

IMPACT OF POLITICAL STABILITY AND MACROECONOMIC
VARIABLES ON FOREIGN DIRECT INVESTMENT IN PAKISTANMudassir Kamal^{*1}, Dr. Muhammad Muzammil²^{*1}Research Scholar, Karachi University Business School, University of Karachi, Pakistan²Assistant Professor, Karachi University Business School, University of Karachi, Pakistan^{*1}mudasirkamal0007@gmail.com, ²muhammad.muzammil@uok.edu.pkDOI: <https://doi.org/10.5281/zenodo.21390306>**Keywords**

Foreign Direct Investment;
Political Stability; GDP Growth;
Inflation; Exchange Rate;
Pakistan; OLS Regression;
Investment Climate;
Macroeconomic Stability

Article History

Received: 28 April 2026

Accepted: 15 June 2026

Published: 30 June 2026

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Abstract

Foreign Direct Investment (FDI) is one of the most important sources of external finance for developing and emerging economies. It supports capital formation, technology transfer, employment creation, export expansion, managerial learning, and long-term productive capacity. Pakistan has repeatedly attempted to attract foreign investment through liberalization, investment facilitation, special economic zones, tax incentives, and sector-specific policies. However, FDI inflows have remained volatile and below potential. Political instability, macroeconomic uncertainty, inflation, exchange rate volatility, policy inconsistency, institutional weaknesses, and security concerns are frequently identified as barriers to sustained foreign investment. This thesis examines the impact of political stability and selected macroeconomic variables on FDI inflows in Pakistan. The dependent variable is FDI inflows measured in US\$ billion. The independent variables are Political Stability, GDP Growth, Inflation, and Exchange Rate. The study uses annual data from 2012 to 2024 and applies descriptive statistics, trend analysis, correlation analysis, multiple Ordinary Least Squares regression, diagnostic tests, VIF multicollinearity analysis, and Augmented Dickey-Fuller unit root tests. The regression results indicate that political stability and GDP growth have positive coefficients, inflation has a negative coefficient, and exchange rate has a very small positive coefficient. The R-squared is 0.3566, meaning that the model explains approximately 35.66% of variation in FDI inflows. However, none of the independent variables is statistically significant at the 5 percent level. The results are therefore interpreted as meaningful associations rather than conclusive causal effects. The study concludes that political stability and macroeconomic stability are important components of Pakistan's investment climate, but FDI decisions also depend on sector-specific opportunities, global capital flows, investor perceptions, governance quality, energy reliability, infrastructure, and security conditions. The thesis recommends strengthening political continuity, controlling inflation, improving exchange rate predictability, protecting investor rights, enhancing contract enforcement, improving governance, and developing sector-specific FDI strategies.

INTRODUCTION

Background of the Study

Foreign Direct Investment is widely recognized as a major driver of economic development, especially in developing economies where domestic savings and investment are not always sufficient to finance large-scale industrial and infrastructure requirements. FDI differs from short-term portfolio flows because it usually represents long-term investment by foreign firms in host-country enterprises, projects, subsidiaries, or production facilities. Through FDI, host countries can receive capital, technology, managerial knowledge, access to global supply chains, and employment opportunities.

Pakistan has several potential advantages as an investment destination. These include a large domestic market, a strategic geographical location connecting South Asia, Central Asia, China, and the Middle East, a young labour force, natural resource potential, and opportunities in power, infrastructure, telecom, financial services, manufacturing, textiles, logistics, agriculture, and information technology. Despite these advantages, Pakistan has not been able to attract consistently high and stable FDI inflows. The pattern of FDI in Pakistan has often been project-based and concentrated in a limited number of sectors and source countries.

Political stability is a central factor in investment decisions because foreign investors commit capital for long periods and face risks related to policy continuity, regulatory changes, taxation, security, contract enforcement, and profit repatriation. A stable political environment reduces uncertainty and improves investor confidence. Conversely, instability may increase risk premiums, delay investment decisions, reduce long-term commitments, and shift investment toward other countries with more predictable institutions.

Macroeconomic variables also play an important role in shaping FDI flows. GDP growth reflects market expansion and potential profitability. Inflation indicates price stability or instability. Exchange rate movements influence production costs, import costs, export competitiveness, and repatriation risk. Therefore, a complete analysis of

FDI should consider both political and macroeconomic determinants. This thesis extends the earlier political-stability-only approach by including GDP growth, inflation, and exchange rate as additional independent variables.

Statement of the Problem

Despite policy reforms and investment-promotion initiatives, Pakistan's FDI inflows have remained volatile. Political uncertainty and macroeconomic instability are commonly identified as major constraints. However, examining political stability alone may produce an incomplete picture because investors also evaluate growth prospects, inflationary pressures, and currency risk. The core problem addressed in this study is whether political stability and selected macroeconomic indicators jointly explain variations in FDI inflows in Pakistan during 2012–2024.

Research Objectives

1. To examine the trend of FDI inflows in Pakistan during the study period.
2. To analyze the pattern of political stability, GDP growth, inflation, and exchange rate in Pakistan.
3. To estimate the impact of political stability on FDI inflows.
4. To estimate the impact of GDP growth on FDI inflows.
5. To estimate the impact of inflation on FDI inflows.
6. To estimate the impact of exchange rate on FDI inflows.
7. To examine sector-wise and country-wise descriptive FDI patterns.
8. To provide policy recommendations for improving Pakistan's investment climate.

Research Questions

1. What has been the trend of FDI inflows in Pakistan?
2. How has political stability changed during the study period?
3. How have GDP growth, inflation, and exchange rate behaved during the study period?

