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in South Asia: Trends, Patterns and Prospects**

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Intra-Regional FDI and Economic Integration in South Asia: Trends, Patterns and Prospects

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1. Introduction

South Asia is unique among the major geographic regions in the world for its low level of intra-regional trade.² The conventional wisdom based on standard trade theory holds that there is little room for fostering intra-regional trade through collective action given the similarities of these countries in terms of resource endowments. However, the proponents of regional economic integration argue that the static comparative advantage argument based on existing patterns of economic integration should not be treated as a guide to policy, and there is ample room for creating economic complementarity through further trade and investment policy reforms. By referring to the on-going process of global production sharing (international production fragmentation) and giving examples from the experiences of the East Asian economies in reaping gains from this new form of international exchange, they argue that there is potential for integrating production processes among countries by promoting vertical (efficiency seeking) foreign direct investment (Dosani 2010, RIS 2008).

The purpose of this paper is to inform this debate by examining emerging trends and patterns of intra-regional FDI in South Asia. There is a sizeable literature on regional economic integration initiatives and intra-regional trade in the region.³ However, to our knowledge, intra-regional FDI and the FDI-trade nexus have not, so far, been studied from a comparative, region-wide perspective. The paper is exploratory in nature: its scope and the depth of analysis is constrained by the nature of data availability.

The paper is structured as follows: Section 2 provides an analytical framework to help delineate the potential channels through which regional economic integration initiatives could affect FDI and trade flows. Section 3 presents a comparative overview of trade and investment policy reforms in the regions. Section 4 surveys trends and patterns of regional foreign direct investment in individual countries in the region, followed by a synthesis of the salient features of intra-regional FDI against the

¹ The author is grateful to Ramesh Paudel for excellent research assistance and to Swarnim Wagle' for his inputs to writing the Appendix on FDI policy regimes in South Asian countries.

² During 2009-11 the share of intra-regional trade in total world trade of the member countries of SAARC (the South Asian Association for Regional Corporation) was 5.2%, compared to ASEAN (the Association of Southeast Asian Nation): 26.5; COMSEA (the Common Market for Eastern and South Africa): 22.3%; and MERCOSUR (the Southern Common Market): 20.5 (calculated from UN COMTRADE database).

³ Chapters in Srinivasan (ed.) 2002 and Dosani et al (ed.) (2010) provide a comprehensive coverage of this literature.

back drop of changing patterns of total regional inward and outward FDI. The key findings and inferences are summarized in the concluding section.

2. Regional Integration, Trade and FDI: An Analytical Framework

Regional economic integration is expected to promote FDI through reduction in trade cost⁴, market enlargement and improving policy credibility. Of course there are a myriad of other factors which influence FDI location decisions. These include political and economic stability, the thrust of economic and investment policies, and the quality and availability of resources and infrastructure. Thus in analytical terms, the issues surrounding the impact of regional economic integration initiatives on FDI are indeed complex, and depend on the type of investment involved.

For the purpose of analysing the impact of regional economic integration on the FDI-trade nexus, it is important to distinguish between horizontal investment (or market-seeking) FDI (HFDI) and vertical (efficiency-seeking) (VFDI). HFDI takes place when a multinational enterprise (MNE) produces the same goods (and services) in order to avoid trade costs of exporting goods from one country another, while retaining its firm specific advantages in production. By contrast, VFDI takes place when a MNE geographically fragments the production process (value chain) of a given product into stages, in order to take advantage of location-specific advantages such as lower factor prices in other countries. Thus, VFDI is more likely to occur for firms with production processes that can be easily fragmented into several stages characterised by different factor intensities and between countries with different factor endowments. In each case, the MNE faces trade-offs in its investment decision: avoiding trade cost through HFDI implies foregoing economies of scale, as production is distributed across several plants located in different host countries, whereas VFDI involves costs of coordinating fragmented activities in several locations ('services link cost', *a la* Jones and Kierzkowski 2000). Some of the factors that are important in these trade-offs are firm or industry specific (e.g. the importance of economies of scale), and some depends on country characteristics such as market size, factor price differences, and various aspect of the trade and investment policy region. VFDI is predicted to occur when factor cost savings are large relative to the costs of coordinating fragmented activities in several locations (Navareti and Venables 2005).

In the context of regional economic integration, HFDI can take two forms, tariff-jumping investment or investment triggered purely by tariff preferences, and investment driven by the market enlargement effect. Tariff-jumping investment would contribute to trade diversion, shifting the

⁴ The term 'trade cost' is used here in a broader sense to encompass all costs that are incurred in conducting international trade and include transport costs, tariffs, and other transaction costs.

location of production from a low-cost source of supply outside the region to a higher-cost source in a member country. The attractiveness of the region for tariff-jumping investment depends on the magnitude of the “margin of preference”, the difference between the preference tariff among the member countries and the tariff applicable to trade with third parties. Differences in members' tariffs may be important in procuring low-cost imported inputs, which could influence the location of investment in relatively low tariff countries in the region from third countries as well as from high tariff countries within the region. This influence would be magnified if there are significant differences among member countries in non-tariff barriers to third country trade. In the early literature on the investment effect of regional economic integration, it was generally believed that, apart from the contemporaneous influence of the existing (initial) preference margins, the formation of a regional trading agreement (RTA) can impact on investment decisions of the tariff-jumping variety by creating a (perceived or real) threat of protection for extra-regional trade. The simple point here was that the creation of a wider regional market may foster a more protectionist approach towards extra-regional trade.⁵ However this postulate is of limited relevance for analysing the investment effects of modern RTAs because most (if not all) partners to RTAs pursue regional trade liberalisation as an integral part of their commitment to unilateral and multilateral (TWO-based) trade liberalisation.

HFDI driven by the market enlargement effect has the potential to promote intra-regional trade. The removal of tariff barriers on intra-regional trade leads to an increase in the size of the “domestic” market, enabling plants that are large enough to exploit economies of scale to be built. The market enlargement effect would be greater if the member nations have similar income levels and demand structures, but diverse preferences for varieties of goods (a condition which is generally met by developed, rather than developing, countries). The formation of a RTA could allow producers to “exchange” scale economies in the provision of differentiated goods. In an enlarged market, economies of scale may be achieved through the construction of large plants that produce a single product (economies of scale in the traditional sense), through the reduction in the number of product varieties in individual plants (horizontal specialisation), and through the manufacture of parts, components, and accessories of a particular product in separate locations (vertical specialisation). The first type of scale economy is particularly important in heavy industry, such as steel, chemicals, petroleum refining and pulp and paper.

It is important to note that, even in a context of significant and continuous decline in the margin of preference (as part of the ongoing multilateral trade liberalisation process), the formation of a RTA can have a significant impact on FDI inflows. For the same reasons emphasised in the

⁵ There is, in fact, evidence that one of the principal factors behind the massive increase FDI inflows to countries in the EC since the late 1980s was the concern that the single market would be heavily protectionist: that the existing structure of protection with national quotas would give way to EC-wide quotas and a tougher trade regime (Balasubramanyam and Greenaway 1993, p. 157).

traditional literature on economic integration (such as scale and scope economies, spill-over externalities etc.), liberalisation among neighbours would expand markets and thus induce better utilisation of resources, creating incentives for new investments. Put another way, if transport and transaction costs associated with trade with the rest of the world are substantial, expansion of the market following the formation of a RTA could be more important for the exploitation of scale economies compared to integration with the global economy.

From about the late 1960s, VFDI has shown phenomenal growth as an integral part of the ongoing process of global production sharing (international production fragmentation) (Jones and Kierzkowski 2001, Feenstra 2011, Athukorala 2010). This phenomenon has been the outcome of the growing ability of modern industry to 'slice up the value chain' of goods traditionally viewed as skill-, capital- or technology-intensive and shift the labour-intensive slices to low-wage locations. Assembly activities related to electronic industries, assembly of semi-conductor devices in particular, are by far the most important. The other industries with significant assembly operations located in developing countries are electrical appliances, automotive parts, electrical machinery and optical products. However, there is evidence from recent studies of trade patterns of standard light manufactured goods such as clothing, footwear and wood products that, even in these industries, there are growing opportunities for countries to specialise in different tasks within the global value change (such as designing, providing technical and managerial expertise, producing accessories, marketing/distribution), rather than producing the good from start to finish within its own national borders (Gereffi *et al.* 2005, Tewari 2006 & 2008).

It is generally believed that RTAs among developing countries (South-South RIAs) are unlikely to have significant impact on intra-regional VFDI flows. This effect depends on members having complementary economic structures (dissimilar patterns of production) which provide scope for intra-industry specialisation. If the members of the RTA are very similar in terms of factor endowments (e.g. their greatest resource is their large labour force), the scope for the relocation of production processes among countries based on "true" competitiveness will not be large (Ethier 1998). Compared to RTAs among developing countries, those involving both developed and developing countries (such as NAFTA and the enlarged EU) are, therefore, likely to have a greater impact on FDI rather than RIAs involving only developing countries.

However, even in the case of South-South economic integration, one can still expect VFDI to occur depending on differences among the member countries in terms of stage of development, even though such differences do not appear significant in the standard developed-developing country comparison. The geographical proximity among member countries, combined with such differences, could play a role in facilitating the restructuring of production across countries. Geographical proximity reduces transaction costs associated with transportation and communication (Schiff and

Winters 2003). Moreover, the country-specific advantages required for vertical specialisations such as the skill-composition of the labour force, entrepreneurial talents, the quality of trade-related logistics are not static but endogenous to the reforms process. Also, over time firms can develop their own specific 'assets' (firm characteristics) required for success in vertical specialisation through their exposure to foreign competition and links forged with foreign buyers (Alvarez 2007).

3. Policy Context

From the inception of their independent nationhood and well into the 1970s, countries in South Asia pursued import substitution (IS) – the promotion of industries oriented toward the domestic market by using import restrictions, or even import prohibition, to encourage the replacement of imported manufactures by domestic products – as the basis tenet of the national development strategy. During the import-substitution era these countries were not very receptive, if not completely hostile, to foreign direct investment. They did not rule out FDI, but wanted it on their own terms. The regulatory mechanism governing the entry of MNEs was characterised by an explicit preference for technical collaboration agreements as opposed to FDI; a policy stance dictated by the desire to achieve the (conflicting) twin objectives of minimising foreign control on business operation and gaining access to foreign technology. Foreign investment applications were generally considered on a case-by-case basis and that too favouring majority local ownership. From about the late 1960s, countries in the region began to encourage export-oriented FDI by offering tax incentives, and in some cases full foreign ownership. Naturally, these policies had little success given the anti-export bias in the overall incentive structure.

