Impact of Foreign Direct Investment and Some Other Factors on Economic Growth of Pakistan

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Abstract
Terrorism and Gross Domestic Product (GDP) is the burning and most important issue for the researchers and *policy* makers of the modern world since 20th century. There are many factors that affect the economic growth of a country but here we discuss only few of them. Foreign Direct Investment (FDI) has a significant and important effect on economic growth of a country especially developing country like Pakistan. The main objective of this article to check the affect of some explanatory variables on economic growth of Pakistan. I have taken one dependent variable and four explanatory variables. Foreign Direct Investment (FDI) is our main explanatory variable and other includes Exports, Inflation rate and Terrorist attacks. Although terrorist attack is not economic variable but we take it in this study because economy of Pakistan disturb worstly due to terrorism. We take the data from years 1973-2013. Ordinary least square (OLS) has been applied to investigate the effect of explanatory variables on GDP of Pakistan. The results show that FDI has Positive significant effects on GDP of Pakistan.
Keywords: Terrorist attacks, FDI inflows, Inflation rate, Exports of goods and services

1. Introduction

One of the crucial goals of a country is to obtain sustainable economic growth. Both for future as well as present generation sustainability can be achieved by growing country's productive capability. According to neo conventional growth models, the variables which play vital role for obtaining growth are technical advancement, population expansion and rate of savings (Solow, 1956). According to endogenous growth model of Romer (1986) and Lucas (1988), assumption of constant and increasing returns to capital cause permanent increase in growth rate. Moreover according to Romer, human capital also play important role in growth process. These findings of Romer are also supported by Barro (1991), when he investigated the relationship between human capital and, economic growth. While according to new growth theory, technological progress and foreign direct investment cause permanent growth effect in host country.

After World War II, forceful economic policies were adopted by the majority of developing countries to make progressive the GDP growth. From 1960 to 1980 Japan along with Korea, Taiwan, Hong Kong and Singapore began to enlarge their economies. After 1940, Thailand, Malaysia, Indonesia and Philippines along with China practiced growth at rapid rate. That speedy growth of Asia was exceptional as its effects did not affect other economies of the world (UNCTAD 1995; Fukasaku 2006; World Bank 1993). Experience of Asian economies described above gave evidence that most crucial variates were FDI, human capital, export and investment which have a crucial contribution in the rapid GDP growth

Because Pakistan is a important country in Asia, the main queries are still waiting for certain answers (1) why it could not attain the rate of growth as others countries of Asia are achieving (2)what would be contribution of variables indicated above in the GDP growth. In economic context, Pakistan has really failed to identify the value of those variates as concluded in the various studies.

Our major explanatory variable is foreign direct investment (FDI). In recent decades foreign direct investment has become the biggest source of capital formation in all over the world especially third word or developing countries like Pakistan. FDI has become an important part of economic development of country.

In this study we take the four independent variables i.e. FDI, Inflation rate, Terrorist attacks and exports. On the next pages we tried to find the effect of these variables on economic growth of Pakistan.

The beauty of the universe is in peace that is why peace is considered as the ornament of the universe. As a human being almighty Allah created us to help each other but ground reality is totally against to it. Today the peace of the world has been converted into the worst cruelty and violence. There are many reasons which are involved to destroy the peace of the world and terrorism is the major cause of it. Terrorism is the problem and social evil of today. It is difficult to define terrorism but it might be said that terrorism is not an activity but a state of mind. Difficult to define and easy to use, the term „terrorism" has no generally accepted definition (Cheema, 2009). The agreed definition of terrorism is not available. Different scholars and academicians defined the term of terrorism according to there on perception and context. Charles Townshend (2002) describes the US and British version of terrorism in his book entitled "Terrorism a very short Introduction" as "The terrorism is the calculated use or threat of violence to inculcate fear, intended to coerce or intimidate governments or societies". Before defining the term terrorism we look the word violence which is associated with word terrorism. In the same way terrorism means to impose your own ideas on other ones through violence. There are many reasons of terrorism and some of the reasons and their impact on society are internal and external. Internal factors include socio- economic, political and religious. External factor consist of Afghan war 1979, agents and agencies of neighbor states and war against terrorism: 9/11. Zeb *et al.* (2013) also included terrorism incident in his study to check the effect of terrorist attacks on economic growth of Pakistan. The result shows that terrorist attacks have significant effect on economic growth of Pakistan.

