Report on Monitoring of Non-Debt Flows in India

September 2001

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Chairman
Advisory Group on
Corporate Governance

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March 24, 2001

Dear Dr. Reddy,

Standing Committee on International Financial Standards and Codes: Advisory Group on Corporate Governance

Please refer to your letter dated May 25, 2000 regarding the constitution of the captioned Advisory Group. I have great pleasure in forwarding herewith the Report of the Advisory Group on Corporate Governance. The Group has attempted to compare the status of corporate governance in India *vis-a-vis* internationally recognised best practices and standards and has listed out suggestions to improve corporate governance standards in India.

The Group studied the various models of corporate governance in the developed and the newly industrialised countries and also compared the legal and regulatory framework of corporate governance obtaining in India *vis-a-vis* international best practices. In this regard, the Group took into account the OECD (Organisation for Economic Co-operation and Development) principles, recommendations of Cadbury Committee, corporate governance principles in U.S., U.K. (London Stock Exchange Combined Code), European countries, East Asian countries as international models available. The Group also studied the recommendations of the committee appointed by Securities and Exchange Board of India in India. Considering the dominant role played by the public sector entities in India, the Group studied the practices prevailing in the central and state public sector enterprises falling under Companies Act. The Group also studied the corporate governance practices in banks and financial institutions in the financial sector in the light of BIS standards as it has major monetary and financial implications.

The recommendations of the Group cover, *inter alia,* responsibilities of the board of directors, accountability to shareholders/stake holders, criteria for selection of independent members of

the board, size and composition of the board, appointment of committees of the board such as audit committee, nomination committee, remuneration committee and investment committee, disclosure and transparency of information and data, and the role of shareholders in a company.

The Group takes this opportunity to place on record its sincere thanks for all your valuable support extended to it.

With kind regards,

Yours sincerely,

(R. H. Patil)

Dr. Y.V. Reddy,
Deputy Governor,
Reserve Bank of India,
Central Office,
Mumbai - 400 001.

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FOREWORD

Introduction

We have great pleasure in placing in the public domain, the reports prepared by eminent experts of our country in various subject areas of the financial system. These reports have made critical assessment of India's status and compliance with prescribed international financial standards and codes and suggest means for achieving the best international practices. In view of the importance of the subject, and the far reaching initiatives that have been taken by the international community in the adoption and implementation of financial standards and codes, we would like to put forth a general overview of this enterprise, particularly, focusing on key concepts and the developments that have taken place in this area in the recent years. We also highlight the ongoing efforts in India in this direction, expecting them to contribute in their own significant way in the overall task of promoting a sound and stable global financial system.

We would, however, like to emphasize that the recommendations contained in these reports are the product of independent evaluation and assessment of standards and codes undertaken by non-official experts, and do not reflect the views of the Reserve Bank or the Government of India or other concerned regulatory agencies.

The international community has emphasised the need for strengthening the architecture of the international financial system in the wake of the recent financial crises. The initiatives have been directed towards preventing the recurrence of such crises and safeguarding global financial stability. In this context of achieving a sound basis for domestic and international financial stability, the on-going efforts in development, adoption and implementation of international standards for the financial system are considered crucial.

What are Standards?

Standards set out by international financial institutions and other standard setting bodies are generally accepted as good principles, practices and guidelines for relevant areas in the financial system. Standards have developed mostly as a result of the recognition and understanding of the weaknesses that precipitated financial crises. Standards are classified by their degree of specificity and reckoned on the basis of their sectoral or functional attributes. They cover a broad range of areas in the financial system and are, therefore, interdependent or sometimes functionally overlapping.

Why are Standards Important?

Standards help to promote sound financial systems domestically and financial stability

internationally. They play an important role in strengthening financial regulation and supervision, enhancing transparency, facilitating institutional development and reducing vulnerabilities. Standards also facilitate informed decision making in lending and investment and improve market integrity and, thereby, minimize the risks of financial distress and contagion. Standards are not ends in themselves but a means for promoting sound financial fundamentals and sustained economic growth. The adoption of standards in itself, however, is not sufficient to ensure financial stability. The implementation of standards must fit into a country's overall strategy for economic and financial sector development taking into account the stage of development, level of institutional capacity and other domestic factors.

What is New about Standards?

The standards devised by standard setting bodies are widely accepted as promising benefits in strengthening financial systems and helping in achieving sustained economic growth. Standards also promote convergence of practices among countries in various areas of the financial system, thereby, allowing clear assessment methodologies for comparability across jurisdictions. For ease of implementation, standards are distinguished by their degree of specificity covering (i) principles or general fundamental rules that offer flexibility in implementation to suit country priorities and circumstances, (ii) practices that are more specific and demonstrate practical applications, and (iii) specific methodologies/guidelines which provide detailed guidance on steps required for relative objective assessment of the degree of compliance. In providing this choice of prioritization and methodological guidance, countries can have effective implementation plans under different economic circumstances.

For Whom are Standards Relevant?

Standards serve many purposes and are of special interest to market participants. They can serve as a means of providing some kind of benchmark for market participants to operate efficiently. They are important to the regulators concerned with the financial system, central bank and Government as they are key components of efforts to strengthen domestic economic and financial systems and preserve financial stability.

What are the Key Standards?

The Financial Stability Forum (FSF) was initiated by members of G-7 in February, 1999 with the mandate to promote international financial stability by improving the functioning of markets and reducing systemic risk through information exchange and international cooperation in supervision and surveillance of financial markets. The FSF has drawn together various standard-setting bodies constituted by means of cooperation among central banks, international financial institutions, national authorities and international supervisory and regulatory bodies. The FSF has posted The Compendium of Standards, which serves as a common reference for various

standards. This is basically an initiative of the Financial Stability Forum and is a joint product of the various standards setting bodies represented on the Forum. Currently there are 69 standards cited in the Compendium, which are organised under three broad headings and fifteen subject areas, viz., macroeconomic policy and data transparency (covering monetary and financial policy transparency, fiscal policy transparency, data dissemination and data compilation), institutional and market infrastructure (covering insolvency, corporate governance, accounting, auditing, payment and settlement, market integrity and market functioning) and financial regulation and supervision (covering banking supervision, securities regulation, insurance supervision and financial conglomerate supervision).

Who are the International Standard Setting Bodies?

International standards setting bodies had existed for a long time, but in the light of the growing degree of global interdependence and linkages, the world economy can be exposed to potential threat of contagion from problems in financial markets. It has, therefore, become imperative to strengthen financial systems through intensified coordination and cooperation among regulatory bodies, international regulatory bodies and international financial institutions charged with fostering standards and codes. There are various international organizations which have made significant contribution to raising standards of soundness and risk-awareness in financial systems.

The International Monetary Fund (IMF) has developed international standards for data dissemination and transparency practices in fiscal, monetary, and financial policies, and has contributed to the development of international standards for banking supervision.

Basle Committee on Banking Supervision (BCBS) has formulated the 'Core Principles of Effective Banking Supervision' which ensure best supervisory practices in the area of banking supervision.

Committee on Payment and Settlement System (CPSS) has advocated 'Core Principles for Systemically Important Payments Systems' that are aimed at enhancing the efficiency and stability of payment, clearing, settlement and related arrangements.

International Accounting Standards Committee (IASC), an independent private sector body, is charged with the responsibility of developing and approving International Accounting Standards (IAS).

International Association of Insurance Supervisors (IAIS) is responsible for setting standards that are fundamental to developing effective insurance regulation and supervisory practices.

International Organisation of Securities Commissions (IOSCO) has established core standards for effective surveillance of international securities transactions and promotes integrity of

markets through rigorous application of standards and effective enforcements against offences.

The Organisation for Economic Cooperation and Development (OECD) promotes policies for efficient functioning of markets and encourages convergence of policies, laws and regulations covering financial markets and enterprises.

Standards Setting Bodies in India

In India, we have standard setting bodies which are, in practice, the national regulators, who have the legal authority to set and implement regulatory rules and procedures in the financial sector. For example, the Reserve Bank of India (RBI) is responsible for regulation and supervision of banks and other financial institutions and money, foreign exchange and Government securities markets. The Securities and Exchange Board of India (SEBI) is charged with the duty to protect the interests of investors in securities and to promote the development of, and to regulate the securities market by measures as it deems fit. The Insurance Regulatory and Development Authority (IRDA) is entrusted with the task of protecting the interests of the policy holders, to regulate, promote and ensure orderly growth of the insurance industry and for matters therewith or incidental thereto. The Department of Company Affairs (DCA) of the Ministry of Law, Justice and Company Affairs, *inter alia,* provides legal framework for incorporation and proper functioning of companies, surveillance over the working of corporate sector to ensure financial health and compliance with statutory provisions, prescribing cost audit rules and appointment of cost auditors, investigation of complaints, coordination with other regulatory bodies such as other Government departments and autonomous institutions like SEBI, RBI and stock exchanges and monitoring the development of professional bodies i.e., Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries (ICS) and Institute of Cost and Work Accountants of India (ICWAI).

Further, we have self regulatory organizations such as the Indian Banks Association (IBA), Fixed Income Money Market and Derivatives Association of India (FIMMDA), Association of Merchant Bankers of India (AMBI), Association of Mutual Funds of India (AMFI), Foreign Exchange Dealers Association of India (FEDAI), Primary Dealers Association of India (PDAI), clearing house associations and stock exchanges, among others, which play a critical role in developing codes of conduct and setting and maintaining standards for different segments of the financial system with a view to promoting and protecting interests of institutions, investors and depositors in India.

India's Standing Committee on International Financial Standards and Codes

With a view to promote and assist in the task of adoption and implementation of international financial standards in India, a Standing Committee on International Financial Standards and Codes was set up on December 8, 1999. The Committee has been entrusted with the task of

monitoring developments in global standards and codes being evolved by standard setting bodies as part of the effort to create a sound international financial architecture and to consider all aspects of applicability of these standards to Indian financial system. The Committee is also assigned with the task of periodically reviewing the progress in regard to the codes and practices and making available its reports to all concerned organizations in public and private sectors with an aim of sensitizing public opinion and creating awareness for the concerned subject areas.

Advisory Groups in India

To assist the Standing Committee, Advisory Groups were constituted in different areas of the financial system under the Chairmanship of eminent experts, generally not holding official positions in government or other regulatory bodies in ten major areas - accounting and auditing, banking supervision, bankruptcy, corporate governance, data dissemination, fiscal transparency, insurance regulation, transparency of monetary and financial policies, payments and settlement system and securities market regulation. The Advisory Groups had, in general, the following terms of reference :

(i) to study present status of applicability and relevance and compliance of relevant standards and codes,

(ii) to review the feasibility of compliance and the time frame over which this could be achieved given the prevailing legal and institutional practices,

(iii) to compare the levels of adherence in India, *vis-a-vis* in industrialized and also emerging economies particularly to understand India's position and prioritize actions on some of the more important codes and standards, and

(iv) to chalk out a course of action for achieving the best practices.

About this Report

The Advisory Group on "Corporate Governance" chaired by Dr.R.H.Patil, former Managing Director, National Stock Exchange of India with Dr. V.V.Desai, Sarvashri Deepak M. Satwalekar, M.G.Bhide, Nandan M. Nilenkani and Rajendra P.Chitale as Members submitted the Report to Dr.Y.V.Reddy, Chairman of the Standing Committee on International Financial Standards and Codes on March 24, 2001. Good corporate governance practices not only serve as a recognised benchmark, but it also facilitates globally the process of convergence in corporate governance in view of the growing integration of international financial and product markets. In this Report, the Group comprehensively reviewed the models of corporate governance prevailing in East Asian countries, U.S., U.K., and other European Countries. The Report has observed that since most of the Indian companies belong to the "insider" model of East Asia, it is very

essential to bring quick reforms in the corporates/banks/financial institutions/public sector enterprises to make them more autonomous and professional. The recommendations of the Group cover areas of responsibilities of the Board to stakeholders/shareholders, selection procedures for the appointment of directors of banks, various committees to oversee the practice of corporate governance, disclosure and transparency standards, role of shareholders, etc.

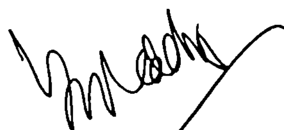
We are grateful to the Chairman and Members of the Advisory Group for the efforts they have undertaken in preparing the Report. The Report of the Group can also be accessed on the Reserve Bank web site <www.rbi.org.in>.

Purpose of this Report

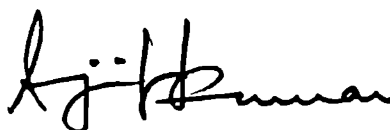
We are publishing the report with the objective of inviting comments from the widest section of market participants and other interested observers on the issues addressed by the Advisory Group. We shall be grateful to receive views and comments on the Report which may be addressed to the Secretariat, Standing Committee on International Financial Standards and Codes, 24th Floor, Central Office, Reserve Bank of India, Fort, Mumbai- 400001 (cpc@bom2.vsnl.net.in). It is requested that the responses on the Report may kindly be sent as early as possible and in any case, before end-July, 2001 for suitable consideration by the Standing Committee.

What Next ?

Although, not taking any particular view on the recommendations of the Advisory Group, the Standing Committee would prepare a summary and highlight key aspects of the recommendations of the Report as also identify action points requiring attention by regulatory authorities/agencies concerned so that the follow up could be undertaken. The Standing Committee would help organize seminars and workshops to enhance awareness and concretize views on recommendations of the Report and seek comments/feedback from both private and public sector organizations, international institutions and experts. We hope to review and complete these tasks in the next few months. However, it is proposed that an annual review of status and progress regarding compliance with and implementation of standards and codes will also be subsequently prepared and submitted to the Ministry of Finance.



(Y.V. Reddy)
Chairman
Standing Committee on International Financial Standards and Codes



(Ajit Kumar)
Alternate-Chairman
Standing Committee on International Financial Standards and Codes

EXECUTIVE SUMMARY

1. India is a major destination of non-debt flows. India attracted around Rs.4000-5,200 crore of non-debt flows in the latter half of 1990s. But some of the non-debt flows like FPI flows have been volatile and hence the need to monitor these flows has become all the more important (Para 2.12).

2. The legal framework for monitoring – compilation and dissemination – of non-debt flows in India has not kept pace with time, leading low coverage for enterprise surveys in India (Survey of India's Assets and Liabilities). Strong legal powers for collection of data are essential for high coverage and good quality and timely statistics. India is yet to reinforce its legal framework for collection of external statistics although it is understood that this is one of the agenda items of the National Statistical Commission which is presently underway (Para 2.14).

3. The existing monitoring of non-debt flows (FDI and FPI) in India is based on a combination of (a) ITRS, (b) enterprise surveys and (c) information from government and other sources.

Foreign Direct Investment

4. A major limitation of FDI statistics is the weak information on FDI outflows. The ITRS system, which generates relatively quick data, does not strictly follow the cardinal principle of 10 per cent rule given in BPM5 to determine FDI and FPI flows (Para 3.22).

5. Given the statistical requirement of Fund's SDDS and IIP standards, detailed data in respect of FDI can only be generated through enterprise surveys which at present suffers from low coverage and timeliness (Para 3.28).

6. A major reason for the low coverage of present enterprise survey (India's Foreign Assets and Liabilities) is the absence of adequate information of entities with foreign exchange exposure (population size), which constrains the coverage and reliability of statistics collected. It would be worthwhile for authorities also to undertake an exploratory survey of suspected units with international exposure so as to identify those missed from the population frame (Para 3.33).

7. It is necessary that FDI statistics generated in India is of international standards. Hence there is a need to upgrade the compilation method of FDI statistics in India by closely working with methodological standards developed by OECD which has considerable know-how in this regard (Para 3.33).

8. There has been no attempt so far to reconcile FDI flows. An attempt should be made to reconcile FDI flows data at least with major FDI partner so that one is comfortable with the quality and reliability of FDI statistics.

Foreign Portfolio investment

9. The major portfolio investors in India can be classified into two groups, viz., (a) Foreign Institutional Investors and (b) Non-International Investors (NRI's, OCBs, PIO's etc.). The major source of FPI statistics in India is the R-Return based International Transactions Reporting System.

10. One of the major components of FPI flows is Foreign Institutional Investors (FII's). FII investment in capital market is generated by RBI (net inflows) as well as by SEBI (net purchases) and these data do not match due to divergent coverage. SEBI data is more comprehensive as it includes FII's net purchase of debt instruments as well (Para 4.30).

11. Arriving at "mark-to-market" value of FII investments on a periodic basis is important to understand the magnitude of (a) repatriated capital and (b) re-invested earnings.

12. For the valuation of FIIs investment at market price following measure may be considered:

    (a) For the listed securities, closing price on the last working day of the applicable month across the two major exchanges viz. Bombay Stock Exchange (BSE), and National Stock Exchange of India (NSE) may be used as initial measure.

    (b) In the case of unlisted securities, the book values as at the end of a financial year be used.

    (c) RBI/SEBI may need to instruct unlisted companies/ companies having unlisted securities having FII investments, to provide the book value on an annual basis to the custodians of the FIIs.

    (d) If the book values are not available, paid-up value of the shares can be taken for valuation purposes;

    (e) In respect of debt instruments, the valuation may be done on the face value of the investment as accumulated by the quantum of interest upto the point of valuation.

    Custodians of FIIs may be assigned the task of arriving at "mark to market" value of both equity securities and debt securities (Para 4.37).

13. For estimating reinvested earnings we recommend the following procedure.

    Reinvested Earnings (RE) = Net Purchases (NP) - Net Inflows (NI)

Where

Net Inflows = Inflows – Outflows

Net Purchases = Purchases – Sales

(Para 4.39)

14. One should also explore the possibility of maintaining data on non-debt flows and stocks in CS-DRMS 2000+ to facililitate compilation of BoP and IIP statistics in accordance with the Fund guidelines contained in BPM5.

CHAPTER I

OBJECTIVES OF THE STUDY

Introduction

1. In the 1990s, private flows have dominated global capital flows to developing countries; the share of private flows in total net capital flows more than doubled from 43.2 per cent in 1990 to 88.4 per cent in 1997 (World Bank, 2000)[1]. The recent financial crisis in East Asia and in Latin America has highlighted the risks and benefits non-debt flows like portfolio flows. It is in this regard the importance of monitoring non-debt capital flows becomes important.

2. In general, non-debt flows can be either in the form of either direct investment or portfolio investment. Portfolio flows generally include portfolio debt investment and portfolio equity investment. With the increasing significance of non-debt flows in total private flows, the monitoring of information on these flows has become important. Although non-debt flows are technically not part of a country's external debt, the volatility of non-debt flows like portfolio flows has accentuated liquidity problems and pressures in financial and foreign exchange markets.

3. As regards hierarchy of global capital flows there is the hypothesis of 'pecking order of capital flows' similar to 'pecking order of capital structure' in corporate finance. The hypothesis maintain that firm prefer internal finance (equivalent to FDI) to external finance i.e. equity (equivalent to FPI). Recent trends in global capital flows validate this hypothesis. The 1990s experience shows that nearly four-fifth of the total net private flows to developing countries have been in the form of foreign direct investment.[2] In India also, the policy framework has encouraged non-debt creating flows. In this connection the following observation of Dr. Y.V. Reddy, Deputy Governor is pertinent:

> "... In India, we have been steadily building up reserves by encouraging non-debt creating flows and de-emphasising debt creating flows..."[3] (p.952).

4. The Reserve Bank of India in its Report on Currency and Finance, 1998-99[4] has also observed that:

> "...The shift in emphasis from debt to non-debt flows has helped to contain the debt service ratio; it also highlights the importance of monitoring of liability service ratio rather

[1] World Bank (2000), Global Development Finance, Washington D.C.

[2] World Bank (2000) Global Development Finance: Analysis and Summary Tables, Washington, p.36.

