Report of the Committee on Compilation of Foreign Direct Investment in India

PREFACE

According to International Monetary Fund (IMF) definition contained in the Balance of Payments Manual, Fifth Edition (BPM-5), FDI has three components, *viz.*, equity capital, reinvested earnings and other direct capital. A large number of countries, including several developing countries report FDI inflows in accordance with the IMF definition, which include reinvested earnings and other direct capital flows, besides equity capital. The Reserve Bank of India (RBI) reports FDI inflows only on the basis of investments received from non-residents on equity and preference share capital under the FDI scheme. As FDI data released by RBI do not capture reinvested earnings and other capital, these inflows to India do not fully comply with standard international coverage and are, therefore, not comparable with FDI data released by many other countries of the world.

With a view to bringing the present FDI reporting system of RBI in alignment with the international reporting system, Government, in consultation with RBI, had constituted a Committee comprising officials from RBI and the Department of Industrial Policy and Promotion (DIPP), Government of India (GoI) in May 2002 to study the conceptual and methodological issues, including data gaps involved and make necessary recommendations to strengthen the collection, compilation and reporting of FDI data.

The Committee was constituted with the following members:

1. Shri I. Srinivas, Director, Department of Industrial Policy and Promotion (DIPP), Government of India.
2. Dr. R. K. Pattnaik, Director, Division of International Finance, Department of Economic Analysis and Policy (DEAP), RBI.
3. Shri M. R. Rangachari, Deputy General Manager, Exchange Control Department (ECD), RBI.

The terms of reference of the Committee were as follows:

1. Study the international definition of FDI;
2. Analyse current practices prevailing in different countries;
3. Analyse current data compilation and reporting practices in India and identify gaps in collection and compilation of FDI data; and
4. Make appropriate recommendations to put the FDI reporting system in alignment with international reporting practices.

The Committee had several rounds of deliberations on the subject, including consultations with technical experts from RBI. The Committee also referred to available published material on the subject.

The Committee is immensely benefited from the guidance received from Shri V. Govindarajan, Secretary, DIPP, Shri M. S. Srinivasan, Joint Secretary, DIPP, Government of India and Dr. Narendra Jadhav, Officer-in-Charge, Department of Economic Analysis and Policy, RBI. The Committee places on record its acknowledgment for the technical assistance rendered by Shri Brijesh Pazhayathodi and Smt. Atri Mukherjee from the Division of International Finance, DEAP, RBI in its work.

(R. K. Pattnaik) (M. R. Rangachari) (I. Srinivas)

Mumbai
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Introduction

During the nineties, foreign direct investment (FDI) accounted for an increasing share of private capital flows to developing countries. According to the World Investment Report 2002 (WIR02) published by United Nations Conference on Trade and Development (UNCTAD), developing countries received 28 per cent of the world FDI inflows in 2001. Global FDI inflows have, however, declined by 51 per cent in 2001, which also affected the flow to developing countries. Developing countries witnessed a 14 per cent decline in FDI inflows in 2001 to US $ 205 billion from US $ 238 billion in 2000. A few developing countries like China and India, however, registered increased FDI inflows in 2001, which is indicative of their attractiveness for international investment.

2. With the opening up of the Indian economy in the early nineties, FDI inflows have shown a consistent growth, bringing in US $ 4 billion in 2001-02 as compared with US $ 129 million in 1991-92 (*Annex-I*). Several independent surveys have rated India among the favourite destinations for FDI. The WIR02 projects bright prospects for FDI in the Asia-Pacific region over the next three to five years with China topping the list, followed by Indonesia and Thailand. Another survey ranks India, Malaysia and Singapore as favoured destinations. The WIR02, however, ranks India at 119th position in terms of Inward FDI Performance Index, which is the ratio of a country's share in global FDI flows to its share in global GDP. This raises the issue of international comparability of cross-country data on FDI. For example, FDI data released by Reserve Bank of India (RBI) comprises equity and preference share capital only and do not include reinvested earnings and other direct capital flows, which otherwise form part of FDI as

per International Monetary Fund (IMF) classification. As such, these data are not readily available in India. Hence, it has become imperative to strengthen the reporting arrangements in order to facilitate proper international comparisons.

Constitution of the Committee on FDI Computation

3. As per the existing practice, RBI disseminates information on FDI inflows mainly on the basis of issue/transfer of equity/preference shares of Indian companies to foreign direct investors. The present system of FDI data dissemination by RBI is in line with the format, definition and classification of balance of payment (BoP) laid down by IMF in the Balance of Payments Manual 5th Edition (BPM5) in so far as equity capital is concerned. Due to non-availability of contemporaneous data, this figure, however, excludes reinvested earnings and other direct capital flows, which are important components of FDI.

4. In view of the above there is a need to align the reporting system with the international reporting practices so as to facilitate proper international comparisons in respect of FDI flows. Following this, a Committee comprising representatives of Department of Industrial Promotion and Policy (DIPP), Ministry of Commerce, Government of India (GoI) and RBI was constituted by GoI to go into the definitional and methodological issues relating to FDI with a view to aligning the present reporting system in India with the international reporting practices. The constitution and terms of reference of the Committee have been given in the preface to the report.

Structure of the Report

5. The remainder of the Report is organised into five sections. *Section II* discusses the methodological issues involved in the compilation of FDI. *Section III* presents the country practices with regard to reporting FDI data. *Section IV* deals with the present system, the divergences of the Indian practice from the international definition and conceptual issues regarding the present FDI data collection and reporting mechanism in India. The recommendations of the committee are contained in *Section V* of the report. *Section VI* by way of conclusion presents the summary of the Report.

Section II
METHODOLOGICAL ISSUES

Definition of Foreign Direct Investment

6. FDI is the process whereby residents of one country (the home country) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (the host country).

IMF Definition

7. According to the BPM5, foreign direct investment is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one

economy in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise.

