Capital Account

6.43 The capital account of India's BOP has emerged with much strength and resilience after liberalization, especially since 1993-94. Net capital inflows from all sources (excluding IMF) averaged about US $8.89 billion per year over the seven years from 1993-94 to 1999-2000. The exchange rate volatility in 1995-96 for the first time under the market determined system resulted in significant leads in import payments and lags in export receipts. In BOP, these elements got reflected as unusually large outflows under "Other Capital". If 1995-96 were to be excluded on this count, net capital inflows averaged about US $9.69 billion per year during 1993-94 to 1999-00. This is against the average of a mere US $3.90 billion during the previous two years (1991-92 to 1992-93). This quantum jump in net capital flows has occurred to a large extent with the much desired shift in favour of non-debt creating foreign investment flows. During 2000-01, net capital inflows, including funds raised through IMD, amounted to US $9.02 billion.

(a) External Assistance

6.44 Gross inflows under external assistance, comprising assistance under Government and non-Government accounts, were about US $2.94 billion in 2000-01, compared with the annual average of US $2.93 billion over the previous five years ended 1999-2000. Net inflows (net of repayments) during 2000-01 were, however, significantly lower at US $0.43 billion, compared with net inflows of over US $0.92 billion per year, on an average, during the previous five years. The marked decline in net inflows during 2000-01 was because of the significant increase in repayments, reflecting pre-payment of about US $290 million against eight fixed interest rate IBRD currency pool loans in May 2000 and the general rising trend in repayments of past loans.

(b) External Commercial Borrowings (ECB)

6.45 Gross disbursement of external commercial borrowings, excluding funds raised through IMD, amounted to US $3.81 billion in 2000-01, compared with the gross disbursement of US $3.19 billion in 1999-2000. The increase in disbursements in 2000-01 was mainly on account of re-financing of pre-payment of more expensive loans with relatively softer terms. The pre-payment of loans was also reflected in significant increase in amortization payments from US $2.87 billion in 1999-2000 to US $5.31 billion in 2000-01. As a result, disbursements, net of amortization payments, in 2000-01 turned negative at US $1.50 billion, compared with the net inflow of US $0.31 billion in the previous year. The negative flows in 2000-01 were more than made up by the funds raised through India Millennium Deposits of US $5.51 billion, resulting in net overall inflow of US $4.01 billion under external commercial borrowing.

6.46 The External Commercial Borrowings policy continues to provide flexibility in borrowings by Indian corporates and public sector undertakings (PSUs), while at the same time, maintaining safe limits for total external borrowings, consistent with prudent debt management. The guiding principles for ECB policy are to keep maturities long, costs low, and encourage infrastructure and export sector financing, which are crucial for overall growth of the economy. The status of approvals given to the corporates under normal windows during the last three financial years is given in Table 6.9.

TABLE 6.9
Approvals given for External Commercial Borrowings during 1998-99 to 2000-01

(In US$ million)

Sectors	1998-99	1999-00	2000-01
Power	3998	2267	1065
Telecom	75	0	0
Shipping	37	27	144
Civil Aviation	0	0	0
Petroleum & NG	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	802
Amount raised under auto-route facility	0	0	546
Total	**5200**	**3398**	**2837**
ECB approval under credit enhancement scheme	**0**	**233**	**1098**

Source: ECB Division, Ministry of Finance, Government of India *(c) Foreign Investment Flows*

6.47 After a sharp set back in 1998-99, foreign investment inflows, made a smart recovery in 1999-2000 and the position was broadly maintained in 2000-01 (Table 6.10). Total foreign investments, comprising direct and portfolio, which averaged about US $5.39 billion during the four years ended 1997-98, fell sharply to US $2.40 billion in 1998-99, as a fall out of the Asian Crisis. In 1999-2000, they recovered to US $5.18 billion and the recovery was maintained in 2000-01, with the total inflow of US $5.10 billion. During the first eight months of 2001-02, total foreign investment inflows have risen by about 47 per cent to US $3.68 billion from US $2.51 billion in the corresponding period in 2000-01, due, mainly, to about 61 per cent increase in foreign direct investments (FDI). The trends in foreign investment flows in 2000-01 and 2001-02 augur well when seen against the background of private capital flows (net) to emerging market economies being only marginal in 2000 and negative in 2001.

(i) Foreign Direct Investment

6.48 Foreign direct investment (FDI) flows, after reaching a peak of US $3.56 billion in 1997-98, receded gradually to US $2.16 billion in 1999-2000. FDI inflows rose only marginally to US $2.34 billion in 2000-01. FDI inflows during the current financial year (2001-02) so far have been encouraging. During April-November, 2001, they show an increase of 61 per cent to US $2.37 billion from US $1.47 billion during April-November, 2000. The source and direction of FDI remained, by and large, unchanged during the 1990's. Companies registered in Mauritius and the US were the principal source of FDI into India during 2000-01, followed by Japan and Germany. The bulk of FDI was channeled into computer hardware and software, engineering industries, services, electronics and electrical equipment, chemical and allied products and food and dairy products.

