

# FDI & Tech Capabilities

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# Outline

East Asian experience

Pakistan experience

FDI strategy

# The East Asian experience

- Rapid growth generated by high rates of investment, initially with external capital and later with domestic saving.
- Government stimulated investment by creating rents and high profits.
- Corporate profits were reinvested.
- Corporate savings thus became a main source of capital accumulation.

# East Asian policies

- Promoted investment in industries with potential for learning, scale economies and productivity growth.
- Promoted forward and backward linkages that stimulated investment in the wider economy.
- Eased constraints on capital accumulation, particularly on capital goods imports.
- Tied government support to private sector performance.

# East Asian policies to build technological capabilities

- Education and human resource development
- Teacher training
- Managerial programs
- Institutions (create ties between firms, universities, and research institutes at home and overseas)
- Support for SMEs and emerging entrepreneurs
- FDI to stimulate business linkages (OEM)
- Technology licensing
- Regulatory reforms

# Outline

East Asian experience

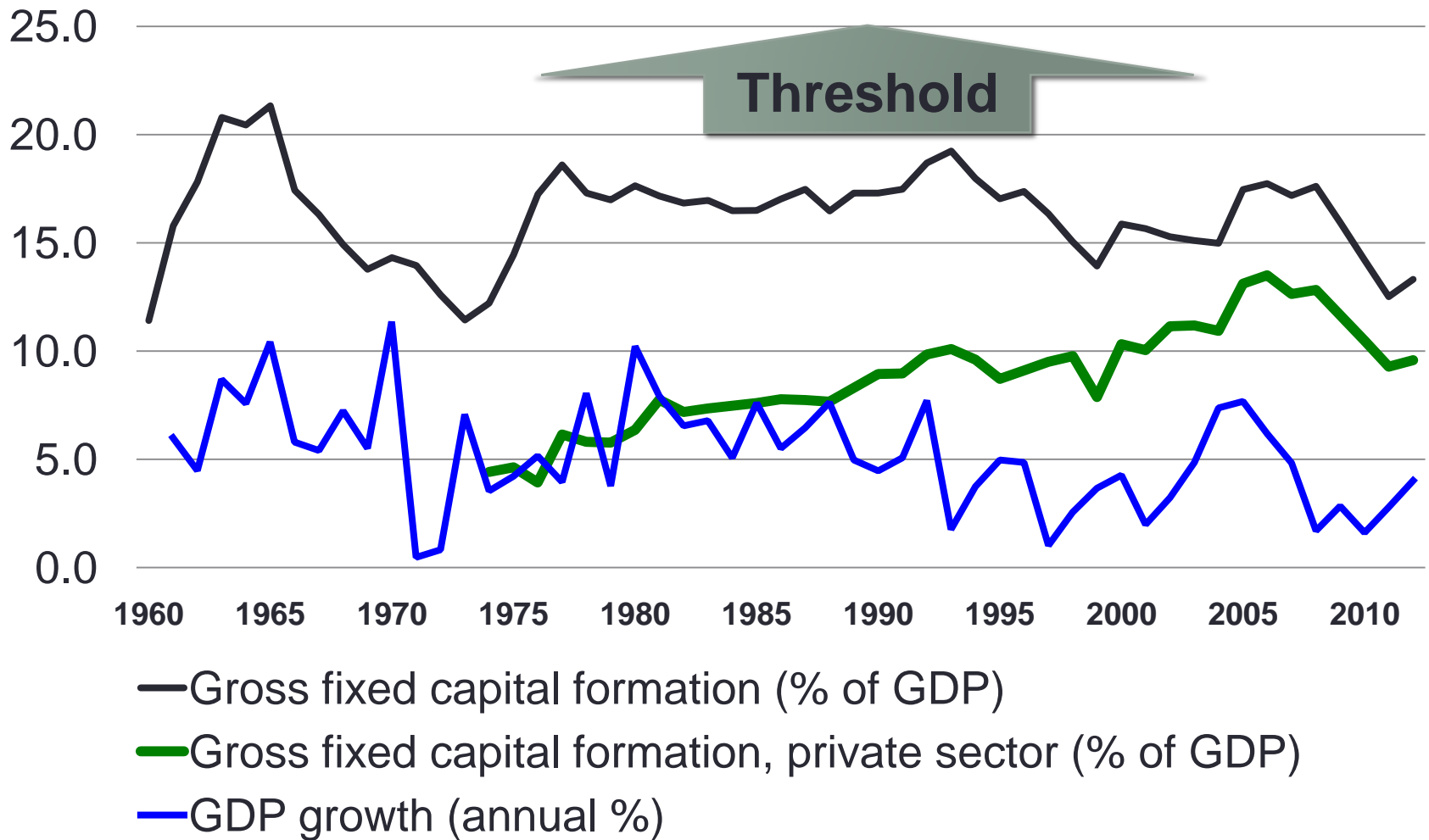
**Pakistan experience**

FDI strategy

## Pakistan experience had some similarity

- We relied on import substitution, technology transfer and foreign capital inflows.
- However, we neglected to build technological capabilities.
- We did not develop a robust relationship between government and industry.
- We could not foster an environment in which corporate profits were reinvested. Corporate savings thus did not become a main source of capital formation.

