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

Rohit Sachdev*

I. Introduction 168
II. The Case for a Legal Comparison 170
  A. India and China: Side-by-Side 172
  B. China's Relative Success in Attracting FDI 173
  C. Deficiencies in the Existing Explanations 174
  D. Postulating a Legal Explanation on the Rule of Law 181
III. A Methodological Comparison of the Legal Foundations of FDI in India and China 186
IV. Governing Capital Inflows: FDI Laws and Regulations 186
  A. The Laws Governing FDI 187
    1. India's Legal Governance 187
    2. China's Legal Governance 190
  B. China's Legal Framework Is More Conducive to FDI Inflows 194
    1. Legal Foundations and Intentions 194
    2. Structure of FDI Legislation 197
  C. The Rule of Law: Better for Some or Better for All? 198
V. Investors in Action: FDI Approval Procedures 199
  A. FDI Approval Process in India 200

---

* J.D./M.B.A. Candidate 2007, Columbia University School of Law, Columbia University Graduate School of Business; A.B. Economics 2001, Brown University. The author thanks Professor Jose E. Alvarez for his valuable direction and guidance during the writing process and the *Columbia Business Law Review* editors for their helpful and insightful suggestions during the editing process.

1. Automatic Route Policy & Procedures 201
2. Government Approval Route Policy and Procedures 202
3. Post-Approval Procedures 203
B. FDI Approval Process in China 204
1. Procedural Framework for EJV Approval 205
2. Procedural Framework for CJV Approval 206
3. Procedural Framework for WFOE Approval 207
C. China's Local and State Governments Are Vertically Integrated into the National Approval Process While India's Are Not 208
1. The Basic Similarities and Differences 209
2. The Major Difference: The Role of Local and State Governments in the Approval Process 210
D. Respect for States' Rights and Its Burden on Rule of Law 212
VI. Conclusion 213

"This is the difference between India and China. In India, everybody has a veto."[1]

I. INTRODUCTION

Although China and India share similar economic and demographic characteristics, China has outstripped its neighbor in attracting foreign direct investment (FDI) since their respective "liberalizations" in 1979 and 1991.[2] Scholars have offered a number of superficially convincing explanations for the persistent divide, which tend to focus on China's excessive use of "round-tripping," the prevalence of

[1] *Survey: India and China: The Tiger in Front*, ECONOMIST, Mar. 5, 2005, at 11 [hereinafter *Tiger in Front*]; *see Face Value: Tigers, Termites and Tenacity*, ECONOMIST, Mar. 13, 2004, at 82 (chronicling India's Disinvestment Minister's reaction to the Indian Supreme Court's blocking of a proposed sale of government shares in two oil companies).

[2] Unless otherwise noted, references to "China" as a political entity are restricted to the People's Republic of China; references to "China" when discussing economic data are exclusive of Hong Kong and Taiwan.

bureaucracy and corruption in India, and China's decade-long "head start" in reforming. A closer evaluation of these justifications, however, suggests that they are only partial explanations at best.

The purpose of this Note is twofold. First, it raises and explores a fundamental issue that has not received adequate attention: whether China's legal regime is more conducive to attracting, maintaining, and increasing FDI inflows than India's. This Note compares the legal foundations that support the inward FDI frameworks in these countries to determine whether the differences in their governing laws and procedural mechanisms contribute to the statistical discrepancies in FDI inflows. Second, this Note attempts to identify those elements of the rule of law that are present (and absent) in each country's FDI regime and how those elements encourage or deter FDI.

This Note's conclusions are revealing but not unexpected. 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. Furthermore, India excludes local and state authorities from the federal approval process, ultimately lengthening the FDI implementation process and deterring investment. China, on the other hand, has a vertically integrated FDI approval process, which generates significant tension between state and national authorities but is nevertheless comparatively more facilitative of FDI inflows.

This analysis reveals that a country's (in this case, China's) disregard of the "rule of law" in political governance may, ironically, allow it more effectively (1) to grant rule of law protections to investors and (2) to implement more efficient approval processes than a country such as India, which preserves rule of law at the highest levels of governance, yet at the expense of streamlined FDI statutory governance and approval procedures. As a result, China can tailor more effectively its FDI governance to foreign direct investors' interests and assist them in circumventing red tape and procedural delay.

Section II develops the case for conducting this study. Section III briefly explains the general methodology behind the analysis. Section IV addresses the laws, regulations, and bureaucratic institutions governing FDI in each country and their effects on FDI, and Section V contrasts India's and China's FDI approval procedures and their effects on FDI. Sections IV and V also address the "rule of law" issue as it pertains to each country's foreign direct investment governance. Section VI then concludes the study.

II. THE CASE FOR A LEGAL COMPARISON

This section explains why several of the most popular explanations for the discrepancy in FDI inflows[3] between

[3] In the interest of consistency, this Note adopts the definition of FDI used by the United Nations Conference on Trade and Development (UNCTAD), whose statistics on FDI and other related measures are widely cited and accepted by current academic literature on FDI. *See, e.g.*, THEODORE H. MORAN, FOREIGN DIRECT INVESTMENT AND DEVELOPMENT: THE NEW POLICY AGENDA FOR DEVELOPING COUNTRIES AND ECONOMIES IN TRANSITION 179 (1999). UNCTAD relies on the International Monetary Fund's (IMF's) Balance of Payments Manual and the Organisation for Economic Co-Operation and Development's (OECD's) Benchmark Definition in defining FDI as "an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)." Furthermore, the investor must exert "a significant degree of influence on the management of the enterprise." FDI includes both the initial transaction and all subsequent transactions with the entity, incorporated or unincorporated. *See* U.N. CONF. ON TRADE & DEV. [UNCTAD], WORLD INVESTMENT REPORT 2005: TRANSNATIONAL CORPORATIONS AND THE INTERNATIONALIZATION OF R&D 10-12, 297-99, UNCTAD/WIR/2005, U.N. Sales No. E.05.II.D.10 (2005), *available at* http://www.unctad.org/Templates/webflyer.asp?docid=6087&intItemID=3489&lang=1&mode=downloads [hereinafter WORLD INVESTMENT REPORT 2005].

The three components of FDI inflows are equity capital (purchase of shares), reinvested earnings (earnings neither distributed as dividends nor remitted to the direct investor by the entity), and intracompany debt

India and China fall short of carrying out their explanatory duty, and why, specifically, a comparison of laws and procedures must fill this void. Although China and India share similar geographic, cultural, demographic, and (to some extent) economic characteristics, a comparison motivated solely by these seemingly superficial characteristics prompts the question as to why *other* developing countries (such as Brazil, South Africa, and Mexico) are not also compared. Indeed, the most compelling argument for a *legal* comparison stems from the paradox surrounding China's greater success in attracting financial capital from Western investors desirous of rule of law protections for their investments despite a political system that is generally antithetical to the rule of law; India has achieved nowhere close to the same level of FDI, even though it retains a longstanding democracy with stable rule of law.

---

transactions (loans, debt securities, and credits) between the investor (parent) and the foreign enterprise. WORLD INVESTMENT REPORT 2005, *supra* note 3, at 297-99. Using this system furthers the interest of consistency with regard to the countries under analysis because while India abides by this definition, China does not. Therefore, some of China's more detailed data will not fall into this definition, and this should be taken into account. *See* ORGANISATION FOR ECON. CO-OPERATION AND DEV. [OECD], CHINA: PROGRESS AND REFORM CHALLENGES 187 (2003).

Not included in FDI inflows, however, are international financial aid flows (loans and grants made by official agencies), private debt transactions (such as bonds, bank loans, and other credits guaranteed by private sector financial institutions), and portfolio investment by foreign investors (investment in equity, debt securities, money market instruments, and derivatives, made without the intention of exercising control but instead for obtaining dividends or capital gains). *See* CHANCHAL CHOPRA, FOREIGN INVESTMENT IN INDIA: LIBERALIZATION AND WTO—THE EMERGING SCENARIO 15 (2003). On the other hand, FDI does include mergers, acquisitions, joint ventures, and expansions of existing businesses, provided that there is an acquisition of equity in the transaction with the intent to take some control.

FDI "stock" is defined as the value of the share of a foreign enterprise's capital and capital reserves (including retained profits) attributable to its parent enterprise (the direct investor), including its net indebtedness to the parent. *See* WORLD INVESTMENT REPORT 2005, *supra* note 3, at 299.

A. India and China: Side-by-Side

Today's business, academic, and (to a lesser extent) legal articles abound with commentaries lamenting and attempting to explain India's failure to match China's ever-increasing level of FDI inflows.[4] Much of this commentary justifies comparing the two countries on the obvious similarities they share, especially their international positions as poor, developing nations with famously cheap labor. However, India and China share as many differences as they do similarities with regard to their economic, political, demographic, historical, and social characteristics.

While they represent the only two nations on the globe with populations of over one billion people[5] and each (contentiously) shares a border on the same continent, India

---

[4] *See, e.g.*, BIMAL JALAN, THE FUTURE OF INDIA: POLITICS, ECONOMICS AND GOVERNANCE 77-78, 200-01 (2005); Mark B. Baker, *Awakening the Sleeping Giant: India and Foreign Direct Investment in the 21st Century*, 15 IND. INT'L & COMP. L. REV. 389, 410-22 (2005); Yasheng Huang & Tarun Khanna, *Can India Overtake China?*, FOREIGN POLICY 74 (2003); *Tiger in Front*, *supra* note 1, at 3; Wolfgang Schürer, *A Geopolitical and Geo-Economic Overview: On the Rise of China and India As Two Asian Giants*, 29-SUM FLETCHER F. WORLD AFF. 145, 145-50, 156-58 (2005); *Reform in India: Democracy's Drawbacks*, ECONOMIST, Oct. 29, 2005, at 23-26; *China & India: What You Need to Know Now*, BUSINESSWEEK, Aug. 22, 2005, at 52-58; Shang-Jin Wei, Can China and India Double Their Inward Foreign Direct Investment? 7, 17, 19 (Nov. 30, 1999) (Working Paper 1999), *available at* www.nber.org/~confer/99/indiaf99/India-China-FDI.PDF); Jeffrey D. Sachs & Nirupam Bajpai, Foreign Direct Investment in India: How Can $10 Billion of Annual Inflows Be Realized? 7, 18-26 (Jan. 11, 2000) (unpublished manuscript, *available at* http://www2.cid.harvard.edu/india/ pdfs/FDI.pdf); *see generally* A COMPARATIVE STUDY OF FOREIGN DIRECT INVESTMENT (FDI) IN CHINA AND INDIA: PROBLEMS AND PERSPECTIVES (Bomma Satyanarayan ed., 1996).

