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ASSESSMENT OF ROOM FOR DEVELOPMENT IN PAKISTAN

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Keywords:

FDI, Trade openness, WTO, Trade agreement, economic development

ABSTRACT

The main theme behind the current research is to find an answer to the question" Is there any Room for Development in Pakistan?" Since Foreign Direct Investment is one of the important determinants of development, hence the above question can be asked alternatively as "How the FDI inflow can be increased in Pakistan?" Thus, the main objective of the study is to find out the key determinants influencing the development of Pakistan. So far as the research methodology is concerned, in this regard, it is proposed that the main variable like size of economy, Developmental Level, Trade Openness, Human Capital and Trade Agreements have been focused. The data have been gathered for the period of 1982-2015 for nine Asian countries from various International Sources of Economic Indicators. For analysis of data the correlation and regression model have been used. The results reveal that all the variables under study have positive impact on the FDI inflow/ Development, but the Trade Openness, Trade Agreements and Literate human Resource have significant positive impact on FDI inflow. It is recommended on the basis of analysis results that Pakistan in order to attract more FDI inflow should educate the labor force, remove the barriers to entry in Pakistan for business and relax the terms and conditions for foreign trade..

INTRODUCTION

Foreign direct investment (FDI) is one of the most important factors of financial flows for the economic development of the countries as compared to the other financial instruments. A multinational corporation (MNC's) by doing investment in the host countries not only provides financial capital to the host countries, but also brings advancement in the technology, management and improves their economic development.

The FDI inflow increases when there is more liberalization for investment all over the world. Now a days, countries engaged in different trade agreements to strengthened up and in return FDI in different region increased. General Agreement on Tariff and Trade (GATT) had a global focal point. Many group of countries also developed a Regional Trade Agreement (RTA's) including European Union (EU) and North American Free Trade Agreement (NAFTA). All those agreements affect the volume of FDI. A broad widen of RTA's has been witnessed in 1990's which includes many developing countries. The countries which are member of RTA's benefits from economies of scale increase in efficiency and the comparative advantage with the member countries. By getting these efficiencies, these countries involve in FDI, so the FDI is used to measure the benefits it gives to the producers to enhance technology and the increase their efficiency. RTA involves the reduction of barriers, which are imposed on tariffs within the associate countries and completion of common tariff between the non-member countries.

According to the World Trade Organization (WTO), the countries which enter to Preferential Trade Agreements (PTA's) fully, remove trade barriers between them and for the non-members there is no

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raise in liberalization polices. These countries are helpless to connect in the Free Trade Area (FTA). The members of FTA liberalize internal trade at the same time as for the outsider, to maintain exterior law enforcement of trade or Custom Union (CU) and the countries which are member of Custom Union, agree on the external polices for tariff imposed on import from the non-members. PTA's include the North American Free Trade Agreement (NAFTA), Association of South East Asian Nations (ASEAN) and the European Union (EU). It has also been settled that the PTA are the important source of liberalization of trade and should be adopted if possible, to grow the ambition of multilateral free trade. This dissertation reacts the query that the trade agreements play role in the presence of multinational corporations (MNC's) in the Asian Developing Countries and used panel data of nine (9) countries during the year 1990-2010 and statistical test ate applied to get the results. The results we got through regression analysis show the significant relation that the trade agreements are essential for the FDI inflows.

The stream of Foreign Direct Investment (FDI) into developing countries varies deeply across countries and over time. There are number of factors which provide a mechanism for making Foreign Direct Investment (FDI) in other countries. The primary concern of this study is to examine the effect of trade agreements on transnational corporation's presence in Asian Developing Countries. The study has the objective to investigate different factors that enhances Foreign Direct Investment (FDI) inflows to the Asian Developing Countries and to evaluate to what extent trade agreement affect the multinational corporations to do investment in Asian Developing Countries. This research has critical proposition for those investors who are attracted in making FDI in Asian Developing Countries. Policy makers consider FDI desirable because it brings innovative technology, training for the workers and also contribute to economic growth.

