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School of Social Sciences
Indira Gandhi National Open University

MEC 205
INDIAN ECONOMIC POLICY

Volume 3 (Block 5 and 6)

MEC-205
Indian Economic Policy

VOLUME-III

(Block 5 and 6)

School of Social Sciences
Indira Gandhi National Open University

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Contents

BLOCK 5
EXTERNAL SECTOR AND TRADE POLICY

BLOCK 5 EXTERNAL SECTOR AND TRADE POLICY

In the post economic reforms period, external sector in the economy has gained prime importance. Foreign trade contributes to economic development in number of ways. Hence, the external sector and trade policy constitutes the subject matter of this block. The block comprises of **three units**.

Unit 18 entitled **Trade Policy** throws light on the characteristics of international trade and status of the Indian trade prior to and post 1991 reforms. Various instruments of Trade policy with special reference to the developing nations have been highlighted. Emerging trade issues, along with the policy response to them in the form of FDI policy have also been spelt out in this unit.

Unit 19 entitled **Foreign Trade and Balance of Payment** discusses the role of foreign trade in economic development of a country. The Unit also examines India's foreign trade and the changes in its direction and composition. The country's Balance of Payment position, and the policy framework adopted for restoring the balance of payments have also been discussed.

Unit 20 on **Foreign Capital** analyses the role of foreign capital in the growth process of a developing economy. It discusses the types, the sources of foreign capital and the evolution of India's policy with respect to the foreign capital. The composition, trend, sources and destinations of overseas foreign direct investment in the context of Indian economy have also been examined.

UNIT 18 TRADE POLICY

Structure

18.0 OBJECTIVES

After going through this unit, you will be able to:

- discuss the characteristics of International trade and in particular about the Indian trade prior and post 1991;
- identify the instruments of a trade policy;
- appreciate the trade policy of developing economies;
- point out the emerging foreign trade issues in the changing nature of world trade;
- explain the role of the FDI policy in India; and
- evaluate the Foreign Trade Policy 2015-20.

18.1 INTRODUCTION

In this unit we shall discuss the Indian trade policy, its features in pre-economic reforms and post- economic reforms periods. We shall highlight the trade related important issues like trade in services, trade and intellectual property rights, and agriculture and regional trade agreements. The features of the trade policy 2015-2020 and its evaluation will also be discussed. To begin with, let us discuss the concept of international trade policy.

18.2 INTERNATIONAL TRADE POLICY

International trade policies from a country's point of view are those policies which the government adopts towards international trade. These are the policies that involve a number of actions like taxes on international transactions of goods and services, subsidies for other transactions, legal limits on the value and volume of imports and exports and many other measures. Trade policy involves a number of instruments described in the section that follow.

Additionally, there are various international organisations ensuring smooth trade flows between the nations. For instance, the World Trade Organisation (WTO) is a major international organisation that deals with the rules of trade between nations. WTO operates a global system of trade rules, acts as a forum for negotiating trade agreements, settles trade disputes between its members and supports the trade related needs of developing countries. Thus, the goal is to ensure that trade flows are as smooth, predictable and free as possible.

18.3 INSTRUMENTS OF A TRADE POLICY

1) Tariffs

Tariffs are among the oldest forms of trade policy instruments and have traditionally been used as a source of government income. Tariffs can be classified as:

- Specific tariffs– taxes that are levied as a fixed charge for each unit of goods imported.
- Ad-valorem tariffs– Taxes that are levied as a fraction of the value of the imported goods.

A compound duty (tariff) is a combination of an ad-valorem and a specific tariff.

In analysing trade policy in practice, it is important to know how much protection a trade policy actually provides. Protection can be categorised as nominal rate or effective rate of protection. The nominal rate of protection (NRP) on any good is the proportional difference between its domestic and international (or world) price arising from the trade policies in question.

These policies can include import tariffs, export taxes, quantitative restrictions, etc. Thus, NRP is

$$NRP = (Pd - Pw)/ Pw \times 100$$

Where Pd and Pw are the domestic and world price, respectively.

Since trade involves both inputs and outputs, it is important to measure effective rate of protection i.e. one must consider both the effects of tariffs on the final price of a good, and the effects of tariffs on the costs of inputs used in production.

The effective rate of protection is a commonly used measure of net effect of trade policies on the incentives facing domestic producers. In case of a garment producer, for instance, taxes or other restrictions on clothing imports raise domestic clothing prices and are beneficial to domestic producers selling in the local market. On the other hand, a tariff-induced increase in the domestic price of fabric raises garment producers' costs and so is harmful to them. The net impact of trade policies on the producers of any good depends on their effects on prices of both their outputs and their inputs.

One can express the amount of effective protection as a percentage of the price that would prevail under free trade. The actual protection provided by a tariff will not equal the tariff rate if imported intermediate goods are used in the production of the protected good.

Thus, Rate of Effective Protection = [VT – VW] / VW where V is value added at world prices (W) and in presence of trade policies (T).

For example: Suppose a 10 per cent tariff is applied to motorcycles, so that a totally India made motorcycle which originally sold for Rs. 25000 (under free trade) can now sell for Rs 27500 because of the protection from foreign imports. In this calculation, effective protection equals nominal, i.e., 10 per cent. However, suppose imported inputs used in motorcycles were Rs.15000. Then the effective rate of protection is 25 per cent {= [(27500 – 15000)/10000)] – 1}.

2) Export Subsidies

It is a payment by the government to a firm or individual that ships a good abroad. When the government offers an export subsidy, shippers will export the good up to the point where the domestic price exceeds the foreign price by the amount of the subsidy. It can be either specific or ad valorem. An export subsidy raises prices in the exporting country while it lowers them in the importing country.

3) Import Quotas

An import quota is a direct restriction on the quantity of a good that is imported. The restriction is usually enforced by issuing licenses to some group of individuals or firms i.e. the right to sell in India is given directly to the governments of exporting countries. License holders are able to buy imports and resell them at a higher price in the domestic market. The profits received by the holders of import licenses are known as quota rents.

4) Voluntary Export Restraints

A voluntary export restraint (VER) is an export quota administered by the exporting country. It is also known as a voluntary restraint agreement (VRA). VERs are imposed at the request of the importer and are agreed to by the exporter to forestall other trade restrictions. A VER is exactly like an import quota where the licenses are assigned to foreign governments and is therefore very costly to the importing country. A VER is always more costly to the importing country than a tariff that limits imports by the same amount. The tariff equivalent revenue becomes rents earned by foreigners under the VER.

5) Local Content Requirements

A local content requirement is a regulation that requires that some specified fraction of a final good be produced domestically. This fraction can be specified in physical units or in value terms. Local content laws have been widely used by developing countries trying to shift their manufacturing base from assembly back into intermediate goods. Local content laws do not produce either government revenue or quota rents. Instead, the difference between the prices of imports and domestic goods gets averaged in the final price and is passed on to consumers. Firms are allowed to satisfy their local content requirement by exporting instead of using parts domestically.

Other restrictions are like Export Credit Subsidies (form of a subsidised loan to the buyer of exports, resulting in the same effect as regular export subsidies), National Procurement [purchases by the government (or public firms) can be directed towards domestic goods, even if they are more expensive than imports], Red Tape Barriers (barriers put by the governments based on health, safety and customs procedures).

18.4 INTERNATIONAL TRADE AGREEMENTS: A BRIEF HISTORY

Post-World War II, in order to take full advantage of bilateral and multilateral coordination, a group of 23 countries began trade negotiations under a provisional set of rules that became to be known as the General Agreement on Tariffs and Trade, or GATT. Officially, the GATT was an agreement, not an organisation-the countries participating in the agreement were officially designated as “contracting parties,” not members. In practice, the GATT did maintain a permanent “secretariat” in Geneva, which everyone referred to as “the GATT”. In 1995, the World Trade Organisation (WTO) was established-finally creating the formal organisation envisaged 50 years earlier. However, the GATT rules remain in force, and the basic logic of the system remains the same. Tariffs were the main point of contention among countries. Thus, various trade rounds (wherein, large groups of countries get together to negotiate a set of tariff reductions and other measures to liberalise trade) were conducted to reach a consensus on the tariff issues. The first five trade rounds under the GATT took the form of “parallel” bilateral negotiations, where each country negotiates pair-wise with a number of countries at once. The sixth multilateral trade agreement, known as the Kennedy Round, was completed in 1967. This agreement involved an across-the-board 50 per cent reduction in tariffs by the major industrial countries, except for specified industries whose tariffs were left unchanged. The so-called Tokyo Round of trade negotiations (completed in 1979) reduced tariffs employing a formula more complex than that used under the Kennedy Round. Finally, in 1994 an eighth round of negotiations, the so-called Uruguay Round was completed. The Uruguay Round, like previous GATT negotiations, cut tariff rates around the world. The average tariff imposed by advanced countries fell almost 40 per cent as a result of the round. More important than this overall tariff reduction were the moves to liberalise trade in two important sectors, agriculture and clothing.

The ninth major round of world trade negotiations, known as the Doha round, began in 2001. Its aim was to achieve major reform of the international trading system, with the fundamental objective to improve the trading prospects of developing countries through the introduction of lower trade barriers and revised trade rules. It ended without the negotiations being completed, resulting in a spurt in bilateral trade agreements.

Check Your Progress 1

1) What is the difference between nominal rate of protection and effective rate of protection?

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2) What is the idea behind the formation of WTO?

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18.5 TRADE POLICY OF DEVELOPING ECONOMIES

Trade policy in developing countries is concerned with two objectives: promoting industrialisation and coping with the uneven development of the domestic economy. Government policy to promote industrialisation has often been justified by the infant industry argument, which says that new industries need a temporary period of protection against competition from established industries in other countries. Using the infant industry argument as justification, many less-developed countries have pursued policies of *import-substituting industrialisation* in which domestic industries are created under the protection of tariffs or import quotas. Beginning from about 1985, many developing countries, dissatisfied with the results of import-substitution policies, greatly reduced rates of protection for manufacturing. As a result, developing-country trade grew rapidly, and the share of manufactured goods in exports rose. The results of this policy change in terms of economic development, however, have been, at best, mixed. This idea had been mainly confounded by the Asian Economies including India.

18.6 TRADE POLICY OF INDIA

18.6.1 Prior to 1991

In the post-independence period, prior to 1991, India followed a protectionist approach. The principle objectives of this protectionist policy were to:

a) stabilise balance of payments,

b) encourage industrialisation,

c) fulfil the objectives of self-reliance and self-efficiency,

d) help in reallocation of resources,

e) increase employment, and

f) provide revenue for the government.

The selection of instruments, adopted for achieving the objectives of the protectionist policy, can be classified in two broad groups: (a) tariff and (b) non-tariff measures. These instruments were basically used to bring about changes in price, volume or other parameters relating to tradable commodities and services. In the pre-reform period, India's import and export policy was guided by the Import and Export Control Act of 1947. In 1977, two additional orders, viz. the Import Control Order and Export Control Order, were introduced and the subsequent annual policy of imports and exports was based on these legislations. A long-term trade policy, for three years, was announced in 1985 by the government and some concrete steps towards liberalisation were taken within the framework of economic reforms.

In the pre-reform period, India's trade policy regime was complex and cumbersome. There were different categories of importers, different types of import licences, alternate ways of importing, etc. Different types of licenses, that used to be issued in the pre-reform period, can be categorised as: (a) Open General License, (b) Automatic License, (c) Supplementary Import License and (d) Imports through government-owned canalised agencies. The trade policy was geared towards developing a self-reliant production structure. There were high tariffs on imports. The intention of high tariffs was to promote domestic production, by making imported goods more expensive than those produced at home. This is what is called import substitution. Apart from import duties, there were various permissions required before importing something. Importing a computer, for instance, required many licenses and permissions. The central government would decide on imports, depending on its assessment of its importance for the national economy.

Import substitution had its other side - that of discouraging exports. There was no active policy of discouraging exports. But import tariffs meant that the profits from investing in import substituting production were higher from investing in production for export. Assuming that costs of production were not substantially higher in India, the profits would also be greater. In exports, on the other hand, Indian producers would have to compete with producers from other countries and there would be no excess profits for them. Thus, the policy of high import tariffs served to discourage investment in exports. In a way, high import tariffs distorted market price signals away from exports towards import substitution.

Economic policies are not just manufactured out of thin air. They are inevitably based on some theory of how the economy functions. What was the theory behind such a control on imports? The theory goes back right to the beginnings of plan development in India and was part of the formulation of the Second Five Year Plan (1961-65). The theory goes by the name of 'export pessimism'.

Export Pessimism

In the post-colonial situation of the 1950s, it was held that the export earnings of underdeveloped countries were subject to severe constraints. World manufacturing was concentrated in the industrialised or developed countries, while the underdeveloped countries were largely agrarian in nature. The structure of world trade reflected this division of the world economy. Under-developed countries exported raw materials and primary goods, such as coffee, tea, raw cotton, or minerals. Developed countries exported manufactured products. World trade was an exchange of the manufacturer of industrialised countries with the agricultural and primary goods of agrarian and primary commodities producing countries.

Manufactured goods are produced by companies, often large companies. With monopolistic market positions, these companies could determine the prices of their outputs, i.e. they were price-makers. Agricultural commodities are produced by large numbers of small producers. These small producers do not have market power and cannot set prices for their products, i.e. they are price-takers. On the other hand, the buyers of agricultural commodities from the developed countries are few in number. This is called a monopsony position, where there are just one or a few buyers along with a large number of sellers for a product. The buyer or buyers can then be price-makers for that primary commodity. The price of, say, coffee could be kept low and thus the returns to the millions of primary commodity producers would also be low.

We need to add a third dimension to the structure of world trade to complete this picture. That is the control of key mineral resources by the Multinational Corporations (or MNCs), sometimes also called Trans-national Corporations (TNCs) of the industrialised economies. The MNCs had operations in more than one country, and they controlled much of the mineral and raw material resources of the developing countries. The classic example of this control was that of crude oil, mainly produced in West Asia, but controlled by the Anglo-American oil majors. The result of this control of crude oil was that the oil majors could keep the price of crude oil low and give a small royalty to the governments of the supplying countries.

The role of under-developed countries in world trade was then to export agricultural commodities or minerals, non-manufactured goods of various kinds. In a competitive market, with a relatively fixed demand for agricultural commodities, an increase in production is likely to result in a fall in the price. Thus, even with an increase in production of the agricultural commodity, there may not be an increase in export earnings since prices may fall.

Suppose there was a productivity increase by the farmers of coffee adopting more productive methods. Would the benefits of increased productivity not accrue to the producers? This would happen only if a few producers (progressive farmers) alone adopted the improved technology while the bulk of the farmers did not. Then, the progressive farmers would get the benefit of higher productivity. Their costs of production would go down. With a constant price, the higher productivity of the progressive farmers would give them higher export earnings. But productivity improvements by farmers can easily spread beyond a group or even country. If all the producers of coffee adopt the improved practice, then the monopsony buyer could use competition among sellers to bring the price down. The premium for increased productivity would then go to the buyers from the developed countries, who may or may not pass on the benefits to consumers in their own countries. On the other hand, the MNC producers of industrialised countries did not have to pass on the benefits of increased productivity. Their monopoly positions allowed them to set prices of manufactures.

The implication of the above two propositions is that the terms of trade (i.e. ratio of prices of what a country sells to the prices of what it buys, or of primary goods' prices to manufactured goods' prices) for under-developed countries' would deteriorate. This, in brief, was the powerful analysis on what is known as the Prebish-Singer hypothesis. This was the understanding of export pessimism - that there was a strict limit to what an under-developed country could earn in the export market.

The other side of export pessimism was import rationing. Since India needed to develop its own industries, it needed scarce foreign exchange to be used mainly for importing equipment and machinery for industries. In times of food scarcity, food may also need to be imported. In this situation the limited foreign exchange earnings needed to be rationed, with the government and not players on the market deciding on what to import and what not to import on the basis of relative prices. Among all commodities that it was economically profitable to import, the government would decide on the most important uses of the limited foreign exchange.

Export pessimism and import controls thus characterised Indian trade policy in the early decades after Independence. It began to change in the mid-1980s and was abandoned with the 1991 liberalisation.

18.6.2 Post 1991

The 1991 trade policy reforms were precipitated by the external debt crisis the government faced. At that time, the Indian government did not have sufficient foreign exchange to cover the external debt payments that were due. In order to avoid defaulting on its international debt obligations, the government was forced to approach the International Monetary Fund (IMF) for a loan.

Trade policy reform, focusing on tariffs and quantitative restrictions, was an important part of the economic reform initiated in 1991. Supplemented by recommendations of an Expert Committee, India's trade policy reform paved the road for a major reduction of average tariffs, tariff peaks, simplification of the tariff and quota regimes, and removal of several import restrictions. These changes reflected a larger vision of reform to enhance the efficiency of domestic industry, together with a number of other objectives such as promoting infant industry, exports, technological upgradation and food security.

The 1991 Union Budget recognised the significance of trade policy reform as part of the overall reform programme, stating for instance that: "The policies for industrial development are intimately related to policies for trade" (Para 11 of Union Budget speech). Several steps were taken to reform trade policy: a more outward oriented regime was put in place, tariffs were reduced in a phased manner, import duties were streamlined or simplified, and a process transforming quantitative border restrictions to price-based measures was begun.

Likewise, export incentives were continued, or new ones provided for a number of products, and institutional changes were made to bring transparency and to facilitate transactions involving domestic and foreign markets. This included the establishment of certain institutions or revised mandates for existing institutions that would help implement the new focus areas (e.g., the Tariff Commission).

Further, 1991 trade policy reform was an exercise that balanced several objectives. For instance, loss of revenue was a major concern, and this was mentioned as a reason for not reducing the import duty more than what was being announced. In a number of instances, import tariffs were kept high to encourage infant industry. The need for protecting Indian industry against foreign competition, and to save foreign exchange, was explicitly recognised. This was balanced with a reduction in tariffs to lower input costs and to encourage export activities. Another important feature of the 1991 reform was that it began opening up the regime for FDI. While FDI was not linked at that time with trade policy, it created a base for increasing economic linkages with global markets.

Average tariff levels prior to 1991 were in triple digits. The 1991 tariff reform reduced these very significantly, but the new levels too were very high at the end of the 1990s. A noteworthy feature of India's tariff peaks and averages in the early 1990s was that though they were reduced from high levels, they were high (particularly for non-agriculture) compared with most tariffs prevailing in economies with low tariffs, e.g. the United States. Before 1991, India imposed high auxiliary duties on imports. These were merged with basic tariffs and the overall combined tariff level.

18.6.3 FDI Policy in India

At the time of independence, policy towards FDI was largely conditioned by two factors: the Industrial Policy Resolution of 1948 and 1956, and the foreign exchange crisis, especially in the late fifties. However, in 1969 a more precise policy towards FDI was evolved. This consisted of setting out three groups of industries where (i) there would be FDI without technical collaboration (ii) only technical collaboration and (iii) no foreign participation. Second, the foreign exchange crisis precipitated the Foreign Exchange Regulation Act (FERA) particularly Article 29 which specified that any foreign owned firm with more than 40 per cent of equity held abroad had to apply to the Reserve Bank of India for approval in cases relating to expansion, mergers, purchase of shares in other firms, etc. FERA came into force in 1974 and all applications had been dealt with by 1979.

A more liberal attitude towards foreign investment emerged after about 1980 or so. This phase begins with the Industrial Policy statements of 1980 and 1982 and, more importantly the Technology Policy Statement of 1983. For one, the policy statements began the process of delicensing. The New Industrial Policy of 1991 was the starting point of a new phase in FDI in India. Thus, with the new FDI policy up to 51 per cent foreign equity was permitted with automatic approval in specified industries producing intermediate and capital goods. Economic reforms post 1991 had encouraged foreign investment as well as foreign collaborations. The dominant policy at that time was export oriented FDI and restrictions on large volume of FDI in the form of equity.