[5] As of 2004, mainland China (excluding Hong Kong and Taiwan) had a population of 1.297 billion people; India had a population of 1.08 billion people. WORLD BANK, WORLD DEVELOPMENT REPORT 2006: EQUITY AND DEVELOPMENT 296 (2005), http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/0,,contentMDK:20227703~pagePK:478093~piPK:477627~theSitePK:477624,00.html [hereinafter WORLD BANK 2006 REPORT].

is one third of the size of China,[6] far more densely populated,[7] and, in terms of the number of people living below the national and international poverty lines, much poorer.[8] Although China's current annual GDP of $1.65 trillion is almost two and a half times the size of India's, and its national per capita income is twice India's,[9] India's growth rate has remained steady since 1997 while China's has declined.[10] While their political systems are markedly distinct from each other, both countries maintain functioning market economies and experienced economic "liberalizations" that grew out of socialist or socialistic, heavily state-managed economies.

B. China's Relative Success in Attracting FDI

The statistics on FDI reveal the stark disparity between the two countries. In 2003, China secured $53.5 billion in FDI inflows, almost equal to the United States's $56.8 billion for the same year, and representing more than twelve times India's $4.3 billion in FDI for 2003.[11] In 2004, the United States again "outperformed" China's $60.6 billion FDI figure

---

[6] India's physical area is 1,222,559 square miles; China's physical area is 3,696,100 square miles. Encyclopedia Britannica Online, *India*, http://search.eb.com/eb/article9111197?query=india%20square%20miles&ct= (last visited Dec. 2, 2005); Encyclopedia Britannica Online, *China*, http://search.eb.com/eb/article-9117321?query=china&ct= (last visited Dec. 2, 2005).

[7] As of 2004, China's density was 139 people per square kilometer; India's population density was 363 people per square kilometer. WORLD BANK 2006 REPORT, *supra* note 5, at 292.

[8] As of 1998, 4.6% of China's population lived below its national poverty line, while 16.6% of the population lived on less than one dollar per day; as of 2000, 28.6% of India's population lived below its national poverty line and 35.3% of its population lived on less than one dollar per day. *Id.* at 278, 294.

[9] In 2004, China's GDP was approximately $1.649 trillion; India's was approximately $692 billion. At purchasing power parity, China's gross national income per capita was $1290; India's was $620. *Id.* at 292, 296.

[10] YASHENG HUANG, SELLING CHINA: FOREIGN DIRECT INVESTMENT DURING THE REFORM ERA 332 (2003).

[11] WORLD INVESTMENT REPORT 2005, *supra* note 3, at 303, 306.

by capturing $95.9 billion of inflows, whereas India's 2004 FDI inflows remained comparatively minuscule at $5.3 billion.[12] Historically, too, China has far surpassed India in attracting FDI. In the fifteen years between 1990 and 2004, inclusive, India absorbed a total of $33.9 billion in FDI, while China secured almost $550 billion.[13] During that time, India and China received, on average, annual FDI inflows of $2.3 billion and $36.3 billion, respectively.[14] In the twenty-five years since 1980, India and China have taken in $35.0 billion and $561.0 billion in FDI, respectively.[15]

Comparing the annual averages and totals of FDI inflows for both countries since 1990 is also relevant on a contextual basis because developing economies, such as those of Mexico, China, and Brazil, first became attractive targets for capital-exporting countries during the 1990-2000 decade.[16] Developing countries collectively received $44.0 billion in annual FDI inflows in 1990 and, by 2000, attracted $253.2 billion annually as a group.[17] In 2004, India's annual FDI inflows accounted for 2.3% of total annual FDI to developing countries, while China's represented 26.0%.[18]

C. Deficiencies in the Existing Explanations

The explanations proffered for India's lackluster performance relative to China are far too numerous to address adequately in a single article. They draw on a host of economic, social, and political differences between the two countries, including: less flexible labor laws and higher-cost labor in India; less real property for corporate expansion in

---

[12] *Id.*

[13] *See* UNCTAD, *FDI Inflows by Host Region and Economy, 1970-2004* (Sept. 29, 2005). *available at* http://www.unctad.org/sections/dite_dir/docs/wir2005_inflows_en.xls [hereinafter UNCTAD].

[14] *See id.*

[15] *See id.*

[16] *See* MORAN, *supra* note 3, at 15-17.

[17] *See* UNCTAD, *supra* note 13.

[18] *See id.* Developing countries in the aggregate absorbed $233.2 billion in FDI in 2004.

India; higher corporate tax rates in India; less favorable export incentives in India; high caps on FDI in various Indian industries; limited access to financial markets in India; burdensome customs procedures in India; China's greater national and consumer wealth base; China's access to vibrant Southeast Asian export markets; a booming, unsustainable Chinese economy; a better industrial infrastructure (e.g., power, roads, etc.) in China; leaner cost structures for companies in China; and greater opportunities to bribe Chinese bureaucrats, to name only a few.[19]

Some or all of these justifications may play a significant role in the India-China FDI divide, and this Note encourages their continuing scholarly analysis. This Section evaluates three of the most commonly argued justifications, each of which either fails to explain *fully* the performance discrepancy or only compels the very analysis taken up in Sections IV and V—investigation into the laws and procedures governing FDI.

First, scholars and commentators argue that China's inward FDI figures are bloated because of the effects of "round-tripping," and therefore, cannot fairly be measured against India's figures. "Round-tripping" describes the process whereby Chinese firms export capital to their subsidiaries in Hong Kong or Macao, which then "re-invest" that Chinese capital back into China in order to benefit from tax breaks and other financial incentives accorded only to foreign investors.[20] The Planning Commission in India, among others, argues that China's practice of recycling investment through ethnically related, but politically distinct, neighboring Chinese economies renders China's FDI

---

[19] *See, e.g.*, Baker, *supra* note 4, at 411-19; *Reform in India*, *supra* note 4, at 23-26; *Tiger in Front*, *supra* note 1, at 3; Jeffrey D. Sachs & Nirupam Bajpai, *Foreign Direct Investment in India: Issues and Problems* 5-8 (Harvard Inst. for Int'l Dev., Discussion Paper No. 759, 2000), *available at* http://www2.cid.harvard.edu/india/pdfs/759.pdf.

[20] *See* YAN WANG, CHINESE LEGAL REFORM: THE CASE OF FOREIGN INVESTMENT LAW 130-31 (2002) [hereinafter WANG, CHINESE LEGAL REFORM].

numbers exaggerated, and therefore, not comparable to India's.[21]

Between 1978 and 1999, capital from Hong Kong, Taiwan, and Macao accounted for 59.3% of China's total FDI inflows.[22] Although Hong Kong's contribution to China's FDI inflows has steadily decreased in the past few years[23] and China has implemented reforms aimed at reducing abuse of its foreign investment regime,[24] "round-tripping" is still estimated to contribute anywhere from 10% to 50% of China's inflows.[25] The problem with relying solely on this "round-tripping" explanation, however, is that it fails to fully explain the performance discrepancy; assuming that "round-tripping" accounts for 50% of China's annual inflows (the most aggressive of the estimates), China's 2004 "adjusted" FDI inflows of $30.3 billion still would have amounted to *over five times* India's $5.3 billion figure.[26]

The second commonly provided explanation, that India's political system and judiciary are more bureaucratic, inefficient, and/or corrupt than China's, is attractive for its simplicity but ultimately incomplete. Consultants conclude that this description does fit India to some extent. In its

---

[21] PLANNING COMMISSION, GOVERNMENT OF INDIA, REPORT OF THE STEERING GROUP ON FOREIGN DIRECT INVESTMENT 15-17 (2002). The Steering Committee on FDI in India was assigned to develop practical suggestions to help increase FDI inflow levels during the Tenth Plan.

[22] HUANG, *supra* note 10, at 36. The capital amount referred to represents *total* inflows, not merely those received from "round-tripping."

[23] WORLD BANK, GLOBAL DEVELOPMENT FINANCE: FINANCING THE POOREST COUNTRIES 2002 41 (2002) [hereinafter WORLD BANK, GLOBAL DEVELOPMENT].

[24] *See* WANG, CHINESE LEGAL REFORM, *supra* note 20, at 131.

[25] *See Foreign Investment in China I: Changing Trends and Policies*, E. ASIAN EXECUTIVE REPORTS, Mar. 15, 1998, at 8, 20 [hereinafter *Foreign Investment in China*]; PLANNING COMMISSION, *supra* note 21, at 17; WORLD BANK, GLOBAL DEVELOPMENT, *supra* note 23, at 41; UNCTAD, WORLD INVESTMENT REPORT 2004: THE SHIFT TOWARD SERVICES 26, UNCTAD/WIR/2004, U.N. Sales No. E.04.II.D.36 (2004), *available at* http://www.unctad.org/Templates/webflyer.asp?docid=5209&intItemID=3235&lang=1&mode=downloads.

[26] *See* UNCTAD, *supra* note 13.

August 2002 report, the Planning Commission hired several Western consulting firms to determine the "causes and reasons for low FDI."[27] The Boston Consulting Group, McKinsey, and A.T. Kearney each determined that bureaucracy, red tape, and excessively drawn out application/approval processes dominated investor concerns in India.[28] In A.T. Kearney's 2004 *FDI Confidence Index*, investors most frequently cited "Bureaucracy" and "Political Stability" as their primary concerns in evaluating India's competitiveness.[29] As will be discussed in more detail in Section V, these factors seem to be partially responsible for the low "actual to approved" ratio of FDI inflows in India. For example, between 1991 and 2000, an average of just 35.8% of approved FDI inflows were eventually realized, suggesting "man-made roadblocks" in the approval process.[30]

Nonetheless, this explanation, standing alone, remains incomplete. China's legal system is also plagued with corruption, informational uncertainties, and bureaucracy, which are largely attributable to a similarly complicated approval procedure for foreign investment that equally antagonizes and deters foreign investors.[31] Survey results further substantiate these similarities. According to A.T. Kearney, investors consider "Legal/Regulatory Environment" and "Corruption/Lack of Transparency" as the greatest risks of doing business in China.[32] The World Bank's 2005 World Development Report survey of global firms showed that 27% of firms determined "corruption" in China to be a major

---

[27] PLANNING COMMISSION, *supra* note 21, at 22, 26.

[28] *Id.* at 26.

[29] A.T. Kearney, *2004 FDI Confidence Index*, GLOBAL BUS. POL'Y COUNCIL, Oct. 2004, at 31-32, *available at* http://www.atkearney.com/shared_res/pdf/ FDICIOct_2004_S.pdf. This work is an annual survey of executives from a number of the world's largest companies that is conducted by consultant A.T. Kearney.

[30] CHOPRA, *supra* note 3, at 152.

[31] *See* DANIEL H. ROSEN, BEHIND THE OPEN DOOR: FOREIGN ENTERPRISES IN THE CHINESE MARKETPLACE 30-35 (1999); WANG, CHINESE LEGAL REFORM, *supra* note 20, at 107-14.