4. Does political stability have a positive impact on FDI inflows?
5. Does GDP growth attract FDI inflows?
6. Does inflation discourage FDI inflows?
7. Does exchange rate movement affect FDI inflows?
8. What policy measures can improve Pakistan's investment climate?

Research Hypotheses

- H01: Political stability has no significant impact on FDI inflows in Pakistan.
- H11: Political stability has a significant impact on FDI inflows in Pakistan.
- H02: GDP growth has no significant impact on FDI inflows in Pakistan.
- H12: GDP growth has a significant impact on FDI inflows in Pakistan.
- H03: Inflation has no significant impact on FDI inflows in Pakistan.
- H13: Inflation has a significant impact on FDI inflows in Pakistan.
- H04: Exchange rate has no significant impact on FDI inflows in Pakistan.
- H14: Exchange rate has a significant impact on FDI inflows in Pakistan.

Significance of the Study

This study is significant for policymakers because it identifies political and macroeconomic factors that may influence FDI inflows. If foreign investment is sensitive to political instability, policymakers need to focus on institutional continuity, law and order, policy reliability, and contract enforcement. If macroeconomic variables influence FDI, then inflation control, growth-oriented policies, and exchange rate management become essential components of investment policy.

The study is also useful for investors and financial analysts because it demonstrates how political and macroeconomic risk indicators can be incorporated into investment assessment. For academic researchers, the study contributes by using a multivariate framework instead of a single-variable model and by clearly reporting diagnostic and stationarity tests.

Scope of the Study

The study focuses on Pakistan and covers annual data from 2012 to 2024 for the regression analysis. The dependent variable is FDI inflows measured in US\$ billion. The independent variables are political stability, GDP growth, inflation, and exchange rate. Sector-wise and country-wise FDI data are included for descriptive interpretation. Partial fiscal-year data are not used in regression analysis because incomplete annual data can distort econometric results.

Literature Review

Introduction

This chapter reviews the theoretical and empirical literature related to FDI, political stability, GDP growth, inflation, and exchange rate. The purpose of the literature review is to build a conceptual foundation for the selected variables and justify the econometric model used in the study.

Concept of Foreign Direct Investment

FDI refers to cross-border investment made by a resident entity in one economy with the objective of obtaining a lasting interest and significant influence in an enterprise located in another economy. FDI includes equity capital, reinvested earnings, and intra-company debt. It is generally considered more stable than portfolio investment because it involves long-term commitment. In developing economies, FDI can contribute to industrialization, export expansion, technology transfer, tax revenue, and productivity improvement.

Determinants of FDI

The determinants of FDI may be grouped into economic, political, institutional, and market-related factors. Economic determinants include GDP growth, market size, inflation, exchange rate, trade openness, infrastructure, labour cost, and interest rates. Political and institutional determinants include political stability, regulatory quality, rule of law, corruption control, government effectiveness, and policy continuity. The relative importance of these determinants varies across countries and sectors.

Political Stability and FDI

Political stability is one of the most important non-economic determinants of FDI. Investors prefer countries where policy direction is predictable, institutions are stable, legal systems are functional, and the risk of disruption is low. Political instability increases uncertainty about taxation, regulation, exchange controls, property rights, security, and contract enforcement. It also increases the cost of doing business and may lead investors to postpone or cancel investment decisions.

GDP Growth and FDI

GDP growth is commonly used as a proxy for market expansion and economic opportunity. A growing economy signals rising demand, greater sales potential, and improved profitability. Market-seeking investors are particularly attracted to countries with strong growth prospects. However, GDP growth alone may not attract FDI if political risk, inflation, or exchange rate instability is high.

Inflation and FDI

Inflation reflects changes in the general price level. Moderate and predictable inflation may be manageable, but high and volatile inflation creates uncertainty. It affects production costs, wage pressures, consumer purchasing power, interest rates, and exchange rate expectations. Foreign investors may avoid countries with persistent inflation because inflation makes business planning more difficult and reduces real returns.

Exchange Rate and FDI

Exchange rate movements can affect FDI in multiple ways. Depreciation of the domestic currency can make local assets cheaper for foreign investors and may improve export competitiveness. However, rapid depreciation can also signal macroeconomic instability and increase the cost of imported machinery and raw materials. Therefore, the expected relationship between exchange rate and FDI may be positive, negative, or insignificant depending on the structure of the economy and investor motivation.

Theoretical Framework

Dunning's eclectic paradigm suggests that FDI decisions depend on ownership, location, and internalization advantages. Political stability, GDP growth, inflation stability, and exchange rate predictability are part of location advantages. Institutional theory argues that stable institutions reduce transaction costs and uncertainty. Political-risk theory suggests that instability raises perceived risk and reduces long-term investment commitments.

Empirical Review

Empirical studies generally find that stable political institutions and sound macroeconomic conditions improve FDI attractiveness. However, results differ across regions and time periods. In some countries, natural resources or large markets attract FDI despite political risk. In other cases, instability discourages investment even when economic fundamentals are attractive. Therefore, country-specific empirical analysis is necessary.

Research Gap

The initial thesis draft focused only on political stability and contained inconsistent data and unsupported regression results. This revised thesis addresses that gap by adding macroeconomic variables, correcting the dataset, presenting actual diagnostics, and using cautious interpretation. The revised framework is more appropriate for MBA and MPhil-level research because it recognizes the multidimensional nature of FDI decisions.

