

**Can Indian Para-diplomacy Harvest FDI Gains from  
China's Loss in the post-Covid era?**

**Santosh Pai and  
Shubhi Bhandari**

© Institute of Chinese Studies, Delhi

Institute of Chinese Studies,  
B-371 (3rd floor), Chittaranjan Park,  
Kalkaji, New Delhi - 110 019  
Landline Telephone: +91-11-4056 4823 Fax: +91-11-23830728  
Email: [info@icsin.org](mailto:info@icsin.org)  
Website: [www.icsin.org](http://www.icsin.org)

## **ABOUT THE AUTHORS**

**Santosh Pai** is Treasurer and Honorary Fellow at ICS, Delhi. He is a partner at Link Legal, an Indian law firm. He has been offering legal services to clients in the India-China corridor since 2010. His areas of interest include Chinese investments in India, India-China comparative law and policy, cross-cultural negotiations and board governance. He holds a B.A., LL.B. (Hons.) degree from NLSIU, Bangalore, LL.M. (Chinese law) from Tsinghua University, Beijing and an MBA from Vlerick University, Belgium (Peking University campus). His manuscript, Practical Guide on Investing in India for Chinese Investors has been translated into Chinese and published by China Law Press. Mr. Santosh Pai is also a member of CII's Core Group on China, teaches two courses on India-China business at IIM Shillong and volunteers at NGOs in his free time.

**Contact:** [santoshkpai@gmail.com](mailto:santoshkpai@gmail.com)

**Shubhi Bhandari** is a registered legal practitioner based in New Delhi, India. A result-oriented professional who is skilled in research, content strategy, data management and legal documentation. An ethical team player and collaborator who is proficient in handling interpersonal situations with empathy and exhibiting high sensitivity and compassion in multi-ethnic environment. She has graduated in B.A. LL.B. (Hons.) from the premier National Law Institute University, Bhopal, India. Post-graduation, she has continued to further her passion in academic research and writing testified by various reputed national and international publications in her name. Beyond professional zeal, she is a trained classical dancer in esteemed forms of Kathak and Bharatanatyam.

**Contact:** [shubhibhandari.sb@gmail.com](mailto:shubhibhandari.sb@gmail.com)

*This paper was presented at the 13<sup>th</sup> All India Conference of China Studies, 2021*

## **Can Indian Para-diplomacy Harvest FDI Gains from China's Loss in the post-Covid era?**

### **Abstract**

There are vast dissimilarities between the design and performance of FDI policies in India and China. While China witnessed consistent growth in FDI inflows since 1978, a post-COVID19 downtrend is expected due to a desire for diversification in global value chains. India's FDI inflows have been more volatile and it is seeking to capitalize on China's demotion on the back of some bold initiatives. This makes a dissection of China's FDI experience instructive from an Indian perspective. This paper presents an overview of prevailing FDI policies in India and China including regional disparities within each country. It then examines individual strategies pursued by local governments in China to determine their suitability for adoption in India after accounting for differences in political and legal systems. The primary focus is on distilling techniques that will not only increase India's weightage in global value chains but also enhance domestic spillovers from FDI to aid growth of domestic manufacturing sector. The results can be instrumental in introducing much needed nuance into India's para-diplomacy efforts. Differentiated strategies employed by State governments at the industry and enterprise levels are likely to extract better results than overlapping efforts with a similar toolkit aimed at a common audience.

### **Keywords**

India, China, foreign direct investment, para-diplomacy, incentives, local governments, domestic spillovers, global value chains

## **Introduction**

The Covid-19 pandemic and the US-China trade war are widely expected to dent China's position as the world's manufacturing powerhouse. As global value chains seek to diversify away from China, India is hoping to position itself as an alternative manufacturing destination and unleash a wave of economic growth. Regardless of the fundamental differences in political systems between India and China, commercial logic dictates that a comparison between the FDI environment in the two countries among global investors is inevitable. This paper describes certain failings of India's FDI policy and embarks on a deeper examination of China's FDI experience through the prism of these failings. It ends by arguing for India to adopt a more nuanced approach towards FDI to enhance its attractiveness in the post-Covid era.

