

Co - Integration Study in Term of Inward FDI (A Case of India and Pakistan)

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Abstract: This paper pursued with the objective of investigating short-term dynamics and equilibrium relations between the two countries in south Asia – India and Pakistan. The main focus of the study is on analyzing patterns of inward Foreign Direct Investment (FDI) in Indian sub-continent. The sample involves yearly time series Foreign Direct Investment (FDI) data from 1980 until 2011. The study employs Engle-Granger Co-integration test, Augmented Dickey-Fuller (ADF) test and Error Correction Modeling (ECM). Empirical results show a significant long-term and the short run relationship between India and Pakistan while to consider India inward FDI as a dependent variable. The finding has one clear implication, that there is a bi-directional relationship involving Foreign Direct Investment (FDI) in India and Pakistan. Analysis of dynamic interactions over post-sample period via impulse response functions and variance decomposition suggest that Pakistan does influence the pattern of Foreign Direct Investment (FDI) inflow in India.

Keywords: Inward foreign direct investment, Indian subcontinent, EG co-integration test

INTRODUCTION

Today new liberalization of trade, capital markets and new e-trading platforms breaking business barriers by creating virtual markets and business re-engineering over the past few decades dramatically change world economies. The Study will examine Foreign Direct Investment (FDI) pattern in India and Pakistan, by investigating short and long run equilibrium between the two neighbor countries while considering India as a dependent variable. Data will analyze using different statistics and Econometrics tools to obtain the actual outcome and provide theoretical as well as arithmetical analysis.

While talking about the economic growth we always consider various key indicators that show the movement or budge of world economy Growth from one point to another. The first and the most important factor will be the population growth with high purchasing power, which is one of the main reasons why the world economy is moving toward Asia, and today Asia showing 40 % of the total world growth in the recent years. High Population will gives a large consumer market, and with large market size, countries are expected to attract more inward Foreign Direct Investment (FDI) as well as it provides greater potential for demand and lower production costs through scale economies and a major catalyst for development.

The study is significant for each country in the regions, as the inward Foreign Direct Investment (FDI) not only increase domestic savings and foreign reserves but also key for bringing new technology, new labor skill, that increases the labor productivity and domestic

competition as well as reduced cost through the realization of scale economies. Nazima Ellahi [1] applied both panel and cross sectional techniques, and has found a strong positive relationship between Foreign Direct Investment (FDI) and Economic growth and suggesting that growth is more depend upon creating investment climax, create stable macroeconomic policy that provides the investor confidence in the country market. Furthermore, in case of financial resources, the Developing countries have two main sources, which as foreign direct investment, or Foreign aid. If the country economic policies are not designed to create an investment friendly environment, and constantly improves country investment atmosphere to gain the investors' confidence, it will turn the countries' economies more depend on foreign aid. These are the reason why today Pakistan economy is more depend on foreign aid.

Many Research studies discover that Foreign Direct Investment (FDI) is a strong weapon of economic growth in today's global context [2-8]. In capital-poor countries, such as Pakistan and India can build up physical capital by attracting more inward Foreign Investment (FDI), which will lead both countries to increase productivity, give new employment opportunity and increase company innovative capacity. Furthermore, the re-engineering of the local business with the help of transformation of foreign advance technology will open local company access to international markets and improve domestic production with the help of technology. India has successfully gained investor confidence in Indian sub-continent while Pakistan has loss investor confidence

and still struggling for it. This paper pursued with the objective of investigating short-term dynamics and equilibrium relations between the two countries in south Asia - India, Pakistan.

