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FDI Policies in China and India: Evidence from Firm Surveys

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1. INTRODUCTION

RESEARCH on China and India broadly agrees that these two countries have pursued widely different policies towards foreign direct investment (FDI).[1] It is safe to assert that by and large China has pursued a more proactive policy towards FDI than India. Many economists have urged India to follow China's approach and undertake a more comprehensive liberalisation. A lesser known fact is that India has pursued comprehensive *domestic* reforms. For example, India has had an explicit privatisation policy, has established a ministry devoted to privatisation, and has undertaken deeper financial liberalisation that resulted in waves of bank privatisation.

Few have empirically examined these policy differences between China and India. In this paper, we provide a quantitative appraisal of the effects of FDI and domestic economic policies on the perceptions of foreign and domestic firms in China and India. Using World Bank private-sector survey data (2002 for China and 2004 for India), we find evidence that foreign-invested enterprises (FIEs) perceive far more restrictions relative to domestic firms in India, with an opposite pattern observed in China. FIEs in India perceive more obstacles to business operations and development than domestic firms, mainly in areas related to government policy and regulations. FIEs in India also face relatively more financial constraints than domestic firms for new investment. In contrast, FIEs in China see government officials more helpful relative to domestic private firms. Existing literature often postulated the existence of a 'national preference', that is, the host government of FDI discriminates against

[1] For details, readers are referred to Lardy (1994), Moran (1999), Huang (2003), Balasubramanyam and Mahambare (2004), Manor (2005), Kochhar et al. (2006), Panagariya (2008), and Subramanian (2008).

FIEs to protect domestic firms (Cave, 1996). Our findings support the prevalence of a national preference in India but not in China.

The differences in perceptions across firm types documented in this paper can be *prima facie* evidence of differential pace of external and internal reforms. It is possible that India has pursued a more aggressive domestic reform agenda, whereas China has pursued a more aggressive external reform agenda. While our results have no normative implications, they do reveal substantial differences in the *overall* pace and scope of reforms between China and India. We argue that the focus of the comparative analysis on China and India should be reform priorities rather than, as commonly argued, more reforms in India.

2. DATA AND DESCRIPTIVE FINDINGS

a. World Bank Survey Data

We use firm survey data from the World Bank for our analysis. Data for India are drawn from the *Firm Analysis and Competitiveness Survey of India* conducted jointly by the World Bank and the Confederation of Indian Industry in 2004. Surveyed Indian establishments were asked to report their economic performance and perception about the business environment.[2] The survey covers a total of 2,286 establishments (plants) from 22 manufacturing sectors and 50 cities.[3]

Data for China are from the *Investment Climate Survey of Chinese Enterprises* conducted jointly by the World Bank and the National Bureau of Statistics of China between 2000 and 2002. This survey covers a total of 2,400 firms from 11 industries (both manufacturing and services) and 18 cities.[4]

Table 1 provides summary statistics of both FIEs and domestic firms for both countries. In the Indian sample, FIEs are older and larger in terms of employment than their domestic counterparts. In the Chinese sample, FIEs are younger and larger (in terms of sales and capital stock) than domestic firms. In both China and India, FIEs are on average more export oriented but do not appear to be more profitable (based on the profit/sales ratio).

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[2] Establishments were chosen randomly so that both manufacturing and service establishments were well represented.

[3] The data set is downloaded from the World Bank's Enterprise Surveys website: http://www.enterprisesurveys.org/.

[4] One hundred or 150 firms were randomly sampled to ensure that both manufacturing and service industry firms were adequately represented. All firms in the survey have employment over a certain minimum threshold (20 for manufacturing and 15 for service industries) were sampled. The World Bank conducted a more comprehensive survey in China in 2005, covering 12,000 firms over 100+ cities. The data are not publicly available yet at the time when this paper is being written.

