CHAPTER I

INTRODUCTION

International economic development has emerged as one of the most important issues before the post-World War II international community. The withdrawal of worldwide colonialism left in its wake a large number of politically independent but economically backward and socially feudalistic nation states. Most of these new countries have an abundance of manpower and natural resources but are grossly lacking in skills, capital and technology. Development is seen in these new states as economic continuation of the political struggle for independence.\(^1\) The rising expectations of their vast populations are making them restive and impatient. In order to catch up with the developed world they want to bridge the gap of centuries in decades; they are "all nations in a hurry".\(^2\) For rapid economic development they need foreign capital and assistance but their past subjugation puts them in fear of the economic might of foreign capital. They seek legal protection of their national sovereignty against the economic and political influences that go with foreign investment.\(^3\)

\(^{1}\) R.P. Anand, New States and International Law, (Delhi, 1972), p. 86.


\(^{3}\) Anand, n.1., p. 61.
The demand for transfer of resources in the shape of capital and technology to the developing countries has taken more time of the United Nations and other international organs than any other single issue. In its sixteenth session the General Assembly of the United Nations declared the 1960's as the First Development Decade and formulated a development strategy postulating an annual growth rate of five per cent in the developing countries. 4 To attain that objective the General Assembly emphasized the need for transfer of resources from the developed to the developing countries. The developing countries' share in world manufacturing was only seven per cent during the sixties. The Lima Declaration adopted by the General Conference of the United Nations Industrial Development Organization in 1975 postulated that this share should go up to 25 per cent by the year 2000. 5 Two non-official international Commissions, headed by Pearson 6 and Brandt, 7 have independently inquired into the problems of international development and emphasized the role of inter-dependence. The Brandt Commission have


7 Brandt, n.5.
also suggested that the creation of employment in the North, i.e., the developed world is directly dependent upon the promotion of development and trade of the South, i.e., the developing world. They, therefore, contend that the economic development of the South is a matter of mutual interest and inter-dependence for both North and South. In their Second Report recently issued the Commission have cited the Mexican crisis during the summer of 1982 as an ample demonstration of the facts of inter-dependence.

The net flows of capital, official as well as private, to the developing countries during the years 1956 - 1981 are indicated in Appendix A. It will be seen that during the fifties and early sixties the aid flows represented by official transfers recorded an increase in absolute as well as in relative terms. The official transfers which constituted 52 per cent of the total in 1956 rose to 69 per cent by 1963. Thereafter, however, the First Development Decade of the UN actually recorded a steady decline of aid flows in relative terms. By the end of the decade the percentage had come down to 50. In the International Development Strategy for the Second Development Decade (1970),


the General Assembly emphasized the need for more official development assistance. The General Assembly postulated a target of one per cent of the gross national product (GNP) of developed countries for transfer of resources to the developing countries by the year 1972 and in any case by 1975. Within this overall target, the General Assembly laid down a target of 0.7 per cent for development assistance to be reached by the middle of the decade. In actual fact, however, the share of official transfers in the total transfer of resources from the developed to the developing countries declined from 50 per cent in 1970 to 35 per cent in 1979. In terms of percentage of GNP of the developed countries, the official development assistance came to only 0.35 per cent in 1981, the percentage for the richest country, viz., the United States, being as low as 0.20 per cent. In the Development Strategy for the Third Development Decade, the General Assembly again exhorted the developed countries to enhance the share of official developmental assistance so as to reach the agreed target of 0.7 per cent of GNP by 1985.

The poorest developing countries of South Asia are the ones worst affected by the slowing pace of development assistance. The net flows of capital to these countries during the years 1960 to 1979 are indicated in

12 GA Res. 35/56 (XXXV) of 5 Dec. 1980.
Appendix B. Their share in official transfers came down from 22 per cent in the sixties to 13 per cent by 1971. It recorded an improvement for a few years thereafter but came down again during the closing years of the decade to a level of 6 per cent below the average of the sixties. So much so, that in India the contribution of net external assistance to the development effort, which was 28, 27 and 34 per cent respectively during the Second Plan (1956-1961), the Third Plan (1961-1966), and the annual plans (1966-1968) intervening between the Third and the Fourth Plans, came down to 11 per cent in the Fourth Plan (1969-1974) and 9 per cent in the Fifth Plan (1974-1979). 14 In Nepal where 94 per cent of the development budget could be financed from foreign sources in the fourth year of the First Plan (1955-60), the proportion came down to 45 per cent in the Fifth Plan (1975-80). 15 In Pakistan the percentage of grant and grant-type assistance came down from 79 in the First Plan (1955-60) to 9 in the Fourth Plan (1970-75); it rose marginally to 17 in the Fifth Plan (1975-80). 16

