# CAN INDIA COMPETE WITH CHINA FOR FOREIGN DIRECT INVESTMENT?

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**Abstract:** India has become world's fourth largest economy in terms of Purchasing Power Parity. Foreign Direct Investment (FDI), plays an important role in a country's economic growth. The new Indian federal government has liberalized many sectors of the economy including the defense sector with the hope of garnering a major chunk of the world's FDI inflows. India's economy is buoyant and the growth rate during the current year, has surpassed that of China for the first time during the last 15 years. For the year 2014, China has been able to attract US $ 128 billion FDI inflows, the highest in the world, whereas India could only attract US $ 42 billion. . A number of factors can be advanced to explain this disparity. But most important factors are corruption and ease of conducting business. This paper is a case based comparative study of the effect of corruption and ease of doing business on FDI in China and India. The study found that corruption adversely impact FDI inflows into a country, but more importantly, FDI inflows depend on ease of doing business, which is the reason why China is able to attract huge FDI, while India is struggling.

**Keywords:** corruption, ease of doing business, foreign direct investment (FDI), transparency international, economy, India, China.

**Introduction:** Foreign Direct Investment (FDI) has become very important for developing countries as well as developed countries. FDI has become a de-facto proxy for assessing the attractiveness of a country for international business. Starting from the 1980s, globalization and technology together have created a global and networked economy that has resulted in a phenomenal growth of international business (Dunning, 2003). All the countries in the world are looking at FDI as a potential source of resources and are vying with each other to attract as much as possible. FDI is an investment by an investor from one country in a foreign country by acquiring at least 10% of a company's capital or by creating a new business entity in the host country (UNCTAD, 2014a). When selecting a host country, the potential investor will look at a number of economic factors including the Gross Domestic Product (GDP), GDP growth rate, corporate tax rates, interest rates and political factors such as political stability, legal framework, rule of law, ease of conducting business (Hu, 2006; Globerman & Shapiro, 2002). However as Alemu (2012) argues that the host country's economic fundamentals alone may not be sufficient for inflows of FDI and some other non-economic factors like threat posed by corruption have also to be taken into account.

The Chinese and Indian Economies have been growing at an unprecedented pace during the last two decades, but unfortunately the same is also true with corruption. Corruption is a social phenomenon that exits in almost all countries of the world that can have a profound effect on the ability of a country in attracting FDI (Mauro, 1995). Research shows that countries with high levels of corruption are normally avoided by potential investors and will have difficulty in making their country a favored destination of FDI. FDI inflow into the country remains hindered by government bureaucracy and corruption' (Mondal, n/d). Corruption also distorts allocation of resources, indirectly contributes to increase in prices and discourages FDI (Zhao, Kim and Du, 2003). Lee and Oh, (2007) studied corruption in Asia from the point of view of pervasiveness and arbitrariness and came to the conclusions that foreign investors may not get deterred by pervasiveness of corruption but may not invest if arbitrariness is high in a country. China and India both are regarded as countries with high corruption.

This paper studies FDI inflows into China and India during the last two decades and analyses as to why India is unable to attract FDI like China.

**Methodology:** This study will use case study approach, a mix of qualitative and quantitative methods and secondary data sources. For the discussion on issues like corruption and foreign direct investment, where a number of mainly qualitative factors need to be included in the study, case study approach has been found to be very effective (Lee, 1989). Case studies will be used to support the main issues discussed in the paper. In the Chinese and Indian context, there are many cases of corruption during the last three decades, but the case studies that have been presented in this paper have been selected by their ability to bring out the many issues that are the focus of this research paper. The criteria used in the selection was the impact (mostly negative) these cases had on investors, the Chinese and Indian government and the governments in foreign countries. Some researchers have studied the effect of corruption on FDI in general. However there are few comparative studies on effect of corruption on FDI inflows into China and India, acknowledged by the world as the economic superpowers of future. This study hopes to fill that gap.

