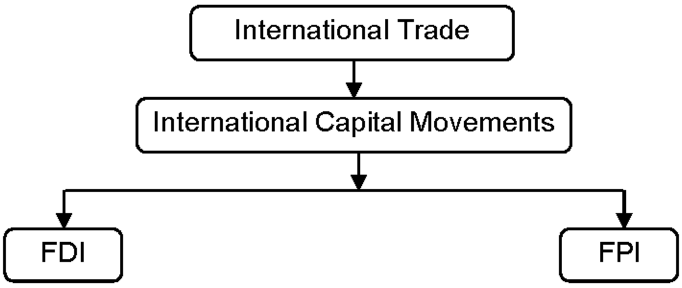
10. INTERNATIONAL CAPITAL MOVEMENTS



Q.No.1. Define the term Foreign capital. What are the different types of foreign capital flows? (A) (SM)

Foreign capital: The term 'foreign capital' includes any inflow of capital into the home country from abroad. Foreign capital may flow into an economy in different ways.

Important components of foreign capital flows:

1. **Foreign aid or assistance:** It may be in the form of
   a) Bilateral or direct inter government grants.
   b) Multilateral aid from many governments who pool funds to international organizations like the World Bank.
   c) Tied aid with strict mandates regarding the use of money or untied aid where there are no such stipulations.
   d) Foreign grants which are voluntary transfer of resources by governments, institutions, agencies or organizations.
2. **Borrowings:** It may take different forms such as
   a) Direct inter government loans.
   b) Loans from international institutions (e.g. World Bank, IMF, ADB).
   c) Soft loans (e.g. from affiliates of World Bank such as IDA).
   d) External commercial borrowing.
   e) Trade credit facilities.
3. **Deposits from non-resident Indians (NRI)**
4. **Investments:** These are in the form of:
   a) Foreign portfolio investment (FPI) in bonds, stocks and securities, and
   b) Foreign direct investment (FDI) in industrial, commercial and similar other enterprises.

SIMILAR QUESTIONS:

1. Describe the nature and types of foreign capital.

A. Refer above answer

2. What are the different types of foreign capital?

A. Refer above answer

Q.No.2. State and explain briefly about Foreign Direct Investment (FDI). (A) (MTP1 M19 - 2M) (SM, M18 - 2M)

FOREIGN DIRECT INVESTMENT (FDI): FDI is defined as a process whereby the resident of one country (i.e. home country) acquires ownership of an asset in another country (i.e. the host country) and such movement of capital involves ownership, control as well as management of the asset in the host country.

1. **FDI according to the IMF and OECD definitions:** The acquisition of at least 10% of the ordinary shares or voting power in a public or private enterprise by non- resident investors makes it eligible to be categorized as FDI. India follows the same.

2. **Foreign Direct Investors:** Investors in FDI may be individuals, incorporated or unincorporated private or public enterprises, associated groups of individuals or enterprises, governments or government agencies, estates, trusts, or other organizations or any combination of the above mentioned entities.

3. **Entry routes for FDI in India:** An Indian company may receive FDI either through

   a) 'Automatic route' without any prior approval either of the GOI or RBI

   (or)

   b) 'Government route' with prior approval of the Government.

4. **Components of FDI:** FDI has three components namely,

   a) Equity capital, **b)** Reinvested earnings

   c) Other direct capital in the form of intra-company loans between direct investors (parent enterprises) and affiliate enterprises.

5. **Instruments for FDI in India:**

   An Indian Company can receive foreign investment by issue of 'FDI compliant instruments' in accordance with the provisions of the Companies Act, 2013 and the SEBI guidelines, are namely:

   a) Equity shares,

   b) Fully and mandatorily convertible preference shares and debentures,

   c) Partly paid equity shares and warrants.

6. **Main forms or Modes of FDI:**

   a) The opening of overseas companies, including the establishment of subsidiaries or branches,

   b) Creation of joint ventures on a contract basis,

   c) Joint development of natural resources,

   d) Purchase or annexation of companies in the country receiving foreign capital.

   e) Equity injection into an overseas company

   f) Acquiring a controlling interest in an existing foreign company

   g) Mergers and acquisitions (M&A)

   h) Green field investment

7. **Characteristics of FDI:**

   a) Direct investments are real investments in factories, assets, land, inventories etc. and involve foreign ownership of production facilities.

   b) The investor retains control over the use of the invested capital and also seeks the power to exercise control over decision making to the extent of its equity participation.

   c) The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise.

   d) A significant degree of influence by the investor on the management of the enterprise.

