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The relationship between foreign direct investment and pro-poor growth policies in Pakistan: The new interface

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ABSTRACT

The lack of asset accumulation may be one of the major reasons for poverty; consequently, the poor have not been able to sustain growth. Investment in the assets of the poor will play an essential role for formulating pro-poor growth policies. The aim of this study is to investigate the potential impact of FDI on the poor in Pakistan over the period 1985–2011. The regression model encompassing the impact of FDI on poverty reflects that if there is one percent increase in FDI is likely to reduce poverty by 0.47% at urban, 0.44% at rural and 0.46% at national levels respectively. The result concludes that although, there is a positive impact of FDI on poverty, this positive impact is not sufficient enough to conclude that investment is pro-poor in Pakistan, because, an intensity of income inequality is more than the FDI's poverty reduction at rural, urban and national levels. Pakistan's investment, poverty and inequality statistics were studied for the first time in terms of pro-poor growth scenario. Pro-poor investment index (PPII) and poverty equivalent investment rate (PEIR) reveal that investment is pro-poor in Pakistan from 1985–1986 to 2002–2005, however, the subsequent years from 2005 to 2011 demonstrated pro-rich investment scenario in Pakistan. If the investment still remains anti-poor in the subsequent years as reflected in the years 2005 to 2011, there is a likelihood that investment may not trickle down to the poor but instead to the non-poor in Pakistan. Thus checking vulnerability would offer wide option for the policy makers to settle the issue of the severity of poverty in the future.

1. Introduction

The lack of asset accumulation may be one of the major reasons — why the poor have not been able to sustain growth. Therefore, investment in the assets of the poor will play an essential role in pro-poor growth policies (Kappel et al., 2004). Financial transfers immediately increase the poor's disposable income and thus welfare. Even so, investments in the assets of the poor are clearly preferable as they durably enable the poor to better participate in and benefit from economic activities without making them dependent on welfare programs (Klasen, 2003).

The United Nations' Millennium Declaration of 2000 outlines eight Millennium Development Goals (MDGs) for 2015. All eight aims are related with human development and reduce poverty in developing nations[1]. Pakistan is a capital-scarce economy and has been relying heavily on foreign capital inflows to finance the saving–investment gap (Siddiqui and Kemal, 2006). In addition to the low saving and investment ratios and lack of physical and human capital, Pakistan is faced with political and macroeconomic instability due to which large and continuous flow of foreign inflows is required to supplement its growth (Ali and Nishat, 2010). The inflow of FDI into Pakistan is small and concentrated only on a few areas, mostly in the power sector. In 1997, Pakistan accounted for 0.2% of world FDI, less than one percent of developing country and Asian country FDI, and 18% of South Asian countries' FDI. In spite of liberalizing its formerly inward-looking FDI regime, tempering or removal of obstacles to foreign investors, and according to various incentives, Pakistan's performance in attracting FDI has been lackluster (Khan and Kim, 1999).

Pakistan over the last few years has developed itself as a potential market for foreign investors with its liberal investment policy, cheap labor, tax incentives and good return on investments. Table 1 demonstrates the FDI in Pakistan over the last decade.

In the general development debate, economic development as measured by growth in GDP per capita is viewed as an important, but not sufficient, means of achieving improvements in human well-being or reduction in poverty (Zaman and Ahmed, 2008; Zaman et al., 2009a, 2009b). The basic framework of analysis is thus the phenomenon of trickle-down effects of economic growth, provided that mechanisms exist to facilitate such trickle-down effects to the impoverished (Zaman et al., 2010a).

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Table 1
FDI in Pakistan (US $ million).

Year	Greenfield investment	Privatization proceeds	Total FDI	Private portfolio investment
2001–2002	357	128	485	−10
2002–2003	622	176	798	22
2003–2004	750	199	949	−28
2004–2005	1161	363	1524	153
2005–2006	1981	1540	3521	1820
2006–2007	4873	266	5139	19
2007–2008	5019	133	5152	−510
2008–2009	3719	-	3719	378
2009–2010	2718	-	2718	417
2010–2011	3978	-	3978	345

Source: GoP (2011).

According to Tambunan (2005, p.1),

The most important mechanism by which trickle-down occurs is via economic growth-led employment creation. FDI may have positive effects on poverty reduction mainly through three ways: (i) labor intensive economic growth with export growth as the most important engine, (ii) technological, innovation and knowledge spillover effects from FDI-based firms on local economy, and (iii) poverty alleviation government programs or projects financed by tax revenues collected from FDI-based firms.

