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EPW Discussion

Dragon as Exemplar?

Beware Convenient Uses of China Model

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After more than a decade of what many experts consider Indian "underperformance" in attracting foreign direct investment (FDI), the last two years witnessed distinct increases in direct investment from abroad.[1] The questions for Indian policy formulation are, which FDI policy will best serve India's developmental goals? What lessons can be learned from China that will contribute to equitable, employment-generating, productivity-improving growth? Are there ways of doing this that do not additionally burden the already-strained social and physical infrastructure of India's urban areas?

In this context, it is helpful for D N Ghosh to draw attention to lessons India may glean from China's FDI experience ('FDI and Reform: Significance and Relevance of Chinese Experience', EPW, December 17, 2005). Ghosh relies almost exclusively on the 2003 book, *Selling China: Foreign Direct Investment during the Reform Era* by China-born political scientist and MIT business school professor, Huang Yasheng. Huang studied China's FDI-dependent experience from what he calls the "demand-side perspective" focusing on the seeming puzzle of China's historically high FDI inflows in the 1980s and 1990s.[2] Ghosh, however, misses the central thesis of Huang's work. As a result, the lessons he posits for India may be misguided. The following analysis draws attention to important elements of the Chinese case that Ghosh has overlooked.

Above all one must take explicit cognisance of the different political systems. Despite what Ghosh claims, a few clauses in China's 1982 constitution did not make a secure business environment. Multi-party democracy, for example, has been part of numerous Chinese constitutions without ever becoming a reality.

Each political system has its costs and benefits. There are developmental advantages to China's blend of single-party authoritarian politics and state-socialist economics. Chief among these advantages are its long-term institutional consistency and its efficacy in policy implementation. But, there are costs too, and these, as I sketch out below, are visible in the institutional structure and economic consequences of China's FDI experience. Similarly, there are developmental costs to India's blend of democratic federal politics and mixed economics. Costly populism, phobia of exposure to the world economy, and poor policy implementation are at the top of most experts' list of such costs. But the core economic problem in China also has a political source: the fear of the Chinese Communist Party (CCP) that an independent entrepreneurial class might challenge the regime has produced perverse institutional contrivances to limit or co-opt that class. The Indian state and its agents do not fear an independent entrepreneurial class. While the Indian state has generally been apathetic, and occasionally even hostile to private business, there has always been political and economic space for an entrepreneurial class. Specific implications of this general conclusion become apparent in a critical analysis of Ghosh's discussion of Chinese FDI policy.

First, consider the politics and perverse outcomes of the Chinese FDI policy. Looking at the downside of Chinese policy, Ghosh incorrectly characterises Chinese FDI policy as non-nationalist and friendly to private domestic entrepreneurs. He also ignores the grave harm to the enterprise and finance systems that resulted from excessive Chinese dependence on FDI. Next, on the upside: Ghosh does not adequately emphasise the importance of negotiating FDI from a position of external macroeconomic strength, or the value of expatriate investment in small- or medium-sized industry.

Chinese FDI: Too Much of a Good Thing?

In Selling China Huang concluded that FDI was "overabundant" in China.[3] He takes as given, a discriminatory politically-sanctioned hierarchy among Chinese domestic enterprises. According to Huang, ill-advised institutional design and misguided incentives resulted in economic and policy "imperfections", creating a "political pecking order" of firms.[4] State-owned enterprises (SOEs) and foreign invested enterprises (FIEs) enjoyed favourable political attention at the expense of private local firms without foreign investment. This institutional design, and the special incentives that accompanied it, favoured FIEs through advantageous tax treatment, convenience in licensing, retained earnings dispensations, and export assistance. From this Huang concluded that China's "large absorption of FDI is a sign of some substantial weaknesses in the Chinese economy".[5]

In his selective use of evidence and themes from *Selling China*, Ghosh ignores Huang's central thesis: That China's FDI policy over the last quarter century retarded and perverted the development of dynamic private enterprise in China. In a 2003 article in the journal *Foreign Policy*, Huang and co-author Tarun Khanna extended the Selling China thesis to a direct China-India comparison. They suggested that the reason why Indian firms are today on the whole performing better than their counterparts behind the Great Wall is that the institutions of China's FDI-centred growth strategy discouraged merit-based domestic investment in potentially dynamic private Chinese firms.[6] Should India really follow such a model?

