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Impact of Foreign Direct Investment on Economic Development of Pakistan

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Abstract

Foreign Direct Investment (FDI) is a crucial substantial promoter for financial development in the unindustrialized nations. It promotes the economic development by motivating domestic investment, increasing human capital creation and by providing the technology transfer in the host states. Thus, the core aim of behind this research is to examine the effect of the foreign direct investment on economic development Gross Domestic Product of Pakistan. Time series data will be evaluated in this study over the period (1985 -2017). The study uses multiple linear regression technique for the analysis of data. Our results suggest that model is significant and shows FDI has a progressive and important influence on the economic development of Pakistan. This research suggests that the local government has to develop strategies and plans in such a way that would encourage the efforts and funds being made for the betterment of a nation in the form of FDI.

Keywords:

FDI,
Economic Growth,
Gross Domestic Product,
Pakistan`s Economy.
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1. Introduction

The backbone of economic growth is an investment, and it may be either domestic or Foreign Direct Investment. The different aspects related to imply a robust link in among Foreign Direct Investment and economic development have been evaluated a long time ago and still going on. Mainly in developing countries, economic growth and its determinant have been a core focus in past decades. According to the World Bank, FDI pertains to the pure investment inflows to obtain a long-lasting managing concern (***10 %*** or even more than of balloting stock) in a business, beneficial in a nation. Besides one of the financiers and may be further created as the total of equity capital, reinvestment of profits added lasting capital and short-range capital as displayed in the balance of payments during that economy.

Though economic development is described as " economic development is a rise in the capability of an economy to make good and services, and contrasted from one era to another. Foreign Direct Investment is seen as a significant critical element of economic development in the rising nations like Pakistan, and it has been a

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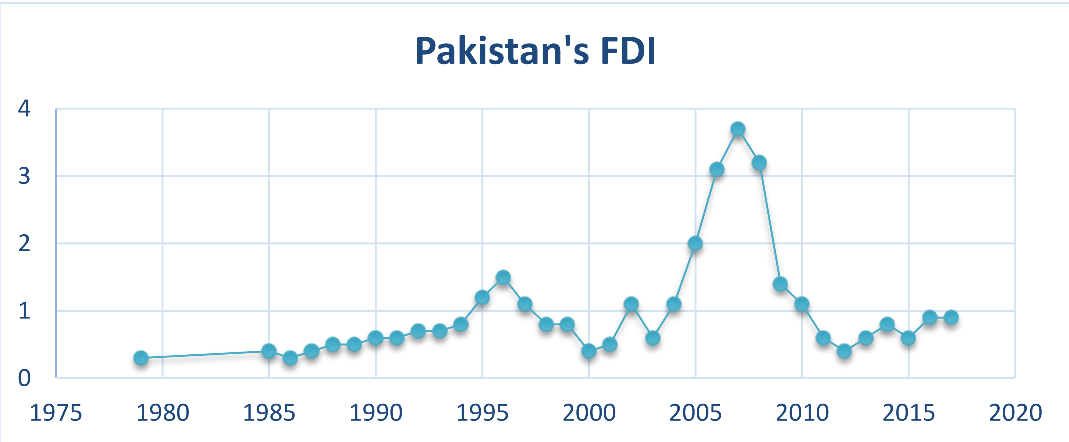
vital source of economic development of Pakistan.(khan 2007)The most important benefit for developing countries FDI enhance the job creation opportunities, transfer of technology spillover, capital formation, Managerial skills, entrepreneurial abilities and boost overall economic development in the host nation. Foreign Direct Investment acts a vital role in growing competition developing a domestic economy, improving business conditions and enhancing the quality of labor and infrastructure. These factors will also have an influence on education, science system in the host country and for these changes might also have an impact not just on marketing and culture but also on individual industries productivity contribution to GDP. The association between two elements FDI and Economic Development remains a controversial topic between economist from both empirical and analytical view. Various research studies have been performed on discovering some prevailing and origin between variables. Economic principles are designed to examine the dependency of an individual variable on other variables. Even with the fact that numerous research studies developed the concept that FDI has a progressive influence on the host nations' economic development, some research studies discussion that the relation in among foreign direct investment and economic development is ambiguous. (N.F2009).

