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Pakistan: a 'big' market with unimpressive inflows

KARACHI: In an article published in June 2019, the Financial Times (FT) reported that foreign direct investment (FDI) in emerging markets had "plunged to its lowest level this century", as the developing world bore the brunt of rising trade tensions and had to deal with slowing economic growth.

It was using a research conducted by the Institute of International Finance, which tracks cross-border capital flows, and conveyed that FDI across emerging and frontier markets fell to 2% of GDP, a massive fall from the pre-financial crisis level of 4.4% in 2007.

One of the main arguments, used to explain why the trend reversed, was to use the 'growth premium' and 'growth differential' numbers. A higher economic growth in emerging markets compared to more advanced economies has historically resulted in greater inflows into that part of the world. However, as growth slowed, and the differential with developed markets narrowed, owing to a variety of factors, so did FDI.

The argument makes sense.

But how does that explain Pakistan's consistently decreasing FDI as a percentage of GDP since 2007 when it amounted to 3.67% to a meagre 0.8% in 2019. Between 2010 and 2019, Pakistan's economic growth improved consistently from 1.6% to over 5.5%. Clearly, in Pakistan's case, there are several other factors at play as well.

Why FDI is important?

Pakistan's single biggest problem has been its ability to generate non-debt creating foreign exchange inflows. It has been able to secure loans, and borrow – at higher interest rates – but talk about investment, and bags of money turn away to economies like Indonesia, Vietnam, Bangladesh, and Sri Lanka.

The Roshan Digital Accounts, which promises overseas investors a higher rate of return, are essentially loans with payments to be made as interest each year.

In no way, the initiative to attract foreign exchange inflows is being criticised. In fact, as most economists would tell you, it is not how much debt you have, but whom you owe it to. Now it is up to you to decide whether a loan from China, the International Monetary Fund, or overseas Pakistanis is better. Keep in mind, future plans to raise money, ability to pay back interest, and expectation of leniency are all factors.

But we digress.

As commendable as the initiative is, foreign exchange inflows truly increase in a sustainable, non-debt creating manner in two ways – exports and FDI.

One could argue that to increase exports, Pakistan will have to import first. However, that is a discussion for another time.

Even for FDI to increase, several factors need to go in Pakistan's favour. It has to show, to the outside world, that regulatory and political stability has been achieved.

It has a big market, which is touted at every turn by every executive, government official and economist, but for small-ticket items like mobile subscriptions, food, etc. When it comes to more – for the lack of a better word – expensive items, the same population is reduced by a massive percentage due to purchasing power.

For example, its ratio of cars per 1,000 people is among the lowest in the world. Its consumption per capita for electricity, cement, steel, and many others, is among the lowest in the region as well.

All this can be attributed to a massive under-served, and under-resourced, population that simply cannot be counted as a potential market for big-ticket items. And investors are completely aware of this.

Instead of pitching Pakistan as just a 'big market', the government needs to show regulatory and political stability. Investors need to feel that once in, Pakistan's regulatory environment will take care of issues that present themselves. In terms of political stability, protests at every turn and statement mean government officials are more busy, and interested, in resolving domestic affairs.

Take PIA's privatisation for example. Almost every government has had to address the elephant in the room. But protests have meant that a retreat on part of the officials has been inevitable.

This is just part of the problem in the government trying to force its writ.

In trying to attract FDI, investors see the government's inability to act, even if there remains a will.

Talk to foreign companies, and they will tell you given the number of choices, Pakistan – while on the radar – is not preferred simply due to an inconsistent policy framework, weakness in its institutions, supply-chain robustness among many, many others. Depending on the sector, the answers vary, but the underlying theme remains the same – poor governance.

These are issues only the government can fix. They are not beyond resolution, and need to be addressed to attract any form of non-debt creating inflows.

Attracting foreign exchange inflows to digital accounts is a start. But the next step – a trickier one but with sustainable returns – is where the government needs to put in the work. The best part – it is in its control.

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