ECONOMIES IN TRANSITION: A COMPARATIVE STUDY ON INDIA AND CHINA

BY
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(06SEPH08)

UNDER THE SUPERVISION OF
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Dedicated

To my parents

DECLARATION

I hereby declare that the research embodied in the present dissertation entitled, **"Economies on Transition: A Comparative Study on India and China"** is an original research work carried out by me under the supervision of **Dr. B. Nagarjuna**, Department of Economics, for the award of Ph.D., from University of Hyderabad.

I declare to the best of my knowledge that no part of this dissertation is earlier submitted for the award of any research degree or diploma in full or partial fulfillment in any other university.

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CERTIFICATE

This is to certify that **Mr. Sidam. Madhukar** has carried out the research embodied in the present dissertation entitled **"Economies on Transition: A Comparative Study on India and China"** for the full period prescribed under PhD ordinances of the University of Hyderabad.

This dissertation is an independent work and does not constitute part of any material submitted for any research degree or diploma here or elsewhere.

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Contents

List of Tables

List of Figures

Acrimony and Abbreviations:

AVE	Ad valorem equivalent
ASEAN	Association of South – East Nations
ALDC	Assistance to Least Developed Countries
APEC	Asia - Pacific Economic Cooperation
BOP	Balance of Payments
BRICs	Brazil, Russia, India, China and South Africa
BIT	Bilateral investment treaty
CEMAC	Economic and Monetary Community of Central Africa
CII	Confederation of Indian Industry
CCP	Chinese Communist Party
CFETS	China Foreign Exchange Trade System
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
CEEB	Center and Eastern Euro barometer
CSSE	Committee on Small Scale Enterprises
CJV	Cooperative Joint Venture
DFID	United Kingdom Department for International Development
DOT	Direction of Trade Statistics
DIPP	Department of Industrial Policy and Promotion
DTT	Double Taxation Treaty
ETDZ	Economic Trade Development Zone
EFE	Free Export Enterprises
EPA	Export promotion agency
EPCG	Export Promotion Capital Goods
EPZ	Export processing zone
EU	European Union
EXIM	Export-Import
EDZ	Economic Development Zone
EEFSU	Eastern Europe and Former Soviet Union
FDI	Foreign Direct Investment
FFE	Foreign Funded Enterprise
FTC	Foreign Trade Corporation
FIAS	Foreign Investor Advisory Service
FTA	Free Trade Agreement
FIPB	Foreign Investment Promotion Board
FIES	Foreign Investment Enterprises
G-8	Group of Eight
GLF	Great Leap Forward
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDAD	Directorate General of Audit –dumping and Allied Duties

GDI	Gross Domestic Index
GDP	Gross Domestic Product
GIPA	Global Investment Prospects Assessment
HDI	Human Development Index
HTDZ	High-technology Development Zones
HRS	Household Responsibility System
ICA	Investment Climate Assessment
ICT	Information and communications technologies
IF	Integrated Framework for Trade-Related Technical
ILO	International Labor Organization
IMF	International Monetary Fund
IPA	Investment promotion agency
IPR	Intellectual Property Rights
ISO	International Organization for Standardization
ISI	Impact of substitution Indoctrination
IT	Information Technology
JVEs	Joint Venture Enterprises
LDB	Live Database
LDC	Least developed country
LTFP	Long Term Fiscal Policy
MENA	Middle East and North Africa
MFN	Most favoured Nation
MIGA	Multilateral Investment Guarantee Agency
MNC	Multinational Corporation
NASSCOM	India's National Association of Software and Service Companies
NTB	Nontariff barrier
NTC	Transitional Corporation
NAP	National Agriculture Policy
NTMS	Most non-tariff Measures
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
OFDI	Outward Foreign Direct Investment
PRC	People's Republic of China
PPP	Public Private Partnership
QR	Quantitative Restriction
R&D	Research and Development
RIA	Regional integration agreement
RTA	Regional Trade Agreement
SACU	Southern Africa Customs Union
SEZ	Special Economic Zone
SITC	Standard International Trade Classification
SME	Small and Medium Enterprise

SOE	State-owned Enterprise
TCMCS	Coding System of Trade Control Measures
TRAINS	Trade Analysis and Information System
TRI	Trade Restrictiveness Index
TRIMs	Trade-related Investment Measures
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
US	United States
UBS	Union Bank of Switzerland
VAT	Value added tax
WTO	World Trade Organization
TRIPs	Trade Related Intellectual Properties
SIE	State Invested Enterprises
TFP	Total Factor Productivity
TVE	Township and Village Enterprises
WFOs	Wholly Foreign Owned Ventures

CHAPTER - I

1.1. Introduction to Economic Transition

Since the fall of the Berlin Wall on the 9th November, 1989, a sizable number of economists have studied the process of transition of economies from socialism to capitalism in the former socialist economies. This process is called economic transition, or transformation of economies (Gerard Roland, 2004). Soviet Union, Central and the Eastern European countries undertook major reforms in their economic systems. These included certain major restructuring of their economies (Dharmendra Dhakal, *et al.,* 2007). Transition has been a dynamic historical process, imposing changes on almost every element of the society. Success in recovering output, however, readily suggests itself as a useful unifying theme for economic assessment, not in the least because of the importance policymakers in transition economies attach to output growth and its immediacy for the welfare of every country (Oleh Havrylyshyn and Thomas Wolf, 1999). In the transition perspective, many countries have passed, and are currently passing, through significant transition phases. For the present, it is important to discuss transitional economics with reference to non-transitional economics. Thus, in the 20th century, underdeveloped regions have adopted a transition policy to catch up with the industrialised nations.

Definition Economic Transition:

"A **transitional economy** is one, which is changing *from a centrally planned economy to a market economy*. These economies undergo radical reforms towards free market economy through Price Liberalisation, where market forces set prices, rather than a central planning organisation and trade barriers are removed is under taken, along with, massive privatisation of government-owned enterprises and resources, the creation of private property and also financial sector to facilitate the total transformation towards a market economy"(*Wikipedia encyclopedia).*

During the period of 1917 to the 1950s, countries, having one-third of the world's population, transform them the market economy, and launched an experiment in constructing an alternative economic system. Initially, in the former Russian Empire and Mongolia, Central and Eastern European countries (CEECs), Baltic nations, China, Northern Korea and Vietnam, much effort was made to control the means of production

and allocation of all resources through state planning. This approach was a failure. Thereafter, the same countries sought to rebuild the markets and reintegrate themselves into the world economy. Most of these economies rejected central planning and embarked on a new path – transition-towards decentralised market mechanisms and widespread private ownership.

The long-term goal of transition is that economic reforms should help to build a thriving market economy and also ensure long-term improvements in the living standards. Transition is a still very much in progress and many important questions do not yet have definitive answers. However, countries will have completed their transition, only when they overcome have problems and undertake further reforms come to resemble those of long-established market economics at similar levels of income (*World Development Report, 1996*).[1]

Figure 1: CLASSIFICATION OF TRANSITION ECONOMIES

Transition economies in Europe and former Soviet Union

CEE: Albania, Bulgaria, Croatia, Czech republic, RYR Macedonia, Hungary, Romania, Slovak Republic, Slovenia.

BALTICS: Estonia, Latvia, Lithuania

CIS: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.

Transition economies in Asia

Cambodia, China, Laos, Vietnam.

Sources: *encyclopedia*

The race to transform centrally planned economies into market economies had led, ten years later, to one group of countries approaching the finishing line, others lost the power at various points along the track and a few were barely off the starting blocks. Some Central and Eastern European economies (CEEEs) and the Baltics are knocking on the doors of the European Union. But in many economies in the Commonwealth of Independent State (CIS), including Russia, there has been uneven progress and prospects remain blurred.

China adopted market-oriented reforms in 1979, while India initiated market-oriented policies, in 1991, due to BoP crisis. China has successfully pursued its transition

[3]. See in World Development report 1996, "From Plan to Market", Published for the World Bank, Oxford University Press, pp.1.

economy, while the Eastern European countries experienced negative growth, falling living standards and mounting inflation. China's story is quite opposite and outstanding - even compared to the tigers of South-East Asia with respect to growth and development.

The experience of the command economies has not been a happy one. Both countries had faced a number of problems. The command economies, East European and the former USSR, China and India suffered more or less from the following ailments: (a) Stagnation in agriculture (b) Stagnation in Industrial sector; and (c) Balance of payments (BOP) crisis (Manmohan Agarwal and Dipankar Sengupta, 1999).

1.2. Background of Economics reforms in China and India towards Economic Transition

Since China and India are two great ancient civilizations, adjacent to each other, with a long history of cultural relationships, comparison between these two countries would help discussion of long time economic performances. China's national economic output was on par with that of Europe around 1400 A.D. In '*The Wealth of Nations'* (1776), Adam Smith attributed the economic stagnation and finally the decline of China to its policy of virtual isolation and self-sufficiency after 1433 - a policy that was not abandoned until 1978. According to Maddison (2001), China was still richer than India in 1820, but India overtook China in the 1950s, though. China has seen more accelerated growth than India in the last quarter of the 20th century (Orvaldur Gylfason 2005). China's new economic reforms began in 1978 with institutional market oriented economic policies. However, India's 1990s reforms began as a gradual process towards market orientation. Even though the economic policies of both countries were quite different, economic growth has been rapid in both China and India.

Since the beginning of the 21st century, both China and India have earned the label of emerging economies in Asia, as well as in the world, plus the present 'Asian Tigers'. Economist Davide Dollar (2009) termed it as 'the Rise of Asia'. Both countries had recognised the importance of trade and economic relations for strengthening bilateral trade. After the events of the 1990s, both economies had integrated themselves into the global market. This effect was mutual benefit for economic development and increase in the growth rates. The economic transitions in China and India had experienced similar reforms pattern at present and sharing long geographical boards, is attracting greater attention around the world. However, due to numerous historical political and economic

reasons, relationships between China and India have generally been at sat a standstill in the past few decades.

India and China would face many challenges in the present global economic scenario. Since both the countries have created new world class companies and infrastructure, foreign investment firms, expansion in trade, domestic markets of these countries have been attracted towards global companies. Therefore, these will be creating competitive conditions in the local domestic markets and also put a strain on macroeconomic management. Anyway, this will create new challenges for both the countries.

1.2.1. An Overview

World's top population superpowers have long been fascinated by the West, but until recently, they were small players in the international economic scenario. Before the 1980s, both the countries' growth rates were relatively disappointing. From the early 1990s, the world has witnessed rapid economic transformation and growth because of market–oriented and long-term reforms, based on improvements in living standards. However, by virtue of sheer size, here the potential to be dominant forces in the international economy exists (*Bloom, Canning, Liu, Mahal and Yip,* 2006).

The competition between the two Asian giants is in the great economic race in the early 21st century and Indian public watches it with excitement and pride. In the world scenario, one has the largest Communist Party in rule and the other is the largest Democracy. Indian economy is the fourth largest in the world, in terms of the purchasing power parity (PPP) standard; the population is 1.21 billion (2011 census). Similarly, China's population is 1.3 billion (2010) and it is second largest economy by the PPP measurement. The success of economic growth has depended on factors, such as large number of skilled human capital, differences in the government policies and social and cultural factors as well. In spite of all these immediate factors, any country would address development wave from sectors like industries, trade and services, infrastructure and information technology (IT), foreign direct investment and so on. To compare both the economies, the fact is that the variables are similar to a greater extent and their differences have led both the countries to take similar paths towards economic development (Mayuri Guntupalli, *et. al.*, 2006).

a. Economic Growth and Development

In 1970s, the per capita GDP of both China and India was at a similar level, but the gap between the two has continued to widen thereafter. In 2010, the GDP of China and India stood at 10.6 % and 8.5% respectively; growth in China was much faster than India. According to "*Human Development Index* (HDI, 2009)," which includes per capita GDP (in PPP terms) and factors such as life expectancy and education levels, China ranks 89th in 2010, while India languished in the 119th place. When we consider the fact that India's population increases at almost 1 % faster than China, the difference in growth in terms of per capita GDP becomes larger.

Table 1: Development Indicators: comparison of India and China (1980-2009)

Indicators	**1980**		**1990**		**2000**		**2009**	
	India	**China**	**India**	**China**	**India**	**China**	**India**	**China**
Population growth (annual %)	2.3	1.3	2.0	1.5	1.7	0.8	1.3	0.5
GDP Growth (annual %)	6.7	1.3	5.5	1.5	4.0	0.8	9.1	0.5
GNI growth(% annual)	6.6	7.7	5.7	3.6	4.3	7.9	9.1	8.9
FDI Inflows GDP	0.043	N.A.	0.07	0.98	0.78	3.2	2.5	1.6
Services (% GDP)	39.6	21.6	43.8	31.5	50.5	39.0	55.3	43.4
Trade (% GDP)	15.6	21.7	15.7	29.2	27.4	44.2	43.6	49.1
Manufacture (%GDP)	16.7	40.2	1	32.7	15.6	32.1	14.8	33.9

*Sourc*e: World Bank Development Indicator, 2011

In addition, economic development of both countries depends on macroeconomic indicators, which have to be encouraged by high growth rates in industry, foreign direct investment, and trade and services sectors. In China, mainly in areas like manufacturing, automobiles, textiles, trade and services, the inflow of FDI is high.

Meanwhile, India has also increased its productivity and economic development recently due to the growth in services and trade, industries and agricultural sectors. Thus, the growth rates of both countries have been rapid since the 1990s. Moreover, both countries have been made remarkable changes in the market-oriented direction and became open to integration into the global economy. The different geographic regions tend to specialise in particular products, because of comparative advantage in both the

countries. China's success in the field of technology has been mostly in hardware, while India's is in software. Both these aspects were quite opposite.[2]

1.3. Reforms and Economic Progress in Transition Economic Cycle Aspects

The transition economic cycle aspects explain how the transition process takes place in an economy. It is interesting to seek the differences between *vicious* and *virtuous* circles in a country in the transition phase. In the vicious circle; the initial step towards market reform creates opportunities for rent seeking and corruption. It results in an open entry to the market, fostering competition, establish a solid rule of law. Its outcome is the emergence of an underground economy. However, limited competition, incomplete liberalisation, incentives to go underground and the poor rule of law can make the transformation go out off-track. Consequently, it does slow down the economic progress, a reversal of growth and a collapse of financial stabilisation.

Virtuous circle allows economies to make steady progress towards an open, liberal market. It results in an initial pain and political opposition (because of the 'pain' element). Still, there will also be earlier recovery and new economic opportunities.[3]

According to Alan A. Bevan & Saul Estrin (2004), the vicious and virtuous circles show similar results. However, opportunities can encourage output growth, new firms and jobs will be created as the builds of reform now begin to spread. A stronger economy improves a country's fiscal position and introduces confidence in financial institutions. These conditions provide the basis for a credible and well-financed government, which, in turn, is able to impose the discipline of law, secure Intellectual Property Rights and provide an adequate social safety net. This market- friendly environment encourages savings, new investments and further growth.

The below given figures (see.2) contrast between the vicious and virtuous circles. The decisive factor that permits a country to move from the vicious to the virtuous circle is, "in our view, the political will to impose the rule of law and establish the security of property rights" (Oleh Havrylyshyn & Thomas Wolf, 1999).

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7. In 2002, then Chinese Premier Zhu Rongji visited the campus of Infosys in Bangalore, India. Addressing 4,000 software engineers, he said, "You are number one in software. We are number three in hardware. If we put these together, we are the world's number one".

3. According to, the World Bank and European Bank for Reconstruction and Development (ERBD), due to the influence of output key of reform; indeed, the reform is painful absolutely right. In the initial the (decline) reforms period, the relationship between growth and reform traces a U-shaped curve.

Figure 2: Reforms and Economic Progress Vicious Circle

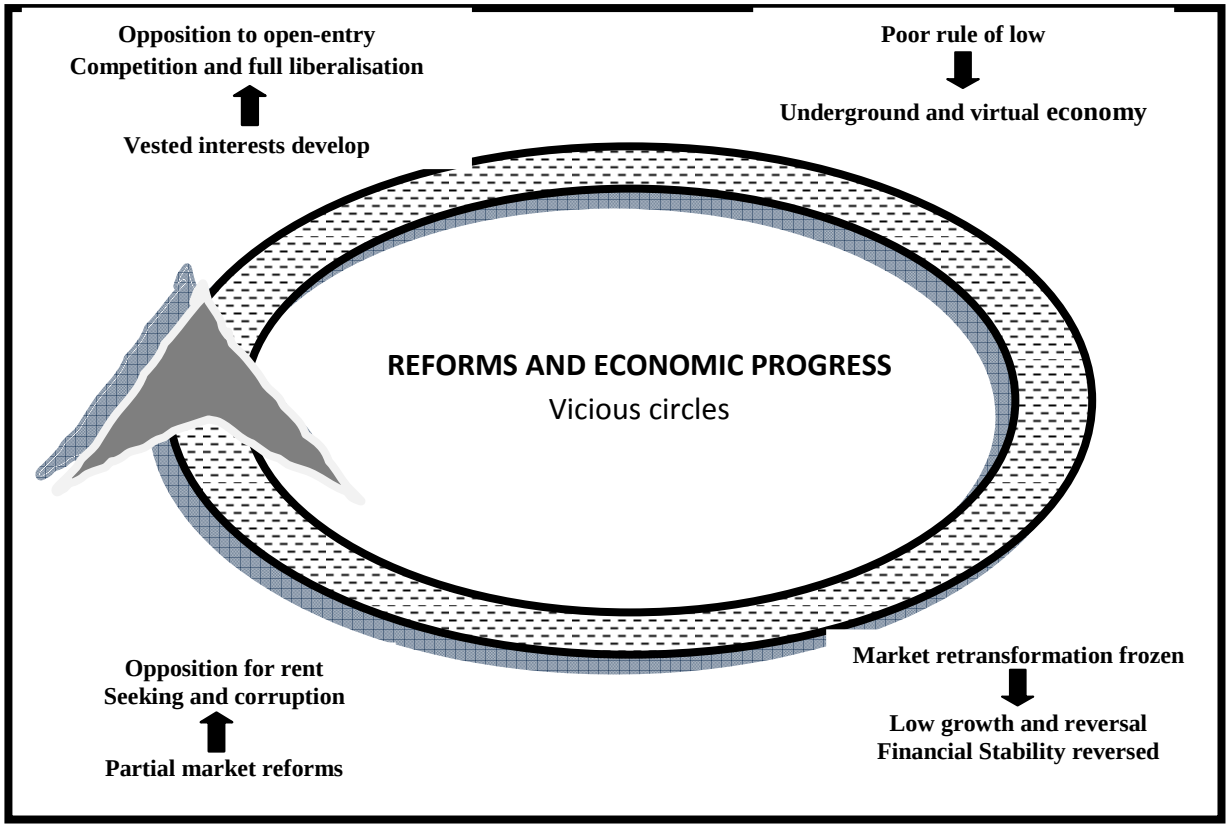
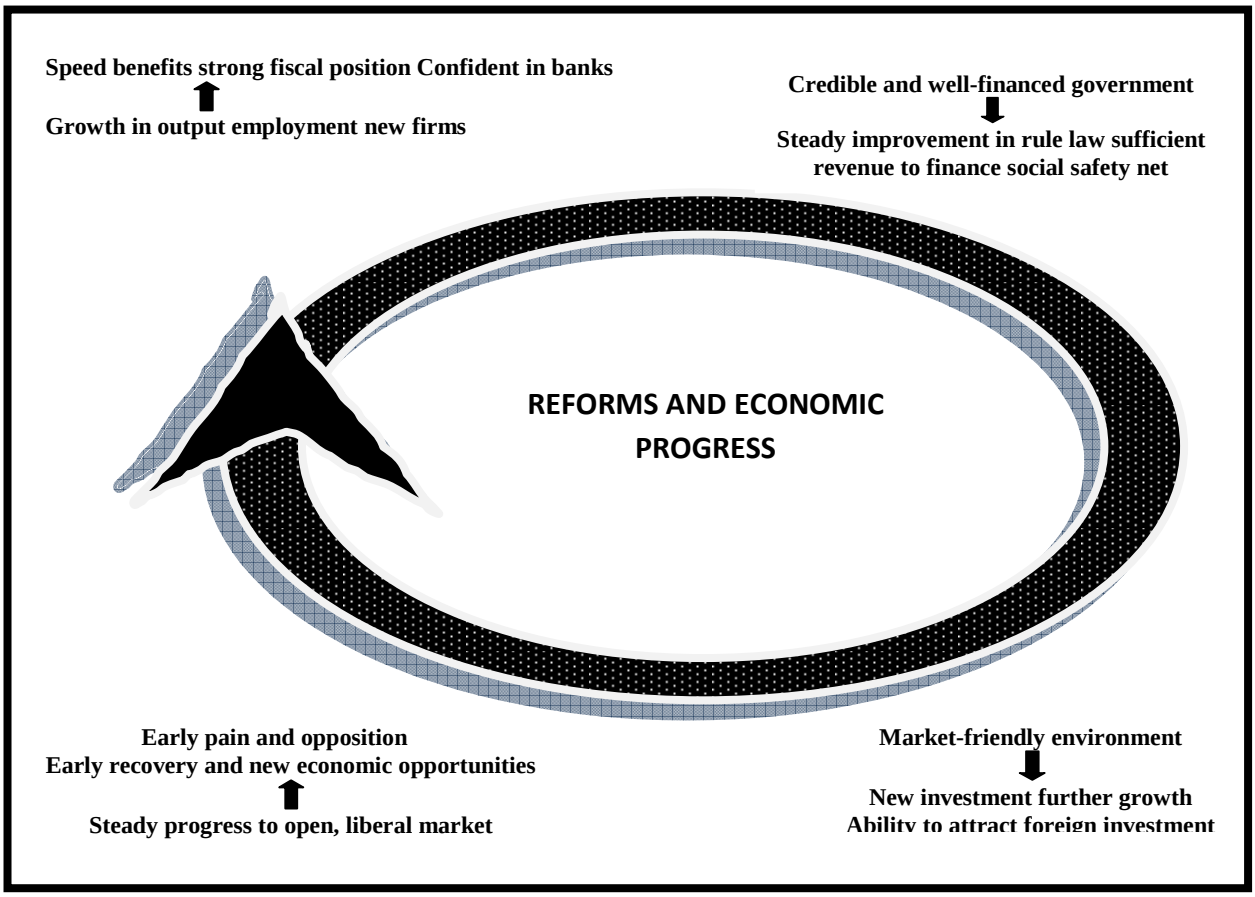


Figure 3: Reforms and Economic Progress Virtuous Circle



a. How do FDI and Trade Influence an Economy

Figure 2 emphasises how Foreign Direct Investment (FDI) and trade would be affecting the entire economy. A transition economy is nothing but economic reforms are held in particular economy. The FDI cycles theory explains the development and why it had been adopted by the CEES countries and particularly highlights the role of FDI into the trade sector (Richard 2008)[4]. Even though different countries could work out reforms in different circumstances, transition countries consider new economic reforms would adopt liberalisation, privatisation and globalisation (LPG) for promoting sustainable economic development and introduce the (LPG) reforms, through creating FDI at a large scale and through trade and other factors. Shiva & Makki (2004) conclude that the FDI and Trade have a positive impact economic development. Thus, LPG would be affecting an entire the economic structure in the economy.

Who these reforms would influence is determined by other indicators in the economy. Impact of FDI and trade are: effect on economic growth (Borensztein, Gregorioand Lee; Balasubramanyam and Salisuand Sapsfored); as well as the effects of economic growth on FDI (Barrel and Pain; Lipsey, Shiva K Makki). This kind of behaviour of changes would occur during the transition phase. However, the transition process includes economic liberalisation in domestic and foreign trade, free capital flow mechanisms, elimination of price controls and privations of state-owned enterprises. Thus, economic growth is being determined by economic factors such as international economics, micro and macro economics, welfare economics, development economics, labour and industrial economics, environment and, finally, public finance.

- International trade can change the entire market structure in the economy. It should depend on export and imports which, in turn, influence other activities. Trade provides the motivation for efficient production of goods and services by shifting the production pattern. FDI and trade are having a vital role to play in economic growth, as well as trigger institutional developments in the recipient country. These factors should influence exogenous and endogenous factors in the absolute market structure in an economy.
- Development economics, it focuses not only on promoting economic growth and structural change, but also on improving the living standard of the population. Trade

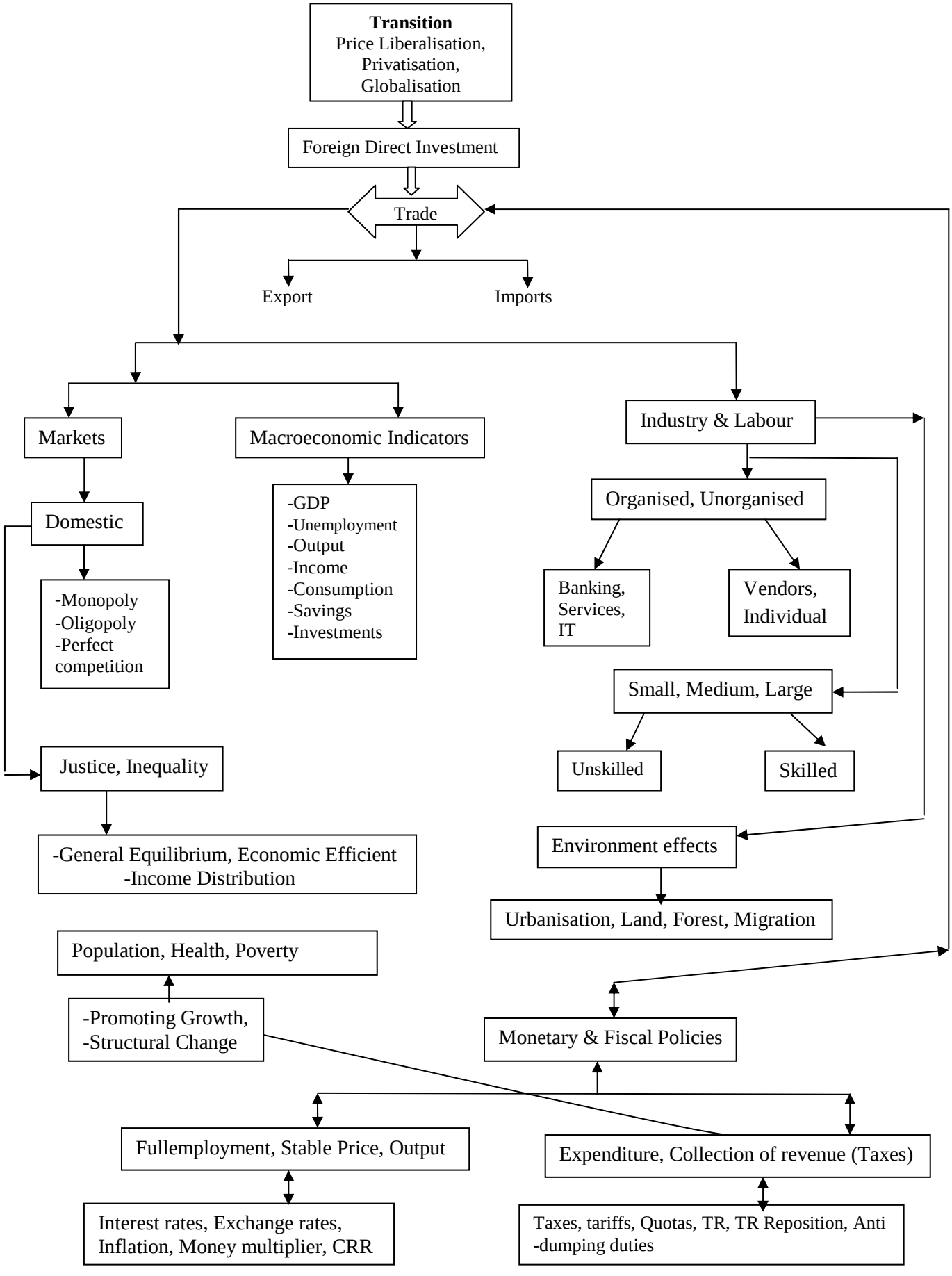
[4]. Initially, FDI investments flow into manufacturing sectors and later on highly industrialised sectors which require higher capitalisation, longer time horizons, high pay offs for the investors and greater risk. During these phases, one would expect FDI into the tradable sector to increase as well.

and FDI are among the most important players to improve the social and cultural activities in an economy. These create conditions for institutional development, services and also income generation.

The economic growth of families and individuals would probably increase their expenditure. With sharp increase in income, it would lead to growth in human development index as well. Thus, the increase in consumption, health and education, in turn, brings forth changes in an economy. Examples of these include: health, education and poverty eradication to run the development programme. This may involve restructuring market incentives.

- Welfare economics is a branch of economics which uses microeconomic techniques to evaluate economic well-being of the people; relatively general equilibrium would have an effect on the economic efficiency and income distribution. These indicators study society, group, community and how it leads to social welfare. Trade and FDI are creating a new market system which is affecting the economy. These effects would improve the living standard of the society.
- Labour and industrial sectors: trade would facilitate for employment generation at various levels in domestic markets, including small, medium and large sectors. FDI is introducing new technological skills, to provide labour training and encourage new input and technology. Labour and industrial sectors have a major role to play for both un-skilled and skilled labour, since the large numbers of non-technical labourers are high in developing countries. Thus, Trade and FDI create a comparative advantage and also provide a wide range of opportunities. Both factors have a significant role to play in the economic development of a country.
- Monetary and fiscal policies: these have a crucial role to play in controlling the whole economy. These factors are important for stabilisation of the entire economic structure by the money accumulation, distributing, taxes, interest rates, stable prices and control of inflation. If the economy is stable, both would create full employment and promote economic growth. In this way, both Trade and FDI are influencing the economy.
- Environment effect: Establishing of new firms can create issues of environmental pollution, urbanisation, and migration - sometimes leading to adverse effects on the economy. The effect of trade and FDI can lead to negative outcome to on economy.

Figure 3: The Influence of FDI and Trade on Economy



- Macroeconomics: its deals with the performance, structural behaviour and decision making in the entire economy. Macroeconomic policies and institutional stability can lead to economic growth. These policies have been the driving forces for trade and FDI in the country. This development models have a relationship between factors such as national income, output, consumption, savings and investment.
- Microeconomics; its studies the behaviour of the individual modern households and firms. It examines how these decisions and behaviours impact the supply and demand for goods and services. It mainly deals with the issues of growth, inflation and unemployment. Trade and FDI create opportunities for employment in the host economy. Inflation can also be controlled by the import of products. In this way, transformation in the economy can take place.

Consequently, trade and FDI would cater for the new innovations, so essential for the sustainable economic growth in the economy. Some works (Helpman *et. al.*, 2004; Antras and Helpman, 2004; Hiranya K. Nath, 2008) have discussed the product differences for determining the patterns of trade and FDI, which can lead to sustainable economic growth.

1.4. Significance of the Study

In the 21st century, comparisons of the economic development of both countries have gained a lot of significance, following diversified decisions taken by policy makers. In the process of transition economics, many countries have been trying to adapt the experience of successful developing countries. The main intent in an economy is market-orientation and industrialising it, which has led to an open economy. Indeed, any emerging country requires huge amount of investments. As brought out in Figure -3, both FDI and Trade would have a strong influence on the entire economy. A similar experience picture was seen during the transition in EU, where FDI, as a substitute for trade, was an extremely important part of the marketisation process because it allowed for quick absorption and implementation of goods and services to fill the gap in the transition economy (Richard, 2008, pp. 330). In addition, both China and India are similarly in many indicators. Though there has been several research studies on the subject, of research is still going on regarding both comparison and development aspects. In the 21st century, both countries have been playing a significant role in market-oriented towards approach the world economy.

The researcher has chosen China and India because both have similar indicators and relatively same level of economic development. So, at this juncture, after transition, which kind of transformation has taken place? How transition process emerged in both countries? What are the effects of transition economics on foreign direct investment (FDI) and trade? Do FDI and trade confer a comparative advantage to both countries? What can these countries learn from each other in the 21st century?

1.5. Objectives of the Study

1. To analyse the process and phases of economic transition in China and India.
2. To investigate and compare the FDI and Trade variables, with reference to economic transition in both economies.

1.6. Hypothesis of the Study

1. Ho. Both countries' economic growth is positive and transition countries are more significant in the globalization scenario.

1.7. Data and Methodology

The data is drawn mainly from secondary sources of date like, various publication of Government of India, Reserve Bank of India (RBI), World Bank transition reports, International Monetary Fund (IMF), World Economic Survey and the Organization for Economic Coordination and Development (OECD) Economics Outlook reports, Reports such as the European Bank for Reconstruction and Development's (EBRD) transition Report and the United Nations Conference Trade and Development (UNCTAD), the China's statistical yearbooks and official statistics of China and India, as well publications of research institutions. Data is employ mostly deals with the period 1978 to 2010. This study is mainly focused on theoretical and empirical analysis. The study would be using the multiple regression data analysis.

1.8. Limitations of the Study

The present study is a comparative analysis of India and China. Indeed, development variables sought are more macroeconomic variables only. But, in both countries, microeconomic variables are entirely different. However, more critical issues need to be addressed in future research. The limitations of this research include:

a. It is very difficult to obtain the entire data on India and China over the period. In the case of India, these were one decade after China introduced its reforms.

b. Reforms were introduced in both countries in different periods. In the case of India, these were one decade after China introduced its reforms.
c. Consequently, sample selected economic variables has taken for analysis. Data is relied upon mostly pertains to the period of 1978 to 2010.

1.9. Chapterisation of the Study

This chapterisation is as follows; the first chapter is introduction and gives an understanding of transition. The second chapter is a review of literature. Chapter third discusses the theoretical background of the transition economies. Fourth chapter gives a comparison of "transition in China and India" perspective analysis. Fifth chapter is discusses economic indicators such as, a) Foreign Direct Investment; and b) Trade. Sixth chapter is summary and conclusion.

CHAPTER -II
REVIEW OF LITERATURE

2.1. Introduction

In this chapter, the review of literature will mainly focus on comparison of the both countries' emerging sectors from the transition perspective. This chapter will cover: general issues, trade and foreign direct investment (FDI). In the 21st century, both countries have been playing a significant role on the international stage, and, after transition, both China and India have integrated their economies with the world economy, though, both countries have initiated different structural reforms processes. The structural reforms process in an emerging economy has two major focus areas for the government: (a) to reduce undue government interference in the functioning of the industry, and (b) to play a crucial and active role in strengthening the public sector in certain areas. There have been several studies in empirical and theoretical - on China and India. FDI and Trade are most significant indicators for economic development in an emerging economy. Thus, numerous authors conclude that between FDI and Trade have a significant relationship, and lead to economic growth.

2.2. Emerging sector's in China and India:

Robert Solomon (1999) stated that the world economy has undergone dramatic changes since the end of the 1970s. The economic transformation has occurred in a number of areas. The focus seems to have shifted from centrally planned economies toward market forces, with lesser government involvement in economics processes. Also, another change has been the intensification of efforts towards 'globalisation' in both industry and finance. Industries that experienced significant growth during the 1990s included IT and automobiles, which brought about economic growth, in the form of flow of capital to 'emerging markets'. However, this was also accompanied by problems and crises.

A.S. Bhalle (2004) lays emphasis on the state economic reforms processes and the impact of economic reforms in both countries. Factors, such as economics stabilisation and long-term structural adjustments, are essential for growth and to meet the challenges of international competition. Both countries had reduced public expenditures and lowered subsidies, in order to reduce fiscal deficits and promote efficiencies in resource allocation. If you compare the other aspects, like FDI, technology, and poverty alleviation, China

seems to have performed better than India. India's initial reforms were not that effective because of high interest rates and restrictive monetary policy. We can conclude that China has tended to encourage rapid growth of village and township enterprises (VTEs). On the other hand, India may have policies on paper, but the implementation has been generally tardy. Thus, China's economic reforms have been more successful than India's.

Thorvaduk Gylfason (2005) has made a comparison of the development strategies and trajectories of the two countries by considering determinants like market-friendly reforms, long coastlines, large overseas communities, diasporas contributing investments. The author poses questions like Can democracy facilitate growth? Don't both countries have to reckon with factors like corruption, inequality, uneven distribution of income, large population and, finally, high child mortality rates?

Ira Kalish (2006) compares the basic growth factors for China and India. Indeed, in both countries, prices of certain commodities products had been fluctuating in the past decades. India and China are different in a number of areas, but have some common elements in areas like economic structures, sources of growth and competitive advantage. On the other hand, due to the financial system in China, state–run companies are able to borrow from state-run banks. In addition, in India, private companies are playing an important role in financial markets, i.e., *Wipro, Infosys*, because state-owned enterprises are controlled by the government and may not always be able to match the performance of private sector companies. India has also to face issues like: slow savings rate, excessive regulation, poor infrastructure, and non-performing loans. After, reforms in both countries, the domestic market has expanded and division of labour has also increased. Also, the number of new local companies is increasing through trade and investment, which would facilitate the creation of new world class companies and new opportunities for the job seekers.

Deepak Mishra (2006) has brought out that India's GDP growth rate is slowly converging to the East Asian level. Its household savings rate is among the highest in the world. In addition, less use of physical capital (and more of human capital) than has been the case with East Asian countries. The increase in private and public savings and corporate sectors saving are increasing because of strong presence of the private sector. However, Indian's corporate and public savings are considerably lower than that of China. This contrast in saving rates is due to the effect of demographic changes (See, Heff, 1980; Ram 1982; Hammesr, 1986; Mason, 1987 and 1988; and Gersovitz, 1988). However, Indian's domestic savings and investment rates show that they are likely to

register only a moderate increase in the medium term and are unlikely to reach the level in East Asia.

Michacle A. (2006) examines the presence' of China in the emerging markets of the world**.** In an era of global economy, significant market opportunities exist because of foreign investment and firms. China has successfully projected itself as the favoured destination for emerging markets and transition economy. As a result, investment is more useful for firms for supporting technology development. Such ventures have more than tripled (China's National Bureau of Statistics, 2004). Even after inflow of FDI, a number of reforms are required for a country to remain competitive in the global economy. There is also the need for maintaining appropriate balance of payments and institutional stability.

In the context of 'global growth and distribution', both China and India are re-shaping the world, with their focus on global trade and structure of production and distribution of income. In future, both countries would be influencing the global economy through sustained high growth. Both countries have middle class people, who are keen to significantly improve their quality of life. The demand for the consumer goods is likely to increase substantially. Also, skilled workers would be required to meet the high demand for manufactured goods. A measure of the growth of both countries is the higher degree of urbanisation. The economic expansions in both countries will certainly influence the global income distribution in the next 25 years and lead to the emergence of the "global middle class".

T. N. Srinivasan (2006) in his article, posits that the after 1980s, both China and India has been growing rapidly and significantly impacting the world economy. The focus on two channels, namely, imports and exports is efficient in both countries and is influencing the rest of the world. Their economic initiatives have had a significant impact on their low and middle income citizens. However, China's growth has slowed down since close to half of its population is engaged in agriculture and rural activities, resulting in low level of productivity. The labour–intensive services are also potential sources of strength for both countries. The fast growing domestic market for goods and services are creating phenomenal export opportunities for both China and India. India's financial system is functioning better than that of China. India has done better than China in five pivotal areas: regulation of labour markets, galvanising the small scale sector, revitalisation of

agricultural growth, prudent investment on infrastructure**,** removal of fiscal deficits and, finally, across the board privatisation and trade liberalisation.

Susan M. Walcott & James Heitzman (2006) have discussed the processes of development in China and India. In both countries, there are IT parks within corridors adjoining urban regions; Bangalore and Hyderabad in India and Chongquing and Chengdu in China. In both countries, the governments issued public policy statements specifically designed to promote clusters in their metropolitan regions. The authors view the techno pole effect as a problem of institutional expansion or organisational change. The concept of techno poles had evolved within cluster analysis "growth poles" that traced the concentrated investment expanding into surrounding areas (Perroux, 1995). In a similar study, Marjusen *et al.,* (1999) suggested that "Global fordien" expansion of technology to other regions. Research is increasingly being focussed on rapidly developing nations, impact of science and technology on urbanisation and emerging innovative clusters within Asia's two largest nations - China and India (Fan, *et. al.,* 2002; Ganer and Prime, 2002; Lalkaka, 2002). The national techno poles, examined in this research, currently constitute peninsulas of privilege credited to connect work and attract a core of cosmopolites. The techno pole and corridor concepts suggest that regional actors are seeking solutions to the problems encountered due to the late entry of capitalism, through a shared space and the knowledge based on society.

Jaishankar Raman (2007) has made a comparison of the economic reforms experiences in China and India. Several authors have also examined the origin of reforms in China. They include: Wee Wong (2002), Srinivasan (2002) and Soled (1995). A perusal of the conditions leading to the introduction of economic reforms in two countries shows that China had surged past India in all the criteria of measurements.

David E, Bloom, David conning, Linlin Hu, Yuanli liu, Anjay mahal, and Winnie Yip (2007) bring out that there has been an increase in work productivity in both countries. Young (1994, 95) applied the growth rate of inputs in a country to estimate the marginal productivity of each factor, to arrive at the overall economic growth. Another approach is to study the impact of different variables that may affect growth in a number of countries. It becomes difficult to explain the relationship between demographic changes, age structure, etc., and the rise in the GDP, because of increase in life expectancy, population health, and the consequent effect on labour quality. In 1975, the ratio of working-age (15-64) to non-working age (0-14) and 65 above in both countries

was around 1.3 billion. In 1970, China launched the “later, longer, fewer” (later age at first birth and longer-inter-birth intervals, fewer births) and adopted the one child policy in 1980. We can know that age changes create supply–side potential changes for economic growth. Earlier, the, reforms in China were more aggressive than those in India. In 1991, India undertook massive economic reforms to overcome the fiscal and balance of payments crises. The emergence of China and India as major players in the international economic arena has made the rest of the world to sit up and take notice. In India the results were significant due to greater transparency, strong presence of private enterprises, large inflow of FDI and increase in foreign trade. In additional, in the next 30 years, high growth rates in India can affect the fertility decline.

Saraj Joseph (2008) has broadly focused on the linkage between the state and the economy in India after independence, especially in the political context which determined the strategy adopted for bringing in changes in economic policy and development. Since, independence, a large number of problems was faced and government has begun to experiment with liberalisation and economic reforms. The viewpoint of the World Bank and International Monetary Fund (IMF) was that the structural adjustment policies imposed by them they on debtors (a country, a person) helped to revive the economy. They argued that their demand for structural adjustments would facilitate reduction of poverty and engender a faster rate of economic growth. Mukharji states that the development strategies were adopted as a result of some adverse economic conditions and the balances of payment crisis in 1991.

Johan Galtung (2008) examines the Chinese model of development. After the Cultural Revolution, a number of steps, including distribution-oriented system and growth-oriented system, have been tried out. The country is trying to combine capitalism and socialism. While capitalism tends to make some people very rich and some were very poor, socialism, despite its plus points, has the tendency to become un-dynamic. Hence, it appears that adopting capitalism to achieve growth and socialism for ensuring better distribution of socio-economic gains would tantamount to sailing in two boats simultaneously.

Yanrui Wu (2008) compares the ‘Regional growth, disparity and convergence in the two economies’. After reforms, disparities seem to have widened in both countries during the period of rapid economic growth. In each country, economic growth has not led to catch-

up effects in the relatively poor regions, as postulated by the new growth theories (Abramovitz, 1986). It can be conclude that, in China, regions had shown greater dispersion then Indian regions. Uneven infrastructure development and urbanisation are the main causes of regional disparity in both countries over the past twenty years.

Vittorio Valli & Donatell Saccone (2009) examine the structural changes and economic development in both countries. Both countries have had to contend with "relative economic backwardness" and the "Fordist Model of Growth". The main intention of the authors was to compare the relation between the structural change and economic development. They opine that the structural changes have increased the social and economic inequalities. In the initial stage, China was strongly developed in industries, while India was more efficient in the service sector. Though the effect of reforms in the agriculture sector share has declined, the industrial sector has grown rapidly. However, the rise in labour productivity activities can lead to rapidly increasing levels of pollution, income and wealth inequalities. Yet, extent of poverty has decreased in both countries.

This paper reveals that the both countries are aggressively promoting software and hardware industries. The Indian domestic market is largely dominated by multinationals, while in China; domestic firms are more into hardware industries. Chinese firms have had strong linkages with institutions and Universities. In India most of the firms has potentially advanced due to information technology, such as, Indian railways reservations system and semi-public projects. Thus, India-China joint venture companies can offer stiff competition to multinationals in the global market.

Amelia U. Santos-Paulino (2010) feel that both China and India can be role models for other developing countries, because of their rapid growth, prudent economic policies, international trade and vibrant capital markets, even though economic reforms are very much influenced by domestic factors. Yao (2009) identifies three determinates of the reforms in China as: (a) the growth consensus (b) dual-track price system in 1978; and (c) privatisation of state owned enterprises (SOEs). While in India, Singh (2009) stresses that international trade, as well as domestic factors, are shaping India's developing model. Both countries would be facing important challenges like institutional reforms internal mobility and labour markets. However, both countries' policies issues like pragmatic approach, industrial policies and trade and liberalisation of commercial policies are key lessons for other developing countries.

2.3. Foreign Direct Investment in China and India:

Kiichiro Fukasaku and Henri-Bernad Solignac Lecomete (1996) stated that trade-policy reform is an essential feature of China's economy. The liberalisation and decentralisation of export activities are boosting the country's exports. China's initial reforms were focused on the development of imports, agriculture sector and substitute industries. Reforms in China import regime has been progressively very slow. This is due to negative factors, such as high nominal protection rates, numerous tariff exemptions, which create a dual regime. Export-oriented firms enjoy access to imports, while the domestic sector remained highly protected from international competition, which leads to misallocation of resources. The lack of firm commitments to import liberalisation might delay China's full integration into the world economy.

Xinhua Liu, Peter Burridge and P.J.N. Sinclair (2002) have explored the relationship between economic growth, FDI and trade. The rapidly expanding Chinese economy, due to high level of openness to the outside world and proxies by external trade, are the main economic determinants for attracting FDI. Moreover, the export are promoting the trade regime for FIE's, with minimum administrative interference. Chinese government still restricts imports; which may cause economic distortion and inefficiency (Corden, 1997). However, the effect on FDI and exports is likely to be too small to be visible at the aggregate level. Economic development, exports and FDI appear to be mutually reinforcing each other under the open-door policy.

Yahsheng Huange & Tarun Khanna (2003) have examined the question: "Can India overtake China"? A report issued in 2000 by the Chinese Academy of Social Sciences concluded: "Because of long-standing prejudices and mistaken beliefs, private and individual enterprises have a lower political status and are discriminated against in numerous ways – both political and in terms of regulations. The legal, policy and market environment is unfair and inconsistent". However, entrepreneurship and free enterprise are flourishing. In China, the banking sector is faced with a huge number of non-performing loans, leading to the subsequent recapitalisation of the banks by the government. India may not be outperforming China overall, but is certainly doing better in certain key areas. It can be concluded that, after observing all factors, India may in due course overtake China. The study also highlights the importance of homegrown

entrepreneurship in long-term economic development and brings out the limitations of the FDI–dependent approach that China is pursuing.

Shiva S. Make (2004) analyses the role of FDI and trade in promoting economic growth across selected developing countries and the linkage between FDI, trade, and economic growth. This study, based on neoclassical approach, argues that FDI affects only the level of income and leaves the long-run unchanged (Solow, 1957; De Mello, 1997). On the other hand, in the long-run, growth can be positive, only because of technological progress or population growth, and both are considered exogenous. According to the neoclassical approach model, on economic growth, FDI can influence the growth in the long-term through judicious use of technology. It needs to be mentioned here that lower inflation rate can bring about a better climate for investment, and trade, since it leads to economic growth. Although a country must be sound in its macro-economic policies, institutional stability is necessary for FDI driven- growth.

Dr. Maathai K. Mathiyazhagan (2005) mainly focuses on the long-run relationship of FDI with the Gross Output (GO), Export (EX) and Labour productivity (LPR) in the Indian Economy at the sectoral level. The relationship between FDI and the host country has an impact on the FDI into the various core sectors in India. FDI has a positive effect on a host economy's development effort (Caves, 1974; Kokko, 1994; Markusen, 1995; Carves, 1996; Sahoo, Mathiyazhagan and Parida, 2001). Though FDI inflows into the sectors have helped to raise the output but still a better role of FDI at the sectoral level is possible. Investor’s advice that the export oriented sectors is to be opened up, since that would lead to high or growth of the economy.

Sinha, Swapna S, Kent, David H, Shomali, Hamid (2007) have made a comparative analysis of FDI in China and India. In both countries, FDI was conceived as an “Export platform” manner, so as to benefit from the global operations of the companies concerned. For attracting FDI by measures, such as (i) Structural Changes; (ii) Strategic infracture; and (iii) Strategy policy initiatives, China has very successfully put in place a congenial business climate. China has followed the ‘export-import’ oriented growth pattern, as opposed to an India’s ‘import substitution’ approach. India believes that allowing full convertibility of the rupee on capital account will help to attract foreign investment into the country.

Linda Y. Yueh (2009) presents a perspective on China's economic growth. China has had to face large portfolios of non-performing loans held by State owned Banks (SOBs), rising unemployment in various forms and institutional frailties. This explains the "gradualist" reforms path undertaken by China as it transitions from a centrally planned to a more market-oriented economy. Still, structural issues like soft-budget constraints, urban bias and weak formal institutions continue to be problem areas. These issues, linked to its gradualist transition, will need to be addressed. In economic growth and global integration, it has led to continuous sustained growth and productivity over the reform period and more with increases in factor accumulation (Wang and Yao 2001), and similar to the 'East Asian tiger's factor accumulation process, associated with small increases in real productivity (Chow, 1994). However, the wide-ranging impact on China's global integration raises further challenges for other countries to assess and manage the effects on their economy.

Anita K Dixit, (2009) emphasises that the process of growth is theoretically visualised to become less dependent on agriculture and rely more on the secondary and tertiary sectors. Theories of structural change suggest that the share of the agricultural sector will fall in the process of economic growth. In the Lewis two sectors model, agriculture was characterised as an over-populated sector with zero marginal productivity, which served as a provider of labour to other productive sectors. Prof. Raganer Nurkse and Maurice Dobb have visualised the agriculture sector as a creator of capital through utilisation of the unemployed. On the other hand, the other model, dealing with the structural transformation of an economy in the process of growth (Kunzents, 1966, 1973; Cheneery and Syrquin, 1975), emphasised on the reduction in the share of the primary sector in the national income. Gujarat is one of the faster growing states in India. This paper mainly focuses on analysing the three sectors in the growth patterns. Also, to calculate the extent of structural change, there is need to undertake a correlation exercise to establish the relationship between the three sectors. Price ratios of the primary sector and other sectors create an overall economic development. Dholakia (1983) has constructed an index - based Coefficient of Structural Change (CSC), in which the output structure compares at two points of time, the relative direction of growth of a region.

