

Chapter 63

Trade Liberalization, Infrastructure Development, and FDI in India and China

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ABSTRACT

The two largest economies in Emerging Asia, China and India, are considered to be the 'power houses' of global economy. China and India adopted the policy of 'opening up to the outside world' respectively in 1978 and 1991. Trade openness and infrastructure development has been acknowledged as crucial pre-conditions for attracting foreign direct investment (FDI). China's path of development was guided by the so called fast growing nations, which laid substantial emphasis on building strong infrastructural base at great speed. But India, on the other hand did not adopt the strategy of building infrastructure base prior to the growth of demand, like the one which has been followed by most successful Asian countries achieving rapid infrastructure development. So early opening up and improved infrastructure has attracted more FDI in China than in India. So the present study seeks to examine the relationship between trade liberalization, infrastructure development and FDI inflows in India and China using secondary time series data in a comparative analytical framework.

INTRODUCTION

The relationship free trade and economic growth is a highly debatable issue and there is no general consensus regarding the impact of external liberalization on growth. In these context the experiences of newly industrializing countries (NICs), Hong Kong, South Korea, Singapore and Taiwan, have been analyzed with mixed conclusions. Of late, the two giants of Asia, India and China, with their domestic markets providing vast scope for diversified industrialization and trade, are classified by international agencies as emerging markets with potential for rapid economic growth. Both economies possess the capacity to become the 'power houses' of global economy. There are many similarities between the two

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economies such as vast pool of employable labour and abundance of natural resource endowments. Also both countries suffer from paucity of capital and a large part of population is still dependent on farm activities. Poverty and relatively poor standard of living continue to affect a large number of people in both the countries. Eradication of poverty and improvement in living standard, therefore, are seen as the basic objectives of development and acceleration in the rate of economic growth as the means to achieve them. Both India and China are home to the world's largest pools of skilled work force and are expected to be the engines of global economic growth in the present century (Bhat, Guha & Pal, 2006).

Foreign trade liberalization received little attention in early stages of the development policy of both India and China. To start with, both the countries adopted inward-looking import substitution policies with an emphasis on self-sufficiency. Later in 1978, China adopted the policy of 'opening up to the outside world' and in 1991, India initiated an import liberalization policy. Comparative advantage replaced self-sufficiency as the basic tenant of trade policy and both the countries are now pursuing market-oriented and outward-looking policies (Sahoo, 2010). India has been a member of the WTO since its inception and China joined the WTO in the year 2001. Both the countries are adhering to the WTO rules in conducting their international trade. Over the last twenty years many developing countries, including India and China have abruptly and substantially lowered tariffs and scaled back other trade barriers.

India's growth has been through information technology (IT), while China's economic growth has been led by manufacturing. To sustain growth, India strives to be a stronger player in manufacturing while China is striving to increase its presence in IT. For India to improve its manufacturing sector, it must increase its FDI inflows for manufacturing and improve basic infrastructure. Conversely, for China to increase its IT sector, necessary policy steps include: focus current IT industry on global exports; spur entrepreneurship and reduce dependence on central government; create a strong trade association to improve regulatory environment; and improve quality and approach of educational system.

The two largest economies in Emerging Asia, China and India, are expected to show different growth trends in 2015 and 2016. GDP growth is expected to accelerate in India (7.7% and 8% in 2015 and 2016, respectively) with expectations of reform under the new government. However, the apparent improvement in forecast growth rates for the Indian economy is also partly a result of significant revisions made by the country's to its GDP data, which raised the base growth rate through 2014 and of the lower oil prices. However, investment and export growth are slow and significant risks remain in the form of obstacles to further reform. China, on the other hand, should continue to see slowing growth momentum (to 7% in 2015 and 6.9% in 2016) despite the benefits of lower oil prices and small stimulus and structural reform measures implemented in 2014.

There is no denial of the fact that infrastructure plays a pivotal role in both the social and economic development of a nation. Direct investment on infrastructure (a) creates production facilities and stimulates economic activities, (b) improves competitiveness by reducing transaction and trade costs and (c) provides employment opportunity to the poor. Global investment (both domestic and foreign) in infrastructure has increased continuously since 2000, reaching a peak in 2008, and then decreasing slightly but maintaining levels reached in 2006. Throughout the 2000s, Asia received the largest amount of global project investment in infrastructure, followed by Latin America. In terms of sector, the number of projects conducted was largest within the power / energy sector during the 2000s in all developed, developing and transition areas, followed by transportation. In case of China, the massive development of physical infrastructure has been the major influencing factor behind its sustained high economic growth and increased competitiveness. But India, on the other hand did not adopt the strategy of building infrastructure base prior to the growth of demand, like the one which has been followed by most successful

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