Policy regimes relating to outward FDI was even more restrictive in all countries. In India, the only country in the region that had some local firms with capacity to venture overseas, government policy towards overseas investment was formulated on the basis of the foreign exchange earning capacity of proposed ventures. As part of the highly restrictive foreign exchange monitoring process, every proposal had to be placed before an inter-ministerial committee on joint venture for approval. Overseas investment was normally permitted only in minority-owned joint ventures. As regards financing of the proposed project, the government severely restricted cash remittances for equity participation and encouraged the export of capital equipment and technology from India for the purpose. It was stipulated that 50% of declared dividends should be repatriated to India. All project proposals were screened on a case-by-case basis, approving only those that promised quick payoffs in the form of exports (Lall 1986).

Sri Lanka led the way in breaking away from the protectionist past, by embarking on a decisive process of economic opening in 1977. Following some hesitant and sporadic attempts to dismantle trade barriers at various points in time from the 1970s, the other countries embarked on significant liberalisation reforms from the late 1980s. In India the liberalisation of commodity markets started with partial trade liberalisation in the early 1980s, but followed a tortuous route throughout the decade. In 1991 India initiated a decisive break away from the strong inward-oriented policy regime, following a massive balance of payment crisis, which severely constrained its ability to continue with past policies. While there are vast inter-country differences in terms of the degree of liberalisation achieved during the ensuing years and comprehensiveness of reforms, by the mid-1990s all these countries seemed to have moved into a seemingly irreversible process of economic liberalisation. Market friendly reforms sustained over three decades have brought about a high degree of commonality relating to the institutional framework among these countries. Tariff levels have come down. All South Asian countries other than Bhutan, had achieved IMF Article 7 status for current account liberalisation by the turn of the last century (Table 1). In addition to trade liberalisation, South Asian countries have substantially removed many other restrictions on foreign trade and operation of the private sector and rationalised their earlier system of dual or multiple exchange rate systems, permitting market forces to play a greater role in determining exchange rates.

As part of liberalisation reforms all countries in the region have become more receptive to FDI. Sri Lanka is unique in the region for concurrent liberalisation of both trade and investment policy regime (Athukorala and Rajapatirana 2000). In other countries, investment liberalisation followed trade liberalisation with a substantial time lag. In addition to FDI liberalisation, a range of measures have been introduced by all countries to entice FDI. These include procedural simplifications, increasing caps on equity participation, and bringing more sectors under automatic approval, various financial incentives, relaxing restrictions on repatriate of profits and capital, fast tracking of FDI approvals, guarantees against nationalisation and expropriate, and signing investment protection agreements with source countries of FDI. Key features of the investment policy regimes are summarized in Table 2, and details on recent reforms in each country are provided in the Appendix.

Despite recent reforms, India's foreign investment regime still reflects the tension between the traditional aversion to foreign investment and the current recognition of its

importance to economic development (World Bank, 2010). For example, FDI is still not permitted in pure retailing; global retailers can only participate in India's retail sector through wholesale trade or by operating retail outlets through local franchises. In apparel and other light consumer-good producing industries, which are important in export expansion and job creation at the current stage of economic development of the country, FDI is limited to 24% of total equity. Restrictions on foreign ownership of land limit the entry of foreign builders and developers in to the construction sector. Projects with 51% or more foreign ownership still require a long procedure of government approval. There are also many unresolved problems relating to the overall investment climate. While 'the License Raj' (the infamous industrial licensing policy) has been largely eliminated at the centre, it still survives at the state level, along with a pervasive 'Inspector Raj'.

Policies relating to outward FDI too have become more liberal in all countries, although they still remain more restrictive compared to those applicable to inward FDI. In India, relaxation of restrictions on overseas investment began in 1992. The first step was to introduce an automatic route for overseas investment up to US\$4 million. The authority for approval of proposals up to US\$15 million was vested with the Reserve bank of India (RBI), but proposals more than US\$15 million still had to be approved by the Minister of Finance. In 2002 the upper limit for automatic approval was raised to US\$100 million per annum, of which 50% could be obtained from any authorised dealer of foreign exchange. In 2004, firms were allowed to invest up to 100% of their net worth under the automatic route. In 2005 this limit was raised to 200% of net worth and prior approval from the RBI was no longer required and firms were permitted to transfer funds through any authorised foreign exchange dealer. Indian firms' access to international financial markets was also progressively liberalised and they were permitted to the use of special-purpose vehicles in international capital markets to finance acquisitions abroad (FICCI 2006).

Trade opening in all South Asian countries has largely taken the form of across-the-board liberalisation, both unilaterally and as part of the liberalisation commitments under the WTO. But, they have also embraced the new-found global enthusiasm for preferential (regional and bilateral) liberalisation over the past two decades. The SAARC⁶ Preferential Trading Agreement (SAPTA) was signed in 1993, and it became operational in 1995 when

⁶ The South Asian Association for Regional Cooperation (SAARC) (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) was formed in 1985. But, for the first decade it was largely engaged in confidence building and public relations campaigns designed to impress domestic audience and foreign powers.

the first round of tariff concessions was exchanged. After 1995, two more rounds of tariff cuts were completed and a fourth round in progress was interrupted by the military coup in Pakistan in 1999. However, the tariff concessions exchanged during the three rounds have hardly made any impact on trade integration within the region. Some of the most important sectors of trade were left out in the commodity-by-commodity negotiation process. Some of the tariff concessions offered were on products which were not even traded among the countries. More importantly, not even a beginning was made towards the removal of non-tariff barriers (Dubey 2010, Kelegama and Mukherji 2008).

SAPTA was superseded by the South Asian Free Trade Area (SAFTA) in 2006. Article 7 of the SAFTA provides for a two-stage tariff reduction program to achieve ‘free’ trade (a tariff structure with all rates below 5%) between the three NLDC member countries (India, Pakistan and Sri Lanka) by 2015 and all NLDC member countries by 2018.⁷ So far there has been little progress in the implementing of the proposed tariff reduction programs. Even if fully implemented, it is unlikely to bring about ‘free trade’ in the region; all countries have opted to retain a long list of “sensitive” products with a view to protecting particular economic sectors against exemption of duties under SAFTA and nearly 53% of current intra-SAARC imports are currently restricted under the sensitive list. India’s sensitive list is more than three times as large as the one it offered in the last round of negotiations for an FTA with ASEAN. A variety of nontariff barriers (NTBs) also continues to frustrate trade. Pakistan has decided not to extend its obligations under the agreement to its trade with India, excluding potentially the largest segment of regional trade from the SAFTA process (Dubey 2010). Some countries have implemented ‘para-tariffs’ (various levies and taxes which do not come under the SAFTA definition of tariffs) which have virtually counterbalanced the limited tariff preferences offered under the SAFTA (Pursell 2011a and b).

A major qualitative change in regional economic integration initiatives in other parts of the world over the past two decade has been the recognition that effective integration requires more than simply reducing tariffs and quotas (Schiff and Winters

⁷ Under SAFTA, India, Pakistan and Sri Lanka are categorized as Non-Least Developed Contracting States (NLDCS) and Bangladesh, Bhutan, Maldives, Afghanistan and Nepal are categorized as Least Developed Contracting States (LDCS). According to Article 14, the NLDCs and LDCs would bring down tariffs to 20% and 30% within the first three years. This would be followed by a further reduction of tariff by NLDCs to the ‘free-trade level’ (0-5%) within 5 years and LDCs within 8 years.

2003, 7-9). It is widely believed that, many other types of barriers have the effect of segmenting markets and impeding the free flow of goods, services, investment and ideas, and wide-ranging policy measures- going well beyond international trade policies – are needed to remove them ('deep integration'). In particular, promoting investment is a prominent objective of many regional integration agreements. However, SAFTA does not cover liberalisation of investment: it only *list* this in Article 8 under the title 'Additional Measure'.

The report of the Group of Eminent Persons (GEP), which was set up by SAARC in 1997 to draw a road map for the implementation of SAFTA, recommended the creation of a Common Investment Area under SAARC. Based on this recommendation, India came up with a draft investment agreement for permitting freer flow of intraregional investment in the region (RIS 2008). The proposals included measures to remove administrative and regulatory constraints on the flow of investment among SAARC countries, to exchange information on possibilities for investment, and promote investment from other regional countries. An agreement for the establishment a SAARC Arbitration Council, as a prelude to negotiating an investment agreement based on the Indian draft, was signed by the SAARC member countries on July 2, 2007, but so far no further progress has been made.

The slow progress of the SAPTA process has led to attempts by some member countries to pursue a 'fast-track' liberalisation of trade through bilateral free trade agreements (FTAs). Currently there are three bilateral FTAs in the region: India-Bhutan, India-Sri Lanka and Pakistan-Sri Lanka. And four FTAs are under negotiation: India-Pakistan, India-Bangladesh, Pakistan-Bangladesh and Sri Lanka-Maldives.

Under the ISLFTA, which became operational on March 1, 2000, Sri Lanka and India have achieved a much higher degree of liberalizing bilateral trade than had achieved under the SAFTA. For instance less than 14% of Sri Lanka's exports are covered by the India's sensitive list under the ISLFTA, compared to nearly 42% under India's SAFTA sensitive list. So far 4150 Indian tariff lines have been made zero duty for Sri Lankan exports to India and 3932 tariff lines for Indian exports to Sri Lanka. Motivated by the positive outcome of the FTA, in 2002 the two governments decided to set up a Joint Study Group to explore possibilities of starting negotiations for a CEPA, modelled on the India-Singapore CECA, to cover both trade and investment. . In 2002, the governments of India and Sri Lanka agreed to explore the option of converting LBBFA into an India-Sri Lanka

Comprehensive Economic Partnership Agreement (ILCEPA) modelled after the India-Singapore CEPA which covers both trade and investment. Fourteen rounds of negotiations have been completed, the last round having been held in Colombo in December 2010.

Pakistan-Sri Lanka FTA (PSLFTA) was signed in July 2002 and came into operation on June 12, 2005. At the time of negotiating the FTA there was hope that it will help Sri Lanka to acquire 'hub state' in Pakistan-India trade. Given the prevailing prohibition on formal cross-border trade between India and Pakistan (see below), it was expected that Sri Lanka would be able to promote Indo-Pakistan trade by encouraging Pakistan investors to open operations in Sri Lanka in order to trade with India using ISBFTA.

