Foreign investment

33. FDI inflows to developing countries are estimated to have gone up to U.S.$ 149 billion in 1997 from U.S.$ 130 billion in 1996. India's share of global FDI flows rose from 1.8 per cent in 1996 to 2.2 per cent in 1997 (Table 6.7). On the other hand, India's share in net portfolio investment flows to the developing countries declined to 5.1 per cent in 1997 after increasing to 8.7 per cent in 1996 (Table 6.8).

34. Foreign investment into India in 1997-98 was lower at U.S.$ 5,025 million compared to U.S.$ 6,008 million in 1996-97 because of a decline in portfolio investment (Table 6.9). Although foreign direct investment (FDI) increased by 18.6 per cent from U.S.$ 2,696 million in 1996-97 to U.S.$ 3,197 million in 1997-98, portfolio investment declined from U.S.$ 3,312 million in 1996-97 to U.S.$ 1,828 million in 1997-98. This decline in portfolio investment is mainly attributable to the contagion from the East Asian crisis, which adversely affected capital flows to all emerging markets.

35. International developments continue to affect capital flows into India in 1998-99 as well. The provisional estimate of total foreign investment at U.S.$ 880 million during April-December, 1998 was sharply lower compared to the inflow of U.S.$ 4253 million during the corresponding period in the previous year. Although FDI flows were weaker, this overall decline in capital flows was mainly attributable to a net outflow in portfolio investment of U.S.$ 682 million during April-December, 1998 as against an inflow of U.S.$ 1742 million during the same period in 1997. Trends in approvals and actual inflows of foreign direct investment are shown in Table 6.10.

36. Mauritius, as in the previous two years, was the dominant source of FDI inflows in 1997-98. U.S.A. and S. Korea were, respectively, the second and third largest sources of FDI. The striking feature was that S. Korea increased its flow of investment in India from a meagre U.S.$ 6.3 million in 1996-97 (0.2 per cent of total FDI) to U.S.$ 333.1 million in 1997-98 (10.4 per cent share). On the sectoral side, although the engineering industry witnessed a decline in inflows in 1997-98, it remained an attractive area for FDI, being the second largest recipient after electronics & electrical equipments.

37. The decline in portfolio investment, from 1997-98 onwards, has been contributed by a decline in flows of both foreign institutional investment and GDRs (Table 6.9). Fresh inflow of funds by FIIs declined from U.S.$ 1,926 million in 1996-97 to U.S.$ 979 million in 1997-98. This trend intensified in 1998-99 with an estimated outflow of U.S.$ 752 million during April-December, 1998 compared to inflows of U.S.$ 973 million during the corresponding period in the previous year. GDRs raised in 1997-98 was U.S.$ 645 million, which was less than half the amount of U.S.$ 1,366 million raised in 1996-97. The declining trend has continued during the first nine months of 1998-99 with only U.S.$ 15

TABLE 6.7

FDI by Host Region

(US $ Million)

Country	1992	1993	1994	1995	1996	1997[e]
China	11156	27515	33787	35849	40800	45300
India	233	574	973	1964	2382	3264
Indonesia	1777	2004	2109	4348	6194	5350
Korea, Rep. of	727	588	809	1776	2325	2341
Malaysia	5183	5006	4342	4132	4672	3754
Philippines	228	1238	1591	1459	1520	1253
Thailand	2114	1804	1322	2002	2268	3600
All developing countries including China	51108	72528	95582	105511	129813	148944
Share of India in developing countries (%)	0.5	0.8	1.0	1.9	1.8	2.2

Source : World Investment Report, United Nations, 1998.

'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.

TABLE 6.8

FII net investment in India as a percent of Portfolio investment in Developing Countries

(US$ million)

Item	1994	1995	1996	1997
Portfolio investment in India #	5348	1361	4579	2816
Net Portfolio investment in developing countries@	85700	22200	52700	55500
India's share in developing countries (%)	6.2	6.1	8.7	5.1

 # Include FII net investment (SEBI data) and GDR (RBI data).
@ Data published in the World Economic Outlook, I.M.F., 1998.

million raised compared to U.S.$ 612 million during the same period in 1997-98. The poor performance of portfolio investment is a consequence of both enhanced emerging market risk-perception, and the depressed condition of the domestic capital market.