LITERATURE REVIEW

Driemeier (2003) investigate that whether Bilateral Investment Treaties (BIT's) play role in attracting FDI and create that the countries having weak rights of probably protection, BIT's not served as a substitute for them to raise investment. On the other hand the countries having superior property protection, BIT's for those countries served as a complement rather than substitute. Rose (2002) accomplished in his dissertation that the countries which belongs to the WTO/GATT, do not have much different pattern of trade then the countries which are not member of WTO/GATT, but these disapproving outcome are complicated to empathize.

Yayati et al (2003) examine that how bilateral stock of FDI affects by the Free Trade Area (FTA) and used panel data for sixty countries. In his econometric model, they observe the effect of host and source countries which belong to the same FTA, and also the effect of the markets of the host and the source countries. They concluded that the source countries with the same enterprise in an FTA doubles the FDI stock and size of the member countries also enjoy grow with the structure on Regional Trade Agreement (RTA's).

Dunning (1980) in his dissertation given the OLI model, he recommended that the firm should have an ownership lead and this ownership lead act as a competitive advantage for them; similarly, locational advantage over another firm is also very critical factor to be considered. Before internalization, firms see these factors and then settle on whether it's beneficial for them to invest or not. According to dunning these three factors act as a three leg Stoll and all legs are important to keep the balance. We can't say that the one leg performs better than the other.

Ahmad et al (2010) used different approaches to analyzed the trade pattern of Pakistan and Srilanka before and after the Free Trade Agreement (FTA) and found that trade between the Pakistan and Srilanka has raise after the FTA. Negative trade balance of Srilanka is because of the larger segment of imports from the Pakistan is based on raw material and the intermediate products which leads toward the gain in efficiency. But still these two countries need cooperation in the field of textile, education, science, tourism and technology.

Gudicello (2011) analyzed the Regional Trade Agreement (RTA) and trade pattern of the fifteen (15) developing countries and USA and also the tariff rates. Except Chile, USA faces an upper tariff as compared to the fifteen (15) countries who are partner of RTA's. USA exports a number of goods to these countries but US imports segment is smaller than these developing countries which are RTA's partner, because in addition to the RTA's some other factors like tariff rate and preferences of market access also create hurdles for US exports to these countries. Moon (2009) discussed the impact of FTA on vertical and horizontal FDI and the benefits of combination the free trade agreements. In case of vertical FDI, the countries having FTA, the trades between them increase but outside the region FDI remained unaffected. In case of horizontal FDI, FDI within the countries decreases but increase in the FDI from outside region. Alaxander (2002) fulfilled that for making FDI, the MNC's consider the human capital, the infrastructure of the host country and the steps taken by the government of that country to attract FDI in their country. Privatization schemes are one of the important factors, which in return bring higher level of FDI. Buthe and Milner (2008) take sample of one hundred and twenty two (122) developing countries and create that the countries, which are associate of trade agreements, have a higher segment of FDI. In order to attract more FDI, the country needs to use GATT/WTO and PTA, to produce the environment of FDI. Baier and Jeffrey (2005) discussed in his dissertation that how Free Trade Agreement (FTA) effect the FDI of the member countries and accomplished that the countries having similar FTA's they generally have same type of financial characteristics which results in greater integration of the international firms and higher investments but some time they have to face difficulty because of the regulatory polices between these countries. FTA effect the member countries in different ways because of the polices mentioned in the agreement, the size of the economy and the per capita income of the both countries, which in turn effect the FDI. Easterly (2009) examined the free trade agreement signed between different countries and how FDI effect by these agreements. He accomplished that due to FDI, the development level of the host country raise because FDI brings foreign technology as well as skills in the host countries. FDI inflows more to the development countries and can be enlarged with having high level of human capital, low trade barriers from the government side and having high level of primary education etc.

Mughal and Akram (2011) investigate the effect of market size along with exchange rate and corporate tax on FDI inflow. FDI contribute toward economic growth due to introduction of new technologies. The results of the study showed that market size along with exchange rate and corporate tax helps in attracting FDI in the long run whereas it has no effect on FDI in the short run. Khan (2007) argues that a well-educated workforce seems as an important incentive for FDI location decision. Countries that have developed human capital attract FDI and FDI positively affect growth and productivity in those countries.