Growth rates in the three sectors are interdependent. Therefore, one can use correlation to analyse the relationship between the three sectors. Two trends a rising agricultural price ratio and a declining per worker income level can be noticed. The agro-

vision document aims at refocusing the agricultural sector. However, for the dynamic agriculture growth, based on commercial crops, the issue of stagnant agricultural incomes presents an argument for public investment in agriculture on distributive grounds.

Choorikkadan Veeramani (2009) mainly focuses on the specialisation pattern under trade liberalisation in China and India, and internal deregulation, rather than on trade liberalisation. The domestic firms in countries, which had been operating under a protective umbrella, were forced to respond to the competitive pressure from imports. Policy changes can improve export competitiveness through efficient resource allocation, greater specialisation and competitiveness. It would be advantageous for both countries, since and trade liberalisation invariably involve adjustment costs. Trade liberalisation would engender trade expansion towards intra-industry trade. Exchange rates were overvalued in both countries - creating a bias against exports. The transition from a controlled to a market based economy can result in better allocation of efficiency gains. First, productive resources could shift from inefficient to efficient industries. Second, resources many shift from inefficient to efficient firms within the industry. Third, resources could shift from inefficient to efficient activities and product lines within the firm. Thus, trade liberalisation can positively impact export growth in both countries. The majority of domestic manufacturing industries and firms in both India and China could compete and survive by specialising in narrow product lines.

D. Krishnamurthy (2009) explores the 'FDI flows in India and China'. He mainly focuses on the efforts by major sectors in both countries to attract FDI in primary, secondary and tertiary sectors; the contrast in the FDI inflows in both countries and the reasons for slow progress in India. This may be partly due to issues connected with labour, tariffs and policies and regulations regarding export-import.

Dolly Sunny (2009) delves into the 'Myth and reality of FDI Flows: India and China integration with the Global economy'. After the oil crisis of the1970s, FDI captured world-wide attention with a short-lived boom in the USA, The Netherlands, and the UK (WIR, 1997, Dolly Sunny) Policy changes are necessary to meet the competition posed by global companies. The broad areas of the economy are generally impacted by factors like: availability of human resources, managerial skills, access to clean technologies, pollution abatement skills, firms-wide local market knowledge, established distribution systems and contact with the customers (Blomstrom, *et. al.,* 1994; Balasubramanyam, *et. al.,* 1996; Borensztein, *et. al.,* 1998; De Mello, 1999). The author has also discussed

measures of governance, such as, effectiveness, regulatory framework, rule of law, graft, political instability and violence. However, adoption of international standard for computation would raise FDI inflows. In India, certain components are impeding the process of attracting FDI, while China is not following the international standards. Therefore, both countries need to modify their macro-economic policies.

Haryana K. Nathan (2009) has discussed the role of trade and FDI in growth in Central Eastern Europe, and Baltic Region (CEEB). These countries substantially liberalised international trade and managed to attract large FDI inflows. The CEEB experienced a substantial decline in output in the initial phase of transition. Fischer, *et al.,* (1996a, HK Nat) argue that restrictive macro-economic policies and restructuring of the economy caused a decline in economic activities. Before transition, one needs to understand other variables of the growth experiences. Macroeconomic variables, structural variables, initial conditions and institutional factors. This analysis brings out that a significant positive effect of trade has been the robust economic transformation of the CEEB. However, FDI cannot have a significant effect on growth, until and unless control on the effect of domestic investment and trade on FDI is adequately monitored. Jade Bhagwath (1973), Balasubramanyam, *et. al.,* (1996) and H.K. Nath (2008) argue that effect of FDI can be stronger in a more liberal trade regime, operating in an appropriate environment and has facilitators such as human capital and new technology. As a result, significant positive effect of trade on growth is a robust result for these transition economies. Domestic investment appears to be an important determinant of growth. It is very essential to develop the financial sector in transition economies.

Anjali Kulkarni (2009) posits that, in recent years, both countries have performed much better than other major country's economics in terms of production, capital generation and trade. This paper mainly focuses on measuring FDI: IMF guidelines based on the recommendations of IMF, in its Balance of Payments Manual (Fifth edition, 1993). While estimating FDI inflows, according to IMF guidelines, these reinvestment earnings are taken as a part of FDI inflows and recorded as inflow on the capital account of the host country's BoP. Thus, the FDI gap between India and China is not very significant.

FDI a comparative Study of China and India:

OECD Report (2002): these countries are bringing in policies to maximise the benefits of foreign presence in the domestic economy, with special focus on the overall effect of

FDI on macroeconomic growth and other welfare-enhancing processes and on the channels through which these benefits take effect. Several studies show that FDI triggers trade and investment, technology spillovers, assists human capital formation, contributes to international integration to create a more competitive business environment and enhances enterprises development. However, FDI can also lead to: increasing domestic backwardness, adverse balance of payments situations, setting of heavy industries that are harmful to the environment, and social disruptions due to accelerated commercialisation. Hence, emerging countries need to reach a certain level of development due to the presence of foreign markets. The benefits could include: (i) Education, (ii) Technology, (iii) Infrastructure; and (iv) Health. Finally, the economic benefits of FDI are real, but they do not accrue automatically. The maximum benefit from foreign corporate presence can be a healthy enabling environment for business. FDI can also encourage domestic, as well as foreign, investment, provide incentives for innovation and improvements of skills and contribute to a competitive corporate climate.

Bruce A. Blonigen (2005) has conducted a detailed study of recent literature regarding FDI determinants and MNEs across the world. The focus on external factors includes: who to influence to attract inflow of FDIs, exchange rates and taxes, trade protection and trade flows. Froot and Stein (1991) say that changes in the level of the exchange rate would not alter the decision by a firm to invest in a foreign country. The appreciation of the currency in a firm's home country lowers the cost of assets abroad, the nominal return goes down in the home currency, leaving the rate of return identical. Froot and Stein (1991) present an imperfect capital markets story as to how a currency appreciation may actually increase foreign investment by a firm. The effect of taxes on FDI has been considerable for both international and public financiers and can affect the inflow of FDI.

Dharmendra, Dhakal, et. al., (2007) have discussed the "FDI and Transition Economies: empirical evidence from a panel data estimator". This paper seeks to identify the factors that determine FDI inflows into transition economies. These include factors, such as: market size, inflation, current account balance, real exchange rate, openness of trade, and governmental regulations. Transnational corporations (TNCs) look for more trade, more open economies for resource-seeking operations, especially as they integrate their global production with variable and horizontal value-chain linkages. On the other hand, changes in the real exchange rates, interest rates and, market size negatively affect

FDI inflow into the host country. Therefore, openness and deregulation in the host country can positively impact FDI inflows into the economies.

Saul Estrin & Klaus E. Meyer (2008) have studied the 'FDI in transition economies: strengthening the gains from integration'. The paper mainly focuses on the potential impact of FDI on host economies and also the patterns of FDI inflows into Central and Eastern Europe (CEE). According to Ghemawat (2007), there are three types of strategies by which MNEs create value. These include: (a) adaption; (b) aggregation; and (c) arbitration. A large argument was FDI and openness of the economy will bring about positive growth (see, Caves 1996; Singh and Jun, 1995). On the other hand, the impact of FDI on host economies is complex, since foreign investors interact with, and thus influence, many local individuals, firms and institutions. This paper discusses the structure and strategy adopted by an MNE located outside the country. FDI would help the host economies to better exploit their comparative advantages and transfer technologies that are more closely aligned with their needs. However, FDI flow had increased productivity of former state-owned firms in the transition economies. Finally, host economies should seek to promote a stable-macroeconomic framework, transparent institutional and policy environment. Government policies are also important for both countries to reap further benefits.

S.R. Keshave (2008) mainly focuses on the impact of FDI on growth in India and its impact on exports, GDI, FOREX, GDP, private final consumption expenditure, trade balance, balance of payments, and FDI lagged (t-1). However, if one country loses, it need not necessarily mean that another country would gains. Kindelberger (1969), discusses the that the relationships arising from the FDI. The conventional wisdom of FDI lies in improving in the long-term conventional wisdom (Leahy and Montangna, 2002). The policies of China and India regarding FDI have become significantly more liberal during the past several years. However, both countries are facing almost similar issues regarding FDI. Some common issues regarding FDI include: SEZs, EPZs, almost similar policies to attract FDI and also some regional problems. China has effectively implemented its WTO commitments and is seeking to achieve its potential for luring FDI. China has achieved significant success in areas like: complementary reforms, domestic markets, improving the performance of state-owned enterprise, intellectual property rights and speeding up competition and judicial enforcement, while India is still far behind

China in attracting FDI. India, it is imperative policy makers that understand the need for putting in place conducive good policies to attract more FDI.

Richard (2008) is convinced that trade and FDI can be integrally related. Of course, FDI can simultaneously act both as a complement and substitute for trade. In Central East European countries (CEES), Trade and FDI are playing a significant role in accelerating economic growth and also integration. During the initial period, awas treated as an important substitute for trade. Since 1989, trade activities have grown significantly in CEES and EU countries. The FDI Cycle Theory explains the stages of development. Initially, FDI investments flow into the manufacturing sector and then into more highly industrialised sectors that involve higher capitalisation, longer time horizons, high pay offs for the investors, and greater risks. During these phases, one would expect FDI into the tradable sector to increase as well. When the exporting sector has a large potential for growth, there can be measurable positive effects on the trade balance and economic growth at the macroeconomic level. At this juncture, the framework focusing on studying FDI into the CEECs was developed to have a better understanding of the current and future state and importance of FDI in the transition process (Poland, Hungry, the Czech Republic and Slovakia). Additionally, the export sector can have a positive effect on the industry and the trade balance of the countries concerned. However, according to the FDI cycle theory, accelerating the economic growth, by the support of domestic conditions (economics legal and political), can provide sufficient stability to encourage long term, more highly capitalised investments; low transportation costs. But still, this is the beginning of the international phase and the real effect on growth is yet to be seen.

2.4. International Trade in Both countries:

Trade in China: This book review brings out that, in China the process of trade reforms has preceded in the direction of integration with the global economy. The question arises: what kind of steps was taken for the development of trade? The dualist trade regime and the export processing system had begun in early 1978. After 1986, recognising the opportunities in China, the Chinese policy makers opted for the ‘Coastal development strategy.’ In addition, all type of the firms were allowed to engage in trading with TVEs, foreign investors, etc., for these allow trade to become a more flexible variant in export processing. China had established two separate trading regimes: (i) export-promotion (EP) trade, and (ii) foreign investment entrepreneurs (FIEs). Though WTO membership

can significantly help in pushing through reforms, the currency reforms in 1994 and openness of trade, the most important dimension for trade is: openness to trade with other countries.

Aamir Hussian Siddiqui & Javed Iqbhal (2000) have studied the impact of trade openness on output growth on Pakistani during the period 1972-2002. The relationship between trade openness and growth is a highly debated topic. Numerous studies on openness of trade have all concluded that openness of trade or liberalisation with growth output is positive (Ahmed, Yusuf and Anoruo Emmanced, 2002; Edwards S., 1998; Eduards, S., 1992; Harrison, A., 1996; Iscan and Talan 1998; Santos Paulino, (2002); Wacziarg, R., 2001; and Yanikkaya Halit, 2003). For the empirical analysis, the first step is co-integration analysis to test the stationarity. ADF (Augmented Dickey Fulalr) test found that all variables show positive stationarity at the first difference. The co-integration result shows that relationship between growth rate and investment is significant. In the case of single variables, Trade, and double variables, such as (Export, Import), GCTES results shows an insignificant relationship between growth and trade growth, while investment growth is found to have a significant relationship with GDP growth.

Dipend Sinha (2000) has surveyed the impact of openness and investment on GDP in 19 Asian countries. Numerous other studies on the subject have been undertaken. Some of these authors under took multi-country and some conducted single country studies. This development model considers GDP growth rate, investment of growth rate, growth of openness and, finally, of population. Before analysis, the Philips-Perron test (1998) is used for testing for the stationary of the variables for empirical estimation. This empirical analysis used ARMA for ascertaining the time series differences. The empirical analysis concluded that China, Hong Kong, Indonesia, and Japan show a very high adjusted R^2. However, in the case of Bangladesh, India, Iran, Japan Pakistan and Singapore, the population growth rate has a negative coefficient, except in South Korea. However, results show the positive relations between GDP growth and growth of openness, domestic, investment and population. In the case of some countries the investment growth is positive. In cases of some others countries, the growth rate of populations is negative. But it is not significantly different from zero. Thus, the growth rate of GDP is positively related to the growth rates of openness and domestic investment. However, the

relationship between the growth rate of GDP and the growth rate of population is not clear cut.

Halit Yanikkaya (2002) has explored the trade openness and economic growth in cross-country. He has mainly focused on the effect of a number of measures of trade openness and how trade policies play a special role in economic growth. Trade openness measures can be: (i) Measures of trade volume, (ii) Measures of trade restrictions. These could result in an adverse association between trade barriers and growth on the other hand, using the average tariff rates shows a positive and significant relationship between trade barriers and growth. Hence, trade promotes growth through a number of channels; technology transfer, scale economies, and comparative advantages.

Razeem Sally (2004) has discussed China's trade policies and integration into the world economy. China's trade policy reforms have a wider significance in the world due to the foreign policy and economic reforms being pursued by it. The author has also addressed issues after opening of China's reforms, what kind of steps were being taken, which kind of commitments like WTO and Free-Trade-Agreement (FTA) were put in place by that country. However, recent Chinese trends in trade and FDI, and other policy reforms, are cast in the historical perspective, when compared to other countries and regions. China's trade policies include domestic economic policies, foreign policy and so on. The effect of liberal trade policies and openness to trade, combined with market-oriented institutions at home, has led to high growth in China. The other facilities have been reforms in export-import, Taxes, and foreign investors. China's, capital-intensive components initially are being imported for labour-intensive processing at home, before being re-exported to markets in developed countries. However, China's integration into the world economy has come a long way, and is expected to go much farther. China, today, is a role model of market-embracing policy reforms for the rest of the developing world. Its liberalisation programme is probably the biggest in the world. Still, China seems poised to go further with economic reform; more trade and investment liberalisation; much more internal liberalisation to integrate the domestic market, and bring about market reforms and administrative reforms. All these are necessary to shore up and extend economic freedom components of the basic as growth and prosperity.

Pallavi Aiyar (2006) in **"***India-China trade: A long road ahead*", brings out that China has replaced Japan as India's top trade partner in North East Asia. The bilateral trade delegation crossed the Himalayas to seek out opportunities for trade and investment. But

a deeper study reveals any celebrations of 'Chindia' to be chimerical. Sino-India economic relationships can home the kind of significance that exists in China's relations with it truly weighty trading partners. Indian exports to China are dominated by low-value and primary-production, especially *iron-ore.* India's exports like, raw cotton are getting the benefit of value addition, including increase in employment, higher profitability, technological upgradation and so on. China top exports to India include electrical machinery and machinery. However, it can be said that trade can provide long-term stability to the bilateral economic relationship; it is affected by short-term circumstances. Indian companies have begun to be attracting ample opportunists in China (i.e., *IT, pharmaceuticals, banking, auto components and manufacturing).* India IT companies such as TACS, Wipro, Infosys, and Satyam have invested in China. Low levels of Chinese investments in India are due to the acquisition of high-value markets for them. In addition, China refuses to make investments in India infrastructure projects due to "security" concerns. However, now there seems to be an increasing willingness on the part of China to engage with India. Thus, China and India are developing the kind of economic linkages that would give real depth to their bilateral ties.

Convergence of *China and India's points* of view since the 1980s has led to the opening of trade dynamics between the two countries. Here the author mainly reveals the possible trends in trade relations between the two Asian giants (in 2015) in world trade. An expansion in bilateral trade would reduce the joint pressure on their economies, besides have more effect on third world markets, and strengthen the complementarities between the two economies. The overall trade of China and Hong Kong combined today is almost eight times greater than that of whole of southern Asia. Moreover, China has continued to reduce tariffs, according to most experts in GDP [i.e., Srivastava in China and lending 2003]. The dynamic of the Chinese exports is such that "*made in China*" good are finding their way into Asian markets. China's companies are attracting global companies, such as pharmaceutical industry and IT. The trade potential can be explained by the level of GDP. CRISILs calculation bring out the comparative advantages of India and China's exports of goods [India has major (RCA agricultural products) grains and cereals, fats and vegetables oils etc. metals citron, steel pharmaceuticals]. In this study we can conclude that effect of openness of trade and WTO entry has benefited in both countries exports. Also, both countries have received a boost because of their forward, looking - economic policies.

Christopher J. Rusko & Karthika Sasikumar (2007) this study is mainly focused on the relationship between China and India. The author discusses the 'from trade to peace' process in both countries. Both countries have strong economic potential because of these possible mechanisms by which commercial interdependence could lead states towards peace. In fact, recently, both countries' relations have been changing in the international scenario, since, today, both are responsible participants in the global economy.

Mahvash Saeed Qureshi & Guanghua Wan (2008) have discussed the trade expansion of China and India, especially with regard to export performance and specialisation; as also how trade structure mutually impacts their trade expansion, to the major trading partners. China and India are now much more integrated with the world economy and their share in global exports has increased. Ahya, *et. al.,* (2004), argue that economic performance had been increasing because of abundant labour, better infrastructure, flexible labour markets, FDI inflows and a favourable investment climate. According to Blazquez-Lidoy, Rodriguez and Santish (2006), the average wage is three to four times lower in China than in Latin America. Both countries trade competition and complementarily to rest of the world exhibit a changing pattern. Consequently, impact of openness of trade in both countries has led to export growth. Also, both countries are almost moderate by complementary in their export-import structure.

Bojana Todorovic (2008) has emphasised the key issues in multilateral trade liberalisation of economies in transition. In post-transition, economies several trade rules were amended so as to be in tune with the global economy. The successes and of rapid recovery by most Central and Eastern European countries (CEECs) from post-transformation recession can be attributed to their integration into international trade and foreign investment flows. Even, after liberalisation of trade reforms, several other reforms were undertaken in the transition economics. Consequently, after trade liberalisation, this experience of transition economies is that for the trade reforms process to be more successful, it is necessary to have in place a legal regulatory and institutional setting so that these can act as "external anchors" for the success of trade reforms.

Andreas Billmeirer & Tommaso Nannicini (2009) in their paper, 'Do open transition economies grow faster', discuss the effect of trade openness on economic growth in transition countries. One argument in that trade openness offers a competitive advantage and has a positive on effect on economic liberalisation. The other one is complicated by a number of factors. Bhagwati and Srinivsa (2001) have also discussed this issue. The

authors have focussed on three issues, namely, (i) Initial conditions versus liberalisation policies as the main drivers for results, (ii) Most transition economies only emerged in the early 1990s, and (iii) Some countries are homogeneous, from there, they shifted to socialised central planning economy. Consequently, it can be said that trade liberalisation leads to growth in transition economies.

2.4. a. Science and Technology:

K.K Subramaniam, has analysed certain elements in the science and technology (S&T) policy. The strategies aspects of Chinese technology policy in the 1980's have been discussed vis-à-vis those of India. The reforms were connecting some imbalances created by the "left errors". Thereafter, there was an inter relationship between economics institutions and technological development. In China changes in technological policies were brought, through technological base and multi-larger development of "walking on two legs" strategy. However, both countries aim should be to develop S&T through autonomous, self-reliant development of technology and finally modernisation of technology, as opposed to import of technology from other countries. In this process, China already has a well developed system in place. India to has made similar efforts towards institution building, and strengthen its science and technology base. The author has highlighted that a selective regulation technology for import and planning of R&D activities to strengthen indigenous innovation are the key components in technology policy for any developing country and make-self reliance the Kernel technology policy. Technological autarky may hamper the development of forces of production and retard the technological progress and modernisation.

Zhang Ming W (2006) has gone into the experiences both the countries. After reforms, both countries have been trying to promote their economic growth and social progress. In the process, there have been both positive and negative experiences. After liberalisation, India has concentrated on the industrial sector, and also self–sufficiency in industrial products. In 1970, India had occupied the rank of 10^{th} biggest industrial power in the world. In both countries, agriculture production has gone up considerably. Since 1970, China has launched more than 15 man-made satellites into outer space. It has even successfully launched manned space flights. Only recently, it sent the first woman astronaut into space into space. Indian has successfully launched satellites. In 1974, a nuclear device was exploded by India. In India, the Rohini satellite (Rs-1) had launched.

While China and India have achieved great successes in the development of S & T, a proper sharing of the experiences will be mutually beneficial for both countries. Due to it's having a dynamic human capital and adopting global best practices, China has made rapid economic progress.

Yanrui Wu and Zhngya Zhou (2006) have undertaken a study on the bilateral trade between India and China. Even though previously a number of authors studied and focused on the expansion of the trade relationship and development (Chen and Uppal, 1971; Swamy, 1973; Harris, 1973; and Bergmann, 1977), their main focus was on trends in bilateral trade and to draw implications for futures trade and economic cooperation. The authors have examined the changes in China –India bilateral trade, both in terms of intensity and intra-industry trade. Thereby both countries export-import activities have been significant influencing their industries and impacting the world commodity trade. China total trade amounted to US$1422 billion in 2005 (NBS, 2006). Thus, the two countries may have comparative advantage in different commodity groups, as shown by Balasubramanyam and Wei (2005). Thus research findings demonstrate that FTAS have boosted bilateral trade between partners.

Renfeng Zhao (2007) describes and compares the trade investment expansion strategies in both countries. The experience of China and India shows that expansion has a significant impact on global growth. In China vast resources of cheap labour and domestic savings to initiate infrastructure development, large amount of FDI and manufacture industry are factors that are influencing it economic success. In the case of India, services sector, pharmacy, and financial markets have been playing a predominate role. China has become an 'assembly factory' in East Asia. It imports parts and components from other region and sells the finished products to the rest of world. India has not fully exploited its potential in international manufacturing, except in textiles and clothing. India needs to consolidate its two strengths: human capital and domestic market potential and second, the IT-enabled services sector. India's National Association of Software and Service Companies (NASSCOM) estimates that, by 2020, India share of the offshore market for engineering services-infrastructure and international reputation will be in place (NASSCOM, 2006). Both countries have their own successful outcomes. The current labelling of China as the 'factory of the world' and India as the world's back office' in international trade may be changing in the coming decade. India telecommunication sector has been doing well, and ranks among the most competitive and cost-effective in

the world. However, both countries are facing similar problems and challenges, like social and environmental degradation, urbanisation and industrialisation.

2.4. b. Transition Economics meaning:

Stanley, Fischer, Ratna Sahay, Vegh and Carlos (1996) have dissected the stabilisation and growth experience in 26 transition economies in Eastern Europe, the former Soviet Union, and Mongolia for the period 1989-1994. Reducing high inflation is a precondition for the revival of growth. As the time profile stabilizes, it is seen that lower fiscal deficits have led to lower inflation and higher growth. The authors have conducted an econometric analysis of the main short-run determinants of growth and inflation. They have surmised that pegged exchange rate regimes (or) fixed exchange rate appear to be more effective in reducing inflation and raising growth. Also, structural reforms play an importance role in reviving growth and reducing inflation. The transition of former command economies to market economics can be judged by comparing the development of economic efficiency in the economy and the transfer of benefits to the population of the country. Even in transition economy countries, there are large variations in the implementation of the economic programmes.

Oleh Havrylyshy and Thomas Wolf (1999) emphasised about the determinants of growth in transition countries. The success of the transition lies in controlling of inflation and liberalising the market. In general growth has been more vigorous and has managed to control to inflation. Success of transition requires the liberalisation of prices, financial sector, external trade and enterprise reform. Output has also increased rapidly through the opening the economy to outside influences and stimulating trade, and resulted in stimulating growth. According to World Bank and European Bank for Reconstruction and Development (ERBD), influence of output is key to the reform process. In the initial stage, the (decline) reforms period, the relationship between growth and reform traced a U-shaped curve. But, unless conditions for an efficiency seeking market economy are in place, investment alone is not going to provide sustainable growth. Any delay in the reforms process can defer the pain (no pain, no gain), since there is no royal road to reforms. In any economy, favourable initial conditions and the institutional development of legal framework play a crucial role in reform. However, results of this comprehensive study show that developing countries will have to pass through vicious and virtuous circles.

Justin You Lin (2004) Gregory W. Komodo has exploration the evolution of China's economic transition. Since 1989, this process has been accelerated due to the transformation of the East Central European economies and of the republic of the former Soviet Union. The former Soviet Republics, Russia and Ukraine, East Central European nations, including Poland, had gone through gradual process, when the ill advised "Shock without Therapy" had been adopted, with all the avoidable losses and pains. The successful transition in China has been due to the policy of *systematic transition and policy of growth economic and also gradual policy approach*. Also, China had learn from the erroneous and mismanaged Polish shock ''therapy approach''. The experience of transition has produced many interesting contrasts to the experiences of transition in *Eastern Europe and former Soviet Union* (EEFSU). In the west, many countries favoured a big bang approach, which expected the transition in EEFSU to have a "J-curve" effect on economic growth. It resulted in raising the GDP and decline in inflation, but led to serious deterioration in other social indicators (World Bank 1960, 2002; Justin You Lin, 2004). In addition, there were experimental and bottom up reforms over the comprehensive and top-down big bang approach (Chen *et al.* 1992; Harrold, 1992; Tefferson and Rawsi, 1995; Mckinneon, 1994; Allmiclion and Naughton, 1992; Murrell 1991, 1992; Perkins, 1992; Rana, 1995; Singh, 1991; Justin Yifu Lin, 2004). The gradual approach in China has achieved dynamic growth to provide protection to enterprises and subsidised the non-viable enterprises. The EEFSU countries and China adopted strategies different strategies in the stage of development. The Soviet type planning system was endogenous to the choice of a CAD (Comparative advantage defying) heavy industry oriented development strategy. On the other hand, China relied on three integrated components for the transition process: (i) Macro policy environment (ii) Planned allocation; and (iii) Traditional micro environment system. However, China also adopted a socialist ideology. It can be concluded that the above policies have been very useful for the development strategy and traditional socialist economic system.

Justin Yifu Lin, Fang Cai, and Zhou Li (2006) have examined "the lessons of China's transition to a market economy". The authors explore the issue of development strategy followed and what kind of measures were considered for the economic development. The beginning of transition is the most successful step in the transition economy (Lin *et al.*, 1996). Some other economists argue that China's success demonstrates the two adopted top-down "shock therapy" approach that characterised the transition in Eastern Europe

and the former Soviet Union (Jefferson and Raw ski, 1995; Mckinnon, 1994; McMillan and Naughton, 1992; Singh 1991; Chen *et al*. 1992; Harold, 1992; Perkins 1992; Justin Yifu Lin, Fang Cai, and Zhou Li). China adopted a Heavy Industry-oriented Development Strategy (HIODS) in the early 1950's. The system had three integrated components, such as: (i) Distorted Macro policy environment, (ii) Planned allocation mechanism for credit; and (iii) Traditional micromanagement institution of state enterprises. The system was found to be very inefficient because of (a) Low allocation efficiency; and (b) Low technical efficiency. It resulted in low incentives to work for 'managers and workers'. China's transition followed a logical process that is predictable from the theoretical model. The traditional economic system was replaced by HIODs in the country's capital-scarce economy. The fault in the earlier economic system was low economic efficient arising from structural imbalance and incentive problems. For correcting and developing the system, micro-management institutional reforms, resource allocation mechanism reform and macro policy environment reform were taken up. For instance, successes of China are in sharp to contrast to those in other Eastern Europe countries and former Soviet Union (Chen *et al.* 1992; Qian and Xu, 1993; Harold, 1992; McMillan and Naughton, 1992; Gelb *et al.* 19993; Mckinnon, 1994). It can be concluded that, initially, industrial sector, agricultural sector and decentralised regional economic factors are very strong in China. These reforms experience have promoted the successes in the transition process.

Vladimir Popov (2009) in his paper, on 'lessons from the transition economics' has asserted that many transition economies succeeded by pursuing policies that were so different from each other's background. Three central European countries–Czech Republic, Hungary and Poland are acclaimed to be success stories of transition. The success is attributed to the eliminations of soft budget constraints. The developing countries should not embark blindly on market friendly policies/reforms. The reasons for successful transition economic policies are different from liberalisation, as can we seen from the economic success of central European countries. For instance, a) Optimal policies are context - dependent, they are specific for each stage of development, e.g., a successful economic policy in one country cannot always be fully replicated in another b) Even though countries may have the same level of development, reforms needed to stimulate growth are different; they depend on the previous history and on the path chosen; and c) Introducing this 'missing ingredient' should not result in the destruction of

other preconditions for growth. The skill of the policymaker lies in creating markets without causing government failure as was the case with CIS countries.

Rita O. Koyame (2011) discusses the transition experience of Czech Republic and Slovakia. The influencing factors for output growth include: background, initial conditions and reforms policies on both countries' economies (Donnorumm, 2009). In both countries, inflation and recession were the main causes for liberalisation in early 1990. They studied the economic indicators, namely, GDP, Inflation, FDI, unemployment rate, public sector deficit/ surplus so on. The reforms policies in the two countries were heavily influenced by European Union (EU) membership requirements. In both countries, transition began at almost the same time but, both countries are now at different development of stages. World Bank (2002), insistence that broad reforms should includes design, sequencing and speed of implementation are still subject to debates. Economic reforms also encompass: Macroeconomic stabilisation, Price and trade liberalisation, imposition of hard budget constraints on banks and enterprises, privatisation, reforms of the tax system and restructuring of public expenditure, Legal and judicial reform, and Reform of public sector institutions. Consequently, both Czech Republic and Slovakia experienced a rise in income inequality during the transition period. They primarily focused on privatisation, liberalisation and macroeconomic stabilisation.

Srinivasan (2004) has studied the merchandise trade in both countries during the period 1983-2002. A more disaggregated picture emerges, in terms of the changes in policies in India and China of several labour-intensive sectors in the world. Bottelier (2003), points out that India's service exports are growing at about double the rate of its merchandise exports, and if current trends continue total exports would exceed 50% in a decade. There is one services sector (IT), in which India has done much better than its counterpart in China. The India IT giants have won contracts despite competition with China's financial sector, China's software sector face the issue of lack of facility with the English language and shortage of experienced project managers. Moreover, India is also ahead of China in the pharmaceuticals sector. Lace and Kynge (2003), state that United National buys more than half of its vaccines from a private Indian company. The fact is that two sectors, namely, software and pharmaceuticals were leading in India due to human capital. These are the driving force to raise a fast-growth economy (Kripalani and Engardio, 2003). We can say that services exports have been the engine of economic growth of India. In sharp contrast, China's growth has been accelerated by manufactured exports.

2.4. c. Inflation:

Stanley, Fischer, Ratna Sahay and Vegh, Carlos (1996) have gone into the stabilisation and growth experience in 26 transition economies in Eastern Europe, the former Soviet Union, and Mongolia during the period 1989-1994. Though the main intent is reducing a high inflation as a precondition for the revival of growth, lower fiscal deficits have led to lower inflation and increase in economic growth. We can conclude that an econometric analysis is necessary mainly on short-run determinants of growth and inflation. And also pegged exchange rate regimes (or) fixed exchange rate appear to be more effective in reducing inflation and raising the growth. However, structural reforms also play an importance role in reviving growth and reducing inflation.

C.P Chandhrasekhar & Jayati Ghosh (2008) bring out that in India, the reasons for increase in the current inflation are: high price a of food products, including cereals, and intermediaries like metals and oil. These, combined with the uncertainty in West Asia, resulting from the occupation of Iraq and standoff in Iran, have created a situation where any instability will have an adverse effect. IMF data shows that due to increase in prices of agricultural raw material, and other commodities in 2005, inflation almost doubled in the two year period in February 2008. Also, coal prices more than doubled last year, even faster than the oil price. Moreover, IMF data shows more than 40 per cent increase in world food prices over 2007. As a result, globally, the prices of many basic commodities have been rising faster than they ever did during the last three decades. Also, imbalances are growing between world supplies.

George R. Hogues, CFA, FRM, Global Equities (2008) has attempted to explain rising inflation and its effect on commodity prices. According to Ben Bernanke in a speech given in February 2004, the Great Moderation refers to the period between 1980 and 2004, due to the changes in US economic activity, consumption and inflation experienced a dramatic decrease in volatility. In recent year in Asia, inflation is accelerating because of rising prices of food, oil and other commodities as well as accommodative monetary policies.

Tustin Yifu Lin (2009) in book review of "Economics Development and Transition: Thoughts, Strategy, and Viability", concluded that institutional framework for market economy reinforced the support for economic liberalisation and individual choice and allowed millions the choice to left themselves out of poverty. This book emphasis on

'China's development process and understanding the fundamental determinant of development and transition strategies'. East Asian economic were able to take advantage of their 'back wardens', only when they adopted a 'Comparative Advantage Defying' (CAD) strategy to 'Comparative Advantage Following' (CAF) strategy and opened their economies to foreign trade and investment. The Scotsman, Adam Smith, and Hayek explain the importance of freedom and the ability of markets of self-correct through myriad adjustments. Hong Kong is the fastest growing economy in the world because it has limited government and trade liberalisation and big market.

2.4. d. Exchange rates:

Yuqing Xing, Guanghua Won (2004) examined the role of exchange rates in the competition for FDI. The importance of exchange rates in determining FDI has been emphasised in literature (i.e, Froot and Stenin 1991; Klenin and Rosenger, 1994; Blonigen, 1997). Basically, devaluation in the currency of the receipt country reduces production costs, and increased the relative wealth of foreign country investors leading to an increase in FDI inflows. Consequently, if the currency of country appreciates more than that of its rival, its FDI inflows will decrease, while the competing country's FDI will increase. The relative FDI of one country is determined by the relative changes in exchanges rate between its currency and that of the source country.

2.5. Research Gap

In this review of literature, a number of authors have made a comparison of the economic policies of India and China. But very few studies have discussed this from the transition economics perspective. The present study is mainly focused on 'transition economic perspective' on FDI and Trade progress of India and China. The study will also explain the role of FDI and trade from a transition economy perspective, for both China and India.

CHAPTER – III

THEORETICAL BACKGROUND OF THE TRANSITION ECONOMIES

3.1. Background of Transition in Eastern and Central European Economies in 1989

3.1.1 EBRD's Indicators of Transition

3.1.2. Research on Economies of Transition

i. Path of Transition Economies

3.1.3. The Importance of Transition for Economies

3.1.4. Pre - Transition Economies and initial Conditions in Eastern and Central European Economies

3.2. How Transition process began in European Countries

3.3. How European countries have achieved consistent Economic Growth and Development: Successful stories of some Transition Economies.

3.4. Lessons that can be drawn from European Economies

3.5. Conclusion

"Perhaps the most useful criterion for assessing success in the transition is the sustainable recovery of output, which can be achieved only by controlling inflation and liberalising markets".

Oleh Havrylyshyn and Thomas Wolf(1999)

3.1. Overview

Economic Transition is a dynamic historical process, imposing change on almost every element of society (IMF, 1999). Since 1989, Central Eastern European (CEE) economies had been undergoing the transition from central planning to free market economy and capitalism (Haslach, 1992). In this process, a number of countries have undergoing rapid transition, while some have achieved only marginal success in this regard. Since, transition economies attached great importance to output growth, the discernable outcome has been the improvement in the living standard of the people of these countries. Privatisation has now become a highly popular concept. The disinvested companies, as also privately owned firms, are generally can seen to outperform State-owned enterprises (SOEs). As a consequence, in middle-income and lower-income countries, privatisation appears to have yielded positive results (John Nellis, 1999).

Governments in transition economies need to choose the most optimum ones from the array of reforms before them. The stylised approach is classified by: (a) Rapid reform, undertaking as many reforms as possible in the shortest possible time; and (b) Change, by way of partial and phased reforms. Each approach is associated with its own characteristic pattern of risks and rewards. A country undertaking economic and political reforms, has before it a range of reform policies and outcomes.

Among the reforms strategies, the all-out approach aims to replaces central planning with the rudiments of a market economy in a single stroke of reforms. These include: rapid price and trade liberalisation, accompanied by an economic stabilisation programme to restore and maintain price stability. Any reform seeks to minimise the duration of the unavoidable pain and quickly sever the links between the state and the productive system to guard against backslide and stagnation. EBRD has identified three main categories of transition objectives which describe how a project may contribute to the process of transition. These are: (a) Structure and extent of markets; (b) Institutions and policies to support markets; and (c) Market-based behaviour patterns, skills and innovation.

Europe's trade began during the time of Dutch Merchants in coastal India and China, and the trade followed fed a growing European fascination with Asian cultures and

aesthetics. In fact, the historical and economic perspective of both countries had risen which was later on interrupted by the colonial period, Cold War and economic autarky in the twentieth century. Thus, transition economics, well being human life time - it's shifted to the global economics architecture (Peter Mandelson, 2007).

Let us now consider the Central Eastern European countries. Poland and Czech Republic are the successful models of economic transition. In China, reform began in 1978 with institutional market oriented economic policies, while in India these stared in 1991. Reforms began as a gradual step toward market orientation in India.[1]

Table 3.1: Existing Conditions of Transition Economies at the onset of Reforms

Region/ Countries	Industrial Sector	Service Sector	GDP	Inflation	Monetary overhang
East-Europe (1989)	Stagnant	Stagnant	Stagnant	Moderate to high	Considerable
India (1991) Democracy	Growing	Booming	Growing	Moderate	Low
China (1978) Communist	Booming	Growing	Growing	Low	Considerable

Table 3.1; explain economic indicators of Europe, India and China. In China's case it was the manufacturing sector. India services sectors export-led growth brought about a painful economic change in Europe. The successful completion of the Doha Round and the maintenances of the WTO agreements, led to be an effective integration with global trading. Thus, global trading system helped to establish reciprocal access to their growing markets since of EU exports is a key system dynamic EU trade policy.

Europe and China at the initial stage of transition negotiated on trade and entered into investment agreement on certain issues which it would ensure a significant role play by China and key focus of resources for EU trade policies for the predictable future. By the decision of FTA with EU, and later on India had helped reduce many of the barriers. India also an encouraging European investment that can be an import sources for capital for India.

[1] . More detail, since 1989, Central and Eastern European Countries including Poland and Hungary, have been in the process of transition from planned economies by the agreement of G24 countries (group of 24 Countries in the Development Assistance Committee of the Organization of OECD and International Organization), Japan provided assistance to these countries for transition. The transition in Poland, Hungary, Czech Republic and Slovakia has shown significant progress and joined the OECD. However, N.A Khan *et. al.*, (2009), discussed the aftermath of introduction of market-oriented reforms in China, market-oriented policies by India by the agreement of IMF, World Bank.

Although European public policies have addressed the need to face the impact of economic change and adoption, it would also be require comprehensive demonstration of reciprocity from India and China. EU trade policy is the means of both delivering the reciprocity and securing European openness that legitismises the demands EU makes of others. Europe stands to gain hugely from the economics strength by the cheap inputs, and as a source of investment in liquidity-rich global capital markets (Peter Mandelson, 2007).

3.1.1. EBRD's Indicators of Transition

The European Bank for Reconstruction and Development (EBRD) has developed a set of indicators which are used to measure the degree of transition in a market economy and the progress of transition. The classification system was originally created in the EBRD's 1994 Transition Report, but it has been refined and amended in 1998. With the help of these indicators, EBRD measures the level of transition of the economies as: less, high and complete transition. The main EBRD's transition indicators are:

- Large-scale privatisation
- Small-scale privatisation
- Governance and enterprise restructuring
- Price liberalisation
- Trade and Foreign exchange system
- Competition policy
- Banking reforms and interest rate liberalisation
- Securities markets and non-banking financial institutions
- Infrastructure reforms.

3.1.2. Research on Economies of Transition

When the Berlin Wall was brought down on November 9, 1989, thousands of people expressed their joy as they felt that the wall stood out as a symbol of the division of Germany. A sizable number of economists have been studying the process of transition from socialism to capitalism in the former socialist economies. The field is called- 'transition economics, or transformation economics'. This process, interesting for research on transition, has grown over time, but the main focus is on transition policies. It was mostly dominated by policies which had attempted to influence various aspects of

economic transition policies. The overall transformation of the economic institutions in the countries concerned has brought about a complete change in the economic condition of the people. In the 20th century, transformation is tremendously influenced by technological progress. Research on the subject- both theoretical and empirical has increased. Further, for research on Europe, the Centre for Economic Policy Research (CEPR) has set up, together with its traditional programme cells, divisions to study areas, such as international macroeconomics, industrial organisation, trade, public policy finance, and labour. Also, a number of economic research institutions was established. These include the Center for Economics Research and Transition (CERT) at Heriot Watt University in Edinburgh and the Stockholm Institute for Transition Economics (SITE) at the Stockholm School of Economics.

As we are into the second decade of the third millennium, there still remain the major challenges of bringing about prosperity and growth, and well - working market institutions in the poorest countries in world. The capitalism objective is to improve the level of prosperity and development as in the advanced industrialised countries.

Though academic research has been increasing in the area of economic transition, many policy advisers feel that transition economics still remains a subject of controversy. It is noteworthy that, while transition policies have been largely unsuccessful in Russian, these have been very successful in China. The Title of some books on Russia, are: *How Russia Became a Market Economy*, Aslund, 1995; *The Coming Russian Boom*, Layard and Parker, 1996; *The Success of Russian Economic Reforms*, Granville, 1995; Gerard Roland, 2009. Open debates and serious research are, therefore utmost importance of to help formulate adequate policies for a successful transition to capitalism (Gerard Roland, 2000).

(i). *Path of Transition Economies*

The transition strategy is being adopted by developing countries to improve their status from poverty to wealth and to help "developing and transitional countries 'jump from the kingdom of necessity to the kingdom of freedom". After that, countries sought to develop 'a Comparative-Advantage Defying' (CAD) strategy". The developing countries leaders desired to catch up with the developed countries, but that was not always possible due to scarcity of resources. Although under - developed countries have relative abundance of labour and natural resources, these countries were diverting resources away

from labour-intensive industries towards capital-intensive ones (iron to steel). Initially, East Asian governments did not choose a CAF-strategy but later on adopted that due to resources constraints and spontaneous development. The faster way to achieve that goal was to employ Soviet style planning and, if did not survive the CAD strategy, the other substitute was "Comparative Advantage Following (CAF) strategy", based on a bottom up development model which creates a higher value for consumers. The comparative advantage is required for getting rid of distorted prices, liberalising trade, and allowing the non-state sector to grow. It was like successfully emerging market economies, especially in East Asian countries which faced 'backwardness' only when they adopted a CAF strategy and opened their economies to foreign trade and investment. Lin at recognised that strict adherence to a CAD strategy that dominated social thought at that time - resulted in spreading government failures in developing countries. After that, he advocated seeking seek the alternative strategies for measuring the CAD strategy, which he calls a "Technical Choice Index (TCI)'. CAD strategy has less economic freedom and more corruption and has a volatile economic growth, inequalities than in countries that adopted a 'Comparative Advantage Following' (CAF) strategy". Lin does not fully support the so-called Washington consensus – a list of policy recommendations for transition economies.

"In the long run, the aggregate of decisions of individual businessmen, exercising individual judgment in a free economy, even if often mistaken, is less likely to do harm than the centralised decisions of a government and certainly the harms is likely to be counteracted faster".

The fundamental goal of economic development is to make the benefits of expanding open to people. By allowing the politicalising of 'coordination', such decisions reduce economic freedom and increase the power of governments. Hong Kong's is the freest economy in the world because it has limited government and trade liberalisation small government and big market. The Scotsman, Adam Smith and Hayek spoke about the 'importance of freedom and the ability of markets to self-correct through myriad adjustments'. East Asian economies were able to take advantage of their 'backwardness', only when they adopted a CAD to CAF strategy and opened their economies to foreign trade and investment, with the following aims:

- To provide incentives to follow a CAF strategy by granting state owned enterprises (SOEs) more autonomy.

- To shift from single-track price system to allocation system to a dual–track system,
- To allow full liberalisation in those sectors that are firmly on the market track, and
- To undertake legal reforms 'to strengthen market institutions' during the transition process.

3.1.3. The Importance of Transition for Economics

The above theories explain the process of economic transition function and reaction to reforms and large-scale transformation. Successful institutions of capitalism are already present in advanced economics, while in developing economies, such institutions are absent. The transition experiences have helped to accelerate various changes in the economies. In the initial stage of transition, the policy advice in *Washington consensus*, laid strong emphasis on: (a) Liberalising prices, (b) Tight monetary policy and balanced budgets to stabilise the macro economy; and (c) Privatising state-owned enterprises, in order to induce profit maximising behaviour. However, transition has forced us to think about institutions not in a static, but in a dynamic, way.

In reality, nobody can tell for sure how transitional the transition is, or whether the countries engaged in this process will end up transformed into successful capitalist economies. However, development policies were formulated decades ago, with the objective to 'help the under-developed economies to catch up with the industrialised countries'.

The outcomes are strongly dependent on the initial set of institutions that from the starting point of transition. The necessary transitional devices adopted by Chinese for more successful transition include, as a dual-track liberalisation and Township and Village Enterprises (TVEs) (Qian, in press, Roland, 2000). However, the question arises whether such measures are stepping-stones towards better institutions or have they created vested interests that block further institutional transition. Institutional perspective, research in transition can help to improve: (i) Understanding of capitalism; and (ii) Large-scale institutional changes. Transition is clearly narrower and can even partly be seen as a subset of those fields. Economic Transition is a history in the making and will sooner or later become a sub-field of economics theory. However, research on transition cannot

develop successfully purely as a field of its own. It must be developed in interaction with various others fields of economics to gain from the various angles provided by the different fields of specialisation. Research on transition can then be simply broken up to the appropriate fields of specialisation–macroeconomics, industrial organisation finance, trade etc.

The main objectives of transition:

Objectives:

- ✓ To improve allocation efficiency and the creation of a competitive market environment open to the world economy.
- ✓ Stabilise the macroeconomics, which is necessary for correct functioning of the price mechanism.
- ✓ To provide better incentives and corporate governance arrangements, through, encouragement of entry of new private firms and the creation of an entrepreneurial class.
- ✓ Creating government institutions "adequate" for a market economy. For running the institutions, there is need for political and institutional stability and protection of private property rights from encroachment (EBRD).

3.1.4. Pre - Transition Situations

The economic advisers played a prominent role in policy debts as has been the case since 1990 in central and Eastern European Economies. Jeffrey Sachs, drew worldwide attention for his forceful statement on the big bang approach, and gradualism approaches. The big bang is a simultaneous and quick introduction of all reforms, support by Lipton and Sachs (1990a), Aslund (1991), Berg and Sachs (1992), Boycko (1992), Murphy, Shlefer, and Vishny (1992), Sachs (1993), Frydman and Rapaxzynski (1994), Woo (1994), and Gerard Roland (2000). At same time, gradualism means the need for a given sequencing of reform support Svejnar (1989), Portes (1990, 1991), Mckinnon (1991), Roland (1991), Dewatripont and Roland (1992a, 1992b, 1995), McMillan and Naughton (1992), Murrell (1992), Aghion and Blanchard (1994), Litwack and Qian (1998), and Wei (1993) and Gerard Roland (2000). No pre-established theory of transition existed before the fall of the Berlin Wall. Transition economics basically aims at giving advice on transition policies. However, most economists agree that stabilisation

is only one of the dimensions of transition in large-scale institutional changes.[2] In addition, transition must have change without economic disturbance, and continue to fulfill the population's needs. To sustain the magnitude of the changes implied by transition; political support needs to be continuously maintained during the reforms process, to avoid policy reversals (Gerard Roland, 2000).

The post-1989 experience in China is that the political and economic circumstances differed from that of Europe. Kornia (1993), and other economists stated that before 1989, many did not predict the output fall. However, there were good surprises of restructuring inside SOE's. Many economists advocated fast privatisation, because of the fear that the alternative of no privatisation, or slow privatisation, would be much worse. Although a few years after the Communists had been evicted from power by the democratic revolutions of 1989, former Communists came back to power via the ballot box in Lithuania (1992), Poland (1993), Hungary (1994), and Latvia (1994). Though the successful development of the non-state sector, especially the Township and Village Enterprises (TVEs), came as a surprise because of its unclear property rights structures, accepting the fact that it should not distract us from knowledge and understanding of transition processes still remains limited and happens mostly "after the fact".

b. ***Initial Transition Situation***

An important fact about socialism is that there was not really a consistent plan at the level of economy. Planning was not only an iterative process, but also a cumulative one. The point of departure for the plan in period t+1 would be the achieved level of production in period t. Planning is an incremental process, known as "planning from the achieved level" (in Russian Planirovanie to Dostignutogo Urovniia, Birman, 1978), it consistently aims to achieve a general equilibrium. Ministries not only played a crucial role in planning, but also tried to response to perceived shortages by enterprises. Thus, this mechanism played a key role in preventing general output collapse in the absence of markets.

Socialist economies, indeed, had a history of market-oriented reforms before the fall of Communism. However, the most immediate consequence of such reforms was

[2]. To create development markets, including financial markets, enforcement of property rights, legal and political changes along with enterprise privatisation and restructuring.

wage drift and soft budget constraints prevailed, in enterprises under reforms under socialism. These increased pressures from below led to a further weakening of the planning system and of the central authorities who yielded to demands of enterprises. An increase in enterprise demand started leading to serious macroeconomic imbalances that the "classical" socialist planning system had been able to prevent. These consequences were: increased foreign borrowing or increased shortage and forced savings. Some countries have had a history of reform before to transition and faced to serious macro-economic imbalances. These called for a stabilisation package, like the one adopted by Hungary, Poland and Yugoslavia. Other countries like German Democratic Republic, Czechoslovakia and Romania, that did not have reforms before, had to face issues like imbalances and stabilisation problems in the initial stages of the transition process.

The institutional legacy is different from country to country at the outset of transition. Their dependence on skill helps to rebuilt institutions. The CEE government agency dealing with international trade developed a familiarity with market based contract law. Sometimes, the absence of an institutional legacy can actually be an advantage. On the other hand, implementing new institutions requires large human, technical and financial resources in all countries undergoing the transition process. Thus, due to this, the new states face a massive additional burden.

Countries that embarked on transition from very different starting points

- Most reforms are inherently slow. Though formal privatisation was accomplished in one or two year, fundamental changes mean that large firms usually take a long time to stabilise.
- The second model of piecemeal and phased reforms starts with localised experiments, which are expanded, as anticipating successes emerge. This strategy relies on this big scope to gain large productivity gain from the very beginning, in partial reform. As a result, as incomes rise, there is need to build momentum for further, more difficult, reforms in a self-reinforcing manner so as to be able to sustain the reform over an extended period. This approach was summarised by Deng Xiaoping's phrase, "feeling the stones to cross the river'. Moreover, the path followed by China, in the initial reforms in 1978, was to open the door to joint ventures. After that, reforms concentrated on the rural economy. The household responsibility system, new rural township and village enterprises (TVEs) emerged and were encouraged to operate on market principles. By 1984, reforms had

spread to the urban economy. Trade and foreign investment reform were then launched. Reforms had accelerated in 1994 and 1995, particularly those concerning taxes, company law and foreign trade.