Both Nepal and Bhutan have long-standing trade treaties with India. In 1996 India and Bhutan also signed a FTA. India has a firm commitment to maintain smooth trade and investment links with these countries because of their geographical position; both countries are viewed by India as part of its security frontier with China (Lama 2010).

In addition to the remaining tariffs and quantitative trade restrictions, restriction on cross-border transport remains a major barriers to trade and cross-border investment in the region. India does not permit transit facilities for the movement of Pakistani goods or persons through its territory. Bangladesh continues to deny transit facilities through its territories for the movement of India's goods or persons to other parts of India. These restrictions add huge costs to trade between the two countries. For instance it takes 45 days transport a container from Delhi to Dhaka; if overland railway transport were permitted by Bangladesh, it would take only 2 to 3 days. Currently, trade between Pakistan and India takes place mostly via Singapore or Dubai. The landlocked countries of Bhutan and Nepal can make large savings in transporting their goods to destinations outside the region if India would allow transit facilities so that their goods could reach ports in Bangladesh (Sobhan 2010).

4. Intra-Regional FDI: Individual Country experiences

This section begins with a county-by-country discussion of intra-regional FDI in South Asian countries in the context of overall FDI in these countries. This is followed by a comparative analysis aimed at identifying broader, region-wide trends and patterns of FDI.

India

In Indian FDI approval data, intra-regional FDI inflows are lumped together under the catch-all residual category of 'other countries'. This catch-all category has accounted for around 1.5% of total value of approved investment during 2000-2011. Aggarwal (2008) has compiled data on intra-regional inward FDI from unpublished approval records of the Secretariat of Foreign Investment (SFI), Ministry of Finance. 1998-2007. According to her data tabulations, during 1998-07, the Indian government has approved 55 intra-regional projects. Sri Lanka is the largest regional investor (45 projects), with Bangladesh (6) and Maldives (4) accounting for the balance. As already noted, from the time of separation in 1947 until 1 September 2012, there was a complete ban on Pakistani investment in India.

Bangladeshi and Maldivian ventures in India are in trade and distribution sectors. The Sri Lankan firms are in a wide range of activities, with textile and garments dominating the product mix. During the past decade a number of clothing producers in Sri Lanka, including the two largest producers in the country, MAS Holdings and Brandix, have set up production bases in India. These companies are expanding their operations in India based on the firm-specific advantages accumulated over three decades of their successful operation in the Sri Lanka in the context of market-oriented policy reforms initiated in the late 1970s. The Indian operations are a strategic move to both gain scale economies by accessing the vast Indian market and reaping cost advantages in global apparel markets by exploiting India's vast unexploited potential for integrating domestic textile production within the global apparel value chain. Both companies have plans to expand operations in India, using Sri Lanka as the regional hub for product design and development, sourcing clothing accessories and top-end apparel production.

MAS and Bandix are family-based Sri Lanka companies with historical roots in textile trade in the country dating back to the colonial era.⁸ Following the trade-cum-investment liberalisation reforms initiated in the late 1970s, a large number of East Asian clothing producers (mostly from Hong Kong) set up production plants in the country. The founders of MAS and Brandix ventured into the export-oriented clothing industry through links forged with the international buyers who came to Sri Lanka following the footsteps of these clothing producers. As the links with foreign buyers became firmly stabilised based on timely delivery and meeting quality standards, the two humble, made-to-order clothing firms rapidly evolved to become groups of companies engaged in the production of fabric, apparel accessories (hangers and elastic etc), product design and development, wet-processing and finishing, and trade-related logistics in the clothing value chain. A number of foreign firms, which initially supplied fabric and clothing accessories to MAS and Brandix have set up backwardly-linked production bases in Sri Lanka.

The MAS group of companies, which grew on the basis of a long standing strategic partnership with Victoria's Secret, is now the largest producers of lingerie (women's intimate wear) in South Asia. Casualwear forms the core of the Brandix group of companies, but it has also ventured into production of lingerie and sportswear over the past two decades. The two groups of companies are now well-established suppliers to a number of brand-name owners such as Victoria's Secret, Marks & Spence, Nike, Speedo, Triumph, La Senza, GAP, DRA, H&M, Lululemon and Oysho, Athleta. MAS has set up production facilities in Sri Lanka in addition to operations in India, China, Indonesia and Mexico. Brandix has large casual wear production plants in Bangladesh, and a Hong Kong based trading company (Brandix Asia), which act as the overseas trading hub for the group. The annual sales turnover of each has been rapidly approaching the billion-dollar mark. MAS employs over 50,000 workers and Bandix over 35,000 in their Sri Lankan operations alone.

In 2006, Brandix started developing a 1000 acre vertically integrated textile and garment park ('Brandix India Apparel City', BIAC) in the port city of Vishakapatnam in India's Andhra Pradesh state. It was formally inaugurated in 2010. With an initial

⁸ The MAS-Brandix story in this section is based on Abeyratne and Karunaratne (2013), MAS (2007), INSEAD (2006), Wijesiri and Ekanayake (2008), and material from the websites of the two companies,

investment of US\$750 million, BIAC is so far the biggest foreign investment in the clothing industry in India. At full capacity, it expects to generate a turnover of US\$1.2 billion and employ over 60,000. Brandix Apparel Ltd, the Sri Lanka based trading and sourcing arm of all apparel manufacturing entities of the Brandix Group, is the first enterprise to start operation in BIAC. It currently employs 1600 workers and has begun to supply fabric from the Indian base to Brandix apparel firms in Sri Lanka and Bangladesh. A number of other world-class companies involved in various layers of the global apparel supply chain (ranging from spinning, knitting and weaving, clothing accessories, apparel making and embellishment, store services and logistic) have either already set up operations or made commitments to do.

Intimate Clothing, a subsidiary of MAS Holdings has set up two plants, one in Chennai and another in Bangalore, and an integrated fabric park in Chintavaram in Nellor District, Andhra Pradesh. The two factories, which started operation in 2006, currently employ over 1500 and 1300 workers respectively. In 2007, MAS launched in India a range of lingerie under its own brand name, *Amante'*. This brand was developed and designed in Sri Lanka to suit the South Asian climate and local taste in colour and print. After the initial launch in Chennai and Bangalore, *Amante'* range of lingerie are now sold in departmental stores and regional multi-brand outlets all over India. The range of Amante brand that is sold in India was initially manufactured in Sri Lanka, but the production was shifted to Chennai factory after three years. The company has plans to expand the distribution network to Pakistan and the Middle East from the Indian base. MAS has invested US\$ 10 million in the Amante line with the aim of making the product a premier brand in the Asian region.

The MAS fabric park, which located in a 714 acre site in Chintavaram, started operation in 2007 with an initial investment of \$200 million. It expects to generate US\$500 Mn export revenue and employ 30,000 workers in full capacity. The park is an integral part of MAS's global supply chain integration strategy, and is expected to attract investment in different stages of the manufacturing and finishing process of warp knit fabrics used in the production of corsetry, swimwear and sportswear. The park has already attracted a 30Mn three-way joint venture between MAS and Dogi Spain and Elastic Fabric of the USA (MAS DogiEFA) and another joint venture between MAS and Miami Exports (a Sri

Lankan firm). A unique feature of the park is a training college, Asian Institute of management and Technology (AIMT), a knowledge centre for garment and textile technology, lean manufacturing and corporate social responsibility and community development programs.⁹ .

The other Sri Lankan firms in India are largely HDFI in nature, set up largely to take advantage of the market opportunities arising from the growth in the Indian consumer market. They include Ceylon Biscuits (Munchee brand), Lion Brewery (Carlsberg beer), John Keels, Hayleys, and Aitken Spence (Hotels). There are also a number of Sri Lankan firms involved in services industry, in particular freight servicing and logistics sector. The Indian beer venture of Lion Brewery is an interesting case of a large MNE (Carlsberg International of the Netherlands) to venture into India. The progress of this joint venture in India has been impressive. The Company now operates four breweries, in Maharashtra, Rajasthan, Himachal and Kolkata.

Pakistan

Indian companies are not officially permitted to investment in Pakistan. However, there is some evidence of Indian investment occurring through unofficial channels. For instance, according to the *Locomonitor* (an electronics database which tracks media reports of overseas investment by large companies) three Indian companies set up business operations in Pakistan during 2002-2007: Tata Consultancy, UTI and Dabur India (an Ayurvedic product firms) (Aggarwal 2008). According to this source Tata Consultancy and UTI (a leading financial services company) ranked among the top 5 investors in Pakistan during that period. In addition, there may have been considerable unrecorded investment undertaken by Indian nationals though long-established family-linked firms operating in Pakistan (Jayasuriya and Weerakoon 2002).

Pakistan Investment Board does not report individual country data on investment from the other South Asia countries, presumably because these are rather small and fewer in number. During 2000-2010, the share of the lump-sum category of the ‘other country’ in total approved FDI (which presumably covers intra-regional investment) has varied in the range of 1% to 3%.

⁹ http://www.fibre2fashion.com/news/printStory.aspx?new_id=43172

Bangladesh

There are 169 South Asian ventures among 1600 foreign-invested enterprises (FIEs) set up in Bangladesh during 1977-2011 (Table 3). India was by far the largest regional investor in the country accounting for 14% of total number of firms, 4.5% of total cumulative planned investment and 17.8% of total employment. Pakistan and Sri Lanka occupied the second and third positions, respectively, in terms of the number of projects and cumulative investment. However, the Sri Lankan firms employed more workers (6778) compared to Pakistani firms (6535). This difference seems to reflect the greater concentration of Sri Lankan firms in export-oriented apparel industry, compared to Pakistani firms.

There are no firm-level data on export performance. But, the data on industry profile and the available limited information from project descriptions suggest that Indian and Pakistani manufacturing investment is heavily concentrated in domestic-market oriented activities (HFDI). By contrast, Sri Lankan investment is more efficiency-seeking (VFDI) in nature, with a heavy concentration on the textile and clothing sector which accounts for over 80% of the total merchandise exporters from Bangladesh. Of the 22 Sri Lankan firms 16 are in textile and clothing sector and related activities (production of clothing accessories and clothing washing plants). The differences in the degree of export orientation of investment from the three countries also mirror the differences in the degree of capital intensity of firms: the average capital per worker in Sri Lankan firms was US\$3390 compared to US\$8798 in Indian firms and US\$15476 in Pakistani firms (according to the data reported in Table 4).

