FOREIGN DIRECT INVESTMENTS IN INDIAN STATES

THE SDG CORNERSTONES

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Executive Summary

There are varied political, social and economic factors across India's states that determine their attractiveness to foreign direct investment (FDI). In the post-COVID-19 world, these same factors will be influenced by the availability of physical, social, natural, and human capital that the UN Sustainable Development Goals (SDGs) are aspiring for. Indeed, the COVID-19 pandemic is a critical juncture where countries across the globe are being forced to face their weaknesses in the global supply chains, which have increasingly come under China's hegemony in recent years. While India's flagship 'Make in India' policy is largely guided by an attempt to attract FDI and nurture value chains that begin and end in India, the prime minister's clarion calls of 'Atmanirbhar Bharat'[a] or 'Vocal for Local' must not be perceived as roadblocks to foreign investments and international trade. The 'Atmanirbhar Bharat' scheme was introduced to increase the resilience of the domestic economy to the elements of uncertainty posed by the COVID-19 pandemic. Through this scheme, the government aims to boost domestic production and make India a 'self-reliant' nation; funds worth INR 20 trillion have been disbursed for this purpose.

FDI is crucial for economic development, modernisation, and employment generation; it contributes to technology transfer, human capital formation, entrepreneurship, and efficiency of resource management. Espousing the spirit of 'competitive federalism', the Indian states have engaged in competition for FDI amongst themselves. States that have been successful in attracting higher FDI have enjoyed greater benefits from its positive spillovers.

This study maps the regional distribution of FDI inflows into India between 2005-06 and 2018-19. Data on FDI inflows are collected by the Reserve Bank of India (RBI) at its various regional offices, each of which often caters to more than one State or Union Territory. This dataset has been decomposed into its state-wise components by employing an appropriate statistical technique. Using this dataset estimated by the authors, the analysis outlines the sub-national trends in FDI inflow. It reviews India's policies on Special Economic Zones (SEZs), land, labour and industry to determine their role in governing the Ease of Doing Business environment, which in turn influences FDI inflow into the domestic economy.

[a] India's vision to become an economically self-reliant nation.

Key Findings

- Developing nations in Asia, such as India, are some of the largest recipients of foreign investment in the world, and there is intense competition for FDI in the region. India recorded US$ 49 billion in FDI in 2019, a 16-percent increase from the previous year. This accounted for 80 percent of FDI flowing into South Asia in 2019.

- Analysis of sub-national FDI flows indicate the emergence of two categories of states: Those that have received uniform (i.e. low volatility) and high volumes of FDI between 2005-06 and 2018-19 are called 'better performing' states; another group that received low volumes of FDI, with high fluctuations (i.e. high volatility) in yearly inflows, are the 'poor performing' states.

- The 'poor performing' states in India with high FDI volatility are Bihar, Madhya Pradesh, Rajasthan, Jharkhand and Uttar Pradesh. The 'better performing' states with low FDI volatility are Delhi, Gujarat, Maharashtra, Tamil Nadu, Karnataka and Andhra Pradesh.

- Ease of Doing Business (EoDB) conditions should be improved to attract more FDI into the regions. For Indian states, this study estimates that a one-percent increase in the EoDB score leads to a 6.32-percent increase in FDI inflow.

- Better performance on the SDGs parameters improves aspects of EoDB, and enables a congenial investment climate. Estimates for the Indian states suggest that a one-percent increase in SDG scores translates into a 0.80-percent increase in EoDB parameters and a 6.77-percent increase in FDI inflows.

- The 'poor performing' states must establish SEZs with favourable conditions, while the 'better performing' states should also focus on the holistic sustainability concerns in accordance with environmental, social and governance (ESG) considerations.

- Current literature suggests that FDI contributes to domestic capital formation. Competition for FDI among Indian states, employing the driving principles of SDGs, will not only ensure long-term economic growth, but also lead to equitable distribution of the gains from FDI.

Introduction

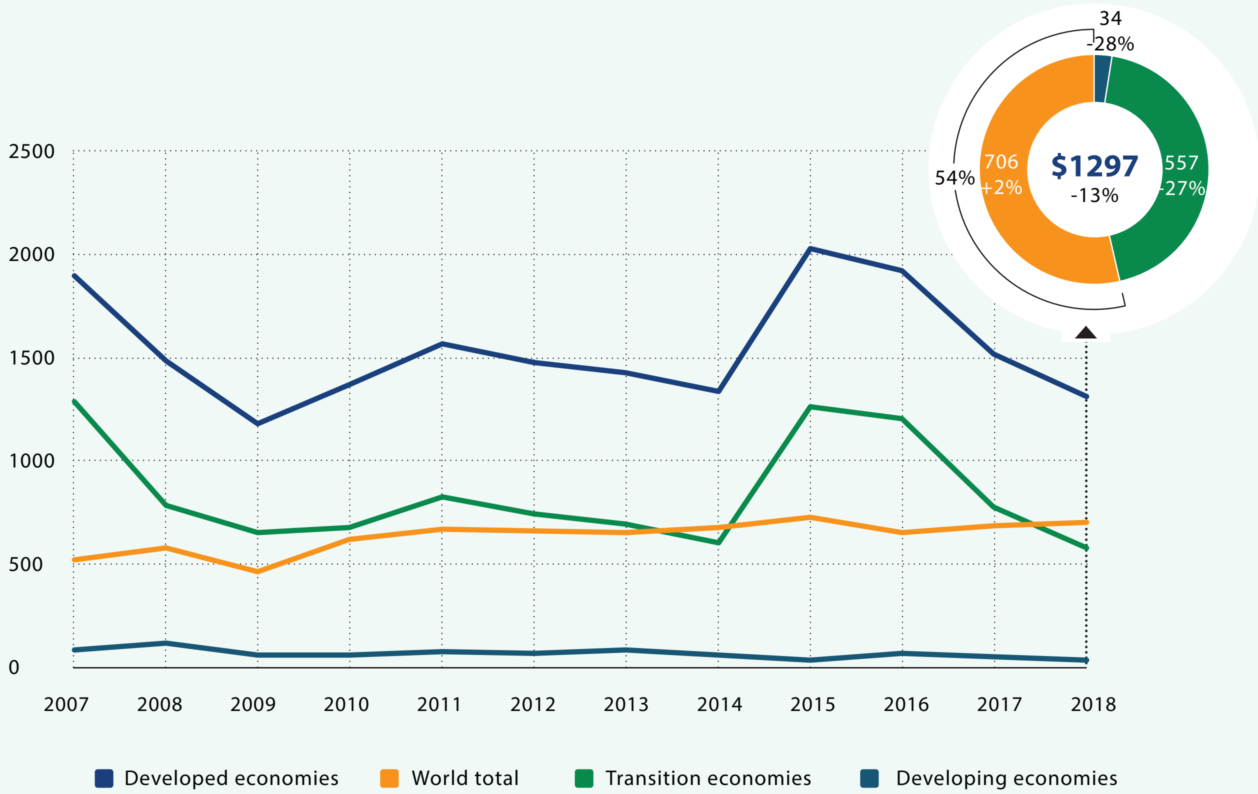
I

Foreign Direct Investment (FDI) is crucial for economic development, modernisation, and employment generation; it contributes to technology transfer, human capital formation, entrepreneurship, and efficiency of resource management.[1,2] Developing countries like India have therefore sought to attract greater FDI. The World Investment Report of 2019[3] found that FDI in developed countries have fluctuated over the period from 2007 to 2018: after a steep fall following the 2008 financial crisis, it recovered to pre-crisis levels in 2015, only to decline once again thereafter. Meanwhile, FDI in developing economies, including India, has remained stable. Indeed, estimates for 2018 suggest that FDI in developing economies was higher that year than in developed economies, accounting for 54 percent of global FDI inflow. Among the developing regions, Asia and Africa registered higher FDI inflows than Latin America and the Caribbean.[4]

Developing countries are more attractive to transnational corporations[5] for various reasons, one of which is the presence of cheap, skilled and unskilled labour. In other words, there are opportunities that could help in cost reduction in terms of labour—India's huge inexpensive labour force, comprised by the largest working age population in the world, is one of the reasons why foreign investors find India attractive.[6] Moreover, land and other infrastructure are also cheaper; there is promise of emerging large markets; and there exist 'created' assets such as communications infrastructure, marketing networks, and innovative technology that all help companies become more competitive.

Current patterns in global production are such that developing countries provide the platform for activities in the lower segments in manufacturing and services, and the developed nations provide expertise in management, technical know-how and skills upgrade. Large-scale migration of both skilled and unskilled labour has played an important role in moulding the current global economic order. In the Gulf countries, for example, economic activities have been driven by migrant skilled labour from the western countries, and unskilled workers from the poorer Asian nations.[7]

Figure 1: Global FDI Trends (in billion USD)



Source: UNCTAD – World Investment Report 2019[8]

Data shows that Asia is one of the largest recipients of foreign investment in the world.[9] Among the top FDI destinations in the region are China, Hong Kong, Singapore, Indonesia and India. Although Southeast Asia is the driver of FDI growth in the region, inflows to South Asia—in particular, India—are also significant. South Asia recorded a four-percent increase in FDI in 2018 to US$ 54 billion from US$ 52 billion in 2017, and by a further 10 percent in 2019 to US$ 60 billion.[10]

FDI in India has been on a long-term growth trend. Along with countries like Vietnam, India is emerging as alternate investment destinations for China. Despite the setback caused by the COVID-19 pandemic, India's large market will continue to attract market-seeking investments. Increasing inflows of foreign investments will boost the domestic economy. Whether the gains from such investments will be distributed evenly across the country is worth examining. Wide variations in FDI inflows across the states will result in an unbalanced growth and can worsen inequality. Policymakers need to focus on ensuring balanced regional growth across the country, and improving the inflow of FDI to the regions.

Lack of state-wise data on FDI in India is a major impediment to objective policymaking. Although the Department of Industry and Internal Trade (DPIIT) has published state-wise FDI values for the period October 2019 to March 2020, constructive policies will require understanding historical trends in regional FDI in India.[11,12] For this purpose, the authors of this report have analysed state-wise FDI inflows over the period 2005-06 to 2018-19, using a newly created database of state-wise FDI.

FDI in the Indian Context

II

Historical Overview

Following independence, the Government of India issued the Industrial Policy Resolution, 1948; some years later, the Industrial Policy Resolution 1956 came out. Between those years, the government introduced the Industries (Development and Regulation) Act, 1951 (IDRA) to regulate and control the development of the private sector. In 1969, MRTP Act (Monopolies and Restrictive Trade Practices Act) was passed. Another piece of legislation that has influenced industrial policy was the Foreign Exchange Regulation Act (FERA) of 1973.

These measures failed to push the country's industrial development; rather, they created inefficiencies, distortions and rigidities in the system, and Indian industries performed poorly and experienced slow growth during the period from 1950 to 1980. The policy regime aimed for a strong public sector, imposed controls over private investment, and promoted a highly protective trade policy and inflexible labour laws (especially after the mid-1970s). It also sought to promote the small-scale sector, as well as balanced regional development. Up to the mid-1960s, policy instruments were aimed at purposive diversification within the industrial sector, and increased public investment. The period after the mid-1960s witnessed a marked deepening of the import-substitution regime and strengthening of domestic regulatory structures. The decade of the 1980s witnessed some experimentation with domestic deregulation that yielded dividends in productivity gains and acceleration in growth to seven percent per annum.[13]

In line with the conditionalities set out by the Structural Adjustment Facility of the International Monetary Fund (IMF) in the 1990s, India carried out the most drastic liberalisation measures as the New Industrial Policy 1991 was announced on 24 July 1991. The policy de-regulated the industrial economy by abolishing industrial licensing, diluting the role of the public sector, delimiting MRTP limits, and promoting foreign investment and technology. The period from 1991 to 1997 saw rapid and wide-ranging reforms in industrial and trade policies, and tax and other policies that influence the macroeconomic management.

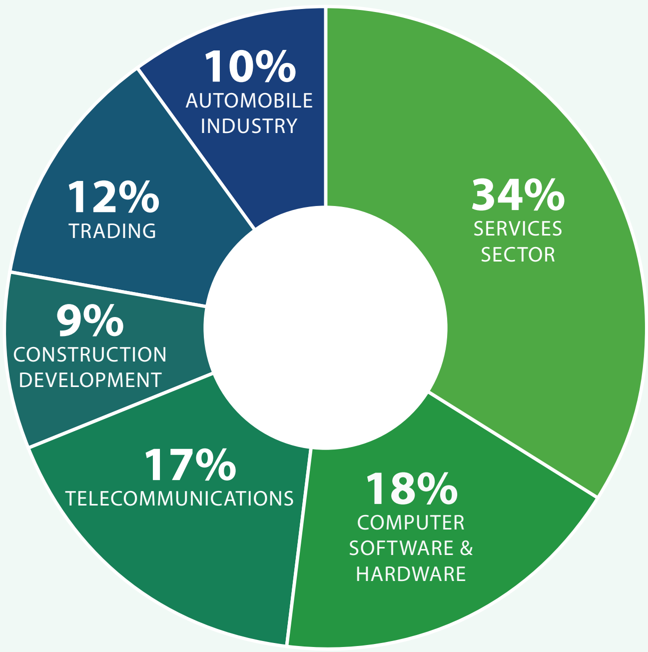
In 2001, India regained momentum towards improving the environment for private investment, opening the economy to foreign competition and infrastructure development. Trade policy reforms made a radical break with the past by discontinuing with the complex system of import licensing and making an open commitment to lowering the tariff rates on imports. India finally began to remove the quantitative restrictions on consumer goods and agricultural products in 2001, especially after a ruling by the World Trade Organization dispute settlement panel on a complaint brought by the US. In addition, the Indian stock market was opened for investment in equity to Foreign Institutional Investors (FIIs).[14]

Key Statistics

As India opened up in the 1990s, the economy was rekindled with a spirit of entrepreneurship and competitiveness. The same spirit seeped into the federal structure of the economy. The Constitution of India provides the federal states a sufficient degree of autonomy over various matters, including foreign investment. Although there are certain critical sectors that require prior government approval for foreign investment such as Defence and Broadcasting Content services, most others are open to foreign competition under the automatic route.

FDI inflow in India has witnessed a positive trend since the launch of the 'Make in India' campaign. Between March 2014 and April 2019, India recorded FDI worth US$ 286 billion, which was 46 percent of the overall FDI from April 2000 to April 2019 (US$592 billion).[15] In FY2017-18, India crossed the US$60-billion mark for the first time. However, the net FDI inflow for April-May 2019 decreased to US$ 6.8 billion, from the US$7.9 billion in April-May 2018. A significant proportion of the FDI in India is in the manufacturing, communication and financial services sectors.[16,17] (See Figure 2) Together the six sectors highlighted in Figure 2 account for more than 50 percent of all FDI in India between April 2000 to June 2019.

Figure 2: Composition of FDI in the top sectors in India (April 2000 to June 2019)



Source: Department for Promotion of Industry and Internal Trade (DPIIT)[18]

The sectors where FDI is completely prohibited[19] include lottery, gambling and betting (including casinos); chit funds;[b] Nidhi companies;[c] trading in transferable development rights; real estate; and manufacturing of cigarettes, or tobacco or tobacco substitutes. At the same time, the number of industries reserved for the public sector has also been reduced. Since 2014, for example, private investment in Rail Infrastructure has been permitted. At present, only two industrial sectors are reserved for public sector: Atomic Energy and Railway Operations. Table 1 shows the sectoral FDI thresholds under the automatic and government routes.

[b] Chit fund is defined as per the Section 2(b) of the Chit Fund Act, 1982. A chit fund is a type of rotating savings and agreement among different persons to subscribe a certain sum of money for a specified period of time. After the specified period of time, the money is returned to the subscriber with interest.

[c] Nidhi company is recognised under section 406 of the Companies Act, 2013. It is a business structure which comes under 20A of the Companies Act, 1956 and ruled by the Ministry of Corporative Affairs (MCA). It performs the functions of lending and borrowing of money within its members where it works through its members only. Nidhi Company is also called as a mutual benefit company. Nidhi Company promotes the art of saving and utilisation of funds within its member community.

Table 1: Selected Sectors with specific thresholds for FDI

Sector	FDI Limit	Entry Route & Remarks
Mining Mining and Exploration of metal and non-metal ores including diamond, gold, silver and precious ores but excluding titanium bearing minerals and its ores	100%	Automatic
Mining (Coal & Lignite)	100%	Automatic
Mining Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities	100%	Government
Petroleum & Natural Gas Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products etc.	100%	Automatic
Petroleum & Natural Gas Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs.	49%	Automatic
Defence Manufacturing	100%	Automatic up to 49% Above 49% under Government route in cases resulting in access to modern technology in the country
Broadcasting • Teleports (setting up of up-linking HUBs/Teleports) • Direct to Home (DTH) • Cable Networks (Multi System operators (MSOs) operating at National or State or District level and undertaking upgradation of networks towards digitalization and addressability • Mobile TV • Head end-in-the Sky Broadcasting Service(HITS)	100%	Automatic
Broadcasting Cable Networks (Other MSOs not undertaking up gradation of networks towards digitalization and addressability and Local Cable Operators (LCOs))	100%	Automatic
Broadcasting Content Services • Terrestrial Broadcasting FM (FM Radio) • Up-linking of 'News & Current Affairs' TV Channels	49%	Government
Up-linking of Non-'News & Current Affairs' TV Channels/ Down-linking of TV Channels	100%	Automatic
Print Media • Publishing of newspaper and periodicals dealing with news and current affairs • Publication of Indian editions of foreign magazines dealing with news and current affairs	26%	Government
Publishing/printing of scientific and technical magazines/specialty journals/ periodicals, subject to compliance with the legal framework as applicable and guidelines issued in this regard from time to time by Ministry of Information and Broadcasting.	100%	Government
Publication of facsimile edition of foreign newspapers	100%	Government
Civil Aviation – Airports Green Field Projects & Existing Projects	100%	Automatic
Civil Aviation – Air Transport Services • Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline • Regional Air Transport Service (Foreign Airlines are barred from Investing in Air India)	100%	Automatic up to 49% Above 49% under Government route 100% Automatic for NRIs

Sector	FDI Limit	Entry Route & Remarks
Civil Aviation • Non-Scheduled Air Transport Service • Helicopter services/seaplane services requiring DGCA approval • Ground Handling Services subject to sectoral regulations and security clearance • Maintenance and Repair organizations; flying training institutes; and technical training institutions	100%	Automatic
Construction Development: Townships, Housing, Built-up Infrastructure	100%	Automatic
Industrial Parks (new & existing)	100%	Automatic
Satellites- establishment and operation, subject to the sectoral guidelines of Department of Space/ISRO	100%	Government
Private Security Agencies	74%	Automatic up to 49% Above 49% & up to 74% under Government route
Telecom Services	100%	Automatic up to 49% Above 49% under Government route
E-commerce activities (e-commerce entities would engage only in Business to Business (B2B) e-commerce and not in Business to Consumer (B2C) e-commerce.)	100%	Automatic
Single Brand retail trading Local sourcing norms will be relaxed up to three years and a relaxed sourcing regime for another five years for entities undertaking Single Brand Retail Trading of products having 'state-of-art' and 'cutting edge' technology.	100%	Automatic up to 49% Above 49% under Government route
Multi Brand Retail Trading	51%	Government
Asset Reconstruction Companies	100%	Automatic
Banking- Private Sector	74%	Automatic up to 49% Above 49% & up to 74% under Government route
Banking- Public Sector	20%	Government
Infrastructure Company in the Securities Market	49%	Automatic
Insurance • Insurance Company • Insurance Brokers • Third Party Administrators • Surveyors and Loss Assessors • Other Insurance Intermediaries	49%	Automatic
Pension Sector	49%	Automatic
Power Exchanges	49%	Automatic
Pharmaceuticals (Green Field)	100%	Automatic
Pharmaceuticals (Brown Field)	100%	Automatic up to 74% Above 74% under Government route
Healthcare (Brownfield)	100%	Automatic up to 74% Above 74% under Government route
Food products manufactured or produced in India Trading, including through e-commerce, in respect of food products manufactured or produced in India.	100%	Government

Source: Compiled by Authors[20,21]

Investment through the automatic route has emerged as the most dominant channel of FDI inflows into the country.[22] As Figure 2 shows, a majority of foreign investments (around 51 percent) has been in sectors that allow automatic inflow of FDI.