Political Expediency First

Ghosh is right that FDI was a "preferred instrument of change" for Chinese policy-makers. However, he does not sufficiently emphasise the political advantages that rendered the institutional structure of FDI-intensive development preferable. That this institutional ensemble was politically useful to the CCP is attested to by its durability over the last quarter century.

Ghosh's valorisation of Chinese FDI policy, particularly his argument that Chinese officials were unconcerned about foreign infringement of sovereignty, belies the nationalist purpose and political considerations that drove its fashioning. Ghosh seems particularly keen to portray Chinese FDI policy as clear-eyed, non-nationalistic, realist economic reasoning. He does so, it seems, to cast Indians who are cautious or sceptical of a highly liberal FDI policy in a poor light. It is hard to square the picture Ghosh paints of China's FDI policy as an enlightened "plan-rational" means of optimising economic growth with an adequately political account of Chinese FDI policy.[7]

Government relations with "business interests" in China are, along with religion and the management of laid-off or retired workers, at the top of the sensitive-issues list for Beijing's rulers.[8] Ghosh's claim that China's FDI policy served to "revive…a dormant indigenous entrepreneurial class" is problematic. Huang makes clear in his book that FDI policy and the "political pecking order of firms" which it produced served powerfully to retard the development of domestic private industry. Neither Huang nor Ghosh point out that this was the favourable political outcome the CCP intended to achieve via what was a successful economic development policy in

the short term. Ghosh downplays the Chinese elite's concern for preventing the growth of an independent, business-oriented domestic entrepreneurial class.

Independent business interests might contest the elite's power to calibrate the country's prevailing state-socialist structure of property rights and, ultimately, rival the party elite's control of the economy. It was the "corporatism" and commercialisation of local state institutions – not an "entrepreneurial class" – that caused foreign-invested business to flourish among the townships and village enterprises and that were crucial to China's recent industrial-commercial growth.[9]

Let us turn now to the clear-eyed non-nationalist acceptance of foreign investors that Ghosh alleges is characteristic of China's stance on FDI. He makes the dubious claim that the fashioning of China's FDI policy was, and continues to be, "pursued without any obsessive hangover (sic) about foreign domination or a nagging fear that their country's national interest or sovereignty is being compromised."[10] Puzzling too is his claim that, "(t)hroughout the 1980s, continuing till the middle of the 1990s, foreign investors were freely allowed to play the role of venture capitalists in a big way." Nothing could be further from the truth.

It is rare for Chinese bureaucrats or politicians to use openly nationalist rhetoric in documents or public explanations related to economic policy.[11] Nevertheless, in trade, investment and foreign economic policy, nationalism is pervasive.[12] Ideologically, China's economic nationalism is more akin to the mercantilist nationalism of America's Alexander Hamilton, Germany's Friedrich List, or India's Rajagopalachari than it is to the contemporary Indian economic nationalism of Sitaram Yechury (CPI(M)) or S Gurumurthy (SJM). Epic battles within China's elite over FDI policy in the early reform period produced "modern treaty ports" – the special economic zones (SEZs) – along China's coast where "polluting" and "decadent" foreign trade activities were quarantined. Later, a subtle and complex array of mechanisms was established to restrain the Gulliver of foreign investment as it stalked into the Middle Kingdom.

It is easy to misunderstand the clever and seemingly-contradictory Chinese FDI policy. Yes, FIEs were offered special treatment as inducements. In particular, joint ventures (JVs) were encouraged with tax and other dispensations. Before Thomas Friedman coined the term, "golden straightjacket", the Chinese were enticing foreigners with incentive-laden access to their market while shrewdly keeping them constrained.[13] Yes, FIEs were favoured over domestic private enterprise, but, this does not mean they were free. Nor does it mean they faced no competition. State-owned domestic enterprise, particularly at the local and regional levels, was often aggressive. The "golden straitjacket" contradiction is central to understanding the Chinese FDI experience. One can start by looking at the numerous fetters the Chinese used to restrain the foreign investment Gulliver.[14] The JV model adopted in China made it easy to control FDI. It ensured that JV enterprise ownership was fragmented (sometimes even adversarial) in ways that politically weakened both foreign and domestic partners.