In 1995, India had reoriented its FDI policy. This is because India signed the Uruguay Agreement in 1995 which made it a member of the World Trade Organisation (WTO) and hence an automatic signatory to the agreement on trade related investment measures (TRIMS). A series of measures that were directed towards liberalising foreign investment included: (i) introduction of dual route of approval of FDI – RBI's automatic route and Government's approval [Secretariat of Industrial Assistance (SIA)/ Foreign Investment Promotion Board (FIPB)] route, (ii) automatic permission for technology agreements in high priority industries and removal of restriction of FDI in low technology areas as well as liberalisation of technology imports, (iii) permission to Non-resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) to invest up to 100 per cent in high priorities sectors, (iv) hike in the foreign equity participation limits to 51 per cent for existing companies and liberalisation of the use of foreign 'brands name' and (v) signing the Convention of Multilateral Investment Guarantee Agency (MIGA) for protection of foreign investments. In order to give a fillip to combat decline in FDI post Asian Crisis in 1997, several measures were taken by the government to further liberalise FDI policies. Measures included were increasing the ceiling for FDI under the automatic route in oil refining from 49 per cent to 100 per cent. Further, in order to standardise India's FDI definition, a Committee was constituted by the Department of Industrial Policy and Promotion (DIPP) in May 2002 to bring the reporting system of FDI in India with international best practices. According to Economic survey 2003-04, the revised definition included three categories of capital flows under FDI: equity capital, reinvested earnings and other direct capital. Previously, the data on FDI reported in the balance of payments statistics used to include only equity capital.

This change in definition was called for in order to bring the reporting system of FDI data in India into alignment with best international practices. Thus, with increasing liberalisation India has become an important destination for FDI. At present 100 per cent FDI is provided in most of the sectors except in defence sector which is open to FDI subject to 26 per cent cap. Sectors where FDI is completely banned are Retail Trading (except single brand wholesale retailing), atomic energy, lottery, business including Government / private lottery, online lotteries, gambling and betting including casinos, business of Chit fund and Nidhi company, real estate business, or construction of farm houses, manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco or of tobacco substitutes and trading in transferable development rights. Thus, with increased FDI there is an increased prevalence of multinational corporations as it is the companies that trade.

Check Your Progress 2

1) What do you mean by export pessimism? State the implications of export pessimism and import control prior to 1991 period.

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2) Identify the measures taken by the government to liberalise FDI policy post 1995.

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3) State the categories of FDI as identified in Economic Survey 2003-04.

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18.7 INDIA AND THE CHANGING NATURE OF WORLD TRADE

There has been a change in the nature of trade. During the Eighth WTO Ministerial Conference held in Geneva in 2011, some Ministers said that the WTO needed to pay more attention to global value chains (GVCs). A global value chain (GVC) is a chain of separate but inter-linked and coordinated activities, which can be undertaken within a single firm or be divided among multiple firms in different geographical locations to bring out a product or a service from conception to complete production and delivery to final consumers.

India participates strongly in manufacturing GVCs for chemicals, electrical instruments and other manufactures (for example, jewellery). India's participation in manufacturing GVCs is due to sourcing of intermediates from abroad. India also shows a high participation rate in services as well, especially business activities.

18.7.1 Trade in Services

Trade traditionally meant trade in goods. However, with several services becoming tradable and due to increased globalisation and integration of the economies, trade in services have become a common parlance among countries. The WTO under the General Agreement on Trade in Services (GATS) recognises three modes of trade in services. Mode 1 is by foreign companies investing in the country where the services are to be provided. Mode 2 is by off-shoring of the service to a foreign location. A good example of this are the call centres that have come up in many cities of India providing services such as answering consumer inquiries, taking orders, etc. Mode 3 is the movement of what in legal terminology is called 'natural persons', another term for migration.

Indian firms have established a strong presence in the world trade in services. Indian firms carry out a multitude of off-shoring tasks– from simple consumer service centres, to accounting services and the various business tasks called Business Process Outsourcing (BPO). These are also called IT Enabled Services (ITES), since they depend crucially on IT and communication technology.

18.7.2 Trade in Intellectual Property

In the WTO regime, trade issues have been somewhat broadened to include matters of Intellectual Property (IP) Rights (TRIPS or Trade Related Intellectual Property Rights). Under TRIPS, all member countries are required to have a similar IP protection law. Patent rights must be allowed for products and not only processes. Before the WTO requirement, Indian IT law protected only processes and not products. As a result, Indian pharmaceutical companies could develop different processes to 'reverse engineer' products initially made in the industrialised countries.

18.7.3 Trade in Agriculture

Another area of contention in trade policy is that towards agriculture. Agreements in this area have been stalled by the collapse of the Doha Round of WTO negotiations. The USA and European Union (EU) both provide large subsidies to their farmers. These are categorised in WTO terms under different colours– Red as trade distorting, such as an export duty or export subsidies, or Green for general support to the sector. But such general support also helps the subsidy-receiving farmers to export at lower prices. This brings down the price of agricultural commodities and could enable the developed countries to increase their agricultural exports. The developed countries have been pressing for an agreement to reduce or, even eliminate controls on agricultural imports.

India has insisted on maintaining controls on agricultural imports, even exports for that matter. The argument is basically that agriculture is not the production of a commodity but is also the means of livelihood of crores of small and medium farmers in the country. Particularly where new jobs in low-skill manufacturing are not growing so fast, India wants to protect its agriculture from cheap exports promoted by subsidies from the developed economies.

18.8 REGIONAL AGREEMENTS RELEVANT FOR INDIA

India has bilateral trade arrangements with all major regional groupings. In Europe, it is a part of European Free Trade Association (EFTA), consisting of Switzerland, Norway, Iceland and Liechtenstein. In 2018-19, India exports to and imports from EFTA stood at US$ 1,534.00 million and US$ 18,076.88 million, respectively. Among SAARC countries, India and Bangladesh have a bilateral trade agreement and both countries are exploring the possibility of entering into a bilateral Comprehensive Economic Partnership Agreement (CEPA). Negotiations for India and Iran entering into a Preferential Trading Agreement (PTA) are under way. Review meetings for India-Nepal Treaty of Trade are going on. With Sri Lanka, India has India-Sri Lanka Free Trade Agreement (ISLFTA), under which duty-free access for almost all the products except a few is provided. India is also negotiating a new Economic and Technology Cooperation Agreement (ETCA) with Sri Lanka. India and ASEAN have agreed to start examining the preliminary proposals related to the scope of the review of ASEAN India Trade in Goods Agreement (AITIGA). Within ASEAN, India has a Comprehensive Economic Cooperation Agreement (CECA) with Singapore, Thailand and Malaysia. Among Latin American countries, India has Preferential Trade Agreements (PTA) with MERCOSUR (Argentina, Brazil, Paraguay and Uruguay) and Chile. India has signed 28 bilateral / multilateral trade agreements with various country/group of countries. However, few agreements as discussed below seem relevant for India.

18.8.1 Regional Comprehensive Economic Partnership (RCEP)

Launched in Cambodia on December 20, 2012, the RCEP is an FTA between ASEAN and its FTA partners (Australia, Brunei, China, Cambodia, India, Indonesia, Japan, the Republic of Korea, Laos, Malaysia, Myanmar, New Zealand, the Philippines, Singapore, Thailand, and Vietnam). The sixteen participating countries account for almost half the world's population, 30 per cent of global GDP, and 25 per cent of world exports. RCEP seeks to achieve a modern, comprehensive, high-quality, and mutually beneficial economic partnership agreement that will cover trade in goods, services, investment, economic and technical cooperation, intellectual property, competition, and dispute settlement. India is participating in the RCEP negotiations but appears to be doing so with extreme caution.

18.9 RECENT SCENARIO IN INDIAN TRADE

In 2018-19, petroleum products were the largest exported commodity, in value terms, with a share of 14.1 per cent in the country's export basket. Other major exports included pearls, precious, semi-precious stones as also gold and other precious metal jewellery besides drug formulations, biological. However, exports of organic chemicals grew at the highest rate at 30.6 per cent in 2018-19. In the import basket of 2018-19, petroleum crude, at 22.2 per cent had the largest share followed by gold and other precious metals (Jewellery at 6.4 per cent and pearls precious/semi-precious stones at 5.3 per cent).

India's major trading partners are the United States of America (USA), which accounted for 16 per cent of India's exports (in value terms) in 2018-19, followed by the United Arab Emirates (UAE), China and Hong Kong. However, in 2018-19, growth of India's exports to the Netherlands was the highest (40.7 per cent), followed by China (25.6 per cent) and Nepal (17.4 per cent). China continues to be the largest source of imports of India accounting for 13.7 per cent of the total imported value in 2018-19. The other important sources from which India imports are the USA, UAE and Saudi Arabia.

In 2018-19, India's exports to countries with which it has a trade agreement stood at US$ 121.7 billion accounting for 36.9 per cent of India's export to all the countries. Similarly, in the same year, India's imports from countries with which it has a trade agreement stood at US$ 266.9 billion accounting for 52.0 per cent of India's imports from all the countries.

18.10 TRADE POLICY OF INDIA 2015-2020

The Government of India announced a Foreign Trade Policy for the period 2015-2020 on 1st April, 2015. The important measures taken by the Government in the Foreign Trade Policy 2015-2020 to include 'Make in India' and 'Digital India' programmes and to ease the trade are:

i) Specific Export Obligation under Export Promotion Capital Goods (EPCG) scheme, in case capital goods are procured from indigenous manufacturers, has been reduced to 75 per cent of the normal export obligation, in order to promote domestic capital goods manufacturing industry.

ii) Under Merchandise Exports from India Scheme (MEIS), export items with high domestic content and value addition have generally been provided higher level of rewards.

iii) For reward schemes and duty exemption schemes, hard copies of applications and specified documents which were required to be submitted earlier have now been dispensed with.

iv) Landing documents of export consignment as proof for notified market can now be digitally uploaded.

v) There will be no need to submit copies of permanent records / documents repeatedly with each application, once the same are uploaded in Exporter/Importer Profile.

vi) For faster and paperless communication with various Committees of Directorate General of Foreign Trade (DGFT), dedicated e-mail addresses have been provided for various Committees, e.g. Norms Committees, Exim Facilitation Committee, etc.

The Foreign Trade Policy 2015-2020 introduced two new schemes, namely, 'Merchandise Exports from India Scheme' (MEIS) for incentivising export of specified goods to specified markets and 'Services Exports from India Scheme' (SEIS) for increasing exports of notified services from India. The scrips can be used for payment of customs duty, excise duty and service tax. All duty credit scrips issued under both the schemes and the goods imported against these scrips are fully transferable. Further, e-Commerce exports of certain specified employment creating sectors, made through courier or foreign post offices, have been supported under MEIS.

Check Your Progress 3

1) State the features of changing nature of world trade.

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2) Discuss the relevance of trade with respect to intellectual property and agriculture issues.

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3) Identify the major features of Exim policy 2015-20 aiming to the export of goods and services.

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18.11 LET US SUM UP

Trade policy refers to all the policies related to both exports and imports. Countries use different instruments of trade policy while framing their own trade policy. For example, most developing countries believed in import pessimism. In the case of India, prior to 1991, Indian trade policy was characterised by export pessimism and import controls. This situation began to change in the 1980's and the control regime was abandoned after 1991 economic reforms. In the changed situation of world trade, firms in the developing economies have managed to get entry into developed economy markets. India also accounts for a larger share of FDI inflows and its FDI policy is being liberalised regularly. India accounts for a substantial share of world trade in the services sector. Agricultural products due to subsidy to its farmers by developed countries are another area of controversy in trade policy. India has bilateral trade arrangements with all major regional groupings and the most controversial one is the RCEP. The long-term export-import policy 2015-20 aimed at doubling India's share in global trade by 2020 and accelerating the country's contribution to the global vibrant economy to derive maximum benefits from expanding global market opportunities. The country is on track to achieve the $1-trillion export target by 2025 with the government and industry deliberating on measures to boost exports, manufacturing and the new foreign trade policy.

18.12 TERM-END EXERCISES

1) India's trade policy prior to 1991 was derived from the policy of self-reliance. In the light of this statement critically evaluate India's trade policy.

2) Explain the important issues which are crucial and hence need to be addressed in India's trade policy.

3) Critically evaluate trade policy of India 2015-20.

4) Discuss India's position in changing the nature of world trade.

5) Highlight the features of FDI policy in India since 1985.

18.13 KEY WORDS

General Agreement on Trade in Services (GATS) : This is the agreement on trade in services, which forms part of the WTO agreements. The preceding GATT did not have any agreement dealing with services. At that time, until the 1990s, there was not much trade in services.

Multi-National Corporation (MNC) : An MNC, sometimes also called a TNC or Trans-national Corporation, refers to a corporation that has subsidiaries or branches in more than one country. The branches may often be 100 per cent owned by the parent corporation, but they may also be with minority investment.

Regional Trade : Refers to trade within a region, such as Europe, or Asia or parts of Asia. Regional trade has often led to Regional Free Trade Agreements (RFTAs).

WTO - World Trade Organisation : Set up as the successor to the General Agreement on Trade and Tariffs (GATT). Its headquarters is in Geneva, Switzerland. The WTO is a membership-based organisation. A member, on being accepted, agrees to all the instruments of the organisation. Unlike GATT, the WTO has a dispute resolution mechanism. Any member is free to take up a case against any other member. This allows for formal equality, but it is often difficult, because of the cost of engaging lawyers in Geneva. But India, for instance, has filed and won cases against the US. Voting in the WTO, as in the UN General Assembly, is 'one country, one vote'. But decisions are usually arrived at through informal consultation mechanisms.

18.14 REFERENCES

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2) India: Trade Policy Review by V. N. Balasubramanyam.

3) Annual Report of the RBI.

4) Ministry of Finance, Economic Survey.

5) FDI in India: History Policy and the Asian Perspectives by Manoj Pant and Deepika Srivastava.

18.15 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 18.3
2) See Section 18.4

Check Your Progress 2

1) See Sub-section 18.6.1
2) See Sub-section 18.6.3
3) Equity Capital, reinvested earnings, direct capital

Check Your Progress 3

1) See Section 18.7
2) See Sub-sections 18.7.2 and 18.7.3
3) See Section 18.10

UNIT 19 FOREIGN TRADE AND BALANCE OF PAYMENT

Structure

19.0 OBJECTIVES

After going through this unit, you will be able to :

- discuss the role of foreign trade in economic development of a country;
- evaluate India's foreign trade and the changes in its direction and composition;
- assess India's position of balance of payment;
- outline the policy framework for restoring equilibrium in balance of payments.

19.1 INTRODUCTION

India is globalising rapidly. Inter-dependence between the economies inthe world has increased multi-fold. External sector in the economy has gained prime importance. Both exports and imports contribute to the production process. Both of these are effective instruments in raising the income levels of the people in a developing economy. Apart from flow of goods, increasing flows of services and capital between nations give rise to payments and receipts in foreign exchange which, in turn, influences the balance of payments (BoP)position. In this unit, we shall examine the various issues related to foreign trade and BoP. Let us begin with explaining the relationship between foreign trade and economic growth.

19.2 TRADE AND ECONOMIC DEVELOPMENT

External trade is important for sustained economic growth. Many of the fastest growing economies of the past few decades have always recorded high trade growth. Trade has many positive spillovereffects on a domestic economy. Apart from increasing foreign exchange reserves, exports boost competitiveness, promote investments, generate linkage with the global economy, increase employment, and can also help in upgradation of skills.

Foreign trade has worked as an 'engine of growth' in the past (witness Great Britain in the 19^{th} century and Japan in the 20^{th}, besides others), and even in more recent times the "outward-oriented growth strategy" adopted by the newly industrialising Economies of Asia, viz., Hong Kong, (now a special administered area of China), Singapore, Taiwan, Malaysia, Thailand, and South Korea, has enabled them to overcome the constraints of small resource-poor under-developed economies.

Contribution of Foreign Trade to Economic Development

Foreign trade contributes to economic development in several ways.

- It provides flow of technology which allows for increases in total factor productivity, and some short-run multiplier effects for countries with unemployed labour.
- It generates pressure for dynamic change through: (i) competitive pressure from imports, (ii) pressure of competing for export markets, and (iii) a better allocation of resources.
- Exports allow increased exploitation of economies of scale, separation of production pattern from domestic demand, and increasing familiarity with absorption of new technologies.

These, in turn, help increase the profitability of the domestic business without any corresponding increase in price.

Foreign trade increases most workers' welfare. It does so at least in four ways: (i) larger exports translate into higher wages; (ii) as workers are also consumers, trade brings them immediate gains through cheaper imports;(iii) it enables most workers to become more productive as the goods they produce increase in value; and (iv) trade increases technology transfers from industrial to under-developed countries (UDCs) and the transferred technology is biased in favour of skilled labour.

Increased openness to trade has been strongly associated with the reduction of poverty in most developing countries, as the historian Arnold Toynbee said 'civilisation' has been spread through 'mimesis': simple copying.

19.2.1 Trade Policy Analysis Tools[1]

A proper analysis of a country's foreign trade can be attempted by analysing (i) Volume of trade, (ii) Share of exports/imports in GDP, (iii) Share of exports/imports in world trade, (iv)Degree of Openness, (v) Composition of trade, (vi) Sectoral and Geographical Orientation of Trade, (vii) Terms of trade, and (viii) Direction of trade.

Volume of Trade

It relates to the size of international transactions. Since a large number of capital, goods and services enter in international transactions and their aggregate can be found only by finding their money value, therefore, the volume of trade can be measured only in terms of money value. The trends in the value of trade help to identify the basic forces that may be operating at different periods in the economy.

However, mere absolute changes in the value of trade may not be satisfactory guide, hence it is necessary to find the changes in the value of trade by relating them to two variables, viz.i) Share of exports/imports in GDP, andii) Share of exports/imports in world trade.

Share of exports/imports in GDP

The share of exports/imports in GDP indicates the degree of outward orientation or openness of the economy to trade. This share reflects ina broad way the nature of trade strategies adopted in the country. The ratio ofexports to GDP could alsobe interpreted to mean supply capability of the economyregarding exports. It can be called as average propensity to export. The similarratio between imports and GDP gives the average propensity to import. Clearly,however, the appropriate share of exports in output under an efficient allocationof resources will be less in bigger economies than in smaller economies.

Share of exports/imports in world trade

The share of exports in the world trade indicates the importance of the country as a nation in the world economy. It reflects the market thrust that the country is able to realise in presence of the various competitors in the world market. Changes in this ratio, thus, indicate the shift in the position of the comparative advantage of the country.

[1]Based upon A Practical Guide to Trade Policy Analysis, co-published by the World Trade Organisation and the United Nations Conference on Trade and Development, 2012.

Degree of Openness

The most natural measure of a country's integration in the world trade is its degree of openness. One might suppose that measuring a country's openness is a relatively straightforward endeavour. Let X^i, M^i and Y^i be respectively country i's total exports, total imports and GDP. Country i 's openness ratio is defined as:

$$O^i = \frac{X^i + M^i}{Y^i}$$

Higher the O^i, the more open is the country. For small open economies like Singapore, it may even be substantially above one. The index can be traced over time.

19.2.2 Composition of Trade

It is indicative of the structure and level of development of an economy. For instance, most of the UDCs depend for their export earnings on a few primary commodities (PCs); these countries export raw materials of agricultural origin and import manufactured industrial products, thus, denying themselves the benefits of value addition in their goods. As an economy develops, its trade gets diversified. It no more remains dependent on a few PCs. It begins to export more of manufactured industrial goods and import industrial raw materials, capital equipment and technical know-how.

Manufactured exports create greater value addition than PCs as they go through more stages of processing. The manufacturing sector has greater linkages with the rest of the economy and, hence, the downstream effect on exports from these sectors islikely to be greater than primary exports.

The commodities entering trade could also be classified by various other criteria such as value added per unit of output, productivity of labour, capital intensity in production, strength of backward and forward linkages, etc.The shifts in the commodity composition of trade in these categories would bring out the nature of structural changes in regard to income generation, employment effect and overall industrialisation through linkages effects, etc.

Sectoral and Geographical Orientation of Trade

The sectoral composition of a country's trade matters for a variety of reasons. For instance, it may matter for growth if some sectors are drivers of technological improvement and subsequent economic growth, although whether this is true or not is controversial. Moreover, constraints to growth may be more easily identified at the sectoral level.

Geographical composition highlights linkages to dynamic regions of the world (or the absence thereof) and helps to think about export-promotion strategies. It is also a useful input in the analysis of regional integration, an item of rising importance in national trade policies.

Simple indexes for the share of each sector in a country's total imports or exports can be constructed using a dataset with sector-level trade data.

Likewise, one can construct indexes of the share of each partner in a country's total imports or exports using bilateral trade data. One can go a step further and assess to what extent a country's export orientation is favourable, i.e. to what extent the country exports in sectors and toward partners that have experienced faster import growth.