Since the early ***1980s***, the changing global economic and political environment has triggered to transform in the relative benefits FDI as ways whereby developing nations may acquire a reasonable economic development rate. The quantity of Foreign Direct Investment raised significantly into the less developed economies from ***1985-2000***. The share of less developed nations in worlds' Foreign Direct Investment (inflows and outflows) has improved from ***17.4 % to 26.1 %*** during ***1985-90*** and ***1995-2000*** respectively. In Pakistan, Foreign Direct Investment inflows rose from ***245*** Million **US$** to ***4.273*** Million **US$** in ***2006*** (WDI indicators ***2008***). Based on Pakistan's Board of Investment (BoI), Foreign Direct Investment was ***5409*** Million **US$** during ***2007–2008***. Ever since the level of Foreign Direct Investment reduced in 2011–2012. Moreover, it comes to be 2807.85 Million **US$** from 2010 until 2017.



Series:Foreign Direct Investment, Net Inflows(% of GDP)
Source:World Development Indicators
Created by Author

Figure 1. *Foreign Direct Investment in Pakistan*

The emerging nations all across the world struggle to attract Foreign Direct Investment by presenting governing improvements, and the providing of numerous motivations for international financers being related to domestic investors. In this condition, it converts imperious to examine the attraction between FDI and economic development of the host state and to measure the influence of FDI on economic development of the host nation. Furthermore, many countries have accessible special Tax enticements and subsidies to interest foreign capital. An essential financial basis for treating foreign capital auspiciously is that FDI and portfolio inflows boost knowledge transfers that quicken total economic growth in receiver states. Meanwhile Pakistan is an unindustrialized nation and usually a developing economy is categorized by small income level, dearth of investment, low level of industrialization, short saving, speedy advance of population, encumbrance of external debt, rareness of foreign aid, scarcity in balance of payment, dearth of technical and professional skills, and substantial dependence on export of crucial goods etc. Also, the local capitals are insufficient to support the development needs; so FDI can be a vital tool of overcoming these flaws essential for economic growth (Maria Carkovic and Ross Levine.)