[32] A.T. Kearney, *supra* note 29, at 31.

constraint, whereas 37% of firms found the same to be true in India. Moreover, 33% of firms found "policy uncertainty" to be a significant obstacle in China, while 21% of firms found it to be a significant obstacle in India.[33] In 2000, China's prosecutorial agencies investigated over 104,000 cases of alleged offenses by public officials; almost 21,000 of these involved abuse of power, dereliction of duty, and fraudulent practices, while the majority of them (over 83,000 cases) involved "corruption and bribery."[34] If, as the evidence suggests, the legal systems of both countries are similarly situated with respect to inefficiency and corruption, then there must be a more robust explanation for the FDI gap. The Section that follows argues that the laws themselves should be scrutinized to a greater degree than the corruption resulting from their abuse.

Lastly, some scholars contend that China's thirteen year "head start" over India in liberalizing explains its comparatively greater FDI inflows.[35] They argue that because China liberalized thirteen years before India did, it therefore had thirteen years more than India to design, implement, and reap the benefits of economic reform. This seems like a viable argument on its face, especially

---

[33] WORLD BANK, WORLD DEVELOPMENT REPORT 2005: A BETTER INVESTMENT CLIMATE FOR EVERYONE 246 (2004), *available at* http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTDRS/0,,contentMDK:20227703~pagePK:478093~piPK:477627~theSitePK:477624,00.html [hereinafter WORLD BANK, 2005 REPORT].

[34] OECD, *supra* note 3, at 131.

[35] China "liberalized" in 1979 under Deng Xiopang's "open door policy," and India "liberalized" in 1991 under the New Industrial Policy. For further detail on the economic and political conditions surrounding these periods, see SUDHIR NAIB, DISINVESTMENT IN INDIA: POLICIES, PROCEDURES, PRACTICES 307-10 (2004); Jagdish Bhagwati, *The Design of Indian Development*, *in* INDIA'S ECONOMIC REFORMS AND DEVELOPMENT: ESSAYS FOR MANMOHAN SINGH 23, 35-39 (Isher J. Ahluwalia & I.M.D. Little eds., 1998); WANG, CHINESE LEGAL REFORM, *supra* note 20, at 12-14; VAI IO LO & XIAOWEN TIAN, LAW AND INVESTMENT IN CHINA: THE LEGAL AND BUSINESS ENVIRONMENTS AFTER WTO ACCESSION 3-4 (2005); GUIGUO WANG, CHINA'S INVESTMENT LAWS: NEW DIRECTIONS 1-7 (1988). The legal ramifications of these economic liberalization policies are discussed further in Section IV.

considering that both economies were similarly situated at the time of their respective liberalizations, such that every additional year of open economic activity in China should presumably have had marginally increasing effectiveness in generating conditions amenable to foreign investors.[36] The measure that is relevant in evaluating this explanation is how India's performance compares *now*, thirteen years after the implementation of its New Industrial Policy, to China's performance in 1992, thirteen years after *its* "open door" reformation in 1979. Comparing the total FDI inflows for each of these countries during their respective thirteen year periods is illustrative:[37] The FDI inflows for China during the years 1980-1992, inclusive, totaled $35.0 billion, while the FDI inflows for India during the years 1992-2004, inclusive, totaled $33.6 billion, just short of China's thirteen year figure.[38] FDI stock figures for the same period also support the "head start" hypothesis: In 1992, China's FDI stock was approximately $36.0 billion, whereas India's FDI stock reached $38.7 billion in 2004.[39]

Although the figures above suggest that the "head start" hypothesis may account for much of the discrepancy between the FDI inflows of India and China, and that "natural, open-market based economic growth over time" may therefore

---

[36] Both countries retained Soviet- or socialist-based industrialization models, and were thus significantly cut off financially from other countries prior to their economic reforms. DEEPAK LAL, UNFINISHED BUSINESS: INDIA IN THE WORLD ECONOMY 77-80 (1999); OECD, *supra* note 3, at 29-33; Bhagwati, *supra* note 35, at 24-36.

[37] A country's annual FDI inflows roughly correspond to the annual increment in its "equity capital" (the change in annual net income minus the change in annual dividends remitted to the parent), plus any new debt financing received from the parent on its annual "balance sheet." Therefore, from a balance sheet perspective, a thirteen year increment in annual FDI inflows is roughly equivalent to the total thirteen year change in the country's net worth (equity capital) and long-term liabilities.

[38] *See* UNCTAD, *supra* note 13.

[39] *See* UNCTAD, Inward FDI Stock, by Host Region and Economy, 1980-2004, 1970-2004 (Sept. 29, 2005), *available at* http://www.unctad.org/sections/dite_dir/docs/ wir2005_instock_en.xls.

offer the ultimate explanation,[40] two additional factors demonstrate that this cannot be so. First, it may not be accurate to compare the thirteenth year India/China FDI figures as calculated above. India benefited from the rapid economic growth that took place worldwide during the 1990s, when the surge in FDI inflows into both developing and developed economies far surpassed historical growth rates in FDI; this "boom" in FDI was absent in the decade following China's liberalization.[41] This, in fact, begs the question: If the "head start" hypothesis offers the primary explanation for the difference in FDI inflows between the two countries, then why, if India's initial thirteen year period saw unprecedented increases in FDI *across countries*, did India not receive *much more* FDI than China did in its thirteen year period?

Second, and perhaps more importantly, the fact that India's political system constitutes a parliamentary democracy, not a one-party state as in China, further undermines the "head start" hypothesis. Assuming that rule of law democracies provide greater legal certainty and offer greater legal protections for foreign investments than

---

[40] If true, this would mean that India will have roughly the same level of FDI inflows in 2016 as China did in 2004. The year 2004 marked the twenty-fifth anniversary of China's liberalization; the twenty-fifth anniversary of India's liberalization will occur in 2016.

[41] *See* MORAN, *supra* note 3, at 15-17; Press Release, UNCTAD, Asia's Share of Global FDI Doubles in 1990s, UNCTAD X/PRESS/23 (Feb. 17, 2000), *available at* www.unctad-10.org/pdfs/pressrel_23.en.pdf; U.N. Econ. & Soc. Comm'n for Asia & Pac. [ESCAP], Trade and Investment Division, *Investment Promotion and Enterprise Development Bulletin for Asia and the Pacific, No. 1*, 10, U.N. Doc. ST/ESCAP/2259 (2003), *available at* http://www.unescap.org/tid/publication/indpub2259.pdf; DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS, OECD, TRENDS AND RECENT DEVELOPMENTS IN FOREIGN DIRECT INVESTMENT 1, 15-18 (2004), *available at* http://www.oecd.org/dataoecd/37/39/32230032.pdf; Robert Osei et al., The Volatility of Capital Inflows: Measures and Trends For Developing Countries 22 (Univ. Nottingham Ctr. Research in Econ. Dev. & Int'l Trade, Paper No. 02/20, 2002), available at http://www.nottingham.ac.uk/ economics/credit/research/papers/ CP.02.20.pdf; OECD, TRENDS IN FOREIGN DIRECT INVESTMENT IN OECD COUNTRIES 1-4, *available at* http://www.oecd.org/dataoecd/24/37/2956446.pdf.

regimes that do not adhere to the rule of law, the "head start" hypothesis suggests that India should have attracted much more capital in its initial thirteen year period than China did, rather than merely following in China's footsteps. The next Section will explore this paradox more thoroughly.

Presumably, India seeks not merely to achieve the same level of FDI as China, but to surpass it. However, without exploring these relevant issues, India risks perpetually playing catch-up to China. Regardless of India's current status as compared with China's in 1992, India currently attracts annual FDI inflows that total less than 9% of China's.[42] It is current, not lagging, economic performance that should drive economic goals and the legislative reform required to achieve them.

D. Postulating a Legal Explanation on the Rule of Law

In light of the natural bases for comparison that exist between India and China and the inability of three of the most popular theories to explain adequately the FDI performance gap between the two countries, this Note attempts to deliver a more substantial analysis by evaluating the legal and procedural frameworks supporting FDI in both countries. This Note's focus on a *legal* analysis is premised on the irony, explained above, that surrounds the existence (and absence) of rule of law in each country.

The phrase "rule of law" has historically been subject to varying interpretations and persistent debate, in both the domestic and international law contexts.[43] For the sake of simplicity and applicability to governance of FDI, when citing the "rule of law," this Note refers to the following four

---

[42] India's 2004 FDI inflows of $5.3 billion represent less than 9% of China's $60.6 billion of FDI. *See* WORLD INVESTMENT REPORT 2005, *supra* note 3, at 303, 306.

[43] *See* Richard H. Fallon, Jr., *"The Rule of Law" As a Concept in Constitutional Discourse*, 97 COLUM. L. REV. 1, 1-24 (1997); JOHN F. MURPHY, THE UNITED STATES AND THE RULE OF LAW IN INTERNATIONAL AFFAIRS 1-25 (2004); *see generally* THE RULE OF LAW (Ian Shapiro ed., 1994).

elements, all of which are recognized by most prominent theorists as essential to a legal regime based on the rule of law: (1) fidelity to sufficiently clear and instructive rules; (2) rules of "principled predictability" or "fair certainty"; (3) rules from valid, or legitimate, sources of governmental authority; and (4) rules from authority external to the individual (or governmental body) exercising legal power.[44]

Although all four factors are equally fundamental to the rule of law, the element of *certainty*, or *predictability*, of the law and its enforcement is most relevant to the FDI-related inquiry. As Friedrich A. Hayek stated, the rule of law means governance by "rules which make it possible to foresee with fair certainty how the authority will use its coercive powers and given circumstances and to plan one's individual affairs on the basis of this knowledge."[45] In the context of a country's legal governance of FDI, the relevant individuals are foreign investors, and the affairs they must plan are their investments. Therefore, a government offering rule of law's *predictability* to a foreign investor should supply clarity as to how it will use its authority to govern the foreign investment; this includes, among other things, commercial and contract law that is intelligible and enforceable, an impartial and efficient judicial system to manage bankruptcies and investment disputes, and protection of property rights.[46]

If the rule of law, as characterized by a democratic political system with an independent judiciary and counterbalancing institutional forces, presumably attracts investment from Western companies because of the certainty and political protections that it affords them, then it is truly perplexing that India received *merely* the same amount of FDI inflows as China did in the thirteen years following

---

[44] *See* RONALD A. CASS, THE RULE OF LAW IN AMERICA 1-22 (2001).

[45] FRIEDRICH A. HAYEK, THE ROAD TO SERFDOM 80 (1944).

