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**LIBERALISATION OF INDIAN FOREIGN DIRECT
INVESTMENT POLICY: 1991–2006**

Introduction

During 1990–1991 India faced economic crisis. Prelude to this crisis was the economic policy of the eighties – higher growth rate was accompanied by higher fiscal deficit, rising current account deficit and larger external debt. However, it was the external and domestic convulsions – the collapse of Soviet block, Iraq-Kuwait war and political instability – which were the direct reasons of this crisis. As a result, India had received external financial aid and deep, structural economic reforms were conducted, whereas Foreign Direct Investment Policy¹ was one of the most significant areas of the reforms.

The purpose of this study is to show the reforms of Indian FDI Policy in the years 1991–2006 and to verify the argument that FDI Policy reforms in India resulted in increase of FDI inflows to this country during the years 1991–2005.

So far, neither the issues of Indian economy nor this country's FDI reforms have been the subject to detailed studies in Poland. This fact, as well as the author's personal interest in Indian economy have been the reasons, for which this study has been written.

In the first part of this study the history of FDI in India has been described, divided into two periods: colonial era and centrally planned economy period. Next, the reforms of FDI regime during period 1991–2005 and FDI regime in 2006 have been characterized. In the last chapter, developing of FDI inflows into India and its structure has been presented. Finally, summary conclusions have been made.

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¹ For “Foreign Direct Investment” the author has been used in this study the abbreviation “FDI”.

1. History of FDI in India

1.1. Colonial era

During the years 1760–1858 India was settled by the British. That was the beginning of more than a hundred years dominance of the United Kingdom on the Indian Peninsula². India was a stable colony with abundant natural and mineral resources. During this era country's economy was based on agriculture. The main commercial goods manufactured during this time were cotton, tea and jute. There wasn't specific industrial policy in the country before the end of First World War. At that time, as well as in the other countries, there were few barriers in FDI policy in India³.

India has been a host country to FDI since eighteenth century. Until the year 1918, FDI in India had been totally dominated by the British companies. First FDI was made in 1767 in textile industry by Scottish Forbes Gokak Company. In 1774 Summer & Heathy had opened first coal mine in Bengal, closed a few years later, because of the British East India Company's government preferences to use imported coal. However, only forty years later a few British companies started to exploit coal mines in Burdwan. In 1843 these companies united in Coal Producing Company in India. The key British investment which took place in the mid-nineteenth century was Indian Railways. Tolls were supposed to become the essential source of income for the British East India Company (Kieniewicz 2003; 503).

There were about 204 British managing agents and a few manufacturing companies from the UK, Switzerland, the Netherlands, Germany, USA and Japan engaged in trading and manufacturing activities at the beginning of the twentieth century. The managing agents were large companies, owing up to 15-20 smaller companies operating in many business areas such as tea, jute, sugar, coal, timber, paper, insurance, shipping, indigo, etc. There were about 11 manufacturing companies from the UK, Europe, USA and Japan which traded their products in India. Many of the British manufacturing companies like Unilever, ITC, Glaxo, ICI, GEC, Goodlass Nerolac, and Britannia Biscuits traded

² More about Indian history: (Kieniewicz 2003).

³ More about FDI history in India: (Nayak 2006)

their goods in India by importing from their mother companies (Nayak 2006; 6).

After the First World War, while the United Kingdom became vulnerable, USA and Japan emerged as powerful nations. American and Japanese companies entered in widely into the Indian market. This resulted in a new composition of foreign investment in India. In fact, this period marked the beginning of FDI in India. During this period trade and investment from the USA increased in India. Among the American companies, the most known ones that started their operation in India were General Motors (1928), Ford Motors (1930), and Colgate Palmolive (1937). Trade investments from Japan also increased during this period. By 1928, Japan emerged as one of the largest cotton trading partner of India. However, British business interests remained as strong as ever. (Nayak 2006; 7-8).

In 1935, under local and international pressures, the British Government in India passed the Government of India Act. This Act allowed the Indian legislators to voice their concern and to lobby on behalf of Indian businesses. The local businessmen and politicians strongly insisted on the British Government in India to introduce import duties on goods imported to India in order to protect the local industries. This forced the foreign companies to make direct investments in manufacturing their products in India. Many of the companies that were engaged in trading activities started to invest in local manufacturing in the thirties. As a consequence, this fact resulted in significant development of FDI and it was a real beginning of FDI in the Indian manufacturing industries.

1.2. Centrally planned economy period

After India became politically independent on 15th August 1947, the Government of India (GOI) faced many problems. Economic and industrial development of India was one of the major tasks but the method to achieve it was very controversial. In 1948, the Industrial Policy Resolution was introduced. It outlined the approach to industrial growth and development and emphasised the importance of securing a continuous production increase and its equitable distribution to the country's economy. After the adoption of the Constitution and the socio-economic goals, the Industrial Policy was comprehensively revised and finally adopted in 1956. This Resolution had as its objective "the acceleration of the rate of economic growth and the speeding up of industrialisation as a means

of achieving a socialist pattern of society". It gave primacy to the role of the State to assume a predominant and direct responsibility for industrial development⁴.

First of all, the GOI nationalized many companies in some industries, which were considered strategic for the country, such as power, oil and petroleum, mining, banking, insurance, and airlines. Then it adopted the Five-Year Plan method to improve the economic and industrial condition of the country. Further, to strengthen the public sector companies, the GOI sought the financial and technical support of Russia, Germany and the United Kingdom. This political program was formulated by J. Nehru, the prime minister of the GOI and the leader of Indian National Congress. The GOI introduced a dual policy, splitting business activities in the country into state and private ones. In areas like steel, oil, power, defence, and telecommunications, the public sector companies were promoted by the GOI. In areas like chemicals, light industries, personal care and consumer goods, the private sector investments were encouraged.

