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Foreign Investment, Foreign Trade and Related Issues: A Case Study for India and China

P.K. Vasudeva

1 Introduction

The unprecedented build-up of foreign exchange reserves in India, to the tune of US$ 120 billion (1 August, 2004) after the payment of more than US$ 2 billion debt by the Reserve Bank of India (RBI), is seen as a sign of economic growth. In the early 1990s, when India's foreign exchange reserves were averaging close to US$ 5.5 billion, the country was in a balance of payment (BOP) crisis. The RBI’s balance of payment statistics suggest that about US$ 1.3 billion of these reserves are on account of foreign direct investment (FDI) inflows during the year 2002–3. A healthy increase in FDI inflows in India in a global slowdown cannot detract from the fact that India accounts for an extremely small share of FDI inflows. China attracts 80 per cent of the FDI inflows in Asia against India’s 5.5 per cent. China’s membership at the World Trade Organisation (WTO) from November 2001 is likely to widen this gap.

Although FDI inflows have risen, however, they continue to be way behind China. India’s share among the developing countries in terms of attracting FDI is only 1.7 per cent compared to China’s 17 per cent. Besides China, India attracts significantly lower FDI than many other South East Asian countries such as South Korea, Thailand and Malaysia. In 2000, China attracted over US$ 44 billion FDI, Thailand over US$ 6 billion and South Korea around US$ 10.45 billion. The corresponding figure for India was US$ 3.19 billion.

The objectives of this chapter are first, to analyse why FDI inflows into India are poor (Sections 2–3); secondly, to formulate a strategy to enhance FDI inflows into India especially when China’s FDI inflows are much more (Sections 4–8); thirdly, to find out the level of FDI inflows in the developing countries, and suggest measures for improvement in India (Sections 9–11).
2 FDI slippage

According to International Monetary Fund (IMF) Report (IMF, 2002), India’s absolute attractiveness had improved compared to the previous survey in June 1999. However, after the international credit rating agency’s revising India’s long-term rupee debt to ‘junk’, there was a further blow to the country’s efforts to bolstering FDI inflows. India slipped eight spots to fifteenth position in the index ranking of the Foreign Direct Investment Confidence Index (FDICI) released by the global management consulting firm A.T. Kearney (Kearney, 2002). The FDICI is constructed on the basis of the response received from the senior management managers (board-level positions) of Fortune 1000 companies. The main cause of this slippage is the simmering conflict with Pakistan over Jammu and Kashmir, which undoubtedly deters foreign investment, while fiscal deficit and poor infrastructure have further constrained India’s attractiveness. According to the FDICI report India will now have to face a nearly 20 per cent decline in the likelihood of receiving FDI.

India’s attractiveness has, however, improved significantly among non-financial services, where investment likelihood increased by 28 per cent over 2001. In the post-9/11 events, India’s high-quality and lower-cost IT talents attracted more IT-related outsourcing services. In other telecoms and utilities, investors consider India as their twenty-fifth most attractive investment destination. Among investor nations, although India’s ranking dropped the most, its position among Japanese investors and in the USA is holding steady. It should be a matter of grave concern to India that its FDI investments are going down rather than increasing.

One of the other main causes of India’s poor FDI is a labour problem as the trade unions rule the roost. The Labour Commission Report (2002) suggested that a ‘hire and fire’ system for inefficient staff should be immediately implemented to improve FDI inflows.

3 Indian FDI statistics

In the case of India, FDI statistics are published by two official sources: (a) the Reserve Bank of India (RBI) and (b) the Secretariat for Industrial Assistance (SIA). The RBI presents a BOP statement in the RBI Bulletin and its Annual Report on a monthly and annual basis, respectively. SIA reports FDI inflows on both approval and actual basis in its monthly SIA Newsletter and SIA Statistics. Interestingly, the definition of FDI and computation of FDI statistics used by the RBI does not conform to the IMF guidelines; there are a number of discrepancies in the RBI projections:

- First, India excludes reinvested earnings (which are part of foreign investor profits that are not distributed to shareholders as dividends are reinvested