**China and India:** China and India have a number of similarities and many differences. China and India are the two ancient civilizations in the world. China has a population of 1.4 billion and India 1.2 billion and together they are home to 40 per cent of the world's population. India got independence from British rule in 1947 and China came under communist rule in 1949. India is world's largest democracy whereas China is most populous and a communist country. India and China are predominantly rural where nearly 70% of the population lives in rural villages. Both countries were considered 'poor' till the turn of last century. Since the birth of People's Republic of China, China had a strong federal government and similarly India had a strong central government. China practiced 'communism' and has a one party rule since the revolution. Notwithstanding the fact that India is a democracy with plethora of political parties, India since independence practiced 'socialism'. In both countries till 1980s the state controlled most of the economic activity. However, the respective practices these countries have followed did not help these country's economies and their respective GDP growth rates were very poor till 1980s. The world used to call the poor Indian growth tare as the 'Hindu rate of growth'. Similarly the Chinese economic growth was low. China has initiated the economic reforms under the leadership of Deng Xiaoping during mid 1980s and India under the leadership of Prime Minister PV Narasimha Rao in early 1990s. Since then, China and India have come a long way. During 2014 China has achieved the distinction of largest economy, with highest GDP in the world, US $ 17617.3 billion. India has become the third largest economy in the world, with US $ 7375.9 billion (International Monitory Fund, 2014).

**Foreign Direct Investment:** The International Monetary Fund (IMF) defines FDI as investment in "an incorporated or unincorporated enterprise in which a foreign investor owns 10 percent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise" (IMF 2004a, IMF 2004b). FDI can takes place in a number of different ways. The investor can acquire a control of a company in host country by starting a green field venture (incorporating wholly owned subsidiary), acquiring shares in an associated enterprise, through mergers and acquisitions, establishing joint ventures or by the way of equity participation. According to the World Investment Report 2014 published by UNCTAD (United Nations Conference on Trade and Development), international FDI inflows increased by 9 percent in 2013 to US $1.45 trillion. Developing countries attracted 54% of all the inward FDI and Asia attracted more inward FDI than Europe or United States. (UNCTAD, 2015).

Developing and underdeveloped economies do not have the required income levels or internal savings that can meet the demand for investment required to create sustainable economic growth. FDI fills the gap between the demand and supply of the economic and other resources (Anita, 2012; Bose, 2012). Hence host countries provide a number of incentives to potential investors to attract FDI. FDI in many countries is triggering domestic economic development and hence different countries are trying their best to attract more FDI (Chung, 2001, Daisuke, 2008). The determinants of FDI include economic conditions in the host country, government policies and investment strategies of the host country. According to Castro and Nunes (2013), determinants of FDI are size of the market, gross domestic product (GDP) growth rate, economic stability, degree of openness. In the present day context, the political environment is an important factor for FDI (Mody & Srinivasan, 1998). FDI has many advantages and disadvantages to both the investor and the host country.

However, one should not look at FDI as all virtue without any disadvantages. FDI's can have some serious disadvantages if the host country is not careful. FDI in strategically important sectors of the economy can adversely affect the growth and development of host countries, or even security of the country. Investors can strip off the assets of the company or divest unprofitable parts of the company, which can lead to job losses and adverse effects on the community. Some unscrupulous foreign companies borrow money by making the subsidiary company collateral locally and lending the funds back to the parent company (Loungani & Razin, 2001). Potential investors also face higher risk as many cross border investments are capital intensive. The legal and political environment of countries can affect the investor adversely. Coca cola had to exit the Indian markets in 1970s due to policy changes by the government at that time. The risks include economic risks, political risks, legal risks and infrastructural risks (Lewandowski, 1997). The economic environment, especially inflation and foreign exchange fluctuations pose a grave threat to FDI.

In the final analysis, most countries in the recent past have realized that FDI can be a catalyst for developing their economies and are making efforts to attract more and more FDI. The top 10 destinations of FDI inflows in the world during year 2013 are as given in the following table.

**Table 1:** World FDI inflows 2013

| Rank | Country | Volume of FDI in US $ billions |
|---|---|---|
| 1 | US | 187.5 |
| 2 | China | 123.9 |
| 3 | Hong Kong | 76.6 |

| | | |
|---|---|---|
| 4 | Brazil | 64 |
| 5 | Singapore | 63.7 |
| 6 | Canada | 62.3 |
| 7 | Australia | 49.8 |
| 8 | Spain | 39.1 |
| 9 | UK | 37.1 |
| 10 | Ireland | 35.5 |
| 12 | India | 28.1 |

Source: Compiled from George Arnett blog, the Guardian (2014) and AT Kearney (2013).