To enhance its developmental activities, the GOI also informally started asking the large foreign and domestic companies in India to take up some of the development work of the GOI by investing in industries that it could not undertake. Foreign companies like Glaxo, Unilever, ICI, General Motors, Ford Motors, Pepsi Drinks, etc. were informally asked to invest in new ventures and at the same time to include local equity in their businesses in India. Some foreign companies undertook the developmental role in India. Many others quitted India during this period, e.g. General Motors, Ford Motors, and Pepsi Drinks (Nayak 2006; 12-13). The policies of the GOI to nationalize companies in certain industries and the informal pressures of the GOI on foreign companies to increase local equity participation in India reduced the FDI flow into India during the fifties.

In the mid-sixties there was the beginning of another important phase in the history of FDI in India. While in the fifties, the GOI had begun to informally suggest the foreign companies to include Indian equity in their companies, during the sixties and in first years of the seventies these issues were formalized through the legislation of the Monopolies and Restrictive Policy Act (MRTPA) in 1969 and Foreign Exchange Regulation Act (FERA) in 1973. Foreign companies were the

⁴ See: GOI, Ministry of Industry, *Industrial Policy Resolution*, 30 April 1956.

subjects of both of the acts. Officially, main objectives of the MRTPA were as follows: the principal prevention of concentration of economic power to the common detriment, control of monopolies, and prohibition of monopolistic and restrictive and unfair trade practices. But in fact, MRTPA restricted companies on the size of operation and the pricing of products and services. With MRTPA and FERA there were changes in industrial policy. The Industrial Policy Resolution 1973 identified high-priority industries where investment from large industrial houses and foreign companies would be permitted⁵. As a result, many companies which did not want to increase equity participation of Indians decided to cease their operations in India (e.g. Coca Cola, IBM).

The year 1978 marked another new phase in the history of FDI in India. Some liberalisation of Import-Export Policy and few changes in FDI Policy were introduced at the end of seventies and during eighties. In the Industrial Policy Resolution 1977, the GOI announced the relaxation in remittances of profits, royalties, dividends and repatriation of capital of foreign companies⁶. Further, the GOI in Industrial Policy Statement 1980 set the tone of liberalisation in India in a slow but steady pace⁷. Industrial Licensing was streamlined and made easier to obtain. Provisions in MRTPA (1969) were modified to simplify business transactions. Export and Import norms were also changed to encourage FDI in India. These changes of FDI Policy and Import-Export Policy during the eighties had caused some effects on FDI development. The number of foreign companies and joint ventures that were registered in India increased. The amount of FDI also rose, but these effects weren't significant (see third chapter of this study Figure 2).

2. Liberalisation of FDI regime: 1991-2006

2.1. Changes of FDI regulations: 1991-2005

The changes in economic policy during the nineties were followed by deep economic and political crises. The crisis hit India in the year 1990, but its real reason can be found in preceding decade. The period from mid-1989 to mid-1991 was packed with series of political developments, one following another. The break-up of the Soviet Union and the unifica-

⁵ More: GOI, Ministry of Industry, *Industrial Policy Resolution*, 2 February 1973.

⁶ More: GOI, Ministry of Industry, *Industrial Policy Resolution*, 23 December 1977.

⁷ More: GOI, Ministry of Industry, *Statement on Industrial Policy*, 23 July 1980.

tion of Germany followed the policy of Glasnost⁸. Iraq invasion on Kuwait set off another oil shock. Domestically there were three changes of government and unprecedented socio-political upheaval. Underlying macroeconomic imbalances that had been building up over the eighties came to a head as a result of these shocks and, along with the inadequate policy response, resulted in a balance of payments crisis in 1990-1991⁹.

In mid-1991, in view of the new economic situation in India and in the world, new Government under the leadership N. Rao (Congress) as the Prime Minister, had decided to take a series of measures to unshackle the Indian industrial economy from the cobwebs of unnecessary bureaucratic control. These measures were complemented by other series of measures being taken by the GOI in the areas of trade policy, exchange rate management, fiscal policy, financial sector reform and overall macro economic management.

The GOI had decided to take a series of initiatives concerning industrial policies related to the following areas: Industrial Licensing, Foreign Investment, Foreign Technology Agreements, Public Sector Policy and MRTP Act. On 24th of July 1991, new Statement on Industrial Policy (SIP) was announced¹⁰.

The GOI observed that, in view of the significant changes which had taken place in the world industrial economy, the relationship between domestic and foreign industry needed to be much more dynamic than it had been in the past, in terms of both technology and investment. The GOI assumed that foreign investment would bring advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. This was particularly necessary in the changing global scenario of industrial and economic cooperation marked by mobility of capital. Therefore, the GOI welcomed FDI which was in the interest of the country's industrial development. In order to encourage foreign investment in high priority industries, requiring large investments and advanced technology, it was decided to provide approval for FDI up to 51% foreign equity in such

⁸ The term of "glasnost" was one of Mikhail Gorbachev's policies introduced to the Soviet Union in 1985. The term is a Russian word for "transparency", "openness".

⁹ More about Indian economic crisis during 1990-1991: (Virmani, 2001).

