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Impact of Foreign Direct Investment (FDI) on Economic Growth of Pakistan

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Abstract
In this study, by using time series analysis we investigated the impact of foreign direct investment on economic growth of Pakistan. We collected the data from IMF and World Bank official websites from 1967 to 2012. We used five variables for this purpose likeFDI,it is dependent variable and Inflation (independent variable),GDP (independent variable),Exports (independent variable) and Imports (independent variable).GDP and Export have the positive relationship with FDI and inflation and import are negatively related with FDI.We used the OLS technique for this purpose. Result suggests that the Pakistan economy isremarkable. If we control the inflation and imports that is increasing day by day, and if we concentrate for increasing the exports then our GDP will increase and we can make the Pakistan economy very well.
Key words:FDI, GDP, Inflation, Import,Export**,** OLS.IFM and World Bank

Introduction:
Economic Performance and economic growth of a country is influenced by several factors for example import/export, foreign direct investment, taxation system, law and order, government policies employment level and inflation. After World War II most of the developing and developed countries in the world adopt aggressive economic strategies to get the economic growth rate of real domestic product. During the year of 1960's to 1980's Japan and four newly industrialized nations (Taiwan, Korea, Singapore and Hong Kong) started to develop their economies and got remarkable outcome. After the half of 1980's, Indonesia, Thailand, Philippines and Malaysia (ASEAN-4) along with China practiced rapid growth and the effect of this expansion also spread to Vietnam and India during that period of time. This rapid cluster expansion of Asia is unique in the sense that its effects were not seen by other nations of the world (World Bank 1993; UNCTAD 1995; Fukasaku 2006). The main reasons for this growth among the others were open economy in the sense of export lead policy, foreign direct investment lead expansion, accumulation of human capital, high levels of domestic savings and market friendly government (World Bank, 1993). Since Pakistan is also Asian nation, here the question arise why Pakistan cannot to achieve rapid growth like the other Asian countries in that time period and what could be the possible role of the above variables in the growth of Pakistan. It has been examined in that period Pakistan actually failed to identify the importance of those variables. If we see the history of economic growth of Pakistan, we will observe several flaws in the construction and implementation of economic strategies made by the related authorities and government.
It has been observed that the foreign direct investment (FDI) is a significant factor that influence significantly on

economic growth of a country. Foreign Direct Investment (FDI) is a most important source of external resource of inflows to developing countries over the years and has become a important part of capital formation in these developing countries, regardless of their share in global distribution of FDI continuing to remain small or even declining. Foreign direct investment (FDI) has been widely considered as a growth-enhancing factor in the developing countries. The effects of FDI in the host country are; boost the employment level, increase in the productivity, boost in exports and improved pace of transfer of technology. The potential benefit of the FDI on the host country are; it facilitates the utilization of local raw materials, introduces new techniques of management and marketing, ease the access to new technologies, foreign direct investment inflows can be used for financing current account deficits, FDI do not generate repayment of principal and interests (as opposed to external debt) and increases the stock of human capital via on the job training. Many policy makers and academics argue that foreign direct investment (FDI) can have significant positive effects on a host country's developmenteffort. In addition FDI can be a source of valuable technologies and know-how while develop linkages with domestic firms.

Thomas, et al. (2008) has argued that multinational corporations' investment imposes the pressure on the local firms in the host country to develop new technologies and innovate. It is also explains why the developing countries are interested in taking measures that attracts foreign direct investment. The developing countries face the problem of gap between savings and thereinvestment which is also to be a bridge by FDI. Results of FDI in technology transfer, creates job, increase in productivity and competition. Kobrin and Le (2005) and Ataullah (2006) such advantages have encouraged the developing countries, including Pakistan, to attract FDI inflows. In order to determine the existence of such merits, several studies have been conduct to check the impact of FDI on economic growth. However, theories and empirical literature happen to offer mixed indication regarding the impact of FDI on economic growth in developing countries.