## **India's FDI failings**

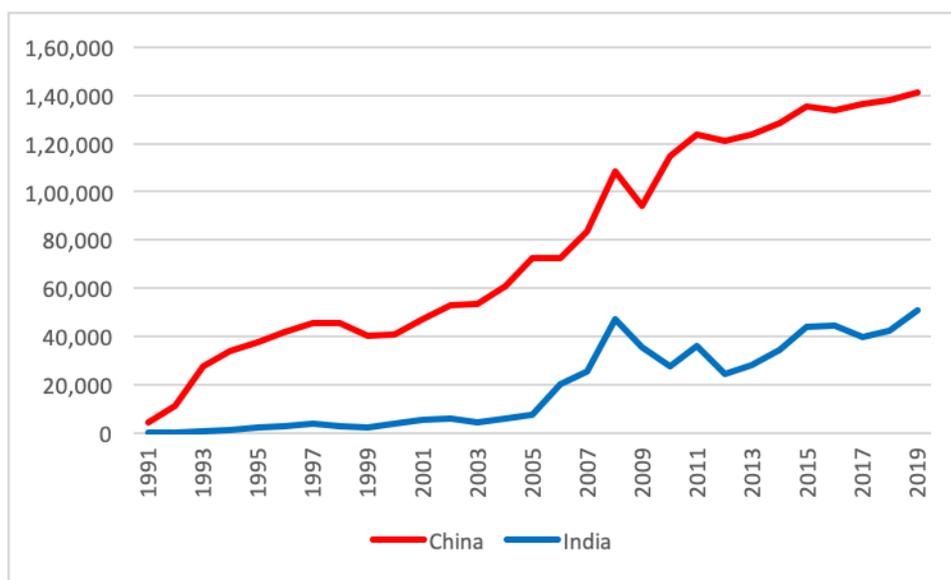
Within a period of five years from 2014 to 2019, India improved its ranking by 79 positions from 142<sup>nd</sup> to 63<sup>rd</sup> in the World Bank's flagship "Doing Business" index. This catapulted India into the list of top 10 performers for the third time in a row (World Bank, 2020). The most recent FDI policy prohibits FDI only in eight sectors (Consolidated FDI Policy, October 2020). These facts indicate the presence of an open and progressive FDI regime that should whet the appetite of any potential investor. Yet when one casts a closer look at India's FDI statistics a totally different picture emerges. First is the relatively limited quantum of FDI inflows that India has managed to attract. For instance, India only managed to attract US\$ 49 billion dollars of FDI in 2019 despite a 16% increase from 2018 compared with US\$ 75 billion received by Brazil, a fellow BRICS member and developing country with less than one-fifth of India's population (UNCTAD, 2020). Secondly, India has not been able to direct FDI and distribute its consequent benefits using policy measures evenly across its geographical territory. Foreign

investments are highly concentrated in a few geographies even today. Out of 28 States and 8 Union territories in India, a staggering 96.47% of the FDI inflows in the last five years were received by only six zones of Mumbai, New Delhi, Bangalore, Chennai, Ahmedabad, and Hyderabad (Ministry of Commerce, 2020). Lastly, India has not been able to leverage FDI across a wide range of sectors to generate jobs and absorb technology. There is a heavy tilt away from manufacturing. In the last twenty years from 2000 to 2019, the services sector, computer software and hardware, trading and real estate sectors collectively accounted for almost 40% of FDI (Ministry of Commerce, 2020). Given these facts, an overhaul of India's FDI framework should target – sustained growth in quantum of inflows, better distribution across the country and a greater thrust on manufacturing sector. The next section examines China's FDI experience using these yardsticks.

### **China's FDI experience**

China's experience in attracting FDI is acknowledged to be effective notwithstanding concerns over neglect of labour and environmental standards. It has experimented with a wide range of strategies that have together managed to - maintain consistent growth in quantum over three decades, achieve relatively better geographical and sectoral spread than India, and most importantly help make China a global manufacturing powerhouse. The chart (**Chart 1**) below depicts annual flows of FDI into India and China from 1991 to 2019.

**Chart 1: Annual FDI Inflows: India and China (1991-2019) in US\$ Million (UNCTAD)**



Source: UNCTAD

### ***Import substitution***

In Mao's China, self-reliance through import substitution industrialization was an overarching objective of China's economic policies for almost three decades from early 1950s to mid-1970s. During this period, foreign trade was restricted, and heavy reliance was placed on import substitution. Exports were merely carried out to compensate for imports. Under this model, the Central government provided subsidies and protection for capital-intensive and technology-intensive industries such as steel, chemistry, electronics, and machinery. Instead of directly importing these goods from developed countries, state-owned firms manufactured these goods by relying on imports of machinery and technology from abroad, mainly the Soviet Union (Pecht, 2007, as cited in Ling Chen, 2018). It is evident that an FDI strategy motivated purely by self-reliance has little chance of success. China's misadventure with import substitution should serve as ample warning to forces within India that seek to place excessive reliance on the recently unveiled Atmanirbhar Mission campaign.

When Deng articulated his ‘four modernisations’, FDI was recognised as an effective way to acquire advanced technology and equipment from foreign countries quickly and with minimal cost. FDI was also a means of better utilising China’s resources in the absence of domestic capital, and of providing valuable experience of modern economic management skills. It is clear the Chinese leadership was politically sincere in its desire to attract FDI, even though such investment also risked bringing capitalist influence into China. (Chen, 2018). China’s efforts to attract foreign direct investment started in earnest with the introduction of the ‘Open Door Policy’ in 1978. There was a dramatic shift in policy from a closed economy that had been dominated by central planning to one that sought to boost domestic economic development by attracting foreign investment. It was accompanied by a political strategy to counter conservatives opposed to economic reforms by launching gradual changes in a handful of places as laboratories for larger changes (Naughton 1995; Shirk 1993 as cited in Ling Chen, 2018).

