

Foreign Direct Investment in Pakistan: Policies and Trends

ASHFAQUE H. KHAN

Recent years have seen a sharp change in the attitude of developing countries regarding Foreign Direct Investment (FDI). The growing balance-of-payments difficulties as well as the decline in concessional aid have forced many developing countries to reassess their stances on FDI and to take substantial unilateral steps to liberalise their inward FDI regimes. In spite of liberalising the inward FDI regime, tempering or removal of obstacles to foreign investors, and according liberal incentives, Pakistan's has been a lacklustre performance in attracting FDI. This paper attempts to find out the reasons why Pakistan has not been able to attract sufficiently large FDI despite liberalisation measures.

The analysis identifies a number of factors responsible for low FDI in Pakistan. These include the lack of political stability particularly during the last eight years, and unsatisfactory law and order situation particularly in the city of Karachi, the largest industrial and commercial centre and the only port of the country. The macroeconomic imbalances and the slowing down of economic activity together with inconsistent economic policies have also discouraged foreign investors to increase their participation in Pakistan. The slow bureaucratic process, inappropriate business environment, and inadequate infrastructure facilities have played their role in discouraging foreign investors to undertake investment initiative in Pakistan. The lack of trained, educated, and disciplined labour force, along with complicated and overprotective labour laws, have inhibited business expansion and frightened away productive investment. The cultural and social taboos as well as the quality of life are not conducive to attracting foreign investors to Pakistan. The lack of welcome to foreign investors by government agencies and officials has also been a problem.

I. INTRODUCTION

In recent years many developing countries have increasingly turned to foreign direct investment (FDI) as a source of the capital, technology, managerial skills, and market access needed for sustained economic growth and development. The move towards more open FDI regimes has been accompanied by a shift in many countries towards greater deregulation of economic activity and greater reliance on market forces in their domestic as well as external economies. The growing balance-of-payment difficulties as well as decline in concessional aid have forced many developing countries to reassess their stances on FDI and have taken substantial

Ashfaq H. Khan is Joint Director at the Pakistan Institute of Development Economics, Islamabad.

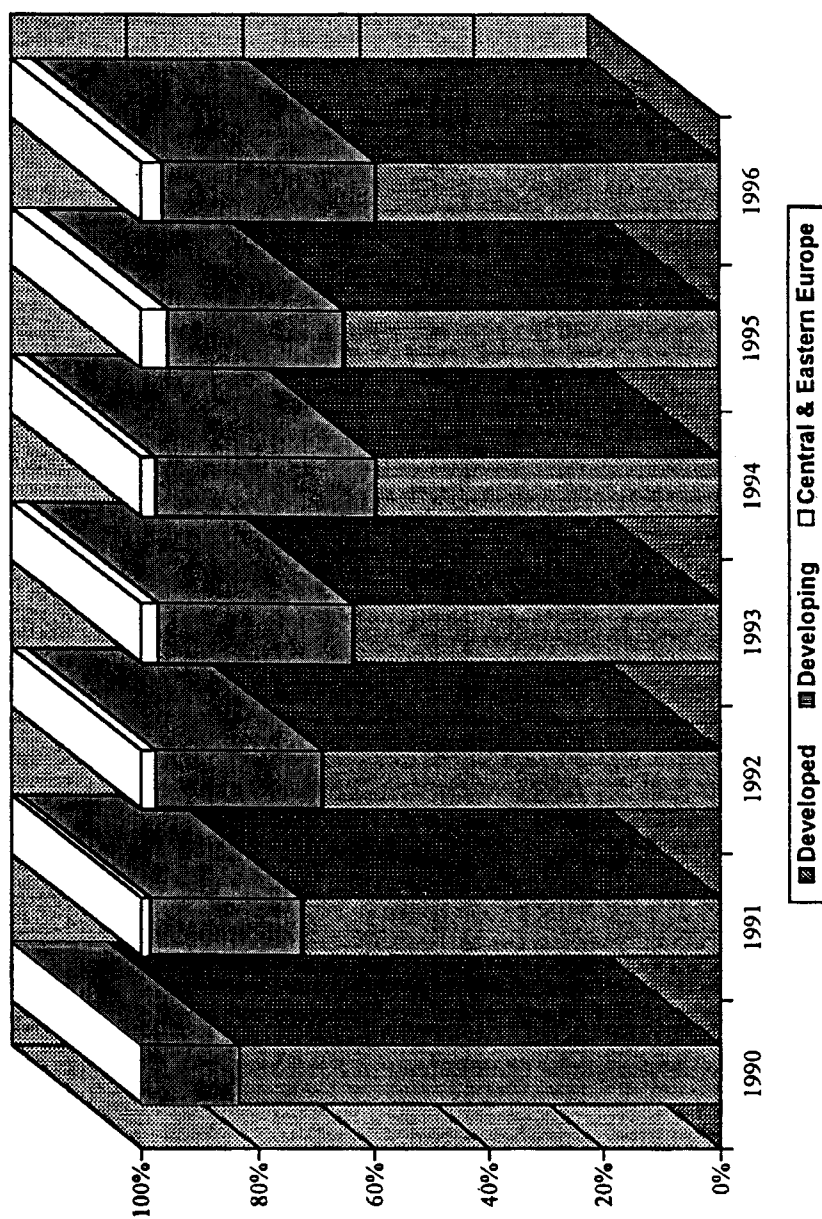
Author's Note: This paper is an updated version of a part of a larger study on this topic completed by me, with the financial support of the Asian Development Bank, Manila.

unilateral steps to liberalise their inward FDI regimes. Liberalisation included tempering or removal of obstacles to foreign investors, the establishment of standards for their treatment, and the increased use of incentives to attract FDI. Many have also adopted or agreed to general standards of treatment and provided a specific guarantees in key areas such as the transfer of funds, expropriation and dispute settlement.

Total capital flows in 1996 amounted to \$ 349.2 billion, rising from \$ 203.8 billion in 1990, thereby registering an annual average growth rate of 11.0 percent (See Table 1). The year 1995 has been an extra-ordinary year as total capital flows increased by 32.6 percent. The boom that began in 1995 continued, with inflows registering a growth of 10.3 percent in 1996—rising from 316.5 billion in 1995 to a new record of almost \$349 billion in 1996. Although developed countries received a record \$208 billion in FDI flows in 1996, there has been a steady decline in their share of global inflows since 1990. The share declined from 83.3 percent in 1990 to 59.6 percent in 1996 (See Fig.1). Such a rapid decline can be attributed to the increasing attractiveness of developing countries, especially those that are growing rapidly and have large domestic markets.

The developing countries have succeeded in attracting growing investment flows, reaching almost \$128.7 billion in 1996 to account for 37 percent of world FDI flows (See Table 1). This is a continuation of a trend that began in 1990 and has propelled developing countries to become a major force in world FDI. Rising from \$34 billion in 1990 the inflow of FDI reached \$128.7 billion in 1996, thus registering an annual average growth rate of 25.6 percent. Most importantly, the share of developing countries in total capital flows more than doubled in just six years. Hence, the current boom in investment flows to developing countries is a reflection of sustained economic growth and continuing liberalisation and privatisation in these countries, as well as the increasing integration of the developing countries into the investment plans of transnational corporations (TNCs). However, to a large extent, the successive annual increments to FDI flows in developing countries reflect the growing attractiveness of a single country, China. With some 33 percent of the total inflows to developing countries, China was the second largest recipient of FDI flows world-wide in 1996 after the United States. The success can be attributed to China's large and growing domestic market and its macroeconomic reforms [UNCTAD 1997]. The inflows into developing countries other than China rose by an average rate of almost 20.0 percent per annum during 1990-96. The Asian countries have strengthened their role as the largest developing-country FDI recipient region, with an estimated \$84 billion of inflows in 1996 (an average increase of 26.7 percent per annum during 1990-96), accounting for 65.5 percent of total developing-country FDI inflows and 24 percent of world FDI inflows. The success of the Asian countries in attracting FDI lies in an investment climate characterised by growing markets and increasingly favourable regulatory frameworks [UNCTAD (1995)].

