

CHAPTER I: THE INDIAN ECONOMY: AN OVERVIEW

Following independence, India pursued a development policy based on centralised planning, regulation and control of private enterprise, state ownership, trade protection and limits on the penetration of foreign capital and technology. This regime determined India's economic development until the mid-1980s when there began some movement towards economic liberalisation and market orientation. India experienced a crisis in its balance of payments in early 1991, which threatened to destabilise the economy.

In response to this crisis, the Government implemented a programme of structural reforms, aimed at stabilising the economy and promoting reliance on market mechanisms, broadly referred to as 'liberalisation'. The main components of the structural reforms programme were exchange and trade liberalisation; financial sector reforms and control of the budget deficit; inflation and money supply. A great deal of significance was placed on promotion of foreign technology transfers and foreign investment in key areas, as well as, the further development of the private sector.

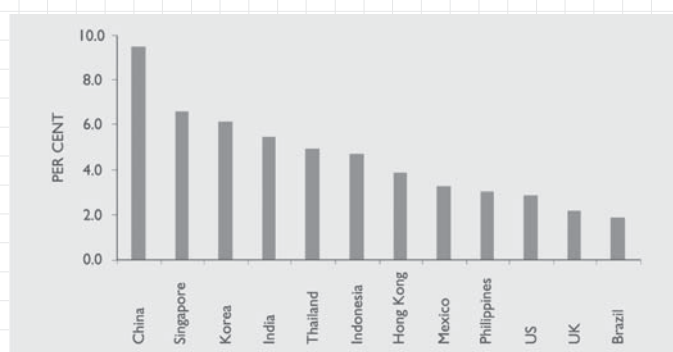
Box I.1: Critical Reforms in the Indian Economy

- Rupee made fully convertible on trade account as of March 1, 1993 and gradual movement towards capital account convertibility set underway
- Abolition of industrial licensing, except in a few 'strategic' sectors
- Rationalisation of indirect and direct tax structures
- Removal of all quantitative restrictions on imports and decontrol of interest rates
- Foreign Direct Investment (FDI) allowed in most sectors of the economy, including services. Bulk of this investment allowed through the 'automatic' route, not requiring specific Government permissions
- Portfolio investments by Foreign Institutional Investors (FIIs) allowed in both equity and debt markets
- The Fiscal Responsibility and Budget Management (FRBM) Act enacted in 2003
- Foreign Direct Investment (FDI) limits raised in telecom, refining and banking; and permitted in insurance

Macro Economic Performance

The policy of liberalisation translated into fairly robust economic performance on almost all fronts. The average Gross Domestic Product (GDP) growth during the period 1992-93 to 2003-04 was a healthy 6.1 per cent as compared to 5.6 per cent during the previous decade. From an international perspective, India figured among the fastest growing economies even in the last decade (Chart 1.1) The Government of India in its Tenth Five Year Plan (2002-2007) has expressed a need to enhance the growth rate further and has set a target of an 8 per cent average annual growth in GDP.

Chart 1.1: Average GDP Growth (1990-2002)

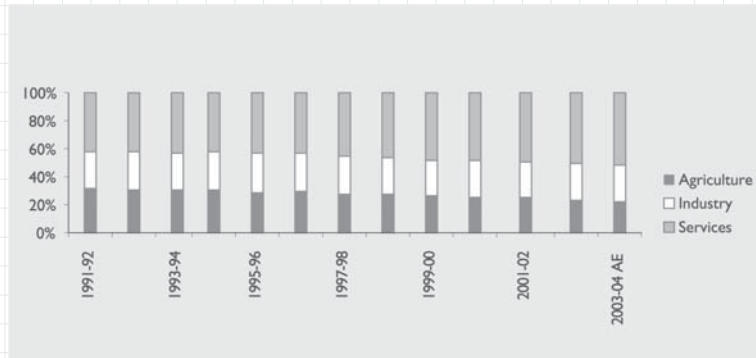


Source: WDI 2004.

The key characteristics of the post-liberalisation growth path include:

- The steady growth and rising share of the 'services' sector (Chart 1.2). This captures the buoyancy of sectors such as information technology, telecommunications and banking & financial services in the economy.

