**Our FDI follies**

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The FDI strategies the current government has adopted are ill-timed and can deeply harm our future economy. The nation needs to debate the tactics and approach before investments are crystallized and become irreversible.

Just look at our past to see what our experience has been by channelling the investment appetite – both domestic and international – into import substitution projects (commercial projects aimed at serving domestic demand, by processing inputs that are directly or indirectly imported), as well as domestic infrastructure and low value-added exports.

Today, bankruptcy and insolvency in terms of the country’s ability to repay foreign debt stare us in the face. As we borrow more to service old debt, we are spiralling into a desperate beggar nation with an almost complete loss of sovereignty and likely loss of security.

Superficially viewed, import substitution to meet domestic demand reduces dependency on imports of finished goods so it is less taxing on our foreign reserves – and it creates domestic employment and transfer of technology. If this were true then why are we hemmed in our current foreign insolvency situation, unemployment and high poverty levels?

Corruption and nepotism are contributors but are not the main drivers. If we look around, many countries are inflicted with corruption but are not insolvent and are in fact thriving. India and Indonesia are two such examples. Why?

In a word, the answer is affordability. No country can afford to borrow beyond its foreign currency earning capacity just to meet domestic demand. Simplistically viewed, foreign inward investment appears to be a noninterest-bearing receipt of foreign liquidity as we sell the family silver. In reality, though, it is the most expensive form of foreign borrowing as investors logically expect returns in foreign currency at rates north of 20 per cent per annum as long as their projects are successful.

If these projects are domestically profitable but do not generate foreign revenue or insufficient foreign revenue, profit repatriation will cause an increase in foreign indebtedness for the nation. And that is what has happened and left Pakistan where it is today.

The only way to avoid worsening our predicament is by putting a halt on further foreign-sourced investment into projects that do not directly generate enough foreign revenue to service the foreign currency needs of the particular project.

Similarly, FDI investments into loss-making state-owned enterprises (SOEs) – normally referred to as ‘privatization’ – if analyzed from this perspective are in fact parasitical, because they either do not generate foreign revenues or generate insufficient foreign revenue to service the foreign currency outflows that arise from the project.

Given our current foreign currency insolvency, we cannot afford the additional foreign ‘debt’ that will result from paying for the expensive though legitimate foreign currency dividend repatriation that will ensue thereafter as long as these projects generate profit in rupees.

Any lay reader may be puzzled why FDI – which many countries are pursuing – is not suitable for Pakistan. The answer is timing. Countries that are generating surplus foreign revenue already can afford FDI for import substitution, infrastructure and future exports. But Pakistan is at a different economic stage currently. It is already in a foreign currency deficit situation. The profit repatriation of FDI projects will exacerbate this situation.

There is a widely held view that the privatization of government-owned banks to foreign investors illustrates the success of privatization through FDI as it has resulted in more efficient and profitable banks that are avoiding bad loans. This is indeed a success as a privatization, but it is a failure as FDI.

Pakistan indeed received foreign proceeds but as FDI this is really a very expensive foreign currency loan. They appointed a board that polices a commercially objective culture, and a merit-based technocratic Pakistani management team. However, all these elements do not warrant a foreign shareholder as a prerequisite – the important element is avoiding unhealthy government interference. The successful operation of these banks generates healthy profits. However, this legitimately translates into bucket loads of foreign outflows by way of profit repatriation to foreign owners forever.

In 2OO2 while as president I was restructuring UBL. Islamabad instructed that UBL be privatized through FDI, incredulously stating: “Let us through privatization pay expensive foreign debt with cheap foreign equity”. I raised my reservations over using the FDI route to achieve this privatization and suggested a domestic route for achieving this.

However, I was informed that the decision was final as we had committed the FDI route to the World Bank as a pre-condition to a further foreign loan from them. So as a true soldier, I fulfilled my responsibility. Thereafter, I have witnessed helplessly bucket loads of profit in rupees being converted and paid out as dividends in hard currency to foreign owners and for the foreseeable future. This has spiralled the country’s foreign indebtedness.

Pakistan too can pursue FDI, provided it restricts FDI to export projects that directly generate surplus foreign revenue. Even FDI into mining for export should be re-negotiated such that instead of exporting raw ore these projects are expanded to include downstream projects that maximize domestic value added before exporting. We are bursting with human resources. Why not maximize their deployment by increasing local value addition and thus maximize foreign receipts from this ore that takes millions of years to replenish?

I fully endorse the privatization of loss-making SOEs in the hope that by operating under objective commercial disciplines they become sustainable without burdening the taxpayer. However, if the projects are not generating foreign currency surpluses they should be sold to domestic investors. At the time of sale, whether to local or foreign investors, the government will have to anyway replenish the past losses, after which only a viable business model assuming sound commercial disciplines will be sold.

The price of the sanitized SOE, once presented as a viable model, protected by an independent board of directors that appoints a sound management team, can be realized in the domestic capital market. I would add that on the back of the historically spiralling fiscal deficit and exploding money supply, Pakistan has a deeper domestic savings base to tap for investment appetite.

Any fear that these monopolistic projects may be bought by rich capitalists can be mitigated by restricting the size of individual shareholdings and sold to retail investors. The government should study the privatization models of such nationally strategic SOEs in other countries at times when they were experiencing balance-of-payments challenges. British Airways’ privatization in the 1970s is one such example. The most important benefit is that Pakistani investors become beneficiaries of the profits once materialized rather than foreigners – and Pakistan avoids foreign dividend outlays forever.

Let’s pray greater wisdom prevails in our government so that it halts its current desperate chase of selling Pakistan resources short in the pursuit of short-term foreign liquidity and eliminating the fiscal deficit triggered by loss-making SOEs. If predicated on the wrong projects, FDI will leave the country further indebted and impoverished in the future.

Friends with access to the current government should strive to bring this folly to the decision-makers' attention, notwithstanding their short-term decision horizon. I would like to assume their decision is well intended but has resulted from misunderstanding the contextual situation within which Pakistan’s economy finds itself.

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