[46] Bruce A. Markell, *A View from the Field: Some Observations on the Effect of International Commercial Law at Reform Efforts on the Rule of Law*, 6 IND. J. GLOBAL LEGAL STUD. 497, 500-06 (1999); Ronald J. Daniels & Michael Trebilcock, *The Political Economy of Rule of Law Reform in Developing Countries*, 26 MICH. J. INT'L L. 99, 100-18 (2004).

their respective economic reforms, and not much more. This outcome is particularly confusing in light of recent research and empirical evidence suggesting a strong, positive relationship between effective, predictable governance and economic development.[47] The "instrumental perspective" is that a country's commitment to the rule of law facilitates protection of the foreign investor's contractual and property rights, which is essential to increasing investment flows and, in turn, economic prosperity.[48] If the institutional and economic infrastructure that democratic India provides for foreign investment is less inviting than that of its undemocratic counterpart, China, then this suggests that certain aspects of the rule of law, which are reflected in India's longstanding democratic regime, may actually engender a system (or policies) that deters foreign investment by simultaneously depriving foreign investors of those rule of law protections presumably guaranteed.[49]

This argument seems credible, especially considering that, in India's case, rule of law systems do not necessarily positively correlate with higher FDI values. Since its independence from the British Raj in 1947, India has maintained a stable parliamentary democracy characterized by the foundational elements of the rule of law:

> [I]t may accurately be said that representative democracy is popular and firmly established. . . . The Constitution . . . has been the source of the country's political stability and its open society. . . . Stability consists of continuity and a reasonable degree of

[47] *See, e.g.*, Daniel Kaufman et al., Governance Matters 4, 12-13 (World Bank, Policy Research Working Paper No. 2196, 1999), *available at* http://wdsbeta.worldbank.org/external/default/WDSContentServer/IW3P/IB/1999/10/27/000094946_99101105050694/Rendered/PDF/multi_page.pdf; *see also* RANDALL PEERENBOOM, CHINA'S LONG MARCH TOWARD RULE OF LAW 450-51, 458-62 (2002); Markell, *supra* note 46, at 509-10; Daniels & Trebilcock, *supra* note 46, at 103-10. For a critical viewpoint, see Kevin E. Davis, *What Can the Rule of Law Variable Tell Us about Rule of Law Reforms?*, 26 MICH. J. INT'L L. 141, 158-61 (2004).

[48] Daniels & Trebilcock, *supra* note 46, at 99-100.

[49] *But see Tiger in Front*, *supra* note 1, at 3.

> predictability . . . [this stability] has been evident in the overall orderly conduct of the nation's business, in the stability of the system, even when governments have not been stable. Revenues are collected and distributed among the central government and the states. State and national legislative elections are regularly held. Transfers of power from one prime minister to another have been smooth . . . . Commerce and industry go on routinely. The military establishment is professional and apolitical. Stability and the open society support each other reciprocally.[50]

The fact that these systems and institutions have thrived, despite numerous wars with Pakistan, political assassinations, an ethnically diverse population (with the accompanying stratification and oppression that results from the caste system), and the reality of grinding poverty for much of the populace, underscores India's dedication to the rule of law.[51] Indeed, at least seventy percent of investors participating in the 2004 A.T. Kearney *FDI Confidence Index* survey favored India over China in both the areas of "Rule of Law" and "Transparency."[52]

China, on the other hand, is "far away from achieving the [r]ule of [l]aw . . . the realization of this dream remains as distant as ever."[53] In China, courts lack qualified lawyers and judges and are subject to political influence, flagrant violations of intellectual property rights persist, inconsistent and incomplete laws are common, and the structure and powers of the *de facto* ruling communist party are not

---

[50] GRANVILLE AUSTIN, WORKING A DEMOCRATIC CONSTITUTION: THE INDIAN EXPERIENCE 633, 635 (2000 ed.).

[51] *Id.* at 662.

[52] A.T. Kearney, *supra* note 29, at 4.

[53] Albert H.Y. Chen, *Toward a Legal Enlightenment: Discussion in Contemporary China on the Rule of Law*, *in* THE RULE OF LAW: PERSPECTIVES FROM THE PACIFIC RIM 40, 40 (Mary-Jane Atwater ed., 2000).

regulated by law.[54] Randall Peerenboom, a noted expert on Chinese governance, describes China's legal system as "in transition toward rule of law but still falling short of the minimal standard of achievement required to be considered rule of law. . . . The cumulative toll of [daily technical problems] . . . is sufficient to deny China's current system the title of rule of law."[55] Peerenboom states:

> [T]he biggest obstacles to a law-based system in China are institutional and systemic in nature: a legislative system in disarray; a weak judiciary; poorly trained judges and lawyers; a low level of legal consciousness; a weak administrative law regime; the lack of a robust civil society; the enduring influence of paternalistic traditions and a culture of deference to government authority; rampant corruption; large regional variations; and the fallout from the unfinished transition from a centrally planned economy to a market economy.[56]

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.[57] China's success in bolstering FDI inflows in this manner naturally raises two questions: First, whether the absence and violation of rule of law elements in China somehow simultaneously allows its ruling party to grant foreign investors greater rule of law protections; and second, whether the rule of law elements that provide the foundation for a transparent, democratic legal system in India also somehow hinder its efforts to attract FDI by *depriving*

---

[54] *Id.* at 40-47; *see also* Kenneth Davies, *Toward a Rules-Based FDI Policy Framework*, CHINA BUS. REV., July-Aug. 2003, at 46, *available at* http://www.chinabusinessreview.com/public/0307/eview.html.

[55] Randall Peerenboom, *Let One Hundred Flowers Bloom, One Hundred Schools Contend: Debating Rule of Law in China*, 23 MICH. J. INT'L L. 471, 525 (2002).

[56] PEERENBOOM, *supra* note 47, at 12.

[57] HUANG, *supra* note 10, at 4-14.

foreign investors of rule of law protections. To evaluate these questions, it is necessary to address the "root" of the FDI "tree," and compare the laws and procedures governing FDI in each country.

III. A METHODOLOGICAL COMPARISON OF THE LEGAL FOUNDATIONS OF FDI IN INDIA AND CHINA

This Note compares India's and China's foundational legal frameworks for FDI in a methodological fashion. The first goal is to identify the mechanisms in India's legal and procedural regimes that seem more convoluted and less conducive to attracting and retaining FDI than China's. The second goal is to evaluate these elements, and their Chinese counterparts, in light of the rule of law concerns described at the end of Section II.

The legal regimes that govern FDI may be analyzed more effectively when viewed as comprising two "frameworks": (1) governing laws and (2) approval processes. Section IV addresses the laws, regulations, and bureaucratic institutions governing FDI in each country and their effects on FDI, and Section V contrasts India's and China's FDI approval procedures and their effects on FDI. Sections IV and V both address the "rule of law" issue as relevant to each country's FDI governance.

IV. GOVERNING CAPITAL INFLOWS: FDI LAWS AND REGULATIONS

Evaluating the laws that govern FDI in both countries compels the conclusion that China's FDI governance is more transparent and accessible to foreign investors, and thus, more effective in attracting foreign investment than the framework established in India. China consciously sought to create a regime that would encourage FDI, as evidenced by: (1) China's explicit intention and directed ambition to disregard past legal traditions in creating its FDI laws, starting with Deng Xiaoping's "open door policy" of 1979; and (2) the establishment of distinct legal vehicles for FDI in

China. The manner in which China *structured* its laws and regulations afford China its central advantage over India: Foreign investors can be "certain of the rules governing the particular form of investment in China they have chosen."[58]

A. The Laws Governing FDI

1. India's Legal Governance

India does not have one primary law governing foreign investment,[59] but rather four laws that regulate different aspects of FDI, including investments, industries, securities, and corporations. Although one widely used reference guide to Indian foreign investment policies declares that "the *entire* foreign investment policy and procedures . . . are duly incorporated under [Foreign Exchange Management Act] regulations,"[60] in fact this is not the case. Rather, the Industries (Development and Regulation) Act of 1951, the Companies Act 1956, and the Takeover Code of the Stock Exchange Board of India ("SEBI") all, directly or indirectly, regulate important aspects of FDI inflows.

The Foreign Exchange Management Act (FEMA) of 1999, however, does give essential approval authority over FDI inflows to the Reserve Bank of India ("RBI"), India's central authority responsible for monetary policy.[61] By allowing the RBI to restrict and to regulate the "transfer or issue of any security by a person resident outside India,"[62] FEMA Section 6(3)(b) grants authority to RBI to set guidelines to determine if and when persons resident outside India may purchase

---

[58] OECD, *supra* note 3, at 59.

[59] PLANNING COMMISSION, *supra* note 21, at 31.

[60] RAJIV JAIN, GUIDE ON FOREIGN COLLABORATION: POLICIES AND PROCEDURES § 1.108 (9th ed. 2003) (emphasis added) [hereinafter JAIN, POLICIES AND PROCEDURES].

[61] *See* The Foreign Exchange Management Act, 1999, No. 42, Acts of Parliament, 1999.

[62] *Id.* § 6(3)(b).

shares of an Indian company.[63] Pursuant to this authority, the RBI promulgated its "Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations 2000" ("FEMA Regulations"), which outline the "automatic route" under which Indian companies may issue shares to persons resident outside India with automatic approval, but only if they are not engaged in certain scheduled industries.[64] The FEMA Regulations also place restrictions on equity participation by foreign investors based on a company's intended sector or industry.[65] Through these provisions, FEMA outlines the initial channels for, and roadblocks, to FDI in India. Nonetheless, FEMA merely serves as the starting point for FDI governance, after which several other equally applicable laws and regulations come into play.

In addition, the Industries (Development and Regulation) Act of 1951 ("IDRA"), the primary statute governing industrial activities in India, requires industrial licenses for manufacturing in certain industries.[66] The government occasionally updates IDRA's provisions through its periodic Industrial Policies announcements.[67] The latest update, the New Industrial Policy of 1991 ("NIP"), constituted part of the single most significant set of economic reforms in India since its independence in 1947. Besides focusing on fiscal deficit, deregulation, and trade and exchange rate policies, the 1991 reforms also aimed at liberalizing foreign investment

---

[63] Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000, § 5, Schedules 1-5, *available at* http://rbidocs.rbi.org.in/index.dll/13521?OpenECMStory?s1secid=1&s2secid=0 [hereinafter *FEMA Transfer Regs.*]; SECRETARIAT FOR INDUS. ASSISTANCE, DEPT. OF INDUS. POLICY AND PROMOTION, INVESTING IN INDIA: FOREIGN DIRECT INVESTMENT; POLICY AND PROCEDURES 19 (2004).

[64] *See FEMA Transfer Regs., supra* note 63, § 5(1), Schedule 1 § 2, Annexures A, B.

[65] *Id.* Annexure B.

[66] SECRETARIAT FOR INDUS. ASSISTANCE, *supra* note 63, at 10; RAJIV JAIN, GUIDE ON FOREIGN COLLABORATION: LEGAL PARAMETERS 252 (9th ed. 2003) [hereinafter JAIN, LEGAL PARAMETERS]; JAIN, POLICIES AND PROCEDURES, *supra* note 60, § 1.677.

