COMPOSITE IMPACT OF FOREIGN DIRECT INVESTMENT AND POLITICAL STABILITY ON ECONOMIC GROWTH OF PAKISTAN

By

Hiba Imtiaz

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ISLAMABAD

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Submitted By: Hiba Imtiaz **Registration #:** MS-ECO-AF-16-ID-OO3

Master of Philosophy
Degree Name

Economics
Name of Discipline

Dr. Sabahat Subhan Name of Research Supervisor	Signature of Supervisor
Miss Zakia Batool Name of Co Supervisor	Signature of Co-Supervisor
Prof. Dr.Syed Bashir Hussain Head of Department	Signature of Head of Department
Prof.Dr.Naveed Akhtar Name of Dean (FMS)	Signature of Dean (FMS)
Brig. Muhammad Ibrahim Name of Director General	Signature of Director General

Date

CANDIDATE DECLARATION FORM

I Hiba Imtiaz

Daughter of Sardar Imtiaz Adalat

Registration No**:** MS-ECO-AF-16-ID-003

Discipline: Economics

Candidate of **Master of Philosophy** at the National University of Modern Languages do hereby declare that the thesis **Composite Impact of Foreign Direct Investment and Political Stability on Economic Growth of Pakistan** by me in the partial fulfillment of M.Phil. Economics degree, is my original work, and has not been submitted or published earlier. I also solemnly declare that I shall not, in future, be submitted by me for obtaining any other degree by this or any other university or institution.

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ABSTRACT

Composite Impact of Foreign Direct Investment and Political Stability on Economic Growth of Pakistan

The main objective of the study is to find the composite impact of foreign direct investment and Political stability on economic growth of Pakistan and secondly to investigate the impact of Foreign direct investment and political stability on the economic growth of Pakistan separately. Foreign direct investment has major and positive impact on growth, but this impact will be greater if there is political stability in the economy because in a developing country like Pakistan political stability plays a principal role in determination of economic growth and sources of capital accumulation. Therefore, the study draws the attention of policymakers towards the composite impact that emphasizes on FDI and political stability to increase the economic growth of Pakistan. The composite impact of FDI and political stability on economic growth is examined for the period of 1980 to2016 using ARDL (Auto Regressive Distributed Lag). Three models have been developed for three different reasons. First model is developed to check the impact of FDI on economic growth, second model is to check the impact of political stability on economic growth and the last model is developed to check the composite impact of FDI and political stability on economic growth. To find the presence of long run relationship among variables, the bound testing approach is applied while ECM (Error Correction Model) is used to find out the short-run relationship among variables. The results of long-run relationship indicate that foreign direct investment has a positive but insignificant relationship with economic growth, while political stability has significant and positive relationship with economic growth, and interactive term has also shown positive and significant relationship with economic growth. In the short run, 12 percent disequilibrium is being corrected annually. The findings recommend that the government should need to strengthen political system and institutions, improve the law and order situation in the country in this way FDI will flourish and there will be imperative impact on economic growth of a country.

Key Words: Interactive Term, Foreign Direct Investment, Political Stability.

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ABBREVIATIONS

ADF	Augmented Dickey-Fuller
ARDL	Auto Regressive Distributive Lag
ECM	Error Correction Model
ECT	Error Correction Term
FDI	Foreign Direct Investment
PS	Political Stability
TO	Trade Openness
GFCF	Gross Fixed Capital Formation
WDI	World Development Indicator

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Chapter 1

INTRODUCTION

Economic growth of any country usually implies amplification in gross domestic product. In order to have a fast-economic growth the economy requires an effective utilization of resources e.g. natural resources, human resources and labor etc. Firms tend to employ more workers creating more job opportunities, with advanced output techniques and assertive economic growth and this will lead to reduction in poverty. Government will be able to spend more on public services like hospitals, education due to boost up in government income. A better economic growth rate is an indicator of business activities occurring in the economy. Business confidences also enhance in small firms and they grow themselves to meet new challenges.

Pakistan is a South Asian country of 180 million individuals with deficiencies of capital resources that hampers its economic growth rate**.** Thus, Pakistan needs more finance for investment to enhance economic growth. At the same time, for the economy of Pakistan to become economically developed, political stability is important. Political Stability is the initial phase in completing anything in any country (Khan, A. (1999). Most of the existing industries in Pakistan produce raw material products and export raw material goods to foreign countries and import heavy machineries and technologies. (Asghari, M., Hilmi, N, &Safa, A. (2014). In this way Pakistan face deficit balance of payment and current account. Industrial part is enduring a lot because of deficiency of energy resources and low level of capital formation; thus, production activities diminish day by day. In this critical situation, to boost up the economic resilience and formulate the strategy of FDI to increase, Pakistan requires FDI.

Researchers and policy makers have been making attempts to find the ways to come up with a solution to overcome the problem of low economic growth. FDI has a prime role to play in the economic sustainability of any country. Foreign direct investment helps to increase the rate of assets information and enlarge high tech supply in the economy of any country. To attain some amount of economic strength developing as well as underdeveloped countries is contingent on developed countries economically for financial support. FDI has possessed the capacity to improve infrastructure assets circumstance of a country and it offers enough roam of technological growth to the country as well. FDI can also be compliant in supporting the host countries to set up mass instructive plans for deprived segment of the society. This sort of help is frequently offered by the non-administrative associations as allowances. Due to the technological development brought by FDI living standard of the common people of the host country could be progressed. The health sector of a recipient country has also been assisted by the foreign direct capital. Thus, it may be said that FDI take an important part in economic and public enlargement of a country. There is positive relationship between economic growth and foreign direct investment. There has been also shown a negative impact on the growth of economy by FDI because there are some studies which claim that pre-requites are missing in the host economy through which FDI shows an adverse impact on economic growth. The literature suggests that the host country should fulfill certain prerequisites and conditions e.g. financial development, macroeconomic situation, political stability, better law and order situation, skilled labor force and supportive infrastructure for FDI to be positively related with the economic growth (Fatima, Hassan,& Tabassum (2013).According to Asiedu (2006), macroeconomic situation, political instability, and corruption are hurdles in investment and have negative impact on FDI. Hence, for FDI to have significant and positive impact on economic growth, Pakistan must focus on political stability, law and order, macroeconomic stability, and crime

It has been examined that FDI drops off day by day in Pakistan, due to bad planning and government policies (Asghari, M., Hilmi, N., &Safa, A. (2014). Political instability, law lessness and the low rate of GDP are the important causes of low FDI. The deterioration security issue has afraid away investors. In a worsening law and order situation FDI cannot be encouraged. The circumstance won't improve until the point when the administration fixes the security and vitality emergencies. It's difficult to pull in speculation except if and until the point when investors are given productive enticements for inclining toward Pakistan over different countries, so chief reason of low foreign direct investment is political instability (Bengoa, M., & Sanchez-Robles, B. (2003).

Political stability is a specific condition in which a country is running so essentially with any political defeat or any instability. Country has a control to appreciate the joint advantages and rewards in a country. Political stability possibly offers us an existence of peace and flourishing, a home, training, substantial family get-togethers, games and recreation. It is intended to shield us from kill, burglary, war, starvation, and gives a more effective distribution of assets; it improves our lives fundamentally. Economic growth and political stability are greatly interrelated. The relationship among growth of economy and stability refers to the manner in which the political stability of a state can heads to its growth of economy. The most observable relationship among growth of economy and stability is the fact that a consistent environment encouraged an economic activity in the economy. Political stability has direct impact on the procedure of economic development and the advance level of a state (Rani, K., and Batool, Z. (2016). As indicated by financial specialists, political variance is unsafe for economic extension of any country. Pakistan is additionally confronting the trouble of political weakness, since political flimsiness prompts a diminish in resource and speed of economic development process and because of political stability, ambiguity arrives in an economy accordingly resource diminishes and economic growth is likewise impacted. As a result of reduction in investment, the level of production similarly diminishes. The powerless political society, instability of government and negligence of political gatherings make the circumstance for a politically instable state. For economic growth of any country political stability is required. Political instability has negative result on the procedure of economic growth. (Zureiqat, H. M. (2005). Political instability is s defined as the propensity of government collapse. Countries with high government collapse, as a result growth is significantly very low. (Alesina, Alberto. (1996). It is common knowledge that political instability retards the development and progress of a country. Political and economic stability can facilitate an influx of FDI in developing countries. Political stability offers high political right, more democracy, low corruption of government in this scenario foreign investors feel safe to invest in political stable country (kim Haksoon (2010).

If a country is politically and socially stable, will attract foreign investors to do high level of investment**.** Foreign direct investment has the prospective for job creation and service**,** which is often followed by higher wages. Resources will be transferred in terms of capital and technical knowledge**.** (Stiglitz, J. E. (2000) also reveals that political risk and business operating situations have been important factor of FDI for countries. Countries with relatively low foreign direct investment, a key determinative were the degree of political unsteadiness. So, country will economically develop with the help of political stability and FDI. To come out from the vicious cycle of poverty and a country must be politically stable to attract foreign direct investment.

Now a days Pakistan is facing a lot of difficulty concerning investment, as speculation conditions are exceedingly changed, as a result of political shakiness, energy circumstance, poor lawfulness condition and high interest rates. Savers experience doubtful to invest in Pakistan. Many countries are confronting the financial economic pandemonium due to the ineffective economic policies, bad economic surroundings and the violence which leads to the decline in the economic growth. The investors observe only the future economic conditions, risk and uncertainty for the investment purpose. Many developing countries have taken some administration policies into the considerations with look upon to terrorism, rigid laws and bad economic policies to conquer these issues (Khan, N. U., & Ullah, M. A. (2015).

There are various studies which has given details about impact of FDI and political stability on the growth of economy separately. They have given either positive or negative effects on the host economy like Shahid and Sarfraz. *et al* (2013) explained the part of foreign direct investment and remittances in the economic development of Pakistan. They explained that FDI and remittances play an important role in the growth of any country. They bring latest technology, improving better infrastructure and generating employment opportunities. Aisen and Francisco *et al*., (2011) explained the political stability affect economic growth. Political instability adversely affects growth and hence there will be low physical and capital accumulation. Rani and Zakia *et al.,* (2016) elucidated the impact of political instability and foreign direct investment on economic development in Pakistan. There is a lot of work done in the literature on composite impact, but they have analyzed different variables together like Neelum Nigar (2010) described the institutional quality and inequality of composite impact on growth of economy.

The present examination is led to ensure the composite effect of FDI and political strength on growth of economy of Pakistan. The study has unique intention to bring active and well-organized policy for future. Political stability and foreign direct investment have one to one relationship with economic growth separately. We develop interactive term of Foreign direct investment and political stability with inspiration to check that how political stability effects the effectiveness of foreign direct investment in promoting economic growth.

1.1 Significance and Rationale of Study

This investigation will be useful to watch the composite effect of Foreign direct investment and political soundness on the economic growth in Pakistan. Literature exists regarding FDI and political stability impact on economic growth separately but it has been tried to search out the composite impact on economic expansion. Composite means to confirm the combine impact of FDI and political stability on growth of economy. It means if we have political stability, it will attract foreign investors to invest in host country, in this atmosphere assets formation and technology will increase. Economic growth will flourish speedily and it will be double. For example, if there is no political stability in a country, we suppose economic growth is about 2 percent. After a few years a country is going so easily with no political tumble down or any instability. It has a control to appreciate the joint advantages and favorable circumstances in a condition as it draws more foreign merchandises in the country. In this scenario economic growth will be double.

In this way we will come to know that political stability is obligatory element for any country. Foreign direct investment is secondary element; it has direct relation with economic growth. A country is politically and socially stable, will attract foreign investors to do high level of investment. FDI has no benefit in host country if the country is political unstable.

1.2 Statement of the Problem

Economic growth is very important for any country. A country cannot achieve economic growth without political stability. Political stability attracts FDI in the host country. Any structure of foreign direct investment forces in a lot of assets information and technological supply into the economy of a country. This study will check that how much change will occur in economic growth of a country, if there is political stability and also foreign direct investment at the same time

1.3 Delimitations of Study

Our study has following delimitations:

To verify the composite impact of FDI and political stability on economic growth.

- A time series data series is used for the analysis.
- Empirical data is collected for the period 1980-2016.
- Data is collected from World development indicator, Polity IV.
- This restricts to the study following variables i.e. Gross domestic product, Foreign direct investment, Political stability, Interaction term (FDI*POL) and Control variables (trade openness, gross fixed capital formation and labor force).

1.4 Objectives of the Study

The major ideas of this research are as follows:

- To verify the impact of Foreign direct investment and political stability on economic growth of Pakistan.
- To analyze the composite impact of Foreign direct investment and political stability on economic growth of Pakistan.
- To recommend the policies according to findings of study.

1.5 Research questions

This study addresses the following research question:

What will be the composite impact of FDI and political stability on economic growth of Pakistan?

1.6 Organization of the study

The research is arranged in different aspects to draw out the composite impact of FDI and political stability on economic growth. Chapter1 introduction consists of the significance of study, problem statement, delimitations of the study, objectives, and research questions concerning about the research. In the next chapter comprises of many previous studies on foreign direct investment, political stability and labor force are explored. In part 3 comprises of the description of data, methodology, definitions of dependent and independent variables. Composite impact of FDI and political stability on economic growth is investigated by use of some econometric techniques. In section 5, results of estimation techniques are demonstrated and explained. The last section consists of final statements, comments and the policy implications of this research. In the last, there are some references.

Chapter 2

REVIEW OF LITERATURE

There is vast literature available highlighting the importance of FDI and political stability to boost up the economic growth. This chapter reviews research articles related to analyze the impact of FDI, political instability labor force and trade openness on economic growth. The different results may be due to the different economic structures of the specific countries studied. There isn't as much work accomplished recognized with composite impact of FDI and political stability on growth of economy of Pakistan. In this study literatures related to labor force, political stability and foreign direct investment are conferred.

Foreign direct investment may permit a country to take in technologies and information that are not willingly accessible to home investors, and in this way boost up output throughout the economy. Foreign direct investment may also take in knowledge that the country does not have, and foreign investors may have better way to international markets. Laura Alfaro (2003) explained the growth and foreign direct investment. Does the sector of the state have any concern with it? He described advantages of FDI across the sectors. The consequence of FDI on growth has diverse across manufacturing, primary and services sectors. He employed an empirical analysis for the period 1981-1999 by using cross-country data. He accomplished that foreign direct investments have a negative effect on growth in the primary sector, whereas a constructive one in manufacturing sector, while the service sector is not obvious.

Shahid and Sarfraz. *et al* (2013) clarified the part of foreign direct investment and remittances on the economic growth of Pakistan. They explained that FDI and remittances play an important role in the growth of any country. They bring latest technology, improving better infrastructure and generating employment opportunities. They have used Engle Granger Co integration method. Empirical outcome indicates that there is constructive effect of remittances on growth of economy in the long run, whereas FDI has negative effect on growth on the grounds that there is absence of pre-necessities in Pakistan. Foreign direct investment could additionally increment monetary growth in the country, if there is proper policy environment, macroeconomic stability, and good law and order conditions.

Asghari and Hilmi *et al*., (2014) explained the impact of FDI on growth of economy: the role of natural resource and environmental policy. They observe whether natural resources and environmental policy in host countries modify the relationship between FDI and host country economic growth. They have used linear dynamic panel-data model employing data from the period 1980–2012.The consequences demonstrate that the effect of arable land, forest area and the interaction among foreign direct investment and environmental policy on growth of economy is negative, but renewable internal freshwater resources flows, mineral depletion and energy exploit have a positive effect.

Bola (2008**)** described FDI role in promoting economic growth. Economic growth will occur due to FDI through the accumulation of capital facilitate new sources of information and advances in the work. FDI positive impact in economy is obtained only if the absorption capacity is improved. Theoretic model of this study supports the investments-growth models. Growth promotion factors consist of savings and investments (classical models), technical progress (neo classical models), respectively R&D, human capital, capital accumulation, externalities. The study emphasized on developing countries or Asiatic countries show that economic growth will enhance as FDI transfer technology.

Javaid Attari and Kamal *et al*., (2008) represented the productive connection among FDI and growth of economy in Pakistan economy. They have investigated the impact of FDI on the exports, imports and the GDP of Pakistan. They have used time series data from 1981 to 2009 and utilizing diverse econometric tests like Augmented Dickey Fuller Unit Root Test, Johansen Co integration Test, Vector Error Correction Model and Granger Causality Test. They have found that there is long run relationship between macroeconomic variables. They have finalized that Granger causality test indicate that in case of Pakistan FDI does not induce GDP. The GDP of Pakistan is still not at solid stage to assume its imperative part in impacting the remote financial specialists. They exhortation that the legislature ought to start new strategies of FDI to appeal the foreign financial specialists and extend the solid fiscal related and monetary arrangements.

Adeel Ahmed Dar (2011) has illustrated a sector wise multivariate co integration analysis related to the FDI and economic growth in Pakistan He has exploited Vector Error Correction Model and panel co integration methodology. He has focused on the sector-specific FDI and GDP by utilizing primary, secondary and tertiary sectors. He has found that there is positive role between FDI and GDP in long run in panel approach but there was miserable relationship was found in sector wise.

Markusen and Venables (1999) inspect the impact of foreign firms on the improvement of local firms in the industrial division. In their model, foreign organizations battle with local makers while making extra require for privately created middle of the road products through linkages with nearby providers. This can demonstrate the best approach to household firms going into the middle of the road products area, which can result in lesser costs that, reflected in lower last costs that add to request, can profit residential firms delivering final merchandise.

Choong and Lim *et al.,* (2009**)** demonstrated the case of Malaysia related to FDI, economic growth. They have examined that cooperation between foreign direct investment (FDI) and economic advancement in advancing Malaysia's economic growth. They have computed a dynamic endogenous development work that contains the effect of economic segment advancement, foreign direct investment and also a couple of locational determinants and used co-coordination structure. The outcome reveal that foreign direct investment, labor, investment, and government expenditure play an essential role in local economic prosperity and it is also established that the interaction among FDI and economic growth exhibits a considerable effect on the growth performance of Malaysia.

Waqas Javad (2016) remarked impact of FDI on economic growth of Pakistan. He has used Autoregressive Distributed Lag-Error Correction Model (ARDL-ECM) strategy to decide long run impacts and short run impacts in the meantime. In long haul and in addition in here and now the foreign direct investment has a vital constructive effect on the growth of economy of Pakistan. The ECM coefficient proposes a convergence to the path of equilibrium. Over the long-time inflation and the populace likewise exhibit essential consequences for the GDP. The trade and GCF have no vital part to clarify the difference in the growth of economy of Pakistan.

Balasubrammanyam (1999) verbalize that FDI is a blend of growth, stock of capital and realizing which may basically build the present heap of economy through practice of organization, capacity change, organizational arrangement and planning. The two investigations found that FDI positively affects the economic growth of developing countries.

R, S Zejan, M. BlomstromM.lipsey (1996) established that foreign direct investment has an essential and helpful effect on the economic system of developing countries by utilizing a board estimation strategy. Foreign direct investment licenses the making countries to manufacture exchange with various countries, so its regular effect is certain on the economy.

Nigel Deified and Chris Jones (2013) examined identified with developing countries commitments of foreign direct investment an ODA to the economic growth. They have used a strategy to confirm the endogeneities. Characteristics. They likewise investigated the ramifications of basics, not only the growth and the connection among establishments and diverse underlying basics of the growth They built up that the by and large capital of foreign has a useful and real effect on the growth, when the establishments are caught into account. Mohamed Amine and ManelleLahdhiri (2012) recognized that foreign direct investment and ODA have valuable and most imperative impacts on the economic matter's growth of the developing countries by employing panel information method.

