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Foreign Direct Investment and Economic Growth: Comparative Position of Chinese and Indian Economies

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Abstract
The main purpose of conducting that research is to find out the patterns and flow of Foreign Direct Investment and economic growth in Chinese and Indian economies. We conducted an exploratory qualitative research to find out flow, patterns and directions of FDI and Economic Growth in these economies. We examined which country is in better position for attracting more FDI and enhancing their economic growth. We examined which country economy performing well as compare to other in term of FDI and Economic Growth. By examining researches and articles of different scholars and other data of FDI published by World Banks, IMF & central banks and other facts and figures relating to FDI and economic growth of these countries, We found that China is in far better position in infrastructure, economic activities and China has favorable business environment as compare to India, However India compete China in better legal and political system. We also find that foreign direct investments have positive impact on economic growth of Indian and Chinese economies. FDI positively impact on GDP growth rate of these countries that lead to increase in their per capita income.

Key words: *Foreign Direct Investment, Economic Growth.*

1. Introduction

China and India are the most important countries in the world in sense of population and economy. Both countries have an ancient cultural heritage. Both countries did much more practical for bringing economic reform and liberalization China in the late 1970s and India in the early 1990s. Both countries are now trying to more liberalizing their economies as they open up to foreign direct investment (FDI).

FDI has increasingly been considered as a catalyst to market growth for the developing countries, particularly in countries such as China and India. More importantly, besides supplementing capital, FDI, as a principal conduit of technology upgrade, know-how transfer and managing skills exchange, heralds the globalization of host economies (United Nations Conference on Trade and Development. 2005; UNCTAD 2006).

From last two decades foreign direct investment well knows by business world, it receives more attention from all over the world. It is accepted all over the world that foreign direct investment (FDI) plays a positive role in the process of economic growth. According to Thomas et al. (2008) foreign affiliates of transnational corporation (TNCs) succeed in developing new products and technologies faster than local firms, thereby exerting competitive pressure and forcing local firms to imitate and innovate. This is the main reason because of why; the developing countries are trying to attract more foreign direct investment.

It is accepted all over the world among policymakers that foreign direct investment (FDI) produce positive productivity results for host countries. In many developing countries which properly utilized FDI as a results more jobs created and people's lives definitely improved, their per capita income, country GDP has raised, which ultimately improve standard of living. These benefits, together with the direct capital financing it provides, suggest that FDI can play an important role in modernizing a national economy and promoting economic development.

The main purpose of conducting that research is to find out the patterns and flow of Foreign Direct Investment and economic growth in Chinese and Indian economies. We conducted an exploratory qualitative research to find out flow, patterns and directions of FDI and Economic Growth in these economies. We examined which country is in better position for attracting more FDI and enhancing their economic growth. We examined which country economy performing well as compare to other in term of FDI and Economic Growth.

We examined Indian and Chinese economies to see patterns and flow of foreign direct investments in these countries. We took two big economies because now day by day they are beating other economies, as we see last few years china beat Japanese economy and Indian economy also trying to beat Chinese economy. From last decade these two economies performed well. They expanded their business worldwide and able to attract satisfactory foreign direct investments.

By examining researches and articles of different scholars and other data of FDI published by World Banks, IMF & central banks and other facts and figures relating to FDI and economic growth of these countries, We found that China is in far better position in infrastructure, economic activities and China has favorable business environment as compare to India, However India compete China in better legal and political system. We also find that foreign direct investments have positive impact on economic growth of Indian & Chinese economy. FDI positively impact on GDP growth rate of these countries that leads to increase in their per capita income.

2. Methodology

We conducted an exploratory qualitative research to find out flow, patterns and directions of FDI and Economic Growth in these economies. We examined which country is in better position for attracting more FDI and enhancing their economic growth. We examined which country economy performing well as compare to other in term of FDI and Economic Growth. Secondary data of World Bank, IMF, UNCTAD investments reports and other financial institutions were used.

3. Review of Literature

Foreign direct investment (FDI) plays a positive role in the process of economic growth. According to Todaro, Smith and Hayami, Foreign direct investment (FDI) has been recognized as an important resource for economic development. FDI may have a positive impact on economic growth leading to an enlarged market size, which in turn attracts further FDI. Some studies in this literature have found that FDI exerts a positive growth effect on the recipient countries (De Mello, 1999; Chong et al., 2010). Many people argue that the flows of FDI could fill the gap between desired investments and domestically mobilized saving (Todaro and Smith, 2003, Hayami, 2001). Further they said that FDI also may increase tax revenues and improve management, technology, as well as labor skills in host countries (Todaro and Smith, 2003, Hayami, 2001).