There are two model routes in a planned economy. However, this does not mean that all countries are in a position to choose between them. Let us examine the Soviet experience in the regards:

- The earlier attempts at partial reform, in the country failed to raise efficiency, largely because they were restricted to only some countries.
- The second, more important reason why gradualism was not an option in CEE and the Soviet Union was that, by the second half of the 1980s, the Soviet planned economy was disintegrating from within. In 1986, the Soviet Union launched political rehabilitation and economic restructuring. These led to inflation and foreign indebtness - rather than higher productivity.

Thus, beside the factor of macroeconomic disequilibrium for choice of reform path, the influence of political, historical, culture and geographic factors can also be very important. In China, the Communist party emerged mainly from internal political movements.

3.2. How Transition process began in European Countries

By the beginning of the 1990s, the continent of Europe found itself completely shaken up by political and economic upheavals. The fall of the Soviet Bloc, which had divided the continent for over four decades, brought about a completely new economic order, with the hitherto Soviet Bloc making the transition to capitalism. Central Eastern European countries transformed their economies in the early 1990s. In the process of economic transition, a stimulating period of capitalism followed. The end of the totalitarianism was seemed as the beginning of a new golden age of economic prosperity.

The combination of socialism and capitalism was inspired by the economic system of Western countries, such as Sweden and France, which has been relatively successful in combining the advantage of socialism with the dynamics of the free market. Although they risked popular discontent and many years of economic austerity, most countries found that the only way to overcome decades of economic mismanagement was transition to a free-market economy, with currency convertibility and the markets were to

be allowed to make all the decisions - no matter how painful (Randy Charles Epping,1995, pp.104-106).

3.2. a. An Evolution of European Economies in Transition

In European, the stronger expression of popular discontent in 1989, was the fall of the communist regimes. The people of Eastern Europe were unhappy with the economic inefficient system. This led to revolt against the socialist system. After the Second World War, Communist Eastern Europe was largely on the periphery of Western European economic development, whereas the rests of the regions were largely undeveloped. The Second World War had led to large scale destruction. Later, the Communist Party assumed power and was very successful in rebuilding the economic infrastructure and to bring a higher rate of economic growth during 1950-1973. However, 1973 onwards, the picture changed drastically. During in the 1980s, governments were struggling to stave off the recession. The early 1980 saw three significant issues specific to Eastern Europe, which made it that much more difficult for the Communist regimes to survive. These were (i) Eastern European countries had a centrally planned economy, which meant that all attributes would be controlled and allocation of resources done accordingly, (ii) In 1970 and early 1980s, the economics of Eastern Europe had maximised their ability to supply the technology and services, that would lead to sustained economic growth. The East European states had to turn to World markets, and (iii) The third issue that made it difficult for the East European Communist government to respond to the worldwide Economic slowdown of the 1980s, was that all their economies were connected to Soviet economy, both through trade and joint ownership of enterprises.

These economic problems of the 1980s put significant pressure on price control. Therefore, Communist governments had raise prices suddenly. These events led to the creation of the independent trade union solidarity in 1980. On the positive side, infant mortality rates dropped to nearly one-third in most of the regions. Prior to the mid-1980s, these governments were neglecting the issue of environment to industrial pollution and environmental degradation. Many opposition parties in Eastern Europe in 1989 launched environmental movements. Thus, the Communist regime fell and these states began the transition to a capitalist economic system. This kind of pressure played an important role in the break –up of each country (Center for History & New Media, Powered by Omeka, 2007- 2010).

One of the reasons for the failure of these countries was the absence of market institutions, which made it difficult to construct appropriate political, legal economic and commercial structures needed for a free market economy (Blawatt, 1995; Tyson *et. al.*, 1994; Smallbone and Welter, 2001; Mugler, 2000; Warner and Daugherty, 2004). Other European countries had a large number of entrepreneurial, small business activities and a strong private sector (Blanch flower, Oswald and Stutzer, 2001; The OECD observe, 1999).

Progress and Outcomes

Outcomes of progress can be discerned by assessing different paths of reforms, initial conditions and history, politics, economics and institutional starting points. To assess progress, we shall now look at some of the broad dimensions: liberalisation, property rights and private ownership, institutions and social policies:

(i) *Liberalisation:* its covers three areas domestic price and markets, foreign trade and currency convertibility, and openness to new business entry. In 1995, newly countries in CEE and the NIS were essentially market economies, with open trade, current account convertibility, and liberalisation policies towards new entry and private business. However, one year is for too short a period to capture the economic impact of the process of liberalisation.

(ii) *Ownership reforms:* in this area, these have been great changes. In CEE and the NIS, the private sector now accounts for over half of economic activity. China has also diversified substantially toward a wide variety of forms. The successful transition involves initiating a process of change towards an efficient pattern of ownership, though institutional reforms have also been affected by initial conditions. However, outcomes of transition require both economic grants and social policy reforms.

(iii) *Economics and Social outcomes:* The success of policies depends on the interplay of reforms across a number of areas. Among advanced reforms, vigorous stabilisation programmes have paved the way for reduction in inflation and a resumption of growth as reforms have taken hold. Production has shifted from industrial to service and trade has been reoriented towards world markets. In addition, FDI inflows have risen sharply. The social impact of transition has also been different. Falling output and rising income

disparities has led to large increase in poverty and growing insecurity in many countries.

At the onset of the reforms, the was a great scope for reallocating the labour source. Any study on financial development of the country takes into account the conditions obtaining at the onset of transition. Also, the right reforms mix need to reflect the initial state of affairs.

3.3. The Successful Transition Economies Experiences: Poland, Czech Republic

Transition from a command economy to a market oriented economy is a dynamic and difficult process that involves several stages of transformation. These transition stages differ, based on the political and socio-economic background of individual states (Rita O. Koyame-March, 2011). Towards the end of the Cold War, the World seemed poised to fall into another deep seated polarisation, in between developed and the developing world. This approach can help in bridging the gaps in standards of living and employment opportunities and social security for the citizens of the countries concerned. The new bipolarisam in the stalled Doha negotiations emerged to provide reforms for global institutions, in the confrontation about human rights and even in the different approaches to fighting terrorism and for building peace and security. Development assistance is at the heart of this new polarisation. Policy makers argue that it would lead to global disarray. The third approach aims for development assistance policies to explain the effectives of the Official Development Assistance (ODA).[3]

Three main indicators affect the relative success of a transition processes. These are: historical background, initial conditions and reform policies initiated towards the transition (Rita O. Koyame-March).

The secret of European Success: towards a New synthesis

There are two common threads that can be seen at work in all cases of success, and that can be spelt out in the argument as the main factors explaining the effectiveness of aid in relation to growth. These include: (a) Aid promotes economic integration, i.e.,

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[3]. (i) DA stimulates and supports the integration of national and local economics at the international level; both globally and regionally.

(ii) Determines institutional reforms and sound economic policies at the appropriate level of government (global regional, national and local), and leaves the private sector to play its fundament role.

the elimination of barriers to economic activity, the enlargement of the market and its smooth functioning; and (b) The application of the subsidiary principle, in that aid stimulates private players (business and civil society), and evolves responsibility towards the lower level of governments. In addition, subsidiary implies that "institutional assignment", i.e., taking policy decisions in the level that is appropriate for that decision (Abdu Chowdhury, Paolo Garonna, 2007).[4]

The Central and Eastern European countries (Poland, the Czech Republic, Slovakia and Hungary, known as the Visegrad four) have rapidly transformed their economies to the point where the transparency of the legal structure provider relatively easy access to CEEC resources and markets; and the prospects for medium, long term stability and growth (Richard, E Stern, 2008).[5]

Many studies concluded that the three central European countries - Czech Republic, Hungary and Poland - are the success stories of transition (Vladimir Popov, 2009; Rita O. Koyame - Marsh 2011). However, the successful transition economies chosen for this study are: (a) Poland, and (b) Czech Republic.

Figures 3.1, 3.2 & 3.3, depict the transition indicators during the period of 2005 – 2011 in Poland and Czech Republic. Poland's GDP growth rate and inflation has been fluctuating over the period and especially in 2008-2009, trends decreased due to the financial recession. Czech GDP sharply declined in 2007-2009, and inflation rate also decreased during the recession period. One other important indicator, i.e., unemployment rate steadily decreased in 2007-2009. However in 2010, the unemployment rate trends appreciated. FDI trends are gradually declining in recession period in both countries. In 2010, Czech Republic FDI net inflows sharply raised, while in Poland, FDI trend was sluggish moving up. Table 2 explains the economic indicators of both countries. We can also be seen from table; (Appendix-3.I).

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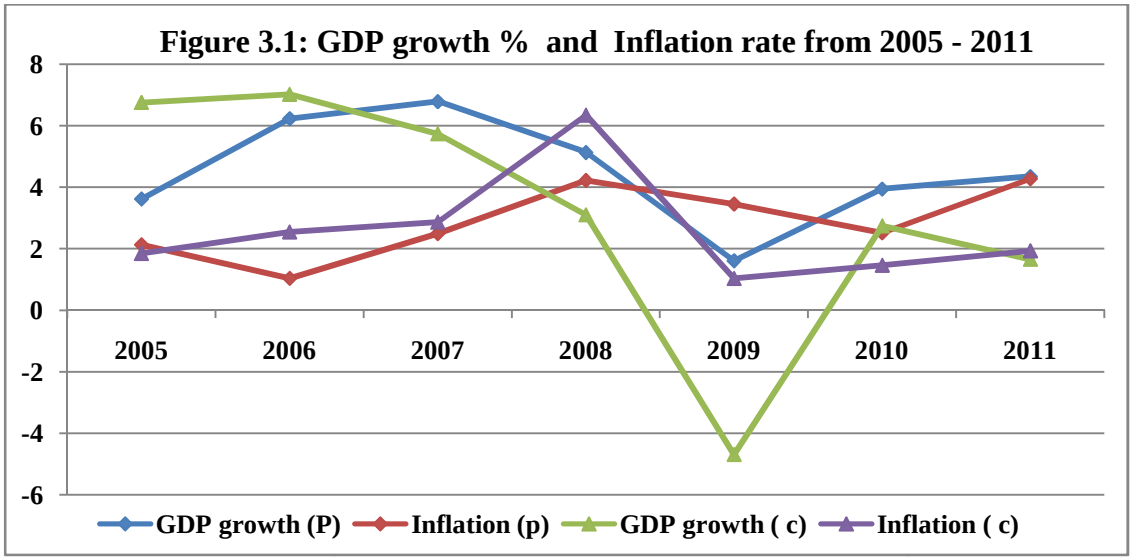
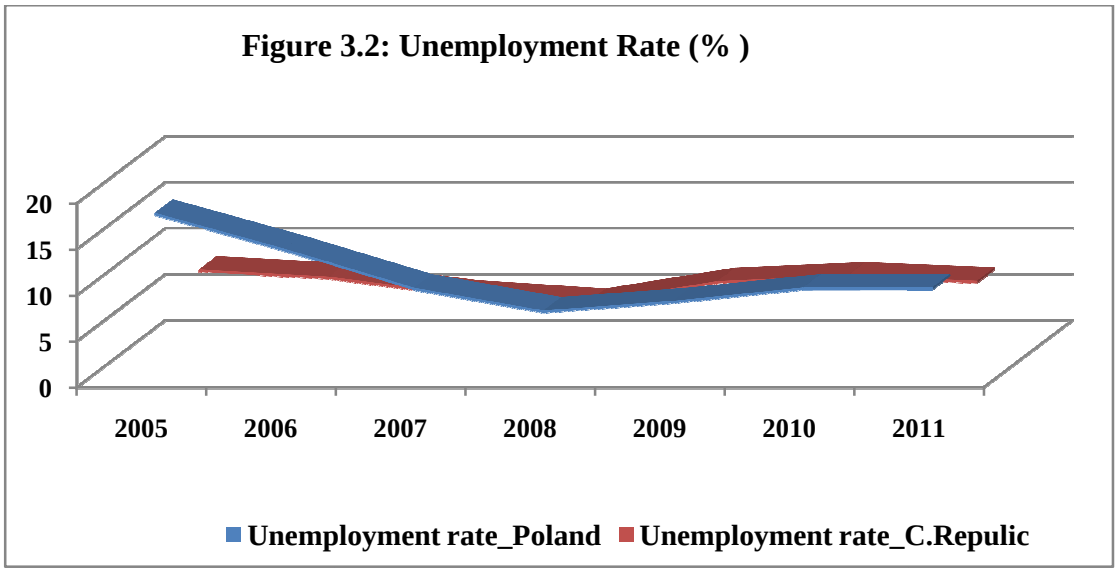
[4]. Abdur Chowdhary, Paolo Graronna (2007), "Effective Foreign Aid Economics Integration and Subsidiary Lessons from Europe", *Central Social and Economics Research*, Warsaw, June (346).

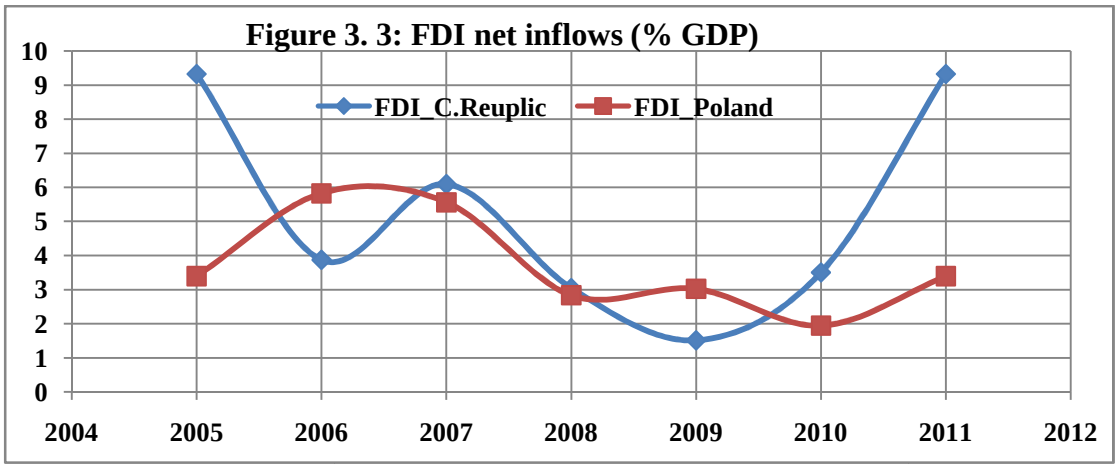
[5]. See, "Foreign Direct investments, Exports and East-West Integration Theory and Practice", pp. 329-331.



Sources: IMF, 2012, P = Poland, C= Czech Republic



Sources: IMF, 2012.



Sources: World Bank Indicators, 2012.

(a). Poland:

During the 1990s, Poland had become the transitional 'Guinea Pig' for Big bang/shock therapy' and it adapted rapid and comprehensive reforms, to bring about macroeconomic stabilisation and tackle the near hyper-inflation. In 1989, inflation was very high in Poland. The "Secret" of Poland's success", is that it was the only country in Europe without recession in 2009. The potential of performance economic characters, such as: (i) Strong market institutions (ii) A resilient economic growth, (iii) Strong economic policies during crisis situations; and (iv) High levels of trust in the government was very much in evidence.

Liberalisation of Prices: On January 1st 1990, most prices were liberalised. After 1990, 90 per cent of prices were determined by the market and there was significant increase in controlled prices as well (Balcerowicz *et. al.,* 1997; 138). There was a high degree of encouragement for hard currency exports (a surplus on the convertible currency current account of the balance of payments was achieved in 1990). Poland is generally regarded as proof of the virtues of rapid and comprehensive change (in November 1996, Poland become a member of the OECD). The first stage of stabilisation in the beginning of 1990 was quite successful in bringing down monthly inflation of 30 to 50 per cent to 3 to 5 per cent. Unfortunately, due to political instability and untimely loosening of monetary and fiscal policies, the inflation control process in subsequent years was rather slow (Balcerowicz et. al., 19997; 142). On March 11, 1994, Poland and the London club of Commercial banks signed an agreement in principle to reduce (by 42. 5 per cent) and reschedule the $ 13.2 billion debt over a thirty year period. However, Poland is one of the EU's lowest personal and corporate tax regimes within five years, following parliament approval of a controversial tax-cut package. The tax-cut is a crucial element in stimulating economic growth (Balcerowicz et. al., 19997, p. 276).

The initial pension reforms had a positive impact on capital market development. As a result, these were a rise in saving culture among the workforce. But, mid-2010 opens pension funds were reduced from 7.3 per cent of gross salaries to 2.3 per cent on May 2011. Polish private bond market remained underdeveloped; the government bonds have high liquidity market, which extends to very long maturities. These bonds are important for private and government for a long-term funding (EBRD, 2011, pp. 146).

Labour market reforms: many economists feel that labour market reforms have not taken place in Poland. Employer's social security payments have been helping to finance one of the world's most flexible disability pension schemes. Also, social safety nets exist.
Enterprises reforms: Privatisation, in the broad sense, has been quite rapid in comparison with that in other countries. Of course, most growth has occurred due to the efforts of the private sector and state enterprises. Bankruptcy of some large enterprises has been seen, but many of them have undertaken radical divestitures - by selling off or leasing out substantial part of their assets. The privatisation of large enterprises continued to be hampered due to by political uncertainty and change of governments. On March 18, 1993, the Sejm rejected the privatisation programme involving around 600 medium size and large enterprises. The actual member of enterprises on the mass privatisation list has fluctuated. The share of the enterprises was to be allocated in a complex system of lottery rounds, beginning July 17, 1995.

Poland's growth has been supported by domestic consumption, labour market trends and public investment. During 2010, the privatisation process was accelerated by the government. Privatisation process has continued to move forward due to favourable market conditions, especially power companies, energy sector and the Insurance sector. Public - Private - Partnership (PPPs) law was passed in 2009. Hence, a large infrastructure is required for upgrading the rapid absorption of EU structural funds. Also, for the period, 2007 - 13 (EU) budget gave more focus to structural funds (EBRD, Report 2011, pp. 146).

Foreign Trade: quantitative trade restrictions and export submission requirements were removed in 1990. There have been several upward revisions in imports tariffs after the sharp reduction in 1990 (EBRD 1994: 33). In June 1995, Poland accepted current account convertibility, in agreement with the IMF. The major focus on current account convertibility exits, with limits on residents' capital account transactions. In 1996, input surcharge was abolished. There is an extensive intervention in the markets for farm products. There are also, price support, export subsidies, credit guarantees and managements of state reserves. The effect of above schemes in Poland is that the country has maintained some restriction on short-term portfolio flows. Initially in 1998, the foreign exchange market was liberalised. Thereafter, the full capital account liberalisation occurred in 2000.

Liberalisation has led to elimination of all restrictions in foreign exchange transactions between banks and non-banks. The EU and other developed markets accounts for more than 70 per cent of foreign trade. In addition, Warsaw Exchange, in 2010, also attracted significant interest from portfolios. The country ranks 70 out of 183 countries in the World Bank's Business Survey 2011 (EBRD Report, 2011, pp-146).

Macroeconomic stabilisation involved the following:

1. A strict fiscal policy, coupled with drastic reduction in subsidies.
2. A tight monetary policy. The confidence of the financial markets has become reinforced. There is now also greater independence for the banks.
3. Income policy: a general wage indexation was introduced in July 1989, in private enterprises sector. Money wage increase over a centrally progression tax. The 1994 strategy for Poland' sought to find an agreement on settlements in the public sector through "Tripartite commission", representing trade union representatives and the government. A multi pillar system operation, encompassing social insurance fund, mandatory pension funds, and additional voluntary insurance, was launched in 1999.
4. The exchange rate was initially used as a monetary anchor. Poland has gradually been able to consolidation the exchange rate, stabilisation controlling regime and even undertook occasional nominal revaluation. As of 16 May 1995, the Central Bank was able to set daily rates within a band of 7% on either side of a fixed mid-rate and to intervene in the interbank foreign exchange market. The Monetary Policy Council, the coordinating monetary policy was helping the country to free the currency from its central bank (p. 27).

Foreign direct investment: In the beginning, FDI growth was disappointing, but slowly picked up pace. In Poland, three to six years extension was granted to priority sectors for large investment in 1993. These were effects in Hungary, Poland, the Czech Republic and Slovakia during the period 1991-93. On March 15, 1996, the country approved the liberalising rules and certain special licences were given to sensitive economic sectors, including financial services, wholesale trade in imported commuter goods real estate and the production of armaments. Also, Poland has opened its first free enterprise zone in 1996.

During 2011, Poland maintained an impressive growth, supported by the exports of industry, and its banking sector remains stable. Additionally, the country is providing a flexible environment for investment, foreign direct investment inflow and portfolio investors (like BoP) (EBRD Report, 2011, pp-146).

(b). Czech Republic:

The beginning of the transition was generally characterised by the tight credit transition. In 1991, total credit growth was lower than inflation (Anderson and Kegels; 1998). As a result, the credit flows rapidly shifted from public sector enterprises towards private enterprises. It is a pluralist multi-party parliamentary representative democracy, a member of the European Union, NATO, the OECD, the OSCE, the Council of Europe and the Visegrád Group. The Czech Republic became the first among Central and Eastern European Countries to join the Organisation for Economic Cooperation and Development (OECD). The Czech Republic is the first former member of the COMECON to achieve the status of a developed country, according to the World Bank analysis. A large part of the economy had been privatised, include banks and telecommunications. The 2009 survey, in cooperation with the Czech Economic Association, found that the majority of Czech economists favour continued liberalisation in most sectors of the economy.

By the end of 1995, the Czech Republic had progressed in the “Early post transformation study”. In October 1995, the Czech government fully liberalised all account transactions and freed capital account transactions, thus achieving convertibility by the agreement of IMF Article 8. During the period 1993-97, the Czech economy had achieved impressive, results like low unemployment, decreasing inflation and stable exchange rates (Engene Nivorozhkin, 2003).

The Czech Republic has become the number one economic and political success story in Eastern Europe. It has had a remarkably successful and rapid transition, while using subsidies to avoid sudden, large-scale bankruptcies due to lay-offs. David Ottaway (IHT, May 28 1995, p 5) suggested two possible reasons for this: (i) Reforms took place in the Communist Party; and (ii) the economy incorporated trade unions as partners, heavy, state spending on social welfare measures and subsidies to reduce unemployment. However, important sectors such as Government sector and business policy will shift increasingly from the macro to micro level, concentrating, about all, on the restructuring of the industrial sector.

Financial policy: The new West European type taxation system was designed to widen the tax base and shift the burden from enterprises to individuals. The introduction of VAT on January 1, 1993, to aim to bring the general VAT rates into line with those of Western Europe (Deutsche Bank, Focus: Eastern Europe, on August 31, 1993). Wages are regulated through a tax on 'excessive increases' law introduced in 1991/92, later on reintroduced in 1992. However, the regulation was not successful in 1995.

Czech Banking sector played an active role with the active cooperation of the corporate foreign banks and investment markets. Also, domestic banks had promoted the consolidation of the National Bank in 1993. But this policy did not work out, and after EU membership, the restrictions were lifted in 1996 (Engene Nivorozhkin, 2003).

Price liberalisation: The only remaining significant price controls relate to utility charges, rents and public services. In addition, market-up are closely regulated in the energy sector (EBRD 1994; 23).

Privatisation: By the end of 1992, former large state industrial enterprises were broken up, mostly into three independent enterprises, either prior to or during the privatisation process (United National Economic Commission for Europe.1994:167). The average number of employees per industrial enterprise is 1,665 and in 1990s this has fallen to 360 (Transition, July-August, vol. 5, no. 6, p. 21). The second and final wave of large scale (voucher) privatisation involving 861 enterprises was completed on 25 November 1994 (EBRD, 1995; p.55).

Mass privatisation, the large banks have become, through their investment funds, the most significant owners of the privatised sector (Brom and Orenstein, 1994:893). However, even in the implementation of mass privatisation, the investment funds have maintained liquidity, and have taken a long-term and active role in enterprise management and are acting like "real Owners' (p. 917). In Europe, the private sector's share of GDP rose from close to zero in 1989 to about 18 per cent in 1992 and some 50 per cent in 1993, and also it is growing fast (UNEC) for Europe 1994:168, *The Economist Survey*, 13 March, 1993, p.10). By the result of privasation, by mid-1993, the private sector accounted for 40 per cent of GDP; it accounted for 1 per cent of employment in 1989 and over 30 per cent in 1992 (*Employment Observatory*, 1993, no.5. pp. 1, 26). Anthony Robison (FT, 13 September 1994, p. 2) cites an official estimate that around 80 per cent of the economy was privatised by the beginning of 1995. Some 80 per cent of

GDP is now in the hands of the private sector, but the Government still owns an average of 40 per cent of privatised companies through the National Property Fund (The Times, Survey, 2 May 1995, p.11). In 1995, privatisation process in Czech Republic was completed, and it was boosted by the share of domestic product. Today, the private sector accounts for 76 per cent of the county's GDP (Engene Nivorozhkin, 2003).

Foreign trade: Capital account transactions remain in control of the government (EBRD, 1994: 24). From January 1, 1995, the country was being allowed to exchange for hard currency. On 1 October 1995, a new foreign exchange law came into force, which conforms to Article 8 of the IMF's guidelines on convertibility. The law covers: current account transactions, full convertibility and partial liberalisation for capital account transactions. The Czech Republic officially became a member of GATT in mid-April 1993. On June 3rd 1993, the EU and the Czech Republic initialed a bilateral association agreement to succeed the one with the erstwhile Czechoslovakia. On October 4th 1993, a trade and cooperation agreement was signed (which needed to be ratified by the Czech parliament). It involves more rapid liberalisation of trade in industrial goods then previously (Deutsch Bank Focus: Eastern Europe, 1993, no. 91, p.9).

FDI: FDI and portfolio investment have gradually risen since transition began in 1990 to over $5 billion. Industrial output is relatively low due to the lack of support of the government; the general philosophy of the government is to leave things to the market. During the period in late 1992 to May 1995, a total of 4,500 bankruptcy petitions were filed, but only 600 bankruptcies were declared (Engene Nivorozhkin, 2003). The exception of tax advantage and subsidy benefits for inward foreign investments (Frances Williams, FT 28 September, 1994, p.6), though, the government remains very strong in its refusal to grant tax privileges to domestic or foreign investors (Transition, July-August 1994, vol. 5, no. 6. P.21). No wonder, the country eliminated nearly all special incentives in 1993 (EBRD 1994; 125). There are free economic zones. Enterprises which are more than 30 per cent foreign-owned are exempted from customs duty for one year (p. 127). According to World Bank (2012), FDI inflows have been decreasing in recent years 2005-2011.

3.3. Lessons that can be drawn European Economic Transition

A lot of literature on transition economics, especially Eastern and Central Europe economies, is available and we can draw lessons and policies regarding newly emerging transition economies. The following issues are significant (World Bank, 2002)[6] :

- In order to have a market-oriented economy, liberalisation of price is a must.
- Price liberalisation, however, has the potential of causing higher inflation initially, when it is instituted. Policy makers must use tight fiscal and monetary policies to curb inflation, otherwise it will become pervasive.
- While the initial conditions that prevailed at the start of transition are critical in explaining output decline early in the transition, market-oriented policy reforms have played a significant role in promoting subsequent economic growth.
- The civil society has a role to play when it comes to commitment towards implementation of reforms policies.
- Policy makers cannot postpone the pain of liquidating and restructuring the old sector, until the cushion provided by new enterprises is in place.
- Policy makers must create an environment that disciplines old enterprises into releasing assets and labour and encourage new enterprises to absorb those resources and undertake new investments.
- External economic shocks should be expected to occur and disrupt growth. Policymakers should take necessary measures to correct the effects of external shocks without delay.
- Adopting second generation reform policies is necessary, in order to correct any mistakes or shortcomings of early reforms policies. New enterprises stand to gain from further reforms.
- Developing legal and regulatory institutions to oversee enterprise management, though time-consuming, is important.

In fact, transparency and accountability should be high on priority in transition economies to facilitate efficiency, social cohesion and of economic growth.

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[6] . Rita O. Koyame-Marsh (2011), "the Complexities of Economic Transition: Lessons from the Czech Republic and Slovakia", *International Journal of Business and social Science*, Vol. 2 19, Special issues – October, overview, p. xxvii-xxix.

The European Experiences:

The major basic stories concerning the European experience of ODA and economic growth are:

(i) Eastern Europe as a main donor and source of funding to support development in other parts of the world

(ii) Eastern Europe promoting economic reforms in the policies of its members at the community, national and regional level (Garonna, 2006).

However, response of two stories, in ODA result is a mixed impact on ODA. And second; is the most extraordinary success story of the last 50-60 years.

We will now focus on the latter assistance policies, to draw lessons of wider applicability. There are several experiences that can be considered characteristic of the European successes in supporting economics integration. Here are the main points:

(i) EU enlargement: support for candidate countries.

(ii) EU regional policies aimed at supporting industrial restructuring, entrepreneurship, innovation and competitiveness.

(iii) The single market; policies aimed at supporting the elimination of barriers, the adoption of standards, the better regulation of markets, so that there can be a level playing field across the entire European economic space.

(iv) Policies aimed at giving a role to private players, the social partners, the voluntary sector, the research community, opinion makers, etc., including the role of Public -Private Partnerships.

(v) While framing policies, give a role play to regional and local governments, local communities and stakeholders; and

(vi) Policies transferring responsibilities from national level to the community level, as in the case of trade (Abdur Chowdhury and Paolo Garonna, 2007).

The Major reasons for, the economic success of Central European countries (Vladimir Popov, 2009), are as under:

1. Optimal policies are context-dependent, they are specific for each stage of development. For instance, one policy in economy cannot always succeed in another economy.

2. Though both countries have the same level of development, reforms needed to stimulate growth can be different; they depend on the previous history and on the path chosen.
3. Finally, introducing this 'missing ingredient' should not result in the destruction of other preconditions for growth. The art of the policymaker is to create markets, without causing government failure, as has happened in many CIS countries.

3.5. Conclusion

Europe's trade with China and India began during the time of Dutch Merchants and still continually maintains a good relationship. Also, European countries continue to the main trade partners with China and India. Since 1989, Central and Eastern European Countries, including Poland and Hungary, have achieved significant progress in transition. In the after math of the transition, Poland, Hungary, Czech Republic and Slovakia have joined the OECD. Also, market-oriented reforms were launched by China in 1979, while India in 1991 with market-oriented policies by the agreement of IMF, World Bank (N.A. Khan, *et. al.*, 2009).

The Czech Republic and Poland are the Central Eastern European countries, which experienced transitional recession in the early 1990s and an enormous increase in inflations rate. In the present context, we can imply that the foreign aid and development assistance are necessary for poverty reduction, debt relief and the efficient economic development. Successful stories in Europe are due to efforts towards poverty reduction and integration the market through sustainable economic growth. The secret of success is towards economic integration and the adoption of economic reforms at the local, national and regional conducive to economic growth.

The story of the success and failure of transition is not necessarily the story of steady shock therapy and unsteady gradualism. The major plan of the post-socialist transformation "novel" is the preservation of strong institutions in some countries and the collapse of these institutions in others. Thus, the story of the success and failure of transition depend on government failure (like weakness of state institutions), not about the market failure (liberalisation).

APPENDIX -3.I

Table 3.2: Selected Economic Indicators of Poland, Czech Republic - 2005 to 2011

Years	Economic Indicators	2005	2006	2007	2008	2009	2010	2011
Poland	GDP growth (%)	3.61	6.22	6.78	5.12	1.60	3.94	4.35
	Agriculture % GDP	4.53	4.29	4.33	3.73	3.65	3.54	--
	Industrial % GDP	30.71	31.11	31.64	31.54	31.74	31.63	--
	Inflation (annual %)	2.124	1.033	2.492	4.215	3.45	2.514	4.268
	Unemployment rate	17.745	13.84	9.603	7.118	8.166	9.623	9.647
	Current account balance (BoP, US$)	-2.382	-3.848	-6.231	-6.603	-3.985	-4.66	-4.307
	FDI net inflows (% of GDP)	3.39	5.82	5.56	2.83	3.02	1.94	3.39
	Population %	38.207	37.949	37.641	37.555	37.47	37.388	37.308
Czech Republic	GDP growth (%)	6.752	7.02	5.735	3.099	-4.695	2.739	1.655
	Agriculture % GDP	3.03	2.60	2.46	2.54	2.27	2.40	N.A
	Industrial % GDP	37.87	38.21	38.44	37.61	37.70	37.65	N.A
	Inflation (%)	1.843	2.543	2.862	6.339	1.033	1.464	N.A
	Unemployment rate	7.927	7.148	5.32	4.392	6.662	7.279	6.7
	Current account balance (BoP, US$)	-0.93	-2.109	-4.394	-2.121	-2.472	-3.031	-2.949
	FDI net inflows (% of GDP)	9.32	3.87	6.09	3.04	1.51	3.50	9.32
	Population (%)	10.221	10.251	10.287	10.381	10.468	10.507	10.53

Sources: World Bank Development Indicators, and IMF, 2012.

CHAPTER – IV

A COMPARISON OF THE 'GRADUAL ECONOMIC TRANSITION IN INDIA AND CHINA: A PERSPECTIVE ANALYSIS

Introduction

During the year 1950, India and China had jointly proposed the doctrine of *Panchsheel* (Five principles), and in the year 1954, both agreed to mutually of border disputes by peaceful means and ensure regional stability. Even after taking these measures for peaceful co-existence, India and China fought a war in 1962. After normalisation, bilateral relations began on a low-key in 1976, and in 1984, an MFN (*Most Favoured Nation*) agreement was signed between the two countries. Again, in 1994, several other agreements were signed between them. Recently, both countires successfully completed 60 years of bilateral relationship. The process of transition that took place in these countries helped them in increasing their economic growth significantly, compared to the rest of the world. When the transition had started in Eastern Europe and Former Soviet Union (EEFSU), most economists of the West favoured a *big bang approach.*[1] Moreover, the companies in both the countries wanted to move up over the value chain in their next stages of development. Both countries together have one-third of the world's population, resulting in some apparent problems like unemployment, environmental degradation, poverty, non-performing loans, institutional failures and so on. To meet these challenges, the countries embarked on different path of reforms, i.e., the transition from a centrally planned to a market-oriented economy. In this chapter, the focus is on comparision between India and China which are experiencing 'transition', and underwent tremendous economic changes between 1980 and 2010. This study is a sector-wise analysis of the three sectors, namely, primary, secondary and tertiary sectors. It also looks at the parameters of growth and Inflation. The entire study period has been classifed into to six successive periods as pre-transition period 1981-1985, 1986-1990 and post-transition period 1991-1995, 1996-2000, 2001-2005 and 2006-2010 respectively.

4.2. Impetus for Transition Economy

The economic reform processes of both India and China have been studied extensively. A number of authors like Worn (2002), Srinivasan (2004) and Solid (1995) have examined the origins of reforms in China and India. Srinivasan primarily focused on the historical perspective of the issue. Ever since the Plenum foundation of the People's Republic of China (PRC) in 1949, the country has undergone an unusual and confused development process, passing through revolutions, socialism and Maoist radicalism and

[1]. Big bang approach- it includes stabilization, price liberalization and privatization.

then gradualist economic reform and the resultant rapid economic growth. The PRC government, formed after 1949, created stability initially, but later, it inflicted terrible sufferings on its own people, particularly during the Great Leap Forward (GLF) famine. Subsequently, the dislocation of the Cultural Revolution turned life upside down in China. Wong and Ding (2002) extensively analysed the reform process and extended the study to various parts of the Chinese economy in detail. The study covered issues, such as restructuring and stability of the economy and sources of economic growth, fiscal federalism and the reforms programme, regional disparity, the process of economic reform and the infrastructure development.

China's approach to economic development is called as "*Crossing the river by groping for stepping –stones*", which was based on steady growth. In the countryside, those reforms were successful at first and became continuously progressive and brought more changes in the direction of further reforms. At the end of 1978, China began a transition at the landmark Third Plenum of the Chinese Communist Party. However, the country decided to look after the terms of trade regarding agriculture. Solid's book presents the events surrounding Chairman Mao's death and the subsequent leadership of Deng Xiaoping and the prosecution of several leaders closely associated with Chairman Mao. In 1979, China reduced the investment, doubled the grain imports and chopped off the ambitions of technology import programme of the "*leap outward'* era. However, the role of collectivity[2] was dramatically reduced by the 'collective's policy,' which became extremely controversial. China's leadership decided not to block the collectives, and after 1980, they gradually shifted and gave it de-facto support. The process of reforms was portrayed as a process of an internal struggle that culminated in Deng's takeover at the helm in China. By 1984, grain output had surged. China's progress after one decade of industrialisation was nullified by its own agricultural weaknesses. China's problem of shortage of food was always there as well. In the agriculture sector, the labour force has reduced. Meanwhile, the non-agriculture sector also flourished from the support of the labour withdrawn from the agriculture sector. Locally run factories in Township and Village Enterprises (TVEs) caused an increase in the number of workers rapidly and output from this sector surged. Thus, successful firm and TVEs emboldened reforms gave

[2]. Collectivity- reforms in agriculture sector and the necessity to give enterprises and other sectors, expanded decision - making autonomy and better incentives.

the country confidence to persist with the reforms. Therefore, in short, rural income increased and thus these reforms gained the support of the bulk of the rural population.[3]

In the case of India, several significant studies are available. These include: Srinivasan (1990, 2002), Joshi and Little (1991, 2002), Ahluwalia (2002), Jalan (1993), Desai (1999) and Sen (2004). Joshi, Little and Jalan explain how the reform process began and the conditions that existed in the immediate years before the crisis and the subsequent adoption of the reform process. Desai provides an analysis on the political challenges and dealings that set the stage for the reform process and the development after initiation of the reforms.

On the other hand, a number of authors have written about the performance of India after 1990, including those by Joshi and Little (2002), Srinivasan (2002) and Krueger (2002). The growth rate, although impressive in comparison to its past performance, does not match up to the performance of other Asian economies that embarked on similar reforms. Srinivasan (1990) clearly states that the resultant development in India is not as significant as that of China, and that the progress made in India would not put it in the path for narrowing the gap with China. Joshi and Little (2004) look at various aspects of the Indian economy, such as fiscal policies, industrial reforms, social policies and reform and trade policies.

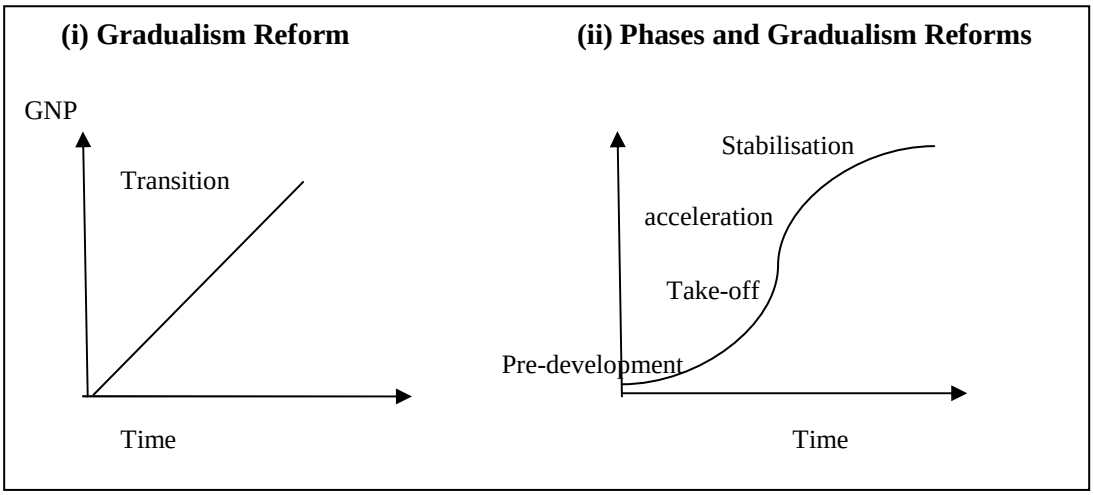
4.3. Economic Reforms in China and India

The literature has been investigating the economic reforms process, presents different assessments of the conditions leading up to the beginning of transition of economies in the two countries. To understand the origins and process of transition of economies in the two countries, we can pose three questions: (1) whether the economic reforms were initiated at the behest of international organisations, which provide funds in exchange for domestic policy changes (2) Whether the reforms were the result of violent and sudden upheaval of domestic politics, and (3) whether there was a gradual change due to the domestic economic crisis that forced the government to adopt changes in the form of economic reforms. China opened up its economy in the year of 1978 under the *No foreign Pressure* doctrine. It was a planned shift to market socialism, based on pure national interest. In India, the economic reforms were initiated in the year 1991 in

[3]. "The Chinese Economy Transitions and Growth", in this book "Market Transitions: Strategy and process", pp. No. 84.

response to the foreign exchange crisis and with the agreement of IMF/World Bank institutions. An actual path of reforms can also turn out to be very different from the initial conditions. Whenever we make a cross-country comparison, we have to keep in mind that they have different initial conditions and political constraints, which play an important role. Thus, the choice can be rational when one takes into consideration the specific context in which the countries' initial conditions are (Gerard Roland, 2000). Figure-1 illustrates the gradual reform, as explained by Justin You Lin, Fang Cain, and Zhou Li.

Figure 4.1: Comparison of the phases of Economies in China and India



It can be seen from figure 4.1, that the phases[4] are consistent with Kay's (1991) conceptualisation of "thermo-dynamic branches" and Rostow's (1960) "modernisation theory".

4.3.1. Transition process in China

China has been in transition for nearly three decades from a centrally planned economy to open market and then followed by a Soviet-style heavy industrialisation. Deng Xiaoping's saying, which best reflects the measures taken up, goes thus: "*No matter it is a white cat or black cat, as long as it can catch imputes mice, it is a good cat"*. Another author in "To cross a river by groping the stepping stones" explained the sequencing of reforms. China adopted pro-market reforms gradually or incrementally,

[4]. The pre-development phase was of dynamic equilibrium, where the status quo does not visibly change. A take-up phase, the process of change gets under way because the state of the system begins to shift. During the acceleration phase, it was an amalgam of learning processes, diffusion and embedding processes. In the stabilisation phase, as speed of social change decreases, a new dynamic equilibrium is reached.

slowly introducing market forces into an administered economy (Linda Y. Yueh). China was the most successful economy for a number of measures.[5] China's development indicators included: (i) Micro-management system reforms, (ii) Resource allocation, and (iii) Macro-management (Justin Yifu Lin, 2004). Micro-management was mainly the replacement of collective farming with a household based system. Resource allocation was an increase in enterprise autonomy and for that, there was a need for distribution of additional imputes and to see the extra outside. The Marco-policy environment involved making policies consistent with the liberalised allocation and micro-management system (Justin Yifu Lin, 2004).

It is a partial reforms strategy characterised by institutional innovations and regional experimentation (Qian and Xu 1993; Fan, 1994; Linda Y. Yueh). Before transition reforms, successes of TVEs in 1979 injected industry and market-orientation into the *rural economy* and led to abundant and surplus labour. These reforms were re-oriented to improve the national and household savings and injected incentives into the economy. Inspired by the successful experiments in the countryside, the authorities introduced further reforms in urban areas in 1984. Managers of the State-Owned Enterprises (SOEs) were granted more autonomy. The administered economy led to a guaranteed lifetime employment "*iron rice bowl*" and social security for the urban residents.

Stability is essential for maintaining a "*Dual track*' transition. When we allow enterprises to sell part of their output at market prices, the authorities must be able to control the administration part. The final projection of China's reform approach is the '*Open-door policy,*' introduced in mid-1980s, and its take-off in the early 1990s. To introduce the Special Economic Zones (SEZs), the government experimented with a limited degree of opening of zones. Since then, it had created SEZs, such as free-trade Zones and High-technology development Zones (HTDZs). SEZs led to attraction of foreign investments in technology and promoted research and development (R&D). This is the result of the good response in high and medium- technology and impressive

[5]. In 1978, transition was gradually started in China (Murphy, Schleifer, and Vishny 1992). The beginning of the transition is the most successful of the transition economy (Lin et al., 1996). Some economists argue that China's success demonstrates the two adopted top-down Polish Shock 'Therapy" approach transition in EEFSU (Jefferson and Rawski 1995; McKinnon 1994; McMillan and Naughton 1992; Singh 1991; Chen et. al., 1992; Harrold 1992; Perkins 1992; Justin Yifu Lin, Fang Cai, and Zhou Li). Other economists argue that larger agricultural labour force, low subsidies to the population, and a rather decentralised economic system have contributed to China's success (Woo 1993, Sachs and Woo 1993; Qian and Xu 1993; Justin Yifu Lin, Fang Cai, and Zhou Li).

upgrading of Chinese exports (Lall and Albaladejo 2004, Linda Y. Yuch). However, China's market share with the East Asian 'tiger' economies achieved the peak of their exports and led growth (Yuch, 2006).

In China, the reform process was, in part, initiated by a change in leadership at the top. Although the period from 1949-1976 witnessed tremendous changes and hardships, there was one factor that seemed to bind people together and that was the leadership of Chairman Mao. There was very little room for dissent and public opinion to the authority of Chairman Mao. However, his demise brought forth a group of thinkers and leaders inclined towards changing the course of the Chinese economy.

China's reforms process began due to the demise of Chairman Mao (Howe, 2003). In the early seventies, the Chinese government was making overtures to the west, in part, due to its difference with the Soviet Union. Large-Scale purchasing of capital equipment was done from both Germany and Japan. The Chinese government began exploring and opening up towards the United States, as evidenced by the historic visit of President Nixon to China in 1972. There was an opinion expressed by the Chinese Communist Party that opening China for trade would be beneficial for the country. At the forefront of this thinking was Deng Xiaoping, who followed the idea of market reform, with Chinese characteristics. At that time, the reform process was ideal, as the overall atmosphere for world trade was very favourable. Deng recognised this fact and decided to use it for the benefit of China.

The reforms process in China was a two-fold problem: to specify and implement the new policies and to educate the party members about the need and benefits of changing the direction of China's economy. The success of the reform process relied primarily on the specific areas that were targeted to introduce changes. In the initial years, the reform process addressed the issue of agriculture. The agriculture procurement prices increased, the communes were recognised and importance was given to individual farmers and incentives for their right to earn and living. In the industrial sector, the reforms included SEZ in the southern part of the country to attract Foreign Direct Investment (FDI) into these areas and some autonomy given to the state-owned enterprises, and the township and village enterprises.

If we observe how China was successful in the transition, the answer would lie in the policies implemented, which include the policy of *systematic transition* and *policy of*

economic growth (Justin Yifu Lin, 2004). However, a larger debate has been about the nature of the economic reforms in China (Sachs and Woo, 1997). Two different schools of thought have emerged in the post-economic reforms period in China-The Experimentation School (E-School) and the Convergence School (C-School). The main tenets for the E-School are that the reforms process in China was successful, primarily because it was gradual and involved trial and error policy making. The E-School also concluded that the success of reforms in China led to their replication in other parts of the world like Latin America, Eastern Europe and the Former Soviet Republics (EEFSU). Further, these reforms have resulted in the creation of new non–capitalist institutions that challenge the existing view that economic growth is possible only by using mainstream capitalist market reforms. The main proponents of these ideas include: Barry Naughton, Thomas Rawski, Peter Nolan, Robert Ash and Justin Lin, Fang Cai and Zhou Li.

On the other hand, the C-School argues that the economic success in China is attributable to its reforms that were similar to those of other East Asian economies. The C-School posits that the non-capitalist institutions have been largely unsuccessful and that further reforms are necessary, in order to create capitalist institutions. Finally, the C-School observes that institutions in China are converging gradually to those in East Asia. The main proponents of the C-School are: Jiffrey Saches, Wing Thye Woo, Michael Bruno, Gang Fan and Geng Xiao.

4.3.1. a. Phases and Frame Work of Economic Reforms

Successful rural reforms also reinforced a certain approach to the reforms process. The sustained growth of Chinese economy has confused, in particular, the major institutions of the market economy that must be in place before any major reforms could be expected to give out positive results. The gradual reform process provided the economy with great resilience, which it needed to face constraints like unfavourable world economic environment, moving away from a rigid bureaucracy and the absence of a sound market infrastructure (World Economic and Social Survey, 2006).

Initially, rural reforms involved little economic (or) social disruption. This approach extended to industrial and commercial reforms, which led to implementation of healthy economic reforms in the period from 1978 to 1994. The aim was to improve the nature of reforms and expand the scope of the market for resource allocation. Overall, the reforms were decentralised, shifting power and resources from the central to local

authorities. This process allowed reduction in barriers and helped market forces to grow. The most recent stage has put stronger emphasis on the need to deal with the growing regional and income disparities brought about by the accelerated growth process. China's transition of its economy has been a gradual process of economic reform, which can be divided into three stages.

a. *First phase of transition* (1979-1994):

In discussing the 1980s (more specifically, 1979-94), the character of China's gradualist transition can be summarised in nine Key features. The basic state policy, termed as 'reforming the system" (Naughton, 1995), has focused on the formulation and implementation of overall reform by creating a pricing system, decreasing the role of the state in resource allocations and opening to the outside world (Michele Alessandrini & Tullio Buccellato, 2008). The first part of Chinese economic reform involved implementing the Household Responsibility System (HRS) in agriculture, by which farmers were able to retain surplus over individual plots of land, rather than farming for the collective. By the end of 1984, nearly 98 percent of all farm households and agriculture output and the household income started to increase. On balance, and in retrospect, the policies described here can be seen to have a clear coherence and to have been overwhelmingly successful. Reduction of the state's monopoly is due to the rapid entry of private enterprises. The growth occurred with economic continuity and stability - powered by robust savings and investment. Since 1994, reforms have expanded emphatically such that the economy had "grown out of the plan". The eventual establishment of the modern market system as the goal of reform was completed. However, in this stage, the country had witnessed agricultural reforms and the dual-track price-setting scheme, involving two prices for the same product. Also, a remarkable boom in investment and enterprises by the TVEs was also considered as the growth engine of the country until the mid-1999s (Qian, 2003a; Michele Alessandrini, *et. al.*, 2008).

b. *Second phase of transition* (1994- 2000):

The Post-Deng Xiaoping leadership was associated with a new phase of reforms. Zhu Rongji played a key role in the period from 1994 to 2000. The task of reforms turned out to be more challenging, as it would impinge upon the fundamentals of central planning system. This task was to allocate the resources to vital sectors. The key feature of the second phase of reforms can be conceptualised in terms of pre-requisites, regularity

in changes and outcomes. Three policy measures were essential prerequisites for the overall package: end of the dual-track system, recentralisation of fiscal resources, and macro-economic austerity. Moreover, macroeconomic policy reforms shifted to a focus on regulatory and administrative restriction in the key market reforms. The outcome of this policy regime was a shift from inflection to price stability. These are because of dramatic downsizing of the state enterprise sector, and acceptance of a moderate amount of privatisation and the emergence of a "reform with losers". Zhee Ronji's policies were stronger, gave more authority to government institutions and involved better decisive policy-making. This phase involved establishment of a social security net and small private enterprises.

c. *Third phase of transition (*2000 onwards):

In this stage, the policy has put stronger emphasis on the need to spread the benefits of economic growth more equitably among all social groups and all regions of the country. In 2006, the Government announced its plans for implementing four types of reforms for enhancement of rural income. These were: (i) a reform of rural taxes and administrative fees; (ii) Water conservation project for enhancing agricultural productivity; (iii) Increase in public investment in socio-economic sectors; and (iv) Political reforms that sought to that sought to provide self-governance to villages.