Levine and Carkovic (2002) confirmed that FDI adversely influences the advancement of the developing countries by employing cross country data. They have connected summed-up plan framework for estimations. Their consequences were not expected with the speculation, that foreign direct investment influences the economies of the developing countries with emphatically

Elizabeth Versey (2012) described economic growth of economy and FDI. She has examined the connection among FDI and economic growth in the case of Soloman Island. The purpose of her study is to explore the involvement of foreign direct investment to economic growth and secondly the main determinants of FDI. She has utilized time series data from 1970 to 2010. She has concluded that domestic investment, trade openness and labor are important factors of economic growth in Solomon Island by FDI growth nexus whereas economic growth, exports, and infrastructure are all significant determinants of FDI.

Borensztein et al. (1998) explored the impact of foreign direct investment on economic growth in a deterioration structure of cross-country. They applied data on FDI streams from developed countries to 69 less creating countries for the two decades, the 1980s. Their revelations suggest that "FDI is a basic vehicle for the trading of advancement, contributing for the most part more to improvement than family unit business enterprise". Lipsey, Zejan and Blomström, (1994) identified that, between developing countries proportions of foreign direct investment inflow to economic growth were emphatically recognized with growth in the consequential five-year term. They depict that the helpful impact of FDI on improvement is bigger in those states that demonstrate bigger measures of per capita wage. Borensztein, De Gregorio, and Lee (1995) found that FDI inflows scarcely inclined improvement for a case of 69 developing countries. Balasubrammanyam, Salisu and Sapsford (1996) used a cross country technique to observe 46 LDCs, in 1970-85. Their outcome supports that FDI improves advancement in those cases in which the host country has acknowledged trade progression systems. Zhang (2001) records proportionate outcome. De Mello (1999) for the period 1970-

90, acknowledged time arrangement and Panel information examination on occurrence of OECD and non-OECD states He ensured that FDI emphatically influences advancement at whatever point FDI and private hypothesis are supplements. Roy and Van give in Berg (2006) utilize a time series data to a synchronous state show (SEM) that expressly gets the bi-directional association among foreign direct investment and advancement in the united states. Their revelations uncover that FDI plays 12 a huge, productive and monetarily basic impact on advancement. The SEM assesses moreover uncover that foreign direct investment improvement is pay inelastic. Their revelations demonstrate that even because of a propelled state, for instance, the U.S grabs from FDI are enormously essential as time goes on.

Chakraborty and Base (2002), investigating the relevant examination of India from 1974 to 1996 moreover found that FDI had a helpful and critical impact on advancement, both in the long and short run. Zhang (2001) investigating East-Asia and Latin America from the 1960s to 1997 uncovered blended evidence on the impact of FDI on advancement finally. While FDI was seen to be improvement enhancing as time goes on in Hong Kong, Taiwan, Mexico, Indonesia and Malaysia this was not the condition in Brazil, Korea, Columbia, Argentina Malaysia, Thailand and Singapore yet in Singapore foreign direct investment has a productive effect of advancement.

Bhissum Nowbutsing (2002) represented the growth of economy, domestic investment and foreign direct investment and also a theoretical framework. She has concentrated on the effects of exterior capital growth ‟ household scheme and development growth. The straight forward choice of the 2-player diversion show is that FDI initiates higher budgetary execution if and just if combination holds. On the other hand, if disjunction applies then fiscal improvement is constantly and wherever generally decreased. Accordingly, unmodified combination outcomes to the essential best conditions, a mix of combination and disjunction prompts the second-best circumstances, and unadulterated disjunction uncovers the third-best conditions. Along these lines, for a country which underlines on FDI remembering the true objective to serve its nearby improvement plan, it is essential to make certain that foreign direct investment does not swarm out family unit firms or neighborhood hypothesis.

Mahembe and Odhiambo (2014) illustrated the FDI and economic growth associated to a theoretical frame work. The connection amongst FDI and economic growth has pulled in impressive consideration over the long time. They have investigated the hypothetical writing on the connection amongst growth of economy and foreign direct investment in an adapted manner. It has discovered that FDI is an essential supporter of the growth of economy of the host country. FDI impacts economic growth by two wide forms (I) foreign direct investment can permit the selection of new advances in the creation method through innovative overflows; and (ii) FDI may excite information exchanges, together as far as work arranging and skill obtaining, and furthermore by presenting elective administration hones and better hierarchical plans.

Moosa (2002), who examined the host country's capacity to receive the rewards of the ventures, He contends that the effect on growth is profoundly reliant on the full-scale financial arrangement working in the country of intrigue. He finds that FDI can have a positive effect on growth, if surplus assets can be assimilated or proficiency expanded through reallocations. That implies that if FDI prevails with regards to enhancing the effectiveness of residential assets, by reallocating them from parts with low efficiency to areas that are exceptionally effective, at that point there will be an expansion in local yield. To a vast degree, FDI can likewise enhance proficiency of local firms through information overflows. These learning overflows start from the human capital that is being exchanged through FDI.

Hashmi and Akram*et al.*, (2007) commented the part of investment in the course of economic growth related to developing country like Pakistan. Their focal point was on the part of investment in the economic growth of Pakistan during the research They have used vector autoregressive approach (VAR). They give more spotlights on people in general and private speculation and the part of political solidness on the economic growth. In long run open and private venture has indicated useful effect on thee economic growth, whereas in the short run time period just private investment demonstrates positive impact on the economic growth. Pakistan economic growth does not play a better role because of political instability and economic uncertainty in a country.

Alfaro and Sayek*et al.,* (2000) accounted growth of economy and foreign direct investment associated with the part of confined markets of finance. They tried to inspect the different connections among FDI, growth and money related markets. Better money related markets enable operators in the economy to exploit information overflows from FDI. They finished that FDI take part a noteworthy role in growth of economy.
Growth and the level growth of local financial markets is very essential. They have also shown that the relationship between FDI and growth is fundamental and FDI advances growth through money related markets.

Elizabeth Asiedu (2006) explained foreign direct investment in Africa. She has explained determinants of FDI to Africa. The empirical results show that FDI will advance through extensive nearby markets, regular asset enrichments, great foundation, low inflation, a proficient legitimate framework and a decent speculation system whereas political instability has the negative impact. It has been concluded that with the help of improvement in institutions and policy environment FDI can obtain in less developed countries and FDI can boost up with the help of World Bank and IMF.

Krifa and Matei*et al.,* (2010) stated FDI, political risk and business climate in developing states. They have attempted to examine experimentally the association between political risk, business surroundings and FDI inflows and to deliver meliorate results about concerning these connections. They have employed two models a dynamic panel model and fixed effect model and exploited 33 developing states of data sample. They have used time period from 1996-2008.They concluded that FDI inflows can increase with low level of political danger and positive business conditions can boost up of the FDI.

Jung and Singh (1996) have advocated the effect of business environment and political danger on foreign direct investment by utilizing an aggregate rundown for these two factors. Hefeker and Busse (2007) planned the effect of political perils on FDI around 12 solitary records. We convey upgrade correct outcomes with respect to these basic factors by observing two models a dynamic board demonstrate and a board show These methodological bits of data will incite the going with basic outcomes. Essentially, we display that a decreased point of political danger is related with a growth in foreign direct investment inflows. Moreover, states of business errand show as a basic factor of FDI streams, our outcomes exhibiting that extraordinary business conditions help up the FDI streams.

Buses and Hefeker (2007) examine the relationship among political risk, institutions and FDI inflows for a data sample of 83 developing countries and used data from 1984-2003. They have used dynamic model of GMM They established that various sub-sections of political danger (government quality, external and internal clash, debasement and ethnic weights, peace, law-based duty of government and nature of organization) affect foreign direct investment inflows. Henisz (2002) exhibits that international are run up against with an extending peril, if political risk climbs in the host country. Their outcomes depict that the effect of political danger relies upon the imperative lead of the multinational as a coordinate with have firms having key associations with the host-government. In a comparative line, Nordal (2001) believes that the political risk may establish a huge bit of country level peril when remote money related masters arrange in creating countries. Singh and jun (1996) consider the effect of the political danger on the foreign direct investment inflows for 31 making states. Their outcomes push that the total document of the political peril is enormous, states portrayed by a high political threat pulling in fewer foreign direct investment.

Anna Ek (2007) explained the effect of foreign direct investment on economic growth. The impact of FDI on economic growth in china is explained in this article. He has taken the time period from 1994 to 2003. Secondary data has been used. The empirical facts have shown that there is a noteworthy effect of foreign direct investment on growth of economy because GDP will increase as new knowledge shift from one country to another.

Chan (2000) contemplates the relationship amongst FDI and economic growth in Taiwan. He centers on whether growth in FDI can be utilized to anticipate economic growth. Chan additionally ponders whether FDI Granger causes economic growth. That is, he is attempting to discover, if FDI adds to expanded growth, as well as if expanded economic growth adds to the inflow of FDI. His decision is that from one viewpoint, remote financial specialists are pulled in by GDP growth and then again, FDI adds to that growth, not by expanded capital amassing but rather through a channel of mechanical headway.

Tidiane Kinda (2008) explained the investment climate and FDI in developing countries. He has discussed how venture atmosphere imperatives endanger FDI appeal in creating countries. The firm level information has been used for estimation. For speculation atmosphere imperatives, we concentrated on physical and money related foundation issues notwithstanding human capital and institutional imperatives. The fundamental outcomes demonstrate that enhancing physical and budgetary foundation expands the likelihood of accepting a foreign firm (FDI). Urata and Kawai (2000), in view of Japanese Small and Medium Enterprises (SMEs) area find that infrastructure is especially essential for creating countries FDI engaging quality. Deichmann et al. (2003) in an investigation of 293 remote firm's area in Turkey find that infrastructure advancement builds the likelihood of FDI.

Dollar et al. (2006) break down the significance of venture atmosphere on exports and FDI likelihood for eight Latin American and Asian countries utilizing firm level information. Their decisions are drawn for all venture atmosphere factors together, which incorporate physical and money related foundation factors without giving particular impact of a specific variable. The researchers infer that better investment atmosphere by and large energizes FDI.

Rehman and Ilyas *et al*., (2010) illustrated the effect of transportation on foreign direct assets. The reason for this examination is to break down the part of infrastructure for and in determining captivations of outside direct venture (FDI). This work means to explore the impacts of host country's foundation accessibility alongside swapping scale and market measure on inflows of FDI towards Pakistan. This investigation has utilized autoregressive disseminated (ARDL) way to deal with co integration and a blunder revision demonstrate in light of ARDL approach utilizing time series information for the period 1975-2008 for Pakistan. In short and in long run this paper exposes a solid constructive effect of infrastructure of Pakistan in drawing in outside direct speculation.

Fung et al. (2005) described transportation as hard in the state of roadways, communications installations and parkways and delicate framework is named with straightforward establishments and serious improvements. Soft foundation is far critical as to hard framework to foreign direct investment. In addition, the investigation depicts that soft infrastructure gives twice returns, financial changes and especially a more market benevolent soft infrastructure welcomes higher internal foreign direct investment in rising economies. Infrastructure can have diverse effect on creating and created countries. In creating economies, infrastructure has a critical engaging quality for FDI inflows (Khadaroo and Seetanah, 2010; Asiedu, 2006). Sekkat and Varoudakis (2007) evaluate that Infrastructure has a noteworthy appeal of FDI even than that of receptiveness and investment atmosphere in developing states. Addison et al. (2006) recognize such limited time affect just for created countries in any case; then again, such circumstance does not exist for creating countries. While, Bee (2008) explained that in created countries, infrastructure is not a help however a marker to pull towards FDI in substantial developing economies.

De Mello (1999) and Balasubra mmanyam Sapsford (1996) considered that FDI is a mix of growth, data and stock of capital which may just frame the present supply of economy through administration rehearse, definitive strategy, capacity headway and getting ready. The two-examination found that FDI decidedly influences the economic growth of developing states.

R, S Zejan, M. Blomstrom M.lipsey, (1996) identified that foreign direct investment has a remarkable and constructive effect on the host countries of economy by utilizing a panel estimation method. Foreign direct investment permits the developing countries to do trade with different states, so its overall effect is constructive on the economy. Unciad (1999) established the both negative and constructive effects of foreign direct investment on the growth of economy and it relies upon factors utilized as a part of estimation conditions. The components may include the proportion of household speculation, the level of training, the underground market. Political insecurity, the term of exchange and GDP per capita. In 1998, Borensztern E, Gregio J, S lee, J. expected that the effect of foreign direct investment may change according to the level of human resources of receiving states. This examination relied upon the thickness of human capital which settle the retentive limit of outside innovation. An unusual condition of human resources initiated the level of foreign direct investment inflow in have states. This suspicion was begun on the bottom of his precise outcomes.

Amna et.al (2010) examined the foreign direct investment effects and the extension on the money related advancement by utilizing time course of action information from 1981 to 2010. To check the model a multi relapse system was utilized. As appeared by the outcomes, foreign direct investment has a constructive and gigantic effect on economy while the swelling has a destructive duty in the economy of Pakistan. Kevin Lehnert and Mamoun Benmamoun (2013) separated the effects of foreign direct investment, laborer repayments and Official movement support (ODA) on the money related progression of making countries by board data. A constructive and basic effect of FDI, the settlements and the formal progress empower (ODA) on the monetary headway of the making countries are spoken to by applying system summed up method approaches. They likewise established that the relationship of the master repayments to the cash related change is more huge than foreign direct investment, and ODA.

Chris Jones and Nigel Driffield (2013) analyzed the contribution of foreign direct investment an ODA to the economic progress in the states developing They practice a framework system to examine the inborn endogeneities. They likewise checked the consequence of organizations, not just the growth and the connection among organizations and diverse wellsprings of the growth. They set that the ordinary capital of foreign has a constructive and enormous effect on the growth, when the organizations are measured. Mohamed Amine and Manelle Lahdhiri and (2012) established that foreign direct investment and ODA have constructive and massive effects on the economic growth matters of the states of developing by employing panel data method.

Durham (2004), foreign direct investment has a negative and an unimportant effect on the money related headway of the making countries. He thought about that the flood of FDI relies on the headway ingestion most extreme of the beneficiary countries. Ali Sharafat (2014) set up that foreign direct investment and the swelling have negative long run effects on the money related change of Pakistan. In the short-run examination validated a unidirectional causality running from foreign direct investment, the associations responsibility and the expansion and the direction rate to change. He utilized the Granger causality Johansen and co-blend procedure for his estimations and the information was acquired.

The examination of S Bende – Nebende, a (2003) recognized that the effects of foreign direct investment inflow is imperative and productive in the long run if there ought to rise an event of less developing states. The impacts are harmful in the states with propel economy.

Greenwood and Görg (2003) asserted that foreign direct investment adversely influences growth of economy. Foreign direct investment does not add to any parts in speeding up the money related improvement in the host countries. Greenwood (2003) in like manner proposed that a harmful effect of foreign direct investment is a direct result of the flood difficulties. Foreign firms also don't make constructive externalities on the gross domestic product improvement. Lensink and Hermes (2003) related negative impacts to money related circumstances of the getting countries. By employing data of 67 creating countries assembled from Latin America, Asia and Africa, they assumed that the foreign direct investment affect is negative for the well-constructed budgetary countries. Levine and Carkovic (2002) certified that FDI contrarily influences the advancement of the getting countries by using cross country data and applying a summed-up technique methodology strategy for estimations. Their consequences were not consistent with the speculation, that FDI emphatically influences the economies of the accepting countries.

So, the effect of FDI is as yet divisive. A few investigations have been led to discover the effect of FDI on the economy. A few examinations watched positive effects and others got negative effects relying upon estimation factors, for example, legislative issues, financial aspects and mechanical states of developing countries.

Political shakiness and economic growth are significantly diligent to each other. Because of political precariousness, dubiousness arrives in an economy and as a result venture diminishes and economic growth is likewise affected. In light of decrease venture, the level of generation likewise lessens. Political uncertainty does upset the flow of foreign direct investment plans both into the private sector as well as the government owned public sector units and that surely manipulates economic growth.

Aisen and Francisco *et al.*, (2011) explained the political stability affect economic growth. They have used GMM estimator for linear dynamic panel data models on a sample covering up to 169 countries and 5-year periods from 1960 to 2004.They have found that there will be low growth rate of GDP per capita, if there is high political instability in a country. Political instability adversely affects growth and hence there will be low physical and capital accumulation. They have just discussed the effect of political instability on growth but they have not explained that how we will overcome the political instability in a country.

Zouhaier and Karim *et al.,* (2007) analyzed the interaction between political instability and investment. They have clarified the political impacts precariousness on investment and economic growth of country. They have utilized unique adjusted panel data and taken11 countries from the Middle East and North Africa (MENA) area over the time of 2000 to 2009.They have found that there is no effect put forth by political instability on investment and economic growth but a negative connection among "political instability" and investment.

Hazem M. Zureiqat (2005) explained the political instability and economic performance. He has explained the relationship between political instability and economic performance. He has used Polity2 for measurement of political instability and GDP per capita for economic performance. He has taken the data from 1985 to 2002 for 25 countries. He has discovered that political precariousness causes slower financial growth. He examined that the relationship between economic execution and political precariousness is exceptionally troublesome and some level of political insecurity can be extremely hurtful to growth in the economy.

Alesina and Roubini*et al.* reported the political unsteadiness and economic growth. They have checked the association among political instability and GDP per capita. They have taken sample from the period 1950 to 1982. of 113 countries. They have found that countries where a high propensity of government collapse, growth decreases with the time.

Alesinaet al. (1996) check the piece of political instability on economic progression by using the data of 113 countries. They have to check economic growth and political frailty by using Generalized Least Square technique. The specialists assumed that economic growth will diminish in light of high probability of government separate. In Foot and Stein (1989) Froot and Stein communicated that when a country's cash reduces, it will decrease generation cost. When it is evaluated in remote cash the inflow of FDI will make strides. Thusly, the capital of outside remote financial specialists will create.

Barro and Lee (1994) check the impact of political precariousness on financial advancement. They have taken the data from the years 1965-1985. They contemplated that political frailty negative influences monetary improvement. Haan and Siermann (1996) explored that nonattendance of political quality has negative association with financial advancement. From the season of 1963 to 1988 they used the case of 96 countries to check the relationship of political flimsiness. Finally, they assumed that political precariousness obstructed the enthusiasm for Asia and it also decreased the monetary advancement.

Kouba and Grochova et al., (2011) explained financial crises, political instability and economic growth. Monetary and financial emergency acquires genuine highlights of political shakiness numerous European countries. They talk about these issues on the case of CEE countries. They have utilized a solitary condition model to dismiss a speculation that world class political insecurity is an insuperable deterrent to financial improvement. The model has a type of expanded generation work and includes growth rates of capital, fares, and work as autonomous factors and government alters as a tip top political precariousness dummy variable.

A. Przeworski a F. Limogni (1993) say 21 observational examination concentrating on a connection connecting political administrations and economic growth. Their outcomes say: eight investigations stressed favorable circumstances of majority rule government; eight examination call attention to commitments of dictatorships and five examinations did not reveal noteworthy contrasts. It ended up evident that obscure recognizing political administrations aren’t proficient. Past issues could barely clarify what a genuine nature of institutional and political condition is.

Haider and Ghani et al., (2003) clarified the results of political insecurity, administration and defilement of bureaucratic on price rises related to the Pakistan. They have analyzed that during different regimes Pakistan’s economic performance demonstrates that macroeconomic fundamentals tend to illustrate an enhancement during the autocratic regimes as assimilated with those existing during democratic regimes. Despotic regimes are ordinarily portrayed by low expansion, strong growth and low level of bureaucratic debasement because of better administration. Conversely, the economic performance amid the majority rule administrations has been seen to intensify with feeble administration and large amounts of dishonesty, high price rises due mostly dependence on seignior age to fund public spending, and dreary growth. They have utilized yearly information and computational demonstrating is done by employing technique of Markov-Regime method with most extreme probability methodology. The estimation results demonstrate that both debasement and poor administration normally relate with political unsteadiness amid the popularity-based administrations connoting the basic require to attain political security and to improve the nature of administration for improved financial results.

