Chapter – V (a)

A comparative study of China and India: in Perspective
Foreign Direct Investment policy and Analysis

5. Introduction
   a. Significance of FDI?
   b. Determinant factors of FDI?
   c. Need for comparison: China and India
   d. Framework of Technology Transfer through FDI in source country
   e. How FDI influences economic indicators in the economy

5.2. An overview of FDI in China and India - a Transition prospective

5.3. Comparison of FDI policy analysis in China and India

5.4. Role of FDI in selected indicators can influence Transition economics
   (1978 to 2010)

5.5. Conclusion
Introduction

Foreign Direct Investment (FDI) is an internal part of an openness of effective international economic system and a major catalyst to development (OCED, 2002). Transitional economy means ‘from planned economy to market-oriented economy’. It involves structural or policy reforms, such as currency or capital market changes. Foreign investment is also a serious problem for an emerging economy. In most cases, foreign investment increase is a postulate sign regarding the state of health of the economy. The injection of foreign currency into the local economy aids long-term investment to its infrastructure. The neo-classical approach argues that FDI affects only the level of income and leave the long-run growth unchanged (Solow, De Mello). This long-run growth changes due technological progress and economic growth. Thus, according to classical model of economic growth, FDI would growth advancing if it affects technology positively and permanently (Shiva S. Makki, Agapi Somwaru, 2001).

The East Asian Economies initiated the process of opening up of external sector and liberalization of economic policies during the 1960s. In China, transition was started in 1979, while India, in 1991, as a result of the various problems of external sector liberalisation and balance of payments. Reforms lead certain major restructuring of the economies. It required large quantity of financial aid to promote and strengthen the micro and macro-economic institutions of the countries and make an appropriate investment-friendly institutional infrastructure. In addition, foreign aid has been received on direct lending program, as well as portfolio investments. On the other hand, for effectiveness of these programs, resources have been limited because of inadequate of sufficient spillover benefits, such as technology and managerial skills, partly due to the reversible nature of the programmes. FDI has been classified into two types such as (a) Inward investment; and (b) Outward investment. Inward investment is an investment that occurs in local resources for instances, tax break, relations of existent regulations, loans on low rates of interest and specific grants. Outward investment is ‘direct investment from abroad’, in local capital which is being invested from foreign resources. FDI is less reversible and at the same time it acts as a channel for transmission of technology and managerial skills (Merlevedes and Schoors, 2004, Dharmenddra Dhakal et al., 2007); and also, Sinh and

---

Weichenrieder (1997), argue that it is an indispensable ingredient in a successful strategy for economic growth and prosperity.

China and India have been emerging countries in the ‘BRIC’ economies, and also these countries are increasingly becoming more imperative economic players in the global scenario. In 2007, the BRIC countries’ share of global GDP amounted to almost 13% (measured at market exchange rates) - or 20% (in PPP terms). In 2007, the BRIC share of the global FDI stock was a mere 3.3% (USD 510 billion), while flows amounted to a somewhat higher 4.5% (USD 90 billion), much smaller than the BRIC countries’ economic weight (Markus Jaeger, 2009).

The potential of growth of emerging markets a Goldman Sachs study ‘Dreaming with BRICS: the path to 2050’ can be larger than the G8 in less than 40 years from now. Kearney’s ‘Global FDI confidence Index’ ranks China as the first rank in country for the last three consecutive years in attracting FDI.

A great amount of research has been done on China and India the area of FDI, development and other aspects. After transition, both countries have been emerging as open market economies. Moreover, re-strengthening development indicators have followed the diversified decisions taken by the policy makers. The transition, intended to make a market-oriented and industrialization, it leads to be an open economy. Still, many countries had followed and successfully promoted on transition prospective. In China and India, many sectors are attracting more FDI. Firms both countries have a comparative advantage over those of other countries. Moreover, FDI has proved to be a dynamic player for development strategies in China and India and other developing counties. Hence, the most important question is ‘what can be learnt from each other’s experience and the challenges ahead?’. 

A recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations (TNCs) during 2010-2012. Presently, top ten sectors, such as services, computer software and hardware, telecommunication, and construction activities are attracted higher FDI inflows. Mauritius, Singapore, the US and the UK share the top sports in attracting FDI. According to UNCTAD, there was no significant growth of Global FDI in 2010.
Figure 5.1: FDI inflows of India, China and World from 1980-2010

Figure 5.1 illustrates how both countries’ FDI inflows compare with those of the rest of the world. In 2010, the global FDI was $1.122 billion and $1.114 billion in 2009. The figure shows 25 per cent below the pre-crisis average during the period 2005 to 2007. It also depicts the FDI inflow trend has been almost parallel to that of the world in certain years. However, China’s FDI flows are slightly parallel to the world FDI in a certain years.

Table 5.1: FDI inward into ‘BRICS’ Countries and the World from 1980 - 2010

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>1910</td>
<td>1418</td>
<td>989</td>
<td>4405</td>
<td>32779</td>
<td>15066</td>
<td>48438</td>
</tr>
<tr>
<td>Russia</td>
<td>N.A</td>
<td>N.A</td>
<td>N.A</td>
<td>2,066</td>
<td>2715</td>
<td>12886</td>
<td>41194.4</td>
</tr>
<tr>
<td>India</td>
<td>79.2</td>
<td>106.1</td>
<td>236.7</td>
<td>2151</td>
<td>3588</td>
<td>7621.8</td>
<td>24639.91</td>
</tr>
<tr>
<td>China</td>
<td>57</td>
<td>1956</td>
<td>3487.1</td>
<td>3752.05</td>
<td>40713.8</td>
<td>72406</td>
<td>105735</td>
</tr>
<tr>
<td>South Africa</td>
<td>-10.3</td>
<td>-448</td>
<td>-78.4</td>
<td>1241.3</td>
<td>887.3</td>
<td>6646.9</td>
<td>1553.02</td>
</tr>
<tr>
<td>Transition economies@</td>
<td>23.6</td>
<td>15</td>
<td>75.2</td>
<td>4112.6</td>
<td>7024.9</td>
<td>31100</td>
<td>68196.976</td>
</tr>
<tr>
<td>Developing economies</td>
<td>7477.0</td>
<td>14153.7</td>
<td>35095.6</td>
<td>256465.2</td>
<td>330129.9</td>
<td>630012.5</td>
<td>573568.06</td>
</tr>
<tr>
<td>Developing economies in Asia</td>
<td>542.6</td>
<td>5397.5</td>
<td>22628.4</td>
<td>148735.1</td>
<td>215768.8</td>
<td>372738.9</td>
<td>357845.87</td>
</tr>
<tr>
<td>World</td>
<td>54076.4</td>
<td>55831.9</td>
<td>207697.2</td>
<td>1401466.4</td>
<td>985795.6</td>
<td>1770872.8</td>
<td>1243670.9</td>
</tr>
</tbody>
</table>

Sources: UNCTAD, US Dollars at current prices and current exchange rates in millions
@Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Georgia, Kazakhstan, Kyrgyzstan, Montenegro, Republic of Moldova, Russian Federation, Serbia, Tajikistan, The former Yugoslav Republic of Macedonia, Turkmenistan, Ukraine, Uzbekistan (UNCTAD, 2010).
Table 5.1 describes the inward FDI of emerging countries of BRICS’ and aggregate of transition countries, developed countries, developing countries and the world from 1980 to 2010. India and China FDI inflows have been tremendously increasing but, if compared to China’s FDI inflows (60387 million) these were was different with those of India in 2009. In the beginning of 1980, India’s FDI inflows were high as against China’s. However, transition economies aggregate FDI inflows have been increasing over the periods. At the same time, aggregate FDI flows of developing economies in Asia in 2010 decreased, as compared with 2005, due to financial recession.

b. Determinant factors of FDI


Figure 5.2: Determinants of inflow of FDI in Transition Economies

Although, most of the research was focused on firm level of productivity and economic growth, while very few of them have discussed on determinates of FDI inflow in to
transition economies in Eastern and Central European Countries.\textsuperscript{2} It is, necessary to the
discusses determinant factors of FDI inflows, effects and consequences in India and China
into transition prospective.

c. Need for comparing both these countries

Both China and Indian provide a fertile grand for research because social-
economic indicators of the countries are similar. These include: size of the territory,
history, population, culture, religion, language, political institutions, real GDP growth
rates, openness of the trade and other indicators. Additionally, in the 21\textsuperscript{st} century, both
economies have been emerging rapidly due to their economic policies, as well as
international trade and capital markets. Moreover, policies and experiences of both
countries would be useful for neighbouring and developing countries. Further, in the
coming years, both countries would emerge as economic and politically powerful
countries in the global scenario. Also the, growth trajectory in both nations has followed a
similar pattern to advanced countries and successful East Asian economies, at comparable
stages of development (Nayyar, 2008; Melia U. Santos-Paulino, 2010).\textsuperscript{3}

d. Framework of Technology Transfer through FDI in source country

The framework adopted to test this hypothesis, shown in Figure-1, has been
adapted from Lan (1996). The advantage is that this offers the chance to comprehend this
important aspect of foreign ownership control in the comparative study of the technology
transfer behaviour between source countries.

There are three dimensions to the problem. One measures the overall contribution
of FDI to indigenous technology capability (direct and indirect). The second explores the
role of technology transfer (technology destination and nature).the third checks the
importance of dissent variables (Ownership control and source - country). Figure 3
describe the interplay of these three dimensions.

The X-axis shows the level of technology transfer taking place through direct
and indirect modes. Direct effect Y axis - the influence of technology refers to direct
acquisition of technology to the FDI firms from their foreign investors.


\textsuperscript{3} See the paper, “China and India: country Role Models of Development Success? UNU-WIDER.
Figure 5.3: Framework of Technology Transfer through FDI

This involves market transactions and easier to capture. Indirect effect implies the spin-off of inward technology outside the FDI firm. Rogers (1962) has explained diffusion of technology to competing companies intensifying competition in the product market. UNCTAD (1985, 1987 and 2001) bring out the three other modes of technology diffusion to indigenous sector from FDI: formation of spin-off enterprise, backward linkages through locally procure inputs leading to emergence of an indigenous supplier into product manufacture relations with the general scientific and business community.

The Z axis brings the various component of technology which the three knowledge forms.

1. **Hard production Technology**: this part is totally embedded knowledge, such as equipment and machinery use in production. Therefore changes in the equipment and machinery (embedded technology) may be considered an indication of technology progress (Solow, 1985). In the present study, therefore impact of capital goods is used to capture the transfer of hard production knowledge through FDI.

2. **Medium Production Technology**: this category involves technology that is either transferred in the form of designs and plans (technology import) or generated through in-house R&D activities by the FDI Firm.
3. **Soft Production and Organisation Technology:** this refers to the relationship between man and the production environment, such as experience, skill and training acquired in the process of production. It can be divided into two types. One is maintaining skills, which handle routine problems including familiarity with the environment, such as tools and quick response to them. The other is innovation skills, which deals with the non-routine problems including exploring and testing. The main channel to transfer this kind of knowledge is personal contacts.

By adopting the analytical framework, outlined above, the study attempt to bring out various aspects of source-country differences in technology behavior.⁴

**e. How FDI inflows influence Economic indicators**

Impact of FDI on the host economy is complex since foreign investments interact with and, thus, influence many local individuals, firms and institutions. Figure 5.4 brings out about the major channels that influence the host economy. Foreign direct investments interact with local firms and the host economy through knowledge, forward and backward linkages and competition. These key variables impact local firms, other industries and related industries; (Altenburg, 2000; Blomstrom and Kokko, 2002; Fan, 2002; and Klaus E Meyer, 2004). Foreign investments closely interact with local business; this channel also impacts the domestic economy. In addition, inward inflow affects many indicators in the host countries. FDI inflows also influence other key aspects, like micro-macro-economy, international trade, and monetary-fiscal policy. These indicators impact the firm (or) economy.

Multinational Enterprises differ in their internal operations, which include the centralisation of decision making, organisational cultures, and human resource management practices. Subsidiaries in emerging economies would differ in their interactions with other business units of the parent’s network. The interactions could include: the development of local supply networks, investment in human capital, employee mobility, and the stages of the value chain, located in the host economy. Figure 5.4 describe the structure and strategy by MNE channels adopted for inflow of FDI into the country. Of particular relevance for MNE spillovers are intra-firm knowledge transfers. Knowledge sharing within the MNE is a precondition for knowledge spillovers. This would also increase with higher value added activities.

Figure 5.4: Channels of Impact of FDI in Economic indicators in Economy

Sources: Saul Estrin and Klaus E. Meyer (2008)
The source of variation is the **mode of entry**. In a joint venture, two partners share their resources, in return for access to the partner’s resources. This can lead to mutual learning, and thus extend linkages and knowledge spillovers in the local business community. Greenfield projects create new businesses and thus have direct positive effects on employment and domestic value is added. These also increase competitive pressures on local enterprises as a result of an acquisition of fully operating enterprises.

Therefore, FDI can help stimulate innovation and invention. Successful local firms find that many entrepreneurs, or top managers, had prior linkage to MNEs. Moreover, large MNEs may stimulate the evolution of industrial clusters. It can lead to a firm drawing other network members to the same location, which can create a larger impact than the initial investment alone. Also, small ambitious firms, in emerging economies, are giving increasing importance to such production networks.

FDI inflow from the parent MNEs to the host country help in distributing investments to the local firms. Transnational corporations (TNCs) look for trade and more open economies for resource-seeking operations, especially as they integrate their global production with horizontal and vertical value-chain linkages. FDI flows into local firms through various channels.

**A. Intra-industry Spillovers:**

In a transition economy, FDI influence on local firms is inter-industry. The main theoretical foundation of these studies of knowledge spillovers is on the basis of demonstration effects and the movement of labour, as show below:

i. **Demonstration effects**: these work through the direct contact between local agents and MNEs operating at different levels of technology. By observing innovations adapted to local conditions, local entrepreneurs may recognise their feasibility and, thus strive to replicate them. As local businesses observe existing users, uncertainty is reduced, and levels of imitation increase. Foreign investors affect local business not only through productivity effects, but in a variety of other ways. The rationale of this literature is that MNEs would directly, or indirectly, share knowledge on how to operate in international markets, by building trade channels and by enhancing the reputation of the country-of-origin.
ii. FDI contributes to human capital formation, especially through training and labour mobility. Trained local employees may move to locally owned firms, or set up their own enterprises. Many successful local firms trace their origins to entrepreneurs or top managers who had prior links to MNEs (Altenbug, 2000).

Wherever such few employees move, they may make a substitutive contribution to local business. FDI would help local firms to access export markets. Moreover, foreign investors may hope to build trade channels and a country-of-origin reputation that local followers may use for enhancing their exports reputation (Altenburg, 2000). This way, foreign investors may support local supplier industries and markets for specialised inputs, such as labour and materials. With these improved inputs; local firms may enhance their services and productivity.

Thus, FDI would help host economies to better exploit their comparative advantages, and transfer their technologies that are more closely aligned with the needs of the hosts.

B. Inter-industry Spillover:

Local firms may benefit from vertical linkages in a supply chain, benefiting from knowledge transfers to suppliers and customers. MNEs may make a deliberate effort to improve the quality of local suppliers, especially for components that cannot be cost-efficiently imported, due to high transportation costs, or where the local industry has a natural cost advantage (e.g., for labour intensive components). These help firms in other industries, for instance, by providing business services, training in sales and marketing.

(i). Lall (1980) provides the first major study on vertical spillovers. Build on Hirschman (1958), Lall develops the theoretical arguments on why backward linkages would emerge, and provides the first systematic empirical evidence. An innovative approach to study vertical linkages has been used by Blederbos, Capannelli and Fukao (2001). This productivity effect is larger when the foreign investors are domestic market oriented, rather than export oriented.

(ii). Some of these variations are due to industry-specific features (Grosse, 2005). An issue of particular relevance for MNEs spillovers is inter-firm knowledge transfer. Knowledge sharing within the MNEs is a pre-condition for
knowledge spillover. Knowledge spillovers would also increase with higher value added activities.

(iii) Another source of variation is the mode of entry. In a joint venture, two partners share their resources in return for access to each other’s resources. This can lead to mutual learning, and, thus, extend linkages and knowledge spillovers in the local business community. These variations influence the effectiveness of government in designing policies aimed to attract more FDI in local firms.

(iv) Moreover, the impact of FDI varies with the ability of local stakeholders to take advantage of the potential benefits with FDI. Benefits are not obtained quasi-automatically. Likewise, local firms have own strategies and resource endowment are crucial for benefiting from interaction with foreign investors.

C. Absorptive Capacity:

Knowledge transfers, within MNEs and within strategic alliances (Lane and Lubatkin, 1998), include joint venture in emerging economies. Lane, Salk and Lyles (2001) and Lyles and Salk (1996) find that local joint venture partners improve their capacity to learn, if collaboration and exchange of information within the organisation is encouraged. Knowledge acquisitions by local joint venture partners are important since the host economy may gain. In this way, the processes of learning from MNE partners willing to share knowledge are different than learning from unrelated businesses actives (Martin and Salomon, 2003).

In the management literature, absorptive capacity is treated as a conceptualised dynamic capability, which is broader than its usage in the empirical spillover literature. In a recent restatement, Zahra and George (2002:186) define absorptive capacity as: “a set of organisational routines and processes by which firms acquire, assimilate, transform, and exploit knowledge to produce a dynamic organisational capability”. It encompasses not only human capital (Cohen and Levinthal, 1990), but also structural characteristics of the organisation abilities to assimilate value and commercialise new knowledge (Lane and Lubatkin, 1998). According to Buckley et. al., (2002), spillovers are different across firms under different forms of ownership. The authors attribute this to different absorptive capacities.
D. Entrepreneurship:
Entrepreneurship is a major driver of economic growth in transition economies. This is a crucial source of innovation, developing new knowledge by combining foreign and local knowledge. In this process, experimentation helps in developing innovations specific to the context, and promotes the process of “economic development as discovery” (Hausmann and Roderk, 2003). FDI can also act as a stimulus to evolutionary processes of resource creation, by promoting innovation and discovery (Kogut, 1996).

E. Clusters:
Industrial clusters have attracted the imagination of policy makers in transition economies, because they provide opportunities for direct interaction between firms, and thus for various firm spillovers and for economically specialisation. Though the evolution of industrial cluster is often driven by network organizations, FDI is a leading firm which may draw other network members to the same location and thus create a larger impact than the initial investment alone. Small ambitious firms emerging economies are increasingly accessing networks.

Yet, the long term-nature of supplier relationships and the global reach of incumbent raise entry barriers. The large firms are better placed in this regard, since they are able to guarantee quality and prompt delivery guarantee quality and just-in-time delivery. However, cluster plays a key role in economic development and also has a potentially central role in MNEs. Consequently, FDI inflows can create clusters in transition economies.5

FDI influence on micro-macro indicators in the transition economy
What are the micro effects on structural changes in the economic and industrial organisation? In general, FDI is conductive to the creation of a competitive environment in the host country. This approach, supported by Markusen and Venlldes (1997), includes two channels for analysis of micro effect in FDI, such as:

a. Product Market Competition

b. Linkage Effects

Product Market Competition (PMC): the MNCs will be substituting the products of domestic firms in the host country.

