'Recent Development of Foreign Capital Flows In India- A Study on Composition, Policies and Trends'

Sandhya.R
Rajalakshmi.K
bency J Samuel

Asst. Professor, MLA Academy of Higher Learning
Asst. Professor, Maharani Lakshmi Ammanni College for Women
Asst. Professor, Maharani Lakshmi Ammanni College for Women

ABSTRACT:

Foreign capital has significant role for every national economy, regardless of its level of development. For the developed countries it is necessary to support sustainable development. For the developing countries, it is used to increase accumulation and rate of investments to create conditions for more intensive economic growth. Capital flow in the forms of portfolio and foreign direct investment is not only an engine for globalization but also a catalyst for economic development for developing countries. This study encompasses to analyze the foreign capital inflows in India as a source of capital which has increased significantly over the last couple of decades. There is a need to develop a healthy enabling environment to reap the benefits. The recipient country should develop adequate regulatory framework, good general education and health condition for human resource and openness to trade and compete.

1.1 TITLE OF THE STUDY

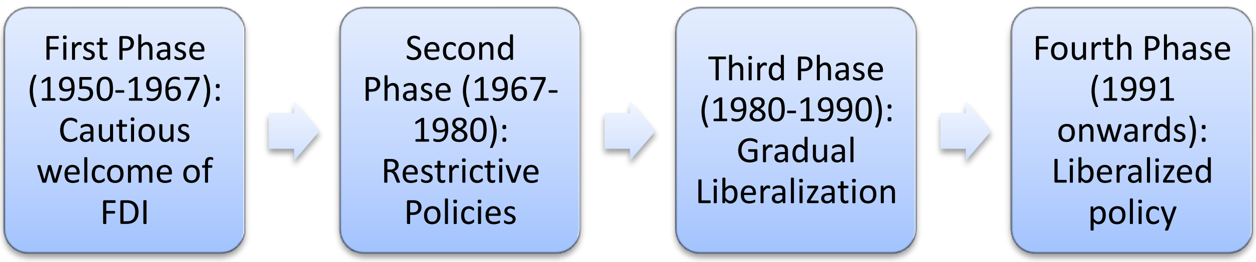
RECENT DEVELOPMENT OF FOREIGN CAPITAL FLOWS IN INDIA- A STUDY ON COMPOSITION, POLICIES AND TRENDS

1.2 INTRODUCTION

Foreign Capital has a key role in the economic development process of the country. It is a source of modernization, income and employment generation in the economy. India's recent liberalization of its foreign investment regulations has generated strong interest by foreign investors, turning India into one of the fastest growing destinations for global investment inflows. Foreign firms are setting up joint ventures and wholly owned enterprises in services such as computer software, telecommunications, financial services and tourism. Capital flows contribute in filling the resource gap in countries where domestic savings are inadequate to finance investment. Capital inflows allow the recipient country to invest and consume more than it produces when the marginal productivity of capital within its borders is higher than in the capital-rich regions of the world.

Capital inflows facilitate the attainment of the millennium development goals (MDGs) and the objective of national economic, empowerment and development strategy (NEEDs). As the economy becomes more open and integrated with the rest of the world, capital flows will contribute significantly to the transformation of the developing economy (Levin, 2001).

POLICY FRAMEWORK OF INVESTMENT INFLOWS IN INDIA



First Phase (1950-1967): Cautious welcome of FDI - During this period, India's development strategy focused on import substitution industrialization. The availability of capital, technology, skills, entrepreneurship etc. was very limited. The attitude towards foreign investments was highly receptive. Foreign investors were assured of non-discriminatory treatment at par with domestic enterprises. It was however, emphasized that the majority interest in ownership and control would always be in Indian hands. The incentives and concessions were offered to attract foreign investments.