Memon and Sheikh *at ell.* (2007**)** explained the political instability: a case study of Pakistan. They examined that political precariousness has turned into a serious and undermining issue in developing and underdeveloped countries. It makes immense issues in the improvement of countries. The soundness of political framework has directly affected the procedures of country and state building. These both need stable political frameworks for their growth and thriving. They explore the possible causes and effects of political instability in Pakistan.

Bhatti and Irbil et al., (2008) explained the impact of democracy, political instability and policy uncertainty on private investment. They examined the impact of political institutions on growth through the investment in private sector of Pakistan. In the politico-economy three main determinants of private investment are democracy, political instability and policy uncertainty. They concluded that political instability and policy uncertainty are negative relation with gross fixed capital formation. Democracy do not have significant effect on the level of private investment in case of Pakistan. Enhance private investment; it is essential that a favorable economic climate be provided in such a way that the investor becomes hopeful towards the expected growth of the economy.

Jahangir Chawdhury (2016) explained political instability a major obstacle to economic growth in Bangladesh. He explained that political stability has an overwhelming and essential aggregate impact yet a minor direct impact on growth. The outcomes prescribe that political steadiness influences economic improvement randomly by its jolt on specific overruling factors. From the optional retributions we see that political robustness is a pivotal indicator both hypothesis rates and in addition open spending. In this section we review how short-and long-run considerations enable us to refine our reference point comes about. It has been explored the impacts of hypothesizing wrapped estimations of the easygoing precariousness measures rather and we have established this does not influence our principle results.

Nazeer and Masih et al. elucidated the impact of political instability on outside direct venture and economic growth. Political instability has been a harming variable that would hold down the flood of FDI and the growth of an economy. They clarified the effect of political flimsiness on FDI and on growth of economy of Malaysia. They have utilized autoregressive appropriated slack (ARDL) approach and also employed a time series information over the time of 30 years from 1984 to 2013. The outcomes reveal that there are both long and short run connection between political insecurity, FDI and economic growth in Malaysia, with economic growth being the most grounded driver for political shakiness and FDI. These discoveries have clear arrangement suggestions in that the administration of Malaysia can make utilization of it by focusing on the advancement in the economy to affect FDI and political flimsiness.

Carmignam (2003) has clarified out the linkages between political insecurity and economic performance. The overview covers both empirical outcome and theoretical modeling. Likewise, the papers by Lothian and Melvin (1991), analyzed the result of political hazard for investment choices. Imperative individual examinations which included Citron and Nickelsburg (1987), who shaped a model of country hazard for outside acquiring that contains a political instability variable and Cherian and Perotti (2001), who develop a hypothetical political hazard model of capital investment.

Mohammed Abdelkader (2015) analyzed the uncertainty, democracy, political instability, and growth of economy in Egypt. They analyzed the relationship between political instability, uncertainty, and political regime, and economic growth in Egypt. They have estimated the vigorous association among growth of economy in Egypt and political instability, uncertainty, and political regime, and estimate their effect on the economy of Egyptian for the period of the last four decades. They have employed time-series data starting from 1972 to 2013 and co integration approach is employed to conclude the long-run and short run relationships. They have concluded that there is constructive effect of the level of democracy on economic growth, while they declare the negative effect of uncertainty on growth of economy

Johnson and Giedeman., *et al* (2006) described the Political Instability, Institutions, and Economic Growth. They have shown that there is positive long-run economic growth due to institution involvement. A different line of research has created blended outcomes concerning the impact of political instability on economic growth. They have used a panel data on political instability, institutions, and economic growth with GMM panel estimator approach. They indicate that political instability does not have negative growth during the period of instability.

Younis and Sharahili*, et al* (2008) discussed the political stability and economic growth in Asia. They reviewed the impacts of different segments of political trickiness on economic growth in ten Asian economies from 1990-2005. Their observational exposures demonstrate a neighboring relationship between political soundness and economic growth. They have isolated the information by utilizing econometrics procedures, which reason that 32.35 scores reaching out of summary of political soundness prompts one percent expansion in economic growth. From these finding in light of Asia encounters, they can assume that political determination expects a transcendent part in attestation of financial progression and wellsprings of capital social gathering. This examination utilizes the conventional degree frameworks moreover; Tinbergen diagrams to demonstrate the relative centrality of political soundness than fiscal opportunity to accumulate capital, assessed by four wellsprings of capital aggregate which are proximate foundations for economic growth. The outcomes in like way obviously demonstrate that the bit of political heartiness in enlivening cash related change is more fundamental than monetary adaptability

A country which is politically and socially stable, will attract foreign investors to do high level of investment. FDI has the prospective for job creation and service, which is often followed by higher wages. Resources will be transferred in terms of capital and technical knowledge. Rani and Zakia *et al.*, (2016) elucidated the impact of political shakiness and foreign direct investment on economic growth of Pakistan. They furthermore take a gander at the elements other than political shakiness and FDI that reason the financial advancement of the country. They have used the ARDL technique by using human development index as dependent variable and Inflation, Population, Political instability, life +expectancy, Foreign Direct Investment, as independent variables. They have done that the association among political precariousness and monetary advancement is damaging, however there is productive relationship among outside direct speculation and financial improvement. In Pakistan remote direct venture is considered as guideline outside wellsprings of financing. FDI has accepted crucial part in monetary advancement of Pakistan. We come to understand that monetary improvement will reduce in perspective of political unsteadiness so; non-trustworthiness of political system is most unsafe for financial advancement. There is need of solid financial arrangements are fundamental for cutting edge economic growth. Government should give careful consideration lift foreign direct investment and to manage political shakiness for economic advancement of Pakistan.

Neelum Nigar (2010) described the institutional quality and inequality of composite impact on growth of economy. She has explored how income disparity impacts the effect of institutional excellence on economic growth by investigating the composite impact of wage disparity and institutional excellence on growth. Nine lesser salary centers pay countries is utilized to look at the inquiry. She has used data from1984-2010.The outcomes recommend that imbalance can antagonistically influence the generally positive effect of institutional quality on growth. This likewise recommends by suggestion that a populist society enhances the effect of organizations on growth.

A person who is qualified enough to do work in any area or in a country is defined as labor force. The Gross Domestic Product portrays as the estimation of definite merchandise which were conveyed inside the points of confinement of countries in the midst of the day and age of one year. It is utilized as a transitional variable of economic growth. The dynamic masses, who pass on stock and attempts to satisfy the necessities of the overall population and toward the day's end number of individuals accessible for labor and they are higher than 16 years, are incorporated into the course of work drive. The developing countries experienced the issue of low level of work control intrigue. On the other hand, unique examination discloses that there is a firm link between labor force and growth of economy. The skilled work drive advances the economic growth (Duval, Eris and Furceri 2010). Developed and developing countries require to accelerate their Gross Domestic Product since it having a basic impact in any economy. In 1960s Pakistan financial system were viewed as a decent representation for the world. In 1960s the normal yearly Pakistan growth rate was 6.8% yet it was decline to 4.8% in 1970s due to partition of East Pakistan and political unsteadiness.

Muhammad Shahid (2014) delineated the impact of work constrain on economic growth in Pakistan. This examination found the long run and short run relationship between GFCF, economic growth and work compel. The time course is employed from 1980 till 2012 and together from World Bank, Pakistan Bureau of Statistic and State Bank of Pakistan. Phillip Perron and Augmented Dicky Fuller tests are utilized to indicate net settled capital strategy is stationary on first complexity, different factors are stationary at level. Co-integration Johnson test demonstrates that the relationship of long run prevails among the factors. The vector mistake rectification demonstrate has demonstrated that budgetary advancement has negative insignificant, net settled capital arrangement positive effect, while in short run has negative connection in short run.

Denton, Spencer (1997) examined populace, work compel, and longtime economic growth by utilizing pattern investigation technique. They set up that the critical degree of the Canadian ordinary citizens is maturing. Their ages are over 65 years, people change rate likewise turn down, the rule reason is low down sumptuousness rates and more decrease is ordinary if improvement proceeds at current levels. The work intensity of Canadian people was in like way turn down. The Canadian economy is for the most part reliant on improvement for work compel advancement in at present

Duval, Eris and Furceri (2010) found the work compel investment hysteresis and their Evidence and causes. They have used drive reaction capacity to manage find the significance effect of work compel investment on mechanical region. They have used the case data of 30-countries from 1960 to 2008 day and age. Regardless, their result exhibits that opposing economic growth have consistent effects on add up to work constrain. Their outcomes moreover reveal that the halfway contribution will be typical accepting figuratively speaking in light of partner impacts.

Mehak (2007) investigated the determinants of female work constrain interest work in Pakistan, an exploratory examination of PSLM (2004-05) little scale data. She has used the logit and probit technique framework to choose the factor impacts female work participation by using the Pakistan Social and Living Standards Measurement Survey 2004-05 data. Exploratory results suggest that educational accomplishment, marital status and age, have vital and supportive results on female work compel. Exactly when women have a place with the single family and approach vehicles, they are more attainable are they appreciate budgetary exercises, while a generous number of youths what's more, the availability of home machines diminishes the probability of Female work compel commitment.

Zafar, Mujahid (2012) explored the Growth of Economy of Labor Force Participation of female They have utilized the time course of action data from 1980 to multi day and age. They have related the ARDL framework to pick the nexus between the money related improvement and female work oblige theory. The outcome demonstrates that there is a relationship of long run among work drive of female support and fiscal improvement in Pakistan

Abbasi. Sarwar, et *al* (2013) investigated Pakistan ladies' labor force participation. They have collected the information from World Bank and Pakistan Bureau of Statistics. They basically utilized the trend analysis procedure which demonstrates that female work support beneath the global standard and created countries. In addition, the vast majority of the female working in casual part likes horticulture. In Pakistan the factor behind the gender segregation is monetary, social and political that destructively predisposed the female work compel support.

Hina and khan *ET all*. (2015) explained the effect of educated labor force on growth of economy of Pakistan. Human capital is by and large considered as a positive benefactor in the economic growth. This examination is an expansion in the writing of human capital and economic growth by looking at the part of human capital arrangement depicted by instruction levels of utilized work compel like work constrain with primary, secondary and advanced education. This is more straightforward measure of human capital than school enlistments and public expenditure on education. Cobb-Douglas function is suggested and time series information is utilized from 1973 to 2013.Results disclosed that there is sure effect of human capital on economic growth over the long run. Unskilled work force has significant effect just in short run. In this way, it is prescribed that Government ought to put more in training area so as to have more profitable work drive. Results likewise give prove that if human capital information sources (H), physical capital, work drive is twofold, the country yield will be more than twofold over the long run, so investment in men can quicken profitability at large scale level.

The piece of the investment in the technique for growth of the economy has a matter of enquiry of a prospering structure of calculated and in addition test thinks about both. The starting stage as highlights of composing is suspected that growth made by experts impressively affect macroeconomic execution. For instance, level of mutual speculation can impact singular interest in the proportion of growth. A way that shared hypothesis is by and large non-restrictive admission suggests excess effects; it's about emphasized by the inward growth designs jointly by means of (Romer, 1986) & (Barro &Salai-I-Martin, 1999). The model admits to consideration possibility of outer effect from that shared speculation may affect growth of the economy.

The relevant consequence of open and additionally singular individual speculation prompts propelling growth of the economy for a broad social affair of developing countries, is investigated [Khan (1996)]. The outcomes of the examination show mutual and individual investment has a varied impact on economic growth, with private speculation having a more noteworthy impact than collective speculation. Furthermore, critical regional deviations are recognized in the regard of impact of both collective and individual investment commitment. (Devarajan, Swaroop, & Zou, 1996) stress on creation shared costs and show winning common costs has huge and in addition critical growth impacts; so, effect of advantages components of mutual spans on per-head growth is additionally horrible.

An investigation analyzed the relationship among FPI, capital growth, and economic growth, using the two-arrange minimum squares (2SLS) strategy Orji (2011). Examination recognizes that the capital game plan of long run effect and outside speculation of private on the advancement of the financial system is more conspicuous than their effect of short run. Relationship of long run between the elements as the botch correction term is gigantic; regardless, change speed is less in the two models. In their result the two-orchestrate smallest squares measures are close to the OLS gauges endorsing that OLS gauges are solid and reasonable. As needs be, endogeneity was not an issue in the assessed models. There is, in this way, no simultaneousness among gross domestic product advancement and game plan of capital illustrate. These closures in this way have some indispensable repercussions as exchanged words in the work.

The impact of capital growth, trade openness and economic growth has researched by (Hye, 2011); Arif& Ahmed, 2012). The examination induced that there exists a bidirectional noteworthy connection connecting GDP growth of Pakistan and the exchange receptiveness. The human capital and assets growth have a huge association with economic growth (Mustafa &Rizov, 2017)]. Trade openness has an unconstructive connection with economic growth Gross fixed capital formation, capital stock, Population and Trade openness has a constructive and critical effect on economic growth of any state controlled by (Hosseini &Leelavathi, 2013)

The scientists utilized 12 OECD countries information to look at any trade advance viability of the economy or not (Economides& Murshid, 2008). The consequence demonstrates the constructive effect of trade on the productivity of growth of business sectors however the impact is genuinely unimportant. (Encourage, 2008) utilized quintile system for estimation to see the impact of transparency of exchange on the growth of the economy by using information that is cross-sectional. The results demonstrate that countries with diminishing rate of economic growth get points of interest more in view of exchange receptiveness over the long haul and trade openness has an unfriendly effect on the growth of the economy in limited ability to focus time.

The trade openness and economic growth considered relationship for investigation and examination by attempting sends out versus imports drove growth investment in Nigeria (Deme, 2002). The results demonstrated that relationship amongst trade and economic growth i.e. exchange plays out a vital demonstration to build efficiency growth (Jin, 2003) used the measurements of the financial system of North Korea to comprehend the trade openness impact on economic growth. The outcome demonstrates that progression of trade raises country profitability that pushes the enhancements in an example of livelihood of country by extending income per capita. This recommends an ascent in the advancement of trade inspires the rate of trade development.

In under developing countries trade openness can act to expand growth among abbreviated levels of human resources by means of access to a more prominent puddle of universal labor. (Grossman &Helpman, 1991) advance this thought through survey that decreasing of trade hindrances could make results to the local economy by means of partners and connections with global business people and markets, moreover rising instigations for provincial innovative work. (Coe &Helpman, 1995 and Keller, 1998) furthermore start the effectiveness of developing impact of trade advancement through the innovative work supernatural occurrence that communicates a country increases numerous points of interest from innovative work executed elsewhere by getting capital situated items from a wide range of countries.

An essential course is that trade may provoke through money related augmentation. A country starts to do the trade and places assets in investigation and progression; proportionate advantages may develop after some time, a course to the assembling of items from more edges of profits and focal points on account of the hoisted level of inconsistency made. By using endogenous example of development, (Grossman &Helpman, 1989) examine the movement of equivalent advantages from conveyance of resources for investigate and improvement and recognize that the state which is well-off in human capital is a net exporter of diverse things and a net shipper of standard things which are work requesting at unfailingly.

The scientists utilized the insights of 12 OECD countries to look at either exchange rises viability of the economy or not (Economidou& Murshid, 2008). The hugeness demonstrates the positive effect of exchange on the productivity of growth of business sectors however the impact is genuinely insignificant. (Cultivate, 2008) utilized quintile technique for estimation to see the impact of receptiveness of exchange on the growth of the economy by using information that is cross-sectional. The results demonstrate that countries with diminishing rate of economic growth get focal points more in light of exchange receptiveness over the long haul and exchange transparency has an unfavorable effect on the growth of the economy in limited capacity to focus time.

Thus, the settlement of already said banter, a great deal of compositions of writing has focused on diagnostically examining the impact of universal exchange on the economic growth. Among growth, structure suggested by (Barro, 1996), financial specialists again and again relapse a determination of advantages of a country on the positive proportions of advancement of exchange. Unmistakable techniques of progression have been utilized, particularly exchange measures (the proportion of fares in addition to imports over GDP), and a clear proportion of the strategy of exchange for instance duty rates or a made marker out of advancement (Sachs and Warner, 1995).

The trade openness encourages of broaden the arrangement of usage in nearby marketplaces (Feenstra, and Romer, 1994 &). (Merlitz, 2003) puts that by opening up to exchange, advertise extents could be traded to the greatest firms of money-making, as pitiful invaluable and are forced to pull back. Basically, (Tybout, (2001) looks and shows that extended contention from all-inclusive trade reasons the market for effective and convincing procedures that ascent and intra-plant sufficiency and gainfulness to enlarge. (Acemoglu, 2002) find that the exchange transparency exhibits the execution of essentials and protect rights of property that are basic to the plan of a financial system which is manageable with snappier improvement. Finally, (Krugman &Venables, 1995) propose advertise passageway may increment joined settlements however thusly discuss the more elevated amounts of income.

A couple of factors have working like contraptions for the offers of exchange the strategy of improvement. (Romer and Frankel 1999) explored properties and environment features between two countries in the state of shared exchange, condition, however (Romalis, 2007) inspected US advancing extent as equipment and gadgets. In the two examinations, supportive and basic elements grasp a positive relationship among exchange movement with advancement. The offers of exchange are not any other unfaltering if characteristic components are used as gadgets as a choice (Tervio, 2002 and Rodriguez& Rodrik, 2000)

The relationship connecting the transparency of trade and the economic growth has influenced a considerable measure in hypothetical and additionally observational compositions over the world. In the reason for making the calculated and perfect bit, the learning compiles themselves in these gatherings particularly the commercialism, traditional monetary specialists and Heckscher-Ohlin thoughts and musings of trade. In like manner, the corporate greed prescribes the beneficial growth in which countries financial advantages are at the charge of another. Besides, a conversation is that in a country the proportion of fares must be more prominent than imports of merchandise and enterprises fares ought to be extra than imports, and should stay anchored from the test of imports toward a path of country to wind up well-off& prevailing too. (Ademola, Olasode, Raji and Adedoyin 2015), (Edwards, 1998 and Nduka, 2013).

The conventional economic analyst guarantees that it is unimaginable for a country to support a critical impact on trade until the end of time. The countries must make and export the merchandise with minimal effort gain and the indistinguishable country must bring in a decent that has an advanced cost of making an item in the possess country. An inconsistency is taking an area in overall trade and it can have a well-built vigorous help for the improvement of the economy (Keho, 2017; Olasode, 2015& Nduka, 2013). the Heckscher-Ohlin theory tells that when two states desire to take part in the overall trade by each other and should have with indistinct frameworks of gathering and the permitted portions on the stock which are at last created. A country alongside fitness commitment should influence the items on substantial measures, thusly to exchange builds the development of the economy. For example, if any two countries need to go into worldwide trade with each other, they ought to have an innovation that is indistinguishable, persevering comes back to scale, and a given factor-force relationship among conclusive goods. A country with upgraded factor abundant should fabricate merchandise at a vast level, along these lines trade will improve the growth of the economy (Heckscher, 1919 and Ohlin, 1933).

Exchange receptiveness puts a basic effect Asia economy consistently employing a GMM of an exceptional and influential information which relies upon the board (Paul and Das 2011). A constructive pressure of the mainly basic factor which is exchange progression of exchange on improvement in equally India& China including day and age (1980-2007) by that is an examination utilizing a board information examination, (Signorell and Marelli 2011) and there prevail a basic relationship among headway of trade and advancement of financial system for Indian Ocean Rim states utilized Fully Modified Ordinary Least Square.

If there should arise an occurrence of Africa, an exploration examined that receptiveness of trade has a constructive relationship with GDP in 38 countries somewhere in the range of 1980 and 2008 (Yeboah, Naanwaab, Saleem, & Akuffo, 2012). Correspondingly, trade liberalization optimistically affects economic growth in Nigeria (Nduka, 2013). A one-sided (coordinate) relationship between trade openness and growth is discovered (Olufemi,2004). This demonstrates the increasing pattern of advancement will be valuable, obligated for the example of financial advancement in Nigeria. A heading reconnection coming to from the growth of the economy is broke down to progression without reaction in the pre-Structural Adjustment Program day and age (development drove exchange), while there win a two-sided association available from economic growth to openness with a criticism impact in the post era.

