CHAPTER IV
RESULTS AND DISCUSSION

As the overall objective of the study is to analyse the Foreign Direct Investment in India with a set of specific objectives already spelt out, the discussion in this chapter is presented in the following sequence

1. The analysis of inflows of FDI is discussed in terms of four components viz., pattern of FDI inflow, actual FDI inflow as a percentage of the FDI approval, analysis of FDI - sourcewise, i.e., the countries from which the FDI had been flowing over the study period and the analysis of FDI - destinationwise, i.e., where the FDI had ultimately ended up with. This is discussed with reference to the FDI flows in major Indian industries.

2. Determinants of FDI inflows were also identified using a multiple regression analysis. This is followed by the impact of FDI on select macro aggregates of the Indian economy.

3. To provide the necessary background to understand the issues involved in FDI inflows in India, the policies of the Government of India are discussed since liberalization.

4. The objectives and functions of Institutions that have been established in the past to design, monitor and regulate the inflows of FDI are discussed next.

5. Problems experienced and involved in the FDI inflows are discussed to bring to light the dimensions of changes required in planning and policies of FDI.
1. Analysis of FDI inflows

A] Pattern of Foreign Direct Investment (FDI) inflow

To discern the pattern of FDI inflow into India, the total FDI from 1980 to 2000-01 was taken and analysed. The FDI included various components like inflow through:

a) SIA/FIPB channel
b) Reserve Bank of India channel
c) Non-Resident Indian deposits

d) acquisition of shares in Indian companies. By analysing the total inflow of FDI, it would be possible to identify pattern of the inflow over the period. For this purpose, a simple linear regression of quadratic type was fitted. The result of the analysis is presented below.

### TABLE IV 1 INFLOW OF TOTAL FDI

| Y = 120.1197 - 79.4063 T + 10.59567 T² * * |
| (-0.95023) (2.8722) |

<table>
<thead>
<tr>
<th>Y = Foreign Direct Investment</th>
<th>T - Year</th>
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<tbody>
<tr>
<td>N = 21</td>
<td>Df = 18</td>
</tr>
<tr>
<td>R² = 0.7903</td>
<td>Figures in parentheses are 't' values</td>
</tr>
</tbody>
</table>

[** - Significant at 5% level]

From the above result, it would be clear, that the FDI had been subjected to a mixed pattern of increasing and decreasing over the period. This is evident by the Figure 4.1.

It had been fluctuating. The slope co-efficient is statistically not significant, but the growth coefficient is statistically significant. This implies that over the period, the FDI had been declining at a weak, but increasing rate. This underscored the need for further probing in relation to various other parameters determining FDI inflow.
FIG: 4.1 FOREIGN DIRECT INVESTMENT IN INDIA FROM 1980 TO 2001
Actual FDI inflow as a percentage of Approval

Over the period 1980 to 2000-01, the actual FDI inflow was computed as a percentage of quantum of FDI approved by the government. It was found that this percentage was declining over the period under reference. This is evidenced by the quadratic function fitted for the percentage of actual FDI inflow expressed in relation to approved quantum of FDI. The result is presented below.

**TABLE IV 2: ACTUAL FDI INFLOWS AS PERCENTAGE OF APPROVED INFLOWS**

<table>
<thead>
<tr>
<th>Y = 41.61521 - 6.0578 T - 0.6006 T²**</th>
</tr>
</thead>
<tbody>
<tr>
<td>(- 2.03713) (1.99649)</td>
</tr>
</tbody>
</table>

Y = Foreign Direct Investment  T - Year
N = 11  Df = 8  R² = 0.3973  Figures in parentheses are 't' values
[** - Significant at 5% level]

From the above result, it is clear that as every year passed, the actual inflow of FDI as a percentage of FDI approvals, declined by about $6 m. What is more alarming is that this decline had been taking place at an increasing rate as shown by the positive statistically significant acceleration coefficient. This is clear from the Figure 4.2.

For the purpose of above analysis, data relating to 1990 to 2000-2001 was used, as data relating to earlier years on FDI approvals was not available. Hence, the results could be viewed as an indicator of post-liberalization experience of the country. Added to this, the coefficient of variation of actual FDI inflow as a percentage of FDI approvals revealed that the percentage fluctuated by 20.72%. Such a wide fluctuation should be
FIG: 4.2 FDI INFLOWS
[ACTUAL AS PERCENTAGE OF APPROVALS]
taken serious note of. This necessitates review of government policies towards FDI, as otherwise in the years to come, inflow of FDI would go down. This has to be viewed seriously, because, in the context of several other countries like China and South East Asian countries are formulating favourable policies to attract larger inflow of FDI.

C] Analysis of FDI - Sourcewise

FDI inflows have come from various countries. Over a period of about eight years, [from 1993 to 2000] there had been a fall in FDI inflows observed in the case of all countries, especially after 1997. This general pattern indicates that the investors abroad waited for the investment climate to improve after 1997. The reasons for this slow down in FDI inflows should be analysed to reverse the trend. The country-wise FDI inflows from 1993 to 2000 is given in the Table IV 3.

From Table IV 3, it could be seen that the countrywise inflow of FDI had been declining over the period, implying that investors abroad had been adopting a 'wait and watch' approach, especially after 1997. Even in the case of Non resident Indians, this tendency is clearly discernable as the percentage of FDI through this channel declined from about 11.78 to 1.60 in 1999, though it picked up marginally in 2000 [4.37%]. USA is one source, which had been constituting a large percentage of total FDI inflow in to India throughout the 90's, but it also slowed down during the decade and finally it ended up at 11.33% by the beginning of the 21st century. All the other countries also reacted in the same way as could be seen from the table. This implies that India had not been
focusing on the alarming change in the inflow pattern and devised its policies accordingly. The extent of percentage variation in the inflow of FDI as indicated by the Coefficient of variation, reveals a very dismal picture. The consistency is never experienced in the inflow from any country. The magnitude of variation ranged between 27.72% in the case of Japan and 213.18% for UAE. Such a wide variation in inflow necessitates a critical review of our FDI policies and makes suitable changes in them. Added to this, India should study the investors in each country, wherefrom inflows are significant and develop policies customized to the country concerned. However, this does not mean the policies could be contradictory. Further, the priority of each investing country should be scrutinized closely so as to direct the inflows into the productive channels and re-direct the flows into unproductive channels. Such an exercise has to be undertaken on a yearly basis. This could start right from the stage of approval till the stage of actual receipt and investment. Apart from these, India should undertake vigorous marketing efforts in prospective and potential destinations, by widely promoting the investible opportunities available in India. This should be reviewed regularly so as to furnish the investors the relevant data and other support required by them. The sourcewise inflows of FDI is represented in Figure 4.3.
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<td>USA</td>
<td>39.06</td>
<td>24.59</td>
<td>22.00</td>
<td>27.82</td>
<td>24.72</td>
<td>11.56</td>
<td>12.60</td>
<td>11.33</td>
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<td>UK</td>
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<td>9.16</td>
<td>5.38</td>
<td>4.22</td>
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<td>10.39</td>
<td>10.44</td>
<td>1.11</td>
<td>43.65</td>
</tr>
<tr>
<td>JAPAN</td>
<td>2.91</td>
<td>2.83</td>
<td>4.72</td>
<td>4.12</td>
<td>3.47</td>
<td>4.16</td>
<td>5.62</td>
<td>2.23</td>
<td>27.72</td>
</tr>
<tr>
<td>NETHERLANDS</td>
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<td>1.46</td>
<td>3.01</td>
<td>2.90</td>
<td>1.59</td>
<td>1.61</td>
<td>2.23</td>
<td>0.01</td>
<td>51.88</td>
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<td>4.26</td>
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<td>2.77</td>
<td>4.03</td>
<td>1.60</td>
<td>29.86</td>
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<tr>
<td>SWITZERLAND</td>
<td>4.82</td>
<td>0.34</td>
<td>0.97</td>
<td>0.44</td>
<td>0.90</td>
<td>0.93</td>
<td>1.03</td>
<td>0.19</td>
<td>116.50</td>
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<tr>
<td>UAE</td>
<td>4.57</td>
<td>0.36</td>
<td>0.05</td>
<td>0.15</td>
<td>0.17</td>
<td>0.05</td>
<td>0.04</td>
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<td>HONGKONG</td>
<td>0.99</td>
<td>1.16</td>
<td>1.27</td>
<td>1.41</td>
<td>1.47</td>
<td>0.77</td>
<td>0.16</td>
<td>1.14</td>
<td>43.39</td>
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<td>0.63</td>
<td>1.31</td>
<td>3.63</td>
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<td>1.67</td>
<td>5.10</td>
<td>0.55</td>
<td>78.41</td>
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<td>SOUTH KOREA</td>
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<td>0.75</td>
<td>0.98</td>
<td>8.91</td>
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<td>1.20</td>
<td>12.85</td>
<td>0.11</td>
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<td>2.76</td>
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<td>0.38</td>
<td>2.18</td>
<td>0.90</td>
<td>6.20</td>
<td>0.29</td>
<td>92.71</td>
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<td>MAURITIUS</td>
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<td>3.77</td>
<td>5.64</td>
<td>6.46</td>
<td>19.00</td>
<td>10.27</td>
<td>13.40</td>
<td>19.53</td>
<td>54.43</td>
</tr>
<tr>
<td>NON RESIDENT INDIANS</td>
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<td>3.46</td>
<td>2.21</td>
<td>6.06</td>
<td>3.31</td>
<td>2.44</td>
<td>1.60</td>
<td>4.37</td>
<td>59.86</td>
</tr>
</tbody>
</table>
D] Analysis of FDI - Destinationwise

One of the important aspects of FDI inflow is to examine the direction in which the FDI inflows have been moving over the study period. For this purpose, the inflow of FDI into various sectors was analysed. This is provided in Table IV.4. It could be noted from the table that the finance sector experienced increasing inflows of FDI from 1992-93, which slowed down in 1996-97, increased in 1998-99 and then remained a low priority for investors as evidenced by poor inflows in 1999-2000 and 2000-2001. On the other hand, the Engineering sector could attract FDI in increasing quantity from 1992-93 which reached a peak of US $ 730 m in 1996-97 and remain hovering around US $ 300 m since then. Electronics and equipments sector revealed a similar pattern but the inflow had been subjected to greater variation as revealed by a higher coefficient of variation [93.08 per cent]. Chemical and allied sector is also one of the beneficiaries of FDI inflows and this sector had the second consistent inflows next to Pharmaceuticals sector. Services sector displayed a dormant picture at least till 1993-94 and then slowly picked up to join the race, but became active after 1997-98. Food and dairy sector remained relatively passive throughout the period under reference though there was an occasional peak in 1996-97. Pharmaceutical sector remained the least active terms of inflow of FDI, as, since 1992-93, its inflow never crossed US $ 62 m. As a result the consistency of the FDI inflows into this sector remained very high compared to the other sectors. Computers sector had fluctuating FDI inflows, recording less than US $ 60 m till 1996-97 and then doubling to end up with a peak of US $ 306 m in 2000-2001. The extent of variation in FDI inflows into this sector is very high as is indicated
by the coefficient of variation [102 per cent] All the other sectors put together also do not present a significantly different inflows pattern. Hence, the inter-year FDI inflow pattern revealed a mixed picture that no specific sector had any significant and consistent FDI inflows.

**TABLE IV.4 FDI INFLOWS - INDUSTRYWISE DESTINATION**

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>Finance</td>
<td>37</td>
<td>42.2</td>
<td>97.7</td>
<td>270.0</td>
<td>217.0</td>
<td>147.9</td>
<td>184.8</td>
<td>-0</td>
<td>40.0</td>
<td>113.7</td>
<td>79.21</td>
</tr>
<tr>
<td>Engineering</td>
<td>69.9</td>
<td>32.9</td>
<td>131.6</td>
<td>261.9</td>
<td>730.2</td>
<td>579.9</td>
<td>427.6</td>
<td>326.0</td>
<td>273.0</td>
<td>313.7</td>
<td>70.05</td>
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<td>Electronics &amp; Equipments</td>
<td>32.8</td>
<td>57.1</td>
<td>56.4</td>
<td>129.6</td>
<td>153.6</td>
<td>644.6</td>
<td>226.3</td>
<td>172.0</td>
<td>213.0</td>
<td>167.5</td>
<td>93.08</td>
</tr>
<tr>
<td>Chemical &amp; Allied Services</td>
<td>47.0</td>
<td>37.5</td>
<td>141.2</td>
<td>126.7</td>
<td>303.3</td>
<td>257.3</td>
<td>375.5</td>
<td>120.0</td>
<td>137.0</td>
<td>171.8</td>
<td>63.39</td>
</tr>
<tr>
<td>Services</td>
<td>2.4</td>
<td>20.2</td>
<td>93.4</td>
<td>100.5</td>
<td>15.2</td>
<td>321.3</td>
<td>368.5</td>
<td>116.0</td>
<td>226.0</td>
<td>140.4</td>
<td>90.81</td>
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<tr>
<td>Food &amp; Dairy</td>
<td>27.9</td>
<td>43.5</td>
<td>60.9</td>
<td>85.0</td>
<td>237.5</td>
<td>112.3</td>
<td>18.6</td>
<td>121.0</td>
<td>75.0</td>
<td>86.9</td>
<td>72.15</td>
</tr>
<tr>
<td>Pharmaceuticals &amp; Cals</td>
<td>3.1</td>
<td>49.5</td>
<td>10.1</td>
<td>54.8</td>
<td>47.6</td>
<td>33.8</td>
<td>28.4</td>
<td>54.0</td>
<td>62.0</td>
<td>38.1</td>
<td>51.29</td>
</tr>
<tr>
<td>Computers</td>
<td>3.3</td>
<td>7.6</td>
<td>10.2</td>
<td>52.1</td>
<td>58.7</td>
<td>139.2</td>
<td>106.2</td>
<td>99.0</td>
<td>306.0</td>
<td>87.5</td>
<td>102.0</td>
</tr>
<tr>
<td>Others</td>
<td>69.1</td>
<td>76.1</td>
<td>162.2</td>
<td>347.0</td>
<td>278.3</td>
<td>656.8</td>
<td>262.1</td>
<td>553.0</td>
<td>578.0</td>
<td>331.7</td>
<td>62.61</td>
</tr>
</tbody>
</table>

