CHAPTER 5
FDI AND INDIAN ECONOMY
5.0 INTRODUCTION

World economy witnessed large-scale decolonization during post-war period, which resulted in an intense desire for development among the newly independent countries. In fact, the 'Big-Push' theory\(^1\) gained acceptance during this period and raised the quantum of investment through greater mobilization of domestic resources and external support in these countries. There was a common belief that the gains from growth would automatically trickle down to the lowest rung of the economic ladder. However, the growth rate remained very low despite huge investment. The structural weaknesses or defective macroeconomic policies came in the way of the very process of growth. Apart from structural weaknesses on the domestic front, developing countries had to face severe external shock (Balassa 1981). The soaring international oil prices of 1973-74 and 1979 gave a jolt to the balance of payments position of the net oil-importing developing countries. All these reasons hampered the process of economic growth of the developing countries. The economic measures and efforts of over three decades failed to pull the developing countries like India out of stagnation. In the mean time, the developing countries were made to believe that liberalization and globalization of their economies could help to come out of this stagnation. Thus, many developing national economies were opened for international business. In this backdrop, India tried to come out of the stigma of a perceived closed economy and started liberalizing her economy gradually.

An Overview

After independence, India adapted a mixed economic model with a major role for the state in industrial production with an emphasis on import substitution strategy. While this policy helped to lay the foundation for industrialization and technological change, national income growth remained low at about 3-4 percent per annum for several decades. The outward oriented Asian countries grew much faster during this period by taking advantage of post-war expansion in international trade and foreign investment flows. During these decades Indian government displayed a "stop-and-go" attitude towards foreign investment. On the one hand, the government sought to establish limits

\(^1\) For a detailed discussion on Big-Push theory, see, Rodan 1961.
on the areas of industrial activity in which foreign investors could operate, and also to restrict the degree of foreign ownership of those operations. On the other hand, the government wanted to draw foreign investment in the hope that it would provide technology and capital for industrialization as well as boost foreign exchange reserves. In this view, for more than three decades, India maintained a selective approach towards foreign investment. Initially post-independence hostility to foreign investment quickly changed to toleration. This was reflected in the shift from the government first Industrial Policy Resolution (IPR) of 1948, which conceded that the participation of foreign capital and enterprise is of value to the rapid industrialization of the country, demanded that the conditions under which it may participate be carefully regulated in the national interest. By the year 1989-90, the situation on the balance of payment and foreign exchange reserves became precarious and the country was driven to the brink of default. In the financial year 1990-91, India entered a period of severe balance of payment crisis and political uncertainty. The credibility reached the sinking level that no country was willing to advance or lend to India at any cost. Exports began to experience serious difficulties. There was a marked increase in petroleum prices because of the Persian Gulf War. The crippling external debts were debilitating the economy. India was left with that much amount of foreign exchange reserves which can finance its three weeks of imports. The outflowing of foreign currency which was deposited by the Indian NRI’s gave a further jolt to Indian economy. The overall Balance of Payment reached at Rs. (-4471) crores. Inflation reached at its highest level of 13%. Foreign reserves of the country stood at Rs.11416 crores. The continued political uncertainty in the country during this period added further to worsen the situation. As a result, India’s credit rating fell in the international market for both short-term and long-term borrowing. All these developments brought the country almost to the verge of default in respect of external payments liability, which could only be averted by borrowing from IMF under standby arrangement and certain emergency measures taken by the then government to restrict imports. In June 1991, a new government headed by P.V Narasimha Rao came to power following the mid-term election. This government initiated a programme of macro-economic stabilization and structural adjustment2 supported by the IMF and World Bank.

2 - For a discussion on the difference between macro-economic stabilization and structural adjustment programme, see, Appendix 5.1
The programme was substantially different from the earlier ones and launched a variety of policy reforms.

A conscious strategy of integrating with the global economy was put into place to integrate the Indian economy with global economy. The reforms introduced under the new economic policies reflected India's determination to facilitate the introduction of foreign capital, management methods, industrial technology and its commitment to the modernization of its economy in the context of open international economic relations, in order to overcome poverty, build a fair society and achieve true self-sufficiency. In this context, foreign investment considered as an instrument of international economic policy aimed at development and globalization of Indian economy. Foreign capital, whose presence in Indian industry was long regarded with concern and suspicion, touted as a panacea for India’s economic problems. The inflows have qualitatively changed the balance of payments situation in India. Deregulation of foreign investment in India started in 1993 in the form of partial liberalization of the capital account. Outflows of capital by the Indian residents remained strictly controlled, whereas inflows and outflows of capital by non-residents were partially deregulated. These changes in policy framework not only led to a surge in inflows of private foreign capital but also contributed to a significant change in the form in which private capital was coming in. Official assistance which was the major source of private foreign capital inflows during the eighties and the main source of meeting the current account deficit became less important during nineties and non-debt creating inflows dominated debt creating inflows. The superior role of Foreign Portfolio Investment (FPI) followed by the Foreign Direct Investment (FDI) has been envisaged. Foreign Direct Investment seem superior to other types of foreign capital inflows in stimulating economic growth for several reasons.\(^3\) Therefore, with realizing the important contribution that FDI can make to economic growth, many constraints that had historically been imposed on FDI were removed and India introduced many policy reforms to attract them. Restrictive investment regimes liberalized; in addition, various types of incentives are being offered to

\(^3\) - FDI is supposed to be non-debt creating and less volatile which offers not just capital but also access to modern technology and know-how. FDI benefits domestic industry as well as Indian consumer by providing opportunities for technological upgradation, access to global managerial skills and practices, optimal utilization of natural and human resources, making Indian industry internationally competitive, opening up export markets, providing backward and forward linkages and access to international quality goods and services. In a world of increased of competition and rapid technological changes, it's complimentary and catalytic role can be very valuable
attract them. In this way greater attention is also being paid to making the macro economic environment more conducive to foreign investors.

As result of reforms FDI inflows during 1991-92 to 2008 increased manifold as compared to during mid 1948 to march 1990 (Figure 5.1). It is observed that there has been a steady flow of FDI in India after its independence. But there is a sharp rise in FDI inflows from 1998 and particularly 2005 onwards. The measures introduced by the government to liberalize provisions relating to FDI in 1991 lure investors from every corner of the world. There were just few (U.K, USA, Japan, Germany, etc.) major countries investing in India during the period mid 1948 to march 1990 and this number has increased to fifteen in 1991. India emerged as a strong economic player on the global front after its first generation of economic reforms. As a result of this, the list of investing countries to India reached to maximum number of 120 in 2008. Although, India is receiving FDI inflows from a number of sources but large percentage of FDI inflows is vested with few major countries. Mauritius, USA, UK, Japan, Singapore, Netherlands constitute 66 percent of the entire FDI inflows to India. U.K. the prominent investor during the pre and post independent era stands nowhere today as it holds a share of 6.1 percent of the total FDI inflows to India. FDI inflows are welcomed in 63 sectors in 2008 as compared to 16 sectors in 1991. It is found that there is a huge gap in FDI approved and FDI realized. It is observed that the realization of approved FDI into actual disbursements has been quite slow. The reason of this slow realization is due to the nature and type of investment projects involved and some factors which are the main deterrents on FDI inflows in India.

Beside this increased FDI has stimulated both exports and imports, contributing to rising levels of international trade. India’s merchandise trade turnover increased from US$ 95 billion in FY02 to US$391 bn in FY08 (CAGR of 27.8%).
5.1 INTEGRATION OF INDIAN ECONOMY WITH THE WORLD ECONOMY

The economic reforms undertaken by the government of India in 1991 made the country one of the prominent performers of global economies by placing it as the 9th largest economy in the world, the 3rd largest economy in Asia and the 4th largest economy in terms of purchasing power parity (PPP). India also ranks as the 11th largest economy in terms of industrial output, and has the 3rd largest pool of scientific and technical manpower. India ranked second in the world in terms of attractiveness for FDI (A.T. Kearney 2007).

India is member of many major multilateral and regional organizations. It is founding member of the International Labour Organization (ILO) which came into existence in 1919 with China and Thailand. Besides, India is founding member of United Nations Industrial Development Organization (UNIDO) in 1945. Apart from these two India is an active member of World Bank, IMF, WTO, WHO, ASEAN, SAARC, IAEA, WIPO, G20 and the World Bank Group i.e., IBRD, IDA, IFC and MIGA.

Economy of India is based on planning through its five-year plans, which is developed, executed and monitored by the Planning Commission. The First Five Year Plan was implemented in 1951 and presently India is experiencing its 11th Five Year Plan (2007-2012). Acceleration of GDP growth rate from single to double digit growth rate and then maintain it, creation of new work opportunities and reducing educated unemployment are among the most important objectives of this plan.
Today, the world’s largest democracy has come to the forefront as a global resource for industry in manufacturing and services sectors. Its pool of technical skills, its base of an English-speaking populace with an increasing disposable income and its burgeoning market has all combined to enable India emerge as a viable partner to global industry. The liberalization move by the Indian government in 1990s has given a boost to the Indian economy and put her into a fast track economic growth route. The results of the liberalization were a large increase in exports, imports, foreign direct investment, with external debt declining and foreign reserves recording strong improvements. Exports growth doubled in the first ten years after the reform, from an annual growth of around 11.4 percent average during 1995–2000, to 25 percent by 2006 (Table 5.1). Services exports, especially software and information technology (IT), also grew rapidly. In 2008 exports of goods and services accounted for around 22 percent of India’s GDP, up from around 8 percent at the eve of the reforms. Imports have also grown remarkably, reflecting India’s growing integration with the global economy.

Table 5.1
India: Trade Performance 1980-2010

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Memorandum: (in percent of GDP)

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Sources: IMF World Economic Outlook 2010.
The destination and source of India’s trade have also become more diverse since the mid 1990s. While in the early part of India’s transformation Europe and other advanced economies accounted for a large share of India’s trade, in the past decade the share of trade with Asia, Africa and the Middle East has grown significantly, surpassing that of the advanced economies (Figure 5.2). At the beginning of India’s transformation, the key contributors to export growth were food and beverage categories, but twenty years later India’s exports are led by services. India’s exports of IT have grown consistently above the global average since 2000, and the share of services in India’s exports has been much higher than in most comparator countries. This Figure shows India’s trade with different regions as % of India’s total trade.

Figure 5.2
India: Share of Trade by Regions  %

Sources: IMF Direction of Trade Statistics

The liberalization also affected GDP growth rate. In 2009, Indian GDP based on purchasing power parity (PPP) stood at $ 3.5 trillion making it the fourth largest economy. With GDP of $ 4282.204 billion, it is behind USA, China and Japan. India is the second fastest growing economy with a GDP growth rate of 9.2% at the end of the second quarter of 2006-2007 and has seen a decade of 7 plus per cent growth.
Since independence, India’s BOP on its current account was negative. From 1996-97, its BOP has been positive, largely on account of increased FDI and deposits from Non-Resident Indians (NRIs), and commercial borrowings. The fiscal deficit has come down from 4.5 per cent in 2003-04 to 2.7 per cent in 2007-08 and revenue deficit from 3.6 per cent to 1.1 per cent in 2007-08. As a result, India’s foreign exchange reserves shot up 55 per cent in 2007-08 to close at US $309.16 billion an increase of nearly US $110 billion from US $199.18 billion at the end of 2006-07. Domestic saving ratio to GDP shot up from 29.8% in 2004-05 to 37.7% in 2007-08. For the first time India’s GDP crossed one trillion dollars mark in 2007.

The strengthening of India’s financial linkages with the external world was also a major focus of the reforms. First, the liberalization of some parts of the capital account mostly equity flows encouraged foreign investment and reduced reliance on short-term debt creating flows. As a result, non-debt creating flow foreign portfolio flows and particularly FDI increased significantly.

Economic development in India depends on the various sectors that constitute the Indian economy. Agriculture, services and manufacturing industries play a vital role in the development of the Indian economy. Agriculture is the backbone of Indian Economy which about 65% of population depends directly on this sector and it accounts for around 22% of GDP. India ranks second world wide in farm output. Globalization and agriculture in India are both intricately connected to each other as agriculture in India prevails over all other sectors because it plays a pivotal role in the socio-cultural life of its people.

Industrial sector contributes 16% to India's GDP and 17% of the total workforce. India is aiming at a sustained GDP growth of 10 percent per annum. This necessitates the growth of the manufacturing sector at 13 to 14 per cent per annum over a long period. The Indian industrial sector underwent significant changes as a result of the economic reforms of 1991, which removed import restrictions, brought in foreign competition, led to privatization of certain public sector industries, liberalized the FDI regime, improved infrastructure and led to an expansion in the production of fast moving consumer goods. India is ranked second in the world in terms of
manufacturing capability (Global Manufacturing Competitiveness Index 2010). India’s workforce of scientists, researchers, and engineers, together with its English-speaking workforce and democratic regime, the report says, make it an attractive destination for manufacturers.

The services sector in India has the biggest share in the country's GDP. The contribution of the services sector in India's GDP has increased a lot in the last few years. Since liberalization share of service sector in GDP has risen from 7% in 1990s to around 53.8% in 2005 and 62.5% in 2009. This shows that the services sector in India accounts for over half of the country's GDP. Because of the success in the IT service sector, India's share in world exports of commercial services tripled during the same period. From January 2000, the emergence of the service sector has change the composition of FDI in India. In the second decade of economic reforms this sector account 27% of total FDI and hold first rank as an attractive sector for foreign investor. This is due to the growth of sub-sectors like IT, financial services and insurance sector.

5.2 OBJECTIVES OF ATTRACTING FDI INFLOWS TO INDIA

The main objective of the economic reforms policy was rapid and sustained improvement in the life quality of the people of India. Central to this goal was rapid growth in income and productive employment and reduction in poverty. Such growth required investment. It believed that foreign capital particularly FDI has the cheapest and most effective way of obtaining latest technology from abroad instead of direct purchasing of capital goods or licensing. Thus, apart from some structural adjustment both in the internal as well as external economy, the new economic policy aimed at attracting more FDI into the economy.

Indian policy makers are preparing to achieve double digit rate of growth in the coming years, accelerating GDP growth rate from 8 to 10 percent and then maintain it at 10 percent in the 11th plan (2007-2012) in order to double per capita income. Foreign direct investment has been seen as a dominant determinant to achieve high rate of economic growth because it brings in scarce capital resource, raise technological capability and increase efficiency through enhancing domestic competition. It is believed that additional $20 Billion a year for next ten years will
drive up GDP growth rate additional 2-3% from the current level of 8% and also India can sustain this growth rate. These monies should arrive in the form of FDI, as it is associated with multiple benefits which can boost economic growth.

From other side, India has to create 70 million new work opportunities in the 11th five year plan (2007-2012) to reach 220 million new jobs by 2025 to reap any demographic dividend, according to an estimate by the national manufacturing policy. A chunk of this is expected to come from manufacturing. The new policy aims to create 100 million jobs and increase the share of manufacturing in India’s GDP to 25% by 2022, from 17% now. To provide gainful employment to a growing young population, India is pushing a national manufacturing policy touted to be the policy that will bolster manufacturing and bridge the missing link in India’s growth. Huge investments are needed to set this sector to provide potential employment to semi skilled and skilled labour which can come through FDI in manufacturing sector. FDI is a powerful tool for economic growth through its strengthening of domestic capital, productivity and employment. FDI also plays a vital role in the upgradation of technology, skills and managerial capabilities in various sectors of the economy.

Many policy makers and academics contend that FDI can have important positive effects on a host country. In addition to the direct capital financing it supplies, FDI can be a source of valuable technology and know-how while fostering linkages with local firms, which can help jumpstart an economy. Based on these arguments, developing countries like India have offered incentives to encourage FDI in their economies. FDI usually comes only when all the criteria is set up to meet the growth. That includes, reduced taxes, favourable labour law, freedom to move money in and out of country, government assistance, full grown infrastructure, reduced bureaucratic involvement, etc. Thus, Indian policy makers have been encouraged to pursue more vigorously the ongoing reform programs because of the fact that it is their firm belief that high growth is the result of liberal economic policy.
5.3 TREND AND PATTERNS OF FDI FLOW IN INDIA: PRE AND POST LIBERALIZATION

The study of foreign investments in India has evolved over the pre and post-independence period in four distinct phases. Though these are not strictly separable, but it is convenient to look at these phases in two separate periods as following:

- Trend and Patterns of FDI Flows in India: Pre-Liberalization period

  *FDI Inflows during 1900-1947*

  *FDI Inflows during 1948-1980*

  *FDI Inflows during 1981-1990*

- Trend and Patterns of FDI Flows in India: Post-Liberalization period

5.3.1 Trend and Patterns of FDI Flows in India: Pre-Liberalization period

5.3.1.1 FDI Inflows during 1900-1947

The historical background of FDI with the existence of MNCs in India is not a recent phenomenon (Belhoste and Grasset, 2008) rather such subsistence is approximately three centuries old. As such, the historical background of MNCs in India can be traced back to as early as 1600s whereby the British capital came to dominate the Indian scene through their Multinational Corporation known as East India Company in the colonial era.

