



Foreign direct investment in India and China: The economic environment

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Abstract

China and India are the two emerging economies of the world. As of 2019, China and India is 2nd and 5th largest country of the world, respectively in nominal basis. On PPP basis, China is at 1st and India is at 3rd place. Both countries together share 19.46% and 27.18% of total global wealth in nominal and PPP terms, respectively. Among Asian countries, China and India together contribute more than half of Asia's GDP. China has been amongst the world's largest recipient countries of Foreign Direct Investment (FDI) since the early 1990s. In 2002, the first year after the country's accession to the World Trade Organisation, it for the first time surpassed the USA to become the world's largest FDI recipient- with the actual amount of FDI accounting for around 10% of the world total. Concerned analysts generally predict that further increases in FDI in China are most likely in the years to come, amid the increasing integration of the country into the world market. Thus, proper assessment of the role has played in China's economic developments are clearly of widespread policy importance.

Keywords: FDI, economic environment, economic growth, investment, globalisation

Introduction

The changing structure of world investment, trade, and capital flow has been the wave of the last three decades. Globalization has altered the economic frameworks of both developed and developing nations in ways that are difficult to comprehend. The persistent rise in the dispersion of current account balances of the world as a whole, wherein the sum of surpluses match the sum of deficits has grown substantially since the World War II. Also, the emergence of unregulated global markets appears to have moved towards a more stable and growth oriented economic globe. Economies have been hit one after the other with the fashion and need for market driven capitalist and liberalized economic system has been the urging need. The 90's has also seen the emergence of finance, which apart from the efficiency, product enhancement, and lower cost of transaction has facilitated the crisis frequencies, globalization, and movement of capital flows internationally without much control. The significant reduction in global trade barriers over the past half century has contributed to a marked rise in the ratio of world trade to GDP. External finance has set forth the movements for growth in trade and development across regional barriers.

Existing studies on the role of FDI in China's economic development have broadly followed two analytical approaches. One approach is to express various measurements of FDI as ratios to main macroeconomic indicators – Gross Domestic Product (GDP), gross fixed capital formation, total exports, etc. – and thereby to infer about the overall contribution of FDI to economic growth. A second approach is to carry out regression analyses of the relationship between various measurements of FDI and indicators of economic development, including both observed indicators such as GDP growth and unobserved indicators such as total factor productivity (TFP) growth. This second approach has been applied to both analyses at the aggregate level and even more popularly comparative studies across sectors or regions. We believe these existing

studies, while offering valuable insights are still far from adequate for producing a definitive account in interpreting and assessing China's experience. At one level, with respect to the broader literature on globalization and late development, the two analytical approaches appear to be excessively narrow in focus. They tend to centre around propositions and hypotheses framed according to mainstream neoclassical economies, while ignoring the important contribution from alternative theoretical traditions. At another level, in applied analysis appear to have remained for the existing studies to cope with. In particular, in the analyses of the relationship between FDI and China's economic development, both of the two approaches have had difficulty in differentiating between correlation and causation. What is conspicuously inadequate in the existing studies is the identification of the concrete channels or mechanisms through which FDI impacts on the economic development of China as a whole as well as on particular sectors and regions. Thus, both for addressing the concerns of the broader literature on globalization and for verifying the mainstream propositions and hypotheses, the interpretation and assessment of the impact of FDI in China must be analysed in relation to China's particular paths or patterns of economic development.

Foreign direct investment: global perspective

Foreign investment has long been a subject of interest. This is evident by the rapid growth in the global foreign investment flows in the 1980s. Conceptually, FDI flows include all funds provided by the direct investor, either directly or through affiliates. Direct investment can be in new equity capital, reinvested earnings or not borrowing from a parent company or its affiliates. In general, countries classify direct investment enterprises as those in which the percentage of foreign ownership is above a certain limit, usually between 10 and 25 per cent. Although there are no uniform criteria among countries, moderate differences in the percentage used for classification do not significantly

alter the measurement of FDI, since the share of Foreign ownership in firms considered to be foreign affiliates is usually much larger. Most of the countries have been making use of foreign capital and foreign technology to accelerate the pace of their economic growth. There is hardly any advanced country the development of which was not assisted by foreign capital or technology. India being a developing country, technology transfer needs no emphasis. Krainer (1967) ^[8] applied multiple regression analysis to study the effect of resource endowment in FDI inputs and the influence of the industry's structure on private capital flows and domestic economy activity. The study regarded FDI in the United Kingdom for the period 1952-1962 and in the USA for the period 1950-1963. The variables studied were the countries' portfolio, the FDI, the index of capacity utilization and the ratio of the British to American long term bond yields. The study concluded that the private FDI of both countries reacts differently to the capacity utilization changes.

Griffin (1970) ^[6] used cross-section data to investigate the interdependence of Foreign Capital inflows, domestic savings and economic development in 32 countries during 1962-1968. The variables used were the gross domestic savings, GDP and foreign savings. The results indicated that a reduction of foreign capital could lead to an increase in both domestic savings and exports – capital ratio. These effects could offset the reduction of the total available resources and thus lead to economic growth, while reducing the level of current consumption.

