Foreign Investment

Foreign Direct Investment (FDI)

6.40 In terms of aggregate annual inflows, FDI maintained its declining trend for the second successive year after 1997-98. FDI inflows in India for the year 1999-2000 (US $ 2155 million) were lower than the previous year (US $ 2462 million). Inflows in the current year, 2000-01, however, are showing signs of improvement. During April-December, aggregate FDI inflows have been higher (US$ 1916 million) than the comparable period of 1999-2000 (US$ 1489 million) (Table 6.8).

6.41 Despite progressively declining volumes of inflows, Mauritius and the USA continue to be the largest sources of FDI for India. Inflows routed through Mauritius declined to US $ 501 million in 1999-2000 compared to US $ 590 million in 1998-99. Incoming FDI from USA on the other hand fell from US $ 453 million in 1998-99 to US $ 355 million in 1999-2000.

6.42 Apart from Mauritius and USA, Japan, Italy and Netherlands respectively were the other three major contributors of FDI during 1999-2000. While inflows from Japan have declined compared to the previous year, they have increased for Italy and Netherlands.

6.43 The engineering industry continues to attract the largest volume of FDI inflows. In 1999-2000, the sector experienced aggregate inflows worth US $ 326 million. Electronics and electrical equipment industries were the second largest recipient of FDI with aggregate inflows amounting to US $172 million. Food and dairy products had a sharp increase in FDI with inflows increasing from US $ 19 million in 1998-99 to US $ 121 million in 1999-2000. Another industry witnessing increase in FDI inflows during 1999-2000 was pharmaceuticals where aggregate FDI during the year rose to US $ 54 million compared to US $ 28 million in 1998-99.

6.44 The inflow of FDI to developing countries has been progressively increasing throughout the decade of 1990s (Table 6.9). China continues to be the largest absorber of FDI among developing nations. Among the South East Asian economies, FDI inflows have sharply declined for Indonesia, and Malaysia is also

TABLE 6.8
Foreign Investment Flows by Different Categories

(U.S. $ million)

									April-Dec.*	
	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	1999-00	2000-01
A. Direct Investment	**315**	**586**	**1314**	**2144**	**2821**	**3557**	**2462**	**2155**	**1489**	**1916**
a. RBI automatic route	42	89	171	169	135	202	179	171	127	330
b. SIA/FIPB route	222	280	701	1249	1922	2754	1821	1410	987	1262
c. NRI	51	217	442	715	639	241	62	84	71	51
d. Acquisition of shares $	—	—	—	11	125	380	400	490	304	273
B. Portfolio Investment	**244**	**3567**	**3824**	**2748**	**3312**	**1828**	**-61**	**3026**	**1916**	**296**
a. FIIs #	1	1665	1503	2009	1926	979	-390	2135	1187	-476
b. Euro Equities & ADRs/GDRs@	240	1520	2082	683	1366	645	270	768	619	696
c. Offshore funds & others	3	382	239	56	20	204	59	123	110	76
Total (A+B)	**559**	**4153**	**5138**	**4892**	**6133**	**5385**	**2401**	**5181**	**3405**	**2212**

*** Provisional**
$ Relates to acquisition of shares of Indian companies by non-residents under Section 29 of FERA
 # Represents fresh inflow/outflow of funds by FIIs
@ Figures include GDRs/ADRs amounts raised abroad by the Indian corporates.

Source: RBI

TABLE 6.9
FDI by Host Region

(US $ million)

Country	1992	1993	1994	1995	1996	1997	1998	1999[e]
China	11156	27515	33787	35849	40180	44236	43751	40400
India	233	550	973	2144	2426	3577	2635	2168
Indonesia	1777	2004	2109	4346	6194	4677	-356	-3270
Korea Rep. Of	727	588	991	1357	2308	3088	5215	10340
Malaysia	5183	5006	4581	5816	7296	6513	2700	3532
Philippines	228	1238	1591	1459	1520	1249	1752	737
Thailand	2114	1805	1343	2000	2405	3732	7449	6078
All Developing Countries (Including China)	51108	78813	104920	111884	145030	178789	179481	207619
Share of India in Developing countries	**0.5**	**0.7**	**0.9**	**1.9**	**1.7**	**2.0**	**1.5**	**1.0**

e : estimates
Note: Figures for India in this table may not be comparable with those in other tables because of differences in coverage and source of information.