British capital came to India during the colonial era of Britain in India. The period from 1900s-1918 can be called as the first phase of FDI in India when there were no restrictions on the nature as well as type of FDI pouring into India. Majority of these investments at those times were exploitative in nature and were just concentrating in the sectors such as mining and extractive industries. It is noticeable fact that despite of allowance of this free flow of FDI, no other country was interested in investing in India other than U.K and all FDI coming to India during that period were from U.K. A rough estimate shows that about 14% of British investments came to India and other Asian countries during 1865-1914. India ranked eighth as a host to foreign investments in 1914. There were about 204 British managing agents and a few manufacturing companies from U.K, Switzerland, Netherlands, Germany, USA, and
Japan engaged in trading and manufacturing activities during this period. Japanese companies started trading on raw cotton and yarn with India in the late nineteenth and early twentieth centuries.

By end of the World War I (1918) a new phase in the FDI inflow to India came about beginning. The United States of America and Japan emerged as powerful nations. Among the American companies, the most notable ones that started their operation in India during this period are General Motors, Ford Motors, and Colgate Palmolive. By 1928, Japan emerged as one of the largest cotton trading partner of India.

Between 1930 and 1945, as many as 28 new manufacturing British subsidiaries started their operations in India. With the continued interest of British investments and the additional interest of American, Japanese and other European countries, the total inward stock of FDI was about $1.0 billion by 1929. India ranked 3rd among the favorable hosts to FDI in 1929. In 1935, as many as 30 foreign companies registered in India as compared to only 7 during the previous period, 1901-1918. Many of the British and Dutch companies that were engaged in trading activities started to invest in local manufacturing in the 1930s.4

The year 1943 was the beginning of a new period in FDI inflow to India. Direct investment by foreign companies, activated in the 1930s was enhanced and encouraged by both the Indian business houses and by the newly formed Government of India (GOI) during this period. Local industries had felt the need for foreign technology and foreign capital by 1942. They largely favored the flow of foreign technology and foreign capital from around the world. From 1943 to 1945, 14 foreign companies registered themselves in India and this trend continued in the subsequent years until 1961. As many as 72 foreign companies were registered in India from 1948 to 1961.5

4 - Table A1, Table A2 and Table A3 in Appendix for a sample list of foreign companies from different countries that came to India during this period.

5 - Figure 4 and Table A4 in Appendix for the number of foreign companies that were registered in India during this period.
5.3.1.2 FDI Inflows during 1948-1980

After independent in 1947, the GOI was faced with many of problems. Economic and industrial development of India was one of the major objectives. First of all, the GOI nationalized many companies in some industries that the government considered strategic for the country. Then it adopted the Five-Year Plan method to improve the economic and industrial condition of the country. The GOI had also understood the need for getting both foreign technology and foreign capital for its industrial growth. It also needed foreign exchange to meet the burgeoning imports of essential commodities. In addition, GOI faced severe foreign exchange problem in 1957-58 and hence encouraged foreign investment in the late 1950s to attract larger foreign exchange. All these factors compelled the government to invite foreign capital and technology to India during this period.

Thus, a large number of foreign enterprises serving Indian market through exports started establishing manufacturing affiliates in the country. This (viz. late 1950s and early 1960s) was the period when Western Multinational Companies (MNCs) started showing real interest in India. In the early 1950s their response was only lukewarm except in the case of one-shot investment in oil refineries. Most foreign drug companies exporting to India also set up their manufacturing subsidiaries in India during this period. A small number of foreign companies rose to prominence in these years (between 1948 and 1959), including Firestone, Dunlop, and Bata Shoe Company. Hindustan Lever, subsidiary of the MNCs Unilever, became India's biggest manufacturer of food products and toilet article.

In the mid 1948, when the first survey of India's international assets and liabilities was undertaken by the Reserve Bank of India (RBI), the stock of foreign investment in the country stood at Rs. 2560 million, and it was mostly of British origin. The bulk of FDI was concentrated in export-oriented raw materials, extractive, and service sectors. Tea plantations and jute accounted for a little over a quarter of total FDI which together contributed half of India's exports; about 32 percent was in trading and other services, 9 percent in petroleum, and only about 20 percent in manufacturing other than jute (Kidron, 1965). It can be observed that tea plantation and Jute accounted for a higher share of FDI as compared to manufacturing and service sectors in mid-1948.
By 1964, FDI stock in the country more than doubled to Rs. 5,655 million. Creation of locational advantages led to a sharp jump in the share of manufacturing in the FDI stock to over 40 percent from around 20 percent at the time of independence. Within manufacturing sector, consumer goods industries such as food and beverages 13.2%, medicines and pharmaceutical 10.9%, textile products 7.2% and intermediate and capital goods such as metal and metal products 14.4%, electrical goods 7.9%, chemicals and allied products 16%, machinery and machine tools 6.9% and transport equipment 6.5% accounted for bulk of FDI stock.

However, the FDI stock from 1974 to 1980 increased from Rs. 9160 million to Rs. 9332 million. By 1980, the stock of FDI in India had gone up to Rs. 9332 million. Not only the magnitude but also the sectoral composition, sources, and organizational forms of investment have undergone considerable changes over this period.

Analysis of the sectoral distribution of the stock of FDI at the end of the financial years 1964, 1974 and 1980 showed the increasing importance of the manufacturing sector. The manufacturing sector, which accounted for only about a quarter of FDI stocks at the time of the independence and 40 percent in 1964, accounted for nearly 87 percent of them in 1980. This jump in the share of manufacturing has been at the cost of plantations, mining, petroleum, and services. In the entire non-manufacturing sector, the absolute volume of FDI as well as its share in total stock has declined over the period 1964-1980. Almost all the inflows of FDI to the country after 1964 came to the manufacturing sector while disinvestment took place in other sectors. Though the total stock of FDI in the country stagnated during the late 1970s, in the manufacturing sector it steadily increased. This significant reorganization in the sectoral pattern of FDIs in the country had been stimulated by the government's selective policy. The share of manufacturing in total stock of FDI in India was favourable even when compared to the sectoral distribution of total flows of FDI to developing countries. Thus, while manufacturing accounted for only 32, 64 and 42 percent of all American (between 1979 and 1981), British (between 1971 and 1978) and Japanese (between 1951 and 1980) FDIs in developing countries respectively (UNCTAD 1983), it accounted for 87 percent of the FDI stock in India.
Within the manufacturing sector, the new investments were directed to technology-intensive sectors such as electric goods, machinery and machine tools, and chemical and allied products (in particular, chemicals and medicines and pharmaceuticals). These three sectors accounted for nearly 58 percent in 1964. The shares of metals and metal products and transport equipment, showed a decline over the 1964-74 periods, but picked up during 1974-80. The rise in importance of technology intensive products in the FDI stock had been at the expanse of traditional consumer goods industries such as food and beverages, textiles products, and other chemical products.

There had also been a geographical diversification of the sources of FDI to India over this period. The home country distribution of FDI manifests considerable erosion of the dominance of the United Kingdom as the source of FDI. In 1964, the share of United Kingdom was nearly 77 percent; by 1980, it had come down to 54 percent. The United States emerged as a major source of FDI, improving its share from 14.5 percent in 1964 to 21 percent in 1980. The other significant sources of FDI, the Federal Republic of Germany, Switzerland, Canada and Sweden have all improved their share over the period.

**5.3.1.3 FDI Inflows during 1981-90**

In the decade of eighties FDI inflows improved considerably as compared to the decade of the seventies. Between 1981 and 1989, total FDI inflows registered an increase of 29 times where as the major investing countries in India namely, United States, Germany, United Kingdom, Japan and Italy recorded an overall rise of 28, 22, 48, 173 and 13 percent respectively. This means during the decade of the eighties, Italy has emerged as a significant investor in India followed by the United Kingdom, United States, Germany and Japan. However, in relative terms, in 1981, German was the largest investing nation in India and its share was as high as 50 percent. United States was the 2nd biggest investor in India with a figure of 21 percent. The United Kingdom was the 3rd largest investing nation and its share was only 7 percent followed by Japan with a figure of 6 percent. The lowest and insignificant share was of Italy i.e. as low as 0.3 percent.

However, at the end of the decade of the eighties, i.e. in 1989, trends changed considerably and as a result, the relative share of the two biggest investing nations
namely, Germany and the United States has declined. The decrease in the case of Germany was 12 percent, whereas the United States has recorded a marginal decline in the share, i.e. by 1 percent. In the case of United Kingdom, the relative share has gone up by 4 percent and it remained as the 3rd largest investing nation in India after Germany and USA. Italy has improved its trends and accordingly, its relative share has become 2 from 0.3 percent in 1981. The largest investing countries, namely, Germany, USA, and UK had maintained their respective rankings held in 1981 also by the end of the eighties.

As regards sector-wise break up of FDI, the largest share in FDI was maintained by the manufacturing sector. The share was 86.9 percent in 1980 while it declined marginally in 1990 to 84.9 percent. In this sector, transport industry registered increase of 5.47 percent times, followed by 4.98 times rise in machinery industry, 4.14 times increase in food products, 3.02 times rise in electrical sector. Textile recorded a rise of 2.87 times and metallurgy sector showed increase of 1.18 times. If we look at the position share of each sub-sector in the manufacturing sector, it was highest for chemicals and allied products followed by metallurgy industry, electrical goods, machinery and machine tools, transport equipment, food and beverages and textile industry. This ranking changed in 1980. Although the share of chemicals and allied products declined, yet it still maintained the 1st rank. Machinery and machine tools rose to the 2nd rank from 4th rank in 1980. Electrical goods came to occupy the 3rd rank and 4th rank went to transport equipment, and 5th and 6th and 7th ranks were of food and beverages, metallurgy and textiles respectively. The share of metallurgy sector recorded a significant fall from 14.6 percent to 6.1 percent.

5.3.2 Trend and Patterns of FDI Flows in India: Post-Liberalization period, 1990 onward

In order to study the impact of economic reforms and FDI policy on the magnitude of FDI inflows, quantitative information is needed on broad dimensions of FDI and its distribution across sectors and sources of FDI inflows.

As a consequence of policy measures (taken way back in 1991) and strong economic fundamentals driven by 18 years of reforms helped FDI inflow grow in India significantly. Irrespective of the ruling party over the years, there is a growing consensus...
and commitments among political parties to follow liberal foreign investment policy that invite steady flow of FDI in India so that sustained economic growth can be achieved.

The actual FDI inflow in India is welcomed under five broad heads: (i) Foreign Investment Promotion Board’s (FIPB) discretionary approval route for larger projects, (ii) Reserve Bank of India’s (RBI) automatic approval route, (iii) acquisition of shares route (since 1996), (iv) RBI’s non-resident Indian (NRI’s) scheme, and (v) external commercial borrowings (ADR/GDR) route.

The FDI inflows grow at about 20 times since the opening up of the economy to foreign investment. During the post reforms period FDI inflows rose from Rs. 409 crore in 1991-92 to Rs. 4,312 crore in 1994-1995 and reached to its peak in Rs. 13,548 crore in 1997 (Table 5.2). Subsequently, these inflows touched a low of Rs. 10,311 in 1999. There have been fluctuations in the inflows of FDI from period 2000-2008. In 2001 and 2002 there has been increase in FDI inflows to Rs. 19,361 crore and Rs. 14,932 crore respectively. Except in 2003 which shows a slight decline in FDI inflows to Rs. 12,117 crore, FDI has been picking up since 2004 and rose to an appreciable level of Rs.17,138 crore in 2004 and Rs. 16,394 crore in 2005 and Rs. 42,138 crore in 2006. In 2007 and 2008 FDI inflows sharply reached to Rs. 51,243 and Rs. 92,326 crore respectively. Total cumulative FDI inflow from 1991 to 2008 amounted at Rs. 4, 23, 053 crore. The annual growth rate was 80% in 2008 over 2007, and compound annual growth rate registered was 40% on an annualized basis during 1991-2008. The increase in FDI inflows during 2008 is due to increased economic growth and sustained developmental process of the country which restore foreign investor’s confidence in Indian economy despite global economic crisis.

However, an analysis of the last eighteen years of trends in FDI inflows (Figure 5.3) shows that there has been a steady flow of FDI in India upto 2004, but there is an exponential rise in the FDI inflows from 2005 onwards.

Number of Greenfield FDI projects attracted by developing countries which are 699 in 2002, 1315 in 2005 and 2534 in 2008, India's share is 90 in 2002 which rose to 192 and 345 in 2005 and 2008.6

6 - Table A5 in Appendix.
<table>
<thead>
<tr>
<th>S. No.</th>
<th>Year</th>
<th>In Rs. Crore</th>
<th>In US $ mn</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1991-92 (Aug-March)</td>
<td>409</td>
<td>167</td>
</tr>
<tr>
<td>2</td>
<td>1992-93</td>
<td>1,094</td>
<td>393</td>
</tr>
<tr>
<td>3</td>
<td>1993-94</td>
<td>2,018</td>
<td>654</td>
</tr>
<tr>
<td>4</td>
<td>1994-95</td>
<td>4,312</td>
<td>1,374</td>
</tr>
<tr>
<td>5</td>
<td>1995-96</td>
<td>6,916</td>
<td>2,141</td>
</tr>
<tr>
<td>6</td>
<td>1996-97</td>
<td>9,654</td>
<td>2,770</td>
</tr>
<tr>
<td>7</td>
<td>1997-98</td>
<td>13,548</td>
<td>3,682</td>
</tr>
<tr>
<td>8</td>
<td>1998-99</td>
<td>12,343</td>
<td>3,083</td>
</tr>
<tr>
<td>9</td>
<td>1999-2000</td>
<td>10,311</td>
<td>2,439</td>
</tr>
<tr>
<td>10</td>
<td>2000-2001</td>
<td>12,645</td>
<td>2,908</td>
</tr>
<tr>
<td>11</td>
<td>2001-2002</td>
<td>19,361</td>
<td>4,222</td>
</tr>
<tr>
<td>12</td>
<td>2002-2003</td>
<td>14,932</td>
<td>3,134</td>
</tr>
<tr>
<td>13</td>
<td>2003-2004</td>
<td>12,117</td>
<td>2,634</td>
</tr>
<tr>
<td>14</td>
<td>2004-2005</td>
<td>17,138</td>
<td>3,755</td>
</tr>
<tr>
<td>15</td>
<td>2005-2006</td>
<td>16,394</td>
<td>3,965</td>
</tr>
<tr>
<td>16</td>
<td>2006-2007</td>
<td>42,138</td>
<td>9,273</td>
</tr>
<tr>
<td>17</td>
<td>2007-2008</td>
<td>51,243</td>
<td>12,699</td>
</tr>
<tr>
<td>18</td>
<td>2008-2009</td>
<td>92,326</td>
<td>21,159</td>
</tr>
</tbody>
</table>

*Source: SIA Statistics, Annual Issues*
Further, the actual inflows of FDI through various routes in India are described in Figure 5.4. During the period 1991-2008 the FIPB route represents larger projects which require bulk of inflows and account for government’s discretionary approval. Although, the share of FIPB route is declining somewhat as compared to RBI’s automatic route and acquisition of existing shares route. Automatic approval route via RBI shows an upward trend of FDI inflows since 1995. This route is meant for smaller sized investment projects. Acquisition of existing shares route and external commercial borrowing route gained prominence (in 1999 and 2003) and shows an upward increasing trend. However, FDI inflows through NRI’s route show a sharp declining trend.
5.3.2.1 India's Share in Global FDI Flows

India is one of the most preferred destinations of global FDI flows. The other countries are China, Brazil, Mexico and Russia. The annual growth rate registered by China was 15%, Brazil was 84%, Mexico was 28%, Russia was 62%, and India was 17% in 2007 over 2006. During 1991-2007 the compound annual growth rate registered by China was 20%, Brazil was 24%, Mexico was 11%, Russia was 41% (from 1994), and India was 41%. India’s FDI need is stood at $ 15 billion per year in order to make the country on a 9% growth trajectory (as projected by the Finance Minister of India in the current Budget). Such massive FDI is needed by India in order to achieve the objectives of its second generation economic reforms and to maintain the present growth rate of the economy. India’s share in world FDI inflows has increased from 0.3% to 1.3% (Table 5.3 & Figure 5.5) from 1990-95 to 2007. But, this is not an attractive share when it is compared with China and other major emerging destinations of global FDI inflows.