[3] Reddy, Y.V. (1999) 'External Debt Policies in Emerging Economies: New Dimensions', RBI Bulletin, July, pp.951-56.

[4] Reserve Bank of India (1999) Report on Currency and Finance, 1998-99.

than t he traditional servicing of debt liabilities only..." (p.X-10).

5. At the international level, the definition and classification of non-debt capital flows are presented in IMF's Balance of Payment Manual – Version 5 (BPM5), published in 1993 and adopted by 139 countries worldwide. These data have to be consistent and integrated with National Accounts, Monetary and Fiscal Accounts for which methodological guidelines are available. Similarly the compilation of a country's international investment position (IIP) allows for check and coherence of both stock and flow data on capital flows. Monitoring of non-debt flows – definition, compilation has to be in accordance with these framework.

6. This study is undertaken with the support of Institutional Development Fund (IDF) grant facility of the World Bank. The project group has representatives from the Reserve Bank of India, the Ministry of Finance, Securities and Exchange Board of India (SEBI) Custodians and Foreign Institutional Investors (FIIs) . The list of persons associated with the project is given in Annexure I.1. The Group had also the benefit of visiting some countries to understand country practices, which were found very valuable. The countries and organizations visited are given in Annexure I.2.

7. This study is thematically bifurcated into five sections. Chapter II examines the role of non-debt flows in developed and developing countries. Section III examines the methodological issues involved in capturing of FDI flows. Section IV analysis the issues involved in the compilation and monitoring of portfolio flows. Section V summarises the main conclusions of the study.

CHAPTER II

THE ROLE OF NON-DEBT FLOWS IN EXTERNAL MANAGEMENT

Developing countries run the current account deficit to finance their investment. The current account deficit is financed through the capital flows (i.e., debt as well as non-debt flows) or through the draw down of reserves. The financial crisis in East Asia, raised questions about the benefits and risks associated with private capital flows. During the East Asian crisis, certain kinds of capital flows had high volatility. The hottest money was short-term loans from international banks[5] and portfolio equity investors. On the other hand, foreign direct investment was relatively very stable.

2.1 An important lesson of East Asian financial crisis is the need to monitor capital flows closely so as to understand the risks and benefits associated with these flows. A pre-requisite for efficient monitoring and management is the existence of an adequate legislative framework to collect capital flows data and an efficient statistical system for capturing these on a continuous basis. This chapter mainly deals with the analytical and legal issues associated with monitoring of capital flows especially non-debt flows. Besides global and regional trends in use of debt *vs* non-debt flows is also examined. The chapter is organized into four sections. Section 1 is devoted to the analytical issues of non-debt flows. Section 2 examines the magnitude of debt and non-debt flows at the global and national levels. Section 3 examines the legislative framework in India for collecting data on capital flows including non-debt flows and Section 4 examines the performance of India with respect to data standards – compilation and dissemination and section 5 summarises the conclusions of the chapter.

Section 1

Non-Debt Flows- Analytical Issues

Theoretical Literature

2.2 The dynamic interaction between debt and equity (non-debt) flows has been a subject matter of much theoretical interest. One strand of literature had examined the 'home bias' of international investment. Empirical evidence reported by Huberman (1997[6]) show that investors prefer to invest in companies with headquarters stationed in their own states or in companies

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[5] International banks put $56 billion in net lending in 1996 and then withdrew an estimated $21 billion in net loans in 1997, for a swing of $77 billion or 73 per cent of the overall capital reversal of $105 billion.

[6] Huberman, G (1997) 'Familiarity breeds Investment', Columbia University, (Mimeo).

where they work. The main explanation for the home bias is an "information asymmetry" which concerns a "home court" advantage to the domestic residents over the foreign residents.

2.3 The other strand of theoretical work relate to the interaction between equity and debt flows in an open economy with imperfect markets[7]. The information possessed by the firm at the time it makes its decisions about investment and finance is the important determinant of the composition of international capital flows. The sequencing of investment and financing decisions are explained by potential agency problem between the board of directors and the managers and with other corporate governance problems.

Empirical Issues

2.4 At the empirical level, the issue is related to the debate on "hierarchy" of capital flows. Although there is a universal implicit preference for non-debt flows like FDI and FPI, the volatility in non-debt flows especially in FPI has raised further questions about the usefulness of these flows itself. In fact the debate on this question is still inconclusive. At one end, it has been argued that foreign outflows lead to prices that overreact and to contagion. An opposing view is that trading is merely the process by which information is incorporated into asset prices and hence international investors do not create or exacerbate crises. Their trading behaviour simply reflects their assessment of the underlying fundamentals.

2.5 Non-debt flows especially flows like portfolio flows have been volatile and outflows on account of these flows have added pressures on foreign exchange, domestic money and international bond markets. For example, in many East Asian countries, capital outflows through short-term portfolio outflows had created substantial pressures in the foreign exchange market and added to liquidity problems in the market. Besides these financial outflows have been a major source of contagion[8]. A typical variant of this "financial channel"[9] of contagion is that of an international portfolio manager who need to raise liquidity in anticipation of future redemptions. In this case, the strategy would be not to sell the asset whose price has already collapsed but other assets in the portfolio of other countries. The net result of this portfolio strategy would be spread of fall inasset prices across markets/countries. The next section is devoted to an analysis of global trends in non-debt flows.

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[7] The analysis of credit market imperfections in closed economy can traced to the pioneering work by Stiglitz and Weiss (1981), See Stiglitz, J.E and Weiss, A (1981) 'Credit Rationing in Markets with Imperfect Information', *American Economic Review*, **71**, pp.393-410.

[8] Glick and Rose (1998) find the pattern of speculative attack is correlated with "trade" linkages, See, Glick, R. and Rose A.K. (1998) 'Contagion and Trade: Why Are Currency Crisis Regional', Federal Reserve Bank of San Frisco (Mimeo).

[9] Kaminsky and Reinhart (1998) find that the pattern of speculative attacks is closely associated with "financial linkages" such as the presence of common lender, See, Kaminsky, G.L. and Reinhart, C.M.(1998) "On Crisis, Contagion and Confusion", George Washington University, November, Mimeo.

Table 2.1: Net Resource Flows to Developing Countries

(In billions of U.S. dollars)

	1991	1992	1996	1997	1998	1999
Net long-term resources flows	124.0	153.7	313.1	343.7	318.3	290.7
Net short-term flows	20.1	38.2	42.9	20.4	-47.6	-11.2
Total net flows (liabilities)	144.1	191.9	356.0	364.1	270.7	279.5
Memo Item						
Share of short-term flows to total net flows	13.9	19.9	12.0	5.6	-13.0	

Source: World Bank (2000) Global Development Finance ,Table 2.3, p.43

Section 2

Non-Debt Flows – Global Trends

2.6 In the 1990s, net capital flows to developing countries increased from $144.1 billion in 1991 to a peak of $364.1 billion in 1997; the East Asian Crisis saw substantial fall in net capital flows (to $270.7 billion in 1998 and $279.5 billion in 1999) [See Table 2.1]. Major declines was evident in the short-term flows which declined by 47.6 billion in 1998 and $11.2 billion in 1999.

2.7 The share of private capital flows in aggregate net resource flows to developing countries increased from 42.6 per cent in 1990 to a peak of 90.1 per cent in 1996 before coming down to 82.1 per cent in 1999 (Table 2.2). The composition of the private capital flows has also undergone a remarkable change during 1990s with increased share of foreign direct investment (FDI) and foreign portfolio investment (FPI) i.e., non-debt flows in the total capital flows; the share of non debt flows (FDI and FPI) has increased from 63.2 per cent in 1990 to 91.9 per cent in 1999. The compositional shifts towards non-debt flows indicate the increasing globalisation in the world and the increasing reliance on private flows rather than on official flows. This also reflects of an implicit preference for non-debt flows as part of prudent external debt management policy of the developing countries, as relying more on debt flows to bridge the saving-investment gap add to the accumulation high external debt and subsequently, increasing the debt servicing of the country.

Table 2.2: Aggregate Net Long-Term Resource Flows to Developing Countries : 1990-2000

(In billions of U.S. dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Aggregate net resource flow (a+b)	**98.5**	**124.0**	**153.7**	**219.2**	**220.4**	**257.2**	**313.1**	**343.7**	**318.3**	**290.7**
(a) Official flows	**55.9**	**62.3**	**54.0**	**53.4**	**45.9**	**53.9**	**31.0**	**39.9**	**50.6**	**52.0**
(b) Total Private flows (i.+ ii)	**42.6**	**61.6**	**99.7**	**165.8**	**174.5**	**203.3**	**282.1**	**303.9**	**267.7**	**238.7**
International Capital Markets	18.5	26.4	52.2	99.8	85.7	98.3	151.3	133.6	96.8	46.7
(i) Debt Flows	15.7	18.8	38.1	48.8	50.5	62.2	102.1	103.4	81.2	19.1
Commercial banks	3.2	5.0	16.4	3.5	8.8	30.4	37.5	51.6	44.6	-11.4
Bonds	1.2	10.9	11.1	36.6	38.2	30.8	62.4	48.9	39.7	25.0
Others	11.3	2.8	10.7	8.7	3.5	1.0	2.2	3.0	-3.1	5.5
(ii) Non-Debt Flows	26.9	42.9	61.6	117.0	124.0	141.1	180.0	200.5	186.5	219.6
Equity flows	2.8	7.6	14.1	51.0	35.2	36.1	49.2	30.2	15.6	27.6
Foreign direct investment.	24.1	35.3	47.5	66.0	88.8	105.0	130.8	170.3	170.9	192.0
Memo Item										
(i) Share of Private Flows in Total Flows	**43.2**	**49.6**	**64.8**	**75.6**	**79.2**	**79.0**	**90.1**	**88.4**	**84.1**	**82.1**
(ii) Share of Non-Debt flows to total private flows	**63.2**	**69.5**	**61.8**	**70.5**	**71.1**	**69.4**	**63.8**	**66.0**	**69.7**	**91.9**

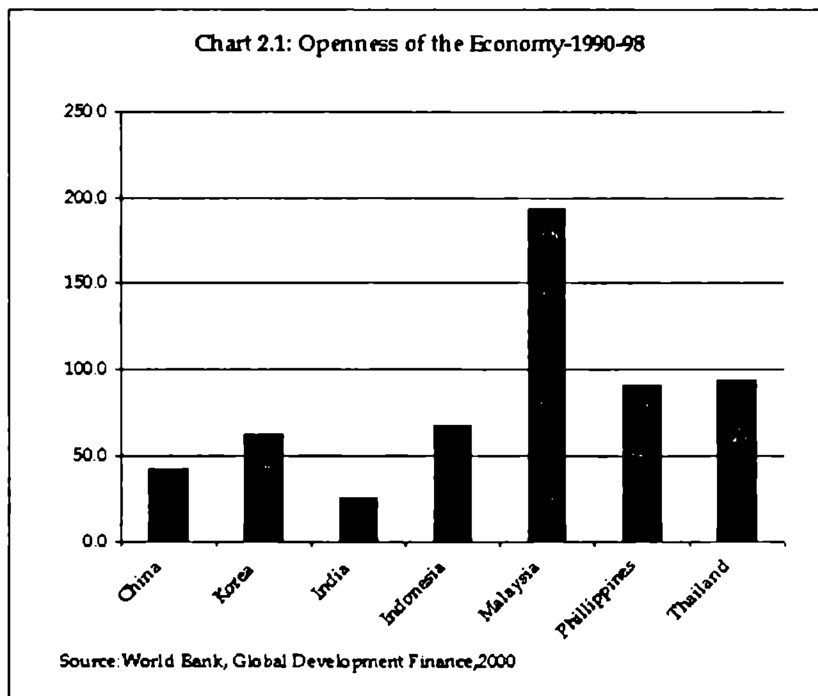
Source: World Bank (2000) Global Development Finance ,Table 2.1, p.36

2.8 Among the non-debt flows FDI and FPI flows have different kind of characteristics and might have different implications for the development strategies of the recipient countries. Foreign investment contributes to the development of countries by increasing the resources for the investment as well by improving the know-how and overall management environment and policy framework (like, improving corporate governance and bringing transparency and

discipline in the system). Along with resources for investment some other externalities in the form of transfer of technology and management could also come with FDI, while FPI could increase efficiency in the domestic capital markets by deepening and widening these markets and raising disclosure and transparency standards.

2.9 Even though bifurcation of foreign investment in to direct investment and portfolio investment has been clearly defined, there is also problem of some "borderline" case where it is difficult to classify an investment as direct investment or portfolio investment. Like, in a country where portfolio investment is highly liberalized, a portfolio investor might buy more than 10 per cent of the shares of companies without having a lasting interest or desire to control the companies, but yet investor's investment would be classified as direct investment. In other case using the control interest as a dividing line, there are circumstances where FDI could turn in to portfolio investment through the dilution of ownership and loss of control and conversely, portfolio investment could be transformed in to FDI, if the investor decides to have a management interest in the companies whose assets it had earlier purchased as portfolio investment.

2.10 Capital flows is basically related to the openness of the economy; countries with relatively open economy and capital account attract more capital flows than with closed economy. Exports and imports of goods and services as a proportion of national income (GNP) provide a good approximation of the openness of the economy. In that respect, India has a relatively closed economy as compared with East Asian economies (See Chart 2.1).



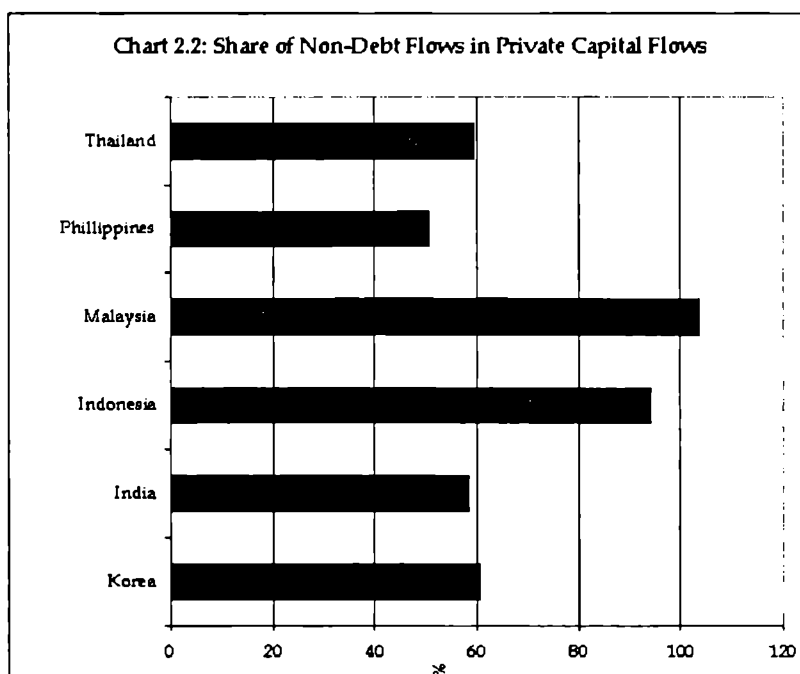
2.11 Private capital flows to India averaged only about U.S.$ 5 billion during 1990-98 with a peak of $7.1 billion in 1994. On the other hand China attracted $38 billion, with a high of $60.8 billion in 1997. Korea attracted on an average $11.1 billion; Malaysia $8.4 billion; Thailand $7 billion and Philippines $2.9 billion during the same period (Table 2.3). In relation to national income, private capital flows in Malaysia was the highest (11.4 per cent) during the same period, followed by China (6.1 per cent), Thailand (5.2 per cent), Philippines (4 per cent) as compared with India's meager 1.4 per cent (See Table 2.3).

Table 2.3: Private Capital Flows to Select Countries: 1990-98

Average	China	India	Indonesia	Korea	Malaysia	Philippines	Thailand
$ billion	38.8	5.0	6.4	11.1	8.3	2.9	7.0
% to GNP	6.1	1.4	3.2	2.7	11.4	4.0	5.2

Source: World Bank (2000) Global Development Finance.

2.12 In terms of composition of private capital flows, non-debt flows (FDI and FPI) accounted for 58 per cent during 1990-98. Most of the countries in East Asia had relatively higher proportion of non-debt flows: Malaysia (nearly 100 per cent), Korea and Thailand (60 per cent) [See Chart 2.2]. Non-debt flows to India comes to Rs.4,000 to Rs.5,200 crore constituting about one-half of total capital flows to India (Table 2.4). The major part of the non-debt flows was in the form of foreign direct investment.



2.13 Experience regarding capital flows especially with regard to non-debt flows however, varies across developing countries. It is therefore important to ascertain the factors influencing non-debt flows (e.g. industry restrictions, acquisition criteria, taxation norms etc.). Among the developing countries China accessed the highest foreign direct investment during the nineties with US $ 42 billion in 1998, while at the same time India has attracted very low FDI with US $ 2.5 billion during the same period. In the case of FDI, India did not find place in the list of top ten countries in developing world . Brazil and Mexico followed China and accessed FDI of US $ 24 billion and US $ 10 billion during 1998, respectively.

Table 2.4 : Composition of Capital Flows under India's Balance of Payments

(US $ million)

Item	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
Total Capital Inflows (net)	7056	3910	3876	8895	8502	4089	12006	9844	8565	10242
1. Non-debt Creating Inflows	103	133	872	4235	4922	4805	6153	5390	2412	5191
a) Foreign Direct Investment	97	129	557	586	1343	2144	2841	3562	2480	2167
b) Portfolio Investment	6	4	315	3649	3579	2661	3312	1828	-68	3024
2. Debt Creating Inflows	5876	3028	1545	2175	2138	2358	7418	5168	5358	3030
3. Other Capital	1077	749	1459	2485	1442	-3074	-1565	-714	795	2021
Memo Item :										
Volatile flows	1081	-511	-764	2880	3972	2710	4150	1732	-816	3401
Stable Flows	5975	4421	4640	6015	4530	1379	7856	8112	9381	6841

Source: Reserve Bank of India, *Annual Report* (Various Issues).

Section 3

Legal framework for Collecting Data on Non-Debt Flows in India

2.14. In India, the legal framework for collecting data on capital flows/non-debt flows or foreign asset and liabilities dates back to 1947. The legal backing for collecting data on assets and liabilities of entities in India is provided by the Ordinance No. XLVII of 1945 issued on December 24th, 1945 to implement the Fund and Reserve Bank of India Agreement. On October 23, 1947, Government of India issued a notification empowering Reserve Bank of India to call for necessary information for the purpose of the census of foreign investments. Subsequently, Reserve Bank of India issued a notification (dated October 2,1948) to all those who were owing foreign liabilities and/or owning foreign assets as on June 30, 1948. The 1945 Government of India Ordinance did not provide for a penalty for non-reporting The response to the surveys were good in the initial years of census/sample surveys and the response rate was as high as 98.9 per cent for the first benchmark survey conducted for the reference year 1948. This was followed by surveys for the years 1953, 1955, and 1961. The coverage of these surveys and subsequent surveys are given in Table 2.5 . As may be seen from Table 2.5, the coverage of enterprise survey has diminished considerably and now stands at 30.6 per cent.

Table 2.5 : Coverage of RBI's Census and Surveys on India's Foreign Liabilities and Assets-1953-1997

Year	No. of companies covered	No. of companies Responded	Percentage of Response
1953	2180	2158	98.9
1955	2129	2038	95.7
1961	2176	2113	97.1
1987	6770	3846	56.8
1992	6269	3214	51.3
1994	3850	2344	60.9
1995	4776	2848	59.6
1997	10395	3182	30.6

Source: Reserve Bank of India, Bulletin (Various Issues).