[67] JAIN, LEGAL PARAMETERS, *supra* note 66, at 248.

policy.[68] In conjunction with the several official Notifications of the Government of India in the Ministry of Industry (Department of Industrial Development) promulgated since implementation, the NIP has made significant headway in loosening the licensing restrictions under the IDRA.[69] Using its power of exemption under Section 29B of IDRA, the central government has, since the NIP, shortened the lists of sectors either totally barred or restricted from foreign investment, including the "list of industries reserved for the public sector," the "list of industries in respect of which industrial licensing is compulsory," and the "list of items reserved for exclusive manufacture in the small-scale sector."[70]

Mergers, acquisitions, and amalgamations are governed by two other statutes. Acquisitions are governed by the Stock Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ("SEBI"), while mergers and joint ventures are regulated primarily by the Companies Act 1956.[71] Because they involve the acquisition of equity shares, acquisitions must meet the provisions of the Companies Act 1956 and the listing agreements with the Indian stock exchange if the securities are listed.[72] All three forms involving the issuance of shares of an Indian company to a foreign investor (a person resident outside India) are still restricted as to equity participation by the sectoral caps promulgated under the FEMA Regulations.[73] The formation, incorporation, and operation of companies in India, including

[68] Montek S. Ahluwalia, *Infrastructure Development in India's Reforms*, *in* INDIA'S ECONOMIC REFORMS AND DEVELOPMENT: ESSAYS FOR MANMOHAN SINGH 87, 89 (Isher J. Ahluwalia & I.M.D. Little eds., 1998).

[69] JAIN, POLICIES AND PROCEDURES, *supra* note 60, § 1.744.

[70] *Id.* §§ 1.746-90; The Industries (Development and Regulation) Act, No. 65 of 1951; India A.I.R. Manual (4th ed. 1979), § 29B.

[71] JAIN, POLICIES AND PROCEDURES, *supra* note 60, §§ 1.1607-8; *see also* RAJIV JAIN, A PRIMER ON INVESTING IN INDIA: A GUIDE FOR ENTREPRENEURS § 1.398 (2d ed. 2004-2005) [hereinafter JAIN, PRIMER].

[72] JAIN, POLICIES AND PROCEDURES, *supra* note 60, § 1.1607.

[73] *Id.*; JAIN, PRIMER, *supra* note 71, § 1.398.

those established by foreign investors, are also regulated by the Companies Act 1956.[74]

2. China's Legal Governance

Like India's FDI regime, China's does not offer a uniform foreign investment code.[75] Although there are purportedly hundreds, and perhaps thousands,[76] of laws, regulations, and decisions relating to foreign investment that the PRC has promulgated over the past two and a half decades, there are three primary forms of FDI entities, or Foreign Investment Enterprises (FIEs), commonly used in China by foreign investors: the Equity Joint Venture ("EJV"), the Cooperative (or Contractual) Joint Venture ("CJV"), and the Wholly Foreign-Owned Enterprise ("WFOE"). Additionally, "foreign-invested companies limited by shares" ("FICLS") are becoming a more visible part of China's private equity landscape.[77] Each FIE is accorded its own namesake law and a corresponding set of regulations. While EJVs historically have been the most popular form in FDI investment,[78] in the past few years WFOEs have overtaken EJVs as the dominant FDI vehicle.[79]

The *Law of the PRC on Chinese-Foreign Equity Joint Ventures* ("EJV Law") governs EJVs and was initially enacted in 1979 as the first foreign investment legislation, part of Deng Xiaoping's "open door policy." By definition, the

---

[74] JAIN, PRIMER, *supra* note 71, § 1.409.

[75] WANG, CHINESE LEGAL REFORM, *supra* note 20, at 65.

[76] KUI HUA WANG, CHINESE COMMERCIAL LAW 83 (2000) [hereinafter WANG, CHINESE COMMERCIAL LAW].

[77] *See generally* Nicholas C. Howson, *Foreign Invested Companies Limited by Shares and Private Purchases of Equity*, *in* BUYING A BUSINESS IN THE PRC: A CHINA LAW & PRACTICE GUIDE, AUGUST 1998 37, 37 (Steven Rozner ed., 1998); Provisional Regulations on the Formation of Foreign-Funded Joint Stock Companies Limited (promulgated by the Ministry of Foreign Trade and Econ. Coop'n, Jan. 10, 1995, effective Jan. 10, 1995); LAWINFOCHINA (last visited Feb. 1, 2006) (P.R.C.).

[78] OECD, *supra* note 3, at 195.

[79] *Id.* For further discussion of the reasons behind this trend, see the text accompanying notes 94-100 *infra*.

EJV Law in its current form requires foreign investors to register EJVs as limited liability companies in China, to share the EJVs' profits and losses, and to contribute at least 25% of the EJVs' registered capital.[80] By allowing the EJV to remain independent from the domestic enterprise, the EJV Law guarantees foreign investors an equity stake and corresponding management power, while limiting the investors' liability.[81] When read in conjunction with the *Regulations for the Implementation of the Law of the PRC on Joint Ventures Using Chinese and Foreign Investment* ("EJV Regulations"), EJVs are required to benefit China economically in some stated respect, whether by advancing technology, producing exports, or training employees.[82] Article 6 of the EJV Regulations gives the Ministry of Foreign Trade and Economic Cooperation ("MOFTEC")[83] power to approve the formation of EJVs.[84] Additional governmental notices and regulations are periodically issued as part of EJV governance.

The *Law of the PRC on Chinese-Foreign Contractual Joint Ventures* ("CJV Law")[85] and the *Detailed Rules for the Implementation of the Law of the PRC on Sino-Foreign Joint Cooperative Ventures* ("CJV Implementing Rules")[86] together

---

[80] Law of the PRC on Chinese-Foreign Equity Joint Ventures (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 15, 2001, effective Mar. 15, 2001) art. 4, 13 P.R.C. LAWS 63 [hereinafter *China EJV Law*].

[81] WANG, CHINESE LEGAL REFORM, *supra* note 20, at 135.

[82] WANG, COMMERCIAL LAW, *supra* note 76, at 96.

[83] Although some statutes refer to MOFERT, the revised name of MOFTEC will be used throughout this article for purposes of consistency.

[84] Regulations for the Implementation of the Law of the PRC on Joint Ventures Using Chinese and Foreign Investment (promulgated by the State Council, July 22, 2001, effective July 22, 2001) art. 6, LAWINFOCHINA (last visited Feb. 1, 2006) (P.R.C.) [hereinafter *China EJV Regulations*].

[85] Law of the PRC on Chinese-Foreign Contractual Joint Ventures (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2000, effective Oct. 31, 2000), 12 P.R.C. LAWS 229 [hereinafter *China CJV Law*].

[86] Detailed Rules for the Implementation of the Law of the PRC on Sino-Foreign Joint Cooperative Ventures (promulgated by the Ministry of Foreign Trade & Econ. Coop.'n, Sept. 4, 1995, effective Sept. 4, 1995),

form the bedrock of CJV law.[87] MOFTEC also issued the *Interpretation of the Implementation of Certain Articles of the Detailed Rules for the Implementation of the Law of the PRC on Sino-Foreign Cooperative Enterprises* as a further addendum to the CJV Implementing Rules.[88] As part of a CJV, the foreign and Chinese partners stipulate their investment intentions and conditions in a written contract, including the terms of profit sharing, ownership, and duration of the CJV.[89]

Choosing the CJV form over the EJV form allows the Chinese partner to contribute capital in the form of cash or land use rights without having to meet a set contribution requirement; it also retains more flexibility because this form is more contractually, and less statutorily, driven.[90] This flexibility has prompted greater use of the CJV form for retail projects, such as the construction of hotels and shopping plazas, and infrastructure projects, including joint exploration of natural resources and construction of power stations and telecommunications networks.[91] The CJV is currently the least popular of the three FIE forms,[92] however, because freedom of contract is protected less and foreign investors are increasingly focused on long-term investments.[93]

The third FIE, the WFOE, is governed by both the *Law of the PRC on Foreign-Funded Enterprises* ("WFOE Law")[94] and

---

LAWINFOCHINA (last visited Feb. 7, 2006) (P.R.C.) [hereinafter *China CJV Implementing Rules*].

[87] WANG, COMMERCIAL LAW, *supra* note 76, at 115.

[88] *Id.* at 116.

[89] *Id.*

[90] GUANGHUA YU & MINKANG GU, LAWS AFFECTING BUSINESS TRANSACTIONS IN THE PRC 270 (2001).

[91] WANG, COMMERCIAL LAW, *supra* note 76, at 118.

[92] OECD, *supra* note 3, at 195. In 2001, the CJV accounted for approximately 13% of the FIE vehicles used; the EJV accounted for almost 34%; and the WFOE accounted for almost 51%.

[93] YU & GU, *supra* note 90, at 272.

[94] Law of the PRC on Foreign-Funded Enterprises (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2000, effective Oct. 31, 2000) art. 2, 12 P.R.C. LAWS 238 [hereinafter *China WFOE Law*].

the *Detailed Rules for the Implementation of the Law of the PRC on Wholly Foreign-Owned Enterprises in China* ("WFOE Rules"), promulgated by MOFTEC.[95] Additionally, MOFTEC issued *An Explanation of Several Terms Used in the Detailed Rules for the Implementation of the Law of the People's Republic Of China on Sole Foreign Investment Enterprises* to articulate more clearly provisions in the WFOE Rules.[96] Article 2 of the WFOE Law defines WFOEs as entities "established in China by foreign investors exclusively with their own capital according to the relevant Chinese laws."[97] Foreign investors increasingly choose the WFOE vehicle because the 100% equity stake allows foreign investors to control fully a WFOE's operations, technology, and profits.[98] The Chinese government prefers the EJV vehicle because of the little supervision EJVs require after approval has been obtained.[99] Consequently, China regulates WFOEs quite strictly.[100]

Four additional legal sources play important roles in regulating FDI in China. First, MOFTEC's 1995 promulgation of the *Several Questions Concerning the Establishment of Foreign Investment Companies Limited by Shares Tentative Provisions* ("FICLS Regulations") created a new FDI vehicle, the FICLS, which allowed private purchases of equity interests in Chinese "companies limited by shares."[101] Second, the *Provisional Regulations on Foreign Investment Guidelines* and the *Guideline Catalog of Foreign Investment Industries* established four categories by which to classify FDI projects (employing sectoral restrictions), in

---

[95] Detailed Rules for the Implementation of the Law of the PRC on Wholly Foreign-Owned Enterprises in China (promulgated by the Ministry of Foreign Trade & Econ. Coop'n, Dec. 12, 1990, effective Dec. 12, 1990) LAWINFOCHINA (last visited Feb. 7, 2006) (P.R.C.) [hereinafter *China WFOE Rules*]; WANG, COMMERCIAL LAW, *supra* note 76, at 128.

[96] WANG, COMMERCIAL LAW, *supra* note 76, at 128.

[97] *China WFOE Law*, *supra* note 94, art. 2.

[98] YU & GU, *supra* note 90, at 272.

[99] WANG, COMMERCIAL LAW, *supra* note 76, at 131.

[100] YU & GU, *supra* note 90, at 273.