LITERATURE REVIEW

Several standard Internationalization theories can be considered explaining Foreign Direct Investment (FDI) Pattern in Indian sub-continent. Even if several researchers have tried to clarify the phenomenon of FDI, and its motivational factors, but we cannot say that there is any single theory who explains the phenomenon of FDI. However, gravity model of international trade in international economics is used in this study, which was first introduced by Jan Tinbergen in 1962. This model used in the determinants of trade flows between two countries base on the distance between the two countries, common borders, common languages, common colonial history. Pakistan and India are sharing large historical background, and having common languages, culture, and the most important social links. The model has also been used in international relations to evaluate the impact of treaties and alliances on trade. Furthermore Porter Nation Diamond model present by Michael Porter also helps to understand the global investment flow and key reasons that manipulate Foreign Direct Investment (FDI) flows. While looking at the current economic situation toward FDI, the weak Government investment policies in Pakistan lead to low Foreign Direct Investment (FDI) while India's economic reforms toward economic growth and providing strong Government support of those policies today generate strong interest of foreign investors to invest in India.

Porter (1990)[9] explains that country related and supporting industries are playing an important part to attract more investment. Today information technology is the key industry, which sustains growth in country overall industries. In modern competitive economies the role of differences in technology is also a key factor that influencing the Foreign Direct Investment (FDI) pattern in Indian sub-continent. Indian software industry today with vast growth potential, mass IT worker skills, providing strong support to other industries by attracting MNCs.

MNCs will always search for innovations, and today Globalized economy, technology directly reflects the role of innovation. The software industry in India produces high quality with low price as well as supply high computer professional to the world market. Information technologies are the key supporting industry, which gives a new shift to the Indian Economy by attracting more MNCs due to high rank technologies availability in the domestic market with cheap price. Today 3.2 Million People are currently

direct employed by IT industry with the 10% increase every year. Nasscom (2014) expects that Indian IT export business to meet the lower end of 11%-14% growth in FY15. Therefore, weak information technology industry can also be one of the main reasons that lead Pakistan to lower foreign direct investment (FDI) inflow as compare with India[10]. Thomas, (2008) argued that Foreign Direct Investment (FDI) can improve productivity, worker innovative skills, transform advance technologies more rapidly than local firms[11], which make the local firm to re-engineering their business process in order to be more competitive. This should be the key reason for India and Pakistan to attract more Foreign Direct Investment (FDI) in order to increase the production capacity and re-engineering the local industry.

India is attracting 80% of Foreign Direct Investment (FDI) in Indian sub-continent, and become a single country to maintain the investor confidence by providing stronger Location advantages. *According to Japanese Foreign Direct Investment (FDI) series*, underdeveloped countries will target by foreign investors to utilize its potential advantages such as low labor costs, cheap raw material land high growth potential. This can be also a positive sign for Indian sub-continent to attract more Foreign Direct Investment (FDI) due to low labor cost and cheap raw material.

While looking the past 60-year history of Indian sub-continent, Pakistan economy was fastest growing economy in Indian sub-continent following by India and Bangladesh after independence from Britain in 1947. But due to the unstable political situation and five times Military takeover makes the government role limited to focus only in political steadiness and pay no heed to the economic policy which lead country to low performance today. This gives us conclusion that the strong political and economic policy and the role of Government investment policy is playing important role in Indian sub-continent and it's directly influence the Foreign Direct Investment (FDI) inflow.

DATA AND METHODOLOGY

The paper attempts a panel exercise to nexus and determines the Foreign Direct Investment (FDI) pattern in Indian sub-continent (India, Pakistan, and Bangladesh). The time series data will study for the period of 1980 until 2011 calculated in US dollar million using two variables inward Foreign Direct Investment (FDI) in India, inward Foreign Direct Investment (FDI) Pakistan.

The assessment technique use in this study is Augmented Dickey-Fuller (ADF) test, Regression analysis, Co-integration and Error correction modeling, normality test, ARIMA, and Granger Causality test to

investigate the correlation between the two countries in term of inward FDI.

