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The Relationship between Foreign Direct Investment and Economic Development A Case of Pakistan

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ABSTRACT

This article examines the role of Foreign direct investment in the economic development of Pakistan. As Pakistan is an emerging economy and is heavily dependent upon the foreign development. The historical data over the 20 years showed that there is significant and positive relationship between foreign direct investment and Economic growth of Pakistan.

Key Words: *Foreign direct Investment, Emerging Economy, Economic Development and Pakistan*

I. INTRODUCTION

Yen examined The impact of FDI and financial sector development on economic growth : empirical evidence from Asia and Oceania. He use panel data methods on a sample of 44 Asia and Oceania countries from the period 1996-2005.Financial sector development is an important precondition for foreign direct investment (FDI) to enhance economic growth in the Asia-Oceania region. To conclude, the complementary growth impact of FDI and financial sector development is most important for least developed countries, and in stimulating economic growth in Asia and Oceania countries, because there is a range of initiatives for enhancing the financial sector, attracting FDI and developing human capital discussed in this paper. Olu etc. examined Global financial crisis discussion series. He took the performance of the Nigeria Stock exchange and financial system in real sector from the period 2008-2009. By using this data he shows that it is leading to decline in external reserves and hence accruable revenue, remittance and official development assistance (ODA) are expected to fall greatly in 2009. Current global financial crisis, triggered by the credit crunch within the US sub-prime mortgage market, continuing to spread and deepen in several countries.To conclude, the crisis may offer an opportunity to look at sectors that have been yawning to allow them to act as pillars for growth and development of the economy : agriculture, tourism and infrastructure.

Muhammad Zia –ur-Rehman , Sources of return and volatility spillover for Pakistan: An analysis of exogenous factors by using EGARCH model. He took data monthly closing prices of Pakistan (KSE-100) and respective Global index (Standard & Poor's " All Countries Global Index") from January 2005 to June 2010. He study the behavior and

magnitude of return movements and volatility movements of KSE- 100 index (Pakistan) with respective global FPI(Foreign portfolio investment), FDI (Foreign direct investment). He concluded, that the contagion effects can be explained by the behavior of the investors. And the return and volatility movement and correlations are found due to investor's perceptions instead of macroeconomic variables and bilateral trade. And he consider the behavior of KSE-100, it has demonstrated positive dependence on the FDI and FPI as FDI and FPI are proved to be exogenous factors for return and volatility movements of Pakistan stock market.

Dr. Maathai examined Impact of foreign direct investment on Indian economy: A sectoral level analysis. He took annual data from the period of 1990-91 to 2000-01 through panel co-integration (PCONT) test. By using PCONT model, observed that the spirit in which the economy has been liberalized and exposed to the world economy at the late eighties and early nineties has not been achieved after so many years.Thus it could be concluded that the advent of FDI has not helped to wield a positive impact on the Indian economy at the sectoral level. Thus , in the eve if Indian plan for further opening up of the economy , it is advisable to open up the export oriented sectors so that a higher growth of the economy could be achieved through the growth of these sectors.

NuzhatFalki examined Impact of foreign direct investment on economic growth in Pakistan. He took data from the period 1980-2006. He investigate the impact of foreign direct investment (FDI) on economic growth in Pakistan. The relationship between FDI and economic growth is analyzed by using the production function based on the endogenous growth theory, other variables that affect economic growth such as trade, domestic capital and labour are also used. FDI is believed to transfer technology, promote learning by doing, train labour and in general, results in spill-overs of human skills and technology. To conclude, Pakistan would be better by focusing on improving infrastructure, human resources, developing local entrepreneurship, creating a stable macroeconomic framework and conditions conductive for productive investments to speed up the process of development.

