

Impact of Terrorism on Foreign Direct Investment: An Empirical Analysis of Pakistan

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ABSTRACT

The purpose of this study is to find out the impact of Terrorism on FDI inflow in Pakistan as well as other variables such as economic growth, market size, trade openness and infrastructure. Using a simple regression model to estimate time series, annual data from 2001 to 2016, the study concludes that market size, economic growth, and trade openness have a significant positive relationship with FDI. At the same time, the result shows that Terrorism and infrastructure has a significant negative relationship with FDI. This empirically builds up the way that Terrorism is a real threat to FDI and economic development of the economies of Pakistan. The empirical outcomes of the study of Terrorism confirmed the way that Terrorism based oppression has harmed the economic prosperity of Pakistan and has debilitated FDI inflows during the sample period. Therefore, Pakistan will take to measures the investment environment in this area. Government strategy makers should consider the situation of Terrorism, instability and lawfulness circumstance to decrease the risk of investors and to ensure their investment ability to host FDI.

JEL Classification: F21, H56, N45

Keywords: Terrorism, FDI, Pakistan, Economic Growth, Market size

INTRODUCTION

Terrorism and Foreign Direct Investment (FDI) are intensely interconnected with each other. Due to Terrorism, insecurity arises in an economy and consequently, foreign direct investment declines, and it is furthermore affected the economic growth (Elgamodi, 2017). The decrease in foreign direct investment, the level of productivity, respectively falls. For the FDI, it is required for overall law in other situations is better positions because the terrorist activities have a direct effect on the development of FDI and the overall growth of the country. FDI also helps in generating employment prospects which eventually leads to an increase in economic growth (Shah & Faiz, 2015). Anwar and Mughal (2013) conducted a study, and they used the data from the period of January 2003 to June 2013. They apply the ARMAX model to analyze the impact of foreign direct investment with Terrorism in Pakistan, as per their study, the exports were not changed due to Terrorism. Whereas portfolio shows a little change and on the other hand, the migrant remittance shows increased. Only migrant remittance shows a positive impact on foreign direct investment. Only one variable migrant remittance raised in a difficult time.

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One of the economic difficulties looked by developing countries is the difference between saving and investment. In this way, these countries continually require foreign capital. Mughal and Akram (2011) present trend of globalization is rapidly focusing on developing countries to attract maximum FDI to boost their economy. This is possible just in this situation when the investor is ready to put resources in a specific economy. Foreign investors want to put their investment and resources in those countries where their investments are safe and will create greater returns than domestic and other locations.

Pakistan government spent a huge amount against Terrorism, war due to this war a large portion of the economy of Pakistan is declining. From 2000, a considerable part of its resources were exploited in this war. According to the Economic Survey of Pakistan (2013), the cost increases \$17.8 billion during the period 2010 - 2011 and \$2.669 billion during 2001-2002. Due to these increases cost the GDP ratio has been declining, which direct show impact of the FDI inflows to Pakistan. The loss of Pakistan economy due to war on terror has been estimated at \$118.32 billion or Rs. 9869 billion during the past 15 years as per economic survey of 2015/2016 revealed on Thursday. (Economic Survey of Pakistan, 2015 & 2016).

After numerous bombings, due to the economy moving towards the decline and the resulting foreign investor feels insecure in Pakistan, foreign direct investment has been stopped, investment in new projects has decreased, and investors plan to change our business to other countries. Apart from this local public, there are also plans to stop investing in projects and to take their money to the markets. Dramatically decreasing investment makes terrible and troubles in the country. If the government takes steps to counter Terrorism, then the cost of the governance increases. Terrorism disturbs every business like agricultural, tourism, textile and mining, etc. (Samreen & Qurrat, 2016). According to Azam and Ather (2015), foreign direct investments are conceived as a blessing in emerging countries to increases employment levels, better lifestyle, enhanced trade and helping in transferring advance technologies. Better job opportunities, trade growth, and introduce to new technology and better exchange rate from foreign countries. Terrorism is the deliberate use or threat of use of violence and aggression by individuals or groups to gain some social or political objectives through terrorization of the general public including the direct victims; Terrorist activities include bombings, suicide attacks, kidnapping, hijacking, threats, assassinations and other aggressive activities (Sandler, Arce & Enders, 2008).