<table>
<thead>
<tr>
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<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Word FDI</td>
<td>225.3</td>
<td>386.1</td>
<td>478.1</td>
<td>694.5</td>
<td>1088</td>
<td>1492</td>
<td>735</td>
<td>716.1</td>
<td>632.6</td>
<td>648.1</td>
<td>958.7</td>
<td>141.1</td>
<td>1833.3</td>
</tr>
<tr>
<td>India’s share in world FDI</td>
<td>0.3</td>
<td>0.7</td>
<td>0.8</td>
<td>0.4</td>
<td>0.2</td>
<td>0.2</td>
<td>0.5</td>
<td>0.5</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>1.4</td>
<td>1.3</td>
</tr>
</tbody>
</table>

*Source: Compiled from the various issues of WIR, UNCTAD, World Bank*
Table 5.4 reveals that during the period under review FDI inflow in India has increased from 11% to 69%. But when it is compared with China, India’s FDI inflows stand no where. And when it is compared with rest of the major emerging destinations of global FDI India is found at the bottom of the ladder (Table 5.4 and Figure 5.6).

### Table 5.4
Emerging Economies of the World

<table>
<thead>
<tr>
<th>Year/Country</th>
<th>China</th>
<th>Brazil</th>
<th>Mexico</th>
<th>Russia</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-99</td>
<td>148.5</td>
<td>89.4</td>
<td>56.4</td>
<td>15</td>
<td>11.4</td>
</tr>
<tr>
<td>2000-07</td>
<td>48.3</td>
<td>169</td>
<td>147.4</td>
<td>126.2</td>
<td>69</td>
</tr>
</tbody>
</table>

Source: compiled from the various issues of WIR, UNCTAD, World Bank

5.3.2.2 India's Share in FDI Flows to Developing Countries

FDI has been the most important source of foreign investment inflows in developing countries like India. According to A.T. Kearney, 2004 India ranks as the 2\textsuperscript{nd} and 3\textsuperscript{rd} most preferred destinations in terms of attractiveness for FDI. A.T. Kearney's 2007 Global Service Location Index ranks India as the most preferred destination in term of financial attractiveness, people and skills availability and
business environment. Similarly, UNCTAD’s World Investment Report, 2005 considers India the 2nd most attractive destination among the TNCS. But, despite India's successful positioning as the most attractive FDI destination the interest has not yet translated into actual FDI and India's share in the global FDI regime is still minuscule as compare to many Asian economies. In terms of FDI inflows during the period 1990 total FDI inflows to developing countries was $36948 million which out of this inflow South, East and South-East Asian countries absorbed $22120 million and India's share was just $ 237 million (Table 5.5). Over the period 1995-2000 FDI flows to developing countries grew from $114891 million in 1995 to $246057 million in 2000. The share of South, East and South-East Asian countries during the same period from FDI inflows to developing countries rose from $76592 million in 1995 to $138698 million in 2000. India's share in FDI inflows among developing countries in the region was very low and rose to $2151 million in 1995 which reached a peak of $3619 million in 1997 and then it declined sharply in 1999-2000 to $2319 million but recovered significantly to $6676 million in 2005. As can be seen from the table while India on an average attracted FDI of $4 to 5 billion per annum, other South East Asian countries attracted much more e.g. China obtained $35849 million in 1995 and $40772 and $72406 millions in 2000 and 2005. Singapore received $17217 and $15004 millions in 2000 and 2005 respectively. (Table 5.5)

From 2006 onward FDI inflow to India has sharply increased where FDI flow rose to $20336 millions in 2006 and $25127 and $41554 millions in 2007 and 2008. While during the same period 2006 to 2008 China received FDI flow of $72715, $83521 and $108312 millions respectively (Table 5.5). Data shows that while the growth of FDI inflows to India has been fairly satisfactory, India's share in the global FDI regime is still minuscule. This calls for further liberalization of norms for investment by present and prospective foreign entrepreneurs. Attracting foreign capital requires an investor-friendly environment. It underlines the need for efficient and adequate infrastructure, availability of skilled and semi-skilled labour force, business-friendly public administration and semi-skilled tax rates.
Table 5.5
FDI Inflows in Selected Asian Developing Countries during the years 1990-2008
(In US $ Millions)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>208664</td>
<td>333818</td>
<td>1392957</td>
<td>945795</td>
<td>1461074</td>
<td>1978838</td>
<td>1697353</td>
</tr>
<tr>
<td>Developing economies</td>
<td>36948</td>
<td>114891</td>
<td>246057</td>
<td>314316</td>
<td>433764</td>
<td>529344</td>
<td>620733</td>
</tr>
<tr>
<td>South, East and South-East Asia</td>
<td>22120</td>
<td>76592</td>
<td>138698</td>
<td>167190</td>
<td>214495</td>
<td>253816</td>
<td>297573</td>
</tr>
<tr>
<td>China</td>
<td>3487</td>
<td>35849</td>
<td>40772</td>
<td>72406</td>
<td>72715</td>
<td>83521</td>
<td>108312</td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>3275</td>
<td>6213</td>
<td>61939</td>
<td>33618</td>
<td>45054</td>
<td>54365</td>
<td>63003</td>
</tr>
<tr>
<td>India</td>
<td>237</td>
<td>2151</td>
<td>2319</td>
<td>6676</td>
<td>20336</td>
<td>25127</td>
<td>41554</td>
</tr>
<tr>
<td>Thailand</td>
<td>2575</td>
<td>2070</td>
<td>3350</td>
<td>8957</td>
<td>9460</td>
<td>11238</td>
<td>10091</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>789</td>
<td>1776</td>
<td>8572</td>
<td>50</td>
<td>-105</td>
<td>67</td>
<td>44</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>180</td>
<td>1780</td>
<td>1289</td>
<td>2021</td>
<td>2400</td>
<td>6739</td>
<td>8050</td>
</tr>
<tr>
<td>Singapore</td>
<td>5575</td>
<td>11503</td>
<td>17217</td>
<td>15004</td>
<td>27680</td>
<td>31550</td>
<td>22725</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2611</td>
<td>5815</td>
<td>3788</td>
<td>3965</td>
<td>6060</td>
<td>8401</td>
<td>8053</td>
</tr>
</tbody>
</table>

Source: WIR various Issues

5.3.2.3 India's FDI Performance Index

UNCTAD's ranking of countries in terms of inward FDI performance (relative to the size of the economy) indicates that the performance of India regarding the inflow of FDI as compared to other Asian countries especially China is not satisfactory. During the period 1990-2008 India ranked 98 in 1990, 120 in 2000, 119 in 2005 and 106 in 2008. China ranked 46 in 1990, 52 in 2000, 64 in 2005 and 88 in 2008 (Table 5.6). Though performance index shows improvement in India's FDI inflows, it is much lower than potential index which is 86 and 84 in 2006 and 2007 respectively. The reasons for low inflows are attributed to a host of factors such as procedural disputes regarding land availability, environmental clearance, delays at state level in getting power and other infrastructural back up.
Table 5.6
Inward FDI Performance Index Rankings
1990-2006

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>46</td>
<td>14</td>
<td>52</td>
<td>52</td>
<td>62</td>
<td>69</td>
</tr>
<tr>
<td>India</td>
<td>98</td>
<td>110</td>
<td>120</td>
<td>117</td>
<td>121</td>
<td>113</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5</td>
<td>9</td>
<td>51</td>
<td>62</td>
<td>64</td>
<td>62</td>
</tr>
<tr>
<td>Singapore</td>
<td>1</td>
<td>2</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>81</td>
<td>119</td>
<td>93</td>
<td>116</td>
<td>115</td>
<td>123</td>
</tr>
</tbody>
</table>

Source: WIR various Issues

5.3.2.4 Actual and Approval FDI Flows

It is found that there is a huge gap in FDI approved and FDI realized (Figure 5.7). This is particularly true, even if the FDI has been increasing steadily since 1991 the percentage of actual inflows of FDI to total approvals is exceptionally low. Surveys indicate that while India is on investors’ radar screens, the interest has not yet translated into actual FDI. During the period 1991-92, 31.7% of approved amount of FDI flew to India and this proportion increased to 43.23% in 1994-95. After that it was fluctuating till 1999-2000, which reached to a highest percentage of 57.2%. Since 2001 the percentage of actual inflows of FDI to approved amount has been increased but from 2005 onward the percentage of actual inflows to approve has been increasing.

A difference of almost 40 per cent (Figure 5.8) is observed between investment committed and actual inflows during the year 2005-06. All this depends on various factors, namely regulatory, procedural, government clearances, lack of sufficient infrastructural facilities, delay in implementation of projects, and non-cooperation from the state government, etc. Some time lag between approvals and actual inflows is understandable, but the actual inflows persistently not exceeding a half could clearly be due to man-made roadblocks or may also be due to the type of investment projects involved (Bhandari et al 2002). Infact, many long term projects under foreign collaborations get delayed considerably, or in some cases, they may even be denied in the absence of proper and sufficient infrastructural support and facilities. These are perhaps some reasons that could be attributed to this low ratio of approvals vs. actual inflows.
5.3.2.5 FDI as Percentage of Gross Domestic Product and Gross Fixed Investment

Share of FDI in GDP in countries of Asia is presented in the table 5.7. Table 5.7 exemplifies share of FDI in GDP in different countries of Asia. In India the share was only 0.7 percent and 0.8 percent during the years 2003 and 2004 respectively. In 2006 sudden increase was witnessed, the share which was at a level of 0.9 percent in 2005, reached up to 1.9 percent in 2006, registering growth of more than 100 percent. The reasons for this splendid growth can be attributed to favorable policies of UPA.
government as well as economic boom during the period. In the next year i.e. 2007 slight decrease was registered when the share stood at 1.7%. In spite of recession in 2009 the figure touched a slight increase mark of 2 percent.

On the other hand Pakistan which was at meager 0.6 percent during the year 2003 reached up to 3.4 percent in 2006 but decreased to 2.1 percent during the referred period. In case of China the share has been around 2 percent from 2003 to 2009 except 2005 when the share crossed level of 3 percent. Vietnam has been top performer where the share has crossed mark of 8 percent during 2007. If the share is compared for different countries between 2008 and 2009 (period of recession) India is exception where the share has increased, while all the other countries i.e. Pakistan, China and Vietnam faced decline in the share.

### Table 5.7
Share of FDI in GDP in Different Countries of Asia during 2003-2009

<table>
<thead>
<tr>
<th>Country</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>1.9</td>
<td>1.7</td>
<td>1.8</td>
<td>2</td>
</tr>
<tr>
<td>China</td>
<td>2.9</td>
<td>2.8</td>
<td>3.4</td>
<td>2.8</td>
<td>2.9</td>
<td>2.1</td>
<td>1.8</td>
</tr>
<tr>
<td>Pakistan</td>
<td>0.6</td>
<td>1.1</td>
<td>2</td>
<td>3.4</td>
<td>2.7</td>
<td>2.2</td>
<td>2.1</td>
</tr>
<tr>
<td>Vietnam</td>
<td>3.7</td>
<td>3.5</td>
<td>3.7</td>
<td>6.5</td>
<td>8.7</td>
<td>8.1</td>
<td>7.6</td>
</tr>
</tbody>
</table>

*Source: Compiled from GITM Journal of Management 2011*

Share of FDI in Gross Fixed Investment (GFI) in various Asian countries is shown in table 5.8. From the table it is discernible that share of FDI in GFI in case of India accounted for 2.9 percent in the year 2003. The figure reached up to the tune of 6.4 percent during 2006, registering growth of 100 percent against the last year i.e. 2005. During the year 2007 the share plummeted to 5.2 percent. For the next two years i.e. 2008 and 2009 recovery was witnessed when the share reached up to 5.5 percent and 5.9 percent respectively. For sudden increase in the share during 2006, stable government and favourable policies are said to be main reasons.

On the other hand, the share of China has been more than 7 percent from the year 2003 to 2009. After 2007 sudden downward trend was witnessed due to global
financial recession. The figure stood at 5 percent and 4.3 percent during 2008 and 2009 respectively. Although the share for Pakistan has been wavering still it has been better than that of India. In case of Vietnam the share has been continuously in double digits during the years between 2003 and 2009. From the year 2006 it has been more than 20 percent.

<table>
<thead>
<tr>
<th>Country</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>2.9</td>
<td>3.2</td>
<td>2.9</td>
<td>6.4</td>
<td>5.2</td>
<td>5.5</td>
<td>5.9</td>
</tr>
<tr>
<td>China</td>
<td>7.3</td>
<td>7</td>
<td>8.4</td>
<td>6.9</td>
<td>7</td>
<td>5</td>
<td>4.3</td>
</tr>
<tr>
<td>Pakistan</td>
<td>4.2</td>
<td>7.6</td>
<td>11.5</td>
<td>16.7</td>
<td>12.7</td>
<td>10.2</td>
<td>9.7</td>
</tr>
<tr>
<td>Vietnam</td>
<td>11</td>
<td>10.7</td>
<td>11.2</td>
<td>20.4</td>
<td>26.7</td>
<td>24.8</td>
<td>23.1</td>
</tr>
</tbody>
</table>

*Source: Compiled from GITM Journal of Management 2011*

The FDI per head is better indicator to illustrate implication of FDI because it provides information as regards FDI based on population of the country. Table 5.9 demonstrates per capita FDI for India, China, Pakistan and Vietnam. In the years 2003, 2004 and 2005 per head FDI for India was $4, $5 and $6 respectively. In the next year i.e. 2006 tremendous growth was registered when the amount became more than double of previous year. In the year 2006 the investment reached at level of $16. For next two years the investment remained at the same level. In 2009 again increase was registered, during the year the investment amounted to $18. For sudden growth during 2006 the major cause can be ascribed to stable government and dedication of government for maintaining growth rate. Inspite of global recession during last two years the figure of FDI inflows did not come down due to India's strong economic fundamentals.

Although per head FDI in India has reached up to $18 in 2009 still it can not be compared with China or Vietnam where the investment has reached at the level of $64 and $70 respectively during 2008.
Table 5.9
Per head FDI during 2003-2009
(In US Dollar)

<table>
<thead>
<tr>
<th>Country</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>18</td>
</tr>
<tr>
<td>China</td>
<td>37</td>
<td>43</td>
<td>61</td>
<td>60</td>
<td>60</td>
<td>64</td>
<td>65</td>
</tr>
<tr>
<td>Pakistan</td>
<td>4</td>
<td>7</td>
<td>14</td>
<td>27</td>
<td>18</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>Vietnam</td>
<td>18</td>
<td>20</td>
<td>49</td>
<td>29</td>
<td>52</td>
<td>70</td>
<td>80</td>
</tr>
</tbody>
</table>

Source: Compiled from GITM Journal of Management 2011.

5.4 TRENDS AND PATTERNS OF ORIGINATING COUNTRIES

The pattern of foreign direct investment inflows could be examined with reference to
the country of origin essentially to see if there is any change in the preference pattern
of countries for investment during the liberalization regime as compared with the
earlier policy regime.

Table 5.10 presents the principal sources of FDI in India during 1979-86 and 1987-90
(pre-liberalization) and table 5.11 presents top 10 investors in post-liberalization
period (1991-2008). In both the periods USA appears as the largest investor in India.
FDI inflows from the USA constitute about 21.61% or $119.47 million of the total
FDI inflows in India during 1979-86. This share increased to 28.80% or $162.74
million during 1987-90. It appears that most of FDI inflows during the pre-
liberalization period (1979-86 and 1987-90) to India came from UK, Germany, Japan
and Netherlands with the FDI inflows of $31.15, $55.95, $76.9 and $11.56 million
respectively. After reforms India broadened the sources of FDI inflows. There were
120 countries investing in India in 2008 as compared to 15 countries in 1991. Thus
the number of countries investing in India increased after reforms.