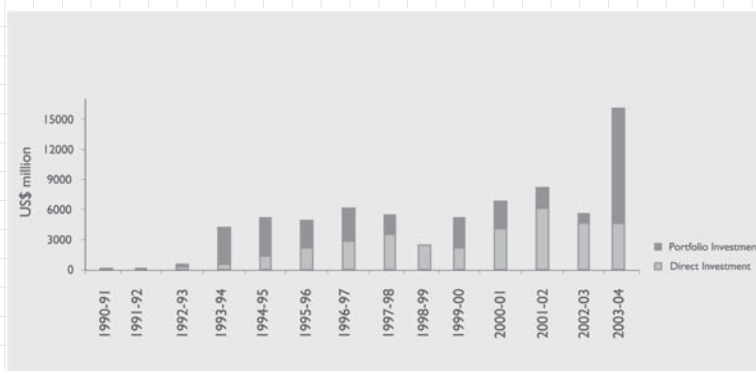
Chart 1.2: Rising Contribution of Services Sector to Overall GDP



Source: CSO

- The growing role of the private sector in investment, both on a stand-alone basis and in partnership with the Government. As a percentage of GDP, the share of private sector investments has gone up from 12.5 per cent in the eighties to 15.4 per cent in the nineties
- The increased importance of foreign resources, both in the form of 'portfolio' and 'Foreign Direct Investments' (Chart 1.3). The result has been a dramatic increase in foreign exchange reserves that are likely to ward off any possible external crisis. The foreign exchange reserves stand at US\$ 118.2 billion as on end September 2004

Chart 1.3: Foreign Investment Inflows

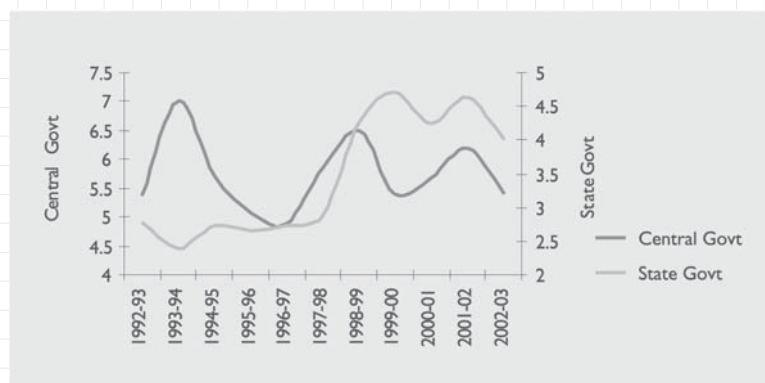


Source: RBI
*Data for 2003-04 is provisional.

The Fiscal Scenario and Policy Initiatives

One of the more serious concerns about the Indian economy has centered on the budgetary position of the Government. For 2002-03, the consolidated fiscal deficit of the Central and State Governments put together touched 9.4% of the GDP (Chart 1.4). Such high deficit levels could potentially act as a brake on the economic growth rate by raising interest rates and diverting expenditure to debt-servicing, rather than more productive expenses.

Chart 1.4: Central and State Government Fiscal Deficit (per cent)



Source: CGA
RBI State Finances

Some critical initiatives have been taken, both at the central and state levels to address these issues, notably the enactment of the Fiscal Responsibility and Budgetary Management Act (FRBMA) and the planned introduction of a VAT regime by the State Governments by April 2005 (see box 1.2). Both are likely to help in bringing the fiscal situation under control.

Box 1.2: FRBM Act and State VAT

Fiscal Responsibility and Budget Management Act

The Fiscal Responsibility and Budgetary Management Bill (FRBMB) was introduced in the Parliament in 2000 and enacted by the Parliament in August 2003, resulting in the Fiscal Responsibility and Budget Management Act (FRBMA). It provides a legal and institutional framework for reducing the deficits and stabilising debt over the medium term. It sets a clear-cut target for the elimination of revenue deficit by 2008. The Act also requires the Central Government, to place before the Parliament, along-with the budget each year, the following statements: a medium-term Fiscal Policy Statement, specifying three-year rolling targets for specified fiscal indicators; a Fiscal Policy Strategy Statement, dealing with the fiscal strategy in the following year and a rationale for deviation in fiscal measures related to taxation, subsidies and borrowings etc; and a Macroeconomic Framework Statement, containing assessment of growth prospects of the economy alongwith underlying assumptions.

This Act, thus, provides a medium term perspective to the fiscal policy of the Central Government, binding it to a pre-specified path of fiscal consolidation, while providing flexibility in fiscal management under extraordinary circumstances like war and natural calamities.

