FDI, TRADE OPENNESS AND ECONOMIC GROWTH NEW DYNAMICS IN CASE OF PAKISTAN

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ABSTRACT**:** *In developing countries economic growth is an indicator of higher living standard on one hand while on the other hand it helps the people of poor countries to get rid of from poverty. The foreign direct investment and trade openness contribute greatly in economic growth. In this era of rapid growth, FDI and trade openness are called active component of economic development, transition and integration of developing economies with the world economy. This study is developed to nit a clear empirical framework that explains the behavior of FDI and TOP on GDP. Whereas to check comprehensive impact of FDI and TOP on economic growth, study used time Series data for the years 1994-2014 collected from WDI for Pakistan. The Johnson co integration and ECM models are applied to check the short run and long run relationship of foreign direct investment and Trade Openness on Economic growth. Study reveals that FDI is having long term positively and significantly relationship with GDP growth but TOP has a negative and significant association with GDP growth. Government can play vital role to establish positive relationship of trade openness by introducing policies favorable for substitute of imported products.*

Key Words: FDI, TOP, GDP Johnson Co integration, Error Correction Model

INTRODUCTION:

Foreign Direct Investment

Foreign Direct Investment (FDI) playing very important role not only in nationwide but across the globe as well, irrespective of developed or less developed countries. Here question arises that if it is having significant role on economic growth then how much it effects empirically especially less developed countries like Pakistan? Along with above all information most of the time FDI is considered as blessing for less developed countries as they always running short of capital and if investors get attract towards them then they can establish their industry and welcome new technology as well. By investing in segments and bringing along with other indirect optimisticeffects including transfer of expertise, training, skills, employment by investors, which all contribute to the long term effects in receiver countries. In addition, the outstanding increase in FDI inflows demands the analysis of their relationship is positive and because of this, importance of FDI inflow to one economy cannot be denied. However, shortage of capital in developing countries gives birth to the problem of saving investment gap, which ultimately push the poor economies in trouble. FDI is considered an effective source to bridge the gap and enhance competition and productivity abilities bytransferring advanced technology in the developing countries.Keeping in view the fruits, advantageous policies for foreign investors are advocated in developing countries to attract FDI inflow. Ampleeconomic literature discussed the possible effects of FDI on economic growth but still confused and has no clear verdict. During the last century Pakistan enthusiastically open its door for FDI to remove poverty, unemployment and uplift the living standard of its people but unlike china and India,Pakistan failed to achieve substantial level of inflow of capital. Moreover, the insufficient inflows have been utilized inappropriately and unsuccessful to produce desire results in economic prosperity as M. Shahbaz*et. al*.[1],states that poor nations are described by deficient in capital formation because of the endless loop of low turnover, low wage, and low investment funds. Hence, these circumstances calls for assistance form Western nations to support the resources deficiencies. Then again, outside obligation goes about as a real requirement to capital framing in developing countries. The load of outside obligation demonstrates that rich nations don't help essentially to financecapital deficiencies in poor nations. As a rule, obligation accumulates due to the overhauling necessities and considered as a key itself to keep the economy on the path of development. In perspective of the above, outside obligation turns into component that engendering destitution, work over-abuse, and a requirement for advancement in poor economies. The reason for the paper is to dissect the synchronous impacts of FDI and remote immediate financing on financial development.

Trade Openness:

In economic literature trade openness is considered as another important determinant of growth performance. It reflects the degree of flexibility in trading activities among different economies[2]. In this era developing countries want the growth quick as wing, for this purpose they heavily dependent on international trade. Trade openness introduces export promotion policies to enhanceand upgrade with new technology, which ultimately remove all the flaws from production and services side of less developed nations.Flexible trade policy promotes efficiency and productivity by creating domestic and foreign competition [3]. Trade openness is a gateway for industrial development in poor nations because imports enhance the capacity to explain the culture and trend of your own country to the rest of the part of world in positive manner. Moreover, easy access to international market provide opportunities to the industry of small open economies

G.M. Grossman*et. al*.[4], intheir study they reveal if we focus to import latest technology and new techniques to assemble the products then import can play a vital role to extend of economic growth of the country. The countries who want to accelerate their economic growth, they should import those things which will ultimately increase the production for export.To evaluate true trade openness we should analyses individual participation of import and export on economic growth.

