Private Investment

Importance of Foreign Private Investment:

There is no doubt that the inflow of foreign capital accelerates the economic growth of under-developed countries in number of ways:

(a) Foreign investment ***supplement domestic savings*** and harnesses them to secure a rapid rate of growth. It serves as a stimulant to additional domestic investment in the recipient country. By increasing the rate of capital formation in the country, it goes a long way in removing the capital deficiency which is the main hurdle in the economic growth.

(b) Foreign investment generally brings along with it technical know how. By providing technical expertise it ***helps in building modern industrial structure*** in the receiving countries. In this way, it adds to their aggregate national product and per capita income which not only works towards removing their poverty but increases the rate of savings which in turn accelerates the process of their growth. In course of time, the vicious circle of poverty is broken and the beneficial circle of prosperity is set in motion.

(c) Foreign investment ***provides valuable foreign exchange*** which is the desperate need of the developing economies. It is generally observed that, in the early years of development, the import bill of such countries goes on mounting because they have to import food grains, machinery and capital and essential industrial raw materials but their exports lag woefully behind. This creates balance of payment difficulties in the solution of which foreign capital proves a god send.

(d) Benefits also accrue from foreign investment to domestic labour in the form of ***higher real wages***, to consumers in the form of ***greater supply of consumer goods***, larger in quantity, better in quality and greater in variety and to the government in the form of ***higher tax revenues***. The economy benefits through the realisation of external economies. Since foreign capital helps in building up economic infra-structure in the form of means of transport and communications, railways, roads, hydro-electric projects supplying irrigation and power, it undoubtedly results in acceleration of the rate of growth.

Determinants of Private Investment:

The private investment rates in developing countries have varied significantly over time. In Pakistan, the private investment rate fall sharply during 1990s. Instead of rapid economic growth, Pakistan witnessed slowing down of economic growth during 1990s. Investment rate decelerate from an average of over 19% of GDP to 15.6% by 1999. There are number of factors that help explain these variations:

(a) **Real Per Capita Growth Rate:** There is general agreement among economists that a country's growth rate would have a positive impact on private investment.

A higher growth rate would increase private investment activity if the relationship between the level of real output and the desired capital stock is relatively fixed.

(b) **Real Interest Rate:** There are competing views about the effect of real interest rates on private investment. A high level of real interest rates raises the real cost of capital, and therefore dampens the level of private investment. But there is another side. Poorly developed financial markets in these countries and inadequate access to foreign financing for most private projects implies that private investment is constrained largely by domestic savings.

(c) **Level of Per Capita Income:** Economists have argued that per capita income levels should be positively related to private investment activity, because higher income countries are better able to devote resources to saving.

(d) **Public Investment Rate:** As with the real interest rate, the impact of the public investment rate (i.e., the ratio of public investment expenditure to GDP) on private investment activity is uncertain.

(e) **Domestic Inflation Rate:** High rates of inflation adversely affect private investment activity by increasing the riskiness of longer-term investment projects, reducing the average maturity of commercial loans, and distorting the information conveyed by prices in the economy. In addition, high inflation rates are often considered a sign of macroeconomic instability and the inability of government to control macro-economic policy, both of which contribute to an adverse investment climate.

(f) **External Debt Burden:** Measured by its debt-service payments ratio and the ratio of external debt to GDP, the external debt burden can have a powerful negative effect on a country's private investment rate. A higher debt-service payments ratio means that fewer resources are available for domestic use, including private investment, and hence should have a direct adverse impact on private investment rates. A high ratio of external debt to GDP, which indicates that the country has a large debt 'overhang', may also discourage private investment.

(g) **Non Economic Factors:** Besides the above economic variables, there are also other non-economic factors, such as political stability and investor confidence, that play an important role in investment behaviour. Another factor is a country's tax and regulatory environment which also plays a vital role in establishing investor's confidence in the administrative structure of the country.

Investment Policy and the Current Situation in Pakistan:

According to Pakistan's Board of Investment, our country's investment policy is based on liberalisation policy. The main features of Pakistan's investment policy are outlined as below:

(a) All economic sectors open to Foreign Direct Investment.
(b) Equal treatment to local and foreign investors.
(c) 100 % foreign equity allowed.
(d) No Government sanction required.
(e) Attractive tax / tariff incentives package.
(f) Remittance of Royalty, Technical & Franchise Fee, Capital, Profits, Dividends allowed.

By October 2004, total foreign direct investment (FDI) stood at $950 million as against $472 million in October 1999. During the year 2004-05, total investment provisionally estimated at 16.9%, slightly lower than last year 17.3%. Fixed investment as percentage of GDP is estimated at 15.3% for the year 2004-05 as against 15.6% last year. Public Sector investment declined from 4.8% in 2003-04 to 4.4% in 2004-05. During the year 2004-05 private sector investment rose marginally to 10.9%.

Net Inflow of Foreign Private Investment
(Direct + Portfolio)

(All figures in US$ million)

Country	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
USA	54.9	324.7	226.6	259.8	373.0	820.5	1766.8	1748.8	427.4	940.6	499.7	269.7	299.7	360.3	808.3
UK	56.7	-2.1	184.8	41.9	199.1	224.5	1820.1	360.0	185.7	295.8	232.1	177.8	567.0	380.9	403.8
UAE	-5.7	17.3	120.4	146.5	417.3	1487.8	677.0	592.8	228.0	248.2	291.7	54.1	29.5	-40.2	228.0
Germany	15.5	11.2	3.8	4.0	15.2	25.1	85.9	69.1	77.0	53.7	19.7	28.1	17.7	-25.7	-20.2
France	0.7	-6.6	2.6	-5.6	-3.5	3.2	1.5	7.6	6.5	7.2	17.8	-0.9	25.2	96.2	-214.3
Hong Kong	-12.7	23.4	5.2	5.0	61.2	55.2	-40.0	94.3	158.7	29.1	148.8	-52.9	171.6	294.6	19.9
Italy	1.3	0.1	0.4	-	0.4	N/A	N/A	N/A	N/A	N/A	N/A	200.5	199.4	97.7	115.4
Japan	9.1	6.6	14.1	11.6	41.7	48.2	68.4	141.1	68.2	38.2	8.4	31.0	34.5	47.2	74.0
KSA	54.9	1.4	43.6	5.3	18.2	278.5	105.0	44.7	-89.9	-133.7	6.6	-79.8	3.3	-40.1	-64.4
Canada	0.6	6.2	0.5	0.5	2.0	5.0	10.9	13.7	2.6	1.2	4.1	9.4	-13.0	-18.8	-25.7
China	0.1	0.3	2.7	14.3	0.5	1.7	712.1	13.7	-101.4	-3.6	47.4	126.1	90.6	696.0	266.6
India	N/A	0.0	0.0	0.1	0.1	0.5	0.1	0.1	0.4	0.1	0.1	N/A	N/A	N/A	N/A
Pakistan	0.3	0.5	0.8	0.9	1.5	3.5	5.1	5.4	2.7	2.1	2.0	0.7	1.5	1.7	0.8
World	182.0	474.6	820.1	921.7	1676.6	3872.5	6959.9	5454.5	3209.5	2738.8	1999.3	760.6	1576.0	2321.4	1786.1

Source: State Bank of Pakistan
FY02=2001-02, FY03=2002-03, etc.