State VAT - Issues and Initiatives

Commodity taxes in India are levied by the Centre in the form of excise and customs duties and by the States in the form of sales tax, octroi (an entry tax) and State Excise Duties. The bulk of Central Excise already works under a Value Added Tax (VAT) regime called CENVAT. The State VAT seeks to replace the commodity taxes imposed by States with two important benefits:

- elimination of tax-cascading
- facilitation of faster movement of goods across States

State VAT is likely to be implemented by April 2005. This is likely to lead to a sharp increase in productivity across States and enhance State tax collections in the medium term.

Demographic Transition – Opportunities and Challenges

Changing population structure constitutes one of the key opportunities and challenges confronting the Indian economy. Estimates by the Planning Commission show a rising share of the 'working age' (15-59) population over the long term (see table 1.1) and a relative decline in the dependent (0-14) age-groups .

Age group	2001	2006	2011	2016
0-14	35.6	32.5	29.7	27.1
15-59	58.2	60.4	62.5	64
60 +	6.3	7	7.9	8.9
All age groups	100	100	100	100
Population	1,027.00	1,113.70	1,194.40	1,267.50

Source: Planning Commission, Government of India

This clearly has implications in terms of:

- Creation of a large pool of labour that can support industrial growth without putting excessive pressure on wages
- A larger share of wage earners in the population also means a higher demand for consumer goods and services. This will help support growth in these sectors

However, the critical challenge clearly lies in providing employment to those entering the labour force. This has to come from enhanced buoyancy of the industrial and service sectors. It is thus, important to ensure that the accelerated GDP growth target of 8 per cent envisaged for the Tenth Five Year Plan period is met.

Indian Industry – Sunrise Sectors and Opportunities

Economic liberalisation and increased globalisation have effectively changed the Indian industrial landscape. Increased opportunities, greater access to resources and knowledge and the forces of competition have transformed it quite dramatically. A number of knowledge and technology intensive sectors have emerged as the sunrise sectors. This section reviews the recent performance of three such 'sunrise' sectors to illustrate the changing shape of India's industrial economy.

Information Technology

The Indian IT industry is heavily leveraged on the global IT market (estimated at US\$ 1 trillion), with more than 50 per cent of its total revenues of about US\$ 17 billion in 2002-03 coming from exports. The biggest buyer is the US with a 60 per cent share, followed by the EU with about 25 per cent. The growth of this sector has led to tremendous pay-offs in terms of wealth creation and employment. The Government has taken a number of initiatives to help sustain its growth (see box 1.3) The key to sustaining this growth lies in the ability of Indian companies to move up the value chain and into areas like IT consulting and systems integration, as well as targeting new industries such as healthcare and retailing.

Finally, a number of Indian companies are exploring the Business Process

Box 1.3: Major Government Initiatives in the IT Sector

- Setting up of a new Ministry of IT in October 1999, which was re-christened as Ministry of Communication and IT in September 2001
- Creation of an IT Venture Capital Fund of about US\$ 21 million in 1999
- Enactment of the Information Technology (IT) Act, 2000, which provides legal recognition to transactions through electronic data interchange
- Lowering custom duties on IT products
- Allowing 100 per cent Foreign Direct Investment (FDI) in the sector, raising the limit on the issue of American Depository Receipts/Global Depository Receipts (ADR/GDR)
- Computerisation of Government departments by spending up to 3 per cent of the budget on IT
- Information Technology Agreement (ITA) of 1996 under which members agreed to reduce the tariff on information technology products to zero
- e-Governance and Software Technology Parks

business, also referred to as IT Enabled Services. This is the fastest growing area in the IT segment with an average growth of close to 70 per cent over the last three years, taking the size of the segment to about US\$ 1600 million in 2001-02.

Critical challenges in the sector, however, still remain to be tackled, and are likely to form the basis of new policy initiatives in the sector. These include:

- A revamp of education policy to meet the manpower needs of the sector. According to a McKinsey-NASSCOM study, India would require 2.2 million IT professionals by 2008
- Efforts to enhance the role of the computer hardware sector that currently accounts for 40 per cent of total revenues of the IT sector. This, in turn, would help in raising personal computer penetration from the current 5.8 per cent
- To effectively use IT, to enable better delivery of public goods and services (e-Governance)

Pharmaceuticals

The year 2005 will be a watershed year for the Indian pharmaceutical industry when India will start implementing a product patent regime (only process patents are recognised now). The industry is adequately geared to meet these challenges. In fact, the process of preparing for this shift in regime has shaped the domestic industry that has strong skills in pharmaceutical manufacturing and chemistry, resulting in globally competitive manufacturing costs and a basket of exportable goods (mainly formulations).

