In this chapter, an attempt has been made to briefly review the foreign trade and foreign direct investment policies which have been adopted by the South Asian Countries to meet the challenges of Globalization as a part of their Structural Adjustment Programme.

Like most developing countries, the South Asian Countries also pursued a development strategy based on import substituting industrialization in the early years of their independence. As a part of this closed macro economic policy, a protectionist trade policy regime and selective foreign direct investment policy had been evolved to encourage and nurture domestic industries. At the same time, a dominant role was assigned to the State in the development process. These import substitution strategies coupled with large public sectors, resulted in rent-seeking activities and uncompetitive production processes.\footnote{Bhagwati, J.N. and Sri Niwasan, T.N. (1975) Foreign Trade Regimes and Economic Development, Mc Millan, Delhi.} Following the success of East Asian countries with higher exports and economic growth during the period from the early seventies to early eighties, a process of policy reforms was initiated. In 1990s, this process of economic reforms was expedited and made more comprehensive. The decade of 1990s, proved to be a turning point for a number of South Asian Economies. It was marked by the adoption of economic reforms as a part of which a significant emphasis was laid on the process of liberalization particularly in the trade and investment regimes to intensify their integration with the world economy.

5.1 POLICY REFORMS IN BANGLADESH

The move towards liberalization in Bangladesh commenced in 1979. But between 1979 and 1990, the reforms were introduced at a relatively
slower rate. The trade reforms introduced during the 1980s were mainly geared towards rationalizing and to a lesser extent, reducing import tariffs and removing quantitative restrictions. From 1990 onwards, Bangladesh embarked on a more liberal policy regime involving both trade and financial liberalization and privatization. The major progress in trade policy reforms came in the period starting in 1991 with a substantial scaling down and rationalizing tariffs, removal of trade related quantitative restrictions and elimination of import licensing, unification of exchange rate and move to more flexible exchange rate system.

Liberalization of Bangladesh’s trade regime since 1991 was more systematic and comprehensive. The overriding objectives of trade policies were to promote competition and achieve neutrality of incentives between production for export and import substitutes while gradually making trade facilitation the centerpiece of customs administration. Outward orientation in Bangladesh in the 1990s covered three major areas: Liberalization of imports through removal of quantitative restrictions; reductions in nominal and effective tariffs; and adoption of a unified and moderately flexible exchange rate regime.

1) Liberalization of Imports -

The liberalization of imports was done via removal of quantitative restrictions. Significant progress was made in removing quantitative restrictions in 1990s as compared to 1980s. Table 5.1 reveals that during 1987-1991, the total number of items in the control list were 315 i.e. 26% which were reduced to 193 (15.6%) during 1991-1993. The same were further reduced to 111 (9%) during 1993-95. But during 1995-1997 and 1997-2002, the number of items in the control list increased to 120 and 122 respectively.

Similarly, the number of trade related items which were 253 during 1987-1991 were reduced significantly to 79 in 1991-1993 and 19 in 1993-95 in

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the control list. However, the momentum could not be maintained and the number of items increased to 27 in 1997-2002 in the control list.

Table 5.1

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of items in</td>
<td>315</td>
<td>193</td>
<td>111</td>
<td>120</td>
<td>122</td>
</tr>
<tr>
<td>the control list at</td>
<td>(26.1)</td>
<td>(15.6)</td>
<td>(9.0)</td>
<td>(9.7)</td>
<td>(9.8)</td>
</tr>
<tr>
<td>the H.S. 4-digit level.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of trade-</td>
<td>253</td>
<td>79</td>
<td>19</td>
<td>27</td>
<td>27</td>
</tr>
<tr>
<td>related items in the</td>
<td>(21.1)</td>
<td>(6.4)</td>
<td>(1.5)</td>
<td>(1.9)</td>
<td>(2.2)</td>
</tr>
<tr>
<td>control list at the</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>H.S. 4-digit level</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Harmonized system)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Figures in parenthesis are percentages. H.S. 4-digit level is the Harmonized commodity description and coding system adopted in 1988. It has been further revised in 1996 covering 5113 items at 6-digit level with detailed product definitions.

Source: Ahmed Sadiq⁷

The progress towards increasing liberalization that was evident until the Import Policy order of 1995-97 seems to have been halted even modestly reversed in the Import Policy Order 1997-2002. Overall, since 1990, trade related quantitative restrictions have been progressively removed.

2 Tariff Rationalization:

Bangladesh significantly reduced its tariff rates and rationalized the structure progressively towards the goal of simplicity and transparency of custom tariffs during the 1990s. Progress in tariff rationalization is shown in Table 5.2(A). It reveals that unweighted average import tariffs during 1991-92 were 57.3% which were brought down to 16.3% during 2004-05. Average protective tax rates as well as top custom duty rate were also significantly reduced, as shown in Table 5.2 (B).

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⁷ Ahmed Sadiq, op.cit
Table 5.2(A)
Average Import Tariffs (Percentage) (Bangladesh)

<table>
<thead>
<tr>
<th>Period</th>
<th>Unweighted</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>57.3</td>
</tr>
<tr>
<td>1992-93</td>
<td>47.4</td>
</tr>
<tr>
<td>1993-94</td>
<td>36.0</td>
</tr>
<tr>
<td>1994-95</td>
<td>25.9</td>
</tr>
<tr>
<td>1995-96</td>
<td>22.3</td>
</tr>
<tr>
<td>1996-97</td>
<td>21.5</td>
</tr>
<tr>
<td>1998-99</td>
<td>20.2</td>
</tr>
<tr>
<td>2001-02</td>
<td>17.0</td>
</tr>
<tr>
<td>2002-03</td>
<td>16.5</td>
</tr>
<tr>
<td>2004-05</td>
<td>16.3</td>
</tr>
</tbody>
</table>


Table 5.2 (B)
Progress in Tariff Rationalization

<table>
<thead>
<tr>
<th>Tariffs</th>
<th>FY 92</th>
<th>FY 97</th>
<th>FY 02</th>
<th>FY 03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Protective tax</td>
<td>61</td>
<td>26</td>
<td>27</td>
<td>22</td>
</tr>
<tr>
<td>Top custom duty rate</td>
<td>350</td>
<td>45</td>
<td>37.5</td>
<td>32.5</td>
</tr>
</tbody>
</table>


Considerable rationalization of the tariff structure occurred and progress was made towards achieving a degree of uniformity and removing some tariff anomalies that existed due to higher tariffs on intermediate goods than final goods (Table 5.3). Percentage of duty free tariff lines was increased from 4.08 in 1991-92 to 15.36 in 2002-03, whereas percentage of bound tariff

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lines which was zero in 1991-92 increased to 13.2% in 1996-97 and remained same during 2002-03. Tariffs on agricultural products were reduced from 71.80% in 1991-92 to 23.35% in 2002-03. Similarly, the tariff rates were also brought down on industrial products from 55.62% to 15.08% during the same period of time. Standard deviation of custom duty was reduced to 11.64% in 2002-03 from 40.85% in 1991-92. Average collection rates of all import taxes also fell from 37.4% in 1991-92 to 34.39% in 1996-97.