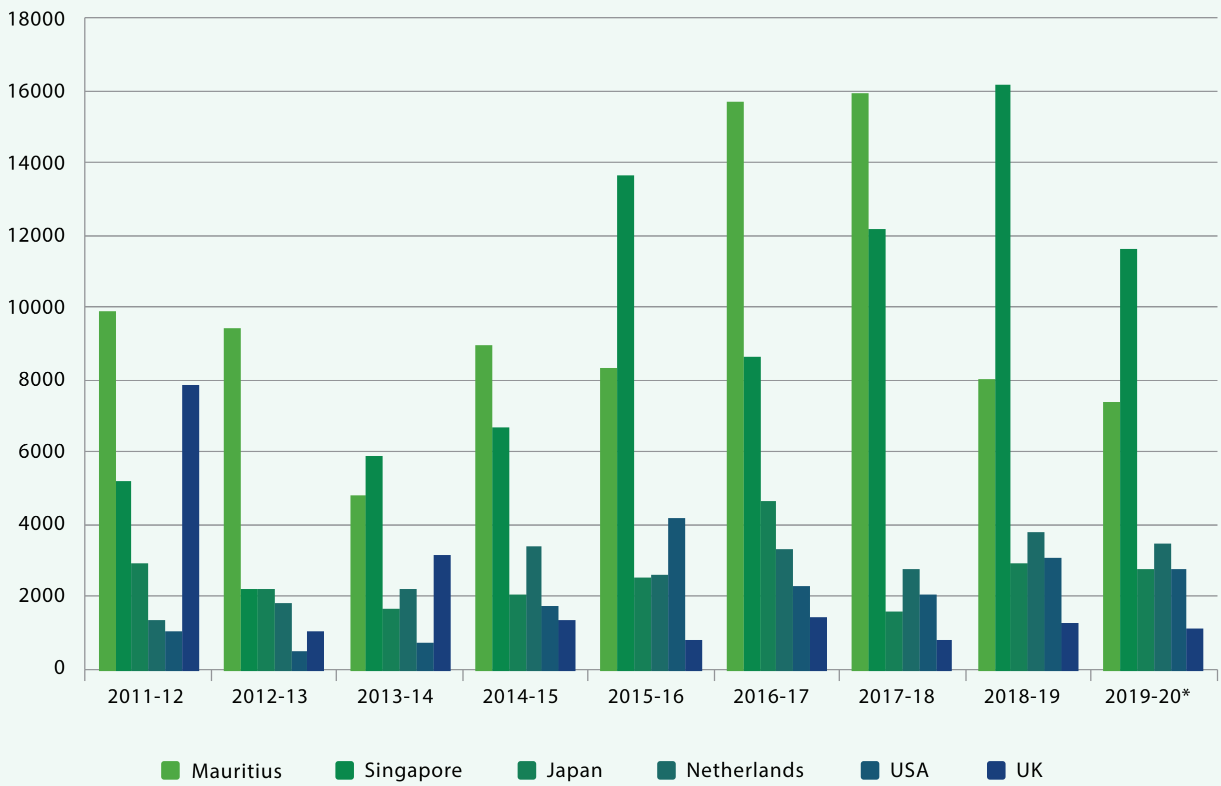
Over the past year, various changes have been made in the country's FDI policy to make India an attractive investment destination: for instance, 100-percent FDI under the automatic route in the coal mining sector was belatedly allowed only for captive consumption, but in 2019 was extended to companies aiming to commercially sell the commodity. Further, investment in contract manufacturing was allowed up to 100 percent under the automatic route, along with easing the local sourcing norms for foreign investors in Single Brand Retail Trading (SBRT) business.[23]

Source Countries: Breaking Myths on FDI numbers

Mauritius, Singapore and Japan—three of the biggest foreign investors in India—together account for almost 60 percent of all FDI that entered India from April 2000.[24] (See Figure 3) These figures, however, might not provide the most accurate representation of bilateral FDI between these countries and India. Often, investment flows through a conduit—countries like Singapore and Mauritius are two such transit points—and the actual investor could be from other countries. As such, when Ultimate Investor Countries (UIC) is taken into account, the share of interregional FDI in developing economies plummets from 47 percent (in 2017) to 28 percent.[25]

Data shows that two-thirds of FDI in India are flowing through third-party countries. This is primarily due to incentives such as Double Taxation Avoidance Agreements (DTAAs) between India and some of these countries—like Mauritius, Singapore, Cyprus and Netherlands.[26] As a result, investors in the US, the UK and even India use these countries as transit points to exploit the DTAAs to avoid taxation in the host country. This is a major incentive that countries have provided to attract investments, and is being practiced by India as well.

Figure 3: Major Investing Countries in India



Source: Authors' own, data from DPIIT[27]

DTAAs are offered by the Union government, and are equally applicable for investments in any of the states or union territories in India. However, the autonomy of the states, the second tier of the federal structure, in attracting foreign investment through the automatic route leads to a secondary level of competition. Not only are countries competing amongst each other for FDI, the states are also competing for the same. Such competitive forces have yielded political gains and economic opportunities in states that have received FDI for a longer duration, and in a uniform manner.

The fact that the best and worst states are ranked according to their achievements across economic, social and environmental parameters, to gauge their respective developmental performance, has led to a competitive spirit that may be a way forward for connecting good governance with good politics. It establishes that the concepts of regional competitiveness are gaining importance equal to national competitiveness especially in terms of the state-wise Ease of Doing Business in India – and this becomes even more important in attracting FDI in the Indian states. In fact, the principles of 'competitive federalism' are being adopted in pursuit of India's development goals. Different states have launched their own campaigns: among them, "Vibrant Gujarat", "Happening Haryana", and "Magnetic Maharashtra."[28] These initiatives began in December 2014, when the Prime Minister's Office issued a set of 98 reform measures based on the 10 business topics monitored by the World Bank's "Doing Business" report.[29] The list was later expanded to 340 points encompassing a Business Reform Action Plan for the states, which formed the basis for the Ease of Doing Business rankings of the Indian states.[30]

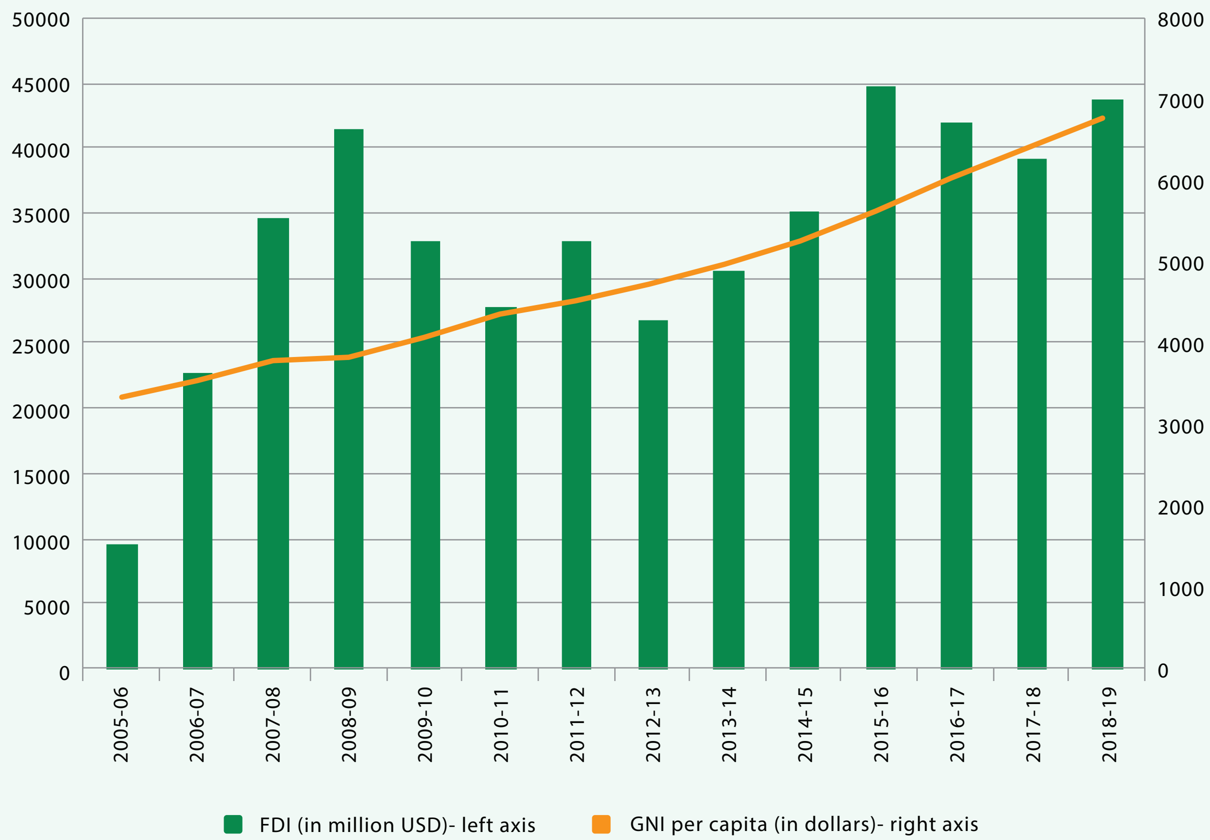
From 'Make in India' to 'Atmanirbhar Bharat'

The Union government's flagship 'Make in India' campaign, launched in 2014, is guided by the principles of competitive federalism. It is aimed at harnessing the potential of India's human, financial, physical, social and natural capital base, and is founded on the premise that by transforming India into a global manufacturing hub, the economy will reap the benefits of FDI inflows. As opposed to foreign institutional investment,[d] FDI is more permanent in nature and provides benefits that accrue to the local economy. The long-term impacts of FDI include transfer of knowledge, managerial skills and capabilities; improved product designs; quality upgrades; channels for international marketing of products; and integration into global production chains.[31]

For a developing country like India, FDI can catalyse economic development, generate employment, and result in technological and knowledge spillovers.[32] Proponents of the endogenous growth theory in economics have emphasised on investments in human capital, as opposed to the early Post-Keynesian and neo-classical literature which focused on technical progress, and savings and investment, respectively, as primary drivers of economic growth.[33,34] Factors that contribute to economic growth such as human capital and R&D are also the key ingredients to attracting FDI.[35] However, growth and welfare implications of FDI may differ across economies, depending on factors such as trade regime,[36] labour cost and host market size,[37] level of education of the workforce,[38] infrastructure, and macroeconomic stability.[39]

[d] Foreign institutional investors (FIIs) are those institutional investors which invest in the assets belonging to a different country other than that where these organisations are based. These investments are made in the secondary market, and are of a shorter duration. They are also likely to enter and withdraw from the market more easily. FDI, on the other hand, is more long-term in nature and the investor invests in a business or firm in the host country. It is relatively more difficult for FDI to be withdrawn from a market.

Figure 4: Trends in India's FDI and Gross National Income (GNI) Per Capita



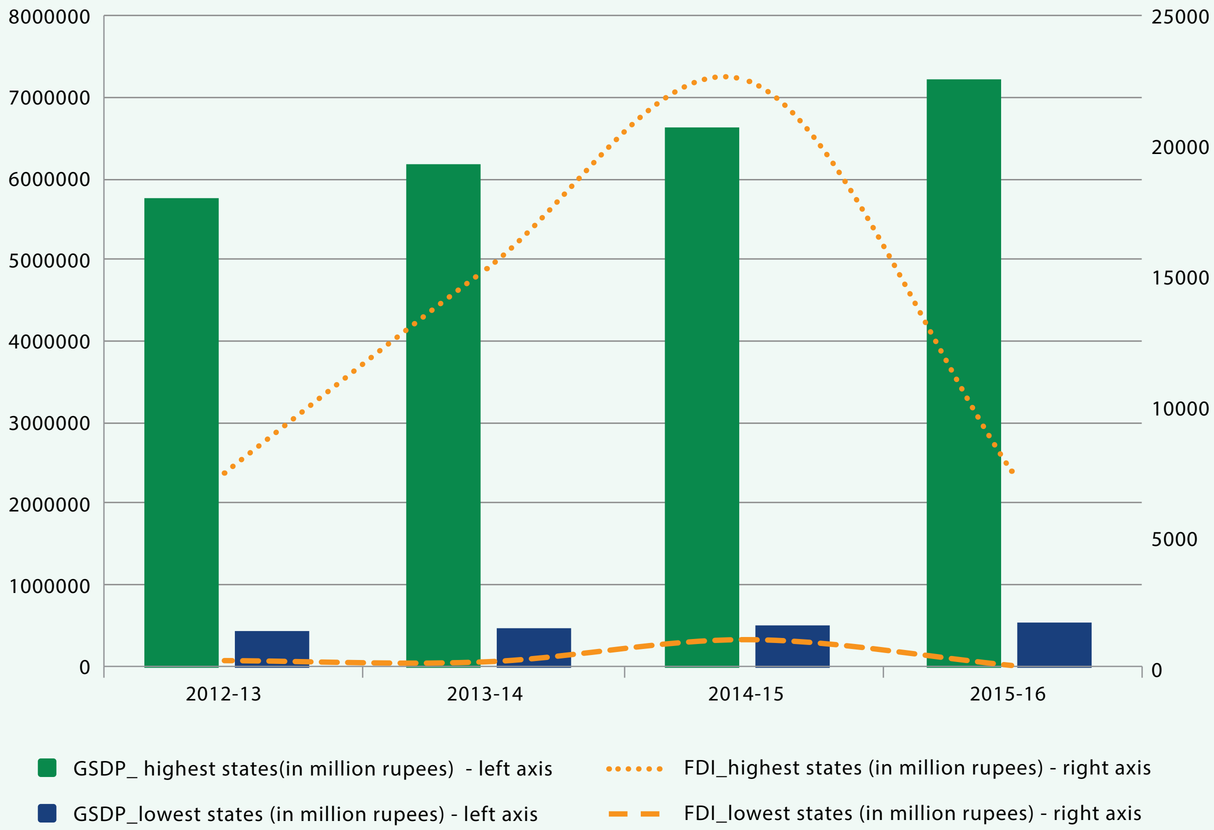
Source: Authors' own, data from Reserve Bank of India (RBI)[40,41]

To be sure, FDI in itself does not automatically translate to human capital. It requires a minimum level of human capital to exist in the host country for FDI to make an impact on capital formation and economic growth.[42,43,44,45] Through the interlinkages between FDI and human capital, the process of technical progress is endogenised into the economic system. R&D, education, training and investments in knowledge creation that accompany FDI flows generate externalities that prevent diminishing returns to scale for labour and physical capital.[46] Subsequently, such spillovers are enjoyed by other sectors of the economy as well. Technology diffusion and productivity growth operate through the backward and forward linkages associated with the establishment of a foreign affiliate of a Multi-National Company (MNC) in the host country. Beyond technological spillovers, inflow of FDI through MNCs also brings productivity gains for the host country's industrial sectors through increased competition.[47] Thereby, through the highly non-linear interaction between human capital formation and technology diffusion, FDI inflows generate economic growth. In turn, higher economic growth creates the basis for FDI inflows in subsequent periods.

This link between FDI and higher economic growth at the national level has been examined in Figure 4. The graph plots the FDI inflow along with per capita gross national income of India. It shows that per capita income has increased over time, along with an increase in the overall level of FDI inflows. However, it will require more in-depth analyses to determine whether per capita income growth is caused by increase in FDI volumes, and vice-versa. To be sure, there is indicative evidence of a positive correlation between FDI and economic growth. As Figure 5 shows, the Gross State Domestic Product (GSDP) of the Indian states is positively correlated to the FDI inflow into those states. Indeed, there is stark contrast between the states with high FDI inflows and those with low or negligible numbers.[48,49]

While GSDP is an indicator of the potential market size of an economy—and can thus be a decisive factor in foreign investment decisions—there are various others, such as the political economy of the country, as well as socio-economic parameters.

Figure 5: Disparities in GSDP and FDI across states in India[50]



Source: Authors' own[51,52]

In India's current scenario, 'Atmanirbhar Bharat' might appear as a deterrent to international trade and foreign investments. Yet, as discussed in this paper, FDI is a catalyst for production and consumption efficiencies in the economy. Therefore, a surge of 'economic nationalism' amidst the pandemic—such as in the form of Atmanirbhar Bharat—will have to be kept in check so that inefficiencies in domestic production are not protected at the cost of domestic consumers, as the former is known to have better bargaining power than the latter.[53]

Competitive Federalism and FDI

III

Competitive federalism has played an important role in attracting greater FDI into the country as liberal economic policies are not the only pull factors of FDI inflow.[54] The efficiency of the political system has a significant influence, too. Research shows that countries which may have similar socio-economic conditions might not necessarily attract similar amounts of FDI inflows due to the differences in their political ecosystems.[55,56] The political dimensions of competitive federalism play an important role in the consolidation of economic reforms. Political affinity between the states, and between the Union government and the states, act as crucial linkages that help moderate conflict across different levels of government. With favourable inter-governmental linkages, regional and state actors are more likely to create a conducive environment to attract foreign investment.[57] Investment flows are also influenced by other factors that determine the costs, risks and barriers to competition in the states.

Following India's structural reforms in the 1990s, the country's regulatory framework was decentralised. Central regulations—the *License Raj*—was abolished, and state-level regulatory mechanisms were championed. States began to enjoy primary authority over the industrial and economic policies of their jurisdictions, including those related to FDI.

Data suggests that certain states have emerged as India's most lucrative destinations for FDI in the years after 1991. A study of 15 states in India over the period 1960-61 to 2006-07 found that although growth performances improved during the post-1991 reforms, the states have diverged in terms of per capita incomes.[58] Five states—Andhra Pradesh, Karnataka, Kerala, Rajasthan and Tamil Nadu—had stable national per capita income levels over the period. Ten states were sub-divided into two groups. The first—consisting of Gujarat, Haryana, Maharashtra, Punjab and West Bengal—have been pulling away from the rest in terms of per capita income. The second sub-group—Assam, Bihar, Madhya Pradesh, Odisha and Uttar Pradesh—have been experiencing per capita income levels below the national level. This divergence was driven by performance in the industrial and services sector in these states, especially after liberalisation.

The same study confirmed the absence of sigma convergence[e] during the period 1960-61 to 2006-07. Beta-convergence[f] is also not observed during the initial pre-reform period. Divergence was recorded following reforms.

[e] The tendency of per-capita incomes across regions to converge over time

[f] Implying that poor states grow at a faster rate than rich states and catch up

As a result, Gujarat, Maharashtra, Karnataka, Andhra Pradesh and Tamil Nadu emerged as FDI hotspots; meanwhile, Bihar, Madhya Pradesh and Uttar Pradesh met with little success.[60] The regional divide has only widened since. This has led to a further divergence between the states across indicators that are influenced by FDI, such as labour productivity and employment generation.

Indeed, the tussle over distribution of power to manage financial resources dates back to policies laid out in the period of British India. Even prior to the Charter Act of 1833, the revenue surplus in the Presidency of Bengal was used to finance the deficit in the Presidencies of Madras and Bombay.[61] This resonates with the contemporary divide between the Southern and Northern states in the context of equitable fiscal measures, on one hand, versus economic convergence on the other. To be sure, India is not alone in experiencing regional divide. In Italy, for example, the Northern and Southern provinces are contrasts, owing to cultural and economic differences: the North has higher standards of living and significantly higher GDP per capita compared to the South.

India's pressing need is to allow greater expenditure flexibility in favour of the states,[62] so that local developmental needs are managed efficiently. India's principles of competitive federalism must be aligned with the objective of harnessing the nation's demographic dividend, the rising middle class, and resource diversity across the states.

