

Foreign Capital

Everywhere in the world, including the developed countries, governments are vying with each other to attract foreign capital. The belief that foreign capital plays a constructive role in a country's economic development, it has become even stronger since mid-1980.

The experience of South East Asian Countries (1986-1995) has especially confirmed this belief and has led to a progressive reduction in regulation and restraints that could have inhabited the inflow of foreign capital.

1. Need for Foreign Capital:

The need for foreign capital arises because of the following reasons.

In most developing countries like India, domestic capital is inadequate for the purpose of economic growth. Foreign capital is typically seen as a way of filling in gaps between the domestically available supplies of savings, foreign exchange, government revenue and the planned investment necessary to achieve developmental targets. To give an example of this 'savings-investment' gap, let us suppose that planned rate of growth output per annum is 7 percent and the capital-output ratio is 3 percent, then the rate of saving required is 21 percent.

If the saving that can be domestically mobilized is 16 percent, there is a shortfall or a savings gap of 5 percent. Thus the foremost contribution of foreign capital to national development is its role in filling the resource gap between targeted investment and locally mobilized savings. Foreign capital is needed to fill the gap between the targeted foreign exchange requirements and those derived from net export earnings plus net public foreign aid. This is generally called the foreign exchange or trade gap.

An inflow of private foreign capital helps in removing deficit in the balance of payments over time if the foreign-owned enterprise can generate a net positive flow of export earnings.

The third gap that the foreign capital and specifically, foreign investment helps to fill is that between governmental tax revenue and the locally raised taxes. By taxing the profits of the foreign enterprises the governments of developing countries are able to mobilize funds for projects (like energy, infrastructure) that are badly needed for economic development.

Foreign investment meets the gap in management, entrepreneurship, technology and skill. The package of these much-needed resources is transferred to the local country through training programmes and the process of learning by doing'. Further foreign companies bring with them sophisticated technological knowledge about production processes while transferring modern machinery equipment to the capital-poor developing countries.

2. Forms of Foreign Capital:

Foreign Capital can be obtained in the form of foreign investment or non-concessional assistance or concessional assistance.

1. Foreign Investment includes Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). FPI includes the amounts raised by Indian corporate through Euro Equities, Global Depository Receipts (GDR's), and American Depository Receipts (ADR's).

2. Non-Concessional Assistance mainly includes External Commercial Borrowings (ECB's), loans from governments of other countries/multilateral agencies on market terms and deposits obtained from Non-Resident Indians (NRIs).

3. Concessional Assistance includes grants and loans obtained at low rates of interest with long maturity periods. Such assistance is generally provided on a bilateral basis or through multilateral agencies like the World Bank, International Monetary Fund (IMF), and International Development Association (IDA) etc. Loans have to be repaid generally in terms of foreign currency but in certain cases the donor may allow the recipient country to repay in terms of its own currency.