



DETERMINANTS OF FDI INFLOWS INTO INDIA AND CHINA – A COMPARATIVE STUDY

Mr. Bipin Namdev Bandekar*

Dr. K. G. Sankaranarayanan**

*Associate Professor (Research Scholar), Narayan Zantye College of Commerce, (Affiliated to Goa University), Goa.

**Associate Professor, Department of Commerce, Narayan Zantye College of Commerce, (Affiliated to Goa University), Goa.

Abstract

Some emerging economies like China have been leaders in the world and have grown at a higher rate benefiting from higher Foreign Direct Investments (FDI) and some like India have been struggling to attract FDI and grow that efficiently. Why China gets 200 billion dollars FDI annually and India gets only 40 billion dollars is a question? This paper examines the determinants of FDI in emerging economies like India and China. The study also compares the major factors of emerging economies like India in attracting FDI as against the factors of leading countries i.e. China in the global economy.

This study adds to the literature by analyzing the Indian data and comparing it with the Chinese data for period 1991-2012. Indian FDI attraction model was tested using OLS and found that India has grown due to its large size market, higher market growth rate, globalization policy, low cost of capital, Exports promotions and infrastructure development. For China, size of the market, economic development by creating strategic infrastructure was identified as major drivers. The Chinese model is also tested with OLS regression and found significant. Thus, size of the market is the most important and the only common factor for flow of FDI in India and China.

India has to repeat some success stories of China to develop infrastructure. Instead of developing service sector, India should try for few large world class SEZs. Economic freedom, supporting manufacture and flexible labor laws will also help India to attract higher FDI.

Keywords: Determinants of FDI, India, China, Ordinary Least Square Model.

Introduction

Emerging economies need foreign capital for growth. FDI is one of the major sources of foreign capital for these countries [Seid (1988); Srinivasan (2002); Jenson (2003)]. Even Government of India (GOI Economic Survey, 2001-02) recognizes the importance of FDI in economic growth. The Relationship between Foreign Direct Investment (FDI) and other Macroeconomic variables has been an attractive area of study. FDI is an investment made by an investor into a company located in a country outside the investors' country. International Monetary Fund (IMF) defines "FDI as a category of International Investment that reflects the objectives of a resident in one economy i.e. Direct Investor, obtaining a lasting interest in an enterprise resident in another economy i.e. Direct Investment Enterprise. It involves direct acquisition of a foreign company, participation in enterprise management, Joint Ventures, Strategic alliance as well as transfer of technology and enterprise. Thus FDI is an investment made by foreign countries in other countries.

Foreign Investment is of growing importance to Global Economic Growth. FDI has been considered to be a key driver of International Economic Integration which provides financial stability, promote economic development and improve social well being. FDI have impact on domestic investment, employment, Human Resource Skills, Environment and Export. On the other hand factors such as Government policies, Infrastructure, Disclosure of Information, legal Obligations, Inflation rate, Foreign Exchange Rate, Tax rates, Natural resources endowment, labour skills, Wage rates, Corruption, Political stability can influence FDI in countries.

Foreign capital is especially important for developing the emerging market economies like India. Since adoption of LPG policy in 1991, India could attract FDI and ranks second to China in adopting foreign investment, thus FDI has boomed in post-reform India. Even the Composition and type of FDI has changed significantly since India has opened up to world market. India is Asia's third largest economy but its FDI inflow was less than 0.1% of GDP before 1991, 0.5% of GDP within 1992-1996 and improved to 1 to 2% of GDP within 2006-2012. During the last two decades there was a significant increase in foreign capital inflow into India. FDI inflows were very less in 1970's and 1980's.

According to UNCTAD's World Investment Report, India's FDI inflow was less than \$ 1 Billion in 1991. It was highest i.e. \$ 47 Billion in 2008 which reduced to \$ 36.19 Billion in 2011, \$ 35.12 Billion in 2012 and reached to a level of \$ 34.4 Billion in 2014. India's growing GDP, geographical location and diversified business are some of the factors which attract foreign investment to the country.