During the Global financial crisis of 2008-2009, China introduced the Economic Stimulus Plan to tackle the crisis. It introduced several incentives and programmes for uplifting the economy. These helped it overcome the low inflation in 2009. By 2010, China curtailed its export dependency by the development of an internal market. In 2011, the World Bank's chief economist, Justin Lin, stated that China, which became the world's second largest economy in 2010, and the world's largest economy in 2030 - by overtaking the U.S.

Still, challenges remain in the path of China's reform process, in particular, the continuing of reforms in the agricultural sector and large state-owned enterprises. Further, China joined the WTO for the protection of its Intellectual Property Rights and undertook greater reforms. China's experience underlines the importance of viewing institutional reform as a process of economic development. Any country can achieve success, only on the bases of initial reform processes involving careful evolution and removal of the obstacles 'step by step'. It is not necessary to have all the required elements of good

governance in place before sustained growth can be initiated (World Economics and Development Repot, 2006, pp. 138).

4.3.2. Transition Process of Indian economy

In India, the process of transition has many starting points, as several investigators concluded (Nayar, 1998; Srinivasan, 1999; Ahluwalia, 2002 and Desai 2003). The reforms took place with an added sense of urgency due to the balance of payment crisis of 1990-91 and the subsequent pressure from international organisations such as the IMF and World Bank. However, the reasons for the initiation of the process of economic reforms was attributed to a number of factors such as the early reforms initiated by the Congress Party in the 1980s, the Gulf War and it is impact on domestic inflation and the results of mass evacuation of Indian nationals from the Gulf region. In fact, it is the changes in the attitude of people who witnessed the spectacular growth in other regions of Asia, and the domestic crisis of fiscal imbalance which led to external pressure for changes in the macro policies in India. However, economic reform was first initiated in the early eighties under the guidance of Mrs. Indira Gandhi and later, received further impetus from Mr. Rajiv Gandhi. The reform process was initiated only in certain areas and, in many other sectors, the country was turning the corner with attitudes towards the reforms itself changing.

However, this process almost ended abruptly with the assassination of Rajiv Gandhi in 1991, but then, was continued by a group of technocrats who were his advisors and thus the changes were observed as coming from the top. Some basic forms of reforms continued, primarily in the areas of licensing and setting up of private enterprises. India faced many problems in the areas of fiscal discipline, at both federal and state levels. This resulted in mounting deficits and debt. At its height, the fiscal deficit stood at 8.4 per cent of India’s GDP in 1990. In the eighties, growth had decreased due to lack of fiscal discipline. After reforms, borrowings at both the federal and state levels had increased. The current account deficit stood at 3.5 per cent of the GDP. The tipping point of the crisis was the depletion of the foreign exchange reserves to $1 billion, which was enough to cover only two weeks’ worth of imports. India’s credit rating plunged, foreign private lending vanished and the threat of inflation was looming large. Amidst this, the Indian government resorted to selling gold to obtain more foreign exchange reserves.

Consequently, major reforms had focused in India economy for sustainable economic development. Generally, reforms that have taken place can be divided into two categories: Macro-economic reforms and Micro-economic reforms.

After 1990 economic reforms in India:

India economic reforms process commenced in 1991 consequent to the Balance of Payments crisis. After 1991, the government signaled a systemic shift towards a more open economy with greater reliance upon market forces, a large role for the private sector, including foreign investment and a restructuring of the role of government. Post-reforms, India's economic performance has scaled great heights. In 1990, the GDP growth was 5.53 percent and 7. 39 percent in 1999 respectively, but growth rates are slightly better than those of the 1980s. The 1990s were accompanied by remarkable external stability, despite the East Asian crisis. Poverty also declined significantly in the aftermath of launching of the reform process and at a faster rate than in the 1980s, according to some studies (as, Ravallion and Datta, Montek. S. Ahluwalia).

Indian remained among the faster growing developing countries in the second sub-period, because other developing countries also slowed done after the East Asian crisis. The growth rate of the world economy was slower in the second half of the 1990s and that should normally have had an effect on the developing countries. However, India's dependence on the world economy is not large enough to account for the slowdown. Critics of liberalisation have blamed the slowdown on the effect of trade policy reforms in the domestic industry (Nambaretla, 1999; Chanhuri, 2000, M. S. Ahluwalia, 2002). However, the appositive view is that the slowdown was due not to the effect of reforms, but rather to the failure to implement the reforms effectively. Even then, India's growth rate has steadily gone up in ten years.

Saving investment and fiscal policies: After reforms, 1991-92 and 1992-93, the balance payment crisis was over by 1993. Fiscal deficit was seen to have caused the balance of payments crisis in 1991. Hence, reduction in the fiscal deficit was an urgent priority in the initial stages of the reforms. Even though household savings have been buoyant in the reform period, total tax revenues increased. But public savings declined steadily; this resulted in lowering of the tax rates, after fiscal failures of both the central and the state governments. However, still India is facing problems, but is gradually moving up the growth ladder.

Reforms in industrial and Trade policy: Indian government lays much focus on Industrial and Trade policies, since it considers these as drivers of economic development. The industrial sector earlier was rather inefficient and needed to be supported by a highly proactive trade policy, after providing tailor-made protection to each sector of the industry.

Industrial policy: Post-reforms, the industrial sector has undergone a sea-change. The Committee on Small Scale Enterprises (1992) and the Prime Minister's Economic Advisory Council (2001) have both pointed to the remarkable success of the China in penetrating world markets in these areas and stimulating rapid growth of employment in the manufacturing sector. A recent study by the World Bank and the Confederation of Indian Industry (Stern, 2001) concluded that the investment climate varies widely across states and these variations are reflected in the disproportional share in investment. Monopolies and Restrictive Trade Practices Act (MRTP) reduced restriction on monopolies; the expansion of the Open General Licensing (OGL) and other commodities. Liberalisation has created a more competitive environment by the conducive economic policies in developing countries.

Trade Policy: Trade policy reform has also made progress, though the pace has been slower than in industrial liberalisation. The economic reforms sought to phase out input licensing and also to reduce import duties. Import license was abolished in capital goods and intermediate goods, which became freely importable in 1993, and also a flexible exchange rate was adopted. As a result of the change in the exchange rate regime, coupled with trade reforms, the current account is now open with limited capital account convertibility. The quantitative restriction on import of capital goods and intermediate goods was also removed. As a result of reduction tariff protection, the weighted average import duty rate declined from the very high level of 72.5 percent in 1991-92 to 24.6 percent in 1996-97. However, India's tariff levels are significantly lower than those in 1991, compared with these of other developing countries.

FDI: Liberalisation of foreign direct investment is another significant area of the Indian reforms process. The policy allows 100 percent foreign ownership in a large number of industrial concerns and majority ownership in all growing banks, and insurance companies, Telecommunication and airlines also have simplified the license procedures now. In 1993, foreign institutional investors were allowed to purchase shares of listed

Indian companies in the stock market and open a window for portfolio investment in existing companies. The share of exports of goods in GDP increased from 5.7 percent in 1990-91 to 9.7 percent in 1997. This resulted in exchange rate depreciating. Export of manufactured goods had a 0.5 percent share in world markets in 1990 and this rose to only 0.55 percent by 1999. India's relatively poor export performance may be attributed to high tariffs. Inflexibility of the labour market is a major factor for the low level of India's competitiveness in exports and also reducing industrial production generally (Planning Commission, 2001). Absence of a systematic unemployment insurance policy may also be a factor. India's Industrial and trade reforms were not strong enough, nor adequately supported by infrastructure and labour market reforms, to generate such a thrust. After 1990, software sector was efficiently developed and led to exports earnings in this area growing from $ 100 million in 1990-91 to $ 6 billion in 2000-01.

Reforms in Agriculture: A feature of post-reforms Indian economic policy is that the reforms have excessively focused on industrial and trade issues. The perception that trade policy changes have not helped agriculture is clearly a misconception. The Index of Agriculture Price relative to manufactured products has increased by almost 50 percent in the past ten years (Ministry of Finance, 2002). The investment in agriculture related infrastructure is critical for achieving higher productivity and this investment is only likely to come from the public sector. After reforms, the government has recognised the need for change and recently removed restrictions on certain essential goods. However, development of modern food processing sector would be essential for the next stage of agricultural development.

Infrastructure Development: Rapid growth in a globalised environmental requires a well functioning infrastructure, such as electricity power, roads, rail connectivity, telecommunications, air transport, and efficient ports. The results in the telecommunication sector have been much better and this is an important factor underlying India's success in Information Technology. Public-private-Partnership (PPP) has also encouraged better risk sharing, accountability, cost recovery and management of infrastructure. Government announced a tax holiday and income tax exemptions on dividends, interest or long term capital gains earned by funds or companies set up to develop, maintain and operate an infrastructure facility. Indian road network is extensive, but most of it is of low quality and this is a major constraint for interior location. In 1998, a tax was imposed on gasoline, earmarked for the national highways, roads and rural

roads. A provision was also made for automatic approval for foreign equity participation up to 74 percent in key infrastructure industries and so on.

Financial sector Reforms: India financial reforms included reforms in the banking and the capital markets and the capital markets relatively early in the process of reforms. In the insurance sector, reforms were introduced at a later state. Banking sector reforms; such as a) Measure for liberalisation, b) Measures designed to increase financial soundness; and c) Measures for increasing competition like more liberal licensing of Private Banks and freer expansion by Foreign Banks. Although, Capital Market was also kept under reforms agenda, due to the after effects of the 1992 stock market crisis. India's banking reforms are different from those in other developing countries in one important respect and that policy towards public sector banks which dominate the banking system. In 1994, the Malhotra Committee made recommendations regards recommended to private insurance companies, but these were not implemented. Finally, amendment was issued in 2000.[6]

2000 onwards economic reforms:

From 2000 onwards, India's growth rate had tremendously increased. Today, it is one of the fastest-growing economies in the world. During the year 2001-2010, GDP average growth was 7.7 percent. This is due to several favourable factors. In 2000, the highest tariff rate on import as a percentage of value added fell to 25 percent from 335 percent reached at the end of the 1980s (Williams & Zagha, 2000 and Panagariya, 2004).

Indian economic reforms surged forward during the period 2001-2010, because the fiscal deficit trend came down in 2002 and world economy rebounded strongly. Also, monetary and fiscal indicators saw a strongly appreciation. As a result of the service sector continuously booming, the average GDP had been 53.34 percent in the period 2001-2010. Industrial sector has been steadily increasing to an average of 27.56 per cent of the GDP, due to the support of output growth and investment. An additional, important sector is agriculture, which is contributing 60 per cent to Indian economy, but this sector's growth has been continuously sluggish and the average GDP is 19.10 percent. However, overall growth rate had accelerated, except in 2008-2010. Major drivers of recent economic growth have included: openness of trade (external trade and investment), growing middle class people fuelling the domestic economy, the demographic dividend of

[6]. Montek S. Ahluwalia (2001), "Economics Reforms in Indian Since 1991, has Gradualism Worked?, *Journal of Economic Perspectives, 2002.*

youthful population, strong companies of modern capital market, some recent economic reforms and a supportive international environment.[7]

The revised annual growth for April-December, 2008-09 for mining was 3.0 per cent, for manufacturing, 3.3 per cent and 2.7 per cent for the electricity sector. There was less growth for capital goods and basic goods in December, 2008. There were net investments of the foreign institutional investors' (FIIs) to the tune of US$ 10 billion from April to September of 2009-10. In June 2009, India attracted foreign direct investment worth US$ 2.58 billion, according to the Department of Industrial Policy and Promotion (DIPP). India's share of trade GDP average growth rate is 30.76% in 30 years and China's, 33.57% (WBD, 2012). India experienced the fastest export growth among major traders in 2011. Meanwhile, China saw the second-fastest export growth among many major economies (WTO, 2012). Total trade average GDP was 39 per cent in 2000-2010. The National Agriculture Policy (2000) was introduced on July 28, 2000, the main focus of this policy was on: demand-driven growth with, altering to domestic marketers and maximising benefits from exports of agricultural products in the face of challenges from economic liberalisation and globalisation.

Comparison of India and China:

Both countries play a significant role in global economy due to their support of various sectors. The only way out of this crisis was to comply with the corresponding conditions laid down by the IMF and World Bank, although it gave an impression that the reforms were taken up on China's free will. It was portent to understand that unless there is internal popular support for the impending change, the reforms would not go on at the desired pace. China and Indian opted for separating the trade liberalisation policy from the privatisation reforms. Thus, the reform processes adopted by India and China had very different beginnings. The reforms did not result out of violent political strife in either country. Although the reforms at first, in the case of India, appeared to be abrupt and drastic, the progression of reforms since then has been at a slower pace. China adopted a stance of economic reforms with a Chinese characteristic and this meant changes in economic policies implemented quickly in the areas found desirable by the central government.

[7] .Shankar Acharya (2007), "Indian Growths: Past and future", ICRIER, New Delhi.

4.4. The Impact of Transition on Structural Changes in both Economies during the period 1980 - 2010

The adoption of the process of transition of the economies mostly involved changes in market liberalisation, macro-economic policies, trade and industrial policy, taxation and financial policy, privatisation and de-regulation. The impact is that China has surged ahead, while India grew gradually in all aspects. India has seen significant growth since its transition began, while China witnessed an extraordinary growth of its economy. The structural changes occurred among the three major productive branches, such as agriculture, industry and service sectors. In this study, we compare both countries' factors, in terms of economic perspective and social and infrastructure measures. Moreover, the countries resorted to their own development models for development and the two countries were conscious to prevent themselves from starting any form of "fordist Model of growth".[8]

The indicators analyses below show very different outcomes in the two countries and similar problems faced by the reform processes. However, there have been changes in different sectors such as industry and services, which are of great importance. In comparing the three sectors, we find that the wages were generally higher in industry and services sectors, but lower in the agriculture sector. The five main "virtuous circles" embedded in the "fordist model of growth" are as under:

a) At first, "***economies of scale of network***' are of great importance for the rapid growth of production. These lead to higher investment, higher productivity, and higher profits that further increase productivity and production. We can observe the rapid growth of the industrial sector, where 'economies of scale' played an important role in both countries.

b) The second important "virtuous circle" operates through '***aggregate demand'***. The rapid increase in productivity leads to a rapid increase in unit-wages without reducing profit margins. These trends, while increasing employment, determine a fast increase in total wages and thus increase total profits and lead to a substantial increase in investment. The rise in consumption and investment leads to a rapid increase in internal demand-led growth, resulting later in gradually turning to export-led growth. However, improvement

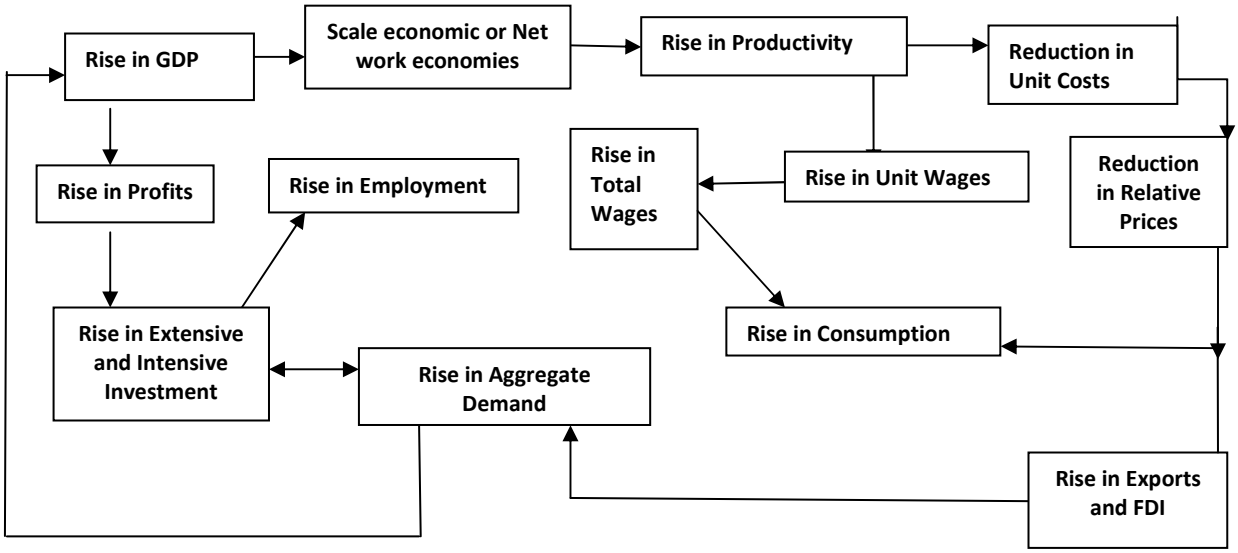
[8]. The US experienced the first wave of the Fordist Model of growth for some decades following 1908. West Europe, Japan and the four Asian "tigers" passed through their second wave in the 1950s and the 1960s. Since the late sixties, the US, Western Europe and Japan experienced a crisis of the Fordist model and have entered a post-Fordist phase. In contrast, China and India have entered the third wave of the Fordist Model of growth respectively in the 1980s and the 1990s.

in productivity leads to competition externally, and export competition will attract foreign development investment.

c) Third one is total "***profits and investment***". The rapid increase in labour productivity permits a substantial rise in total sales, which leads to an increase in total profits, if profit margins remain relatively stable. This leads to a rapid increase in both intensive and extensive investment. The former improves labour productivity, while the latter results in an increase in employment and thus a rise in total wages, consumption and aggregate demand, communication facilities, etc. Moreover, both the countries have an abundant labour force.

d).The fourth is "***relative price***" and the demand for selected goods and services. The rapid increase in the productivity in industrial sector, with economies of scale or network-economy service sectors, can contribute to reducing the prices of their goods or services relative to the average level of prices. The fall in relative prices of these goods or services may boost their demand. The rapid increase in demand favours a rapid rise in profits and investment - contributing to the overall growth of the economy.

Figure 4.2: The "Fordist Model" of Growth in China and India



e). the fifth virtuous circle relies on the '**increase of taxation'** which accrues to the state and local authorities, due to the rapid rise in production and in sales.

Generally, negative effects, such as the greater division and fragmentation of labour, accompany the positive effects of these virtuous circles in labour intensity and alienation in big factories. Moreover, there would be a rapid increase in pollution. Thus, there is a

strong increase in energy consumption associated with rapid economic growth and the greater diffusion of vehicles.[9]

a. An Empirical Analysis of Structural Change in three Sectors

Structural changes can see through the changing share of aggregate GDP produced by the primary, secondary and tertiary sectors. However, most of the changes among different sectors of industry and services have great importance. Unlike in the case of labour, where we could measure simply by counting the entities involved, here, the GDP must be measured in terms of value. Therefore, we must choose an appropriate price standard for comparison and properly treat changes in prices over time. These issues are particularly important in the case of China because the *'Big Push'* socialist development strategy imposed distortions both on the *'iron rice system'* and on the true structure of the economy. The structural changes between the three major productive sectors are given below:

A). Primary sector

B). Secondary Sector

c). Tertiary Sector

In this present analysis, we compared the period of the economic reforms in China and India, which showed a marked difference in the pattern of economic development and structural changes. To understand the economic development of any country, the major indicators must be assessed.

Structural changes can be viewed through the changing shares of total GDP produced by the primary, secondary and tertiary sectors. The process of transition was accompanied by major structural changes in the components while the economy was undergoing transition. The figures given below clearly explain the changes in the three structural components (agriculture, industrial and service sectors) by calculating the Annual percent of Growth from 1980 to 2010. Besides, it has been divided into five years: 1980-1985, 1986-1990, 1991-1995, 1996-2000, 2001-2005 and 2006-2010 respectively. The break-even point was achieved in the 1990s, for pre-and post-transition periods in both countries, since, full-fledged economic reforms commenced from 1990s

[9]. Vittorio Valli and Donatella Saccone (2009), "Structural Change and Economic Development in China and India", *the European Journal of Comparative Economics*, Vol. 6, n.1, pp. 101-129, ISSN. 1722-4667.

onwards in both countries. Of course, the first phase of Indian reforms was initiated in 1980s.

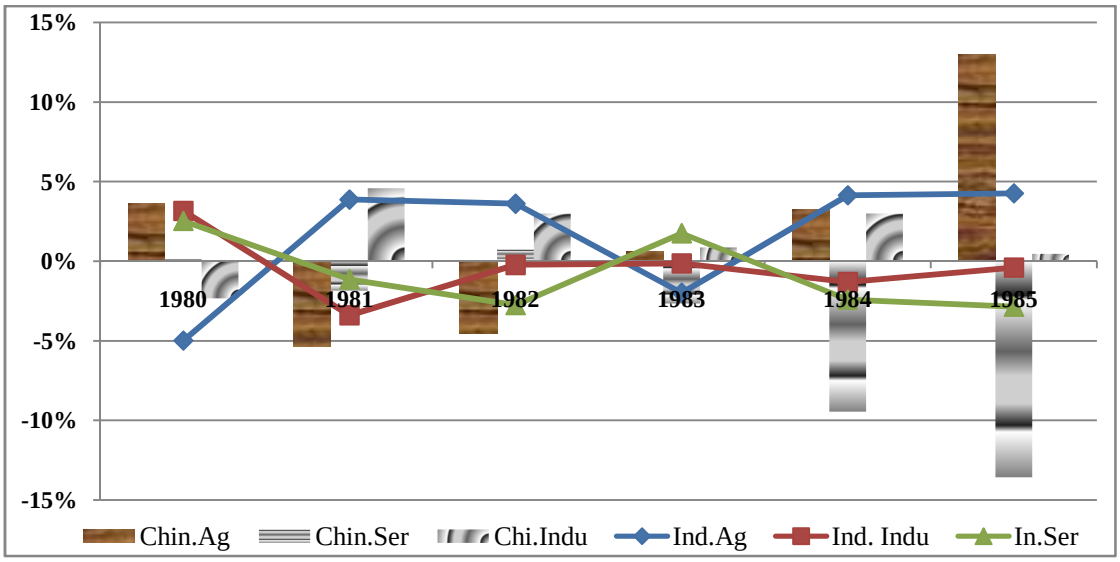
In fact, Indian reforms were first initiated in 1980s. Each country has established a comparative advantage in one specific sector. Subsequently, development along a path of steady growth in the comparative sectors, in the aftermath of globalisation and international trade, opened up additional opportunities for specialisation and addressing the, "unbalanced growth" that would exist in an economy less integrated with the global economy. Although early China was predominantly an agricultural economy, now it had shifted to rapid industrialisation. The service sector still lags behind the explosively growing manufacturing economy (Barry Naughton, 2006).[10] In an almost similar way, India's early focus was on the agriculture sector, but later on, it shifted to the service sector.

Figure 4.3 below explains the structural changes introduced by both China and India. In China, the reforms began in 1978. Basically China's rural economy was much strong due to the leading role being played by its TVEs. These factors helped in attracting foreign investment into the country. China's industrial sector was also growing faster. The manufacturing sector expanded rapidly due to the policy of import-substitution, establishment of SEZs in 1980s, and inflow of foreign investment. During the 1980s, the expansion of rural industries was the key to the country's rapid development. In addition, a number of industrial policies were introduced. Socialist governments tend to follow a high price policy for industrial output, which can lead to an overstatement of industry's contribution. The services sector's annual percent of growth had been negative in the overall periods. It shows a tremendous growth in the services sector. China's government had given more preference to the manufacturing sector compared to other sectors. China's service sector's annual percent of growth is less than that of the agriculture sector. The agriculture sector's annual percentage of growth sharply increased and in the year 1985, it was 15%. During the 1980s and 1990s, the technological transformation of Chinese agriculture accelerated, and output began to rely on massive application of modern inputs. Traditionally, almost dependent on grain, China consumers are increasingly demanding a diverse diet, which puts greater and different demands on the agriculture system. In 1980s, there was an extraordinary rise in the income of peasants. Agriculture Policy

[10]. "The Chinese Economy, Transitions and Growth", *The MIT Press Cambridge*, Massachusetts London, England, pp. 139 to 159.

Reform (1978-93) called for the decentralisation of agriculture production in 1981, and by 1984, the country adopted a "household production responsibility system" (Shenggen Fan and Marc J. Cohen, 1999). Prices of agricultural products and services were, in relative terms, undervalued. At the same time, however, planners followed a development strategy that gave priority to industry - leading to the precocious real development of industry. The agriculture sector is in an inverse relationship with the service sector.

Figure 4.3:
Structural changes in Percent of annual growth in three sectors of China and India from 1980-1985



Note: Colum diagrams indicate for China, and trend line indicates for India.
2. China and India: Ag=Agriculture, Indu=Industries, and Ser=Services.
Source: World Bank Development Indicators.

During the post-1978 reforms, many of the distortions imposed on the price system by the government pre-1978 were eliminated. The gradual opening up of the economy to competition and international trade, along with the elimination of government price controls, drove down the relative prices of manufactured goods, compared with services and agricultural products. Industry displayed the lowest rate of inflation, while, at the same time, enjoying the highest real growth rate of economy (Barry Naughton, p.154). However, there has been a dramatic shift to labour intensive commodities due to the Coastal Development Strategy, full-fledged trade export promotion, and increased participation of FIEs.

The 1980s saw the turning point of Indian economy. The agriculture sector's annual percent of growth was generally negative in 1980 and 1983, and remaining periods, it was positive. It means that generally there has been high growth in percentage terms in respect of the agriculture sector. Agriculture growth steadily increased due to the

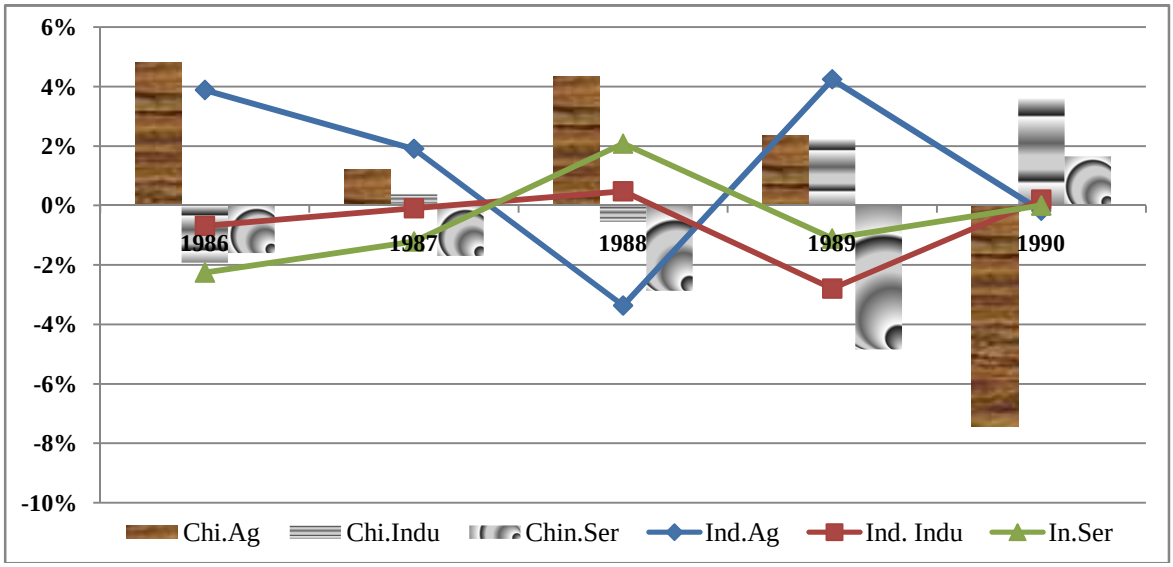
Green Revolution policies.[11] On the other hand, industrial sector annual percentages of growth have been negative, except in 1980. During the second half of the 1980s, however, the world economy recovered and India's exports grew at a steady pace. Since 1980, the industrial sector's performance significantly improved over the 'decade of stagnation'.[12] According to Joshise and Little (1994), the genuine improvement in the export competitiveness of India during this period was due to a major depression of the REER and increased export subsidies. This period also witnessed some doses of industrial deregulation and liberalisation of capital goods imports (C. Veeramani, 2007). Also, there were a robust indigenous industrial sector and low foreign debt economy (Atul Kohil, 1980). The growth in investment in the industrial sector was fuelled in the 1980s by the growing public investments and private corporate investment factor productivity in Manufacturing (Atul Kohil, Viramani 2004b, Rodrik and Subramanian 2004). Besides, the service sector percent of growth has been fluctuating over all the years. It is, today, a dominant sector in the economy. However, in the 1980s, more manufacturing sectors, trade sectors and other companies started attracting more foreign investments.

Figure 4.4 below presents a clear picture of the structural changes in China and India. China's Industrial sector's annual percent of growth has been partially stable over the periods. In 1989 and 1990, the percent of growth decreased. The growth percent of the service sector has been negative, except 2% in the 1990s. However, it is now growing steadily. The agriculture sector's percent of growth has been fluctuating over all the years. In 1986, and 1988, the percent of growth was 5% and 4% respectively. Its result is agriculture growth sluggishly decreased. Despite this, the agriculture sector has performed better than the service sector. However now, many of the agriculture sector workers have shifted to the industrial and service sectors. Also, the Chinese economy was trying to change the focus of agriculture to household activities. This means that industrial growth was constant, and service sector growth was steadily moving up. Agriculture and services have shared an inverse relationship.

[11]. The positive agricultural growth during the initial year of reforms was a substantial hike in minimum support price given by the government, mainly to reduce the gap between domestic and international prices (Chand 2005b), that resulted largely from devolution of the overvalued exchange rate (Ramesh Chand, S.S. Raju, and L.M Pandey, 2007).

[12]. Viramani (2004a, and 2004b) and Rodrik and Subramaniam (2004) have establish via-a variety of more formal tests that 1980. Indeed represents a break from, Indian's 'Hindu Growth rate'.

Figure 4.4:
Structural changes in Percent of annual growth in three sectors of China and India from 1986-1990



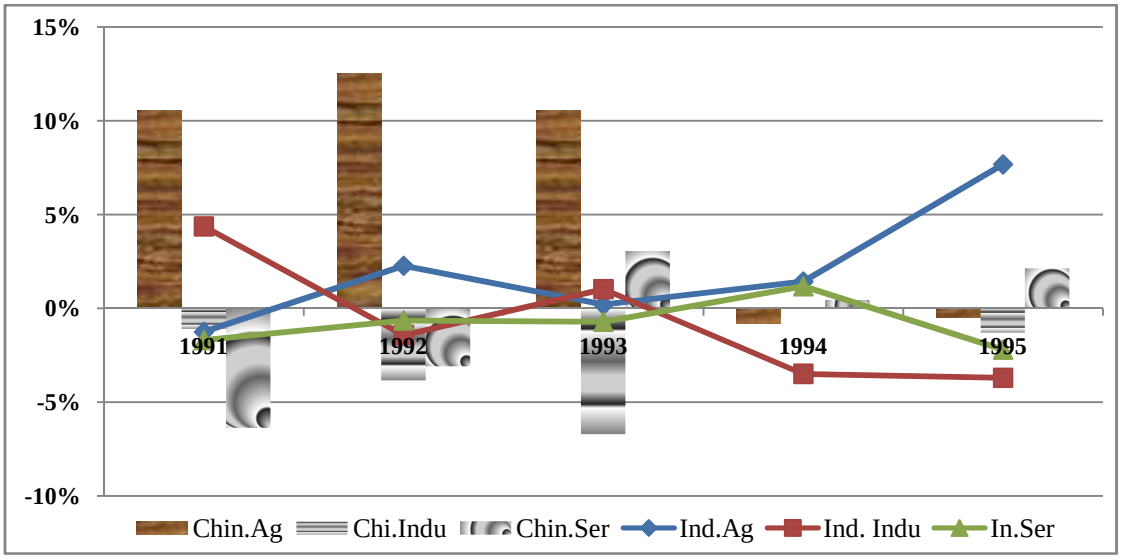
Note: Colum diagrams indicate for China, and trend lines indicate for India.
2. China and India: Ag=Agriculture, Indu=Industries, and Ser=Services.
Source: World Bank Development Indicators.

However, after 1985, growth rate sharply rose due to the creation of the SEZs, which were considered as the growth engines of the country until the mid-1990s. The task of price reform was achieved using the dual-track pricing system. Rural enterprises were allowed to sell over quota products at market prices. During the period 1978 to the early 1990s, diversifying the rural economy by promoting TVEs, modernising the textile industry and expanding facilities to attract foreign investment were the main trends (Manoranjan Mohanty, 2009).

In the case of India, the above figure trend lines explain about the Indian structural changes. Initial economic reforms have an influence on almost every sector of the country's economy. The service sector's annual percent of growth turned to negative in 1986-1987, except in 1988, when it was positive. However, in recent times, the sector's growth has been phenomenal. The industrial sector's annual percent of growth showed partial changes in the overall periods, except in 1989. Its growth has gradually improved. In 1990, industrial sector's performance growth declined by public investment (Veeramani, 2007). Likewise, another important sector is the agriculture sector. Its annual percent of growth has been generally favourable in all the periods. However, in 1988, it was negative. This means that the sector's growth had been steadily declining. But, very interesting is that, in term of growth, the agriculture sector has performed better than the

industrial sector before transition. In the 1990, agriculture exports fluctuated considerably.

Figure 4.5:
Structural changes in Percent of annual growth in three sectors of China and India from 1991-1995



Note: Colum diagrams indicate for China, and trend lines indicate for India.
2. China and India: Ag=Agriculture, Indu=Industries, and Ser=Services.
Source: World Bank Development Indicators.

Figure 4.5 presents a clear figure of the structural changes after transition in both China and India. This transition period is the turning point and also full-fledged economic reforms were accelerated in both countries.

During the period 1990-1991, economic reforms and trade reforms were introduced. With the renewal of economic reform and rapid growth after 1991, structural changes resumed with renewed intensity. Rapid industrial growth dominated the process in other sectors also. After transition, there has been a tremendous increased growth in the industrial and service sectors, while agriculture sector's growth was continually decreasing. The service sector's overall percent of growth was negative in the initial two years, and thereafter, it has been steady. After transition, the service sector's performance has significantly improved, when compared to that of the 1980-1990 decade. The Industrial sector's overall percent of growth has been rapid. However, its percent of growth was negative in some years. This brings out the partial changes in growth of the industrial sector. In addition, the manufacturing-led growth has benefited due to a high domestic saving rate, huge inflows of foreign direct investment (FDI), and increasing investments fueled by exports and fixed investment (Stephen S. Roach, 2006). As a result, the industrial sector rapidly expanded in China. Its effect on agricultures of GDP

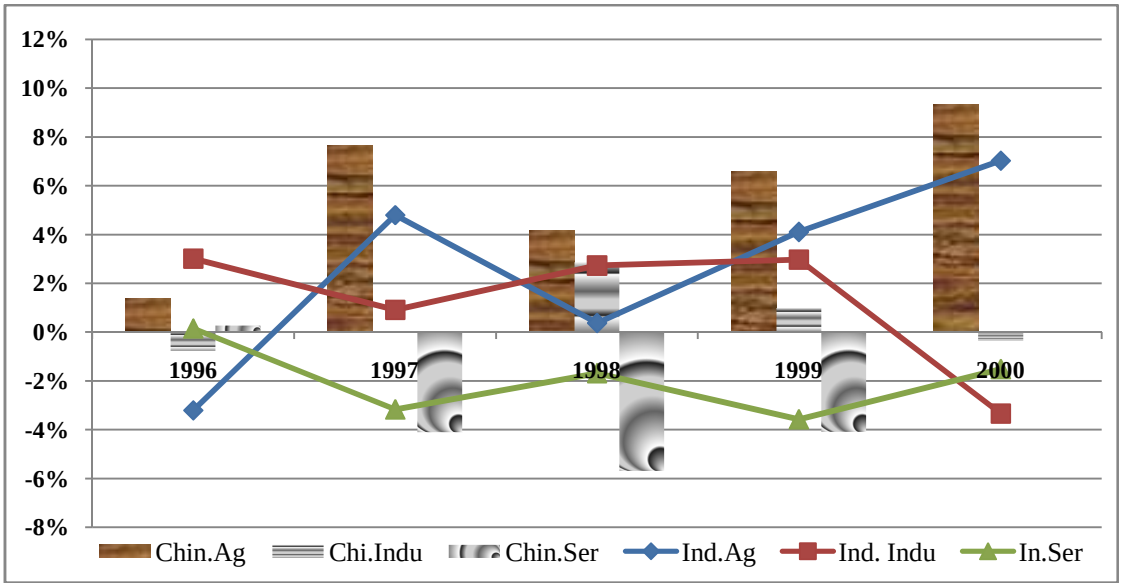
has resumed its rapid decline. Since the late 1990s, as industrial restructuring caused a reduction in manufacturing employment, service employment began to grow more rapidly and has taken up some of the workers displaced from the industrial sector (pp. 153-154**).** The high growth of China's economy has been due to the enormous opportunities created in China's market. These were significantly opened up to foreign investors by policy measures undertaken in the late 1980 and early 1990s (Philip Keefer, 2006). In trade policy, the first best policy thus typically consists of subsidies on the low quality home products and a tariff on high quality imports.

And agriculture sector percent of growth changed tremendous in the initial three years and in the remaining years, it was negative. During the Second phase of reforms, in 1993, the agriculture sector was in a largely free-Market sector (Tey (John) Yeong-Sheng, 2009). In that sense, liberalisation of domestic agricultural market and international trade, with the rise of farm prices, has an enormous influence on production. However, high inflation in 1993, 1994 and 1995 causes rise in grain prices and declined production - leading to increased imports. However, the service sector has been in an inverse relationship with the agriculture sector after the transition period.

India's economic reforms began in 1991 and it absolutely impacted some sectors of the economy. The service sector's percent of growth has been gradually increasing. The industrial sector's percent of growth has been fluctuating over all the periods. It means that slowly mounting in the growth. In addition, the agriculture sector's percent of growth overall the periods was positive, except in 1994 and 1995. It shows that change in the growth by the transition, and remaining periods' growth has steady changed. During 1991 and 1992, inflation was high. In India, the agriculture sector continuously decelerated after transition, while the industrial sector was steadily growing. Also, due to openness of trade, the service sector has grown phenomenally without interruption towards the end of the decade. Improvement in private investment seems to have partially compensated for the decline in public investment. However, there is an undeniable decline in total agricultural investment growth (Roy and Pal 2002; Gulati & Bathla 2001 and Nagaraj, 2011). Several reforms are triggers to growth. These include: trade reforms, tax reforms, industrial reforms and more flexible FDI inflows, reduction of major subsidies, privatisation, and the recovery of banking sector; and tenure protection for workers. Indian National Stock Exchange is becoming one of the world's most efficient exchanges, in term of transition costs and transparency. India liberalised its FDI policy in

1991, and now allows 100% FDI in most of its manufacturing sectors. In India, the liberalised FDI policy allows 100% FDI in most of its manufacturing sectors. The macro-economic reforms commenced with the devaluation of the Rupee in 1991, India signing on the Uruguay Round Agreement of 1994, including Trade Related intellectual Property Right (TRIPs). In 1991, India adopted a pro-Market strategy that liberalised its internal regulatory framework, reduced tariffs, adopted appropriate exchanged rate policies and allowed foreign investments to play a significant role in the economy (Veeramani, 2007).

Figure 4.6:
Structural changes in Percent of annual growth in three sectors of China and India from 1996-2000



Note: Colum diagram indicate for China, and trend line indicate for India.
2. China and India: Ag=Agriculture, Indu=Industries, and Ser=Services.
Source: World Bank Development Indicators.

Figure 4.6 presents a clear picture of the structural changes introduced in both China and India. Both countries' growth had fallen in 1996 to 2000, due to the Asian Financial Crisis, and lack of dramatic progress in trade liberalisation.

China's industrial sector is steadily growing potentially over all periods. The service sector's percent of growth was negative over all the periods. Its show that rapid increased after transition. The Agriculture sector's percent of growth has been positive. However, result shows that there was some decline from 1996-2000. During the period 1996-2000, very slow pace of structural changes occurred due to migration of workers from agriculture, because of the impact of state-sector restructuring. The decline in agriculture growth can be decomposed in the three components: (1) price changes, (2) factor endowments changes, and (3) technologies, major transformation of agriculture

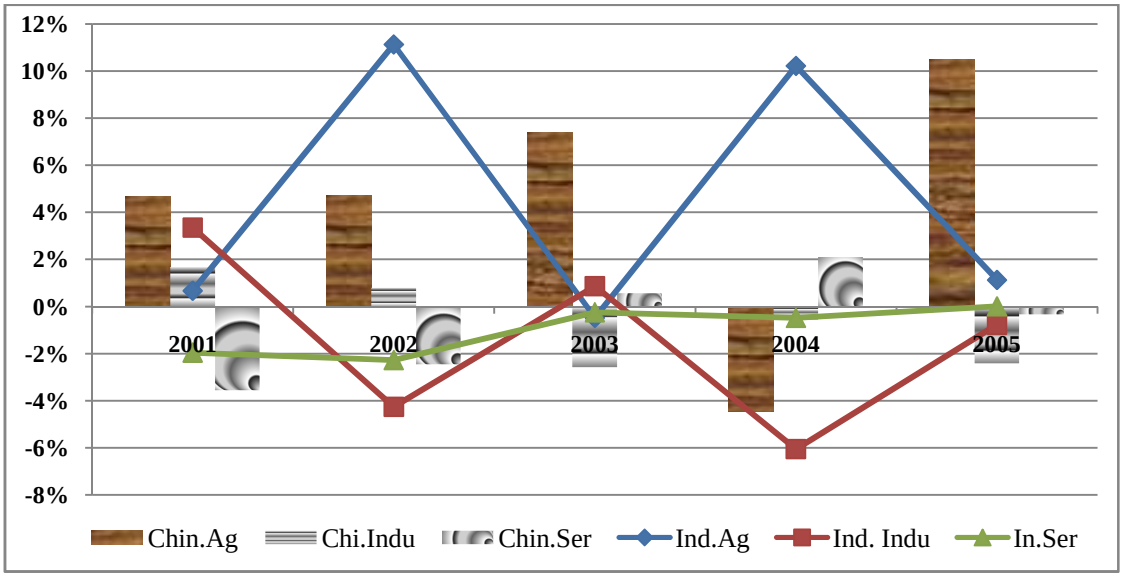
GDP share along with China's Economic Development, previous studies (Ling *et. al.*, 2007, Harrigan, 1997; Martin and Warr, 1993; Woodland, 1982, Kohli, 1998). However, the new policies have imposed a substantial financial burden on the government and hindered reforms in other sectors, resulting in loss in social welfare. Another new policy initiative in 1997 is called "Four Separations and One Perfection" (Shennggen Fan and Marc J. Cohen, 1999).

In the case of India, the service sector's annual percent of growth has been negative in some years. These mean that there have been modest changes in the sector's growth. Today, this is one of the most significant sectors contributing to half of the growth in the Indian economy. And industrial sector's annul percent of growth has been positive in four years and in 2000, it was negative. Its mean partial changes and growth rate progressively increased. Likewise, the agriculture sector's percent of growth was positive, in the sense that its growth continuously decelerated. To the higher inflation led to increase in the price demand in 1998. Thus, the main factors which led to a slowdown in agriculture at national level after 1996-97 were: (a) decline in the area under cultivation, which seems to be a result of growing urbanisation and industrialisation, (b) deterioration in the term of trade for agriculture, (c) poor progress of irrigation and fertilizer, (e) decline in supply of electricity to agriculture, and (f) slowdown in diversification (Ramesh Chand, S.S. Raju and L.M Pandey, 2007).

Especially after 1991, the industrial sector's growth has greatly influenced the agriculture sector's growth. Industrial sector is in an inverse relationship with agriculture growth. Financial institutions have been playing an important role in Indian economy after transition. Indian has steadily strengthened its banking system, improving the regulatory framework, imposing strict prudential norms and encouraging greater competition. The government has allowed private sector entry since the mid-1990s.

Figure 4.7 below presents a clear picture of the structural changes in China and India. From 2000 onwards, both countries have exhibited the fastest growth rates in developing countries in the world. In the new millennium, growth has seen acceleration in both countries.

Figure 4.7:
Structural changes in Percent of annual growth in three sector of China and India from 2001-2005



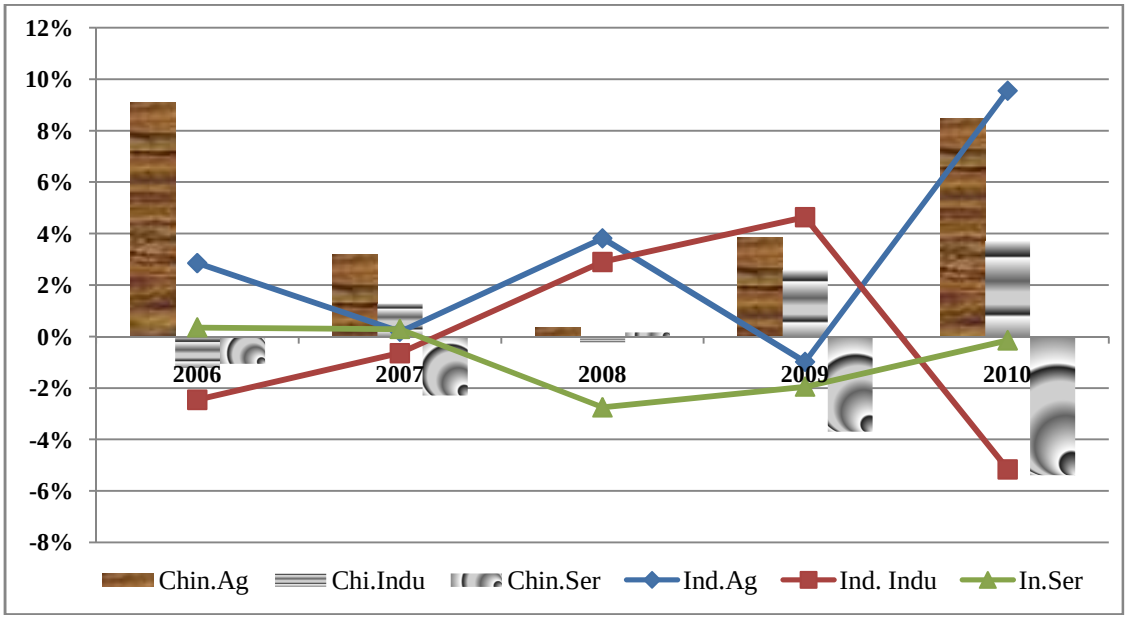
Note: Colum diagram indicate for China, and trend line indicate for India.
2. China and India: Ag=Agriculture, Indu=Industries, and Ser=Services.
Source: World Bank Development Indicators.

China's industrial sector's annual percent of growths has been fluctuating. This sector has shown significantly accelerated growth. This sector's growth has seen very slight changes over all the periods and as its share of the work force climbed steadily to more than 40% in 2004. Especially from the mid-2000s onwards, China's economic growth rate has been one of the fastest among the developing countries. This has led to tremendous growth of the industrial and service sectors. Agriculture sector percent of growth is gradually declining year by year. On the other hand, the industrial sector has been dominating the other sectors.

But the renewed liberalisation of the trading regime signaled by WTO, again led to a surge in China's trade. After 2002, growth of both exports and imports increased significantly by the dramatic increase in export of machinery and electronic items. However, the China export has shifted to much reflect by the abundant labour endowments. The period 1990 to 2001 saw accelerated opening up to foreign capital and major investment by foreign companies. China- productivity gains from the inter-sectoral shift of labour, as well as other that increase total factor productivity technological improvement. However, in China's most successful policy initiatives have been in modernising its infrastructure, allowing labour mobility, welcoming foreign direct investment (FDI) and embracing competition after WTO entry (Veeramani, 2007).

In India, the agriculture sector's percent of growth has been positive, but has seen a deceleration during the post-reform period. It means that agriculture sector has fallen after the high potential growth period. The agriculture sector's contribution to the gross domestic product (GDP) is now quite low about (18%), even though about half of the labour force is still defendant on it.[13] The industrial sector's percent of growth has fluctuated. This result shows that high changes was taken place, and has also steadily enlarged. The service sector too showed tremendous growth without interruption. This is one of the key sectors – contributing more than 53% to the average growth to the Indian economy. From 2005-2006, the service sector has been the most dynamic in India's economy. Moreover, in the new millennium era, the IT exports, continued to be dynamic engines for the growth of the economy (Chauvin and Francoise, 2003; Machele Alessandrini *et. al.*, 2008).

Figure 4.8:
Structural changes in Percent of annual growth in three sector of China and India from 2006-2010



Note: Colum diagrams indicate for China, and trend lines indicate for India.
2. China and India: Ag=Agriculture, Indu=Industries, and Ser=Services.
Source: World Bank Development Indicators.

Figure 4.8 depicts the structural changes in China and India from 2006-2010. China's industrial annual percent of growth has been fluctuating over all the periods. It means that this sector's growth has partially changed in all years. And services sector's percent of

[13]. With the average size of land steadily declining under demographic pressure, the chemical and energy inputs for agriculture getting more expansive, the resource base declining, and with public investment in rural infrastructure decelerating, the agricultural sector been in a bad shape. Also, due to divided access to credit and education, there is little scope particularly for small and marginal farmers, to utilise the opportunities from new technology, new products and markets **(**Veeramani, 2007).

growth were negative. This shows that service sector's growth rate is rapidly growing. Besides, the service sector's growth had been more than that of the industrial sector in 2010, (e.g., the values added growth is 45.89% and 44.58% in 2010). During the year 2006, China was the world's largest exporter of commercial merchandised products. On the other hand, the agriculture sector percent of growth has been positive this means that declining the growth rate primary sector in China. However in the period 2008-09, the three components of growth have been affected by the financial crisis. Later on, during the fiscal year 2000, these slowly recovered the growth.

China is leaving behind its history as a predominantly agricultural economy as it has undergone rapid industrialisation. However, its service sector still lags behind the explosively growing manufacturing economy. The government announced in 2006, its plans for implementing four types of reforms for enhancement of rural income. These were: reforms of rural taxes and administrative fees; water conservation project for enhancing agriculture productivity; increase in public investment in the social-economic sector; and political reforms - providing self-government to villages.

In India, the agriculture sector's percent of growth has been generally positive. In the year of potential growth in the economy, the agriculture sector rapidly decreased. In the period 2009-10, the adverse impact due to the delayed and sub-normal monsoon has been contained to a large extent (Economic Survey, 2009-2010).[14] The industrial sector's percent of growth has slightly changed. But its growth is gradually increasing. According to CSO, estimate of 7.2 per cent GDP growth for 2009-10 reflects the fast paced recovery, given the Index of Industrial Production (IIP) posting a record 16.8 per cent year-on-year growth during the month of December 2009 (Economic Survey, 2009-2010). Besides, the dominant sector has been the service sector and largest share of the GDP, its percent of growth has been high. However, service sector growth in the IT sector is attributed to increased specialisation, and an availability of a large pool of low cost, highly skilled, educated and English-speaking workers, on the supply side, matched on the demand side by increased demand from foreign consumers interested in India's service exports. In the fiscal year 2008-2009, the world financial crisis affected the entire sectors. In this period, high inflation also adversely affected economic growth.