Instability in exports has not any impact on domestic investment, imports of capital goods and economic growth of Pakistan [5]. Imports are important for economic growth as imports plays vital role for industrial role. The casual long run relationship among economic growth, imports and exports of Pakistan. Based on the empirical results, it is suggested that both imports and exports are considered to be an indispensable part for Pakistan's economic growth [6]. The research findings suggest the policy implications that Pakistan should encourage the imports of raw material to enhance the productive capacity and thus economic growth and also embark the trade liberalization policies to accelerate the economic growth.

Significance:

This study is conducted in Pakistan scenario. The variables which are used for the purpose of research are foreign direct investment and trade openness. Above variables are examined to conclude the impact on economic growth. These variables are not used in previous to check the impact on economic growth in Pakistan's scenario. This work is purely for the research purpose. The results are not biased and it can be used for the academic purpose as well as for the policy making.

Literature View

Foreign direct investment:

FDI has been considered as very powerful tool to enhance the growth of GDP of any country, because it always boost the economy without considering the part of their income. Moreover FDI is not only about money it also includes some tangible and intangible goods and services along with latest equipment.

Foreign direct investment always considered always considered as attractive tool to enhance the productivity of host country with the help of some conditions. It also help to improve the quality of export goods with the up gradation of ideas and methodology of production.

If third world countries put some extra effort by exploring their comparative advantage products and by sharing their strategies to improve the quality of products then trade openness can give a relief to the nations.

The fundamental reason of outer obligation in creating districts is to satisfy need sparing financing crevice. Outside obligation influences speculation as well as monetary development [7] . The writing demonstrates that other than satisfying the sparing financing crevice, the outside obligation has antagonistically influenced the development of the numerous creating nations and for few different nations the impact is certain. The essential reason of unfriendly impact is the confinements of the giver offices.

Foreign Direct Investment and Economic Growth:

Foreign Direct Investment is always remain a burning question for the donor and recipient countries in the form of its action and performance. FDI is playing vital role to boost the quality of technology which ultimately increase the growth of GDP. Sometimes FDI helps to import modern equipment which are difficult to import on the behalf of saving only.

FDI is playing a key role to promote new systems in any country, especially to the third world countries because they cannot rely on their savings and capitals. FDI attracts both host country and receiving country because of their favorable concerns. It can be given to any country on the basis of certain term s and conditions so it is mild on effeteness to the receiving country then it is easy to utilize for betterment. In the old-style export sector to increase the capacity of trade and production it creates services that can be used as planned inputs. FDI not only for the favor to import goods and technology but also work to build better human development and capital development as well [8]. Foreign investment claimed that Most of the benefits are transferred to the target countries for foreign investment, much less benefits Multinational Company in the country. A view of the negative effects of FDI on host country's economic development, the level of investment and foreign investment might yield investments, as well as consumption raises the In the host country, because of deterioration or growth at factor cost resource misallocation[4].

V.N. Balasubramanyam*et. al*.[9], create that in creating nations seeking after outward-arranged exchange strategies, FDI streams were connected with speedier development than in those creating nations that sought after internal turned exchange approaches. Different studies wrap just move economies or industrialized nations coating distinctive periods.

In the study by E. Borensztein *et. al*[10]investigates that FDI help monetary development just when a sufficient absorptive limit of the progressed innovation is accessible in speculation getting nation. FDI can work if the host nation has a low human capital stock. 69 Developing nations study come about that remote financing impacts more essentially than household venture. The critical most finding of the paper is that the impact or impact of PDI on Economic development is subject to the level of human capital accessibility in the current nation. FDI is a vehicle for the reception of new advances.

The impact of FDI on economic growth by 58 countries of Africa, Latin America and Asia, where their empirical results show that all type of capital inflow half of the original amount of their domestic investments are depending upon FDI. Whereas FDI is concern globallyit always increase on equal balance to domestic investment and economic growth[11].

in poor nations FDI positively effects on economic growth. FDI may get limited effects on local market but they have attached certain solid externalities[12].