¹⁰ The first Industrial Policy Resolution was introduced in 1948 and it was modified through statements in 1956, 1973, 1977 and 1980. See previous chapter of this study. More about assumption of new Industrial Policy: *Statement on Industrial Policy*, Government of India – Ministry of Industry, New Delhi, 24th July 1991.

industries. Prior to that, it was 40%. This group of industries had generally been known as “Annex III” or “high-priority industries”¹¹. These industries were generally in areas in which FERA companies had already been allowed to invest on a discretionary basis. The GOI wished that there wouldn’t be any bottlenecks of any kind in investing process. In SIP 1991, there was also declaration that:

- clearance for approval (up to 51% percent foreign equity in high priority industries) would be available if foreign equity covers the foreign exchange requirement for imported capital goods. Consequential amendments to the FERA (1973) would be carried out;
- while the import of components, raw materials and intermediate goods, and payment of know how fees and royalties would be governed by the general policy applicable to other domestic units, the payment of dividends would be monitored through the Reserve Bank of India (RBI) so as to ensure that outflows on account of dividend payments would be balanced by export earnings over a period of time;
- other foreign equity proposals, including proposals involving 51% foreign equity, which do not meet the criteria under above, would continue to need prior clearance¹². Foreign equity proposals wouldn’t need necessarily be accompanied by foreign technology agreements;
- to provide access to international markets, majority foreign equity holding up to 51% equity would be allowed for trading companies primarily engaged in export activities. While the thrust would be on export activities, such trading houses would be at par with domestic trading and export houses in accordance with Import-Export Policy;
- a special empowered board would be constituted to negotiate with a number of large international firms and approve direct

¹¹ For the complete list of these 34 high-priority sectors see: *Statement on Industrial Policy*, Government of India – Ministry of Industry, New Delhi, 24th July 1991, Annex III.

¹² For FDI or technology import, which required the Government approval, there was created a new institution – Foreign Investment Promotion Board (FIPB), which aim was to improve the process of investment approvals. This route has been functioning up to these days.

foreign investment in select areas. This would be a special programme to attract substantial investment that would provide access to high technology and world markets. The investment programmes of such firms would be considered in totality, free from pre-determined parameters or procedures.

Next month after announced new Industrial Policy, two new documents detailing SIP 1991 in FDI area were published. First document applied to Foreign Technology Agreement described procedure and list of industries for automatic approval of foreign technology agreements and for 51% foreign equity approvals. Under this document, automatic permission had been given for foreign technology agreements in 35 high-priority industries (described in Annex III of this document) up to a lump sum payment of 10 millions INR, 5% royalty for domestic sales and 8% for exports, subject to total payments of 8% of sales over a 10 year period from date of agreement or 7 years from commencement of production. The prescribed royalty rates were net of taxes and had been calculated according to standard procedures. In respect of industries other than that high-priority, automatic permission had been given subject to the same guidelines as above if no free foreign exchange was required for any payments. All other proposals needed specific approval under the general procedures in force. Moreover, for hiring of foreign technicians, foreign testing of indigenously developed technologies didn't require permission¹³. Second document referred changes in procedures for foreign investment approvals: procedure approvals for FDI up to 51% equity capital and dividend balancing conditions¹⁴.

In November 1991, the GOI allowed the increase in foreign equity to 51% in existing companies and introduced special procedure for it¹⁵. In the same month, there was announced clarification on 'Hotels' & 'Tourism related Industry' and criteria for automatic approval for foreign technology agreement in Hotel Industry¹⁶. In December, the same year, revision of application form for foreign investments/foreign technology agreements¹⁷ and changes in procedures in respect of foreign technology

¹³ More: GOI, MCI, DIPP, Press Note No.10 (1991 series) dated 14.08.1991.

¹⁴ More: GOI, MCI, DIPP, Press Note No.11 (1991 series) dated 20.08.1991.

¹⁵ More: GOI, MCI, DIPP, Press Note No.17 (1991 series) dated 19.11.1991.

¹⁶ More: GOI, MCI, DIPP, Press Note No.18 (1991 series) dated 25.11.1991.

¹⁷ More: GOI, MCI, DIPP, Press Note No.20 (1991 series) dated 13.12.1991.

agreement/foreign investment were made¹⁸. Last day of the year, new procedure of foreign investment up to 51% in trading companies primarily engaged in export activities was introduced¹⁹.

In April 1992, the “Software Industry” was added to list for automatic approval (Foreign Investment and Foreign Collaboration Agreement)²⁰. In June 1992, another revision of items for automatic approval of foreign technology agreement and for 51% foreign equity approvals was made²¹. In the same month, conditions regarding “Dividend Balancing” in all foreign investment approvals (except for industries in the consumer goods sector) and investments by approved international organizations were withdrawn²². In June 1992, procedures for raising of foreign equity up to 51% in existing companies were revised²³.

In January 1993, there were changes in area of fertilizers: abolition of the Special Committee on Fertilizers projects²⁴.

Next change in FDI area was in June 1994, when in relation to approvals for raising foreign equity in existing companies, guidelines for determining issue price of preferential shares were revised²⁵. In October, policy for granting licences and approvals for foreign investments/foreign technology agreements for drugs and pharmaceuticals industry was modified²⁶. In April 1995, revised guidelines issued on 3rd June 1994 for determining issue price of preferential shares was published²⁷.

In November 1996, further liberalisation in parameters (foreign exchange requirements for import of CG and condition of plant & machinery) of automatic approval in foreign equity and foreign technology collaborations was introduced²⁸.

In January 1997, expansion of list of industries for automatic approval for foreign equity was announced. It had been decided to include 3

¹⁸ More: GOI, MCI, DIPP, Press Note No.21 (1991 series) dated 15.12.1991.

¹⁹ More: GOI, MCI, DIPP, Press Note No.23 (1991 series) dated 31.12.1991.

²⁰ More: GOI, MCI, DIPP, Press Note No.5 (1992 series) dated 22.04.1992.

²¹ More: GOI, MCI, DIPP, Press Note No.10 (1992 series) dated 24.06.1992.

²² More: GOI, MCI, DIPP, Press Note No.12 (1992 series) dated 26.06.1992.

²³ More: GOI, MCI, DIPP, Press Note No.13 (1992 series) dated 29.06.1992.

²⁴ More: GOI, MCI, DIPP, Press Note No.1 (1993 series) dated 08.01.1993.

²⁵ More: GOI, MCI, DIPP, Press Note No.2 (1994 series) dated 03.06.1994.

²⁶ More: GOI, MCI, DIPP, Press Note No.4 (1994 series) dated 25.10.1994.