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This continued lack of adequate official assistance has brought to the fore the slow pace of flow of private capital from the developed to the developing countries. A Task Force on Private Foreign Investment set up by the IMF/IBRD Development Committee in 1978 reported in August, 1980; "Increasing flow of private foreign direct investment to developing nations is especially important at the present time." In the International Development Strategy for the Third Development Decade, the UN General Assembly also emphasized the role of international and regional financial institutions and of non-concessional flows from financial markets along with that of official development assistance. Even the Peoples' Republic of China admitted direct private investment of the order of 200 million US dollars in 1979, 550 million dollars in 1980 and over 2 billion dollars in 1981. It will be seen from Appendix 'A' that the share of private capital in the total net flows of capital from the developed countries which kept declining till early sixties has steadily grown in the last two decades and is presently running at over 60 per cent. The countries of South Asia, however, have suffered in this regard also. Their share in the net flows of private capital came down

18 Ibid., p. 19.
from 1.5 per cent in the sixties to a mere 0.3 per cent by the end of the seventies. (see Appendix B)

The nature of private capital flows has also undergone a sea-change. Traditionally, most of the private capital abroad was in the shape of direct private investment which brought in technical and managerial skills without any problems of debt amortization or exchange risks and without placing any fixed interest burden on the host country. The main organizational vehicle for this type of investment, the transnational companies, however, came under severe attack in the host countries because of multifarious reasons and the developing countries saw in them and hence also in this type of investment signs of what they call "neo-colonialism". At the same time, the capital exporting countries and their investors also found out that holding equity investment was not the only means of exercising control of business in a foreign country. It could as well be done through other means, management participation technical assistance agreements, production sharing, supply contracts, etc. As a result, the share of direct private investment which had been fluctuating around 60 per cent in the sixties came down to around 50 per cent in the early seventies and slid down sharply to 17 per cent in 1979; it improved only slightly in the
subsequent two years.\textsuperscript{19} The Pearson Commission reported in 1969 that direct investment had become the least dynamic element in the flow of private capital to developing countries.\textsuperscript{20} In the beginning, the shift was more towards export credits which expanded from around 10 per cent of the total flow of private capital during the late fifties to 36 per cent in 1971.\textsuperscript{21} These export credits tied to specific projects or specific exports constituted a more expensive form of external finance because of the attendant problems of interest and non-competitive prices.\textsuperscript{22} The generation of large OPEC funds in the wake of the oil price hike in 1973 brought in the medium of commercial bank lending in a big way. In the last one decade this commercial bank lending has fast outstripped all other forms of private capital flows; it expanded from 4 billion dollars in 1970 to over 36 billion dollars in 1980.\textsuperscript{23} The data given in Appendix 'C' about the external public debt of the developing countries and of the countries of South Asia among them, would show that in the years 1974 to 1980 the proportion of debt owed to private financial institutions increased from 57 per cent to 77 per cent for all developing countries and from 17 per cent to 72 per cent in the case of countries of South Asia. With such fast growth of commer-

\textsuperscript{19} See Appendix 'A'.
\textsuperscript{20} Pearson Commission, n.6, p.99.
\textsuperscript{21} See Appendix 'A'.
\textsuperscript{22} Pearson Commission, n.6., p. 118
cial bank lending the total external debt of the developing countries reached 450 billion dollars in 1980, 517 billion dollars in 1981 and 626 billion dollars in 1982. Till 1978, the growing commercial bank loans were mostly untied and provided an element of flexibility to the balance of payments positions in the developing countries. After 1978, however, a substantial and growing portion of these loans consists of export credits tied to specific supplies and financing tied to specific projects. The loans are mostly in the form of syndicated bank loans with fluctuating rates of interest, viz., rates expressed as a margin above the London Inter-Bank Offered Rate (LIBOR). In the case of oil importing developing countries the ratio of debt service to their exports rose from 9 per cent in 1972 to 15 per cent in 1979 and 19 per cent in 1981. These drastic changes in the composition of international capital flows, coupled with a high level of interest rates, have placed a number of developing countries in a liquidity squeeze. Already more than 25 countries with between them bank loans of around 250 billion dollars, have been forced into rescheduling.

