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THE STUDYONTHEFACTORS AFFECTING FOREIGN DIRECT INVESTMENTINPAKISTAN

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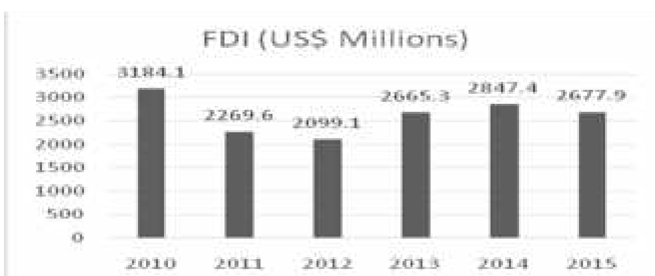
Abstract
Foreign Direct Investment (FDI) became the largest source of capital formation in the world particularly in developing countries. The main purpose of this research is to study the factors which are affecting Foreign Direct Investment in Pakistan. In this research an attempt is made by the researchers to explain on the factorswhich are affecting Foreign Direct Investment in Pakistan. Corruption, Political Stability, Gross Domestic Product, Inflation Rate and Market Size are considered to be the independent variables. Foreign Direct Investment (FDI) is considered to be the dependent variable. The main objective of this research is to analyze the relationship betweenCorruption,Political Stability, GDP, Inflation Rate and Market Size with FDI. The study uses both primary data and secondary data. Time series analysis is undertaken for a period of 20 years (1996-2015). Descriptive Statistics, Correlation Analysis, Reliability Tests and Multiple Linear Regression are also used for this research. The findings show that all theindependent variables have a significant relationship with Foreign Direct Investment in Pakistan. Moreover, it is concluded that with the highest level of GDP will help to increase the FDI in Pakistan.

Keywords: Foreign Direct Investment, Corruption, Political Stability, Gross Domestic Product, Inflation Rate, Market Size.

Introduction

Foreign Direct Investment (FDI) became the largest source of capital formation in the world particularly in the developing countries. It is vital for economic development of a country since sound economic policies and it facilities trade. It is considered to be the largest form of production with respect to technology transfers, unemployment reduction, skill acquisition and market competition in recent years. According to Figure 1, Foreign Direct Investment in Pakistan is increased by 2677.90 USD Million in 2015. Foreign Direct Investment in Pakistan is averaged as 2623.93 USD Million from 2010 until 2015, reaching an all-time high of 3184.30 USD Million in 2010 and a record low of 2099.10 USD Million in 2012. Foreign Direct Investment in Pakistan is reported by the State Bank of Pakistan. In this chapter an attempt is made by the researchers to explain on the factors which affecting Foreign Direct Investment in Pakistan. Corruption, Political Stability, Gross Domestic Product, Inflation Rate and Market Size are considered to be the independent variables. Better employment opportunities are benefitted by adopting Foreign Direct Investment in a country. In fact, it plays a pivotal role in promoting the economic growth and development of any host country.

Figure: 1ForeignDirectInvestment (2010-2015) (US$ Millions)



Source: State Bank of Pakistan

Problem Statement

According to Kowalski(2000), Foreign Direct Investment is important and significant as it acts as forecaster of the economic growth. Foreign Direct Investment provides external resources and advance technology to the economy which act as an engine to the economic growth. Referring to the current situation of Foreign Direct Investment in Pakistan is considered to be poor. It is facing low FDI since past few years. Marshalland Jaggers(2002) had viewed Political Instability as an issue in Pakistan in recent years. Pakistan is a main economic power in Asia but the Political Instability in the country poses a serious threat not only to its economic growth but also on the investment in the country. It was, therefore, intended to estimate the

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effect of this factor on economic performance of developing countries such as Pakistan. The researchersare interested to find out whether Corruption, Political Stability, Gross Domestic Product, Inflation Rate and Market Size are affecting the FDI in Pakistan. Corruption means the misuse of public power for private benefit is most likely to occur wherepublic and private sectors meet. It is a factor which discourages FDI as well as economic growth. Rose-Ackerman(2001) stated that Corruption occurs where public officials have a direct responsibility for the provision of a public service or application of specific regulations.Akhter and Manzoor(2015) had viewed that Pakistan is currently facing the situation of low investment from other countries. Many organizations are corrupt and inefficient due to the presence of bureaucratic red tapes. The general public does not trust institutions in the developing countries, hence they take shortcuts by giving bribes to certain higher hierarchical level individuals in order to get their work done. Chughtai(2014) had opined that Pakistan as the underdeveloped country due to its low rate of Gross Domestic Product. The main reasons are low level saving, low level income, high population growth rate, poverty, and the lack of technical skill. Awan et al. (2014) hadexamined that inflation rate is positively related to FDI in Pakistan. Finally, the Market Size is also an important factor for FDI inflows indicated byGharaibeh (2015). Hence, to find out the solutions to these problems, the research is undertaken.