[14]. We compare to previous decades special focus on agriculture in the five-year plans and steady improvements in irrigation, technology, application of modern agricultural practices and provision of agricultural credit and subsidies since the Green Revolution in India.

Comparison of China and India:

Each country has established a comparative advantage in one specific sector, then developed along a path of steady growth. The ability of the growing modern sector to absorb labour is a key determinant of the economy's ability to transform itself. In India, the major reasons for decline in agriculture sector's growth are: inefficient irrigation facilities, lack of modern technology, insufficient finance and inadequate marketing of agriculture products. In China, the reason for a more fundamental transformation was the economy's growing adoption of cash crops, instead of just growing rice and grains. Hence, transition economic would creates an additional opportunities for specialisation in both economies.

b. Growth and Inflation in Transition Economies

We can observe from Figure 4.9, which illustrates the growth and inflation in India and China from 1979 to 2009. We can also see that much higher fiscal deficits are associated with higher inflation and it resulted in lower growth.[15] Both countries' GDP growth rates and inflation have been growing steadily from 1978 to 2008. After transition, 'big bang approach' resulted in an unexpected sharp and prolonged decline in GDP with high inflation rates and serious deterioration of other social indicators (World Bank 1996; 2002; Justin Yifu Lin, 2004). These factors are determining the economic development. However, too much GDP is also dangerous, as it will usually come with increased inflation. Majority of economists, today, agree that a small amount of inflation is often beneficial to the economy (Game Seven, Melisa Eli, Sail Uncut and Gazed Timincioglu).

The below figure clearly illustrates that the overall inflation and growth in both countries have been moderate since the reform era began, particularly in comparison with other transitional economies. However, China has been troubled by persistent 'boom-bust' cycles, in which periods of unsustainably rapid inflationary growth have been followed by periods of macro-economic austerity and slow growth. Since the initial period of transition in China, the overall average growth rate is increasing at almost 10 per cent annually, except in 1989. China has undergone an inflationary crisis during 1988-1989 that shook the foundations of its political and economic system. Later on, both

[15]. Fischer, Stanley, Sahay, Ratna and Vegh, Carlos (1996), "Stabilization and growth in transition economies: The early experience", *International Monetary Fund*, April, pp. 11.

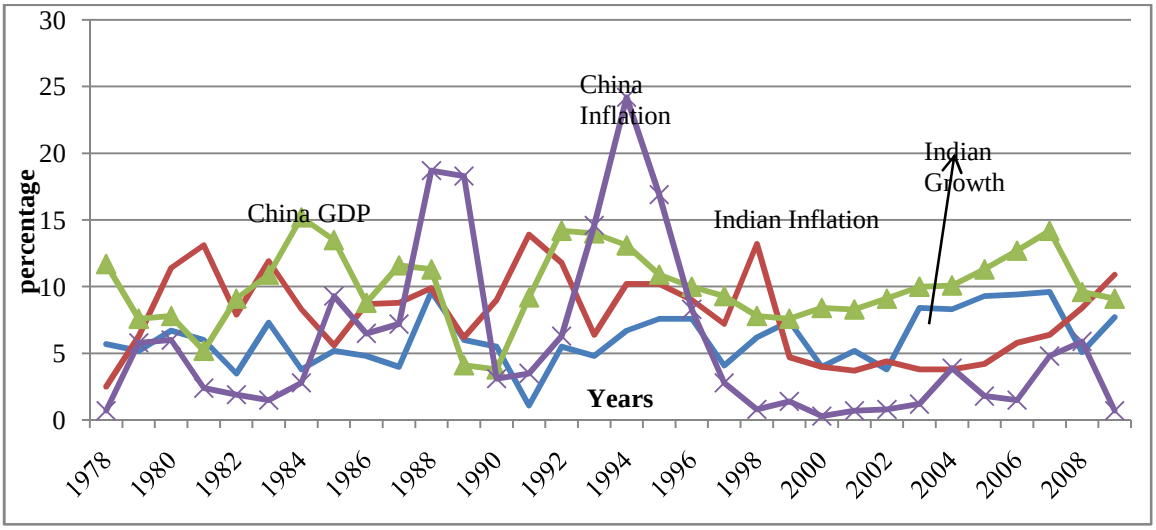
aspects have simultaneously improved healthily. In 1993, it is very interesting to note that both growth and inflation was equal. The years 1978, 1984-1985, 1992-1995 and 2005-2007 witnessed noteworthy levels of growth rates. In 1993-95, inflation rate surged, but had very less dire consequences, China's policy makers declared their intention to achieve a 'soft landing'. By the end of 1997, a soft landing had been achieved, inflation was brought down to very low levels after nearly four years. During the 1998, 1999, 2002 and 2009, inflation rates were negative. In 1994, inflation rate reached the double digit figure of 24.2 percent, which was the highest in 32 years. In 1998 to 2002, China fell into deflation because the consumer prices declined for nearly 26 months. Especially during the world crises in 2009, China's growth rate was moderate, but inflation rate was negative. Every high growth period puts serious strains on the economy, which include inflation and sectoral bottlenecks. Long–term growth is clearly a good thing, but it does not follow that maximum growth in a short time period is always desirable (*Barry Naughton, 2006*). However, inflation and growth rates in the remaining periods show a healthy performance. The stabilisation succeeds, only if growth follows. If growth does not follow the stabilisation policies, governments may find it almost impossible to sustain the stabilisation. However, stabilisation was significant for stimulating the entry of new firms in the early privatisation and restructuring occurred later in transition (Gerard Roland, 2000).

Figure 4.9 explains that India's growth rate has not risen at even two-digit level for three decades. The average growth rate is 6 per cent per year. Indian economy is calculating inflation, using the Wholesale Price Index (WPI).[16] Inflation was 11 per cent in 1980s and 10.9 per cent in 2009. During the period 1980s, Indian economy witnessed the initiation of reforms. In 1979, the growth rate was negative (-5.24) percent and, at the same time, inflation was 15.75 per cent, which was also the overall highest in 32 years. After transition, GDP growth rate had been rapid, except in 1991. At the same time, inflation rate has doubled. Because of financial reforms and the fiscal deficit that took place in 1991, growth rate was adversely affected and stood at 1.1 per cent. The transition effect on economy up to five years' inflation rates had increased. Almost equal inflation rates and growth rates were experienced post-2002, due to increase in oil prices during the period, and due to the adverse impact of drought on agro-products, leading to increase

[16]. It is different from the rest of the world. Each week, Indian Government is calculating inflation by wholesale price of a set of 435 goods is by then. Since these are wholesale prices, the actual prices paid by consumers are far higher (RBI).

in prices -especially of oilseeds and edible oils. Inflation in India, due to causes like increase in international oil prices and natural disaster like drought or floods, is showing a gradual fluctuating trend.

Figure 4.9: Compare the GDP and Inflation of China and India - 1978 to 2009



Sources: World Bank Development Indicators.

However, in the year 2009, the global financial crisis resulted in a significant slowdown in the Indian economy. Finally, both inflation and growth was smoothened. Thus, growth and inflation experiences of both countries have negative correlations. In China, the growth had an impact on inflation, while in India it was the opposite - inflation had an impact on growth. The first half of the financial year 2008-09 was marked by high WPI based inflation - primarily due to the rise in global commodity and fuel prices. Later, the global economic meltdown, starting from September 2008, reversed the trend and inflation slipped into a negative region during June to August 2009. Because of the decline in commodity prices globally, the base effects were felt in both the countries. As regards food inflation, the upswing, noticed in the first quarter of 2008-09, continued during 2009-10 due to the unfavourable south-west monsoon, the worst since 1972 (*Economic Survey of India*). Later on, inflation and growth were smooth and did not increase to double digits in 31 years. Thus, growth and inflation in both countries witnessed negative correlations.

4.5. Conclusion

An impact of economic transition in the both countries' sustainable economic growth had accelerated when compared to the rest of world in the 21st century. Moreover,

companies in both countries were able to move up the value chain in their next stages of development. Comparison of both transition economies demonstrates that the Indian reforms were taken-up in 1991 due to foreign exchange crisis and under pressure from the IMF and World Bank, while China's economy opened up under *No foreign Pressure*, and it was a planned shift to market socialism in national interest. As a result of transition, macro-economic policies are healthier in both countries. Hence, China's overall performance is very remarkable. Even though in India reforms started once decade later, the country is maintaining a relatively similar growth pattern. Yet, transition in both countries is not complete - both are still in the process of transition. Also, several reforms and other policies are lagging behind in the economic system, because of internal inconsistencies in China.

Using the development model "fordist model of growth", one can see how the growth occurred through vicious circles in both economies. China's successful strategy in the past twenty years has been the transfer of its labour surplus from agricultural to manufacturing industry, from low-efficiency sectors to high efficient sectors, while in India, the process of transferring cheap labour from low-value agriculture to higher-value manufacturing industry has been slow, accompanied with a weak industrial growth and unfavourable labour laws. Nevertheless, both countries face similar problems like social and environmental degradation, urbanisation, and industrialisation.

In addition we can clearly see an empirical evaluation has been made on the impact of transition economy on the structural changes in transition period and also growth and Inflation. The results reveal that, in both countries, after transition, the role of the primary sector has been decreasing and secondary and tertiary sectors have tremendously increased through gradual and phase-wise reforms. It explains that both countries' components have shown negative trends of correlation. Both countries' sectors have surged in global integration. In the 21st century, both countries have been dominating the rest of the world.

APPENDIX: 4.I

Table 4.1: Main Economic Reforms from 1976 to 2010 in China

YEARS	MAIN ECONOMIC REFORMS
1976	-Cultural Revolution
1978	Reforms launched
1979	-Creation of HRS (household Responsibility System), peasants allowed to retain over-quota output
1980	-Creation of Special Economic Zones (SEZ)
1981	-Beginning of 1980s; creation of TVEs (Township and Village Enterprises)
1983	-The people's Bank of China was nominally designated a central bank -1982-83 elimination of price controls on more 500 small consumer items - 1980-83 fiscal contracting system, local governments allowed to retain over-quota revenues
1984	-Dual-Track system, enterprises were allowed to sell over-quota product at market prices
1990	-Two stock exchanges were set up
1991	
1992	-"Commercialisation" of SOEs (State Owned Enterprises), Regulations on Transforming the Management mechanism of State-Run Industrial Enterprises -Full price marketisation, -Abolishment of the "iron rice bowl" (the permanent employment system)
1993	-New accounting system - Tax reform
1994	-Abolishment of dual-track exchange rate, -Separating tax reform, a brand new unified tax system including VAT, and recentralisation of tax collection to central government -Adoption of four major banks of the international accounting standards
1995	-Privatization of small SOEs, -Central Bank Law, central bank has the mandate for monetary policy-independent from the central government
1999	-Private ownership and the rule of law incorporated into the Constitution
2000-01	-Ascension to WTO
2004	-Constitution amended to guarantee private property rights
2005	-The conservative Hu-Wen Administration began to reverse some of Deng Xiaoping's reforms in 2005
2006	China was the world's largest exporter of commercial merchandised products,
2008-09	Effect Financial recession (provided a stimulated policies0
	China's government to renewal provided, subsidies in housing, low tax, to improve the infrastructure, Rail connectivity, Roads and ports.
2010	Recovered from crisis

Sources: Michele Alessandrini and Tullio Buccellato (2008)

Table 4.2: Main Economic Reforms from 1975 to 2010 in India

YEARS	MAIN ECONOMIC REFORMS
1975	During the 1970s the Green Revolution was launched Re-introduction of OGL (Open General licensing, list of goods with no license for import) list with 79 capital items
1978	By the end of 1970s, increasing pressures for liberalisation policy from industrial lobbies
1980	In 1980s informal reforms were initiated
1981	Removal of licensing requirements in 20 industries and some relaxation of import controls
1985	-Introductions of replenishment licenses to exporters for incentives -The interest rate on export credit was reduced from 12% to 9% -47 product groups freed from the industrial licensing system
1986	-Canalisation declined from 67% in 1980 to 27% of total imports -Duty-free imports of capital goods allowed in selected "thrust" export industries Between 1985/1986 relation of MRTP (Monopolies and Restrictive Trade Policies)
1987	OGL reaches 1007 capital goods and 620 intermediate goods
1988	-100% of business profits from exports made income tax deductible -OGL reaches 1170 capital goods and 949 intermediate goods
1990	Between 1985/1990, the real exchange rate was depreciated by 30% (nominally 45%) -Introduction of MODVAT (Modified Value Added Tax) covering all manufacturing sub sectors (excl. Petroleum, textile and tobacco)
1991	-Statement of Industrial Policy -Public monopoly limited to 8 sectors, all the others opened to private investments -Relaxation of controls on FDI -Creation of Social Economic Zones, where 100% of FDI allowed in manufacturing sectors
1992	-Introduction of a dual exchange rate: exporters allowed to sell 60% of their exchange in the free market, and 40% to the government at a lower official prices
1993	Foreign companies own up to 51% equity in 34 high priority industries
1994	-The highest tariff rate on import fell to 85% (it was 355% in 1990) -National Telecommunications Policy for private and FDI in cellular and telephone services
1995	-The higher tariff rate on import fell to 50%
1999	-The insurance Regulatory and Development Authority permits private and FDI to operate in the insurance market -Liberalisation of banking -NTP defined FDI in internet services. Infrastructure sectors opened to private and FDI
2000	Economic growth has rapidly increased by this year
2003	-Electricity Bill passed to permit Privatized generation, transmission and distribution of electricity
2004	-The highest tariff rate on imports fell to 25%
2005	SEZ bill passed by the Parliament; FDI policy (2005) allows up to a 100% FDI stake in ventures.
2006-07	India had itself as one of the world's fastest growing economies by this year
2008	India had projected itself as one of the world's fastest growing economies by this year
2009	Effect of Financial recession
2010	Recovered from crisis
Sources: Michele Alessandrini and Tullio Buccellato (2008), Chetan Ahya (2004)	

Table 4.3:

Both countries annual percent of growth of three sectors from 1980 - 2010

Years	**In.Ser**	**Ind. Indu**	**Ind.Ag**	**Chin.Ser**	**Chi.Indu**	**Chi.Ag**
1980	3%	3%	-5%	0%	-2%	4%
1981	-1%	-3%	4%	-2%	5%	-5%
1982	-3%	0%	4%	1%	3%	-5%
1983	2%	0%	-2%	-3%	1%	1%
1984	-2%	-1%	4%	-9%	3%	3%
1985	-3%	0%	4%	-14%	0%	13%
1986	-2%	-1%	4%	-2%	-2%	5%
1987	-1%	0%	2%	-2%	0%	1%
1988	2%	0%	-3%	-3%	-1%	4%
1989	-1%	-3%	4%	-5%	2%	2%
1990	0%	0%	0%	2%	4%	-7%
1991	-2%	4%	-1%	-6%	-1%	11%
1992	-1%	-1%	2%	-3%	-4%	13%
1993	-1%	1%	0%	3%	-7%	11%
1994	1%	-3%	1%	0%	0%	-1%
1995	-2%	-4%	8%	2%	-1%	-1%
1996	0%	3%	-3%	0%	-1%	1%
1997	-3%	1%	5%	-4%	0%	8%
1998	-2%	3%	0%	-6%	3%	4%
1999	-4%	3%	4%	-4%	1%	7%
2000	-2%	-3%	7%	-3%	0%	9%
2001	-2%	3%	1%	-4%	2%	5%
2002	-2%	-4%	11%	-2%	1%	5%
2003	0%	1%	0%	1%	-3%	7%
2004	0%	-6%	10%	2%	-1%	-4%
2005	0%	-1%	1%	0%	-2%	10%
2006	0%	-2%	3%	-1%	-1%	9%
2007	0%	-1%	0%	-2%	1%	3%
2008	-3%	3%	4%	0%	0%	0%
2009	-2%	5%	-1%	-4%	3%	4%
2010	0%	-5%	10%	-5%	4%	8%

Sources: WDI.

Chapter – V (a)

A comparative study of China and India: in Perspective Foreign Direct Investment policy and Analysis

5. Introduction

- **a. Significance of FDI?**
- **b. Determinant factors of FDI?**
- **c. Need for comparison: China and India**
- **d. Framework of Technology Transfer through FDI in source country**
- **e. How FDI influences economic indicators in the economy**

5.2. An overview of FDI in China and India - a Transition prospective

5.3. Comparison of FDI policy analysis in China and India

5.4. Role of FDI in selected indicators can influence Transition economics (1978 to 2010)

5.5. Conclusion

Introduction

Foreign Direct Investment (FDI) is an internal part of an openness of effective international economic system and a major catalyst to development (OCED, 2002).[1] Transitional economy means '*from planned economy to market-oriented economy*'. It involves structural or policy reforms, such as currency or capital market changes. Foreign investment is also a serious problem for an emerging economy. In most cases, foreign investment increase is a postulate sign regarding the state of health of the economy. The injection of foreign currency into the local economy aids long-term investment to its infrastructure. The neo-classical approach argues that FDI affects only the level of income and leave the long-run growth unchanged (Solow, De Mello). This long-run growth changes due technological progress and economic growth. Thus, according to classical model of economic growth, FDI would growth advancing if it affects technology positively and permanently (Shiva S. Makki, Agapi Somwaru, 2001).

The East Asian Economies initiated the process of opening up of external sector and liberalization of economic policies during the 1960s. In China, transition was started in 1979, while India, in 1991, as a result of the various problems of external sector liberalisation and balance of payments. Reforms lead certain major restructuring of the economies. It required large quantity of financial aid to promote and strengthen the micro and macro-economic institutions of the countries and make an appropriate investment-friendly institutional infrastructure. In addition, foreign aid has been received on direct lending program, as well as portfolio investments. On the other hand, for effectiveness of these programs, resources have been limited because of inadequate of sufficient spillover benefits, such as technology and managerial skills, partly due to the reversible nature of the programmes. FDI has been classified into two types such as (a) Inward investment; and (b) Outward investment. *Inward investment* is an investment that occurs in local resources for instances, tax break, relations of existent regulations, loans on low rates of interest and specific grants. *Outward investment* is 'direct investment from abroad', in local capital which is being invested from foreign resources. FDI is less reversible and at the same time it acts as a channel for transmission of technology and managerial skills (Merlevedes and Schoors, 2004, Dharmenddra Dhakal *et al.*, 2007); and also, Sinh and

[1]. See, in OCED report: 'FDI for Development Maximizing Benefits and Minimizing the Cost', 2002, p.g.1.

Weichenrieder (1997), argue that it is an indispensable ingredient in a successful strategy for economic growth and prosperity.

China and India have been emerging countries in the 'BRIC' economies, and also these countries are increasingly becoming more imperative economic players in the global scenario. In 2007, the BRIC countries' share of global GDP amounted to almost 13% (measured at market exchange rates) - or 20% (in PPP terms). In 2007, the BRIC share of the global FDI stock was a mere 3.3% (USD 510 billion), while flows amounted to a somewhat higher 4.5% (USD 90 billion), much smaller than the BRIC countries' economic weight (Markus Jaeger, 2009).

The potential of growth of emerging markets a Goldman Sachs study 'Dreaming with BRICS: the path to 2050' can be larger than the G8 in less than 40 years from now. Kearney's 'Global FDI confidence Index' ranks China as the first rank in country for the last three consecutive years in attracting FDI.

A great amount of research has been done on China and India the area of FDI, development and other aspects. After transition, both countries have been emerging as open market economies. Moreover, re-strengthening development indicators have followed the diversified decisions taken by the policy makers. The transition, intended to make a *market-oriented* and *industrialization*, it leads to be an open economy. Still, many countries had followed and successfully promoted on transition prospective. In China and India, many sectors are attracting more FDI. Firms both countries have a comparative advantage over those of other countries. Moreover, FDI has proved to be a dynamic player for development strategies in China and India and other developing counties. Hence, the most important question is 'what can be learnt from each other's experience and the challenges ahead?

A recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations (TNCs) during 2010-2012. Presently, top ten sectors, such as services, computer software and hardware, telecommunication, and construction activities are attracted higher FDI inflows. Mauritius, Singapore, the US and the UK share the top sports in attracting FDI. According to UNCTAD, there was no significant growth of Global FDI in 2010.

Figure 5.1: FDI inflows of India, China and World from 1980-2010

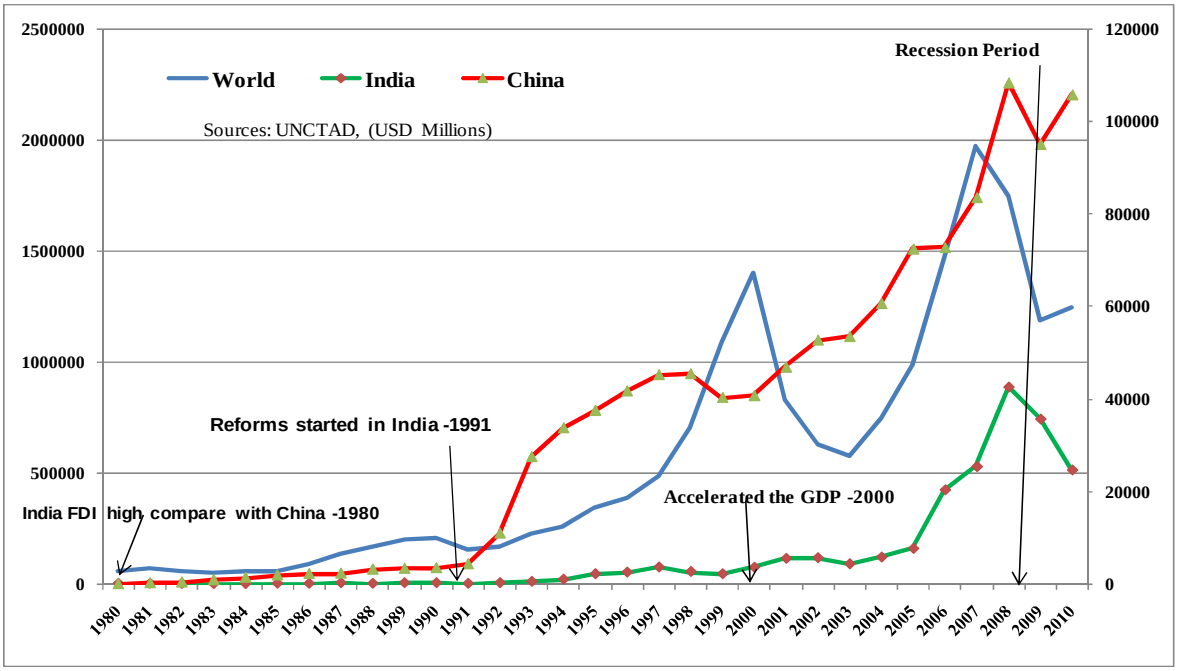


Figure 5.1 illustrates how both countries' FDI inflows compare with these of the rest of the world. In 2010, the global FDI was $ 1,122 billion and $ 1.114 billion in 2009. The figure shows 25 per cent below the pre-crisis average during the period 2005 to 2007. It also depicts the FDI inflow trend has been almost parallel to that of the world in certain years. However, China's FDI flows are slightly parallel to the world FDI in a certain years.

Table 5.1: FDI inward into 'BRICS' Countries and the World from 1980 - 2010

Countries	1980	1985	1990	1995	2000	2005	2010
Brazil	1910	1418	989	4405	32779	15066	48438
Russia	N.A	N.A	N.A	2,066	2715	12886	41194.4
India	79.2	106.1	236.7	2151	3588	7621.8	24639.91
China	57	1956	3487.1	3752.05	40713.8	72406	105735
South Africa	-10.3	-448	-78.4	1241.3	887.3	6646.9	1553.02
Transition economies@	23.6	15	75.2	4112.6	7024.9	31100	68196.976
Developing economies	7477.0	14153.7	35095.6	256465.2	330129.9	630012.5	573568.06
Developing economies in Asia	542.6	5397.5	22628.4	148735.1	215768.8	372738.9	357845.87
World	54076.4	55831.9	207697.2	1401466.4	985795.6	1770872.8	1243670.9

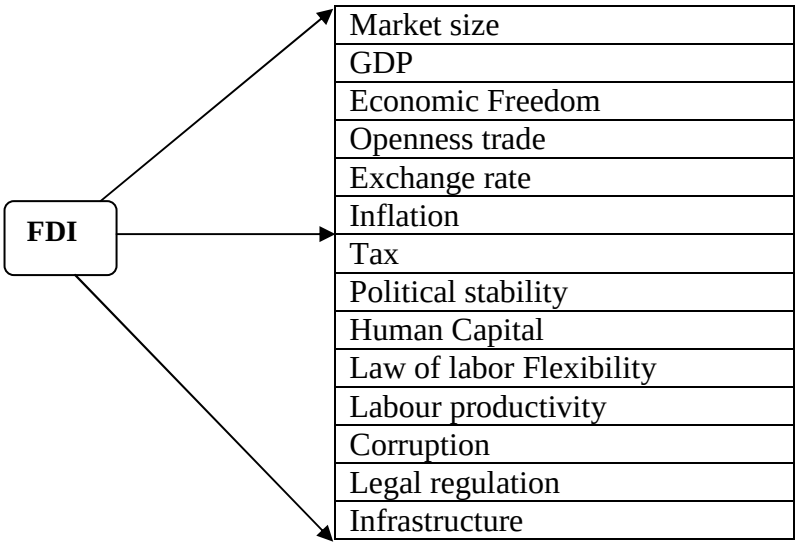
Sources: UNCTAD, US Dollars at current prices and current exchange rates in millions
@Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Georgia, Kazakhstan, Kyrgyzstan, Montenegro, Republic of Moldova, Russian, Federation, Serbia, Tajikistan, The former Yugoslav Republic of Macedonia, Turkmenistan, Ukraine, Uzbekistan (UNCTAD, 2010).

Table -5.1 describe the inward FDI of emerging countries of BRICS' and aggregate of transition countries, developed countries, developing countries and the world from 1980 to 2010. India and China FDI inflows have been tremendously increasing but, if compared to China's FDI inflows (60387 million) these were was different with those of India in 2009. In the beginning of 1980, India's FDI inflows were high as against China's. However, transition economies aggregate FDI inflows have been increasing over the periods. At the same time, aggregate FDI flows of developing economies in Asia in 2010 decreased, as compared with 2005, due to financial recession.

b. Determinant factors of FDI

There has been a significant shift in the FDI inflows towards the have to issued developing world, which will set the future trends of development. Number of researcher focus attention on FDI performance and the determinants of FDI inflows. The studies includes: Root and Ahmed (1979), Schneider and Frey (1985), Trevino, et al. (1999, 2000), Hall et al., (2003), Jeson (2003), Anantaram (2004), (Wei, 2005), Crowtey & Lee (2003), Ramanti, (2004), Lee (2005), Chantarasawat (2004), Singh & Jun (1995), and Hsiao (2001). A few recent studies have focused on FDI inflows into in transition economies. Some of these are: Campos and Kinoshita (2002), Garibaldi, et al. (2001), Konings (2001), Reshmini (2000), Sinna and Weichenrieder (1997).

Figure 5.2: Determinants of inflow of FDI in Transition Economies



Although, most of the research was focused on firm level of productivity and economic growth, while very few of them have discussed on determinates of FDI inflow in to

transition economies in Eastern and Central European Countries.[2] It is, necessary to the discuses determinant factors of FDI inflows, effects and consequences in India and China into transition prospective.

c. Need for comparing both these countries

Both China and Indian provide a fertile grand for research because social-economic indicators of the countries are similar. These include: size of the territory, history, population, culture, religion, language, political institutions, real GDP growth rates, openness of the trade and other indicators. Additionally, in the 21st century, both economies have been emerging rapidly due to their economic policies, as well as international trade and capital markets. Moreover, policies and experiences of both countries would be useful for neighbouring and developing countries. Further, in the coming years, both countries would emerge as economic and politically powerful countries in the global scenario. Also the, growth trajectory in both nations has followed a similar pattern to advanced countries and successful East Asian economies, at comparable stages of development (Nayyar, 2008; Melia U. Santos-Paulino, 2010).[3]

d. Framework of Technology Transfer through FDI in source country

The framework adopted to test this hypothesis, shown in Figure-1, has been adapted from Lan (1996). The advantage is that this offers the chance to comprehend this important aspect of foreign ownership control in the comparative study of the technology transfer behaviour between source countries.

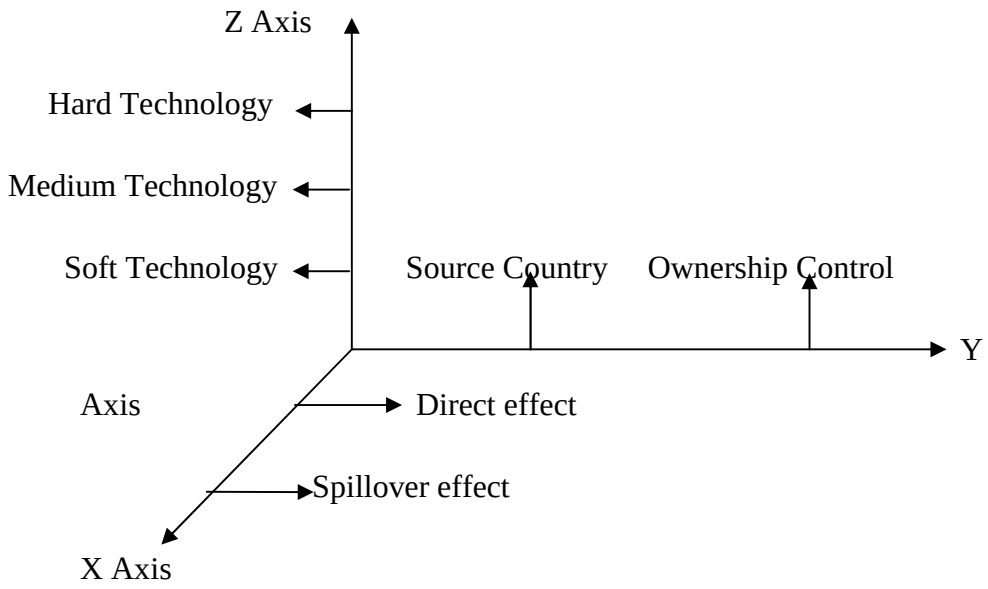
There are three dimensions to the problem. One measures the overall contribution of FDI to indigenous technology capability (direct and indirect). The second explores the role of technology transfer (technology destination and nature).the third checks the importance of dissent variables (Ownership control and source - country). Figure 3 describe the interplay of these three dimensions.

The X-axis shows the level of technology transfer taking place through direct and indirect modes. Direct effect Y axis - the influence of technology refers to direct acquisition of technology to the FDI firms from their foreign investors.

[2]. See in, Dhakal and Dharmendra *et al.*, (2004), "FDI and Transition Economies: Empirical Evidence from a Panel Data estimator", *Economics Bulletin,* Vol. 6, No.33 pp.1-9.

[3] . See the paper, "China and India: country Role Models of Development Success? UNU-WIDER.

Figure 5.3: Framework of Technology Transfer through FDI



This involves market transactions and easier to capture. Indirect effect implies the spin-off of inward technology outside the FDI firm. Rogers (1962) has explained diffusion of technology to competing companies intensifying competition in the product market. UNCTAD (1985, 1987 and 2001) bring out the three other modes of technology diffusion to indigenous sector from FDI: formation of *spin-off enterprise*, backward linkages through locally procure inputs leading to emergence of an indigenous supplier into product manufacture relations with the general scientific and business community.

The Z axis brings the various component of technology which the three knowledge forms.

1. *Hard production Technology*: this part is totally embedded knowledge, such as equipment and machinery use in production. Therefore changes in the equipment and machinery (embedded technology) may be considered an indication of technology progress (Solow, 1985). In the present study, therefore impact of capital goods is used to capture the transfer of hard production knowledge though FDI.
2. *Medium Production Technology*: this category involves technology that is either transferred in the form of designs and plans (technology import) or generated through in-house R&D activities by the FDI Firm.

3. *Soft Production and Organisation Technology:* this refers to the relationship between man and the production environment, such a as experience, skill and training acquired in the process of production. It can be divided into two types. One is maintaining skills, which handle routine problems including familiarity with the environment, such as tools and quick response to them. The other is innovation skills, which deals with the non-routine problems including exploring and testing. The main channel to transfer this kind of knowledge is personal contacts.

By adopting the analytical framework, outlined above, the study attempt to bring out various aspects of source-country differences in technology behavior.[4]

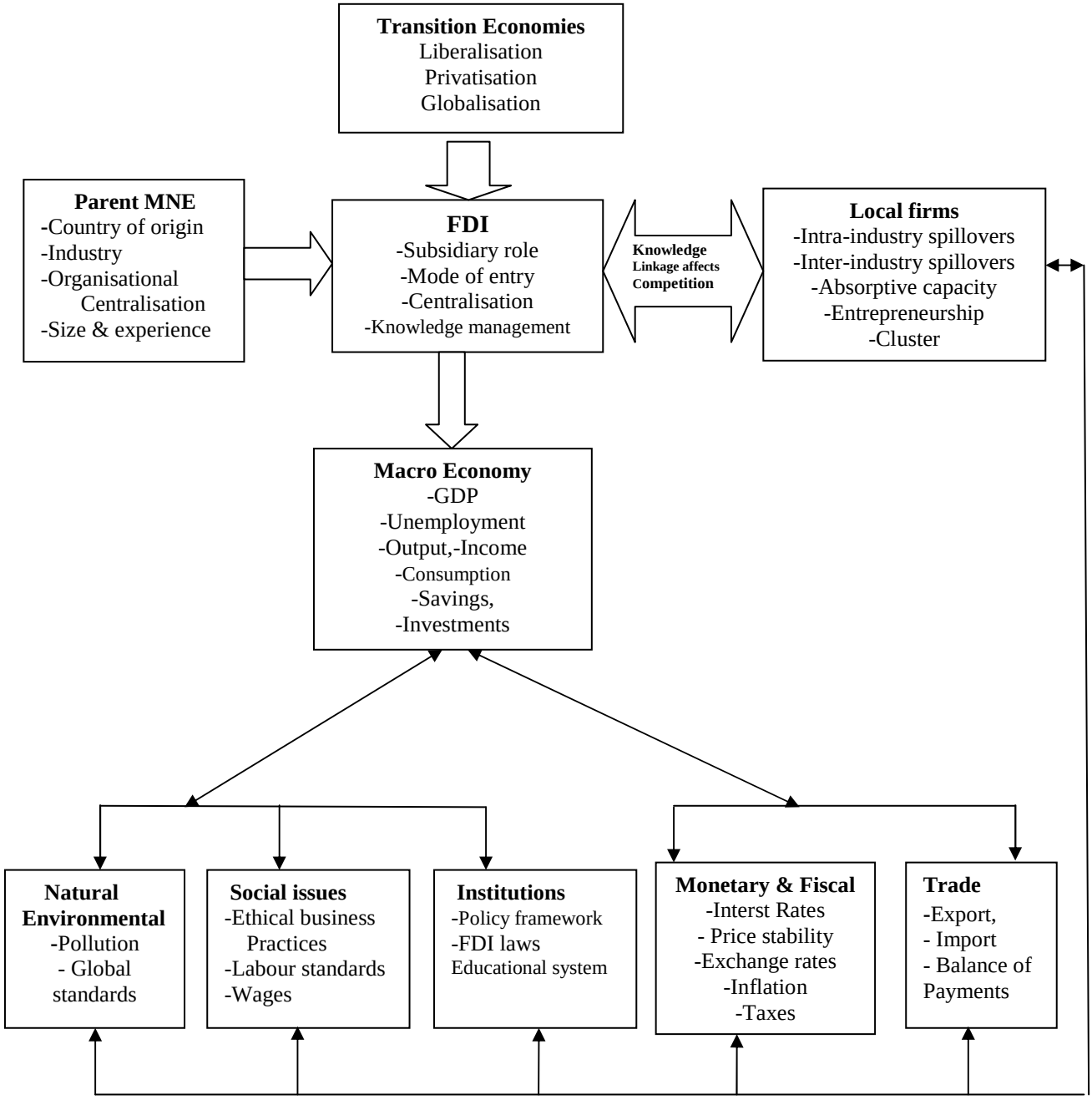
e. How FDI inflows influence Economic indicators

Impact of FDI on the host economy is complex since foreign investments interact with and, thus, influence many local individuals, firms and institutions. Figure 5.4 brings out about the major channels that influence the host economy. Foreign direct investments interact with local firms and the host economy through knowledge, forward and backward linkages and competition. These key variables impact local firms, other industries and related industries; (Altenburg, 2000; Blomstrom and Kokko, 2002; Fan, 2002; and Klaus E Meyer, 2004). Foreign investments closely interact with local business; this channel also impacts the domestic economy. In addition, inward inflow affects many indicators in the host countries. FDI inflows also influence other key aspects, like micro-macro-economy, international trade, and monetary-fiscal policy. These indicators impact the firm (or) economy.

Multinational Enterprises differ in their internal operations, which include the centralisation of decision making, organisational cultures, and human resource management practices. Subsidiaries in emerging economies would differ in their interactions with other business units of the parent's network. The interactions could include: the development of local supply networks, investment in human capital, employee mobility, and the stages of the value chain, located in the host economy. Figure 5.4 describe the structure and strategy by MNE channels adopted for inflow of FDI into the country. Of particular relevance for MNE spillovers are intra-firm knowledge transfers. Knowledge sharing within the MNE is a precondition for knowledge spillovers. This would also increase with higher value added activities.

[4] . See, Umea Krishna (2003) "Inter source–country difference in FDI behaviours: a Comparative study of US and Japans in firms in India", unpublished thesis.

Figure 5.4: Channels of Impact of FDI in Economic indicators in Economy



Sources: *Saul Estrin and Klaus E. Meyer (2008)*

The source of variation is the **mode of entry**. In a joint venture, two partners share their resources, in return for access to the partner's resources. This can lead to mutual learning, and thus extend linkages and knowledge spillovers in the local business community. Greenfield projects create new businesses and thus have direct positive effects on employment and domestic value is added. These also increase competitive pressures on local enterprises as a result of an acquisition of fully operating enterprises.

Therefore, FDI can help stimulate innovation and invention. Successful local firms find that many entrepreneurs, or top managers, had prior linkage to MNEs. Moreover, large MNEs may stimulate the evolution of industrial clusters. It can lead to a firm drawing other network members to the same location, which can create a larger impact than the initial investment alone. Also, small ambitious firms, in emerging economies, are giving increasing importance to such production networks.

FDI inflow from the parent MNEs to the host country help in distributing investments to the local firms. Transnational corporations (TNCs) look for trade and more open economies for resource-seeking operations, especially as they integrate their global production with horizontal and vertical value-chain linkages. FDI flows into local firms through various channels.

A. Intra-industry Spillovers:

In a transition economy, FDI influence on local firms is inter-industry. The main theoretical foundation of these studies of knowledge spillovers is on the basis of demonstration effects and the movement of labour, as show below:

i. Demonstration **effects**: these work through the direct contact between local agents and MNEs operating at different levels of technology. By observing innovations adapted to local conditions, local entrepreneurs may recognise their feasibility and, thus strive to replicate them. As local businesses observe existing users, uncertainty is reduced, and levels of imitation increase. Foreign investors affect local business not only through productivity effects, but in a variety of other ways. The rationale of this literature is that MNEs would directly, or indirectly, share knowledge on how to operate in international markets, by building trade channels and by enhancing the reputation of the country-of-origin.

ii. FDI contributes to human capital formation, especially through training and labour mobility. Trained local employees may move to locally owned firms, or set up their own enterprises. Many successful local firms trace their origins to entrepreneurs or top managers who had prior links to MNEs (Altenbug, 2000).

Wherever such few employees move, they may make a substitutive contribution to local business. FDI would help local firms to access **export markets**. Moreover, foreign investors may hope to build trade channels and a country- of-origin reputation that local followers may use for enhancing their exports reputation (Altenburg, 2000). This way, foreign investors may support local supplier industries and **markets for specialised inputs,** such as labour and materials. With these improved inputs; local firms may enhance their services and productivity.

Thus, FDI would help host economies to better exploit their comparative advantages, and transfer their technologies that are more closely aligned with the needs of the hosts.

B. Inter-industry Spillover:

Local firms may benefit from vertical linkages in a supply chain, benefiting from knowledge transfers to suppliers and customers. MNEs may make a deliberate effort to improve the quality of local suppliers, especially for components that cannot be cost-efficiently imported, due to high transportation costs, or where the local industry has a natural cost advantage (e.g., for labour intensive components). These help firms in other industries, for instance, by providing business services, training in sales and marketing.

(i). Lall (1980) provides the first major study on vertical spillovers. Build on Hirschman (1958), Lall develops the theoretical arguments on why backward linkages would emerge, and provides the first systematic empirical evidence. An innovative approach to study vertical linkages has been used by Blederbos, Capannelli and Fukao (2001). This productivity effect is larger when the foreign investors are domestic market oriented, rather than export oriented.

(ii). Some of these variations are due to industry-specific features (Grosse, 2005). An issue of particular relevance for MNEs spillovers is inter-firm knowledge transfer. Knowledge sharing within the MNEs is a pre-condition for

knowledge spillover. Knowledge spillovers would also increase with higher value added activities.

(iii) Another source of variation is the mode of entry. In a joint venture, two partners share their resources in return for access to each other's resources. This can lead to mutual learning, and, thus, extend linkages and knowledge spillovers in the local business community. These variations influence the effectiveness of government in designing policies aimed to attract more FDI in local firms.

(iv) Moreover, the impact of FDI varies with the ability of local stakeholders to take advantage of the potential benefits with FDI. Benefits are not obtained quasi-automatically. Likewise, local firms have own strategies and resource endowment are crucial for benefiting from interaction with foreign investors.

C. Absorptive Capacity:

Knowledge transfers, within MNEs and within strategic alliances (Lane and Lubatkin, 1998), include joint venture in emerging economies. Lane, Salk and Lyles (2001) and Lyles and Salk (1996) find that local joint venture partners improve their capacity to learn, if collaboration and exchange of information within the organisation is encouraged. Knowledge acquisitions by local joint venture partners are important since the host economy may gain. In this way, the processes of learning from MNE partners willing to share knowledge are different than learning from unrelated businesses actives (Martin and Salomon, 2003).

In the management literature, absorptive capacity is treated as a conceptualised dynamic capability, which is broader than its usage in the empirical spillover literature. In a recent restatement, Zahra and George (2002:186) define absorptive capacity as: "a set of organisational routines and processes by which firms acquire, assimilate, transform, and exploit knowledge to produce a dynamic organisational capability". It encompasses not only human capital (Cohen and Levinthal, 1990), but also structural characteristics of the organisation abilities to assimilate value and commercialise new knowledge (Lane and Lubatkin, 1998). According to Buckley *et. al.,* (2002), spillovers are different across firms under different forms of ownership. The authors attribute this to different absorptive capacities.

D. Entrepreneurship:

Entrepreneurship is a major driver of economic growth in transition economies. This is a crucial source of innovation, developing new knowledge by combining foreign and local knowledge. In this process, experimentation helps in developing innovations specific to the context, and promotes the process of "economic development as discovery" (Hausmann and Roderk, 2003). FDI can also act as a stimulus to evolutionary processes of resource creation, by promoting innovation and discovery (Kogut, 1996).

E. Clusters:

Industrial clusters have attracted the imagination of policy makers in transition economies, because they provide opportunities for direct interaction between firms, and thus for various firm spillovers and for economically specialisation. Though the evolution of industrial cluster is often driven by network organizations, FDI is a leading firm which may draw other network members to the same location and thus create a larger impact than the initial investment alone. Small ambitious firms emerging economies are increasingly accessing networks.

Yet, the long term-nature of supplier relationships and the global reach of incumbent raise entry barriers. The large firms are better placed in this regard, since they are able to guarantee quality and prompt delivery guarantee quality and just-in-time delivery. However, cluster plays a key role in economic development and also has a potentially central role in MNEs. Consequently, FDI inflows can create clusters in transition economies.[5]

FDI influence on micro-macro indicators in the transition economy

What are the micro effects on structural changes in the economic and industrial organisation? In general, FDI is conductive to the creation of a competitive environment in the host country. This approach, supported by Markusen and Venllde s (1997), includes two channels for analysis of micro effect in FDI, such as:

a. Product Market Competition

b. Linkage Effects

[5] . See, Saul Estrin and Klaus E. Meyer (2008), "Foreign Direct Investment in Transition Economies: Strengthening the Gains from Integration ", March 2007.

Product Market Competition (PMC): the MNCs will be substituting the products of domestic firms in the host country.

Linkage Effects: MNCs may work as complimentary firms in the host country. These provide outputs, and promote development of industries. FDI may have benefits, but it will not come without cost. However, liberalisation and the FDI impact macroeconomic factors in the transition countries (S.R. keshava, 2008).

A. Macro-economy: Macro-economics is all about the whole economic performance, structure, behaviour, and decision-making of the entire economy. The impact of FDI on macro-economic growth, in terms of GDP on the basis of endogenous growth models, has been examined by Borensztein, Gregorio and Lee (1998), Saul Estrin and Klaus E. Meyer (2008). The relationship between GDP and inflow FDI is moderately positive. Balasubramanyan, Salisu and Sapsford (1996) studied countries by their trade openness. They found that FDI has a more positive effect on economic growth of countries with export-oriented trade regime, compared to countries having import-substitution type trade regimes. On the other hand, Li and Liu (2005) examined the macroeconomics relationship, taking into account which foreign investors are likely to seek locations with higher economic growth, as well as contribute to this growth. FDI is a majorly macroeconomic variable of concern to policy makers: GDP, unemployment, gross domestic investment, inflation, savings, investment, consumption and output. These variables would have a positive relationship with each other variable.

-**GDP:** This is an important variable for explaining FDI inflows in countries. The investment is crucial importance in countries, where investments neither increasing nor decreasing. In fact, in the case of emerging economies per capita income growth rates are usually high and oftentimes, they are expected to continue to grow for a certain time. This increasing growth would attract more market seeking investors. The numbers of local firms would be increasing in the host countries. Hence, real GDP growth is usually expected to have a positive effect on FDI inflows.

-**FDI imports capital**: It is possible that at a later stage, capital is repatriated through profit remittance or project discontinuation. In this way, the host country pays for the costs of capital. However, FDI capital is appreciated by

the hosts because it tends to be less volatile then other forms of capital inflow (UN 1999, chap, 6).

-**FDI creates employment** if FDI is invested in Greenfield operations, additional jobs may be created in local suppliers. Yet, FDI may also crowd out local firms that use more labour-intensive methods of production. The policy-relevant net-employment effect is, thus, hard to assert (Dunning 1993, chap13; UN 1999, chap). In the case of acquisitions, the employment effect is even harder to assert, because it requires an analysis of what would have happened to the local firm, if it had not been taken over by the foreign investor (Estrin and Meyer, 2004).

- **FDI gross domestic investment:** part of the FDI may be domestically funded, or the capital inflow may increase the exchange rate and, thus, the costs of international borrowing. Both effects can lead to crowding out of local investment.

- **Finance:** Overall, the effect on macroeconomic variables varies greatly with the specific features of an FDI project, such that evidence on macroeconomic relationships may not be transferable from one context to another, and thus provide little guidance for policy makers. Rather, we need to understand the microeconomic effects of FDI, to identify which FDI, and under what circumstances, benefits the host economy.

-**Savings and incomes:** Investment creates income, which leads to savings. When the foreign inflows are rising income levels can increase in all sectors in the host country. At the same time, income generation increases and leads to rise in savings. FDI leads to increase in the investment levels in the transition economies. Thus, in this process, the income generation cycle occurs in an economy. We can, thus, say that income and savings have a positive relationship.

II. Monetary and fiscal policies: these policies have a significant role in play to controlling the whole economy. Let us now discuss the major controlling measures in the present context:

-The effect of host country's inflation on FDI inflows is not apparent; we can say higher rate of inflation indicates internal economic in-stability; which

is also, important for monetary and fiscal policies for the country. Low inflation would provide a better environment for investment, it leads to economic growth (Fisher, and Modigliani; Froot and Stein). If, the host country government is unable to maintain monetary and fiscal policies, it can lead to high inflationary growth, firms face uncertainly in terms of product, and input prices. Thus, MNEs are unable to invest in such countries, as argued by Schneider and Frey (1998), Apergis and katrakilios (1998).

-Taxes: lower taxes rates would make the investments in both domestic and foreign more profitable. Foreign companies would then be interested in making investments in the host country's markets.

-FDI in **exchange rate**: foreign investors may gain or lose from a depreciating exchange rate. For instance, with a depreciate exchange rate they can export more easily and gain from resource-seeking FDI. Foreign investors may lose as well, because they must incur costs to prevent transaction and translation losses when currency depreciates. If depreciation continues, foreign investors tend to avoid making investments. This kind of circumstance will also impede the inflow of FDI.

-Stabilisation: an important factor for attracting FDI into the host country, stabilisation entails controlling prices in a transition economy. The change in the prices, due to fluctuation in exchange rates, can lead to unstable conditions in local firms and also the host country's economy. Foreign investors are not interest to invest in such an economy. Besides, the host country's political stability is also important for inflow of investment. Thus, stabilisation is an important factor in interaction with local firms; institutions and business activities for attracting inflows into the host country's economy.

-**Current account balance:** this is another important variable for determining the strength of the currency of any country. A decrease in current account balance leads to a depreciation in the host country's currency. Such a deficit may lead to inflation and exchange rate differences. In such a case, raising the deficit in current account balance can result in reduction in FDI inflows. On the other hand, if multinational companies take advantage of the current account deficit of the host country by negotiating more favourable operative

terms, the current account deficit may help to increase FDI inflows (Dhakal, Dharmendra et. al., 2007).

III. International Trade:

-**Balance of payments in FDI,** It shows the export and imports of accounting trade process in domestic and foreign countries. It gives details about the inflows and outflows of investment, and physical and soft goods and production values. In the host country, it is an indicator of the strength of its currency. A deteriorating current account balance leads to a depreciation of the host country's currency. It is possible that potential multinational investors view current account deficits negatively, because such deficits may lead to inflation and exchange rate variations. In most cases, an increase in the current account deficit may lead to a reduction in FDI inflows.

-FDI in trade activities generates foreign **exchange** through exports, which counter the financial outflow of repatriated profits. It also creates competitiveness in trade activities. Therefore, in the long-run, FDI should not be a cause for the balance of payments problem, other than seriously misleading foreign exchange regimes. Hence, the real solution is not restricting FDI, but, rather, addressing the foreign exchange constraints of the economies (Xiaolum Sun, 2002).

-**FDI** inflows of **exports and imports** have a very important role to play in the country growth of a country. Yet, FDI can also generate imports, especially in the case of market-seeking FDI, and in the case of outsourcing operations that process imported components. MNEs are typically more internationally oriented, but this affects both sales and procurement. Thus, the net effect of the trade balance may be much smaller than the data on exports by FDI may suggest (UN 1999, chap. 8).

