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Impact of Foreign Direct Investment on Economic Growth in Pakistan

Zia Ur Rahman
National University of Modern Languages
Zia_4939@yahoo.com

Abstract:

The study is conducted to find out the impact of foreign direct investment (FDI) on economic growth of Pakistan. Time series data is utilized which is comprises from 1981 to 2010, collected from the world data bank. Multiple regression technique is used in which gdp is dependent variable while foreign direct investment (FDI) and consumer price index (CPI) are independent variables. The result indicates that there is a positive relationship between the FDI and GDP and have a negative relationship with CPI. When FDI increase the GDP of Pakistan will positively affected by FDI.

1. Introduction:

Foreign Direct investment is a direct investment of a company or entity to in another country. GDP refers to the market value of all final goods and services produced within a country in a given period. It is often considered an indicator of growth and standard of living for a country. Inflation when the price of most goods and services continues to rise upward. It is measured by the consumer price index (CPI).

In FDI capital inflow take place and the resources of a country increases. It has become a most effective technique drawing flow from external sources. This method has a significant aspect of increasing capital resource in developing countries. However the trend of FDI in developing country is declining over the past years**.** For developing countries, the positive impact of foreign direct investment is becoming increasingly popular as a tool for economic growth and strengthening. The most strongest positives of implementing FDI is the increase in aggregate productivity, increased opportunities of employment, greater outflow of exports and exchange of technological advancement between the investor and receiving country.

Internationally:

In a broad sense, Foreign Direct Investment (FDI) is composed of a flow of capital, expertise, and technology into the host country. It is defined as "an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor" (IMF, 2010). In our dynamic age of privatization, liberalization and globalization, FDI has emerged as an important form of international capital flow. Recognizing the importance of investment with no borders, the World Bank has devoted its 2010 issue of "World Development Report" to the issue of trade and investment, discussing in detail the importance of foreign capital flow to the economies of the host countries. According to the World Bank, "few countries have grown without being open to trade. the share of developing countries in world FDI inflows has increased to 36% of global FDI, the highest level since 1997 (UNCTAD, 2005).The capital flow of FDI towards the developing countries are increasing every year but China and India getting the lion share of the increase.

In South Asia:

China and India are the most important countries in the world in sense of population and economy. Both countries have an ancient cultural heritage. Both countries are now trying to more liberalizing their economies as they open up to foreign direct investment (FDI). It is accepted all over the world that foreign direct investment (FDI) plays a positive role in the process of economic growth. Both big economies are trying to beat out each other, Chines beat the Japanese and India is trying to beat out the chines. FDI has increasingly been considered as a catalyst to market growth for the developing countries, particularly in countries such as China and India. More importantly, besides supplementing capital, FDI, as a principal conduit of technology upgrade, know-how transfer and managing skills exchange, heralds the globalization of host economies (United Nations Conference on Trade and Development. 2005; UNCTAD 2006).

In Pakistan:

This research paper aims to analyze the impact of foreign direct investment (FDI) in Pakistan for the period 1981 to 2010 and to observe the relationship between inflation (CPI) and economic growth. Pakistan is a young country with an ancient history and with rapidly growing populations. Her economy primarily depends on agriculture, a per capita income is low and most of the population lives in poverty. Therefore policies to slow down inflation rate and to draw FDI in the country are the central objectives of the macroeconomic policy makers. Pakistan is striving to make its way in the modern world and being the foremost member of SAARC (South Asian Association for Regional Cooperation) and one of the most important country of this region blessed with massive quantity of resources in the form of mineral assets, population (man power), agriculture technology and other God gifted natural resources. FDI and Inflation plays a very vital role in its future growth and development.

Falki (2009) conducted a study on the impact that FDI had on the economic development of Pakistan. The study included data on FDI gathered from the Handbook of Pakistan economy of 2005. Data ranged from 1980 and 2006 and held variables such as domestic variables, labor force and foreign invested capital. Falki used the endogenous theory of growth and a regression analysis, Falki was able to conclude that FDI had a statistically negative effect on the gross domestic product and foreign direct investment in the country.

The purpose of this research paper is to examine the relation of Pakistan's GDP with FDI and inflation (CPI). Study covers the time period from 1981-2010.As World Bank is considered as an authentic source of data collection therefore, the variables data is collected from this reliable source. To examine the relation of Pakistan's GDP with FDI and inflation (CPI). To estimate the effect of FDI on GDP of Pakistan, the study will use the technique of Multiple Regression Model to over the period of 1981 to 2010. In this multiple regression model, GDP is used as dependent variable whereas FDI and CPI are measured as independent variables.

1.2 Objective of the Study:

- To study the impact of FDI on the growth of economy.
- FDI as a tool to increase the skills in human resource, improvement in technology.
- To study the correlation between FDI, GDP.
- To enhance the FDI in Pakistan.

1.3 Hypothesis:

1. Ho: FDI have no impact on GDP.
   H1: FDI have impact on GDP.

2. Ho: There is no significant relationship between FDI, GDP and CPI.
   H1: There is significant relationship between FDI, GDP and CPI.

2. Literature Review:

Foreign Direct investment is a flow of resources from one country to another. This technique paly a very important role to develop a developing country, positively impact the GDP and enhance the resources through which a country can fully utilize the natural resources as well as human resources.

A number of econometric studies have been done in the recent past to prove the validity of the relationship between FDI and economic growth. **Choong** *et al* **(2011)** examine the panel data to find out the relationship between Foreign Direct Investment (FDI), financial development and economic growth using Generalized Method of Moments in a group of 70 developed and developing countries from 1988-2002. They conclude that FDI has a negative but significant impact on economic growth in developing countries. The interpretation for the negative sign of FDI is that the weak regulations and the low degree of the financial sector development in developing countries lead to misallocation of this private capital flow, which reduces and even reverses its impact on economic performance.