Pakistan's commitment is to reduce poverty by stimulating growth in the production sector; creating adequate employment opportunities; improving income distribution; and harnessing the country's economic competitiveness through economic liberalization, deregulation and transparent privatization (GoP, 2010). The Government prioritized the 17 pro-poor sectors through the Medium Term Expenditure Framework (MTEF) from 2008–2009 to 2010–2011. The following social safety nets are major initiatives to reinforce the Government's efforts to reduce the adverse effects of poverty on the poor i.e., Benazir Income Support Programme; Waseela-e-Haq; Pakistan Bait-ul-Mal; Initiatives in Microfinance; Microfinance Credit Guarantee Facility; Institutional Strengthening Fund and Improving Access to Financial Services (GoP, 2011). Table 2 shows the budgetary poverty related expenditures of Pakistan from 2007 to 2011.

Carvalho and White (1996) opine that foreign inflows can affect poverty directly or indirectly. The direct impact comes from the increase in household income while the indirect effect comes from the spillovers of different income generating activities directly affected by foreign inflows. The foregoing discussion confirms a strong linkage between FDI and poverty; however, the results are mixed i.e., whether FDI inflows increase poverty or reduce poverty (Ali and Nishat, 2010; Khan and Kim, 1999; Shahbaz and Aamir, 2008; Klein et al., 2001).

This study intends to determine the correlation between FDI, poverty and inequality in the social context of Pakistan. Time series analysis on poverty measures from different Household Income and Expenditure Surveys/Pakistan Integrated Household Survey is taken for analysis, by selecting survey from 1985 to 2011. In the previous studies on Pakistan, with the exception of Amjad and Kemal (1997), investigators have dealt with the data for very limited time period and have used different poverty lines. In order to achieve the desired objectives; this study uses the multiple regression method and subsequently estimates elasticities for analyzing pro-poor investment index. Pro-poor investment index is calculated on this data set, as proposed by Kakwani and Pernia (2000) and Kakwani and Son (2004). The more specific objectives are:

- To analyze progressive changes in poverty and FDI in Pakistan,
- To assess the magnitude of investment flows and its benefits extended to poor,

Table 2
Budgetary poverty related expenditures by sectors (Rs. million).

Sectors	2006–2007	2007–2008	2008–2009	2009–2010	2010–2011[a]
Roads, highways & bridges	60,003	84,825	99,613	98,456	21,121
Water supply and sanitation	16,619	19,817	22,204	25,459	6640
Education	162,084	182,646	240,378	259,525	153,582
Health	53,166	61,127	83,714	94,399	40,898
Population planning	7002	13,322	5345	7048	2245
Social security and welfare	4513	18,942	29,129	54,571	22,606
Natural calamities	5008	7728	10,083	12,548	-
Agriculture	74,771	83,493	88,912	104,815	35,357
Rural development	22,175	23,334	16,362	20,391	4838
Subsidies	5455	54,872	220,567	234,926	74,458
Food support program	3458	4370	12,420	0	-
Low cost housing	299	597	583	1828	67
Justice administration	5081	7820	9193	10,996	6284
Law and order	2088	2429	104,658	143,639	72,922
Total	421,722	565,322	943,161	1,068,601	441,018

[a] July — December; source: GoP (2011).

- To establish pro-poor growth index as a reference to foreign direct investment.

The study hypothesized that as the foreign direct investment increases; the rate of poverty decreases and it benefits the poor proportionally more than the non-poor. Although, investment is necessary but it is not sufficient to make any significant dent to poverty (Zaman et al., 2010b). This concept is to be tested in Pakistan's social context.

The paper is organized as follows: after the introduction which is provided in Section 1, literature review is carried out in Section 2. Methodological framework is explained in Section 3. The estimation and interpretation of results is mentioned in Section 4. Section 5 concludes the paper.

2. Literature review

2.1. FDI and growth nexus

The role of foreign economic assistance in economic development and growth remains contentious in economic literature. Some empirical studies have shown its positive impact on economic development, while others have highlighted its negative effects as well. Chenery and Strout (1966) concluded, on the basis of empirical evidence from LDCs that foreign capital has a positive effect on economic growth. Bosworth et al. (1999) applied a regression analysis on a sample of developing economies to analyze the effectiveness of various forms of the foreign capital inflows and found that FDI has a strong positive impact on domestic savings and investments than other forms of foreign capital inflows like loans, portfolio investment and borrowings where some of these forms of foreign capital inflows have negative impact on domestic savings and investment.

The relationship between growth and foreign capital inflows varies depending on the countries and variables included in the studies. For example, Shabbir and Mahmood (1992) estimating a two equation model of the rate of real economic growth and saving ratio found that net foreign private investment, disbursements of grants and external loans have a positive impact on the rate of growth of real GNP in Pakistan. Aslam (1987) examined that the public foreign capital inflows did not affect the domestic investment significantly, while the private foreign capital inflows bridged the domestic saving investment gap. To explore the links between globalization and poverty in South Asia, Siddiqui and Kemal (2002), examined globalization impacts on poverty in two different scenarios with homogeneous and heterogeneous labor. They used Computable General Equilibrium Model for Pakistan to conduct simulations in order to assess the impact of an increase in foreign capital on poverty both in the presence and in the absence of trade liberalization. The results reveal that overall globalization hurts the poor in Pakistan.