Foreign Direct Investment in India and China: The Creation of a Balanced Regime in a Globalized Economy

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Introduction

Increased global interdependence is a defining feature of our current geopolitical moment.[1] We are currently witnessing an unprecedented level

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1. *See generally* Jan Aart Scholte, Globalization: A Critical Introduction (Palgrave Macmillan 2d. ed. Jan. 2005); Robert O. Keohane & Joseph S. Nye, *Globalization: What's New? What's Not (And So What?)*, 118 Foreign Pol'y 104 (2000); Int'l Monetary

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of capital interdependence and cross-border economic, financial,[2] and business integration[3] both within developed and developing states.[4] The global economy is dramatically transforming, resulting in a "hand-off" of power to rising actors.[5] China and India are two stars of the global economy's expansion and increased interconnectivity.[6] Between 2000 and 2007, China has enjoyed average GDP growth of 10.2% per year[7] and by one observer is projected to surpass the United States in GDP terms by 2030.[8] India has enjoyed an average GDP growth of 7.8% over the same period[9] and is expected to continue above 7.7% through 2011.[10] Much of

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FUND, WORLD ECONOMIC OUTLOOK: GLOBALIZATION AND INEQUALITY 139 (2007) [hereinafter WORLD ECONOMIC OUTLOOK], *available at* http://www.imf.org/external/pubs/ft/weo/2007/02/pdf/text.pdf (summarizing many globalization changes and their impact on various states).

2. *See, e.g.*, BANK FOR INTERNATIONAL SETTLEMENTS, TRIENNIAL CENTRAL BANK SURVEY: FOREIGN EXCHANGE AND DERIVATIVES MARKET ACTIVITY IN 2004 1–3 (2005), *available at* http://www.bis.org/publ/rpfx05t.pdf (noting the average daily turnover in capital transactions is nearly $2 trillion United States Dollars (USD)).

3. *See, e.g.*, Samuel F. Palmisano, *The Globally Integrated Enterprise*, FOREIGN AFF., May/Jun. 2006, at 127, 129 ("Simply put, the emerging globally integrated enterprise is a company that fashions its strategy, its management, and its operations in pursuit of a new goal: the integration of production and value delivery worldwide. State borders define less and less the boundaries of corporate thinking or practice.").

4. WORLD BANK, GLOBAL DEVELOPMENT FINANCE: THE ROLE OF INTERNATIONAL BANKING 34 (2008), *available at* http://siteresources.worldbank.org/INTGDF2008/Resources/gdf_complete_web-appended-6-12.pdf (noting that in 2007 financial flows to developing countries increased for the fifth year in a row rising to $1.03 trillion USD).

5. *See, e.g.*, MOHAMED EL-ERIAN, WHEN MARKETS COLLIDE (2008); Hugh Son, *AIG Mulling Overseas Life Unit Sale to China Fund, Nikkei Says*, BLOOMBERG, Nov. 20, 2008, http://www.bloomberg.com/apps/news?pid=20601101&sid=aTmy4YpurDYU&dbk#.

6. *See, e.g.*, EL-ERIAN, *supra* note 5, at 106 ("China and India each contributed more to global growth in 2007 than did the United States, the European Union, and Japan."); Roger C. Altman, *The Great Crash 2008*, FOREIGN AFF., Jan./Feb. 2009, at 2, 11–12 (highlighting the strength of both India and China despite the recent economic crisis); Pankaj Ghemawat & Thomas Hout, *Tomorrow's Global Giants: Not the Usual Suspects*, 86 HARV. BUS. REV. 80, 80 (2008) ("Western companies' interest in emerging markets, especially China and India, is reaching a new level of intensity."); Kenneth M. Kletzer, *Liberalizing Capital Flows in India: Financial Repression, Macroeconomic Policy, and Gradual Reforms*, 1 INDIA POL'Y F. 227, 227 (2004), *available at* http://www.brookings.edu/global/~/media/Files/Programs/Global/india_policy_forum/2004_kletzer.pdf (noting that policy changes resulting in trade and foreign investment liberalization "reflect widespread concern that India's past inward orientation inhibited economic growth, especially in comparison with the developing countries of East Asia."); ESWAR PRASAD & SHANG-JIN WEI, BROOKINGS INSTITUTE, UNDERSTANDING THE STRUCTURE OF CROSS-BORDER CAPITAL FLOWS: THE CASE OF CHINA 3 (Dec. 15, 2005), http://www.brookings.edu/~/media/Files/rc/papers/2005/1215globaleconomics_prasad/20051215.pdf ("Over the past decade, China has accounted for about one-third of gross FDI flows to all emerging markets . . . .").

7. WORLD BANK, WORLD DEVELOPMENT REPORT 2009: RESHAPING ECONOMIC GEOGRAPHY 356 (2009), *available at* http://siteresources.worldbank.org/INTWDR2009/Resources/4231006-1225840759068/WDR09_22_SWDIweb.pdf.

8. *Globalisation: The New Champions*, ECONOMIST, Sept. 18, 2008, at 6, *available at* http://www.economist.com/specialreports/displaystory.cfm?story_id=12080711.

9. WORLD BANK, WORLD DEVELOPMENT REPORT 2009, *supra* note 7, at 356.

10. INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK: UPDATE (Jan. 26, 2010), *available at* http://www.imf.org/external/pubs/ft/weo/2010/update/01/pdf/0110.pdf.

this growth is the result of extraordinary inflows of foreign capital to these nations due to a measured, yet profound, liberalization of foreign investment restrictions.[11] Remarkably, both India and China are among those nations least harmed by the current global economic crisis, maintaining above-average economic growth as many nations are experiencing painful economic contraction.[12]

But despite recent changes and current successes, there may be a need for further change, especially within the legal investment regimes[13] that govern foreign investment, including foreign direct investment (FDI)[14] and mergers and acquisitions (M&A).[15] Even with the recent liberalization of their respective economies,[16] and despite large investment inflows, one recent ranking of economic freedom placed India and China far from the most liberalized economies with a ranking of 123 and 132, respectively, out of 179 countries.[17]

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11. *See, e.g.*, Kletzer, *supra* note 6; Prasad & Wei, *supra* note 6, at 1 (noting that China is the largest destination for foreign direct investment and is the third largest trading nation); *see also* Hui Huang, *China's Takeover Law: A Comparative Analysis and Proposals for Reform,* 30 Del. J. Corp. Law 145, 148–54 (2005) [hereinafter *China's Takeover Law*] (highlighting the liberalization of foreign investment restrictions including the expanded ability for foreign firms to invest in domestic Chinese firms); Shaun J. Mathew, *Hostile Takeovers in India: New Prospects, Challenges, and Regulatory Opportunities*, 2007 Colum. Bus. L. Rev. 800, 802 (2007) ("The Indian government's relatively recent embrace of globalization and move away from the socialist policies of the past have inured to the advantage of its economy and its people . . . .").

12. *Globalisation: Turning Their Backs on the World*, Economist, Feb. 21, 2009, at 59.

13. Throughout the Note, I will refer to the legal investment regime as simply the "investment regime." I use it to refer to the specific laws and regulations governing foreign investments as well as any other rules and policies instituted by national or local government.

14. FDI herein is defined as "an international capital flow form the home country to the host country for the purpose of acquiring partial or full ownership of a tangible business entity such as a factory, extractive facility, or wholesale distribution system." Stephen D. Cohen, Multinational Corporations and Foreign Direct Investment 37 (2007). Importantly, the actual capital flow can occur after the acquisition of such assets and entities in the form of a transfer retained earnings such as where a foreign investor uses the host countries capital markets to finance the acquisition. *Id.*

15. *See, e.g.*, Hui Huang, *The New Takeover Regulation in China: Evolution and Enhancement*, 42 Int'l Law. 153, 154-58 (2008) [hereinafter Huang, *The New Takeover Regulation*] (demonstrating a lack of proof that China's new liberalized regulations will result in increased openness and activity); Mathew, *supra* note 11, at 802 (arguing that despite recent liberalization India lacks a well-functioning market for corporate control); Eileen Francis Schneider, Note, *Be Careful What you Wish For: China's Protectionist Regulations of Foreign Direct Investment Implemented in the Months Before Completing WTO Accession*, 2 Brook. J. Corp. Fin. & Com. L. 267 (2007) (arguing that, despite some legal liberalization, the Chinese government continues to frustrate foreign companies' attempts to invest in China).

16. Mathew, *supra* note 11, at 802 (discussing India's "recent embrace of globalization."); Huang, *The New Takeover Regulation*, *supra* note 15, at 154–58 (describing China's recent move away from state-owned enterprises and the opening up of corporate ownership to foreigners); *Raining on India's Parade,* Economist, Oct. 31, 2009, at 18 ("A once-sheltered economy is now increasingly open to foreign capital, which rained down on the country in 2007, only to evaporate last year.").

17. *See* Terry Miller, *Freedom is Still the Winning Formula*, Wall St. J., Jan. 13, 2009, at A17.

Even though China and India are moving in the direction of liberalization, the state of affairs in each nation is quite different.[18] Superficially, India's investment regime places only limited restrictions on foreign M&A activity, including hostile takeovers of Indian companies, yet the regime maintains a complex set of restrictions and licensing requirements that have reduced the ability of Indian companies to attract foreign capital.[19] China, notwithstanding recent reform, still maintains a complex investment regime combining complicated securities law and takeover law restrictions with contradictory regulatory approval requirements often overseen by a number of Chinese agencies.[20] For authorized investments, China's investment regime facilitates a relatively straightforward investment process through the use of standardized legal entities tailored for FDI, a centralized regulatory approval system, and clear guidance on which sectors of the economy are open for foreign investment.[21]

However, superficial investment regimes are not the whole picture. In form, India's regime is arguably the more open;[22] China regulates more sectors of its economy.[23] Despite such regulation, China has been able to court far more FDI.[24] Understanding the success of foreign investment regimes requires looking beyond the regulations at a superficial level, examining the significant differences in how each regime functions and in how each government and agency interacts with that investment regime.[25]

The reform that may be needed in both nations goes beyond merely simplifying an investment regime.[26] At stake is the very role of government

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18. *Id.*

19. *See, e.g.*, Mathew, *supra* note 11; Rohit Sachdev, *Comparing the Legal Foundations of Foreign Direct Investment in India and China: Law and the Rule of Law in the Indian Foreign Direct Investment Context*, 2006 Colum. Bus. L. Rev. 167, 197, 199 (2006) (describing and comparing attributes of India and China's FDI legislation and approval processes).

20. *See, e.g.*, Huang, *China's Takeover Law, supra* note 11, at 149–54 (describing the complex nature of the securities market including the various types and sub-types of shares, each with their own restrictions); Sachdev, *supra* note 19, at 204 (describing the various conflicting authorities from which approval is needed).

21. *See, e.g.*, Sachdev, *supra* note 19, at 197 (noting that China's various legal vehicles "offer foreign investors uniform, user friendly investment tools with transparent rules.")

22. *Compare* Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000 [Annexure B] [hereinafter FEMA Regulations], *available at* http://www.rbi.org.in/Scripts/BS_FemaNotifications.aspx?Id=174 (describing foreign investment limits for various industries in India), *with* Catalogue for the Guidance of Foreign Investment [hereinafter *China Catalogue*], update to online version http://www.fdi.gov.cn/pub/FDI_EN/Laws/GeneralLawsandRegulations/MinisterialRulings/P020071121358108121219.pdf (describing foreign investment limits for various industries in China).

23. *See supra* note 22.

24. *See, e.g.*, Sachdev *supra* note 19, at 168.

25. *See infra* Parts II and III.

26. *See, e.g.*, Eswar Prasad & Shang-Jin Wei, *The Chinese Approach to Capital Inflows: Patterns and Possible Explanations* 16 (Nat'l Bureau of Econ. Research, Working Paper No. 11306, 2005) [hereinafter *The Chinese Approach to Capital Inflows*], *available at* http://www.nber.org/papers/w11306 (arguing that the composition of investments has an important impact on their economic effect).

in structuring and regulating a nation's economy, especially in the face of increasing globalization.[27] Continued sustainable economic growth, and the political stability it fosters, require an investment regime that facilitates a dynamic economy, one that allows capital to flow where it will be used most efficiently and to ensure that once there, it continues to be used effectively.[28] As a 2005 report by the World Bank puts it:

> The investment climate is central to growth and poverty reduction. Improving the opportunities and incentives for firms of all types to invest productively, create jobs, and expand should be a top priority for governments. It is not just about increasing the volume of investment but also spurring productivity improvements that are the keys to sustainable growth.[29]

To achieve sustainable growth, both China and India may require increased openness and continued decomposition of investment restrictions.[30]

But increased openness and liberalization are not without costs.[31] Directly, liberalization means forgoing certain political objectives such as fostering infant industries, maintaining domestic control of assets, and stabilizing domestic labor markets.[32] Indirectly, and perhaps more importantly, liberalization makes a nation's economy increasingly vulnerable to the negative forces of the global economy, ranging from capital flight and financial crises to stunted economic growth and a reduction in the standard of living for the poor.[33] The global economic slowdown from 2008 into 2010 is exposing some of the dangers of aggressive market liberalization and is testing the resilience of foreign investment regimes.[34] Indeed, the downturn has most affected some of the very countries that have

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27. *See, e.g.*, *id.*

28. *See, e.g.*, World Bank, World Development Report 2005: A Better Investment Climate for Everyone 15 (2004) [hereinafter World Development Report 2005], *available at* http://siteresources.worldbank.org/INTWDR2005/Resources/complete_report.pdf.

29. *Id.*

30. *See, e.g.*, Joseph E. Stiglitz, *Globalization and Growth in Emerging Markets and the New Economy*, 25 J. Pol'y Modeling 505, 507-08 (2003) (noting that the rapid economic development of East Asian countries during the 1980s and '90s was largely based on the benefits of globalization and financial and economic integration).

31. *See, e.g.*, Jeffry A. Frieden, Global Capitalism: Its Fall and Rise in the Twentieth Century 386-87 (2006) ("Countries and companies tightly tied into world markets were more susceptible to international financial forces; governments and firms were held to more rigorous global standards than they were used to.").

32. *Id.*

33. *See, e.g.*, Carmen M. Reinhart & Vincent R. Reinhart, *Capital Flow Bonanzas: An Encompassing View of the Past and Present* 3 (Nat'l Bureau of Econ. Research, Working Paper No. 14321, 2008) [hereinafter *Capital Flow Bonanzas*], *available at* http://www.nber.org/papers/w14321 ("Capital inflow bonanza periods are associated with a *higher incidence* of banking, currency, and inflation crises in all but the high income countries . . . ."); *see also infra* Part I.C.