Fig. 1. Inflow of Foreign Direct Investment: A Comparison



Although the South Asian countries have lagged behind considerably as compared with East and South-East Asian countries (they received an estimated \$81 billion in 1996) they have, nevertheless, made significant improvement in attracting FDI. In six years (1990–96) the inflows has grown by more than eight times, rising from \$464 million to \$3.46 billion [See Table 1].

Table 1
Inflow of Foreign Direct Investment: A Comparison

	(Million \$)						
	1990	1991	1992	1993	1994	1995	1996
Total Inflow	203812	158936	173761	218094	238738	316524	349227
Developed Countries	169777	114792	119692	138762	142395	205876	208226
(as % of Total Inflows)	(83.3)	(72.2)	(68.9)	(63.6)	(59.6)	(65.0)	(59.6)
Developing Countries	33735	41696	49625	73045	90462	96330	128741
(as % of Total Inflows)	(16.5)	(26.2)	(28.5)	(33.5)	(37.9)	(30.4)	(36.9)
Central and Eastern Europe	300	2448	4444	6287	5882	14317	12261
(as % of Total Inflows)	(0.15)	(1.5)	(2.5)	(2.9)	(2.5)	(4.5)	(3.5)
Developing Countries							
Minus China	30248	37330	38469	45530	56675	60481	86441
(as % of Total Inflows)	(14.8)	(23.5)	(22.1)	(20.9)	(23.7)	(19.1)	(24.7)
China	3487	4366	11156	27515	33787	35849	42300
	(10.3) ^b	(10.5) ^b	(22.5) ^b	(37.7) ^b	(37.3) ^b	(37.2) ^b	(32.8) ^b
	22122	23129	29632	50924	57507	65249	84283
Asia	(10.8) ^a	(14.5) ^a	(17.0) ^a	(23.3) ^a	(24.1) ^a	(20.6) ^a	(24.1) ^a
	464	463	696	1034	1411	2638	3461
South Asia	(0.2) ^a	(0.3) ^a	(0.4) ^a	(0.5) ^a	(0.6) ^a	(0.8) ^a	(1.0) ^a
Pakistan	244	257	335	357	419	639	690
	(0.12) ^a	(0.2) ^a	(0.18) ^a	(0.17) ^a	(0.19) ^a	(0.2) ^a	(0.2) ^a
	(0.73) ^b	(0.62) ^b	(0.67) ^b	(0.49) ^b	(0.46) ^b	(0.6) ^b	(0.53) ^b
	(1.1) ^c	(1.1) ^c	(1.13) ^c	(0.7) ^c	(0.73) ^c	(0.98) ^c	(0.82) ^c
	(52.6) ^d	(55.5) ^d	(48.1) ^d	(34.5) ^d	(29.7) ^d	(24.2) ^d	(19.9) ^d

Source: *World Investment Report 1997*, Annex Table B.1, pp. 303, UNCTAD, UN, New York and Geneva 1997.

a. as% of total inflows, b. as% developing countries; c.as% of Asia; d.as% of South Asia.

The last two years (1995, 1996) have been exceptionally good years for South Asia as inflows of FDI increased by 87 percent and 31 percent, respectively. Such impressive growth has mainly been the result of growing attractiveness of India to foreign investors. As against the doubling of FDI in Pakistan during 1993–96, the inflows in India increased by five times during the same period.

Viewed against the developments of East and South-East Asian countries, Pakistan stands nowhere in attracting FDI. In 1996 Pakistan accounted for 0.2 percent of World FDI, less than one percent of developing-country and Asian-country FDI, and 20 percent of South Asian countries' FDI. In spite of liberalising inward FDI regime, tempering or removal of obstacles to foreign investors and according liberal incentives, Pakistan's performance in attracting FDI has been lacklustre, at best. Why Pakistan could not succeed in attracting sufficiently large FDI despite liberalising its payments and exchange regime as well as inward FDI regime? The present paper makes an attempt to find out the answer.

A country's success or otherwise, in attracting FDI depend crucially on the enabling environment it creates for foreign investors with the help of investment policy. Hence, it is pertinent to begin the study by reviewing various investment policies given by the respective governments over the last 50 years. The success of the investment policies can be judged by the size of the inflows of the FDI. In the next section the trends in FDI is presented. Here, attempt is made to analyse the performance of the FDI by origin, sector, and structure. The inflow of FDI in Pakistan has been lacklustre, at best, when compared against the performance of the East and South-East Asian nations. Why Pakistan could not attract FDI of comparable magnitude of the East and South-East Asian countries? Attempt is made to answer this question in Section IV. Concluding remarks along with policy suggestions are presented in the final section.

II. REVIEW OF FDI POLICY

The policies of host countries have an important influence on foreign investment decisions. Host countries can adopt policies of stimulating foreign investment or they can restrict foreign participation in their economies in various ways.

Pakistan inherited an agricultural economy on independence in 1947. The industrial capacity was negligible for processing the locally produced agricultural raw material. This made it imperative for succeeding governments to attend to the need of creating manufacturing capacity in the country. In order to achieve this objective, the industrial policies were laid down from time to time with various combinations and mixes of public and private sectors.

Private sector was the main vehicle for industrial investment during the 1950s and 1960s and the involvement of the public sector was restricted to 3 out of 27 basic

industries.¹ By the late 1960s the economy was largely dominated by the private sector in important areas like banking, insurance, certain basic industries and international trade in major commodities.² Interestingly, the services sector was reserved for local investors and foreign investment was not allowed in the field of banking, insurance and commerce. This policy was, however, liberalised and foreign banks were allowed to open branches in Pakistan [Zaheer (1996)].

The pendulum swung to other extreme in the 1970s when government resorted to large-scale nationalisation of industries, commercial banks, development financial institutions, and insurance companies which shattered private sectors' confidence. The status of the public sector was upgraded from catalyst and gap filler to a dominant player in the economy. All foreign investment was, however, exempted from the purview of nationalisation.

After the dismal performance of industrial sector following the 1972 nationalisation, a change occurred in government's approach towards the role of public and private sector in September 1978. The role of public sector was restricted to consolidating the existing enterprises and further investment in this sector was strictly restricted. Nevertheless, industries like steel, fertiliser, cement, petroleum refining and petrochemicals, automotive equipment, and engineering remained in the realm of public sector. The private sector was, however, permitted to participate in these fields as well.

The industrial policy statement of 1984 not only accorded equal importance to public and private sectors but also encouraged private sector to come forward but the process of privatisation was not initiated. Had this been initiated, Pakistan would have attracted considerable amount of foreign direct investment.³ The public sector retained its role in major industrial areas which obviously discouraged the inflows of FDI.⁴

The procedure for grant of permission for setting up an industry was somewhat restrictive. Clearance of the Central Investment Promotion Committee and approval of the Federal Government were required for the following categories of projects.

¹The three basic industries were (i) arms and ammunition; (ii) generation of hydro-electric power; and (iii) manufacturing of railway wagons, telephones, telegraphs and wireless apparatus.

²For a detailed discussion on early period's industrialisation, see Naseem (1981).

³It was an ideal condition to initiate the privatisation process to attract FDI because the economic fundamentals were strong. For example, during the first half of the 1980s (1980-81-1984-85) the real GDP grew at an average rate of 6.7 percent per annum (p.a), manufacturing by 9.5 percent p.a, investment and saving rates averaged 17.2 percent and 14.0 percent respectively, rate of inflation averaged 7.8 percent, budget deficit as percentage of GDP averaged 6.3 percent while current account deficit as percentage of GDP averaged 3.8 percent. Beside strong economic fundamentals there was no serious law and order problem in the major growth poles of the country. And above all, notwithstanding military dictatorship, there was political stability in the country. After all many countries in East Asia grew at a much faster rate and succeeded in attracting FDI under the leadership of military dictator.

⁴FDI through privatisation accounted for 14 percent and 67 percent of total FDI inflows into Latin American and the Caribbean and Central and Eastern Europe, respectively. For a detailed discussion on this, see UNCTAD (1994).

