An Empirical Analysis of the Potential of FDI inflows in India

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Abstract

India needs FDI as a constituent of its tactical investment for acquiring and prolonging Economic Reforms, tempo and developmental economic growth. It was initially low due to frame work of policy regulation. However, from 2005, it jumped up in its output till date; credit goes to the new policy. Research is on to make out the rigorous improvement of Indian economic development by means of incentives that out par the previous ones, attractive such as Human Capita Transfers, Domestic Investment etc. The sole motive of the research is to highlight the consequence of FDI on economic growth in India through the pivot of investments in different spheres in India.

Keywords: FDI, Economic Reforms, economic growth in India

I. Introduction

Since adoption of New Economic Reform 1991 characterised as Globalisation, Liberalisation and Privatisation, until 2010, more focus was given to administration of the economy. In the meantime Planning Commission introduced the 12th Five Year plan in which three different contexts related with growth were adopted with trial able steps. In the initial step, it suggested to maintain the average GDP growth rate of 8.2%, the second step was related to improve economic growth by reducing fiscal and current account deficits. Thirdly the plan precisely expressed the policy measures which would attract FDI, as an important weapon to achieve desired level of growth. Itemphasised the importance of attracting additional foreign investment in the sectors like retail, defence and telecommunication. As these above steps were being declared the major countries like UK, USA, and South Korean are interested to enter into the Indian Territory for business motive by welcoming ‘Invest India’ programme i.e. an investment promotion agency, where Government has 49% equity, the rest is evenly distributed among CII, FICCI and NASSCOM, recognising it a private equity. Out of government’s 49% equity provided by ‘Invest India’
initiative, 43.5% stake held by Department of Industrial Policy and Promotion (DIPP) and rest 5.5% has been shifted to 11 states having 0.5% each, including Telengana, Madhya Pradesh, Kerala and Maharashtra creating healthy atmosphere of investment in India.

Between the year 2014 and 2017, Invest India created FDI worth of $7.4 Billion, creating 94,312 job opportunities. Again, in the year 2016-17, FDI inflows increased to $43 Billion. It encouraged 571 foreign companies to invest in India with worth of $83 Billion. The top five FDI deserving states in India are Maharashtra, Gujarat, Haryana, Karnataka and Andhra Pradesh having top five sectors i.e. food processing, automobile, electronic energy and waste management and chemicals. Now India is most FDI attracting country with 98% FDI, channelized from automatic route and the target is to $100 Billion annual FDI in next two year (Kant, 2014).

Government of India enacted FDI policy measures to enhance foreign investment inflows from 26% to 49% in insurance sector. By lunching 'Make in India' (September 2014), it liberalised 25 spheres in India. Thus in April 2015, with the help of 'Make in India', there was 48% of increase in FDI inflows in India which stood India at 18th position throughout the world in terms of FDI. Thus by the year 2015, India was regarded as top most favourable destination for FDIs.

In India construction activities contributed nearly 10% to GDP. Thus Government of India has invested $1 Trillion on construction and infrastructure activities from the year 2012 to 2017. Out of this, private sector contributed 40% of the fund and Indian government permitted 100% of FDI through automatic routes for township and cities under construction sector.

India is recognised as 7th largest country in production of automobiles in the globe by producing 25.5 million vehicles yearly. Thus FDI in automobile sector was exceeding by 89% during 2014April to 2015February. 100% FDI is allowed in this sector which constituted 7% of GDP in India.

In case of pharmaceuticals sector India occupied Third position in terms of volume and Thirteenth position in terms of value. Thus between the period 2015 to 2020, it is expected that India’s pharmaceuticals sector will grow at 20% annually. Government of India allowed 74% equity for FDI in this sector.

The service sector contributes nearly 53% to the Indian GDP. Technology testing, courier, out sourcing, research and development, banking and insurance included in the service sector. Government of India increased the limit of FDI in insurance sector from 26% to 49%. In railway sector 100% FDI is permitted except railway electrification, mass rapid transport system, and passenger terminals, and high speed trains. The FDI project on this sector expects more than ₹90,000 Cr i.e. US$13 Billion by the year 2020.

