for them to move beyond conflicts and start co-operating politically, economically, and technologically for mutual benefits.

Recent developments and exchanges indicate that the ball is already rolling in that direction. Globalisation for common good requires coming together rather than falling apart, sharing resources and assets rather wasting them in endless disputes and conflicts. In the context of currently shifting global and political economic power, no two nations are better equipped than India and China, to show the world how the common concerns of humanity can be addressed through mutual respect, friendship, healthy competition and sharing of resources.

The Indian economy began to open its door a bit more widely by the middle of the 1980s, at about the same time as did China. By this time, the global economy had already taken hold of the national economies in North America, Europe, and the Pacific Rim. Post-independence era regulations proved a mix blessing for India. After independence the government of India realized the importance of foreign capital which was reflected in first Industrial Policy Resolution of 1948 and many big industries were set up in collaboration with foreign capital. Prior to 1991, the government exercised a high degree of control over foreign investment and industrial activities. FDI inflows in India remained marginal in 1980's but rose steadily after the economic reforms when India opened the gate way for foreign investors. Since then the Foreign Direct Investment in India is increasing continually but it is too low as compare to China. It was less than $ 0.2 billion per year from 1980 to 1990 except in the year 1989.

Post-impendence era regulations proved a mix blessing for India, it missed a 20 years of the information technology revolution that was sweeping the third world and driving the global economy – remember how the IBM and Coca-Cola were kicked out of India in the middle of 1970s. The private sector stagnated under those regulations. Before 1991 India maintained selective approach, which was predominantly governed by multiple objectives of self-reliance, protection of domestic industries, import of select technologies and export promotion, towards Foreign Direct Investment (FDI) for over three decades after attaining independence. FDI in low technology was, however, not encouraged in order to give shelter to local industry and conserve foreign exchange. The policy regime since 1991 made a paradigm shift and regulation of foreign investments in India had been given up. From July 1991 onwards, the government introduced a couple of changes in the country's regulatory policies under policy package known as the structural Adjustment programme (SAP).

In 1979s Deng Xiaoping took command of China three year after Mao's death and introduced massive shift in public policy and opened the Chinese economy for foreign

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capital, technology and competition. Since then, the Chinese economy has been growing at about 9-10 % per year, surpassed many other economies. The most far-reaching FDI liberalisation was the decision in 1999-2001 to accede to the terms of the World Trade Organisation (WTO). Under the WTO accession terms, China was obligated to eliminate all import quotas and tariff in time bound manners. China has eased restrictions on the inflow of foreign capital in to the country's security market through (QFII) program, qualified foreign institutional investors programme, which came to effect as on September 2002. In the absence of a freely convertible currency (QFII) allowed foreign capital in the Yuan-denominated, a share on the Shanghai and Shenzhen Stock Exchanges which were earlier open only for domestic investors. Thus easing restrictions on foreign investment in China's security market was a welcome step. FDI was dropped in India and China by 12% and 11% during the year 1999 due to Asian crisis and the slow adjustment of domestic economies. However, overall trends show that both India and China has shown improvement in their positions regarding FDI inflows but the relative performance of China is far better than that of India.

Table 1: FDI Inflows in China and India (1991-2010)

(US$ million)

Year	**India**	**China**	**Year**	**India**	**China**	**Year**	**India**	**China**	**Year**	**India**	**China**
1991	75	4366	1996	2525 (17)	41726 (11)	2001	5478 (53)	46878 (15)	2006	20328 (167)	72715 (0)
1992	252 (236)	11008 (152)	1997	3619 (43)	45257 (8)	2002	5630 (3)	52743 (13)	2007	25350 (-25)	83521 (15)
1993	532 (111)	27515 (150)	1998	2633 (-27)	45463 (0)	2003	4321 (-23)	53505 (1)	2008	42546 (68)	108312 (30)
1994	974 (83)	33767 (23)	1999	2168 (-18)	40319 (-11)	2004	5778 (34)	60630 (13)	2009	35649 (-16)	95000 (-12)
1995	2151 (121)	37521 (11)	2000	3588 (65)	40715 (1)	2005	7622 (32)	72406 (19)	2010	24640 (-31)	105735 (11)
Average	**797**	**22835**	**Average**	**2907**	**42696**	**Average**	**5766**	**57232**	**Average**	**29703**	**93057**

Note: The figures in parentheses shows growth rate calculated on year-on-year basis.

Source: www.unctad.org/fdistatistics

CONCLUSION

This brief discussion of India and China in the context of foreign capital revealed that both India and China has shown improvement in their positions regarding FDI inflows and the relative performance of China is far better than that of India. The west is becoming alarm what is happening in the world's two most populous nations. Many Americans see both India and China stealing their jobs – China stealing manufacturing jobs (textile, shoes, furniture, hand tools, consumer electronics, ornaments etc.); while India is taking away IT jobs as China turned in to manufacturing hub while India is most preferred destination for IT out sourcing in the world. India has an edge over China in attracting R&D investments due to the availability of more well-trained English speaking people, scientists, doctors and engineers while China has an edge over India in attracting manufacturing investment. Thus foreign investment will grow rapidly in China in manufacturing sector while in service sectors in India as former is the manufacturing hub while later is the service centre in the world.

Why India is lagging behind to China

Economic reforms in India has been started in the year 1991, while market based reforms in China were started in 1978. China has concentrated heavily on different issues such as banking sector, state-owned enterprises, tax reforms, insurance and sound financial system. In India, continued reform actions are lacking in the areas of fiscal consolidation, openness of the economy, tax reforms, foreign investment policy, and the financial sector. China's entry into the world trade organization (WTO) made it very attractive to foreign investors as it is obligated for China to reduce various tariff and non-tariff barriers under WTO commitments in time bound manner. China has enjoyed the higher GDP and real per capita income over the past decade in comparison to India. China's government has offered many incentives like exemption in income tax for foreign firms over the last two decades. Such benefits were not available to domestic Chinese firms. The government initiatives in this concern are lacking in India. China has better infrastructure like railway, road, port, transport, power, banking and insurance facilities, however India failed to provide such kind of infrastructural facilities to the potential foreign investors. In India many domestic firms are in favour of checking the entry of foreign firms due to their inability of facing the competition likely to prevail in the free market mechanism. Many political parties too opposed the entry of foreign capital due to their political interest. However Chinese government never bothered to these pressures. The Chinese five year plans were well framed and aimed at designing effectives policies with rational strategic choices, whereas in India the decisions to accept new foreign investor were taken on a case by case basis, a practice that leads to unnecessary procedural complexities which discouraged foreign investments. Technology imports and Technology Transfer (TT) has been strongly encouraged in China so as to increase the production and productivity. The Chinese polity is a monolithic dictatorship of one party while Indian political system is a federal one in which the power has been divided between the centre and states. There is often coalition government at centre in India so it is very difficult to bring general consensus among all the political parties with varied ideologies to accept and implement the idea of foreign capital that is why, it is comparatively easier in China to formulate and implement policies regarding FDI.

The main Hindrances to FDI Inflows in India and China

Progressively liberal foreign investment policies in India and China have emphasised a greater encouragement and mobilisation of foreign investment inflows. However both the economies still suffer from some weaknesses and constraints either in terms of policy and regulatory framework or in terms of accelerating the reform process which restrict the flow of FDI in these economies. The factors which limit the growth of FDI in India are out dated laws and their inefficient implementation, reservation of items for small scale industries, outmoded and inflexible labour regulations, weak credibility of regulatory system and conflicting role of various agencies and government, corruption and red tapeism, Inadequate, inefficient and poor quality infrastructural facilities, political instability and defective marketing structure.

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