

## FACTORS AFFECTING FOREIGN DIRECT INVESTMENT IN PAKISTAN

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**ABSTRACT:** *Foreign Direct Investment (FDI) plays a crucial role in speeding up the development and economic growth of a country. In developing countries rely on FDI to promote their economy as they face capital shortage for their development process. The strong growth performances experienced by Pakistan economy greatly depends on the FDI. FDI generates economic growth by increasing capital formation through the expansion of production capacity, promotion of export and creation of employment in Pakistan. FDI inflows of Pakistan started fluctuating from 1990s to 2012 and this high volatility of Pakistan FDI inflows drew the researchers' attention to examine the factors affecting FDI inflows in Pakistan by using the annual data from year 1988-2012. Multiple linear regressions model is applied to study the relationship between explanatory variables and explained variable. Empirical results show that gross capital formation, exports, gross national income, have significantly and positively affect Pakistan FDI inflows. Other than that, external debt also significantly affects Pakistan FDI inflows but its relation with FDI is negative. Imports of Pakistan are the final goods & its relationship with the FDI inflow in Pakistan is negative. It is significant affect on FDI in Pakistan. Due to the war conditions in Pakistan the military expenditures increases sharply which shows the foreign investors disinterest in Pakistan from last few years and our results also shows a significant and negative relationship between military expenditures and FDI inflow in Pakistan.*

**KEYWORDS:** FDI, GCF, GNI, IMP, EXP, EXDT, MEXP

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## INTRODUCTION

Foreign direct investment is appraised of foreign ownership of operating assets, such as factories, mines and lands. Increasing foreign investment can be used for instance one measure of rising economic globalization. During last thirty years, there has been a fabulous growth in global Foreign Direct Investment (FDI). In 1981 the total stock of FDI equaled only 6.59 percent of world Gross Domestic Product (GDP), while in 2004 the share of GDP had increased to close to 23.52 percent according to the United Nation Countries of Trade and Development Report (UNCTAD 2004). This has been taken place concurrently due to large growth in

international trade. The growth in international flows of goods, and capital implies that global financial system is becoming increasingly interconnected as economic activity is extended across boundaries. Foreign Direct Investment is an essential portion in the globalization path of action as it intensifies the interaction between states, regions and Multinational Corporations (MNCs). Internationally rising of foreign direct investment, international trade, information and migration are all parts of this progression. This paper investigates different factors of FDI using data for FDI. The first choice of research topics has been made in order to let for the possibility of finding results that can provide knowledge about the nature of FDI with the aim to help the policy makers of the host country and the investing country to take suitable decisions for the progress and grow of economies to both countries.

### **Objectives of the study**

The objectives of this study were to investigate the relationship of foreign direct investment and different factors which affect FDI in the developing country of Pakistan. This study enriches the literature on the FDI. In this study an effort has been made to analyze the empirical study of FDI of Pakistan for investigating the effect of different factors on FDI in Pakistan during the period of 1988 to 2012. The more specific objectives are:

- To examine the relationship between gross capital formation and FDI inflows in Pakistan from 1988-2012.
- To measure the proportional of FDI in Pakistan with reference of gross national income.
- To examine the relationship between external debt and FDI inflows in Pakistan from 1988-2012.
- To examine the relationship between gross national income and FDI inflows in Pakistan from 1988-2012.
- To examine the relationship between exports and FDI inflows in Pakistan from 1988-2012.
- To examine the relationship between imports and FDI inflows in Pakistan from 1988-2012.
- FDI performance v/s potential in Pakistan.

### **Significance of the Study**

Factors of FDI are a popular topic among the researchers. Even though, there have been many previous studies done on the factors of FDI in Pakistan, in this case, researchers have added a relatively new variables such as military expenditure, gross capital formation and gross national income into the model in order to find out whether the amount of military expenditure, gross national income and gross capital formation affects the FDI inflow of Pakistan. This study will contribute to policymakers like State Bank of Pakistan and the Federal Government as it gives them a picture of what variables are significantly affecting FDI inflows in Pakistan. Researchers have included some important economic factors like exports, external debt, imports, gross capital formation, gross national income, and military expenditure. The most important factors are of course the gross national income and military expenditure. This study results can serve as a guideline or reference to State Bank of Pakistan and the Federal Government in formulating monetary and fiscal policy to meet up with the preference of direct investors who consider investing in Pakistan. Besides, these can prevent policymakers from focusing on the unnecessary areas wasting resources in an effort to attract more FDI.