Source: World Investment Report, United Nations, 2000

experiencing a downward trend. The Republic of Korea however, has experienced rapid jump in volume of FDI inflows in 1998 and 1999. As far as India is concerned, its share in total FDI flows to developing countries has declined by one per centage point from 1997 to 1999. The falling share is a cause for concern and underlines the need for even greater policy reforms in the FDI regime.

Portfolio investment

6.45 Aggregate portfolio investment, comprising mainly of investment under ADR/ GDR route and by Foreign Institutional Investors (FIIs), displayed a marked turnaround in 1999-2000. Compared to a net outflow of US $ 61 million in 1998-99, portfolio investment recovered strongly in 1999-2000 to post a total of US $ 3026 million. The bulk of this increase in portfolio investment was attributable to higher FII inflows. From a net outflow of US $ 390 million in 1998-99, FII investment shot up to more than US $ 2 billion in 1999-2000. Higher FII investment in 1999-2000 was indicative, in part, of improving investor perceptions of emerging economies after the Brazilian-Asian-Russian crises. In the current year, however, FII investment has been fluctuating with net FII inflows falling below their comparable levels in the previous year. This could be partly due to an increase in the US interest rates.

6.46 Portfolio investment, accruing through the ADR/GDR route was also much higher in 1999-2000 compared to the previous year. The higher trends illustrate the improved ability of Indian corporates in mobilising funds from overseas markets. The firm trends of inflows through ADR/GDR, are also evident in the current year. In April-December 2000-01, the inflows through this route have increased compared to the same period last year. The success in tapping resources from overseas capital markets vindicates the policy measures taken in recent times for facilitating investment under the ADR/GDR route.

Policies for foreign investment

6.47 The policies and procedures pertaining to foreign direct investment and foreign portfolio investment have been progressively liberalised over the years. In the current year too, specific measures were taken for further liberalising policies and streamlining procedures.

6.48 At present, all FDI are permitted under the automatic approval route, except for a small negative list. In a major effort to encourage investment in e-commerce, FDI upto 100 per cent has been permitted in the sector subject to specific conditions. The dividend balancing condition for FDI in twenty-two consumer goods industries has been removed. The existing upper limit of Rs 1,500 crore for FDI in projects involving electricity generation, transmission and distribution (other than atomic reactor plants) has been dispensed with. For facilitating greater inflow of foreign funds in the crucial oil-refining sector, the ceiling for FDI under the automatic route in oil refining has been increased to 100 per cent from the existing 49 per cent. FDI under the automatic route has been permitted upto 100 per cent for all manufacturing activities (with certain exceptions) in Special Economic Zones (SEZs). Foreign equity participation upto 26 per cent has been allowed in the insurance sector subject to the issue of necessary license by the Insurance Regulatory and Development Authority. 100% FDI has also been allowed (with certain conditions) in the tele-communications sector for Internet Service Providers (ISPs) not providing gateways (both for satellite and submarine cables), infrastructure providers providing dark fiber (IP category I), electronic mail and voice mail.

6.49 FIIs have been permitted greater leverage in the primary/ secondary markets by allowing enhancement of the aggregate FII investment ceiling in the issued and paid-up capital of Indian companies from the normal ceiling of 24 per cent to 40 per cent subject to prescribed prodcedures. The list of Non-Banking Financial Company (NBFC) activities eligible for foreign equity investment has been increased to eighteen with the recent addition of micro-credit/ rural credit. Foreign investment guidelines for NBFCs have been amended for providing a minimum capitalization norm of US $ 0.5 million for activities, which are not fund-based or consultative in nature, irrespective of the foreign equity participation level (the provision would apply to investment advisory services, credit reference and rating agencies, financial consultancy, foreign exchange broking and money changing). Permission has been granted to holding companies in NBFC activities with minimum capital of US $ 50 million to set up 100 per cent downstream subsidiaries with minimum capital of US $ 5 million, subject to specific conditions of disinvestment.