The economic costs related to Terrorism are both direct and indirect. Direct costs resulting from Terrorism include precious lives lost, the cost linked with injuries, damaged goods and infrastructure and other short term losses in business and commerce etc. Indirect costs resulting from terrorist activities include greater security costs, reduced growth of Gross Domestic Product (GDP), increased unemployment, lost FDI, higher insurance payments and greater expected compensations for the riskier locations. Terrorist activities not only cause damage to a particular region and country's infrastructure but also destroy the financial wellbeing of the country (Rasheed & Tahir, 2012)

Shah, Bakar, and Azam (2016) report in their work that rise in terrorist incidents leads towards vulnerability and instability in financial and political achievements. According to the authors, foreign investors cannot make investments in those countries which are highly affected by Terrorism, so due to Terrorism reached a loss of foreign direct investment.

As per the report of the South Asia terrorist portal, the total deaths from 2001 to 2016 were 15290, and during this period, the total injuries were 42452. So, the total damages recorded due to Terrorism were 31409 million dollars (South Asia Terrorism Portal, 2013).

Even though there is adequate literature available on Terrorism and FDI, yet at the same time, there has been a lack of research investigation in Pakistan for Terrorism and FDI relations. Therefore the present study fills this gap by studying the impact of Terrorism on the FDI in Pakistan. This is the cause of how the incurred impact of Terrorism on the economy and how they destroy the economy of the country.

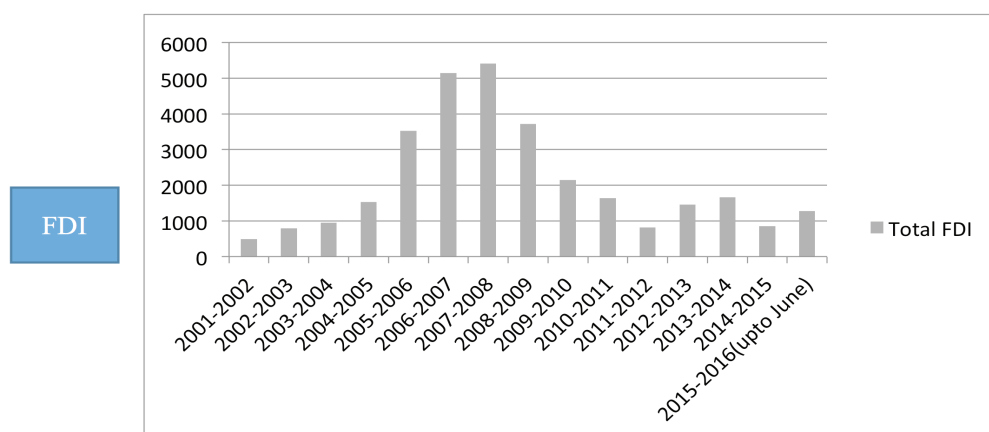


Figure 1: FDI Inflows in Pakistan From 2001 to June 2016
Source: Board of Investment Pakistan (2016)

LITERATURE REVIEW

Some Early studies work is already have been done to discover the association between FDI and Terrorism long with the conventional location control variables such as Economic Growth, Market Size, Trade Openness, Infrastructure, Foreign Direct Investment and Terrorism in various regions and locations. With development, some of these studies are reviewed below:

Aqeel, Nishat, and Bilquees (2004) explain that Pakistan is a developing country and which is always looked with the issue of the shortage of capital and assets for fulfilling domestic requirements. On the other side, because of appeal in a developing economy, it is gainful for developing countries put resources in those countries which are developing and accordingly FDI turns into a wellspring of shared advantages of north and south. Shah and Faiz (2015) conducted the study, and they used panel econometric data of SAARC countries. They collected the data from the period of 1980-2012. The result shows a positive relationship with market size, economic growth, exchange rate, infrastructure, trade openness with foreign direct investment in the selected region. With the improvement in the above factors, the foreign direct investment well improves and as well as the economies also improve in that region. On the other hand, Terrorism shows a negative relationship with foreign direct investment. Increase terrorism it shows decreases the value of the foreign direct investment. The study describes that Terrorism was a significant threat in the way of foreign direct investment and economic growth in the economies of selected countries.

