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POLITICAL RISKS AND INVESTMENT: A CASE STUDY OF PAKISTAN (2012-2022)

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ABSTRACT

This research article explores the link between political risks and patterns of foreign direct investment in Pakistan from the period of 2012-2023. By utilizing both qualitative and quantitative research methods, the study evaluates the level of disturbance caused by political instability, policy inconsistency, outdated infrastructure, bureaucratic hurdles, inflexible tax and tariff paradigms, corruption and other political risks to the flow of domestic and foreign investments in Pakistan. Findings of research suggest that in each period, Pakistan witnessed a decline inflow of investment, although, in some years, a minor increase occurred but it made a slight difference in overall investment. The study endorses the fact that political stability, a conducive atmosphere, flexible policy and regulations help to boost the confidence of investors and it leads to more flow of investment in the country. The smooth flow of investment requires targeted reforms to mitigate the political risks and stimulate sustainable economic growth in Pakistan.

Keywords: FDI, Board of Investment, Bureaucracy, Taxation policy, Inconsistency, Decline.

INTRODUCTION

Political risks play a vital role in shaping the landscape of Foreign Direct Investment in Pakistan. As a state with a dynamic nature of the political environment, foreign investors face numerous challenges as well as navigate through opportunities. The multifaceted political risks that impact FDI in the country. From governance issues, political instability, policy inconsistency, weak in fractures, outdated bureaucratic structure pose great threats to the inflow of FDI. Moreover, civilian and military transitions of powers contributed to the complexity of FDI.

The institutional flaws, regulatory frameworks and the deteriorating situation of rule of law further contributed to the political risks. Foreign investors monitor all the developments in host countries and measures taken by respective governments to counter corruption and other administrative issues. Recent developments, such as tax policies, trade agreements and energy shortfall further hinder the inflow of Foreign Direct Investment. The nexus between political risks and FDI is always critical to analyze the potential of Pakistan for foreign investors.

The political circumstances of any state has key determinants of global investment and economic relations. Political factors such as institutional corruption, instability and uncertain elections affect foreign direct investment up to a great extent. Moreover, Political unrest such as mismanagement of the country's resources not being used to their maximum potential always demotivate foreign investors so ultimately the flow of foreign capital investment depends upon the political environment. (Naina Qadir & Nida Shah, 2001)

Developing countries like Pakistan where an unstable political environment hinders economic growth, suffer from political regime changes, and constitutional deadlocks. There is always confrontation between major institutes of State. Military civil unrest cast too much on economic grounds. investors that do not invest in these states where political situations are uncertain when highly destabilized countries restrict investors from investing them eventually the state has to rely on foreign assistance. (Javed, 2002).

The inflow of foreign direct investment is a minor part of the global structure of FDI. At the end of the 20th century Pakistan just made 0.2% of global FDI and 18% of South Asian countries in the first decade of 21st century FDI stands. These figures show despite Pakistan having an ideal geo-strategic location and central part of the foreign policy of the world unable to attract a reasonable flow of foreign direct investment (Khan H., 2005).

Above mentioned figures of Pakistan's share in global investment in flow show that there are numerous reasons to believe that political factors play an important role in the flow of FDI. Firstly good infrastructure and governance appeal to foreign investors secondly corrupt Institutions cost double in terms of investment. Thirdly, high taxes and costs may affect investment Institutions and political stability, and more foreign direct investment can be attracted, which as a result may affect the overall growth rate of the economy. (Nasreen & Awais M., 2014).

This paper explores the importance of understanding political factors for foreign direct investment and other factors such as corruption, institutional flaws and undemocratic practices that makes skeptical of foreign investors investing in Pakistan. Moreover, these political factors make Pakistan vulnerable to invest in Pakistan. Furthermore, Geo political landscape of Pakistan attracts foreign investors, but practically, political instability, policy inconsistency, and the role of the law make the situation worse for FDI. The first two decades of the 21st century saw a visible decline in foreign direct investment in Pakistan. External and internal factors contributed to this decline, but comparatively political instability caused more harm to FDI in Pakistan compared to more than any other factors. These factors affect investors' mindset. Pakistan needs to be work on the Political environment to boost the confidence of foreign investors.

