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Issues and Problems

Nirupam Bajpai and Jeffrey D. Sachs

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Jeffrey D. Sachs

Abstract

In this paper, we have attempted to identify the issues and problems associated with India's current foreign direct investment regime, and more importantly the other associated factors responsible for India's unattractiveness as an investment location. Despite India offering a large domestic market, rule of law, low labor costs, and a well working democracy, her performance in attracting FDI flows has been far from satisfactory. A restrictive FDI regime, high import tariffs, exit barriers for firms, stringent labor laws, poor quality infrastructure, centralized decision-making processes, and a very limited scale of export processing zones make India an unattractive investment location.

Keywords: economic policy reform, FDI, foreign direct investment, and India

JEL codes: F21, F23

Nirupam Bajpai is an Associate at the Harvard Institute for International Development and Director of the India Program at HIID.

Jeffrey D. Sachs is the Director of the Center for International Development and Galen L. Stone Professor of International Trade at the Department of Economics at Harvard University. He is also a Faculty Fellow at HIID.

Introduction

India's economic policy reforms have played a critical role in the performance of the Indian economy since 1991. Among other things, the reforms have involved opening the economy, making it more competitive, getting the government out of the huge morass of regulation, empowering the states to take more responsibility for economic management and thereby creating a kind of competition between the states for foreign investors. The GDP growth rate which had collapsed to 0.8% in 1991-92 rebounded to a near normal 5.3% in 1992-93, and then accelerated to 6.2% in 1993-94. Subsequently, the GDP grew at an average rate of 7.5% in the three years 1994-95 to 1996-97, before slowing down to 5.1% in 1997-98. It is important to note that despite the slowdown, the average growth rate in the four years 1994-95 to 1997-98 was 6.9%, significantly higher than the growth rate of 5.6% achieved in the 1980s. In 1998-99, the GDP is estimated to have grown at 5.9 percent. The positive trends being seen in most sectors had the capability to more than neutralise the debilitating effects of two general elections in two years, the crisis in East Asia, Kargil operations, the nuclear explosions, and the U.S. sanctions that followed.

In the backdrop of the East Asian crisis, growth did slow down a little bit, but India has kept growing and has avoided the worst of the crisis. From the narrow financial point of view two things that India did were quite helpful. One, it did keep some limit on the short-term capital inflows and did not go overboard in borrowing short term from abroad. This helped India to avoid the financial reversals of some of its neighbors. Second, it kept the rupee flexible and the depreciation of the rupee definitely helped keep the Indian economy more competitive and kept economic growth going during this period.

In the context of the East Asian crisis, certain kinds of money fled while other kinds did not. The hottest money was short-term loans from international banks. Indeed, the reversal of short-term bank lending constituted a very large proportion of the overall $105 billion reversal in capital flows. The banks put in $56 billion in net lending in 1996, and then withdrew an estimated $21 billion in net loans in 1997, for a swing of $77 billion (or 73 percent of the overall reversal). Portfolio equity investors (e.g. country equity funds) also reversed gear, to the extent of $24 billion. Foreign direct investors, by contrast, were very stable. It is estimated that net foreign direct investment remained roughly unchanged between 1996 and 1997, at around $7 billion in net flows each year.

It is significant to point out here that India went through a near disaster in 1991 that was, among others causes, based on short-term borrowing. Of course, at that time it was short-term borrowing from the non-resident Indians, (NRIs) but it was the same kind of phenomenon - lots of short-term capital had come in and lots had moved out and created a severe payments crisis. In terms of foreign investment, it is the direct investment that should be actively sought for and doors should be thrown wide open to foreign direct investment. FDI brings huge advantages (new capital, technology, managerial expertise, and access to foreign markets) with little or no downside.

There are lots of international investors who would flock to India right now, especially now that they see that India has a lot of safety for them in comparison with China, for example. But, they are put off by the fact that they cannot get reliable power or that the road system is so dreadful that even if they are producing effectively, they will not be able to get the goods to the market or back to the port for exports. Continuing fiscal difficulties that are often linked to the chronic infrastructure difficulties remain a major challenge for India.