The largest among the Sri Lankan firms in the Bangladeshi clothing industry is Brandix Casualwear Bangladesh Ltd which started operation in the Comilla FTZ in October 2010. This production facility is part of Brandix Group's regional production chain, which procure fabrics from the Group's plant in India and clothing accessories from its Sri Lankan production base to produce woven bottoms for Marks and Spencer and GAP. When fully operational it will have a total work force of over 2,800, becoming the largest employer in Comilla EPZ. It is the first apparel producer in Bangladesh to receive 'Plan A' certification for environmentally friendly production from Marks and Spencer.

It is important to note that activities of Sri Lankan firms tell only part of the story of Sri Lanka's involvement in the export-oriented apparel industry in Bangladesh. Many clothing factories in Bangladesh (both locally-owned and owned by investors from other countries) employ a large number of managers and technicians from Sri Lanka (Jacob 2013). Based on the early-mover advantage in export-oriented clothing industry (following the liberalisation reforms in the late 1970s) and the rich domestic human capital base Sri Lanka has become a hub of managerial and technical talents for the clothing industry in the region (and beyond)' (Jayasuriya and Weerakoon 2002, Wijayasiri and Dissanayake 2008).

Indian investment in Bangladesh could have been much higher if it were not for some Political constraints impacting on the investment approval (Sobhan 2010). In the early 2000, India's leading conglomerate, Tata, came up with a proposal to invest about \$3.6 billion in Bangladesh to set up a urea fertilizer plant, a steel mill and a power plant. The Mittal Group, the biggest steel conglomerate in the world, sought to invest \$2.5 billion in a steel mill. Both these projects had potential to create export trade with India, contributing to narrowing the persistent massive trade deficit in Bangladesh's trade with India. These projects also could have attracted significant FDI in gas explorations and development and have transformed Bangladesh's image as an FDI destination. But, unfortunately, materialisation of these projects remains captive to politics. The BNP-led government, which held power in Bangladesh during 2001-06, stalled on making a decision on both projects. The public reason given was that Bangladesh could not guarantee enough gas supplies to the two projects to ensure their long-term sustainability. However, as forcefully argued by Sobhan (2010), the real reason was that the approval of such large projects involving Indian investment just prior to a national election would be prejudicial to its election stance against its main rival, the supposedly India-friendly Aswami League. The 'gas' argument seemed a non sequitur because these projects could have encouraged significant FDI in further gas exploration and development in the country.

Sri Lanka

According to the official records there were eight Pakistani firms (textile (4), apparel (2), gloves (1), paper/packaging (1)) and a Bangladesh firm (photocopy paper) operating in Sri

Lanka in the early 2000. There has not been any recorded investment from these two countries since then.

Annual approved investment from India increased from US\$5 million in the second half of the 1980s to about US\$7.5 million by the late 1990s (Table 4). During the first decade of the new millennium, the average investment level was much higher compared to the previous decade, but fluctuated widely from year to year reflecting vicissitudes of the investment climate during the final stage of the ethnic conflict. Investment flows have been growing rapidly following the ending of the ethnic conflict in 2007. During 2010-11 India was the second largest investor in Sri Lanka (after Hong Kong)¹⁰. Given the growing importance of India as a source of FDI, the Sri Lankan Board of Investment opened its first overseas branch in Bangalore on May 23, 2005.

Indian firms' involvement in Sri Lankan manufacturing dates back to the late 1960s when a number of joint ventures were set up in domestic-market oriented industries such as textile, glassware, refrigerators and machine tools. Most of these import-substitution firms went out of business following the liberalisation reforms initiated in 1977. In the 1980s and 1990s India had a relatively lower ranking among source countries of FDI in Sri Lankan manufacturing. The bulk of FDI in Sri Lankan manufacturing during this period was in export-oriented manufacturing (in particular clothing, footwear and other light manufactured goods) in which Indian firms do not have competitive advantage in overseas production because of historical reasons (Lall 1986, Athukorala 2009). In recent years, Indian investors have gained prominence with a district services sector. A number of factors, in particular the removal of restrictions on outward FDI by India, opening up of a number of services industries to FDI in Sri Lanka (in particular telecommunication and petroleum distribution), improvement in the overall investment climate following the ending of the civil conflict have underpinned these recent trends.

The industry profile of Indian investment in Sri Lanka is highly diversified, encompassing steel, cement, rubber products, tourism, computer software, IT-training and other professional services, and hotels and tourist resorts (Table 5). Until the late 1990s, most Indian FDI inflows to Sri Lanka were in manufacturing. Since then the composition has tilted rapidly in favour of services, such as hospitals, restaurants, retail trade and oil

¹⁰ The largest when Indian round-tripping investment taking place via Mauritius is taken into account (See Table 2, Note 2).

distribution. Some of the most visible Indian companies operating in Sri Lanka include Indian Oil Corporation, Tatas (Taj Hotel, VSNL, Tata Tea, Tata Communication), Bharat Airtel, Apollo Hospital¹¹, Adiya Birla Group (L&T), Ambujas, Rediffusion, Ceat, Nicholan Piramal, Jet Airways, Ashok Leyland, and Hero Motors. Indian Human Resources and Educational Companies like ICFAI and Manipal Medical Institute have also started entering Sri Lanka.

Most of the manufacturing ventures set up by Indian investors in recent years are engaged in the production/assembly of certain product (such as vanaspathi¹², copper wire¹³, machinery parts and components) which enjoys tariff preferences (zero or low duty) under the ISLFTA but are subject to high tariff on India's imports from third countries. By 2005, exports by these 'tariff- arbitrage' firms accounted for nearly 45% of total Sri Lankan exports (US\$559) to India, with vanaspathi and copper wire accounting for 22% and 28% of the total, respectively. In recent years, these exports have shown a sharp decline as the arbitrage margins eroded over time owing to multilateral tariff cuts in India (de Mel and Jayaratne 2012).

There are only a few Indian firms which have set up operations in Sri Lanka to exploit Sri Lanka's intrinsic comparative advantage in international production. Among them, perhaps the most prominent is the Indian tyre manufacturer, Ceat (a subsidiary of RPG Enterprises, one of India's largest conglomerates). It first set up a joint venture with a Sri Lankan company with a long-standing reputation in automobile and tyre trade (Associated Motor Works) in 1993, and then in 1999 acquired the largest local tyre manufacturing company (Kelani tyre, previously government owned) and amalgamated the two firms to form Ceat Holding Company (CHC) Pvt. CHC is now the largest tyre manufacturer in Sri Lanka. By 2010 it had captured 55 per cent of the domestic passenger vehicle market, 33% of the three-wheeler tyre market, and 45% of light truck tyre market. Following successful domestic market operation, CHC has started exporting tyres to 14 countries in the world: Bangladesh, Pakistan, Mauritius and Nepal and a number of countries in Africa and the Middle East.

¹¹ This was taken over by the Sri Lankan partner (the government-owned Sri Lanka Insurance Corporation) in 2008.

¹² A type of vegetable oil derived from palm oil.

¹³ Extracted from imported scrap metal.

Ceat's joint-venture operation in Sri Lanka is clearly illustrative of opportunities for creating intra-regional trade and investment linkages through market oriented reforms. The initial trade liberalisation in Sri Lanka permitted early penetration of the vehicle market by Indian firms. This also created opportunities for Indian tyre manufacturers to supply the Sri Lankan market, using their specific technological assets and Indian production bases. The privatisation program in Sri Lanka provided an investment opportunity to capitalise on cheap Sri Lankan rubber-reflecting the country's comparative advantage-and acquire a Sri Lankan production base. Liberalisation in India facilitated outward FDI. The firm-specific assets accumulated over many years through successful operation in India enabled Ceat to produce tyres for both the Sri Lankan and export markets (Jayasuriya and Weerakoon 2002). It is so far the only tyre manufacturing firm in Sri Lanka to obtain ISO 9000 certification (CII 2012).

In the export-oriented clothing industry in Sri Lanka, Indian firms are small players compared to both Sri Lankan firms and firms from other countries. They have set up production bases in Sri Lanka mainly to access the Sri Lankan managerial and technical/design capabilities in producing for third-country markets¹⁴. Some of them are sub-contractors to large Sri Lankan exporting firms.

Nepal

According to the data on cumulative foreign investment in Nepal as at 2011, intra-South Asian invests account for 26% of total foreign-invested firm, 41% of employment in these firms and 48% total cumulative investment (Table 6). India is by far the largest source country, followed by Bangladesh, Pakistan and Sri Lanka, and Bhutan in that order. There is no recorded investment from the Maldives.

Manufacturing accounts for more than half of the recorded projects and 60% of the total planned investment. Out of the total reported Indian projects (501) 60% are in manufacturing and they account for nearly 65% of total cumulate investment. Manufacturing accounts for more than half of the projects and 65% of the total planned investment. Among the other sectors, hotel and tourism show a large concentration given the attractiveness of Nepal as a tourist destination.

¹⁴ There is no relative labour cost advantage; the average factor-worker wage now is much higher in Sri Lanka (US\$ 150 to 180) compared to that in India (around US\$100 to 120).

Until 2005 when the export-quotas under the Multifibre Arrangement (MFA) were in force, a large number of Indian firms set up production plants in the clothing Industry in Nepal to circumvent MFA quota applicable to garment exports from India. There is no annual data to assess the implications of MFA abolition for foreign investment in the clothing industry (Athukorala and Sharma 2006). But, judging from the data on clothing exports from Nepal during the post-MFA years, it seems that most (if not all) of these 'quota-hopping' firms would have gone out of business after the 'easy access' to quota protected markets disappeared.

A major inducement for the bulk, if not all, of the other Indian investors has been opportunities for profit making through 'import deflection'. Because of successive tariff cuts from the late 1980s, tariffs on many intermediate products imports in Nepal are much lower than in India. This, combined with virtual open border between the two countries, has made simple processing industries in a number of product area (including vegetable ghee, copper wires and some cosmetics) geared to the Indian market highly profitable.