TABLE 1
Differences in Attributes Between Foreign and Domestic Firms

	Domestic (1)	*FIE (2)*	*(1)–(2)*
Panel A: India (2004)			
Age	16.65	21.01	−4.36
	(0.24)	(1.46)	(1.32)***
Total sales (million rupee)	648.61	236.77	−2044.22
	(2692.83)	(1644.11)	(1311.19)
Exports (million rupee)	10.40	132.00	−122.00
	(4.17)	(114.00)	(30.70)***
Employment	83.81	355.18	−271.37
	(6.57)	(88.79)	(38.72)***
Book value fixed assets (million rupee)	346.42	1015.48	−669.06
	(205.59)	(294.40)	(1094.29)
Profits (million rupee)	7.20	13.90	−6.71
	(2.39)	(6.75)	(12.90)
Profit/sales	0.12	0.11	1.20
	(0.00)	(0.01)	(1.31)
Number of firms	2,207	79	
Panel B: China (2002)			
Age	16.96	9.07	7.90
	(0.327)	(0.28)	(0.88)***
Total sales (million yuan)	161.10	497.03	−335.93
	(67.65)	(122.17)	(185.92)*
Exports (million yuan)	9.06	133.14	−124.08
	(2.91)	(36.29)	(15.69)***
Employment	530.50	613.59	−83.09
	(64.66)	(75.82)	(174.28)
Book value fixed assets (million yuan)	134.66	281.15	−146.50
	(27.74)	(67.18)	(77.59)**
Profits (million yuan)	0.10	82.49	−82.38
	(12.60)	(25.66)	(34.90)**
Profit/sales	0.59	0.13	0.46
	(0.45)	(0.03)	(1.20)
Number of firms	2,103	297	

Notes:
(i) Simple averages for each ownership type are reported. Standard errors are in parentheses.
(ii) $*p < 0.10$; $**p < 0.05$; $***p < 0.01$.
(iii) FIE, foreign-invested enterprises.

b. Differences in Perceptions about the Business Environment

In this section, we present basic statistics on how the different institutional and legal environments for FDI in China and India shape firms' perceptions about the business environment.[5] Our hypothesis is that *FIEs in India perceive a more difficult business environment, compared with domestic firms, while the opposite is observed in China.* These findings will be confirmed by regression

[5] Similar analysis has been performed by Beena et al. (2004) using firm survey data.

analysis in Section 3. We interpret any significant differences in perception between FIEs and domestic firms within a country as revealed outcomes of policy biases (either for or against FIEs).[6]

Before presenting the main results, several remarks are in order. First, our findings could be subject to the standard selection bias. Given a 'tougher' business environment in India, FIEs in India should be on average more capable of dealing with adverse business situations, compared with FIEs in China. Under these circumstances, the surveyed FIEs in the Indian sample would tend to have better perception, all else equal. Suppose FIEs were randomly assigned to both countries (i.e. no selection), we would have found a more negative perception among FIEs in India compared with our current findings. In short, the potential selection bias goes against our results.

Another remark is that perhaps foreign investors choose certain ownership structure to deal with the adverse business environment. For instance, if contract enforcing institutions are weak in the host country, foreign investors would prefer to acquire a larger equity share of the venture to effectively resolve business conflicts with the local partner. According to the property-rights theory of the firm (Grossman and Hart, 1986; among others), a larger equity share would allocate more resources to the foreign investor when bargaining between the local partner and the investor fails. To verify this claim, we check whether there is any systematic difference in foreign equity shares between FIEs in India and those in China. We find that FIEs in India have much lower foreign equity shares on average than those in China.[7] These results are partly an outcome of legal restrictions on foreign ownership in India and partly a rational response of foreign investors to the underlying institutional environment. To the extent that FIEs in India have lower equity shares, and thus lesser control rights and bargaining power, FIEs in India may have to rely more on the formal legal procedures to settle business disputes and are potentially more constrained by the legal institutions. We will verify this prediction below.

(i) Obstacles to business operations and growth

The surveyed firms in India were asked to choose from a list of 20 different types of factors that affect their daily business operations, covering various issues related to government interventions and infrastructure (see Table 2 for details). If a firm indicates a factor as an obstacle to business operations, it would then be asked to rank the obstacle on a scale between 0 (least severe) and 5 (most severe). We hold an agnostic view about the relevance of each

[6] Despite the usual drawbacks of using survey data, any robust findings based on survey responses point to a promising research avenue for further analysis using comprehensive firm-level data.
[7] The average foreign equity share for FIEs in India is 37.8 per cent, with the median equal to 26.5 per cent. In China, the average is 63.5 per cent, with the median equal to 60 per cent.

