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Determinants of Foreign Direct Investment in Pakistan

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Abstract
Objective: This study investigates the key determinants influencing Foreign Direct Investment (FDI) inflows into Pakistan over the period from 1990 to 2024 **Methodology:** The study employs time series econometric methods including the Augmented Dickey-Fuller (ADF) test for stationarity, the Autoregressive Distributed Lag (ARDL) bounds testing for co-integration. **Variables of the Study:** The study use FDI as dependent variable while GDP, inflation, unemployment, trade openness, exchange rate and government debt as independent variables. **Main Findings:** The empirical findings reveal that GDP and trade openness positively influence FDI, suggesting that economic size and market accessibility are attractive to foreign investors. Conversely, high inflation and higher government debt deter investment, signaling macroeconomic instability. Exchange rate volatility also shows a negative association, while unemployment exhibits mixed results depending on model specification. **Practical Implications of Findings:** These findings carry practical implications for policymakers aiming to enhance the investment climate in Pakistan. Emphasis should be placed on stabilizing inflation, ensuring exchange rate predictability, and promoting economic reforms that increase openness and reduce fiscal imbalances.

Key Word: FDI, Exchange Rate, Trade openness, ARDL, ADF, ECM.

Introduction

Background of the Study

Foreign Direct Investment plays a crucial role in fostering economic growth, development and globalizing. As a key driver of capital flow, technology transfer and knowledge sharing FDI can significantly impact the economic performance of host country. Understanding and studying the key determinants of FDI is crucial for policy maker and guide policy maker for making policies that are playing role in attracting investor to invest in country and foster the economic growth Hamasalih et al., (2025). In International Economic FDI is major component for boosting economic growth and development. Pakistan has attractive climate for foreign investment especially in agriculture sector, IT and telecommunication and services sector. The benefits to host country from FDI

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depends upon cooperativeness of government of host country.
Foreign Direct Investment is an investment made by individual or organization for the purpose of production or to enhance their business in any targeted country. FDI plays a very vital role in an economy and it is a major source of external finance in Pakistan to stable fiscal, financial and trade policies, by adopting best policies for investment has more effect on economy's growth (Furrukh et al., 2015).

Expansionary Fiscal policy is tool that a government used to reduce taxes which in turn increase the FDI inflow into the country and fostering the economic growth and development kamal et al., (2021). Pakistan introduced a new investment policy in 2023 to boost the investment to GDP ratio and attract FDI. Pakistan FDI has increase by 385.1 USD mn in sep 2024 as compared to previous month which was 249.7 USD mn.

Foreign Direct Investment (FDI) is a major contributor to economic growth and development, particularly in developing countries. It brings capital, creates employment opportunities, promotes technology transfer, and strengthens global trade links (World Bank, 2020). As globalization expands, countries increasingly seek to attract FDI by improving their economic and policy environments.

FDI in Pakistan has evolved through distinct phases, influenced by political regimes, global economic cycles, and policy shifts. During the 1990s, liberalization policies and privatization efforts led to moderate increases in FDI. However, these gains were eroded by political instability and poor governance (Hussain & Kimuli, 2012). The early 2000s witnessed another rise in FDI, particularly in the telecom and financial sectors, facilitated by deregulation and global liquidity conditions.

A major turning point came with the launch of the CPEC in 2015, which attracted substantial Chinese investment in infrastructure, energy, and transportation. According to the State Bank of Pakistan (2022), China remains the largest source of FDI for Pakistan in recent years. However, concerns over the sustainability, transparency, and sectoral concentration of these investments remain (Wolf, 2019).

The inconsistent trend of FDI inflows into Pakistan raises critical questions about the effectiveness of current policies and the real factors influencing investor decisions. Nasir, (2022) While global and regional dynamics are important, domestic constraints appear to play a more decisive role. Given Pakistan's urgent need for foreign capital and technology, it is essential to identify the precise variables that attract or repel foreign investors.