The persistent rise in general level of prices is called Inflation. The inflation is mostly attributed to increase in money supply. Thus, when too much money chases too few goods it is called inflation. Now a day's inflation is classified into Wholesale Price Index (WPI), Consumer Price Index (CPI) and Sensitive Price Index (SPI).

Different economist holds different opinion about the consequences and impact of inflation on people's lives and economy of a country. Most of the economists are agreed that high inflation rate negatively affected the economy and many economist agreed that low inflation is good for the economy of a country. Howitt (1990), urges that however inflation is costly but it is necessary to achieve the price stability. Summers (1991) and DeLong and Summers (1992) stated that little or moderate inflation is good for economy of a country. Marty and Thornton (1995) found that a group of economist agreed that moderate inflation is better for the economy of a country. Although many of economists argue that long run inflation has no matter however the inflation concern with poor's.

The majority of the developmental literature also urged upon the function of export expansion to advance the growth prospective (Maneschiold, 2008). However, many studies (also contain the study of Balassa (1978)) have recognized a positive association between GDP growth and export.

Pakistan's major exports were consisting of these commodities (1) raw jute (2) cotton, (3) wool (4) tea and (5) hides from 1948 to 59. Those objects earned 93 % of export income upto 1952 and decreased that share to 75% in 1959. After partitioning of Pakistan in 1971, those objects were exported from Bangladesh and now export of Pakistan has decreased from the level prjor the 1971.

Pakistan did not formulate satisfactory policy to support export expansion. The measures taken by government were frequently in support of big exporters. Trade liberalization established in 1988 under the (SAP). Major strategy measures included (1) civilizing the tax structure (2) developing superior export incentives and (3) decreasing the banned items. An effort was made under SAP (Structural Adjustment Program) to raise the exports of high values. Private sectors were allowed to take part in exporting cotton and rice objects.

SAP left positive effects on export progress of Pakistan. In 1981, primary objects, manufactured and semi manufactured objects had attractive share of exports as 44, 45 and 11 % correspondingly (Economic survey of Pakistan 1987). Decline in the share of primary objects was recorded as 19% while inclinations in the share of manufactured and half-manufactured objects were observed as 57% and 24% correspondingly in the year 1991 (Economic survey of Pakistan **2003).** Manufactured exports had attractive shares in the overall exports as 77 percent and **75%** in the years 2007 and 2008 correspondingly (Economic Survey of Pakistan 2009). That raise in the share was a positive sign for the enhancement of export performance in Pakistan.

Pakistan's export performance has been unsatisfactory as compared to East Asian economies in provisions of monetary importance. Only $2 billion were increased in exports during 1980, s for the ten years period. Also 1.9 billion $ were raised in exports in an era of 9 years in 1990's. Moreover, 4.5 Billion $ have been raised in the most recent 5 years that increased the exports from 7.7 billion $ to 12.35 billion $ (Ashfaque, 2004).

