Research Paper Law

China's FDI Policy is a Structured Model for India

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ABSTRACT

Foreign direct investment in Asia is increasing at a fast pace in the last few years with economic growth. According to United Nations Conference on Trade and Development, (UNCTAD) the whole of Asia at the current market scenario accounts for one-fifth of global FDI inflows. China and India are the two main players in FDI market and due to relative similarity between both the countries; China is a role model for India in its efforts to attract FDI. FDI is actually a superb catalyst of development not an initiator and it can effectively function as a catalyst only in the presence of certain factors such as threshold level of human capital, and the ability of indigenous firms to adapt and restructure the technology provided by foreign firms to suit local factor and product markets both of India and China who are the major players of the South Asian FDI market.

Keywords :

Introduction

The developing nations in South Asia and Asian economy for investment were neglected in the mid 1980's. A region based pattern of FDI flow has emerged in which the investor's attention has shifted from the conventional important developed nations in favour of emerging markets especially in Asia. According to United Nations Conference on Trade and Development, prospects for Asia is most positive with around 85 per cent of experts, multinational corporations and investment agencies expecting significantly increase in FDI flows to Asian regions.[1] According to the report submitted to UNCTAD, in 2007 global market saw an inflow increased in 2006 and 2007. There has been an increase in intra-Asian FDI which has been basically due to the optimum FDI regulations in Asian host countries. Over a period of time, change in government policies has initiated FDI by relaxing policy for foreign investors, reducing the taxes and reducing the complexity of procedures.

Impact of FDI on China's GDP

According to statistics, China approved total FDI investments of US$ 1, 88,300 million dollars which has increased by 34.31% from last year[2]. Such large FDI absorptions by China have made it open for large global investment participation. China started to open itself as a FDI host in 1979 and became the member of World Trade Organisation in December 2001 and in the consecutive year, the manufacturing industry accounted for 67% of the total volume of FDI. The foreign enterprises accounted for contractual projects worth above 100 million US dollars.[3]

FDI and GDP are the major determinants of the economy of any country. FDI affects the GDP of a country directly and hence they are positively correlated. GDP of a country is the symbol of the progress of the country. In 2011, FDI in China was US$ 711.8 billion. Having increased the FDI inflow by US$ 1988 billion, the GDP of China also increased. In 2011, China's GDP was US$ 11.48 trillion and in 2012 China's GDP grew up to 12.38 trillion. China opened up FDI in retail completely in 1992, the sector has seen a rapid growth of increased market consolidation, higher production efficiency enabled by rising investments in rural infrastructure, and booming exports made possible by the setting up of new supply chains. Many of these changes, according to Chinese analysts, were made possible by the entry of foreign retail giants such as Walmart and Carrefour, who changed the way Chinese companies, managed their businesses, from farm to business. Yet, 20 years on, it's Chinese local retailers and not their foreign competitors who dominate the retail market, with initial fears of a foreign invasion ultimately appearing unfounded as local companies learned quickly to out-compete their foreign rivals.

Wal-Mart sources all its merchandise locally and with that it provides jobs for thousands of Chinese people. Although Wal-Mart's US$ 7.5 billion in Chinese sales receipts account for only 2 percent of Wal-Mart Company's annual revenues, its sales in China have risen substantially over the past decade. Around 20,000 Chinese suppliers reportedly provide Wal-Mart Company with about 70 percent of the nearly US$ 420 billion worth of goods that it sells on a global level annually. China has become a major recipient and very crucial for Wal-Mart Company's overall supply chain. Due to this very reason, the company which is a global retail giant per se moved its global sourcing headquarters across the border from Hong Kong to a Shenzhen which is in Southern China.[4]

Reason for the growth of FDI in retail was China's large size of population which suggested a global market. China's large population had an emerging middle class who was optimistic and enthusiastic to spend money. The National Bureau of Statistics announced that retail spending in China grew 17.1% in 2011, and projected that retail sales will increase rapidly over the next years. [5]

FDI Scenario in India

India and China received large FDI flows in the 1990's. FDI flows to China are, however around 15 times more than that of India. According to the past statistics, FDI inflows to China grew from US$ 3.5 billion in 1990 to US$ 52.7 billion in 2002, while the scenario in India was quiet disappointing. In the same time frame, India rose from US$ 0.4 billion to US$ 3.5 billion[6]. China's merchandise exports have been largely a result of FDI. On the contrary, in India FDI has been very less important in driving export. The FDI liberalisation and the overall development strategy of both the countries are likely the reason for the difference in FDI performance index. According to UNCTAD, China was ranked 27th while India was ranked 79th globally in terms of inward FDI potential index[7]. Inward FDI potential index depends on various factors such as share of world FDI inward stock, the rate of GDP growth over the past decade.