[101] Howson, *supra* note 77, at 37-40.

order to help guide foreign investors through the approval process.[102] Third, the *Contract Law of the PRC* (which supplanted the *Foreign Economic Contract Law*) provides foreign investors, as parties to a contract, with more autonomy than domestic contract law does.[103] Finally, the *Provisions of the State Council on the Encouragement of Foreign Investment*, also referred to as the "22 Articles," were adopted in 1986 in an effort to streamline tax treatment, hiring practices, and guarantees against government interference.[104]

B. China's Legal Framework Is More Conducive to FDI Inflows

China's legal governance of FDI is more conducive to facilitating FDI inflows for two reasons. First, unlike in India's case, the Chinese government drafted FDI legislation by breaking dramatically with past economic and legal policy, thereby explicitly signaling to foreign investors China's desire for capital from abroad. Second, the structural framework of Chinese FDI laws proves relatively more transparent and user friendly than its Indian counterpart.

1. Legal Foundations and Intentions

The relative robustness of China's FDI statutory governance stems directly from its motivational and circumstantial foundations. When Deng Xiaoping declared

---

[102] Section V *infra* discusses these investment categories in greater detail.

[103] Contract Law of the PRC (promulgated by the Standing Comm. Nat'l People's Cong., March 15, 1999, effective Oct. 1, 1999) art. 126, 128, 428, 11 P.R.C. LAWS 9, 31, 32; WANG, CHINESE LEGAL REFORM, *supra* note 20, at 67, 157. The Foreign Economic Contract Law of the PRC adopted many principles familiar to foreign investors from market economies.

[104] Provisions of the State Council on the Encouragement of Foreign Investment (promulgated by the State Council, Oct. 11, 1986, effective Oct. 11, 1986), LAWINFOCHINA (last visited Feb. 7, 2006) (P.R.C.); *Foreign Investment in China*, *supra* note 25, at 17.

his "open door policy" in 1979, there were no laws in place that concerned corporations, foreign ownership, or the establishment of legal enterprises controlled by foreign entities.[105] In declaring its goal to "expand international economic cooperation and technological exchange,"[106] the NPC passed the EJV Law with the *specific intention* of attracting foreign investment, an ambition that necessarily required the EJV Law to guarantee the rights and investment interests of foreign investors.[107] The Chinese government also amended its constitution in 1982 to permit "foreign enterprises, other foreign economic organizations and individual foreigners to invest in China and to enter into various forms of economic cooperation with Chinese enterprises and other Chinese economic organizations in accordance with the law of the People's Republic of China,"[108] thereby declaring to the world its intentions and constitutionalizing the role that foreign investors would play in China.[109] 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.

In contrast, 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. India squeezed provisions regulating FDI into anachronistic laws that deal with other, albeit related, subjects. The legislation that most directly deals with FDI, FEMA 1999, is actually the successor of the Foreign Exchange Regulation Act of 1973, enacted to regulate transactions in foreign exchange and securities in general, and historically

---

[105] WANG, COMMERCIAL LAW, *supra* note 76, at 83.

[106] *China EJV Law*, *supra* note 80, art. 1.

[107] WANG, COMMERCIAL LAW, *supra* note 76, at 83.

[108] XIAN FA art. 18, § 1 (1982) (P.R.C.).

[109] It is not the constitutionalization itself that is of importance here (arguably, *any* Chinese statute is enforced only when convenient); rather, it is the *act* of constitutionalizing that is significant, in that China built credibility by signaling its intentions to foreign investors.

considered restrictive of the foreign exchange transactions that are basic to foreign collaboration and investment.[110] The RBI regulates FDI by the grace of only two short provisions in FEMA.[111] A significant part of Indian FDI regulation thus grew out of merely a few words within an antiquated statute devoted to the tangentially related area of foreign exchange regulation, whereas a substantial body of Chinese FDI regulation uses clear-cut, articulated legal constructs for the specific purpose of inviting foreign investment. Therefore, foreign investors are offered certain *legally guaranteed* (via legislative decree) rights in China, but only an administrative overseer in India.

India's rules for industrial licensing of FDI projects follow the same pattern. The IDRA is the current form of the Industrial Policy Resolution of 1948,[112] which was passed upon independence more than fifty years ago with the goal of granting the federal government the ability to direct and to control industrial activities. Effectively, foreign investors' projects are subject to an industrial licensing policy steeped in an amended version of legislation promulgating a socialist-based industrialization process, whereby the central government would maintain control over eighteen basic state industries.[113] Foreign investors are likely deterred by such a regime because (1) investors want to control as much of their investment (operations) as they can, and (2) they fear the foreign government will expropriate their investment.

---

[110] JAIN, LEGAL PARAMETERS, *supra* note 66, at 140.

[111] The Foreign Exchange Management Act 1999 § 6(3)(b), No. 42, Acts of Parliament, 1999.

[112] JAIN, LEGAL PARAMETERS, *supra* note 66, at 249. The Industrial Policy Resolution of 1948 formed the basis for the IDRA of 1951.

[113] *Id.* at 248. This list of industries includes automobiles, heavy machinery, chemicals and pharmaceuticals, cotton and woolen textiles, sugar, paper and newsprint, air and sea transport, and defense. Industrial Policy Resolution of 1948 § 7, Notification No. 1(3)-44(13)/48 (1948), *reprinted in* JAIN, POLICIES AND PROCEDURES, *supra* note 60, §§ 1.799-1.804.

2. Structure of FDI Legislation

As compared to China, the legal structure that governs FDI in India fails in two respects with regard to its ability to attract foreign investors, facilitate FDI entry, preserve investor confidence, and keep FDI working for the country's development. First, India's main FDI laws focus primarily on delegating authority to federal agencies to regulate FDI evaluation and approval procedures. In contrast, China's laws established specific conduits for FIE implementation—the FIE and FICLS vehicles, which offer foreign investors uniform, user friendly investment tools with transparent rules.[114] Due to the conspicuous absence in India of Chinese-style, cookie-cutter legal vehicles for FIE formation, foreign investors considering investment in India inevitably confront less certainty and a more convoluted legal setting for investing. Instead of having the opportunity to select among several specific frameworks tailored to their specific investment goals, FDI investors in India must navigate a greater number of regulatory provisions and attendant bureaucratic hurdles in order to invest. These, of course, only discourage foreign investors from investing in India.

Second, India's main FDI laws, including FEMA and the Companies Act, are, unlike their Chinese counterparts, only tangentially related to FDI, and therefore, lack the full package of investor rights, enabling mechanisms, procedural advantages, and investment incentives that should accompany comprehensive legal regulation. For instance, the short phrases in FEMA that accord RBI the power to regulate FDI inflows do not enable legislative decisionmaking on FDI-related factors such as capital contribution and profit sharing, but rather leave their inception and promulgation to an administrative body.[115] In this way, India does not retain the same type of unified

---

[114] OECD, *supra* note 3, at 59.

[115] *See* The Foreign Exchange Management Act 1999 § 6(3)(b), No. 42, Acts of Parliament, 1999.

approach at the legislative level for creating FDI laws and regulations that China does.

C. The Rule of Law: Better for Some or Better for All?

Against the essential rule of law element of *certainty*, China's use of FIE vehicles offers much more certainty and predictability, through rule of law protections, to the investor; foreign investors in China are certain that they can enter the country on one of three given terms. India's investors, however, are afforded less certainty—they know only that they will be subject to several pieces of legislation and, correspondingly, the authorities that enforce them. The irony present here is that India's legal system is characterized by substantial rule of law protections and rights for its citizens, but its FDI legislation seemingly retains fewer rule of law elements than does its Chinese counterpart, which generally falls far short of extending rule of law protections to its own citizens. India's foreign investors must meander through a tangle of unclear and disjointed rules, whereas China's investors are afforded clear rules, protections, and rights, all embodied in the FIE vehicle of choice.

This recognition suggests two trends: First, regimes without rule of law boundaries and accountable political institutions may be more apt and better equipped to disregard democratic lawmaking procedures in order to generate legislation aimed at meeting a specific goal. While India's FDI laws may be no less capable of handling FDI in the same manner as Chinese laws, the responsibilities attendant upon a rule of law legal system may hinder the development of the most efficient law possible. Perhaps countries can more readily offer investor-specific rule of law protections if they do not generally adhere to the rule of law for all of their citizens. Second, rule of law protections memorialized at the back end (in statutes and administrative rulings) may not necessarily guarantee rule of law processes at the front end (the point where economic agents are confronted with regulation).

V. INVESTORS IN ACTION: FDI APPROVAL PROCEDURES

Two phenomena compel investigation into both countries' national FDI approval procedures. First, business and legal processes take longer to navigate in India than in China. According to the World Bank's World Development Report 2005, starting a business takes an average of 89 days in India but only 41 days in China; enforcing a contract in India takes well over a year (425 days), but only 241 days in China; registering property in India takes 67 days, while doing the same in China takes only 32 days; and insolvency proceedings take about two and a half years for resolution in China, but could take up to a decade in India.[116] The delay in these processes suggests institutional inefficiencies and backlog.

Second, and equally concerning, is the large gap between the annual amounts of FDI approved in India, and the inflows eventually realized. Between 1991 and 2000, only 35.8% of approved FDI resulted in actual inflows to India.[117] The realization rate in 2001 proved somewhat higher, at 45% of FDI approvals.[118] Accordingly, this suggests the existence of one or more of the following circumstances: Indian approval processes that frustrate or deter investors from ultimately executing investments; *post*-approval inefficiencies, perhaps at state or local levels; or corruption at points outside the regulatory framework that impede realization of capital inflows.

Indeed, surveys of foreign investors in India confirm that inefficiencies in the investment approval process constitute a substantial obstacle to seamless investment flows.[119] As cited in the Planning Commission Report, studies performed by the Boston Consulting Group, McKinsey, and A.T. Kearney determined that investors were significantly

---

[116] WORLD BANK, 2005 REPORT, *supra* note 33, at 248.

[117] CHOPRA, *supra* note 3, at 157.

[118] PLANNING COMMISSION, *supra* note 21, at 27.

[119] *Id.* at 26.

deterred by the bureaucracy and inefficient procedural hurdles involved in the application and approval processes.[120] For example, a Confederation of Indian Industries study cited by the Planning Commission Report found that a typical power project in India required forty-three central government clearances and fifty-seven state and local government clearances before commencing full-scale operations.[121] The report concluded: "[T]he precise reason for the low levels of realization is the post-approval procedures, which has in the past played havoc with project implementation . . . *the delays . . . are not at the stage in FDI approval per se . . . [but] at the state level*, as project implementation takes place at the state level."[122] Further analysis of the procedures seems to suggest that this conclusion is correct and in fact compels further inquiry into India's reliance on a federalized approval process.

A. FDI Approval Process in India

There are two methods of FDI entry into India: (1) the "automatic route" under powers delegated to the Reserve Bank of India, necessitating no prior approval by either the government or the RBI;[123] and (2) the government approval route, whereby all activities not covered by the automatic route require approval by the Foreign Investment Promotion Board.[124] The data from recent years reveal that the government approval route remains the primary conduit for FDI inflows and that the automatic route plays a much smaller role.[125] The automatic and governmental approval routes will be discussed in turn.