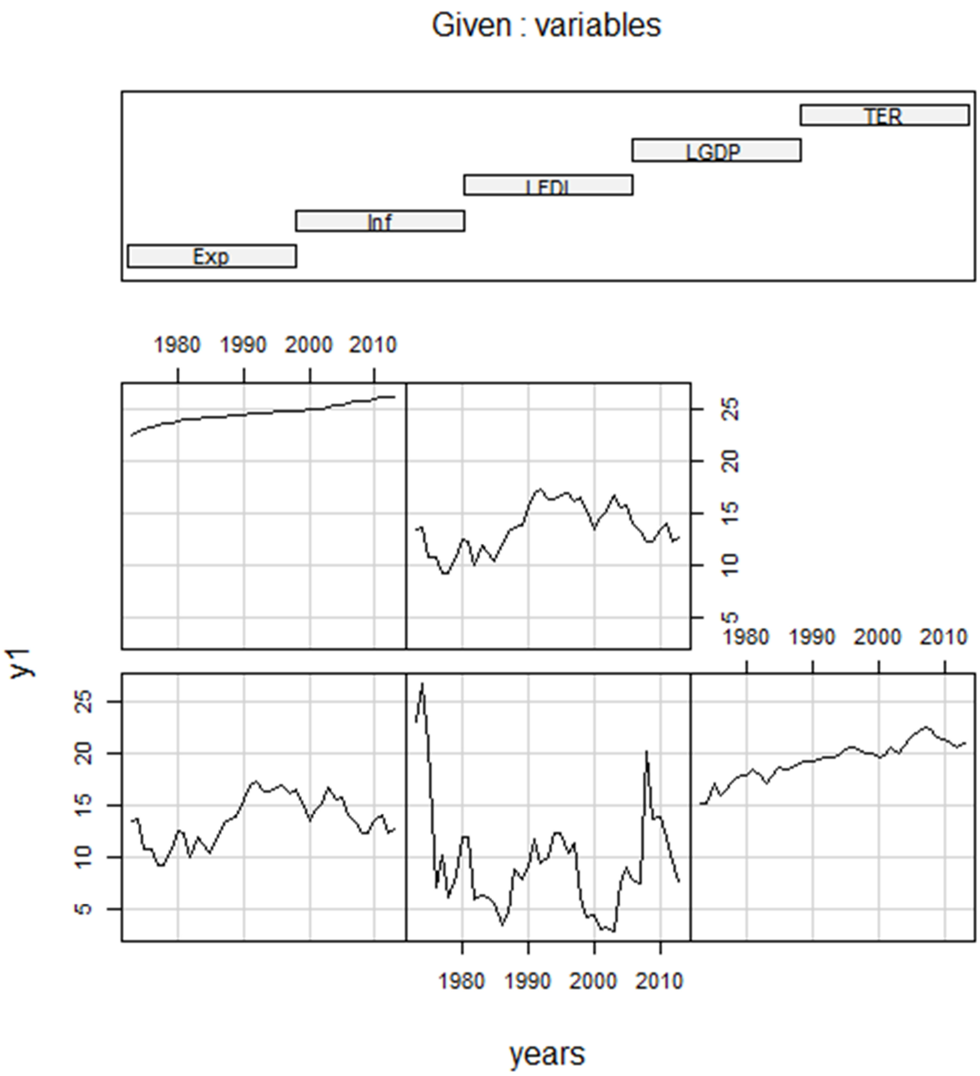

Figure: Time series plot of all the variables during the time period of 1973-2013.

2. Literature Review

Arshad (2102) investigated the lon run relationship between FDI, GDP and trade of Pakistan In this study he uses the time period during 1965-2005. Vector auto regressive (VAR) model are used to estimate the parameter. He concluded that imports and exports have significant effect on GDP in long run but FDI has not significant effect on GDP in long run.

Balassa (1978) analyzed an association between exports and economy development for 11 economies that had previously established an industrialized base. Manufactured and total exports were given separate consideration; at second stage, they made adjustment for marital and foreign investment .At the end they made the modification to increase in the service force.

Falki (2009) studied the impact and consequences of FDI, and other three variables on gross domestic product of Pakistan (GDP). The time period of the research was 1970-2001. Ordinary Least Square method was used (OLS) to estimate the parameters. The result shows that FDI has negative and non- significant effect on GDP.

Feder (1983) analyzed the growth sources for clusters of half-industrialized under expand economies for 1964-1973. They developed an analytical scaffold, export and non-export sectors were not identical according to the marginal factor productivities. Econometric analysis used this framework showed that there were drastically superior marginal factor productivities in the export region. The conclusion exposed that augmentation could be produced by rising summative levels of labor and investment, as well as by re-allotment of on hand assets from the fewer skillful non-sell abroad region to the export sector with superior productivity.

Habib and Sarwar (2013) analyzed the impact of foreign direct investment (FDI) on Employ level of Pakistan. The four variables are included in this study to analyze the impact and to explore the long run relationship between the variables. The Johansaen Co- integration Approach is used to test the relationship between the variables. Data was used during the time period of 1970 to 2011.The result shows that there exists a long run relationship among the variables.