D. Sakyi *et. al*[13]described in their study that if Government of neighbor countries give importance to their policies and make them flexible. Bring stability in their macroeconomicenvironment open new horizons for the relative nearby country. FDI promotes thenew ideas and invention of the technology purpose based, which removes competition in the business sector.

The role of FDI vary from region to region and country to country. It depends upon the conditions that countries do accept to enter FDI in their premises[14].

Trade openness:

Trade openness indicates that countries having no issues regarding import and export their products without any limitation. In trading activities not only import and export are included but borrowing and lending money in the form of foreign direct investment as well.

On the one hand open access trade is beneficial to countries but at the same time they are facing problems and threats to their domestic products as well. Import and Export are considered as tool for the measurement of advanced economies.

Trade openness has introduced new horizons of competition for products in several countries. Now economies are encouraged to analyses the comparative advantages on their products.

Role of trade openness with GDP:

Pakistan`s economy exhibits enormous import dependency like any other developing country due to low level of capital stock and intermediate goods which leads to directly reduction in investment and in turn lower economic growth[15]. The country mainly exports primary goods that are agricultural products and fluctuations in the production and earnings leads to fluctuation in overall output level of economy which also cause swings in imports and balance of payment. The relationship of imports of capital goods, imported intermediate goods and imports of consumer goods to economic growth measured in terms of GDP of PakistanIncrease in the imports of consumer goods leads to decrease the economic growth by reducing the demand of domestic product. In turn domestic consumer goods would be substituting by the imported ones; hence economic growth eventually will fall.

The relationship between trade and productivity is ambiguous up till now, means no study explained their relationship with one opinion some are in the favor of it and few are still against about the positive role of trade openness on economic growth[16]. Africa's economic growth was relatively slow from the mid 1960`s right up until the end of 1970. As a result of structural and institutional bottlenecks, adverse external developments and policies in the early 1980s, Africa's economic situation became progressively worse [17]. Africa's economic growth trend is attached with its trade volumes byremaining world. The GDP rate was slow during the 1960s to the mid-1970s comparison with the global average of 6.1%; this caused the region's export share in the global market to decrease to about 3.1% which is almost half of the original growth rate. But with time, as most African countries began to open up their markets to the rest of the world, the share of trade in GDP has inverted its parentage.

Many economists are in favor of trade openness but some are coming in biased opinion by welcoming attitude of their exports than on importsto smooth their economic growth; as in the case of less developed countries their domestic products suffer if people intend to focus only on imported goods [18]. Likewise the expanding of import because of the likelihood of utilizing the new specialized data by trading enterprise enhanced the effectiveness of these enterprises. As we saw a stun on the fare has had a positive impact on financial development, the other hand a stun on import blunder term has not much impact on monetary development so a stun on import can't has positive impact on financial development. Then again, we watched that fare has immediate & huge connection with financial development in long haul additionally import has noteworthy & converse association with monetary development, so import has negative impact on monetary development in long haul. At the point when in regards to these results, it will be intimated that the trade expands as the nation develops and the import demonstrates a diminishing financial development. At the point when in regards to the information utilized within the study, they show a contrast relatively, it is seen that the builds or diminishes in the import, trade, and GDP dependably happen in the same period. This case shows that the connections between three variables are exceptionally strict

Few decades ago policy makers were in the favor of trade liberalization for the economic growth of their countries.In early 80`s government was itself involved in the agriculture sector of developed and under developed nations. Later on they decided to remove the barriers of tariff to establish the culture of exchanging and selling their products from one country to another [12]. Pakistan also changed and revised their policies to enhance trade with other countries. For short run they adopted tight monetary policy whereas for long term they remove tariff and other barriers for the possibility of trade liberalization.If the countries are working to improve their domestic products then not only they will capture their own market but will attract international market as well. One % increase in world's demand caused the 0.23 % increase in export of cotton lint in Pakistan. Whereas, competitiveness and openness for 1 % increase positively increased cotton export by 0.82 and 0.14 % respectively. Above all information suggest us that if Pakistan put all its focus to improve its policies and products as well then he can get benefits from trade liberalization in positive manners. Pakistan also capture the international market for its products if he open his market for rest of the world with working on policies and proper utilization of all the resources as well. We need proper places to produce goods for export level so we can build our infrastructure accordingly as well. If we reduce the tariff from our imports and exports then we can easily welcome new styles and techniques of production which ultimately help us to capture a bigger market worldwide level.

