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Review Article

New Insights for Revealing the Effect of FDI on Pakistan's Economic Growth: Evidence from the Auto Sector

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Abstract

FDI is one of the important pillar for the development of economic sectors and industries for promoting the high growth of valuable products and improve the quality of useful industrial products. However, as a result of globalization, a country's economic development is no longer completely reliant on its own resources. The foreign direct investment (FDI) made by multinational corporations improves the quality of life for locals by creating employment for them and raising their level of living. FDI may have both positive and negative effects on the expansion of the economy, depending on the factors. South Asia's leading liberal economy is Pakistan. Pakistan permits 100% foreign ownership in its secondary industry due to its open economy and fast-paced private sector. Pakistan's tertiary sector has seen a sharp growth in FDI inflows when compared to other economic sectors. Pakistan's primary sector of the economy is characterised, like other emerging countries, by poor productivity, inefficient labour, energy deficits, and less incentives. However, it seems that the incentives and other variables have only had a modest impact on Pakistan's FDI levels in recent years. The economic development of Pakistan is negatively impacted by foreign direct investment. FDI has a significant influence on Pakistan's short- and long-term economic development.

Keywords: FDI, economic sectors, industrial products, multinational corporations, employment.

INTRODUCTION

FDI is one of the important pillar for the development of economic sectors and industries for promoting the high growth of valuable products. Its benefits includes the more advances in the technology with indigenous businesses and improve the quality of useful industrial products. Due to various advances in the car sectors, various vehicles have been promoted through economic developments with important and advantageous externalities like labor management and training possibilities, which raises the level of the production function [1-3].

Financial institutions, the financial services sector, and financial goods are all developing [1]. Financial health has been steadily becoming better as a consequence of the expansion of financial activity volume and the process of upgrading the financial sector [9]. It is obvious that the elimination of capital inflows, the improvement of the financial system, the development of new financial products, and the diversification of financial enterprises in response to changes in the financial environment all contribute to the financial well-being [2]. Forecasts regarding the country's economic future are unclearly influenced by economic uncertainty. Focusing on economic uncertainty often indicates that there is a high likelihood that something unfavorable will transpire [3].

According to the national human development instance of economic development, endogenous growth theory claimed that a country's economic growth relied on its internal resources [4]. However, as a result of globalization, a country's economic development is no longer completely reliant on its own resources. The foreign direct investment (FDI) made by multinational corporations improves the quality of life for locals by creating employment for them and raising their level of living. Contrary to the new classical growth theory, which contends that external causes like technical improvement are the primary drivers of economic growth, is the view presented here [5].

Effect of FDI on Pakistan's Economic Growth

Using a panel estimating approach, FDI has a considerable and favorable influence on the economies of receiving nations. Because FDI enables trade between developing nations, it has a generally favorable effect on the economy. FDI may have both positive and negative effects on the expansion of the economy, depending on the factors employed in the estimating equations. Political unpredictability, trade terms, GDP per person, the ratio of domestic investment, educational attainment, and the black market are a few possible explanatory factors. FDI has a negligible and detrimental effect on the economic development of poor nations. He came to the conclusion that the ability of recipient nations to absorb technology determines how much FDI flows [6-8].

Pakistan's excellent growth rate for 2012 was 4.4%. South Asia's leading liberal economy is Pakistan. Pakistan permits 100% foreign ownership in its secondary industry due to its open economy and fast-paced private sector. However, just 45% of the working force is employed in the primary sector, while the tertiary sector accounts for a staggering 58% of Pakistan's GDP. Nevertheless, the economy's main driver remains the primary sector. 3.3% was the primary sector's growth rate in 2013, 3.5% was the secondary sectors, and 3.7% was the tertiary sectors. Similar to other nations, Pakistan's tertiary sector has seen a sharp growth in FDI inflows when compared to other economic sectors [9, 10].

