THE ROLE OF INVESTMENT PROFILE, GOVERNMENT STABILITY AND MACROECONOMIC MANAGEMENT IN DETERMINING FPI

Muhammad Asif & Abdul Majid

Department of Management Sciences, Hazara University, Pakistan

ABSTRACT

The objective of this paper is to investigate the effects of investment profile, government stability and macroeconomic management indicators on foreign direct investment in Pakistan. The results of time series data from 1984 to 2013 showed that there is a significant impact of explanatory variables on foreign private investment. Our results show that the government stability and investment profile of the country and per capita gross domestic product encourage the inflow of foreign private investment while real exchange rate depreciation have an adverse relationship with foreign private investment. Our study suggests that the government and its institutions must investment profile of the country, ensure government stability and strengthen the macroeconomic management indicators to make visible improvements in attracting foreign private investment inflow in Pakistan.

Keywords: *Foreign Private Investment, Investment Profile, Government Stability, Exchange Rate*

INTRODUCTION

Investment decision is very critical process especially when the economic, financial and political environment of the host country is complex. Most of the developing countries of the world have abundant natural resources like petroleum, natural gas and coal etc but there are problems related to low investment profile, poor government stability and macroeconomic instability. Pakistan is also one of the countries of world which have rich resources of coal, natural gas, petroleum and precisions stones but the statistics shows that the foreign private investment (FPI) in the country never reach the target set by the government due to poor investment profile and poor macroeconomic management in the country.

The multinational corporations have remained the major contributors in enhancing foreign private investment (Bakare, 2010). FPI is an important element of foreign capital and this benefits the economy through (Aqeel and Nishat,

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2005). Many studies (Alfaro et al. 2003, Khan 2007, Aykut and Sayek 2005) found that FPI has a direct impact on growth. Trade liberalization and providing special incentives to the investors are better strategies to attract FPI (Arslan and Qaisar, 2013). The policies like tax reduction, better infrastructure and sound macroeconomic management have potential to boost FPI inflows to developing countries.

To attract foreign private investment, the recipient country develop good and investor friendly policies, ensure government stability and sound macroeconomic management to restore the confidence of foreign investors (Azam and Khattak, 2011; Khan, 2007). However, it is generally believed that sound macroeconomic management, high investment profile and government stability make a country more attractive host for foreign private investment (Ang, 2007).

The main objective of this study is to explore the determinants of foreign private investment in Pakistan. The other objective is to find the impact of macroeconomic management, investment profile and external conflicts on foreign private investment. The rest of the paper includes literature review section, methodology section, data analysis and discussion section and conclusion section.

LITERATURE REVIEW

There is a plenty of literature available on determinants of foreign private investment inflows for any country (Cheng and Kwan, 2000; Zhang, 2001). According to Dunning and Rugman (1985), foreign private investment contributes to the host country through various ways like technology transfer, higher growth in industrial productivity, development in managerial know-how and improvement in quality and performance of the institutions. However, the inflow of the foreign private investment in any country depends on various factors (Asiedu, 2002; Dogru, 2012; Garibaldi et al., 2002). Some of the factors include: government stability (Busse and Hefeker, 2007); macroeconomic stability (Alguacil et al., 2011); efficient institutions (Du et al., 2012); political stability (Asiedu, 2002), market size (Asiedu, 2006); and exchange rate (Benassy-Quere et al., 2001).

Javed et al., (2013) studied determinants of foreign private investment and found that the macroeconomic management political stability were significant predictors of foreign private investment. Dogru (2012) analyzed the relationship between FPI and its potential macroeconomic and instructional determinants and found

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that macroeconomic management and population growth significantly influences FPI. Azam and Khattak (2011) found that better institutional quality and sound macroeconomic policy encourage FPI inflow. Awan et al (2010) examined the macroeconomic management impact on foreign private investment inflows in Pakistan's economy. They found that domestic investment, trade openness and rate of inflation were significant in attracting FPI.

Harms and Ursprung (2002) examined the relationship between average foreign private investment per capita and indices of political rights, civil liberties, and repression. They found a negative and significant relationship between the dependent variable and all three indices. A related study, Jensen (2003), argues that the countries with stable governments can easily gained the confidence of investors. Asiedu (2002) found that efficient institutions and government stability have a positive impact on foreign private investment. Garibaldi et al (2002) also found similar results.

As this paper focuses on the effects of investment profile, government stability and macroeconomic management on foreign private investment, therefore, we will delimit our discussion only to government stability, investment profile and macroeconomic indicators. Government stability is an assessment of the government's ability to remain in power for specified period of time (Alberto and Perotti, 1996; Banga, 2003; Ramady, 2013). It is generally believed that the government stability has ability to attract the foreign direct investment and investors have greater confidence to invest in the host country where the government is more stable and will complete its tenure (Gastanaga et al., 1998; Harms and Ursprung, 2002; Khan, 1997). Hyun (2006) analyzed the government stability as an indicator of institutional quality that affects foreign private investment positively both in the long run and short run.

