

## **Link between Stock Market Development, Foreign Capital Inflows, Trade Liberalization and Economic Freedom in Pakistan**

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### **Abstract:**

*For the development of a country and encouraging the quest of continued reforms the competition for FDI is growing. Developing countries like Pakistan has, the more quests for foreign direct investment. To draw the attention of FDI, countries guarantee the existence of records regarding structural development by giving surety of business success to foreign investors. The main aim of this study is to establish linkage among stock market development, foreign capital inflows, trade liberalization and economic freedom in Pakistan uses annual data of 1989 to 2017. The results of the study show that there exists co-integration among all the variables while considering FDI as dependent variables. The increment in these factors of FDI i.e. (SMD, TL, EG and EF) helps boosting FDI into the country. For the attraction of FDI into the country, policy makers are recommended to formulate effective policies and strategies.*

**Keywords:** FDI, Economic freedom, Stock market, Trade liberalization

### **I. Introduction**

For enhancing the investments, the development of stock market is an essential part of an economy that is unable to ignore in that country. Investors got attracted to investment by the strong economic fundamentals, larger sizes of the markets and trade policies of the host countries. Developing countries should have a well-developed capital market as it provides a platform to equity traders and it reduces transactions costs and information asymmetries. Hence, it is important to analyze the relationship between foreign inflows and stock market (Sajid, et al, 2021). According to (Rajapakse, 2018) increasing participation of foreigners and a well developed stock market leads to increase in foreign capital inflows in the country.

Foreign investors make their decision to invest in another country by seeing the following factors in that country which are “Ownership specific advantages”, “Location specific advantages”, and “Internationalization advantages” of eclectic theory of FDI by Dunning and Lundan (2008). These factors with empirical evidences are the base for selecting the variables into our study. This theory by Dunning and Lundan (2008)

identifies a structure for the explanation of both (foreign owned production) acquired by a home-country's own enterprises and household production acquired by foreign firms. This theory describes that for getting engage in FDI a firm must meet the three conditions. So the arguments suggest three forms of advantages as recognized by the enterprises. Foreign firms invest in the stock market of host country by seeing these advantages. So as per the empirical evidences of (Khan & Adnan Hye, 2014) that showed an insignificant relationship of stock market development with FDI is the outcome based on these advantages. The ownership advantages are the rights that are particular to some limits like the use of technology, monopolistic power and size, right of using raw materials and to acquire cheap finance. The reason behind the occurrence of these advantages is the imperfection in product and factor market. So, as per this theory these limitations in a country results in not attracting the foreign investors to invest in host country's market. Whereas the Location specific factors are the attributes of host economies which provides foreign firms with opportunities of making profits.

For market seeking FDI, target locations are the economies with high income and larger size of the markets (Asiedu, 2002). Moreover, our study explains that FDI inflows are dependent on macroeconomic factors like GDP growth, market capitalization and liberalization policies (Sharma & Joshi, 2015). Trade liberalization in Pakistan has received honor from international businesses and multilateral financial institutions. Globalized and liberalization policies of trade affect the output level and economic activity and attract foreign investment. That's why, it is essential element to recognize that to what extent the trade policies are liberalized (Mudiyanselage, et al, 2021).

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 (Heckscher-Ohlin) and comparative advantage. By free trading between countries the countries will be enabled to move above their production possibility frontiers trade will assumed to increase growth. Free trade thus helps in economic growth; promote those activities in which the nation has relative advantage of factors of production. To spur the economic growth and foreign investment, free trade is the best factor.

For the purpose of accelerating economic growth and to supplement savings Pakistan depends upon external flows. For the inflows of FDI in a country, economic growth has an essential part (e.g. Al Nasser 2010; Jiménez 2011; Kandil 2011; Mohamed and Sidiropoulos 2010). In the theoretical literature, market size and economic growth are considered as very important factors when the "Locational determinants" of FDI are discussed (Li and Liu 2005). Economic growth can impact FDI positively, negatively and no impact at all (Agosin and Machado 2007; Carstensen and Toubal 2004).