UNCTAD Definition

8. The WIR02 defines FDI as 'an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the FDI enterprise, affiliate enterprise or foreign affiliate. FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated. Individuals as well as business entities may undertake FDI.

9. Flows of FDI comprise capital provided (either directly or through other related enterprises) by a foreign direct investor to an FDI enterprise, or capital received from an FDI enterprise by a foreign direct investor. FDI has three components, *viz.*, equity capital, reinvested earnings and intra-company loans.

- Equity capital is the foreign direct investor's purchase of share of an enterprise in a country other than its own.
- Reinvested earnings comprise the direct investors' share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested.
- Intra-company loans or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises.

OECD Benchmark Definition of Foreign Direct Investment (Third Edition)

10. FDI reflects the objective of obtaining a lasting interest by a resident entity in one economy (direct investor) in an entity resident in an economy other than that of the investor (direct investment enterprise). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.

11. As is evident from the above definitions, there is a large degree of commonality between the IMF, UNCTAD and OECD definitions of FDI. Since the IMF definition is followed internationally, the Committee is in favour of following the IMF definition.

Direct investment enterprise
OECD Definition

12. OECD recommends that a direct investment enterprise be defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise. The numerical guideline of ownership of 10 per cent of ordinary shares or voting stock determines the existence of a direct investment relationship. An effective voice in the management, as evidenced by an ownership of at least 10 per cent, implies that the direct investor is able to influence or participate in the management of an enterprise; it does not require absolute control by the foreign investor.

13. Although not recommended by the OECD, some countries may still find it necessary to treat the 10 per cent cut-off point in a flexible manner to fit the circumstances. In some cases, the ownership of 10 per cent of the ordinary shares or voting power may not lead to the exercise of any significant influence while, on the other hand, a direct investor may own less than 10 per cent but still have an effective voice in the management. OECD does not recommend any qualifications to the 10 per cent rule. Consequently, countries that choose not to follow the 10 per cent rule in all cases should identify, wherever possible, the aggregate value of transactions not falling under the 10 per cent cut-off rule, so as to facilitate international comparability. In India, the holding by each foreign institutional investor (FII)/ Securities and Exchange Board of India (SEBI) approved sub-account of FII cannot exceed 10 per cent of the total paid-up equity capital or 10 per cent of the paid-up value of each series of convertible debentures issued by an Indian company and the total holdings of all FIIs/ sub–accounts of FIIs put together cannot exceed 24 per cent of the paid-up equity capital or paid-up value of each series of convertible shares. However, there is a provision to raise the total FII holding to the level prescribed for FDI subject to the Indian company passing a Board Resolution followed by a special resolution to that effect by its General Body.

14. Some countries consider that the existence of elements of a direct investment relationship may be indicated by a combination of factors such as:

- Representation on the board of directors;
- Participation in policy-making processes;
- Material inter-company transactions;
- Interchange of managerial personnel;
- Provision of technical information; and
- Provision of long-term loans at lower than existing market rates.

15. Other relationships may exist between enterprises in different economies, which exhibit the characteristics set out previously, although there is no formal link with regard to shareholding. For example, two enterprises, each operating in different economies, may have a common board and common policymaking and may share resources, including funds, but with neither having a shareholding in the other of 10 per cent or more. In such cases where neither is a direct investment enterprise of the other, the transactions could be treated as between related subsidiaries. These are not regarded as direct investment in India.

Balance of Payments Manual Definition

16. A direct investment enterprise is defined in the IMF Manual as an incorporated or

unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10 per cent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise). Direct investment enterprises comprise those entities that are subsidiaries (a non-resident investor owns more than 50 per cent), associates (an investor owns 50 per cent or less) and branches (wholly or jointly owned unincorporated enterprises) either directly or indirectly owned by the direct investor. Subsidiaries in this connection also may be identified as majority owned affiliates. Although the 10 per cent criterion is specified in the Manual, some countries may choose to allow for two qualifications that involve a degree of subjective judgment.

17. First, if the direct investor owns less than 10 per cent (or none) of the ordinary shares or voting power of the enterprise but has an effective voice in management, the enterprise may be included.

18. Second, if the investor owns 10 per cent or more but does not have an effective voice in management, the enterprise may be excluded. Although the application of these two qualifications is not recommended in BPM5, the manual says that the countries that apply such qualifications should identify the aggregate value of transactions in order to facilitate international comparability.

19. Direct investors may be individuals, incorporated or unincorporated private enterprises; associated groups of individuals or enterprises; governments or government agencies; or estates, trusts, or other organisations that own direct investment enterprises in economies other than those in which the direct investors reside.

20. The components of direct investment capital transactions are recorded on a directional basis (*i.e.*, resident direct investment abroad and non-resident direct investment in the recording economy).

Standard Statistical Requirements (IMF, UNCTAD and OECD)

21. Countries are expected to compile and disseminate FDI data according to the standard components of balance of payments (BoP). These components are (a) direct investment income, (b) direct investment transactions and (c) direct investment position.

22. The direct investment income component is divided into two categories for (i) income on equity and (ii) income on debt.

23. Direct investment transactions are sub-classified into (i) equity, (ii) reinvested earnings (iii) other capital (inter-company transactions) and (iv) financial derivatives.

24. Equity capital is the foreign direct investors’ purchase of shares of an enterprise in a country other than its own. Equity capital comprises equity in branches, all shares in subsidiaries and associates (except non-participating, preferred shares that are treated as debt securities and included under direct investment in other capital category) and other capital contributions.

25. Reinvested earnings comprise the direct investors’ share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested. Because undistributed (reinvested) earnings result in additions to direct investors’ equity in subsidiaries and branches, these earnings are included as direct investment capital transactions in amounts equal to the corresponding entries recorded under direct investment income.