China is a country that has developed a conducive business environment, attracted FDI over last two and half decade and grown from \$ 6 billion economy (1991) to \$ 230 Billion economy (2014), the third largest and fastest growing economy in



the world. China has been growing at the rate of 9.5% for last ten years. In 2005, FDI Inflow to China was \$ 116 Billion as against \$ 7 Billion for India. In 2010, FDI in China crossed \$ 200 Billion mark. A.T. Kearney FDI confidence Index 2013, 2014 and 2015 ranked China as the second most attractive FDI destinations after United States for the third consecutive year whereas India ranked 5th, 7th and 11th in these years.

Literature Review

As far as the determinants of FDI are concerned, the literature review shows that human capital (Hsiao, 2001) market size (Lall et al, 2003), market growth rate (Jenson, 2003), corruption (Wei, 2003), exchange rate (Crowley and Lee, 2003), political stability (Anantaram, 2004), labor productivity (Ramamurti, 2004), economic freedom (Lee, 2005), infrastructure (Chantasasawat, 2004), openness (Singh and Jun, 1995) and taxes affect FDI flows to global markets.

Lim E.G. (2001) through the review of various studies summarized that Market Size is the most robust positive FDI determinant. Infrastructure and Industrialization also appear to be important determinants. Lower relative labour costs are generally positive for FDI although Unit Labour Cost is a better variable than average wage costs. Political Risk and Economic instability hinder FDI. Red Tapism and Regulatory hurdles have no econometric evidence due to measurement problems. The evidence on Trade Openness is mixed, more than half of the studies show trade openness is positively correlated to FDI. Transport costs are found to have a mixed impact on FDI. The evidence on fiscal incentives including Tax Rate is mixed.

Dees (1998), Singh and Jun (1995), Lecraw (1991), Kravis and Lipsey (1982) all find their measure of openness i.e. Ratio of exports and imports to GDP, as positively correlated with FDI. As expected, political risks in developing nations are found to be significantly negative for FDI by Lecraw (1991), Nigh (1986) and Nigh and Scholl hammer (1987). Woodward and Rolfe (1993) proved that the tax incentives have a positive influence on FDI. Ajayi (2006) stated that a country that is corrupt with a high crime rate cannot attract much FDI because of corruption cost and uncertainty. Iloh (2011) inferred that the skills of labour force are expected to have an impact on FDI decisions.

Dreher et al (2011) emphasized that relative market size, relative financial market development, relative risk, relative endowment of human capital and previous international experience significantly affect foreign investment in post reform period in India. Omojevwe and others (2012) determined the compound growth rate of FDI and the factors affecting inflow in India and Nigeria. The study for the period 1961 to 2010 showed that the growth rate and compound growth rate of FDI into India was much higher than that of Nigeria for the same period. India attracted more FDI than Nigeria due to its larger GDP, higher real interest rate and trade openness and currency depreciation would also encourage more FDI inflow into India. Bandekar et al (2014) determined the factors affecting FDI inflows in India. The study found that Market size, trade openness, infrastructure development and reserves are the significant determinants of FDI inflows in India during the period 1991-2012.

China has many country specific advantages that are significant as being the determinants of FDI. China's preferential foreign investment policies, inexpensive labour, increasing purchasing power and improving investment environment, especially after entry into the World Trade Organization (WTO) in 2001, have made it a favorite destination for global investment (Yunshi and Jing, 2005). Ali and Guo (2005) studied twenty two firms operating in China and found that China's huge potential market size is the most significant factor for FDI inflow in China. Government incentive policies, labour cost and high investment return are the other important reasons. Global integration is also one of the key factors for some foreign firms. Swain and Wang (1997), Liu et al (1997), Zhang (2000), Wei and Liu (2001), Zhang (2002) and others have argued the determinants of FDI inflows into China identified by FDI theories. These determinants are classified as Micro-, Macro, and strategic determinants. Micro factors include firm ownership specific advantages such as product differentiation and the size of the firm. Macro-determinants of FDI include the market size and the growth of the host country, measured by GDP, GDP per capita, GNP, or GNP per capita. Other macro factors include taxes, political risk, exchange rates and so on. Strategic determinants refer to those long-term factors such as to defend existing foreign markets and to diversify firm's activities.