6.50 Policies pertaining to international offerings through ADR/GDR by Indian companies have been further liberalized. Overseas business acquisitions through the ADR/GDR route have been permitted under the automatic / simplified approval mechanism for Indian companies engaged in (1) Information technology and Entertainment software; (2) Pharmaceuticals; (3) Biotechnology; and (4) Any other sector as notified by the Government from time to time. The automatic approvals would be subject to conditions of previous listing, conformation to FDI policy and limiting of transactions to US $ 100 million or ten times the export earnings during the preceding financial year. Indian companies, engaged in IT software and IT services, have been permitted to issue ADR/GDR linked stock options to permanent employees (including Indian and overseas working directors) of its subsidiary companies incorporated in India or outside and engaged in IT software and IT services (subject to eligibility criteria and other conditions). In order to encourage greater skill development in knowledge-based Indian firms, Indian companies engaged in information technology and entertainment software, pharmaceuticals, biotechnology, and any other activities within the knowledge-based sector (as notified by the Government from time to time), have been permitted to issue ESOPs (Employees' Stock Options) to their permanent employees. The liberalised norms for ESOPs have also been extended to multi-product diversified companies subject to specific conditions.

6.51 In order to provide stimulus to the growth of the venture capital industry in India, SEBI has been made the single point nodal agency for registration of both domestic and overseas venture capital funds. Venture Capital Companies/Funds have been allowed to invest through the automatic route, subject to SEBI regulations and sector specific caps on FDI.

6.52 India has taken concrete initiatives for developing standards and codes in different areas of the financial system as part of the global effort in developing sound international financial architecture. The details are provided in Box 6.4.

6.53 The ongoing economic reforms in the area of foreign investment have improved India's attraction as a foreign investment destination in the perception of the international community. The Global Competitiveness Report : 2000, brought out by the World Economic Forum/

BOX 6.4

International Financial Standards and Codes

- An important step in the creation of the sound international financial architecture involves adoption of internationally recognised standards or codes of good practices. Various international organisations including the International Monetary Fund (IMF) and the Bank for International Settlements (BIS) have taken initiatives in developing standards and codes in different areas of the financial system.
- Standards and Codes are being developed in a number of areas, including data dissemination, fiscal, monetary and financial policy transparency, banking regulation and supervision, securities and insurance regulation, accounting, auditing, bankruptcy and corporate governance.
- India has taken concrete steps in the matter. The Standing Committee on International Financial Standards and Codes was constituted in December 1999 by the Reserve Bank of India (RBI) in consultation with the Government of India.
- The terms of reference of the committee include identifying and monitoring developments in global standards and codes, considering applicability of the codes to the Indian financial system, chalking out a road map for aligning India's practices with international best practices and reviewing periodically the status and progress in regard to code and practices.
- The committee has set up ten non-official Advisory Groups on *accounting and auditing, data dissemination, securities market regulation, corporate governance, payment and settlement system, banking supervision, transparency of monetary and financial policies, insurance regulation, fiscal transparency and bankruptcy laws* with eminent external experts to examine the present status of applicability, relevance and compliance with standards and codes, the feasibility and time frame of compliance with international best practices and to advise a course of action for achieving best practices appropriate to them.
- The Group on "Transparency of Monetary and Financial Policies" has submitted its report. Advisory groups on 'Payment and settlement system', 'Insurance Regulation' and 'Banking Supervision' have also submitted parts of their reports. These reports are available on the Reserve Bank of India website (www.rbi.org.in). Other groups are in the process of finalising their reports.

Harvard University recently, lists several encouraging parameters for the Indian economy as an investment destination. Among the main competitive advantages of India, highlighted by the Report, are licensing of technology, availability of suppliers, median income tax rate, export promotion and quality of business environemnt. In the overall growth competitiveness ranking, India's position has improved to 49 form 52 in 1999.

External Commercial Borrowings (ECB)

6.54 Gross aggregate disbursements under external commercial borrowings amounted to US $ 3187 million in 1999-2000. In aggregate terms, this was much lower than US $ 7226 million disbursed in 1998-99. However, it may be mentioned that aggregate disbursements for the year 1998-99 includes proceeds from Resurgent India Bonds (RIBs), worth US $ 4231 million. Excluding RIB accruals, disbursements for 1998-99 are estimated at US $ 2995 million. On a comparative basis, disbursements therefore, were marginally higher in 1999-2000. Repayments for both years were more or less identical figuring US $ 2864 million in 1998-99 and US $ 2874 million in 1999-2000. Excluding RIB proceeds, net disbursements at US $ 313 million were higher in 1999-2000, compared to US $ 131 millions in 1998-99.