Table 5.3
Summary Indicators of MFN Tariffs in Bangladesh

<table>
<thead>
<tr>
<th>Indicators</th>
<th>1991-92</th>
<th>1996-97</th>
<th>2002-03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of bound tariff lines</td>
<td>0.0</td>
<td>13.2</td>
<td>13.2</td>
</tr>
<tr>
<td>Percentage of duty free tariff lines</td>
<td>4.08</td>
<td>14.70</td>
<td>15.36</td>
</tr>
<tr>
<td>Agricultural products</td>
<td>71.80</td>
<td>21.87</td>
<td>23.35</td>
</tr>
<tr>
<td>Industrial products</td>
<td>55.62</td>
<td>20.76</td>
<td>15.08</td>
</tr>
<tr>
<td>Standard deviation of custom duty</td>
<td>40.85</td>
<td>16.22</td>
<td>11.64</td>
</tr>
<tr>
<td>Average collection rates (all imp. taxes)</td>
<td>37.41</td>
<td>34.39</td>
<td>n.a.</td>
</tr>
</tbody>
</table>


3. Exchange Rate Liberalization

Multiple exchange rates were replaced by unified exchange rate in 1992 and the flexibility of the exchange rate system was enhanced to strengthen the competitiveness of exports. In 1994, the taka was made fully convertible for current account transactions. Bangladesh’s Real Effective Exchange Rate (REER) has been remarkably stable for the past many years but during the year 2004 and 2005, the value of taka has been continuously declining.
In addition to trade liberalization, restrictions on movement of foreign capital were also removed.

**FDI Policy of Bangladesh –**

In the late 1980s and 1990s, Bangladesh announced a series of measures and liberalized its FDI policy framework. The country has removed virtually all barriers to foreign investment and business. It has improved its investment and regulatory environment, including the liberalization of the industrial policy, abolition of performance requirements and allowance of fully owned joint ventures. Bangladesh is one of those countries, where foreign investors can open a shop with 100 per cent equity and with any type of ownership.⁵ According to the Industrial Policy 2005, the following investments are allowed in the Export processing Zones:

- 100 percent foreign investment including those of non-resident Bangladeshis.
- Joint ventures of foreign and local investors.
- 100 percent investment of Bangladeshi investors living in Bangladesh.

There is no restriction in land purchase. Foreign investment in Bangladesh is allowed in all sectors except the following reserved areas:

a. production of arms and ammunition and other defence equipment, and machinery,

b. forest plantation and mechanized extraction within the area of reserved forests,

c. production of nuclear energy and

d. Security printing (currency notes) and minting.

Bangladesh adopted a number of policies and provided generous incentives to attract foreign direct investment (FDI) into the country and it perhaps has the most liberal FDI regime in South Asia. These, among others, include: a tax holiday for 5 to 7 years; income tax exemption for 15 years for the experts of foreign enterprises; protection from double taxation; exemption

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from duty for importing machinery and spare parts for 100 per cent export-oriented units; eligibility for full working capital loans from the local banks on banker-client relationship; the option for foreign firms or joint ventures not to sell their shares through public issues. Unhindered remittance of dividends, capitals, gains on capital etc. are allowed. The Government has abolished the licensing system and simplified government approval procedure for investment in Bangladesh.

Bangladesh is also a signatory of the Multilateral Investment Guarantee Agency insuring investors against political risk. As a member of World Intellectual Property Organization (WIPO) and World Association of Investment Promotion Agencies (WAIPA) the country further safeguards the interest of foreign investment. Standard dispute settlement procedures are followed in case there is any dispute of the government with any private party. If the foreign investors feel that their rights have been violated, they can file writs with the High Courts.

In Industrial Policy, the role of the private sector has been recognized as predominant. Government has enacted a law in parliament enabling private investors to set up private Export Processing Zones (EPZ). The units in private EPZs enjoy facilities similar to those in government EPZs. The Private Power Generation Policy has been formulated paving the way for private investment in power generation for which a new Electricity Act and a regulatory commission were planned to be set up. Private investments have already been allowed in gas exploration, gas development, power generation and other mining and exploration activities.

The Industrial Policy, 2005 is based on the philosophy of market economy. Some of the salient features of the Policy are:

- Inspire well-proportioned industrialization across the country by providing incentives, wherever necessary;
- Remove policy discrimination, if any, between domestic and foreign investments;
- Enhance regional and sub-regional cooperation;
Privatize non-profitable industries in the state sector in a short period of time and in phases.

Restrict state investment and administration only to those industries in the public sector which the Govt. thinks are not safe for investment in the private sector.

Provide all out assistance to create a strong capital market so that investments in the industrial sector are increased:

Take necessary steps to bring about the country's industrial development in line with different agreement, with the WTO.

Promote FDI in order to bring about technology transfer, efficiency and management development and enhance marketing skills;

In respect of foreign investments in thrust sectors, preference will be given to small and medium scale investors when allotting plots in industrial enclaves.

On the whole, Bangladesh has taken considerable steps to reform and liberalize all its economic Policies including FDI with low labor costs and almost no restrictions on the entry and exit of foreign investors. Bangladesh is on the track toward becoming an attractive destination for FDI in the South Asian Region.

5.2 INDIA

Trade Liberalization Policy: -

The trend towards liberal trade policy in India was started in mid eighties but found full expression during the years of 1991-92 onwards. In the pre-reform period, India's trade policy was highly complex and cumbersome marked by a structure of high tariff levels and non-tariff restrictions. There were many categories of importers, different types of import licenses and alternative ways of importing. In fact, almost India's imports (more than 95 percent) were subject to one or more type of restrictions. Some modest trade liberalization began in 1985 when there were some simplifications to the quotas, although restrictions were not removed. The transition from 'socialistic
pattern of society' to 'market economy' and integrating Indian Economy with the global market were practiced through 'economic reforms'.

Table 5.4 presents some evidence on average tariff structure for the period 1990-91 to 1997-98 and reveals that successive rounds of tariff reduction brought maximum tariff levels from around 87% in 1990/91 to about 20% in 1997-98 (weighted average tariff). Before liberalization, the top tariffs were in the range 110-150%. Unweighted tariff levels were also brought down from 125% to 35% during the same period. Tariffs on consumer goods, intermediate goods and capital goods were also reduced.

Table 5.4
Average Tariff Structure in India

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unweighted</td>
<td>125</td>
<td>71</td>
<td>41</td>
<td>39</td>
<td>35</td>
</tr>
<tr>
<td>Weighted</td>
<td>87</td>
<td>47</td>
<td>25</td>
<td>22</td>
<td>20</td>
</tr>
<tr>
<td>Consumer goods</td>
<td>153</td>
<td>86</td>
<td>36</td>
<td>33</td>
<td>25</td>
</tr>
<tr>
<td>Intermediate goods</td>
<td>77</td>
<td>42</td>
<td>22</td>
<td>19</td>
<td>18</td>
</tr>
<tr>
<td>Capital goods</td>
<td>97</td>
<td>50</td>
<td>29</td>
<td>29</td>
<td>24</td>
</tr>
<tr>
<td>Maximum Tariff Rate</td>
<td>35.5</td>
<td>85</td>
<td>50</td>
<td>52</td>
<td>45</td>
</tr>
</tbody>
</table>

Source: Pradhan (2002)

Simple average of the tariff rates for the period 1998-99 to 2004-05 are presented in Table 5.5. It is observed from the table that liberalization involved more reduction in the tariff rates. Custom duties (all tariff lines) were reduced from 39.6% in 1998-99 to 22.2% in 2004-05. General maximum custom duty was brought down to 30% from 45% during the same period. Maximum custom duty on non-agricultural products was reduced to 20% in 2004-05. Similarly, custom duty on agricultural products was reduced to 40.1% in 2004-05. General protective taxes and import taxes on agricultural and non-agricultural products were also brought down.