Second Phase (1967-1980): Restrictive Policies During this phase restrictions on FDI flows were imposed. The investible requirements of funds increased due to industrialization and foreign exchange outflows were increasing due to technology and inputs imports. Thus government adopt restrictive attitude towards the FDI to arrest investments which allow higher outflows in terms of royalty payments, dividends, interest etc. Foreign Exchange Regulation Act (FERA) was enacted in 1973 to control FDI inflows.

Third Phase (1980-1990): Gradual Liberalization

The gradual liberalization of FDI policies in the 80's occurred due to the deterioration of foreign exchange position in the wake of oil crisis and low exports growth. Hence a gradual liberalization on foreign investment inflows were allowed in the industrial and trade policies. A degree of flexibility was introduced in the policy concerning foreign ownership. The rules and procedures concerning payments of royalties and lump sum technical fees were relaxed and taxed were reduced.

Fourth Phase (1991 onwards): Liberalized Policy

The industrial policy statement of 1991 has followed an open-door policy on foreign investment and technology transfers. The policy since then has been aimed at encouraging foreign investment particularly in core and infrastructure sectors.

Components/ Composition of Foreign Capital Flows:

India is a developing country, and like many other developing countries, international capital inflows had significantly benefited the Indian economy. International capital flow, such as FDI and FPI flows, has been a huge contribution to positively influence the economic behavior and growth trajectory of the developing countries. There are many forms of the foreign capital inflows:

I. Foreign Capital Investments

1. Foreign Direct Investments (FDI)
2. Foreign Portfolio Investments (FPI)

II. External Commercial Borrowings

III. Non Resident Indian Deposits

I. Foreign Capital Investment

Foreign Capital Investment refers to investments made by an entity which is not the residents of the country. In India there are two components of foreign capital investments.

1. Foreign Direct Investment (FDI): FDI refers to the physical investments made by foreign investors in the domestic country. The physical investments refer to the direct investments into building, machinery and equipments. Reserve Bank of India (RBI) defines FDI as a process whereby residents of one country (i.e., home country) acquires ownership for the purpose of controlling production, distribution and other activities of a firm in the another country (i.e., host country). The direct investor can be an individual, public or private enterprises (referred to as multinational corporations) or Government.

In India there are three important element of FDI:

(a) Equity investments by foreign investors;

(b) Reinvested earnings i.e., retained earnings of FDI companies;

(c) Debt Investment (particularly the inter-corporate debt between related entities).

2. Foreign Portfolio Investment (FPI):

FPI refers to the short-term investments by foreign entity in the financial markets. These are indirect investments and include investment in tradable securities, such as shares, bonds, debenture of the companies. Foreign portfolio investors don't exert management control on the enterprise in which they invest.

The important objective of FPI is the appreciation of the capital investment regardless of any long-term relationship with enterprise. These investments are made with short-term speculative gains.

There are three kinds of FPI in India:

- Foreign Institutional Investment (FII): These are the investments made by foreign institutions like pension funds, foreign mutual funds etc., in the financial markets.
- Global Depository Reserves (GDRs)/ American Depository Reserves (ADRs): These are the instruments which signify the purchase of share of Indian companies by foreign investors or American investors respectively.
- Off- Shore funds: The schemes of mutual funds that are launched in the foreign country

II. External Commercial Borrowings

External Commercial Borrowings comprises of borrowings from international capital market on commercial terms. It covers all medium/ long term loans ex: Supplier's credit, foreign currency convertible bonds, resurgent India bonds. Various commercial banks have also been making successful attempts to raise funds in the international capital markets through formation of mutual funds etc.

III. Non Resident Indian Deposits

NRI deposits refer to the investments made by non-resident citizens in their home countries. The Governments provide several kinds of incentives to non-resident citizens to set up industries and other business units in their home countries.