Indian chemical industries increased revenue from $155 Billion to $160 Billion during the year 2013. Government of India permitted 100% FDI in this sector through automatic route. Other than production of decentralised chemicals, isocyanides,
hydrocyanic acid and phosgene, India’s share in global chemical industries anticipated to increase from 6% to 7% by the year 2023. Textile is the major expected item in India demanded by foreign countries for export. This sector is able to attract $1647 Million by the year 2015 and 100% FDI is permitted through automatic route.

II. Literature Reviews

Echcharfi and Fayou (2016) analysed in their study on the effect of total FDI upon trade balances and economic growth and development of Morocco with the help of standard OLS regression method. The findings reveal that the impact of FDI on trade balance as well as economic growth is unrelated. As they suggested the impact of FDI on the overall growth of the country fluctuates on the basis of structural strength. The collision of FDI on economic growth is positive and significant but in the manufacturing sector where as other sector is simply irrelevant and negatively related. Effect of FDI on trade balances reveals that only in manufacturing and telecommunication sector, FDI is positive and related to extrinsic balances of foods and services. Hence, the negative effect of Morocco is overthrown the positive effect. Therefore the total impact of FDI on growth and development of Morocco is attractive. The impact of FDI on trade balance is not satisfactory due to investing only in manufacturing sector and as the expert of Morocco is highly dependent on imported inputs, it encourages import of the country. As a result the impact of FDI on non-tradable sector decreased the trade balances. It more encouraged import by discouraging exports. Therefore the negative influence of FDI is wiped out the positive effect. Thus, it is insignificant in trade balance also.

India is now a favourable destination for foreign investors. With decreased in governmental trade restrictions on foreign trade and increase in favourable business avenues, attracts foreign investors for the invest prospects. Therefore the FDI in India shows an upward trend in recent year. In this research paper Kothari and Bhatt (February 2015) tries to identify the impact of FDI inflows in Indian stock market i.e. the effect of FDI on NSE NIFTY and BSE SENSEX. By using linear regression method they found that, there positive impact of FDI on BSE SENSEX and NSE NIFTY. Therefore FDI inflows controlled the progress of Indian financial markets. In his research paper Singh (2017) tries to trace out the importance of FDI on Indian Economic growth by strengthening capital formation, increasing domestic investment and promoting technological upgradation. This paper tries investigating the different dimensions of FDI in India. In this research paper author Aggarwal tries to analyse the subtlety of FDI to the situation of labour market. By taking cross sectional data or 25 Indian states of 11 years (1991 to 2001), the result reveals that the inflexible labour market reduces the inflows of FDI into the country. Thus the fixed labour market and labour cost are the important determinants of export related FDIs as against market
seeking FDIs. Regional development and infrastructural development also contributed to the last flow of FDI in both domestic market sector and export sector. In an article, author Fisher and Peters (1998) states that, incentives given by different countries had a direct and certain influence of FDI inflows to the developed country like USA. The stimulating factors which encouraged investment in USA comprised with corporation tax exemptions, grants, job training, and subsidies for infrastructure, employment generation and loan guarantees. But under boundary of European Union, member states found out the existence of inverse relation between FDIs and taxation policies.

Santis, Vicarelli and Meruri(2001) analysed the inflows of FDI in European Union and found that the members of European Union stake holders were more dominated by the chunk of labour than corporate tax. They suggested that when foreign investor are interested to invest through the location advantages, give more importance to overall tax structure rather than a single corporation tax rate. Apart from this trade openness, infrastructural advantages also plays dominant role for attracting FDI to the country.

III. Objectives

The objectives of the present study are:

i. To analyse the direction of Foreign Direct Investment in India.
ii. To make a sector wise analysis of FDI in India.
iii. To investigate the liaison between Foreign Direct Investment and economic development in India.

III.i. Hypotheses

The various hypotheses this study would like to test are:

I. That, there has been no change in the direction of FDI over the years in India.
ii. That, the sector wise inflow of FDI has remained unchanged over the years.
iii. That, FDI has a significant contribution to the economic growth in India.

III.ii. Findings

The findings of the following study are presented under the following 3 sections based on the set hypotheses.