Terms of trade (TT)

Changes in the value of exports may be compared to the changes in the value of imports. The relationship between these two variables is known as the terms of trade (TT), i.e., the terms at which exports exchange for imports; if the exports value in terms of imports value shows an increase, the TT are said to be favourable. Favourable TT implies that for a given value of exports, the country can produce more of imports. Conversely, if the TT is unfavourable a country has to give up more exports to produce a given volume of imports. In short, Terms of trade (TOT) are the relative price, on world markets, of a country's exports compared to its imports. If the price of a country's exports rises relative to that of its imports, the country improves its purchasing power on world markets. The two most common indicators are barter terms of trade and income terms of trade.

19.2.3 Direction of Trade

It is indicative of the structure and level of economic development. As a country develops and its trade gets diversified, it has to seek new outlets for its exports. Its horizon of choice in terms of imports also gets widened. The country begins to trade with an increasingly large number of countries. In this regard, one could ask whether there has been a concentration or dispersion of the markets for exports and sources of supply for imports.

Check Your Progress 1

1) What role does foreign trade play in economic development of a nation?

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2) How does growth of an economy affect the volume of its foreign trade?

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3) What types of changes are observed in the direction of trade as an economy experience growth?

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4) How can you measure the openness of Indian Economy?

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19.3 INDIA'S FOREIGN TRADE

Foreign trade has always been important for the sustained economic growth of an economy. Many Asian economies such as Japan, South Korea, Singapore, and China, have achieved high levels of economic growth with resulting positive spillover in productivity, investments, technology upgradation, and job growth, on the back of export-led growth. Foreign trade will also play a crucial part in India's goal to become a US$ 5 trillion economy.

19.3.1 Volume of India's Merchandise Trade

India is not a major player in global trade. Its share in world's merchandise exports and imports was below one percent level up to the year 2000. Thereafter, on account of various policy measures, India's share in world's merchandise exports and imports started growing and it reached the level of 1.7 per cent and 2.5 per cent respectively in 2019 (Table 19.1). This reflects India's increasing integration with the global value chain.

Table 19.1: India's Share in World's Merchandise Exports & Imports (share in per cent)

Year	Exports	Imports
1980	0.4	0.7
1990	0.5	0.7
2000	0.7	0.8
2010	1.5	2.3
2019	1.7	2.5

Source: UNCTAD Statistics

Table 19.2 shows the growth story of India's external trade in merchandise, exports and imports. India's total merchandise trade increased from US$ 24.4 billion in the year 1980-81 to US$ 844.2 billion in 2018-19 in absolute terms. In the same period, merchandise exports increased from US$ 8.8 billion to US$330.1 billion, while imports grew from US$15.9 billion to US$514.1 billion. It is interesting to see that the value of India's merchandise exports has been stagnant or declining over a relatively long period starting from 2011-12. Growth in India's merchandise exports over 2015-16 was minus 15.5 per cent, as compared with minus 1.3 per cent in 2014-15 and a positive 4.7 per cent in 2013-14. In fact, in 2018-19, growth of India's exports and imports has reduced as compared to the growth in previous year. There are several factors contributing to this situation. Slowdown in the world output, trade tensions and protectionism and less diversification of India's exports basket are few of the reasons for contraction in India's exports. As per opinion expressed by many experts, contraction in India's imports bill in recent years was partially because of decline in oil prices.

Table 19.2: India's Merchandise Trade

Year	Value in US $ Million (Rate of change over previous period in per cent)		
	Exports	Imports	Total External Trade
1980-81	8484.7 (-)	15866.5 (-)	24351.2 (-)
1990-91	18145.2 (113.9)	24072.5 (51.7)	42217.7 (73.4)
2000-01	44560.3 (145.6)	50536.5 (109.9)	95096.8 (125.3)
2010-11	251136.2 (463.6)	369769.1 (631.7)	620905.3 (552.9)
2011-12	305963.9 (21.8)	489319.5 (32.3)	795283.4 (28.1)
2012-13	300400.6 (−1.8)	490736.6 (0.3)	791137.2 (−0.5)
2013-14	314415.7 (4.7)	450213.6 (−8.3)	764629.4 (−3.4)
2014-15	310352.0 (−1.3)	448033.4 (−0.5)	758385.4 (−0.8)
2015-16	262291.1 (−15.5)	381007.8 (−15.0)	643298.8 (−15.2)
2016-17	275852.4 (5.2)	384357.0 (0.9)	660209.5 (2.6)
2017-18	303526.2 (10.0)	465581.0 (21.1)	769107.2 (16.5)
2018-19	330078.1 (8.7)	514078.4 (10.4)	844156.5 (9.8)

Source: Reserve Bank of India

Table 19.3 summarises the contribution of merchandise exports and imports in India's GDP during the years from 1970-81 to 2018-19. Share of merchandise exports in India's GDP has increased from 4.5 per cent in 1980-81 to 12.4 per cent in 2018-19 while share of merchandise imports increased from 8.8 per cent to 19.0 percent during the same period. Total merchandise trade (exports + imports) contributed 31.4 per cent in India's GDP during

2018-19. From 2015-16 onwards, the ratio of the merchandise imports to GDP has been declining for India entailing a net positive impact on the Balance of Payment position. At the same time, merchandise exports to GDP ratio for India has almost been stagnant from 2015-16 onwards.

Table 19.3: Share of Merchandise Exports & Imports in India's GDP (share in per cent)

Year	Exports	Imports	Total External Trade
1980-81	4.5	8.8	13.3
1990-91	5.8	8.7	14.4
2000-01	9.7	12.4	22.1
2010-11	15.3	22.9	38.2
2015-16	12.7	18.8	31.5
2018-19	12.4	19.0	31.4

Source: Reserve Bank of India

Trade Deficit

India has a large deficit in the classical trade in goods. Because of growing difference between India's merchandise imports and exports bills, we have been witnessing a huge deficit in our merchandise trade. In fact, India's merchandise trade deficit has increased from US$ 7.4 billion in 1980-81 to US$ 184.0 billion in 2018-19, Growing deficit in merchandise trade is a matter of concerns for the Indian policy makers and the government has come with many measures under Foreign Trade Policy 2015-20 to increase exports and reduce the trade deficit. The Government of India is currently discussing New WTO compliant Foreign Trade Policy to address various trade related issues.

19.3.2 Volume of India's Trade in Services

India's services trade has been a major driver of its exports over the past two decades. The country has emerged among the fastest growing nations in global services trade. This sector has not only attracted significant foreign investment flows but also contributed significantly to exports as well as provided large-scale employment. India's services sector covers a wide variety of activities such as software, hotels and restaurants, transport, storage and communication, financing, insurance, real estate, business services, community, social and personal services, and services associated with construction.In 2005, India contributed 1.9per cent of world's service exports which increased to 3.5per cent in the year 2019 while its shares in service imports increased from 2.3 per cent to 3.1 per cent in the same period.

The broad trend in India's Services trade in the last ten years is indicated in Table 19.4. It shows that India's export of services has shown an increasing trend from 2011-12 to 2018-19, except for a small dip in 2015-16, whereas imports have also shown an increase from US$ 78.2 billion in 2011-12 to

US$ 126.0 billion in 2018-19 with a net services trade surplus in the above period. The net service trade has shown fluctuations in the recent years.

Table 19.4: India's Service Trade

Year	Value in US $ Million			Growth Over Previous Period (per cent)		
	Exports	Imports	Net Services	Exports	Imports	Net Services
2009-10	96040	60030	36020	-	-	-
2010-11	124640	80550	44080	29.8	34.2	22.4
2011-12	142325	78227	64098	14.2	-2.9	45.4
2012-13	145678	80763	64915	2.4	3.2	1.3
2013-14	151813	78747	73066	4.2	-2.5	12.6
2014-15	158107	81578	76529	4.1	3.6	4.7
2015-16	154311	84635	69676	-2.4	3.7	-9.0
2016-17	164197	95852	68345	6.4	13.3	-1.9
2017-18	195089	117527	77562	18.8	22.6	13.5
2018-19	208000	126060	81941	6.6	7.3	5.6%

Source: Reserve Bank of India

19.3.3 Composition of India's Merchandise Trade

The composition of India's merchandise trade has been changing. In the early decades after Independence, exports were mainly of primary goods, viz. agricultural commodities, and raw materials, such as minerals. Over time, the role of manufactures including engineering goods has been increasing. Overall manufactured goods are as much as 66 per cent of total exports, of which engineering goods contribute as much as 27 per cent of the value of goods exported. These engineering goods include automobiles and parts, agricultural machinery, and electrical machinery.

19.3.3.1 Composition of India's Merchandise Exports

Exports of India are broadly classified into four categories:

Agricultural and allied products-This mainly include tea, coffee, cereals, unmanufactured tobacco, spices, cashew nuts, oil meals, fruits and vegetables and pulses, marine products, raw cotton, etc.

Ores and minerals (excluding coal)- include iron ore, mica, processed minerals, and other ores and minerals.

Manufactured goods- include textile fabrics and manufactures, cotton yarn, fabrics, made-ups, etc., readymade garments of all textile materials, Coir yarn and manufactures, Jute manufactures (including twist and yarn), leather and leather manufactures (including leather footwear, leather travel goods andleather garments), handicrafts (including hand-made carpets), gems and jewellery, chemicals and allied products, machinery, transport and metal manufactures (including iron and steel), etc.

Mineral fuels and Lubricants (including Coal)

The composition of India's merchandise trade has been changing. In the early decades after Independence, exports were mainly of primary goods, viz. agricultural commodities, and raw materials, such as minerals. Over time, the role of manufactures including engineering goods has been increasing. Agriculture and allied products accounted for 30.07 per cent of India's total merchandise exports in 1980-81, this has however, declined to 11.8 percent in 2018-19. At the same time, the share of manufactured goods has witnessed a mixed trend. In fact, share of manufactured goods has gone up from 55.8 percent in 1980-81 to 79.0 per cent in 2000-01 but again declined to 70.3 per cent in 2018-19.

Turning to India's exports by principal products of India, in 2018-19, India's top 3 merchandise exports included engineering goods, petroleum products, and gems and jewellery. In fact, in recent years, petroleum products, precious stones, drug formulations, gold and other precious metals continue to be India's top export items. In 2018-19, engineering goods was the largest exported commodity, in value terms. However, its growth was only 6.3 per cent as compared to 2017-18. Top 5 exported products accounted for more than 60percentshare in India's total merchandise exports in 2018-19. The exports that have not grown as much as would be expected, given India's status as a labour abundant economy, are textiles and textile products, which include garments and leather products. They still account for just a little more than 10 per cent of India's exports.Overall, composition of India's merchandise exports has undergone a positive change. The remarkable achievement is that India has transformed itself from a predominantly primary goods exporting country into a non-primary goods exporting country.

19.3.3.2 Composition of India's Merchandise Imports

Crude oil imports have a large presence in the import basket with the value of India's total imports being influenced bycrude prices. Similarly, gold imports also have a significant presence in the import basket and gold prices influence the value of India's total imports. In the import basket of 2018-19, top 5 products include i) Petroleum, Crude and products at 27.4 percent share, ii) Electronic goods at 10.8 percent share, iii) Machinery, electrical and non-electrical at 7.7 per cent share, iv) Gold at 6.4 per cent share and v) Pearls, precious and Semi-precious stones at 5.3 per cent share. These products together accounted for more than 55 percent of India's imports in 2018-19. Crude oil has been the largest item in India's imports basket which increased from US$ 87.1 billion in 2009-10 to US$ 141.0 billion in 2018-19 which a growth of 29.7 percent over previous year. Growth rates of gold and pearls (including precious and semi-precious stones) however declined in 2018-19.

India's POL(petroleum, oil, and lubricants)imports increased from US$5.8 billion in 1981-82 to US$ 141 billion in 2018-19. Its share in India's total imports basket however declined from 38.1 percent to 27.4 per cent in same time period. As far as imports of Non-POL products are concerned, its shares in India's imports basket increased from 61.9per cent in 1981-82 to 72.6per cent in 2018-19 whereas in terms of absolute value it increased from, US$ 9.4 billion to US$ 373.2 billion in the same period. POL imports witnessed sharp rise in growth rate from 4.8 per cent in 2016-17 to 29.7 per cent in 2018-19. The non-POL imports also increased from − 0.2 per cent in 2016-17 to 4.5 per cent in 2018-19. This is mainly because of a downturn in the Indian economy. Further, rise in growth of POL imports from 2016-17 to 2018-19 was mainly on account of both price increase in the international market and volume consumed by India.

19.3.4 Composition of India's Trade in Services

The composition of service exports has remained largely unchanged over the years. Telecommunications, computer, and information services constitute the bulk of it at around 41-46 per cent between 2016-17 to 2018-19, followed by other business services at about 18-20 per cent, travel at 13-14 per cent and transportation at 9-10 per cent during the same period.The relative shares of the various constituents of service imports have also not varied much with business services constituting about a third of service imports, which is in consonance with the rising level of economic activity in the country. The component of travel and transport services together constitutes another third of total service imports.

Although India's services exports have seen a general increase in growth, a large part of this growth is confined to two categories– telecommunications, computer, and information services and other business services. Given the increasingly large role services trade is playing in the global economy along with a rise in automation and new forms of services, there is an urgent need for diversification of India's services trade to limit the impact of data localisation on services exports.

19.3.5 Direction of India's Foreign Trade

Within the world geographic region, Asia is the largest destination of Indian exports which accounted for 48.8 per cent of India's exports (in value terms) in 2018-19 followed by America and Europe with 20.9 percent and 19.9 percent share, respectively in the same period (Table 19.5). In 2018-19, India's exports (in terms of value) over previous year i.e. 2017-18, grew at a faster rate in CIS & Baltics and Africa region as compared to Asia, America, and Europe. Though, absolute value of merchandise exports was much less in CIS & Baltics and Africa.

In case of merchandise imports, India sourced 62.0 percent of its requirement within Asia in 2018-19. Whereas Europe and America accounted for 15.4 per cent and 12.7 per cent respectively of India's imports in the same time period(Table 19.6). In terms of absolute value, India's imports from America grew at a faster rate of 16.4% in 2018-19 over the previous year. Whereas imports from Baltics & CIS region actually declined by 26.7 percent over the same time period.

Table 19.5: Direction of India's Merchandise Exports by Geography

Value in US$ million

Regions	2017-18	2018-19	% Growth Over Previous Year	Share in % 2018-19
Asia	1,49,635	1,61,216	7.7	48.8
America	62,783	68,861	9.7	20.9
Europe	60,346	64,375	6.7	19.5
Africa	24,904	28,541	14.6	8.7
CIS & Baltics	3,007	3,467	15.3	1.1
Unspecified Region	2,851	3,617	26.9	1.1
Total Exports	3,03,526	3,30,078	8.8	100

Source: Economic Survey 2019-20

Table 19.6: Direction of India's Merchandise Imports by Geography

Value in US$ million

Regions	2017-18	2018-19	% Growth Over Previous Year	Share in % 2018-19
Asia	2,79,667	3,18,762	14.0	62.0
Europe	69,898	79,357	13.5	15.4
America	55,993	65,190	16.4	12.7
Africa	37,789	41,128	8.8	8.0
CIS & Baltics	12,876	9,443	-26.7	1.8
Unspecified Region	9,358	199	-97.9	0
Total Imports	4,65,581	5,14,078	10.4	100

Source: Economic Survey 2019-20

India's largest export destination country is the United States of America (USA), which accounted for 15.9 per cent of India's exports (in value terms) in 2018-19, followed by United Arab Emirates (UAE), China and Hong Kong. India's merchandise exports to China accounted for 3.8 per centin 2014-15 but it increased to 5.1 per cent in 2018-18 whereas, share of India's total exports to UAE has actually declined from 10.6 per centin the same time period. India's top 10 exporting destination during 2018-19 jointly accounted for more than 50 per cent of India's total merchandise exports to world.

China has been the largest source of imports forIndia, accounting for 13.7 per cent of the total merchandised imports in terms of value in the year 2018-19. In fact, share of Chinese imports into India's overall merchandise imports have witnessed a mixed trend from 2014-15 to 2018-19. Other main countries from which India significantly imports are the USA, UAE, and Saudi Arabia. India's top 10 sourcing destination during 2018-19 jointly accounted for more than 52.8 per cent of India's total merchandise imports from world.

Economic Survey 2019-20 has done a very interesting analysis of India's bilateral trade position with respect to its top trading partners over a five years period from 2014-15 to 2018-19 (Table 19.7). India mostly has trade surplus since 2014-15 with its top two trading countries i.e. USA and United Arab Emirates. On the other hand, India has trade deficit continuously since 2014-15 with respect to other major trading partners i.e. China PRP, Saudi Arabia, Iraq, Germany, Korea RP, Indonesia, and Switzerland. India had trade surplus with Hong Kong and Singapore till 2017-18, before it changed to trade deficit in 2018-19. The bilateral imbalances, however, have remained stable in most cases. India's deficit in merchandise trade with China reached up to US$ 63.05 in 2017-18 which marginally improved to US$ 53.37 in the subsequent year.

Table 19.7: Bilateral Trade Surplus/Deficit (Sorted on Year: 2018-19)

US $ Billion

	Country	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**
Trade Surplus Countries	U S A	20.63	18.55	19.90	21.27	16.86
	United Arab Emirates	6.89	10.87	9.67	6.41	0.34
Trade Deficit Countries	China PRP	-48.48	-52.70	-51.11	-63.05	-53.57
	Saudi Arabia	-16.95	-13.94	-14.86	-16.66	-22.92
	Iraq	-13.42	-9.83	-10.60	-16.15	-20.58
	Germany	-5.25	-5.00	-4.40	-4.61	-6.26
	Korea RP	-8.93	-9.52	-8.34	-11.90	-12.05
	Indonesia	-10.96	-10.31	-9.94	-12.48	-10.57
	Switzerland	-21.06	-18.32	-16.27	-17.84	-16.90
	Hong Kong	8.03	6.04	5.84	4.01	-4.99
	Singapore	2.68	0.41	2.48	2.74	-4.71

Source: Economic Survey 2019-20

Check Your Progress 2

1) State the important changes being observed in the composition of India's external trade since 2007-08.

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2) Do you think that direction of India's exports has been changing with BRICS Countries over time?

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3) Give the emerging features of changes in the volume and direction of India's foreign trade.

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19.4 INDIA'S BALANCE OF PAYMENTS

The sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) of the International Monetary Fund (IMF) defines BoP as a statistical statement that summarises economic transactions between residents and non-residents during a specific time period. It consists of the goods and services account, the primary income account, the secondary income account, the capital account, and the financial account. The different accounts within the BoP are distinguished according to the nature of the economic values provided and received, under the double-entry system of accounting in the BoP.

The BoP, thus, includes all transactions showing[2]:

transactions in goods, services and income between an economy and the rest of the world changes of ownership and other changes in that economy's monetary gold, special drawing rights (SDRs), and financial claims on and liabilities to the rest of the world, and unrequited transfers.

These transactions are categorised into:

the "current account" including "goods and services", the "primary income", and the "secondary income", the "capital account", and the "financial account".

[2]Balance of Payments Manual for India, Sept. 2010, RBI

19.4.1 The Current Account

The current account includes flows of goods, services, primary income, and secondary income between residents and non-residents and thus constitutes an important segment of BoP.

Under current account of the BoP, transactions are classified into i) merchandise (exports and imports) and ii) invisibles. Invisible transactions are further classified into three categories, namely (a) Services-travel, transportation, insurance, Government not included elsewhere (GNIE) and miscellaneous (such as, communication, construction, financial, software, news agency, royalties, management and business services); (b) Income; and (c) Transfers (grants, gifts, remittances, etc.) which do not have any quid pro quo.

Exports of goods and services and the receipt of transfers are entered in the current account as credits (+) because they lead to the receipt of payments from foreigners. On the other hand, imports of goods and services and the granting of transfers entered as debits (–) because they lead to payment to foreigners.

The Balance of Trade (BoT) deals only with exports and imports of merchandise (or visible items). The Balance of Invisibles (BoI) shows net receipts on account of invisibles. It is not necessary that BoT should always balance; more often than not, it will show either a surplus or a deficit on BoI. If the surplus on BoI equals the deficit on BoT, the current account will show a net balance. But then there is no reason why these two balances should always be equal, again, always in opposite directions. As a matter of fact, the balance on current account can always show a deficit or a surplus. A surplus on current account leads to an acquisition of assets or repayment of debts previously contracted, and a deficit involves withdrawal of previously accumulated assets or is met by borrowings.

While the "goods and services (invisibles) account" generally forms a major part of the current account, the primary income account reflects amounts payable and receivable in return for providing temporary use of labour, financial resources, or non-produced non-financial assets (natural resources). The net effect of all the transactions under the above accounts is known as the "current account balance". In other words, the current account balance shows the difference between the sum of exports of goods and services as well as income receivable, on the one hand, and the sum of imports and income payable on the other. From a macroeconomic perspective, the value of the current account balance reflects the inflow/outflow of foreign resources bridging the savings-investment gap.