This paper is an effort to examine the impact of FDI on economic growth of Pakistan. The rest of the paper is organized as follows: discusses the theoretical and empirical literature on the relationship between FDI and economic growth, Data collection, methodology, definition of variables, the empirical findings concludes our findings and discusses our results.

Literature Review

In this study we examine the impact of foreign direct investment on economic development. Firstly we understand what is foreign direct investment, the foreign direct investment refers as a company situated in foreign country directly invest in enhancing the production of target country and this investment can be done by foreign country in many way like increase the on hand activities in target country or purchase a firm. BY FDI not only international fund is received but also advanced technology managerial skills and employment prospect are gained (blog.org). The FDI has significant in both developed and less developed countries. Both developed and developing nations are attracting toward FDI for getting foreign capital. In this study done on the impact of FDI on Indian economy find out that government should invest FDI in those areas where production and export in India can be increased so that more foreign investor are attract toward (E, 2013).Investment plays an important role in the progress of economy. Out of all the foreign capital provided to developing country and secure kind of external capital .Not only one nations get advantage rather both nations gain advantage from the FDI (E, 2013).Different studies provide the different views about FDI these studies are examine in this paper.

According to this study many countries are face the problem of capital shortage without capital firms are not run the business activities like managerial productivity; development process and competitive advantage to achieve this company's need capital. On the other side the investor of developed countries wants to achieve the high return on capital .The inward and outward both type of investment are necessary for the development of the counties (Nishal, 2005).In 1980 by the government of Pakistan provide the many facilities to promote the foreign direct investment like tax reduction, tariff, credit facilities, liberalized its trade and foreign exchange rate eased.

During 1990, the foreign direct investment rates are low in Pakistan due to many reason rapid Change in political , environmental change and energy crises even the Pakistan further liberalized the policies , telecommunication and agriculture sector (Nishal, 2005). In this study examine that the labor intensive industries which linked the production activities show that negative linked between foreign direct investment and wages the major element of cost function are labor cost.(Kravis and Lipsey , 1982 ;wheeler and Mody, 1990 ;Lucas , 1993, Wang and swan , 1995 and Barrel and pain 1996), Some researcher said that positive linked among labor cost and foreign direct investment The countries obtained the foreign direct investment opportunities if these countries have the good labor skills, trade policies and relaxation in the tax and tariff. The causal relationship among growth in developing countries and foreign direct investment this is show that increase in economic growth due to foreign direct investment (Hansen and Rand 2006).This study show that complex linked among foreign direct investment inflow and host country trade balance. The positive trade shows the strong economy that is the flow of inward foreign direct investment. The deficit or negative foreign direct investment show that weak or low rate of export and different import policies (Lonnatos, 2004). The foreign direct investments make the value chain like, It is the regional industrial development compact,

- Partnership among investment promotion agencies and trade.
- Partnership among government in regions.
- Partnership among public sector and private sector.
- Partnership among government (UNCTAD) and international organization.