## LITERATURE REVIEW

Bhagwati (1998) claimed that impact of FDI on growth appeared to be positive in case of export promoting countries not in case of small developing economies. This study also revealed that the FDI to GDP ratio and current account balance to GDP ratio of eight transition economies had shown a negative relationship. Akhtar (2000) analyzed locational determinants of FDI. The author argued that market size, exchange rate and relative interest rate had positive and significant relationship with FDI stock. Lehman (2002) found that structural change in external accounts of a country takes place due to FDI inflows. Trade openness and host country risks are found to increase affiliate profitability of FDI and earning repatriations are not determined through constant dividend payout ratio. Woodward (2003) claimed that FDI flows have contributed substantially to current account deficits. Using data of six economies the results of the study showed that FDI was one of the main factors responsible for current account deficit in these countries. By making FDI analogous to loan, the study argued that subsequent repatriation of the capital from the recipient country was same as repayments of loan. Fedderke and Romm (2004) probed FDI determinants within South Africa by utilizing co integration along with error correction techniques. Their findings demonstrated that political risk, property rights, market size, labor cost, openness and corporate tax rates were important variables in attracting FDI. Aqeel and Nishat (2005) empirically identified the variables of FDI growth in Pakistan for the period of 1961 to 2003. They used co-integration along with error correction techniques for identifying factors which influence level of FDI. The results had shown that corporate tax rate, import tariffs, exchange rate, devaluation of rupee and liberalization measures had positive and significant relationship with FDI. Moolman et al. (2006) focused on the supply side determinants of FDI in South Africa for the period 1970-2003. The findings pointed that openness, size of market, nominal exchange rates and infrastructure were the variables which policy makers in South Africa should concentrate on while striving to attract FDI. Hossain (2007) showed that the initial impact of an inflow of FDI on BOP is positive but the medium term effect could become either positive or negative as the investors increase their imports of intermediate goods and services, and begin to repatriate profit.

Azam and Luqman (2008) investigated effects of a variety of economic factors on FDI inflows into Pakistan, Indonesia and India for the period of 1971 to 2005. The authors found that that market size, infrastructure, trade openness, domestic investment, return on investment had significant and positive relationship while external debt, indirect taxes had significant and negative relationship with FDI inflows. Yol and Teng (2009) explored short run and long run domestic variables affecting FDI in Malaysia through co-integration econometric analysis covering period of 1975-2006. The results depicted that GDP, exchange rate and infrastructure positively whereas exports negatively affected FDI in long run. In short run, GDP, infrastructure and exports negatively whereas exchange rate and openness positively influenced FDI. Shahrudin et al (2010) analyzed FDI determinants in Malaysia for period of 1970-2008 by using ARDL framework. The study established that GDP growth rate and money supply had positive and significant correlation with FDI inflows. Rihab and Lotfi (2011) investigated important variables to determine the level of FDI for 71 developing countries by utilizing dynamic panel data technique for period of 2001-2006. They found that GDP, human resources, economy's openness and governance system quality had significant positive association whereas individualism, hierarchal distance and corruption control had negative association with FDI inflows.

Sheng and Hua (2012) studied on the empirical analysis of factors affecting China’s FDI. They made the econometric analysis on the data of China’s FDI and factors like exchange rate, GDP, CPI, resident consumption level and total export during the period of 1983 to 2011. The empirical results showed that exchange rate, export, GDP, CPI have significant effect on China’s FDI.

**Concepts of FDI**

Foreign direct investment is the net inflow of the investment to get hold of a lasting administration interest that is 10 percent or more of voting power in an enterprise working in an economy other than that of the investor. FDI is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital. This sequence demonstrates the net inflows which mean the new investment inflows less disinvestment in the exposure economy from foreign investors.