The impact of trade openness to universal trade and also money related advancement on the growth in Malaysia financial system is examined by (Wong Hock, 2005). An ECM was computed, that shows progression of overall trade positively affects a growth of the economy. Intense pointers demonstrated that progression of worldwide trade causes economic growth an exploration that was diagnostically investigated the eccentric relationship among advance monetarily, progression of trade and in addition the growth of the financial system in Japan (Soukhakian, 2007). Results demonstrated a harmony long run affiliation between economic advancement, exchange, and economic growth in Japan between household credit proportion of credit improvement, trade. and growth.

Conversely, a different research explored the central relationship connecting the trade openness and the economic growth of Turkey was proposed econometric methodologies (the Johansen and co mix and in addition Granger-Causality procedures are used. (Yucel, 2009). The outcomes facilitated that while receptiveness of exchange has an enormous impact, monetary progression horribly affects improvement. In addition, the delayed consequences of Granger causality revealed the nearness of bi-causal relationship among monetary headway, exchange transparency and improvement, in this way sustaining the end that systems which are associated to financial system guided as cash related progression and movement of trade have a constructive and fundamental consequence on financial advancement.

Moreover, a suitable approach of examination is what's more conferred about in a crucial course by which exchange receptiveness is productive in engaging advancement (Wacziarg, 2001 and Taylor, 1998). Rodrik (2002) separated that exchange transparency has a basic unexpected result on compensation just as somewhat portrays the value of the associations. As learning is similarly thought to be a substitute plan to ensure that movement of trade reinforces the change in whole deal. Decidedly, openness is started to help the need for rule which is essential for the entire country and which over the long haul begins yield and headway (Wood&Ridao Cano, 1999).

The association connecting trade openness and economic growth this about certain conspicuousness for little islands developing countries, where openness of trade is for the most part more noteworthy than in rising countries and minimum created countries (Santos-Paulino, 2011). Certainly, openness was acknowledged to essentially enhance the fiscal improvement in SIDS states like Bahrain, (Sinha, 1999),

By and large, a significant number of the investigations perceived a noteworthy association among trade openness and economic growth, independent of changing strategies and openness of trade substitutes utilized. The impact of transparency of exchange on growth was additionally recognized to be coincidental in few cases, first influencing the proficiency or speculation, already enhancing the improvement of the economy. Moreover, to upgrade the upsides of the exchange, systems of exchange must be appropriately going with assist methodologies as well. In any case, numerous investigations were thought to be an insufficiency of consideration in real life with issues associated with decent variety and measurement, hence asking the quality of the results. (Rodriguez& Rodrik, 1999)

The exchange transparency impacts improvement through theory [Levine and Renelt (1992)]. Exchange receptiveness enables a passage to wander products and offers affectations to FDI. Henceforth, it prompts a speedier long-run financial improvement. Contortions utilized in the genuine conversion standard as a method for deciding trade. A horrible connection between the genuine conversion scale deceptions and development which enclosed a trade development of trade connection which is certain Dollar (1992).

A regression system of cross country is prohibited because of the poor hypothetical establishment, low value of database and improper econometric methodology and techniques of econometric (Srinivasan& Bhagwati, 2001). They likewise discussed that the choice of (Rodrik, and Rodriguez 2001) was successful just for average Solow display and not for demonstration of Harrod Domar the favored strategy of export advancement and examined an arrangement of import substitution which would diminish social returns and create a social misfortune. They bolstered (Krueger, 1997) who affirmed higher growth execution of the countries with recognizable techniques prompting a positive connection between receptiveness of exchange and advancement execution of improvement execution of the countries with recognizable methodologies prompting a positive relationship among execution of growth and transparency of exchange.

Three systems through which trade impacts growth efficiency are said (Anderson &Babula, 2008). To start with, it gives full access to remote delegate information sources and innovation and furthermore augments advertise estimate for new unique items and import assortment of different items which are not accessible locally. This upturns productiveness and adequacy of the assembling area. Furthermore, augmentation in size of the market advances assessed benefits from innovative work and thirdly the trade empowers worldwide scattering of general information. Exchange receptiveness frameworks created the quick augmentation of fare joined by the high rate of financial advancement. This more noticeable financial advancement fascinates the sensitivity of various states working with import substitution industrialization of import substitution appear. This empowered them to move from industrialization of import substitution to exchange receptiveness.

To take a gander at the impacts of transparency of imports on lack in the Philippines is checked. Thomas and Bautista (1997). Nuclear families of five were reproduced in this model. The scientist did in the examination involves import apportioning, an indistinguishable extra charge on imports, levy free, tax diminish and half decrease in current record deficiencies. It is resolved that in the Philippines there is an ideal and positive effect of import progression on scarcity and income.

Scientifically, there gives off an impression of being a decent sign that universal trade influences economic growth essentially by encouraging capital growth, mechanical structure improvement, specialized progression and institutional headway. Unquestionably, the expanded capital imports and middle items, which are absent in the neighborhood showcase, can outcome in the expansion underway and effectiveness of assembling Lee (1995). More vigorous involvement in the worldwide commercial center by urging sends out prompts all the greater rivalry and upgrade regarding profitability (Wagner, 2007). Learning-by-doing might be speedier in send out assembling thanks to the information and innovation overflow affect.

Moreover, the advantages of universal exchange are generally produced from the outer condition, the reasonable approach of trade and structure of trade courses of action. There are expansive observational readings because of exchange on economic growth.

Economic hypothesis gauges that trade openness ought to be empowered, which thus growth increments over the long period of time. Hypothesis prescribes that advancement of trade extends trade openings, grows viability and efficiency of dissemination of assets towards the most capable parts and speed up mechanical extension particularly through progression of imports. It is anticipated that awesome innovation imports, increment household change, along these lines expanding profitability and growth. Regardless, following quite a while of progression, tests in Africa and in developing countries by and large, the sign on the growth impacts of exchange transparency stays blended (Easterly and Levine, 2003; Dollar and Kraal, 2003;).Frequent feelings have been progressed to depict the restricted effects of exchange receptiveness on growth. In this investigation, we just stress a portion of the conceivable rationale for the frail experimental proof on the growth impacts of trade openness.

These days, the noteworthiness of "receptiveness" has ended up much like the conviction of "released change", that might be a change contraption in which each one of the twisting of exchange are cleared (CIBER, 1997). Therefore, it is not kidding to catch the issue on the grounds that diverse openness measures have astounding hypothetical recommendations for blast and discernible associations with the expansion. (Wong, 2005) recognized in his investigation that "the writing on the issue has not always been powerful in managing particular meanings of exchange frameworks, nor has it been fit to deal with effectively the problematic topic of estimating the sort of trade introduction taken after by a specific country. An extensive variety of observational investigations has influenced utilization of an assortment of cross-joined circumstances to blast relapses to check endogenous prosperous hypothesis and the significance of progress methodologies (Bloom and Van Reenen, 2006).

As indicated by a plan, the commitment, lead under the law, political immovability, legislative capacity, property rights prosperity, wellbeing and understanding execution, and check the untrustworthiness are really focusing on features highlights of development advancing associations. From this wide theoretical discussion screens a suspicion that countries disregard to make like legitimate affiliations capably will be defied with more charges in showcase selling’s and have to be not competent to the representative and along these lines, to enable private exercises, to advertise trades, and investment funds and economic growth. The highest association of recognition, by the by, does not stay away from the possibility of an opposite connectedness. Without a doubt, in an elective view, helped by observational proof, predicts a more prominent level of advancement will make the necessity for and incite to enhanced associations (Paldam&Gundlach, 2008).

The powerful understandings arrive approximately to help and keep up the level of growth just when joined in the state of a government. A comprehended report resembles a wide culture is capable of embracing the scale of economies natural in clarifying standards and has the total manage of compulsory authority expected to relate the requests and standards. Then again, furnishing the state with overwhelming force produces the issues of shamefulness, cleverness, evil, and infringement in the countrywide control by those in administration points Weingast, (1993) battles that a government solid sufficient to shield land and force understandings is likewise steady and adequate to grab the cash and resources of its occupants. This basic logical inconsistency provides the explanation for obligation and clearness and broad commitment of various foundations that longing for mutual request and run the show.

In Pakistan, there are numerous that analyzed the piece of profitable advancement in empowering economic growth, decrease in neediness and diminishing income disparities. Islam and Shahbaz (2011), Kashif &Khalil (2012). (Raza, 2016) gave a sign of financial consideration However, no investigations from these have deliberated the reasons for money related consideration and gathered deterrents to budgetary incorporation and their recommendations for comprehensive development in the country. In this unique situation, the recent look into expects an entire examination of numerous levels of financial contribution, in such manner to expansive based development in Pakistan and lessening the prevailing gaps in the compositions.

The discussions, containing rising verification that diminishing income imbalances and economic growth may not basic to be conflicting objectives as an essential Kuznets bend prescribed, empowered a discourse and in addition investigation on 'development that is comprehensive' in like manner at once in a while 'genius poor development'. In spite of the fact that there is an agreement that development is wide based on the off chance that it diminishes desperation, various clarifications showed up (OPPG 2005, Besley& Cord, 2006). A related order, empowered by UNDP specialists, recommends development is comprehensive, if divergence diminishes, or if a bit of acquiring of destitute upsurges. Substitute description considerations on the rate for income growth of wages of destitute. Thus, rate of reduction in dejection, denied of basically an adjustment in wage disparity, while an incredible talk focus centers around income and also on consumption (in which manliness changes persevere intense to portray), same request was addressed in a structure of further extents of welfare and flourishing of country (Klasen 2010).

In any case, there is an extensive sign seeing critical relationship among supremacy and in addition the development of the economy).An composed perspective about development has been essential to an exertion of North Douglas (1990) for example, there is a developing structure of developing watched investigation that shows up at the between association between amusingness and economic growth , nearly incited by the understanding that help can likewise bolster growth of positive authority about requirements are accomplished Dollar, and Burnside (2000). A critical exertion of (Peter Linder, 2004) on the advancement of long run of OECD prosperity state upgrades sign that legislature, astoundingly the expansion of discourse, is huge for such a strategy in which state shared expenditure and growth of the state bolster each other. At last, lots of progressed examination of political like shown by Prof P.B. Mehta a gathering in Delhi and additionally a cutting-edge expanding enthusiasm for the piece of center sorts (Birdsall 2007, 2010) accentuations on politics issues and the amount they associate with growth of economy and realignment.

Concluding Remarks:

Different past studies have been reviewed to check the impact of FDI on economic growth. The basic purpose to confirm the relationship between the FDI and economic growth. Most of studies have given positive relation with growth of economy which permits a country to take in technologies and information that are not willingly accessible to home investors, and in this way boost up output throughout the economy. In the same way various articles have been studied regarding political stability like Aisen and Francisco *et al*., (2011) explained the political stability affect economic growth. It has been found that there is not much work related to composite impact of FDI and political instability on economic growth. In the present research it has been found that if there is political stability and FDI in the economy then what will be the impact on economic growth.

Chapter 3

DATA AND METHODOLOGY

It is essential to choose variables with an excellent source of statistics for empirical investigation and effectiveness of study. For efficiency of research and economic investigation, data and also issues related with methodology have incredible significance. Data and methodology are explained that are utilized to evaluate composite impact of foreign direct investment and political stability on growth of economy in Pakistan in this section. This chapter comprises of following sections: 3.1 theoretical framework, 3.2sources of data, 3.3 explanation of selected variables and 3.4 research methodology.

3.1 Conceptual Framework

The theory of exogenous growth generally attributed to as the Solow Swan model of growth or neo classical model of growth. Solow introduced model of Solow in 1956. The theory assumes that economic growth is generated through the accumulation of exogenous factors of production, such as the stock of capital and labor. Empirical studies on economic growth utilizing the exogenous model as formulated by Cobb and Douglas (1928) normally exert the aggregate production function. Following Hicks (1932), the Cobb Douglas production function, or the aggregate production function is designed against: assets input (foreign as well as domestic), the rate of technological advancement and labor input which modifies over time. In agreement to this hypothesis, foreign direct investment advances the assets reserve in the host country; and in result growth of economy is affected. In 1995 Barro and Sala Martin established that there is a positive association among capital growth and output, while Herzer, (2008) has recognized that FDI stimulates growth of economy by expanded investment of domestic. It has been shown through the exogenous or neoclassical growth model that FDI can affect growth of economy immediately through assets accumulation and the addition of latest inputs and foreign machineries in the production function of the host country. Therefore, the model of neo-classical growth demonstrates that foreign direct investment advance growth of economy by augmenting the amount the efficiency of investment in the host country.

Alesina, Ozler, and Swagel (1992) and Siermann (1996) give two, more precise theoretical arguments that why economic growth slows down due to political instability. The concept of uncertainty has used by the Alesina, Ozler, Roubini and Swagel (1992. Uncertainty prevails in the policies of the new government due to the high tendency of government interchange Consequently, investors would depart the economy, and potential investors would look for a steadier atmosphere. Instability decreases the supply of both assets and labor said by the DeHaan and Siermann. As the risk of capital loss increase, it discourages investment. Political disorder cause capital flight and brain drain and hinders the establishment of property rights, which are essential in order to understand productivity gains.

Composite Impact of Foreign Direct Investment and Political Stability

Aisen and Francisco *et al.*, (2011) have given argument that there is direct relation between political stability and economic growth. Political stability and growth of economy are profoundly interrelated. The association among growth of economy and stability alludes to the way in which the political stability of a country can directs to its economy of growth. The most noticeable relationship among economic growth and stability is the way that a steady situation supports an economic activity in the economy. Kalsoom Rani (2016) stated that political stability is mandatory part for economic growth of any state. FDI is secondary element; it has direct relation with economic growth. A country which is politically and socially stable, it attracts foreign investors to do high level of investment**.** Foreign direct investment has the prospective for job creation and service, which is often followed by higher wages. Resources will be transferred in terms of capital and technical knowledge, so it means FDI cannot play a good role in the absence of political stability, therefore a country must be politically stable to attract foreign direct investment. There is a strong composite impact of FDI and political stability on economic growth.

3.2 Data Sources

To verify the composite impact of FDI and political stability on growth of economy, a time series data for FDI, political stability, and vector control variables (trade openness, gross fixed capital information and labor force) has been collected. Empirical data has been collected for the period of 1980 to 2016.Data has been collected from 1980 instead of 1970 because there are structural breaks in 1970 due to partition of Bangladesh so it takes some time to recover. Data has been collected from World development indicator, polity IV. Polity IV variable has represented political stability of Pakistan. Ranmali Abeyasinghe (2004) has used polity IV index as a measure of level of democracy in his research. Center for systematic peace website is engaged in innovative research on the problem of political violence within the structural context of the dynamic global system, that is, global systems analysis. INSCR (Integrated Network for Societal Conflict Research) website has established to coordinate and integrate information resources produced and used by the Center for Systemic Peace. INSCR data resources have been cross-checked with other data resources to ensure, as far as possible, that the information recorded is precise, consistent, and comprehensive. Data has taken in unit form. In order to have better coefficients values; we have changed the data in log form.

Table 3.1

Data Sources

Variable	Data Source
Economic Growth (GDP)	World Development Indicator
Political IV	Index of political stability
Trade openness (TO)	Generated by formula
Gross Fixed Capital Formation (GFCF)	World Development Indicator
Foreign Direct Investment (FDI)	Generated by formula
Labor Force (LF)	World Development Indicator
Interactive Term (IT)	Generated by formula

Table 3.2

Description of Variables

S. No	Indicators	Description
1.	Economic Growth	GDP (constant LCU)
2.	Gross Fixed Capital formation	GFCF (constant LCU)
3.	Labor Force	Labor force participation rate, total (% of total population ages 15+)
4.	Foreign Direct Investment	FDI (constant LCU)
5.	Polity IV	Index of political stability
6.	Trade Openness	Exports +Imports divided by Real GDP
7.	Interactive Term	FDI*PS

Collection of data of all these variables have been taken from WDI (World Development Indicator) in unit form, then converted in log form and index of political stability has taken from polity IV. Data of FDI, Interactive term and Trade openness data have been achieved from formula.

The data for FDI constant has achieved through formula. We have taken Net inflow BOP current US, official exchange rate (LCU per US, period average) and GDP deflator data.

FDI=FDI US dollar* official exchange rate (LCU per US, period average)

=local currency

FDI= local currency /GDP deflator.

TO= export (Constant LCU) +import (Constant LCU)/ Real GDP

Data for interactive term has been achieved through formula.

Interactive term =FDI*PS

Main Model

It is a standard Neo-Classical model of economic growth and developed by Robert Solow. It has three basic sources for gross domestic product: labor (L), capital (k). Neo-classical economists believe that to raise the trend rate of growth requires an increase in the labor supply and a higher level of productivity of labor and capital.

$Q=f(L, K)$ ……………………………….. …………………………. (1)

Where:

- Q is the quantity of products
- L the quantity of labor applied to the production of Q.
- K the hours of capital applied to the production of Q

The basic form of the Cobb-Douglas production function is as follows:

$Q(L, K) = A K^{\alpha} L^{\beta}$ ……………………….…………………………. (2)

Where:
- Q is the quantity of products.
- L is the quantity of labor.
- K is the quantity of capital.
- A is a positive constant.
- β and α are constants.

$Y=AK^{\alpha} L^{\beta}$

Various analysts have done research related to impact of FDI on growth of economy like R, S Zejan, M. BlomstromM.lipsey, (1996) distinguished that foreign direct investment has a noteworthy and useful impact on the host of economy. In the manner Jahangir chawdhury (2016) finished up political precariousness a noteworthy obstruction to economic growth in Bangladesh. As this research is identified with composite effect of FDI and Political stability on economic growth so we have included FDI and political stability variables as F and P.

$Y=k^{\alpha} L^{\beta} F^{Ʊ}P^{ϱ}$ …………………….…………………………….……… (3)

$LogY=logA+\alpha logk_t+\beta logL_t+Ʊ logF_t+\theta logP_t$

$Y_t = a_o + \alpha k_t + \beta L_t + \mho ft + \Theta P_t + e_t$

Where:

a_o = logA

k_t= logk

L_t= logL

F_t=logF

P_t= logP

Composite mean to check the impact of two variables on the third variable. For this purpose, FDI and political instability variables have been multiplied to get the interactive term.

$Y_t = a_o + \alpha k_t + \beta L_t + \mho F_t + \Theta P_t + \delta F_t * P_t + e_t$ …………………………………. (4)

$\delta ft*pt$ is interactive term; it will show the composite impact of FDI and political stability on economic growth.

Three models have been generated in this study. First model of the study is

GDP = f (gross fixed capital formation, labor trade openness, foreign direct investment)

An econometric form of the model:

$$\mathbf{GDP = \alpha_o + \alpha_1 GFCF + \alpha_2 LF + \alpha_3 TO + \alpha_4 FDI + \alpha_5 XI_t + \epsilon_t} \text{...............} \mathbf{(I)}$$

Second model of the study is

GDP = f (gross fixed capital formation, labor trade openness, trade openness, political stability)

An econometric form of the model:

$$\mathbf{GDP = \alpha o + \alpha_1 GFCF + \alpha_2 LF + \alpha_3 TO + \alpha_4 PS + \alpha_5 XI_t + \epsilon_t} \text{...............} \mathbf{(II)}$$

Third model of the study is

GDP = f (gross fixed capital formation, labor trade openness, trade openness, foreign direct investment, political stability, interactive term)

An econometric form of the model:

$$\mathbf{GDP = \alpha o + \alpha_1 GFCF + \alpha_2 LF + \alpha_3 TO + \alpha_4 PS + \alpha_5 FDI + \alpha\ 6\ FDI*PS + \alpha\ 7Xi_t + \epsilon_t} \text{...............} \mathbf{(III)}$$

Where

GDP = Economic Growth

GFCF = Gross Fixed Capital Formation

LF = Labor Force

FDI = Foreign Direct Investment

PS =Political Stability

TO=Trade Openness

FDI*PS=Interactive term

XI_t= Vector control variables including trade openness, gross fixed capital formation and labor force where as $\in_t$ is the random error term.