As indicated by Iqbal and Lodhi (2014), Pakistan's economy is not stable which show different volatility at the micro and macro level; as a result, the FDI inflows are decreasing, and the employment and poverty level are increasing. Terrorism and religious violence have severely affected the economic situation of the country, and their origins are linked to the policies of historical leaders. The authors show that violence practices have turned into a typical practice to accomplish religious, ideological and political objectives. Sectarian and communal violence and terrorism events are included in these activities. Also, after the 9/11 events, religious sectarian and Terrorism development in its most rigid structures in the country, prompting a negative effect on international relations bringing about low FDI inflows and constantly decrease in economic growth. Rauf, Mehmood, Rauf, and Mehmood (2016) define the significance of FDI in developing countries; it decreases the gap between savings-investment, brings innovative technological skill and provides new technical information, increases employment opportunity and reduces the unemployment level. They show in their empirical study to assess the effect of Terrorism and political situation on the inflow of FDI in Pakistan. In this study, the researcher used ordinary least square techniques for annual secondary data and the data collected from Pakistan from 1970 to 2013. The empirical result shows that GDP (economic growth estimates), political stability and trade openness show a significant positive impact with FDI inflow, while Terrorism shows a negative relation with FDI inflows and economic growth. The Terrorism is measured in Pakistan from the data of bomb blast, including all the activities behind the bomb blast like social, religious, political and others. Rihab and Lotfi (2011) studied to essential variables to decide the level of FDI for 71 developing nations by using dynamic panel data method for time of 2001-2006. They found that GDP, HR, economy's receptiveness and administration framework quality had a huge positive relationship while independence, hierarchal separation and fraud control had a negative relationship with FDI inflows. Most of the research Specialists had likewise explored different elements which decide the level of FDI inflows in Pakistan.

Polyxeni and Theodore (2017) expressed in this article from 1996 to 2015, investigate and interact with the mutual interest between the inflows of FDI and Terrorism in Asian countries. We go for assessing the effect of terrorist activities on the FDI inflows in the Asian creating economies, thinking about that they positioned first among the best FDI beneficiary country in 2015, concentrating on the instances of 5 nations of this region. We lead to see past literature on this study, and we current to check out the interaction between FDI and Terrorism with an empirical model, and for this purpose, we used the panel data. The commitment of the article alludes to the way that it incorporates the two fatalities and wounds happening for universal terrorism assaults and it isn't constrained to exclusively looking into the issue of a single country. Ali, Waqas, and Asghar (2015) used autoregressive distributed lag (ARDL) and co-integration approach. They take data from 1989-2014 for determining of terrorism impact on foreign direct investment, according to their results terrorism attacks have negatively affected the foreign direct investment for an extended period. Stock market capitalization and human capital show a positive relationship with foreign direct investment in Pakistan.

While with Terrorism, all financial positions are becoming imbalanced. The infrastructure, cost on security, Balance of payment, International trade, and assurance payments was damaged (Rehman, Khilji, Kashif, & Rehan, 2018). So, in this situation, the confidence of the foreigner investors decreased, and in a result, these investors not invested in the economies of that country due to which the foreign direct investment becomes negative. At the same time,

the economic position of that country becomes weak and poor. Anwar and Mughal (2013) conducted a study, and they used the data from the period of January 2003 to June 2013. They apply the ARMAX model to analyze the impact of foreign direct investment with Terrorism in Pakistan. Per their study, the exports were not changed due to Terrorism. Whereas portfolio shows a little change.

And on the other hand, the migrant remittance shows increased. Only migrant remittance shows a positive impact on foreign direct investment. Only one variable migrant remittance raised in a difficult time. Azam and Lukman (2010) conducted a study on the impact of various factors on foreign direct investment. They conducted the survey in Pakistan, Indonesia and India for the period of 1971-2005. For analyzing each country, they used long linear regression model, and they used the least square method for the factors affecting foreign direct investment. They used secondary data of time series from 1970-2005. Their result showed that FDI improved economic development. Their result also showed that the most important factor which affected FDI was the market size of a country. If the market size of a country is large, it attracts FDI. The other factor which affected FDI was indirect taxes; most companies did not invest due to high indirect taxes.