Linkage Effects: MNCs may work as complimentary firms in the host country. These provide outputs, and promote development of industries. FDI may have benefits, but it will not come without cost. However, liberalisation and the FDI impact macroeconomic factors in the transition countries (S.R. keshava, 2008).

A. Macro-economy: Macro-economics is all about the whole economic performance, structure, behaviour, and decision-making of the entire economy. The impact of FDI on macro-economic growth, in terms of GDP on the basis of endogenous growth models, has been examined by Borensztein, Gregorio and Lee (1998), Saul Estrin and Klaus E. Meyer (2008). The relationship between GDP and inflow FDI is moderately positive. Balasubramanyan, Salisu and Sapsford (1996) studied countries by their trade openness. They found that FDI has a more positive effect on economic growth of countries with export-oriented trade regime, compared to countries having import-substitution type trade regimes. On the other hand, Li and Liu (2005) examined the macroeconomics relationship, taking into account which foreign investors are likely to seek locations with higher economic growth, as well as contribute to this growth. FDI is a majorly macroeconomic variable of concern to policy makers: GDP, unemployment, gross domestic investment, inflation, savings, investment, consumption and output. These variables would have a positive relationship with each other variable.

-GDP: This is an important variable for explaining FDI inflows in countries. The investment is crucial importance in countries, where investments neither increasing nor decreasing. In fact, in the case of emerging economies per capita income growth rates are usually high and oftentimes, they are expected to continue to grow for a certain time. This increasing growth would attract more market seeking investors. The numbers of local firms would be increasing in the host countries. Hence, real GDP growth is usually expected to have a positive effect on FDI inflows.

-FDI imports capital: It is possible that at a later stage, capital is repatriated through profit remittance or project discontinuation. In this way, the host country pays for the costs of capital. However, FDI capital is appreciated by
the hosts because it tends to be less volatile than other forms of capital inflow (UN 1999, chap, 6).

- **FDI creates employment** if FDI is invested in Greenfield operations, additional jobs may be created in local suppliers. Yet, FDI may also crowd out local firms that use more labour-intensive methods of production. The policy-relevant net-employment effect is, thus, hard to assert (Dunning 1993, chap13; UN 1999, chap). In the case of acquisitions, the employment effect is even harder to assert, because it requires an analysis of what would have happened to the local firm, if it had not been taken over by the foreign investor (Estrin and Meyer, 2004).

- **FDI gross domestic investment**: part of the FDI may be domestically funded, or the capital inflow may increase the exchange rate and, thus, the costs of international borrowing. Both effects can lead to crowding out of local investment.

- **Finance**: Overall, the effect on macroeconomic variables varies greatly with the specific features of an FDI project, such that evidence on macroeconomic relationships may not be transferable from one context to another, and thus provide little guidance for policy makers. Rather, we need to understand the microeconomic effects of FDI, to identify which FDI, and under what circumstances, benefits the host economy.

- **Savings and incomes**: Investment creates income, which leads to savings. When the foreign inflows are rising income levels can increase in all sectors in the host country. At the same time, income generation increases and leads to rise in savings. FDI leads to increase in the investment levels in the transition economies. Thus, in this process, the income generation cycle occurs in an economy. We can, thus, say that income and savings have a positive relationship.

**II. Monetary and fiscal policies**: these policies have a significant role in play to controlling the whole economy. Let us now discuss the major controlling measures in the present context:

- The effect of host country’s inflation on FDI inflows is not apparent; we can say higher rate of inflation indicates internal economic in-stability; which
is also, important for monetary and fiscal policies for the country. Low inflation would provide a better environment for investment, it leads to economic growth (Fisher, and Modigliani; Froot and Stein). If, the host country government is unable to maintain monetary and fiscal policies, it can lead to high inflationary growth, firms face uncertainty in terms of product, and input prices. Thus, MNEs are unable to invest in such countries, as argued by Schneider and Frey (1998), Apergis and katrakilios (1998).

- **Taxes**: lower taxes rates would make the investments in both domestic and foreign more profitable. Foreign companies would then be interested in making investments in the host country’s markets.

- **FDI in exchange rate**: foreign investors may gain or lose from a depreciating exchange rate. For instance, with a depreciate exchange rate they can export more easily and gain from resource-seeking FDI. Foreign investors may lose as well, because they must incur costs to prevent transaction and translation losses when currency depreciates. If depreciation continues, foreign investors tend to avoid making investments. This kind of circumstance will also impede the inflow of FDI.

- **Stabilisation**: an important factor for attracting FDI into the host country, stabilisation entails controlling prices in a transition economy. The change in the prices, due to fluctuation in exchange rates, can lead to unstable conditions in local firms and also the host country’s economy. Foreign investors are not interest to invest in such an economy. Besides, the host country’s political stability is also important for inflow of investment. Thus, stabilisation is an important factor in interaction with local firms; institutions and business activities for attracting inflows into the host country’s economy.

- **Current account balance**: this is another important variable for determining the strength of the currency of any country. A decrease in current account balance leads to a depreciation in the host country’s currency. Such a deficit may lead to inflation and exchange rate differences. In such a case, raising the deficit in current account balance can result in reduction in FDI inflows. On the other hand, if multinational companies take advantage of the current account deficit of the host country by negotiating more favourable operative
terms, the current account deficit may help to increase FDI inflows (Dhakal, Dharmendra et. al., 2007).

III. International Trade:

- **Balance of payments in FDI**, It shows the export and imports of accounting trade process in domestic and foreign countries. It gives details about the inflows and outflows of investment, and physical and soft goods and production values. In the host country, it is an indicator of the strength of its currency. A deteriorating current account balance leads to a depreciation of the host country’s currency. It is possible that potential multinational investors view current account deficits negatively, because such deficits may lead to inflation and exchange rate variations. In most cases, an increase in the current account deficit may lead to a reduction in FDI inflows.

- FDI in trade activities generates foreign exchange through exports, which counter the financial outflow of repatriated profits. It also creates competitiveness in trade activities. Therefore, in the long-run, FDI should not be a cause for the balance of payments problem, other than seriously misleading foreign exchange regimes. Hence, the real solution is not restricting FDI, but, rather, addressing the foreign exchange constraints of the economies (Xiaolum Sun, 2002).

- FDI inflows of *exports and imports* have a very important role to play in the country growth of a country. Yet, FDI can also generate imports, especially in the case of market-seeking FDI, and in the case of outsourcing operations that process imported components. MNEs are typically more internationally oriented, but this affects both sales and procurement. Thus, the net effect of the trade balance may be much smaller than the data on exports by FDI may suggest (UN 1999, chap. 8).

**Natural Environment and Social issues:**

The strong bargaining power of MNEs vis-a-vis their employees and the potential host country could lead to a lowering of labour standards and wages and may also have a detrimental impact on the natural environment.

The standardisation of business practices and technologies across the subsidiaries of an MNE would raise standards above local requirements in countries with less
demanding standards. On the other hand, lower standards and lower wages present opportunities to reduce production costs.

Institutional:

Institutional indicators have an important role to play in creating a policy for inflow of FDI. Government policy must also to aim to enable local firms to interact with multinational corporations in ways that benefits both parties. The result shows that most policies that promote the development of local business would also strengthen the abilities of local businesses to make the best out of their interaction with foreign investors, for instance, education policy or competition policy.

5.1. FDI in China and India: a Transition Economies Perspective

(a). Overview of FDI in India:

India is the world’s largest democracy and 4th largest economy (in terms of PPP) in the world. Its consistent performance in growth and abundant high-skilled manpower, and cheap labour provide numerous opportunities for investments through FDI. Since 1991, major reform initiatives have been made in the fields of investment, trade, financial sector, exchange control simplification procedures, and intellectual property rights laws, etc. Pre-liberalisation inflows of private capital from abroad had been negligible and these averaged to less than $200 million in 1985-1990 (Gandhi, 2002). During the 1960s and 1970s, there were negative net inflows of foreign capital, caused by factors such as nationalisation of foreign oil companies and consequent closure or sell-out of foreign oil companies. Faced by the balance of payment crisis, India opted for economic reforms in July 1991, with the intention of restructuring its economy. Foreign investment, which had till then been viewed with mistrust and suspicion, was overnight welcomed. After, liberalisation in 1991, FDI became a significant component of total foreign investment inflows. Also, there was a spurt in inflows, as the Indian corporate sector used the Global Depository Receipts (GDR).

FDI flows rose from $ 236.7 million to the peak level of $ 34613.2 million between 1991 and 1999. FDI, as a proportion of GDP, improved considerably from 0.05 per cent to a peak level of 1.9 per cent in 1996-97, but has been hovering around 1 per cent in subsequent years. Nevertheless, it is far below the expected level, and also in relation to FDI flows to China, a country of comparable size. In mid-1990s, interest rates
(prime lending rate) were significantly higher, around 18 per cent per annum, than rates overseas. Thus, the total net foreign investment in India surged from $133 million to $5181 million between 1991-92 and 1999-2000.

The upward movements were still higher in the case of FDI outflows such as adjustments, in 6.0 million and 1489.7 million in 2009. However, Yasheng Huang of Harvard University expressed doubts about treating the Chinese FDI magnitude as an indicator of economic performance (Huang, 2003).

(b). Overview of FDI in China:

Since the announcement of an ‘Open-door policy’ in December 1978, China had gradually integrated itself into the world economy. China is the leading FDI recipient in recent years, and the largest host country among developing countries. China’s FDI inflows could be classified into decade phases: 1979-90, 1990-2000, and 2000-2010.

The first phase: The aspect of FDI needs to be understood in the wider context of China’s political and economic reforms, in particular, the transition from a planned to a market economy, as Deng Xiaoping said, reforms in China are like “Crossing the river by feeling the stones on the river bed”. China opened up its economy for foreign investment in two stages. First, in 1979, a very cautious opening was made, where domestic enterprises or expertise did not exist such as in oil exploration and production. Second, in 1992, FDI was opened up with the explicit goal of stimulating export industries and removed many move restrictions in FDI. Where the effect of the 1979 opening was modest in terms of FDI, the 1992 policy shift led to a major rise in FDI (Graham and Warda, 2001).

The door widened further after the transition in the mid-1980s, particularly in the 1990s, and capital flows expanded dramatically as a result. Capital flows were particularly high after 1992, mainly because of the huge amount of FDI inflows into China. While around 60 per cent of foreign capital came from external loans in the 1980s, in the 1990s FDI was the main source of capital - accounting for nearly 70 per cent of cumulated inflows. The share of ‘other foreign investments’ includes: foreign portfolio investment, compensation trade, international leasing and processing assembly, has been small. These inflows are by far the largest compared with those
into other developing countries and have remained remarkably stable and robust, despite substantial fluctuations in the Asian and global economies.

a. In recent years, the government has started to issue bonds and shares to overseas buyers abroad, and in China, foreign portfolio investment has been rising. Although, agriculture transformation took place in a big way, ‘Township-Village Enterprises’ (TVEs) through exploration massive increase in ‘rural saving & demand’ and simultaneous exploration of FDI come overwhelmingly from overseas to China.

b. After transition, the Chinese government established four Special Economic Zones (SEZs) in Guangdong and Fujian provinces, and offered special incentive policies for FDI in these SEZs. The total inflows of FDI realised during these 5 years amounted to only US$1.8 billion, averaging US$360 million annually. Since 1984, when Hainan Island and fourteen coastal cities across ten provinces were opened, total FDI inflows amounted to US$ 10.3 in the period 1984-88; with an annual average of US$2.1 billion. This remarkable growth dropped steeply in 1989, mainly due to impact of the Tiananmen incidents. The growth rates of FDI inflows into China slowed down at a meager 6.2 per cent level in 1989 and only 2.8 per cent in 1990 (OCED, 2000). Hence, in 1978-84: a need was felt to extend Chinese regional development strategy to the coastal areas on priority.

_Second phase (1990-2000s),_ China has been attracting the second largest amount of global FDI, after the US and was predicted to climb to the first position in 2002. China entry into the WTO on December 11, 2001, gave a further fillip to the process of liberalisation. Finally, since late 2002, there has been evidence of the beginning of significant capital inflows to China, besides FDI. Full implementation of WTO commitments was to be completed by 2007 (D. Krishnamoorthy). Three distinctive characteristics have marked investment in China over the past decade. First, FDI has been the predominantly from countries in which China has accessed global capital. Second, an unusually large proportion of Chinese FDI inflows are in the manufacturing sector, as opposed to services or resource extraction. Third, FDI inflows have predominately come from other East Asian economies, especially Hong

---

Kong and Taiwan. China received FDI from Eastern provinces of 88 per cent of the stock of FDI between 1983 and 1998, with Guangdong province the most popular destination. The central and western provinces received only 9 per cent and 3 per cent of FDI, respectively. Most of the foreign investments have come from the newly industrialising economies (NIEs). Hong Kong was the largest single investor, accounting for 52 per cent of FDI, followed by Taiwan at 8 per cent. Investment from industrialised countries made up only 24 per cent of the total, with the US and Japan the most important single investors - each contributing 8 per cent of the total. In the special economic zones and related coastal areas, primacy was accorded to export of labour intensive light manufactured goods. However, proliferation of multinational investment includes heavier, more capital and technology investment industries, and infrastructure, mainly for the domestic market or the non-tradable sectors.

- When Deng Xiaoping made the remarkable statement on ‘Southern Tour’ in 1992, this was seen as an attempt to remove the anxiety about China’s overall policy direction. Foreign investors responded quickly because of the institutional foundations and FDI-friendly policies.
- China had largely confined inflows FDI to export manufacturing, and access to the Chinese market had been allowed to only a few selected foreign firms.
- In 1999, mainly due to the impact of the Asian Financial crisis and the rise of acquisition transactions in both OECD and non-OECD countries, FDI inflows dropped to US$40 389 million.

Third phases onwards 2000: Foreign firms have become an important part of the Chinese economy over the previews two decades. In 1983, FDI was only 0.3 per cent of the country GDP. In 1994, the share had risen to 6.2 per cent of GDP, before falling to around 5 per cent. Yet the economy has grown faster. Incoming FDI in 1999-2001 accounted for 11% of total capital formation in China, less than the average. In 2004, the cumulative inflows actually realised through investment surpassed $500 billion. China’s that the country own domestic saving rate is so high, and China is less dependent on FDI for saving than many countries.

In 1983, FDI flows accounted for only 0.9 per cent of China’s gross capital formation. The share increased steadily in the 1980s and early 1990s - reaching 15 per cent in 1994, before falling to around 13 per cent in 1994 for the next four years. Because
FDI has not all been a long-term fixed capital investment, this figure may be an overestimate. The gross fixed capital formation accounted for approximately 80 per cent of FDI inflows in the late 1990s, and the share in earlier years was lower. The remaining 20 per cent was likely to have been used for working capital or to pay for inventory - meaning that FDI inflows probably accounted for around 11 per cent of gross fixed capital formation in the late 1990s.7

FDI brings in a bundle of management experience, marketing channels and technology, along with the basic inflow of resources, and includes some control over the production process, and hence, some transfer of management expertise. FDI has become China’s predominant source of technology transfer. This technology has been all covering the sectors in China since 1993. After 1992, almost two thirds of China’s exports increment came from foreign-invested firms. Thus, FDI has played a key role in industrial growth, technology transfer and trade expansion in China.8

5.2. FDI policies in India and China in the Transition Economies Perspective

a. Policy Regime: India

*Pre-liberalisation period:*

India earlier pursued an open-door FDI policy. Foreign investment was required to be encouraged for mutual benefit, in terms of industrial development. This policy became increasingly restrictive and regulatory during the 1960s and 1970s. The Monopolies and Restrictive Trade Practices Commission (MRTP), set up in 1969, imposed severe restrictions on the size of operations and pricing of products and services of foreign companies. Foreign Exchange Regulation Act (FERA) was enacted in 1973, which required existing foreign enterprises to dilute foreign equity to 40 per cent, if they wished to be treated as Indian companies. The policy’s essential aim was to retain majority domestic ownership and effective control over foreign enterprises. Technology and export-intensive and core sector firms were allowed to retain foreign ownership up to 74 per cent. Foreign exchange requirements for import of capital goods were met through equity investment. Technical collaborations were being permitted for import substitution, and export- substitution, technology upgradation and for export-oriented

7. See, Chunlai Chen and Christopher Findlay (2004), ‘the Impact of Foreign Direct Investment on China’s Economy’, *China’s third economic transformation*, p.g 102-104.

enterprises. The Patent Act, amended in 1970, abolished product patents in pharmaceuticals and chemical industries, thereby drastically curtailing the intellectual property rights. Domestic R&D got a fillip for electrical and mechanical engineering industries. Export performance requirements induced TNCs to explore India’s potential for export-oriented production. The Industrial Policy 1977, providing some relaxation for foreign companies. Also, after 1980s the Industrial Policies was progressively liberalised.

**Post-Transition reform period:**

Until 1991, FDI was allowed in designated industries, subject to various conditionalities regarding domestic equity participation, local content requirements, export obligation and local R & D promotion. Since opening up FDI policy in 1991, the broader process of economic reforms has dramatically changed. Foreign investment has been allowed in a phased manner in most of the sectors and restrictive conditions have either been waived, or relaxed. For purposes of our analysis, the period from 1991 onwards has been divided into four phases for rationalisation, viz., 1991-96, 1997-98, 1999-2001 and 2001 onwards.

**First Phase (1991-96):** the Foreign Exchange crisis of 1991 triggered a major shift in domestic and external policy environment. Many of the economic policies were formulated in India. The IMF and the World Bank also agreed to provide the support to overcome the condition that structural changes to liberalise trade and investment policy regimes would be effected. These reforms were introduced to abolish widespread industrial licensing and facilitate rationalisation of taxes, reduction in import tariffs and reform of Foreign Exchange Regulations. In July 1991, public sectors categories industries were reduced from 17 to 6. Measures were simultaneously initiated for liberalising the policy relating to FDI and technology transfer. Approval mechanism for FDI was made simpler and transparent. Two approval routes, viz.; (i) Automatic route and (ii) Foreign Investment Promotion Board (FIPB) route were introduced. In automatic route, only intimation about transfer of equity funds is required to be given to the RBI. Thirty-five priority industries/sectors were initially notified for approval under the automatic route, for which foreign equity cap was pegged at 51 per cent. The only condition is that foreign equity would also cover foreign exchange for import of capital goods. However, enterprises requiring industrial license under the
industrial (Development and Regulation) Act, 1951, or in which proposed foreign equity investment was more than 24 per cent of a manufacturing unit were reserved for small scale industries. Likewise, industries still require industrial license as per location policy 1991, which would otherwise not qualify for approval under this route.

