



Implementing Regulatory Reform

Foreign Investment Advisory Service

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SOUTH ASIA: PERCEPTIONS OF BUSINESS AND INVESTMENT ENVIRONMENT

Introduction

The paper summarizes independent global surveys of perceptions of the business and investment environment in the eight South Asian countries, which display a wide diversity.

A selection has been made of the most relevant surveys available in the World Bank Group collection. The surveys summarized are: the United Nations Conference on Trade and Development (UNCTAD)'s indices of inward Foreign Direct Investment (FDI) performance and potential, the Economist Intelligence Unit (EIU)'s global business environment rankings, AT Kearney FDI Confidence Index and Globalization Index, International Institute for Management Development (IMD)'s World Competi-

tiveness Yearbook, and World Economic Forum (WEF)'s Global Competitiveness Report. Symptomatic of South Asia's low FDI profile, the available surveys provide only a patchy coverage of South Asian economies.

The paper begins by summarizing FDI data for South Asia drawing on the UNCTAD World Investment Report 2004, including its associated Inward FDI Index, and on the Global Business Environment Forecasts to 2009 developed by the Economist Intelligence Unit. In each case the latest available data has been accessed.

UNCTAD, World Investment Report 2004

Even though global FDI inflows declined in 2003 for the third year in a row to \$560 bil-

Table 1: South Asia at a Glance, 2003

	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Area, surface (000 sq km)	652	148	40	3,287	0	147	796	66
GDP (US\$ million)	4,708	51,914	697	600,637	715	5,851	82,324	18,237
GDP growth (annual %)	..	5.26	6.7	8.6	9.19	3.09	5.15	5.9
GDP per capita (constant, US\$ 2000)	..	395	680	511	2548	241	546	921
Population, total (millions)	..	138	0.87	1,064	0.29	25	148	19
Labor force, total (millions)	..	71	0.42	473	0.12	12	56	9
FDI, net inflows (US\$ millions)	..	102	0.2	4269	14	15	534	229
FDI, inward stock (US\$ millions)	19	2,695	4	30,827	154	148	7,764	2,897

Source : WB, World Development Indicators & Global Development Finance; UNCTAD, World Investment Report, 2004, EIU, Country Profiles

lion since it reached record levels in 2000 at \$1.271 trillion, largely due to a fall in inflows to developed countries, the inflows to developing countries rose by 9% (from \$158 billion in 2002 to \$172 billion in 2003). The latter, however, widely varied by region. The inflows to Asia-Pacific and Africa were up by 14% (\$107 billion) and 28% (\$15 billion) respectively. Inflows to Latin America and the Caribbean declined marginally from \$51 to \$50 billion, while that to Central and Eastern Europe (CEE) fell sharply from \$31 billion to \$21 billion between 2002 and 2003. Liberalization of FDI regimes and improvements in the regulatory framework, among other factors were viewed as facilitators to FDI inflows into developing countries. According to an UNCTAD survey of 335 of the world's largest TNCs and 87 site-selection experts, FDI flows are expected to pick up in Asia and the Pacific and CEE. China and India in Asia and Poland in CEE are considered to be well positioned for an upswing.

China (excluding Luxembourg) became the world's largest FDI recipient in 2003, overtaking the US, the traditionally largest recipient. Within Asia, there is considerable unevenness of FDI inflows. While flows to Southeast Asia rose by 27% to \$19 billion, South Asia received only \$6 billion, despite a 34% increase. Within South Asia, India was the largest recipient with \$4,269m, followed by Pakistan with \$1,405m, Sri Lanka with \$229m, Bangladesh with \$121m, Nepal with \$30m, the Maldives with \$12m, Afghanistan with 1m, and Bhutan not recorded. Their reliance on FDI also varies widely, e.g. the respective proportions of FDI inflows to Gross Fixed Capital Formation and FDI Stock to GDP for each country are: Bangladesh 1.1% and 5%, Bhutan 0.1% and 0.7%, India 4% and 5.4%, Maldives 8.6% and 23%, Nepal 2.7% and 2.5%, Pakistan 15.4% and 10.7%, and Sri Lanka 6% and 15.6%, respectively.

Overall, in the developing world, FDI concentration was 11 percentage points less in 2003 than in 2000 when it was the highest. Nonetheless, the top ten recipients accounted for almost three-fourths of total flows to developing countries.

Indices of Inward FDI Performance and Potential

Countries vary greatly in terms of their success in attracting FDI. The Inward Performance Index gauges the underlying attractiveness of a country for foreign investors, taking into account the size of the economy and competitiveness. It ranks countries by the amount of FDI they receive relative to their economic size, calculated as the ra-

tio of a country's share in global FDI inflows to its share in global GDP. A value greater than one indicates that the country attracts more FDI in proportion to its economic size, a value below one shows that it receives less, and a negative value indicates that foreign investors disinvested in that period. Thus a higher index implies success in the competition to attract FDI.

While all of the developing regions improved their performance index rank in 2001-2003, the indices for South and West Asia were far below one: 0.37 and 0.31, respectively. The best performer in the Index among the developing regions was Central Asia (4.49) followed by East and South-East Asia (1.54).

