Capital account

6.43 Private capital inflows into emerging market economies were estimated at just about US $ 25 billion in 2001, which was barely a tenth of inflows worth US $ 229 billion during 1996. Reduced volume of inflows in the aftermath of the East Asian crisis has particularly affected developing Asia, where private inflows declined from US $122.1 billion in 1996 to only US $16.7 billion in 2001. Volume of official capital flows to emerging market economies has also dropped sharply after the Asian meltdown. However, private capital inflows in 2002 are expected to multiply by nearly two-and-a half times of their level in 2001. The recovery is expected to occur largely on account of growth of inflows in emerging markets of developing Asia. The Indian economy, which has been one of the most resilient performers in developing Asia, is expected to receive much higher capital inflows on account of its strong fundamentals during the current year.

6.44 The capital account balance, which was less than US $ 3.0 billion in 1995-96, was estimated at nearly US $10.4 billion in 2001-02 (Table 6.2). Steady foreign investment inflows have been instrumental in building and maintaining a strong capital account during the later half of the 1990s and thereafter. Non-resident (NR) deposits, though yet to reach their peak pre-East Asian crisis levels of 1996-97, have recovered to grow well during 2000-01 and 2001-02. Commercial borrowings, during recent years, have also been substantial, despite experiencing a net outflow of above US $1 billion during 2001-02. External assistance has remained steady at an annual average of around US $0.9 billion from 1995-96 onward.

6.45 For the third time in seven years, the capital account surplus was more than US $10 billion in 2001-02 (Table 6.2), higher by US $2 billion over 2000-01. Notwithstanding a net outflow of commercial borrowings, the higher surplus was achieved due to strong foreign investment and NR deposit inflows, along with a step-up in net external assistance. Foreign investment and NR deposit inflows have been encouraging during the first half of the current financial year also. However, higher repayments, both for external assistance and commercial borrowings, have led to lower loan estimates, thereby pegging the capital surplus to around US $ 4.9 billion during the first six months of 2002-03. This surplus on capital account, coupled with a current account surplus in the first half of the current financial year, has resulted in a surge in foreign exchange reserves, encouraging the Government towards further liberalization of capital controls (Box 6.4).

Box 6.4: Progress towards further liberalization of capital controls

Though full convertibility of the Indian Rupee has been permitted in the current account for quite some time now, capital controls are being removed only selectively. The Union Budget 2002-03 has made the non-resident schemes fully convertible. Other measures announced during the current year included a hike in foreign exchange allowances for individuals up to US $10,000 and permission to Indian citizens to maintain foreign currency deposits out of foreign exchange earned/retained from travel expenses. In view of the high level of foreign exchange reserves being held by the economy, and the comfortable external sector scenario, capital controls were further liberalized with a view to introducing greater flexibility in capital account transactions. The measures include:

- Removal of the existing limit of US $20,000 for remittance under the ESOP scheme.
- Discontinuation of limits on trade-related loans and advances by EEFC account holders, though the transactions will continue to be reportable to RBI.
- General permission to retain ADR/GDR proceeds abroad for future forex requirements.
- Permission to corporates, which have set up their branches and offices abroad, to acquire immovable property overseas for their business/staff residential purposes.
- Permission to listed Indian companies to invest abroad in companies listed in recognized overseas stock exchanges, and having at least 10 percent shareholding in a company listed on a recognized stock exchange in India, on January 1 of the year of investment. Such investments shouldn't exceed 25 percent of the Indian company's net worth as on the date of the last audited balance sheet.
- Permission to mutual funds to invest abroad in companies which are listed on overseas stock exchanges, and which have at least 10 percent shareholding in a company listed on a recognized stock exchange in India on January 1 of the year of investment. The overall cap for investment abroad by mutual funds has been raised to US $ 1 billion.
- Apart from companies, individuals are also permitted to invest abroad in companies which are listed on overseas stock exchanges, and which have at least 10 percent shareholding in a company listed on a recognized stock exchange in India on January 1 of the year of investment. However, no investment limits have been fixed for individuals.
- With regard to transfer of assets in India, remittance up to US $1 million out of balances held in NRO accounts/ sale proceeds of assets has been permitted. The existing dispensation of permitting different amounts for different purposes, such as education, medical, sale proceeds of immovable property, assets of foreign nationals including retired employees/ widows of Indian citizens resident outside India, and assets in India acquired by NRIs/PIOs by way of inheritance/ legacy, has been removed. Instead, authorized dealers have been permitted to allow remittance up to US $1 million, out of balances held in NRO accounts/ sale proceeds of assets, subject to Indian taxes.

The above measures have come into force from January 10, 2003 and shall remain in vogue for a period of six months from their date of announcement.