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Epitomizing Non-CPEC Foreign Direct Investment in Pakistan

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Abstract

This brief does to usher in an era of debate around non-CPEC FDI in Pakistan which, especially in light of the developing macroeconomic instability in the country, is an area currently ignored by the policy-makers but understandably so given the promise and might of the FDI expected to channel in to the country under CPEC. It analyzes the current status of non-CPEC FDI from the perspective of including the non-traditional barriers to FDI growth apart from lack of security and extremism that contribute to it and presents policy and planning frameworks to attract non-CPEC FDI and sustain it after the completion of the projects initiated under the CPEC.

Introduction

The planning frameworks and discourse aimed atattracting foreign direct investment have to move beyond the traditional focus on the dual paradigm of security and extremism. Eventhough concerns regarding security and extremism have done to crowd-out foreign direct investment from the country, the presence of other controllable factors, mostly pertaining to policy and barriers to entry enacted by the government, have contributed to the lackluster performance in the growth of foreign direct investment, cannot be denied. And therefore, to hold security, extremism and political instability responsible for the entire decline and poor performance in attracting non-CPEC FDI would be a gross misrepresentation of the realities.

Also, to underscore the importance of non-CPEC FDI, one needs to begin by understandingCPEC itself in its entirety. Especially, from a public financial management perspective when a lot of confusion is found regarding whether the financial inflows under the CPEC are Chinese loans or FDI. The government of Pakistan hasn't done much to provide any clarity on what is the type and nature of the financial inflows and how should they be reflected in the national and sub-national budgetary systems and fiscal accounts. If they are to be treated as loans, governmental plans and financial projections on how and when these loans mature and have to be repaid need to be disclosed under the budgetary disclosures of the government and if they are purely FDI, which is the impression that government has implicitly provided until now and what this brief assumes it is, then policies and programs to best channel the FDI need to be enacted at the very least.

Treating it as FDI not only signifies the importance of the CPEC itself but also epitomizes non-CPEC FDI from the perspective that the largesse of the CPEC FDI, that can be transformative but in reality is just FDI channeled under a group of projects each of whom have a certain completion date and are neither continuous nor sustainable in the very long-run, can do to undermine and overshadow non-CPEC FDI which can thus be conveniently ignored. This can prove to be fatal for the Pakistan economy given the situation where CPEC FDI continues till the completion of the CPEC projects, say 2025, but when it ends, foreign investors do not see much

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of a reason nor impetus to invest in Pakistan. And therefore, the bigger question is that while CPEC itself and the FDI inflows under its auspices are large enough to encourageinvestment, does it have the complementarity to encourage and sustain non-CPEC FDI after its own completion. Will the sectors that are being developed under the CPEC sustain themselves and attract foreign investors post-completion of the CPEC?

According to estimates provided by an infographic produced by BIPP[2], Pakistan's economy is the 23rd largest in the world in terms of GDP growth and 26th in terms of purchasing power parity[3]. It has a dynamic market and a vast purchaser base of more than 200 million people to attract foreign investors. The Government has provided a package of incentives e.g., formation of exclusive economic zones; co-production and joint ventures; 100% foreign equity for foreign investors; repatriation of profits and dividends; attractive concessions and tax exemptions; one-window operation at the Board of Investment, etc. to facilitate and encourage private investment and business activity. According to one study, Pakistan will become the 20th largest economy by 2030 and 16th by 2050. However, corruption, financial aberrations, fiscal indiscipline, poor tax regime and governance dysfunctions continue to be the major challenges and, if not addressed urgently, will frustrate the realization of accelerated economic growth and sustainable development and could instead lead to the financial insolvency of the country. Given this situation, the reliance on CPEC only to bolster FDI would create an air of vulnerability around the economic plans and ambitions of the government.

Situation Analysis: Non-CPEC Foreign Direct Investment

The causal analysis of the decline in non-CPEC FDI from Pakistan which has declined around 45% in the period July-November 2016-17 over the same period in 2015-16 reveals that security and extremism, two factors that have been commonly cited as the drivers of negative growth in FDI assume little importance in light of the country's FDI growth during the military dictatorial period from 2000 to 2007[4]. Pakistan's active engagement in the global war on terror and the political economy of FDI during this time meant that if security concerns were so highly correlated with FDI, the country's FDI would have been the lowest during these seven years. However, data reveals that the FDI surged exponentially during these reaching a peak of $5.4 Billion (this high trend was linked with war on terror and these investments were made by coalition partners to mitigate terrorism) in the financial year 2007-2008 following which a period of decline started. The country's FDI was recorded at $824 million in the financial year 2012.

Therefore, while security concerns cannot be ignored as possible contributors to the crowding-out of non-CPEC FDI, the following matrix includes potential inhibiting factors alongside the intensity and scale of each to provide policy-makers in the country a tool to base their future policy decisions on while also enabling the government and private sector organizations to build their capacity in areas of strength where, after the successful removal of inhibitions, the country can make progress and become a serial puller of foreign investment.