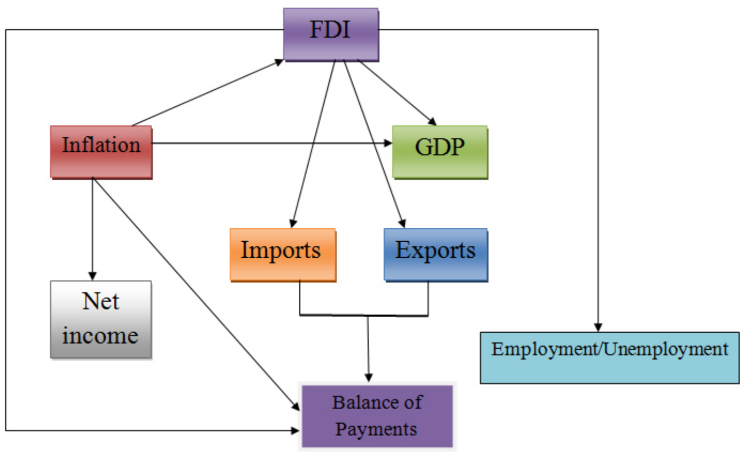
The foreign direct investment are attract those countries where low trade barrier. Even high transaction cost if high trade barrier but in the horizontal foreign direct investment more attract where high trade barrier because due to high horizontal FDI provide the more protection to foreign investor output in the domestic market (Ali , Fiess ,and MacDonald 2010).Foreign direct investment is important for economic growth. According to Todaro, Smith and Hayami, Foreign direct investment is an important factor for economic development of any country. Foreign direct investment has a positive relationship on economic growth that expands the market size, which attract further foreign direct investment. Some studies says that, in this literature we found that on the recipient countries foreign direct investment have a positive growth effect.(De Mello, 1999; Chong et al., 2010).This paper observe the foreign direct investment sinflows India and China, as the China received more foreign direct investment flows as compare to India due to various reasons e.g. China start to receive foreign direct investment in 1979 and become liberalized in terms of investment system. India allowed to foreign direct investment long before of china but did not take steps towards liberalization until 1991. China adopting proactive approaches that attract more foreign direct investment, China provides potential foreign market, low labor costs, , favorable investment incentive that are the important factors for attraction of foreign direct investment (iqbal, et al., 2013).According to Mahmood and Chaudhary (2013) impact of foreign direct investment on tax revenue, the study uses foreign direct investment, GDP of per person employed as an independent variable and tax revenue as a dependent variable. Auto - Regressive Distributive Lag (ARDL) and its error correction model that are used for short run and long run relationships in tax revenue model. Results indicate that short run and long run relationships exist in the tax revenue model. Foreign direct investment has a positive and significant relationship on tax revenue, so the FDI is helpful to increase the tax revenue to the government. GDP of per person employed has a positive and significant relationship on tax revenue, so it also helps in increasing the tax revenue. According to Yasin and Ramzan (2013) this study examined the impact of foreign direct investment and exports on Pakistan economic growth variables have been analyzed through Auto Regressive Distributed Lag Model (ARDL). The results of this study show that there is no long run relationship between dependent and independent variable. In this study we found that there is short run relationship between dependent and independent variables; this shows that this model is not good fit. Exports and foreign direct investment volume less contribute for the economic growth of country.

Methodology

Foreign direct investment (FDI) is often seen as an important factor for economic growth in the developing countries. The core object behind this study is to explore the FDI impact on economic growth and other variables e.g. inflation, employment and unemployment for the development of Pakistan by Foreign Direct investment (FDI) & find out the impact of GDP growth. For this we collect secondary data from 1967 to 2012. The source of data is international monetary fund (IMF) official website. Frequency of data was on annual basis.

- FDI (Dependent variable)
- Inflation (independent variable)
- GDP (independent variable)
- Exports (independent variable)
- Imports (independent variable)

Theoretical Framework



Hypotheses:
H1: FDI impacts on GDP
H2: FDI linked with export
H3: FDI impacts on import
H4: FDI influenceunemployment
H5: FDI effects on inflation
Time series analysis