### ***Exclusive legal regime for foreign investors***

As China implemented a slew of measures to modernize the economy through promotion of foreign trade, providing capital for new technology, encouraging development of managerial skills and introduction of new business practices it also set up an exclusive legal framework for foreign investors. Although the main draw was a combination of low labour costs, access to domestic and foreign markets, and favourable investment incentives, a simplified corporate law framework exempted foreign investors from the vagaries of the mainstream legal system. The Sino-Foreign Equity Joint Venture law was the first law for foreign-invested enterprises to be implemented in 1979. It signalled the first steps of a move away from a planned economy to a free, market-oriented one. The law comprised of a basic framework of principles with only 15 articles (Gao, 2017). The EJV law was followed by two other regulations for foreign investors – Wholly Foreign Owned Enterprise Law (1986) and Contractual Joint Venture Law (1988). Both laws were largely structured on the EJV, but with unique features to regulate new models of foreign investments. WFOE law was aimed at regulating enterprises established exclusively with foreign capital and they were required to be involved in advanced technology and machinery and export majority of their produce. The CJV law on the other hand was initially a special regulation directed to encourage investments from overseas Chinese. It regulated enterprises where foreign and Chinese partners engaged in a venture with a term limit as

decided upon through contracts. The differentiating point of the CJV law was the flexibility it provided for partners to decide on several terms of engagement. Initially it was the only law that allowed investors to freely negotiate the representation of their board based on their own criteria, and established a time-limited, unified verification process. Another advantage was that partners could contractually determine the proportion in which the profits and losses would be shared, and this could vary in proportion to their capital contributions (Yu, 2019).

The Indian corporate law regime has never offered the facility of incorporated entities tailored for use by foreign investors. Only unincorporated forms such as representative, liaison and project offices exist for foreign investors who seek a limited business presence in India. It is pertinent to note that preferential treatment to foreign investors is forbidden under the Indian Constitution and the justiciable principle of national treatment ensures equality to legal entities established in India irrespective of their ownership. Therefore, India has never been able to extend statutory preferential treatment to foreign investors thus losing out on an invaluable tool to attract FDI that China leveraged for several decades.

### ***Special Economic Zones***

Special economic zones (SEZs) were an important conduit for FDI in China. Although China did not pioneer this legal fiction of creating zones where companies were exempt from regular domestic laws it leveraged this strategy effectively to distribute the benefits of FDI across its eastern seaboard. In these demarcated administrative zones, foreign investors could enjoy preferential financial, investment and trade privileges. The first four special economic zones (SEZs) were established in Shenzhen, Zhuhai, Xiamen and Shantou (in Guangdong and Fujian provinces) in 1980. During the period 1984–91, more locations were added such as Hainan Island and 14 coastal cities across 10 provinces in 1984. The Yangtze River Delta, the Pearl River Delta and the Min Nan Delta were opened to FDI in 1985 followed by the Shanghai Pudong New Development Zone and the entire coastal area in 1988 (Liu, 1993). Smaller versions of these early SEZs called as Economic and Technological Development Zones (ETDZs) were created and by 1992 there were about 49 ETDZs. The SEZs and ETDZs with its policies of inexpensive land, tax holidays, rapid customs clearance, tax exemption on imported

raw material and exported finished products, relaxed political interventions, among other such policies, became central to attracting FDI. By 2007, the initial five SEZs had an actual utilised FDI value of US\$7.3 billion, while ETDZs accounted for about US\$17.3 billion (Zeng, 2012).

India introduced a formal framework for establishment of Special Economic Zones in 2006 and has accorded approvals for the establishment of 426 SEZs until date. Out of these only 262 are operational and 142 of these cater to the Information Technology services (IT/ITES) sector. SEZs are home to 5,537 units and occupy a total of 47,584.5 hectares. They have received around INR 5,95,1192.7 million in cumulative investments and employ 22,33,918 persons. In 2018-19, they generated around 35 per cent of total Indian exports (Ministry of Commerce, 2020). Given these statistics, it is possible to argue that there is plenty of scope to improve India's SEZ policy beyond offering current incentives such as 100 per cent income tax exemption for 5 years, duty-free imports for inputs, etc.

### ***Promoting Joint Ventures***

Apart from geographical distribution, China has also experimented with a variety of strategies to attract FDI in specific sectors and from distinct categories of investors. These strategies have been subjected to constant refinement to meet changes in national priorities. The first among such strategies was aimed at promoting joint ventures with domestic companies. Post 1978, the idea of employing market access as a bargaining chip in exchange for advanced technology from foreign sources gradually rose to the top of the China's national economic policy. The China Joint Venture Law stipulated that the technology and machinery should be advanced and appropriate to China's needs (Pearson, 1959). It also contained a warning to foreign investors that they will be required to compensate their Chinese joint venture partner if it was discovered that they had injected outdated technology or machinery into their joint ventures (National People's Congress 1979; State Council 1986). This paved the way for a recurring financial notion of trading market access for technology in two ways - first, foreign investors were willing to pay for the cost of entrance by transferring part of their advanced technology and second, the Chinese side could gain bargaining leverage over foreign investors by approving their entrance to the domestic market. Interestingly, the former method was marked by controlling FDI entrance and forming strategic joint ventures (JVs) only in select industries. Although intended to be modeled after Japan, South Korea, and Taiwan, the selective JV strategy that relied on foreign capital for transfer of technology turned out to be significantly

different from the developmental states, and relied on reverse engineering and self-learning for technological catch-up (Kim, 1997 and Leng, 2005, as cited in Ling Chen, 2018). The State injected capital into forming a few select joint ventures in key industry segments such as the cathode ray tube (CRT) and integrated circuits (IC) and aspired to create national champions like the chaebols in Korea (Huchet, 1997 as cited in Ling Chen, 2018).

