An Overview

of

India

In the

Changing Trends And Patterns In Capital Mobility in Asia

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1.0 BACKGROUND

INDIA is a country of vast dimensions and presents a rare diversity of situations - people, flora, and fauna and even the economy. Indian settlements, their psycho-cultural and biophysical conditions bear a strong imprint of their history. The historical past has a direct bearing on the current access to and control over its resources. Currently, abysmal levels of poverty, the near total break-down in the governance structures, an intense pressure to liberalize the access to her wealth and enable global interests, and the threatening pace of degradation of natural resources and portending implications of climate change provide for a state of flux as she enters the new millennia aiming to acquire greater space in the comity of nations. Land is the most vital resource-base for any country to charter its course of development. Its use and ownership reflects the economic diversity within the country. The access to and control over land, and therefore the resources they contain, still continues to be highly inequitable. The promise of the Constitution of the Socialistic Secular Democratic Republic to create an egalitarian social order has remained rhetoric. The land reforms eagerly awaited with the independence, rapidly petered into a stony silence. Forests, Mineral resources and Built infrastructure are today owned and controlled by large monopolies. These inequities have reflected in the growing unrest among the society and today except for very small part of the country and only a few among her citizens are spared of the threat of violence in everyday life.

From time immemorial various rulers devised ways to extract a share of their produce, which they used to meet their needs. These rulers also established a practice of recording rights so as to levy a proportional tax. These took the form of ownership rights, and then followed with title deeds and other such instruments that established the right to property. Simultaneously it became an instrument for acknowledging the hegemony of the ruler. The British were the most extensive in formalizing such a rule and made the most intense use of such instruments. The stamp of permanence came with the land and forest settlements and they were, as the British called it, `Permanently Settled'. The irony of this Permanent Settlement was that it arose from stating `if we have any business at all in the East, it is to try and found something better than the old approved patterns of oriental despotisms, and give to India the chance at least of becoming a great independent and intelligent community'. The Settlement of land and its relentless hold on the Indian people has today driven most of its poor population to the thresholds of survival. The mountain and tribal communities who did not envision land and natural resources as property that could be owned or vested with the State

with title deeds and other complex instruments were totally deprived of the vast `access region' that they were managing. Six decades of Independent governance has had very limited impact on the positive side of human development and it has barely, if at all, touched the needs of these isolated communities. The colonial Land Acquisition principles and even laws continue till this day!

The wave of globalization and liberalization has clearly favored the large corporate sector to consolidate their hold over mega interventions and thus over the natural resource base. The nature of corporate controls are also a matter of concern as the complexity through which corporate ownership and control is exercised and the growing ability of the small segment of corporate speculators who alter the control of resources lends supports to the credence that in the market place, it is the profits that matter and not the long term health of the resource base or of the local communities.

The free market economy is therefore going to progressively shift the control of resources in larger and larger measure from the communities and the state to the market forces. The real effects are at least three fold:

1. Denial or defeating the purpose of rights and egalitarian legislations, which are the hallmark of democracy
2. Loss of control of the state in managing critical natural resources by transferring their management to corporates particularly the MNCs
3. Progressive abstraction of the real value of natural resources based on global market speculation and cartels adding to consequent vulnerability of the local and larger economy.

2.0 INDIAN ECONOMY: A CONTEXTUAL OVERVIEW

India is the twelfth largest economy in the world by nominal value and the fourth largest by purchasing power parity (PPP). In the 1990s, following economic reform, the country began to experience rapid economic growth, as markets opened for international competition and investment. In the 21st century, India is an emerging economic power with vast human and natural resources, and a huge knowledge base. The Indian economy was initially affected through a reversal of capital flows, rupee depreciation and stock market decline. Thereafter, especially after the collapse of Lehman Brothers, the real sector was affected through a fall in exports and general risk aversion. The decline, however, was partly offset by the resilience of the rural economy due to

improvement in the agricultural terms of trade because of higher support prices for agricultural produce, income generated through the National Rural Employment Guarantee Scheme, agriculture loan waivers, building up of rural infrastructure under the Bharat Nirman programme and increasing awareness through media and mobile phone penetration. Together with the fact that it is largely domestic demand driven, (merchandise exports account for 15 per cent of the GDP), the Indian economy has exhibited considerable resilience in the face of the crisis.