Policies on Foreign Investment

38. Several measures to boost FDI have been announced in 1998-99. Projects for electricity generation, transmission and distribution as also roads and highways, ports and harbours, and vehicular tunnels and bridges have been permitted foreign equity participation up to 100 per cent under the automatic route, provided foreign equity does not exceed Rs. 1500 crore. FDI permissible under Non-Banking Financial

TABLE 6.9
Foreign Investment Flows by Different Categories

(U.S. $ million)

	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	April-Dec. 97-98	April-Dec. 98-99
A. Direct Investment	129	315	586	1314	2133	2696	3197	2511	1562
a. RBI automatic route		42	89	171	169	135	202	186	131
b. SIA/FIPB route	66	222	280	701	1249	1922	2754	2119	1380
c. NRI (40% & 100%)	63	51	217	442	715	639	241	206	51
B. Portfolio Investment	4	244	3567	3824	2748	3312	1828	1742	-682
a. FIIs #	-	1	1665	1503	2009	1926	979	973	-752
b. Euro equities@	-	240	1520	2082	683	1366	645	612	15
c. Offshore funds & others	4	3	382	239	56	20	204	157	55
Total (A+B)	**133**	**559**	**4153**	**5138**	**4881**	**6008**	**5025**	**4253**	**880**

Source : RBI.
*** Provisional.**
 # Represent fresh inflow/outflow of funds by FIIs.
@ Figures represent GDR amounts raised abroad by the Indian Corporates.

TABLE 6.10
Foreign Direct Investment : Actual Flows vs. Approvals

	1991	1992	1993	1994	1995	1996	1997	1998*	Total (91 to 98)
Approvals									
Rs crore	739	5256	11189	13590	37489	39453	57149	25103	189968
US$ million	325	1781	3559	4332	11245	11142	15752	6132	54268
Actual Inflows									
Rs crore	351	675	1786	3009	6720	8431	12085	8433	41490
US$ million	155	233	574	958	2100	2383	3330	2073	11806
Actual Inflows as % of Approvals (In US $ terms)	47.7	13.1	16.1	22.1	18.7	21.4	21.1	33.8	21.7

Source : RBI
*** : Upto September, 1998. Figures are provisional.**
Note : The approval and actual inflows figures include NRI direct investments approved by RBI.

Services now includes “Credit Card Business” and “Money Changing Business”. Regarding equity participation in private sector banks, multilateral financial institutions have been allowed to contribute equity to the extent of the shortfall in NRI holdings within the overall permissible limit of 40 per cent. The Government has also decided to permit FDI up to 49 per cent of the total equity, subject to license, in companies providing Global Mobile Personal Communication by Satellite (GMPCS) services. Also, minimum capitalisation norms earlier required for pure financial consultancy services have been relaxed.

39. GDR/ADR guidelines have been further liberalised in 1998-99. Unlisted companies are now permitted to float Euro issues under certain conditions. All end-use restrictions on GDR/ADR issue proceeds have been removed, except the prevailing restrictions on investment in stock markets and real estate. The 90-day validity period for final approvals of GDR/ADR issues has been withdrawn and final approval will continue to be valid, thereby imparting greater flexibility to issuing companies regarding the timing of issues. Indian companies are now permitted to issue GDRs/ADRs in the case of Bonus or Rights issue of shares, or on genuine business reorganisations duly approved by the High Court. The companies, however, in all such cases, will be required to get approval from the Department of Economic Affairs for the issue of GDRs/ADRs.

Portfolio Investments - NRIs

40. A number of liberalization measures have been taken in 1998-99 to promote portfolio foreign investment. In order to avoid NRIs being crowded out by FIIs, the aggregate ceiling for investment in a company by all NRIs/PIOs/OCBs through stock exchanges has been made separate and exclusive of the investment ceiling available for FIIs. In addition, the aggregate investment ceiling for NRIs/PIOs/OCBs has been raised from 5 per cent to 10 per cent of the paid up capital of a company. In the case of listed Indian companies, the ceiling can be raised to 24 per cent of the paid up capital under a General Body Resolution. Also, the investment limit by a single NRI/PIO/OCB has been enhanced from 1 per cent to 5 per cent of the paid up capital. Policy pertaining to investment in unlisted companies has also been liberalised. NRIs/PIOs/OCBs are now permitted to invest in unlisted companies. However, while investing in unlisted companies, the same norms and approval procedures applicable to portfolio investments in listed companies will apply, and it will be subject to the same investment ceilings as in the listed companies.

Portfolio Investments—FIIs

41. FIIs can purchase and sell Government Securities and Treasury Bills within overall aproved debt ceilings. To facilitate better risk management by investors, authorised dealers have been permitted to provide forward cover to FIIs in respect of their fresh equity investments in India. Moreover, transactions among FIIs with respect to Indian stocks will no longer require post-facto confirmation from the RBI. Also, 100 percent FII debt funds have been permitted to invest in unlisted debt securities of Indian companies.

