POLITECNICO DI TORINO

Corso di Laurea Magistrale in Engineering Management

Foreign Direct Investment. Determinants and effects on local economy.

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A.A. 2018-19

The following thesis has been created as Master's thesis in partial fulfilment of the requirements for the degree of Master in Engineering and Management at Politecnico di Torino. For any further clarification about the topics presented below, please contact the author on the provided contact details.

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Acknowledgment

I would first like to thank my thesis supervisors Prof. Luigi Benfratello and Prof. D'Ambrosio Anna. The assistance of Prof. D'Ambrosio Anna was always open to me whenever I ran into obstacles or any trouble regarding the thesis or any related topics. She consistently allowed me to have liberty to go on with my idea of thesis whilst steering me in the right direction whenever needed.

I would also like to acknowledge my Italian friends in Turin and also Indian friends in Turin-Milan for motivating and supporting me during the tenure. Finally, I must express my profound gratitude to my parents and family for providing me continuous encouragement throughout my degree and research regarding the thesis. This could never be accomplished without the support of the mentioned people. Thank you!

Author

Viranch Andipara

Abstract

With increasing globalization and rapidly growing technology and infrastructure, trade between countries have become vital for the economies involved. Economists and Financial experts have repeatedly stressed about need of FDI inflows to achieve a high trajectory of economic growth for a country. This study emphasis on FDI with the Indian perspective. The start of the thesis focuses on FDI in general and trends seen in India. Then the preceding sections of the study focuses on the determinants and effects of FDI in India and in-depth analysis of the same. Also, keeping a track on spillovers on local economy by foreign investment. In the later sections of this study, its emphasis on the policy changes to attract FDI in India and how past decisions effect the inflows of FDI. Also, there is a short mention in this study about the difference for intercepting the data of a developing country with respect to a developed country which consist of inconsistent data and false entries.

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Chapter 1. Introduction: FDI Trends

1.1 Introduction

FDI refers to the flow of capital between two countries. According to United Nations conference for trade and Development (UNCTAD), FDI is 'investment made to acquire lasting interest in enterprises operating outside of the economy of the investor'. A single flow of investment in terms of capital between two nations is termed as outside FDI for the investing country and inwards FDI for the receiving country.

FDI in a country is directly corelated with numerous factors and can incline or decline accordingly.[i]

- Fluctuation of Monetary conditions
- Change in the economic cycle
- Changes in business regulation
- Changes in the level of business taxes
- Wages and Incentives
- Government

1.2 FDI Globally

During the last three decades, FDI has been vital economic tool to frame policies in almost all the countries. Although the importance towards FDI is strange because of two main reasons; Firstly, the policy guidelines framed for FDI under 'Washington Consensus' which has been questionable from the start and secondly the impact of FDI on domestic countries' development in economic sense is debatable.[ii] Washington Consensus is a set of economic policies which is considered as "standard" reform package for developing countries by Washington DC institutions such as International Monetary Fund (IMF) and World Bank.

Despite of sustained efforts made globally at larger scale the benchmark for the authenticity and trustworthiness of the data for FDI is not achieved yet. Moreover, developing countries struggle and are unfitly equipped with the tools to assess FDI's contribution compared to developed countries. (UNCTAD, 2016)

Up until 1980 the FDI was term associated to developed countries. But in early 1980s the developing countries started erasing restriction on FDI flows and hence multi-national companies made in-roots for respective gains. In 1990s inflow FDI of global percentages accounted by developing countries was 40% compared to moderate 25% earlier. (UNCTAD, 1994)

In current timeframe 2016-17, it can be clearly observed the FDI inflows are stagnant at $671 billion following earlier drops in pre descent year of 2015 and 2016 as stated in United Nations trade and conference on trade and development. (UNCTAD, 2017)

In Africa, inflow amount reduced by 21% in 2017 was $46 billion caused mainly by decline in exporting commodities by big players in the market. Contrary to Africa, Asia remained stable in inflow comparison with $426 billion regaining the top position of the largest receiver. Whilst South America saw 8% rise to figure up at $151 billion, lifted mainly because of economic reforms undertaken in that particular region.

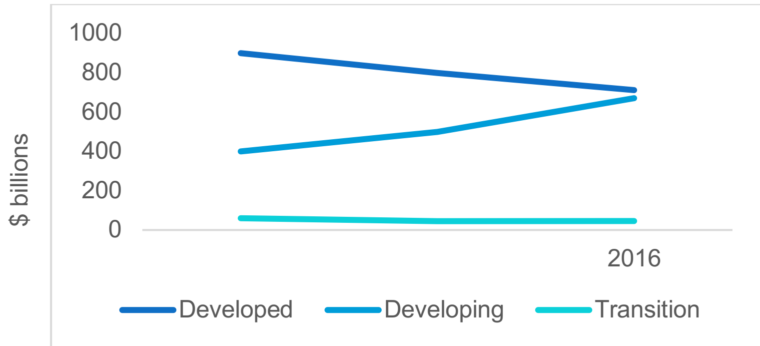

Fig 1. FDI Comparison of different types of countries[1]

Main reason for the reduction in numbers of FDI inflow for developed nations was sudden decline of Merger and Acquisition with less of big deals and restructuring of bilateral agreements between nations

Value and volume of global M&A declined in 2017 by 8% compared to 2016 with total value USD 4,740,969 million over the time period of 12 months. Result was disappointing particularly as it declined successively for second time in both value and volume with respect to 2015. (Bureau Van Dijk, 2017)

[1] Graph is to indicate final value for year 2016.

1.3 Cross country comparison

To have a brief idea, here is the list of FDI accumulated by different countries dated on 31st December 2017 sourced from CIA World Factbook.

	Country	Stock of FDI at home (millions of USD)
1	Netherlands	4,888,000
2	United States	4,084,000
3	United Kingdom	2,027,000
4	Hong Kong	1,901,000
5	China	1,514,000
6	Ireland	1,477,000
7	Germany	1,455,000
8	Singapore	1,285,000
9	Switzerland	1,230,000
10	Belgium	1,093,000

Fig 2. FDI accumulated (countries)[iii]

In 2017, around 65 countries adopted new policies for FDI and about 84 per cent were favorable for the inflows of FDI and attractive to investors. Whilst, investment treaty between any two nations has reached a minimum with lowest 18 taking place in 2018 but continuing with the modernizing the old International Investment Agreement. Investment treaties are bilateral agreement between two countries or companies of different states.

Keeping up with the haul of changes and pace of FDI's vital role in domestic economies, countries have started signing agreements in the interregional or regional group such as G20, BRICS and Commonwealth making it easier for trade and commerce with the alliance countries. (UNCTAD, 2018)

Inwards FDI to developed countries in 2017 dropped to lowest since 2004. Overall, it declined around 33% mainly because of the high number of Cross-country M&A in preceding years due to change in legal or ownership structure of Multi National Enterprise (MNEs). (UNCTAD, 2018)

Recent FDI inflows, top 15 countries in 2016 and 2017 ($ Billions)

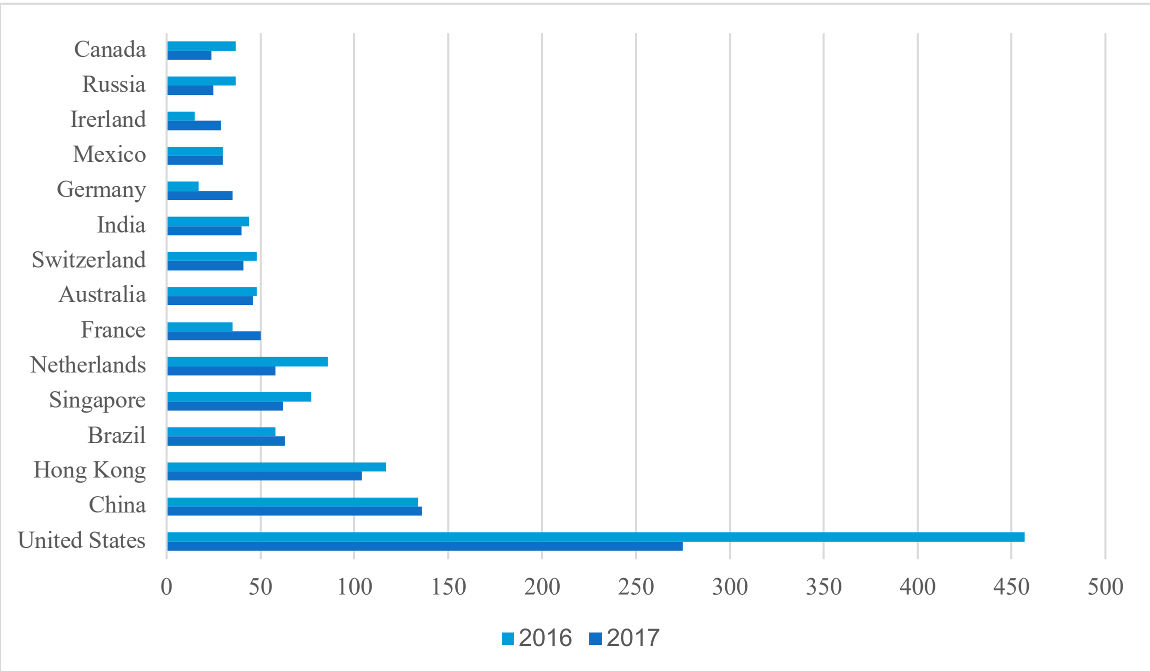

Fig 3. FDI Inflows

Outwards FDI, declined 3% to $1 trillion for developed countries. But for key European players such as Netherlands and Switzerland the reduction was notable which lead to fell of 21% for EU Multinational enterprises. (UNCTAD, 2017)

Whilst in UK it jumped to $100 billion from -$23 billion in 2017 compared to 2016. This was mainly because of aggressive purchasing of MNEs based in UK. Same trend was observed in Germany who saw 60% rose in outflows. It's noteworthy to observe that Germany mainly benefited because of inter-company loans and earnings which are reinvested

Recent FDI Outflows, top 15 countries in 2016 and 2017 ($ Billions)

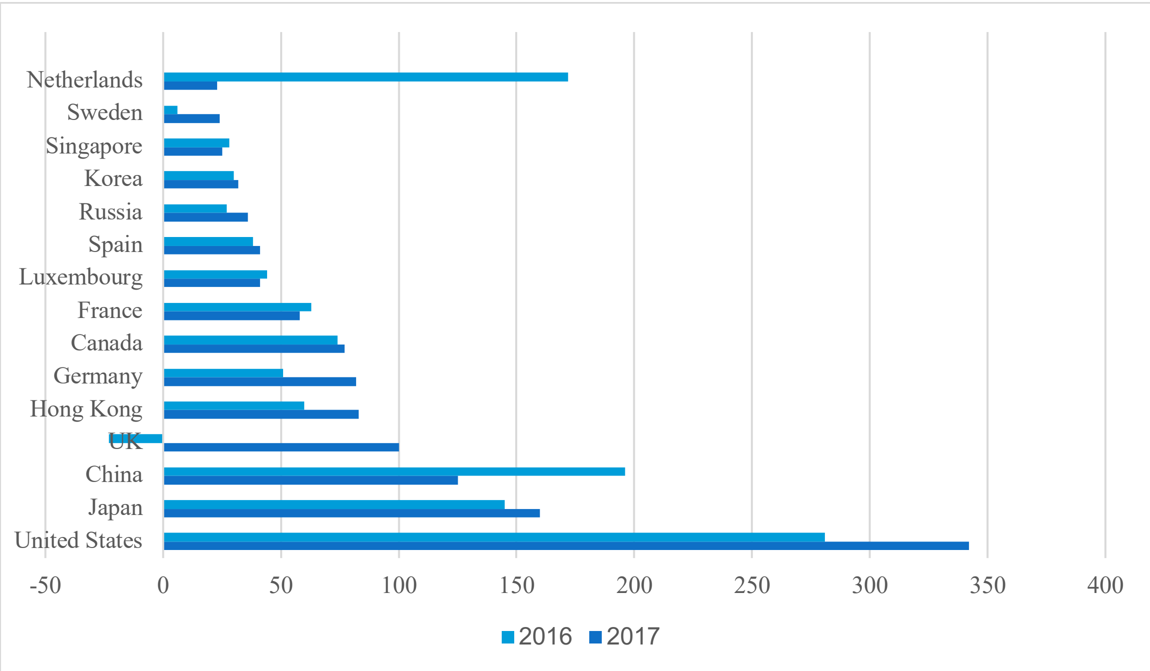

Fig 4. FDI Outflows (UNCTAD, 2017)

Decline in FDI contrasted with other cross-country capital flows. It is important to consider other cross border capital flows when talking about FDI such as portfolio investment and other banking flows because there are many similarities with FDI. FDI can often be short term and volatile like portfolio investments. From 4.7 per cent of GDP in 2015, the capital flow grew to 6.9 per cent. (UNCTAD, 2018) This was after effect of increasing appetite for risk in portfolio investors and global trade speed up overall.