Seim (2009) argues that openness is positively associated with FDI inflows. Firms that wish to expand their market might conclude that in the face of a high degree of opened little restriction and low trade costs, the market could be better served through export rather than FDI, as a result high level of openness is associated with low level of FDI. However, horizontal investment can also be made to serve conjoining markets under which condition a great degree of openness would have positive effect on FDI flows. Mallampally and Psauvant (199) said that the developing countries are becoming the source of attraction for investment decision. Most of the multinational corporations are doing FDI in order to manage the activities and control assets of these countries. As FDI facilitate in the economic development, Governments also want to attract it. Multinational firms are not only interested in the FDI polices and facilities provided by the host countries but also interested in the market size, development level, cost reduction, so that they can maintain their competitive edge, so developing countries also need to develop a such kind of structure that effect FDI.

Liu (2006) mentioned in his dissertation that China is the world's largest FDI receiving country in 2003. He examines that how RTA effect the FDI in China and states that countries while investing in Chine will consider all the factors like size of market, growth level, labor force and economic condition. RTA's encouraged the trade between the member countries instead of investment from non-member countries. Jaumotte (2004) also observe that whether FDI in a country is affected by RTA. He take sample of seventy one (71) developing countries from year 1980-1999 and concludes that the countries are having different RTA benefited more than the countries having same RTA. According to him, market size is the main factor for the attraction of FDI. Other factors my include labor force, good financial position of the RTA member countries. Baltagi et al (2007) in his dissertation investigates the role of Europe Agreements signed between the countries which are member of EU and ten (10) Central and Eastern countries. The result shows that for bilateral FDI, Regional trade agreements are critical. He concluded that the large amount of trade between two host countries shows that the consumer's in those markets can be served at lower cost than the other one. Trade polices of RTA, not only effect the trade but also the FDI, not only within the set of parent countries with some set of host countries but also with the other host countries.

1.1 HYPOTHESIS:

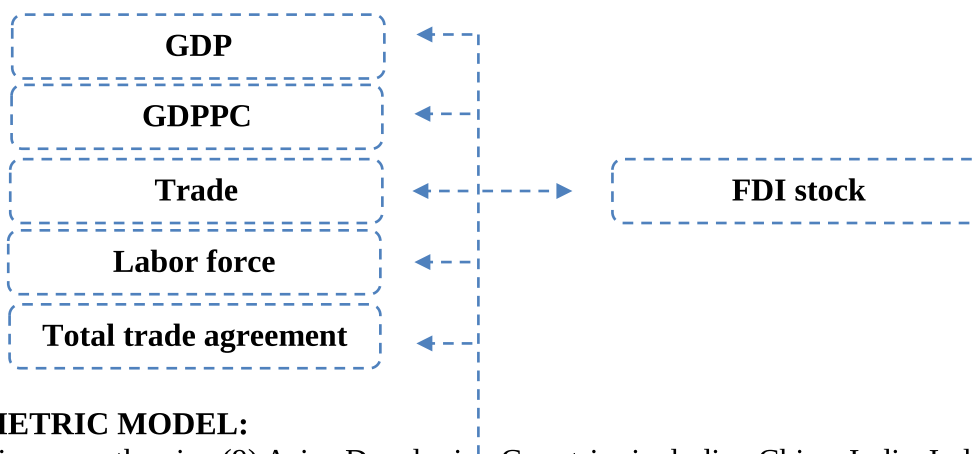
H_1: Trade agreements have impacts on the economic development.

H_0: Trade agreements have no impacts on the economic development.

METHODOLOGY:

The purpose of that knows the impact of trade agreement on the presence of transnational corporations in the Asian Developing Countries. Sample of nine (9) countries including China, India, Indonesia, Pakistan, Malaysia, Srilanka, Philippines, Thailand and Vietnam over the period 1990-2010 has been taken. The dependent variable inward FDI stock has been taken from FDI statistics of United Nations Conference on Trade and Development (UNCTAD). The independent variables GDP, GDPPC, Trade, Labor force are taken from the World Bank and for the trade agreements; WTO-Trade agreement gate way is used to collect data. The number of countries and the data, which are included in analysis, are determined by the availability of data.