The economic environment: Indian context

India had adopted the planned structure of economic growth. Five Year Plans were drawn up with resources allocated to different sectors by the central planning authorities. It was licenced, closed economy, with the public sector holding the commanding heights. The private sector was in a nascent stage. It could enter into areas which were not reserved for the public sector and a licence was required for many projects. Hence, for the first three decades of economic development in India we did not see much of synergy between government and private sector. Economic liberalization began to an extent in 1980, it accelerated that we gradually began to see synergy being practised in economic growth in India, the economic agenda being written in consultation with the private sector. The public sector retreated to make way in areas where the private sector had a competitive edge. A supreme synergistic approach is being followed since 1991 with the increased focus on globalization of the Indian economy. This synergy is now visible in virtually all the fields of economic and commercial activities. Accelerative socio-economic development is indeed the common goal for both the government and the business. Agenda for synergy relationship is, therefore, one of findings innovative ways of working together towards the common goal. The immediate task ahead is to work towards the opportunities on hand. The economic liberalization process has indeed helped raise growth rates in industry and the economy. Urgent measures need to be initiated to sustain the tempo.

In 1991, Indian economy faced a severe crisis. The symptoms of the crisis were evident in the second half of eighties itself in the form of macro-economic imbalances. Pressures generated by the large and persistent fiscal deficits and foreign exchange crisis, high tariffs and inefficiencies

generated by the industrial licensing system had led to a huge deficit in the balance of payments position. Adverse global developments in 1990-91 i.e., the slowdown in world trade following recession in the industrial world, the disruption in Eastern Europe and the Gulf Crisis of August 1990 aggravated the crisis. The current account deficit soared to a level of 3.2 per cent of GDP in 1990-91, which by all means was unsustainable. There was a massive shortage of the foreign exchange reserves. Despite draws of US\$2.5 billion from the International Monetary Fund (IMF) under the contingency and Compensatory Financing Facility, the foreign currency assets dipped from US\$3.4 billion at the end of March 1990 to a very low level of US\$975 million on July 12, 1991. The amount was equivalent to barely a week's value of import bills. India responds to the crisis by simultaneously implementing measures for stabilisation and structural reforms.

The economic environment: Chinese context

The anti-crisis stimulus measures of the Chinese government since 2008 have mostly propped up big state-owned enterprises (SOE) to the detriment of private businesses. Since the outbreak of the financial crisis, private enterprises have found it even more difficult to access bank credit, even though there is plenty available cash in the market; loans primarily have flowed from the state banks to SOEs.

Foreign business investments subject to government restrictions, yet these restrictions are gradually being repealed. In 2014, the NDRC proposed to reduce the number of restricted sectors for foreign investment from 79 to 35, and the number of sectors where they are only allowed a minority share from 44 to 32. Investments in financial companies are to be made easier, while legal affairs consulting will be prohibited. Repatriation of profits is difficult due to foreign exchange controls and extensive approval and implementation procedures. In September 2013, the government established the Shanghai Free-Trade Zone (SFTZ), where commodities can be imported tax-free and foreign investments are permitted in all but 16 sectors. The SFTZ is also seen as a test lab for full yuan convertibility. Capital account settlements have indeed been made easier than in the rest of China, but full convertibility is still limited and tied to several requirements, because the government fears that an uncontrolled outflow of RMB could negatively affect macroeconomic stability. In contrast, Hong Kong residents can exchange an unlimited amount of Yuan since November 2014 in an attempt to facilitate trading between stock exchanges in Hong Kong and Shanghai.

Since 1996, the urban informal sector has been growing rapidly. In 2008, it constituted 60% of China's urban economy and was responsible for 28.8% of China's GDP.

Conclusion

A business environment comprises a number of environmental factors. It can be an "interface" linking various such environmental factors, making a common ground that determines or influences the process of policy making in every business organization which functions within such an environment. An interaction of all such factors, or some of them can also take place, while the business organization is expected to interact with the environment.

Any substantial change in the environment or in any of the factors of the environment is bound to lead to corresponding changes in the business policy of the organization. It is here that this interface works. As observed elsewhere, demand and supply factors, for example, work as an interface between business organizations and business environment. While demand and supply factors make an environment by themselves for the business organization, they act as an interface between the aggregate environment and the organization.

Evidently, a business environment represented by certain dominating factors, which can be called a macro-environment, such as government policies, legal provisions, competitive factors, inflation, deflation or recession, as interface between the organization and its macro-environment, provide opportunities, threats or challenges to the organization. In the colour TV case discussed earlier, technological factors and competitive factor acted as micro-environment interface between the colour TV manufacturers and the macro-environment. While a new entrant is concerned with the existing environment, particularly the micro-environment, and the ways and means for the company to fit in within the framework of the existing environmental interface, an existing company is more interested in tracking the changing environmental factors.

During the course of scanning the business environment, a number of methods like economic and technological forecasting, detailed demographic projections, national and international market trends, changing trade relationship between governments, and so on can be used for identifying environmental changes. It is however, not very easy to identify or accurately measures the changes in the interface in particular or in the macro-environment in general, though some factors can be easily identified.

In a global environment a competitive situation is bound to exist in the market, and hence a competitive marketing strategy in terms of market leader strategy, challenger strategy, niches strategy or follower strategy is appropriate. Such a strategy must ensure a defensive position for the company in the competitive environment. In such situations, the environment itself acts as an interface between the company and its competitor.

The structure of the industry, which includes the company and its competitors in addition to potential entrants, suppliers, buyers, and so on determines the level of competition. Hence the environment is influenced by all of them in some manner or the other. The business policy of every player has, therefore, to take cognizance of the threats posed by every other player including the new entrants. Thus, subject to the influence of a number of factors, the business environment provides opportunities and threats while its internal environment provides its strengths and weaknesses.

A competitive business environment is an essential characteristic of globalization. The nature of competition varies in different economic systems. In the context of widespread globalization process, tremendous changes are taking place in the business environment of economic systems. Corporate concern for international business environment is understandable in relation to the globalization of business.

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