In 2017, the global portfolio was around 1.8 per cent of GDP. Cross country banking and portfolio investment contributed hugely in converting the capital flow in positive numbers.

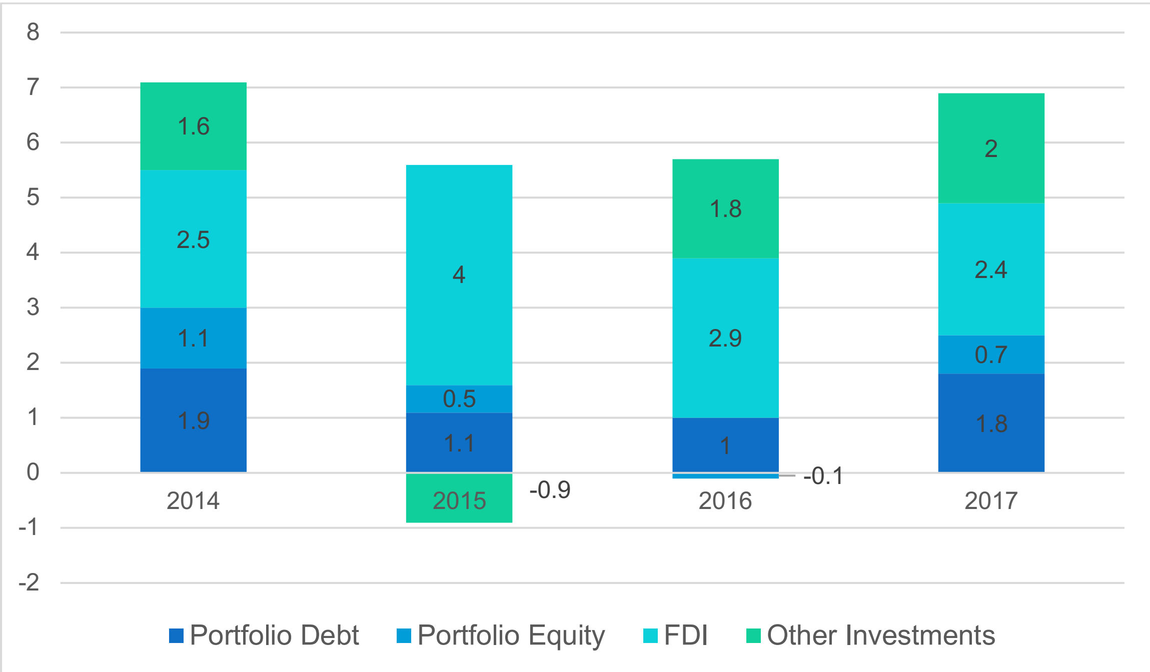

Fig 5. Global Capital Flows (In per cent of GDP)[2]

In the up-coming fiscal years FDI inflows to developing Asian countries is estimated to be stable at the current level which is at $470 billion (UNCTAD, 2017). Two key players for FDI market are China and India in Asia and rightly so being the two most populated countries.

Further analysis will give an idea about the Indian FDI related inflows and outflows and comparison with other competitors and other major

[2] Source – International Monetary Fund

economies around the world. Also overhaul changes in economic policies and liberalization in trade and commerce is benefitting the economy and up scaling at tremendous level.[3]

1.4 FDI trends in India

Before 1991, the government of India had a large share of control over the economic activities in the country. Earlier government's policies mainly focused on reducing the import by substituting the products or commodities. Also closure of any business required the prior approval of government.[iv] A consensus started to build around 1970s that India desperately need to liberalize and increase economic efficiency if it were to meet its challenge to provide employment for a rapidly growing population. To tackle this, government took number of policy reforms to facilitate supply and demand. Restrictions on industrial investment, diversification and expansion was relaxed.

However, in 1990s due to imbalance of payment the economic situation was so bad that the Indian government had to borrow loan from International Monetary Fund (IMF).[v] Thus adapting neoliberal program in 1991 whose primary aim was to reduce the fiscal deficit, which was one of the main reason which lead to economic crisis. Thus, the important components of economic liberalization program adopted in 1991, the stabilization and structural adjustment were aimed at reducing the fiscal

[3] Detail co-relation and explanation in chapter 4

deficit. From 8.3% of GDP government targeted 3-4% over a period of time [Chandrasekhar, C., Ghosh, J. (2000)]. Simultaneously reforms in the banking sector and freedom to private banks to decide the lending and borrowing rate contributed to the positive shift in the economic atmosphere thereafter

In past few decades India's policies towards FDI is highly becoming lucrative and its ranking in ease of business index is improving every subsequent year.[vi] Major companies get lured to the Indian economy because of growing GDP and cheap skilled labor.

FDI trend also is very disruptive as a result of Government of India's vision to achieve US$ 100 billion inflows with in 2020.[vii] In September 2014, Government of India under the leadership of Prime Minister Narendra Modi initiated 'Make In India'(MII) program devised to transform India into a global design and manufacturing hub. Under this initiative 25 sectors in which half being non-manufacturing were identified as special sectors to focus in the program. [viii]

From the operational point of view, the focus was to remove investment from government route to automatic route as much as possible leading to less wastage of time and other resources of investment and multi-national firms. In Indian scenario, the entry of foreign direct investment is regulated through two routes – automatic and government(approval) route. The automatic route stands for more liberalized or less restricted regulations while in government route, prior permission from Government of India or affiliated bodies is required by foreign company or investor. Proposal under the government route are reviewed by Foreign Investment Promotion Board (FIPB). In some cases, the Department of Industrial

Policy & Promotion or Department of Economic Affairs (DEA) also assist the above bodies.

Post 'Make In India' as reported by Government of India strong positive responses was received from foreign investors and the reforms made in the FDI policy. According to The Economic Survey 2015-16, "the launch of the initiatives in September 2014, there was nearly 40 per cent increase in FDI inflows during October 2014 to June 2015 over the corresponding period of the previous year".

Values given is in millions of dollar and percent of GDP, the below representation gives us an idea about India's FDI trend.

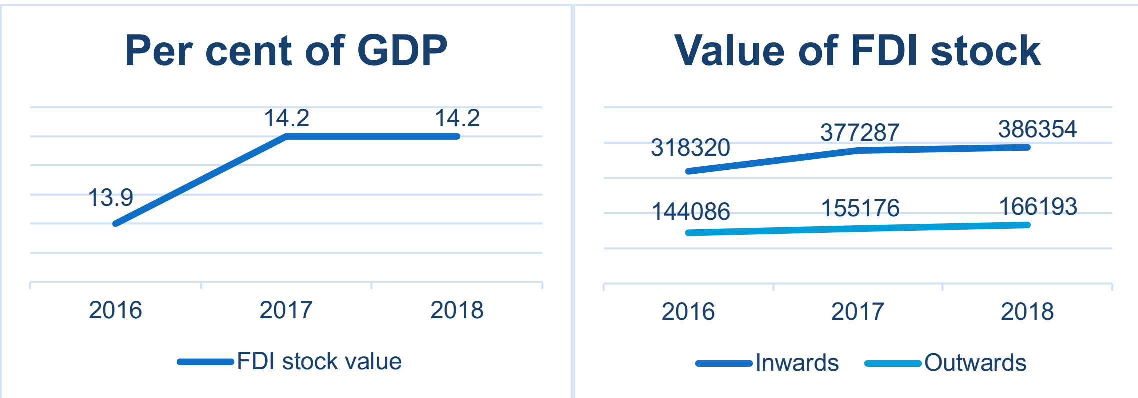

Fig 6. Value of FDI Stock (India)

From 1990s to 2010s, how FDI has evolved in India is an interesting compilation of economic transformations and financial turn arounds, which is focused in the upcoming sections.

Chapter 2. FDI inflows (India) in number

2.1 Classification of FDI

Inwards FDI in India is mainly classified in two terms; Foreign RFDI (Real Foreign Direct Investment) and Portfolio Investments. In some cases where the equity consists of Indian and portfolio investors from abroad are classified as India-related one.

RFDI is termed to investments by foreign firms investing in the same business as abroad. A bank investing in a local bank is considered as RFDI as per the Indian records. If a food and processing overseas firm invest in banking sector in India than such investments are considered as Portfolio investments.

If RFDI is stable, less fluctuating and viewed as long term, Portfolio Investment is highly volatile and fluctuating. In a country like India where there are numerous loopholes in policy structure to exploit, it is debatable and questionable to know the true after math of FDI. Breakdown of inwards RFDI and Portfolio investments in India dating from 2014-2016 which is often regarded as new economic era post 'Make In India' initiative can be seen below.[ix]

Sector/Industry wise FDI Inflows during October 2014 to March 2016					
Sector/Industry/Activity	No. of Cos.	RFDI	Non- RFDI	Total	Share of RFDI (%)
I. Manufacturing (26.2%)	442	11,070.00	2,492.30	13,562.40	81.6
· Transport Equipment (incl. parts, etc.) (7.9%)	75	3,890.40	182	4,072.40	95.5
· Chemicals (4.5%)	73	1,693.40	623.9	2,317.30	73.1
· Machinery & Equipment (2.7%)	70	1,109.30	269.8	1,379.10	80.4
· Food Products & Beverages (2.2%)	46	897.7	247.3	1,145.00	78.4
· Coke & Refined Petroleum Products (1.8%)	3	929.5	6.1	935.6	99.3
· Metals & Metal Products (1.4%)	42	504.7	196.8	701.5	71.9
· Electrical Machinery & Apparatus (1.4%)	30	503.2	196.6	699.8	71.9
· Rubber & Plastic Products (1.3%)	20	477.9	193.3	671.3	71.2
· Non-metallic Mineral Products (0.5%)	19	195.5	88.7	284.2	68.8
· Paper & Paper Products (0.4%)	7	185.6	20.8	206.5	89.9
· Radio, Television & Communication	8	100.9	78.9	179.8	56.1
Equipment (0.3%)					
· Medical, precision & optical instruments,	10	117.3	26.1	143.5	81.7
· Miscellaneous & Others (1.4%)	34	352	354.1	705.8	49.9
Memo: Automotive & Allied Industries		*4473.5*	*200.5*	*4674*	*95.7*

Share of Automotive & Allied in Total Mfg. (%)		*40.4*	*8*	*34.5*	
II. Non-Manufacturing (73.8%)	746	19,251.30	18,958.30	38,209.60	50.4
· Trade (15.7%)	119	3,106.00	5,038.60	8,144.60	38.1
· Transport & Storage & Communications (11.9%)	72	2,975.80	3,208.40	6,184.30	48.1
· Construction (11.5%)	135	3,314.00	2,642.80	5,956.80	55.6
· Business Services (8.8%)	129	3,161.80	1,374.80	4,536.70	69.7
· Hotels & Restaurants (5.5%)	51	1,891.40	979.8	2,871.20	65.9
· Electricity, Gas & Water Supply (4.4%)	58	1,131.40	1,143.20	2,274.50	49.7
· Other Services (3.8%)	18	645.1	1,322.10	1,967.20	32.8
		638.4	1,322.10	1,960.50	32.6
· Healthcare (1.8%)	36	306.2	650	955.8	32
· Mining & Quarrying (1.6%)	9	89.5	732.8	822.3	10.9
· Education (0.4%)	14	6.5	200.4	206.9	3.1
· Agriculture, Hunting & Forestry (0.1%)	4	14.3	18.5	32.9	43.5
Grand Total (I + II)	1,188	30,321.30	21,450.70	51,772.00	58.6