Because, high growth rate of an economy indicates the size of that country's stock market, which could be expected to expand in near future. Foreign firms are attracted this way by the economic growth and plans for new projects. In a 3<sup>rd</sup> world country like Pakistan the sluggish scenario of growth and instability of market structure is a hurdle in attracting foreign direct investment into the country. Whereas the other factors like trade and economic freedom shows positive relationships with FDI. Economic freedom means the liberalization at national level (decrease in government interference into the economy and as a result entrance into free- market) and international level

(reduction in barriers to trade for goods and services, flow of capital and movement of technology (Setayesh & Sheidaee, 2016). So, economic freedom attracts FDI (Singh and Gal, 2020). From the 43 countries of Asian-Pacific region ranking of Pakistan in 32<sup>nd</sup> in EF.

The above stated theory of OLI paradigm (Locational advantage) states that MNEs analyzes the situations of host country before investing. According to Dunning (2009), there are four different sub- categories of Locational advantages which are (resource factors, market factors efficiency factors and strategic asset factors). From the OLI paradigm, Location advantage is suitable category for the economic freedom and EF can be characterized as a major determinant of FDI. According to the definition of EF, two factors of Locational advantages cover it that are (Market factors and Efficiency factors). For the maximization of returns MNEs rely on their foreign affiliates with favor of different markets that have low restrictions on business activities. So, the increasing level of economic freedom causes to be a source of attraction for FDI as host.

Hence, the contribution of this paper is to combine different strands of literature and present in a single research by considering FDI as dependent variable which will drive the valuable conclusion for policymakers. As, the below literature shows that all other studies have discussed variables separately and they used different estimation methods. But this study uses ARDL method. The novelty of the research is to determine the short term and long term relationship of Stock market development, trade liberalization and Economic freedom with FDI by using ARDL method. At the same time, this study is a step forward towards analyzing the relationship that exists among economic growth and FDI in Pakistan. Furthermore, this study utilizes long time series data from the period of 1989 to 2017 and studies four different strands of literature.

This research will develop the relationship among four strands of literature stock market development, foreign capital inflows, trade liberalization and economic freedom in Pakistan during the period 1989 to 2017. This study has also included the economic freedom variable because no such study has studied these four variables combined using time series data. The macroeconomic indicators like stock market development, foreign capital inflow, trade liberalization and economic freedom increases economic growth of a country. Because when a country liberalizes trade its stock market is also developed. This development of stock market leads to increase in economic freedom. Because due to economic freedom the government interference into the economy, barriers to trade for goods and services is reduced and flow of capital and movement of technology among countries is increased which automatically leads towards economic growth.

This research is designed to investigate that how the different indicators like (stock market development, trade liberalization and economic freedom) increases or decreases foreign direct investment. This research further investigates that either the changes in these indicators will attract foreign investment or not? The information of these issues supports for conducting the more reliable research. FDI has received a handsome attraction from the trade liberalization and economic freedom. Moreover, it has not received attraction from the sluggish growth of Pakistan's economy and less developed stock market.

The main aim of this paper is to research relationship of stock market development, foreign capital inflows, trade liberalization and Economic freedom in Pakistan by considering FCI as a dependent variable. This research will focus on a lot of meaningful information that will benefit a wide range of people such as investors in making better investment decisions. This research will be helpful in showing the significance of stock market development, trade liberalization, and economic freedom with FCI. Because for the well being of a country FCI is considered as a very basic variable. This study will help in determining the negative and positive links of these variables with FCI. With respect to EF, it is clear that an economically free environment attracts more and more opportunities to foreign investment. Furthermore, the academicians can likewise utilize this research paper as a mechanism to make new hypothesis that can increase further investigations on foreign capital inflow.

## **II. Literature Review**

Following are the varying investigations that have been explored focusing on stock market development, foreign capital inflow, trade liberalization and economic freedom.

### **A. Relationship between Stock market development and FDI**

Kalu and Ngobe (2021) investigated the relationship among foreign direct investment and stock market development in South African economy. Their estimations from ARDL model show positive but insignificant relationship among FDI and stock market development in long run. Khan and Adnan Hye (2014) explored the enhancement of inflows in FDI and in the end to boost the growth of economy. They analyzed that policies of liberalization had a negative effect on foreign direct investment. Negative impact of size of market found on FDI.