The controversies surrounding the 15th Finance Commission[63] were extremely crucial in this regard. In economic theory, the Commission's approach seemed to be strictly at par with "conditional beta convergence"—i.e., poorer regions tend to grow at a faster rate than the richer ones. Based on this theory, the underdeveloped and overpopulated Northern regions would require a higher investment push from the government to attain economic convergence between these states in the long run. This lack of convergence and huge regional disparities has stalled the development process in India. Speculations were rife whether the Commission's Terms of Reference (ToR) would not only result in a 'penalty' to the Southern states for performing well over the decades, but would also mean that the South will be 'subsidising' the North. However, counter arguments[64] suggested that the Northern states would need more support, owing to their past, faulty policies.

The question is whether the lack of government spending in the Southern states can be balanced by the high foreign investment in that region. The trend of high FDI inflows in the Southern states is established by data.[65] FDI inflows are beneficial in terms of market access, improving economies of scale, access to resources, and improvement of labour markets and opportunities. Such regional trends in foreign investment tend to aggravate inequality amongst regions. Therefore, appropriate fiscal measures favouring the Northern states are important to ameliorate dispersions in terms of growth and development.[66]

India should also keep in mind how the regional macroeconomic parameters—such as private investment, market competitiveness, and trade—have been influential over the years. The future has to find a middle point between the economic centre of gravity in the South and the political centre of gravity in the North. In this context, competitive federalism will have to stand the test of time to prove whether it will be able to bridge regional disparities and avoid a situation of "conflictual" federalism that can lead to clashes between states, or between the Union and state governments.[67]

FDI in India: Socio-Economic Factors

IV

While GSDP captures the potential market size of a regional economy, there are other social and economic indicators that reflect the business attractiveness of a region. Analysing the differences across Indian states requires the creation of a composite index to capture the various indicators. Indices provide decision-makers with an integrated overview that would be otherwise difficult, if at all possible.[68,69] Indexation provides an objective mode of measuring performance and monitoring progress,[9] to move from multiple indicators to a single metric.[70] The construction of a multivariate index is based on the theoretical underpinnings of the multi-attribute utility theory. When certain decisions require making informed choices about multiple objectives, it is helpful if the preferences of the decision-maker are represented numerically through utility functions such as indices.[71] In the context of FDI, there are several factors which determine investment patterns across regions. These factors can be aggregated into various indices to compare the relative performance of the Indian states.

Some of the major parameters that have direct and indirect effects on FDI are innovation, health, education, financial inclusion, digitisation, and human development. This section analyses the indices that capture the relative performance of the Indian states in these parameters. By identifying the gap between the states, it is possible to determine the factors that may be responsible for differences in FDI inflows.

In the context of inward FDI, the political stability and institutional environment of a state is crucial, in terms of its ability to operationalise socio-economic reforms, increase the capacity to innovate, as well as translate them into laudable economic performance. Although data[72,73] shows that countries with higher levels of political corruption and instability attract more FDI inflow, such investments are also contingent upon the size of the economy, and it is more relevant for smaller economies. The influence of political stability on FDI inflows tends to diminish in the case of large developed economies.[74] Nonetheless, the sustainability of investments in a politically unstable economy is questionable in the long run.

A 2018 study by the National Council of Applied Economic Research (NCAER) on the investment potential of the Indian states points towards 'Governance and Political Stability' as a pillar in determining the investment attractiveness of a state – Tamil Nadu, Haryana, Punjab, Gujarat and Madhya Pradesh appear as the top five states in this category.[75] The study also points to the World Bank's World Governance Indicators where India is placed in the bottom bracket with respect to the parameters for political stability, and the absence of violence. This makes it imperative for the country to make

[9] The Multi-dimensional Poverty Index and the Human Development Index are two examples of indices used to monitor progress.

conscious efforts to improve its political climate and reorient policies towards strengthening its governance patterns and institutions, so that it could reap the corresponding benefits of social and economic reforms.[76]

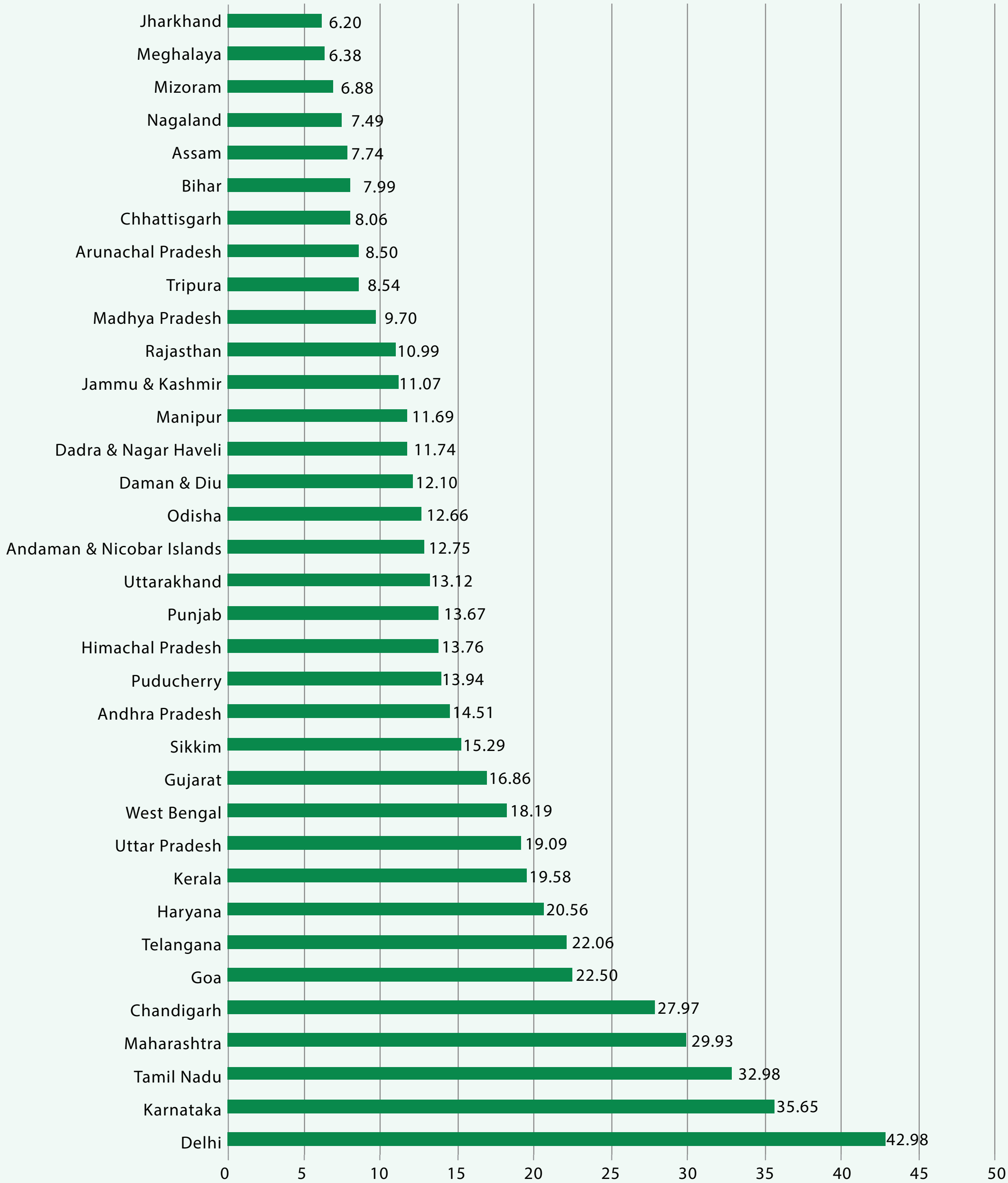
In the same vein, a higher capacity to adopt or innovate newer technologies helps emerging economies such as India, to strengthen their competency and in turn increase inward FDI.[77] It highlights that technology transition is the genesis for the evolution of international investment flows. To study the relation between technological adaptability and FDI flows, the India Innovation Index (2019)[78] and E-Readiness Index (2016)[79] provide valuable insights.

The India Innovation Index (2019) was developed to examine the innovation ecosystem across Indian states and UTs. It was constructed using an input-output approach, on two dimensions—enablers and performance. There are five pillars (23 indicators) corresponding to "enabling" factors: (i) Human capital; (ii) Investment; (iii) Knowledge workers; (iv) Business environment; and (v) Safety and legal environment.

The scores for the "performance" dimension of each state is based on two pillars (10 indicators): (i) Knowledge output and (ii) Knowledge diffusion. The states and UTs have been spatially segregated on the basis of their geographical similarities. A larger index value represents a greater innovative capacity as well as higher ability to perform through effective diffusion of newer technology. The India Innovation Index assesses the strengths and weaknesses of a state on a relative basis, comparing the individual score of a state with the mean score within a peer group, rather than on absolute terms. Although the weights for indicators within each pillar have been assigned using Principal Component Analysis (PCA), equal weights have been assigned for aggregating the various pillars into a single index score. This is a potential limitation of the index, as it attaches equal importance to the various pillars. However, human capital, investment, knowledge workers, business environment, safety and legal environment, knowledge output and knowledge diffusion need not be equally significant in influencing innovation. Assigning weights using PCA, as has been done for indicators under each pillar, would have been a better method of constructing this index. Nonetheless, it serves the purpose of a baseline study to analyse the performance across the states (See Figure 6). The states with the highest scores are Delhi, Karnataka, Tamil Nadu and Maharashtra. At the other end of the spectrum are states like Jharkhand, Meghalaya, Madhya Pradesh, Chhattisgarh and Bihar. As innovation is important in establishing competitiveness, states performing well in the Innovation Index are expected to be more competitive and attractive to businesses than those that lag.

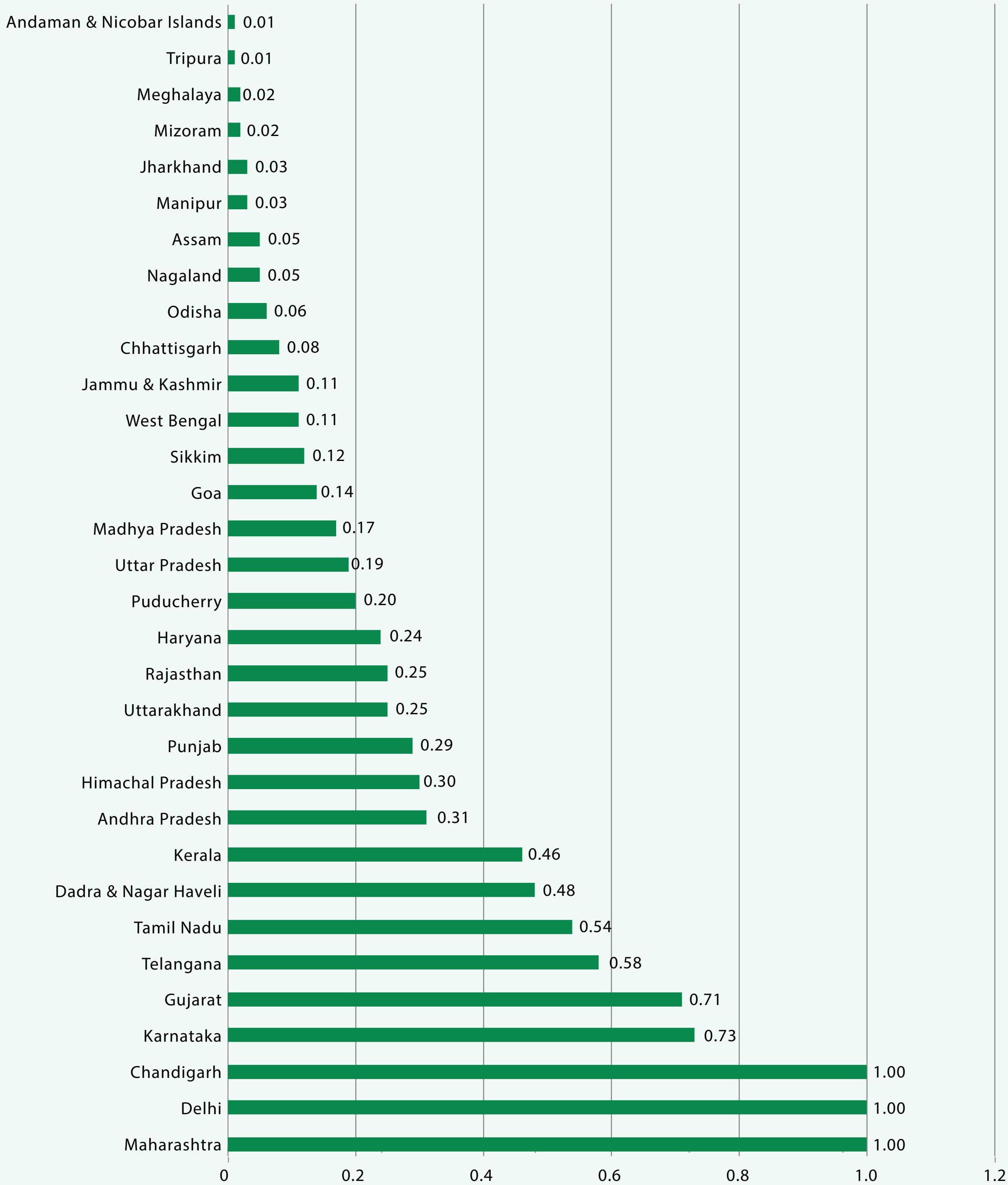
Similarly, penetration and use of electronic services also indicate a state's technological adaptability, ease of doing business, and governance processes. The E-Readiness Index captures indicators across four significant dimensions: e-infrastructure, e-participation, IT services, and e-Governance.[81] The pattern is similar to that of the Innovation Index: Delhi, Maharashtra, Karnataka, Gujarat and Tamil Nadu are among the top ten states that are equipped to adapt to the switch to e-infrastructure and e-governance.

Figure 6: Innovation Index (2019)



Source: NITI Aayog[80]

Figure 7: E-Readiness Index



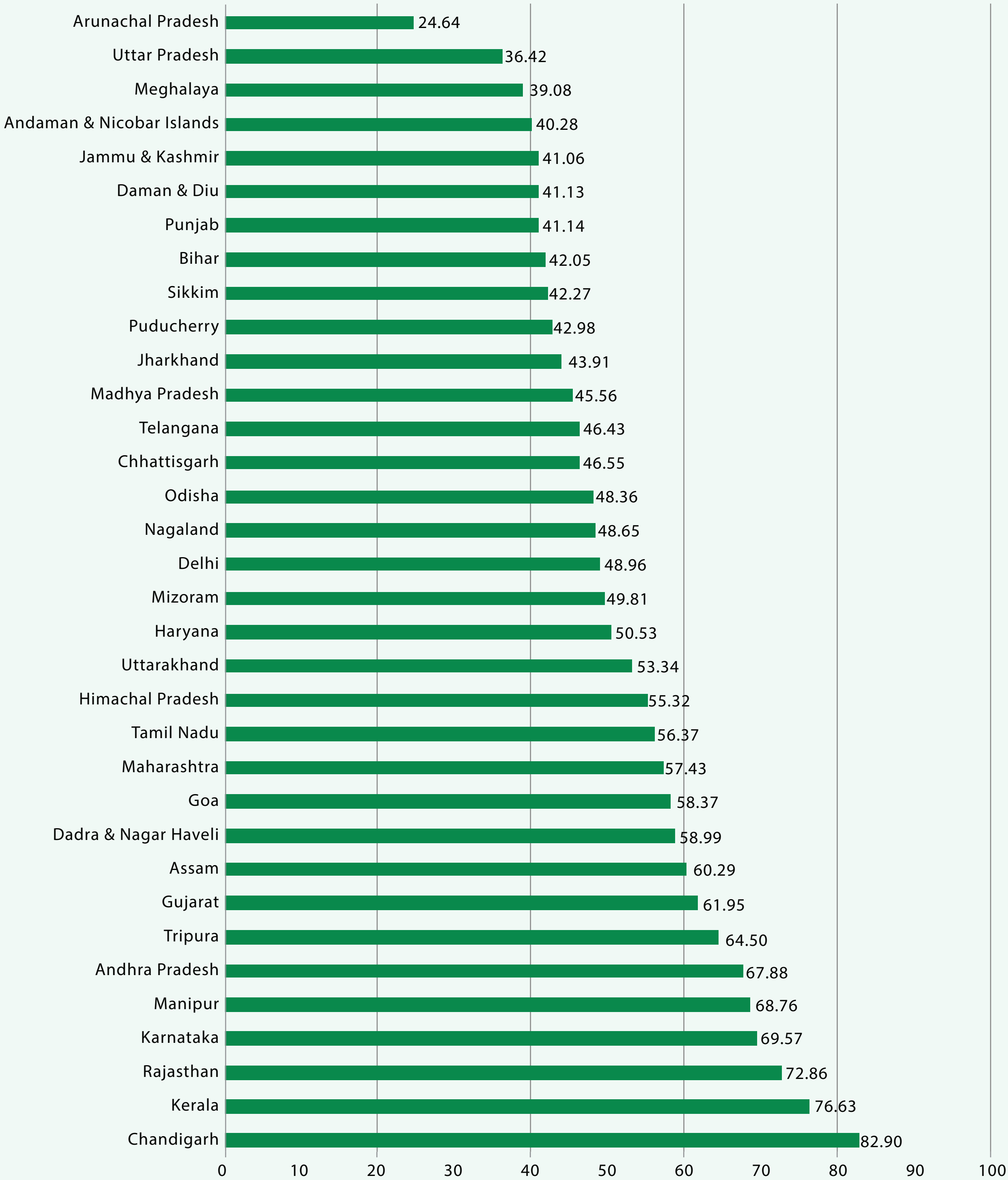
Source: Indicus Analytics[82]

While the previous indices captured the progress of the states in technology and innovation, human development parameters such as education and health are important factors that determine the quality of workforce in a region. Both education and health play a crucial role in attracting FDI by aiding the development of a country's available human capital. Increase in worker productivity as well as efficiency significantly reduce the costs of production and increases prospective profits, thereby creating incentives for investment.[83] As such, these factors increase the locational advantages associated with inward FDI flows. Improving the external efficiency of the education system through increase in secondary or higher education as well as vocational trainings can play a critical role in attracting FDI especially for countries in the low and medium human development range.[84]

The same holds true for regions within a country. Reducing regional gaps in the education system can aid reduction in income inequalities. Health services are equally crucial to worker efficiency and have similar effects on FDI flows. Household and microeconomic studies using anthropometric measures such as nutritional status and indices of morbidity have shown that health is a crucial factor in determining worker productivity.[85,86] Through its impacts in both improving worker productivity and its indirect mechanisms such as improving the returns to education and worker experience, health is extremely important as an enabling factor for FDI inflows. In addition, and especially true in a post-pandemic economy, foreign investors may be wary of investing in areas where access to healthcare is limited and diseases are rampant, for fear of endangering their own health and that of expatriate staff.[87] The following paragraphs examine the performance of India's states in the School Education Quality Index[88] and the Health Index (2016).[89]

The School Quality Education Index is based on a set of indicators that measure the overall effectiveness, quality and efficiency of the school education system across the Indian states and UTs during the reference year 2016-17. The index is calculated based on two categories—outcomes and governance processes aiding those outcomes—with appropriate weights. The outcomes are evaluated on four domains: (i) Learning outcomes (3 indicators); (ii) Access outcomes (3 indicators); (iii) Infrastructure and facilities for outcomes (3 indicators); and (iv) Equity outcomes (7 indicators). The efficiency of governance processes is measured using 14 indicators. Each indicator under the corresponding domains is associated with a particular weight. A drawback of the index is the assignment of weight through consultation with sector experts and states; this makes it biased. A better alternative would have been using statistical measures like PCA to employ weights to indicators within the four sub-domains and in the final aggregation process.