Belgium and Luxembourg were the best performers, while Suriname was the worst (ranked 140) according to the ranking based on Index for 2001-2003. Among the South Asian countries, Pakistan ranked 97, Sri Lanka 104, India 114, and Bangladesh 133 out of 140 countries, which implies a relative poor performance of South Asian countries in competing for FDI.

Similarly, all four of these South Asian countries were classified as "under performers" with very low scores on the of Inward FDI Potential Index which consists of 12 structural variables related to GDP, growth, export, import, commercial energy use, telecommunications, infrastructure, tertiary education, R&D expenditure and FDI stock.

Global Business Environment Forecasts to 2009 (Economist Intelligence Unit), May 2005

The EIU global business rankings model measures quality of the business environment using quantitative data, business surveys and expert assessments. It reflects the main criteria used by companies in formulating their global business strategies and investment location decisions. It covers 60 countries, including three from South Asia (India, Pakistan and Sri Lanka). The scores (on a scale of 1 to 10) and rankings are based on over 70 indicators, grouped into ten different categories of the business environment and produced for 2000-04 and 2005-09.

Among the three South Asian countries, India's position is 48, Sri Lanka 50 and Pakistan 55 (in the ranking of 60 countries). Canada is first, while Iran is the 60th. The business environment in India and Sri Lanka are graded "poor" in 2000-04 and forecasted to be "moderate" in 2005-09, while that in Pakistan is graded "very poor" in 2000-04 and expected to change to "poor" in the next five years.

A T Kearney's FDI Confidence Index, October 2004

The index, which is based on a survey of senior executives of the world's 1,000 largest corporations, is designed to gauge the likelihood of investment in specific markets. It provides data only for India from among the South Asian economies. While China maintains its position as the number one most attractive FDI destination in the world, India has risen from the sixth to the third most likely FDI location globally — the country's highest ranking ever, just behind the US. Although the US remains in the second position, the perception gap between the US and India is closing as investors pursue aggressive off shoring strategies.

CEOs view China and India as the most attractive FDI destinations in the next three years and well into the future, beating markets like Brazil, Mexico and Poland for medium-term attractiveness. While investors view India's highly educated workforce, management talent, rule of law, transparency, cultural affinity, and regulatory environment as more favorable than what China presents, they do view that the investment climate in India is not without its problems. The legal and regulatory environment, corruption and the lack of transparency are viewed as the greatest perceived risks to doing business in China, while bureaucratic procedures and political stability are judged by the investors to have the most serious impacts on India's competitiveness.

Flash Survey

This was conducted in the aftermath of 11 September from 1000 senior executives. Although nearly 95% are more concerned about the global economy than they were a year ago, two-thirds say they still intend to invest abroad at about the same levels already planned for 2002. Geopolitical factors have overtaken economic variables as the key determinants of FDI activity. The US has experienced the largest negative shift in investor sentiment, while China is the only major economy to experience a positive shift, with close to 15% of respondents reporting improved perceptions. China is expected to achieve inflows of \$1 billion in 2001 against a shade less than that in 2000, a remarkable testament to perceptions of its ability to maintain high levels of economic growth on accession to the WTO. The escalating tensions in Central Asia and on its borders with Afghanistan, Pakistan and India are the significant perceived threats.

Now that the M&A boom of 1998-2000, which drove the acceleration of FDI growth to a record level of about \$1.3 trillion in 2000, has subsided, future FDI growth rates are projected by UNCTAD to decrease by about 40% to \$760m in 2001, the lowest level since 1991, and future growth rates are likely to return to the more modest levels of the early nineties. Developed countries will be hardest hit, receiving only half the flows they did in 2000, while developing countries will see more moderate decreases of about 6%, while increasing their share of global flows (but not to previous highs). These pre-terrorist projections are likely to more or less hold, despite CEO negativity on the global economy outlook due to their 'steady as she goes' approach to their already planned reduced levels of FDI. But, for the first time, a greater percentage are inclined to reduce investments rather than to increase them.

Globalization Index

The fifth annual A T Kearney / Foreign Policy Magazine Globalization Index, which appeared in 2005, shows that global integration survived the turbulence of Iraq war, a sharp economic downturn, and the failure of trade talks. It covers 62 key advanced and emerging markets, ranking countries based on their levels of political, economic, personal and technological globalization. The ranking, however, is very poor for the South Asian countries. India is in the worst position (61 out of 62 countries), followed by Bangladesh (58), Pakistan (50), and Sri Lanka (43). China ranks as 54th, while the first position is obtained by Singapore, followed by Ireland, Switzerland and the US.

IMD World Competitiveness Yearbook 2004

In this survey from the Institute for Management Development, a Geneva-based management school which began in 1989, India ranks 34 out of 60 countries in terms of its ability to provide an environment in which enterprises can compete. China, its major competitor, ranks 24. In terms of economic performance, government efficiency, business efficiency, and infrastructure, the rankings of India and China are, respectively: 12 and 2, 33 and 21, 22 and 35, and 57 and 41. Thus, only in terms of business efficiency does India out perform China.

WEF Global Competitiveness Report, 2004

This global survey has been conducted annually since 1996. According to the overall growth competitiveness index in 2004, India ranks 55 while

China 46 out of 104 countries. The ranks of three other South Asian countries as covered in the survey were: Sri Lanka 73, Pakistan 91, and Bangladesh 102.
