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Research Report

Can India emulate China in attracting and benefitting from FDI?

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Can India emulate China in attracting and benefitting from FDI?

by

Karl P. Sauvant and Daniel Allman *

Just four months after his election in May 2014, Prime Minister Narendra Modi launched the “Make-in-India” campaign. The event was broadcast across the globe, with a clear message to foreign investors: India was ripping up the red tape and rolling out the red carpet. The campaign is aimed at “transform[ing] India into a global design and manufacturing hub,” measuring its success by the “opening up of key sectors ... to dramatically higher levels of Foreign Direct Investment [FDI].”¹

How is India doing in this respect, compared to China, which achieved remarkable success through a similar strategy?

In 1980, China’s FDI inflows (US\$57 million) were less than three-quarters of India’s inflows (US\$79 million).² By 2014, China’s FDI inflows (US\$129 billion) outstripped India’s (US\$34 billion) by almost four times.³ Measures of inward FDI stock tell the same story: by 2014, India’s (US\$252 billion) was about a quarter of China’s (US\$1,085 billion) and, for that matter, of Singapore’s (US\$912 billion).⁴

The three key FDI determinants explain the story:

- China’s economy and infrastructure grew much faster than India’s, making China much more attractive to foreign investors and initiating a virtuous cycle: FDI contributes to growth, and growth attracts FDI. It is indicative that foreign affiliates generate over half of China’s exports.
- This combined with a progressively more welcoming FDI framework: China ranks higher than India on the World Bank’s “doing business” index, the World Economic Forum’s “global competitiveness” index and the Milken Institute’s “global opportunity” index.⁵

- China established an extensive investment-promotion infrastructure, with investment promotion agencies (IPAs) at all levels of government, to attract FDI and provide various aftercare services to foreign investors. Increasingly, red carpet replaced red tape, while, simultaneously, efforts were made to improve FDI's contribution to China's development.

Given the size and growth of its market, India has the potential to attract considerably more FDI than it has in the past—as reflected in the fact that India has ranked among the top 10 (if not top five) countries in seven of the eight “FDI confidence” indices prepared by A.T. Kearney since 2004.⁶ Since these indices are based on the assessment of corporate executives, the business community clearly sees India's FDI potential.

How to realize this potential? What can India learn from China's experience?

- As always, the economic determinants are fundamental. As India promotes growth and improves its infrastructure, it too can initiate a virtuous cycle.
- This needs to be supported by quickly improving the regulatory setting. The Make-in-India campaign recognizes this, promising a growing economy alongside a more welcoming investment climate. (On the OECD's “regulatory restrictiveness” index, India is already assessed as being somewhat less restrictive than China toward FDI—although it remains considerably more restrictive than the OECD average.⁷)
- India's investment-promotion infrastructure needs to be strengthened.

As to investment promotion, three signal actions ought to be taken by India immediately:

1. Establish a powerful, unified central IPA, reporting directly to the Prime Minister. Functions should include systematically attracting FDI (and especially FDI exhibiting sustainability characteristics), targeting investors in sectors important to India's development, providing aftercare services, boosting investor trust and perception, and undertaking policy advocacy. Since, in the end, all investment is local, strong IPAs are also desirable at the state level. Proper coordination between the central and state IPAs—admittedly, a challenge—is essential to ensure follow-up and avoid incentive wars among states. As in China, these measures would establish the institutional infrastructure for attracting FDI and benefitting from it. Regular reports to the Prime Minister should detail progress made.
2. Create an independent Investment Ombudsperson Office, headed by a person well respected in the private and public sectors. The Office would mediate where issues arise between governmental authorities and foreign investors, including to prevent conflicts escalating into costly international investor-state arbitrations. This becomes all the more important as, inevitably, rising FDI inflows increase the potential for conflicts. The Prime Minister should be informed through a fast-track procedure about problems that require immediate attention at the highest levels. Establishing such an Office (which worked well in the Republic of Korea) would go beyond

China's investment-promotion efforts, sending a powerful signal to the world's investment community.

3. Launch an independent annual *Indian Investment Report*. Such a report should monitor issues regarding FDI in India (placing them also in an international context), assess the impact of FDI on the local economy, examine matters of special interest to India (e.g., technology transfer, tax issues, linkages with global value chains), and recommend ways to increase FDI inflows and their contribution toward sustainable development.

There is no reason why India should not be able to attract as much FDI, and benefit from it to the same extent, as China. It is up to the government of India to accelerate action.

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¹ Government of India, "Make in India" website <http://makeinindia.com/about>.

² UNCTAD STAT database <http://unctadstat.unctad.org>.

³ *Ibid.*

⁴ *Ibid.*

⁵ See, The World Bank, *World Development Indicators* <http://data.worldbank.org/data-catalog/world-development-indicators>; World Economic Forum, *The Global Competitiveness Report 2015-2016* (Geneva: WEF, 2015); and Milken Institute, *Global Opportunity Index* (Santa Monica: Milken Institute, 2015).

⁶ A.T. Kearney, *FDI Confidence Index* website <http://atkearney.com/ideas-insights>.

⁷ See, <http://oecd.org/investment/fdiindex.htm>.

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