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Manufacturing Sector in Developing Economies and Future of Make in India

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Abstract:

Historically manufacturing has worked as a most important engine of economic growth and development, particularly in developing economies. It has been empirically proven that, there is positive correlation between the degree of industrialization and the level of per capita income in developing economies. Manufacturing sector in developing economies is regarded as the largest absorber of labor force but ironically the employment share of manufacturing in the India's GDP has been pitifully low for almost the entire post-independence period of development. Manufacturing is generally seen as a synonym to industrialization which is driven by huge capital requirement. But in the absence of sufficient national savings, the developing economies find it difficult to finance their investments. These economies are in constant need of foreign capital in form of both direct and indirect investment. But inflow of foreign capital depends on many factors such as macroeconomic factors, institutional factors, political factors and socioeconomic factors. Keeping this view the Government in India launched Make in India campaign in September 2014 with an aim to transform India into global manufacturing hub. It would be interesting to see how it responds through make in India campaign and is able to achieve its objectives. An attempt is made through this paper to examine the major developing economies of world on the basis of factors affecting FDI. The trend so studied has helped to build a premise for Make in India. The study also projects the outcomes of the initiative for India based on the analysis of business environment of India.

Keywords: Developing Economies, FDI, India, Make in India, Manufacturing sector

1. Introduction

Historically manufacturing has worked as a most important engine of economic growth and development, particularly in developing economies. It accelerates the output and decelerates the unemployment. There is linkage and spillover effect between manufacturing and non-manufacturing sectors. It has been empirically proven that as countries shift from developing to developed economy, phenomenal structural transformation happens in that country, (SzirmaiaVerspagen)ⁱ like people shift from primary sector to secondary sector to tertiary sector. Disguised employment reduces from agriculture sector which is hub of such employment. People migrate from rural area to urban area. It has also been empirically proven that, there is positive correlation between the degree of industrialization and the level of per capita income in developing economies (Kaldor, 1966, 1967; Rodrik2009 ,Szirmaia, Verspagen)ⁱⁱ. This is because of huge investment which lead to multiplier effect in the economy. Manufacturing sector in developing economies is regarded as the largest absorber of labor force but ironically the employment share of manufacturing in the India's GDP has been pitifully low for almost the entire post-independence period of development. It only shares 12 percent employment, as against 49.7 and 28.7 in agriculture and service sector respectively.ⁱⁱⁱ The role of manufacturing in the economy changes over time. Empirical evidence shows that as economies become wealthier and reach middle-income status, the share of manufacturing in GDP peaks (at about 20 to 35 percent of GDP). Beyond that point, consumption shifts toward services, hiring in services outpaces job creation in manufacturing, and share of manufacturing in GDP begins to fall along an inverted U curve (McKinsey Global Institute)^{iv}. Manufacturing is generally seen as a synonym to industrialization which is driven by huge capital requirement. But in the absence of sufficient national savings, the developing economies find it difficult to finance their investments. These economies are suffered constantly from huge fiscal deficit due to huge autonomous fiscal expenditure, hence these economies are in constant need of foreign capital in form of both direct and indirect investment.

FDI is mainly defined as capital flow due to the behavior of multinational companies (MNCs). Thus, the factors to affect the behavior of MNCs may also affect the magnitude and the direction of FDI. Inflow of foreign capital particularly in developing economies depends on many factors such as macroeconomic factors, institutional factors, political factors and socioeconomic factors not only this, it also depends on the product life cycle of MNCs. Today is the era of globalization where, there is war of advertisement and battle of cost in the corporate world.

India has faced the challenge of low share of manufacturing in GDP and total employment, in last years. Keeping this view the Government in India launched Make in India campaign in September 2014 with an aim to transform India into global manufacturing hub. It was assumed that by the year 2022 it would have created around 100 million jobs and the manufacturing sector would constitute around a quarter of the GDP.^v But the biggest problem for India is that of investment. India do not have enough money to stimulate the economy, it has already fiscal deficit of 3.5% of GDP.^{vi} Although India has been dramatically improving its macroeconomic variables since last two years. It has been able to create a spot on the map of foreign investors. “We have been Ranked No. 1 investment destination by EY, IMF, frost and Sullivan, foreign policy magazine and Wharton & BAV consulting”.^{vii} But other developing economies are also competing tough among each other’s.