The approval pattern in practice continued to be highly tilted in favour of FIPB route, since until 2003 over 90 per cent of approvals were granted through this route. Investors opted for FIPB route, if their investment firms did not strictly conform to the standard guidelines. In the FIPB route, many sectors were not covered under the automatic route during the initial phase of opening up. After 2000, the proportion of approvals under the FIPB route started coming down, as foreign equity restrictions for many sectors were raised to 100 per cent.

Requirement of dividend balancing was dispensed with in 1992, except for 22 categories of consumer goods. The phased manufacturing programme for progressively enforcing higher local content on foreign firms and joint ventures was discontinued for new projects in July 1991, and for the existing units in 1994. The stipulation that foreign exchange requirement for import of capital goods should be met though foreign equity was also waived in 1996.

In automatic route for approvals by the RBI, initially the lump sum payment of royalty was up to rupees one crore. The ceiling on lump sum royalty payment was raised in 1996 from Rs one crore to US$ 2 million. Payment of royalty on use of brand names and trade markers was, however, not permitted until 2000, and wholly owned subsides were not allowed to pay royalty to their offshore parents.

Second Phase (1997-98)

In the second phase, the liberalisation list of industries for approval under the automatic route was expanded from 35 to 111 in 1997. Sectoral growth has been increasing in specified industry/service sector up to 71 per cent. Also, the foreign equity limit in electric generation transmission and distribution projects was raised from 74 per cent to 100 per cent, subject to a ceiling of Rs. 15,000 crore, which was later lifted. An important press Note No. 18 of 1998 says:

"new proposals for foreign investment and technical collaborations, where foreign investor has or had any previous joint venture or technology transfer/trademark
agreements, were required to be filed with FIPB”.

Keeping in view the spate of representation from investors, the Press Note was amended in 2005. As per revised guidelines, the proposals to provide require justification and satisfaction to the government. The new proposal would not jeopardise the interest of existing JVs which would lie equally on foreign investors and their Indian partners (Ashok Kundra, 2009).

**Third phase (1999-2001)**

In this phase, the focus shifted to opening up of infrastructure, insurance and service sectors and liberalising the royalty payment regime. Foreign equity was permitted up to 100 per cent in roads, ports, harbours, bridges and highways in 1999. The Insurance Act was amended in 1999 to permit up to 26 per cent foreign equity under the automatic route, under license from the Insurance Regulatory and Development Authority (IRDA). Non-Banking Financial Companies (NBFCs), were allowed to make a minimum US$ 0.5 million foreign investment. The condition of dividend balancing on 22 per cent consumer, goods retained in 1992, was withdrawn in July 2000. Foreign Exchange Regulation Act, 1973 (FERA)\(^9\), was replaced by Foreign Exchange Management Act, 1999 (FEMA)\(^10\), with effect from 1.6.2000, to facilitate maintenance of foreign exchanges market and promotion of external trade.

Restriction of 10 year period for the royalty payment from the date of agreement, or seven years from the date of commencement of commercial production was, lifted in September 2000. Also, the restriction on royalty payment to withdraw foreign owned companies for royalty payments. In 2000, the automatic route, with 100 per cent participation with the foreign equity was opened up, except in cases requiring industrial license or relating to acquisition of shares of an existing company or proposals falling outside the notified spectral policies/caps, or under sectors for which FDI is not permitted.

**Fourth phase (2001 onwards)**

During the current phase, policy thrust for opening up service, financial, and key

---

9. FERA’s objective is protecting the Foreign Exchange resources of the country and ensure to proper utilization of thereof in the interests of the economic development of the country.

10. FEMA objective is facilitating external trade payment and payments and to promote the orderly development and maintenance of the foreign exchange market in India.
infrastructure sectors has been sustained. Foreign equity of 100 per cent has been permitted to provide subsidies to NBFCs for setting up new airport projects, drugs and pharmaceutical companies, hotels and tourism sectors, foreign sectors, townships and transport system in 2002 which were permitted under the FIPB and automatic routes. Foreign equity up to 74 per cent, inclusive of investment by FIIs, is allowed in private banks under the automatic route. Besides, foreign equity up to 26 per cent has been allowed for defence industry through the FIPB route. Foreign equity was fully allowed in 2005 under FIPB for the township, housing and built up infrastructure. In addition, a provision was made in 2004 for allowing investment in tea plantations, print media (24 per cent) and publication of scientific and technical journals. Besides, foreign equity is permitted on oil exploration, laying of petroleum product and LNG pipelines. Foreign equity was raised in basic and cellular telecommunications, and limited access system of national and international long distance services was raised to 49 per cent in 2005. These were also recommended by the Steering Group of FDI and the Planning Commission.

In FM radio broadcasting services, 20 per cent foreign equity is permitted by the Ministry of Information and Broadcasting. Moreover, linking non-news and current affairs TV channels were allowed foreign equity up to 100 per cent; in retail trade foreign equity was permitted up to 51 percent with (Foreign Investment Promotion Board) FIPB approvals for ‘single brand’ products only. Thus, this has been allowed to encourage sourcing of goods from India and improving availability of such goods for consumers.11

The government of India has also permitted FDI in Limited Liability Partnership (LLP) companies but only in mining, power, roads and highways, manufacturing activities, and drugs and pharmaceuticals. In these sectors, 100 per cent equity was opened up to FDI through the automatic route. The LLP structure was introduced from April, 2009. As on May 2, 2011, 4,679 were registered with Ministry of Corporate Affairs12. FDI is allowed up to 100 per cent in all activities/sectors except the following which require prior approval by the Government: (i) Manufacture of Cigars & Cigarettes of tobacco and manufacture tobacco substitutes; Electronic aerospace and

---

12. FDI in India: Thursday, May 12, 2011.
defence equipments; manufacture of items exclusively reserved for Small Scale sector with more than 24% FDI; the foreign collaborator has an existing financial/technical collaboration in India in the ‘same’ field [Refer press Note No.1 (2005 series)]

The new consolidated FDI Policy issued by the Govt. of India in March 2011, has introduced and made some major changes. The 2011 FDI Policy enables companies to choose a conversion formula to determine the rate of conversion, subject to FEMA/SEBI pricing guidelines.

The shares can be issued against the import of capital goods/machinery/equipment (including second-hand machinery); and pre-operative/ pre-incorporation expenses (including payments of rent, etc.,). However, before issuing the shares, prior approval is required from Foreign Investment Promotion Board (FIPB), otherwise from the automatic route.

Until now, a foreign investor, with an existing joint venture or technical collaboration (entered before January 12, 2005), could not be allowed into new investment ventures, unless the existing Indian partner issued a no objection certificate and obtained the specific prior Government approval. The 2011 FDI Policy eliminates this earlier protectionist measure. Further, this policy was open to the Indian markets to access but subject to Indian entities-expecting more competition from abroad. In addition, in the health insurance sector, the 10 year disinvestment clause; was done away with and FDI in the animation sector was liberalised. The available FDI policies can be seen on the website and also in a user-friendly way (Economic Survey 2009-10, p 164).

Private equity funds, till now unregulated, are set to come under SEBI Regulations. The market regulator has already started working on regulating private equity players and guidelines would be issued by Economic Affairs Secretary by (R. Gopalan, 2011).

a. Policy Regime: China

China’s FDI policy has been highly admired overall worldwide. It has been successful among developing countries. In China, FDI inflows during 1979 to 2009, was 94,999.42 million (USD) (UNCTAD). Since 1978, China’s strategy was based

---

on the pattern of export-led growth implemented by East Asian economies, and also these policies were based on self-reliance and favouring comparative advantages. Besides, law and regulations attracting more FDIs were notified, as part of “socialist economic reconstruction”. The important objectives and priorities of the FDI are: acquiring gaining to capital, technology and management skills and comparative advantage with low labour costs. Foreign investment was sought for infrastructure development and high technology for import substitution.

Domestic factors have contributed to making a China successful in attracting the FDI. This policy includes: liberalisation, development of infrastructure and a favourable operating environment and to extend preferential treatment to foreign investors. Also, SEZs, and Economic and Technological Development Zones (ETDZs) provide the requisite infrastructure, for more export-oriented investment in the targeted sectors. The country has judiciously combined measures for import protection with those of export promotion. Trade liberalisation was started in China in the late 1980s which took off remarkably during the 1990s, after economic growth had increased remarkably. Opening up trade coincided with the East Asian countries facing issues with rising labour costs. The country offer requisite resource endowment for export-oriented FDI and a strategic location for easy access to Asian counties. However, favourable circumstance inflows of such magnitude could not have been possible in the absence of requisite platform, infrastructure and a congenial operating environment.

China’s economy was opened up on gradual and incremental basis, with a view to secure national-wide support. Reforms moved at a steady pace and FDI policy was evolved in a phased manner. The evolution of China’s FDI policy can be classified and analysed. The legal framework for that was evolved progressively. These legal laws and regulations were amended according to situations. For purposes of our analysis, the period from 1978 onwards has been divided into four phases, as discussed below.

a. First Phase (1979-1985):

Foreign investment, in the initial phase, was permitted only in the form of joint ventures. The “Law of People’s Republic of China on Joint Ventures using Chinese and Foreign Capital” was passed in July 1979. This was mostly experimental in nature till the beginning of 1980s, when the Chinese transition towards a market oriented
system started. China’s FDI policy allowed setting up of Equity Joint Ventures (EJEs) on the principle of “equality and mutual benefit” and could operate for a period of 30 years. Foreign investment was allowed up to 50 percent regulations under law in 1983, in sectors such as finance, banking, transportation, post and telecommunication and retail trade. The governance pattern of EVJs in China was different from that of corporations in the West, because investors in EJVs hold equity interest, but not stock. The State Council granted autonomy to Guangdong and Fujian provinces in matters relating to foreign trade to enable them to set up SEZs. The legal rights of Foreign Invested Enterprises (FIEs) were protected under Article 18 of the 1982 Constitution. The private sector was given legal status in 1984, by recognising it as a supplement of the “socialist market economy”. Thus, the major policy shift facilitated setting up of wholly foreign owned enterprise outsiders SEZs.


In China, foreign investors are encouraged to set up of joint ventures and companies, under the “Law of People’s Republic of China on Enterprises Exclusively with Foreign Capital”, promulgated in 1986. Its regulations were notified under the law in 1990. This Law aims to benefit foreign owned enterprises. This kind of mode is usually favoured in technology intensive enterprises. Besides, under Article 3 of the Law, only export-oriented units could be set up as fully foreign owned enterprises. This enactment of law on Cooperative Joint Ventures was passed in 1988, and its regulation was enforced in 1995. A contractual Cooperative Joint Venture (CJV) is a partnership between the Chinese and foreign enterprises with unlimited liability. In the case of equity joint venture, liability of partners for sharing risks is limited. Wholly foreign Owned ventures (WFOs) have eventually emerged as the most preferred mode of foreign investment. However, China formally applied for participation in the GATT (General Agreement on Trade and Tariff) in 1986, to enforce promoting domestic price reforms, and establish a market-oriented system.14

c. Third Phase (1990 to 2000):

This phase shifted the focus to development and refinement of regulatory framework. The law on Equity Joint Ventures and Regulations for Wholly foreign

Owned Enterprises was amended in 1990. Also, all foreign enterprises were granted protection against nationalisation. Deng Xiaoping reiterated China’s commitment to open door policy for FDI and Market oriented reforms. China set up SEZs during 1992 to push forward the overall economic reforms process. To attract FDI, a number of incentives, and laws were enacted. These include: Foreign Enterprise, Income Tax Law, Software Protection Regulations, Patent Amendments, Trademark Laws and Foreign Exchange Control Regime, governing foreign investment Regulations. The Contract Law Act was amended in 1999 to create confidence amongst investors. The objective of circular flow of capital is to bring Chinese capital under a more favourable regime governing foreign investment. To control malpractices related to overvaluation of equipment and technology supplied by foreign partners “Administrative Procedures for Appraising Foreign Invested Property” were notified in 1994.

FDI inflows are intended to provide for social and economic development. The “Provisional Regulations on Funding Foreign Investment” were notified in 1995. Investment projects under these regulations have been divided into four categories, viz., “encouraged”, “restricted”, “prohibited” and “permitted”.

- The “encouraged” category includes: projects relating to agricultural technology, construction, energy and communication; projects for industry or for new or enhanced technology or for augmenting exports. These Projects use renewable resources or involve new technology or equipment for pollution control and prevention, as well as projects relating to investment in the central and western regions of China.

- The “restricted” category includes: imported technology, for which sufficient capacity exists; or an industry where the state is experimenting with foreign investments; projects for exploration and extraction of minerals and those relating to sectors which are covered under central planning.

- The “prohibited” category includes: dangerous polluting or wasteful processes or those that damage the environment, natural resources, human health or use sizeable arable land. These are considered destructive to protection and development of land resources.
- The “permitted” category includes all those projects which are not covered by the above categories.

These regulations also specified industries for which majority Chinese shareholding is required. Industries sectors in which wholly owned enterprises are not permitted. Includes: airports, nuclear power plants, oil and gas pipelines, subways and railways, projects in aerospace, automobile, defence, mining and petrochemicals, shipping, satellite communications and tourism etc., During the 1999, Chinese economy was thrown open to the private sectors. The private sector, however, continued to face discrimination in the matter of availability of credit.

*d. Fourth Phase: post-WTO Period (2001 onwards):*

After China’s entry into WTO in 2001, foreign companies have been permitted up to 50 per cent equity in telecommunication and value added services, foreign banks and life insurance companies. As per the WTO agreement, laws on technology have transformed to intellectual property rights. Mandatory requirements relating to local content, foreign exchange balancing, technology transfer and restrictions on R & D, institutions, has been withdrawn as per the WTO Agreement on Trade Related Investment Measures. China has to implement economic reforms and undertakes legal and institutional restructuring to fulfill WTO commitments. Also, a number of institutions were created. The opening up of financial and service sectors has created a new wave of investments - leading to buoyancy in inflows. Some policy changes requiring diversion of foreign investment in specific.

Government designated sectors were notified on 25th July 2004. Incentives have been given to certain areas, for instance, island areas. However, this move can lead to rising inequalities amongst regions. Stability has become an important policy plank. The State Council has notified the “Decision on Reforming the Investment System” to abolish government examination and approval for projects that do not require government investment, except large projects. However, China’s parliament passed amendments in March 2004, to protect private property, as against civil protection already in place.

During 2008, at the 12th China International Fair for Investment and Trade in Xiamen, Chinese Vice-Premier Wang Qishan, announced five policies for future
investment areas. These include: promotion of the investment environment, better utilisation of foreign capital and to encourage Chinese enterprises to invest in foreign countries in (2008-09). In 2009, the specific ownership limit of 25 per cent for investment in local banks was removed. Inward FDI is still prohibited in a numbers of industries, which include forestry and logging, manufacture of certain chemicals used for explosives, firearms and weapons, postal services, postal savings and radio and television broadcasting (Assessment of Liberalisation and Facilitation of FDI in Thirteen APEC Economies, December-2010). In 2010, the decision concern items with respect to Administration and Approval was cancelled or adjusted [Guo Fa (2010) No. 21] and the policy on Better utilisation of foreign investment [Guo Fa (2010) No.9] was promulgated by the State Council. The delegates of some authorities of examination, Approval and administration of foreign investment to commercial departments at the provincial level to cancel some items originally subject to foreign investment examination and approval. \(^5\)

**Opening Up of Retail Trade:**

Retail industry has been opened up in a gradual and experimental manner. In 1992, Commercial retail trade was permitted for foreign investment, but was not fully allowed in retail trade. In 1995, the State Council permitted Sino-foreign joint ventures for retail chain stores in Beijing and Shanghai - with 50 per cent shares held by Chinese partners. In 1999, pilot equity joint ventures were allowed in all provincial capital cities, capital cities of autonomous regions and municipalities under direct change of the Central government. With China’s entry to WTO, the number of joint venture enterprises in retail business was increased. In December 2001, the products for which investment was not allowed were also specified. In June 2004, retail operations through foreign investment were extended to the entire country. This was followed by the notification of “Measures for Administration of Foreign Investment in the Commercial sector”, in December 2004. For attracting foreign investment in the commercial sector, local governments have been giving and offering attracting preferential policies, good business locations and favoured treatment in local taxation. However, relevant laws and regulations and long term development plans and implementation measures still need to be put in place. It is felt that considering the state of development of the retail industry and

\(^{15}\) Invest in China (2011), Ministry of Commerce on Issue Concerning Foreign Investment Administration, Shang Zip Han, No. 72.
the scale of operations of foreign retail business, preferential treatment is not warranted. Besides, retail industry involves pressures on urban planning and land use.\textsuperscript{16}

**Cooperation of FDI policies in China and India:**

FDI is the important resource for development in the globalisation process. In both countries, FDI flows have been increasing after they become transition economies. If we consider the major economic aggregates like world production, world capital formation and world Trade, China has been more successful in attracting large inflows of FDI since the beginning of transition. However, both countries’ development strategies and policies are different from each other, as can be seen from the following:

(i). **India’s economic policy** lacks drive on attracting export-oriented FDI. Attempts to provide infrastructure have been sporadic, piecemeal, lukewarm, segmental and half-hearted. Moreover, FDI have not been attracting investment, due to infrastructural and location deficiencies. Also, strengths like availability of cheap workforce, sound financial system and comparative cost advantage in the manufacturing sector could not be properly exploited through export-oriented FDI for infrastructure development.

(ii). **National Interest**: In accepting beneficial inputs, both countries agreed to allow FDI that brought in quick returns. But these activities with ‘un-favourable impacts’, can lead to the monopolisation of market jeopardise development of local industries, and also cause environment pollution.

(iii). In China, physical infrastructure is more competitive, particularly in the coastal areas (CUTS 2003, Marubeni Corporation Economic Research Institute 2002, as mentioned in ‘Investing in India and China’, 2003). But, India may have an advantage in technical manpower, especially in, IT, and better English language skills of its professional (Anjali Kulkarni, 2009).

(iv). In India, FDI has been much less important in driving export growth, except IT sector which has seen tremendous progress. Similarly, for a country that has, millions of unskilled and semi-skilled unemployed persons, the IT sector benefits only the highly educated class. If we compare the manufacturing sector

in both countries, we will find that India exports less than 10 per cent of the goods. In China, it has created gainful employment for millions of industrial workers.

(v). In both countries, technology has been playing an important role in the growth and development process. Technology imports and technology transfer (TT) are strongly encouraged in China, which is not the case with India.

(vi). **Labour reforms** in India continue to be inflexible due to lack of political consensus on labour reforms, rules and regulation regarding disputes difficult. Labour regulations are meant to protect the interests of workers. Reform of these regulations can help in accelerating growth of the manufacturing sector and generating employment in labour-intensive sectors.

(vii). India has shown relatively poor performance, in term of competitiveness, quality of manufacture, skills and productivity. These indicators are responsible for attracting less FDI.