Hussain et al. (2014) examined the relationship between net inflow of foreign direct investment and number of terrorism incident during the time period of 2000 to 2013. The Multiple regression technique was used to test the relationship among the variables. The result shows the negative relationship among the net inflow of foreign direct investment and number of terrorist attacks. It means as the number of terrorism incident increases the net inflow of foreign direct investment decreases.

Kavoussi (1984) observed an association between export extension and economy progress for a cluster of 73 mounting countries. He used data from 1960 to 1978. In both groups which consisted of low and medium income countries he showed that export extension was connected with greater economic development. The constructive impact of exports on whole factor productivity became a reason for this association between export and GDP. He explained that in the developing economies result of composition of things for exports on the association between economic growth and export was considerable.

Louzi et al. (2011) investigated the effect of FDI on the economic growth of Jordan. The time period was used in this research is 1990-2009. The error correction model and co- integration technique was used to estimation. The result shows that the foreign direct investment has no impact on economic growth of Jordan on the other hand domestic investment and trade have positive significant effect on gross domestic product (GDP).

Moschos (1989) observed the cause of export extension on economic development under intercountry combined analysis for the causes of growth. The hypothesis of association under concern was affected by development level that was tested using switching regression. Final findings showed that presence of advancement level under and above economic growth output differ considerably to its contributor factors. The evidence contradicted the outlook that 'the upshot of sell abroad extension on economic development in extra increasing economies had been superior than those among 'fewer developed' economies.

Mulick (2014) analyzed the Gross domestic product (GDP) of Pakistan by using the some economic and socio- economic variables during the time period of 1980 to2003. The Dependent variable is % change in real Gross domestic product (GDP) and explanatory variables are total investment, foreign reserves, unemployment rate etc. Log Ordinary Least Square (OLS) regression is applied to find out the relationship between the variables. The results showed that the economic variables are significant and positive effect on economic growth.

Rasheed and Tahir (2012) studied the relationship among Foreign direct investment (FDI) and terrorist activities. The data time span was 2003 to 2011. The Granger causality and Co- integration model was used to know the relationship between the Foreign direct investment and number of terrorism incident. They showed that the relationship between Foreign direct investment and number of terrorist attacks are negative. It means as Number of terrorist attacks increase then foreign direct investment de creases.

Saad and Sulaiman (2009) focused to evaluate the association between economic growth and export .Data from 1960 to 2005 for Malaysian economy was used. Specified model was consist of 5 variates and was approximated by cointegration and ECM joining production function, economic studies and trade. Finding of study revealed the there being of 1 vector of cointegarting.In the long term those variates were associated together for obtaining their gradual equilibrium. A positive association both in short as well as long term between economic growth and export was observed at 5%. Moreover, findings showed both in long and short term a positive cause of asset on GDP but long term association between work force and GDP was observed. A negative association between import and GDP growth was occurred.

Seemab *et al.* (2010) studied association among GDP, inflation, exports and speculation. Co-integration was utilized to explore the long-term association between those variates. All variates became stationary at 1 difference. ECM was also conducted to evaluate the short-term association among other variates and GDP growth. A positive role of speculation and exports on GDP was revealed on the basis of findings. Positive and considerable role of inflation on GDP was observed in the short term. If there was 1% raise for speculation, GDP raised by a 0.20%, and due to negative contribution inflation in GDP raised by 0.03%. Exports improved GDP assertion was not present for Pakistan in the long-term. The symptom of ECM was according to theory and that showed that for every year 69% adjustments were made. Final findings would help the founder of decisions in building plans to hasten speculation, exports and GDP growth.

Tyler (1981) evaluated the empirical association between export extension and economy progress for mounting countries. He utilized data for 55 middle income countries that were under developing from 1960 to 1977. Positive and significant associations between economic growth and variables which were consist of manufactured output growth, manufactured exports, total exports and asset. He specified a production function model and by utilizing data obtained at unchanged time that model was estimated. Findings revealed that export was significant, alongside investment formation, for elucidation the intercountry discrepancy in GDP for the period 1960-1977.