²⁷ More: GOI, MCI, DIPP, Press Note No.2 (1995 series) dated 10.04.1995.

²⁸ More: GOI, MCI, DIPP, Press Note No.4 (1996 series) dated 05.11.1996.

categories of industries/items relating to mining activities for foreign equity up to 50%, 13 additional categories of industries/items for foreign equity up to 51% and 9 categories of industries equity up to 74% in the list of industries/items eligible for automatic approval by the RBI. These industries were a supplement to the existed list of 35 industries (under Annex-III of the Industrial Policy) which qualify for automatic approval²⁹. The same month, guidelines for consideration of FDI proposals by the FIPB were introduced³⁰. In April 1997, changes in guidelines prescribed for consideration of FDI proposals by FIPB in respect of Non-banking financial Services Sector were introduced³¹. In September 1997, “Forex Broking” was included in the permitted list of Non-Banking Finance Companies (NBFC) activities opened for FDI³². In October 1997, consolidated list of industries/items for automatic approval for foreign equity up to 50%, 51% and 74% was revised³³.

In June 1998, for automatic approval for 100% foreign equity FDI (74% prior to that) for electric generation, transmission and distribution in Power Sector (Hydro-electric and coal/lignite/oil/gas based Thermal Power Plants) were allowed³⁴. In August 1998, “Credit Card Business” and “Money Changing Business” were included in the permitted list of NBFC activities for FDI³⁵. In the same month, there was a revision in guidelines for consideration of FDI proposals by FIPB for FDI up to 100% in Cigarette Industry³⁶. In September 1998, FDI in Banking Sector was allowed. This document describes permissible limit of FDI and clarification of procedure³⁷. In October 1998, FDI for licenced companies operating Global Mobile Personal Communication by Satellite (GMPCS) services were allowed³⁸. In November 1998, there was a revision in guidelines for FDI proposals for purely financial consultancy services that were non-fund based. This document introduced minimum capitali-

²⁹ More: GOI, MCI, DIPP, Press Note No.2 (1997 series) dated 17.01.1997.

³⁰ More: GOI, MCI, DIPP, Press Note No.3 (1997 series) dated 17.01.1997.

³¹ More: GOI, MCI, DIPP, Press Note No.4 (1997 series) dated 30.04.1997.

³² More: GOI, MCI, DIPP, Press Note No.13 (1997 series) dated 05.09.1997.

³³ More: GOI, MCI, DIPP, Press Note No.14 (1997 series) dated 08.10.1997.

³⁴ More: GOI, MCI, DIPP, Press Note No.2 (1998 series) dated 13.06.1998.

³⁵ More: GOI, MCI, DIPP, Press Note No.8 (1998 series) dated 05.08.1998.

³⁶ More: GOI, MCI, DIPP, Press Note No.11 (1998 series) dated 27.08.1998.

³⁷ More: GOI, MCI, DIPP, Press Note No.13 (1998 series) dated 01.09.1998.

³⁸ More: GOI, MCI, DIPP, Press Note No.15 (1998 series) dated 15.10.1998.

zation norms³⁹. In December 1998, guidelines pertaining to approval of foreign/technical collaboration under the automatic route with previous ventures/tie-ups in India were introduced⁴⁰.

In January 1999, there was a revision of guidelines for automatic approval for foreign equity for construction and maintenance of rail beds, non-vehicular bridges, non-vehicular tunnels, ropeways and runways⁴¹. In March 1999, a reduction in timeframe for consideration FDI proposals by FIPB was conducted⁴². In April 1999, a clarification of condition of dividend balancing was done⁴³. In the same month, there was a simplification of procedure of increase in the amount of foreign equity as a result of financial restructuring without any change in the percentage of foreign equity⁴⁴. There were also changes in policy relating to the standard conditions applicable to foreign owned Indian holding companies requiring prior and specific approval of FIPB/Government for downstream investment in Annexure III activities, which qualify for automatic approval⁴⁵. Last change in April 1999 applied to guidelines pertaining to approval of foreign/technical collaborations under the automatic route with previous ventures/ tie-ups in India⁴⁶. In July 1999, a clarification in activities being undertaken by 100% foreign owned NBFCs was introduced⁴⁷. The same month, there was a revision of norms for FDI in NBFCs which are purely financial consultancy services that are Non-fund based⁴⁸. In August 1999, there was setting of Foreign Investment Implementation Authority (FIIA) for quick translation of FDI approvals and implementations⁴⁹. Besides, there was launched special mailbox facility at SIA website (siaapplication@ub.nic.in) for registration of applications to FIPB, which improved investing process⁵⁰. In November 1999, a clarification of regulation to minimum capitalization form for

³⁹ More: GOI, MCI, DIPP, Press Note No.16 (1998 series) dated 03.11.1998.

⁴⁰ More: GOI, MCI, DIPP, Press Note No.18 (1998 series) dated 14.12.1998.

⁴¹ More: GOI, MCI, DIPP, Press Note No.1 (1999 series) dated 04.01.1999.

⁴² More: GOI, MCI, DIPP, Press Note No.5 (1999 series) dated 19.03.1999.

⁴³ More: GOI, MCI, DIPP, Press Note No.6 (1999 series) dated 01.04.1999.

⁴⁴ More: GOI, MCI, DIPP, Press Note No.7 (1999 series) dated 01.04.1999.

⁴⁵ More: GOI, MCI, DIPP, Press Note No.9 (1999 series) dated 12.04.1999.

⁴⁶ More: GOI, MCI, DIPP, Press Note No.10 (1999 series) dated 12.04.1999.

⁴⁷ More: GOI, MCI, DIPP, Press Note No.11 (1999 series) dated 01.07.1999.

⁴⁸ More: GOI, MCI, DIPP, Press Note No.12 (1999 series) dated 01.07.1999.

⁴⁹ More: GOI, MCI, DIPP, Press Release dated 16.08.1999.

