Trade Liberalization and FDI in Pakistan

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Abstract
This paper quantitatively identifies the impact of trade liberalization on foreign direct investment in Pakistan over the period of 1990 to 2005. The main interest of this study how different variables of trade liberalization affect foreign direct investment in Pakistan. The trade liberalization has been measured through four variables that are custom and other duties, taxes, taxes on income profit and capital gain, and interest payment. The study uses Feasible Generalized Least Squares for estimating the results. The variables custom and other duties and taxes on income and capital gain show the statistically significant impact on foreign direct investment. Taxes and interest payment shows the insignificant impact on foreign direct investment.

1.1 INTRODUCITON

The world economy is globalizing and all the countries are experiencing worldwide trade liberalization because in today's world no country can afford to remain isolated. Trade liberalizations are one of the most important incentives for foreign direct investment and it results in inflow of foreign direct reserves. Trade liberalization and foreign direct investment are disjoined for most of the time. Empirical studies shows that they are inter related. Through trade liberalization standard of living improves, economic growth increases, improve welfare and give rise to new capital inflows because of dynamic and static gains from trade. Static gains outcome from reducing in cost of production, due to comparative advantage and variety of product. Dynamic gains include adoption and transfer of practicing better management and efficient energy technologies. The adverse drawback of trade liberalization is that due to tariff and other custom duties reduction the revenue for government decreases.

Liberalization was experienced by different countries and its effect is also different in different economies. From 1947-1980 Pakistan maintained protective regimes for the protection of their domestic industry. Trade liberalization took place in the late 1980s. After 1980 some relaxation are made in trade regimes. Taxes on import and non-tariff barriers have been reduced. In 1985 the tariff barriers has been reduced to 17% from 77%. New trade policy was made in 1987 in which trade was too much liberalized. As tariff and custom duties contributes 10-20 percent to government revenue. So then this gap is filled by increasing other direct and indirect taxes. The Tariff reduces in Pakistan from 225% in 1986-87 to 70% in 1994-95 and the custom duty reduces to 5% from 13%.the formulation of the new trade policy in 1987. From 2000 onwards Pakistan trade regimes are more open as compared to other south Asian countries. In 2000/01 the growth rate is increased from 1.8% to 6-7%. The average annual growth rate is 5.2% over last 60 years. For sustained economic growth trade liberalized policies are needed. No country can achieve economic success without decreasing the barriers in trade. The import tariff has been fallen 30% to 10% over 20 past years. In the certain product manufacturing it's essential for developing countries to open their economies for competitive advantage. Countries like Vietnam, India, and Uganda experienced poverty reduction and faster growth because of trade liberalization. As there are scarce resources and multiple wants every country wants to maximize productivity with lowering cost a way to do is trade. Trade makes the economy better off.

FDI also plays an important role in nation development and growth. From last two decades countries experience growth because of FDI. Different studies show that FDI is more beneficial in developing countries in absolute as well as in relative terms. FDI is beneficial for both host country and home country. In global business FDI is playing a growing role. Due to economic globalization developing countries become attractive for countries. Many developing countries face the problem of saving-investment gap. FDI can be a source of filling that gap up to some extent and capital formation.

Economic theory starting from Ricardo to neoclassical model is clear about giving us the importance and benefits of trade between countries based on relative factor endowments (Hecksher-Ohlin) and comparative advantage. The conclusions of these theories are that free trade models are based on that all countries gain from trade and output of the world is increased. The countries will need to specialize in that product that uses their abounded resources. Assuming that all the countries are using identical technologies and prices will be same between trading countries. By free trading between countries the countries will be enabled to move above their production possibility frontiers trade will assumed to increase growth by securing capital and consumption goods from other nation of the world. Free trade thus helps in economic growth; promote those activities in which the nation has relative advantage of factors of production. Developing countries has labor in abundant in supply their wages will increase and the many of the population will be better off through trade compared to no trade. There are some critics on the assumption made by these trade theories. That how is this possible that all countries have same technology, resources have identical quality, and perfect mobility within countries.