METHODOLOGY:

In assessing the impact of trade openness and FDI on economic growth, FDI and trade openness used as independent variable and GDP growth is proxy variable for economic growth. While for trade openness imports and exports divided by economic growth used as proxy for measurement for the purpose of the study. Role of export can be measured by the economic growth of any country by contribution of their exports. Need of hour is working on domestic products to improve the quality against the availability of imported goods.Share and role of Imports on economic growth can be measured as the effect of economic growth by imports. Time series data modeling techniques used to analyze the relationship between international trade, and economic growth as well as for the relationship of FDI and economic growth. To study the effect of trade openness and FDI on Economic growth of Pakistan we use 20 years data from WDI. Results are reliable and unbiased and can be used for policy implications as well as for further research work.

Data:

This study intends to explore the impact of foreign direct investment (FDI) and Trade openness(TOP) on economic growth. It used the data for the period 1994-2014 with annual frequency so the data is time series. The data on all above variables is taken from World Development Indicators (WDI) 2014. All the data is taken in log form to check the real impact in long run and short run time period.

Econometric Model:

GDP = f(FDI, TOP)

GDP = Economic Growth

TOP = Trade Openness

FDI = Foreign Direct Investment$\Delta Y = \beta 0 + \beta 1 \Delta X t + b1 \Delta X t-1 - \partial \cup_{t-1} + €t$

Where $\beta 1$ shows short run effect and b1 shows long run effect

$$\Delta GDP = \beta 0 + \beta 1 \Delta FDIt + \beta 2 \Delta TOPt - \partial \cup_{t-1} + €t$$

Where ∂ is error correction term or adjustment effect and βShows multiplier impact that will reveal one unit change in independent variable causes how much change in dependent variable.

Econometric techniques:

Unit Root Test:**ADF**

(Stationary at first difference)

Variables	T-Statistics	P value
FDI	-4.261984	0.0016
TOP	-11.21602	0.0000
GDP	2.201280	0.0000

According to above results TOP is significant at first level where its p-value is less than sig- value which express that it rejects the null hypothesis to prove the stationary of the data.Same as results indicates for FDI and GDP that is significant and stationary at first level.

Results of Unit Root Test leads towards next test which is Johansson Co Integration.

Johansson Cointegration:

Johansson Co integration test has been applied on the variables to check long run relationship among the variables. Following two tables are given unrestricted co integration test with trace and maximum eigenvalues.

Johansson Cointegration Test

Long run relationship

Unrestricted Cointegration Rank Test (Trace)			
Hypothesized No. of CE(s)	Trace Statistic	0.05 C.V	Prob.**
None *	79.10128	29.79707	0.0000
At most 1 *	37.65542	15.49471	0.0000
At most 2 *	10.51571	3.841466	0.0012

Trace test indicates 3 co integrating equation(s) at the 0.05 level

*denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug- Michelis (1999) p-values

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)			
Hypothesized No. of CE(s)	Eigen. Statistic	0.05 C.V	Prob.**
None *	41.44586	21.13161	0.0000
At most 1 *	27.13971	14.26461	0.0003
At most 2 *	10.51571	3.841467	0.0012

Max-Eigen statistics indicates 3 co integrating eqn(s) at the 0.05 level

On the basis of above results it signifies the importance of FDI that policy makers should considers it and also support the study of [19] Foreign Direct Investment (FDI) is generally believed to have positive effect on economic growth.

Moreover I. Drigă[20] stated that in less developed countries FDI considered as playing a key role in the growth of their economies, and many economists argued that those countries are more progressing who are inviting FDI from developed nations as compare to work with only their own capital.