However, cultural differences and conflicts in enterprise management blocked the way for modern technology infusion as envisaged by the national government. Incentives were insufficient on both the supply and demand sides. On the supply side, once a joint venture was created, it immediately became part of the foreign multinational's global outsourcing strategy (Tao, 2006 as cited in Ling Chen, 2018). On the demand side, the R&D division of the joint venture became a rubber stamp wherein Chinese employees were discouraged from carrying out independent R&D, which would both run counter to the global strategy of the foreign multinational and increase likelihood of direct competition. For example, in both SEG Samsung and SEG-Hitachi, R&D staff from the China side predicted the change of technology and proposed conducting independent research that went beyond the CRT technology (Motohashi, 2015).

Since India largely equated FDI reform to liberalisation of sectoral limits there has never been an incentive for foreign investors to consciously partner with domestic companies. Unlike China, India has never had a statutory framework to govern relationships between foreign investors and their domestic partners. To the contrary, transplanting corporate governance provisions from the US and UK might have led to further incongruity with the traditional business systems and practices that are replete in India (Varottil, 2009). Such inadequacy of corporate governance norms might have deterred foreign investors from seeking joint ventures.

### ***Decentralisation***

Following the lackluster performance of the Centre-led strategy of introducing advanced technology through joint ventures, local governments were given more powers to attract FDI. At the national conferences of ETDZs held at Tianjin in 1987 and Shanghai in 1989, bold

policy initiatives were announced that delegated powers of approving foreign investment proposal to local governments. As a result, by the early 1990s, the Central government had loosened control on both the number of foreign invested enterprises (FIEs) that sought to enter China and the number of localities that sought to attract FDI. Internationally, it was during the same period that the antenna of global production networks in specific industries of automobile, electronics, and information technology (IT) began to reach into developing countries in a systematic way, not only for gaining access to the domestic market but also for taking advantage of low-cost labor. In some cities, the local city governments first offered tax reductions and exemptions to enterprises. After the enterprises were established, local governments then charged post hoc levies and fees and turn them into extra budgetary revenue (Fu 2000: 174–180). Therefore, local governments in effect increased locally retained funds and local revenue bases at the cost of the revenue to the center.

In India, the ability of State governments to incentivise FDI is limited due to the distribution of legislative powers under the Constitution. A survey of State-level industrial policies in the most prominent FDI destinations within India reveals that there is much too little to differentiate between the tax incentives offered by various States. The thresholds for determining eligibility of foreign investors to qualify for customised incentives reserved for large scale investment projects are also similar. Scale of investment projects described in terms of proposed fixed capital investment either independently or in conjunction with direct employment generation to categorise investment projects as ‘mega’ projects ‘see Table 1’ when offering incentives. Certain States such as Maharashtra and Tamil Nadu also categorize their districts into different zones depending on their level of industrialization and have distinct criteria for each zone.

**Table – 1: Criteria for mega projects in Six Indian States**

States and Zones	Fixed Capital Investment (in INR million)	And / Or	Minimum Employment (persons)	Direct (no. of)
Maharashtra				
Zones A and B	15000	Or	2,000	

Zone C	10000	Or	1,500
Zone D	7500	Or	1000
D+	5000	Or	750
E	3500	Or	500
F	2000	Or	350
Telangana	2000	Or	1000
Karnataka	2500		N.A
Gujarat			
Focus Sectors	10000	And	2000
Core Infrastructure	20000		
Andhra Pradesh	N.A		2000
Tamil Nadu			
Zone A	500		N.A
Zone B	350		N.A
Zone C	200		N.A

### ***Sector-focused FDI***

China also experimented with sector focused efforts at attracting FDI. The Sunan Model which centered around the electronics industry in the Southern Jiangsu area (Suzhou, along with Wuxi and Changzhou) is a good illustration of this approach. During the 1970s and 1980s, leading consumer appliance companies regarded as ‘*four little giants - Xiang Xuehai, Great Wall, Peacock, and Chunhua*’ started as collective enterprises in Suzhou (Suzhou Gazetteer Committee, 1995 as cited in Ling Chen, 2018). In a direct approach, Suzhou officials sought to gain technology for local enterprises either through the purchase of machinery and technology

licenses or through the formation of joint-venture enterprises with or by subcontracting production from Shanghai SOEs. Indirectly, Suzhou was able to attract military electronics firms and their technicians through a Shanghai–Inland–Suzhou pattern. In the 1970s, a ‘*Third Front*’ strategy was developed by Mao Zedong under which many Shanghai technicians and engineers were sent to develop military industries during the Cultural Revolution in the hinterland, such as Sichuan, Guizhou, Jiangsi, and Shaanxi. These local talents were looking forward to returning to Shanghai in the 1980s, but their requests were often rejected due to the limits of the Hukou system. Local officials in Suzhou made many trips to the hinterland and played a crucial role in attracting these Third Front enterprises to relocate to Suzhou (Zhong and Zhang, 2009; Xia and Xuan, 2000, as cited in Ling Chen, 2018). With the confluence of these three approaches focused on a single industry, the flow of talented people to Suzhou not only contributed to local human resources but also brought along electronics industries and technologies as firms transformed from military to civilian electronics enterprises.

