Impact of Economic Growth and Trade Openness on Foreign Direct Investment A Case of Pakistan

Adeel Ashraf

Research Scholar, Department of Management Sciences, University of Gwadar

Abstract

Over the past three decades, global Foreign Direct Investment (FDI) has surged, indicating a profound shift towards economic globalization. FDI is pivotal in fostering interaction between nations, regions, and Multinational Corporations (MNCs), driving international trade, information exchange, and migration. Historically, FDI has spurred the development of host countries by enhancing infrastructure, technical expertise, and financial resources. This study aims to examine the impact of trade openness and economic growth on foreign direct investment. This study used a quantitative methodology to address the issue in question. Secondary data was used to analyze the results of this study. The partial least square technique was adopted for analysis. The findings suggest that trade openness leads to higher foreign direct investment. Moreover, the findings reveal an insignificant relationship between economic growth and foreign direct investment.

Keywords: *Foreign Direct Investment, Multinational Corporations, Economic Growth and Trade Openness*

Corresponding Author: Adeel Ashraf, adeelbaluch91@gmail.com

Introduction

Foreign direct investment (FDI) refers to acquiring operational assets, such as factories, mines, and land, by foreign entities (He et al., 2024). The escalation of foreign investment can serve as an indicator of increasing economic globalization (Ni et al., 2024). Over the past three decades, there has been a remarkable surge in global FDI. In 1981, the cumulative FDI stock amounted to merely 6.59 per cent of the world's Gross Domestic Product (GDP) (Sakyi et al., 2015a). By 2004, this proportion had surged to nearly 23.52 per cent, as reported by the United Nations Conference on Trade and Development (Awan, Ahmad, Shahid, & Hassan, 2014). Foreign Direct Investment is essential in the globalization path of action as it intensifies the interaction between states, regions and Multinational Corporations (Sakyi et al., 2015b). Internationally rising foreign direct investment, international trade, information, and migration are all parts of this progression (Luo et al., 2024). FDI has traditionally played a pivotal role in fostering the advancement of host nations through enhancements in infrastructure, technical expertise, entrepreneurial capabilities, and bolstering financial resources via increased government revenue and foreign exchange reserves. In addition to injecting capital and creating employment opportunities, foreign investment facilitates the transfer of new technologies (Liu et al., 2022). As a country's growth accelerates, it becomes increasingly attractive to foreign investors. Despite conflicting opinions, foreign direct investment (FDI) is widely perceived as a significant catalyst for economic advancement in developing nations (Banday et al., 2021). In contrast, productivity growth within the host economy does not exhibit a significant correlation in developing countries (Khan & Adnan Hye, 2014). Conversely, the prevailing body of research on this subject emphasizes the pivotal role of FDI in fostering economic growth, as we will explore shortly, from various angles (Wu et al., 2024).

Foreign Direct Investment (FDI) to the advancement of its neighbouring countries, South Africa, is often regarded as the primary driver of growth in Southern Africa (Ahmad et al., 2022). This role entails providing FDI capital, transferring technology, contributing to human resource development, and fostering exports to regional economies (Alam et al., 2016). This involvement has led to a deeper understanding of local cultures, regulatory frameworks, and legislative dynamics, potentially giving South African firms advantages over other foreign multinational corporations when considering investments in Sub-Saharan Africa (SSA) (Peng et al., 2023). With the substantial rise in cross-border investment flows in recent years, it becomes imperative to explore the factors that may influence such investment decisions, particularly in financial services, where there has been limited investigation thus far (Chandio et al., 2017). Pakistan's economy necessitates substantial funding for developing diverse sectors, including energy, telecommunications, banking, transportation, infrastructure, healthcare, education, and numerous other interconnected sectors vital for economic expansion (Zhan et al., 2024).

The current study aims to address two important research questions concerning foreign direct investment in Pakistan. First, does economic growth affect foreign direct investment? Second, does trade openness affect foreign direct investment?

This study uses secondary data to examine the effect of economic growth and trade openness on foreign direct investment in Pakistan. The partial least square is utilized for estimation purposes. The findings reveal that trade openness has a significant positive effect on foreign direct investment. Whereas economic growth has a negative but insignificant effect on foreign direct investment. The findings suggest the key role of trade openness in attracting foreign direct investment in Pakistan.

Literature Review

Foreign Direct Investment (FDI) and economic growth have predominantly been conducted globally (Adeel-Farooq et al., 2017). Much empirical research in this field has been scrutinized extensively to formulate specific objectives within the Pakistani context (Amna Intisar et al., 2020). Subsequently, a comprehensive examination has been undertaken to derive significant conclusions and offer policy recommendations tailored to Pakistan's economic landscape (Kumari et al., 2023). Per capita, economic growth hinges predominantly on productivity advancements, often called economic efficiency (Muhammad et al., 2020, Jawaid, 2014). Enhanced productivity generates more goods and services using identical labour, capital, energy, and materials inputs (R. Ahmad et al., 2017). An illustrative instance of this phenomenon occurred during the Green Revolution when agriculture productivity saw notable labour and land utilization boosts (Klasra, 2011). The increased integration of markets through trade and capital flows not only globalizes economies but also exacerbates subnational income disparities in today's developing nations, which tend to persist over extended periods (Rodríguez-Pose, 2012). Not all regions within a country possess the same capacity to engage with global markets, with coastal and economically dense areas often experiencing greater success (Martínez et al., 2007).