3.0 CHANGES IN CAPITAL FLOWS: FROM OFFICIAL TO PRIVATE

Capital inflows can be classified by instrument (debt or equity) and maturity (short or long term). The main components of capital account include foreign investment, loans and banking capital. Foreign investment comprising foreign direct investment (FDI) and portfolio investment represents non-debt liabilities, while loans (external assistance, external commercial borrowings and trade credit) and banking capital including non-resident Indian (NRI) deposits are debt liabilities. India's strong capital flows reveal sustained economic growth of India, positive investment climate, favorable liquidity and interest rates in the global markets. Furthermore, higher domestic interest rates coupled with stable growth rate had created a lower risk perception that attracted higher capital flows. India's approach towards capital flow can be divided into three main phases viz:

1. Phase I between 1947 to 1980
2. Phase II between 1980 to 1990
3. Phase III after 1991 onwards (also called post reform period).

Phase I: This phase was started at the time of Independence and extended up to early 1980 wherein India's dependence on external flows was mainly restricted to multilateral and bilateral concessional finance.

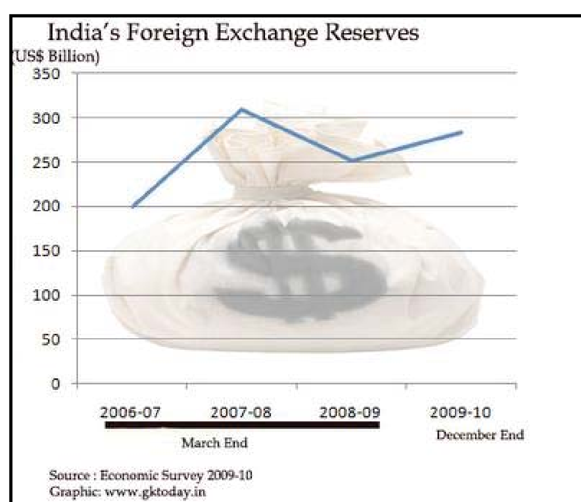
Phase II: This phase began in early 1980s mainly on account of widened current account deficit due to the traditional way of external financing, thus India added recourse to external commercial loans including short-term borrowings and deposits from NRIs.

Phase III: The measures in second phase led to increased short-term debt in total external debt and thus caused a balance of payment crisis in 1991. This phase embarked initiation of reforms process and thus led to market determined exchange rates regime,

removal of trade restrictions, move towards current account convertibility and gradual opening up of capital account.

Capital flows experienced a compositional change from mainly official and private debt flows to non-debt creating flows in the post reform period. Since the introduction of reforms process, India has registered a significant increase in capital flows. The net capital inflows have increased from US$ 7.1 bn in 1991 to around US$ 108 bn in 2008.

Net capital flows as percentage of GDP increased from 2.2% in 1990-91 to around 9.0% in 2007-08. However, if we see gross capital inflows as a percentage of GDP, then it increased from around 7.2% in 1990-91 to around 36.6% in 2007-08. While capital outflows as a percentage of GDP increased from 5% in 1990-91 to around 27.4% in 2007-08. Most of the capital outflows were on account of FII portfolio transactions, Indian investment abroad and repayment of ECBs. All this has offset a lot of increase in capital inflows. However, India has large excess of capital flows over the amount required to finance current account deficit and that resulted in accretion of forex reserves to the tune of around US$ 308 bn by July 2008. Due to the global recession and other factors the subsequent year saw a decline in the reserves which is once again making an upward trend[1].



The composition of capital flows has undergone a complete change from official debt flows to non debt flows as a result of thrust of policy reform after the balance of payment crisis in 1990s, that encouraged non debt creating flows instead of short term debt flows. The official flows got replaced by private equity and external commercial borrowings (ECB). Non-debt flows, particularly private foreign investments witnessed a significant rise. Non-debt flows mainly consisted of foreign direct investment (FDI) and foreign portfolio investments. The FDI inflows registered a significant increase since 1990s, revealing the liberal policy regime and increased investor confidence.

[1] http://currentaffairs.gktoday.in/2010/03/economic-survey-2009-10-indias-foreign.html accessed on 290710

Flows from foreign portfolio have dominated the FDI flows to India during various periods of time. This is unlike the developing and emerging market economies in the world where FDI has always surpassed the FII in flows. FII flows in India however, were more volatile and moved in tandem with domestic and international sentiments. The foreign portfolio investments flows were mainly driven because of lower long-term returns in advanced economies. Furthermore, strong macroeconomic fundamentals, resilient financial sector, deep and liquid capital market, improved financial performance of the corporate sector and attractive valuations in India provided them with better returns. Thus, FIIs inflows increased significantly. However, India is consistently making efforts to encourage more flows through FDI route than the portfolio route and moreover, enhancing the quality of portfolio so as to safeguard its financial markets from the abnormal momentum.