34. *See, e.g.*, *Globalisation: Turning Their Backs on the World*, *supra* note 12, at 59 (highlighting the impact of the global economic downturn on various nations and noting that "[t]he downturn has been sharpest in countries that opened up most to world trade, especially East Asia's tigers.").

opened themselves up the most.[35]

Economic stability and growth require an investment regime that can provide a balanced level of openness to foreign investment, including as between FDI and portfolio investment.[36] The regime must both allow in a sufficient amount of capital and provide the ability for such capital to be put to work in the most efficient areas.[37] All capital inflows are not equal: speculative "hot money"[38] may provide temporary fuel to a nation's economy but is the most vulnerable to quick outflows.[39] In contrast, recent economic literature suggests that FDI provides a stronger buffer against global economic swings, especially for developing economies.[40] It is not just a matter of the number of dollars that flow in but also where they go.[41]

Additionally, to properly channel investment and maximize the benefits of FDI, the regime must be tailored to the particular features of a nation: economic, geographic, cultural, and developmental.[42] Thus, any evaluation of the effectiveness of an investment regime requires careful consideration of differences in social, economic, and political contexts and should not be based on a single variable such as total FDI flow.

Recent commentators have made important and insightful contributions to our understanding of the relationship between FDI and investment regimes.[43] This Note seeks to build on their work by examining the performance of each regime in light of the global economic crisis of 2008

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35. *See id*; *see also* INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK, *supra* note 10 (showing the GDP losses in a number of open and advanced economies).

36. Hui Tong, *The Composition Matters: Capital Inflows and Liquidity Crunch During a Global Economic Crisis* 22 (Nat'l Bureau of Econ. Research, Working Paper No. 15207, 2009) (noting that "Liquidity shocks are more severe for emerging economies that have a higher pre-crisis exposure to foreign portfolio investments and foreign loans, but less severe for countries that have a higher pre-crisis exposure to foreign direct investments.").

37. *See The Chinese Approach to Capital Inflows*, *supra* note 26, at 16.

38. Generally, "hot money" refers to capital flows which are based on short term speculative sentiments rather than fundamentals. V.V. Chari & Patrick J. Kehoe, *Hot Money*, 111 J. POL. ECON. 1262, 1263 (2003) (analyzing the impact of hot money infusions). The makeup of hot money may be primarily bank lending rather than speculative investments by hedge funds and other institutional investors. Martin N. Baily, et. al., *The Color of Hot Money*, 79 FOREIGN AFF., 99, 99-100 (2000) (discussing the impact of hot money investment inflows).

39. *See, e.g.*, *The Whiff of Contagion*, ECONOMIST, Feb. 28, 2009, at 27-28 [hereinafter *Whiff of Contagion*] (noting in describing the threats to Eastern Europe's economy that "[c]ountries that relied chiefly on [FDI] are the least vulnerable now . . . [t]hose that rely on foreign investors buying their bonds . . . are the most vulnerable: their fortunes vary with every twitch of a trader's fingers.").

40. *See The Chinese Approach to Capital Inflows*, *supra* note 26, at 16 ("A large literature shows that it is not just the degree of financial openness, but the composition of capital inflows, that determine the quality of a developing country's experiences [sic] with globalization . . . ."); *Whiff of Contagion*, *supra* note 39.

41. *See The Chinese Approach to Capital Inflow*, *supra* note 26, at 16.

42. Eswar Prasad, *Rebalancing Growth in Asia* 1-2, 18-24 (Nat'l Bureau of Econ. Research, Working Paper No. 15169, 2009), *available at* http://www.nber.org/papers/w15169 (noting the vast differences in Asian economies and noting that global economic conditions may require changes in each economy due to both internal and external economic differences.).

43. Schneider, *supra* note 15.

through 2010. Further, this Note seeks to build on past scholarship by incorporating the findings of recent economic studies.

Part I of this Note discusses the costs and benefits associated with foreign investment liberalization with a focus on FDI and M&A. This Note concludes that, though not without costs, under most circumstances increased foreign investment is a net positive. Parts II and III provide a general overview of China and India's respective investments regimes. Part IV offers contextual explanations for the differences in approach and evaluates the relative effectiveness of each regime in attracting stable and beneficial FDI. Part V discusses some of the potential avenues for continued reform in both China and India.

I. Economic Background

A. The Movement Toward Market Liberalization: Benefits

Providing sustainable economic growth is a primary concern for any government.[44] As one group of economists has noted, "economic growth has been the most reliable source of poverty reduction."[45] Market liberalization, both in terms of improving internal domestic regulation and opening the domestic market to foreign capital flows, is a major part of this quest for growth.[46] Indeed, integrating one's own domestic market into the broader global economy is a defining thrust of modernity and an important source of economic growth[47] As Jeffrey Frieden, an economic and political scholar, notes, "the international economy has enabled countries to develop, alleviate poverty, improve social conditions, lengthen life spans, and carry out social and political reform."[48] Complete isolation from the global economy is no longer a viable option and is found only in the most extreme cases where, by and large, the result has been an abysmal failure.[49]

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44. *See, e.g.*, U.S.-China Joint Statement, Nov. 17, 2009, *available at* http://www.whitehouse.gov/the-press-office/us-china-joint-statement (describing the need for sustained global economic growth).

45. Eswar Prasad et al., *Financial Globalization, Growth and Volatility in Developing Countries* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 10942, 2004).

46. *See id.* at 2–3 (noting the difficulty in establishing an empirical connection between financial integration and higher economic growth); Geert Bekaert et al., *Does Financial Liberalization Spur Growth?*, 77 J. Fin. Econ. 3, 4 (2005) ("We find that equity market liberalizations increase subsequent average annual real economic growth by about 1%, even after controlling for other variables that are commonly used in the economic growth literature."); *Link by Link*, Economist, Oct. 18, 2008, at 79 ("[T]he intellectual tide of the past 30 years has unquestionably been in favour of the primacy of markets and against regulation.").

47. Prasad et al., *Financial Globalization*, *supra* note 45, at 2 (discussing the recent trend in globalization beginning in the 1980s).

48. *See generally* Frieden, *supra* note 31, at 473.

49. *See, e.g.*, *id.* at 475 (noting the history of failure by societies attempting to shield themselves from the global economy); *Survival of the Fittest*, Economist, Sept. 27, 2008, at 13 (highlighting the abysmal failure of the North Korean economy which has almost 1/18th the per capita GDP of South Korea).

Many observers and commentators urge liberalization along Western lines. For example, commentators suggest that China and India should look to Western M&A law for guidance, both in forming statutory regulations and in judicial use of such regulations.[50] Some commentators criticized India and China for failing to liberalize fast enough or even taking steps backward.[51] The following critique from Eileen Schneider, exemplifies the issues and concerns that underscore criticisms leveled against emerging economies, even successful ones. The excerpt also highlights the FDI's role in the host economy as seen by outsiders:

> Chinese regulators should have spent 2006 courting the foreign investment that would help Chinese businesses attract the capital, technology and managers necessary to compete against established international firms. Not only will Chinese firms need foreign money and expertise to compete around the world, they will also need help at home when international firms are allowed to vie for a share of the domestic Chinese market that Chinese firms previously held captive. Instead, Chinese regulators slowed the influx of foreign dollars, just when Chinese firms needed it most, leaving them vulnerable to lose domestic market share and ill-prepared to compete internationally.[52]

Schneider's critique seems grounded on the common, but erroneous, assumption that increased openness will always produce broad economic benefits, both to the domestic economy as a whole and to Chinese firms. China certainly may benefit from FDI inflows, especially those that provide technology and expertise;[53] however, in light of the global economic slowdown, Chinese regulators may have slowed the influx of foreign dollars at just the right time, preserving the benefits of global integration, while minimizing costs.[54] The Chinese investment regime, though not perfect, may be more optimal than critics like Schneider suggest.

B. Benefits of FDI to Emerging Markets

Much modern economic research highlights the benefits FDI may have on a host nation's economy.[55] FDI can be undertaken essentially by three

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50. *See China's Takeover Law*, *supra* note 11 (arguing in part that China should look to Delaware and other western states and nations for guidance in reforming its M&A laws); Mathew, *supra* note 11, at 805 (arguing that "India's securities regulator, drawing from the rich experience of Delaware takeover practice and jurisprudence, [should] adopt a principles-based standard in the Takeover Code governing the actions that a takeover target would be permitted to undertake in response to a hostile bid.").

51. *See, e.g.*, *Reform Needed: India's Financial System Remains Inefficient*, ECONOMIST, Nov. 6, 2008, *available at* http://www.economist.com/agenda/displaystory.cfm?story_id=12581192 (arguing that despite recent efforts to liberalize and reform India's markets, including its FDI regime, India still requires major reform to liberalize and open its financial markets); Schneider, *supra* note 15, at 271.

52. Schneider, *supra* note 15, at 271.

53. *See infra* Part I.B.

54. *See infra* Part I.C.

55. *See, e.g.*, JOAN E. SPERO & JEFFREY A. HART, THE POLITICS OF INTERNATIONAL ECONOMIC RELATIONS 132 (6th ed., 2003).

means: joint-venture (JV), greenfield,[56] and acquisition.[57] FDI itself can provide four important economic gains for the host nation.[58] First, FDI increases the ability of firms to undertake intra-firm trade, which can alleviate market imperfections.[59] Second, the recipients of FDI may experience increases in productivity often through the introduction of new technology and expertise and by engaging dormant or underutilized domestic economic sectors.[60] Third, FDI generates positive externalities, including increases in global trade, new goods and services, improved quality of labor, and increased social welfare such as health, housing, and education.[61] Fourth, and perhaps most important, FDI provides financial capital, which in many emerging economies is an underprovided resource.[62] FDI's role in providing capital is growing larger as an increasing percentage of private capital flowing to emerging economies comes in the form of FDI.[63]

Importantly, increased FDI is likely linked to increased economic growth.[64] Empirical studies disagree, however, as to the degree of linkage and when and where such linkage is most prominent.[65] Recent studies show that, for FDI to be effective, certain threshold requirements must be met, including nominal GDP, a degree of financial market development, institutional maturity, educational level, and a functioning property rights regime.[66] The investment's source can also have an important impact on the effect of specific FDI investments.[67] For example, U.S. firms tend to have both higher returns on foreign investments and lower debt-to-equity ratios than Japanese and Korean firms, despite a tendency for U.S. firms to be less likely to develop long-term relationships with host nation firms.[68] The source of investments may matter more as FDI is coming from more

56. A "greenfield" investment refers to the setup of new assets in a market by a foreign investor. *See* José E. Alvarez, *The Regulation of Foreign Direct Investment: Introduction*, 42 Colum. J. Transnat'l L. 1, 1 (2003).

57. *See id.*

58. Spero & Hart, *supra* note 55, at 132.

59. *Id.*

60. *Id.*

61. *Id.* at 132, 274.

62. *Id.* at 273

63. *Id.*

64. *See generally* Laura Alfaro et al., *How Does Foreign Direct Investment Promote Economic Growth? Exploring the Effects of Financial Markets on Linkages* (Nat'l Bureau of Econ. Research, Working Paper No. 12522, 2007), *available at* http://www.hbs.edu/research/pdf/07-013.pdf (discussing the relationship between FDI and growth); Hsu Chih-Chiang & Wu Jyun-Yi, *Does Foreign Direct Investment Promote Economic Growth? Evidence from a Threshold Regression Analysis*, 15 Econ Bull. 1 (2008).

65. *See, e.g.*, Chih-Chiang & Jyun-Yi, *supra* note 64, at 1 (discussing recent studies and the spectrum of empirical conclusions regarding FDI's effects).

66. *See* Alfaro et al., *supra* note 64, at 1.

67. *See, e.g.*, Spero & Hart, *supra* note 55, at 131 ("Marked differences in the behavior of MNCs from different home countries. . . . suggest that the way in which the home country structures its domestic economy has an important impact on the way in which domestic firms internationalize their business activities.).

68. *Id.* at 131–32.

diverse sources, such as Western Europe and Asia.[69]

The benefits of M&A activity are widely documented, especially those involving benefits to shareholders of target companies.[70] Takeovers, and even the threat of takeovers, are believed to improve market efficiency by allocating resources to higher yielding activities.[71] Takeovers help to put assets in the hands of those who can put them best to work.[72] In nations with particularly bad corporate governance this may be especially beneficial.[73] Additionally, for some firms, acquisition of a domestic company is the best, if not the only, means for entering a new market.[74]

C. The Costs of Liberalization and the Hesitancy for Reform

Foreign Investment and increased market liberalization do not come without costs. Questions remain regarding the distribution of net benefits from the increased rate of growth of global income. Economic change creates winners and losers, even as society improves on a broader level.[75] Foreign investment brings new technologies, new jobs, and new opportunities.[76] But new technology obsolesces those unable to adapt, and the creation of new jobs and new industries is often coupled with the

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69. *Id.* at 267.

70. *See, e.g.*, T.J. Brailsford & S. Knights, *The Financial and Non-Financial Effects of Corporate Takeovers* (Melbourne Institute, Working Paper No. 23/98, 1998), *available at* http://www.melbourneinstitute.com/wp/wp1998n23.pdf; *China's Takeover Law, supra* note 11 at 159-62 (summarizing the literature on takeover effects); Michael C. Jensen, *Takeovers: Their Causes and Consequences*, 2 J. Econ. Persp. 21, 21 (1988). *See generally* Athanasios Kourlaridas, The Law and Economics of Takeovers: An Acquirer's Perspective 1-5 (2008) (describing various studies on takeovers globally).

71. *See, e.g.*, *China's Takeover Law*, *supra* note 11, at 160; Jensen, *supra* note 70.

72. *See* Jensen, *supra* note 70.

73. *See China's Takeover Law*, *supra* note 11, at 162.

74. *See, e.g.*, Michael Barbaro, *Home Depot to Buy Protégé Retailer in China*, N.Y. Times, Dec. 14, 2006, *available at* http://www.nytimes.com/2006/12/14/business/worldbusiness/14depot.html?_r=1&scp=4&sq=enter%20China%20acquisition&st=cse; *Coca-Cola's Coup in China*, Deal Book (Andrew Ross Sorkin ed.), N.Y. Times, Sept. 3, 2008, *available at* http://dealbook.blogs.nytimes.com/2008/09/03/coca-colas-coup-in-china/index.html?scp=5&sq=enter%20China%20acquisition&st=cse (noting that the high price Coca-Cola paid for a Chinese juice maker was because it allowed it to control a Chinese company giving it greater access to the Chinese market.); Kanoko Matsuyama & Saikat Chatterjee, *Daiichi Sankyo to Buy Ranbaxy for as Much as $4.6 Billion,* Bloomberg, Jun. 11, 2008, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a8MrYuG_TXmA (Japanese drug maker to buy an Indian drug maker "will allow Daiichi Sankyo to have a better reach into emerging markets, including India, China and Eastern Europe.").