Natural Environment and Social issues:

The strong bargaining power of MNEs vis-a-vis their employees and the potential host country could lead to a lowering of labour standards and wages and may also have a detrimental impact on the natural environment.

The standardisation of business practices and technologies across the subsidiaries of an MNE would raise standards above local requirements in countries with less

demanding standards. On the other hand, lower standards and lower wages present opportunities to reduce production costs.

Institutional:

Institutional indicators have an important role to play in creating a policy for inflow of FDI. Government policy must also to aim to enable local firms to interact with multinational corporations in ways that benefits both parties. The result shows that most policies that promote the development of local business would also strengthen the abilities of local businesses to make the best out of their interaction with foreign investors, for instance, education policy or competition policy.

5.1. FDI in China and India: a Transition Economies Perspective

(a). Overview of FDI in India:

India is the world's largest democracy and 4th largest economy (in terms of PPP) in the world. Its consistent performance in growth and abundant high-skilled manpower, and cheap labour provide numerous opportunities for investments through FDI. Since 1991, major reform initiatives have been made in the fields of investment, trade, financial sector, exchange control simplification procedures, and intellectual property rights laws, etc. Pre-liberalisation inflows of private capital from abroad had been negligible and these averaged to less than $200 million in 1985-1990 (Gandhi, 2002). During the 1960s and 1970s, there were negative net inflows of foreign capital, caused by factors such as nationalisation of foreign oil companies and consequent closure or sell-out of foreign oil companies. Faced by the balance of payment crisis, India opted for economic reforms in July 1991, with the intention of restructuring its economy. Foreign investment, which had till then been viewed with mistrust and suspicion, was overnight welcomed. After, liberalisation in 1991, FDI became a significant component of total foreign investment inflows. Also, there was a spurt in inflows, as the Indian corporate sector used the Global Depository Receipts (GDR).

FDI flows rose from $ 236.7 million to the peak level of $ 34613.2 million between 1991 and 1999. FDI, as a proportion of GDP, improved considerably from 0.05 per cent to a peak level of 1.9 per cent in 1996-97, but has been hovering around 1 per cent in subsequent years. Nevertheless, it is far below the expected level, and also in relation to FDI flows to China, a country of comparable size. In mid-1990s, interest rates

(prime lending rate) were significantly higher, around 18 per cent per annum, than rates overseas. Thus, the total net foreign investment in India surged from $133 million to $5181 million between 1991-92 and 1999-2000.

The upward movements were still higher in the case of FDI outflows such as adjustments, in 6.0 million and 1489.7 million in 2009. However, Yasheng Huang of Harvard University expressed doubts about treating the Chinese FDI magnitude as an indicator of economic performance (Huang, 2003).

(b). Overview of FDI in China:

Since the announcement of an 'Open-door policy' in December 1978, China had gradually integrated itself into the world economy. China is the leading FDI recipient in recent years, and the largest host country among developing countries. China's FDI in flows could be classified into decade phases: 1979-90, 1990-2000, and 2000-2010.

The first phase: The aspect of FDI needs to be understood in the wider context of China's political and economic reforms, in particular, the transition from a planned to a market economy, as Deng Xiaoping said, reforms in China are like "Crossing the river by feeling the stones on the river bed". China opened up its economy for foreign investment in two stages. First, in 1979, a very cautious opening was made, where domestic enterprises or expertise did not exist such as in oil exploration and production. Second, in 1992, FDI was opened up with the explicit goal of stimulating export industries and removed many move restrictions in FDI. Where the effect of the 1979 opening was modest in terms of FDI, the 1992 policy shift led to a major rise in FDI (Graham and Warda, 2001).

The door widened further after the transition in the mid-1980s, particularly in the 1990s, and capital flows expanded dramatically as a result. Capital flows were particularly high after 1992, mainly because of the huge amount of FDI inflows into China. While around 60 per cent of foreign capital came from external loans in the 1980s, in the 1990s FDI was the main source of capital - accounting for nearly 70 per cent of cumulated inflows. The share of 'other foreign investments' includes: foreign portfolio investment, compensation trade, international leasing and processing assembly, has been small. These inflows are by far the largest compared with those

into other developing countries and have remained remarkably stable and robust, despite substantial fluctuations in the Asian and global economies.

a. In recent years, the government has started to issue bonds and shares to overseas buyers abroad, and in China, foreign portfolio investment has been rising. Although, agriculture transformation took place in a big way, 'Township-Village Enterprises' (TVEs) through exploration massive increase in 'rural saving & demand' and simultaneous exploration of FDI come overwhelmingly from overseas to China.

b. After transition, the Chinese government established four Special Economic Zones (SEZs) in Guangdong and Fujian provinces, and offered special incentive policies for FDI in these SEZs. The total inflows of FDI realised during these 5 years amounted to only US$1.8 billion, averaging US$360 million annually. Since 1984, when Hainan Island and fourteen coastal cities across ten provinces were opened, total FDI inflows amounted to US$ 10.3 in the period 1984-88; with an annual average of US$2.1 billion. This remarkable growth dropped steeply in 1989, mainly due to impact of the Tiananmen incidents. The growth rates of FDI inflows into China slowed down at a meager 6.2 per cent level in 1989 and only 2.8 per cent in 1990 (OCED, 2000).[6] Hence, in 1978-84: a need was felt to extend Chinese regional development strategy to the coastal areas on priority.

Second phase (1990-2000s), China has been attracting the second largest amount of global FDI, after the US and was predicted to climb to the first position in 2002. China entry into the WTO on December 11, 2001, gave a further fillip to the process of liberalisation. Finally, since late 2002, there has been evidence of the beginning of significant capital inflows to China, besides FDI. Full implementation of WTO commitments was to be completed by 2007 (D. Krishnamoorthy). Three distinctive characteristics have marked investment in China over the past decade. First, FDI has been the predominantly from countries in which China has accessed global capital. Second, an unusually large proportion of Chinese FDI inflows are in the manufacturing sector, as opposed to services or resource extraction. Third, FDI inflows have predominately come from other East Asian economies, especially Hong

[6] . Main Determinants and Impacts of Foreign Direct investment on China's Economy", December 2000, Directorate for Financial, Fiscal and Enterprise Affairs, Working paper on International Investment, number 2000/4.

Kong and Taiwan. China received FDI from Eastern provinces of 88 per cent of the stock of FDI between 1983 and 1998, with Guangdong province the most popular destination. The central and western provinces received only 9 per cent and 3 per cent of FDI, respectively. Most of the foreign investments have come from the newly industrialising economies (NIEs). Hong Kong was the largest single investor, accounting for 52 per cent of FDI, followed by Taiwan at 8 per cent. Investment from industrialised countries made up only 24 per cent of the total, with the US and Japan the most important single investors - each contributing 8 per cent of the total. In the special economic zones and related coastal areas, primacy was accorded to export of labour intensive light manufactured goods. However, proliferation of multinational investment includes heavier, more capital and technology investment industries, and infrastructure, mainly for the domestic market or the non-tradable sectors.

- When Deng Xiaoping made the remarkable statement on 'Southern Tour' in 1992, this was seen as an attempt to remove the anxiety about China's overall policy direction. Foreign investors responded quickly because of the institutional foundations and FDI- friendly policies.
- China had largely confined inflows FDI to export manufacturing, and access to the Chinese market had been allowed to only a few selected foreign firms.
- In 1999, mainly due to the impact of the Asian Financial crisis and the rise of acquisition transactions in both OECD and non-OECD countries, FDI inflows dropped to US$40 389 million.

Third phases onwards 2000: Foreign firms have become an important part of the Chinese economy over the previews two decades. In 1983, FDI was only 0.3 per cent of the country GDP. In 1994, the share had risen to 6.2 per cent of GDP, before falling to around 5 per cent. Yet the economy has grown faster. Incoming FDI in 1999-2001 accounted for 11% of total capital formation in China, less than the average. In 2004, the cumulative inflows actually realised through investment surpassed $500 billion. China's that the country own domestic saving rate is so high, and China is less dependent on FDI for saving than many countries.

In 1983, FDI flows accounted for only 0.9 per cent of China's gross capital formation. The share increased steadily in the 1980s and early 1990s - reaching 15 per cent in 1994, before falling to around 13 per cent in 1994 for the next four years. Because

FDI has not all been a long-term fixed capital investment, this figure may be an overestimate. The gross fixed capital formation accounted for approximately 80 per cent of FDI inflows in the late 1990s, and the share in earlier years was lower. The remaining 20 per cent was likely to have been used for working capital or to pay for inventory - meaning that FDI inflows probably accounted for around 11 per cent of gross fixed capital formation in the late 1990s.[7]

FDI brings in a bundle of management experience, marketing channels and technology, along with the basic inflow of resources, and includes some control over the production process, and hence, some transfer of management expertise. FDI has become China's predominant source of technology transfer. This technology has been all covering the sectors in China since 1993. After 1992, almost two thirds of China's exports increment came from foreign-invested firms. Thus, FDI has played a key role in industrial growth, technology transfer and trade expansion in China.[8]

5.2. FDI policies in India and China in the Transition Economies Perspective

a. Policy Regime: India

Pre-liberalisation period:

India earlier pursued an open-door FDI policy. Foreign investment was required to be encouraged for mutual benefit, in terms of industrial development. This policy became increasingly restrictive and regulatory during the 1960s and 1970s. The Monopolies and Restrictive Trade Practices Commission (MRTP), set up in 1969, imposed severe restrictions on the size of operations and pricing of products and services of foreign companies. Foreign Exchange Regulation Act (FERA) was enacted in 1973, which required existing foreign enterprises to dilute foreign equity to 40 per cent, if they wished to be treated as Indian companies. The policy's essential aim was to retain majority domestic ownership and effective control over foreign enterprises. Technology and export-intensive and core sector firms were allowed to retain foreign ownership up to 74 per cent. Foreign exchange requirements for import of capital goods were met through equity investment. Technical collaborations were being permitted for import substitution, and export- substitution, technology upgradation and for export-oriented

[7] .See, Chunlai Chen and Christopher Findlay (2004), 'the Impact of Foreign Direct Investment on China's Economy', *China's third economic transformation,* p.g 102-104.

[8] .See, Bary Naughton (2007), "The Chinese Economy, Transition and Growth', the MIT Press Cambridge, Massachusetts, London, England, p.p 401-404.

enterprises. The Patent Act, amended in 1970, abolished product patents in pharmaceuticals and chemical industries, thereby drastically curtailing the intellectual property rights. Domestic R&D got a fillip for electrical and mechanical engineering industries. Export performance requirements induced TNCs to explore India's potential for export-oriented production. The Industrial Policy 1977, providing some relaxation for foreign companies. Also, after 1980s the Industrial Policies was progressively liberalised.

Post -Transition reform period:

Until 1991, FDI was allowed in designated industries, subject to various conditionalities regarding domestic equity participation, local content requirements, export obligation and local R & D promotion. Since opening up FDI policy in 1991, the broader process of economic reforms has dramatically changed. Foreign investment has been allowed in a phased manner in most of the sectors and restrictive conditions have either been waived, or relaxed. For purposes of our analysis, the period from 1991 onwards has been divided into four phases for rationalisation, *viz.*, 1991-96, 1997-98, 1999-2001 and 2001 onwards.

First Phase (1991-96): the Foreign Exchange crisis of 1991 triggered a major shift in domestic and external policy environment. Many of the economic policies were formulated in India. The IMF and the Word Bank also agreed to provide the support to overcome the condition that structural changes to liberalise trade and investment policy regimes would be effected. These reforms were introduced to abolish widespread industrial licensing and facilitate rationalisation of taxes, reduction in import tariffs and reform of Foreign Exchange Regulations. In July 1991, public sectors categories industries were reduced from 17 to 6. Measures were simultaneously initiated for liberalising the policy relating to FDI and technology transfer. Approval mechanism for FDI was made simpler and transparent. Two approval routes, viz.; (i) Automatic route and (ii) Foreign Investment Promotion Board (FIPB) route were introduced. In automatic route, only intimation about transfer of equity funds is required to be given to the RBI. Thirty-five priority industries/sectors were initially notified for approval under the automatic route, for which foreign equity cap was pegged at 51 per cent. The only condition is that foreign equity would also cover foreign exchange for import of capital goods. However, enterprises requiring industrial license under the

industrial (Development and Regulation) Act, 1951, or in which proposed foreign equity investment was more than 24 per cent of a manufacturing unit were reserved for small scale industries. Likewise, industries still require industrial license as per location policy 1991, which would otherwise not qualify for approval under this route.

The approval pattern in practice continued to be highly tilted in favour of FIPB route, since until 2003 over 90 per cent of approvals were granted through this route. Investors opted for FIPB route, if their investment firms did not strictly conform to the standard guidelines. In the FIPB route, many sectors were not covered under the automatic route during the initial phase of opening up. After 2000, the proportion of approvals under the FIPB route started coming down, as foreign equity restrictions for many sectors were raised to 100 per cent.

Requirement of dividend balancing was dispensed with in 1992, except for 22 categories of consumer goods. The phased manufacturing programme for progressively enforcing higher local content on foreign firms and joint ventures was discontinued for new projects in July 1991, and for the existing units in 1994. The stipulation that foreign exchange requirement for import of capital goods should be met though foreign equity was also waived in 1996.

In automatic route for approvals by the RBI, initially the lump sum payment of royalty was up to rupees one crore. The ceiling on lump sum royalty payment was raised in 1996 from Rs one crore to US$ 2 million. Payment of royalty on use of brand names and trade markers was, however, not permitted until 2000, and wholly owned subsides were not allowed to pay royalty to their offshore parents.

Second Phase (1997-98)

In the second phase, the liberalisation list of industries for approval under the automatic route was expanded from 35 to 111 in 1997. Sectoral growth has been increasing in specified industry/service sector up to 71 per cent. Also, the foreign equity limit in electric generation transmission and distribution projects was raised from 74 per cent to 100 per cent, subject to a ceiling of Rs. 15,000 crore, which was later lifted. An important press Note No. 18 of 1998 says:

> *"new proposals for foreign investment and technical collaborations, where foreign investor has or had any previous joint venture or technology transfer/trademark*

agreements, were required to be filed with FIPB".

Keeping in view the spate of representation from investors, the Press Note was amended in 2005. As per revised guidelines, the proposals to provide require justification and satisfaction to the government. The new proposal would not jeopardise the interest of existing JVs which would lie equally on foreign investors and their Indian partners (Ashok Kundra, 2009).

Third phase (1999-2001)

In this phase, the focus shifted to opening up of infrastructure, insurance and service sectors and liberalising the royalty payment regime. Foreign equity was permitted up to 100 per cent in roads, ports, harbours, bridges and highways in 1999. The Insurance Act was amended in 1999 to permit up to 26 per cent foreign equity under the automatic route, under license from the Insurance Regulatory and Development Authority (IRDA). Non-Banking Financial Companies (NBFCs), were allowed to make a minimum US$ 0.5 million foreign investment. The condition of dividend balancing on 22 per cent consumer, goods retained in 1992, was withdrawn in July 2000. Foreign Exchange Regulation Act, 1973 (FERA)[9], was replaced by Foreign Exchange Management Act, 1999 (FEMA)[10], with effect from 1.6.2000, to facilitate maintenance of foreign exchanges market and promotion of external trade.

Restriction of 10 year period for the royalty payment from the date of agreement, or seven years from the date of commencement of commercial production was, lifted in September 2000. Also, the restriction on royalty payment to withdraw foreign owned companies for royalty payments. In 2000, the automatic route, with 100 per cent participation with the foreign equity was opened up, except in cases requiring industrial license or relating to acquisition of shares of an existing company or proposals falling outside the notified spectral policies/caps, or under sectors for which FDI is not permitted.

Fourth phase (2001 onwards)

During the current phase, policy thrust for opening up service, financial, and key

[9]. FERA's objective is protecting the Foreign Exchange resources of the country and ensure to proper utilization of thereof in the interests of the economic development of the country.

[10]. FEMA objective is facilitating external trade payment and payments and to promote the orderly development and maintenance of the foreign exchange market in India.

infrastructure sectors has been sustained. Foreign equity of 100 per cent has been permitted to provide subsidies to NBFCs for setting up new airport projects, drugs and pharmaceutical companies, hotels and tourism sectors, foreign sectors, townships and transport system in 2002 which were permitted under the FIPB and automatic routes. Foreign equity up to 74 per cent, inclusive of investment by FIIs, is allowed in private banks under the automatic route. Besides, foreign equity up to 26 per cent has been allowed for defence industry through the FIPB route. Foreign equity was fully allowed in 2005 under FIPB for the township, housing and built up infrastructure. In addition, a provision was made in 2004 for allowing investment in tea plantations, print media (24 per cent) and publication of scientific and technical journals. Besides, foreign equity is permitted on oil exploration, laying of petroleum product and LNG pipelines. Foreign equity was raised in basic and cellular telecommunications, and limited access system of national and international long distance services was raised to 49 per cent in 2005. These were also recommended by the Steering Group of FDI and the Planning Commission.

In FM radio broadcasting services, 20 per cent foreign equity is permitted by the Ministry of Information and Broadcasting. Moreover, linking non-news and current affairs TV channels were allowed foreign equity up to 100 per cent; in retail trade foreign equity was permitted up to 51 percent with (Foreign Investment Promotion Board) FIPB approvals for 'single brand' products only. Thus, this has been allowed to encourage sourcing of goods from India and improving availability of such goods for consumers.[11]

The government of India has also permitted FDI in Limited Liability Partnership (LLP) companies but only in mining, power, roads and highways, manufacturing activities, and drugs and pharmaceuticals. In these sectors, 100 per cent equity was opened up to FDI through the automatic route. The LLP structure was introduced from April, 2009. As on May 2, 2011, 4,679 were registered with Ministry of Corporate Affairs[12]. FDI is allowed up to 100 per cent in all activities/sectors except the following which require prior approval by the Government: (i) Manufacture of Cigars & Cigarettes of tobacco and manufacture tobacco substitutes; Electronic aerospace and

[11] . See, Ashok tundra (2009), 'India China, A Comparative Analysis FDI Policy and Performance', FDI Policy: India, p.p. 71 to 79.

[12] . FDI in India: Thursday, May 12, 2011.

defence equipments; manufacture of items exclusively reserved for Small Scale sector with more than 24% FDI; the foreign collaborator has an existing financial/technical collaboration in India in the 'same' field [Refer press Note No.1 (2005 series)][13].

The new consolidated FDI Policy issued by the Govt. of India in March 2011, has introduced and made some major changes. The 2011 FDI Policy enables companies to choose a conversion formula to determine the rate of conversion, subject to FEMA/SEBI pricing guidelines.

The shares can be issued against the import of capital goods/machinery/equipment (including second-hand machinery); and pre-operative/ pre-incorporation expenses (including payments of rent, etc.,). However, before issuing the shares, prior approval is required from Foreign Investment Promotion Board (FIPB), otherwise from the automatic route.

Until now, a foreign investor, with an existing joint venture or technical collaboration (entered before January 12, 2005), could not be allowed into new investment ventures, unless the existing Indian partner issued a no objection certificate and obtained the specific prior Government approval. The 2011 FDI Policy eliminates this earlier protectionist measure. Further, this policy was open to the Indian markets to access but subject to Indian entities-expecting more competition from abroad. In addition, in the health insurance sector, the 10 year disinvestment clause; was done away with and FDI in the animation sector was liberalised. The available FDI policies can be seen on the website and also in a user-friendly way (Economic Survey 2009-10, p 164).

Private equity funds, till now unregulated, are set to come under SEBI Regulations. The market regulator has already started working on regulating private equity players and guidelines would be issued by Economic Affairs Secretary by (R. Gopalan, 2011).

a. Policy Regime: China

China's FDI policy has been highly admired overall worldwide. It has been successful among developing countries. In China, FDI inflows during 1979 to 2009, was 94,999.42 million (USD) (UNCTAD). Since 1978, China's strategy was based

[13]. Department of Industrial Policy and Promotion, Ministry of Commerce, Govt. of India, FDI Policies and procures, p.p. 8.

on the pattern of export-led growth implemented by East Asian economies, and also these policies were based on self-reliance and favouring comparative advantages. Besides, law and regulations attracting more FDIs were notified, as part of "socialist economic reconstruction". The important objectives and priorities of the FDI are: acquiring gaining to capital, technology and management skills and comparative advantage with low labour costs. Foreign investment was sought for infrastructure development and high technology for import substitution.

Domestic factors have contributed to making a China successful in attracting the FDI. This policy includes: liberalisation, development of infrastructure and a favourable operating environment and to extend preferential treatment to foreign investors. Also, SEZs, and Economic and Technological Development Zones (ETDZs) provide the requisite infrastructure, for more export-oriented investment in the targeted sectors. The country has judiciously combined measures for import protection with those of export promotion. Trade liberalisation was started in China in the late 1980s which took off remarkably during the 1990s, after economic growth had increased remarkably. Opening up trade coincided with the East Asian countries facing issues with rising labour costs. The country offer requisite resource endowment for export-oriented FDI and a strategic location for easy access to Asian counties. However, favourable circumstance inflows of such magnitude could not have been possible in the absence of requisite platform, infrastructure and a congenial operating environment.

China's economy was opened up on gradual and incremental basis, with a view to secure national-wide support. Reforms moved at a steady pace and FDI policy was evolved in a phased manner. The evolution of China's FDI policy can be classified and analysed. The legal framework for that was evolved progressively. These legal laws and regulations were amended according to situations. For purposes of our analysis, the period from 1978 onwards has been divided into four phases, as discussed below.

a. First Phase (1979-1985):

Foreign investment, in the initial phase, was permitted only in the form of joint ventures. The "Law of People's Republic of China on Joint Ventures using Chinese and Foreign Capital" was passed in July 1979. This was mostly experimental in nature till the beginning of 1980s, when the Chinese transition towards a market oriented

system started. China's FDI policy allowed setting up of Equity Joint Ventures (EJEs) on the principle of "equality and mutual benefit" and could operate for a period of 30 years. Foreign investment was allowed up to 50 percent regulations under law in 1983, in sectors such as finance, banking, transportation, post and telecommunication and retail trade. The governance pattern of EVJs in China was different from that of corporations in the West, because investors in EJVs hold equity interest, but not stock. The State Council granted autonomy to Guangdong and Fujian provinces in matters relating to foreign trade to enable them to set up SEZs. The legal rights of Foreign Invested Enterprises (FIEs) were protected under Article 18 of the 1982 Constitution. The private sector was given legal status in 1984, by recognising it as a supplement of the "socialist market economy". Thus, the major policy shift facilitated setting up of wholly foreign owned enterprise outsides SEZs.

b. Second Phase (1986-1989):

In China, foreign investors are encouraged to set up of joint ventures and companies, under the "Law of People's Republic of China on Enterprises Exclusively with Foreign Capital", promulgated in 1986. Its regulations were notified under the law in 1990. This Law aims to benefit foreign owned enterprises. This kind of mode is usually favoured in technology intensive enterprises. Besides, under Article 3 of the Law, only export-oriented units could be set up as fully foreign owned enterprises. This enactment of law on Cooperative Joint Ventures was passed in 1988, and its regulation was enforced in 1995. A contractual Cooperative Joint Venture (CJV) is a partnership between the Chinese and foreign enterprises with unlimited liability. In the case of equity joint venture, liability of partners for sharing risks is limited. Wholly foreign Owned ventures (WFOs) have eventually emerged as the most preferred mode of foreign investment. However, China formally applied for participation in the GATT (General Agreement on Trade and Tariff) in 1986, to enforce promoting domestic price reforms, and establish a market-oriented system.[14]

c. Third Phase (1990 to 2000):

This phase shifted the focus to development and refinement of regulatory framework. The law on Equity Joint Ventures and Regulations for Wholly foreign

[14] . See, "Transition and Development in China: Towards Shared Growth, 2000", pp. 90.

Owned Enterprises was amended in 1990. Also, all foreign enterprises were granted protection against nationalisation. Deng Xiaoping reiterated China's commitment to open door policy for FDI and Market oriented reforms. China set up SEZs during 1992 to push forward the overall economic reforms process. To attract FDI, a number of incentives, and laws were enacted. These include: Foreign Enterprise, Income Tax Law, Software Protection Regulations, Patent Amendments, Trademark Laws and Foreign Exchange Control Regime, governing foreign investment Regulations. The Contract Law Act was amended in 1999 to create confidence amongst investors. The objective of circular flow of capital is to bring Chinese capital under a more favourable regime governing foreign investment. To control malpractices related to overvaluation of equipment and technology supplied by foreign partners "Administrative Procedures for Appraising Foreign Invested Property" were notified in 1994.

FDI inflows are intended to provide for social and economic development. The "Provisional Regulations on Funding Foreign Investment" were notified in 1995. Investment projects under these regulations have been divided into four categories, viz., "encouraged", "restricted", "prohibited" and "permitted".

-The "encouraged" category includes: projects relating to agricultural technology, construction, energy and communication; projects for industry or for new or enhanced technology or for augmenting exports. These Projects use renewable resources or involve new technology or equipment for pollution control and prevention, as well as projects relating to investment in the central and western regions of China.

-The "restricted" category includes: imported technology, for which sufficient capacity exists; or an industry where the state is experimenting with foreign investments; projects for exploration and extraction of minerals and those relating to sectors which are covered under central planning.

-The "prohibited" category includes: dangerous polluting or wasteful processes or those that damage the environment, natural resources, human health or use sizeable arable land. These are considered destructive to protection and development of land resources.

-The "permitted" category includes all those projects which are not covered by the above categories.

These regulations also specified industries for which majority Chinese shareholding is required. Industries sectors in which wholly owned enterprises are not permitted. Includes: airports, nuclear power plants, oil and gas pipelines, subways and railways, projects in aerospace, automobile, defence, mining and petrochemicals, shipping, satellite communications and tourism etc., During the 1999, Chinese economy was thrown open to the private sectors. The private sector, however, continued to face discrimination in the matter of availability of credit.

d. Fourth Phase: post -WTO Period (2001 onwards):

After China's entry into WTO in 2001, foreign companies have been permitted up to 50 per cent equity in telecommunication and value added services, foreign banks and life insurance companies. As per the WTO agreement, laws on technology have transformed to intellectual property rights. Mandatory requirements relating to local content, foreign exchange balancing, technology transfer and restrictions on R & D, institutions, has been withdrawn as per the WTO Agreement on Trade Related Investment Measures. China has to implement economic reforms and undertakes legal and institutional restructuring to fulfill WTO commitments. Also, a number of institutions were created. The opening up of financial and service sectors has created a new wave of investments - leading to buoyancy in inflows. Some policy changes requiring diversion of foreign investment in specific.

Government designated sectors were notified on 25th July 2004. Incentives have been given to certain areas, for instance, island areas. However, this move can lead to rising inequalities amongst regions. Stability has become an important policy plank. The State Council has notified the "Decision on Reforming the Investment System" to abolish government examination and approval for projects that do not require government investment, except large projects. However, China's parliament passed amendments in March 2004, to protect private property, as against civil protection already in place.

During 2008, at the 12th China International Fair for Investment and Trade in Xiamen, Chinese Vice-Premier Wang Qishan, announced five policies for future

investment areas. These include: promotion of the investment environment, better utilisation of foreign capital and to encourage Chinese enterprises to invest in foreign countries in (2008-09). In 2009, the specific ownership limit of 25 per cent for investment in local banks was removed. Inward FDI is still prohibited in a numbers of industries, which include forestry and logging, manufacture of certain chemicals used for explosives, firearms and weapons, postal services, postal savings and radio and television broadcasting (Assessment of Liberalisation and Facilitation of FDI in Thirteen APEC Economies, December-2010). In 2010, the decision concern items with respect to Administration and Approval was cancelled or adjusted [Guo Fa (2010) No. 21] and the policy on Better utilisation of foreign investment [Guo Fa (2010) No.9] was promulgated by the State Council. The delegates of some authorities of examination, Approval and administration of foreign investment to commercial departments at the provincial level to cancel some items originally subject to foreign investment examination and approval.[15]

Opening Up of Retail Trade:

Retail industry has been opened up in a gradual and experimental manner. In 1992, Commercial retail trade was permitted for foreign investment, but was not fully allowed in retail trade. In 1995, the State Council permitted Sino-foreign joint ventures for retail chain stores in Beijing and Shanghai - with 50 per cent shares held by Chinese partners. In 1999, pilot equity joint ventures were allowed in all provincial capital cities, capital cities of autonomous regions and municipalities under direct change of the Central government. With China's entry to WTO, the number of joint venture enterprises in retail business was increased. In December 2001, the products for which investment was not allowed were also specified. In June 2004, retail operations through foreign investment were extended to the entire country. This was followed by the notification of "Measures for Administration of Foreign Investment in the Commercial sector", in December 2004. For attracting foreign investment in the commercial sector, local governments have been giving and offering attracting preferential policies, good business locations and favoured treatment in local taxation. However, relevant laws and regulations and long term development plans and implementation measures still need to be put in place. It is felt that considering the state of development of the retail industry and

[15]. Invest in China (2011), Ministry of Commerce on Issue Concerning Foreign Investment Administration, Shang Zip Han, No. 72.

the scale of operations of foreign retail business, preferential treatment is not warranted. Besides, retail industry involves pressures on urban planning and land use.[16]

Cooperation of FDI policies in China and India:

FDI is the important resource for development in the globalisation process. In both countries, FDI flows have been increasing after they become transition economies. It we consider the major economic aggregates like world production, world capital formation and world Trade, China has been more successful in attracting large inflows of FDI since the beginning of transition. However, both countries' development strategies and policies are different from each other, as can be seen from the following:

(i). ***India's economic policy*** lacks drive on attracting export-oriented FDI. Attempts to provide infrastructure have been sporadic, piecemeal, lukewarm, segmental and half-hearted. Moreover, FDI have not been attracting investment, due to infrastructural and location deficiencies. Also, strengths like availability of cheap workforce, sound financial system and comparative cost advantage in the manufacturing sector could not be properly exploited through export-oriented FDI for infrastructure development.

(ii). National Interest; In accepting beneficial inputs, both countries agreed to allow FDI that brought in quick returns. But these activities with 'un-favourable impacts', can lead to the monopolisation of market jeopardise development of local industries, and also cause environment pollution.

(iii). In China, physical infrastructure is more competitive, particularly in the coastal areas (CUTS 2003, Marubeni Corporation Economic Research Institute 2002, as mentioned in 'Investing in India and China', 2003). But, India may have an advantage in technical manpower, especially in, IT, and better English language skills of its professional (Anjali Kulkarni, 2009).

(iv). In India, FDI has been much less important in driving export growth, except **IT sector** which has seen tremendous progress. Similarly, for a country that has, millions of unskilled and semi-skilled unemployed persons, the IT sector benefits only the highly educated class. If we compare the manufacturing sector

[16] . See, Ashok kundra (2009), 'India China, A Comparative Analysis FDI Policy and Performance', p.p. 185 to 192.

in both countries, we will find that India exports less than 10 per cent of the goods. In China, it has created gainful employment for millions of industrial workers.

(v). In both countries, technology has been playing an important role in the growth and development process. Technology imports and technology transfer (TT) are strongly encouraged in China, which is not the case with India.

(vi). ***Labour reforms*** in India continue to be inflexible due to lack of political consensus on labour reforms, rules and regulation regarding disputes difficult.

Labour regulations are meant to protect the interests of workers. Reform of these regulations can help in accelerating growth of the manufacturing sector and generating employment in labour-intensive sectors.

(vii). India has shown relatively poor performance, in term of competitiveness, quality of manufacture, skills and productivity. These indicators are responsible for attracting less FDI.

(viii). India's FDI policy does not offer any special ***incentives,*** or super national treatment, to foreign investors. This is partly due to risk-averse nature of NRIs since most of them are professional and lack managerial capability for export production with low wage labour. On the other hand, China has provided industrial infrastructure incentives, such as location, duration of operations, high-tech content, and the export intensity of the enterprises to foreign investment.

(Viiii). The ***positive feature*** of the Indian economy, such as adequate number of skilled manpower at competitive rates, tax incentives for export manufacture and liberal FDI policy have not been projected aggressively. Chinas FDI policy was envisioned and mandated by political leadership at the highest level.

(x). Moreover, foreign investors are facing problems in setting up joint ventures due to ***restrictions on domestic*** debt financing. In China, local and provincial authorities have not been vested with power to approve FDI, and decentralisation of powers, speedier clearance of proposals, is not fully in place.

(xi). In China, provincial authorities directly undertake promotion activities accord and investment approvals. However, India due does not have a system

of automatic approvals.

(xii). Acquisition of land for setting up zones is very easy in China, while in India, the recent furor over acquisition of land for SEZs virtually stalled implementation of the scheme. China too is against acquisition of agriculture land for setting up zones. Still, China has an edge over India due to a different political regime.

(xiii). In China, provincial and local authorities enjoy considerable autonomy in economic decision making, logical strategies, choice and chronological flows, while in India, the approach is very slow.

(xiiii). A ***key lesson*** that can be drawn from Yao & Sing (2011), particularly for developing economies, is the adoption of a pragmatic approach to economic reforms, and capacity of the country's, economic decision makers in this regard (Amelia U. Santos-Paulino, 2010).

The study regarding the experience of China and India contain important lessons for developing countries as they embark on economic development. Bhagwati (2006) stated that sustainable development should succeed in achieving openness in the world economy, as well as in economic freedom and political freedom (Amelia U. Santos-Paulino, 2010).

5.3. FDI an Empirical Analysis in Both Countries

At this juncture, let us analyse the determinant factors that influence the inflow of FDI in both countries. India companies are giving stiff completion to international companies in some areas. However, statistics reveal only a part of the story at the macroeconomic level. At the micro level, things look quite different. India is creakingly building from the ground up, while China is pursuing a top-down approach - which reflects their contrasting political systems. China's domestic companies are reaping the benefits due to the FDI it has attracted since the early 1980s.

China's export-led manufacturing boom has been mostly due to the FDI it has attracted. These are provided effectively and have proved to be a substitute to domestic entrepreneurship for the last 31 years. China's economy may have taken off, but its private sector still does not have world-class companies to compete with the big multinationals. India has not been attracting the amount of FDI anywhere near that of China. The India FDI gap is also a tale of two diasporas. While China has large and wealthy diasporas that have been longing to help the mother - land and the money sent has been warmly received, this is not the case with India.

TNCs seek more trade and more open economies for resources-seeking operations, especially as they integrate their global production with vertical and horizontal value-chain linkages. In this way, for a country to be a part of the integration process, it must allow the TNCs to easily import and export. Thus, integration is important, when TNCs seek a base to serve regional markets (Chakravarthy, Lopez, and Porta, 1995; Dharmendhra et.al, 2007). In order to use this phenomenon, our model infers openness of the host economy as a determinant of FDI flows, and it is expected that this variable will be positively associated with FDI inflows in both countries.

The Determinate Variables influencing FDI in China and India:

Econometric model is employed to access the cross-country influence of macroeconomic variables on FDI. These are:

a. *Gross Domestic Product (GDP):* It is a substitute for market size. It is a most significant variable for explaining FDI inflows into emerging economies. Per capital income growth rate rates are usually high and after some time, these would be expected to continue to move upward. It helps attract market seeking investors. For this reason, real GDP growth is usually expected to have a positive effect on FDI inflows.
b. *Openness of trade:* there are two ways to measure the openness of trade. One is the effective tariff rate, which is the ratio of tariff revenue to total imports (import total revenue taxes ratio). The other is: trade ratio (share) import+export) in total GDP (I+E/GDP).
c. *Inflation:* high rate of inflation indicates internal economic instability. It implies that the host country is unable to maintain necessary monetary stability. Under conditions of high inflation, firms face uncertainty in pricing of products.
d. *Current account balance:* this is a measure of the strength of the currency of the host country. A deterioration in currency account balance leads to a depression of the host country currency. It leads to inflation and adversely impacts the exchange rate. An increase in the current deficit may lead to reduction in FDI.
e. *Real Exchange rate:* foreign investment gain or loss impact the exchange rate. With depreciate exchange rate, it can export more easily and gain from

resources seeking FDI. If, it continuously depreciating investors will avoid the investments. Therefore, the import exchange rate depreciation on FDI inflow is ambiguous.

f. *Interest rates:* Interest rates are the main determinants of investment on a macroeconomic scale. The current thought is that if interest rates increase across the board, then investment decreases - causing a fall in national income.

Methodology:

In order to analyse the association of the different macroeconomic variables, we have used four regression models to find the possible significant factors which might influence the foreign direct investment in both countries. The four regression models are as follows:

Model I: $\log(\text{fdi}) = c + \log(\text{gdp}) + \text{diff}(\log(\text{fdi})) + \varepsilon t$

Model II: $\log(\text{fdi}) = c + \log(\text{reer}) + \log(\text{ot}) + \varepsilon t$

Model III: $\log(fdi) = c + IT + Inflation + \varepsilon t$

Model IV: $\log(\text{fdi}) = c + \log(\text{gdp}) + \log(\text{reer}) + \log(\text{ot}) + \text{inter} + \text{infla} + \varepsilon t$

Where, C= constant, fdi = Foreign direct investment, gdp = Real gross domestic product, infla = Inflation rate, reer = Real effective exchange rate, ot = openness of trade, inter = interest rates, Δfdi = Change in FDI, and = random error term. The purpose of our empirical investigation is to analyse the effects of FDI on economic growth and how does FDI (USD) inflow interact with macroeconomic variables, such as GDP (US$), Openness of trade(USD) (E+I/GDP)[17], inflation (cons. annual %), Real effect exchange rates (2005=100), Current account balance (USD) and interest rates (percentage) in both countries. The effects of FDI on economic growth in a framework of cross-country analysis, for using a data during the period 1978 to 2010 will be tested.

There are several advantages of adopting a log-linear form. For the analysis, in the case of both countries, certain macroeconomic variables are extreme values, arising in some years and from certain OECD countries. We have accounted for log-linear variables such as FDI, GDP, Real effect exchange rate, and openness of trade. Linear variables are inflation and interest rate. However, logarithms have been used to unify the data.

[17]. Jay Squall and Kenneth Wilson (2006), "A New Approach to Measuring Trade Openness", he employed, Trade openness is popularly measured as (X+M)/ GDP).

Table 5.2: Descriptive Statistics of India

	FDI	GDP	Inflation	REER	IT	OT
Mean	5976.00	4.9E+11	7.98	123.16	6.27	0.184
Median	974.00	3.2E+11	8.32	103.90	6.87	0.176
S.Er	1893.82	6.9E+10	0.56	5.99	0.45	0.014
S.D	10879.16	3.9E+11	3.22	34.41	2.56	0.080
Minimum	5.64	1.4E+11	2.52	86.30	-1.08	0.101
Maximum	42545.72	1.7E+12	13.87	181.80	10.74	0.425
Obse.	33	33	33	33	33	33

Table 5.2; presents some figures about India, where the FDI inflow is influenced by other macroeconomics variables. And FDI has a significant correlation with GDP, Inflation, REER, IT and Openness of trade. So, monetary and fiscal variable are playing a vital role in stabilisation of the economy.

Table 5.3: Correlation Matrix's of India

	FDI	GDP	Inflation	REER	IT	OT
FDI	1					
GDP	0.902	1				
Inflation	0.017	-0.0239	1			
REER	-0.296	-0.3976	0.1461	1		
CAB	-0.723	-0.770	-0.353	0.095		
IT	-0.258	-0.363	-0.323	0.064	1	
OT	0.892	0.896	-0.140	-0.574	-0.259	1

The correlation matrix: describes the correlation between two or more variables. Correlation is one of the most common and useful statistical tool. A correlation is a single number that describes the degree of relationship between two variables. We have considered macroeconomic variables for correlation between FDI and other variables. Table 5.3, explains, the correlation matrix of India, where it is seen that FDI has a strong and positive correlation with GDP, inflation and openness of trade. The existence of statistical significant correlation implies positive FDI inflows. If we observe other macroeconomic variables, real exchange rate, and interest rate have a strong negative statistically significant correlation with FDI.

Table 5.4: Descriptive Statistics of China:

	FDI	GDP	Inflation	REER	IT	OT
Mean	33298.23	1.25E+12	5.47	151.84	1.9572	0.3689
Median	33766.50	5.59E+11	3.32	114.44	2.2490	0.3413
S.E	5919.81	2.59E+10	1.11	13.16	0.6048	0.0246
S.D	34006.74	1.49+12	6.35	75.63	3.4745	0.1413
Minimum	0.08	1.48E+11	-1.41	82.35	-7.9820	0.1423
Maximum	108312.00	5.88E+12	24.24	319.48	7.4690	0.6489
Obser.	33	33	33	33	33	33

Table 5.4 presents some figures about China. It would be see that FDI inflows have a strong association with other macroeconomics variables. FDI has a significant correlation with GDP, Inflation, REER, IT, Cab and Openness of trade. So, FDI is impacted by certain macroeconomic variables in China.

Table 5.5: Correlation Matrix's of China:

	FDI	GDP	Inflation	REER	IT	OT
FDI	1					
GDP	0.9248	1				
Inflation	-0.2385	-0.2654	1			
REER	-0.5747	-0.3928	-0.1442	1		
CAB	0.8478	0.9235	-0.2210	-0.2919		
IT	-0.0606	-0.0517	-0.7326	0.1714	1	
OT	0.8259	0.6946	-0.0230	-0.7422	-0.2879	1

The above table explains that in China FDI has a strong and positive correlation relationship with GDP, Cab, and openness of trade. The existence of statistical significant correlation means to attract the FDI inflows. In China, if we observe other macro-economic variables, real exchange rate, and interest rate have a strong negative statistical significant correlation with FDI. Thus, the determinant factors to the FDI inflows such as GDP and openness of trade have a significant correlation with FDI.

Empirical Analysis Results

The purpose of our empirical investigation is to analyse cross-country the effects of FDI on economic growth in China and India and to examine factor that determines. These include: FDI, GDP, Inflation, REER, Interest rate and openness of trade. We test the effect of FDI inflows to investments in the framework of cross-

country equation. The empirical model has four equations. The regression models shows results and we can compare the multiple regression coefficients of both countries. In the constructed the regression models, all four equations yield different coefficients. However, during the phase transition, the FDI inflows in both countries have been large.

Table 5.6 reveals that different regression results, vis-à-vis models 1, 2, 3 and 4. Regression model 1, explains whether FDI of any country can account for both growth of the country and it own past behavior, i.e., change in FDI in the modeling period. Basic specification with dependent variables is FDI; independent variables are change: in FDI, GDP. Model 2, explains whether FDI of any country can be explained through exchange rate policy changes and behaviour and the country opening up the economy and the effect of that. It includes: interaction of FDI, with REER, and OT. By means of Model 3, FDI inflow can be explained through interest rates (monetary policy of any country) and inflation (general price changes over a period of time). Regression model 4, presents the impact of all the studied variables on FDI and its changing policy structure in the any economy. The dependant variable is FDI, and explanatory variables are: GDP, inflation, openness of trade, exchange rate and interest rates. The four regression models show that most coefficients have the expected signs. The estimated R^2 values shows a fit in cross sectional data.

India model result: we can be postulate that GDP, Real effective exchange rates and percentage change in FDI are more significant than other variables. The remaining variables are not statistically significant.

Table 5.6: Determinant Factors of FDI in India: Regression results

	Model 1	**Model 2**	**Model 3**	**Model 4**
Constant	-85.262***	24.639***	13.892***	-35.287***
Change in FDI	0.6256***			
GDP	3.4404***			2.113***
Interest Rate			-0.667***	0.0021
Inflation			-0.342***	-0.0586
REER		-1.953***		-2.462***
OT (E+I)/GDP		4.888***		1.325*
Obsr.	33	33	33	33

Note: *, ** and *** are 1%, 5% and 10% level of significance, respectively.

Model 1: the regression result reveals that the interaction of FDI gives a positive and statistically significant coefficient while change FDI and GDP. FDI inflows depend

on GDP, this has also been the case, of FDI inflows performance to attract FDI investments in India. Especially, after financial reforms FDI inflows and GDP rate have been accelerating in on economy. The changes in FDI and GDP is (10%) positive statistically significant. It means that change in FDI and GDP have a positive impact on attracting FDI inflows into India. The estimated coefficients indicate that the India can benefit positively from FDI, through the positive interaction with change in FDI and GDP. This leads to economic growth in developing countries. Recent literature ahs concluded that FDI and GDP have a positive correlation relationship.

Model 2: The interaction of FDI has a positive and statistically significant coefficient with REER and trade. REER has (10%) negatively statistical significance. Openness of trade (10%) has a positive statistical significance. REER has a vital role to play in domestic and foreign countries to influence investment. The FDI and trade is interaction of statistically significant. This implies that FDI and trade are helping each other in advancing the growth rate of income in developing countries. In addition flow of advanced technology by FDI can increase the growth rate of the host economy by interacting with trade. The estimated coefficients indicate that host countries benefit positively from FDI, and through FDI's positive interaction with REER and OT.

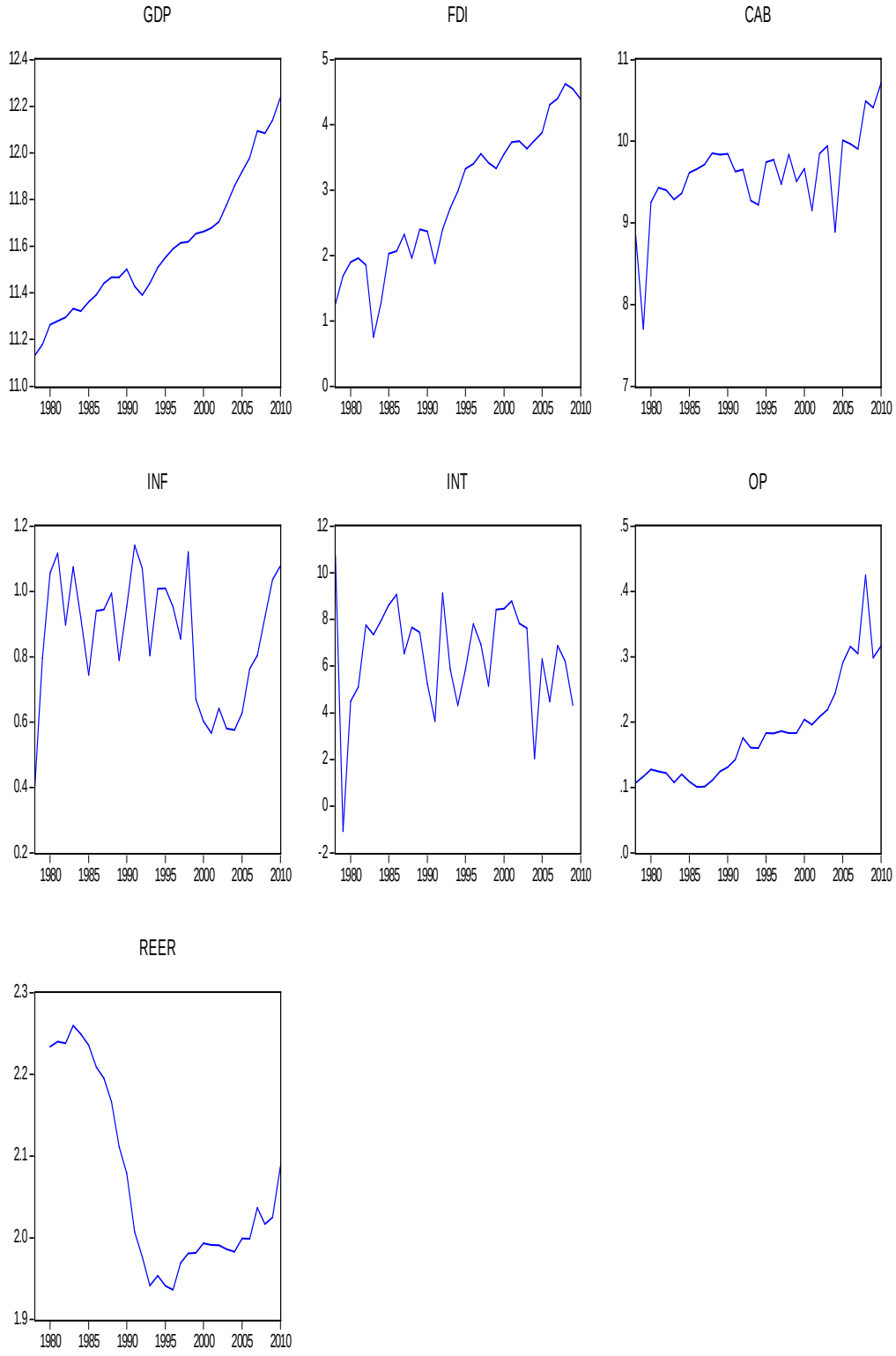
Model 3: Macroeconomic policies and institutional stability could have a significant impact on FDI and economic growth. Interest rate and inflation have (10%) negatively statistical significance. Recent literature indicates that FDI is greatly influenced by the host country policies, such as monetary, fiscal and open market policies such as inflation rates, and interest rates. If change in inflation and interest rate it would be positive in impact to FDI. The estimated coefficients indicated that host countries benefit positively from FDI, and through FDI positive interaction with low interest rate and inflation.

Model 4: Overall regression result the interaction of FDI yields a positive statistically significant and non-positive variables: such as GDP, inflation, interest rate, REER and trade. The empirical estimated coefficient results show that GDP (10%) has a strong positive significance and REER (10%) ahs a strong negative significant, and also openness of trade at (1%) significance level. Remaining coefficients of the variables such as inflation and interest rates, are not statistical significant for FDI inflow. Indian has favourable policies, tax insensitive, cheap labour cost to be able to attract FDI inflows, after the transition reforms was introduce in the 1991. There is a positive relationship between FDI and the GDP growth rate, but also a positive interaction

between FDI and REER in triggering economic growth. Thus macroeconomics indicators have influenced FDI inflows in to India. A country's economic growth is also affected by its macroeconomic policies and institutional stability. Efficient macroeconomic policies and institutional stability are necessary preconditions for FDI-drive growth to materialise. The estimated coefficients inflation and interest rate are not statistically significant, but REER has negative statistical significance. So, this implies that lowering the inflation rate would indicate that the host country's macroeconomics policies are stable and disciplined. When Interests rate and REER are low, these help attract to investments - both foreign and domestic.

Figures 5.5: emphases the behaviour of macroeconomics variables with FDI in India. It explains the fluctuating trend lines in different variables and trends over all the periods in India. This methodology is employed for all the studied variables on FDI and its changing policy structure in the any economy. In India, GDP trend has been accelerated, especial after transition reforms. World Bank report, on 2000 onwards shows the growth rates have rapidly grown. Inflation rate is the overall period has show a fluctuating trend. However, in the period 1998 to 2005, inflation trend was downwards due to effect of drought, Oil shock effect and financial deficiency. The inflation rate is a key indicator of fiscal and monetary policies of a country. A low inflation rate would provide a better climate for investment, trade and economic growth (Fisher and Modigliani; Froot and Stenin; Shiva S. Makki, 2004). Real effective exchange rate was very high before transition reforms periods and effect of the reforms in exchange rate was drastically decreased due to devaluation of the rupee and the fall in the exchange rate. Thereafter, full convertibility of the rupee, FDI inflows also increased. The CAB has been showing fluctuating trend from the beginning, which means that it is increasing growing the FDI inflows. Also, interest rate is overall period trend should a fluctuation trend, which led to sluggish influence on the FDI inflows. In 1979, IT was negative. Openness of trade (export-import) trend was fluctuating before reforms, but financial reforms trend has changed. Results show that FDI inflows are slowly picking up; though imports are higher than exports in India. In exports the matter of IT and services sectors are booming after 2000. Thus, trends levels show the factors that influence the FDI inflows in India. FDI inflows were sluggish before transition reforms. Thereafter, FDI inflow started steadily swelling, by due to the influence of macroeconomic variables.