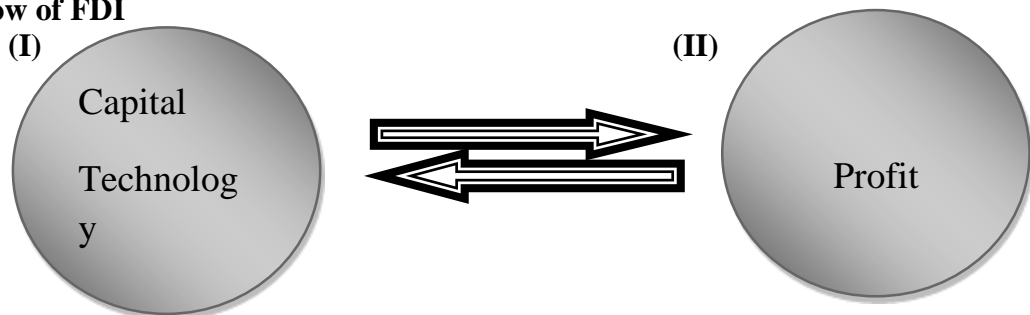
**Components of FDI**

The idea of FDI includes the capital funds that the direct investor provides to a direct investment enterprise as well as the capital funds received by the direct investment enterprises from the direct investor. It comprises not only the initial transaction establishing the relationship between the investor and the enterprise but also all subsequent transactions between them and the components of Direct Investment constitute direct investment income, direct investment transactions and direct investment position. FDI flows are the sum of three basic components; viz. equity capital, reinvested earnings and other capital associated with inter-company debt transactions:

**Mechanism of Foreign Direct Investment**

A direct investment is defined by the International Monetary Fund (IMF) 2011, an investor who is a resident of another country and owns 10 percent common shares or voting right in the enterprise or the equivalent in the host country. There is an explanation of “Foreign Controlled Resident Corporation”. Foreign controlled enterprises include subsidiaries which have more than 50 percent voting power owned by a foreign parent. "Associates" of which foreign ownership of equity is 10-50 percent. As a consequence from the vision point of the host country and for examining construction, do business, control, and employment, leftovers the ideal perception.

**Figure, Inflow of FDI**



In figure (I) home country make available technology and capital to the host country, in figure (II) the host country return the profit on the FDI to the host country. In this process social welfare improves and revenues of the both country Governments also increase.

## RESEARCH METHODOLOGY

In methodology, we explained the methods and approaches used to collected data. Research methodology describes the research activities and how to process them. For the purpose of research, several methods and approaches are used. The reunion of these methods and approaches depends upon the nature of the work and the research that is going to be presented. We used the methodology, which is suitable to conduct this research.

### Research Approach Used in Study

For the research point of view, there are two types of approaches widely used in the research. These are quantitative and qualitative approaches. We used quantitative research method to perform this research study. Our data nature is quantitative.

### Type of Data & Data Sources

There are two types of data used in the earlier research one is primary data and other is secondary data. We used the secondary time series data and valuable information from following official departments of Pakistan and some International organizations for this research.

- a) Board of investment of Pakistan
- b) State Bank of Pakistan
- c) Federal bureau of Statistics of Pakistan
- d) World Bank Indicator Report
- e) International Monetary Fund
- f) United Nation Conference on Trade and Development

### Selected Variables in This Study

- Dependent variable  
Foreign direct investment
- Independent variables
  1. External Debt
  2. Export of Goods and Services
  3. Import of Goods and Services
  4. Gross National Income
  5. Gross Capital Formation
  6. Military Expenditures

### Description of variables

- **Foreign Direct Investment**  
Foreign direct investment (FDI) is the investment undertaken by an entity resident of one economy in an enterprise resident in a different economy, with the intention of obtaining and sustaining a lasting interest in the enterprise and also to exercise a major level of influence in its management. Management and voting rights are granted to the investors if the investor's ownership level is greater than or equal to 10% of the common shares. Shares ownership less than 10% is termed as the portfolio investment and is not categorized as Foreign Direct Investment.
- **External Debt**  
External debt is that part of the total debt in a country which is owed to the creditors outside the country. The debtors can be the government, corporations or citizens of that country.

External debt of the developing countries is generally in large quantities beyond the government's ability to repay.