The city of Kunshan, also in Jiangsu province, implemented another unique FDI infusion method that led to FIEs becoming major development allies of local governments to rescue township and village enterprises (TVE) who were struggling with losses due to mismanagement. When the four consumer electronics giants mentioned above started registering losses, FIEs were allowed to rescue them by forming joint ventures rather than the conventional exchange of technology for market access. A precondition for these joint ventures was that the domestic firms had to abandon their original brands and produce exclusively under foreign brands. At the same time, most of the small and medium-sized enterprises that had links with SOEs were privatized and conservative leaders such as Li Peng and Yao Yilin prevented them from establishing linkages or competing with SOEs (Zweig, 2002; Huang 2008, as cited in Ling Chen, 2018). Ironically, this conservative backlash pushed local governments in the same direction as the decision to open Pudong District and Deng’s southern tour in 1992. Whereas the former constrained the development of local enterprises, the latter encouraged China’s opening up to coastal cities. It was during these political and economic changes that local governments in Sunan started to shift their preference for development partners from TVEs to FIEs. This also gave Kunshan a headstart in attracting FIEs within Jiangsu.

Sector-focussed efforts in India have had little success with the notable exception of the phased-manufacturing program (PMP) employed in the mobile phone industry that managed to draw investments from Samsung, Xiaomi, Vivo and Oppo by progressively increasing customs duty for components. In the absence of any national policy that identifies or allocates priority sectors among States, each State is free to choose certain sectors as *thrust sectors* ‘see Table 2’. This has resulted in a lot of overlapping priorities between States and is also a source of confusion among investors looking to identify an investment destination. Among the six States covered in this paper, given below is a list of sectors that are identified as thrust sectors by two or more States.

**Table - 2: Overlapping Thrust Sectors in Six Indian States**

Thrust Sectors	States
Electric Vehicles	Maharashtra and Gujarat
Aerospace and defence	Maharashtra, Tamil Nadu (only aerospace), Telangana and Andhra Pradesh
Industry 4.0	Maharashtra, Karnataka and Gujarat.
Textiles	Andhra Pradesh, Maharashtra, Gujarat and Telangana.
Pharmaceuticals, Biotechnology and Medical and Diagnostic Devices	Telangana, Maharashtra, Gujarat, Tamil Nadu and Andhra Pradesh.
Agro & Food Processing	Maharashtra, Andhra Pradesh, Telangana, Gujarat and Maharashtra.
Green Energy	Maharashtra, Telangana and Gujarat.
Mineral based industries	Telangana, Maharashtra and Andhra Pradesh.
Research & Development	Telangana and Karnataka.
Automobiles and components	Tamil Nadu, Telangana, Gujarat and Andhra Pradesh

Chemicals and petrochemicals	Andhra Pradesh (petrochemicals), Telangana and Gujarat (chemicals).
Ceramics	Gujarat and Telangana.
Gems and Jewellery	Gujarat and Telangana
Renewable Energy	Telangana and Tamil Nadu
Logistics	Maharashtra and Telangana
Electronics	Andhra Pradesh and Telangana

As a result of such overlap, even when a potential foreign investor decides to locate its manufacturing unit in India there is a long gestation period during which it has to engage with multiple State governments often in direct competition with each other to obtain the best possible package of incentives.

### ***Role of bureaucrats***

The ability to align career prospects of bureaucrats with State interests is one of the hallmarks of China's cadre-based administration and the goal of attracting FDI was no exception. In Jiangsu province, a major manufacturing base located in the Yangtze River Delta near Shanghai, seeking FDI was clearly embraced as the most rapid and efficient strategy to boost economic indicators. The method used for score calculation in Jiangsu's cadre evaluation system illustrates the intensity of competition. The score that city-level officials receive in cadre evaluation for a policy target is calculated as:  $40 \sim (X_i - \min(X)) / (\max(X_i) - \min(X)) + 60$ . In the said formula,  $X_i$  is the actual value achieved for the policy goal, and  $\max(X_i)$  and  $\min(X)$  represent, respectively, the highest value and the lowest value of the indicators produced among all localities in Jiangsu. The higher the value that a city achieved relative to other localities, the higher the score that city bureaucrats would receive (Ling Chen, 2018). Undisputedly, large top ranked MNCs stood out as the most favorable business allies for officials during the early 1990s. From the perspective of local Chinese bureaucrats, the essence of winning the political competition was not only realizing certain policy targets but also excelling at achieving them by accomplishing more at a faster rate than their peers in other cities. The system instilled strong downward pressure from higher-level bureaucrats on lower-

level bureaucrats within their jurisdiction to increase performance against indicators. At the same time, the institution also created upward pressure for lower-level bureaucrats to win over their peers for tenure and promotion. (Ling Chen, 2018). Large MNCs were chosen by local bureaucrats as developmental allies because they provided a shortcut for achieving political ambitions and building up economic and technology indicators, at a speed incomparable with small FIEs. Technology giants such as Samsung, Fujitsu, Foxconn, Compal, Intel, LG, Sharp, Philips, and Panasonic were simultaneously the major contributors to GDP, FDI, fiscal revenue, high-tech industrial output, and high-tech exports—all indicators that occupied the top position in the cadre evaluation system. These firms were regarded as the ‘*dragon’s head enterprises*’ that performed a particularly crucial role in achieving rapid industrialization and economic development. Increasingly, the strategy of attracting large MNCs became the target for local competition and ossified into a stable policy preference.