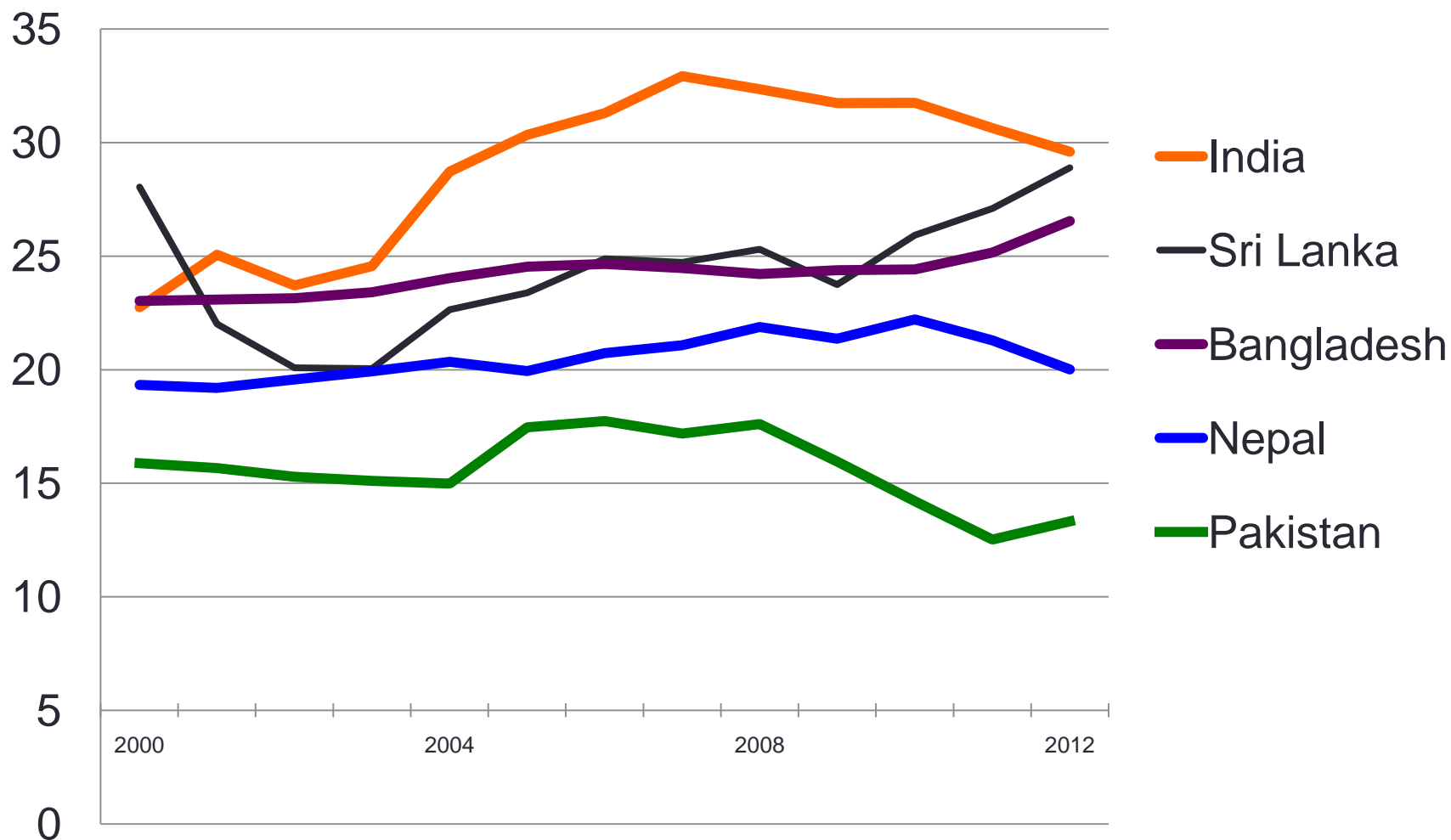
# Capital formation in Pakistan is well below the threshold for dynamic growth





# Lowest capital formation in South Asia

(GFCF % of GDP, World Bank *World Development Indicators*)