Nepal has untapped potential for hydroelectricity production for both the domestic market and for neighbouring states in India through FDI participation. Currently over 80% of electricity demand in the country is met by electricity purchased from India. The estimated hydro-electric power potential of Nepal is about 45,610 MW, but a mere 1.37% of this is currently exploited (Lama 2010. Table 6.2). India and Nepal started cooperating in the construction of a number of projects including Gandak (15MW), Kosi (18MW), Trisuli (21 MW), and Devighal (14MW) during the 1960s and 1970s. However, little has been done since then; the Karnadi, Rapti, and Pancheswar projects have been discussed for nearly four decades without any progress because the two countries' failure to agreeing on how to share the benefits of these projects. The situation has become more complex because of domestic power politics over the past decade (Lama 2010). The government monopoly in electricity distribution and the compulsion for private-sector electricity producers to supply to the national supply grid (owned and managed by the Nepalese Electricity Authority) have also been a major hurdle for FDI in this sector.

Bhutan and Maldives

There are no data on FDI inflows to Bhutan and Maldives disaggregated by the country of origin. In Bhutan India is believed to be the largest investor, with investment predominantly in hydropower (Dorji 2011). Unlike in Nepal, Indian cooperation in harnessing water resources has been widely accepted in Bhutan and all hydropower projects in the country are jointly owned and managed by Indian companies in collaboration with the government owned companies. There has also been some investment by Singapore and India in tourism and the financial sector.

In Maldives, some Sri Lanka clothing firms had production bases set up in order to circumvent quota bidding restriction on Sri Lankan exports to developed-country market. These production bases were shifted back to Sri Lanka after the MFA phasing out in 2005. Sri Lankan and Indian firms seem to have a significant involvement in tourist resorts and hotels, and tourism-related services (WTO 2003).

Intra-regional FDI: Comparative Analysis

In order to provide the context for analysing the magnitude and patterns of intra-regional FDI, total FDI inflows to, and outflows from, the countries in the region are summarised in Tables 7 and 8. FDI inflows to South Asia were rather small in the 1960s and 1970s. Following the liberalisation reforms, there has been some increase, but the combined regional inflows amounted to a mere 3% of total (global) flows and 5.1% of flows to developing countries. India accounts for the lion's share (over 90%) of total inflows to the region.

On the outflow side, total outward FDI from India recorded a notable increase from the early 2000's and surged from 2005 following the substantial removal of foreign exchange restrictions on capital transfer for overseas acquisitions. Total FDI outflow from India increased from about US\$ 20 million in the early 1990s to nearly US\$ 15 billion in 2011, albeit with some annual fluctuation. Over the past decade India has been the third largest foreign direct investor in the developing world after China and Brazil.¹⁵ However, India still remains a net FDI recipient, even though the gap between outflow and inflows has been sharply narrowing over the past few years. During the 1990s, annual out flows on average amounted to 7% of inflows. This increased from about 30% to 60% between 2000-5 and 2010-11. Outward FDI from the other countries still

¹⁵ This based on based FDI outflow data from UNCRAD, *World Investment Report database*.

remains small and only the figures for Sri Lanka has indicated a continuous increase over the past five years, albeit from a very low base.

How important are the intra-regional FDI inflows to the South Asia countries compared to total inflows to these countries? The available data does not permit a precise comparison. The data pieced together in the previous section from FDI monitoring agencies in individual countries suggest that they accounts for rather small share, perhaps less than 5% of the total cumulative FDI in the region by the turn of the last decade. At the individual country level, regional inflow seems to account for a significant share only in Nepal and the tiny countries of Maldives and Bhutan. In Sri Lanka, India has been the largest south country in recent years, but it still accounts for around 13% total inflows.

India is by far the largest regional investor in South Asia. However, the notable increase in India's total outward investment in recent years has not be reflected it its investment in the region. As can be seen in Table 8, the regional share of Indian outward investment has declined continuously, from 4.5% in 2003-04 to a mere 0.1% in 2006-07. Among the South Asian countries, Sri Lanka is the largest recipient of Indian FDI. In 2006-07, Sri Lankan received 85.0% total intra-regional Indian FDI followed by Bangladesh (11.1%). The data also points to a notable decline in the share of Nepal in India's intra-regional FDI. In addition to the political instability in the country, phasing out of MFA in 2005 which put an end to quota-hopping investment, and gradual dissipation of profitability of 'tariff arbitrage' due to significant tariff cuts in India in recent years seem to have contributed to this decline.

A general characteristic of FDI from developing countries (or, FDI by the so called emerging market multinational enterprises) is its heavy concentration in developing countries. Moreover, the bulk of their FDI is intra-regional, mostly in neighbouring countries. Until recently Indian companies investing overseas shared the general pattern of third-world concentration, although they were unique for their wider spread within the developing world. The past decade has also seen a clear compositional shift in Indian FDI in favour of developed countries and transitional economies (Athukorala, 2009, Table 2).

The significant shift in Indian FDI away from developing countries, and in particular the sharp decline in the share of intra-regional investment has been underpinned by a notable shift in the sectoral/industry composition of overseas activities of Indian firms. Manufacturing share in total approved Indian FDI declined from 70% in the early 1990s to 30% by the middle of this decade, reflecting a notable services sector bias. Within manufacturing, iron and steel, pharmaceuticals, automotive, chemicals and fertiliser have become the major areas of concentration. Overseas operations of Indian MNEs in these product areas are predominantly horizontal (market-seeking) in nature, with a strong preference for locating in countries with large

domestic markets. Tariff jumping motive which was an important driver of their location in developing countries in the past has lost its relevance because of the significant across-the-board tariff cuts in these countries over the past few decades. Notwithstanding significant trade and investment liberalisation couple with dismantling of the industrial licencing, so far there are no significant globally-oriented firms in electronics and electrical industries (other than in computer software) in India. Computer software is a notable exception, but most of the Indian global players in this industry are generally at the lower rungs of the vertically integrated global production chain with limited potential for further slicing of the value chain to generate VFDI within the region (Bhide' 2008).

As regards the industry/sectoral composition of regional FDI, HFDI has continued to account for the bulk of intra-regional flows, with a notable shift from domestic-oriented manufacturing to services and construction. However, there are early signs that VFDI has begun to play a role in stimulating intra-regional trade. The most prominent case is the textile and garment sector in which Sri Lanka is emerging as the hub of technology and managerial talents. Emerging patterns of textile and garment exports from the region show that there are Substantial differences among countries in in terms of their competitive advantage different segments/product lines in global markets – Pakistan: bed linen, home furnishing, carpets, basic menswear (in particular denim) and hosiery; Sri Lanka: lingerie, swimwear and formalwear; Bangladesh: men’s wear, sports and casualwear; and India: women tops, blouses, skirts, embellished and embroidered clothing and men’s underwear (Tewari 2007). Moreover, India and Pakistan established textile (fabric) industries with unexploited potential for supplying fabrics to garment producing firms. Given these complementariness, there is significant potential for trade and investment expansion in the region through vertical specialisation in the clothing and textile sector. There is also some evidence, in particular from Sri Lanka, of regional investment of HFDI variety in some other industries attracted by the availability of specific natural resources or skilled manpower.

5. Concluding remarks

Total annual flows of FDI into the South Asian region has increased substantially following the market-oriented policy reforms initiated three decades ago, but they still account for a small share (around 3%) of total global flows. India continues to account for over 90% of these flows. Compared to total inflows, intra-regional inflows of FDI seem to have increased at a slower rate and still they accounted for about 5% total cumulated FDI in the region over the past three decades.

Total outward investment by Indian MNEs has increased rapidly in recent years; Indian is now the third largest investor in the developing world after China and Brazil. But, the intra-

regional share of total outward FDI from India has shrunk in recent years. Indian overseas FDI, both global and regional, is predominantly of horizontal type (market seeking). Notwithstanding significant trade and investment liberalisation couple with dismantling of the industrial licencing, so far no significant globally-oriented firm with potential for slicing the value chain among countries has emerged in Indian manufacturing.

Horizontal FDI has continued to dominate the composition of South Asian intra-regional FDI, which a significant shift in favour of services sector activities. There are some indications of vertically integrated cross-border production operations emerging, but it is unlikely that these emerging patterns would be powerful enough to transform regional trade patterns so as to substantially reduce the region's dependence on extra-regional markets for trade expansion in the foreseeable future. These nascent vertical production chains have so far remained confined to a few product lines, predominately to garment and also to some product for which availability of specific specify natural resources play an important role in firms' locations decisions. In other industries, particularly in electronics and electrical goods industries (in which global production sharing is servility concentrated), no significant new regional firms with the capacity to undertake significant outward FDI have emerged so far. The Indian computer software industry is the often-cited example of South Asian success in joining global production networks (Dosani 2010). But most of the Indian global players in this industry are at the lower rungs of the vertically integrated global production chain with limited potential for further slicing of the value chain to generate VFDI within the region.

There is no data to probe the impact on the trade-FDI nexus of the preferential tariff cuts achieved so far under SAFTA and the bilateral FTAs that have been in force. However, information put together in this paper suggests that it was the cross border liberalisation of trade and investment regimes (both unilaterally and as part of the WTO commitments), that have set the stage for the emergence of VFDI in the region. The Sri Lanka export-oriented clothing industry, which has begun to act as the hum of the textile-clothing value chain in the region, grew out of the significant concurrent liberalisation of trade and investment policy reforms in the country over the past three decades. Liberalisation reforms in India and Bangladesh enabled leading clothing firms in Sri Lanka to set up production bases in India and Bangladesh. It is important to note that the entry of these firms to set up integrated production complexes in India predates the signing of the India-Sri Lanka FTA. India-Sri Lanka FTA was instrumental in attracting some 'tariff- arbitrage' manufacturing firms to Sri Lanka firms, but, naturally, they have not had a lasting impact on Sri Lanka-India bilateral trade. When the Sri Lanka-Pakistan FTA was signed in 2002, there was much hope that it would enable Pakistani firms to set up production based on Sri Lanka to trade with India by circumventing the preparing prohibition on using land routes to export goods to

that country. But according to the Sri Lankan investment approval record no single Pakistani firm has set up production bases in Sri Lanka.

Appendix

FDI Regimes in South Asia¹⁶

India

India started trade liberalisation and deregulation of industrial sector in the mid-1980s. The process gathered momentum after 1991. Over the past two years, FDI has been regulated by the Consolidated FDI Policy issued by the Department of Industrial Policy and Promotion (DIPP). The first Consolidated FDI Policy was issued in 1 April 2010 to reflect the current regulatory framework by consolidating all prior regulations on FDI contained in the Foreign Exchange Management Act (FEMA) 1999, the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations 2000, and the Reserve Bank of India circulars and press notes. Changes to the FDI policy are proposed by any ministry, discussed in inter-ministerial meetings, approved by Cabinet, and released through press notes by the DIPP. These changes are reflected in the Consolidated FDI Policy issued every six months. Sectors not listed in the Policy are 100% open to FDI under the automatic route subject to applicable laws, rules, and security conditions.