FDI flows mainly concentrated in the services sector in India. This reflects the service led growth of the Indian economy and its comparative advantage in international trade in services. It may be noted that IT sector has enabled greater international trade for India and thus received major investments since liberalization. Furthermore, financing, insurance, real estate and business services have also witnessed a large increase in their share in FDI flows in last few years. FDI has emerged as a vehicle to deliver services to the international markets.

4.0 Geographical Context of Asia

Intra-ASEAN FDI flows can be traced back to the 1997 East Asian financial crisisvwhich caused a severe region-wide recession. The crisis also adversely affected output,vcurrencies, stock markets other asset prices, and capital inflows across ASEAN member countries. ASEAN members experienced a drastic decline of about US$12 billion in the net FDI flow to them from 1997 to 1998, Developing Asia dominates both as sources and destinations of FDI in terms of both stocks and flows among the developing countries. It is interesting to note that during the period after crisis (1998 to 2000) the average of ASEAN share of FDI inflows declined to a low of 2.3 percent compared to a high 5 percent on average between 1988 and 1990, while their FDI outflows increased. During this period the role of China in the world economy has exponentially increased. 40 percent of total FDI inflows to Asia region has been directed to China. China's large domestic market and low labor cost have been among the main attractors of massive FDI into the country. While India is a relatively late-comer and its

industrialization strategy is much less dependent on FDI, its vast pool of skilled workers, strong institutional quality, and large domestic market has begun to attract greater global and regional FDI inflows. Both China and India are also significant exporters of capital, including FDI. India is becoming an important host from for investments from Korea, Hong Kong and Singapore. Conversely, many Indian firms use Singapore as a regional headquarters, particularly following the signing of a bilateral Comprehensive Economic Cooperation Agreement (CECA). More interestingly, a great deal of investments into India has thus far taken the form of foreign portfolio investments which have purchased stakes in existing Indian enterprises or in the form of private equity (including venture capital). These flows do not necessarily show up in the FDI statistics but are clearly contributing to domestic investment in India which has been rising rapidly. In addition, Mauritius has low corporate tax and has signed a liberal Double taxation agreement (DTA) with India. As such, many investments from other sources have been re-routed to India via Mauritius, which has consistently been the top source of FDI to India. Therefore, the actual extent of flows of FDI between India and East and Southeast Asia may be understated. In relation to the last point, it is important to note that the data analyzed above exclude the offshore financial centers (OFCs) such as the British Virgin Islands (BVI), Bermuda, Cayman Islands, Mauritius and Western Samoa as sources of FDI. Insofar as at least some part of inflows from the OFCs involve FDI that originated from other Asian economies, and the inflows are not destined back to originating economy (i.e. trans-shipping as opposed to round-tripping), we may be undercounting the size of intra-Asian FDI flows. For instance, the BVI has consistently been the second largest source of FDI into China, surpassed only by Hong Kong, with the Cayman Islands and Western Samoa also being among the top 10 in 2006.

In fiscal 2008-09, the widening of the CAD coupled with net capital outflows resulted in the drawdown of foreign exchange reserves of US$ 20.1 billion (excluding valuation) as against an accretion of US$ 92.2 billion in 2007-08. During 2009-10, the accretion in foreign exchange reserves on a BoP basis (i.e. excluding valuation) was US$ 9.5 billion in H1 (April-September 2009) of 2009-10 as against a decline of US$ 2.5 billion during the corresponding period of the previous year. This was mainly on account of higher capital inflows to the tune of US$ 17.9 billion in the form of portfolio investment vis-à-vis an outflow of US$ 5.5 billion in H1 (April- September 2008) of 2008-09.

5.0 CURRENT SITUATION

The adverse impact of the global financial market turmoil was reflected in lower capital inflows during 2008-09. There was massive decline in net capital flows from US$ 106.6 billion in 2007-08 (8.8 per cent of GDP) to US$ 7.2 billion (0.6 per cent of GDP) in 2008-09. The decline was mainly due to net outflows under portfolio investment including foreign institutional investments (FIIs), American depository receipts (ADRs)/ global depository receipts (GDRs) (US$ 14.0 billion), banking capital including NRI deposits (US$ 3.2 billion) and short-term trade credit (US$ 1.9 billion). However, notwithstanding these adverse developments, the resilience of FDI inflows (US$ 17.5 billion in 2008-09) reflected the growing perception of India as one of the favourite long-term investment destinations.

The revival in capital flows witnessed during Q1 of 2009-10 gathered momentum during Q2 of 2009-10. Net capital flows at US$ 29.6 billion in April-September 2009 remained higher as compared to US$ 12.0 billion in April-September 2008. All the components under net capital flows, except loans and banking capital, showed improvement during April-September 2009 from their levels in the corresponding period of the previous year. In banking capital, net inflows under non-resident deposits remained higher during April-September 2009 as compared to their previous year's level.