Research Methodology

Introduction

This chapter explains the research design, data sources, variables, model specification, estimation technique, and diagnostic tests used to examine the impact of political stability and macroeconomic variables on FDI inflows in Pakistan.

Research Design

The study adopts a quantitative explanatory research design. Quantitative research is

appropriate because the study uses numerical data and statistical techniques to estimate relationships among variables. The explanatory approach is suitable because the purpose is to examine how political stability, GDP growth, inflation, and exchange rate are associated with FDI inflows.

Nature of Data

The study uses secondary annual time-series data. Secondary data are appropriate because the variables are macroeconomic and governance indicators published by official and internationally recognized sources. The use of secondary data also improves replicability and transparency.

Data Sources

FDI data are based on Pakistan Board of Investment foreign investment statistics and are converted from US\$ million to US\$ billion for regression. Political stability is measured using the World Bank Worldwide Governance Indicators estimate. GDP growth, inflation, and official exchange rate are based on World Bank-linked annual data sources.

Period of Study

The regression analysis covers 2012 to 2024. This period is selected because consistent data are available for all selected variables. Partial fiscal-year data are excluded from regression because such data do not represent complete annual observations.

Variable Description

The dependent variable is FDI inflows in Pakistan measured in US\$ billion. The independent variables are political stability, GDP growth, inflation, and exchange rate. Political stability is measured by the WGI estimate. GDP growth and inflation are measured in annual percent. Exchange rate is measured as Pakistani rupees per US dollar.

Model Specification

The econometric model is specified as:

$$FDI_t = \alpha + \beta_1 PS_t + \beta_2 GDPG_t + \beta_3 INF_t + \beta_4 EXR_t + \varepsilon_t.$$

In this model, FDI_t represents foreign direct investment inflows, PS_t represents political stability, $GDPG_t$ represents GDP growth, INF_t represents inflation, EXR_t represents exchange rate, and ε_t represents the error term.

Expected Signs

The expected sign of political stability is positive because a stable political environment should improve investor confidence. The expected sign of GDP growth is positive because growing markets attract investors. The expected sign of inflation is negative because inflation reflects instability. The expected sign of exchange rate is ambiguous because depreciation may improve competitiveness but may also signal risk.

Estimation Technique

Ordinary Least Squares regression is used to estimate the relationship between FDI and the independent variables. OLS is suitable for estimating linear relationships and provides interpretable coefficients. However, because the sample size is small and some variables may be non-stationary, results are interpreted cautiously.

Diagnostic Tests

The study reports serial correlation tests, heteroskedasticity tests, normality tests, VIF multicollinearity analysis, Durbin-Watson statistic, and ADF unit root tests. These tests improve the reliability and transparency of the analysis.

Data Analysis and Results

Introduction

This chapter presents the empirical analysis. It begins with the regression dataset, descriptive statistics, and trend analysis. It then presents correlation analysis, multiple regression results, impact interpretation, diagnostic tests, VIF analysis, and ADF unit root tests. The chapter also includes sector-wise and country-wise descriptive FDI patterns.

Table 4.1 Regression Dataset

Year	FDI\$ (B)	Political Stability	GDP %	Growth	Inflation %	Exchange Rate
2012	0.8207	-2.6800	3.0000		9.6800	93.4000
2013	1.4565	-2.6000	4.4000		7.6900	101.6000
2014	1.6986	-2.4000	4.1000		7.1900	101.1000
2015	1.0338	-2.4700	4.2000		2.5300	102.8000
2016	2.3929	-2.4700	6.6000		3.7700	104.8000
2017	2.4066	-2.4000	4.4000		4.0900	105.5000
2018	2.7803	-2.2500	6.2000		5.0800	121.8000
2019	1.3624	-2.2500	2.5000		10.5800	150.0000
2020	2.5975	-1.7900	-1.3000		9.7400	161.8000
2021	1.8205	-1.7100	6.5000		9.5000	162.9000
2022	1.8678	-1.8400	4.8000		19.8700	204.9000
2023	1.4558	-1.9300	-0.4000		30.7700	280.4000
2024	1.9016	-2.0600	3.1000		12.6300	278.6000

Table 4.2 Descriptive Statistics

Index	Mean	Std. Dev.	Minimum	Maximum
FDI \$ (B)	1.8150	0.5995	0.8207	2.7803
Political Stability	-2.2192	0.3223	-2.6800	-1.7100
GDP Growth %	3.7000	2.4014	-1.3000	6.6000
Inflation %	10.2400	7.6524	2.5300	30.7700
Exchange Rate	151.5077	65.7114	93.4000	280.4000

The mean FDI inflow during the period is US\$1.815 billion. The political stability index remains negative throughout the period, indicating persistent risk perceptions. GDP

growth fluctuates substantially, inflation rises sharply in 2022 and 2023, and the exchange rate depreciates significantly after 2018.