The emergence of Mauritius is the significant development of post-liberalization
period. Mauritius is the largest investor in India in recent times. One possible
explanation for the dominance of Mauritius is the Double Taxation Avoidance
Agreements i.e. (DTAA)\(^7\) entered into with Mauritius, exempting capital gains from Indian Income Tax, 1961 and benefiting foreign investors, could be only one of the reasons of spurt in investment inflows from Mauritius. The inflows from U.S.A are routed through Mauritius due to tax advantage. South Korea, Malaysia, Cayman Islands and many more countries predominantly appears on the list of major investors apart from U.S., U.K., Germany, Japan, Italy, and France which are not only the major investor now but during pre-liberalizations era also.\(^8\) South Korea has emerged as a new source of foreign investment. Korean firms have aggressively moved into India, since they perceive the Indian market as their only chance to enter the last unexplored market, to beat their established corporate rival from Japan and the US.

### Table 5.10
**Major Sources of Foreign Direct Investment in India 1979-1990**

<table>
<thead>
<tr>
<th>Country</th>
<th>1979-86</th>
<th>% age of total</th>
<th>1987-1990</th>
<th>% age of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mauritius</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>U.S.A.</td>
<td>119,47</td>
<td>21.47</td>
<td>162.74</td>
<td>28.8</td>
</tr>
<tr>
<td>Japan</td>
<td>76.9</td>
<td>13.91</td>
<td>27.9</td>
<td>4.94</td>
</tr>
<tr>
<td>Netherland</td>
<td>11.52</td>
<td>2.09</td>
<td>5.46</td>
<td>0.97</td>
</tr>
<tr>
<td>U.K.</td>
<td>31.15</td>
<td>5.63</td>
<td>45.56</td>
<td>8.06</td>
</tr>
<tr>
<td>Germany</td>
<td>55.95</td>
<td>10.12</td>
<td>43.72</td>
<td>7.73</td>
</tr>
<tr>
<td>Singapore</td>
<td>0.94</td>
<td>0.17</td>
<td>6.88</td>
<td>1.22</td>
</tr>
<tr>
<td>France</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>South Korea</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Switzerland</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total FDI Inflows</strong></td>
<td><strong>295.93</strong></td>
<td>-</td>
<td><strong>292.25</strong></td>
<td>-</td>
</tr>
</tbody>
</table>


---

\(^7\) This agreement means that any foreign investor has the option of paying tax either in India or in Mauritius. The tax rates in Mauritius are amongst the lowest in the world.

\(^8\) Table A6 in Appendix for the Statement on Country-wise and Year-wise FDI inflows 2000-2008.
Table 5.11
Country Wise/Year Wise FDI Inflows
(From August 1991 to March 2008)
(In million US $)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Mauritius</td>
<td>124659</td>
<td>35686.5</td>
<td>75036.1</td>
<td>72844.6</td>
<td>25859.3</td>
<td>46162.14</td>
<td>25859.3</td>
<td>222,207.52</td>
<td>319,437.05</td>
<td>220,483.91</td>
</tr>
<tr>
<td>2</td>
<td>U.S.A.</td>
<td>83542.33</td>
<td>17993.1</td>
<td>16541.33</td>
<td>13572</td>
<td>19040</td>
<td>29791.68</td>
<td>19040</td>
<td>33,203.78</td>
<td>36,383.72</td>
<td>18,361.03</td>
</tr>
<tr>
<td>3</td>
<td>Netherlands</td>
<td>21743.34</td>
<td>5468.01</td>
<td>10315.5</td>
<td>7475.62</td>
<td>11618.8</td>
<td>22779.26</td>
<td>4343.86</td>
<td>78,247.30</td>
<td>19,670.99</td>
<td>35,863.06</td>
</tr>
<tr>
<td>4</td>
<td>Japan</td>
<td>29693.65</td>
<td>9856.86</td>
<td>9965.37</td>
<td>19804.6</td>
<td>4343.86</td>
<td>5337.44</td>
<td>11618.8</td>
<td>22,457.28</td>
<td>58,306.08</td>
<td>66,872.07</td>
</tr>
<tr>
<td>5</td>
<td>U.K.</td>
<td>22279.01</td>
<td>2814.99</td>
<td>12840.17</td>
<td>16988.1</td>
<td>8628.97</td>
<td>6585.36</td>
<td>8628.97</td>
<td>5,229.22</td>
<td>27,894.49</td>
<td>6,788.65</td>
</tr>
<tr>
<td>6</td>
<td>Germany</td>
<td>23510.8</td>
<td>3714.74</td>
<td>5987.29</td>
<td>6629.28</td>
<td>3624.98</td>
<td>7274.88</td>
<td>3624.98</td>
<td>28,532.04</td>
<td>27,751.60</td>
<td>7,065.57</td>
</tr>
<tr>
<td>7</td>
<td>France</td>
<td>9638.43</td>
<td>3415.83</td>
<td>5951.31</td>
<td>5301.48</td>
<td>1642.51</td>
<td>5289.3</td>
<td>1680.46</td>
<td>13,972.47</td>
<td>14,155.04</td>
<td>8,796.27</td>
</tr>
<tr>
<td>8</td>
<td>Korea</td>
<td>0920.85</td>
<td>761.65</td>
<td>203.03</td>
<td>1814.37</td>
<td>1128.62</td>
<td>1227.14</td>
<td>1642.51</td>
<td>3,876.56</td>
<td>22,043.19</td>
<td>11,927.32</td>
</tr>
<tr>
<td></td>
<td>(South)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Singapore</td>
<td>12393.18</td>
<td>5015.23</td>
<td>1606.63</td>
<td>2262.26</td>
<td>1680.46</td>
<td>2855.01</td>
<td>1128.62</td>
<td>2,935.48</td>
<td>5,208.04</td>
<td>2,249.54</td>
</tr>
<tr>
<td>10</td>
<td>Switzerland</td>
<td>7951.23</td>
<td>1872.24</td>
<td>1780.21</td>
<td>2516.87</td>
<td>4289.59</td>
<td>3137.05</td>
<td>4289.59</td>
<td>3,151.00</td>
<td>9,017.24</td>
<td>1,474.61</td>
</tr>
</tbody>
</table>

Source: SIA various Issues.
The analysis in (Table 5.12) presents the major investing countries in India during 1991-2008. Mauritius (Figure 5.9) is the largest investor in India during 1991-2008. FDI inflows from Mauritius constitute about 39.9% (table 5.12) of the total FDI in India and enjoying the top position on India’s FDI map from 1995. The US is the second largest investing country in India. While comparing the investment made by both (Mauritius and US) countries one interesting fact comes up which shows that there is a huge difference (between FDI inflows to India from Mauritius and the US) in the volume of FDI received from Mauritius and the US. FDI inflow from Mauritius is more than double then that from the US. The other major countries are Singapore with a relative share of 7.2% followed by UK, Netherlands, Japan, Germany, Cyprus, France, and Switzerland. Among 120 investor countries in India Iran ranks 106 position with FDI inflow of Rs. 1.5 million in 2000-2003 and Rs. 0.08 million in 2006 and Rs. 0.1 million in 2007. Total cumulative FDI inflows from Iran during 2000-2008 are Rs. 1.68 million or $ 0.04 million (Table A6 in Appendix).

Table 5.12
Major Sources of FDI in India during 1991-2008

<table>
<thead>
<tr>
<th></th>
<th>Mauritius</th>
<th>USA</th>
<th>Singapore</th>
<th>UK</th>
<th>Netherlands</th>
<th>Japan</th>
<th>Germany</th>
<th>Cyprus</th>
<th>France</th>
<th>Switzerland</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>39.9</td>
<td>8.8</td>
<td>7.2</td>
<td>6.1</td>
<td>4.4</td>
<td>3.4</td>
<td>2.9</td>
<td>2.1</td>
<td>1.5</td>
<td>1.1</td>
</tr>
</tbody>
</table>

Source: Compiled & computed from the various issues of Economic Survey, RBI Bulletin, and Ministry of Commerce.

Figure 5.9
Major Sources of FDI in India during 1991-2008

Source: Compiled & computed from the various issues of Economic Survey, RBI Bulletin, and Ministry of Commerce.
Thus, an analysis of last eighteen years of FDI inflows shows that only five countries accounted for nearly 66% of the total FDI inflows in India. India needs enormous amount of financial resources to carry forward the agenda of transformation (i.e. from a planned economy to an open market), to tackle imbalance in BOP, to accelerate the rate of economic growth and have a sustained economic growth.

5.5 TRENDS AND PATTERNS OF FDI FLOW AT SECTORAL LEVEL

The Indian government placed special emphasis on drawing foreign investment into sectors that are perceived of high priority for the following reasons:

- Need for rapid development
- Volume of investment required
- Importance for overall economic growth and employment
- Comparative advantages in terms of human or natural resources

The sector-wise share of FDI until the early 1990s was heavily concentrated in the industrial sector. During 1980s the bulk of FDI 87% of total inflow was absorbed by industrial sector in food and beverages, textiles, machinery, machine tools, transport equipment, metal and metal products, electrical goods, chemical and chemical products, paper and paper products, rubber goods and etc. While primary sector like agriculture, mining and petroleum attracted 8.9% of total FDI inflows. Service sector's share in telecommunications, power generation and services were very negligible just 4.1% out of total FDI inflows.

Following the 1991 liberalization programme, however, there has been a sharp rise in foreign investment in the service sector that encompasses critical elements of the modern economy, namely, telecommunications, power generation, consulting services and so on. Increased FDI inflows to the service sector, especially in infrastructure and power generation, is a welcome development because these areas had long been reserved for public sector enterprises, which were inefficient in managing them, making India's trade and industrial sector among the least competitive in the international context. Generally, major foreign investments made in the 1990s include:
Since 2000, foreign investor's interest in fast growing service sectors has boomed. These growth sectors include computer software, telecommunication, construction activities, housing and real estate, banking, finance, insurance, hotels and tourism. Rapid growth in software reflects rapid technological changes in the IT sector which shows India's comparative advantage regarding low cost, high skill IT workers. Opening of the financial sector to foreign investment also is encouraging some investment in this sector.9

In particular, the relative importance of industrial sector has declined with the opening up of infrastructure and services sector including telecommunications to FDI under the liberalization policy. And within the manufacturing itself the preference pattern of FDI is shifting away from heavy capital goods industries to light industries.

5.5.1 Sectoral Analysis of FDI Inflows

5.5.1.1 Infrastructure Sector

FDI up to 49% is allowed for investing companies in infrastructure/ services sector (except telecom sector) through FIPB route. The infrastructure sector constitutes Power, Non-conventional energy, Petroleum and natural gas, Telecommunication, Air Transport, Ports, Construction activities and (including roads and highways), real estate. The infrastructure sector accounted for 28.62% of total FDI inflows from 2000 to 2008.

9 - Table A7 in Appendix for the Statement on Sector-wise and Year-wise FDI inflows 2000-2008.
Initially the inflows were low but there is a sharp rise in investment flow from 2005 onwards (Figure 5.10). Telecommunication received the highest percentage (8.05%) followed by construction activities (6.15%), real estate (5.78%), and power (3.16%). The major investment comes from Mauritius (56.30%) and Singapore (8.54%). In order to attract the investment, New Delhi (23.2%) and Mumbai (20.47%) enjoy the top two positions in India.

Infrastructure sector received 2528 numbers of foreign collaborations with an equity participation of $ 111.0 billion or 41.15% of the total investment. Out of 2528 foreign collaborations 633 were technical and 2795 are financial collaborations during 1991-2008. The top Indian companies which received FDI inflows in Infrastructure sector during 2000 to 2008 are IDEA, Cellule Ltd, Bhaik Infotel P.Ltd, Dabhol Power Company Ltd, Aircel Ltd, and Relogistics Infrastructure P.Ltd.

India has encouraged FDI in infrastructure sector from the very initiation of its economic reforms, but the demand for it is still not being fulfilled. In fact, investment is heavily concentrated in consumer durables sector (which is quick yielding and where withdrawal is easy) rather than in long-term investment projects such as power generation, maintaining roads, water management and on modernizing the basic infrastructure. Maitra (2003) reveals that the shortage of power is estimated at about 10% of the total electrical energy and approximately 20% of peak capacity requirement.

Figure 5.10

Source: Compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI.
However, insufficient and poor conditions of India’s infrastructure are the major factors to the slowdown in growth which reduces the trust and enthusiasm for FDI from investors and economic growth of the country. Further, insufficient power supply, inadequate and unmaintained roads, an over-burdened railway system, severely congested urban areas, may continue to plague the Indian economy in the coming years. On the whole, the emphasis on modernizing basic infrastructure has been rather mild, whereas this could have been the priority in order to generate employment in both rural and urban areas.

5.5.1.2 Services Sector

Services sector puts the economy on a proper glide path. It is among the main drivers of sustained economic growth and development by contributing 55% to GDP. There is a continuously increasing trend of FDI inflows in services sector with a steep rise in the inflows from 2005 onwards (Figure 5.11). Service sector received an investment of $19.2 billion which is 19.34% of the total FDI inflows from 1991-2008 from FIPB/SIA, acquisition of existing shares and RBI’s automatic routes only. However, this amount does not include FDI inflows received through acquisition route prior to January 2000. Among the subsectors of services sector, financial services attract 10.25% of total FDI inflows followed by banking services (2.22%), insurance (1.60%) and non-financial services (1.62%) respectively. Outsourcing, banking, financial, information technology oriented services make intensive use of human capital. FDI would be much more efficient and result oriented in these services vis-a-vis services which make intensive use of semiskilled and unskilled labour.

Figure 5.11

Source: Compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI.
In India, FDI inflows in services sector are heavily concentrated around two major cities-Mumbai (33.77%) and Delhi (16.14%). Mauritius tops the Figure by investing 42.52% in services sector followed by UK (14.66%) and Singapore (11.18%). The total number of approvals for services sector (financial and non-financial) have been of the order of 1626 (5.78% of the total approvals) with an equity participation of $8.7 billion, 10.28% of the total investment. Services sector ranks 3rd in the list of sectors in terms of cumulative FDI approved from August 1991 to December 2008.

Out of 1626 numbers of foreign collaborations, 77 are technical and 1549 are financial in nature. Majority of collaborations in technology transfers are from USA (30) and UK (8). The leading Indian companies which received FDI inflows in services sector are: Cairn (I) Ltd, DSP Merrill Lynch Ltd, AAA Global Ventures Pvt. Ltd., Kappa Industries Ltd, Citi Financial Consumer Finance (I) Ltd, Blue Dart Express Ltd, Vyasa Bank Ltd, CRISIL Ltd, Associates India Holding Co. Pvt. Ltd, Housing Development Finance Corp. Ltd.

5.5.1.3 Trading Sector

Trading sector received 1.67% of the total FDI inflows from 1991-2008. Trading (wholesale cash and carry) received highest percentage (84.25%) of total FDI inflow to this sector from 2000-2008 followed by trading for exports with 9.04%, e-commerce with 2.38%. Trading sector shows a trailing investment pattern upto 2005 but there is an exponential rise in inflows from 2006 onwards (Figure 5.12).

Figure 5.12

Source: Compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI.
Further, major investment inflows came from Mauritius (24.69%), Japan (14.81%), and Cayman Island (14.60%) respectively from 2000-2008. Investment in India is heavily concentrated in three cities viz. Mumbai (40.76%), Bangalore (15.97%) and New Delhi (12.05%).

As far as technology transfers are concerned, total numbers of 20 technical and 1111 financial collaborations have been approved for Trading sector from 1991-2008. Maximum numbers of technology transfers are approved from USA (5), Japan (3) and Netherlands. The top five Indian companies which received FDI inflows are Multi Commodity Exchanges of India Ltd, Anchor Electricals, Multi Commodity Exchanges of India Ltd, Metro Cash and Carry India Pvt. Ltd, and Essilor India Pvt. Ltd.

5.5.1.4 Consultancy Sector

Consultancy sector received $ 1.1 billion which is 1.14% of total inflows received from 2000-2008 through FIPB/SIA route, acquisition of existing shares and RBI’s automatic route. Management services received an investment of $ 737.6 million, marketing $138.65 million and Design and Engineering services constitute an investment of $ 110.43.