Thus, the Indian pharmaceutical industry is not only able to service domestic markets, but is also actively involved in exports. Exports accounted for nearly 38 per cent of the total pharmaceuticals production with the main focus on the generics market (drugs that do not enjoy patent protection) and bulk drugs (raw materials). The Indian industry has devoted a significant amount of resources to obtaining regulatory clearances for marketing in the developed markets. The growing affluence of the Indian population, the proposed increase in spending on health by the Government and an increasing number of drugs coming off patent (estimated at US\$ 65 billion in the 2003-2008 period) are likely to help maintain the current momentum of the industry.

Auto Ancillaries

The US\$ 3.75 billion Indian auto ancillaries and components industry has established itself as a major player in both the domestic and international markets. A major feature of the auto ancillary industry is its high degree of export orientation - exports had grown from US\$ 330 million in 1997-98 to US\$ 800 million in 2002-03. Exports to US and Europe forms around 60 per cent of total component exports, followed by exports to Asian markets. India's presence in the international market is likely to grow further as global manufacturers leverage India's low-cost and highly skilled labour to reduce their cost of inputs.

Several Government initiatives have helped the industry. The Auto Policy of 2002 removed earlier stipulations on indigenisation and import-balancing requirements and granted 'automatic' permission to foreign automobile manufacturers to set up wholly owned subsidiaries in India. This had strong multiplier effects for the components industry. In addition, the recent Government initiatives such as improvement in road infrastructure, better connectivity to ports, and faster clearance of export consignments have reduced the time taken in exports, thereby saving on working capital requirements. The Government has also reduced customs duties on raw materials required to manufacture components, making Indian components more cost-competitive. The duty regime is targeted to match the ASEAN levels in the near future.

Infrastructure: Bottlenecks and Solutions

Infrastructure constitutes the backbone of any economy. Supply bottlenecks of critical services can hamper growth and development. The urgency to revamp infrastructure, stems not only from the need to service existing sectors, but also from the rapidly growing needs of the 'sunrise sectors', fuelled by their rapid growth. An increase in domestic penetration of IT services, for instance, needs expansion of broadband linkages in telecom. Global competitiveness of manufacturing sectors like auto-ancillaries require better road and port facilities, to keep costs down. Energy demands by China and India are already having a profound impact on fuel prices.

Successive Indian Governments have laid considerable emphasis on infrastructure; there is a substantial gap between rising demand and the supply or availability. India not only lags behind the developed countries, but also its developing country peers (see table 1.2).

Table 1.2: Some International Comparisons of Infrastructure Availability

	Electric power consumption (kWh per capita)	Telephone mainlines (per 1,000 people)	Roads paved (per cent of total roads)	Personal computers (per 1,000 people)
China	827	137	22	19
Hong Kong	5,447	580	100	387
India	582	38	46	6
Indonesia	384	35	46	11
Malaysia	2,628	196	76	126
Singapore	6,948	471	100	508
South Korea	5,607	486	75	256
Thailand	1,448	99	98	28
UK	5,601	588	100	366
US	12,331	667	59	625

Source: WDI 2003

However, recent policy initiatives in a number of these sectors address some of the critical bottlenecks in the infrastructure sectors, in a comprehensive fashion. Most importantly, they attempt to remove the barriers to greater private participation in these sectors, including Foreign Direct Investment. This section reviews some of the developments in the five critical areas of power, telecommunications, roads, railways and civil aviation.

Power

Despite a rapid expansion of power generation (from 1300 MW in 1947 to 1,13,506 MW in 2004) and simultaneous growth in transmission and distribution, the sector has not been able to keep pace with the growth in demand, resulting in a chronic shortage. During the Ninth Five Year Plan period, for instance, only 19,015 MW of actual capacity addition took place, compared to a target of 40,245 MW.

State Electricity Boards (SEBs), have traditionally been responsible for generating and supplying power. This in turn, has led to un-economic tariffs for the agricultural sector, lower slabs for domestic consumption and high transmission and distribution (T&D) losses that often result from theft and poor billing and collection efficiency.