- (i) Industries specified for reasons of over-capacity, price regulation, and implementation of a programme of assembly-cum-manufacture requiring indigenisation of the manufacture of components or projects of major national importance or for religion, security or socio-economic objectives.
- (ii) Projects involving foreign private investment.
- (iii) Large project costing Rs300 million and above.
- (iv) Projects requiring cash foreign exchange of more than Rs 50 million for plant and machinery.
- (v) Projects involving imports of second hand machinery.
- (vi) Projects in which more than 60 percent of the raw material was importable provided the value of each import exceeded 20 percent of the total investment in fixed assets.

Clearance and approval were required for both local and foreign investors. Foreign private investment was nevertheless, encouraged in the form of joint equity participation with local investors and in the areas where advanced technology, managerial and technical skill and marketing expertise were involved. Foreign investment was also encouraged in industrial projects involving advanced technology and heavy capital outlay like engineering, basic chemicals, petrochemicals, electronics and other capital goods industries.

In order to encourage FDI in export-oriented industries, an Export Processing Zone (EPZ) was set up in Karachi. Apart from foreign investors, overseas Pakistanis were also encouraged to invest in industrial projects in the EPZ on the basis of non-repatriable investment. The concessions and facilities offered by the EPZ included duty free import and export of goods, tax exemption, etc. The foreign investment was also entitled to the facilities such as foreign nationals employed in Pakistan were permitted to send monthly remittances to the country of their domicile up to 50 percent of net income, and foreign nationals on returning from Pakistan were permitted to transfer their savings.

Adequate legal framework for foreign investment was provided in the form of Foreign Private Investment (promotion and protection) Act, 1976 and the Protection of Economic Reforms Act, 1992. These Acts provide for security against expropriation and adequate compensation for acquisition. These Acts also guaranteed the remittance of profit and capital, remittance of appreciation of capital investment and relief from double taxation in cases of those countries with which Pakistan has agreement for Avoidance of Double Taxation.

Despite these incentives, the highly regulated nature of Pakistan's economy proved a deterrent to the inflows of the FDI. Specially the following elements discouraged foreign investment.

- (i) A highly regulated economy with public ownership, industrial licensing, and price controls.
- (ii) An inefficient financial sector with mostly public ownership, directed, credits and segmented markets.
- (iii) A non-competitive and distorting trade regime, with import licensing, bans, and high tariffs.

Pakistan began to implement a more liberal foreign investment policy as part of its overall economic reform programme during the end of the 1980s. Based on the primary of the private sector a *new industrial policy package* was introduced in 1989. A number of policy and regulatory measures were taken to improve the business environment in general and attract FDI in particular. A Board of Investment (BOI), attached to the Prime Minister's Secretariat, was established to attract FDI. A 'one-window' facility was established to overcome difficulties in setting up new industries. The new industrial package opened up virtually all Pakistan's industrial sectors to foreign investment. The requirement for *government approval* of foreign investment was removed with the exception of few industries such as arms and ammunition, security printing, currency and mint, high explosives, radioactive substances, and alcoholic beverages (in fact, these industries were also closed for domestic private investors). In all industrial sectors, other than those indicated above, foreign equity participation of up to 100 percent was allowed and that foreign investors were also allowed to purchase equity in existing industrial companies on a repatriable basis. There was also no requirement of having local partners. *Foreign investment was however, excluded from agricultural land, forestry, irrigation, real estate including land, housing and commercial activities (UNCTAD 1994).*

All the investors, whether domestic or foreign, were required to obtain No Objection Certificate (NOC) from the relevant provincial government for location of the project. Thus, the physical location of the investment was effectively controlled by the provincial government which was considered a major bottleneck in speedy industrialisation. At present, an NOC is only required if foreign investment is envisaged in the areas which are in the *negative list* of the relevant provincial government. According to the authorities, there are only a small number of areas which are on the *negative list* of the provincial governments.

The foreign investors in the past were not free to negotiate the terms and conditions of payment of royalty and technical fee suited to the requirements of foreign collaborators for transferring technology. Later this restriction was removed and the investors were allowed to negotiate the terms of conditions as suited to them as well as acceptable to the multinationals wishing to transfer the requisite technology.

The Government has been stressing the need for attaining self-reliance in the engineering and technical industries since 1960. In this regard a *deletion policy* with reward and penalty was prepared by the government to encourage and boost

indigenisation with a view to ensure transfer of technology. The Deletion Committee of the Engineering Development Board (EDB) monitors the progress to see whether the deletion policy is being followed properly. However, the requirements are not rigidly followed by the industrial units and the EDB usually maintained a lenient attitude towards the defaulting industries giving them chance to improve their performance in the future. *In fact, the reward and penalty system in deletion policy has never worked in reality.*

One of the most important measures taken by the Government affecting the flow of FDI has been the liberalisation of the *foreign exchange regime*. Residents and non-resident Pakistanis and foreigners are now allowed to bring in, possess and take out foreign currency, and to open accounts and hold certificates on foreign currency. Foreigners using foreign exchange have now access to the capital market. Remittance of principal and dividends from FDI and from portfolio investment made by foreign and non-resident Pakistani investors are allowed without prior permission or clearance from the State Bank of Pakistan (SBP). In order to further liberalise foreign exchange regime, Pakistani rupee has been made convertible with effect from July 1, 1994. The ceiling and caps earlier imposed on contracting of foreign loans have been abolished. Foreign currency account holders are now also allowed to obtain rupee loans on the collateral of foreign currency account balance. Foreign investors are not subjected to more taxation on income than those applicable to investment made in similar circumstances by the domestic investors. They also get relief from double taxation in case Pakistan has signed agreement with investors countries' of origin.

The Government has also enacted an extensive set of investment incentives including credit facilities, fiscal incentives and visa policy.⁵ Import policy has also been liberalised considerably, the maximum tariff rate has been reduced from 225 percent in 1986-87 to 45 percent in 1996-97. A large number of quantitative restrictions and non-tariff barriers have also been removed. Debt-equity ratio for all industrial units has been fixed at 70:30 instead of 60:40 in case of projects based on imported machinery. For some projects like power sector projects, the debt-equity ratio has been fixed at 80:20. Special industrial zones (SIZs) with massive fiscal incentives have been set up to attract foreign investment in export-oriented industries.

Notwithstanding significant deregulation and various incentives/concessions given to foreign investors, Pakistan still faces serious problems as far as implementation of foreign investment policies are concerned. There is a strong perception among foreign investors that the pro-business policies and inducement used to attract prospective new investors are somehow lost in the

⁵For a detailed discussion on these incentives, see Khan (n.d.).

reality they encounter when they actually begin to set up and operate their business in Pakistan.⁶

The investment approval requirement has been removed but other regulations instituting the need for other administrative approvals, however, are still in place. As a routine matter, foreign companies are required to register with the Corporate Law Authority. Theoretically, this should be a simple procedure under the Companies Ordinance, 1984 but, in practice long delays occur between filing of documents and its incorporation.⁷ Numerous permits and clearances from different government agencies at national, regional and local levels still apply to investors.

Incentives/concessions to foreign investment apart, private investors continue to face a plethora of federal, provincial, and local taxes and regulations. Beside paying a wide range of taxes these firms have to deal with a large number of agencies and required to fill too many forms. Foreign firms operating in Pakistan are currently facing cash flow problem as a result of plethora of taxes. Foreign investors in Pakistan have also to cope with a complex legal situation. Uncertainty is exacerbated by the practice of issuing Special Regulatory Orders (SROs) which can amend or alter existing laws, instead of adapting the law as a whole to new circumstances and policies. The legal situation is even further complicated by the fact that government agencies are empowered to introduce certain changes through administrative orders. This is not only a major source of impediment in setting up new project by local and foreign investors but also causing, according to one estimate, Rs 60 billion loss to national exchequer per annum.