6.49 FDI is seen as a means to supplement domestic investment for achieving a higher level of economic growth and development. FDI benefits domestic industry as well as the Indian consumers by providing opportunities for technological up-gradation, access to global managerial skills and practices, optimal utilization of human and natural resources, making Indian industry internationally competitive, opening up export markets, providing backward and forward linkages and access to international quality goods and services. Towards this end, the FDI policy has been constantly reviewed, and necessary steps have been taken to make India a most favourable destination for FDI. The major initiatives taken

TABLE 6.10

Foreign Investment Flows by Different Categories

(US$ million)

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01*	Apr-Nov* 2000-01	Apr-Nov* 2001-02
A. Direct investment	**97**	**129**	**315**	**586**	**1314**	**2144**	**2821**	**3557**	**2462**	**2155**	**2339**	**1468**	**2365**
a. RBI automatic route	—	—	42	89	171	169	135	202	179	171	454	235	538
b. SIA/FIPB route	—	66	222	280	701	1249	1922	2754	1821	1410	1456	915	1310
c. NRIs (40% & 100%)	—	63	51	217	442	715	639	241	62	84	67	49	33
d. Acquisition of shares**	—	—	—	—	—	11	125	360	400	490	362	269	484
B. Portfolio investment	**6**	**4**	**244**	**3567**	**3824**	**2748**	**3312**	**1828**	**-61**	**3026**	**2760**	**1037**	**1315**
a. FIIs#	—	—	1	1665	1503	2009	1926	979	-390	2135	1847	267	799
b. GDRs / ADRs@	—	—	240	1520	2082	683	1366	645	270	768	831	696	477
c. Offshore funds & others	6	4	3	382	239	56	20	204	59	123	82	74	39
Total (A+B)	**103**	**133**	**559**	**4153**	**5138**	**4892**	**6133**	**5385**	**2401**	**5181**	**5099**	**2505**	**3680**

* Provisional.

** Relates to acquisition of shares of Indian companies by non-residents under section 5 of FEMA 1999. Data on such acquisitions have been included as part of FDI since January 1996.

\# Represents fresh inflow of funds by Foreign Institutional Investors (FIIs).

@ Represents the amounts raised by Indian Corporates through Global Depository Receipts (GDRs) and American Depository Receipts (ADRs).

BOX 6.7
Major initiatives to attract FDI during 2000-2001 & 2001-02

- In pursuance of Government's commitment to further facilitate Indian industry to engage unhindered in various activities, Government has permitted, except for a small negative list, access to the automatic route for FDI, whereby foreign investors only need to inform the Reserve Bank of India within 30 days of bringing in their investment, and again within 30 days of issuing any shares.
- Non-Banking Financial Companies(NBFCs) may hold foreign equity up to 100 per cent if these are holding companies.
- Foreign investors can set up 100 per cent operating subsidiaries (without any restriction on number of subsidiaries) without the condition to disinvest a minimum of 25 per cent of its equity to Indian entities, subject to bringing in US $ 50 million, out of which US $ 7.5 million to be brought upfront and the balance in 24 months. Joint venture operating NBFCs that have 75 per cent or less than 75 per cent foreign investment will also be allowed to set up subsidiaries for undertaking other NBFCs activities, subject to the subsidiaries also complying with the applicable minimum capital inflow.
- FDI up to 49 per cent from all sources is permitted in the private banking sector on the automatic route subject to conformity with RBI guidelines.
- In the process of liberalization of FDI policy, the following policy changes have been made :
  (i) 100 per cent FDI permitted for B to B e-commerce. (ii) Condition of Dividend Balancing on 22 consumer items removed forthwith. (iii) Removal of cap on foreign investment in the Power sector. And (iv) 100 per cent FDI permitted in oil-refining.
- Automatic Route is available to proposals in the Information Technology sector, even when the applicant company has a previous joint venture or technology transfer agreement in the same field. Automatic Route of FDI up to 100 per cent is allowed in all manufacturing activities in Special Economic Zones (SEZs), except for the following activities:
  (i) Arms and ammunition, explosives and allied items of defence equipment, defence aircraft and warships; (ii) Atomic substances; (iii) Narcotics and psychotropic substances and hazardous chemicals; (iv) Distillation and brewing of alcoholic drinks; and (v) Cigarettes/cigars and manufactured tobacco substitutes.
- FDI up to 100 per cent is allowed with some conditions for the following activities in Telecom sector:
  (i) ISPs not providing gateways (both for satellite & submarine cables); (ii) Infrastructure Providers providing dark fiber (IP Category I); (iii) Electronic Mail; and (iv) Voice Mail.
- FDI up to 74 per cent is permitted for the following telecom services subject to licensing and security requirements (proposals with FDI beyond 49 per cent shall require prior Government approval):
  (i) Internet services providers with gateways; (ii) Radio paging; and (iii) End-to-end bandwidth.
- Payment of royalty up to 2 per cent on exports and 1 per cent on domestic sales is allowed under automatic route on use of trademarks and brand name of the foreign collaborator without technology transfer. Payment of royalty up to 8 per cent on exports and 5 per cent on domestic sales by wholly owned subsidiaries to offshore parent companies is allowed under the automatic route without any restriction on the duration of royalty payments.
- Offshore Venture Capital Funds/Companies are allowed to invest in domestic venture capital undertakings as well as other companies through the automatic route, subject only to SEBI regulations and sector specific caps on FDI.
- FDI up to 26 per cent is eligible under Automatic Route in the Insurance sector, as prescribed in the Insurance Act, 1999, subject to their obtaining licence from Insurance Regulatory & Development Authority.
- FDI up to 100 per cent is permitted in airports, with FDI above 74 per cent requiring prior approval of the Government.
- FDI up to 100 per cent is permitted with prior approval of the Government in courier services subject to existing laws and exclusion of activities relating to distribution of letters. FDI up to 100 per cent is permitted with prior approval of the Government for development of integrated township, including housing, commercial premises, hotels, resorts, city and regional level urban infrastructure facilities such as roads and bridges, mass rapid transit systems and manufacture of building material in all metros, including associated commercial development of real estate. Development of land and providing allied infrastructure will form an integral part of township's development.
- FDI up to 100 per cent is permitted on the automatic route in hotel and tourism sector and for Mass Rapid Transport Systems in all metropolitan cities, including associated commercial development of real estate. FDI up to 100 per cent in drugs and pharmaceuticals (excluding those which attract compulsory licensing or produced by recombinant DNA technology and specific cell/tissue targeted formulations) placed on the automatic route.
- The defence industry sector is opened up to 100 per cent for Indian private sector participation with FDI permitted up to 26 per cent, both subject to licensing.
- International Financial Institutions like Asian Development Bank, International Financial Corporation, Commonwealth Development Corporation, German Investment and Development Company (DEG) etc., are allowed to invest in domestic companies through the automatic route, subject to Securities and Exchange Board of India/Reserve Bank of India guidelines and sector specific caps on FDI.