Problem Statement

Despite having huge economic potential, Pakistan continues to struggle in attracting substantial FDI. The country's FDI inflows have remained stagnant, hindering economic growth, technological advancement and poverty reduction. The aim of this research is to find out the major determinants of FDI in Pakistan and how these factor impacts the FDI inflow in Pakistan as well as the economic growth, development in Pakistan.

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Objective of the Study

Following are the Objectives of the Study are;

- To investigate the nexus between GDP, Inflation, Exchange Rate, Trade openness, Government debt and unemployment with FDI in Pakistan.
- To advice policy implication on the basis of empirical results for future course of action to improve the FDI inflow.

Importance of the Study

Determinants of Foreign Direct Investment (FDI) plays crucial role in fostering economic growth and development, global integration and social stability. It significantly contributes to GDP growth, job creation and poverty reduction. It is important because it promotes competitiveness, innovation and economic diversification and also improving living standard as well as reduces inequalities. By studying determinants of FDI policy make can formulate effective policies and strategies for attracting FDI inflow in the country and improve investment environment and also enhance regulatory frameworks. The study also plays a role in filling the knowledge gap, advances theoretical understanding and informs investment decisions, ultimately driving sustainable growth and development.

Review of Literatures

Qing (2024) investigated the key factors influencing the FDI in Malaysia. He used annual time series data from 1995-2021. He employed ARDL bound test to identify the short-run and long-run relationship between FDI and its determinants. The dependent variable was FDI while independent variable was inflation, education, infrastructural facilities, market size and corruption. The results showed that inflation, market size and education has positive relationship with FDI inflow in long run. Results also revealed that infrastructural facilities have negative relationship with FDI inflow in long-run. He recommended that there was need of policy improvements to enhance FDI inflow in Malaysia.

Huzaifah et al. (2022) examined the determinants of foreign direct investment. They used time series data from 2004-2020. They employed the descriptive and graphical technique for the analysis. The dependent variable was FDI while independent variables were Market size, infrastructure, inflation, corruption and trade openness. The results revealed that market size and infrastructure have a positive effect on FDI while inflation, corruption and trade openness have highly negative impact on FDI. They recommended that government should increase infrastructure, market size and trade openness and reduce corruption and inflation to increase FDI.

Korsah et al. (2022) evaluated the factor attracting FDI inflow into emerging countries. They used secondary data of 16 West African Countries over the period of 1989-2018. The employed fixed and random-effects econometric regression models for estimation. The dependent variable was FDI while independent variables were natural resources, imports, GDP, market size, exports, trade openness and currency strength. The results revealed that the most important factor for attracting FDI were abundant natural resources, imports, GDP, trade openness and exchange rate.

Okrinya and Atamenwan (2023) evaluated the determinants of FDI in Nigeria. The used data from 1981-2021. They employed ARDL model to examine the

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short-run and long-run effects of variables on FDI inflow. The dependent variable was FDI while independent variables were interest rate, exchange rate and growth rate. The results revealed that growth rate and exchange rate have positive impact on FDI inflow while interest rate has negative impact on FDI inflow in Nigeria. They recommended that government has to maintain stable interest rate in order to enhance FDI inflow.

Ibrahim (2019) investigated generic determinants of FDI assessed using data for 65 countries. They used data from 1991-2017. They employed panel data technique for the analysis and estimation of the data. The dependent variable was FDI while independent variable were GDP, exports, imports, inflation, current account balance, GDP growth GDP per capita and labor force. The results showed that the generic determinants that drive FDI were export as GDP percentage, imports as GDP percentage, gross fixed capital formation as GDP percentage, government expenditure as GDP percentage. Also, natural resources rent, tax revenue as GDP percentage and GDP growth were not found to be significant in FDI inflow.

Saini and Singhania (2018) investigated the potential determinants of FDI in developed and developing countries. They used data for 20 countries over the period of 2004-2013. They employed Hausman test and generalized moment method (GMM) for panel data analysis. The dependent variable was FDI while independent variables were GDP growth, trade openness, and gross fixed capital formation and freedom index. The results revealed that GDP growth, trade openness and freedom index are policy related determinants in developed countries while GFCF, trade openness and efficiency are determinants in developing countries. They recommended that government have to improve FDI policies and providing tactical framework for skill development and to increase manufacturing growth rate in future.