Soyoung etc. examined, The impact of capital inflows on emerging East Asian Economies: Is too much money chasing too little good? By employing a panel vector autoregression (VAR) model he investigate the effects Why a surge in capital inflows can increase asset prices. To find the answer their results suggest that capital inflows indeed contributed to asset price appreciation in the region, although capital inflow shocks explain a relatively small part of asset price fluctuations. Positive capital flow shocks increase stock prices immediately and land prices with some delay. In the end, the conclusion of whole discussion is how to manage these capital inflows.

Geert and Campbell examined, Financial openness and productivity. He took data from the period 1980 to 2006 of 96 countries. He use panel probit analysis to show that financial openness does not significantly influence the probability of a banking crisis (and the point estimates are, in fact, negative).The impact of openness on factor productivity growth is more important than the effect on capital growth. Their work fits into a growing research area that investigates the links between financial openness and productivity. To conclude, results on the growth effects are not uniformly positive. Moreover, the alarming income divergence for the poorest countries poses a huge challenge for development economics that globalization by itself cannot resolve.

Philip etc examined International financial integration. He explain the cross-country and time-series variation in the size of international balance sheet. To investigate the rates of return earned on foreign assets and liabilities, they have used the MSCI return indices and partner countries stock market returns weighted and OECD International direct investment statistical yearbook. The broad trends in international financial integration for a sample of industrial countries, and seek. The supported data shows rates of return varying over time and across asset classes. To conclude, the study of higher-frequency data on rates of return would also be useful in modeling the international transmission of business cycle shocks.

Isil etc, examined, World markets for mergers and acquisition. He took a sample of 56,978 cross-border mergers from the period 1990 to 2007. The relative stock market performance between two countries affects the propensity of firms in these countries to merge. The impacts of currency movements and of stock market performance on merger propensities are likely symptomatic of a more general valuation effect, in which more highly valued firms tend to purchase lower-valued firms. About one-third of worldwide mergers combine firms from two different countries. To conclude, a significant factor in determining acquisition patterns is currency

movements; firms tend to purchase firms from countries relative to which the currency of the acquirer's country has appreciated.

Francesca examined The impact of economic integration on FDI and Exports . He use the gravity-model approach to analyse the impact on FDI stocks of specific variables. His results shows that the tariffs consistently have no impact on FDI , implying that the 'tariff-jumping' argument is not supported by the empirical analysis. To conclude, analysis on the complementary vs. substitutability issue of exports and FDI shows that, on aggregate, FDI and exports are complementary: a 10% increase in exports will lead- most of the time- to increase in FDI exceeding 10%.

Anusha etc examined Foreign ownership and firm performance. He took data from emerging markets from the period 1980 to 2007. By using transaction-specific acquisition data and firm-level accounting data they evaluate the post-acquisition performance of publicly traded U.S firms. To create an appropriate control group of non-acquired firms they use a difference-in-difference approaches combined with propensity score matching. To conclude, emerging market firm acquisitions impact the performance of U.S target firms.

Bruno etc. examined Calculating tragedy: assessing the costs of terrorism. He took data on terrorist activities. He propose a new approach based on life satisfaction or subjective well being data to analyse effects of terrorist acts on various aspects of the economy. The results in this paper refer only to the Northern Ireland conflict. To conclude, by using the life satisfaction approach, in which individual utility is approximated by self-reported subjective well-being, suggest that people's utility losses may far exceed the purely economic consequences.

Yessengali etc. examined The impact of macroeconomic indicators on stock exchange performance in Kazakhstan. He took monthly data of KASE for the period of January 2001 to August 2009. He use a new methodology-cointegration technique within ARDL framework. To conclude, the results of the study are consistent with the theory and introducing new dummy variable to capture the crisis impact demonstrates the practical evidence for KASE evolution. In addition, the long –run relationship of KASE index with macroeconomic variables shows the evidence of informational inefficiency of KASE.

