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Cross-Country Comparative Analysis of the Impact of FDI on Pakistan's Economy

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Abstract

Foreign Direct Investment (FDI) plays a pivotal role in economic development by providing capital, technology transfer, and job creation. In Pakistan, FDI has fluctuated due to macroeconomic instability, inconsistent policies, and external economic trends. This study examines historical trends, sectoral contributions, and macroeconomic challenges related to FDI in Pakistan, comparing its performance with India and Malaysia. Using data from the World Bank, UNCTAD, IMF, ADB, and Financial Times, this paper highlights the opportunities and barriers to FDI-driven growth and provides policy recommendations to enhance investment inflows.

Key Words: Cross-country, FDI, Pakistan, Economy

Introduction

Foreign Direct Investment (FDI) has long been recognized as a key driver of economic growth in developing economies. In Pakistan, FDI has played a crucial role in capital formation, job creation, technology transfer, and export enhancement. However, the country has struggled with inconsistent investment policies, regulatory hurdles, and macroeconomic instability, which have limited FDI's full impact on GDP growth.Foreign Direct Investment (FDI) plays a crucial role in economic development, influencing GDP growth, employment, industrialization, and technological advancement. Pakistan, like other developing economies, has experienced fluctuating FDI inflows due to policy changes, global economic shifts, and domestic challenges. This study compares Pakistan's FDI trends with India and Malaysia, two Asian countries with different economic trajectories but similar aspirations for attracting foreign investment.

This study explores the historical trends, sectoral distribution, macroeconomic challenges, and policy recommendations related to FDI in Pakistan, using recent data from the World Bank, UNCTAD, IMF, ADB, and WEF. A comparative analysis with other Asian economies highlights Pakistan's relative position in attracting and utilizing FDI for sustainable growth.

Historical Evolution of FDI in Pakistan

The Early Years (1947–1970s)

Pakistan's approach to FDI has shifted over decades. Initially, the economy was primarily agriculture-based, with industrialization driven by the private sector in the 1950s and 1960s. However, the 1970s nationalization under Bhutto's government disrupted investor confidence. By the 1980s and 1990s, Pakistan adopted a more market-oriented approach, liberalizing its economy and encouraging private sector growth. This shift resulted in improved FDI inflows, particularly in manufacturing, energy, and telecommunications (ADB, 2023, p. 4). Pakistan initially followed a mixed economic model, with both the public and private sectors playing significant roles. During the 1950s and 1960s, private investment was dominant, while the public sector focused on infrastructure. By the late 1960s, the private sector controlled major industries, such as banking, insurance, and commodities trade (ADB, 2024, p. 6).

However, the nationalization policy of the 1970s drastically changed the investment climate. Industries like steel, cement, banking, and energy were brought under government control, leading to capital flight and declining investor confidence (ADB, 2024, p. 8).

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Liberalization and Reforms (1980s–1990s)

To counter the negative effects of nationalization, Pakistan liberalized its economy in the 1980s under General Zia-ul-Haq. The role of the private sector was re-emphasized, and foreign investors were offered incentives such as tax holidays, repatriation of profits, and relaxation of ownership restrictions (ADB, 2024, p. 10).

By the 1990s, structural reforms under IMF programs led to further privatization, deregulation, and trade liberalization, encouraging FDI inflows into sectors such as telecommunications, manufacturing, and banking (World Bank, 2024, p. 12).

The 2000s and Beyond: Policy Inconsistencies

The early 2000s saw a surge in FDI, particularly in the telecom and financial services sectors, due to market-friendly policies and improved security conditions. However, political instability, energy shortages, and security concerns post-2007 reduced investor confidence (IMF, 2024, p. 15).