26. Other capital covers the borrowing and lending of funds, including debt securities and suppliers’ credits between direct investors and subsidiaries, branches and associates.

27. Direct investment position data are also divided into four categories such as, (i) equity capital (ii) reinvested earnings (iii) other capital and (iv) financial derivatives.

28. One distinguishing feature of FDI from the viewpoint of direct investors is that direct investment enterprises often represent units in a multinational operation, the overall profitability of which depends on the advantage to be gained by deploying the various resources available to the investors in units located in different economies. Direct investors are thereby in a position to derive benefits in addition to the investment income that may accrue on the capital that they invest (e.g., the opportunity to earn management fees or other sorts on income). Such extra benefits are likely to be derived from the investors’ associations with the enterprises over considerable period of time.

Section III
COUNTRY PRACTICES

Methodology

29. A study of the country practices reveals that almost all countries while compiling the FDI data for BoP purposes follow the IMF Manual (BPM5). According to BPM5, the direct investment data should be presented as follows:

Standard Components of BOP as per BPM5
(Direct Investment)

Components	Credit	Debit	Net
1. Direct Investment Abroad			
1.1. Equity Capital			
1.1.1. Claims on affiliated enterprises			
1.1.2. Liabilities to affiliated enterprises			
1.2. Reinvested Earnings			
1.3. Other Capital			
1.3.1. Claims on affiliated enterprises			
1.3.2. Liabilities to affiliated enterprises			
1.4. Financial Derivatives			
1.4.1. Claims on affiliated enterprises			
1.4.2. Liabilities to affiliated enterprises.			
2. Direct Investment in Reporting Country			
2.1. Equity Capital			
2.1.1. Claims on direct investors			
2.1.2. Liabilities to direct investors			

2.2. Reinvested Earnings
2.3. Other Capital
    2.3.1. Claims on direct investors
    2.3.2. Liabilities to direct investors
2.4. Financial Derivatives
    2.4.1. Claims on direct investors
    2.4.2. Liabilities to direct investors

30. An analysis of the coverage and methodology/ definitions adopted by select countries - developed, developing and least-developed - is presented in *Annex 2A* and *2B.* A brief resume is in order in the following paragraph.

31. It may be observed that in the reporting format of Balance of Payments Year Book 2001 that the Asian countries like China, Hong Kong and Japan have provided the FDI data with the break- up of equity capital, reinvested earnings and other capital as per the BPM5. However Indonesia, Republic of Korea and Thailand have not provided FDI data under the reinvested earning category. On the other hand Pakistan has not provided FDI data under the other capital category. Other than Asian countries, Germany, Mexico, USA, UK, Russia, Australia, France and Switzerland have provided FDI data under all three categories. South Africa, Belgium-Luxemburg, Brazil, Euro area and New Zealand have not provided data under reinvested earning category. Chile has not provided data under other capital category and Canada has not provided data under equity capital category. It may be mentioned in this context that India's current practice does not capture FDI data both under reinvested earning and other capital category. Therefore, the FDI data for India consist only of equity capital. Same is the case with Singapore and Mauritius.

Institutional Practices

32. A review of the institutional practices followed in select countries - developed, developing and least-developed - reveals that in most of the countries the central bank compiles and disseminates the FDI data with few exceptions, where FDI data are compiled and disseminated by governments and other agencies. For example, the central banks compile and disseminate FDI data in countries like China, Germany, India, Indonesia, Mexico, South Africa, Republic of Korea, Thailand, Mauritius, Russia, Belgium-Luxemburg, Brazil, Chile, France, Euro area, Philippines, Pakistan and Switzerland. On the other hand in countries like USA, UK, Singapore, Hong Kong, it is the government which collects and disseminates the FDI data. In Japan, the Ministry of Finance is responsible for the compilation of statistics, but the actual preparation of statistics (including data collection) is entrusted to the central bank.

Source

33. In case of Hong Kong, South Africa, Russia, Belgium-Luxemburg, Chile and USA, data on FDI are obtained from annual sample surveys/ reports filed by the recipient entities. In Indonesia, data on direct investment are derived from semi-annual reports provided by FDI enterprises. In Thailand, FDI data are compiled on the basis of information obtained from International Transactions Reporting System (ITRS), bank reports and non-bank debt surveys.

Section IV
PVESENT INDIAN PRACTICE AND DIVERGENCES

Present Data Reporting Mechanism in India
Status of Data Reporting

34. Following the methodology prescribed in BPM5, data on fresh inflows of foreign direct investment are being captured through reporting of these transactions by the companies who receive these funds. Under the general reporting system, Authorised Dealers (ADs) have to report the inflows and outflows of foreign investment through R-returns. The companies who receive the foreign direct investment are required to report these receipts with full details (i.e., name of the investor and investee company, country from where investment is received, amount, and currency, etc.) to the regional office of the Exchange Control Department (ECD). The reporting of data by the companies is done in two stages. In the first stage when a company brings in the funds through automatic route, it has to report to the ECD the receipt of the funds within 30 days. In the second stage, the company has to file FC-GPR after issuing of shares.

35. RBI publishes foreign investment data on a monthly basis in the RBI Bulletin, which provides component-wise details of direct investment and portfolio investment. Direct investment comprises of inflows through (i) Government (SIA/FIPB) route, (ii) RBI automatic route, (iii) NRI, and (iv) acquisition of shares. Portfolio investment covers: (i) GDRs / ADRs (ii) FIIs, and (iii) offshore funds and others.