**Analysis of FDI into India and China:**

**FDI Inflows India:** Indian economy currently is the third largest economy in the world by Purchasing Power Parity. After an average annual growth rate of 7.05 percent during last 10 years, Indian economy has slowed down during 2012 to 4.7 percent and 5.0 percent in 2013 (World Bank, 2014). But during 2014 the growth rate has gathered upward momentum, reaching 6.5 percent. India is also member of the G-20 group of nations.

With regards to FDI, Indian government, during the first decade after independence, had a reasonably open door policy. 1960s and 1970s saw dramatic changes and the FDI policy has become very restrictive. The main causes that led to the restrictions according the government were huge foreign exchange outflows in the form of royalties, dividends and technical fees. The government tried to divert FDI from consumer goods to capital goods. There was concentered effort by the government to extend its control over the industry and other important sectors of the economy that resulted in nationalization of banks, insurance companies. The passage of legislation like the Monopolies and Restrictive Trade Practices Act (MRTP) (1969) and the Patent Act (1970) and Foreign Exchange Regulation Act (FERA) (1973) discouraged FDI. MRTP, FERA legislations coupled with the Industrial Policy Statements that were issued by the Government of India, from time to time between 1960 and 1980 have made FDI in India totally unattractive for investors.

The decade from 1980 to 1990 saw some improvements in Indian government's policy towards FDI and many sectors including services sectors were opened up for FDI. Since 1985 India was having balance of payment problems and by end of 1990, India was facing an economic crisis. The situation was so grave that in January 1991, India had foreign exchange reserves of just $ 1.2 billion, which came down by half by June 1991, sufficient only for three months of essential imports (Livemint, 2009). India was compelled to initiate economic reforms due to its own compulsions. The real impetus to attract FDI was provided through economic reforms initiated by the Indian government during 1991. To promote FDI, Indian government set up the Foreign Investment Promotion Board as a single window service to speed up the process and eliminate bureaucratic delays. As part of these reforms, during 1990-1991, automatic approval of up to 51 percent was permitted in 34 priority sectors in manufacturing and services. Mining sector was opened for FDI in 1992-1993. During 1993-1994, foreign investors were allowed to repatriate profits and capital. During 1998-1999, Foreign Exchange Management Act (FEMA) replaced draconian FERA. Year 2005-2006 saw some real efforts by Indian government to attract FDI, by allowing 100% foreign equity in development of infrastructure, townships and housing. Further liberalization came in 2009-2010 when Indian government relaxed the FDI norms in commodity exchanges and aircraft maintenance, and permitted 100% FDI in mining Titanium bearing minerals.

The average FDI during the decade from 1980-1990 was US $ 0.11 billion with a minimum of US $ 0.8 billion in 1980 to a maximum of US $ 0.25 billion in 1989. FDI into India averaged only US $0.2 billion between 1985 and 1991. This is due to the effect of unfriendly policies followed by Indian policy makers at that time. Even after India started liberalizing their economic policies, the FDI inflow into India up to 1995 was less than $ 1 billion. Policy changes and replacing Foreign Exchange Regulation Act (FERA) with Foreign Exchange Management Act (FEMA) in 1999 led to an increase in FDI in the following years. The FDI in India crossed the $5 billion mark for the first time in 2001. The proactive policy changes and effort by the Government of India resulted in many fold increase in FDI from 2005 onwards reaching a peak at $42.55 billion during 2008. After 2008, the FDI started its downward trend due to a host of factors and reached $ 24.20 billion and $ 28.20 billion during 2012 and 2013 respectively. Corruption undoubtedly is one of the main factors for this downward trend. In the final analysis, India notwithstanding an impressive GDP growth could not attract FDI like other countries. According to a UNCTAD report, FDI inflow into India as a percentage of its fixed capital formation is 4.3 percent compared to the global average of 8.3%. FDI as percentage of GDP in India is 12.2 percent whereas the ratio for developing countries is 30.4 percent (Mathew, 2014). In 2014 while China attracted US $ 123.9 billion India had to be content with US $ 28.1 billion.