Table 5.5
Simple average of the tariff rates (in India)

<table>
<thead>
<tr>
<th></th>
<th>1998-99</th>
<th>2002-03</th>
<th>2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>All tariff lines</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs duties (CD)</td>
<td>39.6</td>
<td>29.0</td>
<td>22.2</td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>6.0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other selective protective taxes</td>
<td>0.0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>35.0</td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td><strong>General maximum CD</strong></td>
<td>45.0</td>
<td>30.0</td>
<td>30</td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>6.0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>General maximum: CD + other</td>
<td>36.0</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td><strong>Non-agricultural tariffs</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs duties</td>
<td>27.4</td>
<td>19.7</td>
<td></td>
</tr>
<tr>
<td>Other general Protective taxes</td>
<td>5.9</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other selective import taxes</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>33.3</td>
<td>19.7</td>
<td></td>
</tr>
<tr>
<td>General maximum: CD + other</td>
<td>36.0</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td><strong>Agricultural tariffs</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs duties</td>
<td>40.6</td>
<td>40.1</td>
<td></td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>6.5</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other selective import taxes</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>47.1</td>
<td>40.1</td>
<td></td>
</tr>
<tr>
<td>General maximum CD</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>8.6</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>General maximum: CD + other</td>
<td>108.6</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>


The liberalization involved more trade reforms. The import licensing system was abolished, with the exception of import of most consumer items. The cash compensatory scheme for exports, which had been a major subsidy item on the federal budget, was withdrawn as an effort to both restore fiscal discipline and promote a greater degree of allocative efficiency. It also eliminated licensing requirements for about one third of consumer goods.8 In the early 1998, RBI decided to allow foreign institutional investors to bring

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funds that could later be repatriated, while Indian companies were permitted to borrow on international capital market with fewer RBI's restrictions.9

The focus of Indian Govt.'s EXIM policy announced on 31st March, 2002 for the period 2002-07 was on making a shift from import liberalization phase of the past to a purely export-oriented one so as to boost exports to achieve 1 percent share in global trade in 2007 from 0.67% in 2002.10 This policy removed quantitative restrictions on 715 items. As a part of her commitment under the WTO Agreement, India has brought her tariff rates to lower levels than those prevailing at the time of Agreement. Although India’s tradable economy is still very heavily protected but it is now more diversified, flexible and competitive.11 Table 5.6 and 5.7 provides profile of some main measures taken to affect imports and promote exports since 1991.

Table 5.6
Main Measures Effecting Imports, Introduced Since 1991 (in India)

<table>
<thead>
<tr>
<th>Year</th>
<th>Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>Tariff rate was reduced to half -150 percent from 355 percent, import licensing system has been dismantled.</td>
</tr>
<tr>
<td>1992-93</td>
<td>Another cut in peak rate to 110 percent, free imports of almost all intermediate and capital goods.</td>
</tr>
<tr>
<td>1993-94</td>
<td>Peak rate reduced to 85 percent. Removed 146 items from the negative (restricted) list.</td>
</tr>
<tr>
<td>1995-96</td>
<td>All Non-Tariff Barriers have been phased out from all tradable except consumer goods and tariff rates brought down to the maximum of 50 percent.</td>
</tr>
<tr>
<td>1998-99</td>
<td>Removal of all quantitative restrictions on imports of around 2300 items from SAARC countries.</td>
</tr>
<tr>
<td>2000-01</td>
<td>Peak rate reduced to 35 percent.</td>
</tr>
</tbody>
</table>

Source: Economic survey, various issues.

### Table 5.7
Main Measures Taken to Promote Exports Since 1991 (in India)

<table>
<thead>
<tr>
<th>Year</th>
<th>Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>The rupee was devalued twice in July 1991 leading to 20 per cent depreciation in its value.</td>
</tr>
<tr>
<td>1992-93</td>
<td>EOU-EPZ (Export Oriented Units – Export Processing Zones) system was expanded to agricultural and allied exports with 50 percent DTA (Domestic Tariff Area) sales allowed.</td>
</tr>
<tr>
<td>1993-94</td>
<td>Partial convertibility of rupee on trade account was introduced subsequently followed by full convertibility on current account.</td>
</tr>
<tr>
<td>1994-95</td>
<td>An Electronic Hardware Technology Park Scheme was introduced at par with the EPZs.</td>
</tr>
<tr>
<td>1999-2000</td>
<td>The concept of Free Trade Zone was accepted.</td>
</tr>
<tr>
<td>April 2000</td>
<td>Setting up of SEZs (Special Economic Zones)</td>
</tr>
<tr>
<td>June 1, 2000</td>
<td>FEMA (Foreign Exchange Management Act) was introduced.</td>
</tr>
<tr>
<td>2004-09</td>
<td>1) A new scheme called ‘Target Plus has been introduced to accelerate exports.</td>
</tr>
<tr>
<td></td>
<td>2) To boost the exports of fruits, vegetables, flowers, minor forest produce and their value added products another scheme called, ‘Vishesh Krish Upaj Vojana’ has been introduced.</td>
</tr>
<tr>
<td></td>
<td>3) To accelerate exports in services a scheme called “Served from India” has been launched.</td>
</tr>
<tr>
<td></td>
<td>4) SEZ Act, 2005 has been enacted.</td>
</tr>
<tr>
<td></td>
<td>5) To create trade related infrastructure and to facilitate the import and export of goods and services', free ‘Trade and Warehousing Zone’ scheme has been introduced</td>
</tr>
</tbody>
</table>

**Source:** Economic survey, various issues.

Highlights of Foreign Trade Policy of India (2004-09) have been presented in Annexure IV.
FDI Policy Framework in India –

India has introduced many policy reforms to attract FDI since independence. Changes in policy framework in India dealing with FDI inflows could be studied in four phases viz.

(i) Cautious welcome policy (1948-66).
(ii) Selective and restrictive policy (1967-79).

Phase – I – Cautious Welcome Policy (1948-66)

Soon after independence, the need for defining a policy with respect to foreign investment was felt in the context of initiating a process of rapid economic development. Although there is no separate law governing the FDI policy in India, it has generally been guided by the industrial policy statements and five year Plans from time to time. The Industrial Policy Resolution of 1948 recognized that participation of foreign capital and enterprise particularly as regards technical know how would be of value for the rapid industrialization of the country. However, it was thought that the conditions under which foreign capital could participate in Indian industry should be carefully regulated in national interest. The domestic industry was accorded considerable protection in the form of high tariffs and quantitative restrictions on imports.

Foreign investors were assured of a national treatment as stated by the Prime Minister Jawaharlal Nehru in April 1949 that once foreign investment had been allowed to be made in the country, it would be given non-discriminatory treatment. Firms with foreign investment were given assurance for free remittance of profits, dividends and interest and compensation in the event of acquisition. Foreign Exchange crisis of 1957-58 compelled the Government to adopt a more liberal approach to FDI and also marked a change in foreign collaboration in India in two ways – (i) foreign enterprise began to take equity participation more frequently, (ii) more of technical collaborations started to accept equity participation in lieu of royalties and fees. In a bid to attract foreign investment, a host of incentives and
concessions were also extended. During 1950s and early 1960s, western MNCs started showing real interest in India. Moreover, in 1966, the Government decided that investments made by NRIs would be allowed without any limit in Public limited Industrial concerns, and up to 49 percent in private industrial concerns and in special cases, their share would be increased to 51 percent.

**Phase – II – Selective and restrictive policy (1967-79)**

Phase – II is known as the period of selective and restrictive policy. The Government was prompted to restrict the procedure for FDI because of increasing burden of competition, outflows due to remittances of dividends, profits, royalties and technical fees abroad on account of serving of FDI. Moreover, the increase in technology imports became a significant proportion of exchange account of the country. So some restrictions were put on proposals of FDI and Govt. Policy became highly selective. Foreign Exchange Regulations Act (FERA) was amended in 1973, to regulate the entry of foreign capital.