Stein and Daude (2001 found that countries having quality institutions tend to do better in attracting foreign private investment. Investment profile is an assessment of factors affecting the risks to investment that are not covered by other political, economic and financial risk components (Neumayer and Spess, 2005; Ramady, 2013). A good investment profile of the country attracts the foreign investors while the poor investment profile adversely affects the FDI inflows (Asiedu, 2002; Dutta and Roy, 2011; Garibaldi et. al. 2002). It is clear from the review of literature that the inflow of foreign private investment is largely affected by investment profile, government stability and macroeconomic management

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indicators. The government stability, investment profile of the country and sound macroeconomic management enhance the quality of host country institutions which build the confidence of foreign investors and encourage the inflow of foreign private investment.

METHODOLOGY AND DATA SOURCE

The foreign private investment depends upon sound macroeconomic management of the host country. The macroeconomic management of the country includes per capita gross domestic product, real exchange rate. Beside macroeconomic factors the institutional factors like government stability and investment profile of the country also encourage the foreign investors to invest in the recipient country.

To analyze the impact of macroeconomic management and institutional factors on foreign private investment, the key macroeconomic indicators are linked to observe the process and their role in the economy of Pakistan. Ehimare (2011), Orji and Mba (2010), and Osinubi and Amaghionyeodiwe (2010), used various macroeconomic variables for estimation. The other studies [Fanta (2011), Ehimare (2011), Bakare (2011), Wafure and Nurudeen (2010), Zakaria (2008), Iyoha (1998) and Ekpo (1997)] also discussed this relationship. The current study is comprised of following model.

Foreign Private Investment = f (Investment Profile, Govt. Stability, Exchange Rate, Per Capita GDP) ---------- (1)

The equation 1, can be written in econometric model as:

$$FPI_t = \alpha_0 + \alpha_1 IP_t + \alpha_2 GS_t + \alpha_3 ER_t + \alpha_4 GDPPC_t + \varepsilon_t$$

Where the FPI is the dependent variable and IP, GS, ER and GDPPC are the explanatory variables.

The investors perceived confidence from better macroeconomic management of the host country which results in more foreign private investment from the abroad. Similarly the poor macroeconomic management negatively affects the inflow of foreign private investment. The investment profile of the country exerts a significant positive impact on inflow of foreign private investment. Better investment profile of the country attracts more investment from the abroad. The government stability also plays a vital role in attracting foreign private investment. The data regarding foreign private investment, real exchange rate and per capita gross domestic product is extracted from World Development

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Indicators. Data is taken as a percentage of GDP. The data regarding investment profile and government stability is extracted from International Country Risk Guide (ICRG) of Political Risk Services (PRS) group website. The range of each series is 0 to 12, where 0 means very high risk and 12 means very low risk. The data set covers the years from 1984 to 2013.

RESULTS AND DISCUSSION

The results of descriptive statistics are shown in table 1. The descriptive statistics analysis includes number of observations, minimum & maximum values, average, standard deviation, Skewness and Kurtosis. The descriptive statistics show that all the variables are normally distributed.

Table 1: Descriptive Statistics

	FPI	IP	GS	ER	GDPPC
Mean	1.0359	5.5777	6.9750	47.5242	612.0685
Median	0.6845	5.3950	6.7500	47.2737	587.4144
Maximum	3.6683	8.0000	10.8300	101.6289	806.3826
Minimum	0.1782	2.4200	2.1700	14.0463	446.2713
Std. Dev.	0.8759	1.4691	2.3286	25.7011	102.7655
Skewness	1.8463	-0.0113	-0.0984	0.4156	0.3253
Kurtosis	5.5329	2.0482	1.9112	2.1000	1.9656
Jarque-Bera	25.0628	1.1331	1.5304	1.8762	1.8667
Probability	0.0000	0.5675	0.4653	0.3914	0.3932
Sum	31.0777	167.3300	209.2500	1425.7260	18362.0500
Sum Sq. Dev.	22.2489	62.5851	157.2487	19155.8200	306261.8000
Observations	30.0000	30.0000	30.0000	30.0000	30.0000

The results of correlation analysis are shown in table 2. The results are evident that investment profile of the country, government stability within the country, exchange rate and per capita gross domestic product of the country are significantly positively associated with the foreign private investment. The correlation coefficient of investment profile is 0.487 which shows that there is a 49 % direct association between investment profile and FPI. The correlation coefficient of government stability is 0.162 which shows that there is a 16 % correlation between government stability and FPI. The correlation coefficient of exchange rate is 0.314 which shows that there is a 31 % positive association

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between exchange rate and FPI. The correlation coefficient of per capita GDP is 0.531 which shows that there is a 53 % correlation between per capita GDP and FPI.