36. The cash component of direct investment, as indicated above, is published on a monthly basis in the RBI Bulletin, while the cash and non-cash components (provision of capital goods) of direct investment are included in the direct investment data in table for ‘India’s Overall Balance of Payments’ every quarter in the RBI Bulletin. The data on reinvested earnings are available with a lag since such data are collected from annual surveys on FDI companies. The latest available survey on ‘Finances of Foreign Direct Investment Companies’ relating to 1999-2000 was published in May 2001 issue of RBI Bulletin. In view of the lag in availability of reinvested earnings data, the direct investment transactions data disseminated in the BoP statistics for the first time do not include reinvested earnings. The inclusion of reinvested earnings also necessitates adjustment in other items of BoP in addition to changes in the inflow of FDI. The data on ‘other capital’ are not separately compiled since such transactions are not reported.

37. In India, the BoP statistics including that of FDI are compiled on a quarterly basis by the RBI, using an international transactions reporting system (ITRS) as the principal source of information. Data on foreign direct investment obtained under various routes (i.e. RBI, SIA/ FIPB, NRI/OCB, and mergers and acquisitions) are captured from investee companies who receive these funds. The companies who receive the FDI report send these receipts with full details to the concerned regional office of the ECD. Based on the consolidated reports sent by the Regional offices, the Central office of RBI compiles the data on FDI. The data reported by the companies to the RBI are used as a benchmark for final compilation and monitoring of these data.

Divergence from the International Practices

38. The reporting format as prescribed by BPM5 and the present practice in India are set out in the table given below: -

	BPM5 Requirements	Present Practice
1	**Equity Capital**	
	Claims on direct investors	Included
	Liabilities to direct investors	Included
2	**Reinvested Earnings**	
	Claims on direct investors	Not Included
	Liabilities to direct investors	Not Included
3	**Other Capital**	
	Claims on direct investors	Not Included
	Liabilities to direct investors	Not Included

Reinvested earnings and other capital

39. As alluded to earlier, according to the international definition (i.e. BPM5 and OECD definition), reinvested earning is a part of FDI. But as per the present practice in India, reinvested earnings are not captured in its FDI data. Furthermore, according to the international definition, there is a category of other capital, which covers the borrowing and lending of funds-including debt securities and suppliers credits between direct investors and subsidiaries, branches and associates.

Swap

40. The investment made by foreign investor/ entity on swap basis is also not captured by the present system

Venture capital

41. FDI investment by international bodies in Indian companies as venture capital funds is not captured, as it placed under Schedule 6 of Foreign Exchange Management Act (FEMA) Regulations 20/2000 dated May 3, 2000, which is not covered by the FC-GPR reporting system.

External Commercial Borrowing (ECB): Inter-Company Debt Transactions

42. As of now, the data regarding inter-company debt transactions are included under ECB. Conceptually, this component should be captured under other capital in FDI.

Conceptual Issues

Inclusion of ADR/GDR under FDI

43. According to BPM5, foreign portfolio investment includes, in addition to equity securities and debt securities in the form of bonds and notes, money market instruments and financial derivatives such as options. Equity securities cover all instruments and records acknowledging,

after the claims of all creditors have been met, claims to the residual values of incorporated enterprises. Shares, stocks, participation, or similar documents – such as ADRs – usually denote ownership of equity.

44. Following the above definition, notwithstanding the treatment of ADR/GDR as FDI under FEMA, RBI publishes ADRs/GDRs as portfolio investment. DIPP, however, treats this as FDI.

Balance of Payments Effect

45. At a conceptual level, it is important to recognise that the flow of FDI in terms of reinvested earnings has neutral effect on overall BOP position. The amount recorded under reinvested earnings included in the capital account has a contra entry under the investment income in the current account. It means that depending on inflow/outflow in the capital account there will be an offsetting entry in the current account. For example, if the reinvested earnings recorded an inflow under capital account, it will be an outflow under the current account and vice versa.

Grants

46. At present the grants given by the parent company to the subsidiaries in India do not get reported under FC-GPR. However, this should form part of FDI, as it is a financial assistance from the parent company to its Indian subsidiary without any repayment obligation.

Investments in Unincorporated entity

47. It may be noted that more and more unincorporated entities are getting registered. In unincorporated entities like branches, project offices, liaison offices, etc., substantial foreign interest is involved. But the data on this category are not captured in the present FDI data.

Foreign Currency Convertible Bonds

48. In India as per the present practice, foreign currency convertible bonds are included in FDI only when it is converted into equity. Otherwise an FCCB is treated as ECB.

Control premium, non-competition fee

49. The reporting format for FDI prescribed under FEMA 1999 by RBI does not capture control premium / non-competition fee, etc. paid by the foreigner and as a result the FDI data is underestimated to that extent.

Section V
RECOMMENDATIONS

50. Recording comprehensive, comparable and up to date statistics on FDI is a crucial prerequisite for economic analysis and policy making. The objective of the Committee is not only to suggest detailed operational and conceptual definition of FDI, but also to determine what should be the ideal coverage of the data. Against the backdrop of the analysis presented in the

preceding sections, the recommendations of the Committee are set out below.

Coverage

Reinvested earnings

51. It may be mentioned that RBI has started capturing data on reinvested earnings through surveys. However, it may be noted that there are some basic constraints to base the FDI compilation on reinvested earnings data derived through the existing survey method. Some of the major limitations in doing so are as follows:

- The responses from the companies are very poor.
- The survey does not give any weightage to the companies according to their share in the total reinvested earnings.
- The composition of companies in the survey differs from year to year. This creates a problem of composition for example, if the companies reported in one year do not report in the next year, the reinvested earnings data obtained on the basis of survey will not be comparable.

52. In view of the above, the committee recommends a mandatory reporting system for all the companies for which the following alternatives could be considered:

a. Through the modification of FEMA for making it mandatory for the companies to report these data. OR
b. The Committee understands that DIPP is contemplating a system of mandatory registration for all FDI companies. DIPP may include such reporting requirement under the IDR Act of 1956 for making it mandatory for the companies to report these data.
c. With a view to improving the response from the FDI companies in the immediate time frame, DIPP may issue a press note calling upon the companies to co- operate with the questionnaire sent by the RBI.