In the background of these difficulties, a new investment policy of 1997 has been announced only recently.⁸ The highlights of the Investment Policy 1997 are as follows:

- (i) Previously only manufacturing sector was open to foreign investors. Now agriculture, services/infrastructure, and social sectors are open for foreign investment on repatriable basis.
- (ii) Manufacturing sector has been prioritised in four categories, namely, (a) value added or export industries, (b) high-tech, (c) priority industries, (d) agro-based industries. The units which export 80 percent or more of their products in any one year or have minimum value addition of 40 percent of production value is treated as value added or export industries

⁶In his speech to Rotary Club of Islamabad Cosmopolitan on May 16, 1996 the United States Ambassador, Thomas W. Simons, Jr., narrated the experience of a foreign investor who faced enormous problem in setting up a plant in Pakistan. The problems included the inefficiencies of the 'One-Window Operation', various administrative delays, unceremonious withdrawal of tariff concessions, the high-handedness of labour inspectors, and unjust corporate taxation (Before the firm ever entered production or earned a single rupee, it received a corporate tax bill from tax authorities). For further details, see USIS (1996). Similar sentiment was expressed by the visiting investors, who stated that bureaucracy in Pakistan was impeding foreign investment. See *Business Recorder* and *The Nation*, dated November 30, 1997.

⁷See Kim *et al.* (1997).

⁸The details of the Investment Policy 1997 are documented in BOI (1997).

respectively. High-tech industries include information technology, solar technology, aerospace, defence production, etc. Priority industries include engineering/capital goods industries, chemicals, and others. Agro-based industries include production of quality/hybrid seeds, edible oil extracting/refining, livestock/poultry feeds, milk processing, etc.

- (iii) A National Industrial Zones (NIZs) will be established at a few selected prime sites.
- (iv) Same Labour Laws will apply in the NIZs as are applicable in the existing Export Processing Zone.
- (v) Visa policy has been considerably relaxed as compared to the past.
- (vi) To improve working relations among the employers and employees and to increase the productivity, Labour Laws have been revised. The contract labour system will be encouraged for the industries to improve work force and to be competitive in the world market. The right to replace unwilling workers has been given. Outside trade union activity under ILO Agreement will be trade based and not factory based. To check the growth of trade unions, those unions receiving less than 20 percent votes in referendum will stand dissolved automatically and their registration will be cancelled.
- (vii) At the moment there are 24 different taxes which are levied by the Federal and Provincial Governments and the Local Authorities. These taxes have been rationalised and reduced to 5.
- (viii) To improve the physical infrastructure an investment of about Rs 100 billion is being earmarked to upgrade the existing roads, and construction of new highways and motorways.

Like all the previous Investment Policies, the present one is also highly incentive oriented with the exception that it opens agriculture and services sectors to foreign investors, relaxes visa policy, reduces multiplicity of taxes, and revises Labour Laws so as to improve working relations between employers and employees.

III. TRENDS IN FOREIGN DIRECT INVESTMENT

The success of FDI policies can be judged by the size of the inflows of capital. Pakistan has been making efforts to attract FDI and such efforts have been intensified with the advent of deregulation, privatisation and liberalisation policies initiated at the fag end of the 1980s. Table 2 documents the size of the inflow of foreign investment in Pakistan during the last two decades. Foreign investment rose from a tiny \$10.7 million in 1976-77 to \$ 949.5 million in 1996-97, thus growing at the annual compound growth rate of 23.8 percent. With the beginning of the overall liberalisation programme (1991-92 onwards) the inflow of foreign investment grew at the compound growth rate of 9.4 percent p.a. Investment inflows in 1995-96 increased by 93.3 percent mainly due to the inflow of investment in private power

Table 2
Inflow of Foreign Investment in Pakistan

Year	Direct	Portfolio	Total	(Million \$) As % of Total	
				Direct	Portfolio
1976-77	—	—	10.7	—	—
1977-78	—	—	35.5	—	—
1978-79	—	—	36.0	—	—
1979-80	—	—	28.2	—	—
1980-81	—	—	35.0	—	—
1981-82	—	—	98.0	—	—
1982-83	—	—	42.1	—	—
1983-84	—	—	48.0	—	—
1984-85	70.3	23.4	93.7	75.0	25.0
1985-86	145.2	16.0	161.2	90.0	10.0
1986-87	108.0	21.0	129.0	83.7	16.3
1987-88	162.2	10.5	172.7	93.9	6.1
1988-89	210.2	7.2	217.4	96.7	3.3
1989-90	216.2	-4.7	211.5	102.2	-2.2
1990-91	246.0	-9.0	237.0	103.8	-3.8
1991-92	335.1	218.5	553.6	60.5	39.5
1992-93	306.4	136.8	443.2	69.1	30.9
1993-94	354.1	288.6	642.7	55.1	44.9
1994-95	442.4	1089.9	1532.3	28.9	71.1
1994-95*	442.4	227.8	670.2	66.0	34.0
1995-96	1101.9	205.2	1306.9	84.3	15.7
1996-97	682.1	267.4	949.5	71.8	28.2

Source: State Bank of Pakistan.

Note: Direct Investment consists of cash, capital equipment brought-in, and reinvested earnings.

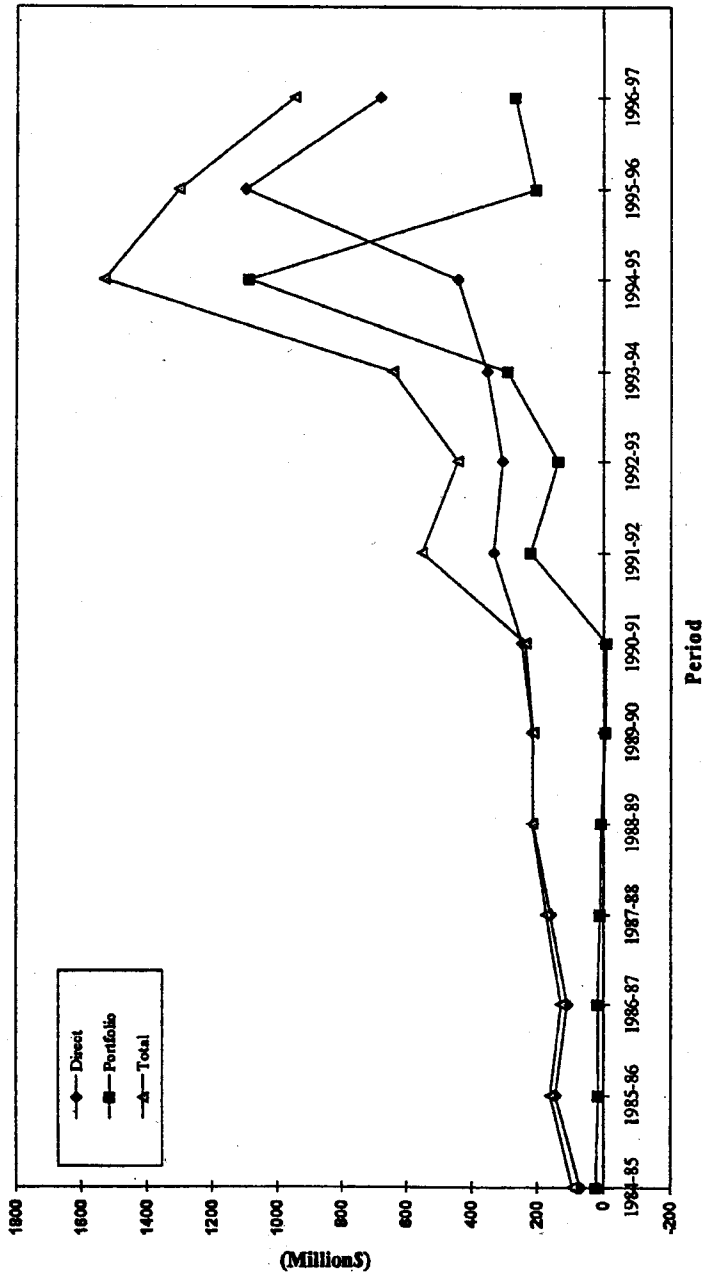
* = Excluding 862.2 million of PTC Vouchers.

project (See Figure 2). Although significant by absolute terms, the increase appears trivial when compared with the relatively more buoyant economies of East and South-East Asia. As stated at the outset, while FDI flows to all developing countries reached \$128.7 billion in 1996, East and South-East Asia region received the bulk of this share—an estimated \$81.2 billion.