⁵⁰ More: GOI, MCI, DIPP, Press Release dated 17.08.1999.

all permitted non-fund based NBFCs with foreign investment was introduced⁵¹.

In February 2000, there was a significant expansion of list of industries/activities eligible for automatic route for FDI, Non-Resident Indian (NRI) and Overseas Corporate Bodies (OCB) investment. Long list of “high-priorities” industries was replaced by short list of limited FDI industries. The GOI, on review of the policy on FDI, had decided to place all items/activities under the automatic route for FDI/NRI and OCB investment except the following: all proposals that require an Industrial Licence which included the item requiring an Industrial Licence under the Industries (Development and Regulation) Act 1951, foreign investment consisting of more than 24% in the equity capital of units manufacturing items reserved for small scale industries, and all items which require an Industrial Licence in terms of the locational policy notified by the GOI under the New Industrial Policy of 1991⁵²; all proposals in which the foreign collaborator has a previous venture/tie-up in India; all proposals relating to acquisition of shares in an existing Indian company in favour of a foreign/NRI/OCB investor; all proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not allowed and/or whenever any investor chooses to file an application to the FIPB and not to avail of the automatic route. All proposals for investment in public sector units as also for export oriented units were qualified for automatic route subject to the above parameters⁵³.

In March 2000, regulation applied to FDI in the NBFCs acting as holding company was introduced. This document described condition of disinvestment of equity in their 100% downstream subsidiaries⁵⁴. In July 2000, there was the next review of existing sectoral policy and sectoral equity cap for FDI and NRIs/OCBs investments⁵⁵. In August 2000, there were guidelines for simplifying the approval procedures

⁵¹ More: GOI, MCI, DIPP, Press Note No.14 (1999 series) dated 15.11.1999.

⁵² In locations other than cities of more than 1 million population, there was no requirement of obtaining industrial approvals from the GOI, except for industries subject to compulsory licensing. As for as cities with population greater than 1 million are concerned, industries other than those of a non polluting nature such as electronics, computer software and printing had to be located outside 25 km of the periphery, except in previously designated industrial areas.

⁵³ More: GOI, MCI, DIPP, Press Note No.2 (2000 series) dated 11.02.2000.

⁵⁴ More: GOI, MCI, DIPP, Press Note No.6 (2000 series) dated 31.03.2000.

⁵⁵ More: GOI, MCI, DIPP, Press Note No.7 (2000 series) dated 14.07.2000.

under the automatic route for all FDI proposals concerning the IT sector⁵⁶. In September and October 2000, there were reviews of existing sectoral policy and sectoral equity cap for FDI and investment by NRIs/OCBs⁵⁷.

In January 2001, there were guidelines pertaining to the approval of foreign/technical collaborations under the automatic route with previous venture/tie-up in India concerning foreign investment agreements⁵⁸. In May 2001, there was the next revision of existing sectoral guidelines and equity cap on FDI, including investments by NRIs and OCBs⁵⁹.

In January 2002, guidelines for FDI in development of integrated township, including housing and building materials were introduced⁶⁰. In March 2002, a revision of existing sectoral guidelines for FDI, including investment by NRIs and OCBs in advertising and film sector, was announced⁶¹. In July 2002, complete prohibition on foreign investment and foreign technology collaboration in any form in lottery business, gambling and betting was introduced⁶². In the same month, there was a revision of existing sectoral guidelines for FDI, including investments by NRIs and OCBs in agriculture sector⁶³ and liberalisation of policy applied to capitalization of import payables (issue of shares against lump sum fee, royalty and External Commercial Borrowings)⁶⁴.

In November 2003, a liberalisation of shares against External Commercial Borrowings was done⁶⁵.

In January 2004, a revision of existing sectoral guidelines and equity cap FDI, including investments by NRIs and OCBs was published⁶⁶. In March 2004, a revision of existing sectoral guidelines and equity cap on FDI, including investment by NRIs, OCBs and foreign international arrangements in the Banking Sector, were announced⁶⁷.

⁵⁶ More: GOI, MCI, DIPP, Press Note No.8 (2000 series) dated 29.08.2000.

⁵⁷ More: GOI, MCI, DIPP, Press Note No.9 (2000 series) dated 08.09.2000; GOI, MCI, DIPP, Press Note No.10 (2000 series) dated 19.10.2000.

⁵⁸ More: GOI, MCI, DIPP, Press Note No.1 (2001 series) dated 02.01.2001.

⁵⁹ More: GOI, MCI, DIPP, Press Note No.4 (2001 series) dated 21.05.2001.

⁶⁰ More: GOI, MCI, DIPP, Press Note No.3 (2002 series) dated 04.01.2002.

⁶¹ More: GOI, MCI, DIPP, Press Note No.4 (2002 series) dated 27.03.2002.

⁶² More: GOI, MCI, DIPP, Press Note No.5 (2002 series) dated 05.07.2002.

⁶³ More: GOI, MCI, DIPP, Press Note No.6 (2002 series) dated 05.07.2002.

⁶⁴ More: GOI, MCI, DIPP, Press Note No.3 (2003 series) dated 29.07.2003.

⁶⁵ More: GOI, MCI, DIPP, Press Note No.5 (2003 series) dated 28.11.2003.

⁶⁶ More: GOI, MCI, DIPP, Press Note No.1 (2004 series) dated 28.01.2004.

⁶⁷ More: GOI, MCI, DIPP, Press Note No.2 (2004 series) dated 05.03.2004.