In sectors where FDI is allowed up to 100%, FDI enters under the automatic route, subject to sectoral regulations and other conditions. In sectors where FDI is capped, prior approval from the FIPB is required. Until 1 September 2012, India did not permit Pakistani citizens or entities incorporated in Pakistan to invest in India and Indian national to invest in Pakistan. Permitting full-foreign ownership remains politically sensitive, as was evident by the government's decision to permit majority foreign ownership in retail in November 2011 and then immediately put the decision on hold.¹⁷

Foreign companies must comply with reporting requirements mandated by the Foreign Exchange Management Act, notify the regional office of the Reserve Bank of India within 30 days of receipt of inward remittances, and file the required documents with that office

¹⁶ This section heavily draws on the cross-country indicators of FDI regulation in World Bank Group (2010), and the Trade Policy Reviews of each of the five members of the World Trade Organization (WTO) as follows: Nepal (March 2012), India (September 2011), Sri Lanka (November 2010), Pakistan (January 2008), and Bangladesh (September 2006).

¹⁷ <http://blogs.ft.com/beyond-brics/2011/12/07/rip-fdi-in-indian-retail/#axzz1rThp9unA>

within 30 days of issuing shares to foreign investors. Companies in India are allowed to open and maintain a foreign currency account with an authorized dealer. The minimum capital requirement for foreign and domestic companies is INR 100,000 (\$2,230), which must be paid in upon incorporation (WTO 2011).

India has signed 79 bilateral investment promotion and protection agreements (BIPA), of which 70 have entered into force as of late 2010. It is negotiating 20 bilateral investment protection agreements. The Arbitration and Conciliation Act (1996) governs domestic and international arbitrations. Moreover, certain federal acts and acts enacted by different Indian states have mandatory statutory arbitration provisions. There are no notable differences between domestic and international arbitration. Most commercial disputes can be submitted to arbitration, but there are certain exceptions, such as the non-payment of admitted debt or income tax, and industrial disputes. Institutional arbitrations are slowly gaining momentum, although parties still tend to prefer ad hoc proceedings. Indian courts are able to assist arbitration proceedings with interim relief. Decisions enforcing or denying enforcement of arbitration awards may be appealed to the Mumbai High Court and the Supreme Court. On average, it takes around 33 weeks to enforce an arbitration award rendered in India, from filing an application to a writ of execution attaching assets (assuming there is no appeal), and 43 weeks for a foreign award (World Bank 2010).

Pakistan

In spite of various bureaucratic controls, the government attitude throughout the 1950s and 1960s was favourable to private investment. FDI regime was more liberal, although there was greater emphasis on joint ventures with minority foreign ownership and technology licensing compared to FDI in fully foreign-owned venture. However, supremacy of the state and socialist ideology under a socialist government dominated policy in the 1970s. As a result, a large-scale program of nationalisation of key industrial units, widespread controls of domestic and foreign trade were instituted.

Reforms started slowly in the early 1990 as part of a widespread reform package in conformity with the World Bank conditionality. Removal of restrictions foreign investment was a major element of the reform program. Full foreign ownership of firms, with full freedom for remittance of profit and investment proceeds, is not allowed in almost all sectors of the economy.

Pakistan's primary and manufacturing industries are largely open to full ownership by foreign investors with some exceptions.¹⁸ Corporate agriculture was subject to a maximum ceiling of 60% until recently, but is now fully open; however, there is a requirement of a minimum investment of US\$300,000. It is specific services sectors where restrictions on foreign equity ownership are applied more stringently. Only Pakistani citizens can own local newspaper companies. Foreign ownership in nationwide television channels is limited to a less-than-50%. In banking, a maximum of 49% foreign ownership is permitted. In life insurance, the cap of 51% was removed in September 2006 to allow 100% foreign equity, but minimum investment requirements were retained. Other service sectors where restrictions remain are tourism and air transport. Overall, Pakistani equity restrictions on average are less than the South Asian regional, and global averages for all sectors except banking, insurance and the media. On average openness to foreign equity participation, Pakistan scores better than India, but lags behind Bangladesh and Sri Lanka,

There is no minimum capital requirement for domestic or foreign companies. In general, there is no discrimination between foreign and domestic investors when it comes to availing of incentives such as liberal tariff and tax concessions (e.g., income tax holidays), administered by the Ministry of Commerce.

Pakistan ratified ICSID membership in 2005 (signed in 1966), and three cases have been settled through ICSID since 2002. Pakistan also has signed nearly 50 Bilateral Investment Treaties, and has signed 54 agreements with countries to avoid double taxation. Beyond the investment laws, it is the general political-economic climate of the country, especially after 2001, that has deterred foreign investment. Indeed, in the face of risks posed by political instability, violence, crime and corruption prevalence, FDI regimes in isolation have very little effect on FDI attraction.

¹⁸ In manufacturing, as in almost all countries, arms and ammunition, high explosives, radioactive substances, and currency printing and minting, are not open to foreign ownership. While the production of alcoholic beverages is also banned, industrial alcohol is not.

Bangladesh

In Bangladesh opening up of the economy to FDI began with the enactment of the Foreign Investment (Promotion and Protection) Act in 1980, which provided for the protection and equitable treatment to foreign investment, guarantee against expropriation or nationalisation without compensation, repatriation of invested capital and profits. The Bangladesh Export processing Zone Authority Act was passed in 1980 which provided for setting up of three Export Processing Zones during the ensuing decade. The subsequent reforms in the early 1990s included allowing 100 per cent foreign in all foreign investment projects, and extended EPZ privileges to all export-oriented projects regardless of their location.

No prior approval is required for foreign direct investment other than registration with the Board of Investment. All sectors in the economy are fully open to foreign capital participation, but in practice certain strategic sectors, including port and airport operation, railway freight transportation, and electricity transmission and distribution are dominated by publicly owned enterprises operating under monopolistic market structures, presenting obstacles for foreign investors. The Foreign Private Investment Act provides legal protection to foreign investors against nationalisation and expropriation. It also guarantees repatriation of profit, capital and dividend.

Foreign investments can register with the Board of Investment, the Bangladesh Export Processing Zones Authority (BEPZA) and the Bangladesh Small and Cottage Industries Corporation (BSCIC). Registration is not compulsory, but registered investors have access to "one stop" service for infrastructure and institutional support services, including pre-investment counselling, electricity, gas, and water and sewerage connection, and telecommunication facilities. Registration with BOI is permitted only for investors in manufacturing. These investors are eligible for free repatriation of profit. The BEPZA and BSCIC are also responsible for allocating industrial plots, entitlement to import items on the restricted list, approving the payment of royalties, technical know-how or technical assistance fees, and appointing and remunerating foreign personnel.

Foreign investors enjoy the same incentives as domestic entrepreneurs in respect of tax holidays, accelerated depreciation allowances, concessional duties on imported capital machinery and other measures, as contained in the Industrial Policy 1999 and 2005. There

are no distinctions between domestic private investors relating to investment incentives or export and import policies. Incentives include, 100% foreign ownership in most sectors, tax holiday, reduced import duties on capital goods and spares, duty free imports for 100% export oriented firms, and tax exemption of technology fees and interests on foreign loans.

As of 2007, Bangladesh had bilateral agreements for avoidance of double taxation as well as the promotion and protection of investment with at least 18 countries. The Arbitration Act (2001) governs both domestic and international arbitrations. It grants the high court division of the Supreme Court of Bangladesh the power to determine the jurisdiction of the arbitral tribunal in certain circumstances. Commercial matters can generally be submitted to arbitration. Although the arbitration law is modern, in practice, the courts in Bangladesh are not yet fully supportive of the arbitration process. Furthermore, the domestic courts are overburdened, which lengthens the enforcement process. On average, it takes around 26 weeks to enforce an arbitration award in local courts, from filing an application to a writ of execution attaching assets (World Bank 2010).

Sri Lanka

As a reaction to the dismal economic outcome of the inward-looking policy, Sri Lanka embarked on an extensive economic liberalization process in 1977, becoming the first country in the South Asian region to do so. Liberalization of the foreign direct regime, with a major focus on attracting export-oriented FDI, was a key element of the reform program. Liberalisation reforms initiated in 1997 was unique in South Asia in that it involved significant liberalization of both trade and investment regimes. The principal act governing FDI approval and monitoring is the Board of Investment Act of 1978 and the amendments made to it in 1980s, 1983 and 1992. Article 157 of the Sri Lanka Constitution guarantees the safety of foreign investment.

Sri Lanka permits full (100%) foreign ownership in most manufacturing and in a number of services activities, including banking, insurance, finance, construction, and telecommunications. However, select strategic sectors, such as railway freight transportation and electricity transmission and distribution are closed to foreign capital participation. Foreign ownership in the primary sector (mining, oil and gas) is limited to a maximum of 40%. In the media industry, foreign capital participation in local television

channels and newspaper companies must be less than 40%. Foreign equity participation in the retail distribution sector is only allowed if it exceeds \$1,000,000.

In 2000, Sri Lanka notified to the WTO that its investment regime does not provide for local-content requirements, trade-balancing requirements, foreign exchange balancing requirements, exchange restrictions resulting in import restrictions or domestic sales requirements involving restrictions on exports. The Board of Investment (BOI) encourages investors to locate their factories in BOI-managed industrial processing zones to avoid land allocation difficulties. It aims at being a "one-stop" shop for foreign investors but, in practice, investment in certain sectors requires the approval of several agencies. The BOI approves projects, grants licences, establishes eligibility for tax incentives, and assists in procurement. It is also responsible for administering a number of tax incentives for the so-called "BOI companies," and for managing export-processing zones and industrial parks. However, some of the benefits provided by the BOI incentives schemes are contingent upon export performance requirements. There are no restrictions to the remittance of corporate profits and dividends of foreign companies operating in Sri Lanka. The government has not expropriated a foreign investment since the 1970s; the last expropriation dispute was resolved in 1998.