24 See Appendix 'C'.
In these growing flows of private capital, the share of countries of South Asia, as already stated, is minimal. Yet these countries are also forced to go in for international bank loans on a substantial scale. Their share in direct investment declined from 1.5 per cent in 1969 to 0.2 per cent in 1977; the trend thereafter is not yet very clear. There could be many reasons for this. It has often been said that private capital is unwelcome in these countries on political and ideological considerations. It has also been said that their policies relating to private capital are highly restrictive and their investment laws and procedures are complex, dilatory and inefficient.

The investment climate that affects foreign private capital comprises laws, policies and procedures relating to protection and repatriation of capital and earnings, licensing and regulation of industries, and taxation. A number of Commissions, Committees and Groups under the UN system have concerned themselves with these matters

29Over 2 billion dollars by 1980. See Appendix 'C'.

and attempted to evolve certain model principles, such as those relating to double taxation and restrictive business practices. The GATT and the UNCTAD have also done a lot of work to improve the climate for international trade. The UN Commission on Transnational Corporations has been grappling with the problem of devising a code of conduct for the transnational corporations. The General Assembly itself has passed a series of resolutions on subjects like permanent sovereignty over natural resources, economic rights and duties, new international economic order and international development strategy. Yet it cannot be said that any binding rules of international law have emerged. The main elements of international investment climate are still controlled almost entirely by local policies and municipal laws and regulations.

The municipal laws and regulations of the countries of South Asia on these matters are many. These also change rapidly not only because of quick or violent changes of government but also because of the fast changing socio-economic situation itself. Current and precise information on all these laws and regulations is very hard to come by. There are, of course, some national as well as international institutions which seek to bring out such information for the benefit of foreign private investors. All these attempts suffer from three basic difficulties.
Firstly, the promotional literature put out by most of these agencies tends to sacrifice precision at the altar of brevity and simplicity even in matters like taxation, which are strictly controlled by law and in which finer prints are sometimes more important to determine the exact tax liability of the investor. Secondly, these are not updated and kept abreast of the changing laws and rules. Thirdly, and most importantly, none of them are referenced with the sources of information so as to provide a mechanism for the reader to find out the latest position on any particular point at the time of his actual interest. Little wonder then that the doubts and apprehensions of foreign investors about the efficacy of laws and polities in these countries on foreign investment are often exaggerated enough to hold them back at the very threshold; finding out the correct position would itself involve a special and herculean effort. 'The cost of on the spot investigation and time consuming efforts required to work through an alien administration have often been critical barriers to foreign investors.'

A 1970 study noted, "In both India and Pakistan there has been a relaxation over time in the terms of entry for foreign investors. This has been manifested chiefly in changing policies towards composition and control combined with

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31 OECD, n.17, p.18.
an increasingly pragmatic interpretation of such policies on the merits of specific cases". Nevertheless, a much later study of 1979 stated, "India and Pakistan and the other countries of South Asia have had very restrictive policies towards foreign investment with accordingly small flows." 33

Keeping in mind the above background, the present study seeks to fulfil two objectives: firstly, to ascertain the evolution of minimum standards of international law relating to private foreign investment and, secondly, to present a total picture of investment laws, policies and procedures of some of the countries in South Asia, India, Pakistan, Sri Lanka and Bangladesh. The study is divided into six chapters. The first chapter gives a short analysis of the stock and flows of foreign private capital in these countries to serve as an appropriate setting for the subsequent discussions. The next three substantive chapters deal with Expropriation and


33 World Bank, Private Direct Foreign Investment in Developing Countries, Staff Working Paper No. 348 (July 1979), p. 7.
Repatriation, Licensing and Regulation of Industries, and Taxation. In each of these chapters an attempt is made initially to ascertain the minimum standards of international law. This is followed by an analysis of the laws and procedures of the subject countries. Since some of the laws enacted in the former British India are still current 'as adapted' in Pakistan and Bangladesh, the laws and procedures in India are presented first so as to avoid the need for a repetition of concepts and principles which are common to some or all of these countries. This presentation of the economic laws and practices is followed by a brief analysis of the municipal laws vis-a-vis the international law in an attempt to ascertain if any useful conclusion can be drawn which can be of help at the national, regional or international levels. The main conclusions flowing from this study are given in the last chapter.

The Indian law stated in the study is amended upto 1983. For other countries also an attempt has been made to give the latest position. A reference to the original sources, be they the enacted laws or judicial decisions or official notifications, reports or documents, is given at every point so as to make it possible for the reader to check up the current position of the particular provi-
sion with reference to such sources even at a later date.

The study does not concern itself with political or ideological factors; its import is purely legal and economic.