8. **Categories of FDI:**

   Based on the nature of foreign investments, FDI may be categorized as horizontal, vertical or conglomerate.

   a) **Horizontal Foreign Direct Investment:** It takes place when the investor establishes the same type of business operation in a foreign country as it operates in its home country.

EX: A cell phone service provider based in the United States moving to India to provide the same service.

b) **Vertical Foreign Direct Investment:** It takes place when the investor establishes or acquires a business activity in a foreign country which is different from the investor's main business activity yet in some way supplements its major activity.

EX: An automobile manufacturing company may acquire an interest in a foreign company that supplies parts or raw materials required for the company.

c) **Conglomerate Foreign Direct Investment:** It takes place when an investor makes a foreign investment in a business that is unrelated to its existing business in its home country. This is often in the form of a joint venture with a foreign firm already operating in the industry as the investor has no previous experience.

d) **Two - Way Direct Foreign Investments:** If FDIs are reciprocal investments between countries that occur when some industries are more advanced in one nation. EX: The computer industry in the United States, the automobile industry in Japan.

SIMILAR QUESTIONS:

1. Define Foreign Direct Investment.
A. Refer the introduction
2. Who are the Foreign Direct Investors?
A. Refer 2nd point
3. What are the different routes for securing FDI? (MTP2 N18 - 2M)
A. Refer 3rd point
4. How an Indian company can receive FDI?
A. Refer 3rd, 4th and 5th points
5. Enumerate the components of Foreign Direct Investment?
A. Refer 4th point.
6. Which are the important forms of FDI?
A. Refer 6th point
7. What are the modes of Foreign Direct Investment (FDI)? (SM, N18 - 3M)
A. Refer 6th point
8. What are the features of FDI?
A. Refer 7th point
9. Explain the four categories of FDI?
A. Refer 8th point
10. Distinguish between horizontal and vertical Foreign Direct Investment. (RTP N19)
A. Refer 8th point

Q.No.3. Outline the reasons for Foreign Direct Investment. (B) (SM)

Foreign Direct Investment (FDI): It is defined as a process whereby the resident of one country (i.e. home country) acquires ownership of an asset in another country (i.e. the host country) and such movement of capital involves ownership, control as well as management of the asset in the host country.

Reasons for Foreign Direct Investment:

International capital movements also have found adequate empirical support. Investments move across borders on account of:

1. The increasing interdependence of national economies and the consequent trade relations and international industrial cooperation established among them
2. Internationalization of production and investment of transnational corporations in their subsidiaries and affiliates.

3. Desire to reap large-scale technological economies

4. To achieve rapid rate of technological innovations

5. Necessity to retain direct control of production knowledge or managerial skill that could easily and profitably be utilized by corporations.

6. Desire to procure a promising foreign firm to avoid future competition and the possible loss of export markets.

7. Risk diversification so that recessions may be experienced with reduced severity.

8. Shared common language or common boundaries and possible saving in time and transport costs because of geographical proximity.

9. Necessity to retain complete control over its trade patents and to ensure consistent quality and service or for creating monopolies in a global context.

10. Promoting optimal utilization of physical, human, financial and other resources.

11. *Desire to capture high potential emerging markets with substantially high and growing population.*

12. *Ease of penetration into the import restrictions economies.*

13. *Lower environmental standards in the host country and the relative savings in costs.*

14. *Stable political environment and overall favourable investment climate in the host country.*

15. *Higher degree of openness to foreign capital exhibited by the recipient country and preferential investment systems such as special economic zones to encourage FDI.*

16. *The strategy to obtain control of strategic resource to ensure their uninterrupted supply at the lowest possible price; usually a form of vertical integration.*

17. *Desire to secure access to minerals or raw material deposits located elsewhere and earn profits through processing them to finished form (E.g. FDI in petroleum).*

18. *The existence of abundance and low relative cost of labour in the host country coupled with shortage and high cost of labour in capital exporting countries, especially when the production process is labour intensive.*

19. *Lower level of economic efficiency in host countries and identifiable gaps in development.*

20. *Tax differentials and tax policies of the host country which support direct investment. (But a low tax burden cannot compensate a generally fragile and unattractive FDI environment).*

21. *Inevitability of defensive investments in order to preserve a firm's competitive position.*

22. *High GDP and high per capita income coupled with their high rate of growth. (Philanthropic objectives such as strengthening of socio-economic infrastructure, alleviation of poverty and maintenance of ecological balance of the host country).*

23. *Prevalence of high standards of social amenities and possibility of good quality of life in the host country.*

SIMILAR QUESTION:

1. "Foreign capital is not a bag of unmixed blessings as far as its impact on the host country is concerned". Comment on this statement.