As per the amended rules, all branches of foreign companies in India and Indian Joint Stock Companies in which non-resident holdings was more than 40 percent were expected to bring down their share to 40 per cent within a period of 2 years. Govt. listed industries in which FDI was not considered desirable in view of development of indigenous technology. The Govt. had made it clear that while it would strictly enforce the provisions of FERA, the companies which diluted their non-resident holdings to less than 40 percent would be treated at par with Indian companies, except in cases specifically notified. Their future expansion would be guided by the same principles as those applicable to Indian companies. From 1973, further activities of MNCs were limited to a selected group of core or high priority areas only. Only a limited number of companies were given discretionary treatment under licensing. Technical Evolution Committee (TEC) was formed in 1976 to assist Foreign Investment Board (FIB) in screening the foreign collaboration proposals. In consultancy services, Indian consultants were assigned the primary role.
Major features of foreign direct investment policy during the first two phases are as follows:

**Major features of FDI policies during the pre-liberalization period:**

<table>
<thead>
<tr>
<th>Phase I (1948-66)</th>
<th>Phase II (1967-79)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receptive Attitude or Cautious Welcome</td>
<td>Restrictive attitude</td>
</tr>
<tr>
<td>Non-discriminatory treatment to FDI</td>
<td>Restriction on FDI without technology</td>
</tr>
<tr>
<td>No restrictions on remittance of profits and dividends.</td>
<td>Above 40% stake not allowed.</td>
</tr>
<tr>
<td>Ownership and control with Indians.</td>
<td>Allowed only in Priority area.</td>
</tr>
<tr>
<td></td>
<td>FDI controlled by FERA</td>
</tr>
<tr>
<td></td>
<td>Discretionary power in sanctioning the projects.</td>
</tr>
</tbody>
</table>

**Phase III – 1980-90: The period of Partial Liberalization**

Towards the end of the 1970s, however, India’s incapability of increasing exports both in value and volume particularly manufactured goods along with second oil shock kept the policy makers to worry. This has been due to lack of international competitiveness which has been because of lack of appropriate technology, poor quality of goods, limited range and high cost partly due to highly protected market. Hence to deal with the situation arising out from the above, the Govt. of India came forward with an appropriate strategy which has been reflected in the Industrial Policy statements of 1980 and 1982. This is the Phase when the Government committed to liberalization. It did everything it could, in terms of changing the policies and highlighting its locational advantages in order to attract foreign investors. In this phase, the Govt. gave signals for the start of a new era in the Indian Economy by introducing a new industrial policy, which laid foundation for the liberalized economy.
The Government of India took many steps like:

<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>100% Export oriented Units were exempted from FERA 1973 and other export regulations.</td>
</tr>
<tr>
<td>1982-83</td>
<td>Liberalized facilities with regard to bank deposits and investments in equity shares of the corporate sector. RBI also simplified Exchange control procedural formalities to facilitate investment.</td>
</tr>
<tr>
<td>1983-84</td>
<td>The Govt. provided the incentives in form of tax concessions and exemptions to NRIs.</td>
</tr>
<tr>
<td>1984</td>
<td>Several areas of industrial activities were opened to foreign Investment like the communication, electronics industry etc.</td>
</tr>
<tr>
<td>1985</td>
<td>Licensing was made more liberal. This allowed units to change their product mix to certain degree without Govt. permission, which led to record collaborations in 1986 i.e. 1200.</td>
</tr>
<tr>
<td>1985-86</td>
<td>Govt. abolished estate duty which was considered as one of the major hurdles in the way of inward remittances to India by NRIs.</td>
</tr>
<tr>
<td>1986-87</td>
<td>Govt. permitted NRIs to subscribe to the memorandum and Article of Association of a new company and take up their share up to face value of Rs. 10,000 for the purpose of its corporation. Also allowed Indian companies with more than 40 percent non resident interest to acquire immovable properties in India.</td>
</tr>
<tr>
<td>1988</td>
<td>Quantitative ceiling of Rs. 40 lacs for making Investment by NRIs in private Ltd. Companies were also removed. Fast channel was set up in for expediting clearances of FDI proposals from major investing industries.</td>
</tr>
</tbody>
</table>

Thus the above said process of industrial Policy reforms directed at fostering greater competition, efficiency and growth in the industrial sector with a stable, pragmatic and non-discriminatory policy.

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India entered the decade of nineties with a more liberal policy towards FDI, encouraged by the results of cautious deregulation of the Indian economy during 1980s. The Govt. of India, in June 1991, initiated a Programme of macro economic stabilization and structural adjustment and as a part of the structural adjustment policies, New Industrial Policy was also announced, which marked the start of the process of full scale liberalization, thereby, intensifying the process of globalization of Indian economy with that of world economy.

In the new liberalized industrial and trade environment, the Govt. is progressively assuming the role of a promoter, facilitator and catalytic agent instead of a regulator and controller of economic activities. In fact, the last decade of the 20th century was momentous in the economic history of India as it witnessed a successful transition of India from a controlled inward looking and slow growing economy into a liberalized and open economy that has now found a place amongst the fastest growing economies in the world.

Table 5.8 depicts some measures which have been taken for the liberalization of FDI inflows to India.

The effort is aimed at moving India from the inward-oriented economy to one that is better integrated with World Economy. The same was expressed by the Government of India in its New Economic Policy, which was announced in July 1991. The New Economic Policy allows FDI in all the sectors including service sector, except where the existing and notified sectoral policy does not permit FDI beyond ceiling. FDI for virtually all item/activities can be brought in through the automatic route under powers delegated to the RBI and for the remaining items through Govt. Approval. In fact, the following are the routes by which FDI is allowed under New Economic Policy:
Table 5.8
Some Measures of Liberalization of FDI Inflows to India

<table>
<thead>
<tr>
<th>Measures for the Rise in FDI Inflows after 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening up of new sectors (integrated townships, defense industry, tea plantations, etc.)</td>
</tr>
<tr>
<td>Removal of FDI caps in most sectors, including advertising, airports, private sector oil refining, drugs and pharmaceuticals, etc.</td>
</tr>
<tr>
<td>Greater degree of automaticity for investment.</td>
</tr>
<tr>
<td>Liberalization of foreign exchange regulations by way of simplification of procedures for making inward and outward remittances.</td>
</tr>
<tr>
<td>Policy to allow foreign companies to set up wholly owned subsidiaries in India enabling foreign companies to convert their joint ventures into wholly owned subsidiaries.\textsuperscript{a}</td>
</tr>
<tr>
<td>Sectoral reforms, especially in sectors such as telecom, information technology and automobiles making these sectors attractive destination for FDI.</td>
</tr>
<tr>
<td>Public sector disinvestment emerging as an important means to promote FDI.</td>
</tr>
<tr>
<td>Liberal policy towards Foreign Venture Capital Investment (FVCI) giving an impetus to investment in technology and infrastructure projects.</td>
</tr>
<tr>
<td>Various investment facilitation measures such as facility for electronic filing of applications, online chat facility with the applicants, online status on registration/disposal of applications, dedicated e-mail facility for investment related queries, etc., contributing substantially to improving investor's confidence.\textsuperscript{b}</td>
</tr>
<tr>
<td>An inter-ministerial Committee set up by the Government in 2001 to examine the extant procedures for investment approvals and implementation of projects, and suggest measures to simplify and expedite the process for both public and private investment.\textsuperscript{c}</td>
</tr>
<tr>
<td>The activation of the Foreign Investment Implementation Authority (FIIA) that is supposed to meet at regular intervals to review and resolve investment-related problems.\textsuperscript{d}</td>
</tr>
</tbody>
</table>

Note:

a) The percentage of FDI through merger and acquisition route has increased to around 30 per cent (from around 10 per cent in 1999), which is still much lower than the global percentage of 70-80 per cent.

b) On an average, about 2,000 responses in a year are given to investors and potential investors.

c) The committee has submitted Part I of its report of the Government, which is under examination. A sub-Group of the Committee is specifically looking into simplification of procedures relating to private investment. The sub-Group will submit its report shortly.

d) A recent study conducted by FICCI, FIIA acknowledges that it has emerged as a problem-solving platform.