The freedoms Ghosh alleges foreign investors enjoyed in China were curtailed by a range of measures: The 1980s SEZs literally fenced in the physical and financial components of FDI. FIEs were eventually allowed to move inland from their coastal quarantine. However, high up-front, non-interest-bearing equity deposits and a host of regulations at the national, regional and enterprise levels replaced the earlier geographic restraints. Added to the mix was an abundance of informal protection for wholly-domestic Chinese competitors to FIEs. Some of these were so brazen they might make even the drafters of India's "Press Note 18" blush.[15] Finally, Ghosh's chief omission is his failure to emphasise the most important nationalist safeguard of them all: the product of all FDI investment was for export only.

What was the broad political economy context of this now controversial Chinese FDI regime? For over two decades the Chinese government has taken advantage of its citizens' world-topping savings rates to operate its banking system as a supplement to both its fiscal and welfare/social security systems. This produced an overhang of bad loans so large that by most accounting

standards much of the Chinese banking system was (and may still be) technically insolvent. This institutional 'leger de main' has cleverly disguised what would otherwise have been much higher government deficits. While the banking system was busy servicing this "socialist social contract" and helping keep large SOEs alive, FDI became the centrepiece of a new institutional ensemble that supported the industrial-commercial sector during the first two decades of China's post-Mao economic readjustment.

The FDI-intensive finance of China's export-led strategy was successful at doing two things: attracting or earning foreign exchange (thus avoiding India's bane – a precarious balance of payments position) and providing an alternative (non-state, yet also tame) source of finance for new firms. It did so without overly empowering or emboldening either the domestic or foreign partners in those firms. En route the policy created employment opportunities (particularly at the township and village levels), and generated growth (much of China's recent growth was investment-driven, not productivity-driven).

The so-called reform and openness ('gaige kaifang') of the FDI policy has, according to University of Michigan political scientist Mary Gallagher, "resulted in a strengthened Chinese state, a weakened civil society (especially labour), and a delay in political liberalisation."[16] China's FDI institutions achieved a marriage of long-term political expediency with medium-term growth that helps to explain China's favourable external macroeconomic position. The consequence, however, (like China's banking policy) may be economically harmful in the long run.

China: Leninist Capitalism

China finance guru and economist Nicholas Lardy, along with Huang and most other experts agree that today China has a tremendously vulnerable Achilles heel: its rickety and still highly-politicised finance system.[17] In conjunction with a state-socialist property rights regime, this system has stifled dynamism among the country's firms. Remember, according to Huang, the discriminatory "political pecking order" among firm types is the result of political favouritism.

To understand the full consequences of China's FDI regime we should follow Gallagher's lead and extend further the political logic behind it. Doing so reveals the system of Leninist capitalism that emerged in China at the end of the 1990s. Such an exercise also helps us understand how the politics of Indian financial reform, while tortuous, have yielded a more flexible and fertile environment for firms. Where Huang is satisfied with identifying perverse effects of the nexus between FDI and the "political pecking order" of firms, I argue that we must look beyond microeconomics and consider the consequences of the "success" of the Chinese FDI regime so admired by Ghosh. A good place to look for such consequences is the realm of securities finance (the allocation of corporate or public funding through stocks and bonds).

For elite officials in the Communist Party and its government in Beijing, China's success in attracting FDI was part of a package in which "all good things went together". As mentioned above, FDI itself attracted foreign exchange and funded new industrial-commercial enterprise. However, exports from foreign-invested firms brought in the bulk of foreign exchange, producing a favourable balance of payments. These inflows produced a growing stockpile of hard currency reserves, which authorities used to protect a low exchange rate based on pegging the Chinese yuan to the US dollar. (The low exchange rate amplified the export advantage of China's already-cheap goods.) At the margin, FIEs promoted growth and employment, particularly in rural and peri-urban areas. China's FDI-centred matrix of institutions based on political financing decisions produced abundant finance, trade and currency flows.