A number of power sector reforms have been initiated since 1991. Some key reforms were:

- The Central Electricity Regulatory Commission (CERC) was set up at the national level and State Electricity Regulatory Commissions (SERCs) were set up in 23 states; with more in the offing
- The issue of one-time settlement of dues payable by SEBs was addressed by securitising the dues
- The Electricity Laws (Amendment) Act passed in 1998 to enable private participation in the transmission sector
- In 2000, the Indian Electricity Grid Code was established to ensure grid discipline
- An Accelerated Power Development and Reforms Programme (APDRP) was formulated to provide support to States undertaking distribution reforms

The process of reform in the sector culminated in the passage of the Electricity Act in 2003. The main features of the Act are:

- A National Electricity Policy was formulated
- Thermal generation was delicensed and captive generation permitted freely
- The regulatory commissions allowed open access to the distribution network
- Trading was recognised as a distinct trading activity
- Consumer tariffs were based on progressively reduced cross subsidies and move towards actual cost of supply
- Metering of connections to be made mandatory
- Provision for generation and distribution in rural areas was permitted without a licence.

The implementation of the Electricity Act is likely to bring far reaching changes in the sector and help incentivise both public and private investments. 11 Independent Power Producers (IPPs) with 4000 MW of capacity have already achieved financial closure in the last one year. Large investments are likely in all three critical areas – transmission, distribution and generation.

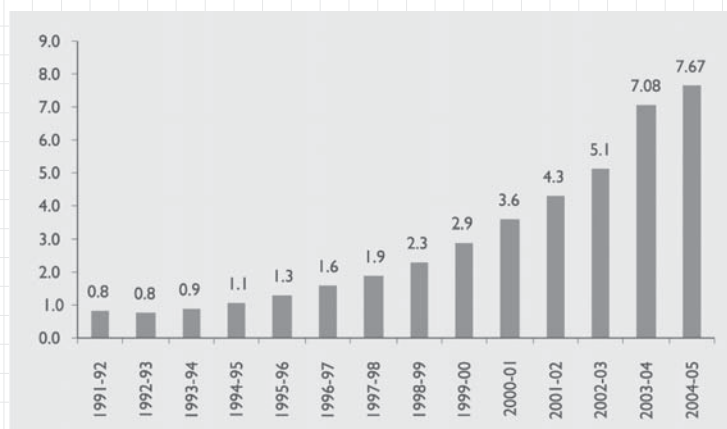
Telecommunications and IT

The telecommunications sector in India has seen a rapid transformation over the past decade manifested in a sharp rise in tele-density (see chart 1.5). Much of this change has been driven by policy initiatives and reforms (see box 1.4), recognizing the sector's role in the overall economic development as well as in supporting the expansion of Information Technology and related services.

The National Telecom Policy (NTP) explicitly recognises this dual role of the sector and emphasizes both:

- The provision of universal services to all uncovered areas
- Creation of a modern and efficient telecommunications infrastructure, taking into account the convergence of media, telecom and consumer electronics

Chart 1.5: Tele-density (connections per '00 households)



Source: Department of Telecommunications
*July 2004

In terms of the pattern of growth, the bulk of the growth in telephony over the last five years has come from cellular services with fixed line telephony lagging behind.

Box 1.4: Telecom Sector Reforms

- Telecom equipment manufacturing deregulated in 1991
- Cellular phone services and basic services thrown open to the private sector in 1992 and 1994 respectively
- The National Telecom Policy (NTP) allowing private sector participation in basic services announced in 1994 and replaced by NTP in 1999
- NTP'99 also provides for registration of Other Service Provider category to promote BPO activities
- Telecom Regulatory Authority of India (TRAI) set up in 1997 as an independent regulator
- New policy for Internet Service Providers (ISPs) announced in 1998, opening the area to the private sector
- Migration from fixed licence fee to revenue sharing regime in August 1999
- Establishment of a dispute settlement mechanism called Telecom Disputes Settlement and Appellate Tribunal through TRAI (Amendment) Act, 2000
- National long distance service opened to competition in August 2000
- International Long Distance (ILD) services and Internet telephony opened for competition with effect from April 1, 2002
- Introduction of Calling Party Pays (CPP) in May 2003

- Unifies Access Service Licensing regime for basic and cellular operators introduced in October 2003
- Interconnection usage charge introduced in 2003-2004
- Reduction in the licence fee for basic / cellular / unified access services with effect from April 1, 2004

While there has been considerable expansion of tele-density over the last few years, the levels are low compared to both developed and developing economy standards. To achieve the optimal level of service provision, the Government's broad policy of taxes and regulation will have to be largely promotional. As pressures build up on the radio frequency spectrum, the policy of allocating frequency spectrum will also have to be revisited.

A large number of policy initiatives in the Indian telecom sector and the huge potential that the Indian market offers, are likely to enhance the volume of investment in this sector and help meet the objective of increasing the tele-density.