**FDI Inflows China:** China in initial years after revolution has discouraged foreign investment. With the initiation of economic reforms during 1980s, China has opened its doors for FDI in a limited and selective way. During 1980s and 1990s China permitted FDI in selected industries and selected special economic zones and export oriented

manufacturing. While joining WTO, China opened its services sector also to FDI. In order to facilitate FDI and also promote healthy competition amongst different provinces, China has been able to develop a highly decentralized policy for FDI. Provinces have been establishing 'one stop' facility for allowing investors to complete all required procedures in one place, in order to speed up the process. Since then FDI had played an important role in China's economic development and exports. By 2010, according to China's Ministry of Commerce, enterprises with FDI accounted for 50% of the total imports and exports, 30% of industrial output and 22% of industrial profits and FDI has 'catalyzed' China's economic reform (The world Bank, 2010). China has become the most sought after destination for all types business across the world for manufacturing their products. In 1982, China could attrct FDI of US $ 0.43 billion, but after economics reforms this figure started going up and it stands now at a staggering US $ 128 billion for 2014.

**Corruption in India and China:** Corruption is a complex and distinct phenomenon. Transparency International (TI), the corruption watchdog of the world defines corruption as 'misuse of entrusted power for private gain' (TI, 2008). Corruption according to UNDP is principally a governance issue, reflection of institutional failure or lack of capacity on the part of government 'to manage society by means of a framework of social, judicial, political and economic checks and balances' (UNDP, 2006). Robert Klitgaard's (1995) equation summarizes the corruption framework effectively as "Corruption = Monopoly + Discretion – Transparency (in governance)". Corruption in a country can be classified into three levels. The first one is petty bureaucratic corruption that takes place at the lowest level like in government offices. The second level is administrative corruption, involving senior administrative officials of the government and the third or highest level is at the political level, what is known as 'grand larceny' (Pathak and Prasad, 2006).

India: Corruption and bribes have been considered pretty common in India throughout its history, though in the recent past it appears they have reached unprecedented levels. Indian political parties, police and judiciary have been ranked as the first, second and third corrupt institutions respectively in India (Xu, 2014). According to a 2012 Hindustan Times youth survey conducted across India targeting educated, young people in the age group of 18 to 25, at least 42% of young Indians have paid a bribe, 39.3% said that they will not be ashamed of paying bribe, 39.4% felt that Indians are more tolerant of Corruption and 42.6% reported that nobody has ever stopped them from paying a bribe (Hindustan Times, 2012). According to Transparency International's Corruption Perception Index (CPI) for India from 1995 to 2014, Corruption India has been increasing with each passing year. The CPI score is on a scale of 1 to 10, where a high score is an indication of low levels of corruption and low score is an indication of high levels of corruption in a country. With regards to the rank, the higher the rank, the higher the corruption. India's CPI score during this period was between 2.78 to 3.8. India's rank among various countries is between 46/54 (1995) and 95/180 (2011). During the last two decades the nature of corruption in India has changed. From 1950 to 1980s the petty corruption and administrative corruption were more prominent, but starting from 1980s, the political corruption has become the more predominant. During the last decade, starting from 2000 till 2012 India has witnessed unprecedented political corruption both in quantity and number of cases. The corruption scandals that came to light during the last three decades prove this point beyond reasonable doubt. The major corruption scandals that took place in India during the last three decades are Bofors (1980), HDW Submarine Scandal (1987), Airbus scandal (1990), Harshad Mehta Securities Scam(1992), Fodder Scam (1996), Ketan Mehta Stock Market scam ( 2001), UP Food Grain Scam ( 2003), Satyam Computers ( 2009), Commonwealth Games (2010), 2G Sprectrum Scam (2010), Tratra Truck Scam ( 2011), Coal allocation scam (2012), Augusta Westland ( 2013) and Sarada Chit funds( 2013). (Business Today, 2014; Financial Times, 2014.)