External Commercial Borrowings (ECBs)

42. The higher net inflows of U.S.$ 3,999 million of ECBs in 1997-98 compared to U.S.$ 2,848 million in 1996-97 reflected lower amortisation. Disbursements in 1997-98 stood at U.S.$ 7,371 million, which was marginally lower than U.S.$ 7,571 million recorded in 1996-97. ECB approvals in 1997-98 have been placed at U.S.$ 8,712 million, which is slightly higher than the level in 1996-97. Regarding sectoral allocation, power accounted for the highest approvals of U.S.$ 3 billion, followed by telecom with U.S.$1.5 billion (Table 6.11). In 1998-99 up to 23.12.98, approvals have been placed at U.S.$ 3,804 million. The reduced attractiveness of ECB of the corporate sector has been underscored by a very steep decline in actual disbursements to U.S.$ 1.6 billion (excluding U.S $ 4.2 billion on account of RIBs) in the first two quarters of 1998-99 compared to U.S.$ 4.3 billion in the same period last year. Increase in cost of ECB funds has come about due to a general increase in the risk premium for emerging market borrowers, downgrades by international credit rating agencies and the rise in forward premia. After several years of unchanged or slightly improving ratings, major rating agencies started to re-examine our ratings in early 1997 (Table 6.12). Both the deteriorating external environment and persistent large fiscal deficits have been cited as the main reasons for downgrading.

43. ECB is approved by the Government within an annual ceiling that is consistent with prudent debt management, keeping in view the balance of payments position. The existing ECB policy was reviewed in 1998-99 in light of the financial

needs of various sectors and the impact on international markets of both the East Asian crisis and economic sanctions. Regarding the sectoral requirements, infrastructure and exports continue to be accorded high priority in ECB allocation. The changes in the ECB guidelines are summarised in Box 6.3.

Non-Resident Deposits

44. The Resurgent India Bond (RIB) scheme, launched in the current financial year, was open to both NRIs/OCBs and the banks acting in fiduciary capacity on behalf of them. The scheme, that opened on August 5, 1998 and closed on August 24, 1998, mobilised U.S.$ 4.2 billion. The interest rates on these five year bonds were 7.75 per cent for U.S. dollar, 8 per cent for Pound Sterling, and 6.25 per cent for Deutsche Mark. Other features of RIBs include joint holding with Indian residents, allowing them to be gifted to Indian residents, easy transferability, loanability, premature encashment facility, and tax benefits.

45. Net inflows under non-resident deposits declined from U.S.$ 3,314 million in 1996-97 to U.S.$ 1,119 million in 1997-98 (Table 6.13). The outflow under FCNRA continued due to redemption payment. Also, the relative rates of return and the perceived risk premium on emerging market debt has influenced the flows into these accounts. Some of the domestic policy-related factors which seem to have contributed towards subdued net flows include imposition of incremental cash reserve ratio of 10 per cent on non-resident deposits and the linking of interest rates under FCNR(B) with LIBOR, which had the effect of lowering interest rates offered under this scheme, and thereby reducing its attractiveness. In order to encourage mobilisation of long-term deposits, and concomitantly to discourage short-term deposits, the interest rate ceiling on FCNR(B) deposits of one year and above was raised and the ceiling on such

TABLE 6.11

Status of ECB Approvals

(US $ Million)

Sector	1996-97	1997-98	1998-99*
Power	1874	3014	2733
Telecom	289	1492	75
Shipping	146	210	36
Civil Aviation	45	373	0
Petroleum & Natural Gas	783	230	40
Railways	144	179	15
Financial Institutions	1502	795	50
Ports, Roads, etc.	0	61	0
Others (including exporters)	3797	2358	855
Total	**8580**	**8712**	**3804**

*** as on 23.12.98**
Source : ECB Division, Ministry of Finance, Government of India.

BOX 6.3

Changes in ECB guidelines, 1998-99

(Position as of December, 1998)

- The cooling-off period for making a fresh application for ECB was reduced from six months to three months with effect from 30.4.98, and subsequently to one month with effect from 10.7.98.
- Proceeds of ECB can now be deployed for project related rupee expenditure in all sectors subject to certain conditions.
- The limit under the 'US$ 3 million scheme' has been raised to US$ 5 million. Small borrowers, therefore, can now avail of a higher borrowing limit than before. The Government has also delegated ECB sanctioning power to RBI up to US$ 10 million under all the ECB schemes.
- The minimum maturity requirement under various ECB schemes has been revised as follows: (I) US$ 3 million scheme with 3 years simple maturity now stands revised to US$ 5 million scheme with 3 years simple maturity; (2) the minimum average maturity has been fixed at 3 years for ECB up to US$ 20 million, and 5 years for larger amounts (as against 3 years for US$ 15 million, and 7 years for amounts greater than US$ 15 million earlier); (3) ECB of any amount by 100% EOUs need an average maturity of 3 years.
- ECB eligibility under the scheme for exporters has been raised to three times (from two times earlier) the average export performance during last three years subject to a maximum of US$ 100 million.
- Average maturity requirement for ECB under the long term maturity window which is outside the ECB cap is reduced from 10 years to 8 years for borrowing up to US$ 100 million, and from 20 years to 16 years for borrowing up to US$ 200 million for general corporate objectives.
- In order to enable the corporates to hedge exchange rate risk, domestic rupee denominated structured obligations have been permitted to be credit-enhanced by international banks/ international financial institutions/joint venture partners.
- Prepayment of ECB by Indian corporates has been allowed if this is met out of inflow of foreign equity.