(viii). India’s FDI policy does not offer any special incentives, or super national treatment, to foreign investors. This is partly due to risk-averse nature of NRIs since most of them are professional and lack managerial capability for export production with low wage labour. On the other hand, China has provided industrial infrastructure incentives, such as location, duration of operations, high-tech content, and the export intensity of the enterprises to foreign investment.

(Viii). The **positive feature** of the Indian economy, such as adequate number of skilled manpower at competitive rates, tax incentives for export manufacture and liberal FDI policy have not been projected aggressively. Chinas FDI policy was envisioned and mandated by political leadership at the highest level.

(x). Moreover, foreign investors are facing problems in setting up joint ventures due to restrictions on domestic debt financing. In China, local and provincial authorities have not been vested with power to approve FDI, and decentralisation of powers, speedier clearance of proposals, is not fully in place.

(xi). In China, provincial authorities directly undertake promotion activities accord and investment approvals. However, India due does not have a system
of automatic approvals.

(xii). Acquisition of land for setting up zones is very easy in China, while in India, the recent furor over acquisition of land for SEZs virtually stalled implementation of the scheme. China too is against acquisition of agriculture land for setting up zones. Still, China has an edge over India due to a different political regime.

(xiii). In China, provincial and local authorities enjoy considerable autonomy in economic decision making, logical strategies, choice and chronological flows, while in India, the approach is very slow.

(xiii). A key lesson that can be drawn from Yao & Sing (2011), particularly for developing economies, is the adoption of a pragmatic approach to economic reforms, and capacity of the country’s, economic decision makers in this regard (Amelia U. Santos-Paulino, 2010).

The study regarding the experience of China and India contain important lessons for developing countries as they embark on economic development. Bhagwati (2006) stated that sustainable development should succeed in achieving openness in the world economy, as well as in economic freedom and political freedom (Amelia U. Santos-Paulino, 2010).

5.3. FDI an Empirical Analysis in Both Countries

At this juncture, let us analyse the determinant factors that influence the inflow of FDI in both countries. India companies are giving stiff completion to international companies in some areas. However, statistics reveal only a part of the story at the macroeconomic level. At the micro level, things look quite different. India is creakingly building from the ground up, while China is pursuing a top-down approach - which reflects their contrasting political systems. China’s domestic companies are reaping the benefits due to the FDI it has attracted since the early 1980s.

China’s export-led manufacturing boom has been mostly due to the FDI it has attracted. These are provided effectively and have proved to be a substitute to domestic entrepreneurship for the last 31 years. China’s economy may have taken off, but its private sector still does not have world-class companies to compete with the big multinationals. India has not been attracting the amount of FDI anywhere near that of China. The India FDI gap is also a tale of two diasporas. While China has large and wealthy diasporas that have been longing to help the mother - land and the money sent has been warmly received, this is not the case with India.
TNCs seek more trade and more open economies for resources-seeking operations, especially as they integrate their global production with vertical and horizontal value-chain linkages. In this way, for a country to be a part of the integration process, it must allow the TNCs to easily import and export. Thus, integration is important, when TNCs seek a base to serve regional markets (Chakravarthy, Lopez, and Porta, 1995; Dharmendhra et.al, 2007). In order to use this phenomenon, our model infers openness of the host economy as a determinant of FDI flows, and it is expected that this variable will be positively associated with FDI inflows in both countries.

**The Determinate Variables influencing FDI in China and India:**

Econometric model is employed to access the cross-country influence of macroeconomic variables on FDI. These are:

a. *Gross Domestic Product (GDP)*: It is a substitute for market size. It is a most significant variable for explaining FDI inflows into emerging economies. Per capital income growth rate rates are usually high and after some time, these would be expected to continue to move upward. It helps attract market seeking investors. For this reason, real GDP growth is usually expected to have a positive effect on FDI inflows.

b. *Openness of trade*: there are two ways to measure the openness of trade. One is the effective tariff rate, which is the ratio of tariff revenue to total imports (import total revenue taxes ratio). The other is: trade ratio (share) import+export) in total GDP (I+E/GDP).

c. *Inflation*: high rate of inflation indicates internal economic instability. It implies that the host country is unable to maintain necessary monetary stability. Under conditions of high inflation, firms face uncertainty in pricing of products.

d. *Current account balance*: this is a measure of the strength of the currency of the host country. A deterioration in currency account balance leads to a depression of the host country currency. It leads to inflation and adversely impacts the exchange rate. An increase in the current deficit may lead to reduction in FDI.

e. *Real Exchange rate*: foreign investment gain or loss impact the exchange rate. With depreciate exchange rate, it can export more easily and gain from
resources seeking FDI. If, it continuously depreciating investors will avoid the investments. Therefore, the import exchange rate depreciation on FDI inflow is ambiguous.

f. Interest rates: Interest rates are the main determinants of investment on a macroeconomic scale. The current thought is that if interest rates increase across the board, then investment decreases - causing a fall in national income.

**Methodology:**

In order to analyse the association of the different macroeconomic variables, we have used four regression models to find the possible significant factors which might influence the foreign direct investment in both countries. The four regression models are as follows:

Model I: \( \log(\text{fdi}) = c + \log(\text{gdp}) + \Delta \log(\text{fdi}) + \varepsilon_t \)

Model II: \( \log(\text{fdi}) = c + \log(\text{reer}) + \log(\text{ot}) + \varepsilon_t \)

Model III: \( \log(\text{fdi}) = c + \text{IT} + \text{Inflation} + \varepsilon_t \)

Model IV: \( \log(\text{fdi}) = c + \log(\text{gdp}) + \log(\text{reer}) + \log(\text{ot}) + \text{Inter} + \text{infla} + \varepsilon_t \)

Where, \( C = \) constant, \( \text{fdi} = \) Foreign direct investment, \( \text{gdp} = \) Real gross domestic product, \( \text{infla} = \) Inflation rate, \( \text{reer} = \) Real effective exchange rate, \( \text{ot} = \) openness of trade, \( \text{Inter} = \) interest rates, \( \Delta \text{fdi} = \) Change in FDI, and \( \varepsilon = \) random error term. The purpose of our empirical investigation is to analyse the effects of FDI on economic growth and how does FDI (USD) inflow interact with macroeconomic variables, such as GDP (US$), Openness of trade(USD) \((E+I)/GDP)_{17}\), inflation (cons. annual %), Real effect exchange rates \((2005=100)\), Current account balance (USD) and interest rates (percentage) in both countries. The effects of FDI on economic growth in a framework of cross-country analysis, for using a data during the period 1978 to 2010 will be tested.

There are several advantages of adopting a log-linear form. For the analysis, in the case of both countries, certain macroeconomic variables are extreme values, arising in some years and from certain OECD countries. We have accounted for log-linear variables such as FDI, GDP, Real effect exchange rate, and openness of trade. Linear variables are inflation and interest rate. However, logarithms have been used to unify the data.

---

Table 5.2: Descriptive Statistics of India

<table>
<thead>
<tr>
<th></th>
<th>FDI</th>
<th>GDP</th>
<th>Inflation</th>
<th>REER</th>
<th>IT</th>
<th>OT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>5976.00</td>
<td>4.9E+11</td>
<td>7.98</td>
<td>123.16</td>
<td>6.27</td>
<td>0.184</td>
</tr>
<tr>
<td>Median</td>
<td>974.00</td>
<td>3.2E+11</td>
<td>8.32</td>
<td>103.90</td>
<td>6.87</td>
<td>0.176</td>
</tr>
<tr>
<td>S.Er</td>
<td>1893.82</td>
<td>6.9E+10</td>
<td>0.56</td>
<td>5.99</td>
<td>0.45</td>
<td>0.014</td>
</tr>
<tr>
<td>S.D</td>
<td>10879.16</td>
<td>3.9E+11</td>
<td>3.22</td>
<td>34.41</td>
<td>2.56</td>
<td>0.080</td>
</tr>
<tr>
<td>Minimum</td>
<td>5.64</td>
<td>1.4E+11</td>
<td>2.52</td>
<td>86.30</td>
<td>-1.08</td>
<td>0.101</td>
</tr>
<tr>
<td>Maximum</td>
<td>42545.72</td>
<td>1.7E+12</td>
<td>13.87</td>
<td>181.80</td>
<td>10.74</td>
<td>0.425</td>
</tr>
<tr>
<td>Obse.</td>
<td>33</td>
<td>33</td>
<td>33</td>
<td>33</td>
<td>33</td>
<td>33</td>
</tr>
</tbody>
</table>

Table 5.2; presents some figures about India, where the FDI inflow is influenced by other macroeconomics variables. And FDI has a significant correlation with GDP, Inflation, REER, IT and Openness of trade. So, monetary and fiscal variable are playing a vital role in stabilisation of the economy.

Table 5.3: Correlation Matrix’s of India

<table>
<thead>
<tr>
<th></th>
<th>FDI</th>
<th>GDP</th>
<th>Inflation</th>
<th>REER</th>
<th>IT</th>
<th>OT</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>0.902</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td>0.017</td>
<td>-0.0239</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>REER</td>
<td>-0.296</td>
<td>-0.3976</td>
<td>0.1461</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CAB</td>
<td>-0.723</td>
<td>-0.770</td>
<td>-0.353</td>
<td>0.095</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IT</td>
<td>-0.258</td>
<td>-0.363</td>
<td>-0.323</td>
<td>0.064</td>
<td>-1</td>
<td></td>
</tr>
<tr>
<td>OT</td>
<td>0.892</td>
<td>0.896</td>
<td>-0.140</td>
<td>-0.574</td>
<td>-0.259</td>
<td>1</td>
</tr>
</tbody>
</table>

The correlation matrix: describes the correlation between two or more variables. Correlation is one of the most common and useful statistical tool. A correlation is a single number that describes the degree of relationship between two variables. We have considered macroeconomic variables for correlation between FDI and other variables. Table 5.3, explains, the correlation matrix of India, where it is seen that FDI has a strong and positive correlation with GDP, inflation and openness of trade. The existence of statistical significant correlation implies positive FDI inflows. If we observe other macroeconomic variables, real exchange rate, and interest rate have a strong negative statistically significant correlation with FDI.
Table 5.4: Descriptive Statistics of China:

<table>
<thead>
<tr>
<th></th>
<th>FDI</th>
<th>GDP</th>
<th>Inflation</th>
<th>REER</th>
<th>IT</th>
<th>OT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>33298.23</td>
<td>1.25E+12</td>
<td>5.47</td>
<td>151.84</td>
<td>1.9572</td>
<td>0.3689</td>
</tr>
<tr>
<td>Median</td>
<td>33766.50</td>
<td>5.59E+11</td>
<td>3.32</td>
<td>114.44</td>
<td>2.2490</td>
<td>0.3413</td>
</tr>
<tr>
<td>S.E</td>
<td>34006.74</td>
<td>1.49E+12</td>
<td>6.35</td>
<td>75.63</td>
<td>3.4745</td>
<td>0.1413</td>
</tr>
<tr>
<td>S.D</td>
<td>0.08</td>
<td>1.48E+11</td>
<td>-1.41</td>
<td>82.35</td>
<td>-7.9820</td>
<td>0.1423</td>
</tr>
<tr>
<td>Minimum</td>
<td>108312.00</td>
<td>5.88E+12</td>
<td>24.24</td>
<td>319.48</td>
<td>7.4690</td>
<td>0.6489</td>
</tr>
<tr>
<td>Obs.</td>
<td>33</td>
<td>33</td>
<td>33</td>
<td>33</td>
<td>33</td>
<td>33</td>
</tr>
</tbody>
</table>

Table 5.4 presents some figures about China. It would be seen that FDI inflows have a strong association with other macroeconomics variables. FDI has a significant correlation with GDP, Inflation, REER, IT, Cab and Openness of trade. So, FDI is impacted by certain macroeconomic variables in China.

Table 5.5: Correlation Matrix’s of China:

<table>
<thead>
<tr>
<th></th>
<th>FDI</th>
<th>GDP</th>
<th>Inflation</th>
<th>REER</th>
<th>IT</th>
<th>OT</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI</td>
<td>1</td>
<td>-0.2385</td>
<td>-0.3928</td>
<td>-0.1442</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>0.9248</td>
<td>1</td>
<td>-0.2654</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td>-0.2385</td>
<td>-0.2654</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>REER</td>
<td>-0.5747</td>
<td>-0.3928</td>
<td>-0.1442</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CAB</td>
<td>0.8478</td>
<td>0.9235</td>
<td>-0.2210</td>
<td>-0.2919</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>IT</td>
<td>-0.0606</td>
<td>-0.0517</td>
<td>-0.7326</td>
<td>0.1714</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>OT</td>
<td>0.8259</td>
<td>0.6946</td>
<td>-0.0230</td>
<td>-0.7422</td>
<td>-0.2879</td>
<td>1</td>
</tr>
</tbody>
</table>

The above table explains that in China FDI has a strong and positive correlation relationship with GDP, Cab, and openness of trade. The existence of statistical significant correlation means to attract the FDI inflows. In China, if we observe other macroeconomic variables, real exchange rate, and interest rate have a strong negative statistical significant correlation with FDI. Thus, the determinant factors to the FDI inflows such as GDP and openness of trade have a significant correlation with FDI.

Empirical Analysis Results

The purpose of our empirical investigation is to analyse cross-country the effects of FDI on economic growth in China and India and to examine factors that determines. These include: FDI, GDP, Inflation, REER, Interest rate and openness of trade. We test the effect of FDI inflows to investments in the framework of cross-
country equation. The empirical model has four equations. The regression models shows results and we can compare the multiple regression coefficients of both countries. In the constructed the regression models, all four equations yield different coefficients. However, during the phase transition, the FDI inflows in both countries have been large.

Table 5.6 reveals that different regression results, vis-à-vis models 1, 2, 3 and 4. Regression model 1, explains whether FDI of any country can account for both growth of the country and it own past behavior, i.e., change in FDI in the modeling period. Basic specification with dependent variables is FDI; independent variables are change: in FDI, GDP. Model 2, explains whether FDI of any country can be explained through exchange rate policy changes and behaviour and the country opening up the economy and the effect of that. It includes: interaction of FDI, with REER, and OT. By means of Model 3, FDI inflow can be explained through interest rates (monetary policy of any country) and inflation (general price changes over a period of time). Regression model 4, presents the impact of all the studied variables on FDI and its changing policy structure in the any economy. The dependant variable is FDI, and explanatory variables are: GDP, inflation, openness of trade, exchange rate and interest rates. The four regression models show that most coefficients have the expected signs. The estimated $R^2$ values shows a fit in cross sectional data.

India model result: we can be postulate that GDP, Real effective exchange rates and percentage change in FDI are more significant than other variables. The remaining variables are not statistically significant.

Table 5.6: Determinant Factors of FDI in India: Regression results

<table>
<thead>
<tr>
<th></th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-85.262***</td>
<td>24.639***</td>
<td>13.892***</td>
<td>-35.287***</td>
</tr>
<tr>
<td>Change in FDI</td>
<td>0.6256***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>3.4404***</td>
<td></td>
<td></td>
<td>2.113***</td>
</tr>
<tr>
<td>Interest Rate</td>
<td></td>
<td>-0.667***</td>
<td>0.0021</td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td></td>
<td>-0.342***</td>
<td>-0.0586</td>
<td></td>
</tr>
<tr>
<td>REER</td>
<td></td>
<td>-1.953***</td>
<td>-2.462***</td>
<td></td>
</tr>
<tr>
<td>OT (E+I)/GDP</td>
<td></td>
<td>4.888***</td>
<td></td>
<td>1.325*</td>
</tr>
<tr>
<td>Observations</td>
<td>33</td>
<td>33</td>
<td>33</td>
<td>33</td>
</tr>
</tbody>
</table>

Note: *, ** and *** are 1%, 5% and 10% level of significance, respectively.

Model 1: the regression result reveals that the interaction of FDI gives a positive and statistically significant coefficient while change FDI and GDP. FDI inflows depend
on GDP, this has also been the case, of FDI inflows performance to attract FDI investments in India. Especially, after financial reforms FDI inflows and GDP rate have been accelerating in on economy. The changes in FDI and GDP is (10%) positive statistically significant. It means that change in FDI and GDP have a positive impact on attracting FDI inflows into India. The estimated coefficients indicate that the India can benefit positively from FDI, through the positive interaction with change in FDI and GDP. This leads to economic growth in developing countries. Recent literature ahs concluded that FDI and GDP have a positive correlation relationship.

**Model 2:** The interaction of FDI has a positive and statistically significant coefficient with REER and trade. REER has (10%) negatively statistical significance. Openness of trade (10%) has a positive statistical significance. REER has a vital role to play in domestic and foreign countries to influence investment. The FDI and trade is interaction of statistically significant. This implies that FDI and trade are helping each other in advancing the growth rate of income in developing countries. In addition flow of advanced technology by FDI can increase the growth rate of the host economy by interacting with trade. The estimated coefficients indicate that host countries benefit positively from FDI, and through FDI’s positive interaction with REER and OT.

**Model 3:** Macroeconomic policies and institutional stability could have a significant impact on FDI and economic growth. Interest rate and inflation have (10%) negatively statistical significance. Recent literature indicates that FDI is greatly influenced by the host country policies, such as monetary, fiscal and open market policies such as inflation rates, and interest rates. If change in inflation and interest rate it would be positive in impact to FDI. The estimated coefficients indicated that host countries benefit positively from FDI, and through FDI positive interaction with low interest rate and inflation.

**Model 4:** Overall regression result the interaction of FDI yields a positive statistically significant and non-positive variables: such as GDP, inflation, interest rate, REER and trade. The empirical estimated coefficient results show that GDP (10%) has a strong positive significance and REER (10%) ah a strong negative significant, and also openness of trade at (1%) significance level. Remaining coefficients of the variables such as inflation and interest rates, are not statistical significant for FDI inflow. Indian has favourable policies, tax insensitive, cheap labour cost to be able to attract FDI inflows, after the transition reforms was introduce in the 1991. There is a positive relationship between FDI and the GDP growth rate, but also a positive interaction
between FDI and REER in triggering economic growth. Thus macroeconomics indicators have influenced FDI inflows in to India. A country’s economic growth is also affected by its macroeconomic policies and institutional stability. Efficient macroeconomic policies and institutional stability are necessary preconditions for FDI-drive growth to materialise. The estimated coefficients inflation and interest rate are not statistically significant, but REER has negative statistical significance. So, this implies that lowering the inflation rate would indicate that the host country’s macroeconomics policies are stable and disciplined. When Interests rate and REER are low, these help attract to investments - both foreign and domestic.