Theories proposed by economist are also in favor of free trade. Theory by Ricardo and neo classical are that due to comparative advantage and relative factor endowment (Hecksher-Ohlin) will be benefited for both nations. Previous studies show the relationship between them. According to Rupa Chanda (1997) trade and foreign policies cannot be viewed independently because there is a interlink age between final goods and intermediate services and trade policies are important in understanding FDI. A study on FDI founds that Pakistan should liberalize because its benefits are greater than cost Guisinger (2007). By using secondary data khan and Qayyum (2007) by using bound tasting approach they found that trade liberalization and financial reform policies has positive effect on the economy in long run because market imperfection decreases private saving, investment, capital efficiency and real GDP increases. Another research done for different countries Svaleryd and Vlachos (2000) investigates by using secondary data that causality is running from trade to financial institution and from financial institution to trade. The industries that are near to maturity can facilitate themselves from trade liberalization in much better way than other industries Shafaeddi (2005) founds by using secondary data.

1.2 RESEARCH QUESTION

In this study the impact of trade liberalization on FDI will be examined. The variables of FDI will be taken from the secondary data. There are many other variables that effect FDI like law and order condition, inflation, labor wage, and resource availability etc. The main research question of this study is that is there impact of trade liberalization on FDI and how much. The study will focus on four independent variables and one dependent variable that are taxes, custom and other duties, taxes on income profit, capital gain and interest payment, and foreign direct investment.

1.3 OBJECTIVE

After partition Pakistan maintain protective regimes for protecting their domestic industry for almost 30 to 35 years in late 1980s liberalization took place. The study concerns about the impact of foreign direct investment. The study takes the data from 1990 because of the reason because of the reason that trade liberalization started in that era. This study will show the response of trade liberalization, other taxes, taxes on capital gain, interest payment on inflow of FDI. The main objective is to find that the impact of trade liberalization on FDI is positive or not.

1.4 SIGNIFICANCE OF THE RESEARCH

This study is helpful for finding the impact of trade liberalization on FDI. It will show the importance of fluctuation in trade liberalization and how it affects FDI. The research target is FDI. The impact of trade liberalization either gave exposure to FDI or act as an incentive or not. FDI is a basic variable for maintaining a country balance of payment and foreign exchange reserve. This study will give us knowledge that how much is there any impact of trade liberalization on FDI and how much. Can we stimulate FDI through trade liberalization or not. The research for finding the impact of trade liberalization on FDI is studied for different countries but very limited research was done for Pakistan. The research available for Pakistan is on FDI and trade liberalization no such research was done in which the impact of trade liberalization on FDI was studied. The research will figure out the benefits of trade liberalization.

1.5 LIMITATION OF RESEARCH

There are limitations in my research as there are many variables that come in trade liberalization and FDI. The custom duties, tariff duties, non tariff duties, impose duties, quotas, and excise duty are the duties imposed on trade but I can’t take all the variables separately due to shortage of time and the non availability of the relevant data so taking them all together as a custom and other duties. Different variables also come in FDI like inward FDI, outward FDI, joint venture, merger and acquisition, licensing, and franchising etc. the concentration of my research will be on FDI, taxes, taxes on income and capital gain, interest payments, trade liberalization.

1.6 ORGANIZATION OF STUDY

This study consist of five chapters, introduction, literature review, Methodology, results and recommendation and at last a brief conclusion about the report. In introduction I briefly explain the topic its significance and limitation. The second chapter I discuss the research of different authors related to my topic and gave their findings. Chapter three and four is about the methodology used for finding the relationship between dependent and independent variables. In last chapter the results of the study is interpret and some recommendation have been made. In the end of the study conclusion has been made about the report which gave an overall idea about the report.

