Capital Flows

34. Basic capital flows, i.e. excluding “other capital” and special flows on account of IMF, fell during the BOP crisis reaching a low of 1.4 per cent of GDP in 1992-93. In the next three years, they rose sharply to an average of US $6.8 billion per annum (compared to an average of US $3.4 billion in the previous two years). They increased further to US $10.8 billion in 1996-97. Over the period 1993-94 to 1996-97, they have averaged about 2.5 per cent of GDP.

35. Looked at in terms of sub-aggregates, there is a sharp fall in capital flows on official account (government and RBI: the latter includes IMF flows) and a more than corresponding increase in the flows on corporate or business account. Net flows on private account rose from about US $2.2 billion in 1992-93 to an average of US $6.3 billion in 1993-94 to 1995-96, and further to US $10.4 billion in 1996-97. Over the same period, net flows on official account have fallen from an inflow of US $2.3 billion in 1992-93 to an outflow of US $593 million in 1996-97.

36. The other noticeable underlying trend is the rise in equity flows relative to debt flows. Equity flows (net) have risen from US $557 million in 1992-93 to US $5.8 billion in 1996-97. Debt flows (Aid, ECB, NRI, IMF, Rupee debt service) in contrast followed a U shaped curve from US $3.9 billion in 1992-93 to about US $4.0 billion in 1996-97. The ratio of equity flows to debt flows has, therefore, risen. This strengthens the self-correcting mechanism on the capital side of the balance of payments. To the extent equity consists of FDI, the flows are inherently more stable. In the case of portfolio equity, a sudden sharp fall in inflows will lead to an equally sharp fall in prices and PE ratios. This provides a strong incentive for new investors to enter the equity market and pick up bargains. In contrast, an incipient BOP problem not only raises the cost of new debt inflows, but also makes roll-over of old debt more difficult, thus adding to the problem.