Model Specification

$$Indfdi = f(Pakfdi) \dots\dots\dots(1.1)$$

The foreign direct investment link between India and Pakistan can be described by using the following model in linear form.

$$Indfdi_t = \alpha + \beta Pakfdi_t + \alpha_t \dots\dots\dots(1.2)$$

α and $\beta > 0$

Where

- ϵ_t is the error term (assumed to be normally)
- α and β represent the slope (coefficient of regression)
- $Indfdi_t$ = FDI in India in particular time
- $Pakfdi_t$ = FDI in Pakistan in particular time

β how a unit changes in the independent variable affects the dependent variable. A number of statistical and econometric tests must carry out in order to investigate the correlation between India and Pakistan in term of Foreign Direct Investment (FDI).

In order to investigate the order of integration through unit root that each variable is stationary at which level, Augmented Dickey-Fuller test will carry out. Due to autocorrelation problem in simple Dickey fuller the Augmented Dickey-Fuller (ADF) was develop to examine that variable is stationary or non-stationary. The order of integration will be describe zero if the data is stationary at level. While if the data will be stationary at first difference we can say that order of integration is one, which lead us to process for further analysis.

Engle-Granger Co-integration test will be employed to examine the statistical relation between the two countries Foreign Direct Investment (FDI) developed by Granger and Weiss [12] and Engle and Granger [13]. Before investigating co-integration the three main conditions must be satisfied.

1. The First condition of Engle-Granger co-integration test is that two variable must be integrated in the same order. If there are two variables to investigate both must be integrated in the same order.
 $X_t \approx 1(1)$ and $Y_t \approx 1(1)$ (Both Variables must be stationary at first difference)
2. The Second condition is to establish the linear association between the two variables.

$$X_t = \alpha + \beta Y_t + U_t$$

$Y_t = \alpha + \beta X_t + U_t$ (β need to be significant and there must be linear Association between X_t and Y_t)

3. The third condition is that Error term must be stationary nature.

Once the Above conditions are satisfied, the Engle-Granger Co-integration tests will used to examine the existence of co-integration between India, Pakistan and Bangladesh in term of Foreign Direct Investment (FDI).

Furthermore in Order to investigate the stationary using Augmented Dickey-Fuller (ADF) the below model will be tested.

$$\Delta u_t = \mu u_{t-1} + \sum_{i=1}^n \lambda_i \Delta u_{t-i} + v_t \quad (\mu \text{ must to be statistically significant})$$

Before using Augmented Dickey-Fuller (ADF) test the below conditions must be satisfied in order to come up with the finding that the data is stationary or not.

$$\Delta Y_t = B_1 + ZY_{t-1} + \epsilon_t \dots\dots\dots \text{(Model only for intercept)} \dots\dots\dots 2.1$$

$$\Delta Y_t = B_1 + B_2 t + ZY_{t-1} + a_i + \epsilon_t \dots\dots\dots \text{(Trend and Intercept)} \dots\dots\dots 2.2$$

$$\Delta Y_t = ZY_{t-1} + a_i + \epsilon_t \dots\dots\dots \text{(No Trend, No intercept)} \dots\dots\dots 2.3$$

The hypotheses being test are.,
 $H_0 =$ (the data is not stationary, it contains the unit root)
 $H_1 =$ (data is stationary, it does not contain a unit root)

If not all the variables are stationary at level, we must proceed to first difference in order to identify if the variable is stationary in first difference to satisfy the condition set by Engle-Granger Co-integration tests. Once the P-value is less than the critical values at 1%, 5% and 10% significance level, then H_0 hypothesis can accepted that data series is stationary. The moment the tested data series are stationary at first difference, we must investigate condition set by Engle-Granger Co-integration tests that the Error term must be stationary nature. Once all conditions are fulfilling, we can say that the variable are co-integrated. Once the variable found co-integrated, the Error Correction Model (ECM) technique can now deployed for further investigation. Error Correction Model (ECM) is a restricted Vector Autoregressive (VAR) technique. ECM is a unique technique that restricts the long run behavior of endogenous variables to converge to its co-integrating relationship. On the top of that, it also allows for short run adjustments among the tested variables.