Figure 5.13

Major share of investment in consultancy services comes from Mauritius with 37.2%, USA 25.47% and Netherlands 6.63% respectively. FDI inflows in consultancy sector registered a continuous increasing trend of FDI inflows from 2005 onwards (Figure 5.13). Further, in India Mumbai (38.76%) and New Delhi (13.01%) received major percentages
of FDI inflow for consultancy sector from 2000-2008. Total numbers of technology transfers in consultancy services are 125, out of which 40 technical collaborations are approved with USA, 21 with UK, and 14 with Germany from 1991-2008.

5.5.1.5 Education Sector

FDI up to 100% is allowed in education sector under the automatic route. Education sector received $308.28 million of FDI inflow from 2004-2008. Education sector shows a steep rise in FDI inflows from 2005 onwards (Figure 5.14). Heavy investment in education sector came from Mauritius with 87.95%, followed by Netherlands (3.76%) and USA (2.93%) respectively. In India, Bangalore received 80.14% of total FDI inflow followed by Delhi (6.45%) and Mumbai (5.58%) respectively. As far as technology transfer and financial collaborations are concerned, total number of 2 technical and 112 financial collaborations are approved for education sector. Out of 2 technical collaborations, USA and Japan begged one each during 1991-2008. Further, India is endowed with a large pool of skilled people with secondary and tertiary level of education. India with this level of education attracts foreign firms in science, R & D, and high technology products and services. The endowment of science, engineering, and technology oriented people facilitate the spillovers of technology and know-how. Moreover, the medium of instruction at these education levels is English the lingua franca of business. India with this added advantage benefits in attracting foreign firms in education sector.

**Figure 5.14**

![Trends in Education Sector](image)

*Source: Compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI.*
5.5.1.6 Housing and Real Estate sector

Housing and Real Estate sector accounts $ 4.7 billion of FDI inflows which is 5.78% of the total inflows received through FIPB/SIA route, acquisition of existing shares and RBI’s automatic route during 2000-2008. There is an exponential rise (Figure 5.15) in the amount of FDI inflows to this sector after 2005.

![Trends in Housing and Real Estate Sector](image)

**Figure 5.15**

*Source: Compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI.*

Heavy investment i.e. 61.96% came from Mauritius. In terms of most attractive locations in India New Delhi and Mumbai with 34.7% and 29.8% shares are on the first and second positions. The total numbers of foreign collaborations in Housing and Real Estate sector is 18 with an equity participation of US$1.0 bn during 1991-2008. Maximum numbers of foreign collaborations in Housing and Real Estate sector is with Mauritius (7), Singapore (2), and U.K (2). The top five Indian companies which received maximum FDI inflows in this sector are: Emaar MGF Land Pvt. Ltd, Emaar MGF Land P. Ltd, Shivaji Marg Properties, Shyamaraju & Company (India) Pvt. Ltd, and India Bulls Infrastructure Development.

5.5.1.7 Construction activities sector

Construction activities Sector includes construction development projects viz. housing, commercial premises, resorts, educational institutions, recreational facilities, city and regional level infrastructure, township. The amount of FDI in construction activities during Jan 2000 to Dec. 2008 is US$ 4.9 bn which is 6.15% of the total
inflows received through FIPB/SIA route, acquisition of existing shares and RBI’s automatic route. The construction activities sector shows a steep rise in FDI inflows from 2005 onwards (Figure 5.16). Major investment in construction activities is received from Mauritius which is accounted nearly 58.61% of total FDI inflows during 2000-2008. In India Delhi, Mumbai, and Hyderabad receives maximum amount (viz. US$ 1245.61, 1000.5, and 943.22 bn) of investment. As far as technology transfers are concerned, total numbers of 9 technical and 223 numbers of financial collaborations have been approved for construction activities, which accounts for 0.11% of the total collaborations approved during August 1991 to December 2008. Maximum numbers of technical collaborations are approved with France (3) and USA (2). The top five Indian companies’ which received FDI inflows in this sector are: W.S Electric Ltd, Carmen Builders & Construction Pvt. Ltd, Caitlin Builders & Developers Pvt. Ltd, W.S. Electric Ltd, and PVP Ventures Pvt. Ltd.

![Figure 5.16](source: Compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI.)

5.5.1.8 Automobile Industry

Automobile Industry Sector comprises Passenger cars, auto ancillaries, etc. FDI inflows in the automobile Industry sector, during January 2000 to December 2008 is US$ 3.2 billion which is 4.09% of the total inflows received through FIPB/SIA route, acquisition of existing shares and RBI’ automatic route. The trends in automobile sector show that there is a continuous increase of investment in this sector after 2005 onwards (Figure 5.17). Major investment came from Japan (27.59%), Italy (14.66%),
USA (13.88%) followed by Mauritius (7.77%) and Netherlands (6.91%). in India Mumbai, New Delhi and Ahmedabad received major chunks of investment i.e. 36.98%, 26.63% and 9.47%). The total numbers of approvals for automobile industry have been of the order of 1611 with an equity participation of US$ 6.1 bn, which is 7.01% of the total investment. Automobile industry sector ranks 5th in the list of sectors in terms of cumulative FDI approved from August 1991 to Dec 2008. Out of 1611 numbers of foreign collaborations approved 734 are technical and 877 are financial in nature. Highest numbers of technical collaborations with Japan are in automobile Industry. Major Indian companies which received highest percentage of FDI inflows in automobile industry are Escorts Yamaha Motor Ltd, Yamaha Motors India Pvt. Ltd, Punjab Tractors Ltd., Yamaha Motor Escorts Ltd, Endurance Technologies P. Ltd, General Motors India Ltd, and Fiat India Automobile P. Ltd.

5.5.1.9 Computer Software and Hardware Sector

Computer Software and Hardware sector received US$ 8.9 bn which constitute 11.43% of the total FDI inflows during the period Jan 2000 to Dec 2007. Computer Software and Hardware sector shows a continuous increasing trend of FDI inflows (Figure 5.18). Mauritius with an investment of US$ 4789 bn remained at the top among the investing countries in India in this Sector. Other major investing countries in this sector are USA (12.88%), Singapore (10.07%) etc. Among Indian locations Mumbai received 22.44% of investment followed by Bangalore (10.8%), and Chennai (9.90%).

Source: Compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI.
Computer Software and Hardware industry fetched 3636 numbers of foreign collaborations. Out of 3636, 125 are technical and 3511 are financial in nature with an equity participation of US$ 3.0bn. Major technological transfers come from USA (43.2%) and Japan (10.4%). The top Indian companies which received FDI inflows in this sector are: I Flex Solutions Ltd, I Flex Solutions Ltd, Tata Consultancy Services Ltd, Infrasoft Technologies Ltd, Mphasis BFL Ltd, I- Flex Solutions Ltd, Digital Global Soft Ltd, India Bulls Financials Services P. Ltd, IFLEX Solutions Ltd, Unitech Reality Projects Ltd.

**Figure 5.18**

![Trends in Computer Software & Hardware Sector](image)

*Source: Compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI.*

### 5.5.1.10 Telecommunications Sector

Telecommunications Sector comprises Telecommunications, Radio Paging, Cellular Mobile/ Basic Telephone Services etc. India received cumulative FDI inflows of US$ 100.4 bn during 1991-2008. Out of this, Telecommunications Sector received an inflow of US$ 8.2 bn, which is 8.4% of the total FDI inflows during August 1991 to December 2008. There has been a steady flow of FDI in telecommunications from 1991 to 2005, but there is an exponential rise in FDI inflows after 2005 (Figure 5.19). Mauritius with 82.22% of investment remains on the top among the investing countries in this sector. Other investing countries in the telecom sector are Russia (5.41%) and USA (2%). New Delhi attracts highest percentage (32.58%) of FDI inflows during Jan 2000 to Dec 2008. The total numbers of approvals for
telecommunications Industry have been of the order of 1099 with an equity participation of US$ 13.3 bn, 14.34% of the total investment. Telecommunication sector ranks 2nd in the list of sectors in terms of cumulative FDI approved from August 1991 to Dec 2008. Out of 1099 foreign collaborations, 139 are technical and 960 are financial in nature. Highest numbers (32) of technical collaborations are approved with USA followed by Japan (19), U.K. (12), Canada (12) and Germany (12). The leading Indian companies which received FDI inflows in this sector are: Bhak Infotel p. Ltd, Aircel Ltd, Bharti Tele Ventures Ltd, Bharti Telecom ltd, Flextronics Software Systems Ltd, Hathway Cable & Data Com. Pvt. Ltd, Unitech Developers & Projects Ltd, Hutchison Essar South Ltd. Etc.

**Figure 5.19**

![Trends in Telecommunications Sector](source)

*Source: Compiled and computed from the various issues SIA Bulletin, Ministry of Commerce, GOI.*

### 5.6 FOREIGN DIRECT INVESTMENT POLICY IN INDIA: PRE AND POST LIBERALIZATION

The trend and pattern of FDI inflow has been the result of the policy framework affecting FDI. Realizing the important contribution that private foreign investment particularly FDI can make to economic development and growth, India has introduced many investment regimes to attract them. During the first three decades after independence in 1947, foreign investment in India was highly regulated. In the 1980s, there was some relaxation in foreign investment policy in line with the industrial policy liberalization of the time. The major policy initiative towards attracting FDI
was outlined in the Industrial Policy Statement of July 1991. Since then, several measures have been taken to liberalize and simplify the norms and procedures pertaining to FDI. Restrictive investment regimes have been liberalized. In addition, various types of incentives are being offered to attract FDI. Greater attention is also being paid to making the macro-economic environment more conducive to foreign investors. Provision of infrastructure and other support services is being targeted and financial sector reforms are being undertaken to facilitate financial flows in various forms.

Thus, changes in policy frameworks in India dealing with Foreign Direct Investment are studied in two periods; pre and post liberalization viz.

5.6.1 Policy Measures for FDI in Pre-Liberalization period

5.6.1.1 FDI Policy Development during 1948-66

5.6.1.2 FDI Policy Development during 1967-79

5.6.1.3 FDI Policy Development during 1980-90

5.6.2 Policy Measures for FDI in the Post-Liberalization period since 1990

5.6.1 Policy Measures for FDI in Pre-Liberalization period

5.6.1.1 FDI Policy Development during 1948-66: Period of Cautious welcome policy

Before independence India lacked a policy of its own foreign capital. Resultantly, foreign enterprises found it convenient to export products to India and were justified by local circumstances to set-up branches or wholly owned subsidiaries. Local entrepreneurs, which did not have many prospects for obtaining foreign collaborators, set-up industrial units without foreign collaborations as in the case of Cotton textiles, Cement and Paper or obtained the services of foreign consultants as in the case of steel (Tata Iron and Steel company).

The advent of independence brought into focus the various issues involved in the import of foreign capital and expertise into the country, and the need for defining a policy with respect to foreign investment. The new independent government had specific views on industrialization and role of foreign capital. This was reflected in
the first policy document, Industrial Policy Resolution of 1948. It was necessary that the conditions under which foreign capital could participate in Indian industry should be carefully regulated in the national interest. FDI policy is a part of industrial policy therefore in the industrial policy statement of April 1949; three important assurances were given to foreign investors:

(i) India would not make any discrimination between foreign and local undertakings.

(ii) Foreign exchange position permitting, reasonable facilities would be given to foreign investors for remittances of profits and repatriation of capital.

(iii) In case of nationalization of the undertaking fair and equitable compensation would be paid to foreign investors.

In April 1956 a new industrial policy resolution was drafted and passed by parliament, which provided a list of industries wherein the scope of operation of private-local as well as foreign investors became insignificant and consequently, these industries had become the part of the India's public sector for operation. However, the foreign exchange crisis faced by the Indian economy in 1957-78 led to liberalization in the government's attitude towards FDI. Hence, for attracting more inflow of FDI in India for meet of projects, the Indian government announced various incentives and concessions like reduction in tax rates, etc.

In the mid-1950's when industrialization got underway foreign capital ventured into India primarily with technical collaboration. The foreign exchange crisis of 1958 marked a change in foreign collaboration in India in two ways: (i) foreign enterprise began to take equity participation more frequently, (ii) more of technical collaborations started to accept equity participation in lieu of royalties and fees. After 1958, Indian entrepreneurs were given provisional licenses required to secure part or all of the foreign exchange by way of foreign investment. The government extended the AID Investment Guarantee Program to cover American private investment in India. It gave a number of tax concessions to foreign enterprise. The licensing procedure was streamlined to avoid delays in approvals of foreign collaboration.
Double taxation avoidance agreements with Finland, France, U.S.A., Pakistan, Ceylon, Sweden, Norway, Denmark, Japan and West Germany were signed.

The Indian Investment Centre (IIC), with offices in major investor countries, was set up in 1961 to promote foreign investment in India. Anticipating the foreign exchange bottleneck to continue and affect the Third Five Year Plan projects, the government issued a list of industries in 1961 in which foreign investment were to be welcome taking into account the gaps in capacity in relation to plan targets. This list included some of the industries, which were reserved for public sector, such as drugs, aluminium, heavy electrical equipment, fertilizers, synthetic rubber and etc. However, it was clearly stated that foreign investment to cover the foreign exchange cost of plan and machinery in the approved projects would be welcomed. This has been the logical demand from Indian government to ease out the foreign exchange crisis. Similarly, it was also pointed out that the proportion of foreign held equity would depend upon the degree of sophistication of technology and volume of required foreign exchange. However, the local major stake in ownership through welcome was not to be insisted upon.

In order to encourage foreign investment by NRIs, in 1965 the Finance Act, made provision for certain additional tax concessions. The interest accruing in a Non-Resident Account on money transferred from abroad through recognized banking channels and deposited in any bank in India was exempted from tax.

In May 1966 the government decided that investment by NRIs would be allowed without any limit in public limited industrial concerns in India. In private limited industrial concerns with a minimum issued and paid up capital of Rs. 10 lacs, their share would be allowed up to 49%. In special cases it would be increased to 51% or even more, provided resident Indian participation would go up to 49% within a period of say 5 years. But they would not be allowed to invest in proprietorship or partnership and dividends would not be allowed to be repatriated.

5.6.1.2 FDI Policy Development during 1967-1979: The Period of Selective Policy
The first phase of liberal attitude towards FDI was continued till mid sixties. This resulted in a significant outflow of foreign exchange in the form of remittances of dividends, profits, royalties and technical fees. These outflows of foreign
exchange caught the government's attention in the background of foreign exchange crisis in the late sixties. To meet any crisis in future, the government of India streamlined the procedure for inviting foreign collaborations and their approvals. Since then the second phase of restrictive attitude had started. In this direction, the very first step taken by the government was to set up a new agency known as Foreign Investment Board (FIB) in 1968 to deal with all the cases involving FDI or collaboration except those in which total investment in share capital exceeded Rs. 20 million and where in the proportion of foreign equity 40 percent exceeded. All the cases covering under the category of more than 40 percent equity held by a foreign firm and Rs. 20 million share capitals had to be approved by the cabinet committee.

A sub-committee of FIB was empowered to take appropriate decision in regard to the approval of foreign collaborations wherein the share of foreign-held equity must not be more than 35 percent and also wherein total investment stood at Rs. 10 million. The administrative ministers had got the authority to approve the cases involving only technical collaboration. However, foreign investment unaccompanied by technology had not been favoured. Accordingly, three lists of industries were issued by the government of India wherein clear cut demarcation was made for industries. First list covered those industries where no collaboration had been considered necessary. Second list included those industries wherein only technical collaboration could be possible. Third list dealt with those industries wherein foreign investment could be invited. In the case of second and third list of industries, permissible range of royalty payments was also specified for different items which generally did not exceed 5 percent. The permitted duration of the collaborations was reduced from 10 to 5 years. Similarly, restrictions were imposed on the renewals of agreements. To give a right direction, a Technical Evaluation Committee (TEC) was formed in 1976. The main objective of TEC was to assist the FIB in screening the proposals of foreign collaborations and discuss them with the representatives of various scientific agencies of the country, such as the Council of Science and Industrial Research (CSIR), and the Department of Science and technology (DST).
Another guideline was that wherever Indian consultancy was available, it was to be utilized fully and exclusively. If foreign consultants were engaged, then Indian consultants must be assigned the primary role. An important aspect came up and from February 1972, the government of India came forward with an expansion plan in those industries with major foreign equity subject to their accepting dilution of foreign equity by raising certain proportion of estimated cost of expansion through issues of additional equity to Indian nationals. The government's decision in respect of industrial policy of 1970 which were concretized in 1973, sought to restrict the further operations of foreign companies (along with those of local large industrial houses) to select group core industries. These industries were considered to be of basic, vital and strategic importance. In the same year a new Foreign Exchange Regulation Act, 1973 popularly know as FERA came into effect and which was to be considered as cornerstone of the Indian regulatory framework for FDI. The section 29 of FERA covers all existing non-banking foreign branches and companies incorporated under the Indian companies Act with more than 40 percent foreign equity participations. In other word, FERA came to regulate the entry of foreign capital and investment in the form of branches, Non-Resident Indians (NRIs) investment and employment of foreigners in India.

