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Impact of Foreign Direct Investment on the Economic Growth of Pakistan

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Abstract

Certain complementary indication in the literature affecting to the influence of foreign direct investment on the host state's economy, I proceed the situation of Pakistan then test the assumed relationship for this country. The data designed for this study has covered over the period of 1980 to 2010. Moreover, foreign direct investment, including with four former variables Inflation, debt, trade and Domestic capital, to degenerate gross domestic profit of the country. The methodology to evaluate the effect of these variables on the economy of Pakistan, which has been restricted to the least, squares method. The amalgamation of the variables has been determined over the presentation of Augmented Dickey Fuller Test and is initiated to clamp in the end. The outcomes specify that the economic concert of Pakistan be negatively influenced by foreign direct investment although the economy has been promoted by internal outlay. Moreover, the inflation, trade and debt negatively affect gross domestic product. The consequences of the study indicate a negative and statistically insignificant relation between the foreign direct investment and Gross domestic product in Pakistan. Strategies praises are proposed from the outcomes that are found in the study, concerning the foreign direct investment in Pakistan.

Key words: Foreign direct investment, Inflation, Domestic Capital, Pakistan

1-INTRODUCTION

The basis on which investment develops in the state, is a foreign direct investment (FDI). In the developing countries, foreign direct investment has more significance such as this investment releases the openings of investments. The foreign reserves of the country increases by foreign direct investment, in developing countries like Pakistan it also increases the significance of the FDI. And it is very popular for growing the economic development of the developing states (Nadeem & Ahmed, n.d.).

All developing countries, like Pakistan, is struggling hard to attain and stand with the long run economic growth. now in a global world, it become to be more complex to reply the questions: 'whatever regulates the economic growth' Tahir et al., (2015). Economic growth effected by different aspects as for its multifaceted aspects. Internal features as reserves and resources are deliberated significant for attaining surprising economic growth Romer (1986)such as foreign direct investment is external factor commencing external states are also similarly essential for enlightening economic growth particularly for developing nations Barajas et al., (2009); (Azman-Saini etal., (2010); Almfraji and Almsafir (2014).

In a developing economy, economic growth is greatly imperative and have well place to improve the life people. The possibility that can be improved through enhanced instructive and wellbeing conveniences. Modern study indicates that economic growth encourages development of human beings Nourzad and Powell (2003). Which is definitely the aim of economic events all over the world. The Foreign Direct Investment and economic growth correlation is a controversial issue between economist commencing together experimental and theoretic view. Miscellaneous research has been conceded to verdict the present and causation between variables Malik (2015).

The Foreign direct investment (FDI) is one of the standard tonic in the economic development literature Adegbite and Ayadi (2011) ,FDI has been defined as direct venture of a business or corporation to another state. GDP discusses to the market value of all finishing goods and services produced in a country within a given time period. In the developing countries, foreign direct investment has become the most established and largest element of capital flows Adams (2009). Therefore, FDI has become an essential alternate in the improvement procedure of an economy.

The foreign direct investment in the possession of the country rises and capital invasion occur. Represent stream from outside bases has become a greatest operational practice. This technique has a substantial feature of growing capital supply in developing countries. However, the tendency of foreign direct investment in developing country is diminishing over the past years. For developing countries, the progressive influence of foreign direct investment is flattering gradually common as a utensil for economic growth and establishment. The solidest positives of applying FDI is the rise in aggregate output, improved prospects of occupation, more outflow of exports and exchange of technological development among the investor and receiving country Rahman (2014).

Several aspects influence monetary production and economic growth of a republic. For economies in general and certainly in developing markets, Foreign Direct Investment (FDI) has perceived and discussed as an important element. Though, there remain two opposing assessments Saqib et al., (2013) .The effect of FDI flows on economic growth in Nigeria has been studied by Esther and Folorunso (2011) .They found that FDI had a favorable effect on the economic growth. Though, they also give information that the level to which FDI impacts the economic growth certainly could be restricted by human capital Adegbite and Ayadi (2011).

The global organization's share in the host country enforces the compression on the confined companies to improve innovative skills and modernize discussed by Thomas et al., (2008). Besides, they describe the purpose, that the developing countries are concerned in compelling processes that fascinate foreign direct investment. Fundamentally, the developing countries face the problem of slit between reserves and investment which has to be connected by FDI .The outcomes are, transmission of technology, employment conception, and efficiency increase and competition improvement Le and Ataullah (2002).