Samreen and Qurrat (2016) conducted a study they used the quantitative research approach the data collected during the period 2001 to 2013. They state that terrorism impact each industry likes textile and tourism, agriculture and mining. Travelling is the ideal approach to diminish the nervousness and stress. Tourism assumes on focal part in the development of the economy since it is the best approach of procuring foreign exchange. Cinar (2017) to investigate the impact of the economic growth and Terrorism over the 115 countries of the world, used panel data techniques and found that the economic growth and Terrorism have a negative impact on low-income level countries as compared to high-level income countries. According to Choi (2015), a country with a high-level industrial development with less inclined to national and international terrorist attacks. For this purpose, he analysis 127 countries data from 1970 to 2007. The study conducts by Mubashra and Shafi (2018) to check the relationship between the counter-terrorism and the economic growth of Pakistan for the period from 1980 to 2015. They were concluded that counter-terrorism has long term impact on the economic growth of Pakistan on the said period.

After reviewing the literature (Ali et al., 2015; Anwar & Mughal, 2013; Rauf et al., 2016), it is seen the impact of Terrorism on FDI is negative. The other significant location determinants of FDI are also discussed with a different context. More exclusive research on Terrorism, along with other important variables affecting FDI inflows to the Pakistanis needs to be done. The current study seeks to fill the gap in the literature in Pakistan.

RESEARCH METHODS

The research uses annual secondary data of Pakistan, collected for the period 2001- 2016. The study data is obtained from different sources such as the official website of the World Bank (www.worldbank.org), Board of Investment (www.boi.org.pk) and South Asia Terrorism Portal (www.satp.org).

This study used descriptive statistics, correlation, Unit Root Tests for data stationarity and Regression analysis to check the impact of Terrorism on foreign direct investment in Pakistan

and other potential variable have also been included. In case the first the minimum numbers of observation greater the number of the independent variable in this situation, the researcher used the time series regression. The present research meets the criteria mentioned above (in this study, the observation is 16, and the independent variable are 5). We have used the time series regression. This study used annual data of Terrorism in Pakistan and also the data of the other five variables, economic growth, market size, infrastructure, trade openness, and FDI.

Augmented Dickey-Fuller Test

At this, the assumption of regression analysis that the data should be stationary. Before analyzing regression analysis, first have checked data stationarity, to check data Stationarity different test are applied. We used augmented ducky fuller test. If all the variables become stationary at the level we will directly use the regression. If some of these variables become stationary at the level and some on first difference, then use ARDL (Auto-Regressive Distributed Lag) to check long-run association among the variables. If all the variables become stationary at the first difference, so it uses co-integration to check the log-run association of our variables.

Model

FDI= $\alpha + \beta$ (Economic Growth, Market Size, Infrastructure, trade openness and Terrorism) + error term

The model that can be estimated and developed is as follows:

FDI= $\alpha + \beta_1 \text{Eco} + \beta_2 \text{Size} + \beta_3 \text{Infra} + \beta_4 \text{Trade} + \beta_5 \text{Terror} + \mu$

Where α represents intercept β (1, 2...5) represents the coefficient of the variables. The μ represents the error term in the model.

FDI is the dependent variable.

FDI= Foreign Direct Investment

The following are explanatory variables.

Eco = Economic Growth

Infra = Infrastructure

Size = Market Size

Trade = Trade Openness

While Terrorism is independent variable

Terror =Terrorism

Variables

Depended Variable:

Foreign Direct Investment:

Foreign direct investment is used as the dependent variable in this research. Similar to Shah and Faiz (2015), Farooq and Khan (2014) FDI uses the proxy is (net inflows of FDI in the US) and obtained the data from the WDI database from 2001 to 2016.

Independent Variables:

Market Size:

The market size of the host country plays a very important role in attracting FDI from the source country this statement supported by empirical evidence in FDI literature. The population is used as a proxy and data obtained from the WDI database. The proxy is similar to the Shah and Faiz (2015). The result shows that the broad market size has a positive association with the inflow of FDI in a host country.