With the operation of FERA on January 1974, all the existing companies came under the direct control of Reserve Bank of India (RBI) and they were required permission from RBI to continue their business in India. The RBI extended permission subject to their accepting to Indianise or dilute their foreign equity as per the guidelines issued by the government of India for the effective implementation of the act. Under the guidelines issued by the government all FBs were required to transfer their business to Indian companies having upto 40 percent foreign equity. Similarly, the rupee companies were also directed to dilute their foreign equity to a maximum of 40 percent. Companies working under the core of public sector, tea plantations and those engaged in manufacturing base on sophisticated technology or predominantly producing for export were, however, allowed to retain 51 percent to 74 percent foreign equity. FERA, therefore, put a
general ceiling of 40 percent on the foreign equity participation in the country.

In this regard, some MNCs, most famously IBM and Coca Cola, refused to abide by the FERA and took their operations out of India several years after its implementation, most MNCs chose to stay and sold their shares to Indians. These MNCs actually benefited because their newly "Indianised" affiliates were able to expand and diversify without any of the restrictions which had applied to foreign firms, notably those which had limited foreigners' access to certain industrial sectors.

Hence, implementation of the provision of the Act would leave only a limited number of engaged firms in specified activities to be with more than 40 percent foreign equity. Only these companies were to be given a discriminatory treatment under the industrial licensing. All other companies incorporated in India with foreign equity upto 40 percent would be free to expand, diversify and operate in any field like any local company. An assurance in this regard has been given in the industrial policy statement of 1977. A statement on industrial policy was presented by the government to parliament on December 23, 1977. Under this statement, foreign investment and acquisition of technology necessary for India's industrial development could be allowed where they were in national interest and on terms determined by the government. As a rule majority interest in ownership and effective control could be in Indian hands except in highly export-oriented and sophisticated technology areas and 100% export-oriented areas. Where foreign investments had been approved, there could be complete freedom of remittance of profits, royalties, dividends and repatriation of capital subject to the usual regulations.

With a view to encourage investment by Non-Resident Indians (NRIs), in October 1975, the government decided to permit NRIs and persons on Indian origin to invest in the equity capital of permitted industries up to a maximum of 20% of new issues of capital of new industries. Such investment were made by remittances from abroad through approved banking channels or out of funds held in non-resident (External) account.
In October 1976, the scheme under which NRIs were allowed to start industrial units in India by bringing in imported machinery was liberalized to permit equity investment up to 74% without any minimum limit in a number of priority sector industries. The permission was also granted for investment in other industries provided the investors undertook to export 60% of the output. The scheme was applicable only to new units and to existing industrial undertaking seeking expansion and diversification. Capital invested under the scheme was eligible for repatriation after the unit had gone into commercial production subject to adherence to export obligation.

5.6.1.3 FDI Policy Development during 1980-1990: The Period of Partial Liberalization

Towards the end of the 1970s India's failure to step up significantly the volume and proportion of her manufactured exports in the background of the second oil price shock began to worry the policy makers. It led to the realization that international competitiveness of Indian goods had suffered from growing technological obsolescence and inferior product quality, limited range, and high cost which in turn were due to the highly protected local market. Another limiting factor for Indian manufactured exports lay in the fact that marketing channels in the industrialized countries were substantially dominated by MNCs. The government intended to deal with the situation by (i) putting emphasis on the modernization of plants and equipment through liberalized imports of capital goods and technology, (ii) exposing the Indian industry to competition by gradually reducing the import restrictions and tariffs, and (iii) assigning a greater role to MNCs in the promotion of manufactured exports by encouraging them to set up export-oriented units. This strategy was reflected in the policy pronouncements that were made in the 1980s.

The Industrial Policy Statement in 1980 and 1982 announced a liberalization of industrial licensing (approval) rules, a host of incentives, and exemption from foreign equity restrictions under FERA to 100% export-oriented units. It was also decided to set up four more export processing zones (EPZ) in addition to the two existing ones, namely those at Kandla (set up in 1965) and at Santacruz (set up in 1972) to attract MNCs to set up export-oriented units. The trade policies in this period gradually
liberalized the imports of raw materials and capital goods by gradually expanding the
list of items on the Open General Licence (OGL). Between 1984 and 1985, 150 items
and 200 types of capital goods were added to OGL list. Tariffs on imports of capital
goods were also slashed. Imports of designs and drawings and capital good were
permitted under a liberalized Technical Development Fund Scheme. The
liberalization of industrial and trade policies was accompanied by an increasingly
receptive attitude towards FDIs and foreign licensing collaborations.

In 1980, certain Policy guidelines were issued to streamline the foreign collaboration
approvals delegating the powers to administrative ministries to approve foreign
collaborations not involving an outflow of more than 50 lakh in foreign exchange and
without any foreign equity participation. The rules concerning payments of royalties
and lump-sum technical fees were also relaxed. Tax rates on royalties were reduced
from 40 percent to 30 percent in 1986. A degree of flexibility was introduced in the
policy concerning foreign equity participation, and exceptions from the general
ceiling of 40 percent on foreign equity were allowed on the merits of individual
investment proposals. To facilitate the inflow of high technology to the existing
industry, the cabinet committee on economic affairs decided in December 1986 to
permit foreign equity participation even in existing Indian companies employing high
technology. The approvals for opening liaison offices by foreign companies in India
were liberalized and procedures for outward remittances of royalty, technical fees and
dividends etc. were streamlined. New procedures were introduced enabling direct
application by a foreign investor even before choosing an Indian partner. A 'fast
channel' was set up in 1988 for expediting clearances of FDI proposals from major
investing countries viz. Japan, Germany, USA and UK.

The technical development fund was widened in scope to include import of all kinds
of capital equipment, technical know-how and assistance, drawings and designs and
consultancy services. The ceiling for import under the Fund was raised to a foreign
exchange equivalent of Rs. 20 million per year.

This process of industrial policy reforms directed at fostering greater competition,
efficiency and growth in the industrial sector with a stable, pragmatic and non-
discriminatory policy. Substantial procedural liberalization had been done for domestic industry, which was reflected in joint ventures and investment also. These covered areas of industrial licensing, procedures for collaborations, appointment of directors, technicians, visa requirements, custom procedures, repatriation of funds etc. In the tourism sector, 51 percent foreign equity participation was permitted as a norm. New foreign investments in existing companies were made possible if the same had justified grounds of technology or export.

With a view to encourage foreign investment by NRIs and overseas corporate bodies, they could invest in the new issues of public or private limited companies in any business activity (except real estate business) upto 100% of the issued capital without any obligation to associate resident Indian participation in the equity capital at any time.

In May 1983, relaxations granted to NRIs investment were subjected to a specific limit. An overall ceiling of: (a) 5 percent of the value of the total paid up equity of the company concerned, (b) 5 percent of the total paid up value of each series of convertible debentures was fixed on purchases of equity stock exchanges on repatriation and non- repatriation basis together.

In 1985-86, the government abolished the Estate Duty, which was considered as one of the major hurdles in the way of inward remittances to India by NRIs of Indian nationality or origin. The surcharge on income tax was also abolished bringing down effective rate of tax on NRI income from 22.5% to 20%.

During 1986-87, the government permitted Indian companies with more than 40 percent non-resident interest to acquire immovable properties in India. Further, NRIs were allowed to invest: (i) up to 100 percent of the equity capital in sick industrial units, (ii) in new issues of Indian shipping companies under the 40 percent scheme (iii) in diagnostic centre in India under 40 percent or 74 percent scheme.

The focus of policies in this period, therefore, was on sharpening the international competitiveness of Indian enterprises by exposing them to increased domestic and international competition. These policy changes in 1980s are as halting reforms because these were not comprehensive in their scope and did not go far enough to make a significant impact.
5.6.2 Policy Measures for FDI in the Post-Liberalization period since 1990

India's balance of payments problem and the measures adopted to overcome the problem in a limited manner became a matter of great concern. Among the measures taken, the country borrowed substantial amount from IMF, curbed imports extensively and pledged country's gold to different central banks of different nations. In order to give stability to India's external sector and to review the slumping credit rating of the country, the government of India gave rethinking on foreign investment policy and as a result, the authorities came out with drastic changes in trade, investment and industrial policy. The new policy was initiated to increase the stake of foreign investors in Indian companies provided a bigger room for their entry axed the procedural formalities, provided additive incentive for the import of technology and to the NRIs. Thus, the main objective of the new FDI policy was to create a congenial environment for FDI inflows in India. Diluting the provision of FERA, the new policy removes the 40 percent ceiling for foreign equity participation that existed during the pre-reform period. Moreover, it provided for automatic approval of foreign collaborations in many cases. In case of nine categories of industries, viz., mining services, basic metal and alloys, electric generation and transmission, non-conventional energy generation and distribution, construction, land and water transport, storage and warehousing services and some manufactures like industrial and scientific instrument, the RBI granted automatic approval of foreign collaboration even if foreign participation in equity goes up to 74 percent. In case of infrastructure projects of this group, automatic approval would be availed even with 100 percent foreign equity participation. In case of three categories of industries, such as mining of iron ore, metal ore and non metallic minerals, foreign equity participation was not to exceed 50 percent if automatic approval was expected. In addition to this, in 1999-2000, the list of automatic approvals was widened covering important industrial and service sectors (SIA Newsletter 2001).

However, if a foreign investor wished to have greater participation in equity than that mentioned above, documents had to be routed through the Foreign Investment Promotion Board (FIPB), which was under the Industry Ministry of the
Government of India. The FIPB sanctions even 100 per cent equity participation in cases where Indian companies were unable to raise funds or in cases where at least one-half of output is meant for export. It was also done in cases where foreign investors were to bring in proprietary technology (Indian Investment Centre 1997).

The new policy extended FDI to trading, hotels and tourism-related companies, units of export-processing zones, banking and non-banking financial services, of course, with varying degree of foreign equity participation. FDI was also allowed in those areas where the big industrial houses were not previously allowed to invest. The new policy permits for opening of branch/liaison offices of foreign companies, revoking the prohibition of 1973. The branch office could be set up for conducting research and development, undertake export-import activities and for making available desired technology. An offshore venture capital company might contribute to an entire equity base of a domestic venture capital fund and might also set up a domestic asset management company (Indian Investment Centre 1997).

The Indian government became quite liberal regarding dividend repatriation abroad. There was no bar if taxes were paid. However, in a limited number of consumer goods, such outflow had to be balanced with export earnings for a period of seven years. Disinvestments could be made subject to a few RBI formalities. A new foreign trade policy was announced with wide ranging liberalization of import controls across the board and substantial reduction in import duties, devaluation of the rupee etc. Policies relating to foreign financial participation in Indian companies and those relating to foreign technology agreements had also undergone a radical change.

On July 24, 1991 a statement of New Industrial Policy (NIP) was presented to the parliament. Despite being somewhat longwinded in its efforts to portray it as a continuation of the policies and basically not against the Industrial Policy Resolution of 1956, but only an exercise in modification of old policies to meet the new challenges, the statement virtually dismantled the industrial licensing system under the IDR Act. It was stated that a full realization of the industrial
potential of the country calls for this process of change which was in consonance with the established practice in as much as industrial policy has also been modified through statements in 1973, 1977 and 1980 to meet new challenge.

5.7 HIGHLIGHT OF INDUSTRIAL POLICY STATEMENT, July 1991

1. Industrial licensing was abolished except for a list of 18 industries related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons and items of enlist consumption.

2. Areas, wherein the government's view, security and strategic concerns predominate, have been reserved for the public sector. In this regard 8 industry group were in this reserved list. Other measures to soften the rigor of industrial licensing included the following:

3. All existing units would be provided a new broad banding facility to enable them to produce any article without additional investment.

4. All substantial expansions of existing units would be exempted from licensing.

5. The system of phased manufacturing programme run on an administrative and case by case basis was discontinued, first for new projects and finally even for old ones.

6. While the doors were flung open for the inflow of FDI, the government of India specified certain high priority areas where faster clearances and approvals were promised. As such, it was decided that in 34 specified industries, automatic approval would be given to such investment upto 51 percent of equity as well as for the employment of foreign technology. The list of high priority industries has been expanded. Electronics software has been added to this list. Most basic drugs and formulations have also been brought under the automatic approval policy. In mining (except atomic minerals and minerals fuels) too, foreign equity upto 51 percent will be automatically approved.

7. The new industrial policy does not restrict the extent of foreign equity holdings or sectors eligible for foreign investment. The policy leaves all such decisions,
including selection of technology and the terms negotiated for transfer, to the commercial judgment of the entrepreneurs. Therefore, while the facility of automatic approval for FDI can be available from the RBI much quicker, other proposals for direct investment are equally welcome. The government of India would consider all FDI proposals including those for 100 percent foreign equity holdings for setting up wholly owned subsidiaries.

8. In the case of 100 percent export oriented units and units in the free trade zone/export processing zones, foreign participation may go to 100 percent of equity.

9. Earlier it was a condition that dividends would be repatriated out of export earnings. In June 1992, government withdrew this restriction on dividends; the foreign companies were no longer required to generate export to justify dividends except in 22 products in the consumer goods sector.

10. Import of components, raw materials and intermediate goods and payment for know-how fees and royalty is to be governed by the general policy applicable to domestic units.

11. It was clarified that foreign equity proposals need not necessarily be accompanied by foreign technology agreements.

12. To provide access to international markets majority foreign equity hold upto 51 percent would be allowed for trading companies primarily engaged in export activities. Such trading companies would be on par with domestic trading and export house in accordance with the import export policy.

13. No permission would be necessary for hiring of foreign technicians and foreign testing of indigenously developed technologies.

14. Foreign companies have been allowed to use their trademarks on domestic sales.

15. A special empowered board, namely the Foreign Investment Promotion Board (FIPB), has been constituted to negotiate with large international corporations and approved FDI in selected areas. This is considered to be a special programme to attract substantial investment that would provide access to high technology and world markets.
16. Foreign investment in the power sector is actively encouraged and can take place wither in the form of a joint venture foreign equity.

17. In order to modernize the telecom facilities in the country; the government has announced a comprehensive policy for attracting private, including foreign investment, in value added and basic services.

18. A new policy announced for encouraging investment in oil exploration and production as well as in refining and marketing of petroleum products.

19. FDI permitted upto 20 percent in the case of NRI and upto 40 percent in the banking service sector, subject to the guidelines/norms stipulated by RBI.

20. In 13 April, 1992, India finally signed Multilateral Investment Guarantee Agency (MIGA) protocol. This protects the foreign investors from non-commercial risks including risks of expropriation.

21. In January 1993, Provisions of Foreign Exchange Regulation Act (FERA) have been liberalized. As a result of which companies with more than 40 percent of foreign equity are also now treated on par with fully Indian owned companies.

22. NRIs and Overseas Corporation Bodies (OCBs) are allowed to investment upto 100 percent equity in high priority industries, with repatriability of capital and income. Investment upto 100 percent of equity is allowed in export house, trading houses, start trading houses, hospitals, sick industries, hotels and tourism related industries and without the right of repatriation in the previously excluded areas of real estate, housing and infrastructure.

23. Policies relating to foreign financial participation in Indian companies and those relating to foreign technology agreements had also undergone a radical change.

24. The liberalized facility of direct investment by NRIs was confined only to capital raised by Indian companies for setting up new industrial projects or for expansion/diversification of existing industrial undertaking. However, with the abolition of the list of industries which were not open for direct investment by NRIs and with the addition of the hotel industry, the scope for investment by
NRIs had been widened. NRIs had also been permitted to invest in 12 percent, 6 year NSCs and it was exempted from wealth, income and gift taxes.