6.55 In the first half of the current year (April-September, 2000), repayments (US$ 2465 million) have exceeded disbursements (US$ 2360 million), resulting in net repayments of US$ 105 million. The comparative estimate for April-September, 1999 was a net disbursement of US$ 80 million. Though disbursements in the current year (US$ 2360 million) are higher than the comparable period of the previous year (US$ 1387 million), the repayments in the current year are above those in the same period of the previous year (US$ 1307 million). As a result there has been a net repayment in the first half of 2000-01 as against net disbursement during the corresponding period of 1999-2000.

6.56 Despite a marginal improvement in the volume of disbursements in the current year, ECB accruals continue to be low. The reasons behind the low mobilization can be traced, *inter alia,* to hardening of international interest rates (particularly US dollar denominated) and the relatively sluggish demand of domestic industry for investment.

6.57 ECB approvals are also exhibiting a declining trend in the current year. As in the previous years, the power sector has received the highest ECB approvals during the current year (Table 6.10). Petroleum and natural gas,

TABLE 6.10

Status of ECB Approvals

(US $ million)

Sector	1998-99	1999-00	2000-01*
Power	3998	2267	375
Telecom	75	0	0
Shipping	37	27	144
Civil Aviation	0	0	0
Petroleum & Natural Gas	40	218	150
Railways	15	0	0
Financial Institutions	150	125	70
Ports, Roads etc.	0	80	0
Others (including Exporters)	885	129	60
Approval given by RBI	0	552	602
Amount raised under auto-route facility	0	0	318
Total	5200	3398	1719

***As on 31-12-2000.**
Source : ECB Division, Ministry of Finance, Government of India.

shipping, and financial institutions have been the other major recipients. The amounts raised by Indian corporates under the "Structured Obligation Window" is higher during the first three quarters of the current financial year (2000-01) as compared to the total approvals given under this window during 1999-2000. While total approvals under the window during 1999-2000 amounted to US$ 233 million, during the current financial year (as on December 31, 2000), total approvals have amounted to approximately US$ 1090 million.

6.58 A series of policy liberalisations have been effected for further facilitating the use of External Commercial Borrowings as a window for resource mobilization. Some of these measures are as mentioned:

- Fresh ECB approvals upto US $ 50 million and all refinancing of existing ECBs have been placed under the automatic route. Under this arrangement, any corporate being a legal entity, registered under the Companies Act, Societies Registration Act, Cooperative Societies Act, including proprietorship/ partnership concerns, will henceforth be eligible to enter into loan agreement with overseas lender for raising fresh ECB for an amount upto US$ 50 million, or for refinancing an existing ECB, provided it is in compliance with the ECB guidelines. The corporates would not be required to obtain prior approvals for raising ECBs upto US$ 50 million or for refinancing of existing ECBs.
- The RBI has been delegated the authority to sanction fresh ECB approvals upto US$ 100 million.
- RBI has also been delegated the power to approve prepayment as per the prevailing guidelines.
- The existing all-in-cost ceilings for normal projects, infrastructure projects and long term ECBs are now 300, 400 and 450 basis points over 6 months LIBOR, for the respective currency in which the loan was to be raised, or applicable bench marks as the case may be.
- The average maturity for the purpose of ECB guidelines has been declared to be the weighted average of all disbursements, taking each disbursement individually and its period of retention by borrowers.
- Corporates, having underlying exposures in respect of crude and petroleum products have been permitted to hedge commodity price risk subject to detailed guidelines of the RBI.

6.59 The Standard & Poor's outlook on long term foreign currency rating for India was revised to 'stable' from 'positive' in October 2000. However, the outlook on long term local currency rating remains 'stable'. In October 1999, Moody's Investors Service had revised India's country ceiling for foreign currency bonds and notes from Ba2 with a 'stable' outlook to Ba2 with 'positive' outlook.

Non-Resident Deposits

6.60 A time series profile of net inflows under various Non-resident deposit accounts is given in Table 6.11.

6.61 The net aggregate inflows under Non-resident deposits were much higher in 1999-2000 compared to both 1998-99 and 1997-98. The growing volume of NRI deposits underlines the expatriate investment community's increasing confidence in the Indian economy.