TABLE 2
Problems of Business Operations Facing Indian Firms

Obstacles to Business Operation and Growth Issues	*Domestic (1)*	*FIE (2)*	*(1)–(2)*
Telecommunication	0.384	0.519	−0.135
	(0.018)	(0.103)	(0.094)
Electricity	1.842	1.329	0.513
	(0.033)	(0.149)	(0.174)***
Transportation	0.651	0.734	−0.083
	(0.022)	(0.108)	(0.120)
Access to land	0.569	0.494	0.075
	(0.024)	(0.114)	(0.129)
High taxes	1.729	1.861	−0.131
	(0.032)	(0.153)	(0.170)
Tax administration	1.475	1.709	−0.234
	(0.030)	(0.152)	(0.162)
Customs and trade regulations	0.889	1.385	−0.496
	(0.028)	(0.140)	(0.148)***
Labour regulations	0.983	1.165	−0.181
	(0.027)	(0.147)	(0.147)
Skills & education of available workers	0.936	1.051	−0.115
	(0.027)	(0.139)	(0.145)
Business licensing and operating permits	0.681	0.936	−0.255
	(0.023)	(0.135)	(0.126)**
Access to financing (e.g. collateral)	0.910	0.886	0.024
	(0.027)	(0.131)	(0.147)
Cost of financing (e.g. interest rates)	1.009	1.165	−0.155
	(0.028)	(0.140)	(0.150)
Economic & regulatory policy uncertainty	0.711	1.154	−0.443
	(0.024)	(0.133)	(0.130)***
Macroeconomic instability	0.599	0.910	−0.311
	(0.022)	(0.128)	(0.120)***
Corruption	1.427	1.722	−0.295
	(0.032)	(0.169)	(0.172)*
Crime, theft and disorder	0.724	0.679	0.044
	(0.024)	(0.106)	(0.128)
Anti-competitive or informal practices	0.500	0.823	−0.323
	(0.022)	(0.139)	(0.117)***
Regulation specific to your industry	0.376	0.782	−0.406
	(0.019)	(0.135)	(0.102)***
Legal system/conflict resolution	0.428	0.810	−0.382
	(0.019)	(0.121)	(0.105)***
Access to foreign technology	0.222	0.299	−0.077
	(0.014)	(0.085)	(0.078)

Notes:
(i) The original question in the World Bank's Indian firm survey: 'Please tell us if any of the following issues are a problem for the operation and growth of your business. If an issue poses a problem, please judge its severity as an obstacle on a four-point scale, where 0 = no obstacle, 1 = minor obstacle, 2 = moderate obstacle, 3 = major obstacle and 4 = very severe obstacle.'
(ii) Simple averages for each ownership type are reported, with standard errors in parentheses.
(iii) *$p < 0.10$; **$p < 0.05$; ***$p < 0.01$.
(iv) FIE stands for foreign-invested enterprises.

factor as a business constraint and report the averaged perceptions for all constraints for both ownership types.

Of the 20 'obstacle' categories, 16 of them show that FIEs in India perceive less favourable business environment than domestic firms. Of the 16 factors, the difference in perception is statistically significant for nine of them. Specifically, FIEs in India perceive stronger constraints on issues related to (i) the provision of electricity, (ii) customs and trade regulations, (iii) business licensing and operating permits, (iv) economic and regulatory policy uncertainty, (v) macroeconomic instability, (vi) corruption, (vii) anti-competitive and informal practices, (viii) industry-specific regulations and (ix) legal system and conflict resolution. Notice that these significant differences may not solely be an outcome of biased treatment by the government. In particular, given the prevalence of informal businesses and family firms in the Indian economy, the revealed disparity in perceptions can arise from domestic firms having better access to informal channels to resolve business difficulties.

