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Impact of Foreign Direct Investment on Economic Growth of Pakistan

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Abtract: Foreign direct investment (FDI) in Pakistan is one of the major external Sources of funding to meet obligation of resources gap and goal achievement. FDI has played a vital role in the economic growth of Pakistan. It contributed significantly in the human resource development, capital formation, and organization and managerial skills of the people in the country. In this discussion we proved that FDI plays a crucial role for the economic growth of a country. Not only FDI but many other factors related to FDI impact positively to the economic growth of Pakistan. In this research the external debt are negatively related with GDP of Pakistan.

Keywords: Resources gap, Economic growth, Remittances, Inflation, External debt, Enhance.

I. Introduction

According to the international monetary funds, foreign direct investment, commonly known as FDI….” Refers to an investment made to acquire lasting or long-run interest in enterprise, operating outside of the economy of the investor.” The investment is direct because the investor which could be a foreign person, company or group of entities is seeking to control, manage, or have significant influence our the foreign enterprise.FDI is a major source of external finance which means those countries with limited amounts of capital can receive finance beyond national border from wealthier countries. According to World Bank FDI and small business growth are the two critical elements in developing the private sector in lower-income economies and reducing poverty. FDI is measured as earnings retained by subsidiaries or branches in Pakistan and transfers of funds

from parent firm to their foreign subsidiaries in the Pakistan. The transfer includes both debt and equity raised capital. In addition, aggregate FDI includes purchases of existing companies and real estimate transaction. Foreign direct investment has grown

dramatically as a major form of international capital transfer over the past decade. Between 1980 and 1990 world flows of FDI-define as cross- border expenditure to acquire or expand corporate control of productive assets have approximately tripped. Foreign direct investment (FDI) in Pakistan is one of the major external sources of funding to meet obligation of resources gap and goal achievement. FDI has played a vital role in the economic growth of Pakistan.FDI contributed significantly in the human resource development capital formation, and organization and managerial skills of the people in the country. Total foreign investment was $6.0 billion of which FDI amounted to $ 4.16 billion in the year 2007. The open FDI reign forced the host countries to adopt greater deregulation policies and reliance and market forces in their economies. Most development countries like Pakistan now consider FDI as the major external source of Funding to meet obligation of resources gap and economic growth.

II. Literature Review

This research examines studies conducted by various researches. The studies are analysis the impact of foreign direct investment on economic growth of Pakistan. Various studies on the subject of FDI on economic growth have been presented. The majority of this research work has been done internationally. The review covers both theoretically and particularly the empirical studies on the subject.

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Naveed shahzad, M. zahid (2010) conduct the study on "determinants of FDI in Pakistan from (1991) to (2010). In this study the researcher has taken five independent variable which are GDP, interest rate, domestic investment, inflation rate and tax rate and one depend variable is FDI. The model of this study is

$$Y(FDI) = \beta° + \beta 1(GDP) + \beta 2(INF) + \beta 3(D.INV) + \beta 4(INT) + \beta 5(T) + \varepsilon$$

Qaiser Abbas, Salman Akbar, ALI shan Nasir and their group (2011) conduct the study on impact of foreign direct investment on GDP from (2001) to (2010). This study may apply multiple regression models. Model of this paper is

$$GDP = \propto + \beta 1FDI + \beta 2CPI$$

The result of this study is overall model is significant. There is a positive and significant relationship between GDP and FDI while a significant relationship between GDP and CPI. Amana Muhammad Gudaro and her group (2012) conduct the study on impact of FDI on economic growth of Pakistan since (1981) to(2010). In this paper the link between GDP, FDI, and CPI is measured with help of multiple regression models. Model of this research paper is

$$GDP = \alpha + \beta 1\ (FDI) + \beta 2\ (CPI) + \mu$$

The result of this paper is that there are positive relationship of "FDI" with growth and negative relationship of "CPI" with growth. Atif Ali Jaffer, nabila Asghar, Mahnaz, M.ALI and Rooma Asjed (2012) conduct the study on "Foreign direct investment and current account balance of Pakistan" From 1983 to 2011 by employing autoregressive distributive lag (ARDL) approach. The model of thi study is LI°=F (LFDI)

$$CABECT = F\ (FDI, DUM2008, UM9/11)$$

The result of these study show that an increase in FDI causes of increase in Io and worsens CABECT of Pakistan with long-run, the confirming long-run relationship of FDI inflows with Io and CABECT. M.Ayaz, M.Umair Yusuf, M. Asghar (2013) conduct the study on "export performance under the role of FDI in Pakistan" from (1975) to (2011). This study examine the short-run and long-run association between FDI, export and growth for Pakistan employing the autoregressive and distribution lags (ARDL) approach in the time series frame work. The model of this study is

$$LEXPt = \beta 1 + \beta 2LGDPt + \beta 3LFDIt + \beta 4LTOTt + \varepsilon t$$

The result of this study is there are positive relationship between FDI and exports in short run is predicted by the parameters of (ARDL).