J Benson Durham examined Econometrics of the effects of stock market development on growth and private investment in lower income countries. He took noteworthy experience of emerging markets from the period 1994 through 1998. With respect to growth and equity market development, the long –run model suggests that higher income drive the overall position relation. The econometrics on private investment produces more lucid results. Lagged valuation changes clearly affect private investment decisions in higher but not lower income countries. To conclude, both long-and short-run transmission mechanisms from stock market liberalisation to desirable macroeconomic performance seem somewhat questionable in the context of lower income countries.

Nielsand Robert examined Foreign direct investment , financial development and economic growth. He took dataset from the period 1970-1995 of 67 LDCs. The methodology follows the voluminous growth regression. FDI may help to raise economic growth in recipient countries. Empirical investigation suggests that these countries should first reform their domestic financial system before liberalizing the capital account to allow for enlarged FDI inflows. To conclude, Sub-Saharan African countries have very weak financial systems and consequently FDI does not contribute positively to growth.

Mahr etc. examined Economic evaluation of foreign direct investment in Pakistan. He took time series data on Pakistan's imports and exports from the period 1973-2004, to study the impact of FDI. To check the stationary of analysed used data he applied the Unit roots (ADF test).FDI has played a vital role in the economic growth in Pakistan. To conclude, the results of export model show that FDI has negative relation with real exports in the short-run and positive relation in the long run because export model estimations indicate that with one percent increase in FDI, real export decrease by -0.08 percent n the short-run and increase by 1.62 percent in the long run.

Elijah etc.Exchange Rate Volatility, Inflation Uncertainty and Foreign Direct Investment in Nigeria. He took data from period between1970 and 2005.By using the GARCH model the estimation results show that exchange rate volatility and inflation uncertainty exerted significant negative effect on foreign direct investment during the period. As infrastructural development, appropriate size of the government sector and international competitiveness are crucial determinants of FDI inflow to the country. To conclude, International competitivenessas shown in this study is important incentive for FDI inflow.

Muhammad Azam, Ling Lukman examined Determinants of Foreign Direct Investment in India,Indonesia and Pakistan: A Quantitative Approach. He took secondary time series data from the period 1971 to2005. By using Log linear regression model and the method of least squares estimate the various economic determinants effects on FDIinflows. It has been acknowledged that FDI bring benefits to the recipient countries by providing capital, foreign exchange, new technology and bridge the gap between domestic savings and investment. To conclude, to enhance more FDI into Pakistan , India and Indonesia, the ,management authorities of each respective country needs to ensure stable economic and political environment, provision of physical quality infrastructure, maintaining inflation rate , encourage domestic investment, curtail external debt, financial incentives, reduce duties, peace and security , law & order situation and consistency in the government because these all are the key factors for potential investors in making investment choices.

MarialA.Yol, Ngie Teng Teng, examined Estimating the domestic determinants of foreign direct investment flows in Malaysia: Evidence from Cointegration and error-correction model. He took annual data from the period 1975 to 2006. By using the trace and Maximum-eignvalue cointegration tests they identify three cointegrating relations between FDI flows and the determinants. The results of the long-run FDI equation indicate that FDI flows in Malaysia are positively influenced by real exchange rate, GDP growth and infrastructure while negatively by exports. To conclude, one important finding is the negative relationship between FDI flows and exports of goods and services in both the short run and long run

Debjiban Mukherjee examine, Comparative Analysis of Indian Stock Market with International Markets. He took data from1st January 1995 to 31st July,2006. The depth of the market judged by the total capitalization is less for the Indian markets compared to its counterpart. To conclude, the time period has been divided into various eras to test the correlation between the various exchanges to prove that the Indian markets have become more integrated with its global counterparts and its reaction are in tandem with that are seen globally.

Durga Prasad Samontaryexamined, Impact of Corporate Governance on the Stock Prices of the Nifty 50 Broad Index Listed Companies. He took data for financial years from the period 2007-2008 of 50 companies from NIFTY 50 Index from India. By using cross-sectional regression analysis they demonstrate significant relationship between share price (dependent variables) and independent variables (EPS, Sales, Net Fixed Assets and corporate Governance factors) and identify the variables having the most impact on the share price of the company. To conclude, EPS clearly affects the share price of the companies in Nifty 50 Broad Index and the other two most significant variables are Sales and net Fixed Assets.