To predict whether make in India will success or not, is all depend on inflow of foreign capital, and this flow of foreign capital largely depends on business environment of India’s and other major developing countries of the worlds. Thus, it becomes compulsion to study and analysis the business environment of India and other countries.

2. Methodology

This paper is based on secondary data which is collected from different sources like, IMF, World Bank, WTO, Ministry of Finance, RBI, Economic survey, Ministry of Commerce Industry, Ministry of labor & Employment & Labor Bureau. Report on employment unemployment survey.

The paper study the comparative analysis of India with major developing economies of world. For that I select top five developing economies which attract highest amount of FDI in 2015 as per World Investment Report 2016 by UNCTED (see table no 1A). These economies are China, Singapore, India, Brazil, and Mexico.

3. Literature & Review

Manufacturing play a great role in the economy, particularly in developing economies. Manufacturing increase when Investor Invest money in the economy. The investment leads to economic growth because $Y = C+I+G+NX$ (Sullivan, Seffrin, Perez)^{viii}. Investment

has a multiplier effect in the economy. Investment multiplier = $\frac{1}{1-mpc}$

Where, MPC = marginal propensity to consumer.

Import has negative effect in the economy.

Because $Y = C+I+G+X-IM$

Where

- Y = Total Income/ OUTPUT
- C = Consumption expenditure
- I = Investment
- G = Govt. Expenditure
- X = Export

IM = Import

According to Cornwall (1977), as cited by (Kathuria, Raj 2010)^{ix} the manufacturing sector would act as engine of growth particularly in developing economies for two reasons –

1. Output, the scope for learning and productivity increase becomes larger. Thus, the rate of growth of productivity in manufacturing will depend positively on the rate of growth of output in manufacturing.

2. Manufacturing sector leads to enhance productivity growth through its linkages with other manufacturing and non-manufacturing sectors because it engrosses a lot of human capital, which eventually make discretionary expenditure in the economy, by which other sectors in the economy also get benefit. There is an empirical correlation between the degree of industrialization and the level of per capita income in developing countries because industrialization leads to huge injection in the economy, which has multiplayer effect in the economy. By doing this people get employment by which they create demand in the economy and in this way economy and per capita income grow (Kaldor, 1966, 1967; Rodrik, 2009) as cited by (Szirmaia, Verspagen).^x It has been empirically proven that, linkage and spillover effects are sturdier for manufacturing than in other sectors. (Szirmaia, Verspagen). Form quarter to quarter as economy grow the role of different sectors changes in the economy, like any other sector, the role of manufacturing also changes in the economy over time. Empirical evidence shows that as economies become wealthier and reach middle-income status, manufacturing’s share of GDP peaks (at about 20 to 35 percent of GDP). Beyond that point, consumption shifts toward services, hiring in services outpaces job creation in manufacturing, and manufacturing’s share of GDP begins to fall along an inverted U curve.^{xi} (Szirmaia, Verspagen)^{xii} also mention this phenomenon in their paper title Manufacturing and economic growth in developing countries, 1950–2005. Employment follows a similar pattern: manufacturing’s share of US employment declined from 25 percent in 1950 to 9 percent in 2008. In Germany, manufacturing jobs fell from 35 percent of employment in 1970 to 18 percent in 2008, and South Korean manufacturing went from 28 percent of employment in 1989 to 17 percent in 2008.^{xiii} (See Table 10) The industrialization requires huge money. But one of the economic problems of developing countries is that they do not have enough national savings to finance their investments. They are in constant need of foreign capital in forms of both direct and indirect investments. FDI is mostly defined as capital flow resulting from the behavior of multinational companies (MNCs). Thus, the factor to

affect the behavior of MNCs may also affect the scale and the direction of FDI. Agiomirgianakis *et al.* (2003) as cited by (ErdalDemirhan, MahmutMasca)^{xiv}

MNCs expand their activity for number of reasons like, the exploitation of economies of scale/scope, the use of specific advantages, often owing to a life-cycle pattern of their products or just because their competitors are engaged in similar activities.