Abbas *et al* (2011) conducted a study to examine the influence of FDI and CPI on the GDP of SAARC member nations. The study concluded that the general model in these countries developed a positive relationship between FDI and GDP, while negative relationship between Consumer Price Index and GDP. This conclusion was tested using the multiple regression models. The data of the SAARC countries ranged from the year 2001 to 2010.

Falki (2009) arrange a study to elaborate the impact of FDI on GDP in Pakistan. The study includes the data from1980 to 2006 and the data source is the Handbook of Pakistan economy and held variables such as domestic variables, labor force and foreign invested capital. Falki used the endogenous theory of growth and a regression analysis, Falki was able to conclude that FDI had a statistically negative effect on the gross domestic product and foreign direct investment in the country.

Adam & Tweneboah (2009) conducted an independent study on FDI and the stock market development in the country and found that FDI in Ghana had a positive impact on the development of the economy and the stock market. The examination included data of market capitalization as a proportion of the local GDP and Ghanacedi and Dollar exchange and the net FDI influx of the quarters between the years 1991 to 2006. With the use of multivariate co-integration analysis and the Vector Error Correction Model., the study revealed that the relationship between FDI and the Ghanaian stock market will be beneficial in the long run for the country
Md. Gazi Salah Uddin *et al* 2008. A time-series analysis was also employed to prove the causal relationship between FDI and economic growth of Bangladesh using annual data from 1975 to 2005 The Granger Causality test and Error Correction Models were employed taking care of stochastic properties of the variables. Time-series analysis indicates the causal nexus between export, FDI and GDP

Ilan, 2007) investigates the impact of foreign direct investment (FDI) on economic growth using detailed sectoral data for FDI inflows to Indonesia over the period 1997-2006. In the aggregate level, FDI is observed to have a positive effect on economic growth. However, when accounting for the different average growth performance across sectors, the beneficial impact of FDI is no longer apparent.

Balamurali (2004) examines the relationship between foreign direct investment and economic growth of Sri Lanka for the period 1977-2003 using Johansen's full information maximum likelihood method by considering relationship between real gross domestic product, foreign direct investment, domestic investment and openness of the trade policy regime.

3. Data and Methodology:

3.1 Introduction:

In this chapter we will discuss the data source and the methodology. From where we gather data and the source is authentic and reliable. And which technique is suitable for our model.

3.2 Data and Methodology:

The purpose of this research paper is to examine the relation of Pakistan's GDP with FDI and inflation (CPI). Study covers the time period from 1981-2010.As World Bank is considered as an authentic source of data collection therefore, secondary data of the mentioned variables is collected from this reliable source. To examine the relation of Pakistan's GDP with FDI and inflation (CPI), the following theoretical model is used.

GDP = F (FDI & CPI)

The core intention of the paper is to study the effect of FDI on GDP of Pakistan.
The trend of foreign Direct Investment inflows is also observed with relevance to GDP growth and inflation of Pakistan. To examine the relation of Pakistan's GDP with FDI and inflation (CPI), the following multiple regression model is used.

$$GDP = \quad {}_{1} FDI + \; {}_{2}CPI + \mu$$

Where,
FDI = Foreign Direct Investment
GDP = Gross Domestic Product
CPI = Inflation Rate

3.3 Empirical results:

We used the following multiple regression model for the study

$$GDP = \quad {}_{1} FDI + \; {}_{2}CPI+\mu$$

Table.01

Country	Variables	Coefficient	T-values	F-statistic	R-square
Pakistan	**FDI**	0.394659	15.53548	192.2058	0.936649
	CPI	-10136519	-16.52626		

The proposed model empirical results are depicted by the above table. The slope coefficients of the inputs (FDI) in the multiple regression analyses have positive impact on GDP whereas the slope coefficients of the inputs (CPI) have negative impact on GDP.

If one percent change in FDI occurs, it will bring about 0.39% change in GDP while 1 percent change in CPI will bring- 1.13% change in GDP by holding other variables constant. Estimates (FDI and CPI) are highly significant. As the value of F is too high, 192.2058 and the value of P is so small i.e., 0.000 we can deduce that model is overall very much significant and the results are not by chance. The r-square of this model is 0.94 that means 6% variation in the model is unexplained by FDI and CPI whereas remaining variation (94%) is explained by FDI and GDP.

4. Conclusion:

This study investigates the impact of FDI on GDP of Pakistan, data is comprises on the time period from 1981-2010, which is collected from the world data bank .Empirical results indicate that there is a positive relationship between the FDI and GDP and have a negative relationship with CPI. When FDI increase the GDP on Pakistan will positively affected by FDI.

5. Recommendations:

Government role is very important in this regard, 1st of all his policies to give incentive or make an atmosphere which encourage the foreign investor and make agreements for long term. And provide a business friendly environment so that they satisfy with the investment. FDI in human resource, to improve their skills, import of new technology, and import of capital and make a investment of binary basis, so that both are benefited one for capital and 2nd for technological enhancement. A no of recommendation are as follows;

1. By introducing the facilities for FDI it will help to encourage foreign investors to come and invest in Pakistan.
2. FDI can lead to indirect productivity gains through spillovers.
3. FDI may provide better access to technologies for the local economy, so we must offer free trade for encouraging the FDI.
4. The increase flow of FDI in a country has given a major boost to the country's economy which will help to increase GDP rate.
5. Hence measures must be taken in order to ensure that the flow of FDI in a country must continue to grow.
6. Reduce indirect taxes.
7. Balance social equity.

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