

## Significance of Foreign Direct Investment in the Economic Development of Pakistan and Afghanistan

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### Abstract

The main objective of the study is to find out the impact of foreign direct investment on the economic development of central Asia, Afghanistan and Pakistan particular. For this research we have collected the data from the secondary source. The study was showing that the inflows of FDI are increasing in some countries. In 1992 the inflows of FDI of Pakistan was 258.43 US dollar, at that time the inflows of Afghanistan was nothing. In the year 2007 it was concluded that inflows of Pakistan was us \$4374 million. During the 2007 the inflows level in Afghanistan was USD 289. In this paper it has concluded that the most profitable area power sector, telecom, education and information technology. Thus, our paper is trying to prove that FDI has main role for the development of welfare with the way of providing the welfare society. Therefore, the study is trying to suggest that for the enhancement of FDI government of Pakistan and Afghanistan need to remove the political instability and terrorism and should focus on the physical infrastructure.

**Keywords:** Central Asia; Information technology; Welfare; Physical infrastructure; Economic development

### Introduction

In the simple words, foreign direct investment means one investor invests his money in another country. Portfolio investment is also known as the indirect investment. Foreign direct investment has the crucial role for the economic growth of economy. Foreign direct investment is the way for the investors to invest at the level of domestic savings. The advantages of foreign direct investment are to attract the capital, knowledge and increase the balance of payment. Foreign direct investment is known as the pivotal component of economy. Many studies have proved that there is positive effect of FDI on the growth of all developing and under developing countries. With the increase in the level of FDI, then there will increase the liberalization of trade in Pakistan, there is need of adopted the domestic policies for the improvement of foreign direct investment. For the attracting of FDI there is need of friendly policies and there is need to develop the foreign investors' confidence. In the circumstances of the political stability any country can be adopted the FDI. Foreign direct investments are affected by the uncertainties. Such types of uncertainties' become the reason of government decision. All the previous studies have proved that due to uncertainties the investors do not invest in such of countries.

### Statement of the Problem

In this paper, we have analyzed the causes of decrease the level of FDI from last few decades. Gross domestic product is the way to explain the inflows level of FDI. Our study is proving that due to inconsistent policies the level of FDI in Pakistan is low. From 2007-08 the FDI inflows was declining. In Pakistan the reason of the losing the FDI level is the terrorism.

### Objectives

- 1) Reason of decreasing FDI in Pakistan and Afghanistan.
- 2) How to attractive the foreign investors towards the Pakistan and Afghanistan.
- 3) Impact of terrorism on the FDI on the Pakistan and Afghanistan.
- 4) Political instability impact on the FDI inflows of Pakistan and Afghanistan.

### The case of Pakistan

According to modern research Pakistan has come at 9<sup>th</sup> no in the world ranking due to hardworking people. In Pakistan, foreign and local investors would like to invest in every sector of business. The government of Pakistan is trying to encourage investors for the support of investment. Pakistan is also known as the gateway for the foreign investment. Although in 2006 Pakistan has achieved his goal in attracting the 4274 USD, almost 70% FDI (Figure 1).

### The case of the Afghanistan

Afghanistan is facing the depressing position from last 20 years. Due to these circumstances the poverty of Afghanistan is going to decline. Afghanistan's nation cannot afford of safe drinking and electricity, therefore in this condition they need the foreign direct investment. However, the poor infrastructure has become the challenge for all types of business. Afghanistan Transitional commercial trade is trying to encourage the foreign investors for the investment into the Afghanistan. For the enhancement of foreign direct investment in Afghanistan government are trying to make a friendly environment here. However, it has been observed that there is not proper data available related to FDI. During the 2008 the FDI level had recorded till 288\$. The largest investors in the world are the USA, Iran and South Africa. The main objective of this study is to provide the reason of low level of FDI in Pakistan and Afghanistan. We are explaining some suggestions related to improve the FDI level (Figure 2).