According to Hayami FDI may help the host country to break out of the vicious cycle of underdevelopment (Hayami, 2001). Jenkins and Thomas described that the benefits accrued from FDI may include the acquisition of new technology, employment creation, human capital development, contribution to international trade integration, enhancing domestic investment, and increasing tax revenue generated by FDI (Jenkins and Thomas, 2002; World Bank, 2000). According to Bartels and Pass FDI in-flows can contribute to poverty reduction in a particular country only when the enabling environment and actual FDI flows are enveloped by a policy coherence that is well-attuned to prevailing economic conditions and well-articulated, by that particular host country's policy-makers, to local, regional and global investment dynamics [Bartels and Pass (2000)].

Production and other business activities of MNEs being increasingly finely 'sliced and diced' into smaller and smaller constituent elements, and then reconfigured, so as to gain competitive advantage from economies of scale and economies of scope [Bartels and Pass (2000)]. Borensztein, De Gregorio, and Lee (1998) and Xu (2000) show that FDI brings technology, which translates into higher growth only when the host country has a minimum threshold of stock of human capital.

Wheeler and Mody (1992) show FDI to be self-reinforcing because the existing stock of foreign investment is a significant determinant of current investment decisions. Alfaro, Chanda, Kalemli-Ozcan and Sayek (2004), Durham (2004), and Hermes and Lensink (2003) provide evidence those only countries with well-developed financial markets gain significantly from FDI in terms of their growth rates.

Foreign investors keep in the mind to do FDI after seeing and properly examining the economic and market conditions of the host country, Followings are the main

4. Factors affecting FDI: (Conditions of those factors in China and India)

a) Economic Activity

Economic activity of a country effect on the flow of FDI, better conditions definitely have positive effect on Foreign Direct Investment. Different researcher proved in their researches that favorable and growing economic activities convince the foreign investors to make investment in host country. According to Shatz and Venables (2000) market size determines the foreign markets in which firms invest. Fung et al. (2002) examine the determinants of FDI from the United States and Japan in China using a regional data set. They find that the GDP level has a significant positive impact on inflows of FDI. Zhang and Daly (2011) proof the same result in the opposite flow direction. Billington (1999) stresses that in addition to a high GDP, economic growth positively effects FDI inflow.

Chinese gross domestic product (GDP), adjusted for purchasing power parity, ranked number 2 after USA, whereas Indian adjusted GDP ranked number 4 after Japan. Over the past two decades, China's average annual growth rate was above 9 percent, and the average annual inflation rate was kept below 3 percent. The Chinese economy continues its robust development, total growth in 2005 exceeded expectations at nearly 10 percent.

In contrast, the Indian rate also jumped from about 3 percent a year during 1950-79 to between 5-6 percent a year during 1980-2004 (Chai and Roy 2006). According to the research on the contribution of GDP growth to FDI by Hsiao and Shen, the elasticity of a 1 percent increase in GDP raises FDI by 2.117 percent (Hsiao and Shen 2003).

Hryckiewicz and Kowalewski (2010) note that size and growth is not only important for FDI of industrial firms. Besides that size or growth factors there are also many other which influence the pattern of FDI. According to Addison and Heshmati (2003) openness to trade is a significant FDI parameter, especially for Latin America. In (2002) Asiedu reveals that in developing countries, openness to FDI depends on the type of investment. She also finds that openness to trade has a positive impact on FDI flows.

Pantulu and Poon (2003), Janicki and Wunnava (2004) argue that openness to trade is an important determinant and explain that trade and investments complement each other. Nonnenberg and Cardoso de Mendonça (2004) stress that the openness of an economy is a proxy for the “willingness of a country” to accept FDI and that it is an important factor in attracting capital.

Al Nasser (2007) and Torrisi et al. (2008) find similar results and conclude that the openness of an economy enhances FDI. Zhang and Daly (2011) reveal that China’s FDI are flowing to open economic regimes and to countries with high volumes of export from China. Baniak et al. (2005) explore important factors that determine the flow of FDI into transition countries and show that macroeconomic instability reduces inward FDI.

In conclusion we can say china has big and structured market and well established and more liberalization oriented polices and have large numbers of customers for attracting foreign direct investment. However India has also a big market with huge customers but not like China a well established foreign connections and economic stability for attracting FDI.

b) Infrastructure

Infrastructure of a host country also plays an important role for attracting of foreign Direct Investment. Al Nasser (2007) supports these findings for FDI decisions in Latin America. Addison and Heshmati (2003) stress that level of information and communication technology strongly impacts inward FDI. According to Borenzstein, De Gregoria and Lee adequate levels of education and infrastructure are required to fully benefit from FDI (Borenzstein, De Gregoria and Lee, 1998).

By the following table we can see different provinces of china that receive FDI and their % of Total FDI in India.

Table-1: Province-wise FDI Inflows in China 1979-2005.