These flows did a lot of good for China's rulers and for the economy. They secured the external macroeconomic position of the country. They satisfied the finance needs of a favoured foreign-invested industrial-commercial sector. They produced economic growth to meet the rising

material expectations of citizens, and they helped to legitimise the regime. Above all, these flows were organised (the FIE "golden straitjacket") to minimise any challenge (foreign or domestic) to the political control of the single party state. This left the Chinese political elite at liberty to manipulate other parts of its financial system, particularly securities finance.

The system of securities finance made it possible for elite officials to allocate access to capital markets in a politically instrumental fashion. Initially, in the early 1990s, this took the form of political favours and competitive rivalries between the Shanghai and Shenzhen municipalities where most securities were listed, traded and regulated. These favours and rivalries disrupted the central elite's management of the economy and threatened its authority to define property rights (financial securities embody rights, after all). In response to such disruptive consequences, the centre relieved the "troublemaking" municipalities of their securities-related authority, shifting control to agencies directly under the state council.

In the mid-1990s, a new system coalesced. This happened as a result of premier Zhu Rongji doing two things: he asserted central control over securities and banking finance and he restructured the government into a more lean and responsive instrument of Leninist 'dirigisme'. With all securities-related authority centralised and all innovative spirit squeezed out of the system, securities finance became a primary tool for the discretionary allocation of access to funds. Premier Zhu used securities finance to pursue two primary objectives; restructuring SOEs and managing the dominant political coalition in the polity. Zhu used access to securities finance to reward or punish the powerful ministries, sectors and provinces who were the "partners" in China's "intramural coalition".[18] The wily premier also manipulated securities finance to provide life support to ailing SOEs, thereby helping the banking system to service (and delay the demise of) the "socialist social contract".

The result? A new system of Leninist capitalism. The nature of a country's securities finance regime says a lot about the variety of capitalism prevailing there. The CCP had successfully "hacked" the core institution of capitalism – securities finance – bending it to their political will. China's quarter century of reforms produced what economist and China-expert Barry Naughton has called "Potemkin stock markets".[19] This was the impressive façade of change and dysfunctional interior of atavistic dirigism. The securities finance regime in China today is merely the old wine of developmental-state directed-finance grandly presented in the new bottles of terminal-based nation-wide share trading.[20] In 2004 Chinese securities finance was where Indian securities finance was in 1964, when the state-promoted Unit Trust of India US-64 was established.

Securities finance in China does not provide a market for companies or a market for corporate control. The nominally high market capitalisation of China's two exchanges is inflated by two-thirds, since only one-third of the shares actually "float" or trade freely. The difficulty of accessing the market for initial offerings in China today is perhaps even worse than the challenges faced by Indian firms in the pre-reform days of the dreaded controller of capital issues. Much of this is a political consequence of the "success" of China's FDI-intensive model: it provided the macroeconomic strength and institutional structure upon which the party elite's recentralising and manipulation of the financial sector was built.

India: Advantage of Adversity

In 1991, as precious gold bullion was shipped from the Bombay docks to deal with the reform-provoking balance-of-payments crisis, India was a reverse-image of China. Its profile of exposure to the international economy, its export capacity, and (as Ghosh rightly points out) its trade and investment philosophy all were the opposite of China's. Just as many "good things went together" in the macroeconomic and institutional matrix surrounding China's FDI policy, many "bad things went together" in the Indian macroeconomic and institutional matrix that lacked FDI. This created a powerful set of incentives for India's economic policy "change team" assembled in 1991 by the

ruling Congress Party.[21] The mandarins (forgive the turn of phrase) in North Block explained to politicians that it would take too long to resolve India's chronically precarious balance of payments through a China-style FDI-intensive, export-led programme.

Instead of FDI, India would use foreign portfolio investment (FPI) to attract much-needed foreign exchange. Improvement in securities finance would have politically and economically useful second-order consequences. Firms would have a greater range of options for corporate finance. Securities finance would provide a useful temporary way to sidestep the obstreperous trade unions and hidebound managements of the country's then-lumbering banks. It would also put pressure on those banks to reform.