Studies have shown that market size has a significant effect on inward FDI. Rapid economic growth creates large domestic markets and business opportunities for foreign firms to invest in China. Swain and Zhang (1997) analyzing data of FDI in China in the period of 1978-92, used GDP and real GDP growth rate; Liu et al (1997) using GDP, GDP growth, wages, concluded that market size is the fourth most important economic factors for the pledged FDI in China. Their empirical results indicated that the real GDP rate was significantly related to inward FDI in China. The positive relationship between market size and inward FDI is also confirmed by Zhang (2000) and Wei and Liu (2001). Hence, market size is the most



important factor for foreign firms to invest in China. The larger the market size of province, the more FDI is likely to be received (Zhang, 2002).

Costs factors are one of the determinants of FDI, among which labor cost has been extensively investigated in the study of FDI. It is logical to say that foreign firms can take advantage of low labor cost by investing in developing countries but other argument is cost of transportation and low productivity often exceeds the cost of labor in developing countries (Miller, 1993). Swain and Wang (1997) found that there was a positive relationship between the relatively cheap labor in China and inward FDI. Liu et al (1997) also agreed that the low wage rates were one of the most important economic factors for FDI. Both Zhang and Yuk (1998) found that China's relative cheap labor costs greatly encourage HK Multinationals to invest in Mainland China. On the other hand, Zhang (2000) concluded that the labor cost factor hardly had any influence on US MNE decisions to invest in China. Even recently, low labor cost is considered to be key location factor for foreign investors in China (Wei and Liu, 2001), especially in manufacturing industries. However, the low-labor-cost advantage of China may not be sustainable as China now faces competition from its neighboring countries such as Vietnam, Laos, and India, which are also endowed with cheap labor factors and have adopted various policies to attract FDI.

It has been argued that political instability in the host country could discourage the inflow of FDI and most of the empirical studies support this argument; some empirical evidence suggested that political factors played an insignificant role in firms' decision to invest abroad (Swain & Wang, 1997, Zhang, 2002, Andreosso – O'Callaghan & Wei, 2003).

Geographic proximity of the host to the home country of investors is one of the important determinants. Theoretically, the more the geographic distance between the home and the host country, the less the FDI (Grosse & Trevino, 1996; Wei and Liu, 2001). However, Liu et al. (1997) found that geographic distance have little influence as a determinant of FDI in China, the reason being that the rapid developments in communication technology mitigates distance factors. However, Yuk and Zhang (1997) found that the location of FDI projects in China, funded by capital from Hong Kong, was hugely influenced by geographic distance.

Culture proximity between FDI sources and hosts would encourage FDI flows into China (Liu, *et al*, 1997, Zhang, 2001). There is not enough evidence to support the view that the cultural issues were a significant determinant of western FDI in China (Liu *et al*, 1997).

Sweeny M. (2010) through a regression analysis of GDP and FDI flows from 1992 to 2008 showed a statistically significant linkage between FDI inflows and overall GDP for both India and China. Sinha, Kent and Shomali(2007) tested Indian FDI attraction model using OLS and autoregressive models and found that India has grown due to its human capital, size of the market, rate of growth of the market and political stability. For China, congenial business climate factors comprising of making structural changes, creating strategic infrastructure at SEZs and taking strategic policy initiatives of providing economic freedom, opening up its economy, attracting diasporas and creating flexible labour laws were identified as drivers for attracting FDI.

Objectives of the Study

The basic objective of this study is to identify and compare the determinants that influence the flow of FDI in India and China.

