



## Shifts in Foreign Portfolio Investments In India

**For Prelims:** [Foreign portfolio investments](#), [Double Taxation Avoidance Agreement](#), [Foreign Direct Investment](#), Assets Under Custody, Capital Market.

**For Mains:** Difference in FDI and FPI, Risks Associated with FPI.

**Source:** [BL](#)

### Why in News?

[Foreign portfolio investments \(FPIs\)](#) into India have witnessed a **significant reshuffling in the pecking order among regions**.

- This transformation is attributed to various factors, including **regulatory changes, geopolitical events, and strategic alliances**.

### What are the Significant Changes in India's FPI Landscape?

- **Luxembourg's Ascendancy:**
  - Luxembourg has become the **third-largest region for FPIs in India**, surpassing Mauritius, with its **Assets Under Custody (AUC)** growing by 30% to ₹4.85 lakh crore.
    - Globally, its equity assets are now second only to the United States.
  - The surge is linked to **strengthened India-Europe ties**, resulting in three financial agreements.
    - Luxembourg hosts over **1,400 FPI accounts out of 3,000 in Europe (excluding the UK)**.
    - Collaborations, notably with **GIFT City**, have further strengthened financial ties between India and Luxembourg.
- **France's Notable Gains:**
  - France has entered the top ten FPIs with a remarkable 74% growth in AUC, reaching ₹1.88 lakh crore.
  - This ascent is fueled by the **favourable tax provisions under the [Double Taxation Avoidance Agreement \(DTAA\)](#)** between India and France.
- **Other Players in the Reshuffled Landscape:**
  - **Ireland and Norway** have climbed one position each, now ranking **5<sup>th</sup> and 7<sup>th</sup> among FPI jurisdictions**.
    - Ireland's attractiveness stems from its tax efficiencies and global reach, offering regulated funds exemption from Irish tax on income and gains.
  - Also, despite a 19% year-on-year growth in AUC, **Canada dropped one place in the rankings**. The impact of the diplomatic tensions between India and Canada on investments remains uncertain.

What is Foreign Portfolio Investment?

▪ **About:**

- FPI refers to investments made by foreign individuals, corporations, and institutions in the financial assets of India, such as **stocks, bonds, and mutual funds**.
  - These investments are mainly for the purpose of **short-term gains and portfolio diversification**, unlike **Foreign Direct Investment (FDI)** which involves long-term ownership of assets.

▪ **Benefits:**

- **Capital Inflow:** FPI results in the **inflow of foreign capital into the Indian financial markets**, which contributes to increased liquidity and capital availability.
- **Boost to Stock Market:** Increased FPI can positively impact the stock market, **leading to higher valuations** and increased investor confidence.
- **Technology Transfer:** FPI often involves investments in technology-oriented sectors, leading to **induced technology transfer and advancements in various industries**.
- **Global Integration:** FPI promotes global integration of financial markets, allowing Indian markets to align with global trends and attract foreign investors.

▪ **Risk:**

- **Market Volatility and Capital Flight:** FPI flows can be volatile, driven by global economic and geopolitical factors.
  - Sudden inflows or outflows can lead to **market instability and currency fluctuations**, harming both domestic investors and the economy.
- **Transparency and Identification of Beneficial Owners:** Identifying the ultimate beneficiaries of complex FPI structures can be challenging for regulators, **raising concerns about potential misuse of funds** and tax evasion.

▪ **Assets Under Custody:** AUC refers to the total value of **financial assets that a custodian manages for their clients**. It can also refer to the closing market value of all equities held by FPIs.

▪ **Pecking Order:** The pecking order in the context of FPIs refers to the **ranking or hierarchy of regions or countries** from which foreign investors channel their investments into a target country, in this case, **India**.

