THE INFLUENCE OF THE MACROECONOMIC VARIABLES AND BUSINESS ENVIRONMENT ON THE FOREIGN DIRECT INVESTMENT INFLOWS IN PAKISTAN: THE MODERATING ROLE OF POLITICAL STABILITY

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THE INFLUENCE OF THE MACROECONOMIC VARIABLES
AND BUSINESS ENVIRONMENT ON THE FOREIGN DIRECT
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ROLE OF POLITICAL STABILITY

By

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ABSTRACT

The study has the attributes of pioneering attempt in examining the research gaps and evaluating the role of the moderating effect of political stability (PS) on the relationships between macroeconomic variables, business environment variables and the foreign direct investment (FDI) inflows in the case of promising nation such as Pakistan in the SAARC region. Indeed, the study poses a new stream of research in investigating the effect of political stability as moderating variable, recognizing the importance of PS as a critical variable in the course of foreign investment, thus, the research framework of this study was designed with integration of New Growth theory and firm theory in tracing the impact of political stability on foreign direct investment. This study was confined to the annual data for the period 1991 to 2011 obtained from the official sources such as SBP, UNCTAD, World Bank and IMF. In its empirical analysis, this study used the ADF test to check the stationary of the data using EViews and hierarchal regression using SPSS statistical software packages. The moderating effects of the determinants political stability on the relationships were empirically examined. The findings of this study revealed that GDP growth rate, degree of openness, inflation rate, corruption control index and political stability were significant predictors of FDI inflows; whereas, other determinants such as exchange rate and infrastructure were not significant in the case of Pakistan. These findings, therefore, strongly suggested that political stability is very important for the country’s domestic and foreign investment in the future course of direction. The study makes several practical inferences for designing suitable macroeconomic policy and undertaking measures to promote a high economic growth with rising FDI inflows in the political economy of Pakistan.

Keywords: Macroeconomic Variables, Business Environment, Political Stability, Foreign Direct Investment, Pakistan
ABSTRAK


Katakunci: Pemboleh Ubah Makroekonomi, Persekitaran Perniagaan, Kestabilan Politik, Pelaburan Langsung Asing, Pakistan
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<table>
<thead>
<tr>
<th>TABLE OF CONTENT</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>TITLE PAGE</td>
<td>i</td>
</tr>
<tr>
<td>CERTIFICATION OF THE THESIS</td>
<td>ii</td>
</tr>
<tr>
<td>PERMISSION TO USE</td>
<td>iii</td>
</tr>
<tr>
<td>ABSTRACT</td>
<td>iv</td>
</tr>
<tr>
<td>ABSTRAK</td>
<td>v</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENTS</td>
<td>vi</td>
</tr>
<tr>
<td>TABLE OF CONTENT</td>
<td>vii</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>xiii</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>xv</td>
</tr>
<tr>
<td>LIST OF ABBREVIATIONS</td>
<td>xvii</td>
</tr>
<tr>
<td>LIST OF APPENDICES</td>
<td>xix</td>
</tr>
</tbody>
</table>

**CHAPTER ONE**

**INTRODUCTION**

1.1 Background of the Study 1

1.2 Problem Statement 12

1.3 Research Question 16

1.4 Research Objective 16

1.5 Scope of the Study 17

1.6 Significance of the Study 18

1.7 Organization of the Dissertation 19

**CHAPTER TWO**

**THE HISTORICAL ACCOUNT OF THE ECONOMY AND FOREIGN DIRECT INVESTMENT (FDI) IN PAKISTAN**

2.1. Introduction 21

2.2 Profile of Pakistan 21
2.3 Pakistan Economy and FDI Flows in Historical Perspective 23
  2.3.1 Early Years (1947-1958) 24
  2.3.2 Years of Growth (1958-1969) 27
  2.3.3 Years of Nationalization (1972-1977) 33
  2.3.4 Years of Country’s Economic Expansion (1978-1990) 36
2.4 Pakistan FDI inflows in the: A Comparison with Selected Asian Countries 40
  2.4.1 FDI Gamut: India versus Pakistan 40
  2.4.2 Concluding Comment 46
2.5 Sectorial Distribution of FDI Inflows in Pakistan 46
2.6 Doing Business in Pakistan 48
  2.6.1 Global Competitiveness Index: A Comparison 50
2.7 Pakistan Capital Formation: A Comparison 52
2.8 A Perspective on Reasons to Invest In Pakistan 54
  2.8.1 Abundant Land and Natural Resources 54
  2.8.2 Geo-strategic Location 54
  2.8.3 Potential in the SAARC Region 54
  2.8.4 Trained Workforce 54
  2.8.5 Investment Opportunities in Pakistan 55
2.9 Foreign Direct Investment Policy in Pakistan 55
  2.9.1 FDI Act of 1976 56
    2.9.1.1 Fields for FPI 56
    2.9.1.2 Approval of FPI 56
    2.9.1.2 Repatriation Facilities 57
    2.9.1.3 Remittances 57
    2.9.1.4 Tax Concession and Escaping of Double Taxation 57
    2.9.1.3 Equal Treatment 58
  2.9.2 FPI (Foreign Private Investment) Act 1992 58
    2.9.2.1 Short Title 58
2.9.2.2 Over-ride other Laws 59
2.9.2.3 Autonomy to Bring (Foreign Currency) 59
2.9.2.4 Protection Policy of Foreign Currency Accounts 59
2.9.2.6 Security of Economic Incentives for Setting-up of Firm 59
2.9.2.7 Protection of Transfer of Tenure to Private Sector 60
2.9.2.8 Protection of Foreign Investment 60
2.9.2.9 Privacy of Banking Transaction 60
2.9.2.10 Protection of Financial Interest 60
2.10 Summary 60