6.62 Among the individual accounts, FCNR (B) deposits recovered strongly in 1999-2000 from their net negative levels in 1998-99. The aggregate NRI deposits for 1999-2000 could surpass the previous year level mainly on

TABLE 6.11

Net flows under Non-Resident Deposits*

(US$ million)

Schemes	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	April-Dec. 1999-2000	April-Dec. 2000-01p
FCNR(A)	-2249	-2796	-1949	-2270	-1	—	—	—
FCNR(B)	1979	2669	1773	971	-144	746	619	-83
NR(E)RA	1049	-208	1244	1197	980	948	587	687
NR(NR)RD	742	1279	2246	1256	941	470	307	379
FC(B&O)D	-533	—	—	—	—	—	—	—
Total	988	944	3314	1154	1776	2164	1513	983

p: Provisional Estimates
*** All figures are inclusive of accrued interest and valuation factor.**
Source: RBI

account of heavy inflows under FCNR(B) account. For this particular account in the current year (April-December 2000-01) there has been a net outflow of US $ 83 million as against the net inflow of US $ 619 million in the comparable period of 1999-2000. The Rupee denominated NR(E)RA account had more or less the same levels of inflows in 1999-2000 and 1998-99. In the current year so far, the NR(E)RA account has had the highest volume of deposits among the three main accounts (US $ 687 million). The non-repatriable Rupee denominated NR (NR) RD account had much lower inflows in 1999-2000 compared to 1998-99. The inflows in this account during April-December, 2000 (US $ 379 million) have been a shade higher than the level in the comparable period of the previous year (US $ 307 million). The volume of net deposits in this account has been reducing progressively since 1996-97. The NRI investors' favourable assessment of India's macro-fundamentals was evident in the overwhelming response received by the IMD (Indian Millennium Deposits) scheme floated on October 21, 2000. The scheme netted US $ 5.51 billion. The details of the Scheme are given in Box. 6.5.

BOX 6.5

Salient features of India Millennium Deposit (IMD) scheme

- The IMD scheme was launched by the State Bank of India for Non-Resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) on October 21, 2000. It closed on November 6, 2000.
- The scheme had a maturity period of 5 years. The interest rates offered were 8.5 percent in US Dollars, 7.85 per cent in Pound-Sterling and 6.85 per cent in Euro.
- The major features of the scheme were full repatriability of principal and interest, joint holding facilities, exemption from income-tax, gift tax and wealth tax in India and transferability between the NRIs/OCBs/Banks acting in fiduciary capacity on behalf of NRIs/OCBs by endorsement and delivery.
- Authorised dealers were permitted to grant loans in non-repatriable Rupees, in India, to the holders of IMDs for personal purposes, for carrying on business activities and for making direct investment in India subject to certain conditions.
- The scheme succeeded in mobilising US$ 5.51 billion.
- The proceeds of the scheme would be utilised in investment in Government securities and advances to infrastructure projects.
- IMD proceeds would also shore up India's foreign currency reserves in the wake of high international oil prices.
- IMDs (unlike bonds) are not tradeable in the secondary market and cannot be encashed prematurely in foreign exchange.

External assistance

6.63 Aggregate gross disbursements under external assistance amounted to US $ 3081 million in 1999-2000, which was marginally higher than US $ 2936 million in 1998-99. The principal repayment during 1999-2000 (US $ 2233 million) was slightly higher than 1998-99 (US $ 2105 million) while net inflows for 1999-2000 (US $ 848 million) were almost the same as in 1998-99 (US $ 831 million).

6.64 During April-September 2000-01, the gross disbursements (US $ 967 million) have been lower than the comparable period of the previous year (US $ 1184 million). However, repayments during the current year (US $ 1359 million) have been higher than over the same period of last year (US $ 1068 million). As a result, net repayments during the current year (April-September 2000-01) have amounted to US $ -392 million compared to US $ 116 million over the same period in the previous year.

6.65 The lower disbursements in the current year are attributable to lower volume of disbursements under non-Government loans. On the other hand, higher repayments have resulted from pre-payment of about US $ 290 million against eight fixed interest rate IBRD currency pool loans (interest rates ranging between 9.25%-11.6%) during May 2000.