- **Exports**

One of the nearly all vital indicators of economic growth is sell abroad goods, which have an effect on the extent of freedom or trade barriers, to rise up the economy, implies non tariff barriers on exports to increase our exports.

- **Imports**

Our key imports are finishing goods but our exports are initial goods that are the reason of our negative trade balance, as a result concern was that the effect of imports on FDI is negative.

- **Gross National Income**

Gross national income is the major instrument or measure tool which shows the growth of the economy of the country, in simple words GNI or GNP can define as it is a monetary measure of all factor of payments to resource owners: It represents the total market value of all final goods and services produced factors of production located within a nation's boundaries in a given period of time.

- **Gross Capital Formation**

A common measure of the relative size of the FDI is the Gross Capital Formation. GCF formerly known as gross domestic investment consists of outlays on additions to the fixed assets of the economy plus net changes in the level of inventories. Inventories are stocks of goods held by firms or organizations held by to meet temporary fluctuations in the production or sales and work in process.

- **Military Expenditures**

Military expenditure is known as a defense budget of a country. It is the amount of financial resources dedicated by an entity or a country. Military expenditure is the amount spent by a nation on the military in a given year.

### Model Specification & Statistical Techniques

We used the following model for our study. We selected the variables which are affecting the FDI inflow in Pakistan from the period of 1988 to 2012.

$$FDI = f(GNI, EXP, IMP, GCF, MEXP, EXDT) \dots \dots \dots (1)$$

Where,

FDI= Foreign Direct Investment

IMP = Import of Goods and Services

EXP= Export Goods and Services

EXDT= External Debt

GCF = Gross Capital Formation

GNI = Gross National Income

MEXP = Military Expenditures

**Table. 1: Expected sign of variables used in regression**

GNI	Positive	Rehim and Munir (2004) Awan et al (2011)
Exports	Positive	Sheng & Hua (2012) Hossain (2007)
Imports	Negative	Mencinger (2008), Hossain (2007)
External Debt	Negative	Naeem et al (2005) Azam & Luqman (2008)
GCF	Positive	Naveed & Muhammad (2010)
MEXP	Negative	Shahbaz et al (2012)

Source: author's own.

We used the different statistical tools to present the collected data which led us to develop a better understanding and interpret the results in the shape of valuable information. After reviewing existing literature on determinants of FDI, it can be observed that there is a shortage of literature which investigated these variables as determinants of foreign direct investment in general and for Pakistan in particular. Therefore, this study for the first time, intends to determine the relationship of capital stock, GNI, Exports, Imports, Military expenditure, External Debt, with inflows of FDI in Pakistan for the period of 1988 to 2012 through Ordinary Least Squares (OLS) regression technique. In order to estimate the regression model statistical software, Electronic views (Eviews) has been used.

### HYPOTHESES' OF STUDY

H<sub>0</sub>: There is no relationship between all independent variables and FDI inflow in Pakistan.

H<sub>1</sub>: At least one independent variable has relationship with FDI inflow in Pakistan

H<sub>0</sub>: There is no relationship between external debt and FDI inflow in Pakistan.

H<sub>1</sub>: There is relationship between external debt and FDI inflow in Pakistan.

H<sub>0</sub>: There is no relationship between imports and FDI inflow in Pakistan.

H<sub>1</sub>: There is relationship between imports and FDI inflow in Pakistan.

H<sub>0</sub>: There is no relationship between exports and FDI inflow in Pakistan.

H<sub>1</sub>: There is relationship between exports and FDI inflow in Pakistan.

H<sub>0</sub>: There is no relationship between gross capital formation and FDI inflow in Pakistan.

H<sub>1</sub>: There is relationship between gross capital formation and FDI inflow in Pakistan.

H<sub>0</sub>: There is no relationship between gross national income and FDI inflow in Pakistan.

H<sub>1</sub>: There is relationship between gross national income and FDI inflow in Pakistan.

H<sub>0</sub>: There is no relationship between military expenditures and FDI inflow in Pakistan.

H<sub>1</sub>: There is relationship between military expenditures and FDI inflow in Pakistan.