The inter-sectoral comparison of inflow of FDI was undertaken to identify the sectoral preference of the investors over the study period. Table IV.5 contains details about the percentage of FDI inflow into the selected sectors since 1992-93 to 2000 - 01. It could be noted from the table that Engineering, Electronics and equipments and Chemical and allied services sector together accounted for nearly 54 per cent of total FDI inflow in 1992-93. But in 1993-94, except the Electronics and equipments sector, the other two received lesser percentage of inflow. On the other hand, Finance, Services, Food &
dairy and Pharmaceutical sectors recorded significant improvement in FDI inflows during 1993-94. They received more than 40 per cent of the total inflows during that year. In 1994-95, the finance sector received marginally lesser percentage of inflows compared to 1993-94, but engineering, Chemical and allied services, sector experienced increased inflows of FDI. The year 1995-96 was more favourable towards finance, engineering and electronics and equipments sectors, while the other sectors recorded poor inflows. In 1996-97, engineering sector alone registered almost doubling of inflows (35.5 per cent) in FDI compared to 1995-96. Apart from this, the chemical and allied and food and dairy sectors alone recorded improvement in inflows. The year 1997-98 witnessed a reversal in the trend observed in 1996-97, as there was nearly 16 per cent decline in inflows recorded by the Engineering sector, but an appreciable increase in inflows was reported by electronics and equipments sector. Service sector once again became popular with nearly 11 per cent of FDI inflows, and marginal increase in inflows was witnessed by computer sector. The erratic fluctuations in inflows of FDI in to the different sectors continued in 1998-99. This is supported by the increase in inflows found with Finance, Engineering, Chemical and allied services and services sectors, which together received more than 56 per cent of the total FDI inflow during that year. The year 1999 - 2000 was a shock for almost all the sectors, though only food and dairy sector improved upon its previous performance of FDI inflows. Services, computers and electronic and equipments sectors had some positive increase in their inflows of FDI in 2000-01 while the other sector had nothing spectacular to discuss about.
### TABLE IV.5 FDI INFLOWS - INDUSTRYWISE DESTINATION

[PERCENTAGE OF TOTAL INFLOW]

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</tr>
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<tbody>
<tr>
<td>Finance</td>
<td>1.32</td>
<td>11.44</td>
<td>11.20</td>
<td>19.04</td>
<td>10.55</td>
<td>5.00</td>
<td>9.24</td>
<td>1.27</td>
<td>2.1</td>
</tr>
<tr>
<td>Chemical &amp; Allied</td>
<td>16.79</td>
<td>10.16</td>
<td>16.19</td>
<td>8.94</td>
<td>14.77</td>
<td>8.70</td>
<td>18.78</td>
<td>7.59</td>
<td>7.17</td>
</tr>
<tr>
<td>Services</td>
<td>0.86</td>
<td>5.47</td>
<td>10.71</td>
<td>7.09</td>
<td>0.74</td>
<td>10.87</td>
<td>18.43</td>
<td>7.34</td>
<td>11.83</td>
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<tr>
<td>Food &amp; Dairy</td>
<td>9.96</td>
<td>11.79</td>
<td>6.98</td>
<td>5.99</td>
<td>11.55</td>
<td>3.80</td>
<td>0.93</td>
<td>7.65</td>
<td>3.93</td>
</tr>
<tr>
<td>Pharmaceuticals &amp; Cals</td>
<td>1.11</td>
<td>13.41</td>
<td>1.16</td>
<td>3.86</td>
<td>2.31</td>
<td>1.14</td>
<td>1.42</td>
<td>3.42</td>
<td>3.25</td>
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<td>Computers</td>
<td>2.96</td>
<td>2.06</td>
<td>1.17</td>
<td>3.67</td>
<td>2.85</td>
<td>4.71</td>
<td>5.31</td>
<td>6.26</td>
<td>16.02</td>
</tr>
<tr>
<td>Others</td>
<td>30.32</td>
<td>21.27</td>
<td>31.02</td>
<td>24.51</td>
<td>14.26</td>
<td>24.35</td>
<td>13.11</td>
<td>34.98</td>
<td>30.26</td>
</tr>
</tbody>
</table>

Destination-wise analysis of FDI inflows revealed that no sector preference was discernable over the study period. The reasons for such an erratic inflows pattern into various sectors have to be analyzed and based on that necessary modifications in policies are to be brought about. The destination-wise FDI inflows is represented in Figure 4.4.
FIGURE 4.4: FDI - DESTINATIONWISE

PERCENTAGE OF INFLOW

INDUSTRY

TOTAL
OTHERS
D. APPLIANCES
COMPUTERS
PHARMACEUTICALS
FOOD & DAIRY
SERVICES
CHEMICAL
ELECTRONICS
ENGINEERING
FINANCE

1992-93
1993-94
1994-95
1995-96
1996-97
1997-98
1998-99
1999-00
2000-01
2. Determinants of FDI inflows

One of the important objectives of this study is to identify the determinants of FDI inflows. This would help to examine the policies relating to each one of these determinants so as to make the overall environment favourable for increased inflows of FDI in to India. In this context, the following determinants were selected: Gross Domestic Product [GDP], Coal Production [CLPRDN], Number of telephone lines [TELE], Exports [EXP], Imports [IMP], Number of commercial vehicles registered [a proxy for infrastructural development] [COMMVHL], population [proxy for potential market size] [POP], foreign exchange reserve [EXRSR] and industrial disputes [IDIS]. Each one of these determinants were selected for the justifications explained in the Chapter on Methodology.

With the above variables, the multiple regression equation used is given below:

\[ \text{FDI} = a + b_1 \text{GDP} + b_2 \text{CLPRDN} + b_3 \text{TELE} + b_4 \text{EXP} + b_5 \text{IMP} + b_6 \text{COMMVHL} + b_7 \text{POP} + b_8 \text{EXRSR} + b_9 \text{IDIS} \]

In the above equation, 'a' is the intercept and \( b_1, b_2, \ldots, b_9 \) are the coefficients of the respective variable.

The result of the above equation is presented in the Table IV.6 below.
From the table it could be noted that the variables included in the regression equation explained nearly 97 per cent of the variations in the FDI inflows\(R^2 = 0.968\). The F value also is found statistically significant \(F = 33.6453\) implying that the equation is fit for drawing inferences.

Among the determinants included in the equation, Gross Domestic Product, Number of telephone lines, Exports, Imports, Number of commercial vehicles registered and
Number of industrial disputes were found to be statistically significant. The other determinants are not statistically significant.

Gross Domestic Product represents the productive capacity of the economy. It reflects both the size of the domestic market and the purchasing power of the citizens. A positive relationship between GDP and FDI implies that FDI flows into an economy with a sufficiently large host country market to accommodate the increase in local supply. From the equation it is clear GDP is statistically significant. It implies that a unit increase in GDP would lead to 0.016 unit increase in FDI. The positive relationship between GDP and FDI has to be read in conjunction with India's objective to achieve a higher growth rate.

Coal production is taken as a proxy for mineral resources in the country. This determinant was not statistically significant in the above function.

Number of telephone lines, taken as a proxy for improvement in standard of living of the people, was positively related to FDI inflows. This implies that with improvement in standard of living, the demand for improved communication facilities would go up. This in turn would open up opportunities for multinational corporations to invest in the development of telecommunication sector. The statistically significant coefficient of this variable \( t = 1.96941 \) indicate, that for every unit increase in number of telephones, the FDI inflows would go up by 0.17 unit. This is very much justified by the Governmental action to privatize the telecommunication sector. This could be expected to give a boost.
to the inflow of FDI in to India. Further with the improvement in communication facilities in the country, the access to remote markets would become possible, which would enlarge the business opportunities. This again would have favourable impact on the inflow of FDI.

Exports have inverse relationship with the FDI inflows. This is because, as the level of nation's exports increases, it has the effect of altering local labour market and driving domestic wages towards world levels. So FDI becomes less profitable. Hence, the exports would decline with increase in inflow of FDI. This also very much supported by the increasing wage levels in the private sector units in Indian economy. As regards the public sector and government employees, the Government had announced the Pay commission causing a hefty hike in wages and salary. This is very much conformed by the negative sign in the regression equation shown above. The co-efficient of exports was also statistically significant. With every unit addition to exports, the FDI inflows would decline by 0.02 units.

As regards imports, they are directly related to inflow of FDI. This is very much in consistence with the findings of the previous studies. The past studies have concluded that FDI flows into those countries that are importing goods from abroad. Import substitution argument also explains the reasons for inflow of FDI. FDI credits vertically integrated production units and so increases the amount of trade. Given the oligopolistic structure of markets and international integration, imports and the level of FDI are always complementary. In the case of India, with the liberalization, entry of
multinational corporations has facilitated inflow of modern technology. As a result, imports have gone up along with the increase in inflow of FDI.

The coefficient of imports in the above regression equation was statistically significant. One unit increase in imports leads to 0.059 unit increase in imports.

There exists a very close relationship between infrastructural development and inflow of FDI. This is because, the infrastructure should improve to attract foreign manufacturers. With lower wages and greater profit potential, there exists a positive relationship between FDI inflows and the level of development of the country's infrastructure. In the above regression equation, the number of commercial vehicles registered was taken as a proxy for infrastructural development. This variable was found to be statistically significant as could be seen from the equation. With every unit addition to number of commercial vehicles registered, the FDI inflows would go up by about 0.45 units.

In reality, a number of automobile manufacturers like Ford, Hyundai, General motors and others in the passenger car segment and Suzuki, Kawasaki and others in the two wheeler segment have brought in a revolution in these segments and consumers have a very wide choice. The increasing sale of heavy vehicles reported, also indicate the improvement in infrastructural development. At the national and state level, higher allocations are made towards development of roads. Development of roads is also taking place on 'Build Operate and Transfer' [BOT] basis. This augurs well for India, as
Increasingly number of multinational corporations are entering into this segment of infrastructure.

Population is considered as a measure of potential market size of the host country. A larger population would increase the projected profit from foreign investment. Hence, FDI inflows have a direct relationship with the size of population. But in the regression equation fitted, population was not statistically significant. Foreign exchange reserve was also not statistically significant in the above equation.

Industrial disputes in a country reflect the level of manufacturing in the industrial sector. With larger number of industrial disputes, the production of the industrial sector is bound to be low. This would bring down the profit expectations. As a result number of industrial disputes adversely affect the inflow of FDI. In Indian experience, the increasing disturbance in the industrial scene has a dampening effect on the inflow of FDI. Hence, a negative sign associated with the coefficient of industrial dispute in the regression equation is very much consistent. In the above equation, industrial disputes turned out to be statistically significant. The coefficient indicated that with every unit increase in industrial disputes, the inflow of FDI would go down by 0.537 units.

Impact of FDI on select macro aggregates

The impact of FDI inflows on various macro aggregates was also analysed to ascertain whether the inflows had any beneficial effect on the economy. The macro aggregates
selected were employment, Gross domestic savings, Net national product, personal disposable income and enrolment in schools. Each of these aggregates is significant from the point of view of economic growth. Hence necessary policy initiatives have to be suitably tuned. This would be taken into account while suggesting policy options.

The results of the functions fitted for the selected macro aggregates are presented in the Table IV 7 below.

**TABLE IV 7 IMPACT OF FDI ON SELECT MACRO AGGREGATES**

<table>
<thead>
<tr>
<th>Macro aggregate</th>
<th>Regression equation</th>
<th>R²</th>
<th>'t'</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment</td>
<td>( Y = 25.7810 + 0.000899X )</td>
<td>0.62</td>
<td>5.1344</td>
</tr>
<tr>
<td>Gross Domestic Savings</td>
<td>( Y = 20.7169 + 0.0011X )</td>
<td>0.40</td>
<td>3.5300</td>
</tr>
<tr>
<td>Net National Product</td>
<td>( Y = 271165 + 288.0852X )</td>
<td>0.54</td>
<td>4.7508</td>
</tr>
<tr>
<td>Personal Disposable Income</td>
<td>( Y = 258357 + 379.3096X )</td>
<td>0.80</td>
<td>8.5942</td>
</tr>
<tr>
<td>Enrolment in Schools</td>
<td>( Y = 132.3252 + 5.85187X )</td>
<td>0.76</td>
<td>5.0524</td>
</tr>
</tbody>
</table>

[\( ** \) Significant at 5% level]

One of the justifications given for liberalization was, that it would encourage inflow of FDI and in turn generate employment opportunities. To examine whether this had happened in Indian experience after liberalization, a simple regression was fitted taking employment as a dependent variable and FDI inflows as independent variable. The result presented in the table given above indicate that over the period [since 1991],
employment had been increasing as evidenced by positive regression coefficient 
\[+ 0.000899\] This implies that for every unit increase in FDI, employment would go up 
by about 0.0009 unit.