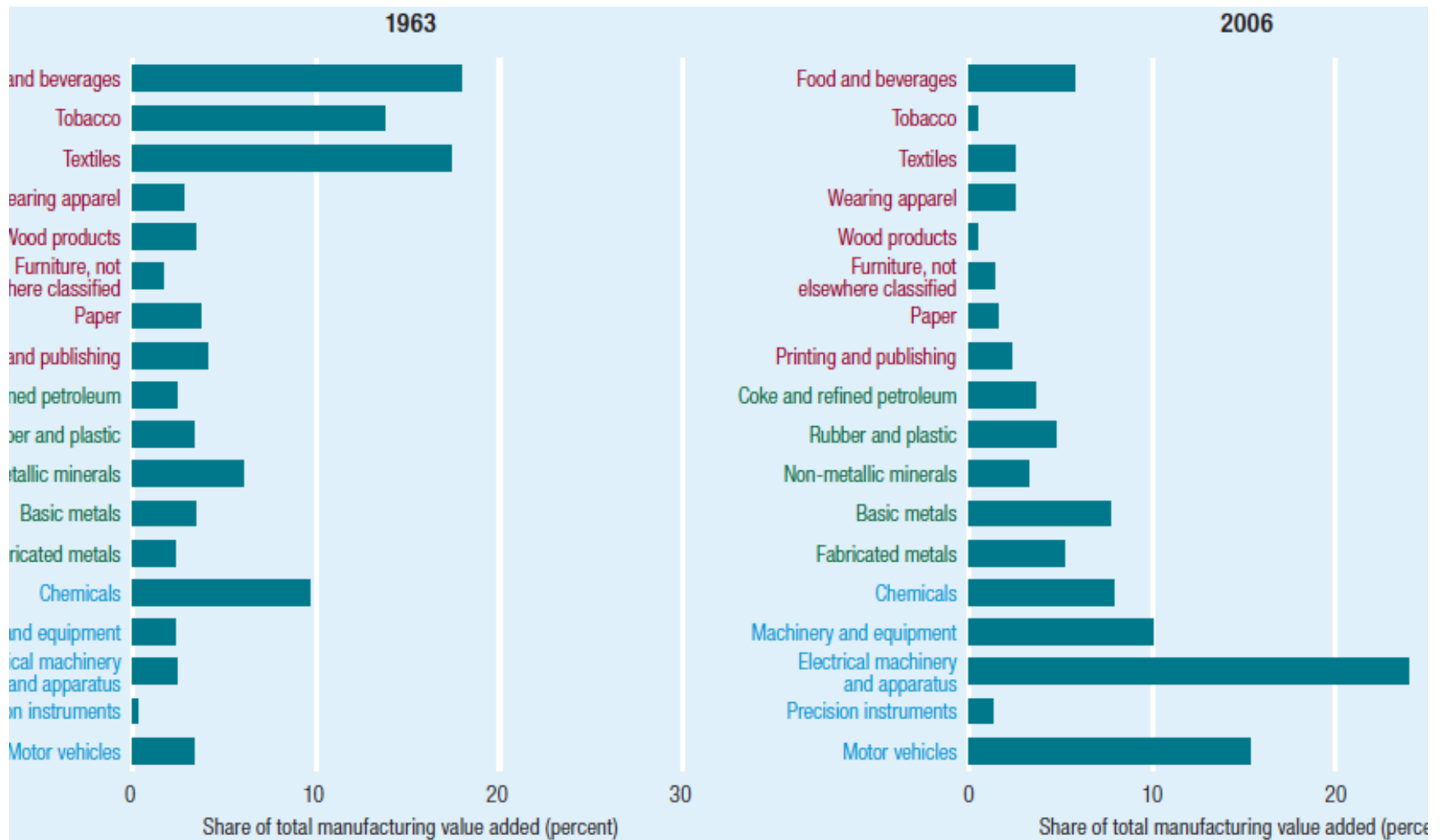
# Low propensity of the rich to invest

(Accumulation/Concentration Ratio, %, UNCTAD)

	1970-1979	1980-1994	1995-2000
Bangladesh	11	16	34
India	25	28	34
Korea	46	53	70
Malaysia	28	32	41
Pakistan	14	18	22
Thailand	35	46	49