1.3 LITERATURE SURVEY

Renu Kohli (2001), examined the controversial issue of reserve options with an open capital account. India is gradually liberalising its capital account and the issue of freeing capital outflows. There are restrictions upon outflows which stem mainly from the concern that the rupee needs to be protected from a speculative attack depleting foreign exchange reserves. Current trends in reserve accumulation revealed that maintaining a sizeable level of foreign exchange reserves is an important objective of the central bank. This view was reinforced by the authorities' response to an actual or perceived threat to a fall in foreign exchange reserves, viz. two efforts at bolstering the country's reserves through the Resurgent India Bond and the India Millenium Bond issues in 1998 and 2000 respectively.

Kohli et al (2003), analyzed that the whole world including India had witnessed significant changes in the composition and direction of capital flows during the last decade (1990-2001). As per the study, it was revealed that private capital flows had dominated overall capital flow components. Such developments had created a good amount of interest amongst the economists and academicians to understand and analyze the trends of foreign capital flows, and had also motivated them to create an environment where it became desirable for the government to bring in important policy changes.

Dr. Sumanjeet (2009), analyzed that total foreign investments into India in 2007-08 stood at US $ 59288 million (about Rs 2.5 lakh crore), up by a whopping 162 per cent over the previous year. October 2007 witnessed the highest inflow - US $ 11591 million (Rs 48682 crore), CMIE data shows. July, September, December and January too witnessed heavy investments and these months brought in about 50 percent of the total inflows for 2007-08.

Sudhansu Sekhar Nanda, (2015), stated that the size of net capital inflows to India has increased significantly in the post reform period. It is also important to note that capital inflows increased extensively since 2005. However, capital inflows declined during 2007-08 to 2008-09 as a consequence of global financial crisis. The movement of capital inflows clearly indicates that capital inflows in India are highly volatile.

Jyoti Gupta & Dr. Rachna Chaturvedi (2017), studied that India, for all the talk of doing well in attracting FDI inflows, is still punching below its weight. A resurgent Indian government has wizened to the requirements and has initiated several reforms thus making FDI regulations more lucrative by raising the FDI cap in various sectors, opening many new sectors for FDI and by adopting automatic approval route for some sectors. While the above can be touted as measures in the right direction, the FDI numbers flatter to deceive.

1.4 Statement of the Problem

Foreign capital has significant role for every national economy, regardless of its level of development. Capital flow in the forms of portfolio and foreign direct investment is not only an engine for globalization but also a catalyst for economic development for developing countries. The movement of capital inflows clearly indicates that capital inflows in India are highly volatile. However, the economic benefits from foreign capital don't accrue automatically. There is a need to develop a healthy enabling environment to reap the benefits.

1.5 Objectives of the Study

- To study the composition and determinants of the Capital flows in India.
- To understand the recent trends of the Capital Inflows
- To compare the FDI inflows Country wise and Sector wise for the year 2016-17 and 2017-18

1.6 Scope of the Study

This study analyzes the foreign capital inflows in India as a source of capital which has increased significantly over the last couple of decades. It evaluates the recent development in Foreign Capital flows related to the globalization of the world economy. It also studies the policy changes in the recent era in an atmosphere of global uncertainties. Hence, the scope of this study is to cover the full view on various aspects of the capital inflows to India and their policy implications.

1.7 Techniques of Data Collection

All the required data for the study was collected from secondary sources. The relevant secondary data had been collected from reports of the Ministry of Commerce and Industry, Department of Industrial Promotion and Policy, Government of India, Reserve Bank of India, and World Investment Report and also through books, articles, reports, journals and websites.