75. *See, e.g.*, PBS Interview with Robert Rubin, former United States Treasury Secretary, (Sept. 26, 2000 and Apr. 16, 2001) [hereinafter Robert Rubin Interview], *available at* http://www.pbs.org/wgbh/commandingheights/shared/minitextlo/int_robertrubin.html ("With respect to trade and capital markets, in my view at least, global integration has been substantially beneficial to the global economy and to most of the participants in the global economy, although it has certainly had dislocating effects on some."); World Economic Outlook, *supra* note 1, at 139 ("Based on observed movements in Gini coefficients . . . inequality has risen in all but the low-income country aggregates over the past two decades, although there are significant regional and country differences . . . .").

76. *See* Robert Rubin Interview, *supra* note 75.

closing of old industries and old jobs.[77] And of course, market liberalization can expose a nation to the broader mood of the global market, often irrespective of an individual nation's own economic disposition.[78]

The global economic slowdown from 2008 into 2010 has led many to rethink their approach to the liberalization of markets and the courting of FDI.[79] Some even see the crisis as caused, or at least magnified by, financial globalization.[80] Yu Yongding, a prominent Chinese economist, recently remarked: "The United States has been a model for China. Now that it has created such a big mess, of course we have to think twice."[81] In India, concerns over the credit crisis led the Reserve Bank of India (RBI) to reverse course on liberalizing some financial regulations: it will not permit issuance of credit-default swaps, a major contributor to the crisis.[82]

As the West increasingly talks about the need for their own re-regulation and increased market intervention,[83] some commentators have suggested that the West is now beginning to emulate the economic model of emerging economies like China.[84] The Chinese government has called on the West to avoid protectionism and maintain liberalized global markets,[85] a dramatic and telling reversal of roles that underscores the shifts in global power that are taking place. While the advanced economies painfully felt flat or negative GDP growth in 2008 and 2009, China's GDP grew 9.6% in 2008 and 8.7% in 2009.[86] The IMF forecasts GDP growth in China of nearly 10% in 2010 and 2011.[87] India's GDP grew 7.3% in 2008 and 5.6% in 2009 and was forecasted to grow around 7.7% in both 2010 and 2011. Perhaps most striking is that China and India have posted significantly higher growth rates in 2009 than in 1998, immediately following the Asian financial crisis of 1997–98, suggesting that these countries are improving

77. *See, e.g.*, FRIEDEN, *supra* note 31, at 474–75. ("Multinational corporations bring new technologies and methods; this drives domestic firms out of business. . . Governments open their boarders to the world economy and provides some citizens the potential for wealth and success; this can consign other citizens to hardship and distress.").

78. *See, e.g.*, *id.* at 386–87.

79. Jeffrey Sachs, *Amid the Rubble of Global Finance, a Blueprint for Bretton Woods II,* GUARDIAN, Oct. 21, 2008, *available at* http://www.guardian.co.uk/commentisfree/2008/oct/21/globaleconomy-g8 ("The international financial system is broken. An integrated set of reforms will be needed to achieve sustained economic growth and shared prosperity."); *Special Report: Charting a Different Course,* ECONOMIST, Oct. 11, 2008, at 26.

80. *Link by Link*, *supra* note 46, at 79 (outlining the relationship between global financial deregulation and the recent crisis); *Special Report: A Monetary Malaise*, ECONOMIST, Oct. 11, 2008, at 22 ("The large saving surplus in emerging economies caused a flood of capital to rich ones, largely America . . . . This flood of capital fuelled the financial boom by pushing long-term interest rates down.").

81. *Charting a Different Course*, *supra* note 79.

82. *Id.*

83. *See, e.g.*, *Special Report: Taming the Beast*, ECONOMIST, Oct. 11, 2008, at 6–16.

84. *See, e.g.*, *Capitalism at Bay*, ECONOMIST, Oct. 18, 2008, at 15.

85. Chen Deming, *Protectionism Doesn't Pay*, WALL ST. J., Feb. 20, 2009, at A17 (The Chinese minister of Commerce explains that "China calls on these governments not to replay history and revert to protectionism and economic isolationism.").

86. INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK: UPDATE, *supra* note 10, at 2

87. *Id.*

their ability to capture global growth while simultaneously protecting their own domestic economies from global shocks and extreme domestic disorder.[88]

The implications of recent economic research is somewhat self-evident, yet deserves being explicitly stated: countries have a significant interest in regulating how much investment enters their borders, where it comes from, what kind of investment it is, and where it is being put to use.[89] One recent paper argues that economies with a medium level of global financial exposure are at the highest risk for "systemic sudden stops," or stops and potential reversals of capital flows.[90] Additionally, large capital inflows are associated with a higher incidence of domestic economic turmoil including banking crises, currency adjustments, inflation, and sovereign debt defaults.[91] The increased propensity for crisis can be significant.[92] For example, large capital inflows are associated with roughly a 20% increase in banking crises.[93] For some nations, the increases in various crises and default are even higher.[94]

Increased growth from financial integration is not always correlated with broader social positives. For example, volatility in growth rates can have the effect of reducing the well-being of most households in an economy, especially that of the poor.[95]

But the recent research does not necessarily suggest that countries should retreat from globalization;[96] countries differ dramatically in how they are affected by globalization.[97] Instead the research suggests a responsible reaction to globalization: countries that take certain steps reduce the negative impact of financial globalization and position themselves to better realize positive gains.[98] Such measures include the

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88. *Id*; *Sittin' on the Dock of a Bay*, ECONOMIST, Nov. 22 2008, at 51.

89. INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK: UPDATE, *supra* note 10, at 2; *see also* SPERO & HART, *supra* note 55, at 267–92 (examining the implications of FDI investment in emerging markets and how various nations have dealt with investment).

90. Guillermo A. Calvo, Alejandro Izquiredo & Luis-Fernando Mejia, *Systemic Sudden Stops: The Relevance of Balance-Sheet Effects and Financial Integration* 28–30 (Nat'l Bureau of Econ. Research, Working Paper No. 14026, 2008), *available at* http://www.nber.org/papers/w14026.

91. *Capital Flow Bonanzas*, *supra* note 33, at 29–31 (noting the incidence of a financial crisis is higher around capital inflow bonanzas while also qualifying this trend to show how income levels and other factors may mitigate this effect).

92. *Id.* at 97.

93. INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK: UPDATE, *supra* note 10, at 2.

94. *Capital Flow Bonanzas supra* note 33, at 31-34 (showing data for each nation covered by the study).

95. Prasad et al., *Financial Globalization*, *supra* note 45, at 2.

96. M. Ayhan Kose, et al., *Financial Globalization: A Reappraisal* 4 (IMF Working Paper, 2006), *available at* http://www.imf.org/external/pubs/ft/wp/2006/wp06189.pdf ("There is little formal empirical evidence to support the oft-cited claims that financial globalization in and of itself is responsible for the spate of financial crises that the world has seen over the last three decades.").

97. *See, e.g.*, Prasad et al., *Financial Globalization, supra* note 45, at 2.

98. *Id.* at 2–3.

strengthening of financial institutions, increasing transparency especially with regard to financial regulation, use of a flexible exchange rate, and avoidance of external debt.[99] Additionally, emerging economies have experienced greater growth when they have used domestic savings rather than foreign capital to finance investments, suggesting that a reliance on foreign capital may also limit growth potential.[100]

II. China's Investment Regime

A. Background to China's Investment Regime

In the past decade or so, China began a process of legal reform ostensibly motivated by the desire to open its markets in anticipation of, and in accordance with, its requirements for joining the WTO.[101] One of China's policies is that of reducing control over state-owned enterprises (SOEs) or businesses whose ownership is government-dominated.[102] One commentator summarizes the restructuring of the Chinese economy:

> [I]n some sectors, the government is encouraging the consolidation of SOEs into large integrated conglomerates that are intended to be global leaders in their field; in other sectors, the state is reducing the level of its equity ownership, making a large number of SOEs available for private capital.[103]

Of nearly 135,000 SOEs, four to five thousand are privatized annually.[104]

Nonetheless, observers disagree over the degree to which reforms represent liberalization and whether they actually result in an opening of their markets to foreign investors, or simply provide additional mechanisms by which the government may frustrate foreign entrance.[105] Recent empirical data suggest that preliminary fears that new regulations would

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99. *Id.* at 2-7.

100. Eswar Prasad, Raghuram Rajan & Arvind Subramanian, *Foreign Capital and Economic Growth* (IZA Discussion Paper 5, 2007), *available at* http://ssrn.com/abstract=1048861.

101. *See, e.g.*, Karen Halverson, *China's WTO Accession: Economic, Legal, and Political Implications*, 27 B.C. Int'l & Comp. L. Rev. 319 (2006) (discussing the implications for change including the potential for political and economic liberalization or a backlash into reactionary nationalism); K. Thomas Liaw, Investment Banking & Investment Opportunities in China: A Comprehensive Guide For Finance Professionals 24-49 (2007) (highlighting the key changes mandated by WTO accession).

102. Huang, *The New Takeover Regulation*, *supra* note 15, at 154-55.

103. *Id.* at 154.

104. *Id.* at 154-55.

105. *See, e.g.*, David Boitout & Raphael Chantelot, *A Brave New World for Chinese M&A*, 25 Int'l Fin. L. Rev. 40, 40 (2006) (noting that the effect of new M&A regulations will "depend on the willingness of the Chinese authorities to approve high-profile transactions in the face of certain public anxiety about foreign investors."). *Compare* Schneider, *supra* note, 15, at 287 (arguing that China's 2006 Regulations were meant to "[hold] up foreign acquisitions and mandate[e] time-consuming and vague reporting requirements . . . .") *with* Liaw, *supra* note 101 at 50 ("Improvements in infrastructure and relaxation of regulations, especially after the accession to the World Trade Organization, have made the Chinese markets more accessible.").

stifle foreign investment[106] are premature, as the data indicate strong investment inflows.[107] Yet even these data are not fully conclusive due to the lack of transparency in reporting.[108]

China's authorities have provided for a relatively centralized governmental approval process that vertically integrates local, regional, and national authorities.[109] Chinese law distinguishes between two categories of companies based on their source of capital: (1) domestic companies, defined as having typically less than 20% foreign capital or shareholders, and (2) Foreign Investment Enterprises (FIEs), of which there are three distinct legal types—joint-venture, Wholly Foreign-Owned Enterprises (WFOEs), and Foreign Invested Companies Limited by Shares (FICLS).[110] The choice of specific legal entity will be determined largely by the type of investment being made, such as whether it is a joint venture with a Chinese company or a direct acquisition of Chinese assets. [111]

B. China's Legal Entities for Foreign Investment

There are two types of joint-ventures which have varying capital requirements, structure, and tax implications: equity joint-ventures (EJV)[112] and cooperative/contractual joint-ventures (CJV).[113] Both EJVs

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106. *See, e.g.*, Schneider *supra* note 15, at 271 ("Chinese regulators slowed the influx of foreign dollars, just when Chinese firms needed it most . . . .").

107. *Foreign Direct Investment*, Economist, Feb. 13, 2010, at 102, *available at* http://www.economist.com/markets/indicators/displayStory.cfm?story_id=15502863; *Opportunities Abroad: China Gets Most Foreign Direct Investment Among Developing Countries, But Its Share is Falling*, Economist, June 16, 2008, *available at* http://www.economist.com/daily/chartgallery/displaystory.cfm?story_id=11565600 (noting that China's FDI in 2007 was $84 billion, its highest level ever).

108. *Hot and Bothered*, Economist, June 26, 2008, at 79–80, *available at* http://www.economist.com/finance/displaystory.cfm?story_id=11639442 ("[T]he new inflow of FDI is 60% higher than a year ago, yet the actual use of this money for fixed investment has fallen by 6%. Some of it has been diverted elsewhere."); World Bank, China Quarterly Update 6 (June 2008), *available at* http://siteresources.worldbank.org/CHINAEXTN/Resources/cqu_june08_en.pdf ("However, the amount of speculative inflows is difficult to estimate because of uncertainty about the amount of reserves transferred to other institutions and whether and how the reserves reflect valuation changes, and a blurry delineation between speculative inflows and other transactions, with some FDI reported to be disguised speculative inflows.").

109. *See* Sachdev, *supra* note 19, at 208–09 ("The Chinese model formally incorporates state and local governments, while the Indian model is formally national and leaves foreign investors on their own to deal with the state and local governments once national approval has been granted.").

110. Peter Huang, *A Primer on China's New Cross-Border M&A Rules,* Practicing Law Institute, PLI Order No. 13438, 3 (Oct. 2007) [hereinafter *A Primer*]; *see generally* Sachdev, *supra* note 19, at 190–94.

111. *See generally* Sachdev, *supra* note 19, at 190–94.

112. Law of the People's Republic of China on Chinese-Foreign Equity Joint-Ventures, *available at* http://english.mofcom.gov.cn (P.R.C.); Regulations for the Implementation of the Law on Sino-Foreign Equity Joint-Ventures [collectively hereinafter EJV Law], *available at* http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=51062 (2001).