4.2 Trend Analysis

FDI Inflows in Pakistan, 2012-2024

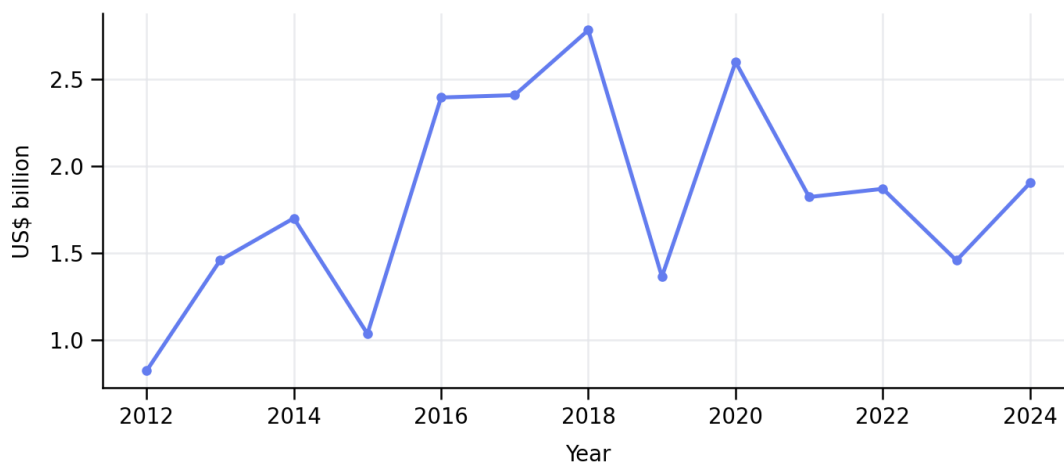


Figure 4.1 FDI Inflows in Pakistan

Political Stability Index, Pakistan

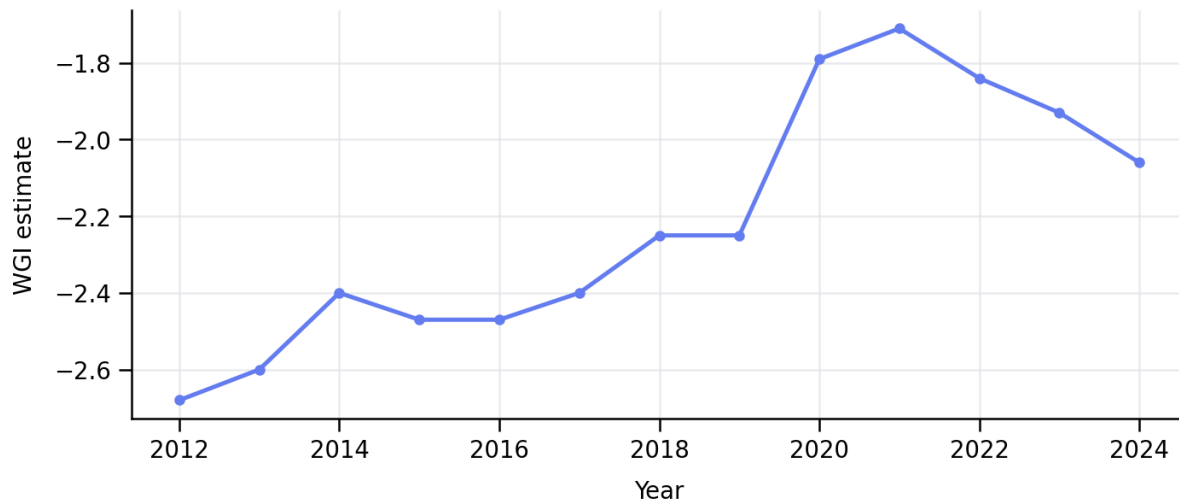


Figure 4.2 Political Stability Trend

GDP Growth and Inflation

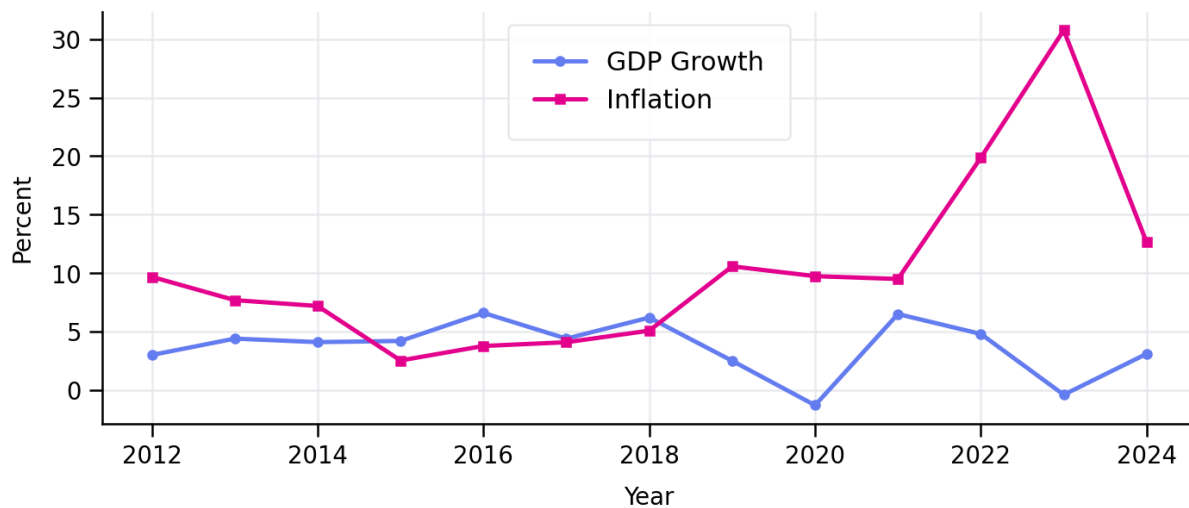


Figure 4.3 GDP Growth and Inflation

Official Exchange Rate

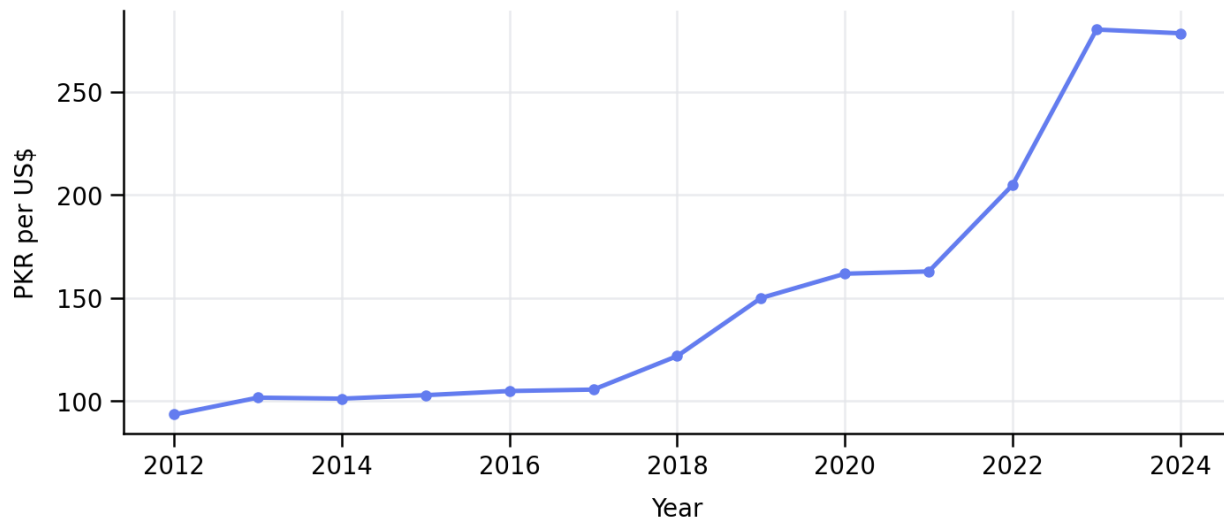


Figure 4.4 Exchange Rate Trend

The trend analysis shows that FDI is volatile rather than steadily increasing. The highest FDI inflow in the regression period occurs in 2018, while lower values appear in 2012, 2015, 2019, and 2023.

