Promoting Private Investment in Low Income Countries

Statement by Dr. Abdul Hafiz Sheikh, Minister for Privatization and Investment Pakistan

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Mr. President of ECOSOC, Excellencies, distinguished guests and dear colleagues,

I am delighted to be here and I am thankful for this opportunity. I think we are meeting here at a very important time. When our leaders meet in September, they will be faced with very important decisions. And I think what is decided then could have far reaching consequences for the whole world. We have had a very good session this morning already. And I can see that this tradition of talking to people, is gaining ground. People from different institutions coming together, along with the government and private sector representatives, provides coordination and coherence to the global developmental agenda. I am honoured to be here and on behalf of my Mission, I would like to thank all of you for honouring us with your presence.

Many of you are coming from the Bank Fund meetings and I am sure that it is very hard. You can see that I am in the unenviable position of trying to say something interesting or new on a subject that probably has been thrashed to death over the last week or so. I will still attempt, however. I will first look at where we are in terms of FDI and private capital flows and then what are the important factors in this area? And how we might chalk out a future programme?

But first, what are the big facts?

One, FDI (Foreign Direct Investment) for the LIC (Low Income Countries) has been rising for the last four years. Its share in developing countries' FDI has increased from 7% to 11%.

Second, FDI has risen from less than 0.5% to almost 3% of GDP of LIC.

Third, FDI has been important in many LIC including India, Azerbaijan, Vietnam, Pakistan, Lesotho, Mauritania, Maldovia, Mozambique and others.

Fourth, FDI has been limited to a few resource based sectors, with limited benefits to the overall economy.

Five, ODA importance for LIC in terms of percentage GDP has been declining.

Six, several donor countries have increased their contribution to ODA but in totality it is about 0.25%, which is less than the 0.34%, achieved in the early 90s and well below the target of 0.7%. Although five countries are above the threshold.

Seven, private transfers, which are NGO grants and remittances have increased. They are now USD 10 billion and USD 134 billion respectively.

Eight, flow from other developing countries to LIC have increased and China, Brazil, South Africa, Saudi Arabia, India, Malaysia are emerging as important players. These flows are increasing because of FDI outflows and due to overseas ODA & migration from LIC to other developing countries.

Nine, privatization programmes are connected to and are a catalyst for attracting FDI into LIC. International bank lending has virtually collapsed, especially for the poor countries.

This is the overall picture. If you look at it, it looks like a mixed one. If you combine this mixed picture with the relatively strong growth in developing countries, one could say that glass is half full rather than half empty. Now to turn to the lessons. I think we shall ask ourselves a very fundamental question about history, which is that why is it that some countries have gotten ahead and others have been left behind? If you look at the history of last 50 years when many countries started in roughly the same situation, some have achieved per capita incomes that are 10 times or even 50 times than others. What are the factors?

In my view there are three main factors which explain why some countries are ahead. One, countries that invested in their people got ahead while others were left behind. In other words, you cannot have developed countries with under-developed people. Two, the countries that relied on private sector got ahead. Those that relied on government as the dominant player were left behind. And third, the countries which found a way to do business with others got ahead.

It is this third point that I want to focus upon. That no country has developed without finding a way to sell products to others and without finding a way for others to come in their countries and invest. So it is an optimistic message. That if others can do it we can too. Now people talk about Brazil, India, China, Mexico and Russian Federation – that they account for 60% of FDI or 88% of the growth in FDI but this was not always the case. For some countries this is a very recent phenomenon. The point I want to draw from this is the role of domestic economic policies in attracting foreign investment.

We need to have a dual message – one for developing countries and one for the developed partners. For the developing countries the message has to be that you cannot change the geography. Perhaps you cannot change the history but you can definitely change the way you govern. Therefore, we find that the role of domestic policy, economic reform and making the government work, have to be the dominate messages for developing countries.

I would like to relate this to our own recent experience. In the 1990s, we had growth rates of 3 to 4%, virtually no FDI and the economy was stagnant. Five years ago we opened it up. We created a new investment regime. Now there are no restrictions on foreigners in any sector. No restriction of percentage of equity you can own. No restriction on repatriation of capital, royalties, dividends or profits. We have reduced the role of bureaucracy. We have simplified our tax regime and we have been aggressive in our privatisation programme.

Both the quantity and quality of the investors has improved. The FDI has doubled in the last three years. For this year it is 51% more compared to the last year for the first seven months. Our remittances have more than doubled. Our growth rate was 6.4 last year it will be 7.5% this year and hopefully 8% next year - one of the best in Asia. Domestic investment has also been increasing.

So the question; the enduring puzzle really is that why in the face of mounting evidence we have countries that are lagging behind in pursuing these obvious set of remedies. This is the question we talked about this morning and perhaps we should talk about again this afternoon.

Reform, although necessary, is not sufficient. Sometimes, in spite of reform you may not get the result and this is where the role of development partners comes in. Why would this be the case? Well, sometimes you may happen to be in a difficult neighbourhood.