1.8 Discussion & Analysis

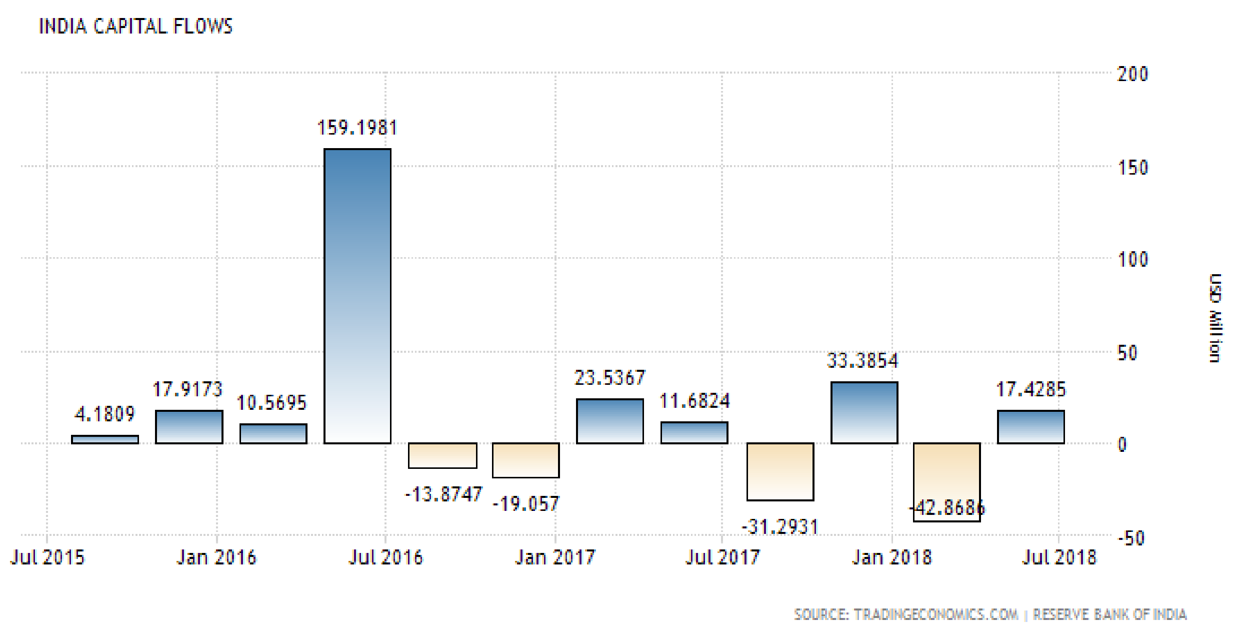
"Capital flows refer to the movement of money for the purpose of investment, trade or business production, including the flow of capital within corporations in the form of investment capital, capital spending on operations and research and development."

Foreign Capital refers to the capital flows from resident entity of one country to the resident entity of another country. The resident entity may be an individual, corporate firm or a Government.

TRENDS IN FOREIGN CAPITAL FLOWS

Foreign direct investment (FDI) in India increased by about 3 per cent to $61.96 billion in 2017-18 on account of steps taken by the government to improve business climate and liberalized policy norms. FDI inflows stood at $60 billion in the previous fiscal.