2.15. Most of the crisis affected countries in East Asia had similar low rates of reporting but they have lately reinforced their legal system with fresh law/presidential decrees which provide for penalties for non-reporting. At one end, we have countries like People's Republic of China which has a (exchange) control based reporting system of external exposures of domestic entities, which is fairly comprehensive; entities which do not report data could be barred from accessing external funds, release of foreign exchange for debt servicing etc. At the other end we have Singapore, which has no exchange controls but has a reporting system with in-built penalties[10]. In the case of other countries in the region, the system had provided for most of the cases, an in-built penalty system for non-reporting (See Table 2.5 and 2.6). For example, in Thailand, as per the Exchange Control Act, 1942, any violation of Exchange Control Act which includes non-reporting of data invokes a penalty of 3 years imprisonment or a fine not exceeding Thai Baht 20,000 or both. Similarly in Indonesia, under the April 8, 1998 Presidential Decree, entities (private) which have received foreign commercial borrowing but has not reported to Bank Indonesia is liable to pay an amount of 10 per cent of the amount of their foreign commercial borrowing as penalty[11]. In India, the 1945 Ordinance and 1947 and 1948 RBI notification did not provide for penalties in case of non-reporting and this has contributed significantly to decline in response rate. The issue of reinforcing the legal framework including the question of penalties for non-reporting for collecting statistics is being examined separately by National Statistical Commission appointed recently by Government of India.

Table 2.6: Details of Legal Framework for Collection of External Account Data in Select ASEAN plus 3 countries

Countries	Details of Statutes
1. Indonesia	Bank of Indonesia Decrees in 1998 and 1999
2. India	Govt. of India Ordinance No XLVIII dated December 24, 1945 and RBI notification dated October 2, 1948.
3. Japan	Foreign Exchange and Foreign Trade Law
4. Korea, Republic of	Foreign Exchange Law
5. Phillippines	Executive Order 352
6. People's Republic of China	The Provisional Regulations on External Debt Statistics (August 27,1987)
7. Singapore	Statistics Act
8. Thailand	The Exchange Control Act,1942,The Commercial Banking Act

[10] In Singapore, non-reporting of statistics involve a penalty of $ 1,000 with an additional penalty of S$ 100 after the due date.

[11] In Indonesia, private companies is liable to pay Rupiah 500,000 for every one week of late reporting.

Table 2.7: Institutional Framework for Collecting Capital Flows Data in Select ASEAN plus Three Countries

Countries	Agency responsible for Monitoring Capital Flows
1. Indonesia..................................	Bank of Indonesia (BOI)
2. India..	Reserve Bank of India (RBI)
3. Japan.......................................	Bank of Japan (BOJ)
4. Korea, Republic of....................	Bank of Korea (BOK)
5. People's Republic of China.......	State Administration of Foreign Exchange (SAFE), of People's Bank of China
6. Phillippines...............................	Bangko Sentral ng Pilipinas (BSP)
7. Singapore.................................	Department of Statistics (DOS)
8. Thailand....................................	Bank of Thailand(BOT)

2.16 In most countries the Central Bank (Indonesia, Japan, Korea, Philippines, People's Republic of China, Thailand) is responsible for collating capital flows data. In Singapore it is the national statistical agency, Department of Statistics (Table 2.7). In the case of People's Republic of China, there are multiple agencies involved in the monitoring of capital flows; the State Administration of Foreign Exchange (SAFE) of People's Bank of China complies external debt data, while other government departments monitor other aspects of the capital flow. For example, Ministry of Foreign Trade and Economics Co-operation (MOFTEC) controls direct investment including offshore investment. These agencies have introduced new formats of reporting, new data capturing mechanisms (including enterprise surveys) to track capital flows. The countries, which have introduced new reporting formats, include Thailand (for capturing private debt), Korea (for capturing foreign exposure of financial intermediaries), Indonesia (for foreign exposure of corporates), .

2.17 A major challenge confronted by most countries including India with regard to enterprise surveys is the absence of adequate information of entities with foreign exchange exposure (population size), which constrains the coverage and reliability of statistics collected. A crucial requirement for enterprise surveys to be adequate is the availability of information about the total population with external exposure. Given deregulated environment in the industrial and financial sphere in India, this is a challenging task. It would be worthwhile for authorities also to undertake an exploratory survey of suspected units with international exposure so as to identify those missed from the population frame. In the next section, we examine the record of India with regard to data compilation and timeliness in dissemination.

Table 2.8: Periodicity and Timeliness of country data of Emerging Market Economies – 1997 and 1999

Economy	Original Standards (Among 18 variables)			New Standards (25 variables)
	1997	1999	Change from 1997	No. of standards satisfied
1. Argentina	12	17	5	23
2. Brazil	15	14	-1	18
3. Chile	11	15	4	19
4. China	5	5	0	6
5. Colombia	13	15	2	21
6. Czech Republic	17	17	0	21
7. Egypt	1	3	2	4
8. Hong Kong SAR	6	12	6	12
9. Hungary	14	16	2	19
10. India	8	11	3	13
11. Indonesia	13	16	3	20
12 Israel	17	18	1	23
13. Korea	6	7	1	15
14. Kuwait	11	16	5	7
15. Malaysia	16	17	1	19
16. Mexico	3	3	0	23
17. Morocco	15	17	2	3
18. Peru	9	14	5	23
19. Philippines	12	17	5	14
20. Poland	9	13	4	21
21. Russian Federation	1	3	2	16
22. Saudi Arabia	12	14	2	4
23 South Africa	12	12	0	15
24. Thailand	12	17	5	23
25. Tunisia	6	8	2	8
26. Turkey	13	16	3	21
27. Venezuela	12	8	-4	11

Source: Institute of International Finance, Data Release Practices of Emerging Market Economies: 1999 Assessment, Washington D.C.,Table 1, p.6.

Section 4

India's International Record in Data Compilation and Dissemination of External Accounts

2.18 Institute of International Finance, Washington (IIF) has also established a Working Group[12] to develop a set of benchmark standards for data coverage, periodicity and timeliness in 25 areas. The IIF standards relate to data standards in respect of (a) national accounts (output, expenditure and production index), (b) inflation (consumer and producer prices), (c) balance of payments (exports/imports, current and capital account), (d) assets and liabilities (reserves, drawn on reserves, external debt – public, private, short-term debt amortization schedule), (e) monetary accounts (monetary survey, monetary aggregates, domestic credit central bank balance sheet, interest rates), (f) fiscal accounts (central government budget, public sector accounts, public debt). The performance against these standards were published in April 1996, 1997 and the latest report relate to 1999 for 27 emerging market economies which was released on January 6,2000[13] (See Table 2.8). In the original standards (18 variables), two countries (Brazil and Venezuela) have recorded deterioration in data standards as compared with 1997 performance. According to the new 1999 standards (25 variables), none of the economies fully satisfies all the standards, but gives high marks to nine countries – Argentina, Colombia, the Czech Republic, Israel, Mexico, Peru, Poland, Thailand and Turkey – for their overall performance against the IIF's benchmark standards.

2.19 According to IIF data standards (original standards) India's compliance of data standards has improved from 8 to 11 during 1997-99 (Table 2.9). In the new data standards (25 valuables) India complies only with 13 out of 25 data standards. In the case of India, the major data weakness was in respect of external accounts especially in the area of drain on reserves, external debt, public sector accounts, etc.

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[12] (1995) IIF *Improving Standards for Data Release by Emerging Market Economies,* September.

[13] (2000) IIF *Data Release Practices of Emerging Market Economies: 1999 Assessment.*

Table 2.9: Data Standards – Performance of India vis-à-vis select ASEAN Countries - IIF 1999 Data Standards – December 1999

Variables	Standard week lag	China	India	Korea	Indonesia	Philippines	Thailand
1. Output	12	X	X	X	X	X	X
2. Expenditure	12			X	X	X	X
3. Production Indices	6	X	X	X			X
4. Consumer Prices	2	X		X	X	X	X
5. Producer Prices	2	...	X	X			X
6. Exports and Imports	4	X	X	X	X		X
7. Current account	12		X	X	X	X	X
8. Capital account	12		X	X	X	X	X
9. Reserves	1		X		X		X
10 Disposition of Reserves and drains on Reserves	1	...		...	X		X
11. External Debt	12			X	X		X
12. Public Sector External Liabilities	12			X	X	X	X
13. Private Sector External Liabilities	12			X	X	X	X
14. Private Financial Sector External Liabilities	12			X	X		X
15. Private Nonfinancial Sector External Liabilities	12	...		...	X		X
16. Short-term External Debt	12			X	X	...	...
17. Amortization Schedule	12	...		...		X	X
18. Monetary Survey	4				X	X	X
19. Money Supply	4	X	X	X	X	X	X
20. Domestic Credit	4		X		X	X	X
21. Central Bank Balance Sheet	4		X		X	X	X
22. Interest Rates	1	X	X	X	X	X	X
23. Central Government Budget	4		X		X	X	X
24. Public Sector Accounts	12	...	...	...			
25. Public Debt	12	...	...	...		X	X

Notes: 1. X = meets IIF standard, ...=Not Reporting Variable, blank = does **not** meet IIF standard.

2. Lags are in number of weeks between end of period and availability of data.

Source: Institute of International Finance, (1999) *Data Release Practices of Emerging Market Economies: 1999 Assessment*. Washington, p.8.

Section 5

Conclusion

This chapter examined the analytical and institutional aspects relating to non-debt flows and some of the major conclusions are as follows:

* India has a relatively less open economy with respect to capital flows. Private capital flows to India averaged about US $ 5 billion in the 1990s with a peak of $ 7.1 billion in 1994.
* Non-debt flows accounted for about 58 per cent of private capital flows to India in the 1990s.
* The legal framework for collecting data on external accounts in India is relatively weak and does not provide for penalty for non-reporting and hence the coverage of enterprise surveys has diminished over time.
* The absence of information on population of entities with foreign exposure has also contributed to low coverage of enterprise surveys in India.
* IIF evaluation of India's data standards has found marked improvement in India's data compilation and dissemination but is still the standards set by ASEAN countries.

Chapter III

MEASURING FOREIGN DIRECT INVESTMENT IN INDIA

In the 1990s, foreign direct investment (FDI) has come to account for an increasing share of private capital flows to developing countries. India has been one of the favorite destination for FDI flows. FDI flows to India was to $2.1 billion in 1999-2000 which is marginally lower than the peak inflow of $3.5 billion in 1997-98[14]. India's attractiveness as a FDI destination has improved considerably in recent years: the A.T. Kearney's January 2000 FDI Confidence Index[15] shows an increase in attractiveness as compared with the earlier assessment in June 1999. Some of the recent measures to promote FDI in India include passing of Insurance Regulatory and Development Act (IRDA) permitting foreign equity participation in domestic private insurance companies and the announcement in February 2000 of automatic route for FDI investment except for a small negative list.

3.2 Apart from FDI, firms generally borrow from foreign banks/firms and raise funds other sources in foreign financial markets as well as official flows. FDI differs in nature from private bank lending in the sense that it is non-debt creating and that returns to it are directly linked to the performance of projects. Since the investors have long-term interest and involvement in the production activities financed, FDI flows are not usually geared towards short-term profits unlike portfolio investment and not generally prone to herd behaviour. Hence, many observers believe that in the event of changes in market sentiment, FDI flows would not be much affected. This belief is based on the notion that FDI flows by nature tend to be 'long-term' and hence would be 'stable'.

3.3 There are a number of data issues which constrain comparability of FDI statistics across countries. Firstly, the balance of payments differentiation between FDI and portfolio flows is most often arbitrary. Foreign investment in the equity of a company above a critical component is classified as FDI, whereas that below is classified as portfolio equity investment. The quality of FDI statistics is determined by the comprehensiveness, timeliness, reliability and international comparability of the data. Countries are expected to compile and disseminate FDI statistics based on standard balance of payments and international investment position (IIP) components. In this chapter, we examine various issues relating to statistical measurement of foreign direct investment (FDI) in India. This chapter is organized into five sections. Section I examines the methodological issues in the compilation of FDI statistics including the major international initiatives. Section 2 analyse the trends in FDI flows to India vis-a-vis major ASEAN countries.

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[14] Reserve Bank of India, *Bulletin*, p.808.

[15] A.T. Kearney, *FDI Confidence Index*, January 2000, Vol.3, Issue 1. This index is based on a semi-annual survey of CEOs and CFOs and other top executives of global 1000 companies.

Section 3 critically examines the present FDI data capturing mechanism in India. Section 4 discusses the suggested framework for compiling FDI statistics and Section 5 summarises the major conclusions of this chapter.

Section I

Foreign Direct Investment- Methodological Issues

3.4 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 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.

3.5 BPM5[16] defines direct investment as:

> "....category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy.......Direct investment comprises not only the initial transaction establishing the relationship between the investor and the enterprise but also all subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated"(p.86).

3.6 Fund's BPM5 recommends that an equity threshold of 10 per cent be used to establish a direct investment relationship. It uses the "Fully Consolidated System" for identifying enterprises within a direct investment relationship. According to this system, the direct investment relationship extends to all directly and indirectly owned subsidiaries (incorporated enterprises that are more than 50 per cent owned by direct investors) associates (incorporated enterprises that are between 10 and 50 per cent owned by the direct investor) and branches (wholly or jointly

[16] International Monetary Fund, *Balance of Payments Manual.*, Fifth Edition, 1993, Para 359.

owned unincorporated enterprises) of the direct investor [Box 3.1].

3.7 In terms of the definition given in paragraphs 3.5 to 3.6, direct investment reflect the lasting interest of a resident entity in one economy (direct investor) in an entity resident in another economy (direct investment enterprise) and covers all transactions between direct investors and direct investment enterprises. In other words, direct investment covers the initial transaction between the two and all-subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated. Direct investment transactions occurring abroad in the reporting economy are sub-classified into (a) equity capital, (b) reinvested earnings, (c) other capital (inter-company transactions) and (d) financial derivatives.

3.8 The inclusion of derivatives associated with FDI has been a subject matter of much discussion in recent times. In fact, this issue was first raised at the Fund Balance of Payments Committee meeting in 1998, when the Committee agreed to add a supplement to BPM5. Subsequently, the Fund had circulated a paper titled The Statistical Treatment of Financial Derivatives[17]. But due to the lengthy process of rewriting the corresponding section 1993 SNA, the Fund has recently issued a revised guideline titled "Financial Derivatives: A Supplement to the Fifth Edition of the (1993) Balance of Payments Manual". This process confirmed the view that financial derivatives should be treated as financial assets and transactions in them, in general, be reported as separate transactions, rather than as integral parts of the value of the underlying transactions or financial assets to which they may be linked as hedges. The process led two significant changes in statistical compilation. First, a less restrictive view was taken as to which financial derivatives fall within the SNA asset boundary, allowing for the inclusion of more over the counter instruments. Second, and related to the first point, interest rate swaps and forward rate agreements were recognized as financial assets, and net cash settlement payments in these contracts classified as financial transactions rather than as investment income flows.

3.9 In May 1997, the OECD's Group of Financial Statisticians (GFS), the Fund and the OECD jointly launched the Survey of Implementation of International Methodological Standards for Direct Investment (SIMSDI), a comprehensive survey of data sources, collection methods and dissemination and methodological practices for direct investment statistics. More than 100 countries participated in the survey. In general, the survey results indicated that countries have shown improvement, from the time of the Godeaux Report[18], in the extent to which countries conform to the international standards in the balance of payments manuals and the OECD's Benchmark Definition of Foreign Direct Investment.

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[17] Heath, R.M. (1998) *The Statistical Measurement of Financial Derivatives*, IMF Working Paper No.24, March., Washington.

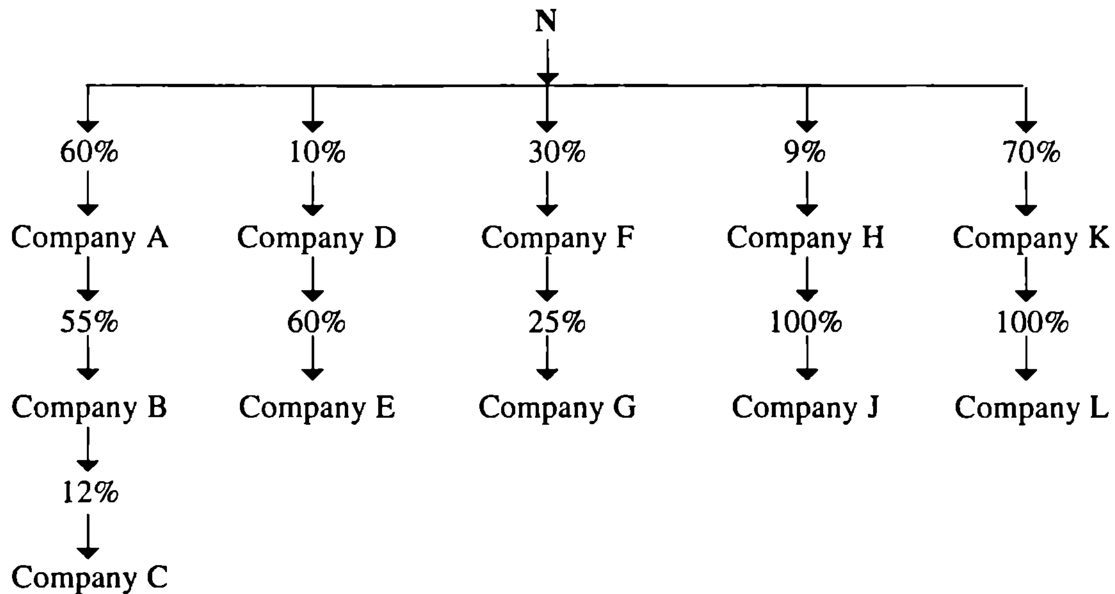
[18] (1992) *Report on the Measurement of International Capital Flows* (Chairman: Mr. Godeaux), International Monetary Fund, September.

3.10 United Nation's Conference on Trade and Development (UNCTAD) has served as a focal point within the United Nations Secretariat for all matters relating to foreign direct investment and transnational corporations. UNCTAD has been compiling data on Foreign Direct Investment (FDI), Foreign Portfolio Investment (FPI) and about transitional corporations in their World Investment Report since 1990.

Box 3.1

Identification of Related Enterprises in A Direct Investment Relationship

The following example illustrates the concept of subsidiaries, associates and branches comprising a group of enterprises related to a direct investor. Assume enterprise N has the following investments:



According to international standards, the enterprises A, B, C, D, E, F, J, and L are considered to be in a direct investment relationship with N and in direct investment relationships with each other. Transactions between these enterprises would be reported as direct investment transactions if they were between a resident and non-resident entity.

According to the definition of direct investment:

A is a subsidiary of N.

B is a subsidiary of A and therefore a subsidiary of N, even though only 33 per cent of B is indirectly attributable to N.

C is an associate of B and therefore an associate of N, though N's subsidiary B, even though only 4 per cent of C's capital is indirectly attributable to N.

D is an associate of N.

E is subsidiary of D and therefore an associate of N, even though only 6 per cent of E is indirectly attributable to N.

F is an associate of N.

G is an associate of F but not of N as F is only an associate of N.

H is neither a subsidiary nor an associate of N. No direct investment relationship is established.

J Is subsidiary of H but neither a subsidiary nor an associate of N.

K Is a subsidiary of N.

L Is a branch of K and thus a branch of N.