China: Research attributes a number of reasons for the growth of corruption, including political, cultural and historical reasons. Unfortunately, aaccording to Huang, China has a history of corruption, but the present-day corruption has its source in economic reforms s an unintended by product. He is of the view that 'dual track' economy that resulted from economic reforms led to a parallel market and state driven economy simultaneously and this resulted in increasing corruption. The private entrepreneurs need for capital and the ability of state enterprises to provide the same and the approval needed from local officials resulted in corrupt practices (Huang, 2015). Culturally, Chine society works around a concept called 'Guan Xi' or relationships. It is known fact that in China to be able to transact business one needs a strong network of friends, who help each other and that is at the heart of 'Guan Xi'. Another cultural aspect of Chinese society is is that of gift giving. Giving and taking gifts for festivals are a socially acceptable norm in Chinese's society for many centuries. In the initial stages of reforms, unscrupulous businesses made huge profits by manipulating the local officials and deriving 'price arbitrage'. The officials benefited from the gifts and bribes. Due to the language barriers and lack of knowledge about local practices inter-

national investors had to take local firms as agents or partners and in many cases these agents or partners did the ground work. This arrangement suited many investors as this speeded up the process of getting the required permits from the local officials and also fuelled corruption. Most researchers are of the opinion that corruption retards economic growth, but in case of China this did not prove to be true. In case of China 'the opposite seems to be happening' (Huang, 2015). China has been perceived to be a country with high levels of Corruption like India, by Transparency International. China's CPI is score is between 2.16 (1995) and 4.0 (2013), and rank among different countries is 41/52( 1996) and 100/174 (2014). One can see from this China's corruption has been increasing every year since 1996.

The ever growing corruption has become a cause of worry for the Chinese's government. This has culminated in President Xi Jinping's anti-corruption drive after assuming the office in 2012, in which he promised to go after both 'Tigers and Flys', to root out corruption. As a result of his campaign, till date, 414, 000 officials have been disciplined and 201,600 officials were investigated and punished till 2013. According to another estimate by Branigan (2015) in the Gaurdian, 100, 000 officials were punished till now' During 2014, China has published a list of 150 corrupt officials who are now hiding in other countries like US, Canada and Australia and seeking their extradition. The deputy Chief Engineer of the Railawy Ministry, who was in charge of the projects liking China with bullet trains was arrested for embezzeling US $ 2.7 billion in 2011. Li ChangXing , who was the chairman of Yuanhua International Corporation, trading in cigarettes has absconded to Canada with US $ 7.7 billion. People's bank of China .According to Nanayakkara (2014), the five reasons as to why the corruption is getting worse in China are, Too much stick and not enough transparency, lack of accountability, ability of Chinese officials to launder proceeds of corruption offshore, failure to regulate the business sector, and the lack of bottom up reform. General XU Calhou, one of the senior generals was caught with cash, which needed 14 trucks to haul it away. Precious stones and a solid gold statue of Mao Zedong were also recovered from him. Zhou Yongkong, the former security chief was the biggest 'tiger' caught till date. The other 'tigers' who were arrested include Ling Jinhua, Jiang Jemin, Liu Tienan

**Effects of corruption on Foreign firms:** Corruption in a country affects investors in many ways. First, it increases cost of doing business in a country. Second, it creates uncertainty for the corporation, if the process of obtaining required licenses involves discretion of politicians and bureaucrats. Third, it encourages middlemen to engage in corrupt activities. Fourth, the investors may have to face serious legal implications including prospect of going to jail, if they are caught. Fifth, they may be blacklisted by the host country and many other potential countries if it comes to light that the company engaged in malpractices. Sixth, the investing corporation might not be able to attract talented people in the host country. Seventh, the customer or public perception about unethical conduct can harm the brand image and reputation of the firm in the new host country. Eighth, it can harm the brand image in the home country as well. Ninth, it may result in financial damage in terms of fines imposed, even when the company does not admit guilt. Tenth and the gravest of all is corruption if tolerated in any form, tends to be accepted by society and becomes a way of life.