113. Law of the People's Republic of China on Chinese-Foreign Contractual Joint-Ventures, *available at* http://english.mofcom.gov.cn (P.R.C.); Law of the People's Republic of China on Chinese-Foreign Contractual Joint-ventures [collectively hereinafter CJV Law],

and CJVs are registered as limited liability companies (LLCs), where equity interests are made through the contribution of registered capital.[114]

EJVs are historically the most common joint-venture vehicle.[115] The formation of EJVs is approved by the Ministry of Commerce (MOFCOM),[116] which must also determine that the EJV benefits China in some economic regard.[117] Once established and approved, EJVs are subjected to little regulation and oversight when compared to WFOEs.[118]

Although it is the least common FDI vehicle, CJVs offer increased flexibility over EJVs in structuring and managing the joint-venture, due to the contractual freedom provided for at law.[119] For example, the CJV is used for infrastructure and energy projects where investors may desire to define the relationship between voting rights and dividend distributions independent from ownership percentages.[120]

The third, and most common, legal entity for FDI is the WFOE.[121] The WFOE Law allows foreign investors to exercise complete control over the company, making the WFOE model especially attractive where a suitable domestic partner cannot be found or where there are concerns regarding sharing control over the company's assets.[122]

Recently MOFCOM established a new legal entity for foreign investment, the FICLS.[123] This allows for equity stakes in companies that are limited by shares.[124]

C. China's Regulatory Environment

Though Chinese law allows foreign investors to choose a variety of investment entities, the destination of the investment may be severely limited or altogether closed. Chinese regulatory agencies have divided business activities and sectors into three types: (1) prohibited, (2) restricted, and (3) encouraged.[125] Chinese law specifically sets out which industries or sectors fall into the prohibited, restricted, and encouraged sectors.[126] The impact of each designation is extremely important, not only in deter-

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available at http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=51032 (2000); *see generally* David Boitout & Bastien Trelcat, *The Pros and Cons of Joint Ventures*, INT'L FIN. L. REV., Sept. 2006, at 3; Sachdev, *supra* note 19, at 190-92.

114. *See supra* note 113.

115. Sachdev, *supra* note 19 at 190.

116. This ministry is often referred to as the MOFTEC.

117. Sachdev, *supra* note 19, at 191.

118. *Id.* at 193.

119. *Id.* at 191-92 (the contractual freedom that makes CJVs attractive in some instances make it generally less attractive due to concerns over protecting the freedom of contract in China).

120. Boitout & Trelcat, *supra* note 113.

121. ORGANIZATION FOR ECON. CO-OPERATION AND DEV. [OECD], CHINA: PROGRESS AND REFORM CHALENGES 195 (2003) (In 2001, the WFOE accounted for almost 51% of FIE vehicles used).

122. Sachdev, *supra* note 19 at 193.

123. *Id.* at 189-93.

124. *Id.* at 193.

125. *See generally China Catalogue*, *supra* note 22.

126. *Id.*

mining whether foreign investment is allowed, but also how much and through what legal entity the investment can take place.[127] Restricted activities may require extensive regulatory authorization, and investment may be limited to a joint-venture entity.[128]

D. M&A Regulations

Cross-border M&A activity is increasing, following a wave of EJVs in the 1980s, the rise of CJVs in the '90s, and more recently the rise of WFOEs.[129] Both cross-border and domestic M&A activity are seen as primary means for privatizing SOEs.[130] The FIEs laid out above become the vehicles for any foreign M&A transaction.[131] Chinese M&A law sets out two types of M&A transactions: an acquisition of the shares or capital of an existing company (an equity purchase), and the formation of a FIE and the purchase of the assets of an existing domestic company (an asset purchase).[132] Thus, in the case of an equity purchase, the investor must purchase the stock right of a shareholder of the non-foreign-invested enterprise or such an enterprise must be converted into an FIE, and in an asset purchase, the foreign investor must first set up a FIE to purchase the assets of the domestic company.[133]

China is gradually liberalizing M&A regulation.[134] The recently promulgated 2006 M&A Takeover Regulations supplement and replace the previous M&A regulations from 2002 and 2003, and, combined with other measures adopted in 2006, form a coherent body of law regulating foreign M&A activity.[135] The 2006 M&A Regulations now allow foreign, publicly listed shares to be used as consideration in the purchase of assets or equity.[136] This makes it easier for companies to merge or make acquisitions.[137]

Acquisitions are subject to extensive regulatory review that can involve a number of distinct agencies including MOFCOM, the State-Owned Assets Supervision and Administration Commission of the State Council (SASAC), the State Administration of Taxation, the State Administration for

127. Tai Hsia, Chuan Li & David Patrick Eich, Kirkland & Ellis LLP, *Moving Target: A Guide to Recent Chinese M&A and Private Equity Reform*, INT'L FIN. L. REV., Oct. 2006, at 42, 42-43.
128. *Id.* at 42.
129. Hui Huang, *China's New Regulation on Foreign M&A: Green Light or Red Flag?*, 30 UNSW L.J. 804, 804 (2007).
130. Huang, *The New Takeover Regulation*, *supra* note 15, at 154-55.
131. Regulations for Merger with and Acquisition of Domestic Enterprises by Foreign Investors (sometimes referred to as Provisions on the Takeover of Domestic Enterprises by Foreign Investors), promulgated Aug. 8, 2006, effective Sept. 8, 2006, art. 2 [hereinafter 2006 M&A Regulations], *available at* http://www.yfao.gov.cn/Enshow2.aspx?id=172.
132. *Id.* art 2.
133. *Id.*
134. Huang, *China's New Regulation*, *supra* note 129, at 805.
135. *Id.* at 804. For a listing of the other relevant supplementing regulations, see *A Primer*, *supra* note 110, at 2-3.
136. Huang, *China's New Regulation*, *supra* note 129, at 804.
137. *Id.*

Industry and Commerce (SAIC), the State Administration for Foreign Exchange, and the China Securities Regulatory Commission (CSRC).[138] For smaller transactions involving a total investment of less than USD $100 million and involving an FIE that is in the encouraged or permitted category, regional MOFCOM approval may be sufficient.[139]

MOFCOM also serves as the primary antitrust authority for reviewing cross-border M&A transactions.[140] In August 2008, China's new antitrust laws took effect, fourteen years after drafting began.[141] Pre-closing antitrust approval must now be sought if at least two parties have turnover in China of at least USD $52.5 million and either: (a) all parties have combined global turnover of at least USD $1.3 billion, or (b) the combined turnover in China of all parties exceeds USD $260 million.[142] The new antitrust regulations are especially important for foreign investment in China. It already appears that China may use the new regulations as a tool for economic nationalism, blocking deals on antitrust grounds to protect certain economic sectors and prevent excess foreign investment.[143]

Recently, MOFCOM granted approval for InBev's bid to buy American beer maker Anheuser Bush, approval which was necessary as both parties have significant stakes in various Chinese breweries.[144] However, the InBev approval was conditioned on a freeze on either party from increasing their respective stakes in Chinese breweries, despite the fact that neither party controls more than 30% of a domestic brewery.[145]

More importantly, however, was MOFCOM's recent decision to block Coca-Cola's attempted friendly takeover of Chinese juice maker Huiyuan.[146] The decision was anxiously awaited, as it was the first case

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138. Adam Li, *The Changing Landscape of the PRC Foreign Direct Investment Law,* Practicing Law Institute, PLI Order No. 14705 (June-July, 2008).

139. *A Primer*, *supra* note 110, at 4.

140. *Id.* at 6-7.

141. Anti-Monopoly Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 20, 2007, effective Aug. 30, 2008) (2007) (P.R.C.) [hereinafter Anti-Monopoly Law], *available at* http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=85714; Greg Miao, *The New Anti-Monopoly Law of the People's Republic of China Takes Effect Today*, Skadden, Arps, Slate, Meager & Flom (Aug. 1, 2008), *available at* http://www.skadden.com/content/Publications/Publications1429_0.pdf.

142. Miao, *supra* note 141, at 2.

143. *See, e.g.*, William Bi & Stephanie Wong, *Coca-Cola Rebuff Wasn't Protectionist, China Says*, BLOOMBERG (Mar. 24, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aBLXVkasM7hk ("The ruling had raised concern China may be using a new anti-monopoly law to block foreign competition and handed ammunition to opponents of Chinese acquisitions in other countries."); Bill Powell, *China Says 'Keep Out' to Coca-Cola*, TIME (Mar. 18, 2009), http://www.time.com/time/business/article/0,8599,1886024,00.html (noting that despite the Chinese government's insistence to the contrary, the decision to block the Coca-Cola takeover is being interpreted as a nationalistic defense of a nationally known company.).

144. Stephanie Wong & Li Yanping, *China Gives Conditional Nod for InBev to Buy Anheuser,* BLOOMBERG (Nov. 18, 2008), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ahkV7695qBzM.

145. *Id.*

146. Powell, *supra* note 143.

involving a friendly foreign takeover of a domestic company under China's new antitrust regulations.[147] The deal itself was extremely favorable to Huiyuan shareholders as Coca-Cola was offering three times the current market valuation of the company.[148] The deal was expected to pass MOFCOM approval, and the failure to obtain antitrust approval was both a major surprise and step backward from market liberalization.[149]

China's securities laws make hostile takeovers especially difficult, if not impossible.[150] Two formal obstacles make hostile tenders offers, especially by foreigners, nearly impossible:[151] The first is the structure of Chinese stock securities.[152] Generally, shares of Chinese companies are divided into A and B shares.[153] For the most part, foreign investors are limited to purchasing B shares, which account for a very small percentage of corporate shares outstanding.[154] Additionally, A shares have subclasses which may further limit ownership rights.[155] The result is that a large number of a company's shares may not be tradable on open markets and may only be transferred by private takeover agreement.[156] The second obstacle is the widespread ownership of stocks by the state, which may simply refuse to sell.[157] This situation is changing, however, as the state sells a larger number of shares, privatizes SOEs, and changes non-tradable shares into tradable ones.[158] The result should be a significant increase in the number of hostile takeovers.[159] Nonetheless, because of the need for regulatory approval, including antitrust approval, it is yet to be seen whether foreign investors such as private equity firms will be able to partake in this restructuring.

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147. Dune Lawrence, *Coca-Cola Deal First to Be Blocked Under Chinese Monopoly Law*, Bloomberg (Mar. 18, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a0vVDxSXD9sw; Alison Leung, *Coca-Cola Bid for Huiyuan to Test China Antitrust Law*, Reuters (Sept. 10, 2008), http://www.reuters.com/article/businessNews/idUSHKG30862820080910 ("Some industry experts argue Beijing has no interest in killing a non-sensitive deal but others say a public outcry will have regulators scurrying to protect a beloved national brand.").

148. *Hard to Swallow*, Economist, Mar. 21, 2009, at 68–69; Leung, *supra* note 147.

149. *Hard to Swallow*, *supra* note 148 ("Coke has spent years developing its presence in China, and has invested heavily, presumably making it one of the world's more acceptable buyers. It is also one of the few companies able to finance a big deal in today's difficult circumstances. If Coke was not acceptable to the Chinese authorities, then who would be?")

150. *See, e.g.*, *China's Takeover Law*, *supra* note 11, at 157–59.

151. *Id* at 149–51.

152. *Id.*

153. *Id.*

154. *Id.* at 149 (in 2004 B shares accounted for a mere 0.4% of shares in terms of market capitalization on Chinese stock markets).

155. *Id.* at 150.

156. *Id.* at 150.

157. *Id.* at 158.

158. *Id.* at 158.

159. Huang, *The New Takeover Regulation*, *supra* note 15, at 174.

III. India's Investment Regime

A. The Legal and Regulatory Environment

Like China, India is also undergoing a process of market liberalization, spurned ironically in part from witnessing rapid economic growth in China and the other Asian tigers.[160]

FDI in India is governed by a number of laws, foremost of which is the Foreign Exchange Management Act of 1999 (FEMA) for all FDI and the Takeover Code of the Stock Exchange Board of India (SEBI) for foreign M&A activity.[161] Acting under FEMA, the RBI issued a set of regulations which outline an "automatic route" through which foreign investors may be granted automatic approval for investment.[162]

Like China, India restricts foreign investment in certain sectors of the economy.[163] The FEMA Regulations altogether prohibit foreign investment via the automatic route in some sectors like banking and atomic energy.[164] In others, like telecommunications, pharmaceuticals, and mining, the FEMA Regulations cap the percentage of investment in a company.[165] Schedule I, § 2 allows for the automatic issuance of shares or convertible debt to foreign investors, provided that the company is not engaged in any restricted activity,[166] does not require an industrial license per the Industries Act of 1951, and the issuance is not done "with a view to acquiring existing shares of any Indian company."[167] The Industries Act of 1951 requires certain licenses to operate in certain industrial sectors.[168] Recently this Act has been updated with the goal of liberalizing foreign investment in part by reducing the list of industries for which licensing is required.[169]

Where FDI cannot be made via the automatic route, approval must be granted from the Foreign Investment Promotion Board (FIPB).[170] Recently, most FDI has required FIPB approval.[171] In addition to the need for approval for restricted industries, and industries requiring a license to operate, government approval is also required in instances where the for-

160. *See, e.g.*, Kletzer, *supra* note 6.
161. Foreign Exchange Management Act, 1999, No. 42, Acts of Parliament, 1999, *available at* http://finmin.nic.in/the_ministry/dept_eco_affairs/america_canada/fema_acts/index.htm; Substantial Acquisition of Shares and Takeovers, Regulations 1997, as amended, *available at* http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec_id=5&sub_sec_id=5; *see generally* Sachdev, *supra* note 19, at 187 (additionally, the Industries Act of 1951 and the Companies Act of 1956 may regulate FDI).
162. FEMA Regulations, *supra* note 22.
163. *Id.*
164. *Id.* at Annexure A.
165. *Id.* at Annexure B.
166. *Id.* at Annexure A.
167. *Id.* at Schedule 1, § 2.
168. Industries (Development and Regulation) Act of 1951, *available at* http://labour.delhigovt.nic.in/act/details_acts/industrialdevelopment/industries/part_2.html; Sachdev, *supra* note 19, at 188.
169. Sachdev, *supra* note 19, at 189.
170. *Id.* at 200.
171. *Id.*

eign investor has already made an existing investment in the same economic sector.[172]

Importantly, FDI approval in India is centered almost entirely on the national level.[173] Locally mandated approval, registration, or licensing requirements are not coordinated through national level offices, thus investors must conduct separate negotiations at the local level should such approvals be required.[174]

B. M&A Regulations

In India, M&A is the primary means for FDI.[175] Until 2006, both FIPB and the RBI had to grant approval in cases where there were attempts to acquire control of a domestic company.[176] The required approvals were a major obstacle for foreign M&A activity, especially for hostile takeovers.[177] Since 2006, only RBI approval is needed, although all FEMA restrictions regarding restricted and limited economic sectors still apply.[178]

India's antitrust regime was just recently promulgated and a number of its key provisions have yet to come into force.[179] In 2007, the Competition (Amendment) Act of 2007 was enacted, replacing and amending legislation from 1969 and 2002.[180] The Competition Act requires the Competition Commission of India to notify and approve certain transactions.[181] Like China, the full effect of the legislation is yet to be seen.[182]

IV. Striking the Balance

A. Differences Between Each Regime

The foreign investment regimes of India and China differ dramatically, both in statutory structure and in practice.[183] Analytically, the differences can be divided between the statutory structure of each regime, including the legal entity used and the relevant governing regulations, and the approval process necessary to consummate a foreign investment.[184] These differences go a long way toward explaining the dramatic disparities in FDI