---

[120] *Id.*

[121] *Id.*

[122] *Id.* at 27 (emphasis added).

[123] JAIN, POLICIES AND PROCEDURES, *supra* note 60, § 1.907; SECRETARIAT FOR INDUS. ASSISTANCE, *supra* note 63, at 10.

[124] SECRETARIAT FOR INDUS. ASSISTANCE, *supra* note 63, at 3.

[125] *See* CHOPRA, *supra* note 3, at 145-49. Generally, during the last ten years, the annual FDI inflow amounts channeled through the government route have far exceeded those channeled through the automatic route (in

1. Automatic Route Policy & Procedures

RBI identifies those proposals for issuance and purchase of shares by a person residing outside of India that qualify for the automatic route in Section 5(1) and Schedule I of the FEMA Regulations.[126] The FEMA Regulations state that all FDI (up to 100% equity participation) is channeled through the automatic route, except in four instances: (1) investments that require an industrial license; (2) proposals in which the foreign investor has a previously existing venture in the same field; (3) application for acquisition of shares in an existing Indian company; (4) investments falling outside sectoral caps or in sectors in which FDI is barred.[127] In these four instances, government (Foreign Investment Promotion Board or "FIPB") approval is required before RBI approval, the final and necessary approval,[128] can be given.[129]

Neither government nor RBI approval is necessary for proposals that qualify for the automatic route; instead, the Indian company issuing shares must submit a report to RBI no later than thirty days from the date of receiving funds.[130] In determining the corporate form of the new entity, foreign

some years, the government route has channeled more than ten times the annual inflows in the automatic route). For instance, in 2001-02, the government route channeled 36.2% of total annual FDI inflows, while the automatic route channeled only 12.5% (other routes included NRI, acquisition of shares, equity capital of unincorporated bodies, reinvested earnings, and other capital). In 2003-04, the government route channeled 19.9% of the annual FDI inflows, while the automatic route helped facilitate only 11.4%. However, as of December 16, 2005, the Reserve Bank of India predicted that the automatic route would actually surpass the government route in utilization and that the automatic route would channel 22.7% of 2004-05 annual FDI inflows, while the government route would facilitate only 19.2%. Reserve Bank of India, RBI Bulletin No. 46: Foreign Investment Inflows (Dec. 16, 2005), *available at* http://www.rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=7190.

[126] *See FEMA Transfer Regs.*, *supra* note 63, § 5(1), Schedule 1.

[127] *Id.* Schedule 1 §§ 1(2), 2(1), 3.

[128] *Id.* § 5(1).

[129] *Id.* Schedule 1 §§ 1(2), 2(1)(i), 3.

[130] *Id.* Schedule 1 § 9(1)(A).

investors may choose whether or not to incorporate.[131] If the investor opts to incorporate, the entity must be incorporated under the Companies Act 1956 in the form of a joint venture or wholly-owned subsidiary. The company must file for registration and incorporation with the Registrar of Companies and is then subject to Indian laws and regulations just as any other domestic Indian enterprise.[132] Although they are created by a separate legal document, these new entities must still abide by the sectoral caps under the FEMA regulations introduced above.[133] FEMA Regulations and restrictions on automatic route approval also apply to investments in existing companies.

2. Government Approval Route Policy and Procedures

As stated above, four circumstances regarding FDI necessitate government approval. In these cases, investment proposals are first sent to the Secretariat for Industrial Assistance ("SIA") and are then transferred for review to the FIPB, the board chaired by the Secretary of the DEA. It generally takes thirty days to receive a decision on a submitted proposal. The FIPB has complete discretion in rendering its decisions, including freedom from all predetermined parameters and procedural requirements[134] and full authority to negotiate with investors to maximize FDI inflow potential.[135] However, this same flexibility may slow down the process because it also allows the FIPB to consider a host of factors in determining whether or not to approve FDI proposals.

The FIPB's *Guidelines for the Consideration of Foreign Direct Investment (FDI) Proposals by the Foreign Investment Promotion Board (FIPB)* lists some of the factors it may

---

[131] SECRETARIAT FOR INDUS. ASSISTANCE, *supra* note 63, at 16.

[132] *Id.*

[133] *Id.*

[134] JAIN, POLICIES AND PROCEDURES, *supra* note 60, § 1.948.

[135] *Id.* § 1.953.

consider in rendering its decisions,[136] including sectoral requirements, the advantages and disadvantages of granting industrial licenses, the nature of technology collaboration, and export requirements.[137] Furthermore, the FIPB is encouraged to prioritize investment proposals that do not qualify for automatic approval but that fall within sector limits, involve infrastructure projects, have export potential, or are likely to increase employment.[138] The board is also advised to scrutinize proposals for the amount of equity held by foreign investors and the resultant balance of equity ownership, as well as, whether the induction of capital is characterized by new foreign equity or merely by expansion of the entity through the purchase of existing shares.[139]

3. Post-Approval Procedures

After the foreign investor obtains RBI or government approval and before the foreign-owned entity's operations can commence, the investor must apply for and secure numerous other clearances at both the federal and state levels.[140] At the federal level, investors must obtain registration and license approvals from the SIA, the Central Excise Department, and the Inspector of Boilers, as well as, the necessary clearances from the Factory's Inspector, Environmental Authority, and the Pollution Control Board.[141] Then, at the state level, the investor must: (i) register with the Sales Tax Commissioner and Provident Fund Commissioner; (ii) obtain permission for land

---

[136] Press Note No. 3, Foreign Inv. Promotion Bd., Dep't Indus. Policy & Promotion, Guidelines for the Consideration of Foreign Direct Investment (FDI) Proposals by the Foreign Investment Promotion Board (FIPB) (Jan. 17, 1997), *available at* http://mines.nic.in/comp3.html [hereinafter *Press Note No. 3*]; Press Note No. 5, Foreign Inv. Promotion Bd., Dep't Indus. Policy & Promotion, (Mar. 19, 1999), *available at* http://siadipp.nic.in/policy/changes/press5_99.htm [hereinafter *Press Note No. 5*].

[137] *Press Note No. 3*, *supra* note 136, § 6.

[138] *Id.* § 7.

[139] *Id.* § 8.

[140] JAIN, PRIMER, *supra* note 71, §§ 1.414-15.

[141] *Id.*

use/construction from the State DI, Department of Town and Country Planning, Local Authority/District Collector, and the municipality; (iii) secure a power connection from the Electricity Board; (iv) acquire a water connection from the Water Department; (v) procure a fire license from the Fire Service Department; and (vi) meet clearance protocols established by the State Pollution Control Board, Chief Controller of Explosives, and Chief Inspector of Boilers.

B. FDI Approval Process in China

Foreign investors are placed "squarely in the middle of the often ferocious struggle between central and local authority in China."[142] Conflicts of interest exist between local authorities who favor rapid growth and community prosperity, and the central government, which fears inflation and desires to redirect investment into sectors of national priority. Consequently, foreign investors often either attempt to limit their total investment or to break their projects into smaller "phases" in order to keep the investment proposals under the purview of the local authorities. The lack of clarity over the level of approval authority legally allocated to provincial or local commissions on foreign trade and economic cooperation, also known as COFTEC, further exacerbates this tension.[143]

The approval processes for each of the three primary forms of FDI investment (EJV, CJV, and WFOE) are similar and are codified in the legislation and implementing rules for each vehicle; details of state and local involvement are also articulated within the relevant provisions.[144] These

---

[142] John E. Lange, *Equity Joint Venturers Puzzle over Approval and Equity Financing Issues*, CHINA L. & PRAC., June 1996, at 20.

[143] Local authorities often assert their legal ability to approve projects with investment amounts of up to $30 million, while MOFTEC disagrees. *Id.*

[144] Because this Section focuses on approval procedures, the relative advantages and disadvantages of the various FDI forms in China (for instance, tax advantages, capital contribution requirements, etc., offered by certain vehicles but not others) will be discussed only insofar as they

procedures will be discussed in turn, according to the type of FIE.

1. Procedural Framework for EJV Approval

An EJV is subject to examination and approval by MOFTEC,[145] assuming that the foreign investors have previously identified and negotiated with their partners.[146] If either of the following two situations exist, however, the EJV must be authorized by the "governments of provinces, autonomous regions or municipalities directly under the central government or relevant departments of the State Council [COFTEC]":[147] (1) the investment amount is less than $30 million,[148] or (2) the state need not allocate any additional raw materials, and the national balance in certain sectors is not affected.[149] EJVs successful in gaining approval through COFTEC must also receive final approval by MOFTEC.[150] Ventures with investment amounts greater than $30 million usually require MOFTEC's approval, and those over $100 million must also be approved by the State Council.[151] According to the EJV Regulations, the EJV should receive a decision within three months of submitting the application[152] and, after receiving the approval certificate, must register with the state industry association.[153]

---

are relevant to explain the approval procedures for each vehicle. WANG, CHINESE COMMERCIAL LAW, *supra* note 76, at 129-30.

[145] *China EJV Regulations*, *supra* note 84, art. 6.

[146] This is, by nature, a vital step in the process, but will not be given attention here because of its relative unimportance in the approval process.

[147] *China EJV Regulations*, *supra* note 84, art. 6; Lange, *supra* note 142, at 20.

[148] *China EJV Regulations*, *supra* note 84, art. 6(1); Lange, *supra* note 142, at 20.

[149] *China EJV Regulations*, *supra* note 84, art. 6.

[150] *Id.*

[151] Lange, *supra* note 142, at 20.

[152] *China EJV Regulations*, *supra* note 84, art. 8.

[153] *Id.* art. 9.

EJV approval will be declined in five circumstances:[154] (1) where China's sovereignty is threatened; (2) where China's laws may be violated; (3) where the EJV Regulations' requirement that EJVs "promote the development of China's economy and the raising of scientific and technological levels for the benefit of socialist modernization and construction"[155] is not satisfied; (4) where the EJV would cause environmental pollution; or (5) when there is "obvious inequity" in any of the agreements or contracts. MOFTEC also applies equity participation limits based on the sectoral caps pursuant to the *Foreign Investment Industrial Guidance Catalog*.[156]

2. Procedural Framework for CJV Approval

The approval process for a CJV proves less grueling than that for an EJV. For CJV approval, parties must submit materials similar to those listed in the EJV section to MOFTEC;[157] the application must be approved by COFTEC, however, if: (1) the investment amount is below a prescribed minimum, (2) the investment is self-financed and requires no state funding, (3) any consents required by state departments for export quotas or licenses have already been acquired, or (4) the existence of any other conditions stipulated by COFTEC.[158]

Furthermore, the relevant approval authorities are instructed to deny approval if the investment threatens China's sovereignty, endangers state security, causes environmental pollution, or violates Chinese laws or regulations.[159] Parties can expect to receive notice by the approval authority within forty-five days,[160] half the time stipulated for either EJV or WFOE approval, and then must

[154] *Id.* art. 4.

[155] *Id.* art. 3.

[156] *Id.* art. 3.