Zeb *et al.* (2013) studied the impact of FDI, Political instability, trade openness and terrorism attacks on GDP of Pakistan. For this research he used the data froe tome period 1972-2012. Ordinary least square method was used to estimate the parameters. They also give the definition of all the variables briefly. The results show that the FDI has a positive significant effect on GDP of Pakistan. The terrorist attacks also positive effect on GDP. They also give the logic where the terrorist attacks effect GDP positively and have significant effect.

3. Methodology

The main objective of this article is to analyze the relationship between the FDI and GDP of Pakistan and also check the relationship between GDP and Number of terrorist Attacks. The data that is used in this research is from the period of 1973-2013. We used five variables in this model which are the followings. 1) Gross Domestic product (GDP) 2) Foreign direct investment (FDI) 3) Exports of goods and services (% of GDP) (EXP) 4) Inflation rate (INF) 5) Terrorist attacks as number of terrorism incident (TER). Ordinary Least Square (OLS) method is used to check the affect of independent variables on GDP. The regression model is as follows

$$\mathrm{LGDP} = \alpha + \mathrm{LFDI} + \beta_2\,\mathrm{INF} + \beta_3\,\mathrm{EXP} + \beta_4\mathrm{TER} \quad (1)$$

Table 2. Determinants of economic growth in Pakistan

Variables	Proxy	Data source
Dependent Variable: Economic Growth	Natural log of GDP	World development indicators
Independent variables: Foreign Direct Investment	Natural log of FDI	World development indicators
Inflation Rate	INF	World development indicators
Exports of goods and services (% of GDP)	EXP	World development indicators (GTD)

4. Definition and explanation of the variables

4.1 Gross Domestic Product (GDP)

Our dependent variable is Gross Domestic Product (GDP) of Pakistan in current US dollars. We transform the value of GDP in Natural logarithm from to avoid sharpness of time series data.

4.2 Foreign Direct Investment (FDI)

The Economic Growth of a country significantly affected by the foreign direct investment (FDI). Foreign direct investment (FDI) consider as largest source of economic growth of a country which act like a engine to boost the economy. In this article we try to find out the effect of FDI on economic growth of Pakistan. We take the natural logarithm of FDI to avoid the sharpness of time series data. The proxy we used for foreign direct investment is LFDI in current US dollars.

4.3 *Exports of goods and services (% GDP)*

Exports of goods and services represent the value of all goods and other market services provided to the rest of the world. They include the value of merchandise, freight, insurance, transport, travel, royalties, license fees, and other services, such as communication, construction, financial, information, business, personal, and government services. They exclude compensation of employees and investment income (formerly called factor services) and transfer payments (World Bank 2014).

4.4 Inflation rate (% change)

The persistent rise in general level of prices is called Inflation. The inflation is mostly attributed to increase in money supply. Thus, when too much money chases too few goods it is called inflation. Now a day's inflation is classified into Wholesale Price Index (WPI), Consumer Price Index (CPI) and Sensitive Price Index (SPI).

4.5 Terrorist Attacks

Terrorism has become burring and more important issue of modern world and media last few decades. Terrorism destroys the peace of the world. Economic growth of Pakistan significantly disturb due to continuous war against terrorism that is fought in tribal areas of Pakistan. Poverty, unemployment poor law and order situation, corruption and external factors etc are responsible terrorism in Pakistan Therefore I include this variable in this article to know the effect of this variable on economic growth of Pakistan . TER proxy is used in this research. We take the data of number of terrorism incident in Asian states from the website of Global terrorism database. This database is maintained by the researchers in university of Maryland. This database contains the detailed record of around 98000 terrorist incidents in all over the world. All the data sets available on this website are sure events not doubted.