Railways

The Indian railway network is one of largest railway systems in the world with a capital base of about US\$ 11.5 billion. It has an extensive network, spread over 63,122 Route Kilometres (Rkm). Approximately, 26 per cent of the railway network is electrified.

One of the critical problems in Indian railways has been the decline in share of its internal resources, which has negatively impacted its financial position. This decline is due to the loss of its freight market share to road transport, which has seen massive investments in the highway and pipeline sectors. Relatively higher freight rates in order to subsidise ordinary passenger segments have also taken their toll. Besides this, there is a large speed differential between freight and passenger services that reduces the traffic throughout the system. The use of IT in freight segment is also somewhat short of the potential.

In order to ease these bottlenecks, the Government has adopted a number of new initiatives:

- World's largest reservation system has been set up. It connects 2,500 terminals through the Internet.
- First phase of computerised Freight Operation Information System completed to enable online tracking of cargo
- Freight structure rationalised by reducing the number of classes and the ratio between the highest and lowest freight rates
- High speed goods trains, time tabled parcel trains and integrated transport facilities are being developed through the terminal warehousing scheme
- A new BOLT scheme, which envisages private participation, has been initiated
- Various models of participation by State Governments (cost-sharing model) in railway projects have been initiated
- Finally, the National Rail Vikas Yojana announced in August 2002, focuses on:
 - Strengthening of the golden quadrilateral to enable the railways to run more long-distance mail and freight trains at higher speed
 - Strengthening of rail connectivity to ports and development of multimodal corridors to the hinterland
 - Completion of four mega bridges, 'last mile' and other important projects

Roads

The Indian road network of 3.3 million kms is the second largest in the world. Roads carry about 70 per cent of the freight and 85 per cent of passenger traffic and can be broadly divided into national highways, state highways, major district roads and rural roads. A number of initiatives have been taken by the Government in the last few years to improve the quality of the road network (see box 1.5). The result of the initiatives is now visible and has dramatically enhanced the quality of road travel and transport in India.

Box 1.5: Road Sector Initiatives

- System of annuity based BOT system in place to attract private sector investors
- The National Highways Development Project (NHDP) comprising:
 - 5,846 km Golden Quadrilateral (GQ) connecting the four metro cities with an investment of US\$ 11 billion
 - 7,300 km North-South and East-West corridors
 - 1,133 km of port connectivity
- Creation of a Central Road Fund to mobilise resources through cess to fund road construction
- 100 per cent Foreign Direct Investment (FDI) allowed in road sector projects
- Duty-free import of specified modern high capacity equipment for highway construction
- State Government initiatives such as enacting infrastructure development acts, amendments to the Indian Tolls Act and setting up of State Road Development Corporations

The thrust in this critical area is likely to continue with the Government playing an active role in investments. The partnership with the private sector in this area is likely to gain momentum.

Civil Aviation

The civil aviation sector in India has made significant strides in coping with domestic and international traffic. During the month of July 2004, all operational airports together handled 57.94 thousand aircraft movements (excludes defence & other non-commercial movements), 4.57 million passengers and 105.53 thousand tonnes of cargo. Indian Airlines Ltd. and private airlines provide domestic air services, while Air India Ltd., Indian Airlines Ltd. and other international airlines operating to India handle international air services. Private operators cater to nearly 60.1 per cent of the domestic air traffic.

The Indian Government has in the last few years taken major policy initiatives to improve the viability of airports (See box 1.6). The Expert Committee on Civil Aviation headed by Shri Naresh Chandra submitted its report in December 2003 and has recommended a hike in FDI limit up to 49 per cent, allowing all private domestic carriers to fly some international routes; privatisation of not only the Delhi and Mumbai airports but all airports, and a sharp reduction of taxes to enhance the quality of this service along-with the creation of incentives for new investments. While many of the recommendations have been implemented, others are at various stages of consultation.

Box 1.6: Initiatives in the Civil Aviation Sector

- The Airport Infrastructure Policy, 1997, permits private equity participation in development of airport infrastructure to bridge the resource gap as well as to bring greater efficiency

- FDI in joint ventures for modernisation of Mumbai and Delhi airports allowed up to 49 per cent
- Domestic Air Transport Policy allows participation by foreign individuals/companies (except foreign airlines) of up to 40 per cent and the participation of non-resident Indians (NRIs) of up to 100 per cent in domestic air transport services
- New International airports are being set up in Bangalore, Hyderabad and Goa with private sector participation
- Excise duty on ATF halved from 16 per cent to 8 per cent in February 2004

Ports and Shipping

Ports and shipping are a crucial segment of the transportation infrastructure. There are 12 major ports and 185 Minor/Intermediate ports located along India's 7,517 kms long coastline. Maritime transport accounts for about 95 per cent of the country's foreign trade in terms of volume and 70 per cent in terms of value.