Musabeh and Zouaoui (2020) examined the determinants of FDI inflows and effect of FDI-policies adopted by the host countries in North Africa. Their results showed that trade openness had a positive relationship whereas market size variables had a negative and insignificant relationship with change of FDI inflows. Zafar (2013) analyzed the performance of stock market by using some macroeconomic determinants of stock market by utilizing a time series analysis. He concluded that for attracting foreign investors there must be improvement in law and order situations of a country because it may increase market capitalization and FDI.

### **B. Relationship between Trade liberalization and FDI**

Khan et al. (2018) analyzed the link of foreign direct investment with importing and exporting activities of Pakistan using annual time series analysis during the period 1978 to 2016. Tsaurai (2017) analyzed the link among financial improvement, trade liberalization and economic growth in case of Argentina. Pradhan et al. (2019) examined the link among trade liberalization, FDI, Financial investment, financial development and growth in economy of 19 Eurozone countries from the period 1988 to 2013 by using panel (VECM) model into this study.

Hajilee et al. (2019) examined the relationship among financial market inclusion, openness to trade. Their results showed that when the economies will be more integrated then automatically there will be a decrease in poverty and equal wealth distribution will be enhanced. Zahongo (2017) findings revealed that trade openness

could be accomplished by encouraging new sources for investment and with increasing the level of institutions with new skills and abilities. Bibi et al (2014) found the long run link between foreign capital inflows, trade liberalization, inflation and exchange rates. Zeeshan et al (2019) examined the impact of financial and trade liberalization on the growth of Pakistan economy. His results concluded that there was liberalization to trade in Pakistan but there is a lack to financial liberalization. Similarly, Ali and Panhwar (2017) examined the effect of trade liberalization over Pakistan's economic development. Semancikova (2016) analyzed the relationship among trade, trade liberalization and macro-level performance.

### **C. Relationship between Economic freedom, Economic growth and FDI**

Hayet and Naceur (2021) investigated the macroeconomic effect of economic freedom on inflows of FDI using econometric method of generalized moments (GMM). According to their results estimations show that FDI have a positive effect on economic growth that requires higher level of economic freedom. Silva et al. (2018) explored the link among performance of stock market and economic growth in Sri Lanka. Their results showed a positive correlation among performance of stock market and growth. Haydaroglu (2016) examined the impact of FDI and economic freedom on economic growth. The results of his study showed that economic freedom and FDI had a significant positive impact on economic growth.

Dkhili et al. (2018) investigated the participation of economic freedom to attract FDI as well as enhancing the intensity of growth in an economy. Their results showed significant positive relationship among economic liberalization and FDI, among economic liberalization and growth. Iamsiraroj and Doucouliagos (2015) examined that does the growth of a country attracts FDI or not using meta-regression analysis. Their results showed that there can be a positive, negative and no association of economic growth with FDI. Rise in growth rate indicates the size of a country's stock market. From the review of relevant literature, it is clear that the researchers have not studied the combine link of stock market development, foreign capital inflow, trade liberalization and economic freedom. So this research is conducted to focus on the link between these four strands of literature by considering FCI as dependent variable in Pakistan using time series data during the period 1989 to 2017. So, the arguments cited in the preceding part posed the following hypothesis:

- H<sub>1</sub>: There is a negative relationship among stock market development and FDI.
- H<sub>2</sub>: There is a positive relationship among trade liberalization and FDI.
- H<sub>3</sub>: There is a positive relationship among economic freedom and FDI.
- H<sub>4</sub>: There is a positive relationship among economic growth and FDI.

The main objective of this study is to investigate the link between stock market development, trade liberalization and economic freedom with FDI from the period 1989 to 2017 in order to know the strength and direction of short run and long run relationships using time series data. There's no study being done that can prove the presence of interconnection between Stock market development, foreign capital inflows, Trade liberalization and Economic freedom in Pakistan. That's why, the essential interconnection and the way of causality still remain un-clear.

### III. Data and Methodology

#### A. Data Sources

We have collected secondary data on annually basis. World Development Indicators (WDI) is the source of data for Market capitalization, FCI (Net inflows), trade liberalization and GDP growth of Pakistan and the data on economic freedom has been taken from Fraser Institute Vancouver Canada. This study covers the time period of 28 years from 1989 to 2017 by using annual time series data.