Research Objectives

Theobjective of this research is to find out whether there exists any relationship between Foreign Direct Investment and different factors which affect the Foreign Direct Investment in the developing country of Pakistan. An attempt has been made by the researchers to analyze the factors affecting Foreign Direct Investment in Pakistan**.** The following are the objectives of the study:

1. To analyze the relationship between Corruption and Foreign Direct Investment in Pakistan.
2. To examine the relationship between Political Stability and Foreign Direct Investment in Pakistan.
3. To find out the association between Gross Domestic Product and Foreign Direct Investment in Pakistan.
4. To probe into whether thereexists any relationship between Inflation Rate and Foreign Direct Investment in Pakistan.
5. To study the association between Market Size and Foreign Direct Investment in Pakistan.

Scope and Significance of the Study

Harding and Javorcik (2012) viewed that FDI inflows creates good jobs both from the worker’s and the country’s perspective. On the one hand, that is, for the worker, such jobs are likely to pay higher wages than jobs in indigenous firms in developing countries. This research will concentrate on the factors that influence the Foreign Direct Investment in Pakistan. The independent variables which are Corruption, Political stability, Gross Domestic Product, Inflation Rate and Market Size are also considered. This research has used both primary and secondary data. Secondary data was collected through the state bank of Pakistan, trading economics, World Bank, journals, articles, books, and also from past research. The primary data was collected through questionnaires. Questionnaire consists of four parts and each part has several questions in it. Questionnaires were sent to 68 respondents as calculated according to Raosoft survey calculator.The sample comprising by the foreign investors, businessman, official officers, and general individuals from both private and government organizations in Pakistan. Both private and government sectors in Pakistan are the samples considered for the research. Hence, these are considered to be the most important scope of this research. The businessman, government, every individual and foreign investor will be benefited from this study. This research is vital for businessmen as they can make investment decisions. It is helpful for the government as it can make some changes in economic policy on FDI. As Foreign Direct Investment is reliable it can be regarded as the important matter for economic development of the country.

Literature Review

Dependent Variable

ForeignDirectInvestment is one of the main forms of modern capital internationalization. According to the International Monetary Fund, the definition of FDI is an investment made by a company or individual in one country in business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company.Khawar (2005)probed that Foreign Direct Investment plays a major role in the economic development of the host country. Most countries have been using foreign investment and foreign technology to speed up their economic growth. Over the years, Foreign Direct Investment has helped the economies of the host countries to obtain a launching pad from where they can make further improvements. Any forms of Foreign Direct Investment inject a large amount of technological resources and capital knowledge into the economy of the country. This helps in taking the particular host economy ahead. FDI ensures a large amount of domestic capital, employment opportunities and production levels in the developing countries, which is an important step in the national economic growth.