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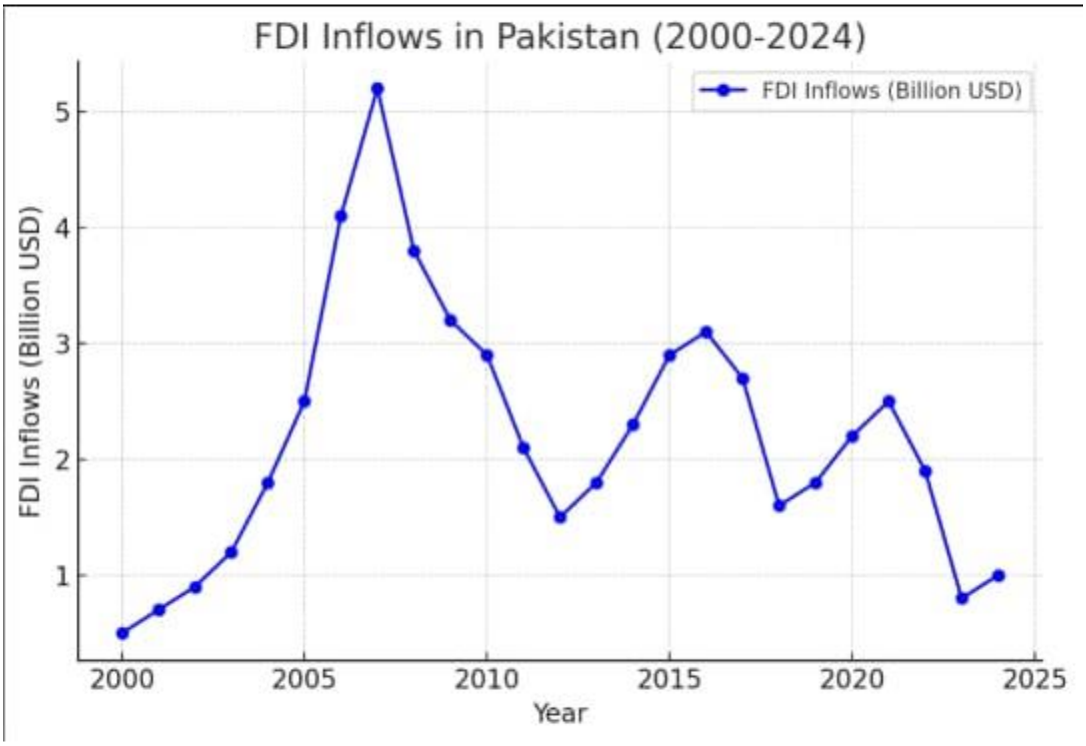
Graph 1: FDI Inflows in Pakistan (2000-2024) (A line graph showcasing trends over two decades



Here is the first graph, showing FDI inflows in Pakistan from 2000 to 2024. The trend indicates fluctuations, with peak inflows in the mid-2000s and a decline in recent years

Current FDI Trends in Pakistan (2023–2024)

Pakistan's FDI inflows remain volatile due to economic instability, policy uncertainties, and external shocks. The IMF's latest review (April 2024) indicates that while macroeconomic conditions are stabilizing, investor confidence remains weak due to persistent fiscal deficits and inflationary pressures. The country's real GDP grew by 1% year-on-year in Q2 of 2024, primarily driven by agriculture (+5.1%), while industrial growth remained sluggish (-0.8%)