For China, the ideal analysis is a comparison of firms' perceptions between FIEs and domestic firms over the same set of constraints. However, as the World Bank does not ask the same set of questions in the Chinese survey, we choose questions that are conceptually closest to the 20 'obstacle' questions in the Indian survey. Results are reported in Table 3. We find that FIEs in China are more likely to perceive government officials as helpful and receive income tax exemptions. We find no significant difference in perceptions about tax compliance and predictability of laws and regulations between ownership types.

(ii) Perceptions about the legal and financial institutions

An extensive literature has shown that legal and financial institutions are important determinants of a country's economic development.[8] In this section, we compare the perceptions between FIEs and domestic firms about these institutions in India and China, respectively.

In the Indian survey, establishments were asked to report their dependence on domestic bank loans to finance investments in working capital and new capital, respectively. As Table 4 (Panel A) shows, for FIEs in India, an average of 35 per cent working capital investment was financed by domestic commercial banks, compared with 30 per cent for domestic firms. The gap, however, is not statistically significant. There is also no significant difference in financing for new investments.

Notice that several factors can shape firms' perceptions here. As is widely discussed in the finance literature, FIEs have better access to the internal capital market through their foreign headquarters (Desai et al., 2004; Berger et al., 2008). Even though the financial market in the host country is underdeveloped

[8] See Acemoglu et al. (2005) for a literature review.

TABLE 3
Problems of Business Operation Facing Chinese Firms

Regulation Complexity and Uncertainty	*Domestic (1)*	*FIE (2)*	*(1)–(2)*
Government help rather than hinder business (0–100)	33.627	39.220	−5.593
	(0.709)	(1.896)	(2.003)***
Predictability of laws and regulations (0–100)	27.313	29.381	−2.068
	(0.720)	(1.937)	(2.041)
Received income tax exemption? (0 or 1)	0.180	0.611	−0.431
	(0.008)	(0.028)	(0.025)***
Difficulty in complying tax laws, owing to inspections and audits (1–5)	1.586	1.622	−0.035
	(0.018)	(0.049)	(0.051)
Difficulty in complying tax laws: freq. of changes in rules and rates (1–5)	1.563	1.645	−0.082
	(0.018)	(0.055)	(0.053)

Notes:
(i) Simple averages for each ownership type are reported, with standard errors in parentheses.
(ii) ***$p < 0.01$.
(iii) FIE, foreign-invested enterprises.

or biased against FIEs, the foreign subsidiary may not be constrained by it if it does not rely on the host country's banks for financing.

Regarding financial constraints in China (Panel B), we use the survey questions about why firms did not apply for loans. Firms were asked whether they were discouraged to apply because of complicated application procedures or because of the low approval rate. It appears that the low approval rate is a less important concern for FIEs in China, compared with domestic firms. Taking these responses at face value, these results imply that FIEs in China appear to be relatively less financially constrained, consistent with the evidence in the existing literature (e.g. Manova et al., 2009).

Regarding perceptions about the judicial system, FIEs in India are less confident about contract and property rights enforcement (Table 4, Panel A) than their domestic counterparts, which is consistent with the findings in Table 2. However, despite this negative perception, FIEs appear to be more likely to take court actions to resolve overdue payment disputes. One possibility is that domestic firms have access to informal sources of finance. On the contrary, we find that in China domestic firms and FIEs perceive a similar likelihood of contract upholding by the courts and are equally likely to use the courts to resolve business disputes (see Table 4, Panel B), suggesting the presence of legal neutrality.