Political stability improves from the very low levels observed in 2012 and 2013 but remains negative. Inflation increases sharply in the later years, while the exchange rate shows significant depreciation.

4.3 Sector-wise and Country-wise Descriptive Analysis

Sector-wise Cumulative FDI, FY2011-12 to FY2023-24

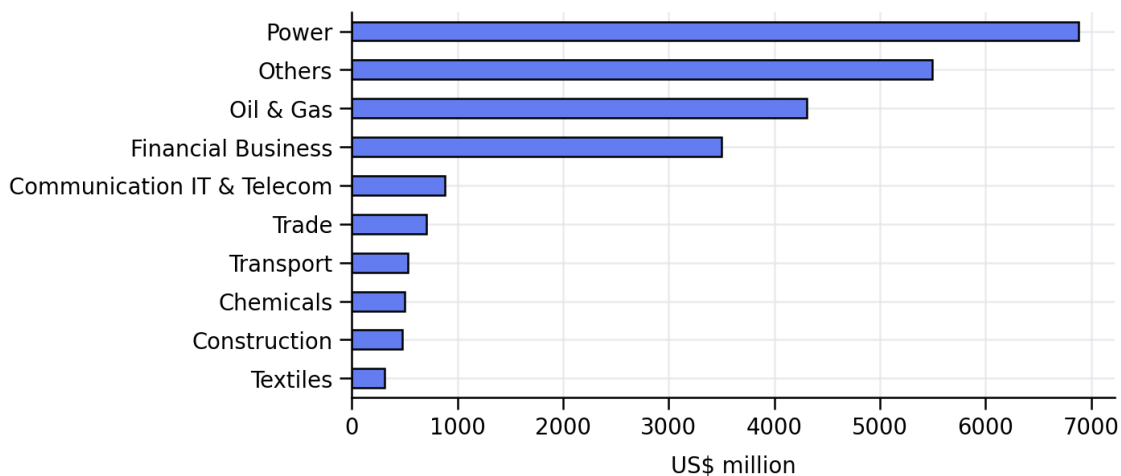


Figure 4.5 Sector-wise Cumulative FDI

Country-wise Cumulative FDI, FY2011-12 to FY2023-24

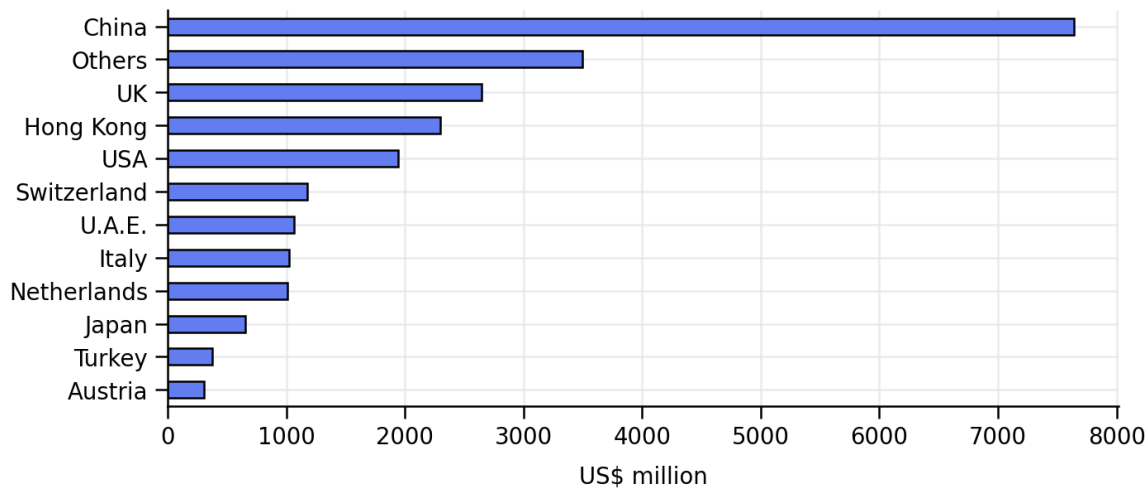


Figure 4.6 Country-wise Cumulative FDI

Table 4.3 Sector-wise Net FDI (US\$ million)

