CHAPTER 4

FOREIGN INVESTMENT POLICY IN INDIA: AN OVERVIEW

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CHAPTER 4

FOREIGN INVESTMENT POLICY IN INDIA: AN OVERVIEW

We turn to examine now the evolution of foreign investment policy in India in the post-liberalization period. Major policy changes affecting foreign direct investment and foreign portfolio investment during the period are listed separately. The objective of this attempt is to evaluate whether India went in for a big bang type of liberalisation or a gradualist one giving the economy time to adjust. Before presenting the details of the reforms programme, we delve into the economic background which warranted the policy changes.

4.1 NEED FOR POLICY CHANGES

Indian economy experienced four episodes of macroeconomic crises since independence. The crises are referred to as the first crisis (1965-67), second crisis (1973-75), third crisis (1978-81) and the fourth crisis (1990-91). In all four crises, the two major symptoms of crisis were in evidence - inflation above 10 per cent and a widening of the current account deficit. The fourth crisis was different from the earlier three crises in two respects. First, the widening of the current account deficit was from a base of persistently high deficits and a heavy build up of foreign debt. Second, the cut off of private foreign lending, that had become a significant element in the capital account of the balance of payments. The first three crises were principally caused by exogenous shocks while the fourth was largely policy induced¹.

The fourth episode of the macroeconomic crisis started in July 1991. The crisis was brought to a head by a steep fall in foreign exchange reserves to about $1 billion (equal to two weeks imports), a sharp downgrading of India’s credit rating in the international capital market and a cut-off of foreign private lending.

The basic features of the crisis were high inflation (12 per cent and rising), large current account deficits (3 per cent of GDP) and a heavy and growing burden of domestic and foreign debt.\textsuperscript{2} In 1990-91 the central fiscal deficit was 8.3 percent of GDP. The primary deficit was 4.3 percent. The internal debt of the government rose from Rs. 485 billion (36 per cent of GDP) at the end of 1980-81 to Rs. 2830 billion (54 per cent of GDP) at the end of 1990-91. As a result, between 1980-81 and 1990-91, the interest paid by the government on its debt almost doubled from 10 per cent to 19 per cent of total central government expenditure.\textsuperscript{3} India’s external debt increased from $18.3 billion in 1980-81 to $ 71.1 billion in 1990-91.

The state of Indian public finances reached crisis proportions by the end of the 1980s. The public debt-GNP ratio increased through the 1980s, jumping drastically towards the end of the decade to nearly 60 per cent. The rise in foreign borrowing was a major component of the fiscal crisis. The external public sector debt as a proportion of GNP doubled during the 1980s to 21 per cent by 1987-88. In consequence, debt service as a proportion of exports increased more than threefold to 32 per cent in 1986-87 from only seven years earlier. In January 1991 the government was forced to take IMF loans worth $ 1.8 billion by drawing from the Compensatory and Contingency Financing Facility and the first tranche of the standby facility.\textsuperscript{4}

Strict capital controls existed till the reform of the 1990s. Y V Reddy\textsuperscript{5} had pointed out five major reasons for the existence of capital controls in the pre-

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reform period. First, the public opinion since independence has been suspicious about the presence of foreign trading interests or foreign capital, since national freedom was lost to foreign traders who were licensed to trade in India by the then rulers. Second, the concerns about capital outflows, reinforced by repeated stress on balance of payments often due to droughts, wars and supply shock, mainly oil. Third, with the adoption of planned approach to development, the emphasis was on utilizing domestic savings for domestic investment. Fourth, till the 1980s, the policy makers believed that the world trade was not open enough to permit strong export-led growth of a large economy like India. They argued that strong protectionism will be put in place by industrial countries if India followed the export-led growth path. Fifth, since the domestic economy was endowed with a reasonable base of human skills, institutional, social and physical infrastructure, and diversified industrial base, the country could successfully launch on the path of self-reliance with relatively low level of economic dependence on the rest of the world.

According to Jalan’s\(^6\) estimate, between 1956 and 1991, India has experienced balance of payments problems of varying intensity in as many as thirty years. Thus the post-independence inward looking strategy of development, which was supposed to make India economically strong and self reliant, turned out to be one which, after a few initial years, made India increasingly dependent on periodic international rescue operations.\(^7\)

By the beginning of the 1980s, the share of foreign direct investment in gross capital formation was among the lowest for India among all developing countries (only 0.2 per cent as against the average of about 6 per cent for developing countries as a group).\(^7\) The highly restrictive policies towards foreign equity investment continued, without any significant change, until mid-1991.

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Until the 1980s the two major sources of external capital for India were bilateral government-to-government foreign aid and borrowing from international financial institutions at concessional rates. Only in the 1980s did the government borrow from private sources on commercial terms. Among private creditors non-resident Indians (NRIs) were an important source of deposits in Indian banking system. In 1980-81, out of $ 18.3 billion of public and publicly guaranteed external debt, only $ 2 billion was owed to private creditors. But on the eve of the macroeconomic crisis of 1990-91 external debt had nearly quadrupled to $ 71.1 billion, of which $ 23 billion was owed to private creditors. Thus debt to private creditors had grown eleven fold in just 10 years. NRI deposits, which were negligible in 1980-81, amounted to $14 billion in 1990-91. Short term debt at $ 8.5 billion in 1990-91 was more than 2.5 times the level of net foreign exchange reserves at $ 2.1 billion. Debt service, as a per cent of export of goods and services, increased from 9.3 percent in 1980 to 35.3 per cent in 1991. When oil prices rose with the Iraqi invasion of Kuwait in August 1990, the confidence of external lenders, particularly NRIs, in the government’s ability to manage the economy eroded. NRI deposits dried up, with net inflows falling from $ 2.3 billion in 1989-90 to $1.6 billion in 1990-91 and to a mere $ 290 million in 1991-92. Thus India came close to having to default on its external debt.\(^8\)

### 4.2 EVOLUTION OF FOREIGN DIRECT INVESTMENT POLICY

Indian government policy towards FDI has evolved over time in tune with the requirements of the process of development in different phases. Soon after independence, India embarked on a strategy of import substituting industrialization in the framework of development planning with a focus on encouraging and improving the local capability in heavy industries including the

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machinery-manufacturing sector. As the domestic base of ‘created’ assets, viz, technology, skills, entrepreneurship was quite limited; the attitude towards FDI was increasingly receptive. FDI was sought on mutually advantageous terms, though the majority local ownership was preferred. The government adopted a more restrictive attitude towards FDI in the late 1960s as the local base of machinery manufacturing capability and local entrepreneurship developed and as the outflow on account of remittances of dividends, profits, royalties, and technical fees, etc, abroad on account of servicing of FDI and technology imports grew sharply.

Restrictions were put on proposals of foreign direct investments unaccompanied by technology transfer and those seeking more than 40 per cent foreign ownership. From 1973 onwards the further activities of foreign companies (along with those of local large industrial houses) were restricted to a select group of core or high priority industries. The Foreign Exchange Regulation Act, (FERA) of 1973 required all foreign companies operating in India to register under Indian corporate legislation with up to 40 per cent foreign equity. Exceptions from the general limit of 40 per cent were made only for companies operating in high priority or high technology sectors, tea plantations or those producing predominantly for exports.

In the 1980s the attitude towards FDI began to change as a part of the strategy of modernization of industry with liberalized imports of capital goods and technology, exposing the Indian industry to foreign competition and assigning a greater role to multinational enterprises in the promotion of manufactured exports. The policy changes adopted in the 1980s covered liberalisation of industrial licensing (approval) rules, a host of incentives and exemption from foreign equity restrictions under FERA to 100 per cent export-oriented units and a degree of flexibility concerning foreign ownership.
After pursuing a restrictive policy towards FDI over the four decades with a varying degree of selectivity, India changed tracks in 1990s and embarked on a broader process of reforms designed to increase her integration with the global economy. The major policy reforms initiated in the post liberalisation period are presented in chronological order in the following section.

4.3 CHRONOLOGICAL LISTING OF FDI POLICY REFORMS\(^9\)

**1991-92**

- As against the previous policy of considering all foreign investment on a case by case basis and that too within a normal ceiling of 40 per cent of total equity investment, new policy provides for automatic approval of FDI up to 51 per cent of equity in a specified list of 34 specified high-priority, capital intensive, high technology industries, provided the foreign equity covers the foreign exchange involved in importing capital goods and outflows on account of dividend payments are balanced by export earnings over a period of 7 years from the commencement of production. Foreign technology agreements are also liberalized for the 34 industries with firms left free to negotiate the terms of technology transfer based on their own commercial judgement and without the need for government approval for hiring of foreign technicians and foreign testing of indigenously developed technologies. This is only subject to a registration procedure with the Reserve Bank of India.