In the Asian Development Outlook (ADB, 2004),^{xv} it has been specified that in recent years FDI has significantly enhanced as a result of many factors, such as rapid technological progress, rise of globally integrated production and marketing networks, existence of bilateral investment agreements, recommendations from multilateral development banks, and positive evidence from developing countries that have opened their doors to FDI. The determinants of FDI are divided into macroeconomic factors, institutional factors, political factors and socioeconomic factors. Macroeconomic factors include labor and potential macroeconomic risk like inflation rate and unemployment rate. Institutional factors are track record of government, corruption and civil liberties whereas political factors include political regime and political instability. Lastly, socioeconomic factor uses literacy, infant death and infant mortality rate as indicators. Infrastructure quality can be considered as a factor that affects foreign direct investment as well as per Vadlamannati, Tamazian, and Irala (2009) as cited by (ONG KER XIN, PNG GEOK THYE, POON DAO CHUN, TAN LAY YOKE, YONG KAH CHUN)^{xvi} (Table 1.1, 1.2, 1.3)

There are many factors that affect the Foreign Direct Investment in developing economies.

Labour Costs and Productivity: - Charkrabarti (2001) as cited by (ErdalDemirhan, MahmutMasca)^{xvii} claims that wage as an indicator of labour cost has been the most argumentative of all the potential determinants of FDI. There is no unanimity in the studies regarding the role of wages in attracting FDI. Goldsbrough (1979), Saunders (1982), Flamm (1984), Schneider and Frey (1985), Culem (1988), and Shamsuddin (1994) as cited by (Erdal and Mahmut) establish that higher wages discourage FDI. (See table of employment and work force of India. (See table 1.1, 2.3, 2.4)

Infrastructure: - Infrastructure covers many dimensions ranging from roads, ports, railways and telecommunication systems to institutional development (*e.g.* Accounting, legal services, *etc.*). According to ODI (1997) as cited by (derirhan, masca)^{xviii} poor infrastructure can be seen, however, as both an hindrance and an opportunity for foreign investment. However, in low-income countries, infrastructure is often cited as one of the major restraints. But foreign investors also point to the potential for attracting significant FDI if host governments permit more substantial foreign participation in the infrastructure sector.

Jordan (2004) claims that good quality and well-developed infrastructure increases the productivity potential of investments in a country and therefore stimulates FDI flows towards the country. According to Asiedu (2002) and Ancharaz (2003), the number of telephones *per* 1,000 inhabitants is a standard measurement in the literature for infrastructure development. Charkrabarti (2001) as cited by (ErdalDemirhan, MahmutMasca)^{xix}

Growth: - Economic growth regarded as one of the important indicators of health of economy. Charkrabarti (2001) as cited by (Demirhan, Masca)^{xx} states that the growth hypothesis developed by Lim (1983) maintains that a rapidly growing economy provides relatively better opportunities for making profits than the ones growing slowly or not growing at all. According to Hansen and Rand (2006), as cited by (ONG KER XIN,

P'NG GEOK THYE, POON DAO CHUN, TAN LAY YOKE, YONG KAH CHUN)^{xxi}. Rapid growth of an economy might attract more FDI by multi-national companies (MNCs) as they locate new profit opportunities. High GDP growth rate signifies soundness and stability of economic policies, and the effectiveness of the government institutions which are mainly looked for in international transactions. Thus, it will cause the levels of aggregate demand for investments (both domestic and foreign) to rise (Zhang, 2001) (see table 1.2, 2.5,)