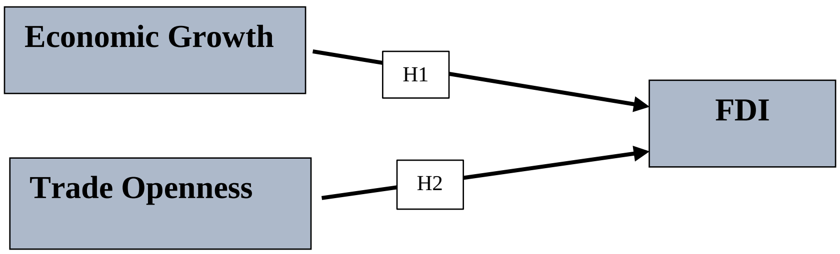
A striking example is China, where in 2007, its GDP per capita equalled Britain's in 1911 (McKay, 2024). Presently, Shanghai, a leading economic hub in China, boasts a GDP per capita comparable to Britain in 1988, while lagging regions like Guizhou resemble Britain's financial status in 1930 (Zheng, 2018). China's vast size, the accessibility of coastal areas to international trade, and the strategic positioning of Shanghai are key factors contributing to this divergence (Zhao & Zhang, 2007).

Hypothesis

H_1: Economic growth has a positive impact on FDI

H_2: Trade Openness has a positive impact on FDI

Conceptual Framework



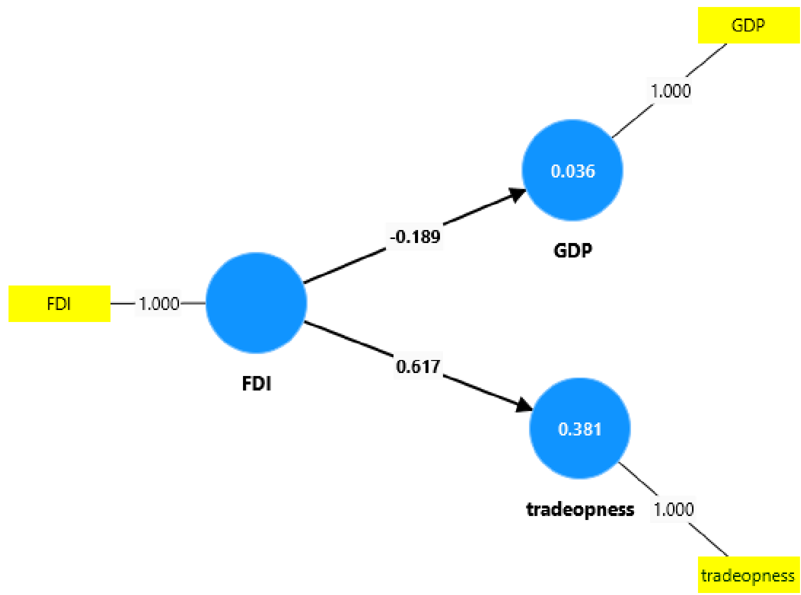
Methodology

This study aims to examine the impact of trade openness and economic growth on foreign direct investment. This study used a quantitative methodology to address the issue in question. Secondary data was used to analyze the results of this study. The partial least square technique was adopted for analysis. Data was collected from the FDI in Pakistan, and we analyzed the information. All the quantity of this research was acquired from past data studies. I collected all data from many sites and World Bank websites, which I took from research, and I put these data into the SMARTPLS software, a good method I use to determine. Data collection years 1970 to 2022 FDI: I analyzed the data using smartpls4 vision.

Data Analysis

Structural Model

The table below shows the data I analyzed from SMARTPLS 4 and measures the GDP of Pakistan, FDI, and trade openness. FDI has an impact of -0.189 on GDP in data studies, and FDI's impact on trade openness is 0.617. I analyzed my research data, which is shown in the framework Structure.



Outer loadings

Table 1 shows the data of Outer loadings, which all in one is "**1**" that shows the given table Partial Least Squares Structural Equation Modeling (PLS-SEM), "outer loading" refers to the relationship between a latent variable and its observed indicators.

Outer Loadings Table 1:

	FDI	**GDP**	**trade openness**
FDI	1		
GDP		1	
trade openness			1

Hypothesis Testing and Regression Analysis:

Table 2 shows the mean value of the original sample of FDI->GDP is -0.189, and FDI->Trade openness is 0.617; from my analysis, the data P value is FDI->GDP is 0.071 is Not supported and FDI->Trade openness is 0 mean its Support all data are given the Table 2.

Path coefficient Table 2:

	Original sample (O)	Sample Mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values	
FDI -> GDP	-0.189	-0.191	0.105	1.808	0.071	Not supported
FDI -> trade openness	0.617	0.607	0.109	5.645	0.000	Supported

R-Square:

All Variable dependent and independent values in the shows Table 2 the determination that illustrates the variables that show the GDP R-square is 0.036, with a mean of 36.0%. Trade openness is 0.369, with a mean of 36.9%, adjusted in R-Square.

Table 3 R-square:

	R-square	R-square adjusted
GDP	**0.036**	**0.017**
trade openness	**0.381**	**0.369**

Conclusion and Discussion

FDI arises as a critical driver of economic globalization, fostering interaction among nations and contributing to the development of host countries. While its impact on productivity growth may vary, the consensus underscores its importance in driving economic development. South Africa's role as a 'growth pole' in Southern Africa highlights the potential for regional growth through FDI and technology transfer. Understanding the factors influencing investment decisions is essential, particularly in sectors crucial for economic growth like energy, telecommunications, and infrastructure. Going forward, policymakers must prioritize attracting FDI through strategic investments and policies conducive to foreign investment. Research into the determinants of investment decisions, especially in developing economies like Pakistan, is necessary to facilitate sustainable economic growth and development.

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