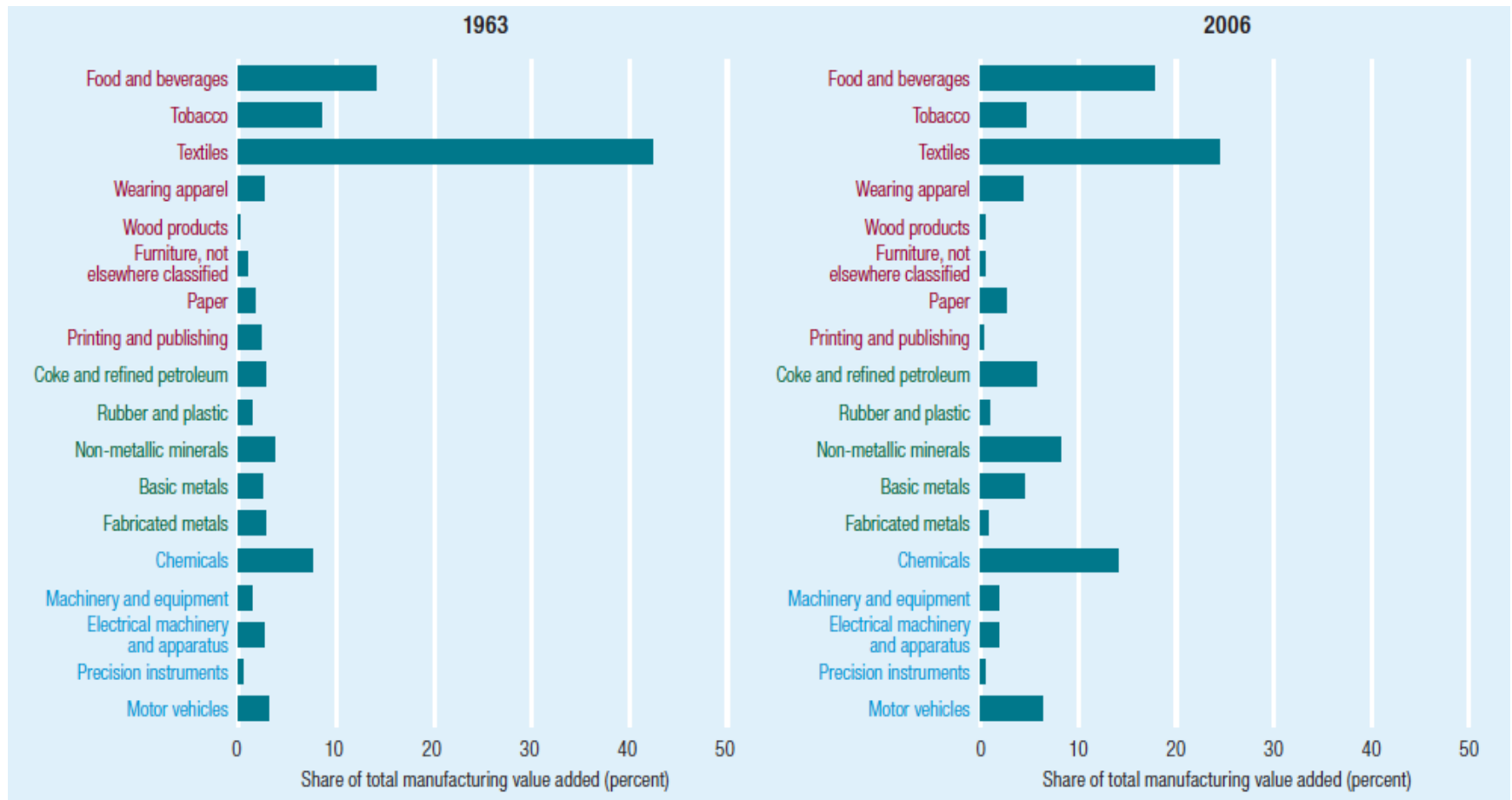
# Korea: shift to high-tech manufacturing

(low, medium, high technology, % of MVA, UNIDO)



# Pakistan: manufactures still low-tech 50%

(low, medium, high technology, % of MVA, UNIDO)



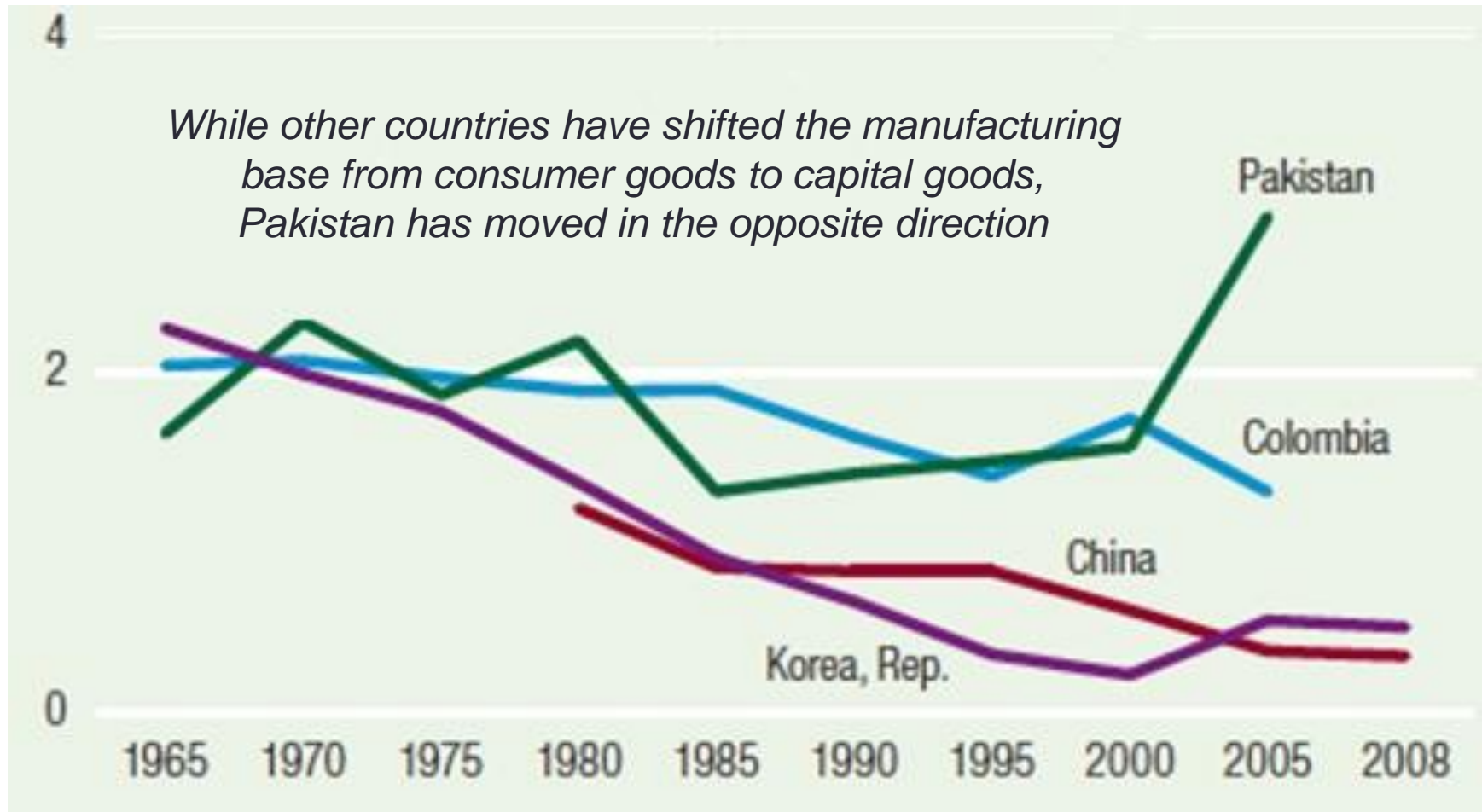
# Pakistan: exports low technological content