19.4.2 The Capital Account

The capital account[3] shows credit and debit entries for non-produced non-financial assets and capital transfers between residents and non-residents. It

[3] As Defined in Balance of Payments and International Investment Position Manual Sixth Edition (BPM6), IMF

records acquisitions and disposals of non-produced non-financial assets, such as land sold to embassies and sales of leases and licenses, as well as capital transfers, that is, the provision of resources for capital purposes by one party without anything of economic value being supplied as a direct return to that party.

To be more precise, the capital account shows the change in the nation's assets abroad and the foreign assets in the nation, other than official reserve assets. It includes direct investments (e.g. building of a foreign plant), the purchase or sale of foreign securities (stocks, bonds, and treasury bills), and the change in the nation's non-bank and bank claims on and liabilities to foreigners during the year. Increases in the nation's assets abroad and reductions in the foreign assets in the nation (other than official reserve assets) are capital outflows or debits (–) in the nation's capital account because they lead to payment to foreigners. On the other hand, decreases in the nation's assets abroad and increases in foreign assets in the nation are capital inflows or credits (+) because they lead to the receipt of payments from foreigners.

19.4.3 The Financial Account

The financial account reflects net acquisition and disposal of financial assets and liabilities during a period. The transactions under financial account appear both in the BoP and in the integrated international investment position (IIP) statement owing to their effect on the stock of assets and liabilities. The sum total of net transactions under the current and capital account represents net lending (surplus) or net borrowing (deficit) by the economy from the rest of the world, which is reflected in the financial account as net outflow or inflow of capital. Thus, the financial account shows how the net lending to or borrowing from the rest of the world has occurred. Conversely, it shows how the current account surplus is used or the current account deficit is financed. The financial account together with the "other changes account" explains the change in the IIP between the beginning and end-periods.

The sum of the balances on the current and capital accounts represents the net lending (surplus) or net borrowing (deficit) by the economy with the rest of the world. This is conceptually equal to the net balance of the financial account. In other words, the financial account measures how the net lending to or borrowing from non-residents is financed. The financial account plus the other changes account explain the change in the IIP between beginning- and end-periods.

19.4.4 Net Errors and Omissions

While BoP accounts are, in principle, balanced, imbalances may occur in practice on account of imperfect compilation procedures and different data sources. This imbalance, a usual feature of BoP statistics, is termed "net errors and omissions" and is identified explicitly in the BoP statement. Net errors and omissions in simple terms are derived residually as the difference between total of receipts and payments (both current and capital together with the financial account). Therefore, a positive value of net errors and omissions indicates any or all of the following:

- the credit transactions (current or capital or both) are understated;
- the debit transactions (current or capital or both) are overstated;
- the net increase in assets in the financial account is overstated;
- the net increase in liabilities in the financial account is understated.

In the case of a negative value of net errors and omissions, the opposites of the above would hold.

19.5 INDIA'S BALANCE OF PAYMENTS – RECENT TRENDS

In India, Reserve Bank of India publishes the quarterly and annual BoP statistics in two formats, an old format and a BPM6 format as recommended by the IMF. Table 19.8 presents the summary of the India's BoP account from 2014-15 to 2018-19. Table 19.9 exhibits the overall situation of India's BoP whereas Table 19.10 demonstrates the key indicators of India's BoP as a percentage of GDP. Figure. 19.1 exhibit Current Account Deficit (CAD) as per cent of GDP over the period of time which has been further captured for the period of 2009-14 and 2014-19 in the Table 19.11.

Table 19.8: Balance of Payments(in US $ million)

S. No.	Item	2014-15	2015-16	2016-17	2017-18	2018-19
1	2	3	4	5	6	7
I	Current Account					
1	Exports	3,16,545	2,66,365	2,80,138	3,08,970	3,37,237
2	Imports	4,61,484	3,96,444	3,92,580	4,69,006	5,17,519
3	Trade Balance (1-2)	-1,44,940	-1,30,079	-1,12,442	-1,60,036	-1,80,283
4	Invisibles (net)	1,18,081	1,07,928	98,026	1,11,319	1,23,026
	A. Services	76,529	69,676	68,345	77,562	81,941
	B. Income	-24,140	-24,375	-26,302	-28,681	-28,861
	C. Transfers	65,692	62,627	55,983	62,438	69,946
5	Goods and Services Balance	-68,411	-60,402	-44,098	-82,474	-98,342
6	Current Account Balance (3+4)	-26,859	-22,151	-14,417	-48,717	-57,256

II	Capital Account					
	Capital Account Balance	89,286	41,128	36,447	91,390	54,403
i.	External Assistance (net)	1,725	1,505	2,013	2,944	3,413
ii.	External Commercial Borrowings (net)	1,570	-4,529	-6,102	-183	10,416
iii.	Short-term credit	-111	-1,610	6,467	13,900	2,021
iv.	Banking Capital(net) of which:	11,618	10,630	-16,616	16,190	7,433
	Non-Resident Deposits (net)	14,057	16,052	-12,367	9,676	10,387
v.	Foreign Investment(net) of which:	73,456	31,891	43,224	52,401	30,094
	A. FDI (net)	31,251	36,021	35,612	30,286	30,712
	B. Portfolio (net)	42,205	-4,130	7,612	22,115	-618
vi.	Other Flows (net)	1,028	3,242	7,460	6,138	1,026
III	Errors and Omission	-1,021	-1,073	-480	902	-486
IV	Overall Balance	61,406	17,905	21,550	43,574	-3,339
V	Reserves change [increase (–) / Decrease (+)]	-61,406	-17,905	-21,550	-43,574	3,339

Source: Economic Survey 2019-20

Table 19.9: India's Balance of Payments (BoP)Situation

(in US $ million)

Year/ Item	Current Account	Capital Account	Overall Balance
1981-82	-3179	657	-2523
1991-92	-1178	3777	2599
2001-02	3400	8357	11757
2011-12	-78155	65324	-12831
2018-19	-57256	53917	-3339

Source: Database on Indian Economy, Reserve Bank of India

Table 19.10: Key indicators of India's Balance of Payments (As per centof GDP)

Year	Exports	Imports	Net Invisibles	Trade Balance	Import Cover of Reserves (In months)
1981-82	4.5	8.3	2.1	-3.8	3.3
1991-92	6.8	7.8	0.6	-1.0	5.3
2001-02	9.2	11.6	3.1	-2.4	11.5
2011-12	17.0	27.4	6.1	-10.4	7.1
2018-19	12.4	19.0	4.5	-6.6	9.6

Source: Database on Indian Economy, Reserve Bank of India

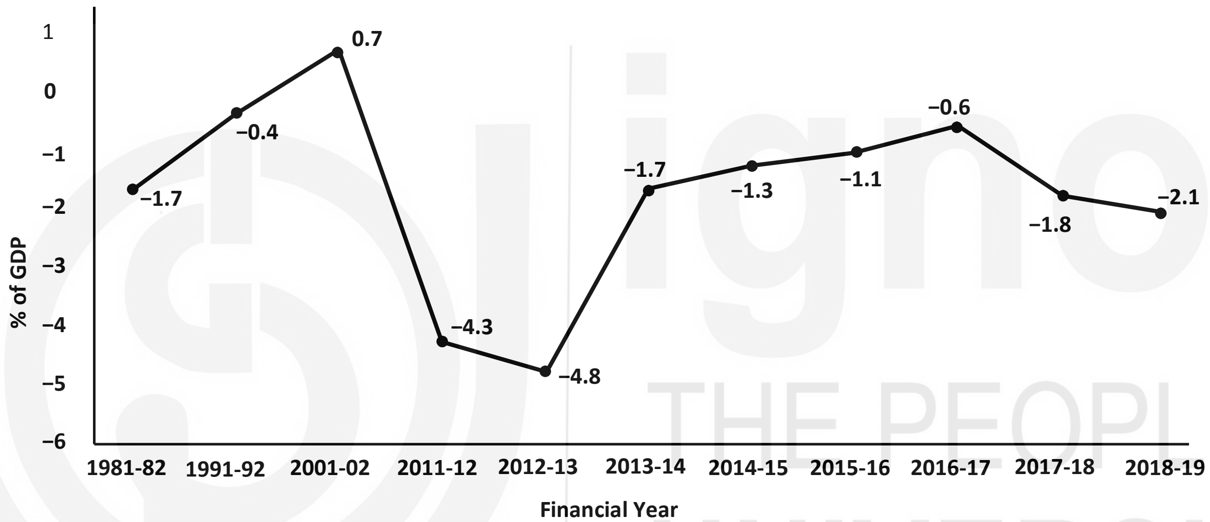

Fig. 19.1: Current Account Deficit (CAD) as per cent of GDP

Source: Computed from database on Indian Economy, Reserve Bank of India

Table 19.11: Current Account Deficit (CAD) as per cent of GDP

	2009-14	2014-19	2018-19
CAD as per cent of GDP	-3.3	-1.4	-2.1

Source: Economic Survey 2018-19

19.5.1 The SalientFeatures of India's BOP

For an emerging and aspiring market economy like India which need access of foreign savings and capital to meet the investment requirement for a US$ 5 trillion-economy, improvement in BoP position is critical. It ensures financing of essential imports like crude oil and other such inputs that drive the major sectors of the economy to ensure livelihood to crores of people in the country.

Before 1991

The entire period was very challenging for India's BoP, partly because of slow growth of exports in relation to import requirements and partly because of adverse external factors. Foreign exchange reserves were at a low level, generally less than necessary to cover three months' exports. Almost the entire CAD (92 per cent) was financed by inflows of external assistance.

Recent Developments

The prominent features of the BoP situation as it has emerged over the last two decades can be briefly summarised as follows:

- **Widening Deficit on Balance of Trade Account –** Goods: Deficit towards merchandise trade has been the biggest component of India's current account deficit which is adversely impacting the BoP position. India's exports and imports have multiplied fast, but imports have risen at a faster rate than exports. In the recent years, the escalation of global trade tensions and global slowdown have worsened India's trade deficit. As imports grew faster than exports, the deficit in Balance of Trade (goods) widened to 10.7 per cent of GDP in 2012-13 which narrowed down to 4.9 per cent of GDP in 2016-17, but again increased to 6.6 per cent of GDP in 2018-19. The improvement in the deficit of BoT in 2016-17 was on mainly on account of more than fifty per cent decline in crude prices.

- **Role of Invisibles** –There has been a phenomenal increase in net surplus on account of invisibles principally, due to a) buoyancy in private transfers (i.e. inward remittances), and fast expansion in exports of services, especially software. India is unique among emerging economies to have a sizable invisible surplus that substantially offsets the merchandise trade deficit. Net Private transfer receipts, mainly representing remittances by Indians employed overseas, increased marginally from USD 65.7 billion in 2014-15 to around USD 70.0 billion in 2018-19. According to the Economic Survey 2018-19, India remained a top remittance recipient country in 2018, followed by China, Mexico, Philippines, and Egypt, with remittance inflows peaking at all-time high. Of three main components of net invisibles, net services grew from USD 76.5 billion in 2015-16 to USD 81.9 billion in 2018-19. Economic Survey 2019-20 points out that the surplus on net services has been significantly financing the merchandise trade deficit which reached its peak to about two-thirds of merchandise deficit in 2016-17 before declining to less than half in the last couple of years. Overall, net invisibles as a proportion of GDP reflects the net impact of service exports and imports and unilateral transfers on BoP. In recent times, net invisibles have grown from USD 118.1 billion in 2015-16 to USD 123.0 billion in 2018-19. However, India's net surplus on account of invisibles has been steadily declining in relation to GDP. As a matter of fact, India's net invisibles were 6.2 percent of GDP in the year 2013-14 which continuously declined and reached to 4.2 percent of GDP in 2018-19 and thereafter marginally improved to 4.5 per cent of GDP in 2019-20.

- **Current Account** - Slowdown in global demand, higher global crude oil prices, subdued global trade activity and geo-political uncertainties took a toll on India's external sector as the CAD widened to its highest level since 2012-13. (RBI Bulletin November 2019) India's external sector faced persistent global headwinds in 2018-19. As a result, CAD which averaged 1.3 per cent of GDP during 2013-14 to 2017-18 rose to 2.1 per cent of GDP. (RBI Bulletin November 2019). India's Current Account Deficit (CAD) as a percentage of GDP has shown variable trend. The CAD for the year as a whole widened to –4.8 per cent of GDP in 2012-13. Thereafter, it started narrowing down to –0.6 per cent in 2016-17. CAD again increased to –2.1 per cent in 2018-19, primarily on the back of higher trade deficit. Economic Survey 2019-20 has pointed out that India's CAD to GDP ratio significantly improving from 2009-14 to 2014-19.

- **Developments in Capital Account** – Major components in the capital account are foreign investment (including foreign direct investment and portfolio investment) and borrowings.On the capital account, India has been running a significant surplus. As a result, India has been rapidly building up its foreign exchange reserves. However, during 2018-19, foreign investment declined to US$30.1 billion as compared to US$ 73.5 billion in period of 2014-15. Economic Survey 2018-19 states that robust foreign direct investment (FDI) inflows, were more than outweighed by withdrawals under portfolio investment reflecting an escalation of global risk aversion. Among other forms of capital flows, banking capital recorded a net inflow ofUS$ 7.4 billion in 2018-19, a 36 per cent decline over US$11.6 billion in 2014-15. Among debt creating capital flows, net external assistance increased by 97.9 per cent to US$3.4 billion in 2018-19 as against US$1.7 billion in 2014-15. External Commercial Borrowings (ECBs) experienced a significant increase in net inflow of US$10.4 billion during 2018-19 which is a massive increase of more than five times as against a net inflow of US$1.6 billion in 2014-15, reflecting in part a possible credit crunch in the country. Net NRI deposit declined by 26.1 percent to US$1.0 billion in 2018-19 as against US$14.0 billion in 2014-15. Net short-term trade credit has shown a mixed trend and after recording a sharp decline during 2014-15 and 2015-16 due to import contraction, it has increased to US$ 13.9 billion in 2017-18 and thereafter declined to US$2.0 billion in 2018-19. Overall, in 2018-19, net capital flows fell short of financing current account deficit resulting in depletion of foreign exchange reserves. The capital account demonstrates following features: (a) Both inflows and outflows of capital have increased. (b) The composition of capital flows is undergoing a change: (1) Official external assistance has been gradually losing out its significance; (2) FDI and portfolio investment have surged, and among the two, the inflows on account of FDI have been more than on account of portfolio investment (except 2010-11 when the trend got reversed). (3) With easing of controls, external commercial borrowings have been coming back into prominence.

On account of average GDP growth of 7.5 per cent during the period 2014-19, the Balance of Payments (BoP) position of India improved from an accumulated foreign reserve of US$ 304.2 billion at end of 2013-14 to US$ 412.9 billion at end of 2018-19. In recent period, financing of the current account has become less vulnerable to capital flight as compared to the previous period. At the same time, it has been observed that growth of forex reserves in India bears no correlation with movements in net Foreign Portfolio Investment (FPI). The widening of the current account deficit over the period has been largely on account of a higher trade deficit driven by rise in international crude oil prices (Indian basket). Net remittances from Indians employed overseas has been constantly increasing over the years helping stabilising the BoP situation. India's balance of payments position in 2018-19 came under pressure from higher current account deficit (CAD) as well as lower net capital inflows. Nevertheless, continuous improvement in BoP position of India shows sentiments and confidence being reflected by global economy which increasingly believes in India's growth story.

19.6 EXTERNAL DEBT

External debt is the component of total debt held by creditors of the foreign nations. Debt can be in the form of money owed to banks (Asian Development Bank (ADB), International Bank for Restructuring and Development (IBRD) outside the domestic nation or borrowings from the global financial institutions like the World Bank and International Monetary Fund (IMF).

In a developing country like India, external borrowing is important to increase the volume of funds available for investment. However, it is important that borrowed money be used for investment (other than in a situation of a dire emergency) so that economy grows and is able to repay the debt. Along with growth there is a need for foreign earning too to increase so that the debt can be repaid.

Classification of External Debt

The external debt in India is classified as:
(i) long-term debt and(ii) short-term debt.

The long-term debt consists of external commercial borrowings, borrowings from global financial institutions like IMF (Multilateral Debt), borrowings from private banks (Bilateral Debt), trade credit, NRI deposits, etc. On the other hand, short-term debt comprises of FII investments in government T-bills, investment in T-bills by foreign central banks, external debt liabilities of commercial banks and RBI.

External Debt Indicators

Key indicators such as debt to GDP ratio, debt service ratio, short-term debt to total debt, short-term and total debt to foreign exchange reserves, concessional debt to total debt and debt expressed in terms of present value are commonly used to assess the stability and sustainability of a country's stock of external debt relative to the absolute level of the debt.

Evolution and Characteristics of India's External Debt

As per Ministry of Finance report[4], external debt is largely used for financing specific projects at the Central and State levels. States are not permitted to contract external debt directly and therefore in the existing system all external debt (even those not used for financing Central Govt. projects) are first contracted in the Consolidated Fund of India and then on-lent to States. Most of the external debt is from Multilateral agencies such as IDA, IBRD, ADB, etc. A small proportion of existing external debt comes from bilateral agencies. All these loans are generally long-term variable rate loans linked to LIBOR. While calculating effective rate of interest for these loans, impact of exchange rate variation needs to be considered.

Prior to 1991, the bulk of short-term debt was borrowed by public sector canalising agencies for financing the import of petroleum, petroleum products and fertilisers. Such short-term debt constituted around 10 per cent of total external debt during the 1980s. The experience with the balance of payments crisis of 1991 led to the adoption of policies for prudent external debt management with less dependence on short-term foreign capital.

India's external debt has undergone significant level and compositional changes since the early 1990s. Drawing on the lessons from the external payment crisis of 1991 and the recommendations of the High-level Committee on Balance of Payments, 1993 (Chairman: Dr C. Rangarajan), the policy approach has been guided by[5] :

- restrictions on size, maturity and end-use of External Commercial Borrowings (ECBs);
- LIBOR-based interest ceiling on non-resident deposits to discourage the volatile component of such deposits;
- pre-payment and refinancing of high cost external debt; and
- measures to encourage non-debt creating financial flows such as foreign direct investment (FDI) and foreign portfolio investment (FPI).

Highlights of India's External Debt[6]

At end-March 2020, India's external debt was placed at US$ 558.5 billion, recording an increase of US$ 15.4 billion over its level at end-March 2019.Commercial borrowings remained the largest component of external debt, with a share of 39.4 per cent, followed by non-resident deposits (23.4 per cent) and short-term trade credit (18.2 per cent).

At end-March 2020, long-term debt (with original maturity of above one year) was placed at US$ 451.7 billion, recording an increase of US$ 17.0

[4] Government Debt, Status Report, March 2012, Department of Economic Affairs, Ministry of Finance
[5] RBI Bulletin December 2017
[6] RBI release on 30th Jun 2020

billion over its level at end-March 2019. Whereas, the share of short-term debt (with original maturity of up to one year) in total external debt declined to 19.1 per cent from 20.0 per cent, the ratio of short-term debt (original maturity) to foreign exchange reserves declined to 22.4 per cent from 26.3 per cent in the same period.

US dollar denominated debt continued to be the largest component of India's external debt, with a share of 53.7 per cent at end-March 2020, followed by the Indian rupee (31.9 per cent), Yen (5.6 per cent), SDR (4.5 per cent) and the Euro (3.5 per cent).

The external debt to GDP ratio – a summary measure of a country's potential to service external debt by switching production to exports – declined sharply from 28.3 per cent at end-March 1991 to 19.8 per cent by end-March 2019.

An increase in external debt to GDP ratio increases debt servicing and draws down on forex reserves, worsening BoP position. After a significant reduction in 2014-19 relative to 2009-14, India's external debt to GDP ratio slightly increased by 0.3 per cent at the end of first half of 2020 over its level at end-March 2019, primarily on account of an increase in commercial borrowings, non-resident deposits and short-term trade credit. Even though the increase in external debt – on average – exceeded the pace of expansion of the domestic economy in nominal terms since the second half of the 2000s, the ratio remained modest relative to its level during the 1990s and stood at 20.6 per cent of GDP at end-March 2020.

A rising share of short-term debt makes the BoP position more vulnerable because of relatively higher rates of interest on such borrowings. However, a contraction of short-term debt has been experienced in the falling share of short-term debt (with original maturity of up to one year) in total external debt since 2012-13. At a time when exports are not growing rapidly, loans at high interest rates can create pressure on BoP in the future.