The ECM model formulated as follows:

$$\Delta Y_t = \mu_i + \sum_{i=1}^n A_i \Delta Y_{t-i} + \sum_{i=1}^n \xi_i \Theta_{t-i} + v_t \quad (2)$$

Where:

Y_t is in the form of $n \times 1$ vector

A_i and ξ_i are the estimated parameters

Δ is the difference operator

v_t is the fractional vector that explains unanticipated

movements in Z_t and Θ (error correction term)

ECM is only able to provide direction of causality within the data Collection period. We will further investigate the relative strength of the observed variables beyond the sample period. Impulse Response Functions (IRF) and Variance Decomposition (VDC) technique are used to solve this problem.

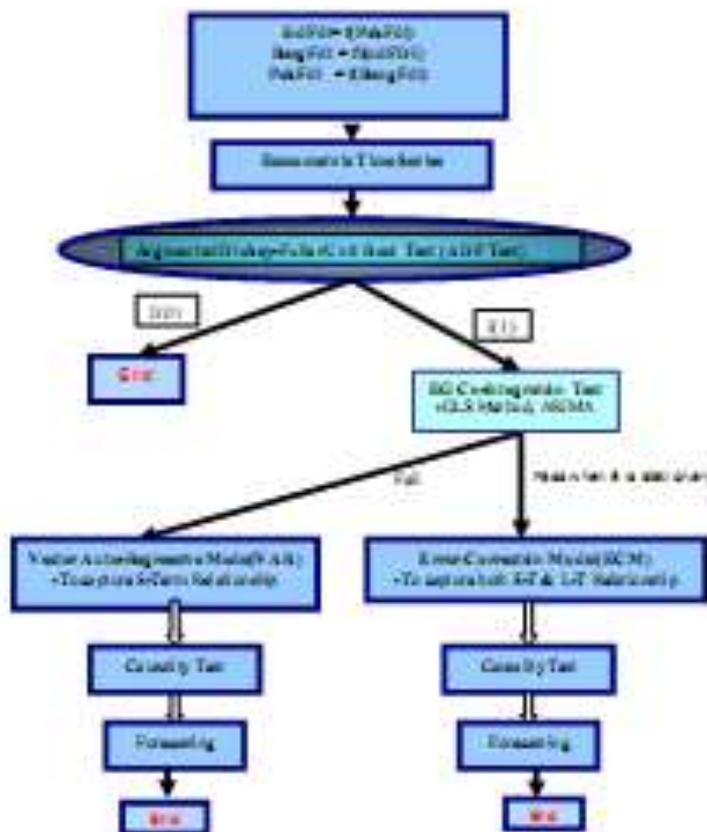


Fig-1: Research Flow

EMPIRICAL FINDINGS

To investigate the Foreign Direct Investment (FDI) pattern and co-integration between India and Pakistan, the finding time series econometric model is deployed below. Those involve Augmented Dickey-Fuller test, Co-integration test, VECM, Causality Test, and OLS, ARIMA. To determine the significance level a hypothesis test is carried out using Augmented Dickey-Fuller (ADF). Table 1 India and Pakistan Foreign Direct Investment (FDI) statistics are showing non-

stationary at all legs, which direct us to continue for first difference. Table 2 statistics indicate in first-difference that India and Pakistan inward Foreign Direct Investment (FDI) data series are consistently stationary at all lags, which explain that all India and Pakistan inward Foreign Direct Investment (FDI) are integrated at first difference. As such, the preliminary requirements in Engle-Granger Co-integration procedure that both variables must integrate in some order (1) first difference his now been fulfilled

Table 1: Unit Root Test on PAK, IND, BANG via ADF (at level)