Total foreign investment consists of direct and portfolio investment. Pakistan in recent years has witnessed spurt of investments made in the stock market, popularly known as portfolio investment. Prior to 1991-92, portfolio investment has not only been low but exhibited a fluctuating trend. However, with the beginning of liberalisation policies in 1991-92 portfolio investment crossed the \$1.0 billion mark in 1994-95. This impressive increase does not reflect the true picture of the trends in portfolio investment witnessed during the post-liberalisation period. If \$ 862.2 million sale of PTC vouchers which was a one time phenomenon, was excluded, the portfolio investment not only declined to \$ 227.8 million in 1994-95 but followed an average trend of \$ 224.0 million during 1991-92 to 1996-97 as against an average flows of only \$ 9.0 million prior to reform (1984-85 to 1990-91).⁹

⁹The State Bank of Pakistan publishes direct and portfolio investment separately from 1984-85 onwards.

Fig. 2. Inflow of Foreign Investment in Pakistan



The major component of the total foreign investment is the FDI which rose from \$ 70.3 million in 1984-85 to \$682.1 million in 1996-97, thus growing at the compound growth rate of 19.1 percent p.a. Since the beginning of the liberalisation programme (1991-92) the FDI has grown at the compound growth rate of 12.6 percent as opposed to pre-liberalisation period (1984-85–1990-91) when it grew at the compound growth rate of 19.6 percent p.a. In particular, the year 1995-96 registered a phenomenal growth of 149.1 percent mainly due to the inflow of FDI in the private power project. The FDI, on average, accounted for almost 78 percent of total inflows over the period 1984-85 to 1996-97 but this share has declined to 62 percent during the post-reform period. As stated above, the share of portfolio investment has increased considerably during the post-reform period as Pakistan succeeded in attracting, on average, \$224 million per annum.

The US has been the single largest source (32.6 percent) of FDI in Pakistan over the last 17 years followed by UK (14.3 percent), UAE (11.4 percent), Japan (5.7 percent), and Germany (5.2 percent) (See Table 3). During the post-reform period the shares of the US and the UK further rose to 41 percent and 16.2 percent respectively while those of UAE declined to 5.3 percent; and Japan and Germany remained more or less unchanged. Further focusing on the patterns of FDI by origin reveals that almost 60 percent of FDI came from three sources, namely, the US, the European Union (EU) and Japan. This share jumped to almost 72 percent during the post-reform era. It may be noted that Japan, which has emerged as a major investor globally, has invested an insignificant amount in Pakistan. As against an average of \$24.4 billion per annum during 1985-96 globally, Japan invested only \$24.4 million (or 0.1 percent) per annum in Pakistan during the same period.

FDI in Pakistan consists of three elements, namely, cash brought in, capital equipment brought in, and re-invested earnings. Over the last 15 years (1980–94), cash brought in has been the largest (56 percent) form of FDI followed by re-invested earnings (30 percent) and capital equipment brought in (14 percent). However, during the post-reform period (1991–94) the shares of cash brought in and reinvested earnings declined while that of capital equipment brought in increased (See Table 4).

It is important to note that the share of re-invested earnings in FDI has been declining since 1991—falling from 30.5 percent in 1991 to 11.9 percent in 1994 (See Table 4). There appears to be two reasons for such a rapid decline. Firstly, as a result of the liberalisation programme, the cost of production has gone up considerably and along with the plethora of taxes due to fiscal consideration, the after tax profit of foreign firms have declined. Consequently, the reinvested earnings which originate as savings from investment previously made, have slowed down. Secondly, as a result of liberalisation the entry barriers of foreign firms were removed which led to higher inflow of new investment. Consequently, the share of re-invested earnings in total FDI declined considerably after 1991.

Table 3
Shares of Inflow of FDI from Various Countries

Year	U.S.A.	U.K.	U.A.E.	Germany	France	Hong Kong	Italy	Japan	Saudi Arabia	Canada	Nether-lands	Others
1980-81	14.8	15.7	15.0	3.9	0.2	0.06	-0.15	0.68	0.16	0.30	1.71	47.6
1981-82	15.5	19.9	8.4	3.6	0.19	0.15	0.02	0.43	0.23	0.30	1.52	49.8
1982-83	11.6	16.9	10.0	3.3	0.23	0.06	0.01	0.50	2.6	0.23	3.34	51.3
1983-84	8.8	16.3	8.2	4.8	0.10	0.51	-	0.45	2.5	0.21	1.35	56.8
1984-85	24.5	12.7	16.9	9.1	1.71	0.85	0.14	9.53	5.4	0.43	9.71	9.1
1985-86	24.2	8.6	47.9	2.9	0.55	1.9	0.27	4.33	-5.0	-	0.89	13.5
1986-87	39.7	4.7	23.7	5.0	1.39	6.20	0.37	8.7	0.92	0.74	0.55	8.0
1987-88	28.2	15.7	15.0	11.3	3.08	3.39	0.67	8.38	0.55	0.62	0.25	12.8
1988-89	45.1	10.8	6.2	4.8	3.68	3.01	0.57	8.0	0.24	0.43	0.81	16.3
1989-90	43.4	10.5	7.3	5.2	2.77	0.42	1.75	7.45	0.51	0.42	2.45	17.8
1990-91	52.8	13.7	3.7	5.1	2.88	1.34	1.18	10.65	0.36	0.77	0.93	6.6
1991-92	63.7	6.1	3.1	6.4	2.53	-	0.59	5.28	0.03	0.90	0.24	11.1
1992-93	44.7	8.4	3.1	11.8	1.98	4.05	0.19	7.18	2.67	0.09	1.83	14.1
1993-94	32.2	9.0	2.1	2.6	3.13	0.34	0.08	8.38	0.54	0.34	-0.03	41.3
1994-95	39.9	8.7	10.6	4.0	3.05	0.49	0.06	3.68	0.20	0.09	1.02	28.2
1995-96	29.0	30.1	4.8	2.4	1.28	3.11	0.04	7.52	2.46	0.07	1.09	18.8
1996-97	36.1	35.2	8.0	2.6	1.50	1.10	0.26	5.36	-2.49	0.25	1.13	9.99

Source: State Bank of Pakistan.

Table 4
Inflow of Foreign Direct Investment by Type

Years	As % of Total Assets		
	Cash Brought in	Capital Equipment Brought in	Reinvested Earnings
1980	42.9	31.0	26.1
1981	57.2	19.2	23.4
1982	45.0	23.1	31.8
1983	73.3	2.9	23.8
1984	53.6	1.9	44.5
1985	65.1	1.4	33.4
1986	74.2	1.3	24.5
1987	47.9	1.0	51.1
1988	56.1	0.8	40.7
1989	52.7	16.1	31.1
1990	66.7	8.1	25.1
1991	63.5	5.9	30.5
1992	40.4	33.0	26.5
1993	64.7	11.6	23.7
1994	32.4	55.7	11.9
Average			
1980-94	55.7	14.2	30.1
1991-94	50.2	26.5	23.3

Source: State Bank of Pakistan.