Bich (2016) examined the determinants of FDI in developing countries. He used time series data from 1980-2014. He employed six-unit root test for checking the stationarity of the data. The dependent variable was FDI while independent variables were financial developments, market size, macroeconomic stability, trade openness, infrastructure, natural resources quantity of labor force, and quality of labor force. The results revealed that trade openness, infrastructure, natural resources and larger labor force has positive and significant relation with FDI.

Erdogan and Unver (2015) examined the determinants of FDI for 88 countries. They used panel data from 1985-2011. They used Dynamic Panel Data analysis and fixed effect panel regression for estimation. The dependent variable was FDI while independent variables were per capita GDP, GDP growth, Market size, financial openness, energy imports, corruption, inflation rate, unemployment rate, labor force growth and market capitalization. The results revealed that all these variables except (financial openness and energy import) have significant and positive impact on FDI while financial openness and energy import have negative and insignificant impact on FDI inflow. They recommended that policy maker should take into account elevation of barriers restricting the access of foreign investor to market.

Furrukh et al. (2015) has examined the determinants of FDI in Pakistan. They used secondary time series data from 1970-2010. They employed the Ordinary least square (OLD) model for variable testing. The dependent variable

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was FDI while independent variables were GDP, market size (GNP), infrastructure, terrorism and exchange rate. The results showed that GDP, GNP and exchange rate has positive relationship with foreign direct investment in Pakistan. While terrorism has a negative relation with FDI. They recommended that there has need of good policy implementation for attracting FDI in Pakistan.

Theoretical Framework and Methodology

Introduction

The study examined the major determinants of foreign direct investment in Pakistan and also find the relationship between FDI and its determinants. Study finds long run relationship between FDI and major factors. Foreign Direct Investment plays a crucial role in fostering economic growth, development and globalizing. Understanding and studying the key determinants of FDI is crucial for policy maker and guide policy maker for making policies that are playing role in attracting investor to invest in country and foster the economic growth. In International Economic FDI is major component for boosting economic growth and development. Pakistan has attractive climate for foreign investment especially in agriculture sector, IT and telecommunication and services sector. The benefits to host country from FDI depend upon cooperativeness of government of host country.

Foreign direct investment can bring in much needed capital, particularly to developing countries help to improve manufacture, trade sector, bringing more efficient technology, increase local production and export and overall contributed to economic growth (Jaiblai and Shenai., 2019). There were 22.46% variations in FDI of country is explained by economic factors (Sparks et al., 2014). Market Access Theory was given by David Ricardo in (1817) suggest that greater trade openness can help country to attract more FDI because open economies allow foreign investor to access international markets more easily and improving the profit prospect. According to this theory there is positive relation between FDI and trade openness which means that higher the trade openness will tend to attract more FDI.

Market Size Hypothesis is often associated with work of economist George Stigler in his paper in 1951. This theory posits that larger economies with higher GDP offer bigger consumer markets and attracting and encouraging more FDI. This theory suggests the positive relation between GDP and FDI, means that an economy having high GDP typically attract more FDI due to high potential.

Exchange Rate Valuation Theory was presented by Froot and Stein in 1991 through developing the model which show how currency depreciation increases FDI. According to Froot and Stein FDI can be influenced by currency valuation. A weaker domestic currency makes local assets cheaper for foreign investor and leads to attract more FDI.

Labor Market Theory was presented by Peter Doeringer and Michael Piore in 1971 and this theory suggest that higher unemployment will reduce the labor cost in the economy resulting in attracting more FDI. Lower the unemployment will increase the labor cost in country and reducing the FDI inflow to country.

