Amity Management Review
2015, Vol. 4, No. 1

FDI in india: Post Liberalization Analysis

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Foreign Direct Investment (FDI) is one of the most important source of financial resources of non-debt type for developing countries for economic development and growth. FDI helps to transfer the technology from developed to developing countries. India has continuously sought to attract investment from the world's major investors. With the advent of globalization and liberal policies of Indian government in 1991, foreign investment has helped the Indianeconomy grow tremendously.These investments have been a key driver for accelerating the economic growth through employment generation, improved access to managerial expertise and competing internationally with higher efficiency.This paper has made an attempt to analyze the trend of FDI flow into the country. The study is diagnostic and exploratory in nature and makesuse of secondary data. The study finds and concludes that the foreign direct investment inIndia have significantly improved and developed the economy.

Keywords: Foreign Direct Investment, Foreign Institutional Investment, liberalization, GDP, etc.

Introduction

FDI involves the movement of factors of production into operating facilities abroad. It may be either in the form of investment in foreign branches or in subsidiaries, or in the form of a merger with and acquisition of a foreign firm. There are a number of views explaining why a firm moves abroad. Firstly, capital moves from a capital abundant economy to capital scarce economy and it continues moving until the marginal productivity of capital in the two countries becomes equal. Both the countries gain from this movement. Secondly, firms having some sort of ownership advantage find themselves in an oligopolistic position and move abroad in order to reap advantages from their oligopolistic position. Thirdly, it is believed that firms move to a foreign country to take the advantage of cheap raw material or cheap labour there so as to minimize the cost of production. Most of developing countries use FDI for acquiring the resources for economic growth and development. With the liberalization of capital account and initiation of structural reforms India has also opted for inflow of FDI in the country. It needs FDI not just to revamp its pitifully inadequate infrastructure but even more urgently to become part of the global network. Greater global trade would also bring new ideas, technology and economies of scale. Several policy measures have been announced during the post-reform period for encouraging FDI. India has brought a paradigm shift in its FDI policy by gradually removing restrictions on FDI flow. Now, India has one of the most liberal policy frameworks for FDI and foreign technology transfer.

Literature review

There is an enormous theoretical and empirical literature dealing with the relationship between FDI and growth. Chopra (2002) examined the effect of policy reforms on the FDI in India during the study period from 1980 to 2000. The study observed many policy related variables such as the degree of openness of the economy, debt-service ratio, foreign exchange rate and GDP as the explanatory variables of FDI inflows in India. The empirical result revealed that GDP was an important factor which motivates FDI in the country. Banga (2003) concluded that FDI is found to be attracted to large market size, low labour cost, high productivity of labour, and financial health of the economy and higher availability of electricity in the economy. Kathuria and Das (2005) analyzed the effect of increased FDI flows on the innovation strategies of the domestic manufacturing firms in the Indian

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context using post liberalization data. The results showed that in the post-liberalization era, the relationship between FDI and domestic R&D had undergone a change, with substitution coming out strongly in the later period when the effects of FDI were deemed to have been absorbed.Sharma et al. (2007) analyzed the trends and patterns of FDI inflows in India and found that FDI was more stable component of all kinds of capital inflows and gained great importance in recent times. Top five states constitute around 65 per cent and top 10 sectors constitute nearly 72 per cent of total FDI inflows in the country. There seems a large gap between approvals and inflows in different sectors. The states which are good in infrastructure and well developed have attracted much of the FDI.Kamath(2008) established the relationship between FDI inflows, exports and GDP in the Indian economy. The results indicated that a greater inflow of foreign capital has led to growth in the exports of goods and services and also growth of the economy over the period of study from 1991-2005. Ramesh Kumar and Alagappan (2008) found in their study on FDI into Indian economy that the design of FDI inflows into India during and after the LPG regime of 14 years from 1991 to 2004. The results revealed that real inflows and outflow of FDI in Indian economy was unstable and was having a shaky trends during this ear. It may be due to slow approvals of conversion into actual inflows. SIA and FIPB route were at the top followed by other modes like RBI automatic route, share acquisition route and NRI route