CHAPTER THREE
LITERATURE REVIEW 62
3.1 Introduction 62
3.2 Foreign Direct Investment 62
   3.2.1 FDI Definition 62
   3.2.2 Classification of FDI 63
3.3 FDI and Economic Growth 64
   3.3.1 Determinants of FDI 69
3.4 Towards Literature Review of Microeconomic Variables and Business Environment 74
   3.4.1 Gross Domestic Product Growth Rate (GDPGR) 75
   3.4.2 Export 78
   3.4.3 Imports 80
   3.4.4 Degree of openness 81
   3.4.5 Exchange Rate 84
   3.4.6 Inflation Rate 87
   3.4.7 Interest Rate 89
3.4.8 Infrastructure 90
3.4.9 Corruption Control Index 91
3.4.10 Labor Cost 93
3.4.11 Political Stability 95

3.5 Underpinning Theory 100
3.5.1 FDI Theory 100
3.5.2 Eclectic Theory 103
3.5.3 Harrod–Domar model: Basic Foundation towards Growth theory 104
3.5.4 Investment theory of Firm 105
3.5.5 New Growth Theory Model towards FDI 107

3.6 Summary 112

CHAPTER FOUR
RESEARCH DESIGN AND METHODOLOGY 114

4.1 Introduction 114
4.2 Theoretical Framework 114
4.3 Hypotheses Development 115
  4.3.1 GDP growth rate and FDI 115
  4.3.2 Degree of Openness 116
  4.3.3 Exchange Rate and FDI 117
  4.3.4 Inflation Rate (INFRATE) and FDI 117
  4.3.5 Infrastructure 118
  4.3.6 Corruption Control Index 118
  4.3.7 Labor Cost (LBC) and FDI 119
  4.3.8 Political stability and FDI 120
4.4 Data Collection Procedure 122
4.5 Operational Definitions 124
4.6 Data Analysis
   4.6.1 Stationary Analysis of the Data
      4.6.1.1 Augmented Dickey Fuller (ADF)
4.7 Preparing data for Multiple Regression Analysis
   4.7.1 Detecting Outliers
   4.7.2 Multicollinearity Check
   4.7.3 Testing the Normality of the Error Terms
   4.7.4 Testing the Linearity, Homoscedasticity and the Independence of Errors
4.7 Summary

CHAPTER FIVE
DATA ANALYSIS AND RESULTS
5.1 Introduction
5.2 Descriptive Analysis
5.3 Pearson Correlation Analysis
5.4 Multiple Regression Analysis Results
5.5 Hierarchical Regression Analysis Results
   5.5.1 The moderating effect of the Political Stability on the Macroeconomic Variable and Business Environment, FDI Inflows in Pakistan
5.6 Summary of the Findings

CHAPTER SIX
DISCUSSION, CONCLUSION AND RECOMMENDATIONS
6.1 Introduction
6.2 Summary of the Study
6.3 Discussion
   6.3.1 Relationship between Macroeconomic Determinants and FDI
### LIST OF TABLES