3. REGRESSION ANALYSIS

We conduct regression analysis to verify the *t*-test results above. In any country, the location and industry of operation can differ substantially between FIEs and domestic firms, which in turn affect their perceptions about the

TABLE 4
Firms' Perception About the Financial and Legal Institutions

	Domestic (1)	*FIE (2)*	*(1)–(2)*
Panel A: India			
Access to finance from domestic commercial banks			
Domestic commercial banks: contribution to working capital	30.230	35.417	−5.187
	(0.673)	(3.897)	(3.649)
Domestic commercial banks: contribution to new investments	31.439	27.678	3.761
	(0.917)	(4.696)	(4.632)
Perception on the courts			
Agreement: the judicial system will enforce my contractual and property rights (1 = fully disagree – 6 = fully agree)	4.057	3.707	0.350
	(0.032)	(0.173)	(0.172)**
% of overdue payments disputes resolved by court action	1.349	4.778	−3.429
	(0.265)	(2.704)	(1.448)**
Panel B: China			
Access to finance from domestic commercial banks			
Why no loans? application for bank loans too cumbersome	0.255	0.255	0.000
	(0.013)	(0.036)	(0.039)
Why no loans? do not expect to be approved	0.197	0.120	0.077
	(0.012)	(0.027)	(0.035)**
Perception on the courts			
% of problems with clients solved in courts	8.270	6.973	1.297
	(0.539)	(1.308)	(1.511)
% of problems with suppliers solved in courts	4.513	3.079	1.434
	(0.393)	(0.886)	(1.079)
Likelihood that the legal system would uphold contracts (0–100)	63.869	64.733	−0.864
	(0.915)	(2.431)	(2.592)

Notes:
(i) Simple averages for each ownership type are reported, with standard errors in parentheses.
(ii) *$p < 0.10$; **$p < 0.05$; ***$p < 0.01$.
(iii) FIE stands for foreign-invested enterprises.

business environment. For instance, a firm whose production involves more suppliers could be more dependent on a sound legal environment. A firm operating in an industry that requires more working capital for production is more likely to face financial constraints. In addition, business and institutional environments can differ widely across regions within India and China (Banerjee and Iyer, 2005; Li and Zhou, 2005; Du et al., 2008). We include city and industry fixed effects in our regressions to capture all unobserved city- and industry-specific characteristics.[9]

In addition to the industrial and regional determinants, firms' perception about the business environment can be related to many firm attributes. For

[9] The study of the sectoral or regional determinants of perceptions is interesting in its own right but is left for future research. In Huang and Tang (2010), we explore a number of regional and industrial determinations of ownership biases in China.

example, larger firms tend to have more bargaining power with their suppliers and sometimes even with the government. Older firms are more likely to have established business and social networks, allowing them to resolve disputes informally. In addition, exporters need to go through complicated customs procedures, while nonexporters do not. The list of firm characteristics underlying the differences in perceptions is nonexhaustive. Permitted by the availability of data, we control for the firm's (log) sales (a proxy for firm size), age (a proxy for established networks) and exporter status in the regression and estimate the following specification for each country:

$$Y_{ijr} = \alpha + \beta FIE_i + d_j + d_r + \mathbf{X_i}\gamma + \varepsilon_{ijr}, \tag{1}$$

where i, j and r stand for firm, industry and region, respectively. *FIE* is the dummy variable for *FIE*s; d's are fixed effects; $\boldsymbol{X_i}$ is a vector of firm-level controls; α is a constant; ε_{ijr} is an error term, assumed to be orthogonal to the regressors.

To estimate equation (1), we use a probit model if Y_{ijr} is an indicator variable; an ordered probit model if Y_{ijr} is a categorical variable; and an ordinary least squares (OLS) model if Y_{ijr} is a fraction. Based on the t-test results above for India, we expect $\beta > 0$ if Y measures business constraints and $\beta < 0$ if Y represents positive perception (e.g. confidence in courts). We expect opposite signs of β for China.

a. Obstacles to Business Operation and Growth

Using one of the 20 'obstacle' variables in Table 2 as the dependent variable, we estimate equation (1) using the Indian sample. Each row in Table 5 corresponds to one regression. In Panel 1, we include city and industry fixed effects as controls. As all dependent variables take discrete values between 0 and 5, we use an ordered probit model for estimation. Except for the one with 'access to financing' as the dependent variable, the coefficient on the FIE dummy is positive for all regressions, implying that FIEs in general experience more obstacles to businesses than domestic firms in India. Of these positive coefficients, nine of them are statistically significant (with many of them significant at the 1 per cent level).[10] In the last three columns, we repeat the identical analysis for each dependent variable by adding the three firm-level controls. Five of the nine previously significant coefficients remain significant.

