Taking the next step

29.4.03 Pak: eco Dawn

By Shahid Javed Burki

A RECENT issue of *Businessweek*, a magazine read widely by the business community the world over carries a story about Pakistan's economic situation. It is one of the most positive accounts I have seen in a western publication in recent times.

The story's main thrust is that the Pakistani economy is now at a point from which it may begin on the path towards growth much higher than the country has achieved in the recent past. That would only happen if the level of investment increases. How would that happen? To answer that question let me refer to the debate that is now raging in the area of development economies.

In spite of the determined effort on the part of various players involved in the drama of development, much of the developing world — in fact, most of it, barring a few countries of East Asia — remain stuck in what economists call a "low level equillibrium trap." This fancy phrase has a simple meaning. What it implies is that a very large number of developing countries do not generate a sufficient amount of resources of their own to produce a healthy rate of economic growth. The poor do not have much capacity to save and much of the developing world's population is very poor. With only small amounts of savings, they need a large infusion of capital from the world outside to kick-start their economies.

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national output as development assistance. The developing world would not stay trapped in poverty if the rich countries had not gone back on their promise to bring about a quantum increase in the level of resources placed at the disposal of development agencies.

As always, the truth lies somewhere in between these two extreme positions. It was to discover what is really the situation concerning the state of development and the economic prospects of developing countries that the international community got engaged in a great deal of activity over the last couple of years. Numerous heads of state and government came together on three occasions to debate the state of the developing world and to devise a new approach to development and poverty alleviation. Conferences were held in New York in September 2000; in Monterrey, Mexico, in March 2002 and in Johannesburg, South Africa, in the summer of last year.

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America; and the opening up to foreign capital and international trade of several large Third World economies, particularly China and Brazil, and, to a lesser extent, India. For the rate of growth in FDI to be sustained, it would be necessary to create a receptive environment in most developing countries and not just those that are privatizing state-owned companies or have large domestic markets that foreigners find attractive. How can this be done?

Third, it is important for various sources of external finance to work together and find synergies in which each partner will be able to play the role with which it is most comfortable. How to ensure that this could — or, indeed, would — happen?

All these issues, posed above as questions, lead to the same conclusion. International conferences are important in that they heighten everybody's awareness of some of the world's more intractable problems. Low growth rates in many areas of the developing world and persistent poverty that is commonly associated with anemic growth are two such problems of which all world citizens should be aware.

But exhortations to do more and to keep under bureaucratic review of what is being done are not necessarily the best way to produce the results we want. It is a good thing to be aware of the problems, also to strategize the means for overcoming them and to keep ourselves generally informed of the way things are developing. But we need something much more than that, and that brings me to my final point.

> It will inevitably be the domestic investor who will be the first to recognize that a positive and supportive environment now exists for him to risk his resources. Once he has done that and demonstrated a successful outcome for his endeavours, foreigners will follow. It is this contribution to development on which we should be focusing a great deal of our attention.

side to kick-start their economies.

There is nothing very new about this finding. It has been around for more than half a century when the colonized world of the first half of the 20th century became the developing world of last century's second half. It was on the belief that poor countries needed to augment their own savings with foreign capital that the world began to erect a complex system of interlocking institutions to ensure that these flows would indeed become available. We now have the World Bank, a series of regional development banks, a large number of sub-regional banks and a vast array of bilateral institutions all working hard to provide the world's poor countries with capital. A significant part of this capital is given on highly concessional terms.

It is my estimate that since the first concessional dollar flowed to the developing world some time in the late 1940s, some three trillion dollars have been provided to poor countries. This is not a small amount; it is equivalent to about a third of the gross domestic product of America at the beginning of the 21st century. What has this large amount of assistance yielded in return? In economics there are always at least two answers to every question. According to one view, most of the aid provided to the developing world has been wasted by corrupt regimes not much interested in helping the citizens of the countries over which they rule. Those disappointed with the returns on foreign aid point, as evidence for their disappointment, the continued existence of a low-level equillibrium trap, persistence of absolute poverty at about the same level in absolute terms — unchanged for decades at about 1.2 billion people — and the widening per capita income gap between the world's rich and poor parts.