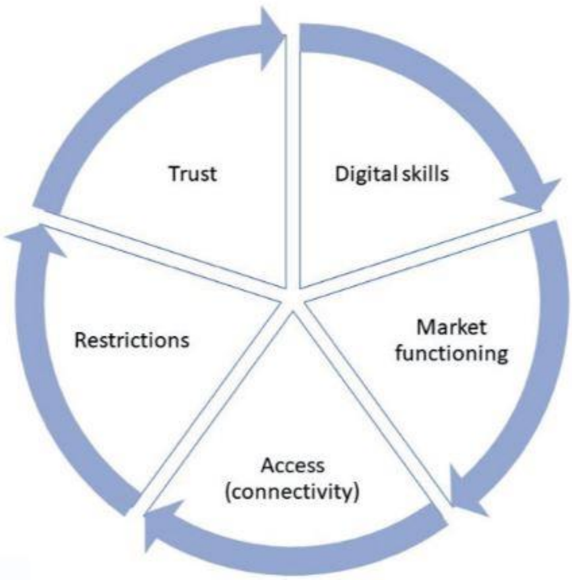

Fig-1: Shows the different factors affecting the economic growth

Pakistan's primary sector of the economy is characterized, like other emerging countries, by poor productivity, inefficient labor, energy deficits, and less incentives. Automotive, infrastructure, commercial machinery, construction, pharmaceuticals, textiles, and electronics make up the secondary sector. The tertiary industry has expanded quickly over the last ten years, much like the world economy. Trade, financial services, oil and gas exploration, and technology make up Pakistan's tertiary industry. The financial industry has assets of 10 billion rupees in 2012. FDI of $570 million US was invested in oil and gas exploration. While 11% of the GDP is accounted for by infrastructure. 12 billion US dollars have been invested in the IT industry during the last seven years [9–11].

However, it is impossible to claim that Pakistan's secondary and tertiary industries have not both benefited from foreign direct investment. Energy issues and a weak law and order environment that are harming these industries cannot be ignored. Similar to aggregated level findings, aggregation biased. The data shortage, particularly at the sector level, might also contribute to outcomes that are unclear. To examine the FDI driven growth hypothesis for Pakistan, however, may be important [12, 13].

In addition to these benefits, Pakistan, which has a population of roughly 130 million, has a considerable opportunity for the marketing of both durable and consumer products. Apart from several incentives, these two elements should have drawn a decent amount of FDI to Pakistan on their own. However, it seems that the incentives and other variables have only had a modest impact on Pakistan's FDI levels in recent years. Despite giving attractive incentives, a great location, and a sizable population, why couldn't Pakistan get FDI like the PRC, Hong Kong, China, Malaysia, and Thailand. In light of these determining variables, the 10 basic components-which may as well be referred to as the ten checkpoints-that control foreign investment in Pakistan are the primary necessity. These include infrastructure, a skilled work force, a high quality of life, a welcoming attitude, political stability, law and order, economic strength, government economic policies, government bureaucracy, local business environments, and economic strength [14–16].

At the time of its independence, Pakistan's economy was mostly rural and lacked an industrial infrastructure. The decision-makers at the time had to concentrate on enacting economic development reforms, with a specific emphasis on developing an industrial setup and employing the raw resources readily accessible in their early phases of the economic development effort. However, these changes in the form of industrialization investments caused the agricultural sector to spiral into underdevelopment and had no discernible impact on the nation's economic development [17–18].

The socio-economic and sociopolitical conditions of Pakistan have consistently lagged behind the effort and have not improved as a result of efforts to increase FDI and use this investment in ways that may flow toward attaining lofty objectives of economic development [19, 20].

Economic growth and financial development are causally related in both directions. Because every country has its own economic policy and its economic development is dependent on other factors, the results of the many research demonstrate that the links between variables are not generalized and are not relevant for cross-border nations. The different economic policies of the agencies charged with carrying them out determine a nation's level of financial development [21, 22].

The study demonstrates that since every country has its unique economic strategy and its economic development relies on other factors, the associations between variables are not generalized and are not relevant for cross-border nations. A nation's financial development is influenced by the separate economic policies of the institutions that are putting them into practice. One strategy for luring cutting-edge technology to Pakistan is via FDI [23–25].