As regards domestic savings, this is an important macro aggregate as it lays down the 
basis for supply of funds for investment. An economy like China experienced a very 
high rate of domestic savings [above 40 per cent], consequent to the opening up of the 
economy. This in turn provided a strong foundation for attracting more FDI inflows. 
India with about 23 per cent of domestic savings should improve its level of savings to 
reap the benefits of inflow of FDI. Even the existing level of inflow of FDI has benefited 
Gross domestic savings in India. This is because, with the entry of multinational 
corporations, the wages and salary structure has gone up. With more income, the 
savings capacity of the economy has also gone up. This is substantiated by the 
equation stated in the table above. The statistically significant coefficient implies that for 
every unit increase in FDI inflows, the Gross domestic saving would increase by about 
0.0011 unit.

FDI inflows have a positive impact on Net National Product [or National income]. This is 
because, infrastructural development and better utilisation of available resources take 
place with the liberalization of the economy. Consequently, the output in the economy 
also grows, contributing to national income. Since liberalization, a positive impact on 
national income is observed with increasing FDI inflows. The regression equation 
shown in the table supports this. The statistically significant regression coefficient
implies that for every unit addition to FDI inflows, the national income goes up by 288.0852 units.

Personal disposable income reflects the purchasing power of the people. Larger this component of income, greater would be the demand for goods and services and savings potential. Consequent to liberalization, the earnings potential of skilled and trained workforce have gone up, as is evident from the direction of FDI flows to electronics industry, services sector and consumer durable industry. With huge population size, the increase in Personal disposable income has a salutary effect on further inflow of FDI. From the table given above, it could be understood that with a unit increase in FDI inflows, the personal disposable income would go up by 379.3096 units. The statistically significant coefficient implies that since liberalization, continued inflow of FDI has improved the personal disposable income.

The impact of inflow of FDI on enrolment in school was taken to indicate the extent of trained manpower required by the country after liberalization. This is because, India is a most favoured destination of the foreign investors, because of the availability of cheap labour. The multinational corporations seek trained manpower for their operations. So unless education and training opportunities are improved, soon preference for India for investment may be lost. So enrolment in school was taken for analysis.
Enrolment in school also has a statistically significant relationship with inflow of FDI. This is clear from the regression equation contained in Table IV.7. The coefficient implies that for every unit of increase in FDI inflows, the enrolment goes up by 5.85 units.

**POLICY ON FDI**

The government policies on Foreign Direct Investment (FDI) have been changing since 1991-92. Analysis of these policies would help to place in proper perspective the prospects and problems of FDI. This was also taken into consideration while suggesting methods of improving the inflows of FDI.

As apart of the structural adjustment policies introduced in the Indian economy by the Government of India since July 1991, policies relating to foreign financial participation in Indian companies and those relating to foreign technology agreements have also undergone a radical change. Briefly stated, three tiers for approving proposals for foreign direct investment in the country were introduced: (1) the Reserve Bank's automatic approval system, (2) Secretariat for Industrial Approvals for considering proposals within the general policy framework but outside the powers delegated to Reserve Bank; and (3) Foreign Investment Promotion Board, specially created to invite, negotiate and facilitate substantial investment by international companies that would provide access to high technology and world markets. The foreign investment policy was further liberalized during the period under review. Fully owned foreign
enterprises will henceforth be allowed to set up giant power projects without the requirement to balance dividend payments with export earnings.

The general permission granted by the Reserve Bank under the provision of the Foreign Exchange Regulation Act, 1973 has brought the FERA companies (i.e. those having more than 40% foreign equity) on par with the Indian companies and thus provides a level playing field to all. The existing FERA companies have also been extended the facility of 51% equity. Also, the use of foreign brand names and trademarks on goods for sale within the country has been permitted. Significant amendments to the FERA for relaxing several of its restrictive provisions have been contemplated.

The following measures were introduced in the recent period to further liberalise the foreign investment policy:

(1) Except for 22 industries in the consumer goods sector, the earlier stipulation that dividend remittances of companies receiving approval under the foreign equity up to 51% scheme, must be balanced by export earnings over a period of 7 years, was scrapped in respect of all foreign direct investment (by non-NRIs) in June 1992. The measure was extended to investment by NRIs / Overseas Corporate Bodies (OCBs) in September 1992.

(2) For the purpose of investment in oil refineries and development of discovered oil fields, foreign private equity participation to the extent of 26 per cent is considered
as sufficient For making investment in Indian companies, NRIs / OCBs have been granted automatic approval by the RBI to invest, with full repatriation benefits, up to 100% in the issue of capital or convertible debentures of a private / public limited company engaged in or proposing to engage in high priority industries, subject to certain conditions.

The existing scheme of 100% NRI investment in cent per cent export oriented units and also for the revival of sick units will continue cent per cent NRI participation in power generation has also been permitted. In the context of such revisions, the earlier 74% scheme has been discontinued.

The Government has set up a Bureau, officially known as the Interface for NRI Scientists and Technocrats (INRIST), that will bring NRI scientists and technocrats in contact with Indian industries which would benefit from the expertise of NRIs.

The Department of Industrial Development has set up an "investment promotion and project monitoring cell" popularly known as facilitation cell, to provide pre and post investment services for different industrial approvals and respond to queries relating to various ministries / departments.

RBI has granted general permission to foreign citizens of Indian origin, whether resident in India or not, to acquire / hold and transfer by sale or inheritance, residential properties situated in India subject to certain stipulations.
General permission has been granted to Non-resident Indian citizens and foreign citizens of Indian origin to let out their residential properties acquired for their bonafide residential purpose but which on account of their residence abroad, are not required for their immediate residential purpose. The rental income or proceeds of any such income shall both be repatriable outside India at any time in future and such funds should be credited to the owner's Ordinary Non Resident Rupee account maintained with an authorized bank in India.

In order to simplify and remove regulations which hinder free flow of foreign capital into India as also investment by Indian companies in joint venture overseas, restriction imposed on FERA companies (i.e., companies incorporated in India in which the non-resident interest is more than 40%) under sec 26 (7), 28, 29, and 31 of FREA, 1973 have all been removed as outlined below, thereby placing them on par with other Indian companies in regard to their operations in India. FERA companies are now permitted.

(a) To borrow money or accept deposits from persons resident in India.

(b) To accept appointment as agent or technical or management advisers in India, of any person or company.

(c) To allow their trademarks to be used by any person or company

(d) To carry on in India any activity of trading, commercial or industrial nature except agricultural and plantation activity

(e) To acquire any undertaking in India carrying on any trade, commerce or industry or purchase the shares of any such company, and
(f) To acquire, hold, transfer or dispose of by sale, mortgage, lease, gift, settlement or otherwise any improvable property in India

Person of Indian nationality or origin and others (returning home after a minimum stay of immediate preceding 6 months abroad) have been granted general permission to bring into India as part of their baggage, gold, in any form, up to 5000gms, provided duty is paid at the rate of Rs220/- per 100 gms. (earlier Rs 450/- per 10 gms) in any convertible foreign currency (1)

As part of the continuing efforts to provide an investment friendly environment in India for foreign investors, the following policy initiative were undertaken during the year 1992-93.

(I) To keep pace with the ever expanding global technological revolution in the field of computers, an Electronic Hardware Technology Park (EHTP) scheme was set up allowing for 100% equity participation, duty free import of capital goods and a tax holiday i.e. exemption from corporate income tax for block of 5 years commencing from the date of the starting of commercial production.

(II) In the new National mineral policy, the ceiling on foreign equity participation in Indian companies engaged in mining activities was hiked to 50%. In the area of non-captive mines, equity participation of over 50% by foreign partners could be considered on a case by case basis.
(III) Authorized dealers were delegated powers to allow remittance of dividend (including interim dividend) on equity / preference shares to non-resident shareholders of all Indian companies, as also those in which investments have been made by NRIs / OCBs under the 40% scheme or any other scheme with repatriation benefits.

(IV) NRIs were allowed to invest up to 100% on non-repatriation basis, in any partnership / proprietorship concern or in private / public limited companies (except in agricultural / plantation activities) without seeking prior approvals of other RBI. However, OCBs are not permitted to invest in proprietorship / partnership concerns.

In keeping with the objective of attracting funds from the NRIs in the form of deposit and foreign investment several steps were taken during the year 1993 - 94, such inflows, even while adhering to considerations of cost effectiveness and dampening of volatility. Major policy initiatives undertaken during the year were as follows:

(1) Deposits Under Foreign Currency Non Resident Account (FNCRA) scheme proved to be volatile during the payments crisis of 1990-92. They were also relatively costly given the spread above international interest in the prescription of interest rates for these deposits as also the cost implicit in the provision of exchange guarantee for such deposits. In this regard, the Bank’s Annual Report for 1992-93 had observed, "attempts have been made in the recent period to restructure the existing FCNRA scheme and to put in place new schemes which (a) reduce the reliance on the FCNRA
scheme, (b) make exchange risk cover a commercial proposition, and (c) reduce volatile components of deposits under the existing FCNRA scheme. In pursuance of this objective deposits of four different maturities i.e. "6 months and above but less than one year", one year and above but less than two years," two years and above but less than three years", "and three years only" were completely withdrawn effective from May 15, 1993, Oct 12, 1993, Feb 15, 1994 and August 15, 1994 respectively. Furthermore, interest rates prescribed on FCNRA of various maturities were fine-tuned from time to time to secure alignment with movements in international interest rates. Interest rates on Non Resident (External) Rupee Accounts (NR (E) R) deposits were also revised downwards effective Oct 18, 1994 while the interest rate on savings deposits was brought down from 5% to 4.5% those on term deposits are not allowed to exceed 8%. (II) In consonance with the move toward full convertibility in the current account, the interest accruing on deposits under Non Resident (Non - Repatriable) Rupee Deposits (NR (NR) RD) was rendered eligible for repatriation effective from Oct 1, 1994. The principal amount under the scheme will continue to be non-repatriable. (III) The Foreign Currency Ordinary Non-repatriable (FCON) scheme, introduced in June 1991, under which the principal as well as interest earned were not repatriable, was suspended with effect from August 20, 1994. Interest accruing on the existing FCON scheme from the quarter beginning Oct 1, 1994 was however made eligible for repatriation.
Major policy changes were effected with a view to ensuring that investment flows were channelled in a manner consistent with overall Macro-economic requirements. The following policy guidelines were drawn out in this regard:

(IV) With a considerable improvement in the external payments position and the level of reserves, it was considered necessary to follow a restrictive policy towards Foreign Currency Convertible Bonds (FCCBs) as they constitute a part of the country’s external debt till their conversion into equity. As per the fresh guidelines of the government (issued on May 11, 1994) for Euro issues, companies were allowed to issue FCCBS only on merits as a part of the external debt restructuring programme which was intended to lengthen maturity and soften terms.

(V) Under the automatic approval scheme for foreign investments, new guidelines were issued for determining issue price of preferential shares issued to foreign investors to increase their stakes up to 51% in the business of any Indian company engaged in the high priority industries shown in the Annex-III to the statement on industrial policy of July 24, 1991.

Consequent upon the abolition of the office of the Controller of Capital Issues (CCI) and subsequent guidelines issued by the Securities and Exchange Board of India (SEBI) on June 11 and 17, 1992, existing companies wishing to raise foreign equity were to make the issue at a price decided by the shareholders in a special resolution. In certain proposals received from the existing companies for enhancement of foreign
equity, however, the companies were found to be issuing foreign equities at a large
discount to the market price, (set out in the last year's Report) This mismatch in the
price of shares for investment and dis-investment could cause distortion in the inflows
and outflows of foreign exchange under the head of foreign investment

With the objective of preventing a few shareholders from getting substantial and undue
enrichment and unearned gains, to ensure higher foreign equity flows, and to make
both investment and dis-investments market-related, it was decided with effect from
August 4, 1994 that preferential allotment of shares by companies must be at market
related price applicable to all foreign investment proposals whether approved by the
RBI or by the SIA/FIPB subject to the following guidelines

The issue price of shares under preferential allotment (other than allotment on rights
basis), would have to be at the market value of the shares determined on the basis of
their average price during the immediate preceding six months at the main listing
center calculated on the monthly average of the high and low rates quoted for the
shares at such centres. In the absence of a market price, however, (as in the case of
Unlisted companies, Listed companies, where shares are not regularly traded, etc) the
RBI would be guided by the net asset value and earnings per share.

vi) Indian companies engaged in or proposing to engage in housing and real
estate development, i.e., (1) development of serviced plots and construction of built-up
residential premises, (2) real estate covering construction of residential and
commercial premises including business centers and offices, (3) development of
townships, (4) city and region level urban infrastructure facilities including roads and
bridges, (5) manufacturing of building materials and (6) financing of housing
development were allowed to issue shares/convertible debentures to NRIs up to 100%
of the new issue on repatriation basis. Repatriation of original investment in such
cases would be permitted by the RBI only after a lock in period of three years from the
date of issue of shares / debentures.

The above facilities which were not available to OCBs, have now been extended to
them on the same terms and conditions as applicable to NRIs.

vii) NRIs / OCBs were so far permitted to invest in schemes of domestic Mutual Funds
floated by public sector banks / financial institutions on non-repatriation basis. With a
view to providing further incentives to NRIs / OCBs to invest in domestic Mutual Funds,
they were permitted to invest on repatriation basis also. As a new policy measure, such
investments were also permitted to be made through secondary market.