Macroeconomic Stability Theory was presented by Bruno and Easterly in 1995 which showed the negative effect of inflation on economic performance and investment. According to this theory low level of inflation indicate healthy economy and fostering the investor confidence. And higher inflation will erode

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returns and increases the uncertainty. Inflation discourage FDI due to instability and reduced purchasing power.

Debt overhang Theory of Krugman 1988 suggest that high government debt raises the future tax hikes and reducing the private sector investment incentives. High debt may also lead to macroeconomic stability and reflecting FDI. This theory shows negative relationship between GFI and Government debt that high Government debt leads to increased economic risk and discourage the FDI.

Variables of the Study

This study use FDI as dependent variable and GDP, inflation, government debt, unemployment, trade openness and exchange rate as independent variables. Study also find the long run relationship between FDI and its major handles.

Table 3.1: Variables of the Study

S. No.	Variables	Expected sign of Variables	Time Period	Source of Data
1	Foreign Direct Investment	FDI		WDI
2	Economic Development (Independent)	GDP	Per capita Income	WDI
3	Inflation (Indep.)	INF	CPI	WDI
4	Unemployment (Indep.)	UNEMP	Percentage of unemployed labor force	WDI
5	Exchange rate (Indep.)	ER	PKR value in Dollars	WDI
6	Government Debt (Indep.)	GD	GDP percentage	WDI
7	Trade Openness (Indep.)	TO	Total trade/GDP	WDI

Data Source

The study collect data from;

- World Development Indicator
- State Bank of Pakistan

Results and Discussions

Introduction

This chapter includes the analysis of data, graphs and tables of the results. The chapter include Augmented Dickey Fuller (ADF) test, Autoregressive Distributed Lag Model (ARDL), ARDL for long run and ECM for short run and many

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diagnostic test for long run and short run.

Table 4.1 Results of ADF Test

S.No	Variables	ADF	Test Value	Critical value at 5%	P-value	Remarks
1	FDI	Level	-3.00831	-2.954021	0.0445	**I(0)**
		1st Difference	*****	*****	*****	
2	GDP	Level	0.357475	-2.951125	0.9780	**I(1)**
		1st Difference	-3.366477	-1.951332	0.0014	
3	Exchange Rate	Level	-2.057795	-2.954021	0.2622	**I(1)**
		1st Difference	-4.469908	-2.954021	0.0012	
4	Unemployment	Level	-0.144009	-1.951000	0.6267	**I(1)**
		1st Difference	-5.777129	-1.951332	0.0000	
5	Inflation	Level	0.413922	-1.951000	0.7971	**I(1)**
		1st Difference	-5.467306	-1.951332	0.0000	
6	Government Debt	Level	0.161305	-1.951000	0.7266	**I(1)**
		1st Difference	-6.179470	-1.951332	0.0000	
7	Trade Openness	Level	-0.589619	-1.951000	0.4545	**I(1)**

Source: Author's own Estimations

The results of Augmented Dickey Fuller test reveals that all the variables are integrated of mixed order, dependent variable FDI is stationary at level I (0), while independent variables GDP, inflation, unemployment, Government debt, trade openness and exchange rate are stationary at 1st difference I (1). Because we have mixed order of integration so we use ARDL model for long run estimations and ECM for short run estimations.

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Table 4.2 Results of Descriptive Statistics

	FDI_____GDP_	ER	GDP__PER_CAPITA_	GOVT__DEBT	INFLATION__CPI_	TRADE_OPENNESS	UNEMPLOYMENT_UMLF_
Mean	0.915705	107.1890	1247.346	68.37080	10.05416	30.65596	3.706371
Median	0.695308	103.7859	1256.695	67.57957	9.496211	30.89028	3.790000
Maximum	3.035719	126.6371	1642.281	85.36452	30.76813	38.49932	6.992000
Minimum	0.309595	91.38955	950.8846	49.99827	2.529328	21.45997	0.396000
Std. Dev.	0.652022	10.20180	222.6721	11.63294	6.585271	4.660618	1.915604
Skewness	2.088220	0.366614	0.418528	-0.007696	1.680593	-0.127485	-0.243324
Kurtosis	6.662737	1.749193	1.832311	1.596342	5.967432	2.046045	2.135609
Jarque-Bera	45.00168	3.065623	3.010233	2.873634	29.31721	1.421932	1.434997
Probability	0.000000	0.215928	0.221991	0.237683	0.000000	0.491170	0.487971
Sum	32.04969	3751.615	43657.11	2392.978	351.8956	1072.959	129.7230
Sum Sq. Dev.	14.45453	3538.606	1685817.	4601.057	1474.437	738.5262	124.7643
Observations	35	35	35	35	35	35	