Net inward FDI into India remained buoyant at US$ 21.0 billion during April-September 2009 (as against US$ 20.7 billion in April-September 2008) reflecting the continuing liberalization and better growth performance of the Indian economy. During this period, FDI was channeled mainly into manufacturing (21.4 per cent) followed by communication services (12.8 per cent) and the real estate sector (12.6 per cent). Net outward FDI of India at US$ 6.8 billion in April-September 2009 remained at almost the same level as that of the corresponding period of 2008-09. Due to the large inward FDI, the net FDI (inward minus outward) was marginally higher at US$ 14.1 billion in April-September 2009. Portfolio investment mainly comprising FIIs and ADRs/ GDRs witnessed large net inflows (US $ 17.9 billion) in April-September 2009 (net outflows of US $ 5.5 billion in April- September 2008). This was mainly due to large purchases by FIIs in the Indian capital market reflecting revival in the growth prospects of the economy and improvement in global investors' sentiment. The inflows under ADRs/GDRs increased to US$ 2.7 billion in April-September 2009 (as against US$ 1.1 billion in April-September 2008).

The net external commercial borrowings (ECBs) inflow remained lower at US$ 0.7 billion in April-September 2009 than the US $ 3.2 billion in April-September 2008. Banking capital (net) amounted to US$ 1.1 billion in April-September 2009 as compared to US$ 5.0 billion in April-September 2008. Among the components of banking capital, NRI deposits witnessed higher net inflows of US$ 2.9 billion in April-September 2009 as compared to US$ 1.1 billion in April-September 2008. Short-term trade credit recorded a net outflow of US$ 0.6 billion (inclusive of suppliers' credit up to 180 days) during April-September 2009 as against a net inflow of US$ 4.9 billion during the same period of the previous year. Other capital includes leads and lags in exports, special drawing rights (SDR) allocation, funds held abroad, advances received pending issue of shares under FDI and other capital not included elsewhere (n.i.e). Other capital recorded a lower net outflow of US$ 4.3 billion in April-September 2009 as compared to US$ 10.3 billion in April-September 2008.

PUBLIC FINANCE PUBLIC ACCOUNTABILITY COLLECTIVE
Auditing Ecology, Ecologising Audit

[PFPAC]

Extending Environics Trust's work on monitoring the harmful impacts of development activities on ecology and compliance with environmental laws and governance, PFPAC engages in research and advocacy on the interface between audit findings on implementation of environmental legislation. PFAPC believes that there is a need to engage with reports from the Comptroller and Auditor General of India – a constitutionally established Supreme Audit Institution of India and ask questions as to what happen to audit findings and recommendations, as well as critically monitor the changing stylistics of audit reporting. Audit findings on even matters such as mining or forest receipts highlight the non-compliance with environmental legislation. Followed up in a systematic campaign fashion through the skillfully drafted RTI, the same can result in compilation of evidence of non-compliance. We propose to come out with Audit Briefs as a communication tool to disseminate the research findings with other groups working on environmental governance issues. We at PFPAC feel that there is also a need to present critique of the changing language in audit reporting. PFPAC also wish to take up critical review of training modules on environmental audit. We will constantly strive in auditing ecology and compliance of environmental legislations but to also ensure that we work towards an aim to ecologise Audit.

Environics Trust is a not for profit research and community development organisation and an enabling institution. Environics conducts participatory research on issues of environment and human behavior and uses these outcomes for innovative community development programmes. Environics anchors several networks and partnerships. Environics is a co-founder and promoter of the mines minerals and PEOPLE alliance (mm&P), the Indian Network on Ethics and Climate Change (INECC), the EIA Resource and Response Centre (eRc). Environics promotes and mentors environmentally sound enterprises and among these is the Biodiversity Conservation India Limited (BCIL), the largest Sustainable Built environment enterprise in India. Environics provides research and evaluatory services to International, National, State and Local Institutions and directly works with marginalised communities such as those in the mountain regions, tribals and communities adversely affected by mining and industrialisation. Environics is an observer member of UNFCCC; Founder Members of the Editorial Board of the worlds largest community and mining portal www.minesandcommunities.org and a member of the Asian TNC Research Network. Environics is currently co-hosts the Secretariat for The Access Initiative Coalition (TAI) and Coordinates the Occupational and Environmental Health Network of India (OEHNI).

www.environicsindia.in www.mmpindia.org www.ercindia.org www.inecc.in
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