Market size: - Market size of a country represents the potential demand for the country's output and also its economic conditions. It is an important element that will determine the foreign direct investors' investment in a particular country as per Asiedu, (2002). Charkrabarti, (2001) Moosa&Cardak, (2006) as cited by (ONG KER XIN)^{xxii} stated that a larger market size of a country indicates that the country will be more efficient in utilizing their resources and exploitation of economic of scale. Large population help in two ways first by supplying labour in the market, and second by creating demand in the market. Hence, small market size country will lose its competitiveness in comparison to such countries in attracting more investors (Medvedev, 2012). (See Table 3, 4)

Tax: - The literature remains fairly indecisive regarding whether FDI may be sensitive to tax incentives. Some studies have shown that host country corporate taxes have a significant negative effect on FDI flows. Others have reported that taxes do not have a significant effect on FDI. Hartman (1994), Grubert and Mutti (1991), Hines and Rice (1994), Loree and Guisinger (1995), Cassou (1997) and Kemsley (1998) as cited by (ErdalDemirhan, MahmutMasca)^{xxiii} find that host country corporate income taxes have a significant negative effect on attracting FDI flows. However, Root and Ahmed (1979), Lim (1983), Wheeler and Mody (1992), Jackson and Markowski (1995), Yulin and Reed (1995) and Porcano and Price (1996) as cited by (ErdalDemirhan, MahmutMasca)^{xxiv} conclude that taxes do not have a significant effect on FDI. Swenson (1994) reports a positive correlation.

Inflation rate: - Inflation rate is taken as a proxy for the level of macroeconomic stability of a country. Usually, high rate of inflation, so called the uncontrolled inflation, in a country will reduce the return on investment and act as an indicator of macroeconomic instability. It is considered as a sign of economic tension and unwillingness of the government to balance its budget and failure of the central bank to conduct appropriate monetary policy.^{xxv} (See Table 9)

3.1. Some theories of FDI

3.1.1. Production Cycle Theory of Vernon

Production cycle theory developed by Vernon in 1966 was used to explain certain types of foreign direct investment made by U.S. companies in Western Europe after the Second World War in the manufacturing industry. Vernon trusts that there are four stages of production cycle: innovation, growth, maturity and decline. According to Vernon, in the first stage the U.S. transnational companies create new innovative products for local consumption and export the surplus in order to serve the foreign markets. According to the theory of the production cycle, after the Second World War in Europe has amplified demand for manufactured products like those produced in USA. Thus, American firms began to export, having the advantage of technology on international competitors. If in the first stage of the production cycle, manufacturers have an advantage by possessing new technologies, as the product develops also the technology becomes known. Manufacturers will standardize the product, but there will be companies that you will copy it. Thereby, European firms have started duplicating American products that U.S. firms were exporting to these countries. US companies were forced to perform production facilities on the local markets to preserve their market shares in those areas. (Vintiladenisia 2009)^{xxvi}

3.2. The Eclectic Paradigm of Dunning

The eclectic theory developed by professor Dunning is a mix of three different theories of foreign direct investments (O-L-I):

1) "O" from Ownership advantages: c) Economies of large size such as economies of learning, economies of scale and scope, greater access to financial capital (refer Table 3)

2) "L" from Location: When the first condition is fulfilled, it must be more beneficial for the company that owns them to use them itself rather than sell them or rent them to foreign firms.

Location advantages of different countries are the key factors to determining who will become host countries for the activities of the transnational corporations.

The specific advantages of each country can be divided into three categories--

a) The economic welfares consist of quantitative and qualitative factors of production, costs of transport, telecommunications, market size etc. (see Table 3, 4,5)

b) Political advantages: common and specific government policies that affect FDI flows

c) Social advantages: includes distance between the home and home countries, cultural diversity, attitude towards strangers etc.

3) "I" from Internalization: Supposing the first two circumstances are met, it must be profitable for the company the use of these advantages, in association with at least some factors outside the country of origin (Dunning, 1973, 1980, 1988) as cited by (Vintila, Denisia)^{xxvii}

Unemployment causes downward pressure in the labor market. The main cause of unemployment is lack of Investment in the economy. Employment beyond a point is also not good for economy. Its cause's upward pressure in the labor market.