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Independent Variable

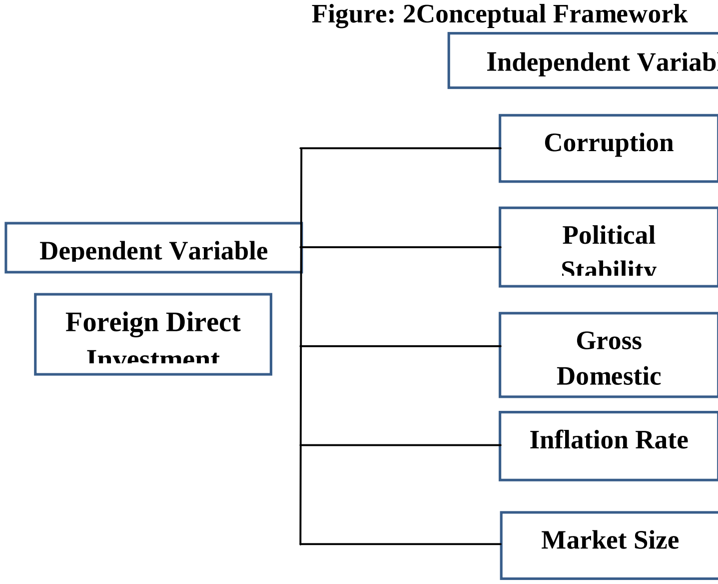
Egger and Winner (2006) examined the relationship between FDI and Corruption, applying a panel data model in a sample of 59 countries with OECD and non-OECD economies over the period from 1983 to 1999. The results of the research stated that Corruption has an adverse effect on FDI for any of the analyzed countries. That conclusion highlights that the impact of Corruption on the amount of FDI is outweighed and should be taken into account in both OECD and non-OECD countries. Political Stability is very important for a country's normal macroeconomic and business environment. Political riskis largely determined by Political Stability and good governance of the government (Yousaf et al., 2008). The constantly changing political system and the unstable government can lead to political risks which, in turn, will negatively affect the level of domestic and foreign investment in a country. There is no doubt thatPolitical Instability in not good since it will negatively affect a country's economic development and growth process by its dent on the physical and human resources. If the country's Political Stability condition is not good, foreign investors will hesitate to bring any projects until they are assured that the business environment would to be favorable (Brada et.al., 2006). Rihab and Lotfi (2011) exploredvital variables to determine the level of FDI within 71 developing countries throughemploying dynamic panel data technique over the period of 2001-2006.Their findings demonstrated that GDP, economy's openness, human resources and the quality of governance system had significant positive correlation while individualism, corruption control and hierarchal distance had negative correlation with FDI inflows.Faiza et al. (2013) explored the effect on Foreign Direct Investment due to the growth and InflationRatein Pakistan utilizing annual time series data for the period of 1990 until 2011. FDI is taken as dependent variable while GDP and InflationRate are taken as independent variables. The studyrevealed that Foreign Direct Investment has a positive relationship with InflationRate and growth.Asiedu (2006) well evaluated the Market Size benefits of regionalism. The research suggested that there are three reasons of FDI enhancement as regional economic cooperation. Firstly, regionalism can promote Political Stability by restricting membership only to elect democratic government. Secondly, coordination of policies among member countries which reveals curbing corruption, implementing sound, stable macroeconomic policies and investor friendly framework. Thirdly, it expands the size of market, which makes region more attractive for FDI. This research also highlighted the significance of regionalism to those countries which are in small size and low income. Small countries can also attract Foreign Direct Investment in better manner as they join coalition to achieve largerMarket Size. Although the regionalism provides opportunity to increase FDI, but policy coordination among member nations of bloc remains mainproblem to be solved.

Research Methodology

Theoretical Framework

This study has adopted both primary data and secondary data. Primary data is collected by the way of questionnaires. Two types of variable namely, dependent and independent is used for the study. The main objective of this study is to find out the factors affecting Foreign Direct Investment. The researchers have chosen a dependent variable and an independent variable. Dependent variable is explained as what you measure during the study and what is affected during the study. The dependent variable responds to the independent variable. Corruption, Political Stability, Gross Domestic Product, Inflation Rate and Market Size are dependent variables used for the study. Independent variable is the Foreign Direct Investment in Pakistan.

Figure: 2Conceptual Framework



ResearchHypotheses

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The following Null and alternative Hypothesis are framed in order to test the objectives:
H0-Null Hypothesis (No Correlation)
Ha-Alternative Hypothesis (Has Correlation)

H1
H01: There is no correlation between Foreign Direct Investment and Corruption.
Ha1: There is a correlation between Foreign Direct Investment and Corruption.

H2
H02: There is no correlation between Foreign Direct Investment and Political Stability.
Ha2: There is a correlation between Foreign Direct Investment and Political Stability.

H3
H03: There is no correlation between Foreign Direct Investment and Gross Domestic Product.
Ha3: There is a correlation between Foreign Direct Investment and Gross Domestic Product.

H4
H04: There is no correlation between Foreign Direct Investment and Inflation Rate.
Ha4: There is a correlation between Foreign Direct Investment and Inflation Rate.

H5
H05: There is no correlation between Foreign Direct Investment and Market Size.
Ha5: There is a correlation between Foreign Direct Investment and Market Size.

Descriptive Analysis
In this research, the data was collected through mailed questionnaires and Time Series Analysis. This is being tested with the assistance of statistical package for social sciences (SPSS). Apart from this the researchers have also adopted Descriptive Statistics, Correlation Analysis and Multiple Linear Regression to get the results. Primary Data is used to test two variables namely Corruption and Political Stability. Secondary data is used to test Time series analysis for a period ranging for 20 years (1996-2015). Three independent variables namely Gross Domestic Product, Inflation Rate and Market Size are considered. The secondary sources of data were collected from World Bank Statistics, State Bank of Pakistan, IMF and Economic Survey of Pakistan.

Research Findings
This part is about the analysis of discussions and findings and also includes the relationship of hypothesis test between independent and dependent variable. Additionally, this part also pays attention on the empirical findings of the current research with the combination findings from other researchers as a support for this research. The results from Pearson's correlation and Multiple Linear Regression will also be discussed throughout this chapter.