Section 3.2

Trends in FDI Flows to India

Trends in FDI flows to India

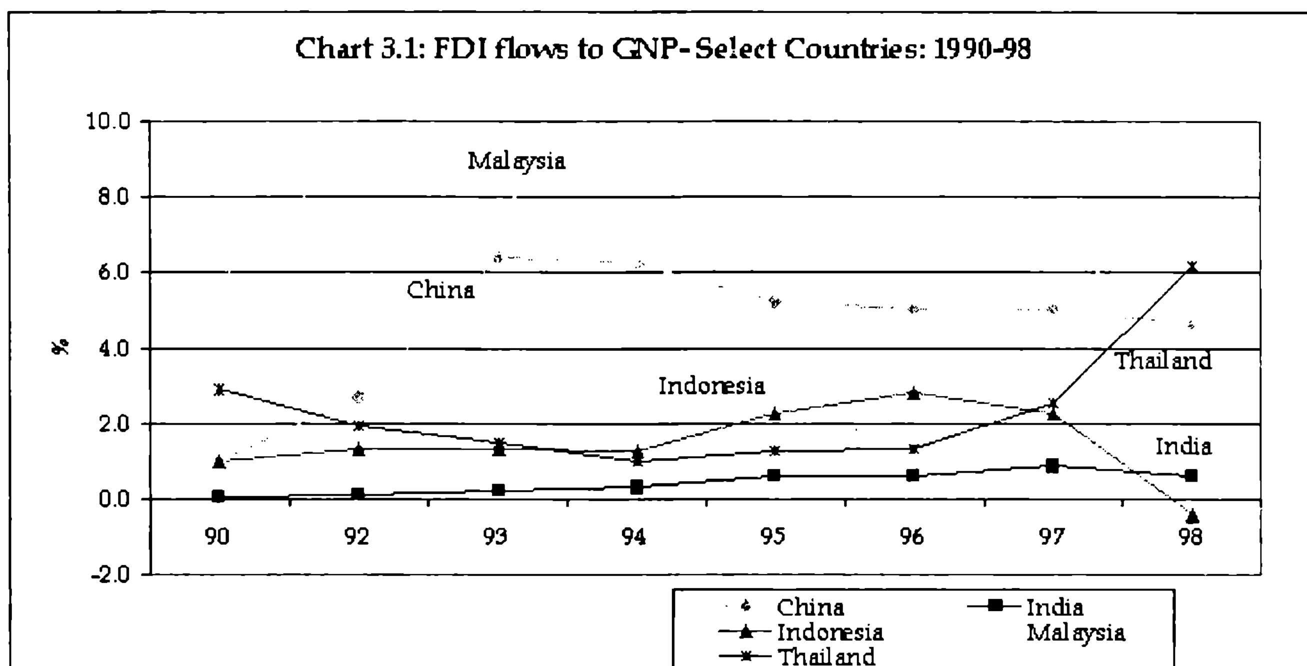
3.11 During the 1990s, India became one of the favorite destination for FDI flows in the world. During the decade, the average annual FDI flows to India expanded more than six times rising to $2.7 billion in 1995-98 and reaching a peack of $3.6 billion in 1997 from $ 470 million in 1991-94. FDI flows to India were about one half of that of Korea in the early 1990s, but during 1995-98, India almost caught up with $2.7 billion FDI as compared with Korea's $3.1 billion during that period.

3.12 The Government of India has made continuous efforts since the beginning of 1990 to attract FDI. The industrial policy reform, which was part of the New Industrial Policy Act of 1991, was further reinforced in February 2000 with fresh initiatives. Some of the recent major reforms include

- Ending the state monopoly in insurance and telecommunication;
- Opening up banking and manufacturing for competition;
- Foreign ownership cap raised to 100 per cent in most of the sectors
- Divestment of state stake in PSUs.
- Increasing foreign ownership in areas such as chemicals, electricity, construction, transport;
- Advertising, tourism and film production thrown open to foreigners.

3.13 But for a short negative list India has now an more or less automatic system of investment approvals except for a short negative list. Foreign exchange controls have been substantially relaxed and international trade markets are protected by legislation. India has 37 bilateral investment treaties and 93 Avoidance of Double Taxation Treaties. India is a member of Multilateral Investment Guarantee Agency since 1994.

3.14 Chart 3.1 shows net FDI inflows into India vis-à-vis major countries in the ASEAN region. Net FDI inflows are divided by GNP in each case in order to remove the effect of market size, inflation and currency movements. India attracted FDI flow on an average to the tune of 0.4 per cent of GNP in the 1990s as compared with 6.6 per cent in Malaysia, 4.5 per cent in China, 2.3 per cent in Thailand, 1.5 per cent in Indonesia, and 1.7 per cent in Philippines (See Chart 3.1). FDI flows as proportion of GNP was the highest in Malaysia; it increased from 2.3 per cent of GNP in 1990 to 7.3 per cent in 1998. Malaysia was one of the first to reach the limits of import substitution policies and promote export orientation of firms. Malaysia



also benefited from its proximity to Singapore, as substantial foreign presence in the latter offered opportunities for Malaysia to attract labour-intensive manufacturing in which Singapore was rapidly losing its competitiveness. Thailand also attracted FDI investment to the tune of 2.3 per cent of GNP in the 1990s, also due to export-oriented policies. Indonesia which attracted on an average about FDI investment of 1.5 per cent of GNP owes its success principally to oil and gas sector.

3.15 Essentially, the industrial policy has been the guiding post for formulating the foreign investment policy since independence. Foreign investment was highly regulated and government used to give prior approval on case-by-case basis until the beginning of 1980s when foreign investment policy was revised in view of widening deteriorating balance of payments position and emerging new international positions. Some special schemes were introduced to attract the foreign direct investment during the early eighties. Thus, 1980s witnessed a gradual but dissemble sign of easing of restrictions on foreign investment inflows. In the wake of sharp external payments difficulties, foreign investment was given more thrust by making the entry of foreign investors easy in the new economic reforms. Foreign direct investment policy was radically changed and a three-tier system of approvals of foreign direct investment was introduced. Presently, there are two routes viz., (1) Reserve Bank of India (RBI) Automatic Route and (2) Secretariat for Industrial Assistance (SIA)/ Foreign Investment Promotion Board (FIPB) Route. Under the automatic route, foreign investment is permitted in all sectors upto 100 per cent of the equity of the investing company, if the activities of the company do not lie in 13 areas as indicated in a list known as Annexure 3.2. However there are certain restrictions viz., cap on percentage holding by foreign investors in respect of 8 areas as indicated in Annexure 3.3. If

the investment is in areas indicated to is under Annexure 3.2 or if restrictions placed in Annexure 3.3 are attracted, an application is to be made to Secretariat for Industrial Assistance (SIA)/ Foreign Investment Promotion Board (FIPB). The details of the various FDI schemes and their reporting system are presented in Annexure 3.1.

3.16 Table 3.1 presents FDI flows by different categories. As can be seen from this table, nearly 80 per cent of FDI approvals are through SIA/FIPB route. But the actual FDI inflow as a proportion of approvals is only around one-fifth in the 1990s (Table 3.2).

Table 3.1: Foreign Direct Investment Flows by Different Categories

(US $ million)

	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
Total Foreign Direct Investment	**315**	**586**	**1314**	**2144**	**2821**	**3557**	**2462**	**2155**
Of which through								
a. RBI automatic route	42	89	171	169	135	202	179	171
b. SIA/FIPB route	222	280	701	1249	1922	2754	1821	1410
c. NRI (40% and 100%)	51	217	442	715	639	241	62	84
d. Acquisition of Shares	-	-	-	11	125	360	400	490

Source: Government of India, Economic Survey, 1998-99,p.100.

Table 3.2: Foreign Direct Investment: Actual Flows vs. Approvals

	1991	1992	1993	1994	1995	1996	1997	1998	Total (91 to 98)
Approvals									
Rs. Crore	739	5256	11189	13590	37489	39453	57149	28783	193648
US$ million	325	1781	3559	4332	11245	11142	15752	6975	55111
Actual Inflows									
Rs. Crore	351	675	1786	3009	6720	8431	12085	9116	42173
US$ million	155	233	574	958	2100	2383	3330	2230	11963
Actual inflows as % Of Approvals, (in US $ terms)	**47.7**	**13.1**	**16.1**	**22.1**	**18.7**	**21.4**	**21.1**	**32**	**21.7**

Source: Government of India, Economic Survey, 1998-99,p.

3.17 The source and direction of foreign investment flows including FDI inflows show that Mauritius and USA are the major source of foreign investment inflows during 1990s followed by Japan (Table 3.3). Bulk of the FDI investment was channelised into engineering electronics, food and dairy products.

Table 3.3: Foreign Investment-Countrywise Inflows

(US $ Million)

Source	1990-91		1997-98		1998-99		1999-2000	
	Amount	% to total	Amount	%to total	Amount	% to total	Amount	% to total
1. Mauritius			900	30.5	590	29.5	501	31.7
2. U.S.A.			687	23.2	453	22.6	355	22.4
3. Japan			164	5.5	235	11.7	142	8.9
4. Italy			43	1.5	116	5.8	125	7.9
5. Germany			151	5.1	114	5.7	31	2.0
6. South Korea			333	11.3	85	4.3	8	5.1
7. Netherlands			159	5.4	53	2.6	82	5.2
8. Others			518	17.5	354	17.8	337	21.3
Total (1 to 8)			2,956	100.0	2,000	100.0	1,581	100.0

Source : RBI, Annual Report, 1999-2000, p.108

Section 3.3.

FDI- Present Data Capture Mechanism in India – Its Strength and Limitations

Present Data Capturing and Monitoring of FDI

3.18 In India, the balance of payment statistics including that of FDI are compiled on a quarterly basis by the Reserve Bank of India, using an international transactions reporting system (ITRS) as the principle source of information. ITRS is supplemented by enterprise surveys conducted by the RBI and information from Government departments/agencies. Under the ITRS, ADs are required to report details in respect of transactions when an individual remittance exceed a stipulated amount.

3.19 The ITRS forms are coded manually and the processed results of BOP figures now available with a lag of one quarter; earlier the time lag for publication was two years. This improvement was possible due to the introduction of a new reporting system from 500 critical ADs accounting for 80 to 85 per cent of the transactions (that have the capability to report ITRS forms electronically).

3.20 Foreign Direct Investment (FDI) statistics in India is collected and disseminated by the Reserve Bank of India. The regulatory reporting system in India is discussed in Annexure 3.1. Data on fresh foreign direct investment obtained under various routes (i.e. RBI, SIA/FIPB, NRI/OCB, and Merger and Acquisitions) in India is captured through two sources viz., (a) Authorised Dealers (ADs), and (b) through 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. While 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 concerned regional office of the ECD. The data reported by the companies to the RBI is used as a benchmark for final compilation and monitoring of these data.

3.21 Two sets of FDI data are disseminated – (1) FDI sanctions which contains data in respect of SIA/FIPB approvals and (2) FDI inflows which contains data in respect of SIA/FIPB and RBI automatic route. The data based on FDI sanctions provide information about the industry-wise approvals but this again is not based on standard NIC classification. Data of origin of FDI inflows based on sanctions is also available.

Deficiencies in Data Capturing of FDI flows in India

3.22 The deficiencies in data capture on foreign direct investment in India are as follows.

- A major lacunae in FDI statistics is the absence of information on FDI outflows.

- Data on fresh inflows of foreign direct investment are being captured through reporting of these transactions by (a) the companies who receive these funds as well as through (b) reporting of these transaction by the banking system (ADs) in R-returns submitted on a fortnightly basis. Data on "retained earnings" are captured through a quinquinnal census and surveys on an annual basis with a lag of three to four years. As per SDDS requirements, data on retained earnings "along with other BoP accounts should be available quarterly with a lag of one quarter. The Reserve Bank has already launched quarterly enterprise surveys to collect these data. But the quality of even annual data collected presently is far from satisfactory. Firstly, as discussed in Chapter 2, the coverage of these enterprise surveys is very low. Secondly, even at the company level data are readily available only by the end of the year when they finalise their balance sheets. Hence the institutional arrangements for capturing data on retained earnings need to be revamped.
- Data on other direct investment capital transactions (e.g. inter-company loans) are currently inseparably included in loans under 'other investment'.
- At present, the classification of foreign investment flows based on the above reporting system, basically classifies foreign investment flows which comes directly to the company as FDI and which comes through the stock exchange as FPI. Consequently, the cardinal principle of 10 per cent rule given in BPM5 to determine direct investment is not strictly adhered to.
- There is at present no mechanism through which it could be known that a particular company has received FDI investment and issued shares but not reported. There is no system by which it can be monitored that the company has received funds but not issued the shares. In other words, information about population of FDI companies is not adequate.
- There is no adequate system in place by which approvals by SIA/ FIPB can be monitored for fruition.
- The industry classification is not in terms of any standardized code such as NIC classification.
- There is considerable FDI investment in service sector, but there is no standard classification for service sector.
- In the case of investment under NRI/ OCB route, no comprehensive database is available. This is particularly so in the case of NRI investment through their rupee accounts.
- Under NRI/ OCB and Mergers and Acquisition routes, inflow data is collected scheme-wise. Sector-wise and industry-wise classification is not captured.
- FDI investment by international bodies in Indian companies as venture capital fund is not fully captured, especially when they divest their equity holding.
- Foreign investment through non-equity routes viz. subcontracting, management contracts, turnkey arrangements, franchising, licensing, product sharing, equipment supply, and technical know-how are not captured at all.

Statistical Requirements as per BPM5

(a) BoP Components

3.23 Countries are expected to compile and disseminate FDI data according to the standard components of BoP presented in the BPM5 (Table 3.4). These components are (a) direct investment income, (b) direct investment transactions and (c) direct investment position.

3.24 The direct investment income component is divided into categories for (i) income on equity and (ii) income on debt. Direct investment transactions are sub-classified into (i) equity, (ii) reinvested earnings (iii) other capital (inter-company transactions) and (iv) financial derivatives.

3.25 Direct investment position data are divided into categories for (i) equity capital plus reinvested earnings (ii) other capital and (iii) financial derivatives.

Table 3.4: Standard Components of BOP as per BPM5
(Direct Investment)

Components	Credit	Debit	Net
1. Direct Investment Abroad			
1.1. Equity Capital			
1.1.1.1. Claims on affiliated enterprises			
1.1.1.2. 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			

(b) IIP Components

3.26 The international investment position (IIP) is the balance sheet of the stock of a country's external financial assets and liabilities. The statistical framework for the IIP is IMF's Balance of Payments Manual (BPM5). The IIP framework records at a specified date an economy's claims on and liabilities to the rest of the world (residency principle), in addition to monetary gold and SDRs. Foreign assets and liabilities are valued at market prices in the IIP. Compliance of IIP is set in a three-year transition period framework which is to end on December 31,2001. The data are to be disseminated on an annual basis within two quarters of the reference period; dissemination of quarterly data within one quarter is encouraged.

3.27 The IIP compilation requires national compilers to account for changes in foreign assets and liabilities in terms of price and exchange rate changes.

Section 3.4

Proposed Modifications in Data Capturing/ Monitoring

3.28 The requirements of international standards in statistical compilation discussed above cannot be met by present ITRS system as detailed information is only available with entities. Moreover the present enterprise surveys of assets and liabilities will also not be able to meet such data bifurcation. Hence both the present enterprise survey formats and ITRS system need to be modified. For meeting BPM5 and IIP standards one has to depend on modified enterprise surveys (India's Foreign Assets and Liabilities) for which we recommend the incorporation of IIP standards (Table 3.5). A suitable survey model worth emulating is the quarterly survey method adopted in Hong Kong and Australia (Australian Bureau of Statistics).

Table 3.5: Standard Components of International Investment Position as per BPM5

(Direct Investment)

Components	Position at Beginning of Year	Changes in Position Reflecting				Position at End of Year
		Trans-actions	Price Changes	Exchange Rate Changes	Other Adjust-ments	
1. Direct Investment Abroad						
1.1. Equity Capital and Reinvested Earnings						
1.1.1. Claims on affiliated enterprises						
1.1.2. Liabilities to affiliated enterprises						
1.2. Other Capital						
1.2.1. Claims on affiliated enterprises						
1.2.2. Liabilities to affiliated enterprises						
1.3. Financial Derivatives						
1.3.1. Claims on affiliated enterprises						
1.3.2. Liabilities to affiliated enterprises						
2 Direct Investment in India						
2.1. Equity Capital and Reinvested Earnings						
2.1.1. Claims on direct investors						
2.1.2. Liabilities to direct investors						
2.2. Other Capital						
2.2.1. Claims on direct investors						
2.2.2. Liabilities to direct investors						
2.3. Fiancnail Derivatives						
2.3.1. Claims on direct investors						
2.3.2. Liabilities to direct investors						

3.29 Timeliness of the data has an impact on the analytical value of the statistics. Timely data plays crucial role in facilitating more knowledgeable market decisions and more effective policymaking. There is an important trade-off for users between accuracy detail on the one hand, and timeliness of the release of statistics on the other. Generally, within given resource levels, significant improvements in timeliness can only be made at the expense of detail, accuracy and revisability. Besides, one has to also consider the burden of reporting by entities. Most countries face the trade off between comprehensive reporting as dictated by BPM5 and IIP and the burdens associated with such reporting. This involves delicate balancing of trade-off so that efficient monitoring is achieved. Given the fact that the base of monitoring capital flows in India is partially developed and the need to meet international data and transparency initiatives is growing, a certain degree of increase in burden of reporting is bound to occur. But given the substantial benefits it can bring as compared with marginal increase in costs of reporting entities, these are worth undertaking. Many countries have two sets of data: "most

timely" data followed by "most comprehensive" statistics. The IIP format which we had advocated would fall under "most comprehensive statistics" For policy purposes, it is essential that data generated should be timely and from this point of view we recommend certain modifications in present ITRS reporting system and these are discussed in subsequent paragraphs.

3.30 At present FDI data is generated through R-Returns which is timely but not very comprehensive given the statistical requirements of BPM5 and IIP. The data requirements of BPM5 and IIP can only be provided by FDI companies. Hence there is a need to augment/ revamp the existing quarterly enterprise surveys of assets and liabilities as per the IIP format prescribed by Fund (Table 3.4 and 3.5). A precondition for timely and comprehensive reporting is the existence of adequate legal framework for collection of data.

3.31 Foreign direct investment forms a part of financial account under balance of payments. Balance of payments is compiled in India on a quarterly and annual basis with a lag of three months. For balance of payments compilation all inflows i.e., fresh inflows and retained earnings and outflows under foreign direct investment are required on a quarterly basis. Under present reporting system, fresh inflows and outflows are being reported by the companies to the Reserve bank of India while they bring in foreign exchange under any of the routes of foreign direct investment and through R-returns also; retained earnings are captured through a survey of FDI companies conducted by the Bank. As balance of payments data is compiled quarterly and annually, information on foreign direct investment is required to be furnished on a quarterly and annual basis. Fresh inflows and outflows are reported on a monthly basis with a lag of around two months, while retained earnings under foreign direct investment are captured on an annual basis through a survey with a lag of around three years. Various proposals to capture appropriate and timely information on foreign direct investment would be discussed in the following sub-sections.

Capture of Forex Transcations at Branch Level (ADs).

3.32 The Exchange Control Department of the RBI is at in the advanced stage of finalizing an "electronic form" for monitoring Foreign Exchange Transcations. The aim of the proposed monitoring system is to monitor the present regulatory prescriptions as well as generate data for BoP and for other statistical requirements. The proposed system is based on collection of data from the branches of the banks (ADs) dealing in foreign exchange. It is based on the presumption that almost all of external accounts data emanates from some transaction that takes place at the level of the bank branch. The aim is to capture the transaction that takes place at the bank branch in its totality. Each transaction in respect of foreign exchange carried out at the branch will result in creation of a record with necessary codes. The entire work carried on at a branch throughout the day will result in one transaction file. This file is proposed to be transferred to the Central Office of Exchange Control Department of RBI over V-SAT.

At the Central Office various files from the bank branches will be received and merged into a main transaction file. One programme at the Central Office will detect as to what variables are present in the particular record and will update all the tables having that variable. If at a later date we want to have a new table it can be prepared from the main transaction file. These tables will be used for processing the data in order to obtain final output statements. The data will also be used for making some preliminary statistical analysis and also it will be passed on for further statistical and policy analysis. The various modules in the programme are discussed in Annexure 3.4.

