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A Comparative Outlook of Indo-China Trends of FDI - An Overview

Abstract

Foreign investment is one of the most written about issues in the context of Indo-China growth. The lead of China in this regard is indisputable.. The key difference between China and India is that the former has a larger market size, higher-growth, better hard infrastructure, early bird benefit in liberalizing its economy and additional incentives offered to MNC's. India on the other hand with the upper hand in the service sector, an independent judiciary, democratic institution, superior corporate culture, a well-developed capital market has become the next hot spot to attract FDI's. FDI is often used as a barometer to comparative competitiveness of economic but there are other factors which make one wonder whether FDI is as important as it is perceived. Japan, Korea, and Taiwan did not receive significant FDI in the 60s and 70s and yet they grew at stupendous rates. However important FDI may be, it certainly is not a panacea for all ills, single-minded forces .

Keywords: Foreign Direct Investment, BPO, IFC.

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Introduction

India and China are the world's next major superpowers even though when both countries have embraced different approaches of development.

China is taking tangible but slow steps towards embracing private entrepreneurship while India is committed to open door for multinationals. Both countries have come up with strong economic growth since 1980. China's 9% GDP growth can be attributed to the strength of its manufacturing sector resulting from a variety of goods ranging from automobiles to textiles. India has also experienced a GDP growth of 7.6% however, India's service sector companies comprises of approximately 52% of its GDP while China's is significantly lower at 41%.

In general, FDI has been positive to economies of both, India and China & plays an important role in development of both countries and has provided goods and services that did not otherwise exist. China and India have achieved relatively successful outcomes following their own growth tracks. However, one of the distinctions between China as the 'factory of the world' and India as 'World's back office' in international trade may be changing in the coming decade since China is aiming to develop its service sector whereas India hopes to strengthen its manufacturing industries

FDI has been defined as involving an equity stake of 10% or more in a foreign enterprise. It refers to investment in a foreign country where the investor retains control over the investment. It typically takes the form of starting a subsidiary, acquiring a stake in an existing firm or starting a joint venture in the foreign country.

FDI is often used as a barometer to compare the competitiveness of economies but FDI is influenced by many factors other than the intrinsic strength of a nation. A country receives higher FDI not only due to intrinsic strength like the size of the market, state of infrastructure, growth potential etc but also because of factors like preferential tax treatment, which may not necessarily reflect the competitiveness of an economy. These factors have to be neutralized before FDI numbers can be used to compare two countries.

China and India's foreign trade patterns are largely dissimilar and have been from the beginning. In the case of China, using its vast resources of cheap labor and domestic savings to initiate infrastructure building and invite large amount of FDI to spur the development of the manufacturing industry in the coastal areas has been seen as one of the initial and leading drivers for the country's economic success. India's strength, on the other hand is based on knowledge based sectors such as

IT and pharmaceuticals, more developed financial markets and a more robust private sector.

The indian economy is also expanding, but so far the process of transferring cheap labour from low value agriculture to higher value manufacturing industry has been slow. This is mainly due to relatively weak industrial growth and unfavourable labour laws that have created a strong incentive for firms to use more machinery and hire fewer workers. India may choose to follow the East Asia model to attract foreign investment and beef up manufacturing industry. At the same time, India will continue expanding its strong service sector in business and engineering services that has drawn major global firms to outsource their operations to India and has the potential to continually drive India's foreign trade.

China embraced globalizations and trade enthusiastically, welcoming foreign direct investment with no inhibitions, and gradually gaining control over the world markets for low-tech labor-intensive manufacture. While reforms in India are supposed to have been that starting with more or less the same per capita incomes 25 years back, Chinese incomes today are double that of India's - a result not only of a faster GDP growth, but also of a low population increase

Aim of the Study

To study the effect of FDI in achieving self reliance in all sectors of economy of Indo- China.

Advantages of FDI

1. The role of FDI in providing foreign currency is arguably more important than its role as a bridge between savings and investment rate. It is possible for the government to print money and fill the gap to a large extent by itself, without the aid of FDI; though printing money is not always an option as it would increase liquidity in the market and cause inflation. But even FDI increases liquidity and puts inflationary pressures on the economy.
2. FDI brings the latest technology to a country, which improves the overall competitiveness of the country's economy. Due to the dissemination of technology, even other industries are benefited. Due to the 'contagion effect' and the 'competition effect', other company's competitiveness improves and the nation as a whole gain. There are other 'spillover effects', also, like MNCs train their employees who can go and work in a domestic firm after a few months or years. It helps in developing human capital, and India and China have definitely gained from FDI in this respect.
3. Foreign companies may be more efficient and help in setting up industries which otherwise would not have been set up. Thus, it helps in increasing employment opportunities in the country.
4. FDI also helps in raising the export level of a country.