Journal of Law, Policy and Globalization
ISSN 2224-3240 (Paper) ISSN 2224-3259 (Online)
Vol.33, 2015

5 Data Analysis

Table 3. Descriptive statistics

Variable	N	Mean	SE Mean	St Dev	Min	Q1	Median	Q3	Max
LGDP	41	24.631	0.141	0.903	22.568	24.114	24.664	25.227	26.19
LFDI	41	19.339	0.289	1.847	15.202	17.97	19.634	20.606	22.444
INF	41	9.634	0.833	5.331	2.914	6.113	8.838	11.898	26.663
EXP	41	13.631	0.358	2.295	9.241	12.118	13.527	15.678	17.359
TER	41	233.5	72.2	462.2	0	4	49	182	2213

The above table shows the descriptive statistics of the variables. LGDP is dependent variables while LFDI, INF, EXP and TER are the explanatory variables. The model consists of 41 values.

Table 1 Correlation matrix between all the variables

Variables	LGDP	LFDI	Inf	Exp	TER
LGDP	1.00000	0.94046	-0.26163	0.36498	0.64028
LFDI	0.94046	1	-0.23332	0.4765	0.4424
Inf	-0.26163	-0.23332	1	-0.01714	0.10462
Exp	0.36498	0.4765	-0.01714	1	-0.00125
TER	0.64028	0.4424	0.10462	-0.00125	1

Above is the table of correlation matrix of all the variables which shows the relationship between all these variables. Some variable shows the positive relationship between GDP and others shows the negative relationship with GDP. The relationship between GDP and FDI is perfectly positive which means that as FDI increasing the GDP also increasing reasonably. The relationship between GDP and Inflation rate is Negative it means as inflation rate increase in Pakistan GDP decreases. The relationship of Exports and terrorist attacks with GDP is Positive.

Table 4 The Unit root test augmented dickey fuller (ADF)

Variable	ADF at level	P- value	ADF With 1st Differences	P_ value
LGDP	-4.07433	0.0139	-4.90951	0.0016
LFDI	-4.10829	0.0134	-7.15457	0.0000
INF	-3.21947	0.0952	-7.19398	0.0000
EXP	-1.70021	0.7326	-5.80134	0.0001
TER	2.471584	1.0000	-5.03495	0.0011

Note: Critical value for trend and intercept at 5% level of significance= -3.53

For checking the stationary of data set we apply the augmented dickey fuller (ADF). It is necessary to check the stationary of data set before testing the long run association between the variables. Table 4 shows the results of augmented dickey fuller (ADF) unit root test for all the five variables. The Null hypothesis for augmented dickey fuller (ADF) test is that all the series are Non-Stationary while the alternative hypothesis is that the series are stationary. Schwarz Information Criteria (SIC) was used as a lag length selection method. Null hypothesis of Non-Stationarity for original data (Individual intercept and trend) for LGDP and LFDI are clearly rejected at level and at 1st difference While INF, EXP and TER are non- stationary at level but stationary after taking the 1st difference. It means LGDP and LFDI are integrated at order zero and INF, EXP and TER are integrated at order one.

Table 5: Results of Ordinary Least Square (OLS)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	17.30566	0.394830	43.83064	0.0000
LFDI	0.383883	0.023486	16.34536	0.0000
INF	-0.018729	0.006215	-3.013287	0.0047
EXP	-0.004165	0.016105	-0.258621	0.7974
TER	0.000595	8.02E-05	7.421211	0.0000
R-squared	0.958306	Mean dependent var	24.63121	
Adjusted R-squared	0.953673	S.D. dependent var	0.903446	
S.E. of regression	0.194455	Akaike info criterion	-0.323385	
Sum squared resid	1.361255	Schwarz criterion	-0.114413	
Log likelihood	11.62940	Hannan-Quinn criter.	-0.247289	
F-statistic	206.8579	Durbin-Watson stat	1.580676	
Prob(F-statistic)	0.000000			

Above is the estimated ordinary least square regression model. In this model LGDP is our dependent variable and LFDI, INF, EXP and TER are our dependent variables. The value of R^2 95.83% and value of adjusted R^2 95.36%. The value of F- statistic is 206.8579. The significance value of F- statistic and R^2 is the evidence of Goodness of model. The p value is 0.0000 which is less than 5% which also show the goodness fit of our model. The value of Durbin-Watson test statistic for dependent variable is 1.580676. If the value of Durbin-Watson test is lies between 1.5-2.5 it means there is no autocorrelation. In our model the value of Durbin-Watson test is 1.580676 it means there is no autocorrelation in this study and the model of regression assumes that the error terms are uncorrelated.