In India half of th total FDI inflows is from two major countries which are Mauritius and USA. It is interesting to know that electrical industry is having a very big share of FDI inflows followed by other industries like transportation industry, telecommunications, fuels and service sector. Gupta (2009) attempted to give an overall picture of FDI in India and evaluates the positive and negative aspects of FDI on Indian economy since the inception of New Economic Reforms measures. In this study it was found that the major source of FDI in India is through both the equity route which accounted for 82 per cent of the total FDI inflows in India while 15% of total direct investment was through reinvested earnings of FDI companies. Acquisitions accounted for 32 per cent of total FDI. Kumar and Dhingra (2011) concluded that FDI inflows have shown significant growth in the post liberalization period. The compound annual growth rate of actual FDI inflows during this period was 29.56 per cent. The analysis of structure of FDI in India reveals that there definitely has been a shift in favor of service sector and a steep fall in the share of manufacturing sector in post-liberalization era.

Analysis

FDI is an important mode through which investment takes place in India. The importance of FDI extends beyond the financial capital that flows into the country. In addition, FDI can be a tool for bringing knowledge and integration into global production chains, which are the foundation of a successful exports strategy. This paper contains an analysis of the trends and patterns of FDI inflows in India as a whole as well as route-wise.

Trends and Patterns of FDI inflows in India

Table 1 reveals the trends and patterns of FDI inflows in India during the post-liberalization period from 1991 to 2014. During 1991-92, FDI inflows in India was recorded to $129 million, which had tremendously increased to the level of $315 million, with 144 per cent annual growth rate in 1992-93 over the previous year. In 1993-94, a growth rate of 86 per cent was recorded in FDI inflows over 1992-93 and reached to the level of $586 million. FDI inflows in India increased considerably in 1994-95 and reached to $1314 million, with 124 per cent annual growth rate.

FDI inflows increased from the level of $129 million in 1991-92 to the level of $2144 million in the year 1995-96, with a growth rate of 63 per cent over 1994-95. During the period from 1991-92 to 1995-96 the average FDI inflows had amounted to $898 million and recorded average annual growth rate of 83.52 per cent. During the period from 1991-92 to 1995-96, the highest FDI inflows in India had amounted to $2144 million in 1995-96, whereas the highest annual growth rate of 144 per cent was recorded in 1992-93. The increase was largely due to the expanded list of industries or sectors which were opened up for foreign equity participation. However, after LPG regime, in the new economic policy and the new industrial policy of 1991 number of steps were taken to liberalize the FDI rules and regulations to have a positive FDI environment in the country.

Policy towards foreign investment was liberalized in 1991 to permit automatic approval for foreign investment upto 51 per cent equity in 34 industries. The foreign investment promotion board was also established to process applications in cases, which were not covered by automatic approval. During 1992-93 several measures were taken to encourage investment flows in the economy through FDI, portfolio investment, NRI investment and deposits and investment in global depository receipts. FDI has been allowed in exploration, production and refining of oil and marketing of gas. Under the new industrial policy of July 1991, approvals for FDI upto 51 per cent of equity in specified high-priority industries were given automatically subject to the condition that the dividend payments should be balanced by export earnings over a specified period of time (Economy Survey, 1992-93).

During 1996-97, FDI inflows increased to $2821 million, with 31.6 per cent annual growth rate over the previous year. In the next year, a growth rate of 26.1 per cent was recorded in FDI inflows and reached to the level of $3557 million in absolute terms. During the period from 1991-92 to 1997-98, the total amount of the FDI inflows had amounted to $10866 million and it was found that there had been a continuous increase in FDI inflows. The Foreign Investment Promotion Board (FIPB) had permitted FDI in the area of financial services in 1997-98. During 1998-99, FDI inflows in India declined to $2462 million by 30.8 per cent annual growth rate and it was found that FDI inflows had declined for the first time since 1991-92 due to unfavourable international economic environment.

