

**Foreign Direct Investment:
A Critical Analysis of FDI from 1991-2005**

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Abstract

The Concept of Foreign Direct Investment is now a part of India's economic future but the *term* remains vague to many, despite the profound effects on the economy. Despite the extensive studies on FDI, there has been little illumination forthcoming and it remains a contentious topic. The paper explores the uneven beginnings of FDI, in India and examines the developments (economic and political) relating to the trends in two sectors: Industry and Infrastructure and sub sector Telecom, to illustrate that.

Table of Contents

Introduction	3
Uneven Beginning	4
Maintaining the Flow	8
Another Beginning	9
Sector Analysis	10
Significant Change versus Struggling On	10
Understanding FDI	12
A Procedural Battle	13
FDI Redux	15
Sub sector: Telecommunications	15
FDI Culture	16
Conclusion	19
Annexure	20
Bibliography	23

Introduction

There is hardly a facet of the Indian psyche that the concept of 'foreign' has not permeated. This term, connoting modernization, international brands and acquisitions by MNCs in popular imagination, has acquired renewed significance after the reforms initiated by the

Indian Government in 1991. Contrary to the grand narrative 'opening of flood-gates idea' of 1991, what took place was a gradual process of changes in policies on investment in certain sub-sections of the Indian economy.

As a result of controversy surrounding Foreign Direct Investment owing to a lack of understanding, it has become the eye of a political storm. The paper aims to present a unique understanding of FDI in the context of liberalisation and the prevailing political climate.

FDI eludes definition owing to the presence of many authorities: Organisation for Economic Co-operation and Development (OCED), International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD) and United Nations Conference on Trade and Development (UNCTAD). All these bodies attempt to illustrate the nature of FDI with certain measuring methodologies.

Generally speaking FDI refers to capital inflows from abroad that invest in the production capacity of the economy and are

"usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. FDI also facilitates international trade and transfer of knowledge, skills and technology."¹

It is furthermore described as a source of economic development, modernization, and employment generation, whereby the overall benefits (dependant on the policies of the host government)

...triggers technology spillovers, assists human capital formation, contributes to international trade integration and particularly exports, helps create a more competitive business environment, enhances enterprise development, increases total factor productivity and, more generally, improves the efficiency of resource use.²

Changes in the national political climate have precipitated a marked trend towards greater acceptability of FDI. The envisioned role of FDI has evolved from that of a tool to solve the crisis under the *license raj system* to that of a modernising force that has been given special agencies and extensive discourse. This evolution is illustrated by analysis of the Economic policies of the Indian government from 1991 to 2005. The primary focus of this analysis will be towards the industrial and infrastructural sectors which form the beginning of the gradual liberalization process that was started in 1991. A complete understanding of these two sectors will provide interesting statistics and information regarding trends of FDI.

Uneven Beginning

In most narratives on India's liberalization, 1991 has acquired a revolutionary status as a time of change in the planning of India's future. The appointment of Economist Manmohan Singh, considered a non-political figure, as finance minister signalled a different approach to

¹ Planning Commission of India.2002. *Report of the Steering Group on Foreign Direct Investment: Foreign Investment India*. [government report]. p 11. New Delhi: Planning Commission, Government of India. Accessed on June 10, 2005. Available at http://planningcommission.nic.in/aboutus/committee/strgrp/stgp_fdi.pdf. Internet.

² OECD.2002. *Foreign Direct Investment for Development: Maximizing benefits minimizing costs Report of the Steering Group on Foreign Direct Investment: Foreign Investment India*. p 5. Paris: OECD. Accessed on June 10, 2005. Available at <http://www.oecd.org/dataoecd/47/51/1959815.pdf>. Internet.

economics; one that in itself was radical, but did not significantly permeate the economic imagination of the Nation or the State.

Data from various individuals and agencies can lead to different conclusions all of which can be challenged on different grounds. The Ministry of Finance, however, forms my primary source of information for two main reasons: it has been the agency of and party to economic reform and has compiled data on the state of reforms for the entire duration of their history.

As early as the introductory chapter of the Ministry of Finance Economic Survey for 1991, the conclusion is that "compared to domestic investment the contribution of foreign investment is bound to remain minor".³ At the time the focus for long term planning was still inwards as efforts were on to solve the balance of payments crisis with India's own 'resources and ingenuity' as self reliance presented itself as the only alternative.⁴ Denying the imminence of reform at the time, the Indian government clung to the 'self-reliance model' and intended to reform only as much as was absolutely essential to arrest the crisis and revert to status quo.

Unevenness in implementation of policy was due to opposition to economic reforms from several stakeholders. Owing to the likelihood of reforms challenging over manning and under productivity; the first major revolt from workers in the public sector, who for the preceding four decades enjoyed employment with a virtual permanence.

A significant protest that took political roots began in the form of the *Swadeshi Jagaran Manch* (SJM) created by the RSS in the November of 1991; a few months after the new liberal economic policy. The 'fight' against globalisation and privatisation found its chief targets in multinational companies. FDI was seen to be a new form of 'western imperialism' which the Indian Nation was to combat through indigenous capabilities. The rhetoric aimed at exploiting the feeling of insecurity spawned by the liberalization of the economy and strengthening national identity which was held synonymous with Hindu consciousness by invoking the spectre of foreign domination.⁵

The tactic worked; many Indian capitalists accustomed to decades of protectionist policies, anxious about the impact of liberalization on their well being; got together to complain that foreign capital would drive them out of business.⁶ An argument of this nature came from the director of the Confederation of Indian Industry, a business lobby group, in an attack in April 1996 on the role of multinational corporations in India.

He accused them of not being committed to India for the long term, of not bringing in state of the art technology, and of an over reliance on imported components rather than Indian made ones.⁷

The population of rural India was barely affected and only remotely concerned with FDI but it formed the largest part of the Indian Nation and was swayed by anti- FDI rhetoric. Thus,

³ Economic Department, Ministry of Finance & Company Affairs. 1992. *Economic Survey 1991-1992*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p 23.