Research Methodology

The data set used for the study consists of yearly observations for the period 1991-2012 i.e. 22 years for the developing countries like India and China. FDI inflow data till the year 2014 is referred wherever required. The data has been obtained from UNCTAD - World Investment Report and World Bank's World Development Indicators.

In this study, FDI inflow is the Dependent Variable (DV) and Gross Domestic Product (GDP), GDP per capita, GDP growth, Electric Power consumption, Exchange Rate, Exports as percentage of GDP, Inflation rate, Trade openness, (Import & Export as % of GDP), External debt and Real Interest Rate are 10 Independent Variables (IV).

Relationship between FDI and Macroeconomic Variables. (Regression Model)

$$\text{Equation 1: } y = a + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + b_5X_5 + b_6X_6 + b_7X_7 + b_8X_8 + b_9X_9 + b_{10}X_{10} + u$$

Where,

y = FDI inflow (in millions US \$) (Dependent Variable), a = Constant

X₁ to X₁₀ = Independent Variables b = Regression Coefficients of variables u = error term

X₁ = GDP (in Billions US \$)



- X₂ = Official Exchange Rate (LCU per US \$)
X₃ = External Debt (in millions US \$)
X₄ = Inflation Rate (Annual CPI in %)
X₅ = Trade openness, (Import & Export as % of GDP)
X₆ = Exports (% of GDP)
X₇ = Real Interest Rate (Annual %)
X₈ = GDP Growth (Annual %)
X₉ = GDP Per Capita (in US \$)
X₁₀ = Electric Power Consumption (KWH per capita)

Tools of Analysis

Correlation Analysis, ANOVA and Stepwise Multiple Regression Analysis (Ordinary Least Square i.e. OLS) and Time Series Analysis are the Statistical tools used to analyze the data.

Hypotheses of the Study

Based on research on FDI literature on determinants and factors, constructs are developed and hypotheses are formed for emerging nations like China and India. The constructs that were measured at national level were Market Size (GDP), Market Growth Rate (GDP Growth Rate), Economic Development (GDP Per Capita), Exchange Rate, External Debt, Economic Stability (Inflation Rate), Globalization/Trade openness (Import and Export % of GDP), Infrastructure Development (Electric Power Consumption), Export Promotion (Export % of GDP) and Cost of Capital (Real Interest Rate).

Ho: There is no relationship between Dependent variable (FDI inflows) and Independent variables (GDP, Exchange Rate, External Debt, Inflation Rate, Trade openness, GDP per capita, GDP Growth, Electric Power Consumption, Exports, Real Interest Rate) in India.

Ho: There is no relationship between Dependent variable (FDI inflows) and Independent variables (GDP, Exchange Rate, External Debt, Inflation Rate, Trade openness, GDP per capita, GDP Growth, Electric Power Consumption, Exports, Real Interest Rate) in China.

Analysis and Discussions

The abbreviations of variables used in the study and the expected relationship between various independent variables and the dependent variable are depicted in Table 1.

Table 1: Abbreviations and Expected Relationship of Independent Variables with FDI Inflows

S. No	Variable	Abbreviation (INDIA)	Abbreviation (CHINA)	Expected Relationship with FDI
1	FDI Inflows	IFDIINF	CFDIINF	-----
2	Gross Domestic Product	IGDP	CGDP	Positive
3	Exchange Rate	IEXCHRAT	CEXCHRAT	Negative
4	External Debt	IEXTDEBT	CEXTDEBT	Negative
5	Inflation Rate	IINFLNRAT	CINFLNRAT	Negative
6	Trade Openness	ITOPEN	CTOPEN	Positive
7	GDP Per Capita	IGDPPC	CGDPPC	Positive
8	GDP Growth	IGDPGR	CGDPGR	Positive
9	Electric Power	IELPOWCONS	CELPOWCONS	Positive
10	Export	IEXPOT	CEXPOT	Positive
11	Real Interest rate	IRINTR	CRINTR	Negative

Source: Literature Review

The Indian Model and Chinese Model of FDI include ten determinants and the impact of these determinants in the model was tested to predict FDI inflows and changes.