Such advantages have inspired the evolving countries, including Pakistan, to entice FDI entries. In order to determine the presence of such profits, several studies have been conducted to check the influences of FDI on growth. Still, ideologies and experimental literature transpire to agreement-varied suggestion about the effect of FDI on economic growth in developing countries. The present paper tries to analyze the effect of foreign direct investment on the economic growth +of Pakistan in correspondence of four variables along with export, inflation, domestic capital and debt. The core objective of this research is to evaluate the correlation of foreign direct investment and economic growth of developing, and developed countries foreign direct investment used as an instrument to rise the abilities in human source, development in expertise. In addition, to study the relationship between FDI, GDP. In addition, it measures the influence of trade directness on FDI in Pakistan and recommend strategies to the management to entice supplementary foreign direct investment in the economy of nation.

The rest of the paper is structured as follows: Section 2 describes the relevant literature on Section 4 provides the discussion on results while Section 5 accomplishes our outcomes and discusses our results and section 6 gives recommendations.

2-LITERATURE REVIEW

The Foreign Direct investment is a stream of possessions beginning one country to another. This system play a significant part to improve an evolving country, certainly effect the GDP and develop the capitals over which a state can completely exploit the natural means along with mortal incomes Rahman (2014). A numeral of studies has explored the correlation among foreign direct investment and economic growth, the matter is outlying, as of stable in sight of the varied outcomes got. Maximum of these studies have usually accepted ordinary development accounting basis for evaluating the result of FDI influxes on progress of national income beside with other aspects of manufacturing Falki (2009).

Adams discussed that 'the theoretical link between Foreign Direct Investment and economic growth can be found in modernization and dependency theories'. Modernization theory recommends that subsequently economic growth needs capital investment, FDI could show up as the setup to the economic growth. Yet, the original growth theory climaxes that it is the data transmission over FDI to the developing countries that are unusual in the required arrangement and education. Further, FDI also carries to the host country a set of supervisory assistances and advertising familiarity Adams (2009). Mamun and Nath has opposed in provision of the modernization theory demanding that FDI shows a double role by paying to capital accretion and by rising whole dynamic yield Saqib et al., (2013).

Comparatively the contrary, the requirement theory recommends that if a country were influenced by the foreign investment, at that time its economic growth would suffer from an adverse effect. This is because Foreign Direct Investment generates monopolies in the manufacturing area, which subsequently effects the less-consumption of internal assets Adams (2009). The presence statement that an economy measured by foreign person would not progress naturally, but would slightly develop in a dis articulated means Amin (1974).
This is because the outcome increases, by which demand in one part of a country generates demand in another is weedy and thus prominent to standing growth in the developing countries.

This argument is essential, as most FDI to Africa is in the usual possessions zones that have significant obstacles to entrance. Pigato (2000). On the other hand, the degree at which FDI promotes to improve the economic growth, the value of surroundings of the receiver country Clegg and Wang (2004). The level of investments in the host country, relates to the value of surroundings and the grade of directness and the degree of advanced progress. Host states with surprising amount of investments, open trade establishment and exciting technical invention would use after improving FDI to their markets Falki (2009). The above-mentioned diversified theoretic structure primes the empirical studies directed by several scholars Alfaro et al., (2011) stated that FDI encourages economic growth in countries where the domestic set-up is well settled and trade and FDI strategies are more substantial Adams (2009). Balasubramanyam, determined that FDI has advanced growth growing possessions in those states where the labor force is very educated and which is succeeding export advancement trade strategies relatively than import interchange trade rules Balasubramanyam et al., (1996).

One more study to conclude the association between FDI and growth, Durham (2004) could not recognize some progressive link between FDI and economic growth of the country, but providing suggestion that the positive belongings of FDI are depending on the absorptive competence of host nations. Similar Durham, several studies have initiated that whether FDI would positively influence economic growth of the country in a host country or not, depends on certain situations. As concerns the effect of FDI on economic growth is apprehensive, Almfraji and Almsafir (2014) revised an wide-ranging volume of fiction on the correlation amid FDI and economic growth. Their key outcomes precise that the effect of FDI on economic growth is expressively positive, but in some circumstances, it is negative or insignificant.