2. LITERATURE REVIEW

According to Mason and Baptist (1996), in agrarian economies the agriculture sector intervention helps to reduce poverty. It requires labor intensive economic growth in host country so that FDI investment can bring employment generation. As Moran (1998) figures out the important fact that exposure to foreign competition plays vital role in skill up gradation. FDI plays an agent in establishing link between trade liberalization and economic growth argued by Taylor (1998) and Waciarg (2001). Study by Atkinson and Brandolini (2003) state that country can't get benefits if countries investment creates domestic income inequality.

Trade openness as FDI has become one of the main argument among economist and policy makers in explaining the growth phenomena in developing countries Dawson, (2006). It has been experienced that countries with more trade liberalization outperformed compared to less liberalized countries (World Bank, 1993). Lloyed and Maclaren (2000), Jonsson and Subramanian (2001) Asian economist also supported the opinion that trade liberalization causes economic growth. Although some economist like Harrison (1996) and Rodrik (2001) oppose that trade liberalization lead to growth. Empirical studies in cross country and country specific supports the link between FDI and growth (Kohpaiboon, 2004, Mansouri, 2005). There is interaction between FDI, growth, and trade (Lipsey, 2000 and Pahlavani, 2005). The link between FDI and economic growth can be traced back to dependency and modernization theories. These theories suggest that FDI can increase economic growth according to the principal that requires capital investment (Adam 2009). The new growth theories emphasizes that FDI plays a role in technology transfer as developing countries lacks necessary infrastructure such as education, liberalized financial markets, socio economic and political stability (Calvo 2002). Organizational and managerial skills, marketing networks of multinational enterprises transfer through FDI (Balasubramanyam 1996).

Adenikinju and Olofin (2000) analyze that industrial sector development can be achieved by trade liberalization, industrial sector growth, and foreign direct investment. Lucas, 1988, Grossman and Helpman, (1989) explained that the hurdles caused by foreign exchange are reduces by open trade regime observed in developing nations. Increasing openness expected to have positive impact on economic growth World Bank (1989). To analyze the welfare effects of trade and investment liberalization, Egger, Larch, Pfaffermay (2007) carried out study for different countries. For this purpose he uses panel data from year (1970-1990). By using physical capital model and three-factor knowledge model of trade and multinational activity he found that Investment liberalization increases cost of production because of tariff, non tariff and other barriers. It also put pressure on skilled labor. The effect will be different for skilled labor intensive country and skilled labor deficient country. However the effect on welfare is positive.

Multilateral trade and investment liberalization: effects on welfare and GDP per capita convergence carried out study for one developing country. For this purpose he uses the secondary data. By using theoretical model and percentage row endowment graph he found that due to changes in multilateral trade and bilateral trade the economy has been affected but multilateral trade has more positive effect on GDP and welfare as compared to bilateral trade liberalization. Trade liberalization, market competition and wage inequality in Manufacturing sector Anwar, Sun (2012) carried out study for china. For this purpose he uses firm's level panel data for 2000, 2003, 2006. By using Econometrics models and theoretical model they found that trade liberalization has effects skilled–unskilled wage inequality in China's manufacturing sector.

The combine effect of trade liberalization and financial development on economic growth khan and Qayyum (2007) carried out study for Pakistan. For this purpose he uses annual data of 1961-2005. By using bound tasting approach they found that trade liberalization and financial reform policies has positive effect on the economy in long run because market imperfection decreases private saving, investment, capital efficiency and real GDP increases. Does financial development leads to trade liberalization? Svaleryd and Vlachos (2000) carried out study for different countries. For this purpose they use the data of 138 countries from 1960-1994. From empirical evidence they found that causality is running from trade to financial institution and from financial institution to trade. Development of financial institution effect will be different on import base country and on export base country. Financial institutions take steps toward trade liberalization because all the models show that it has a significant effect. Trade liberalization increases aggregate income volatility, decreases risk, investment and GDP increases.