There was a decline of 12.5 percent in FDI inflows from $2462 million during 1998-99 to $2155 million from year 1999-2000 mainly due to slow demand of domestic investment. The most important reasons for the declining trend included several restrictions imposed on India by the USA for carrying out nuclear test at Pokhran, the instability of political environment at the central government level, Indian economy in slow state, the restrictions regarding Trade Related Investment Measures (TRIMS), the poor domestic industrial and external economic financial crisis of South-East Asia.A number of FDI policy initiatives were taken in the year of 1999-2000 to further facilitate inflows of FDI in India. In August 1999, Foreign Investment Implementation Authority (FIIA) was set up for smooth and fast approvals leading to increase in actual flows.

In 2000-01, FDI inflows in India increased to the level of $4029 million with 87 per cent annual growth rate over the previous year. The share of equity capital, re-invested earnings and other capital was $2400 million, $1350 million and $279 million respectively in total FDI inflows (Table 2). The Gujarat earthquake (January 2001), the terrorist attack on the Indian Parliament (December 2001), and the terrorist attack on the World Trade Centre (WTC) (September 2001) brought about a temporary dislocation in FDI inflows in India. Table 1 reveals that during the period from 1996-97 to 2000-01, average annual growth rate of 20.28 per cent was recorded and average FDI inflows had amounted to $3005 million, which was 3.35 times greater than average FDI inflows from 1991-92 to 1995-96. The highest FDI inflows of $4029 million and the highest annual growth rate of 87 per cent were recorded in 2000-01. Hence, it may be concluded that equity capital component of FDI inflows was the sole component of FDI inflows till 2000-01.

In the year 2001-02, FDI inflows in India increased to the level of $6130 million, a growth rate of 52 per cent was recorded over the previous year. This was due to liberalization of the FDI policy. The inflows of the FDI decreased to the level of $5035 million (decrease of 17.9 per cent) in 2002-03, which further declined to $4322 million (decrease of 14.2 per cent) in 2003-04. The overall decline in 2002-03 and 2003-04 was principally due to the sharp fall in the net equity mainly in electronics, electrical and service sectors (RBI, Annual Report 2002-03). Table 2 reveals that the share of equity capital, re-invested earnings and other capital was $2229 million, $1460 million and $633 million respectively in total FDI inflows in 2003-04. FDI inflows grew steadily through the first half of the 90s but stagnated between 1996-97 and 2003-04. The year-on-year fluctuations until 2003-04 make it difficult to identify a clear trend.

During 2004-05, FDI inflows in India increased by 40 per cent and reached to the level of $6051 million in absolute terms. FDI inflows in India had amounted to $8961 million in absolute terms, which were increased by 48 per cent during 2005-06 on the back of positive investment climate, improved growth prospects and initiatives aimed at rationalizing and liberalizing the FDI policy and simplifying the procedures. The average FDI inflows in India from 2001-02 to 2005-06 had amounted to $6100 million which was 2.03 times greater than average FDI inflows from 1996-97 to 2000-01 and recorded an average annual growth rate of 21.62 per cent. The highest FDI inflows of $8961 million were recorded in 2005-06, while the highest annual growth rate of 52 per cent was recorded in 2001-02.

According to RBI, Annual Report 2002-03, in order to compete with international market and to have congruence with best international practices, Coverage of data on FDI was increased in 2000-01 by including many new terms namely, reinvested earnings, equity capital of unincorporated bodies, and inter-corporate debt transactions of the related entities.