**Figures 5.5:** emphases the behaviour of macroeconomics variables with FDI in India. It explains the fluctuating trend lines in different variables and trends over all the periods in India. This methodology is employed for all the studied variables on FDI and its changing policy structure in the any economy. In India, GDP trend has been accelerated, especial after transition reforms. World Bank report, on 2000 onwards shows the growth rates have rapidly grown. Inflation rate is the overall period has show a fluctuating trend. However, in the period 1998 to 2005, inflation trend was downwards due to effect of drought, Oil shock effect and financial deficiency. The inflation rate is a key indicator of fiscal and monetary policies of a country. A low inflation rate would provide a better climate for investment, trade and economic growth (Fisher and Modigliani; Froot and Stenin; Shiva S. Makki, 2004). Real effective exchange rate was very high before transition reforms periods and effect of the reforms in exchange rate was drastically decreased due to devaluation of the rupee and the fall in the exchange rate. Thereafter, full convertibility of the rupee, FDI inflows also increased. The CAB has been showing fluctuating trend from the beginning, which means that it is increasing growing the FDI inflows. Also, interest rate is overall period trend should a fluctuation trend, which led to sluggish influence on the FDI inflows. In 1979, IT was negative. Openness of trade (export-import) trend was fluctuating before reforms, but financial reforms trend has changed. Results show that FDI inflows are slowly picking up; though imports are higher than exports in India. In exports the matter of IT and services sectors are booming after 2000. Thus, trends levels show the factors that influence the FDI inflows in India. FDI inflows were sluggish before transition reforms. Thereafter, FDI inflow started steadily swelling, by due to the influence of macroeconomic variables.
Figure 5.5: Behaviour of Indian Macro Economic Indicators from 1978-2010
2). FDI in China:

**China model result**: All factors have shown the expected, outcomes these include: GDP, real effective exchange rate which are significant. The remaining macroeconomic variables are not statistical significant. In the case of the China, FDI inflows depend upon current year performances, its inverse relationship with India. The result shows that GDP and real effect exchange rate strongly influence FDI inflows. Openness of trade, inflation and interest rates are not much influenced in China.

**Table 5.7: Determinant Factors of FDI in China: Regression results**

<table>
<thead>
<tr>
<th></th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-49.774***</td>
<td>29.984***</td>
<td>9.6115***</td>
<td>2.515</td>
</tr>
<tr>
<td>Change in FDI</td>
<td>0.513***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>2.148***</td>
<td>-0.1539</td>
<td>0.1137</td>
<td>0.956***</td>
</tr>
<tr>
<td>Interest Rate</td>
<td></td>
<td>-0.0079</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td>-3.651***</td>
<td>-3.928***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>REER (Exchange Rate)</td>
<td>-0.0079</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>O/T= (E+ I)/GDP</td>
<td></td>
<td>2.871***</td>
<td></td>
<td>0.6858</td>
</tr>
<tr>
<td>Obser.</td>
<td>33</td>
<td>33</td>
<td>33</td>
<td>33</td>
</tr>
</tbody>
</table>

Note: *, ** and *** are 1%, 5% and 10% level of significance, respectively.

**Model 1**: regression results show that the interaction of FDI has a positive and statistically significant coefficient, with change FDI and GDP. Change in FDI and GDP are (10%) of positive statistical significance. The estimated coefficients indicate that host countries benefit positively from FDI, and through FDI’s positive interaction with change in FDI and GDP.

**Model 2**: The interaction of FDI is a positive and statistically significant coefficient with REER and Trade. REER is (10%) negative statistical significant and openness of trade is (10%) positive statistical significant. As well as these both variables are quite opposite. The estimated coefficients result shows that China’s benefit positively from FDI and through positive interaction with REER and Trade. The effect of exchange rates targeting to stabilisation policies. The estimated coefficient of FDI is positive statistically significant, with the estimated coefficient of trade. These indicate that impact of FDI in the host country’s economic growth (Shiva Makki, 2004, WB). Coe and Helpman (1995); HK Natha (2008), argue that trade is the spillover effect of foreign R&D on domestic productivity. Thus, trade policies are significant to drive up the GDP.

**Model 3**: Regression results shows interaction of FDI has negative coefficients with interest rate and Inflation. Interest rate and Inflation are statistically insignificant in
China. Inflation is an important player. Too much inflation and too low inflation would affect the economy. The effect of macroeconomics stabilisation policies represent that these can potentially affect growth. Berg, et. al., (1996), used inflation as a stabilisation proxy. As a result show that the China can benefit from low positive with interest rate and Inflation.

**Model 4:** Overall regression results reveal that GDP (10%) have positive statistical significance and REER (10%) is negative statistical significance. On the other hand, macroeconomic variables, such as interest rate and inflation and openness of trade are not statistically significant. The results indicate FDI has a positive effect on domestic investment. It implies that FDI stimulates to domestic investment. These findings conform to those to Borensztein, Gregorio, and Lee; Shiva S Makki, 2004. Shiva S Makki, in his analysis concluded, explained that trade is not statistically significant. Our results are that trade interacts negatively with FDI. GDP, REER greatly influence to FDI in the China. However, in China’s domestic market, the low labour cost, abundant natural resources and autonomy are the major driving forces for attracting FDI from other countries.

**Figure 5.6:** Explains and that FDI has a positive interaction with GDP. Even recent literature reveals that FDI and GDP have a positive relationship in host countries. China’s growth has been steadily increasing and the country has the fastest growth rate among the Asian countries. So, it leads to attracting FDI inflows. Before transition inflation rate was high, but after 1997, the inflation rate was come downward resulting in increasing FDI inflows. Effective real exchange rate, since the beginning of transition shown has been downward trend which is favourable for FDI inflows. Example, with depreciate exchange rate it can export more easily and gain from resources seeking FDI. However, if the inflation rates it continuously depreciates investors will avoid the investments. Therefore, the impact of exchange rate depreciation on FDI inflow is ambiguous. Also the current account balance position was positive, except in five years, it leads to more FDI inflows. During the transition period, interest rates have been fluctuating but these rates were moderate another positive sign for encouraging foreign investment. High interest rates lead to capital outflows thereby depreciation of the currency. In other words, exchange rate depreciation may cause the rise in interest rate. Therefore, both the interest rate and exchange rate might be affecting each other (Pradyumna Dash).
Openness of trade trend level has been growing because export revenue has been high after the WTO accession in 2001. In China, export trend is higher than that of import, it means export-lead the Trade. After transition economies, technology, knowledge may also be transform through exports and imports and it leads promote the economic growth, attracting the investments (Frankel & Romer, 1999; Frankel, Romer & Cyrus, 1996; Grossman & Helpman, 1997; Fank S.T. Hsiao et. al., 2006). Consequently, it would attract more foreign investors to invest in host countries. Thus, the macroeconomics variables are vital role to attract FDI inflows in China.

**Figure 5.6: Behaviors of China Macro Economic Indicators from 1978-2010**

---

**Figure 5.6: Behaviors of China Macro Economic Indicators from 1978-2010**

- **GDP**
- **FDI**
- **CAB**
- **INF**
- **INT**
- **OP**
- **REER**
Comparison of both models

The correlation between FDI and growth rate could arise from an endogenous determination of FDI. In other words, FDI itself may be influenced by innovations in the stochastic process governing growth rates. The endogenety problem is addressed by using the instrumental variables (see Borensztein, Gregori, and Lee; Shiva S. Makki, 2004). The estimated coefficients on FDI and trade are positive, but statistically insignificant. In fact, theoretically, FDI-Trade shows a positive growth. The interaction between FDI and trade is positive and statistically significant, according to Liu et. al., (2002) brought out the relationship among economic growth, foreign direct investment and trade in China. This alternative estimation also suggests that our results are robust. Some estimations of coefficient results show statistical insignificance, but, theoretically these would show significance. Even though some authors argued that IT, inflation, and REER are negative and positive growth, still there is ambiguity about these variables.

Findings suggest that, both countries are attracting FDI inflows from other countries by both through their domestic markets and cheap labour costs. On the other hand, the effective macroeconomic policies and institutional stability and initial conditions of countries are necessary for inflow of FDI. Lowering the real exchange rate, current account balance, interest rates would promote economic growth in transition economies. Yuqing Xing, Guanghua Won (2004) argues that the relative FDI of one country is determined by the relative changes in exchanges rate between its currency and the source country. Berg et al., (1999) emphasised the importance of macroeconomic stabilisation for growth in transition economies of the Central and Eastern Eurobarometer (CEEB) regions. Consequently, a country’s economic growth is also affected by the macroeconomic policies and institutional stability in both countries.

5.4. Conclusion

China has the greatest FDI potential among the BRICS, on account of economic size and rapid economic growth. In additional, China has grown at a phenomenal rate and other transition counties are now trying to catch up. India, still, is far behind. India can certainly learn lessons from China and create a congenial business climate in the country to catch up in the China. In both countries, macroeconomic variables can play a crucial
role to attract huge foreign investments. Results show that China’s strengthen its GDP and favourable, exchange rates, while in India GDP, exchange rates and openness of trade are more attractive influences for FDI. If, India can create structural changes at a fast pace, it might attract more FDI and grow rapidly. However, in fact, India has created economical freedom for increased private sector and Trans National Corporation (TNC) participation, brought about openness of trade to become more global in its outlook and formulated flexible labour laws to attract free market demand, in its quest to become a major player in the global economy.
CHAPTER – V (b)

A COMPARATIVE STUDY ON TRANSITION ECONOMIES IN CHINA AND INDIA: A PERSPECTIVE TRADE ANALYSIS

5.2.1. Introduction of Trade
   b. Background of Trade
   c. Significance of Openness of Trade
   d. Trade policy reforms in Transition Economies
   e. Trade and growth take off in Asia

5.2.2. An overview of Trade in China and India in the Transition Perspective

5.2.3. Trade policies analysis of China and India

5.2.4. Role of Trade in selected indicators - influences in both Transition Economies from 1978 to 2010.

5.2.5. Conclusion
5. Introduction

Both countries share a common legacy of foreign influence or domination. Thereafter, communism took roots in China and democratic socialism in India. In the two Opium Wars (1839-1843 and 1856-1860), Great Britain coerced China to open up trade, partly to facilitate an exchange of British opium for Chinese tea. The Japanese invasion of (1937, p.25) followed by civil war and Communist revolution in 1949, did not endear the Chinese to foreign commerce, and for a long time afterwards, these experiences hampered China’s attempts to open up its economy to the outside world. Similarly, the East Indian Company dominated for India close to 100 years before delivering it to the British Crown in 1857. Until recently, did not show much India’s interest in attracting foreign capital and opening up to external trade. These events help reveal why liberalisation of foreign trade took so long to arrive in India and China (Thorvaldur Gylfason 2005). Since Adam Smith stated that the economics has been searching for the causes and effects of the growth of income and wealth and for the explanation of the structure of international trade, the exchange of goods and services are across national borders (Vladimir Bencaek, 2008).

Both countries are now playing a vital role in the 21st century global economy. Their expansion of trade has had a noticeable impact on global level growth, and through a number of channels, with trade showing arguably the strongest growth (Winter and Yusuf 2007; Renfeng Zhao, 2007). India had the fastest export growth among major traders in 2011, with shipments rising 16.1 per cent. Meanwhile, China had the second-fastest export growth of a much major economy, at 9.3 per cent (WTO). India also emerged as the second-fastest importer after China, growing at a rate of 6 per cent in 2011. India’s account of trade GDP growth rate average is (30.76%) in 30 years; and China’s (33.57%) (see Table-5b.1). China has constructed to success story of economic strength activities by such as traditional manufacturing and export-led growth strategy and foreign trade, and also has a vast resource of cheap labour and domestic savings. Meanwhile, the service sector and reliance, to a large extent, on domestic demand, IT, pharmaceuticals and potential of financial market have become the leading drivers in India’s success in triggering economic potential growth.  

An increase in use of technology has affected both countries sectors but it quite the opposite way. The services

---

sector requires a large number of human development skills. However, the policy implications of the development strategies of both the countries vary (Patricia Costa, Mayuri Guntupalli, Vishaal Rana, and Huong Trieu, 2006). In both countries, trade, as a per cent of GDP, has generally risen steadily during the period 1980-2010. In 2010, the figure was 55.23 per cent for China and 46.32 for India, as against the global figure of 55.86 per cent. Thus, both countries can learn from each other in several areas.

Table 5b.1:
Measure of China’s and India’s integration with the world Economy from 1980-2010

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merchandise Exports</td>
<td>1.81</td>
<td>2.73</td>
<td>6.20</td>
<td>1.48</td>
<td>2.49</td>
<td>7.61</td>
<td>1.57</td>
<td></td>
</tr>
<tr>
<td>Merchandise Imports</td>
<td>1.99</td>
<td>4.22</td>
<td>5.33</td>
<td>1.32</td>
<td>2.25</td>
<td>6.59</td>
<td>1.39</td>
<td></td>
</tr>
<tr>
<td>Trade (% GDP)</td>
<td>15.56</td>
<td>13.05</td>
<td>15.68</td>
<td>23.13</td>
<td>27.38</td>
<td>41.32</td>
<td>46.32</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merchandise Imports</td>
<td>1.48</td>
<td>1.59</td>
<td>2.35</td>
<td>3.47</td>
<td>5.15</td>
<td>1.42</td>
<td>3.27</td>
<td></td>
</tr>
<tr>
<td>Trade (% GDP)</td>
<td>21.66</td>
<td>22.50</td>
<td>29.16</td>
<td>38.81</td>
<td>44.24</td>
<td>68.63</td>
<td>55.23</td>
<td></td>
</tr>
<tr>
<td>World</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merchandise Exports</td>
<td>1.97</td>
<td>1.88</td>
<td>3.47</td>
<td>5.17</td>
<td>6.45</td>
<td>1.049</td>
<td>1.52</td>
<td></td>
</tr>
<tr>
<td>Merchandise Imports</td>
<td>2.01</td>
<td>1.95</td>
<td>3.55</td>
<td>5.22</td>
<td>6.65</td>
<td>1.076</td>
<td>1.52</td>
<td></td>
</tr>
<tr>
<td>Trade (% GDP)</td>
<td>38.48</td>
<td>37.96</td>
<td>38.27</td>
<td>42.02</td>
<td>49.08</td>
<td>53.82</td>
<td>55.86</td>
<td></td>
</tr>
</tbody>
</table>

Note: Trade is the sum of exports and imports of goods and services measured as a share of gross domestic product.

Sources: World Bank, 2012 (All values in current, millions US$)

Table 5b.1 presents the measure of China’s and India’s integration with the world economy during the period 1980 to 2010. In China’s exports are soaring compared with imports because potential manufacture sector since transition.

Figure 5b.1: Comparison of India, China and World Trade GDP percent from 1978-2010
While in India, export was low but after the reforms export have been accelerated the growth, imports are low to compare with exports. Also, except 1990, Indian exports more than imports. Although after effect of financial crisis in the World trade as a result of decline trade in both countries. Till 2009, trade growth rate was rapidly raised in both countries. The World Trade Organisation (WTO) in 2009, 9 per cent has declines in global trade for 2009 the largest in over 60 years (Economic Survey, 2009-10).

b. Background of the Trade

In earlier times, trading was mostly through the barter system, since then the currency system that we know today was not in vogue. Hence, people used to exchange goods. A close examination would shows that the barter system was based on feature like comparative advantage and “division of labour”. In this process, the needs of the consumer used to be met. However, the mechanism had a number of disadvantages. No wonder, in course of time, the currency system took strong roots.

Domestic market is based on the principle that human depends upon each other. The barter system was based on homogeneous products, centralised markets operate, and a mismatch between demand and supply. In today’s domestic markets, all kind of products are available. If case of a demand-supply gap, this is always scope for approaching other markets for trading purpose.

In some respects, the domestic market is similar to international trade, because all trade indicators must be taken into account. While the domestic market operates homogeneously, the international trade is exogenous. For both domestic and international trade, there are various policies, conditions, and restrictions. Depending on the country’s economic solution, prices of certain products need to be cheap (especially for the domestic consumers), but high in the international market.

The dynamic effects (Balars, 1961), which aim at economic integration, may influence the rate of growth in GNP of the participation nations and: a) increase the size of the market b) Affect specific and general cost structures, c) benefit trade creation by linking economic regions d) influence the location and volume of real trade; and e) influence economic efficiency.

Transition is a part of economics. Transition is the process of economy in which trade has an important role to play for integration with the local markets. Trade involves
an openness of all elements of the economy. Trade creation and diversion are the two concepts most widely used in internal economic integration.

c. Significance of Openness of Trade in China and India

The domestic market is an important player in the process of international trade. Similarly, when the domestic market is facing issues like mis-match in supply-demand and, scarcity of resources, international trade can help overcome these. International trade includes bilateral trade relationship between two countries, which encompass institutional development, division of labour, specific products innovation and opportunity cost.

India and China have achieved remarkable growth by the openness of trade. Opening up the trade has triggered the growth of GDP and expanded their share in the world economy. China’s trade expansion has, at least in part, been reflected in greater specialising in the final processing assembly of large volume of goods and made the country a world factory of re-exports. In China, half of exports are to other countries, mostly in certain high technology products.

**Figure 5b.2: Export/GDP ratios of China and India from 1978 - 2010**

![Graph showing Export/GDP ratios of China and India from 1978 to 2010]

**Note:** Export= Exports of goods and services (% of GDP)

**Sources:** World Bank (2011).

However, China’s (r) manufacturing, export-led growth contrasts with (l) India’s services, demand-driven growth (IMF, 2012). In China, (see figure 5b.2) the simple ratio of
exports to GDP is 1.4 per cent in 1980 and 2.8 per cent 2010, the corresponding figures were 0.32 and 2.1 per cent respectively.

After transition 1991, export-GDP ratios have steadily moving upward in both countries. However, in both countries, export-GDP ratios declined in 2008 due to effects of the global recession. We can conclude that China is much more integrated into world trade compared with India.

d. A Simple Model of Economic Reforms

Figure 5b.3 explains the maximum possible, or potential, output that can be produced with given input levels and technology. These levels of outputs could not have been achieved with fewer inputs with the existing technology. However, the economy is producing point A, where the output is less than the country’s potential output, given its frontier production possibility set. The country is producing at point A due to various non-price and organisational factors. Also, government policies can use to influence production.

In this context, there are two basic options for the government, which are not mutually exclusive. Alternatively, the government may choose to maintain the same input level and to effectively use the inputs to produce at B.

However, policy emphasis needs to be different, depending on which path the government would like to choose. One option for the government is the path from A to C,
reduce the levels by encouraging substitution and intensive use of inputs. The relatively major emphasis of the fiscal policy reforms is on pruning government expenditure.

On the other hand, the government may choose the path from \( A \) to \( B \), by improving the competitive structure to achieve efficient use of inputs. Accordingly, these policies can be applied to influence competitive structure, trade policy, exchange rate policy and investment policy, all of which play a dominant role in the reform process. Indeed, developing countries with serious supply bottlenecks and unemployment problems tend to go more for the choice of the path from \( A \) to \( B \) relative to the path from \( A \) to \( C \) and \( B \).

In this study, analysis is restricted to examine the types of trade policy reforms, implementation of which impact export promotion and import liberalisation. Several empirical studies conclude that there is a strong and significant effect of openness to trade on growth performance (Srinivasan, 1998; Kaliappa Kalirajan, 2004). Thus, trade policies are playing a crucial role in economic development.