Other Capital

53. Since the component other capital of the FDI cover the borrowing and lending of funds, including debt securities and suppliers credit between direct investors and subsidiaries, branches and associates; short term and long term commercial loans incurred by a resident company where the foreign lender has a stake of 10 per cent or more; and the debt incurred by resident subsidiaries, branches and associates of the FDI investor from the parent foreign direct investment enterprise abroad, the same may be treated as other capital under FDI. Efforts by RBI may be undertaken to initiate a comprehensive reporting mechanism for the same.

Swap

54. The approvals for foreign investment granted by RBI on a Swap basis may be used to capture the value of the FDI in Indian enterprises and included in the FDI data.

Venture Capital

55. Foreign investment in Indian venture capital is presently not being captured in the FDI data, as the reporting of the same is not in place. *Schedule 6 of FEMA* may be brought under *schedule 1* so that data on venture capital would automatically be captured under the present reporting system.

Investments in Unincorporated Entity

56. RBI may devise a suitable reporting mechanism to capture these data either through the entities themselves or through authorised dealers.

Grant, Control Premium, Non-Competition Fee, etc.

57. The format for reporting the FDI data *viz.*, FC-GPR prescribed under FEMA, may be amended to capture these data.

Treatment of ADRs / GDRs

58. The Committee examined both arguments in favour and against the inclusion of ADRs and GDRs in FDI data. It was noted that ADRs/GDRs were in some ways distinct from portfolio investment because they do not attract 10 per cent ceiling and also permit automatic acquisition of shares on retirement of GDRs/ ADRs. However, taking into account the principles of long-term relationship and management interest, the Committee is of the view that the present practice of treating ADRs/ GDRs as portfolio investment may continue. The Committee is also of the view that the present conflict between FEMA categorisation of ADRs/ GDRs as FDI and IMF definition may be removed by deleting ADRs/GDRs from Schedule I to FEMA Regulations and placing it under a separate schedule.

Section VI
Conclusion

59. In the view of the Committee, the present system of capturing FDI data by the RBI may be supplemented by the implementation of the recommendations mentioned in the previous section. The recommendations are summarised as given in the table below.

	Divergence from the international definition	**Present Practice**	**Recommendations**
1	Reinvested earnings and other capital	Not included	Should be captured through survey by RBI by making the reporting system mandatory for the companies through modification of FEMA or IDR Act.
2	Swap	Not included	Should be captured on the basis of existing valuation approval by RBI.
3	Venture capital	Not included	Schedule 6 of FEMA may be brought under schedule 1.
4	External Commercial Borrowing (ECB) between related entities	Shown under external commercial	RBI should devise a suitable reporting mechanism.

		borrowings	
5	Investment in unincorporated entities	Not included	RBI should device a suitable reporting mechanism.
6	Control premium, non-competition fee, etc.	Not included	FC-GPR form may be modified suitably to incorporate this information.

Proposed Modifications in Data Capturing/ Monitoring

Comprehensive Reporting Format

60. The Committee at a technical level understands that the present reporting system in respect of FDI does not comprehensively and sufficiently capture the requirements of international standards regarding compilation of FDI. Furthermore, the present enterprise survey of assets and liabilities does not meet adequately the BPM5 requirements. In view of this, the Committee recommends that the present survey formats and reporting system need to be modified. In the Committee's view, a suitable survey model may be developed in line with the quarterly survey method adopted in Hong Kong and Australia (Australian Bureau of Statistics).

61. The Committee understands that there is a trade-off between comprehensive reporting as indicated in BPM5 and the burdens associated with such reporting. This involves delicate balancing of trade-off so that efficient monitoring is achieved. In view of this, the group recommends that reporting system besides having "most timely" data should also have "most comprehensive" statistics. For this purpose, the group recommends that a technical group involving officials from DEAP, ECD and DESACS from RBI may finalise the format and other technical details of the survey.

Legal Framework

62. As alluded to earlier, at present FDI data are generated through specific reporting by FDI companies, which does not meet the statistical requirements of BPM5. Thus, there is an urgent need to strengthen the reporting arrangements from the FDI companies so as to collect the additional inputs. The Committee recommends that for timely and comprehensive reporting, there should be adequate legal framework for collection of data.

63. At the conceptual level, there are a number of broad principles, which need to be considered in the compilation of FDI statistics. The first and foremost is the adoption of clear concepts and definitions; capital flows like FDI should be clearly defined so as to facilitate external account recording. It is important that the concepts, definitions and classifications used are internally consistent and support comparability of these statistics with other compilers. Secondly, the compilation of FDI statistics has to be based on internationally accepted BPM5. Moreover, BPM5 has to be consistent and integrated with other accounts, *viz.*, national accounts, monetary and fiscal accounts, for which internationally acceptable methodological standards are available. The advantage of these systems is that these data are consistent with the 1993 System of National Accounts (SNA). Thirdly, the compilation of these statistics has to be in accordance with international special data dissemination standards (SDDS) and International Investment Position (IIP). The IIP is the balance sheet of the stock of a country's financial asset and liabilities, which is also based on BPM5. The compilation of international investment data as part of the broader

set of accounts allows for checks on coherence and consistency.

ANNEX

Annex 1:

Recent FDI Trends in India

Fiscal 2001-02 witnessed FDI inflows of US $ 4.06 billion (net of ADRs/ GDRs). Compared with US $ 2.46 billion received in 2000-01, this represents 66 per cent growth. The upward trend has been sustained during the first quarter of fiscal 2002-03 with FDI inflows of US $ 1.35 billion (net of ADRs/ GDRs) as against US $ 0.63 billion (net of ADRs/ GDRs) in the corresponding period of fiscal 2001-02, representing 106 per cent growth. It is pertinent to note that this growth has been achieved at a time when global FDI inflows have been experiencing a steep decline of 51 per cent (during 2001).