The government has set for itself an ambitious target of achieving $10 billion in actual FDI inflows per year. In order for this target to be met, it is essential to undertake some hard reform steps. We will discuss these in section VI. Should the Government decide to implement some of the most critical reform actions necessary for making India an attractive investment destination, then it is very likely that India will not only be able to meet the target, but in fact do much better than that. Of course, additionally, availability of infrastructure services, such as uninterrupted power, good roads, and adequate port, and telecomm facilities are very essential.

In order to achieve the government's goal, it is crucial to raise the FDI approvals to actual ratio. On a cumulative basis, FDI approvals between April 1991and September 1998 were of the order of $54,268 million, whereas, actual FDI during the same period was a mere $11,806 million. Therefore, actual FDI as a proportion of FDI approved was only 21.7 percent (Table 1). The same ratio is much higher in China, Indonesia, Korea, Malaysia, Philippines, and Thailand.

A few of the Indian States have been more reform-oriented, such as Andhra Pradesh, Gujarat, Karnataka, Maharashtra, and Tamil Nadu, but states, such as Haryana, Kerala, Orissa, Madhya Pradesh, Punjab, Rajasthan and West Bengal have a lot to catch-up with. Of course, Bihar and Uttar Pradesh are even further behind. States that are ahead in the reform efforts right now are going to find that if they move against the populist policies and set up regular markets for services, such as power and water then they are going to be ahead of the rest in the game.

There are rather significant differences in reform interest and economic performance between a large part of northern India and southern India where Karnataka, Tamil Nadu and Andhra Pradesh are quite dynamic now in trying to get the infrastructure, and the policy regime right to attract large-scale foreign investment. In the north, in Bihar, Uttar Pradesh one does not see the same kind of reform dynamism and the results are therefore poor in terms of economic growth. These differences will be noticed politically sooner rather than later, (as inequalities will become glaring) and the states that are ahead will be rewarded with better performance and the states that are behind will find that there is the demand to catch up with the states that are growing Bajpai and Sachs (1999). That will spur a kind of competition among the Indian states and make the reform process go much faster.

State-wise approvals of FDI in India suggest differing performances among Indian states. States are now in competition with one another to attract private investment, both domestic and foreign. State-level data on FDI approvals (aggregate FDI approvals between 1991-97) suggest that the relatively fast moving reformers have tended to attract higher investments, both from foreign and domestic investors.

From the long-term development point of view, we are of the view that India has tremendous growth prospects through export-led growth and that export-led growth involves a broad range of sectors, both traditional and new Bajpai and Sachs (1998). The most interesting by far of the new sectors is software and information technology. India is becoming one of the most important players of the world in this sector and it is the fastest growing foreign exchange earner for India. Export-led growth in services is one of the most interesting developments, and export-led growth in manufactures, the more traditional textiles and apparel, in electronics and other labor-intensive operations remains an area where India could do a lot more than in the past.

China has achieved a lot more in manufactured export production than India and for no particular reason. India has the resource base, it has the entrepreneurship, has the access to the sea coast, a vast labor force, it has everything that coastal China has had except the interest of government which neglected this for a long time and which even today underemphasises the role of industrial facilities, underemphasises the role of infrastructure, of land area, of effective port facilities that one needs to be able to compete with China in this area Bajpai, Jian and Sachs (1997). But it is, we believe, a place where one could find tens of millions of jobs over the next few years in real, significant foreign exchange earning private sector activity. This would require a change of attitude, a real promotion of these sectors both at the state and central government levels.