ZERO MEAN		PAKISTAN		INDIA	
		Tau	P-Value	Tau	P-Value
	1	-2.45	0.0161	-2.47	0.0154
	2	-1.51	0.1201	-1.09	0.2436
	3	-1.98	0.0467	0.49	0.8149
	4	-1.95	0.0496	5.55	0.9999
	5	-0.88	0.3244	1.62	0.9709
SINGLE MEAN	1	-2.95	0.0515	-2.83	0.0659
	2	-1.97	0.2987	-1.48	0.5287
	3	-2.45	0.138	0.05	0.9557
	4	-2.56	0.1135	5.12	0.9999
	5	-1.65	0.4443	1.69	0.9993
TREND	1	-3.78	0.032	-3.85	0.0278
	2	-2.5	0.3241	-2.61	0.2783
	3	-3.22	0.1014	-1.17	0.8968
	4	-3.83	0.0304	4.2	0.9999
	5	-3.43	0.0697	1.45	0.9999

H₀: Data series have a unit root (non-stationary)

H₁: Data series has no unit root (stationary)

Table 2: Unit Root Test on First-Differenced PAK, IND, BANG via ADF

ZERO MEAN		PAKISTAN		INDIA	
		Tau	P-value	Tau	P-value
	1	-3.43	0.0012	-2.96	0.0044
	2	-1.94	0.0416	-3.3	0.0018
	3	-2	0.0452	-3.89	0.0004
	4	-2.58	0.0119	4.35	0.0099
	5	-3.74	0.0006	2.39	0.0043
SINGLE MEAN	1	-3.35	0.0211	-2.99	0.0468
	2	-1.81	0.0369	-3.48	0.016
	3	-1.87	0.0303	-4.25	0.0025
	4	-2.6	0.0155	3.68	0.0099
	5	-4	0.0051	2	0.0397
TREND	1	-3.32	0.0433	-2.88	0.0131
	2	-1.62	0.0403	-3.78	0.0333
	3	-1.37	0.0465	-5.22	0.0013
	4	-2.21	0.0454	2.24	0.0399
	5	-4.23	0.0137	1.14	0.0399

H₀: Data series have a unit root (non-stationary)

H₁: Data series has no unit root (stationary)

Table 2 (Zero mean or no-intercept case, Single mean or intercept case. Intercept and deterministic time trend case)

Table 2 Augmented Dickey-Fuller (ADF) test showing that the both2 variable is stationary at first difference ($X_t \approx 1(1)$ and $Y_t \approx 1(1)$).

Once the first Condition fulfilled, we need to investigate the second condition that there must be linear Association between the variable by using linear regression model. Table 3 shows that there is a positive relationship between India and Pakistan in term of Foreign Direct Investment (FDI) so therefore we accept

the alternative hypothesis that all the variables are linear association. This will fulfill our second requirement set by Engle-Granger Co-integration test that there must be linear Association between X_t and Y_t .

Once the variable is found linear associated we must investigate the third condition set by Engle-Granger Co integration test that the Error term must be stationary in nature (Error terms model must be time-invariant). The results from the Augmented Dickey Fuller test presented in Table 4 showing that the long-term residual (r) is stationary at all lags. This finding indicates few important implications. The long-term residuals stationary implies that there is a significant

long run-term relationship between India and Pakistan in term of Foreign Direct Investment (FDI). Having fulfilled all three requirements, it is said that all three

variables are co-integrated, which lead us for further analysis using Vector Error Correction Model.

Table 3: Analysis of long-run Regression

India vs. Pakistan (India = Dependent Variable)					
Variable	DF	Parameter Estimate	Standard Error	t Value	Pr> t
Intercept	1	2310.37655	2148.14998	1.08	0.291
Pak	1	4.52251	1.23789	3.65	0.001
Bang	1	2.93646	0.55401	5.3	<.0001

H₀: No Long-term relationship exists

H₁: Long-term relationship exists

Table 4: Stationary tests for long-run residuals (r)

ZERO MEAN	DV =India VS Pak	
	Tau	Pr< Tau
1	-0.26	0.0453
2	-4.23	0.0001
3	-1.17	0.0161
4	-1.98	0.0468
5	-1.61	0.0487

Residuals have a unit root (non-stationary); H₁: Residuals have no unit root (stationary)

Table 5: Pearson Correlation showing in the positive response in India, and Pakistan