A. Refer above answer

Q.No.4. Name the determinants of Foreign Direct Investment of a host country? (A) (SM)

Foreign Direct Investment (FDI): It is defined as a process whereby the resident of one country (i.e. home country) acquires ownership of an asset in another country (i.e. the host country) and such movement of capital involves ownership, control as well as management of the asset in the host country.

Host Country Economic Determinants of Foreign Direct Investment:

1. **Market-seeking FDI:**
   a) Market size and per capita income
   b) Market growth
   c) Access to regional and global markets
   d) Country-specific consumer preferences
   e) Structure of markets
2. **Resource or asset-seeking FDI:**
   a) Raw materials
   b) Low-cost unskilled labour
   c) Availability of skilled labour
   d) Technological, innovative, and other created assets (eg., brand names)
   e) Physical infrastructure
3. **Efficiency-seeking FDI:**
   a) Costs of the physical and human resources and assets (including an adjustment for productivity)
   b) Other input costs (e.g., intermediate products, transport costs)
   c) Membership of country in an regional integration agreement, which could be conductive to forming regional corporate networks

SIMILAR QUESTIONS:

1. Outline the factors influencing foreign investments.
A. Refer above answer
2. Describe the factors influencing foreign direct investments?
A. Refer above answer
3. Enumerate the host country determinants of Foreign Direct Investment?
A. Refer above answer
4. What are the market seeking determinants of FDI in a host country?
A. Refer 1st point
5. What are the resource (or) asset seeking determinants of FDI in a host country?
A. Refer 2nd point
6. What are the efficiency seeking determinants of FDI in a host country?
A. Refer 3rd point

Q.No.5. Explain the policy framework with regarding to the Foreign Direct Investment of a host country? (B) (SM)

Foreign Direct Investment (FDI): It is defined as a process whereby the resident of one country (i.e. home country) acquires ownership of an asset in another country (i.e. the host country) and such movement of capital involves ownership, control as well as management of the asset in the host country.

Policy Framework with regarding to the FDI of a host country:

1. Economic, political, and social stability
2. Rules regarding entry and operations
3. Standards of treatment of foreign afflicates
4. Policies on functioning and structure of markets (e.g., regarding competition, mergers)

5. International agreements on FDI Privatization policy
6. Trade policies and coherence of FDI and trade policies
7. Tax policy

Q.No.6. How the Foreign Direct Investment of a host country favours the Business Facilitation? (B) (SM)

Foreign Direct Investment (FDI): It is defined as a process whereby the resident of one country (i.e. home country) acquires ownership of an asset in another country (i.e. the host country) and such movement of capital involves ownership, control as well as management of the asset in the host country.

Business Facilitation by means of FDI in a host country:

1. Investment promotion (including image building and investment-generating activities and investment-facilitation services)
2. Investment incentives:
   a) "Hassle costs" (related to corruption and administrative efficiency)
   b) Social amenities (e.g., bilingual schools, quality of life)
   c) After-investment services

Q.No.7. Name the factors which discourage inflow of foreign investments in the host country? (A) (SM)

Foreign Direct Investment (FDI): It is defined as a process whereby the resident of one country (i.e. home country) acquires ownership of an asset in another country (i.e. the host country) and such movement of capital involves ownership, control as well as management of the asset in the host country.

Factors in the host country discouraging inflow of foreign investments are:

1. Infrastructure lags
2. High rates of inflation
3. Balance of payment deficits
4. Poor literacy and low labour skills
5. Rigidity in the labour market
6. Bureaucracy and corruption
7. Unfavourable tax regime
8. Cumbersome legal formalities and delays
9. Small size of market and lack of potential for its growth
10. Political instability
11. Absence of well- defined property rights
12. Exchange rate volatility
13. Poor track-record of investments
14. Prevalence of non-tariff barriers
15. Stringent regulations
16. Lack of openness,
17. Language barriers
18. High rates of industrial disputes

19. Lack of security to life and property

20. Lack of facilities for immigration and employment of foreign technical and administrative personnel

21. Double taxation

22. Lack of a general spirit of friendliness towards foreign investors

SIMILAR QUESTION:

1. **What are the factors in the host country that discourage inflow of foreign investments?**

A. **Refer above answer**

Q.No.8. What are the benefits of Foreign Direct Investment to the host country? (A) (SM, RTP M18)

Foreign Direct Investment (FDI): It is defined as a process whereby the resident of one country (i.e. home country) acquires ownership of an asset in another country (i.e. the host country) and such movement of capital involves ownership, control as well as management of the asset in the host country.