#### B. Model specification

For the variables, to determining the time series characteristics ADF (Dickey and Fuller, 1981) technique will be used. ARDL model will be used in this study. Based upon ARDL model by Pesaran et al. (2001), bounds testing for Co-integration technique will be applied. While for checking the short term results Error correction term (ECT) will be applied to know the speed of adjustment (Pesaran and Shin, 1999). For checking stability of model CUSUM test has been used.

#### C. Description of Variables

##### *Stock Market Development*

The measurement of stock market development has been done through Market capitalization as % of GDP.

$$\text{Market capitalization} = \text{Total market value of listed shares} / \text{GDP}$$

##### *Foreign Capital Inflows*

For measuring the inflows of foreign capital, net inflows of foreign direct investment are used as a proxy.

##### *Trade liberalization*

For the measurement of TL, trade openness is being used as a proxy.

##### *Economic growth*

GDP (Annual % growth) is used as a proxy to economic growth.

##### *Economic freedom*

The index of economic freedom is measured by the Fraser Institute Vancouver Canada on a rating scale of (0 to 10).

### IV. Data Analysis

To see the linkage among the independent and dependent variable (foreign capital inflow) in Pakistan time series analysis technique is applied. In this paper, foreign capital inflow is dependent variable and stock market development, trade liberalization, economic freedom and economic growth are independent variables.

$$Y = \beta_0 + \beta_1 \text{SMD} + \beta_2 \text{TL} + \beta_3 \text{EF} + \beta_4 \text{EG} + \varepsilon_t$$

Where, FCI = Foreign capital inflow, SMD =Stock market development, TL =Trade liberalization, EF =Economic freedom, EG =Economic growth and  $\varepsilon_t$ = error term.

### A. Statistical Analysis

Table 1 shows the descriptive statistics. In this table, Null hypothesis accepted due to the normality of the residuals. As per the Jarque-Bera test representations demonstrates that the residual of FDI variable has no normal distribution. On the other hand, the residuals of MC, TO, EF and EG have normal distribution. The average of Foreign direct investment is 1.12 with standard deviation of 0.84. The average of market capitalization is 20.9 with standard deviation of 11.2. The average of trade openness is 33.2 with standard deviation of 3.64. The average of economic freedom is 5.70 with standard deviation of 0.39. The average of gross domestic product is 4.22 with standard deviation of 1.77.

**Table 1: Descriptive statistics**

	FDI	MC	TO	EF	GDP
<b>Mean</b>	1.12	20.9	33.2	5.70	4.22
<b>Median</b>	0.81	18.9	32.9	5.68	4.45
<b>Maximum</b>	3.66	46.5	38.9	6.23	7.70
<b>Minimum</b>	0.38	5.90	25.3	4.81	1.01
<b>Std-Dev</b>	0.84	11.2	3.64	0.39	1.77
<b>Skewness</b>	1.91	0.75	-0.46	-0.60	0.15
<b>Kurtosis</b>	5.69	2.88	2.63	2.41	2.51
<b>Jarque-Bera</b>	26.5	2.75	1.22	2.16	0.39
<b>Probability</b>	0.00	0.25	0.54	0.33	0.82

**Table 2: Correlation Analysis**

	FDI	MC	TO	EF	GDP
<b>FDI</b>	1	0.47	0.16	0.40	0.08
<b>MC</b>	0.47	1	-0.24	0.47	0.47
<b>TO</b>	0.16	-0.24	1	-0.48	-0.09
<b>EF</b>	0.40	0.47	-0.48	1	-0.08
<b>GDP</b>	0.08	0.47	-0.09	-0.08	1

Table 2 shows that all variables of our study have a significant correlation with foreign direct investment. There is a positive and significant correlation of market capitalization, trade openness, economic freedom and GDP with foreign direct investment.

### B. Time Series Analysis

#### *Unit root test (ADF)*

This table 3 estimates the unit root testing through ADF test and indicates that some of our variables are integrated at 1<sup>st</sup> difference like foreign direct investment is integrated at 1<sup>st</sup> difference with coefficient value of -3.43 and P-value of 0.01. Market capitalization is also integrated at 1<sup>st</sup> difference with coefficient value of -6.54 and P-value of 0.00. Trade openness has the coefficient value of -6.94 with P-value of 0.00 and integrated at 1<sup>st</sup> difference. Economic freedom has the coefficient value of -4.66 and P-value of 0.00 which is also integrated at 1<sup>st</sup> difference. While the GDP is integrated at level with coefficient value of -3.37 and P-value of 0.02.