- Investment above 51 per cent equity is also permitted on the basis of case by case approvals given by a specifically constituted Foreign Investment Promotion Board (FIPB) charged with expeditious processing of governmental approvals.

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The procedure for Indian companies to invest abroad and develop global linkages in this way was also streamlined.

The Foreign Exchange Regulation Act (FERA) was amended to remove a number of constraints earlier applicable to firms with foreign equity operating in India and also to make it easier for Indian businesses to operate abroad.

India signed the Multilateral Investment Guarantee Agency (MIGA) Convention and became a member of MIGA along with many other developing countries interested in the promotion foreign investment.

Restrictions placed in March 1991 on sale of foreign exchange for import of capital goods, which were allowed initially only under foreign lines of credit available with financial institutions. Subsequently, in November 1991, this policy was relaxed permitting such imports up to a limited extent against suppliers' credit. Import of capital goods up to a value of Rs. 50 lakhs was also permitted against free foreign exchange and up to a value of Rs. 100 lakhs if the importer could arrange suppliers' credit for 360 days. Import of capital goods would also be allowed (i) against a matching inflow of foreign equity, (ii) against release of free foreign exchange up to 15 per cent of the cost of import up to a limit of Rs. 100 lakhs where 85 per cent of the cost is financed by external commercial borrowing, (iii) for export-oriented entities against borrowings for a minimum period of two years provided the borrowings are liquidated out of the net foreign exchange earnings of the borrowing unit.

LERMS system introduced in March 1992. LERMS (Liberalized Exchange Rate Management System) replaced the previous exim scrips system. Under the LERMS system, virtually all capital goods and raw materials and
components are made freely importable subject to tariff protection as long as foreign exchange to pay for the imports is obtained from the market.

- Earlier prohibition against use of foreign brand name or trademark in goods sold in the domestic market withdrawn.

- Abolished all industrial licensing, irrespective of the level of investment for certain industries related to security and strategic concerns, concerns related to safety and overriding environmental issues, and manufacture of products of a hazardous nature. Certain locational guidelines remain designed to discourage the clustering of industries, particularly the polluting industries in the periphery of major urban centers. Existing industries also free to expand according to their market needs without obtaining prior expansion or capacity clearance from the government.

- Abolition of industrial capacity licensing permits firms to freely manufacture any article in response to market demand (except those subject to compulsory licensing). Phased manufacturing programs which allow for the enforcement of strict local content requirements are abolished.

- Mandatory convertibility clause allowing financial institutions to convert part of their loans into equity if felt necessary by their management is waived.

- MRTP act amended removing the threshold limits of assets in respect of MRTP and dominant undertakings. Prior approval for investment in de-licensed industries from the government is no longer required. As amended, the MRTP act gives more emphasis to the prevention and control of monopolistic, restrictive and unfair trade practices.

**1992-93**

- Many more industries delicensed. Competition promoted by the opening up of many areas previously reserved for the public sector to private and
foreign investment. Policies put in place to attract foreign direct and portfolio investment. Amendment of Sick Industrial Companies Act to permit public enterprises to be examined by the Board for Industrial and Financial Reconstruction (BIFR).

- Financial Sector reforms.

- The previous dividend balancing condition applicable to 51 per cent equity is removed, except for consumer goods industries.

- The list of high-priority industries was rationalized and revised including new industries and adding software.

- Existing companies with foreign equity can raise it to 51 per cent subject to certain prescribed guidelines. FDI is also allowed in exploration, production and refining of oil and marketing of gas. Captive coal mines can also be owned and run by private investors in power.

- NRI s and overseas corporate bodies (OCBs) predominately owned by them are also permitted to invest up to 100 per cent of equity in high-priority industries with repatriability of capital and income. NRI investment up to 100 per cent of equity is also allowed in export houses, trading houses, star trading houses, hospitals, export oriented units, sick industries, hotels and tourism-related industries and without the right of repatriation in the previously excluded areas of real estate, housing and infrastructure. Foreign citizens of Indian origin are now permitted to acquire house property without permission of the Reserve Bank of India.

- Disinvestment of equity by foreign investors no longer needs to be at prices determined by the Reserve Bank. It has been allowed at market rates on stock exchanges from September 15, 1992 with permission to repatriate the proceeds of such disinvestment.

Provisions of the Foreign Exchange Regulation Act (FERA) are liberalized through ordinance dated January 9, 1993 as a result of which companies with more than 40 per cent of foreign equity are now also treated on par with fully owned Indian companies.

Investment Promotion and Project Monitoring cell set up in the Department of Industrial Development to provide information and guidance to entrepreneurs regarding licensing policy, tariffs, corporate laws, current status of applications pending with the Department, infrastructure facilities and incentives available at state levels for setting up industries, etc. Peak import tariff brought down from a maximum of 150 per cent to 100 per cent. Rates for import duties on project imports, capital goods and general machinery were reduced. The Export Promotion Capital Goods (EPCG) Scheme made capital goods importable at 25 per cent and 15 per cent duty as long as the importers agreed to fulfill a stipulated export commitment.

Taxation of capital gains restructured to allow for inflation accounting. Double taxation of partnership firms abolished and financial assets such as equities and debentures are exempted from the wealth tax.

1993-94

States began exercising the initiative given to them by the Center's 1991 reforms. States in the vanguard of reform included Gujarat, Kerala, Maharashtra, Uttar Pradesh and Andhra Pradesh. Liberalization efforts undertaken include:

- Committees appointed to review laws relating to various aspects of liberalization.
o Private participation in development of ports, power stations and desalination of water supplies, etc.

o Restructuring of District Industries Centers (DICs) in progress.

o Walk-in-system for financial assistance by Gujarat Industries and Investment Corporation (GIIC) and Gujarat State Finance Corporation (GSFC).

o Green channel scheme introduced to expedite industrial clearance.

o A state level agency set up to deal with Board of Industrial and Financial Reconstruction (BIFR) cases of state-owned Public Sector Enterprises (PSEs).

o High-level development committees set up to investigate offers for taking over 10 PSEs listed for disinvestment in Kerala.

o District Collectors' permission to convert agricultural land into industrial use no longer required.

o Industrial location policy revised to permit setting up of non-polluting, non-hazardous and high-tech industries within the municipal zone of Greater Mumbai.

o Private participation encouraged in power projects and establishment of industrial estates.

o Committee set up under State Chief Secretary for expeditious decision on NRI and Foreign Direct Investment.

o District and Division level Authorized Committees with substantial decision-making powers set up to strengthen single-window clearance system.

o Simplification of inspection system by departments.
- Privatization/closure of loss-making public sector industrial undertakings and corporations.

- Involvement of private sector in development and management of industrial estates, generation and distribution of power.

- Special facilities to NRIs and foreign industrialists.

- Various aspects and procedures for obtaining power connection streamlined.

- Power Purchase Agreements have been signed with private developers for setting up of Power Projects. The offers received, for undertaking projects, from private parties are being evaluated in Andhra Pradesh.

- **Specific Center initiated reforms include:** 13 minerals earlier reserved for the public sector were opened to the private sector in March 1993. Consequently, the number of industries reserved for the public sector is reduced to 6 (defense, atomic energy, coal and lignite, mineral oils, railway transport, minerals specified in the schedule to the Atomic Energy Order of 1953).

- Motor car and white goods industries were delicensed effective April 28, 1993. Raw hides and skins, leather and patent leather, excluding chamois leather, also delicensed. Overall number of items in respect to compulsory licensing is reduced to 15.

- Manufacture of readymade garments (formerly reserved for small-scale units) now open to large scale enterprises as of July 29, 1993. This is subject to an export of 50 per cent and investment and assets in plant and machinery of the large unit to not more than Rs. 3 crore.

- The Development Commissioners for Export Promotion Zones (EPZs) were delegated some specific powers for 100 per cent Export Oriented
Units (EOUs) and EPZs. These powers earlier rested with Zonal Authorities under the Ministry of Commerce. This brings down the level at which clearances are required.

- Excise duties on capital goods are rationalized and import duties are reduced further to lower capital costs and stimulate investment.

- Five-year tax holiday for new industries in industrially backward States and UTs and for power generation anywhere in India is introduced.

- Export credit refinance limits are augmented; 90 percent of refinance credit is now available in US Dollars.

- The limit for compulsory consortium lending is raised from Rs. 5 crore to Rs. 50 crore. This gives greater flexibility to corporate investors to choose their bank and take advantage of increased competition.