[10] In particular, compared to domestic firms, FIEs experience more severe obstacles in areas related to (i) transportation, (ii) tax administration, (iii) customs and trade regulations, (iv) business licensing and operating permits, (v) economic and regulatory policy uncertainty, (vi) macroeconomic instability, (vii) crime, theft and disorder, (viii) industry-specific regulation and (ix) legal system and conflict resolutions.

TABLE 5
Did Foreign Firms Perceive More Obstacles for Business Operations and Growth in India?

	Panel 1			*Panel 2*		
	Coeff. on FIE	*t stats*	*Num. Obs.*	*Coeff. on FIE*	*t stats*	*Num. Obs.*
Dependent variable = {0,1,2,3,4} for 'obstacles' in the following category						
Firm-level controls	–			ln(sales), ln(age) and exporter status		
Telecommunication	0.246	(1.60)	2,258	0.186	(1.11)	2,055
Electricity	0.062	(0.46)	2,272	0.00	(0.01)	2,067
Transportation	**0.361*****	(**2.65**)	2,271	**0.246***	(**1.65**)	2,066
Access to land	0.001	(0.00)	2,271	−0.009	(−0.05)	2,068
High taxes	0.168	(1.38)	2,272	0.103	(0.77)	2,067
Tax administration	**0.291****	(**2.29**)	2,272	0.210	(1.54)	2,067
Customs and trade regulations	**0.433*****	(**3.52**)	2,245	**0.331****	(**2.41**)	2,045
Labour regulations	0.198	(1.43)	2,267	0.132	(0.87)	2,064
Skills & education of available workers	0.051	(0.41)	2,274	0.018	(0.13)	2,069
Business licensing & operating permits	**0.333****	(**2.31**)	2,266	0.218	(1.37)	2,063
Access to financing	−0.0540	(−0.41)	2,271	−0.047	(−0.33)	2,067
Cost of financing	0.147	(1.16)	2,271	0.197	(1.43)	2,067
Econ. & regulatory policy uncertainty	**0.402*****	(**3.17**)	2,252	**0.362*****	(**2.62**)	2,051
Macroeconomic instability	**0.273****	(**1.97**)	2,252	0.229	(1.50)	2,052
Crime, theft and disorder	**0.254***	(**1.95**)	2,272	0.177	(1.26)	2,068
Corruption	0.051	(0.39)	2,269	0.016	(0.10)	2,066
Anti-competitive or informal practices	0.229	(1.55)	2,266	0.0713	(0.43)	2,064
Regulation specific to your industry	**0.469*****	(**3.15**)	2,264	**0.406****	(**2.44**)	2,064
Legal system/conflict resolution	**0.425*****	(**2.96**)	2,263	**0.354****	(**2.28**)	2,061
Access to foreign technology	0.284	(1.48)	2,229	0.292	(1.38)	2,030

Notes:
(i) City (50) and industry (22) fixed effects are always included.
(ii) t statistics in parentheses.
(iii) $^{*}p < 0.10$, $^{**}p < 0.05$, $^{***}p < 0.01$.
(iv) FIE stands for foreign-invested enterprises.
(v) Differences that are least 10% significance are in bold.
(vi) Estimation method — Ordered Probit.

In Table 6, we examine whether FIEs in China are different in experiencing difficulties in complying tax regulations. We use three different categorical variables as dependent variables – difficulties in complying with tax regulations owing to (i) tax inspection or (ii) frequent tax changes, as well as (iii) whether

TABLE 6
Did Foreign Firms Encounter More Difficulties in Tax Compliance in China?