And then there are those who maintain that aid has worked. For evidence they use the remarkable increase in life expectancy in all parts of the developing world, the drop in the rate of infant mortality, and the increase in the proportion of children attending school. All this — and many things more — would not have happened if the poor had not received aid from the rich.

In fact, this group laments the fact that most developed countries have failed in their promise, made in the late 1960s, to provide at least 0.7 per cent of their GDP as aid. Today, America sets aside only 0.1 per cent of its

of last year.

These three conferences sought to redefine the purpose of development and the means for achieving it. In New York, the world leaders agreed to reach seven "millennium development goals," the most ambitious of which was to reduce by one-half the incidence of poverty within a period of 15 years, from 2000 to 2015. At Monterrey, the leaders issued a declaration that focused on a variety of issues, including the need for mobilizing private capital for investment in the developing world. At Johannesburg, it was agreed not to ignore environment as the world pushed to increase the rate of economic growth in poor countries. Development, to be sustainable, had to mind the world's physical resources and not permanently degrade them. Do we now have a new strategy of development as a result of these three well attended conferences? Having taken a close look at the experience of development over the last half century, are we now closer to finding a solution to persistent poverty, widening income disparity, and an assault on environment? Is there something missing from the way the new development strategy has been framed on which we need to focus?

In this space today I will take up the last question and make three points which have significant pertinence for the world at the start of the 21st Century. One, the most significant development of this past decade and a half has been the enormous growth in foreign capital flows to the developing world. The really attractive part of this flow is foreign direct investment which has increased steadily year after year by more than 10 per cent per annum and is considerably less volatile than other types of external flows, in particular funds invested in developing countries' capital markets.

At about 250 billion dollars a year in recent years, FDI is close to five times the amount of net ODA received by the developing world, hence its increasing significance in augmenting the low rates of savings in poor countries. However, we know that some 80 per cent of FDI is concentrated in only a dozen countries in East Asia and Latin America. What could be done to spread this amount more evenly across the developing world?

Second, a significant amount of FDI was produced by two developments: privatization of state-owned assets in many parts of the developing world, in particular in Latin

something much more than that, and that brings me to my final point.

I am struck by the fact that so little was said about the need to increase domestic investment in the documents prepared for and the statements issued after the three conferences to which I have referred. And yet we know from the experience of the countries that have climbed out of poverty and are now industrialized, that in their case it was increased domestic investment that led the way. Once domestic investors developed confidence in the future of their economies, they found ways of raising resources for deployment. Some recent analytical work done on sources of growth suggests that domestic investor confidence is by far the most important contributor to sustained development.

If that is the case, we need to focus our attention not just on how to increase ODA, how to get more foreign investment into the developing world and how to get the various sources of external finance to work in tandem. We need also to work on improving the environment for domestic investors and, with that as the focus, we need to focus much more on issues of governance.

Domestic investors look for the same type of comforts demanded by foreign players: security for their investments, their employees, and their assets; a sound legal framework in which contracts can be speedily enforced; a transparent regulatory system that works not to generate rents for those who enforce it but to protect both the investor and the consumer; continuity of government policies; a good human resource; and a sound physical infrastructure.

It will inevitably be the domestic investor who will be the first to recognize that a positive and supportive environment now exists for him to risk his resources. Once he has done that and demonstrated a successful outcome for his endeavours, foreigners will follow. It is this contribution to development on which we should be focusing a great deal of our attention, but also as part of a new and more focused development strategy for reigniting growth and alleviating poverty.

The implication of this for Islamabad's policymakers should be clear from what I have said above. They must focus a great deal of their attention on creating an environment that is friendly for domestic investors. Once local investors loosen their purse strings, foreigners will most certainly follow.