2. Literature Review

There are numerous studies done on FDI and Economic Development and investigate the real and essential association among FDI and Economic development some of the studies are reviewed below.
DE MELLO (1997|). Surveys the importance of Foreign Direct Investment on progress in developing nations, stated that FDI is progress enhancing, and has motivated in the long run on empirical and theoretical analysis basis. He sheds light that FDI is an essential element to fill the resource gap in many developing countries. Knowledge and higher economic growth can be achieved in the host country by FDI. MNCs are the source of expertise transferred and higher the value-added production in the recipient economy. But on the other hand, in (1999) he utilizes panel data and time series data of ***32*** advanced and developing countries by stationarity test on the economic advancement of developing countries through inward Foreign Direct Investment, but the result shows the weak relationship of FDI on economic growth. E. BROENSZTIEN et al. (1998). Comprised 69 growing countries in his research as a cross-country regression framework. The study suggests that the influence of FDI on financial development of the state is reliant on the level of social investment of host nation and contribute the local economy one when the host economy has sufficient absorptive capacity. The study further specifies the role of FDI states that as a significant way for the shift of technology to emerging countries. HWM et al. (2008) indicates the FDI and economic development association in Malaysia and states that FDI is an important vehicle of economic development, besides investment FDI conveys numerous more remunerations in the host nation like managing resources, advance expertise employment opportunities and generating more exports and contributed to the development of the technical capabilities of local country. CARKOVIC AND LEVINE (2002) concluded their study that there is no active connection between FDI and Economic Growth of any host country. There is no any significant influence of inward FDI on the Economic development of the host country. MLK and KH (2015) analyzed an influence of FDI and trade openness on financial development of Pakistan. Used time series data over 2008-2013, the research established that FDI, trade openness and domestic capital change entirely economic development. Advanced FDI substitutes ancient technology with progressive technology and trains the labor strength of that nation. While it is recommended that the state must take any effective actions like as steadying the exchange rate to increase FDI into the host country, Muhammad et al. (2013) recognized the connection between interest rate and asset of Pakistan in (1964-2012). The research discovered that financing was one of the core reasons of GDP that plays a significant part in improving up the economy. Interest rate and investment were instantly involved to one another, variation in the rate of lending (interest rate) varies investment and preserving design in the economy of Pakistan NUZHAT (2009) explored that influence of Foreign Direct Investment on the economic development of Pakistan by consuming production function built at the endogenous growth theory cover from 1980-2006. The outcomes attained of the research shows that there is an adverse also statistically irrelevant connection among GDP and FDI inflows of Pakistan. NAJABAT ALI 2017. Studies utilize time series data throughout 1991-2015. Study designs on correlation and multiple regression analysis procedures for the exploration of data. Outcomes expose that FDI holds a progressive influence on the economic development of Pakistan. The research advises that the administration must convey modifications in the national market to invite FDI furthermore in Pakistan. Qaiser Abbas (2011) examines the influence of Foreign Direct Investment on (GDP) of (Sarac nations). This association is established on utilizing multiple regression models. The alteration in GDP is used as response variable although FDI and inflation are measured as predictor variables. Study covers from the year 2001 to 2010 of (Saarc nations). The outcome displays that the general model is vital. It is a progressive and essential association among GDP and FDI during an inappropriate relationship among GDP and inflation. Naqeeb-Ur-Rehman defines the association among FDI and economic development. Two models hold to examine the time series data on Pakistan from 1970-2012. The study provides to the current article by investigative the altered experimental methods to evaluate the association among FDI and economic development. The vector error correction model proposes that FDI depends on economic development, but this association is not vice versa. The second model displayed that FDI, human capital and exports are vital issues of economic development. Meanwhile, the adverse connection among collaborative variables (FDI & human

capital) and economic development specifies that the small level of human capital affect the economic development of Pakistan.

3. Theoretical Diagram

This model displays the association between dependent and independent variables.

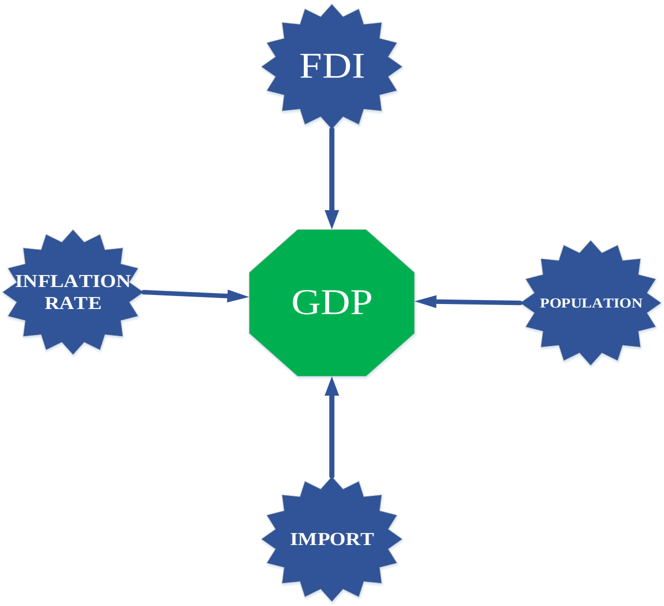


Figure 2. *Theoretical Diagram of Variables*

3.1 Description of variables

Dependent Variable

The dependent variable is the responding variable which response to the change that you make. A response variable is that which depends on different independent variables to exercise the outcome of variations in it. In this real research GDP is a response variable, which has been used as a proxy for the economic development of the state. In our case, real GDP in a Million US$ used.so here, we changed the values into standard logarithm system to escape the quickness in time series data.