[157] *China CJV Implementing Rules*, *supra* note 86, art. 7.

[158] *Id.* art. 6.

[159] *Id.* art. 9.

[160] *Id.* art. 7.

apply to the state industry association for registration and a business license within thirty days afterward.[161] Because CJVs are usually focused on export processing, issues of performance requirements, management control, and investment returns usually do not present as many problems during the approval process.[162] Also, the contractual nature of the CJV makes it a more flexible vehicle than the EJV.

3. Procedural Framework for WFOE Approval

For the reasons discussed above, the Chinese government favors EJVs over WFOEs and, consequently, applies a much stricter approval process to WFOEs.[163] This extra scrutiny extends beyond the additional alternative performance requirement listed in WFOE Law Article 3, that WFOEs either adopt advanced technology or export fifty percent of their output, and beyond the numerous sectoral bars present in the WFOE Implementing Rules.[164] For instance, WFOE Rules Article 10 explicitly requires that foreign investors submit a detailed proposal (known as *baogao*)[165] to the local or county level government where their enterprises will be located.[166] This obligation is strenuous for foreign investors, and would usually be assumed by the Chinese partner in a joint venture.[167] Only after receiving a written reply from the local government can the investor formally apply to MOFTEC (or the other relevant approval authority).[168]

Investors who wish to use the WFOE vehicle must submit a full application to MOFTEC, including the same material required in the case of an EJV, along with documents

[161] *China CJV Law*, *supra* note 85, art. 6.

[162] ROSEN, *supra* note 31, at 28.

[163] WANG, COMMERCIAL LAW, *supra* note 76, at 131-32.

[164] *See China WFOE Law*, *supra* note 94, art. 3; *China WFOE Rules*, *supra* note 95, art. 4-5.

[165] ROSEN, *supra* note 31, at 29.

[166] *China WFOE Rules*, *supra* note 95, art. 10-11.

[167] ROSEN, *supra* note 31, at 29-30.

[168] *China WFOE Rules*, *supra* note 95, art. 11; WANG, COMMERCIAL LAW, *supra* note 76, at 132.

confirming the financial credit of the investors and the written reply of the local government.[169] The ninety-day approval window applies to WFOEs as it does to EJVs. Like in the cases of the other two forms of FIEs, after receiving approval, the foreign investor has thirty days to apply to the state industry authority for registration and a business license.[170] As in the cases of its FIE counterparts, applications can be rejected if investments are found to threaten China's sovereignty, endanger national security, violate Chinese laws, diverge from China's economic development goals, or pollute the environment.[171]

In reality, pursuant to the WFOE Articles 3 and 6, a WFOE application will face tough examination prospects unless it encourages the development of China's national economy through one of the following (or related) methods:[172] adoption of advanced technology and equipment; development of new products; production of import substitutes; or exportation of at least fifty percent of annual output. While the government has relaxed the approval procedures in practice, especially in non-crucial industries, the approval process is still more restrictive than that regulating joint ventures.[173]

C. China's Local and State Governments Are Vertically Integrated into the National Approval Process While India's Are Not

The most significant difference between the national-level approval processes for FDI in India and China is the degree of involvement by local officials in each system. 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.

[169] *China WFOE Rules*, *supra* note 95, art. 11(5).

[170] *Id.* art. 13.

[171] *Id.* art. 6.

[172] *Id.* art. 3, 6; WANG, COMMERCIAL LAW, *supra* note 76, at 133-34.

[173] WANG, COMMERCIAL LAW, *supra* note 76, at 234.

Analysis of this legal and bureaucratic divide echoes the results of the Planning Commission's report that most of the approval impediments in India occur below the national level.

1. The Basic Similarities and Differences

Although the two countries' FDI approval processes differ in substance and functional style, they remain quite similar in form and in their objectives. Although the Indian approval mechanisms are bifurcated into "automatic" and "government" approval routes, while China's process is organized according to the type of FIE vehicle used, such structural divisions must be placed in functional context in order to distill the true nature of the processes. India's "automatic" route can be used only if the proposal does not fall into one of four large, restrictive pools. As few proposals qualify for "automatic" treatment (as discussed above), most of India's FDI approvals go through its "government" route.[174] In terms of India's system, China can be said to have only a "government" approval route (one in which MOFTEC and/or COFTEC review and approve investment proposals). Thus, most FDI entering each country is channeled through a "government" approval route.

Two additional, minor differences between the systems are worth mentioning briefly, but are undeserving of lengthy scrutiny because they do not substantively contribute to this comparative analysis. The first concerns the decisionmaking priorities of the FIPB and MOFTEC in considering investment proposals. MOFTEC receives clear, numbered guidelines by each FIE's investment legislation on what circumstances require it to deny approval. In contrast, the FIPB's guidelines, promulgated in *Guidelines for Consideration of Foreign Direct Investment Proposals*, are numbered, but remain lengthy, uncoordinated, and

---

[174] The fact that the automatic approval route goes underutilized suggests the possibility that the automatic route is overburdened with restrictions that force many approvals through the government approval route.

characterized by a lack of order in prioritization.[175] For instance, the *Guidelines* are over three pages in length. Presumably, by allowing India's FIPB greater discretion in the approval process, the *Guidelines* may promote both efficiency and inefficiency. Second, India's investment approval window is actually shorter than China's—the FIPB guarantees a response within thirty days, while MOFTEC presumably takes ninety days.

2. The Major Difference: The Role of Local and State Governments in the Approval Process

The most significant difference between the countries' FDI approval frameworks is the role played by local and state bureaucracies within the national approval procedures (run by FIPB and MOFTEC in India and China, respectively). Specifically, China has a vertically integrated approval process, one in which the state and local authorities (COFTEC) are integrated into the nationalized approval process, while India's regional authorities play little role in FIPB's *formal* investment proposal consideration.

COFTEC has authority to approve the investment proposal if it is for less than $30 million (or if the state is not required to expend additional raw materials). By this allowance, China's approval system grants regional authorities formal approval authority in numerous situations. As described in the previous section, COFTEC is so integrated into the approval procedures that there are ongoing tussles between it (the local authority) and MOFTEC (the national authority) over investment approvals. Perhaps this explains the ninety-day time frame required by the Chinese government to approve investment proposals, which is three times longer than India's determination period.

India, on the other hand, assigns the formal investment approval authority directly to a national regulatory body—namely, the FIPB. Indian localities only get involved if

[175] *See Press Note No. 3, supra* note 136.

approval has been given by FIPB. As the Planning Commission reports:

> [A]fter the [government, or FIPB] approval has been obtained, the applicant may get his unit/company registered with the Registrar of Company. *Subsequently, the company needs to obtain various clearances such as, land clearance, building design clearance, pre-construction clearance, labor clearance etc. from different authorities before beginning its operations.* These clearances, moreover, differ from sector to sector and may also differ from state to state.[176]

As part of this post-approval project "clearance" process,

> each industrial unit is, moreover, supposed to maintain records in regard to production, sale and export, use of specified raw material including public utilities like water and electricity, labor related details, financial details and details in regard to industrial safety and environment.
>
> The unit is also subject to periodic inspection by the factory's inspector, labor inspector, food inspector, fire inspector, Central excise inspector, air and water inspector, mines inspector, city inspector and the like, the list of which may go up to *30 or more*.[177]

Although regional political forces play little role in the FIPB's formal investment considerations, according to the Planning Commission's report, they clearly become involved intimately soon afterward.

In fact, China's approval processes suffer from the opposite problem. Approvals in China are likely to stall at the national level, but turnaround occurs much more quickly at the state and local levels.[178] Leaving the investment

---

[176] PLANNING COMMISSION, *supra* note 21, at 69 (emphasis added).

[177] *Id.* (emphasis added).

[178] OECD, *supra* note 3, at 65-67.

application at China's national-level bureaucracy could very well result in approval delay of six months to three years.[179]

This discrepancy between the approval systems of each country raises significant issues, especially in light of the Planning Commission's finding that the tangle of bureaucratic controls and procedures at the post-approval level, when the regional authorities become involved, is the "precise reason" for low levels of realization in approved FDI inflows in India.[180] Although China's inclusion of regional authorities in the national-level procedures would seem to hinder the efficiency of its approval process, by formalizing the regular infighting that inevitably develops between the central and state governments, it essentially allows MOFTEC and COFTEC to grant *dual* approval, thereby enabling the foreign investor to begin immediately operations after approval is granted (without having to submit independently to local authorities). This suggests that China's inclusion of state and local approval authorities within the national-level approval process framework may result in a more streamlined process *overall* for FDI approvals, one that generates regional approval under a nationally promulgated framework. Instead of being granted a similar, united approach in India, after FIPB approval is granted, the foreign investor is left to fend for himself in the trenches with state and local authorities, who are (unlike their counterpart COFTEC in China) not supervised by any national authority during that process. The Chinese system may help investors address more effectively the post-approval regional bureaucracy once and for all, concurrently with national approval.

D. Respect for States' Rights and Its Burden on Rule of Law

When judged against the rule of law standard of certainty, or predictability, China offers more such

[179] *Id.* at 65.
[180] *Id.* at 27.

protection to foreign investors than India. 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.

Although India's approval processes are cumbersome enough for foreign investors to navigate such that they delay and deter the realization of investment, they adhere to one important democratic element sidestepped by China: federalism or the respect for states' rights. 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. Evidently, although China's approach works better for foreign investment, this more streamlined FDI approval process comes at the expense of states' rights. Therefore, India seemingly holds steadfast to the foundational democratic element of federalism but, in doing so, is hampered in offering rule of law protections to its foreign investors.

VI. CONCLUSION

This Note attempts to reach past the trite metaphors accorded to India and China, such as "financial dragons," "Asian tigers," and "lumbering elephants." Its conclusions intend to be premised on more than a superficial comparison of two countries with large, poor populations and cheap labor. It bypasses the commonly proffered explanations for confoundingly low levels of FDI in India and investigates the very laws and procedures that govern such inflows.

Analyzing the laws and procedures that govern FDI inflows leads to the conclusion that India's laws governing

FDI are entrenched within and interspersed throughout antiquated legislation, offering a structural framework far less conducive to investment entry than China's clearly articulated, three-pronged investment vehicle legislation. Furthermore, because state and local authorities are absent from India's national FDI approval process, foreign investors confront additional layers of bureaucracy at the state and local levels following national approval, which prolongs "final" approval and ultimately delays the implementation of investments. In contrast, China's system formally incorporates such regional authority into the national approval process and allows the investor to begin operations once both approvals are stamped.

Finally, examining the rule of law as it relates to the India-China FDI divide suggests that, because India abides by the rule of law generally as a functioning democracy, it is perhaps less capable of pushing through investor-friendly legislation and usurping states' rights in efforts to provide a more attractive legal environment for FDI inflows. In considering both its laws and its approval procedures, India offers less certainty and predictability, and thus, fewer rule of law protections to its foreign investors than China. Essentially, India may be sacrificing financial inflows for better domestic governance.