**Indian Case:** The following case proves that some of these consequences are real.

Case of Westland Helicopters: In 2010, Augusta Westland's won a contract for supplying 12 helicopters to the Indian Government and with expected orders for more and future cooperation. The deal was worth US $734 million. This firm is owned by Italian aircraft company Finmeccanica. They beat their competitors, Sikorsky, in winning this bid. However in an anti-climax Finmeccanica's chief executive Giuseppe Orsi was arrested by Italian police in 2013 and was placed under house arrest in connection with this case. Italian authorities have also issued arrest warrants for the two middlemen, Guido Ralph Haschke and Christian Michael, who brokered the deal. It was alleged that the company was involved in paying bribes to the tune of $ 68 million, which is nearly 10 percent of the purchase price, to Indian officials to secure the contract and also falsified invoices to facilitate this. Italian prosecutors also named former chief of the Indian Air Force, Air Marshal Sashindra Pal Tyagi in the bribery probe. Italian police, during the investigation, seized a suitcase full of incriminating documents from Guido Ralph Haschke, one of the middlemen, about the Indian deal which the Italian prosecutors called as 'dream suitcase'. One of the documents, a hand written note, listed how the bribe money was distributed. According to investigators and prosecutors, the list had headings like 'POL' for politicians, 'AF' for officials of Indian Air Force, 'FAM' for family members of the Indian Air Force chief. Haschke agreed to cooperate with Italian police under plea bargain, said that he made the list from the information provided by other 'consultant' or middleman Christian in London hotel. One of the entries says that US $ 3.9 million was paid to one 'AP', who the investigators say is Ahmad Patel an important, powerful and senior politician from ruling Congress party and political secretary to the Congress party chief Sonia Gandhi. Another document, a

memo by Haschke to the company written in 2010, clearly states that the Indian Air Force officer agreed to make a recommendation supporting Augusta Westland Helicopters over competitors for a bribe of US $ 5 million. One of the issues that helped Augusta Westland to be in the competition for the deal was the changed requirement regarding the altitude criteria set for helicopters, due to which their firm was not making the to the final list. Haschke said the Air Force chief's family members, his two cousin brothers offered to get that requirement waived for money which eventually was done leading credence to the allegations that bribes have been paid. According to the investigation by Central Bureau of Investigation (CBI), the counter part of FBA, Haschke was paid US $ 27 million and Christian $ 40 million by the firm, a major part which was paid in bribes in India. The investigators said the family members of the Air Force chief were paid in cash, leaving no paper trail. Haschke did not admit the guilt, but under plea bargain agreed to serve 22 months of house arrest, which was to be converted to community service. Orsi was released after serving 80 days in jail. India eventually cancelled the deal after the charges were filed against Orsi. Augusta Westland on its part did not admit guilt in the court, but settled the case by agreeing to pay a $10.3 million in fines . However the court in Italy sent the CEO to jail in March 2016. (Magnier, 2013; Anand et.al. 2014, Sylvers & Roy, 2014)

**Chinese case**: Glaxo SmithKline(GSK): During 2012 China's State Administration for Industry and Commerce, a regulatory authority received a number of anonymous emails, against a multinational company , Glaxo SmithKline(GSK), operating in China that the firm indulged in massive corruption. Similar emails were received by the executives of the firm also during 2013. In March that year, one of the emails included a video showing its China division, Mark Reilly, having sex with his girlfriend in his apartment. An in-depth investigation by Chinese authorities revealed massive corruption. According to their report, GSK set up units to bribe doctors and officials, for inflating the prices of their medicines, some times as much as 7 to 8 times, in return for bribes. It is alleged GSK has paid bribes to the tune of US $ 490 million. GSK on its part hired a private British Corporate Investigator, Peter Humphrey, who happens to be the head investigating company located in Shanghai, China. He was also asked to investigate one of their employees, Vivian Shi, who was suspected of sending the emails, whose family has high political connections. He was arrested by Chinese authorities and his wife was also detained. GSK agreed with some of the charges and dismissed some its employees for wrong doing. Briton's Serious Fraud Office , a government body, announced launching of Criminal investigation in GSK. As a result of this the company lost US $ 2.2 billion dollars in market capitalization. (The Economist, 2014)

**Discussion and Findings:** FDI into a country is influenced by a number of economic factors like market size, the GDP and its growth, interest rates, inflation, policies, and ease of conducting business to name a few. FDI is also influenced by a number of other factors like political stability, infrastructure and legal framework. Another important parameter is ease of doing business. Corruption is also one of the important factors that many investors take into account as corruption increases the cost of doing business. For this discussion we are treating other factors as constant and trying to analyze the influence of corruption on the FDI inflows.