INDIA CAPITAL FLOWS

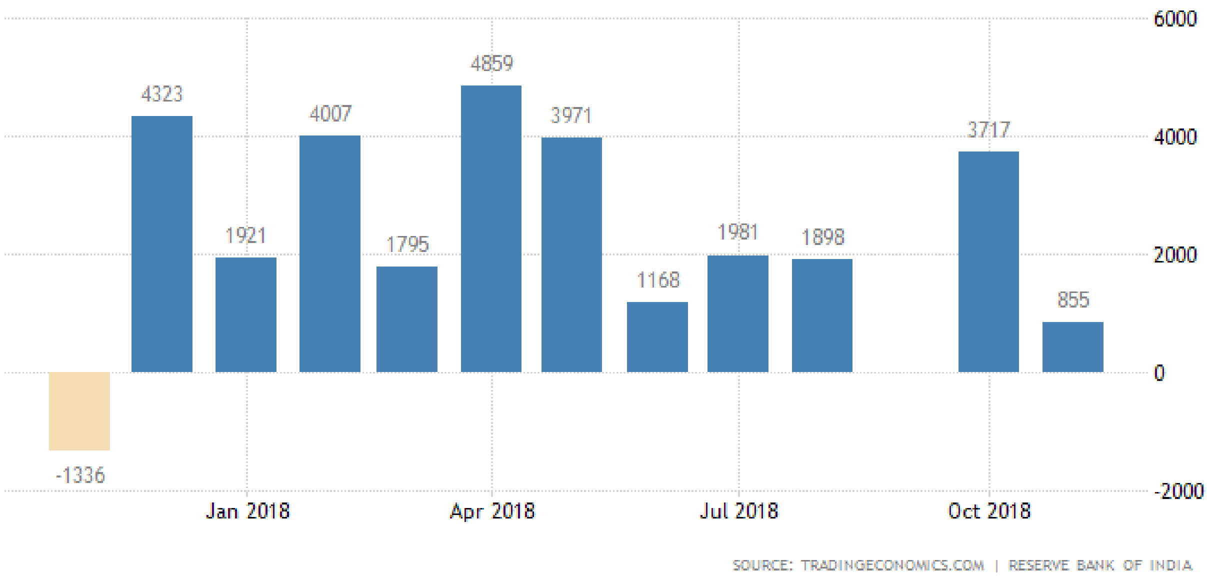


India recorded a capital and financial account surplus of 17.43 USD Million in the second quarter of 2018. Capital Flows in India averaged 8.13 USD Million from 2010 until 2018, reaching an all time high of 766.97 USD Million in the second quarter of 2013 and a record low of -271.47 USD Million in the second quarter of 2011.

Emerging market (EM) capital flows have proven to be more volatile during 2018 in the face of rising US interest rates. The rupee has depreciated more than 10 per cent against the US dollar since January 2018 which led to have a more see-saw changes in the Foreign capital flows.

According to the Moody's, the Government estimates that the measures will increase capital inflows by $8-$10 billion, or 0.3-0.4 per cent of GDP, in the fiscal year that ends March 31, 2019.

INDIA FOREIGN DIRECT INVESTMENT



Foreign Direct Investment in India increased by 855 USD Million in November of 2018. Foreign Direct Investment in India averaged 1328.99 USD Million from 1995 until 2018, reaching an all time high of 8579 USD Million in August of 2017 and a record low of -1336 USD Million in November of 2017.

According to Department of Industrial Policy and Promotion (DIPP), the total FDI investments in India April-June 2018 stood at US$ 12.75 billion, indicating that government's effort to improve ease of doing business and relaxation in FDI norms is yielding results.

Data for April-June 2018 indicates that the services sector attracted the highest FDI equity inflow of US$ 2.43 billion, followed by trading – US$ 1.63 billion, telecommunications – US$ 1.59 billion and computer software and hardware – US$ 1.41 billion. Most recently, the total FDI equity inflows for the month of June 2018 touched US$ 2.89 billion.

During April-June 2018, India received the maximum FDI equity inflows from Singapore (US$ 6.52 billion), followed by Mauritius (US$ 1.49 billion), Japan (US$ 0.87 billion), Netherlands (US$ 0.84 billion), and United Kingdom (US$ 0.65 billion).

India has become the most attractive emerging market for global partners (GP) investment for the coming 12 months, as per a recent market attractiveness survey conducted by Emerging Market Private Equity Association (EMPEA).

Annual FDI inflows in the country are expected to rise to US$ 75 billion over the next five years, as per a report by UBS.