172. *Id.* at 201.
173. *Id.* at 208-09.
174. *Id.* at 208.
175. Jitheesh Thilak, *Regulating M&A: An Insight into Competition Laws in India*, 32 Int'l Bus. Law. 161, 161 (Aug. 2004) (in 2000 approximately 40% of FDI was through M&A).
176. Mathew, *supra* note 11, at 820.
177. *Id.* at 821.
178. *Id.* at 821.
179. Terry Calvani & Karen Alderman, *BRIC in the International Merger Review Edifice*, Presentation at the Cornell Law School Int'l L.J. Symposium: Comparative Antitrust Policies in Mergers and Acquisitions, Feb. 27, 2009, at 7 (transcript on file with the *Cornell International Law Journal*).
180. The Competition (Amendment) Act 2007, 2007, *available at* http://164.100.24.219/BillsTexts/LSBillTexts/asintroduced/competition%202007.pdf; *see also id.* at 7.
181. *See supra* note 180.
182. *See, e.g.*, Calvani & Alderman, *supra* note 179, at 7.
183. *See, e.g.*, Sachdev, *supra* note 19, at 169.
184. *See generally id.* (comparing the Indian and Chinese FDI regimes).

inflows between India and China and may better explain the current disparity in investment inflows than other political and economic explanations.[185]

The statutory structure of China's investment regime, and the context in which it was promulgated, provide investors with greater predictability of government actions, is more transparent and user-friendly, and by being tailored to FDI, has signaled China's deep and lasting commitment to attracting foreign investment.[186] Rohit Sachdev summarizes the differences:

> India's statutory governance of FDI is comparatively more convoluted and more antiquated than China's, and therefore, it is less conducive to attracting, processing, and retaining FDI inflows. In addition, China uses distinct legal vehicles that prove more transparent and more comprehensible for foreign investors than India's outdated legislation.[187]

Investors are unlikely to make significant investments unless they are provided some sense of certainty or predictability in how a host nation will interpret its FDI laws and whether it will respect the contractual rights and property rights inherent in the investment.[188] Absent a high degree of confidence in the clarity, integrity, and stability of investment rules, investors may exaggerate the dangers inherent in a host nation's investment regime, resulting in less investment than would otherwise be provided.[189]

Typically, examinations of such certainty and predictability are associated with broader studies of a state's rule of law, including access to the judiciary and stability in the law.[190] While China is the preferred destination for FDI, in such studies, India is seen as far stronger in observing the

185. *Id.* at 168-73.

186. *Id.* at 194 (noting that China's FDI regime both (1) broke "dramatically with past economic and legal policy, thereby explicitly signaling to foreign investors China's desire for capital from abroad" and (2) the regime's structure "proves relatively more transparent and user friendly than its Indian counterpart.").

187. *Id.* at 169.

188. OECD Global Forum on International Investment, New Horizons and Policy Challenges for Foreign Direct Investment in the 21st Century 4 (Nov 27, 2001), http://www.oecd.org/dataoecd/25/2/2421642.pdf ("Multilateral investment rules are designed to underpin domestic investment regimes and to reassure foreign investors that, whatever the rules of a potential host country look like, they will always comply with certain basic principles. The resulting greater legal certainty would produce greater propensity to invest abroad and greater FDI flows overall and would also minimize the risk of capital flights.").

189. *Id.* ("Moreover, a large number of potential host countries, especially among developing countries, suffer from a 'perception gap', whereas they are perceived by foreign investors as posing a much greater risk that the reality would justify.").

190. *See, e.g.*, Ronald J. Daniels & Michael Trebilcock, *The Political Economy of Rule of Law Reform in Developing Countries,* 26 Mich. J. Int'l L. 99 (2004); Daniel Kaufman et al., World Bank, *Governance Matters V: Aggregate and Individual Governance Indicators for 1996-2005* (2006), *available* at http://siteresources.worldbank.org/INTWBIGOVANTCOR/Resources/1740479-1150402582357/2661829-1158008871017/gov_matters_5_no_annex.pdf; A.T. Kearney, 2004 Foreign Direct Investment (FDI) Confidence Index (2004).

rule of law[191] and controlling corruption.[192] Thus, a state can largely disregard the rule of law in other areas of society and still attract foreign investment so long as the state provides clarity and transparency and observes the rule of law where foreign investments are concerned.[193]

Investors may be more confident in China's commitment to attracting FDI than in India's efforts.[194] First, investors may view China as more likely than democratic India to maintain consistent policy goals and objectives because of China's long-term communist leadership.[195] Or alternatively, investors may have more confidence in a single-party regime to put into effect liberalizing reforms beneficial to investors, which, in an open democracy, may be too politically costly to enact.[196]

Second, China has explicitly and actively sought to reform its investment regime to court foreign investment in a way that signals a deep commitment to attracting and maintaining high levels of foreign investment.[197] The sustainability of this commitment to foreign investment may be furthered by the single-party autocratic rule of China.[198] Because there is less of a threat of political change in China, there may be a perception that the government is less likely to make an about-face and curtail investment rights.[199] China's FDI laws were formed with the specific intention of attracting foreign investments and were tailored to that end, beginning with the promulgation of the EJV law following Deng Xiaoping's "open door policy" of 1979.[200] Soon thereafter, the Chinese constitution was amended to more explicitly allow for foreign investment.[201]

Subsequently, new legal vehicles were added to China's foreign investment regime that allow for different types of economic cooperation and

191. Daniel Kaufman et al., *Governance Matters V: Aggregate and Individual Governance Indicators for 1996-2005*, *Data Tables*, (World Bank Policy Research Working Paper, Sept. 2006), *available* at http://siteresources.worldbank.org/INTWBIGOVANTCOR/Resources/1740479-1150402582357/2661829-1158008871017/gov_matters_5_tables.pdf (China and India were ranked in the 41st and 56th percentile, respectively, in terms of observing "Rule of Law"); A.T. Kearney, *supra* note 190, at 4 (73% of investors surveyed found India to better observe the Rule of Law).

192. Kaufman et al., *supra* note 190 (China and India were ranked in the 31st and 47th percentile, respectively, in terms of "Control of Corruption").

193. *See, e.g.*, Sachdev, *supra* note 19, at 181–86.

194. *See, e.g.*, *id.* at 194.

195. *See, e.g.*, Kaufman et al., *supra* note 190 (China was ranked seventeen percentage points higher than India in terms of political stability, although both ranked low, below the 50th percentile).

196. Sachdev, *supra* note 19, at 185 ("A one-party government seemingly has the authority, leverage, and nimbleness to implement legal infrastructural, and economic directives that drive economic progress by encouraging FDI inflows; this has evidently been the case over the past couple of decades in China.").

197. *See, e.g.*, *id.* at 195 ("With the primary goals of accelerating development, increasing investment capital, and importing technology, China proactively pursued foreign investment as part of its revamped economic strategy by promulgating new legislation devoted to that end.").

198. *Id.* at 185.

199. *See, e.g.*, *id.* at 198.

200. *Id.* at 194–95.

201. *Id.* at 195.

investment by foreigners ranging from joint-venture agreements to direct acquisition of a domestic company to greenfield investment.[202] Each type of foreign investment has a legal form that is directly tailored to and created for foreign investment.[203] Additionally, China's government continues to explicitly signal its desire for FDI in certain economic sectors by designating FDI in certain economic areas as "encouraged."[204] While the government also designates certain sectors as restricted or even prohibited, the move to continually label a large number of sectors as "permitted" or "encouraged" may signal to investors a continued desire to attract and evaluate FDI.

India has largely failed to signal an explicit commitment to attracting foreign investment, increasing the perception that such investment is a low priority of the Indian government, thus making any governing laws more subject to change.[205]

India's investment regime covering industrial licensing is also critiqued for its complexity, which may confuse potential foreign investors.[206] This licensing regime dates back to the early 1950s and was based on a socialist economic paradigm designed to restrict foreign investment and maintain control over key industrial sectors.[207] Jeffrey Frieden describes this paradigm as the foundation that shaped India's economic policy during the 1950s and '60s, of which FDI regulations were but one means to tighten state control over the economy:

> From Mexico to Nigeria, from Peru to India, foreign corporations were excluded from many industries, and foreign ownership was strictly limited, often to a minority share. Many developing countries allowed FDI only if the foreign company did not compete with local firms, shared ownership with local investors, brought in important new technologies, and agreed to reinvest most of its profits. Governments subjected foreign companies to closer scrutiny and greater controls.[208]

Absent a dramatic and explicit break with past industrial and economic policy, investors may be significantly deterred by India's investment regime, despite recent liberalization, for fear that the policy goals of old will return.

India and China's investment regimes also differ in terms of their respective power structures. China's regime is driven by explicit statutory authorizations of power while India relies on government agencies to fill in the details.[209] China's investment regime creates specific avenues foreign investors must pass through to have an investment approved and imple-

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202. *See supra* Part II.
203. *See supra* Part II.
204. *See China Catalogue*, *supra* note 22, at 1-18 (listing encouraged industries).
205. *See e.g.*, Sachdev, *supra* note 19, at 195 ("In contrast [to China], India's legislative actions, both during and since 1991, have not sought to promote FDI as actively as China's. In some respects, India has done just the opposite.").
206. *See, e.g.*, *id.* at 196.
207. Frieden, *supra* note 31, at 312-16; Sachdev, *supra* note 19, at 196.
208. Frieden, *supra* note 31, at 349-50.
209. Sachdev, *supra* note 19, at 194-98.

mented.[210] India's investment regime functions by virtue of delegation to other federal agencies, such as the RBI, which in turn enacts their own regulations and procedures, thus creating an added layer of confusion and uncertainty likely to deter potential investors.[211] Because India did not tailor its investment regime to attract foreign investment as China did, investors in India lack the enumerated procedures and requirements available to investors in China.[212]

Differences in the approval process in each country largely stems from this difference in statutory power structure.[213] The result is that the approval process is longer in India than in China and requires navigating various national and local bureaucracies.[214]

One survey of potential investors saw reducing bureaucracy such as in FDI approval as the most serious concern regarding India's competitiveness.[215] A variety of economic approvals and processes from starting a business and enforcing a contract take significantly longer in India than in China;[216] FDI approval is no different.[217] The impact of the longer approval process is unclear, but it may result in a reduction in investments even attempted in India. The added days necessary to obtain regulatory approval could mean the difference between a proposed FDI project being profitable or not. [218]

Perhaps more significantly, India's approval process includes various nominally separate approval procedures for national and local agencies, while China maintains a vertically integrated approval process that fosters simplicity and clarity.[219] In some cases involving smaller investments (less than USD $30 million), FDI approval in China is only needed at the state and local level through the provincial commerce authority, COFTEC.[220] In India, all FDI approval must begin at the national level and only proceeds to the local level if national approval is granted.[221] A vertically integrated approval process does have a significant drawback: the inclusion of local and national authorities in the approval process in China creates some infighting which may hinder investment approval.[222] However, absent a vertically integrated process, as in China, investors in India must personally deal with various local and provincial authorities after receiving national approval.[223]

Overall, the vertical system creates greater predictability and clarity for

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210. *Id.* at 197.
211. *Id.*
212. *Id.* at 197.
213. *Id.* at 207-09.
214. *Id.* at 209-11.
215. A.T. Kearney, *supra* note 190, at 32.
216. World Development Report 2005, *supra* note 28, at 248.
217. Sachdev, *supra* note 19, at 199.
218. *Id.* at 199-200.
219. *Id.*at 208-09.
220. *Id.* at 210.
221. *Id.* at 210-11.
222. *Id.* at 210.
223. *Id.* at 212.

investors offering a standardized framework for investors.[224] Sachdev summarizes the impact of each approval process:

> Upon entering China, investors can be certain of the nature, if not the speed, of the approval process. Comparatively, foreign investors in India encounter far less certainty regarding investment approval procedures because of the lack of coordination between the national and state/local bureaucracies and the sheer volume of approvals required at the local level.[225]

B. Policy Objectives

A nation's foreign investment regime is an important tool in structuring an economy and promoting economic growth.[226] But like any regulation, a foreign investment regime impacts more than economic variables. It can also be an important tool in promoting other political and social objectives, such as maintaining control over key economic sectors and maintaining domestic job security.[227] Thus, foreign investment regimes should not be judged solely on the volume of FDI that is brought in.

China still maintains a single party socialist government emphasizing public ownership of property.[228] The Chinese Constitution states:

> The basis of the socialist economic system of the People's Republic of China is socialist public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people. The system of socialist public ownership supersedes the system of exploitation of man by man; it applies the principle of 'from each according to his ability, to each according to his work.[229]

Recently the state has officially acknowledged the role of private ownership but only in so far as it complements state ownership.[230] This recent liberalization of the Chinese securities market and loosening of M&A regulations should therefore be seen as complementing the state control of assets.

One key policy objective that persists despite recent liberalization is the notion of protecting key economic sectors, especially those that are

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224. *Id.* at 210-13.
225. *Id.* at 213.
226. *See e.g.*, World Development Report 2005, *supra* note 28, at 167-74 (discussing some of the costs, benefits, and means to selectively attract FDI).
227. *See* Frieden, *supra* note 31, at 312-16 (describing India's transition away from free market principals). More governments invoke national security to restrict foreign investment. OECD, OECD Adopts Guidelines to Avoid Protectionist Use of Security Measures, Jul. 23, 2009, http://www.oecd.org/document/22/0,3343,en_2649_34887_43384662_1_1_1_1,00.html (noting this use of national security exemptions for blocking investments affecting national economic security).
228. *See e.g.*, The Constitution of the People's Republic of China, art. 6, *available at* http://english.peopledaily.com.cn/constitution/constitution.html.
229. *Id.*
230. *Id.* art. 11 ("The individual economy of urban and rural working people, operated within the limits prescribed by law, is a complement to the socialist public economy. The state protects the lawful rights and interests of the individual economy. The state guides, helps and supervises the individual economy by exercising administrative control.").

related to national security.[231] This is especially true regarding foreign acquisitions of domestic companies.[232] The 2006 M&A Regulations require special approval by MOFCOM of any acquisition that "involves a key industry, has or may have an impact on the national economic security or results in a transfer of the actual control of a domestic enterprise that owns a well-known trademark or a historic Chinese brand name."[233] Such broad language could potentially be used in conjunction with antitrust approval requirements to exercise control over almost any economic sector.[234] Thus far, no major foreign acquisitions of domestic companies have been approved under the new regulatory scheme.[235] However, the new regulations may signal a desire to break with the past policy of protectionism.[236] But given the current financial turmoil, there may be strong pressure to insulate domestic firms from the global financial storm.[237]

Continued economic growth is a crucial policy goal of the Chinese government.[238] Extraordinary rates of economic growth have helped to keep the Communist Party in power and maintain a stable social and political order,[239] with GDP growth as high as 8% per year.[240] While economic growth is important in every nation, in China it is of such importance that it is conducted at the expense of democratic choice, environmental concerns, and the desire for domestic consumption if necessary.[241] Maintain-

231. *See e.g.*, *China Catalogue*, *supra* note 22; Huang, *China's New Regulation*, *supra* note 129, 807-085 (2007).