III.iii. Section 1: Direction of FDI in India

Among the several foreign investing Mauritius is the top channel of FDI and followed by Singapore top India by the year 2017-18 and total FDI constituted as $37,366 Million in the financial year which was $36,317 Million in previous year according to RBI data base. So there is increase in FDI inflows into the country over the financial year. FDI in Mauritius increased from $13,383 million in 2016-17 to $13,415 Million in 2017-18 and total share of FDI in Singapore increased to $9,273
Million from $6,529 Million in 2017-18. Table 1 reflects the direction of FDI flowing into India.

| Country/Year     | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|------------------|---------|---------|---------|---------|---------|
| Mauritius        | 3,695   | 5,878   | 7,452   | 13,383  | 13,415  |
| Netherland       | 1,157   | 2,154   | 2,330   | 3,234   | 2,677   |
| Singapore        | 4,415   | 5,137   | 12,479  | 6,529   | 9,273   |
| USA              | 617     | 1,981   | 4,124   | 2,138   | 1,973   |
| Cayman Islands   | 25      | 72      | 440     | 49      | 1,140   |
| Japan            | 1,795   | 2,019   | 1,818   | 4,237   | 1,313   |
| Germany          | 650     | 942     | 927     | 845     | 1,095   |
| Hong Kong        | 85      | 325     | 344     | 134     | 1,044   |
| UK               | 111     | 1,891   | 842     | 1,301   | 716     |
| UAE              | 239     | 327     | 961     | 645     | 408     |
| Switzerland      | 356     | 292     | 195     | 502     | 506     |
| France           | 229     | 347     | 392     | 487     | 403     |
| Italy            | 185     | 167     | 279     | 364     | 308     |
| China            | 121     | 505     | 461     | 198     | 350     |
| Cyprus           | 546     | 737     | 488     | 282     | 290     |
| Canada           | 11      | 153     | 52      | 32      | 274     |
| South Korea      | 189     | 138     | 241     | 466     | 293     |
| other            | 1,626   | 1,685   | 2,243   | 1,490   | 1,889   |
| Total FDI inflows| 16,052  | 24,750  | 36,068  | 36,316  | 36,323  |

Table 1. FDI Inflows in India (Country Wise): (in US$ Million)

Notes- Includes FDI through SIA/FIPB and RBI routes
Source- Compiled from RBI Database

Data collected from RBI annual report reveals that at the end of financial year in March 2017-18 inflows of FDI in to manufacturing sector decreased to $7.06 Billion as compared to previous year which is stood at $11.97 Billion. Nevertheless, FDI into service sector, especially in the field of communication increased from $5.86 Billion in 2015-16 to $8.80 Billion in 2017-18. There is also increase in FDI inflows wholesale and retail sector to $4.78 Billion as compared to $2.71 Billion in previous year. Thus it is the service sector which elucidated for around 50% of total purposed FDI i.e. $37.36 Billion in 2017-18 including interest of the foreign companies into
different new areas like Fin tech, financial technology, online marketing etc. Sectors like mining constructing shows a declining trend in FDI share during 2017-18 whereas hotels and restaurants, distribution, transport, energy generation and electricity recorded an increasing trend in 2017-18. Japan and Singapore are major source of FDI in India after Mauritius. The capabilities of a nation to captivate foreign direct investment into the country are significantly based on government attitudes towards policy making for foreign investors. It is the right path of India’s Honourable Prime Minister Sri Narendra Modi to attract more foreign investment into the country for overall development. By following his path of development India is now capable to attract FDI worth of $60.1 Billion in 2016-17.

The Department of Industrial Policy and Promotion (DIPP) has expressed renew and adjusted FDI policy 2017-18 to streamline the existing policy. The main focuses of this FDI policy 2017 are

To introduce Foreign Investment Facilitation Portal (FIFP) instate of Foreign Investment Promotion Board (FIPB) to act as an administrative body to promote FDI aspirant.

The FDI policy 2017 prepaid a list of sector wise specific administrative departments observed as Competent Authorities to provide government approvals for FDI. Approvals can be given through specified application format in the field of single brand, food product retail trading, multi brand and financial service sector.

To operate FDI propositions DIPP has introduce Standard Operating Procedures (SOP). It is a procedure format having detail information regarding time line and procedures for application along with the schedule of Competent Authorities for availing permission for getting up FDI in India.

Discussion with DIPP has been made mandatory for FDI approvals. It states that the authority can reject a deal with unanimity of the DIPP.