Fig 7. Sector wise inflows

The first year covering the new regime, India's FDI inflow reportedly increased to $45.1 billion from $36 billion in 2013-2014 which can be seen in the table below. The increase in the inflow was impressive at 25.3 percent in 2014-15 compared to precedent year. On the other side of it, equity inflows grew little lower yet not negligible at 26.1 percent.[4]

[4] Source: (1) Based on the data provided by DIPP from April 2008 to May 2017. (2) by RBI on its website

From the below table we can study about the amount of FDI in different forms in India

India's gross FDI Inflows ($ billion)						
Year	Total FDI Inflows	Equity Inflows	Reinvested Earnings	Others	Change over previous year	
					Total Inflows	Equity Inflows
2016-17	60.1	44.7	12.2	3.2	8.3	8.8
2015-16	55.6	41.1	10.4	4	23.1	28.8
2014-15	45.1	31.9	10	3.2	25.3	26.1
2013-14	36	25.3	9	1.8	5	10.5
2012-13	34.3	22.9	9.9	1.5	-26.4	6.2
2011-12	46.6	35.9	8.2	2.5	33.9	61
2010-11	34.8	22.3	11.9	0.7	-7.7	-17.7
2009-10	37.7	27.1	8.7	1.9	-10	-15.6
2008-09	41.9	32.1	9	0.8	20.4	19.3

Fig 8. Gross FDI inflows

2.2 Comparison of inflows in different sectors

The perception in general has been that the initiative by the government started yielding results quickly. Hence, October 2014 is used as a focal point to examine the effect over a span of time frame given in the table below

Top 15 recipients of FDI Inflows during October 2014 to March 2017						
Sector		Oct 2014-Mar 2017		2016-2017		
	Rank	Inflows ($ mn)	Share in total (%)	Rank	Inflows ($ mn)	Share in total (%)
Services Sector*	1	18,775.20	18.8	1	8,684.10	20
Computer Software & Hardware	2	11,430.30	11.5	3	3,651.70	8.4
Trading (incl. retail)	3	8,650.00	8.7	4	2,789.30	6.4
Construction (Infrastructure activities, townships, etc.	4	7,522.29	7.5	7	1,965.90	4.5
Telecommunications	5	7,312.20	7.3	2	5,563.70	12.8
Automobile Industry	6	5,826.10	5.8	8	1,609.30	3.7
Chemicals (Other than fertilizers)	7	3,211.40	3.2	11	1,392.80	3.2
Electrical Equipment	8	2,840.60	2.8	5	2,230.70	5.1
Information & Broadcasting (Including Print Media)	9	2,731.20	2.7	9	1,516.70	3.5
Hotel & Tourism	10	2,608.90	2.6	13	916.1	2.1
Cement and Gypsum Products	11	2,254.90	2.3	6	2,130.10	4.9
Power	12	2,240.10	2.2	12	1,113.00	2.6

Metallurgical Industries	13	2,059.10	2.1	10	1,440.20	3.3
Drugs & Pharmaceuticals	14	2,016.80	2	14	857.4	2
Hospital & Diagnostic Centres	15	1,844.50	1.8			
Total (incl. others)		99,718.40	100		43,478.30	100

Fig 9. Top 15 recipients of FDI[5]

Obviously, just be relaxing the tough FDI norms is not a guarantee for substantial increase in inflows. While assessing the inflows we also need to consider the disinvestments by which resources are drained out and acquisitions which doesn't add to the already equity base by the investee company investing as foreign direct investment. In actual terms, the real impact, post the MII Initiative is less than what the numbers suggest.

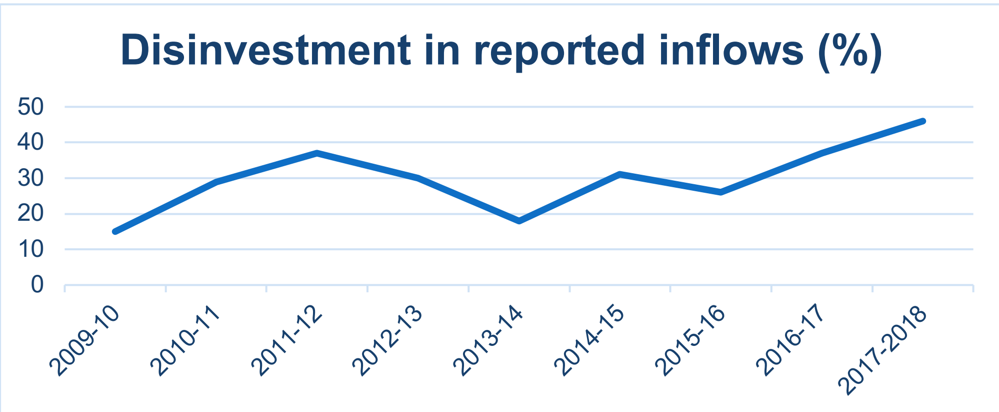

Fig 10. Disinvestment in reported inflow[x]

[5] Based on the data provided by DIPP on its website.

Also, Indian firms withdrawing investments from abroad cannot be equated with foreign companies disinvesting as Indian companies do not indulge in private equity investments abroad.

Its justifiable that the government of India tagged June 2016 amendments as ‘radical change’ to FDI norms as it can inject and transform thrust hungry sectors. We will study and analyze the policy re-structed for all the sectors under ‘Make In India’ in the later sections of the proceeding chapter.

2.3 Major countries and trend

It’s astonishing to observe that the major FDI inflows in India comes from a country like Mauritius mainly because of its tax haven symbol.

For many decades, companies have followed practice of creating a non-operational center in Mauritius to channel their money earned elsewhere. Despite being the corporate tax at 15 per-cent in Mauritius the effective tax is barely 3 per-cent.

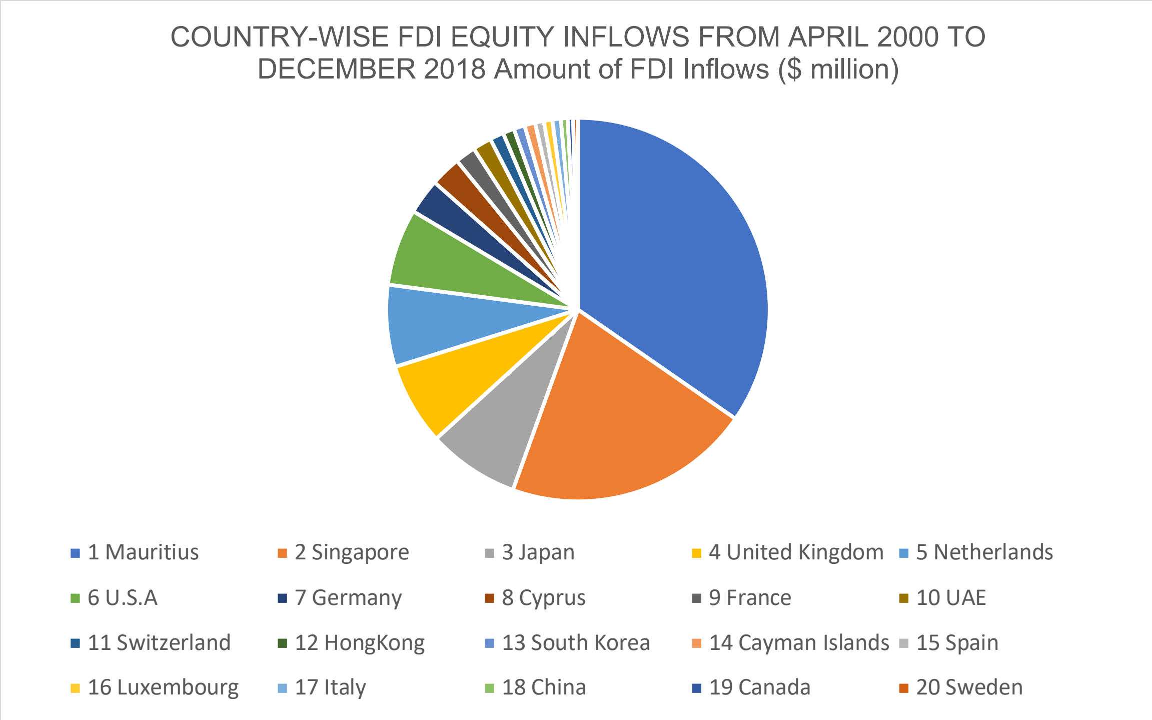

Fig 11. Country-wise FDI inflows[6]

Mauritius being the highest at staggering 35 per-cent of the inwards FDI in India followed by Singapore (21%) and Japan (8%).

However, India have taken noticeable steps to crack down on tax haven by negotiating with Mauritius to tax capital gains on transfer of shares and investment in India. In last quarter of 2016, India and Singapore signed double tax avoidance agreement which is believed to be a vital amendment in FDI norms. Aftermath of the following changes made Singapore more attractive than Mauritius and could overtake in coming years.[xi]

A case worth noticing is about acquisition of Flipkart one of the two main e-commerce website with Amazon in India by Walmart's Singapore based entity firm. Acquiring around 77 percent stack worth a value as high as USD 16 billion making it the biggest e-commerce deal in the history. Also,

[6] Source: Based on data provided by RBI in its website.

Singapore's good reputation of a law-abiding country than Mauritius help India authorities to feel confident that companies in Singapore will play by the book and there is less chance of scrutiny.

Fig 12. Walmart's acquisition of Flipkart

Among the other reasons, high living standard for FDI asset holders, global capital markets and good governance are advantages of Singapore over others to invest in India. Apart from Singapore and Mauritius, Japan has always been India's key strategic and economic partner. From USD 2.6 billion in fiscal year 2015-16 to USD 4.7 billion in 2016-17. Boosting to already flowing numbers, mutual goal between two countries to double the Japanese firms in India in next 5 years will only increase the FDI.[xii] The investment by Japan is getting diversified and now the focus is not only on automobile and telecommunications. Also, official statement from Indian authorities about economic reforms and GST changes further signifies that Japan is going to invest heavily in India for coming years.

Below are few key projects in India by Japan:

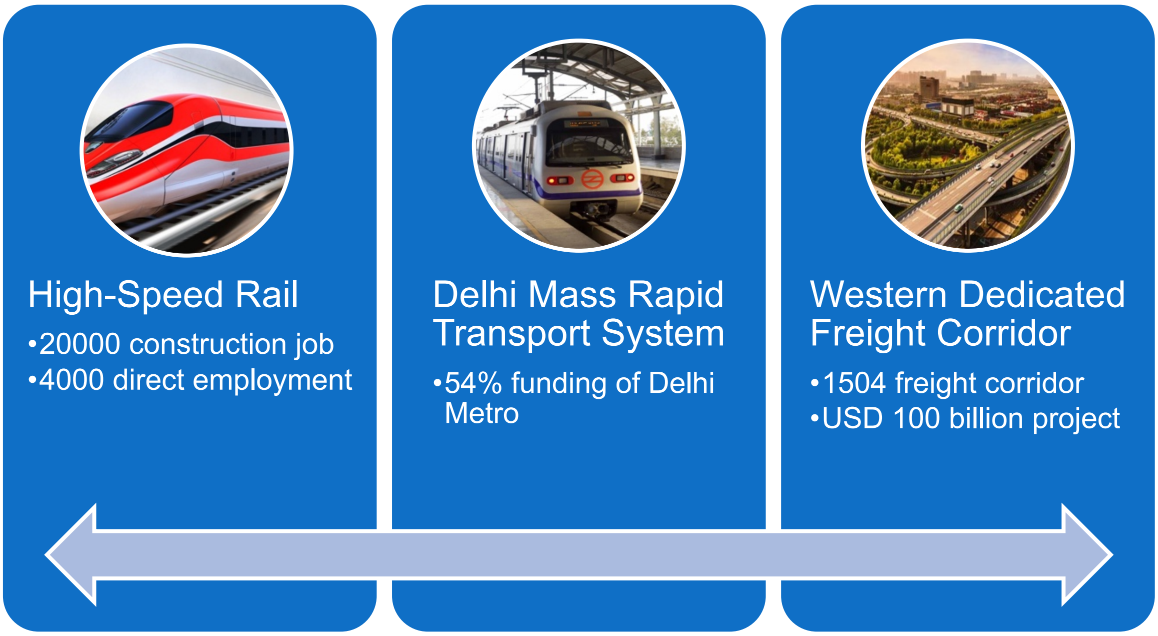

Fig 13. Japanese funded projects in India

Apart from these countries, UK is currently the leading country to invest in India. Report by CBI stats that UK's investment in India has created roughly half a million jobs with nearly 40 percent new companies investing in 2017-18 fiscal year. From 2000 to current year the total FDI inflows from UK to India is estimated somewhere around $50.57 billion. With significance investment all across India trend of UK investing is heavily inclined towards southern India mainly in state of Karnataka and Tamil Nadu.