Manufacturing, mining and quarrying, and commerce have traditionally dominated the preferences of the foreign investors during the last 15 years accounting for 83 percent of total inflow of FDI (See Table 5). Among the three

Table 5
Shares of Different Economic Groups in Total FDI

Year	(Percent)						
	Agriculture Forestry Hunting & Fishing	Mining & Quarrying	Manufac- turing	Construction	Utilities	Commerce	Transport, Storage & Communication Others
1980	-	24.6	74.6	1.3	-	1.8	0.5 2.8
1981	0.50	18.9	60.2	0.46	-	-3.8	1.3 22.4
1982	0.15	24.5	74.6	0.41	-	-1.1	0.3 1.1
1983	0.28	44.3	26.0	0.43	-	2.2	2.0 4.5
1984	0.27	4.3	54.7	0.15	-	29.4	2.1 9.1
1985	1.85	17.9	33.5	0.3	-	37.4	1.7 7.6
1986	0.40	27.8	26.4	0.01	0.05	37.3	3.6 4.4
1987	0.03	56.7	9.8	-	0.05	25.6	2.5 5.4
1988	-	48.8	11.7	-0.15	0.18	30.9	5.2 3.3
1989	1.18	55.1	8.6	9.04	-	19.5	4.7 1.9
1990	-	34.4	8.7	10.66	0.02	38.9	5.0 2.4
1991	-	45.5	16.2	5.18	0.07	33.2	-1.1 0.9
1992	-	4.1	11.9	36.31	9.59	34.4	-0.3 3.9
1993	-	9.8	11.1	17.38	0.01	61.1	0.2 0.3
1994	0.28	4.6	35.0	10.68	31.74	13.5	2.0 2.1
Average							
1980-94	0.33	28.1	30.9	6.1	2.8	24.3	2.0 4.4
1991-94	-	16.0	18.5	17.4	10.3	35.5	0.2 1.8

Source: Foreign Liabilities and Assets and Foreign Investment in Pakistan (Various Issues) State Bank of Pakistan.

sectors, almost 31 percent of FDI went to manufacturing followed by mining and quarrying (28 percent) and commerce (24 percent). A significant change in the composition of FDI was witnessed in the post-reform period. Manufacturing, and mining and quarrying suffered considerable decline while commerce, construction and utilities gained significantly. In fact, the share of utilities jumped from almost zero in 1993 to 32 percent in 1994 owing entirely to the inflow of FDI in the private power project with Hubco alone accounting for 92 percent.

IV. WHY LOW INFLOW OF FDI IN PAKISTAN?

The developing countries have experienced rapid growth in the flow of FDI in recent years. The inflow of FDI in Pakistan has however, remained far from encouraging despite numerous highly attractive incentives offered to foreign investors, particularly after the liberalisation programme initiated since 1991-92. Attractive incentives apart, Pakistan with a population of about 135 million offers a vast potential for the marketing of both consumer and durable goods. At the same time Pakistan with its geographical contiguity with the Central Asian Republics, also has the potential to serve as a gateway for foreign investors for extending their marketing activities into the countries of the region. By looking at the amount of FDI Pakistan has received in recent years it appears that the incentives and above-mentioned two factors have resulted in limited success. Why Pakistan could not attract FDI like those of China, Thailand, Malaysia, Hong Kong and Indonesia despite offering competitive incentives, geographical location and relatively large size of population? This section attempts to provide answers to this query.

The fundamental requirement which governs foreign investment revolves around ten main factors, these might be called the *ten checkpoints or ten commandments*. These factors are political stability; law and order situation; economic strength; government's economic policies; government bureaucracy; local business environment; infrastructure; quality of labour force; quality of life; and welcoming attitude.¹⁰ An attempt is made to consider the conditions that have prevailed in Pakistan with respect to above mentioned ten factors.

(i) Political Stability

This factor is essential to attract foreign direct investment because it creates confidence in the foreign investors.¹¹ In the absence of political stability there would be political turmoil which could wipe out overnight even the most lucrative investments and endanger the lives of personnel. Many investors have paid a heavy price for overlooking or ignoring this factor in other parts of the world [Jegathesan (1995)]. Lack of political stability has been the hallmark of Pakistan during the last

¹⁰See Shirouzu (1993).

¹¹See MIGA (1994).

eight years (1988–96). Three elected governments were dismissed on various charges while four caretaker regimes remained in power for 90 days each over the last eight years. Such a frequent change in government accompanied by abrupt changes in policies and programmes are hardly congenial for foreign investors.

(ii) Law and Order Situation

Unsatisfactory law and order situation keep the prospective foreign investors on the sidelines. Safety of capital and the security for the personnel engaged in the project are essential ingredients which govern foreign investment. Unfortunately, the law and order situation has remained far from satisfactory in the major growth poles of the country. Karachi, the largest industrial and commercial centres and the only commercial port of the country has remained disturbed in varying degree since 1989. In recent years the law and order situation has also deteriorated in the Punjab province. Notwithstanding attractive incentives offered to foreign investors this factor has discouraged them to set up their businesses in Pakistan.¹²

(iii) Economic Strength

Investors would not want to invest in a country where the economic fundamentals are so weak that it is unpredictable what the government would do next to shore up a sagging economy. A country that has sound economic fundamentals is not likely to make drastic or negative changes. The investor is assured of a growing economy, and of increased opportunities for business, as more government development projects and private sector investments put purchasing power in the hands of the people. Increased purchasing power means increased positive multiplier effects on the economy and a source for stability. Furthermore, foreign investors are unlikely to increase their participation in economies that are expected to remain affected by foreign exchange scarcities for several years into the future [UNCTC (1985)].

As compared with the decade of the 1980s Pakistan's macroeconomic imbalances has worsened in the 1990s, along with the slow down of economic activity. As against an annual average growth rate of 6.4 percent in the 1980s the real economic activity (GDP) has slowed down to an average of 4.7 percent during the first seven years of the 1990s. In particular, the large-scale manufacturing has slowed down to an average of 3.5 percent as against almost 8.0 percent during the 1980s.

¹²A report in the *Business Recorder*, March 26, 1996 quoting a member of the Japanese delegation which was entertained in the SITE Association of Pakistan, Karachi, as saying that "they were worried about the prevailing disturbed law and order situation in Karachi and that they also witnessed a strike in Karachi which in its wake paralysed the city's business activity". The Japanese delegation members also reportedly disclosed that they were instructed prior to their visit to Pakistan that they should refrain from freely moving about in Karachi. These impression of the visiting Japanese businessmen by and large, explain the reservations on the part of foreign investors.

Fiscal deficit averaged 6.9 percent of GDP, the rate of inflation remained in the double-digit level and current account deficit averaged above 5 percent of GDP during the first seven years of the 1990s. Thus, attractive incentives notwithstanding, the macroeconomic imbalances and slowing down of economic activity must have discouraged foreign investors to increase their participation in Pakistan.

(iv) Government's Economic Policies

Foreign investors (in fact, all investors) are concerned about government policies that could in one way or another affect business—trade and investment. In particular, the inconsistent economic policies discourage foreign investors in undertaking projects of medium-to-long-run duration. Pakistan's track record in maintaining consistent economic policies has been poor. The abrupt changes in policies with a change in government as well as a change in policy within the tenure of a government have been quite common in Pakistan. Pressures to raise revenues (for fiscal consideration), and other conflicting objectives, have led to inconsistencies in investment and industrialisation policies, and an *ad hoc* and changing incentive system. Revenue measures are not at all in harmony with the industrial policies. Several instances of change in policy stance in recent years can be identified which are well documented in Khan (n.d.).

(v) Government Bureaucracy

This could be the biggest 'burden' in any investment environment.¹³ It does not matter how efficient the government thinks its investment machinery is; what is critical is the perception of businessmen, especially those already in the country. Do businessmen feel that they have the support of government officials in their efforts to set up and operate efficient business units, or do they feel that they have to 'fight' the government to get projects off the ground? The general perception of businessmen in Pakistan is that there exist a large gap between the policies and their implementation [Shirouzu (1993)]. The implementation of policies has been slow and the bureaucracy has not responded to the initiatives with conviction.¹⁴ Such perception about the slow implementation of policies is not at all conducive to attract FDI in Pakistan.

(vi) Local Business Environment

This covers many factors, including the availability of local lawyers, secretarial service, accountants, architects and building contractors, local consultants etc.—all required both before and during the life of a project. Also, there is the question of the availability of ancillary and supporting industries, their quality, and

¹³See footnote No. 6.

¹⁴See letter from the Secretary-General, Overseas Investors Chamber of Commerce and Industry to Mr. Lee Kuan Yew, Senior Minister Government of Singapore, dated April 21, 1992.

their cost. Another question would be the availability of suitable joint-venture partners, and whether there are lists of potential partners that the investors can choose from. But most importantly, foreign investor need to know if local businessmen are investing in their own country. A satisfied foreign investor, operating an efficient, growing enterprise and re-investing in that country is the best testimony to the country's "investor-friendly" environment.