III.iv. Section II: Sector Wise Inflows of FDIn in India

India announced most transparent and liberal Trade Policy on FDI among various economies which is reflected in Table 2. The salient features of FDI in India are:

- **FDI is allowed up to 100% in all the sector except:**
  - That items which required license from Government
  - That deals related with acquisition of shares in Indian company by NRIs.
  - All proposals on which FDI policy is not permitted.
- **100% FDI is allowed to Special Economic Zones (SEZ) through automatic route in subject to sectorial norms and ethics.**
- **Government of India allowed 100% FDI through automatic route for establishment of Export Oriented Units (EOU). Those proposals which are not come under automatic route would be approved by FIPB.**
| sl. no. | Sectors                                                                 | Sectoral Cap/Route                                                                 |
|--------|------------------------------------------------------------------------|----------------------------------------------------------------------------------|
| 1      | Construction Development Projects                                      | 100%, Automatic subject to various conditions                                     |
| 2      | Pharm Sector (Brownfield)                                              | 100% FDI, FIPB beyond 49%                                                        |
| 3      | Railway infrastructure                                                 | 100%, Automatic, FDI beyond 49% in sensitive area from security point of view     |
| 4      | Banking Private sector                                                 | 74% (FDI+ FII) by FIPB if beyond 49%                                             |
| 5      | Broadcasting (i) FM Radio (ii) Cable Networks (iii) DTH                | 26% (FDI+FII) FIPB                                                                |
|        |                                                                        |                                   49% (FDI+FII) Automatic                                                            |
|        |                                                                        |                                   74% (FDI+FII) FIPB beyond 49%                                                      |
| 6      | Defence Industry                                                       | 49%                                                                              |
| 7      | Single brand product retailing                                         | 100% subject to sourcing condition, FIPB beyond 49%                                |
| 8      | Asset Reconstruction Companies                                         | 10% (FDI+FII) by FIPB if beyond 49%                                               |
| 9      | Civil Aviation                                                         | 49% FDI (100% For NRIs) Automatic                                                 |
| 10     | Telecom sector                                                         | 100% FDI, FIPB beyond 49%                                                         |
| 11     | Power exchange                                                         | 49% (26% FDI +23% FII) Automatic                                                  |
| 12     | Multi brand product retailing                                          | 51% subject to various conditions                                                  |
| 13     | Satellite and Establishment and operation                               | 74% FIPB                                                                        |
| 14     | Security agency in Private sector                                      | 49% FIPB                                                                        |
| 15     | Stock exchange, depositories, clearing crop                            | 49% (26% FDI +23% FII) Automatic                                                  |
| 16     | Petroleum and Natural gas Refining                                     | 49% FDI in case of PSUs, Automatic                                               |
| 17     | Publishing of Newspaper and current news                               | 26% (FDI+FII) FIPB                                                               |
| 18     | Commodity Exchanges                                                    | 49% (26% FDI+ 23%FII) Automatic                                                  |
| 19     | Credit informing Company                                               | 74%, Automatic, FII only 24%                                                     |
| 20     | Insurance                                                              | 49%, up to 26% Automatic, beyond it FIPB                                         |

Table 2. FDI Limit in Different Sectors. Source- FIPB Database
III.v. Impact of FDI in Infrastructure:

The impact of Foreign Direct Investment in infrastructure increased by 90% in the year 2011 and this sector summed up 4% to the entire sum of FDI plans and 9% to the entire employment opportunities. Improvement in infrastructure provides the Governmental bodies of India to accelerate their budget plan proposals to twice its infrastructure expenditure from US$ 500 Billion to US$1 Trillion during the year 2012-17. The Government of India is expected to minimise the deficits related to infrastructure and would hopefully to attract foreign investors in this sector. Government also allowed investors to make use of most infrastructural sectors like power plans, airport, ports and harbours, roads and highways etc. In order to increase enchantment of infrastructural sector, government has drawn out tax holiday period and encourage several projects based on Public-Private Partnership (PPP) mode. Attracted by these assorted opportunities offered in this sector, many private participants along with foreign participants have initiated their participation in various infrastructural sectors. As a result various international participants like Jacobs H&G, Toyo Engineering, Aker Solutions and Tec Himont are already started their investments in infrastructural sector in India. However environmental cleanliness issues, high inflation, land acquisition and high interest rate restricts additional projects and especially the governmental regulatory frame work rhythmically obstructs the inflows of foreign capital into the economy.