A time-series study was also engaged to verify the fundamental connection between FDI and economic growth of Bangladesh using annual data. The Causation test and Error Rectification Models were working enchanting maintenance of stochastic possessions of the variables. Time- series analysis specifies the causative relationship between distribute, FDI and GDP of the country Rahman (2014). The effect of FDI on the GDP of the countries. The study concluded that the common model in these states developed a positive relation between FDI and GDP, while negative relationship between inflation and GDP. The result was verified by means of the several regression models Abbas et al (2011).The foreign direct investment would only have positive effect on economy of the host country if FDI is in the shape of pure technology transfer Campos and Kinoshita (2002). In contrast to the studies that find a positive correlation between FDI and growth, others find a non-significant or negative effect (Akinlo, 2004). The FDI utilizes substantial adverse influence on the host country Hermes and Lensink (2003) This study therefore enhancements the effort of Fry (1993); Sylwester (2005) reviewing the consequence of FDI dependency on economic growth.

The FDI rises practical development in the host state by means of a contamination influence, (Findlay, 1978) which affluences the approval of innovative professional dealings by the native organizations. In the same way, De Gregorio (1992) studied a panel of 12 Latin American states. The consequences propose a significant and positive effect of FDI on the economic growth of the country. Moreover, the research illustrates that the efficiency of FDI is technologically advanced than the production of local deal. Although, Fry (1993) studied the starring role of FDI in encouraging progress by consuming the structure of a short-cut model for a shared stage sequence cross section data of the developing countries. The states involved in the model were Pakistan, Mexico, Brazil, Chile, Egypt, Sri Lanka, Argentina Turkey, Venezuela, and five Indonesia, Korea, Philippines Thailand, Malaysia, India, Nigeria. These current studies have not providing continual authorization in favor of a strong connection among outside elements and economic development for Pakistan economy. The outcomes of some of the studies show that marginal elements effect economic growth positively while some others show that external factors badly effect economic growth. So, empirical study of the connection between outside bases and economic growth is definitely Tahir et al., (2015).

Therefore, in order to entice the foreign direct investment in host country then it is the requirement for host country-precise study, its strategy exploration. The strategy management, structure condition, investment development, expertise standing, labor education position will be the determining factor for the causation and influence of FDI and economic growth.

The current researches have not offer dependable proof in the indulgence of a forceful association of peripheral elements and economic growth for the economy of Pakistan. The consequences of some of the studies indicate that determining factors affect the economic growth of the country positively, although further precise that peripheral bases badly effect the economic growth. Consequently, empirical analysis of the association of peripheral bases and economic growth has certainly needed.

3-METHODOLOGY AND RESEARCH DESIGN

The key element of the study is to measure the impact of foreign direct investment on the economic growth in Pakistan. The time period for study is 1981-2010.The data on the variables should be obtained from, State bank of Pakistan and world development indicators.

The theoretic approach that is used, to inspect the relations of foreign direct investment and economic growth is based on succeeding production function.

$GDP_t = ß_0 + ß_2FDI_t + ß_2D_t + ß_3GDS_t + ß_4INF_t + ß_5T_t + \varepsilon_t$

Variables	**representation**	**source of data**
Dependent Variable: Economic growth	GDP per capita at PPP	world development indicators
In dependent variables:		
FDI	FDI per capita	state bank of Pakistan
• Inflation	GDP deflator	world development indicators
• Export	percentage of GDP	world development indicators
• Debt	log of total debt service	world development indicators
• Domestic capital	savings as percentage of GDP	world development indicators

In this model GDP is a dependent variable and written on the left side of the equation. The variables for this research study are trade, debt, inflation, domestic capital and foreign direct investment written on the right side of the equation. We have time series data taken from secondary source of state bank of Pakistan. Data assortment has built on Pakistan economy and its economic section. Generally, time series data express the belongings of non –stationery in intensities which will be studied through integration analysis.

Above table, show the dependent variable and independent variables along with the representations and source of data

3.1 GDP per capita:

In fact, Gross Domestic Product is the degree at which whole economy's expenses and productivity measure. In actual relations, gross domestic product is a state profits subsidizing to the economic growth by observing the numeral domestic goods produces from local possessions. Malik (2015)

In this research, Gross domestic product is our dependent variable, because for the economic growth we use GDP per capita at the purchasing power of the parties and integrate the population consequence. Martin found that Gross domestic product per capita has been used as a delegation for economic growth of the nation Roubini et al., (1992).