	India	Pakistan
India	1	
Pakistan	0.554901	1

Error Correction Model (ECM)

As per fulfill the assumption that the total variable must be stationary to proceed with ECM analysis. Three variables India, Pakistan and Bangladesh Foreign Direct Investment (FDI) are used in Vector Error Correction model. This forecasting technique investigates long term and short-term

responses involving the two way tested variables. Each variable will test in two ways by putting them dependent and independent against the other variable. Based on the Akaike results (AIC), the optimum lag-length of the tested model lies at lag 2 (ECM technique prefers lower AIC value). Table 6 summarizes all relevant test results

Table 6: Error Correction Model at lag 2

Variable	DF	Estimate	Standard Error	t Value	Approx Pr> t
Intercept	1	-382.2029	443.023	-0.86	0.3972
ldInd	1	0.3519	0.2023	1.74	0.0954
l2dInd	1	0.4936	0.1995	2.47	0.0212
Lr	1	-0.1669	0.1165	-1.43	0.1654
ldPak	1	1.4512	0.8476	1.71	0.1003
l2dPak	1	1.8787	1.4756	1.27	0.2157

INDIA VS PAKISTAN (Dependent Variable = INDIA) Indf=f(Pak)

The key component in ECM is that supports long-term equilibrium relationship between India, and Pakistan in term of Foreign Direct Investment (FDI). *lr* is the error correction term at leg2showing the long run Foreign Direct Investment (FDI) relationship. P-value is reported significance level. The P-value in table 6 (0.1654 / 2= 0.0827) which indicate the significant long

run relationship between India and Pakistan Foreign Direct Investment (FDI) at 10 per cent level while taking India as the dependent variable. As find, the presence of the long run relationship the next step is to identify short run relationship. As such, the Granger Causality test will conduct and its results are reported in Table 7.

Table 7: Granger causality test (short-run dynamics)

Source	DF	Mean Square	F Value	Pr> F
Numerator	2	8650345	2.82	0.0806

INDIA VS PAKISTAN (Dependent Variable = INDIA)

Table 7 F-value 2.82, which indicate the short run relationship between India and Pakistan while taking India as a dependent variable. Finding also indicates that India more relies on Pakistan in term of the Foreign Direct Investment (FDI).

Q and LM Tests for ARCH Disturbances

One of the key assumptions of the ordinary regression model is that the errors have the same variance throughout the sample. If the error variance is

constant, we can say that its Homoscedasticity model. If the error variance is not constant, the data said to be *heteroscedastic*, and heteroscedasticity causes the OLS estimates to be inefficient. To determine whether the error terms have constant variance, the LM ARCH test will perform. The test results are shown in Table 8 below. From the test statistic, the study fails to reject H_0 at 5% significance level at order. This indicates that the residuals are Homoscedastic or operating at constant variance.

Table 8: LM Tests for ARCH Disturbances (DV =IND)

Order	LM	Pr> LM
1	0.1205	0.0085
2	0.1971	0.0062
3	4.5405	0.0287
4	4.9186	0.0358
5	5.6822	0.0384
6	5.6855	0.0093
7	8.1182	0.3223
8	8.8562	0.3546
9	28.982	0.0007
10	29.224	0.0011
11	29.225	0.0021
12	29.429	0.0034

H_0 : Homoscedastic (Constant variance in ϵ_t); H_1 : Heteroscedastic (Inconstant variance in ϵ_t)

Test for Normality

Tests for normality can either classified as a parametric or non-parametric. Parametric methods can lead to more accurate estimates than non-parametric method as in parametric assumption the data is normally distributed. Normality test on the error term distribution is necessary before any statistical analysis can made. The test statistics for normality are based on the empirical distribution function involving Kolmogorov-Smirnov, Cramer-von Mises, and

Anderson-Darling statistics. Table 9 result showing using Anderson-Darling test indicate to accept the null H_0 hypothesis at the 5 % significance level. This means that the data is normally distributed which lead us for further analysis.