However the corruption India and China differs in many ways.

**India:** FDI inflows into India before 1990 were very insignificant, mostly due to investor unfriendly policies and poor economic climate. The economic reforms in India were initiated in the year 1991. However during the period 1991-1995 FDI inflows into India remained under US $ 1billion with no significant increase, in spite of economic reforms, mainly due to two reasons. First, the reforms initiated were too late and too little and outside investors were watching the seriousness of Indian government's commitment to reforms. Second the infamous Harshad Mehata stock market scam had a great negative impact on Indian stock markets and economy and did not generate any confidence in foreign investors.

Various investor friendly reforms and concerted efforts undertaken by the successive Indian governments to attract FDI and the growing GDP during the decade 1995 to 2005 have helped to create a favorable view of India as a viable destination for FDI, notwithstanding a few scams that have been reported. The period 2000 to 2008 has seen many pro-investor policies and an unprecedented GDP growth that resulted in a large middle class with increasing purchasing power. For the first time in independent India's history the GDP reached close to US $ 500 billion mark in 2001. FDI inflows started displaying a growing trend with inflows crossing US $ 5billion during 2000 and continued to grow till 2008, reaching an unprecedented US $ 42.55 billion. The most important factor during this period is that India has not witnessed any major corruption scam.

Between 2008 and 2009 the GDP grew by 7.4 percent to US $ 1224.1 billion. However 2009 has also witnessed one of the biggest corporate scams in India, to the tune of US $ 1.5 billion, involving the fourth largest IT firm at that time, 'Satyam Computers' listed on New York stock exchange and NASDAQ. The FDI inflows for the year 2009 decreased by 16.2 percent to US $ 35.65 billion. The

2G spectrum scam of 2010 was a mega scam of US $40 billion involving politicians, public servants and corporations. Though the GDP and other economic indicators were showing a growth trend, FDI inflows have decreased by 44 percent from the 2008 level.

In 2011 and 2012, notwithstanding a large growth in GDP, FDI has gone down by 45 percent and 42 percent respectively over 2008 levels, which can be attributed the major corruption scams Tatra truck scandal and Coalgate scam ( $ US 40 billion). This observation is supported by an article in China Post, which has reported that the corruption in India has resulted in a slump of FDI by 78% in June 2011 (The China Post, 2011). 2013 witnessed the Westland helicopter scandal.

The 2014 general elections in India resulted in change of the federal government with Bharatiya Janata Party winning an absolute majority for the first time in many decades. Most political analysts agree that corruption in government and high places played a decisive role in the rout of the Congress party led UPA coalition. 2014 witnessed an increase of 24 percent in FDI over the previous year to US $ 35 billion indicating support to the argument corruption indeed adversely affects FDI inflows. Bardhan (1997) is of the view that corruption in a country negatively affects its ability to attract FDI as it works as a tax on profits. Empirical evidence from studies of several researchers proves that corruption has a negative effect on several important determinants of FDI Investments (Castro and Nunes (2013). Indian experience support these views.

A study and simulation by Ketkar, Murtuza and Ketaker (2005) regarding the link between Corruption Perception Index (CPI) of Transparency International (TI) and the FDI in 22 developing countries found that one point improvement in CPI would result in average additional FDI of 0.5 %. According to Wei (1997) a well-known researcher in this area, a raise in the tax rate on multinational firms or increase in corruption levels in a host country reduce inward foreign direct investment (FDI)".. According to a study of data from 45 countries by Qian, Sandoval-Hernandez & Jarret (2012), 'corruption distance adversely influences both the likelihood of FDI and the Volume of FDI'. Such corruption scandals are forcing the potential investors to look for opportunities in other developing countries. While India has experienced a decrease in FDI in 2011, Brazil's FDI inflows increased by 16% and reached US $ 30.2 billion dollars (New York Times, 2011). Due to the spate of corruption scandals, by February 2011, FDI in India fell more than 31% compared to the previous year, at a time when overall FDI and FDI into developing countries increased. New York Times report says "analysts and executives say foreign executives have lately been spooked by highly publicized government corruption scandal over the awarding of wireless communication licenses" (Bajaj, 2011).