(viii) Under the Oct 1993 guidelines for issue of bonds by Public Sector Undertaking
(PSUs), Government have allowed PSUs to issue bonds under its public issues to
NRIs / OCBs through prospectus by private placement with the facility of repatriation of
both principal and interest on the bonds. No limit, however, has been specified for NRI
/ OCB investments in such bonds.
(ix) Besides the various investment facilities extended to NRIs / OCBs on repatriation basis and under various non-repatriable schemes, the NRIs / OCBs were permitted to make investment in partnership / proprietorship concern, shares, debentures of Indian companies, Indian mutual funds floated by public sector banks / financial Institutions, deposits with Indian companies, real estate, etc. Neither the investment / deposit amount nor the income / interest thereon, was eligible for repatriation. Further, the investment / deposits held in India by Indian nationals who have become non-residents on account of their going abroad on employment / immigration, as well as income / interest earned on such investment / deposits was not allowed earlier to be repatriated abroad. The income / interest on such investment / deposits are, however, now permitted to be repatriated in a phased manner over a period of three years, as indicated below

(I) Income accruing during 1994-95 and thereafter to the extent of US $1000 per annum is remittable with immediate effect (b) income earned over and above US $1000 in a year would be allowed to be remitted as follows:-

(1) One third of the annual income earned during the financial year 1994-95, (2) Two third of the annual income earned during 1995-96 and (3) the entire amount earned during 1996-97 and onwards. Remittance of such income, however would be allowed only after the payments of tax as per the provision of the Income Tax Act (3)
With a view to opening more areas for investment by NRIs / OCBs RBI has decided to allow them to invest, on a repatriation basis, in all activities except agriculture and plantation activities, subject to certain conditions during 1994 - 95. Accordingly, existing or new Indian companies (both private and public limited companies) engaged in proposing to engage in any activity including financial, hire purchase leasing, trading other services etc (except agricultural / plantation activities) are allowed to issue equity shares / convertible debentures on repatriation basis to NRIs / OCBs provided the aggregate allocation of shares / convertible debentures qualifying for repatriation benefits to such non-residing investors does not exceed 24% of the new issue. Earlier NRIs and OCBs were permitted to invest on a repatriation basis in new issues of shares / convertible debentures made by companies engaged in industrial or manufacturing activities and also in certain other sectors such as hotels, hospitals, shipping development of computer software and oil exploration. It has also been decided to permit authorized dealers to grant loans to NRIs holding Indian passports for acquisition of a house / flats for residential purpose against security of immovable property proposed to be acquired by them subject to certain conditions.

(II) As a process of further liberalisation, general permission has been granted to NRIs / OCBs to purchase the shares on repatriation basis of Public Sector Enterprise (PSES) dis-invested by Central Government subject to the condition that (a) the holding of share by a NRI or by an OCB, at any time, does not exceed one percent of the paid-up capital of the PSE concerned, (B) the purchase consideration/bid money is received by way of remittance from abroad through normal banking channels.
(III) NRIs resident in Nepal will be permitted hence forth to make investment in India provided the funds for the purpose are remitted in free foreign exchange through proper banking channels. Such investments will either be on repatriation or on non-repatriation basis depending on the terms and conditions applicable under the existing schemes under NRI investment.

(IV) In the context of on going economic liberalisation, the policy and procedures governing approvals under the schemes for 100% Export Oriented Units (EOUs) and Export processing Zones (EPZs) were further revised. All proposals conforming to the parameters presented vide press note No13 (1991) series dated Oct 9, 1991, Department of Industrial Development, Ministry of Industry, shall receive automatic approval within two weeks from Secretariat of Industrial Approvals (SIA), Ministry of Industry (Department of Industrial Development) in the case of 100% EOU and from the Developments Commissioners (DCs) concerned for units to be set up in EPZs. All other proposals which do not conform to the parameters for automatic approvals, shall be considered by the Board of Approvals (BOA) and disposed within 45 days from SIA.

(V) Under the National Telecom Policy, 1994 which enunciates the guidelines for the entry of private sector into Basic Telecom Services, joint venture between an Indian and a foreign company is allowed subject to a maximum of 49% equity participation from the latter.
(VI) It has been decided that foreign investment up to 51% and foreign technology agreements in the case of bulk drugs, their intermediates and formulations thereof (except those produced by the use of recombinant DNA technology) will be granted automatic approval subject to the parameter of RBI (4).

Since the second half of 1993-94, the Indian economy has experienced surges in capital flows which took the forms of foreign investment flows both direct and portfolio, and inflows into various deposit schemes for non-resident Indians. With current account deficits remaining modest during 1993-94 and 1994-95, the policy response to the capital flows was accommodative and this enabled an unprecedented build up of international reserves. With the consequent attenuation of monetary targets threatening the objective of inflation control, the policy stance switched to one of throwing sand in the wheels in the second half of 1994-95. Various measures put in place were progressively tightened during the first half of 1995-96 in support of the conduct of monetary policy. With the widening of the current account deficit and the onset of volatility in the foreign exchange markets in the second half of 1995-96, the restrictive stance of policy was eased and a number of measures were taken to relax controls and allow for a larger inflow of foreign capital. As in the past, these measures were related to foreign investment flows and deposits by NRIs and the policy objective of attracting capital flows has been carried forward during the first half of 1996-97 (5).

Policy changes in 1996-97 were: Under the Automatic route, the ceiling for lump sum payments of technical know-how fee was increased from Rs. 1 crore to US $2 million,
effective Nov 5, 1996 With a view to liberalizing the existing facility for investments by NRIs in India, it was decided to allow investments by NRIs to establish schools and colleges in India subject to certain regulations. With a view to expanding the coverage of investment proposals considered under the Automatic Approval Route effective Jan 17, 1997, the Government announced the inclusion in Annexure III of the statement of Industrial Policy 1991 (i) 3 categories of industries / items relating to mining activities for foreign equity up to 50% (ii) 13 additional categories of industries / items for foreign equity up to 51% and (iii) 9 categories of industries / items for foreign equity up to 74% (6)

Foreign Direct Investment was allowed into sixteen non-banking financial services (merchant banking, underwriting, portfolio management services, investments advisory services, financial consultancy, stock broking, asset management, venture capital, custodial services, factoring, credit refinancing, credit rating, leasing and finance, housing finance, forex holding and credit card services) during the year 1997-98, through the Foreign Investment Promotion Board (FIPB) subject to guidelines relating to minimum capitalization norms, schedule of capitalization and domestic equity participation. In a major drive to simplify procedures for foreign direct investment under "automatic route, the Reserve Bank dispensed with the need for its prior approval for such proposals. In order to simplify procedures further in respect to foreign direct investment cases already approved by the Government of India (SIA / FIPB), the Reserve Bank dispensed with requirement for its "in principle" permission before receiving overseas investment or for issuing shares to foreign investors. Indian companies satisfying the
conditions stipulated in the letter of approvals issued by SIA / FIPB could issue shares / securities to foreign investors and file one copy of the application together with required documents with the concerned Regional office of Reserve Bank within 30 days from the date of issue of shares. Expanding the scope of “automatic route” for foreign direct investments, the government of India approved 13 additional categories of industries / items under services sector for foreign equity participation up to 51% of the equity, three items relating to mining activity up to 50% foreign equity participation and nine categories of industries / activities up to 74% foreign equity participation.

As a part of liberalization process, Reserve Bank of India decided to permit foreign banks operating in India to remit their profits surplus to their head offices without the approvals of the Reserve Bank. The permission is subject to the banks complying with the provisions of Banking Regulation act, 1949 (7).

Financial turmoil in the world economy, imposition of economic sanctions and sluggishness in domestic activity had some bearings on foreign investment during the year. The Union Budget, 1999 - 2000 announced the establishment of Foreign Investment Implementation Authority [FIIA] in order to rationalize and simplify approval and implementation procedures of foreign investment proposals. With a view to further facilitating inflows of foreign direct investment, expansion of automatic list of approvals and a more dynamic role for Foreign Investment Promotion Board were also announced (8).

A number of policy initiatives were taken during the year to further facilitate inflows of foreign investment. In August 1999, a Foreign Investment Implementation Authority (FIIA) was established for speedy conversion of approvals to actual flows. The Insurance Regulatory and Development Act (IRDA) was passed in December 1999 permitting foreign equity participation in domestic private insurance companies up to 26% of the paid-up capital. Moreover, investments in all sectors, except for small negative list, were placed, in February 2000, under automatic route for direct investments. Indian companies were allowed, subject to specified norms, to raise funds for investments through issue of ADRs / GDRs without prior government approval and up to 50% of these proceeds were allowed for acquisition of companies in overseas markets. Indian companies could acquire companies engaged in information technology and entertainment software, pharmaceuticals and bio - technology in the overseas market through stock - swap options up to $ 100 m on automatic basis or ten times the export earnings during the preceding financial year as reflected in the audited balance sheet, whichever is lower (9).

FDI is seen as a means to supplement domestic investment for achieving a higher level of economic growth and development. FDI benefits domestic industry as well as the Indian consumers by providing opportunities for technological up-gradation, access to
global managerial skills and practices, optimal utilization of human and natural resources, making Indian industry internationally competitive, opening up export markets, providing backward and forward linkages and access to international quality goods and services. Towards this end, the FDI policy has been constantly reviewed, and necessary steps have been taken to make India a most favourable destination for FDI. The major initiative taken to attract FDI during 2000–2001 & 2001–2002 are as follows:

- In pursuance of Government’s commitment to further facilitate Indian industry to engage unhindered in various activities, Government has permitted, except for a small negative list, access to the automatic route for FDI, whereby, foreign investors only need to inform the Reserve Bank of India within 30 days of bringing in their investment, and again within 30 days of issuing any shares

- Non-Banking Financial Companies (NBFCs) may hold foreign equity up to 100% if these are holding companies

- Foreign investors can set up 100% operating subsidiaries (without any restriction on number of subsidiaries) without the condition to disinvest a minimum of 25% of its equity to Indian entities, subject to bringing in US $50 m out of which US $ 7.5 m to be brought upfront and the balance in 24 months. Joint venture operating NBFCs that have 75% or less than 75% foreign investment will also be allowed to set up subsidiaries for undertaking other Non Banking Financial Company
activities, subject to the subsidiaries also complying with the applicable minimum capital inflow

- FDI up to 49% from all sources is permitted in the private banking sector on the automatic route subject to conformity with RBI guidelines

- In the process of liberalization of FDI policy, the following policy changes have been made
  
  (i) 100% FDI permitted for B to B e-commerce
  
  (ii) Condition of dividend balancing on 22 consumer items removed forthwith
  
  (iii) Removal of cap on foreign investment in the Power Sector
  
  (iv) 100% FDI permitted in oil-refining

- Automatic Route is available to proposals in the Information and Technology Sector, even when the applicant company has a previous joint venture or technology transfer agreement in the same field. Automatic Route of FDI up to 100% is allowed in all manufacturing activities in Special Economic Zones (SEZs), except for the following activities

  (i) Arms and ammunition, explosives and allied items of defence equipment, defence aircraft and warships,

  (ii) Atomic substances,

  (iii) Narcotics and Psychotropic substances and hazardous chemicals,

  (iv) Distillation and brewing of alcoholic drinks,
(v) Cigarettes / cigars and manufactured tobacco substitutes

FDI up to 100% is allowed with some conditions for the following activities in Telecom Sector:

(i) ISPs not providing gateways (both for satellite & submarine cables),

(ii) Infrastructure Providers providing dark fiber (IP Category I);

(iii) Electronic Mail,

(iv) Voice Mail

FDI up to 74% is permitted for the following telecom services subject to licensing and security requirements (proposals with beyond 49% shall require prior Government approval) (i) internet services providers with gateways, (ii) Radio Paging, and (iii) End-to-end bandwidth

Payment of royalty up to 2% on exports and 1% on domestic sales is allowed under automatic route on use of trademarks and brand name of the foreign collaborator without technology transfer. Payment of royalty up to 8% on exports and 5% on domestic sales by wholly owned subsidiaries to offshore parent companies is allowed under the automatic route without any restriction on the duration of royalty payments.
Offshore Venture Capital Funds / Companies are allowed to invest in domestic venture capital undertakings as well as other companies through automatic route, subject only to SEBI regulations and sector specific caps on FDI.

FDI up to 26% is eligible under Automatic Route in the Insurance sector, as prescribed in the Insurance Act, 1999, subject to their obtaining licence from Insurance Regulatory & Development Authority.

FDI up to 100% is permitted in airports, with FDI above 74% requiring prior approval of the Government.

FDI up to 100% is permitted with prior approval of the Government in courier services subject to existing laws and exclusion of activities relating to distribution of letters. FDI up to 100% is permitted with prior approval of the Government, for development of integrated township, including housing, commercial premises, hotels, resorts, city and regional level urban infrastructure facilities such as roads and bridges, mass rapid transit systems, and manufacture of building material in all metros, including associated commercial development of real estate. Development of land and providing allied infrastructure will form an integral part of township's development.