Literature Review

Political risks like all other factors have adverse consequences, even though all other forms of risks are highly studied and discussed but political factors did not get much place in studies. Below are some studies which explore the relationship between political risks and foreign direct investment (FDI) as a whole and specific reference to Pakistan.

Afza and Anwar (2013) investigated the key indicators of political risks which affect foreign direct investment in Pakistan. From the year 1980-2010. The results reported trade openness, business incentives, and exchange rate stability. Market size positively affects FDI. Whereas political instability, security challenges, high inflation rate, and strict taxes and regulations adversely affect FDI in Pakistan.

Asif et al (2008), this study explores and investigates the fluctuations of foreign direct investment in Pakistan due to deep-rooted political instability. The study shows that there is a direct connection between political risks and FDI. Political instability, law and order situation, strict tax policies and regulations, incompetent bureaucracy and lack of infrastructure adversely affected the flow of investment in Pakistan in the period 1990-2015.

Goswami and Haider (2014), the author examines the effect of political risks on FDI in 146 countries by using a systematic approach to factors analysis. By using this approach the author figure out which specific factor of political risks contributed more toward hindering the inflow of FDI. The results of the study showed that government incompetence is a major contributing factor for deterring FDI, rather the attitude of the partner country toward the host country and internal conflicts are responsible.

Koijen et al. (2016), the study showed that the flow of investment is associated with political stability. The outcomes are responsive to political risks from public sector reforms, environment and healthcare.

Kong et al. (2001), the author argues that every firm and industry in society is being threatened by the political landscape of the country such as state power and political interference. It negatively impacts the overall inflow of investment in the country. The political risks overall affect the performance of industries and eventually, result in mistrust between the host and partner states.

Memon et, al. (2015) noted that for better economic growth, political stability is an essential element. Political instability integrated all segments of society and it led to the collective growth of society. The states can never achieve success with pathetic political systems and pragmatic societies. The same case with Pakistan. Undemocratic practices since independence affect overall economic growth in Pakistan.

Nasreen and Anwar (2014) investigated the overall impacts of political risks in terms of the inflow of foreign direct investment in Pakistan. The data used for this study is from 1981-2012. The research concluded that FDI inflow is negatively affected by political risks in the long and short term as well. The study further suggested that per capita GDP and quality of infrastructure also contribute in this context. Inflation also hampers the inflow of foreign direct investment in Pakistan.

Pastor and Veronesi (2012) examined the relations between tax and regulations, political uncertainty and FDI. The results showed that if the political government is incompetent to deal with these issues it affects the inflow of foreign direct investment. So host states must make efforts to address the basic problems such as tax reforms, currency regulations and political instability. Inconsistency in government policies and an incompetent legal system badly affect the flow of FDI.

Rani and Batool (2016) examined the correlations of FDI. Political instability, and economic growth in Pakistan and figure out variables affecting it. The study consists of the period of 1980-2013. The results showed that negative relations exist between political instability and foreign direct investment. Moreover, the inflow of foreign direct investment is positively linked with economic development and political instability.

Rios-Morales et al. (2009) analyzed that the role of political risks is an important indicator of Foreign Direct Investment. The results showed that good governance and political stability contribute positively to the inflow of FDI. In the case of Pakistan, these factors such as political instability, bad governance and institutional gaps badly affect the inflow of FDI in Pakistan. Moreover, corruption, order of law, and instability cast much of Pakistan on investment grounds.

Sehar (2016) stated that there is enough evidence and research which indicates political instability and risks negatively affect economic growth in Pakistan. Political risk lowers private investment breeds corruption and misgovernance in Pakistan. Pakistan is going through a long political instability phase which badly affects the inflow of foreign direct investment and hinders overall economic growth in the country.

