

Impediments to attract fdi in pakistan essay



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On the basis of our results, we concluded that almost all aforementioned variables significantly affect FED; results also indicate fitness of our selected model. Moreover, Our results are generally consistent with the findings of other researchers

Key Words: Foreign Direct Investment, Trade Openness, GAP, Inflation, Currency Depreciation, Political Instability, Terrorism in Pakistan

Introduction Foreign Direct Investment (FED) plays a dynamic role in the growth Of economy. Due to globalization of business activities FED has become the major concern of developing countries. Investors mostly from developed economies are exploring new emerging markets to expand their business activities because of relatively tough competition and saturation in local markets.

In respect of world FED outflow, rising markets like China and India are the hot destinations. Why FED? Being a developing economy, Pakistan is also a part of this race. Major focus of government is to attract foreign direct investment in country by creating oft image of Pakistan and by marketing lucrative investment purport entities in country. GOP reformed and liberalized investment policies to suit investor requirements. But in recent past political turmoil in the country effects on FED inflows very negatively.

Research Questions? What are the determinants of foreign direct investment inflow in country? What are the elements which are affecting FED inflows in country and how they affect decisions of potential foreign investors?

The main purpose of our research study is to analyze the factors which are the determinants of FED inflows in any country. We studied literature to identify all those aspects which are the prime reasons for potential investors

to invest in any country. Secondly, our research study also analyzed the factors effecting capital inflows in the country and impediments to attract FED in any country. It has been demonstrated by number of researchers that political and macroeconomic stability both play important role to attract foreign investment in any country. They also find that multinational enterprises prefer countries that are more open to trade and with fewer restrictions on FED as the destinations of their investment.

Number of other searchers also conducts studies to identify the factors that affect FED inflows like conflicts with neighboring countries, changing governments, and short tenures of policy makers, currency depreciation, strikes, riots, bomb blasts, terrorist attacks, assassination and many more.

Research Objectives: However, such findings raise some questions which we try to tackle through this study. First of all, we will explore the determinants of FED flow in any country secondly we will identify the elements which are affecting FED inflows and how they are effecting decisions of foreign investors. We will explore the lattice risks to foreign investment and up to what extend political instability is responsible for the flight of Macs or foreign capital from Pakistan?

Secondly we will seek to identify the political factors affecting the FED inflow in country, and how they affect decisions of potential foreign investors? Last but not least the key objective of our study is to discover how trade regime, currency depreciation, law and order situation like cross border conflicts, Terrorism, target killing, sectarian and political parties' clashes, changes in investment policies, effects the inflow of foreign funds in Pakistan? Report

Sections: We will initiate our report by demonstrating studies and findings of other researchers on related topics I. E.

What are the determinants of FED inflows in any country and what impediments countries face to attract investment and how economy, law and order and political instability effect FED inflows trends in countries.

We examined the pattern Of month wise FED inflows in Pakistan from July 2001 to June 201 2 as our dependent variable against number of independent variables like export trend, consumer price index (ICP), currency depreciation in terms of IIS\$, terrorist activities and fatalities in terrorist violence for same period. Our major data source is State Bank of Pakistan and other Government departments. We will use regression, nova and correlations models to analyze our data and to originate results based on our findings. In last section, we will conclude on the basis of our data findings and argued that how political instability, trade openness, inflation, currency depreciation impacts on FED inflows in country.

Literature Review Foreign direct investment (FED) being the Single largest component of private capital flows has contributed to investment and growth in developing countries, leading to technological improvements, the reduction in poverty ND the improvement in living standards. The distribution of these flows has, however, remained uneven. The countries that lagged behind in attracting FED are the ones that faced macroeconomic instability, pursued inconsistent economic policies, had relatively poor physical and human infrastructure, and had bureaucracies that did not

pursue initiatives with conviction. FED plays an important role in the development of an economy.

Higher foreign direct investment in Pakistan would relax the foreign exchange constraint for imports, and support the increase in the investment/GAP ratio necessary to deliver the higher growth rates.

With foreign direct investment, there should also be a productivity increasing transfer of technology. Bona (1996) exposed the benefits for the country that attracts the FED such as; it helps to develop the managerial knowledge and skill of the organization which further help to develop the competencies of the organization and provide new market opportunities. It provides better view of technology and developed countries can adopt the technologies. It enables the host country to provide better quality of goods and services to their people.