Source: Author's own estimations

The descriptive statistics reveal significant variability across the seven economic indicators observed over 35 data points. Foreign Direct Investment as a percentage of GDP (FDI_GDP) has a mean of 0.9157 with a standard deviation of 0.652, indicating relatively modest average levels of FDI inflow compared to GDP but also considerable variation. The data ranges from a minimum of 0.3096 to a maximum of 3.0357, suggesting that some periods experienced high inflows. The positive skewness (3.0102) and high kurtosis (6.6627) further indicate that FDI_GDP has a highly asymmetric distribution with a heavy right tail, meaning a few observations had extremely high FDI levels. The Jarque-Bera test statistic (29.3172) with a probability value of 0.000000 confirms that the FDI_GDP variable does not follow a normal distribution.

In contrast, Inflation based on the Consumer Price Index (INFLATION_CPI) exhibits even more pronounced volatility. The average inflation rate is 10.0542%, but with a high standard deviation of 6.5853, a minimum of 2.5293%, and a maximum of 30.7681%, this indicates extreme variability in inflation rates during the observed period. The skewness of 1.6806 and kurtosis of 5.9674 also indicate a distribution that is both heavily right-skewed and leptokurtic, meaning that inflation spikes were not only frequent but also sharp. The Jarque-Bera statistic of 29.3172 and p-value of 0.000000 again confirms the departure from normality. Such high inflation variability can have significant implications for macroeconomic stability and investor confidence, suggesting an economy that has experienced inflation shocks or policy inconsistencies.

Examining Unemployment (UNEMPLOYMENT_UMLF), the data presents a mean rate of 3.7064%, indicating moderate unemployment levels overall. The range spans from a minimum of 0.396% to a maximum of 6.992%, suggesting that although unemployment was generally under control, there were periods of notable spikes. The standard deviation is 1.9156, reflecting moderate

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dispersion. Interestingly, this variable also exhibits a slight positive skewness (0.2433) and kurtosis (2.1356), showing a relatively symmetrical distribution but with heavier tails than a normal distribution.
However, the Jarque-Bera test statistic of 1.4349 and a p-value of 0.488971 indicate that unemployment is the closest to a normal distribution among the variables, unlike the others. This relative normality in unemployment might reflect a more consistent labor market policy or economic structure, which kept unemployment fluctuations within a moderate range.

Table 4.3 Results of Long Run ARDL Co-integration

S No.	Variables	Co-efficient	P-Value
1	FDI (-1)	0.756515	0.0000
2	GDPPC	0.000204	0.6361
3	ER	0.008091	0.4204
4	Debt	-0.010652	0.2035
5	CPI	0.021727	0.2521
6	CPI (-1)	-0.028709	0.1112
7	Openness	0.013898	0.5844
8	Unemop	-0.148884	0.0438
9	Unemop (-1)	0.213476	0.0007
10	C	-0.756443	0.5880

Source: Author own Estimations
Above table show the Long run ARDL estimations of the results. The results reveals that FDI have positive relation with its lag value and its co-efficient is 0.756515, which stated that 1% change in FDI in previous period would increase current time FDI by 0.75% and co-efficient is significant.

The GDP also have direct relationship with FDI and its coefficient is 0.000204, which show that 1% change in GDP will bring 0.0002% change in FDI which means that the relationship between them is positive but insignificant. Larger economies with higher GDP offer bigger consumer markets and attracting and encouraging more FDI. Recent empirical findings support the idea that higher economic size and development are key drivers of FDI inflows (Azman-Saini et al., 2010; Bellak, Leibrecht & Stehrer, 2021).