**e. Trade Policy Reforms in Transition Economies**

Trade liberalisation has been an integral part of the transition process undertaken by former centrally planned economies at the beginning of the 1990s. Trade liberalisation was expected to proceed rapidly and most efficiently with major flows of the centrally planned economic system. The issues, here, are:

I. The distorted price structure, resulting from the previous system of administered prices, and

II. The centralised and highly integrated production system by large monopolistic enterprises.

In other words, trade opening was designed to ‘import’ world prices and “inject” more competition into national economies.

Trade liberalisation can play an important role in restructuring economics in the context of transition economies. Outcomes of trade liberalisation in transition economies, can be based on: a) Macroeconomic variables, b) Structural policies (including external liberalisation); and c) Initial conditions in different transition countries.

In addition, monetarists point out the importance of political factors, timing of the reforms and success in winning public support, since there are issues like inflation and generally high unemployment rate. Consequently, transition countries have tended to
adopt a rapid and radical reform approach. Recent developments also clearly show a parallel between recent GDP performance and openness in transition economies.

Main lessons learnt from liberalisation experience of transition economics for domestic policy and decision-makers are as follows:

- Radical and fast trade liberalisation, initiated in the early stages of the reforms process, has been more successful in overcoming initial distortions.
- The success of trade reform is largely dependent on proper legal framework and institutional settings.
- An “external anchor” has to make an essential contribution for the success of trade reforms.

f. Trade and Growth take off in Asia

After trade liberalisation, a number of countries began to emerge, as economists and policymakers took note of some surprising successes in the developing world. Economies that experienced a dramatic acceleration in their growth and began to transform themselves into advanced nations include: South Korea, Taiwan, Hong Kong and Singapore. Today, the lists of countries that have experienced accelerated growth include the world two most populous nations - China and India. As can be seen, South Korea began it economic ascent in the 1960s, China at the end of the 1970s, and India around 1990. The process has been marked by major changes in economic policies. The new policy involved reducing government regulation in different areas, including a move towards free trade. The Asian successes stories demonstrate that the proponents imports-substituting industrialisation proved were wrong. It is possible to achieve development through an export-oriented approach and adopting approaches like: trade liberalisation, reduction in tariffs and the lifting of other import restrictions. After 1980s, India’s participation in inwards trade surged as tariffs were brought down and import quota areas removed within a short period. India’s economic growth has been high. The big question is, how India’s growth rate has increased so dramatically? The question is the subject of heated debates among economists, some have argued that, after trade liberalisation, India’s participation in the global economy was crucial. Other has pointed out that India growth began accelerating around 1980, but became full-fledged from the beginning of the 1990s. However, whatever was the effect of change India’s transition has been a welcome development (pp. 256-268).
5.2.2. An overview of Trade in China and India in a Transition Perspective

An overview of China and India:

China and India established diplomatic relations on April 1, 1950. After that, both countries Prime Minister were being visited countries have been visiting each other’s country. In 1984, China and India entered into a trade agreement, which provided them the status of Most favoured Nation (MFN). Subsequently to in 1992, both countries established full-fledged bilateral trade relations. In 1994 marked the beginning of a new era in China-India economic relations. A recent development of the India-China economies ties is the rapid increase in bilateral trade. However Indian industries’ ambivalence over the proposed Indo-China Free Trade Agreement (FTA) stems from concerns over previous FTAs signed by the two governments.

Rajiv Gandhi’s visit to China in December 1988 signified a warming trend in relations and agreement to broaden bilateral ties in various areas. As the mid-1990s approached, slow, but steady, improvement in relations with China was visible. Top-level dialogue had continued with the December 1991 visit of Chinese Premier Li Peng to India and the May 1992 visit to China of Indian President Ramaswami Venkataraman. Border trade was resumed in July 1992 after a break of more than thirty years. Consulates were reopened in Bombay (now Mumbai) and Shanghai in December 1992, and, in June 1993, the two sides agreed to open an additional border trading post. Though Rajiv Gandhi’s visit to China in December 1988 was usually identified as a turning point and breakthrough in India-China relations, it should also be noted that many years of previous effort contributed to it. Eventually, in 1984, India and China signed a trade agreement, which provided for Most Favoured Nation Treatment and also in 1994, the two countries signed the agreements on avoiding double taxation. However, both countries reforms began at different periods and situations.

a. Trade reforms process in China

Chinese economies reforms began in 1978. These created conditions for rapid economic growth and structural changes. In 1980, the country began to attract FDI inflows. Soon, the country began to emerge as an important global trade power. China was the second largest trading nation in the world (after the United States). Its trade activities are growing more rapidly, compared with any other large economy. Trade liberalisation has been an integral part of China’s economic reforms process since its
beginning. China’s trade policy reforms took a new twist with the country’s entry into the WTO on December 11, 2011.

For a long period of time, China was considered a Communist country with a closed economy. In the overall 31 year of reforms, the country has continuously pursued trade liberalisation and trade promotion. The high growth rate of China is attributed to high level of trade and greater investment effort. The Special Economic Zones have also helped to increase the productivity. This led to a surge of trade. China’s trade gradually expanded after the 1990s. Since 2002, trade has been rapidly increasing. This has contributed to stabilisation of the economy. International trade “Opening” and “Domestic” economic reforms were complementary processes which can be described in a single term: “Reforms and opening” (Gaige Kaifeng). Of course, today, global economy is very much an important sign for trade and investment. In China, growth of trade has been driven by foreign investment that was itself part of the East Asia-wide economic restructuring. The liberalisation policies were adopted for the opportunities they offered by bringing in relatively liberal rules on export processing.

**Trade Reforms in Transition process**

The domestic economy was rigorously sheltered from the world economy by, what we might term a “double air lock” that controlled flow of both goods and services. The first “Air lock” was the centrally controlled foreign trade monopoly. The, second “Air lock” was the foreign exchange system. The “double air lock” system was important for exports of commodities. If allowed, market forces would influence domestic prices. The socialist price system is an extreme version of the price relationships created by the common “import substitution industrialisation” (ISI) development strategy. The strategy restricted new imports and protected their new industries and fostered industrialisation. The period 1978-1979 set up the pace of technology imports due to sudden shortage of foreign exchange reserves in China. Ultimately, opening up of China, with a particular motive and opportunity brought about dramatic changes in the world economy.

*Initial reforms had the enormous task of transforming the whole foreign trade system. Chinese policy makers initially took modest, but innovative, steps to open up new trade centre’s in the southern provinces of Guangdong and Fujian in 1978-1979. Thereafter, SEZs were set up in Guangdong and Fujian, as well as other Export*
Processing Zones (EPZs). Both Guangdong and Fujian provinces were developed to provide strong incentives to expand trade.

Initiatives in the mid-1980’s had created some initial breach to liberalizing the main national trading system. A comprehensive liberalisation package was adopted in 1984. As a result, imports surged by more than 50 per cent in 1995-despite setbacks, and policy makers maintained some flexibility in the rules of trade. They also created the framework for the subsequent growth trade and investment. The main elements of the initial phases of trade reforms included devaluation - an important factor for exchanging the value across countries for achieving successful trade reforms. During the pre-reforms period, the Chinese government maintained an overvalued currency. In 1986, the value of the Chinese currency had declined to about 60 per cent. After 1986, dual-exchange rate regime was introduced. As a result, exporters could sell their foreign exchange earnings in a slightly regulated secondary market. China’s devaluation in the 1980s coincided with realignment of currency rates throughout East Asia.

The number of companies authorised to engage in foreign trade was also allowed to expand dramatically. Many foreign trade companies were set up. By 1988, there were 5,000 FTCs, each of which was still foreign owned. Exports were liberalised much more rapidly than imports. But still, a number of domestic companies were sheltered from import competition. Also, there was a steadily shift away from the trade plane and in the direction of financial incentives. Pricing changes provided incentives, decentralisation increased competition, and devolution made exporting a potentially lucrative business. Foreign Trade companies (FTC) tie up with domestic companies resulted in lower cost and cheap production of labour intensive goods. However, the share of exports produced by TVEs increased rapidly, accounting for one fifth procurement by the FTCs by mid-1990s. Creation of Tariff and Non-tariff Barriers: Chinese policy makers proceeded cautiously. And they carefully took steps for creation of tariffs barriers. Before, reforms, a new set of tariffs were promulgated that raised tariffs, which remained high for the next decade. In 1992, according to World Bank (1994, 1956), China’s tariffs were similar to these of other development countries. Not-tariff barriers and tariffs were “in a complementary fashion to achieve the government’s objectives”. However, Chinese imports were regulated by a combination of tariffs, quotas and administrative guidance exercised over state-owned trading companies.
In the mid-1980s, China moved from a planned trading system to a system of high tariffs, multiple non-tariff barriers, and high administrative discretion. Still, the trading system has been dominated by state-run organisations with major market power. This led to increasing profits and revenue. Steady reforms in trading had created an essential minimum degree of flexibility and further allowed the foreign-trade system to harmonise with changes in the economic system. Trade barriers were first converted to tariff equivalents, to facilitate China’s entry into the WTO. This system was borrowed from the East Asian playbook and adopted selective measures of exports promotion and designed to offset the anti-export bias for at least some products. This partial system of rebates of value-added taxes for exports began in 1985 and expanded in 1990s. Consequently, the most important step was the creation of an entirely separate export-processing trading regime, and to avoid the old centralised foreign trade monopoly.

*A dualist trade regime the export processing* contract was begun in Guangdong province before reforms in 1978. In 1986, the government had recognised the opportunities for China in the ongoing restructuring of Asian export production network. On the other hand, they were allowed to adopt a more flexible variant of export processing. In 1987, China had established time separate trading regimes. EP (or) export-promotion for trade, responding to the extremely open regulation, had grown rapidly. The EP regime and foreign invested enterprises together were the drivers of China’s export expansion. Foreign Investment Enterprises (FIE’s) was gradually becoming important players in China’s export growth. During the period 1992 to 2005, it accounted for 63 per cent of increment exports. Clearly, the liberation influence on foreign investment had played a fundamental role in China’s exports successes. Moreover, domestic firm exports stagnated for four years. In the period 1985 to 2004, total exports increased 17.6 per cent annually.

**Towards an Open Economy**

From the mid-1990s, China began to move in the direction of a genuinely open economy. Moreover, membership of the WTO was a powerful motivating factor. The common theme linking these reforms was reducing the degree of dualism in the trade regime and prepared the way for an open economy. Membership of WTO, was considered very much useful to help push through reforms. The discussion of these changes first covers the currency reforms in 1994, WTO membership and other aspects.

1. *Currency convertibility:*
On January 1, 1994, reforms abolished the secondary “swop” or (exchange) market for foreign exchange that had been one of the important transition devices. In China foreign currency was greatly liberalised and current account convertibility was achieved. As a result, the importers of goods and services can purchase these thought foreign exchange. The WTO permits exporters to discount VAT on exports. China’s policy makers have been quick to see the advantage of such a discount. Thus the, 1994 reforms succeeded in moving China to a more integration of trading with the global economy.

Though the 1994 success was partial, China could more quickly to full currency convertibility, including the capital account and established a “managed float” for the Chinese currency. A flexible exchange rate would adjust in the long-run the supply and demand for foreign exchange market so as to stabilise the currency. In the aftermath of the Asian financial crisis of 1997-1998, all Asian currencies were under downward pressure, and policy makers decided to hold the line and not allow the currency to depreciate. However, China’s exports had started to grow rapidly after 2002.

China formally applied to reform the GATT (General Agreement on Trade and Tariff) in 1980; it might be a quick and relatively painless process. After that, China was to start market reforms. Finally, China was become the 143rd member of the WTO, on December 11, 2001. There after then, China’s trading institutions integrated with the global economy.

After 1989, there was no longer a constituency for an “easy” entry by China into WTO. The Uruguay Round negotiations, created by the WTO in 1996, signaled a fundamental shift in the term global trade negotiations. Earlier agreements had been restricted to a clearly delineated “foreign trade sector”. It was a more systematic development of China’s characteristics of the negotiation economics. Modern economics are now primarily focused on trade and services. During the Uruguay Round, itself trade liberalisation was achieved, by a “Grand Bargain” in developed and developing countries. This round was more useful for the developed and developing countries. The, primary attributes included extension of trade negotiations and new areas relating to services, investment and intellectual property rights. This was the external bargain that China was required to make as a condition for WTO membership.
The requirements were that China opens up the OT (Openness of Trade) regime and dramatically reduce the dualism of its trading regime. China was extended trading right without restriction, including provide the trade rights to domestic and foreign private companies, and this was made effective on July 1, 2004. Under this law, the China government no longer restricts trade to a limited number of states owned FTCs, except in a few agricultural commodities. China began low tariffs in preparation for WTO membership immediately after the foreign exchange reforms of 1994. The reduction tariffs stages were from 45 per cent in 1992 to 17 per cent in 1999 respectively. As per the actual agreement, China agreed to lower average industrial tariffs to 9.4 per cent in 2005. The agreement lowered average agricultural tariffs to 15 per cent, which was also easily achieved.

However, openness in imports is the most import dimension of its overall openness to trade, besides both openness of trade to competition and an access to lowest cost supplies. Earlier, the ‘false start’ of trade liberalisation through the ordinary trade (OT) regime was abandoned and China adopted a dualistic ISI regime. After WTO membership, drastic changes in trade occurred. China has become more than three times as open to world trade in the six years from 1998 to 2004. After 2002, there has been a huge increase in China’s foreign trade due to recent liberalisation and WTO membership. On November 1991, China joined the Asia-Pacific Economic Cooperation (APEC) group, which promotes free trade and cooperation in economic, trade, investment and technology spheres. China served as APEC chairman in 2001, and Shanghai hosted the annual APEC leaders meeting in October of that year. China’s annual exports have growth grown from 6.78 per cent to 28.36 per cent and import annual growth from -0.89 per cent to 20.13 per cent in 1980 and 2010 respectively.

a. Trade reforms process in India

In India, domestic economic deregulation began in the mid-1980s. The collapse of socialist economies in 1990s worldwide, coupled with a foreign exchange crisis, and India’s own financial crisis were some circumstances that prompted the reforms. India systematically began to reorient its policy framework in the early 1980s and a number of policies were reamed. Before 1991, trade with India was considered one of the most restrictive in the world, due to complexity, inflexibility and wide number of tools used for as policy instruments. At the same time, there was the severe balance of payments crisis in 1991. Later on, comprehensive and systemic reforms in India were under taken.
(Choorikkadan, Veeramanim, pp. 74-76). According to the World Bank (2005), China’s rate of growth was GDP the fastest at an average rate of 10.3 per cent during the year 1980-90, while India’s was 5.7 per cent. There were five major components to reforms, namely, export promotion, domestic deregulation, permission to enter the economy, and reduction of tariff and non-tariff barriers on imports (Christopher J Rusko and Karhika Sasikumar; 2007).

The root cause of the twin crisis could be traced to macroeconomics, mismanagement throughout the 1980s, as reflected in an unsustainably high fiscal deficit, in particular the revenue deficit. The Quantitative Restrictions (QRs) on importing capital goods and intermediate goods were completely removed and customs duties in the manufacturing industries were gradually reduced in 1992. In 1993, the government adopted full convertibility of the rupees for the current account, and FDI has been encouraged in all manufacturing industries and the approval process has been made simple and transparent (Choorikkadan, Veeraman). Macroeconomic stabilisation policies had included devolution and other structural economic reforms. The macroeconomic stability has endured in the ten years of economic reforms up to 2003. The current account recorded a surplus equivalent to 0.3 and 1.4 per cent of GDP in 2001-2003.

Export and import

After liberalisation of trade in India, huge foreign investments were attracted by domestic markets. FDI is an important indicator of gain from economic reforms in India. India account FDI inflows grew from 79.16 million USD in 1980 to 24639.9 million USD in 2010. It has helped to attract large volumes of FDI and FII into the country. For stimulating foreign investments, the government is providing a number of exemptions, incentives, taxes and tariff reduction. State governments are showing commitment to established and strengthen SEZs, and setting up agriculture economic zones to provide a strong push to the country’s export growth rates. Additionally, new labour policy regimes are allowing freedom for entrepreneurs in the SEZs to “hire and fire”, consequently, increasing employment opportunities and maximising gains from SEZs (Charan D. Wadhva, 2006). India’s foreign corporations have grown rapidly, especially since 2003, when all restrictive quantitative on imports were removed. Thus, Indian trade been has steadily improving after 2008 financial crisis; and trade GDP was 46 per cent in 2010 (WBI).

India economy is flourishing after recession. Also, wide-ranging reforms and increased investment have lifted potential growth to almost 9 per cent, helped by improvements in infrastructure. The government should step up efforts to restructure public expenditure; reduce the fiscal deficit; relax some of the constraints facing the financial sector and further promote international integration (OCED, 2012). India’s export annual growth has been from 11.1 per cent 17.92 per cent and likewise import annual growth grown from 8.54 per cent 24.75 per cent in the period 1990 to 2010 (World Bank, 2012). The Indian information technology (IT) industry has been the subject of much discussion on the successful growth of the knowledge industry in a developing country. Group of academicians and experts have cited the success story of IT in India as a lesson for other countries. In India, it is being spread across key sectors such IT enabled services (ITES), software, and e-business. The rapid accelerating progress of IT in India software can be seen from its growth from a small $150 mm industry in 1991, to $5.7B in 2002, an annual growth rate of 50 per cent.

In 2010, India was ranked 124th among 179 countries in the Index of Economic Freedom World Rankings, which is an improvement from the preceding year. India's major trading partners are the European Union, China, the United States of America and the United Arab Emirates.

5.2.3. Trade policies analysis in India and China

An overview of trade policies in China and India:

Recently, economists have again become interested in comparing the two giant’s developing economies largely due to theirs spectacular growth performance in the 1980s and 1990s and subsequently there has been rising significance for the world economy and political affairs. A number of authors are interested by the institutional settings and their impact on the economic performance of the two countries (Huang and Khamo, 2003). Dzever and Jaussual (1999) reported that a series of studies of business strategies of firms and srinivasan (2007) shed light on macroeconomic performance. The strongly macroeconomics performances of both countries and real GDP is expected to rise at an average 10 per cent in China and 8 per cent in India over the period (IMF, 2007a). Also, economic liberalisation reforms undertaken by both countries may have played a crucial role in triggering the high growth rates, since opening up of trade produces excess to
imported inputs, new technology and larger markets and spurs growth (Harries, 1996; Frankel and Romer, 1999).