Many problems still plague India's regime of securities finance. But even the harshest critics of India's reform process concede that 1990s securities finance, driven in large measure by competition between the National Stock Exchange and Bombay Stock Exchange, was one of the most remarkable change stories of the decade. Today, Indian firms and their shares of stock are some of the most competitive and attractive in the developing world and beyond. Why? One important reason is that Indian businesses and regulators have operated for more than a decade with a securities finance system that (for all its failings) has steadily approached global best practices and, in the case of the takeover code, perhaps even set them itself. How do we know India's regime of securities finance is so good? Discount the recent long bull-run. It may be rigged and US interest rates have been low anyway. Ignore most of the foreign institutional investors' (FII) money. Much of it is Indian (on a roundtrip ticket) or expatriate Indian investment. Consider instead the behaviour of one of the largest, most risk-averse, socially progressive, and conscientious investors in the world today: The California Public Employees Retirement Scheme (CalPERS). This is not the "hot money" that gets India's Left policy intellectuals and politicians like Gurudas Dasgupta (CPI) so exercised. Not all FII are alike. CalPERS invests for a minimum of three years and normal investment durations are roughly a decade. For years now India has ranked high on CalPERS index of equities finance regulation among developing and transitional countries.[22]Two years ago the massive pension fund moved to invest US $ 100 million in Indian firms through Indian stock exchanges. Notably, CalPERS board withheld approval for such investments in China because, among other things, that country's regime of governance for securities finance ranks too low on many measures of corporate and trading standards.

In summary, it is important to recognise that there are developmental costs that offset the benefits of China's non-democratic politics. Similarly there are developmental benefits that offset the costs of an Indian democracy at once feisty and staid.

Other Lessons from China's FDI Regime

One would think the Foreign Investment Promotion Board, the Planning Commission, the finance ministry and other official and unofficial groups should consider with great care how India ought to devise its FDI policy. Not manoeuvring strategically vis-à-vis investors and domestic business to optimise the character and quality of FDI would be irresponsible. Toward this end, what lessons should be drawn from the China case?

In a 2003 comment on the newly revised Indian FDI/GDP ratio data, economist Raghbendra Jha (also inspired by Huang's Selling China) asked the counter-intuitive question posed by the China-India FDI comparison: "is more FDI always better?" His answer bears repeating. "It is more important" Jha wrote, "to ensure that quality FDI comes in".[23] But, what is quality FDI? Business school texts abound with cases that emphasise the importance of transfer of technology, managerial skills and positive forward and backward linkages in the domestic economy and in global supply chains that come with FDI.[24] These are bread-and-butter ambitions for any developing country's FDI policy. Are there more specific lessons India should draw from China in its focus on the quality of FDI it wishes to attract?

One of the most important aspects of the Chinese FDI and growth story more broadly has to do with a point Ghosh raises, but does not adequately emphasise, the role of small- and medium-sized enterprises. The flourishing of small industry in rural China's township and village enterprises (TVEs) was one undeniably positive consequence of China's FDI policy. The TVE boom provided employment and spread the benefits of industrial growth beyond core urban areas. Economist Pranab Bardhan has often noted – with pointed (if tacit) comparison to Indian small-scale industry policy – that the key to the success of China's TVE experience was a hard budget constraint. China's TVEs were often allowed to fail.[25]

Where did much of the TVE investment come from? Only once, in a whole paper dedicated to discussing the lessons of China's FDI experience (published less than one month in advance of the 2005 'Pravasi Bharatiya Divas') does Ghosh mention the role of overseas ethnic Chinese in China's FDI miracle. When wage costs for labour-intensive manufacturing around the Pacific Rim rose in the 1970s and 1980s, entrepreneurs of the ethnic Chinese diaspora relocated to mainland China. The Chinese government, particularly at the local level, welcomed expatriate investment. True, there was no explicit ethnic nationalist policy here, but there was a powerful informal bias based on Chinese heritage, native-place and dialect affinities. On the other hand, the Indian government has, until very recently, failed to draw on the entrepreneurial skill and capital of its expatriate and ethnic diaspora.[26]

China was not the sovereignty-be-damned, non-nationalistic policy of Ghosh's characterisation and it should be noted that there were significant downside consequences to China's FDI model. One lesson India might draw from China's experience, therefore, is that policy-makers may have more room for manoeuvre than they think. With external macroeconomic conditions probably more stable today than they have been at any time since independence, Indian policy-makers are in a better position to make strategic decisions about how to craft FDI-related institutions.