(Amount in US $billions)

Rank	Province	Amount of FDI inflows	%age of total India FDI
1	Guangdong	151.657	24.36%
2	Jiangsu	89.848	14.44%
3	Shanghai	55.394	8.90%
4	Shandong	52.932	8.50%
5	Fujian	47.851	7.68%

Sources: China Foreign Investment Report 2006, Ministry of Commerce

Using China's provincial and municipal data, Hsiao and Shen found out that the development of cities and infrastructure and easy access to markets are two of the primary factors often determining MNCs' choice of where to invest (Hsiao and Shen 2003).

Region-wise FDI Equity inflows in India, 2000-2006

(Amount in US $millions)

Rank	Regional office	State covered	Amount of FDI inflows	%age of total India FDI
1	Mumbai	Maharashtra, Darda &Nagar Haveli, Daman & Diu	7,486.6	24.91%
2	New Delhi	Delhi, Part of Up and Haryana	7,045	23.42%
3	Chennai	Tamil Nadu, Pondicheery	2,295	7.64%
4	Bangalore	Karnataka	2,052	6.82%
5	Hyderabad	Andhra Pradesh	1,157	3.86%
6	Ahmedabad	Gujarat	970	3.26%

Sources: Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, India. *Fact Sheet on FDI, from Aug.1991-Dec.2006*

Tamuli asserted that FDI inflows to these states seemed to respond to infrastructure availability, business managers' perception of investment climate, educational qualification of manufacturing workers and productivity level of manufacturing industries (Tamuli 2006). India needs to build and improve their infrastructure like china for attracting more FDI.

c) Legal and Political System

Legal and political system plays a vital role for attracting FDI. According to Ramcharran (1999), political instability in terms of civil wars, illegal capital flight, financial-market instability and political corruption have significant effects on FDI. Ramcharran (2000) shows that regulatory and risk reduction factors contributed positively to FDI and that an unaccommodating legal environment and country risks are the main deterrents of FDI. Baniak et al. (2005) find that legal stability is crucial for stimulating FDI inflows, and increasing transparency regarding the legal framework of a country affects FDI decisions.

Naudé and Krugell (2007) confirm this and emphasize that the regulatory burden and the rule of law are robust determinants of FDI. In addition, UNCTAD (2008b) finds that participatory, transparent, and accountable governance systems that promote and enforce the rule of law are critical. Naudé and Krugell (2007) argue that, in addition to the quality of the legal system, political stability plays a significant role in attracting FDI.

The lack of a well-structured and transparent legal system in China poses serious problems for foreign investors. A clear and strict hierarchical system of norms does not really exist yet. Moreover, different ministries and departments of the central and local governments have issued many diverse regulations, which result in the failure of the foreign companies to find out which regulations exactly apply to them.

In contrast, India enjoys a strong British-based legal and accounting system, which helps it to attract more capital from Western countries. Therefore, the absence of reliable legal and secure property rights and vast differences in culture help to explain China's below par performance in attracting FDI from Western countries, compared with the performance of India. Meanwhile, India's long history of private property, democracy and similar law system with

Western countries should prove attractive for potential foreign investors. In other words, even if economic policy is great and politics stable, if there are no property rights and contract enforcement in a country, there's no way anyone can do business. Here the china needs to improve their legal and political system for attracting more inflows of FDI.

d) Business Environment of the Host Country

Good Business environment of the host country prove a positive sign for attracting of Foreign Direct Investment, and that is proved by many researcher in their articles. Rodriguez and Pallas (2008) show that foreign investors are motivated by labor costs, but human capital, a fundamental element of increased per-worker labor productivity, is likewise a significant determinant of FDI inflows.

According to Janicki and Wunnava (2004) labor costs are a key determinant for FDI inflows in developing countries. According to Wei (2000) a rise in the tax rate on multinational firms reduces inward FDI. According to Wei (2000) corruption affects both the volume and the composition of inward FDI flows. Baniak et al. (2005) find that the time requirements and the complexity of bureaucratic procedures influence the expected utility from profit, thereby affecting the results of FDI decisions. Bénassy-Quéré et al. (2007) confirm that bureaucracy is an important determinant for FDI inflow.

A survey of global executives was conducted by the Global Business Policy Council (GBPC) in 2005 and published as FDI Confidence Index. Both China (2.19) and India (1.95) are at the center of the FDI radar screen for they are considered as the 1st and 2nd most attractive FDI locations globally. This is the fourth year in a row that China held the top spot and India rose from 3rd to 2nd place, surpassing the United States (GBPC 2005). The results of survey of Global Business Policy Council (GBPC) revealed that those who were surveyed regarded China as the most attractive location with 55% of the CEO surveyed were willing to invest the most in China, followed by India (36%). Again, both countries are considered as the most favored investment destination (United Nations Conference on Trade and Development. 2005).

5. FDI and Economic Growth in China and India: Comparative Analyses

Following table consists of data world investment report 2006.