BENEFITS OF FOREIGN DIRECT INVESTMENT IN A RECEPIENT COUNTRY:

1. **Foreign Competition:** Entry of foreign enterprises generates a competitive environment in the country. The domestic enterprises are compelled to compete with the foreign enterprises which results in positive outcomes (in the form of cost-reducing and quality-improving innovations, higher efficiency and increasing variety of better products and services at lower prices ensuring wider choice and welfare for consumers).
2. **Effect on Output and Input:** FDI allows countries to finance more investment than can be supported by domestic savings. The provision of increased capital to work with labour and other resources available in the host country can enhance the total output.
3. **Growth and development:** From the perspective of emerging and developing countries, FDIs can accelerate growth and foster economic development by providing capital, technological know-how, management skills and marketing methods and critical human capital skills in the form of managers and technicians.
4. **Technological benefits:** The new technology enhances the recipient country's production possibilities.
5. **Political Reforms:** Competition for FDI among national governments helped to promote political reforms important to attract foreign investors, including legal systems and macroeconomic policies.
6. **Rise in employment opportunities:** FDI not only creates direct employment opportunities but also, through backward and forward linkages, generate indirect employment opportunities. This benefits if the recipient country is a developing country with abundance population.
7. **Improvement in Production Base:** FDI involves setting up of production base (factories, power plants, etc.). It generates direct employment as well as domestic investments propelled in the downstream and upstream projects that generate multiplier effects on employment and income.
8. **Rise in Wage level:** FDIs promote relatively higher wages for skilled jobs. More indirect employment will be generated to persons in the lower-end services sector occupations catering even to the less educated and unskilled persons engaged in those units.
9. **Better access to foreign markets:** FDI generally entails people-to-people relations and is considered as a promoter of bilateral and international relations. Greater openness to foreign capital leads to higher national dependence on international investors, making the cost of discords higher.
10. **Promotion of ancillary units:** This results in job creation and skill development for workers.
11. ***Export promotion:*** *Foreign enterprises possessing marketing information with their global network of marketing are in a unique position to utilize these strengths to promote the exports of developing countries.*

12. ***Eases External Debt service:*** *If the foreign capital produces goods with export potential, the host country is in a position to secure scarce foreign exchange. This can be used to import needed capital equipment or materials to assist the country's development plans or to ease its external debt servicing.*

13. ***Raises tax revenue:*** *The foreign investment projects act as a source of new tax revenue in the host country which can be used for development projects.*

14. ***Enjoy economies of scale:*** *With foreign investments economies of scale can be realized so that consumer prices might be lowered.*

15. ***Weakens the market power of domestic monopolies:*** *Increased competition resulting from FDIs will weaken the market power of domestic monopolies resulting in increase in output and fall in prices.*

16. ***Favourable Balance of payment position:*** *FDIs with a distinct advantage over the external borrowings, it is considered to have a favourable impact on the host country's balance of payment position.*

17. ***Better work culture and higher productivity standards brought in by foreign firms:*** *These possibly induce productivity related awareness and also contribute to overall human resources development.*

SIMILAR QUESTIONS:

1. Do you think FDI would help prevent formation of monopolies?
A. Refer 15th point
2. Elucidate the potential costs and benefits of Foreign Direct Investment.
A. Refer above answer
3. Mention the effects of FDI on host country labour?
A. Refer above answer
4. How do foreign direct investments affect human capital in recipient countries?(RTP M19)
A. Refer 3rd point
5. Mention two arguments made in favour of FDI to developing economies like India? Illustrate your answer
A. Refer any 2 points

Q.No.9. What are the potential problems associated with Foreign Direct Investment? (A) (SM)

Foreign Direct Investment (FDI): It is defined as a process whereby the resident of one country (i.e. home country) acquires ownership of an asset in another country (i.e. the host country) and such movement of capital involves ownership, control as well as management of the asset in the host country.