Sri Lanka has signed investment protection agreements with about 28 countries and double taxation agreements with about 38 countries. The Arbitration Act No. 11 of 1995 regulates both domestic and international arbitrations, and is based on the UNCITRAL Model Law. Most commercial matters may be submitted to arbitration, and parties are free to select arbitrators of any nationality, gender, or professional qualifications. There are several arbitral institutions, including the Arbitration Centre of the Institute for the Development of Commercial Law and Practice and the Sri Lanka National Arbitration Centre. The efficiency of arbitration is hindered by its interaction with overburdened domestic courts, and there are significant delays in enforcing arbitration awards. Enforcement proceedings are commenced in the High Court. On average, it takes around 103 weeks to enforce an arbitration award, from filing an application to a writ of execution attaching assets (World Bank Group 2010). Unlike in many countries, the longest part of the enforcement proceedings is the time it takes from the first hearing in enforcement proceedings to the first instance court decision (1 year).

Nepal

Liberalisation of FDI policy began in 1992 the promulgation of the New Industrial Policy and the amendment of the Foreign Investment and Technology Act (of 1980) in 1992. Nepal's investment framework consists of the Industrial Enterprises Act of 1992 and the Foreign Investment and Technology Transfer Act of 1992. The Industrial Enterprises Act established the One-Window Committee coordinated by the Director General of the Department of Industries under the Ministry of Industry. The investment regime permits foreigners to invest up to 100% in all sectors of the economy, except those that are on the “negative list.”¹⁹ Some of these exceptions may only be modified by the parliament, others may be amended by the Government.

All agreements entailing the transfer of technology from abroad require government approval. This includes non-equity relationships such as franchising. Foreign individuals are not permitted to own land, but resident companies may do so even if foreign-owned. A further *ad hoc* restriction is that total foreign shareholding in all financial services institutions is limited to 67% of the issued share capital, except banks (80%). Prior approval is required for all FDI. The Department of Industries may itself approve FDI applications for projects with an investment cost of under the equivalent of about US\$12.5 million. Applications in respect of larger investments are decided by the Industrial Promotion Board.

No specific performance requirements are imposed as an inducement or condition of investment. Nepal prohibits the nationalization of any private-sector industries; it guarantees full repatriation of capital, profits, technology transfer payments, or dividends and interest on foreign loans. No income tax is imposed on interest income earned by a foreign investor from foreign loans; 15% income tax is levied on royalty, technical, and management service fees; a maximum rate of 20% is levied on export income; priority is

¹⁹ The list include (i) cottage industries; (ii) personal services (e.g. hair cutting, beauty parlour, tailoring, driving training); (iii) arms and ammunitions industries; (iv) explosives and gunpowder; (v) industries related to radioactive materials; (vi) real estate business (excluding construction); (vii) motion picture industries (produced in national languages and the language of the nation); (viii) security printing; (ix) currency and coinage business; (x) retail business; (xi) travel agencies; (xii) trekking agencies; (xiii) water rafting; (xiv) pony trekking; (xv) horse riding; (xvi) cigarette, *bidi*, alcohol production (excluding those exporting over 90% of their production); (xvii) internal courier services; (xviii) atomic energy; (xix) tourist lodging; (xx) poultry farming; (xxi) fisheries; (xxii) bee keeping; and (xxiii) consultancy services (e.g. management, accounting, engineering, and legal services).

given in supplying electricity to investment projects; and the government facilitates business visas to the families of foreign investors.

In case of a dispute with third parties or with the Government, foreign investors have recourse to Nepali courts. International arbitration to settle a dispute with the Government is available to foreign investors but only if the investment agreement provides for such right. It has signed reciprocal encouragement and protection of investment agreements with about five countries, and has double taxation avoidance agreements with 10 countries including China, India, Sri Lanka, and Thailand. Nepal signed a Trade and Investment Framework Agreement with the United States in April 2011, and the bilateral investment promotion and protection agreement (BIPA) with India in October 2011.

Bhutan

In 2002, the government of Bhutan announced the national FDI policy and initiated measures to put in place the institutional and legal framework for creating an enabling environment for attracting FDI. The new policy replaced the *ad hoc* system of investment approval of the past and put in place a transparent system for approval and regulation of all foreign investment, with the exception of portfolio investment, which are not allowed. Investors are expected to meet a minimum investment size: US\$1 million in manufacturing and US\$500,000 in services. In both cases, the foreign investor is permitted to hold up to 70% of ownership. Repatriation of capital and profit is subject to government approval.

Maldives

Foreign investment regime in Maldives is very liberal. Foreign investors are permitted to fully own and operate business in all sectors of the economy. Investment incentives apply equally to foreign and domestic investor. There are no exchange controls on repatriation of profit and capital. There is no company tax, but foreign investors are required to pay an annual royalty fee. The royalty is 3 % of gross income or 15% of profits, whichever is greater, for majority foreign-owned companies. For others, the two alternative rates are 1.5% and 7.5%.

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Table 1: A Summary of Trade Regimes in South Asian Countries circa 2010

Policies	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Exchange Rate	Unified	Unified	Unified	Unified	Unified	Unified	Unified
Exchange Rate Determination	Free Float	Peg to Indian Rupee	Free Float	Fixed Parity a	Peg to Indian Rupee	Managed Float	Managed Float
Payment Convertibility							
Current Account (IMF Article VII status)	Yes, Some Limit	Yes	Yes	Yes	Yes	Yes	Yes
Capital Account	No	No	Yes, limited	Yes	No	No	No
Import Restrictions							
Import Licensing	No		No	Yes	Yes, Limited	No	Yes, Limited
QRs on Imports	Yes, Limited		No	Yes	Yes	No, Minor Rest:	Yes, Minor
State Monopolies	Yes		Yes	Yes	Yes	Yes	Yes
MFN Tariff Simple Average	14.6	21.9	14.1	20.2	12.6	13.5	11.4
Applied Tariff Trade Weighted	13.2	14.8	7.8	20.5	14.6	14.7	9.5
ROW Applied Tariff Trade Weighted	4.5	0.6	4.8	3.7	2.8	6.8	5.3
Tariff binding coverage at WTO	15.5	No	73.8	97.1	99.4	98.7	37.8
Average of Bound Tariff Rates	169.2	N/A	50.2	36.9	26.0	59.9	30.3
Ease of Doing Business (rank out of 181)	110	124	122	69	121	77	102
Logistic Performance Index (1-to 5 best)	2.5	2.2	3.1	N/A	2.1	2.6	2.4

Source: Athukorala, Bandara and Kelegama 2011 (updated to 2010)

Table 2: Foreign Investment Policy Regimes in South Asian Countries

Areas	Bangladesh	India	Nepal	Pakistan	Sri Lanka	Bhutan	Maldives
Limits on foreign Equity Participation	100%	Up to 51% in most industries; Up to 24% in small scale industries; and 100% in export-oriented industries, power, electronic and software technology parks. Investment from Pakistan remained prohibited until 1 September 2012	100% foreign owned or joint venture in all sectors, except for a negative list industries	100% in all sectors.	100% in all sectors	70% in all sectors	100%
Fiscal Incentives	i) Tax holiday for 7 years ii) Tax exemption on royalties, interest on foreign loans and capital gains from the transfers of shares iii) 5% import duty on capital equipment and spare parts for initial installation	i) Income tax holiday of 10 year for EPZ firms and 5 year for other investors. ii) Access to finance for export-oriented industries at concessional interest rates iii) Tax relief under Avoidance of double taxation agreements iv) 10 year income tax holiday for firms located in EPZ.	(i) Corporate tax rate for export-oriented industries is 8% of profit or 0.5% of export earnings ii) Corporate tax rate for import competing industries is 20% iii) 2.5% duties on imports of M/E and spare parts iv) 5-10% duties on most industrial intermediate inputs refunded to export-oriented industries under the duty draw back scheme	i) No custom duty on imports of plant, machinery & equipment for export-oriented and hi-tech industries ii) zero import tariff on plant and machinery (not available locally) used for agriculture	i) Exempted from income tax on capital gains arising from share transfers ii) income tax??? iii) Duty draw back for export-oriented industries	Selective tax exemption	No specific incentives
Repatriation of Profits and tax on expatriates income	100% repatriation of capital and dividends is allowed	100% repatriation of capital, profits and dividend is allowed after payment of tax	100% repatriation of dividends and capital is allowed	100% repatriation of capital, dividend and profits is allowed	i) 100% repatriation of profits and dividend is allowed ii) expatriates income is taxed at a concessional rate of 15% for 5 years	100% repatriation of profits and dividend subject to approval	100% repatriation of profits and dividends allowed
Minimum capital requirement	None	US\$2100	None	Agriculture and infrastructure: \$0.3mn	US\$500,000	Manufacturing: US\$1Mn Services: US\$0.5 Mn	None

				Telecom: \$0.15 Mn.			
EPZ status	Yes, in some designated area	Yes, in some designation area	No	Yes, in some designated area	Yes, country-wide		
Protection of Foreign Investment	i) Guarantee against nationalization ii) International convention for settlement of industrial disputes	i) Settlement of disputes is govern by the Indian Arbitration Act 1940 ii) UN Convention for the recognition and enforcement of foreign arbitral awards	i) Guarantee against national ii) Dispute settlement through mutual consultations and in accordance with the arbitration rules of UN Commission on International Trade Law	i) Guarantee against nationalization ii) Settlement of dispute through the International Commission on Settlement of Investment Disputes	i) Protection against nationalization under the bilateral investment agreements and constitutional guarantee ii) International Convention for the Settlement of Investment Disputes		
Outward direct investment	All foreign investment require prior approval	Overall limit of \$100 million in one financial year subject to approval. Investment by Indian nationals in Pakistan was not permitted under the approval route.	Nor permission is given for foreign investment for Nepalese citizens except by Only by government notice	All foreign investment require prior approval	All foreign investments require prior approval. Priority to investments which promote domestic exports	Strict controls on all foreign investments	Strict contro foreign inve

Source: IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions* supplements by various country sources.