Hafiz Sohail younas and group (2014) conduct a study on impact of "Foreign direct investment on economic growth in Pakistan". The study has used data from (2000) to (2010) by using two stages least square method of simultaneous equation estimation .The model of this study is

$$Qg = \alpha° + \alpha 1 + \alpha 2Lg + \alpha 3Zg$$

Where Qg=growth rate of real aggregate output, I= domestic investment, Lg= growth rate of labor, Zg= growth rate of other variable, $\alpha°$=constant term and $\alpha 1$ $\alpha 2$ $\alpha 3$ are parameters .The result show that there exist a positive relationship between economic growth, proxies by GDP and FDI in Pakistan.

Taqadus basher and his group (2014) conduct a study on "impact of foreign direct investment on economic growth (A comparison of south Asian state and china) for the study purpose annual data are used. The variable selected are FDI, ED, and REM. Analyzed tools of OLS test and granger causality test are used to used to analysis the data. This study model will be as

$$Y = \alpha + \beta 1\ (FDI) + \beta 2(ED) + \beta 3\ (REM) + \epsilon$$

The result of this research is as china is much faster growing economy than south Asia region including Pakistan.

III. METHDOLOGY

The main purpose of this research is to determine the impact of FDI (foreign direct investment), ED(external debt), REM(remittances), CPI(inflation) on Pakistan economic growth (GDP) study cover time period from 1995 to 2011. This data are taken from source of word bank, economy of Pakistan books, index monde and economic survey of Pakistan.

IV. MODEL

This model existing for the purpose of testing hypotheses fellows:-

$$Y= \beta° + \beta 1\ (FDI) + \beta 2\ (REM) - \beta 3 (ED) + \beta 4\ (CPI) + \mu$$

Where

y= GDP

FDI=foreign direct investment

REM=remittances

ED= external debt

CPI= inflation

$\beta°$= constant

$\beta 1$, $\beta 2$, $\beta 3$, $\beta 4$= Coefficients and

μ= Error term

Variable	Coefficient	t-Statistic
C	14.62745	4.031334
FDI	0.062616	1.046840
REM	0.222585	1.198673
ED	-0.318363	-2.810404
CP	0.106169	1.005663

R-squared	Adjusted R-squared	S.E. of regression	F-statistic	Durbin-Watson stat
0.424847	0.233129	1.813786	2.216003	2.404057

Form the result we have found the exact equation which show the clear relationship between independent and dependent variables. In this case we have four independent variables to find the impact of foreign direct investment on economic growth; it is compulsory for us to find other three factors along with.

The exact equation is…..

$$Y=14.627+(0.062)FDI+(0.222)REM-(0.318E)D+(0.106)CPI+\mu$$

In this situation the independent variables(FDI,REM,CPI) make positive relationship with economic growth of Pakistan .The other factor ED are negatively impacted with economic growth of Pakistan. We explain it individually…

Foreign direct investment has positive relationship with GDP. With the increase in foreign direct investment the economic growth will enhance. Foreign direct investment can boost up the economy of a country. It gives the employment opportunities and also increases the standard of living of the people. It also increased the working capacity of labors. If foreign direct investment shifts downward or decline then economy can experience downfall, people became poor and poor. The other is external debt. It impact negatively on economic growth, which means that the external debt is very harm full for the growth of developing countries. In 1982 the Mexico declared that it was unable to service its large foreign debt. The same was announced by so many developing countries that they also could not repay their previous loans because of tight monetary policy. External debt with its high rate of interest is very difficult for the developing countries like Pakistan to repay it. As debt crises were on through i1980s, it became clear that debtor countries were suffering low economic growth and lack of access to international finance but this cost was not leading to repayment that would end the crises. The remittances are also positive with GDP. Remittances increase the foreign reserves. Foreign reserve is used for the make better the living standard of the poor people in developing country especially just like Pakistan. Inflation is another factor to improve the economic growth of Pakistan. In developing countries most of investor is in favors of inflation because with this the price of product increases also the profit of investor. Empirical findings prove that the inflation may enhance economic growth and our findings show that the positive effect of inflation on the economic growth which means the producers and entrepreneurs have incentives to invest the country where the price are growing up.