(%, UNIDO)

Pakistan				Lower Middle Income Developing countries
Year	1990	2000	2011	2011
Manufacturing value added in GDP	16	14	18	24
- of which: medium or high technology	32	30	25	40
Manufactured exports in total exports	88	87	81	79
- of which: medium or high technology	8	11	11	55

# Manufacturing transformation

(MVA, ratio of consumer goods to capital goods, UNIDO)



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# Why FDI?

- FDI can raise the investment ratio under constrained balance of payments.
- FDI also has wider benefits:
  - FDI can augment capital accumulation with technology and skills transfer.
  - FDI can also provide access to global production networks: expand exports.
- Pakistan needs FDI for all three reasons.



# FDI strategy

- The wider benefits of FDI are not automatic.
  - Technology can obsolesce or be absorbed into technological progress and productivity growth.
  - Profits from FDI can be repatriated or reinvested.
- Hence, FDI strategy involves generating inflows and capturing the wider benefits.

## Pakistan needs a broader FDI strategy

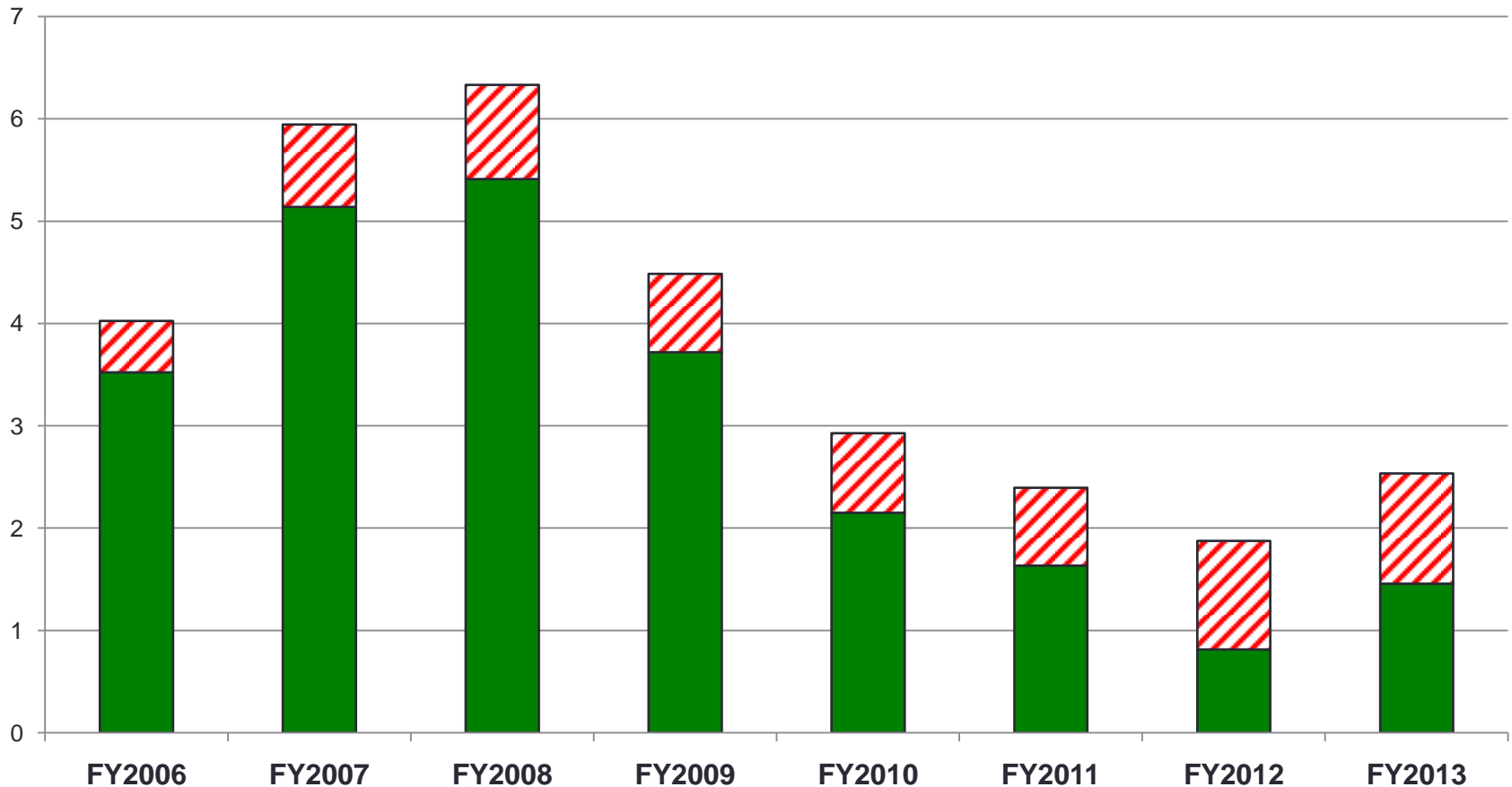
- A preoccupation with macroeconomic management emphasizes attracting foreign capital inflows and neglects the need to create an investment environment conducive for reinvestment and technological upgrading.
- Pakistan needs to attract FDI and also promote sequential investment.