232. *China Catalogue*, *supra* note 22, at 23-24 (prohibiting projects that endanger the military or involve weapons).

233. 2006 M&A Regulations, *supra* note 131, art. 12.

234. *See e.g.*, *Coca-Cola and Huiyuan: The Acid Test*, CHINA ECON. REV. (Oct. 2008), *available at* http://www.chinaeconomicreview.com/cer/2008_10/Coca-Cola_and_Huiyuan:_The_acid_test.html (noting the potential application to a Chinese juice manufacturer: "The [anti-trust] law's ambiguity, and public sentiment for the famous Chinese juice brand, make the outcome uncertain. The law, which took effect on August 1, has a clause protecting 'famous brands' from foreign acquisitions. It also bars mergers that hurt competition, giving regulators wide discretion.").

235. *Id.*

236. *See e.g.*, Schneider, *supra* note 15, at 269-70 (2007) ("Before the [2006 M&A Regulations] became effective, China shielded domestic industries from competition without violating WTO principles by bureaucratically stalling several acquisitions of its domestic firms.").

237. *See* Clive Crook, *New China Tariffs Pose Needless Risk*, NAT'L J., Sept. 19, 2009, at 17.

238. *See e.g.*, China in 2009: Year of the ox, ECONOMIST, Dec. 22, 2008, http://www.economist.com/world/asia/displaystory.cfm?story_id=12833897.

239. *Id.* (noting that even GDP growth rates of 5-6% may be so low as to test the stability and longevity of the current political order.).

240. Xu Sitao, *Divergence Grows Between China and the West - Part I*, YALE GLOBAL ONLINE, Dec. 18, 2008, http://yaleglobal.yale.edu/display.article?id=11756 ("For China, maintaining a 8 percent growth rate is not just an economic but political imperative, and it trumps any supposed failure to provide world leadership. Government economists anticipate that China needs at least 8 percent growth to create ample new jobs. Rising unemployment combined with the growing rural-urban economic gap could bring the most serious challenge to the government.").

241. Elizabeth Economy, *The Great Leap Backward*, FOREIGN AFF. (Sept./Oct. 2007), *available at* http://www.foreignaffairs.org/20070901faessay86503/elizabeth-c-economy/the-great-leap-backward.html ("China's rapid development, often touted as an eco-

ing economic growth may even trump the policy of maintaining state ownership of key assets, resulting in further market liberalization to foster investment, entrepreneurship, and economic choice.[242]

Like China, India traces its current regulatory scheme to a socialist past.[243] Creating jobs and protecting important industries have been, and continue to be, key national objectives.[244] Unlike China, India does not have single party rule but maintains a relatively liberal democracy.[245] This may be the most important difference in the political context of each investment regime. Long-term economic growth and market liberalization may be trumped by populist protectionism, as those opposed to market liberalization may vote for parties and candidates who share such sentiments.[246] Those who are set to benefit from globalization, at least in the short term, may be small in number, while those who perceive short term risks from globalization may be large in number and voting power.[247] As one author notes:

> Why should particular classes of labor be made more vulnerable by globalization than holders of capital? Why should the low-yield, but risk-averse farming strategies of an Indian farmer with a small plot of land give way to large-scale commercial farming that takes the land away from him? If banks and big creditors can be insured against economic shocks, why can't self-employed workers?[248]

Recently, those favoring continued market liberalization may be falling into the minority.[249]

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nomic miracle, has become an environmental disaster. Record growth necessarily requires the gargantuan consumption of resources, but in China energy use has been especially unclean and inefficient, with dire consequences for the country's air, land, and water."); Sitao, *supra* note 240 ("China took steps in mid-November to boost the economy with a stimulus package that inherently favors infrastructure investment over consumption").

242. Zhiwu Chen, *Economic Crisis Could Push Reform in China*, Yale Global Online, Nov. 12, 2008, http://yaleglobal.yale.edu/display.article?id=11596.

243. Frieden, *supra* note 31 at 349; Sachdev, *supra* note 19, at 196.

244. Economy, Industry & Trade, Embassy of India http://www.indianembassy.org/dydemo/industry.htm ("Early planners in free India had to keep in mind two aims: all-round development and generation of large-scale job opportunities. Economic development strategies were evolved with an eye on these twin objectives."); FEMA Regulations, *supra* note 22 (setting out protected economic sectors).

245. CIA World Factbook - India, CIA, https://www.cia.gov/library/publications/the-world-factbook/geos/in.html#Govt.

246. Pratap Bhanu Mehta, *Lessons on Globalization from India*, Yale Global Online, Jun. 17, 2004, http://yaleglobal.yale.edu/content/lessons-globalization-india ("[I]n developing countries, voters excluded from the gains of globalization or made more vulnerable by it are expressing their dissatisfaction against government. . . . In India, for instance, globalization is often blamed for everything from starvation deaths of farmers to scarce power and water.").

247. *Id.*

248. *Id.*

249. *See e.g.*, Floyd Norris, *Fearing Protectionism Inside India*, Int'l Herald Tribune, Jan. 26, 2007.

C. Differences in Context

The policy motivations of each nation emerge from the broader social and political context, and thus are in some ways inseparable. But other contextual aspects influence the effectiveness of each investment regime. Contemporary economic research has noted the impact of certain characteristics and "threshold" requirements on sustainable economic growth that benefits society at large.[250] Such factors impact the desirable amount of FDI, how effective it will be, where it should be employed, and where improvements in an investment regime should lie.[251] The upshot is that direct liberalization may not be the best way to improve the economic benefits of FDI.[252] Other changes that are only tangentially related to FDI, such as improving physical infrastructure, may be the best means to improve the benefits of FDI.[253]

Neither China nor India appears initially to meet more threshold requirements than the other. However, each nation differs, sometimes considerably, in measurements of factors deemed important to attracting and using FDI.[254]

Broad political stability differs dramatically between India and China.[255] Domestic political stability may be one of the biggest impediments to foreign investment and economic growth in India, and one of the biggest benefits to investment in China.[256] One survey ranked political stability as the second most serious factor impacting India's competitiveness.[257] Another study judged India's political stability to be the lowest of all Asian countries surveyed, while China was judged the most stable.[258]

Additionally, the benefits of FDI are greatest in countries with developed financial markets.[259] In measures of capital market sophistication, an important aspect of financial markets, India and China differ dramatically both in terms of size and their respective levels of sophistication, including market capitalization, accounting practices, and share transfer restrictions.[260] The market capitalization of listed companies is far greater

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250. *See supra* notes 64-67; *see generally supra* Part I.
251. *See generally supra* Part I.
252. *See generally supra* Part I (discussing countries' threshold requirements).
253. *See infra* notes 264-71 and accompanying text.
254. *See supra* notes 64-67.
255. *See e.g.*, Muhammad Younis et al., *Political Stability and Economic Growth in Asia*, 5 Am. J. Applied Sci. 203, 205 (2008), *available at* http://www.scipub.org/fulltext/ajas/ajas53203-208.pdf.
256. *Id.* at 208 ("India's growth is facing some political challenges at present and will have to face them in the future also because of the political instability bred by its multi party and democratic political system.").
257. A.T. Kearney, *supra* note 190, at 32.
258. Younis et al., *supra* note 255, at 205.
259. Alfaro et al., *supra* note 64.
260. Franklin Allen et al., *Law, Finance, and Economic Growth in China*, 77 J. Fin. Econ. 57, 59-60 (2005) (noting that China institutions suffer from significantly less developed investor protection systems, corporate governance, accounting standards, and banking system.); *see generally* Sweta Chhaochharia, *Capital Market Development: The Race Between China and India* 14 (2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1130074 (describing some of the differences in capital markets

in China, yet recent growth has been far greater in India.[261] Both nations suffer from various capital market deficiencies in terms of corporate governance and sophistication of products traded.[262] Yet in a broader measure of financial market sophistication by the World Economic Forum, India was ranked dramatically higher at thirty-second, compared to China's ranking of seventy-eighth.[263]

Physical infrastructure is another important factor in both attracting FDI and efficiently putting it to work.[264] The results are mixed on which nation fares better. China is perceived as having the better infrastructure, at least insofar as investors are concerned.[265] While India's information technology infrastructure is perceived as marginally better,[266] China's physical infrastructure is perceived on a broader level as much more advanced.[267] Perhaps more importantly, India's education system is seen as stronger, capable of producing high quality engineers, scientists, and business leaders.[268] The World Economic Forum, in its 2009-2010 Global Technology Report, ranked India's overall education system thirty-seventh while ranking China fifty-second.[269] Even more striking are India's quality of management schools, ranked fifteenth, and the quality of math and science education, ranked twenty-seventh.[270] China was ranked seventy-second and thirty-fifth, respectively.[271] China's relative weakness suggests that China depends far more heavily on foreign investment for the introduction of new technology and on foreign companies for providing highly skilled employees, managers, and scientists from abroad.

Lastly, historical cultural differences may affect the role of and need for legal regulations.[272] Previous literature has suggested that legal sys-

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including size and standard accounting practices); *see also* Huang, *The New Takeover Regulation*, *supra* note 15, at 155–58 (describing the current share restrictions in China).

261. *See supra* note 260.

262. *Id.*

263. Soumitra Dutta & Irene Mia, World Economic Forum, The Global Information Technology Report 2009-10 321, http://www.weforum.org/documents/GITR10/index.html.

264. *See e.g.*, A.T. Kearney, *supra* note 190, at 31–32; OECD Global Forum on International Investment, *supra* note 188, at 2 (listing level of infrastructure as one of the main determinates of international investment flows).

265. A.T. Kearney, *supra* note 190, at 31–32

266. *See e.g.*, Rajan Chandras, *Infrastructure: A Wake-Up Call for India, China*, Intelligent Enterprise, Apr. 20, 2007, http://www.intelligententerprise.com/blog/archives/2007/04/infrastructure.html.

267. Prakash Gupta, *Lessons for India in China's Infrastructure Build Up*, Business Week, Jan. 15, 2008, *available at* http://www.businessweek.com/globalbiz/content/jan2008/gb20080115_286401.htm?chan=search. *But see* Yasheng Huang, *China Could Learn from India's Slow and Quiet Rise*, Yale Global Online, Jan 27, 2006, http://yaleglobal.yale.edu/content/china-could-learn-india%E2%80%99s-slow-and-quiet-rise (arguing that a narrow focus on building physical infrastructure to attract FDI may be less important than building a solid education system.).

268. Dutta & Mia, *supra* note 263; Yasheng Huang, *supra* note 267.

269. Dutta & Mia, *supra* note 263, at 355.

270. *Id.* at 354, 366.

271. *Id.* at 354, 366.

272. Franklin Allen, et al., *supra* note 260, at 58, 67 (describing the advantages of an English common-law origin legal system which India, but not China, uses).

tems that trace their origin to English common-law based models, like India, tend to have better institutions, less corrupt government, more efficient courts, better accounting standards, and ultimately better outcomes for the financial system as a whole.[273] Recent literature suggests China may be an exception to this trend but only in regard to private, non-listed, companies.[274] The expansion of China's economy may be largely dependent on the growth of private non-listed businesses, which have prospered in spite of relatively weak legal protections and a non-English common-law based legal system.[275]

However, the success of private sector non-listed businesses is largely due to "alternative financing and governance mechanisms" in China that are inaccessible to foreigners wishing to make investments.[276] Chief among these are "reputation and relationships" ranging from a strong tradition of family run firms to friends of government officials who are able to "ease" the problem of complying with government regulations through profit sharing with government officials.[277]

Additionally, one article suggests the role of Confucian views in Chinese culture may reduce the ability or desire for drastic legal reforms.[278] The authors argue that, because of the influence of Confucianism in China, change should be "gradual and should be fully implemented only after they are proven correct."[279] Of course, this does not rule out change but simply advocates reform only after a record of proven investment performance.

D. Performance of Each Regime

The past decade or so has provided an interesting test case for evaluating the investment regimes of both India and China, as a period of extraordinary global economic growth has preceded the current global economic downturn.[280] This allows us to view each regime in both the best and the worst of times.

China's investment regime has attracted more foreign investment than

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273. *Id.* at 58, 67 (summarizing the research by La Porta, Lopez-de-Silanes, Shleifer, and Vishny.)

274. *Id.* at 99.

275. *Id.* at 77–78 ("The Private Sector dominates the State and Listed sectors in terms of both the size of the output, and the growth trend: Total output in 1999 is US[$1.2 trillion] for the Private Sector, while it is around US [$400 billion] in the State and Listed sectors combined; the Private Sector grew at an annual rate of 14.3% between 1996 and 2002, while the combined State and Listed sectors grew at 5.4% during the same period.").

276. *Id.* at 96.

277. *Id.* at 96–98 ("The main problem for the application for a license seems to be dealing with government bureaucracy. To ease this problem, most of the firms' founders/executives ask the friends of government officials to negotiate on their behalf, or the firms can offer profit sharing to government officials.").

278. *Id.* at 98.

279. *Id.*

280. *See e.g.*, *Globalization: Turning their Backs on the World*, ECONOMIST, Feb. 21, 2009, at 59.

India over the past fifteen years.[281] Relative to the size of their economies, the UN Conference on Trade and Development (UNCTAD) consistently ranked China higher than India for FDI performance from 2005 to 2007.[282] In 2007, both countries were ranked relatively poorly in a worldwide ranking of FDI performance: India ranked one hundred-sixth and China eighty-eighth.[283]

The author has not found any broad research directly linking FDI inflow volatility to broader social ills such as increased poverty and unemployment. However, recent anecdotal evidence suggests that a rapid reduction in FDI inflows, especially following a rapid inflow can have a devastating impact on communities that were largely dependent on FDI activity.[284] A recent report covering a region of China that was once fueled by foreign investment is telling.