The constructed model is given below

$$\mathrm{LGDP} = 17.30566 + 0.383883\mathrm{LFDI} - 0.018729\mathrm{INF} - 0.004165\mathrm{EXP} + 0.000595\mathrm{TER} \qquad (2)$$

In this study FDI and terrorist attacks are our focus variables. If we look the sign of coefficient of FDI that is positive and significant and the value of coefficient of FDI is 0.383883. It means that FDI positively affected economic growth of Pakistan. If we increases one unit in foreign direct investment (FDI) on the average Gross domestic product (GDP) increase 38.39% keeping the affect of all other independent variables constant. The Exports has negative affect ct on economic growth of Pakistan but if we look the P- value the exports has insignificant affect on economic growth of Pakistan.

The next variable is Inflation rate in % and if we see the sign of Inflation rate that is negative which shows that as the inflation rate increase the Gross domestic product (GDP) will decreases. It means Inflation rate has negative and significant affect on economic growth of Pakistan.

Now we discuss the last variable of this study i.e. number of terrorism incident. If we the coefficient of terrorist attacks that has positive and significant affect on economic growth of Pakistan. The value of coefficient of terrorist attacks is very low that is 0.000595. If we interpret it this means that if one terrorist attack increase on the 0.06% increase in gross domestic product of Pakistan (GDP) keeping the affect of other independent variables constant. But this is non sense how can increase GDP as number of terrorism incident increase. I try built this positive relationship between GDP and terrorist attacks. If we look on the way to determine the GDP as describe above. If we look the report of annual budget of Pakistan development expenditure are decreasing as number of terrorism incident increasing (This we can see on the web site of State Bank of Pakistan (SBP) and Securities and Exchange Commission of Pakistan (SECP), Pakistan) but on the other hand non development expenditure are increasing in annual budget of Pakistan. Therefore as the number of terrorism incident increasing in Pakistan the expenditure on security and defense institutions are increasing because protection of the lives of the masses are the 1st priority of any Government. So that's why as the number of terrorism incident increasing the GDP of Pakistan is also increasing, it is not in the sense productivity it is in the sense of security and defencing. (Zeb et al., 2013). Although number of terrorism incident is not a economic variable but in prospect of Pakistan it is very important for economic growth of Pakistan. In Pakistan due to terrorism many of revenue generating institution of Pakistan disturb seriously such as tourism, investment and Educational institutions etc.

6. Conclusion

Foreign direct investment (FDI) has vital role in economy of any country. In this paper I try to explore the relationship between Gross domestic product (GDP) and Foreign direct investment (FDI) by using the time series data for the period 1972-2012 in Pakistan. Foreign direct investment is the key of economic development of any economy. As our results shows that Foreign direct investment has positive and significant effect on economic growth of Pakistan. It is recommended that the policy makers and governments should focus on improving infrastructure; creating transparency in the trade policy, stabilize political environment, increase human resources and creating a stable macroeconomic framework for attracting more and more foreign cash inflows in order to increase economic growth of Pakistan.

In these days government of Pakistan is engaged to overcome the evil of terrorism and spend more and more money and recourses. The government should be paying his attention to take necessary steps for development of economic growth which is also a reason of terrorism in Pakistan because poverty is also a reason of terrorism in Pakistan. Poverty and economic growth is interlinked. It is also recommended that government should decrease the expenditure on terrorism and also pay the attention to achieve the goals of social and economic welfare. The government should be decreases the budget that is spent on defensive and offensive anti-terrorism measures. Pakistan can motivate so many foreign investors because of its suitable geographical place, aggressive incentives and reasonable population size. However, Pakistan awfully requires to organize some factors like law and order situation, adverse government economic strategies, political vagueness, war against terrorism, inauspicious domestic business atmosphere, less suitable infrastructure and pitiable quality of life etc. domestic investment and economic growth are positively affected by FDI and it has an access to highly developed technologies and administrative skills which will be crucial for improving human capital.

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