Hypothesis Testing
The hypothesis is tested by using the following variables:
Correlation between Foreign Direct Investment and Corruption
H01: There is no correlation between Foreign Direct Investment and Corruption.
Pearson Correlation Results for Primary Data:

Table: 9Pearson Correlation Result

Correlation		FDI	Corruption
Foreign Direct Investment	Pearson Correlation	1	.310
	Sig.(2-tailed)		.010
	N	68	68
Corruption	Pearson Correlation	.310	1
	Sig.(2-tailed)	.010	
	N	68	68

Source: Primary Data

From the above table it can be inferred that a weak positive correlation 0.310exists between the FDI and Corruption. The value .010 (1%) is lower than 0.05 which is the significant level and the null hypothesis is rejected. As a result, the alternative hypothesis is accepted. This finding is reliable according to the previousstudy of Ravi (2015), the researcher concluded that there is a significant corruption between corruption and Foreign Direct Investment in Pakistan.

Correlationbetween Foreign Direct Investment and Political Stability
H02: There is no correlation between Foreign Direct Investment and Political Stability

Table: 10 Pearson Correlation Result

Correlation		FDI	Corruption
Foreign Direct Investment	Pearson Correlation	1	.732
	Sig.(2-tailed)		.000
	N	68	68
Political Stability	Pearson Correlation	.732	1
	Sig.(2-tailed)	.000	
	N	68	68

Source: Primary Data

From the above table it is evidenced that the significant value is .000 (0%) which is lower than the significant level ($P<0.05$) and hence null hypothesis is rejected and alternative hypothesis is accepted. Furthermore, this finding is unreliable according to Nadeem (2015), who found out a negative relationship between Foreign Direct Investment and political instability in Pakistan due to thedecisions of investment are mostly determinedby the political risk such as blockage.

Correlation between Foreign Direct Investment and Gross Domestic Product, Inflation rate and Market Size
H03: There is no association between Foreign Direct Investment and Gross Domestic Product, Inflation Rate and Market Size.
Multiple Linear Regression results for Secondary data:

Table: 11SignificantValue Range

Significant Level	Null Hypothesis
(P< 0.05)	Reject
(P= 0. 05)	Accept
(P>0.05)	Accept

Table: 12MultipleRegressionModelSummaries

Gross Domestic Product, Inflation Rate and Market Size

R	R^2	AdjustedR^2	SE	F Value	Sig
.637	.406	.295	1.345	3.646	.035

Source: Secondary DataLevel of significant 5%

Foreign Direct Investment (Y) = $\alpha+\beta 1X1+\beta 2X2+\beta 3X3+e$

Foreign Direct Investment (Y) = -1.320+ .308X1 + .455X2+ .335X3 +e

From the above table it is clear that the regression result for the X1 independent variable (GDP) is positive. Hence, there is an association between FDI and GDP. The Regression coefficient result is .308. It is clear that the increase in GDP will increase the Foreign Investment in Pakistan. It is also inferred that, the $P < \alpha$ ($.035 < 0.05$) which shows that the null hypothesis is rejected and the alternative hypothesis is accepted by 5% which is a level of significance.Discussing on the second independent variable X2 (Inflation Rate) is positive which states that, there is a significant positive relationship between Foreign Direct Investment and Inflation Rate.

The third independent variable X3(Market Size) and Foreign Direct Investment is positive which states that there is a significant relationship between both variables. The results of F value (3.646) is significant at 5%. The whole regression is significant and established 40.60% between independent variable and dependent variable. The coefficient of correlation (R) value is 0.637, which states that there is a good relationship between the variables. The coefficients of determinant (R2) value are 0.406, which states the level of correlation between Foreign Direct Investment and independent variables which are Gross Domestic Product, Inflation Rate and Market Size.

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Conclusions

From theabove research it is clear that all the objectives of the research are achieved. This research has probed the relationship between the Foreign Direct Investment and Corruption, Political Stability, Gross Domestic Product, Inflation Rate and Market Size in Pakistan. The research has used both the primary data and secondary data. From the study it is evidenced that there is a weak positive correlation between FDI and Corruption. There also exists a strong positive correlation between FDI and Political Stability, Gross Domestic Product, Inflation Rate and Market Size. Hence, it can be concluded that there exists more Corruption with the decrease of the FDI and high level of Political Stability GDP, Inflation Rate and Market Size prevails with the increase of FDI.

Recommendation

The Pakistan government can improve the infrastructure facilities, local skills development by attracting more foreign investors through improving national saving and investment. The government may take initiative to attract the foreign investors by having strong policies. It is also recommended to other researchers to cover an in depth study for many years, say thirty years, in order to have accuracy in data.

The next recommendation to further study is to have other variables like economic growth, openness of trade, terrorist attack as dependent variables. This will attract the foreign investors. The government may also implement new policies to attract FDI and adopt incentives for transfer of technology.

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