<table>
<thead>
<tr>
<th>Tables</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 1.1</td>
<td>Foreign Direct Investment inflows during the Period of 1991– 2011 (Millions of U.S. dollars)</td>
<td>5</td>
</tr>
<tr>
<td>Table 2.1</td>
<td>The Government of Pakistan: Political Regimes 1947- 2012</td>
<td>23</td>
</tr>
<tr>
<td>Table 2.2</td>
<td>FDI inflows in 1949 to 1958 in Pakistan (Million USD)</td>
<td>26</td>
</tr>
<tr>
<td>Table 2.3</td>
<td>FDI inflows in 1958 to 1968 in Pakistan (million of USD)</td>
<td>30</td>
</tr>
<tr>
<td>Table 2.4</td>
<td>West and East Pakistan income period of 1949-1970</td>
<td>32</td>
</tr>
<tr>
<td>Table 2.5</td>
<td>FDI inflows in 1969 - 1978 in Pakistan Million USD</td>
<td>34</td>
</tr>
<tr>
<td>Table 2.6</td>
<td>FDI inflows in Pakistan 1977 – 1990 Million USD</td>
<td>38</td>
</tr>
<tr>
<td>Table 2.7</td>
<td>FDI inflows in 2001 to 2011 Pakistan comparisons with neighbor countries (million USD)</td>
<td>41</td>
</tr>
<tr>
<td>Table 2.8</td>
<td>FDI in Sectoral distribution in Pakistan (million USD)</td>
<td>47</td>
</tr>
<tr>
<td>Table 2.9</td>
<td>Doing business in Pakistan comparing with other countries 2010 to 2011</td>
<td>50</td>
</tr>
<tr>
<td>Table 2.10</td>
<td>Global Competitiveness of Pakistan comparing with selected Asian countries: 2006 to 2011</td>
<td>51</td>
</tr>
<tr>
<td>Table 2.11</td>
<td>Capital formation (as percentage of GDP) comparison with other countries</td>
<td>53</td>
</tr>
<tr>
<td>Table 4.1</td>
<td>The Source of Data Collection for Each Variable</td>
<td>123</td>
</tr>
<tr>
<td>Table 4.2</td>
<td>Measurement of the Variables</td>
<td>125</td>
</tr>
<tr>
<td>Table 4.3</td>
<td>ADF unit root test result using the Trend and intercept</td>
<td>128</td>
</tr>
<tr>
<td>Table 4.4</td>
<td>Multicollinearity Test with all variables</td>
<td>131</td>
</tr>
</tbody>
</table>
Table 4.5  Multicollinearity Test after dropping (LBC)  132
Table 4.6  Normality test of the Residuals  135
Table 5.1  Descriptive Statistics of the Constructs (n=21)  139
Table 5.2  Pearson Correlation Analysis  140
Table 5.3  Summary of the correlation analysis  141
Table 5.4  Examining Variables’ predictive power  143
Table 5.5  Examining the Moderating effect of Political Stability  147
Table 5.6  Summary of the hypotheses testing results  152
Table 6.1  Overall Infrastructure Quality Ranking  166
Table 6.2  List of Pakistani Prime minister during the period 1988-2012  171
# LIST OF FIGURES

<table>
<thead>
<tr>
<th>Figures</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 1.1</td>
<td>Pakistan FDI inflows during the period of 1991-2011</td>
<td>13</td>
</tr>
<tr>
<td>Figure 2.1</td>
<td>MAP of Pakistan</td>
<td>22</td>
</tr>
<tr>
<td>Figure 2.2</td>
<td>FDI inflows in 1949 to 1958 in Pakistan (Million of USD)</td>
<td>26</td>
</tr>
<tr>
<td>Figure 2.3</td>
<td>FDI inflows in 1958 to 1968 in Pakistan (million of USD)</td>
<td>30</td>
</tr>
<tr>
<td>Figure 2.4</td>
<td>West and East Pakistan income period of 1949-1970</td>
<td>32</td>
</tr>
<tr>
<td>Figure 2.5</td>
<td>FDI inflows in 1969 - 1978 in Pakistan Million USD</td>
<td>34</td>
</tr>
<tr>
<td>Figure 2.6</td>
<td>FDI inflows in Pakistan 1977 – 1990 Million USD</td>
<td>38</td>
</tr>
<tr>
<td>Figure 2.7</td>
<td>FDI inflows in 2001 to 2010: Pakistan in comparison with Neighboring countries</td>
<td>42</td>
</tr>
<tr>
<td>Figure 2.8</td>
<td>GDP Growth Rate in 2001 to 2010 Pakistan comparisons with India</td>
<td>45</td>
</tr>
<tr>
<td>Figure 2.9</td>
<td>Global Competitiveness of Pakistan comparing with selected Asian countries 2006 to 2011</td>
<td>52</td>
</tr>
<tr>
<td>Figure 2.10</td>
<td>Capital formation (as percentage of GDP) comparison with other countries</td>
<td>53</td>
</tr>
<tr>
<td>Figure 4.1</td>
<td>Research Framework</td>
<td>114</td>
</tr>
<tr>
<td>Figure 4.2</td>
<td>Histogram of the regression residuals</td>
<td>133</td>
</tr>
<tr>
<td>Figure 4.3</td>
<td>Testing Normality using Normal Probability Plot</td>
<td>134</td>
</tr>
<tr>
<td>Figure 4.4</td>
<td>Testing Normality using Q-Q Plot</td>
<td>134</td>
</tr>
</tbody>
</table>
Figure 4.5     Scatterplot of the residuals  