A) Indian FDI Model

The correlation analysis (Annexure 1) with the help of Karl Pearson's correlation coefficient (r) explains that there exists strong positive correlation between India's FDI Inflows and GDP, External Debt, Trade openness, Exports, GDP per capita, Electric power consumption, FDI inflows and Exchange Rate has moderate positive correlation and Inflation Rate possess



weak positive correlation. But FDI inflows have moderate negative correlation with Real Interest Rate. It is also noted that Exchange rate, External Debt and Inflation rate do not represent expected negative relation with FDI inflow into India. The overall Correlation is significant at 1% level. (R= 0.99).

The Step wise Multiple Regression Analysis presents the nexus between FDI flows into India and various independent variables in terms of OLS Technique. In OLS Method, we reject the null hypothesis that there is no significant relationship between FDI inflows and various independent variables. The result of OLS regression is summarized in Table No. 2.

Table: 2 Model Summaries and ANOVA (DATA SET 1991-2012) Country – INDIA

Model	R	R ²	Adjusted R ²	S.E. of Regression	Durbin Watson	F value	P value
1	0.994	0.988829	0.978673	2049.994	3.019829	97.36547	2.90e-09
2	0.994	0.988644	0.980127	1978.870	2.938576	116.0786	2.80e-10
3	0.993	0.985975	0.977344	2112.887	2.932558	114.2385	8.77e-11
4	0.991	0.981899	0.972848	2313.053	2.620194	108.4893	4.14e-11

Source: Authors compilation from regression models.

- Dependent Variable: IFDIINF.
- Predictors: (Constant), IELPOWCONS, IINFLRAT, IGDPGR, IRINTR, IEXCHRAT, IEXTDEBT, IEXPOT, IGDP, ITOPEN, IGDP.
Predictors: (Constant), IELPOWCONS, IINFLRAT, IGDPGR, IRINTR, IEXCHRAT, IEXTDEBT, IEXPOT, ITOPEN, IGDP.
Predictors: (Constant), IELPOWCONS, IINFLRAT, IGDPGR, IRINTR, IEXCHRAT, IEXTDEBT, IEXPOT, IGDP.
Predictors: (Constant), IELPOWCONS, IGDPGR, IRINTR, IEXCHRAT, IEXTDEBT, IEXPOT, IGDP.

The empirical analysis suggests that the Coefficient of Correlation is very high (i.e. R=0.99). It indicates that there is high degree of correlation between FDI inflows and other independent variables. R² (0.98) implies that about 98.2 % of total variation in FDI Inflows is due to GDP, Exchange Rate, External Debt, GDP Growth, Electric Power Consumption, Exports, Real Interest Rate where as remaining 1.2 % is due to other factors. The adjusted R² is 0.97. Model 4 (Annexure 3) offers the best predictors as the value of adjusted R square is 0.97 in it. This model explains 97 % of total variation in the dependent variable (FDI Inflows). Moreover, GDP, Exchange Rate, External Debt, GDP Growth, Electric Power Consumption, Exports, Real Interest Rate are the seven significant independent variables amongst ten variables under investigation. The regression coefficients provide that these factors are significant at 1% level. Inflation rate is significant at 10 % level. F ratio (108.48) also turns significant here. GDP Per Capita and Trade openness are judged as insignificant factors. The value of Durbin Watson Test (2.62 > 2) explains the existence of negative auto correlation.

B) Chinese FDI Model

The correlation analysis (Annexure 2) depicts that there exists strong positive correlation between FDI flows in China and GDP, GDP per capita, External Debt and Electric power consumption. Exports and Trade openness have moderate positive correlation with FDI inflows. But FDI inflows possess negative correlation with Inflation Rate, GDP Growth and Exchange Rate. Correlation is significant at 10% level. (R = 0.933).

The Step wise Multiple Regression Analysis presents the relation between FDI inflows to China and various independent variables in terms of Ordinary Least Square Technique (OLS). The results of OLS regression are summarized in Table No.3.