**China:** Corruption is a major problem for China too. Corruption in China is an unintended byproduct of the economic reforms initiated in the 1980s. At the time of implementing economic reforms and opening China to foreign direct investment, China did not have administrative structures as it did not have market economy. That necessitated using the existing administrative infrastructure for covering FDI too. China's culture of Guan Xi and acceptability of gift giving and receiving gifts, indirectly contributed to the increased corruption. The availability of skilled labor, ability to absorb modern technologies, young and dynamic workforce all made China an attractive destination for all manufacturing firms from America and Europe. However as the language, work culture, legal framework was totally different from capitalistic countries, the investors needed local partners to establish their business operations in China.

Another difficulty was as all firms in China before reforms belonged to the state, all businesses needed collaboration with state owned business. Handling such a situation needed local knowledge and expertise. This necessitated hiring or taking local partners for the contacts and Guan Xi. As Guan Xi is based on reciprocation, corruption has started becoming more and more predominant. Then the development work has been decentralized by the central leadership, with a view to facilitate speedy development. In fact provinces were made to compete with each other in development. Due to this decentralization local officials were given powers to approve many projects. Most of the approvals needed to be socially and politically correct. This in turn has led to the increase in corruption, due to the discretionary powers enjoyed by officials.

Initially FDI was approved for export oriented manufacturing investors. However after China joined WTO, the country opened their services sector to FDI. Apart from that the growing GDP has created a new and prosperous middle class, which has become a lucrative market for many multinationals. This can be seen in the number of multinational pharmaceutical firm's presence in China. Some of these firms have resorted to bribing to increase their sales/ profits. Statistics show that less than 3% were caught for corruption before 2012. Hence many people started believing that the cost of involving in corrupt activity is more profitable and less risky than not engaging in such activities. Many multinational companies on their part treated bribery as the additional costs of doing business and factored that into their revenue models. In spite of the corruption, the production costs were still much lower than their home countries and this made sense to enter China.

This explains as to why that FDI inflows increased in China during the last three decades, making it the number one country in 2014, attracting highest amount of FDI, beating traditional favorite, the United States of America. However, as the problem of corruption appears to be spiraling out of control and with serious consequences socially and from foreign investors. Recently many foreign investors have started debating their options of moving to other countries. Other countries are now actively rolling out incentives for foreign investors. All these factors have culminated with the President of China announcing his big fight against corruption going after 'tigers and flys'.

**Conclusion:** China and India are few countries with the dubious distinction of having increasing levels of corruption with each passing year since 1995, according to Transparency International's Corruption Perception Index. China like India has many laws to deal with corruption. China is also actively developing new legal frame work, for dealing with corruption. However in China too, the major problem is in implementation.

A number of studies have empirically proven that corruption in a country adversely affects the inward flows of FDI. Corruption adds to costs of conducting the business.A few scholars argue that corruption in a country may not affect the FDI inflows or have positive impact by facilitating faster transactions. This study finds that may not be the case. Each corruption scandal that came to light in India had an adverse effect on FDI inflows, the larger the scandal the higher the adverse nature of the impact.

One reason that China is able to attract FDI where as India is not as successful lies in the nature of corruption in these countries. While analyzing corruption and its effects on their business investment opportunities in a particular country, firms look at two related issues, first, pervasiveness of corruption and second, arbitrariness of corruption. In China though corruption is pervasive arbitrariness is low. Where as in India arbitrariness is very high and what it means is one is not guaranteed of the result even after paying bribes. That partially explains why India's corruption has a detrimental effect on FDI, whereas in China , it has the opposite effect.

**Scope for further research:** This study has not taken into account all other determinants of FDI for this study and concentrated totally only the effect of corruption on FDI in India. Future research can include more determinants and study their cumulative effect.

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