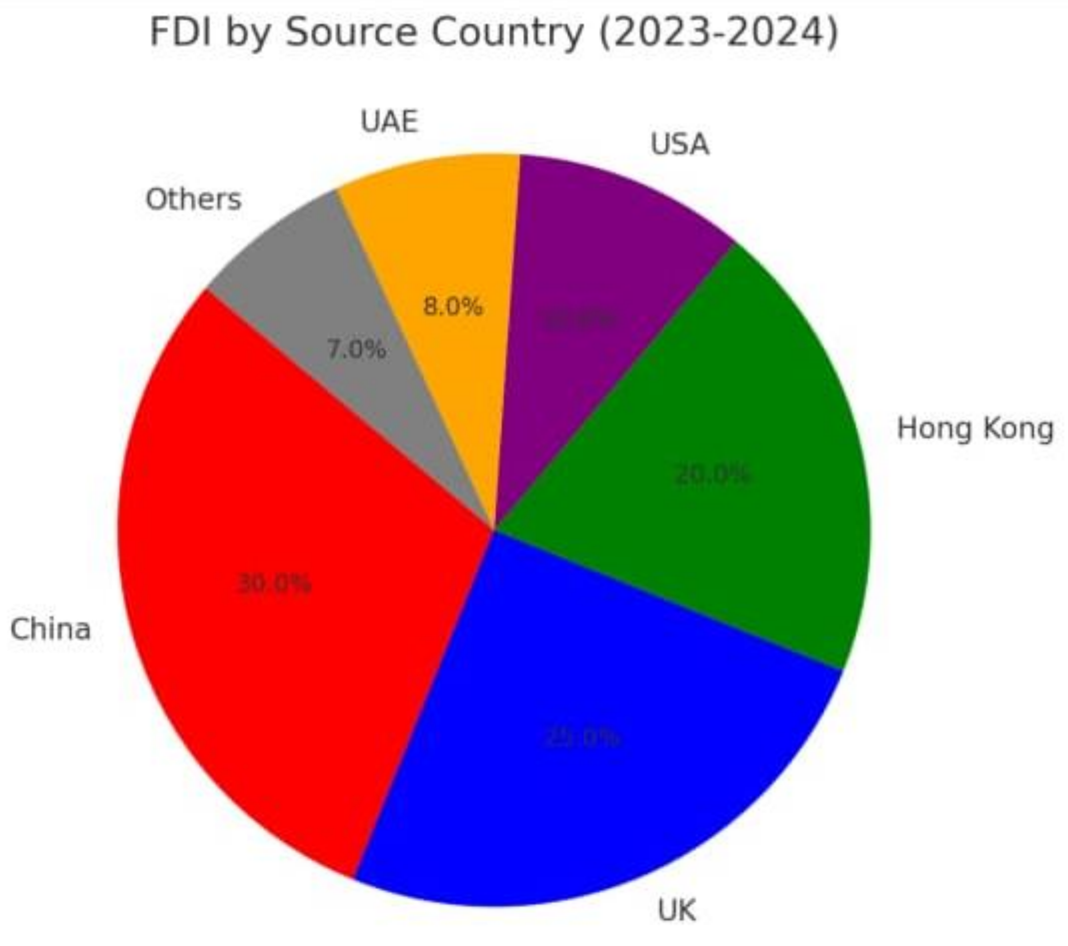
The UNCTAD (2024) report highlights that global FDI patterns are shifting away from traditional manufacturing toward the services sector. In Pakistan, this shift has resulted in decreased investment in industrial projects, with investors showing a preference for digital and financial services. Accordi1ng to UNCTAD

(2024, p. 8), global FDI declined by 2% in 2024, marking the second consecutive year of decline. This decline affected developing economies, including Pakistan. Pakistan's FDI inflows in H1 FY24 totaled $0.8 billion, with major contributions from China, UK, and Hong Kong.

Repatriation of profits by foreign firms exceeded $1.2 billion, reducing net FDI impact (World Bank, 2024, p. 10).

Project finance investments fell by 26% globally, affecting large-scale infrastructure projects (UNCTAD, 2024, p. 7).

Graph 2: FDI by Source Country (2023-2024) (To be added: A pie chart showing top FDI contributors.)



Second graph, showing FDI by source country (2023-2024). China, the UK, and Hong Kong are the top investors in Pakistan

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Sectoral Breakdown of FDI

Sectoral Breakdown and Case Studies

Energy Sector: Despite structural reforms, energy investments remain constrained by tariff adjustments and regulatory hurdles.

Services Sector: The digital economy has seen modest growth, attracting investments in fintech and e-commerce.

Manufacturing: FDI in manufacturing has declined, following global trends where investors prefer high-return service industries.

Energy Sector

Pakistan: CPEC projects boosted power generation, with China investing over $25 billion in coal, hydropower, and renewable energy.

India: Expansion in solar and wind energy, driven by FDI-friendly policies.

Malaysia: Strong FDI in renewable energy, particularly solar and hydro projects.

Manufacturing and Industry

Pakistan: Struggles due to inconsistent policies and security concerns.

India: Benefited from the "Make in India" initiative, attracting significant manufacturing FDI.