Section 3.5

Conclusions

3.33 The conclusions of the this chapter can be summarized as follows:

- India's attractiveness as a FDI destination has improved considerably in recent years.
- The compilation of FDI statistics – both stocks and flows- has to be based on internationally accepted BPM5 and IIP frameworks.
- The balance of payment statistics and those of FDI are compiled on a quarterly basis by the Reserve Bank of India, using an international transactions reporting system (ITRS) and by detailed enterprise surveys conducted by RBI and information from Government departments/agencies.
- The data on foreign investment flows by source and nature of industry are available and disseminated publicly, but data in respect of FDI and FPI is not disseminated separately.
- At present, the classification of foreign investment flows based on the ITRS reporting system, basically classifies foreign investment flows which comes directly to the company as FDI and which comes through the stock exchange as FPI. Consequently, the cardinal principle of 10 per cent rule given in BPM5 to determine direct investment is not strictly adhered to.
- Due to the absence of strong legal framework and absence of penalty for non-reporting the coverage of the present enterprise survey (India's Foreign Assets and Liabilities) is dismally low and inadequate.
- A major reason for the low coverage of present enterprise survey (India's Foreign Assets and Liabilities) is the absence of adequate information of entities with foreign exchange exposure (population size), which constrains the coverage and reliability of statistics collected. . It would be worthwhile for authorities also to undertake an exploratory survey of suspected units with international exposure so as to identify those missed from the population frame.

- For meeting BPM5 and IIP standards one has to depend on modified enterprise surveys for which the incorporation of IIP standards is recommended. The incorporation of IIP standards would involve redesigning the enterprise surveys on lines undertaken in Hong Kong and Australia.

- Countries could have two sets of data: "most timely" data followed by "most comprehensive" statistics. The IIP format which we had recommended would fall under "most comprehensive statistics" For policy purposes, it is recommended that a ITRS reporting system based on the lines proposed in Annexure 3.2 on capturing on foreign exchange transactions at branch level (ADs) may be implemented.

- It is very essential that the FDI statistics generated in India is of international standards. Hence there is a need to work with international agencies like OECD to harmonise our methodological standards with that of advanced countries.

- It is also worthwhile to explore the possibility of maintaining data on non-debt flows (both flows and stocks) in CS-DRMS2000+ so as to facilitate compilation of BoP and IIP statistics in accordance with BPM5.

CHAPTER IV

MEASUREMENT OF PORTFOLIO INVESTMENT IN INDIA

In recent times, private capital flows in the form of portfolio flows have increased considerably to developing countries. The 1995 Mexican crisis[19] and the East Asian financial crisis[20] brought into focus the role of portfolio flows especially that of offshore investment funds in exacerbating volatility in markets they invest in [Kin and Wei (1999[21])]. India has also received around $ 1-4 billion of net annual inflows on account of portfolio investment in recent years and has been a major source of volatility in capital and foreign exchange markets in recent years. . In India, in recent times, there has been internationalization of equity markets and this has taken several forms. First, the movement towards dematerialized form of shares has led to higher turnover of the investments in equity markets and issuance of "depository receipts" (DRs) which can be traded internationally. Secondly, many Indian IT companies have passed national markets and have gone abroad and even listed their shares (ADRs) on the overseas stock exchange. Thirdly, IT companies have been allowed to retain 70 per cent of their export earning abroad which can be used for overseas acquisition of firms/assets[22]. Hence the need to monitor portfolio flows has become imperative. In this chapter, we examine the various aspect of data capture of portfolio flows.

4.2. As per BPM5, portfolio investment includes investment in resident entity in one country in the equity and debt securities of an enterprise resident in another country which seem primarily for capital gains and do not necessarily reflect a significant and lasting interest in the enterprise. The category also includes investments in bonds, notes, money market instruments and financial derivatives other than those included under direct investment. Data on portfolio flows published by international agencies like IMF, World Bank and national authorities greatly differ. IMF uses balance of payments data while World Bank uses data reporting under its Debtor Reporting System and market sources of information. Data compilers have enormous difficulty in compiling accurate estimates of FPI; the greatest source of inaccuracy is the application of threshold rule such as the 10 per cent rule. In fact the major source of discrepancy at the global level has been traced to discrepancy in portfolio flows.

[19] During the Mexican crisis, portfolio flows to Latin America fell from a net inflow of $ 61 billion 1994 to approximately zero during 1995(See, IMF(1998) *International Capital Markets- Developments, Prospects and Key Policy Issues*, Washington D.C,p.16.

[20] In the case of East Asian financial crisis, decline in bank lending to the tune of $73 billion, apart from a decline of portfolio flows to the tune of $8.5 billion and FDI to the tune of $2.4 billion in 1997 contributed to the crisis. See IMF (1998) *op.cit*,p.16.

[21] Kin, W and Wei, S.J (1999) ' Offshore Investment Funds: Monsters in Emerging Markets?', NBER Working Paper No. 7133.

[22] Acquisition can be from EEFC Account, 50 per cent of ADR/GDR proceeds, stock swap etc.

4.3 In general, portfolio flows have greater volatility than FDI flows as they are less costly to reverse and has the potential to assume "hot money". Portfolio flows also require servicing in the form of divestment and repatriation. As outflows under portfolio investment would occur at market price (and not at book value), valuation of portfolio investment periodically on mark-to-market assumes greater importance. Even though, portfolio flows are not included in the external debt of the country, they could assume the character of "hot money" under adverse conditions and could influence the forex situation and its price (exchange rate) in the country. Hence from the point of liability/debt/forex management and policy point of view, it is necessary to know the magnitude of reversible portfolio flows at any point in time. This chapter is devoted to the analysis of issues involved with portfolio flows in India –analytical, statistical and data capture and reconciliation of data compiled by different agencies. This chapter is organized as follows: In Section 1, the international initiatives to monitor portfolio flows is examined. In section 2, magnitude of Foreign Portfolio flows to India vis-à-vis other ASEAN countries is analysed. Section 3 analyses the portfolio investment scheme in India. Section 4 examines the data capturing/ monitoring mechanism with respect to portfolio flows in India is discussed including the issue of reconciliation between the data on FIIs investment reported by the Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI). In Section 5, the modifications to the data capturing mechanism of FII investments and their valuations and the new institutional arrangement is presented. The data capturing issues related to GDRs, ADRs, and FCCBs are discussed in section 6. The issues related to monitoring of flow of investments by Indian Mutual Funds in Overseas Securities Markets are examined in section 7. Section 8 summarises the major conclusions of this chapter.

Section 4.1

International Initiatives to Monitor Portfolio Flows

Measurement of Portfolio Flows

4.4 The Fund's BPM5[23] defines portfolio investment as:

> "Equity securities and debt securities in the form of bonds and notes, money market instruments and financial derivatives such as options. Excluded are any of the aforementioned instruments included in the categories of direct investment and reserve assets"(p.91).

Thus according to Fund's BPM5 portfolio investment includes investment in resident entity in one country in the equity and debt securities of an enterprise resident in another country which seem primarily for capital gains and do not necessarily reflect a significant and lasting interest in the enterprise. The category also includes investments in bonds, notes, money market instruments and financial derivatives other than those included under direct investment. Thus

[23] International Monetary Fund, (1993) *Balance of Payments Manual*, Fifth Edition, Washington, p.91.

Fund BPM5 even includes derivatives or secondary instruments like options in the category of FPI.

4.5 According to the Fund's 1996 Coordinated Portfolio Investment Survey Guide, the essential characteristic of instruments classified as portfolio instruments is that they are traded or tradable.

- Equity securities have been defined in the Survey as instruments and records acknowledging, after the claims of all creditors have been met, claims to the residual values of incorporated enterprises (shares, stocks, participation, American/Global Depository Receipts (ADRs/ GDRs), mutual funds and investment trusts.
- Debt securities include bonds and notes, money market securities (instruments such as treasury bills, commercial and finance paper, negotiable certificates of deposits with maturities of one year or less), and financial derivatives or secondary instruments, such as options. However, in the survey no guidelines or definitions were given for recording of money market instruments and financial derivatives.

Sources of Data on Portfolio Flows

4.6 There are different sources of FPI data, (a) the Fund, (b) the World Bank, (c) the Institute of International Finance, (d) source countries (such as United States Treasury, Bank of Japan) and (e) some commercial companies tracing investment funds such as Micropal of Standard and Poor's. But the figures compiled by these agencies do not tally due to differences in coverage and diverse methodology used. But the most important source of divergence in the estimates of portfolio flows is due to the difficulties of classifying "borderline" cases of foreign investment into FDI and FPI using theBPM5 prescribed 10 per cent criterion to identify "lasting interest" in companies.

(a) The Fund

4.7 The Fund provides perhaps the most comprehensive source of data on portfolio flows. The compilation of portfolio flows is based on Fund's BPM5. The methodological developments at the Fund in the compilation of portfolio flow can be traced back to Godeaux Committee Report (1992) which examined the conceptual issues and reasons for divergence in global and portfolio flows in detail[24]. The Godeaux Report had also examined the underlying factors causing discrepancies in the global financial account[25].

[24] The Godeaux Report was preceded by a report on statistical discrepancies in the world current account: (1987) *Report on the World Current Account Discrepancy* (Esteva Report), International Monetary Fund, September.

[25] In 1992, the IMF Committee on Balance of Payments Statistics was established to oversee the implementation of the recommendations contained in the reports of two Fund Working parties that investigated the principal sources of discrepancy in global balance of payments statistics published by the Fund; advise Fund on methodological and compilation issues in the context of balance of payments and international investment statistics and foster greater coordination of data collection among countries.

Report on the Measurement of International Capital Flows, 1992.

4.8 The main agenda of the Godeaux Report was to reconcile the discrepancy between assets and liabilities at the global level of capital flows. The capital account of the balance of payment is usually broken into four broader heads, viz., (i) direct investment, (ii) portfolio investment, (iii) other capital and (iv) reserves. World inflows in each of these four categories should, in principle, balance world outflows. The Working Party appointed by the Godeaux Committee found that during 1986 to 1989, global capital inflows in each year exceeded global outflows by an average of $ 40 billion per year. Through data reconciliation, the Working Party was able to reduce this global discrepancy by an average of $23 billion per year. The Godeaux Report concluded that the residual discrepancy was essentially attributable to portfolio investment. As can be seen from Table 4.1, even now there exists substantial divergence in the figures of assets and liabilities of global and portfolio flows. The committee had , therefore, recommended that a coordinated benchmark survey of international portfolio assets and liabilities broken down by partner country, be conducted among the major countries.

Table 4.1 : Global Balances on Capital Account and Portfolio Flows: 1991-98

(U.S. $ billion)

Year	Capital Account			Portfolio Investment		
	Credit	Debit	Balance	Asset	Liabilities	Balance
1991	23.5	13.7	9.8	-341.9	416.9	75.0
1992	28.8	9.2	19.6	-352.3	457.0	104.7
1993	31.5	12.2	19.3	-542.3	698.5	156.2
1994	44.3	21.8	22.5	-344.0	410.8	66.8
1995	39.0	21.4	17.6	-365.0	552.8	187.8
1996	55.2	54.1	1.1	-624.6	800.5	175.9
1997	45.6	46.1	-0.5	-717.3	997.3	280.0
1998	45.7	54.5	-8.8	-963.3	844.2	-119.1
Average Imbalance 1991-98			10.1			115.9

Source: International Monetary Fund (1999) Annual Report, IMF Committee on Balance of Payments Statistics,p4.

Fund's Coordinated Portfolio Investment Survey (CPIS)

4.9 Based on the recommendation of the Godeaux Report, the Fund undertook a CPIS survey to address global asymmetries in portfolio investment. The major goal of the Survey (CPIS) was to ensure that all the main investing countries undertook a benchmark portfolio asset survey at the same time; participating countries followed mutually consistent definitions and classifications. All participating countries provided a breakdown of their stock of portfolio investment assets by the country of residency of the non-resident issuer. The survey looked at 1997 overseas investments by 29 countries covering 4,000 banks, 8,000 non-bank financial institutions and 13,000 non-financial enterprises and was based on standardised definitions and methodologies.

4.10 The survey results which were published in January 2000 was able to identify an additional $750 billion in assets[26]. The survey data provides information on how participating countries allocated their portfolio investment assets among individual countries by the world's principal investing countries. This survey data provides a rich source of counterparty data for countries to reconcile their data on portfolio flows. Besides, the countries involved in the survey have provided meta data on the approaches they have used, the methodology employed, the survey frame, etc. which will be valuable for data computers. The Fund Committee on Balance of Payments Statistics, which examined the results of CPIS survey, viewed the survey a success and recommended the conduct of a repeat survey (at year end-2001). The content of the next survey is to be broadened to include country's portfolio holdings of assets of short-term debt securities (in addition to long-term debt securities and equities included in the first survey) held as claims on nonresidents, The 2001 survey will extend participation to more countries and offshore centers.

(b) The World Bank

4.11 The compilation of portfolio flows data by World Bank is based on its Debtor Reporting System (DRS). Bank uses apart from DRS information obtained from creditors through the debt data collection systems of other agencies such as the Bank for International Settlements (BIS), the Organisation of Economic Co-operation and Development (OECD), market sources (for instance, bond markets) and estimates made by country economists of the World Bank and desk officers of the Fund. As compared to Fund's quarterly and annual data, the World Bank data is available only on an annual basis and is regularly published in Bank's Report on "Global Development Finance".

(c.) U.S. Treasury Data

4.12 The United States Treasury data on portfolio transactions by US residents represents the

[26] International Monetary Fund, (2000) *Results of the 1997 Coordinated Portfolio Investment Survey*, , Washington, January.

most comprehensive source of country data available worldwide and dates back to 1997 for some countries. The data series provides monthly data on U.S. residents gross portfolio purchases and sales of foreign (non U.S.) stocks and foreign (non U.S) long-term bonds (bonds with an original maturity of over one year). The data is collected from banks, securities dealers, investors and "other entities" in the U.S. that deal directly with foreign residents regarding transactions in foreign securities. Data is published for a significant number of countries broken down on a regional basis into Europe, Latin America, Asia and Africa. Under each region, a category is provided for "other" that includes data for countries not independently identified. A fifth category in addition to these regional groups provides data on transactions undertaken by regional and international organizations.

(d.) Commercial Companies - Micropal of Standard and Poor's.

4.13 Estimates of portfolio flows to emerging markets have sometimes been derived from data on asset values of mutual funds invested in these markets. Micropal of Standard and Poor's is one such agency which compile data on emerging market equity funds and report on their performance (returns to shareholders), size (in terms of net asset values) and type (open vs close ended). Some analysts have utilized data on changes in total net assets of open ended funds to estimate net equity flows to emerging market economies (Rea (1996[27]))

Recommendations of the Draghi Committee Report of the Working Group on Capital Flows on Data Requirements.

4.14 The Draghi Committee Report of the Working Group on Capital Flows (2000) appointed by the Financial Stability Forum has also examined the issue of reconciliation between debtor and creditor data. While admitting that total reconciliation is not feasible due to conceptual, methodological and differences in source of data, the Report calls for "...efforts to reconcile as much as possible or at least explain the differences..".

[27] Rea, J (1996) 'U.S. Emerging Market Funds: Hot Money or Stable Sources of Investment Capital', Investment Company Institute, *Perspective*, December.

Section 4.2

Portfolio Flows to India – An Inter-country Comparison

4.15 The average FPI inflow into India during the 1990s comes to $ 1.9 billion (Table 4.2). During the similar period, China attracted $3.2 billion Among the East Asian economies, Korea attracted $ 3.1 billion followed by Indonesia's $ 1.9 billion, Malaysia's $ 1.6 billion, Thailand's $1.1 billion and Philippines 0.9 billion . In relation to their GNP, Malaysia had the highest ratio, followed by Indonesia (Table 4.3). The next section is devoted to an examination of sources of portfolio flows in India.

Table 4.2: Foreign Portfolio flows to Select Countries : 1990-98.

Year	China	Korea	India	Indonesia	Malaysia	Philippines	Thailand
1990	0	518	105	312	293	0	449
1992	1194	3045	21	119	385	333	4
1993	3818	6029	1840	2452	3700	1445	3117
1994	3915	2525	4729	3672	1320	1407	-538
1995	2807	3559	1517	4873	2299	1961	2154
1996	3466	3700	4398	3099	4353	1333	1551
1997	8457	1257	2116	298	-489	73	-308
1998	1273	4096	342	250	592	454	2341
Average (1990-98)	3,116	3,091	1,884	1,884	1,557	876	1,096

Source: World Bank,(2000) Global Development Finance- Country and Summary data , Washington.

Table 4.3: FPI Flows to Select Countries: 1992-98

(% to GNP)

Year	China	Korea	India	Indonesia	Malaysia	Phillippines	Thailand
1992	0.3	1.0	0.0	0.1	0.7	0.6	0.0
1993	0.9	1.7	0.7	1.6	6.1	2.6	2.5
1994	0.7	0.6	1.4	2.2	1.9	2.1	-0.4
1995	0.4	0.7	0.4	2.5	2.8	2.6	1.3
1996	0.4	0.7	1.1	1.4	4.6	1.5	0.9
1997	1.0	0.3	0.5	0.1	-0.5	0.1	-0.2
1998	0.1	1.3	0.1	0.3	0.9	0.7	2.1

Source: Same as Table 4.2.

Section 4.3

Portfolio Investment Scheme in India

4.16 In India portfolio investment mainly constitute investment by foreign investors comprising Foreign Institutional Investors (FIIs), Non-Resident Indians (NRIs), Overseas Corporate Bodies (OCBs) and Persons of Indian Origins (PIOs) and others in (a) equity and debt securities, (b) funds raised by Indian Mutual Funds abroad (Off-Shore Mutual Funds) and (c) funds raised by Indian corporate abroad in the form of Global Depository Receipts (GDRs) and American Depository Receipts (ADRs). Broadly, the portfolio investors could be classified in two groups viz., Foreign Institutional investors (viz. FII's investment in GDRs/ADRs) and Non-Institutional investors like NRIs/ OCBs/ PIOs and others.

Various Facilities Available For Portfolio Investment

4.17 In India, various schemes are available for the portfolio investment by FIIs, NRIs, OCBs, and PIOs Box IV.1 presents definition of various portfolio investors in India and Annexure IV.1 presents an overview of permissible foreign equity by NRIs/OCBs/PIOs/FIs/FIIs. Since the inception of economic reforms in 1991, the environment was made more conducive for portfolio investment with bringing procedural changes for investment and offering more facilities for investment in equity securities as well as in debt securities. We discuss below the various investment facilities available to (a) FIIs, (b) NRIs/ OCBs/PIOs and the analysis is based on type of investment of these entities.

Box 4.1. Portfolio Investors

Non-Resident Indian (NRI):

An Indian citizen who stays abroad for employment/ carrying on business or vacation outside India or stays abroad under circumstances indicating an intention for an uncertain duration of stay abroad is a NRI.

Person of Indian Origin (PIO)

A person of Indian origin (PIO) is a foreign citizen (other than a citizen of Pakistan or Bangladesh) who is deemed to be of Indian origin if the following condition is met: (i) he or she held an Indian passport, at any time, or (ii) he/she or either of his/her parents or any of his/her grand parents was citizen of India by virtue the Constitutions of India or Citizenship Act, 1955 (57 of 1955). A spouse (not being a citizen of Pakistan or Bangladesh) of an Indian citizen or of a person of Indian origin is also treated as a person of Indian origin for the above purposes provided the bank accounts are opened or investments in shares/ securities in India are made by such persons only with their NRI spouses.