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Automatic Route: With a view to provide greater access to foreign capital as well as technology, to Indian trade and industry, a quick and hassle free route, called the automatic route by RBI was opened in 1992.

i) Government approval: The Government is committed to promote accelerated growth in the industrial sector and the role of FDI is well recognized to support domestic investment as well as for achieving high level of development. To achieve this goal, the Indian Government, has therefore, put in place the appropriate procedures and guidelines for FDI proposals.

ii) Other Modes: Global Depository Receipts (GDR)/American Deposit Receipts (ADR)/Foreign Currency Convertible Bonds (FCCB) are treated as FDI and Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ADRs/FCCBs which are not subject to any ceilings.

The areas where FDI is prohibited/allowed up to a certain limit and the illustrative lists of sectors under automatic route where FDI up to 100% is allowed are mentioned in Annexure V.

Transparency and openness have been the most significant features of FDI policies in the fourth phase. The degree of openness is reflected in (i) sectors open to FDI (ii) higher level of foreign equity participation and (iii) transparency in approval procedures. One striking aspect of the present liberalization policy is that unlike the previous phases, it is not necessary that FDI is accompanied by foreign technology agreements. There is a liberal approach towards investment by NRIs; NRIs and overseas corporate bodies can invest up to 100 percent in high priority industries. Another distinctive feature of the policy is the simplification of procedures.

Thus, the ongoing measures taken since 1991 are focused towards a virtual elimination of the both direct and indirect barriers to FDI (indirect
barriers in the form of investor protection, differences in accounting standards, level and regulatory structure). In short, FDI policies in India are characterized by receptive attitude till the mid-sixties, to a policy of restrictions and controls till 1980 and then to gradual liberalization till 1990 and finally to a policy of full-fledged liberalization since 1991.

5.3 POLICY REFORMS IN NEPAL

With the introduction of Structural Adjustment Programme (SAP) in 1985/86, several changes were made including a massive tariff reduction from 450 percent to 110 percent. In 1990, special priority was given to the development of export oriented industries by making specific arrangements for setting up an Export Processing Zone (EPZ) and also by providing maximum incentives and facilities for export in New Industrial policy (1991). All round economic liberalization process took momentum in 1991 which included both demand management and removal of structural rigidities from the economy. The changes made aimed at a shift in the focus of development strategy from inward import-substituting industrialization to an export-led strategy so as to benefit from globalization process. Table 5.9 presents simple average of the tariff rates for the period 1998-99 to 2002-03 and reveals that general maximum custom duty (all tariff lines) were brought down to 25% in 2002-03 from 80% in 1998-99. Agricultural as well as non agricultural tariffs were also reduced and in 2002-03, custom duty on agricultural products was 13.5% and that on non-agricultural products, it was 13.8%.

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Table 5.9
Simple Average of the Tariff Rates in Nepal

<table>
<thead>
<tr>
<th>All tariff lines</th>
<th>1998-99</th>
<th>2002-03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customs duties (CD)</td>
<td>14.0</td>
<td>13.7</td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>2.5</td>
<td>0</td>
</tr>
<tr>
<td>Other selective protective taxes</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>16.2</td>
</tr>
<tr>
<td>General maximum CD</td>
<td>80.0</td>
<td>25</td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>General maximum: CD + other</td>
<td></td>
<td>28</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Non-agricultural tariffs</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Customs duties</td>
<td></td>
<td>13.8</td>
</tr>
<tr>
<td>Other general Protective taxes</td>
<td></td>
<td>2.8</td>
</tr>
<tr>
<td>Other selective import taxes</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>16.6</td>
</tr>
<tr>
<td>General maximum: CD + other</td>
<td></td>
<td>28</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Agricultural tariffs</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Customs duties</td>
<td></td>
<td>13.5</td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td></td>
<td>2.8</td>
</tr>
<tr>
<td>Other selective import taxes</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>16.3</td>
</tr>
<tr>
<td>General maximum CD</td>
<td></td>
<td>25</td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>General maximum: CD + other</td>
<td></td>
<td>28</td>
</tr>
</tbody>
</table>


Additional measures initiated to promote international trade, include the introduction of a bonded warehouse, duty drawback scheme and initiation of the dry port facilities.

FDI Policy-

In Nepal, emphasis to foreign investment was given since 1980-85. Steps towards clear cut policy towards foreign investment was introduced in 1980s, with the enactment of the foreign Investment and Technology Act (FITA) in 1981 and accorded various facilities and provisions for foreign
investors. Industries with 25 percent to 50 percent value added on their productions were granted full exemption from Income Tax for five years.\(^\text{15}\)

Facilities of convertible foreign currencies were also provided for joint venture industries under FITA, for the importation of necessary machineries, equipment and tools, spare parts and components, raw materials, technical consultancy and assistance and so forth. The FITA-1981 was replaced by foreign investment and technology transfer Act, 1992 with amendments made in 1993-96. The basic objectives of this act were to provide 100 percent equity investment, full remittances of profits, dividends and repatriations of capital facilities and concessions to foreign investors through single window system etc. In July 2000, a fast track committee (FTC) was formed with a view to make quick decisions on foreign investment related projects. The sectors that have been opened up to foreign investment are: manufacturing, energy based industries, tourism, mineral resource based industries, and agro-based industries. FDI is not permitted in retail business; travel agencies; cigarette, tobacco and alcohol production other than for export.

It is said that Nepal has the maximum potential to attract foreign investment among the low income countries in the region. It is considered to be a friendly country that offers market potential, flourishing local entrepreneurial culture in both small and large business etc.

5.4 POLICY REFORMS IN PAKISTAN

Some liberalization measures were introduced in the early 1980s with dismantling of quotas on a range of some imported goods, including capital goods. But the replacement of Non-Tariff Barriers (NTBs) by tariffs from 1987-88 onwards marked the beginning of the main era of trade liberalization. Table 5.10 presents tariff structure by commodity group as well as the percentages of industries protected by tariff and non-tariff barriers. It is revealed that there was a marked shift in the decade of 1980s not only in the tariff structure but also in the percentages of industries which were affected by the reduction in

The weighted average of tariff including both final goods and raw material (capital and consumer goods) was 19.19% during 1980-81, which were brought down to 13.30% in 1997-98. The percentage of industries in which domestic prices were higher than import prices plus tariffs plus sales tax was 34.4% in 1980-81, the same was reduced to 2% only in 1990-91 and the industries where domestic prices were lower than or equal to import prices plus tariffs plus sales tax were increased from 57.8% to 71.7% and 7.8% to 26.3% respectively.