The business environment in Pakistan has fluctuated from one government to another. The political stability, law and order situation, and government policies determine the business environment of the country. The performance of these three elements has been far from satisfactory and have played an important role in discouraging foreign investors to undertake investment initiative in Pakistan.

(vii) Infrastructure

The availability, reliability, and cost of infrastructure facilities (power, telecommunications, water supplies) are important ingredients of a business environment conducive to foreign investment. Pakistan still lacks in efficient infrastructure, more particularly it faces grave power shortage and the existing power supply system is faulty which causes frequent power break-downs, load-shedding and big voltage fluctuations, that are bound to damage electronically controlled instruments and equipments, on the one hand and production losses on the other [Shirouzu (1993)].

Pakistan also compares unfavourably in infrastructure facilities with other developing countries that have attracted higher levels of foreign investment. Pakistan has only 18 percent of paved roads in good condition as against 50 percent in Thailand, 31 percent in Philippines, and 30 percent in Indonesia. Pakistan's extensive but poorly managed railway system does not make good for this disadvantage. Telecommunication is another bottleneck: there are only 10 telephones per thousand persons in Pakistan compared with 31 and 112 in Thailand and Malaysia, respectively. Pakistan's amount of electricity produced per capita is higher than Indonesia's (435 kwh as against 233 kwh), but ranges from one fourth (Malaysia) to one half (Thailand) of the other two countries.¹⁵ In most cases the urban infrastructure is grossly inadequate. Only 50 percent of population have access to safe drinking water as against 81, 72, and 78 percent in the case of Philippines, Thailand and Malaysia, respectively.¹⁶

Karachi Port is six times more expensive than Dubai port (Jebel Ali), three times more expensive than Colombo port and twice as expensive as Bombay port.¹⁷

¹⁵Realising the fact that Pakistan faces severe deficiencies in power, a highly attractive power sector policy was announced in March 1994 with a view to attract FDI in this sector. A discussion on this is deferred till Chapter 5.

¹⁶All the information pertaining to infrastructure are taken from the *World Development Report 1995*, The World Bank, Washington, D.C. For an excellent review of Pakistan's infrastructure, see Kemal and Shabbir (1995).

¹⁷Item-wise cost structure of Karachi and other ports handling is given in Khan (n.d.).

While other ports offer goods container terminal facilities, Karachi port cannot even offer priority berthing for container vessels. There are frequent delays and cancellations of berthing and sailing due to obsolete tugs and pilot boats at Karachi port. Moreover, due to the lack of maintenance the berths are unsafe. Karachi port cannot even provide proper container handling equipments and shortage of space and bad planning of the port staff results in high cost to the consignees. Large vessels cannot come to the port because of the lack of dredging of shipping channel. Moreover, congestion in the hazardous cargo results in container being detained longer time in the barge. All these have made Karachi port much expensive than other ports of neighbouring countries. Such infrastructure deficiencies may have discouraged the flow of FDI in Pakistan.

(viii) Labour Force

A technically trained, educated and disciplined labour force along with country's labour laws are critical factors in attracting foreign investors. Pakistan has been facing acute shortage of technically trained and educated labour force, especially in middle managerial positions and engineering cadre which may have discouraged foreign investors. In particular, Pakistan is at more serious disadvantageous position in terms of education and health indications as compared with other developing countries that have attracted FDI at a much higher levels. Pakistan's adult illiteracy rate is 62 percent as against 17 percent for Malaysia, 16 percent for Indonesia, 5 percent for Philippines and 6 percent for Thailand. Only 80 percent of primary school age male children are enrolled in school (49 percent for female), and the lowest rate for the four reference countries is 93 percent for Malaysia. Pakistan's expenditure on education accounts for only 1.1 percent of total expenditure as against 10 percent for Indonesia, 15.9 percent for Philippines, 21.1 percent for Thailand and 20.3 percent for Malaysia.¹⁸ It also has by far the worst indicators of public health among the five countries. With general level of education and health care being at such low levels, foreign investors may not find the workforce they need. Beside poor education and health indicators, Pakistan's labour laws are complicated and over protective which have discouraged job creation, inhibited business expansion and have frightened away much needed productive investment. Such labour laws have created unnecessary labour disputes posing problems for management and causing productivity losses which have also discouraged foreign investment in Pakistan [Shirouzu (1993)].¹⁹

(ix) Quality of Life

The cultural and social taboos along with the quality of life are critical to

¹⁸These statistics are taken from the *World Development Report 1997*, The World Bank, Washington, D. C.

¹⁹See also the letter from Secretary-General, Overseas Investors Chamber of Commerce and Industry addressed to Mr. Shahid Javed Burki, Adviser to the Prime Minister on Finance, Planning and Economic Affairs, dated November 24, 1996.

attract foreign investors. These factors are less conducive to foreign investors in Pakistan who are accustomed to liberal life styles. This is in fact, one of the largest hidden handicap Pakistan possess against Newly Industrialised Economies (NIEs) and ASEAN countries [Shirouzu (1993)]. Foreign investors find better conditions in Indonesia and Malaysia (both Muslim countries) in the ASEAN region in terms of social life and the quality of life is also better there than in Pakistan.

(x) Welcoming Attitude

The attitude that the country portrays to a foreign investor when he is in the country is very important. Ministers and top civil servants while on investment missions abroad encourage foreigners to visit their country—both as tourists and investors. However, is this attitude pervasive? Do all government officers, labour leaders, and opposition party politicians feel the same way? Have immigration and customs officials at the airports and other entry points been fully briefed to be made aware of the critical role they play in the entire investment promotion efforts? These attitudes play an important role in foreign investors' decision making. Although the high government officials and business leaders express their enthusiasm for inviting foreign investment, the lack of environment to accommodate foreigners and foreign investment prevails in Pakistan. The ancillary government agencies and officials seem to have a different and unsympathetic attitude toward foreign investors [Shirouzu (1993)].

The ten check points discussed above constitute an investment environment and can be classified into four "Cs", namely, *cost*, *convenience*, *capability*, and *concessions*. What is the *cost* of doing business in Pakistan? These include every factor that goes to make the cost of the product and those that increase costs unnecessarily. These also include the social and other costs that companies and individuals must bear. How easy is it to do business in Pakistan (*convenience* of business, living, banking, travel, communications, etc.)? What is the *capability* of the infrastructure to sustain project needs, the capability of workers to meet productivity needs, the capability of the government machinery to respond to competitive needs? What *concessions* or incentives exist for foreign investors? These include tax holiday, export incentives, concessional funding, and other cost reducing or profit enhancing incentives.

During the last 50 years various governments have concentrated mainly on one "C", i.e., *Concessions* through their investment policies and have given little or no attention to the other "Cs", namely, *Cost*, *Convenience*, and *Capability*. As a result, despite numerous concessions Pakistan has failed to attract FDI of comparable amounts of the East and South-East Asian nations. The four "Cs" as a whole represent enabling environment for investment. Unless the enabling environment is improved, in other words, all the four "Cs" are in place in Pakistan, no amount of fiscal concessions will attract foreign investment of comparable magnitude of the

East and South-East Asian nations. A recent publication has ranked 35 emerging economies around the world in terms of economic and social environment and has placed Pakistan as number 34.²⁰ Investment policies must be designed to improve economic and social environment of the country which are, in fact, represented by the four "Cs" mentioned above.

V. CONCLUDING REMARKS

The purpose of this paper has been to review the investment policies over the last 50 years and discuss the trends in FDI in Pakistan. Despite offering competitive incentives over the last 50 years, geographical location, and relatively large size of population, Pakistan could not attract FDI like those of many East and South-East nations. This paper has highlighted some of the factors essential for attracting FDI in Pakistan. One of the main factors in attracting FDI is the improved law and order situation in the country. No amount of fiscal and other concessions in the midst of disturbed law and order situation would draw the attention of foreign investors. Apart from law and order situation, macroeconomic stability and consistent economic policies are also vital to encourage foreign investors to undertake initiatives in the Pakistan.