Economic Growth:

The second explanatory variable of the study is economic growth. Gross domestic product growth per capita (GDPPC) is used as a proxy and data obtained from the WDI database same as the proxy used by Shah and Faiz (2015). The results that show the relationship between FDI and economic growth are positive.

Trade Openness:

The third important independent variable of the model is trade openness. Trade Openness as an important source of FDI inflows in Pakistan. (The import plus export as a percentage of gross domestic product) is used as a proxy for trade openness and data obtained from the WDI database (Shah & Faiz, 2015)

Infrastructure:

The fourth important independent variable of the study is the infrastructure. The present study takes the similarly proxy used by Shah and Faiz (2015), Khachoo and Khan (2012), Agrawal (2011) and Anitha (2012) is "Electricity Production" and data obtained from WDI database.

Terrorism:

The primary variable of the study is Terrorism. According to Shah and Faiz (2015), the proxy used for this variable is (number of attacks) in this study the proxy is formulated by summing up the data on Bombs and Fedayeen Suicide attacks, assassinations and hostages data obtained from South Asia Terrorism Portal (SATP) on the basis Proxy used by Shah and Faiz (2015).

Table 1:*Description of Variables*

Variables	Proxy	Data Source
Dependent Variable		
Foreign Direct Investment	FDI	WDI
Explanatory Variables		
Market Size	Pop	WDI
Economic Growth	GDPPC	WDI
Trade Openness	Trade	WDI
Infrastructure	Infra	WDI
Terrorism	Terr	SATP

ANALYSIS AND DISCUSSION**Table 2:***Descriptive statistics*

	FDI	INFRA	SIZE	TERRO	TRADE	ECO
Mean	2.1309	26.84405	1.6608	380.5000	31.95552	40.03320
Median	1.7409	29.99929	1.6508	360.0000	32.82500	22.8808
Maximum	5.5909	33.70381	1.9308	691.0000	35.68173	24.7654
Minimum	3.7808	0.000000	1.4208	36.00000	25.13914	31.2398
Std.Div	1.6209	10.63846	16383348	251.1191	2.800371	20.6931
Sum Sq.Dev	3.9219	1697.651	4.0315	945912.0	117.6312	211.663

Table 2 shows the descriptive statistics among the variables of FDI, Infrastructure, Market Size, Trade Openness, Economic Growth and Terrorism.

In this research, we use Annual data for all variables the data used in this study are time series so first of all, we find data stationarity so for data stationarity purposes we used Augmented Dickey-Fuller (ADF) test to check the stationarity of our data.

The results of the ADF test for stationarity of data for all variables are the following.

Table 3:

ADF Test

Variables	ADF Test value	Order of Integration
Foreign Direct Investment	-3.851360	I (0)
Economic Growth	-3.591689	I (0)
Infrastructure	-2.319293	I (0)
Market Size	-3.365519	I (0)
Trade Openness	-3.930411	I (0)
Terrorism	-2.877282	I (0)

Superscript *** show significance level at 10% and ** show significance level at 5%.
The values are rounded off to two decimal places.

Augmented Dicky Fuller test shows that all the variables of the data are normal (stationary) at a level. So we used the following regression analysis for our study.

Regression Analysis

Table 4:

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LGSIZE	0.619211	3.34473	2.484290	0.0386
INFRA	-0.057279	0.032062	-1.786509	0.1043
ECO	0.136579	0.102294	3.335157	0.0114
TERRO	-0.020910	0.001338	2.562740	0.0492
TRADE	0.164224	0.121353	2.353279	0.0578
C	47.06767	64.44156	0.730393	0.4819
R-squared	0.549305	Mean dependent var		21.21689
Adjusted R-squared	0.323957	S.D. dependent var		0.765451
S.E. of regression	0.629367	Akaike info criterion		2.191793
Sum squared resid	3.961034	Schwarz criterion		2.481514
Log likelihood	-11.53435	Hannan-Quinn criter		2.206629
F-statistic	2.437588	Durbin-Watson stat		2.657169
Prob (F-statistic)	0.108043			

The results show that market size, economic growth and trade openness, have a positive impact on FDI inflow in Pakistan except for Terrorism and infrastructure. The relationship between Market size and FDI inflow is positive in Pakistan. The proxy is used for market size as a population in our study, and market size statistically shows a significant effect on FDI. It means larger markets of Pakistan help to promote FDI inflow, goods and services in the country and also help to get the large scale of economic benefit. The size of the larger market

causes more potential consumers and therefore provides more opportunities for trade and mass-market and many other helpful benefits.