Overseas Corporate Body (OCB)

Overseas Corporate Bodies are bodies predominantly owned by individuals of Indian nationality or origin resident outside India and include overseas companies, partnership firms, societies and other corporate bodies which are owned, directly or indirectly, to the extent of at least 60 % by individuals of Indian nationality or origin resident outside India as also overseas trusts in which at least 60 % of the beneficial interest should be actually held by them and not in the capacity as nominees. The various facilities granted to NRIs are also available with certain exceptions to OCBs so long as the ownership/beneficial interest held in them by NRIs continues to be at least 60 percent.

Table 4.4: Investment Regulations for Entry Into and Exit From Selected Markets- End-1998

Country	Entry	Exit	
	Availability of Listed Stocks to Foreign Investors	Repatriation of interest, Dividends and Profits	Repatriation of Capital
Argentina	Free	Free	Free
Brazil	Free	Free	Free
Chile	Relatively free	Free	After one year
Czech Republic	Free	Free	Free
Mexico	Free	Free	Free
South Africa	Free	Free	Free
Turkey	Free	Free	Free
China	Special classes of shares	Free	Free
Hong Kong SAR	Free	Free	Free
India	Authorised investors only	Free	Free
Indonesia	Relatively free	Free	Free
Korea	Free	Free	Free
Malaysia	Relatively free	A 10 per cent levy on repatriation of capital gains	
Philippines	Free	Free	Free
Singapore	Free	Free	Free
Thailand	Relatively free	Free	Free

Source: International Monetary Fund (1999) Annual Report on Exchange Arrangements and Exchange Restrictions, Washington.

(a) Facilities for Portfolio Investment for FIIs in India

4.18 FIIs are allowed to invest in various instruments like, equities, Government securities, and units of Indian mutual funds etc. As compared with other countries in Asia and Latin America, in India only authorized investors are allowed to invest stocks in stock exchanges. FIIs with one-year (3-5 years earlier) track record can seek registration with SEBI on payment of an amount of $ 10,000 as registration fee and $1,000 for registration of each sub-account . Till date there are bout 541 registered FIIs in India. FIIs investment has to be routed through a custodian (for safe keeping of assets and settlement of trades); there are at present 15 custodians registered with SEBI. These authorised investors i.e., FIIs are free to exit without any lock in period i.e., there is free repatriation of dividend profits including capital (Table 4.4). FIIs investments are subject to a tax of 10 per cent and 30 per cent on long term and short-term capital gains respectively (Table 4.5). The FII funds routed through companies registered in Mauritius have occupied a special place in portfolio investment in India in recent times (See Box IV.2).

Table 4.5: Taxation of Capital Gains on Portfolio Investment in Selected Countries: 1999

Country	Top Marginal Rate (in per cent)
Czech Republic	32
Hungary	40
Mexico	35
Poland	40
Turkey	55
China	40
India	20
Indonesia	30
Hong Kong	15
Korea	40
Malaysia	32
Philippines	35
Singapore	28

Box 4.2- Double Tax Treaty with Mauritius:

The FII funds invested through companies registered in Mauritius has occupied a special place in portfolio investment in India in recent times.

India has a treaty with Mauritius for "Avoidance of Double Taxation Treaty" (AADT). Besides India has also similar arrangements with 59 countries. As per this Taxation agreement, if an entity is registered in Mauritius and is assessed for tax in Mauritius, the income earned by way of capital gains is totally exempted in India. There are four tax advantages to a Mauritian company:

i. The income from royalty is taxed @ 15 per cent against the normal rate of 20 per cent in India.

ii. The fees for technical services are not taxed in India unless the Mauritian company has a permanent establishment in India.

iii. The dividend income is totally exempted in India in the hands of the investor.

iv. The tax paid in India is allowed as a credit against the tax payable in Mauritius on that income.

Thus a Mauritius company investing in Indian stock markets virtually pays has no tax or a small amount of tax in India.

What makes the avoidance of double taxation treaty between India and Mauritius extremely attractive for FIIs is the nature of incorporation of a company in Mauritius as an off-shore entity. Under the Income Act, 1995 companies set up as off-shore entities in Mauritius pay a maximum of 15 per cent tax. For a registration of an offshore company in Mauritius, the capital requirement is very low (as low as $10). The other condition is that it should have at least two resident directors from Mauritius and at least two meetings in a year should be held in Mauritius. Such simplified procedure makes registration of a company in Mauritius simpler and attractive for FIIs.

Off-shore entities can freely repatriate profits and capital out of Mauritius because no foreign exchange control is applicable on them. Besides under the Mauritius laws, public inspection of documents relating to off-shore companies is not permitted.

Investment in Equity/ share of Indian companies

4.19 FIIs are permitted to invest in all type of securities in the primary and secondary markets including equity shares/ debentures of companies listed on the stock exchange(s) in India and also unlisted companies and PCDs/FCDs/Rights renunciations/ warrants/ units of domestic mutual fund schemes. They are also allowed to participate in (a) stock lending, (b) buy-back offers and (c) takeover offers. Portfolio investment in any of the listed companies on Indian stock exchanges/ over-the-counter exchange can be made by foreign institutional investors subject to the condition that the aggregate holding of shares of the FIIs/NRIs/OCBs put together does not exceed 24 per cent of the paid up equity capital of the company. The holding of a single FII or the concerned FII group i.e., aggregate holding of each SEBI approved sub-account of an FII in a company would also be subject to a ceiling of 10 per cent of total paid-up equity capital. However, the collective investment by FIIs limit can be increased by a company to 40 per cent on passing of necessary resolutions in their Board/share holders meeting. The overall ceiling of 24 percent[28] would, however, not include direct foreign investment by a foreign collaborator and investment by FIIs through Off-shore funds, Global Depository Receipts (GDRs) and Euro- Convertible Bonds.

Investment in Government securities

4.20 FIIs are also permitted to invest in Government securities. Since May 18, 1995, FIIs were permitted to invest in Government dated securities and treasury bills. The FIIs permitted include 100 per cent debt funds and FIIs with a ceiling of 30 per cent investment in debt instruments.

Investment in mutual funds

4.21 FIIs have been permitted to invest in mutual funds floated by public sector banks/ financial institutions and private sector. Reserve bank has granted general permission to domestic mutual funds to issue units or other similar instruments under the schemes floated by them with the approval of SEBI.

Forward Cover

4.22 The Authorised Dealers (ADs) are permitted to provide forward cover to FIIs with rupee as one of the currencies provided that the value of the hedge does not exceed 15 per cent of the market value of the equity as at the close of business on March 31, 1999, converted at the rate of US$1 = Rs.42.43 plus the increase in the market value/inflows after March 31, 1999 provided that the forward cover once taken does not exceed the value of the underlying investment. ADs were given the option of extending the cover fund-wise or FII-wise according to their operational feasibility.

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[28] In the case of banking companies, the limit is 16 per cent.

(b) Facilites available for NRI/ OCBs/ PIOs

4.23 NRIs/ OCBs/ PIOs are permitted to invest in shares and debentures of Indian companies, Government securities, commercial papers, company deposits, and investment in mutual funds floated by public sector banks/ financial institutions.

Portfolio investment in shares/ debentures of Indian companies

4.24 Portfolio investment by NRIs/ OCBs are permitted in shares / debentures through designated branches of authorized dealers preferably located at centers having stock exchanges. NRIs/ OCBs are permitted to make investment in shares/ debentures (convertible/ non-convertible) of Indian companies, with or without repatriation benefits provided the purchase is made through a stock exchange and also through designated branch of an authorized dealer. The investment will subject to an overall ceiling of (i) 10 percent of the total paid up equity capital of the concerned and (ii) 10 percent of the total value of each series of the convertible debentures issued by the company concerned for all non-residents with repatriation and without repatriation benefits taken together. Further, investment made by any single non-resident investor in equity/ convertible debentures of any listed Indian company should not exceed 5 per cent of its paid up equity capital or 5 per cent of the total paid up value of each series of convertible debentures issued by it. Designated branches of authorized dealers have been delegated powers to transact such transactions.

Government securities/ units

4.25 NRIs are freely permitted to invest their funds in Government securities or Units of UTI through authorized dealers. Units can also be purchased directly from UTI. Government securities and Units of UTI held by NRIs could be transferred and sold. Units of UTI can be, however, repurchased directly by UTI. Proceeds of Government securities are allowed to be repatriated if securities were purchased out of funds remitted from abroad or out of NRE/ FCNR accounts. Sale/maturity proceeds of securities purchased out of funds in NRO accounts can only be credited to NRO accounts and cannot be remitted abroad. Interest earned is, however, repatriable.

Commercial papers

4.26 NRIs/OCBs are allowed to invest in commercial papers issued by Indian companies complying with the conditions stipulated by RBI (IECD), on non-repatriation basis. General permission has been granted to this effect.

Company Deposits

4.27 General permission has been granted to Indian companies (including non-banking finance companies registered with Reserve Bank) to accept deposits from NRIs/ PIOs/ OCBs with repatriation as well as non-repatriation basis subject to certain conditions.

Investment in Mutual funds

4.28 NRIs/OCBs have been permitted to invest in mutual funds on both repatriation and non-repatriation basis.

Forward Cover

4.29 The same facility of forward cover offered to FIIs, which has been discussed above, was also offered to NRIs /PIOs/ OCBs subject to same conditions.

Table 4.6: Foreign Portfolio Investment Flows by Different Categories

(US $ million)

	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999 2000
Total Foreign Portfolio Investment	**244**	**3587**	**3824**	**2748**	**3312**	**1828**	**-61**	**3026**
Of which through								
a. FII's	1	1665	1503	2009	1926	979	-390	2135
b. GDRs and ADRs	240	1520	2082	683	1366	645	270	768
c. Off-shore funds & others	3	382	239	56	20	204	59	123

Source: Government of India, Economic Survey, 1998-99,p.100.

Section 4.4

Data capturing/ monitoring system of Portfolio investment in India

4.30 Presently, data on portfolio investment by FIIs is collected as part of ITR system (subject to certain limitations) and published on a periodic basis. The present data capturing mechanism with regard to portfolio investment in India by various agencies are presented in Box IV.2. Table 4.7 presents data generated by the Reserve Bank of India based on actual inflow and outflow data provided by Authorised Dealers. These data are at variance with those published by SEBI due to the following reasons:

(1) While RBI data is collected from ADs based on sale/purchase of equities[29]. On the other hand, SEBI data is based on net purchase/sales of equity and debt instruments and is collected from custodians and the reporting comprises of trades made in primary and

[29] RBI data is collected from custodian banks at a company stock level and is also based on the weekly net cash inflow.

secondary markets as well. SEBI data is more comprehensive in the sense the data includes FII's purchase of debt instruments as well.

(2) Reinvested sale proceeds would be included in SEBI data as in inflow while it would not be so for RBI which tracks actual inflows and outflows.

(3) SEBI figures incorporate all sales as outflows while actual outflows may be net of taxes and other expenses paid.

(4) While RBI may be capturing inflow data at the actual exchange rate, SEBI is converting all purchase and sales figures in a month into US $ at the monthly average exchange rate of previous month. Thus, the US $ figure in SEBI data is only indicative.

Table 4.7: FIIs Investment based on RBI and SEBI – 1993 to 2000

(US $ million.)

Period	Net Inflows reported by RBI	Net purchases reported by SEBI
1993-94	1665	1634
1994-95	1503	1528.3
1995-96	2009	2035.7
1996-97	1926	2431.9
1997-98	979	1650.1
1998-99	-390	-386.1
1999-2000	2135	2339.1
Sep-99	-154	-170.1
Oct-99	-100	-139.7
Nov-99	-23	283.2
Dec-99	356	345.4
Jan-00	129	45.1
Feb-00	477	707.2
Mar-00	342	275
Apr-00	322	593.4
May-00		57.5
Jun-00		-212.6
Jul-00		-336

Note: RBI data prior to 1996-97 are not comparable with subsequent data.

4.31 There are considerable gaps in the reporting of portfolio investment by NRIs/ PIOs/ OCBs . Besides, investments in unlisted companies by FII's is also an area which needs considerable improvement[30]

Box 4.3

Portfolio investment by FIIs in India - Present Reporting System

Portfolio investment by FIIs into equity/shares on the Indian companies as well as in Government securities are captured by two agencies viz., Reserve Bank of India (RBI), and Securities and Exchange Board of India (SEBI) through different sources.

Reserve Bank of India

As foreign exchange transactions are routed through authorized dealers (ADs), RBI collects data on FIIs investment from ADs. In a view of requirement of collection of information on FIIs investment on a high frequency basis for better monitoring, ADs are required to report the inflows and outflows of foreign exchange by FIIs on a weekly basis. ADs provide only fresh inflows and outflows of foreign exchange by FIIs and not the investment-wise break up (i.e. investment in equity/shares, government securities, and mutual funds etc.) of these inflows and outflows. This reporting mechanism of FIIs investment has the following limitations, viz., earned profit, realized capital gains and tax paid which are required for balance of payments compilation are not available.

Custodians are required to report daily transactions of FIIs to RBI. This is used to monitor the aggregate holding of FII in companies as per the applicable limits. Besides custodians also report FII wise transaction report covering individual trade details. Custodians are required on a monthly basis to reconcile the RBI's records with the custodian records. In addition, there is also a monthly report which summarises the number of trades and trade values. Custodians also report to RBI the net exposure of FIIs on derivatives.

Securities and Exchange Board of India (SEBI)

SEBI collect information on the purchase and sales of equity/ shares and debt securities by FIIs from their designated custodians on a daily basis. The purchases of equity/ shares and debt securities by FIIs are not only from fresh inflows but may also be from ploughing back of dividends and realized capital gains. The FIIs investment data capturing mechanism of SEBI provide only consolidated (trade wise) purchases and sales by them during a period and does not provide detailed information on break up of investment out of fresh inflows, realized capital gains, amount ploughed back etc.. Another thing left out in SEBI's data capturing system is the tax paid, other maintenance expense.

[30] Further there are special funds of India institutions and banks which are floated outside the country under specific approvals from RBI. Some of these have constituted under mutual fund structures whereas some have specific RBI approval. While these funds use local custodians, their portfolios are not traced. They can represent significant proportions of foreign investments.

Section 4.5

Proposed Modifications in the Data Reporting/ Monitoring Mechanism of FII Investments in Securities

4.32 The limitations of the existing data reporting mechanism of portfolio flows was discussed in Section 4 .The modified data reporting/capturing mechanism will need to collect comprehensive data in a timely manner so as to be useful for policy purposes and also meet international standards of data dissemination. Hence there may be need to modify the existing data reporting system of portfolio flows to overcome these deficiencies. This may involve new institutional arrangements for data reporting. From BoP compilation, liability/forex management point of view, finding out mark to market value of the portfolio investment is very crucial and the institutional arrangements to get this information reported on a periodic basis as well as methodology to derive the mark-to-market value need to be devised.

FIIs investment

4.33 FIIs turnover (purchase and sales) in Indian stock exchanges is reported in Table 4.8 and these show that FIIs tunover has increased from Rs.10,361 crore in 1994-95 to Rs. 1,00,659 crore in 1999-2000. FIIs now account for about 5 per cent of the total turnover in Indian stock exchanges. FIIs cumulative net investment now accounts for 5 per cent of total market capitalization in India (Table 4.9). As discussed in Box IV.2 portfolio investment by FIIs are reported to the Reserve Bank and SEBI. As regards portfolio investment by Foreign Institutional Investors (FII's) is concerned, currently there is in place, a structured monitoring mechanism , viz., (a) the designated securities custodian to SEBI, and (b) the designated cash agent to RBI.

Table 4 .8 : Share in Annual Trading Volume Accounted for by Foreign Institutional Investors in India: 1994-95 to 1999-00.

(Amount in Rs. Crore)

Year	Purchases	Sales	Total Turnover by FIIs	Total Turnover (All India)	Share of FIIs in Total Turnover (Per Cent)
1994-95	7569	2792	10361	162905	6.4
1995-96	9575	2851	12426	227368	1.2
1996-97	14742	7342	22083	646116	3.4
1997-98	18212	12298	30510	908681	3.
1998-99	16320	17126	33446	1023382	3.3
1999-00	55299	45360	100659	2067031	4.9

Source: Reserve Bank of India, SEBI.

4.34 The reporting by the securities custodian to SEBI essentially consists of, (a) daily report of the inflows and outflows of securities into the FII account, i.e., trades for purchases/sales in secondary markets; (b) trades for purchases in primary markets (IPO' s),private placements; (c) trades for investing in rights issues; (d) receipts of corporate benefits (bonus shares); (e) purchase/sale of debt securities (f) conversion, splits and consolidations, mergers, amalgamations, etc. (g) cancellations and amendments to the above trades/data. Besides there is also monthly report submitted by the Custodians to SEBI, which is essentially a summary of the daily reports, with the additional input of the net holdings of the FII as a percentage of the issuer company's paid-up capital. These reports are to be issued separately for each sub-account of a Registered FII.

Table 4 .9 : Ownership Ratio of Domestic Investors and International Investors in India: 1994-95 to 1999-00.

(Amount in Rs. Crore)

Year	Market Capitalisation (All India)	FIIs cumulative net investment	FIIs share in total market capitalization
1994-95	473349	10225	2.2
1995-96	572257	16950	3.0
1996-97	488332	24350	5.0
1997-98	589816	30078	5.1
1998-99	574064	29272	5.1
1999-00	912842#	39211	4.3

relates to BSE only.

Source: Same as in Table 4.8

4.35 Gaps in the present reporting system However, considering the information available with the securities custodian, it is not possible at present to bifurcate the data reported by custodians to SEBI into, (a) purchases made from fresh inflows of foreign exchange, and (b) purchases made out of re-invested earnings . Besides, the present reporting system does not capture the following:

- Taxes paid by FIIs (required for balance of payments compilation);
- Dividend earned
- Dividends re-invested
- Profits earned
- Profits reinvested

"Mark-to-Market" Value of FIIs Investment

4.36 Arriving at "mark-to-market" value of FII investments on a periodic basic is very crucial from not only data compilation angle but also from the point of view of framing policies in this regard. For this a methodology and basis for deriving portfolio valuations of FIIs on mark to market basis on a monthly basis needs to be devised.

4.37 Proposed recommendations: The mark to market value of FIIs investment take into account the determination of the price for valuation of listed as well as unlisted securities. For the valuation of FIIs investment at market price following measure may be considered:

1. For the listed securities, closing price on the last working day of the applicable month across the two major exchanges viz. The Bombay Stock Exchange (BSE), and National Stock Exchange of India Ltd. (NSE) may be used as initial measure.
2. In the case of unlisted securities, the book values as at the end of a financial year be used.
3. RBI/SEBI may need to instruct unlisted companies/ companies having unlisted securities having FII investments, to provide the book value on an annual basis to the custodians of the FIIs to ensure compliance.
4. If the book values are not available, paid-up value of the shares can be taken for valuation purposes;
5. In respect of debt instruments, the valuation may be done on the face value of the investment.

4.38 Custodians of FIIs may be assigned the task of arriving at "mark to market" value of both equity securities and debt securities, separately on the above discussed measures on a monthly basis. This may not be difficult task for the custodians as their remuneration from FII is often linked to the "mark-to-market" value of their portfolio. Further, the foreign funds having specific approval may also be brought under the reporting system as applicable to FIIs so that their portfolios may also be traced.

Reinvested Earnings

4.39 As per BPM5, foreign investment flows will have to be bifurcated into (a) equity capital, (b) reinvested earnings, (c) other capital and (d) financial derivatives. For estimating reinvested earnings, we recommend the following procedure.

Reinvested Earnings (RE) = Net Purchases (NP) - Net Inflows (NI)

Where

Net Inflows = Inflows – Outflows

Net Purchases = Purchases – Sales

When NI>NP, RE will be negative and when NI<NP, RE will be positive. Based on the above concept, we had worked out re-invested earnings based on the above concepts for certain custodial accounts and these have yielded positive results. These data is at present already reported by ADs to RBI.