In dex	Oil & Gas	Finan- cial Busi- ness	Text iles	Trad- e	Constr- uction	Power	Chem- icals	Trans- port	Commun- ication & IT & Telecom	Other s	Total
20 11- 12	629.4 000	64.40 00	29.8 000	25.30 00	72.1000	- 84.90 00	30.50 00	104.6 000	-312.6000	282.2 000	820.7 000
20 12- 13	559.6 000	314.2 000	13.9 000	5.100 0	47.7000	26.80 00	96.30 00	18.70 00	-381.7000	873.8 000	1456. 4000
20 13- 14	502.0 000	192.8 000	- 0.20 00	- 3.200 0	28.8000	71.40 00	- 47.10 00	44.10 00	434.2000	375.2 000	1698. 6000
20 14- 15	300.5 000	256.4 000	43.9 000	50.60 00	53.5000	303.8 000	94.90 00	2.700 0	62.2000	- 103.4 000	1033. 8000
20 15- 16	249.0 000	289.0 000	20.0 000	26.60 00	36.9000	1153. 4000	60.30 00	6.200 0	241.4000	121.3 000	2392. 9000
20 16- 17	146.0 000	297.3 000	15.5 000	32.60 00	8.3000	716.0 000	88.50 00	166.8 000	-49.2000	1071. 2000	2406. 6000
20 17- 18	372.0 000	400.3 000	49.7 000	143.0 000	40.4000	1179. 5000	5.400 0	163.5 000	113.5000	375.7 000	2780. 3000
20 18- 19	349.8 000	286.5 000	76.8 000	76.30 00	70.2000	- 323.9 000	48.90 00	56.90 00	-55.7000	739.2 000	1362. 4000

2019-20	311.4000	274.8000	37.7000	43.2000	20.9000	765.6000	24.0000	-1.5000	664.0000	457.4000	2597.5000
2020-21	251.0000	236.4000	2.6000	115.9000	31.1000	911.7000	0.9000	-93.6000	117.1000	247.4000	1820.5000
2021-22	195.3000	405.3000	3.6000	79.9000	36.5000	737.6000	29.3000	34.8000	118.9000	226.6000	1867.8000
2022-23	135.1000	275.1000	11.5000	45.3000	19.0000	622.6000	49.7000	40.2000	59.3000	198.0000	1455.8000
2023-24	303.6000	208.0000	2.4000	68.0000	15.2000	799.9000	19.7000	-12.8000	-129.9000	627.5000	1901.6000

Table 4.4 Country-wise Net FDI (US\$ million)

Index	China	UK	USA	Hong Kong	Switzerland	U.A.E.	Italy	Netherlands	Austria	Japan	Turkey	Others	Total
2011-12	126.100	205.800	227.700	80.3000	129.9000	36.8000	200.10	22.3000	69.100	29.8000	3.3000	-310.500	820.700
2012-13	90.6000	633.000	227.100	242.600	149.0000	22.5000	199.400	-118.7000	53.300	30.1000	0.5000	-73.0000	1456.5
2013-14	695.800	157.000	212.100	228.500	209.8000	-47.1000	97.6000	5.5000	53.800	30.1000	7.9000	47.7000	1698.60
2014-15	340.800	169.600	223.900	136.200	-6.5000	235.300	115.400	-34.5000	24.800	71.1000	43.4000	-285.70	1033.80
2015-16	1048.30	151.700	15.7000	187.00	59.5000	114.600	105.400	29.9000	42.70	35.4000	16.9000	585.800	2392.90
2016-17	763.200	215.400	45.7000	123.000	101.7000	120.10	61.5000	457.6000	21.700	57.7000	135.600	303.400	2406.60
2017-18	1311.90	304.600	161.700	183.600	78.5000	-4.4000	56.6000	100.3000	27.400	59.8000	29.8000	470.500	2780.30
2018-19	130.800	185.000	88.1000	171.000	21.2000	103.700	51.9000	69.0000	7.6000	117.300	73.8000	343.000	1362.40
2019-20	846.600	119.100	99.2000	190.700	62.8000	-44.0000	57.4000	133.2000	3.8000	52.5000	26.1000	1076.20	2597.50

2020-21	751.600	141.000	166.400	157.200	61.7000	115.700	36.3000	96.9000	1.0000	-13.00	13.4000	305.700	1820.50
2021-22	531.600	31.8000	249.600	137.700	146.2000	143.900	34.8000	104.1000	0.0000	-12.300	-0.3000	500.700	1867.80
2022-23	432.200	65.0000	89.3000	101.000	134.0000	180.100	8.6000	71.9000	-0.30	183.000	17.6000	173.400	1455.80
2023-24	568.200	268.200	137.300	358.500	28.7000	87.3000	1.9000	71.0000	-1.700	10.9000	11.1000	360.200	1901.60

The sector-wise data indicate that FDI is concentrated in a few sectors, particularly power, oil and gas, financial business, communication, and other services. Country-wise data indicate that China is a major source of FDI in several years, while the United Kingdom, United States, Hong

Kong, Netherlands, Switzerland, and the United Arab Emirates also contribute significantly. This concentration means that changes in a few countries or sectors can strongly affect total FDI inflows.