The main focus is on α 6 in equation three which is the parameter for the interaction of foreign direct investment and political stability. Interaction models are generally used to capture the impact of one variable over the other through the mediating mechanism.

As the data has changed in log form so model will be as follow

$$LogGDP=LogGFCF+LogLF\ logTO+LogFDI+\in_t$$

$$LogGDP=LogGFCF+LogLF+logTO+PS+\in_t$$

$$LogGDP=LogGFCF+LogLF+logTO+LogFDI+PS+LogFDI*PS+\in_t$$

3.3 Variables

Foreign direct investment, Political stability and interaction term are independent variables while gross domestic product is the dependent variable. Trade openness, labor force and gross fixed capital formation are control variables.

Economic growth of a country implies an expansion in gross domestic product. Gross domestic product is dependent variable of this study. The enhancement in real gross domestic product means there is an increase in the value of national output. Economic growths caused by more effective utilization of sources of information, e.g. work profitability, physical capital, vitality is alluded to as concentrate growth, which facilitates consumers to enjoy more goods and services and have better standards of living. To measure GDP can be difficult but at its most basic, the calculation can be done in two ways, 1)income approach and 2) expenditure method.

Trade openness is most significant variable of the study and performs a most important task for economic growth and growth of a state and it is an independent variable of study. Trade openness is removal of hindrances on free trade of products among countries is referred to as trade openness. It includes deduction of tariff hindrances, like surcharges and taxes in addition to permitting rules, quotas which are considered in nontariff barriers.

Trade liberalization technique might merely on the nonexistence of any trade schemes. This is recognized like "openness of trade**."** or laissez-faire trade".

Political soundness is additionally key variable of this study and it is profoundly interconnected with economic growth. Even in countries assumed as political stable, political change can have a significant impact on the economy. It is a specific situation in which country is running so smoothly with any political collapse or any instability. In this way a country has an order to appreciate the mutual advantages and reward in a state.

Politically unstable surroundings usually mean that the government is misusing or mismanaging the country's resources; resources are not being used to their full competence.

Capital is one of important factors of production in modernistic time of technology. It is considered as property engaged by labor for manufacturing supplementary commodities plus services and machinery, equipment's. In addition, production of goods plus services, chances of jobs are also developed services by valuable utilization of capital. GFCF is an independent variable and is computed in the log form. It identifies to the net increase in physical assets i.e. investment minus disposals within the measurement period. It doesn't account for the consumption of fixed capital and furthermore does not include land purchases.

Foreign direct investment may permit a state to take in technologies and knowledge that are not easily accessible to home investors, and in this way boost up productivity growth throughout the economy. Foreign direct investment may also take in knowledge that the state does not have, and foreign investors may have better access to international markets.

It has often been perceived that for financial support developing as well as underdeveloped countries are reliant on the economically developed states that would assist them to achieve some amount of economic strength. FDI has been able to improve the infrastructural situation of a country.

A person who is qualified enough to do work in any area or in a country is defined as labor force. The GDP portrays as the estimation of conclusive products which are delivered inside the limits of countries amid the day and age of one year. The GDP utilizes as an intermediary variable of economic growth. The dynamic populace, who deliver merchandise and enterprises to satisfy the necessities of the country and at the end of the day number of individuals who's accessible for job and they are above 16 years in ages, are incorporated in the process of labor force.

In statistics, an interaction may happen when considering the relationship among two or more variables. It describes a condition in which the simultaneous influence of two variables on a third variable. This study has generated interactive term by multiply the FDI variable and political stability as FDI*PS. The main focus of this study is to analyze the impact of interactive term on economic growth of Pakistan. . Model of interaction are for the most part used to catch the impact of one variable over the other through the mediating mechanism.

3.4 Methodology

For the estimation of long run as well as short run impact study has utilized ARDL model technique. Since this study employs time series data, therefore it is important to check stationarity. For that this study uses unit root test. Unit root are the tests for stationarity in time series. A commonly used test that is valid in large samples is the augmented Dickey – fuller test.

In1999 Pesaran and Shin demonstrated the Autoregressive Distributed Lag (ARDL) model which referred to single co integration. The ARDL technique has the advantage that it does not require all variables to be I (1) as the Johansen framework and it is still appropriate if variable have I (0) and I (1). This estimation technique has different exclusive characteristics, which are following below.

1. Dissimilar to the other techniques, ARDL strategy permits mixture of integration on different orders; it infers that it's appropriate regardless of different order of integration whether they are integrated of order zero or one.
2. Diverse lag lengths are used for different variables in this model,
3. It is appropriate to compact with short sample measure as compare to other methods.
4. It is simple and easy to understand by having a single equation, which makes it easy to solve and explain.

5. Error correction model (ECM) a vital component which is useful to drive out from ARDL through simple linear conversion.
6. It figures short-run and also long-run coefficients collectively.

   Nkoro, E., &Uko, A. K. (2016)

3.4(1) Assumption of ARDL Approach:

ARDL Assumptions has been explained by (Nkoro, E., &Uko, A. K. (2016).

1. ARDL can't be evaluated, if any variable has an incorporated of order i.e. I (2), in light of the fact that for this situation the value of F-stats of bond test will be invalid.
2. Lags must be appropriate.
3. Errors must be Serially independent.
4. Model must be dynamically stable.
5. We can apply ARDL, if variables are stationary at level.
6. We also can run ARDL, if variables are stationary at first difference.
7. We can run ARDL, if variables are stationary at level and first difference.

3.4(2) Benefits of ARDL:

1. It tells us long run relationship.
2. It tells us short run relationship.
3. It tells us speed of adjustment with the help of error correction term.
4. ARDL is best one, if you have small sample size.

Bound Testing Procedure

To decide either there exists long run relationship among variables or not, bound test is a procedure which is utilized. This method is significant for application of ARDL model. This methodology is used to check the long run relationship among variables but after specification of model as well as integration order of variables. This strategy is more efficient for size of sample which is small.

There will be cointegration among all variables, if estimation of wald test is larger than value of upper bound recommend by Pessran and Pesan (2001). Null hypothesis is approved that there is no co incorporation among variables, if value of F value is less than value of lower bound. The result is undetermined, if estimation of wald-test exists in upper and lower bound.

In addition, alluring condition is if F value of Wald test is larger than upper bound critical incentive to detect presence of cointegration among variables.

Model 1

It will confirm either it will positive or negative impact of FDI on economic growth of developing state like Pakistan. Gross domestic product is dependent variable whereas gross fixed capital formation, labor force, trade openness and foreign direct investment are independent variables of first model. The lagged level coefficients of variables are restricted to zero applying bound test with the aim to confirm the long-run equilibrium association. Null hypothesis of test:

H0: $\beta_1 = \beta_2 = \beta_3 = \beta_4 = 0$

H1: $\beta_1 \neq \beta_2 \neq \beta_3 \neq \beta_4 \neq 0$

$\Delta GDP = \beta_0 + \beta_1 GFCF_{t-1} + \beta_2 LF_{t-1} + \beta_3 TO_{t-1} + \beta_4 \; FDI_{t-1} \ldots\ldots\ldots\ldots + \sum_{i=1}^{p} \delta_{1i}\, \Delta GDP_{t-i} + \sum_{i=0}^{p} \delta_{2i}\, \Delta GFCF_{t-i} + \sum_{i=0}^{p} \delta_{3i}\, \Delta LF_{t-i} + \sum_{i=0}^{p} \delta_{4i}\, \Delta TO_{t-i} + \sum_{i=0}^{p} \delta_{5i}\, \Delta FDI_{t-i} + \mu_t \ldots\ldots(1)$

H0 will accept to results that there is a long run relationship present in the model, whenever calculated value of F-statistics exceeds by value of upper bound. Next step is to calculate equation (1) above to take hold of long run parameters of dynamic model.

$GDP_t = \theta_0 + \theta_1 GFCF_t + \theta_2 LF_t + \theta_3\, TO_t + \theta_4 FDI_t \ldots\ldots\ldots (2)$

An unrestricted (ECM) is applied, for detection of short run estimations of the model, The ECM model equation is stated below,

$$\Delta \mathrm{GDP}_t = \gamma_0 + \sum_{i=1}^{\rho} \gamma_1 \Delta GDP_{t-1} + \sum_{i=0}^{\rho} \gamma_{2i} \Delta \mathrm{GFCF}_{t-1} + \sum_{i=0}^{\rho} \gamma_{3i} \Delta LF_{t-1} + \sum_{i=0}^{\rho} \gamma_{4i} \Delta TO_{t-1} + \sum_{i=0}^{\rho} \gamma_{5i} \Delta FDI_{t-1} + \psi ECT_{t-1} + \epsilon_t \ldots.\ (3)$$

Equation of ECT

$$ECT_{t-1} = GDP_{t-1} - \theta_o - \theta_1 GFCF_{t-1} - \theta_2 LF_{t-1} - \theta_3 TO_{t-1} - \theta_4 FDI_{t-1} \ldots\ldots\ldots (4)$$

Model 2:

It will verify that what will the effect of political stability on economic growth of developing country like Pakistan either it will positive or negative impact. In second model dependent and independent are same as utilized in first model, it has simply excluded FDI variable and added political stability variable to check the consequences of political stability on economic growth. Data has been taken in unit form and then change in log form and data of political stability is in index form.

ΔGDP = β_0+ $\beta_1 GFCF_{t-1}$+ $\beta_2 LF_{t-1}$+ $\beta_3 TO_{t-1+}$ β_4 PS_{t-1} ....+ $\sum_{i=1}^{p} \delta_{1i}\, \Delta GDP_{t-i} + \sum_{i=0}^{p} \delta_{2i}\, \Delta GFCF_{t-i} + \sum_{i=0}^{p} \delta_{3i}\, \Delta LF_{t-i} + \sum_{i=0}^{p} \delta_{4i}\, \Delta TO_{t-i} + \sum_{i=0}^{p} \delta_{5i}\, \Delta PS_{t-i}$ +μ_t........(5)

Further step is to estimate equation (5) above to take hold of long run parameters of dynamic model.

$GDP_t = \theta_0 + \theta_1 GFCF_t + \theta_2 LF_t + \theta_3\, TO_t + \theta_4 PS_t$......... (6)

The ECM model equation is stated below,

$$\Delta \mathrm{GDP}_t = \gamma_0 + \sum_{i=1}^{\rho} \gamma_1 \Delta GDP_{t-1} + \sum_{i=0}^{\rho} \gamma_{2i} \Delta \mathrm{GFCF}_{t-1} + \sum_{i=0}^{\rho} \gamma_{3i} \Delta LF_{t-1} + \sum_{i=0}^{\rho} \gamma_{4i} \Delta TO_{t-1} + \sum_{i=0}^{\rho} \gamma_{5i} \Delta PS_{t-1+} \psi ECT_{t-1} + \in_t \ldots \text{(7)}$$

Equation of ECT

$$ECT_{t-1} = GDP_{t-1} - \theta_o - \theta_1 GFCF_{t-1} - \theta_2 LF_{t-1} - \theta_3 TO_{t-1} - \theta_4 PS_{t-1} \ldots\ldots\ldots \text{(8)}$$

Model 3

Third model has important and significant role in this study**.** It will investigate that, what will be impact on economic growth in the presence of political stability and high foreign direct investment. Gross domestic product is dependent variable whereas gross fixed capital formation, labor force; foreign direct investment, political stability and interactive term are independent variables of third model.

ΔGDP = β_0+ $\beta_1 GFCF_{t-1}$+ $\beta_2 LF_{t-1}$+ $\beta_3 FDI_{t-1+}$ β_4 PS_{t-1}+$\beta_5 TO_{t-1+}\beta_6 INTER_{t-1}$ ....+ $\sum_{i=1}^{p} \delta_{1i}\, \Delta GDP_{t-i} + \sum_{i=0}^{p} \delta_{2i}\, \Delta GFCF_{t-i} + \sum_{i=0}^{p} \delta_{3i}\, \Delta LF_{t-i} + \sum_{i=0}^{p} \delta_{4i}\, \Delta \mathrm{FDI}_{t-i} + \sum_{i=0}^{p} \delta_{5i}\, \Delta PS_{t-i} + \sum_{i=0}^{p} \delta_{6i}\, \Delta \mathrm{TO}_{t-i} + \sum_{i=0}^{p} \delta_{7i}\, \Delta INTER_{t-i}$ +μ_t........(9)

Further step is to estimate equation (9) above to take hold of long run parameters of dynamic model.

$GDP_t = \theta_0 + \theta_1 GFCF_t + \theta_2 LF_t + \theta_3 FDI_t + \theta_4 PS_t + \theta_5 TO_t + \theta_6 INTER_t$......... (10)

The ECM model equation is stated below,

$$\Delta \mathrm{GDP}_t = \gamma_0 + \sum_{i=1}^{\rho} \gamma_1 \Delta GDP_{t-1} + \sum_{i=0}^{\rho} \gamma_{2i} \Delta \mathrm{GFCF}_{t-1} + \sum_{i=0}^{\rho} \gamma_{3i} \Delta LF_{t-1} + \sum_{i=0}^{\rho} \gamma_{4i} \Delta FDI_{t-1} + \sum_{i=0}^{\rho} \gamma_{5i} \Delta PS_{t-1} + \sum_{i=0}^{\rho} \gamma_{6i} \Delta \mathrm{TO}_{t-1} + \sum_{i=0}^{\rho} \gamma_{7i} \Delta INTER_{t-1} + \psi ECT_{t-1} + \in_t \text{..... (11)}$$

Equation of ECT

ECT stands for error correction term. It alludes to a gathering of numerous time series models most generally utilized for data where the primary variables have a long-time stochastic pattern additionally perceived as co integration. It is a hypothetical driven method supportive for computing both long- and short-term impacts of one-time arrangement on another. Error correction term tells us long run speed of adjustment. It means, due to any reason dependent variable away from equilibrium point, then how much time will require that it will come to equilibrium point

$$ECT_{t-1} = GDP_{t-1} - \theta_o - \theta_1 GFCF_{t-1} - \theta_2 LF_{t-1} - \theta_3 FDI_{t-1} - \theta_4 PS_{t-1} - \theta_5 TO_{t-1} - \theta_6 INTER_{t-1} \text{......... (12)}$$

Error Correction Mechanism (ECM)

At the point when evaluation of long run relationship has completed, the further step is to find the short run relationship among variables. Relationship of short run will be assessing through error correction mechanism. It is a theoretical driven methodology accommodating for evaluating both long- and short-term impacts of one-time arrangement on another. Error correction term tells us long run speed of adjustment. It means, due to any reason dependent variable away from equilibrium point, then how much time will require that it will come to equilibrium point. ECM value must be negative and significant and value must be in between o and -1.

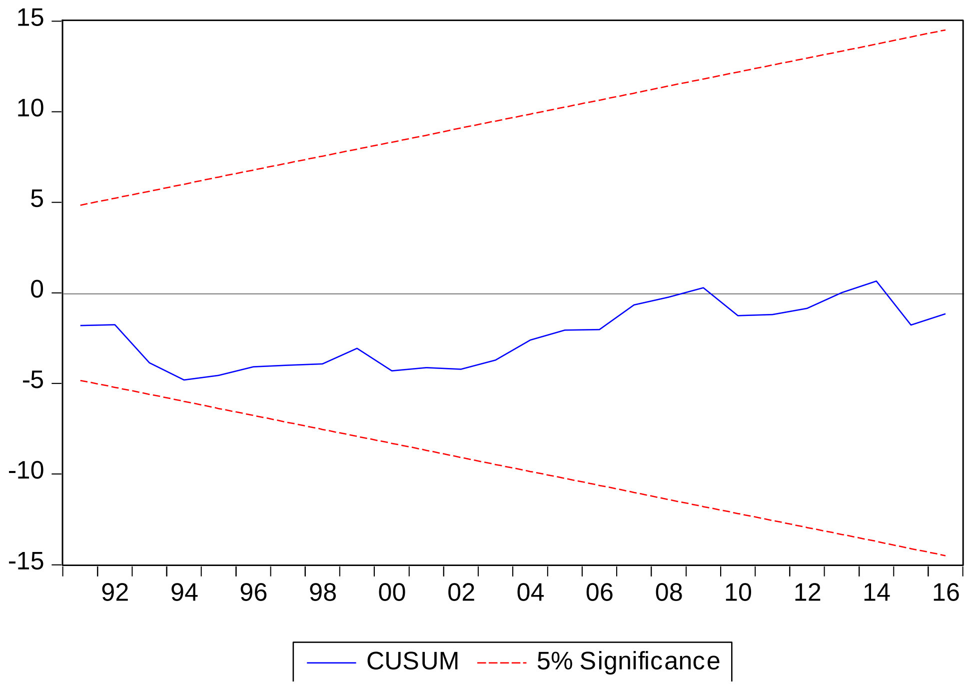
Normality Test

A test of normality is being used; with the aim to analyze either the residuals are shared normally or not. Afterwards it is essential for application ARDL. In general, an estimation technique is supposed to be dispersed normally. Without this the outcome of F-Statistics and also t-statistics do not pass correct results.

Cusum Test

Cusum test is developed by Brown (1975). Cusum test is applied to check whether there is break in our model or not. It is used to check the stability of model. Parameters lye within two critical bounds i.e. two dotted line in the Graph 3.1, if parameters are persistent. Parameters are said to be unstable or it means that we can say there are breaks in this model or model is not stable, if a line goes outside the bounds. Break means sudden change in year.

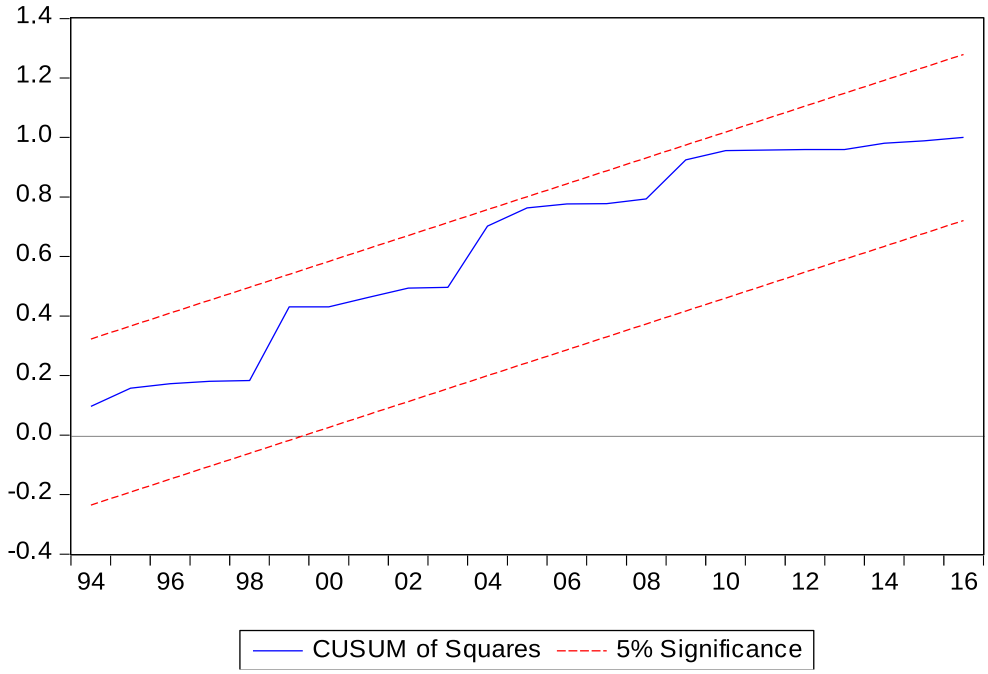
Graph 3.1



Cumulative Sum of Test Square

Cumulative Sum of Square test is important to reveal that the regression coefficients are evolving surprisingly. The regression coefficients are evolving suddenly, if red lines crossing blue lines.