Table 2 presents the revised inflows of FDI in India from the year 2000-01. The revised practice of reporting FDI statistics addressed the issue of underestimated FDI inflows in India. The equity inflows have been differentiated under equity inflows of incorporated bodies and equity inflows of unincorporated bodies. In absolute terms, the share of reinvested earnings in total FDI inflows in India was $1350 million (33.51 per cent) in 2000-01, $1645 million (26.83 per cent) in 2001-02, $1833 million (36.41 per cent) in 2002-03, $1460 million (33.78 per cent) in 2003-04, $1904 million (31.47 per cent) in 2004-05 and $2760 million (30.80 per cent) in 2005-06, whereas the share of other capital i.e. inter-corporate debt transactions was $279 million (6.92 per cent) in 2000-01, $390 million (6.36 per cent) in 2001-02, $438 million (8.70 per cent) in 2002-03, $633 million (14.65 per cent) in 2003-04, $369 million (6.10 per cent)in 2004-05 and $226 million (2.52 per cent) in 2005-06.Therefore, it may be concluded that the share of reinvested earnings and other capital in total FDI inflows accounted significant share. From the increase in FDI inflows since 2004-05 and particularly in 2006-07 when total FDI inflows in India crossed the $20 million mark for the first time, India has emerged as one of the leading FDI destinations in Asia in recent years.

Table 1 reveals that FDI in India increased sharply from $8961 million during 2005-06 to $22826 million in absolute terms during 2006-07 on the strength of expansion in domestic activity, the rising pace of mergers and acquisitions in sectors such as financial services, manufacturing, banking services, information technology, and construction. The inflows of FDI in India stood at $34835 million in absolute termsand a growth rate of 52.6 per cent was recorded during 2007-08. The pick-up in FDI inflows reflected investor's interest in the Indian economy due to the rationalization and liberalization of the FDI policy. FDI was largely driven by equity and reinvested earnings during the year 2008-09. Further steps were taken to maintain and extend the equity route by increasing the access to local equity markets by the foreign firms that created positive effect in reducing the volatility of market which was experiencing major jerks due to global financial crisis impact.

Table 1 reveals that in 2008-09, FDI inflows in India were recorded to $37838 million, which declined to $37763 millionin 2009-10 and reached to the level of $30380 million in 2010-11. During the period from 2006-07 to 2010-11, the average FDI inflows had amounted to $32728 million which were 5.37 times higher than average FDI inflows during the period from 2000-01 to 2005-06 and average annual growth rate of 47.05 per cent was recorded. The highest FDI inflows in India had amounted to $37838 million in 2008-09, whereas the highest annual growth rate of 155 per cent was recorded in 2006-07.

During the period under study, annual growth rate in FDI inflows was positive from 1991-92 to 1997-98, but thereafter, it was negative in 1998-99, 1999-00, 2002-03, 2003-04, 2009-10 and 2010-11 and positive in 2000-01, 2001-02 and from 2004-05 to 2008-09. The growth rate of 154.7 per cent in FDI inflows was highest in 2006-07 and declined rate of -30.78 per cent was highest in 1998-99 as compared to their respective previous years. The cumulative FDI inflows in India from August 1991to March 2000 were $15483 million and from April 2000 to March 2011 were $198170 million (table-1).

Table 2 depicts that the cumulative FDI inflows in India from August 1991 to March 2011 were $213653 million. It is also found that total FDI inflows (equity components only) was $155553 million and share of incorporated bodies i.e. government (SIA/FIPB route), RBI route, NRI route and acquisition of shares were $32706 million,

$81403 million, $2616 million and $31088 million respectively, whereas share of equity capital of unincorporated bodies was $7740 million. Further, it is also found that the share of reinvested earnings and other capital in total FDI inflows in India was $51582 million and $6518 million respectively.The NRI route of equity capital of incorporated bodies was switched off after 2002-03.

Table 3 depicts that RBI route accounted for 38.10 per cent, reinvested earnings 24.14 per cent, Government route (SIA/FIPB) 15.32 per cent, acquisition of shares route 14.55 per cent, equity capital of unincorporated bodies 3.62 per cent, other capital 3.05 per cent and NRI route 1.22 per cent share of total FDI inflows in India. Thus, it is concluded that the highest rank (1st rank) is attained by RBI route followed by reinvested earnings (2nd rank), government route (SIA/FIPB) (3rd rank), acquisition of shares (4th rank), while NRI route has (7th rank) lowest rank in the cumulative FDI inflows in India from August 1991 to March 2011.