China's experience also suggests that policy formulation should consider the consequences for domestic enterprise and growth associated with different types of FDI access. For example, it may be desirable to encourage investment in specific locations, such as rural areas, and in specific sectors, such as small-scale industry. FDI in small-scale industry holds some promise for addressing at least two looming public policy challenges. How will India provide employment for the 71 million new potential employees due to join the workforce within the next five years?[27] Even if jobs could be found in cities, those cities could not absorb such numbers. The social and physical infrastructure needed to accommodate them is not likely to be ready in time. Second, how will India find economic opportunities for those affected by India's geographic, gender, and social disparities? Rural or semi-rural, small- and medium-sized enterprise (SME) is one good place to look for such flexible opportunities.

In addition to these positive socio-economic potentialities, the SME sector can draw on the experience and invoke the legitimacy of India's Gandhian legacy. Gandhi was, after all, himself a returned expatriate with an interest in small-scale industry. He called "for production by the masses" rather than "mass production".[28] A vibrant SME sector, catalysed by expatriate FDI could thus serve both as a driver of humane economic growth and as a reservoir of checks and balances against the power of large domestic and international business conglomerates.

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Notes

1 The empirics of FDI flows are themselves painfully fraught. Indian data (for financial year 2000 and forward) have now been aligned with those of most other major countries. Nevertheless, since Chinese (and increasingly Indian) FDI flows disguise a lot of "roundtrip" money, clear apples-to-apples comparisons are tricky. ("Roundtripping" is when funds that originate in China or India sneak out and come back in disguised as "foreign" investment). Some have argued that when updated Indian data are compared with appropriate estimates of Chinese FDI (i e, aggressively discounted for roundtripping) the differential between the two countries' FDI/GDP ratios would be much narrower.