India's neighbors that are relying heavily on FDI, such as China, Indonesia, Malaysia, and Thailand, have been pulling far ahead of India in economic growth, income levels, and productivity, while also increasing their security and geopolitical influence in the world community. India's continuing ambivalence to FDI, as a result, exacts a heavy toll on the Indian economy. Undoubtedly, India is ceding billions of dollars of FDI to its neighbors each year, flows that otherwise would have come to India. While China achieved actual FDI inflows of around $45.3 billion in 1997, India settled for a mere $3.2 billion! (Table 2). Why is it that India, which provides the largest market after China in the developing world is unable to attract substantial volume of FDI? Further, when it comes to comparing China and India, why can India not match or even outpace China in attracting FDI given India's superior conditions regarding the rule of law, democracy, and the widely spoken English language?

As against the pre-1991 policy of considering all foreign investment on a case by case basis and that too within a normal ceiling of 40% of total equity investment, the new policy provides for automatic approval of FDI up to 51% of equity in a specified list of 34 specified high-priority, capital intensive, hi-technology industries, provided the foreign equity covers the foreign exchange involved in importing capital goods and outflows on account of dividend payments are balanced by export earnings over a period of 7 years from the commencement of production. Investment above 51% equity is permitted on the basis of case by case approvals given by a specifically constituted Foreign Investment Promotion Board (FIPB). Foreign technology agreements were also liberalized for 34 industries with firms left free to negotiate the terms of technology transfer based on their own commercial judgement and without the need for government approval for hiring of foreign technicians and foreign testing of indigenously developed technologies. This is subject to a registration procedure with the Reserve Bank of India (RBI).

In December 1996, the government allowed automatic approval of FDI up to 74 percent by the RBI in nine categories of industries[1]. Subsequently, in January 1997, the government announced the first ever guidelines for expeditious approval of FDI in areas not covered under automatic approval. Priority areas for FDI proposals, as mentioned in the guidelines include infrastructure, export potential, large scale employment potential particularly for the rural areas, items with linkages with the farm sector, social sector projects like hospitals, health care and medicines, and proposals that lead to induction of technology and infusion of capital. Refer to Appendix I for a chronological listing of policy reform in the FDI regime and related areas.

All over the world, FDI is seen as an important source of non-debt inflows, and is increasingly being sought as a vehicle for technology flows, and as a means of building inter-firm linkages in a world in which multinational corporations (MNCs) are primarily operating on the basis of a network of global interconnections. In the current global scenario, it is possible for India to achieve very dynamic growth based upon labor-intensive manufacturing, that combines the vast supply of Indian labor, including skilled managerial and engineering labor, with foreign capital, technology, and markets Bajpai and Sachs (1997). On this basis, the East Asian economies have achieved growth rates consistently above 6 percent per year, and China has managed growth in excess of 10 percent per year in the 1990s. Malaysia, to cite another example, has shifted from being a raw-material exporter in the 1970s (with commodities accounting for 80 percent of exports) to a manufacturing exporter (with manufactures, mainly electronics, accounting for 70 percent of exports), and with GDP growth of 8 percent per year. MNCs offer the capital, international market access, and technology that India lacks, and are therefore vital to remolding India as a strong and rapidly growing economy.

Usually, there are a number of firm-specific and country-specific factors that affect location decisions of individual FDI projects. Be that as it may, the WEF's 1997 global executive survey identified six important factors that determine FDI location. Of course, there are a complex set of considerations, including tax rates, exit barriers, wages, project approval procedures, and decentralized decision-making and so on that matter. According to the results of the survey, *market size* is supposed to be the most important factor that a firm has in mind while making a decision on investment location. In addition, the *expected growth in market size* is another significant factor. Empirical analysis confirms the significance attached by the investors on both the current market size and the expected growth in market size. There exists a strong positive correlation between FDI inflows and the market growth index. Another important factor in the determination of FDI flows is *competitiveness*.

Findings of the survey suggest that countries that are more competitive have better prospects of attracting FDI[2], especially by an exporting firm. Empirical results bear

[1] Some of these industry categories are construction and maintenance of roads, bridges, ports, harbors, runways; electricity generation and transmission; exploration and production of POL and gas; and mining services except for gold, silver, and precious stones.