2.4 Analysis of Automobile sector

With India aiming to develop its auto component sector and linked automotive industries, which has great effect on main core passenger car automobile sector. FDI in automobile has already penetrated in the local economy up to an extent. India being the 4th destination for FDI in automobile in Asia. Auto Industry in India has grown and stabilize up to extent that it can cater the global quality as well as quantity needs since it changed FDI policies and trade regimes.

As of today, automobile in India:

- 11 Car manufacturers
- 12 Commercial utility vehicles
- 10 Two wheelers manufacturers
- 3 three wheelers manufacturers
- 12 Tractor manufacturers

The first major FDI player in India was Suzuki was dated back to 1990's when the company partnered with Maruti Udyog limited, a government run entity only to permit Suzuki to enter the Indian market for auto in 1983. After the 1991 makeover to policies, in 1993 FDI for passenger car was given a green signal by state authorities.

Beside liberalization, India has skilled manpower and strong R&D due to availability of Ancillary industries dated long ago which is a pillar for automotive industry and its growth.

Let's go through at the FDI inflows in automobile industries from January 2000 to December 2010. (Directorate of Economies and Statistics)

Sector	FDI Inflows $US in millions	Total FDI inflows (percent)
Heavy vehicles	1479.20	1.16
Passenger vehicles	3008.04	2.37
Auto ancillaries	635.44	0.50
Others (transport)	617.47	0.49
Total	5740.16	4.52

Fig 14. FDI inflow in Automobile sector

Top five countries who invest overseas in automobile sector in form of FDI in world are Japan, USA, Netherlands, Italy and Mauritius. When considering these 5 countries the percent of FDI in Indian automobile sector is around 70.56. Japan being the first at 24 percent followed by USA at 14.61 percent. (Source: Directorate of Economies and Statistics)

Ranks	Country	FDI Inflows in $US in millions	Percentage of FDI Inflows in Automobile Industries
1	Japan	1,359.69	23.69
2	U. S. A	838.70	14.61
3	Netherlands	722.25	12.58
4	Italy	634.04	11.65
5	Mauritius	495.32	8.63
Total of above		4050	70.53

Fig 15. Top 5 countries FDI inflows in Automobile.

If we observe the company wise FDI inflow made in automobile sector it is pretty evident that major companies from around the world see Indian automobile sector very lucrative and foresee a huge return on their investment.

Let's, consider the top 10 FDI inflows in automobile sector during January 2000 to December 2015

Sl. no	Name of Indian company	Country	Name of foreign Collaborator	Item of Manufacture	Amount of FDI inflows (US$ million)
1	Ford India Limited	USA	Ford motor company	Manufacture of motor cars	438.11
2	Daimler India Pvt. Ltd.	Germany	Daimler AG	Manufacture of motor vehicles for the transport of goods	377.38
3	Daimler India Pvt. Ltd.	Germany	Daimler AG	Manufacture of commercial vehicles such as vans, lorries	236.80
4	Renault Nissan automobile Pvt. Ltd.	Japan	Nissan motors company	Manufacture of transport equipment & parts	274.67
5	Ford India Limited	USA	Ford international service Ltd.	Manufacture of motor cars	237.16
6	General Motors Pvt. Ltd.	China	SAIC general motors investment Ltd.	Manufacture of passenger cars	229.38
7	Honda Siel Cars India Ltd.	Japan	Asian Honda motors Co Ltd.	Manufacture of motor cars	213.07

8	Honda Siel Cars India Ltd.	Japan	Honda motors Co Ltd.	Manufacture of motor cars	215.98
9	Ford India Limited	USA	Ford motor company	Manufacture of passenger cars	185.39
10	VE Commercial Vehicles Ltd.	Sweden	Akitebolaget Volvo	Manufacture of motor vehicles for the transport of goods	223.88

Fig 16. Top 10 Companies in Automobile for FDI Inflows[7]

The strategy in general for Japanese companies investing abroad is constructed around two main agenda: one being simulating the host economy and other being enhancing international competitiveness. Developing policies with respect to human resources, infrastructure, capability and finance is the base strategy to invest in India by Japanese companies.

[7] Source: RBI regional data websites.

Chapter 3. Effects and Determinants of FDI

3.1 Determinants of FDI

The two main determinants of inwards FDI according to UNCTAD 1993 are market size and market growth. In a way these two determinants are similar, except the market size of domestic nation, which is measured by the magnitude of GDP, and market growth which is measured by the percent change in GDP or level change in GDP. According to market size hypothesis, the potential of growth of domestic economy in terms of GDP is directly related to the FDI positively. Most studies on FDI emphasis that large market size attracts foreign firms to produce whilst the small market size foresee MNC to produce overseas. However, if an economy grows at a faster rate, it attracts more foreign firms and attracts more FDI. In this case growth rate of the domestic economy is a better determinant of the demand in FDI than the scale or size of the economy (Wang and Swain 1995).

In 1993 Robert Lucas in his research paper argued that in addition to size of the domestic market, FDI also depends on the export of market. Though market size hypothesis argues that inward FDI was a function of size of market, many countries which are export-oriented attract more FDI as they served the option for the export market of the product. Thus, if firms of local economy are export oriented it leads to attracting overseas firms to export their product from the market. But based on Kojima hypothesis it can be argued that the MNCs activities could be affected by the import of the host country. In such scenario, import of host country would appear as the cost determinants of FDI, as high intensity of import of country could deter the inflow of FDI into the country. Other determinant of FDI is degree of openness. Degree of openness is the ratio of the summation of imports and exports to GDP.[xiii] The degree of openness of the host country also represents the degree up to which the host country is globalized. Higher the globalization, would be higher the inflows of FDI in to host country.

Other major concern is socio-political changes in the host economy which often is a key determinant for FDI into the host country. Kobrin (1976) stats that "potential manifestation as constraints upon foreign investors" might be more relevant in determining FDI. Socio-political activities such as strikes, war and riots can not only lead to loss of people and damage of properties but can also result in prolong stoppage of commercial activities. Another area which can be affected by the socio-political development is the inefficiency of labour force and which could be disruptive in production and other business-related activities.

The above analysis reveals that for a particular location, the major determinants of FDI can be determined on the basis of OLI Paradigm. OLI stands for Ownership advantages, Location advantages and Internalization advantages. OLI Paradigm is a well know economic tool developed on the basis of Internalization theory published by British economist John Dunning (Dunning J. H., 1979).

Though there is no significant conclusion from the earlier research papers and literatures, from the above survey we can consider that the socio-political development, imports, exports, degree of openness, market size, market growth, exchange rate, tax rates and rate of the host economy are the major determinants of FDI. Since this study is more focused towards India, we need to include other determinant that is capital and labour cost which is normally less than other western countries. (Lai, 2011).

Perception is ‘capital and labour cost’ is a vital determinant examined by MNCs before investing in the host country. This perception has convinced some policy makers to encourage low wages as FDI policy (Carsten, 2003). In India, the minimum wage is 333 rupees which roughly translates to 5 dollars for semi-skilled labour.[xiv] Competition to preserve low labour cost often leads to pressure on wages and affecting the host economy in a negative way (Episten, 2001).

3.2 FDI determinants in India

Apart from the FDI determinants discussed above let’s consider other possible determinants which are of greater importance in India scenario.

Labour cost: Higher labour productivity, which itself is a sign of higher compensation towards labour, attracts more inwards FDI. This relationship is like a concatenation of events where higher productive of labour leads to higher FDI, which increase the productivity. However, if the labour costs are increased due to regulatory and laws this theory is not applicable of vicious circle (Eric Rougier, 2017).

GDPFC: It represents the market size of the India. GDP is the market value of all the finished goods and services produced within a country in a specific time[xv]. GDP as the name suggests is the gross value of the finished products that is gross national products minus the net factor income earned abroad.

In a dynamic economy, the prices of product keep fluctuating and hence there is a need to convert the domestic product price into fixed price domestic product.

GDPGR: It represents the growth rate of the GDP at fixed price in India. This is an essential variable since many times it is assumed that growth of the market is more important in attracting FDI rather than the market size of the host economy (Bhattacharya, 1996)

REER: Since the study aims at the cumulative FDI inflows and determining variables of FDI in India it is necessary to take weighted exchange rate rather than just bilateral exchange rates of two nations. The weighted average of nominal effective exchange rate adjusted by domestic to foreign inflation rate is real effective exchange rate.

OPEN: Openness is the term used for the degree of openness of the host country's economy. Hence, more the openness more the globalization and more FDI inflows towards host country. The present openness of Indian economy can be calculated by ration of summation of imports and exports to GDP at fixed cost.

$$OPEN = \frac{Imports+Exports}{GDP}$$

IR: Interest rate is explanatory determinant of FDI in this analysis. Interest rate is call money rate of major commercial banks. The weights are proportional to amount accepted by the banks during a period. Interest rate is normally deterring variable because if the opportunity cost of purchasing the domestic asset is made high (associated with increase in interest rate), it becomes hurdle for foreign firms to invest and hence, FDI inflows would decrease in normal scenario. Thus, negative relation can be associated with IR and FDI. This is also the predicted relation between interest rate and FDI inflows as interest rate is considered as the opportunity cost for any kind of investment (Lucas, 1993)

FDII: FDII is inflow of foreign direct investment into India. It is foreign direct investment made by non-residence Indian residing abroad or MNCs investing locally and also includes investments made by all the different routes which we discussed above. Since the FDI inflow values are subject to fluctuation of price, GDP deflator can be used to deflate the FDI data of India.

Thus, major determinants for attracting inwards FDI in India are REER, Openness, IR, Labour and Capital cost.

3.3 Effect on Employment

Impact of FDI on employment can be classified into four groups (Someshu, 2015)

Employment generation: It means setting up new plant and hence creating new jobs as well as increasing the production capacity. It also enhances existing plant’s efficiency.

Crowding-out employment (Competition): It means reduce in employment to survive the competition. Many times, injection of foreign funds by foreign firms in local economy leads to intense competition and as a result domestic firm tend to reduce employment in order to survive the competition.

Shifting of employment: This normally happens when the FDI is mostly in form of merger and acquisition. When local firms merge with the foreign firm the workers of local firm are often shifted to the new firm which is shifting on employment.

Loss of employment (Substitution): FDI can also lead to loss of job. MNCs often have a specific approach of management and often for improving efficiency and cash flows the employment is reduced. Also, the fact that advance machinery and technology would reduce the employment or sometime result in loss of employment.

The effect on employment by FDI cannot be generalized. It is highly sensitive to other geographical co-relators such as workforce of the local economy, state of the economy and political stability. However, income of any economy will go up only when the unemployed resources of that economy is employed and it can be achieved by a local content requirement policy of the same countries (Spencer, 1987).The impact of FDI on the domestic economy mainly depends on the type of policies and the kind of FDI received by the domestic country. Very little can be said on prior basis, since the FDI effects varies with country to country.