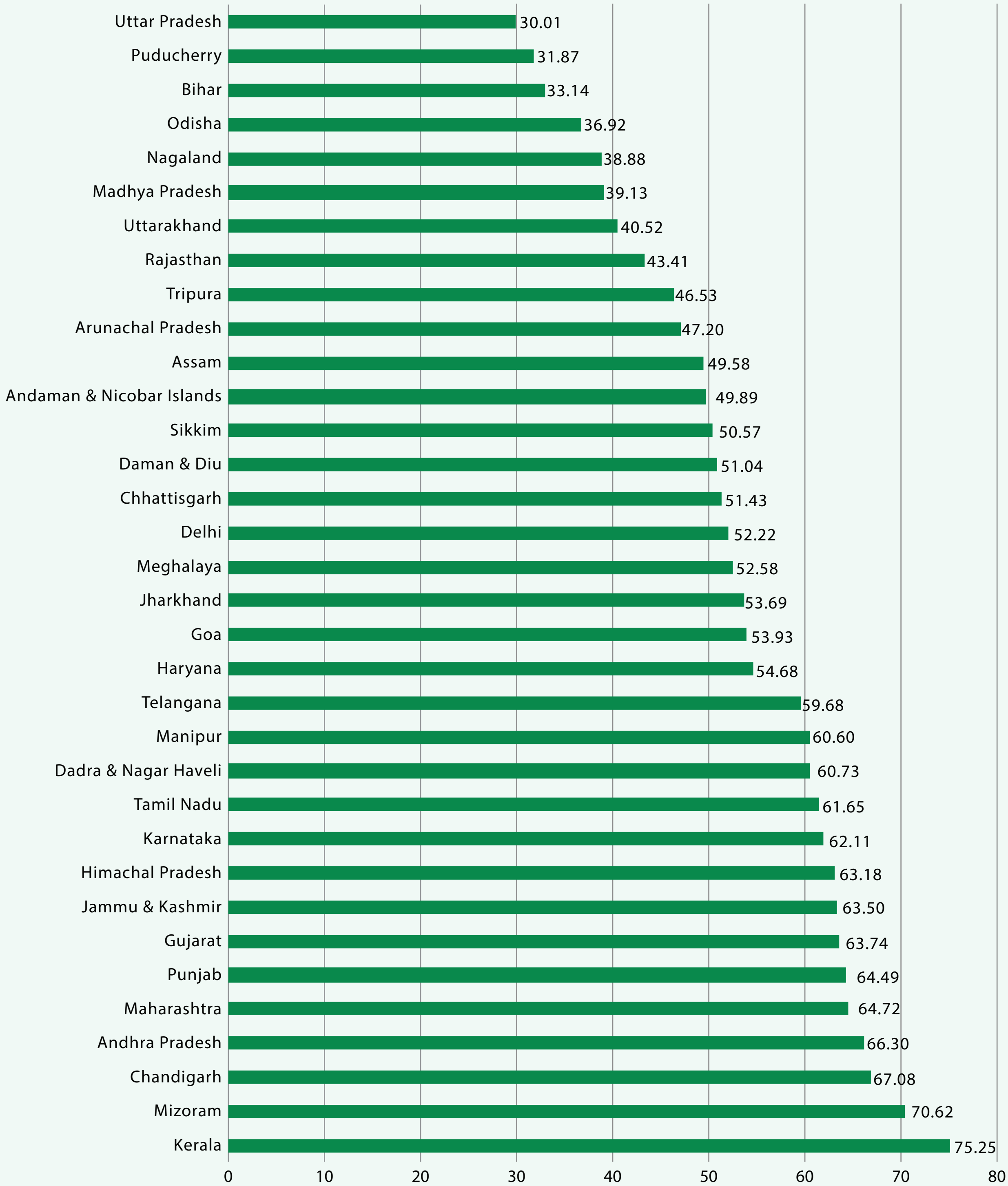
Figure 8: School Education Quality Index (SEQI)



Source: NITI Aayog[90]

The Health Index 2017-18, meanwhile, highlights the performance of the Indian states across health outcomes such as neo-natal mortality rate, proportion of low birth weight among newborns, immunisation coverage; governance and information indicators such as data integrity measured as the percentage deviation of reported data from annual survey, and average occupancy of senior officials at the Union, state and district levels; and health system and delivery indicators. There are huge disparities across India, with most of the better performers in the indices discussed earlier also registering higher values in the health index (See Figure 9). The performance of states like Kerala in both health and education indicators is noteworthy. Improvements in life expectancy by one year increases gross FDI inflows by nine percent, suggesting that health is an integral component of human capital, and thus FDI inflows, into developing economies.[91]

Figure 9: Health Index

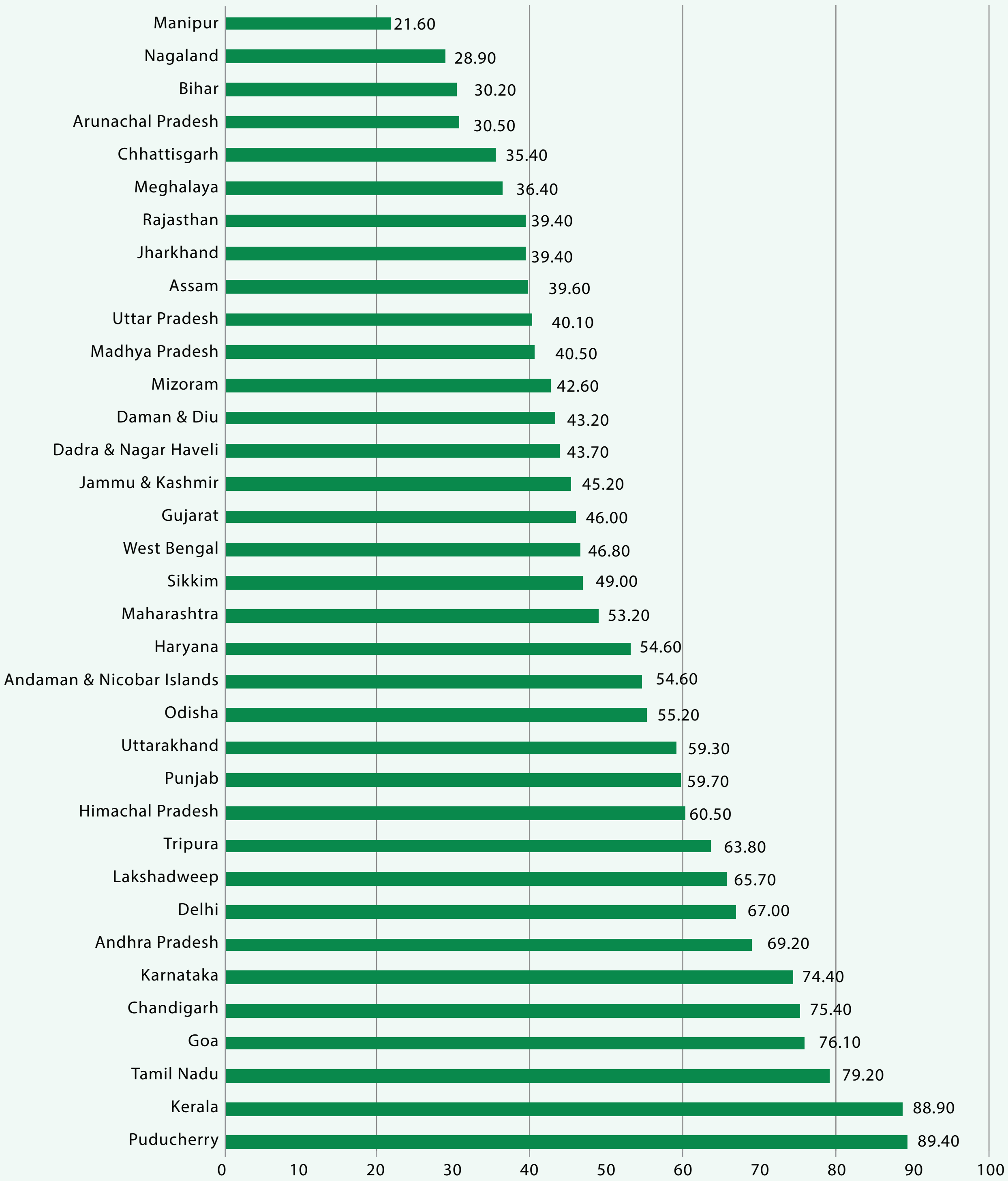


Source: NITI Aayog[92]

Another measure of development is the penetration of formal financial institutions. Financial inclusion not only entails ease of access to financial services but also reduction in associated costs, greater securitisation, and improved dissemination of information regarding financial markets. These increase the efficiency of financial markets in attracting capital inflows. All these factors increase business incentives which are generally associated with larger inward FDI in a globalised economy. There is a strong correlation between positive shocks to financial inclusion and foreign capital inflows, both in the short and long terms.[93] Besides development of financial markets, financial inclusion also serves to stabilise the macroeconomic environment, thereby creating incentives for foreign capital inflow. The progress of Indian states in financial inclusion has been captured by the CRISIL Inclusix index.

CRISIL Inclusix is a relative index that comprehensively measures financial inclusion by incorporating various forms of basic financial services into a single metric based on three critical dimensions: branch penetration, credit penetration, and deposit penetration. The input parameters focus on the widening of financial services, i.e., its outreach, and not the relative deepening of the financial sector. This is because looking at the value or amount can lead to erroneous conclusions as it can be influenced disproportionately by a few large-value transactions that do not necessarily reflect the extent of financial inclusion. States like Karnataka, Andhra Pradesh, Delhi and Tamil Nadu have scores greater than 60 in the financial inclusion index. (See Figure 10)

Figure 10: Financial Inclusion Index (Inclusix)



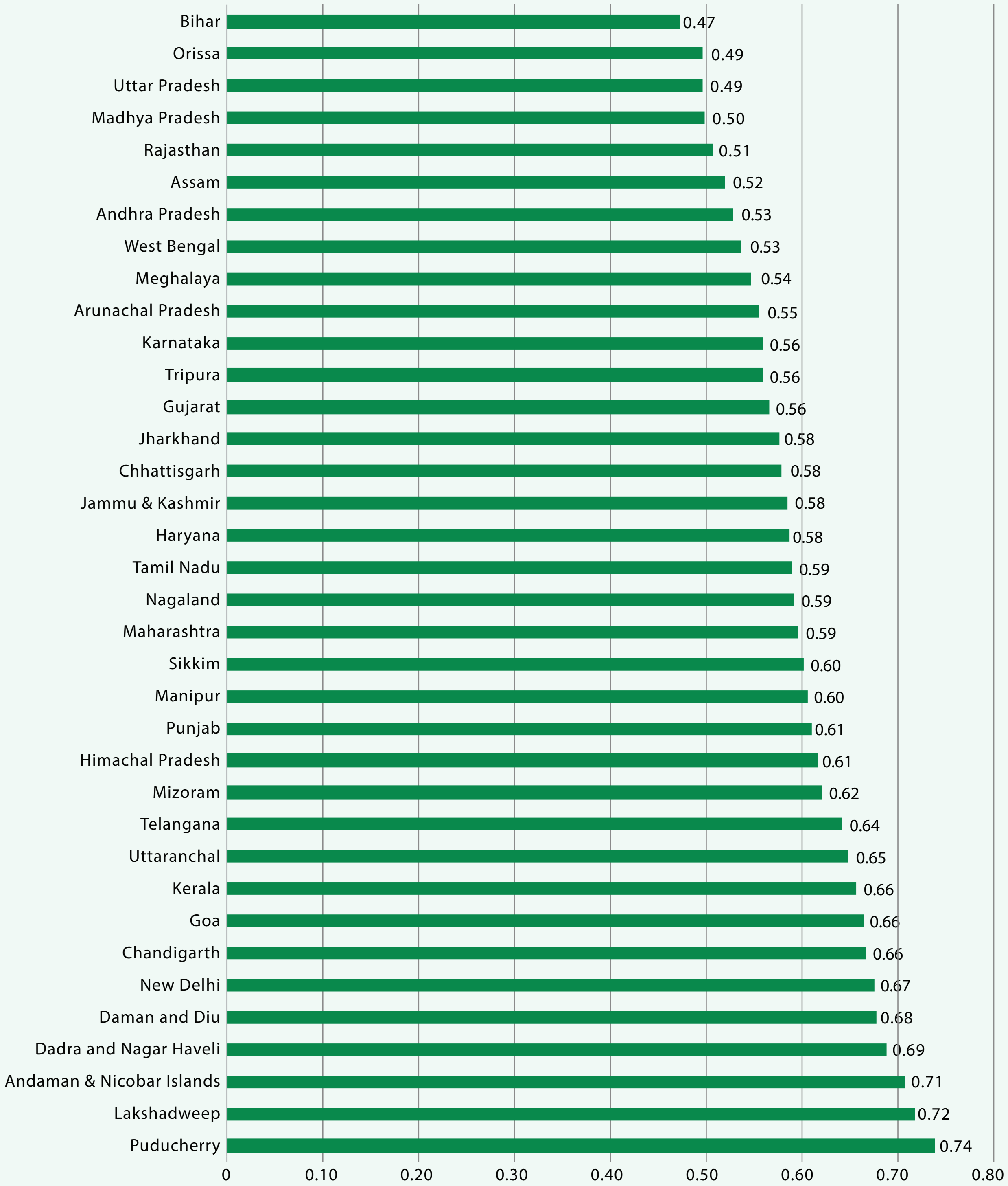
Source: CRISIL[95]

Economic development—reflected in parameters like infrastructure, capacity building, and financial inclusion–and human development (higher literacy rate, better nutrition and health) help increase the efficiency and productivity of human capital. Together, economic and human development contribute to the creation of enabling conditions for a conducive business environment. Regional gaps in the level of development give rise to location advantages directing FDI flows. Therefore, levels of human development as well as economic development achieved across the Indian states and UTs are critical factors in the study of inward FDI flows. The education, health, innovation, financial inclusion indices can only provide a partial analysis of the various developmental stages of an economy. A more holistic measure is provided by the Human Development Index (HDI). Following the methodology of the official United Nations Development Programme (UNDP) HDI developed initially by Amartya Sen, MahbubulHaq, Gustav Ranis and Meghnad Desai, the sub-national human development index depicts state-wise performance.[96]

The index comprises three dimensions: education, health, and standard of living, for the years 1990-2018. The indicator used for the corresponding dimensions are mean years of schooling for adults aged 25 years and above, expected years of schooling, life expectancy at birth, and (log of) gross national per capita income (measured at PPP, 2011 US$)—the same as those used for the HDIs. The data collected is used to compute the sub-national variation which is applied to the national values for the corresponding years using a multiplicative scaling coefficient that inflates/deflates the sub-national estimates so that their population-weighted averages coincide with the corresponding national value.

The indices show that states like Maharashtra, Gujarat, Karnataka, Andhra Pradesh and Delhi—which perform well in terms of FDI inflows as discussed in Section 8—register strong performance values in most of the indices. However, states such as Goa, Kerala, Rajasthan and Mizoram out-perform them in some of the development indicators. This highlights that FDI inflows are also explained by factors that are not entirely captured by these indicators. In addition to certain limitations posed by non-availability of data, the indices also suffer from subjectivity in the assignment of weights. Except for the India Innovation Index (and only partially), none of the other indices have employed statistical techniques to determine weights. Therefore, understanding the factors responsible for attracting FDI inflows requires indices that capture a larger set of information, in a more statistically robust manner.

Figure 11: Human Development Index[97]



Source: Global Data Lab[98]

The Sustainability Dimension

V

The Sustainable Development Goals (SDGs)

The previous sections have sought to explain the importance of FDI for developing economies like India, and described the various development indicators that influence the attractiveness of a region for business. Multi-National Enterprises (MNEs) are motivated in their overseas expansion by four broad drivers: natural resources, markets, efficiency, and strategic assets.[99] India is well-endowed with natural resources such as minerals and forests. It has a large population, and its emerging economy presents a great market opportunity for investors.

Identifying the different categories of FDI facilitates a better understanding of the factors that determine such investment decisions. Some of the major determinants of FDI are market size and growth potential, institutional and regulatory quality, trade openness, infrastructure quality, economic and political stability, labour quality and costs, and cultural linkages. Moreover, intangible assets (e.g., brand name, protection of patent, and managerial skills) also serve as motivating factors, as do lesser cost of capital, superior management, better advertising, promotion and distribution network, access to raw materials, economies of scale, efficient transportation infrastructure, and substantial R&D investment in the host country.[100,101,102,103]

The Sustainable Development Goals (SDGs) can throw light on the enabling conditions of foreign investment. When compared to the aforementioned traditional factors, the indicators enshrined in the SDGs are more holistically designed in explaining the relative Ease of Doing Business (EDB) conditions in India's states (See Figure 12). Ghosh, Bhowmick and Saha (2019)[104] have constructed a comprehensive index of SDGs for 23 Indian states using 51 crucial indicators. This index is an improvement over the NITI Aayog on two counts: indicators that capture the performance of India's states on climate action have been included; and the index has been computed using PCA to assign weights to the sub-indicators under each goal, and also weights to each of the 14 SDGs to arrive at the final state-wise composite SDG index.

Empirically, higher volumes of FDI flow into the states that perform better on this SDG index (Appendix 1).[105] The relationship is expressed in equation (1).

$$\ln FDI_j = 10.923 + 1.94 \ln SI_j \ldots\ldots\ldots\ldots\ldots\ldots \quad (1)$$

$$(0.00) \qquad (0.00)$$

$$n = 22;\ R^2 = 0.616;\ adj\ R^2 = 0.59$$

$$\text{Prob} > F = 0.00$$

where, SI_j and FDI_j refer to the SDG index score and per capita FDI values for 2016-17 for state 'j'; the figures in parentheses represent the p-values associated with the coefficients.

Equation (1) suggests that the SDG index has a statistically significant (at 1% level) and positive impact on per capita FDI. This is primarily because better performance in the SDG indicators translate into enablers for business activities (Appendix 1, Table A1.1). As they encompass a broad range of developmental goals—including the alleviation of poverty, industrial growth and innovation, gender equality, biodiversity, social justice, and climate action—the SDGs capture crucial elements of the five types of capital that are the pillars of an economic system.

Figure 12: The Ease of Doing Business and SDG matrix[106,107]

		SDG CLASSIFICATION					
		Embryonic Stage	**Waking from Slumber**	**Evolving Stage**	**Progressive Systems**	**Advanced Stage**	**Top Performer**
EDB CLASSES	**Stage 1**	Uttar Pradesh, Assam					
	Stage 2	Bihar, Jharkhand			Haryana, Uttarakhand		
	Stage 3		Odisha, Chhatisgarh	West Bengal	Punjab		Kerala
	Stage 4		Madhya Pradesh	45- degree line	Karnataka	Himachal Pradesh, Telengana	Tamil Nadu
	Stage 5				Andhra Pradesh		Goa
	Stage 6				Maharashtra, Gujarat		Delhi

Source: Ghosh, Bhowmick and Saha (2019)[108]

This introduces a novel way of understanding the role of capital in economic development. It is not only human capital or physical capital alone that will help an economy leap onto higher trajectories of development. Social capital and natural capital, too, are important as they ensure the sustainability and viability of physical and human capital. Together, these four types of capital create adequate opportunities for the inflow of financial capital in the form of foreign direct investments. Through their impacts in decreasing long-term risks, improving governance processes, creating business opportunities, and enhancing overall competitiveness, the four types of capital encapsulated in the SDGs create the necessary enabling conditions for FDI inflows. The following equation represents the relationship between Ease of Doing Business and SDGs.

$$\ln EDB_j = -\,0.084 + 0.801 \ln SI_j \quad \text{..............} \quad (2)$$
$$(0.696) \quad (0.005)$$
$$n = 20;\ R^2 = 0.616;\ adj\ R^2 = 0.597$$
$$\text{Prob} > F = 0.00$$

where, EDB_j refers to the Ease of Doing Business 2016 score of state 'j'; the figures in parentheses represent the p-values associated with the coefficients.

In equation (2), it is estimated that the SDG index positively contributes to ease of doing business, as given by the positive sign of the slope coefficient (0.801).