Table No: 3 Model Summaries and ANOVA (DATA SET 1991-2012) Country – CHINA

Model	R	R ²	Adjusted R ²	S.E. of Regression	Durbin Watson	F value	P value
1	0.976	0.958068	0.919948	17913.28	1.877932	25.13307	3.77e-06
2	0.975	0.958062	0.926609	17151.85	1.890352	30.45991	6.48e-07
3	0.972	0.957950	0.932072	16501.11	1.893955	37.01910	1.02e-07
4	0.966	0.957385	0.936078	16007.20	1.833487	44.93218	1.57e-08
5	0.965	0.955751	0.938052	15758.11	1.653759	53.99887	2.60e-09
6	0.962	0.954955	0.940878	15394.46	1.643510	67.83964	3.37e-10
7	0.953	0.948087	0.935872	16032.92	1.494711	77.61800	1.09e-10
8	0.951	0.942844	0.933318	16349.06	1.615501	98.97661	2.23e-11
9	0.933	0.940383	0.934108	16252.00	1.529877	149.8514	2.32e-12

Source: Authors compilation from regression models.



- a. Dependent Variable: CFDIINF.
- b. Predictors: CGDP, CRINTR, CEXPOT, CGDPGR, CEXCHRAT, CINFLRAT, CELPOWCONS, CTOPEN, CEXTDEBT, CGDPPC.
Predictors: CGDP, CRINTR, CEXPOT, CGDPGR, CEXCHRAT, CINFLRAT, CELPOWCONS, CEXTDEBT, CGDPPC.
Predictors: CGDP, CRINTR, CEXPOT, CGDPGR, CEXCHRAT, CINFLRAT, CELPOWCONS, CGDPPC.
Predictors: CGDP, CRINTR, CEXPOT, CGDPGR, CEXCHRAT, CINFLRAT, CGDPPC.
Predictors: CGDP, CRINTR, CGDPGR, CEXCHRAT, CINFLRAT, CGDPPC.
Predictors: CGDP, CRINTR, CEXCHRAT, CINFLRAT, CGDPPC.
Predictors: CGDP, CRINTR, CEXCHRAT, CGDPPC.
Predictors: CGDP, CEXCHRAT, CGDPPC.
Predictors: CGDP, CGDPPC.

The OLS Regression analysis suggests that the Coefficient of Correlation is very high i.e. 0.93. It indicates that there is high degree of correlation between FDI inflows and other independent variables. R^2 (0.94) implies that about 94 % of total variation in FDI Inflows is due to GDP and GDP Per Capita where as remaining 6 % is due to other factors. The adjusted R^2 is 0.93. Model 9 (Annexure 4) offers the best predictors as the value of adjusted R square is 0.93. This model explains 93 % of total variation in the dependent variable (FDI Inflows). GDP and GDP Per Capita are the only two significant independent variables amongst ten variables under investigation. All other variables are insignificant. The regression coefficients provide that these factors are significant at 1% level. F ratio (149.85) also turns significant. GDP Growth, External Debt, Electric power consumption, Exports, Trade openness, Inflation Rate, Real Interest Rate and Exchange Rate are judged as insignificant factors. The value of Durbin Watson Test (2.019) nearby 2 reflects the absence of auto correlation. Table 3 shows the significant P value 0.00 less than 0.05 to reject the null hypothesis. Thus, it is concluded that this model is a Good Fit and these independent factors can be used to predict China's FDI Inflow.

Comparison between Determinants of FDI Inflows in India and China

China's achievements and comparison with India explains the success of congenial business environment adopted by China. In 1978, China (\$ 163.6 billion) was behind India (\$ 168.0 Billion) in GDP. In 2012, China (\$ 8229 Billion) is far ahead of India (\$ 1878 Billion) in GDP. Modern China has FDI stock of \$ 2730 Billion (2014) whereas India has a stock of \$ 252 Billion which is just 10 % of China.