FDI up to 100% is permitted on the automatic route in hotel and tourism sector and for Mass Rapid Transit Systems in all metropolitan cities, including associated commercial development of real estate. FDI up to 100% in drugs and Pharmaceuticals (excluding those, which
attract compulsory licensing or produced by recombinant DNA technology and specific cell/tissue targeted formulations) placed on the automatic route

- The defence industry sector is opened up to 100 per cent for Indian private sector participation with FDI permitted up to 26 per cent, both subject to licensing

- International Financial Institutions like Asian Development Bank, International Financial Corporation, Commonwealth Development Corporation, German Investment and Development Company (DEG) etc , are allowed to invest in domestic companies through the automatic route, subject to Securities and Exchange Board of India / Reserve Bank of India Guidelines and sector specific caps on FDI (10)

Institutions for promoting FDI

a] FOREIGN INVESTMENT PROMOTION BOARD [FIPB]

1 The Government is committed to promoting accelerated growth in the industrial sector. The role of foreign direct investment (FDI) as a means to support domestic investment for achieving a high level of economic development is well recognized. Increasing the level of inflow of FDI into the country is one of the main objectives of the Government's economic development strategy. In order to achieve this goal the Government is also committed to putting in place appropriate institutional
arrangements and transparent rules, procedures and guidelines for investment
promotion and for considering and approving the proposals for FDI. Accordingly, the
Government have decided to constitute the Foreign Investment promotion Board
(FIPB). The Board will comprise the core group of secretaries to Government and
would have the following composition

(i) Industry Secretary, Chairman (Secretary, Department of Industrial policy &
promotion), Government of India

(ii) Finance Secretary, Government of India

(iii) Commerce Secretary, Government of India

(iv) Secretary (Economic Relations), Ministry of External Affairs, Government of
India

The Board may co-opt other secretaries to the Government of India and top
officials of financial institutions, banks and professional experts of industry and
Commerce, as and when necessary.

The objective, functions and procedures of the Board will be as detailed below

Objective

The objective of the Board will be to promote the inflow of foreign direct
investment (FDI) into India –

(i) by undertaking investment promotion activities and

(ii) through facilitating investment in the country by international companies,
non resident Indians (NRIs) and other foreign investors in projects which
are considered to be of benefit to the Indian economy but do not qualify for automatic approval by the Reserve Bank of India (RBI) and / or are outside the parameters of the existing policy for clearance of investment proposals. The Board shall consider all investment proposals with or without technical collaboration and / or industrial

Functions

The main functions of the Board will be as follows

(i) to ensure expeditious clearance of the proposals for foreign investment

(ii) to review periodically the implementation of the proposals cleared by the Board

(iii) to review on a continuous basis the general and sectoral policy regimes relating to FDI and in consultation with the Administrative Ministries and other concerned agencies evolve a set of transparent guidelines for facilitating foreign investment in various sectors

(iv) to undertake investment promotion activities including establishment of contact with the invited selected international companies to invest in India in the appropriate projects

(v) to interact with the Industry Associations/ Bodies and other concerned Government and Non-Government agencies on relevant issues in order to facilitate increased inflow of FDI
(vi) to identify sectors into which investment may be sought keeping in
view of the national priorities and also the specific regions of the
world from which investment may be invited through special efforts
(vii) to interact with the Foreign Investment promotion Council (FIPC)
being constituted separately in the Ministry of Industry, and
(viii) to undertake all other activities for promoting and facilitating
foreign direct investment, as considered necessary from time
to time

The Board would submit its recommendations to the Government for suitable action

PROCEDURES

The FIPB should meet on a fixed day every week to ensure quick disposal of the cases
and may have more frequent meetings whenever considered necessary. Foreign
investment proposal received by the Board's Secretariat should be put up to the Board
with in 15 days of receipt and the Administrative Ministers must offer their comments
either prior to and / or in the meeting of the FIPB. It should be the endeavor of FIPB to
ensure that as far as possible the Government's decisions on a FDI proposal is
communicated to the applicant within six week. The Board shall have the flexibility of
purposeful negotiation with the investors and consider project – proposals in totality free
from parameters, in order to ensure maximum foreign direct investment into the country.
It would function as a transparent, effective and investor friendly single window
providing clearance for foreign investment proposals. The Board will lay down its own
mode and working procedures keeping in view the requirements of each proposal considered by it.

APPROVAL LEVELS

The recommendation of FIPB in respect of the project – proposals each involving a total investment of Rs 600 crores or less would be considered and approved by the Industry Minister. The recommendation in respect of the projects each with a total investment of Rs 600 crores would be submitted to the Cabinet Committee on Foreign Investment (CCFI) for decision. The CCFI would also consider the proposals which may be referred to it or which have been rejected by Industry Minister. The approval letters in all cases will be issued by Secretariat of FIPB.

SECRETARIAT

There shall be only one secretariat of FIPB to be located in the department of Industrial policy & promotion, Ministry of Industry. This secretariat would receive and process the applications / proposals for foreign investment and place them before FIPB for consideration. Thereafter, it would submit the recommendations of the Board to the Industry Minister of CCFI, as the case may be for decision. The secretariat will ensure that all the applications received by it are put up before FIPB within 15 days of their receipt and that the Administrative Ministries must offer comments either prior to and/or in the meeting of FIPB. The secretariat would also be responsible for communicating to
the applicants the decisions of the Government on their proposals and would carry on the activities relating to post-approval amendments providing advice and guidance to the entrepreneurs and investors and investment promotion and facilitation

GUIDELINES FOR THE CONSIDERATION OF FOREIGN DIRECT INVESTMENT PROPOSALS BY THE FOREIGN INVESTMENT PROMOTION BOARD

The Government has taken a series of steps to further liberalize and streamline the procedures and mechanism for approval of both domestic and foreign direct investment. In fulfillment of its commitment to provide greater transparency in decision making, the Government has announced a set of Guidelines for consideration of foreign direct investment proposals by the Foreign Investment Promotion Board.

A set of Guidelines announced in this regard is given below for general information and for information of investors.

The following Guidelines are laid down to enable the Foreign Investment Promotion Board (FIPB) to consider the proposals for Foreign Direct Investment (FDI) and formulate its recommendations.

1. All applications should be put up before the FIPB by the SIA (Secretariat of Industrial Assistance) within 15 days and it should be ensured that comments of
the administrative ministries are placed before the Board either prior to/or in the meeting of the Board

2 Proposals should be considered by the Board keeping in view the time-frame of 30 days for communicating the Government decision.

3 In cases in which either the proposal is not cleared or further information is required, in order to obviate delays presentation by applicant in the meeting of the FIPB should be resorted to

4. While considering cases and making recommendations, FIPB should keep in mind the sectorial requirements and the sectorial policies vis-à-vis proposal(s).

5 FIPB would consider each proposal in totality (ie., if it includes apart from foreign investment, technical collaboration/industrial license) for composite approval or otherwise. However, the FIPB's recommendation would relate only to the approval for foreign investment, technical collaboration and the foreign investor will need to take other prescribed clearances separately.

6 The Board should examine the following while considering proposals submitted to it for consideration

- Whether the items of activity involve industrial license or not and if so the considerations for grant of industrial license may be gone in to;

- Whether the proposal involves technical collaboration and if so - (a) the source and nature of technology sought to be transferred, (b) the terms of payment (payment of royalty by 100% subsidiaries is not permitted)

- Whether the proposal involves any mandatory requirement for exports and if so whether the applicant is prepared to undertake such obligation (this is for
small Industry units, as also for dividend balancing and for 100% EOU/EPZ units);

- Whether the proposal involves any export projection and if so the items of export and the projected destinations,

- Whether the proposal has concurrent commitment under other schemes such as EPCG Scheme etc

- In the case of Export Oriented Units (EOUs) whether the prescribed minimum value addition norms and the minimum turnover of exports are met or not

- Whether the proposal involves relaxation of location restrictions stipulated in the industrial licensing policy, and

- Whether the proposal has any strategic or defense related considerations

- Whether the proposal has any previous joint venture or technology transfer/trademark agreement in the same or allied field in India, the detailed circumstances in which it is considered necessary to set-up a new joint venture/enter into new technology transfer (including trademark), and proof that the new proposal would not in any way jeopardize the interest of the exiting joint venture or technology/trademark partner or other stake holders.

7. While considering proposals the following may be prioritized

a) Items falling within Annexure - III of the New Industrial Policy (i.e. those which do not qualify for automatic approval)
(i) Items falling in infrastructure sector

(ii) Items which have an export potential

(iii) Items which have large scale employment potential and especially for rural people,

(iv) Items which have a direct or back ward linkage with agro-business / farm sector

(v) Items which have greater social relevance such as hospitals, human resource development, life saving drugs and equipment

(vi) Proposals which result in induction of technology or infusion of capital

The following should be especially considered during the scrutiny and consideration of proposals

(a) The extent of foreign equity proposed to be held (keeping in view sectorial caps if any – e.g. 24% for SSI units, 40% for air taxi / airlines operators, 49% in basic / cellular / paging, etc. in telecom sector) 100% FDI is allowed in specified activities of Telecom sector. Vide press note No. 7, dt. 14.7.2000 and No. 9 dt. 8.9.2000

(b) Extent of equity with the composition of foreign / NRI (which may include (OCB) / resident Indians.

(c) Extent of equity from the point of view whether the proposed project would amount to a holding company / wholly owned subsidiary / accompany with dominant foreign investment (i.e. 76% or more) venture.
(d) Whether the proposed foreign equity is for setting up a new project (joint venture or otherwise) or whether it is for enlargement of foreign / NRI equity or whether it is for fresh induction of foreign equity / NRI equity in an existing Indian company.

(e) In the case of fresh induction of foreign / NRI equity and / or in case of enlargement of foreign / NRI equity in existing Indian companies whether there is a resolution of the Board of Directors supporting the said induction/enlargement of foreign / NRI equity and whether there is a shareholders agreement or not.

(f) In the case of fresh induction of equity in the existing Indian companies and/or enlargement of foreign equity in existing Indian companies, the reason why the proposal has been made and the modality for induction/enhancement [i.e., whether by increase of paid up capital/authorized capital, transfer of shares (hostile or otherwise) whether by rights issue, or what modality].

(g) Issue / transfer / pricing of shares will be as per SEBI / RBI guidelines.

(h) Whether the activity is an industrial or a service activity or a combination of both.

(i) Whether the item of activity involves any restriction by way of reservation for the small scale sector.

(j) Whether there are any sectorial restriction on the activity (e.g. there is ban on foreign investment on real estate while it is not so for NRI / OCB Investment).
(k) Whether the item involves only trading activity and if so whether it involves export or both export and import, or also includes domestic trading and if domestic trading whether it also includes retail trading.

(l) Whether the proposal involves import of items, which are either hazardous, banned or detrimental to environment (e.g. import of plastic scrap or recycled plastics).

9. In respect of the industries/activities listed in Annex III now refer to Annexure 'B' of schedule 1 to FEM (Transfer or Issue of security by a person Resident outside India) Regulations, 2000, given in Appendix 32 1 of the New Industrial Policy automatic approval for majority equity holding (50 / 51 / 74 per cent) is accorded by the Reserve Bank of India. FIPB may consider recommending higher levels of foreign equity in respect of these activities keeping in view the special requirements and merit of each case.

10 In respect of other industries/activities the Board may consider recommending 51 per cent foreign equity on examination of each individual proposal. For higher levels of equity up to 74 per cent the Board may consider such proposals keeping in view consideration such as the extent of capital needed for the project, the nature and quality of technology, the requirement of marketing and management skills and the commitment for exports.
11 FIPB may consider and recommend proposal for 100 per cent foreign owned holding/subsidiary companies based on the following criteria

(a) where only "holding" operation is involved and all subsequent/downstream investment to be carried out would require prior approval of the government,

(b) where proprietary technology is sought to be protected or sophisticated technology is proposed to be brought in,

(c) where at least 50% of production is to be exported,

(d) proposal for consultancy; and

(e) proposal for power, roads, ports and industrial modal towns/industrial parks or estates

12 In special cases, where the foreign investor is unable initially to identify an Indian joint venture partner, the Board may consider and recommend proposals permitting 100 per cent foreign equity on a temporary basis on the condition that the foreign investor would divest to the Indian parties (either individual, joint venture partners or general public or both) at least 26 per cent of its equity within a period of 3-5 years

13 Similarly in the case of a joint venture, where the Indian partner is unable to raise resources for expansion/technological upgradation of the existing industrial activity the Board may consider and recommend increase in the proportion/percentage (up to 100 per cent) of the foreign equity in the enterprise
14. In respect of trading companies, 100 per cent foreign equity may be permitted in the case of the activities involving the following:

(i) exports,

(ii) bulk imports with export/expanded warehouse sales,

(iii) cash and carry wholesale trading,

(iv) other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group.

15. In respect of the companies in the infrastructure/services sector where there is a prescribed cap for foreign investment, only the direct investment should be considered for the prescribed cap and foreign investment in an investing company should not be set off against this cap provided the foreign direct investment in such investing company does not exceed 49 per cent and the management of the investing company is with the Indian owners.

16. No condition specific to the letter of approval issued to a foreign investor would be changed or additional condition imposed subsequent to the issue of a letter for approval. This would not prohibit changes in general policies and regulations applicable to the industrial sector.
17. Where in case of a proposal (not being 100% subsidiary) foreign direct investment has been approved up to a designated percentage of foreign equity in the joint venture company, the percentage would not be reduced while permitting induction of additional capital subsequently. Also in the case of approved activities, if the foreign investor(s) concerned wishes to bring in additional capital on later dates keeping the investment to such approved activities, FIPB would recommend such cases for approval on an automatic basis.

18. As regards proposals for private sector banks, the application would be considered only after "in principle" permission is obtained from the Reserve Bank of India (RBI).

19. These Guidelines are meant to assist the FIPB to consider proposals in an objective and transparent manner. These would not in any way restrict the flexibility or bind the FIPB from considering the proposals in their totality or making recommendations based on other criteria or special circumstances or features it considers relevant. Besides these are in the nature of administrative Guidelines and would not in any way be legally binding in respect of any recommendation to be made by the FIPB or decisions to be taken by the Government in cases involving Foreign Direct Investment (FDI). These Guidelines are issued without prejudice to the Government's right to issue fresh guidelines or change the legal provisions and policies when ever consider necessary.
FIPB TO EXPEDITE APPROVALS

Foreign Investment Promotion Board has decided to expedite clearance for direct investment proposals Sources said the FIPB had decided to get on with the job of clearing FDI proposals which generally get stuck due to bureaucratic hurdles such as deferments sought by the administrative ministries and absence of officials of the concerned ministers This would also send right signals to the foreign investors

Though no time-frame has been fixed for clearing proposals, the FIPB has decided that if a proposal conforms to the policy guidelines, approval would be granted without waiting for comments of the administrative ministries.