3.2 Foreign direct investment per capital:

for the economic growth of the country Foreign direct investment is necessary and key element Kowalski (2000).in long run foreign direct investment has a negative relation with the economic growth Kogid et al., (2010). In the under developing countries foreign direct investment has a stimulator for the economic growth Tsai (1994). The adverse relationship of foreign direct investment with gross domestic product development by compelling panel facts of SAARC countries Akram et al., (2011). The symbol used for foreign direct investment is the FDI per Capita in US$. Information for this variable has taken from the State Bank of Pakistan. The estimated symbol for foreign direct investment is negative Saqib et al., (2013).

3.3 Inflation:

inflation regulates equilibrium of the economy of a country Kowalski (2000).the problem creates in the economy when level of inflation is so high in a country. Such as documented in the literature that economic growth of the country and inflation has a negative association, representative of this variable is gross domestic product deflator, and it has a negative correlation with the dependent variable.

3.4 Export

It has been taken as one of the basic variable troubling economic growth. Trade openness has been extensively used with a substitution of trade to GDP ratio in the literature, Waheed and Younus (2010). Exports are the consignment of things and facilities beginning from native country to the rest of the world, where trades goods are claimed. The external growth rises when our exports increases. Export used such as a proportion of gross domestic product as a substitution for export variable and suppose it has a negative indication for an amazing import as paralleled to exports. Moreover, the data should be obtain from world development indicator.

3.5 Domestic capital

It is the gross capital founding and is amount of immovable investment development. Stable properties are equipment, apparatus's, infrastructures, institutes etc. The resources can be improve by reserved and communal sectors. Gross Domestics Investment refer to the involvement of Administration of the state concerning its economy Kowalski (2000). The delegation designed for this variable is gross domestic savings as percentage GDP. In addition, the data should be obtain from world development indicators.

3.6 Debt

Debt is the key determinant of economic growth Kowalski (2000).Relationship between total debt and economic growth is to be negative Amjad and Khan (2004). It is discussed that the peripheral debt is a problematic for the economy of the country Fosu (1996). A comprehensively obligated budget is supposed to be concern Kowalski (2000).the replacement used for debt is total debt and expediencies in US dollar($) . Debt has taken from world development indicators.

4-RESULTS AND DISCUSSION

To estimate the coefficients of the regression equation, at this time I used the ordinary least square method (OLS).and verified it for the stationarity of the variables. By using the augmented dickey fuller test (ADF) in the stationarity of the time series.

Table 2: Stationarity test results ADF

	Variables		ADF test statistics			
	I(0)		I(1)		I(2)	
	C	C & T	C	C & T	C	C & T
GDP	0.81	-1.58	-2.22	-2.56	-5.56	-5.45
FDI	-3.17	-4.16	-4.48	-5.45	-	-
INF	-4.36	-4.73	-7.04	-6.92	-	-
T	-2.51	-2.54	-6.37	-6.33	-	-
D	-1.86	-3.35	-7.37	-7.22	-	-
GDS	-1.79	-1.27	-6.45	-6.95	-	-

Only through the exemption of FDI, it is verify by elevations for each order. All variables are originating to have unit-root and the sequences are non-stationary at stages. Foreign Direct Investment is stationary. augmented dickey fuller test (ADF) is another time working at initial variance and the outcomes show that trade, inflation, GDS are stationary at early difference, When the level of significance is at 1%.GDP is dependent variable which is to be stationary at the 2nd difference at the level of 1% significance.

FDI invasions are deducted from gross secure outlay to analyze domestic capital to avoid twice calculating Adams (2009).Social investment is represent by the lesser conservatory acceptance and the skill and part as a percentage of GDP is a substitution for the grade of addition of a state in the global economy. FDI influences the host state's economy. The administrative danger is a complex extent of these features and it comprises aspects similar regulation and instruction, administration constancy, governmental excellence, dishonesty, and self-ruled responsibility.

Table 3: Summary of results for time series of 1981-2010 Variables

Variables	Coefficients	T-statistics	P-Values
Constant	-0.137	-0.9656	0.3452
FDI	-21.99	-3.124	0.0000
Inflation	-2.2	-1.952	0.081
Debt	-7.78	-3.1076	0.000
Trade	-25.53	-2.3279	0.015
GD	38.75	5.728	0.000
Adjusted R2	0.962		
DWS	1.931		
F Statistics	42.24		
P (F-Statistics)	0		

The outcomes of study show an adverse and significant correlation which relating to our dependent variable GDP and other variable foreign direct investment. In the same way, Gross Domestic Product has showed negative relationship with our independent variables trade, inflation debt. All independent variables have shown significant effect on the dependent variable excluding debt. In addition, for long-term combination it is essential to be present. The method in which residuals are found to be stationary, and co-integration are existing Saqib et al., (2013). Therefore, for this purpose, Augmented Dickey Fuller Test is used and it has found to be stationary.