Graph 3.2



Summary

This chapter has presented the components of theoretical framework, data sources, and description of variables and main model of the study. It also explains how the data of FDI, trade openness and interactive term with the help of formula is used. This section also displayed the method of estimation which occupied ARDL econometric framework and model of ADF. After Cusum test, LM test is used, to identify parameters stability.

Chapter 4

RESULTS AND DISCUSSION

4.1 Introduction

This chapter gives the empirical results of the long run relationship of composite impact of foreign direct investment and political stability on growth of economy accompanied by the short run dynamics and an error correction model representation. Diverse tests are performed in this section, before the investigation of long and short run elements. For determining the order of integration Augmented Dickey Fuller (ADF) Test is applied, and to confirm the existence of co integration among the variables the Bond test is useful. By using ARDL (Auto-Regressive Distributed Lag) approach the co integration is tested and the short-run elements are estimated utilizing the ECM (Error Correction Mechanism). When the estimation is finished, test of Cusum is performed to check the model stability and correlation test is applied to check the strength of relationship between the variables.

It is important to know the essential features of the data, for example, the summary statistics for the scale variables and measures of the data. It is essential in light of the fact that if the information is affirmed in a straightforward way, it's very confused to be comfortable with the pattern and example of the statistics. Data can understand in advance by methods of descriptive statistics. These statistics may assist in a research study with large data, to control the data and present it in a summary table. Descriptive statistics of all variables will be discussed below.

4.2 Descriptive Statistics

Summary statistics of entire variables occupied in study and is verified in the below table.

Table 4.1

Descriptive Statistics of the Variables

	LNREALGDP	LNGFCF	LNLF	LNFDI	PS	LNTO	NEW _INTERACTIVE _TERM
Mean	29.34410	27.65167	3.907167	19.75864	1.459459	-0.46569	31.41451
Median	29.35585	27.69881	3.906206	19.82580	5.000000	-0.50172	109.3579
Maximum	30.09722	28.13014	3.979308	21.87543	8.000000	1.417131	164.4849
Minimum	28.43776	26.97003	3.811097	17.18860	-7	-2.35225	-128.4373
Std. Dev.	0.473441	0.312601	0.041184	1.113009	6.410038	1.094742	125.2604
Skewness	-0.222989	-0.55879	-0.61081	-0.21961	-0.23517	-0.14375	-0.230961
Kurtosis	1.985126	2.548766	3.319986	2.837816	1.183358	1.871910	1.152123
Jarque-Bera	1.894500	2.239421	2.458576	0.337960	5.428840	2.089335	5.593197
Probability	0.387806	0.326374	0.292501	0.844526	0.066243	0.351809	0.061017

Summary statistics of the all variables are explained in Table 4.1 This research has utilized annual time series data from year 1980-2016 which comprises 36 observations. This signifies that average value for log of real gross domestic product (LNGDP) is 29.34 and together with 0.473 standard deviation. Standard value of log of gross fixed capital formation (LNGFCF) is 27.65. The average value of log of labor force (LNLF) is 3.90 with standard deviation 0.04. The average value of log of trade openness (LNTO) is -0.465 with 1.094 standard deviation. The average value of log of foreign direct investment (LNFDI) is 19.75 with 1.11 standard deviation. Average value of interactive term is 31.41 with standard deviation is 125.26.

To check the goodness of fit a Jarque-Bera test is utilized that tells that whether residuals are normally distributed or not. Variables of this research which includes foreign direct investment, trade openness, labor force, gross fixed capital formation, gross domestic product and interactive term all are normally distributed and the probability shows the Jarque-Bera probability

It is very essential to know which approach is applied in the study whether OLS, ARDL, or co integration. For determining the order of integration Augmented Dickey Fuller (ADF) has applied. ARDL model cannot be employed if any of the variables in the model is stationarity at second difference.

4.3 Augmented Dickey Fuller test

The null and alternate hypotheses of the Augmented Dickey-Fuller t-test are as follows

Hθ: Data is not stationary (variable has a unit root)

H1: Data is stationary (variable has no unit root)

Reject the null hypothesis of a unit root against the one- sided alternative if the ADF statistics is less than (less to the left) of the critical value and concluded that the series is stationary.

For the order of integration of the individual series, the ADF test is performed and the result of the test of ADF is given in table 4.2.

Table 4.2

Results of Augmented Dickey Fuller (ADF) Test

Variables	ADF TEST Results			
	ADF test stat	-3.567		
LN REAL GDP			**Prob**	**Result**
	1% level	3.632		
	5% level	-2.948		
	10% level	-2.612	0.0118	I (1)
	ADF test stat	-3.341		
LNGFCF	1% level	-4.2436	**Prob**	**Result**
	5% level	-3.544		
	10% level	-3.204	0.07	I (0)
	ADF test stat	-2.836		
LNLF	1% level	-3.653	**Prob**	**Result**
	5% level	-2.9571		
	10% level	2.6174	0.0645	I (0)
	ADF test stat	-6.5263		
LNTO	1% level	-3.632	**Prob**	**Result**
	5% level	-2.948		
	10% level	-2.612	0.000	I (1)
	ADF test stat	-3.632		
PS	1% level		**Prob**	**Result**
	5% level	-3.632		
	10% level	-2.948		
		-2.6128	0.0001	I (1)
	ADF test stat	-5.326		
LNFDI	1% level	-3.632	**Prob**	**Result**
	5% level	-2.948		
	10% level	2.6128	0.0001	I (1)
	ADF test stat	-5.496628		
NEW-INTERACTIVE TERM	1% level		**Prob**	**Result**
	5% level	-3.6329		
	10% level	-2.948404		
		-2.612874	0.0001	I (1)

Note: Authors calculated by using E-views 9

The results all variables of the ADF test are shown in the Table 4.2

The outcome of ADF test statistics, for independent as well as dependent variable includes of log of real gross domestic product (LNREALGDP), log of gross fixed capital formation (LOGGFCF), log of labor force (LNLF), log of trade openness (LNTO) and log of foreign direct investment (LOG FDI), political stability (PS) and composite term FDI and political stability.

It depicts that log of real gross domestic product (LNREALGDP) has unit root issue at level and after taking first difference, the LOGGDP variable becomes stationary. The next variable is gross fixed capital formation (LOGGFCF) variable, it is stationary at level. The other variable is labor force (LNLF) becomes stationary at level as its probility value is less than 0.05 at level. Trade openness (LNTO) and the variable FDI (LOGFDI) becomes stationary at first difference. The composite variable (LogFDI*PS) become stationary after taking first difference as value of probility is less than 0.05 at first level.

Co integration technique is helpful when a few variables are stationary at level and further are on the first difference respectively. The fundamental motivation behind this research survey is to observe the effect of foreign direct investment and political strength on growth of economy independently and furthermore to check the composite effect of FDI and political stability on economic growth in Pakistan. Consequently, three models have been analyzed in this study. The model 1 examines the FDI impact on growth of economy in Pakistan. In model 2 investigates political stability impact on growth of economy. The model 3 checks the composite impact of FDI and political stability on economic growth.

The study performs Bond test, ARDL approach, ECM for short run, long run and Cusum test on three models respectively to understand the results more accurately.

4.4 Model 1

Model 1 has important and significant role in this study. This model explores the impact of foreign direct investment on economic growth. Many developing states need higher investment to achieve high economic growth. Developing country like Pakistan needs capital for the growth of its industrial and economical sector. Foreign direct investment (FDI) is an important instrument require for the development of the economic and technological sectors of Pakistan. Pakistan is adding up amongst the countries that are scared of physical capital and foreign business enterprises and could help to get better overall living standard in the country. It brings along different services opportunities for the people of Pakistan and helps them to get better their skills through transmit of technological and strategic managerial abilities.

Gross domestic product is dependent variable whereas gross fixed capital formation, labor force, trade openness and foreign direct investment are independent variables of Model 1.

Before applying ARDL, optimal lag length of Model 1 has been determined by using lag length criteria.

Table 4.3

Optimal Lag Selections Table

Lag	LogL	LR	FPE	AIC	SC	HQ
0	99.25583	NA	2.27e-09	-5.712475	-5.485731	-5.636182
1	250.3286	247.2100	1.11e12*	-13.35325	-11.99279*	-12.89549*
2	272.3617	29.37751	1.49e-12	-13.17344	-10.67926	-12.33422
3	288.3859	16.50977	3.51e-12	-12.62945	-9.001552	-11.40877
4	343.2053	39.86861*	1.18e-12	-14.43668*	-9.675067	-12.83454

The Table 4.3 depicts the optimal lag selection criterion outcome of model 1. There are diverse criteria's similar to AIC (Akaike information criterion), SC (Schwarz information criterion) (Hannan-Quinn information criterion), log LR (LR test statistics sequential modified) and FPE (Final prediction error), SC and AIC are those criteria which are used frequently. In accordance with AIC criterion 4 lags are optimal and SC criterion 1 lag is optimal.

Table 4.4
Estimation of ARDL of Model 1

Variable		Coefficient	t-Statistic	Prob.*
LNREALGDP (-1)		0.60632	3.229768	0.0044
LNGFCF		0.045498	0.604165	0.5529
LNGFCF (-1)		-0.092505	-1.211379	0.2406
LNGFCF (-2)		-0.073293	-1.00837	0.3259
LNGFCF (-3)		0.557069	3.593548	0.0028
LNLF		-0.051352	-0.607999	0.5504
LNLF (-1)		-0.067745	-0.971782	0.3434
LNLF (-2)		0.006691	0.078063	0.9386
LNLF (-3)		-0.15632	-1.767264	0.0932
LNTO		0.037675	0.98799	0.3356
LNTO (-1)		0.0455	1.169686	0.2566
LNTO (-2)		0.060441	1.59188	0.1279
LNFDI		0.007352	0.832704	0.4154
R-squared	0.999405			
F-Stats	2279.44			

The above Table 4.4 demonstrates the outcome of model 1 of ARDL. The results show that labor force and GFCF has significant impact on growth of economy of Pakistan, whereas trade openness and FDI have insignificant impact on growth of economy of developing state like Pakistan. Economic growth can be encouraged by gross fixed capital formation through a number of ways, like by creating enormous advantages, by the transfer of information, technology and information spillovers. It produces resourceful use of resources, skill development and trade facilities which in turn provides higher foreign exchange, enlarge those sectors of economy which are not well developed. The responsibility of human and physical capital is very effectual in the less developed countries.

From 1980 ahead the effect of trade dimensions on growth became remarkable, when Pakistan gradually moves towards current tariff modification plan for industrial sector growth. After tariffs reduce, Pakistani business enterprises began bringing in crude materials and transitional items which expanded labor efficiency and as an outcome prompted assist rapidly economic growth. (Ashfaque Hasan 2000). The value of R-squared is 0.999. The value of R squared demonstrates that how much independent variables together can manipulate dependent variable in this model.

It is very imperative to confirm the existence of long run equilibrium relationship among variables before moving towards long and short run results, ARDL bound testing approach has been applied.

Table 4.5

Bound Test

Order of Lag	F-Statistics	Lower Bound	Upper Bound
4	4.240486	3.03	4.06

Note: significant at 10%

It is confirmed from the bound test that whether a long-run relationship exists or not. The null hypothesis of this test is that there is no long-run relationship against the alternate hypothesis that there exists co integration. 4.2404 is the value of F-Statistics, which is larger than upper bound value of 4.06 and it has been taken from the table specified by Pesaran (2001). Co integration exists, if the bound test calculated value comes more than upper bound. At the point when a long-run relationship exists, so now it can go to results identified with long-run and short-run results

Table 4.6

Short Run Results of ARDL

Regressor	**Coefficient**	**Standard Error**	**T-Ratio**	**Probability**
D(LNGFCF)	0.045498	0.075307	0.604165	0.5529
D (LNGFCF (-1))	0.073293	0.022685	3.230901	0.0038
D (LNLF (-1))	-0.006691	0.085708	-0.078063	0.9386
D (LNLF (-2))	0.156320	0.088453	1.767264	0.0932
D(LNTO)	0.037675	0.038132	0.987990	0.3356
D (LNTO (-1))	-0.060441	0.037968	-1.591880	0.1279
D(LNFDI)	0.007352	0.008829	0.832704	0.4154
ECM (-1)	-0.393680	0.187729	-2.097068	0.0496

In Table 4.6, the results of the short-run parameters and error correction term of first model are demonstrated. In Model 1 gross domestic product is dependent variable whereas gross fixed capital formation, labor force, trade openness and foreign direct investment are independent variables. Increase in gross fixed capital formation induces an increase in the gross domestic product in the short run. Labor force likewise constructively affects the dependent variable while the trade openness adversely impacts on economic growth. Increase in foreign direct investment induces an increase in the gross domestic product in the short run

In Model 1, the term of ECM explains a speed of adjustment to achieve the equilibrium. Value of ECM should have a negative symbol as well as it's obligatory to be significant. The coefficient of ECT has negative symbol which point out convergence in the long-run. In the current model, ECM value is -0.39, it suggests that 39 percent of disequilibrium is being corrected annually, if the control variable moves in the same direction.

(Lipsey &Zejan (1996) found that FDI has a noteworthy and positive effect on the economy of host country in long and as well as a short run. FDI general effect is positive on the economy as it allows the host states to make trade with different countries. The negative impact of trade liberalization on the economic growth of Pakistan in short run may be due to the weak conflict management institutions and lack of quality institutions in the country. The negative effect may be due to the exports of raw material instead of final goods

Table 4.7

Long –Run Coefficients of ARDL

Note: * shows significance at 5% and ** shows significance at 10%.

Regressor	Coefficient	Standard Error	T-Ratio	Probability
LNGFCF	-0.160618	0.307895	-0.521665	0.6079
LNLF	-0.682602	0.349471	-1.953246	0.0657*
LNTO	0.364804	0.204567	1.783299	0.0905**
LNFDI	0.018675	0.022968	0.813078	0.4262

In table 4.7 long-run results of Model 1 are demonstrated. The outcome demonstrates that there is negative and insignificant effect of gfcf and growth of economy; it shows that if we increase 1 percent increase in gross fixed capital formation, in this response there will be a decrease of 0.160 percent in gross domestic product i.e. economic growth.

The conclusion demonstrates that at 5% level of significance which means that there is a significant as well as negative association among labor force and gross domestic product. It depicts that if we bring 1 percent expansion up in labor force, in this response there is a decay of 0.68 percent in economic growth.

There is a constructive but significant relationship among trade openness and gross domestic product at 10% level of significance. If there is a 1 percent increase in terms of trade, then there is an increase 0.36 percent increase in economic growth.

There is a positive and insignificant connection among GDP and FDI. It shows that if there is a 1 percent amplify in FDI then there is a 0.018 percent increment in the growth of economy. Findings of current study are allying with Nuzhat Falki (2009) discussed impact of FDI on economic growth in Pakistan. The results of the study shows a insignificant relation between FDI and economic growth. Perquisites are required for FDI to show significant results. Prerequisites include presence of liberal trade, improved infrastructure. Human resource and stable macroeconomic framework.

Mohey&Ghulam (2004) moreover discover very much built constructive outcome of FDI on economic growth of Pakistan. Financial specialists are especially engaged with contributing to Pakistan economy because of new security approaches and politically unfaltering quality. One of the fundamental causes to clarify the constructive effect is that the foreign direct investment inflow catches the creative innovation and the investment increment in the country wealth.

A few diagnostic tests have been applied, to guarantee the stability of the Model 1. Durbin Watson is utilized with a specific end goal to check the presence of Auto-correlation however it checks auto-relationship of request one as it were. To check there exist auto-connection of higher request LM test has been utilized.

Serial Correlation LM Test

To determine serial correlation, LM test is utilized in the model. The insignificant value of F-Stats (0.30) shows that there is no serial correlation.

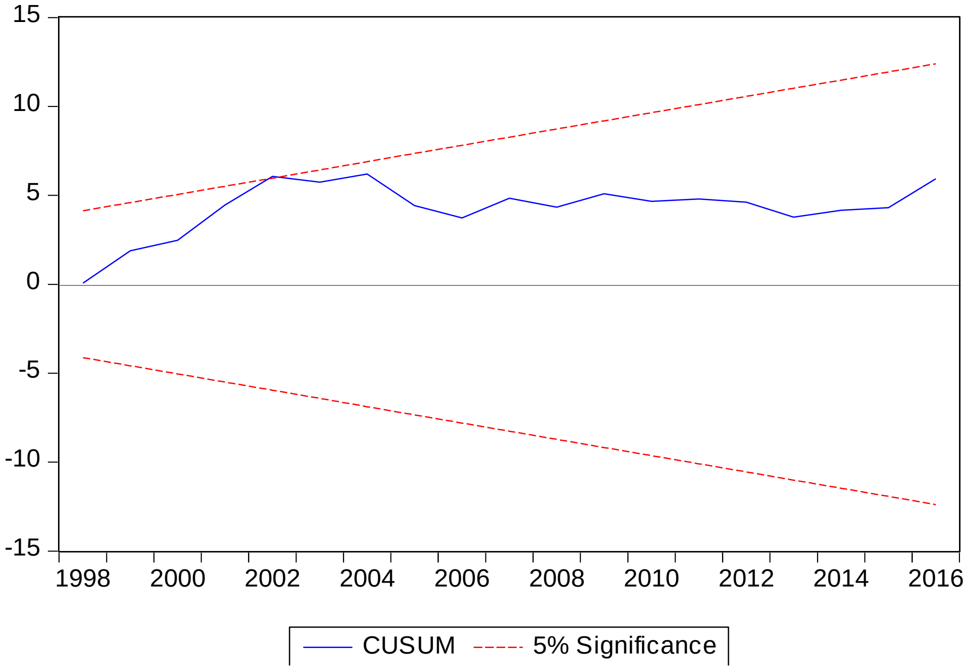
Histogram-Normality Test

To investigate the residuals are normally distributed or not, a test of normality is also used “Jarque-Bera” test is applied, in order to see the regularity of the data series. It checks that whether the data is normally distributed or not. Results show that the Jarque-Bara is 13.519, which has the probility value 0.266, which is insignificant and leads to the normality of the distribution. The bell-shaped normality distribution also supports the results.

The Cumulative Sum of Recursive Residual (CUSUM) and Cumulative Sum of Residual Square (CUSUMSQ) trial of estimation parameters are performed to check the steadiness parameters as created by Brown (1975). Parameters lie among the two critical bound, symbolize in the graph underneath by the dotted line, if they are stable. The parameters are unstable if the line goes outward the limits.