Figure 5.5: Behaviour of Indian Macro Economic Indicators from 1978-2010



2). **FDI in China:**

***China model result*:** All factors have shown the expected, outcomes these include: GDP, real effective exchange rate which are significant. The remaining macroeconomic variables are not statistical significant. In the case of the China, FDI inflows depend upon current year performances, its inverse relationship with India. The result shows that GDP and real effect exchange rate strongly influence FDI inflows. Openness of trade, inflation and interest rates are not much influenced in China.

Table 5.7: Determinant Factors of FDI in China: Regression results

	Model 1	**Model 2**	**Model 3**	**Model 4**
Constant	-49.774***	29.984***	9.6115***	2.515
Change in FDI	0.513***			
GDP	2.148***			0.956***
Interest Rate			-0.1539	0.1137
Inflation			-0.0079	0.0293
REER (Exchange Rate)		-3.651***		-3.928***
OT= (E+ I)/GDP		2.871***		0.6858
Obser.	33	33	33	33

Note: *, ** and *** are 1%, 5% and 10% level of significance, respectively.

Model 1: regression results show that the interaction of FDI has a positive and statistically significant coefficient, with change FDI and GDP. Change in FDI and GDP are (10%) of positive statistical significance. The estimated coefficients indicate that host countries benefit positively from FDI, and through FDI's positive interaction with change in FDI and GDP.

Model 2: The interaction of FDI is a positive and statistically significant coefficient with REER and Trade. REER is (10%) negative statistical significant and openness of trade is (10%) positive statistical significant. As well as these both variables are quite opposite. The estimated coefficients result shows that China's benefit positively from FDI and through positive interaction with REER and Trade. The effect of exchange rates targeting to stabilisation policies. The estimated coefficient of FDI is positive statistically significant, with the estimated coefficient of trade. These indicate that impact of FDI in the host country's economic growth (Shiva Makki, 2004, WB). Coe and Helpman (1995); HK Natha (2008), argue that trade is the spillover effect of foreign R&D on domestic productivity. Thus, trade policies are significant to drive up the GDP.

Model 3: Regression results shows interaction of FDI has negative coefficients with interest rate and Inflation. Interest rate and Inflation are statistically insignificant in

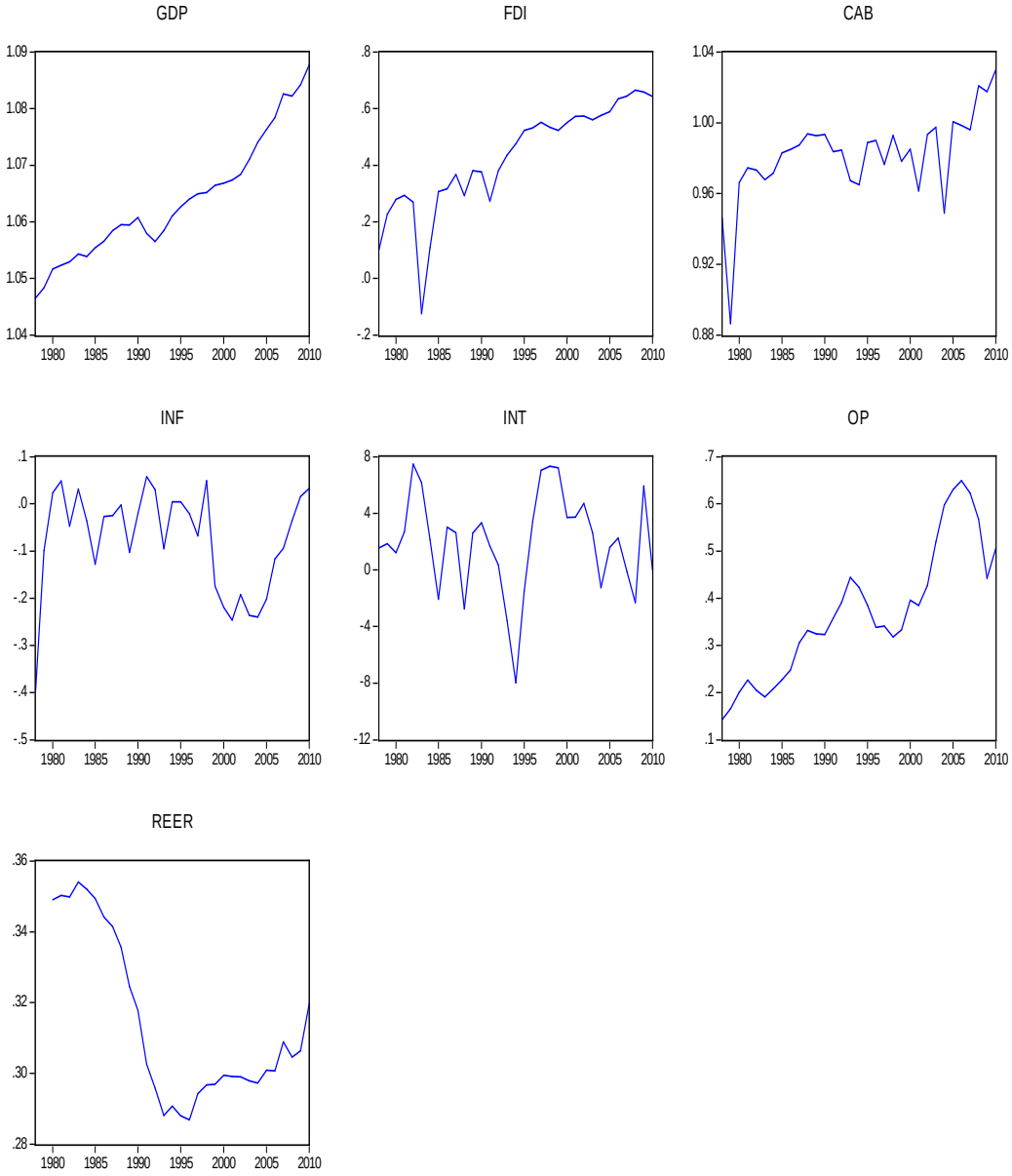
China. Inflation is an important player. Too much inflation and too low inflation would affect the economy. The effect of macroeconomics stabilisation policies represent that these can potentially affect growth. Berg, et. al., (1996), used inflation as a stabilisation proxy. As a result show that the China can benefit from low positive with interest rate and Inflation.

Model 4: Overall regression results reveal that GDP (10%) have positive statistical significance and REER (10%) is negative statistical significance. On the other hand, macroeconomic variables, such as interest rate and inflation and openness of trade are not statistically significant. The results indicate FDI has a positive effect on domestic investment. It implies that FDI stimulates to domestic investment. These findings conform to those to Borensztein, Gregorio, and Lee; Shiva s Makki, 2004. Shiva S Makki, in his analysis concluded, explained that trade is not statistically significant. Our results are that trade interacts negatively with FDI. GDP, REER greatly influence to FDI in the China. However, in China's domestic market, the low labour cost, abundant natural resources and autonomy are the major driving forces for attracting FDI from other countries.

Figure 5.6: Explains and that FDI has a positive interaction with GDP. Even recent literature reveals that FDI and GDP have a positive relationship in host countries. China's growth has been steadily increasing and the country has the fastest growth rate among the Asian countries. So, it leads to attracting FDI inflows. Before transition inflation rate was high, but after 1997, the inflation rate was come downward resulting in increasing FDI inflows. Effective real exchange rate, since the beginning of transition shown has been downward trend which is favourable for FDI inflows. Example, with depreciate exchange rate it can export more easily and gain from resources seeking FDI. However, if the inflation rates it continuously depreciates investors will avoid the investments. Therefore, the impact of exchange rate depreciation on FDI inflow is ambiguous. Also the current account balance position was positive, except in five years, it leads to more FDI inflows. During the transition period, interest rates have been fluctuating but these rates were moderate another positive sign for encouraging foreign investment. High interest rates lead to capital outflows thereby depreciation of the currency. In other words, exchange rate depreciation may cause the rise in interest rate. Therefore, both the interest rate and exchange rate might be affecting each other (Pradyumna Dash).

Openness of trade trend level has been growing because export revenue has been high after the WTO accession in 2001. In China, export trend is higher than that of import, it means export-lead the Trade. After transition economies, technology, knowledge may also be transform through exports and imports and it leads promote the economic growth, attracting the investments (Frankel & Romer, 1999; Frankel, Romer & Cyrus, 1996; Grossman & Helpman, 1997; Fank S.T. Hsiao et. al., 2006). Consequently, it would attract more foreign investors to invest in host countries. Thus, the macroeconomics variables are vital role to attract FDI inflows in China.

Figure 5.6: Behaviors of China Macro Economic Indicators from 1978-2010



Comparison of both models

The correlation between FDI and growth rate could arise from an endogenous determination of FDI. In other words, FDI itself may be influenced by innovations in the stochastic process governing growth rates. The endogenetiy problem is addressed by using the instrumental variables (see Borensztein, Gregori, and Lee; Shiva S. Makki, 2004). The estimated coefficients on FDI and trade are positive, but statistically insignificant. In fact, theoretically, FDI-Trade shows a positive growth. The interaction between FDI and trade is positive and statistically significant, according to Liu *et. al.*, (2002) brought out the relationship among economic growth, foreign direct investment and trade in China. This alternative estimation also suggests that our results are robust. Some estimations of coefficient results show statistical insignificance, but, theoretically these would show significance. Even though some authors argued that IT, inflation, and REER are negative and positive growth, still there is ambiguity about these variables.

Findings suggest that, both countries are attracting FDI inflows from other countries by both through their domestic markets and cheap labour costs. On the other hand, the effective macroeconomic policies and institutional stability and initial conditions of countries are necessary for inflow of FDI. Lowering the real exchange rate, current account balance, interest rates would promote economic growth in transition economies. Yuqing Xing, Guanghua Won (2004) argues that the relative FDI of one country is determined by the relative changes in exchanges rate between its currency and the source country. Berg et al., (1999) emphasised the importance of macroeconomic stabilisation for growth in transition economies of the Central and Eastern Eurobarometer (CEEB) regions. Consequently, a country's economic growth is also affected by the macroeconomic policies and institutional stability in both countries.

5.4. Conclusion

China has the greatest FDI potential among the BRICS, on account of economic size and rapid economic growth. In additional, China has grown at a phenomenal rate and other transition counties are now trying to catch up. India, still, is far behind. India can certainly learn lessons from China and create a congenial business climate in the country to catch up in the China. In both countries, macroeconomic variables can play a crucial

role to attract huge foreign investments. Results show that China's strengthen its GDP and favourable, exchange rates, while in India GDP, exchange rates and openness of trade are more attractive influences for FDI. If, India can create structural changes at a fast pace, it might attract more FDI and grow rapidly. However, in fact, India has created economical freedom for increased private sector and Trans National Corporation (TNC) participation, brought about openness of trade to become more global in its outlook and formulated flexible labour laws to attract free market demand, in its quest to become a major player in the global economy.

CHAPTER – V (b)

A COMPARATIVE STUDY ON TRANSITION ECONOMIES IN CHINA AND INDIA: A PERSPECTIVE TRADE ANALYSIS

5.2.1. Introduction of Trade

b. Background of Trade

c. Significance of Openness of Trade

d. Trade policy reforms in Transition Economies

e. Trade and growth take off in Asia

5.2.2. An overview of Trade in China and India in the Transition Perspective

5.2.3. Trade policies analysis of China and India

5.2.4. Role of Trade in selected indicators - influences in both Transition Economies from 1978 to 2010.

5.2.5. Conclusion

5. **Introduction**

Both countries share a common legacy of foreign influence or domination. Thereafter, communism took roots in China and democratic socialism in India. In the two Opium Wars (1839-1843 and 1856-1860), Great Britain coerced China to open up trade, partly to facilitate an exchange of British opium for Chinese tea. The Japanese invasion of (1937, p.25) followed by civil war and Communist revolution in 1949, did not endear the Chinese to foreign commerce, and for a long time afterwards, these experiences hampered China's attempts to open up its economy to the outside world. Similarly, the East Indian Company dominated for India close to 100 years before delivering it to the British Crown in 1857. Until recently, did not show much India's interest in attracting foreign capital and opening up to external trade. These events help reveal why liberalisation of foreign trade took so long to arrive in India and China (Thorvaldur Gylfason 2005). Since Adam Smith stated that the economics has been searching for the causes and effects of the growth of income and wealth and for the explanation of the structure of international trade, the exchange of goods and services are across national borders (Vladimir Bencaek, 2008).

Both countries are now playing a vital role in the 21st century global economy. Their expansion of trade has had a noticeable impact on global level growth, and through a number of channels, with trade showing arguably the strongest growth (Winter and Yusuf 2007; Renfeng Zhao, 2007). India had the fastest export growth among major traders in 2011, with shipments rising 16.1 per cent. Meanwhile, China had the second-fastest export growth of a much major economy, at 9.3 per cent (WTO). India also emerged as the second-fastest importer after China, growing at a rate of 6 per cent in 2011. India's account of trade GDP growth rate average is (30.76%) in 30 years; and China's (33.57%) (see Table-5b.1). China has constructed to success story of economic strength activities by such as traditional manufacturing and export-led growth strategy and foreign trade, and also has a vast resource of cheap labour and domestic savings. Meanwhile, the service sector and reliance, to a large extent, on domestic demand, IT, pharmaceuticals and potential of financial market have become the leading drivers in India's success in triggering economic potential growth.[1] An increase in use of technology has affected both countries sectors but it quite the opposite way. The services

[1]. China-manufacture export-led growth contrasts India –services sector demand driven growth (IMF Survey, March, 16, 2012).

sector requires a large number of human development skills. However, the policy implications of the development strategies of both the countries vary (Patricia Costa, Mayuri Guntupalli, Vishaal Rana, and Huong Trieu, 2006). In both countries, trade, as a per cent of GDP, has generally risen steadily during the period 1980-2010. In 2010, the figure was 55.23 per cent for China and 46.32 for India, as against the global figure of 55.86 per cent. Thus, both countries can learn from each other in several areas.

Table 5b.1:
Measure of China's and India's integration with the world Economy from 1980-2010

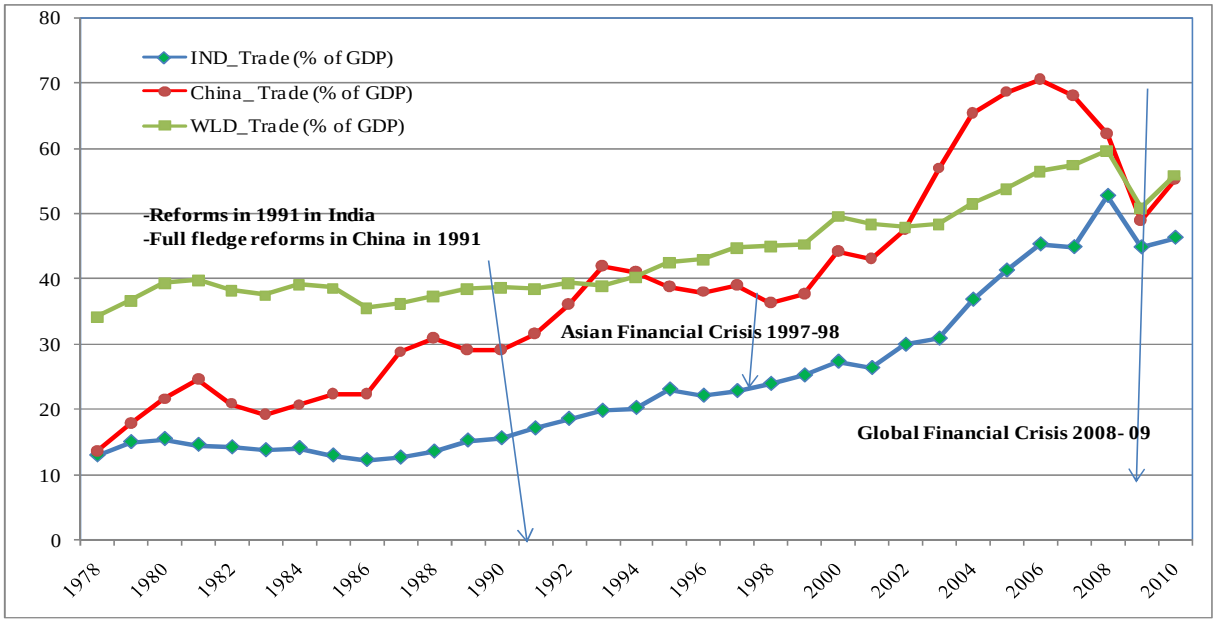
Indicators \ Years		1980	1985	1990	1995	2000	2005	2010
India	Merchandise Exports	1.81	2.73	6.20	1.48	2.49	7.61	1.57
	Merchandise Imports	1.99	4.22	5.33	1.32	2.25	6.59	1.39
	Trade (% GDP)	15.56	13.05	15.68	23.13	27.38	41.32	46.32
China	Merchandise Exports	8.58	9.14	1.79	3.063	4.23	9.96	2.19
	Merchandise Imports	1.48	1.59	2.35	3.47	5.15	1.42	3.27
	Trade (% GDP)	21.66	22.50	29.16	38.81	44.24	68.63	55.23
World	Merchandise Exports	1.97	1.88	3.47	5.17	6.45	1.049	1.52
	Merchandise Imports	2.01	1.95	3.55	5.22	6.65	1.076	1.52
	Trade (% GDP)	38.48	37.96	38.27	42.02	49.08	53.82	55.86

Note: Trade is the sum of exports and imports of goods and services measured as a share of gross domestic product.

Sources: World Bank, 2012 (All values in current, millions US$)

Table 5b.1 presents the measure of China's and India's integration with the world economy during the period 1980 to 2010. In China's exports are soaring compared with imports because potential manufacture sector since transition.

Figure 5b.1: Comparison of India, China and World Trade GDP percent from 1978-2010



While in India, export was low but after the reforms export have been accelerated the growth, imports are low to compare with exports. Also, except 1990, Indian exports more than imports. Although after effect of financial crisis in the World trade as a result of decline trade in both countries. Till 2009, trade growth rate was rapidly raised in both countries. The World Trade Organisation (WTO) in 2009, 9 per cent has declines in global trade for 2009 the largest in over 60 years (Economic Survey, 2009-10).

b. Background of the Trade

In earlier times, trading was mostly through the barter system, since then the currency system that we know today was not in vogue. Hence, people used to exchange goods. A close examination would shows that the barter system was based on feature like comparative advantage and "division of labour". In this process, the needs of the consumer used to be met. However, the mechanism had a number of disadvantages. No wonder, in course of time, the currency system took strong roots.

Domestic market is based on the *principle* that human depends upon each other. The barter system was based on homogeneous products, centralised markets operate, and a mismatch between demand and supply. In today's domestic markets, all kind of products are available. If case of a demand-supply gap, this is always scope for approaching other markets for trading purpose.

In some respects, the domestic market is similar to international trade, because all trade indicators must be taken into account. While the domestic market operates homogeneously, the international trade is exogenous. For both domestic and international trade, there are various policies, conditions, and restrictions. Depending on the country's economic solution, prices of certain products need to be cheap (especially for the domestic consumers), but high in the international market.

The dynamic effects (Balars, 1961), which aim at economic integration, may influence the rate of growth in GNP of the participation nations and: a) increase the size of the market b) Affect specific and general cost structures, c) benefit trade creation by linking economic regions d) influence the location and volume of real trade; and e) influence economic efficiency.

Transition is a part of economics. Transition is the process of economy in which trade has an important role to play for integration with the local markets. Trade involves

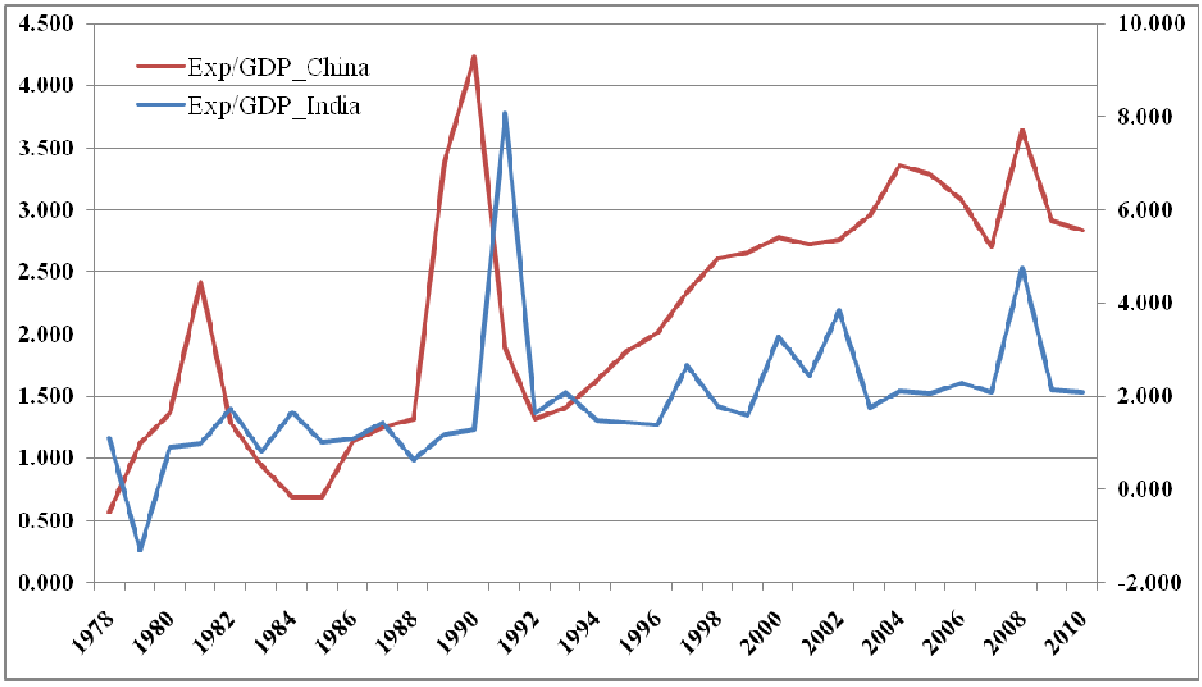
an openness of all elements of the economy. Trade creation and diversion are the two concepts most widely used in internal economic integration.

c. Significance of Openness of Trade in China and India

The domestic market is an important player in the process of international trade. Similarly, when the domestic market is facing issues like mis-match in supply-demand and, scarcity of resources, international trade can help overcome these. International trade includes bilateral trade relationship between two countries, which encompass institutional development, division of labour, specific products innovation and opportunity cost.

India and China have achieved remarkable growth by the openness of trade. Opening up the trade has triggered the growth of GDP and expanded their share in the world economy. China's trade expansion has, at least in part, been reflected in greater specialising in the final processing assembly of large volume of goods and made the country a world factory of re-exports. In China, half of exports are to other countries, mostly in certain high technology products.

Figure 5b.2: Export/GDP ratios of China and India from 1978 - 2010



Note: Export= Exports of goods and services (% of GDP)
Sources: World Bank (2011).

However, China's (r) manufacturing, export-led growth contrasts with (l) India's services, demand-driven growth (IMF, 2012). In China, (see figure 5b.2) the simple ratio of

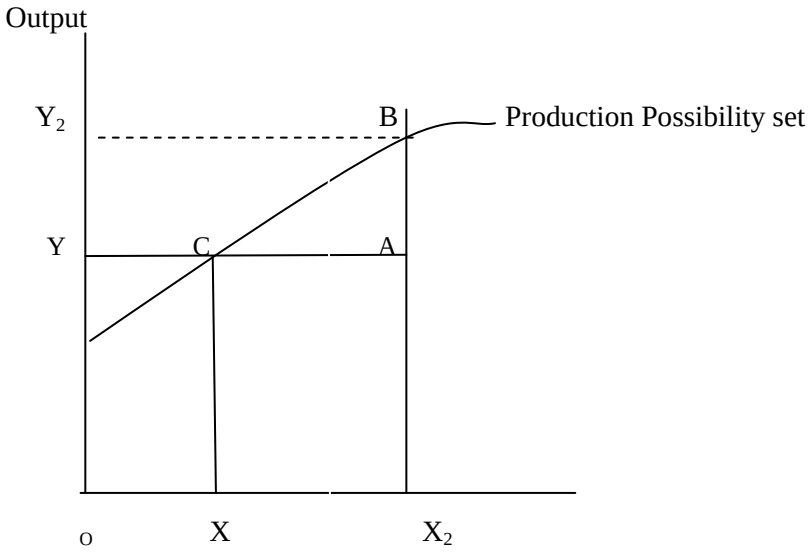
exports to GDP is 1.4 per cent in 1980 and 2.8 per cent 2010, the corresponding figures were 0.32 and 2.1 per cent respectively.

After transition 1991, export-GDP ratios have steadily moving upward in both countries. However, in both countries, export-GDP ratios declined in 2008 due to effects of the global recession. We can conclude that China is much more integrated into world trade compared with India.

d. A Simple Model of Economic Reforms

Figure 5b.3 explains the maximum possible, or potential, output that can be produced with given input levels and technology. These levels of outputs could not have been achieved with fewer inputs with the existing technology. However, the economy is producing point *A*, where the output is less than the country's potential output, given its frontier production possibility set. The country is producing at point *A* due to various non-price and organisational factors. Also, government policies can use to influence production.

In this context, there are two basic options for the government, which are not mutually exclusive. Alternatively, the government may choose to maintain the same input level and to effectively use the inputs to produce at *B*.



Source: Kaliappa Kalirajan (2004)

However, policy emphasis needs to be different, depending on which path the government would like to choose. One option for the government is the path from *A to C,*

reduce the levels by encouraging substitution and intensive use of inputs. The relatively major emphasis of the fiscal policy reforms is on pruning government expenditure.

On the other hand, the government may choose the path from *A to B,* by improving the competitive structure to achieve efficient use of inputs. Accordingly, these policies can be applied to influence competitive structure, trade policy, exchange rate policy and investment policy, all of which play a dominant role in the reform process. Indeed, developing countries with serious supply bottlenecks and unemployment problems tend to go more for the choice of the path from *A to B* relative to the path from *A to C and B.*

In this study, analysis is restricted to examine the types of trade policy reforms, implementation of which impact export promotion and import liberalisation. Several empirical studies conclude that there is a strong and significant effect of openness to trade on growth performance (Srinivasan, 1998; Kaliappa Kalirajan, 2004). Thus, trade policies are playing a crucial role in economic development.

e. Trade Policy Reforms in Transition Economies

Trade liberalisation has been an integral part of the transition process undertaken by former centrally planned economies at the beginning of the1990s. Trade liberalisation was expected to proceed rapidly and most efficiently with major flows of the centrally planned economic system. The issues, here, are:

I. The distorted price structure, resulting from the previous system of administered prices, and
II. The centralised and highly integrated production system by large monopolistic enterprises.

In other words, trade opening was designed to 'import' world prices and "inject' more competition into national economies.

Trade liberation can play an important role in restructuring economics in the context of transition economies. Outcomes of trade liberalisation in transition economies, can be based on: a) Macroeconomic variables, b) Structural policies (including external liberalisation); and c) Initial conditions in different transition countries.

In addition, monetarists point out the importance of political factors, timing of the reforms and success in winning public support, since there are issues like inflation and generally high unemployment rate. Consequently, transition countries have tended to

adopt a rapid and radical reform approach. Recent developments also clearly show a parallel between recent GDP performance and openness in transition economies.

Main lessons learnt from liberalisation experience of transition economics for domestic policy and decision-makers are as follows:

- Radical and fast trade liberalisation, initiated in the early stages of the reforms process, has been more successful in overcoming initial distortions.
- The success of trade reform is largely dependent on proper legal framework and institutional settings.
- An "external anchor" has to make an essential contribution for the success of trade reforms.

f. Trade and Growth take off in Asia

After trade liberalisation, a number of countries began to emerge, as economists and policymakers took note of some surprising successes in the developing world. Economies that experienced a dramatic acceleration in their growth and began to transform themselves into advanced nations include: South Korea, Taiwan, Hong Kong and Singapore. Today, the lists of countries that have experienced accelerated growth include the world two most populous nations - China and India. As can be seen, South Korea began it economic ascent in the 1960s, China at the end of the 1970s, and India around 1990. The process has been marked by major changes in economic policies. The new policy involved reducing government regulation in different areas, including a move towards free trade. The Asian successes stories demonstrate that the proponents imports-substituting industrialisation proved were wrong. It is possible to achieve development through an export-oriented approach and adopting approaches like: trade liberalisation, reduction in tariffs and the lifting of other import restrictions. After 1980s, India's participation in inwards trade surged as tariffs were brought down and import quota areas removed within a short period. India's economic growth has been high. The big question is, how India's growth rate has increased so dramatically? The question is the subject of heated debates among economists, some have argued that, after trade liberalisation, India's participation in the global economy was crucial. Other has pointed out that India growth began accelerating around 1980, but became full-fledged from the beginning of the 1990s. However, whatever was the effect of change India's transition has been a welcome development (pp. 256-268).

5.2.2. An overview of Trade in China and India in a Transition Perspective

An overview of China and India:

China and India established diplomatic relations on April 1, 1950. After that, both countries Prime Minister were being visited countries have been visiting each other's country. In 1984, China and India entered into a trade agreement, which provided them the status of Most favoured Nation (MFN). Subsequently to in 1992, both countries established full-fledged bilateral trade relations. In 1994 marked the beginning of a new era in China-India economic relations. A recent development of the India-China economies ties is the rapid increase in bilateral trade. However Indian industries' ambivalence over the proposed Indo-China Free Trade Agreement (FTA) stems from concerns over previous FTAs signed by the two governments.

Rajiv Gandhi's visit to China in December 1988 signified a warming trend in relations and agreement to broaden bilateral ties in various areas. As the mid-1990s approached, slow, but steady, improvement in relations with China was visible. Top-level dialogue had continued with the December 1991 visit of Chinese Premier Li Peng to India and the May 1992 visit to China of Indian President Ramaswami Venkataraman. Border trade was resumed in July 1992 after a break of more than thirty years. Consulates were reopened in Bombay (now Mumbai) and Shanghai in December 1992, and, in June 1993, the two sides agreed to open an additional border trading post. Though Rajiv Gandhi's visit to China in December 1988 was usually identified as a turning point and break-through in India-China relations, it should also be noted that many years of previous effort contributed to it. Eventually, in 1984, India and China signed a trade agreement, which provided for Most Favoured Nation Treatment and also in 1994, the two countries signed the agreements on avoiding double taxation. However, both countries reforms began at different periods and situations.

a. Trade reforms process in China

Chinese economies reforms began in 1978. These created conditions for rapid economic growth and structural changes. In 1980, the country began to attract FDI inflows. Soon, the country began to emerge as an important global trade power. China was the second largest trading nation in the world (after the United States). Its trade activities are growing more rapidly, compared with any other large economy. Trade liberalisation has been an integral part of China's economic reforms process since its

beginning. China's trade policy reforms took a new twist with the country's entry into the WTO on December 11, 2011.

For a long period of time, China was considered a Communist country with a closed economy. In the overall 31 year of reforms, the country has continuously pursued trade liberalisation and trade promotion. The high growth rate of China is attributed to high level of trade and greater investment effort. The Special Economic Zones have also helped to increase the productivity. This led to a surge of trade. China's trade gradually expanded after the 1990s. Since 2002, trade has been rapidly increasing. This has contributed to stabilisation of the economy. International trade "Opening" and "Domestic" economic reforms were complementary processes which can be described in a single term: "Reforms and opening" (Gaige Kaifng). Of course, today, global economy is very much an important sign for trade and investment. In China, growth of trade has been driven by foreign investment that was itself part of the East Asia-wide economic restructuring. The liberalisation policies were adopted for the opportunities they offered by bringing in relatively liberal rules on export processing.

Trade Reforms in Transition process

The domestic economy was rigorously sheltered from the world economy by, what we might term a "double air lock" that controlled flow of both goods and services. The first "Air lock" was the centrally controlled foreign trade monopoly. The, second "Air lock" was the foreign exchange system. The "double air lock" system was important for exports of commodities. If allowed, market forces would influence domestic prices. The socialist price system is an extreme version of the price relationships created by the common "import substitution industrialisation" (ISI) development strategy. The strategy restricted new imports and protected their new industries and fostered industrialisation. The period 1978-1979 set up the pace of technology imports due to sudden shortage of foreign exchange reserves in China. Ultimately, opening up of China, with a particular motive and opportunity brought about dramatic changes in the world economy.

Initial reforms had the enormous task of transforming the whole foreign trade system. Chinese policy makers initially took modest, but innovative, steps to open up new trade centre's in the southern provinces of Guangdong and Fujian in 1978-1979. Thereafter, SEZs were set up in Guangdong and Fujian, as well as other Export

Processing Zones (EPZs). Both Guangdong and Fujian provinces were developed to provide strong incentives to expand trade.

Initiatives in the mid-1980's had created some initial breach to *liberalizing* the main national trading system. A comprehensive liberalisation package was adopted in 1984. As a result, imports surged by more than 50 per cent in 1995-despite setbacks, and policy makers maintained some flexibility in the rules of trade. They also created the framework for the subsequent growth trade and investment. The main elements of the initial phases of trade reforms included *devaluation* - an important factor for exchanging the value across countries for achieving successful trade reforms. During the pre-reforms period, the Chinese government maintained an overvalued currency. In 1986, the value of the Chinese currency had declined to about 60 per cent. After 1986, dual-exchange rate regime was introduced. As a result, exporters could sell their foreign exchange earnings in a slightly regulated secondary market. China's *devaluation* in the 1980s coincided with realignment of currency rates throughout East Asia.

The number of companies authorised to engage in *foreign trade* was also allowed to expand dramatically. Many foreign trade companies were set up. By 1988, there were 5,000 FTCs, each of which was still foreign owned. Exports were liberalised much more rapidly than imports. But still, a number of domestic companies were sheltered from import competition. Also, there was a steadily shift away from the trade plane and in the direction of financial incentives. *Pricing changes* provided incentives, decentralisation increased competition, and devolution made exporting a potentially lucrative business. Foreign Trade companies (FTC) tie up with domestic companies resulted in lower cost and cheap production of labour intensive goods. However, the share of exports produced by TVEs increased rapidly, accounting for one fifth procurement by the FTCs by mid-1990s. *Creation of Tariff and Non-tariff Barriers:* Chinese policy makers proceeded cautiously. And they carefully took steps for creation of *tariffs barriers*. Before, reforms, a new set of tariffs were promulgated that raised tariffs, which remained high for the next decade. In 1992, according to World Bank (1994, 1956), China's tariffs were similar to these of other development countries. Not-tariff barriers and tariffs were "in a complementary fashion to achieve the government's objectives". However, Chinese imports were regulated by a combination of tariffs, quotas and administrative guidance exercised over state-owned trading companies.

In the mid-1980s, China moved from a planned trading system to a system of high tariffs, multiple non-tariff barriers, and high administrative discretion. Still, the trading system has been dominated by state-run organisations with major market power. This led to increasing profits and revenue. Steady reforms in trading had created an essential minimum degree of flexibility and further allowed the foreign-trade system to harmonise with changes in the economic system. Trade barriers were first converted to tariff equivalents, to facilitate China's entry into the WTO. This systems was borrowed a from the East Asian play book and adopted selective measures of *exports promotion* and designed to offset the anti-export bias for at least some products. This partial system of rebates of value-added taxes for exports began in 1985 and expanded in 1990s. Consequently, the most important step was the creation of an entirely separate export – processing trading regime, and to avoid the old centralised foreign trade monopoly.

A dualist trade regime the export processing contract was begun in Guangdong province before reforms in 1978. In 1986, the government had recognised the opportunities for China in the ongoing restructuring of Asian export production network. On the other hand, they were allowed to adopt a more flexible variant of export processing. In 1987, China had established time separate trading regimes. EP (or) export-promotion for trade, responding to the extremely open regulation, had grown rapidly. The EP regime and foreign invested enterprises together were the drivers of China's export expansion. Foreign Investment Enterprises (FIE's) was gradually becoming important players in China's export growth. During the period 1992 to 2005, it accounted for 63 per cent of increment exports. Clearly, the liberation influence on foreign investment had played a fundamental role in China's exports successes. Moreover, domestic firm exports stagnated for four years. In the period 1985 to 2004, total exports increased 17.6 per cent annually.

Towards an Open Economy

From the mid-1990s, China began to move in the direction of a genuinely open economy. Moreover, membership of the WTO was a powerful motivating factor. The common theme linking these reforms was reducing the degree of dualism in the trade regime and prepared the way for an open economy. Membership of WTO, was ***considered*** very much useful to help push through reforms. The discussion of these changes first covers the currency reforms in 1994, WTO membership and other aspects.

a. *Currency convertibility:*

On January 1, 1994, reforms abolished the secondary "swop" or (exchange) market for foreign exchange that had been one of the important transition devices. In China foreign currency was greatly liberalised and current account convertibility was achieved. As a result, the importers of goods and services can purchase these thought foreign exchange. The WTO permits exporters to discount VAT on exports. China's policy makers have been quick to see the advantage of such a discount. Thus the, 1994 reforms succeeded in moving China to a more integration of trading with the global economy.

Though the 1994 success was partial, China could more quickly to full currency convertibility, including the capital account and established a "managed float" for the Chinese currency. A flexible exchange rate would adjust in the long-run the supply and demand for foreign exchange market so as to stabilise the currency. In the aftermath of the Asian financial crisis of 1997-1998, all Asian currencies were under downward pressure, and policy makers decided to hold the line and not allow the currency to depreciate. However, China's exports had started to grow rapidly after 2002.

a. China formally applied to reform the GATT (General Agreement on Trade and Tariff) in 1980; it might be a quick and relatively painless process. After that, China was to start market reforms. Finally, China was become the 143rd member of the WTO, on December 11, 2001. There after then, China's trading institutions integrated with the global economy.

After 1989, there was no longer a constituency for an "easy" entry by China into WTO. The Uruguay Round negotiations, created by the WTO in 1996, signaled a fundamental shift in the term global trade negotiations. Earlier agreements had been restricted to a clearly delineated "foreign trade sector". It was a more systematic development of China's characteristics of the negotiation economics. Modern economics are now primarily focused on trade and services. During the Uruguay Round, itself trade liberalisation was achieved, by a "Grand Bargain" in developed and developing countries. This round was more useful for the developed and developing countries. The, primary attributes included extension of trade negotiations and new areas relating to services, investment and intellectual property rights. This was the external bargain that China was required to make as a condition for WTO membership.

The requirements were that China opens up the OT (Openness of Trade) regime and dramatically reduce the dualism of its trading regime. China was extended trading right without restriction, including provide the trade rights to domestic and foreign private companies, and this was made effective on July 1, 2004. Under this law, the China government no longer restricts trade to a limited number of states owned FTCs, except in a few agricultural commodities. China began low tariffs in preparation for WTO membership immediately after the foreign exchange reforms of 1994. The reduction tariffs stages were from 45 per cent in 1992 to 17 per cent in 1999 respectively. As per the actual agreement, China agreed to lower average industrial tariffs to 9.4 per cent in 2005. The agreement lowered average agricultural tariffs to 15 per cent, which was also easily achieved.

However, openness in imports is the most import dimension of its overall openness to trade, besides both openness of trade to competition and an access to lowest cost supplies. Earlier, the 'false start' of trade liberalisation through the ordinary trade (OT) regime was abandoned and China adopted a dualistic ISI regime. After WTO membership, drastic changes in trade occurred. China has become more than three times as open to world trade in the six years from 1998 to 2004. After 2002, there has been a huge increase in China's foreign trade due to recent liberalisation and WTO membership. On November 1991, China joined the Asia-Pacific Economic Cooperation (APEC) group, which promotes free trade and cooperation in economic, trade, investment and technology spheres. China served as APEC chairman in 2001, and Shanghai hosted the annual APEC leaders meeting in October of that year. China's annual exports have growth grown from 6.78 per cent to 28.36 per cent and import annual growth from -0.89 per cent to 20.13 per cent in 1980 and 2010 respectively.

a. Trade reforms process in India

In India, domestic economic deregulation began in the mid-1980s. The collapse of socialist economies in 1990s worldwide, coupled with a foreign exchange crisis, and India's own financial crisis were some circumstances that prompted the reforms. India systematically began to reorient its policy framework in the early 1980s and a number of policies were reamed. Before 1991, trade with India was considered one of the most restrictive in the world, due to complexity, inflexibility and wide number of tools used for as policy instruments. At the same time, there was the severe balance of payments crisis in 1991. Later on, comprehensive and systemic reforms in India were under taken

(Choorikkadan, Veeramanim, pp. 74-76). According to the World Bank (2005), China's rate of growth was GDP the fastest at an average rate of 10.3 per cent during the year 1980-90, while India's was 5.7 per cent. There were five major components to reforms, namely, export promotion, domestic deregulation, permission to enter the economy, and reduction of tariff and non-tariff barriers on imports (Christopher J Rusko and karhika Sasikumar; 2007).[2]

The root cause of the twin crisis could be traced to macroeconomics, mismanagement throughout the 1980s, as reflected in an unsustainably high fiscal deficit, in particular the revenue deficit. The Quantitative Restrictions *(QRs)* on importing capital goods and intermediate goods were completely removed and customs duties in the manufacturing industries were gradually reduced in 1992. In 1993, the government adopted full convertibility of the rupees for the current account, and FDI has been encouraged in all manufacturing industries and the approval process has been made simple and transparent (Choorikkadan, Veeramani). Macroeconomic stabilisation policies had included devolution and other structural economic reforms. The macroeconomic stability has endured in the ten years of economic reforms up to 2003. The current account recorded a surplus equivalent to 0.3 and 1.4 per cent of GDP in 2001-2003.

Export and import

After liberalisation of trade in India, huge foreign investments were attracted by domestic markets. FDI is an important indicator of gain from economic reforms in India. India account FDI inflows grew from 79.16 million USD in 1980 to 24639.9 million USD in 2010. It has helped to attract large volumes of FDI and FII into the country. For stimulating foreign investments, the government is providing a number of exemptions, incentives, taxes and tariff reduction. State governments are showing commitment to established and strengthen SEZs, and setting up agriculture economic zones to provide a strong push to the country's export growth rates. Additionally, new labour policy regimes are allowing freedom for entrepreneurs in the SEZs to "hire and fire", consequently, increasing employment opportunities and maximising gains from SEZs (Charan D. Wadhva, 2006). India's foreign corporations have grown rapidly, especially since 2003, when all restrictive quantitative on imports were removed. Thus, Indian trade been has steadily improving after 2008 financial crisis; and trade GDP was 46 per cent in 2010 (WBI).

[2] . See "India and China: From trade to Peace?" *Asian perspective*, vol. 31, p.p. 99-123.

India economy is flourishing after recession. Also, wide-ranging reforms and increased investment have lifted potential growth to almost 9 per cent, helped by improvements in infrastructure. The government should step up efforts to restructure public expenditure; reduce the fiscal deficit; relax some of the constraints facing the financial sector and further promote international integration (OCED, 2012). India's export annual growth has been from 11.1 per cent 17.92 per cent and likewise import annual growth grown from 8.54 per cent 24.75 per cent in the period 1990 to 2010 (World Bank, 2012). The *Indian information technology* (IT) industry has been the subject of much discussion on the successful growth of the knowledge industry in a developing country. Group of academicians and experts have cited the success story of IT in India as a lesson for other countries. In India, it is being spread across key sectors such IT enabled services (ITES), software, and e-business. The rapid accelerating progress of IT in India software can be seen from its growth from a small $150 mm industry in 1991, to $5.7B in 2002, an annual growth rate of 50 per cent.

In 2010, India was ranked 124th among 179 countries in the Index of Economic Freedom World Rankings, which is an improvement from the preceding year. India's major trading partners are the European Union, China, the United States of America and the United Arab Emirates.

5.2.3. Trade policies analysis in India and China

An overview of trade policies in China and India:

Recently, economists have again become interested in comparing the two giant's developing economies largely due to theirs spectacular growth performance in the 1980s and 1990s and subsequently there has been rising significance for the world economy and political affairs. A number of authors are interested by the institutional settings and their impact on the economic performance of the two countries (Huang and Khamo, 2003). Dzever and Jaussaual (1999) reported that a series of studies of business strategies of firms and srinivasan (2007) shed light on macroeconomic performance. The strongly macroeconomics performances of both countries and real GDP is expected to rise at an average 10 per cent in China and 8 per cent in India over the period (IMF, 2007a). Also, economic liberalisation reforms undertaken by both countries may have played a crucial role in triggering the high growth rates, since opening up of trade produces excess to

imported inputs, new technology and larger markets and spurs growth (Harries, 1996; Frankel and Romer, 1999).

China and India are now much more integrated with the world economy and, interestingly, the developing countries' imports have increased at the same time. China is becoming a world factory in re-exports. An opposite trend is shown by India and industrial exports dropped from 55 per cent in 1990 to 44 per cent in 2006, while the share of exports to developing countries has increased.[3] The Work Bank, 2004. The assertion of T.N. Srinivas (2006) is that this is due to the difference in investment climate in various countries, as a result of variations in competitiveness, growth and prosperity across countries and variations in policies or across sub national units within countries. Also, the total share of import significantly rose in both countries and was also strengthened by big markets. The many developing and emerging countries are already expressing fears about the domination of both countries in international trade markets. Both countries are now considered huge and fast growing for a range of goods and services, and thus providing export opportunities for producers in the rest of the world. In addition, the large and growing market opportunities in China and India are wide-mainly due to the large inflow of FDI (Choorikkadan, Veeramani).

a). China's Trade policies:

The trade policy reforms have also led to significant change in China's trade pattern. As the reforms progress, market focus come to play a great part in resource allocation. In China, Deng's open-door policy of 1978 promoted the opening of foreign imports and encouraged the development of an export oriented sector. As a result, tariffs, quotas, and import and export licences were reduced over the subsequent years 1992 to 1996 (Brigitte Desroches *et. al.*, 2009).

China was a more open economy through a gradual and highly managed transition. By the mid-1980s, export processing zones (EPZs) was more widely spread and a two-tiered export regime was put in place. Export processing segments benefiting from duty free import were afforded high levels of protection through tariffs and multilayered non-tariffs barriers (Greene *et.al.* 2007). The share of manufactured goods (SITC5-8) in total merchandise exports increased from roughly 50 per cent in 1980 to 80 per cent in 1992. China had become an importer of petroleum and natural gas in 1992.

[3] . In the case of India, Export has not been affected, compared to other countries of the world, during the phase of global slowdown (DGCI & S, 2012).

During 1992, China, declared its intention to establish a "socialist market economy" and began to make substantial tariff cuts. It resulted in strong, extensive reforms. Also, China agreed to implement reforms as a part of the terms for entry into WTO. China had also committed to a further phased reduction and removal of non-tariff. Agriculture production had a limit on subsidies of 855 of the value of foreign output (Green *et. al.*, 2006). After the 1990s, stress have been on reducing the tariffs, and bring the simple average tariffs. For instance, tariffs on non-agriculture products were being reduced from 41 per cent in 1992 to 14 per cent in 2001 and further to 9 per cent in 2005. In agriculture, import was reduced from 47 per cent in 1992 to 24 per cent in 2001 and 15 per cent in 2005.

The trade reforms that China has embraced as a result of its WTO accession are steadily leading to reduction in tariffs, and China WTO commitments represents milestones (Greene *et. al.* 2006). Additionally, by the end of 2003, China agreed to allow foreign services suppliers to engage in the retailing of all products. The end of 2004, all firms were to have the right to import and export those goods, subject to state trading monopolies: such as oil and fertilizers. Foreign financial institutions are now permitted to provide services, and by the end of 2006, most of the restrictions on free entry and were removed.

China's policies to attract foreign investment, by exempting investment from regulations, and providing infrastructure have been very successful (T.N. Srinivas 2006). In areas such as, power and communication, QR on imports was removed and tariffs rates were gradually reduced. China has gradually liberalised the labour market, and brought in more flexibility in the structure of production on the basic of comparative advantage (Mang 2000; Brooks and Tao, 2003).

The East Asian Economies tend to advance together through trade expansion, based on shifting comparative advantage over time. Tariff rate were raised between 1986 and 1991, after that it is being reduced in the subsequent years (World Bank, 1994; and Tseng *et. al.*, 1994). The promotion of exports through liberalities and decentralisation of export activities, has been controlled by the extensive use of non-tariff measures (NTMS), Such as mandatory import plan, canalization of import, import licensing (33%), and import (30%) controls 1993 *(Tseng, et. al.*, pp 4-5*)*. Despite recent efforts to reduce and rationalise tariffs and NTMs, China's import regime is one of the most protective in Asia, along with India and Pakistan. Also after gaining, membership of WTO/GATT, China's

government undertook steps to liberalise the trade regime further. It continued efforts to liberalise and rationalise the import regime to sustain the transition process to a market economy in the coming years.

Greene *et. al.,* (2005) conclude that all services liberalisation commitments are specified in the (GATT schedules). The ambitious GATT schedules China that implemented were in five sectors, such as banking, insurance, telecommunication, distribution and engineering services. Additionally, through China's merchandise exports are generated from foreign invested companies, there is some indication that China's FDI policies may be more restrictive than what trade or investment data suggest. However, China's was implemented of GATTs commitments these significant impact on trade (Prezemy Slaw Kowaliski, 2005). The tariffs were reduced by 50 per cent for consumer in the SEZs. China's actual tariff revenues collected, relative to total imports, are at a much lower rate of 5.6 per cent in 1992, compared with other developing countries, such as India 51.2 per cent in 1986 and Pakistan 30.8 per cent in 1990. China's exports associated with import duty concession amounted to more than 60 per cent of total manufacture export in 1991(World Bank, 1993, p.60).

China's trade performance can be seen as a gradual evolution of its highly centralised trade regime into a more decentralised one, more independent and local enterprise. De Menit (1995) stated that the trade regime's permission has remained quite restrictive, "broad exemption from central regulations and controls liberally granted by local authorities were the main secret of China's trade success" (p. 28).

b). Indian Trade Policies:

In India, during the mid-1980s, trade openness began. The initial step was expanding the number of goods that could be imported under the 'open general license' classification. These reforms mainly involved: a reduction in canalisation; permitting trade in and the expansion of replenishment import license, and reduction of import duties on capital goods permitted from import. The general level of tariff, the mean tariff rates was decreased from 100 per cent in 1980 to around 30 per cent in 2001-02 (Brititte Desroches, *et. al.,* 2009).