THEORETICAL FRAMEWORK:



ECONOMETRIC MODEL:

The analysis covers the nine (9) Asian Developing Countries including China, India, Indonesia, Pakistan, Malaysia, Srilanka, Philippines, Thailand and Vietnam. The dependent variable in this model is inward FDI stock and the data is obtained from the FDI statistics of UNCTAD. FDI stock is chosen as a dependent variable as a substitute of FDI because FDI stock provides a good representation of FDI inflow. This model attempt to clarify the FDI stocks received by the country, our variable of interest in this model is trade agreement. The other variables, which are included in this model to capture the effect of FDI stock, are market size, development level, openness and human capital and the different proxies used for these variables. The model is as follows:

$$LnFDISTKjt = \alpha + \beta1LnGDPjt + \beta2LnGDPPCjt + \beta3LnTradejt + \beta4LnLbfrcjt + \beta5LnTTA + \varepsilon$$

Note that the LnFDIstock is the natural log of FDI stock. Similarly for the market size in Lngdp is the natural log of gross domestic product, for development level Lngdppc is the natural log of gross domestic product per capita, for openness Lntrade is the natural log of trade, for human capital Lnlbrforc is the log of labor force and for trade agreement Lntta is the natural log of total trade agreement. Total trade agreements are the sum of RTA's and PTA's signed between these nine (9) countries.

EXPLANATIONS OF THE VARIABLES INCLUDED IN THE MODEL:

FDI STOCK:

FDI stock is the compute of foreign direct investment. Capital and reserves that initiate in one country and migrate to another for the purpose of investment. The amount of FDI in a country provides a clear depiction of that country development level, health and confidence.

Nations keep notice of the track of their FDI level and also from time to time include this information in their annual report discussing their economic health and projections for the future. Inward FDI stock is the stock that comes from other countries. The countries having good economic condition, FDI may be high, because it provides a signal to the investors that there is an opportunities for the firms to earn higher profit.

Outward FDI stock mean that how much a country is involved in an FDI i.e. how much they invest in other countries. It means that how much a government and a country pay out overseas. Outward FDI stock is a signal that the companies are large sufficient to turn their investment activities away from the national boundaries.

SIZE OF THE HOST MARKET:

Market size and development level of the host market is one of the essential factors for attracting FDI. Many studies show that the sizes of the domestic market positively consequence the inflow of FDI. Market size is measured by GDP and it has been noticed that the FDI inflows is greater in those countries who has large market, high economic growth and greater purchasing power, so by investing in those countries the MNC's receive higher return on their investments and their profits will be higher. Large market size is required for the resourceful utilization of the resources and to take benefit from economies of scale.

DEVELOPMENT LEVEL:

Development level is measured by using alternative GDPPC and it shows a significant association with the foreign direct investment (FDI).

TRADE OPENNESS:

FDI is also effect by the degree of openness of the host country for trade, but the motivational factor of the MNC's also effect he FDI inflow related to the degree of openness. The firm who wants to enlarge their size sometimes argues that the more openness and the slight limit on trade, it is better to do export in those countries rather than go for FDI, so we can say that the high degree of openness results is low level of FDI, but in case of horizontal FDI, openness positively affects FDI inflows. In case of vertical FDI, the MNC's seek to take benefit of natural factor endowment and for them the high degree of openness is good, because low trade barriers and lower cost is added to the total cost of products produced for the purpose of export to the other branches of the firm, so those firms greater openness has a positive impact on investment.

HUMAN CAPITAL:

Many studies demonstrate the important of human capital as an important determinant of carrying out FDI in developing countries. FDI is dejected because of lack of human capital. Educated and skilled labor force not only results in higher level of FDI but also effect the activities performed by the MNC's in those countries. MNC's while opening subsides in the host country not only look for machinery, technology and equipments but also seek the presence of the total employee and the type of training given to them. The type of training given to the employee vary on the industry, mode of entry, type of operation, condition of local market and type of investment. Skilled and educated labor results in the reduction of cost of training.

FDI also effect the tertiary education of host country. MNC’s provides opportunities to the skilled students in the field of engineering, business study and the natural sciences and this helps the graduates to complete their tertiary training and in return government also invest in the education because the MNC’s demand for the skilled labor.