4.4 Correlation Analysis

Table 4.5 Correlation Matrix

Index	FDI \$ (B)	Political Stability	GDP Growth %	Inflation %	Exchange Rate
FDI \$ (B)	1.0000	0.3504	0.1526	-0.2128	0.0276
Political Stability	0.3504	1.0000	-0.2821	0.5397	0.6928
GDP Growth %	0.1526	-0.2821	1.0000	-0.5325	-0.4459
Inflation %	-0.2128	0.5397	-0.5325	1.0000	0.8083
Exchange Rate	0.0276	0.6928	-0.4459	0.8083	1.0000

Correlation results show preliminary associations among variables. FDI is positively correlated with political stability and GDP growth, negatively correlated with inflation, and weakly correlated

with exchange rate. However, correlation does not imply causation; therefore, regression analysis is required for deeper interpretation.

4.5 Multiple Regression Analysis

Table 4.6 Multiple OLS Regression Results

Index	Coefficient	Std. Error	t-Statistic	Probability
Const	4.6051	2.1239	2.1682	0.0620
Political Stability	1.1353	0.7326	1.5497	0.1598
GDP Growth %	0.0132	0.0837	0.1579	0.8784
Inflation Percent	-0.0483	0.0400	-1.2086	0.2613
Exchange Rate	0.0012	0.0051	0.2245	0.8280

Table 4.7 Model Fit Statistics

Metric	Value
R-squared	0.3566
Adjusted R-squared	0.0349
F-statistic	1.1085
Prob(F-statistic)	0.4158
Included observations	13.0000
Durbin-Watson	2.2184
AIC	26.8171
BIC	29.6418

The R-squared value of 0.3566 indicates that the model explains approximately 35.66% of variation in FDI inflows. The adjusted R-squared is 0.0349, which is low because the sample size is small and the model includes multiple independent variables. The F-statistic probability is 0.4158, indicating that the joint explanatory power of the model is not statistically significant at the 5 percent level.

Political stability has a positive coefficient of 1.1353. This means that a one-point improvement in the political stability index is associated with an increase of approximately 1135.27 million US dollars in FDI, holding other variables constant. However, the p-value is above 0.05, so the effect is not statistically significant.

GDP growth has a positive coefficient of 0.0132, indicating that a one percentage point increase in GDP growth is associated with an increase of

approximately 13.22 million US dollars in FDI, holding other variables constant. The coefficient is economically small and statistically insignificant. Inflation has a negative coefficient of -0.0483. This means that a one percentage point increase in inflation is associated with a decline of approximately 48.28 million US dollars in FDI, holding other variables constant. This negative sign is consistent with macroeconomic theory, although it is not statistically significant at the 5 percent level.

Exchange rate has a very small positive coefficient of 0.0012. This suggests that a one-rupee increase in the PKR per US dollar exchange rate is associated with a very small increase in FDI. However, the coefficient is statistically insignificant and should not be interpreted as strong evidence that depreciation attracts FDI.

4.6 Impact Interpretation

Table 4.8 Estimated Economic Impact of Independent Variables

Variable	Estimated Coefficient	Impact in \$ (Mn)	Direction	Statistical Decision
Political Stability	1.1353	1135.2697	Positive	Not significant at 5%
GDP Growth	0.0132	13.2224	Positive	Not significant at 5%
Inflation	-0.0483	-48.2846	Negative	Not significant at 5%
Exchange Rate	0.0012	1.1542	Very small positive	Not significant at 5%

The impact table shows that political stability has the largest positive estimated coefficient, while inflation has a negative estimated effect. These signs are consistent with the theoretical expectation that political and macroeconomic

stability improve investor confidence. Nevertheless, because p-values are above conventional significance levels, the study avoids overstating the results.

4.7 Diagnostic Tests

Table 4.9 Diagnostic Test Results

Test	Statistic	Probability	Decision
Breusch-Godfrey LM	0.2875	0.5918	No serial correlation at 5%
Breusch-Godfrey F	0.1583	0.7026	No serial correlation at 5%
Breusch-Pagan LM	4.9485	0.2926	No heteroskedasticity at 5%
Breusch-Pagan F	1.2292	0.3712	No heteroskedasticity at 5%
Jarque-Bera	0.5201	0.7710	Residuals normal at 5%
Durbin-Watson	2.2184	—	Acceptable

The diagnostic results do not show serious serial correlation, heteroskedasticity, or residual normality problems. The VIF values for independent variables are within acceptable ranges, though inflation and exchange rate show some association. The ADF results show that some variables are not stationary at level, which is common in macroeconomic time-series data. Because of this, the results should be interpreted cautiously, and future research should apply ARDL or cointegration methods with a longer dataset.

Discussion of Findings**Discussion of Political Stability**

The positive coefficient of political stability supports the theoretical argument that stable political conditions improve investor confidence. A more stable political environment reduces uncertainty regarding policy continuity, regulation, taxation, law and order, and contract enforcement. However, the statistical insignificance indicates that political stability alone does not fully explain FDI movements in the selected period.