### Literature Review

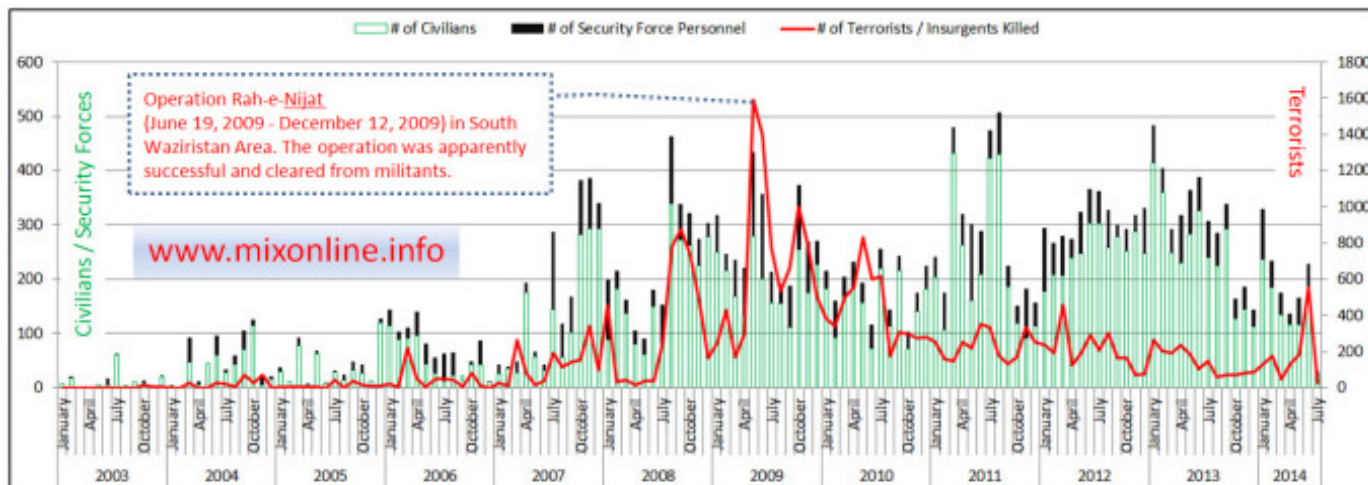
Agarwal analyzed that impact of FDI on Pakistan. They had taken the time series data and applied the Phillips-Parson test for this

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### Trend of Terrorism related Deaths in Pakistan

Figure 1: Trend of Terrorism related Deaths in Pakistan (Click chart to open in a new window for high quality).

### Terrorist Attacks Related to Islam

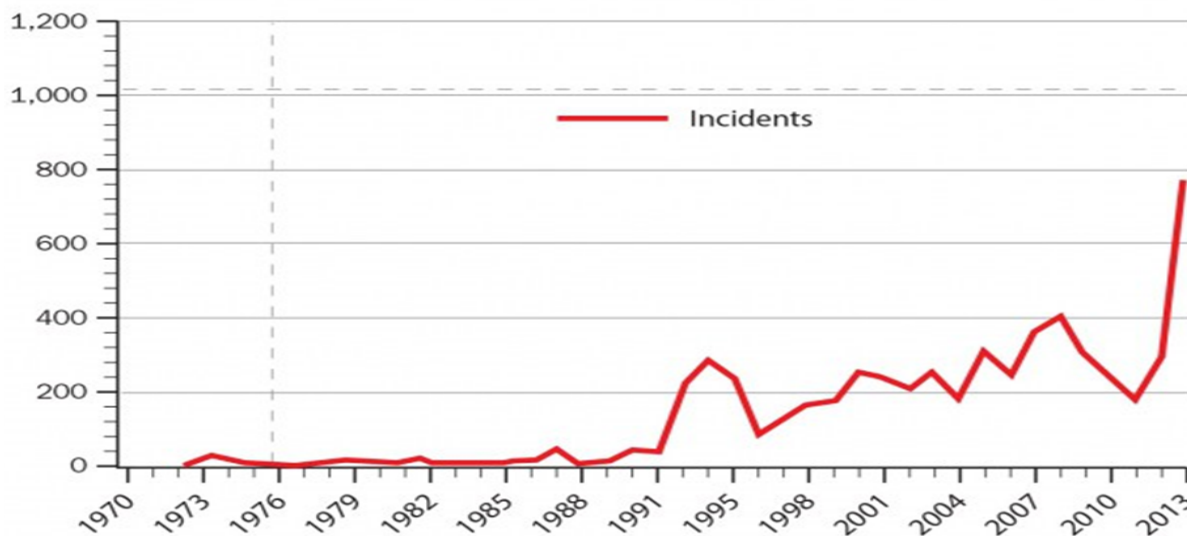


Figure 2: Terrorists attacks related to Islam.

purpose. The study had proved that increase size of market has the direct link with the FDI inflows of Pakistan. This study was showing that there is need of encouraging policies for the stable FDI inflows [1].