In our study, here is the mixture of integrations at level or 1<sup>st</sup> difference which represents the non-existence of co-integration. Stationary of the variables is checked using ADF test. So, the mixed integrations of the variables show that Autoregressive

Distributed Lag Model (ARDL) should be employed because our variables have stationary at different orders.

**Table 3: ADF (Unit root test)**

Variables	Level		1 <sup>st</sup> difference		2 <sup>nd</sup> difference		Decision
	Trend	Trend & intercept	Trend	Trend & intercept	Trend	Trend & intercept	
FDI	-2.76 0.07	-2.70 0.24	-3.43 0.01	-3.38 0.07	-6.15 0.00	-6.02 0.00	I(1)
MC	-2.67 0.09	-4.07 0.01	-6.54 0.00	-6.42 0.00	-8.01 0.00	-7.84 0.00	I(1)
TO	-1.29 0.61	-2.56 0.29	-6.94 0.00	-6.82 0.00	-10.38 0.00	-10.16 0.00	I(1)
EF	-1.38 0.57	-1.74 0.70	-4.66 0.00	-5.40 0.00	-5.74 0.00	-5.57 0.00	I(1)
GDP	-3.37 0.02	-3.28 0.09	-6.28 0.00	-6.18 0.00	-7.48 0.00	-7.26 0.00	I(0)

**Autoregressive Distributive Lag Model**

The ARDL bounds testing technique by Pesarn and Shin (1999) and Pesarn et al. (2001) is used when the variables have different orders of integration. ARDL model contains various limitations such as we can assign different lag length into our model. Following is the econometric equation of ARDL.

$$Y_t = \beta_0 + \beta_1 Y_{t-1} + \dots + \beta_k Y_{t-p} + \alpha_0 X_{t-1} + \alpha_1 X_{t-2} + \dots + \alpha_q X_{t-q} + \epsilon_t$$

Where  $\epsilon_t$  is random term in the model.

**Table 4: Bounds test**

Test Statistic	Value	Signif.	I(0)	I(1)
F-Statistic	5.79	10%	2.2	3.09
K	4	5%	2.56	3.49
		2.5%	2.88	3.87
		1%	3.29	4.37

This table 4 shows the lower bounds I(0) and upper bounds I(1) critical values. These outcomes states that there exists long term linkage among all variables because the value of F-statistics is 5.79 which is above the upper bound values which show that all variables of study are bound in long term when dependent variable is FDI. If the values of F-statistics are below the critical values of lower bounds then this indicates the absence of long term relationship. If the values of F-statistics are above the critical values of upper bounds then this indicates the existence of long run relationship. If the values of F-statistics are found among the critical values of upper and lower bounds then the decision will be indecisive about the presence of long term relationship.

In this table, the values of F-statistics lies are above the critical values of upper bound I(1) and according to Pesarn et al. (2001) and Nayaran (2004) there will be the existence of co-integration and further there will be the possibility of moving towards the long term and short term relationship with the rejection of null hypothesis also. That's why we have concluded with the presence of long term relationship between variables. In this table 5, results shows that the negative value of market capitalization coefficients which is -0.07 and the probability value of 0.67 means that there is a negative and insignificant association among market capitalization and foreign direct investment. Whereas, the coefficient value of trade openness 1.89 and probability value of 0.00 shows the existence of positively significant linkage among trade openness and foreign capital inflow, it means that if we increase 1% in trade openness then consequently the foreign



capital inflow will also be increased with 1.89%.The relationship of economic freedom with foreign capital inflow has been found positively significant, which indicated that the increase in economic freedom with 1% will also increase 5.77% in foreign direct investment. Whereas, the relationship of GDP is positive but insignificant with FCI.

