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Impact of FDI on Economic Growth: Evidence from Pakistan

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ABSTRACT

The main resolution this study to explore the effect of FDI on Economic Growth in Pakistan. The study covered the time period from 1980 to 2006. This essay examines and synthesizes the body of theoretical and empirical research on the subject. The overview of FDI's impact on Pakistan's economic growth is first drawn. Secondly, the printed literature is consulted to locate material that draws from theoretical and empirical discoveries. Furthermore, this essay clarified theoretical approaches that explain how and why these approaches function. Third, three useful metrics are suggested in this article for additional study. By critically analyzing and presenting current theory and research on FDI on Economic Growth in Pakistan, this study makes a contribution to the field.

Keyword: Economic Growth, FDI, Pakistan

Introduction

Foreign direct investment is the term used to describe the flow of capital from one nation to another. According to the numerous trade theories, a nation should invest in another nation if the donor nation has a distinct competitive edge over domestic businesses in the recipient nation. According to the internalization theory, a nation engages in foreign direct investment (FDI) due to economies of scale that can cut production prices in a different country. FDI is an important indicator for encouraging economic growth, FDI is essential to development due to a variety of factors, some of which varies from nation to nation. distinct economies saw distinct contributions from foreign direct investment (FDI). For example, developing

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economies saw varying effects from FDI on economic growth (Immurana, Iddrisu, Mohammed, et al. 2023a).

Third world countries invest may have the following potential advantages for the host economy: facilitating the utilizes and exploits regional raw materials, presents modern marketing and management techniques, facilitates the ability to use new technology allows for the use of foreign inflows to finance by providing on-the-job training, the pool of human capital is expanded and current account deficits are reduced. investment from overseas sources does not result in principal and interest repayment like external debt does. This essay aims to investigate how foreign direct investment (FDI) impacts the expansion of the economy in conjunction with four additional factors: debt, trade, inflation, and domestic investment (Dawood et al. 2023).

The remainder of the document is structured as follows: The both practical and theoretical studies on the connection between FDI and financial expansion is covered in Section 2. Section 3 provides information on data estimation, model specification, and variable definitions. The empirical data are presented in Section 4, and our conclusions and a discussion of our findings are presented in Section 5. Since no new research has been done on the subject and the prior research produced varied findings, we are conducting this investigation to determine the most recent results. The study aims to: a) determine the connection between economic growth and foreign direct investment throughout time and demonstrate the causal relationship between the two variables (Shafqat et al. 2023).

Problems Statement

One of the negative effects of overseas direct investment is developing nations for a number of reasons, such as unsteady political and financial landscapes, problems with security, and a deficiency of suitable law and order. The primary barrier to reduced investment in Pakistan is political unrest; in addition, Pakistan's economic problems are unappealing due to the country's propensity for IMF, World Bank, and other loan tendencies. It highlights the drawbacks of high interest rates and currency volatility (Ilyas et al. 2023).

The nation's economy's stability is determined by inflation. A high rate of inflation may indicate that the economy is experiencing more and more problems. a negative correlation between GDP growth and inflation. One believes that an economy in significant debt is troubled. According to some, the economy is having issues with its external debt. One of the main factors influencing macroeconomic growth is debt. It is discovered that the overall amount of debt and economic growth are negatively correlated (Qadri et al. 2023).

Research Question

1. What is the influence of foreign direct investment on economic growth in Pakistan?

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2. Is there any link between foreign direct investments on economic growth in Pakistan?

Research Objective

1. To examine the influence of foreign direct investment on economic growth in Pakistan.
2. To inspect the result of foreign direct investment on economic growth in Pakistan.

Literature Review

The literature claims that while foreign direct investment (FDI) speeds up the economies of developing nations, it has no lasting impact on the economies of poor nations. For a variety of reasons, such as environment of shaky politics and economy, worries about security, and a deficiency of suitable law and order, foreign direct investment (FDI) adversely affects underdeveloped countries, FDI hasn't helped Pakistan's economy grow more rapidly (Tabassum et al. 2023).

Likewise, Khan and Khan (2011) showed that, for Pakistan between 1981 and 2008, FDI accelerates GDP growth over the long term. Melnyk et al. (2014) also looked into the relationship between growth rates in post-communist transition countries and increases in foreign direct investment (FDI). Pakistan is a well-known investment destination with a 200-year history of dominance by British corporations. Pakistan began the process of nationalization in the 1970s, namely under the Zulfiqar Ali Bhutto Regime. After a few decades, nevertheless, it has become clear that the attitude toward privatization must change in order to keep up with the pace of globalization. Pakistan's economy is struggling because it is not developed enough to participate in the process of globalization and reap the full benefits (Ullah, Ur Rahman, and Rehman 2023).

The topic of discussion has been the connection between FDI inflows and economic growth. of numerous research; yet, due to the inconsistent results, the matter is far from resolved. The majority of these studies have usually used the standard growth accounting paradigm to examine how FDI inflows and other production factors affect the growth of the national income. The existence of diminishing returns in the physical capital placed restrictions on the influence of foreign direct investment (FDI) on the pace of production growth within the framework of neo-classical models (Solow, 1956) (Zahra et al. 2023).

As a result, FDI might only have a level and not a rate influence on the output per capita. Put differently, its long-term ability to modify the pace of output growth was compromised. Therefore, it is not surprising that conventional economics did not take FDI seriously as a growth engine. The Novel Approach to Economic Development, on the other hand, comes to the conclusion that FDI may have an impact on both the level and growth rate of output per capita.

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According to the study's findings, Pakistan would be able to successfully transform the benefits that come with foreign direct investment (FDI) if the country's financial sector continues to grow toward a specific degree of development. In the instance of Pakistan, the coefficient of FDI is negative, but the interaction term between the financial development index and FDI is positive. This implies that foreign direct investment (FDI) will only benefit growth performance in the event that the home financial sector is well-established and operating profitably; in other words, FDI will have a negative influence on economic growth. The study also offers evidence of the causal connection between growth and foreign direct investment with fostering growth via the expansion of the financial sector (Javaid et al. 2023).

CONCLUSION

The findings indicate that foreign direct investment (FDI) did not make a significant contribution to When compared to domestic labor and capital, Pakistan's economic development between 1980 and 2006. Consequently, the government must devise a strategy to attract FDI that promotes economic growth rather than hinders it. To examine the effects of foreign direct investment, we have used a range of methods and procedures. This part presents the empirical results and commentary. The sequence of integration is determined using the ADF test.

Pakistan would do better by concentrating on enhancing building a solid macroeconomic framework, human resources, infrastructure, and local entrepreneurship, and fostering an environment that encourages profitable investments to hasten the development process in order to make FDI a major contributor to economic growth. The majority of research papers in assessments of the literature indicated a favorable correlation between growth and FDI. This article employs a variety of statistical tests to examine this effect. Similar to other research, its findings indicate that trade liberalization and domestic capital have a beneficial role in escalation and that foreign direct investment (FDI) is not the only driver driving economic growth.

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