China and India are now much more integrated with the world economy and, interestingly, the developing countries’ imports have increased at the same time. China is becoming a world factory in re-exports. An opposite trend is shown by India and industrial exports dropped from 55 per cent in 1990 to 44 per cent in 2006, while the share of exports to developing countries has increased.³ The assertion of T.N. Srinivas (2006) is that this is due to the difference in investment climate in various countries, as a result of variations in competitiveness, growth and prosperity across countries and variations in policies or across sub national units within countries. Also, the total share of import significantly rose in both countries and was also strengthened by big markets. The many developing and emerging countries are already expressing fears about the domination of both countries in international trade markets. Both countries are now considered huge and fast growing for a range of goods and services, and thus providing export opportunities for producers in the rest of the world. In addition, the large and growing market opportunities in China and India are wide-mainly due to the large inflow of FDI (Choorikkadan, Veeramani).

a). China’s Trade policies:

The trade policy reforms have also led to significant change in China’s trade pattern. As the reforms progress, market focus come to play a great part in resource allocation. In China, Deng’s open-door policy of 1978 promoted the opening of foreign imports and encouraged the development of an export oriented sector. As a result, tariffs, quotas, and import and export licences were reduced over the subsequent years 1992 to 1996 (Brigitte Desroches et al., 2009).

China was a more open economy through a gradual and highly managed transition. By the mid-1980s, export processing zones (EPZs) was more widely spread and a two-tiered export regime was put in place. Export processing segments benefiting from duty free import were afforded high levels of protection through tariffs and multilayered non-tariffs barriers (Greene et al. 2007). The share of manufactured goods (SITC5-8) in total merchandise exports increased from roughly 50 per cent in 1980 to 80 per cent in 1992. China had become an importer of petroleum and natural gas in 1992.

³. In the case of India, Export has not been affected, compared to other countries of the world, during the phase of global slowdown (DGCI & S. 2012).
During 1992, China, declared its intention to establish a “socialist market economy” and began to make substantial tariff cuts. It resulted in strong, extensive reforms. Also, China agreed to implement reforms as a part of the terms for entry into WTO. China had also committed to a further phased reduction and removal of non-tariff. Agriculture production had a limit on subsidies of 855 of the value of foreign output (Green et. al., 2006). After the 1990s, stress have been on reducing the tariffs, and bring the simple average tariffs. For instance, tariffs on non-agriculture products were being reduced from 41 per cent in 1992 to 14 per cent in 2001 and further to 9 per cent in 2005. In agriculture, import was reduced from 47 per cent in 1992 to 24 per cent in 2001 and 15 per cent in 2005.

The trade reforms that China has embraced as a result of its WTO accession are steadily leading to reduction in tariffs, and China WTO commitments represents milestones (Greene et. al. 2006). Additionally, by the end of 2003, China agreed to allow foreign services suppliers to engage in the retailing of all products. The end of 2004, all firms were to have the right to import and export those goods, subject to state trading monopolies: such as oil and fertilizers. Foreign financial institutions are now permitted to provide services, and by the end of 2006, most of the restrictions on free entry and were removed.

China’s policies to attract foreign investment, by exempting investment from regulations, and providing infrastructure have been very successful (T.N. Srinivas 2006). In areas such as, power and communication, QR on imports was removed and tariffs rates were gradually reduced. China has gradually liberalised the labour market, and brought in more flexibility in the structure of production on the basic of comparative advantage (Mang 2000; Brooks and Tao, 2003).

The East Asian Economies tend to advance together through trade expansion, based on shifting comparative advantage over time. Tariff rate were raised between 1986 and 1991, after that it is being reduced in the subsequent years (World Bank, 1994; and Tseng et. al., 1994). The promotion of exports through liberalities and decentralisation of export activities, has been controlled by the extensive use of non-tariff measures (NTMS), Such as mandatory import plan, canalization of import, import licensing (33%), and import (30%) controls 1993 (Tseng, et. al., pp 4-5). Despite recent efforts to reduce and rationalise tariffs and NTMs, China’s import regime is one of the most protective in Asia, along with India and Pakistan. Also after gaining, membership of WTO/GATT, China’s
government undertook steps to liberalise the trade regime further. It continued efforts to liberalise and rationalise the import regime to sustain the transition process to a market economy in the coming years.

Greene et. al., (2005) conclude that all services liberalisation commitments are specified in the (GATT schedules). The ambitious GATT schedules China that implemented were in five sectors, such as banking, insurance, telecommunication, distribution and engineering services. Additionally, through China’s merchandise exports are generated from foreign invested companies, there is some indication that China’s FDI policies may be more restrictive than what trade or investment data suggest. However, China’s was implemented of GATTs commitments these significant impact on trade (Prezemy Slaw Kowaliski, 2005). The tariffs were reduced by 50 per cent for consumer in the SEZs. China’s actual tariff revenues collected, relative to total imports, are at a much lower rate of 5.6 per cent in 1992, compared with other developing countries, such as India 51.2 per cent in 1986 and Pakistan 30.8 per cent in 1990. China’s exports associated with import duty concession amounted to more than 60 per cent of total manufacture export in 1991(World Bank, 1993, p.60).

China’s trade performance can be seen as a gradual evolution of its highly centralised trade regime into a more decentralised one, more independent and local enterprise. De Menit (1995) stated that the trade regime’s permission has remained quite restrictive, “broad exemption from central regulations and controls liberally granted by local authorities were the main secret of China’s trade success” (p. 28).

b). Indian Trade Policies:

In India, during the mid-1980s, trade openness began. The initial step was expanding the number of goods that could be imported under the ‘open general license’ classification. These reforms mainly involved: a reduction in canalisation; permitting trade in and the expansion of replenishment import license, and reduction of import duties on capital goods permitted from import. The general level of tariff, the mean tariff rates was decreased from 100 per cent in 1980 to around 30 per cent in 2001-02 (Brititte Desroches, et. al., 2009).

It was recognised after 1991 that reforms for the reshaping India’s economic policies, could be helped by drawing appropriate lessons from the “East Asian miracle”, based on more export-oriented and more globally connected strategies of development.
The government came out with a clear vision and the objective of its economic reforms came only after regaining macro-economic stability. Major economic reforms are:

(i) Macroeconomies management reforms; and (ii) Structural and sector specification economies reforms. Macroeconomic reforms mainly focus on stability in the economy. This macro-economic stabilisation would provide a strong foundation for medium and long term structural economies reforms and accelerate the rate of economic growth in a phased manner. It would be possible only on open trade, and reduction in the tariffs and restrictions on foreign investment. Second, the structural economic reforms focus primarily on the following areas: Trade policy/external sectors policies; divestment/privatisation policies, as well as, the financial sector and also policies of attracting foreign direct investment. The main aim is to provide an open market to international competition, revenue exchange rate controls, encourage private investment and participation in industry in an eventually liberalised economy (Charan D. Wadhava).

Export credit financing is an important incentive to trade. In 1982, the Export-Import Bank of India (EXIM Bank) was established as a special institution for coordinating the activities of various agencies engaged in finance trade. The EXIM Banks main aim is to promote engineering exports. The Hussain Committee and the Narasimhan Committee reports on 1985-86, called for including policies for the Long Term Fiscal Policy (LTFP) in future trade policy and on reducing tariffs quotas. The import-export policy (1985-88) pointed out the need for considerable relaxation of import controls and lowering of import duties on capital goods. Another policy (1988-91) brought out the need to reinforce the process of trade liberalisation. This policy’s aim is towards self sustained export growth (Krishan Lekha Sood, 1989, pp.108-155).

After full-fledged reforms started in 1990s, large reduction in tariffs in all goods services, over the period 1990-2005 was introduced. The trade regime in India since 1991 has unmistakably reflected a growing appreciation of a liberal trade system. Especially significant has been the effect of liberalisation on the manufacturing sector. The trade reforms in India was focused on both tariff and non-tariff issues. On the tariff front, policy makers designating and contracting tariff had a very appropriate way in the nineties. The intermediate focus areas were high taxes and barriers to series trade. India has opted to cultivate an extremely complex system of duty exemption scheme, specially investment and establishment rules and SEZs that provide incentives, particularly to

4. Trade and economic development: India, Pakistan and Bangladesh” Sega Public New Delhi.
export firms. Tariff items are often affected by more than one of these and use tariff concessions, although recent amendments were made in the trade policies such as simplification of trade procedures and reduction in tariff and non-tariffs rates. The aim of introduction of special scheme is primarily to benefit exporters, in areas such as the of import capital goods at concessional rates under export promotion capital goods scheme (EPCG).

In 2006, the Trade Minister, Kamal Nath, announced two new schemes that focused on products and market areas—providing a thrust to employment generation, particularly in semi-urban and rural areas to: a) Promote exports of products of labour intensive industries; and b) Promote exports to specified markets.

To compare with the OECD countries, India has more restrictions in trade, banking, insurances, mobile telecom sector and distribution. The New Foreign Trade policy aims to double the percentage of global merchandise trade within the next five years. In addition, it seeks to continue liberalisation efforts by reducing tariffs, unshackling control simplifying procedures and bring down transaction costs, extensive use of duty rebates and exemption to neutralise the incidence of all reviews and duties on inputs used in export products and establishing export processing zones. Nevertheless, in the foreign Trade policy, two main elements are contradictory. In second objective the cross-board duty reduction would have more beneficial economy-wise and export effect than selective duty exemption in export sectors (Prezemy slaw kowalski, 2008).

Governments across the world have also taken various policy initiatives. According to the World Bank survey, the main actions taken by governments can be grouped into two categories: (i) To increase banks’ liquidity to alleviate liquidity pressure or trade finance; and (ii) Enhancing the exports. The foreign Trade Policy (FTP) 2009-2014 set the objective of achieving annual export growth of 15 per cent, with an annual export target of US$200 bullion by March 2011 (Economic Survey, 2009-2010, pp. 150). Also, the long term policy objective of the Government is to double India’s share in global trade by 2020.5 India’s services sector policy focuses on FDI, tariff and tax, credit and finance and other trade related, e.g. user-friendly policies, opening up of on insurance sector, rationalising taxes, tax exemption in some cases. Trade policy measures taken by the RBI and the Government in the Budget 2009-10 and Foreign Trade Policy (2009-14)

seek to help the export sector in general and the employment intensive sectors affected by the world recession, and additionally, check inflation caused mainly by supply-side constraints, which include reducing import duties such as on oil.

The SEZs policies had supported quality infrastructure, complemented by an attractive fiscal package and single window clearance in mechanism. And non-tariff measures such as during 2009-10 (up to December 31, 2009), the Directorate General of Anti-dumping and Allied Duties (GDAD) has initiated 11 fresh antidumping investigations (pp.173). Trade policy measures were taken up under FTP 2009-14. India account FDI inflows have grown 79.16 million USD in 1980 to 24639.9 million USD in 2010. This is reflected in its Foreign Trade Policy for 2004/09, which states, "For India to become a major player in world trade, we have also to facilitate those imports which are required to stimulate our economy (World Bank, 2012).

Comparison of trade policies of both countries

Trade activities in both countries have increased since the last two decades. Even after the grim global recession, both countries’ trade growth is moving towards global economy. Both countries mainly focus on macroeconomics indicators, monetary, fiscal policies and structural indicators. Also, control mechanisms, such as prohibitive tariffs, quantitative restrictions and import licensing, were significant reducing external trade possibilities (Lardy, 2002; Srinivasan, 2004). India has attracted far less FDI. This is not because of the lack of potential opportunities, but due to policy hurdles and other constraints in investment while China has several flexible policies, and other incentives other to attract investments. Thus, even though both countries are having different approaches, but in the 21st century, both have been attracting investments.

5.2.4. Impact of Openness of Trade on Economic growth in both Transition Economies

A heated debate exists in the economics discipline whether openness to trade is beneficial for growth (Andreas Billmeier and Tommaso Nammicini (2009); Amir Hussain Siddiqui, Javed Iqbal (2005). Several empirical studies have brought out the effect of openness of trade, or liberalisation on economic growth (Edward, 1992, 1993, 1988; International trade.}

---

6. It clearly explains its Trade policy measures in Economic Survey (Box.7.4, 7.5) pp.168-700, International trade.

7. To enhance competitiveness for products which are labour intensive, technology intensive, technology intensive and values added, further export incentives were undertaken on 11th February, 2011 for more than 600 products such as: agriculture, chemicals, carpets, engineering, electronics and plastics sectors.
Frankel and Romar, 1999; Saches & Warner, 1995; Sala-i-Martin) while robust positive relationship are difficult to find (Harrison, 1996, Harrison & Hanson, 1999; Levine & Renelt, 1992; O’Rourke, 2000; Yanikkaya Halit (2003); Amir Hussain Siddiqui, Javed Iqbal (2005); Santos Paulne (2002); and Sinha D., Sinha T (2002).

Let us now examine the impact of openness of trade on economic growth in India and China. Some important variables for model building for analysis and detailed explanation are as follow:

i. **Gross domestic product**: It is a very significant variable for explaining the economic growth of a country. Per capital income growth rates are usually high and after some time these would be expected to continue to move upward.

ii. **Openness of trade**: This is an important factor for rapid economic development. This variable is widely used for trade measure analysis. This is also known to be an instrument of economic growth (Jeffrey A. Frankel and Romer, 1999). Also, openness of trade has a crucial role to play in transition economies and under-developing countries. It is denoted as OT.

iii. **Population growth**: It is an important variable that can impact growth in transition countries. Population growth enlarges labour force and, therefore, can increase economic growth. It also, provides a large domestic market for the economy. Population growth can growth encourages competition, which stimulates technological advancements and innovations. Which is denoted as a Pg. Especially, China and India having a large population in world. However, uncontrolled population growth can also have negative consequences take large scale unemployment and put a strain on scare domestic resources.

iv. **Investment growth**: All theories of growth suggest that investment is an important determinant of growth countries (Dollar, 1992; Nafizinger, 1981; UNDP; 1996; Solow, 1957). It is a significant measure of openness of trade in developing countries. Investment growth rates; are often considered by economists to be important indicators of longer-term economic growth (the growth of output and employment) and potential productivity. We include investment as denoted by Inv.g.

v. **Foreign Direct Investment**: An important vehicle of technology transfer stimulates domestic investment, facilities investments and improvement in human capital in the developing countries. Caves (2006) Vertical vs. Horizontal FDI
theory states that firms either undertake FDI to seek efficiency in their global supply value China, or make FDI to enter horizontally to explore new markets. It can lead to export-growth in the host country.

vi. *Real Effective Exchange Rate*: Foreign investment firms gain or lose due to depreciating exchange rate. With depreciate exchange rate, one can export more easily and gain from openness of trade. If, it is continuously depreciating investors will avoid making investments. This would lead to imbalance of trade in the receipt country.

The main objective of the study is to examine the effect of the openness of trade on GDP growth in transition economies. Numerous studies have been undertaken. The overall finding is that on these variables and trade liberalisation tends to have a positive effect on growth (Andreas Billmeier and Tommaso Nannicini, 2009). We above discussed the importance openness of trade on both countries.

Sinha (2002), Aamir Hussain Siddiqui, Javed Iqbal (2005) have also used the variables for model. The volume of Trade (import plus export) is used as proxy of openness. We are using the variable - openness of trade (E+M/GDP). We are using OLS model that the earlier studies used for analysis of the trade measures (Sinha D. Sinha T, 2000; Edwards, 1998; Santos-Paulion, 2000; Yanikkaya, 2003; Waczirry, 2001). They derived the following equation:

\[ \ln Otg = \beta_1 + \beta_2 Yg + \ln \beta_3 Inv + \ln \beta_4 Pop + \ln \beta_5 fdi + \ln \beta_6 Reer + \epsilon \]

Where Otg is the trade growth and also used as a proxy for openness (E+I/GDP); Yg refers to GDP (current USD) growth, Inv.g (per cent GDP) is the fixed investment growth, Pop.g (millions) is the population growth, fdi (USD) is the foreign direct investment, Reer (2005=100) is Real effective exchange rate and finally, \( \epsilon \) is the error term. All variables are in log form. The effect of openness of trade on economic growth in the framework is cross–country analysis, for using data during the period 1978 to 2010. Data has been obtained from International Financial Statistics (IMF’s) and World Bank Indicators.
**Table 5b.2: Descriptive Statistics of India: 1980-2010**

<table>
<thead>
<tr>
<th></th>
<th>GDP</th>
<th>OT</th>
<th>Population</th>
<th>Investment</th>
<th>FDI</th>
<th>REER</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mean</strong></td>
<td>4.13E+11</td>
<td>0.174</td>
<td>934.073</td>
<td>26.415</td>
<td>6359.39</td>
<td>141.313</td>
</tr>
<tr>
<td><strong>Median</strong></td>
<td>3.47E+11</td>
<td>0.168</td>
<td>932.5</td>
<td>24.269</td>
<td>2151</td>
<td>113.039</td>
</tr>
<tr>
<td><strong>S. D.</strong></td>
<td>2.28E+11</td>
<td>0.069</td>
<td>157.738</td>
<td>5.212</td>
<td>11123.86</td>
<td>64.891</td>
</tr>
<tr>
<td><strong>Kurtosis</strong></td>
<td>-0.01623</td>
<td>1.391</td>
<td>-1.272</td>
<td>0.007</td>
<td>3.99</td>
<td>1.522</td>
</tr>
<tr>
<td><strong>Skewness</strong></td>
<td>0.9587</td>
<td>1.241</td>
<td>0.016</td>
<td>1.119</td>
<td>2.18</td>
<td>1.668</td>
</tr>
<tr>
<td><strong>Minimum</strong></td>
<td>1.58E+11</td>
<td>0.089</td>
<td>682.25</td>
<td>19.215</td>
<td>5.64</td>
<td>82.350</td>
</tr>
<tr>
<td><strong>Maximum</strong></td>
<td>9.63E+11</td>
<td>0.373</td>
<td>1190.524</td>
<td>37.371</td>
<td>42545.72</td>
<td>319.482</td>
</tr>
<tr>
<td><strong>Obs.</strong></td>
<td>31</td>
<td>31</td>
<td>31</td>
<td>31</td>
<td>31</td>
<td>31</td>
</tr>
</tbody>
</table>

Tables 5b.2 & 3 show both countries’ models of the descriptive statistics of all variables. In India, GDP average growth is 4.13 per cent point over time. Openness of trade average growth is 0.174. The population is 934.07, investment for the entire mean and the median were partial equally. Also, FDI average growth is 6359.39 over time. Quite often, is useful to examine whether a given time series approximates to the normal distribution. For all series, the mean and the median were not equal. The kurtosis statistics provide a measure of the thickness of the tails of a distribution, which were in most cases less than 3. However, FDI kurtosis is 3.99. Skewness statistics were used to check the symmetry of the probability distribution.

On the other hand, China’s GDP average growth is 1.32 per cent point over time. Openness of trade average growth is 0.38. The population is 1191.72 per cent; investment growth rate is 40.3, and FDI 35444.27 per cent over time. For all series, the mean and the median were not equal the kurtosis statistics that provide a measure of the thickness of the tails of a distribution were in most cases less than 3. The skewness statistics are used to check the symmetry of the probability distribution.