**Table 5: ARDL long run elasticities**

Variables	Coefficient	Std.Error	t-Statistic	Probability
Constant	-7.24	1.47	-4.91	0.00
LN MC	-0.07	0.16	-0.42	0.67
LN TO	1.89	0.61	3.07	0.00
LN EF	5.77	1.39	4.13	0.00
LN GDP	0.08	0.17	0.47	0.63

**Table 6: ECM Representation of ARDL**

Variables	Coefficient	Std.Error	t-Statistic	Probability
Constant	-7.417854	2.272164	-3.264665	0.0049
LN MC	-0.074393	0.180527	-0.412085	0.6857
LN TO	1.943091	0.700646	2.773284	0.0136
LN EF	5.912029	2.224384	2.657828	0.0172
LN GDP	0.083685	0.167276	0.500279	0.6237
ECT	-1.023592	0.151458	-6.758237	0.0000
R <sup>2</sup>	0.840776	D.W	2.399551	
Adj.R <sup>2</sup>	0.761165	Prob(F-Statistic)	0.000043	
S.E. of regression	0.127205	F-statistic	10.56095	

This table 6 represents the short run results estimated through the ECM equation. These results show that value of (R-square) is 0.84 and adjusted (R-square) has the value of 0.76. So it means that 84% variation in FDI (dependent variable) is because of independent variables. ECT value is (-1.02) which is negatively significant at 1% level. Error correction term tell us regarding long term speed of adjustment. The 2.39 value of durbin-watson shows no autocorrelation.

### Stability Tests

This graphical representation of figure 1 shows that our model has stability and the model has no structural breaks.

**Figure 1: CUSUM**

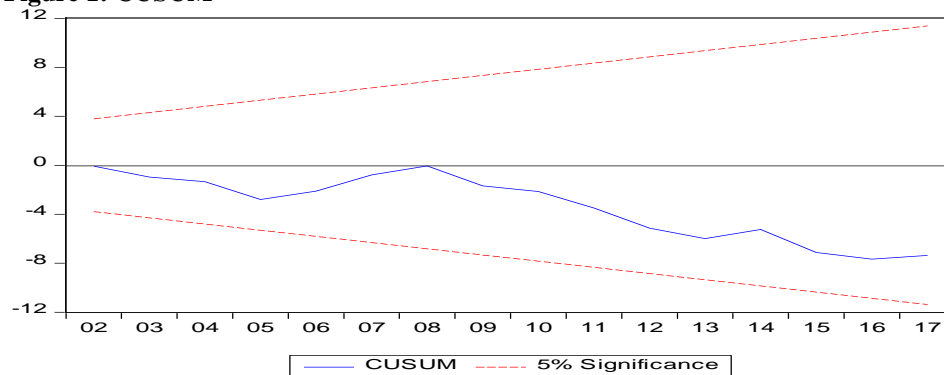
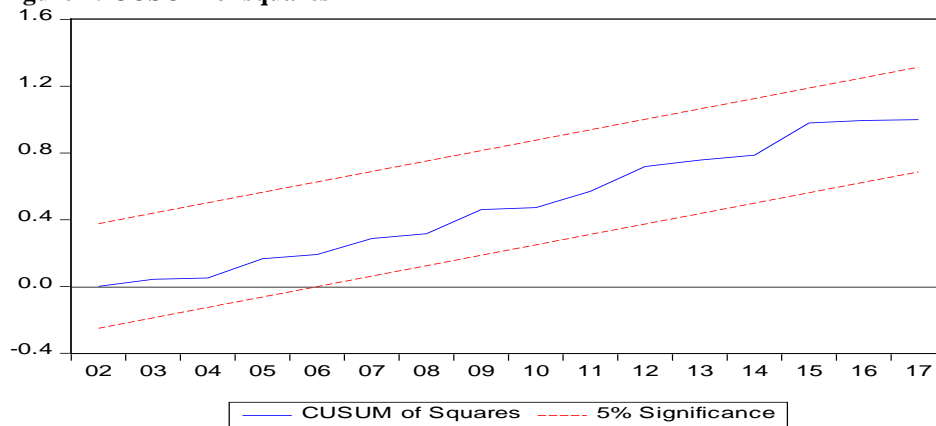


Figure 2 also indicated there is stability in the model with having no structural breaks. Both of our plots are at 5% level of significance and within critical values so it is concluded that our models are stable structurally.