Route - Wise FDI inflows in India

There are four routes through which the FDI inflows in India could be approved: (i) Government approval ((SIA) Secretariat for Industrial Assistance or the (FIPB) Foreign Investment Promotion Board route; (ii) Reserve Bank of India (RBI) automatic approval route; (iii) Non-Resident Indian (NRI) investments route and (iv) through acquisition of shares route.

FDI in sectors and activities to extent permitted under the automatic route need not required any prior permission or approval from the government or the central bank i.e. RBI. The investor has to inform / notify the proper regional office of the RBI within 30 days about the receipt of inward remittances and has to submit related documents within 30 days of the issue of shares to foreign investors. However, in the limited category of sectors where prior government approval is compulsory, proposals submitted by investors are considered in a fix time frame and transparent manner by the FIPB. For all those activities which are included in the automatic route, investors have to take necessary government approval through the FIPB. The FDI inflows under automatic approval and governmental approval are regulated by the FEMA Act, 1999.

Table 1: FDI Inflows in India (August 1991-March 2014 in US$ million)

Year	Amount of FDI Inflows	Annual Growth $ Value
1991-92	129	-
1992-93	315	144.2
1993-94	586	86.0
1994-95	1314	124.2
1995-96	2144	63.2
Average	**898**	**83.52**
1996-97	2821	31.6
1997-98	3557	26.1
1998-99	2462	-30.8
1999-00	2155	-12.5
2000-01	4029	87.0
Average	**3005**	**20.28**
2001-02	6130	52.1
2002-03	5035	-17.9
2003-04	4322	-14.2
2004-05	6051	40.0
2005-06	8961	48.1
Average	**6100**	**21.62**
2006-07	22826	154.7
2007-08	34835	52.6
2008-09	41873	20.20
2009-10	37745	-9.86
2010-11	34847	-7.68
Average	**34425**	**42.00**
2011-12	46556	33.60
2012-13	34298	-26.33
2013-14	36046	5.10
Average	**38967**	**4.12**
August 1991-March 2000	15483	
April 2000-March 2014	323554	
August 1991-March 2014	339037	

Source: Secretariat for Industrial Assistance, various FDI Fact Sheets.

Table 2: FDI Inflows in India Equity and Other Components (August 1991-March 2014 in US$ million)

Year	Government (SIA/FIPB) Route (a)	RBI Route (b)	NRI Route I	Acquisition of Shares* (d)	Equity capital of unincorporated bodies# I	Total FDI (Equity) (a+b+c+ d+e) = I	Reinvested Earnings II	Other Capital II	Total FDI Inflows (I+II+III)
1991-92	66	-	63	-	-	129	-	-	129
1992-93	222	42	51	-	-	315	-	-	315
1993-94	280	89	217	-	-	586	-	-	586
1994-95	701	171	442	-	-	1314	-	-	1314
1995-96	1249	169	715	11	-	2144	-	-	2144
1996-97	1922	135	639	125	-	2821	-	-	2821
1997-98	2754	202	241	360	-	3557	-	-	3557
1998-99	1821	179	62	400	-	2462	-	-	2462
1999-00	1410	171	84	490		2155	-	-	2155
2000-01	1456	454	67	362	61	2400	1350	279	4029
2001-02	2221	767	35	881	191	4095	1645	390	6130
2002-03	919	739	-	916	190	2764	1833	438	5035
2003-04	928	534	-	735	32	2229	1460	633	4322
2004-05	1062	1258	-	930	528	3778	1904	369	6051
2005-06	1126	2233	-	2181	435	5975	2760	226	8961
2006-07	2156	7151	-	6278	896	16481	5828	517	22826
2007-08	2298	17127	-	5148	2291	26864	7679	292	34835
2008-09	4699	17998	-	4632	702	28031	9030	777	37838
2009-10**	3471	18990	-	3148	1540	27149	8669	1945	37763
2010-11**	1945	12994	-	4491	874	20304	9424	652	30380
2011-12	3046	20427	-	11360	1021	35854	8205	2494	46556
2012-13	2319	15967	-	3539	1059	22884	9880	1534	34298
2013-14	1185	14869	-	8245	975	25274	8978	1794	36046
Total									

Note: *Relates to acquisition of shares of Indian companies by non-residents under Section 29 of FERA.
Source: RBI Monthly Bulletins; December 2004 and November 2011.