The functionality of the matrix is that like a policy analysis tool (template) that policy- makers can populate in context of the available data/information applicable to each of the vertical and horizontal dimensions of the matrix. The intensity of risk can be quantified if data on sensitivities to certain occurrences is available or otherwise can be rated using a low-medium-

[2] See BIPP Infographic "Pakistan's Debt Profile" IG-02-17. Link: http://www.sjbipp.org/publications/IG/IG-02-17.pdf
[3] These estimates are provided by the World Bank.
[4] Ibid, p.1

high likelihood scale. The scale of risk can be determined using something like a small-medium-large rating method.

Table.1: Non-CPEC FDI Risk Analysis Matrix:

Contributory Factor	ScaleofRisk	Intensity of Risk	Mitigating Factor	Policy
Energy and Infrastructural Deficiencies				
Institutional Void				
MisGovernance				
Protectionist Policies: Presence of Tariffs and Quotas				
Capacity Deficits				
Security and Extremism: International Perception				
PresenceofCPEC				

How to attract Foreign Direct Investment?

An investment policy was introduced by the Board of Investment (BOI) to attract new investors in 2013. The idea was to take FDI stock 20% of the GDP by attracting $2 million in 2013, $2.5 billion in 2014, $ 2.75 in 2015, $ 3.25 in 2016 and $ 4 billion in 2017 through decreasing the cost of working together. Inspite of the claims, in financial year 2013-2014,the government could not accomplish its target.

According to Abbas (2015), the data points out that since 2007 more than half of the FDI inflows have been in two sectors; oil and gas and telecommunications. In IT sector the government needs to introduce policies in order to diversify its FDI inflows in other sectors as well. The government should focus on the stable macroeconomic policies and better law and order situation in the country to attract the foreign investors. Discontinuation of the ongoing policies with every changing government is discouraging for foreign investors which portraits Pakistan as an unstable economy, so it should be put into consideration. As Gulf countries are budget surplus so the government should focus on this specific region for FDI inflows.

The federal and provincial governments and private sector organizations should collaborate to form an inclusive framework to resolve the evolving FDI crisis in Pakistan. While there is growing interest in the oil and gas sector of Pakistan that is considered to have a huge growth potential, the decline in investor interest and confidence in sectors like telecommunications is of serious concern. The government needs to revive the investor confidence through program, projects and incentive structures that can rebuild the investor confidence in the Pakistani markets. While the traditional markets that have contributed to the country's growth in the last decade or so must be promoted to harness their full potential, the high growth and low cost industries and product categories must also be promoted simultaneously to create and promote a modern image of the Pakistan economy. Such entrepreneurial tendencies need to be supported by effective institutional, technical and economic frameworks supported by the collaboration of the government and private sector.

Industries and product categories that the country has competitive advantage in, apart from textiles and cotton, need to be explored and advanced through effective policy-making and promotion at the federal and provincial level. Industries like cement and commodities like sugar need to be promoted as high growth and high value commodities that can provide safe and secure opportunities for high profit earning for foreign investors.

The Board of Investment's (BOI) policy, 2013[5] that outlines a conceptual framework for cooperation of economic sectors for mobilizing the private investment, both domestic and foreign, provides targets and strategic solutions to the foreign direct investment problems of Pakistan. Amongst others, creation of one window, public-private sector dialogue, development of special economic zones and coordination with stakeholder ministries to realize 7%-8% growth target.

Conclusion

Pakistan improved 5 places in the Ease of Doing Business rank last year when it climbed up to the 144th position from 148th in 2015. However, with political concerns pertaining to charges of corruption on the ruling Muslim League, ouster of the Prime Minister in July and political instability that has resulted as a consequence of the turmoil, the ease of doing business position of Pakistan has suffered a 3 position decline to 147th as reported by the doing business report of the World Bank released in the last week of October, 2017.

Unless political stability which is a function of security too amongst a host of other factors like removal of barriers to entry like lack of government facilitation and support to international investors, tariffs and quotas, protectionism and nationalization of local produce, is achieved in the country, Pakistan's FDI situation is unlikely to improve. And since FDI is a key contributor to the foreign exchange reserves, the desired macroeconomic stability, especially in context of the recent loan repayments to the IMF and the government's resolve to not draw any further loans from the institution, is more even more dependent on the non-CPEC FDI.

One direction for the government to look towards is to enact policies and find ways it can bolster non-CPEC FDI and not allow the promise of the CPEC to overshadow and undermine the foreign direct investment that could channel into sectors of the economy or regions of the country that are configured as parts of the CPEC plans. Also, a greater reliance on the CPEC for attracting foreign direct investment disallows planning for post-CPEC period and opens the gates for significant FDI decline as and when the CPEC matures and nears its completion.

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[5] The Investment Policy was released by the Federal Board of Investment of the Government of Pakistan in 2013.