CHAPTER II
FOREIGN PRIVATE CAPITAL IN SOUTH ASIA

The countries of South Asia are, with the sole exception of Nepal, all former British colonies which attained their independence in 1947-48. Burma had been separated from British India in 1937. At the time of Indian independence in 1947 the former British India was partitioned into India and Pakistan - the latter in two geographically separated wings, West Pakistan to the west of India and East Pakistan to its east. The Eastern Wing of Pakistan separated in 1971 and formed the independent State of Bangladesh.

These countries are among the poorest countries of the world with per capita GNP ranging (1980) from 130 dollars in Bangladesh to 300 dollars in Pakistan. Together, they account for about 4 per cent of the world area but as much as 21 per cent of the world population. Their aggregate GNP in 1980 was a mere 1.2 per cent of the GNP of all free market economies. Their share in world exports was of the order of 0.7 per cent only.

After independence all these countries embarked upon planned economic development with a view to attaining rapid industrialisation, increased employment and
improved standards of living. India is the largest country in the region with an area of 3.3 million square kilometres and a population in 1980 of 673 million. Her average growth of GNP during the last decade was of the order of 3.6 per cent per annum, the average annual growth of per capita GNP being under 1.5 per cent. At the time of independence, India had already some sort of industrial base. Forty per cent of the foreign private capital in India in 1948 was invested in industry. (See Appendix D) By 1960 industry contributed 20 per cent of its GNP with large scale manufacturing (within industry) contributing 14 per cent. These percentages increased to 26 and 18 by 1980. During the same two decades, the share of primary commodities in the export trade of India came down from 55 to 39 per cent with that of manufactures going up from 45 to 61 per cent.

Pakistan, at the time of independence, was almost entirely an agricultural economy with the East as the world's largest producer of raw jute and the West a major exporter of cotton with hardly any industry between them. Both wings were also poor in industrial raw materials and minerals. In 1949-50, the share of manufacturing in

GNP was only 5.8 per cent, 7.9 per cent for West Pakistan and 3.8 per cent for East Pakistan. By 1969-70 these percentages had increased to 12, 15.8 and 8.4 respectively.\(^2\) The percentages for 1980 were 25 for Pakistan and 13 for Bangladesh. The average annual growth rate of GNP during the last decade was 4.7 per cent in Pakistan and 3.9 per cent in Bangladesh. The share of primary commodities in the export trade of Pakistan came down from 73 to 44 per cent between 1960 and 1980 with the share of manufactures going up from 27 to 56 per cent. In Bangladesh, with the coming up of jute industry, the share of manufactures in export trade, which was negligible in 1949-50 went up to 66 per cent in 1980.

Sri Lanka, recorded an average annual growth rate of GNP of 4.1 per cent in the last decade. Industry contributed 30 per cent to GNP in 1980 as against 20 per cent in 1960, and the share of manufactures in export trade went up from 1 to 12 per cent during the same twenty years.

Burma and Nepal are still primarily agricultural economies with primary commodities constituting the bulk

of their export trade.

Of the total stock of private capital abroad as much as 75 per cent is in the developed market economies only; the developing countries account for just about 25 per cent. It has already been noted that the share of the countries of South Asia in the net flow of private capital to developing countries is under one per cent. On the eve of World War II the total stock of private foreign capital in these countries was of the order of 5,385 million dollars of which 60 per cent was direct proprietary investment; the remaining 40 per cent being portfolio investment. The direct investment was mostly in plantations and extractive industries, while portfolio investment was in infrastructure industries. There was relatively little foreign capital in manufacturing. Most of this capital was of British origin. In the last 40 years while the net flow of capital has not been very high the pattern of its growth has undergone a lot of change. The preponderance of direct proprietary investment yielded place to export

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4 See Appendix 'B'.

credits which, in turn, have in the last few years been outstripped by commercial bank loans. With the emphasis of the importing countries shifting to the import of industrial and technological skills, more and more of private foreign capital is engaged in manufacturing. Also the British monopoly has fast eroded and countries like the United States, Federal Republic of Germany, Switzerland, Japan and Italy have taken ever increasing shares.

An attempt at giving a country-wise analysis of private foreign capital is beset with many definitional and statistical problems. For example, direct private investment has been traditionally considered to comprise substantive equity participation with effective control of management. In practice, different countries apply different tests to determine effective control of management in terms of varying minimum percentages of equity holding and other long-term capital ranging from 10 to 50 per cent and some times depending also on the degree of diffusion of investors. Similarly, statistics of country-wise flows are often distorted by diversion.

of considerable portions of flows to affiliates in third countries, to off-shore banking centres and to 'tax havens' to be invested elsewhere. Further, the compilation of data in the host countries generally takes long and up-to-date statistics are not available. In India, for example, the Reserve Bank of India compiles and publishes data about foreign private capital in the country, but the last set of statistics published are those for the year 1974. An enquiry made with the Bank in March 1983 elicited the response, "data regarding foreign investment in India up to 1976 are being finalized..." Within these limitations, an attempt is made in the following paragraphs to have an idea of the pattern and growth of private foreign capital in different countries in South Asia to provide some useful background to the discussion in the subsequent chapters.