III.vi. Impact of FDI in Automobile

The automobile sector in India deals with 78% of FDI projects during 2011-12, which is shows 28% of increment in comparison with 2010. It shared 8% of entire FDI deals and generates 16% of job opportunities. Now India is the seventh largest manufacturer of Passenger Vehicle (PV) and 2nd largest manufacturer of Medium and Heavy Commercial Vehicle (MHCV) and two wheeler markets. Government of India take initiatives to improve automobile sector by enacting Auto Policy, 2002 to captivate FDI and making India as export and manufacturing nerve centre. As a consequence Government of India permits 100% of equity approval through automatic route for synthesizing automobiles. Therefore, India has five major manufacturing automobile hubs – Sanand (Gujarat), National Capital Region (NCR), Pant Nagar (Uttar Khand), Chennai (Tamil Nadu) and Pune (Maharashtra). The Auto Policy, 2002 empowered these states by providing incentives like guaranteed energy facilities, tax holidays and provision for direct access to land. Again, to promote exports of automobile sector the programme like Focus Market scheme is lunched to provide cash benefits up to 5% for vehicles exports. Now a day, India is the most favourable destination for foreign investment in automobile sector of Asia.
III.vii. Impact of FDI in Technology

FDI in techno sector has a favourable impact on GDP by growing by US$ 4 Billion in 1998 to US$ 80 Billion in 2011. It provides both direct as well as indirect business to more than 10 million people in India. The Government initiation like establishing Software Technology Park of India (STPI), Tax free zones and Special Economic Zones (SEZ) gives strong support export of several technology services. These IT sector bagged US$ 6,197 Million with the help of FDIs, which is the 46% hike in growth rate than previous year. Most of the FDI acknowledged by software and hardware services, online business, IT enable services and IT services. As a result this investment generated 153 projects with an anticipation of 41,607 employment opportunities in the technology sector.

III.viii. Impact of FDI in Financial services

FDI in financial service sector grew by 21% and its value of the purposed project increased by 75% during the period 2011. But in spite of growth efficiency, the share of FDI projects in this sector, comparatively low than other developing economies because of various governmental regulation frame work, capital account convertibility and capital lock-ins systems. Several surveys reveal that, it is the capital account convertibility act like major obstacles faced by foreign investors and capital lock-ins are major problems in the field of investment. Apart from these problems, it is the insurance sector favourable FDI proposals and about 47% of the people in India have able to connect with banking facilities and 15% of Indian population has life insurance. Hence, reclining Insurance Regulatory and Development Authority (IRDA) policy on marketing, will attract more foreign cooperation in this sector.

III.ix. Impact of FDI in Retail Sector

Organised retailing in India has the major impact on population by growing the demand for branded products, high propensity to spend and this spending through credit and debit cards. As a result 10 million jobs are created in India through FDI projects in multi brands as well as single brand retailing. Govt. allowed 100% FDI in single brand retailing instead of 51% and this will encourage reputed single brand retailing firms to enter into India having investment proposals.

III.x. Impact of FDI in Consumer Products

FDI in consumer product increased by 31% in the year 2011 by creating 10% of total FDI deals and 28,400 employment opportunities. Investors are interested to invest in packaged food and beverages sector in India. It is expected that India’s large population and economic growth will stand India in 5th position among large
countries by the year 2025. As the major FDI projects covers these consumer products which demanded by middle class people at least. Thus this growing demand for the products forced several companies to coping with the need of the consumer, to innovate with differentiated products.

III.xi. Impact of FDI in Clean –tech

As per the edition of Ernst and Yong’s Renewable energy country attractiveness indices published in November 2011, India stood at fourth position after Germany, China and US, out of 40 countries in the field of FDI in clean tech. National Action Plan on Climate Change (NAPCC) in India lay down purchase targets of 5% in the field of a minimum renewable energy, India also permitted investors to invest in renewable power generation sector on a frame own operate basis. This will go to give a strong strength to this economy by providing 15% of Green electrification by the year 2020.

Figure 1 shows the sector wise inflow of FDI in India.