### DATA ANALYSIS

This section turned the analysis of the data that had been gathered for the research. We using the multiple linear regression model for the research and analyze the data to show which

independent variables significantly affect the FDI inflow in Pakistan. Data analysis would be carried out as to fulfillment of the objectives and hypothesis both. With the annual data from the year 1988 to 2012, researchers run the model using E-views and the following results are obtained.

### Descriptive Analysis

Descriptive analysis is the first step in this research. It helped to describe relevant aspects of phenomena of foreign direct investment and provide detailed information about each relevant variable. E-Views software has been used for analysis of the different variables in this study. Descriptive statistics shows the mean and standard deviation of the different variables used in the study. It also presents the minimum and maximum values of the variables, which help in getting a picture about the maximum and minimum values of a variable.

Table-2 provides descriptive statistics of the collected variables.

Descriptive Analysis						Table- (Billions) 2	
	FDI	EXDT	EXP	IMP	GCF	GNI	MEXP
<b>Mean</b>	1.30	30.6	12.5	16.6	12.4	97.3	2.16
<b>Median</b>	0.716	29.7	10.3	11.6	11.8	71.4	1.54
<b>Maximum</b>	5.59	52.6	24.1	39.1	17.1	237	6.28
<b>Minimum</b>	0.186	14	4.41	7.01	8.22	40.1	0.473
<b>Std. Dev.</b>	1.57	11.2	6.01	9.99	2.55	60	1.62
<b>Observation</b>	25	25	25	25	25	25	25

The above table gives descriptive statistics for FDI in Pakistan for a period of twenty five years from 1988 to 2012 and for a 25 year observations. Table shows that Foreign Direct Investment (FDI) average value is 1.30 Billions US dollars and standard deviation is 1.57 Billions US dollars. This means that the value of FDI can deviate from mean to both sides by 1.57 Billions. The maximum and minimum values of FDI are \$5.59 Billion and \$0.186 Billion respectively. Information from descriptive statistics also indicates that the mean of external debt is \$30.6 Billion and standard deviation is \$11.2 Billion. The maximum and minimum values of external debt are 52.6 Billion and 14 Billion respectively.

The mean of export is \$12.5 Billion and the standard deviation is \$6.01 Billion. Maximum value is \$24.1 Billion while minimum is \$4.41 Billion. Moreover, it takes an average \$16.6 Billion in order to import with standard deviation of \$9.99 Billion. Maximum value is \$39.1 Billion, while minimum value to import is \$7.01 Billion. From Table-1 it is seen that the mean of gross capital formation (GCF) is \$12.4 Billion and standard deviation is \$2.55 Billion. The maximum value of GCF is \$17.1 Billion while the minimum value is \$8.22 Billion.

Furthermore, it is seen that the mean of gross national income (GNI) is \$97.3 billion and standard deviation is \$60 Billion. The maximum value of gross national income is \$237 Billion while the minimum value is \$40.1 Billion. Information from descriptive statistics also indicates that the mean of Military Expenditure is \$2.16 Billion and standard deviation is \$1.62 Billion. The maximum and minimum values of military expenditure are \$6.28 and \$0.473 Billion respectively.



**Quantitative Analysis**

Empirical results of this study are shown in the table and estimation equation is given below,

$$FDI = -5.78E+09 - 0.021681DEBT + 0.165317EXOFGOS -$$

$$0.043020IMOFGOS + 0.004772GCF + 0.070924GNI - 0.029771MILITEXP + \mu$$

**Results of Variables Used in Regression Model****Table. 3**

Dependent Variable: FDI

Method: Least Squares

Sample: 1988 2012

Included observations: 25

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-5.78E+09	9.69E+08	-5.966068	0.0000
EXDT	-0.021681	0.047671	-0.454815	0.0547
EXP	0.165317	0.140918	1.173146	0.0560
IMP	-0.043020	0.032827	-1.310506	0.0065
GCF	0.004772	0.001658	2.878746	0.0100
GNI	0.070924	0.017284	4.103459	0.0007
MEXP	-0.029771	0.006492	-4.585548	0.0002
R-squared	0.934704	Mean dependent var	1.30E+09	
Adjusted squared	R- 0.912939	S.D. dependent var	1.57E+09	
S.E.of regression	4.62E+08	F-statistic	42.94460	
Durbin-Watson stat	2.135805	Prob(F-statistic)	0.000000	