Tahir (2011) stated that Pakistan failed to get rid of political instability mainly due to constitutional conflicts and is still stuck in feudalism, and a sectarian segregation system since independence. The disputes with India's internal socio-economic gaps, and intra-provinces differences, are some of the reasons which encourage undemocratic elements to deepen their roots in the system (Tahir, 2011)

Zurawick and Habib (2009) investigate the effects of political instability and corruption on the flow of foreign direct investment. Investors first analyzed the level of corruption in the host country, and compared the level of corruption between the host and home country to analyze the difference. The main result of this study is that corruption is the primary reason for the lack of foreign direct investment.

Political landscape of Pakistan

Pakistan's short history as a country has been problematic. And intra-provinces mistrust as well as a well-rooted contention with India since Independence created hindrances to giving real political and economic stability. As a whole Pakistani Nation has been stuck somewhere between the military drive to complete control of state Institutions to weak civilian rule over the last seven decades. On the religious ground, this has been a division among secular and religious groups since the Inception of Pakistan. For more than three decades the military extended their control over the government. Pakistan witnessed four military coups. However, Democracy could not flourish in true spirit. But despite All hen dresses, the civilian government itself did not allow full democracy to be stable. Since Independence, not a single Prime Minister completed his constitutional tenure. The beginning of the 21st century made the same hopes that maybe true democracy can make its way, but unfortunately, the principles of democracy are far away from reality (Asia, 2012).

Political stability and foreign direct investment go hand in hand with each other. Geographically Pakistan is located in an important region geographically but ethnic and political differences paved the way for an unstable government since 1947 after the death of Quaid-e-Azam and Liaquat Ali Khan there was not a single leader who was rational. Politics based on self-interest opened up for the first Martial Law in 1958 by a General Ayub Khan Ali the economic growth in his Hero was interesting but all the policies were temporary and not much lasting lesson impacts. A decade of Martial Law from 1958 to 1969 witnessed numerous challenges on the external as well as internal front. Eventually general elections had to transfer power to another chief of Army staff general resistance brought good results and the first general elections were held in 1970. The result of the general election started a new debate. Zulfiqar Ali's Bhutto did not accept the majority of Sheikh Mujibur Rahman from East Pakistan. it started internal turmoil and India attacks on east Pakistan which left the Pakistani government shocked. Eventually internal as well as external support resulted in separation of East Pakistan on 16th December 1971. (Historical reviews of political instability and economic growth of Pakistan.) (Dr Irshad Khan developing country studies)

After the creation of Bangladesh, Bhutto started a government in West Pakistan. After the completion of his five year tenure, general elections were held in 1977, which paved the way for third Martial Law. General Zia ul Haq imposed the 3rd Martial Law which ended in 1985 and saw an Islamization, Afghan War internal political instability.

After the death of Zia-Ul-Haq elections were held and Benazir Bhutto Got the majority but her government did not last so long, from 1985 - 1999 four governments changed. Such political instability gave chance to general power Musharraf to enforce the 4th Martial Law in 1999. From 1999 to 2023. Pakistan witnessed the Afghan war's internal security challenges.

Political Rises and investment in Pakistan (Khan, 2010). Pakistan remains one of the most risky states in terms of foreign investment with numerous internal and external challenges such as political instability, among state institutions, an increase in foreign debt, and a high cost of investment. The Pakistani stock market also witnessed a huge decline in the last decade due to global and internal crises. (Robert, 2010).

Political Risks and Foreign Direct Investment in Pakistan

FDI plays a key role in the development of developing countries. One reason is that foreign direct investment enhances the utilization of new technology and employment rates; moreover, FDI puts pressure on locals to work more effectively to create a competitive environment. Furthermore. FDI brings numerous benefits to the host country such as labour management, and local advancement, it attracts innovative technology transfer, promoting international trade and opportunities, generating millions of jobs in the host country, helping to boost local infrastructure, and making the case for more FDI. (Impact of FDI on economic growth)

Unfortunately, Pakistan's profile in terms of foreign direct investment remained low from 2013 to 2023. Pakistan is one of the most attractive states for FDI due to her geopolitical location. However political risks and factors contributed a lot to making investors skeptical about investing in Pakistan in this era.