Table 10 Durbin-Watson test results showing that there is an absence of autocorrelation among the residuals.

Table 9: Test for Normality

Test	Statistic	Statistic	p Value
Shapiro-Wilk	W	0.94514	0.1367
Kolmogorov-Smirnov	D	0.18523	0.0119
Cramer-von Mises	W-Sq	0.174192	0.01304
Anderson-Darling	A-Sq	0.824593	0.0601

Tests for Normality (DV = India (India vs Pakistan)

Table 10: Autocorrelation Test Via Ljung-Box Test

TO LAG	PR>CHISQ
6	0.4957
12	0.6925
18	0.9002

H0: The data are independently distributed
H1: The data are not independently distributed
(DEPENDENT VARIABLE: INDIA)

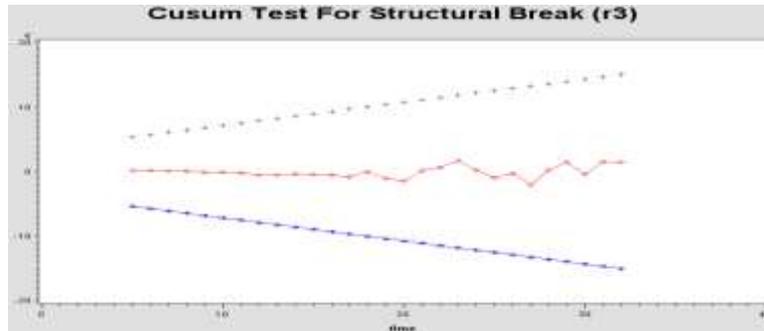


Fig-2: Plot of CUSUM (on Short –run Residuals of the Model) INDIA VS PAKISTAN (DV= INDIA)

CUSUM analysis (or cumulative sum of residual test) is one of the important tools in econometric modeling. This technique will deploy to address diagnostic problems associated with parameter instability. Looking at all the Chart above, the CUSUM analysis indicates the presence of parameter stability (short-run and long-run parameters) since the short-run residuals lie within the lower and upper boundaries. As a whole, the predictive model developed from this study

can considered credible since the tested model does not suffer from any major diagnostic shortcoming.

Table 11 showing simple impulse response by a variable and it can interpret as the impact that a shock in one variable has effect on another variable. A unite shock is applied to each variable and see its effects on the below mention table.

Table 11: Simple Impulse Response by Variable

Variable	Lag	Ind	Pak
Resp\Impul			
Ind	1	0.4775	1.0128
	2	0.1724	5.1405
	3	-0.613	8.7426
	4	-1.02	11.287
	5	-1.201	11.269
Pak	19	0.0367	4.1757
	20	-0.084	5.1559
	1	-0.178	1.4001
	2	-0.177	1.607
	3	-0.173	1.2528
	4	-0.076	0.7266
	5	0.0091	0.1626
	19	-0.055	0.8052
	20	-0.082	0.9285

Table 12: Variance Decomposition by Variable

Variable	Lead	Pak	Ind
Pak	1	1	0
	2	0.9374	0.0626
	3	0.9345	0.0655
	4	0.9262	0.0738
	5	0.927	0.073
	19	0.9286	0.0714
	20	0.9305	0.0696
Ind	1	0.0641	0.9359
	2	0.0987	0.9013
	3	0.7473	0.2527
	4	0.9056	0.0944
	5	0.9311	0.0689
	19	0.9501	0.0499
	20	0.9509	0.0491

Variance decomposition literally means breaking the variance of the error of forecast for each variable into several components. A structure helps to analyze the contribution rate of the impact of each structural change on the endogenous variable (usually measured by variance).

CONCLUSION AND DISCUSSION

In terms of Foreign Direct Investment (FDI) several empirical studies indicate that regional or neighborhood countries can be co-integrate due to strong economic and political understanding. However, in term of trade and investment there is zero relationship between Pakistan and India, while our findings suggest that having multiple economic and political issues between Pakistan and India, there is still economic integration existing between these countries. The paper tries to access empirically the pattern of Foreign Direct Investment (FDI) between India, and Pakistan using annual data from 1983 to 2014. Evidence presented that there is statistically significant long run relationship between India, Pakistan, running from Pakistan to India.