Dependent Variable	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
	Compliance Difficulty Tax Inspection (1–5)		*Compliance Difficulty Freq. Tax Changes (1–5)*		*Received Income Tax Exemption (0 or 1)*	
FIE	−0.0430	−0.0416	−0.00274	−0.0255	1.138***	0.949***
	(−0.55)	(−0.46)	(−0.04)	(−0.29)	(12.54)	(9.21)
ln(sales)		0.0142		−0.0171		0.179***
		(1.09)		(−1.31)		(10.02)
Exporter		−0.0566		0.0758		0.354***
		(−0.53)		(0.71)		(2.87)
ln(1+age)		0.00369		−0.00508		−0.0826*
		(0.10)		(−0.14)		(−1.70)
N	2,399	2,264	2,399	2,264	2,399	2,264
Log-likelihood	−2,436	−2,275	−2,416	−2,273	−1,061	−938

Notes:
(i) City and industry fixed effects are always included.
(ii) *t* statistics in parentheses.
(iii) $^{*}p < 0.10$, $^{**}p < 0.05$, $^{***}p < 0.01$.
(iv) FIE stands for foreign-invested enterprises.
(v) Estimation method: ordered probit (1–4) and probit (5–6).

the firm receives income tax exemption. In columns (1) and (3), after controlling for city and industry fixed effects, we find no significant relation between foreign ownership and difficulties in tax compliance. The results remain the same after firm controls are included in columns (2) and (4). We find strong evidence that FIEs in China are significantly more likely to receive income tax exemption than domestic firms.

b. Perceptions About the Legal and Financial Institutions

Next, we study Indian firms' perceptions about the judicial system. In Table 7, we correlate 'confidence in judicial system' and 'predictability of regulations' with the FIE dummy and a full set of fixed effects and firm-level controls using the Indian sample [columns (1) and (2)]. We also use the fraction of overdue payments resolved in court and the average number of days spent dealing with government officials, respectively, as dependent variables in columns (3) and (4). The results show no significant relation between the perception about the legal system and foreign ownership.

In Table 8, we examine firms' perceptions about the legal environment in China. FIEs in China do not appear to perceive the legal environment differently from the domestic private firms, regardless of whether we use the 'confidence in courts' measure [column (3)] or the 'predictability of laws and regulations'

TABLE 7
Confidence in the Judicial System and Predictability of Regulations (India)

Dep. Var.	*(1)*	*(2)*	*(3)*	*(4)*
	Confidence in Judicial System	*Predictability of Regulation*	*% of overdue Payments Resolved in Courts*	*Average No. of Days Spent Dealing With Govt Reg.*
FIE	−0.127	−0.0729	0.224	1.443
	(−0.85)	(−0.56)	(0.09)	(0.92)
ln(sales)	−0.00789	0.00199	0.163	0.216
	(−0.58)	(0.15)	(1.00)	(1.37)
Exporter	−0.0836	−0.128*	−1.027	0.214
	(−1.26)	(−1.80)	(−1.36)	(0.28)
ln(1+age)	−0.00352	−0.0701*	−0.112	−0.214
	(−0.09)	(−1.91)	(−0.28)	(−0.50)
N	1,995	1,993	1,551	2,061
Log-likelihood or R^2	−3,016	−3,016	0.102	0.208

Notes:
(i) City and industry fixed effects are always included.
(ii) t statistics in parentheses.
(iii) $^*p < 0.10$, $^{**}p < 0.05$, $^{***}p < 0.01$.
(iv) FIE stands for foreign-invested enterprises.
(v) Estimation method: ordered probit (1–2); OLS (3–4).

TABLE 8
Confidence in the Judicial System and Predictability of Regulations (China)

Dep. Var.	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*
	% of Problems with Clients Solved in Courts	*% of Problems w/Suppliers Solved in Courts*	*Likelihood Legal System Would Uphold Contracts*	*Predictability of Laws or Regulations*	*Govt's Help Rather than Hinder Business*
Foreign	−0.809	−1.906	−2.454	1.000	0.703
	(−0.48)	(−1.54)	(−0.85)	(0.41)	(0.31)
ln(sales)	0.711***	0.416*	1.620***	1.640***	1.248***
	(2.77)	(1.96)	(3.58)	(4.42)	(3.63)
Exporter	−0.388	−1.188	1.561	−2.012	−1.411
	(−0.18)	(−0.81)	(0.45)	(−0.72)	(−0.52)
ln(1+age)	2.943***	1.935***	−1.106	−0.359	−0.733
	(3.80)	(3.25)	(−0.91)	(−0.35)	(−0.76)
N	2,195	2,133	1,940	1,922	2,101
R^2	0.0498	0.0352	0.125	0.033	0.0981

Notes:
(i) City and industry fixed effects are always included.
(ii) t statistics in parentheses.
(iii) $^*p < 0.10$, $^{***}p < 0.01$.
(iv) Estimation method: OLS.