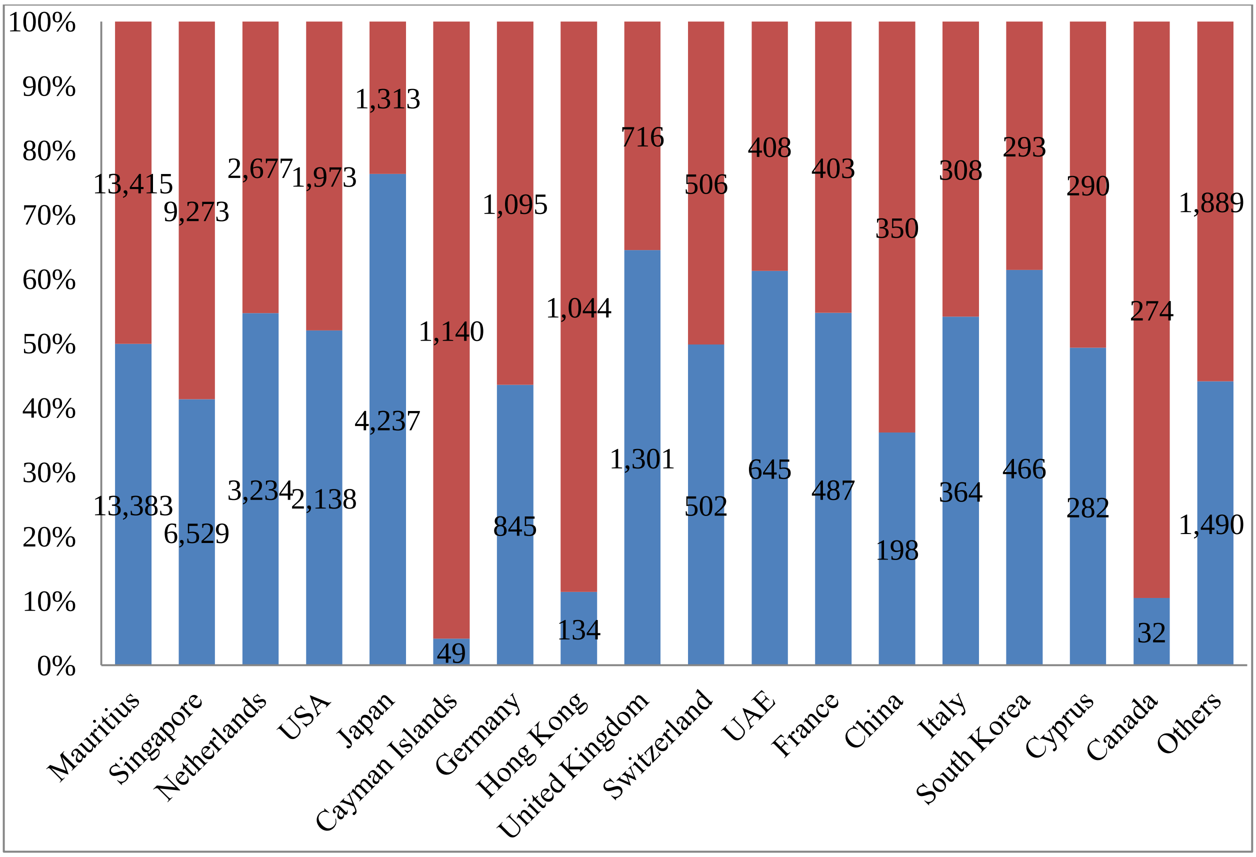
The World Bank has stated that private investments in India is expected to grow by 8.8 per cent in FY 2018-19 to overtake private consumption growth of 7.4 per cent, and thereby drive the growth in India's gross domestic product (GDP) in FY 2018-19.

Table Showing Foreign Direct Investment Flows to India: Country-Wise and Industry-Wise

