Global Journal of Management and Business Research: B
Economics and Commerce
Volume 14 Issue 7 Version 1.0 Year 2014
Type: Double Blind Peer Reviewed International Research Journal
Publisher: Global Journals Inc. (USA)
Online ISSN: 2249-4588 & Print ISSN: 0975-5853

Economic Determinants of Domestic Investment: A Case of Pakistan

By Amer Sohail, Umer Rehman & Muhammad Azeem

University of Sargodha, Pakistan

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GJMBR-B Classification: JEL Code: M50, P36

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Economic Determinants of Domestic Investment: A Case of Pakistan

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I. Introduction

Domestic investment is a tool for measuring the level GDP. It is an important component of GDP which is used for future productivity of an economy. It includes both replacement purchases plus net additions to capital assets and investments in inventories. The gross domestic investment includes three types of investments like; non-residential investment, residential investments and change in inventories. In Pakistan, the trend of capital formation through these three means is negligible therefore there is harsh need to investigate what are the basic determinants of gross domestic investments in Pakistan. Recently, the empirical evidence suggests that the fastest growing countries are the biggest FDI-host countries and resultantly the domestic level of investment creep up (Fabry & Zeghni, 2002). The attention has been changed from FDI to domestic investment which is the real leader of economic growth after the financial crisis in Asian countries. Whereas, few researchers have questioned that how did domestic investment increase in some developing countries and did not in others, in particular, what causes domestic investment and what retards it. So, it is an important issue to address for a country like; Pakistan that is characterized by high unemployment, poverty rates, lack of capital formation and demolishing financial markets. Policy makers and scholars are in rush to identify, what are the factors that are important in determining investment process. The study intends to investigate what are the determinants of domestic investment in Pakistan. Because, Pakistan's economy is suffering for lack of indigenous resources, which are relevant for surge in economic progress of a country. The study contributes to the existing literature in the following ways: first, in most of the existing studies FDI has been considered as major predictor of economic growth whereas less emphasis has been given to domestic investments. So, this study bridges this gap by exclusively considering the role of domestic investments in economic growth. Secondly, most of the empirical studies have been carried out on the direct relationship between domestic investment and its determinants in developing countries but remained inconclusive. Because, the scholars have focused on the impact of determinants like; short and long run respectively. However, in this study OLS regression has been used, the technique will not only identify the direction of the relationship but will also measure the magnitude of the relationship. Finally, this research has been conducted following the recent economic reform efforts in Pakistan like; involving the economic liberalization for both domestic and foreign investment, financial developments, leveraged industrial policies and most importantly after the massive social-economic changes in region.

Author α σ ρ: Department of Management Sciences University of Sargodha Gujranwala Campus. e-mail: Azeem_pugc41@yahoo.com

II. Literature Review

In the last 40 years, we were checking the relationship between saving and foreign capital flow. In this research, our aim is to identify the role foreign capital as substitute or complementary. There is the massive debate on empirical and theoretical levels. The dependency ratio also affects the foreign capital inflows and saving rate. This is a very interesting topic and more attractive for study in developing countries (Khan,1992). Having focus on factors that affect savings in Pakistan. In this article, they conclude that bad effect of foreign capital on national saving in Pakistan. In 1970's, declining period was started for Pakistan but saving was increasing in South East Asian countries (Hussein, 1995). The trend of private saving compared with the private saving of south East Asian countries by using co integration techniques probed by different studies Some other factors also influenced the long run evolution of saving like; wealth, public sector debt and so on (Khan,H, 1997). The attitude of developing countries toward foreign direct investment has emerged, but the sentiment is weaker for Pakistan. Policies are very weak in Pakistan for inflow of foreign direct investment. Private investment playing a crucial role in many developing countries especially in Pakistan. As, Khan & Khan, (2001) analyzed the determinants of private investment with the help of ARDL technique. They probed the relationship between long and short run investment that exist in Pakistan's environment. Foreign capital inflows are substitute or complementary the researchers have proved that. In Pakistan the impact of FDI have long run impact on investments (Ahmed & Ahmed, 2002) . The contribution of domestic investment to the economy has been debated extensively over the years. These debates help out of developed and under developed economies. So, the most relevant material is put in this research of domestic investment which are reducing the spread of poverty in our economy.

III. Methodology

The data has been derives from SBP and business recorder of Pakistan for the period of 1973-2010. The regression and correlation techniques have been applied to conclude the results. In this line of research, in most of the studies a subset of the following variables (among others) as the exogenous variables in the domestic investment equation: FDI, exports and money supply.

$$GDI = 0+ 1\ G\ r + 2\ FDI + 3\ FI+4\ H+5\ Cr + e\ldots\ldots\ldots\ldots\ldots\ldots 1$$

Where: GDI, Denotes domestic investment (net of FDI)

Denotes the growth rate of real GDP,

FDI, Denotes foreign direct investment as a ratio of GDP,

X, Denotes the exports of goods and services as a ratio of GDP,

FI, Denotes financial intermediation as calculated by M2 as a ratio of GDP,

Table No : 01 Details of Variables

Variable	Description of the Data	Source
Gr	Growth rate of real GDP	
FDI	Foreign Direct Investment as a ratio of GDP	SBP
GDI	Gross Domestic Investment as a ratio of GDP	SBP
FI	Financial intermediation proxied by M2 /GDP	SBP
X	Export of goods and services as a ratio of GDP	SBP

The details of the variables have given in table no 01 along with proxies and sources of date from where the date set has been extracted.