- Sick Industrial Companies (Special Provision) Act, 1985 (SICA) amended in December 1993 to facilitate early detection of sickness in companies and speedy enforcement of remedial measures.

**1994-95**

- Efforts made to facilitate private entry into infrastructure areas including natural resource sectors and non-tradable infrastructure services such as electricity, internal transport and telecommunications. Specific developments included in this area include:
  
  - National Mineral Policy revised and the Mines and Mineral Development Act amended to open up the sector to private and foreign investment. Ten minerals were de-reserved for exploitation by the private sector.
RBI based automatic approval policy for foreign investment made applicable to mining (except atomic materials and mineral fuels), subject to a limit of 50 per cent on foreign equity.

The new power sector policy framework attracted 138 private proposals for creating 58745 megawatts of capacity with an investment of Rs. 219927 crores. Of these, 41 proposals are from foreign investors or joint ventures with foreign partners. Thirteen were cleared at the end of 1994-95 fiscal year.

National Telecom Policy of 1994 allows for private provision of basic telecom services. For value added services, government permits a maximum of 51 per cent equity. Basic services, cellular mobile and radio paging limit is 49 per cent. Open system of tendering/bidding of licenses is concluded.

Enables private Air Taxi companies to operate as regular domestic airlines.

Development and maintenance of airport infrastructure and material handling areas etc., opened up to private participation.

National Highway Act amended to enable toll collection on National Highway users. Further amendments are foreseen to permit private participation in construction, maintenance and operation of roads on a Build-Operate-Transfer (BOT) basis.

Further private participation in the infrastructure is encouraged in the leasing of port equipment, operation and maintenance of container terminals, cargo handling terminals, creation of warehouse and storage facilities, transportation within ports, setting up private berths by coastal based industries, ship repairs and maintenance.
India took a major step toward current account convertibility in March 1993 when the exchange rate was unified and transactions on trade account were freed from exchange control. The determination of the exchange rate of the rupee was left to the market. The RBI on February 28, 1994 announced the liberalization of exchange control regulations up to a specified limit relating to:

(a) exchange earners foreign currency accounts.
(b) basic travel quota.
(c) gift remittances.
(d) donations and
(e) payments of certain services rendered by foreign parties.

- Industrial licensing for almost all bulk drugs abolished.
- Automatic approval of foreign investment up to 51 per cent and foreign technology agreements permitted for all bulk drugs and formulations, barring only a few.
- Import duties reduced to 15 per cent on export related capital goods, 25 per cent for project imports and most capital goods and continuation of concessional duties at 20 per cent for power projects, and 0 per cent for fertilizer projects.
- MODVAT extended to capital goods and petroleum products.
- Corporate tax reduced from 45 per cent for widely held companies and 50 percent for closely held companies to 40 per cent for domestic companies and from 65 per cent to 55 per cent for foreign companies.
- Five-year tax holiday to new industrial undertakings that was initially allowed for industrially backward states in the 1993-94 budget now extended to all backward areas notified by the Department of Revenue.
Major overhaul of the excise tax structure, including rationalization of rates, elimination of most end-use exemptions and a general shift from specific to ad valorem duties.

Continued reform in customs duties, including reduction of the peak tariff rate, elimination of most end-use exemptions and removal of exemptions from countervailing duties.

Foreign Investment allowed for NRIs and persons of Indian origin in a wide range of construction and real estate related activities. Foreign investment also allowed in constructing and operating highways, expressways and bridges on a toll tax system, generating electricity on Build-Operate Own (BOO) basis, basic telephone services and certain operations in railways on Build-Operate-Lease-Transfer (BOLT) basis. Without prior approvals, foreign investors can now own up to 24 per cent equity in any Indian firm and up to 20 per cent in new private banks.

1995-96

Under zero duty import of capital goods scheme, which is available for imports of capital goods of at least Rs. 20 crore, there are now two windows to fulfill export obligation on FOB (free on board) or NFE (net foreign exchange earnings) basis.

Advance licenses have been made transferable after the export obligation has been fulfilled and the Bank Guarantee/LUT (letter of undertaking) redeemed.

The concept of a back to back letter of credit has been introduced to enable an advance license holder to source his inputs from domestic suppliers.

The list of sensitive items has been pruned after taking into account the reduction in customs duties and excise duties. Besides, flexibility has been
provided to the exporter for using un-utilized c.i.f. (cost, insurance, freight) value of sensitive items for importing non-sensitive items.

- Realization of export proceeds is no longer a condition for availing of facilities, including transferability of the duty exemption licenses or the goods imported under such licenses.

- The Software Technology Park (STP) scheme and the Electronic Hardware Technology Park (EHTP) scheme are amended in several respects, including value addition norms and DTA (domestic tariff area) sales.

- Definition of consumer goods is changed to suit the needs of importers, so as to allow them to freely import parts, components and spares of consumer goods as well. These were earlier restricted to the extent they could only be imported by the actual user. With these changes, any person can import parts or components of consumer durables freely without a license and without actual user condition.

- List of freely importable consumer goods is further expanded to include 78 items, including natural essential oils, instant coffee, refrigerated trucks, etc. Additionally, import of 90 consumer items is permitted by all persons against the freely transferable special import licenses (SILs) that are granted to the export and trading houses. The SILs are tradable in the open market at a premium to be determined by the market forces.

- List of goods permitted to be imported against the freely transferable import licenses which are granted to the export houses/trading houses/star trading houses and super star trading houses has been expanded to include items, *interalia*, electric drilling machines, blank 8 mm video tapes/cassettes, bar code readers, electronic diaries, ropeway systems, cable cars, electric shavers, powered mowers for lawns, parks or sports grounds, marine containers, video monitors, and certain types of hand tools.
• Newsprint including glazed newsprint has been made freely importable, by all persons.

• Import of mandatory spares up to 5 per cent of the c.i.f. value of the license has been allowed.

• An alternative route of the Pass Book scheme, for some categories of exporters, has been opened. Basic customs duty credit may be utilized for payment of customs duty against import of goods of a non-negative nature.

• During the Uruguay Round of negotiations at the WTO, India sought under the GATS agreement to offer entry to foreign services providers in services sectors in which entry was considered to be advantageous in terms of capital inflows, technology and employment. In return, India sought greater access for its skilled personnel to the markets of its major trading partners. Broadly speaking, India's commitments cover a limited offer in the insurance sector as per existing practice. In the banking sector, India permits entry of eight new licenses per year both for new entrants and existing banks, subject to a maximum share of assets in India both on and off balance sheets of foreign banks not exceeding 15 per cent of the banking system as a whole. As far as commitments in other financial services, such as merchant banking, financial leasing, factoring, venture capital, financial consultancy etc., all envisage locally incorporated joint venture companies with foreign equity not exceeding 51 per cent except for stock brokering where the limit is 49 per cent.

• Several reforms in the Industrial sector relating to FDI include:
  
  o The number of items, in respect to industrial licensing requirements is reduced to 15. These industries account for only 15 per cent of the value added in the manufacturing sector.
- Number of industries reserved for the public sector is reduced to 6, viz. defense products, atomic energy, coal and lignite, mineral oils, railway transport, minerals specified in the schedule to the Atomic Energy Order 1953. Private participation in some of these sectors is also permitted on a case by case basis.

- More private initiative is encouraged in development of infrastructure like power, roadways, telecommunication, shipping and ports, airports and civil aviation etc.

- The manufacture of readymade garments- an item reserved for exclusive manufacture by the ancillary/small scale industrial undertakings opened to large scale undertakings, subject to an export obligation of 50 per cent and investment limit of Rs.3 crore.

- Automatic approval of foreign investment up to 51 per cent and foreign technology agreements permitted for 35 priority industries which account for 50 per cent value added in the manufacturing sector.

- Foreign investment has also been liberalized in many sectors, including:
  
a. 35 high-priority industries

b. Export/Trading/Star trading houses

c. Hotels & Tourism related industry

d. 100 per cent EOUs and units in FTZ and EPZ

e. Sick industries

f. Mining

g. Telecommunications

h. Power
i. Medical clinics, Hospitals, Shipping, Oil exploration and Deep sea fishing.

j. Industries reserved for SSI

k. Housing, real estate, business centers & infrastructure facilities.

l. Portfolio investment (Investment in shares & debentures).

m. Government securities

n. Units in UTI

o. Public sector mutual funds

p. Private sector mutual funds

**1996-97**

- The Foreign Investment Promotion Council is set up.

- The Foreign Investment Promotion Board (FIPB) is streamlined and made more transparent.