### Table 5.10
Tariff Structure by Commodity Group (in Pakistan)

<table>
<thead>
<tr>
<th>Years</th>
<th>Capital goods</th>
<th>Consumer goods</th>
<th>Capital goods</th>
<th>Consumer goods</th>
<th>Weighted average</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980-81</td>
<td>32.15</td>
<td>28.42</td>
<td>34.06</td>
<td>13.79</td>
<td>22.06</td>
</tr>
<tr>
<td>1984-85</td>
<td>15.02</td>
<td>17.66</td>
<td>94.09</td>
<td>12.94</td>
<td>19.19</td>
</tr>
<tr>
<td>1987-88</td>
<td>19.54</td>
<td>24.56</td>
<td>31.92</td>
<td>19.53</td>
<td>22.22</td>
</tr>
<tr>
<td>1989-90</td>
<td>19.77</td>
<td>11.53</td>
<td>23.32</td>
<td>20.12</td>
<td>17.84</td>
</tr>
<tr>
<td>1994-95</td>
<td>12.48</td>
<td>13.90</td>
<td>31.56</td>
<td>20.85</td>
<td>17.84</td>
</tr>
<tr>
<td>1997-98</td>
<td>8.31</td>
<td>11.10</td>
<td>19.27</td>
<td>16.22</td>
<td>13.30</td>
</tr>
</tbody>
</table>

### Percentage of industries protected by tariff and non-tariff barriers

<table>
<thead>
<tr>
<th>Impact of protection on domestic producers prices</th>
<th>Percentage of industries affected in</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic prices are higher than c.i.f. import prices plus tariffs plus sales tax</td>
<td>34.4</td>
</tr>
<tr>
<td>Domestic prices are lower than c.i.f. import prices plus tariffs plus sales tax</td>
<td>57.8</td>
</tr>
<tr>
<td>Domestic prices are equal than c.i.f. import prices plus tariffs plus sales tax</td>
<td>7.8</td>
</tr>
</tbody>
</table>

**Source:** R. Siddiqui

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A new comprehensive trade liberalization Programme commenced in 1997 and continued until 2004/05 when the general custom duty was reduced to 25 percent from 35% in 1998-99 (Table 5.11). Presently, in 2004-05, custom duties on agricultural and non-agricultural products were 18.1% and 16.6% respectively. Large number of exceptions and concessions were being phased out overtime. Pakistan Govt. has also completed a comprehensive liberalization of the trade and other polices that affects its agriculture sector in contrast to India, Bangladesh and Sri Lanka where there are strong protectionist elements.

**Table 5.11**

Simple Average of the Tariff Rates in Pakistan

<table>
<thead>
<tr>
<th></th>
<th>1998-99</th>
<th>2002-03</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>All tariff lines</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs duties (CD)</td>
<td>21.3</td>
<td>16.8</td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other selective protective taxes</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>16.8</td>
</tr>
<tr>
<td>General maximum CD</td>
<td>35.0</td>
<td>25</td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>General maximum: CD + other</td>
<td></td>
<td>25</td>
</tr>
<tr>
<td><strong>Non-agricultural tariffs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs duties</td>
<td>16.6</td>
<td></td>
</tr>
<tr>
<td>Other general Protective taxes</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Other selective import taxes</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>16.6</td>
</tr>
<tr>
<td>General maximum: CD + other</td>
<td></td>
<td>25</td>
</tr>
<tr>
<td><strong>Agricultural tariffs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs duties</td>
<td>18.1</td>
<td></td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Other selective import taxes</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>18.1</td>
</tr>
<tr>
<td>General maximum CD</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>General maximum: CD + other</td>
<td></td>
<td>25</td>
</tr>
</tbody>
</table>

**Source:** World Bank. 2004. Trade Policies in South Asia: An Overview, Washington, D.C. (three volumes); Central Board of Revenue (Pakistan).

FDI Policy-
The first step towards the liberalization of FDI by Pakistan was taken in 1984 with the announcement of the industrial policy statement giving an equal plank to the public and private sectors. Foreign private investment was encouraged in the form of joint equity participation with local investors and in areas where advanced technology managerial and technical skills and marketing expertise were needed.\(^{17}\)

The Govt. of Pakistan has adopted a liberal regulatory regime at macro level consisting of three main laws aiming at facilitation and protection for investors.

- Foreign private investment Act, 1976.
- Furtherance and Protection of Economic Reforms Act 1992; and

These laws have become fundamentals of investment policy of the country. The Board of Investment (BOI) was also set up to help generate opportunities for FDI and provide investment services. BOI is a "single window facility" which helps the establishments of new industries. To facilitate foreign investment, Pakistan has signed bilateral agreements on the promotion and protection of investment with 46 countries.

The salient features of FDI policy of Pakistan are:

- All economic sectors are open to FDI except for some sectors of strategic importance.
- Equal treatment to local and foreign investors.
- 100 percent foreign equity allowed in projects.
- With only a few exceptions, no Govt. sanction is required for setting up any industry.
- Remittance of Royalty, Technical and Franchise Fee, capital, profits and dividends is allowed without hindrance.

Based on its efforts to globalize, Pakistan has a decent foreign investment policy in place that encourages foreign investors in almost all economic sectors based on a single window clearance.

5.5 SRI LANKA

Sri Lanka was the first South Asian Economy to follow the policy of reforms programme measures. During the first decade after independence from British Colonial Rule in 1948, it continued with a liberal trade regime but due to increasing balance of payments problems, the policy shifted towards protectionist import substitution and it became one of the most inward oriented and regulated economies. However, again, liberalization carried out in 1977 by a sharp change in its policy direction. A series of trade reform measures started in 1977 when exchange controls were removed. Prior to this the country faced a complex structure of tariff and non-tariff measures, with 19 major tariff bands with tariff rates as high as 500%. Many import quotas were removed in 1977, the 19 tariff bands were reduced to 6 in 1978 (top rate of 100%) and by 1995 were reduced to 3 bands (top rate of 35%). Similarly export controls and duties were also reduced gradually, incentives for non-traditional exports were provided; duties on all minor agricultural exports (i.e. with the exception of tea, coconut and rubber) were abolished by 1988 and the duties on major agricultural exports were removed in 1992.

Table 5.12
Trade liberalization in Sri Lanka: Milestones

<table>
<thead>
<tr>
<th>Imports:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1977: Imports were liberalized except for 150 items.</td>
</tr>
<tr>
<td>1981: Private sector was allowed to import sugar and rice.</td>
</tr>
<tr>
<td>1987: Textile imports were liberalized.</td>
</tr>
<tr>
<td>1996: Only 223 items were under import license out of 6000 items.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Exports:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1977: 21 items under export control</td>
</tr>
<tr>
<td>1987: 11 items under export control</td>
</tr>
<tr>
<td>1994: 4 items under export control</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tariffs:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978: Six band tariff rates 0%- 5%- 12.5%- 25%- 50% -100%</td>
</tr>
<tr>
<td>1980: Turn-over tax on domestic industry, 2%- 5%- 10%</td>
</tr>
<tr>
<td>1987: Four band tariff, range from 5% to 60%</td>
</tr>
<tr>
<td>1993: Maximum import duty 50%</td>
</tr>
<tr>
<td>1994: Four band tariff, 10%- 20%- 35%-45%</td>
</tr>
<tr>
<td>1995: Three band tariff, 35%- 20%-10%</td>
</tr>
<tr>
<td>Export duties were abolished in 1992.</td>
</tr>
</tbody>
</table>

Source J. Weerahewa

The main feature of Sri Lanka’s liberalization is not so much the degree and intensity of reforms but the relatively long time horizon over which the reforms were introduced. Table 5.12 shows some milestones covered under trade liberalization programme in Sri Lanka as discussed above.

The second phase of reforms that started during 1990s included further tariff cuts and simplifications, removal of exchange controls on current account transactions and flexible exchange rates. In 1997, maximum tariff in Sri Lanka was 35 percent on consumer goods, the tariff rate for intermediate goods was 20 percent and the tariff rate for raw materials and capital goods was 10 percent. Table 5.13 presents data on simple average of tariff rates in Sri Lanka for the period 1998-99 to 2004 which reveals that custom duties (all tariff lines) were brought down from 17.6% in 1998-99 to 11.3% in Jan.2004. General maximum custom duty was reduced from 35% to 27.5% during the same period.