TRADE AGREEMENT:

Trade agreement is one of the best ways to open market for the MNC’s to do FDI in the host country. Trade agreements remove barriers, protect interest and enhance the efficiency of the multinational firms in the host country. Removal of trade barriers and creating more stable trading pattern and investment environment make it easier for the MNC’s to do investment in the host country. The common trade agreements are Regional Trade Agreement (RTA) and the Preferential Trade Agreement (PTA).

REGIONAL TRADE AGREEMENT (RTA):

More than partially of the international trade is being coved by the RTA’s and operate at the side of global multilateral agreements under the WTO. RTA’s are mostly the grouped of countries that are formed with the objectives of reducing barriers to trade between the member countries. These union or grouping may be between countries which are not essentially belongs to the same geographical region. European Union (EU), North American Free Trade Agreement (NAFTA) is the several regional trade agreement signed between the member countries.

PREFERENTIAL TRADE AGREEMENT (PTA):

It is a trade agreement signed between countries that realize tariff for certain product to the countries that signed the agreement. It is form of an economic integration. The countries engaged in PTA’s to raise that level of FDI. A PTA is trading bloc, in which preferential access given to the certain products from the countries participating in trade.

PTA leads to the alternate of high-cost domestic production by the low-cost imports from other members. The countries which are member of PTA’s are requisite to establish a Free Trade Agreement (FTA) which allows free trade among members but each member can have its own trade policy towards non-members e.g., NAFTA creates FTA.

Similarly Custom Union (CU) requires common external trade policies towards non-members e.g. European Union (EU) is a full custom union.

RESULT AND INTERPRETATIONS

CORRELATION MATRIX

Correlations

		FDI	Market size	Trade Open	Dev Level	Human Capital	Trade agree
FDI	Pearson Correlation	1					
	Sig. (2-tailed)						
Market size	Pearson Correlation	.559**	1				
	Sig. (2-tailed)	.000					
Trade Open	Pearson Correlation	.481**	.421**	1			
	Sig. (2-tailed)	.000	.000				
Dev Level	Pearson Correlation	.641**	.610**	.369**	1		
	Sig. (2-tailed)	.000	.000	.000			
Human Capital	Pearson Correlation	.590**	.565**	.366**	.750**	1	
	Sig. (2-tailed)	.000	.000	.000	.000		
Trade agre	Pearson Correlation	.422**	.439**	.467**	.244**	.280**	1
	Sig. (2-tailed)	.000	.000	.000	.001	.000	

**. Correlation is significant at the 0.01 level (2-tailed).

INTERPRETATION OF CORRELATION MATRIX:

The correlation matrix makes it clear that the entire variables have a strong and significant positive association with FDI in flow. The correlation values of market size, trade openness, developmental level, human capital and trade agreements are 0.559, 0.481, 0.641, 0.590 and 0.422 respectively. These values are for above the acceptance region of 0.05 to consider the correlation significant. Thus it is concluded that all the variables included in model are very significant and explain the variation in FDI inflow.

REGRESSION ANALYSIS

R^2 0.734, F=39.235 **Coefficients**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	.131	.395		.332	.740
	Market size	.043	.028	.112	5.546	.000
	Trade	.090	.034	.166	2.652	.009
	Dev Level	.296	.072	.350	4.099	.000
	Lab Force	.147	.075	.159	2.950	.003
	Trade agree	.113	.040	.177	2.838	.005

a. Dependent Variable: FDI

INTERPRETATION:

The regression result above indicates the R^2 value of 0.734 asserting that 73% change in FDI is due to the variables included in model, in other words the model explains 73% variation in the FDI inflow stock, the F value is 39.235 asserting that the model is statistically significant. The P and corresponding T values asserts that all the variables included in model are positively significant in explaining the FDI inflow.

CONCLUSION

From the above analysis it can be concluded that increasing the market size, developmental level, trade openness, and free trade agreements the state can increase the stock of FDI inflow thus the government should relax the trade barriers, in the form of quota, tariff, custom and duty and sign free trade agreement with as many countries as possible to boost its foreign trade.

RECOMMENDATION

On the basis of analysis results it is strongly recommended for the economic development of Pakistan and all emerging countries to boost their respective market size, developmental level, relax the policies regarding tariff, quota, custom duty, and other related trade barriers, increase the level of educated and skillful labor force and reinforce the regional trade agreements and preferential trade agreements.

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