- First ever guidelines are announced by the government for consideration of foreign direct investment proposals by the FIPB which are not covered under the automatic route in January of 1997. Priority areas addressed in the guidelines include infrastructure, industries having export potential, large scale employment potential particularly for rural areas, items with linkages to the farm sector, social sector projects like hospitals, health care and medicines, and proposals that lead to introduction of technology and infusion of capital. FDI approvals, are however subject to sectoral caps; 20 per cent (40 per cent for NRIs) in banking; 51 per cent in non-banking financial companies without any special conditions (100 per cent with specified minimum levels of foreign investment); 100 per cent in power, roads, ports, tourism and venture capital funds; 49 per cent (not to be offset against the FDI in an investment holding/company where there is a cap of 49 per cent) in telecommunications (basic, cellular, paging services); 40 per
cent (100 per cent for NRIs) in domestic air-taxi operations/airlines; 24 per cent in small scale industries; 51 per cent in drugs/pharma industry for bulk drugs; 100 per cent in petroleum; and 50 per cent in mining except for gold, silver, diamonds and precious stones.

- The FIPB allows 100 per cent foreign equity in cases where the foreign company cannot find a suitable Indian joint-venture partner, subject to the condition that the foreign investor divests at least 26 per cent of its equity within three to five years.

- New guidelines also allow foreign companies to set up 100 per cent companies on the basis of these criteria:
  
  (a) where only holding operation is involved and all downstream investments to be carried out need prior approval.

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

  (c) where at least 50 per cent of production is exported

  (d) consultancy proposals and

  (e) projects in power, roads, ports and industrial towns and estates.

- The FIPB will also allow proposals for 100 per cent trading firms for exports, bulk imports, cash-and-carry wholesale trading and other import of goods and services provided that at least 75 per cent is for procurement and sale of goods and services among group firms.

- The list of industries eligible for automatic approval of up to 51 per cent foreign equity is expanded, including three industries relating to mining activity for foreign equity up to 50 per cent. An additional 13 industries for foreign equity of up to 51 per cent are included. These 13 industries include a wide range of industrial activities in the capital goods and
metallurgical industries, entertainment electronics, food processing, and the service sectors having significant export potential.

- Foreign Institutional Investors (FIIs) are allowed to invest in unlisted companies and in corporate and government securities.

- External commercial borrowing (ECB) guidelines are liberalized and made more transparent.

- In December, 1996, the government allows automatic approval of FDI up to 74 per cent by the RBI in nine categories of industries, including electricity generation and transmission, non-conventional energy generation and distribution, construction and maintenance of roads, bridges, ports, harbors, runways, waterways, tunnels, pipelines, industrial and power plants, pipeline transport except for Petroleum, Oil and Lubricants and gas, water transport, cold storage and warehousing for agricultural products, mining services except for gold, silver and precious stones and exploration and production of POL and gas, manufacture of iron ore pellets, pig iron, semi-finished iron and steel and manufacture of navigational, meteorological, geophysical, oceanographic, hydrological and ultrasonic sounding instruments and items based on solar energy.

**1997-98**

- The list of industries eligible for foreign direct equity investment under the automatic approval route by the RBI increased in 1997-98. Equity investment up to 100 per cent by NRIs/OCBs has been permitted in high priority industries in metallurgical and infrastructure sectors.

- Number of industries subject to compulsory industrial licensing reduced from 14 to 9.

- Investment ceiling on plant and machinery for small scale industrial undertakings enhanced from Rs. 60 lakh/Rs. 75 lakh to Rs. 3 crore and for
tiny units to Rs. 25 lakh from Rs. 5 lakh. 15 items reserved for manufacture in the small sector are de-reserved.

1998-99

- Projects for electricity generation, transmission and distribution and construction and maintenance of roads, highways, vehicular tunnels and vehicular bridges, ports and harbors are permitted foreign equity participation up to 100 per cent under the automatic route. Automatic route is subject to a ceiling of Rs. 1500 crore on foreign equity.

- FDI permissible under Non-banking Financial Services now includes "Credit Card Business" and "Money Changing Business".

- Multilateral financial institutions are allowed to contribute equity to the extent of shortfall in NRI holdings, and within the overall permissible limit of 40 per cent in private sector banks.

- FDI up to 49 per cent equity is allowed subject to license, in the companies providing Global Mobile Personal Communication by Satellite (GMPCS) services.

- Unlisted companies are permitted to float Euro issues under certain conditions.

- End use restrictions on GDR/ADR issue proceeds have been removed except those on investment in stock markets and real estate.

- Indian companies permitted to issue GDRs/ADRs in the case of Bonus or Rights issue of shares, or on genuine business reorganizations duly approved by the High Court.

- Delicensed coal and lignite, petroleum (other than crude) and its distillation products and bulk drugs.

- Delicensed sugar
• De-reservation of coal and lignite and mineral oils

• Companies permitted to buy-back their own shares subject to restriction of buy-back to 25 per cent of paid up capital and free reserves.


• Patent bill approved by Rajya Sabha and subsequently promulgated through ordinance.

• Number of items, including some farm implements and tools, are removed from products reserved for exclusive manufacture by SSI sector.

• April 1998 Exim policy further delicensed 340 items of import moving them from restricted list to OGL.

• India unilaterally removed all quantitative restrictions on imports of around 2300 items from SAARC countries effective August 1, 1998.

• Further encouragement of private sector participation and investment in infrastructure continues.

• New Telecom policy is under preparation.

1999-2000

• Foreign Investment Implementation Authority (FIIA) was established in order to ensure that approvals for foreign investments (including NRI investments) are quickly translated into actual investment inflows and that proposals fructify into projects. In particular, in cases where FIPB clearance is needed, approval time has been reduced to 30 days.

• Foreign owned Indian holding companies permitted to make downstream investment within permissible equity limits through the automatic route
provided such holding companies bring in the requisite funds from abroad. Also, the need to obtain prior approval of the FIPB for increasing foreign equity within already approved limits has been dispensed with in all cases where the original project cost was up to Rs.600 crore.

- Indian software companies, which are listed in foreign exchanges and have already floated ADR/GDR issues, to acquire foreign software companies and issue ADRs/GDRs without reference to the Government of India or the RBI up to the value limit of US $ 100 million. For acquisitions beyond US $ 100 million, proposals would require examination by a Special Composite Committee in the RBI.

- The track record scrutiny process for ADR/GDR issues and the two stage approval by the Ministry of Finance has been dispensed with. Indian companies would henceforth be free to access the ADR/GDR markets through an automatic route without the prior approval of the Ministry of Finance subject to the specified norms and post-issue reporting requirement. As ADRs/GDRs are reckoned as part of FDI, such issues would need to conform to the existing FDI policy and permissible only in areas where FDI is permissible. Such ADR/GDR issues would, however, be governed by the mandatory approval requirements under the FDI policy.

- The Insurance Regulatory and Development Act (IRDA) was passed by Parliament in December, 1999. The Act, which seeks to promote private sector participation in the insurance sector permits foreign equity stake in domestic private insurance companies up to a maximum of 26 per cent of the total paid up capital.

- All items are placed under the automatic route for FDI/NRI/OCB investment except for a small negative list, which includes the following:
- Items requiring an industrial license under the Industries (Development and Regulation) Act, 1951.
- Foreign investment being more than 24 per cent in the equity capital of units manufacturing items reserved for small scale industries.
- All items requiring industrial license in terms of the locational policy notified under the New Industry Policy of 1991.
- Proposals having previous venture/tie-up in India with foreign collaborator.
- Proposals relating to acquisition of shares in existing Indian company by foreign/NRI/OCB investor.
- Proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not permitted and/or applications chosen to be submitted through FIPB rather than automatic route by the investors. This is an important step to dispense with case-by-case approval procedure and to impart greater transparency in the process of foreign investment.

- Subject to sectoral policies and sectoral caps the automatic route would be 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 would qualify for automatic approval subject to the aforesaid parameters.

2000-01

- 100 per cent FDI permitted for Business to Business e-commerce.
- Removal of cap on investment in the power sector.
- 100 per cent FDI permitted in oil refining.
- 100 per cent FDI allowed in Special Economic Zones for all manufacturing activities.

- Condition of Dividend Balancing on 22 consumer items removed forthwith.

- The limit of Rs 1500 crores for FDI in projects involving electricity generation, transmission and distribution (other than atomic reactor plants) has been dispensed with.

- 100 per cent FDI allowed (with certain conditions) in the telecommunications sector for Internet Service Providers (ISPs) not providing gateways (both for satellite and submarine cables), infrastructure providers providing dark fiber (IP category I), electronic mail and voice mail.