Dynamic Impacts of Trade Liberalization on Foreign Direct Investment Oyamada (2003) carried out study for Japan. Source of the data is GTAP version 5 database. By using general equilibrium model (APD) they found that if 50% barriers have been removed the FDIs will increase and so MNEs but does not reduces the domestic production in Japan. The Japan trades with Asian countries affect china products adversely. That how trade liberalization effect FDIs in central Europe and Eastern Europe Majocchi and Strange carried out study for central Europe and EasternEurope. They uses thedata from Italian firms from 1990-2003. The sample consisted of 172 manufacturing and 100 services firms. For this purpose they use conditional logit model. They found that market size and potential, the availability of labor, the quality of infrastructure all has positive impact on FDIs. Trade liberalizations have a positive influence on FDIs. The negative effect of FDIs is that there is less control of administration on prices.

To find out the impact of trade liberalization on jobs and growth, Dee, Francois, Manchin, Norberg, K. Nordås, Tongeren (2011) carried out study for G20 countries. They use the statistics of G20 countries of 2004. There analysis is based on multi-regional model of the global economy and global trade analysis project (GTAP). For this purpose they use a computable general equilibrium model (CGE). They concluded the following result. The trade liberalization has positive effect on employment, income and labor productivity. Lowering the trade barriers increases trade and FDIs. Most of the services are traded through FDIs. Due to increase FDIs demand for skilled labor increases but it affects adversely unskilled labor. There analysis is based on multi-regional model of the global economy and global trade analysis project (GTAP). To examine Cross Country Externalities of Trade and FDI Liberalization Liu and D Qiu (2010) carried out study by taking the assumption of that world consist of three countries. For this purpose they use modified Helpman, Melitz, and Yeaple (HMY) (2004) model with heterogeneous firms, heterogeneous industries, and heterogeneous Countries. They found that changes in one country trade policy do affect that country FDIs and trade, but also affect other country FDIs and export and thus policy exhibits cross-country externalities. FDIs liberalization also effect both skilled and unskilled labor demand there demand drops because due to the switch from export to FDI by some firms.

To examine that are trade and FDIs are substitute or complement? A.Carter and Yilmaz (1999) carried out study by taking the data from 127 processing industry of turkey from 1980-1999 time periods. For this purpose they use Heckscher –ohlin model. The relation between FDI and trade is based on data aggregation. They found evidence that there exist complementarities between FDI and trade. The effect of implementing trade liberalization policies, economic reforms, structural change or de-industrialization in developing countries since 1980s Shafaeddi (2005) carried out study by taking the secondary data from developing countries. They found that data show different result at different time but its overall impact is not positive. The sample countries show that the manufacturing goods have not been increased. Countries with low level of industrial base and development experience de-industrialization. Improvement in production capacity and export structure increase export. Furthermore sample data from countries shows that industries that are near to maturity can facilitate themselves from trade liberalization in much better way than other industries.

Causal links between export, FDIs and output Ahmed, Cheng and Messinis (2007) carried out study by taking evidence from sub-Saharan African countries. For this purpose thay use secondary data from year (1991-2001). By applying a Granger-causality test in a bivariate Vector Auto-regression (VAR) framework they found that FDIs contributes to economic growth through capital formation, technology transfer, employment increase, enhancing business completion, technological improvement. All these factors increase export which in turn increase output. There exist short run and long run causality. Trade liberalization implication for developing countries noshab carried out study for Pakistan. For this purpose she use panel data from 1991_2000.They found that Pakistan trade and investment is fully liberal. Tariff and non tariff duties contributes around 20% to the government revenue. Due to lack of competition of Pakistan industry many industries have been closed because per unit cost of production is high also is the case of agriculture sector. The demand for imported goods is high because they are cheap. The unemployment in Pakistan is increasing because of many factors and one of them is low FDIs because of energy crises. The agreement with WTO on trade contributes various sector developments. Keeping in view the cost of institutions and benefits Pakistan should carefully take steps towards liberal trade.