So, FED is important in all aspects of the economy it will help to develop knowledge, skill, provides better technology, better goods and services which helps economy to excel. FED defined by UNCLAD " Foreign direct investment (FED) is defined as an investment involving a long- term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FED enterprise or affiliate enterprise or foreign affiliate).

FED implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy.

Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated” Determinants of FED There are number of factors that determine the level of FED inflows in host country. R-teeth (2005) mentioned in his research the factors that appeared to have a strong influence on the investment decision were economic growth, openness, interest rates and job vacancies, while wage rate changes and variations in the inflation rate had a short-term impact. Exchange rate appreciation encouraged FED in the longer run but discouraged it in the medium-run. (This could be explained by assuming that a strong Australian dollar reflects Australia’s sound economic environment, making it a good place to invest.

There may also be prospects of growth and higher net returns, as intermediate goods can be bought more cheaply in the international market place).

His research also demonstrates that the corporate tax rate appeared to have an unexpected positive effect in the longer run. FED and GAP & Market Size Sashimi et al. , (2011) architectonics that there is a positive and significance allegations between foreign direct investment and gross domestic product, trade openness and population. All & Gull (2005) argued that China has a big market size which is the most significant factor for FED.

There are several other reasons which make China prominent from others when it comes to FED inflow.

For example they had large population with fast growing economy, government provide more and better business environment as compared to other countries. The other key factors to attract the foreign direct investment are the high return on the investment and also a low labor cost. SO, there is significant relationship bet.

' en FED and GOP and Market size, government policies. Anoraks and Palomino (2001) confirmed that the local market growth, a consistent macroeconomic environment, liberalizing policies, availability Of energy and a good business environment had a significant relationship with FED inflow. The labor cost is another important factor in FED inflow.

So, on the basis of above literature review we can hypotheses that there would be positive relationship between FED and GAP and market size. HI: GAP & Market size is positively correlated with FED. FED and Export Trends We can observe rapid increase in FED flows in recent past.

Alms et al. , (2003) research also showed that foreign direct investment (FED) flows has increased in recent years. On the other hand the distribution of FED is not balanced and the poor countries face difficulty to attract the FED. Said research also indicates that in economies where the trade is given importance the FED has relatively high. In addition, the common trends in FED differ from economy to economy.

So, it is possible that it may be positive in Europe but negative in Asia.

Kinshasa and Scamps (2003) argued that the region's FED is motivated by abundance of natural resources and labor cost. Secondly, Poor quality of the

bureaucracy is found to be a deterrent to foreign investors as they conceive it as a high transaction cost which directly affects profitability of their investment projects. A similar argument is made with respect to the rule of law, which was also found to be an important determinant of FED in transition economies.

Furthermore, they added that foreign investors prefer transition countries that are more open to trade and with fewer restrictions on FED as the destinations of their investment. They also find that progress on economic reform (external liberalizing) plays a large role. Etiquette et al. (2003) allusions that the impact Of FED and Transnational Corporation (Tans) on growth of a country depends on many factors; one important factor is the trade policy regime in host countries.

In the decision of foreign investor the trade policy regime plays a decisive role. It is concluded from the study that those countries gain more from FED which follow the export promotion trade regime rather than those working under the protection of Import substitution policies. ERDA and Tattoos (2002) research demonstrate that the market size, trade openness, economic and physical infrastructure of the host country has a positive relationship with the FED inflow. On the other hand if the economic structure is not stable than it would be difficult to attract the FED in host country.

A research was conducted on the Turkey suggest that the host country has several benefits offered to investors but lack of exchange rate and economic inability of Turkey has affected their efforts to attract the FED inflow. So, if

host country has a stable environment than there are greater chances of FED in the country.

Janice & Wannabe (2004) indicates that international trade is the most important determinant of investment. The profit from FED is large but it is not easy to achieve. If the countries want to gain advantages of international investment than it should made such economic and political policies so that the business environment remains constant and should be according to investor's requirement. The cheap labor cost also provides attraction to investor but low wages does not help to increase the purchasing power of the individuals.

So, from this literature review we can hypothesize that there would be positive relationship between trade openness and FED. H2O: Trade openness is positively correlated with FED.