Graph 4.1

Parametric Stability Test (CUSUM)



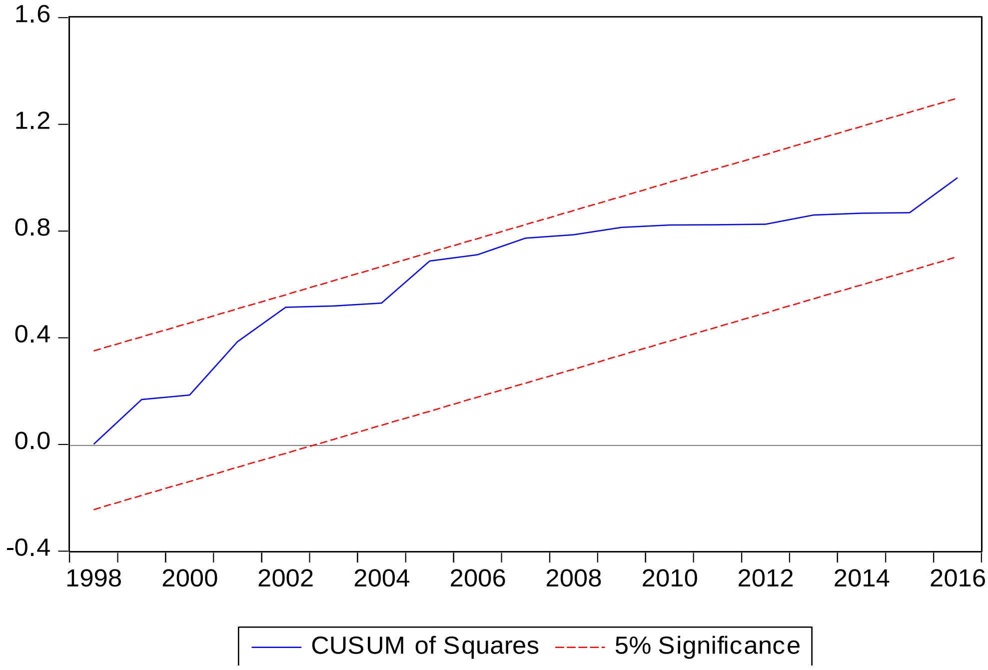
Above figure displays the result of parametric stability test lies both in the critical bound as a result for the period 1980-2016 the estimated parameters are consistent. The conclusion illustrates that the parameters are persistent as all variables lie in the critical bounds.

The straight lines in Graph 4.1describe critical bounds at 5 % level of significance

Parameters lay between two critical bound, represent in the graph under the dotted line, if they are stable. The parameters are unstable if the line goes outside the bounds. Figure bellow describes the outcomes parametric stability test lay together in the critical bound. Therefore, the estimated parameters are stable.

Graph 4.2

Parametric Stability Test (CUSUMSQ)



Conclusion of Model 1

Model1 has been utilized to prove the impact of FDI on growth of economy of Pakistan from the period of 1980 to 2016. Gross domestic product is dependent variable and GFCF, labor force, trade openness, and foreign direct investment are independent variables. By using ARDL technique, Long-run and short run results have been found. To verify the long run relationship in the estimation model, the bound test approach is applied. Both in long run and short run the FDI has an overall constructive effect on the Pakistan economy. One cause to make clear the constructive effect is that the foreign direct investment inflow carries the innovation and the speculation advance the country economy. Gross fixed capital formation and labor force negatively affect the economic growth in this model.

4.5 Model 2

Model 2 has vital and significant task in study. It inquires the impact of political stability on economic growth of Pakistan. Investment and growth of any country highly depend upon the stable and peaceful environment. Issues of employment, poverty, inflation and human capital development can easily be solved in an environment that is free of political instability.

There is a chance of lower growth rate of GDP linked with higher level of political instability (mentioned in working paper of IMF).

It is verified that what is the impact of political stability on growth of economy of developing country like Pakistan. In Model 2 dependent and independent are same as utilized in model 2, only excludes FDI variable and add political stability variable to check the consequences of political stability on economic growth. Data of all variables have been taken in unit form and then change in log form for estimation. Index of political stability has been taken from polity IV.

Optimal lag length has been determined in the following table by using lag length criteria.

Table 4.8

Optimal Lag Selections

Lag	LogL	LR	FPE	AIC	SC	HQ
0	7.726079	NA	5.83e-07	-0.165217	0.061527	-0.088925
1	175.6942	274.8569*	1.03e-10*	-8.829951	-7.469489*	-8.372197*
2	192.2274	22.04432	1.92e-10	-8.316814	-5.822634	-7.477598
3	210.3370	18.65838	3.98e-10	-7.899214	-4.271317	-6.678537
4	260.4339	36.43412	1.77e-10	-9.420239*	-4.658624	-7.818100

The Table above stands for the optimal lag selection criterion to model 2. There are diverse criteria's in this table like AIC, SC and HQ but usually applied criterion are SC and AIC. In accordance with AIC criterion 4 lags are optimal and SC criterion 1 lag is optimal.

Table 4.9

Estimation of ARDL of Model 2

Variable	Coefficient	Std.Error	t-Statistic	Prob.*
LNGFCF (-2)	-0.272583	0.098572	-2.765328	0.0138
LNLF	0.074936	0.079363	0.94421	0.3591
LNLF (-3)	-0.1915	0.080227	-2.386974	0.0297
LNTO	0.059797	0.034223	1.747295	0.0997
LNTO (-2)	0.134042	0.045754	2.929622	0.0098
PS	0.001768	0.000811	2.179885	0.0445
R-squared	0.999547			
F-Statistic	2208.83			

The above table shows the results of Model 2 of ARDL in which trade openness and political stability have positive and significant impact on growth of economy whereas gross fixed capital function has negative and significant impact on growth of economy. There has been a constructive and significant impact on economic growth by labor force. The value of R-square is 0.999 and the value of adjusted R-squared is 0.99 The value of R squared shows that how much independent variables jointly can influence dependent variable in model 2.

It is very significant to check the presence of long run equilibrium relationship among variables, utilize ARDL bound testing approach.

Table 4.10

Bound Test

Order of Lag	F-Statistics	Lower Bond	Upper Bond
4	4.077068	3.04	4.06

Note: significant at 10%

It confirms from the bound test that whether a long-run relationship exists or not. The null hypothesis of this test is that there is no long-run relationship against the alternate hypothesis that there exists co integration. Table 4.10 exposes that 4.077 is the value of F-Statistics, which is bigger than upper bound value of 4.06 and it has been acquired from the table given by Pesaran (2001). Co-integration exists, if the bound test calculated value comes more than upper bound. Now it can move to result identified with long-run and short-run, as long-run relationship exists.

Table 4.11

Estimation of VECM

Regressor	Coefficient	Standard Error	T-Ratio	Probability
D(LNGFCF)	0.054644	0.072941	0.749150	0.4646
D (LNGFCF (-2))	0.272583	0.098572	2.765328	0.0138
D (LNLF (-1))	-0.123509	0.085629	-1.442374	0.1685
D (LNLF (-2))	0.191500	0.080227	2.386974	0.0297
D(LNTO)	0.059797	0.034223	1.747295	0.0997
D (LNTO (-1))	-0.134042	0.045754	-2.929622	0.0098
D(PS)	0.001768	0.000811	2.179885	0.0445
ECM (-1)	-0.369146	0.178472	-2.068373	0.0552

The results of short-run the Model 2 parameters and error correction term are demonstrated in Table 4.11. In second model dependent variable is GDP whereas and independent variables are GFCF, labor force, trade openness and political stability. Increase in gross fixed capital formation induces an increase in the gross domestic product in the short run. Trade openness negatively impacts on economic growth whereas Labor force a has constructive impact on the gross domestic product. In short run there is significant and constructive relationship among political stability and economic growth.

In Model 2 ECM explains a speed of adjustment to achieve the equilibrium. Value of ECM should have a negative symbol as well as its essential to be significant. Coefficient of error correction term has negative sign which reveals convergence in the long-run. In the current model, ECM value is -0.36, it suggests that 36 percent of disequilibrium is being Corrected annually.

Trade openness has significant and negative impact on growth of economy of developing state like Pakistan. (Umer (2014) accomplished that trade hindrances estimates negative and significant impact on economic growth in long run. In short run, the impact of trade openness on economic growth is not clear. Pakistan should focus on trade openness policies to enhance economic growth. There is negative impact of trade liberalization on the economic growth of Pakistan. It may be due to the weak conflict of management institutions and deficient of quality institutions in the country or due to the export of raw material instead of final goods. (Abdullah (2010). Labor force has constructive impact on growth of economy in short run. Latest education institutes that generates labor skilled, which advance the economic growth of Pakistan. (Shahid (2014).

Table 4.12

Long –Run Coefficients of ARDL

Regressor	Coefficient	Standard Error	T-Ratio	Probability
LNGFCF	-0.781763	0.610482	-1.280568	0.2186
LNLF	0.190589	0.422169	0.451451	0.6577
LNTO	0.704490	0.358199	1.966756	0.0668*
PS	0.004790	0.002593	1.846817	0.0834**

Note: * shows significance at 5% and ** shows significance at 10%.

long-run results of Model 2 are demonstrated in Table 4.12. The outcomes exhibit that effect of gfcf and growth of economy is insignificant and negative it shows that if we raise 1 percent in gross fixed capital formation, in this response there is a 0.781 percent decrease in gross domestic product i.e. economic growth.

Impact of labor force and gross domestic is a positive but insignificant relationship it portrays that if we raise 1 percent increase in labor force, in this reaction there will be a raise of 0.190 percent in economic growth.

Impact of political stability and gross domestic product is a positive and significant relationship. It illustrates that if we raise 1 percent in political stability then there will be an add to of 0.0047 percent in the economic growth.

According to the long run coefficients of ARDL the Political stability has constructive and significant effect on the growth of economy of Pakistan. Political stability increases investment rate and growth of a country highly depend upon the stable and peaceful environment. Many economic and social issues like issues of employment, poverty, and human capital development can easily be solved in an environment that is free of political instability. (Radu (2015) discussed the influence of political stability on economic growth in Romania and concluded that political stability has a significant role in a country's economic growth and that a stable political environment assists in building a consistent and continuous path for sustainable growth. Political stability guarantees job creation, higher state revenues, poverty reduction, increased welfare and education level and these accomplishments are carried benefits to all citizens of country, consequently violence will significantly reduce.

Labor force has also positive impact on economic growth, it means labor force participation increases then the economic growth also increases. Labor force can be depicted as the lively populace, who create merchandise and enterprises to satisfy the necessities of the general public. Low level of labor force is significant trouble that creating countries are confronting now days. Connection between labor force participation rate and economic growth is exceptionally solid, which is affirmed in different investigations. Economic growth improves due to expertise of labor force (Eris &Furceri 2010). To confirm model stability various tests of diagnostic have been applied. In order to check the existence of auto-correction Durbin Watson is used but it checks auto-correction of only first order. To check there exist auto-correction of higher order LM test has been used.

Serial Correlation LM Test:

To determine the serial correlation, LM test is utilized in the model. If probability value is greater than 0.05, it means problem of serial correlation is not exist, so null hypothesis can't be rejected. In contrast, null hypothesis is rejected; if value of probility is lower than 0.05. It is clear in the above table that the problem of serial correlation is not present in the model as the value of Chi-Square is 0.091 which is more than 0.05, in this way null hypothesis is accepted for this model.

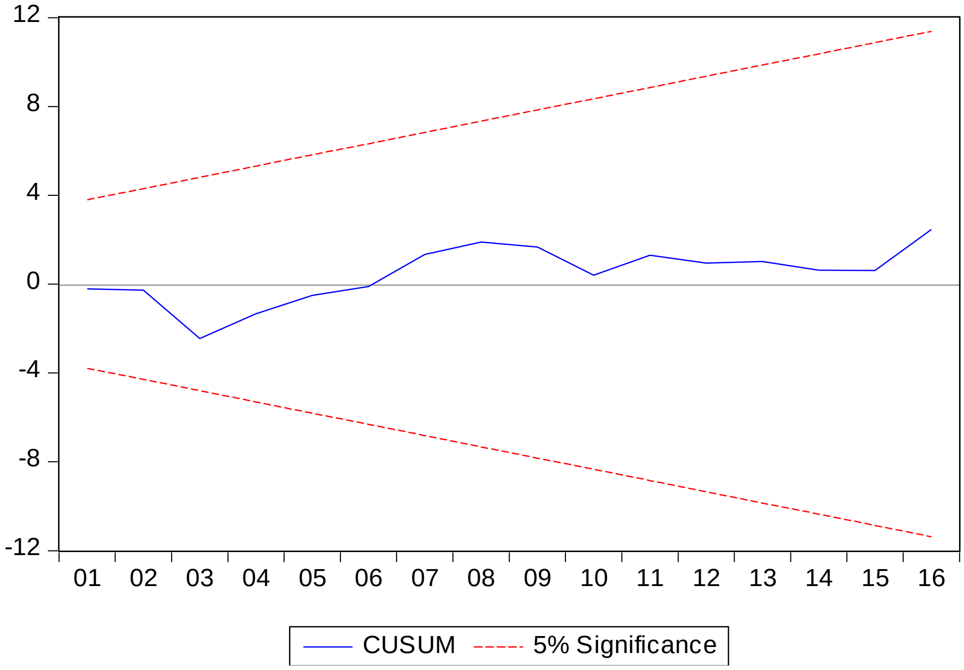
Histogram-Normality Test:

To examine the residuals are normally distributed or not, in Model 2 a test of normality is utilized. Test of "Jarque-Bera" is applied, in order to see the regularity of the data series. It checks that whether the data is normally distributed or not. Residuals of Model 2 are normal according to the above figure, because the probability value is 0.3945.

The Cumulative Sum of Recursive Residual (CUSUM) and Cumulative Sum of Residual Square (CUSUMSQ) tests of estimation are performed to check the stability parameters as developed by Brown (1975). Parameters lie among the two critical bound signified in the diagram under by the dotted line, if the parameters are stable. The parameters are unstable, if the line goes outside the limits

Graph 3

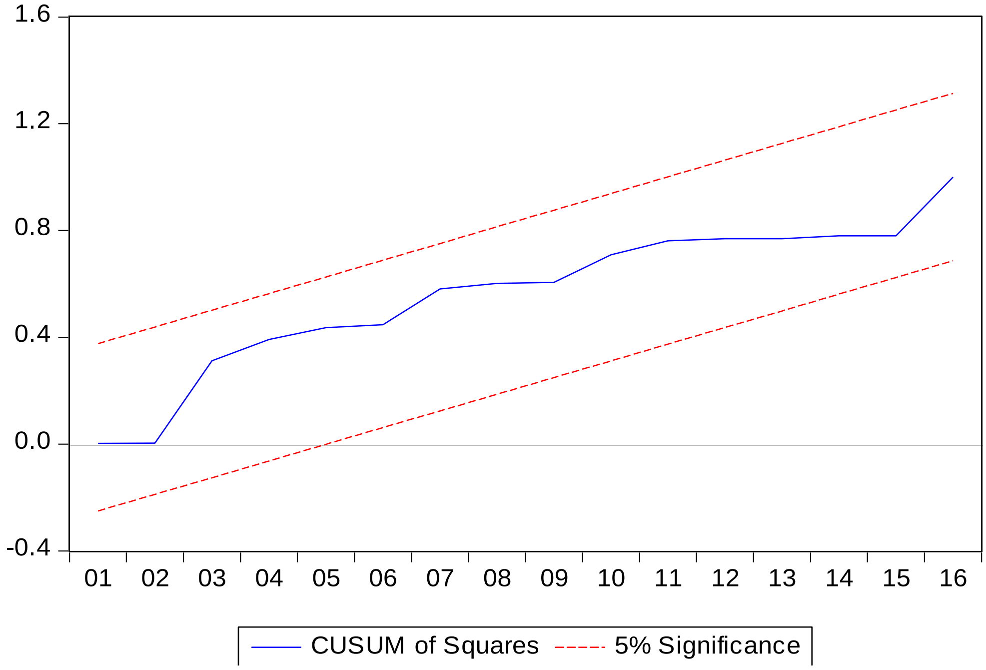
Parametric Stability Test (CUSUM) of second model:



The outcome of parametric stability test lies both in the critical bound as shown in the Figure above. For the period 1980-2016, the estimated parameters are stable. The outcome explain that the parameters are stable as all variables lie in the critical bounds.

Graph 4

Parametric Stability Test (CUSUMSQ)



The straight lines represent critical bounds at 5 % level of significance

Parameters lie among two critical bounds, described in the diagram above the dotted line, if the parameters are stable. It means the parameters are unstable; if the line goes outside the bounds. The outcome of tests of parametric stability of second model lay both in the critical bound as shown in the figure above so, estimated parameters are stable.

Conclusion of Model 2

To prove the impact of political stability on growth of economy of Pakistan over the period of 1980 to 2016 of model 2 has been developed. Gross domestic product is dependent variable and GFCF, labor force, trade openness, and political stability are independent variables. By utilizing ARDL technique, Long-run and short run outcomes have been found. To verify the relationship of long run in the estimation model test of bond is utilized. In short run and long run the political stability has a general constructive effect on the Pakistan economy. One cause to make clear the positive effect is that investment and growth of any country highly depend upon the stable and peaceful environment. Issues of employment, poverty, inflation and human capital development can easily be solved in an environment that is free of political instability.

4.6 Model 3

Model 3 has important and significant role in this study. Interactive term has been generated by multiplication of log of FDI and index of political stability. It means, a country which is politically and socially stable, attract foreign investors to do high level of investment in the country. Foreign direct investment has the prospective for job creation and service, which is often followed by higher wages. Resources can transfer in terms of capital and technical knowledge in the host country. Advantages of FDI for the host country can be huge, including innovation overflows, human capital development, improvement of aggressive business condition, commitment to global exchange incorporation and change of big business advancement.

It is investigated that, what is the impact on economic growth in the presence of political stability and high foreign direct investment. Gross domestic product is dependent variable whereas gross fixed capital formation, labor force; foreign direct investment, political stability and interactive term are independent variables of third model.

Before applying ARDL on Model 3, optimal lag length has been determined by using lag length criteria.

Table 4.13

Optimal Lag Selections

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-101.5003	NA	1.39e-06	6.382373	6.696624	6.489542
1	96.55315	302.9053*	2.31e-10*	-2.385479	0.128526*	-1.528131*
2	139.4749	47.97136	4.89e-10	-2.027935	2.685826	-0.420408
3	200.5091	43.08300	8.58e-10	-2.735832*	4.177683	-0.378126

The optimal lag selection criterion result of Model 3 of study has been portrayed in the above table. There are various criteria’s like FPE (Final prediction error), AIC (Akaike information criterion), SC (Schwarz information criterion) (Hannan-Quinn information criterion) and log, LR (sequential modified LR test statistics. AIC and SC are those criteria which are utilized frequently. AIC criterion 3 lags are optimal and SC criterion 1 lag is optimal

Table 4.14

Estimation of ARDL

Variable	Coefficient	Std.Error	t-Statistic	Prob.*
LNGFCF	0.094973	0.053061	1.789863	0.0867
LNLF	0.002991	0.07378	0.040541	0.968
LNFDI	0.008571	0.006667	1.285576	0.2114
PS	0.025481	0.010856	2.347148	0.0279
PS (-1)	0.01322	0.01151	1.148549	0.2625
PS (-2)	0.00128	0.000741	1.726459	0.0977
LNTO	0.04573	0.031033	1.473581	0.1542
NEW_INTERACTIVE_TERM	-0.00122	0.000546	-2.232801	0.0356
NEW_INTERACTIVE_TERM (-1)	-0.000725	0.000576	-1.25777	0.2211
R-squared	0.999496			
F-Statistics	4143.98			

The outcome of Model 3 of ARDL has been demonstrated in table 4.14 in which impact of FDI and political stability has positive and significant results whereas gross fixed capital function has also positive and significant impact on economic growth. The value of R-squared is 0. 999.The value of R square shows that how much independent variables jointly can influence dependent variable in particular model.

Before moving towards long and short run results, it is very important to check the existence of long run equilibrium relationship among variables, ARDL bound testing approach has been used.

Table 4.15

Bound Test

F-Statistics	Lower Bond	Upper Bond
3.639187	2.53	3.59

Note: significant at 10%

It confirms from the bound test that whether a long-run relationship exists or not in the Model 3. This test has null hypothesis that is there is no long-run association adjacent to the alternating hypothesis that there exists co integration. The value of F-Statistics shown in the table 4.15 is 3.639 which is larger than value of upper bound 3.59. Co integration survives, if the bound test calculated value appears more than higher bound. It has been established that long-run association take places, so now it can go to outcome related to the third model long-run and short-run results.