Given the increased impetus on trade, there is an urgent need for better port connectivity and infrastructure for handling larger vessels. Focus on providing hinterland connection to various ports through railways and roads will reduce congestion levels at many ports. The pace of privatisation and corporatisation of ports has been stepped up. Though the average turnaround time for ships has improved, it is still lower compared to international standards. In order to ease the problems, the government has taken several initiatives in this sector. Listed below are some of them:

- FDI up to 100 per cent under automatic route allowed in construction and maintenance of ports and harbors, shipping and inland water transport sectors
- Government has taken steps for phased corporatisation of major ports
- Public-private partnership in the ports sector is being encouraged
- Guidelines for formation of joint ventures by major ports issued
- Inland Water Transport Policy approved by the Government
- Government has introduced tax incentives (tonnage tax) in the budget
- Action has been initiated to formulate a National Maritime Policy to provide fiscal, financial, administrative and legislative measures for growth and development of the maritime sector including ports, shipping and inland water transport in India

The Investment Scenario

The Indian investment scenario has undergone rapid transformation in the post liberalisation phase. The new regime did away with licensing, capital controls, quantitative restrictions on imports and decontrolled interest rates and reduced restrictions on foreign imports. Together, these led to a significant improvement in the 'investment climate', creating incentives for private investors, both domestic and foreign. Besides, Central and State Governments continue to offer a number of incentives for investment projects (see box 1.7). As a consequence, the share of private investment rose sharply from 12.5 per cent of GDP in the eighties to 15.4 per cent in the nineties.

Box 1.7: Investment Incentives

Central Government Investment Incentives

- 100 per cent profit deduction for developing, maintaining and operating infrastructure facilities
- Tax exemption of 100 per cent on export profits for ten years
- Deduction in respect of certain inter-corporate dividends to the extent of dividend declared

- Various capital subsidy schemes and fiscal incentives for expansion in the north-eastern and other industrially backward regions
- Export infrastructure improvements schemes

State Government Investment Incentives

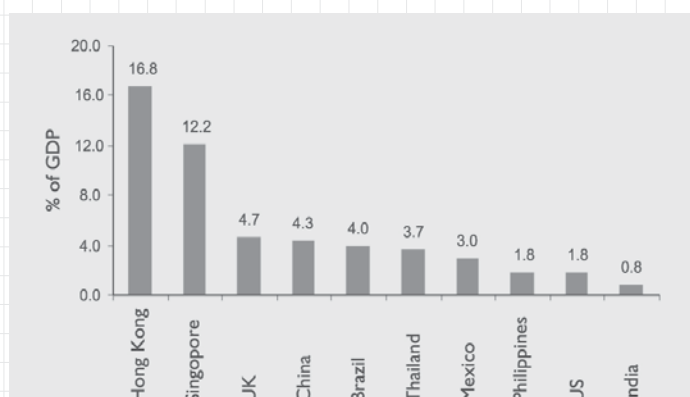
- Single window approval system for setting up industrial units
- Electricity duty, registration fee and stamp duty exemptions
- Reservation of plots for NRIs, EOUs and Foreign Investment Projects
- Rebate on land cost, tax concessions and octroi refunds
- Interest rate and fixed capital subsidy
- Various incentives for backward area development and industrial development like capital subsidy, exemption from sales tax levy, subsidies on power rates, cheap developed land, loans etc.

investment cycle peaked in 1995-96 and subsequently went into a period of decline. Current indicators point to an incipient recovery in investments fuelled by a resurgence in the manufacturing sector and a steady decline in interest rates.

Foreign Direct Investment

The critical role of FDI in the economic development process is widely recognised, not just as a source of financial capital but also as a tool to enhance knowledge and technology transfer and integration into global production chains. A number of studies have showed a strong link between FDI flows and export growth.

Chart 1.6: Net Average FDI Inflow (1997-2002)



Given India's size, the quantum of FDI inflow falls well short of its potential (see chart 1.6). In fact, it has one of the lowest FDI inflows to GDP ratios among all economies. However, the FDI policy has been revamped continuously to encourage foreign investments. Foreign investment is allowed freely in almost all sectors including services. In some sectors the existing and notified sector policy permits FDI within a ceiling. Besides, virtually all items/activities can be brought in through the automatic route under powers delegated to the RBI. For the remaining activities, Government approvals are accorded on the recommendations of the Foreign Investment Promotion Board (FIPB). The automatic route is available not just to new ventures but to existing companies as well. Foreign technology agreements have also been actively promoted by the Government, to attract the desired investment through the automatic route.