Figure 5.1    The Moderation effect of PSI on GDPGR- FDI relationship  

Figure 5.2    The Moderation effect of PSI on DOP-FDI relationship  

Figure 5.3    The Moderation effect of PSI on Exchange Rate-FDI relationship  

Figure 5.4    The Moderation effect of Inflation Rate on FDI relationship  

Figure 5.5    The Moderation effect of PSI on Infrastructure-FDI relationship
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADF</td>
<td>Augmented Dickey Fuller</td>
</tr>
<tr>
<td>ARDL</td>
<td>Autoregressive Distributed Lag Model</td>
</tr>
<tr>
<td>BOP</td>
<td>Balance of Payments</td>
</tr>
<tr>
<td>CCI</td>
<td>Corruption Control Index</td>
</tr>
<tr>
<td>CEEC</td>
<td>Central and Eastern European Countries</td>
</tr>
<tr>
<td>CRP</td>
<td>Commodity-Producing Sector</td>
</tr>
<tr>
<td>DOP</td>
<td>Degree of Openness</td>
</tr>
<tr>
<td>ECM</td>
<td>Error Correction Model</td>
</tr>
<tr>
<td>EXCHRATE</td>
<td>Exchange Rate</td>
</tr>
<tr>
<td>FA</td>
<td>Foreign Aid</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>GCI</td>
<td>Global Competitiveness Index</td>
</tr>
<tr>
<td>GDPGR</td>
<td>Gross domestic production growth rate</td>
</tr>
<tr>
<td>HRM</td>
<td>Human Resource Management</td>
</tr>
<tr>
<td>INFRAS</td>
<td>Infrastructure Index</td>
</tr>
<tr>
<td>INFRATE</td>
<td>Inflation Rate</td>
</tr>
<tr>
<td>LBC</td>
<td>Labor Cost</td>
</tr>
<tr>
<td>MENA</td>
<td>Middle East and North Africa</td>
</tr>
<tr>
<td>Acronym</td>
<td>Description</td>
</tr>
<tr>
<td>---------</td>
<td>--------------------------------------------------</td>
</tr>
<tr>
<td>NPV</td>
<td>Net Profit Value</td>
</tr>
<tr>
<td>PSI</td>
<td>Political Stability Index</td>
</tr>
<tr>
<td>SBP</td>
<td>State Bank of Pakistan</td>
</tr>
<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference of Trade and Development</td>
</tr>
<tr>
<td>USD</td>
<td>United States Dollar</td>
</tr>
<tr>
<td>WIR</td>
<td>Word Development Report</td>
</tr>
</tbody>
</table>
# LIST OF APPENDICES

<table>
<thead>
<tr>
<th>Appendix</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appendix-1</td>
<td>List of Pakistani Prime ministers during the period 1947 -2012</td>
<td>217</td>
</tr>
<tr>
<td>Appendix-2</td>
<td>Political stability Index Measure</td>
<td>220</td>
</tr>
<tr>
<td>Appendix-3</td>
<td>Descriptive Statistics, Skewness and Kurtosis of Constructs</td>
<td>222</td>
</tr>
<tr>
<td>Appendix-4</td>
<td>Test of Normality for Independent Variables</td>
<td>231</td>
</tr>
<tr>
<td>Appendix-5</td>
<td>Predictor’s Coefficients Test</td>
<td>235</td>
</tr>
<tr>
<td>Appendix-6</td>
<td>Interaction Value</td>
<td>236</td>
</tr>
</tbody>
</table>
CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

It has been widely acknowledged in theory as well as in practice that Foreign Direct Investment (FDI) leads to several economic benefits to the recipient country by providing capital, foreign exchange, transfer of technology, organizational framework and managerial skills, infusing competition and facilitating exports by enhancing her access to foreign markets (Brooks & Sumulong, 2003; Gorg & Greenaway, 2004; Crespo & Fontura, 2007; Salman & Feng, 2010; UNCTAD, 2011; Javed et al., 2012). Some economists have opined that FDI can also induce increase in the domestic investment through its backward and forward linkages involved in the process of infusing innovation and boosting economic growth in the host country (Brooks & Sumulong, 2003; Awan, Khan, & us-Zaman, 2011).

By and large, the significance of FDI flows for both the developing and developed countries is widely recognised in the economic literature. Over the last decade of the twentieth century, FDI inflows have increased at least double than the trade flows in the world economy (Sinani & Meyer, 2003; Rajana et al., 2008). During the first decade of the 21st century, thus, FDI in the world economy has grown very fast. Developing countries have tended to enhance their capital formation in their industrialization process by seeking the help of foreign capital through FDI. The process is encouraged since marginal productivity of capital is presumed to be high in these countries, so that investors from the developed world would estimate high returns for their capital invested in developing economies. In
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