No of years	FDI , Net inflows (BOP current US$)	FDI net inflows (% of GDP)	GDP per capita (current US$)	Exports (us $)	Imports (us $)	Inflation, consumer prices (Annual %)
1967	3688040000.0	2.6	135.15	678985800	1340972000	6.81
1968	4918720000.0	3.4	143.80	740984600	1194975000	0.17
1969	6149400000.0	4.3	149.38	747984300	1196975000	3.19
1970	23000000.00	0.23	168.86	778983700	1470969000	5.35
1971	1000000.00	0.01	173.71	757234100	1355999000	4.73
1972	17000000.00	0.18	148.35	1096084000	1580919000	5.18
1973	(4000000.00)	-0.06	97.98	855556200	1031186000	23.07
1974	4000000.00	0.05	132.01	1200200000	1822800000	26.66
1975	25000000.00	0.22	165.59	1230800000	2539300000	20.90
1976	8220530.00	0.06	188.84	1430100000	2584200000	7.16
1977	15223200.00	0.10	207.48	1404400000	2877100000	10.13
1978	32273190.00	0.18	236.64	1646700000	3293000000	6.14
1979	58254130.00	0.30	253.21	2107300000	4485001000	8.27
1980	63632990.00	0.27	294.31	2958200000	5709197000	11.94
1981	108084800.00	0.38	337.42	3461200000	6466601000	11.88
1982	63833090.00	0.21	356.50	3055881000	6687354000	5.90
1983	29457030.00	0.10	321.66	3419646000	6592699000	6.36
1984	55510170.00	0.18	337.51	3448628000	7048454000	6.09
1985	131389300.00	0.42	326.23	3246344000	7105458000	5.61
1986	105730300.00	0.33	323.16	3796228000	7230436000	3.51
1987	129377600.00	0.39	326.94	4414018000	7005030000	4.68
1988	186491600.00	0.48	365.25	5227069000	833711400000	8.84
1989	210599900.00	0.52	369.83	5576987000	8735975000	7.84
1990	245263000.00	0.61	357.73	6216943000	9350912000	9.05
1991	258414500.00	0.57	395.34	7725444000	8434857000	11.79
1992	336479900.00	0.69	412.13	8442739000	9984114000	9.51
1993	348557000.00	0.68	425.34	8394305000	11552190000	9.97
1994	421024600.00	0.81	418.10	8449778000	9883123000	12.37
1995	722631600.00	1.19	476.15	10132270000	11777210000	12.34
1996	921976200.00	1.46	484.33	10703070000	13567630000	10.37
1997	716253100.00	1.15	465.03	10040500000	12967600000	11.38
1998	506000000.00	0.81	451.29	10252210000	10900340000	6.23
1999	532000000.00	0.84	445.80	9668691000	10684440000	4.14
2000	308000000.00	0.42	511.70	9940179000	10862330000	4.37
2001	383000000.00	0.53	490.04	10600270000	11361300000	3.15
2002	823000000.00	1.14	480.74	11007710000	11073080000	3.29
2003	534000000.00	0.64	543.59	13917670000	13,423660000	2.91
2004	1118000000.00	1.14	628.63	15350080000	14337310000	7.44
2005	2201000000.00	2.01	690.85	17195690000	21441920000	9.06
2006	4273000000.00	3.35	789.41	19418010000	29603690000	7.92

2007	5590000000.00	3.90	870.63	20320950000	30555710000	7.60
2008	5438000000.00	3.32	978.80	21056880000	39137640000	20.29
2009	2338000000.00	1.44	949.12	20808540000	33030000000	13.65
2010	2018000000.00	1.14	1016.61	23955250000	34300240000	13.88
2011	1308770000.00	0.62	1189.37	29756880000	40423580000	11.92
2012	76660000.00	0.46	1185.15	678985800	4057657000	8.79

Table.1 Expected signs from literature

Variable	Description	Sources	Expected sign
FDI	Investment in fix assets in foreign.	World bank	
GDP	Use to measure the economic growth of country	World bank	+ve
IMP	Imports generate income at abroad	IMF	-ve
EXPR	Exports of goods and services generate income at home	IMF	+ve
INF	Outcome of inflation is the tendency of all Prices and wage rates to rise.	World bank	-ve

Table.2 Descriptive statistics

Method	EXPR	FDI	GDP	IMP	INF
Mean	22.23208	0.951522	439.4715	22.76981	8.952826
Median	22.40952	0.550000	367.5400	22.87318	7.880000
Maximum	24.11633	4.300000	1189.370	27.44915	26.66000
Minimum	20.33611	-0.060000	97.98000	20.75398	0.170000
Std. Dev.	1.156561	1.096799	279.9765	1.231852	5.403217

Table.3Unit root test

Variables	I(o)
FDI	-3.588509***
EXPR	-2.928142**
IMP	-3.584743***
INF	-2.602225*
GDP	-3.584743***