B] FOREIGN INVESTMENT PROMOTION COUNCIL (FIPC)

Apart from making the policy framework investor-friendly and transparent, promotional measures are also taken to attract Foreign Direct Investment into the country The Government has constituted a Foreign Investment Promotion Council (FIPC) in the Ministry of Industry This comprises professionals from Industry and Commerce It has been set up to have a more target-oriented approach towards

Foreign Direct Investment promotion. The basic function of the council is to identify specific sectors/projects within the country that require Foreign Direct Investment and target specific regions/countries of the world for its mobilization.
C] FOREIGN INVESTMENT IMPLEMENTATION AUTHORITY

In pursuance of the announcement in the Union Budget Speech for 1999-2000, the Government has set up the Foreign Investment Implementation Authority (FIIA) in the Ministry of commerce and Industry. The FIIA will facilitate quick translation of Foreign Direct Investment (FDI) approvals and implementations, provide a pro-active one stop after care service to foreign investors by helping them obtain necessary approvals, sort out operational problems and meet with various Govt. Agencies to find solutions to problems and maximizing opportunities through a partnership approach.

The FIIA shall take steps to:

- understand and address concerns of investors;
- understand and address concerns of approving authorities;
- initiate multi agency consultations, and
- refer matters not resolved at the FIIA to higher levels on a quarterly basis,
  including cases of projects slippage on account of implementation bottlenecks.

The functions of the FIIA shall be as under:

- expediting various approvals/permissions;
- fostering partnership between investors and government agencies concerned,
- resolve difference in perceptions;
- enhance over all credibility;
- review policy framework and
liaise with the Ministry of External Affairs for keeping India’s diplomatic missions abroad informed about translation of FDI approvals into actual investment and implementation

The modalities of functioning of FIIA shall be as under

i) The FIIA shall set up a Fast Track committee (FTC) to review and monitor mega projects. It will nominate members of the FTC from representatives of various Ministries / Agencies / State Government at the working level. The representative of the AM concerned shall act as the project coordinator and shall head the FTC. The FTC shall prescribe the time frame within which various approvals / permissions are to be given on a project-to-project basis. FTC shall also flag issues that need to be resolved by FIIA. Based on the inputs provided by FTC, the FIIA will give its recommendations on each project on the basis of which Administrative Ministries / State Government shall take action under their own laws and regulations.

ìi) The FIIA will initiate inter-ministerial consultations and make appropriate recommendations to the competent authority, i.e. Ministry / Department concerned at the Central Government level and the state Government, as the case may be, on issues requiring policy intervention.

ìii) The FIIA will act as a single point interface between the investor and government agencies including Administrative Ministries / State Government / Pollution Control Board / DGFT / Regulatory Authorities / Tax Authorities / Company Law Board, etc.
The FIIA shall meet once every month to review cases involving investment of Rs 100 crore or more, consider references received from the FTC, and monitor the functioning of various FTCs. It would also entertain any complaint regarding implementation bottlenecks from FDI approval holders regardless of the quantum of investment.

The FIIA shall also make recommendations from time to time on any issue relating to the speedy implementation of FDI projects and also to provide transparency in government functioning with respect to FDI projects.

Secretariat

The secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion shall function as the secretariat of the FIIA.

D) RBI / SIA PROCEDURES FOR APPROVAL FOREIGN DIRECT INVESTMENT IN INDIA

Government of India tabled a statement of Industrial policy in parliament on 24th July 1991. The statement substantially liberalized the procedures inter alia governing foreign investment policy followed in the country. With a view to providing greater access to foreign capital as well as technology to India Trade and Industry, a quicker and hassle free route called the Automatic Route by RBI was opened, for approval of certain types of foreign financial/technical collaboration proposals.
With the forming of FEM (Transfer or Issue of security by a Person Resident Outside India) Regulations, 2000 by Reserve Bank of India, Automatic Route of FDI has further been streamlined. Even cap on proposals exceeding Rs. 600 crores, which were earlier not eligible under Automatic Route, does not find place in these Regulations.

**Items not eligible for Automatic Approval**

Automatic route of Reserve Bank for foreign investment is not available for the following items

1. Banking
2. NBFC’s activities in Financial Services Sector
3. Civil Aviation
4. Petroleum including exploration / marketing
5. Housing & Real Estate Development sector for investment from persons other than NRI's / OCBs.
6. Venture Capital Fund & Venture Capital Company
7. Investing companies in Infrastructure & Service Sector
8. Atomic Energy & Related Projects
9. Defense and Strategic Industries
10. Agriculture (Including plantation)
11. Print Media
12. Broadcasting
13. Postal Services
SECTORAL CAP ON FOREIGN DIRECT INVESTMENT UNDER AUTOMATIC ROUTE OF RESERVE BANK

As per automatic route of Reserve Bank foreign direct investment is permitted in various manufacturing/industrial/other activities and the same may range from 49% to 100% subject to the compliance with the provisions of the Industrial Policy and Procedures as notified by the Secretariat for Industrial Assistance (SIA). Following is the list of industries in which automatic route of Reserve Bank for foreign investment is available and such investment shall be to the extent as indicated against each activity.

1 Telecommunications sector - 49%

(i) In basic, Cellular Mobile, paging and Value added Services, and Global Mobile Personal Communications by Satellite Subject to the license from Department of Telecommunication of Government of India. 100%

(ii) In manufacturing activities

2 Housing and Real estate - 100%

Only NRIs / OCBs are allowed to invest in Estate the areas listed below.

a) Development of serviced plots and construction of residential premises

b) Investment in real estate covering construction of residential and commercial premises including business centers and offices

c) Development of townships

d) City and regional level urban infrastructure facilities, including both roads and bridges
e) Investment in manufacture of building materials

f) Investment in participatory ventures in (a) to (e) above

g) Investment in Housing finance institution

3. Coal and Lignite 49%

(i) In Public Sector Undertaking (PSUs) and 50%

(ii) In other than PSUs

a) Where private Indian companies are setting up or operating power projects as well as coal or lignite mines for Captive consumption.

For setting up coal processing plants provided the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing.

4 Drugs & Pharmaceuticals 74%

For bulk drugs, their intermediates and formulations (except those produced by the use of recombinant DNA technology)

5 Hotel & Tourism 51%

(i) Hotels include restaurants, beach resorts, and other tourist complexes providing accommodation and / or catering and food facilities to tourists.
(ii) Tourism related industry includes travel agencies, tour operating agencies and tourist transport operating agencies, units providing facilities for cultural, adventure and wildlife experience to tourists, surface air and water transport facilities to tourists, leisure, entertainment, amusement, sports, and health units for tourists and Convention / Seminar units and organization.

6 Mining 74%

Exploration and mining of diamonds and precious stones

100% for Exploration and mining of gold and silver and minerals other than diamonds and precious stones, metallurgy and processing.

7 Advertising 74%

8 Films 100%

Film industry (i.e., film financing, production, distribution, exhibition, marketing and associated activities relating to film industry) subject to the following

(i) Companies with an established track record in films, TV, Music finance and insurance

(ii) The company should have a minimum paid up capital of US $10 million if it is the single largest equity shareholder and at least US $5 million in other case.
(iii) Minimum level of foreign equity investment would be US $2.5 million for the single largest equity share holder and US $1 million in other cases.

(iv) Debt equity ratio of not more than 1:1, i.e., domestic borrowings shall not exceed equity.

(v) Provisions of dividend balancing would apply.

9. Oil Refining 100%

10. Manufacturing activities 100%

   The company is not engaged in any of Special Economic Zones (SEZs) (a) arms and ammunition, explosives and allied items of defense equipment, defense aircrafts and warships. (b) atomic substances,
   (c) narcotics and psychotropic substances and hazardous chemical,
   (d) distillation and brewing of alcoholic drinks,
   (e) cigarettes / cigars and manufactured tobacco substitutes

11. Any other sector / activity

   (other than those items which are not eligible for automatic approval)

   100%
The National Industrial Classification (NIC) 1987 shall remain applicable for description of activities and classification for all matters relating to FDI / NRI / OCB investment.

AVAILABILITY OF AUTOMATIC ROUTE FOR MANUFACTURING / INDUSTRIAL / OTHER ACTIVITY

(i) New Ventures

An Indian company which is not engaged in any activity, or in manufacturing of items for which automatic route is not available, is permitted to issue shares or convertible debentures to non-resident persons on repatriation basis, subject to the sectoral caps aforementioned, and following conditions

(i) The issuer company does not require an industrial licence,

(ii) The shares or convertible debentures are not being issued for acquiring existing shares of another Indian company,

(iii) The non-resident investor who proposes to be a collaborator, does not have any previous investment / collaboration / tie up in India in the same or allied field in which the Indian company issuing shares is engaged. However, this condition is not applicable to FDI proposals relating to the Information Technology (IT) sector

(ii) Existing Companies
Automatic Route for FDI/NRI/OCB investment is available to the existing companies besides new companies.

For existing companies with an expansion programme, the additional requirements, are that (i) the increase in equity level must result from the expansion of the equity base of the existing company (i.e. by fresh issue of capital) without acquisition of existing shares by NRI/OCB/foreign investors, (ii) the investment should be in the sector(s) under the automatic route.

For existing companies without an expansion programme, the additional requirements for eligibility for automatic route are (i) that they are engaged in the industries under automatic route (including additional activity under the automatic route regardless of whether the original activities were undertaken with Government approval or by accessing the automatic route), (ii) the increase in equity level must be from expansion of the equity base.

Availability of Automatic Route in case of Trading Company

An Indian trading company is permitted to issue shares / convertible debentures to the extent of 51% of its capital to persons resident outside India. The remittance of dividend in respect of such shares would be permissible only when the company secures registration as an Export / Trading / Star Trading / Super Star Trading House from the DGFT, Ministry of Commerce, New Delhi.
Availability of Automatic Route in case of Small Scale Industrial Unit

In case of a SSI unit, it is permitted to issue shares and convertible debentures up to 24% of its capital but such SSI unit must not engage itself in activities for which automatic route is not available. The ceiling of 24% may be enhanced to specified sectoral caps.

I) Provided

(i) the unit gives up SSI status; and

(ii) the unit is not engaged or does not propose to engage itself in manufacture of items reserved for SSI sector.

However, Export Oriented Units or EPZ / FTZ / EHTP / STP units are permitted to issue shares or convertible debentures to a non-resident person beyond 24% subject to the sectoral caps without being required to fulfill the other two conditions.

Mode of receiving payment for shares or convertible debentures

The Indian company issuing shares or convertible debentures to a person resident outside India shall receive the amount of consideration for such shares-

(i) by inward remittance through normal banking channels, or

(ii) by debit to NRE / FCNR account of the person concerned maintained with an authorized dealer / authorized bank.
Pricing of the issue

Price of shares issued to persons resident outside India by the Indian company shall not be less than:

(a) The price worked out in accordance with the SEBI guidelines, where the issuing company is listed on any recognized stock exchange in India, and

(b) Fair value of shares certified by a Chartered Accountant as per the guidelines issued by the erstwhile Controller of Capital issues, in other cases

Reporting

Under the automatic route no approval is required for receiving the FDI or issue of shares to Foreign Collaborators. The only requirement is to submit the following reports to the Reserve Bank

(i) Report of receipt of FDI within 30 days of receipt of the amount giving the specified particulars, and

(ii) Report of issue of shares within 30 days of issue, in FC_GPR along with the prescribed documents

Foreign Direct Investment by way of Global Depository Receipts (GDR) / American Deposit Receipts (ADR) / Foreign Currency Convertible Bonds (FCCB)

Foreign Investment through GDRs / ADRs, Foreign Currency Convertible Bonds (FCCBs) are treated as Foreign Direct Investment. Indian companies are allowed to raise equity capital in the international market through the issue of GDR / ADRs /
FCCBs. These are not subject to any ceilings on investment. An applicant company seeking Government's approval in this regard should have a consistent track record for good performance (financial or otherwise) for a minimum period of three years. This condition can be relaxed for infrastructure projects such as power generation, telecommunication, petroleum exploration and refining, ports, airports and roads.

There is no restriction on the number of GDRs / ADRs / FCCBs to be floated by a company or a group of companies in a financial year. A company engaged in the manufacture of items covered under Automatic Route is likely to exceed the percentage limits under the Automatic Route, whose direct foreign investment after a proposed GDR / ADR / FCCBs issue is likely to exceed 50% / 51% / 74% as the case may be, or which is implementing a project not contained in project falling under Government Approval route, would need to obtain prior government clearance through FIPB before seeking final approval from the Ministry of Finance.

There are no end-use restrictions on GDR / ADR issue proceeds, except for an express ban on investment in real estate and stock markets. The FCCB issue proceeds need to conform to external commercial borrowing end use requirements; however, 25 per cent of the FCCB proceeds can be used for general corporate restructuring.

All Approvals are on repatriation basis.
All foreign investments approved, unless otherwise specified, or falling under automatic route of RBI, are on repatriation basis. Dividends declared on foreign investments can be remitted freely through an Authorized Dealer (AD) except in the case of a trading company which is required to secure registration as an Export / Trading / Star Trading / Super Star Trading House from DGFT, New Delhi before making remittance of dividend. The condition of ‘Dividend Balancing’ stands discontinued vide Press Note No. 7(2000 series) dated 14.7.2000 but the export obligation and concomitant dividend balancing will remain applicable until the date of issue of this Press Note.

