ECONOMIC DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN PAKISTAN

KHAIR-UZ-ZAMAN[1], S HUMAILA HASHIM[2]& ZAHID AWAN[3]
[1]*Khair-uz-Zaman, Department of Economics, Gomal University, DeraIsmail Khan (NWFP) Pakistan (E-mail: drzaman2001@yahoo.com)*
[2] *Shumaila Hashim, Qurtuba University, Dera Ismail Khan (E-mail: shs_1234@hotmail.com)*
[3] *Zahid Awan, Gomal University, Dera Ismail Khan (E-mail: zebi_awan@yahoo.com)*

ABSTRACT

This paper empirically investigates the economic determinants of Foreign Direct Investment (FDI) in Pakistan. In this study we used time series data for the period of 1970-71 to 2002-03. To check stationarity in the levels of data, we applied Augmented Dickey Fuller Test and then we estimated data by using an Error Correction Model (ECM). Unit Labor Cost and Inflation were statistically significant with negative and positive signs respectively. Both Market Size and Trade Balance were also found statistically significant with positive signs. Service Sector was insignificant with positive sign. Through these tests we proved that all variables were significant except Service Sector.

INTRODUCTION

The economic growth of foreign direct investment (FDI) in recent decades has generated three main currents of thought which have attempted to explain this phenomenon. First the market imperfection hypothesis, Horaguchi and Toyne (1990)], which postulates that FDI is the direct result of an imperfect global, market environment. Second, the internationalization theory Rugman (1985,1986) where FDI takes place multinationals replace external markets with more efficient internal ones. Third the electric approach to international production Dunning (1986, 1988) where FDI emerges because of ownership, internationalization and location advantages. The above theories are significant steps towards the development of a systematic framework for the emergence of FDI.

The growth of world FDI in recent years has been exceptional. The US $ value of the world FDI inflows reached a record US $ 1.3 trillion in 2000 from just over US $ 200 billions in 1993. In 1980, FDI stock represented the equivalent of only 5% of world GDP; this percentage has almost tripled to 14% by the end of 1990s. The changing perceptions and more attractive policies of the host developing nations have changed the destinations of FDI flows from industrially developed countries to high growth developing countries. FDI stock held by developing countries has risen from $132.95(b) in 1980 to $1438.48(b) in 1990. Their share in inward stock has reached to 30.14% in 1999 as against 26.2% in 1980.

Since the 1980, attracting FDI has been one of the most important policy goals of both developing and developed countries. To achieve this objective a number of countries have not only liberalized restrictions on FDI, but also provided incentives to attract FDI.

Previous researchers have studied the contribution of FDI to domestic productivity and there is a general agreement about the positive impact of FDI on economic development. [Aitkin and Harrison (1999)]. Though some found negative results but most empirical studies found a positive relationship between FDI, productivity and growth Markusen et al (1999). Generally, we see FDI brings the most needed capital, improved managerial skill, modern