Following are the general arguments put forth against the entry of foreign capital.

1. **Capital-intensive methods:** FDIs concentrate on capital-intensive methods of production and service which is inappropriate for the less developed countries with labour-abundancy.

2. **Accentuates income inequalities:** The inherent tendency of FDI flows to move towards regions or states which are well endowed in terms of natural resources and availability of infrastructure has the potential to accentuate regional disparity and thus income inequalities.

3. **Negative impact on tax mechanism:** If the foreign corporations are able to secure incentives in the form of tax holidays or similar provisions, the host country loses tax revenues.

4. **Crowding effect:** Foreign firms partly finance their domestic investments by borrowing funds in the host country's capital market. This raises interest rates and lead to a decline in domestic investments in the host country through 'crowding-out' effect.

5. **Instability in the balance of payments:** FDI brings in more foreign exchange, improves the BOP and raises the value of the host country's currency in the exchange markets. Thus increased imported inputs or large scale repatriated profits places a strain on the host country's Bop and the home currency leading to its depreciation. Such instabilities endanger long-term economic planning.

6. Human resource development and acquisition of new innovative skills through FDI may not be realized in reality
7. *High profit orientation of foreign direct investors tends to promote items of elite and popular consumption and on non-essential items.*
8. *Foreign entities are accused of being anti-ethical as they frequently resort to methods like aggressive advertising and anticompetitive practices which induce market distortions.*
9. ***Foreign technology drive out domestic firms from the industry:*** *The high growth of wages in foreign corporations can influence a similar escalation in the domestic corporations which are not able to cover this increase with growth of productivity. The result is decreasing competitiveness of domestic companies.*
10. ***Deleterious effects on employment potential of home country:*** *FDI involves domestic companies 'off - shoring', or shifting jobs and operations abroad in pursuit of lower operating costs and consequent higher profits.*
11. *The continuance of lower labour or environmental standards in host countries is highly appreciated by the profit seeking foreign enterprises.*
12. ***Acute hostilities:*** *At times of severe controversies there is potential national security considerations involved when foreign firms function in the territory of the host country.*
13. ***FDI may have adverse impact on the host country's commodity terms of trade:*** *This could occur if the investments go into production and sale of export goods. Thus increased exports drive down the price of exports relative to the price of imports.*
14. *FDI is also held responsible by many for ruthless exploitation of natural resources and the possible environmental damage.*
15. ***Dual economy:*** *With substantial FDI in developing countries there is a strong possibility of emergence of a dual economy with a developed foreign sector and an underdeveloped domestic sector.*
16. ***Sovereignty is put at risk:*** *Excessive amount of power of foreign investment sector leads to potential loss of control by host country over domestic policies and therefore the less developed host country's sovereignty is put at risk.*
17. *Mighty multinational firms are often criticized of corruption issues, unduly influencing policy making and evasion of corporate social responsibility.*

SIMILAR QUESTIONS:

1. Critically examine the general arguments put forth against entry of foreign capital.

A. Refer above answer

2. What are the grounds on which the opponents of foreign investments criticise the flow of FDI to developing countries?

A. Refer above answer

Q.No.10. How the Foreign Direct Investment (FDI) in India has its impact initially with its introduction? (A) (M18 - 2M) (SM)

Foreign Direct Investment (FDI): It is defined as a process whereby the resident of one country (i.e. home country) acquires ownership of an asset in another country (i.e. the host country) and such movement of capital involves ownership, control as well as management of the asset in the host country.

Introduction of Foreign Direct Investment (FDI) in India:

The most important shift in investment policy occurred when India embarked upon economic liberalisation and reforms programme in 1991 to raise its growth potential and to integrate it with the world economy.

1. **Measures towards the implementation of FDI in India:**

   The following are the series of measures directed towards liberalizing foreign investments and for ensuring access to foreign technology and funding Automatic approval of FDI such as

a) Simplification of procedures,

b) Setting up of Foreign Investment Promotion Board (FIPB abolished w.e.f May 2017),

c) Signing of the Multilateral Investment Guarantee Agency Protocol for protection of foreign investments,

d) Permitting use of foreign trade marks and brand names,

e) 100% FDI in multitude of sectors,

f) Enactment of Foreign Exchange Management Act (FEMA),

g) Passing of the SEZ Act in 2005, Special Economic Zones (SEZ),

h) Support to mergers, acquisitions and green field investments,

i) Encouragement to foreign technology collaboration agreements etc.