3.3. Analysis of Business Environment of India

1. Demographic Dividend of India:^{xxviii}

	Median Age(years)	Average Age(years)
	India	India
By 2020	31.2	
By 2030		29

Table 1

1. Demographic dividend of India:^{xxix}

LFPR	-	359 Person per 1000 Person
WPR	-	325 Person per 1000 Person
PU	-	34 Person per 1000 Person
UR	-	94 Person per 1000 Person

3.4. Category Wise

"Out of 1000 employed person, 455 are employed in agriculture, Forestry & fishing while 89 and 75 are employed in manufacturing sector respectively".^{xxx}

- "With 356 million 10-24 years old, India has world's largest youth population whereas, china rank second with 269 million youth. 28% of India's population is 10 to 14 years old. Youth growing at fastest rate in India".^{xxxii}

1. Labour Cost

Labour participation Rate 35%. Excess supply in labour market. "Every year we add 14 million into workforce. While only 2 million get formal job".^{xxxii}

2. Economic Environment

1. India's GDP predictions by different organization

Sl.no	Name of Organization	Rate of Growth In %	
		2015	2016
1.	World Bank	7.50	7.90
2.	Asian Development Bank	7.40	7.80
3.	United nations world economic situations & prospects	7.60	7.70
4.	IMR	7.50	7.50
5.	RBI	7.40	7.80
6.	Moody's	7	7.5

Table 2

2. Key macroeconomic variables: ^{xxxiii}

Data Categories	Unit	2012-13	2013-14	2014-15	2015-16
Growth Rate (GDP)	%	5.6	6.6	7.2	7.6
Saving Rate	% of GDP	33.8	33.0	33.0	Na
Capital Formation	% of GDP	38.6	34.7	34.2	Na
Per capital net national Income At current mkt. prices	Rupees	71050	79412	86879	93231
Electricity generation growth	%	4.0	6.0	8.4	4.4d
Prices					
WPI	%	7.4%	6	2	-2.8C
CPI	%	10.2	9.5	5.9	4.9C
External Sector					
Foreign exchange Reserve	US & billion	292.0	304.2	342.6	355.0
Average exchange Rate	Rs. /US \$	54.40	60.51	61.14	65.03
Money & credit					
Schedule Commercial Bank Credit	% change	14.1	13.9	9.0	11.3
Fiscal Indicator	% of GDP	4.9	4.5	4.0	3.5
Gross fiscal Deficit					
primary deficit	% of GDP	1.8	1.2	0.8	0.7

Table 3

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- Na = Not available
d = April to December 2015-16
e = April to January 2015-16
g = y-o-y growth rate on January 08, 2016
h = Budget estimate
s = Budget estimate of 2016-17

3. India is operation below its potential level or full employment level. So, there is aenormous opportunity for growth and to push economy towards full employment level. Investors are looking positively towards India. "We have been ranked No. 1 investment destination by EY, IMF, Frost & Sullivan foreign policy magazine" "we have also been ranked No. 1 investment destination by Wharton & BAV consulting, beating Singapore, Ireland, Indonesia and Vietnam." ^{xxxiv}

4. Conclusion

Share of manufacturing sector in India's economy has been pitiably low since post-independence. Population growth is consistently increasing in India. Every year Work force are entering in labour market at large number. But majority of population are still depended on agriculture. If we would not promote our manufacturing, then the big assets which we have today in the form of human capital would become liability. This will push the economy backward. Although government of India is aware with the situation. Skill India, digital India, e-krinti, Make in India, smart cities, etc. are result of his awareness.

Business environment of India is looking very comprehensive. Population is growing at very fast rate. If we maintain the same pace for a long time, then India would be world's most populated country. With 365 million 10 -24 years, old, India has world's largest youth population. There is excess supply in the labour market in India which means low wage rate in labour market. India has achieved the phenomenal growth rate in last five years which made India world's fastest growing economy. All the macroeconomic variables of India are showing favorable condition for doing business here. Major economic and demographic indicators are improving consistently by leaps and bound. Government is proactively working to create a vibrant inventor friendly environment in

India. Foreign investors have very high expectations from India. India has emerged as best FDI destination among all the developing economies of world.