(US$ million)					
Source/ Industry	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18 P**
1	**2**	**3**	**4**	**5**	**6**
Total FDI	16,054	24,748	36,068	36,317	37,366
Country-Wise Inflows					
Mauritius	3,695	5,878	7,452	13,383	13,415
Singapore	4,415	5,137	12,479	6,529	9,273
Netherlands	1,157	2,154	2,330	3,234	2,677
USA	617	1,981	4,124	2,138	1,973
Japan	1,795	2,019	1,818	4,237	1,313
Cayman Islands	25	72	440	49	1,140
Germany	650	942	927	845	1,095
Hong Kong	85	325	344	134	1,044
United Kingdom	111	1,891	842	1,301	716
Switzerland	356	292	195	502	506
UAE	239	327	961	645	408
France	229	347	392	487	403
China	121	505	461	198	350
Italy	185	167	279	364	308
South Korea	189	138	241	466	293
Cyprus	546	737	488	282	290
Canada	11	153	52	32	274
Others	1,626	1,682	2,243	1,490	1,889
Sector-wise Inflows					
Communication Services	1,256	1,075	2,638	5,876	8,809
Manufacturing	6,381	9,613	8,439	11,972	7,066
Retail & Wholesale Trade	1,139	2,551	3,998	2,771	4,478
Financial Services	1,026	3,075	3,547	3,732	4,070
Computer Services	934	2,154	4,319	1,937	3,173
Business services	521	680	3,031	2,684	3,005
Electricity and other energy Generation, Distribution & Transmission	1,284	1,284	1,364	1,722	1,870
Construction	1,276	1,640	4,141	1,564	1,281
Transport	311	482	1,363	891	1,267
Miscellaneous Services	941	586	1,022	1,816	835
Restaurants and Hotels	361	686	889	430	452
Real Estate Activities	201	202	112	105	405
Education, Research & Development	107	131	394	205	347
Mining	24	129	596	141	82
Trading	0	228	0	0	0
Others	293	232	215	470	226
P: Provisional.					

India remains a preferred destination for foreign direct investment (FDI) as domestic consumption remains strong, according to RBI Annual Report. The Manufacturing sector has gathered momentum, helped by both services and agriculture sectors, consumption demand remains robust in the country making it an attractive investment destination. In the services sector, the impulses of growth are broadening and expansion in employment conditions is generating anticipations of improvement in demand conditions.

Chart Showing Country Wise Inflows for the year 2016-17 & 2017-18



The above chart shows Country Wise FDI Inflows in India for the year 2016-17 and 2017-18.

Country Mauritius have been the highest contributor of FDI for the past 2 financial years. FDI inflows were concentrated mostly in Mauritius and Singapore that accounted for about 61 percent of total equity investments. FDI flow of Singapore has increased from US$6529 million to US$9273 million, however, the inflows from Netherlands, USA and Japan has decreased consequently. Cayman Islands, Germany Hong Kong and UK and have increased their FDI contribution to India from 2016-17 to 2017-18.

Overall, the FDI inflows have increased from US$ 36,317 million to US$ 37,366 million. The increase in foreign capital flow was mainly due to higher flows into the communication services, retail and wholesale trade, financial services and computer services. Sectors like construction and mining witnessed a decline in FDI inflows during 2017-18, whereas electricity and other energy generation, distribution and transmission and restaurants and hotels recorded a slight increase in inflows, as per data from the Reserve Bank of India's annual report.

FDI is important as India would require huge investments in the coming years to overhaul its infrastructure sector to boost growth. Decline in foreign inflows could put pressure on the country's balance of payments and may also impact the value of the rupee. The government needs to take steps for reviving the domestic investment to attract foreign investors.

FINDINGS:

The Composition of Foreign Capital flows consists of

I. Foreign Capital Investments

• Foreign Direct Investments (FDI)

• Foreign Portfolio Investments (FPI)

II. External Commercial Borrowings

III. Non Resident Indian Deposits

➧ Foreign direct investment (FDI) in India increased by about 3 per cent to $61.96 billion in 2017-18 on account of steps taken by the government to improve business climate and liberalized policy norms. FDI inflows stood at $60 billion in the previous fiscal.

➧ India recorded a capital and financial account surplus of 17.43 USD Million in the second quarter of 2018.

➧ Emerging market (EM) capital flows have proven to be more volatile during 2018 in the face of rising US interest rates. The rupee has depreciated more than 10 per cent against the US dollar since January 2018 which led to have a more see-saw changes in the foreign capital flows.