Dividend Balancing now not Applicable

The condition of Dividend Balancing applicable to 22 specified consumer goods sector has been discontinued vide Press Note No.7 (2000 series) DT. 14.7.2000. “Vide Press Note No.12 of 1992 series, it had decided to withdraw the condition of dividend balancing in all foreign investment approvals except for industries in the 22 specified consumer goods sector. On review of the existing policy on dividend balancing applicable to 22 specified consumer goods industries, and with a view to attracting FDI, it has been decided, with immediate effect, to remove the condition of dividend balancing on these 22 consumer goods industries. This decision will come into force from the date of issue of this Press Note and the export obligation and concomitant dividend balancing will remain applicable until the date of issue of this Press Note”.

Foreign Technology Transfer
With a view to injecting the desired level of technological dynamism in Indian industry and for promoting an industrial environment where the acquisition of technological capability receives priority, foreign technology induction is encouraged both through FDI and through foreign technology collaboration agreements. Foreign technology collaboration agreements are permitted on an automatic basis. However, cases involving industrial license / SSI reserved items shall not qualify for automatic approval and would have to be routed through SIA / FIPB.

The Reserve Bank of India through its regional offices accords automatic approval to all industries for foreign technology collaboration agreements subject (i) the lump sum payment not exceeding US $2 million, (ii) royalty payable being limited to 5 per cent for domestic sales and 8 per cent for exports, subject to a total payment of 8 per cent on sales over a 10 year’s period, and (iii) the period for payment of royalty not exceeding 7 years from the date of commencement of commercial production, or 10 years from the date of agreement, whichever is earlier (The aforesaid royalty limits are net of taxes and are calculated according to standard conditions).

All other proposals for foreign technology collaboration agreement, not meeting any or all of the parameters for automatic approval stated in above Para are considered for approval, on merits, by the Ministry of Commerce and Industry. As provided in schedule II to FEM (Current Account Transactions) Rules, 2000 foreign exchange for remittances under technical collaboration agreements where payment of royalty exceeds 5% on local scales and 8% on exports and lump-sum payment exceeds US $2 million shall not
be released (except where payments are made out of funds held in RFC or EEFC accounts) unless the requisite approval has been obtained from the Ministry of Commerce and Industry.

Remittance of royalty and payment of lump sum fee under the technical collaboration agreement shall be made by the authorized dealers if they are registered with the Reserve Bank Of India. In other cases the remittance shall be allowed with the specific permission of RBI (except where payments are made out of funds held in RFC or EFFC account). Exclusive payments for use and or purchase of trademark franchise in India are not allowed, although such payments may be subsumed in the other fee payable. However, as per Press Note No.9 (2000 series) dated 8.9.2000 payment of royalty up to 2% for exports and 1% for domestic sales is allowed under automatic route on use of trademarks and brand name of the foreign collaborator without technology transfer.

Standard conditions attached to approvals for foreign investment & technology agreement approved by RBI

1. The total non-resident shareholding in the undertaking should not exceed the percentage(s) specified in the approval letter.

2. (a) The royalty will be calculated on the basis of the net ex-factory sale price of the product, exclusive of excise duties, minus the cost of the standard bought-out components and the landed cost of imported components, irrespective of the source of procurement, including ocean freight insurance, custom duties, etc.
The payment of royalty will be restricted to the licensed capacity plus 25% in excess thereof for such items requiring industrial license or on such capacity as specified in the approval letter. This restriction will not apply to items not requiring industrial license. In case of production in excess of this quantum prior approval of government would have to be obtained regarding the terms of payment of royalty in respect of such excess production.

(b) The royalty would not be payable beyond the period of the agreement if the orders has not been executed during the period of agreement. However, where the order themselves took a long time to execute, then the royalty for an order booked during the period of agreement, but executed after the period of agreement, would be payable only after a Chartered Accountant certifies that the orders in fact have been firmly booked and execution began during the period of agreement, and the technical assistance was available on a continuing basis even after the period agreement.

(c) No minimum guaranteed royalty would be allowed.

3. The lump sum shall be paid in three installments as detailed below, unless otherwise stipulated in the approval letter.

First 1/3rd after the approval for collaboration proposal is obtained from the Reserve Bank of India and collaboration agreement is filed with the Authorised Dealer in Foreign Exchange

Second 1/3rd on delivery of know-how documentation.
The Reserve Bank of India approves third and final 1/3rd on commencement of commercial production, or four years after the proposal and agreement is filled with the Authorized Dealer in Foreign Exchange, whichever is earlier.

The lump sum can be paid in more than three installments, subject to completion of activities as specified above.

4. All remittances to the foreign collaborator shall be made as per the exchange rates prevailing on the date of remittance.

5. The applications for remittances may be made to the Authorized Dealer in Form A - 2 with the under noted documents:
   (a) A "No Objection" Certificate issued by the Income Tax authorities in the standard form or copy of the certificate issued by the designated bank regarding the payment of tax where the tax has been paid at flat rate of 30% to the designated bank.
   (b) A certificate from the Charted Accountant in form TCK / TCR (depending upon the purpose of payment).
   (c) A declaration by the applicant to the effect that the proposed remittance is strictly in accordance with the terms and conditions of the collaboration approved by RBI / Government.

6. The agreement shall subject to Indian Laws.
7. A copy of the foreign investment and technology transfer agreement signed by both the parties may be furnished to the following authorities

(a) Administrative Ministry / department

(b) Department of Scientific and Industrial Research, Technology Bhavan, New Delhi – 110016

(c) Concerned Regional Office of Exchange Control Department, RBI

(d) Authorized Dealer designated to service the agreement

8. All payments under the foreign investment and technology transfer including Rupee payments (if any) to be made in connection with engagement / deputation of foreign technical personnel such as passage fare, living expenses etc of foreign technicians, would be liable for the levy of cess under the Research and Development Cess Act, 1986 and the Indian Company. While making such payments should pay the cess prescribed under the Act.

9. A return (in duplicate) in Form TCD should be submitted to Regional Office of the Reserve Bank of India in the first fortnight of January each year.

Guidelines Pertaining to Approval of Foreign / Technical collaboration under the Automatic Route with previous Ventures / Tie-up in India

The Government has reviewed the present Guidelines relating to approval of foreign/technical collaborations under the automatic route and after careful
consideration it has been decided that foreign financial / technical collaborators with previous ventures / tie-up in India would be subject to the following guidelines:

(I) Automatic route for FDI and / or technology collaboration would not be available to those who have or had any previous joint venture or technology transfer/trademark agreement in the same or allied field in India. RBI, therefore, have to stipulate necessary declaration before applications for the automatic route are taken on record.

(II) Investors of technology to the suppliers of the above category therefore will have to necessarily seek the FIPB / PAB approval route for joint ventures or the technology transfer agreements (including trade-mark) giving detailed circumstances in which they find it necessary to set-up a new joint venture / enter into new technology transfer (including trade-mark).

(III) The onus is clearly on such investors/technology suppliers to provide the requisite justification as also proof to the satisfaction of FIPB / PAB that the new proposal would not in any way jeopardize the interests of the existing joint venture or technology / trademark partner or other stakeholders. It will be at the sole discretion of FIPB / PAB to either approve the application with or without conditions or reject in toto duly recording the reasons for doing so.

Non-applicability of Guidelines pertaining to approval of foreign / technical collaboration under the automatic route with previous ventures / tie-ups in India to Information Technology (IT) Sector
The present guidelines provide for approval under the automatic route for all foreign direct investment proposals relating to the Information Technology sector, with exception of Business-to-consumer (B2C) e-commerce, subject, inter-alia, to the following:

Automatic route for FDI and / or technology collaboration would not be available to those who have or had any previous joint venture or technology transfer / trade mark agreement in the same or allied field in India.

Considering the special nature and needs with a view to further simplifying the approval procedures and facilitating greater investment inflows into the IT sector in the country, it has been decided that FDI proposals relating to the IT sector will, with immediate effect, be exempt from the condition cited above.

**SIA / FIPB ROUTE FOR ITEMS NOT COVERED BY AUTOMATIC ROUTE**

Foreign Investment policy under Government Route for Trading Activities

Foreign investment in trading activities beyond 51% is permissible with the FIPB approval. Under this route FDI up to 100% is permitted for the following trading activities.
Exports,

- Bulk imports with export/ex-bond warehouse sales;
- Cash and carry wholesale trading;
- Other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group and for third party use or onward transfer/distribution/sales.

The following kinds of trading are also permitted, subject to provisions of EXIM Policy:

- Companies for providing after sales services (that is not trading per se)
- Domestic trading of products is permitted at the wholesale level by such trading companies who wish to market manufactured products on behalf of their joint ventures in which, they have equity participation in India.
- Trading of hi-tech items/items requiring specialized after sales service.
- Trading of items for social sector.
- Trading of hi-tech, medical and diagnostic items.
- Trading of items sourced from the small scale sector under which, based on technology provided and laid down quality specifications, a company can market that item under its brand name.
- Domestic sourcing of products for export.
Test marketing of such items for which a company has approval for manufacture provided such test marketing facility will be for a period of two years, and investment in setting up manufacturing facilities commences simultaneously with test marketing.

The above restrictions shall be applicable for e-commerce retail trading also.

PROBLEMS OF FDI

In view of the fact that FDI can do much in the development of economies, it is necessary to design policies, which can maximize the benefits and minimize the costs of this source of capital-inflows to the less-developed countries. In doing so one needs to understand the various problems that these countries have to face in achieving their objectives, and the measures required to cope with them. It is also useful to design a set of incentives to attract adequate amount of investment, and provide safeguards against any misuse of the poor countries by the powerful foreign investors.

Changing colonial mind-set

A problem in the way of using FDI is the strong attitude of many of the less-developed countries against this sort of capital-inflow. This is the product of the bitter experiences of these countries in respect of their colonial exploitation, a major instrument of which was the foreign private capital. Since these countries have freed themselves from colonial rule only very recently, this attitude continues to persist. However, it needs to be emphasized that the situation in this respect has now altogether changed. The
foreign investor is now willing to enter a country if invited. This is unlike the past practice when he came with the political power to impose himself on a subjugated country. The conditions of entry are subject to bargaining between the foreign investor and the host-country. In the past conditions were simply laid down by the investor only. The foreign investor is now prepared to be treated on equal footing with the investors from other countries, as also those of the host-country. In fact in certain cases the investor may even put up with some type of regulations, provided these are uniformly applied to all the foreign investors. The government of the host-country can design an overall frame of its development programme, and earmark a specified role for the foreign investor. In view of this, it is essential that the host-country change its attitude towards the FDI, so as to provide a basis for a serious consideration of its entry and its use.

**Market-orientation**

Another essential change necessary for the entry of FDI is to shift to a market-economy with government-intervention restricted to areas that fall beyond the perceptions and capacities of private entrepreneurs, such as infrastructure, human capital etc. This requires that the less-developed countries should change their economies in two principal directions. One is to remove the distortions in their markets. These consist of price-controls, exchange-controls, high tariffs, large subsidies etc. Experience suggests that FDI in economies with distorted markets has not done well. It has in fact generated net losses for the host-countries. It is necessary that such government intervention is
reduced to the minimum and should be only for the furtherance of social aims. Second important thing to do is to globalize the economy. This implies that the domestic market gets extended to the world market, in the absence of restrictions in the flows of products, and factors. This also means integration of the host-economies with other economies, so that MNCs can operate in a number of countries through their firms located in different countries.

Control of investment

A matter of great significance for the host-country is to control the foreign investment so that it is used in its interest. One great difficulty in this regard is the ownership of equity, which vests with foreign investor. This also involves high costs in terms of remittances abroad. The best solution to this problem, of course, lies in separating equity from other components of direct foreign investment, namely equipment, technology, management, and marketing capabilities. If funds in foreign exchange could be found, the country can secure other components that are more appropriate for its needs, or that cost less when they are not tied to equity capital. In case this is not possible to the extent desired, then the host-country should allow a hundred percent foreign equity in very few activities where there is no alternative. In some cases, there can be joint ownership, i.e., foreign and domestic, beginning with majority equity for foreigners. In other cases, there could be minority ownership of equity for foreigners. Further, in all the cases the foreign ownership may be diluted over a period of time. In addition, time limits can be laid down in the agreements in respect of the duration for which foreign investment is allowed. Of
course, in both the matters, namely the foreign share of ownership of equity as also period for which foreign investment is to operate, there should be ample chance for the foreign investor to recover his costs and make profits comparable to those in other countries.

**Managing remittances**

Another serious problem, which needs to be tackled, is that of remittances profits abroad. On the face of it, these direct costs should cause no concern so long as the benefits from investment exceed them. The difficulties may, however, crop up when one has to find foreign exchange for affecting these remittances. This is all the more difficult for those capital-receiving countries, which are already heavily indebted. To meet the additional foreign exchange to service the profits of FDI, exports should rise correspondingly. In its absence, certain measures can help but these may prove to be highly counter-productive. For example, curbs on imports like quotas, tariff exchange restrictions etc., may reduce demand for foreign exchange, and make available foreign exchange to repatriate profits etc. but this course will be at the expense of productivity and efficiency of the economy. Again, measures like higher taxation and credit-tightness may reduce aggregate demand, including demand for imports. But this will involve reduction in consumption and investment. Devaluation of the currency may be another way out to boost exports. But this may result in a possible deterioration in the terms of trade, and unfavorable change in income-distribution. Thus, it is necessary that to minimize such costs, the entry of FDI should be decided upon with reference to the
debt-servicing capacity of the host-country, which in turn depends upon its
development-programme, including its capacity to export. In other words, the decision
regarding FDI should not be dependent only or even mainly on considerations of
benefits and costs confined to foreign investment.