⁴ Ibid.

⁵ Boutron Isabelle. 2005. The Swadeshi Jagaran Manch: An Economic Arm of the Hindu Nationalist Movement. In *Critical Issues in Indian Politics: The Sangh Pariwar. A Reader* edited by Christophe Jaffrelot. Page 394. New Delhi: Oxford University Press.

⁶ Tharoor, Shashi. 1997. *India: from midnight to the millennium*. India: Penguin Books. p 173.

⁷ Ibid.

in the interests of political expediency, P.V. Narasimha Rao, the then Prime Minister, could not and took care not to reform the economy too fast.⁸ Before announcing any reforms in contentious areas such as taxation, financial services and the public sector, the Prime Minister appointed committees to explore each issue, and make recommendations.⁹ These recommendations, almost identical to prescriptions made by the World Bank and the IMF, were deemed more acceptable from Indian committees.

Politics and political standpoints made a very large impact on the trajectory of reforms. The following paragraph illustrates the importance.

The PM was also highly sensitive to the impact of reform on India's voters; his instincts were driven by politics, not economics. A way to measure the popularity of the reforms can be done through the elections. The delinking in 1971 of state assembly polls from those to the national Parliament, some state or other is constantly going to the polls and as a result the central government face constant judgements at the tribunal of public opinion. Rao felt that an electoral setback even in one state could be interpreted as a verdict against the economic reforms nationwide; he therefore downplayed them as much as possible, and avoided making reforms that might have been politically costly in the short term, such as laying off public sector workers, privatizing or closing down inefficient factories, reducing subsidies, or taxing agricultural income. Despite this, when electoral defeats came in states like Karnataka, and Andhra Pradesh, political stalwarts were quick to ascribe them to the reforms, alleging that the populous in general did not benefit from them.¹⁰

Election time manifestos of major political parties are an indicator of the standpoints of major political parties, and also tools to analyse the variance that liberalization could take. The party in power is concerned with self-perpetuation and cannot afford to alienate anyone. In an effort to broaden support bases, political parties often dilute their original agendas. An analysis of political party agendas is important as it forms the crux of the agenda once elected.

The political parties that vied for the nation's attention in their election manifestoes presented their agenda (a mix of ideology and party advancement) that could be implemented in 1991. Of the three major political parties (Congress, BJP and Communist Party (Marxist) (CPI(M)) had already placed the state of the Indian economy by tracing it to the IMF loans that were taken in 1981 by one of the previous Congress government.¹¹ The BJP talked about reversing current trends with the declaration that the country was corrupt and on the verge of bankruptcy.¹² Their economic strategy required holding the price line and liberating the economy from bureaucratic controls and not excising duties on item of mass consumption for 5 years.¹³ In their tenure agriculture would have been given the first priority. The crux of the viewpoint can be summed by "we will make our economy truly *Swadeshi* by promoting native initiatives."¹⁴ The above viewpoints were contrasted by the

⁸ Ibid.

⁹ Ibid.

¹⁰ Ibid, 174.

¹¹ Communist Party of India (Marxist). 1991. *Manifesto: Eleventh Lok Sabha Elections*. New Delhi: Hari Singh Kang.

¹² Bharatiya Janata Party. 1991. *Election Manifesto 1991*. New Delhi: Bharatiya Janata Party All-India General Secretary Manifesto Committee. p 11.

¹³ Ibid.

¹⁴ Ibid.

Congress Party that announced that foreign investment and technology collaboration would be permitted to obtain higher technology, to increase exports and to expand the production base. The Congress realized the importance of a change in the economic model but was also wary of domestic concerns. With their announcement for investment was a warning that "such foreign investment will not be at the cost of self-reliance".¹⁵ The different approach of the Congress Party meant that if elected there could not be policies that alienated the segment of the population that followed or shared other party viewpoints.

Even after Congress came to power and reforms began, FDI was not in anyway defined in 1991 nor was it considered a mechanism for development. In the context of the time the emphasis is placed on stabilizing the economy. The goals for the upcoming year were to consolidate gains, bring problems under control and restore "the government's capacity to pursue the social goals of generating employment, removing poverty and promoting equity"¹⁶. What this illustrates is that while the new policy had brought in a dramatic increase in investment activity, there was no clear understanding of FDI as a proper mechanism for development or its future role.

This trend was visible through 1992-1993 where investment has increased but the role of the government emphasizes its role in '*filmi*' terms as a protector of the weak and to "ensure peace, and prevent mischief"¹⁷. It is in 1993-1994 where there seems to be a realization on the importance of FDI. Reading the definition it seems that both literature and economics have come together as an ideal definition of this concept is given that seems to weave together knowledge, technology, and high rates of growth.¹⁸ It takes another year before the policy reforms properly percolate down to the level of state governments and state capitals; the actual benefits of new industrial investment can only accrue if investment approvals and intentions are translated into real investment, employment and production. The role of the state government is critical because resources for production such as land use, water, power generation, and distribution and roads come under the purview of state governments.¹⁹

The far reaching unanimity for FDI within came in 1995-1996 when the government began to showcase the progress made as a result of FDI along with defending the changes to critics. Statistics had been available for most years, but now FDI entered the mindset of the government. The future of India's growth and output was seen to be connected to FDI and it was deemed necessary for promoting higher growth of output, exports and employment.²⁰

¹⁵ Indian National Congress (Congress Party of India). 1991. Manifesto. Available at http://www.congresssandesh.com/manifesto/1991/manifesto91_1.html. Internet

¹⁶ Economic Department, Ministry of Finance & Company Affairs. 1992. *Economic Survey 1991-1992*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p. 2.

¹⁷ Ibid, p.17.

¹⁸ Foreign trade acts as a window on the world through which knowledge of new products, processes, technology, marketing, finance, employee training and management techniques can flow. By continuing to shut out the import and export of certain goods we are keeping thus window shut for concerned producers. In the last decade, FDI has proved to be an even more powerful channel for the transfer of knowledge and export capability. In some East Asian countries very high rates of FDI have been associated with high rates of growth of GDP and manufactured exports. China, a socialist market economy committed to self reliance, attracted more than \$15 billion of FDI in 1993 by allowing up to 100 percent foreign equity and opening virtually every sector of the economy. India should not lag behind other Asian countries in reaping the benefits of FDI especially for the development of infrastructure and exports.