Table 5.13
Simple average of the tariff rates (in Sri Lanka)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>All tariff lines</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs duties (CD)</td>
<td>17.6</td>
<td>11.3</td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>2.1</td>
<td>0</td>
</tr>
<tr>
<td>Other selective protective taxes</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>13.4</td>
<td></td>
</tr>
<tr>
<td><strong>General maximum CD</strong></td>
<td>35.0</td>
<td>27.5</td>
</tr>
<tr>
<td><strong>Other general protective taxes</strong></td>
<td>3.5</td>
<td></td>
</tr>
<tr>
<td><strong>General maximum: CD + other</strong></td>
<td>31.25</td>
<td></td>
</tr>
<tr>
<td><strong>Non-agricultural tariffs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs duties</td>
<td>8.8</td>
<td></td>
</tr>
<tr>
<td>Other general Protective taxes</td>
<td>1.9</td>
<td>0</td>
</tr>
<tr>
<td>Other selective import taxes</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>10.7</td>
<td></td>
</tr>
<tr>
<td><strong>General maximum: CD + other</strong></td>
<td>31.3</td>
<td></td>
</tr>
<tr>
<td><strong>Agricultural tariffs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs duties</td>
<td>24.6</td>
<td></td>
</tr>
<tr>
<td>Other general protective taxes</td>
<td>3.5</td>
<td>0</td>
</tr>
<tr>
<td>Other selective import taxes</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>28.1</td>
<td></td>
</tr>
<tr>
<td><strong>General maximum CD</strong></td>
<td>27.5</td>
<td></td>
</tr>
<tr>
<td><strong>Other general protective taxes</strong></td>
<td>3.8</td>
<td></td>
</tr>
<tr>
<td><strong>General maximum: CD + other</strong></td>
<td>31.3</td>
<td></td>
</tr>
</tbody>
</table>

Trade and payment system were also further liberalized. Sri Lanka accepted obligations under Articles VIII of IMF in 1994 of gradually relaxing Capital account transactions where as full liberalization of current transactions were allowed in 1993. The managed floating Exchange Rate Regime was also abandoned and adopted a full float in 2001.

**FDI policy:**

There are basically two distinctive phases in Sri Lanka’s FDI policy. The first phase was from 1948-1977, when the public sector was the dominant entity and controlled the country’s resources. The second phase started in post 1977 period when Sri Lanka launched its economic reform program, which favoured private sector led export-oriented development including a greater role for FDI. The most important feature of FDI policy measure in Sri Lanka was the establishment of Board of Investment (BOI) in 1992 with wide powers of tax relief and administrative discretion in all matters related to FDI.

Sri Lanka’s investment laws are transparent and automatic across a range of sectors. Although FDI is permitted in most sectors, there is long list of sectors where FDI is barred completely or where foreign investors may only take a minority stake in an enterprise. There are few areas such as money lending, retail trade investment, providing personal services other than for the export, of tourism sectors, coastal fishing, education of students, etc. which are reserved for Sri Lankan. Areas such as growing and processing of primary products, mining, timber based industries etc, where foreign investment is restricted to 40 percent and approval by BOI is required.

Sri Lanka Govt. has not set out any principles of foreign investor treatment and protection in its national law. The repatriation of capital and profits is guaranteed and there is ready access to foreign exchange. It has also a network of Bilateral investment treaties with 24 countries. Following
India, Sri Lanka has also provided a range of tax incentives to foreign investors e.g. breaks on taxes on corporate profits and dividends, value added tax and import and excise duties. Some of the fiscal incentives include an initial tax holiday of five years followed by a long term concessionary rate varying from 15-20 percent depending on the industry, import duty exemptions on capital equipment in some industries and zero duties in raw materials in the export of manufactured goods.

Overall, the Board of Investment of Sri Lanka provides all services for foreign investors including approval of projects, grant of licenses and tax incentives etc. Foreign investment is mainly encouraged in enterprises that make extensive use of foreign capital or technology, in export oriented industries and in infrastructure projects. For restricted sectors such as telecommunication, education, mass transportation mining etc. permits are required from other govt. agencies for more than 49% equity participation. In many sectors, automatic approval is given for equity participation up to 100 percent. There are no exchange controls on current account transactions and no barriers to the remittance of corporate profits and dividends for foreign enterprises.

A brief of Foreign Direct Investment and Trade policy regimes of the South Asian Economies, viz. Bangladesh, India, Nepal, Pakistan and Sri Lanka is presented in Tables 5.14 and 5.15. Annexure VI & VII presents the export policies of these countries and the latest trends of some representatives' tariffs on intermediate goods and machinery in South Asia. In Bhutan and Maldives, the foreign direct investment and trade policies are still in a state of formulation, and therefore, have not been presented.

Overall, we can conclude that there has been a positive change in the policies with regard to trade and FDI in all South Asian Economies. These economies have now realized the major role that FDI and Trade can play in
<table>
<thead>
<tr>
<th>Policy Area</th>
<th>Bangladesh</th>
<th>India</th>
<th>Nepal</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI Institutions</td>
<td>Board of Investment</td>
<td>Foreign Investment Promotion Board and Council</td>
<td>Board of Investment</td>
<td>Board of Investment</td>
<td>Board of Investment</td>
</tr>
<tr>
<td>Foreign Equity Participation</td>
<td>100% ownership</td>
<td>Upto 51% in most industries upto 24% in industries reserved for the small scale sector 100% in export oriented - industries like power, electronic and software technology</td>
<td>100% percent foreign ownership in almost all sectors</td>
<td>-100% without any permission of the government - No Objection Certificate (NOC) not required from the provincial governments</td>
<td>100% foreign ownership in almost all sectors</td>
</tr>
<tr>
<td>Fiscal Incentives</td>
<td>Tax holidays the industries located in free trade zones (3-7 years depending on their location) Reduced Import duties on</td>
<td>100% export oriented units exempted from payment of corporate income tax for the first five years of operation</td>
<td>Income tax exemption on interest income earned from foreign loan; national priority industries and for 5 years from the date of commercial production in manufacturing energy</td>
<td>No custom duty on import of plant, machinery &amp; equipment for categories of industries like value-added or export industry and hi-</td>
<td>Tax holidays (5-20 years) depending on the value of investment, employment and foreign exchange</td>
</tr>
<tr>
<td>Capital Machinery and Spare Parts</td>
<td>Finance for export from banks at special confessional rates of interest</td>
<td>Based, agro-and forest-based and mining industries.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>-------------------------------------------------</td>
<td>--------------------------------------------------</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax exemption on royalties, interest on foreign loans, capital gains from the transfer of shares</td>
<td>Tax relief under avoidance of double taxation agreements</td>
<td>tech industry. First year allowance of 75% and reinvestment allowance of 50% for industries like engineering/capital goods, petro-chemicals, agro-based industry, etc. Zero import tariff on plant and machinery used for agriculture</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Duty free imports for 100% exporters</td>
<td>Income Tax holiday for 100% export oriented units and units in export processing zones for ten years</td>
<td>Export Processing Zones</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital Machinery and Spare Parts</th>
<th>Finance for export from banks at special confessional rates of interest</th>
<th>Based, agro-and forest-based and mining industries.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax exemption on royalties, interest on foreign loans, capital gains from the transfer of shares</td>
<td>Tax relief under avoidance of double taxation agreements</td>
<td>tech industry. First year allowance of 75% and reinvestment allowance of 50% for industries like engineering/capital goods, petro-chemicals, agro-based industry, etc. Zero import tariff on plant and machinery used for agriculture</td>
</tr>
<tr>
<td>Duty free imports for 100% exporters</td>
<td>Income Tax holiday for 100% export oriented units and units in export processing zones for ten years</td>
<td>Export Processing Zones</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Repatriation</th>
<th>Repatriation of capital and dividends allowed</th>
<th>Repatriation of dividends and capital with certain restriction.</th>
<th>Full repatriation of capital, capital gains, dividend, profits allowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repatriation of capital and dividends allowed</td>
<td>Repatriation of capital and dividends allowed</td>
<td>Repatriation of dividends and capital with certain restriction.</td>
<td>Full repatriation of capital, capital gains, dividend, profits allowed</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Infrastructural Incentives</th>
<th>Export Processing Zones</th>
<th>Export Processing Zones 11 Industrial Districts provide developed land on rent and other utility facilities at reasonable rates No individual foreign national can own land and building -Purchase of land and building in company’s name permitted</th>
<th>Export Processing Zones NO ceiling of land for registered agricultural companies involved in production, processing and marketing of agricultural products on commercial lines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export Processing Zones Relatively lower price of land in industrial estates/areas with electricity, gas, water, sewerage etc.</td>
<td>Export Processing Zones Foreign company can acquire or hold immovable property in India for carrying on its activity Foreign citizen of Indian origin may also acquire any immovable property in India, except for agricultural land, farm house and plantation</td>
<td>Export Processing Zones 11 Industrial Districts provide developed land on rent and other utility facilities at reasonable rates No individual foreign national can own land and building -Purchase of land and building in company’s name permitted</td>
<td>Export Processing Zones NO ceiling of land for registered agricultural companies involved in production, processing and marketing of agricultural products on commercial lines</td>
</tr>
</tbody>
</table>