- Payment of royalty up to 2 per cent for exports and 1 per cent for domestic sales allowed under automatic route on use of trademarks and brand name of the foreign collaborator without technology transfer.

- Payment of royalty up to 8 per cent on exports and 5 per cent on domestic sales by wholly owned subsidiaries to offshore parent companies allowed under the automatic route without any restriction on the duration of royalty payments.

- Offshore Venture Capital Funds/Companies allowed to invest in domestic venture capital undertakings as well as other companies through the automatic route, subject only to SEBI regulations and sector specific caps on FDI.

- Existing companies with FDI are eligible for automatic route to undertake additional activities covered under automatic route.
• FDI up to 26 per cent is eligible under automatic route in the insurance sector, as prescribed in the Insurance Act, 1999, subject to obtaining a license from the Insurance Regulatory & Development Authority.

• Automatic route is available to proposals in the Information Technology Sector, even when the applicant Company has a previous joint venture or technology transfer agreement in the same field.

**2001-02**

• FDI up to 100 per cent is permitted on the automatic route for manufacture of drugs and pharmaceuticals, provided the activity does not attract compulsory licensing or involve use of recombinant DNA technology and specific cell / tissue targeted formulations. FDI proposals for the manufacture of licensable drugs and pharmaceuticals and bulk drugs produced by recombinant DNA technology and specific cell / tissue targeted formulations will require prior Government approval.

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

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

• FDI up to 100 per cent is permitted for development of integrated townships, 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 materials. Development of land and providing allied infrastructure will form an integral part of township’s development, for which necessary guidelines/norms relating to minimum capitalization, minimum land area,
etc., will be notified separately by the Government. FDI in this sector would be permissible with prior Government approval.

- FDI up to 100 per cent is permitted on the automatic route in hotel and tourism sector.

- FDI up to 100 per cent is permitted in courier services subject to existing laws and exclusion of activity relating to distribution of letters. FDI in this sector would be permissible with prior Government approval.

- FDI up to 100 per cent is permitted on the automatic route for Mass Rapid Transport Systems in all metropolitan cities, including associated commercial development of real estate.

- NRI investment in foreign exchange is made fully repatriable whereas investments made in Indian rupees through rupee accounts shall remain non-repatriable.

- FDI up to 74 per cent is permitted for the following telecom services subject to licensing and security requirements:
  - Internet service providers with gateways.
  - Radio paging.
  - End-to-end bandwidth.

Proposals with FDI beyond 49 per cent shall require prior Government approval.

- FDI up to 49 per cent from all sources is permitted in the banking sector on the automatic route subject to conformity with guidelines issued by RBI from time to time.

2002-03

- FDI up to 100 per cent permitted under the automatic route in the advertising sector. FDI under the automatic route up to 100 per cent
available for film sector and will not be subject to conditions about debt equity ratio, minimum level of equity investment etc.

- FDI up to 100 per cent allowed in tea sector, including tea plantations, permitted subject to compulsory disinvestment of 26 per cent equity in favour of Indian partner within a period of five years and prior approval of the state government in case of any future land use change.

- Re-issuance of ADR/GDR permitted to the extent of ADRs/GDRs which have been redeemed into underlying shares and sold in the domestic market.

- FDI up to 100 per cent permitted with prior approval of the government for development of integrated township, including housing, commercial premises, hotels, resorts and regional level urban infrastructure facilities such as roads and bridges and mass rapid transit system.

- Automatic route of FDI up to 100 per cent allowed in all manufacturing activities in Special Economic Zones, except some of the activities such as arms and ammunitions, explosives and allied items of defence equipment, defence aircrafts and warships, atomic substances, narcotics, distillation and brewing of alcoholic drinks and cigarettes and cigars.

- FDI in print media sector is allowed up to 26 per cent of paid-up equity capital of Indian entities publishing periodicals and newspapers dealing with news and current affairs.

**2003-04**

- FDI limit in Private Sector Banks is raised to 74 per cent under the automatic route including investment by FIIs. This will include FDI investment under Portfolio Investment Scheme by FIIs, NRIs and shares acquired prior to September 16, 2003 by OCBs and continue to include
IPOs, private placements, GDRs/ADRs and acquisition of shares from existing shareholders.

- The aggregate foreign investment in a private bank from all sources will be allowed up to a maximum of 74 per cent of the paid up capital of the bank. At all times, at least 26 per cent of the paid up capital will have to be held by residents, except in regard to a wholly-owned subsidiary of a foreign bank.

**2004-05**

- Increase in the FDI limits in “Air Transport Services (Domestic Airlines)” up to 49 per cent through automatic route and up to 100 per cent by non-resident Indians (NRIs) through automatic routes. (No direct or indirect equity participation by foreign airlines is allowed).

- New proposals for foreign investment/technical collaborations would henceforth be allowed under the automatic route, subject to sectoral policies as per the following guidelines:
  
  a. Prior approval of the Government would be required only in cases where the foreign investor has an existing joint venture for technology transfer/trade mark agreement in the ‘same’ field.
  
  b. Even in the above mentioned cases, the approval of the Government would not be required in respect of the following:

    o Investments to be made by venture capital funds registered with SEBI; or
    
    o Where the existing joint venture investments by either of the parties is less than 3 per cent; or
    
    o Where the existing venture/collaboration is defunct or sick.
- Foreign investment in the banking sector has been further liberalized by raising FDI limit in private sector banks to 74 per cent under the automatic route including investment by FIIs. The aggregate foreign investment in a private bank from all sources will be a maximum of 74 per cent of the paid up capital of the bank and at all times, at least 26 per cent of the paid up capital held by residents except in regard to a wholly owned subsidiary of a private bank. Further, the foreign banks will be permitted to either have branches or subsidiaries, not both. Foreign banks regulated by a banking supervisory authority in the home country and meeting Reserve Bank’s license criteria will be allowed to hold 100 per cent paid up capital to enable them to set up wholly-owned subsidiary in India.

- FDI ceiling in telecom sector in certain services (such as basic, public mobile radio trunked services (PMRTS), global mobile personal communication service (GMPCS) and other value added services), has been increased from 49 per cent to 74 per cent in February 2005. The total composite foreign holding including but not limited to investment by FIIs, NRI/OCB, FCCB, ADRs, GDRs, convertible preference shares, proportionate foreign investment in Indian promoters/ investment companies including their holding companies etc., will not exceed 74 per cent.

- In January 2004, guidelines on equity cap on FDI, including investment by NRIs and Overseas Corporate Bodies (OCBs) were revised as under:
  - FDI up to 100 per cent is permitted in printing scientific and technical magazines, periodicals and journals subject to compliance with legal framework and with the prior approval of the Government.
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- FDI up to 100 per cent is permitted through automatic route for petroleum product marketing, subject to existing sectoral policy and regulatory framework.

- FDI up to 100 per cent is permitted through automatic route in oil exploration in both small and medium sized fields subject to and under the policy of the Government on private participation in exploration of oil fields and the discovered fields of national oil companies.

- FDI up to 100 per cent is permitted through automatic route for petroleum products pipelines subject to and under the Government policy and regulations thereof.

- FDI up to 100 per cent is permitted for Natural Gas/LNG pipelines with prior Government approval.

**2005-06**

- FDI cap in the domestic airlines sector has been enhanced from 40 per cent to 49 per cent and NRI investment is permitted up to 100 per cent with no direct or indirect equity participation by the foreign airlines.

- FDI up to 100 per cent under the automatic route is now permitted for development of township, housing, built up infrastructure and construction development projects. The minimum area requirement has been reduced to 10 hectares for serviced housing plots and 50,000 square meters built up area for construction-development projects.

- FDI cap has been increased from 49 per cent to 74 per cent in basic and cellular telecom services. The revised cap includes both FDI and portfolio investment.
- FDI has been permitted in FM Radio Broadcasting up to a maximum of 20 per cent (which is inclusive of FDI, NRI, PIO and FII).

- Guidelines for approval of foreign/technical collaborations for projects with existing joint venture/collaboration in the same field have been reviewed.

Procedural Simplifications

- Transfer of shares in an existing Indian company from residents to nonresidents and vice-versa (except in the financial sector and where SEBI takeover code is attracted).

- Conversion of ECB/loan into equity, provided the activity is covered under the automatic route and the foreign equity after such conversion falls within the sectoral cap.

- Conversion of preference shares into equity provided the increase in foreign equity participation is within the sectoral cap and the activity is under the automatic route.