during 2000-01 and 2001-02 to attract FDI are given in Box 6.7.

(ii) Portfolio Investment

6.50 Fresh inflows for portfolio investment by foreign institutional investors (FIIs) during 2000-01 were US $1.85 billion, slightly lower than the inflows of US $2.14 billion in the previous year. During the first eight months of 2001-02, such inflows amounted to US $799 million, an increase of US $532 million over the inflows during the corresponding period in 2000-01. The policy in regard to portfolio investments by FIIs is reviewed constantly and major initiatives are taken, when necessary. In the Budget for 2001-02, it was proposed to raise the limit for portfolio investment by FIIs from the normal level of 24 per cent of the paid up capital of the company to 49 per cent, subject to the approval of the General Body of the shareholders by a special resolution. More recently, Indian companies have been permitted to raise the aggregate ceiling for portfolio investment by FIIs through secondary market from the normal level of 24 per cent upto the applicable sectoral cap levels of the issued and paid up capital of the company, subject to compliance with the special procedure, viz., (a) approval by the Board of Directors of the Company to the enhanced limit beyond 24 per cent, and (b) a Special Resolution passed by the General Body of the Company approving the enhanced limit beyond 24 per cent.

6.51 Funds raised through issue of ADRs / GDRs amounted to US $831 million in 2000-01, compared with US $768 million in 1999-2000. During the current financial year upto November 2001, US $477 million has been raised through this route. The Government has been liberalizing the guidelines for issue of GDRs/ADRs in a phased manner. The initiatives taken in 2001-02 include: (a) As a follow up of the announcement in the Budget for 2001-02, Indian companies have been permitted to list in foreign stock exchanges by sponsoring ADR/GDR issues with overseas depository against shares held by its shareholders subject to prescribed conditions; (b) All companies that have made an ADR/GDR issue earlier and listed abroad have been permitted the facility of overseas business acquisition through ADR/GDR stock swap under the automatic route subject to conditions that include adherence to FDI policy and the value limit for the transaction not to exceed US $100 million or 10 times the export earnings during the proceeding financial year; and (c) Operational guidelines for facility for limited two way fungibility for Indian ADRs/GDRs announced by the Finance Minister in the Union Budget 2001-02 are under finalisation in consultation with the RBI and the SEBI.

(d) Non-Resident Indian Deposits

6.52 Fresh accruals to Non-Resident deposits, including accrued interest, rose by over 50 per cent to US $2.32 billion in 2000-01, on top of an increase of over 60 per cent in 1999-2000 (Table 6.11). During the first eight months of the current financial year, 2001-02, accruals to NRI deposit were about US $1.98 billion, higher than the US $1.52 billion in the same period last year. The outstanding balances under non-resident deposit schemes continued their increasing trend, reflecting the overall confidence of non-resident Indians in the strength of the economy. Outstanding balances under all the non-resident deposit schemes amounted to US $24.65 billion at the end of November 2001, up from US $23.07 billion at end-March 2001 and US $21.68 billion at end-March 2000.