The existence of cumbersome process of getting permits and clearances not only guarantees administrative delays but it also breeds corruption and nullify the usefulness of 'one window operation'. Various administrative delays, the unsympathetic attitude of labour inspectors and problem like these are the common complaints of the foreign investors. The authorities should streamline administrative procedures regarding approval and official clearances and must improve the workings of the 'one window operation'

Foreign investors in Pakistan have to cope with a complex legal situation. The laws and regulations should be simplified, updated, made more transparent, and their discretionary application must be discouraged. Payment of taxes and contribution in Pakistan is complex and cumbersome. In addition to the corporate income taxes, a large number of indirect taxes are levied at the federal, provincial, and local levels. There is urgent need to reduce the number of taxes and contributions; streamline regulations and administrative procedures; and most importantly reduce the contact of foreign firms with a large number of tax and contribution collecting agencies. There are enormous anomalies in the existing tax structure of Pakistan which needs urgent attention. Overprotective labour laws do not encourage productivity and frightens away much needed productive investment. There is a need to rationalise the overprotective labour laws, and multiple levies on employment which inhibit business expansion and job creation. The availability of better quality and more reliable services in all area of infrastructure are key ingredients of a business environment conducive to foreign investment. If Pakistan wants to catch up gradually with the development of the economies of East and South-East Asia, it will have to invest more in the areas of

²⁰See World Times Global Research/The World Paper, November 1997.

education and physical infrastructure. Besides these measures, a number of institutional changes such as restructuring of the Board of Investment and Export Promotion Bureau on professional line need to be undertaken on urgent basis.

All these recommendations are directed towards improving the enabling environment for investment which, in turn, is represented by the four "Cs", i.e., Cost, Convenience, Capability, and Concessions. Pakistan has so far concentrated mainly on one "C", i.e., Concessions but has paid little or no attention to the other three "Cs". Unless these three "Cs" are improved no amount of Concessions will attract FDI of comparable magnitude of East and South-East Asian nations.

REFERENCES

- Board of Investment (1997) *Pakistan Investment Policies*. Islamabad: Board of Investment, November.
- Jagathesan, J. (1995) Foreign Direct Investment in Developing Economies. In Claire Liuksila (ed) *External Assistance and Policies for Growth in Africa*. Washington, D. C: International Monetary Fund.
- Kemal, A. R., and T. Shabbir (1995) Infrastructure and Private Sector Development in Pakistan. In Sadiq Ahmed and Rohil Hafeez (eds) *Private Sector Development in Pakistan*. Lahore: Maktaba Jadeed Press.
- Khan, Ashfaq H. (n.d.) *Foreign Direct Investment in Pakistan*. Manila: Asian Development Bank. (Forthcoming.)
- Kim, Y. H., Z. Iqbal, and U. A. Afridi (1997) *Private Sector-led Industrialisation*. Pakistan 2010: Long Term Perspective Study. Islamabad: Pakistan Institute of Development Economics, July.
- MIGA (1994) Annual Report. Multilateral Investment Guarantee Agency. Washington, D. C.
- Naseem, S. M. (1981) *Underdevelopment, Poverty and Inequality in Pakistan*. Lahore: Vanguard Publication.
- Pakistan, Government of (1984) *Industrial Policy Statement*. Islamabad: Ministry of Industries. June.
- Pakistan, Government of (1989) *Industrial Policy Package*. Islamabad: Ministry of Industries. July.
- Shirouzu, H. (1993) Observations on General Economic Situation of Pakistan Relating to Investment Climate. Karachi: The Federation of Pakistan Chambers of Commerce and Industry, March.
- UNCTAD (1985) *Trends and Issues in Foreign Direct Investment-related Flows*. New York: United Nations Centre on Transnational Corporation, United Nations.
- UNCTAD (1994) *World Investment Report* New York: United Nations.
- UNCTAD (1995) *World Investment Report*. New York: United Nations.
- UNCTAD (1997) *World Investment Report*. New York: United Nations.

USIS (1996) *Prospects for Expanding Pakistan-U.S. Economic Relations*. Speech by US Ambassador Thomas W. Simons, Jr. in Rotary Club of Islamabad Cosmopolitan meeting, May 16, 1996.

Zaheer, Zahid (1996) *Role of Foreign Direct Investment in Pakistan*. Karachi: Overseas Investors Chamber of Commerce & Industry. (March.)

Comments

This is a very informative paper on foreign direct investment in general and for Pakistan in particular. To provide a perspective on the size of flows involved, it starts out by providing information on total foreign direct investment around the world for the 1990-1996 period. We are informed that in 1996, Pakistan accounted for 0.2 percent of World FDI, 0.53 percent of FDI in developing countries, 0.82 percent of FDI in Asia, and approximately 20 percent of FDI in South Asia. Armed with these "sobering" statistics for Pakistan, the paper proceeds to provide an account of the changing FDI policies in Pakistan from 1947 to 1997. Generally, the trend in these policies, except for the 1972-77 period, has been of gradual liberalisation culminating in the 1997 investment policy. This latest policy compares favourably with any developing country's investment policy. For perspective, it would have been useful to compare this policy with current policies of other developing countries like India, Bangladesh, China, etc.

The paper goes on to provide detailed information on annual flows of FDI to Pakistan from 1976-77 to 1996-97. It looks at these flows by country of origin, by type of flow, and by type of economic activity. The paper assumes that the flows coming to Pakistan are low given its population of 135 million people, its geographical contiguity with the Central Asian Republics, and its potential to serve as a gateway for other countries of the region. It would have been useful to compare FDI as a ratio of GDP for Pakistan with those of countries like India, China etc. to get a proper perspective on FDI flows to Pakistan.

The remainder of the paper is devoted to providing reasons for why FDI has been low inspite of the liberal FDI policy and the favourable aspects mentioned above. Ten factors are taken up which run the whole gamut of things like political stability, law and order, economic strength, economic policies, government bureaucracy, local business environment, infrastructure, labour force, quality of life, and welcoming attitude. Pakistan is found wanting in all of these factors, the presence of which presumably would stimulate increased FDI. These ten factors are crystallised into four factors, in fact four "Cs." These are concessions, cost, convenience and capability. Except for concessions everything else is found to be lacking in Pakistan or Pakistan is found deficient in them. The paper concludes by recommending that all these factors need to be taken care of if Pakistan wants to attract larger FDI flows.

While I have no disagreement with the author's observations, my question is that if all the ten factors (or the 4 "Cs") are improved in Pakistan then would the country really need FDI? By that time it would already be on a course of sustained high economic growth. I think my difference with Ashfaq Khan is in the way we

view FDI. He believes that Pakistan is destined to receive high amounts of FDI if only it could get its act together. He believes that FDI can be a large source of balance of payments support. I believe that getting its act together is the main thing in the medium term during which time there is no prospect for high amounts of FDI flowing to Pakistan. Countries like Malaysia, Thailand, and South Korea had surpluses in their current accounts first before FDI increased substantially. They did not rely on FDI for financing their current account deficits but rather mobilised domestic savings and encouraged domestic investment. As Ashfaque states so rightly on page 22, "But most importantly, foreign investors need to know if local businessmen are investing in their own country." I would hastily add to this remark, *with their own funds.*

Generally FDI is the riskiest of all investments that multinational corporations undertake. All things the same they would rather export than set up facilities or a subsidiary in the host country. Prior to FDI they look at less risky options like licensing a domestic company, or selling a franchise. FDI is the last resort which at times is forced by the countries where the MNCs export like Japanese and German MNCs in the U.S. While the present paper is informative, it would be even more informative if it were to look closely as to why the existing FDI has happened in Pakistan.

Overall this is a good background paper for serious policy discussions on the prospects of increased FDI in the short or medium term (next 5 years or so). The 10 factors or 4 "Cs" are important in their own right for increased domestic investment, savings, and rapid economic growth. Whether it was intended or not, the paper made me realise that the prospects for increased FDI in Pakistan are indeed slim in the medium term. Therefore, they cannot be relied upon to ameliorate the nation's current balance-of-payments difficulties.

Nasir M. Khilji

U.S. Bureau of the Census, and
Economic Adviser,
U.S./Saudi Arabian Joint Commission,
on Economic Cooperation (JECOR),
Riyadh.