Table 2: Correlation Analysis

	FPI	IP	GS	ER	GDPPC
FPI	1.000	0.487	0.162	0.314	0.531
IP	0.487	1.000	-0.088	0.412	0.485
GS	0.162	-0.088	1.000	0.162	0.042
ER	0.314	0.412	0.162	1.000	0.946
GDPPC	0.531	0.485	0.042	0.946	1.000

The results of regression analysis are shown in table 3. The foreign private investment is used as the dependent variable while the investment profile, government stability, exchange rate and per capita GDP are used as explanatory variables. The results show that the investment profile, government stability and per capita GDP has significant positive relationship with foreign private investment while real exchange rate has significant negative relationship with foreign private investment. The diagnostic statistics of the model are shown in the table 3 below. The value of R-Square is 0.838 which reveals that there is 84 % variation in dependent variable is explained by the explanatory variables. This also represents the goodness of fit of the model.

The value of F-statistics is 24.96 which is significantly highly than the bench mark and represents the overall significance of the model. The value of Durban-Watson is 1.868 which represents that there is no serious problem of serial correlation. Same is the confirmed by the serial L-M statistics. The Jarque-Bera statistics represents the normality of the data. The value of ARCH test and White test revealed that there is no hetroscedasticity present in the model. The Ramsey RESET value represents the stability of the model. All the statistics show that there is no serious econometric problem with the regression model.

Table 3: Regression Analysis

ISSN: 1019-8180

Dependent Variable: FPI				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-9.361556	1.483065	-6.312305	0.0000
IP	0.141621	0.069753	2.030324	0.0535
ER	-0.068836	0.012564	-5.478991	0.0000
GDPPC	0.019518	0.003184	6.130753	0.0000
GS	0.133186	0.045238	2.944126	0.0071
MA(1)	0.473329	0.186891	2.532652	0.0183

Diagnostic Statistics

R-squared = 0.838753, Adjusted R-squared = 0.805160 F-statistic = 24.96805 Durbin-Watson stat = 1.867801, Jarque- Bera = 1.6916 (0.429), Breusch-Godfrey Serial Correlation LM Test = 0.462 (0.793), Heteroskedasticity ARCH Test = 3.53 (0.06) Heteroskedasticity White Test = 6.131(0.408), Ramsey RESET Test = 34.043 (0.000)

From the table 3, it is clear that investment profile of the host country positively contribute to the foreign private investment inflow. The results show that a unit increase in investment profile of the country will bring a 0.14 unit increase in foreign private investment. An improvement in the investment profile of the country will boost the confidence level of the investors which leaves a significant and encouraging impact on foreign private investment in flow. Similarly, the government stability has also a encouraging impact on foreign private investment. The investors used to investment more in the country where the government is stable, political stability and smooth functioning of government institutions. The results show that a unit increase in government stability will improve foreign private investment by 0.133 units in Pakistan. The exchange rate has a significant negative relationship with foreign private investment.

The results show that unit depreciation in domestic exchange rate will discourage foreign private investment by 0.067 units. The investors invest more in a country where the exchange rate is stable. The investors do not invest in the economy whose exchange rate has frequent fluctuations in exchange rate over limited period of time. Finally, the per capita GDP has significant positive contribution in attracting foreign private investment inflow. The results show that a unit increase

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in per capita GDP will encourage foreign private investment by 0.02 unit. Per capita GDP represents the strength of labor productivity. The investors invest more in a economy where the human capital is more productive and efficient. In the light of above estimated results it is suggested that to attract foreign private investment in the country the government must ensure the stability in the political system as well as in their institutions. The government should ensure a stable exchange rate policy to attract foreign private investment.

CONCLUSION

There are many factors that directly affect the inflow of foreign private investment. These factors include institutional as well as macroeconomic factors. The objective of this paper is to investigate the effects of investment profile, government stability and macroeconomic management indicators on foreign private investment in Pakistan. The descriptive analysis, correlation and regression analysis were used to estimate the results. The results of time series data from 1984 to 2013 showed that there is a significant impact of explanatory variables on foreign private investment. Our results show that the government stability and investment profile of the country and per capita gross domestic product encourage the inflow of foreign private investment while real exchange rate depreciation have a adverse relationship with foreign private investment. The diagnostic statistics including F-statistics, Durban-Watson statistic, L-M test, ARCH test and White test confirmed that the model is statistically reliable, valid and free from econometric issues and used for further forecasting. Our study suggests that the government and its institutions must investment profile of the country, ensure government stability and strengthen the macroeconomic management indicators to make visible improvements in attracting foreign private investment inflow in Pakistan.

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