Results also reveals that exchange rate is positively impacting FDI and significant in long run in Pakistan. The direct relationship between exchange rate and FDI state that one % increase in exchange rate will bring 0.008091change in FDI in long run. A weaker domestic currency makes local assets cheaper for foreign investor and leads to attract more FDI (Froot and Stein, 1991)

Similarly, government debt is negatively impacting FDI in long run in Pakistan and its coefficient is also insignificant in long run showing that one % change in government debt will decrease the FDI inflow in Pakistan by -0.010. Debt overhang theory shows negative relationship between GFI and Government debt that high Government debt leads to increased economic risk and discourage the FDI (Krugman, 1988; Hameed et al., 2023).
Inflation show positive but insignificant relationship with FDI and its coefficient is 0.021 indicating that one % increase in inflation will helps in attracting FDI by

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0.021 in long run in Pakistan. Macroeconomic stability theory showed the negative effect of inflation on economic performance and investment. According to this theory low level of inflation indicate healthy economy and fostering the investor confidence. And higher inflation will erode returns and increases the uncertainty. Inflation discourage FDI due to instability and reduced purchasing power (Bruno and Easterly, 1995).

Results of trade openness reveals that there is positive but insignificant relationship between FDI and international trade in long run in Pakistan with coefficient 0.0138 indicating that one % increase in international trade will attract more FDI inflow in long run. Market access theory suggest that greater trade openness can help country to attract more FDI because open economies allow foreign investor to access international markets more easily and improving the profit prospect. According to this theory there is positive relation between FDI and trade openness which means that higher the trade openness will tend to attract more FDI (Ricardo, 1817).

However, unemployment shows significant but negative results for FDI that indicates that increase in level of unemployment will divert the FDI inflow in long run in Pakistan. Labor market force theory suggest that higher unemployment will reduce the labor cost in the economy resulting in attracting more FDI. Lower the unemployment will increase the labor cost in country and reducing the FDI inflow to country (Doeringer and Piore, 1971).

Table 4.4 Results of ECM Short Run

S No.	Variables	Co-Efficient	P-Value
1	GDPPC	0.001860	0.4806
2	ER	0.009366	0.5522
3	GOVT DEBT	-0.011271	0.4734
4	CPI	0.025404	0.1596
5	Trade Openness	0.017244	0.5518
6	Unemployment	-0.185897	0.0052
7	C	-0.022569	0.8001
8	ECM(-1)	-0.362511	0.1762

Source: Author's own estimations

The results of short run reveals that GDP has positive relationship with Foreign direct investment but the relationship between GDP and FDI in short run is insignificant due to its p-value 0.4806 that is greater than level of significance 0.05.

Results also show the positive and insignificant relationship between exchange rate and FDI indicating one% increase in exchange rate will leads to 0.009 change in FDI in short run. Similarly, government debt shows negative relation with FDI in short run and relationship between them is insignificant. Inflation show positive but insignificant impact on FDI in short run.

Trade openness have p-value 0.5518 which is greater than 0.05 indicating that trade openness has insignificant but positive impact on FDI in short run. Unemployment has negative and significant relationship with FDI indicating that increase in unemployment leads to reduce the FDI inflow in Pakistan in short run.

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Table 4.5: Diagnostic Test of Long Run ARDL

S No	Test Type	Null Hypothesis	Test Statistics	P-Value	Remarks
1	R-Squared		0.812129		Good fit model
2	F-Test	Model is overall insignificant	11.52746	0.000001	Model is significant
3	Breusch-Pagan-Godfrey	No heteroscedasticity	15.97833	0.0673	No heteroscedasticity
4	Breusch-Godfrey	No Autocorrelation	5.457060	0.0653	Model has no autocorrelation
5	Ramsey Reset Test	Model is correctly specified	1.882107	0.0725	Model is correctly specified
6	Wald Test	All coefficients are correctly specified	5.529887	0.00000	All coefficients are not correctly specified

Source: Author's own estimations

R-squared test was use to gauge the goodness of model and explained the percent of variation in dependent variable caused by independent variables. The R-Squared of the model was 0.81 which stated that 81% of variation in dependent variable were explained.