Over the past decade the region has become one of the world's fastest-whirring economic engines—a global hub in the manufacture of clothing, shoes and electronics—serviced by tens of millions of migrant workers. Now the region is undergoing an equally remarkable contraction. In the past year thousands of factories, perhaps one-third to one-half of the total, have closed.[285] While FDI is a far more stable form of investment, especially in times of global economic panic, than speculative capital inflows like those into local securities markets, a slowing or halt of FDI can have painful implications.[286] The relationship between FDI and economic growth, as one article notes, is "far from straightforward," and it "varies across countries and time periods."[287] The direction of causation between economic growth and FDI flows is often unclear.[288] One study from 1999 suggests that there is a positive causal relationship between FDI flows and economic growth in China: FDI flows predicted economic growth.[289] Another study from 2002 suggested that the causality may run the opposite

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281. U.N. CONFERENCE ON TRADE AND DEVELOPMENT [UNCTAD], WORLD INVESTMENT REPORT 2008: TRANSNATIONAL CORPORATIONS, AND THE INFRASTRUCTURE CHALLENGE 255, U.N. Doc. UNCTAD/WIR/2008 (2008), *available at* http://www.unctad.org/Templates/WebFlyer.asp?intItemID=4629&lang=1 [hereinafter UNCTAD, WORLD INVESTMENT REPORT 2008]; UNCTAD, WORLD INVESTMENT REPORT 2004: THE SHIFT TOWARD SERVICES 370, U.N. Doc. UNCTAD/WIR/2004 (2004) [hereinafter UNCTAD, WORLD INVESTMENT REPORT 2004], *available at* http://www.unctad.org/Templates/WebFlyer.asp?intItemID=4629&lang=1.

282. UNCTAD, WORLD INVESTMENT REPORT 2008, *supra* note 281, at 10–11, 214.

283. *Id.* at 214.

284. *Time to Change the Act*, ECONOMIST, Feb. 21, 2009, at 69 (noting the dramatic contraction of a region of China that was once fueled by foreign investment); *U.S. is SZ's Biggest Foreign Investor*, SHENZHEN GOVERNMENT ONLINE, Jun. 19, 2009, http://english.sz.gov.cn/ln/200906/t20090619_1146790.htm (noting the significance of foreign investment in Shenzhen).

285. *Time to Change the Act*, *supra* note 284

286. *Whiff of Contagion*, *supra* note 39, at 27–28.

287. Xiaoying Li & Xiaming Liu, *Foreign Direct Investment and Economic Growth: An Increasingly Endogenous Relationship*, 33 WORLD DEVELOPMENT 393, 395 (2005).

288. *Id.* (discussing the difficulty in studying the linkage between economic growth and FDI).

289. *Id.*

way in India: economic growth predicted FDI flows.[290]

More recent economic data on GDP growth and FDI flows reinforce the causal linkage previously suggested in China[291] and suggest that FDI may be a statistically significant predictor of GDP growth in India.[292] A regression analysis of GDP and FDI flows from 1992 to 2008 shows a statistically significant linkage between FDI inflows and overall GDP for both China and India.[293]

Additionally, volatility in FDI inflows may reduce the ability of a domestic economy to maximize FDI's benefits. This may be one factor influencing China's higher ranking in FDI performance than India.[294] Such volatility may produce detrimental effects, especially on lower economic classes.[295] China has performed far better in terms of providing low levels of volatility in FDI flows.[296] Volatility is measured as the standard deviation of percentage changes in FDI flows year over year.[297] The volatility of FDI flows in India from 1998 to 2008, the period from the last major global financial crisis to the current one, was 48.5%.[298] Volatility in China over the same period was 10.5%.

Perhaps the most remarkable test of each regime has been during the current global economic downturn. FDI flows to developing countries, including India and China, have decreased during the current downturn.[299] Remarkably, the impact has been worse in some of the most developed nations like Britain, Italy, and Germany, each of which saw FDI decrease by 50% or more in 2008.[300] In contrast, India saw FDI increase by over 60% from 2007 to 2008 as FDI to China grew by approximately half that amount, 30%.[301] Official numbers are not available as of this writing; however, initial estimates show both India and China suffering small to moderate decreases in FDI in 2009.[302] By one estimate, FDI to China fell by approximately 3% in 2009 while FDI to India fell 19%.[303] To

290. Chandana Chakraborty & Parantap Basu, *Foreign Direct Investment and Growth in India: a Cointegration Approach*, 34 Applied Econ. 1061, 1063 (2002).

291. Li & Liu, *supra* note 287, at 395.

292. *See* Appendix A.

293. *See* Appendix A

294. UNCTAD, World Investment Report 2008, *supra* note 281, at 214.

295. *See e.g.*, Prasad et al., *Financial Globalization*, *supra* note 45.

296. *See* UNCTAD, World Investment Report 2009: Transnational Corporations, Agricultural Production and Development 249, U.N. Doc. UNCTAD/WIR/2009 (2009) [hereinafter UNCTAD, World Investment Report 2009]; UNCTAD, World Investment Report 2008, *supra* note 281, at 255; UNCTAD, World Investment Report 2008, *supra* note 281, at 370.

297. *See* UNCTAD, World Investment Report 2009, *supra* note 296, at 249; UNCTAD, World Investment Report 2008, *supra* note 281, at 255, 370.

298. This indicates that there is approximately a two-thirds chance that expected FDI inflows could grow, or shrink, in India at the average rate plus or minus 48.5%. Data on file with the author.

299. *Foreign Direct Investment*, *supra* note 107, at 102.

300. *Id.*

301. UNCTAD, World Investment Report 2009, *supra* note 296, at 249 .

302. *Foreign Direct Investment*, *supra* note 107, at 102.

303. *Id.*

provide some context, the same estimate suggested 2009 FDI decreases of 41% in Russia, 50% in Brazil, and 57% in the United States.[304] One recent estimate for India shows FDI beginning to surge into 2010 with FDI flows to India up 13% for the month of December 2009 as compared to the same month in the previous year.[305]

V. Proposals for Change

Both India and China have successfully courted tremendous volumes of FDI inflows.[306] Yet both nations fail to maximize their use and attraction of FDI.[307] There are several steps that each nation could take to improve their FDI attraction and usage. Some proposed reforms would change the investment regime itself, while others would have a major indirect impact on FDI.

First, India would do well to consider incorporating several aspects of China's FDI regime as a component of future reform. For example, India may benefit from emulating China's policy of explicitly signaling a commitment to FDI by promulgating a separate body of law that is relatively clear and tailored to foreign investors.[308] Recent moves by the Commerce and Industry Minister, Anand Sharma, suggest that India is well on its way in this direction.[309] India should follow China and provide clear guidance to investors about who makes the relevant decisions as well as how and on what basis those decisions are made.[310] While both nations suffer from prolonged bureaucratic processes, India has the most to gain by reducing bureaucracy and increasing investment simplicity.[311]

Additionally, India should reevaluate industry specific FDI restrictions.[312] Some restrictions may make sense, considering political and social differences. But as one commentator points out, the specifics of some restrictions suggest a lack of careful deliberation: "Why, for example, does India permit 100% FDI in the manufacture of hazardous chemicals

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304. *Id.*

305. *FDI Regime Eased; FIPB Can Clear Deals Up to Rs 1,200 cr*, THE ECONOMIC TIMES, February 12, 2010, *available at* http://economictimes.indiatimes.com/articleshow/5563052.cms?prtpage=1.

306. UNCTAD, WORLD INVESTMENT REPORT 2008, *supra* note 281, at 214 (China and India rank eighty-eight and one hundred sixth, respectively, on an Inward FDI Performance Index for 2007).

307. *Id.* at 13 (contending that China has high FDI potential but low performance, whereas India has lower FDI potential and low performance).

308. *See supra* text accompanying notes 186-196.

309. *FDI Regime Eased*, *supra* note 305 (noting India's recent easing of an FDI policy).

310. *See supra* text accompanying notes 186-196.

311. *Cf.* A.T. KEARNEY, NEW CONCERNS IN AN UNCERTAIN WORLD 6 (2007) [hereinafter A.T. KEARNEY, NEW CONCERNS] ("While China is the chosen investment location of Asian investors (out of all investors with a high likelihood of investing in China, 34 percent are Asian) in the near future, India attracts a broader set of global investors, gaining recent interest from companies such as IBM, General Motors and Nokia.").

312. *Raining on India's Parade*, ECONOMIST, Oct. 31, 2009, at 18 (discussing limitations of India's foreign investment regime and noting the seeming lack of justification for industry specific restrictions).

and industrial explosives, but 74% in telecoms, 26% in insurance and none at all in supermarkets?"[313] Next, India should work to simplify and integrate local FDI approval into a national scheme[314] or reduce the need to seek local approval altogether by offering more "automatic route" approvals.[315] Because a single party does not govern India, India may suffer more than China from infighting between local and national approval agencies. However, the benefits from a vertically integrated approval process appear to outweigh their costs.[316] Additionally, India should include mechanisms that impede temporary or quick regulatory change. Insulating FDI legislation from political whims in a nation that is perceived as relatively unstable may have an important impact on the sentiments of investors concerned with changing political winds.[317]

Also, an unclear or restrictive antitrust approval system can be a deterrent to foreign investment.[318] Both India and China have either just completed or are in the process of reforming their antitrust policies and regulations.[319] In India further reforms may be needed to address ambiguities in the original Competition (Amendment) Act.[320]

China would also benefit in emulating elements of India's FDI regime. For example, while India has recently prospered in the high tech markets, especially in software and services,[321] China has prospered from the manufacture of low-margin, low-tech activities.[322] Where China has been successful in producing high tech items, foreign owned firms have

313. *Id.*

314. *See supra* text accompanying note 173-174.

315. *See supra* notes 162-164. *But see* Sachdev, *supra* note 19, at 213 ("By passing off the investment (and investor) to state and local authorities once approved, the Indian FDI regime implicitly respects the division between national and state institutions, and therefore, refrains from encroaching upon state political and regulatory territory. In contrast, China's FIE legislation itself seems to have been implemented with the goal of usurping states' (and other local authorities') roles in the approval process.").

316. *See e.g.*, Sachdev, *supra* note 19, at 199-200 ("[S]tudies performed by the Boston Consulting Group, McKinsey, and A.T. Kearney determined that investors were significantly deterred by the bureaucracy and inefficient procedural hurdles involved in the application and approval processes.").

317. *Cf.* A.T. Kearney, New Concerns, *supra* note 311, at 21 (noting that in India, "[p]olitical resistance to privatization remains high,").

318. *See e.g.*, Anu Bradford, *Chinese Antitrust Law: The New Face of Protectionism?*, Huffington Post, Aug. 1, 2008, http://www.huffingtonpost.com/anu-bradford/chinese-antitrust-law-the_b_116422.html ("[T]he [new antitrust regulation] reflects the resurgence of protectionist sentiments in China following the increase in foreign acquisitions of Chinese corporations. Some domestic groups favored the law as a tool to control the conduct of state-owned enterprises and to abolish trade barriers among different regions within China.").

319. *Supra* Parts II.D & III.B.

320. *See, e.g.*, Gireesh Chandra Prasad, *Competition Commission Ready to Address Industry's Concerns Over 9 Issues*, Economic Times, Apr. 10, 2008, *available at* http://www.cci.gov.in/index.php?option=com_news&task=details&sid=4 (describing draft regulations proposed by the Competition Commission of India to address ambiguities and other problems with the Competition Act).

321. *India's Prowess in Services and China's Manufacturing Strength*, Financial Times, May 19, 2005 (noting the rise of the high tech industry in India).

322. *Time to Change the Act*, Economist, Feb. 21, 2009, at 69-70.

overwhelmingly reaped the benefits.[323] This is a trend that is increasing in China.[324] The result is that China is increasingly at the mercy of global macroeconomic factors that are outside of its control, such as the costs of raw materials and labor.

Industrial diversification will require attracting foreign investment that strengthens other industrial sectors; however, there are two major problems that have prevented increased foreign investment in these sectors.[325] Globally, China suffers from a widespread belief that Chinese manufactured products suffer from a lack of quality. [326] Recent concerns over toxic toys and milk have exacerbated China's problem of perceived quality.[327] Second, China suffers from a weakness in the protection of intellectual property.[328] Previous economic and investment growth was not dependent on the strength of intellectual property protections, but rather on factors such as the availability of low input costs and cheap labor.[329]

Both of these problems can be addressed, at least in part, with legal reforms aimed at attracting the right kind of FDI. First, Chinese incentives should target the high-tech industry and protectionism should be resisted. MOFCOM should be wary of maintaining a strong hand over high-tech "strategic" industries. Such perceived protections may signal the potential for protectionism or even nationalization of high-tech companies in the future. MOFCOM should work toward increasing the number of high-tech sectors that are classified as permitted and encouraged in the Catalogue for the Guidance of Foreign Investment. Examples of some high-tech activities that are currently listed as restricted include the production of: satellite television receivers and key parts, color TVs, analogue mobile communications systems, and the manufacture of large medical equipment such as MRIs.[330] Some, if not all, of these industries could be deemed permitted since they should not implicate national security concerns.

Cooperation with and even manufacturing by foreign companies may help increase access to quality control technologies and practices and, in

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323. *Id.* (noting more than 60% of high-tech exports are manufactured by foreign owned firms, a percentage that has been increasing since at least 1998).

324. *Id.*

325. *Id.*

326. *Time to Change the Act*, *supra* note 322, at 69–70 (noting that in one study 80% of respondents "cited low quality as an important barrier to the sale of Chinese products abroad.").

327. *See, e.g.*, *Land of Milk and Money*, ECONOMIST, Oct. 3, 2008, http://www.economist.com/science-technology/displaystory.cfm?story_id=E1_TNPQPJTD (discussing the 2008 tainted milk controversy); Nancy Shute, *A Fresh Look in China's Toxic Toy Chest*, US NEWS & WORLD REPORT, Aug. 27, 2007, at 16–17.

328. *Time to Change the Act*, *supra* note 322, at 69–70; Peter K. Yu, *Intellectual Property, Foreign Direct Investment, and the China Exception*, *in* THE GLOBAL CHALLENGE OF INTELLECTUAL PROPERTY RIGHTS 153, 153–54 (Robert C. Bird & Subhash C. Jain eds., 2008).

329. Yu, *supra* note 328, at 153 (noting that foreign investors "entered the Chinese market because of the drastically lower production costs, the country's enormous market, its inefficient economic system and the preferential treatment of foreign investors.").