- Conversion of non-repatriable equity invested by NRIs in foreign exchange into repatriable equity allowed under the automatic route provided the original investment was made in foreign exchange under the FDI scheme notified under the FEMA regulations and the sector/activity in which the investment is proposed to be converted into repatriable equity is on the automatic route for FDI.

**2006-07**

- FDI has been allowed up to 100 per cent under the automatic route for distillation and brewing of potable alcohol, manufacture of industrial explosives, manufacture of hazardous chemicals, manufacturing activities located within 25 kms of the Standard Urban Area limits requiring industrial license under the IDR(Act) 1951, setting up of greenfield airport
projects, laying of natural gas/LNG pipelines, market study and formulation and investment financing in the petroleum sector, and cash and carry wholesale trading and export trading.

- FDI caps have been increased to 100 per cent and automatic route extended to coal and lignite mining for captive consumption, setting up of infrastructure relating to marketing in petroleum and natural gas sector and exploration and mining of diamonds and precious stones.

- FDI has been allowed up to 100 per cent on the automatic route in power trading and processing and warehousing of coffee and rubber. FDI has also been allowed up to 51 per cent for ‘single brand’ product retailing which requires prior approval of Government. Specific guidelines have been issued for governing FDI for ‘single brand’ product retailing.

- Mandatory divestment conditions for Business to Business e-commerce have been dispensed with.

- The transfer of shares from resident to non-resident including acquisition of shares in an existing company has been placed on the automatic route subject to sectoral policy on FDI.

- Agriculture & plantations removed from the list of prohibited sectors for FDI, and the activities permitted within these sectors were included in the sector specific policy. FDI up to 100 per cent is permitted under the automatic route in floriculture, horticulture, development of seeds, animal husbandry, pisciculture, aqua-culture and cultivation of vegetables & mushrooms under controlled conditions, and services related to agro and allied sectors. FDI up to 100 per cent with prior Government approval is permitted in tea plantation subject to the conditions of divestment of 26 per cent equity of the company in favour of an Indian partner/Indian public within a period of five years and prior approval of the State Government.
concerned in case of any future land use change. Besides the above two, FDI is not allowed in any other agricultural sector/activity.

**2007-08**

- Enhancement of the Foreign Direct Investment ceiling from 49 per cent to 74 per cent in the Telecom sector.
  
  o The enhancement of the FDI ceiling will be applicable in case of Basic, Cellular, Unified Access Services, National/International Long Distance, V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS) and other value added Services.
  
  o Both direct and indirect foreign investment in the licensee company shall be counted for the purpose of FDI ceiling. Foreign Investment shall include investment by Foreign Institutional Investors (FIIs), Non-resident Indians (NRIs), Foreign Currency Convertible Bonds (FCCBs), American Depository Receipts (ADRs), Global Depository Receipts (GDRs) and convertible preference shares held by foreign entity. Indirect foreign investment shall mean foreign investment in the company/companies holding shares of the licensee company and their holding company/companies or legal entity (such as mutual funds, trusts) on proportionate basis. Shares of the licensee company held by Indian public sector banks and Indian public sector financial institutions will be treated as ’Indian holding’. In any case, the ‘Indian’ shareholding will not be less than 26 per cent.
  
  o FDI up to 49 per cent will continue to be on the automatic route. FDI in the licensee company/Indian promoters/investment companies including their holding companies, shall require approval of the Foreign Investment Promotion Board if it has a bearing on the
overall ceiling of 74 per cent. While approving the investment proposals, FIPB shall take note that investment is not coming from countries of concern and/or unfriendly entities.

**2008-09**

- The sectors in which FDI is prohibited is specified as: retail trading (except single brand product retailing), atomic energy, lottery business, gambling and betting, business of chit fund, Nidhi companies, trading in transferable development rights (TDRs) and activities/sectors not opened to private sector investment.

- 49 per cent FDI in credit information companies has been allowed.

- FDI up to 26 per cent and FII up to 23 per cent in commodity exchanges, subject to no single investor holding more than 5 per cent, have been allowed.

- FDI up to 100 per cent under the automatic route has been allowed both in setting up and in established industrial parks.

- FDI cap in the civil aviation sector, which includes 74 per cent FDI in non-scheduled airlines, chartered airlines and cargo airlines, has been relaxed. 100 per cent FDI in maintenance and repair organizations, flying training institutes, technical training institutions, and helicopter services/seaplane services has been allowed.

- FDI policy in the petroleum and natural gas sector has been rationalized.

- FDI up to 100 per cent (with prior government approval) in mining and mineral separation of titanium-bearing minerals and ores, its value addition, and integrated activities has been allowed.
4.4 SECTOR SPECIFIC FDI POLICY

While investments are prohibited in some sectors/activities, there are restrictions/conditions/caps on the investment in certain other sector/activities. The caps in various sector(s)/activity and the channels for the entry of FDI into India are detailed out in Table 4.1.