Independent Variable

An Independent variable is that who is accountable on behalf of the variations on the dependent variables. A controlled variable plays a vital part in the variations of dependent variable.it also cause and effect on the dependent variable. This research utilizes four independent variables mentioned FDI, inflation rate, population growth, and import. The research practices these variables to examine the association of certain controlled variables and the response variable.

Foreign Direct Investment

Foreign Direct Investment is a vital and substantial predictor of economic development. Foreign Direct Investment deals external resources and advances expertise to the economy, which acts as an instrument to the economic development. We are demanding to examine the impact of this variable on the economic development of Pakistan.

Inflation Rate

Inflation, as estimated by the customer value list, indicates the yearly interest variation in the charge to the regular customer of obtaining a bucket of assets and duties that may remain static or altered at stated interludes, such as annually. The Laspeyres method is regularly practiced (WBD). It takes as an independent variable.

Population

The population is a significant variable that stimulates the growth rate of any country. It defines the number of people is living together in the form of a group in any state. There is a difference of opinion concerning the value of the growth rate of population. The relationship between economic development and community is positive, and also contrary depends upon the different factors. Population growth is the real power and strength of any country. It adds to the cheap labor supply for productive purposes and delivers the potential for enormous markets for goods and services.

Import

Import is an independent variable, which was measured to be an outflow of an economy's budget in the post-liberalization era, but rapidly world economies have accepted the significance and worth of imports in achieving supplies of rising economic development. Thus, isolationist's rules were suspended in the concern of economy and endorse acknowledgment of technological and reserve dispersal from settled economies.

4. Methodology and Data

This analysis intends to inspect the influence of FDI on the economic health of Pakistan. Secondary data collected from various source such as WDI database issued by World Bank, and SB of Pakistan considered as an authentic source of data. Multiple arguments of economic review of Pakistan has been used for this research. The study examines time series data from the period of ***1985*** to ***2017***. Stata software has been used for the analysis of data. Report on the statistic of all the variables is presented below in Table 1.

4.1 Descriptive Statistics

Variable	Obs	Mean	St: Deviation	Min	Max
Year	**33**	**2001**	**9.66954**	**1985**	**2017**
Real GDP	**33**	**1450.378**	**376.052**	**1032.802**	**2137.375**
FDI	**33**	**130302.3**	**145368.1**	**9569.721**	**563827.2**
Inflation Rate	**33**	**7.99697**	**4.213408**	**0**	**20.3**
Population	**33**	**142.4516**	**31.15348**	**92.21949**	**197.016**
Import	**33**	**21805.57**	**15450.7**	**7005.031**	**53527.25**

Source: Author's calculation

Table.1 shows the summary statistics of all the variables.

This research uses Stata software for descriptive statistics so that the arithmetical data might be created reasonable. This is hard to reveal distinct yearly data; accordingly, Table #1 is the complete record of descriptive statistics. The overhead report shows all the variables explicit details and values of the data. The Table has been including four main areas named as Mean, St: Deviation, Minimum and Maximum. The aim of applying the mathematics mean in its place of the median is to estimate the central tendency because there are final standards in data and a standard deviation is applied to test the differences in the mean of the variables as well.

4.2 Model Description

In the current study, multilinear regression has been utilized to define the association between Foreign Direct investment and economic development of Pakistan. The proxy used as a real GDP for economic growth.

Where the regression model defines as:

$Y = \alpha + \beta 1X1 + \beta 2\, X2 + \beta 3X3 + \beta\, 4X4 + \xi$

Where ***Y*** = Gross Domestic Product (DEPENDENT VARIABLE)

X1 = Foreign Direct Investment

X2 = Inflation Rate

X3 = Population

X4 = Import

B = Coefficient of independent variable

α = Constant

ξ = error term.