Undoubtedly, China's track record in attracting FDI is far superior to that of India. In fact, India has been considered an 'underachiever' in attracting FDI. However, within this otherwise form conviction about unmatched Chinese superiority in skepticism about what all China includes while compiling its FDI figures and consequently about the actual intensity of the FDI gap between China and India as suggested by the official statistics of the respective countries. On the other hand, it had been pointed out in the FDI literature that Indian FDI is hugely under-reported because of non-conformity if India's method of measuring FDI to the international standards.

Gap Analysis

There are striking elements of non-conformance between the IMF definition of FDI and that used by the RBI for computational purposes. In fact, compared to the international standard, the Indian FDI statistics appears to be limited because it includes only one component-foreign equity capital reported on the basis of issue/transfer of equity or preference shares to foreign direct investors. Some of the principle components that India excludes from the IMF definition while estimating actual FDI inflows are:

1. Reinvested earnings by foreign companies (which are part of foreign investor profits that are not distributed to shareholders as dividends and are reinvested in the affiliates in the host country).
2. Proceeds of foreign equity listings and foreign subordinated loans to domestic subsidiaries as part of inter-company (short and long term) debt transactions.
3. Overseas commercial borrowings (financial leasing, trade credits, grants, bonds) by foreign direct investors in foreign invested firms.
4. Non-cash acquisition of equity, investment made by foreign venture capital investors, earning data of indirectly held FDI enterprises, control premium, non-competition fee etc. as per IMF definition, which are normally included in other country statistics.

As mentioned above, an especially important component of FDI that is excluded in India constitutes the reinvested earnings, which companies so far have reported on a sporadic and voluntary basis. India has had foreign companies here for decades and many of them have re-invested heavily over the years. If the retained earnings from all these are cumulated, then the current returns on the stock of retained earnings would have to be added to the returns on measured FDI. Added together, these total returns would be high relative to the stock of measured FDI. However, even the flow in recent years can increase since several multinationals have been reinvesting their profits in India and this is not being captured of FDI, a practice China adopts.

There are various following other reasons which contribute a great deal towards this gap otherwise we would be drawing conclusions by comparing apples and oranges which is meaningless

Low Tax Slabs & Incentives to Foreign Investors

The Chinese government provides incentives to Foreign companies and MNCs in the form of taxes to attract huge amounts of foreign investment including a two-year tax holiday followed by 15% tax rates instead of 33%.. FIE's also enjoy duty-free concessions for imported equipment, improved land use rights etc, which give them an unfair advantage over domestic players. As a result, Chinese domestic companies pay 33% income-tax, while most FIEs pay an average rate of only 15%.

In contrast, India has adopted a restrictive FDI policy to protect its domestic firms. Unlike China, India imposes higher corporate taxes on foreign players upto maximum 45% over 34 % for domestic companies. This acts as a disincentive for foreign players to invest in India.

Manufacturing and Trade patterns:

Huge FDI inflow enable China to develop its infrastructure and become the world's largest manufacturer of consumer durables. It has also liberalised and privatised state owned enterprises for attracting more FDI. China has been the factory of the world and has attracted FDI to set up factories. By nature, the manufacturing sector tends to be more capital-intensive compared to service sector. The level of investment required in a capital-intensive unit is much greater than in the services sector. India's figure has also started moving up, as more and more investment has been coming in capital intensive sectors like steel, automobile etc.

Early Bird Incentives

China started liberalizing its economy in 1978, whereas India started the process only in 1991. It would not be logical to compare India's figure with those of China since early liberalization has given China a head start, but if figures of the two countries are examined from this perspective it is observed that China had attracted only US$ 1.7 billion of FDI in the first five years after liberalization (1979-84), whereas India attracted US$ 4 billion in its first five years of liberalization (1991-96). India also attracted more FDI in the first ten years after liberalization than China did

However, India still has a high level of government regulation of business, bureaucracy and poor actual infrastructure development.. A study namely "World Investment Prospects to 2010: Boom or Backlash, "done by the Economist Intelligence Unit and Columbia University projected capabilities of India and China to attract FDI in 2010.