Economic Department, Ministry of Finance & Company Affairs. 1992. *Economic Survey 1994-1995*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p.12.

¹⁹ Ibid, p.17.

²⁰ Economic Department, Ministry of Finance & Company Affairs. 1992. *Economic Survey 1995-1996*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p.15.

Furthermore the government also defended FDI by stating that “fears of foreign investment swamping our domestic industry or creating unemployment are unfounded or grossly exaggerated”.²¹

The acceptance of FDI was not shared by the opposition, as by the next elections the party positions show some level of variance but the general feelings were similar. The BJP stayed critical of the Congress Party and their so called “acceptance of IMF conditionalities” coupled with what they referred to as a radical different approach to Foreign Investment.²² The criticism delved into another level, as the party viewed that at some level the *License Quota Permit Raj* has remained intact. BJP believed in the *Swadeshi* approach, but recognized that foreign Investment would be required and encouraged for world class technology. The party was able to effectively change its stance by allowing for FDI but stating that it would “strive to minimize dependence of foreign saving” thus elaborating distinctions that would keep India’s economic sovereignty. The party elaborated that globalisation is not a synonym for the obliteration of national economic interest. The party was able to change its viewpoint by separating a progressive India open to new ideas, new technology and fresh capital but at the same time not a westernized India.²³

Meanwhile the Communist party stayed true to its previous stance and offered strong criticism of the general economic policy that unfolded since 1991. Needless to say the policies were seen as pro multinational and anti public sector and local industries.²⁴ The issue of self reliance was still considered important and the policy of globalization and privatization were seen to strike a heavy blow at the self reliant path of development. The inclusion of FDI was analysed as MNC’s acquiring vital sectors of the economy. The most important observation by CPI (M) was policy evaluation; that the BJPs economic nationalism was a crude mixture of *swadeshi* demagogy and actual support to liberalization policy of the congress. The Communist party observed the trends from the state governments of BJP and was able to effectively summarize and offer criticism that the BJP party line had oscillated between extremes (perhaps to mobilize support) from denouncing Enron and threatening to throw it into the sea, to quickly striking a fresh deal with the same company²⁵

Thus by 1996, though there was difference of opinion on FDI, term was slowly being worked into the party position as a debateable and election issue. If nothing else the topic has sparked discussion as its future will affect the welfare of the country.

Maintaining the Flow

With the new government focus on FDI was evident in changes in 1996-97 that resulted in an increase in understanding and resources towards investment. This included the setting up of the Foreign Investment Promotion Council along with the Foreign Investment Promotion Board (FIPB) being streamlined and made more transparent. The first ever

²¹ FDI has proved to be the most effective and rapid method of technology transfer (in the form of knowledge, technical and marketing skills, organization and management systems, new materials, and products) and effective promotion of comparative advantage through exports. Even when it forms a small fraction of the total investment, its catalytic role is out of proportion to its size. For India to aspire to sustained growth of 7 to 9 percent over the next few decades we have to be prepared to encourage a rapid increase of FDI to levels comparable to China’s 30 billion or more per year. Government of India. Ministry of Finance. 1995-1996. *Economic Survey*. 15

²² Bharatiya Janata Party.1991. *Election Manifesto 1996*. New Delhi: Bharatiya Janata Party All-India General Secretary, Manifesto Committee, p.16.

²³ Bharatiya Janata Party.1991. *Election Manifesto 1996*. New Delhi: Bharatiya Janata Party All-India General Secretary, Manifesto Committee. p. 24.

²⁴ Communist Party (Marxist). *Party Manifesto, 1996*. New Delhi: Communist Party. p.1.

²⁵ Communist Party (Marxist). *Party Manifesto, 1996*. New Delhi: Communist Party. p.4.

guidelines were announced for consideration of foreign direct investment proposals by the FIPB, which were not covered under the automatic route.²⁶ The list of industries eligible for automatic approval of up to 51 per cent foreign equity were expanded and there was a recognition that foreign direct investment flows provided savings without adding to the country's external debt. The case of comparison for numbers and example seem to be China and the Asian Tigers that were enjoying the economic boom.

By now FDI trends are taken more serious and FDI flow had to be maintained for the economy to grow. The government recognized that greater procedural simplifications were still needed in the area of FDI. In 1998 when there was a decline in FDI the government had to take greater technical measures in terms of liberalising investment norms in bring in FDI. Though these were steps in the right direction the government was not able to function as a central ruling body and elections had to be called that resulted with a BJP government.

Another Beginning

By now after having been in power the BJP in 1998-1999, overhauled its previous stance and in its party manifesto admitted that that "the country cannot do without FDI because besides capital stocks it brings with it technology, new market practises and most importantly employment".²⁷ However there is a clarification that FDI will be encouraged in core areas so that it usefully supplements the national efforts and discourage FDI in non priority areas.²⁸ The Communist party while talking about land reforms also made a slight recognition of foreign capital that is "to be solicited to those areas for which clear cut priorities are set."²⁹ CPI (M) was not clear as the so called 'priorities' were to be themselves are to be determined by the need for developing new production capacities and acquiring new technology. Meanwhile the Congress party (now was on a different level than the other party) planned an increase both the level and productivity of investment, both domestic and foreign, public and private, in infrastructure like power, roads, ports, railways, coal, oil and gas, mining and telecommunications.

The trends now illustrated that while the facets of FDI were not completely understood by all the parties it was a topic that was a major election and policy topic. The analysis reveals that FDI at this point could not be blocked but the parties through their policy realized that its speed could be controlled to garner effective longevity for the party while balancing the investment needs of the country.