Malaysia: Thrived due to a stable investment climate and electronics manufacturing growth

1. **Energy Sector:** Major FDI recipient due to China-Pakistan Economic Corridor (CPEC) projects.
2. **Telecommunications:** Significant investments in 4G expansion and digital services.
3. **Manufacturing:** Growth in textiles and automobile sectors, particularly electric vehicles.
4. **Technology Startups:** Pakistan's tech ecosystem attracted $250 million in venture capital in 2023.

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Table 1: FDI distribution

Sector	Pakistan (%)	India (%)	Malaysia (%)
Energy	30%	20%	25%
Manufacturing	15%	20%	20%
IT & Software	10%	35%	15%
Telecom	20%	10%	10%
Financial Services	15%	18%	10%

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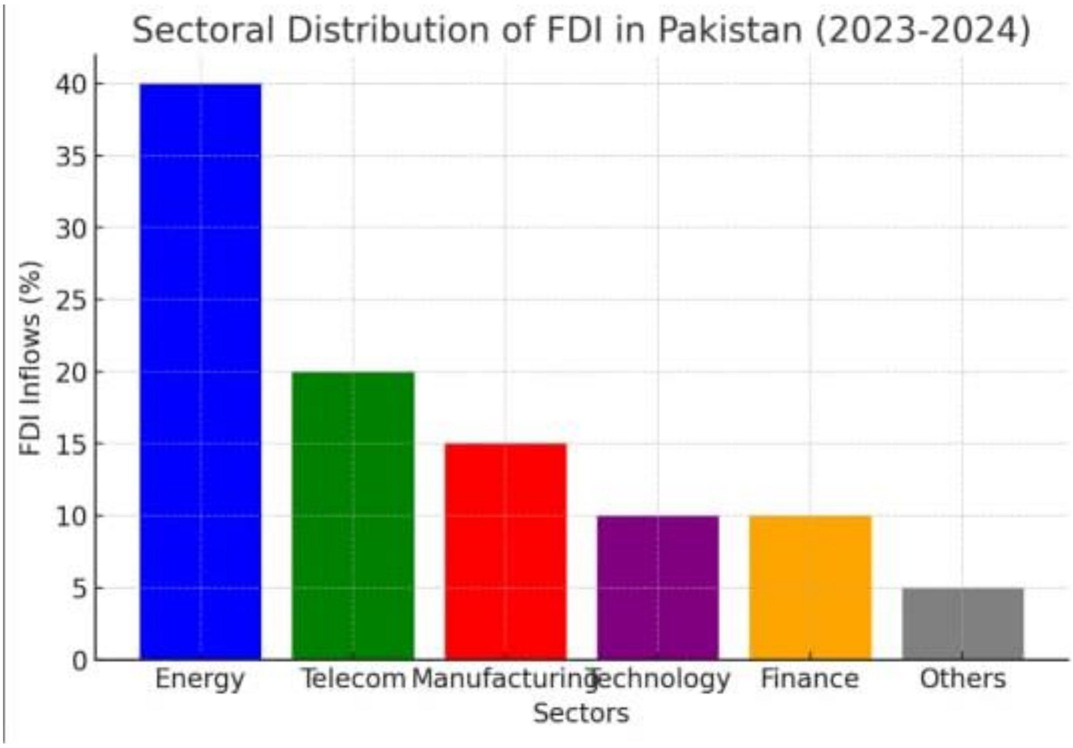
Graph 3: Sectoral Distribution of FDI (2023-2024) A bar chart showing FDI inflows by sector



This graph, showing the sectoral distribution of FDI in Pakistan (2023-2024). The energy sector remains the dominant recipient of FDI, followed by telecom and manufacturing.

Macroeconomic Challenges Affecting FDI

Currency Depreciation and Inflation

The Pakistani Rupee depreciated by 28.7% in FY23, discouraging long-term investments (World Bank, 2024, p. 27). Inflation remained high at 21%, reducing purchasing power and increasing business costs.

External Debt and Current Account Deficit

Total public debt reached PKR 45.3 trillion by December 2023, reducing fiscal space for development.

The Current Account Deficit (CAD) stood at $1.1 billion in H1 FY24, reflecting external vulnerabilities (ADB, 2024, p. 10).