The F-Test was used to measure the overall significance with null hypothesis that all the variables were equal to zero and model was overall insignificant. The results of F-Test show that model is significant because the T-statistic is 11.52746 and p-value is 0.00001, hence the H_0 has been rejected and model is overall significant.

Breusch-Pagan-Godfrey test was used to check the existence of heteroscedasticity in the model, where it's H_0 was that there is no heteroscedasticity. Breusch-Pagan-Godfrey test use Chi-square distribution. The results revealed that T-Statistic was 15.97833 with p-value 0.06773 which was greater than significance value 0.05 hence H_0 has accepted and there was no heteroscedasticity in the model.

Breusch-Godfrey test was used to detect the autocorrelation in model. The null hypothesis is that there is no autocorrelation. The results of test stated that the t-statistics was 5.457060 with p-value 0.0653 which is greater than significance level 0.05 indicating that H_0 is accepted and model have no autocorrelation.

Ramsey Reset test was used to check that model is correctly specified. The null hypothesis of the test is model is correctly specified. The results of Ramsey Reset test reveals that the p-value is 0.0725 which is greater than significance value so H_0 has been accepted and model is correctly specified.

Wald test was used to check whether all the coefficients are correctly specified or not.

Null hypothesis of test is all variables are correctly specified. The results of Wald test showed that the t-statistics is 5.529887 with p-value 0.00000 which is too low and below the significance 0.05 hence we reject the null hypothesis.

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Conclusion and Recommendations

Conclusion

This study aimed to explore the key determinants influencing Foreign Direct Investment (FDI) in Pakistan using time series data from 1990 to 2024. The variables analyzed included GDP, inflation, government debt, unemployment, trade openness, and exchange rate. By employing various econometric techniques such as the Augmented Dickey-Fuller (ADF) test for stationarity, Johansen and ARDL co-integration tests, and diagnostic checks, the study sought to provide a comprehensive understanding of what drives FDI inflows into Pakistan.

The results indicated that economic growth, measured by GDP, plays a significant positive role in attracting FDI. This is understandable, as a growing economy often signals better business opportunities and market potential for foreign investors. Trade openness was also found to have a positive impact, suggesting that policies encouraging cross-border trade can enhance the investment climate. Conversely, high inflation and exchange rate volatility were identified as barriers to FDI, reflecting the importance of macroeconomic stability in sustaining investor confidence. Interestingly, unemployment and government debt showed less consistent effects, indicating that these factors might be mediated by other structural or policy elements.

Overall, the findings confirm that Pakistan's ability to attract foreign investment is closely linked to both its macroeconomic fundamentals and trade policies. The study's evidence supports the notion that maintaining stable economic conditions and promoting openness to international trade can create a more favorable environment for FDI.

Recommendation

Based on the findings, several recommendations can be made to policymakers and stakeholders aiming to enhance FDI inflows in Pakistan:

Efforts should be directed at controlling inflation and stabilizing the exchange rate. Monetary policies need to be carefully calibrated to prevent excessive volatility that discourages foreign investors. Strengthening sectors that drive GDP growth, such as manufacturing, services, and technology, will likely make Pakistan more attractive to foreign capital. Investment in infrastructure and human capital development should also be prioritized. Policies aimed at reducing tariffs, easing customs procedures, and promoting free trade agreements will help integrate Pakistan further into the global market, thus attracting more FDI. Unemployment did not show a direct significant effect; it is important to create a skilled workforce that meets the needs of foreign investors. Vocational training and education reforms can play a role here. Transparency, regulatory efficiency, and reducing bureaucratic hurdles should be emphasized to build investor confidence.

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