25. During 1996-97 Foreign Institutional Investors (FIIs) were allowed to invest up to 100% of their funds in debt instruments of Indian companies effective January 15, 1997. With effect from March 8, 1997, FIIs were allowed to invest in government of India dated securities up-to 30%. On January 17, 1997, the government allowed under the Automatic Approval route inclusion in Annexure –III of the Statement of Industrial Policy 1991, the following:

(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%.

(iii) 9 categories of industries/items for foreign equity up to 74%.

26. During 1997-98 FDI was allowed into sixteen non-banking financial services through the Foreign Investment Promotion Board (FIPB). Expanding the scope of "automatic route" for FDI, the government of India approved 13 additional categories of Industries, items under services sector for foreign equity participation up to 51% of the equity. There were 3 items relating to mining activity up to 50% foreign equity participation and 9 categories of industries/activities up to 74% foreign equity participation.

27. As a part of the liberalized policy the RBI has decided to permit foreign banks operating in India to remit their profits or surplus to their head offices without the approval of the RBI. The RBI also allowed branches of foreign companies operating in India to remit profits to their head offices without the prior approval of Reserve Bank.

28. In August 1999, a Foreign Investment Implementation Authority (FIIA) was established within the Ministry of Industry in order to ensure that approvals for foreign investments (including NRI investments) were quickly translated into actual investment inflows and that proposals fructify into projects. In particular, in cases where FIPB clearance was needed, approval time was reduced to 30 days.
29. An 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 26 percent of the total paid up capital.

30. Considering the enhanced opportunities of Indian software companies for expanding globally, operational norms governing their overseas investments and mode of financing acquisition of overseas software companies has been liberalized. In December 1999 a notification was issued by the Ministry of Finance permitting Indian software companies, which are listed in foreign exchanges and have already floated ADR/GDR issues, to acquire foreign software companies and issue ADR/GDRs without reference to the Government of India or the RBI up to the value limit of US $100 million. For acquisition beyond US $100 million, proposals would require examination by a Special Composite Committee in the RBI.

5.8 POLICY INITIATIVES SUBSEQUENT TO INDUSTRIAL POLICY STATEMENT, 1991

Foreign investment policy in the post-reforms period has emphasized greater encouragement and mobilisation of non-debt creating private inflows for reducing reliance on debt flows. Progressively liberal policies have led to increasing inflows of foreign investment in the country.

5.8.1 Route for Inward Flows of FDI

A. Automatic Route: the automatic approval route of the RBI was introduced to facilitate FDI inflows. Companies proposing foreign investment under the automatic route do not require any government approval. The automatic route encompasses all proposals where the proposed item of manufacturing/activity does not require an industrial license and is not reserved for the small-scale sector. A ceiling of equity participation up to 50 percent in three sectors (i.e., private sector banking, telecommunication and coal and lignite) up to 51 per cent in twenty-one sectors (i.e., petroleum, housing and real estate, trading, cable network, hotel and tourism etc.) and up to 74 per cent in nine sectors (i.e., atomic energy, mining,
establishment and operation of satellite, advertisement and film, drugs and pharmaceuticals, power, broadcasting, township development and postal services) has been imposed. Existing companies can also enhance equity up to these prescribed limits. However, non-resident Indians (NRIs) and the overseas corporate bodies predominantly owned by them are allowed 100 percent equity. Foreign technology agreements are also approved by the RBI subject to the condition that the lump sum payment of fee does not exceed Rs 10 million and the royalty payment is not more than 8 per cent on exports. The ceiling on lump sum fee has recently been raised from Rs 10 million to US$ 2 million and a provision for payment of royalty of 5 per cent on domestic sales has also been made.

**B. Government Approval:** For the following categories, government approval for FDI is necessary:

- Proposals attracting compulsory licensing
- Items of manufacturing reserved for the small scale sector and
- Acquisition of existing shares

**5.8.2 Foreign Investment Promotion Board:** The FIPB is especially empowered to engage in purposive negotiation and also consider proposals in totality free from predetermined parameters on procedures. The approach of FIPB is liberal for all sectors and all type of proposals. The totality of package proposed is examined and approved on merits within a period of thirty days. Indian companies getting foreign investment approval through FIPB route do not require any further clearance from RBI for the purpose of receiving inward remittance and issue of shares to the foreign investors. Such companies are required to notify the regional office concerned of the RBI of receipt of inward remittances within 30 days of such receipt and to file the required document with the concerned regional offices of the RBI within 30 days after issue of shares to the foreign investors.

**5.8.3 Foreign Investment Promotion Council:** Apart from making the policy framework investor-friendly and transparent, promotional measures are also taken to attract FDI 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 toward FDI promotion. The basic function of the Council is to identify specific sectors/projects within the country that require FDI and target specific regions/countries of the world for its mobilization.

5.8.4 Foreign Investment Implementation Authority: The government has set up (FIIA) in the Ministry of Commerce & Industry. The FIIA will facilitate quick translation of FDI approvals into implementations, provide a pro-active one stop after care service to foreign investors by helping them to obtain necessary approvals, sort out operational problems and meet with various government agencies to find solutions to problems and maximizing opportunities through a partnership approach.

The FIIA takes 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 level to high levels on a quarterly basis, including cases of projects slippage on account of implementation bottlenecks.

Functions of FIIA:
The functions of FIIA shall be as under:

- expediting various approvals/permissions;
- fostering partnership between investors and government agencies concerned;
- resolve difference in perceptions;
- enhance overall 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.
5.8.5 Secretariat for Industrial Assistance: The SIA has been set up by the government of India in the Department of Industrial Policy and Promotion in the Ministry of Commerce & Industry to provide a single window for entrepreneurial assistance, investor facilitation, receiving and processing all applications which require government approval, conveying government decisions on applications filed, assisting entrepreneurs and investors in setting up projects, (including liaison with other organizations and state governments) and in monitoring implementation of projects. It also notifies all government policy relating to investment and technology and collects and publishes monthly production data for 213 select industry groups. As an investor friendly agency, it provides information and assistance to Indian and foreign companies in setting up industry and making investments. It guides prospective entrepreneurs and disseminates information and data on a regular basis through its two monthly newsletters the "SIA Newsletter" and the "SIA Statistics" as also through its website address. It also assists potential investors in finding joint venture partners and provides complete information relevant policies and procedures, including those, which are specific to sectors and the state governments.

5.8.6 Special Economic Zones (SEZs) Scheme: India was one of the first countries in Asia to recognize the effectiveness of the Export Processing zone (EPZ) model in promoting exports, with Asia’s first EPZ being set up in Kandla in 1965, followed by the Santa Cruz Electronic Export Processing Zone (SEEPZ) in Bombay (now Mumbai) in 1972. In 1984 EPZs were established in Cochin (Kerala), Falta (Calcutta, now Kolkata), Madras (now Chennai) and Noida (Uttar Pradesh). The Visakhapatnam EPZ (Andhra Pradesh) was established in 1989 and the Surat EPZ (Gujarat) in 1997. These eight EPZs were distributed over India such that there were three each in the south and west of India, but only one each in the north and east.

The zones were not able to emerge as effective instruments for export promotion on account of multiplicity of controls and clearances, the absence of world class infrastructure and an unstable fiscal regime. In 2000-01, India decided to replace its EPZ model with a SEZ model in the Export and Import (EXIM) policy announcement made in. This was done with a view to providing an internationally competitive and hassle-free
environment for exports, earning foreign exchange, attracting foreign investment, generating employment, attracting the latest technology into the country, backward and forward linkages by way of sourcing of raw materials from and supply of finished goods to DTAs (Domestic Tariff Areas), upgrading skills and creating a source of skilled manpower, and developing backward areas.

SEZs are under the administrative control of the Development Commissioner (DC). There is a single-window clearance for SEZs, and all approvals and clearances for the establishment and operation of units in the SEZ are granted by the Unit Approval Committee which comprises the DC and nominees of the central and state governments. The Central government has offered various incentives and facilities both to developers of SEZs as well as industrial units coming up in SEZs. All kinds of units, namely, manufacturing, trading and service activities are permitted in SEZs. FDI up to 100 per cent in manufacturing sector is allowed through automatic route, barring a few sectors.

Exports from Special Economic Zones have been showing a steady increase (Table 5.13).

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<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Kandla SEZ</td>
<td>527.8</td>
<td>729.3</td>
<td>710.8</td>
<td>1482.7</td>
<td>1882.0</td>
</tr>
<tr>
<td>SEEPZ SEZ</td>
<td>5193.7</td>
<td>6083.2</td>
<td>6589.8</td>
<td>12047.7</td>
<td>11264.7</td>
</tr>
<tr>
<td>Cochin SEZ</td>
<td>304.3</td>
<td>270.4</td>
<td>290.0</td>
<td>802.7</td>
<td>4471.0</td>
</tr>
<tr>
<td>Noida SEZ</td>
<td>1043.2</td>
<td>1001.2</td>
<td>2479.0</td>
<td>6893.0</td>
<td>16843.4</td>
</tr>
<tr>
<td>Madras SEZ</td>
<td>690.8</td>
<td>822.4</td>
<td>979.2</td>
<td>2383.9</td>
<td>3046.5</td>
</tr>
<tr>
<td>Visakhapatnam SEZ</td>
<td>219.1</td>
<td>357.3</td>
<td>288.0</td>
<td>749.7</td>
<td>741.3</td>
</tr>
<tr>
<td>Surat SEZ</td>
<td>NA</td>
<td>NA</td>
<td>1539.7</td>
<td>5197.4</td>
<td>12294.0</td>
</tr>
<tr>
<td>Falta SEZ</td>
<td>20.0</td>
<td>520.5</td>
<td>573.7</td>
<td>998.7</td>
<td>1026.3</td>
</tr>
<tr>
<td>Total for SEZs</td>
<td>899.0</td>
<td>9784.1</td>
<td>13450.2</td>
<td>30555.7</td>
<td>51569.2</td>
</tr>
</tbody>
</table>

*Source: www.sezindia.nic.in*
In 2007-08, foreign investment, including NRI investment in the setting up of units in SEZs, was Rs. 3899 crore (Table 5.14). Table 5.15 shows the distribution of total investment made in different central government SEZs. In 2007-08 the seven central government SEZs have attracted FDI to the tune of Rs. 865.8 crore which comprises about 8 per cent of the total FDI inflows into the country.

**Table 5.14**  
Government SEZs (EPZs Converted to SEZs)

<table>
<thead>
<tr>
<th>Zone</th>
<th>Government Investment</th>
<th>Private Investment By Units (excl. FDI)</th>
<th>FDI Proposed</th>
<th>FDI Made</th>
<th>Total Private Investment made</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kandla SEZ</td>
<td>93.6</td>
<td>238.1</td>
<td>0.0</td>
<td>137.4</td>
<td>375.5</td>
</tr>
<tr>
<td>SEEPZ SEZ</td>
<td>57.3</td>
<td>635.1</td>
<td>461.9</td>
<td>154.3</td>
<td>789.4</td>
</tr>
<tr>
<td>Noida SEZ</td>
<td>117.7</td>
<td>540.0</td>
<td>0.0</td>
<td>135.0</td>
<td>675.0</td>
</tr>
<tr>
<td>MEPZ SEZ</td>
<td>87.5</td>
<td>434.3</td>
<td>252.5</td>
<td>237.4</td>
<td>671.4</td>
</tr>
<tr>
<td>Cochin SEZ</td>
<td>104.3</td>
<td>429.0</td>
<td>0.0</td>
<td>76.8</td>
<td>505.8</td>
</tr>
<tr>
<td>Falta SEZ</td>
<td>101.1</td>
<td>385.4</td>
<td>-</td>
<td>8.4</td>
<td>393.8</td>
</tr>
<tr>
<td>Visakhapatnam SEZ</td>
<td>67.9</td>
<td>371.5</td>
<td>200.0</td>
<td>116.5</td>
<td>488.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>629.7</strong></td>
<td><strong>3033.7</strong></td>
<td><strong>914.4</strong></td>
<td><strong>865.8</strong></td>
<td><strong>3899.5</strong></td>
</tr>
</tbody>
</table>

*Source: www.sezindia.nic.in*

**5.8.7 Incentives for FDI:** The package of incentives offered to foreign investors includes sector specific tax rebates and concessional import duties. Export earnings are tax free in India and infrastructure sectors have been accorded high priority. A five-year tax holiday is admissible for investment in the power sector. It is proposed to raise it to ten years in any block or fifteen years for mega projects of 1000 MW and above. Concessional import duty of 20 per cent on equipment and 16 percent return on equity are also guaranteed. Further, import duties on capital equipment for mega projects have been waived. In 1995, a five-year tax holiday was given for investment in highways, bridges, airports and rapid transportation system under Build, Operate and Transfer (BOT) schemes. The road sector is exempted from payment of customs duty on equipment for load construction. Some incentives have also been offered by state governments which include land, water and power at concessional rates and sales tax concessions and cash subsidies.
5.9 SECOND GENERATION OF LIBERALIZATION AND REFORMS, 2000 ONWARD

In February 2000, the government took a major decision to place all items under the automatic route for FDI/NRI/OCB investment except for a small negative list. The negative list included the following:

1. Items requiring an industrial license under the Industries (Development and Regulation) Act, 1951.

2. Foreign investment being more than 24% in the equity capital of units manufacturing items reserved for small scale industries.

3. All items requiring industrial license in terms of the location policy notified under the New Industry Policy of 1991.

4. Proposals having previous venture/tie-up in India with foreign collaborator.

5. Proposals relating to acquisition of shares in existing Indian company by foreign /NRI/OCB investor.

6. Proposals fall outside notified sectoral policy/cap or under sectors in which FDI is not permitted and or application 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.

Furthermore, 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% FDI/NRI/OCB investment.

During the year 2000-2001 and 2001-2002 to attract FDI some major initiatives created.

1. FDI up to 100% has been permitted in e-commerce subject to specific conditions. The dividend balancing condition for FDI in twenty-two consumer goods industries has been removed. The upper limit of Rs.150 crores for FDI in project involving
electricity generation, transmission and distribution has been dispensed with. The ceiling for FDI under the automatic route in oil refining has been liberalized to 100% from 49%. The limit has been raised to 100% for all manufacturing activities in Special Economic Zones also. Foreign equity participation up to 26% has been allowed in the insurance sector subject to the issue of necessary license by the Insurance Regulatory and Development Authority.

2. 100% FDI has also been allowed in the telecommunications sector for Internet Service Providers (ISPS) not providing gateways, infrastructure providers providing dark fiber, electronic mail and Voice mail.

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

4. The defence industry sector is also opened up to 100% for Indian private sector participation with FDI permitted up to 26%, both subject to licensing.

5. FDI up to 100% is permitted with prior approval of the government in courier services.

6. FDI up to 100% is permitted on the automatic route for Mass Rapid Transport System in all metropolitan cities, including associated commercial development of real estate.

7. FDI up to 100% is placed on the automatic route in drugs and pharmaceuticals. Institutions like International Finance Corporation, Common Wealth Development Corporation, German Investment and Development Company (DEG), etc; are allowed to invest in domestic companies through the automatic route subject to SEBI/RBI guidelines and sector specific caps in FDI.

8. Significant changes made during 2001-2002 include allowing payment of royalty up to 20% on exports and 1% on domestic sales under automatic route on use of trademarks and brand name of the foreign collaborator without technology transfer. Payment of royalty up to 8% on export and 5% on domestic sales by wholly owned subsidiaries to off share parent companies is allowed under the automatic route
without any restriction on duration of royalty payments. The radical recommendations for empowering the Foreign Investment Promotion Board and Foreign Investment Implementation Authority to expedite the process of administrative and policy approvals. This Committee has also suggested that Special Economic Zones should be developed as the most comparative destinations for export related FDI by simplifying laws, rules, administrative procedures and reducing red tape to the levels found in China. Recognizing inadequate infrastructure in the country as a primary hurdle to FDI growth, in 2002, a committee on FDI urged states to enact a special investment law relating to infrastructure to expedite investment in infrastructure sector and remove obstacles to production in the sector. The committee also recommended removal of FDI caps on all manufacturing and mining sectors and raising it in telecom, civil aviation, broadcasting and insurance sector.

The committee has made three recommendations:

1. Enactment of a new law on FDI granting national treatment to foreign firms and removing the enforcement directorate as their supervisory body.