The growth rate of real GDP per capita, expressed as the log difference of real GDP per capita in the host nations, is the dependent variable. The World Economic Outlook 2001 database produced by the International Monetary Fund contains statistics on GDP and per capita GDP (IMF). Utilizing a deflator, real GDP and per capita GDP figures are taken from the World Bank's 1999 World Development Indicators. In our sample, the average annual growth rate ranges from 6.5% to 11.2%, with a low of -0.8% and a standard deviation of 4%. For each host economy, the starting real GDP is calculated as the real GDP for the first sample year. When appropriate, information presented in local currencies is translated into US dollars using the average market exchange rate for the current year. The exchange rates were compiled using data from the Asian Development Bank (ADB2001)'s Key Indicators of Developing Asian and Pacific Countries [26–30].

There are more intriguing topics that need further research. For instance, are different kinds of FDI responsible for various growth impacts of sector-level FDI. Examining the growth in various areas is another way that this topic may be extended. To be more precise, nonmanufacturing FDI in the mining and agricultural sectors may not significantly affect per capita GDP growth overall, but it may encourage development in the mining and agricultural sectors. Additionally, time-varying estimating methods, like as rolling regressions, might be used to track the effect of FDI in relation to changes in international trade policy of host countries over time provided data over longer time periods are available [31, 32].

Any country that accepts FDI gains access to better and more modern technology innovations, improved human resource and administrative concepts, well-trained personnel, and managerial expertise in addition to their investment. The economic development of Pakistan is negatively impacted by foreign direct investment. Numerous studies carried out in Pakistan and other developing countries concluded that this decrease in output is caused by unfavorable government policies, technological gaps, a lack of qualified human skills, unsuccessful R&D, and a lack of absorption capacity, all of which contribute to the economy's defect [32, 33].

The prerequisites for FDI to be beneficial for the economy are to ensure that there is an adequate local market for production, better human resources, development of the import substitute industry, and manufacturing units. For this reason, the government should ensure that foreign investors have incentives and opportunities to transfer modern management techniques and technological advancements, sound business environments and opportunities to strengthen local markets, long-term strategies to develop macroeconomic framework for proper and significant use of FDI, and bi-lateral relationships with potential foreign investors to draw them and to increase exports. Any nation should view FDI as a resource to be used and utilized to gain benefits rather than exploited [17, 19].

FDI and Pakistan's economic growth were related from 1966 to 2014 [7]. It is discovered that utilizing the autoregressive distributed lag error correction model (ARDL ECM) technique, FDI has a significant influence on Pakistan's short- and long-term economic development. The link between FDI, the local banking industry, and economic development in Pakistan from 1972 to 2005 [8, 9]. Due to the degree of economic system maturity, FDI has a beneficial long-term and short-term impact on economic growth. The findings also demonstrate that ideal FDI-attracting circumstances in the host nation are crucial for maximizing both those investments' positive effects [10].

The endogenous growth theory (EGT) is a theory of economic development that contends that the economy's own resources may be used to generate growth. However, in the case of Pakistan, it has historically been a territory with excellent investment prospects that was under the hands of British businesses around 200 years ago. Pakistan had a significant nationalization process. The focus gradually moved to the need for privatization to keep up with the rate of globalization. Because Pakistan's economy has not yet developed enough to profit from globalization, it is having issues. They came to the conclusion that the country's high mass level of CO_2 emissions was exacerbated by fast economic expansion and significant population shift, which hurt the sustainability agenda [11]. The influence of renewable energy certificates (REC) on GHG emissions in Pakistan using yearly time-series data from 1981 to 2015 and they discovered a negative correlation between the two variables [12]. According to the data, there is a direct correlation between RECs and reduced GHG emissions. The efficacy of land use and renewable energy sources in minimizing climate changes in a nation is shown by the other elements that further decrease GHG emissions, such as agricultural value-added and land reforms.