According to a survey conducted by the Federation of Indian Chambers of Commerce and Industry (FICCI), it was suggested that China has a better FDI policy framework, market growth, rate of return, consumer purchasing power, labour laws and tax regime than India.[8] In India, the FDI is not allowed in retailing. FDI is allowed in franchising and commission agent services. In both these segments proposals are examined and given approval under the Foreign Investment Promotion Board (FIPB). The present FDI policy in India states two ways of FDI inflows in India. FDI up to 100% is allowed under the automatic route in all activities except a small list that requires approval of the government. FDI in activities under automatic route does not require any prior approval either by the government or the Reserve Bank of India (RBI).

Why there is a need of huge FDI in India

In a newspaper article, when asked by Eric Schmidt (CEO of Google Inc.), whether India or China is much booming in terms of prospective growth then he pointed out India in a very optimistic manner. According to Google estimates, 5 billion people are set to gain access to the internet worldwide and a majority of this would come from India. But a very critical issue was pointed out that of India's 1.2 billion population, only 130 million are connected to the internet. A mere 20 million have access to high-speed broadband connection. Eric Schmidt remarked that there is a need to improve the situation which is possible by investment in the Internet infrastructure. According to Sam Pitroda, chairman of National Innovation Council, India needs to spend US$ 20 billion on technology.[9]

Google also remarked that the current scenario of internet availability in India is the same as that of USA in 1994. Hence there is a need of FDI investment in internet sector of India but that could be efficiently possible when the policy framework provides prospective investment benefits to the investors.

Obstructions for FDI in India

The population factor of India is of major importance as far as FDI is concerned. This has opened a great FDI market for the investors. However, India is still not able to attract FDI like China. The reason for this is not only the policy framework but other aspects also. These are:

Political Instability: In recent past years, the government at the centre has become instable with multiple political parties having formed ruling coalition. This instability has been caused due to the different views and agendas of parties in coalition. In China, due to a unified political decision making factor this problem is not present. Apart from this, corruption has dominated almost all the public service departments of India. This has created a sense of discouragement in the minds of foreign investors and has abstained them from investing in India.

Bureaucratic obstructions: Unlike that in China where the policy is utmost liberal, India has actually a stringent set of rules. Foreign investors have to deal with insufficient and slow moving bureaucracy for several things. Although the Indian economy is progressing towards liberalization and globalization, the process of economic reforms is rather quiet slow. The complex approval procedure confronting foreign investors also discourages FDI.

Taxes and tariffs: India follows a complex tax and tariff structure, which makes it difficult for potential investors to project their returns. This complexity arises because different states of India have different tax and tariff policy. This creates a lot of chaos for the foreign investors and also adds to the uncertainty of proper returns for the investors.

Conclusion

India is fast emerging as a major destination for investment by the global retail chains but there are barriers like low purchasing power, heterogeneous consumer base, poor logistics networks and regulations which are not at all investment friendly. These barriers have to a great extent reduced the investment prospects in India for the foreign investors. In order to attract FDI, the government needs to improve the regulatory and infrastructure obstructions. No doubt that the FDI is directly proportional to the GDP growth but the actual impact of FDI depends on overall growth and performance of Indian economy. FDI in retail sector of Indian economy would provide the same prospects as that of China. Entry of foreign retailers would improve the quality of employment but its impact on job opportunities would depend on overall growth of economy, growth of food processing and development of logistics. Apart from retail, India needs a great amount of FDI in internet industry. Though there is a substantial FDI in software sector yet the availability of internet facility is very limited. China has shown a tremendous growth and this has provided a set lesson for India as both nations have shared similar historical, geographical and economical past. Population aspect is also a key factor for both nations as this provides lucrative prospects for the investors as is quite evident from the economic growth of China. Regulated FDI in China has strengthened Chinese economy. India has to learn from the Chinese experience as how to attract larger FDI and how to effectively utilise that for increasing output and export.

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