# FDI and FPI



## Foreign Direct Investment (FDI)

- **About:**
    - Investment made by foreign entities/individuals in **businesses and assets** located in a different country
  - **FDI Routes:**
    - **Automatic Route:**
      - ◆ No prior government approval required
      - ◆ Up to 100% allowed in non-critical sectors
    - **Government Approval:**
      - ◆ Necessary in certain sectors or for investments above specific thresholds
      - ◆ Administered by **Department for Promotion of Industry and Internal Trade (DPIIT)** and RBI
  - **Examples of Approval via Auto and Govt Route:**
    - Banking (Private sector): up to 49% (auto) + above 49% and up to 74% (Govt)
    - Defence: up to 74% (auto) + above 74% (Govt)
    - Healthcare (Brownfield): up to 74% (auto) + above 74% (Govt)
    - Telecom Services: up to 49% (auto) + above 49% (Govt)
  - **Foreign Investment Promotion Board (FIPB):**
    - Comes under Ministry of Finance
    - Responsible for processing FDI proposals – facilitated by **Foreign Investment Facilitation Portal (FIIP)**
    - Making recommendations for Government approval
- Govt's prior approval is mandatory for FDI from countries sharing land border with India (China, Bangladesh, Pakistan, Bhutan, Nepal, Myanmar and Afghanistan)
- **India's Top 5 FDI Sources (FY 2022-23):**
    - Mauritius
    - Singapore
    - USA
    - Netherland
    - Japan
  - **India's Top Sectors Attracting FDI (FY 2022-23):**
    - Services Sector
    - Computer Software & Hardware
    - Trading
    - Telecommunications
    - Automobile Industry



## Foreign Portfolio Investment (FPI)

- **About:**
  - Investments made by foreign individuals, institutions, or funds in financial assets
  - Known as Fly by Night or Hot Money
- **Imp Features:**
  - **Purchase of financial assets** occur without gaining ownership
  - Passive investment approach
  - Investors earn returns through **dividends, interest, and capital appreciation**
- **Example:**
  - Stocks, Bonds etc.
- **Regulatory Body:**
  - Securities and Exchange Board of India (SEBI)

Difference between FDI and FPI		
Features	FDI	FPI
Nature of Investment	Long-term	Short-term
Objective	Long-term presence in a foreign country	Earning quick returns on investments
Control	Significant (over the invested entity)	No or limited control
Investments in	Tangible assets (e.g., factories, buildings)	Financial assets (e.g., stocks, bonds)
Returns	Profits, Dividends, and Capital appreciation	Dividends, Interest, and Capital appreciation
Policy Regulations	Govt policies and sector-specific regulations	Flexible regulations and easier entry/exit
Impact on Economy	Job creation, technology transfer, and economic growth	Short-term liquidity and impact on stock market performance



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## UPSC Civil Services Examination, Previous Year Questions (PYQ)

### Prelims

**Q. Which one of the following groups of items is included in India's foreign-exchange reserves? (2013)**

- (a) Foreign-currency assets, Special Drawing Rights (SDRs) and loans from foreign countries
- (b) Foreign-currency assets, gold holdings of the RBI and SDRs
- (c) Foreign-currency assets, loans from the World Bank and SDRs
- (d) Foreign-currency assets, gold holdings of the RBI and loans from the World Bank.

**Ans: (b)**

**Q. With reference to Foreign Direct Investment in India, which one of the following is considered its major characteristic? (2020)**

- (a) It is the investment through capital instruments essentially in a listed company.
- (b) It is a largely non-debt creating capital flow.
- (c) It is an investment which involves debt-servicing.

**(d)** It is the investment made by foreign institutional investors in the Government securities.

**Ans: (b)**

**Mains:**

**Q.** Justify the need for FDI for the development of the Indian economy. Why is there a gap between MoUs signed and actual FDIs? Suggest remedial steps to be taken for increasing actual FDIs in India. **(2016)**

**Q.** Foreign Direct Investment in the defence sector is now set to be liberalised. What influence is this expected to have on Indian defence and economy in the short and long run? **(2014)**

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