FED and Inflation There are numerous factors that play role in attracting FED in any country. Asides (2005) examined that large local markets, natural resource endowments, good infrastructure, low inflation, an efficient legal system and a good investment framework promote FED. In contrast, corruption and political instability have the opposite effect. These findings are consistent with the reports of multinational companies that operate in the region. " The inflation rate in Pakistan was recorded at 6.90 percent in November of 2012".

(tragicomedies, 2012) FED and Political Stability

Eczema and Deserves (2010) argued that Granting fiscal incentives to foreign investors can be an effective strategy, especially in developing countries. Product market deregulation and active labor policies may mitigate their resistance and contribute to greater attraction of FED in the medium run. By taking sample 127 countries, Grog and Which (2009) identified factors that affect a host country's attraction for FED which are Economic Activity, the Legal & Political System, the Business Environment and Infrastructure. The results revealed that Singapore is the most attractive country for FED investors. Singapore receives the most index points for its legal and political system for its business environment.

Harms and Restrung (2001) claims that multinational enterprises preferred democratic regimes in choosing host countries for their FED. On the other hand, Lie and Arsenic (2003) found that political instability does not have a statistically significant effect on FED, yet "regime durra; ability;" encourages such investment. Kim (2010) argued that hosting countries with higher political rights have higher FED outflows and politically stable countries produce capital flows to invest in politically unstable countries. Also, high GAP countries have more foreign trades than low GAP countries, so the absolute volume of FED flows should be higher for high GAP countries.

Braded et al. 2005)has demonstrated that both economic transition and political instability, whether of domestic origin or stemming from international conflicts and tensions, significantly affected FED inflows into the transition economies of Central Europe and the Commonwealth of Independent State (CICS). Transition status tends to increase FED inflows and the good reform performance of the Central European and Baltic

countries enabled them to receive inflows that were several-fold. They demonstrate how restoration of peace to the region and the elimination of tensions, both internal and among the countries of the region bring important economic benefits.

Sashimi et al. (2011) conducted study to check the impact of the Political Stability on FED in OIC countries for the period 2000-2009, they argued that Political stability is playing an important role in determining FED in OIC Countries. Their study demonstrates that there is direct relationship between political stability and FED. So, on the basis of this literature we can hypothesises that political stability would be positively correlated with FED- HA: Political stability is positively correlated with FED. FED and Law & Order Law and order situation in a host country play a vital role in attracting FED inflows.

Particularly in case of Pakistan, we all know that political, Law & order situation in country is not very good. For example, many shops and businesses were burnt & looted on the occasion when Benazir Bhutto (APP Leader) was assassinated.

Khan and Kill (1997) also analyzed that law and order situation, macroeconomic stability and consistent economic policies are also vital to encourage foreign investors to undertake initiatives in he Pakistan Buses and Heftier (2005) covered a period of 20 years in the cross county analysis; their research demonstrate that political indicators including government stability, investment profile, internal conflict, corruption, law and order, ethnic tensions, and democratic accountability of the government matter for

the investment decision of multinationals. Multinational corporations seem to care about internal and external conflicts that affect the host country of their investment, as it increases economic and political instability.

The threat of incidence of civil wars, political violence, trade inactions or an all-out war increases the risk premium of investment projects, thus reducing overall investment. Interestingly, changes in corruption do not significantly affect FED inflows.

HA: Law and order is positively correlated with FED. FED and Currency Depreciation
Instable currency of host country creates negative impact on FED inflows. Allah (2011) quantified the impact of exchange rate volatility on foreign direct investment for the Pakistan economy particularly find that exchange rate volatility has negative impact on FED inflow in short run (it suggests that a 1% increase in real exchange rate causes 0. % decrease in FED), while this impact is positive in the long run.

McHugh and Kara (2011) estimated market size impact on FED inflows along with exchange rate and corporate tax rate in Pakistan from 1984 to 2008. They found that market size as the most dominating positive impact factor to attract FED inflows in long run, whereas no influence of market size on FED inflows in short run can be found. The study also found exchange rate as significant negative impact determinant in long run and as well as in short run. So, on the above literature we can hypothesises that instable currency allee has negative effect on FED.

HA: Currency depreciation is negatively correlated with FED.