Table 19.12: India's External Debt (Per cent of GDP)

2009-14	2014-19	2018-19
23.90	19.70	19.80

Source: Economic Survey 2019-20

Table 19.13 summarises the key external debt indicators of India reflecting that India's external debt is not unsustainable.

Debt Service Ratio indicates the claim that servicing of external debt makes on current receipts and is, therefore, a measure of strain on BoP due to servicing of debt service obligations. Debt Service ratio was badly hight at 35.3per cent in 1991 which increased till 2016 and then declined continuously since 2016 from 8.8 per cent to 6.5 per cent in 2020 (end-March).Total External Debt to Exports Ratio, another measure of debt sustainability, increased since 2014 till 2016 and then reduced to 107.1 per cent.

Table 19.13: India's Key External Debt Indicators

End-March	Ratio of External Debt to GDP	Debt Service Ratio	Ratio of Foreign Exchange Reserves to Total Debt	Ratio of Concessional Debt to Total Debt	Ratio of Short-term Debt to Foreign Exchange Reserves	Ratio of Short-term Debt (original maturity) to Total Debt
1991	28.3	35.3	7.0	45.9	146.5	10.2
2001	22.1	16.6	41.7	35.4	8.6	3.6
2011	18.6	4.4	95.9	14.9	21.3	20.4
2014	23.9	5.9	68.2	10.4	30.1	20.5
2015	23.8	7.6	72.0	8.8	25.0	18.0
2016	23.4	8.8	74.3	9.0	23.2	17.2
2017	19.8	8.3	78.5	9.4	23.8	18.7
2018	20.1	7.5	80.2	9.1	24.1	19.3
2019	19.8	6.4	76.0	8.7	26.3	20.0
2020	20.6	6.5	85.5	8.6	22.4	19.1

Source: Reserve Bank of India

As per the report published in the Economic Survey 2018-19, international comparison of external debt based on World Bank data shows that among the top twenty developing debtor countries in 2017, India's external debt to Gross National Income (GNI) ratio at 19.8 per centwas fourth lowest, while China continues to have the lowest ratio of 14 per cent. In terms of the foreign exchange reserves cover to external debt, India's position was fifth highest at 75.9 per cent, whereas India has fifth lowest short-term debt to foreign exchange reserves at 25.1 per cent among the top twenty developing debtor countries. Again as per the World Bank data, though India is the third largest debtor country (in absolute amounts) among developing countries (after China and Brazil), its average-age of debt is much higher given that its ratio of short-term debt to total debt is only about 19.0 per centwhile that of China is 69 per cent. Higher age of debt reduces the rollover risk.

Overall, external debt of India continues to be dominated by long-term borrowings. India continues to be among the less vulnerable nations with its external debt indicators. India's external debt remains low as compared to the average external debt to GDP ratio of all developing countries (25.6 per cent) according to World Bank's International Debt Statistics, 2020. The prudent external debt policy pursued by the government has helped in maintaining foreign debt within manageable limits.

Check Your Progress 3

1) Examine recent scenario of current account deficit in India.

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2) Why did India face the adverse balance of payment prior to 1991?

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3) What are the trends and challenges of India's Balance of Payments?

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19.7 LET US SUM UP

Trade has long been considered, and accurately so, as one of the most preferred indicators ofa country's capacity to sustain economic growth. That is because trade is a reflector of competitiveness.Currently, global trade is going through a challenging phase due to a variety of factors.Perhaps the chiefamong them is the trade wars between some of the major nations seeking to capture a large proportion of trade flows.Thesetradewars between the economies in the world result in negative repercussions across the globaleconomy through their impact on the value chains and the creation of policy uncertainty. Other factors contributing to uncertainty which is affectingglobal economic growth (and thus global trade) include BREXIT. This, and the slowdown ofgrowth in the EU, (including its major exporter, Germany) has led to subdued demand in one of the largesttrading blocs in the world. Multilateralism has also not made much headway with the lack of progress of theDoha Development Round.

The composition of India'sexternal trade has been changing from primary goods to manufacturing andengineering goods. Similarly, direction of India's exports is shifting away fromthe traditional markets (EU, USA, and Japan) to Asia. India's merchandise trade balance has improved from 2009-14 to 2014-19 althoughmost of the improvement in the latter period was on account of more than fifty percentdecline in crude prices in 2016-17.Engineering goods, petroleum products, precious stones, drug formulations andbiologicals, goldand other precious metals continue to be top-exported commodities. Crudepetroleum, electronic goods, machinery, gold, precious stones, and coal constitutetop import items. India's top five trading partners continue to be USA,China, UAE, Saudi Arabia, and Hong Kong.India's balance of paymenthas been in surplus resulting in rapid build-up of foreign exchange reserves largelydue to massive inflows of foreign capital. Indian economy has been steadilybecoming more open and hence international consequences need to be kept inmind by the policy makers.

19.8 KEYWORDS

Balance of Payments : The balance of payments is the record of all international trade and financial transactions made by a country's residents.

External Debt : External debt is the portion of a country's debt that is borrowed from foreign lenders, including commercial banks, governments, or international financial institutions

Degree of Openness : The degree of openness is an economic metric calculated as the ratio of country's total trade, the sum of exports plus imports, to the country's gross domestic product.

Terms of Trade : Terms of trade are the relative price of exports in terms of imports.

Trade Deficit : Also called a negative balance of trade, a trade deficit is an amount by which the cost of a country's imports exceeds its exports.

Trade Policy : Trade policy refers to the regulations and agreements that control imports and exports to foreign countries. In other words, it defines standards, goals, rules, and regulations that pertain to trade relations between countries.

19.9 REFERENCES

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2) Basu, Kaushik and AnnemieMaertens, (ed.), (2011).*The New Oxford Companion to Economics in India*, Oxford University Press, New Delhi

3) Bhagwati, Jagdish, (2004).*In Defence of Globalisation*, Oxford University Press, New Delhi

4) EXIM Bank of India, Annual Reports.

5) RBI, Annual Reports.

6) Ministry of Finance, Economic Survey, 2017-18, 2018-19, 2019-20

7) Reddy, Y.V.: *India and the Global Financial Crisis: Managing Money and Finance,* Orient Blackswan, Hyderabad.

19.10 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 19.2 and answer
2) See Section 19.2 and answer
3) See Section 19.2 and answer
4) See Section 19.2 and answer

Check Your Progress 2

1) See Section 19.3 and answer
2) See Sub-section 19.3.5 and answer
3) See Section 19.3 and answer

Check Your Progress 3

1) See Section 19.5 and answer
2) See Section 19.5 and answer
3) See Section 19.5 and answer

UNIT 20 FOREIGN CAPITAL

Structure

20.0 OBJECTIVES

After going through this unit, you will be able to:

- analyse the role of foreign capital in the growth process of a developing economy;
- know the types and sources of foreign capital;
- explain evolution and various phases of India's policy towards foreign capital;
- discuss composition, trend, and sources of origin of inward Foreign Direct Investment to India;
- examine composition, trend, and destinations of Overseas Foreign Direct Investment (OFDI) of India; and
- evaluate the Government of India's Policy towards Foreign Capital.

20.1 INTRODUCTION

The term Foreign Capital is primarily associated with inflow of foreign capital into home country from foreign countries. Spread of globalisation and opening of the economies along with recent technological advances have led to movement of firms from one geography to another, thereby contributing to the economic integration of the world. For any economy, particularly for the developing economy, foreign capital plays acritical role including by (i) bridging investment-saving gap (ii) bridging management, entrepreneurship, technology and skilling gap (iii) bridging foreign exchange gap, (iv) undertaking initial business risks, (v) contributing to development of basic economic infrastructure, (vi) supporting stability of foreign exchange and reducing balance of payment deficit, (vii) facilitating integration with other economies of the world for trade of goods and services and (vii) eventually supporting higher development. Because of these collateral benefits associated with foreign capital, greater use of foreign capital is associated with improved prospects for economic growth.

Foreign capital helps to improve the competitiveness of the domestic economy by breaking domestic monopolies. A healthy competitive environment always pushes firms to continuously enhance their processes and product offerings, thereby fostering innovation. Consumers also gain access to a wider range of competitively priced products.

From the perspective of both governments and businesses, foreign capital has become an important factor in driving economic growth and development. By acquiring a controlling interest in foreign assets, businesses can quickly explore new products, technologies, and markets. Leveraging the foreign capital, governments can create jobs and improve economic growth. Various studies have shown that the growth of developing and emerging economies is being driven by leveraging incoming foreign capital in the form of direct investments. At the same time, firms investing abroad can realise higher growth rates and diversify their income, which creates opportunities for investors.

In this unit we shall discuss these various issues related to the foreign capital.

20.2 TYPES OF FOREIGN CAPITAL

In the broader term, foreign capital can be classified in the following categories:

1) Foreign Investment:
   i) Foreign Direct Investment (FDI)
   ii) Foreign Portfolio Investment (FPI)
2) External Commercial Borrowings (ECB)
3) Commercial Deposits by Non-Resident Citizens / NRI Deposits
4) External Assistance
   i) Loans

ii) Grants

iii) Debt Service Payment

iv) Foreign Aid

According to Reserve Bank of India (RBI), foreign investment means any investment made by a person resident outside India on a repatriable basis in capital instruments of an Indian company or to the capital of a limited liability partnership (LLP).

Similarly, Foreign Direct Investment (FDI) is the investment through capital instruments by a person resident outside India (a) in an unlisted Indian company; or (b) in 10 per cent or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company. In a broader sense, FDI pertains to international investment in which the investor obtains a lasting interest in an enterprise in another country. More precisely, it may take the form of buying or constructing a factory in a foreign country or adding improvements to such a facility, in the form of property, plants, or equipment. FDI is calculated to include all kinds of capital contributions, such as the purchases of stocks, as well as the reinvestment of earnings by a wholly owned company incorporated abroad (subsidiary), and the lending of funds to a foreign subsidiary or branch. The reinvestment of earnings and transfer of assets between a parent company and its subsidiary often constitutes a significant part of FDI calculations.

RBI describes Foreign Portfolio Investment (FPI) as any investment made by a person resident outside India in capital instruments where such investment is (a) less than 10 per cent of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company or (b) less than 10 per cent of the paid-up value of each series of capital instruments of a listed Indian company. Broadly speaking, FPI is a category of investment instruments that is more easily traded, may be less permanent, and do not represent a controlling stake in an enterprise. These include investments via equity instruments (stocks) or debt (bonds) of a foreign enterprise e.g. Foreign Institutional Investors, which does not necessarily represent a long-term interest.

While FDI tends to be commonly undertaken by multinational corporations, FPI comes from many diverse sources such as a small company's pension or through mutual funds held by individuals. The returns that an investor acquires on FPI usually take the form of interest payments or dividends. Investments in FPI that are made for less than one year are distinguished as short-term portfolio flows.

Calculations of FDI and FPI are typically measured as either a "flow", referring to the amount of investment made in one year, or as "stock", measuring the total accumulated investment at the end of that year.

As per framework introduced by RBI, External Commercial Borrowings (ECBs)[1] are commercial loans raised by eligible resident entities from

[1]Master Direction - External Commercial Borrowings, Trade Credits and Structured Obligations, FED Master Direction No.5/2018-19, Reserve Bank of India

recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters apply in totality and not on a stand alone basis. RBI further prescribes the framework for raising loans through ECB. The ECB Framework enables permitted resident entities to borrow from recognised non-resident entities in the following forms:

i) Loans including bank loans;

ii) Securitised instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares / debentures);

iii) Buyers' credit;

iv) Suppliers' credit;

v) Foreign Currency Convertible Bonds (FCCBs);

vi) Financial Lease; and

vii) Foreign Currency Exchangeable Bonds (FCEBs)

However, ECB framework is not applicable in respect of the investment in Non-convertible Debentures (NCDs) in India made by Registered Foreign Portfolio Investors (RFPIs).

Commercial loans, which primarily take the form of bank loans issued to foreign businesses or governments. External Assistance to India denotes multilateral and bilateral loans received under the agreements between Government of India and other Governments/International institutions and repayments of such loans by India, except loan repayment to erstwhile "Rupee area" countries that are covered under the Rupee Debt Service. This also include Official Development Assistance (ODA), received by the country from donor countries and International organisations e.g. UNO, World Bank etc. The main objective of such aid is to promote the economic development of the recipient countries.

20.3 FOREIGN INVESTMENT IN INDIA

20.3.1 Trends and Magnitude of FDI

At the time of opening of the Indian economy in 1991, foreign investment, was small, a total of just \$103 million. With the opening up of the economy, it grew substantially and in 2006-07 reached \$29.2 billion. In recent years, FDI trend in Indian Economy is moving in upward direction that too rapidly. FDI has emerged as the predominant source of external financing. The attractiveness of India as a preferred investment destination could be ascertained from the large increase in gross and net FDI inflows to India. Gross inflow of foreign investment in India grew from \$4.03 billion in 2000-01 to \$74.39 billion in 2019-20. In terms of net inflow of FDI to India (inflow less outflow from India), this figure has grown from \$3.27 billion in 2000-01 to \$43.01 billion in 2019-20. FDI inflows have continued to be buoyant in 2019-20. In both gross and net terms, FDI flows in 2019-20 were

$74.4 billion and 43.0 billion respectively, well above their respective levels in 2018-19. The significant increase in FDI inflows to India reflected the impact of liberalisation of the economy since the early 1990s as well as gradual opening up of the capital account. As part of the capital account liberalisation, FDI was gradually allowed in almost all sectors, except a few on grounds of strategic considerations, subject to compliance of sector specific rules and regulations.

During the global financial crisis, when there was a significant deceleration in global FDI flows the decline in FDI flows in 2009-10 to India was relatively moderate on the back of strong rebound in domestic growth. However, in subsequent year of 2010-11, gross FDI equity inflows to India witnessed significant moderation. After the launch of Make in India in September 2014, the trends in FDI have improved, showing a positive impact on the foreign investors due to investor friendly signals from India. India has jumped from 15th position in 2014 to 10th position in 2015 in the most trusted nations for FDI. According to World Investment Report 2020, published by UNCTAD, despite a slowdown in the global economy and growing global investment concerns due to disruptions in supply chains, India was able to sustain the pace of FDI in 2019-20 and was the 9th largest recipient country globally in 2019. Economic Survey 2019-20 pointed out that continuous liberalisation of FDI guidelines has been responsible for rising in flows of foreign investment into the country.

Trends in Foreign Portfolio Investment (FPI)

Foreign Portfolio Investment (FPI) is the entry of funds into a country where foreigners deposit money in a country's bank or make purchases in the country’s stock and bond markets, sometimes for speculation. Portfolio investments mainly include investment by foreign institutional investors (FIIs), funds raised through of American Depository Receipts (ADRs) or Global Depository Receipts (GDRs) by Indian companies and through offshore funds. An increase innet FPI flows improves the Balance of Payment (BoP) position and arises on account of cross-border transactions involving debt or equity securities, other than those included in direct investment or reserve assets. However, FPI is often referred to as “hot money” because of its tendency to flee at the first signs of trouble in an economy or improvement in investment attractiveness elsewhere in the world, particularly in the US, at the hands of the Federal Reserve.

The Indian rules for foreign portfolio investments (FPIs) have undergone several regulatory changes designed to ease investment in the last few years. FPIs primarily consist of securities and other financial assets passively held by foreign investors, generally for short-term speculation. Foreign portfolio investment differs from foreign direct investment in that it does not give the invest or direct ownership of financial assets.

FPIs in India have been volatile over the years. In 2008-09, 2015-16 and 2018-19, there was a net portfolio outflow from the country that was seen as weakening of confidence of investors in India’s economy.

The net portfolio out flow in 2008-09 was $14.03 billion. This is when the financial crisis hit the developed economies, and many financial institutions would have withdrawn investments from India and other developing countries, in order to strengthen their balance sheets at home. In 2015-16 foreign portfolio flows, remain vulnerable to bouts of global risk aversion which resulted in outflow to the tune of $4.13 billion. Similarly, in 2018-19, there was a net portfolio outflow of $0.62 billion from the country that was seen as weakening of confidence of investors in India's economy.

Trends in External Assistance to India

External assistance is composed of loans and grants. External assistance by India - denotes aid extended by India to other foreign Governments under various agreements and repayment of such loans. External Assistance to India denotes multilateral and bilateral loans received under the agreements between Government of India and other Governments/International institutions and repayments of such loans by India, except loan repayment to erstwhile Rupee area countries that are covered under the Rupee Debt Service. However, most of the assistance in the initial periods of planning were in the form of interest-bearing loans, while only a fraction was in the form of outright grants. According to a position paper published by Department of Economic Affairs, Ministry of Finance, Government of India in March 2008.

"As per the extant policy, Government of India does not accept aid in areas where it has substantial control. While bilateral aid is accepted only from G-8 countries, the Russian Federation, and the EC, tied aid is not accepted at all. Channelisation of external assistance from smaller partners (other than those mentioned above), is only through multilateral organisations to promote greater aid harmonisation. Further, all countries can provide bilateral development assistance directly to autonomous institutions, universities, NGOs, etc through a simplified procedure. Directing of external assistance of smaller size towards the non-government sector allows this sector to remain an effective channel for implementation of development programmes and strengthens the civil society".

Net Inflow of external assistance reached an all-time high of $4.72 billion in 2010-11 and a record low of $-3.33 billion in 2003-04 (Table 20.3 in Appendix 20.2).

Trends in NRI Deposits / Outstanding

NRI deposits were first introduced in February 1970. The initial scheme was a rupee denominated account, the Non-resident (External) Rupee Account (NRE), with repatriable principal and interest. In November 1975, a foreign currency denominated deposit facility, the Foreign Currency Non-resident Account (FCNRA) was added. This deposit was also repatriable and was made attractive to the banks through the RBI assuming the exchange rate risk. Currently, there are three kinds of deposit accounts of Indian banks where NRIs or PIOs (persons of Indian origin) can park their funds - NRE (non-resident external-rupee account), NRO (non-resident ordinary rupee account) and FCNR(B) (foreign currency non-resident bank account).

Deposits in NRE accounts are freely repatriable unlike NRO accounts. Both NRE and NRO accounts are rupee denominated. FCNR(B) are foreign currency accounts - dollar, euro, and pound sterling accounts.

Notwithstanding positive accretions of deposits under Non-Resident (External) Rupee (NRE) accounts; and Non-Resident Ordinary (NRO) accounts, there was a net outflow of US$12.4 billion from non-resident deposits during 2016-17, following a lumpy redemption of FCNR(B) deposits raised by banks under the Reserve Bank's special swap window during September to November 2013.

Net flows into non-resident deposit account declined by 17 per cent in 2019-20 as deposits under the Non-Resident (External) Rupee (NRE) accounts, which accounted for the bulk of the inflows declined sharply. Softening of term deposit rates and expectations of further depreciation of rupee amidst global uncertainties partly moderated flows into this account. Among the other two accounts, deposits in Non-Resident Ordinary Rupee (NRO) accounts and the Foreign Currency Non-Resident (Banks) [FCNR (B)] accounts remained at the previous year's level

20.3.2 Sectoral Distribution of FDI

Sectoral Distribution of Equity FDI Inflows to India

From a sectoral perspective, FDI[2] in India mainly flowed into services sector (with a cumulative total of $132.8 billion — 69.5 per cent of total equity FDI flow in the past five years from 2015-16 to 2019-20) followed by manufacturing, $43.5 billion (around 22.83 per cent during) the same period. Share of service in total equity FDI inflow to India increased from 62.6 percent ($22.6 billion) in 2015-16 to 77.8 per cent (28.3 billion) in 2017-18 and then declined to 74.2 per cent in 2019-20 ($31.6 billion). Within manufacturing sector, automobile, chemicals (other than fertilizers) and drugs & pharmaceuticals are the main sectors responsible for significant FDI.

The Service sector in India includes Financial, Banking, Insurance, Non-Financial/Business, Outsourcing, Research and Development (R&D), Courier, Tech, Testing and Analysis services. Within services, the top three sectors which witnessed highest cumulative inflows of FDI during past five years from 2015-16 to 2019-20 include communication services ($29.5 billion), financial services ($22.0 billion) and retail and wholesale trade ($20.5 billion).