➧ Foreign Direct Investment in India averaged 1328.99 USD Million from 1995 until 2018, reaching an all time high of 8579 USD Million in August of 2017 and a record low of -1336 USD Million in November of 2017.

➧ According to Department of Industrial Policy and Promotion (DIPP), the total FDI investments in India April-June 2018 stood at US$ 12.75 billion, indicating that government's effort to improve ease of doing business and relaxation in FDI norms is yielding results.

➧ Annual FDI inflows in the country are expected to rise to US$ 75 billion over the next five years, as per a report by UBS.

➧ India remains a preferred destination for foreign direct investment (FDI) as domestic consumption remains strong, according to RBI Annual Report. The Manufacturing sector has gathered momentum, helped by both services and agriculture sectors, consumption demand remains robust in the country making it an attractive investment destination.

➧ In the services sector, the impulses of growth are broadening and expansion in employment conditions is generating anticipations of improvement in demand conditions.

➧ Country Mauritius have been the highest contributor of FDI for the past 2 financial years. FDI inflows were concentrated mostly in Mauritius and Singapore that accounted for about 61 percent of total equity investments. FDI flow of Singapore has increased from US$6529 million to US$9273 million, however, the inflows from Netherlands, USA and Japan has decreased consequently. Cayman Islands, Germany Hong Kong and UK and have increased their FDI contribution to India from 2016-17 to 2017-18.

➧ FDI inflows have increased from US$ 36,317 million to US$ 37,366 million. The increase in foreign capital flow was mainly due to higher flows into the communication services, retail and wholesale trade, financial services and computer services. Sectors like construction and mining witnessed a decline in FDI inflows during 2017-18, whereas electricity and other energy generation, distribution and transmission and restaurants and hotels recorded a slight increase in inflows, as per data from the Reserve Bank of India's annual report.

CONCLUSION:

Foreign capital has a key role to play in the economic development of India. There are several ways in which capital flows and economic growth are related. However, impact of capital flows on economic growth ultimately depends on their being stable and less volatile. The size of net capital inflows to India has increased significantly in the post reform period. It is also important to note that capital inflows increased extensively since 2005. Indian government has been continuously proceeding for economic reforms and is quiet assured to secure legislation to allow more foreign investment in various sectors. The recipient country should develop adequate regulatory framework, good general education and health condition for human resource and openness to trade and compete.

REFERENCES

- https://tradingeconomics.com/india/indicators
- https://sol.du.ac.in/mod/book/view.php?id=1735&chapterid=1702
- https://www.imf.org/external/np/pp/eng/2016/110416a.pdf
- https://www.murdoch.edu.au/Research-capabilities/Asia-Research-Centre/_document/working-papers/wp155.pdf
- Jyoti Gupta & Dr. Rachna Chaturvedi (2017), "A Study to Analyze FDI Inflow to India", IOSR Journal of Economics and Finance (IOSR-JEF), e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 8, Issue 5 Ver. II (Sep.- Oct .2017), PP 44-52, www.iosrjournals.org
- Kamna Dhawan & Shikha Jain (2014), "Trends Of Foreign Capital and Foreign Investment in India", Vol. I, Issue I, June 2015, pp. 67-75
- Narendar, et al., (2015), "Composition of Foreign Capital Inflows and Growth in India: An Empirical Analysis", ISSN (2226-8235) Vol-4, Issue 4
- Renu Kohli (2001), "Capital Flows And Their Macroeconomic Effects In India"
- Sudhansu Sekhar Nanda, (2015), "Foreign Capital Flows in India: Determinants and Developments", ISSN: 2321-7782, Volume 3, Issue 10
- Dr. Sumanjeet (2009), "Foreign Capital Flows into India: Compositions, Regulations, Issues and Policy Options", ISSN: 1037-4612