**Figure 2: CUSUM of squares**



## V. Results and Discussion

From the results it has been concluded that the stock market development is not statistically significant with foreign capital inflow. Size of the market as (% of GDP) has negative relationship with FCI in long run as well as short run. The results states that 1% increase in market capitalization will decrease 0.07% in FDI. This finding of our study is aligned with the findings of (Khan & Adnan Hye, 2014) and (Musabeh and Zouaoui, 2020). So the proposed hypothesis is accepted. From the time period of last twenty years, Pakistan has no inflow of FDI. In Pakistan there is only 1.1pc of FDI (% of GDP). So, for enhancing the foreign capital inflow there must be the policies in every country like attractive and friendly business environment and a well developed financial framework so that the investors will be attracted for doing investment in that country. So, we hypothesized that:

H<sub>1</sub>: There is a negative relationship among stock market development and FDI.

Our results of trade liberalization are significant with FDI and these results are according to our proposed hypothesis as suggested by the empirical evidences like (Iqbal & Shahid, 2015). Because according to our results, 1% increase in trade openness will also increase 1.89% in FDI. The liberalization to trade helps a country to decrease its government revenues by attracting FDI. Trade liberalization in Pakistan plays a positive part for investors in the form of incentives because Pakistani government always tries its best to terminate the hurdles in the way of foreign direct investment. Therefore, it was hypothesized that:

H<sub>2</sub>: There is a positive relationship among trade liberalization and FDI.

On the other hand, our results of economic freedom suggest that there is a positive relationship of economic freedom with FCI in long run and short run. Thus, this finding of our study relates to our proposed hypothesis indicating that there is a positive

relationship of economic freedom with FCI. Because according to results 1% increase in economic freedom will also increase 5.77% in FDI. This finding of our results is relevant to (ROŽĀNS, 2016) and (Kapuria-Foreman, 2014). Kapuria-Foreman (2014) states that with the increase in specific components of EF like (protection of property rights, reducing government intervention and lowering barriers to capital flows and foreign investment), FDI increases positively. So the null hypothesis is accepted that was:

H<sub>3</sub>: There is a positive relationship among economic freedom and FDI.

Many empirical studies found that economic growth is motivation for FDI attraction and their study showed significant relationship (e.g., Al Nasser 2010; Jiménez 2011; Kandil 2011). Faster growing markets are the preferences of the investors because growing markets provides effective scales of production (Agosin and Machado 2007; Carstensen and Toubal 2004). There is the possibility of impact of growth (negative, positive and no effects) towards FDI (Iamsiraroj and Doucouliagos, 2015). Moreover, here we have found that GDP has positive and insignificant relationship with FCI. The reason behind insignificant results is that from 2005 onwards Pakistan faces the problem of war on terror which adversely affects Pakistan prosperity and economic growth. Our findings are relevant to the findings of (Shamusddin, 1994) who examined the insignificant GDP with FDI in low developed countries. Market size and growth rates are not the motivating factors for FDI (Akinlo, 2004). That's why we hypothesized according to previous studies:

H<sub>4</sub>: There is a positive relationship among economic growth and FDI.

## VI. Conclusion and Policy Implications

This study concludes that the ARDL model with bounds test approach has been used and the results showed the presence of co-integration and long run relationship among all variables of the study. We found the negative relationship between stock market development and FCI. Trade liberalization and economic freedom found to be positively linked with FCI. While the GDP growth found to be positively linked with FCI. On the basis of our study findings, we can recommend following appropriate policies in favor to enhance the inflow of foreign capital like:

- The attractive and friendly business environment and a well developed financial framework so that the investors will be attracted to doing investment.
- Pakistan should reduce the trade barriers that causes hurdles in the way of liberalization like the Pakistan should reduce the taxes, interest payments, taxes on income and capital gain as well as custom and other duties.
- To promote more freedom the government needs to lessen the barriers to tariffs and trade.
- Pakistan's government should leave the dependence on debt and must adopt other ways of attracting foreign capital inflow into the country.
- There is a need of government support in informal sectors because these sectors are the engine of economic growth and also they have an effect on foreign capital inflow.
- These recommendations mentioned above are in accordance with this study results which we have conducted by keeping hypothesis in view thereby.

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