These accounting disputes aside, few would argue that a country with India's economic potential and relative capital scarcity could not have "done better" at attracting FDI. FDI is one area where absolute numbers matter for two reasons. First, there is evidence that the global stock of potential FDI is limited, and therefore its distribution among countries tends toward a zero-sum dynamic. Second, FDI is prospective, and the amount of FDI relative to the current size of economy is not the best of indicators.
See, F Sader, 'Privatisation and Foreign Investment in the Developing World', The World Bank, Washington DC, 1992. Guy Pfeffermann, 'Business Environment Surveys', International Finance Corporation, Washington DC, 2002. Barry Eichengreen and Hui Tong, 'Is China's FDI Coming at the Expense of Other Countries', National Bureau of Economic Research, Cambridge, MA, 2005. Busakorn Chantasasawat, 'Is China Diverting FDI from Its Neighbouring Countries?' in EAI Background Brief, East Asian Institute, National University of Singapore, Singapore, 2005.
2 Yasheng Huang, Selling China: Foreign Direct Investment During the Reform Era, Cambridge University Press, New York, 2003.
3 For example, many Chinese state-owned enterprises (SOEs) and regions really have no use for or did not deserve the FDI flows they received. In spite of this, government incentives directed investment to those firms, regions and sectors. For Huang, "high" FDI is indicated by the ratio of FDI to domestic investment (DI) or the ratio of FDI to contractual arrangements.
4 Huang takes these policies as given. He does not adequately consider the possibility that the "imperfect" economic institutions might have been designed "more perfectly" to serve political ends.
5 Huang, Selling China: Foreign Direct Investment During the Reform Era, xv.
6 Yasheng Huang and Tarun Khanna, 'Can India Overtake China?' Foreign Policy, July/August 2003, pp 75-83.
7 Ghosh's account is reminiscent of the politically neutral ideal-type "developmental state" derived from Chalmers Johnson's study of Japan's ministry of international trade and investment (MITI). See, Chalmers Johnson, MITI and the Japanese Miracle, Stanford University Press, Stanford, 1982.
8 One might now add disgruntled farmers who are losing their land to that list.
9 Jean Chun Oi, Rural China Takes Off: Institutional Foundations of Economic Reform, University of California Press, Berkeley, 1999.
10 Presumably, Ghosh here means to write the colloquial term "hang-up" which is defined in the Concise Oxford English Dictionary as, "an emotional problem or inhibition". The argument I present here with respect to FDI is that, because the Chinese are likely to suffer a painful FDI-induced "hangover", the Indians may be justified in their FDI-related "hang-up". See, http://www.askoxford.com.
11 The exception is if the policy involves the Japanese, in which case a good dose of nationalist venom is generally 'de rigeur'.
12 See, George T Crane, 'Imagining the Economic Nation: Globalisation in China', New Political Economy, 4, no 2, 1999, pp 215-32; Peter Hays Gries, China's New Nationalism: Pride, Politics, and Diplomacy, University of California Press, Berkeley, 2004; Suisheng Zhao, A Nation-State by Construction: Dynamics of Modern Chinese Nationalism, Stanford University Press, Stanford, 2004.
13 Thomas L Friedman, The Lexus and the Olive Tree, Farrar Straus Giroux, New York, 2000. Friedman's "golden straightjacket" refers to the alleged economic benefits countries would enjoy if they adopted a range of constraining globally- and market-oriented policies. In the Chinese FDI "golden straightjacket", FIEs enjoyed access to a low-wage high-quality infrastructure export platform if they complied with a range of constraining limitations on their business decisions.
14 Margaret M Pearson, Joint Ventures in the People's Republic of China: The Control of Foreign Direct Investment under Socialism, Princeton University Press, Princeton, NJ, 1991.
15 'Press Note 18' (1998) issued by the ministry of industry and the Foreign Investment Promotion Board seems to have worked well in giving Indian JV partners some protection from coercive or predatory foreign partners. 'Press Note 1' (2005) led to a shift in emphasis favouring contractual solutions to "conflicts of interest" among JV partners. See, 'Govt Scraps Press Note 18, Replaces It with Press Note 1', Indian Express, January 13, 2005.
Those who claim that China never took action akin to India's Press Note 18 ignore the many informal "dirty-tricks" in the Chinese playbook. A good example is the "dual facility" common gambit in which a local JV partner allows the foreign collaborator to build, manage and link a new facility to the global supply chain. Then the local partner duplicates the facility as a non-JV, often in the same neighbourhood. Soon the first facility seems to be doing poorly and the new "duplicate" is vibrant.
Though Chinese FDI policy is today much more liberal than in the early days of the SEZs, rules still strictly regulate equity size, geographic location and (as in India) investments in auto, retail, telecommunication services and other sensitive industries. Discretionary approval for large-scale investment (over $ 30 million) persists. Discretionary control of size leads to the "miniaturisation" of FDI in China, yet another salutary outcome for the CCP which prefers that large-scale industry is state owned. See, Jun Fu, Institutions and Investments: Foreign Direct Investment in China During an Era of Reforms, Studies in International Economics, University of Michigan Press, Ann Arbor, 2000.
FDI procedures in which foreign partners manage to devise some advantage over their local partners are quickly revised. This happened in the case of 'zhong-zhong-wai' (Chinese-Chinese-foreign) partnerships in the telecommunications sector in the late 1990s. See, Paul H Folta, Cooperative Joint Ventures, January-February 2005; available from http://www.chinabusinessreview.com/public/0501/folta.html.
16 Mary Gallagher, 'Reform and Openness: Why China's Economic Reforms Have Delayed Democracy', World Politics, 54, 2002, pp 338-72.
17 Morris Goldstein and Nicholas Lardy, 'What Kind of Landing for the Chinese Economy?' Institute for International Economics, Washington DC, 2004.
18 In the Chinese context of a state-socialist single party polity, that coalition is an "intramural coalition" within the Chinese state itself.
19 Barry Naughton, 'China's Financial Reform: Achievements and Challenges: BRIE Working Paper 112', Berkeley Roundtable on the International Economy, Berkeley, 1998.
20 Carefully calibrated semi-repression of the financial system makes the whole thing possible. Low (sometimes negative) real interest rates on bank deposits, a tightly limited supply of equity shares, state support for the financial services industry and central bank use of repo markets (along with massive sterilisation routines) are the only reasons there is any value or trading volume at all in China's securities markets. Of course, there are also various controls on capital account convertibility.
21 Vanita Shastri, 'Liberalising India's Economy: Context and Constraints' in Amita Shastri and A Jeyaratnam Wilson (eds), The Post-Colonial States of South Asia: Democracy, Development, and Identity, Palgrave, New York, 2001, pp 241-63.
22 The securities governance regime indicator includes variables such as: (1) market liquidity and volatility, (2) market regulation/legal system/investor protection, (3) settlement proficiency, (4) transaction costs, and (5) capital market openness. Every year the CalPERS board reviews the parameters of an investment index that includes a wide range of political, social and economic factors. A private consultant, Wilshire Associates, then compiles the index. The board also sets thresholds for countries'