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Sector/Activity</th>
<th>FDI Cap/Equity</th>
<th>Entry Route</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Advertising and Films</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>2</td>
<td>Airports</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a</td>
<td>Greenfield Projects</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>b</td>
<td>Existing Projects</td>
<td>100%</td>
<td>FIPB beyond 74%</td>
</tr>
<tr>
<td>3</td>
<td>Air Transport Services</td>
<td>49% FDI</td>
<td>Automatic</td>
</tr>
<tr>
<td></td>
<td></td>
<td>100% - for NRI investment</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Alcohol- Distillation and Brewing</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>5</td>
<td>Asset Reconstruction Companies</td>
<td>49%</td>
<td>FIPB</td>
</tr>
<tr>
<td>6</td>
<td>Banking- Private Sector</td>
<td>74% 20% (FDI+FII)</td>
<td>Automatic FIPB</td>
</tr>
<tr>
<td>7</td>
<td>Broadcasting</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a</td>
<td>FM Radio</td>
<td>FDI + FII investment up to 20%</td>
<td>FIPB</td>
</tr>
<tr>
<td>b</td>
<td>Cable Network</td>
<td>49% (FDI+FII)</td>
<td>FIPB</td>
</tr>
<tr>
<td>c</td>
<td>Direct-To-Home</td>
<td>49% (FDI+FII), Within this limit, FDI component not to exceed 20%</td>
<td>FIPB</td>
</tr>
<tr>
<td>d</td>
<td>Head end in the sky broadcasting service</td>
<td>74%</td>
<td>FIPB</td>
</tr>
<tr>
<td>e</td>
<td>Setting up hardware facilities such as up-linking, HUB/Teleports</td>
<td>49% (FDI+FII)</td>
<td>FIPB</td>
</tr>
<tr>
<td>f</td>
<td>Up-linking a News and Current Affairs TV Channel</td>
<td>26% (FDI+FII)</td>
<td>FIPB</td>
</tr>
<tr>
<td>g</td>
<td>Up-linking a Non-news &amp; Current Affairs TV Channel</td>
<td>100%</td>
<td>FIPB</td>
</tr>
<tr>
<td>No.</td>
<td>Industry/Activity</td>
<td>Ownership</td>
<td>Approval</td>
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<tr>
<td>8</td>
<td>Business Services</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>9</td>
<td>Cigars &amp; Cigarettes-Manufacture</td>
<td>100%</td>
<td>FIPB</td>
</tr>
<tr>
<td>10</td>
<td>Coffee, Rubber Processing and Warehousing</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>11</td>
<td>Commodity Exchanges</td>
<td>49%</td>
<td>FIPB</td>
</tr>
<tr>
<td>12</td>
<td>Construction and maintenance</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>13</td>
<td>Credit Information Companies</td>
<td>49%</td>
<td>FIPB</td>
</tr>
<tr>
<td>14</td>
<td>Insurance</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>15</td>
<td>Coal &amp; Lignite mining for captive consumption by power projects, and iron &amp; steel,</td>
<td>100%</td>
<td>Automatic</td>
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<tr>
<td></td>
<td>cement production and other eligible activities permitted under the Coal Mines</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Development of Townships, Housing, Built-up infrastructure and Construction</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td></td>
<td>Development Projects.</td>
<td></td>
<td></td>
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<tr>
<td>17</td>
<td>Courier services for carrying packages, parcels and other items which do not</td>
<td>100%</td>
<td>FIPB</td>
</tr>
<tr>
<td></td>
<td>come within the ambit of the Indian Post Office Act, 1898.</td>
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<tr>
<td>18</td>
<td>Defence Production</td>
<td>26%</td>
<td>FIPB</td>
</tr>
<tr>
<td>19</td>
<td>Drugs &amp; Pharmaceuticals</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>20</td>
<td>Agriculture and Animal Husbandry</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td></td>
<td>Floriculture, Horticulture, Development of Seeds, Animal Husbandry,</td>
<td></td>
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<tr>
<td></td>
<td>Pisciculture, aqua-culture, cultivation of vegetables, mushrooms, under</td>
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<td>controlled conditions and services related to agro and allied sectors.</td>
<td></td>
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<tr>
<td>21</td>
<td>Health and Medical Services</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td></td>
<td>Hazardous chemicals, viz., hydrocyanic acid and its derivatives; phosgene and its derivatives; isocyanates and di-isocyanates of hydrocarbon</td>
<td>100%</td>
<td>Automatic</td>
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<tr>
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</tr>
<tr>
<td>23</td>
<td>Hotels and Tourism related Industry</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>24</td>
<td>Industrial Explosives Manufacture</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>25</td>
<td>Industrial Parks - both setting up and already established Industrial Parks</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>26</td>
<td>Infrastructure Company in the Securities Market</td>
<td>49%</td>
<td>FIPB</td>
</tr>
<tr>
<td>27</td>
<td>Investing companies in infrastructure / services sector</td>
<td>49% (FDI 26%) (FII 23%)</td>
<td>FIPB</td>
</tr>
<tr>
<td>28</td>
<td>Mining covering exploration and mining of diamonds &amp; precious stones; gold, silver and minerals</td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td>29</td>
<td>Non Banking Finance Companies- Approved Activities</td>
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<tr>
<td>i</td>
<td>Merchant Banking</td>
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<td>ii</td>
<td>Underwriting</td>
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<td>iii</td>
<td>Portfolio Management Services</td>
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<td>iv</td>
<td>Investment Advisory Services</td>
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<td>v</td>
<td>Financial Consultancy</td>
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<td>vi</td>
<td>Stock Broking</td>
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<td>vii</td>
<td>Asset Management</td>
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<td>viii</td>
<td>Venture Capital</td>
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<td>ix</td>
<td>Custodial Services</td>
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<td>x</td>
<td>Factoring</td>
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<td>Credit Rating Agencies</td>
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<td>xii</td>
<td>Leasing &amp; Finance</td>
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<td>Housing Finance</td>
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<td>xiv</td>
<td>Forex Broking</td>
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<td>Credit Card Business</td>
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<td>xvi</td>
<td>Money Changing Business</td>
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<td>xvii</td>
<td>Micro Credit</td>
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<tr>
<td>xviii</td>
<td>Rural Credit</td>
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</tr>
<tr>
<td>30</td>
<td>Petroleum &amp; Natural Gas Sector</td>
<td></td>
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</tr>
<tr>
<td>a</td>
<td>Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products, actual trading and marketing of petroleum products, petroleum product pipelines,</td>
<td>100%</td>
<td>Automatic</td>
</tr>
</tbody>
</table>
|   | natural gas/LNG pipelines, market study | b | Refining | 49% in case of PSUs
100% in case of private companies | FIPB (in case of PSUs)
Automatic (in case of private companies) |
<table>
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</thead>
<tbody>
<tr>
<td></td>
<td>31</td>
<td>Ports and Harbours</td>
<td>100%</td>
<td>Automatic</td>
<td></td>
</tr>
<tr>
<td></td>
<td>32</td>
<td>Print Media</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a</td>
<td></td>
<td>Publishing of newspaper and periodicals dealing with news and current affairs</td>
<td>26%</td>
<td>FIPB</td>
<td></td>
</tr>
<tr>
<td>b</td>
<td></td>
<td>Publishing of scientific magazines/ specialty journals/periodicals</td>
<td>100%</td>
<td>FIPB</td>
<td></td>
</tr>
<tr>
<td></td>
<td>33</td>
<td>Power including electric generation (except Atomic energy); transmission, distribution and Power Trading.</td>
<td>100%</td>
<td>Automatic</td>
<td></td>
</tr>
<tr>
<td></td>
<td>34</td>
<td>Research and Development Services excluding basic Research and setting of R&amp;D/academic institutions which would award degrees/diplomas/certificates</td>
<td>100%</td>
<td>Automatic</td>
<td></td>
</tr>
<tr>
<td></td>
<td>35</td>
<td>Satellites - Establishment and operation</td>
<td>74%</td>
<td>FIPB</td>
<td></td>
</tr>
<tr>
<td></td>
<td>36</td>
<td>Security Agencies in Private Sector</td>
<td>49%</td>
<td>FIPB</td>
<td></td>
</tr>
<tr>
<td></td>
<td>37</td>
<td>Special Economic Zones</td>
<td>100%</td>
<td>Automatic</td>
<td></td>
</tr>
<tr>
<td></td>
<td>38</td>
<td>Storage and Warehouse Services</td>
<td>100%</td>
<td>Automatic</td>
<td></td>
</tr>
<tr>
<td></td>
<td>39</td>
<td>Tea Sector including Tea Plantation</td>
<td>100%</td>
<td>FIPB</td>
<td></td>
</tr>
<tr>
<td></td>
<td>40</td>
<td>Telecommunications</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| a |   | Basic and cellular, Unified Access Services National International Long Distance V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS) and other value added services | 74% including FDI, FIIs, NRI, FCCBs, ADRs, GDRs, convertible preference shares, and proportionate foreign equity in Indian promoters/Investing telecom Company | Automatic (up to 49%)
FIPB (beyond 49%) |
<p>| | | |</p>
<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>b</td>
<td>ISP with gateways, radio paging, end-to-end bandwidth.</td>
<td>74%</td>
</tr>
<tr>
<td>c</td>
<td>ISP without gateway, infrastructure provider providing dark fibre, electronic mail and voice mail required.</td>
<td>100%</td>
</tr>
<tr>
<td>d</td>
<td>Manufacture of telecom equipments</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a</td>
<td>Wholesale/cash &amp; carry trading</td>
<td>100%</td>
</tr>
<tr>
<td>b</td>
<td>Trading for exports</td>
<td>100%</td>
</tr>
<tr>
<td>c</td>
<td>Trading of items sourced from small scale sector</td>
<td>100%</td>
</tr>
<tr>
<td>d</td>
<td>Test marketing of such items for which a company has approval for manufacture</td>
<td>100%</td>
</tr>
<tr>
<td>e</td>
<td>Single Brand product retailing e-commerce</td>
<td>51%</td>
</tr>
<tr>
<td>f</td>
<td></td>
<td>100%</td>
</tr>
<tr>
<td>42</td>
<td>Transport and Transport Support Services</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Consolidated FDI Policy, March 2010, DIPP, Ministry of Commerce and Industry, GOI.

### 4.4.1 FDI PROHIBITED SECTORS

FDI is prohibited in the following activities/sectors:

a. Retail Trading (except single brand product retailing)

b. Atomic Energy

c. Lottery Business including Government /private lottery, online lotteries, etc.

d. Gambling and Betting including casinos etc.

e. Business of chit fund

f. Nidhi company

g. Trading in Transferable Development Rights (TDRs)

h. Real Estate Business or Construction of Farm Houses
i. Activities / sectors not opened to private sector investment.

Besides foreign investment in any form, foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also completely prohibited for Lottery Business and Gambling and Betting activities.

4.5 EVOLUTION OF PORTFOLIO INVESTMENT POLICY IN INDIA

India’s development strategy was focused on self-reliance and import substitution until the 1980s. Current account deficit was financed mainly through debt flows and official development assistance. There was a general disinclination towards foreign investment or private commercial flows. Since the initiation of the reform process in the early 1990s, however, India’s policy stance has changed substantially, with a focus on harnessing the growing global foreign direct investment (FDI) and portfolio flows. The High Level Committee on Balance of Payments \(^{10}\) made the following recommendations:

1. a compositional shift in capital flows away from debt to non-debt creating flows.

2. strict regulation of external commercial borrowings, especially short-term debt.

3. discouraging volatile elements of flows from non-resident Indians.

4. gradual liberalisation of outflows and

5. disintermediation of Government in the flow of external assistance.

After the launch of the reforms in the early 1990s, there was a gradual shift towards capital account convertibility. From September 14, 1992 FIIs and Overseas Corporate Bodies (OCBs) were permitted to invest in financial instruments. The FIIs had to get registered with SEBI and required RBI’s

permission under FERA. RBI’s permission under FERA enabled the registered FII to buy, sell and realize capital gains on investments made through initial corpus remitted to India, to invest on all recognized stock exchanges through a designated bank branch, and to appoint domestic custodians for custody of investments held. The Government guidelines of 1992 also laid down the eligibility conditions for registration such as track record, professional competence, financial soundness etc.