TABLE 6.12

Sovereign Ratings by major Rating Agencies

(December 1994 to October 1998)

Month/Year	Moody's	Standard & Poor's	Duff & Phelps	JBRI
December, 1994	Baa3 (investment grade) (upgraded)			
July/August, 1995		BB+ (speculative grade) (rating maintained)		BBB+ (investment grade) (rating maintained)
October, 1996		BB+ (speculative grade) (upgraded from stable to positive outlook)		
February, 1997	Baa3 (investment grade) (negative outlook)			
October, 1997		BB+ (speculative grade) (revised the outlook from positive to stable)		
November, 1997			BBB- (investment grade)	
January, 1998	Decided to review the existing rating for possible downgrading.			
May, 1998		Decided to change the outlook from stable to negative.		
June, 1998	Ba2 (speculative grade) (stable outlook)	BB+ (speculative grade) (negative outlook)	BBB- (investment grade) (negative outlook under review)	
August, 1998			BB+ (speculative grade) (stable outlook)	
October, 1998		BB (speculative grade) (stable outlook)		Decided to revise the rating to BBB.

Source: ECB Division, Ministry of Finance

deposits below one year was reduced in April, 1998.

46. As at the end of March 1998, outstanding balances under various non-resident deposit schemes stood at U.S.$ 20,367 million. Comparison of estimated net flows under non-resident deposits during April-November 1998 vis-à-vis the corresponding period in 1997 shows a compositional shift in favour of Rupee denominated accounts in response to policy initiatives undertaken in 1997-98. Net inflows under non-residents deposits, (excluding redemption payments under FCNRA which had since been discontinued) at US $ 367 million during April-November, 1998 were substantially lower than those of US $ 2266 million in the same period of 1997. Positive flows have been recorded only in the NR(E)RA and NR(NR)RD schemes. The initiatives in terms of freeing of interest rates and removal of incremental CRR, may have acted as incentives to attract deposits in these accounts.

TABLE 6.13

Outstanding Balances and Net Flows under various Non-Resident Deposit Schemes

(US$ million)

A. Outstanding Balances under Different Schemes*

Schemes	As at the end of					
	March 94	March 95	March 96 (Revised)	March 97 (Revised)	March 98 (Revised)	Nov. 98 (P.E.)
FCNR(A)	9300	7051	4255	2306	1	0
FCNR(B)	1108	3063	5720	7496	8467	7621
NR(E)RA	3523	4556	3916	4983	5637	5778
NR(NR)RD	1754	2486	3542	5604	6262	6449
FC(B&O)D	533	—	—	—	—	—
TOTAL	**16218**	**17156**	**17433**	**20389**	**20367**	**19848**

B. Net flows under Non-Resident Deposits*

Schemes	1993-94	1994-95	1995-96	1996-97	1997-98	Apr-Nov. (P.E.) 1997-98	Apr-Nov. (P.E.) 1998-99
Foreign Currency Non-Resident (Accounts) (FCNR(A))	-1317	-2249	-2796	-1949	-2305	-2233	-1
Foreign Currency Non-Resident(Banks) (FCNR(B))	1075	1979	2669	1773	971	340	-846
Non-Resident External Rupee Accounts (NR(E)RA)	728	964	-208	1244	1197	935	559
Non-Resident (Non Repatriable) Rupee Deposits (NR(NR)RD)	1187	682	1279	2246	1256	991	654
Foreign Currency (Banks & Others) Deposits (FC(B&O)D)	-576	-558	—	—	—	—	—
TOTAL	**1097**	**818**	**944**	**3314**	**1119**	**33**	**366**

P.E. : Provisional Estimates. *** All figures are inclusive of accrued interest.**

Source : RBI.

External Assistance

47. Gross disbursements under external assistance have declined modestly from U.S.$ 3,056 million in 1996-97 to U.S.$ 2,877 million in 1997-98. Amortisation payments in 1997-98 were U.S.$ 1,978 million as against U.S.$ 1,947 million in 1996-97. Net inflows, therefore, declined from U.S.$ 1,109 million in 1996-97 to U.S.$ 899 million in 1997-98. Gross disbursements during April-September, 1998 was lower at U.S.$ 830 million compared o U.S.$ 1,066 million during the corresponding period of the previous year. Repayments were nearly the same at U.S. $ 965 million during April-September, 1998 as compared to U.S. $ 976 million during the same period in the previous year. Net disbursements, therefore, declined from U.S. $ 90 million during April-September, 1997 to U.S $ -135 million during April-September, 1998