Is export and FDI in developing countries substitute or compliment? Tariq Majeed and Ahmad carried out study for different countries. For this purpose they use panel data of 49 countries from the year 1970-2004. By using equation they found that there are many factors that affect FDIs and export. The GDP, economic growth, domestic absorption and exports positively affect FDI and external debt and BOP deficit have negative effects on FDI.This provides significant evidence that there exist complementary relationship between FDI and exports with causation in both directions.Convergence between trade liberalization and economic growth zhang june (2001).For this purpose they use the data from IMF, international statistical statistics and world investment report 1992-1996. The paper links regional integration and economic convergence. The benefit from FDI is capital gain, exchange rate, technological improvement, skilled labor and gaining foreign market access. Most

East Asian economies have FDI which is labor intensive that's why it is less value added and have less convergence. The result of the study is that there exist income convergence between FDI and trade in long run.

3.0 RESEARCH METHODOLOGY

3.1 INTRODUCTION

This chapter of the research will tell us about analysis of the data, model used for the secondary data and about the hypothesis made. Through the model the independent and independent variables will be mentioned. The acceptance and rejection of our hypothesis will tell us about the significance or non significance of the relation between our data.

3.2 THE NATURE OF QUANTITATIVE RESEARCH

Quantitative research refers to use of statistical data for estimating the results of dependent and independent variables for explaining the research question. The findings and conclusion are descriptive in nature. The quantity of the impact between dependent and independent is the emphases of the quantitative research. The research has analyzed the data through statistical data. By using quantitative method the study has estimated results through statistical data for Pakistan. The relationship between dependent and independent variable are analyzed from 1990 to 2005.

3.3 DATA DESCRIPTION

The most useful way to collect the secondary data about the research topic is the internet and the research papers available on different sites like the digital library of HEC and through number of research papers, journals and articles are available. The data for this study is collected from state bank of Pakistan, international financial statistics, world development indicator (WDI). This report will use the secondary data from time period 1990-2005.

3.4 ANALYTICAL TECHNIQUE

To test the relationship among the dependent and independent variables in gretl test has been run. Data of dependent variable (FDI, Taxes, and Taxes on income) and independent variables (trade liberalization) has been obtained from WDI. Annual wise data has been taken. And then the unit root and feasibility generalize least square (FGLS) has been run.

3.5 VARIABLE

The independent variable is trade liberalization. The trade liberalization is the vast concept and many variables come in it like tariff and non tariff duties, custom duties, taxes on import and export etc. for this study the trade liberalization will be measured through custom and other duties, taxes, taxes on income profit and capital gain, interest payments.

The dependent and independent variable are as follow:

3.5.1 INDEPENDENT VARIABLE

A. Custom and other duties
B. Taxes
C. Taxes on income profit and capital gain
D. Interest payments

3.5.2 DEPENDENT VARIABLES

A. Foreign direct investment

3.6 OPERATIONAL DEFINITIONS

3.6.1 CUSTOM AND OTHER DUTIES

Custom and other duties referred to taxes levied on goods that a country import by a custom authorizes of a country. It helps in increasing the tax revenue of a state. The custom duty value varies on different goods. The value of custom is fixed by the custom authority of a country.

3.6.2 TAXES

The fee levied on the individuals of the country. It contributes to government revenue. It's mandatory on all the nationals of the country. It may be in the form of direct or in direct tax. Its percentage is also fixed by the government authorizes.

3.6.3 TAXES ON INCOME PROFIT AND CAPITAL GAIN

Taxes levied on the income on the individuals usually known as income tax. Sometimes it is fixed and sometimes it varies with income. This tax is levied on those individuals who do jobs.

Tax is also levied on those individuals who do business. They pay the tax on their capital gain.

The profits investors earn, have to pay the tax according to it to the government.

3.6.4 INTEREST PAYMENT

The amount the borrower pays to lender most of the time these are banks. The percentage of interest payment affects the investment.