Major economies of world are not performing well from past tow three years. There is recession like situation in economies like Japan, EU, UK and up to some extent in USA & Russia. Liquidity trap like situation are there in the countries like UK, Japan, EU. Growth rate of major developing economies like China, Singapore, Mexico, and Brazil, are slowing down. Inflation rate in some of the economies like Brazil, are considerably high. In some of the economies like Singapore, China inflation rate is either very low or in negative. In most of the economies like China, Singapore, Indonesia, share of manufacturing in GDP has achieved the empirically proven the standard level. Most of the economies like China, Singapore, and have crossed the danger level of credit GDP gap.

On the other most of the economic, demographic, and political indicators of India are demonstrating very sound position. India has emerged as the fastest growing major economy in the world. India has absolute demographic and economic advantage in the world. It has emerged as best FDI destination among developing economies. Today is the era of globalization, where there is war of advertisement and battle of cost in the corporate world. Thus, to fight such battle India seems to best battle fields in the world. Thus, Make in India campaign to transform India into global manufacturing hub is going to success in future.

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**Appendix
Global Comparative Analysis**

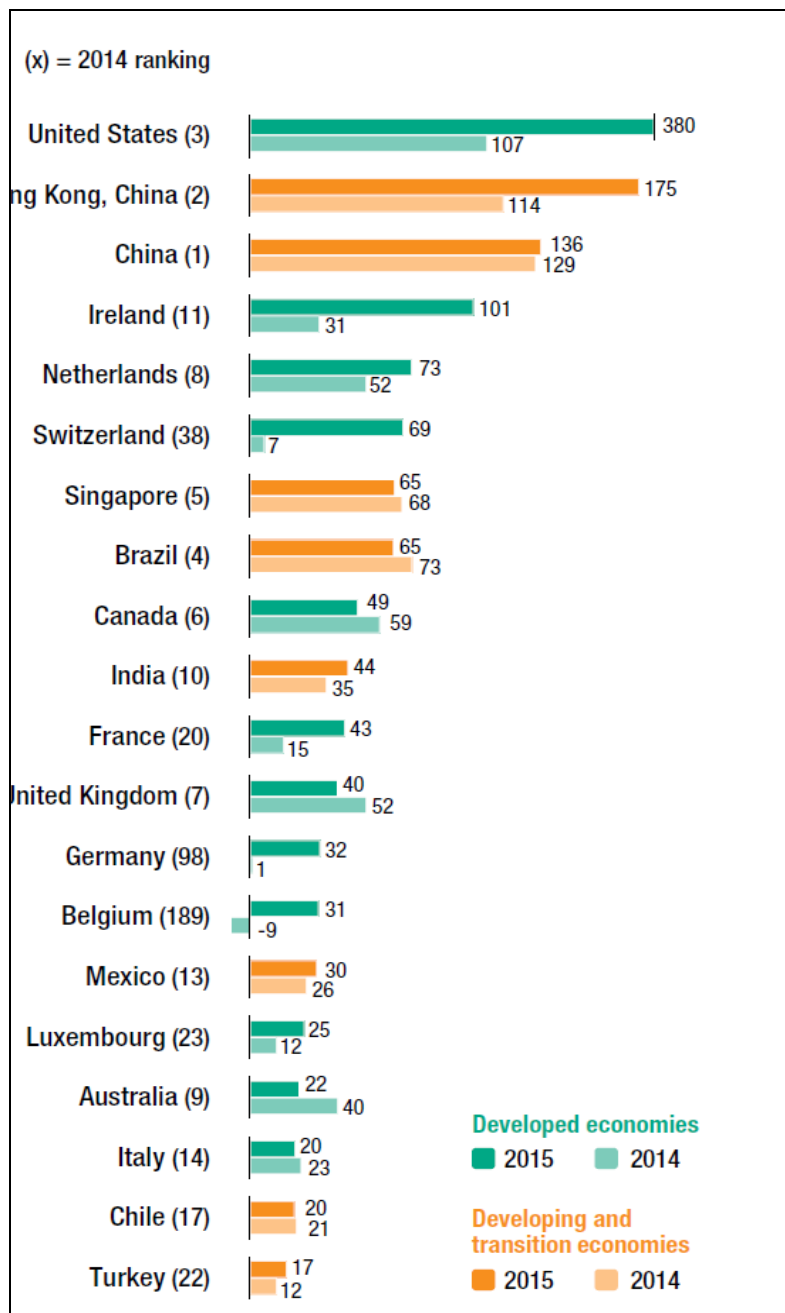


Figure 1: FDI Inflows, top 20 host economies, 2014 and 2015 (Billions of dollars)

Name of countries	2015	Growth rate % annual
China	1.37	.506
Singapore	.0053	1.298
Brazil	.279	.886
India	1.31	1.227
Mexico	.126	1.31