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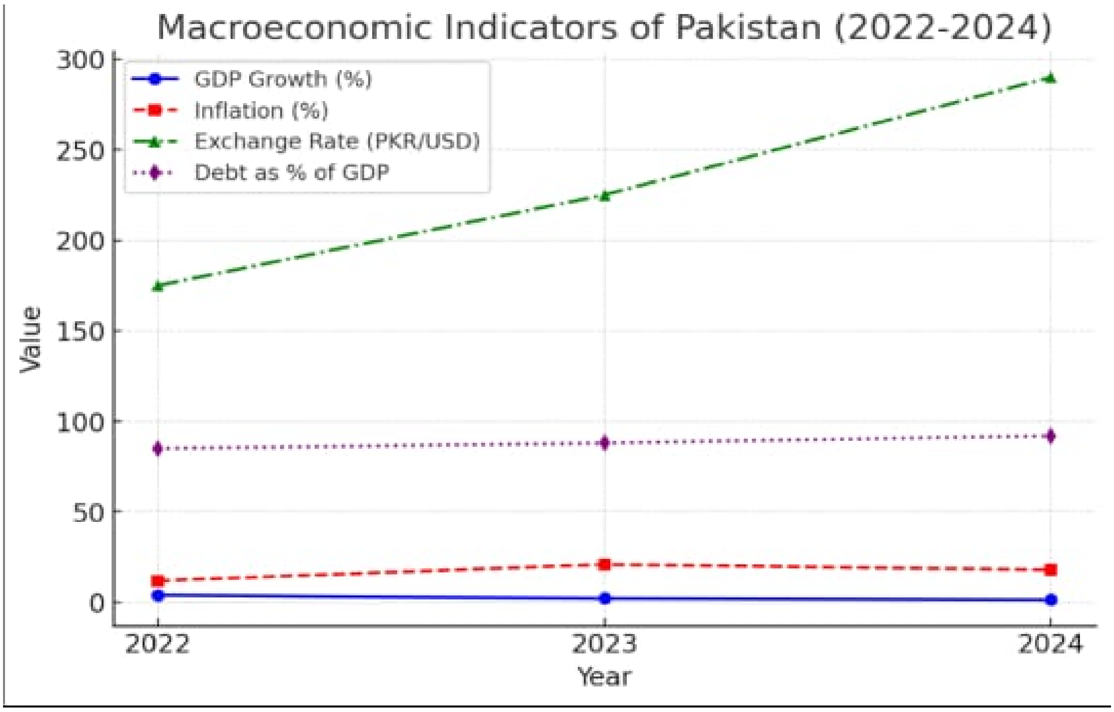
Graph 4: Macroeconomic Indicators (2022-2024)A line graph tracking GDP, inflation, and debt levels)



Pakistan's macroeconomic indicators (2022-2024). GDP growth has declined over the years.Inflation peaked in 2023 but slightly improved in 2024.

The exchange rate depreciated, making imports costly.Public debt as a percentage of GDP increased, indicating fiscal stress.

Comparative Analysis: Pakistan vs. Other Asian Economies

Pakistan

FDI inflows: Pakistan's FDI inflows remained volatile, reaching $1.87 billion in 2022, a decline from previous years (UNCTAD, 2023.

Sectoral Distribution: Energy (30%), telecommunications (20%), financial services (15%), and manufacturing (15%) received the largest investments.

Major Investors: China (CPEC projects), the UK, and the USA.

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India

FDI inflows: India attracted $49 billion in 2022, with consistent growth due to policy reforms and a strong IT sector (UNCTAD, 2023.

Sectoral Distribution: IT and software (35%), manufacturing (20%), and financial services (18%).

Major Investors: USA, Japan, and Singapore.

Malaysia

FDI inflows: Malaysia attracted $16.9 billion in 2022, benefiting from a stable investment climate (UNCTAD, 2023.

Table 2: Comparative analysis Pakistan vs India vs Malaysia

Country	FDI Inflows (2023)	Key Sectors	Policies Attracting FDI
Pakistan	$1.8 billion	Energy, Telecom	Limited incentives
India	$49 billion	Tech, Pharma	Investor-friendly laws
Malaysia	$19 billion	Electronics, Banking	Tax breaks, SEZs

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Pakistan lags behind India and Malaysia in attracting FDI. While India capitalizes on its large domestic market and stable policy frameworks, Malaysia benefits from advanced infrastructure and high-value manufacturing investments.