Pakistan, for example, was in a difficult neighbourhood but the neighbourhood is getting better. Three - four years ago, I used to think that the best way to develop Pakistan is to take it out and transport it somewhere else. Perhaps somewhere between Italy and Switzerland. Now I no longer think that. I think we should stay in the neighbourhood. Because the growth rates in South Asia are much higher than in the neighbourhood in which I wanted to move to.

Neighbourhoods are important. We find that many of our dynamics have changed. Three years ago, we had tension on our Eastern borders. Now we have serious peace talks. Afghanistan was an active conflict now it is an active reconstruction. Our trade with Afghanistan is approximately one billion dollars and it is helping the whole region get noticed.

The other area where reform alone may not be enough is when countries are very poor, repatriation is very weak, and domestic demand lacks so badly that the private sector may not be able to generate the revenue streams to create attraction. This becomes a formidable challenge to design transactions in attracting the private sector. This also becomes a case for intervention by the development partners and donors. What should the donors do? This issue is well traversed. Obviously, they are to fulfil commitments, make aid flows more reliable, improve effectiveness, support market access and continue the search for innovative instruments.

Today we need to focus on some of those innovative instruments, whether they are IFF, a form of global tax, voluntary contribution, securitisation of remittances, risk mitigation measures or a good idea that somebody suggested this morning. That idea is to offer incentives in rich countries to promote FDI in other countries. For example, if you are a developed country, what incentive can you offer to companies in your own country that invest in small or medium sized labour intensive enterprises in developing countries? These are the challenges.

I would like to make a comment on two things that we discussed this morning. One is whole issue of public-private partnership and its role in promoting investments and infrastructure. I have had trouble with this whole idea of public-private partnership because if you define it in a certain way then everything is a public-private partnership.

Whenever the government is trying to procure, whenever it is trying to give out a contract, whenever it is trying to do any business, inevitably the private sector gets involved. So these public-private partnerships are everywhere.

But if you define it in another way, perhaps more technically correct way than I have a very difficult time in finding any successful examples. I always hear about some South African example or British example but my search, which is quite a determined search, has not thrown up a lot of good examples.

So what is it? Is it a seductive slogan which politicians like to cling on to and people in the international agencies find comforting and intellectually challenging? Or is it really something that one can focus upon, zero in, and put in the resources needed to make it a genuine solution to some of our investment problems. Perhaps the right way to pose the question would be that how can we bring in private sector into those areas, which have traditionally been the domain of public sector such as the telecom sector in our country.

I will share with you an interesting story. A few years back I used to live in the U.S. I went to visit a friend in Pakistan. He was a University Professor. It was his daughter's wedding. I was sitting with him and his door bell rang. We were told that the people from Telephone Company are there and they had come to install the telephone. My friend, the University Professor, said "Isn't this interesting that I had applied for the telephone in the year that my daughter was born and that they have come now on the day of her wedding!" It was taking 20 years to get the telephone at a time when it was taking 20 minutes in some countries. Fortunately, it now takes 20 minutes in Pakistan as well.

So what was the reason – country after country cling on to public sector monopoly. They are unwilling to search for obvious solutions that can solve their infrastructure problems. There are now five international companies operating in Pakistan and the service is 100 times better. Rates are down and the cost of doing business is low. Nobody complains of the telephone sector as a constraint but they do of electricity and gas. So we have to continue on this path.

The question we need to focus on is that how can we convince the private sector to come into areas such as roads, electricity, transport, airports, water and so on. I am sure there is a lot of experience within World Bank and other places but we have to see why the stories are not being replicated fast enough and not in larger numbers. I think that is a puzzle.

The other point that I want to touch on briefly is this whole case of domestic versus foreign investment. Because in developing countries, it rages all the time. Whenever you talk about FDI people ask; what about domestic investment? You are ignoring and hurting it. I believe this is a false dichotomy. It is an artificial distinction in foreign and domestic investment. In today's world it is very hard to determine the nationality of capital.

The other thing is that the rich people or investors do not think very differently from each other. In fact most of the times they do not think at all, their bankers do. I think the same set of factors, which motivate the foreign investors are critical in motivating the domestic investors, or the overseas residents.

It is important to give the message that same things need to be done to attract domestic investors that are done for foreign investors. Domestic investors then get the comfort that they will not be cheated. That the rule of the game will be fair. That there will be due process. That the legal system will not be fake.

I believe the last two messages are to the developing countries; that the biggest challenge we face is to make governments work. Ensure that they are focused, deliver services and confine themselves to areas where others are unwilling or not able to operate. And that they create the space for private sector. If you do that and get your act together, others will want to come in and partner with to. If you do not focus on your domestic reform and are not interested in participating in such dialogue platforms, chances are that others may not want to become your developmental partners. So it is very important to do that.

And to the donor countries, one has to say that they have to reach out and help those who are determined to help themselves. 2005 is a historic year. When our leaders meet in September they will meet in the background of some facts. What are those facts? One and a half billion people are worse off today than 20 years ago. 54 countries are poorer today than in 1990. We can no longer afford to miss the opportunity. We have difficult challenges but most worthwhile things in life are difficult. The response should not be to abandon the pursuit but to redouble the effort.