In January 2005, guidelines pertaining to approval of foreign/technical collaborations under the automatic route with previous ventures/tie-up in India were introduced⁶⁸. In March 2005, changes in FDI Policy in townships, housing, built-up infrastructure and construction development projects were announced⁶⁹. In the same month, a clarification regarding guidelines pertaining to approval of foreign/technical collaborations under the automatic route with previous ventures/tie-ups in India was notified⁷⁰. In November 2005, a clarification pertaining to conversion of NRI investment into repatriable equity was published⁷¹. In the same month, the enhancement of the FDI ceiling from 49 per cent to 74 per cent in the Telecom Sector⁷² and changes relating to FDI in Terrestrial Broadcasting FM were introduced⁷³.

In January 2006, there was a change in FDI Policy in Up-linking of TV Channels⁷⁴. In the same month, a clarification regarding FDI in townships, housing, built-up infrastructure and construction-development projects was introduced⁷⁵. In February 2006, guidelines for FDI in Retail Trade of ‘Single Brand’ Products⁷⁶ and overall rationalisation of the FDI Policy were announced⁷⁷. In March 2006, the increase of FDI ceiling from 49% to 74% in the Telecom Sector was announced⁷⁸.

Summing up, within fifteen years of liberalisation in FDI Policy in India, there were three turning points. The first one in 1991/1992⁷⁹, when regulation allowing up to 51% FDI under automatic route was introduced. The second one in 1997/1998, when regulation allowing higher than 51% FDI was announced and number of industries allowing FDI under automatic route increased. And Finally in 2000/2001, when a long list of “high-priority” industries was replaced by the short list of limited FDI industries and regulation allowing up to 100% FDI

⁶⁸ More: GOI, MCI, DIPP, Press Note No. 1 (2005 Series) dated 12.01.2005.

⁶⁹ More: GOI, MCI, DIPP, Press Note No. 2 (2005 Series) dated 3.03.2005.

⁷⁰ More: GOI, MCI, DIPP, Press Note No. 3 (2005 Series) dated 15.03.2005.

⁷¹ More: GOI, MCI, DIPP, Press Note No. 4 (2005 Series) dated 31.08.2005.

⁷² More: GOI, MCI, DIPP, Press Note No. 5 (2005 Series) dated 3.10.2005.

⁷³ More: GOI, MCI, DIPP, Press Note No. 6 (2005 Series) dated 15.10.2005.

⁷⁴ More: GOI, MCI, DIPP, Press Note No. 1 (2006 Series) dated 13.01.2006.

⁷⁵ More: GOI, MCI, DIPP, Press Note No. 2 (2006 Series) dated 16.01.2006.

⁷⁶ More: GOI, MCI, DIPP, Press Note No. 3 (2006 Series) dated 10.02.2006.

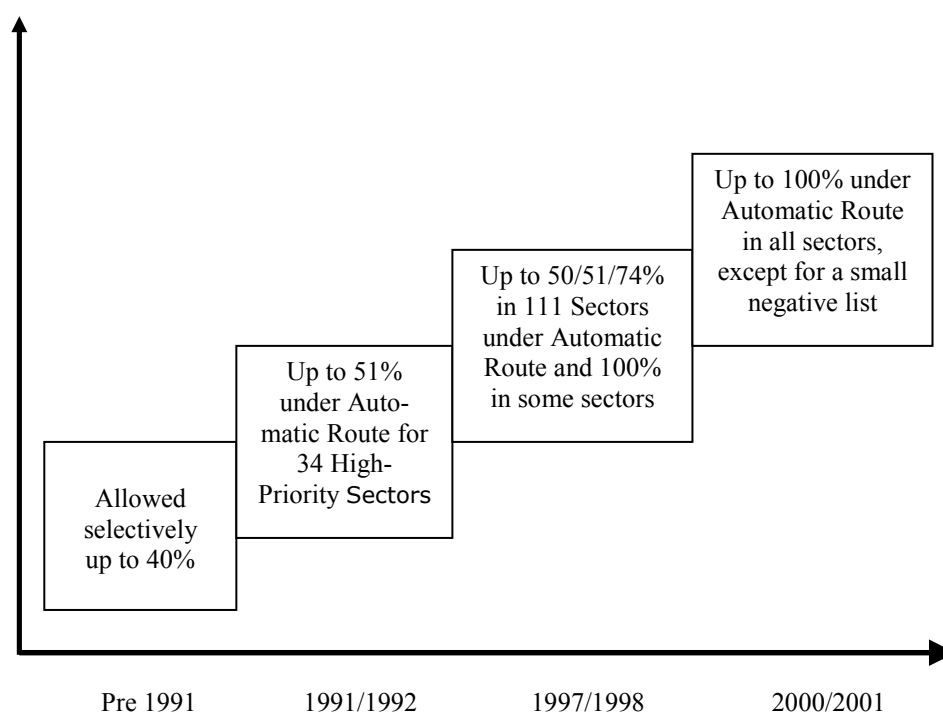
⁷⁷ More: GOI, MCI, DIPP, Press Note No. 4 (2006 Series) dated 10.02.2006.

⁷⁸ GOI, MCI, DIPP, Press Note No. 5 (2006 Series) dated 3.03.2006.

⁷⁹ Financial year in India last from 1 April do 31 March.

in a lots of industries was introduced. Figure 1 shows liberalisation measures in FDI Policy during 1991-2005 in India.

Figure 1. Stages of FDI policy liberalisation in India: 1991-2005



Source: own elaboration on the basis of research.

2.2. FDI policy and procedures in the year 2006

After 15 years of changes, FDI framework in India is similar to other developing countries with open economy. In the 2006 policy, FDI up to 100% are allowed, under the automatic route, in most activities, especially in manufacturing. Sectors prohibited for FDI are: retail trading (except “single brand” product retailing), nuclear energy, lottery business, gambling and betting. There are also some FDI limit restrictions, generally in services, e.g. in green-field airports the limit is 100% for FDI under automatic route, but in existing projects beyond 74% under FIPB route; in air transport the limit is 49% for FDI and 100% for NRI’s investment, both under automatic route; in banking private sector the limit

is 74% under automatic route; in broadcasting the limit for FM radio is 20% under FIPB route, for cable network is 49% under FIPB route, for Direct-To-Home is 49% under FIPB route, etc⁸⁰.