Many past literatures have contrasting views about the effect of FDI on employment in India mainly because of restrictive nature of Indian economy. During the last decade the FDI inflows in India has increased in numbers significantly as we discussed above however the increase in FDI has accompanied with strong regional concentration. As a result, employment is not impacted at a national level. [xvi]

Let's consider FDI as percent of GDP and employment in India to find out the relation between them. Here the time period is taken from 1991 to 2018

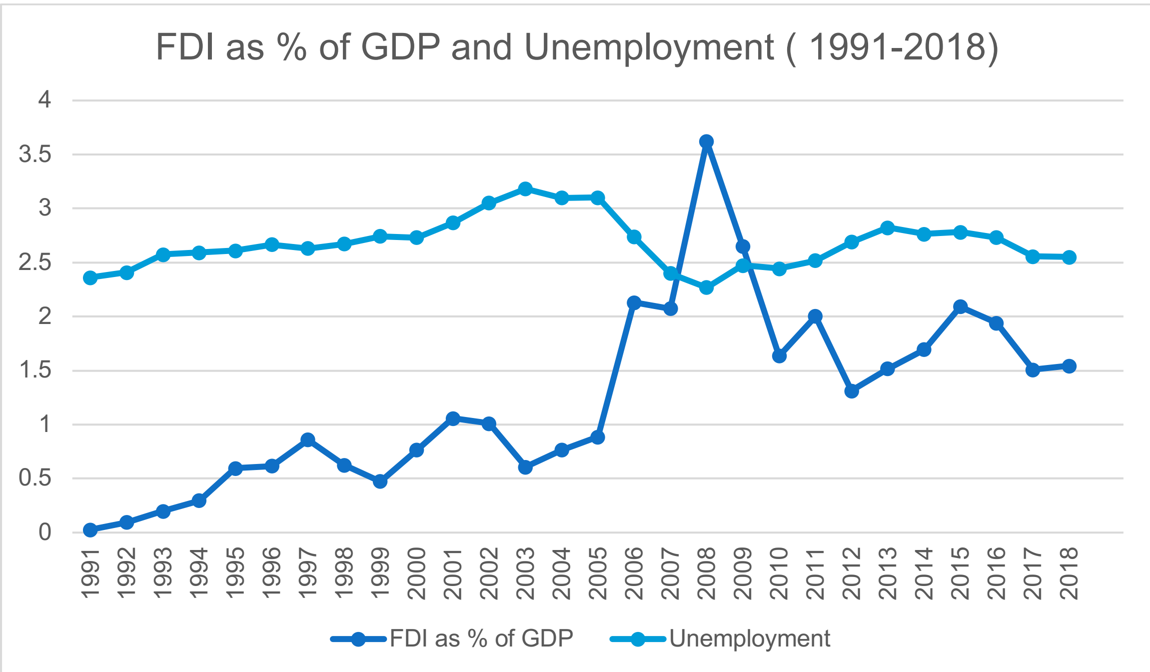

Fig 17. FDI inflows as % of GDP and unemployment (Source: World Bank)

Above figures reveals that the total impact of FDI on employment in India is not uniform. This is mainly because most of the FDI comes in form of brownfield project instead of greenfield project in India. Brownfield project is the investment made in the merger and acquisition or already existing plant which fails to create job in a steady and continuous manner while Greenfield project is creating new plant or establishing a company.

Apart from parity between greenfield project and brownfield project another reason could be the high inequality in income. The FDI effect on employment showing mixed trend has been validated by the panel data analysis (Rizvi, 2009). Through their research using Seemingly Unrelated Regression (SUR) found out there is no significant relation between FDI and employment during 1985 to 2008. According to OECD (Organization for Economic Co-operation and Development) India’s average is below the OECD average in terms of employment to population average. Also adding to it, the data on OECD website suggests the effect of FDI in India in terms of employment is less than other BRICS nations such as Brazil and Russia.

In India, majority of FDI inflow comes in service sector that is around 17 percent. However, since the global financial crisis in 2008 the percentage dropped significantly for few years and recovering slowly but the employment creation remained stable. Skilled labour from all over the country flooded the service sector before 2008 due to high wages and fast upscale of job positions. But as soon as the financial crisis, the exports reduced and as a result the service sector couldn’t bare the labour cost resulting in loss of employment or not getting hired to begin with, and at the same time FDI inflows also reduced significantly. Thus, FDI inflows has a direct impact on the job creation in service sector when it comes to India. Other sector which theoretically is often linked with job creation due to FDI is manufacturing sector. Since 70% of employed people are affiliated with agriculture or ancillary industries and majority of FDI happens in service sector, the impact of manufacturing sector in job creation is very less and sometimes argued has a negative effect on employment. This is because normally foreign investment in Indian manufacturing sector often is aimed at increasing efficiency, upgrading machines and technology resulting in the loss of manpower from a specific plant.

Thus, above study and the graph suggest that during the last two decades FDI inflows has been increasing at a moderate pace but the employment statistics overall has no significant effect of FDI and thus FDI inflows in India is not a responsible factor for employment. India certainly is an economic powerhouse in terms of inflows of FDI and has seen tremendous growth on service and manufacturing sector over the last two decades. Adding to it, FDI has contributed to the local economy multidimensionally to boost the economic parameters but as far as employment generation is concerned, there is yet to be develop a concrete methodology to study the co-relation between them. Below, this study attempts at developing a concrete methodology to analyze the effect of FDI on employment generation in India.

3.4 Spillover effects of FDI

The below section of this study is based on spillovers effect of FDI on a notion that MNCs compared to local firms have superior techniques and advanced technology (Hyper, 1976). Multinational companies can transfer spillovers positively through various means such as subcontracting, FDI and strategic alliances. However, FDI is considered the superior mean to transfer as it can internalize technology transfer at low or no extra cost (Caves, 1976). Production improvement in the domestic firm after the FDI investment is also a form of spillover. It can be classified as horizontal spillover and vertical spillover. Horizontal spillover is sectorial while vertical spillover is inter-sectorial. Let's examine the spillover effects further to study the effects of FDI

Below are the few of technology transfer channels and spillovers from FDI: horizontal and vertical spillover (Sasidharan, 2006)

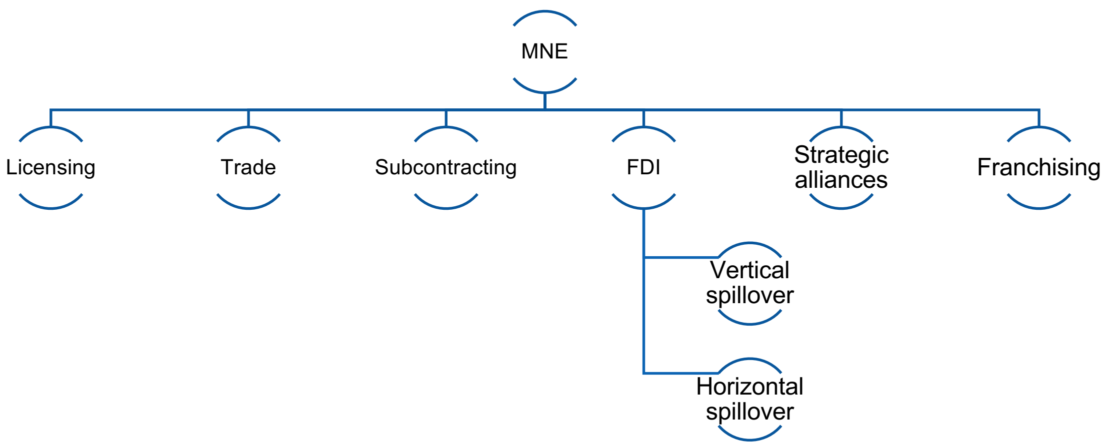

Fig 18. Technology transfer channels

Horizontal spillovers: The entry on multinational enterprise usually increase the productivity of the domestic firm. Primarily, 'demonstration effect' can be seen as the local firm imitate the organizational, managerial and technological skills from foreign firm to improve the overall efficiency. Secondly, 'labour turnover' arises from the shifting of highly skilled employees and workers from MNC to domestic firm. In a way, these workers are carrier of technology into the local firm whilst vice versa effect can also be observed as many times workers move from the domestic firm to the MNC's plant abroad. Third, is a situation of crowding out competitors which can be termed as 'competition effect'. For instance, MNCs in an ideal scenario wants to enter highly concentrated market. As a result, local firm with the presence of MNC is forced to improve the efficiency and competitiveness. Thus, crowding out local firms due to inability of survive the competition and making an exit from the market. Such scenario is illustrated as "market stealing effect" by Aitken and Harrison (Aitken, 1999).

Vertical spillovers: The phenomenon of spillover is just not limited to the specific industry. Interaction of different industries can also lead to spillovers. Inter industry spillover which often is created due to buyer-supplier relationship of domestic and foreign firm is vertical spillovers. "The presence of FDI has helped to raise the productivity of many domestic suppliers, and this has often had beneficial spillover effects on the rest of their operations " (Dunning J. , 1992). Vertical spillovers are both way upstream and downstream. MNCs usually get the raw material from the domestic suppliers benefiting the domestic firm and affiliated factors. MNCs have incentive to choose local supplier because of the possible high cost and time in transporting the raw material from abroad. Many times MNCs are obliged to choose domestic supplier because of the local government's norms and regulation of using the local content in products and commodities. Also, the stringiest requirement and high standard of quality forces the domestic supplier to improve their production and efficiency. Therefore it may works in backward mechanism, improving the production of domestic firms.

Spillover effect of FDI in India scenario

From early 1990s when Indian economy was starting to become less restrictive started creating job in IT sectors with the help of FDI. Initially, bulk of the projects were about the software development for the overseas client directly from India or on site. This is in a way quite similar with MNCs setting up their production unit in China due to cheap labour and higher efficiency. The output of the Chinese production unit was with accordance to design requirement and impeccable quality. Engaging in such projects benefited Indian workers tremendously and a vertical spillover effect can be observed as the transfer of knowledge can be seen from the foreign client to local provider. Firstly, transfer of high skills and techniques from foreign client to Indian professionals just by executing their jobs. Secondly, more and more service provider started proposing the same implementation of advance softwares' to the domestic clients as well which resulted in advancement of telecommunication, finance, banking and other local business in India.

Thus, by moving upwards in the value chain of FDI, India's service sector ripped many positive spillovers and advancements. As the service sector gained experience, more and more sectors started implementing and multiplier effect happened across the length of the country. As a result of this, India today is the fastest growing technology hub in the world.[xvii]

Many global enterprises for their low end and non-core activities have their joint ventures and captive firms based in India. When the activities involved with the business are complex and require high degree of skills these enterprises which are BPO (Business Process Outsourcing) are often called as KPO (Knowledge Process Outsourcing). Due to BPOs and KPOs India has become a lucrative destination for FDI and is improving constantly because of business analytics field which is quite evident as major names such as HSBC, Citibank and TESCO etc have their business analytic centre in India. So from the above analyse it is justifiable to say FDI has positive vertical spillovers in India.

The improved quality process and business management operations by India firm is evident mainly because of horizontal spillovers. The operation of global firms from India such as IBM and Accenture have made Indian firms focus on lean practices and cost optimization through cross team trainings and obtaining or adopting rigid quality standards, quality certified process such as Capability Maturity Models (CMM). Whether its CMM or any other quality certified process Indian IT firms have an unique brand value in the world to be regarded as efficiency and cost efficient which makes them eligible to penetrate elite IT markets such as US and Canada.

Let’s consider Manufacturing and Service industry since both of them contribute much of FDI inflows in India. Service industry mainly consist of IT, health, bank and finance sector which is not so capital intensive and can be easily scaled while manufacturing industry require considerable amount of capital to initiate and also require large sum of capital to scale up. Adding to it, the main advantage for service industry over manufacturing is the large availability of English speaker workers and trained personals in Statistics, Computer and other Engineering Management fields. Whilst, India has short supply of blue collared skilled workers and also lags behind in training the workforce when compared to other developed countries because of the high capital involvement.[xviii] Other important factor which hinders the growth of manufacturing industry is the stiff competition and unmatchable efficiency of India’s counterpart China.