The SDG-Ease of Doing Business Index matrix (See Figure 12) depicts the relationship between the performance of the states on these parameters. A clusterisation of states is observed along the 45-degree line. Uttar Pradesh and Assam are some of the worst performing states, while Delhi is the top state in both SDGs and Ease of Doing Business. A positive association between improvements in SDGs and Ease of Doing Business parameters is also explained by the interlinkages of the various SDGs. SDGs 8 and 9—which capture most elements of physical capital, output markets and innovation—have high interlinkages with SDGs 1-5 which encompass demographic parameters that improve labour market conditions.[110]

Michael Porter's diamond model of competitiveness reiterates this philosophy, albeit using a different lexicon. A nation's competitive advantage is explained by a complex network of interactions between the factor market and demand (output) market conditions, agglomeration effects of related and supporting industries, and institutional frameworks to guide firm strategy, structure and rivalry.[111]

Ease of Doing Business

How does India fare in terms of these enabling conditions? The various Ease of Doing Business rankings reflect India's attractiveness as an investment destination. As highlighted earlier, the SDGs encompass various outcome and process indicators that capture the overall socio-economic and ecological progress of a nation or region. Improvements in health, education, social justice, governance, infrastructure development, access to clean energy and affordable housing enhance the input market conditions necessary for investment. Better employment opportunities and reduced inequalities in income generate positive demand pull, which in turn attract market-seeking investments. Clearly, EoDB and attractiveness to business will improve as a consequence of socio-economic development under the ambit of the SDGs. Consequently, improvements in doing business parameters will provide investors with a positive signal regarding the potential of the region in generating high returns to their investments, thereby leading to more FDI inflows.

The World Bank (WB) and the Asia Competitiveness Institute (ACI) have both created EoDB indices. While India's ranking in the WB index has increased from 142 in 2014 to 63 in 2019, the performance of the sub-national economies is not captured in this measurement. A sub-national picture can provide a more holistic understanding of the states' friendliness to business.[112]

The ACI sub-national index provides rankings of Indian states in terms of indicators of the parameters discussed earlier (see Appendix 2). It is observed[113] that in the three-year period 2016-18, the composition of the top five states have remained the same: Maharashtra, Delhi, Gujarat, Karnataka and Andhra Pradesh. In congruency with earlier findings on FDI and GSDP, the states of Bihar, Madhya Pradesh and Uttar Pradesh have been the worst performing states according to ACI rankings. The ACI EoDB rankings for 2016 has a strong influence on India's FDI values for 2016-17 (see Appendix 1, Table A1.3). This is represented in the following equation.

$$\ln FDI_j = 12.98 + 6.32 \ln EDB_j \;\ldots\ldots\ldots\ldots\ldots\; (3)$$
$$(0.00) \qquad (0.00)$$
$$n = 20;\ \mathrm{R}^2 = 0.56;\ adj\ R^2 = 0.54;$$

The WB, too, has estimated an index on the performance of the Indian states. However, the rankings are based on a survey conducted in key cities in these states as a proxy,[114] and therefore may misrepresent the actual scenario. The ACI index is an improvement over this, and thus a more reliable source of information. The index is computed on the basis of three broad categories: attractiveness to businesses (A); business friendliness (B); and competitiveness policies (C).[115]

It can be argued that there is a positive association between improvements in either the regional competitiveness, or the attractiveness to business parameters, with the achievement of sustainability parameters highlighted in the SDGs. This helps in creating enabling conditions for FDI inflows which are long-term in nature and more holistic than economic indicators alone.

Analytical Framework

VI

FDI and Capital Formation

According to National Income theory, total savings is identical to the total investment in an economy. When this identity is extended to open economy macroeconomics with capital account transactions, it reveals the relationship between domestic private savings, government savings, and foreign savings with domestic investment. The following equations explain the relationship.

$$Y \equiv C + I + (G - T) + CA\ (= X - M) \ldots\ldots\ldots\ldots (4)$$

$$(S - I) + (T - G) \equiv CA \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (5)$$

where,

$$CA = \Delta NFA \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (6)$$

Therefore,

$$S + (T - G) - CA \equiv I \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (7)$$

Here, S represents private savings which is equivalent to the difference between national income (Y) and domestic private consumption (C). $(T - G)$ represents Taxes and Government Expenditure (or government savings). ΔNFA is the aggregate net acquisition of foreign assets which is also defined as the sum of acquisition of foreign assets by domestic citizens (capital accounts) and acquisition of foreign assets by the central bank (also called accommodating capital account transactions). ΔNFA is equal in magnitude to the Current Account (CA). In other words, a CA deficit (surplus) is accompanied by a net inflow (outflow) of foreign assets. Inflow of foreign assets is a proxy for foreign savings. Therefore, equation (7) represents the link between private domestic savings, government savings, foreign savings, and domestic investment.[117] FDI inflows are recorded as part of the capital account in the Balance of Payments and is reflected in the aggregate net acquisition of foreign assets component in equation (7). FDI inflows are thus expected to increase domestic investment (I).

To be sure, there are instances where FDI inflows can lead to a decrease in domestic investments, or crowding-out effects. Crowding-in can happen if FDI stimulates backward or forward production linkages in the host country especially through demand for intermediate inputs, and positive spillovers of FDI such as technology transfer.[118] A study of the FDI inflows into five South Asian countries during the period 1965-1996, found complementarity between FDI and domestic investment.[119] A similar pattern was seen in an examination of FDI inflows into Malaysia from 1960 to 2003.[120] However, the impact of FDI can be different in developing countries and less developed ones, and over time as well. An explanation, especially for developing regions such as Asia and Africa, rests on the experience that FDI inflows enhance domestic investment through beneficiary effects, i.e., more advanced production technology, improved organisational and managerial skills, marketing know-how, and market access. The consequent improvement in competition, technology, and institutions, encourage domestic entrepreneurship.

A multi-country analysis of the impacts of FDI on domestic investments between 1970 and 2004 suggests that the impacts of FDI in India and several other less developed and developing nations is either the crowding-out of domestic investment, or have no impact at all. On the other hand, a lagged effect of FDI is to increase domestic investment, especially in the LDCs and developing nations. This is primarily because domestic firms are unable to compete with the foreign firms immediately, resulting in crowding out. Over time, as different types of production linkages are generated, domestic investments increase in upstream and downstream industries. As MNCs hire and train local workers, domestic labour productivity increases, encouraging more domestic firms to enter the market.[121] Thus, it can be assumed that FDI inflows this year is likely to boost domestic investment in the next year.

This increase in domestic investment is captured by Gross Capital Formation of the next year. As FDI inflows positively influence domestic investment in subsequent years, this analysis uses the ratios of Gross Fixed Capital Formation (GFCF) to disaggregate the data on FDI in India at the regional office level. It is assumed that when FDI flows into a particular regional office, the nature in which it flows into its constituent states can be estimated from the GFCF in those states during the following year.

A more specific study of FDI inflows into India during the period 1996-2009 examined whether there is any long-run cointegrated relationship between FDI, Gross Fixed Capital Formation, and GDP in the Indian context, in particular, by considering the possible presence of multiple structural breaks. It also analysed the direction of causality between the three data series—FDI and economic growth, GFCF and economic growth, and FDI and GFCF (in both directions), which is instrumental for bringing out the present growth trajectory and future policy implications. The empirical analysis suggests that there is a unidirectional causality from India's domestic GDP to FDI at 10 percent level and from FDI to domestic investment, measured by GFCF at 5 percent. In other words, India's GDP have a far greater impact in attracting FDI inflows, which in turn gives a boost to domestic investment. Stated alternatively, FDI in India plays a complementary role in the country's domestic investment scenario.[122]

Another study of a heterogenous panel of 30 countries adopted panel integration and cointegration methods to examine the long-run relationship between FDI and domestic investment across America, Europe, Africa and Asia. For all variables and for all countries, both panel bivariate and multivariate cointegration tests provide evidence of the existence of cointegration between the involved series. Though the results are mixed, countries in Asia and Africa are observed to experience crowding in impacts due to FDI inflows. This implies that FDI inflows boost domestic investment.[123]

These findings are consistent with the complementarity hypothesis between FDI and domestic investment.[124,125,126] However, the contrasting evidence of FDI resulting in the crowding out of domestic investment, especially among the developed countries in North America and Europe, are due to the entry of FDI in sectors where domestic firms already exist, resulting in strong mergers and acquisitions.[127,128]

This trend was also observed in a study analysing FDI flows in Canada by Hezaji and Pauly (2003) over the period 1970-1998.[129] The objective of the study was to test the prior notion that outward FDI reduces domestic GCF while inward FDI increases GCF. While the latter holds true, they have shown that the results are more heterogenous when it comes to outward FDI and depends to a large extent upon the investment partner. Such positive spillovers of FDI into Gross Fixed Capital Formation have been found in various other economic literature as well.[130,131] Following the patterns observed across several empirical studies, this present analysis uses the GFCF in these states as an estimate of the share of FDI flowing into these states.[132]

State-wise FDI Decomposition

Since the data for FDI at the state level has been made available only recently (for the period October 2019 to March 2020),[133] the focus of this paper is on decomposing the data at the regional office level to its constituent states between 2005-06 to 2018-19. Regional data on FDI inflows can be disaggregated into individual states by estimating the share in which FDI is expected to flow. For example, the Kolkata office of the RBI caters to West Bengal, Sikkim and the Andaman and Nicobar Islands, while the Guwahati office in Assam covers the northeastern states. A key outcome of FDI inflows is domestic investment. Despite the fact that FDI is a relatively small share of Gross Fixed Capital Formation in India, Gross Fixed Capital Formation (GFCF) is the best available metric of estimating state-wise FDI in India.

Higher GCF in a particular period can be an outcome of higher FDI inflows in the previous period into the corresponding state. Intuitively, FDI at regional office 'j' in time period 't' can be decomposed into the FDI flowing to the states under the jurisdiction of 'j' by using the GFCF of the states in the following year 't+1'.

We decompose FDI based on the following formula:

$$FDI_{it} = w_{it} \cdot FDI_{RO_j} \quad \text{.......(1)}$$

And,

$$w_{it} = \frac{GCF_i^{t+1}}{GCF_{ROj}^{t+1}} \quad \text{.......(2)}$$

Where,

- GCF_i^{t+1} is the Gross Capital Formation of state 'i' in year 't+1'; and GCF_{ROj}^{t+1} is the sum of the gross capital formation of all states that are included in regional office 'j' (RO_j) for year 't+1'.
- w_{it} is the weight attached to a particular state based on its GCF in comparison to the total GCF of all states falling under the jurisdiction of the same Regional office.
- FDI_{RO_j} is the total FDI registered in regional office 'j' in time period 't.'

Following this methodology, we decompose FDI in RO_j for year 't' into FDI of state 'i' for year 't', i.e., FDI_{it}. The weights in which the aggregate figures are decomposed is defined by (2) (see Appendix 4).

FDI: How Fare the Indian States?

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Table 2: Decomposition of FDI, By State (normalised annual values ranging from 0-1)

STATES	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Gujarat	0.146	0.119	0.191	0.264	0.084	0.134	0.120	0.086	0.138	0.223	0.176	0.180	0.164	0.166
Karnataka	0.398	0.228	0.172	0.190	0.105	0.250	0.183	0.179	0.299	0.503	0.322	0.114	0.675	0.618
Chhattisgarh	0.004	0.004	0.003	0.002	0.002	0.039	0.007	0.014	0.010	0.007	0.003	0.002	0.001	0.002
Madhya Pradesh	0.005	0.005	0.002	0.002	0.003	0.046	0.008	0.025	0.008	0.008	0.003	0.002	0.001	0.001
Odisha	0.069	0.004	0.001	0.001	0.015	0.003	0.003	0.009	0.008	0.001	0.000	0.001	0.005	0.006
Chandigarh	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.004	0.000	0.000	0.000	0.000	0.000	0.000
Haryana	0.042	0.003	0.003	0.000	0.010	0.034	0.010	0.001	0.009	0.003	0.002	0.000	0.006	0.042
Himachal Pradesh	0.009	0.001	0.001	0.000	0.004	0.013	0.002	0.003	0.001	0.000	0.000	0.000	0.001	0.006
Punjab	0.032	0.002	0.001	0.000	0.008	0.029	0.003	0.000	0.004	0.002	0.000	0.000	0.001	0.009
Puducherry	0.008	0.010	0.003	0.003	0.001	0.249	0.003	0.481	0.010	0.009	0.005	0.002	0.004	0.004
Tamil Nadu	0.253	0.409	0.057	0.158	0.078	0.000	0.166	0.000	0.320	0.544	0.352	0.117	0.269	0.235
Manipur	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Meghalaya	0.000	0.000	0.000	0.001	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Tripura	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Nagaland	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Assam	0.000	0.000	0.000	0.003	0.001	0.001	0.000	0.000	0.000	0.001	0.001	0.000	0.001	0.001
Telangana	0.000	0.000	0.000	0.000	0.000	0.000	0.043	0.120	0.036	0.096	0.041	0.039	0.032	0.104

STATES	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Andhra Pradesh	0.232	0.191	0.105	0.112	0.124	0.234	0.059	0.083	0.069	0.101	0.083	0.079	0.066	0.210
Rajasthan	0.001	0.016	0.004	0.034	0.003	0.009	0.004	0.023	0.006	0.077	0.004	0.009	0.009	0.034
Jammu and Kashmir	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.001	0.000	0.000	0.000	0.000
Uttarakhand	0.000	0.001	0.000	0.000	0.002	0.008	0.003	0.004	0.001	0.005	0.002	0.000	0.002	0.001
Uttar Pradesh	0.000	0.003	0.000	0.000	0.003	0.013	0.013	0.002	0.003	0.011	0.005	0.000	0.005	0.002
Kerala	0.013	0.004	0.004	0.007	0.013	0.007	0.057	0.013	0.011	0.034	0.007	0.024	0.016	0.024
Sikkim	0.000	0.000	0.000	0.001	0.000	0.000	0.001	0.000	0.001	0.001	0.009	0.000	0.002	0.013
Andaman & Nicobar Islands	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.010	0.000	0.000	0.000	0.000	0.000	0.000
West Bengal	0.089	0.019	0.047	0.043	0.011	0.017	0.045	0.064	0.069	0.034	0.066	0.002	0.015	0.099
Maharashtra	0.835	1.000	1.000	1.000	0.745	1.000	1.000	1.000	0.499	0.836	0.715	1.000	1.000	1.000
Dadra & Nagar haveli	0.057	0.074	0.084	0.141	0.076	0.098	0.100	0.208	0.028	0.044	0.000	0.000	0.000	0.000
Daman and Diu	0.048	0.076	0.015	0.043	0.031	0.029	0.028	0.322	0.013	0.042	0.038	0.053	0.053	0.053
Delhi	1.000	0.787	0.364	0.165	1.000	0.496	0.945	0.565	1.000	1.000	1.000	0.315	0.603	0.927
Goa	0.007	0.025	0.005	0.003	0.017	0.056	0.005	0.002	0.003	0.005	0.001	0.004	0.003	0.001
Bihar	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.001	0.000	0.000	0.001	0.000	0.000	0.000
Jharkhand	0.000	0.000	0.000	0.000	0.000	0.001	0.003	0.000	0.000	0.001	0.002	0.000	0.001	0.000

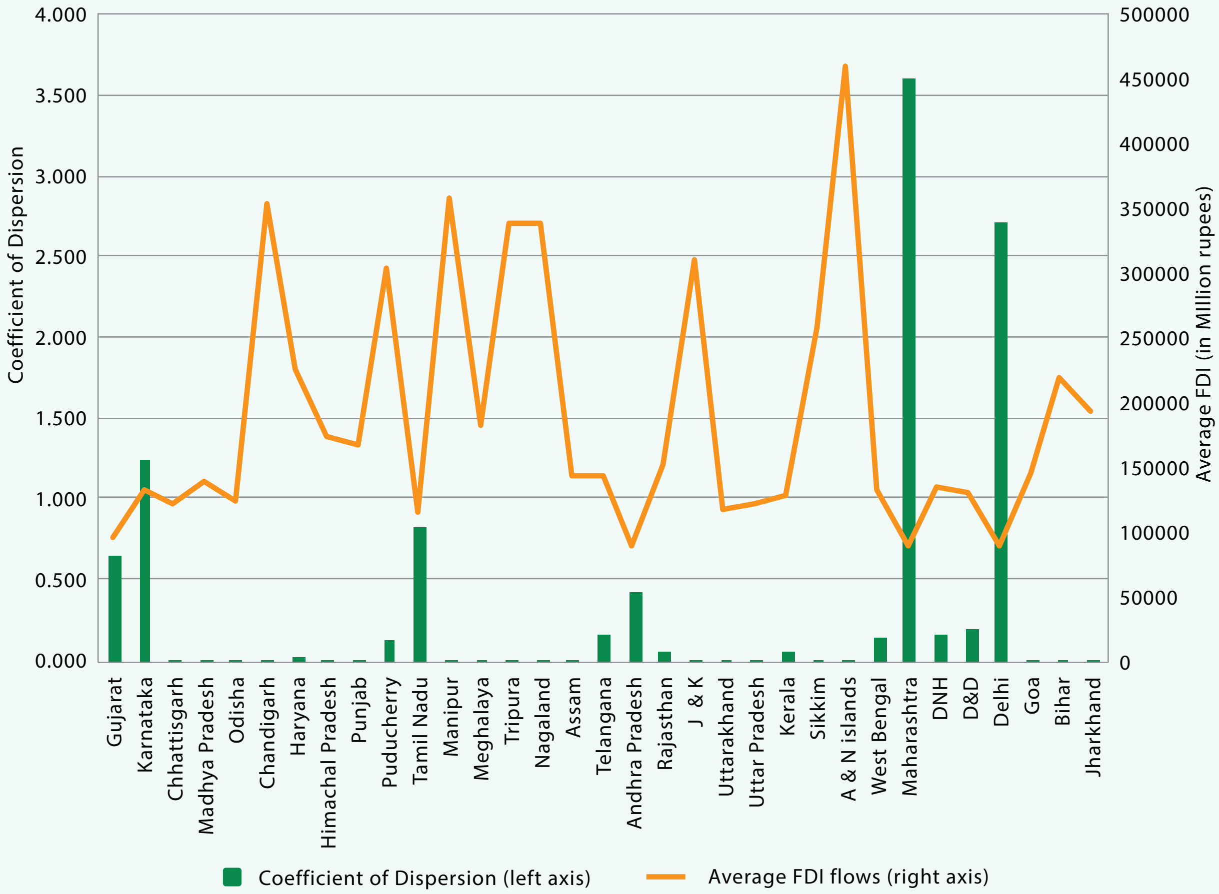
Source: Authors' calculations[134]

Regional Trends

Empirical evidence suggests that FDI inflow has been concentrated in a few states in India. (See Figure 13).[135] Not only is FDI clustered in a few states, there is also a pattern of north-south divide between the states.[h,136] FDI inflows are concentrated in states such as Maharashtra, Gujarat, Karnataka, Tamil Nadu, Andhra Pradesh and Delhi. Meanwhile, Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh received smaller amounts of investment.

[h] North-south divide in this context refers to geographic location of states. It is not related to the North-south or center-periphery models of development and international economics.

Figure 13: Average FDI inflows (in INR million), By State



Source: Authors' own, using data from DPITT & ASI[135]

Figure 13 shows the state-wise average FDI inflows from 2005-06 to 2018-19,[138] and plots the coefficient of dispersion of FDI inflows to these states over time.[i] Average FDI inflows have been highest in Maharashtra, Delhi, Karnataka, Tamil Nadu, Gujarat and Andhra Pradesh. Complementing the high inflows into these regions, the coefficient of dispersion in the annual inflows of FDI have been less than 1. Values of the coefficient of dispersion for states with the least average FDI inflows—Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh—have been higher. Relative to their performance in FDI inflows, the states are categorised as follows:[139]

- **Poor performers:** States with coefficient of dispersion greater than 1: Bihar, Madhya Pradesh, Rajasthan, Jharkhand and Uttar Pradesh.
- **Better performers:** states with a coefficient of dispersion less than 1: Delhi, Gujarat, Maharashtra, Tamil Nadu, Karnataka and Andhra Pradesh.