ECM Test:

ECM can be derived from Johansson co integration which integrates the short-run dynamic with the long-run equilibrium

Dependent Variable: D(GDP)			
Variable	Coefficient	t-Statistic	Prob.
C	2.245529	4.157141	0.0002
D(FDI)	1.39E-09	2.535204	0.0155
D(TRADE)	-1.49E-12	-3.406406	0.0067
FDI(-1)	3.66E-10	2.087126	0.0283
TRADE(-1)	-4.13E-13	-2.627468	0.0334
ECM	-.48942	-6.465521	0.0000

R-squared	0.545142
Adjusted R-squared	0.485293
S.E. of regression	2.172227
Sum squared resid	179.3056
Log likelihood	-93.34114
F-statistic	9.108525
Durbin-Watson	1.862457
Prob(F-statistic)	0.000009

According to the results of ECM there is a long run and short run effect of both variables on economic growth. FDI has a long and short run relationship with GDP in positive way. On the other hand trade openness has a negative but significant effect on GDP in long and short run.

Discussion:

According to above given literature there wasclash, that is there a positive or negative effect of trade openness on economic growth. It`s true that there is a vast literature which examined and prove it as a positive and significant factor for economic growth but in case of it declared as a negative andsignificant factor for economic growth. So difference of opinion is still there regarding the desirability of openness. Its impact on economy varies from area to area and location to location. It depend on the social, economic and political development level as well as macroeconomic policies. Less developed countries (LDCs) like Pakistan have gained as well as suffered from trade openness. It`s true that trade openness is the need of the hour and no country can survive without it as isolated state. Like other LDC's Pakistan, for three decades from1950's to 1970's, economy remained heavily regulated and protected. However, due to domestic economic situation and world economy, in 1980's Pakistan started follow to trade openness.

By the end of 1980`s policy makers of Pakistan came up with economic reforms to meet the pace of economic growth of the rest of the world. Today Pakistan's economy is more exposed and abundant than it was two decades ago, But even than it negatively impacts on the economy of Pakistan. Due to openness of trade there is deficit of balance of payments because our imports majority is final and finished goods with greater ratio of luxury goods as well as it consist of machinery. On the other hand our exports are not final goods it may in form of raw or mediating goods so these are not as beneficial as it consider. Due to this difference of trade it creates deficit of balance. So it negatively affects the economic growth of Pakistan. There are also negative aspects of globalization.

In case of FDI, few decades ago investors get attracted to invest their money to Pakistan. They found attraction to invest in less developed countries as compare to developed nations[21]. FDI is always depend on the economic condition of the world if the trend is towards developed nations then less developed countries suffer. But fortunately from few years investors attracted towards less developed countries as there is always manage to establish and flourish on their own requirements. Therefore we found positive and significant role of FDI on economic growth of Pakistan.

CONCLUSION:

This study found the results as FDI consider a source of transferring resources from developed countries to less develop country. As FDI plays positive and significant role on economic growth. FDI only be considered positive and useful if we will be available with trained and educated members who can utilized the resources in productive manners. This positive input will help to enhance economic growth and bring political stability as well.

To get effective results of FDI on economic growth we need to follow stable political situations and macro-economic conditions should favor the complete scenario. Developing countries are sensitive to get effect by FDI instantly so they need to be organized and clearer about their objectives.[22]Foreign direct investment in less developed countries always proved to be fruitful in every manner either full employment or full utilization of natural resources or implication of policies in term of business and balancing the budget and other objectives as well.Countries which are having less capital are experiencing growth rate at less pace. Whereas as on the flip side of research trade openness is dealing in the case of Pakistan playing significant but negative role on economic growth in long run. As Pakistan falls in category of developing nation so whenever they welcome for foreign products they exploits the rights of their domestic producers. But it is recommended that once Pakistan understands the requirements of FDI and start working on fast pace with economic growth then gradually Pakistan can come up with certain policies of Trade openness. There are certain future recommendations for this research in extended form as determination of FDI and Trade openness for the case of Pakistan to implement the policies positively.

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