2. FDI and Economic Development in India:

a) FDI is a major source of non-debt financial resource for the economic development of India.

b) According to United Nations Conference on Trade and Development (UNCTAD)'s World Investment Report 2016, India ranks as the tenth highest recipient of FDI globally in 2015 with $44 billion.

c) According to Department of Industrial Policy and Promotion (DIPP) during April - September 2016:

i) The total FDIs India received rose 30 % year-on-year to US$ 21.6 billion.

ii) The services sector attracted the highest FDI equity inflow (US$ 5.29 billion), followed by telecommunications (US$ 2.79 billion), and trading (US$ 1.48 billion).

d) India received the maximum FDI equity inflows from Mauritius (US$ 5.85 billion) followed by Singapore, Netherlands, Japan and the USA.

e) India has also moved up by one rank to become the sixth most preferred investment destination.

f) With the government taking steps to improve the ease of doing business and to relax regulations, FDI into the country surged by 60 % to $4.68 billion in November 2016 *(from $2.93 billion in November 2015)*.

3. FDI and Repatriation in India:

a) All foreign investments are repatriable (net of applicable taxes) except in cases where the investment is made or held on non-repatriation basis or where the sectoral condition specifically mentions non-repatriation.

b) Further, dividends/ profits (net of applicable taxes), on foreign investments, being current income can be remitted outside India through an Authorized Dealer bank.

c) Only NRIs are allowed to set up partnership/ proprietorship concerns in India on non-repatriation basis.

SIMILAR QUESTIONS:

1. Explain the state-of-affairs of Foreign Direct Investment in India.

A. Refer above answer

2. What will be the effect of repatriation in terms of FDI?

A. Refer 3rd point

Q.No.11. Outline the areas in which foreign investment is prohibited in India? (A) (SM)

In India, foreign investment is prohibited in the following sectors:

1. Lottery business including Government / private lottery, online lotteries, etc.

2. Gambling and betting including casinos etc.

3. Chit funds
4. Nidhi company
5. Trading in Transferable Development Rights (TDRs)
6. Real Estate Business or Construction of Farm Houses.
7. Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.
8. Activities / sectors not open to private sector investment e.g. atomic energy and railway operations (other than permitted activities).
9. Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for lottery business and gambling and betting activities.

SIMILAR QUESTION:

1. Which are the sectors in India where FDI is prohibited? Why?

A. Refer above answer

Q.No.12. Name the recent changes that have been brought in FDI to make India the most open economy in the world. (B) (SM)

With the objective of making India the most open economy in the world for FDI and for providing major impetus to employment and job creation, the FDI regime was radically liberalized on 20-June-2016.

Changes introduced in the FDI policy include: Increase in sectoral caps brings more activities under automatic route and easing of conditions for foreign investment. These include easing of FDI in

1. Defence sector
2. E-commerce
3. In respect of food products manufactured or produced in India
4. Pharmaceuticals (Greenfield and Brownfield)
5. Airports (both Greenfield and Brownfield)
6. Airport transport services
7. Private security agencies
8. Animal husbandry
9. Establishment of branch offices
10. Liaison office or project office
11. Teleports
12. Direct to home cable networks
13. Mobile TV and headend-in-the sky broadcasting service
14. Single brand retail trading.

Q.No.13. Outline the overseas direct investment made by Indian companies? (B) (SM)

FDI outflows of India: These are the overseas investments by the Indian entrepreneurs which will be in the form of joint ventures (JV) and wholly owned subsidiaries (WOS).

1. **Changes in Outward Foreign Direct Investment (OFDI):**
   a) OFDI had undergone substantial changes not only in terms of size but also in terms of geographical spread and sectoral composition.
   b) OFDI from India stood at US$ 1.86 billion in the month of June, 2016.
   c) The overseas investments have been primarily driven by resource seeking, market seeking or technology seeking motives.

2. **Overseas direct investment by Indian companies:**

a) Many Indian IT firms like Tata Consultancy Services, Infosys, WIPRO, and Satyam acquired global contracts and established overseas offices in developed economies to be close to their key clients.

b) There has been a surge in resource seeking overseas investments by Indian companies, to acquire energy resources in Australia, Indonesia and Africa.

c) Indian entrepreneurs are also choosing investment destinations in countries such as Mauritius, Singapore, British Virgin Islands, and the Netherlands on account of higher tax benefits they provide.

d) At present, any Indian investor can make overseas direct investment in any bona- fide activity except in certain real estate activities.

e) This has been made possible by progressive relaxation of the capital controls and simplification of procedures for outbound investments from India. For example, the annual overseas investment ceiling to establish JV and WOS has been raised to US$ 125,000 from US$ 75,000.

f) The RBI has also relaxed norms for foreign investment by Indian corporates by raising the borrowing limit.

g) Policies in respect of foreign investments undergo changes from time to time.