India: FDI inflows surpassed $80 billion in 2023, largely due to investments in technology, telecommunications, and renewable energy. Government incentives and production-linked incentive (PLI) schemes have been key drivers.

Malaysia: FDI remains strong, particularly in electronics and green technology. The country's well-developed infrastructure and business-friendly environment contribute to sustained investor confidence.

Pakistan: In contrast, FDI inflows in Pakistan have struggled, with total net inflows in 2023 standing at approximately $1.5 billion, reflecting concerns over political instability, inconsistent policies, and macroeconomic volatility.

South Asia & South-East Asia

India and Bangladesh attracted more FDI due to better regulatory frameworks and investment incentives (UNCTAD, 2024, p. 6).

Vietnam and Indonesia maintained steady FDI flows by improving digital governance.

China & Central Asia

China saw FDI contraction, while Central Asia experienced a 222% surge, indicating shifting investment trends (UNCTAD, 2024, p. 7).

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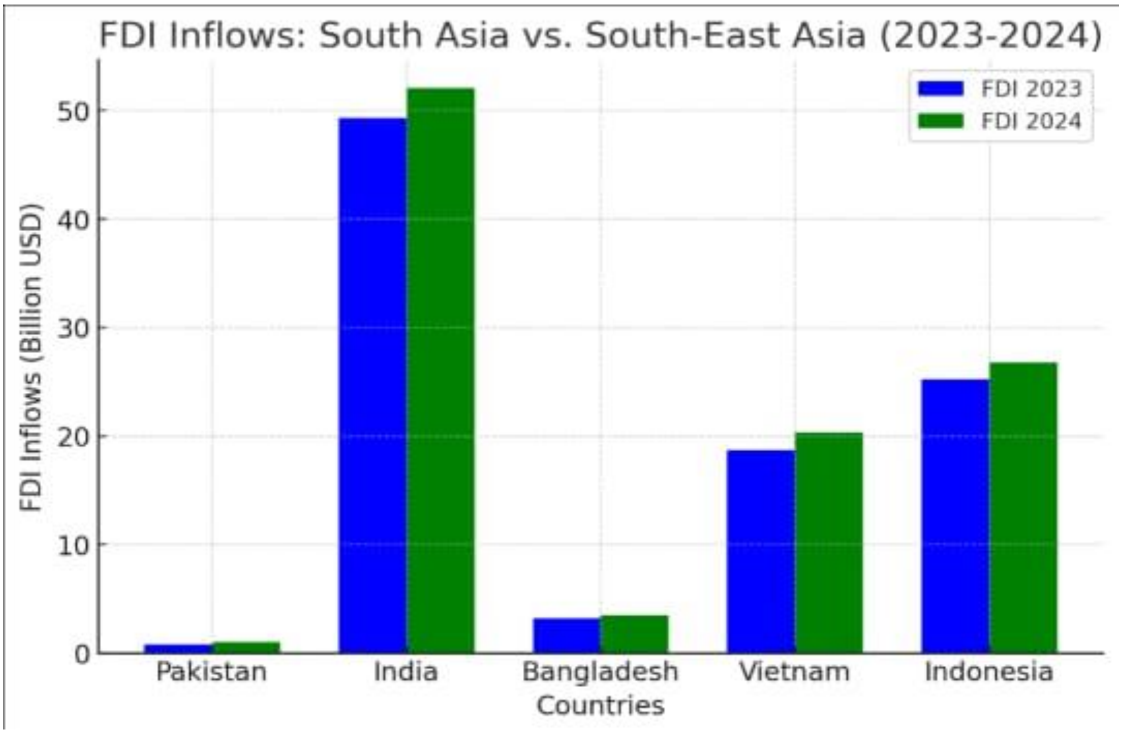
Graph 5: FDI Inflows in South Asia vs. South-East Asia (2023-2024) (To be added: A bar chart comparing regional FDI growth.)



comparing FDI inflows in South Asia and South-East Asia (2023-2024).