It was recognised after 1991 that reforms for the reshaping India's economic policies, could be helped by drawing appropriate lessons from the "East Asian miracle", based on more export-oriented and more globally connected strategies of development.

The government came out with a clear vision and the objective of its economic reforms came only after regaining macro-economic stability. Major economic reforms are: (i) Macro-economies management reforms; and (ii) Structural and sector specification economies reforms. Macroeconomic reforms mainly focus on stability in the economy. This macro-economic stabilisation would provide a strong foundation for medium and long term structural economies reforms and accelerate the rate of economic growth in a phased manner. It would be possible only on open trade, and reduction in the tariffs and restrictions on foreign investment. Second, the structural economic reforms focus primarily on the following areas: Trade policy/external sectors policies; divestment/privatisation policies, as well as, the financial sector and also policies of attracting foreign direct investment. The main aim is to provide an open market to international competition, revenue exchange rate controls, encourage private investment and participation in industry in an eventually liberalised economy (Charan D. Wadhava).

Export credit financing is an important incentive to trade. In 1982, the Export-Import Bank of India (EXIM Bank) was established as a special institution for coordinating the activities of various agencies engaged in finance trade. The EXIM Banks main aim is to promote engineering exports. The Hussain Committee and the Narasimhan Committee reports on 1985-86, called for including policies for the Long Term Fiscal Policy (LTFP) in future trade policy and on reducing tariffs quotas. The import-export policy (1985-88) pointed out the need for considerable relaxation of import controls and lowering of import duties on capital goods. Another policy (1988-91) brought out the need to reinforce the process of trade liberalisation. This policy's aim is towards self sustained export growth (Krishan Lekha Sood, 1989, pp.108-155).[4]

After full-fledged reforms started in 1990s, large reduction in tariffs in all goods services, over the period 1990-2005 was introduced. The trade regime in India since 1991 has unmistakably reflected a growing appreciation of a liberal trade system. Especially significant has been the effect of liberalisation on the manufacturing sector. The trade reforms in India was focused on both tariff and non-tariff issues. On the tariff front, policy makers designating and contracting tariff had a very appropriate way in the nineties. The intermediate focus areas were high taxes and barriers to series trade. India has opted to cultivate an extremely complex system of duty exemption scheme, specially investment and establishment rules and SEZs that provide incentives, particularly to

[4] . Trade and economic development: India, Pakistan and Bangladesh" Sega Public New Delhi.

export firms. Tariff items are often affected by more than one of these and use tariff concessions, although recent amendments were made in the trade policies such as simplification of trade procedures and reduction in tariff and non-tariffs rates. The aim of introduction of special scheme is primarily to benefit exporters, in areas such as the of import capital goods at concessional rates under export promotion capital goods scheme (EPCG).

In 2006, the Trade Minister, Kamal Nath, announced two new schemes that focused on products and market areas-providing a thrust to employment generation, particularly in semi-urban and rural areas to: a) Promote exports of products of labour intensive industries; and b) Promote exports to specified markets.

To compare with the OECD countries, India has more restrictions in trade, banking, insurances, mobile telecom sector and distribution. The New Foreign Trade policy aims to double the percentage of global merchandise trade within the next five years. In addition, it seeks to continue liberalisation efforts by reducing tariffs, unshackling control simplifying procedures and bring down transaction costs, extensive use of duty rebates and exemption to neutralise the incidence of all reviews and duties on inputs used in export products and establishing export processing zones. Nevertheless, in the foreign Trade policy, two main elements are contradictory. In second objective the cross-board duty reduction would have more beneficial economy-wise and export effect than selective duty exemption in export sectors (*Prezemy slaw kowaliski, 2008*).

Governments across the world have also taken various policy initiatives. According to the World Bank survey, the main actions taken by governments can be grouped into two categories: (i) To increase banks' liquidity to alleviate liquidity pressure or trade finance; and (ii) Enhancing the exports. The foreign Trade Policy (FTP) 2009-2014 set the objective of achieving annual export growth of 15 per cent, with an annual export target of US$200 bullion by March 2011 (Economic Survey, 2009-2010, pp. 150). Also, the long term policy objective of the Government is to double India's share in global trade by 2020.[5] India's services sector policy focuses on FDI, tariff and tax, credit and finance and other trade related, e.g. user-friendly policies, opening up of on insurance sector, rationalising taxes, tax exemption in some cases. Trade policy measures taken by the RBI and the Government in the Budget 2009-10 and Foreign Trade Policy (2009-14)

[5] . See in, foreign Trade Policy, 2009-2014, p.27, Annual Report, 2010-11.

seek to help the export sector in general and the employment intensive sectors affected by the world recession,[6] and additionally, check inflation caused mainly by supply-side constraints, which include reducing import duties such as on oil.

The SEZs policies had supported quality infrastructure, complemented by an attractive fiscal package and single window clearance in mechanism. And non-tariff measures such as during 2009-10 (up to December 31, 2009), the Directorate General of Anti-dumping and Allied Duties (GDAD) has initiated 11 fresh antidumping investigations (pp.173). Trade policy measures were taken up under FTP 2009-14.[7] India account FDI inflows have grown 79.16 million USD in 1980 to 24639.9 million USD in 2010. This is reflected in its Foreign Trade Policy for 2004/09, which states, "For India to become a major player in world trade, we have also to facilitate those imports which are required to stimulate our economy (World Bank, 2012).

Comparison of trade policies of both countries

Trade activities in both countries have increased since the last two decades. Even after the grim global recession, both countries' trade growth is moving towards global economy. Both countries mainly focus on macroeconomics indicators, monetary, fiscal policies and structural indicators. Also, control mechanisms, such as prohibitive tariffs, quantitative restrictions and import licensing, were significant reducing external trade possibilities (Lardy, 2002; Srinivasan, 2004). India has attracted far less FDI. This is not because of the lack of potential opportunities, but due to policy hurdles and other constraints in investment while China has several flexible policies, and other incentives other to attract investments. Thus, even though both countries are having different approaches, but in the 21st century, both have been attracting investments.

5.2.4. Impact of Openness of Trade on Economic growth in both Transition Economies

A heated debate exists in the economics discipline whether openness to trade is beneficial for growth (Andreas Billmeier and Tommaso Nammicini (2009); Amir Hussian Siddiqui, Javed Iqbal (2005). Several empirical studies have brought out the effect of openness of trade, or liberalisation on economic growth (Edward, 1992, 1993, 1988;

[6] It clearly explains its Trade policy measures in Economic Survey (Box.7.4, 7.5) pp.168-700, *International trade.*

[7]. To enhance competitiveness for products which are labour intensive, technology intensive, technology intensive and values added, further export incentives were undertaken on 11th February, 2011 for more than 600 products such as: agriculture, chemicals, carpets, engineering, electronics and plastics sectors.

Frankel and Romar, 1999; Saches & Warner, 1995; Sala-i-Martin) while robust positive relationship are difficult to find (Harrison, 1996, Harrison & Hanson, 1999; Levine & Renelt,1992; O'Rourke, 2000; Yanikkaya Halit (2003); Amir Hussian Siddiqui, Javed Iqbal (2005); Santos Paulne (2002); and Sinha D., Sinha T (2002).

Let us now examine the impact of openness of trade on economic growth in India and China. Some important variables for model building for analysis and detailed explanation are as follow:

i. *Gross domestic product:* It is a very significant variable for explaining the economic growth of a country. Per capital income growth rates are usually high and after some time these would be expected to continue to move upward.

ii. *Openness of trade:* This is an important factor for rapid economic development. This variable is widely used for trade measure analysis. This is also known to be an instrument of economic growth (Jeffrey A. Frankel and Romer, 1999). Also, openness of trade has a crucial role to play in transition economies and under-developing countries. It is denoted as OT.

iii. *Population growth:* It is an important variable that can impact growth in transition countries. Population growth enlarges labour force and, therefore, can increase economic growth. It also, provides a large domestic market for the economy. Population growth can growth encourages competition, which stimulates technological advancements and innovations. Which is denoted as a Pg, Especially, China and India having a large population in world. However, uncontrolled population growth can also have negative consequences take large scale unemployment and put a strain on scare domestic resources.

iv. *Investment growth:* All theories of growth suggest that investment is an important determinant of growth countries (Dollar, 1992; Nafizingor, 1981; UNDP; 1996; Solow, 1957). It is a significant measure of openness of trade in developing countries. Investment growth rates; are often considered by economists to be important indicators of longer-term economic growth (the growth of output and employment) and potential productivity. We include investment as denoted by Inv.g.

v. *Foreign Direct Investment:* An important vehicle of technology transfer stimulates domestic investment, facilities investments and improvement in human capital in the developing countries. Caves (2006) Vertical vs. Horizontal FDI

theory states that firms either undertake FDI to seek efficiency in their global supply value China, or make FDI to enter horizontally to explore new markets. It can lead to export-growth in the host country.

vi. *Real Effective Exchange Rate*: Foreign investment firms gain or lose due to depreciating exchange rate. With depreciate exchange rate, one can export more easily and gain from openness of trade. If, it is continuously depreciating investors will avoid making investments. This would lead to imbalance of trade in the receipt country.

The main objective of the study is to examine the effect of the openness of trade on GDP growth in transition economies. Numerous studies have been under taken. The overall finding is that on these variables and trade liberalisation tends to have a positive effect on growth (Andreas Billmeier and Tommaso Nannicini, 2009). We above discussed the importance openness of trade on both countries.

Sinha (2002), Aamir Hussian Siddiqui, Javed Iqbal (2005) have also used the variables for model. The volume of Trade (import plus export) is used as proxy of openness. We are using the variable - openness of trade (E+M/GDP). We are using OLS model that the earlier studies used for analysis of the trade measures (Sinha D. Sinha T, 2000; Edwards, 1998; Santos-Paulion, 2000; Yanikkaya, 2003; Waczirry, 2001). They derived the following equation:

$$lnOtg = \beta_1 + ln\beta_2\, Yg + ln\beta Invg + ln\beta_4 Popg + ln\beta_5\, fdi + ln\beta_6\, Reer + \varepsilon$$

Where Otg is the trade growth and also used as a proxy for openness (E+I/GDP); Yg refers to GDP (current USD) growth, Inv.g (per cent GDP) is the fixed investment growth, Pop.g (millions) is the population growth, fdi (USD) is the foreign direct investment, Reer (2005=100) is Real effective exchange rate and finally, ε is the error term. All variables are in log form. The effect of openness of trade on economic growth in the framework is cross–country analysis, for using data during the period 1978 to 2010. Data has been obtained from International Financial Statistics (IMF's) and World Bank Indicators.

Table 5b.2: Descriptive Statistics of India: 1980-2010

	GDP	OT	Population	Investment	FDI	REER
Mean	4.13E+11	0.174	934.073	26.415	6359.39	141.313
Median	3.47E+11	0.168	932.5	24.269	2151	113.039
S. D.	2.28E+11	0.069	157.738	5.212	11123.86	64.891
Kurtosis	-0.01623	1.391	-1.272	0.007	3.99	1.522
Skewness	0.9587	1.241	0.016	1.119	2.18	1.668
Minimum	1.58E+11	0.089	682.25	19.215	5.64	82.350
Maximum	9.63E+11	0.373	1190.524	37.371	42545.72	319.482
Obs.	31	31	31	31	31	31

Tables 5b.2 & 3 show both countries' models of the descriptive statistics of all variables. In India, GDP average growth is 4.13 per cent point over time. Openness of trade average growth is 0.174. The population is 934.07, investment for the entire mean and the median were partial equally. Also, FDI average growth is 6359.39 over time. Quite often, is useful to examine whether a given time series approximates to the normal distribution. For all series, the mean and the median were not equal. The kurtosis statistics provide a measure of the thickness of the tails of a distribution, which were in most cases less than 3. However, FDI kurtosis is 3.99. Skewness statistics were used to check the symmetry of the probability distribution.

On the other hand, China's GDP average growth is 1.32 per cent point over time. Openness of trade average growth is 0.38. The population is 1191.72 per cent; investment growth rate is 40.3, and FDI 35444.27 per cent over time. For all series, the mean and the median were not equal the kurtosis statistics that provide a measure of the thickness of the tails of a distribution were in most cases less than 3. The skewness statistics are used to check the symmetry of the probability distribution.

Table 5b.3: Descriptive Statistics of China: 1980-2010

	GDP	OT	Population	Investment	FDI	REER
Mean	1.32E+12	0.38	1191.72	40.33	35444.27	141.31
Median	7.28E+11	0.35	1211.21	38.34	37520.53	113.039
S. D	1.52E+12	0.13	111.64	5.22	33985.76	64.891
Kurtosis	2.679505	-0.56	-1.16	1.27	-0.56	1.522
Skewness	1.821381	0.49	-0.38	1.21	0.65	1.668
Minimum	1.89E+11	0.19	987.05	33.51	57	82.350
Maximum	5.93E+12	0.64	1341.41	55.09	108312	319.482
Obs.	31	31	31	31	31	31

Empirical Analysis:

Table 5b.4 explains the regression results of openness of trade in both transition economies from 1980-2010. The empirical literature shows that trade openness or liberalization impact output growth. Most of the studies have concluded that the openness of the trade regime has a positive relation with GDP growth (Edwards, S., 1992; Harrison, A., 1996; Edwards, S., 1998; Ahmed, Yusuf and Anoruo Emmanuel 2000; Waxziarg R., 2001; Santos Paulino, 2002; and Yanikkaya Halit, 2003). We have considered coefficient value as‘t-statistics value’ for significant levels.

Table (see 5b.4) presents the regression result of India. The influence of the GDP, FDI and investment are continuously increasing the growth rates. Export growth was found to be quite impressive. GDP has a positive statistical significance at 1 percent level, FDI is has a positive statistical significance at 5 percent level. Also, investment growth impacts of the trade. It has a positive statistical significance at 5 percent level. So effect of openness of trade in Indian economic growth is noteworthy. Indeed, a number of authors have concluded there is that a relationship between OT on GDP, positive FDI and economic growth (Wacziarg, 2001, Ann Harrison 1996).

Table 5b.4: Regression Results of China and India

	India Coefficients	**China Coefficients**
Constant	-4.271191 (0.3434)	7.109854 (0.751427)
LGDP	0.488505 (2.194749)*	0.912273 (5.476507)*
LINV.	0.498249 (2.134425)**	0.160046 (0.713745)
LPOP	-1.483055 (-1.538617)	-4.089601 (-2.391004)**
LEX	-0.506895 (-1.893202)	-1.002121 (-3.375751)**
LFDI	0.061306 (1.907164)**	-0.003169 (0.290003)
R^2	0.890247	0.924832
Adj. R^2	0.868296	0.909798
D-W sta.	0.778158	1.403854
No. observations	30	30

Note: the *t*-statistics are in parentheses.
Sources: *, **, & *** noted 1, 5, and 10 per cent respectively

Also, the GDP growth also affects trade growth (Rodriguez & Rodrik, 2000). On the other hand, Population and REER are statistically insignificant for trade growth. However, domestic investment growth, FDI growth and GDP growth have trade led growth in India. The effect of FDI leads to Trade growth (Borensztein, Gregorio, and Lee; Balasubramanyam, Salisu, and Sapsford; Shiva Makki 2004). Both have interrelationship among FDI, trade and economic growth. The "new" growth theories, suggest that a country's openness to the world economy helps in improving domestic technology and hence productivity rises (e.g., Barro & Sala-i-Martina, 1995; Grossman and Helpman, 1991; Romar 1992; Jang C. Jin, 2006). R^2 value of the Indian model fit the result, and Adj., R^2 value is 0.86829.

Regression results of China show that while GDP, Population, and REER are positive, other variables, Investment and FDI, are not positive. In China GDP growth rate was rapid from the beginning of reforms. This result is positive openness of trade. Also, export-GDP ratio is very much high compared with import growth. Previous literature concluded that GDP-trade growth leads to economic growth. GDP growth is influenced by trade growth at 1 per cent statistical significant level. Population growth is also an increasing sign of economic growth. Hence, population growth influences trade growth at negative statistically significance at 5 percent level. REER is gradually decelerating in China which is favorable for trade growth. In addition, investment growth and FDI have statistical insignificance with trade growth. Consequently, population growth, GDP growth and Real exchange growth rate causes trade growth in China. R^2 value of the Indian model fit for result and Adj. R^2 value is 9.909789.

Figure 5b.4: India Results: emphases the performance of Indian macroeconomics variables from 1980-2010. It is explains the fluctuating trend lines in different variables and trends over all the periods. It has employed all the studied variables on FDI and its changing policy structure in the any economy. In India, GDP trend has been accelerated - especial after transition reforms. According to the World Bank report, from mid-2000 onwards, growth rates has rapidly moving up. During 2008-2009, due to the financial recession the on growth rate as well as trade growth reduced. Real effective exchange rate was very much high before transition reforms periods and after trade reforms exchange rate was gradually decreased due to devaluation of the rupee and exchange rate. Later on, devaluation of rupee led to increasing the growth rate. Openness of trade: it (export-import) trend fluctuated before transition but after financial reforms in 1990s and trade

policies, changed the overall trend it result shows imports are higher than exports in India. Indian export growth also has been gradually growing after the openness of trade. In the matter of export IT and service sectors are booming after 2000. Indian main exports such as: Gems and jewelry constitute the single largest export item, accounting for 16 percent of exports. India is also the leading exporter of textile goods, engineering goods, chemicals, leather manufactures and services. Population growth: India with a population of 1.22 billion (2012) it is the second most populous country in the world. With more than 50% population below the age of 25 and about 65% below 35, the average age of an Indian after 10 years is likely to be 29 years. However, some of the reasons for India's rapidly growing population are poverty, illiteracy, and high fertility rate, rapid decline in death rates or mortality rates. Investment growth: India's domestic investment growths have been fluctuating from 1980 till 2000. After mid-2000, effect of growth has changed in investment. Levine and Renelt (1992) suggest that openness and growth relations occur through changes in investment, and increasing openness may stimulate FDI from abroad. Foreign Direct Investment, trends levels show the factors that influence the openness of trade in India. FDI inflows were sluggish before transition reforms thereafter FDI inflows started steadily swelling by the effects of the macroeconomic indicators. Thus, it has led to encourage economic growth rate in India. FDI inflows in 79.16 millions USD 1980 and it has grown up to 24639.9 million USD in 2010. During 2000, the FDI inflows amounted to 3587.99 million USD due to which the economic growth rate tremendously increased. Thus, trends levels show the factors that influence the FDI inflows in India.

Figure 5b.5: China Results: explain that trade growth has a positive interaction with GDP. Even recent literature reveals that FDI and GDP share a positive relationship in host countries. China's growth has gradually increased since the reforms and is the fastest among the Asian countries. During 1980- 2010, its overall average growth rate was 10 per annum. Because of openness of trade, China has become the second largest trading nation in the world. Effective real exchange rate, since the beginning of transition the exchange rate has shown a downward trend – favourable for FDI inflows. In the begging, its rate was 319.482 in 1980. With depreciating exchange rate it can export more easily and gain from resources seeking FDI. Therefore, the impart of exchange rate depreciation on FDI inflow is ambiguous. In other words, exchange rate depreciation may cause a rise in interest rate. After 1990s, several reforms took place it leads to effect sharply down in 117.268. Therefore, both the interest rate and exchange rate might be affecting each other

(Pradyumna Dash). Openness of trade trend level has been growing because export revenue has been high after the WTO accession in 2001. In China, export trend is higher than import, it means that exports have led the trade growth. After transition, technology, knowledge transfer has also helped to transform the economy through exports and imports and promote economic growth by attracting investments (Frankel & Romer, 1999; Frankel, Romer & Cyrus, 1996; Grossman & Helpman, 1997; Fank S.T. Hsiao *et. al.*, 2006). Thus, the macroeconomic variables are playing a vital role in openness of trade in China. Population growth: China is on the top over (1.35 billion) playing the world's most populous nation. China's population rate has been continuously growing. The implementation of the one child policy growth was in early 1980s. Improvement in the health care pulled the death data down while birth rate continues to soar; the classic "population explosion" phase. China population was 996.1 million in 1980 and 1,334.7 millions in 2009. Investment growth: China having a strong domestic investment climate because then country's rural economy well developed by the TVEs. For the development of an economy, initial conditions also play a significant. Its growth rate was 52.412 in 1980 and 48.166 in 2010. Also, FDI inflows have been increasing the investments. These combined with an exceptionally high level of domestic investment, have propelled the economic growth at a furious pace. China's growth has been more export-led. So, investment growth leads to growth in trade. Foreign Direct Investment: in China after reforms, FDI inflows have slowly increased. SEZs were established to accelerate the inflow of foreign investments in China. China's FDI inflow was 57 million USD in 1980 and has grown up to 105735 million USD in 2010. After full-fledged of reforms in 1990s, FDI inflows have been an accelerated growth 3,487.1 millions USD. In 2000 after, accession to WTO, FDI inflows increased tremendously to reach 46878.59 million USD in 2010.

Figure 5b.4: Performance of India's Macroeconomic Indicators from 1980-2010

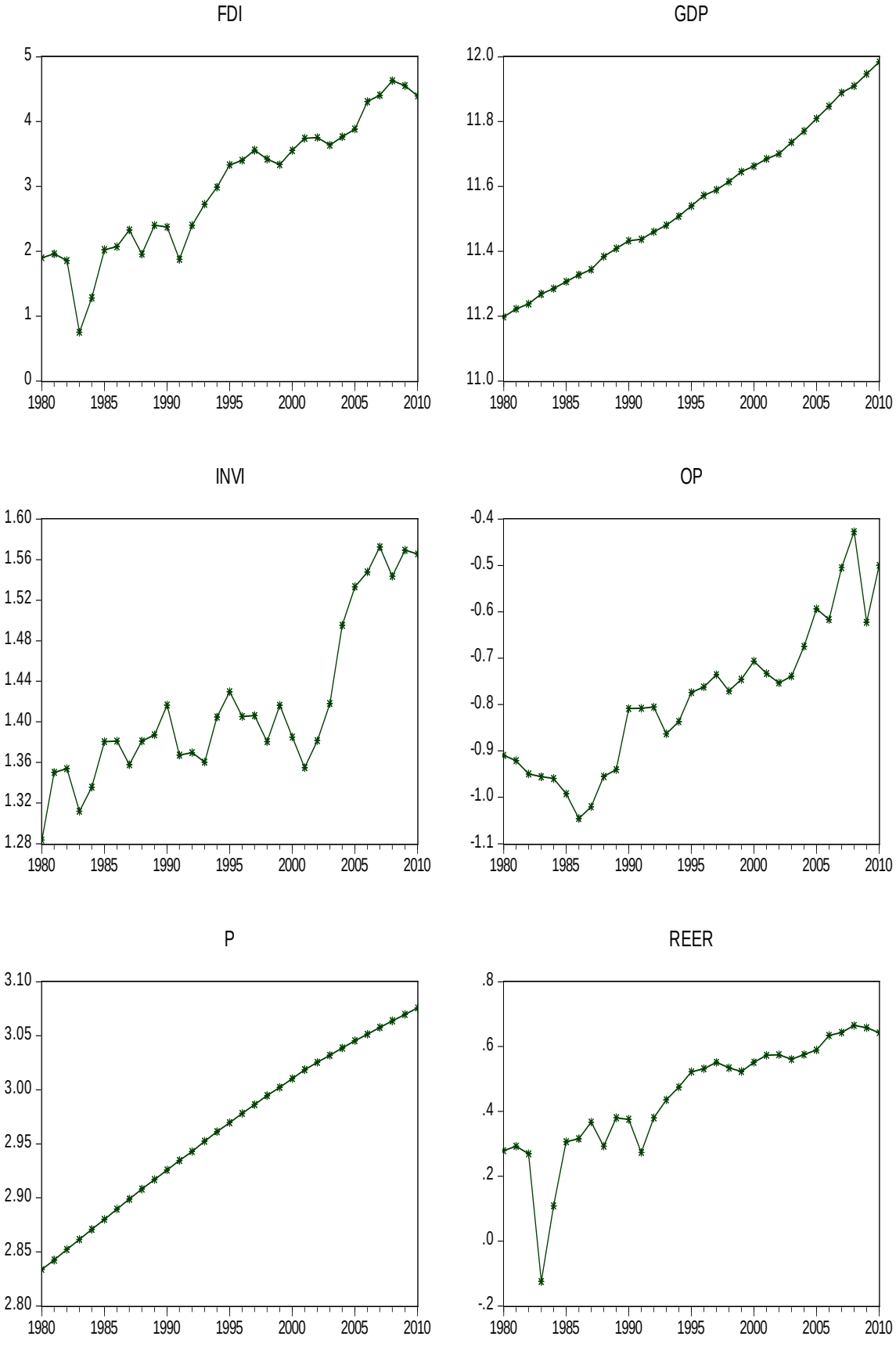
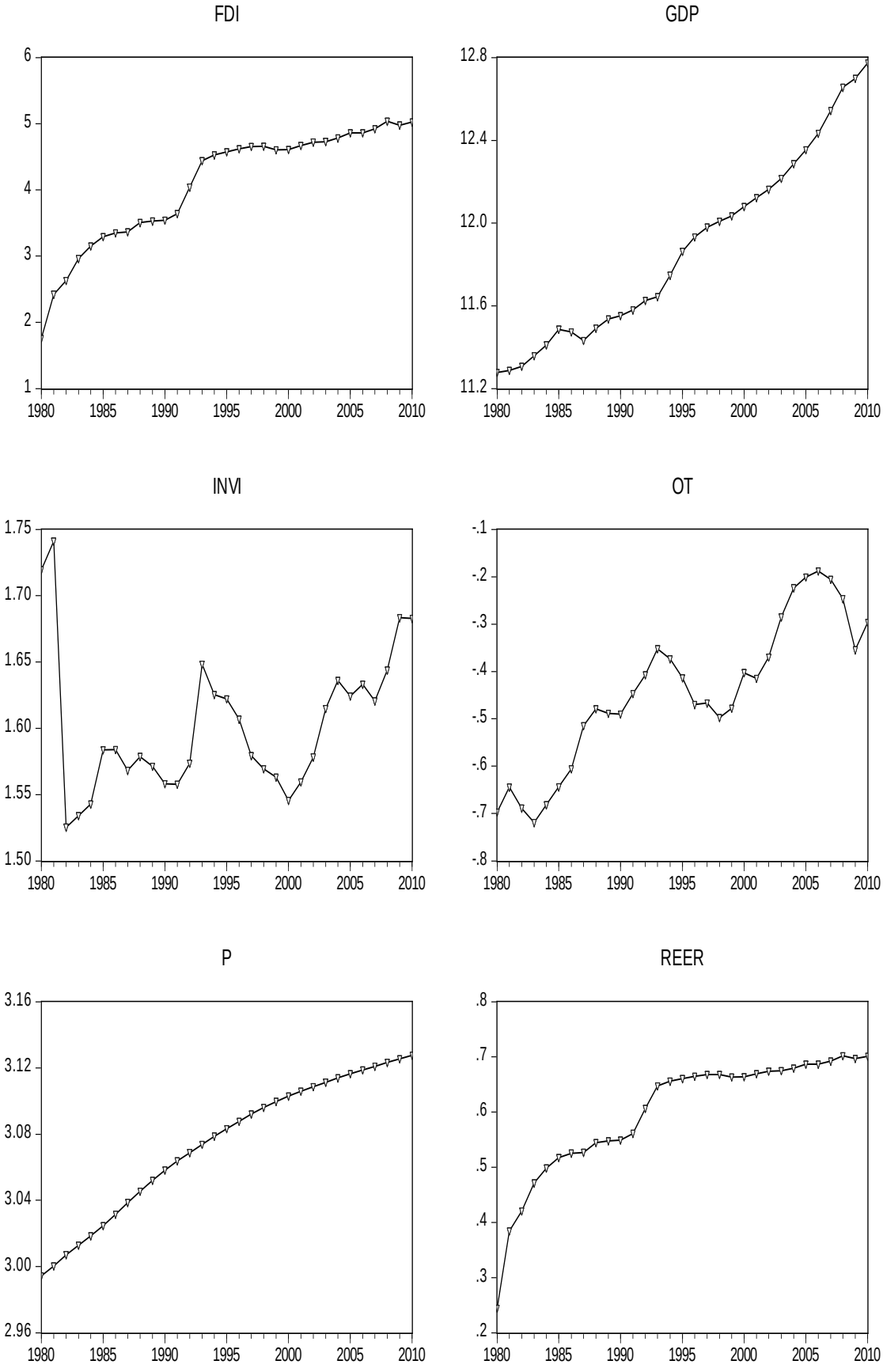


Figure 5b.5: Performance of China's Macroeconomic Indicators from 1980-2010



Comparison of the both models:

During the past 30 years, China's economy has changed from a centrally planned system that was largely closed to international trade to a more market-oriented one that has a rapidly growing private sector. Exports growth has been a major determinant in the China's rapid economic growth. In case of India, after reforms market-oriented policies had taken place for ensuring sustainable economic growth. However, full-fledged of economic reforms were began after 1990s in both countries. Also, innovative trade policies were introduced in both countries. From mid-2000 onwards the growth rates have been rapidly accelerating in both countries among the various transition economies. It can be concluded that a positive relationship exists between openness of trade and GDP growth in both countries.

5.2.5. Conclusion

Both countries share a common legacy of foreign influence or domination. Thereafter, Communism took roots in China and democratic socialism in India. In both countries the effect of openness of trade has led to economic growth. Openness of trade is an important subject in the economics discipline. Both countries have introduced market-oriented reforms for ensuring sustainable economic development. The main objective is to effect openness of trade on GDP growth in transition economies. Numerous studied made on these openness of trade have all concluded that the result is robust.

Recently, economists have again become interested in comparing the economies of the two developing economies largely due to theirs spectacular growth performance in the 1980s and 1990s and subsequently there has been rising significance for the world economy and political affairs. Recent year good performance shows "India had the fastest export growth among the major traders in 2011, with shipments rising 16.1 per cent. Meanwhile, China had the second-fastest export growth of any major economy at 9.3 per cent" (World Trade Report 2012).

Indian, regression results, explains domestic investment growth, FDI growth and GDP growth cause trade growth in India. In the case of China, population growth, GDP growth and Real exchange growth rate have triggered trade growth in that country.

APPENDEX- 5b -I

Table 5b.5: Measures of Trade Openness

S.No.	Measure	Definition
1	Mi/GDP_i	Import trade intensity; measured as: imports (M) divided by countrs *i*'s nominal; income (GDP)
2	Xi/GDP_i	Export trade intensity; measured as: exports (X) divided by country *i*'s GDP
3	$(X+M)_i$ /GDP	Trade intensity (TI); measured as exports and imports divided by country *i*'s GDP
4	$(X+M)_i/2(GDP+M)_i$	Adjusted trade intensity; where the denominator is modified to handle outliers such as Singapore and Hong Kong where there is high import for re-export, originally suggested by Andersen (1994)
5	$1-[(X+M)_i/GDP_i]x$ 100	Adjusted trade intensity; and alternative method for handling outliers, originally suggested by Frankel (2000)
6	$M/GDP_i-(1-GDP_i/\sum_{i=1}^{k} GDP_i)$	Adjusted trade intensity; a modification to the Frankel (2000) approach, suggested by Li *et. al.*, (2004)
7	$(X+M)/_r GDP_i$	Real trade intensity; where the denominator is purchasing power parity adjusted GDP (real GDP) flowing Alcala and Ciccone (2004)

Sources: Jay Squalli and Kenneth Wilson, 2006.

Table 5b.6: Key Trade and investment Policies During the Reform Ear	
China	**India**
Attracting Export-oriented FDI: - Passage of the export processing law (1978) - Adoption of a dualistic trade regime that promoted exports via FDI (Mid-1980s). - Easing of regulations on the entry and operation of foreign enterprises (Through the Sino-Foreign Equity Joint Venture Law of 1979, Sino-Foreign Cooperative Joint Venture Law of 1986, and the Wholly Foreign-Owned Enterprise Law of 1988). - /creation of Special Economic Zones (SEZs) (1980s). - Introduction of tax incentives and Facilitation of financing to channel	-Gradual liberalisation of restrictions on Foreign ownership through a system of automatic clearance of FDI proposals and the opening up of new sectors to foreign ownership (e.g, mining, software, banking, telecommunications) (1991 onwards). - Formal FDI Policy adopted (1996). -100% foreign ownership permitted in most manufacturing sectors (last -1990s). Passage of a Special Economic Zones Act to Promote exports more systematically with incentives (2005).

FDI towards SEZs. - Liberalisation of labour regulations in SEZs ensuring relatively low wages and ample supply of skilled workers. - Formalisation of a duty drawback system to ensure duty-free access to materials used in export processing (1987 onwards).	
Import Liberalisation: -Passage of a customs regulation to rationalize tariff schedules (1985). Liberalisation of the system of export licensing and quotas (from covering 2/3 of exports in 1991 to only 8% in 1999). -Tariff reductions implemented following the adoption of a socialist market (1992 onwards). Further reforms to import control regime implemented as part of WTO accession (2001).	Introduction of a package of trade and investment reforms (1991). - Abolition of import licensing on machinery and raw materials (1991). - Establishment of India, as a signatory to the General Agreement on Tariffs and Trade (GATT), as founding member of the WTO (January 1, 1995). - Abolition of licensing on consumer goods (2001).
Exchange rate management: Devaluation of domestic currency and movement to currency convertibility of account transactions (1997). Adoption of a managed floating exchange rate (mid-2005 onwards)	- Unification of the dual exchange rate system and commencement of current account convertibility (1994). - Maintenance of a depreciated exchange rate (2000 onwards).
FTA strategies: - Accession to its first FDI, the Asia Pacific Trade Agreement (2001). - Signing of the ASEAN-China FTA (2005). - Establishment of 11 FTAs, including bilateral agreements with Thailand, Hong Kong, Macao, Chile, New Zealand, Pakistan, Singapore, Peru, and Taipei (as of June 2011).	-Signing of its first FTA, the Asia Pacific Trade Agreement (1976) -Signing of the South Asian FD=TA (2006). -Establishment of 11 FTAs, including bilateral agreements with Sri Lanka, Nepal, Afghanistan, Singapore, Bhutan, Chile, South Korea, and a plurilateral agreement with Latin American countries (as of June 2011).

Source: Ganeshan Wignaraja (2011).

CHAPTER - VI

SUMMARY AND CONCLUSION

Transition Economics is a dynamic historical process that imposes change on almost every element of society (IMF, 1999). Since 1989, Central Eastern European (CEE) economies had been undergoing the transition from central planning to free market economy and capitalism (Haslach, 1992). The main intent for such an economy is to become market-oriented and more industrialised. During the transition in EU, FDI, as a substitute for trade, was an extremely essential part of the marketisation process, because it facilitated quick absorption and implementation of goods and services to fill the gaps in the transition economy. Similarly, in China and India, economic indicators such as FDI and Trade have been transforming the economic scenario. Though the FDI cycles theory explains the development and its applicability, in the case of the CEES countries the role of FDI particularly significant in trade sector (Richard, 2008).

Europe's trade with India and China began during the time of Dutch Merchant and still continuing at a healthy pace. In fact, European countries were more fascinated with Asian cultures and aesthetics and remain the main trade partners of China and India. Since 1989, Central and Eastern European Countries including Poland, Hungary and Slovakia, have significant progressed in the process of transition. These countries joined the OECD before transition phase stated.

In the 21st century, both countries experience accelerated economic growth, which would make both of them major players in the global economic. In recent years economic development of both countries has been due to the diversified decisions taken by policy makers. This economic transformation has become an interesting subject for study by scholars, especially economists. The World's two populous superpowers have long been fascinated the West, but till recently they were small players in the international economic scenario. Before 1980s, both the countries' growth rates were relatively sluggish. But, since the 1990s, the world has witnessed rapid economic transformation and growth because of market–oriented and long-term, reform which led's to on improved living standards of the people worldwide. In 1970s, the per capita GDP of both China and India's was a similar level but the gap between the two has continued to widen. China's growth has been much faster much than that of India. However, the virtue of sheer size,

the potential to be dominant players in the international economy exists. The competition between the two Asian giants' ancient civilisations, and also the great economic race in the early 21st century is something that the Indian public watches with excitement and pride.

6.2. Importance of Study

Let's now focus attention on comparison of both transition economies. India's economic reforms commenced 1991 in the aftermath of the foreign exchange crisis and under pressure from the IMF/World Bank. On the other hand, China's economy opened up under *No foreign Pressure.* It was a planned shift to market socialism for safeguarding its national interests. Moreover, with the integration of both countries, their companies are able to move up the value chain in their next stage of development. However, the approaches of both countries have been quite different. China was able to successfully achieve its ends on the basis of initial reform processes with a careful evolution and remove the obstacles 'step by step' to ensure a sustainable economic growth. As a result of transition, macro-economic policies are healthy in both countries. The "fordist model of growth" reveals how the growth occurred through vicious circles in both economies. China's successful strategy in the past twenty years had been due to its ability to transfer its labour surplus from the agricultural to the manufacturing sector - from low-efficiency sectors to highly efficient sectors; while in India, the process of transferring cheap labour from low-value agriculture to higher-value manufacturing industry had been slow due to weak industrial growth and unfavourable labour laws. Both countries are facing almost similar challenges like social and environmental degradation and the upheavals caused by urbanisation and industrialisation. In addition, this study has conducted an empirical evaluation of structural changes in the three sectors and also growth and Inflation. As a result, in both countries after transition reforms, the role of the primary sector has been decreasing, and that of the secondary and tertiary sector's has tremendously increased through gradual and phased reforms. It has explained that both countries' components have a negative correlation. Of course both countries have different areas of specialisation. China's major thrust is on its industrial sector, while in India, the major focus area in recent times has been the service sector. Both these sectors are, today, contributing more than half towards ensuring sustainable economic growth in the transition economic phase.

How important determinant factors are the FDI inflows into both countries? Foreign Direct Investment (FDI) is an internal part of an openness of effective international economic system and a major catalyst to development (OCED, 2002). Transitional economy involves structural or policy reforms such as currency or capital market changes. The investment is also a major issue for an emerging economy. In most cases, mobilising foreign investment is a sign that the economy has potential. China has far the greatest FDI potential among the BRICs, on account of its economic size and rapid economic growth. In addition, China has shown a phenomenal growth rate and the other transition countries, including India, are now trying to catch up with it but still lagging far behind. India can learn lessons from China and create a similar congenial business climate in the country. In China and India, macro-economic variables also have a crucial role to play in attracting large foreign investments. Empirical results reveal that in China, GDP and exchange rates are favourable for potential investors; while in India, GDP and exchange rates and Openness of trade are major influences to attract FDI inflows. In India, FDI inflows depend on the previous year's FDI performance, while in China, these depend on the current year's FDI performance. However, in fact, India has created economical freedom to facilitate increased private sector and Trans National Corporation (TNC) participation, introduced openness of trade to be become more global in its outlook, and formulated flexible labour laws in its quest to become a major player in the global economy.

Both countries share a common legacy of foreign influence or domination. Thereafter, Communism took roots in China and democratic socialism in India. In both countries, openness of trade and market-oriented reform has triggered faster and more sustainable economic growth. Openness of trade is an important subject of discussion in the field of economics. The main objective is to study the effect of the openness of trade on GDP growth in transition economies. Numerous studies made in this area have all concluded that the result is robust.

Recently, economists have again become interested in comparing the economies of the two developing economies largely due to theirs spectacular growth performance in the 1980s and 1990s and subsequently, there has been rising significance for the world economy and political affairs. The good performance in recent years shows that "India had the fastest export growth among the major traders in 2011, with shipments rising 16.1 per cent. Meanwhile, China had the second-fastest export growth of any major economy -

at 9.3 per cent" (World Trade Report, 2012). Regression results explain that domestic investment, Foreign Direct Investment and GDP growths cause trade growth in India. In the case of China, population growth, Gross Domestic Product and Real exchange rate have triggered trade growth in that country.

The Central Eastern European countries experienced a transitional recession in the early 1990s and also a phenomenal one time increase in inflation rates. Therefore, we can infer that the foreign aid, and development assistance are most necessary for poverty reduction and bring about a more sustainable economic development. In addition, the secret of successful economic growth is to adopt economic integration introduce economic reforms at the local, national and regional levels

It can be seen that the story of the successes and failure of transition is not really the story of steady shock therapy and unsteady gradualism. The major plan of the post-socialist transformation 'novel' is the preservation of strong institutions in some countries and the collapse of these institutions in the other countries. Thus, the story of the successes and failure of transition depended on government failure (like strength of state institutions), not about the market failure (liberalisation).

Lessons from European countries

(i) Government regional policies must aim at supporting industrial restructuring, entrepreneurship, innovation and competitiveness;
(ii) The market policies should aim at elimination of barriers, adoption of transparent standards, and better regulation of markets, so as to provide better access to cross countries.
(iii) Policies should support the private players, social partners, the voluntary sector, research community and opinion makers, etc,. including exploring the role of Public-Private-Partnerships;
(iv) Policies would be provide to regional and local governments, local communities and stakeholders;
(v) Policies regarding transferring responsibilities from national governments to the community level need to be put in place.

It can be seen that China's overall performance has been extraordinary, even though the transition process in both countries is not complete yet. Still, in China several

reforms and other policies are lagging behind in the economics system due to internal inconsistencies.

The hypothesis assumption has concluded that both countries' has experienced rapid economic growth rates due to their adopting transition economic policies and that other transition countries are also progressing effectively in the global economic scenario. Therefore, the hypothesis can be accepted. Both countries can learn lessons from each other. In the 21st century, both China and India have been playing a significant role towards bringing about market-orientation in the world economy.

6.3. Suggestions for further Research

This study has laid emphasis on comparison of China and India's transition economies. The researcher has especially focused on FDI and trade in the transition perspective. There is need for studying the performance of other emerging countries, in terms of resources necessary for ensuring sustainable development, FDI inflows necessary for that and facilitative trade policies to bridge the gap at the national and international levels.

- Both countries reforms started different over the period of time. Even India, economic reforms initiate has taken place in 1980s. Here, certain data may not fully match that of China, because here the process began in 1978. Therefore, the researcher has considered the same periods in his study. Further scope exists for analysing the scenario after full-fledged reforms in both countries.
- Basically, this study is on macro-economic indicators. The researcher has focused on a macro-level study only. There is certainly scope for a detailed sectoral level analysis on this subject.
- The aim of a transition economy is to achieve economic stabilisation. The researcher has, therefore, I have examined the monetary and, fiscal variables. However, in addition to endogenous factors, exogenous factors can also help in stabilisation of the economy. Hence, there is need for a focused research on external and internal factors.

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APPENDIX - I

Table- 1: GDP and Inflation of India & China, from 1978 to 2009

Years	GDP growth (annual %)	Inflation Consumer Price (annual %)	GDP growth (annual %)	Inflation, Consumer Price (annual %)
	India		**China**	
1978	5.71	2.5	11.7	**0.7**
1979	**-5.24**	6.3	7.6	5.8
1980	6.74	**11.4**	7.8	6
1981	6	**13.1**	5.2	2.4
1982	3.47	7.9	**9.1**	1.9
1983	7.3	**11.9**	**10.9**	1.5
1984	3.82	8.3	**15.2**	2.8
1985	5.23	5.6	13.5	**9.3**
1986	4.77	8.7	8.8	6.5
1987	3.96	8.8	11.6	7.2
1988	9.64	9.9	11.3	**18.7**
1989	5.95	6.2	4.1	**18.3**
1990	5.53	9.0	**3.8**	3.1
1991	**1.06**	**13.9**	9.2	3.5
1992	5.48	**11.8**	14.2	6.3
1993	4.77	6.4	14	**14.6**
1994	6.65	**10.2**	13.1	**24.2**
1995	7.57	**10.2**	10.9	**16.9**
1996	7.56	9.0	10	8.3
1997	4.05	7.2	9.3	2.8
1998	6.19	**13.2**	**7.8**	**-0.8**
1999	7.39	4.7	**7.6**	**-1.4**
2000	**4.03**	**4.0**	8.4	0.3
2001	5.22	3.7	8.3	0.7
2002	**3.77**	4.4	9.1	**-0.8**
2003	**8.37**	3.8	10	1.2
2004	8.28	3.8	10	3.9
2005	9.35	4.2	10.4	1.8
2006	9.67	5.8	**11.6**	1.5
2007	9.06	6.4	13	4.8
2008	7.09	8.4	9	5.9
2009	7.7	**10.9**	9.1	**-0.7**

Sources: International Monetary Fund, 2010.

Table 2: Structural Changes in three sectors in India and China From 1981-2010

	In.Ser	Ind. Indu	Ind.Ag	Chin.Ser	Chi.Indu	Ind.Ag
1981	40.07	25.56	34.37	22.01	46.11	31.88
1982	41.21	25.62	33.17	21.85	44.76	33.39
1983	40.50	25.66	33.84	22.44	44.38	33.18
1984	41.51	26.00	32.49	24.78	43.09	32.13
1985	42.73	26.10	31.17	28.67	42.89	28.44
1986	43.71	26.28	30.00	29.14	43.72	27.14
1987	44.25	26.31	29.44	29.64	43.55	26.81
1988	43.35	26.18	30.47	30.51	43.79	25.70
1989	43.84	26.94	29.23	32.06	42.83	25.10
1990	43.84	26.88	29.28	31.54	41.34	27.12
	1%	**1%**	**-2%**	**4%**	**-1%**	**-2%**
1991	44.59	25.76	29.65	33.69	41.79	24.53
1992	44.88	26.13	28.99	34.76	43.45	21.79
1993	45.20	25.87	28.93	33.72	46.57	19.71
1994	44.68	26.80	28.52	33.57	46.57	19.86
1995	45.68	27.83	26.49	32.86	47.18	19.96
1996	45.61	27.02	27.37	32.77	47.54	19.69
1997	47.11	26.78	26.12	34.17	47.54	18.29
1998	47.92	26.07	26.02	36.23	46.21	17.56
1999	49.69	25.31	24.99	37.77	45.76	16.47
2000	50.46	26.19	23.35	39.02	45.92	15.06
	1%	**0%**	**-3%**	**2%**	**1%**	**-5%**
2001	51.46	25.34	23.20	40.46	45.15	14.39
2002	52.66	26.46	20.87	41.47	44.79	13.74
2003	52.79	26.24	20.97	41.23	45.97	12.80
2004	53.05	27.93	19.03	40.38	46.23	13.39
2005	53.04	28.14	18.82	40.51	47.37	12.12
2006	52.86	28.85	18.29	40.94	47.95	11.11
2007	52.70	29.04	18.26	41.89	47.34	10.77
2008	54.20	28.22	17.59	41.82	47.45	10.73
2009	55.27	26.97	17.76	43.43	46.24	10.33
2010	55.36	28.43	16.21	45.89	44.58	9.53
	1%	**1%**	**-4%**	**1%**	**0%**	**-4%**

Source: WDI, Value added (% Growth),
Ser=Service sector, Indu=Industrial Sector, Agri= Agriculture sector

APPENDIX-II

1). India's Final Results: FDI

Dependent Variable: LOG(FDI)
Method: Least Squares
Date: 05/20/12 Time: 19:31
Sample: 1978 2010
Included observations: 33

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-36.90526	14.07645	-2.621773	0.0142
LOG(GDP)	2.183003	0.485837	4.493287	0.0001
LOG(EXCHRATE)	-2.522663	0.633185	-3.984086	0.0005
LOG(OPENTRADE)	1.100654	0.911617	1.207365	0.2378
INFLATION	-0.068515	0.041249	-1.661024	0.1083
INT	-0.020068	0.057326	-0.350059	0.7290

R-squared	0.931971	Mean dependent var	6.664061
Adjusted R-squared	0.919374	S.D. dependent var	2.459669
S.E. of regression	0.698418	Akaike info criterion	2.282968
Sum squared resid	13.17027	Schwarz criterion	2.555060
Log likelihood	-31.66897	Hannan-Quinn criter.	2.374519
F-statistic	73.97843	Durbin-Watson stat	1.167091
Prob(F-statistic)	0.000000		

2). China's final model results: FDI

Dependent Variable: LOG(FDI)
Method: Least Squares
Date: 05/20/12 Time: 19:32
Sample: 1978 2010
Included observations: 33

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.116948	16.75915	0.066647	0.9474
LOG(GDP)	1.022142	0.553299	1.847361	0.0757
LOG(EXCHRATE)	-4.079440	1.303368	-3.129923	0.0042
LOG(OPENTRADE)	0.351535	2.022518	0.173811	0.8633
INFLATION	0.028733	0.070273	0.408879	0.6859
INT	0.106658	0.123206	0.865684	0.3943

R-squared	0.805184	Mean dependent var	8.876079
Adjusted R-squared	0.769107	S.D. dependent var	2.979606
S.E. of regression	1.431739	Akaike info criterion	3.718622
Sum squared resid	55.34665	Schwarz criterion	3.990714
Log likelihood	-55.35726	Hannan-Quinn criter.	3.810173
F-statistic	22.31852	Durbin-Watson stat	1.867923
Prob(F-statistic)	0.000000		

1). Result of India Trade:

Dependent Variable: LOT
Method: Least Squares
Date: 07/02/12 Time: 11:00
Sample (adjusted): 1978 2010
Included observations: 31 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.271191	4.422653	-0.965753	0.3434
LGDP	0.488505	0.222579	2.194749	0.0377
LINV	0.498249	0.233435	2.134425	0.0428
LPOP	-1.483055	0.963889	-1.538617	0.1365
LEX	-0.506895	0.267745	-1.893202	0.0700
LFDI	0.061306	0.032145	1.907164	0.0681

R-squared	0.890247	Mean dependent var	-1.809524
Adjusted R-squared	0.868296	S.D. dependent var	0.378239
S.E. of regression	0.137267	Akaike info criterion	-0.961794
Sum squared resid	0.471055	Schwarz criterion	-0.684248
Log likelihood	20.90781	Hannan-Quinn criter.	-0.871321
F-statistic	40.55675	Durbin-Watson stat	0.778158
Prob(F-statistic)	0.000000		

2). Result of China Trade:

Dependent Variable: LOT
Method: Least Squares
Date: 07/02/12 Time: 11:02
Sample (adjusted): 1978 2008
Included observations: 31 after adjustments
HAC standard errors & covariance (Bartlett kernel, Newey-West fixed bandwidth = 4.0000)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	7.109854	9.461801	0.751427	0.4594
LGDP	0.912273	0.166579	5.476507	0.0000
LINV	0.160046	0.224234	0.713745	0.4820
LPOP	-4.089601	1.710412	-2.391004	0.0247
LEX	-1.002121	0.296859	-3.375751	0.0024
LFDI	-0.003169	0.010926	-0.290003	0.7742

R-squared	0.924832	Mean dependent var	-1.807715
Adjusted R-squared	0.909798	S.D. dependent var	0.375563
S.E. of regression	0.112795	Akaike info criterion	-1.354501
Sum squared resid	0.318069	Schwarz criterion	-1.076955
Log likelihood	26.99476	Hannan-Quinn criter.	-1.264028
F-statistic	61.51741	Durbin-Watson stat	1.403854
Probe(F-statistic)	0.000000		