The economic growth does not have a positive effect on the foreign direct investment. The deficiency of positive result of FDI can be outstanding the short level of the improvement of economic marketplaces. Moreover, it has expected that the absorptive capability of the countries in the area have not extended the inception wanted to create usage of the equipment, information, and supplementary services related with FDI**.** National asset, though, is positive and significantly connected with economic development in the OLS. A one percent point increase in the domestic investment has relate with between 0.16 and 0.19 percentage point rise in per capita GDP.

Table 4: Residuals stationarity test

	With Intercept	with Intercept & Trend
ADF Test Statistic	-5.536	-7.285
Probability	0.0001	0.000

Above table shows that the Augmented Dickey Fuller value is larger than the critical value at all stages, therefore it can state that at a high significance level the error time is stationary. In addition to this, it determines that in the end there is negative relation between GDP and FDI.

5-CONCLUSION AND SUGGESTIONS

The contradictory indication originates in the observed literature directed us to suppose that the foreign direct investment in a developing country like Pakistan Would be negatively upsetting its economic growth and accomplishment, the dependency theory was estimated to rule in this situation. Our study outcomes have continued dependable with our preliminary chances and have showed that foreign direct investment has an adverse part in this economy. Moreover, Pakistan economic performance negatively affected by the not only foreign direct investment but also inflation, trade, debt. Foreign direct investment is assumed to transmission of expertise, encourage awareness by performance, structure of efforts and overall, outcomes concluded the social assistances and knowledge. Capital formation may possibly benefit from countless means, which are plentiful in a developing country like Pakistan. Consequently, the policy makers in Pakistan certainly, and in other developing countries could take suitable policy activities to entice FDI and rise the influx of labors. Doing this will finally help the developing countries as well as Pakistan to attain the long-run economic development. The outcomes of the study are constant with the preceding empirical research. In addition, the study initiates a negative link between imports and economic growth in the setting of Pakistan economy. The fundamental causes are problematic to pin down; yet, the essential structure of imports displays that Pakistan is an oil-insufficiency land outlay around 30 per cent of imports to oil-related products. In addition, the arrangement of imports, size productions and data related problems might be the possible reasons. In this concern, Domestic investment would advantage the state's economy, and thus reliance on foreign investment should stay restricted. Furthermore, in our research, the relationship of the variables is also verify to grip in the end. Therefore, monetary strategies restricting foreign direct investment in Pakistan and increasing internal savings should be expressed and executed.it looks like that maximum of the profits of Foreign Investment become weakened by the side of the indicators and return on earnings back to the financier country. It can be clarified by the partial capability of the host nation to fascinate the allocation of information and technology for advance growth.

6- FURTHER RESEARCH RECOMMENDATIONS.

Foreign Investment and the host country's economy is intermediary along with adequate through some new variables that have not been involved into explanation in this learning for the determination of stinginess. Empirical Literature shows that expertise influences the foreign direct investment, because it is a solid transitional variable. I propose that a suitable substitute for this variable stay recognized and dignified to promote progress on this study. Government should take solid steps in order to increase foreign as well as domestic investment and protect industries that would benefit the country's economic condition instead of totally relying on foreign investment and aids. Incentives and relaxation should pursue for foreign investors so that they likely to invest in our country instead to investing some other country. When our Dross Domestic Products goes on increasing our total output would definitely go up because GDP is the measure of size of economy using its own natural resources. Government should take measures in order to stabilize the exchange rate that may attract more investors for sake of higher profits. Higher FDI inflows in turns fetch labor that is more educated and replace the obsolete technology Moreover, a different significant variable of sum of Human Capital existing in the host country can have a regulating effect on the innovative association of foreign direct investment and gross domestic product. Therefore, I put forward advance study integrating these variables and commanding to enhance recommend strategies. and designate imperative trader to economic growth for foreign direct investment, Pakistan would ensure improved by concentrating on informative arrangement, social possessions, evolving home-grown entrepreneurship, generating a continuous macroeconomic structure and settings which encouraging the dynamic reserves to accelerate the procedure of improvement and growth.

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