Nicolas etc. examined ,International equity holdings and stock returns correlations: Does diversification matter at all for Portfolio choice?. He took data for the year 2001 for 28 source and 41 destination countries and stock market correlation over the period 1950 -1975 find a robust positive relationship between bilateral equity holdings and bilateral return correlations. By running the OLS regression of bilateral correlation of stock returns on bilateral equity holdings it comes to know that asset holdings increase with the correlation of stock returns between countries, at odds with what theory predicts. To conclude, assets returns correlation i-e asset “sustainability” –is endogenous.

R.V.Nagubadi etc. examined,Foreign direct investment outflows in the forest products industry: the case of the United States and Japan. He identify the determinants of foreign direct investment outflows from the U.S and Japan. He took data of outflows from the period 1982 to 2004. According to the SURE analysis there is a positive relationship between the FDI outflows and imports for Japan.The U.S and Japan are the two largest economies in the world demanding forest resources to meet their demand for various wood products. To conclude, a strong motive of the MNEs is to maximize the profits to their investment by capturing locational advantages, promoting improved and cost-effective technologies by increasing their ownership-specific advantages like R & D .

Prof. A. Q khan and Sana Ikram examined, Testing semi-strong form of efficient market hypothesis in relation to the impact of foreign institutional investor’s (FII’s) investments on Indian capital market. He took data of Monthly FII’s net investment from the period of 1st April 2000 to 30th April 2010. By using Karl-Persons’ Product Moment Correlation Coefficient and linear regression equations they determine the degree

and direction of the relationship between the variables involved. The forest products exports have been opposite but insignificant effects on the FDI outflows, positive for the U.S and negative for Japan in the SURE model. The effect of trade-weighted interest rate is positive and significant for the FDI outflows from the U.S., but not for Japan. To conclude, recently the emerging economies , China, India, Russia, Brazil and other countries have been experiencing high rates of growth.

Wenjie etc. examined Foreign ownership and firm performance: Emerging-market acquisitions in the United States. He took data from the period 1980 to 2007.By using transaction-level M & A information to examine the post-acquisition performance of publicly listed U.S targets. He has examined the abnormal stock return for the acquired targets around various different windows of time surrounding the announcement of the acquisition. U.S. target firms undergo significant restructuring after acquisition by an emerging-market firm. To conclude, the evidence presented in the paper strongly indicates that emerging market firm acquisitions impact the performance of U.S target firms.

Vassilis examined Regional distribution and spatial impact of FDI in Greece: evidence from firm-level data. He took data from the period 2002 to 2006. Strong evidence suggests the foreign owned firms self-select into regions and sectors of high productivity. The bulk of the effects concentrate in non-manufacturing activities, high-tech sectors, and medium-sized high productivity firms.FDI inflows constitute a positive demand shock that strengthens capital accumulation and job creation domestically. To conclude, foreign investments have inequitable location patterns that can intensify existing spatial and sectoral asymmetries. The overall impact of Greece on relative regional performance and cross-regional convergence is not detrimental.

Ari examined The Home Country Effects of FDI in Developed Economies. He took data on the developed home countries of multinational corporations. The effects on investment, the balance-of-payments, technology and knowledge, and political decision-making in the home country are discussed to answer the question that is what is the impact on home country exports and production structure. To conclude, outward FDI is beneficial to the investing firm, but that the effects on the home country vary depending on the characteristics of the investment project and the business environment in the home and host countries.