The rise in FDI flows to India has been accompanied by strong regional concentration. As per the data released by Department for Promotion of Industry and Internal Trade (DPIIT)[3], the top six states, viz., Maharashtra (30.35 per cent), Karnataka (17.92 per cent), Delhi (16.6 per cent) Gujarat

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[2]in equity through SIA/FIPB and RBI routes only and excluding acquisition of shares and equity capital of unincorporated bodies, as per Reserve Bank of India.

[3]https://dipp.gov.in/sites/default/files/FDI_Factsheet_March20_28May_2020.pdf

(11.05 per cent), Jharkhand (7.7 per cent) and Tamil Nadu (4.21 per cent) accounted for over 80 per cent of the FDI equity flows to India between October 2019 to March 2020. The top two states, i.e., Maharashtra and Karnataka accounted for over 45 per cent of FDI flows during this period. Maharashtra alone accounted for over 30 per cent of FDI flows to India during the same period.

Despite impressive growth rates achieved by most of the Indian states as well as aggressive investment promotion policies pursued by various state governments, the concentration of FDI flows across a few Indian states continues to exist.

20.3.3 Countries of Origin of FDI in India

Countries of Origin of FDI Equity Inflows to India

Singapore and Mauritius remained the major source countries, accounting for about 50 per cent of cumulative equity FDI flows during past five years from 2015-16 to 2019-20, followed by the Netherlands (8.4%), the US (7.6%), Japan (6.5%) and the Cayman Islands (3.1%).

During 2019-20, India received the maximum FDI equity inflow from Singapore (US$ 12.6 billion), followed by Mauritius (US$ 7.5 billion), Netherlands (US$ 5.3 billion), Cayman Islands (US $3.5 billion), USA (US$ 3.4 billion) and Japan (US$ 2.3 billion).

20.3.4 Evolution of Inward Foreign Capital Policy

The Indian growth story in the last three decades is a story of constant renewal and finding new purpose to meet the goals and aspirations of a billion people. The Indian economy has evolved and made significant progress from a closed economy until the 1990s to a vibrant economy of today. India's policy on investment by foreign capital can also be divided into two phases, pre- and post-1991. There has been a sea change in India's approach to foreign investment from the early 1990s when it began structural economic reforms encompassing almost all the sectors of the economy.

Pre-Liberalisation Period (Pre-1991 Period)

Historically, an extremely cautious and selective approach was followed by India while formulating Foreign Capital Policy. Import-substitution strategy was preferred in implementing industrialisation framework. Protecting and nurturing domestic industries was the primary goal. FDI through foreign collaboration was welcomed in the areas of high technology and high priorities to build national capability and discouraged in low technology areas. The regulatory framework was driven by the enactment of Foreign Exchange Regulation Act (FERA), 1973. Foreign equity holding in a joint venture was allowed only up to 40 per cent. Subsequently, various exemptions were extended to foreign companies engaged in export-oriented businesses and high technology and high priority areas including allowing equity holdings of over 40 per cent. As India continued to be highly protective, these measures did not add substantially to export competitiveness. Recognising these limitations, partial liberalisation in the trade and investment policy was introduced in the 1980s with the objective of enhancing export competitiveness, modernisation, and marketing of exports through Trans-national Corporations (TNCs). The announcements of Industrial Policy (1980 and 1982) and Technology Policy (1983) attempted for a liberal attitude towards foreign investments in terms of changes in policy directions. The policy was characterised by de-licensing of some of the industrial rules and promotion of Indian manufacturing exports as well as emphasising on modernisation of industries through liberalised imports of capital goods and technology. This was supported by trade liberalisation measures in the form of tariff reduction and shifting of large number of items from import licensing to Open General Licensing (OGL).

Post-Liberalisation Period (Post 1991 Period)

Major shift occurred when India embarked upon economic liberalisation and reforms programme in 1991 aiming to raise its growth potential and integrating with the world economy. Industrial policy reforms gradually removed restrictions on investment projects and business expansion on the one hand and allowed increased access to foreign technology and funding on the other. A series of measures that were directed towards liberalising foreign investment included: (i) introduction of dual route of approval of FDI– RBI's automatic route and Government's approval (SIA/FIPB) route, (ii) automatic permission for technology agreements in high priority industries and removal of restriction of FDI in low technology areas as well as liberalisation of technology imports, (iii) permission to Non-resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) to invest up to 100 per cent in high priorities sectors, (iv) hike in the foreign equity participation limits to 51 per cent for existing companies and liberalisation of the use of foreign "brands name" and (v) signing the Convention of Multilateral Investment Guarantee Agency (MIGA) for protection of foreign investments. These efforts were boosted by the enactment of Foreign Exchange Management Act (FEMA), 1999 [that replaced the Foreign Exchange Regulation Act (FERA), 1973] which was less stringent. This along with the sequential financial sector reforms paved way for greater capital account liberalisation in India. Table 20.1 summarises the evolutionary phases of India's inward FDI policy regime.

Table 20.1: Evolution of India's Inward FDI Policy

Policy Phase / Period	Salient Features of Inward FDI Policy
After Independence	• India's policy with regard to foreign capital was formulated, for the first time, in the Industrial Policy Resolution of April 1948. • The government recognised participation of foreign capital and enterprise, particularly as regards to industrial technique and knowledge for rapid industrialisation of the economy. • There were no restrictions on the 100 per cent ownership of Indian subsidiaries, but the authorities exerted informed pressure on foreign companies to sell part of their equity to local investors. • The policy environment was sufficiently unpredictable to discourage new entrants into India.
During 1960-1980s	• FDI policy of India was more restrictive due to the need to develop local industries. • No FDI was allowed without transfer of technology. • Renewals of foreign collaborations were restricted. • Foreign Exchange Regulation Act, 1973 was restricted to FDI in certain core or high priority industries. • Equity participation was restricted to 40 per cent. • FDI regime was characterised by a cautious welcome to foreign investments meaning retaining majority domestic ownership and effective control in foreign enterprises. • Inward-looking, import substitution strategy of economic development began, quota, permit, and license regime prevailed all the way and was guided and controlled by the bureaucracy. • Development pattern was characterised by strong centralised pharming, government ownership of basic and key industries, excessive regulation and control of private enterprise, trade protectionism through tariff and non-tariff barriers.
1980s to 1990s	• Attitude towards FDI was liberalised as a part of the industrial policy resolutions. • Inward looking regulatory regime continued until the early 1980s. • Government of India introduced a series of measures through 1985-industrial policy, to reduce control on industries, particularly large ones.
Since 1991	• Government started the process of liberalisation of FDI policy in July 1991; the first-generation reforms created conducive environment for foreign investment in India. Foreign investment and

	technology collaboration was welcomed to obtain higher technology, to increase exports and to expand the production base. • Foreign Exchange Regulation Act (FERA), 1973 was replaced with Foreign Exchange Management Act, 1999 (FEMA). • Licensing and permit quota regime were eliminated, and firms in all but a few sectors were allowed to start operations without government approval. • Automatic route for FDI is permitted. • Except for certain specified activities, no prior approval from exchange control authorities i.e., Reserve Bank of India is required. • Many new sectors were thrown open for FDI. • Eventually, FDI was permitted in virtually every sector, except those of strategic concern such as defence and transport. • Approval mechanism for FDI was made simpler and transparent. • Two approval routes i.e., automatic route and Foreign Investment Promotion Board (FIPB) route was introduced. • Capital account restrictions were eased to allow Indian companies to raise capital abroad, by way of Eurobonds and GDR/ADRs. • Foreign companies were permitted to set up 100 per cent subsidiaries in India. • Focus shifted to opening of infrastructure, insurance and service sector, liberalising royalty payment regime and permitting royalty on trademarks and brand names. • Foreign equity was permitted up to 100 per cent in roads, ports, harbours, bridges, and highways in 1999. • In the year 2000, a paradigm shift occurred, wherein, except for a negative list, all the remaining activities were placed under the automatic route. • From 2014 onwards, FDI regime was further liberalised in the sectors like defence, mining, insurance, pensions e-commerce, retail, and media etc.

Source: Compiled from various reports published by RBI, Ministry of Finance

20.3.5 Key Measures Taken by India to Attract FDI

Advantage India: Key Facts

i) India has the world's most liberal FDI rules with sectors like insurance, defence, single brand retail, food processing, smart cities and space technology opening up for foreign investment.

ii) India ranked 63rd out of 190 countries in World Bank's Ease of Doing business 2020 report, a significant improvement from the previous year's spot, when it ranked 77th.As such, India joined the list of 10 most improved economies for the third year in a row.

iii) This has been possible as the government has continued to regularly review FDI norms, basis the changing economic landscape and geopolitical environment. All these proactive steps have borne fruit, as is evident from the ever-increasing volumes of FDI inflows and first five months of fiscal 2021 witnessed highest ever inflow of US$35.7 billion, a 13 per cent increase from last year.

iv) Given India's growing demographics, and huge e-commerce and technological markets, activity in both areas are expected to grow in the following years.

Over the years, systematic reforms have helped the Indian economy withstand many a crisis. India is taking a holistic approach to address other historical issues: for instance, it has already announced labour reforms to allow more flexible labour related practices; power reforms (addressing high industrial power tariffs) and port-linked industrial cluster policy (to resolve the issue of scarcity of industrial land). Structural reforms within the Agricultural sector, along with US$13 billion Agri-infra fund will be enablers to attract FDI.

According to the survey conducted by Confederation of Indian Industry (CII) and Ernst & Young (EY) on "FDI in India– Now, Next and Beyond, Reforms and opportunities" India can expect to attract US$120 billion to US$160 billion of FDI annually by 2025 if it manages to increase the FDI to GDP ratio between 3 per cent to 4 per cent range by 2025. This can aid in bringing back India's GDP growth rate to 7-8 per cent range. The above growth will be stimulated by the recent structural reforms, raising of the FDI limits in multiple sectors and the Atmanirbhar Bharat strategy of the Government of India.

The Government has undertaken several structural reforms with a focus on land, labour, liquidity, and law that will globally position India as an attractive investment destination. Since the onset of the pandemic, it has injected over Rs. 20 lakh crores stimulus for the economy. The sectors covered include power, manufacturing, defence, land, education, mining, and minerals.

Some of the important reforms that have been put in motion are:

i) Corporate tax rate for new manufacturing facilities at 15 per cent to make it competitive vis-à-vis ASEAN countries.

ii) Abolition of Dividend Distribution tax on companies.

iii) Phased and graded duty structure to incentivise indigenous manufacturing of intermediate and final goods e.g., Electric Vehicles.

iv) Production linked incentives of Rs. 197 thousand crores for 13 sectors.

v) Monetary incentives on incremental sales for a period of five years to offset disability manufacturing in India. Initial focus on high import items (cell phones) and healthcare related products.

vi) Increase in FDI limit for defence production under automatic route from 49 per cent to 74 per cent.

vii) Expanded the definition (turnover and investment thresh holds) of MSMEs to encourage MSMEs to grow.

viii) Consolidating over 100 labour laws into 4 codes with higher exemptions for retrenchment and fewer registrations.

ix) Implementing a GIS system to provide information on industrial land include plot-level information.

x) Enabling ease of doing business through faceless e-assessment for taxation, decriminalisation of companies' law and allowing for netting of qualified Financial Contracts.

xi) Opening of commercial mining of coal and integrated licensing regime for minerals mining.

xii) Airport Authority of India (AAI) has awarded 3 airports out of 6 bids for Operation and Maintenance on Public Private Partnership (PPP) Basis.

xiii) Power Departments/ Utilities in Union Territories to be privatised. This will improve operations and financial efficiency in Distribution and provide a model for emulation by other utilities across the country.

xiv) New Public Sector and Enterprises Policy where all sectors are open to private sector while public sector enterprises will play a role in defined areas.

xv) "Atmanirbhar Bharat Rozgar Yojana" launched to incentivise creation of new employment opportunities during the COVID recovery phase.

The reforms related to corporate tax cuts, labour, agriculture, Production Linked Incentives (PLI) & Phased Manufacturing Plan (PMP), Micro Small & Medium Enterprises (MSME), coal and mining etc. were the long-pending demands of the industry and multilateral agencies. These reforms will help in increasing not just the productive capacity of the economy, they will also make the economy more efficient in use of the resources available.

20.3.6 Consolidated FDI Policy, 2020

India announced its latest consolidated foreign direct investment (FDI) policy, which is in effect from October 15, 2020 (as per the official circular released by the government). The Consolidated FDI Policy, 2020 incorporates restrictions notified earlier in the year on FDI coming in from overseas entities or citizens belonging to neighbouring countries that share a land border with India, including China, to prevent opportunistic takeovers of firms.

Key changes

i) This Revised Policy supersedes all the press notes, press releases, clarifications and/or circulars issued by the DPIIT, which were in force as on 15 October 2020.

ii) The Revised Policy is aligned with the Implementation of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (NDI Rules) and Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 by incorporating all necessary changes, including procedural instructions on payment of inward remittance and reporting requirements.

iii) Government scrutiny of investments from India's neighbouring countries - An entity of a country, which shares a land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country– can invest only under the Government approval route. The Revised Policy also included the scenario with respect to transfer of ownership of an Indian entity, directly or indirectly, resulting in the beneficial ownership falling within the restriction/purview stated above. Therefore, any transfer of ownership resulting into transfer of beneficial ownership to entities or citizens of neighbouring countries sharing land borders will require government approval.

iv) Revisions of sectoral caps: Annexure of this unit provides details of various caps and entry route applicable for specific sectors.

Check Your Progress 1

1) State how foreign capital contributes to economic growth?

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2) What do you mean competitiveness of the economy? How does foreign capital help to create healthy competitive environment in the economy?

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3) State the nature of technology gap faced by a developing economy.

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4) State various types of Foreign Capital.

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5) Distinguish between Foreign Direct Investment (FDI) and Foreign Portfolio Investment.

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6) List the top sectors and country of origin responsible for FDI into India.

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7) State three important reforms introduced to attract FDI in India.

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20.4 CAPITAL OUTFLOW- OVERSEAS FOREIGN DIRECT INVESTMENT

Here, we describe outflow of capital as the movement of assets out of a country in terms of Overseas Foreign Direct Investment (OFDI). Reserve

Bank of India (RBI) defines OFDI outside India as investments, either under the Automatic Route or the Approval Route by way of contribution to the capital or subscription to the Memorandum of a foreign entity or by way of purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange. This signifies a long-term interest in the foreign entity [Joint Venture (JV)/ Wholly Owned Subsidiary (WOS)], but it does not include portfolio investment.

As per RBI, "JV / WOS" means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party/Resident Indian makes a direct investment. A foreign entity is termed as JV of the Indian Party/Resident Indian when there are other foreign promoters holding the stake along with the Indian Party. In case of WOS entire capital is held by the one or more Indian Party/Resident Indian.

Overseas Foreign Direct Investment (OFDI) is divided into three categories i.e. equity, loans and guarantee issued.

20.4.1 Drivers of India's OFDI

One of the essential motives of Indian firms' overseas direct investment has been essentially to tap the host country markets, i.e. such investments have been market-seeking. A detailed survey conducted by the Export-Import Bank of India (Exim Bank)[4] identifies number of factors that are responsible for Indian businesses expedition abroad. Some of these include:

i) Regulatory changes in the FDI investment.

ii) Expending of existing market and increasing appetite to take risk by Indian companies.

iii) Value addition through enhanced technical knowhow.

iv) Low factor cost advantages in the host country (as in natural resources).

v) If the interest rate in a foreign country is low as compare to India, there would be greater incentive to borrow abroad and make direct investments abroad.

vi) Depreciation of Indian currency will make it more attractive for Indian companies to invest overseas in another currency.

vii) Saturation of the Indian market lead to the need to enhance their export-competitiveness in third country markets.

viii) To exploit the domestic market potential in other countries.

However, a clear outcome that emerges from the Exim Bank survey is that the overseas investment activities of Indian companies are essentially motivated by a set of firm-specific objectives. It can be just a market entry

[4]Outward Direct Investment from India: Trends, Objectives and Policy Perspectives, Export-Import Bank of India, May 2014.

strategy or market entry plus strategy (e.g. accessing strategic asset)implying a multi-purpose intention of making an overseas investment.

20.4.2 Evolution of OFDI Policy in India

After independence and before the process of liberalisation and globalisation of the economy in 1991-92, India followed a very restrictive and inward looking OFDI policy regime. No cash remittance was allowed and repatriation of dividend from the profits from overseas projects was mandatory. To some extent, policy regime supported promoting OFDI amongst developing countries under the overall objective of enhancing south-south cooperation. During the period of 1960s to 1980s, Indian businesses also preferred inward looking approach which is characterised by seeking protection from foreign direct investment (FDI) and imports. During this period, Indian businesses were highly dependent upon domestic markets and operated with low technological capabilities, inadequate product quality and low productivity.

With the gradual opening of the economy since 1991-92, regulatory regime guiding India's OFDI was witnessed gradual changes over the period of time. Current OFDI policy orientation is now more or less region/country neutral. This has encouraged large number of Indian firms to establish their foothold in international markets, through acquisitions and investments in businesses. Table 20.2 summarises the evolution of Indian policy regime towards OFDI.

Table 20.2: Overview of Evolution of India's OFDI Policy Regime

Policy Phase / Period	**Salient Features of OFDI Policy**
Phase I (1992-94)	• The period of Economic Liberalisation in India • "Guidelines Governing Indian Joint Ventures / Wholly owned Subsidiaries Abroad" was introduced. • 'Automatic Route' for overseas investments by Indian entrepreneurs was introduced in 1992. • Cash remittances were allowed for the first time. However, the total value was restricted to US$ 2 million with a cash component not exceeding US$ 0.5 million in block of 3 years. • Provided more operational freedom to investors, subject to the condition that no additional financial transfers from India was required. • Removed the requirement of only minority equity shareholding in JVs. • Financial sector was excluded from the purview of automatic approvals.

Phase II (1995-1999)	• Aimed at providing a transparent policy framework for Indian investors to plan their business. • Guidelines for Indian Direct Investment in Joint Ventures and Wholly-owned Subsidiaries Abroad was suitably amended to support the overseas investment by the Indian businesses. • Conception of Fast Track Route work relating to approvals for overseas investment was transferred from Ministry of Commerce to the Reserve Bank of India to provide a single window clearance mechanism. • Limits were raised from US$ 2 million to US$ 4 million and linked to average export earnings of the preceding three years. • Above US$ 4 million, approvals were considered under the normal route approved by a Special Committee. • In 1997, limit of automatic approval was increased up to US$15 Million. • Investment proposals in excess of US$ 15 million were considered by the Ministry of Finance with recommendations of the Special Committee and were generally approved if the required resources were raised through the global depository receipts (GDR) route. • The exchange earners, other than exporters, were brought under the fast track route in 1997. • Permitted acquisitions of foreign companies. • The condition that the amount of outward investment should be repatriated in full by way of dividend, royalty, etc. within a period of five years was done away. • Investments in Nepal and Bhutan, in Indian currency, increased up to INR. 120 crores. • In 1999, annual ceiling of OFDI under fast track mode was further increased to US$ 30 Million in SAARC countries and Myanmar. For other countries, the ceiling remained at $15 million. • A series of measures to encourage software industry in India to expand capacity: reduce costs, improve quality, and invest abroad, were introduced.
Phase III (2000 onwards)	• Implementation of the Foreign Exchange Management Act (FEMA) in June 2000. • Liberalisation under FEMA and thereafter scope of outward FDI expanded significantly. • **2002-**Annual limit of investment under automatic approval increased to US$ 100 Million to Indian corporate with a proven track record for investment in overseas joint ventures or wholly owned subsidiaries, even where the investment is not in the same core activity as they are engaged. They were also allowed to invest in such

	ventures up to 100% of their net worth. • **2005:** Automatic route for investment abroad was raised to 200% of net worth. • **2006:**Done away with the requirement that only promoter corporates could issue guarantee on behalf of JV/WOS. Any Indian entity was permitted to issue guarantees. • **2007:** Automatic approval was made up to 300% of net worth in June' 07 and this limit was increased to 400% in September' 07. • **2008:** Permitted Indian private entities in the oil sector to invest in unincorporated entities in oil sector up to 400% of their net worth under the automatic route. • **2013:** Brought down the ceiling of automatic approval to 100% of net worth. However, provisions in the oil sector remain unchanged.

Source: Compiled from Joseph (2019)[5] and Reserve Bank of India

Currently, Overseas Foreign Direct Investment (OFDI) outside India is governed by Foreign Exchange Management (Transfer or Issue of any Foreign Security) (Amendment) Regulations, 2004 ('FEMA Regulations'), as amended from time to time.