5. Results and Analysis

Finding of the study are present in the table below.

Numbers of Obs = 33
F(4,28) = 87.02
Prob > F = 0.0000
R-Squared = 0.9353
Root MSE = .06804

5.1 Multilinear Regression Analysis.

Real GDP(Millions)	Co-Efficient	Robust St:Error	T	p> t	95% conf.Interval	
FDI	.0794272	.0151399	5.25	0.000	.0484145	.1104399
Inflation Rate	-0.346658	.0270842	-1.28	0.211	-.0901454	.0208138
Population	-2.235188	.2082259	-10.73	0.000	-2.66172	-1.808657
Import	.3060765	.0627901	4.87	0.000	.1774567	.4346963
Constant	14.47084	.5075457	28.51	0.000	13.43118	15.5105

Source: Author's calculation

Table.2 shows the Regression Result.

If we substitute the value in regression equation, then we have equation like this.

$Y = \alpha + \beta 1\ X1 + \beta 2X2 + \beta 3\ X3 + \beta 4\ X4 + \xi$ becomes

$Y = 14.47 + .0794X1 + .034X2 + -2.234X3 + .30607X4 + \xi$

Conferring to the equation by practicing all the independent variables FDI, Inflation rate, population and import fixed at zero. The finding of the study reveals that a one percent rise in FDI will reach ***0.079*** % increase in GDP ceteris paribus. Besides, ***01 %*** rise in the level of imports translates into a ***0.306 %*** increase in GDP. Alternatively, the relationship between the inflation rate and GDP is negative although not statistically significant. Specifically, a ***01%*** increase in the inflation rate will lead to a ***0.0346 %*** decline in GDP while holding all the else constant.

Similarly, population growth is found to affect GDP negatively. Notably, ***01%*** increase in the population growth will reduce GDP by ***2.23 %*** of all other things being constant at ***5%*** level of significance and ***95%*** level of confidence. FDI had the ***0.000*** level of significance inflation rate had a ***0.200*** level of importance and import had a ***0.00*** level of significance and the pop had also ***0.000*** level of significance. The coefficient of determination ***R*** square value is ***0.935*** that means independent variables explain ***93%*** variance in economic growth of Pakistan include FDI, Inflation rate, Population, and Import. It says other variables not comprised in this research contributed ***7%*** of the variance on the dependent variable. ***F*** estimated value is higher than ***F*** critical value means the overall model is significantly fitted.

6. Conclusion

This research aims to examine the effect of Foreign Direct Investment on the economic health of Pakistan under ***32*** years from ***1985-2017***. The results of this research disclose that FDI has a real influence on the economic development of Pakistan. Multilinear regression analyses show that FDI and GDP are completely associated with each other. Investments from foreign countries perform a major performance in economic development, increase in assets and set-up infrastructure in an unindustrialized nation. In a state, direct investment is enlightening of an optimistic trend of investment with ultimately interprets the rise in GDP and economic development of the nation. It is further being verified from the considerations above-mentioned in the related works. All researches performed in this respect requirement have the thought the political, social and economic condition of the homeland Pakistan. It need be prevailing for the financier's real welfares and possibilities for the Foreign Direct Investment to influence the economy. Deprived of these, any asset made would be incapable of yielding the consequences that were desired. It must be recognized that the constitutional government has to develop guidelines and plans in such a way that would keep the energies and funds were presented. For an underdeveloped state such as Pakistan, the requirement of the moment is to an emphasis on infrastructure progress, HR practice, boosting district administrators, construction of a well-built macroeconomic atmosphere and safeguarding occasions that would be encouraging for investors and deliver energy to the developmental process. Hence, the research suggests that administration policy producers should realize developments to the local business to invite more FDI in Pakistan. In the current study, multilinear regression has been used to define the association between FDI and economic development of Pakistan. The proxy used as a real GDP for economic growth.

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