Thus from the above findings it can argued that FDI has positive spillovers in India both horizontally and vertically in service Industry while negligible to no effect can be observed in Manufacturing and Production industry.

CHAPTER 4. EFFECTS OF POLICIES ON ATTRACTING FDI

4.1 Sectorial policy changes

After 1991 relaxation, present government started the initial process of further liberalizing the FDI with policy in fourth quarter of 2014. Starting with raising FDI cap on FDI in defence industries, government lifted the participation of foreign firms in railway sectors and interference in upgradation of infrastructure. Later in 2015, changes were announced in broadcasting, air transport and construction. Another succession of changes occurred in June 2016 and published through press release by Department of Industrial Policy and Promotion (DIPP).

Changes effected in the FDI policy during the 2014-16 can be seen in the table below.

Sector	2014		2015		2016	
	Jan-Jun	Jul-Dec	Jan-Jun	Jul-Dec	Jan-Jun	Jul-Dec
Manufacturing Sector						
• Defence Industries	Jun	Jul, Aug			Jun	
• Medical Devices						
• Pharmaceuticals			Jan			
					Jun	

Services						
• Railway Infra		Aug				
• Construction		Dec		Nov		
• Trading				Nov	Mar	
• Civil Aviation, Satellites etc.				Nov	Jun	
• Broadcasting				Nov	Jun	
Financial Sector						
• Insurance, Financial services			Mar, Apr		Mar	Oct
• ATM						
• Credit Information				Oct		
• Stock exchanges				Nov		
					Feb	
Agricultural Services						
• Plantations				Nov		
• Animal Husbandry					Jun	

Source: Based on the circulars issued by DIPP.

Fig 19. Changes effected in the FDI policy from 2014-2016.

4.2 Literature evidence regarding FDI policies and its effects

In the above section, the table gives an overview of the policy changes as per the official publications by Government of India and we shall discuss its effect in the proceeding sections. Before analyzing the policy effects on inflows let's refer few literatures on the FDI policy in India.

- As per ‘Review on Policy Developments of FDI in India’ (Arben Sahiti, 2017) historical data on FDI inflows in India has strong evidence of government’s role in the increased inflows post 1991. Historical evidence also show how a government can maneuverer the FDI policy in order to increase FDI overall, in a certain section, by industry activity or to strength its core industries. Also, the literature reveals about India’s scenario in opening economy and relaxing the FDI norms and necessity to follow a proactive pattern rather than reactive. In case of reactive policy reforms, it can severely limit the bargaining and negotiation of the host government.
- In the working paper, ‘Impact of government policies and investment agreements on FDI inflows’ (Banga, 2003) there have been key conclusions derived for the FDI policy in developing countries. According to the research paper, policy regarding lower tariff rates plays an important role in attracting FDI in India while fiscal incentives provided by the local government is less impactful compared to removing of restriction of FDI flow. Also Bilateral Investment treaties (BITs) have more impact if the treaty is with developed nation compared to developing nation. APEC is found to have a positive effect on FDI in India while ASEAN is not found to have positive impact on FDI inflows.
- Another study, ‘The economic impact of FDI in India’ (S Chandrachud, 2013) has argued about the effects of FDI policy in all fronts. Study also mentions about the concern regarding ‘jobless growth’ after the liberalisation period meaning the amount of jobs created has been consistently insufficient with respect to the changes of policy providing the fact that respective policy measure has positive impact on job employment. Also a noteworthy

suggestion in the study was restructuring the government role in FDI Policy that is shifting the power from central government to state or third tier local government in order to get more meaningful impact of the policy.

- Other key aspect to evaluate the effects of policy is to see the parity of its benefits across the region of a particular country. In India as mentioned in a research ‘Foreign Direct Investment (FDI) and economic growth of the states of India’ (Singh, 2010) the effects of FDI policy has effected the richer states more than the poor states of India. Other claim by the study was about the parity between the type of benefits by FDI. Data from 2000-2010 suggests that there have been significant Industrial reforms but the key link to connect that with the infrastructure reforms is missing.
- Another panel data analysis, ‘Economic Reforms, Foreign Direct Investment and its Economic Effects in India’ (Chandana Chakraborty, 2006) supported the parity of the inflows of FDI as stated by earlier literature. Also, mentioning about positivity of the policy mainly in Manufacturing and Service sector post reforms which needs to be addressed by the policy makers. In short, the study concludes about Indian FDI policy being very region oriented and highly focused on few industries. On a longer run, the growth effects of such policy on the economy can be questionable.
- In literature, ‘Analytical Study of Foreign Direct Investment in Indian Automobile Sector’ (Nishkikant C Dhande, 2018) which was aimed to identify the effect of automobile policy in attracting inflows of FDI, it was observed that liberalised policy for MNC over the period of time has rejuvenate the sector and had made Indian automobile market competitive the rest of the world. The Automobile mission plan launched for 2006-2016 tenure almost reached its objective for

2014-2015 with FDI inflow exhibit of 167,600 million Indian Rupees as mentioned in this study.

To summarise, most of the literatures had an positive impression of the FDI policy in attracting the FDI inflows and had focus on the post liberalisation period in India which is after 1991 when overhaul of policy changes were introduced in FDI. However from the number of above literature it cannot be ignored the need to improve the impact of policy in order to have a sustainable inflows and all round development in the local economy.

In the next sections, we will analyse the newer changes in the policy adopted in different sector to attract FDI in India.

4.3 Change of policy and its possible effects

Defense Industries

In 2001, 100 per cent FDI was allowed in all the manufacturing activities while defense industries were granted 26 per cent cap on foreign ownership. The main two reason behind such an implication prior to 2001 in defense industries were because (i) strategic and economic motives and (ii) FDI has security implications if involved in this specific sector. However, under the MII (Make In India) thrust by present government the cap was raised up to 49 per cent in August of 2014. In June 2016, government of India through a press release removed the 49 per cent cap and stating explicitly allowing 100 per cent of FDI. [xix]

The defense exports over the subsequent three years after MII are as follows. (Source: based on NOCs issued by DPP)

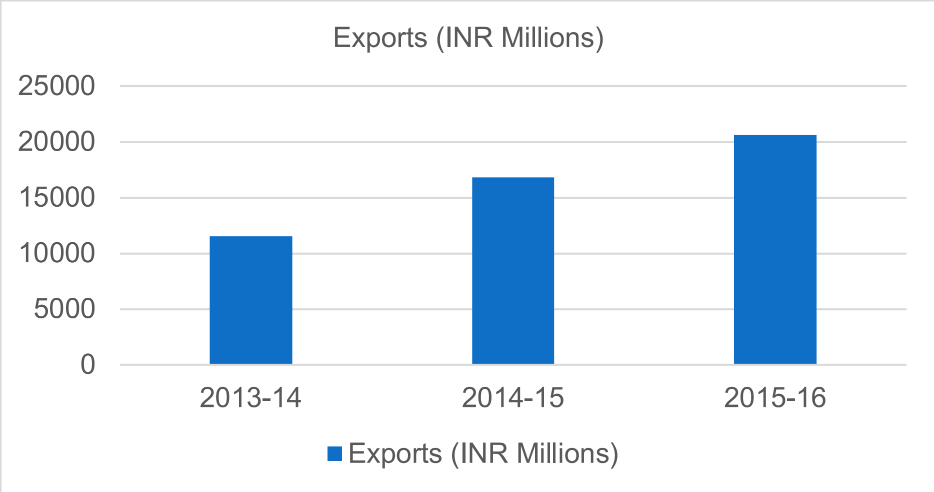

Fig 20. Defense exports post MII

Pharmaceutical sector

FDI in pharmaceutical has been widely discussed in India because of two important factor. One, problem accruing as “brownfield FDI” because of large foreign companies taking over the local firms and two, the consequences of this with availability of cheap medicines produced by local firms. Due to the brownfield investment, the earlier government had restricted the automatic approval to 49 per cent FDI. Under MII, the automatic route cap was raised to 74 per cent. The main purpose of the above change was stated by the government as “to promote the development of sector”.[xx]

Major foreign investors in the sector (March 2014-September 2016)

Name of foreign company	Country	Name of Indian company	Amount of FDI inflows (USD M)
Abbot Asia Holding Ltd	United Kingdom	Abbott Heathcare Pvt Ltd	447.48

Mylan Group B. V, Netherlands	Netherlands	Mylan Laboratories Ltd	372.63
Hospira Pte Limited	Singapore	Hospira Heathcare India Pvt Ltd	301.61
Glaxo Smithkline Pte Ltd	Singapore	Glaxo Smithkline Pharmaceuticals Ltd	228.39
Jubilant Pharma Limited	Singapore	Jubilant Generics Limited	174.07
Sanofi Pasteur Merieux	France	Shantha Biotecnics Limited	123.82
Fresenius Kabi (Singapore) Pte Ltd	Singapore & Germany	Fresenius Kabi Oncology Ltd	118.25
Bluewater Investment Ltd	Mauritius	Aptuit Laurus Private Ltd	63.49
Meiji Seka Pharma Co Ltd	Japan	Medreich Ltd	55.48
Dashtag	United Kingdom	Fulford (India) Limited	29.89

Source: Achievement Report, Pharmaceuticals sector

Fig 21. Pharmaceutical sector after MII

Single Brand Retail Trade

Single brand retail as the name suggest for the company which itself runs a single brand as retailer. In June 2016 earlier strict norms were relaxed for sourcing norms having cutting edge technology. New policy under MII relaxed local sourcing norms for 3 years. Further on, policy applicable to SBRT was relaxed in January 2018 when 100 per cent FDI was allowed through the automatic route.[xxi] However initially the cap of 30 per cent mandatory purchase from India was removed for 5 years.

Broadcasting Carriage Services

FDI up to 49 per cent was allowed in the sector earlier through automatic route while government's prior permission was needed for more than 49 per cent FDI investment. This decision was in line with government's objective of minimizing the role of FIPB (Foreign Investment Promotion Board). However, companies require a permission from the sectoral ministry. [xxii]

Major foreign investors in sector (April 2014-Feb 2017)

Name of foreign company	Country	Indian company	FDI Inflows (USD M)
Buzzer Investments Ltd	Mauritus	Star India Pvt Ltd	344.4
Star Entertainment Holdings Ltd	British Virgina	Star India Pvt Ltd	266.0
Quikr Mauritius Holding Pvt Ltd	Mauritus	Quikr India Pvt Ltd	237.2
Nickeloden Asia Holdings Pte Ltd	Singapore	Prism Tv private Limited	144.6
Thymelicus Holding B. V.	Singapore	Cinepolis India Pvt Ltd	58.85
Dunearn Investments (Mauritius) Pte Ltd	Mauritus	Zomato Media Private Limited	47.65
Plenty Private Equity Fund Limited	Mauritus	Pvr Ltd	44.32

Source: Achievement Report, Media and Entertainment sector

Fig 22. Broadcasting sector after MII

Civil Aviation

In case of FDI in airports, government approval beyond 74 per cent stack was done away with. Under the revised policy, stack of the the 'foreign airline' cannot exceed 49 per cent in the airline however further investment is possible with government approval. [xxiii] The FDI policy over the years in civil aviation makes an interesting reading. The essence of FDI, long term investment and spillover was certainly missing when it comes to civil aviation as 49 per cent investment by overseas can make up only by portfolio investors.

Major foreign investors in sector (April 2014-March 2016)

Name of foreign company	Country	Indian Company	FDI Inflows (USD M)
ETIHAD Airways	UAE	Jet Airways Ltd	305.96
Dachser Beteiligungs-AG	Singapore	Dachser India Pvt Ltd	20.10
Kick2shop Logistics Services International	Singapore	Instakart Services Private Limited	19.50
UAC Transport Aircraft	Russia	Multirole Transport Aircraft Limited	16.88
Singapore Airlines Limited	Singapore	Tata SIA Airline Limited	11.01
AEQUS Manufacturing Investment Private	Mauritius	AEQUS Private Limited	10.14
Musaliamveet til Abdul Kader Yusuffali	UAE	Cochin International Airport Limited	10.02

Source: Achievement Report, Aviation sector

Fig 23. Aviation sector after MII

Agricultural Sector

No FDI was allowed in agriculture sector whilst 100 per cent FDI was allowed on Agriculture services prior to 2010. In sectors such as animal husbandry, floriculture, development of seeds, aqua culture and other allied sector 100 per cent FDI inflows is allowed through the automatic route. However, in core Agriculture sector apart from the services mentioned above, 100 per cent FDI is allowed in tea sector including plantation with clause of 26 per cent divestment in favor of Indian partner with a period of 5 years (Ministry of Commerce and Industry, 2002).