Over the last two decades, overseas investment has become one of the key mechanisms of Indian companies to establish their global operations. Indian businesses are more open to the idea that their future growth would be influenced not only through exports but also by establishing physical presence overseas.

Permissible Sources for Funding Overseas Foreign Direct Investment

RBI allow funding for overseas direct investment can be made by one or more of the following sources:

i) Withdrawal of foreign exchange from an AD bank (Authorised dealer Category) in India.

ii) Swap of shares (refers to the acquisition of the shares of an overseas JV / WOS by way of exchange of the shares of the Indian party).

iii) Capitalisation of exports and other dues and entitlements.

iv) Proceeds of External Commercial Borrowings / Foreign Currency Convertible Bonds.

v) In exchange of ADRs / GDRs issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and the guidelines issued by Government of India in the matter.

vi) Balances held in Exchange Earners Foreign Currency account of the Indian Party maintained with an Authorised Dealer.

[5]Joseph, Reji K.: Outward FDI from India: Review of Policy and Emerging Trends.

vii) Proceeds of foreign currency funds raised through ADR / GDR issues.

20.4.3 Trends and Magnitude of OFDI flows from India

In terms of flow of overseas investment, equity and loans would be relevant as a very small proportion of guarantees are invoked which require the flow of money. Table 20.7 (in appendix 20.2) shows that outward foreign direct investment flows rose from US $ 677.7 million in 2000-01 to US$ 12.9 billion in 2019-20.

Cumulative OFDI for the period of 2000-01 to 2019-20 in the form of equity and loans constitute 66.7 per cent and 30.6 per cent share respectively of the total OFDI from India. Only 2.7 per cent of guarantee was actually invoked during this period. Annual OFDI flows exhibited a growing trend till 2007-08.The global financial crisis affected the flow of outward FDI from India in 2009-10. Thereafter, it shows mixed trend. The share of financing OFDI through equities declined from 88.8 per cent in 2000-01 to 48.4 per cent in 2019-20, while share of loans in financing outward OFDI from India rose from 10.4 per cent to 45.9 per cent during the corresponding period.

20.4.4 Sectoral Composition of OFDI flows from India

The sectoral pattern of cumulative outward FDI shows that during past five years from 2015-16 to 2019-20, it has been mainly invested in financial, insurance and business services (34.8 per cent) followed by manufacturing sector (22.1 per cent), wholesale, retail trade, restaurants and hotels (12.5 per cent) and agriculture and mining (12.0 per cent).

20.4.5 Destination-Wise OFDI flows from India

Table 20.9 (in Appendix 20.2) depicts destination-wise distribution of OFDI from India during past five-year period from 2015-16 to 2019-20. Top ten destination countries accounted for 79.6% share of India’s cumulative OFDI during 2015-16 to 2019-20. Singapore (19.2%) has emerged as the top destination of India’s cumulative OFDI during the same period followed by Mauritius (16.3%), United States of America (13.1%), United Kingdom (7.7%) and the Netherlands (7.6%).

The recent trend is showing that outward FDI form India is increasingly flowing to developed countries. This reflects growing confidence of the Indian corporate to expand their global footprints. Indian firms invest in foreign shores primarily through mergers and acquisition (M&A). With rising M&A activity, companies will get direct access to newer and more extensive markets and better technologies, which would enable them to increase their customer base and achieve a global reach.

According to the RBI Annual report 2019-20, outward direct investment by Indian entities also remained robust as Indian entities continued to expand their overseas business operations. Outward FDI was mainly in the form of equity and loans to subsidiaries/ affiliated enterprises, primarily to Singapore, the US, the UK, Mauritius, Switzerland, and the Netherlands, which accounted for 75 per cent of total overseas investments during the period.

Most of these investments were made in the business services, manufacturing and restaurants and hotels sector.

According to the information published by India Brand Equity Foundation (IBEF)[6], some of the facts and figures with respect to major overseas investments by Indian companies during 2019-20 were:

i) In 2019-20, India invested in 120 projects and created 5,429 new jobs in the UK to become the second-largest source of foreign direct investment (FDI).

ii) In 2020, Zerodha announced to introduce an option to invest in US stocks on its platform.

iii) In August 2020, Axis Securities launched new platform to invest in US stocks to meet the increasing interest of the Indian retail investors in the US stock markets.

iv) In February 2020, Bharti Airtel invested US$ 978.92 million in its wholly owned subsidiary in Mauritius.

v) In January 2020, Calleis Infrastructure invested US$ 81.12 million in its wholly owned subsidiary in the UK.

vi) In December 2019, Indian Oil Corporation Limited's (IOCL's) INDMAX refining technology was licensed to Naftna Industrija Srbije (NIS) of Serbia for production of higher value products.

vii) In December 2019, memorandum of understanding (MoU) was signed between National Small Industries Corporation (NSIC) and Aramco Asia for developing the MSME Ecosystem in India in the Oil and Gas sector.

viii) In December 2019, Panacea Biotec bagged orders worth nearly Rs 1.7 billion (US$ 24.32 million) from UN agencies, including UNICEF, for supply of Pentavalent vaccine.

ix) In December 2019, supply chain focused fintech firm, LivFin, raised US$ 5 million of equity capital from German development finance institution DEG.

x) In November 2019, PVR Cinemas, a leading multiplex chain, launched its first property in Sri Lanka, marking its first international venture.

xi) In September 2019, Liquefied Natural Gas (LNG) importer Petronet entered into an agreement with US LNG developer Tellurian Inc. and invested US$ 2.5 billion.

xii) In September 2019, Reliance Power announced joint venture (JV) with Japanese energy major JERA to jointly set up a 750-Megawatt (MW) gas-based combined cycle power project (phase-1) at Meghnaghat in Bangladesh.

[6] https://www.ibef.org/economy/indian-investments-abroad seen on 28th Dec 2020.

xiii) In September 2019, OYO acquired Copenhagen-based data science firm Danamica. This marked the fast-growing lodging start-up to expand its business in Europe.

Check Your Progress 2

1) State the important factors responsible for Capital Outflows.

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2) State the composition and destination of India's Overseas Foreign Direct Investment.

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3) What is the distinction between Joint Ventures (JVs) and Wholly Owned Subsidiary (WOS)?

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4) State the important points of India's OFDI Policy since 2000 onwards.

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20.5 LET US SUM UP

Foreign capital contributes to the economic growth of a developing economy by bridging various gaps i.e. saving gap, foreign exchange gap, technological gap, skilling gap etc. Foreign capital can be public through participation of government agencies and through multilateral organisations (the World Bank, ADB) or private. Again, foreign private capital is of two types — Foreign direct investment and portfolio investment. Foreign capital has grown substantially with opening-up of the economy. However, the total foreign investment has become volatile due to portfolio investment. Several new forms of investment (i.e. setting up of research centres by MNCs securing access of raw materials, etc.) have emerged. Since 1991, Government of India has taken various steps to liberalise the Indian economy. Thereafter, India has been witnessing significant inflows of foreign direct investment from various countries and across the sectors. In recent years, India's global ranking on "Ease of Doing Business" has been significantly improved on account of various measures initiated by Government of India to facilitate foreign investment in India. All these measures have helped India in becoming one of the attractive destinations for FDI.

Overseas investment is one of the foremost steps to enter the global marketplace. The policy regime governing India's outward FDI (OFDI) has undergone significant change since 1991-92. In recent years, India has taken necessary steps to make its presence felt in the global arena. Key motivations of Indian firms for considering OFDI are to maximise gains in ways such as promotion of exports, securing of energy resources, acquisition of technology, strategically securing supply-chain and sourcing of raw materials and intermediary goods. Investment outlook in some of the overseas market looks positive. In recent years, outward FDI are mainly financed through equity and loans. Overseas investment from India have undergone a considerable change, not only in terms of magnitude but also in terms of geographical spread and sectorial composition. Overseas investment by Indian companies is expected to increase, backed by the growing appetite of the Indian corporates to establish their footprints abroad and the liberal regulatory regime, stable market conditions and considerable impact of the investment on local economies.

Various studies have established that for Indian economy, foreign capital, particularly FDI has had a positive impact. FDI inflow has helped supplementing domestic capital, as well as bridging technology and skills gaps of existing companies. It also helped to establish new companies. All of these have contributed to economic growth of the Indian Economy.

20.6 KEY WORDS

Saving Gap : The difference between the required rate of investment and the actual rate of saving available in an economy.

Trade Gap : The difference between the expenditure of foreign exchange and receipts of foreign exchange in transactions of goods and services.

Multinational Corporations : A business organisation which owns or controls income generation assets in more than one country, and in so doing produces goods or services outside its country of origin.

Foreign Direct Investment : More generally refers to the value of the MNC's investment in equity shares of an enterprise in a foreign country.

Portfolio Investment : Refers to equity holdings by a non-resident in the recipient country's joint stock companies.

Overseas Foreign Direct Investment : Refers to the investments made in the overseas entities by way of contribution to their capital or subscription to the Memorandum of Association of a foreign entity or by way of purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange, but it does not include portfolio investment.

20.7 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 20.1
2) See Section 20.1
3) See Section 20.1
4) See Section 20.2
5) See Sub-section 20.3.2
6) See Sub-sections 20.3.2 and 20.3.3
7) See Sub-section 20.3.5

Check Your Progress 2

1) See Sub-section 20.4.1
2) See Sub-sections 20.4.4 and 20.4.5
3) See Section 20.4
4) See Sub-section 20.4.2

APPENDIX 20.1

Consolidated FDI Policy 2020 effective from 15th October 2020[7]

PROHIBITED SECTORS

Inward FDI to India is prohibited in:

a) Lottery Business including Government/private lottery, online lotteries, etc.

b) Gambling and Betting including casinos etc.

c) Chit funds

d) Nidhi company

e) Trading in Transferable Development Rights (TDRs)

f) Real Estate Business or Construction of Farmhouses

g) 'Real estate businesses shall not include development of townships, construction of residential /commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014.

h) Manufacturing of cigars, cheroots, cigarillos, and cigarettes, of tobacco or of tobacco substitutes.

i) Activities/sectors not open to private sector investment e.g.(I) Atomic Energy and (II) Railway operations (other than permitted activities mentioned under the consolidated FDI policy).

Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business, Gambling and Betting activities.

Permitted Sectors

Table: Sector Specific Limits of Foreign Investment in India

Sector	FDI Cap/Equity	Entry Route
AGRICULTURE		
AGRICULTURE & ANIMAL HUSBANDRY		
• Floriculture, Horticulture, and Cultivation of Vegetables & Mushrooms under controlled conditions;	100%	Automatic
• Development and Production of seeds and planting material;		
• Animal Husbandry (including breeding of dogs), Pisciculture, Aquaculture, Apiculture; and		

[7] Department for Promotion of Industry and Internal Trade (FDI Division), Ministry of Commerce & Industry, Government of India.

• Services related to agro and allied sectors		
Note: Besides the above, FDI is not allowed in any other agricultural sector/activity		
PLANTATION SECTOR		
• Tea sector including tea plantations	100%	Automatic
• Coffee plantations		
• Rubber plantations		
• Cardamom plantations		
• Palm oil tree plantations		
• Olive oil tree plantations		
Note: Besides the above, FDI is not allowed in any other plantation sector/activity **Other condition:- Prior approval of the State Government is required in case of any future land use change.**		
MINING AND PETROLEUM & NATURAL GAS		
MINING		
Mining and Exploration of metal and non-metal ores including diamond, gold, silver, and precious ores but excluding titanium bearing minerals and its ores; subject to the Mines and Minerals (Development & Regulation) Act, 1957.	100%	Automatic
Coal & Lignite • Coal and Lignite mining for captive consumption by power projects, iron & steel and cement units and other eligible activities permitted under and subject to the provisions of Coal Mines (Special Provisions) Act, 2015 and the Mines and Minerals (Development and Regulation) Act, 1957. • Setting up coal processing plants like washeries subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing. • For sale of coal, coal mining activities including associated processing infrastructure subject to the provisions of Coal Mines (Special Provisions) Act, 2015 and the Mines and Minerals (Development and Regulation) Act, 1957 as amended from time to time and other relevant Acts on the subject.	100%	Automatic

Mining and mineral separation of titanium bearing minerals and ores, its value addition, and integrated activities. • Mining and mineral separation of titanium bearing minerals & ores, its value addition, and integrated activities subject to sectoral regulations and the Mines and Minerals (Development and Regulation Act, 1957).	100%	Government
Petroleum & Natural Gas		
• Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products, petroleum product pipelines, natural gas/pipelines, LNG Regasification infrastructure, market study and formulation and Petroleum refining in the private sector, subject to the existing sectoral policy and regulatory framework in the oil marketing sector and the policy of the Government on private participation in exploration of oil and the discovered fields of national oil companies.	100%	Automatic
• Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs.	49%	Automatic
MANUFACTURING		
• Subject to the provisions of the FDI policy, foreign investment in 'manufacturing' sector is under automatic route. Manufacturing activities may be either self-manufacturing by the investee entity or contract manufacturing in India through a legally tenable contract, whether on Principal to Principal or Principal to Agent basis. Further, a manufacturer is permitted to sell its products manufactured in India through wholesale and/or retail, including through e-commerce, without Government approval.	100%	Automatic
• Notwithstanding the FDI policy provisions on trading sector, 100% FDI under Government approval route is allowed for retail trading, including through e-commerce, in respect of food products manufactured and/or produced in India.	100%	Government
DEFENCE		

• Defence Industry subject to Industrial license under the Industries (Development and Regulation) Act, 1951 and Manufacturing of small arms and ammunition under the Arms Act, 1959 **Note**: **Other Conditions Applicable as notified by the Govt of India**	100%	Automatic up to 74% Government route beyond 74% wherever it is likely to result in access to modern technology or for other reasons to be recorded.
SERVICES SECTOR		
BROADCASTING		
Broadcasting Carriage Services	100%	Automatic
• Teleports (setting up of up-linking HUBs/ Teleports);		
• Direct to Home (DTH);		
• Cable Networks (Multi-System operators (MSOs) operating at National or State or District level and undertaking upgradation of networks towards digitalisation and addressability);		
• Mobile TV;		
• Headend-in-the Sky Broadcasting Service (HITS)		
Cable Networks • (Other MSOs not undertaking upgradation of networks towards digitalisation and addressability and Local Cable Operators (LCOs))	100%	Automatic
Note: Infusion of fresh foreign investment, beyond 49% in a company not seeking license/permission from sectoral Ministry, resulting in change in the ownership pattern or transfer of stake by existing investor to new foreign investor, will require Government approval.		
BROADCASTING CONTENT SERVICES		
• **Terrestrial Broadcasting FM (FM Radio),** subject to such terms and conditions, as specified from time to time, by Ministry of Information & Broadcasting, for grant of permission for setting up of FM Radio stations.	49%	Government
• **Up-linking of ‘News & Current Affairs’ TV Channels**	49%	Government

• **Uploading/Streaming of News & Current Affairs through Digital Media**	26%	Government
• **Up-linking of Non- 'News & Current Affairs' TV Channels/ Down-linking of TV Channels**	100%	Automatic
PRINT MEDIA		
• Publishing of newspaper and periodicals dealing with news and current affairs	26%	Government
• Publication of Indian editions of foreign magazines dealing with news and current affairs	26%	Government
• Publishing/printing of scientific and technical magazines/specialty journals/ periodicals, subject to compliance with the legal framework as applicable and guidelines issued in this regard from time to time by Ministry of Information and Broadcasting.	100%	Government
• Publication of facsimile edition of foreign newspapers	100%	Government
CIVIL AVIATION		
AIRPORTS		
• Greenfield projects	100%	Automatic
• Existing projects	100%	Automatic
AIR TRANSPORT SERVICES		
(1) (a) Scheduled Air Transport Service*/ Domestic Scheduled Passenger Airline (b) Regional Air Transport Service	100%	Automatic up to 49% (Automatic up to 100% for NRIs) Government route be 49%
(2) Non-Scheduled Air Transport Services	100%	Automatic
(3) Helicopter services/seaplane services requiring DGCA approval	100%	Automatic
OTHER SERVICES UNDER CIVIL AVIATION SECTOR		
(1) Ground Handling Services subject to sectoral regulations and security clearance	100%	Automatic
(2) Maintenance and Repair organisations; flying training institutes; and technical training institutions.	100%	Automatic
CONSTRUCTION DEVELOPMENT: TOWNSHIPS, HOUSING, BUILT-UP INFRASTRUCTURE		

• Construction-development projects (which would include development of townships, construction of residential/commercial premises, roads or bridges, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure, townships)	100%	Automatic
INDUSTRIAL PARKS		
• Industrial Parks- new and existing	100%	100% Automatic
SATELLITES- ESTABLISHMENT AND OPERATION		
• Satellites- establishment and operation, subject to the sectoral guidelines of Department of Space/ISRO	100%	Government
PRIVATE SECURITY AGENCIES		
• Private Security Agencies	74%	Automatic up to 49% Government route beyond 49% and up to 74%
TELECOM SERVICES		
• Telecom Services (including Telecom Infrastructure Providers Category-I) All telecom services including Telecom Infrastructure Providers Category-I, viz. Basic, Cellular, United Access Services, Unified License (Access Services), Unified License, National/International Long Distance, Commercial V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS), All types of ISP licenses, Voice Mail/ Audiotex/UMS, Resale of IPLC, Mobile Number Portability Services, Infrastructure Provider Category-I (providing dark fibre, right of way, duct space, tower) except Other Service Providers	100%	Automatic up to 49% Government route beyond 49%
TRADING		
• Cash & Carry Wholesale Trading/Wholesale Trading (including sourcing from MSEs)	100%	Automatic
E-COMMERCE ACTIVITIES		
• E-commerce activities	100%	Automatic
SINGLE BRAND PRODUCT RETAIL TRADING		
• Single Brand Product Retail Trading	100%	Automatic

MULTI BRAND RETAIL TRADING		
• Multi Brand Retail Trading	51%	Government
DUTY FREE SHOPS		
Duty Free Shops • **Note: Duty Free Shops would mean shops set up in custom bonded area at International Airports/International Seaports and Land Custom Stations where there is transit of international passengers.** • Foreign investment in Duty Free Shops is subject to compliance of conditions stipulated under the Customs Act, 1962 and other laws, rules, and regulations. • Duty Free Shop entity shall not engage into any retail trading activity in the Domestic Tariff Area of the country.	100%	Automatic
RAILWAY INFRASTRUCTURE		
Railway Infrastructure • **Construction, operation and maintenance of the following:** (i) Suburban corridor projects through PPP, (ii) High speed train projects, (iii) Dedicated freight lines, (iv) Rolling stock including train sets, and locomotives/coaches manufacturing and maintenance facilities, (v) Railway Electrification, (vi) Signalling systems, (vii) Freight terminals, (viii) Passenger terminals, (ix) Infrastructure in industrial park pertaining to railway line/sidings including electrified railway lines and connectivity to main railway line and (x) Mass Rapid Transport Systems.	100%	Automatic
Note: i) Foreign Direct Investment in the above mentioned activities open to private sector participation including FDI is subject to sectoral guidelines of Ministry of Railways. ii) Proposals involving FDI beyond 49% in sensitive areas from security point of view, will be brought by the Ministry of Railways before the Cabinet Committee on Security (CCS) for consideration on a case to case basis.		
FINANCIAL SERVICES		
• Foreign investment in other financial services, other than those indicated below, would require prior approval of the Government.		
ASSET RECONSTRUCTION COMPANIES		

• **Asset Reconstruction Company' (ARC)** means a company registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).	100%	Automatic
BANKING- PRIVATE SECTOR		
• Banking- Private Sector	74%	Automatic up to 49% Government route beyond 49% and up to 74%.
BANKING- PUBLIC SECTOR		
• Banking- Public Sector subject to Banking Companies (Acquisition and Transfer of Undertakings) Acts 1970/80. This ceiling (20%) is also applicable to the State Bank of India and its associate Banks.	20%	Government
CREDIT INFORMATION COMPANIES (CIC)		
• Credit Information Companies	100%	Automatic
INFRASTRUCTURE COMPANY IN THE SECURITIES MARKET		
• Infrastructure companies in Securities Markets, namely, stock exchanges, commodity exchanges, depositories and clearing corporations, in compliance with SEBI Regulations	49%	Automatic
INSURANCE		
• Insurance Company	49%	Automatic
• **Intermediaries or Insurance Intermediaries including:** Insurance brokers, re-insurance brokers, insurance consultants, corporate agents, third party administrator, Surveyors and Loss Assessors and such other entities, as may be notified by the Insurance Regulatory and Development Authority of India from time to time.	100%	Automatic
PENSION SECTOR		
• Pension Sector	49%	Automatic
POWER EXCHANGES		
• Power Exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations, 2010.	49%	Automatic
WHITE LABEL ATM OPERATIONS		

• White Label ATM Operations	100%	Automatic
OTHER FINANCIAL SERVICES		
• Financial Services activities regulated by financial sector regulators, viz., RBI, SEBI, IRDA, PFRDA, NHB or any other financial sector regulator as may be notified by the Government of India.	100%	Automatic
PHARMACEUTICALS		
• Greenfield	100%	Automatic
• Brownfield	100%	Automatic up to 74% Government route beyond 74%

APPENDIX 20.2

Table 20.1: Foreign Investment Flows

Amount in US $ Million						
Year	Gross inflows/ Gross Investments to India	Repatriation/ Disinvestment	Direct Investment to India (2-3)	FDI by India (Overseas Investment by India)	Net FDI to India (4-5)	% growth over previous year
1	2	3	4	5	6	
2000-01	4031	0	4031	759	3272	
2001-02	6130	5	6125	1391	4734	44.7%
2002-03	5095	59	5036	1819	3217	-32.0%
2003-04	4322	0	4322	1934	2388	-25.8%
2004-05	6052	65	5987	2274	3713	55.5%
2005-06	8962	61	8901	5867	3034	-18.3%
2006-07	22826	87	22739	15046	7693	153.6%
2007-08	34844	116	34729	18835	15893	106.6%
2008-09	41903	166	41738	19365	22372	40.8%
2009-10	37746	4637	33109	15143	17966	-19.7%
2010-11	36047	7018	29029	17195	11834	-34.1%
2011-12	46552	13599	32952	10892	22061	86.4%
2012-13	34298	7345	26953	7134	19819	-10.2%
2013-14	36047	5284	30763	9199	21564	8.8%
2014-15	45147	9864	35283	4031	31251	44.9%
2015-16	55559	10652	44907	8886	36021	15.3%
2016-17	60220	18005	42215	6603	35612	-1.1%
2017-18	60974	21544	39431	9144	30286	-15.0%
2018-19	62001	18699	43302	12590	30712	1.4%
2019-20	74390	18384	56006	12993	43013	40.1%

Notes:

1. **Data on FDI have been revised since 2000-01 with expanded coverage to approach international best practices.**
2. **Negative (-) sign indicates outflow.**
3. **Direct Investment data for 2006-07 include swap of shares of 310 Crore.**

Source: Reserve Bank of India.