SIMILAR QUESTION:

1. Give an account of overseas direct investments by Indian companies?

A. Refer 2nd point

Q.No.14. State and explain briefly about Foreign Portfolio Investment (FPI). (A)
(MTP1 M18 - 3M)(SM)

FOREIGN PORTFOLIO INVESTMENT (FPI): Foreign Portfolio Investment is the flow of 'financial capital' rather than 'real capital' and does not involve ownership or control on the part of the investor.

Examples of FPI:

i) Deposit of funds in an Indian or a British bank by an Italian company.

ii) The purchase of a bond of a Swiss company or of the Swiss government by a citizen or company based in France.

1. **Characteristics of FPI:**

a) Following International Standards, Portfolio Investments are characterized by lower stake in companies with their total stake in a firm at below 10 percent.

b) FPIs are typically of short term nature, and are not intended to enhance the productive capacity of an economy by the creation of capital assets.

c) Unlike FDI, portfolio capital moves to investment in financial stocks, bonds and other financial instruments.

d) FPIs are effected largely by individuals and institutions through the mechanism of capital market.

e) FPIs have their immediate effects on balance of payments or exchange rates rather than on production or income generation.

f) FPI is not concerned with either manufacture of goods or with provision of services.

g) Logically, portfolio capital moves to a recipient country which has revealed its potential for higher returns and profitability.

h) FPIs are largely expected to be speculative and once investor confidence is shaken, such capital has a tendency to speedily shift from one country to another, occasionally creating financial crisis for the host country.

SIMILAR QUESTIONS:

1. What is meant by Foreign Portfolio Investment? (MTP1 M18 - 3M)

A. Refer definition

2. What are the characteristics of Foreign Portfolio Investments (FPI)?

A. Refer 1st point

Q.No.15. Who are Foreign Portfolio Investors? Also execute their features. (B) (SM)

Foreign Portfolio Investors includes Investment groups of Foreign Institutional Investors (FIIs), Qualified Foreign Investors (QFIs) and sub accounts etc.

Note: NRIs don't come under FPI.

1. **After the new SEBI guidelines, the RBI stipulated that Foreign Portfolio Investors include:**
   - **a)** Asset Management Companies,
   - **b)** Banks,
   - **c)** Pension Funds,
   - **d)** Mutual Funds, and
   - **e)** Investment Trusts as Nominee Companies, Incorporated / Institutional Portfolio Managers or their Power of Attorney holders,
   - **f)** University Funds,
   - **g)** Endowment Foundations,
   - **h)** Charitable Trusts and Charitable Societies
   - **i)** Sovereign Wealth Funds (regulated as FIIs) etc.
2. **Features of Foreign Portfolio Investors:**
   - **a)** Foreign Portfolio Investors do not have any intention of exercising voting power or controlling or managing the affairs of the company in whose securities they invest.
   - **b)** The singular intention of a Foreign Portfolio Investor is to earn a remunerative return through investment in foreign securities and is primarily concerned about the safety of their capital, the likelihood of appreciation in its value, and the return generated.
   - **c)** Portfolio investors will evaluate, on a separate basis, the prospects of each independent unit in which they might invest and may often shift their capital with changes in these prospects.

QUESTIONS FOR ACADEMIC INTEREST – FOR STUDENT SELF STUDY

Q.No.16. Why the investment in a host country may be found profitable by foreign firms? (C) (SM)

Investment in a host country may be found profitable by foreign firms because of some firm-specific knowledge or assets (such as superior management skills or an important patent) that enable the foreign firm to gainfully outperform the host country's domestic firms.

Q.No.17.What are the various forms of import restrictions in terms of foreign trade? (C) (SM)

Blanket bans, high customs duties or non-tariff barriers which make it difficult for the foreign firm to sell in the host-country market by 'getting behind the tariff wall'.

Q.No.18.What is meant by Green field investment? (C) (SM)

Green field investment means establishment of a new overseas affiliate for freshly starting production by a parent company.