overall scores on the index and on each of the contributing sub-variables. Countries that exceed these thresholds are deemed "permissible", and the board can then vote to invest there (occasionally disregarding Wilshire recommendations and voting for even tighter standards). CalPERS approval is a widely-used benchmark for "responsible investing" among those in the institutional investment community worldwide who look for investment cues that combine social and political considerations with those of financial risk. For years India's securities and corporate "scores" were well above the threshold, but its labour standards were not. In 2004, India finally "scored" favourably on labour standards and the pension fund sank 100 million dollars into Indian equities. China is still 'verboten' on various indicators including governance of securities finance.
See, for example, Wilshire Associates, 'Permissible Equity Markets Investment Analysis and Recommendations', Santa Monica, 2003. Also see, Reuters, 'Calpers Skips India, China on Poor Labour, Accounting Standards', Economic Times, February 20, 2003 available from http://economictimes.indiatimes.com/articleshow.asp?artid=37989574. And, 'Calpers Invests $ 100 M in India', Business Line, November 3, 2004.
23 Raghbendra Jha, 'FDI: Is More Always Better?' Economic Times, July 28, 2003; available from http://economictimes.indiatimes.com/cms.dll/html/uncomp/articleshow?msid=98113.
24 Notable is Huang's claim that China did poorly on the first part, the transfer of technology and management skills. Huang, Selling China: Foreign Direct Investment During the Reform Era, p 247.
25 Pranab Bardhan, 'Crouching Tiger, Lumbering Elephant: A China-India Comparison' in Kaushik Basu, Pulin B Nayak and Ranjan Roy (eds), Markets and Governments, Oxford University Press, New Delhi, 2004.
26 Ashok S Guha and Amit S Ray, 'Expatriate vs Multinational Investment: A Comparative Analysis of Their Roles in Chinese and Indian Development', Indian Council for Research on International Economic Relations, New Delhi, 2000.
27 In addition, one should not forget the 38 million already unemployed persons or the underemployment problem in the informal sector. See, Jo Johnson, 'India Gains Credibility as an Emergent Export Titan', Financial Times, December 1, 2005.
28 Pyarelal Nayar summarised Gandhi's thoughts on mass production in an article entitled, 'Mass Production versus Production by the Masses', Mohandas K Gandhi, The Collected Works of Mahatma Gandhi, Vol 54, Publications Division, Ministry of Information and Broadcasting, Government of India, New Delhi, 1992, p 21. Emphasising the positive potential of small-scale industry for Indian political and economic life, "Gandhi started with the village and the villager, with local autonomy and employment, with work in small-scale industries", Lloyd I Rudolph and Susanne H Rudolph, Postmodern Gandhi and Other Essays: Gandhi in the World and at Home, Oxford University Press, New Delhi, 2006, p 24.