Table 4.16

Short Run Results of ARDL

Regressor	Coefficient	StandardError	T-Ratio	Probability
D(LNGFCF)	0.094973	0.053061	1.789863	0.0867
D(LNLF)	0.002991	0.073780	0.040541	0.9680
D(LNFDI)	0.008571	0.006667	1.285576	0.2114
D(PS)	0.025481	0.010856	2.347148	0.0279
D (PS (-1))	-0.001280	0.000741	-1.726459	0.0977
D(LNTO)	0.045730	0.031033	1.473581	0.1542
D(NEW_INTERACTIVE_ TERM)	-0.001220	0.000546	-2.232801	0.0356
ECM (-1)	-0.728457	0.151193	-4.818065	0.0001

The results of short-run parameters and error correction term are demonstrated in Table 4.15. Increase in gross fixed capital formation induces an increase in the gross domestic product in the short run. Labor force likewise positively affects the economic growth whereas the trade openness has constructive impacts on economic growth. Composite impact of FDI and political stability has negative and significant impact on economic growth in short run. The reason behind this everything takes some time to settle. Economy also take time to give positive result by using new technology and machineries.

To attain the equilibrium in particular dynamic model, term ECM has used which describes a speed of adjustment. The value of ECM must be negative symbol as well as its necessary to be significant. The negative symbol with the coefficient of error correction term point outs convergence, in the long-run. In the current model, ECM value is -0.0012 it suggests that 12 percent of disequilibrium is being corrected annually.

Table 4.1 7

Long –Run Coefficients of ARDL

Regressor	Coefficient	StandardError	T-Ratio	Probability
LNGFCF	0.130375	0.060715	2.147322	0.0425**
LNLF	0.004106	0.001202	3.415973	0.0168*
LNTO	0.062776	0.044932	1.397143	0.1757
LNFDI	0.011766	0.007314	1.608743	0.1023***
PS	0.054884	0.013865	3.958499	0.0006*
Newinteractive term	0.02669	0.0007071	3.7745722	0.0009

Note: * shows significance at 5% and ** shows significance at 10%

Table 4.17 demonstrates the long run results of third model. The outcome illustrates that there is a significant but constructive impact of gross fixed capital formation and economy of growth, it shows that if we 1 percent rise in gross fixed capital formation, in this response there will be an increase of 0.130 percent in economic growth.

The outcome confirms that at 5 % level of significance among labor force and gross domestic product there is a constructive but significant relationship. It represents that if we raise 1 percent increase in labor force, in result 0.004 percent increase in dependent variable (GDP).

Relationship between trade openness and gross domestic product is positive and significant. If we enhance 1 percent in trade openness, in result 0.062 percent increase in dependent variable. The outcome in the above table reveals that relationship between interactive term and economic growth is positive and significant. It means if we increase 1 percent in interactive term, in this response 0.026 percent increase in economic growth.

Foreign direct investment shows positive impact on economic growth of Pakistan in long run. Basically, foreign businessmen are more interested to put resources in developing countries due to cheap raw material and labor cost to get more advantages. FDI is the basic tool to increase the economic growth education, technology, new capital goods, skilled labor will automatically increase in host country. (Rahman (2014).

Political stability shows a constructive impact on growth of economy. Investment and growth of any country highly depend upon the stable and peaceful environment. Investment and growth of any country profoundly rely on the steady and serene condition. Issues of work, poverty, inflation and human capital improvement can undoubtedly be tackled in a situation that is free of politically unstable. There is a chance to bring down growth rate of GDP per capita connected with larger amount of political instability (working paper by IMF).

Composite impact of FDI and PS shows a constructive impact on growth of economy Pakistan it means FDI and political stability both increases side by side in a country, economic growth will increase more rapidly. FDI inflows are largely depending upon political stability of host country. Countries with high political rights have tendency of capital out flows (Hanson (2010). Foreign investors are interested to invest in countries, with low political instability. A country which is socially and politically stable will have more investment opportunities. Capital goods, technical knowledge and skilled labor will increase in the host country (Lucus (1990). At the point when this condition prevails in any country, where it has the two components of interactive term i.e. (political stability and FDI inflows), economic growth will flourish rapidly.

Diverse diagnostic tests have been used to ensure the model stability in order to check the existence of auto-correction Durbin Watson is used but it checks auto-correction of only first order. To check there exist auto-correction of higher order LM test has been used.

Serial Correlation LM Test:

F Statistics	3.121008	Probability F (2,17)	0.06505648

To discover the serial connection, LM test is utilized in the model. The problem of serial relationship must not be available in demonstrate, for example if it exists then the outcome will not be suitable. It can further be applied used in the models, when lagged values for dependent variables are being applied as independent variables.

For analysis of hypothesis, if probility value is more than 0.05, so null hypothesis can't be rejected, it implies problem of serial correlation is not existing. Conversely null hypothesis is rejected; if probility value is lower than 0.05. The probility of Chi-Square is 0.09 which is greater than 0.05 in the above table, the issue of serial correlation is not present in the model, in this way null hypothesis is accepted for this model.

Histogram-Normality Test:

To verify either the residuals are normally distributed or not, a normality test is used. It is important to utilize ARDL afterwards. All around the approximation model is supposed to be normally distributed. If it is not correct, further the outcomes for the t and F statistics don't deliver correct information.

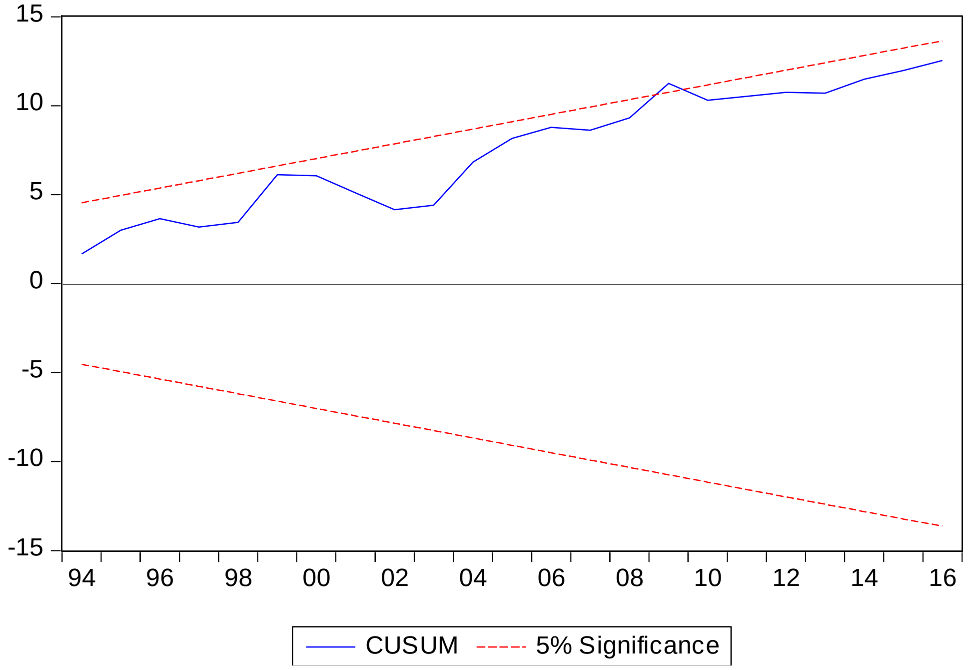
Another test of "Jarque-Bera" is applied., in order to see the regularity of the data series. It checks that whether the data is normally distributed or not. As the probability value is 0.648 in the above figure, it shows that residuals are normal

Brown developed in (1975) the stability parameters which are confirmed by completing the Cumulative Sum of Recursive Residual (CUSUM) and Cumulative Sum of Residual Square (CUSUMSQ) tests of estimation. It has been shown in the diagram that parameters lie between the two critical bound, by the dotted line, it implies parameters are steady. If the line goes outside the limits, it signifies that the parameters are unstable.

Bellow figure illustrates the result of parametric solidness test lies both in the critical bound. Subsequently for the time of 1980-2016, the estimated parameters are stable. The result shows that all variables lie in the critical bound so the parameters are stable.

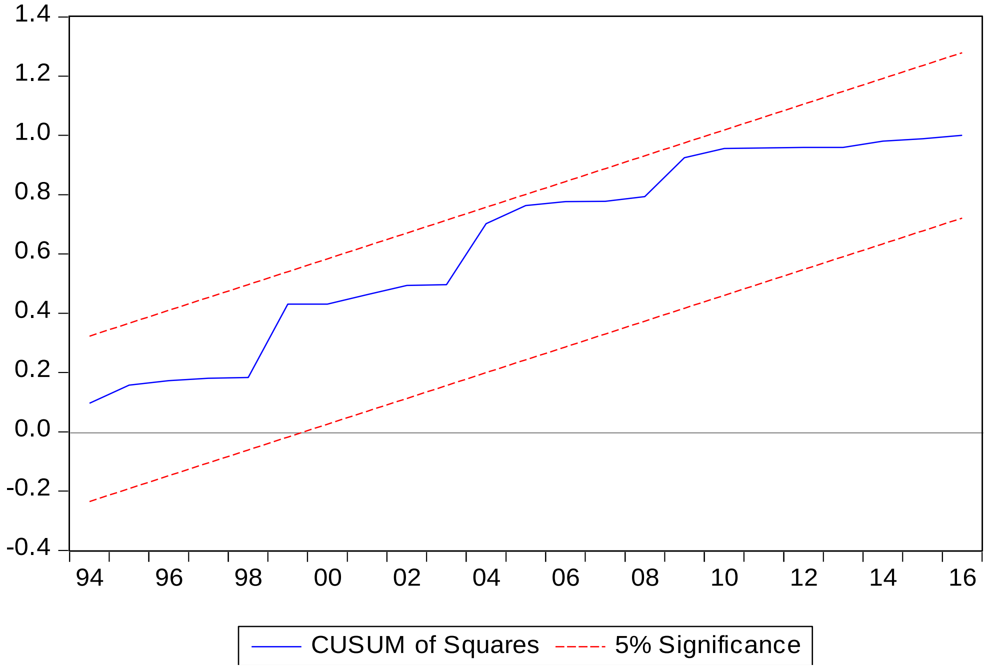
Graph 5

Parametric Stability Test (CUSUM)



Graph 6

Parametric Stability Test (CUSUMSQ):



The straight lines represent critical bounds at 5 % level of significance.

Parameters lie between two critical bound as shown in the graph above the dotted line, it implies the parameters are stable. The parameters are unstable, if the line goes outside the bounds. Above figure shows that the result of parametric stability tests lay both in the critical bound. Along these lines, for the period 1980 to 2016 the estimated variables are stable.

Table 4.18

Correlation Matrix

	LNGFCF	**LNLF**	**LNFDI**	**PS**	**LNTO**	**NEW_INTERATIVE_TERM**
LNGFCF	1.0000	-0.013335	0.870249	0.482642	-0.910822	0.468008
LNLF	-0.013335	1.0000	0.292770	-0.319105	0.141536	-0.319696
LNFDI	0.870249	0.292770	1.0000	0.371322	-0.710641	0.352918
PS	0.482642	-0.319105	0.371322	1.0000	-0.343573	0.998898
LNTO	-0.910822	0.141536	-0.710641	-0.343573	1.0000	-0.333174
NEW_INTERACTIVE_TERM	0.468008	-0.319696	0.352918	0.998898	-0.333174	1.0000

Note: Calculated by Author using E-Views 9

Correlation matrix that depicts association and strength between independent variables as shown in table 4.18 Correlation coefficients reveal the degree of linear relationship among variables while sign illustrates the direction of the correlation coefficient of association among variables. Feasible connection among all variables has been indicated in table 4.18. The value of correlation coefficients in the diagonal of the correlation matrix make clears the connection of a variable with itself. The higher matrix of correlation discloses that there prevails unfavorable as well as weak and vigorous connection between the independent factors.

There is negative and very strong association between LNTO and LNGFCF as represented by a coefficient value that is -0.91. There is positive but very weak association among LNTO with LNLF which is also demonstrated by the coefficient value. Its value is 0.14.

There is positive but moderate connection between Interactive term and LNGFCF. It is represented to a coefficient value which is 0.46. A negative and weak relationship between LNLF with interactive term with the coefficient value -0.31. The association among interactive term and LNTO is also harmful and feeble -0.33. The outcome explained above point out that there is no issue of multicollinearity in the model.

Conclusion of Model 3

Model 3 has been produced to make sure the composite impact of FDI and political stability on growth of economy over the time of 1980 to 2016 in Pakistan. Gross domestic product is dependent variable and gross fixed capital, labor force, trade openness, political stability, FDI and interactive term are utilized as independent variables. It has been discovered that short run and long-run outcomes by utilizing method of ARD. Moreover, the bound test approach is connected to verify the relationship of long run in the estimation display. The political stability has a general constructive outcome in the long run as well as in short run in the economy of Pakistan. One reason to clear up the beneficial outcome is that growth of any country profoundly relies on the steady and quiet condition. Issues of business, poverty, and human capital advancement can be solved in a situation that is free of political precariousness. Increase index of 32.35 scores in political stability leads to one percent improvement in economic growth. (Younis (2008). FDI proves a constructive impact on economic growth. Foreign direct investment facilitates to enlarge the rate of capital information and increase technological supply into the economy of a country. Living standard of the common community of the host country could be enhanced due to the technological growth brought by FDI (Alfaro, (2008). In the third model composite term illustrates a positive impact on economic growth. Many economists believe that there are many factors that affect the FDI in host country. Political risk is one of the most important variables that limit the capital flows. Composite term will increase in that circumstances in a country where it has less chances of political instability and more FDI inflows. In this way economic growth will have positive impact.

Chapter 5

CONCLUSION AND POLICY RECOMMENDATIONS

The study tried to find out the impact of composite impact of FDI and political stability on economic growth of Pakistan for the period of 1980-2016.Following variables are used for this study i.e. gross fixed capital formation, gross domestic product, trade openness labor force, political stability, foreign direct investment, and interactive term. These variables are in the form of a unit and then we have changed the data in log form to obtain better results. All the models have same dependent variables i.e. GDP because it has been tried to check robustness in which we have tried to explore the relationship between FDI and growth with and without including political stability.

First of all, effectiveness of association among all variables is analyzed, and detected the causal association among variables. ADF test is applied which gives the conclusion that indicated at different orders. Then bound test is applied as it approves the existence of long run association among entire variables in the model. The evaluation of long run and short run of the model has been calculated in the study. To accomplish the targets of research, ARDL approach is applied. We have generated three models for three different reasons. First model is created to make sure the impact of FDI on economic growth, second model is for to affirm the effect of political stability on economic growth and the last model is produced to check the composite impact FDI and political stability on economic growth. We have applied ARDL technique on three models separately.

Overall outcome in first model discloses that negative and insignificant effects on economic growth in long run by gross fixed capital formation whereas Labor force has also negative and insignificant impact. Trade openness and foreign direct investment both these variables have a positive but major impact on economic growth in case of Pakistan. It shows that if there is a 1 percent amplify in FDI then there is a 0.018 percent increment in the growth of economy. One cause is that foreign direct investment facilitates in exchanging advance innovations know-how and expands business levels to the host nations. Besides, FDI conveys enormous and constructive externalities to the developing countries, for example, work administration training opportunities and accordingly builds the standard of production function. By advancement trade, it enables developing countries of economies to keep on there on feet by innovation overflow. (Shahid, F., Hassan, S., Bakhsh, K., &Tabasam, N. (2013).

Moreover, the ECM (error correction term) is -0.39, it recommends that 39 % disequilibrium is being corrected annually.

Second model is generated to affirm the impact of political stability on growth of economy of Pakistan in short and long run. Overall result in second model discloses that in long run negative and insignificant consequence on economic growth by gross fixed capital formation whereas Labor force has positive and insignificant impact. Trade openness and political stability both these variables have a positive and significant impact on economic growth. Most of previous studies on economic growth have established that unsteady political regimes slow down the growth, whereas stable political frameworks work as medium for growth. It illustrates in empirical results that if we raise 1 percent in political stability then there will be an add to of 0.0047 percent in the economic growth. These studies set forward that political volatility often leads to slower economic growth. Some studies s put forward that political precariousness hinders growth, specifically bringing down aggregate factor yield. China's fast economic growth and financial blast depend mostly on political security which depends on its one gathering political framework. At present India's growth is confronting some political confronts and should confront them in the future likewise on account of the political flimsiness reared by its multi-party and law based political framework (Bhatti, A. M., Ali, A., Nasir, M., &Iqbal, (2008). But in short run time period, trade openness has an unfavorable and less important effect on economic growth whereas political stability still has positive impact in short run. The parameter of ECM is -0.36, it recommends that 36 % disequilibrium is being corrected annually.

In general result of last model discloses that in long run gross fixed capital formation, Labor force and trade openness have positive impact on economic growth of Pakistan. Whereas foreign direct investment, political stability and interactive term have a positive but significant impact on economic growth. It means if there is one percent increase in interactive term then there will be 0.0266 percent increase in economic growth. Political stability and foreign direct investment have one to one relation with each other. It means when there is increase in political stability, investors will run to invest in that country. FDI inflow starts in host country, advanced technology and investment of that country will increase automatically. When we have both essential aspects i.e. FDI inflows and peaceful, political environment in a country so in these circumstances economic growth of a country will increase more rapidly.

5.1 Policy Recommendations

Economic growth is the most powerful instrument for reducing poverty and improving the quality of life in developing countries. Growth can generate virtuous circles of prosperity and opportunity. Strong growth and employment opportunities improve incentives for parents to invest in their children's education by sending them to school. This may lead to the emergence of a strong and growing group of entrepreneurs, which should generate pressure for improved governance. Strong economic growth therefore advances human development, which, in turn, promotes economic growth. In Asian economies, Political stability is assuming a vital part in deciding growth of economy. China's fast economic growth and financial blast depend generally on political steadiness which depends on its one gathering political structure. Empirical results of this study conclude that one percent increase in political stability leads to 0.0047 percent increase in the economic growth. From these findings based on Pakistan economy, we can conjecture that political stability plays a dominant role in determination of economic growth and sources of capital accumulation. Government should take various steps to attain political stability in a country.

- Government should improve the law and order situation in the country and enhance satisfactory political stability. Political system should be calm and smooth.
- Strife's, processions are very common in developing country like Pakistan. Government should keep an eye on unhealthy exercises through police, intelligence departments and other law requirement organizations to control these processions to create peaceful environment.
- To strengthen his political system and institutions, eliminate corruption, give timey justice, seek consensus based political solutions and crime must be tackled.

Countries with high political rights have higher FDI outflows. Also, countries with high level of corruption of government and low level of democracy have higher FDI inflows (Kim Haksoon (2010). Empirical results of this study conclude that one percent increase in foreign direct investment leads to 0.0018 percent increase in the economic growth. Political stability effects the effectiveness of FDI in promoting economic growth of a country. Government should acquire different steps to attract FDI in a country.

- Government should work on law and order and crime must be tackled if both domestic and foreign direct investment are to feel safe enough to do business in any country.

Foreign investors will do high level of investment for long period of time in peaceful environment.

- ❖ Government should spend on labor sources as some industries require higher skilled labor, for example pharmaceuticals and electronics. Therefore, multinationals will invest in those countries with a combination of low wages, but high labor productivity and skills. For example, India has attracted significant investment in call centers, because a high percentage of the population speak English, but wages are low. This makes it an attractive place for outsourcing and therefore attracts investment (Tejvan Pettinger (2017). Investment in human asset will be beneficial for FDI and in this way economic growth also flourish.
- ❖ Government should focus on trade related issues. Foreign investors attract towards those countries in which they must face less barriers or trade tax include tariffs, such as duties and surcharges, and nontariff, such as licensing rules and quotas.

Composite impact of FDI and political stability on economic growth is very imperative as political stability effects the effectiveness of FDI in promoting growth of an economy of country.

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