Table 3: Cumulative FDI Inflows in India (August 1991-March 2014 in US$ million)

Rank	Route of FDI inflows into India	Amount of FDI inflows	Share as % of total FDI inflows
1	RBI Route	81403	38.10
2	Reinvested Earnings	51582	24.14
3	Government Route (SIA/FIPB)	32706	15.32
4	Acquisition of Shares	31088	14.55
5	Equity Capital of Unincorporated bodies	7740	3.62
6	Other Capital	6518	3.05
7	NRI Route	2616	1.22
	Gross Total	213653	100

Source: Compiled by the author

Conclusions

India has already marked its presence as one of the fastest growing economies of the world. India ranked among the top three attractive destinations for inbound investments. Since 1991, the regulatory environment in terms of foreign investment has been consistently improved and simplified to make it investor friendly. This includes opening of many new sectors to FDI, raising FDI equity caps in sectors already opened and procedural simplification. Today the recent FDI policy in India is widely reckoned to be among the most liberal in the emerging economies and FDI up to 100% is allowed under the automatic route in most sectors and activities. The government of India recently launched a major new national programme "Make in India" designed to facilitate investment, foster innovation, enhanced skill development, protect intellectual property and build best- in class manufacturing infrastructure. This may result in unprecedented business prospects.

Policy Recommendation

During post reform period, India's competence in drawing in FDI as a host has been relatively low compared to other developing countries due to the poor Investment climate and infrastructure and fluctuating foreign exchange rate. (Ahktar,2013). Thilakaweera (2014), found that income level of the host country and structure of the income distribution is also considered by the foreign companies before investing into infrastructure projects to assess the expected return on their investments. Our government should implement a stable exchange rate in the country to improve the investor's confidence and should also be obligated to liberalize the trade policy to increase openness in the country. (Azim, Haider and Ullah 2012).

The need of the hour is to remove administrative barriers and focus should be on great coordination between the centre and states to ensure that the substantial foreign interest in investing in India gets translated into actual investment flows to the country. India should consciously work towards attracting greater FDI into R&D as a means of strengthening the country's technological progress and competitiveness. Another way to increase the flow of FDI in our country by making the provision of a one-stop after-care service to foreign investors and tailored the investment-service activities for prospective and current investors' needs. Therefore, FDI would lead to a more comprehensive integration of India into the worldwide market, if done in the right manner. It can prove to be a boon and not a bane.

Against this backdrop, it is pertinent to highlight the number of measures announced by the Government of India to further liberalise the FDI policy to promote FDI inflows to India. These measures, inter alia included (i) allowing issuance of equity shares against non-cash transactions such as import of capital goods under the approval route, (ii) removal of the condition of prior approval in case of existing joint ventures/technical collaborations in the 'same field', (iii) providing the flexibility to companies to prescribe a conversion formula subject to FEMA/SEBI guidelines instead of specifying the price of convertible instruments upfront, (iv) simplifying the procedures for classification of companies into two categories 'companies owned or controlled by foreign investors' and 'companies owned and controlled by Indian residents' and (v) allowing FDI in the development and production of seeds and planting material without the stipulation of 'under controlled conditions'.The government is taking more steps to boost FDI in the country. It has raised the foreign investment limit to 49 per cent in defence manufacturing and relaxed the policy in construction sector. The government has also increased the FDI cap in insurance to 49 per cent.These measures are expected to boost India's image as a preferred investment destination and attract FDI inflows to India in the near future.

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