FDI inflows have not been uniform over the period 2005-06 to 2018-19 in the states that performed poorly. The enabling conditions have either not been favourable for inward

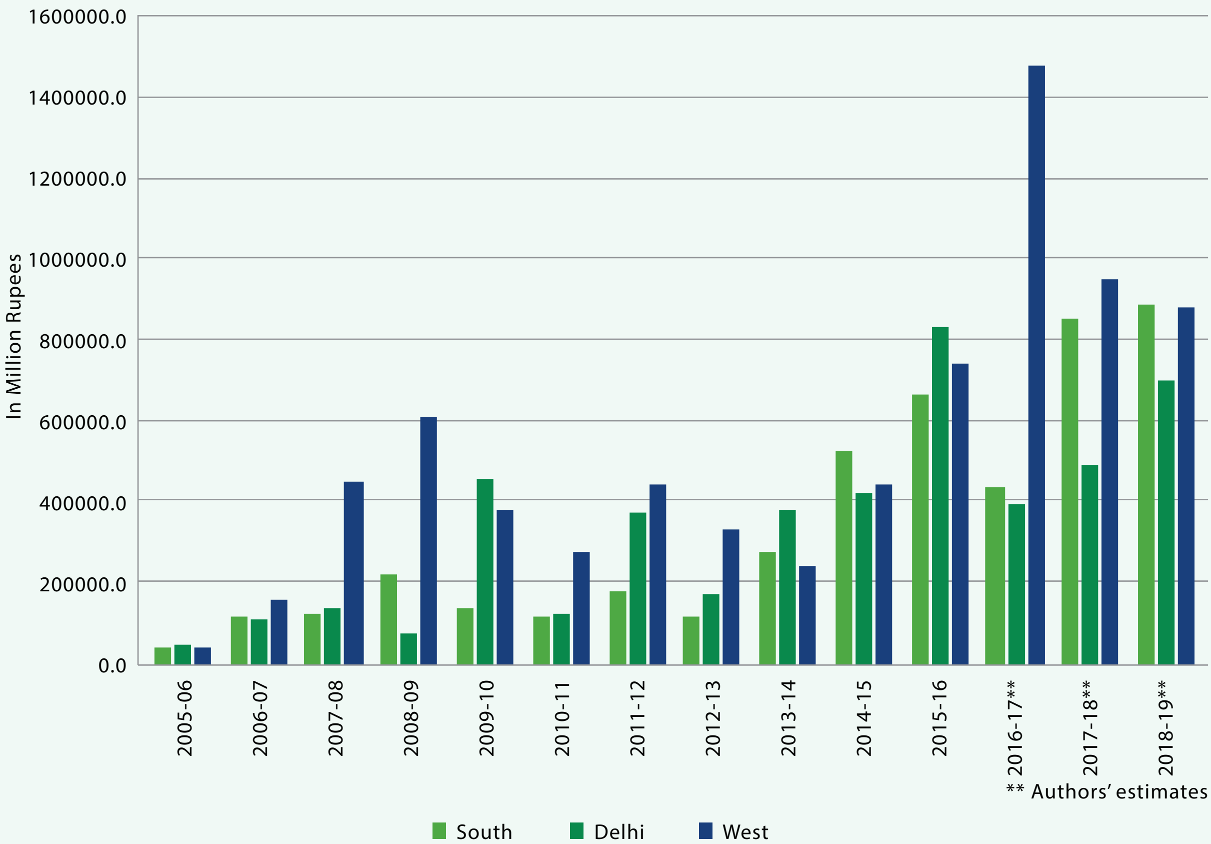
[i] Coefficient of dispersion is calculated using the formula: (standard deviation/mean). It measures the volatility of the data under consideration and reflects the degree of volatility of an observation from its mean. Higher coefficient of dispersion implies higher fluctuations in yearly FDI flows from the mean, and a lower coefficient of dispersion reflects relatively uniform FDI inflows.

investments or they have not been reliable. These states lack the basic enabling conditions like a strong input market, efficient transport networks connecting the production unit to the final market, and financial and regulatory institutions. The result is uneven FDI flows among the poorly performing states such as Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh—reflected in a coefficient of dispersion greater than 1. The aforementioned enabling conditions, at the same time, have been more favourable among the better performing states. This is exhibited in the performance of the better performing states in parameters such as health, education, financial inclusion, human development, and innovation. (See Figures 6-11).

A study on the political determinants of FDI in India, attributes the lower levels of FDI in such states, especially during the coalition years of 2000-2013, to political factors such as: differences in the political affiliation of the Chief Minister (CM),and the party in power at the Union government; weak regional leadership due to the presence of a significant number of members of legislative assembly (MLAs) from the CM's opposition parties; and the dominant presence of MLAs aligned to the party at the Union government, but not affiliated to the CM's party. These factors increase the vulnerability of these states to electoral cycles and increase the political risks of investment. However, regional non-alignment with the ruling party at the Union government is neither a necessary nor sufficient condition for poor FDI inflows. Examples from Karnataka and Gujarat suggest that the presence of a "strong regional leadership effect" in these states outweighed the political uncertainties caused by differences between the Union and state governments.[141]

The data also suggests the emergence of regional agglomerates of FDI in India. The FDI inflows in the country have tended to concentrate in three economic belts: Delhi (North); Maharashtra-Gujarat (West); and Karnataka-Tamil Nadu-Andhra Pradesh-Telengana (South).[142]

Figure 14: FDI inflows to the major economic zones (in INR million)



Source: Authors' own, data from RBI, DPITT & ASI[143,144,145]

Figure 14 shows the FDI inflows to the three regional agglomerates covered in this study. Other economies such as West Bengal, Kerala, Assam, Madhya Pradesh, Chhattisgarh, Jharkhand and Odisha have been virtually left out of the race, and they have failed to develop at the same pace as the leading states.

The results of this analysis can be viewed in the context of a model developed by Steven Globerman and Daniel Shapiro (2003) on the role of governance in attracting FDI.[146] Their model, however, considered the governance factor to consist of an effective, impartial, and transparent legal system that protect property and individual rights; stable credible and honest institutions; and government policies that favour free and open markets. This study considers the SDG index to be a broader representation of governance as it embraces various socio-economic parameters. The Globerman and Shapiro report found that FDI from the US flowed in greater magnitude into countries with better governance infrastructure. This present analysis suggests similarly that states that perform well in the SDGs are more likely to attract FDI.

The Role of SEZs

Competition to attract investment is more intense among the better performing states, than among the poorer performers.[147] It will require substantial efforts to ameliorate such gaps, and Special Economic Zones (SEZs) can play a role. In addition to fiscal incentives, customs duty and tariff exemptions, and administrative streamlining, SEZs also provide basic infrastructure.

India was one of the first countries in Asia to recognise the importance of Export Processing Zones (EPZs) to strengthen the export base. Asia's first EPZ was established in Kandla, Gujarat in 1965.[148] The EPZ model was later refurbished into the SEZ model. The SEZ policy was launched in April 2000 and the SEZ Act came into force in 2005 as an umbrella legislation to regulate the development of SEZs for promoting Indian exports.[149] The main objectives of the Act were the following:[150] 1) generation of additional economic activity; 2) promotion of exports of goods and services; 3) promotion of investment from domestic and foreign sources; 4) creation of employment opportunities; and 5) development of infrastructure facilities.

In the aforementioned 'poor' performing regions, the Union and state governments must focus on improving both economic and political factors. Primary of these are infrastructure development and political stability. SEZs can boost investment by making infrastructure provisions that are not available outside these zones. In consideration of their efforts, governments can then expect investors operating in SEZs to create jobs, boost exports, diversify the economy, and build productive capacity.[151] Furthermore, these SEZs should incorporate principles of the SDGs, as has been the recent focus of the UN Conference on Trade and Development. In line with this study's earlier arguments on improving sustainability parameters to boost the investment climate, these SDG-modelled zones would operate at the highest standards of governance. Relatively weaker states would not need to follow policies of "race to the bottom" to attract businesses.[j] Instead, investing on the SDGs would make sustainable development impact a new locational advantage.[152]

India's SEZ policies revolve around providing tax breaks and other liberal regulations to foreign investors.[153] Certain states too have implemented their own SEZ plans, with the following elements: continuous power supply at fixed tariff by establishing Independent Power Producers; the exemption of new industries from electricity duty, state and local taxes, stamp duty and registration fees; the appointment of a development commissioner to provide all labour law-related permits at a single point, along with providing small-scale industry registration, IT registration and environmental clearances; and the declaration of such SEZs as Industrial Townships, thereby enabling them to function as autonomous municipal bodies.[154] Since 2006, India's SEZs have helped increase the country's trade, investment, job opportunities. Investments in SEZs have also increased during this period—from US$590 million in 2006 to US$69.3 billion in 2018.[155]

[j] 'Race to the Bottom' refers to the process of providing additional benefits to attract investors through tax concessions, easing of labour standards or environmental regulations.

While all the Indian states come under the purview of the same SEZ Act of 2005, the efficacy of these policies and the number of operational SEZs in each state vary. As the business climate and the scale economies differ across states, the FDI inflow also varies. A 2017 study that used panel data techniques on 16 groups of states in India over a 14-year (2001 to 2014) found that the enactment of SEZ policy (as well as operational SEZs) in a state has induced more FDI inflow.[156]

There are 240 operational SEZs in India as of February 2020; 32 of these are in Maharashtra, and only seven are in West Bengal.[157] This partly explains why Maharashtra is a top performer in attracting FDI, and West Bengal is one of the poorest. In turn, the difference in the implementation of the SEZ policy in these two states at the local level can be attributed to political reasons: the power struggle in West Bengal has effectively pushed the issue of SEZs to the backburner. This is despite the fact that West Bengal was the first state in India to establish an SEZ in Falta in 2003.[158] In 2006, in Singur, Hooghly district, 1,000 acres of agricultural land were being acquired for Tata's Nano automobile plant. There was fierce opposition to the proposal, led by the Trinamool Congress. The Singur area was not an SEZ but set the stage for the protest against the acquisition of Nandigram for its development as a SEZ. The Trinamool Congress (TMC) used the Nandigram episode to their advantage and supported the peasants in their protest. Consequently, the TMC won the Panchayat elections in Singur, Nandigram and also in other areas where land acquisition was conducted, thereby controlling eight out of the 18 districts in the state. The current chief minister of West Bengal, TMC's Mamata Banerjee, also supported the movement to scrap the SEZ Act. In other words, the opposition to land acquisition for SEZs gained enough momentum to overturn Bengal's Communist government of 34 years in 2011. The idea of development of SEZ did not sit well with the West Bengal polity and all the political parties in the state tried to benefit politically from the protests in Singur and Nandigram.[a] Since then, there has been no concerted effort to develop SEZs in the state.

FDI in India: Labour, Land and Industrial Policies VIII

Most of the targets identified under the UN SDGs are better enablers of business friendliness, as they are holistically designed and consider the broad structural patterns of society and economy. To ensure that FDI inflows generate benefits that are sustainable and equitable across different segments of society, and in consonance with the wider principles of democracy, it is important that FDI policies are aligned to the three E's: Economy, Equity and Ecology. Policies and business decisions have yet to adopt an integrated approach.

Land, labour, and industrial policies are important in reducing the cost of doing business; as are education, health, housing, and other welfare measures. External stimuli like pandemics can bring about devastating and unprecedented impacts. In India, the informal sector accounts for the majority of the labour force. During periods of crisis, people engaged in this sector are left in a perilous situation. Over the long run, this will have adverse impacts on the labour markets as there will be a sudden dearth of labour where they are required the most—the urban economic centres. If states can adopt a policy where sustainability is the driving principle, it will enhance the many elements of the factor markets (land and labour, among others). Although this could add to the burden of the Union and state exchequers, it also generates new investment opportunities as businesses or investors can create "shared value" with society.[159] The responsibility need not rest upon the Union or state governments alone; businesses must incorporate sustainability as an important strategy for their own bottomlines.

Before private investors are induced to create shared value, it is essential to create a level playing field for FDI competition across the country. This will require an initial thrust from the governments, especially in the poor performing regions, to develop the input market conditions. First, this will involve deepening the financial and banking system, in alignment with the demands of the digital age. Second, the country's basic education and health facilities should be improved. There are strong human capital formation linkages with the education and health infrastructure of a region. Finally, these input market-enhancing conditions are inextricably linked with the natural resource base of the region. Therefore, government policies must also ensure the integrity of the ecosystem from which society derives many benefits. In this regard, ecosystem valuations must be encouraged to reflect on the true competitive advantage of the states across the country.

The future of the global economic system is mired in uncertainty and it has become more pressing to push for informed and holistic policymaking. By definition, sustainability is equipped to tackle some of the challenges of an unpredictable economic environment. FDI, with its immense development potential must also be linked with sustainability dimensions. Sustainable development initiatives will not only help bridge the gap between states in EoDB, but also safeguard the economy from future crises.

Labour Reforms in Independent India

The industrial sector in India witnesses frequent disputes between employers (seeking to maximise profits) and employees (demanding fair wages and fair hours of work).

This can often lead to strikes and lock-outs, which hamper productivity and disturb the harmony in the industrial sector. Labour laws are in place to address these issues, such as the Industrial Disputes Act (IDA), 1947. Labour legislations can be oriented towards a system of collective bargaining between employers and trade unions, or one that would emphasise the role of the State in the resolution of conflicts. The Indian legislators sitting in parliament at the time of independence, favoured the more paternalistic approach on the ground that it would better serve the cause of social justice. There are a total of 44 labour laws in place in India. (See Table 3)

Table 3: India's Key Labour Laws

	Domain	Acts/ Rules
1	Industrial Relations	The Industrial Disputes Act, 1947
2		The Plantation Labour Act, 1951
3		The Industrial Employment (Standing Orders) Act, 1946
4		The Trade Unions (Amendments) Act, 2001
5	Industrial Safety & Health	The Factories Act, 1948
6		The Mines Act, 1952
7		The Dock Workers (Safety, Health & Welfare) Act, 1986
8	Child & Women Labour	Equal Remuneration Rules, 1976
9		The Child and Adolescent Labour (Prohibition & Regulation) Act, 1986
10	Social Security	The Payment of Gratuity Act, 1972
11		Employees Compensation(Amendment) Act,2017
12		Maternity Benefit(Amendment) Act,2017
13		The Personal Injuries (Emergency) Provisions Act, 1962
14		The Personal Injuries (Compensation Insurance) Act, 1963
15		Employees liability act 1938
16		The Employees' Provident Fund & Miscellaneous Provisions (Amendment) Act, 1996
17		The Employees State Insurance Act, 1948
18		The Employees Compensation Act, 1923
19	Wages & Bonus	The Payment of Wages (Amendment) Act, 2017
20		The Payment of Bonus (Amendment) Act, 2007
21		The Working Journalists and Other Newspaper Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955
22		The Working Journalist (Fixation of Rates of Wages) Act, 1958
23		The Minimum Wages Act, 1948

	Domain	Acts/ Rules
24	Labour Welfare	The Unorganised Workers Social Security Act 2008
25		The Bonded Labour System (Abolition) Act, 1976
26		The Cine Workers' Welfare Fund Act, 1981
27		The Cine Workers and Cinema Theatre Workers (Regulation of Employment) Rules, 1984
28		The Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979
29		The Contract Labour (Regulation & Abolition) Act, 1970
30		The Beedi & Cigar Workers (Conditions of Employment) Act, 1966
31		The Employment of Manual Scavengers and Construction of Dry latrines Prohibition Act, 1993
32		The Iron Ore Mines, Manganese Ore Mines & Chrome Ore Mines Labour Welfare Fund Act, 1976
33		The Limestone & Dolomite Mines Labour Welfare Fund Act, 1972
34		The Mica Mines Labour Welfare Fund Act, 1946
35	Employment	The Employment Exchanges (Compulsory Notification of Vacancies) Rule, 1960

Source: Ministry of Labour and Employment[160]

The issue of flexibility in the Indian labour market has been the subject of debate in recent years in the context of employment in the manufacturing sector. Despite economic growth, the 1980s was associated with high unemployment rates in the factory-manufacturing segment.[161] Employment elasticity in the organised manufacturing sector has also been low and declining rapidly due to rigidities in the labour market, leading in turn to high labour adjustment cost.[162] A similar scenario presented itself in the decade ending 2020—a period of economic growth characterised by stagnant, even declining employment rates.

Following the 1991 economic reforms, the labour markets liberalised as well. The standard arguments for undertaking labour market flexibility (LMF) in India advocate that labour laws act as a barrier to growth in employment in the organised sector. Labour market rigidities artificially raise market wages above equilibrium levels and thus deter private investments due to reduced profit margins. This in turn contributes to rising unemployment. Moreover, protective labour laws give rise to a dual labour market, widening the gap between the workers in the organised sector and those in the unorganised. The law that pays attention to labour flexibility is the Industrial Disputes Act, 1947 (IDA), specifically its Chapter V B. The IDA doubles up as a device to provide employment security to workers, and for compensations accruing to workers in case of layoff or retrenchment.

'Labour and employment' falls under the Concurrent List and, therefore, both the Union and State governments formulate the relevant laws. The 2nd National Labour Commission Report (2004) made recommendations for significant labour reforms, which would only be expedited in 2014. For example, the Rajasthan government passed legislation to amend four key labour laws: The Factories Act (1948), The Apprentices Act (1961), The Contract Labour (Regulation and Abolition) Act (CLRA) (1970), and The Industrial Disputes Act (IDA) (1947).[163] The Government of Madhya Pradesh and Haryana followed suit. For Madhya Pradesh, in particular, the reforms are around processes — registration in a day, licences for 10 years, shops to be open from 6 am till midnight, reduction in registers and returns, and raising the threshold for labour inspections to factories employing up to 50 labourers. As many as 11 categories of industries[k] from the Madhya Pradesh Industrial Relations (MPIR) Act of 1961, and new establishments, have been exempted for an indefinite period of time from provisions

[k] These include textiles, leather, cement, iron and steel, electrical goods, sugar, electricity, public motor transport, and engineering including the manufacture of motor vehicles.

guiding industrial dispute resolution, strikes/lockouts and trade unions.[164] In Gujarat, new establishments were exempted from all labour laws except those relating to minimum wages, compensations and workers' safety.[165]

Most recently, in May 2020, the UP government issued an ordinance suspending as many as 18 major labour laws[166] for the next three years.