Dunning analyzed that how the trade, financial policies effected the inflows of FDI of Pakistan. For this purpose they had applied the co-integration and error correction method. This study is proving that there is positive relationship between FDI and financial policy. They had analyzed that how the trade, financial policies effected the inflows of FDI of Pakistan. For this purpose they had applied the co-integration and error correction method. This study is proving that there is positive relationship between FDI and financial policy [2].

Penrose, E., applied the unit root test and Johansen-Juselius test and taken the data from 1991 to 2001. They had found that there is short run relationship between market size of market and FDI inflows. They had taken the annual time series data for the period of 1971 to 2009. For this purpose they had run the regression to check the relationship between dependent and independent variables. Their study had proved that there is high degree of relationship between trade openness and government friendly policies [3].

Cantwell analyzed the impact of international political relations on the inwards of fdi of Pakistan. They had applied the Autoregressive Distributed lag bounds test. For this purpose they had taken the data

from 1978-2008. However, study had proved that there is short run relationship between them [4].

Azam analyzed the different patterns of FDI in Pakistan and analyzed the impact of FDI on Pakistan. For this purpose they had utilized the co integration and connection mechanism. This study has proved that FDI has the crucial role in the development of the economy. In this study is also proving that public policy has also impact on the FDI inflows [5].

Jacqueline K examined the major economic determinants of FDI in the production sector of Iran. For this purpose they had utilized the quarterly time series data. They used the regression model to check the relationship between dependent and independent variables. Study had proved that GDP, real growth rate and per capita income are known as the key determinates of FDI inflows [6].

Borensztein observed the determinates of FDI in developing country. They used the panel data for this purpose and applied the OLSS model for this purpose and analyzed that there is correlation of FDI at the level of economy, risk and variables which are related to the macroeconomic variables [7].

Findly examined that how the trade, financial policies effected the inflows of FDI of Pakistan. For this purpose they had applied the co-integration and error correction method. This study was proving that there is positive relationship between FDI and financial policy [8].

Wang and Blomstrom highlighted that economic development of FDI in Pakistan. They had taken the time series data and concluded the results that GDP growth rate had the positive impact on the inflows of FDI. Hence, the all the authorities should have maximum utilization of resources for the development of GDP growth rate Analyzed that impact of FDI on Brazil. They had taken the time series data and applied the Phillips-Parson test for this purpose. The study had proved that increase size of market has the direct link with the FDI inflows of Brazil. This study was showing that there is need of encouraging policies for the stable FDI inflows. They had applied the unit root test and Johansed-Juselius test and taken the data from 1992 to 2009. They had found that there is short run relationship between market size of market and FDI inflows [9].

Frank, A., They had examined the major economic determinants of FDI in the production sector of Japan. For this purpose they had utilized the quarterly time series data. They used the regression model to check the relationship between dependent and independent variables. Study had proved that GDP, real growth rate and per capita income are known as the key determinates of FDI inflows [10-12].

## Data and Methodology

Nature of the study is describing that we have utilized the secondary data. We have taken the data from 1992 to 2007. We have obtained the data from World Bank indicator and utilized the methods of tabulations and figures for the explanation of our aim.

## Positive effects of FDI

Many studies have been observed that FDI have the positive impact on the economy of the country. Many studies have highlighted the crucial role of FDI on the economy of poor country. Foreign direct investment is the source of the external finance. It is seen that due to shortage of capital Pakistan and Afghanistan are facing the problem of

the low foreign investment. As well as, it is showing that foreign direct investment is the way to fill up the gap between saving and investment. It is also utilized to increase the revenue and productivity. Foreign direct investment is also known as the catalyst for the development of the economy.