[2] Competitiveness is defined as a country's ability to achieve sustained high rate of growth in per capita real income, as measured by per capita GDP in constant prices. It is judged by the overall competitiveness index (CI). Eight factors make up the CI. These are openness, government, finance, technology, infrastructure, management, labor, and institutions.

testimony to this relationship, which is statistically significant. Yet another factor determining FDI is the *ability to repatriate capital and remit profits*. With regard to this factor too, there is strong statistical evidence to suggest that investors view inability to repatriate capital and remit profit as one of their main concerns. The more open an economy to the rest of the world, the more likely it is to offer freedom in capital movement across national borders. High degree of openness would imply lesser restrictions on remittance of capital income that may be in the form of interests, dividends, profits, or capital gains. The remaining two factors cited by executives as determinants of FDI are *productivity and work habits of workers* and *quality of infrastructure.*

In the analysis of each of these above-mentioned factors in relation to India, it turns out that India does poorly on competitiveness, infrastructure, and skills and productivity of labor. With regard to the overall ranking based on the competitiveness index, India is ranked 52nd out of a total of 59 countries ranked in the GCR 1999 (Table 3). This is primarily because India ranks 59th in openness; 56th in labor; 55th in overall infrastructure, 46th in finance; and 38th in technology. However, in terms of both the current market size and the expected growth in market size, India was placed second after China. For this reason, India is ranked 3rd among the top 5 countries to attract the most FDI inflows in the medium term, and as per the FDI outlook index[3], India ranks 6th in a total of rankings for 53 countries as per the GCR 1997. Of course, among the countries that offer large and growing markets, factors such as the regulatory regime, competitiveness, quality of infrastructure, openness, and cost of labor play a significant role in determining which countries get the most FDI. On repatriation of capital and remittance of profits, India allows repatriation of capital along with capital appreciation. Remittance of dividends is freely permitted and remittance of principal and interest on foreign loans is also freely allowed if repayment terms have been previously approved by the Reserve Bank of India (RBI). Remittance of royalties, technical fees, and salaries to foreign employees are allowed according to the terms and conditions of specific collaboration agreements.

Major impediments to larger FDI inflows in India:

In addition to India's poor performance in terms of competitiveness, quality of infrastructure, and skills and productivity of labor, there are several other factors that make India a far less attractive ground for direct investment than the potential she has. Given that India has a huge domestic market and a fast growing one, there is every reason to believe that with continued reforms that improve institutions and economic policies, and thereby create an environment conducive for private investment and economic growth that substantially large volumes of FDI will flow to India. We list some of the major deterrents below:

[3] The FDI outlook index captures the central role of market size and its expected growth in driving FDI flows.

1. Restrictive FDI regime

The FDI regime in India is still quite restrictive. As a consequence, with regard to cross-border ventures, India ranks 57th in the GCR 1999. Foreign ownership of between 51 and 100 percent of equity still requires a long procedure of governmental approval. In our view, there does not seem to be any justification for continuing with this rule. This rule should be scrapped in favor of automatic approval for 100-percent foreign ownership except on a small list of sectors that may continue to require government authorization. The banking sector, for example, would be an area where India would like to negotiate reciprocal investment rights. Besides, the government also needs to ease the restrictions on FDI outflows by non-financial Indian enterprises so as to allow these enterprises to enter into joint ventures and FDI arrangements in other countries. Further deregulation of FDI in industry and simplification of FDI procedures in infrastructure is called for.

2. Lack of clear cut and transparent sectoral policies for FDI

Expeditious translation of approved FDI into actual investment would require more transparent sectoral policies, and a drastic reduction in time-consuming red-tapism.

3. High tariff rates by international standards

India's tariff rates are still among the highest in the world, and continue to block India's attractiveness as an export platform for labor-intensive manufacturing production. On tariffs and quotas, India is ranked 52nd in the 1999 GCR, and on average tariff rate, India is ranked 59th out of 59 countries being ranked. Much greater openness is required which among other things would include further reductions of tariff rates to averages in East Asia (between zero and 20 percent). Most importantly, tariff rates on imported capital goods used for export, and on imported inputs into export production, should be duty free, as has been true for decades in the successful exporting countries of East Asia.