But FDI is not the best tool to compare the two economies. FDI is affected by so many factors, many of which are not related to the competitiveness of an economy. A high level of FDI is not a sign of strength, in fact, is a sign of structural weakness. Thus massive FDI inflow into China is not a celebrated achievement of its reforms. Foreign players started investing in China because they realized that Chinese domestic players were not competitive enough and did not exploit the business opportunities efficiently. As the majority of players in China are State Owned Enterprises, which are relatively uncompetitive, it is easier for foreign investors to compete and succeed in China. Thus to sustain a high rate of growth, China needs productive investment, which is supplied by foreign investors, FDI helps mash the inefficiency of the SOE's.

Strategies for FDI Improvement in India

In order to be competitive with China, India would need to focus on certain strategiesI for growth prospects, and attractiveness to FDI inflows. These are as follow:

Export oriented FDI Policies

Export oriented FDI is an important means of expanding manufactured export for developing countries, it helps in the improvement of quality and competitiveness of manufacturing industries. Focus of FDI is mainly fall under export oriented unit. For sustainable development India needs a larger export market for manufactured goods where FDI could flow in.

Expansion of Special Economic Zones (SEZ)

All developing countries have utilized export. Processing zones(EPZs) or other SEZs to attract foreign investment in the country. India has models of EPZ and Export Oriented Units (EOU), EPZs are located at various places including Cochin, Falta (near Kolkata). Kandla, Chennai, Noida, Santacruz (Mumbai). Visakhapatnam and Surat, Incentives provided to attract investment in these area were zero import duty and a special 10 years income tax rebate. But these special zone fail to achieve estimated export targets.. So government should pay more attention in these area.

Creation of Investment Climate

There are three major problem in India i.e. lack of harmonization of govt. policies, lower in infrastructure development, and economic instability, which directly influence the investment climate. Therefore, Government should make such a policy framework for FDI, which will help in building up favourable investment climate.

The actual extent of FDI in the country would largely depend upon various factors like government policies etc. If the government opens up some sector like retail and finance, which it has done, there will be more onslaught of FDI in the country. India has to take care of its infrastructure and bureaucrats to create a better environment for business. India is pushing its SEZ project quite seriously, which would be highly instrumental in attracting higher FDI.

China is apparently doing much better than India in almost all spheres. A foreign firm has to pay taxes at a rate of 45% in India. Whereas in China, the average rate is around 25%. The infrastructure in India cannot even be compared with what China has to offer i.e. roads, airports, ports, and electricity etc. which is far superior to India. There is strong political support for development in China and red-tapism and bureaucracy less rampant than in India. The market is much bigger than the Indian market. As long as investors get a good return from investments in China, they would keep on pouring money into the Chinese economy.

There are various reasons for investing in India:- an independent judiciary, democratic institutions, a superior corporate culture, a well-developed capital market, a resurgent private sector, better availability of higher skilled labor.

Due to inadequate transparency and unreliable data, it is difficult to predict what path the Chinese economy will follow. There are several problems with the Indian economy also but the problems are widely known and discussed. China gives the area of a unified, well-oiled reform engine, but under the surface are the powerful tensions of clashing ethnicities, regional inequalities, large-scale migration, and extensive corruption. In India, nothing is under the surface. The path seems more certain that is the case with China.

China may offer higher returns for investors but the risk seems to be higher. Boston Consulting Group report has concluded that 90% of MNCs in India make a profit whereas only 45% do in China. As a long-term investment decision, India appears to be a safer bet, if not a more profitable one.

India might play a very crucial role in the world economy – more than even China in the coming decades. China is predominantly prevalent in the industrial sector, which contributes any 20% to the US GDP whereas India's strength lies in the services sector which constitutes 79% of the US GDP. India would probably be the first country in the world to use its brain power and not just the muscle power of its labor to ride on the development band wagon, India is indeed targeting white collar jobs compared to the blue collar jobs created in China.

Conclusion

Foreign Direct Investment is life blood for developing economy and key indicator of future fast track development. As we know that India is a Agricultural country and agriculture is background of Indian economy. If FDI is coming to this sector, it will be more favourable for India. A news from the world Bank "Doing Business in 2017. Removing obstacles to Growth" Indicates that India has made the highest progress among the South Asian Nations in improving its investment. Climate last year and was rated among the top ten reforms in the world Commerce Ministry put the view that for acquiring growth rate over 9% per annum for the next years, Indian economy needs on investment rate of 35.1 percent of gross domestic product (GDP).

FDI is often considered a boom and that is why there is so much focus on it. But there are also disadvantages attached to FDI and one needs to consider them too. India definitely needs FDI but it should be careful while giving excessive concession to attract foreign companies. Looking at the current onslaught of FDI in India, the future seems to be bright and the gap between the Indian and Chinese numbers would only get narrower with time.

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