Bargaining for better terms

An issue of considerable importance for the less-developed countries is that of securing
MNCs' entry on favorable terms. An important aspect of the terms is the share of the
gains that these can wrest from the MNCs. Much of these gains are in the nature of
quasi-rents (i.e. unearned surpluses) from the supply of technological knowledge,
management and capital, which the MNCs take away in the form of excessive royalties,
salaries, fees, interest etc. The reason is that these corporations have greater
bargaining power because of their large size, their capability to exercise wider options,
and their capacity to avoid some forms of regulation of the countries in which they
operate. Besides, their multi-national feature enables them to maximize their global
profits, even at the cost of some countries.

Under these circumstances the less-developed countries may not get very favorable
terms, or in respect of their gains, they may not be able to ensure a fair distribution of
the gains. But they can at least minimize the harmful conditions of the contracts, or in
respect of the division of gains minimize the unfairness in the distribution - profile. This
requires considerable knowledge and tact on the part of negotiators while drawing up
contracts with the MNCs. The items on which MNCs may negotiate are many and varied. These include income and sales tax concessions, tariff and non-tariff protection of the products, royalty payments, management fees, credit policies, subsidies etc. A proper handling of these should enable the less-developed countries to settle for contracts, which are favourable, or the least unfavorable for them. In fact with greater preparedness these countries can secure much by way of benefits from the MNCs, including sharing of gains.

**Bottlenecks preventing FDI flow**

Today, India is a preferred destination for foreign investors, and holds one of the top six preferred destination status. In keeping with WTO commitments, the government has announced policies, which are no less liberal than other countries, and is aiming to have an open market by 2004 where most of the restrictions to entry will be dropped. Despite this, foreign enthusiasm is not exactly at its zenith, and no large-scale investment is coming in. Investment that is flowing in is in small numbers and a chunk of the cake is moving out of India.

This is due to the fact that policy implementation is still a lengthy process, there are rigidities in the execution of the project which leads to time and cost overruns, administration is not decentralized, there are bureaucratic delays and there is the absence of transparent guidelines all of which go to make the project unviable, and
therefore, unattractive. The foreign investor is used to working in an environment that is competitive where he can get maximum benefits at the shortest time.

Also, India today is far behind with respect to infrastructure development which is the main foundation for attracting FDI. Unless and until the foreign investor is convinced about the safety of his investment and optimistic about its growth, why would he invest his money in Indian soil?

Thus, the government has to play more than a proactive role in attracting FDI by cutting down on existing bottlenecks and making the environment more congenial for investments. Government has to change its role from that of a regulator to that of a facilitator.

India does not welcome FDI in all sectors. Even in sectors where it is welcome, it is not easy for FDI to flow in for various reasons. One major reason is that the supply of FDI depends on what India offers in terms of likely risk-adjusted dollar returns on this form of investment. In most cases, the anticipated returns are low in relation to the risks of investment in sectors where India welcomes FDI.

So, sectors where the risks are low and likely returns are high for foreign investment are those where FDI supply is likely to be high. But, this has never been reason enough for India to allow FDI precisely in such sectors. Thus, FDI inflows to India are more on account of those investors who have taken a relatively long-term view that India would
eventually establish a market economy or those who are given incentives of assured returns (guarantees / WTO conditional ties). But, for the most part and in a large number of sectors, India does not offer a market economy environment that would attract FDI.

While the present policy broadly permits foreign investment in all areas except a few such as defense, atomic energy, atomic minerals, in general, etc. FDI requires approval subject to certain parameters under two routes: automatic approvals by the reserve Bank of India up to 51 per cent in 35 priority industries, and Foreign Investment Promotion Board approval (the Empowered Committee sanctioning limit is Rs300 crore while anything beyond this limit is referred to the Cabinet Committee)

It is true that recently, several initiatives have been taken to enhance the flow of FDI into the country. For example, FIPB clearance approval time has been reduced to 30 days. In February 2000, the government took a major decision to place all items under the automatic route for FDI / NRI / OCB investment except for those in the negative list. The automatic route is now available to all foreign and NRI investors with the facility to bring in 100 per cent FDI/NRI/OCB investment. All proposals for investment in public sector units, as also for EoU / EPZ / EHTP / STP units also qualify for automatic approval. However, all these are subject to sectoral policies and sectoral caps. Clearly, these facts send out signals that India’s demand for FDI is not unlimited. Naturally therefore, FDI inflows are low and nowhere near the so-called targets of $4-10 billion per year.
Since India's economic reforms have been rather slow compared to many other developing countries, large FDI inflows are not attracted. We have severe infrastructure bottlenecks that place India at a disadvantage compared to other developing nations. India's legal framework cause unnecessary delays and involves a cumbersome process and therefore is not congenial to foreign investors for free markets. In the infrastructure sector, there is the additional problem of unremunerative tariff pricing.

In absolute terms, FDI inflows into India came down even as we were liberalizing further. Part of the problem is attributed to the deficiencies in the service and financial sectors that is keeping foreign investment at bay—the high level of non-performing assets, restrictive guidelines for foreign investment inflow into sectors like insurance, have all lead to FDI bypassing these crucial sectors. But that is not the only reason.

US Ambassador to India, Esserman, has criticized India on its long drawn-out process and archaic rules and has said that trade barriers and multiple clearances both at the center and the state and time delays are reducing India's opportunities of tapping foreign investment.

A closer examination will reveal that the FDI confidence index refers to the potential of the host country and this potential is determined by the size of GDP. Thus, there is a close co-relation between ranking of countries on the FDI confidence index and GDP. That is how India happens to improve its ranking even while experiencing some decline in the already low level of FDI inflows.
Foreign investment by multinational enterprises, through combinations of protection, inappropriate tax and other fiscal incentives, and performance requirements (including constraints on foreign ownership of resources), typically generate appreciable inefficiencies and misallocation of resources in the host country, with constrained foreign firms exhibiting older technology and business practices than unconstrained foreign firms in other countries and, more often than not, leaving the host country worse off than if it had never received the investment in the first place.

Macro Implications of Foreign Investment Liberalization

Concerns have been expressed that foreign investment liberalization may adversely affect the balance of payments and macro economic stability. First, the net contribution of foreign investment to the host country's balance of payments could become negative over time if profits are systematically repatriated abroad rather than reinvested locally or if foreign controlled enterprises display a greater propensity to source abroad than domestic firms. Second, it has been noted that, if the inflow of capital becomes very large, it may complicate the conduct of monetary and exchange rate policies and in particular the implementation of macroeconomic stabilization programmes and large capital inflows may put upward pressure on the real exchange rate. Depending on the monetary policy setting, this would be the result of either nominal exchange rate appreciation or higher inflation. In both cases, the current account deficit is likely to deteriorate-sometimes leading to deficits that are larger than desirable. Lastly, it has been pointed out that excessive reliance on external financing may make the economy,
its banking sector in particular, vulnerable to sudden reversals in financial market conditions abroad and in foreign investors' sentiment, as evidenced most recently in Asia.

Corruption, unnecessary regulatory requirements, complicated or non-transparent administrative procedures, and intellectual property rights still impose substantial costs on foreign and domestic investors (Hoekman and Saggi 1999). Corruption tends to have a greater impact on foreign direct investors, given their closer interactions with local officials as well as with domestic suppliers and clients, than on banks and portfolio investors.

In India labour laws present special difficulties in two areas. The termination of employment is difficult. It requires permission from government, which is not easily forthcoming. Secondly, the closure of the establishments. This is a sensitive area. With a high level of unemployment and underemployment it is difficult to find a job in an organized sector. If the job is lost it is even more difficult to find another. This will be a great challenge particularly in view of the fact that during the 80s growth of the economy has not been accompanied by a corresponding growth in employment. The employment elasticity has been declining. Further labour unions in the organized sector are strong, and are more concerned about protecting their job security and perks rather than productivity and competitiveness. By looking at this labour problem the foreign investor will hesitate to invest in India.
Even after automatic approval, a lot of paper work remains. For example, there are 13 agencies which must be approached even after abolition of licensing for clearances, such as power connection, pollution control, town planning, etc., because there is no single window system. Each of the thirteen clearances takes its own time. Further, there are the provincial level industrial policies, regulations, and procedures. All these lead to less inflow of FDI.

In industries such as chemicals, drugs, and pharmaceuticals, the strength or weaknesses of intellectual property protection plays an important role in FDI. In India, the intellectual property protection is weak compared to other countries. So, the Government of India should make attempts to strengthen it so as to attract more of FDI.

FDI inflows have two main aspects viz., (a) Attracting them into the country (b) Disciplining these inflows.

As far as the first aspect is concerned, these have been constrained by slow pace of liberalization and poor performance of economic reforms apart from structural problems like high debt-service ratios, slow growth of exports and adverse balance of payment problems. Economic development programme in the country is hindered, apart from other factors, by 'vote bank politics' which does not allow bold steps to be taken, which is very crucial to economic development. Foreign investors are apprehensive of sustainability of economic reforms in the country. Reforms have succeeded in societies where economic and social tensions are kept under leash. But in a democratic form of
government such tensions get translated into votes against the party in power. Social
tensions are there as reforms in the initial stages are pro-rich. Many potential investors
in India are holding back because they are unsure whether the commitment to reforms
is deep-seated and widely supported across party lines, and because many rules are
not transparent.

As far as the aspect of disciplining foreign capital is concerned only legislation is not
adequate to achieve the objective. The state requires economic power—a production
base and command over capital. Public sector should fulfill, at least, three major
requirements. These are (a) productive efficiency (b) it must be able to generate a
reinvestible surplus and (c) most important of all, it should become an instrument in the
hand of the state to demonstrate how capital under social control can be made to
function.

In spite of the bold liberalization policy, India has not been successful in attracting FDI in
a big way. One of the factors responsible for this may be the statements of our own
leaders and bureaucrats, who with some hope of attracting foreign capital, make
statements which give an impression that the government is going to offer more and
more concessions to foreign investors. As a result of these statements foreign investors
prefer to 'wait and watch' rather than start investing in India in a big way. In this
connection, Alok Ray discusses six factors on which FDI depends. He says that there
are six areas in which India's achievements in relation to other countries will be judged
by foreign investors.
i) Political Stability and Irreversibility of Economic Reforms.

FDI is a long-term investment decision and if with frequent changes of Central Government, we are going to revert the policies of economic reforms introduced by earlier governments, then foreign investors will not consider India as a prospective country to invest their resources.

ii) State of Infrastructure

FDI will flow into India only if it is convinced that they will get uninterrupted supply of power, accompanied by excellent transport and communication services.

ii) Policy Regime

This includes policies regarding tariff rates and domestic restrictions on repatriation of profits and capital.


Mere declaration of bold and imaginative policies along with very defective and faulty implementation of these policies is a sure recipe for disaster on the FDI front.
iii) Labour Market Conditions:

Indian wages are considerably lower than large number of countries. We also have substantially large stock of highly skilled manpower. But, India is also known for problems of labour indiscipline. Under such a situation the foreign investor will think twice before entering India on a long-term basis.

(iv) Intellectual Property Rights:

Foreign investor will hesitate to enter India, particularly in R & D activities, if the controversies regarding IPR are not settled.

Reasons for the low FDI inflows are:

The first reason can be found out in the per capita income. It should be noted here that mere higher number of persons never indicates a larger market size, if it is not backed by purchasing power. According to an estimate of 1994 per capital Gross National Product (GNP) of India was $320. This explains the reason behind the lower FDI inflow in India, when compared against other developing countries.

In addition to this among the other major recipients of FDI in this region, growth rate of GDP is much lower for India. It was only 3.8% during the period 1990-94. GDP growth rate in India declined by two percentage points (from 5.8% to 3.8%) from the eighties to
the early nineties. No doubt, this fact disseminates negative signal to the potential investors worldwide.

The third reason can be traced out in the relatively lower savings rate in India. The rate of GDS in India oscillates between 20 to 24% in the current decade. Low domestic savings rate, as we know, creates a problem of capital formation. For example, where the foreign investors are allowed 51% equity participation, the 49% capital is to be supplied domestically. But if the domestic saving rate is low wherefrom will this capital be supplied?

According to World Investment Report 1995, relative to other factors, incentives are only a minor element in attracting FDI inflows. One must note that foreign investors attach far greater importance to the overall investment climate than preferential policies. Stability in the economic and political frontier and the prevailing legal framework are among the most important other factors which govern investment decisions of the foreign firms.

Incentives are essential, but if in an economy incentives are present and there is, for example, no eco-political stability foreign investors will turn their back on the country. This is exactly what is happening in our country. The foreign investors are attracted by the incentives, sign memorandum of understanding and finally frustrated by the lack of political stability in the country they lose all their interest. This very fact is revealed by the presence of a wide gap between the approved and the actual inflows of foreign direct capital in India.
One more disadvantage of the Indian economy in attracting FDI inflows is the presence of a multi-party political system in this country. Owing to this system it is often seen that two rival parties dominate over the centre and the states respectively. This creates a real problem in obtaining clearance from both the centre and the state governments.

Last but not least, the Department of Economic Analysis and policy of the Reserve Bank of India in a study on "Pattern of FDI and technology transfer in Indian industry since 1991" noted that in comparison to China, the contribution of non-resident Indians to the total direct investment in India is unimpressive.
END NOTES