The empirical results clearly indicate that strong political and economic understanding between Pakistan and India will lead both countries to strong inward Foreign Direct Investment (FDI) and productivity gain. Both countries urgently need to remove all trade barriers, resolve political and border dispute, and come over its historical disaster and join hands for overall regional development. Pakistan can be a perfect market for Indian outward Investment as both countries are sharing long border, same culture and Language. Strong political and economic understanding between the Indian sub-continent will give access to each country to target more than 1.5 billion consumer in local market twice than a whole Europe Population. The importance of the study cannot be ignored because south Asia is considered one of the favorite destinations

of Foreign Direct Investment (FDI), while India is considered a second favorite destination for Foreign Direct Investment (FDI) globally. Technological differences between countries are playing an important role in attracting FDI because foreign investor is not only looking for lower cost location and cheap labor. Pakistan urgently need to develop new investment policies by investing in education, technology and power sector to see Foreign Direct Investment (FDI) as a source of economic development to increase income level and create more employment. If Pakistan will be able to provide stable economical and investment policy with domestic location advantages, it will be a great opportunity for foreign firm to enter in large market size with low domestic competition. We can take an example of Japan automobile companies in Pakistan where they facing zero domestic competition, but facing strong domestic competition in the Indian market.

According to Gravity approach the closer two countries are (geographically, economically, culturally), the higher will be the Foreign Direct Investment (FDI) flows between these countries. However, at present there is no investment policy between Pakistan and India to invest in each other country. Zero investment at present give a key opportunity for both countries to invest in each other via set up a new tax-free industrial zone in border side, in sharing resources to increase productivity by followings the absolute advantage theory. Pakistan and India must solve the border dispute and remove trade barriers by encouraging more investment from each other countries including Bangladesh. Secure business environment and Government support are urgently required to attract foreign direct investment in Pakistan.

The above mention statistics show that Pakistan urgently needs to look on their Foreign Direct Investment (FDI) Policy in order to attract more investment inflow and redirect the economy toward

growth by creating more domestic and foreign investment demand. It is suggested that the government should push for the speedy improvement of infrastructure sector's requirements, which are important for diversification of business activities. Government should provide not only additional incentives, but also a secure investment environment to foreign investors to invest in undeveloped states with high potential. Although India at present is the key destination for world Foreign Direct Investment (FDI) but Indian sub-continent still needs to go on a long road in order to be a real competitor in the future global economies. They need to invest in human capital, education and research and development, new technologies, infrastructure, security of the citizens, and sectors with high-income elasticity of demand like power sector in Pakistan. Foreign Direct Investment (FDI) will significantly boost domestic competitiveness, which will lead to both social and economic gain.

Pakistan urgently needs to restore law and order situation, particularly in the city of Karachi, the largest industrial and commercial center and the key part of the country. Logistics need to improve by providing the infrastructure such as roads and build new railway lines direct from Pakistan to India to Bangladesh while connecting China. Pakistan should extend the railway line from Khyber to china, which will facilitate trade activities with china and encourage other investor to invest in Pakistan near china border.

Pakistan Governments should take into consideration the different alternatives to produce power or to attract more Foreign Direct Investment (FDI) in power sector. Pakistan should allow the contribution of China and Iran in power sector as well as construct different Dams for energy creation. Government support for the business community is almost absent in Pakistan, which discourage local and foreign investor to invest in these countries. Indian Sub-continent has a huge potential for development but Pakistan and India still needs to understand the realities of the global investment markets, and Promotional efforts to attract Foreign Direct Investment (FDI). Vulnerable Investment architecture and weak national policies are key factor that influences Foreign Direct Investment (FDI) in Pakistan, while the same factors positively affect inward FDI flows to India.

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