Portfolio investment by NRIs/OCBs:

4.40 The investments are to be made by NRIs/OCBs only out of the fresh remittances from abroad through normal banking channel or out of the funds held in the NRE/FCNR account of the NRIs/OCBs with the bank.

4.41 Present reporting system: As per the earlier practice, RBI used to give approvals to the NRIs/OCBs on the basis of an application in Form RPC/RPI (i.e. RPI for NRIs and RPC for OCBs) before they were allowed to invest in the secondary market. But as per the revised guidelines, presently, NRIs/OCBs do not require RBI approval for making investment in secondary markets in India. However, banks are required to report to RBI on a daily basis company-wise investment made by OCBs/NRIs in Form LEC(NRI).

4.42 Gaps in the present system: The present guidelines indicate that the shares/securities acquired by these NRIs/ OCBs might be kept with the designated bank with whom the bank account (FC) is opened. However, it is not mandatory and allows the NRIs/OCBs to keep their acquisition of shares with any other local representative of their choice (i.e. relative, friend or broker etc.) in India. It also allows exporting the shares to the country of residence of the NRI investor. Thus it is very unlikely of an existence of a single source of information relating to the investments made by these class of investors. Even if such an information exists, it may not be complete as the acquisitions outside India (without specific fund flow, which do not appear in LEC reporting) will not be known. Similarly, the sale transactions by these investors are not known except that the designated bank collects information at the time of repatriation of sale proceeds.

4.43 Even though, the regulations are specific about NRIs/OCBs transacting the business on delivery basis, they (NRIs/OCBs) may opt for holding the shares in street name without registering the transfer. Thus, these transactions may not be appearing in the periodic company report of share holding pattern to RBI.

4.44 Proposed recommendations: In the absence of an authentic single source, it has not been possible to assess the size of investments by NRIs/OCBs in the Indian securities markets. However, similar information is readily available in respect of FIIs investment. This was possible as the appointment of local custodian for the FII investment is mandatory and the local custodian submits the periodic reports to the regulators.

4.45 As a first step in this direction, it is suggested that, some of the existing guidelines in the Exchange Control Regulations are to be clarified/ modified so that the information flow relating to OCBs' investments are compiled on a regular basis. The steps recommended in this directions are:

- Mandatory appointment of custodian in India for OCBs to hold their acquisition of shares and securities in Indian markets including acquisition of shares through direct deals and/ or exercising the conversion option on FCCBs and of GDRs into underlying shares;
- Custodians to submit periodic report to RBI giving the value of outstanding investment of OCBs at the current market price; and
- All other reporting on flow of funds of OCBs investments to continue.

NRI Investment :

4.46 It is observed that large investments by NRI community are routed through an OCB to avail the tax benefits. Investment by individuals (NRIs) is not very significant in value terms but quite high in terms of numbers. Thus imposing the condition of holding the investments through a custodian may not be a prudent one. Thus, there is only a limited way by which these information relating to outstanding investments of NRIs can be compiled.

4.47 Presently, all the companies, which have non-resident share holders, are expected to submit periodic reports (either quarterly or half yearly) to RBI giving their share holding pattern. We recommend a modification to such report so that NRI holdings (Individuals) can be separately shown. In case of listed shares the value can be arrived at by taking the last traded price of the scrip on a recognized stock exchange. In case of unlisted shares the valued price of the scrip, if available, or book value of the scrip may be taken for arriving at the value.

4.48 As the efforts involved in the collection and compilation of these details are very large, option of availing the services of any reputed agency should be explored.

Section 4.6

Data on GDRs, ADRs and FCCBs

Various Issues on GDRs, ADRs, and FCCBs

4.49 Amount raised by Indian companies through GDRs/ ADRs have increased substantially since after they were allowed to source the funds from overseas through these instruments in 1992. Even though Indian companies were also permitted to mobilize funds from overseas markets through issuing Foreign Currency Convertibility Bonds (FCCBs) during the same year, the amount raised by Indian companies through FCCBs is not substantial in comparison of issue of GDRs/ ADRs. There are various issues related to data capturing on GDRs, ADRs, and FCCBs, which would be dealt in the following paragraphs.

Global Depository Receipts (GDRs)

4.50 The underlying shares of a Depository Receipts (DRs) issue are allotted in the name of Overseas Depository Bank (ODB), who in turn issues Depository Receipts in the international market. The underlying shares are deposited with a local custodian approved by the Government of India (GOI) and Reserve bank of India (RBI). As long as the DRs are in validity the underlying shares continue in the safe custody of the local custodian and no dealing in these shares are possible.

4.51 Presently, the local custodians of the DRs are sending a monthly report to RBI giving the details of DRs cancelled and outstanding balance of underlying shares in the Depository's account. This report may be used to arrive at the forex exposure on outstanding DRs.

4.52 The DR holder has a right to cancel the DRs and seek delivery of the underlying shares which they may wish to sell in the local market or continue holding in their name. If the DR holder sells the underlying shares so released he is expected to repatriate the proceeds. If his holding is continued, it will be reflected in the company's periodical report as non-resident holding.

4.53 As per the regulatory guidelines, underlying shares pursuant to cancellation of DRs can be released only in demat form. Thus, there is no possibility of the DR holders holding the shares in street name.

Foreign Currency Convertible Bonds (FCCBs)

4.55 A company can issue, generally, two types of FCCBs:

(i) FCCBs convertible into equity shares of the company; and

(ii) FCCBs convertible onto GDRs/ ADRs.

4.56 In the case of first category, the bondholder has a right to convert the FCCBs into equity shares of the company at a given price, exercisable during a definite period. The conversion terms are governed by the offer document issued at the time of the offer. As per the approval given to the issuers, the issuer is to submit periodical reports in Form TS1 to RBI on the extent of conversion option exercised by the bondholders. On exercise of conversion option, if the bondholder is a body corporate, their holding will reflect in their custodians' periodic report. If the bondholder is an individual, the company's (issuer's) periodic report to RBI will reflect the changes in the non-resident holding subsequent to conversion of FCCBs.

4.57 In the case of second category, on exercising the conversion option, the bond holders get the relevant GDRs/ ADRs through the paying agent who generally acts as the Overseas Depository Bank (ODB) for the DRs. Thereafter, the procedure followed will be the same as that followed for other DRs as stated above.

4.58 Normally, the FCCBs are quoted in the overseas market which also reflects the current market price of the shares in India. Depending upon the advantages the bondholders have on the conversion price versus current market price of the shares, the FCCBs may be quoted at a premium or discount to its issue price.

4.59 Recommendations: In order to arrive at the foreign exchange exposure on account of outstanding GDRs/ADRs and FCCBs, followings proposals may be considered:

- Periodic report from the local custodian of the DRs to be suitably modified so that the value of the outstanding underlying shares are reflected at current market price giving the aggregate value of underlying shares as on the date;
- Periodic reporting from the issuers of FCCBs to MoF to include the current foreign exchange liability on the outstanding FCCBs. This can be arrived by valuing the FCCBs at mark to market price. If the FCCBs are not traded or their market price is not available, their redemption value on maturity may be considered for valuation.
- Periodic report from the issuers on the share holding pattern should include all non-resident holdings of the individuals, with separate break up of NRIs and foreign national.
- Even though the issuers report to the RBI in Form TS1 about the conversion of FCCBs, some further assistance may be required in actually quantifying the outstanding balances. For this, the local custodians of the GDRs for FCCBs may be asked to submit reports as to the overall quantum pending conversions on a basis and frequency similar to that applicable in respect of FIIs data.

Section 4.7

Monitoring the flow of investments by Indian Mutual Funds in Overseas Securities Markets

4.60 The registered Indian mutual funds were permitted to invest in Overseas markets, initially within the limit of US $ 500 million and ceiling of US $ 50 million for an individual mutual fund subject to certain conditions, as announced by RBI in the Credit and Monetary Policy in 1997. Following the announcement by RBI, SEBI appointed a committee of representatives from the Government & industry and the recommendations of the committee were accepted by SEBI.

4.61 Mutual funds reporting: In order to monitor the trends of investments by mutual funds, SEBI has instructed Mutual Funds to make arrangement with their custodians, to submit a daily report of transactions in the secondary market, with effect from December 23, 1999. The format specified requires summary reporting of total purchases and sales in following:

1. equity;
2. debt; and
3. BSE sensitive scrips.

Presently, data on fund raised by Indian mutual funds abroad is captured, but the investments made by these mutual funds abroad are not captured (the trustees of the mutual funds are required to make certain reporting to RBI). Thus information in respect of the periodic inflows/ outflows as well as the portfolio valuation as on specified dates is not available.

4.62 Recommendations: In a view of presently some of Mutual Funds have been able to effect such investments as approved, there is need to evolve right at the inception, a structured reporting mechanism which will give the desired inputs to enable the monitoring of the size of Mutual fund investment in India and abroad. Hence the approval by SEBI for a mutual fund/ its assets management company to invest in overseas markets may encompass the following:

- Reporting may be done by the custodians duly approved for the scheme/ fund;
- A daily reporting of inflows and outflows in prescribed format on the lines of the daily reporting by FIIs custodians to SEBI with suitable modifications relating to the country, currency.
- A summary reporting on a monthly basis, in prescribed format on the lines of the monthly reporting by FII custodians to SEBI;
- A quarterly portfolio valuation of the assets, using generally accepted methods of valuation

(specific to the issuer country regulations) in US $ terms;

- The investments made out of the remittances are governed by the initial approvals from the amounts invested abroad, there may be a surplus arising out of earnings (interest etc.) or realized portfolio appreciations. There may be a need to periodically monitor the data of amounts re-invested abroad, other than the issues of appropriate guidelines governing the retention of the same, and
- There may be occasions when the fund chooses to extinguish a part of its GDR holding, and simultaneously seeks possession of the underlying shares for eventual sale; there may be a need to periodically monitor such data, apart from the issue of appropriate guidelines, governing the reinvestment of the sale proceeds, and the treatment of the limits already approved.

Section 4.8

Conclusions

The major conclusions of this chapter are as follows:

- In India, various schemes are available for the portfolio investment by FIIs, NRIs, OCBs, and PIOs The average FPI inflow into India during the 1990s comes to $ 1.9 billion but has been volatile.
- Portfolio flows have greater volatility than FDI flows as they are less costly to reverse and has the potential to assume "hot money". As outflows under portfolio investment would occur at market price (and not at book value), valuation of portfolio investment periodically on mark-to-market assumes greater importance.
- The most important source of divergence in the estimates of portfolio flows is due to the difficulties of classifying "borderline" cases of foreign investment into FDI and FPI using theBPM5 prescribed 10 per cent criterion to identify "lasting interest" in companies.
- Presently, data on portfolio investment by FIIs collected on the basis of ITR System. There are two regulatory reporting of data vis. (a) RBI and (b) SEBI. The Reserve Bank of India based on actual inflow and outflow data provided by Authorised Dealers. These data are at variance with those published by SEBI although in recent times, the magnitude of divergence in the case of annual data has narrowed down considerably.

Gaps in the present reporting system However, considering the information available with the securities custodian, it is not possible at present to bifurcate the data reported by custodians to SEBI into, (a) purchases made from fresh inflows of foreign exchange, and (b) purchases

made out of re-invested earnings . Besides, the present reporting system does not capture the following:

For estimating reinvested earnings we recommend the following procedure.

Reinvested Earnings (RE) = Net Purchases (NP) - Net Inflows (NI)

Where

Net Inflows = Inflows – Outflows

Net Purchases = Purchases – Sales

When $NI > NP$, RE will be negative and when $NI < NP$, RE will be positive.

- Arriving at "mark-to-market" value of FII investments on a periodic basic is very crucial from not only data compilation angle but also from the point of view of framing policies in this regard. For the valuation of FIIs investment at market price following measure may be considered: For the listed securities, closing price on the last working day of the applicable month across the two major exchanges viz. The Bombay Stock Exchange (BSE), and National Stock Exchange of India Ltd. (NSE) may be used as initial measure.
- In the case of unlisted securities, the book values as at the end of a financial year be used. RBI/SEBI may need to instruct unlisted companies/ companies having unlisted securities having FII investments, to provide the book value on an annual basis to the custodians of the FIIs to ensure compliance. If the book values are not available, paid-up value of the shares can be taken for valuation purposes. In respect of debt instruments, the valuation may be done on the face value of the investment as accumulated by the quantum of interest upto the point of valuation.
- Custodians of FIIs may be assigned the task of arriving at "mark to market" value of both equity securities and debt securities, separately on the above discussed measures on a monthly basis. This may not be difficult task for the custodians as their remuneration from FII is often linked to the "mark-to-market" value of their portfolio.

CHAPTER V

CONCLUSIONS

This chapter summaries the major conclusions of the study on "Non-Debt Flows:

5.1 India is a major destination of non-debt flows. The policy framework for external flows (since 1991) favoured non-debt flows to debt flows. But some of the non-debt flows like FPI flows have been volatile and hence the need to monitor these flows have become all the more important.

5.2 The legal framework for monitoring – compilation and dissemination – of non-debt flows in India has not kept pace with time. This has led to low coverage for enterprise surveys in India (Survey of India's Assets and Liabilities). While the crisis affected ASEAN-4 countries like Indonesia, Malaysia, Thailand and Korea has reinforced their legal framework for collection of data, India is yet to undertake such an exercise although this is one of the agenda items of the National Statistical Commission which is presently underway.

5.3 The existing monitoring of non-debt flows (FDI and FPI) in India is based on a combination of (a) (ITRS), (b) enterprise surveys and (c) information from government and other sources.

5.4 Given the statistical requirement of Fund's SDDS and IIP standards, detailed data in respect of foreign investment can only be generated through enterprise surveys which at present suffers from low coverage and timeliness. The ITRS system, which generates relatively quick data, does not strictly follow the cardinal principle of 10 per cent rule given in BPM5 to determine FDI and FPI flows.

FDI Flows

5.5 A major limitation of FDI statistics in India is the weak information on FDI outflows. Besides the coverage of enterprise survey is very low in India. The low coverage of present enterprise survey (India's Foreign Assets and Liabilities) is the absence of adequate information of entities with foreign exchange exposure (population size), which constrains the coverage and reliability of statistics collected. It would be worthwhile for authorities also to undertake an exploratory survey of suspected units with international exposure so as to identify those missed from the population frame.

5.6 In order to meet the requirements international standards (SDDS, IIP) and BPM5, we recommend comprehensive quarterly enterprise surveys. For this the existing formats of surveys need to be modified to take into consideration data requirements of BPM5, SDDS and IIP.

5.7 It is necessary that FDI statistics generated in India is of international standards. Hence there is a need to upgrade the compilation method of FDI statistics in India by closely working with methodological standards developed by OECD which has considerable know-how in this regard.

5.8 There has been no attempt so far to reconcile FDI flows. An attempt should be made to reconcile FDI flows data at least with major FDI partner so that one is comfortable with the quality and reliability of FDI statistics.

5.9 The major methodological advances in respect of FDI flows like the treatment of derivatives should be incorporated in the compilation practices of FDI statistics in India.

FPI

5.10 The major source of FPI statistics in India is the RBI based on International Transactions Reporting System.

5.11 One of the major components of FPI flows is Foreign Institutional Investors (FII's). FII investment in capital market is generated by RBI (net inflows) as well as by SEBI (net purchases) and these data do not match due to divergent coverage. SEBI data is more comprehensive as it includes FII's net purchase of debt instruments as well.

5.12 Arriving at "mark-to-market" value of FII investments on a periodic basic is important to understand the magnitude of (a) repatriated capital and (b) re-invested earnings.

5.13 For the valuation of FIIs investment at market price following measure may be considered:

(a) For the listed securities, closing price on the last working day of the applicable month across the two major exchanges viz. Bombay Stock Exchange (BSE), and National Stock Exchange of India (NSE) may be used as initial measure.

(b) In the case of unlisted securities, the book values as at the end of a financial year be used.

(c) RBI/SEBI may need to instruct unlisted companies/ companies having unlisted securities having FII investments, to provide the book value on an annual basis to the custodians of the FIIs.

(d) If the book values are not available, paid-up value of the shares can be taken for valuation purposes;

(e) In respect of debt instruments, the valuation may be done on the face value of the investment as accumulated by the quantum of interest upto the point of valuation.

Custodians of FIIs may be assigned the task of arriving at "mark to market" value of both equity securities and debt securities.

5.14 For estimating reinvested earnings we recommend the following procedure.

Reinvested Earnings (RE) = Net Purchases (NP) - Net Inflows (NI)

Where

Net Inflows = Inflows – Outflows

Net Purchases = Purchases – Sales

5.15 One should also explore the possibility of maintaining data on non-debt flows and stocks in CS-DRMS 2000+ to facililitate compilation of BoP and IIP statistics in accordance with the Fund guidelines contained in BPM5.

Annexure 1.1:

List of Persons Associated with the Project

1. Dr. D. Ajit, Director, Division of International Economic Relations, Department of Economic Analysis and Policy, Reserve Bank of India, Mumbai (**Convener**).
2. Dr. Manas Bhattacharya, Additional Economic Adviser, Department of Economic Affairs, Ministry of Finance, Government of India, New Delhi.
3. Shri Prashant Saran, General Manager, Exchange Control Department, Reserve Bank of India, Mumbai.
4. Shri P. Gupta, Division Chief, Foreign Institutional Investor and Custodial Division, Securities and Exchange Board of India, Mumbai.
5. Dr. C.L. Agarwal, Assistant Adviser, Department of Statistical Analayis and Computer Services, Reserve Bank of India, Mumbai.
6. Shri A.P. Singh, Deputy General Manager, ICICI Ltd., Mumbai.
7. Shri K.R. Kamath, Vice President, ICICI Ltd., Mumbai.
8. Shri Clifford D'souza, Vice-President, Morgan Stanley and Dean Witter, Mumbai.
9. Shri K.S. Iyengar, Assistant Vice President, Stock Holding Corporation of India, Ltd., Mumbai.
10. Shri S. Venkatesh, Standard Charted Bank, Mumbai.
11. Shri Sunil Kumar, Research Officer, Division of International Finance, Department of Economic Analysis and Policy, Reserve Bank of India, Mumbai.

Annexure 1.2:

List of countries and organisations visited

1. Australia

(a) Australian Bureau of Statistics, Canberra.

(b) Australian Prudential Regulatory Authority, Sydney.

2. Malaysia

(a) Bank Negara, Kuala Lumpur.

(b) Standard Charted Bank- Custodial Services, Kula Lumpur.

3. Thailand

(a) Bank of Thailand, Bangkok.

(b) Securities and Exchange Commission, Bangkok.

4. Hong Kong

(a) Hong Kong Monetary Authority, Hong Kong.

(b) Securities and Futures Commission, Hong Kong.

5. United Kingdom

(a) Commonwealth Secretariat, London.

Annexure 3.1

Various Facilities for FDI Investment in India and their Reporting System

Various Facilities or Routes

1. Foreign investment policy in India has undergone drastic change over the last couple of years. Approval procedure of foreign direct investment has also been modified considerably to suit the changing economic domestic economic scenario and international economic developments. Presently, there are two routes viz., (1) Reserve Bank of India (RBI) Automatic Route and (2) Secretariat Industrial Assistance (SIA)/ Foreign Investment Promotion Board (FIPB) Route. Under the automatic route, foreign investment is permitted in all sectors upto 100 per cent of the equity of the investing company, if the activities of the company do not lie in 13 areas as indicated in a list known as Annexure A. However there are certain restrictions viz., cap on percentage holding by foreign investors in respect of 8 areas as indicated in Annexure B. If the investment is in areas indicated to is under Annexure A or if restrictions placed in Annexure B are attracted, an application is to be made to Secretariat for Industrial Assistance (SIA)/Foreign Investment Promotion Board (FIPB).