Table 4: Labour Reforms, by State

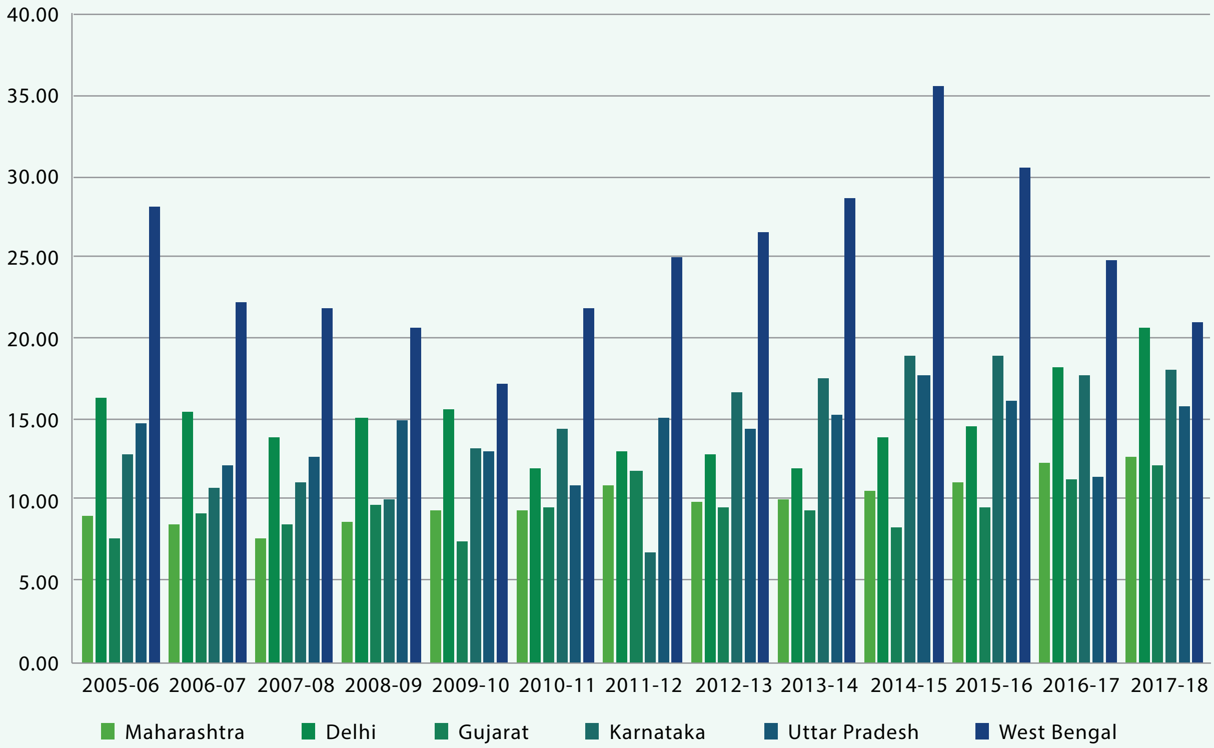
	STATES / REFORM	MAHARASHTRA	GUJARAT	TAMIL NADU	KARNATAKA	WEST BENGAL	UTTAR PRADESH	MADHYA PRADESH	RAJASTHAN
1	Notification for payment of Wages in Bank account		✓	✓			✓	✓	✓
2	Permitting Night work to women	✓	✓	✓	✓		✓	✓	✓
3	Enhancing threshold for the definition of factory [10 to 20 (with Power) &20 to 40 (without Power)]	✓							✓
4	Enhancing Overtime Time	✓					✓	✓	
5	Enhancing threshold from 100 to 300 for prior-permission for layoff, retrenchment, closure	✓					✓	✓	✓
6	Enhancement in retrenchment compensation		✓					✓	✓
7	Limitation Period for raising ID reduced from 3 to 1 year		✓					✓	
8	Fixed Term Employment		✓				✓	✓	✓
9	Time line prescribed for disposal of application for registration of Trade Unions [varies from 15 days to 4 months]		✓	✓	✓			✓	✓
10	Minimum wages to be paid by cheque or in Bank A/C (Section 11)		✓				✓	✓	✓

Source: Ministry of Labour and Employment, Government of India[167]

The labour reforms introduced by the various state governments over the years are aimed at incentivising inward flow of private investments by boosting business sentiments. However, these reforms have had a negative impact on the share of wages across the different states. States with relatively higher magnitude of labour reforms, particularly those aimed at favouring the industrialist class at the expense of the workers, have witnessed a significant reduction in wage shares of workers. Figure 15 shows, for example, that the percentage share of wages in net value added for West Bengal (i.e., the state with the least labour reforms) has remained considerably high as compared to other states that have enacted more significant labour reforms. This can possibly deter the growth of the investments flowing into the states by limiting the size of the host markets. The 'top performer' states, in terms of FDI inflows, have a relatively lower share of wages in the basket of net state value added. Meanwhile, the 'poor performers' are yet to capitalise on the benefits of pro-market reforms.

The challenge for state governments is to adopt free market policies while exercising caution. As they seek to introduce labour market flexibilities to encourage investment flow, the governments must strike a critical balance between the two objectives of boosting business sentiments and ensuring workers' welfare.

Figure 15: Share of wages in Net Value Added (%)



Source: Authors' own, using various editions of Annual Survey of Industries[168]

The Government of India has embarked on unifying the various labour laws into four codes, namely:

1. The Code on Wages, 2019.
2. The Occupational Safety, Health and Working Conditions Code
3. The Code on Social Security
4. The Industrial Relations Code

The Code on Wages was passed by Parliament on 30 July 2019. The labour reforms assume significance as India's GDP growth fell to an over-six-year low of 4.5 percent in the second quarter of 2019-20, while retail inflation rose to a 40-month-high of 5.54 percent in November.[169] The remaining three codes have been introduced in the Lok Sabha for recommendations. The codification is in line with the recommendations of the 2nd National Labour Commission Report of 2004, and aimed at bolstering investment, both domestic and foreign by improving business climate across India.

Will the new reforms suit the needs of the Indian economy? The post-COVID-19 economy will carry new challenges for India. The issue of migrant labour, for example, will demand an overhaul of various policies in the country, and business sentiments are likely to be affected in the process.

COVID-19, Migrant Labour, and the Impact on Foreign Investments

The magnitude of India's informal labour is massive. According to some estimates, around 80 percent of India's workforce is engaged in the informal sector.[170] While India has policies for social security in the areas of education, healthcare, skilling, food security, and pensions, most of them are restricted to the organised sector.[171] The pandemic-induced unemployment has risen across sectors, worsening poverty and exacerbating hunger-related illnesses and deaths. For poor nations such as India, where 50 million workers have migrated to other cities in search of livelihood,[172] the level of distress, especially in the informal sectors, is severe.

India's problem is threefold. First, there are huge regional disparities in labour requirements, available opportunities, and labour supply across India.[173] This is why labour migration within and across economic sectors is rampant in the country, resulting in an equilibrium where the demand and supply for labour are simultaneously realised and wage rates vary accordingly. Evidently, industrial states like Maharashtra are a magnet for migrants from labour-abundant states such as West Bengal. As the COVID-19 situation in Maharashtra worsened around the month of

May, state officials sent over 100,000 migrants back to West Bengal by 41 'Shramik Special' trains[174] – resulting in a political scuffle between the two states and the Union government. Estimates suggest that as 2.6 million migrant labourers are returning home or dying of hunger, the equilibrium is getting disrupted.[175] These disturbances in India's labour market will only impede the effective operation of value chains associated with foreign investments in the country.

Second, as migrant labourers return to their homes, it will bring down wages due to the oversupply of labour in those regions, in turn creating an impact on the quality of labour, particularly in the case of workers in rural areas.[176] In contrast, labour-scarce regions will see an increase in wages in the short term, which many business enterprises might be unable to afford. In both cases, both domestic and foreign firms with smaller subsidiary operation units are bound to suffer.

Finally, small businesses associated with foreign companies that are dependent on migrant labour from distant regions will likely fail to sustain themselves in the short or medium term. This is because production processes might become inefficient due to the combined lack of physical assets and human skills, which will no longer be available in the specific regions.

From its eastern regions to the west, India's migrant distress has been one of the most important issues associated with the COVID-19 pandemic. Unless prompt actions are taken, the situation will not only lead to more suffering for migrant workers and their families, even illness and deaths, but will also have a detrimental effect on the country's investment climate.

India's Land Reform Policies

Land reforms broadly refer to the regulation of ownership, operation, lease, sale, and inheritance of land. In India, land resources are not only relatively scarce in relation to the massive population, but also unequally distributed. Therefore, land reform policies are important in enhancing agricultural productivity, reducing inequalities, easing access to land resources for industrial setups, and generating demand in the local market—all of which in turn stimulate private investments (both domestic and foreign). (See Table 5 for the key acts and rules in force with respect to India's land reform policies.)

Table 5: Key Land Reform Acts/Rules

	Acts/Rules/Policies
1.	Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement (RFCTLARR) Act, 2013
2.	The Registration Act, 1908
3.	Land Acquisition Act, 1894
4.	RFCTLARR (Amendment) Second Bill, 2015
5.	RFCTLARR (Amendment) Bill, 2015
6.	Registration (Amendment) Bill, 2013
7.	National Rehabilitation & Resettlement Policy, 2007
8.	RFCTLARR Act 2013 (sub-section 2 of Section 109) Rules 2015
9.	RFCTLARR (Compensation, Rehabilitation and Resettlement and Development Plan) Rules 2015
10.	RFCTLARR (Social Impact Assessment and Consent) Rules 2014
11.	Land Acquisition (Companies) Rules, 1963

Source: Department of Land Resources[177]

In a survey of US companies conducted between September and October 2018, three out of five CEOs said that land acquisition is an area where massive hurdles need urgent attention from the Indian government. In 2015, the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement (RFCTLARR) (Amendment) Ordinance provided for the creation of a land bank that would in turn incentivise inward FDI flows.[i]

Various attempts have also been made to simplify procedures in Delhi and Mumbai in the governance of land resources to improve the ease of doing business in these regions. (See Table 6)

This present study has found a stark contrast between land governance in states like West Bengal, Odisha, and Jharkhand, on one hand, and on the other, Maharashtra, Delhi, Gujarat, Karnataka, Telengana and Andhra Pradesh. There are various factors for such variance, primary of which is the political economy of land acquisition policies in the particular states.

Table 6: Amendments to land resource governance in Delhi and Mumbai

	Delhi	Mumbai
1.	Model Sale Deed	All land titles or deed records have been digitized at the Sub-Registrar's Office (SRO)
2.	Appointment Management System	To check the encumbrances
3.	Digitization of Record of Rights (RoR)	Service delivery standards have been introduced to provide maps within a specific time frame though an online portal
4.	Stamp Duty Calculator	Disputes related to land have been mandated to be adjudicated within 1 year as per amendment of Maharashtra Act No XI of 2016
5.	Delhi Online Registration Information System	The grievances related to land can be reported through "Aaple Sarkar" portal
6.	Grievance Redressal Management System	Land dispute information has been made available online through e-DISNIC software
7.	To view cadastral map(sajra) of the revenue villages alongwith Record of Rights (Khatauni)	Registration Act has been amended with insertion of Section 89 A, according to which, every court shall send copies of order affecting any immovable property and every recovery officer shall send copies of order or interim order attaching or releasing any immovable property to the concerned Sub-Registrar
8.	Statistics on land disputes (Revenue Cases)	Title search can be conducted online without requirement of any physical visit (for Paid search)
9.	Check encumbrance details online	Tax dues on property can be checked online on MCGM's website
10.	Free Public access of Casdastral MAPs	eStepIn for online registration slot booking at SROs launched
11.		eRegistration system launched for online registration of leave and license rent agreements
12.		eSecure Bank Treasury Receipt (eSBTR) for payment of Stamp Duty
13.		eASR for online statement of rates launched in Aug 2014

Source: Department of Land Resources[179]

[i] Because it will make it easier to identify vacant plots of land, reduce the transaction costs involved, and enable price discovery.

Industrial Policies

Industrial policy is a subject that falls under the Concurrent List, and state governments formulate their own, in conformity with the Union government's. There are considerable disparities in industrial policy among the different states, owing to variations in social and economic infrastructure which in turn significantly influence levels of private investment. The key factors in these infrastructure developments include industrial policy, finances, and governance systems. (See Table 7)

Table 7: Industrial Policy, By State

STATES / STRATEGY	MAHARASHTRA	GUJARAT	TAMIL NADU	KARNATAKA	WEST BENGAL	UTTAR PRADESH	MADHYA PRADESH	RAJASTHAN	DELHI
Development of industrial infrastructure	✓	✓	✓	✓	✓	✓	✓	✓	✓
Human resource development through capacity building and skill up gradation.	✓	✓	✓	✓	✓	✓	✓	✓	✓
Facilitation mechanism and procedural reforms.				✓	✓		✓	✓	✓
Providing competitive fiscal incentives and exemptions	✓	✓	✓	✓	✓	✓	✓	✓	✓
Promoting cluster development in new industrial areas		✓		✓	✓		✓		✓
Promotion of MSMEs	✓	✓		✓	✓	✓	✓		
Encouragement to Minorities, Backward classes, Physically challenged persons	✓	✓		✓					
Encouragement to Women entrepreneurs.	✓	✓		✓					
Encouragement for export promotion.	✓	✓		✓	✓	✓			✓
Encouragement for adoption of green and clean practices.	✓	✓		✓			✓	✓	✓
Intellectual property rights initiatives				✓					
Encouragement for anchor industries/ thrust sectors	✓	✓	✓		✓	✓	✓	✓	
Incentives and concessions for Large, Mega, Ultra Mega, Super Mega enterprises	✓	✓		✓	✓				✓
Support for R&D, innovation and startups	✓	✓		✓		✓			✓
Creating land bank for industries	✓				✓		✓		✓
Promoting government, industry and academia inter-linkage	✓	✓			✓				✓
Single-window system	✓	✓			✓		✓		✓
Facilitating Ease of Doing Business initiatives	✓	✓			✓	✓	✓		✓
Promote processing of agricultural produce for enhancing farmer's income	✓	✓							
Special fiscal incentives to set up industrial parks in under-developed regions/ sectors	✓	✓			✓		✓	✓	✓

Source: Department for Promotion of Industry and Internal Trade[181]

With the deregulation of private investments following the reforms in the 1990s, the states that were more advanced in industry managed to leapfrog, while the less industrialised states lagged even more. The faster growth of the former, attracted more private investments, which only perpetuated the cycle by accentuating already existing regional disparities. States with poor infrastructure or poor governance are unable to attract private investments, to begin with. Therefore, proactive public policy, in the form of increased public investments or fiscal incentives, is crucial to the industrial development of such states.[182]

FDI in a Post-Pandemic India

IX

Changes were made to the FDI policy yet again in the midst of the COVID-19 pandemic vide Press Note 3 of 2020 which aimed at preventing acquisitions of businesses of Indian companies. Para 3.1.1 of the Consolidated FDI Policy 2017 was amended to the effect that any entity of a country that shares a land border with India or any citizen of any such country can only invest in India through the government route. Further, if any investment causes change in beneficial ownership, approval of the government would be required.[183] This prohibition is primarily aimed at China, as restrictions were already in place for investors from Bangladesh and Pakistan; also, Myanmar, Bhutan and Sri Lanka are not major investors in India.[184] The change in FDI policy comes at the same time as news of the People's Bank of China making incremental investments in HDFC. Thus, the aim is to prevent Chinese acquisition of undervalued shares of Indian listed companies. This measure is applicable to all sectors (greenfield or brownfield)[m] and also to listed and unlisted companies. However, there are concerns that the ambivalent relationship of Chinese investors and India (FDI inflow from China has been constantly increasing since 2014) might be jeopardised after the requirement of government approval for investment.

The COVID-19 pandemic has highlighted concerns about the economics of globalisation and the dependency of large populations of the world on imports from China. This made India stand by its decision of not joining the ASEAN-led Regional Comprehensive Economic Partnership (RCEP) negotiations.[185] However, there are concerns that India might lose an opportunity of regional trade integration in the post-COVID-19 scenario, which could provide trade and investment opportunities for the country. Japan and Australia were among those trying to convince India to join the RCEP as it would provide the participating countries with a forum for counteracting China's growing footprint in Asia. Further, it was stated by Australian High Commissioner-Designate Barry O'Farrell that the 'Make in India' policy of the government would send a message of India being an attractive investment destination.[186]

Analysts are of the view that the global economy could recover from the Covid-induced recession by the end of this year—but only if the supply-side constraints can be contained with simultaneous revival in consumption demand.[187] Analysing this in the Indian context would entail making the economy more competitive by strengthening its product and input markets, especially in relation to its Southeast Asian competitors such as Vietnam and Thailand. In a post-COVID-19 situation, countries may be looking towards India for more processed food, marine produce, meat, fruits and vegetables, tea, rice and other cereals due to the underlying apprehension in importing edible products from China.[188]

[m] Greenfield and brownfield investments are two types of foreign direct investment. In greenfield investment, a company will build its own, brand-new facilities in the host country. Brownfield investment, on the other hand, refers to investments where a company purchases or leases an existing facility.

On 12 May 2020, Prime Minister Narendra Modi announced a INR 20-trillion economic stimulus package (roughly 10 percent of the GDP) in an attempt to mitigate the economic fallout of the COVID-19 crisis, and make the domestic economy self-reliant.[189] This amount subsumes previous measures (worth INR 11.25 trillion)[190] undertaken by the RBI and the Ministry of Finance as soon as the pandemic began.

The Prime Minister's clarion call of making India *'Atmanirbar'* (self-reliant) and being 'vocal for local' has its foundations in increasing the efficiency of domestic production and consumption processes. An example of 'self-reliance' is in the domestic production of Personal Protective Equipment and N-95 masks that are among the essentials in the battle against Covid. However, despite the change in India's economic focus towards conversion of global processes into domestic mechanisms, the importance of making India attractive to foreign investments cannot be denied in fuelling India's growth story in the post-pandemic world.

The five pillars of 'Atmanirbhar Bharat' are economy, infrastructure, democracy, system, and demand.[191] The stimulus package was divided into five tranches which focused on businesses (including MSMEs), workers (migrants, farmers, labourers), agriculture, industrial growth, and government reforms. These tranches indirectly address key aspects of the SDGs, including SDGs 3 (good health and well-being), 8 (decent work and economic growth), 9 (industry, innovation and infrastructure) and 16 (strong institutions). Improvement in SDGs 8, 9 and 16 generate feedback effects that can create a conducive environment for investment. The following are the tranches:

1. The first tranche of the stimulus package emphasised on the implementation of the *Pradhan Mantri Garib Kalyan Yojana,* under which INR 1.7 trillion is made available for the poor to help them fight COVID-19. With regard to the MSMEs, equity support will be provided to MSMEs either categorised as non-performing assets (NPAs) or are stressed. The definition of MSMEs will also be revised to the effect of increasing the asset and turnover limit for being classified as such. The fact that foreign tenders for government procurement up to INR 2 billion has been disallowed, reduces the competition faced by MSMEs from foreign companies. This is a crucial step towards the 'Make in India' programme and 'Atmanirbhar Bharat Abhiyaan'.[192] Further, certain amendments to the Insolvency and Bankruptcy Code have also been made, such as increasing the minimum limit for initiating corporate insolvency, from INR 100,000 to INR 10 million—this excludes MSMEs from having to undergo the corporate insolvency processes.[193] These initiatives underpin efforts to boost industry, innovation and infrastructure (SDG 9) and to ensure good health and well-being (SDG 3).

2. The second tranche is aimed at promoting the welfare of famers, labourers and migrant workers. Agricultural loans have been extended for three months and new Kisan Credit Cards have been issued. Further, new agricultural market reforms are envisioned to enable farmers to exercise more opportunities for trading agricultural produce and also conduct inter-state trade without barriers.[194] Once again, through these measures, farmers can exercise more freedom in selling their produce which can help improve their incomes and standards of living. These strategies can help achieve the goals of ending poverty, ensuring good health and well-being, and to some extent, ensuring decent work (SDG 8).

3. The third segment of the stimulus package focuses on the additional measures taken in the agricultural sector. Liquidity of INR 2 trillion will be injected in the agricultural sector and funds will also be transferred to the PM KisanYojna.[195]

4. Part 4 is aimed at bringing investment for achieving 'Atmanirbhar Bharat'. It includes reducing bureaucratic red-tape and providing expedient investment clearances, forming schemes to attract investment in sectors like solar manufacturing, advanced cell battery storage, amongst others. Further, states will be ranked on the basis of their investment attractiveness[196] The government has also opened up the coal sector for participation by the private sector to increase India's self-reliance. Measures for increasing ease of doing business will also be implemented—for example, shortening of the mining plans, and making processes available online. These measures are aimed at ensuring greater transparency in institutions (SDG 16). Transparency in governance can encourage investments, which positively influence SDGs 8 and 9.

Increasing self-reliance in the sector of defence production is also one of the aims of the Union government's 'Atmanirbhar Bharat' campaign. A list of weapons will be notified for which imports will be banned based on yearly timelines, along with indigenisation of imported spare parts and separate allocation of budget for domestic procurement. One of the key steps is the corporatisation of the Ordnance Factory Board (OFB) which manages a network of factories in India that indigenously produce defence equipment for the Indian armed forces.[197] Further, FDI in defence manufacturing will be increased from 49 percent to 74 percent under the automatic route – to attract foreign funds in the sector and increase technological infusion.[198]

5. The final tranche is aimed at improving government reforms, which are crucial for attracting FDI. According to the World Bank's Doing Business Report,[199] India's rank jumped from 142 in 2014 to 63 in 2019. A large part of this can be attributed to the streamlining processes undertaken by the Union government from 2014 – this included expedient grant of permits and licenses, and self-certification. These reforms also significantly contribute to creating a conducive environment for investments by ensuring a strong institutional framework (SDG 16).