4. 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. Brazil, China, and Russia are examples where regional governments take the lead in pushing reforms and prompting further actions by the central government. In Brazil, it is São Paulo and Minais Gerais which are the reform leaders at the regional level; in China, it is the coastal provinces, and the provinces farthest from Beijing, in the lead; in Russia, reform leaders in Nizhny Novgorod and in the Russian Far East have been major spurs to reforms at the central level.

5. Limited scale of export processing zones

The very modest contributions of India's export processing zones to attracting FDI and overall export development call for a revision of policy. 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[4] compared with China's initial efforts in 1980, the Indian EPZs never seemed to take off -- either in attracting investment or in promoting exports.

6. 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. In our view, 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.

7. Stringent labor laws

Large firms in India are not allowed to retrench or layoff any 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. Most importantly, the continuing barrier to the dismissal of unwanted workers in Indian establishments with 100 or more employees paralyzes firms in hiring new workers[5]. With regard to labor regulations and hiring and firing practices, India is ranked 55th and 56th respectively in the GCR 1999. Labor-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 labor force.

8. 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. Be that as it may, 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

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[4] According to UNCTAD (1982), the first two EPZs were established in Mayagaez, Puerto Rico (1962) and Kandla, India (1965).

[5] According to the Industrial Disputes Act (IDA), 1947 if a firm employs 100 or more workers, then workers cannot be laid-off without the prior permission of the concerned state government. Besides, the Act prohibits closure unless of course the state government has granted approval to do so.

expect has had highly adverse results, both in terms of availability of funds for investment and a negligible presence of foreign banks and no presence of foreign insurance companies in the country.

9. 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.

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Table1 : Foreign Direct Investment: Actual Inflows vs. Approvals

	1991	1992	1993	1994	1995	1996	1997	1998*	1991-98 totals
Approvals									
US $ Mn.	325	1,781	3,559	4,332	11,245	11,142	15,752	6,132	54,268
Actual Inflows									
US $ Mn.	155	233	574	958	2,100	2,383	3,330	2,073	11,806
Actual as % of Approvals	47.7	13.1	16.1	22.1	18.7	21.4	21.1	33.8	21.7

* Up to September 1998
The approval and actual inflows figures include NRI direct investments approved by the RBI
Source: **Economic Survey, 1998-99**, Government of India

Table 2: FDI by Host Region ***(US $ Million)***

	1992	1993	1994	1995	1996	1997*
Country						
China	11,156	27,515	33,787	35,849	40,800	45,300
India	233	574	973	1,964	2,382	3,264
Indonesia	1,777	2,004	2,109	4,348	6,194	5,350
Korea, Rep. Of	727	588	809	1,776	2,325	2,341
Malaysia	5,183	5,006	4,342	4,132	4,672	3,754
Philippines	228	1,238	1,591	1,459	1,520	1,253
Thailand	2,114	1,804	1,322	2,002	2,268	3,600
All developing countries including China	51,108	72,528	95,582	105,511	129,813	148,944
Share of India in developing countries (%)	0.5	0.8	1.0	1.9	1.8	2.2

* Estimates
Source: **Economic Survey, 1998-99**, Government of India

Table 3: Factor Rankings for India and Selected Countries

Country	India	Singapore	Malaysia	Korea	Thailand	Mexico	China	Philippines	Indonesia	Brazil
Overall Rank	52	1	16	22	30	31	32	33	37	51
Openness	59	2	23	35	33	28	52	42	21	53
Government	27	1	4	17	9	24	13	12	5	50
Finance	46	2	10	18	25	44	19	38	51	53
Infrastructure	51	7	25	27	36	40	49	46	41	44
Technology	38	2	24	19	44	31	43	41	51	37
Management	41	12	26	32	40	28	53	24	46	29
Labor	56	1	19	26	48	34	15	28	42	53
Institutions	35	2	30	32	34	45	36	49	55	41

Source: **The Global Competitiveness Report, 1999.**

Appendix I
Chronological listing of FDI Policy reform and related areas.