***, **,* show 1%, 5% and 10% level of significance

Table.4 Covariance

	EXPR	GDP	IMP	INF
EXPR				
GDP	217.7336			
IMP	1.118244	213.0377		
INF	0.247422	170.9877	0.294249	

1. Results

Table. 5 Regressions:

R square	Adjusted R square	F-statistic	Prob(F-statistic)	Durbin-Watson
0.519	0.433	32.387	0.0255	0.604

Table. 6

Variable	Coefficient	t-statistic	Prob.
EXPR	0.508	2.0056	0.04112
GDP	0.0016	1.970	0.04058
IMP	-0.1441	-0.6477	0.5208
INF	-0.0604	-2.0139	0.0397

Interpretation:

Beforapplying the ordinary least square (OLS) Method to estimate the Coefficient of Regression equation. We tested the stationary of variables. The stationary of the time series is tested through the Augmented Dickey Fuller(ADF) test. Each series is tested at levels, and with the only exception of 'FDI' all variables are found to have unit root and the series are stationary at levels. Dependent variable FDI is stationary at level at 1% Level of significance. Our independent variables are found to be stationary such as GDP at level at 1% level of significance, IMP at level at 1% level of significance, EXPR at level at 5% level of significance and
Inflation is stationary at level at 10% significance level. Our finding shows that a positive and non significance relationship betweenourfocus variableGDP and dependent variable FDI.IMP indicate negative and non significance relationship similarly EXPR shows positive and significance relationship with Foreign Direct Investment (FDI). Inflation shows negative and significance relationship with FDI. Table 6 showst-statistic is greater than the critical value 1.96 it shows significance relationship otherwise relationship is non-significance, we conclude that the positive and significance relationship of GDP and EXPR with dependent variable FDI hold in the long run.IMP havenegative and non-significance relationship with FDI and INF have negative and significance relationship with FDI. However these relationship shows to be long term.

Conclusion

The conflicting facts found in the observed literature led us to expect that the foreign direct investment in a developing nation like Pakistan would be negatively distressing its economic performance and development, and that the dependency theory was anticipated to hold in this case. Our research results have remained reliable with our initial expectations and to be specified that FDI has a negative role to play in this country. Augmented Dickey Fuller (ADF) test was employed to evaluate the long term relationship between independent variables (exports, imports, GDP, and inflation) and the dependent variable (Foreign Direct Investment). A developing country like Pakistan that is plentiful in many resources may possibly help from capital formation. In this regard domestic investment would promote the country's economy, or consequently dependency on foreign investment should remain limited. Furthermore, in our study the relationship of the variables is also proved to hold in the long run. By encouraging formulation and implementation of domestic saving and investment could be economic policies limited FDI in Pakistan. This can be explained by the limited capability of the host country to absorb the transfer of information and a technology for more growth.

Suggestions and Recommendation:

- The exports can encourage the economy to import high-value inputs, possessions and technologies.
- By significance, these elements may have a positive impact on the productive capability of the financial system.
- It recommended that exports encouragement incentives decide a specialty of the financial system accompanied by the scale benefices.
- We suggest an export-led growth path mainly by the primary phase of development in the later stage addiction on FDI may be reasonable alternative.
- Exports increased the monetary growth so government must focus on the worth added exports by exports-oriented strategies in the economy.
- Government should raise the current standard of the export things according to the
- Worldwide principles to get betterment in the exports earrings.

- There is a need of enviable and superior transportation facilities and suitable defense Condition toward magnetize FDI in the state.
- It is essential to reduce the energy crisis similar to electricity and gas load-shedding, frustrated security position due to conflict against the violence and the political volatility to attract FDI and to reduce its pessimistic shock on the economic growth of Pakistan.
- It is recommended that to reduce the magnitude of funds deficits should be by rising returns that would in turn have require of systematic improvements in the tax structure and by decreasing unproductive spending.
- We suggest that a suitable substitute for this variable be recognized and deliberate to more develop on this research.

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