Major change in the above-mentioned criteria was introduced under June 2016 overhaul changes. The consolidated FDI policy removed the cap of companies only producing genetically modified seeds and relaxing further in agriculture sector. Inflows to agriculture sector also can boost significantly allied sectors such as Irrigation, Road network, Electrification, Telecommunication connectivity and Housing. Due to FDI investments, concept of middlemen can be terminated which has been dominant in agriculture sector in India since many years. While from the non-government cult it can be argued that India's revenue to foreign countries can impact negatively and hence impacting the overall economy of India.

A Follow-up

It is perhaps fitting that government opted to label July 2016 as "major and radical changes", for the changes which could impact two-three major sectors such as agriculture, defense and health. FDI policy changes in specific sector could drastically change the agriculture and health system which could also affect adversely to local constituencies. Lifting the cap on brownfield investment will give added incentives to take over the local producer which provides affordable medicines not only to Indian market, but also all across the world. Apart from these, there were several other implication of policy changes. In defense sector, foreign companies were earlier not so keen to manufacture in India versus after the change might see it as viable option to meet its offset manufacturing obligations with inevitable spillover of technology.

4.4 Effects of policy changes in Automobile sector

Let’s go through the major initiatives and changes in automobile sector by government of India in order to attract inwards FDI.

Auto Policy 2002: As per this policy, 100 per cent FDI is allowed in automobile sector without any prior permission through automatic route as well as no minimum amount of investment is needed. [xxiv]

R&D expenditure deduction: In its 2016 union budget, finance ministry of India announced reduction from 200 per cent to 150 per cent weighted reduction in research and development expenditure under Income Tax Act and also announced 150 per cent weighted reduction for expenditure on skill development. This will directly assist the industry in improving its product and performance. However, it is noteworthy to see that ACMA (Automotive Component Manufactures Association) then demanded the restoration of 200 per cent weighted reduction on R&D. [xxv]

Digital India: Government of India emphasis on role of technology and how it can be disruptive in automotive sector. The growing digitalization in the country under the ‘Digital India’ campaign will drive innovation in numerous ways such as e-mobility and technology-based cab and ride sharing platform. From the customers point of view ease reach of digital connectivity pre and post purchase can indirectly influence the automotive sector to a greater extent. According to survey published in a report, social media and OEM website by 2020 can influence 70 per cent automobile sales or $40 billion. (Srivatsan Rajan, 2017)

Automotive Mission 2016-2026: Automotive mission 2016-2026 is a roadmap led by government stating the collective vision of automobile sector's contribution in development, maturity of technology, inclined with global standards and worldwide competitiveness. Other key milestone is to become top three automobile industry in the world with increase exports around 35-40 of overall production. The other key milestone to be achieved is automobile sector contributing 12 per cent to overall India's GDP and creation of 65 million jobs (Automotive Mission 2016-2026, 2016).

FAME Scheme: FAME (Faster Adoption and manufacture of electric vehicle) launched by Department of Heavy Industry under 'National Electric Mobility Mission Plan 2020' in 2015 released fund allocation and utilization of around half a billion in Indian Rupees in order to support the particular segment. It was aimed to cover all segments i.e. two and three wheelers, cars, LCVs and busses etc. and all types of hybrid and electric vehicles (FAME India scheme, 2019)

Duty reliefs: To encourage and support local manufacturing, custom duty on cars and Multi-utility vehicles valued above $40000 has been increased from 60 to 75 per cent and further to staggering 100 per cent.[xxvi] Moreover, concessional import duty has been extended to numerous hybrid vehicles' parts in order to achieve cost efficiency in industry.

In the union budget 2015-16, government announced credit of $124 billion to farmers which is expected to boost agricultural machinery and tractors segment.

Ministry of Road Transport and Highways proposed an incentive worth 8-12 per cent of the cost of new vehicle for surrendering old vehicle under

Voluntary Vehicle Fleet Modernization programme (VMP) which indirectly boost the automotive sector

Thus, numerous initiatives and policy reforms in Automobile sector took under 'Make In India' after 2014. Following above changes, FDI inflows from USD 3.05 billion in 2012-14 increased by 72% in 2014-216 with USD 5.25 billion.

Major foreign investment in Automobile sector post MII from April 2014 – March 2016 (Automotive Sector: Achievement Report, 2016).

S. No	Foreign collaborator	Country	FDI (USD Million)
1	Ford International Services and Fort Motors	USA	979.50
2	SAIC General Motors Investment Limited	China, Hongkong	973.93
3	Suzuki Motor Corporation	Japan	477.61
4	Daimler AG	Germany	389.04
5	Nissan Motor Co. Ltd.	Japan	169.20
6	Isuzu Motors Asia Limited	Singapore, Japan	116.67
7	FCC Co. Ltd.	Japan	95.19
8	Continental Automotive GMBH	Germany, Netherlands	72.53
9	Renault group BV	Netherlands	72.51
10	Caparo India Limited	United Kingdom	56.77
11	Blue Elephant Finance Limited	Mauritius	53.90
12	Showa Corporation	Japan	52.85
13	Lear Automotive Services	Netherlands	49.64
14	Fiat Group Automobiles S.P.A	Italy	48.49
15	Singapore Airlines Limited	Singapore	46.01
16	MAN Truck & Bus	Germany	42.70
17	Distribution & Logistics Infrastructure	Mauritius	35.50
18	Yorozu Corporation	Japan	33.09

19	NHK Spring Co. Limited	Japan	31.31
20	Bussan Automotive Singapore Pte Limited	Singapore	29.72
21	Toyoda Iron Works Co Limited	Japan	27.77
22	AINOS Holding Limited	Mauritius	24.88
23	Saif Partners India V Limited	Mauritius	24.21
24	Normandy Holdings Limited	Mauritius	22.79
25	Valeo Bayen	France	22.30

Fig 24. Post MII inflows, April 2014 – March 2016

While the above Annexure focuses on foreign investment made by oversea collaborator to its Indian company there have been key infrastructure creation in automotive sector by foreign automobile giants following the MII initiative.

- In June 2016, Honda inaugurated its second assembly line at scooter manufacturing plant in state of Gujarat.
- In April 2016, ISUZU Motors – a Japanese automobile manufacturer started a greenfield manufacturing unit with investment of USD 445 million in Andhra Pradesh.
- Investment of USD 280 million by Tata Motors and Fiat limited was done in Pune city for joint assembly line of SUV cars
- Another greenfield project by Suzuki motors was initiated in 2015 in Ahmedabad for car and power train manufacturing.
- In July 2015, Mercedes Benz inaugurated its second manufacturing facility in Chakan.

Source: (Automotive Sector: Achievement Report, 2016)

4.5 Evidence of Policy effects on attracting FDI

To verify the literature and the data of the inflows provided by the government source, let’s examine the independent data provided by FDI Intelligence, Financial Times Ltd 2019. The data considered is of 2018 and the inflows registered in the calendar year of 2018.

The variables considered to evaluate the effect of policy transformations occurred from 2014 are type of investment, type of industry activity, inflows from major company and main beneficiary region of the inflow of FDI. Also amount of investment is synced with the industry sector in order to get a clear picture of the policy and how it affected the different sectors.

Type of Investment

According to data by Financial Times, there have been 804 entries of FDI inflows by foreign firms into the India companies. Out of the total number of inflows, most of the inflows were new compared to expansion or injection of existing investment which can be a sign of good foreign direct investment policy. About 78 percent of FDI inflows in 2018 came as ‘new’ investment which can be a positive signal for the employment in the domestic economy while about 21 percent of FDI was for the expansion of foreign firm for its plant based in India.

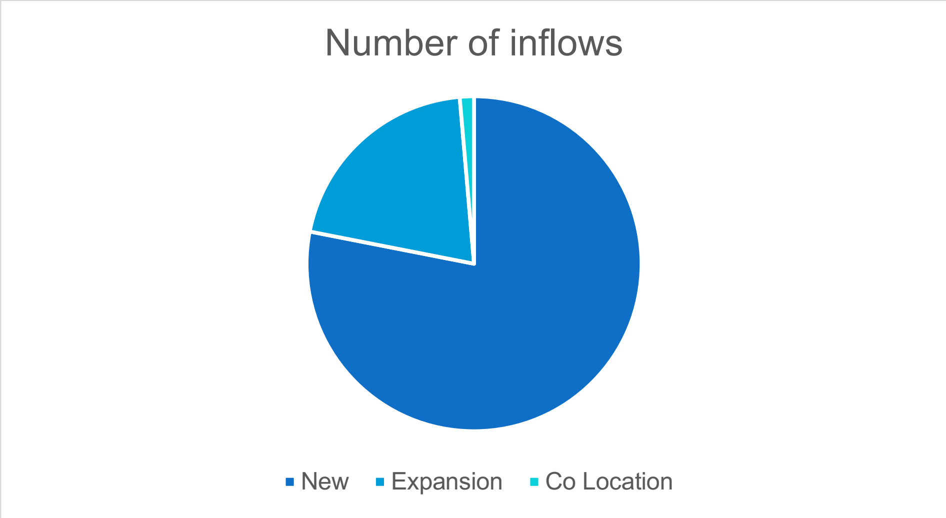

Fig 25. Type of investments

Type of Industry activity

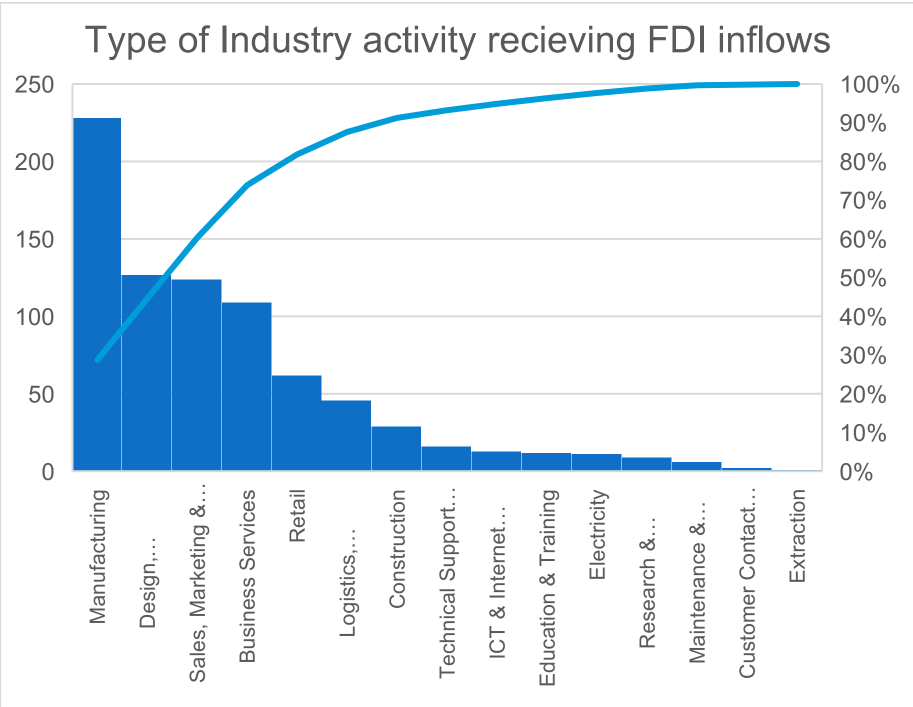

Fig 26. Type of Industrial activity

From the data provided by Financial Times, it is quite evident that most of the inflow happened in Manufacturing sector. Another key activity benefited in 2018 were Business services and 'Sales, Marketing and Services' which shows a highly similar trend with the past literature and the above findings. Under the MII, government planned to improve the thrust sector with service and manufacturing playing a key part in the initiative. From the above trend, it is quite clear that the thrust sectors under which policy changed during the past years have got a positive response.