3.7 HYPOTHESIS

In this study impact of trade liberalization on FDI will be checked. The variables of trade liberalization are custom and other duties, taxes, taxes on income and capital gain, and interest payment. The impact of these four variables on FDI will be checked. The hypothesis of the study is according to variables of trade liberalization and FDI. Statistical tools are used to test the hypothesis analyze and interpret the collected data.
Hypothesis "H0" custom and other duties does not have impact on FDI.
Hypothesis "H1" custom and other duties have impact on FDI.
Hypothesis "HO" taxes do not have impact on FDI.
Hypothesis "H2" taxes have impact on FDI.
Hypothesis "HO" taxes on income profit and capital gain do not have impact on FDI.
Hypothesis "H3" taxes on income profit and capital gain has impact on FDI.
Hypothesis "HO" interest payment does not have impact on FDI.
Hypothesis "H4" interest payment has impact on FDI.

3.8 MODEL SPECIFICATION

$$Y = a + \beta 1x1 + \beta 2x2 + \beta 3x3 + \beta 4x4 + \varepsilon$$

Y= dependent variable
a = constant
β = coefficient
X = independent variables
ε = error
For this study the modal become
FDI = a + β C.D + β T + β T on inc & C.G + β I.P
Where
C.D = custom duties
T = taxes
T on inc & C.G = taxes on income and capital gain
I.P = interest payment
a = constant
β = coefficient
ε = error

4.0 FINDING AND ANALYSIS

After developing hypothesis by studying the literature and specifying the model, data is fitted into software known as gretl for identifying that whether trade liberalization has impact on FDI or not.

4.1 ESTIMATING THE RESULT

The report results are estimated through the econometric tool known as AR1 (Autoregresive model). Computes feasible GLS (Generalize Least Square), estimates the model in which error term will assume to follow first-order autoregressive process.The tests results are shown through Model 1.

Model 1: Cochrane-Orcutt, using observations 1991-2005 (T = 15)
Dependent variable: v1
rho = -0.154066

	coefficient	Std.error	t.ratio	p-value
const	9.45945e+017	2.09606e+019	0.04513	0.9649
V2	8.73030e+07	3.13945e+08	0.2781	0.7866
V3	-2.06124e+07	1.78999e+08	-0.1152	0.9106
V4	2.97779e+06	3.44347e+08	0.008648	0.9933
V5	-2.31938e+07	1.47559e+08	-0.1572	0.8782

Statistics based on the rho-differenced data:

Mean dependent var	2.41e+18	S.D. dependent var	9.34e+18
Sum squared resid	1.10e+39	S.E. of regression	1.05e+19
R-squared	0.100152	Adjusted R-squared	-0.259787
F(4, 10)	0.282732	P-value(F)	0.882567
rho	-0.048071	Durbin-Watson	2.053856

From the model above it is shown that changes in independent variable which is custom and other duties has changed V2 which is inflow of FDI. If custom and other duties change by 1 percent the FDI will be changed by 8.7 percent. A change in taxes will cause change of 2.0 percent, change in taxes on income profit and capital gain will cause change of 2.9 percent in FDI and change in interest payment will bring change of 2.3 percent.

4.2 SIGNIFICANCE LEVEL

The model interpret that there is positive relationship between dependent and independent variables which is shown by P value. As the P value is less then Durbin-Watson so it shows that our results are significance. The value of P is also greater than 0.5 which also indicates that our results are significant. We will reject H0 and accept H1, H2, H3 and H4 which means that reducing custom and other duties, Taxes, Taxes on income and capital gain and profit, and interest payment will causes FDI to increase.

5.0 CONCLUSION

Pakistan maintained protective trade policy after partition in order to boost domestic industries. At the end of 1980 and to the start of a 1990 trade liberalization took place. The focus of this report is to find the impact of Trade liberalization on FDI in that time period. For this purpose the study uses the secondary data taken from WDI from year 1990 to 2005. Empirical analysis had been done in that study. This study attempts to found the impact of Trade liberalization on FDI in case of Pakistan. Trade liberalization is measured through custom and other duties, taxes, taxes on income profit and capital gain, and interest payment. The relationship has been found through AR 1. Through the interpretation of the result it was found that trade liberalization has the significant and positive impact on FDI. Pakistan can attract FDI by removing trade barriers. The results show that importance of trade Liberalization. The research recommendation is to reduce custom and other duties in order to achieve FDI in Pakistan which will be helpful in different ways.