The result further show that Economic growth has a positive relationship with FDI and statistically observed to be significant which means that when average economic growth is increased has caused the inflow of FDI also increase during the concerned period. From our results, we found that investors prefer the rising economies because they provide better opportunities for investing in maximizing returns.

The result found that the coefficient of trade openness can be estimated that the FDI inflow has increased due to the increase in trade openness. The results show that trade openness is a positive relationship with FDI and statistically a significant element in attracting the flow of FDI in Pakistan. The investors choose to invest in those economies which are highly open and easily accept foreign investments.

In this study, electricity production uses as a proxy for infrastructure. The results show that the effect of infrastructure on the FDI is quite negative and statistically is not significant. It means that the infrastructure has of the country has not up to the mark to attract foreign direct investment.

The results found that Terrorism has a negative relationship with FDI inflow in Pakistan and statistically significant. The negative coefficient of Terrorism shows that the increase in Terrorism has significantly decreased the FDI inflow in Pakistan for the selected period. The fact is that the flow of FDI level decreases because of different reasons. Due to Terrorism and uncertain situation and instability in the country leads to discouraging the investors from investing their capital. It not just makes uncertainty in the financial and investment environment but also decreases the production and productivity level; security costs increases. Because of this, these economies cause FDI to be displaced.

CONCLUSION

The consequences of this research are important and supportive in the arrangement making for upgrading FDI inflows with the end goal to advance economic improvement. It has been recognized that FDI conveys advantages to the beneficiary countries by giving capital, new technology, and foreign exchange in such a way overcoming any issues among savings and investments. Pakistan is standing up to some significant deterrents in the form of attracting FDI and the leading cause of an impression of being Terrorism mongering in Pakistan. The current study made an effort to empirically examine the impact of Terrorism on inward FDI in Pakistan. The time-series data are used in this study data, analyze from 2001 to 2016. The result shows that the variable market size, economic growth and trade openness, are the key factors of FDI inflows in Pakistan and huge significant positive impact on FDI inflow. However, infrastructure and Terrorism have a significant negative association with FDI inflow in Pakistan. Finally, the results show for variable Terrorism confirmed that Terrorism has damaged the financial position of Pakistan and also damaged the FDI inflows during this period. Therefore, Pakistan will take appropriate measures to improve the investment environment in this region. Government policymakers should consider the situation of Terrorism, insecurity, law and order, to reduce the risk of investors and to ensure their ability to host FDI.

LIMITATION OF THE STUDY

In this study, we have attempted to describe an issue of Terrorism and its impact on the foreign direct investment inflow toward in Pakistan, also have some limitation in this study as under.

- Many types of research have been made on a different combination of variables, which interpreting different relationship among these variables, but I have used just six variables which are as follows, FDI, Terrorism, economic development, trade openness, Market size and infrastructure.
- Political instability and corruption are also one of the immense problems of Pakistan, concerned with economic development also not included in this research.
- The impact of the financial crises of 2007-2008 also not included in this research.

Future Direction

In this research, we strived to analyses relevant and update the literature on the relationship between Terrorism and FDI and some control variables (Economic development, trade openness, Market size and infrastructure.

We suggest some points for future work if someone interested in exceeding the Knowledge about this Phenomenon.

- First, the time duration of the study is just 16 years from 2001 to 2016, if the time duration may exceed. It may exceed the accuracy in the results.
- As this result is just on Pakistan; this research may also apply to developing and developed economies.

Policy Recommendations

- The government should take some serious and adequate step against the terrorist attacks.
- The government must ensure the law and order situation in the country to reduce the risk of investors and to ensure their ability to host FDI

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