The cumulative FDI inflows from January 1991 to June 2002 are around US$ 25.02 billion net of ADRs/GDRs. The realisation rate against FDI approvals has risen from 17 per cent in 1992 to 72 per cent in 2001. The sectors that account for maximum FDI are fuel (power, oil refineries, gas); telecom; electronic goods, IT and software; automobiles; and services. The major investing countries are Mauritius (mainly routed from developed countries), USA, Japan, UK, Germany, the Netherlands and South Korea. The states that account for maximum FDI are Maharashtra, Delhi, Tamil Nadu, Karnataka and Gujarat.

During the first half of 2002, the FDI inflows went mainly into transportation industry, services, telecom and electronics/IT/software.

Some of the factors that explain the recent spurt in FDI inflows into India are:

- Progressive liberalisation of FDI policy has strengthened investors' confidence –opening up of new sectors (integrated townships, defence industry, tea plantations, etc.); removal of FDI caps in most sectors, including advertising, airports, private sector oil refining, drugs and pharmaceuticals, etc.; and greater degree of automaticity for investment.
- Liberalisation of foreign exchange regulations by way of simplification of procedures for making inward and outward remittances.
- Sectoral reforms**,** especially in sectors such as telecom, information technology and automobiles have made them attractive destination for FDI.
- Policy to allow foreign companies to set up wholly owned subsidiaries in India has enabled foreign companies to convert their joint ventures into wholly owned subsidiaries. The percentage of FDI through merger and acquisition route has increased to around 30 per cent (from around 10 per cent in 1999), which is still much lower than the global percentage of 70-80 per cent.
- Public sector disinvestment has finally emerged as an important means to promote FDI.
- Liberal policy towards Foreign Venture Capital Investment (FVCI) has given an impetus to investments in technology and infrastructure projects.
- Various investment facilitation measures taken by DIPP such as facility for electronic filing of applications, online chat facility with the applicants, online status on registration/ disposal of applications, dedicated e-mail facility for investment related queries, etc., have also

contributed substantially to improving investors' confidence. On an average, about 2,000 responses in a year are given to investors and potential investors.

- Government has set up an inter-ministerial Committee to examine the extant procedures for investment approvals and implementation of projects, and suggest measures to simplify and expedite the process for both public and private investment. The Committee, which was set up in September 2001, has submitted Part I of its report to the Government, which is under examination. A sub-Group of the Committee is specifically looking into simplification of procedures relating to private investment. The sub-Group will submit its report shortly.
- The Foreign Investment Implementation Authority (FIIA) has been activated and now meets at regular intervals to review and resolve investment-related problems. A recent study conducted by FICCI, FIIA acknowledges that it has emerged as a problem-solving platform.

Annex 2A

Table 1 : FDI Coverage and Methodology for Select Countries

Sr. No.	Country	Items/Components	FDI during 2000 (US $ Million)	Percentage to Total
1	Australia	Equity Capital	4019	34.9
		Re-Invested Earnings	3910	33.9
		Other Capital	3599	31.2
		Total	11528	100
2	Belgium-	Equity Capital	40627	47.0
		Luxembourg		
		Re-Invested Earnings	0	0.0
		Other Capital	45871	53.0
		Total	86498	100
3	Brazil	Equity Capital	30016	91.6
		Re-Invested Earnings	0	0.0
		Other Capital	2763	8.4
		Total	32779	100
4	Canada	Equity Capital	0	0
		Re-Invested Earnings	7994	12.8
		Other Capital	54222	87.2
		Total	62216	100
5	Chile	Equity Capital	2904	79.0
		Re-Invested Earnings	771	21.0
		Other Capital	0	0
		Total	3675	100
6	China Mainland	Equity Capital	20841	54.3
		Re-Invested Earnings	16022	41.7
		Other Capital	1536	4.0
		Total	38399	100
7	China	Equity Capital	35479	55.1
	Hong Kong	Re-Invested Earnings	20275	31.5
		Other Capital	8679	13.5
		Total	64433	100
8	Euro Area	Equity Capital		
		Re-Invested Earnings		
		Other Capital		
		Total	304570	100
9	France	Equity Capital	26650	61.7
		Re-Invested Earnings	3220	7.5

		Other Capital	13300	30.8
		Total	43170	100
10	Germany	Equity Capital	111280	58.8
		Re-Invested Earnings	-4150	-2.2
		Other Capital	82050	43.4
		Total	189180	100
11	India	Equity Capital	2315	100
		Re-Invested Earnings		
		Other Capital		
		Total	2315	100
12	Indonesia	Equity Capital	892	
		Re-Invested Earnings	0	
		Other Capital	-5442	
		Total	-4550	
13	Japan	Equity Capital	7590	92.2
		Re-Invested Earnings	-100	-1.2
		Other Capital	740	9.0
		Total	8230	100.0
14	Republic of Korea	Equity Capital	7735	88.6
		Re-Invested Earnings	0	0.0
		Other Capital	997	11.4
		Total	8732	100
15	Mauritius	Equity Capital	265.6	
16	Mexico	Equity Capital	4781	36.0
		Re-Invested Earnings	3622	27.3
		Other Capital	4884	36.8
		Total	13287	100.0
17	New Zealand	Equity Capital		
		Re-Invested Earnings		
		Other Capital		
		Total	3209	
18	Pakistan	Equity Capital	209	67.9
		Re-Invested Earnings	99	32.1
		Other Capital	0	0.0
		Total	308	100.0
19	Philippines	Equity Capital	1024	50.5
		Re-Invested Earnings	579	28.5
		Other Capital	426	21.0
		Total	2029	100
20	Russia	Equity Capital	948	34.9
		Re-Invested Earnings	95	3.5
		Other Capital	1672	61.6
		Total	2715	100
21	South Africa	Equity Capital	913	95.0
		Re-Invested Earnings	0	0.0
		Other Capital	48	5.0
		Total	961	100
22	Singapore	Equity Capital	6390	100
		Re-Invested Earnings		
		Other Capital		
		Total	6390	100
23	Switzerland	Equity Capital	11238	62.8
		Re-Invested Earnings	5022	28.1
		Other Capital	1642	9.2
		Total	17902	100
24	Thailand	Equity Capital	3402	101.1