![Fig.1. Sector Wise FDI Inflows in India: (Year 2017)](source)

Source: Compiled from RBI database

III.xii. Section III: FDI's Contribution in Economic Growth in India

FDI is vital form of investment required by India in order to achieve economic reform, perceive peace and stability and to continue economic development and growth. FDI provides win-win situation for both the FDI providing country and FDI receiving country, while former can anticipated to gain from investment and latter can able to explore the opportunities in order to increase the capacity and set out preferred position through its achievements. This preferred position of a FDI receiving country again depends on the perception of the investors. If investors are expected to continue their investment for long time period, then it creates positive attitudes towards economic growth and development otherwise short run investment purposed by profit
motives, is less effective and less significance for the country. Thus, relying upon the different sectors and categories of business FDI may be a viable and attractive decision and it is the combination of Government Trade Policy, market’s expectation, market analysis, analysis of natural and internal resources and competitiveness. FDI is treated as an important aspect to influence economic development in FDI receiving countries. FDI is vigorously backed by the Endogenous Growth model to improve the economic growth in the country. As per the Endogenous Growth model, FDI is recognised as the vital factor for promoting economic development by the means of improving human capital, advancing technological upgradation, promoting growth of the country by the way of learning by doing and transferring information (LAN, 2006). But whether the purposed FDI deals are viable for economic growth or not, is a matter of discussion. For this, it is very crucial to figure out the relationship between FDI and other macro-economic variables in the country.

III.xiii. FDI and Gross Domestic Product

It is believed by several policy makers that FDI improves economy development and growth by adopting technological upgradation and dissemination, expanding capital stocks, creating technical torrent for local markets etc. The local firms are able to merchandise their expertise with the help of wide distribution and accretion of skills among the labours. As a result, new managerial skills and efficient organisation management practices are introduced in different business fields. Thus, increase in efficiency and productivity in different spheres improves Gross Domestic Product in India (JALLAB, 2008). This shows a positive relationship between FDI and GDP growth rate. But the negative effect of on GDP would advise a retrospect Governmental and developmental policy frameworks for fascinate favourable FDI proposals to the country, which ultimately improves GDP growth rate.

III.xiv. FDI and Foreign Reserves

Foreign exchange reserves are the exogenous assets which include the sum of Gold held by the country, Special Drawing Rights (SDR), exchange reserves with International Monetary Fund (IMF) and convertible foreign currency held by country’s bank. Host counties are tries to capture international investment because of stock marketing networks, enormous apprise to knowledge and information for their industries which ultimately increase their capacity to maintain high level of foreign reserves in host countries (CHOPRA, 2003).

III.xv. FDI and Capital Formation

It is the efficiency in productions which increases the country’s ability competency to create utilities. Mobilisation of corporate and private savings towards corporate investment instead personal consumption, leads to capital formation in the economy.
(SCOTT, 2003). By building forward and backward linkage between different sectors, FDI strengthen the domestic investment.

III.xvi. FDI and Employment

FDI is regarded as an important factor for generating employment opportunities in the host country. Employment is one of the important aspects of social issues, which influence the development aspect of each developing country. There are three major components of FDI by way of which it generate Employment opportunities in host countries. These are

- Foreign companies provide employment to the local people of host country.
- By the way of forward and backward linkages between different sectors, employment opportunities are generated.
- By increasing investment through FDI in different sectors of countries employments are generated.

IV. Conclusion

FDI improves economy growth and development of a country, particularly in India by creating job opportunities for unemployed youth, adding Government revenue in the form of income and taxes, development of infrastructure, stability in financial sector and increasing financial support system, eradication of poverty. In the post reform period investment in the way of non-debt has given strong support and financial strength to Indian financial market. From the year 2000 to 2002, the FDI inflows have been exceeded from US $ 4029 Million to US $ 6130 Million. But during the period 2002 to 2004, FDI got downward momentum to US $ 4322 Million. Again it was increased from US $ 4322 Million to US $ 37182 Million in the year 2004-2010. The marginal growth rate FDI inflows decreased from 146% in the year 2006 to 6% in the year 2010. The report published by UNCTAD reveals that FDI inflows started recovering from the next half of 2009 and 2010, when South Asia is the first to oppose back from recent down term.

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