The trends of FDI now resulted in policy formulation. For example in 1999-2000, when a second year of decline continued a Foreign Investment Implementation Authority (FIIA) was set up for providing a single point interface between foreign investors and the government machinery, including state authorities. This body was also empowered to give comprehensive approvals. After this point FDI has acquired an acceptable status and the debate is on the levels that will be allowed.

By the next election in 2004, FDI had become a non-electable issue. There was widespread acceptance of the topic among all the party lines and it was no longer will it be allowed but how the polices would be designed for FDI.

²⁶ Economic Department, Ministry of Finance & Company Affairs. 1992. *Economic Survey 1996-1997*. New Delhi: Ministry of Finance & Company Affairs, Government of India. Available at <http://indiabudget.nic.in/es96-97/CHAPT7.HTM>. Internet

²⁷ Bharatiya Janata Party. *Election Manifesto 1999*. Available at <http://www.bjp.org>. Internet.

²⁸ Bharatiya Janata Party. *Election Manifesto 1999*. Available at <http://www.bjp.org>. Internet.

²⁹ Communist Party of India (Marxist). *Election Manifesto 1999*. New Delhi: Communist Party.

Sector Analysis

When the reforms began in 1991 it was inevitable there would be a discrepancy as various sectors have different characteristics and procedures. The reforms and policies on FDI have trickled down to various sectors in different speed and effectiveness. Thus the progress of FDI will be effectively analyzed by studying two sectors of the Indian economy: Industry and Infrastructure. These sectors are an agglomeration of sub sectors that when combined form the integral components of the economic growth.

Significant Change versus Struggling On

When initial reforms took place in 1991, Industry was one of the first to benefit from the reforms as it resulted in changing the overall system. Firstly the new policy of July 1991 sought substantially to deregulate industry so as to promote the growth of a more efficient and competitive industrial economy. During this process the procedures for investment in non-priority industries were streamlined. On a central level the foreign Investment Promotion Board (FIPB) was established to negotiate with large international firms and to expedite the clearances required. The FIPB also considered individual cases involving foreign equity participation over 51 percent.³⁰ Furthermore for industry an important step was the removal of the Mandatory Convertibility Clause.³¹ The government realised that foreign investment had been traditionally tightly regulated in India and now the government hand was lifting.

These changes while dramatic did not yield results immediately; though Foreign Investment was liberalised in 1992, manufacturing declined. The widespread social disturbances and economic uncertainties which prevailed during the year contributed to this decline and to a weakening of investment demand as investment intentions suffered from the uncertain conditions which prevailed. On a positive note by this time due to the announcement of the new industrial policy in July 1991, a large number of Government- induced restrictions, licensing requirements and controls on corporate behaviour were eliminated.³²

The full impact of the events surrounding *Ayodhya* in 1992 were felt a year later, as the incident had disrupted industrial activity and had upset business plans and investment decisions.³³ It was in the years of 1995-1996 that Industry observed a change that has become a staple of attracting FDI to India ever since. With state governments undertaking procedural and policy reforms in line with liberalization taken by the centre, reforms were initiated by most state governments for promoting foreign investment, thus encouraging investment participation in industry.

While Industry had taken a stride forward, an examination of Infrastructure reveals a policy and approach that differs significantly from Industry. From the onset the status of infrastructure sector did not cause any state of panic, as overall the sector was not seen to

³⁰ Economic Department, Ministry of Finance & Company Affairs. 1992. *Economic Survey 1991-1992*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p.12.

³¹ A considerable portion of industrial investment in India is financed by loans from banks and financial institutions. These institutions have thus far followed a mandatory practice of including a convertibility clause in their lending operations for new projects. This has provided them the option of converting part of their loans into equity if felt necessary by their management. Although this option has not been often exercised, it has often been interpreted as an unwarranted threat to private firms of takeover by financial institutions. Economic Department, Ministry of Finance & Company Affairs. 1992. *Economic Survey 1991-1992*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p. 81.

³² Economic Department, Ministry of Finance & Company Affairs. 1993. *Economic Survey 1992-1993*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p.123.

³³ Economic Department, Ministry of Finance & Company Affairs. 1994. *Economic Survey 1993-1994*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p 92.

be performing too badly, and was seen as the stabilizing force of the economy. The sector was seen as a bloc and in its components while the performance of coal and telecommunications sectors fell short of the respective targets; simultaneously energy, railways, and shipping exceeded their respective targets thus bringing up the overall performance of the sector to positive growth.³⁴

This discrepancy was recognized in n 1992-1993 when the general review mentioned in an overview that capital intensive infrastructure industries such as power, irrigation and telecommunications, were handicapped by a number of constraints and where possible these industries should eventually develop competitive market structures.³⁵ Once again the shipping, railways and telecommunications were able to meet targets while the performances of coal and power have been below target. As a result the sector as a whole was not liberalized but there were only suggestions that it was important to attract foreign and private investment in the power sector to overcome the resource constraint.³⁶

1993-1994 followed the trend whereby instead of economic data the analysis offered was the shortcomings on the Infrastructure sector such as its development largely in the public sector and need for structural changes in the organization, operation and management of the public sector enterprises.³⁷ The call to induce greater efficiency and accountability by replacing the monopolistic nature of these sectors with a competitive environment was not followed by steps to make this dream a practicality.

1994-1995 follows in the same footsteps of the previous years but with recognition that as government's ability to undertake investment in infrastructure is severely constrained and it is necessary to induce much more private sector investment and participation in the provision of infrastructure services.³⁸ 1995-1996 illustrates the great unevenness of the growth that is taking place within sectors and between technologies. By the time infrastructure is linked to FDI as the condition of infrastructure has a direct correlation to international competitiveness and flow of FDI, the government has finished its tenure.³⁹

Understanding FDI

The period of the next coalition government in 1996-1998 could be seen as a willingness to understand FDI by placing policies that would result in an increase in FDI and further liberalization. There was a greater understanding on the role of FDI in both the sectors. Industry still lead the reforms whereby automatic approval of FDI was increased up to 74 per cent by the Reserve Bank of India in nine categories of industries,

including electricity generation and transmission, non-conventional energy generation and distribution, construction and maintenance of roads, bridges, ports, harbours, runways, waterways, tunnels, pipelines, industrial and power plants, pipeline transport except for POL and gas, water transport, cold

³⁴ Economic Department, Ministry of Finance & Company Affairs. 1992. *Economic Survey 1991-1992*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p 81.