When many Jiangsu cities managed to attract some of the world’s most successful consumer electronic firms there was a shift in FDI strategy that caused such dragon head enterprises to drive the development of local firms as midstream and downstream suppliers. Incentives were offered to FIEs to progressively localize larger segments of their production. Local officials also realized the advantages of group offshoring and started focusing their efforts on attracting entire value chains rather than a single large firm terming this pattern as *when one flies in, the entire flock flies in* (Zhang, 1997).

### ***Courting FDI from SMEs***

It was not just the large investors that were courted by China. In sharp contrast with the Jiangsu cadres described above, Guangdong bureaucrats adapted central policies and invented the institution of informal contracting to attract FDI when they employed competed for FDI. Guangdong officials leveraged their proximity to Hong Kong and Taiwan and focused their efforts on attracting risk-taking guerilla investors. Such investors often chose to work with government agencies and local enterprises through informal arrangements for resource and profit sharing. The officials chose to focus on the long-term development of domestic enterprises rather than indicators for political achievement. In fact, they even resorted to concealing foreign investment and under reporting investment levels. Unlike their Jiangsu

counterparts who concentrated on projects that were '*high, large, and new*' they focused on projects that were '*short, small, and quick*'. The Guangdong cadres consider the latter to be invaluable for local development. In this manner, the electronics industry in the Pearl River Delta took shape with assembling firms at the bottom of the value chain set up by guerilla investors. Throughout the 1990s, Guangdong companies were often denounced as sweatshops in comparison with their Jiangsu counterparts which were higher-end multinationals. However, after local entrepreneurs and managers gained initial hands-on manufacturing experience in meeting production standards, an increasing number of foreign investors began to feel confident in subcontracting complete orders to domestic producers without intervening in the daily management of production. This change provided Chinese entrepreneurs coming from both within and outside of the region the opportunities to develop the capabilities of managing orders independently and adapting to multiple customers. They became the first group of entrepreneurs to establish indigenous electronics firms (Zeng, 2004 as cited in Ling Chen, 2018).

In sharp contrast to the Jiangsu experience where domestic firms were sacrificed to make space for multinationals, firms in the Shenzhen region began to benefit from informal sub-contracting arrangements with SOEs and multinationals which were licensed by the government to produce specific products. In addition, they also established their independent sales channels both in China and abroad. Due to their agility and cost competitiveness, the domestic firms progressed from producers of individual components to OEM producers for the multinationals. These arrangements were termed '*informal*' because the license holders were prohibited from outsourcing their manufacturing activities and it was only because the government officials turned a blind eye that such arrangements could proliferate. Eventually products sold under such relationships carried the logos of both the licensed firm and their sub-contractor allowing the latter to gain brand recognition.

India has a robust scheme to promote medium, small and micro enterprises within domestic industry. However, when it comes to FDI it is hard to discern any such concerted efforts. FDI projects which fail to qualify as 'mega' projects seldom receive any attention from State agencies.

## ***Absorbing technology through FDI***

Towards the late 1980s, when absorption of technology from foreign investors did not yield expected results, Chinese policy makers started emphasizing on independent technological catch-up. The 15-Year Science and Technology Development Plan drafted in 1982 had specifically mentioned that the major technologies needed for national economic development should be primarily based upon introduction of advanced technology from abroad and should move away from the full process of independent R&D<sup>1</sup>.

During the first half of the 1990s, the SSTC, together with the State Council, drafted and issued several rounds of five-year and ten-year science and technology plans. Although these plans did not directly criticize the strategy of exchanging market access for technology, they pushed for the establishment of a vibrant national system that would be conducive to technology innovation and S&T progress. The plans highlighted the importance of conducting '*independent research in addition to introducing technology from foreign countries*'. The decision to develop and aid non-governmental technology enterprises through enterprise incubators was also made during this period (Segal, 2003 as cited in Ling Chen, 2018).

From 1998 onwards, the Ministry of Science and Technology (MOST) in collaboration with several academic institutions, carried out a wide range of in-depth studies on key industries such as electronics and IT, automobiles, telecommunications, and aviation. These studies revealed that after two decades after opening doors to foreign investors, domestic enterprises in most of the key sectors still lacked independent capacity for developing new products and the incentives to conduct R&D. Hence, the concept of indigenous innovation was formally incepted in the public sphere in the mid-2000s (Liu, 2011).

In theory, the word '*indigenous*' shows a strong reaction against the FDI fascination associated with the strategy of exchanging market for technology. The reasons behind Chinese domestic self-reliance was that this process failed to provide expected and adequate learning and innovation capacities. Furthermore, dependence on foreign firms was viewed as a source of

---

<sup>1</sup> State Planning Commission and State Science and Technology Commission of the Republic of China: 1982.

technology often reduced or eliminated the desire among domestic firms to innovate. As a result, domestic firms often fell into the vicious circle of lag–import technology–lag again–import again (Wen and Hua 2006).