# FDI strategy must begin at home

- Government needs to work with industry to:
  - Encourage reinvestment to upgrade production, train workers, create supplier linkages and develop exports.
  - Strengthen policies and institutions that support building up of industrial technological capabilities.
- Without such internal efforts, FDI adds to the balance of payments difficulty.

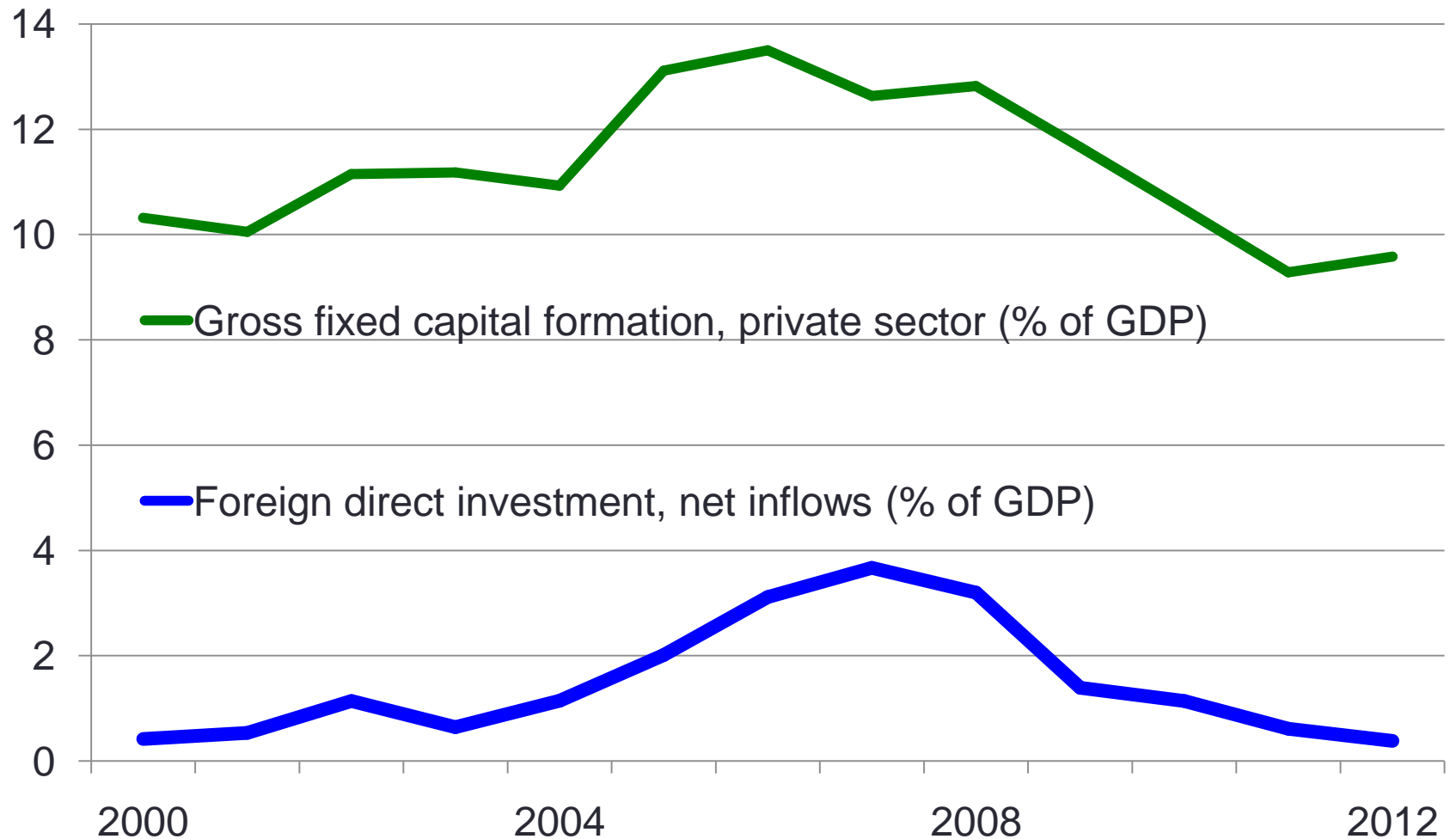
# FDI would double with reinvestment

(Billions USD, State Bank of Pakistan)