³⁵ Economic Department, Ministry of Finance & Company Affairs. 1993. *Economic Survey 1992-1993*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p 13.

³⁶ Economic Department, Ministry of Finance & Company Affairs. 1993. *Economic Survey 1992-1993*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p 178.

³⁷ Economic Department, Ministry of Finance & Company Affairs. 1994. *Economic Survey 1993-1994*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p 129.

³⁸ Economic Department, Ministry of Finance & Company Affairs. 1995. *Economic Survey 1994-1995*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p 134.

³⁹ Economic Department, Ministry of Finance & Company Affairs. 1996. *Economic Survey 1995-1996*. New Delhi: Ministry of Finance & Company Affairs, Government of India. p 144.

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.⁴⁰

The government also announced in January 1997 the first ever guidelines for FDI expeditious approval in areas not covered under automatic approval.

This above trends illustrates the earlier point of the government recognizing and carrying forth of the previous work done by the Rao government. While the advantage of FDI did not reach the mindset of the common man the government seemed to show possibilities of development through FDI. For example when Indian industry registered a modest growth rate of 7.1 per cent in 1996-97, which was much lower than the 12.1 per cent growth in 1995-96, there was research carried out which revealed this was partially attributable to the mining and electricity generation sectors which recorded meagre growth rates of 0.7 per cent and 3.9 per cent respectively. Thus the policy was immediately rectified by expanding the list of industries eligible for foreign direct equity investment under the automatic approval route by RBI in 1997-1998.⁴¹

For infrastructure there was a realization that investments were, by their very nature, for long-term return activities. This implies that there is a continuing mismatch between the required debt maturities and the availability of funding. The focus of this government shifted from Infrastructural direct investment to more towards equity investment. In terms of specific cases there is only literature on two areas namely roads and ports in relation to FDI. By 1997-1998 the most the term "infrastructure" was expanded to include telecom, oil exploration and industrial parks to enable these sectors to avail of fiscal incentives such as tax holidays and concessional duties. Liberalisation of foreign investment norms in the road sector resulted in granting of automatic approvals for foreign equity participation up to 74 per cent in the construction and maintenance of roads and bridges and up to 51 per cent in supporting services to land transport like operation of highway bridges, toll roads and vehicular tunnels.⁴² Civil Aviation also dealt with a new policy for private investment that was announced allowing for 100 per cent NRI/OCB equity and 40 per cent foreign equity participation in domestic airlines.⁴³ The development of the Infrastructure sector for FDI was still haphazard as power, telecommunications, postal services, railways, urban Infrastructure have no mention of FDI.

In a narrative of the governments it can be easily observed that a strong legacy of FDI was inherited and the trend that continued were along the same fissures of development whereby liberal policies advanced with certain modifications. The weak hold on power by the

⁴⁰ Economic Department, Ministry of Finance & Company Affairs. 1997. *Economic Survey 1996-1997*. New Delhi: Ministry of Finance & Company Affairs, Government of India. Available at <http://indiabudget.nic.in/es96-97/CHAPT7.HTM>. Internet

⁴¹ Economic Department, Ministry of Finance & Company Affairs. 1998. *Economic Survey 1997-1998*. New Delhi: Ministry of Finance & Company Affairs, Government of India. Available at <http://indiabudget.nic.in/es97-98/indus.htm>. Internet

⁴² Economic Department, Ministry of Finance & Company Affairs. 1998. *Economic Survey 1997-1998*. New Delhi: Ministry of Finance & Company Affairs, Government of India. Available at <http://indiabudget.nic.in/es97-98/infra.htm>. Internet

⁴³ Economic Department, Ministry of Finance & Company Affairs. 1998. *Economic Survey 1997-1998*. New Delhi: Ministry of Finance & Company Affairs, Government of India. Available at <http://indiabudget.nic.in/es97-98/chap98.pdf>. Internet

government meant there could not be an overhaul by further increasing FDI at a phenomenal level but slowly opened the economy by carrying on the reforms that the Congress had started.

A Procedural Battle

In the next governments of the BJP, though the party ideology was initially formulated with its own unique ways of FDI advancement, the prospect of advancing overall development, and an established system by the last two governments resulted in continuing the reforms in the economy along the same lines. In course of the year several policy measures were announced for reviving industrial investment. These included reduction of income and corporate tax rates, reduction in excise duties on intermediates and customs duties on raw materials, reduction in bank rate and cash reserve ratio. By now the government had liberalised investment norms in various sectors, further simplified procedures, delicensed and de-reserved some of the key industries and stepped up public investment in infrastructure industries.

For industry the period started with a decline whereby the total foreign investment (FDI and portfolio) declined to \$ 2312 million in 1998-99 from \$ 5853 million in 1997-98, as a result of a reduction of \$ 1.8 billion portfolio flows and a 32 per cent reduction in FDI. During 1998, the flows to developing countries declined by 3.8 per cent, resulting in India's share in these flows falling sharply to 1.4 per cent. World FDI flows to developing countries peaked in 1997 (\$ 173 billion) when India's share in these flows was 1.9 per cent.⁴⁴ Nationally this resulted in several measures taken for facilitating the inflow of foreign investment in the economy. The scope of the automatic approval scheme of the RBI was again significantly expanded. The Government decided to place all items under the automatic route for Foreign Direct Investment/ NRI and OCB investment except for a small negative list and set up a Group of Ministers for reviewing the existing sectoral policies and caps. The Union Budget (1999-2000) permitted FDI up to 74 percent, under the automatic route, in bulk drugs and pharmaceuticals. In 2000-2001 the time frame for consideration of FDI proposals was reduced from 6 weeks to 30 days for communicating Government decisions. The 2001-2002 years were not good for Industry due to an industrial slowdown.