In May 2001, the State Development and Planning Commission (SDPC) and the MOST jointly published the Tenth Five-Year Plan of Science and Technology Development. The plan adopted the term indigenous innovation for the first time and pointed out that one of the major overall goals for the next five years was to dramatically raise the country’s overall level of science and technology and the capacity of indigenous innovation. The central strategy in realizing such major goals was to accelerate the pace of industrial upgrading and continuous technology innovation in several key high-tech industries that were of vital importance to the national economy, including electronics, optoelectronics, IT, biotechnology, aerospace, and new materials industries. The long-term goal was to build a national innovation system in which enterprises were the major agents for innovation, supported by institutions that brought together industry, university, and basic research.

India’s FDI policy, both at the Centre and State levels, clearly prioritizes scale of investment and employment generation over technology absorption. In fact, it is difficult to pinpoint what the Indian government considers to be high technology in the absence of sector-specific policy formulations aimed at foreign investors.

## **Conclusion**

India has not been able to realize its potential as an FDI destination over the last three decades despite successive liberalisation of sectoral caps and projecting the attractiveness of its domestic market. A more nuanced FDI policy is required to attract global value chains and investors looking for alternatives to China. This paper has described several FDI strategies employed by China with varying degrees of success. Except for one or two of them like incentivising bureaucrats or issuing exclusive licenses, it is possible for India to replicate or adapt the remaining strategies.

More specifically, the following objectives might be worth emulating:

- a) A comprehensive national FDI policy that reduces overlaps between industrial policies of States and provides clarity about national priorities to foreign investors may be formulated;
- b) Additional parameters to judge the benefits of FDI and distribute incentives such as nature of technology employed, gaps in supply chains addressed, export potential, ability to reduce import dependence, whether it involves re-location or diversification from China, etc. may be embedded in national and State level policies;
- c) A government led SEZ policy that establishes and promotes specific locations for manufacturing units in relevant sectors can be considered to replace the present voluntary registration system for SEZs;
- d) SME-focussed incentives to draw niche players in industries that do not require economies of scale may be considered; and
- e) A robust technology policy that complements the FDI policy to incentivise absorption of technology and localise research and development as spill overs of FDI may be considered.

In addition to the above, India also needs to undertake periodic surveys or consultations amongst existing foreign investors to obtain a better understanding of bottlenecks that prevent them from achieving profitability or realizing their expansion goals. Pain points such as land acquisition, availability of human resources and complex tax laws can be alleviated through constant reform.

India also needs to undertake damage control to re-assert its position as a viable FDI destination. The recent decision of the Indian government to stay away from the Regional Comprehensive Economic Partnership (RCEP) has dampened interest among potential foreign investors which were looking at India as a manufacturing destination for global exports. The fact that more than 50% of the US\$ 36 billion in FDI that India managed to attract from April-August 2020 was cornered by a single business group also raises concerns about the politics-business nexus in India that might work against foreign investors.

In 2020, India has launched several laudable policy initiatives such as the Aatmanirbhar Mission, production linked incentives and export preparedness index which can be described as Make in India 2.0. Indeed, these are positive steps in the right direction. However, the overall impression that a potential foreign investor gets of India as an FDI destination is still

predominantly one of confusion. A simple question such as ‘*which is the best location in India to manufacture product X?*’ is bewilderingly complex to answer. It is indeed ironic albeit logical that India needs to learn from China’s own experience to capitalize on the window of opportunity presented by the global anti-China backlash in the post-Covid era.

## References

Chen, Chunlai. 2018. The liberalisation of FDI policies and the impacts of FDI on China’s economic development in China’s 40 Years of Reform and Development, 595-617, 2018.

Chen, Ling. 2018. *Manipulating Globalisation*, Stanford University Press.

Das. *Foreign Direct Investment in China: Its Impact on the Neighboring Asian Economies*, *Asian Business & Management*, 2007, 6, (285–301).

Defraigne, Jean-Christophe. ‘*The prospects of Chinese firms in an opening economy: Breaking away from the “flying geese” pattern or turning into another case of East Asian ersatz capitalism?*’, *Belgeo* [Online], 3 | 2005, Online since 28 October 2013, connection on 22 May 2020.

FDOFu, Jun. 2000. *Institutions and Investments: Foreign Direct Investment in China during an Era of Reforms*. Ann Arbor: University of Michigan Press.

*Foreign direct investment under socialism*. New Jersey: Princeton University Press.

Huchet, Jean Francois. 1997. *The China Circle and Technological Development in the Chinese Electronics Industry*. In *The China Circle: Economics and Electronics in the PRC, Taiwan, and Hong Kong*, (ed.) by Barry Naughton. Washington, DC: Brookings Institution Press.

Kim, Linsu. 1997. *Imitation to Innovation: The Dynamics of Korea’s Technological Learning*. Boston: Harvard Business School Press.