If it helps to provide the necessary infrastructure, domestic investment may also play a crucial role in luring in international capital. The role of FDI is significant in terms of expanding or contracting domestic economic opportunities, depending on the corresponding crowding-in/out effect on domestic investment, for a resource-deficient developing country like Pakistan. Foreign capital inflows are a significant source of capital formation. Determining the respective contributions of the three investment categories, the mechanisms of crowding-in/out impact, and their interrelationships are thus crucial. A nation's economic operations are complex and intertwined. Therefore, rather than being sequential, the economic system is more like a game. The link between economic growth and domestic and international (public and private) investment is examined in this research using a simultaneous equations framework to account for the impacts of infrastructure development and capital costs [20, 24, 28].

The two types of foreign private investment are portfolio investment and foreign direct investment (FDI). The FDI is the sole topic of this research. Both inbound and external FDI are possible. Outward FDI refers to direct investment overseas, while inbound FDI refers to direct investment inside the country of origin. Investing involves buying products that have the potential to produce more products. There are two different forms of FDI: inbound and external FDI. Tax incentives and other kinds of disincentives are applicable to the former. Foreign direct investments, or FDI as they are commonly called, are prevented by the risk insurance offered to domestic sectors and the subsidies given to local businesses [11, 17, 18].

Foreign companies generate competition; therefore their presence may inspire native companies to operate more efficiently. Even foreign investment, if it results in higher-paying employment being created in the host nation, may contribute to raising worker salaries. Policymakers are naturally interested in learning what characteristics entice FDI since it provides numerous potential advantages to host nations. There is no assumption among many academics and decision-makers that Foreign Direct Investment (FDI) is unique in any way. One widely held belief is that FDI aids in hastening the economic growth process in host nations. Foreign direct investment (FDI) may have significant beneficial benefits on a host country's development effort, however many policymakers and scholars dispute this claim. It is not overstated to suggest that FDI, by providing cutting-edge technology, modern management, and marketing strategies, plays a crucial role in the stimulation of national economic growth. For lower income nations like Pakistan, India, and Indonesia, FDI is one of the sources of external financing when local resources are insufficient to pay the needs of development [20, 23].

The research findings showed that market size, which indicates a country's degree of development and the ability to take advantage of economies of scale, was the most significant economic determinant. This finding is expected to boost the appeal of FDI in comparison to other types of internalization. The weight of foreign debt is similar to a deterrent for FDI, as seen by the negative association between this variable and FDI inflow. Positively important in explaining FDI influx are the impacts of infrastructural facilities. The impact of indirect taxes has been determined to be large and unfavourable in Pakistan's instance. Since multinational firms obviously want to increase their profits, it is reasonable to infer that they are attentive to tax-related issues since taxes directly affect profits [24, 27].

For instance, domestic investment yields a substantial positive outcome, and the significant positive association indicates that domestic investors are making investments in Pakistan. In the case of Pakistan, the impact of trade openness has been substantial and it demonstrates liberalization, both of which are helpful in impacting FDI influx. However, other factors, such as inflation and government consumption in Pakistan, have been determined to be minor, but this does not imply that they do not play a part in influencing FDI influx. With the exception of two drivers (trade openness and government consumption), the empirical findings of Pakistan and India were comparable, but Indonesia's results did not match the economic determinants of FDI for either Pakistan or India [29, 31].

A correlation between trade openness and economic growth that was positive and a correlation between foreign debt, the budget deficit, and productivity growth that was negative. Remittances from overseas workers have a large beneficial influence on economic development. It is discovered that inflation has a negative effect on economic growth while discussing the elements affecting Africa's economic development. These results concur, however they were conducted in Bangladesh. It is asserted, however, that inflation had a beneficial effect on economic growth [32, 33].

CONCLUSION

FDI plays important role in different industrial sectors. The investment amount is important; rather, the effectiveness of the financial sector has a favorable effect on economic growth. It is found conflicting results in earlier empirical studies on the impact of worker remittances on economic development and poverty alleviation. It is usage of renewable energy impacted economic development in four OECD countries and found that it had a large effect.

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