Result No.1

Dependent Variable: Y				
Method: Least Squares				
Date: 12/11/14 Time: 00:22				
Sample: 1995 2011				
Included observations: 17				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	14.62745	3.628439	4.031334	0.0017
FDI	0.062616	0.059815	1.046840	0.3158
REM	0.222585	0.185693	1.198673	0.2538
ED	-0.318363	0.113280	-2.810404	0.0157
CPI	0.106169	0.105572	1.005663	0.3344
R-squared	0.424847	Mean dependent var		4.735294
Adjusted R-squared	0.233129	S.D. dependent var		2.071214
S.E. of regression	1.813786	Akaike info criterion		4.268638
Sum squared resid	39.47783	Schwarz criterion		4.513701
Log likelihood	-31.28343	F-statistic		2.216003
Durbin-Watson stat	2.404057	Prob(F-statistic)		0.128474

Result No.2

Dependent Variable: Y				
Method: Least Squares				
Date: 12/11/14 Time: 00:29				
Sample: 1995 2007				
Included observations: 13				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	9.430305	5.295315	1.780877	0.1128
FDI	0.029497	0.060615	0.486628	0.6396
REM	0.193604	0.247380	0.782619	0.4564
ED	-0.190533	0.147624	-1.290657	0.2329
CPI	0.334376	0.286245	1.168148	0.2764
R-squared	0.450806	Mean dependent var		5.253846
Adjusted R-squared	0.176210	S.D. dependent var		1.828759
S.E. of regression	1.659834	Akaike info criterion		4.135036
Sum squared resid	22.04040	Schwarz criterion		4.352324
Log likelihood	-21.87773	F-statistic		1.641703
Durbin-Watson stat	2.353431	Prob(F-statistic)		0.255012

Result No.3

Dependent Variable: Y				
Method: Least Squares				
Date: 12/11/14 Time: 00:32				
Sample: 1995 2003				
Included observations: 9				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	14.09747	6.602683	2.135113	0.0996
FDI	0.071200	0.070375	1.011722	0.3689
REM	0.607093	0.401213	1.513144	0.2048
ED	-0.178165	0.256783	-0.693837	0.5260
CPI	-1.249901	1.951129	-0.640604	0.5566
R-squared	0.457787	Mean dependent var		4.588889
Adjusted R-squared	-0.084427	S.D. dependent var		1.681104
S.E. of regression	1.750631	Akaike info criterion		4.258011
Sum squared resid	12.25884	Schwarz criterion		4.367580
Log likelihood	-14.16105	F-statistic		0.844292
Durbin-Watson stat	2.528657	Prob(F-statistic)		0.563170

V. Conclusion

The research Endeavour proves that the economic growth of a developing country like Pakistan, the foreign direct investment is a compulsory factor. It is very useful to boost the economy. Foreign direct investment is positively related with GDP of developing countries. FDI provide the golden opportunities for the poor to proof themselves, and make high their standard of living. It reduced the poverty from the economy of a country. This paper proved that every country should adopt the FDI projects

VI. Policy Implication

Concrete policies, strong infrastructure, and investment friendly policies of countries always give confidence to foreign investors for investments in those countries. The policies representing the true interests of the host countries also guide foreign investments into right areas where they are needed most Pakistan has received comparatively higher amount of FDI over the last two decades. Especially during the decade of 1990s, Pakistan received high amount of FDI due to its market-oriented policies, conducive environment for investment and reemphasis on of the private sector for economic growth. The dimension of the FDI flows into Pakistan can be explained in terms of its size and percentage of gross capital formation (GCF). The size of FDI inflows in Pakistan was not significant until 1991 due to the regularity policy framework. However, under the new policy regime, it was expected to assume a larger role in catalysing Pakistan economic development. It is observed that there has been a steady build up in FDI inflows in post-liberalisation period.We should make a very power full policy for the economy growth with help of foreign direct investment.Through this policy many poor and villegy people get employment and mader their life better. Foriegn direct investment is one of the major part of developing countries to boost up the economy.

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