Liu, Feng-chao, Denis Fred Simon, Yu-tao Sun, and Cong Cao. 2011. *China’s Innovation Policies: Evolution, Institutional Structure, and Trajectory*. *Research Policy* 40(7): 917–931.

Motohashi, Kazuyuki. 2015. *Global Business Strategy: Multinational Corporations Venturing into Emerging Markets*. Springer Open. ISBN 978-4-431-55468-4 (eBook).

Naughton, Barry. 1995. *Growing out of Plan: Chinese Economic Reform, 1978–1993*. New York: Cambridge University Press.

Pearson, Margaret M. 1959, *Joint ventures in the People’s Republic of China : the control of*

Pecht, Michael. 2007. *China's Electronics Industry*. Norwich, NY: William Andrew Publishing.

Segal, Adam. 2003. *Digital Dragon: High-Technology Enterprises in China*. Ithaca, NY: Cornell University Press.

Tao, Yi-Feng. 2006. *A Catch-up Strategy? China's Policy towards Foreign Investment*. In *Japan and China in the World Political Economy*, (ed.) Saadia Pekkanen and Kellee Tsai. New York: Routledge.

Varottil, Umakanth, A cautionary tale of the transplant effect on Indian corporate governance, Volume 21, NLSIU Review, 2009.

Wen, Xin, and Xuan Hua. 2006. *Yinjin luohou zai yinjin: hushi chuanguang de houguo zhengzai xianxian*. Dangjian wenhui yuekan 1: 24–24.

Xinhua Ribao, September 24. Zeng, Fankui. 2004. *Shenzhen dianzi gongye fazhan lishi huigu*

Zhang, Gongpu. 1997. *Kuobu mai xiang xinshiji: laizi kunshan jingji jishu kaifaqu de baogao*

Zhong, Yongyi, and Shucheng Zhang, ed. 2009. *Jiangzheng zhongguo di yige zifei kaifaqu* Nanjing: Jiangsu renmin chubanshe.

Zweig, David. 2002. *Internationalizing China: Domestic Interests and Global Linkages*. Ithaca, NY: Cornell University Press.

### **ICS OCCASIONAL PAPER *Back Issues***

ICS Occasional Papers showcase ongoing research of ICS faculty and associates on aspects of Chinese and East Asian politics, international relations, economy, society, history and culture.

<b>Issue No/Month</b>	<b>Title</b>	<b>Author</b>
No.68  Mar 2021	Reigning in the Brahmaputra: Challenges to and Opportunities of Inter-basin Cooperation	Yash Johri Shivi Sanyam Rahul Suryavanshi
No.67  Feb 2021	India's Role in the Indo-Pacific Region in the post-COVID 19 World Order	Ananya Raj Kakoti
No.66  Jan 2021	Recent Initiatives to Promote China Studies in India: A Preliminary Report and Assessment	Madhavi Thampi
No.65  Jan 2021	Fledgling Sub-Regionalism in Eastern South Asia: Reasons for China's Shift Towards Bilateralism in BCIM	Mahendra P Lama
No.64  December	Nation Branding and Public Diplomacy: India and China Compared	Md Yasin



## PRINCIPAL SUPPORTERS TO ICS RESEARCH FUND

### TATA TRUSTS



MINISTRY OF EXTERNAL AFFAIRS  
GOVERNMENT OF INDIA



INDIAN COUNCIL OF  
SOCIAL SCIENCE RESEARCH

GARGI AND VIDYA  
PRAKASH DUTT FOUNDATION



JAMNALAL BAJAJ  
FOUNDATION

PIROJSHA GODREJ FOUNDATION

## ICS PUBLICATIONS



A short brief on a topic of contemporary interest with policy-related inputs



Platform for ongoing research of the ICS faculty and associates



Authored by the faculty, also emerging from research projects and international conferences



Draft paper of ongoing research

## ICS JOURNAL



In its 57th year, *China Report* is a refereed journal in the field of social sciences and international relations. It welcomes and offers a platform for original research from a multi-disciplinary perspective, in new and emerging areas, by scholars and research students. It seeks to promote analysis and vigorous debate on all aspects of Sino-Indian relations, India-China comparative studies and multilateral and bilateral initiatives and collaborations across Asia.

*China Report* is brought out by Sage Publications Ltd, New Delhi.

Editor  
Associate Editor  
Assistant Editor  
Book Review Editor

Sreemati Chakrabarti  
G. Balachandirane  
Rityusha Mani Tiwari  
Vijay K Nambiar



**INSTITUTE OF CHINESE STUDIES**  
B-371 (3rd floor), Chittaranjan Park,  
Kalkaji, New Delhi - 110 019  
Landline Telephone: +91-11-4056 4823

<http://www.icsin.org/>

[info@icsin.org](mailto:info@icsin.org)



[twitter.com/ics\\_delhi](https://twitter.com/ics_delhi)



[facebook.com/icsin.delhi](https://facebook.com/icsin.delhi)



[ln.linkedin.com/lcsdelhi](https://in.linkedin.com/lcsdelhi)



[soundcloud.com/ICSIN](https://soundcloud.com/ICSIN)



[youtube.com/ICSWEB](https://youtube.com/ICSWEB)



[instagram.com/icsdelhi](https://instagram.com/icsdelhi)