All activities require prior Government approval for FDI in cases, where the foreign investor has an existing joint venture or technology transfer/trademark agreement in the same field, or where more than 24% foreign equity is proposed to be inducted for manufacture of items reserved for the Small Scale sector. But even in cases where the foreign investor has a joint venture or technology transfer/trademark agreement in the same field, prior approval of the Government will not be required in the following cases: investments to be made by Venture Capital Funds registered with the Security and Exchange Board of India (SEBI); or where in the existing joint-venture investment by either of the parties is less than 3%; or where the existing venture/collaboration is defunct or sick.

FDI under the automatic route does not require prior acceptance either by the GOI or the RBI. Investors are only required to notify the concerned regional office of the RBI within 30 days of receipt of inward remittances and file required documents with that office within 30 days of issue of shares to foreign investors.

Under the Government approval route, applications for FDI proposals, other than by Non-Resident Indians (NRI), and proposals for FDI in 'Single Brand' product retailing, are received in the Ministry of Finance, Department of Economic Affairs. Proposals for FDI in "Single Brand" product retailing and by NRIs are received in the Ministry of Commerce and Industry, Department of Industrial Policy and Promotion. Applications can be submitted either in the prescribed pro-forma FC-IL form, or on plain paper with a check list⁸¹.

Foreign investments in equity capital of an Indian company under the Portfolio Investment Scheme are not within the ambit of FDI Policy and are governed by separate regulations of the RBI and the SEBI.

Foreign investors intending to set up Branch/Liaison/Project Offices⁸² would also be governed by specific Regulations under Foreign

⁸⁰ For complete list of FDI limit in 2006, see: GOI, Ministry of Commerce and Industry, Department of Industrial Policy & Promotion, *Foreign Direct Investment Policy – April 2006*, New Delhi 2006.

⁸¹ This list is available on the DIPP website: www.dipp.gov.in.

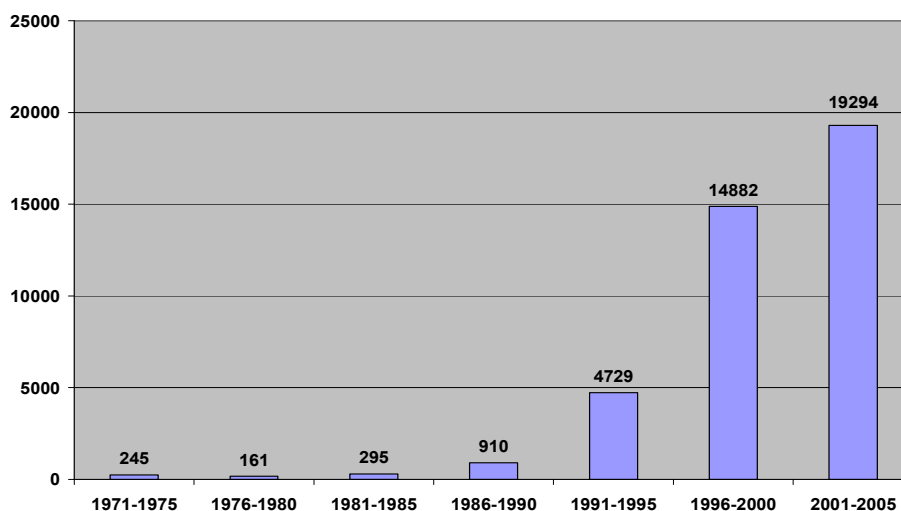
⁸² These offices are "unincorporated bodies".

Exchange Management Act (FEMA) which prescribe accepted activities and approvals required for such offices⁸³.

3. FDI inflows to India: 1991-2005

With the changes in Indian FDI Policy, there has been a steady rise in the average annual amount of FDI during the period 1991-2005. In particular, it is visible in comparison to previous periods. Figure 2 shows average inward FDI to India in five-year periods during 1971-2005. In the period 1986-1990 average inward FDI was 910 mln USD, in 1991-1995 it was about five times more – 4.7 bn USD, in 1996-2000 it was 14.9 bn, and in 2001-2005 it was 19.3 bn.

Figure 2. FDI inflows, 1971-2005 (in million USD)



Source: own calculations on the ground of UNCTAD Statistics (years: 1971-1990) and *India FDI Fact Sheet – May 2006*, Department of Industrial Policy & Promotion – Ministry of Commerce and Industry (years: 1991-2005).

Table 1 shows detailed data about the annual average inward FDI to India during 1991-2005 and yearly per cent changes. The dynamics of annual growth was changing within this period. Last two years were

⁸³ This information is available at the RBI website: www.rbi.org.in.

optimistic for India because in the years 2004/2005 and 2005/2006 there was over forty per cent increase in FDI inflows.

Table 1. FDI inflows to India during reforms period: 1991/1992 – 2005/2006

Fiscal year	mln INR		mln USD	
	Amount of inflows	Yearly change	Amount of inflows	Yearly change
1991/1992	4090	..	167	..
1992/1993	10940	167%	393	135%
1993/1994	20180	84%	654	66%
1994/1995	43120	114%	1374	110%
1995/1996	69160	60%	2141	56%
1996/1997	96540	40%	2770	29%
1997/1998	135480	40%	3682	33%
1998/1999	123430	-9%	3083	-16%
1999/2000	103110	-16%	2439	-21%
2000/2001	126450	23%	2908	19%
2001/2002	193610	53%	4222	45%
2002/2003	14932	-23%	3134	-26%
2003/2004	12117	-19%	2634	-16%
2004/2005	17138	41%	3755	43%
2005/2006	24613	44%	5549	48%
Total	161411		38905	

Source: *India FDI Fact Sheet – May 2006*, Department of Industrial Policy & Promotion – Ministry of Commerce and Industry.