Table-2: Comparison of FDI inflows to China and India

(Amount in US $millions)

	1990-2000 (annual average)	**2002**	**2003**	**2004**	**2005**
China	30104	52743	53505	60630	72406
India	1705	5627	4585	5474	6598
Developing economies	134670	163583	175138	275032	334285
World	495391	617732	557869	710755	916277

Source: UNCTAD, *World Investment Report 2006* (www.unctad.org/wir)

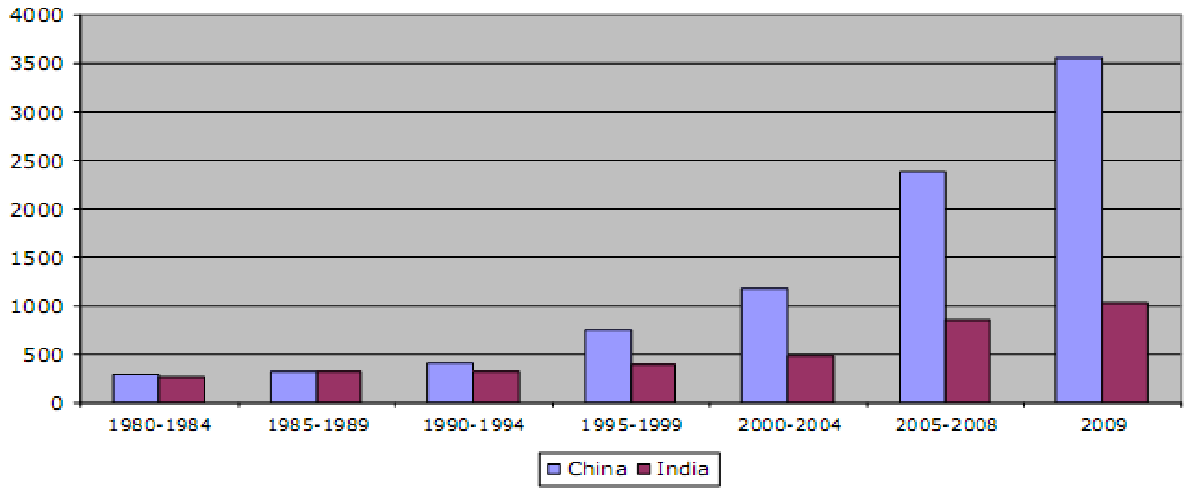
India's share of global flows to developing countries appears to be very small, especially compared with those received by China. The reported inflows of US $6.6 billion in 2005 represented a mere 1.9 percent of total inflows to developing economies, in contrast to US $72.4 billion inflows to china with a share of 21 percent (Ray 2005).

As table-2 shows flow of FDI of china and India we see all over china is receiving more FDI as compare to India, it is due to better climate and better business climate to the investors as compare to India. It is the result of better policies for foreign direct investment by Chinese Government.

6. Economic growth

Figure-1 refers to the Gross Domestic Product per capita since 1980.
It is apparent that until the beginning of the '90s GDP per capita was similar in the two "developing" countries. Since the mid '90s, China's growth has been much faster, so in the final year (2009) per capita GDP in China was more than three times that of India.

Figure 1 - GDP per capita



Source: Processing of IMF Statistics

By observing that above given figure we can say as FDI flows increased time to time then GDP of both countries raised, so we see China received more FDI as compare to India so, GDP per capita of China is also greater the India. However we see in above figure that GDP per capita of India also increased with the passage of time as FDI inflows in Table-2 increased.

7. Conclusion

In this paper we examine FDI flows in China and India, as the China receiving more FDI flows as compare to India due to many reasons like China opened its doors to FDI in 1979 and has been progressively liberalizing its investment regime. India allowed FDI long before that but did not take comprehensive steps towards liberalization until 1991.

China adopting proactive approach for attracting more FDI, China providing low labor costs, potential foreign market, favorable investment incentives that factors playing important role for attraction of FDI.

Chinese gross domestic product (GDP), adjusted for purchasing power parity, ranked number 2 after USA, whereas Indian adjusted GDP ranked number 4 after Japan. Over the past two decades, China's average annual growth rate was above 9 percent, and the average annual inflation rate was kept below 3 percent. The Chinese economy continues its robust development, total growth in 2005 exceeded expectations at nearly 10 percent. In contrast, the Indian rate also jumped from about 3 percent a year during 1950-79 to between 5-6 percent a year during 1980-2004, and also China has better infrastructure for attracting of FDI. But India is far better in political and legal system as compare to China.

China has 5 to 6 time greater FDI inflows and economy then India and China is playing well in business market so because of that Economic growth of India is also below from China as we see in figures and tables in above our discussion; however India is also trying to improve their policies regarding FDI attraction and brought many reforms like tax incentives to investors for doing more investment in their country.

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