There are multinational corporations that have expressed interest in shifting their value chains to India; this will help push the country's growth opportunities. At this stage, when companies are looking for alternatives to China for making investments, the Indian government must plan to further the process of doing business in the country in a more holistic way by simplifying property registration and taxation, and improving the disposal rate for disputes.[200] While Japan has pledged US$ 2.2 billion to facilitate the relocation of companies out of China,[201] German footwear company, Von Wellx is set to completely move its production from China to Agra in India.[202]

The announcement of the first three parts is centred around boosting the agricultural sector and MSMEs that form the backbone of the Indian economy. Additionally, it aims to operationalise the human capital base by enhancing the health of the Indian labour market – which is necessary for attracting foreign investments into the country. Overall, the stimulus package reflects the government's approach at providing a strong supply side push by making liquidity available to businesses, to keep the fiscal deficit low in the long term. However, some believe that a demand-side stimulus would have been more pertinent at this juncture and the government should have focused on ways to increase consumption by suspending or reducing taxes. An increase in consumption would have also resulted in higher revenues, which could have offset the revenue losses owing to tax cuts.[203]

Although India's objective to become self-reliant is deemed as the correct way to move forward by the political elite, there should be certain caveats. First, spending INR 81 billion to boost private sector investment in building India's social sector infrastructure might in the long term fail[204] in addressing the wealth inequality and financial equity concerns of India's large population. Such measures encourage foreign investment in India's public infrastructure to a large extent. Naysayers suggest that a more decentralised, people-centric approach would have been more effective.[205] If India is to ride the post-pandemic wave of countering China's dominance across global markets, it must synchronise its domestic production and foreign investment policies. Investors are keen to explore destinations that offer transparent and democratic business environments. It lends credibility and long-term assurance to the investment partnership. By posing as the vanguard in sustainable business practices, the 'poor performing' states can attract foreign investors looking to diversify their production activities.

Second, for India, 'going local' cannot be the only way out and should not be confused with anti-globalisation tendencies being witnessed in many parts of the world. Indeed, the 21st-century concept of 'self-reliance' is different from India's Swadeshi movement or the Gandhian values of simple living.[206] Economies have a heavy dependence on diverse product baskets which include a large proportion of imported commodities. Therefore, even if India is able to become self-reliant for commodities that are on the lower end of the value chains, it is impossible for the economy to rely on its domestic production for 'complex' goods and services that are often essential. For example, where the global healthcare sector is overwhelmed by the COVID-19 patients, 80 percent of the necessary medical equipment used in India (including in government hospitals) is imported from other countries.[207] Will 'Atmanirbhar Bharat' be able to stand the test of time to prove itself as an economic catalyst for India? To be sure, the vision of 'Atmanirbhar Bharat' is an essential rider of the 'Make in India' scheme of the government. Both these visions are aimed at improving India's economic potential and projecting India as a major destination for investment and boosting domestic economic activity.[208]

Conclusion

X

In their book, *Why Nations Fail,* Daron Acemoglu and James Robinson observe that small institutional differences between regions, during a critical juncture in history, can play a significant role in shaping the trajectory of these regions. In 1346 the Bubonic Plague, or the Black Death, reached Europe and by 1351 had wiped out half the population of France, Italy, North Africa, the Mediterranean and England. The plague resulted in a magnitude of deaths, and had a great transformative impact on the social, economic and political structures of medieval European societies.[209] The existing feudal order in Western Europe implied that the peasants had to perform extensive unpaid labour under their lords. The large-scale labour scarcity in the aftermath of the plague, uprooted the social foundations of the feudal order. Peasants realised their importance in the socio-economic order, and began to demand higher wages from their lords. From an extractive institution, the labour markets in Western Europe transformed into more inclusive ones.

The Eastern European experience, however, was different. The lords were better organised than their western counterparts, and had slightly more rights and more consolidated holdings. Towns were also weaker and smaller, with lesser organisation among peasants. This allowed the lords to expand their landholdings and keep the peasants servile. Although initial differences between the two regions were small, the Bubonic plague led to the creation of an inclusive labour market in Western Europe while it led to the 'second serfdom' in Eastern Europe. This set in play highly different responses across the two regions, the impacts of which can still be observed today with the wide differences in the levels of development in the two regions.[210]

Today the global economy faces a similar watershed. The COVID-19 pandemic has revealed the importance of socio-economic development in enhancing the resilience of an economy against sudden disruptions to the status-quo. The future trajectory of prosperity (or poverty) of many nations will be determined based on the policies they adopt. Investors are likely to choose destinations that follow holistic development objectives that preserve the trinity of ecology, economy and society. The pandemic has shown the inextricable link between these three. Economic activity has come to a standstill and its repercussions are being felt variably among different sections of society. Due to the lack of adequate social security measures, inequalities are likely to rise. It is not an unknown fact that social inequalities can lead to lower productivity, political uncertainty and economic instability. These are detrimental to FDI which is usually long-term in nature, and requires a pre-condition of socio-economic stability in the host country or region.

India, with its large population, has the potential to become the world's leader in manufacturing and production. The government's call for a 'self-reliant' economy shows its awareness of India's potential. However, in the age of the Fourth Industrial Revolution, embracing technology is of paramount importance. A direct impact of higher FDI inflows is technological spillover. Although it is important to invest in innovation and R&D, the benefits of FDI must not be overlooked. This study argues that FDI can be a game changer for a post-pandemic India by ensuring that attractiveness to business is improved not only by providing financial incentives. Rather, state governments must invest in achieving the Sustainable Development Goals, which create enabling conditions for investment. The conditions thus created will entail inclusive labour market reforms, social security measures, transparency in governance, mitigating impacts of climate change, sustainable urban planning, access to energy, and strong social institutions.

This analysis explored the link between improvements in these parameters and ease of doing business conditions, and finds a positive correlation. Policymaking must acknowledge this interlinkage and align future FDI policies with these principles. A robust socio-economic environment conveys an optimistic message regarding the business climate of a region. It reduces the vulnerability of investments to unforeseen social, political and environmental conflicts. At a sub-national level, sustainable development has the potential to ameliorate disparities across states.

The increasing concentration of FDI among only a few of India's states has led to skewed economic growth across the regions. As the data suggests, such widespread inequality in FDI inflows is further exacerbated by the positive spillovers of FDI in those regions. The presence of foreign firms acts as a signal to new investors regarding the business climate in these areas and increased FDI continue to flow in regions like Maharashtra, Delhi, Karnataka, Tamil Nadu, Gujarat and Andhra Pradesh, whereas the other states are left behind. Eventually these regions have emerged as economic hotspots with high employment opportunities and facilities for a better standard of living—urbanisation, industrialisation, and agglomeration of firms have created 'pull' factors for FDI.

It is important that states which have been lagging in FDI inflows take economic and political measures to bolster the creation of enabling conditions. There is a tendency for better performing states to compete amongst themselves and the poor performers to remain confined to their own group. Therefore, the policy of competitive federalism, as proposed by the current government cannot automatically ensure development of all the states. Under the business-as-usual scenario, it will only lead to an increase in concentration of FDI among the select few states.

Regional disparities in FDI inflows can be ameliorated through improvements in physical infrastructure and creation of SEZs modeled on the SDGs. This will help enhance competitiveness of the poor performing states. Once these states have set up basic infrastructure, they have the potential to become the destination for the next phase of FDI inflows. This will not only open new avenues of opportunity for the people living in these areas, but also advance the convergence agenda between the Indian states.

These factors are, however, inextricably linked to global events. An unprecedented blow to the global economy will send ripples across the entire economic system, adversely affecting investments in sub-national economies such as those in India. There is no doubt that the world economic order, investment patterns and globalisation trends will be revised after the COVID-19 pandemic, at least for a few years. Research shows that the downward pressure on FDI will be in the range of -5 percent to -15 percent compared with previous forecasts[211] and the predicted global recession that the world will experience may have a chance of sparing India and China, relative to the other developing nations.[212] Indeed, as the COVID-19 pandemic has been altering global economic processes, the People's Bank of China (PBoC) raised its stake in India's largest non-banking mortgage provider, the Housing Development Finance Corporation (HDFC) Bank, from 0.8 percent to 1.01 percent. Following this, New Delhi took a decision to amend its FDI policy by making government approval mandatory for any foreign investment from countries that share land borders with India to curb "opportunistic takeovers" of domestic Indian firms.[213]

Although the global revisions in FDI will affect countries that are severely hit by the pandemic—such as the US, Europe and China—there will be disruptions in demand in almost all the world economies. The profits of the MNEs are predicted to be more at risk in the emerging economies than in the developed countries, and the hardest hit industries would include the automobile sector, airlines, energy and basic materials.[214] Mitigating the negative impacts of such events will require ensuring that investments consider environment, social and governance factors. This will prevent investments in unethical practices, and increase the resilience of an investment to external risks.[215] Therefore, competition for FDI among Indian states, employing principles of sustainable development, will ensure long-run, sustainable growth for the entire economy and equitable distribution of gains from FDI.

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Appendices

Table A1.1: Regression of Ease-of-Doing-Business Index on SDG Index

. regress ln_edb ln_SDG

Source	SS	df	MS
Model	1.00868923	1	1.00868923
Residual	1.80589625	18	.10032757
Total	2.81458548	19	.148136078

Number of obs	=	20
F{ 1, 18)	=	10.05
Prob > F	=	0.0053
R-squared	=	0.3584
Adj R-squared	=	0.3227
Root MSE	=	.31675

ln_edb	Coef.	Std. Err.	t	p>|t|	[95% Conf. Interval]	
ln_SDG	.8009756	.2526101	3.17	0.005	.2702614	1.33169
_cons	-.0837456	.2110719	-0.40	0.696	-.5271912	.3596999

Source: Nilanjan Ghosh, Soumya Bhowmick and Roshan Saha,
" SDG index and Ease of Doing Business in India: a Sub-national Study," ORF Occasional Paper 199, (June, 2019).

Table A1.2: Regression of FDI per capita on SDG Index

. regress In_fdi_pc 1n_SDG

Source	SS	df	MS
Model	84.7507511	1	04.7507511
Residual	52. 7939152	20	2.63969576
Total	137.544666	20	6.54974602

Number of obs	=	22
F(1, 20)	=	32.11
Prob > F	=	0.0000
R-squared	=	0.6162
Adj R-squared	=	0.5970
Root MSE	=	1.6247

In_fdi_pc	Coef.	Std. Err.	t	p>|t|	[95% Conf. Interval]	
In_SDG	6.765361	1.193978	5.67	0.000	4.274768	9.255955
_cons	10.92274	1.036332	10.54	0.000	8.760987	13.08449

Source: Nilanjan Ghosh, Soumya Bhowmick and Roshan Saha,
" SDG index and Ease of Doing Business in India: a Sub-national Study," ORF Occasional Paper 199, (June, 2019).

Table A1.3: Regression of FDI on Ease of Doing Business

Regression Statistics	
Multiple R	0.74814407
R Square	0.55971954
Adjusted RS	0.53525952
Standard Error	2.21588789
Observations	20

ANOVA

	df	SS	MS	F	Significance F
Regression	1	112.359328	112.359328	22.88303188	0.00014862
Residual	18	88.3828643	4.91015913		
Total	19	200.742192			

In_FDI	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0%
Intercept	12.9897546	1.06605453	12.1848876	0.00	10.7500572	15.2294521	10.7500572	15.2294521
In_EoDB	6.3257261	1.32237186	4.78362121	0.000148619	3.5475259	9.1039263	3.5475259	9.1039263

Source: Author's calculation using FDI data for 2016-17 and Asia Competitiveness Institute Ease of Doing Business Index (2016).

Appendix 2. EDB Index scores of Indian states

RANK	STATES	EASE OF DOING BUSINESS 2016 INDEX
1	Maharashtra	1.000
2	Gujarat	0.798
3	Delhi	0.772
4	Goa	0.688
5	Andhra Pradesh	0.649
6	Tamil Nadu	0.602
7	Karnataka	0.576
8	Madhya Pradesh	0.567
9	Himachal Pradesh	0.556
10	Telengana	0.519
11	Punjab	0.495
12	West Bengal	0.462
13	Chhattisgarh	0.453
14	Odisha	0.453
15	Kerala	0.429
16	Haryana	0.359
17	Jharkhand	0.313
18	Uttarakhand	0.287
19	Bihar	0.278
20	Assam	0.224
21	Uttar Pradesh	0.000

The scores are normalised to range from 0 to 1. Scores for Jammu & Kashmir and Rajasthan are not available.

(Source: Giap, Tan Khee, Sasidaran Gopalan, Jigyasa Sharma, and Tan Kong Yam. Inaugural 2016 Ease of Doing Business Index on Attractiveness to Investors, Business Friendliness and Competitive Policies (EDB Index ABC) for 21 Sub-National Economies of India. Asia Competitiveness Institute, 2016, pp. 318)

Appendix 3. SDG index scores of Indian States

RANKS	SDG	scores
1	Goa	0.704
2	Kerala	0.634
3	Tamil Nadu	0.614
4	Delhi	0.606
5	Himachal Pradesh	0.578
6	Telengana	0.529
7	Karnataka	0.516
8	Maharashtra	0.514
9	Uttarakhand	0.513
10	Punjab	0.504
11	Gujarat	0.488
12	Haryana	0.482
13	Andhra Pradesh	0.462
14	West Bengal	0.397
15	Jammu and Kashmir	0.395
16	Rajasthan	0.390
17	Chhattisgarh	0.371
18	Madhya Pradesh	0.353
19	Odisha	0.341
20	Assam	0.318
21	Jharkhand	0.273
22	Uttar Pradesh	0.269
23	Bihar	0.250

Source: Nilanjan Ghosh, Soumya Bhowmick and Roshan Saha, "SDG index and Ease of Doing Business in India: a Sub-national Study," ORF Occasional Paper 199, (June, 2019).

Appendix 4 : Weights calculated using Gross Fixed Capital Formation

STATES	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17**	2017-18**	2018-19**
Andaman & Nicobar Islands	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.14	0.00	0.00	0.00	0.00	0.00	0.00
Andhra Pradesh	1.00	1.00	1.00	1.00	1.00	1.00	0.58	0.41	0.66	0.51	0.67	0.67	0.67	0.67
Assam	0.66	0.79	0.74	0.72	0.80	0.87	0.58	0.32	0.86	0.96	0.84	0.84	0.84	0.84
Bihar	0.08	0.08	0.04	0.16	0.07	0.11	0.16	0.84	0.08	0.09	0.34	0.34	0.34	0.34
Chandigarh	0.00	0.01	0.01	0.00	0.01	0.00	0.00	0.52	0.01	0.01	0.00	0.00	0.00	0.00
Chhattisgarh	0.47	0.47	0.63	0.51	0.42	0.46	0.47	0.36	0.55	0.46	0.53	0.53	0.53	0.53
Dadra & Nagar Haveli	0.06	0.06	0.08	0.12	0.09	0.09	0.09	0.14	0.05	0.05	0.00	0.00	0.00	0.00
Daman and Diu	0.05	0.07	0.01	0.04	0.04	0.03	0.03	0.21	0.02	0.05	0.05	0.05	0.05	0.05
Delhi	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Goa	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Gujarat	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Haryana	0.50	0.48	0.55	0.48	0.43	0.44	0.64	0.13	0.61	0.63	0.74	0.74	0.74	0.74
Himachal Pradesh	0.11	0.19	0.17	0.16	0.18	0.17	0.14	0.34	0.09	0.04	0.11	0.11	0.11	0.11
Jammu and Kashmir	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Jharkhand	0.92	0.92	0.96	0.84	0.93	0.89	0.84	0.16	0.92	0.91	0.66	0.66	0.66	0.66
Karnataka	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Kerala	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Madhya Pradesh	0.53	0.53	0.37	0.49	0.58	0.54	0.53	0.64	0.45	0.54	0.47	0.47	0.47	0.47
Maharashtra	0.89	0.87	0.91	0.85	0.87	0.89	0.89	0.65	0.92	0.91	0.95	0.95	0.95	0.95
Manipur	0.00	0.00	0.00	0.01	0.01	0.00	0.00	0.48	0.01	0.00	0.01	0.01	0.01	0.01
Meghalaya	0.16	0.14	0.10	0.16	0.16	0.12	0.40	0.01	0.12	0.03	0.13	0.13	0.13	0.13
Nagaland	0.01	0.00	0.00	0.03	0.00	0.00	0.00	0.51	0.00	0.00	0.00	0.00	0.00	0.00
Odisha	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Puducherry	0.03	0.02	0.04	0.02	0.02	1.00	0.02	0.98	0.03	0.02	0.01	0.01	0.01	0.01
Punjab	0.39	0.32	0.28	0.35	0.37	0.38	0.21	0.02	0.30	0.31	0.15	0.15	0.15	0.15
Rajasthan	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Sikkim	0.00	0.00	0.00	0.02	0.02	0.01	0.02	0.00	0.01	0.03	0.12	0.12	0.12	0.12
Tamil Nadu	0.97	0.98	0.96	0.98	0.98	0.00	0.98	0.00	0.97	0.98	0.99	0.99	0.99	0.99
Telangana	0.00	0.00	0.00	0.00	0.00	0.00	0.42	0.59	0.34	0.49	0.33	0.33	0.33	0.33
Tripura	0.17	0.07	0.16	0.08	0.03	0.00	0.01	0.00	0.02	0.01	0.01	0.01	0.01	0.01
Uttar Pradesh	0.70	0.84	0.53	0.53	0.67	0.63	0.80	0.32	0.87	0.68	0.73	0.73	0.73	0.73
Uttarakhand	0.30	0.16	0.47	0.47	0.33	0.37	0.20	0.68	0.13	0.32	0.27	0.27	0.27	0.27
West Bengal	1.00	1.00	1.00	0.98	0.98	0.99	0.98	0.86	0.99	0.97	0.88	0.88	0.88	0.88

Source: Annual Survey of Industries and Ministry of Statistics and Programme Implementation, Government of India.

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[106] Based on their performance in terms of the SDG index the states are classified in the following manner:

- **Embryonic Stage:** SIj< (μ – σ)
- **Waking from Slumber:** (μ – σ) <SIj< (μ – 0.5 * σ)
- **Evolving Stage:** (μ – 0.5 * σ) <SIj< μ
- **Progressive Systems:** μ <SIj< (μ + 0.5 * σ)
- **Advanced Stage:** (μ + 0.5 * σ) <SIj < (μ + σ)
- **Top Performers:** SIj < (μ + σ)

where,
μ is the mean of the SI scores across the states;
σ is the standard deviation of the SI scores across the states.

[107] Based on the performance in the Ease of Doing Business index, states are classified as follows:.

- Stage 1: EDBi< mean (EDBi) – sd (EDBi)
- Stage 2: mean (EDBi) – sd (EDBi) <EDBi< mean (EDBi) – {0.5 * sd(EDBi)}
- Stage 3: mean (EDBi) – {0.5 * sd(EDBi)} <EDBi< mean (EDBi)
- Stage 4: mean (EDBi) <EDBi< mean (EDBi) + {0.5 * sd(EDBi)}
- Stage 5: mean (EDBi) + {0.5 * sd(EDBi)} <EDBi< mean (EDBi) – sd (EDBi)
- Stage 6: EDBi> mean (EDBi) + sd (EDBi)

Where mean (EDBi) refers to the mean value of the EDB index, and sd (EDBi) refers to the standard deviation of the EDB index.

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$$Y_t^j = \frac{(y_t^j - \min(y)_t^j)}{(\max(y)_t^j - \min(y)_t^j)}$$

where,

Y_t^j refers to the normalised value of FDI in state 'j' in year 't';

y_t^j refers to the value of FDI in state 'j' in year 't';

$\min(y)_t^j$ refers to the minimum FDI value across all states 'j' in year 't';

$\max(y)_t^j$ refers to the maximum FDI value across all states 'j' in year 't'.

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[138] FDI has been calculated till the year 2018-19. But according the methodology used by the authors to calculate state-wise FDI figures, GCF for the following year is required. Since Gross Capital Formation data from ASI, MOSPI is available till 2016-17, the authors have estimated FDI for the states for the years 2016-17, 2017-18 and 2018-19 using the GCF ratios for 2016-17.

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