Source E views constructed by authors

Following are the accomplishment of the empirical outcome of multiple linear regressions model, researchers carried out analytic inspection tests to make sure the error terms of the multiple linear regressions are normally distributed and the model is correctly specified. The result point towards that the external debt is significant at 5 percent level of significance. The relationship between FDI and external debt is negative as stated by the theory of foreign direct investment, and the coefficient of external debt is 0.021681 that means one unit increase in external debt brings 2 units decrease FDI inflow in Pakistan. The coefficient of export of goods is 0.165317 which is significant at 5 percent level of significance and its relationship with the foreign direct investment is positive according to the results of E views data analysis. When there is one unit increase in export of goods and services it brings 16 units increase in FDI inflow.

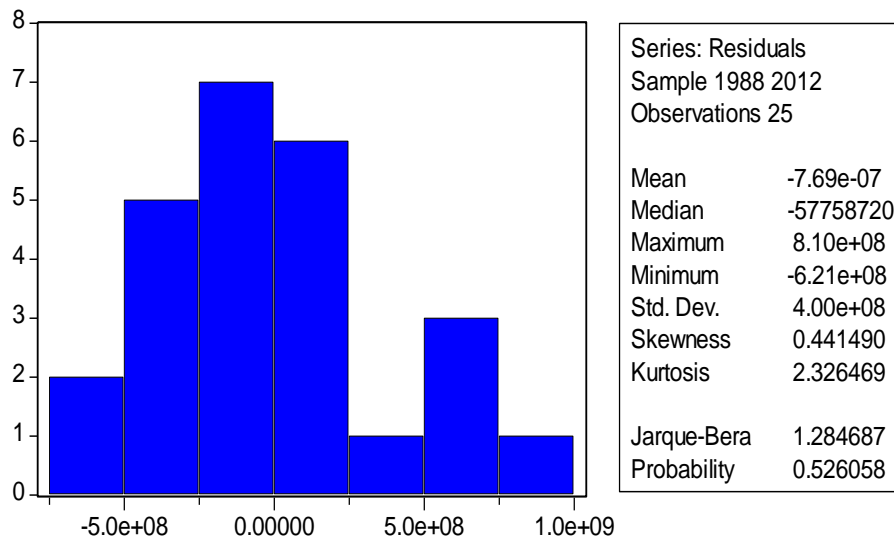
Import of goods is highly significant at 1 percent level of significance and its relation to the FDI inflow is negative as the theory of FDI stated, which means that one unit increase in import of goods which show to 4 units decrease in foreign direct investment inflow in Pakistan. Gross capital formation is highly significant at 1 percent level of significant and its relation to the foreign direct investment is positive as determined by the earlier studies. One unit increase in gross capital formation leads to the 4.8 units increase in foreign direct investment inflow in Pakistan.

Gross National Income is highly significant at 1 percent level of significance and it is positively related to the foreign direct investment inflow in Pakistan that shows when gross national income of a country like Pakistan is increases the inflow of FDI is also increases and vice versa. One unit change in gross national income brings 7 units change in foreign direct investment.

Relationship between military expenditure and FDI inflow is negative and it is highly significant at 1 percent level of significance. One unit change in military expenditure brings 2.9 units change in foreign direct investment. R-Squared is 0.934704 and adjusted R-Squared is 0.912939 which make obvious that the independent variables included in the model have physically powerful impact on foreign direct investment inflow in Pakistan.

The value of F-Statistic is highly significant at 1percent level of significance which shows that the model of our research study is good fitted.

**Normality Test of the Model (Jarque-Bera Normality Test) Table.4**



Hypothesis.

H0: Error terms are not normally distributed

H1: Error terms are normally distributed

Critical value:  $\alpha = 0.10$

Test statistic: p-value = 0.526058

Decision rules:

Reject H0 if p-value more than  $\alpha = 0.10$ , otherwise do not reject H0.

To find out whether the error terms of the model are normally distributed, Jarque-Bera normality test was used. Given the p-value of 0.526058 is more than the 10 percent level of significance; we conclude on that the error term of the model is normally distributed.