2. Making investment in most sectors automatic removing it from discretionary ambit of the FIPB even while empowering it and the foreign investment implementation authority to carry out as many clearances as possible such as registration for exist and direct tax payments.

3. Replacing the present permission driven approach vis-à-vis FDI to a proactive promotion approach.

4. The committee suggested that the government rules of business should be changed to empower the Foreign Investment Implementation Authority (FIIA) to expedite the processing of administrative and policy approvals.

a. In short, the recommendations of the committee can be listed as follows:

5. Allow up to 40 percent FDI by foreign airlines in insurance and airlines.

6. Permit up to 100 percent FDI in petroleum refining, oil marketing, diamond mining, petroleum exploration, and coal washery, airports, banking and investing companies, radio paging, advertising and trade.
7. Pull all proposals except plantations and housing on automatic route.

8. FDI barred sectors—Cap foreign investment at 49 percent for plantations and allow 100 percent FDI in real estate (housing).

a. Recently, a number of measures have been taken to further promote FDI. These include:

9. Raising the foreign ownership cap to 100 percent in most of the sectors.

10. Ending state monopoly in insurance and telecommunications.

11. Opening up of banking and manufacturing to competition


13. Lure of the large market is the main attraction for FDI into India

In the second generation of reforms since 2003 several measures have been taken to further promote of FDI. The drug and pharmaceutical sector, airports, township development, hotels and tourism, courier service and mass rapid transport system are now open to 100 percent FDI. In the telecommunication sector, FDI up to 74 percent has been permitted for internet service providers with gateways, radio paging and end-to-end bandwidth. The foreign investment limit in the banking sector has been increased to 49 percent.

In 2004, guidelines on equity cap on FDI, including investment by NRIs and Overseas Corporate Bodies (OCBs) were revised as under:

1. FDI up to 100 percent 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.

2. FDI up to 100 percent is permitted through automatic route for petroleum product marketing, subject to existing sectoral policy and regulatory framework.

3. FDI up to 100 percent is permitted through automatic route in oil exploration in both small and medium sized field subject to and under the policy of the government on private participation in exploration of oil field and the discovered field of national oil companies.
4. FDI up to 100 percent is permitted through automatic route for petroleum products pipelines subject to and under the government policy and regulations thereof.

5. FDI up to 100 percent is permitted for Natural Gas/LNG pipelines with prior government approval.

In 2004-05 Parliament of India declared that FDI will continue to be encouraged in areas of infrastructure, technology and exports. Thus, in pursuance of government's commitment to further facilitate Indian industry, government has permitted access to FDI through automatic route, except for a small negative list. Latest revisions to further liberalize the FDI regime are as under:

1. Increase in the FDI limit in "Air Transport Services" up to 49 percent through automatic route and up to 100 percent by NRIs through automatic routes.

2. Foreign investment in the banking sector has been further liberalized by raising FDI limit in private sector banks to 74 percent under the automatic route including investment by FIIs. 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 RBI's license criteria will be allowed to hold 100 percent paid up capital to enable them to set up wholly-owned subsidiary in India.

3. FDI ceiling in telecom sector in certain services (such as basic, Public Mobile Radio Trunk Services (PMRTS), Global Mobile Personal Communication (GMPCS), has been increased.

4. And recently in Carrying forward the big-ticket reforms agenda, the government in October 2012 decided to move ahead with its proposal to hike foreign investment ceiling in the insurance sector to 49 per cent. The government also gave green signal to foreign investment in pension funds and allowed 26% FDI in this sector that could go up to 49 per cent, allowing FDI forms a part of the amendments to Pension Fund Regulatory and Development Authority (PFRDA) Bill, approved by the Union Cabinet.
The process of Economic Reforms pre and post 1990s

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<tbody>
<tr>
<td>Allowed selectivity up to 40%</td>
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<tr>
<td>Up to 51% under Automatic Route for priority sectors</td>
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<tr>
<td>Up to 74/51/50% in 111 sectors under Automatic Route 100% in some sectors</td>
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<tr>
<td>Up to 100% under Automatic Route in all sectors except a small negative list</td>
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<tr>
<td>More sectors opened; Equity caps raised; conditions relaxed; Foreign exchange Management</td>
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</table>
5.10 DETERMINANTS AND DETERRENTS OF FDI INFLOWS TO INDIA

5.10.1 Determinants of FDI Inflows to India

The determinant of FDI varies from one country to another due to their unique characteristics and opportunities for the potential investors. In specific the determinants of FDI in India have been divided into internal and external factors viz.

A. Internal Determinants

B. External Determinants

A. Internal Determinants: The eleven types of determinants, belonging to internal factors are listed in Table 5.15.

Table 5.15
Internal Determinants of FDI Inflows in India

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Foreign Investment Policy and Procedure</td>
</tr>
<tr>
<td>2.</td>
<td>Industrial Environment</td>
</tr>
<tr>
<td>3.</td>
<td>Financial Markets in India</td>
</tr>
<tr>
<td>4.</td>
<td>Foreign Exchange Regulation</td>
</tr>
<tr>
<td>5.</td>
<td>Characteristics of Indian Economy</td>
</tr>
<tr>
<td>6.</td>
<td>Signing of MIGA</td>
</tr>
<tr>
<td>7.</td>
<td>Bilateral Agreements</td>
</tr>
<tr>
<td>8.</td>
<td>Socio-cultural Environment</td>
</tr>
<tr>
<td>9.</td>
<td>Fiscal Policy</td>
</tr>
<tr>
<td>10.</td>
<td>Raw Material Availability</td>
</tr>
<tr>
<td>11.</td>
<td>Trade Policy</td>
</tr>
</tbody>
</table>


- Characteristics of Indian Economy: The Characteristics of Indian Economy are identified as the 5th most important macro economic determinant influencing the flow of FDI in India. The ranking of various factors grouped under the characteristic of Indian economy are as following:
- Huge Size of the Indian Market
- Large Size of Middle-Income Class
- Availability of Cheap Labour Force
- Industrial Sector Diversification
- Availability of Skilled Labour
- Availability of Unskilled Labour

- **Signing of Multilateral Investment Guarantee Agency Protocol (MIGA):** This factor is quite highly significant determinant affecting FDI inflow in India. Countrywise significant of this factor is reported to be the highest in USA based firms. Industry wise significance of signing MIGA protocol is shown to be important in food processing industry.

- **Bilateral Agreements:** Bilateral agreements have been identified as the seventh most striking determinants of FDI inflow in India, at the macro level. At the bilateral level, key investment concepts, principals and standards have been developed through the conclusion of treaties for the protection and promotion of FDI.

- **Socio-Cultural Environment in India:** This is the eighth most significant determinant among the internal factors having positive impact on FDI inflow in India. Ranking of these factors in terms of their positive relationship with FDI is as under:

  - Widespread use of English
  - Consumerism
  - Strong Media of Advertisement
  - Demonstration Effect
  - Attitude of Public towards Foreign Investment

- **Fiscal Policy:** Low tax on income derived by foreign companies as dividend, interest, royalty or technical fees is a fiscal incentive, which is a significant determinant of FDI inflow in India.

**B. External Determinants:** External factors have been further categorized under 8 sub-factors. Ranking of these sub-factors having a positive impact on FDI inflow in India is as under Table 5.16.
Table 5.16
External Determinants of FDI Inflows in India

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Market saturation in home country</td>
</tr>
<tr>
<td>2.</td>
<td>Encouragement from home country</td>
</tr>
<tr>
<td>3.</td>
<td>Developing countries welcoming attitude towards FDI</td>
</tr>
<tr>
<td>4.</td>
<td>Use of unused resources</td>
</tr>
<tr>
<td>5.</td>
<td>Competition from other MNCs</td>
</tr>
<tr>
<td>6.</td>
<td>GATT Round</td>
</tr>
<tr>
<td>7.</td>
<td>Restrictions on further expansion in home country</td>
</tr>
<tr>
<td>8.</td>
<td>High research and development expenditure in home country</td>
</tr>
</tbody>
</table>


5.10.2 Deterrents to FDI Inflows in India

The major macroeconomic impediments to FDI inflow in India is as under table 5.17.

Table 5.17
Ranking of Deterrents to FDI Inflows in India

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Foreign Investment Policy and Procedure</td>
</tr>
<tr>
<td>2.</td>
<td>Infrastructure bottlenecks</td>
</tr>
<tr>
<td>3.</td>
<td>High tax rate</td>
</tr>
<tr>
<td>4.</td>
<td>Pro-labor laws or lack of exit policy</td>
</tr>
<tr>
<td>5.</td>
<td>High import tariff</td>
</tr>
<tr>
<td>6.</td>
<td>Political risk</td>
</tr>
<tr>
<td>7.</td>
<td>Weak intellectual property regime</td>
</tr>
<tr>
<td>8.</td>
<td>High rate of interest</td>
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1. **Foreign investment policy and procedure:** Certain drawbacks in the Indian foreign investment policy and procedures are the most important hurdle in the inflow of international direct investment. These drawbacks are lack of transparency in the policy, bureaucratic delays, widespread corruption and policy transparency.

According to Boston Consulting Group, investors find it frustrating to navigate through the tangles of bureaucratic and procedures. McKinsey (2001) found that, the time taken for application/bidding/ approval of FDI projects was too long. Delays in decision-making, due to the multiplicity of agencies, at Central and State levels, the plethora of rules, and the bureaucratic mind-set of the many officials who have to be approached for permissions, was by far the most frequently cited obstacle. The Indian Government must find ways to simplify and speed up decision-making. Consolidation of regulatory agencies for a sector, and "single window" clearance procedures are beginning to improve the situation in India.

2. **Infrastructure Bottlenecks:** At macro level, this is the most significant barrier to FDI inflow to India. Lack of developed infrastructure is a stumbling block in the way of international direct investment in India. Poor infrastructure affects the productivity of the economy as a whole and hence it's GDP/per capita GDP. The condition of the infrastructure not only affects the operations of the business, but tarnishes the image of the country for potential investors in a very tangible way. Infrastructure barriers are as following:

   (i) Power sector problem
   (ii) Non-satisfactory roads and railroads
   (iii) Inadequate port facilities
   (iv) Non-satisfactory conditions of water supply and sewerage system
   (v) Air services

3. **High tax rate:** High tax rates in India have worked in discouraging the inflow of foreign investment in India which consists of following:

   - High corporate tax rate
   - High income tax and excise rate
4. **Pro-labor laws or lack of exit policy:** Pro labour law or lack of exit policy in India is reported as one of the most significant barrier to FDI inflow in India. Foreign investors want that there should be flexibility in the labour market conditions. Large firms in India are not allowed to retrench or layoff workers, or close down the unit without the permission of the state government. While the law was enacted with a view to monitor unfair retrenchment and layoff, in effect it has turned out to be a provision for job security in privately owned large firms. This is very much in line with the job security provided to public sector employees. With regard to labour regulations and hiring and firing practices, India is ranked 55th and 56th respectively in the GCR 1999. Labour-intensive manufacturing exports require competitive and flexible enterprises that can vary their employment according to changes in market demand and changes in technology, so India remains an unattractive base for such production in part because of the continuing obstacles to flexible management of the labour force. Similarly labour laws discourage the entry of green field FDI because of the fear that it would not be possible to downsize if and when there is a downturn in business. Labour laws, rules and procedures have led to deterioration in the work culture and the comparative advantage that is even beginning to be recognized by responsible Trade Unions.

5. **High Import Tariff:** High import tariff in India is the 5th most powerful hurdle in the way of the FDI inflow in India. High import duty increases the cost of production in items where import content is high. Import duty on components and raw material is more than on finished goods. In machine tool sector, the customs duty on finished machine tools is 25 percent. This is less than the import duty on certain raw material used in the manufacture of machine tools such as steel plates which amount to 30 percent. India continued to be one of the most protected markets in Asia (Chulsu Kim, Deputy Director General of WTO). Quantitative restrictions still apply on 30 percent of the items imported into India. According to IMF, the average import tariff in the East Asian Economics is about 12 percent whereas in India it is as high as 20 percent.

6. **Political Risk:** Political risk is reported to be a significant deterrent of FDI inflow in India. Political risk in India has come to occupy the 6th rank. It is a significant barrier to FDI. According to UK investors, there is always the fear of government
back tracking. It may take retrograde steps and send wrong signals to investors. Economic reforms are not yielding fruits because of the Indian bureaucratic system and lack of a pragmatic policy framework. Investor's confidence can be gained only if the system works openly and there is no corruption.

According to UNCTAD (1991, p.2): "political stability is one of the key factors in the policy framework of the government to facilitate FDI in host countries". An uncertain political environment deteriorates the trust as it makes the investor feel insecure (Hakro and Ghumro 2007).

7. **Weak intellectual property regime:** Weak Intellectual Property Regime (IPR) is found to be 7th major macroeconomic barrier to FDI inflow in India. In high technology industries, pharmaceuticals, machinery and electrical equipment, intellectual property regime are of great concern. The world's number one pharmaceutical company, Glaxo Welcome says it is holding back on investment in India because of concerns on IPR. In order to stimulate international investment in R&D intensive industries like pharmaceuticals, it is necessary to provide adequate protection of intellectual property.

8. **High rate of interest:** High rate of interest is cited as the 8th most powerful macroeconomic impediment to FDI inflow to India. High rate of interest raises the cost of financing the projects. The cost of capital in India is a major factor limiting infrastructure financing.

9. **Low investment of Indian Diasporas:** The Indian Diaspora with their lack of business interests have for long opted for the portfolio variety of investments principally bank deposits, the sudden withdrawals of such investments was one of the proximate causes for the economic crisis India experienced in 1991. It is also argued that Indian Diaspora or the non-resident Indians (NRIs) lack the marketing and labour management skills and hence the relatively low levels of NRI investments in India (Guha and Ray, 2000). But then it is also shown that what little NRI investments India has attracted are export oriented, mostly labour-intensive exports such as garments. While in other countries like China, the Chinese Diaspora is business oriented. The opening up of China to trade and investment appears to have provided the Chinese
Diaspora the opportunity to extend and or shift their business interests to the mother country to take advantage of relatively low cost labour and land. This could be one of the reasons for the relatively low volumes of FDI in India.

10. Limited scale of export processing zones: India’s export processing zones have lacked dynamism because of several reasons, such as their relatively limited scale; the Government’s general ambivalence about attracting FDI; the unclear and changing incentive packages attached to the zones; and the power of the central government in the regulation of the zones, in comparison with the major responsibility of local and provincial government in China. Ironically, while India established her first EPZ in 1965 compared with China’s initial efforts in 1980, the Indian EPZs never seemed to take off either in attracting investment or in promoting exports.

11. Financial sector reforms: Reform of India’s financial sector is crucial for large FDI flows into India. However, only some partial steps have been undertaken and these are by no means going to make any meaningful changes to the existing system. India’s banking and insurance companies were nationalized more than two decades ago. While a number of countries had undertaken such actions in the 1970s and early 1980s, for instance Mexico, France, and Chile, however, they have almost completely reversed this policy by now. But, India still continues to rely on a state-owned, state-run banking system and the insurance sector till very recently remained a government monopoly. This as one would expect has had highly adverse results, both in terms of availability of funds for investment and a negligible presence of foreign banks and foreign insurance companies in the country.

12. High corporate tax rates: Corporate tax rates in East Asia are generally in the range of 15 to 30 percent, compared with a rate of 48 percent for foreign companies in India. High corporate tax rate is definitely a major disincentive to foreign corporate investment in India. With respect to tax evasion, India is ranked 48th in the GCR 1999.

13. Lack of decision-making authority with the state governments: The reform process so far has mainly concentrated at the central level. India has yet to free up its state governments sufficiently so that they can add much greater dynamism to the reforms. In most key infrastructure areas, the central government remains in control or
at least with veto over state actions. Greater freedom to the states will help foster greater competition among themselves. The state governments in India need to be viewed as potential agents of rapid and salutary change.

14. No liberalization in exit barriers: While the reforms implemented so far have helped remove the entry barriers, the liberalization of exit barriers has yet to take place. This is a major deterrent to large volumes of FDI flowing to India. An exit policy needs to be formulated such that firms can enter and exit freely from the market. While it would be incorrect to ignore the need and potential merit of certain safeguards, it is also important to recognize that safeguards if wrongly designed and/or poorly enforced would turn into barriers that may adversely affect the health of the firm. The regulatory framework, which is in place, does not allow the firms to undertake restructuring.