By foreign investment, the Reserve Bank of India refers to long-term investments as measured by the aggregate of net foreign liabilities of branches of foreign companies operating in India, foreign-held shares including proportionate free reserves and foreign held debentures of Indian companies, and long-term loans obtained by these companies from private and official institutions

OECD, Survey (1983), p. 19
abroad. Relevant portions of the data published by the Reserve Bank of India from time to time for the period from 1948 to 1974 are given in Appendix 'D'. In absolute terms the stock of foreign capital in the non-official sector in India went up from Rs. 2,646 million in 1948 to Rs. 18,218 million in 1974 including valuation changes and the effect (Rs. 2,001 million) of devaluation of the rupee in June, 1966. The net annual flows were of a very modest order during the 1950's. These increased in the 1960's coinciding with the Third Five Year Plan (1961-66) and reached the peak of Rs. 1,639 million in 1967. The next decade, however, started with a sharp decline during the years 1970 and 1971. The recovery in the subsequent years was modest and the net inflows remained at levels much lower than those of the sixties. In 1948 direct investment in Indian branches or subsidiaries or in controlled Indian companies constituted 75 per cent of the total stock of foreign private capital in India. If equity investment in non-controlled Indian companies which was of the order of Rs. 571 million were also added the percentage of total proprietary investment would be

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8See also K.K. Subrahmanian, Import of Capital and Technology: A Study of Foreign Collaborations in Indian Industry (New Delhi, 1972), pp. 29 ff.
96. As against, that, in 1974, proprietary investment comprised only 50 per cent of the total stock of foreign capital. The ratio of direct investment continued to rise till 1961 when it reached 91 per cent. Then, coinciding with the spurt in overall growth from 1961, the portfolio investment picked up much faster so as to reach the level of 53 per cent by the end of the decade; in the subsequent years the proportion stabilized at around 50 : 50. Within the portfolio investment again, the proportion of creditor capital as distinct from non-controlling equity capital built up much faster. Such equity capital, which comprised 86 per cent of the portfolio investment in 1948, came down to 17 per cent in 1965; it stabilized at around 10 per cent in later years. The declining share of direct investment was also made up largely of reinvested earnings rather than of fresh cash inflows. For the 10 years, from 1965 to 1974, reinvested earnings totalling Rs. 2,310 million constituted 77 per cent of that the total addition of Rs. 3,015 million in direct investment. The country-wise and sector-wise position also underwent a total change. In 1948, 80 per cent of the foreign capital was of UK origin. In 1974 this percentage stood reduced to 38. The US which started with a 7 per cent share in 1948 went up to 29 per cent in by midsixties and stayed at that
level thereafter. The other countries whose shares went up perceptibly were West Germany and Italy accounting for 10 and 5 per cent respectively in 1974. The post-independence bias in favour of manufacturing is obvious. In 1948 the share of manufacturing was only 27 per cent and that too was made up mostly of less sophisticated industries like, food, beverages and textiles. By the end of the sixties the share of manufacturing reached 60 per cent and bulk of it was in basic and heavy industries like machinery, transport and constructional utilities; food, beverages and textiles accounting for only 12 per cent of foreign capital in the manufacturing sector in 1974. In the years since 1974, according to the UNCTAD\textsuperscript{9} and OECD\textsuperscript{10} data, there was a net outflow of private capital from India during the years 1975, 1977, 1978 and 1979 and a netflow in the years 1976 and 1980. The overall total for these six years was a net inflow of 69 million dollars. This was made up mostly of capital from OPEC countries and commercial banks. In respect of the free market countries there was a net outflow of 50 million dollars over these six years. The stock of direct investment during these years went up by 226 million dollars\textsuperscript{11}.


\textsuperscript{10}OECD, \textit{Survey} (1983)

\textsuperscript{11}Not including figures for 1977, which are not available.
mainly because of the reinvested earnings.

Pakistan and Bangladesh, the territories forming part of Pakistan on the partition of India in 1947, had attracted relatively little investment capital before independence. After independence also there was little evidence of any considerable inflow of capital from abroad.\(^{12}\) The data in Appendix 'E' are indicative of the flow of private foreign capital to Pakistan during the years 1957 to 1980. The net inflow grew modestly during the late fifties and early sixties, reaching a peak in 1964 and did not grow much thereafter till the mid seventies. Two-thirds of the direct investment was made up of reinvested earnings. The shift from primary sectors towards manufacturing was again quite obvious; the share of manufacturing went up from 33 per cent in 1964 to over 80 per cent in 1968.\(^{13}\) In the last few years, from 1976 onwards, the net flow of private capital to Pakistan has improved mainly because of large inflows from OPEC countries. The share of UK which was over 60 per cent during the fifties came down to around 20 per cent by 1979. The United States' share went up from 7 per cent in 1956 to 15 per cent by the end of the seventies. The United Arab Emirate, with


32 per cent, emerged as the highest contributor during the years 1972-1979.\textsuperscript{14}

Bangladesh, even after liberation, has not attracted much foreign private capital. The total inflow during the years 1975 to 1980 was of the order of 97 million dollars of which 11 million dollars came from the free market countries and the rest from OPEC and commercial banks.\textsuperscript{15}

Sri Lanka attracted considerable foreign capital before World War II for investment in plantation industries, like tea and rubber. The total foreign private capital invested in companies in Sri Lanka before the war was estimated at some 65 million pounds. After independence there was no indication of any appreciable volume of private investment from abroad. In fact there was a definite outflow of capital as Sri Lanka nationals purchased existing enterprises established earlier by overseas interests.\textsuperscript{16} The data given in Appendix 'F' in


\textsuperscript{15}UNCTAD, n. 9

\textsuperscript{16}Conan, n. 12, p. 7.
respect of the period from 1950 to 1981 would show that a negative trend continued right into the seventies. The year 1978 marked the turning point and in the following three years there has been a substantial inflow of foreign capital. Sri Lanka has gone in for syndicated bank loans in a relatively big way.