This study intends to show the impact of locational economic determinants on Foreign Direct Investment in short run and long run. FDI is one of the most important sources of capital inflow used by the developing economies to fulfill their economic needs. Pakistan, as a developing country, is also a large recipient of FDI, but unfortunately the inflow of FDI in Pakistan is small and concentrated only in a few areas.

In this study, we examine the short run and long run relationship between FDI, real GDP, exchange rate, inflation rate, infrastructure facilities and the democracy by using Autoregressive Distributed Lag Model (ARDL) for period 1971 to 2010. We also examined the causality between FDI and real GDP.

The findings suggest that gross domestic product, infrastructure facilities and democracy has positive and significant relationship with FDI in long run as well as in short run, while exchange rate and inflation rate has no effect on foreign direct investment in long run. Although, FDI is growing in Pakistan but this inflow is not enough. It is not very encouraging as compared to other economies of this region. Therefore, government policy makers should try to make a friendly business environment so that investors feel easy with legal and financial framework of the country. The policy makers must made efforts to control the volatility in exchange rate and inflation through effective monitory policy measures.