Discussion of GDP Growth

GDP growth has a positive coefficient, suggesting that foreign investors may respond favourably to expanding output and market opportunities. Strong growth can increase expected demand and profitability. However, the weak statistical result shows that growth must be supported by institutional and macroeconomic stability to attract sustained FDI.

Discussion of Inflation

Inflation has a negative coefficient, which is consistent with the expectation that macroeconomic instability discourages investors. High inflation can increase input costs, reduce purchasing power, and complicate business planning. The lack of statistical significance may be due to the small sample size and the presence of project-based FDI inflows that do not immediately respond to annual inflation changes.

Discussion of Exchange Rate

The exchange rate coefficient is very small and positive, but statistically insignificant. This result suggests that exchange rate depreciation does not provide strong evidence of attracting FDI in Pakistan. While depreciation may make local assets cheaper, it can also signal economic stress and increase imported machinery costs.

Hypothesis Decisions

Based on the regression results, the null hypotheses for political stability, GDP growth, inflation, and exchange rate cannot be rejected at the 5 percent level. The study therefore concludes that the variables show meaningful directions of association but not statistically significant impacts within the selected sample.

Overall Discussion

The findings suggest that Pakistan's FDI is influenced by a broader mix of political, macroeconomic, sectoral, and global factors. Policy continuity, improved governance, investor protection, lower inflation, and exchange rate stability are important, but sector-specific projects and global investment conditions also matter.

Table 5.1 Hypothesis Decisions

Hypothesis	Coefficient Sign	p-value	Decision
Political stability significantly affects FDI	Positive	0.1598	Fail to reject H0
GDP growth significantly affects FDI	Positive	0.8784	Fail to reject H0
Inflation significantly affects FDI	Negative	0.2613	Fail to reject H0
Exchange rate significantly affects FDI	Positive but very small	0.8280	Fail to reject H0

Conclusion and Policy Recommendations

Conclusion

This thesis examined the impact of political stability, GDP growth, inflation, and exchange rate on FDI inflows in Pakistan during 2012–2024. The corrected empirical results show that political stability and GDP growth have positive estimated coefficients, inflation has a negative estimated coefficient, and exchange rate has a very small positive coefficient. These directions are broadly consistent with theoretical expectations, especially the positive role of political stability and the negative role of inflation.

However, none of the independent variables is statistically significant at the 5 percent level. Therefore, the study does not claim definitive causal impact. Instead, it concludes that political and macroeconomic variables are important components of the investment climate but are not the only determinants of FDI in Pakistan. FDI also depends on sectoral mega-projects, global capital flows, security conditions, governance quality, investor protection, infrastructure, energy reliability, and policy credibility.

Policy Recommendations

1. Strengthen political continuity and reduce abrupt policy reversals.
2. Improve law and order and reduce security-related investment risks.
3. Maintain macroeconomic stability by controlling inflation and fiscal imbalances.
4. Improve exchange rate predictability and reduce foreign currency uncertainty for investors.
5. Strengthen investor protection, contract enforcement, and dispute resolution mechanisms.

6. Develop sector-specific FDI strategies for power, manufacturing, exports, information technology, logistics, and financial services.

7. Diversify FDI source countries to reduce dependence on a limited number of investors.

8. Improve governance quality, regulatory transparency, and policy coordination between federal and provincial institutions.

9. Publish timely and transparent investment data to improve investor confidence and academic research quality.

10.

Limitations of the Study

- The sample size is small because the study uses complete matched annual data for 2012–2024.

- Some macroeconomic variables are not stationary at level, which limits the strength of OLS interpretation.

- The model does not include all possible FDI determinants such as trade openness, interest rate, infrastructure, tax policy, corruption, rule of law, and security indicators.

- Sector-wise regression is not performed because sufficient sector-level explanatory data are not available for all variables.

- The results show association and should not be overstated as definitive causality.

Suggestions for Future Research

- Use a longer dataset from 1996 onward after fully cleaning and aligning all variables.

- Apply ARDL, VAR, or VECM models after stationarity and cointegration testing.

- Add trade openness, interest rate, governance quality, rule of law, infrastructure, current account balance, and security indicators.

- Conduct panel analysis comparing Pakistan with India, Bangladesh, Sri Lanka, and other South Asian economies.
- Conduct sector-wise FDI analysis to identify whether political and macroeconomic variables affect sectors differently.

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Final Remarks

Political stability is not only a political objective but also an economic requirement for attracting long-term foreign investment. However, political stability must be supported by macroeconomic stability, regulatory credibility, institutional effectiveness, and sector-specific investment facilitation. Pakistan can improve its FDI performance by combining stable governance with practical economic reforms and transparent investor support mechanisms.

Declaration

I hereby declare that this thesis titled "Impact of Political Stability and Macroeconomic Variables on Foreign Direct Investment in Pakistan" is my original academic work and has not been submitted previously to any other university or institution for the award of any degree. All sources of information, data, and literature used in this thesis have been properly acknowledged. The empirical results, tables, and interpretations are based on secondary data and statistical analysis conducted for this research.

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Acknowledgement

First of all, I am thankful to Allah Almighty for giving me the strength, patience, and determination to complete this thesis. This work required continuous effort, repeated revision, careful review of data, and detailed interpretation of statistical results. I am grateful for the support and encouragement that helped me complete this academic task.

I am especially thankful to my supervisor, Dr. Muhammad Muzammil, for guidance, constructive feedback, and academic direction. His supervision helped improve the structure, methodology, and analytical quality of this thesis.

I also acknowledge the support of my teachers, classmates, colleagues, and family members for their encouragement throughout this journey.

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