For Infrastructure by 1998-1999 the narrative is stabilizing to the same concept of broad statements regarding the role of infrastructure and its importance to the government. In terms of procedures automatic approval for foreign equity participation up to 100 per cent is permitted for electricity generation, transmission and distribution for foreign equity investment not exceeding Rs.1500 crore (excluding atomic reactor power plants). Once again in the outlook section the government realized the importance of infrastructure but there are not concrete steps listed to achieve this. In 1999-2000 there is talk of infrastructure growing in the year there is no data available on the role and amount of foreign direct investment.

Breaking down into sub sectors for Infrastructure reveals that compared to Industry, Infrastructure has had a large discrepancy in its sub-sectors. For example the power sector performance during the period 1992-93 to 1999-2000 has been disappointing despite significant reforms in the sector, such as setting up of a regulatory authority and opening power generation to private investment, both domestic and foreign. For the postal sector the emphasis on social objectives has outweighed other considerations and user charges

⁴⁴Economic Department, Ministry of Finance & Company Affairs. 1999. *Economic Survey 1998-1999*. New Delhi: Ministry of Finance & Company Affairs, Government of India. Available at <http://indiabudget.nic.in/es98-99/indus.htm>. Internet.

remained low. Therefore, notwithstanding the revision of tariff, the postal services continue to run into a deficit; in 1999-2000, the postal deficit was Rs. 1,596 crore. One of the important conclusions of the above review of infrastructure development is that the demand for infrastructure services continues to outpace supply.

There is recognition of the role of Infrastructure in the upcoming years, as it is a 'pre-condition to rapid economic development' but the policies have not brought the required change as quickly as expected. For example in urban infrastructure 100 percent FDI has been permitted on the development of integrated townships since 2001. However investments did not materialize because of very rigid existing conditions relating to land procurement especially in urban areas, where land revenue and reform legislation have precedence over organization. Moreover there are problems relating to lack of clear titles, old protective tenancy and rent control. The suggestion is that the system of maintenance of land records needs to be improved through computerization.

FDI Redux

By 2002 FDI changes completely for India as it is given new importance in Ministry of Finance's Economic Survey in the form of a new subsection in Industry that exclusively dealt with FDI and went to great lengths to define its role, and provides much more data than in the previous years. There is also particular mention on how RBI is evaluating some modifications in the way that Indian FDI is measured, which could lead somewhat higher estimates for India. By now garnering FDI is a prized commodity in a competitive global arena and is analysed in context as other countries are also improving policies and institutions, to further increase their FDI flows. By 2003-2004 the non-comparability of the Indian FDI statistics was addressed by a committee constituted in May 2002 by Department of Industrial Policy & Promotion (DIPP), in order to bring the reporting system of FDI data in India into alignment with international best practices.⁴⁵

For infrastructure from 2002-2003 (re formulation of FDI data) there is mention in sub sectors for FDI and not for infrastructure as a whole. Telecom has been a major recipient of FDI and during the period of

August 1991 to June 2002, 831 proposals for FDI of Rs. 56,226 crore were approved and the actual flow of FDI during the above period was Rs. 9528 crore. In terms of approval of FDI, the telecom sector is the second largest after the energy sector. In 2002, the increase of FDI inflow was of the order of Rs 1077 crore during January to July 2002.⁴⁶

The FDI target for the Telecommunication sector is estimated at US \$2.5 billion per annum, by the Steering Group on FDI, Planning commission. By 2003-2004 literature on Infrastructure talks about investments needed to bring infrastructure to world standards. However there is no mention of details. Finally for 2004-2005 there is data for Telecom but in general there is no data on FDI in the infrastructure sector as a whole.

The analysis of both the sectors and especially Infrastructure raises questions on the haphazard nature of FDI taking place. While this trend may have been acceptable in the

⁴⁵ The committee submitted report in October 2002, and recommended that FDI statistics should include, besides equity capital, 'reinvestment earnings (retained earnings of FDI companies) and other direct capital (inter corporate debt transactions between related entities).

⁴⁶ Economic Department, Ministry of Finance & Company Affairs. 2003. *Economic Survey 2002-2003*. New Delhi: Ministry of Finance & Company Affairs, Government of India. Available at <http://indiabudget.nic.in/es2002-03/chapt2003/chap94.pdf>. Internet.

early 1990s, when FDI was in its infancy the recognition and building of reforms by the successive governments raises the questions on what part of FDI is the government attention shifted in.

Sub sector: Telecommunications

Further narrowing of FDI in sub-sectors reveals more interesting trends. Research into Telecommunications furthers the haphazard nature of FDI investment and policy making. The current process for FDI in telecommunications can be attributed to two policies that were undertaken by the government: National Telecom Policy of 1994 and New Telecom Policy of 1999. Before the economic reforms 'teledensity' was low, infrastructure growth was slow, and the lack of reforms restricted investments and adoption of new technologies. The existing legislative and regulatory environment needed major changes to facilitate growth in the sector.

It was 1991 when the programme was undertaken to expand and upgrade India's vast telecom network. The programme included: complete freedom of telecom equipment manufacturing, privatisation of services, liberal foreign investment and new regulation in technology imports.⁴⁷ Simultaneously, the government-managed Department of Telecommunications (DoT) was restructured to remove its monopoly status as the service provider.⁴⁸ The government programme was formalised on a telecom policy statement called National Telecom Policy 1994 on 12 May 1994. However the 1994 policy was not sufficient to make the India's telecommunications sector fully open and liberalised. The incumbent monopoly (DoT) was indifferent in implementing the national telecom policy effectively due to its lack of commitment and also due to the instability at the Centre (frequent changes of governments) over 1994 and 1998. This paved the way for designing a new policy framework for telecommunications which was called the New Telecom Policy 1999 (NTP99) and was delivered by the new government led by BJP coalitions.