1991-92 As against the previous policy of considering all foreign investment on a case by case basis and that too within a normal ceiling of 40% of total equity investment, new policy provides for automatic approval of FDI up to 51% of equity in a specified list of 34 specified high-priority, capital intensive, hi-technology industries, provided the foreign equity covers the foreign exchange involved in importing capital goods and outflows on account of dividend payments are balanced by export earnings over a period of 7 years from the commencement of production. Foreign technology agreements are also liberalized for the 34 industries with firms left free to negotiate the terms of technology transfer based on their own commercial judgement and without the need for government approval for hiring of foreign technicians and foreign testing of indigenously developed technologies. This only subject to a registration procedure with the Reserve Bank of India.

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

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

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

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

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

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

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

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

Abolition of industrial capacity licensing permits firms to freely manufacture any article in response to market demand (except those subject to compulsory licensing).

Phased manufacturing programs which allow for the enforcement of strict local content requirements are abolished.

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

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

1992-93 Many more industries delicensed. Competition promoted by the opening up of many areas previously reserved for the public sector to private and foreign investment. Policies put in place to attract foreign direct and portfolio investment. Amendment of SICA to permit public enterprises to be examined by BIFR. Financial Sector reforms.

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

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

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

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

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

India signed the Multilateral Investment Guarantee Agency Protocol for the protection of foreign investments on April 13, 1992.

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

Investment Promotion and Project Monitoring cell set up in the Department of Industrial Development to provide information and guidance to entrepreneurs regarding licensing policy, tariffs, corporate laws, current status of applications pending with the Department, infrastructure facilities and incentives available at state levels for setting up industries, etc.

Peak import tariff brought down from a maximum of 150% to 100%. Rates for import duties on project imports, capital goods and general machinery were reduced. The Export Promotion Capital Goods (EPCG) Scheme made capital goods importable at 25% and 15% duty as long as the importers agreed to fulfill a stipulated export commitment.

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

1993-94 States began exercising the initiative given to them by the Center's 1991 reforms. States in the vanguard of reform included Gujarat, Kerala, Maharashtra, Uttar Pradesh and Andhra Pradesh. Liberalization efforts undertaken include:

- Committees appointed to review laws relating to various aspects of liberalization.
- Private participation in development of ports, power stations and desalination of water supplies, etc.
- Restructuring of District Industries Centers (DICs) in progress.
- Walk-in-system for financial assistance by Gujarat Industries and Investment Corporation (GIIC) and Gujarat State Finance Corporation (GSFC).
- Green channel scheme introduced to expedite industrial clearance.
- A state level agency set up to deal with Board of Industrial and Financial Reconstruction (BIFR) cases of state-owned Public Sector Enterprises (PSEs).
- High-level development committees set up to investigate offers for taking over 10 PSEs listed for disinvestment in Kerala.
- District Collectors' permission to convert agricultural land into industrial use no longer required.
- Industrial location policy revised to permit setting up of non-polluting, non-hazardous and high-tech industries within the municipal zone of Greater Mumbai.
- Private participation encouraged in power projects and establishment of industrial estates.
- Committee set up under State Chief Secretary for expeditious decision on NRI and Foreign Direct Investment.
- District and Division level Authorized Committees with substantial decision-making powers set up to strengthen single-window clearance system.
- Simplification of inspection system by departments.
- Privatization/closure of loss-making public sector industrial undertakings and corporations.
- Involvement of private sector in development and management of industrial estates, generation and distribution of power.
- Special facilities to NRIs and foreign industrialists.
- Various aspects and procedures for obtaining power connection streamlined.
- Power Purchase Agreements have been signed with private developers for setting up of Power Projects. The offers received, for undertaking projects, from private parties are being evaluated in AP.