Decision:

We reject H0, in view of the fact that p-value (0.526058) is more than  $\alpha = 0.10$

Conclusion: We have sufficient evidence to conclude that the error terms are normally distributed.

## FINDINGS & RESULTS

We started out with the F-test to see whether the multiple linear regressions model is significant. After proving Statistical the model to be significant, diagnostic checking was performed, including Jarque-Bera normality test to see whether the error terms of the model are normally distributed and the results showed that the error terms of the model are normally distributed. Results show that the external debt is significant to Pakistan FDI inflows at 5 percent significance level and exports of goods also 5 percent level of significance, while other independent variables such as gross capital formation product, imports of goods, gross national income, and military expenditures have 1 percent level of significance. Gross national income plays an important role in this study because it indicates how well a country's population demand for the productivity. It is important for foreign investor to determine whether to invest or not from the view of market opportunity.

The hypothesis testing of GNI in this dissertation shows that gross national income is significant and positively affects Pakistan foreign direct investment inflows at the significance level of 1 percent. This result is consistent with previous researchers like Bhagwati (1998), Awan et al. (2011), which also uses gross domestic product as the indicator for market size. In the research paper of Naeem et al. (2005), it is mentioned that external debt itself has been recognized normally as an important determinant of FDI inflow into the host countries. In this research case, it was similar as the test results in chapter 5 proved that external debt was statistically negative significant to foreign direct investment inflows to Pakistan. The result is consistent with the past researches done by Azam & Luqman (2008), Naeem et al (2005).

Researchers found that the exports of goods significantly affects Pakistan FDI inflows and has a positive relationship with Pakistan FDI inflows at the 5 percent significance level. This result is in row with the study done by Demakes et al. (2005), Aqeel and Nishat (2005), Sheng & Hua (2012). In their studies, it is verified that foreign direct investment increase as exports of goods increases appreciates in the host country. On the other hand, multiple researchers found the opposite results. In the study by Yol & Teng (2009), they said that the increase of exports in the host country led to the decrease in FDI inflows of the host country.

In this research study, the independent variable imports of goods stood out as it is found to be significant at the significance level of 1 percent. This means that there is significant relationship between imports and foreign direct investment inflows to Pakistan. Its relationship with the foreign direct investment is negative because Pakistan imports the final goods which has negative effect on trade. The researchers whom results were same as our findings are mentioned Mencinger (2008), Ejaz & Atif (2010).

GCF is found to have a significant positive relationship with Pakistan FDI inflows at the 1 percent significance level. This result is on par with the study done by Naeem et al. (2005), Azam and Lukman (2008), Shahzad and Zahid (2011) whom verified that domestic investments or gross capital formation is significant and have a positive effect on the inflows of FDI. A country's willingness to accept foreign direct investment is important to the FDI of that particular country.

This research concluded that military expenditure is a significant determinant of Pakistan FDI inflows. Based on the result, there is a negative relationship between military expenditure and Pakistan FDI inflows. In the past research paper, Rehim and Munir(2004) mentioned that the political instability which may lead to the decrease in FDI inflow. This then will discourage more foreign firms to invest in the host country for the increased expected level of risks. As military expenditures of host country increases, it discourages the FDI inflows into Pakistan.

## **CONCLUSIONS & RECOMMENDATIONS**

Since FDI, along with trade, has been an important mechanism which has brought about a greater integration of the Pakistan's economy with the world economy. The changing patterns reflect the growing investor confidence in the country from 2000 to 2007 but after that due to the war conditions foreign investors are reluctant to invest in Pakistan despite of favorable condition with large market size and cheaper labor force. External debt on Pakistan is increasing with the passage of time and Pakistan has paid a large amount of its revenues in the form of interest on this debt. Our government has recently taken loan from IMF on high rate of interest, this attitude is also discouraged the foreigner investors to invest their investment in Pakistan and our findings also showed a negative and significant relationship between the external debt and FDI in Pakistan. Pakistan exports are small as compared to the imports & this is the reason Pakistan trade balance is deficit and more importantly Pakistan exports primary goods. Military expenditures are increasing due to control on terrorism attacks in Pakistan and it has negative impact on foreign direct investment and foreign investors' decisions to made investments in Pakistan. With population of 190 millions in 2012, Pakistan presents a huge and fast growing domestic market for a range of goods and services, and thus export opportunities for producers in the rest of the world. Large and growing market opportunities in Pakistan are widely seen, as evidenced by the large inflows of foreign direct investment till 2008, after 2008 FDI decrease in Pakistan due to lack of law and order situations and terrorists attacks.