**Table 1.3: Share of Top Investing Countries in FDI Inflows
January 1991 - July 2004 (US\$ million)**

Rank	Country	1991	2000	2001	2002	2003	2004 Jan-July	FDI inflows	Percentage of total
1	Mauritius	3420.1	829.9	1667.5	1517.6	562.2	473.8	8471	34.68
2	USA	2310.3	418.4	367.6	282.8	413.9	274	4067.1	16.16
3	Japan	817.6	229.2	221.5	412.6	94.4	16.8	1792.1	7.34
4	Netherlands	607.9	127.2	229.2	155.7	252.6	329	1701.6	6.96
5	UK	657	65.5	285.3	353.9	187.6	110.9	1660.2	6.8
6	Germany	661	86.4	133.1	138.1	78.8	71.2	1168.6	4.78
7	France	270.9	79.4	132.3	110.5	35.7	36.4	665.1	2.72
8	Korea (South)	571.8	17.7	4.5	37.8	24.6	20.1	676.4	2.77
9	Singapore	343	116.6	35.7	47.1	36.5	27.1	606.1	2.48
10	Switzerland	233.6	43.5	39.6	52.4	93.3	58.9	521.3	2.13

Source: SIA (FDI Data Cell)

Mauritius is the top investing country, while the electrical equipment sector attracts the largest share of FDI inflow.

**Table 1.4: Sectors Attracting Highest FDI Approvals and Inflows
August 1991 - July 2004 (US\$ million)**

Rank	Sector	Amount of FDI approved	Percent of Total FDI approved	Amount of FDI Inflows	Percent of Total FDI Inflows	Inflows as Percent of approvals
1	Fuel (i) + (ii)	19040	28.19	2374	9.97	14.43
	(i) Power	11855	17.21	-	-	-
	(ii) Oil refinery	7185	10.98	-	-	-
2	Telecommunications	11635	17.1	2659	11.08	26.44
3	Transportation industry	5352	8.4	2805	11.56	56.09
4	Electrical equipment	4941	7.75	3543	14.83	78.07
5	Metallurgical industries	4202	6.22	421	1.76	11.52
6	Services sector	3782	5.8	2104	8.37	58.95
7	Chemicals (other than fertilisers)	3359	4.83	1518	5.74	48.47
8	Food processing industries	2742	3.87	1125	4.43	46.76
9	Hotel & Tourism	1354	1.99	230	0.97	19.85
10	Paper & Pulp (including paper products)	832	1.26	336	1.27	41.1

Source: SIA (FDI Data Cell).

Defining Foreign Direct Investment (FDI): Some Critical Issues

According to the IMF, FDI is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy, in an enterprise resident in another economy.

There is a divergence in the definitions of FDI as stated by the IMF and used by the RBI for reporting its FDI statistics. According to the Balance of Payments manual of the IMF, FDI includes equity capital, reinvested earnings of foreign companies, inter-company debt transactions, short-term and long-term loans, financial leasing, trade credits, grants, bonds, non-cash acquisition of equity, investment made by foreign venture capital investors, earnings data of indirectly held FDI enterprises and control premium, non-competition fee, and so on. The concept of FDI includes the following organisational bodies:

- Subsidiaries (in which the non-resident investor owns more than 50 per cent)
- Associates (in which the non-resident investor owns between 10 and 50 per cent)
- Branches (unincorporated enterprises, wholly or jointly owned by the non-resident investor)

Statistics on FDI reported earlier by the RBI in the balance of payments included only equity capital and this tended to underestimate the quantum of FDI inflows. According to the International Finance Corporation, India's adoption of a standard method of FDI computation would raise its net annual FDI inflows from US\$ 2-3 billion to US\$ 8 billion and would be 1.6 per cent of its gross domestic product.

Table 1.5: FDI Inflows in India (US\$ million)

Item/year	2000-01	2001-02	2002-03	2003-04
FDI - by data currently published	2907.6	4221.9	3133.9	2776.1
FDI - by international definition	4029.0	6131.0	4660.0	4675.0
Additional amount on account of international definition	1121.4	1909.1	1526.1	1898.9

Source: DIPP, RBI

The RBI has revised the FDI definition, 2000-01 onwards, to include equity capital, reinvested earnings and other direct capital.