TABLE 9
Did Foreign Firms Encounter More Difficulties in Borrowing (India)?

Dep. Var.: Borrowing?	*(1)*	*(2)*	*(3)*	*(4)*
	Access to Domestic Finance		*Access to Finance for New Investment*	
FIE	−0.0310	−4.477	−4.022	−9.215*
	(−0.01)	(−1.09)	(−0.82)	(−1.80)
ln(sales)		2.053***		1.362***
		(5.51)		(2.65)
Exporter		3.710*		3.308
		(1.91)		(1.20)
ln(1+age)		3.214***		4.252***
		(3.38)		(3.22)
N	2,156	1,963	1,472	1,332
R^2	0.213	0.25	0.208	0.218

Notes:
(i) City and industry fixed effects are always included.
(ii) t statistics in parentheses.
(iii) *$p < 0.10$, *** $p < 0.01$.
(iv) FIE stands for foreign-invested enterprises.
(v) Estimation method: OLS.

TABLE 10
Did Foreign Firms Encounter More Difficulties in Borrowing (China)?

Dep. Var.	*(1)*	*(2)*	*(3)*	*(4)*
	Application for Bank Loans too Cumbersome		*Do Not Expect to be Approved for Loans*	
FIE	−0.120	−0.112	−0.466***	−0.263
	(−0.91)	(−0.75)	(−2.91)	(−1.47)
ln(sales)		−0.00986		−0.0602**
		(−0.43)		(−1.99)
Exporter		−0.0942		−0.267
		(−0.50)		(−1.29)
ln(1+age)		−0.198***		0.0525
		(−3.04)		(0.78)
N	1,196	1,140	1,172	1,117
Log-likelihood	−636	−605	−515	−488

Notes:
(i) City and industry fixed effects are always included.
(ii) t statistics in parentheses.
(iii) **$p < 0.05$, ***$p < 0.01$.
(iv) FIE stands for foreign-invested enterprises.
(v) Estimation method: probit.

measure [column (4)] as the dependent variable. Notice that we no longer find a significantly positive relation between governments' helping hand and foreign ownership, as the *t*-test results above suggest.[11]

In the last two tables, we examine whether access to finance differs between the two ownership types. In the Indian sample (Table 9), FIEs are shown to be less likely to obtain domestic banks' finance for new investments. These results are robust to the inclusion of a full set of fixed effects, as well as the standard firm controls. In Table 10, we find evidence that FIEs in China are *less* likely to be concerned about being disapproved for a loan application. In other words, we find no evidence that FIEs in China perceive being more financially constrained than domestic firms.

4. CONCLUSIONS

In this paper, we examine empirically how the different FDI policy approaches in China and India shape foreign firms' perception about the business environment. Using World Bank survey data, we find that FIEs in the host country's India perceive more obstacles to business operations and growth than domestic firms, especially for issues related to government regulations and the legal environment. These findings are consistent with the fact that India's FDI liberalisation has lagged domestic liberalisation.

Opposite patterns are observed in the data for China. Compared to domestic firms, FIEs in China generally find government officials more helpful in promoting business development. In the area of tax exemption, FIEs perceive far fewer obstacles. There is no difference in perception about the legal and financial institutions between FIEs and domestic firms.

Our paper is the first attempt to provide a quantitative assessment of the implications of FDI policies in the two largest developing nations. Our findings suggest different policy priorities for the two countries. For India, the priority in their next stage of reforms should be on reducing obstacles for FIEs, whereas for China the priority should be on domestic liberalisation.

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[11] A reason is that a larger firm has more bargaining power and can often influence government policy. Once firm size is controlled for, the positive perception of FIEs about the government officials disappears.

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