With the passing of the Foreign Exchange Management Act in 2000, new guidelines were issued to provide the foreign exchange control context where foreign exchange related transactions of FIIs were permitted by RBI. The new philosophy was characterized by the preference for institutional funds and prohibition on portfolio investments by foreign natural persons except non-resident Indians, where direct participation by individuals takes place.

Right from 1992, FIIs have been allowed to invest in all securities traded on the primary and secondary markets including shares, debentures and warrants issued by companies which were listed or were to be listed on the Stock Exchanges in India and in schemes floated by domestic mutual funds. The holding of a single FII and of all FIIs, NRIs and OCBs together in any company was initially subject to the limit of 5 per cent and 24 per cent of the company’s total issued capital, respectively.

India has been following a cautious and gradual approach to capital account liberalisation in the post-reform period. While virtually all restrictions on foreign non-debt capital inflows into India have been lifted (except for a few sectoral caps), India continues to maintain restrictions on debt inflows, particularly of short maturities, and outward investment. Recognizing that the foreign flows augment the domestic capital stock and thereby higher economic growth and provide other dynamic gains from financial integration, the Committee on Capital Account
Convertibility\textsuperscript{11} suggested a cautious approach to liberalisation of forex flows. As regards FIIs, the committee recommended certain procedural relaxations, such as dispensing with prior RBI approval for FIIs’ private placement/primary market investment and prior approval under exchange controls for disinvestments, and removal of restrictions on debt instrument including maturity restrictions and on investment in treasury bills. Some of these recommendations were accepted, and the entry and exit processes of FII’s investment were liberalized.

\textbf{TABLE 4.2}

\textbf{CHRONOLOGY OF FOREIGN PORTFOLIO INVESTMENT POLICY}

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Date</th>
<th>Policy Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>September 1992</td>
<td>FIIs allowed to invest by the Government Guidelines in all securities in both primary and secondary markets and schemes floated by mutual funds. Single FIIs to invest 5 per cent and all FIIs allowed to invest 24 per cent of a company’s issued capital. Broad based funds to have 50 investors with no one holding more than 5 per cent.</td>
</tr>
<tr>
<td>2</td>
<td>November 1996</td>
<td>100 per cent debt FIIs were permitted.</td>
</tr>
<tr>
<td>3</td>
<td>April 1997</td>
<td>Aggregated limit for all FIIs increased to 30 per cent subject to special procedure and resolution.</td>
</tr>
<tr>
<td>4</td>
<td>April 1998</td>
<td>FIIs permitted to invest in dated Government securities subject to a ceiling.</td>
</tr>
<tr>
<td>5</td>
<td>June 1998</td>
<td>Aggregate portfolio investment limit of FIIs and NRIs/PIOs/OCBs enhanced from 5 per cent to 10 per cent and the ceilings made mutually exclusive.</td>
</tr>
<tr>
<td>6</td>
<td>June 1998</td>
<td>Forward cover allowed in equity. FIIs permitted to invest in equity derivatives.</td>
</tr>
<tr>
<td>7</td>
<td>February 2000</td>
<td>Foreign firms and high net-worth individuals permitted to invest as sub-accounts of FIIs. Domestic portfolio manager allowed to be registered as FIIs to manage the funds of sub-accounts.</td>
</tr>
<tr>
<td>8</td>
<td>March 2001</td>
<td>FII ceiling under special procedure enhanced to 49 per cent.</td>
</tr>
<tr>
<td>9</td>
<td>September 2001</td>
<td>FII ceiling under special procedure raised to sectoral cap.</td>
</tr>
<tr>
<td>9</td>
<td>December 2003</td>
<td>FII dual approval process of SEBI and RBI changed to single approval process of SEBI.</td>
</tr>
</tbody>
</table>

\textsuperscript{11} ‘Report of the Committee on Capital Account Convertibility’ (Chairman: S. S. Tarapore), 1997. RBI, Mumbai.
<table>
<thead>
<tr>
<th></th>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>November 2004</td>
<td>Outstanding corporate debt limit of US$ 0.5 billion prescribed.</td>
</tr>
<tr>
<td>11</td>
<td>April 2006</td>
<td>Outstanding corporate debt limit increased to USD 1.5 billion prescribed. The limit on investment in Government securities was enhanced to US$ 2 billion.</td>
</tr>
<tr>
<td>12</td>
<td>November 2006</td>
<td>FII investment up to 23% permitted in infrastructure companies in the securities markets, viz. stock exchanges, depositories and clearing corporations.</td>
</tr>
<tr>
<td>13</td>
<td>January and October 2007</td>
<td>FIIs allowed to invest US $3.2 billion in Government Securities (limits were raised from US$ 2 billion in two phases of US $ 0.6 billion each in January and October)</td>
</tr>
<tr>
<td>14</td>
<td>June 2008</td>
<td>The Government increased the cumulative debt investment limits from US $3.2 billion to US $5 billion and US $1.5 billion to US $3 billion for FII investments in Govt. Securities and Corporate Debt, respectively.</td>
</tr>
<tr>
<td>15</td>
<td>October 2008</td>
<td>The Government increased the cumulative debt investment limits from US $3 billion to US $6 billion for FII investments in Corporate Debt.</td>
</tr>
<tr>
<td>16</td>
<td>October 2008</td>
<td>Removal of regulation for FIIs pertaining to restriction of 70:30 ratio of investment in equity and debt respectively.</td>
</tr>
<tr>
<td>17</td>
<td>October 2008</td>
<td>Removal of Restrictions on Overseas Derivatives Instruments (ODIs)</td>
</tr>
<tr>
<td>18</td>
<td>March 2009</td>
<td>E-bids platform for FIIs to bid for allotments under overall FII debt limits.</td>
</tr>
<tr>
<td>19</td>
<td>August 2009</td>
<td>FIIs allowed to participate in interest rate futures.</td>
</tr>
</tbody>
</table>


The evolution of FII policy in India has displayed a steady and cautious approach to liberalisation of a system of quantitative restrictions. The policy liberalization has taken the form of (i) relaxation of investment limits for FIIs (ii) relaxation of eligibility conditions and (iii) liberalisation of investment instruments accessible for FIIs. In so far as investment limits are concerned, the initial limit for an individual FII was 5 per cent of the total issued capital. This was raised to 10 per cent in June 1998 and the ceiling for single FII was separated from that of a single NRI/PIO/OCB. The aggregate investment ceiling for all FIIs was 24 per cent of the issued and paid-up capital in a company. However, this was allowed to be increased subject to passing of resolution by the Board of Directors of the company followed by passing of a special resolution by the General Body of the
company. The ceiling limit under special procedure was enhanced in stages as follows:

(i) to 30 per cent from April 4, 1997
(ii) to 40 per cent from March 1, 2000
(iii) to 49 per cent from March 8, 2001 and
(iv) to sectoral cap/statutory ceiling from September 20, 2001.

Under eligibility conditions, the definition of broad based funds was relaxed in August, 1999 and in February, 2000 and newer entities, such as foreign firms were allowed to invest as sub-accounts. In order to have a level playing field in intermediation, domestic portfolio managers were allowed in February, 2000 to manage the funds of sub-accounts, so as to give end-customers a greater choice about the identity of their fund manager in India.

FIIIs were initially allowed to invest only in listed securities of companies. Gradually, they were allowed to invest in unlisted securities, rated government securities, commercial paper and derivatives traded on a recognized stock exchange. From November 1996, any registered FII willing to make 100 per cent investment in debt securities were permitted to do so subject to specific approval from SEBI as a separate category of FIIIs or sub-accounts as 100 per cent debt funds. The overall cap on investments in Government securities, both through the normal route and the 100 per cent debt fund route, was revised from US $1 billion to US $1.75 billion in November, 2004. Moreover, investments were allowed only in debt securities of companies listed or to be listed in stock exchanges. Investments were free from maturity limitations. FII investments were also allowed in dated Government securities from April 1998. Treasury bills, being money market instruments, were originally outside the ambit of such investments, but were included subsequently from May 1998.
An overview of the foreign investment policy in India reveals the fact that policy changes were introduced in India not in one go but it was a gradualist one. Even after the completion of nearly two decades, reform measures are still continuing which is an indication of the fact that reforms are never ending and an unfinished business in the agenda of the Government of India.

India had its first severe balance of payments crisis in 1956, which led to the formation of the Aid India Consortium. Thereafter, in several years, India sought extraordinary assistance from bilateral donors and/or the IMF to tackle difficult balance of payments problems (e.g., in 1966, 1973, 1980, 1987 and 1991).