

Exchange Rate, Market Size and Human Capital Nexus Foreign Direct Investment: A Bound Testing Approach for Pakistan

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Abstract : This study investigates the motivators of foreign direct investment (FDI) which will provide a panacea tool and ground breaking results related to it in case of Pakistan. The study considers exchange rate, market size and human capital as the motivators for attracting FDI. In this regard, time series data on annual basis has been collected for the period 1985-2010 and an Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root tests are utilized to determine the stationarity of the variables. A bound testing approach to co-integration was applied because the variables included in the model are at I(1) - first level stationary. The empirical findings of this study confirm the long run relationship among the variables. However, market size and human capital have strong positive and significant impact, in short and long-run, for attracting FDI but exchange rate shows negative impact in this regard. The significant negative coefficient of the ECM indicates that it converges towards equilibrium. CUSUM and CUSUMSQ tests plots are with in the lines of critical value, which indicates the stability of the estimated parameters. However, this model can be used by Pakistan in policy and decision making. For achieving higher economic growth and economies of scale, the country should concentrate on the ingredients of this study so that it could attract more FDI as compared to the other countries.

Keywords : ARDL, CUSUM and CUSUMSQ tests, ECM, exchange rate, FDI, human capital, market size, Pakistan

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