Capital account

6.40 Capital inflows can be classified by instrument (debt or equity), duration (short-term or long-term) and nature (stable or volatile) of flows. Such taxonomy helps calibrate the policy of liberalization of the capital account. Figure 6.5 shows that foreign investment (net) has been a relatively stable component of total capital flows, fluctuating broadly between 1 per cent and 2 per cent of GDP during this decade. However, it seems to have shifted to a higher plane from 2003-04 with average for 2003-04 to 2006-07 roughly double that during 2000-01 to 2002-03. In contrast, the debt flows have fluctuated much more, with a down trend till 2003, which resulted in net outflows in the three years to 2003-04, and a rising trend from 2004-05. The trend in net capital flows since 2003-04 therefore seems to be broadly driven by the rising ratio of debt flows (Figure 6.5). Variations in debt flows have been primarily due to lumpy repayments on government guaranteed or related External Commercial Borrowing (ECB).

6.41 Net capital flows rose from a level of US$ 25.0 billion in 2005-06 to reach US$ 46.4 billion in 2006-07, which implies a growth of 85.8 per cent. The major developments in 2006-07 include: (i) a quantum jump in external commercial borrowings (net); (ii) significant rise in foreign direct investment inflows with a simultaneous rise in outward investment; (iii) large inflows in the form of non-resident Indian (NRI) deposits; and, (iv) an initial fall in portfolio investment, which was somewhat compensated by a recovery in the latter half of the year. The World Economic Outlook (WEO) reported that many emerging markets and developing countries similarly experienced historically high levels of net foreign exchange inflows. The acceleration in gross flows was sharper than net flows. Net private capital flows to emerging market economies and developing countries, after falling by 18.5 per cent in 2006, have risen by 124.3 per cent to reach US$ 495.4 billion in 2007. Thus, net capital flows into India have been substantial in the current financial year.

Non-debt Flows

Foreign investment

6.42 As a proportion of total capital flows and on a net basis, foreign investment has had a mixed trend in the post-reform period. In 2006-07, the proportion stood at 33.5 per cent, down from 62.2 per cent in 2005-06 with negligible growth in foreign investment, year-on-year. The proportion rose to 43.4 per cent in the first half of 2007-08. Of the two major components of foreign investment, namely, FDI and portfolio investment comprising foreign institutional investment (FII), Euro equities and others, the latter had been a major but not-so-stable source of foreign investment flows in the period 1993-94 to 2005-06 (Figure 6.6)

Figure 6.5 **Total capital a/c (net), foreign investment (net) and debt flows**

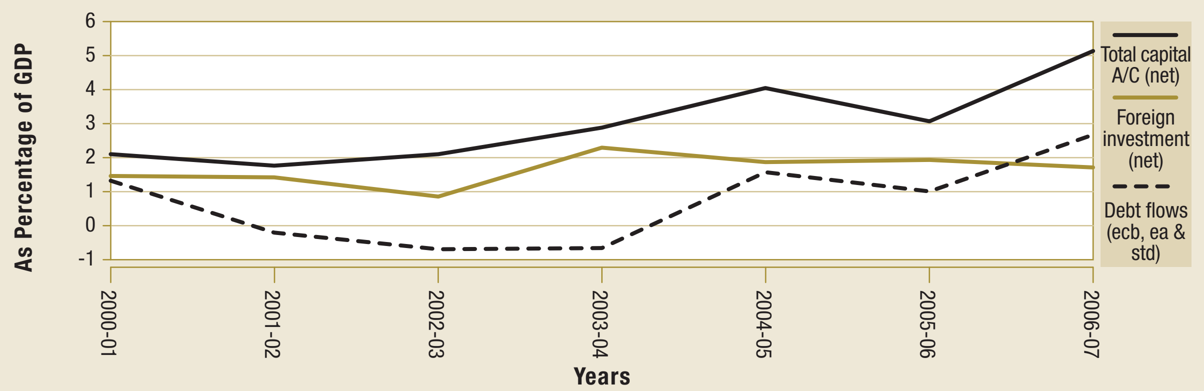

Figure 6.6 ECB, FDI, portfolio, other capital flows and total capital account