(1) RBI Automatic Route

2. This Route has been in existence since 1991. Keeping in pace with domestic and international developments, the Automatic Route has been gradually expanded and liberalised.

3. In February 2000, the government announced that FDI investment would be available through the RBI automatic route *except* for 13 areas that have been placed on (a) negative list[1] (See Annexure 3.2), (b) areas reserved for small-scale sector where foreign investment already exceeds 24 per cent and (c) 7 sectors where sectoral investment caps apply[2] (See Annexure 3.3). To apply to these sectors or above the investment caps, permission is required from FIPB.

4. Under this route, companies have to report to the concerned regional office of the ECD (RBI) giving details such as name of the investor and investee companies, country from where investment is received, and amount etc. within 30 days of receipt of funds. Companies are also required to make a detailed report in Form FC- GPR within 30 days after shares have been issued to the concerned Regional Office of the ECD. The Regional Offices prepare a monthly statement in a prescribed form (Form 111) (Annexure III) and send it to the Central

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[1] The negative list includes investment in agriculture, petroleum industry, defense-related equipment and industrial explosives.

[2] Foreign ownership of equity is limited to 49 per cent in telecommunications, 74 per cent in bulk pharmaceuticals, mining of diamonds and precious stones and advertising and 51 per cent in hotels and tourism related industry.

Office of the RBI in the first week of the next month, and the information is entered in a database. Details of the various tables in the database and various reports generated by the computer programme are given in (Annexure IV). Effectively, there is a lag of two to three months in compiling the final data on foreign direct investment.

(2) SIA/ FIPB Route

5. The companies, whose activities are included in the 13 areas mentioned in Annexure A or who want to have foreign equity more than the prescribed limits in the priority industries, have to approach the Secretariat for Industrial Approvals (SIA) and Foreign Investment Board (FIPB) for necessary approval. SIA indicate the nature of activity to be carried out by the Indian Company and also the percentage of holding by foreign investors. RBI has granted general permission to the companies who have obtained approval from SIA/ FIPB to issues shares to the foreign investors subject to certain reporting requirements.

6. Like RBI Automatic Route, under SIA/ FIPB Route also companies have to report the receipt of funds within 30 days to the concerned regional office of the ECD giving full details. Thereafter, the companies are required to make a formal report in Form FC-GPR within 30 days of the issue of shares to the concerned Regional Office of the RBI. The Regional Offices of the RBI submit a monthly statement in a prescribed form (Form 174) to the Central Office of the RBI in the first week of the next month. In the central office, the information is entered in a database

Mergers and Acquisition

7. Under this route, foreign investors invest by obtaining a stake in the Indian companies by acquiring existing shares of the Indian companies either by the way of open offer or negotiated deals under the prior approval of FIPB. Thereafter, the buyer or the seller approaches Central Office of the RBI for 'in principle approval' for receiving the funds. Subsequently, an application along with the Foreign Inward Remittance Certificate is made to the Central Office of the RBI for granting final approval. On the basis of this certificate data are entered in the database in the central office of the Bank.

Annexure 3.2

List of activities or items for which automatic route Of Reserve Bank for Investment from Persons Resident Outside India is not available

1. Banking
2. NBFC's activities in Financial Services Sector
3. Civil Aviation
4. Petroleum including exploration/refinery/marketing
5. Housing & Real Estate Development sector for investment from persons other than NRIs/ OCBs.
6. Venture Capital Fund & Venture Capital Company
7. Investing companies in Infrastructure & Service Sector
8. Atomic Energy & related projects
9. Defence and strategic industries
10. Agriculture (including plantation)
11. Print Media
12. Broadcasting
13. Postal services

Annexure 3.3

Sectoral cap on Investments by Persons Resident Outside India

Sector	Investment Cap	Description of Activity/Items/Conditions
1. Telecommunications	49%	i) In basic, Cellular Mobile, paging and Value Added Services, and Global Mobile Personal Communications by Satellite subject to the licence from Department of Telecommunication of Government of India.
	100%	ii) In manufacturing activities.
2. Housing and Real Estate	100%	**ONLY** NRIs/OCBs are allowed to invest in the areas listed below:
		a) Development of serviced plots and construction of residential premises
		b) Investment in real estate covering construction of residential and commercial premises including business centers and offices
		c) Development of townships
		d) City and regional level urban infrastructure facilities, including both roads and bridges
		e) Investment in manufacture of building materials
		f) Investment in participatory ventures in (a) to (e) above
		g) Investment in housing finance institutions
3. Coal and Lignite	49%	i) in Public Sector Undertakings (PSU and
	50%	ii) in other than PSUs
		a) Where Private Indian companies are setting up or operating power projects as well as coal or lignite mines for captive consumption;
		b) For setting up coal processing plants provided 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 particles who are supplying raw coal to coal processing plants for washing or sizing.
		c) For exploration or mining of coal or lignite for captive consumption
4 Drugs & Pharmaceuticals	74%	For bulk drugs, their intermediaries and formulations (except those produced by the use of recombinant DNA technology)

Sector	Investment Cap	Description of Activity/Items/Conditions
5. Hotel & Tourism	51%	i) Hotels include restaurants, beach resorts, and other tourist complexes providing accommodation and /or catering and food facilities to tourists. ii) Tourism related industry includes travel agencies, tour operating agencies and tourist transport operating agencies, units providing facilities for cultural, adventure and wild life experience to tourists, surface, air and water transport facilities to tourists, leisure, entertainment amusement, sports,, and health units for tourists and Convention/Seminar units and organizations.
6 Mining	74%	Exploration and mining of diamonds and precious stones
	100%	Exploration and mining of gold and silver and minerals other than diamonds and precious stones, metallurgy and processing
7. Advertising	74%	Advertising sector
8. Films	100%	Film industry (i.e. film financing, production, distribution, exhibition, marketing and associated activities relating to film industry) subject to the following: i) Companies with an established track record in films, TV, music, finance and insurance ii) The company should have a minimum paid up capital of US $ 10 million if it is the single largest equity shareholder and atleast US $ 5 million in other cases iii) Minimum level of foreign equity investment would be US $ 2.5 million for the single largest equity shareholder and US $ 1 million in other cases iv) Debt equity ratio of not more than 1:1 i.e., domestic borrowings shall not exceed equity v) Provisions of dividend balancing would apply.
9. Any other sector/activity (other than those including in Annexure 3.2)	100%	——

Annexure 3.4

The Proposed Branch Level Forex Module for Capturing Forex Transactions

1. The proposed branch level computerisation programme for foreign exchange transactions (hereafter FX programme) is for use of Category A and Category B branches. This FX programme aims at those bank branches that are not computerised or are partially computerised. All the known activities at the branch level will be incorporated in the computer programme. It will be mandatory to use the computer programme for any foreign exchange related work. If some new type of work crops up, the branches will inform Central Office who will get a new module written for that particular work and up-date all the branch level programmes. The programme will also create various registers such as Export Bill Register and Import Bill Register.

2. There will be certain items that are not handled at the branch. For example, many C Category branches will maintain Non Resident Accounts. The details of such accounts will be incorporated in the B Category Branch on regular intervals (weekly or monthly). The C Category branches can send these details either through a floppy disk or hard copy. Similarly, the Money Changers will submit all the details of the transactions carried on by them when they submit exchange to the bank for sale.

3. The Branch level forex module will be such that it can later become a part of the overall branch / bank computerisation. We have not thought of any particular language in which this module can be written but we require that it should be such that it should provide forward and backward linkages to all platforms.

4. The programme will classify the transactions in three basic categories e.g. Sales, Purchases and Others. If a certain transaction, such as issuance of a bank draft, affects the Nostro or the Vostro balances of the bank it will be classified as a Sales or a Purchase transaction. The Sales menu will ask the operator as to what transaction is to be undertaken. The operator will indicate say 'Issue of Bank Draft'. The next menu will ask relevant questions like the currency, drawee bank, country in which payable, beneficiary, amount, details of the purchaser, purpose for which the draft is purchased. The programme will not only print the draft, it will create various advices and also prepare the daily accounts of the bank branch. Finally, it will add a record to the daily transaction file incorporating all the inputs given by the operator.

5. There will be certain items which result in neither Sale nor Purchase of foreign exchange. For example when a bill is sent for collection, it results in neither sale nor purchase. Yet the programme records the details of the bill sent for collection and it will monitor till the proceeds of the bill have been received. It will keep on issuing reminders to exporter. Similarly, the

programme can monitor submission of Bills of Entry for Imports.

6. All the parameters will be open-ended. For example, the bank finds that the commodity exported is not listed in the list of commodities provided by the programme. The programme will ask "whether you want to add a new commodity to the commodity list?". If the Operator says 'yes' he will be able to write a new commodity in the screen. He may also be asked by the programme to provide more details about the commodity and reason why it cannot be classified in the existing classifications. This transaction will be reported as an exception requiring the attention of the exchange control authorities. If the addition of a new category of commodity is considered necessary, the Master File of Commodity will be up-dated and transmitted to all the branches for updating.

7. If there are banks who are completely computerised and are not willing to adopt the branch level module given by RBI, we will give them a choice of continuing with their existing systems. However, they will have to modify their systems in such a way as to give us the required output as given by the Branch level module.

8. The Branch level software will also analyze the data collected and will make some exception reporting. The exception reporting may be structured separately for various kinds of transactions. For example, the software may keep track of the mean value of inward remittances and any inward remittance with more than three standard deviations may be reported for individual attention. More sophisticated statistical models may be employed for keeping a track of other functions such as the risk profiles of the bank, possibility of a fraudulent transaction etc.

9. Though the transaction record will have hundreds of fields, it may not necessarily increase the size of the record. We understand that in certain languages, the blank fields can be compressed.

TRANSMISSION MODULE :

- It will have capability of transmitting the daily transaction file to the Central Server at the Central Office both through VSAT and Internet.
- The files so transmitted will remain on Routers till they reach the Central Server. Thus, it will be necessary at the end of the day that only the sender gets connected to Infinet or Internet. The Store and Forward System will take care of the file reaching final destination.
- If a report from a particular office does not reach the Central Server the next day, a reminder is automatically generated and sent to that branch.
- If reports from any branch do not reach the Central Server for 5 consecutive days (2 consecutive days in case of critical branches), a reminder to the GM of International Division of that bank will be sent electronically. Simultaneously, a report will be generated so that the officers manning the central server become aware of non-submission.

- The transmission module will also be capable of transmitting master files to the branches and updating the same. On switching on the system at the branches everyday, the system will receive all files from the Central Office and update the system.
- There is a risk that a hacker may continuously monitor the output from a particular branch and so get all the information about the goings on in the branch, it will be necessary to encrypt the data, especially if it is being sent on Internet.

CENTRAL OFFICE MODULE

10. The programme at the Central Server will receive the daily transaction file from the branch and will do the following functions.

- Will create a log that the file has arrived. In case of non-receipt of file, it will generate reminders. It will also keep track that the branch has sent a transaction file for each of its working days.
- It will do some preliminary validations to ensure that there are no obvious mistakes in the transmitted record. For example, it may check that the total value of the transactions reported is not beyond three standard deviations from the mean for that branch. If there are any exceptionally large transactions, the branch will be forced by the programme to make some comments separately.
- The daily transaction file will update a branch level transaction file. Such branch level transaction files will be kept on the hard disk for a period of one month after which it will send to archives.
- The Central Office Module will run various application programmes relating to different functions such as foreign investment, export follow-up and import follow-up. The programme will scrutinize the incoming transaction and relevant fields will be supplied to the above mentioned application programmes.

11. The application programmes will include, inter alia, the following:

1) Creation of file which will tell us about export bills negotiated / sent for collection. This can be matched with the DTRs received from Customs to find out the bills, which have not been negotiated within 21 days of export. Similarly, information about the export bills, which have not been realized either within 6 months can be found out.
2) Information about imports taking place in India, classified according to commodities, country of import etc.
3) BoP data.
4) Data about the Non resident accounts (However this data will be on a consolidated basis,

as "C" Category branches are not covered under the proposal.

5) Data about foreign investment.
6) Outflow data in respect of Consultancy, dividends, technical know-how etc.
7) Information about Open positions and Gap statements.

Annexure 4. 1:

Extent of permissible Foreign Equity by NRIs/OCBs/PIOs/FIs/FIIs

Areas of investment	NRIs/OCBs/PIOs	FIs/FIIs
1. a) 35 priority industries announced in July 1991	100% equity, repatriable, automatic approval by RBI.	51% equity, repatriable, automatic approval by RBI.
b) 9 High priority industries in metallurgical and infrastructure sector announced in December 1996.	74% equity, repatriable, automatic approval by RBI.	74% equity, repatriable, automatic approval by RBI.
c) 13 priority industries announced in Dec. 1996.	51% equity, repatriable, automatic approval by RBI.	51% equity, repatriable, automatic approval by RBI.
d) Export/Trading/Star trading house.	Investment upto 100%,	51% equity, repatriable, automatic approval by RBI
2. 100% EOUs and Units in FTZ and EPZ, Software and Hardware Technology Parks.	100% equity, automatic approval by SAI/DC(EPZ)	100% equity, repatriable, automatic approval by SAI/ DC(EPZ)
3. Sick industries	100% private placement prior approval by RBI	
4. Mining	50% automatic approval by SIA/FIPB	50% Automatic approval by SAO/FIPB
5. Telecommunications	Upto 49% with approval in basic, cellular mobile and paging, VSAT and other wireless services and upto 51% with approval in other value added services, (not to be offset against the FDI, in the investment company with Indian ownership).	Upto 49% with approval in basic, cellular mobile and paging, VSAT and other wireless services and upto 51% with approval in other value added services, (not to be offset against the FDI, in the investment company with Indian ownership).
6. Entertainment electronics	51% equity automatic approval.	51% equity automatic approval.
7. Power	Upto 100% with approval	100% equity, with approval.
8. Medical clinics, hospitals, shipping, oil exploration, deep-sea fishing, Ind. With licenses	Upto 100% equity, repatriable, prior approval by SIA	Upto 51% equity, case by cases approval by SIA

Areas of investment	NRIs/OCBs/PIOs	FIs/FIIs
9. Industries reserved for SSI.	Upto 24%, repatriable prior approval by SIA, export obligations.	Upto 24% equity prior SIA approval, export obligations.
10.Housing, real estate, business centres, infrastructural facilities.	100% equity on repatriation basis, automatic approval.	No foreign investment is allowed except for company property.
11.Domestic air taxi operations	Upto 100% with approval	Upto 40% with approval.
12.Banking services	Upto 40% with approval	Upto 40% with apparoval
13.Non-banking Financial Companies (NBFCs)	Upto 51% with no conditions, upto 100% with conditions	Upto 51% with no conditions, upto 100% with conditions.
14.a) Disinvestment shares of PSE's b) Units in UTI c) Public sector mutual funds d) Private sector mutual funds	NRIs/OCBs are permitted to invest on these shares/units/funds on a repatriable basis through both primary and secondary markets.	Only FIIs are permitted to invest on these shares/units/ funds on a repatriable basis through both primary and secondary markets. FIIs are also allowed to invest on dated govt. securities under certain conditions.
15.Portfolio Investment (Inv. In shares & Debentures)	Individual ceiling 1%, collective ceiling 5%, relaxable to 24% by General Body Resolution only in listed company stock share. Premitted to invest in unlisted companies.	Only FIIs are permitted to invest subject to individual ceiling of 10% and collective ceiling of 24% in both listed and unlisted companies. 100% investment in debt securities of companies by registered FII Debt Funds also allowed.
NRIs=Non-resident Indians. OCBs=Overseas Corporate Bodies, FIIs= Foreign Institutional Investors.	PIOs=Persons of Indian origin FIS=Foreign investors SAI=Secretariat for industrial approval	EOU=Export Oriented unit EPZ=Export Processing Zone FIZ=Free Trade Zone

Annexure 4.2.

Investment regulations for FPEI entering and existing emerging stock markets, 1988 and 1995*

1988			1995		
Entry Are listed stocks free available to foreign investors?	Exit Repatriation of Income	Capital	Entry Are listed stocks free available to foreign investors?	Exit Repatriation of Income	Capital
Free entry			**Free entry**		
Jordan	Free	Free	Argentina	Free	Free
Malaysia	Free	Free	Bangladesh	Free	Free
Portugal	Free	Free	Botswana	Free	Free
			Brazil	Free	Free
Relatively free entry			Costa Rica	Free	Free
Argentina	Restricted	Only after 3 years	Cote d'Ivoire	Free	Free
Chile	Free	After 5 years	Croatia	Free	Free
Costa Rica	Some restrictions	Some restrictions	Czech Republic	Free	Free
Greece	Some restrictions	Some restrictions	Ecuador	Free	Free
Indonesia	Some restrictions	Some restrictions	Egypt	Free	Free
Jamaica	Some restrictions	Some restrictions	Ghana	Free	Free
Kenya	Some restrictions	Some restrictions	Greece	Free	Free
Sri Lanka	Some restrictions	Some restrictions	Hungary	Free	Free
Thailand	Free	Free	Jordan	Free	Free
Trinidad and Tobago	Relatively free	Relatively free	Malaysia	Free	Free
Venezuela	Some restrictions	Some restrictions	Mexico	Free	Free
			Namibia	Free	Free
Restricted by nationality			Oman	Free	Free
Pakistan	Only after 1 year	Only after 1 year	Pakistan	Free	Free
			Panama	Free	Free
Special classes of shares			Peru	Free	Free
Mexico	Free	Free	Poland	Free	Free
Philippines	Free	Free	Portugal	Free	Free
Zimbabwe	Restricted	Restricted	South Africa	Free	Free
			Turkey	Free	Free
Special funds only			Zambia	Free	Free
Brazil	Free	Some restrictions			
India	Some restrictions	Some restrictions	Relatively free entry		
Korea, Republic of	Free	Free	Chile	Free	After 1 year
Taiwan Province			Indonesia	Some restrictions	Some restrictions
of China	Free	Free	Jamaica	Free	Free
Turkey	Free	Free	Kenya	Free	Free
			Korea	Free	Free
Closed			Lithuania	Free	Free
Bangladesh	Some restrictions	Some restrictions	Sri Lanka	Some restrictions	Some restrictions
Nigeria	Some restrictions	Some restrictions	Thailand	Free	Free
Peru	Restricted	Restricted	Trinidad and Tobago	Free	Free
Colombia	Some restrictions	Free	Venezuela	Some restrictions	Some restrictions
			Zimbabwe	Free	Free

1988			1995		
Entry Are listed stocks free available to foreign investors?	Exit Repatriation of Income	Capital	Entry Are listed stocks free available to foreign investors?	Exit Repatriation of Income	Capital
			Special classes of shares		
			China	Free	Free
			Philippines	Free	Free
			Authorised investors only		
			Colombia	Free	Free
			India	Free	Free
			Mauritius	Free	Free
			Taiwan Province Of China	Some restrictions	Some restrictions
			Closed		
			Nigeria	Some restrictions	Some restrictions

Source: International Finance Corporation, 1989 and 1996.

* Key to entry: Free entry: no significant restrictions to purchasing stocks; relatively free entry: some registration procedures required to ensure repatriation rights; special classes: foreigners restricted to certain classes of stocks, designated for foreign investors; authorized investors only: only approved foreign investors may buy stocks; closed: closed, or access severely restricted (e.g., for non-resident nationals only).

Key to Exit: Repatriation of income: dividends, interest, and realised capital gains; repatriation of capital: Initial capital invested; free: repatriation done routinely; some restrictions: typically, requires some registration with or permission of Central Bank, Ministry of Finance, or an Office of Exchange Controls that may restrict the timing of exchange release.