At the beginning of the new century, India introduced a new method of collecting and presenting FDI data. The changes were necessary because in previous periods India had different definition of FDI than IMF and UNCTAD and data weren't comparable to other countries⁸⁴. Prior to that, FDI data in India had only one component: "equity

⁸⁴ In IMF and UNCTAD definition, flows of FDI comprise capital provided (either directly or through other related enterprises) by a foreign direct investor to an FDI enterprise, or capital received from an FDI enterprise by a foreign direct investor. FDI has three components: equity capital, reinvested earnings and intra-company loans. Equity capital is the foreign direct investor's purchase of shares of an enterprise in a country other than its own. Reinvested earnings comprise the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested. Intra-company loans or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors (parent

capital” under FIPB route, RBI automatic route and NRI route. Equity capital of unincorporated bodies (liaison/branch/project office), reinvested earnings and other capitals (e.g. borrowings) were missing. Those new components were introduced to data statistics in fiscal year 2000/2001. Table 2 shows FDI data as per international practices for the period 2000/2001 to 2005/2006. It is visible that new components are important part of FDI inflows to India.

Table 2. FDI data as per international practices (August 1991 – February 2006)

Financial Year	Equity			Reinvested earnings	Other capital	Total FDI inflows
	FIPB route/ RBI automatic route/ Acquisition route	Equity capital of unincorporated bodies				
08.1991 - 03.2000	15483	15483
2000/2001	2339	61	135	279		4029
2001/2002	3904	191	1645	390		6130
2002/2003	2574	190	1833	438		5035
2003/2004	2197	32	1460	633		4322
2004/2005	3251	527	1508	367		5653
04.2005 - 02.2006	4300	210	1257	203		5970
Total	34048	1211	9053	2,31		46622

Source: *India FDI Fact Sheet – May 2006*, Department of Industrial Policy & Promotion – Ministry of Commerce and Industry.

After the year 1991 the structure of FDI inflows has undergone globalization. However, there is some surprise in inflows structure, because a substantial part of the total FDI inward into India is routed through Mauritius. The advantages of routing FDI into India through this country have been acknowledged by a number of major fund managers and multinationals, which have already established their subsidiaries in Mauritius. There are specific regulations, which make it attractive for foreign firms to channel investment in India through companies based in

enterprises) and affiliate enterprises. *World Investment Report 2005*, UNCTAD, New York 2005, p. 297.

this country⁸⁵. Therefore, Mauritius has emerged as the largest source of FDI into India (38%), much ahead of USA (15%), Japan (7%), the Netherlands (6%), United Kingdom (6%) and Germany (5%) during the period of August 1991 – March 2006⁸⁶.

Policy preferring high-technology FDI, presented in previous part of this study, has determined sector structure of FDI inflows. The major sectors of FDI inflows were electrical equipment (white goods, computer software and electronics sector) and telecommunications sector. During August 1991 – March 2006, the first sector represented 17.49% share in total inflows, the second one - 10.58%. Next, services sector 9.45%, fuels (power and oil refinery 8.10%, chemicals (other than fertilizers) 6.33%. Others had smaller than 3.5% share in total inflows⁸⁷. It is visible that FDI has been made in modern sectors, which have perspectives in the globalizing world.

Conclusion

FDI in India has a long history. In colonial era, before the end of the First World War, there were no restrictions in FDI policy. Major source of FDI was the United Kingdom. The nature of FDI was trading and finance. After the year 1918, there were significant changes. Import duties were introduced, therefore some of foreign companies decided to change external market into internal. Major sources of FDI were the United Kingdom, USA and Japan. The nature of FDI was trading, finance, services and manufacturing.

Since 1948, when India became independent, significant barriers in FDI Policy have been introduced. Due to this fact, FDI inflows were low and some foreign companies closed their operations in India during the fifties, sixties and seventies. In the years 1978-1990, there were some changes in Import-Export Policy and in FDI Policy, but there were still

⁸⁵ Specifically, Mauritius' Double Taxation Agreement (DTA) with India has been widely used for routing investments into India with a substantially reduced withholding tax rate of 5% on dividends paid out of India. However, with the elimination of shareholders tax on dividends since 1997, there was no withholding tax on dividends and this type of tax treaty planning had ceased to be as attractive as it used to be.

⁸⁶ Own calculations on the ground of *India FDI Fact Sheet – May 2006*, Department of Industrial Policy & Promotion – Ministry of Commerce and Industry.

⁸⁷ For complete list, see: *India FDI Fact Sheet – May 2006*, Department of Industrial Policy & Promotion – Ministry of Commerce and Industry.

high barriers. During 1948-1990 main sources of FDI were the UK, USA and Germany. The focus of FDI was mainly on manufacturing.

The economic crisis in 1990-1991 changed Government view on FDI. Before the crisis, FDI was treated as just another form of foreign capital to plug the “domestic savings gap”, whereas in the new reform approach many other advantages were recognised, such as technology and international trade. Furthermore, some pressure on reform was made by International Monetary Fund, World Bank and World Trade Organisations. The GOI had decided to take a series of measures to unshackle the Indian economy from the cobwebs of unnecessary bureaucratic control. One of the elements of this new policy was the liberalisation of FDI regime. These measures have been complemented by the other series of actions taken by the GOI in the areas of trade policy, tax policy, exchange rate management, fiscal policy, financial sector reform etc. Generally, the new way for country development was to open Indian economy to global competition.

The survey has shown steps undertaken towards liberalisation of FDI regime in India during the years 1991 – 2006. Gradual reduction of barriers resulted in significant increase of FDI inflows into India. There were also changes in sources and nature of FDI. Sources of FDI during this period were globalizing. Nature of investments was not only manufacturing, but also services.

There are many determinants of FDI inflows to India but liberalisation of FDI Policy obviously seems to be the most important one.

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