Notes: In Bhutan and Maldives the FDI Policies are still at a very nascent state of formulations.
### Table 5.15
Summary of Trade Regimes in South Asia

<table>
<thead>
<tr>
<th>Policies</th>
<th>India March 04</th>
<th>Pakistan 2002-03</th>
<th>Bangladesh*** 2004/05</th>
<th>Sri Lanka Feb 04</th>
<th>Nepal August 03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange Rate</td>
<td>Unified</td>
<td>Unified</td>
<td>Unified</td>
<td>Unified</td>
<td>Unified</td>
</tr>
<tr>
<td>Exchange Rate determination</td>
<td>Free float</td>
<td>Free float</td>
<td>Free float</td>
<td>Free float</td>
<td>Pegged</td>
</tr>
<tr>
<td>Payment convertibility</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes,some limits</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Current account</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Capital account</td>
<td>Yes, limited</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Import restrictions (trade reasons)</td>
<td>No</td>
<td>No</td>
<td>No, but some restrictions</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>General import licensing</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Some QRs on imports</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes, minor</td>
<td>Yes, minor</td>
</tr>
<tr>
<td>State import monopolies (excl POL)</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Tariff structure May 03</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Top normal CD rate</td>
<td>30*</td>
<td>25</td>
<td>25.0</td>
<td>27.5</td>
<td>25</td>
</tr>
<tr>
<td>Other normal protective taxes</td>
<td>0</td>
<td>-</td>
<td>4.0</td>
<td>3.75</td>
<td>4.5</td>
</tr>
<tr>
<td>Top normal protection rate</td>
<td>30</td>
<td>25</td>
<td>29.0</td>
<td>31.25</td>
<td>29.5</td>
</tr>
<tr>
<td>Average CD rate</td>
<td>22.2</td>
<td>17.3</td>
<td>16.3</td>
<td>11.3</td>
<td>13.7</td>
</tr>
<tr>
<td>Average of other normal protective taxes</td>
<td>0</td>
<td>1.5</td>
<td>3.9</td>
<td>2.1</td>
<td>4.3</td>
</tr>
<tr>
<td>Average of other protective taxes</td>
<td>0</td>
<td>0</td>
<td>6.3</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Average CD + other protective taxes</td>
<td>22.2</td>
<td>18.8</td>
<td>26.5</td>
<td>13.4</td>
<td>18.3</td>
</tr>
<tr>
<td>% of products with total protection rates&gt;normal maximum protection rate**</td>
<td>2.8</td>
<td>1.1</td>
<td>15.8</td>
<td>0.9</td>
<td>5.8</td>
</tr>
<tr>
<td>Number of normal CD slabs</td>
<td>7</td>
<td>4</td>
<td>4</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Number of CD slabs&gt;normal</td>
<td>17</td>
<td>10</td>
<td>None: uses para- tariffs &amp; VAT exemption for extra protection</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Range of CD slabs&gt;normal</td>
<td>40-210%</td>
<td>40-250%</td>
<td></td>
<td>75&amp;100%</td>
<td>40,80,130%</td>
</tr>
<tr>
<td>% of ad valorem tariff lines&gt;normal CD rate</td>
<td>2</td>
<td>0.1</td>
<td></td>
<td>0.2</td>
<td>5.2</td>
</tr>
</tbody>
</table>
Note: CD=Customs duty(*) The “general maximum CD rate is defined as a rate which includes at least 5% of total tariff lines, and above which there are no more than 10% of total tariff lines. The “general maximum” is 30% in India because of the large number of agricultural Customs duties clustered at this rate. The Indian general maximum CD rate for industrial tariffs is 20%. (**%) Percent of tariff lines with total protection rates (inclusive of selective para-tariffs) in excess of “normal maximum” CD plus normal (generally used) para-tariffs. (****) Tariff data on Bangladesh as of Jun, 2004. These figures reflect tariff changes announced in the FY05 budget on June 10, 2004, which indicated significant move towards reduction of protection: via reduction of the top rate to 25, move to three non-zero tariff slabs, and rationalization of supplementary duties.


<table>
<thead>
<tr>
<th>% of tariff lines with specific duties</th>
<th>5.3</th>
<th>0.9</th>
<th>protection</th>
<th>1.8</th>
<th>0.6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use anti-dumping</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Percent tariff lines bound at WTO</td>
<td>72.4</td>
<td>36.8</td>
<td>13.2</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Avg of bound tariff rates</td>
<td>506.36.8</td>
<td>188.3</td>
<td>50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export policies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Some export QRs</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Some export taxes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Some direct export subsidies</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Indirect export subsidies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Trade openness: trade-GDP ratio (%)</td>
<td>19</td>
<td>33</td>
<td>33</td>
<td>77</td>
<td>44</td>
</tr>
</tbody>
</table>

Note: CD=Customs duty(*) The “general maximum CD rate is defined as a rate which includes at least 5% of total tariff lines, and above which there are no more than 10% of total tariff lines. The “general maximum” is 30% in India because of the large number of agricultural Customs duties clustered at this rate. The Indian general maximum CD rate for industrial tariffs is 20%. (**%) Percent of tariff lines with total protection rates (inclusive of selective para-tariffs) in excess of “normal maximum” CD plus normal (generally used) para-tariffs. (****) Tariff data on Bangladesh as of Jun, 2004. These figures reflect tariff changes announced in the FY05 budget on June 10, 2004, which indicated significant move towards reduction of protection: via reduction of the top rate to 25, move to three non-zero tariff slabs, and rationalization of supplementary duties.

the enhancement of their economic development. Stepping up of the reform process and ongoing initiations such as further simplification of rules and regulations and improvement in infrastructure are expected to provide the necessary impetus to go a long way towards making South Asia as an attractive destination.