Table 20.2: Net Inflow of Portfolio Investment

(Amount in US $ Million)

Year	GDRs/ADRs	FIIs	Offshore Funds and Others	Portfolio Investment by India	Net Portfolio Investment	% Growth over Previous Year
	1	2	3	4	(1+2+3-4)	
2004-05	613	8,686	16	24	9,291	
2005-06	2,552	9,926	14	0	12,492	34.5%
2006-07	3,776	3,225	2	56	6,947	-44.4%
2007-08	6,645	20,328	298	-163	27,434	294.9%
2008-09	1,162	-15,017	0	177	-14,032	-151.1%
2009-10	3,328	29,048	0	-20	32,396	330.9%
2010-11	2,049	29,422	0	1,179	30,292	-6.5%
2011-12	597	16,813	0	238	17,171	-43.3%
2012-13	187	27,582	0	878	26,891	56.6%
2013-14	20	5,009	0	207	4,822	-82.1%
2014-15	1,271	40,923	0	-11	42,205	775.3%
2015-16	373	-4,016	0	487	-4,130	-109.8%
2016-17	0	7,766	0	154	7,612	284.3%
2017-18	0	22,165	0	50	22,115	190.5%
2018-19	1,820	-2,225	0	213	-618	-102.8%
2019-20	0	552	0	-851	1,403	327.1%

Source: Reserve Bank of India

Table 20.3: Net Inflow of External Assistance to India

(US $ million)

Year	Net Inflow of Foreign Aid	% Growth over Previous Year
2000-01	-537	
2001-02	332	161.8%
2002-03	-3912	-1278.3%
2003-04	-3225	-17.6%

2004-05	952	129.5%
2005-06	1545	62.3%
2006-07	1290	-16.5%
2007-08	1655	28.3%
2008-09	2179	31.7%
2009-10	3129	43.6%
2010-11	4720	50.8%
2011-12	2612	-44.7%
2012-13	910	-65.2%
2013-14	1500	64.8%
2014-15	1261	-15.9%
2015-16	1715	36.0%
2016-17	1734	1.1%
2017-18	2197	26.7%
2018-19	2337	6.4%
2019-20	2475	5.9%
Source: Reserve Bank of India		

Table 20.4: NRI Deposits Outstanding

(Value in US $ million, Growth in %)		
Year (end-March)	**Total**	**% Growth over Previous Year**
2002	25174	
2003	28529	13.3%
2004	33266	16.6%
2005	32975	-0.9%
2006	36282	10.0%
2007	41240	13.7%
2008	43672	5.9%
2009	41554	-4.8%
2010	47890	15.2%
2011	51682	7.9%
2012	58608	13.4%
2013	70822	20.8%
2014	103844	46.6%

2015	115163	10.9%
2016	126929	10.2%
2017	116867	-7.9%
2018	126182	8.0%
2019	130423	3.4%
2020	130581	0.1%
Notes: 1. The figures are outstanding as on last Friday of March.		
2. The figures on NRI deposits are as reported by scheduled commercial banks in India.		
Source: Reserve Bank of India.		

Table 20.5: Foreign Direct Investment Flows in Equity to India: Industry-wise

							(US$ million, Share in %)
	Sector/Industry	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**Cumulative Inflows (Apr 2015 to March 2020)**
S. No.	**Total FDI in Equity (SIA/FIPB & RBI Routes only)**	**36068 (100.0%)**	**36317 (100.0%)**	**37366 (100.0%)**	**38744 (100.0%)**	**42629 (100.0%)**	**191124 (100.0%)**
	Sector-wise Inflows						
1	Manufacturing	8439 (23.4%)	11972 (33.0%)	7066 (18.9%)	7919 (20.4%)	8153 (19.1%)	43549 (22.8%)
2	Services	22565 (62.6%)	22064 (60.8%)	28306 (77.8%)	28255 (72.9%)	31622 (74.2%)	132812 (69.5%)
2.1	Communication Services	2638 (11.7%)	5876 (26.6%)	8809 (31.1%)	5365 (19.0%)	6838 (21.6%)	29526 (22.2%)
2.2	Retail & Wholesale Trade	3998 (17.7%)	2771 (12.6%)	4478 (15.8%)	4311 (15.3%)	4914 (15.5%)	20472 (15.4%)
2.3	Financial Services	3547 (15.7%)	3732 (16.9%)	4070 (14.4%)	6372 (22.6%)	4326 (13.7%)	22047 (16.6%)
2.4	Computer Services	4319 (19.1%)	1937 (8.8%)	3173 (11.2%)	3453 (12.2%)	4104 (13.0%)	16986 (12.8%)
2.5	Business services	3031 (13.4%)	2684 (12.2%)	3005 (10.6%)	2597 (9.2%)	3684 (11.7%)	15001 (11.3%)
2.6	Restaurants and Hotels	889 (3.9%)	430 (1.9%)	452 (1.6%)	749 (2.7%)	2546 (8.1%)	5066 (3.8%)
2.7	Transport	1363 (6.0%)	891 (4.0%)	1267 (4.5%)	1019 (3.6%)	2333 (7.4%)	6873 (5.2%)

2.8	Electricity and other energy Generation, Distribution & Transmission	1364 (6.0%)	1722 (7.8%)	1870 (6.6%)	2427 (8.6%)	1906 (6.0%)	9289 (7.0%)
2.9	Education, Research & Development	394 (1.7%)	205 (0.9%)	347 (1.2%)	736 (2.6%)	528 (1.7%)	2210 (1.7%)
2.10	Miscellaneous Services	1022 (4.5%)	1816 (8.2%)	835 (2.9%)	1226 (4.3%)	443 (1.4%)	5342 (4.0%)
3	Construction	4141 (11.5%)	1564 (4.3%)	1281 (3.4%)	2009 (5.2%)	1937 (4.5%)	10932 (5.7%)
4	Real Estate Activities	112 (0.3%)	105 (0.3%)	405 (1.1%)	213 (0.5%)	564 (1.3%)	1399 (0.7%)
5	Mining	596 (1.7%)	141 (0.4%)	82 (0.2%)	247 (0.6%)	217 (0.5%)	1283 (0.7%)
6	Others	215 (0.6%)	470 (1.3%)	226 (0.6%)	102 (0.3%)	137 (0.3%)	1150 (0.6%)
Figures in parenthesis represent share in percentage Note: Includes FDI in Equity through SIA/FIPB and RBI routes only (excluding acquisition of shares and equity capital of unincorporated bodies)							
Source: Reserve Bank of India							

Table 20.6: Foreign Direct Investment Flows in Equity to India: Country-wise

(Value in US$ million, Share in %)						
Source/Industry	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**Cumulative Inflows (Apr 2015 to March 2020)**
Total FDI in Equity (SIA/FIPB & RBI routes only)	**36,068**	**36,317**	**37,366**	**38,744**	**42,629**	**1,91,124**
Country-wise Inflows						
Singapore	12479 (34.6%)	6529 (18.0%)	9273 (24.8%)	14632 (37.8%)	12612 (29.6%)	55525 (29.1%)
Mauritius	7452 (20.7%)	13383 (36.9%)	13415 (35.9%)	6570 (17.0%)	7498 (17.6%)	48318 (25.3%)
Netherlands	2330 (6.5%)	3234 (8.9%)	2677 (7.2%)	2519 (6.5%)	5295 (12.4%)	16055 (8.4%)

Cayman Islands	440 (1.2%)	49 (0.1%)	1140 (3.1%)	863 (2.2%)	3496 (8.2%)	5988 (3.1%)
U.S.A.	4124 (11.4%)	2138 (5.9%)	1973 (5.3%)	2823 (7.3%)	3401 (8.0%)	14459 (7.6%)
Japan	1818 (5.0%)	4237 (11.7%)	1313 (3.5%)	2745 (7.1%)	2308 (5.4%)	12421 (6.5%)
France	392 (1.1%)	487 (1.3%)	403 (1.1%)	375 (1.0%)	1167 (2.7%)	2824 (1.5%)
United Kingdom	842 (2.3%)	1301 (3.6%)	716 (1.9%)	1211 (3.1%)	1125 (2.6%)	5195 (2.7%)
South Korea	241 (0.7%)	466 (1.3%)	293 (0.8%)	982 (2.5%)	777 (1.8%)	2759 (1.4%)
Hongkong	344 (1.0%)	134 (0.4%)	1044 (2.8%)	598 (1.5%)	678 (1.6%)	2798 (1.5%)
Cyprus	488 (1.4%)	282 (0.8%)	290 (0.8%)	161 (0.4%)	657 (1.5%)	1878 (1.0%)
Germany	927 (2.6%)	845 (2.3%)	1095 (2.9%)	817 (2.1%)	443 (1.0%)	4127 (2.2%)
Belgium	57 (0.2%)	172 (0.5%)	213 (0.6%)	56 (0.1%)	388 (0.9%)	886 (0.5%)
U.A.E.	961 (2.7%)	645 (1.8%)	408 (1.1%)	853 (2.2%)	323 (0.8%)	3190 (1.7%)
Luxembourg	784 (2.2%)	99 (0.3%)	243 (0.7%)	251 (0.6%)	252 (0.6%)	1629 (0.9%)
UK Virgin Islands	203 (0.6%)	212 (0.6%)	21 (0.1%)	290 (0.7%)	250 (0.6%)	976 (0.5%)
China	461 (1.3%)	198 (05%)	350 (0.9%)	229 (0.6%)	162 (0.4%)	1400 (0.7%)
Others	1725 (4.8%)	1905 (5.2%)	2498 (6.7%)	2768 (7.1%)	1796 (4.2%)	10692 (5.6%)

Figures in parenthesis represent share in percentage

Note: Includes FDI in Equity through SIA/FIPB and RBI routes only (excluding acquisition of shares and equity capital of unincorporated bodies)

Source: Reserve Bank of India

Table 20.7: Component-wise Break-up of OFDI

Value in $ Million, Share in %					
Year	**Equity (1)**	**Loan (2)**	**Guarantee Invoked (3)**	**Actual OFDI Outflow (1+2+3)**	**Guarantee Issued**
2000-01	602.1 (88.8%)	70.6 (10.4%)	5.0 (0.7%)	677.7 (100.0%)	112.6

2001-02	878.8 (87.9%)	120.8 (12.1%)	0.4 (0.0%)	1000.0 (100.0%)	155.9
2002-03	1746.3 (94.5%)	102.1 (5.5%)	0 (0.0%)	1848.4 (100.0%)	139.6
2003-04	1250 (79.8%)	316.6 (20.2%)	0.0 (0.0%)	1566.6 (100.0%)	440.5
2004-05	1482 (74.3%)	513.2 (25.7%)	0.0 (0.0%)	1995.2 (100.0%)	316
2005-06	6657.8 (84.7%)	1195.3 (15.2%)	3.3 (0.0%)	7856.4 (100.0%)	546.8
2006-07	12062.9 (90.6%)	1247 (9.4%)	0.0 (0.0%)	13309.9 (100.0%)	2261
2007-08	15431.5 (83.4%)	3075 (16.6%)	0.0 (0.0%)	18506.5 (100.0%)	6553.5
2008-09	10732.3 (76.3%)	3333.2 (23.7%)	0.0 (0.0%)	14065.5 (100.0%)	3104.9
2009-10	6761.7 (65.1%)	3602.8 (34.7%)	24.2 (0.2%)	10388.7 (100.0%)	7600.8
2010-11	9351.8 (55.8%)	7346.9 (43.9%)	52.5 (0.3%)	16751.2 (100.0%)	27230.5
2011-12	6288.4 (43.0%)	8325.2 (57.0%)	0.0 (0.0%)	14613.6 (100.0%)	16249.4
2012-13	5856.2 (57.4%)	4351 (42.6%)	0.0 (0.0%)	10207.2 (100.0%)	16665.2
2013-14	10194.50 (72.9%)	3725.50 (26.6%)	64.90 (0.5%)	13984.90 (100.0%)	22980.5
2014-15	3985.70 (58.0%)	2852.90 (41.5%)	35.70 (0.5%)	6874.30 (100.0%)	24080.9
2015-16	8192.38 (66.3%)	4096.99 (33.1%)	74.19 (0.6%)	12363.56 (100.0%)	22,914.61
2016-17	10480.23 (68.4%)	4509.80 (29.5%)	321.53 (2.1%)	15311.56 (100.0%)	25,226.45
2017-18	10018.61 (60.5%)	3529.43 (21.3%)	3015.49 (18.2%)	16563.53 (100.0%)	20,856.24
2018-19	8092.30 (59.9%)	4221.43 (31.2%)	1195.82 (8.9%)	13509.55 (100.0%)	24,159.00
2019-20	6236.95 (48.4%)	5907.25 (45.9%)	736.07 (5.7%)	12880.27 (100.0%)	22,252.48
Cumulative OFDI from 2000-01 to 2019-20	**136302.47 (66.7%)**	**62443.00 (30.6%)**	**5529.10 (2.7%)**	**204274.57 (100.0%)**	**243846.88**

Figures in parenthesis represent share percentage

Source: Compiled from Khan (2012), Joseph (2009), RBI-ODI and Department of Economic Affairs

Table: 20.8: Sector-wise Composition of OFDI Outflow

					Value in US $ Million, Share in %		
S. No.	**Sectors**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**Cumulative OFDI (2015-16 to 2019-20)**
1	Financial, Insurance and Business Services	4245.69 (34.3%)	4563.03 (29.8%)	6743.56 (40.7%)	5345.48 (39.6%)	3687.43 (28.6%)	**24585.19 (34.8%)**
2	Manufacturing	2457.4 (19.9%)	3721.62 (24.3%)	2993.95 (18.1%)	3015.30 (22.3%)	3430.14 (26.6%)	**15618.41 (22.1%)**
3	Wholesale, Retail Trade, Restaurants and Hotels	1441.09 (11.7%)	2023.37 (13.2%)	1270.78 (7.7%)	1780.40 (13.2%)	2322.85 (18.0%)	**8838.49 (12.5%)**
4	Agriculture and Mining	401.13 (3.2%)	1751.31 (11.4%)	3695.41 (22.3%)	1998.87 (14.8%)	641.58 (5.0%)	**8488.3 (12.0%)**
5	Construction	242.07 (2.0%)	339.28 (2.2%)	445.97 (2.7%)	763.09 (5.6%)	864.73 (6.7%)	**2655.14 (3.8%)**
6	Electricity, Gas and Water	574.37 (4.6%)	618.98 (4.0%)	59.6 (0.4%)	140.45 (1.0%)	797.31 (6.2%)	**2190.71 (3.1%)**
7	Community, Social and Personal Services	575.42 (4.7%)	655.02 (4.3%)	367.46 (2.2%)	309.31 (2.3%)	199.21 (1.5%)	**2106.42 (3.0%)**
8	Transport, Storage and Communication Services	2372.02 (19.2%)	1515.68 (9.9%)	913.44 (5.5%)	113.77 (0.8%)	901.33 (7.0%)	**5816.24 (8.2%)**
9	Miscellaneous	54.37 (0.4%)	123.27 (0.8%)	73.36 (0.4%)	42.88 (0.3%)	35.69 (0.3%)	**329.57 (0.5%)**
	Total	**12363.56 (100.0%)**	**15311.56 (100.0%)**	**16563.53 (100.0%)**	**13509.55 (100.0%)**	**12880.27 (100.0%)**	**70628.47 (100.0%)**
Figures in parenthesis represent percentage							
Source: Compiled from RBI-ODI and Department of Economic Affairs							

Table 20.9: Top Ten OFDI Destination Countries

					Value in US $ Million, Share in %		
S. No.	**Country**	**2015-16**	**2016-17**	**2017-2018**	**2018-19**	**2019-20**	**Cumulative OFDI (2015-16 to 2019-20)**
1	Singapore	1439.21 (11.6%)	2892.72 (18.9%)	2665.53 (16.1%)	2846.06 (21.1%)	3717.03 (28.9%)	13560.55 (19.2%)
2	Mauritius	3362.68 (27.2%)	5091.96 (33.3%)	1440.84 (8.7%)	535.24 (4.0%)	1052.05 (8.2%)	11482.77 (16.3%)
3	United States of America	1648.36 (13.3%)	1892.64 (12.4%)	1256 (7.6%)	2478.02 (18.3%)	1976.33 (15.3%)	9251.35 (13.1%)
4	United Kingdom	642.13 (5.2%)	1378.78 (9.0%)	837.07 (5.1%)	1442.27 (10.7%)	1141.2 (8.9%)	5441.45 (7.7%)
5	Netherlands	1146.46 (9.3%)	743.71 (4.9%)	1143.34 (6.9%)	1105.06 (8.2%)	1232.56 (9.6%)	5371.13 (7.6%)
6	United Arab Emirates	1750.29 (14.2%)	888.01 (5.8%)	644.33 (3.9%)	734.86 (5.4%)	439.54 (3.4%)	4457.03 (6.3%)
7	Switzerland	677.91 (5.5%)	491.71 (3.2%)	484.06 (2.9%)	498.86 (3.7%)	636.46 (4.9%)	2789 (3.9%)
8	Russia	222.64 (1.8%)	311.57 (2.0%)	409.83 (2.5%)	525.06 (3.9%)	590.46 (4.6%)	2059.56 (2.9%)
9	Cayman Island	9.87 (0.1%)	90.18 (0.6%)	591.75 (3.6%)	419.22 (3.1%)	60 (0.5%)	1171.02 (1.7%)
10	British Virgin Islands	128.8 (1.0%)	102.32 (0.7%)	130.79 (0.8%)	85.12 (0.6%)	181.69 (1.4%)	628.72 (0.9%)
	Total OFDI to Top 10 Countries	**11028.35 (89.2%)**	**13883.6 (90.7%)**	**9603.54 (58.0%)**	**10669.77 (79.0%)**	**11027.32 (85.6%)**	**56212.58 (79.6%)**
	Total OFDI (to All Countries)	**12363.56 (100.0%)**	**15311.56 (100.0%)**	**16563.53 (100.0%)**	**13509.55 (100.0%)**	**12880.27 (100.0%)**	**70628.47 (100.0%)**

Source: Compiled from RBI and Department of Economic Affairs