		Re-Invested Earnings	0	0.0
		Other Capital	-36	-1.1
		Total	3366	100
25	United Kingdom	Equity Capital	95730	73.7
		Re-Invested Earnings	26080	20.1
		Other Capital	8030	6.2
		Total	129840	100
26	U.S.A.	Equity Capital	216760	75.3
		Re-Invested Earnings	23660	8.2
		Other Capital	47260	16.4
		Total	287680	100

Source: Balance of Payments Statistics Year Book 2001.

Table 2 : FDI Coverage and Methodology for select countries

Sr. No.	Country	Institution Compiling BoP	Method/ Reporting System	Source/Coverage
1	Australia	The Australian Bureau of Statistics (ABS) compiles and disseminates Australia's BoP.	BPM 5	Data are reported by resident direct investors and direct invest enterprises.
2	Belgium-Luxembourg	The National Bank of Belgium (NBB) is responsible for compiling and publishing the BoP of Belgium- Luxembourg Economic Union (BLEU) and Belgium.	BPM 5	Trade credits and debt securities between affiliated enterprises are registered but are not included in direct investment. Re-invested earnings are not registered. Basic data on DI are verified with other sources and compared with DI survey. Data for direct investment transactions are obtained from yearly DI survey, information published by the enterprises according to legal provisions and from the Supervisory Institution for Financial Markets.
3	Brazil	The Central Bank of Brazil (CBB) is responsible for compiling FDI data.	Differs from the version recommended by the BPM5.	Primary source of the data is exchange records. The classification of the exchange record permits separating funds received directly by enterprises for capital participation from inflows of funds for purchases of equity securities. Investment in goods as reported in export and import statistics is also taken into account for conversions of loans into equity and reinvestments of profits.
4	Canada	The BoP Division of Statistics Canada is responsible for the compilation of Canada's BoP.	BPM 5	Reinvested earnings are obtained from the quarterly survey of the Industrial Organisation and Finance Division of Statistics Canada.
5	Chile	Central Bank of Chile (CBC)	In some cases BPM 5 is not adopted. Does not always comply with the recommendations of BPM 5	Annual and quarterly data on reinvested earnings are derived from special surveys or financial statements of direct investors and direct investment companies. DI data are based on data provided by the Foreign Exchange Transactions System and by the Foreign Investment Committee and on estimates of reinvested earnings.
6	China Mainland	The State Administration of Foreign Exchange (SAFE) of the People's Bank of China (from1996). Prior to 1996, data collected from Govt. Agencies, Banks and Safe's internal records.	BPM-5 on the basis of International Transactions Reporting System (ITRS)	Transaction records are supplemented with new surveys.
7	China Hong	The Census and Statistics Dept.	BPM5	Data on FDI obtained from" Survey of External Claims, Liabilities and

	Kong	(C&SD) of the Hong Kong Special Administrative Region (HKSAR).		Income” (SECLI).
8	Euro Area	The ECB publishes Balance of Payment statistics for Euro Area.	Follows third edition of the OECD Benchmark Definition of FDI. The 10% ownership criterion is used for defining the EURO area data on direct investment	
9	France	The Banque de France (BdF) is responsible for compiling the statistics on France’s BoP.	BPM 5	Data on FDI comes from two sources, the direct reporting enterprises and the banks.
10	Germany	The Central Bank (Deutsche Bundes bank).	BPM5	Annual Survey on Foreign Assets and Liabilities of Direct Investors and Direct Investment Enterprises
11	India	The Reserve Bank of India is responsible for compiling the FDI data.	BPM 5	Data obtained from exchange control records. Data on non-cash inflows and retained earnings are taken from Survey of Foreign Assets and Liabilities.
12	Indonesia	Bank Indonesia (BI).	Presently BPM4 and will be adjusted to BPM5 gradually.	Data on DI derived from semi-annual reports provided by FDI enterprises.
13	Japan	Ministry of Finance (MOF) is responsible for the compilation of statistics, but the actual preparation of statistics (including data collection) is entrusted to the Bank of Japan. (Supplementary surveys)	Broadly BPM5	Japan’s BoP includes all investments by non-residents in unlisted resident companies’ stocks in FDI. (As per BPM5 this goes to Portfolio).
14	Republic of Korea	The Bank of Korea (BOK) is responsible for the compilation of the FDI data.	BPM 5	Direct Investment depends on the administrative records of the Government.
15	Mauritius	The Bank of Mauritius is responsible for compilation of FDI data.		Returns of commercial banks.