The New Telecom Policy 1999 (NTP99) was developed at the backdrop of three major events witnessed by the Indian economy after the reform process began in 1991. First, although NTP94 was a right step to bring reform in the telecommunications industry, it failed to achieve a desired goal until 1997. Second, the coalition government of the BJP brought stability to the Central government and after assuming power; the BJP-led government announced and followed through with further reform in telecommunications to attain an effective and efficient communications sector.⁴⁹ This policy is an example that economics reforms and political systems coexist. In order to achieve the BJP-led coalition government immediately formed a high powered committee to develop the Internet Services Development Policy headed by then Kerala CM Chandrababu Naidu.⁵⁰ The committee and the interest of the government led to the new policy.

As a result in addition to the sectoral caps, the government policy played a major role in the liberalization of the telecom sector. As a result a large number of private operators started operating in the basic/mobile telephony and Internet domains. Teledensity has increased, mobile telephony has established a large base, the number of Internet users has seen a steep growth, and large bandwidth has been made available for software exports and IT-

⁴⁷ Hossain, Moazzem and Rajat Kathuria. 2003. Telecommunications Reform and the Emerging 'New-Economy': The Case of India. Available at <http://www.devstud.org.uk/publications/papers/conf03/dsaconf03hossain.pdf>.
Internet.

⁴⁸ Ibid.

⁴⁹ Ibid.

⁵⁰ Ibid.

enabled services, and the tariffs for international and domestic links have seen significant reductions.

FDI Culture

Many economists in the country have now realized the advantages of FDI to India. While the achievements of the Indian government are to be lauded, a willingness to attract FDI has resulted in what could be termed an "FDI Industry". While researching the economic reforms on FDI, it was discovered that there exists a plethora of boards, committees, and agencies that have been constituted to ease the flow of FDI. A call to one agency about their mandate and scope usually results in the quintessential response to call someone else. Reports from FICCI and the Planning Commission place investor confidence and satisfaction at an all time high; citizens too deserve to be clued in on the government bodies are doing.

According to the current policy FDI can come into India in two ways. Firstly FDI up to 100% is allowed under the automatic route in all activities/sectors except a small list that require approval of the Government. FDI in sectors/activities under automatic route does not require any prior approval either by the Government or RBI. The investors are required to notify the Regional office concerned of RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issue of shares to foreign investors.⁵¹ All proposals for foreign investment requiring Government approval are considered by the Foreign Investment Promotion Board (FIPB). The FIPB also grants composite approvals involving foreign investment/foreign technical collaboration.⁵² As this clarity is useful for future investors, it has to be seen if these bodies are effective. The Initial research revealed four major bodies that have been constituted and could provide data pertaining to FDI

1991 Foreign Investment Promotion Board FIPB

- consider and recommend Foreign Direct Investment (FDI) proposals, which do not come under the automatic route. It is chaired by Secretary Industry (Department of Industrial Policy & Promotion).

1996 Foreign Investment Promotion Council FIPC

- constituted under the chairmanship of Chairman ICICI, to undertake vigorous investment promotion and marketing activities. The Presidents of the three apex business associations such as ASSOCHAM, CII and FICCI are members of the Council.

1999 Foreign Investment Implementation Authority FIIA

- functions for assisting the FDI approval holders in obtaining various approvals and resolving their operational difficulties. FIIA has been interacting periodically with the FDI approval holders and following up their difficulties for resolution with the concerned Administrative Ministries and State Governments.

2004 Investment Commission

- Headed by Ratan Tata, this commission seeks meetings and visits industrial groups and houses in India and large companies abroad in sectors where there was dire need for investment.

Attempting to research and call these bodies resulted in no direct contact but a list of various other sub bodies.

⁵¹ Department of Industrial Policy and Promotion. 2005. *Foreign Direct Investment-Policy & Procedures*. New Delhi: Government of India. p.2. Available at http://dipp.nic.in/manual/manual_03_05.pdf. Internet.

⁵² Ibid.

Project Approval Board (PAB) for approving foreign technology transfer proposals not falling under the automatic route.

- **Licensing Committee (LC)** for considering and recommending proposals for grant of industrial license.
- In addition, concerned Ministries/ Departments issue various approvals as per the allocation of business and various Acts being administered by them.
- At the **State level**, State Investment Promotion Agency and, at the district level,
- **District Industries Centres**, generally look after projects.
- Concerned departments of the State Government handle sectoral projects.
- **Fast Track Committees (FTCs)** have been set up in 30 Ministries/Departments for close monitoring of projects with estimated investment of Rs. 100 crores and above and for resolution of issues hampering implementation.
- **“Investment Promotion and Infrastructure Development Cell”** gives further impetus to facilitation and monitoring of investment, as well as for better coordination of infrastructural requirements for industry
- **SIA** has been set up by the Government of India in the Department of Industrial Policy and Promotion in the Ministry of Commerce and Industry to provide a single window for entrepreneurial assistance, investor facilitation, receiving and processing all applications which require Government approval, conveying Government decisions on applications filed, assisting entrepreneurs and investors in setting up projects, (including liaison with other organizations and State Governments) and in monitoring implementation of projects.
- **CCFI Cabinet Committee on Foreign Investment**- meets at the ministerial level and is guided by the prime Minister, considers foreign investment exceeding Rs 3 billion as requiring special political attention.
- **Indian Missions Abroad**- can also receive project proposal and will forward them to the institutions in New Delhi.
- **Indian Investment Centre**- (This was supposed to be closed after the Planning Commission was established but still continues to operate) established as an autonomous organization in 1960 with the objective of doing promotional work abroad to attract foreign private investment into India and establishment of joint ventures, technical collaborations and third country ventures between Indian and foreign entrepreneurs.

Officially FDI policy is reviewed on an ongoing basis and measures for its further liberalization are taken. The

change in sectoral policy/ sectoral equity cap is notified from time to time through Press Notes by the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion. Policy announcement by SIA are subsequently notified by Reserve Bank of India (RBI) under Foreign Exchange Management Act (FEMA).⁵³

While clear procedures have been established for FDI but the government needs to seriously evaluate how much resources and money is being poured to what is becoming the FDI industry. At present the monetary value of FDI is feeding a makeshift industry that deals with dealing with the concept and procedures of FDI.