Major contributor and receiver of FDI inflows

Let's try to observe the leading contributor to FDI inflows in India post the policy changes discussed above. From the data following trends can be observed.

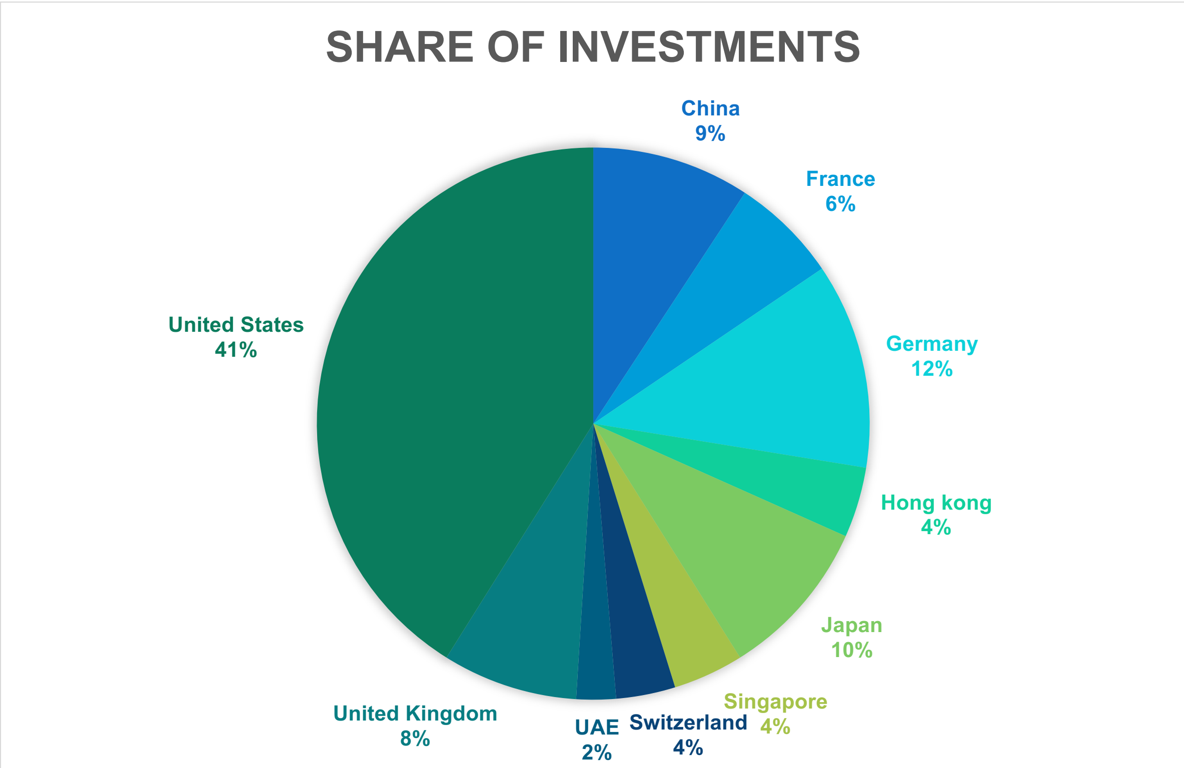

Fig 27. Share of investments

Almost half the number of investments done post the policy changes under MII in India have been from United States' firms. Apart from United States, other leading contributor for inwards FDI in order were Germany, Japan, China and UK.

Whilst talking about major receiving FDI states of India, Maharashtra and Tamil Nadu received the greatest number of inflow investment followed by Gujarat, Karnataka and Andhra Pradesh.

Industry sector and amount of FDI

Industry sector	capital investment in sector($ millions)
Aerospace	983.53
Automotive components	1151.3271
Automotive OEM	4919.9083
Beverages	47.2
Biotechnology	37.2
Building materials	1062.77
Business machines & equipment	17.8
Business services	1487.2
Ceramics & glass	115.13
Chemicals	977.3
Coal, oil & gas	7890.31
Communications	2630.69
Consumer electronics	1033.835
Consumer products	1691.199434
Electronic components	1310.85
Engines & turbines	330.68
Financial services	2266.8
Food & tobacco	1313.342
Hotels & tourism	645.377
Industrial equipment	1283.83781
Leisure & entertainment	331
Medical devices	362.6
Metals	3106.89
Minerals	0
Non-automotive transport OEM	458.5
Paper, printing & packaging	3570
Pharmaceuticals	166.34
Plastics	202.84
Real estate	5735.366
Renewable energy	2456.3

Rubber	984.28
Semiconductors	542.51
Software & IT services	3322.66
Space & defence	212.84
Textiles	288.9
Transportation	542.55
Warehousing	729.8

Fig 28. Industry sector and amount of FDI

From the table, which is based on the data from Financial times, it is evident that largest inflow of investment came in Automobile and related sector and Oil & Gas sector. Other noteworthy sectors which received significant amount of FDI are Real estate and Software & IT services.

4.6 Conclusion

"The concept of Make in India has really succeeded as it added more employment. With this, India has now become a vibrant market for manufacturers. For the products that are made out of the initiative, we have a strong domestic market with increasing demand. I believe that infrastructure sector is where foreign investments can come in a big way," quoted by Dipankar Dasgupta professor of economics at India Statistical Institute.

As discussed earlier, Mauritius is the largest contributor towards inwards FDI but in terms of greenfield investments in Automotive sector USA, Germany, Japan and Netherlands remains the leaders. According to Department of Industrial Policy and Promotion, FDI inflows through approval route has increased 87% with investment size of 2.2 billion during 2014-15 following amendments of FDI policies in various sector.

Foreign investment rose 717% in 2014-15 with 90% of FDI through automatic route. A state wise survey also shows that more than 70% FDI inflows happened in Delhi, Haryana, Gujarat, Karnataka, Andhra Pradesh and Tamil Nadu.[xxvii] It can be concluded from above findings and figures that policy changes with view to attract FDI under the 'Make In India' by government of India gets approval and positive response from global automakers in automobile sector. And also, the historic trend of attracting more inflows in service and manufacturing sector post the liberalization period was observed again post 'Make in India' policy changes discussed above.

Chapter 5. Conclusion

5.1 Numerous factors causing uncertainty in FDI

Interpretation of FDI data could vary significantly in case of India and other developing economies with compare to developed countries. There are various factors affecting the real inflow of FDI that occurs. FDI policymakers' main focus revolve around on attracting more FDI inflows and for which they rely heavily on inaccurate numbers and prediction because of the uncertainties caused by various factor. Because of this problem, it is difficult to draw conclusion specially with respect to individual sectors.

This study attempts to elaborate the factors that affect the reported inflows. They are

- False reporting
- Delayed reporting
- Disinvestments
- Weak Internal system

Delayed reporting

Reporting of inflows in subsequent year can be considered normal as it would have evened out over the number of years. However, if we consider the specific set of policies and attempt to see the significant effect of the policy over FDI inflows, delayed reporting can be troublemaker and hence no concrete evidence can be figured out as delayed reporting of time frame such as a year later could distort the real evidence and finding of how the policy impacted the particular segment in terms of FDI inflows compared to earlier.

False reporting

Present government has acknowledged the issue of delayed reporting and it had been seen through the timeline of earlier government as well. RBI have released numerous press note through its website changing the requirements and modifying the old procedure of reporting the inflows. [xxviii] Companies are required to clear the backlog of pending entries of inflow by Reserve Bank of India in order to implement the new procedure or reporting. In the due process, companies report the earlier entries again due to changes in the status for oversight caution against the laws and regulation. Thus, when dealing with large inflows, false reporting can alter the inflows of various industry specific FDI data.

Disinvestments

Disinvestment in simple terms is withdrawal of capital from a particular firm by the investor or parent company. Other similar phenomenon is repatriation of capital which occurs when the capital is transferred back to the country of origin from overseas. Apart from repatriation of capital, disinvestments and acquisition also undermine the impact and level of contribution to new capacity creating in the local economy. Thus, it is important to identify the mode of entry and nature of foreign investment to know the real impact of FDI.

Weak Internal system

India should develop its local institutions dealing with foreign investments and the various boards associated with it. According to Economic Times, government has spent around $166 million in promoting and for publicity of the initiatives such as ‘Make in India’ and ‘Digital India’ since the launch in 2014. [xxix] If even a piece of such huge capital is utilized in analysis of data and strengthening the data collection, coupled with inter disciplinary organization coordination the value harnessed from FDI could be significantly greater.

5.2 Influence of past decision on FDI inflows

The high numbers of reported inflows over the past few years has been hugely credited to government’s initiative. As seen in the preceding section, even if the policy amendments can affect the inflows of the FDI positively there is possibility of various factor which might hinder the direct influence and impact of such decisions over the actual inflows. The net foreign investment consisting of Direct and Indirect portfolio investments post the MII initiative shows as drastic reduce in 2016 (Reserve Bank of India, 2017). Such a drastic reduce in inflows suddenly wouldn’t have occurred if the foreign investors responded consistently with policy changes in specific sectors.

Moreover, on observing trend, among the other possibilities in which further investment is made into the existing companies, a dominant one is acquisition of existing shares. [xxx] Thus, acquisition can provide volume for the inflow of capital while the important dimension is overlooked in terms of fresh capital into the local economy from overseas.

From the two view point mentioned in this study, with the first being 1991 liberalization of policy and second the overhaul changes under the present government's initiative post 2014 it can be observed that policy changes certainly impact the state of FDI but to evaluate accurately the real impact on development on economic front and change of inflows is a complex task and also other co-relating factors should be considered while observing the influence of past decision in policy changes.

5.3 FDI is neither a blessing, nor is it disguise

FDI is not an 'only blessing' phenomenon as there are numerous negative effects too related with it. It is a hoax to consider FDI only brings capital to the Indian enterprises and firms. Many countries have escalated their efforts to attract FDI which is evident from the number of growing bilateral investment treaties (BITs) and double taxation treaties (DITs) (United Nations, 2003). Increasing number of treaties can also impact negatively as it induces many limitations for the host country and policymakers in order to align with the treaties signed. To have a sustained flow of FDI and the expected benefits from the FDI, opening up the economy with liberalized policy is not enough. MNC's investment are often based on economic incentives rather than social welfare or with the approach to boost the host countries' economy. Countries are increasingly favoring the targeted approach for FDI which is not without risk, whilst has been seen as a tool to increase the investment that can benefit the host countries' objective (UNCTAD, 2002).

Apart from the policy environment, as we have seen earlier MNC usually focus on the existing advantages present such as low labour cost and logistic costs which is influencing factor when locating the export activities in the developing countries like India. Without proactive governance as we discussed above, it is difficult to take advantage of dynamic advantages that come with the FDI. It is important that there is enough absorbing capacity which is necessary for skill development and other spillovers to obtain from knowledge transfer.

However, designing a perfect mechanism and incentive benefits is a complex task. Due to the competition by host countries to attract FDI, often the profit shifts from host country to foreign enterprises. (United Nations, 2003).

In India's case as we have seen most of the FDI occurs in three main ways that is RFDI, foreign investors and inflow on domestic entrepreneur's accounts by foreign entities (largely in public sectors). In RFDI, there is little interest to finance domestic firms and transfer high and advanced technology through spillovers unless a specific clause stated with the agreement. Often RFDI of large scale has an objective of market control which not only displaces the existing entrepreneurs but also emerges as an obstacle for future ones.

The second type of investment comes through foreign investors investing in local firms through automatic route. With little to contribute to dynamic benefits of FDI, foreign investors investing also has a downside risk of large capital outflows and disinvestments.

The third type of FDI, i.e. inflow on domestic entrepreneurs' accounts could be misleading with balancing of investments and borrowings of portfolios. Thus, only a detailed and micro-level research on the same can assist to find out the real impact of such transactions to national development. In this context, India's approach towards attracting inwards FDI and policy framework looks too unidirectional and simplistic.

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