16	Mexico	Bank of Mexico is responsible for the compilation of BoP.	In transition between BPM4 and BPM 5	Data for DI is obtained from the financial statements that the direct investment enterprises are obliged to submit to Ministry of Trade and Industrial Development.
17	New Zealand	Statistics New Zealand (SNZ) compiles New Zealand's BoP.	BPM 5.	The DI threshold applied is 10 per cent or more of the equity ownership in an enterprise at the individual investor level. The types of DI investment included are changes in equity capital, unremitted earnings and changes in long and short-term capital.
18	Pakistan	Records of the foreign exchange dept. of State Bank.	BPM 4. Preparation under way to adopt BPM 5.	Confined to transactions routed through ADs.
19	Philippines	The Department of Economic Research (DER) of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas-BSP) compiles the BoP.	BPM 5. However full compliance yet to be achieved.	Data for DI obtained from ITRS.
20	Russia	Compiled by Bank of Russia (BR)	BPM 5	Based on Non-Financial enterprises surveys conducted by SSC. A supplemental source of information is the data on privatization provided by the Federal Fund of Property and Customs.
21	South Africa	The South African Reserve Bank is responsible for compiling the BoP.	BPM 5	Main sources of data on inward and outward DI are the quarterly and annual sample surveys.
22	Singapore	Singapore Dept. of statistics (DOS) is responsible for the compilation of the balance of payments.	BPM5	Includes Equity holdings of foreign investors in their subsidiaries and branches. Also included are net purchase of properties by foreigners and a contra-entry to Re-invested earnings by foreign investors. Data are obtained from the survey of foreign equity investments in Singapore and the survey of property transactions.
23	Switzerland	The Swiss National Bank collects data and compiles BoP.		Data on DI in Switzerland cover DI by foreign enterprises in enterprises in Switzerland. The data relate to equity capital, re-invested earnings and inflows and outflows of credit. Data sources are the quarterly and annual surveys carried out by the Swiss National Banks.
24	Thailand	The Bank of Thailand (BOT) compiles the data.	BPM 5	DI compiled from data obtained from ITRS, bank reports, and a non-bank debt survey. Currently, DI does not include reinvested earnings or transactions in

				debt securities and suppliers' credits between direct investors and subsidiaries, branches.
25	United Kingdom	Office for National Statistics (ONS) and Bank of England.	BPM 5	DI includes investors' share of unremitted profits of the subsidiary or associated company. FDI is derived from annual and quarterly inquiries carried out by the ONS and the Bank of England.
26	U.S.A.	The Bureau of Economic Analysis (BEA), Dept of Commerce is responsible for compilation of US BoP.	BPM 5	BEA Conducts a number of mandatory surveys for capital flows on data relating to direct investment. Comprehensive benchmark surveys are conducted periodically.

Source: Balance of Payments Statistics Year Book 2001.

Annex 2B

TABLE 3 : Definitions Used for Identifying Direct Investment Enterprises Resident in the Reporting Economy

(by number of countries)

Region	Countries those apply the 10 percent equity threshold	Countries those use a percent of ownership different from the 10 percent threshold	Countries those apply the 10 percent threshold but allow for a qualification to the threshold:		Countries those apply a value threshold when identifying FDI enterprises	Countries those apply a different treatment for incorporated and unincorporated enterprises
			Countries those Include enterprises in which the investor has a voice in the management but owns less than 10 percent of ordinary shares or voting power	Countries those exclude enterprises in which the investor has no voice in the management but owns more than 10 percent of ordinary shares or voting power		
OECD (29)	24	6	7	2	4	3
Africa (15)	11	2	2	0	—	—
Asia (13)	2 — 10	0	1	—	E	r
pe (16) 14		—	3	1	M	d
le East (2) 2 —	—	—	1	—	W	s
ern Hemisphere (21) 16		1	1	1	**T**	**t**
l (96) 77	**3**	**4**			N	t

- India also adopts the 10 percent rule (Individual FII limit is 10 per cent and classified as portfolio investment).Figures in brackets represent total numbers of countries in the region. Source: Report on the Survey of Implementation of Methodological standards for Direct Investment, IMF (March 2000).

TABLE 4 : The Components of FDI Other Capital Transactions included in the Statistics

(by number of countries)

Region	Countries those include in their FDI other capital transactions:				
	Long-term loans	Short-term loans	Financial leasing	Trade credits	Bonds and money market instruments
OECD (29)	25	23	13	17	14
Africa (15)	8	8	4	7	4
Asia (13)	10	10	4	7	3
Europe (16)	14	12	6	10	4
Middle East (2)	—	—	—	—	—
Western Hemisphere (21)	13	10	3	12	1
Total (96)	**70**	**63**	**30**	**53**	**26**

Note : India does not include long-term/short-term loans, leasing, trade credits and bonds and money market instruments in its FDI data whereas majority of the countries treat long-term/short-term loans and trade credits as FDI. Therefore, India's FDI reporting is an underestimation to that extent.
Figures in brackets represent total numbers of countries in the region.
Source : Report on the Survey of Implementation of Methodological standards for Direct Investment, IMF (March 2000).

TABLE 5 : Components of FDI Equity Capital Transactions included in the Statistics

(by number of countries)

Region	Countries those include in their FDI equity capital transactions		
	Transactions in voting and non-voting stocks	Reinvested earnings	Non-cash acquisition of equity
OECD (29)	28	23	19
Africa (15)	6	6	7
Asia (13)	7	9	7
Europe (16)	11	9	13
Middle East (2)	2	2	2
Western Hemisphere (21)	10	18	18
Total (96)	**64**	**67**	**66**

Note - India does not include reinvested earnings and non-cash equity transactions in its FDI reporting.
Figures in brackets represent total numbers of countries in the region.
Source: Report on the Survey of Implementation of Methodological standards for Direct Investment, IMF (March 2000)

TABLE 6 : Countries that included Indirectly Owned FDI Enterprises in FDI Statistics

(by number of countries)

Region	Countries those include earnings data of indirectly held FDI enterprises	Countries those equity and other group transactions within a group of related entities as FDI without consideration of the percentage of equity held by these enterprises in each other	Countries those apply the fully consolidated system	
			Partially	Fully
OECD (29)	13	13	12	10
Africa (15)	6	5	5	3
Asia (13)	4	4	6	1

Europe (16)	5	6	7	1
Middle East (2)	1	1	1	—
Western Hemisphere (21)	6	2	12	—
Total (96)	**35**	**31**	**43**	**15**

Note -India does not include earnings data of indirectly held FDI enterprises.
Figures in brackets represent total numbers of countries in the region.
Source: Report on the Survey of Implementation of Methodological standards for Direct Investment, IMF (March 2000).