IV. Results

In this section the results of the study have been presented in different tables. It is a co-relational study; in order to go for regression analysis the properties of data should be examined. The descriptive statistics have been presented in table no 02 which show that most of the variables have normal standard deviations which indicate that there is less variation in time series of data. The coefficients of skewness and kurtosis also indicate that all the time series are normal and appropriate for regression analysis.

Table No : 02 Descriptive Statistics

	Export as a %age of GDP	FDI as a %age of GDP	GDI as a %age of GDP	GDS as a %age of GDP	Imports as a %age of GDP	M2 as a %age of GDP
Mean	0.539421	0.021439	18.19572	11.11167	0.896660	0.419954
Median	0.550478	0.019499	18.31845	10.54257	0.755789	0.406806
Maximum	1.191845	0.059260	22.52262	18.10428	2.024221	0.508111
Minimum	0.131507	-0.007151	12.81189	3.998153	0.234898	0.297474
Std. Dev	0.303847	0.013568	1.980600	4.374095	0.589840	0.053139
Skewness	0.454862	0.923387	-0.326181	0.029857	0.501691	-0.191701
Kurtosis	2.223062	4.361356	4.376912	1.675265	1.847894	2.262416

The properties of data further analyzed by using pair-wise correlation analysis, its results have been shown in table no 02. The coefficients of correlation between predictors clearly indicate that there is not any serious problem of multi-coliniarity and auto-correlation inresponse variables. However, few variables have shown the concerns for multi-coloniarity and auto correlations like; exports to GDP, imports to GDP and M2. Moreover, this much of correlation between the above said variables can be justified because these are the macro economic variables which have collective movements in response to external shocks. Overall, the data is appropriate for regression analysis.

Table No : 03 Correlation Analyses

	FDI as %GDP	Exports as %GDP	GDS as %GDP	Imports as % GDP	M2 as %GDP
FDI as %GDP	1				
Exports as %GDP	0.4873	1			
GDS as % GDP	0.2704	0.4308	1		
Imports as %GDP	0.3713	0.4053	0.4661	1	
M2 as %GDP	0.4340	0.6621	0.3235	0.5285	1

In order to investigate the relationship between the variables, regression analysis has been applied, and its results are reported in table no 04. Balance of trade, money supply and gross domestic savings are the important determinants of domestic investments. The results of the study indicate that there are the positive and significant relationships between gross domestic investments with respect to foreign direct investment, gross domestic savings and money supply in country. It has been probed that as the foreign funds will move in, the level of domestic investments will also creep up. There are the two approaches to address this phenomena, the formal one narrates that as the MNC'S (Multi-national Corporations) will flourish in country the auxiliary industries will also charge in with the local funding. However, the later one suggests that the confidence of local investor boot up as he finds the international investors in country.

Table No : 04 Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FDI	99.00018	17.51985	5.650743	0.0000
EX	4.325702	1.561064	2.770996	0.0092
GDS	0.136654	0.089891	1.520229	0.0383
IMP	-3.436955	1.042692	-3.296233	0.0024
M2	6.859344	5.835457	1.175460	0.0485
C	10.92578	2.559829	4.268167	o0.0002
R-squared	0.735496	Mean dependent var		18.19572
Adjusted R-squared	0.694167	S.D. dependent var		1.980600

Moreover, exports have positive relationship with domestic investments, which implies that, the expansion in exports followed by increase in domestic production. The returns of exports are more than sale within country. So, the domestic producer become active as he finds international demands for product in order cope rich returns. Additionally, the negative relationship with imports revels that massive inputs from off border may curtail domestic production and may losses the confidence of local producers.

V. Conclusion

The study intends to investigate the determinants of gross domestic savings in Pakistan from the period of 1973-2010. All the annual time series of data have been extracted from the valid sources of data like; *business recorder and state bank of Pakistan*. In order to assess their behavior over time, and to evaluate how these variables have either hindered or encouraged the growth of investment in Pakistan's economy. Domestic investment in Pakistan is stimulated by real GDP growth as well as expansion of exports of goods and services, domestic savings and foreign direct investments. Moreover, the flow of FDI to Pakistan is "crowd in" domestic investment but with the more magnitudes than GDP growth and exports expansion. The development of financial sector and human capital is vital for economic escalation in country. However, the stimulation in formal credit and formation of industrial capital may lead towards promulgation in domestic investments. The Pakistan's economic environment demands massive level of domestic investments. As for as the concern of economic determinants, the study has tried to cover all most all aspects of economic determinants, but the local environment demands to probe some other cultural aspects. In Pakistan, our social values are quite different from the developed part of the world which drives the spending and saving balance of any individual and entity. Consequently, further studies should try to include some socio-graphic values as determinants of gross domestic savings along with economic determinants in studies.

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