**Table 5b.3: Descriptive Statistics of China: 1980-2010**

<table>
<thead>
<tr>
<th></th>
<th>GDP</th>
<th>OT</th>
<th>Population</th>
<th>Investment</th>
<th>FDI</th>
<th>REER</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mean</strong></td>
<td>1.32E+12</td>
<td>0.38</td>
<td>1191.72</td>
<td>40.33</td>
<td>35444.27</td>
<td>141.31</td>
</tr>
<tr>
<td><strong>Median</strong></td>
<td>7.28E+11</td>
<td>0.35</td>
<td>1211.21</td>
<td>38.34</td>
<td>37520.53</td>
<td>113.039</td>
</tr>
<tr>
<td><strong>S. D.</strong></td>
<td>1.52E+12</td>
<td>0.13</td>
<td>111.64</td>
<td>5.22</td>
<td>33985.76</td>
<td>64.891</td>
</tr>
<tr>
<td><strong>Kurtosis</strong></td>
<td>2.679505</td>
<td>-0.56</td>
<td>-1.16</td>
<td>1.27</td>
<td>-0.56</td>
<td>1.522</td>
</tr>
<tr>
<td><strong>Skewness</strong></td>
<td>1.821381</td>
<td>0.49</td>
<td>-0.38</td>
<td>1.21</td>
<td>0.65</td>
<td>1.668</td>
</tr>
<tr>
<td><strong>Minimum</strong></td>
<td>1.89E+11</td>
<td>0.19</td>
<td>987.05</td>
<td>33.51</td>
<td>57</td>
<td>82.350</td>
</tr>
<tr>
<td><strong>Maximum</strong></td>
<td>5.93E+12</td>
<td>0.64</td>
<td>1341.41</td>
<td>55.09</td>
<td>108312</td>
<td>319.482</td>
</tr>
<tr>
<td><strong>Obs.</strong></td>
<td>31</td>
<td>31</td>
<td>31</td>
<td>31</td>
<td>31</td>
<td>31</td>
</tr>
</tbody>
</table>
Empirical Analysis:

Table 5b.4 explains the regression results of openness of trade in both transition economies from 1980-2010. The empirical literature shows that trade openness or liberalization impact output growth. Most of the studies have concluded that the openness of the trade regime has a positive relation with GDP growth (Edwards, S., 1992; Harrison, A., 1996; Edwards, S., 1998; Ahmed, Yusuf and Anoruo Emmanuel 2000; Wacziarg R., 2001; Santos Paulino, 2002; and Yanikkaya Halit, 2003). We have considered coefficient value as ‘t-statistics value’ for significant levels.

Table (see 5b.4) presents the regression result of India. The influence of the GDP, FDI and investment are continuously increasing the growth rates. Export growth was found to be quite impressive. GDP has a positive statistical significance at 1 percent level, FDI is has a positive statistical significance at 5 percent level. Also, investment growth impacts of the trade. It has a positive statistical significance at 5 percent level. So effect of openness of trade in Indian economic growth is noteworthy. Indeed, a number of authors have concluded there is that a relationship between OT on GDP, positive FDI and economic growth (Wacziarg, 2001, Ann Harrison 1996).

Table 5b.4: Regression Results of China and India

<table>
<thead>
<tr>
<th></th>
<th>India Coefficients</th>
<th>China Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-4.271191</td>
<td>7.109854</td>
</tr>
<tr>
<td></td>
<td>(0.3434)</td>
<td>(0.751427)</td>
</tr>
<tr>
<td>LGDP</td>
<td>0.488505</td>
<td>0.912273</td>
</tr>
<tr>
<td></td>
<td>(2.194749)*</td>
<td>(5.476507)*</td>
</tr>
<tr>
<td>LINV.</td>
<td>0.498249</td>
<td>0.160046</td>
</tr>
<tr>
<td></td>
<td>(2.134425)**</td>
<td>(0.713745)</td>
</tr>
<tr>
<td>LPOP</td>
<td>-1.483055</td>
<td>-4.089601</td>
</tr>
<tr>
<td></td>
<td>(-1.538617)</td>
<td>(-2.391004)**</td>
</tr>
<tr>
<td>LEX</td>
<td>-0.506895</td>
<td>-1.002121</td>
</tr>
<tr>
<td></td>
<td>(-1.893202)</td>
<td>(-3.375751)**</td>
</tr>
<tr>
<td>LFDI</td>
<td>0.061306</td>
<td>-0.003169</td>
</tr>
<tr>
<td></td>
<td>(1.907164)**</td>
<td>(0.290003)</td>
</tr>
<tr>
<td>R²</td>
<td>0.890247</td>
<td>0.924832</td>
</tr>
<tr>
<td>Adj. R²</td>
<td>0.868296</td>
<td>0.909798</td>
</tr>
<tr>
<td>D-W sta.</td>
<td>0.778158</td>
<td>1.403854</td>
</tr>
<tr>
<td>No. observations</td>
<td>30</td>
<td>30</td>
</tr>
</tbody>
</table>

Note: the t-statistics are in parentheses.
Sources: *, **, & *** noted 1, 5, and 10 per cent respectively
Also, the GDP growth also affects trade growth (Rodriguez & Rodrik, 2000). On the other hand, Population and REER are statistically insignificant for trade growth. However, domestic investment growth, FDI growth and GDP growth have trade led growth in India. The effect of FDI leads to Trade growth (Borensztein, Gregorio, and Lee; Balasubramanyam, Salisu, and Sapsford; Shiva Makki 2004). Both have interrelationship among FDI, trade and economic growth. The “new” growth theories, suggest that a country’s openness to the world economy helps in improving domestic technology and hence productivity rises (e.g., Barro & Sala-i-Martina, 1995; Grossman and Helpman, 1991; Romar 1992; Jang C. Jin, 2006). R² value of the Indian model fit the result, and Adj., R² value is 0.86829.

Regression results of China show that while GDP, Population, and REER are positive, other variables, Investment and FDI, are not positive. In China GDP growth rate was rapid from the beginning of reforms. This result is positive openness of trade. Also, export-GDP ratio is very much high compared with import growth. Previous literature concluded that GDP-trade growth leads to economic growth. GDP growth is influenced by trade growth at 1 per cent statistical significant level. Population growth is also an increasing sign of economic growth. Hence, population growth influences trade growth at negative statistically significance at 5 percent level. REER is gradually decelerating in China which is favorable for trade growth. In addition, investment growth and FDI have statistical insignificance with trade growth. Consequently, population growth, GDP growth and Real exchange growth rate causes trade growth in China. R² value of the Indian model fit for result and Adj. R² value is 9.909789.

**Figure 5b.4: India Results:** emphases the performance of Indian macroeconomics variables from 1980-2010. It is explains the fluctuating trend lines in different variables and trends over all the periods. It has employed all the studied variables on FDI and its changing policy structure in the any economy. In India, GDP trend has been accelerated - especial after transition reforms. According to the World Bank report, from mid-2000 onwards, growth rates has rapidly moving up. During 2008-2009, due to the financial recession the on growth rate as well as trade growth reduced. Real effective exchange rate was very much high before transition reforms periods and after trade reforms exchange rate was gradually decreased due to devaluation of the rupee and exchange rate. Later on, devaluation of rupee led to increasing the growth rate. Openness of trade: it (export-import) trend fluctuated before transition but after financial reforms in 1990s and trade
policies, changed the overall trend it result shows imports are higher than exports in India. Indian export growth also has been gradually growing after the openness of trade. In the matter of export IT and service sectors are booming after 2000. Indian main exports such as: Gems and jewelry constitute the single largest export item, accounting for 16 percent of exports. India is also the leading exporter of textile goods, engineering goods, chemicals, leather manufactures and services. Population growth: India with a population of 1.22 billion (2012) it is the second most populous country in the world. With more than 50% population below the age of 25 and about 65% below 35, the average age of an Indian after 10 years is likely to be 29 years. However, some of the reasons for India's rapidly growing population are poverty, illiteracy, and high fertility rate, rapid decline in death rates or mortality rates. Investment growth: India’s domestic investment growths have been fluctuating from 1980 till 2000. After mid-2000, effect of growth has changed in investment. Levine and Renelt (1992) suggest that openness and growth relations occur through changes in investment, and increasing openness may stimulate FDI from abroad. Foreign Direct Investment, trends levels show the factors that influence the openness of trade in India. FDI inflows were sluggish before transition reforms thereafter FDI inflows started steadily swelling by the effects of the macroeconomic indicators. Thus, it has led to encourage economic growth rate in India. FDI inflows in 79.16 millions USD 1980 and it has grown up to 24639.9 million USD in 2010. During 2000, the FDI inflows amounted to 3587.99 million USD due to which the economic growth rate tremendously increased. Thus, trends levels show the factors that influence the FDI inflows in India.

**Figure 5b.5: China Results:** explain that trade growth has a positive interaction with GDP. Even recent literature reveals that FDI and GDP share a positive relationship in host countries. China’s growth has gradually increased since the reforms and is the fastest among the Asian countries. During 1980-2010, its overall average growth rate was 10 per annum. Because of openness of trade, China has become the second largest trading nation in the world. Effective real exchange rate, since the beginning of transition the exchange rate has shown a downward trend – favourable for FDI inflows. In the begging, its rate was 319.482 in 1980. With depreciating exchange rate it can export more easily and gain from resources seeking FDI. Therefore, the impart of exchange rate depreciation on FDI inflow is ambiguous. In other words, exchange rate depreciation may cause a rise in interest rate. After 1990s, several reforms took place it leads to effect sharply down in 117.268. Therefore, both the interest rate and exchange rate might be affecting each other
Pradyumna Dash. Openness of trade trend level has been growing because export revenue has been high after the WTO accession in 2001. In China, export trend is higher than import, it means that exports have led the trade growth. After transition, technology, knowledge transfer has also helped to transform the economy through exports and imports and promote economic growth by attracting investments (Frankel & Romer, 1999; Frankel, Romer & Cyrus, 1996; Grossman & Helpman, 1997; Fank S.T. Hsiao et al., 2006). Thus, the macroeconomic variables are playing a vital role in openness of trade in China. Population growth: China is on the top over (1.35 billion) playing the world’s most populous nation. China’s population rate has been continuously growing. The implementation of the one child policy growth was in early 1980s. Improvement in the health care pulled the death data down while birth rate continues to soar; the classic “population explosion” phase. China population was 996.1 million in 1980 and 1,334.7 millions in 2009. Investment growth: China having a strong domestic investment climate because then country’s rural economy well developed by the TVEs. For the development of an economy, initial conditions also play a significant. Its growth rate was 52.412 in 1980 and 48.166 in 2010. Also, FDI inflows have been increasing the investments. These combined with an exceptionally high level of domestic investment, have propelled the economic growth at a furious pace. China’s growth has been more export-led. So, investment growth leads to growth in trade. Foreign Direct Investment: in China after reforms, FDI inflows have slowly increased. SEZs were established to accelerate the inflow of foreign investments in China. China’s FDI inflow was 57 million USD in 1980 and has grown up to 105735 million USD in 2010. After full-fledged of reforms in 1990s, FDI inflows have been an accelerated growth 3,487.1 millions USD. In 2000 after, accession to WTO, FDI inflows increased tremendously to reach 46878.59 million USD in 2010.
Figure 5b.4: Performance of India’s Macroeconomic Indicators from 1980-2010

- **FDI**
  - 1980: 11.0
  - 1985: 11.2
  - 1990: 11.4
  - 1995: 11.6
  - 2000: 11.8
  - 2005: 12.0
  - 2010: 12.2

- **GDP**
  - 1980: 1.28
  - 1985: 1.32
  - 1990: 1.36
  - 1995: 1.40
  - 2000: 1.44
  - 2005: 1.48
  - 2010: 1.52

- **INVI**
  - 1980: -1.1
  - 1985: -1.0
  - 1990: -0.9
  - 1995: -0.8
  - 2000: -0.7
  - 2005: -0.6
  - 2010: -0.5

- **OP**
  - 1980: 2.80
  - 1985: 2.85
  - 1990: 2.90
  - 1995: 2.95
  - 2000: 3.00
  - 2005: 3.05
  - 2010: 3.10

- **P**
  - 1980: -0.2
  - 1985: 0.0
  - 1990: 0.2
  - 1995: 0.4
  - 2000: 0.6
  - 2005: 0.8
  - 2010: 1.0

- **REER**
  - 1980: 2.80
  - 1985: 2.85
  - 1990: 2.90
  - 1995: 2.95
  - 2000: 3.00
  - 2005: 3.05
  - 2010: 3.10
Figure 5b.5: Performance of China’s Macroeconomic Indicators from 1980-2010

FDI

GDP

INVI

OT

P

REER
Comparison of the both models:

During the past 30 years, China's economy has changed from a centrally planned system that was largely closed to international trade to a more market-oriented one that has a rapidly growing private sector. Exports growth has been a major determinant in the China's rapid economic growth. In case of India, after reforms market-oriented policies had taken place for ensuring sustainable economic growth. However, full-fledged of economic reforms were began after 1990s in both countries. Also, innovative trade policies were introduced in both countries. From mid-2000 onwards the growth rates have been rapidly accelerating in both countries among the various transition economies. It can be concluded that a positive relationship exists between openness of trade and GDP growth in both countries.

5.2.5. Conclusion

Both countries share a common legacy of foreign influence or domination. Thereafter, Communism took roots in China and democratic socialism in India. In both countries the effect of openness of trade has led to economic growth. Openness of trade is an important subject in the economics discipline. Both countries have introduced market-oriented reforms for ensuring sustainable economic development. The main objective is to effect openness of trade on GDP growth in transition economies. Numerous studied made on these openness of trade have all concluded that the result is robust.

Recently, economists have again become interested in comparing the economies of the two developing economies largely due to theirs spectacular growth performance in the 1980s and 1990s and subsequently there has been rising significance for the world economy and political affairs. Recent year good performance shows "India had the fastest export growth among the major traders in 2011, with shipments rising 16.1 per cent. Meanwhile, China had the second-fastest export growth of any major economy at 9.3 per cent" (World Trade Report 2012).

Indian, regression results, explains domestic investment growth, FDI growth and GDP growth cause trade growth in India. In the case of China, population growth, GDP growth and Real exchange growth rate have triggered trade growth in that country.
### APPENDIX- 5b -I

**Table 5b.5: Measures of Trade Openness**

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Measure</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$\frac{M_i}{GDP_i}$</td>
<td>Import trade intensity; measured as: imports ($M_i$) divided by country $i$’s nominal income ($GDP_i$)</td>
</tr>
<tr>
<td>2</td>
<td>$\frac{X_i}{GDP_i}$</td>
<td>Export trade intensity; measured as: exports ($X_i$) divided by country $i$’s GDP</td>
</tr>
<tr>
<td>3</td>
<td>$\frac{(X+M)_i}{GDP_i}$</td>
<td>Trade intensity (TI); measured as exports and imports divided by country $i$’s GDP</td>
</tr>
<tr>
<td>4</td>
<td>$\frac{(X+M)_i}{2(GDP+M)_i}$</td>
<td>Adjusted trade intensity; where the denominator is modified to handle outliers such as Singapore and Hong Kong where there is high import for re-export, originally suggested by Andersen (1994)</td>
</tr>
<tr>
<td>5</td>
<td>$1-\left(\frac{(X+M)_i}{100}\right)\frac{1}{GDP_i}$</td>
<td>Adjusted trade intensity; and alternative method for handling outliers, originally suggested by Frankel (2000)</td>
</tr>
<tr>
<td>6</td>
<td>$\frac{M_i}{\sum_{i=1}^{k} GDP_i}$</td>
<td>Adjusted trade intensity; a modification to the Frankel (2000) approach, suggested by Li et al., (2004)</td>
</tr>
<tr>
<td>7</td>
<td>$\frac{(X+M)<em>i}{\sum</em>{i=1}^{k} GDP_i}$</td>
<td>Real trade intensity; where the denominator is purchasing power parity adjusted GDP (real GDP) flowing Alcala and Ciccone (2004)</td>
</tr>
</tbody>
</table>

*Sources: Jay Squalli and Kenneth Wilson, 2006.*

---

**Table 5b.6: Key Trade and Investment Policies During the Reform Era**

<table>
<thead>
<tr>
<th>China</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Attracting Export-oriented FDI:</strong></td>
<td>- Gradual liberalisation of restrictions on Foreign ownership through a system of automatic clearance of FDI proposals and the opening up of new sectors to foreign ownership (e.g. mining, software, banking, telecommunications) (1991 onwards).</td>
</tr>
<tr>
<td>- Adoption of a dualistic trade regime that promoted exports via FDI (Mid-1980s).</td>
<td>-100% foreign ownership permitted in most manufacturing sectors (last -1990s).</td>
</tr>
<tr>
<td>- Creation of Special Economic Zones (SEZs) (1980s).</td>
<td></td>
</tr>
<tr>
<td>- Introduction of tax incentives and Facilitation of financing to channel</td>
<td></td>
</tr>
</tbody>
</table>

---

183
<table>
<thead>
<tr>
<th>FDI towards SEZs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Liberalisation of labour regulations in SEZs ensuring relatively low wages and ample supply of skilled workers.</td>
</tr>
<tr>
<td>- Formalisation of a duty drawback system to ensure duty-free access to materials used in export processing (1987 onwards).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Import Liberalisation:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Passage of a customs regulation to rationalize tariff schedules (1985).</td>
</tr>
<tr>
<td>- Liberalisation of the system of export licensing and quotas (from covering 2/3 of exports in 1991 to only 8% in 1999).</td>
</tr>
<tr>
<td>- Tariff reductions implemented following the adoption of a socialist market (1992 onwards).</td>
</tr>
<tr>
<td>Further reforms to import control regime implemented as part of WTO accession (2001).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Exchange rate management:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Devaluation of domestic currency and movement to currency convertibility of account transactions (1997).</td>
</tr>
<tr>
<td>- Adoption of a managed floating exchange rate (mid-2005 onwards)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FTA strategies:</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Accession to its first FDI, the Asia Pacific Trade Agreement (2001).</td>
</tr>
<tr>
<td>- Signing of the ASEAN-China FTA (2005).</td>
</tr>
<tr>
<td>- Establishment of 11 FTAs, including bilateral agreements with Thailand, Hong Kong, Macao, Chile, New Zealand, Pakistan, Singapore, Peru, and Taipei (as of June 2011).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Establishment of India, as a signatory to the General Agreement on Tariffs and Trade (GATT), as founding member of the WTO (January 1, 1995).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Unification of the dual exchange rate system and commencement of current account convertibility (1994).</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Maintenance of a depreciated exchange rate (2000 onwards).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Signing of its first FTA, the Asia Pacific Trade Agreement (1976)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Establishment of 11 FTAs, including bilateral agreements with Sri Lanka, Nepal, Afghanistan, Singapore, Bhutan, Chile, South Korea, and a plurilateral agreement with Latin American countries (as of June 2011).</td>
</tr>
</tbody>
</table>

Source: Ganeshan Wignaraja (2011).