■ FDI net inflows    ▨ Outflows of profits and dividends

# FDI comes when private sector invests



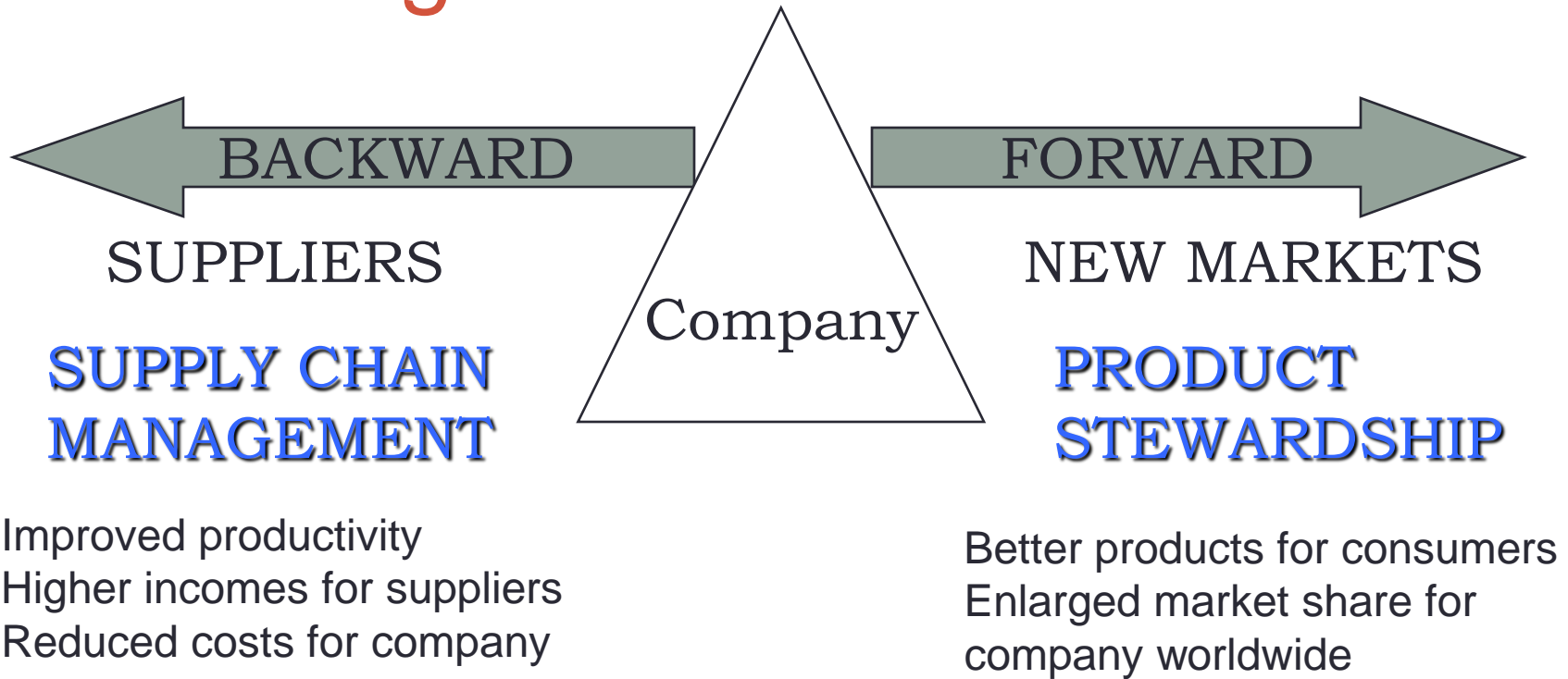
# Government-industry relationship

- High-level, institutionalized consultation is needed on:
  - urgent problems of energy, security and investor confidence;
  - practical matters of regulatory barriers that impede entrepreneurship and business; and
  - Strategic plans for industrial upgrading.