Robert D. Gay examined Effect Of Macroeconomic Variables On Stock Market Returns For Four Emerging Economies: Brazil, Russia, India, And China. He took data of beginning of 2004. By using Box-Jenkins ARIMA Model, he investigate time-series relationship between stock market index prices and the macroeconomic variables of stock exchange rate and oil price for Brazil, Russia, India and China. The change in oil prices may be better reflected in the inflation rate, which may have a more profound effect on stock market. To conclude, there was no significant relationship found between present and past stock market returns, suggesting the markets of Brazil, Russia, India, and China exhibit the weak-form of market efficiency.

Husni Ali Khrawish1, examined Determinants of direct foreign investment: Evidence from Jordon. He took data from the period of 1997 to 2007. By using MLRM he applied a version of the model he examine determinants of foreign direct investment flows into the economy of Jordan. To conclude, the analysis has shown that there are significant and positive relationship between foreign direct investment flows into the economy of Jordan and economic and financial variables.

Andrés Rivas examined Are European Stock Markets Influencing Latin American Stock Markets?. He took data from the period January 1988 to December 2004. By using OLS model he examine the stock markets of Latin American countries(Brazil, Chile, and Mexico)whether they are affected by the US and European stock markets from January 1988 to December 2004. He find evidence that Latin American stock markets are affected by Spanish stock market. To conclude, first Spain, seem to have influenced Latin American markets. Second , the effects of European markets are not homogeneous across Latin American markets or through time.

KornélHalmos examined, The Effect of FDI, Exports and GDP on Income Inequality in 15 Eastern European Countries. He used GINI coefficient to calculate relative mean difference. Higher GDP has also a significant effect on the GINI index. The lowest income inequality is demonstrable in Slovakia, Slovenia, the Czech Republic and Hungry. The export openness is the highest in Estonia, the Czech Republic and Slovakia. To conclude, if the local companies become a part of the global supply chain, with the increasing competitiveness, the salary gap between

multinational and local companies can be reduced significantly.

II. Empirical Analysis

Results	N	Minimum	Maximum	Mean	S.D
NOP	60	-.08	.39	.1061	.10450
CR	60	.21	3.29	1.0723	.70993
DR	60	.25	.96	.5707	.15596
ACP	60	.12	196.18	22.1012	38.67694
ITID	60	37.96	684.06	147.2950	118.31366
CCC	60	-3352.80	286.12	114.9390	598.15309

For analysis purpose 60 observations has been taken. TABLE 4.1 Shows that the average value of Net operating profitability of Cement Industry is 10.6% of total assets. The value of standard deviation of the net operating profitability is .10, which shows that net operating profitability of any company of cement Sector is dispersed by 10% from the average value. This may be positively or negatively dispersed. The maximum value of net operating profitability is 0.39 which means one company of cement Sector scored 0.39 net operating profitability. And minimum value which shows net operating loss -0.08 indicates that one company of cement sector has to bear highest loss. Current ratio has an average of 1.07 and maximum in a particular year is 3.29 times and minimum is 0.21. The value of standard deviation of the current ratio is 0.70, which shows that current ratio of any company of cement Sector is dispersed by 70% from average value.

Average value of debt ratio is 57 % and maximum is 96 % and minimum is 25%. The value of standard deviation of the debt ratio is 0.15, which shows that debt ratio of any company of cement Sector is dispersed by 15% from its average value. No. of days account receivable have an average of 22 days. It means in the cement industry it takes 22 days to collect cash from debtors against credit sales and No of days A/R dispersed to maximum 196 days. In the Cement Sector maximum days to collect cash from debtors are 196 days and minimum days are 0.12.

In the case of No. of days Inventory, 147 days are on the average which means that after every 147 days the inventory shipped for sale. These days are dispersed to maximum 118 from the average days. The maximum No. of days Inventory having one company in the industry are 684 and minimum is only 37.

The average of cash conversion cycle is days; it means it takes 114 days to complete a transaction. Complete transaction means that, the purchase of raw material, the manufacturing of products, selling out them & Receiving cash against the sales. These days are dispersed to maximum 598. The maximum days of operating cycle having one company in the cement Industry are 286 and minimum no of days are -3352.

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