Table 4: Population size 2015 billion: ^{xxxv}

Name of countries	Age- 65 years and above	15 to 64 years	0 to 14
China	9.18	73.61	17.2
Singapore	11.05	70.07	15.88
Brazil	7.58	68.9	23.53
India	5.49	65.3	29.21
Mexico	6.31	65.63	28.06

Table 5: Age distribution % of total population:^{xxxvi}

Name of countries	2011	2012	2013	2014	Average growth %
China	790	796	802	806	.633
Singapore	2.9	3	3.06	3.11	2.33
Brazil	105	106	108	110	1.53
India	475	478	488	497	1.5
Mexico	51	53	54	55	2.57

Table 6: Labour force (fig. million):^{xxxvii}

Name of countries	2011	2012	2013	2014
China	4.3	4.5	4.6	4.7
Singapore	2.9	2.8	2.8	3
Brazil	6.7	6.2	6.5	6.8
India	3.5	3.6	3.6	3.6
Mexico	5.3	4.9	4.9	4.9

Table 7: Unemployment rate %:^{xxxviii}

Name of countries	2013	2014	2015e	2016f	2017f	2018f
China	7.7	7.3	6.9	6.7	6.5	6.3
Singapore	N/A	N/A	N/A	N/A	N/A	N/A
Brazil	3	0.1	-3.8	-4	-0.2	0.8
India	6.6	7.2	7.6	7.6	7.7	7.7
Mexico	1.4	2.3	2.5	2.5	2.8	3

Table 8: GDP growth rate:^{xxxix}

E --- Estimates, f--- Forecast, N/A --- Not available

Name of countries	2011	2012	2013	2014	2015
China	5.4	2.6	2.6	2	1.4
Singapore	5.3	4.5	2.4	1	-0.5
Brazil	6.6	5.4	6.2	6.3	9
India	8.9	9.3	10.4	6.4	5.9
Mexico	3.4	4.1	3.8	4	2.7

Table 9: Inflation – consumer price index annual %:^{xl}

Name of countries	2011	2012	2013	2014
China	31.50	31.01	30	Na
Singapore	20.26	20.38	18.78	18.40
Brazil	13.87	12.58	12.31	11.67
India	18	17.7	17.08	17.05
Mexico	17.07	17.89	17.57	17.67

Table 10: Manufacturing value added % of GDP:^{xli}

Name of countries	2011	2012	2013	2014	Q1 2016
China	6.7	13.8	19.4	22.2	30.1
Singapore	6.6	14.6	22.6	22.5	14.8
Brazil	12	12.1	10.6	9.1	4.6
India	2.6	1.6	-0.1	-3	-2.9
Mexico	4.5	4.2	6.3	6.5	8.3

Table 11: Credit to GDP gap

Credit gap %

https://www.bis.org/statistics/tables_j.pdf^{xlii}