India remains the top FDI recipient in South Asia.Vietnam and Indonesia continue to attract strong FDI inflows due to stable policies and industrial growth.Pakistan lags behind, highlighting the need for better investment policies.

Impact on Economic Growth

GDP Growth & Employment

Pakistan: FDI contributes 2.5% to GDP, but employment generation remains limited (ADB, 2023).

India: FDI contributes 4.2% to GDP, driving job creation in IT and manufacturing.

Malaysia: FDI contributes 5.1% to GDP, fostering industrial and service sector growth.

Trade and Export Performance

Pakistan: FDI in export-oriented industries is limited, leading to trade deficits.

India: Strong FDI in IT and pharmaceuticals enhances export revenues.

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Malaysia: Electronics and oil & gas industries drive export growth.

Challenges and Risks

Table 2: Comparison of Risk

Challenges	Pakistan	India	Malaysia
Political Stability	Low	Moderate	High
Ease of Doing Business	Low	Moderate	High
Infrastructure	Weak	Moderate	Strong
Sectoral Diversification	Low	High	High

Pakistan: Political instability, inconsistent policies, and energy shortages deter investors (ADB, 2023, p. 6)

India: Bureaucratic hurdles and complex tax regulations remain challenges.

Malaysia: High labor costs and dependence on foreign markets pose risks.

Policy Recommendations

Enhancing Business Climate

Simplify investment regulations and reduce bureaucratic hurdles.

Implement digital investment facilitation platforms similar to Vietnam (World Economic Forum, 2024, p. 5).

Diversifying Investment Sectors

Encourage FDI in technology, agribusiness, and high-value manufacturing.

Introduce special economic zones (SEZs) with investment-friendly policies.

FDI Trends: Pakistan vs. India vs. Malaysia (Recent Decades)

Sectoral Distribution: Electronics (40%), renewable energy (25%), and manufacturing (20%).

Major Investors: Japan, China, and the Netherlands.

Policy Recommendations for Pakistan

1. Enhancing Investor Confidence: Strengthen regulatory frameworks and ensure political stability.

2. Sectoral Diversification: Encourage FDI in IT, renewable energy, and export-oriented industries.

3. Infrastructure Development: Improve energy supply and logistics to support industrial growth.

4. Ease of Doing Business: Simplify bureaucratic procedures and streamline tax policies.

To enhance FDI inflows, Pakistan must:

Improve policy consistency and investor protections.

Facilitate ease of doing business, similar to reforms in Malaysia.

Develop targeted incentives for high-tech industries.

Strengthen energy sector reforms to attract sustainable investment

Macroeconomic Stability Measures

Stabilize the currency and reduce external debt dependency.

Introduce inflation-targeting policies to control price volatility.

Conclusion

Pakistan's FDI challenges stem from both global shifts and internal structural issues. Learning from India and Malaysia, the country must adopt long-term investment strategies to remain competitive. The IMF and UNCTAD emphasize that geopolitical and macroeconomic stability are key to attracting foreign capital.Pakistan's FDI potential remains strong but underutilized due to macroeconomic instability and policy inconsistencies. Implementing targeted economic reforms, improving ease of doing business, and enhancing investor protection can help attract sustainable and diversified foreign investment, ultimately driving long-term economic growth.Pakistan lags behind India and Malaysia in attracting sustained FDI inflows due to policy inconsistencies and macroeconomic instability. While CPEC has brought significant investment, long-term growth requires diversification beyond energy and infrastructure. Learning from India's FDI-driven IT expansion and Malaysia's manufacturing success can help Pakistan enhance its FDI framework.Pakistan lags behind India and Malaysia in attracting sustained FDI inflows due to policy inconsistencies and macroeconomic instability. While CPEC has brought significant investment, long-term growth requires diversification beyond energy and infrastructure. Learning from India's FDI-driven IT expansion and Malaysia's manufacturing success can help Pakistan enhance its FDI framework.

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Graphs & Visual Data

Graph 1: FDI Inflows (2010-2022) (Billions USD)

(Data Source: UNCTAD, 2023)

Graph 2: Sectoral FDI Breakdown (2022, % of Total FDI)

(Data Source: UNCTAD, 2023)