

Measures should be taken to attract Foreign Direct Investment in such a way that it boosts Exports but trimmed down Trade Deficit

Economic globalization has integrated national economies into the international economy through trade, foreign direct investment, capital flows, migration, and transfer of technology. It has been often asserted that exports and foreign direct investment (FDI), which now account for a significant proportion of newly industrialized economies' GDP and investment, explain the high economic growth rate and the macroeconomic stability achieved by these countries. Globalization has also helped them to manage high productivity through better technologies and modern management skills. The experience of the East Asian economies suggests that FDI was instrumental to the growth of their foreign trade.

Pakistan is a developing country and has inadequate domestic capital to finance its entire investment activities. Pakistan has been promoting the inflow of foreign direct investment (FDI) as well as liberalizing its foreign trade regime. Especially through mid 1980s Pakistan has introduced such policies which attract FDI boosts exports of the country. Figure 1 & Figure 2 show that imports, exports and FDI have increased over time. However, the decline in the FDI in the mid 1990s and mid 2000s is associated with political instability. These figures clearly indicate the complimentarity of foreign trade to FDI that means FDI endorse both the imports as well as the exports.

Qayyum and Mahmood (2013) investigate the inter-linkages between the foreign trade and Foreign Direct Investment (FDI) in case of Pakistan. Annual data for the period 1985-2010 have been considered for eight major trading partners, i.e., Canada, France, Germany, Hong Kong, Japan, Saudi Arabia, UK and USA. Johansen Fisher Panel Cointegration Test and Vector Error Correction Mechanism (VECM) is used to examine whether the FDI and foreign trade are complements or substitutes. The analysis gives evidence in the favour of complimentarity of FDI and foreign trade i.e. FDI promotes the foreign trade of Pakistan with its trading partners.

Figure 1: Imports and Exports

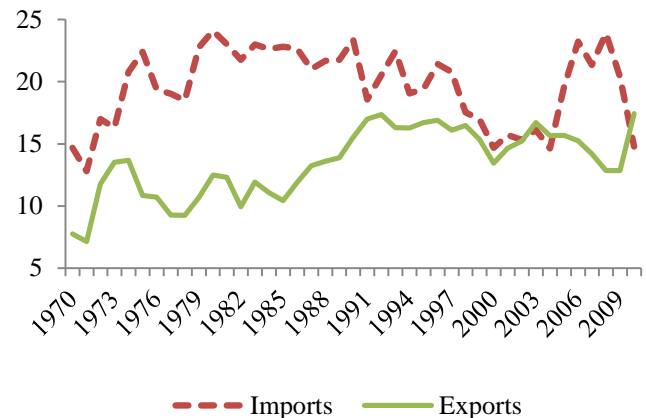
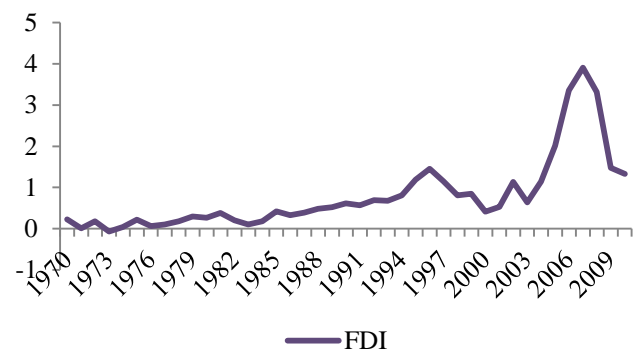


Figure 2: Foreign Direct Investment



Findings of the study suggest that Pakistan needs to take all those measures that encourage the exports but cut down the imports burden. Similarly, measures are also taken to attract FDI but side by side they must take into their kind consideration the impact of FDI on the imports. Pakistan is a developing country and usually suffers from balance of payment deficit so it is recommended that it should direct its policies in such a way that attract the FDI, promote the exports and reduce the level of imports, hence our trade deficit is trimmed down.

Qayyum, U. And Z. Mahmood (2013), "Inter-linkage between Foreign Direct Investment and Foreign Trade in Pakistan: Are they Compliments or Substitute?", *PIDE Working Paper* (Forthcoming)