Foreign investment

6.50 Policies in the post-reforms period have emphasized upon greater encouragement and mobilisation of non-debt creating private capital inflows for reducing reliance on debt flows as the chief source of external resources. Progressively liberal policies adopted in this regard have led to increasing inflows of foreign investment in the country, both in terms of direct investment (FDI), as well as portfolio investment. A disaggregated time series profile of foreign investment inflows is given in Table 6.10. At a more micro-level, a month-wise illustration of foreign investment inflows for the first seven months of 2001-02 and 2002-03 are given in Table 6.11.

Table 6.10 : Foreign investment inflows

(in US $ million)

		1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
A.	**Direct investment**	**129**	**315**	**586**	**1314**	**2144**	**2821**	**3557**	**2462**	**2155**	**2339**	**3904**
a.	SIA/FIPB	66	222	280	701	1249	1922	2754	1821	1410	1456	2221
b.	RBI	-	42	89	171	169	135	202	179	171	454	767
c.	NRI	63	51	217	442	715	639	241	62	84	67	35
d.	Acquisition of shares*	-	-	-	-	11	125	360	400	490	362	881
B.	**Portfolio investment**	**4**	**244**	**3567**	**3824**	**2748**	**3312**	**1828**	**-61**	**3026**	**2760**	**2021**
a.	GDRs/ADRs#	-	240	1520	2082	683	1366	645	270	768	831	477
b.	FIIs**	-	1	1665	1503	2009	1926	979	-390	2135	1847	1505
c.	Offshore funds and others	4	3	382	239	56	20	204	59	123	82	39
Total (A+B)		**133**	**559**	**4153**	**5138**	**4892**	**6133**	**5385**	**2401**	**5181**	**5099**	**5925**

* 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 the amount raised by Indian corporates through Global Depository Receipts (GDRs) and American Depository Receipts (ADRs)

** Represents fresh inflow of funds by foreign institutional investors (FIIs).

Source: RBI.

Table 6.11 : Monthly foreign investment inflows

(in US $ million)

		2002							Apr-Oct 2001	Apr-Oct 2002
		Apr	May	Jun	Jul	Aug	Sept	Oct		
A.	**Direct investment**	**174**	**491**	**400**	**154**	**234**	**233**	**298**	**2049**	**1984**
	a. SIA/FIPB	36	212	56	70	177	71	220	1240	842
	b. RBI	56	260	37	22	31	39	64	501	509
	c. NRI	-	-	-	-	-	-		30	-
	d. Acquisition of shares*	82	19	307	62	26	123	14	278	633
B.	**Portfolio investment**	**-73**	**107**	**-272**	**43**	**-33**	**-131**	**108**	**1245**	**-251**
	a. GDRs/ADRs#	-	20	-	-	-	-	117	477	137
	b. FIIs**	-73	87	-272	43	-33	-131	-9	729	-388
	c. Offshore funds and others	-	-	-	-	-	-		39	-
Total (A+B)		101	598	128	197	201	102	406	3294	1733

* 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 the amount raised by Indian corporates through Global Depository Receipts (GDRs) and American Depository Receipts (ADRs).

** Represents fresh inflow of funds by Foreign Institutional Investors (FIIs). Source: RBI, Mumbai.

Table 6.12 : FDI inflows in select Asian economies

(in US $ million)

	1996	1997	1998	1999	2000	2001
World	386140	478082	694457	1088263	1491934	735146
Developed economies	219908	267947	484239	837761	1227476	503144
Developing economies	152685	191022	187611	225140	237894	204801
Asia	93331	105828	96109	102779	133707	102066
South, East and South-East Asia	87843	96338	86252	99990	131123	94365
a. China	40180	44237	43751	40319	40772	46846
b. India	2525	3619	2633	2168	2319	3403
c. Indonesia	6194	4677	-356	-2745	-4550	-3277
d. Korea	2325	2844	5412	9333	9283	3198
e. Malaysia	7296	6324	2714	3895	3788	554
f. Philippines	1520	1249	1752	578	1241	1792
g. Singapore	8608	10746	6389	11803	5407	8609
h. Thailand	2271	3626	5143	3561	2813	3759

Source: World Investment Report (WIR), 2002; UNCTAD.