The statistical analysis and findings of Indian FDI Model suggested that as per correlation matrix ($R= 0.99$) there exists positive correlation between India's FDI Inflows and GDP, External Debt, Trade openness, Exports, GDP per capita, Electric power consumption and Exchange Rate. But FDI inflows have negative correlation with Real Interest Rate. It is also noted that Exchange rate, External Debt and Inflation rate represents inverse relation with FDI inflow.

Overall, the OLS Model was found significant (99% confidence level, alpha equals 0.01, $F= 108.48$, $p=0.000$, $R^2=0.982$, Adj. $R^2= 97.3\%$). Correlation matrix showed co linearity between GDP and GDP per capita variable. These statistics helps to reject the null hypothesis and supports the findings that there exists significant relationship between FDI Inflows in India and the determinants like GDP, External Debt, Exchange Rate, Exports, Electric power consumption, GDP Growth and Real Interest Rate.

The statistical analysis and findings of Chinese FDI Model suggested that as per correlation matrix ($R= 0.933$) there exists positive correlation between FDI flows in China and GDP, GDP per capita, External Debt, Electric power consumption, Exports and Trade Openness. But FDI inflows possess negative correlation with Inflation Rate, GDP Growth and Exchange Rate.

Overall the OLS Model was found significant (99% confidence level, alpha equals 0.01, $F= 149.85$, $p=0.000$, $R^2=0.94$, Adj. $R^2= 93.4\%$). Correlation matrix showed co linearity between GDP and GDP per capita variable. These statistics helps to reject the null hypothesis and supports the findings that there is significant relationship between FDI Inflows in China and the determinant factors such as GDP and GDP per capita.

The study of Indian and Chinese FDI Model reflects the result that market size measured by GDP has a significant effect on inward FDI. Thus, size of the market is the most important and the only common factor for flow of FDI into India and China.

Conclusion

The study tried to explore the determinants of FDI in emerging economies and select two largest countries in the world to study the phenomenon of foreign investment inflow in these countries. One country i.e. China has grown rapidly and other



i.e. India has trailed behind trying to catch up but is still far behind. China got \$ 237 billion FDI while India got only \$ 34 billion in 2014.

Indian FDI Model tested using OLS and found that India has grown due to its large size of the market, higher rate of growth of the market, globalization policy, infrastructural development, large exports and low cost of capital. Chinese FDI is determined by its large size market and economic development. Thus, Market size measured by Gross Domestic Product (GDP) is the most important and the only common factor for flow of FDI in India and China.

India can learn lessons from China and create congenial business environment in the country to catch up with China. India has to make structural changes in the economy. It has to repeat some of the success stories in the structural changes. Immediate reform is required in Railways, Telecommunication sector, power and electricity sector. Infrastructure development should be undertaken by using foreign exchange reserves. Govt. has to focus on health and education. India has to diversify from developing service sector and support skill-neutral mass manufacturing growth to employ large number of unemployed youth. Also, Labor laws have to be relaxed to promote mass production. Like Chinese SEZs, India should also develop few large SEZs with world class infrastructure having banks, townships, shopping malls, recreation centers, prominent school franchises and airports, etc. These Strategic policy initiatives can create conducive business climate to attract higher FDI and help India in becoming a global player in the world economy.

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Annexure 1
Correlation Matrix (INDIA)

	IFDIINF	IGDP	IEXCH RAT	IEXT DEBT	IINFL RAT	ITOPEN	IEXPOT	IRINTR	IGDP GR	IGDP PC	IELPOW CONS
IFDIINF	1										
IGDP	0.85	1.00									
IEXCHRAT	0.52	0.64	1.00								
IEXTDEBT	0.82	0.97	0.57	1.00							
IINFLRAT	0.12	0.11	-0.47	0.22	1.00						
ITOPEN	0.89	0.95	0.71	0.88	-0.07	1.00					
IEXPOT	0.88	0.93	0.72	0.86	-0.11	1.00	1.00				
IRINTR	-0.49	-0.65	-0.11	-0.66	-0.49	-0.56	-0.56	1.00			
IGDPGR	0.18	0.33	0.32	0.20	-0.14	0.35	0.38	-0.13	1.00		
IGDPPC	0.86	1.00	0.63	0.97	0.12	0.95	0.93	-0.66	0.34	1.00	
IELPOWCONS	0.89	0.98	0.71	0.92	0.03	0.96	0.95	-0.60	0.40	0.98	1.00