Inflow of FDI has boomed in Pakistan from 2000 to 2007. The Pakistani government policy towards FDI has changed over time in tune with the changing needs in different phases of development. The changing policy framework has affected the trends of FDI inflows received by the country. Even though manufacturing industries have attracted rising FDI, the services sector accounted for a steeply rising share of FDI stocks in Pakistan since the 2000s because of the mobile telecommunications and internet services. Thus, although the magnitude of FDI inflows has increased, in the absence of policy direction the size of them have gone into services and consumer goods industries bringing the share of manufacturing and technology sectors down.

Our results are mostly consistent and supported by the past research papers. The results of this study can be a guideline and provide insight to policymakers such as government and State Bank of Pakistan in determining the ways to attract more foreign direct investment inflow to Pakistan. We conclude that Pakistan is a developing country and there is a need of FDI for its growth and our results showed the importance of GNI and capital stock for attracting more FDI in Pakistan. If the local investors make investment in Pakistan then it will encourage the foreign investors to come and invest in Pakistan.

## **IMPLICATIONS & LIMITATIONS OF THE STUDY**

Practically, this research paper provides an insight on decision making for the investors, policy makers, and practitioners such as Federal Government, State Bank of Pakistan and other stock holders of Pakistan. It plays an important role in formative the ways to attract additional foreign direct investment inflow to Pakistan. From the investors perspectives, increase or decrease in gross national income growth can predict the future development of the country. It also tells investors whether the country is worth to invest in for long term given that the country's development is trending well.

Besides that, gross national product also plays an important role in determining the foreign direct investment inflow to Pakistan. Gross national product determines the ability of a country's population in the demand of outputs. Investors such as foreign firms or companies will most likely take into consideration of this factor since sales is based on the country's demand. Thus, this portrays as an indication for the government to refine the economic policy, increasing the country's population income so as to increase the gross domestic product of the country.

Domestic investment (gross capital formation) which turns out to be positively significant to the FDI inflows in Pakistan did not come as a surprise as well. Awan et al. (2011) stated that gross fixed capital formation means increase in domestic fixed capital level. The study also discovered that external debt negatively related to Pakistan FDI inflows. According to Azam and Lukman external debt increase of foreign liabilities and payments of interest on external debt which effect seen on the current account balance of the country. Lastly, the study showed military expenditure is significant but negatively related to Pakistan FDI inflows.

The very first limitation of the study is the sample size of the research which is too small with only 25 years. Annual data from year 1988 – 2012 was obtained to run the model, however, the data is considered insufficient as the minimum requirement is 30 observations. The reason researchers weren't able to get 30 years data was because military expenditures weren't available before the year 1988. In this research study, we mainly focused on secondary data collection method. To access the internal data of developing countries like Pakistan is also a very sensitive issue. Moreover, the unhelpful behavior of executives regarding research activities proved to be a big obstacle in conducting the research. Keeping these limitations in mind, we fully focused on secondary data that is published in articles, annual reports, survey reports and statistical reports issued by official departments of Pakistan and International organizations. The data used in this study is aggregate annual time series, covering the period 1988-2012. The limitations are acknowledged for it does not detract from the significance of findings but merely provide platforms for future research.

## **RECOMMENDATIONS FOR FUTURE RESEARCH**

Since sample size is the main root of the problems, it is highly recommended that next researchers who are interested in further studying this paper should increase the sample size to more than 30 observations. Researchers may use monthly, quarterly or semiannual data instead of using annual data. This is because the bigger the sample size, the lower the probability of having multicollinearity, heteroscedasticity and autocorrelation problems. This will prevent

the needs to split the model but run it as a whole instead. Hypotheses testing will provides researchers with better results in detecting these problems.

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