330. *China Catalogue*, *supra* note 22, at 19–22.

turn, help reduce China's reputation for poor quality.[331] Second, China should look seriously at reforming its intellectual property protections.[332] While pervious economic growth did not require strong intellectual property protections, as China's economy matures, moving toward higher end manufacturing, stronger intellectual property protections may be an increasingly important component of growth.[333] This is especially true as increased labor costs are making China less attractive as a source of cheap, unskilled labor.[334]

China could also emulate India in fostering a highly educated labor pool.[335] China may improve its long-term ability to attract high quality FDI by improving both its educational infrastructure and its research and development spending.[336] As witnessed in India, increased levels of human capital, including measures of education level, have a positive impact on FDI inflows.[337] Additionally, increased domestic education levels also increase the degree to which FDI creates positive spillover effects, increasing the technology level of the local economy.[338] Furthermore, improvements in human rights, although a politically sensitive issue, have also been linked to increased success in attracting FDI.[339]

Next, despite a straightforward review process, China's relatively young antitrust regime is already suffering from uncertainties in imple-

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331. *See Raising the Bar: Can China Meet the Quality Challenge?*, *in* New Challenges for 'Made in China' 9, 11 (2009), http://knowledge.wharton.upenn.edu/article.cfm?articleid=2252; Jeannie J. Yi & Shawn X. Ye, The Haier way: The Making of a Chinese Business Leader And a Global Brand 28-30 (2003).

332. Yu, *supra* note 328, at 158-170 (discussing several reasons whyh intellectual property reforms may be beneficial to China including alignment with national modernization goals, developing local statekholders, and fostering a stronger and sustainable export economy.).

333. *Id.* (noting the rise of Chinese technology companies such as Lenovo and Haier and the need for strong protections for their trademarks and other intellectual property).

334. *See e.g.*, *How Rising Wages Are Changing the Game in China*, Business Week, Mar. 27, 2006, *available at* http://www.businessweek.com/magazine/content/06_13/b3977049.htm.

335. *See e.g.*, *supra* notes 268-271 and accompanying text.

336. Mehmet Ögütçu and Markus Taube, *Getting China's Regions Moving*, at 15, OECD Observer, No. 231/232 (May 2002), *available at* http://www.oecd.org/dataoecd/29/1/2089554.pdf (noting that more government efforts is needed to improve education infrastructure in western Chinese provinces).

337. Nabamita Dutta & Kwasi Osei-Yeboah, *Foreign Direct Investment and Human Capital: The Role of Political and Civil Rights* 1 (Sept. 2008), *available at* http://ssrn.com/abstract=1263038 ("Low skills and inadequate level of training impact adversely on the rate of return of FDI, and thus deter capital inflows. Developing countries with appreciable levels of human capital attract more FDI inflows.").

338. Magnus Blomstrom & Ari Kokko, *The Economics of Foreign Direct Investment Incentives* 14 (Nat'l Bureau of Econ. Research Working Paper No. 9489, Feb. 2003), *available at* http://www.nber.org/papers/w9489 ("These [technology] imports seem to be larger in countries and industries where the educational level of the local labor force is higher, where local competition is tougher, and where the host country imposes fewer formal requirements on the affiliates' operations.").

339. *See e.g.*, Dutta & Osei-Yeboah, *supra* note 337, at 2-3 (discussing relationship between civil and political rights with FDI maximization).

mentation created by recent MOFCOM decisions.[340] The current antitrust regime provides clear, intelligent guidance with a relatively fast approval process.[341] However, questions remain as to whether MOFCOM will use antitrust policy as a tool for protectionism, and recent actions by MOFCOM suggest that this may indeed be the case.[342] The Anti-Monopoly Law states that MOFCOM shall prohibit any transaction that "has or may have effect of eliminating or restricting competition," unless the companies can show that the transaction will be overall beneficial to China despite any concentration of business.[343] Facially this represents a rather mainstream view of antitrust policy.[344]

However, absent specific precedent and an implementation of judicial review, interpretation of what constitutes a restriction of competition is solely subject to the view of MOFCOM.[345] MOFCOM's decision to block the acquisition of the domestic juice maker Huiyuan by Coca-Cola shocked some observers and it appears probable that it was the wrong decision.[346] In the long term, China would greatly benefit from explicitly signaling their willingness to allow foreign ownership of formerly state controlled companies and companies with some national significance like Huiyuan.[347]

Both India and China may benefit in the short run from allowing an increased level of foreign acquisitions of domestic companies. Of course, Western free market ideals need not dominate. Neither nation need open up all economic sectors and key industries to foreign acquisition or investment; the political and social concerns may trump economic proscriptions.[348] With impressive positive GDP growth rates in recent years, China and India can afford to be cautious.[349] Indeed recent growth may be because of, rather than in spite of, measured protectionism, especially in light of recent economic turmoil.[350] However, the benefits to economic

340. *Hard to Swallow*, *supra* note 148, at 68-69 (discussing the recent decision to block Coca-Cola's friendly takeover of Chinese juice maker Huiyuan).

341. *See e.g.*, Calvani & Alderman, *supra* note 179, at 7-8, 14-16, 24-27, 35 (discussing the types of transaction subject to review and the timeline of the review process).

342. *See Hard to Swallow*, *supra* note 148, at 68-69.

343. Anti-Monopoly Law *supra* note 141, art. 28.

344. *See* U.S. Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines, Apr. 2, 1992, revised Apr. 8, 1997, *available at* http://www.usdoj.gov/atr/public/guidelines/hmg.htm#02 (discussing the broad goals of the United States' merger policy).

345. Anti-Monopoly Law, *supra* note 141, art. 28.

346. *See e.g.*, *Hard to Swallow*, *supra* note 148.

347. *Id.*

348. *See* Cohen, supra note 14, at 161-63; Wang Zhile, *Foreign Acquisition in China: Threat or Security?*, 3 China Security 86, 87-88 (2007), *available at* http://www.wsichina.org/cs6_6.pdf.

349. *See* Pritha Mitra, *Has Government Investment Crowded out Private Investment in India?*, 96 Am. Econ. Rev. 337, 338 (2006) (noting India's growth rates); Eswar S. Prasad & Raghuram G. Rajan, *Modernizing China's Growth Paradigm*, 96 Am. Econ. Rev. 331, 331-32 (2006) (noting China's growth rates).

350. *See* Keith Bradsher, *As China Stirs Economy, Some See Protectionism*, N.Y. Times, Jun. 24, 2009, at B1.

growth and market efficiency may be too great to continue to forgo.[351] Prolonged economic growth may not be achievable in each nation without some continued measured liberalization of FDI regulations.[352]

Both nations should re-examine their limitations on FDI by economic sector. All means used to attempt to funnel FDI to favored economic sectors are not equal.[353] Encouraging FDI in certain sectors through favorable tax treatment and fast approval may be vastly different than prohibiting FDI in other non-favored sectors.[354] Only those sectors that are truly seen as politically sensitive should remain protected.

Conclusion

India and China are exemplars of the changes brought on by globalization. They are two of the fastest growing economies in the world and possess two of the largest domestic markets by number of consumers.[355] FDI has been a major contributor to both nations' growth, bringing in more than just investment capital.[356] FDI has fostered the introduction of technology, human know-how, and helped to link nations internationally.[357]

India and China both have complex FDI regimes that, while allowing for large nominal volumes of FDI inflows, still have major flaws. Both nations still protect large economic sectors from investment, are slow to approve foreign acquisitions of domestic firms (if at all), and are characterized by excessive bureaucracy.[358] India and China's FDI regimes do not need to be fully liberalized.[359] It is not necessarily prudent to open one's economy up to the full forces of the global market, especially in the case of those nations still developing stable financial institutions and developing local human capital.[360]

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351. Zhile, *supra* note 348, at 90.

352. *See* Parantap Basu et al., *Liberalization, FDI, and Growth in Developing Countries*, 41 Econ. Inquiry 510, 510-11, 515 (2003) (noting the relationship between GDP growth and FDI).

353. *See* Yu Yongding, *The Experience of FDI Recipients: The Case of China*, *in* Multinationals and Economic Growth in East Asia 423, 438-40 (Shujiro Urata et al. eds., 2006).

354. *Id.*

355. World Bank, World Development Report 2009: Reshaping Economic Geography 352-56 (2009), *available at* http://siteresources.worldbank.org/INTWDR2009/Resources/4231006-1225840759068/WDR09_22_SWDIweb.pdf.

356. Mathew, *supra* note 11, at 802 (noting India's recent financial openness and a departure from past socialist policies).

357. *Globalisation: Turning Their Backs on the World*, *supra* note 12, at 60 ("FDI is one of the commonest routes by which skills and technology are transferred from rich to poor countries.").

358. Bi & Wong, *supra* note 143 ("The ruling had raised concern China may be using a new anti-monopoly law to block foreign competition and handed ammunition to opponents of Chinese acquisitions in other countries."); Sachdev, *supra* note 19, at 199-200 ("[S]urveys of foreign investors in India confirm that inefficiencies in the investment approval process constitute a substantial obstacle to seamless investment flows.").

359. *See, e.g.*, Prasad, Rajan & Subramanian, *supra* note 100, at 5-6.

360. *Id.*

However, continued liberalization, when done strategically and carefully, may be an important source for maintaining prolonged economic growth.[361] One study estimated that financial market liberalization alone could account for an additional one percent of GDP growth per year.[362] Further gains in attracting more FDI and in making better use of it can be obtained even absent further liberalizations.[363] Substantive, yet politically minor changes to India and China's investment regimes may yield substantial positive benefits.[364] Now more than ever, nations must reevaluate their relationship in the global economy. This involves not only looking outward, but also inward.[365] Positive reform from within may be the most effective and efficient way to maximize the benefits from the global economy.[366]

In February 1998, during the middle of the last major global economic crisis, Chaun Leekpai, the Thai Prime Minister, summarized the need to look inward:

> If you are going to be part of this global market you had better be able to defend yourself from this market. . . . One of the lessons this crisis has taught us is that many of our structures and institutions were not ready for this new era. Now we have to adapt ourselves to meet international standards. The whole of society expects it. They are looking for better government and transparent government.[367]

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361. *See, e.g.*, Bekaert et al., *supra* note 46, at 4 ("We find that equity market liberalizations increase subsequent average annual real economic growth by about 1%, even after controlling for other variables that are commonly used in the economic growth literature."); Prasad et al., *Financial Globalization*, *supra* note 45, at 7 ("[F]inancial globalization, in combination with good macroeconomic policies and good domestic governance, appears to be conducive to growth.").

362. *See, e.g.*, Bekaert et al., *supra* note 46, at 4 ("We find that equity market liberalizations increase subsequent average annual real economic growth by about 1%, even after controlling for other variables that are commonly used in the economic growth literature.").

363. *See, e.g.*, Stiglitz, *supra* note 30, at 508 ("China showed that one could attract enormous amounts of foreign direct investment without having full capital market liberalization (indeed, it has been the most successful emerging market country in attracting foreign direct investment).").

364. *See, e.g.*, Raj Kumar, *Changing Role of the Public Sector in the Promotion of Foreign Direct Investment*, Asia-Pacific Dev. J., Dec. 2003, at 1, 17 (describing policy actions that may promote FDI); Dani Rodrik, *Trading in Illusions*, Foreign Policy, Mar.-Apr. 2001, at 54, 61-62; Stiglitz, *supra* note 30, at 22-23 (discussing the need for educational and legal reform to create an environment conducive to FDI growth).

365. Rodrik *supra* note 364, at 62 (describing the need to tailor development strategies based on a country's individual strengths).

366. *See, e.g.*, Marc Proksch, *Selected Issues on Promotion and Attraction of Foreign Direct Investment in Least Developed Countries and Economies in Transition*, *in* Investment Promotion and Enterprise Development Bulletin for Asia and the Pacific No. 2, 1, 17 (2003) ("[I]t is the overall development level and level of a country's competitive advantages that will be the most important determinant of an investor's investment location decision. The development of national competitiveness, especially in a globalized world, is therefore essential for effective FDI attraction and for overall economic development.").

367. Thomas Friedman, *Foreign Affairs; Heal Thyself*, N.Y. Times, Feb. 7, 1998, *available at* http://www.nytimes.com/1998/02/07/opinion/foreign-affairs-heal-thyself.html?scp=5&sq=financial+risis+globalization+Op-Ed&st=nyt.

While both China and India have weathered the global economic storm relatively well,[368] it would benefit each nation to follow Leekpai's advice to ensure continued economic and social prosperity.

368. *Turning Their Backs on the World*, ECONOMIST *supra* note 12, at 59.

Appendix[369]

A. China: FDI and GDP Regression

Regression Statistics	
Multiple R	0.966288393
R Square	0.933713259
Adjusted R Square	0.929294143
Standard Error	282868.9812
Observations	17

ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	1.69063E+13	1.69063E+13	211.2895987	3.02313E-10
Residual	15	1.20022E+12	80014860539		
Total	16	1.81065E+13			

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	-744629.7628	172507.3906	-4.31650934	0.000611174
FDI Flows	44.8371176	3.084598383	14.53580403	3.02313E-10

	Lower 95%	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	-1112320.561	-376938.9652	-1112320.561	-376938.9652
FDI Flows	38.26245181	51.41178339	38.26245181	51.41178339

B. India: FDI and GDP Regression

Regression Statistics	
Multiple R	0.926794639
R Square	0.858948304
Adjusted R Square	0.849544857
Standard Error	108641.8188
Observations	17

369. Note: GDP is dependent variable. International Monetary Fund, World Economic Outlook 2009 database, http://www.imf.org/external/pubs/ft/weo/2009/02/weodata/index.aspx; United Nations Conference on Trade and Development, World Investment Report 2009, Country Fact Sheet: India, *available at* http://www.unctad.org/sections/dite_dir/docs/wir09_fs_in_en.pdf (contains data for both India and China); United Nations Conference on Trade and Development, World Investment Report 2005 306 (2005), *available at* http://www.unctad.org/en/docs/wir2005_en.pdf; United Nations Conference on Trade and Development, World Investment Report 2003 251 (2003), *available at* http://www.unctad.org/en/docs/wir2003light_en.pdf.

ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	1.07814E+12	1.07814E+12	91.34398878	9.03453E-08
Residual	15	1.77046E+11	11803044798		
Total	16	1.25518E+12			

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	381670.6603	32163.96945	11.86640414	5.03668E-09
FDI Flow	23.36723618	2.444935249	9.557404919	9.03453E-08

	Lower 95%	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	313114.7826	450226.5381	313114.7826	450226.5381
FDI Flow	18.15598007	28.57849228	18.15598007	28.57849228