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

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

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

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

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

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

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

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

CRR and SLR are reduced to 14% and 34.75% respectively to make more credit available for the commercial sector.

Minimum lending rate for the highest credit slab is reduced to 15%

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

1994-95 Efforts made to facilitate private entry into infrastructure areas including natural resource sectors and non-tradable infrastructure services such as electricity, internal transport and telecommunications. Specific developments included in this area include:

- National Mineral Policy revised and the Mines and Mineral Development Act amended to open up the sector to private and foreign investment. Ten minerals were de-reserved for exploitation by the private sector.
- RBI based automatic approval policy for foreign investment made applicable to mining (except atomic materials and mineral fuels), subject to a limit of 50% on foreign equity.
- The new power sector policy framework attracted 138 private proposals for creating 58, 745 megawatts of capacity with an investment of Rs. 219,927 crore. Of these, 41 proposals are from foreign investors or joint ventures with foreign partners. Thirteen were cleared at the end of 94-95 fiscal year.
- National Telecom Policy of 1994 allows for private provision of basic telecom services. For value added services, government permits a maximum of 51% equity. Basic services, cellular mobile and radio paging limit is 49%. Open system of tendering/
bidding of licenses is concluded.
- Enables private Air Taxi companies to operate as regular domestic airlines.

- Development and maintenance of airport infrastructure and material handling areas, etc., opened up to private participation.
- National Highway Act amended to enable toll collection on National Highway users. Further amendments are foreseen to permit private participation in construction, maintenance and operation of roads on a Build-Operate-Transfer (BOT) basis.
- Further private participation in the infrastructure is encouraged in the leasing of port equipment, operation and maintenance of container terminals, cargo handling terminals, creation of warehouse and storage facilities, transportation within ports, setting up private berths by coastal based industries, ship repairs and maintenance.
- India took a major step toward current account convertibility in March 1993 when the exchange rate was unified and transactions on trade account were freed from exchange control. The determination of the exchange rate of the rupee was left to the market. The RBI on February 28, 1994 announced the liberalization of exchange control regulations up to a specified limit relating to:
    (a) exchange earners foreign currency accounts;
    (b) basic travel quota;
    (c) gift remittances;
    (d) donations; and
    (e) payments of certain services rendered by foreign parties.
- Industrial licensing for almost all bulk drugs abolished.
- Automatic approval of foreign investment up to 51% and foreign technology agreements permitted for all bulk drugs and formulations, barring only a few.
- Import duties reduced to 15% on export related capital goods, 25% for project imports and most capital goods, and continuation of concessional duties at 20% for power projects, and 0% for fertilizer projects.
- MODVAT extended to capital goods and petroleum products.
- Corporate tax reduced from 45% for widely held companies and 50% for closely held companies to 40% for domestic companies. And from 65% to 55% for foreign companies.
- Five-year tax holiday to new industrial undertakings that was initially allowed for industrially backward states in the 93-94 budget now extended to all backward areas notified by the Department of Revenue.
- Major overhaul of the excise tax structure, including rationalization of rates, elimination of most end-use exemptions and a general shift from specific to ad valorem duties.
- Continued reform in customs duties, including reduction of the peak tariff rate, elimination of most end-use exemptions and removal of exemptions from countervailing duties.

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

1995-96 Under zero duty import of capital goods scheme, which is available for imports of capital goods of at least Rs. 20 crore, there are now two windows to fulfill export obligation on FOB (free on board) or NFE (net foreign exchange earnings) basis.

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

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

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

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

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

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

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

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

Newsprint including glazed newsprint, has been made freely importable, by all persons.