# Pakistan's FDI profile

- ✓ Natural resources: mining, oil and gas.
- ✗ Exports: weak infrastructure, skill base.
- ✓ Market: food, beverage, consumer goods and service industries.
  - ✓ Sequential investment to upgrade production, create linkages and develop exports.

# FDI linkages

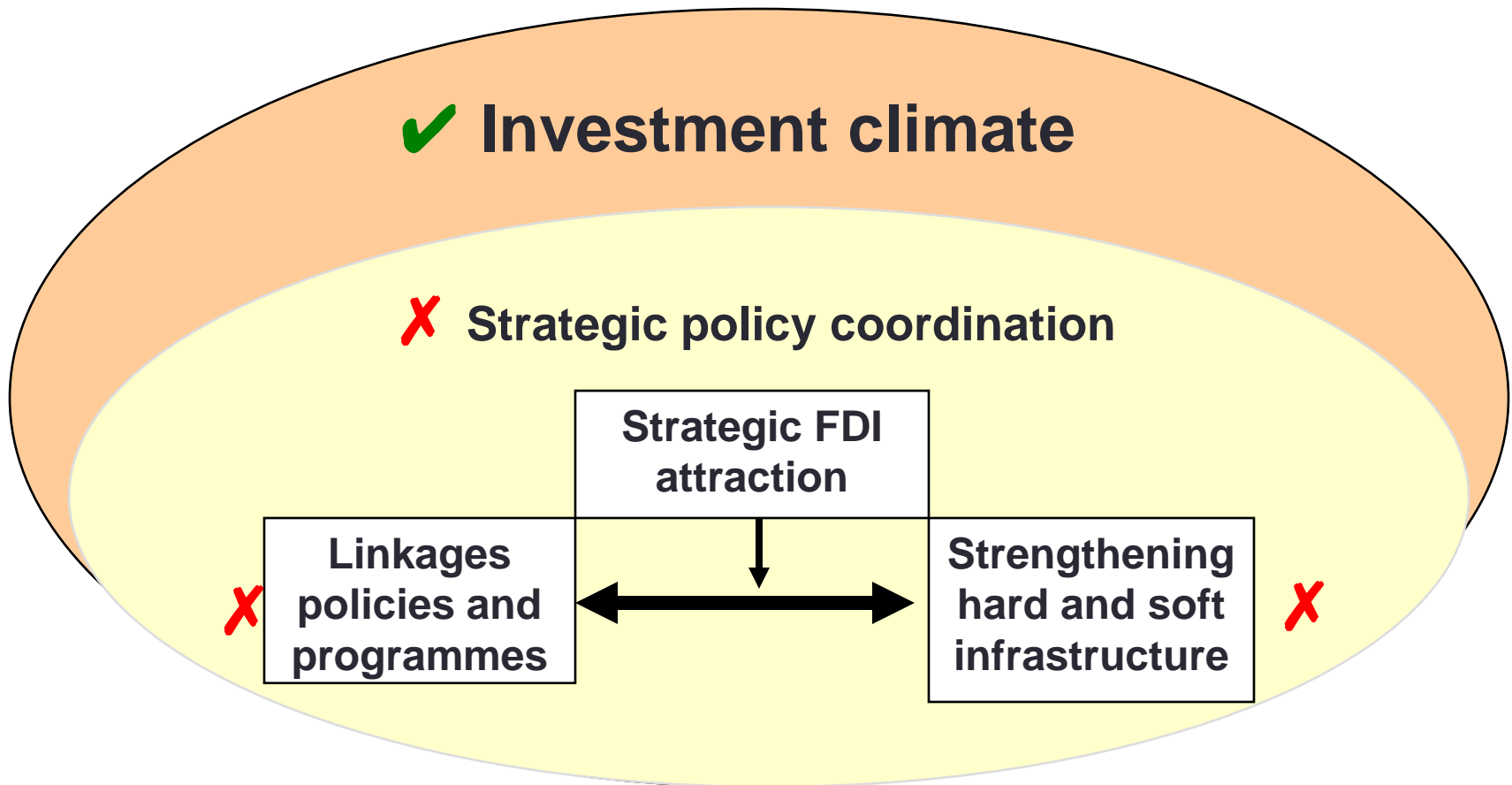




# FDI is part of larger industrial strategy

- Industrial transformation: shift to a high technology, knowledge-based economy
  - Diversify existing industrial base (technological upgrading, linkages, exports)
  - Target growth industries (e.g. engineering, ICT, petrochemical products)
  - Encourage SMEs and entrepreneurship development
  - Develop clusters of knowledge-based activities

# Investment score card



# Summary

- FDI is more than an external resource inflow.
- FDI can also modernize industry and better integrate Pakistan into international production.
- Natural resources and large internal market are Pakistan's main attractions for FDI.
- With appropriate policies, significantly wider benefits can be realized, including exports.