6.51 Annual aggregate foreign investment inflows varied between US $ 4 to 6 billion during the period 1993-94 to 2001-02 (except for 1998-99). The average volume of foreign investment inflows during the period is estimated to be roughly US $ 4.9 billion (US $ 5.2 billion excluding 1998-99). Inflows during the current year (April-October 2002) have been around 53 percent of the inflows during the corresponding previous period. The reduced volume of inflows is attributable to heavy outflow of portfolio investment during the current year so far.

Foreign direct investment (FDI)

6.52 FDI inflows are an indicator of the foreign investor community's long-term stakes in the host economy. A time-series profile of FDI inflows into select Asian host economies is given in Table 6.12. In 2001, developing economies of Asia accounted for around 14 percent of total global FDI inflows. China has been the largest recipient of FDI inflows among developing economies of Asia with its share in total FDI of these economies increasing from 43 percent in 1996 to almost 46 percent in 2001. India, though way behind China in attracting FDI inflows, has marginally improved its share in total FDI inflows of developing economies of Asia from 2.7 percent in 1996 to 3.3 percent in 2001. A sharp rise in volume of FDI inflows in the Indian economy in 2001-02 (Table 6.10) thus its growing attractiveness as an investment destination.

6.53 In the aftermath of the East Asian crisis in 1997-98, overall net private capital flows to emerging markets, including those in developing Asia, experienced sharp decline. Though the decline is largely attributable to reduced volumes of portfolio inflows, FDI inflows also fell. The reduction in FDI inflows in the Indian economy after 1997-98 (Table 6.10) therefore, is reflective of the overall depressed trends of private capital flows in emerging market, including developing Asia (with the notable exception of China).

6.54 Against this subdued backdrop, the spurt in FDI inflows in India in 2001-02 is remarkable for several reasons. First, in terms of overall trends in FDI inflows into emerging markets of developing Asia, the year 2001 was hardly encouraging. Even then, the Indian economy received its highest FDI inflows in the post-reforms period, surpassing the previous high of 1997-98. Second, the major part of the year 2001-02 was characterized by a synchronized slowdown in the global economy, which dampened investor sentiments and tightened international capital markets. But India received higher FDI inflows notwithstanding the rigidities in global financial markets. Finally, the year 2001 saw the Indian economy grappling with exogenous shocks like the Gujarat earthquake (January 2001) and the terrorist attack on the Indian Parliament (December 2001), apart from the calamitous developments on September 11, 2001. The ability of the economy to overcome these shocks and attract record FDI inflows, point to the increasing attractiveness of India's country-specific attributes (e.g. strong macro-economic fundamentals, expanding market, large pool of human resources etc.), in securing FDI.

6.55 As part of the ongoing process of liberalizing FDI policies, the Planning Commission had set up a Steering Committee on FDI in August 2001, for suggesting measures for enhancing FDI inflows in India. The major recommendations of the Committee are given in Box 6.5. Besides, other measures adopted during the current year for encouraging greater FDI inflows included permission for 100 percent FDI in development of integrated townships and regional urban infrastructure, tea sector (including tea plantation), advertising and films, and permission to foreign firms to pay royalty on brand name/trade mark as a percentage of net sales in case of technology transfer.

6.56 In line with more liberal policies pertaining to overseas investment by Indian firms, overseas direct investment (ODI) outflows from India have been exhibiting rising trends in recent years. Aggregate outflows rose from US $0.2 billion in 1995-96 to roughly US $1.2 billion in 2000-01. In 2001-02, the

Box 6.5 : Major recommendations of the Steering Committee on foreign direct investment set up by the Planning Commission

The Steering Committee on FDI set up by the Planning Commission in August 2001 has submitted its report, which is currently being considered by the Government. The main recommendations of the Committee are:

- Enactment of a Foreign Investment Promotion Law incorporating and integrating relevant aspects for promoting FDI.
- Urge States to enact a special investment law relating to infrastructure for expediting investment in infrastructure and removing hurdles to production in infrastructure.
- Empower the Foreign Investment Promotion Board (FIPB) for granting initial Central-level registrations and approvals wherever possible, for speeding up the implementation process.
- Empower Foreign Investment Implementation Authority (FIIA) for expediting administrative and policy approvals.
- Disaggregating FDI targets for the tenth Plan in terms of sectors, and relevant administrative ministries/ departments, for increasing accountability.
- Reduction of sectoral FDI caps to the minimum and elimination of entry barriers. Caps can be taken off for all manufacturing and mining activities (except defence), eliminated in advertising, private banks, and real estate, and hiked in telecom, civil aviation, broadcasting, insurance and plantations (other than tea).
- Overhauling the existing FDI strategy by shifting from a broader macro-emphasis to a targeted sector-specific approach.
- Informational aspects of the FDI strategy require refinement in the light of India's strengths and weaknesses as an investment destination and should use information technology and modern marketing techniques.
- The Special Economic Zones (SEZs) should be developed as internationally competitive destinations for export-oriented FDI, by simplifying laws, rules, and procedures, and reducing bureaucratic rigmarole on the lines of China.
- Domestic policy reforms in power, urban infrastructure, and real estate, and de-control/de-licensing should be expedited for attracting more FDI.

actual outflows declined to around US $0.9 billion. However, the previous year witnessed a sharp rise in volume of approved investment, which shot up from US $1.4 billion in 2000-01 to US $3 billion in 2001-02. The increase in approvals was largely on account of higher approvals sought for foreign equity investment, which also explains the lower materialization of actual outflows compared to approvals, since the global equity markets suffered from sharp erosion in confidence last year, particularly after September 11, 2001. The depressed global equity market trends have manifested in the current year also. During the first half of the current year, actual outflows, at US $0.4 billion, have been just around 40 percent of the total approvals worth US $1.1 billion. In the current year, the bulk of India's overseas corporate investments have been in the manufacturing sector, followed by non-financial services. Sudan has accounted for the largest share of investment approvals in the current year (US $ 0.75 billion), followed by USA, Mauritius and Singapore.

6.57 Foreign exchange inflows from Indian overseas investments in joint ventures and wholly owned subsidiaries have been steadily rising. While inflows rose from US $ 0.04 billion in 1999-2000 to US $ 0.05 billion in 2000-01, there was a more than five-fold increase in 2001-02, when the inflows aggregated around US $0.3 billion. In the first half of the current year, inflows from overseas investment have been at around US $ 0.03 billion.

Portfolio investment

6.58 Portfolio investments, by their very nature, reflect much shorter-term commitments compared to FDI, and hence are prone to greater volatility. The time-series profile of aggregate portfolio inflows (Table 6.10) captures these fluctuations, particularly after 1996-97. It is mentionable in this context that private portfolio investment inflows in emerging markets dropped sharply after the East Asian crisis. Developing Asia has not been an exception in this regard, with the year 2001 experiencing a net outflow of US $13.5 billion from emerging markets in the region. The Indian economy, though not experiencing a net outflow, had its third lowest volume of portfolio investment in 2001-02 for the period 1993-94 to 2001-02.

6.59 Among the various components of portfolio investment, foreign institutional investment (FII) comprises the bulk of portfolio inflows. FIIs diversify their portfolios internationally with the objective of minimizing risks and maximizing returns. Country and region-specific factors have important roles to play in determining investment decisions of portfolio investors. In the year 2002, perspectives for expected returns from various emerging markets became subdued. While market sentiments turned unfavourable in Latin America due to heightened economic and financial difficulties in the region, equity markets in developing Asia also fell back, though not by the same extent as elsewhere. Domestic equity markets in India have also remained largely subdued during the year.

6.60 During the current financial year, April-October 2002, FII outflows occurred for every month, except May and July 2002, underlining risk-averse perceptions of FIIs. The heaviest outflow occurred in June 2002, which coincided with high security tensions in the Indian subcontinent, followed by issue of travel advisories by some Western nations. Concerns arising from scanty rainfall and outbreak of drought-like conditions also affected FII perceptions regarding prospective yields from Indian markets, as did the downgrading by some international credit rating agencies. The contrast in FII inflows during the current year becomes evident when compared with the last quarter of 2001-02, a time when the global economy was relatively more upbeat, and global equity market sentiments more positive.

6.61 The adverse effects of a global slowdown and delayed recovery, on international capital markets, are also evident from the lower resource mobilization by Indian corporates through the ADR/GDR route. The volume of equity finance raised from international markets by Indian firms had dropped in 2001-02 itself, which further reduced overall portfolio investment. Portfolio inflows are unlikely to improve till global recovery gathers momentum and investors become less risk-averse towards emerging markets.