Q.No.19.Summarize the benefits of foreign capital in a host country? (C) (SM)

Benefits from foreign capital do not occur in all cases, nor do they occur in the same magnitude in all the host countries.

Q.No.20.What are the arguments or opinion of critics with regard to foreign investments? (C) (SM)

Criticisms with regard to foreign investments:

1. Critics argue that foreign entities are highly focused on profits and have an eye on exploiting the natural resources and are almost always not genuinely interested in the development needs of host countries.
2. Foreign capital is perceived by the critics as an instrument of imperialism, or as a perpetrator of dependence and inequality both between nations and within nations.

Q.No.21.Define FDI impact on the host country's commodity terms of trade. (C) (SM)

FDI impact on the host country's commodity terms of trade can be defined as the price of a country's exports divided by the price of its imports.

Q.No.22.Give some examples in supporting the sentence "Many safeguards and performance requirements are put in place by developed and developing countries to improve the ratio of benefits to costs associated with foreign capital." (C) (SM)

Many safeguards and performance requirements are put in place by developed and developing countries to improve the ratio of benefits to costs associated with foreign capital. A few examples are:

i) Domestic content requirements on inputs,
ii) Reservation of certain key sectors to domestic firms,
iii) Requirement of a minimum percent of local employees,
iv) Ceiling on repatriation of profits,
v) Local sourcing requirements
vi) Stipulations for full or partial export of output to earn scarce foreign exchange.

DIFFERENCES

Q.No.23.Distinguish between Foreign Direct Investment and Foreign Portfolio Investment. (A) (RTP N18,N18 - 3M,SM, MTP2 M18 - 5M)(M19-2M)

Foreign Direct Investment (FDI) VS Foreign Portfolio Investment (FPI):

Foreign Direct Investment	Foreign Portfolio Investment
1. Direct investments are real investments in factories, assets, land, inventories etc. and involve foreign ownership of production facilities and typically occurs through acquisition of more than 10 percent of the shares of the target asset.	1. Portfolio capital, in general, moves to investment in financial stocks, bonds and other financial instruments and is effected largely by individuals and institutions through the mechanism of capital market.
2. Investment involves creation of physical assets	2. Investment is only in financial assets

3. Has a long term interest and therefore remain invested for long	3. Only short term interest and generally remain invested for short periods.
4. Relatively difficult to withdraw	4. Relatively easy to withdraw
5. Not inclined to be speculative	5. Speculative in nature
6. Often accompanied by technology transfer	6. Not accompanied by technology transfer
7. Direct impact on employment of labour and wages	7. No direct impact on employment of labour and wages
8. Enduring interest in management and control	8. No abiding interest in management and control
9. Securities are held with significant degree of influence by the investor on the management of the enterprise.	9. Securities are held purely as a financial investment and no significant degree of influence on the management of the enterprise.

TEST YOUR KNOWLEDGE

1. Distinguish between horizontal and vertical foreign direct investment
2. What is meant by automatic route?
3. What are the reasons for the speculative nature of foreign portfolio investments?
4. What impact does FDI have on host country employment?
5. Outline the effect of FDI on technology of host country?
6. Enumerate the effect of FDI on domestic industries?
7. Do you think FDI would help prevent formation of monopolies?
8. Do you agree with the argument that FDI is likely to reduce employment?
9. What implications do FDI have on domestic resource use?
10. Why did India discourage FDIs in its early stages?
11. Which of the following is a FDI?
    i) Claram Joe, a German investor buys 5000 shares of Ford, a US Automobile company.
    ii) Annette D, the US Company acquires all the equity shares of Emeline & Co in Alice Land which makes computer components.
    iii) A Bulgarian investor Boryana Gergiev pays cash and buys 0.2 % of all outstanding equity shares of Mariette Company which makes computer peripherals.
    iv) Maansi Tech solutions purchase 52% stake in a Sarra, a Jamaican technology firm
    v) Kora extends a loan to Christa Victorine, a power producing firm in which it holds 60 percent of equity.
    vi) Augusta Corp lends pounds 10 million to Lee Sud, a Dutch parts making firm in which it holds 79 percent of equity.
    vii) Labour group in your country oppose the flow of FDI into the country on grounds of perceived inequities consequent on FDI. What are their arguments?
    viii) Beth & Sushil are members of the committee for resolution of the issue cited under What arguments would they put forth to convince the labour groups of the welfare implications for labour that may arise from FDI?

THE END