Table 3: South Asian Investment in Bangladesh at 2011

Source country/Industry	Number of Firms	Cumulative investment (US\$ million)	Employment
INDIA			
Manufacturing	108	266.083	30243
Food	18	20.1	2127
Textile	2	20.4	2177
Clothing	24	54.2	17699
Leather products/footwear	3	36.1	2754
Wood products	1	0.5	51
Paper & paper products	3	2.4	255
Chemical, rubber and plastic	32	62.1	3626
Fabricated metal products	17	66.6	886
Other manufacturing	8	3.7	668
Construction/housing	4	4.2	468
Comp. software and IT services	19	8.8	1277
Trade and services	11	29.6	1479
Clothing washing plants	6	7.5	1099
Total	142	308.635	33467
PAKISTAN			
Manufacturing	39	93.4	6035
Food	2	11.5	120
Textile	6	12.3	672
Clothing	6	6.8	2943
Leather products/footwear	1	0.1	30
Wood products	1	0.1	15
Paper & paper products	2	4.1	322
Chemicals, rubber and plastic	6	1.4	404
Non-metallic mineral products	1	0.4	27
Fabricated metal products	10	56.0	1245
Other manufacturing	4	0.8	257
Construction/housing	2	1.4	333
Comp. Software & IT services	1	0.5	62
Trade and services	4	2.5	105
Total	46	97.7	6535
SRI LANKA			
Manufacturing	23	29.0	6778
Food and beverages	2	0.3	151
Textiles	2	7.4	151
Clothing	7	10.1	5463
Chemicals, rubber and plastic	2	0.4	148

Fabricated metal products	2	0.5	51
Miscellaneous manufacturing	8	5.2	814
Clothing accessories	4	2.8	219
Computer software and IT services	4	1.4	151
Trade and services	6	27.0	1121
Clothing washing plants	1	0.5	102
Total	31	51.4	8050
<i>Memo items</i>			
FDI from all source countries	1598	10179.5	26007
South Asian share	13.7	4.5	17.5
India	8.9	3.0	12.7
Pakistan	2.9	1.0	2.4
Sri Lanka	1.9	0.5	2.7

Source: Compiled from data extracted from Bangladesh Board Investment website.

Table 4: Indian Direct Investment in Sri Lanka, 1984-2011

	Total FDI (US\$ Mn)	FDI from India		India's rank among source countries
		US\$ Mn	Share (%)	
1984-89	50.0	5.1	12.2	12
1990-94	231.0	7.5	3.2	14
1995-99	433.6	7.6	1.7	8
2000	173.5	1.9	1.1	8
2001	121.3	14.4	11.9	5
2002	168.0	101.3	60.3	1
2003	158.4	53.8	34.0	1
2004	214.0	25.2	11.8	4
2005	249.0	17.9	7.2	4
2006	506.2	27.1	5.4	9
2007	644.7	42.9	6.7	4
2008	779.0	126.0	16.2	2
2009	601.0	78.0	13.0	3
2010	516.3	110.2	21.3	1
2011	1067.0	147.0	13.8	2

Notes

- (1) The sharp increase in India's share was mainly due to IOC investment of US\$44.7 investment in that year.
- (2) For the first time BOI records indicate FDI inflows from Mauritius during 2009-2011: 2009: US\$12 Mn, 2010: US\$ 15 and S2011: US\$253. Presumably the bulk (if not all) of these are Indian investment 'round-tripped' via Mauritius in order to reap tax advantages under the India-Mauritius Bilateral Investment Treaty.

Source: Data for 2003-2011 are from CII (2012) (data provided by the Sri Lanka Board of Investment). Data for 1984-2002 were compiled from BOI records and Central Bank of Sri Lanka, Monthly bulletin of Statistics (various issues)

Table 5: Industry Profile of India Direct Investment in Sri Lanka, as at 2010

	Number of firms	Cumulative approved Investment (US\$ Mn) ¹		
		LOCAL	FOREIGN	Total
Manufacturing	81	15.1	99.2	114.3
Food, beverages and tobacco	14	3.9	30.5	34.4
Clothing	13	2.8	9.6	12.4
Textile	2	0.0	1.0	1.1
Wood and wood product	3	0.0	1.1	1.1
Printing and publishing	2	0.0	1.2	1.2
Chemical, petroleum and rubber products	9	2.5	3.7	6.2
Automobile tyres (CEAT India)	1	1.0	1.5	2.5
Non-metallic mineral products	8	0.8	6.1	6.8
Fabricated metal products	21	3.5	32.3	35.8
Other manufacturing	9	1.6	13.6	15.2
Construction of commercial building and housing complexes	5	4.2	10.0	14.2
Service and trade	18	34.9	234.1	269.0
Data processing/software	5	0.8	4.0	4.8
Mobile telecommunication (Bharat Airtel)	1	0.0	186.1	186.1
Petroleum retailing (Indian Oil Corporation)	1	31.3	37.4	68.6
Total	104	54.2	343.6	397.8
Memo items				
Total foreign invested projects in Sri Lanka	852	984.2	3,535.8	4,520.0
Share of Indian FIEs (%)	12.2	5.5	9.7	8.8

Note: Values in Sri Lankan rupee converted at US\$/SLR = 114.4.

---Data not available.

Source: Compiled from unpublished records of the Board of Investment, Colombo.

Table 6: South Asian Direct Investment in Nepal as at 2011

Sour country/sectors	No of Projects	Total investment	Investment	Employment
BANGLADESH	26	7.0	3.6	4166
Agriculture	1	0.1	0.1	100
Construction	1	0.1	0.1	20
Manufacturing	9	5.8	2.7	3310
Service	9	0.6	0.4	202
Tourism	6	0.3	0.2	534
Bhutan	3	0.4	0.0	98
Manufacturing	1	0.1	0.0	0
Service	1	0.1	0.0	12
Tourism	1	0.2	0.0	86
INDIA	501	847.4	437.6	56407
Agriculture	7	10.7	5.6	784
Construction	17	30.3	25.3	830
Energy Based	12	112.6	69.5	1222
Manufacturing	296	398.4	198.4	36142
Mineral	6	60.5	30.5	1521
Service	112	166.9	87.6	11781
Tourism	51	67.9	20.5	4127
PAKISTAN	15	29.3	2.0	2403
Manufacturing	7	3.8	1.6	2288
Service	5	25.2	0.3	57
Tourism	3	0.3	0.1	58
Total		0.0	0.0	
SRI LANKA	4	1.2	0.6	99
Service	4	1.2	0.6	99
Total	549	885.3	443.9	63173
Memo items				
Direct investment from all countries	2108	2056.0	919.3	155432
South Asian share (%)	26.0	43.1	48.3	40.6
Bangladesh	1.2	0.3	0.4	2.7
Bhutan	0.5	0.0	0.0	0.2
India	23.8	41.2	47.6	36.3
Pakistan	0.7	1.4	0.2	1.5
Sri Lanka	0.2	0.1	0.1	0.1

Source: Compiled from, Government of Nepal, *Industrial Statistics 2011*, Kathmandu: Department of Industry.

Table 7: Foreign Direct Investment Inflows, (1980-2004) (US\$ million)

	1990-94	1995-99	2000-04	2005	2006	2007	2008	2009	2010	2011
South Asia	968.3	3 731.9	6 305.6	11 295.8	26 272.0	32 689.4	50 959.6	39 322.7	28 098.1	34 791.8
Afghanistan	0.0	1.0	59.1	271.0	238.0	188.7	94.4	75.7	211.3	83.4
Bangladesh	6.7	356.8	415.9	845.3	792.5	666.4	1 086.3	700.2	913.3	1 136.4
Bhutan	0.4	0.4	1.6	9.1	72.2	3.0	7.2	18.3	16.3	13.9
India	413.9	2 619.2	4 958.8 ¹	7 621.8	20 327.8	25 505.6	43 406.3	35 595.9	24 159.2	31 554.0
Maldives	6.9	10.4	30.4	73.2	95.2	126.5	174.2	152.1	211.8	281.6
Nepal	1.6	11.7	5.8	2.5	- 6.6	5.9	1.0	38.6	86.7	95.5
Pakistan	419.9	536.1	633.4	2 201.0	4 273.0	5 590.0	5 438.0	2 338.0	2 022.0	1 327.0
Sri Lanka	118.8	196.4	200.6	272.0	480.0	603.4	752.2	404.0	477.6	300.0
Meme Items: FDI outflow as a % of,										
Global outflow	0.5	0.6	0.8	1.2	1.8	1.7	2.8	3.3	2.1	2.3
Outflow from developing countries	1.6	2.1	2.8	3.5	6.2	5.7	7.8	7.6	4.6	5.1

Increase in recorded FDI inflows during this sub-period partly reflects revisions to the estimation procedures. The Reserve bank of India revised the FDI estimation procedure in 2003 (with effect from 2001) to include retain earnings. In 2001 and 2002, this new component accounted for about 40% of the total reported FDI figures (RBA, Monthly Bulletin, January 2004, Table 46).

Table 8: FDI outflow from South Asia, 1990-2011 (US\$ Mn)

	1990-94	1995-99	2004-05	2005	2006	2007	2008	2009	2010	2011
South Asia ²	22.0	145.6	1 574.3	3 071.8	14 426.6	19 768.4	19 376.5	16 047.4	13 259.1	14 873.2
Bangladesh	0.3	4.1	7.7	3.3	3.6	21.0	9.3	29.3	15.4	9.2
India	20.3	119.8	1 528.2	2 985.5	14 285.0	19 594.4	19 256.5	15 927.1	13 151.0	14 752.0
Pakistan	- 3.0	10.8	29.0	45.0	109.0	98.0	49.0	71.0	47.0	62.0
Sri Lanka	4.4	10.9	9.4	38.0	29.0	55.0	61.7	20.0	45.7	50.0
Meme Items:										
FDI outflow as a % of,										
Global outflow	0.0	0.0	0.2	0.3	1.0	0.9	1.0	1.4	0.9	0.9
Outflow from developing countries	0.1	0.2	2.3	2.3	6.0	6.2	5.9	6.0	3.3	3.9

Note:

- (1) Annual average.
- (2) No recorded outflow data for Nepal, Maldives and Bhutan (presumably negligible)

Source: Compiled from UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

Table 9: India's Intra-regional Outward FDI, 1996-2007

	Total	South Asia		Host country composition (%)				
	US\$ Mn	US\$ Mn	%	Bhutan	Bangladesh	Maldives	Nepal	Sri Lanka
1996-02	6354	165	2.6	0	9.1	12.8	40.7	37.4
2002-03	1334	16	1.2	0	7.4	0	35.6	57.0
2003-04	1191	54	4.5	0	7.6	0	9.9	82.6
2004-05	2263	16	0.7	0	11.1	0	24.9	64.1
2005-06	2136	21	1.0	0	5.9	5.4	3.9	84.9
2006-07	5371	5	0.1	0.9	11.1	0.9	2.1	85.0
Total	18654	280	1.5	1.8	8.4	7.9	29.5	51.4

Source: Aggarwal (2008) (Based on Ministry of Finance Approval Records)