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

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

The Harmonized System (HS) of commodity classification, developed by the CCC (Customs Cooperation Council), Brussels has been in use the world over since the late eighties. India has adopted the system for Customs, Excise, Drawback and compilation of foreign trade statistics purposes. The first attempt to introduce the same system in the Trade sector was made with the publication of "Import Licensing Policy" in two volumes in October 1991. However, the sweeping changes which took place with the liberalization in the EXIM Policy, 1992-97, reduced the utility of the document. The entire exercise was thereafter taken up afresh at the eight digit extended level, and the new Indian Trade Classification (ITC) has now been brought out with the objectives of:

i) Greater transparency in the import and export licensing policy.

ii) Compatibility with the system of classification followed by Customs, Central Excise and the DGCI & S on Harmonized System (HS) of Commodity Classification.
iii) Reduction in discretionary controls and areas of ambiguity and disputes on import policy matters.
iv) Development of the basic module for computerization and Electronic Data Interchange (EDI).

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

Several reforms in the Industrial sector relating to FDI include:

- The number of items, in respect to industrial licensing requirements is reduced to 15. These industries account for only 15% of the value added in the manufacturing sector.
- Number of industries reserved for the public sector is reduced to 6, viz. defense products, atomic energy, coal and lignite, mineral oils, railway transport, minerals specified in the schedule to the Atomic Energy Order 1953. Private participation in some of these sectors is also permitted on a case by case basis.
- More private initiative is encouraged in development of infrastructure like power, roadways, telecommunication, shipping and ports, airports and civil aviation etc.
- The manufacture of readymade garments - an item reserved for exclusive manufacture by the ancillary/small scale industrial undertakings opened to large scale undertakings, subject to an export obligation of 50% and investment limit of Rs. 3 crore.
- Automatic approval of foreign investment up to 51% and foreign technology agreements permitted for 35 priority industries which account for 50% value added in the manufacturing sector.

Foreign investment has also been liberalized in many sectors, including:

a) 35 high-priority industries
b) Export/Trading/Star trading houses
c) Hotels & Tourism related industry
d) 100% EOUs and units in FTZ and EPZ
e) Sick industries
f) Mining
g) Telecommunications
h) Power
i) Medical clinics, Hospitals, Shipping, Oil exploration, Deep sea fishing, Ind. With licenses.
j) Industries reserved for SSI
k) Housing, real estate, business centers & infrastructure facilities.
l) Portfolio investment (Inv. In shares & debentures).
m) Government securities

n) Units in UTI
o) Public sector mutual funds
p) Private sector mutual funds

1996-97 The Foreign Investment Promotion Council is set up.

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

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

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

New guidelines also allow foreign companies to set up 100% companies on the basis of these criteria:

(a) where only holding operation is involved and all downstream investments to be carried out need prior approval;
(b) where proprietary technology is sought to be protected or sophisticated technology is proposed to be brought in;
(c) where at least 50% of production is exported;
(d) consultancy proposals; and
(e) projects in power, roads, ports and industrial towns and estates.

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

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

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

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

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

1997-98 To increase the growth rate of industrial production, which had fallen to 7.1% in 1996-97 from 12.1% in 1995-96, the government

a) cut personal and corporate income tax rates across the board;
b) excise duties on intermediate goods and customs duties on imported raw materials brought down;
c) "infrastructure" broadened to include telecommunications, oil exploration and industrial parks, to enable these sectors to avail of fiscal incentives such as tax holidays and concessional duties;
d) Bank rate and Cash Reserve Ratio (CRR) reduced in the Credit policies announced during 1997-98;
e) Banks given freedom in assessing credit requirement for borrowers by withdrawing restrictions on maximum permissible bank finance.

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

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

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

1998-99 Projects for electricity generation, transmission and distribution and construction and maintenance of roads, highways, vehicular tunnels and vehicular bridges, ports and harbors are permitted foreign equity participation up to 100% under the automatic route. Automatic route is subject to a ceiling of Rs. 1500 crore on foreign equity.

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

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

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

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

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

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

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

Delicensed sugar

De-reservation of coal and lignite and mineral oils

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

National Task Force on IT and Software Development submitted 108 point Action Plan in July 1998. Recommendations accepted by government and directions for their implementation given to concerned parties.

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

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

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

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

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

New Telecom policy is under preparation.