5.1 DISCUSSION AND RECOMENDATIONS

The trade liberalization plays a supporting role in production, trade, and distribution of final tradable goods. Trade liberalization had a positive effect on FDI because of demand effects the tradable goods. Trade liberalization has the impact on economy as it contributes to GDP. Efficient policies increase the trade and investment opportunity which will be an advantage for developing countries. Those Economies have sustained economic growth whose economies are open to trade and investment with the rest of the world. Developing countries have a shortage of capital because of saving investment and export import gap and having less foreign exchange to finance their investment needs. To bridge this gap developing countries need inflow of FDI which can be increased through trade liberalization. FDI is highly dependent on the world economy and exchange rate fluctuations. FDI in business services is necessary in an economy to compete in international market. FDI improves human capital and wage inequality in developing countries. Foreign direct investment plays a vital role in most of the developed countries like European Union. This paper quantitatively identifies the impact of trade liberalization on foreign direct investment in Pakistan over the period of 1990 to 2005. The main interest of this study how different variables of trade liberalization affect foreign direct investment in Pakistan. The trade liberalization has been measured through four variables that are custom and other duties, taxes, taxes on income profit and capital gain, and interest payment. The study uses Feasible Generalized Least Squares for estimating the results. The variables custom and other duties and taxes on income and capital gain show the statistically significant impact on foreign direct investment. Taxes and interest payment shows the insignificant impact on foreign direct investment.

On Trade Liberalization so far little research had been done on that important issue. For developing country like Pakistan this is an important issue which affects country different macro economic variables. History shows that there are certain reasons through which Trade Liberalization affects FDI. Trade liberalization and FDI are the main concern of my report. There are many other factors on which FDI depends on such as countries economic condition and exchange rate.

In past decades trade liberalization does shows the positive impact on FDI. On one hand trade liberalization costs Pakistan in decreasing the revenue of the government but on the other hand it benefits Pakistan by increasing FDI. The impact of trade liberalization on the economy can't come in one year its benefits come after at least five years.

The government of Pakistan tries to removes the hurdles that come in the way of FDI. Trade liberalization plays as a role of incentive for foreign investors. Trade liberalization helps in increasing the growth rate in Pakistan as it did in other countries like India and European Union. The study will suggest that Pakistan should liberalize to enhance FDI. Decreasing trade is one of the factors of decreasing GDP in Pakistan.

Trade Liberalization is an incentive for FDI in a way that as Foreign investor's motives are profit maximizing. So they can maximize their profit due to Trade Liberalization because it will reduce their cost of production. Policies should focus on reducing Trade Liberalization by decreasing custom and other duties for attracting FDI.

Different literature had been shown that there is link between Trade Liberalization, FDI, and growth. The economy of Pakistan can gain from trade by implementing efficient policies. Other developing countries like India they liberalize trade more than Pakistan and gain more. Pakistan should realize that Trade Liberalization will be helpful for increasing international trade.

The countries having more open trade experience positive influence on economic growth because of different reasons like increasing employment level, increasing FDI, increasing human capital, increasing trade, and transfer of skill.Trade Liberalization will boost FDI that will be harmful for domestic industries so some measures should be taken by policy makers in order to protect the domestic industries.

The impact of reducing custom and other duties, taxes, taxes on income and capital gain, and interest payment will be more effective in Pakistan if our economic and political condition will stable. From 2005 onwards Pakistan faces the problem of war on terror which adversely affects Pakistan prosperity and economic growth. The foreigners are reluctant to invest because of the security problems. Pakistan can't enhance the FDI by reducing trade liberalization other measures are also necessary for FDI increase.

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