Annexure 2
Correlation Matrix (CHINA)

	CFDIINF	CINFL RAT	CEXPOT	CRINTR	CGDP GR	CGDP PC	CT OPEN	CELPOW CONS	CEXCH RAT	CEXT DEBT	CGDP
CFDIINF	1										
CINFLRAT	-0.28	1.00									
CEXPOT	0.67	-0.30	1.00								
CRINTR	0.05	-0.68	-0.01	1.00							
CGDPGR	-0.19	0.57	0.11	-0.65	1.00						
CGDPPC	0.93	-0.23	0.51	0.02	-0.22	1.00					
CTOPEN	0.67	-0.26	0.99	-0.04	0.12	0.52	1.00				
CELPOWCONS	0.96	-0.27	0.70	-0.02	-0.10	0.95	0.70	1.00			



CEXCHRAT	-0.13	-0.04	0.25	0.43	-0.22	-0.33	0.25	-0.23	1.00		
CEXTDEBT	0.93	-0.24	0.54	0.03	-0.20	0.99	0.56	0.95	-0.28	1.00	
CGDP	0.93	-0.23	0.50	0.01	-0.22	1.00	0.52	0.95	-0.33	0.99	1.00

Annexure 3

Model 4: OLS, Using Observations 1991-2012 (T = 22)						
Dependent Variable: IFDIINF_						
		Coefficient	Std. Error	t-ratio	p-value	
Const		-86253.5	8728.51	-9.8818	<0.00001	***
IGDP_		-86.323	12.8153	-6.7359	<0.00001	***
IEXCHRAT		-1080.95	118.531	-9.1196	<0.00001	***
IEXTDEBT		0.217807	0.0425052	5.1242	0.00015	***
IEXPOT_		2180.41	340.245	6.4083	0.00002	***
IRINTR_		1542.28	320.789	4.8078	0.00028	***
IGDPGR_		-1052.56	275.396	-3.8220	0.00187	***
IELPOWCONS_		317.277	31.1198	10.1953	<0.00001	***
Mean dependent var		11758.09		S.D. dependent var	14037.34	
Sum squared resid		74902970		S.E. of regression	2313.053	
R-squared		0.981899		Adjusted R-squared	0.972848	
F(7, 14)		108.4893		P-value(F)	4.14e-11	
Log-likelihood		-196.6639		Akaike criterion	409.3279	
Schwarz criterion		418.0562		Hannan-Quinn	411.3840	
Rho		-0.329188		Durbin-Watson	2.620194	

*** Significant at 1% Level.

Annexure 4

Model 9: OLS, Using Observations 1991-2012 (T = 22)						
Dependent Variable: CFDIINF						
		Coefficient	Std. Error	t-ratio	p-value	
Const		-64287	21866.7	-2.9400	0.00841	***
CGDPPC		1514.33	319.266	4.7432	0.00014	***
CGDP_		-1088.5	234.844	-4.6350	0.00018	***
Mean dependent var		98278.68		S.D. dependent var	63312.60	
Sum squared resid		5.02e+09		S.E. of regression	16252.00	
R-squared		0.940383		Adjusted R-squared	0.934108	
F(2, 19)		149.8514		P-value(F)	2.32e-12	
Log-likelihood		-242.9154		Akaike criterion	491.8308	
Schwarz criterion		495.1039		Hannan-Quinn	492.6018	
Rho		0.210645		Durbin-Watson	1.529877	

*** Significant at 1% Level.