## Negative effects of FDI

Different researchers are giving arguments that there are also some disadvantages of FDI. On the basic of different literatures it has proved that FDI sometime FDI can consider worsen. Sometimes, the values of import are more than export. FDI is beneficial for urban area and discourage the domestic entrepreneurship. Different studies have proved that FDI transmission towards the developing countries have lower quality. Sometime the technologies which have been transferred to under developing country it is overpriced.

## Inflows of FDI into Central Asia and Pakistan

In this table we are showing that inflow in both Asia and Pakistan are increasing. Data is evidence that which we were collected from the world development indicator. Our results are also showing that Kazakhstan inflows are also increasing rapidly in the comparing of last few years (Table 1).

## Results and Discussion

According to different researchers FDI has the crucial role in the development of the economy. FDI is the known of the way to finance the deprived country. For the poor country foreign direct investment is particularly known as the source of financing. Foreign direct investment is the way to improve the gap between saving and investment. For the development of the poor country foreign direct investment is the way financing. Many scholars have been provided that the flows of FDI into central Asia countries. During the2008Afghanistan inflows were the 288 USD. Further, our study is trying to expose that UAE UK, Hong Kong are the major contributors of FDI inflows. In Afghanistan the major contributors were China, UAE and Turkey. There is no doubt that FDI has the main role in the development of growth and increasing the opportunities of the job. Moreover, our study is providing that how much increase the FDI level as the same rate economic growth will increase. As a result for a high growth rate we need high capital this circle is known as the virtuous circle of economic growth.

## Conclusion

Our study is showing that the main reason of low FDI in Pakistan and Afghanistan are the paucity of capital and lack of latest technology. Our study haves proved that FDI is very much crucial for the economic development of Pakistan and Afghanistan. Foreign direct investment is also source to provide the tangible and intangible assets to developing and under developing country. The tangible assets are become the reason of the increase the financing of recipient countries while the intangible assets are become the reason of increasing the managerial skills, and provide the job opportunities. Thus, the increase the FDI level is the reason of boost the poverty of all countries. A comparison between Pakistan and other central Asian has proved that the inflow in Pakistan is high then other countries. The study is suggested that both government need to remove terrorism from the country and need to improve the domestic infrastructure. In addition, for the enhancement of FDI there is need to formulate the adequate policies.

Years	Afghanistan	Armenia	Azerbaijan	Kazakhstan	Kyrgyzstan	Pakistan	Tajikistan	Turkmenistan	Uzbekistan
1992	-0.29	19.63	0.00002	0.00002	0.00002	258.43	0.00002	0.00002	0.00002
1993	0.37	2.41	0.00002	200.00	0.00002	336.56	8.00	0.00002	8.00
1994	-0.03	9.00	0.02	1271.41	11.00	348.65	8.00	78.00	49.00
1995	0.03	0.90	23.00	659.71	38.19	421.025	13.00	104.00	74.00
1996	0.13	25.33	340.0	964.26	96.08	722.64	20.00	234.00	-25.00
1997	0.68	17.61	627.4	1136.92	46.78	921.98	19.00	109.06	91.00
1998	-1.47	51.91	1114.9	1321.28	83.04	716.26	19.00	108.86	168.00
1999	-0.02	236.9	1022.8	1151.48	109.3	507.00	26.00	63.00	141.00
2000	6.05	135.2	510.41	1471.67	44.41	533.00	22.00	126.00	122.00
2001	0.18	124.2	129.95	1282.54	-2.41	309.00	25.00	127.00	76.00
2002	0.69	87.81	226.52	2836.00	6.00	384.00	8.49	171.00	84.00
2003	0.55	149.7	1392.44	2589.85	4.81	824.00	37.07	200.00	66.00
2004	57.9	155.5	3286.00	2068.46	46.00	534.00	32.65	200.00	71.00
2005	311	218.9	3557.00	4157.3	176.90	112.80	273.00	243.00	1.18
2006	416.00	259	-	1974.8	43.50	2202.00	545.7	-	45.4
2007	-	244	1678	6144.0	183.00	4274.00	339.6	-	165.0

Table 1: Inflows of FDI into Central Asia and Pakistan.

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