Conclusion

⁵³ Department of Industrial Policy and Promotion. 2005. *Foreign Direct Investment-Policy & Procedures*. New Delhi: Government of India. p.1. Available at http://dipp.nic.in/manual/manual_03_05.pdf. Internet.

As evidenced by analysis and data the concept and material significance of FDI has evolved from the shadows of shallow understanding to a proud show of force. The government while serious in its efforts to induce growth in the economy and country started with foreign investment in a haphazard manner. While it is accepted that the government was under compulsion to liberalize cautiously, the understanding of foreign investment was lacking. A sectoral analysis reveals that while FDI shows a gradual increase and has become a staple for success for India, the progress is hollow (Annexure 1 and 2). The Telecommunications and power sector are the reasons for the success of Infrastructure. This is a throwback to 1991 when Infrastructure reforms were not attempted as the sector was performing in the positive. FDI has become a game of numbers where the justification for growth and progress is the money that flows in and not the specific problems plaguing the individual sub sectors.

Political parties (Congress, BJP, CPI (M)) have changed their stance when in power and when in opposition and opposition (as well as public debate) is driven by partisan considerations rather than effort to assess the merit of the policies. This is evident in the public posturing of Hindu right, left and centrist political parties like the Congress. The growing recognition of the importance of FDI resulted in a substantive policy package but also the delegation of the same to a set of eminently dispensable bodies. This is indicative of a mood of promotion counterbalanced by a clear deference of responsibility.

In the comparative studies the notion of Infrastructure as a sector has undergone a definitional change. FDI in the sector is held up primarily by two sub sectors (telecommunications and Power) and is not evenly distributed.

The three major industrial houses (CII, ASSOCHAM, FICCI), World Bank and the Planning Commission have similar recommendations for FDI and yet despite their concurrence, a comprehensive policy in this respect is still to be formulated after 15 years of India's economic reforms. The *Swadeshi* alternative has receded in public policy debate.

The decisions governing FDI have been spread over many areas and agencies that have to be streamlined or an overarching regulatory body and practical policy has to be developed.

Thus the impact of the reforms in India on the policy environment for Foreign Direct Investment presents a mixed picture. The industrial reforms have gone far, though they need to be supplemented by more infrastructure reforms, which are a critical missing link.

Annexure

Annexure 1

Table 7.17 : Foreign direct investment approval and inflows					
Sl. No.	Financial Year	Amount in rupees in crore		Amount in US\$ in million	
		Approvals	Inflows	Approvals	Inflows
1	1991-1992 #	1,345	408	527	165
2	1992-1993	5,546	1,094	1,976	393
3	1993-1994	7,469	2,018	2,428	654
4	1994-1995	9,971	4,312	3,178	1,374
5	1995-1996	36,608	6,916	11,439	2,141
6	1996-1997	40,206	9,654	11,484	2,770
7	1997-1998	40,033	13,548	10,984	3,682
8	1998-1999	30,324	12,343	7,532	3,083
9	1999-2000	17,976	10,311	4,266	2,439
10	2000-2001	25,207	12,645	5,754	2,908
11	2001-2002	14,465	19,361	3,160	4,222
12	2002-2003	7,904	14,932	1,654	3,134
13	2003-2004	6,224	12,117	1,353	2,776
14	2004-2005 *	6,784	11,726	1,475	2,549
Total		250,062	131,385	67,210	32,290

Notes: 1. # Aug.-March; * Up to November 2004

2. As most of the sectors /activities have been placed under automatic route in recent years, which do not require any approval, the FDI approvals statistics are not a true reflection of the FDI approved.

Annexure 2

Table 7.18 : Sector-wise FDI approvals and inflows

(Cumulative from August 1991 to November 2004)

Amount rupees in crore (US \$ in million)

Rank	Sector	No. of approvals	Amount approved	percentage approved Amount in rupee terms	Amount Inflows	Percentage of total Inflows in rupees terms*
1.	Fuels					
	> Power	371	43,687 (11,888)	17.47	-	-
	> Oil Refinery	338	26,079 (7,185)	10.43		
	TOTAL (power + oil refinery)	709	69,766 (19,073)	27.90	10,433 (2,459)	9.78
2.	Telecommunications (radio paging, cellular mobile, basic telephone services)	805	41,371 (11,441)	16.54	11,231 (2,674)	10.53
3.	Transportation industry	1,105	21,110 (5,427)	8.44	12,123 (2,909)	11.36
4.	Electrical equipments (including computer software & electronics)	4,746	18,947 (4,888)	7.58	16,093 (3,793)	15.09
5.	Metallurgical industries	428	15,412 (4,212)	6.16	2,043 (481)	1.92
6.	Services sector (financial, non-financial & others)	1,332	16,917 (4,417)	6.77	8,752 (2,174)	8.20
7.	Chemicals (other than fertilizers)	1,074	12,618 (3,492)	5.05	6,405 (1,653)	6.00
8.	Food-processing industries	784	9,562 (2,746)	3.82	4,481 (1,128)	4.20
9.	Hotel and tourism	537	4,909 (1,353)	1.96	981 (232)	0.92
10.	Paper and pulp (including paper products)	137	3,116 (832)	1.25	1,282 (336)	1.20
11.	Other sectors (total of remaining sector excluding above)	7,078	36,334 (9,330)	14.53	57,561 (14,451)	30.80
	Total for all sectors (August 1991 to November 2004)	19,444	2,50,062 (67,211)	100.00	1,31,385 (32,290)	100.00
Note:						
1. As most sectors/activities have been placed under automatic route in recent years, which do not require any approval, the FDI approval statistics are not a true reflection of the FDI approved.						
2.* Percentage figures do not take into account the amount of FDI inflows for RBI's-NRI Schemes, acquisition of existing shares (upto 1999), stock swapped & advance pending for allotment of shares, as these are not categorized, Sector-wise.						

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