Political risks range from policy shifts from one government to another state institution moreover, the brute corruption and outdated infrastructure do not make any sense for investors to invest in Pakistan has some important political factors that contributed to low investment in Pakistan.

1) Political instability
2) Corruption
3) Inefficient bureaucracy
4) Policy in consistency
5) Security concern
6) Lack of infrastructure
7) Legal challenges
8) Restrictive regulation
9) Political interference in business
10) Taxation policy

Political instability

A Politically favourable environment always attracts foreign investors. Although Pakistan witnessed a historic transition of government through general elections after 2008. But soon the political government came into action with strikes, sit-in, and protests started by the opposition, the same in the case of the 130-day-long sit-in in Islamabad led by PTI Chairman Imran Khan in 2014. Eventually, his government witnessed the same response when PTI came to power in 2018 opposition started collective campaigns against PTI which resulted in the collapse of the PTI government in 2021. So economic business and Pakistan have suffered a lot in recent years which resulted in a huge decline for foreign direct investment in Pakistan.

Corruption

There is a strong Nexus between corruption and FDI which eventually damages the flow of FDI in Pakistan. Some stats show that corruption is badly rooted in Pakistan. Moreover, corruption is one of the negative deifications of FDI, which enhances the expenditures of business burns reducing overall effectiveness and productivity. Consequently, it can be argued that corruption affects FDI and affects the economic development of the state. Rising the Nexus among foreign direct investment, corruption, and growth in developing and developed markets (Fiza, 2021).

Inefficient Bureaucracy

The domestic administration of bureaucrat structure has a key role in attracting foreign investment, so in this context, the quality of Bureaucracy is important indicators of local administration that make business more sustainable by providing regulation assistance and overall favourable scenarios for foreign investors. Pakistan is the 45th largest economy and a member of the G20 developing economy. Overall, in just one year the South Asia region received 47 billion dollars in terms of FDI. In 2015 India alone got 44 billion dollars and all other states shared three billion. It highlights the quality of Indian bureaucracy and Pakistani beauty dresses. (Quality and FDI inflow Nexus South Asian perspective (Adeel, 2020).

Policy Inconsistency

Inconsistent economic growth, payment crisis, inconsistent tax policies, high-interest rates, and devaluation of the Rupee lower the interest of foreign investors in Pakistan. For instance, FATF gray list costs Pakistan over 38 billion USD in economic loss and impacts investors' confidence in Pakistan. Moreover, regulation, procedures, and real tapism will contribute to the decline of FDI in Pakistan. Pakistan witnessed a 30 PC decline in FDI from 1.85 billion to 1.3 billion USD in just 8 months of 2020 to 2021 (Shahrukh, 2021).

Security Concerns

Terrorism and security challenges not only affect the state's reputation, population and infrastructure but also have a great impact on foreign direct investment, uncertain security scenarios climatize the confidence of foreign direct investors in that country which leads to the decline in foreign direct investment. Similarly, Pakistan has also witnessed security challenges for a long time which reduce the inflow of foreign investment. This is a significant negative access between security concerns and FDI. From 2010 to 2020, the inflow of FDI in Pakistan reached a record low of USD 1.72 billion due to the intensity of security challenges (Irfan, 2014).

Lack of infrastructure

Development is vital for a country to attract foreign direct investment in Pakistan, also enhance exports and fiscal growth. A country with pathetic infrastructure decreases the interest of investors, therefore quality of infrastructure is essential for foreign direct investment. Pakistan's infrastructure needs are rising and the resources are not enough to meet these rising needs. For the economic progress of Pakistan, it is to improve the quality of infrastructure. It is understood that the infrastructure of Pakistan will improve overall GDP and FDI will improve (Aqeel, 2022).

Restrictive regulations

Several factors are known to influence the state attractiveness for FDI but these factors are directly affected by regulations of that state. If laws and regulations are stricter and subject to uncertainty most likely to reduce interest of foreign investors as compared to the country wherein rules and regulations are comparatively less restricted, they are more open to FDI. Pakistan, a developing country belongs to the former category for FDI which resulted led to a decline in the inflow of FDI in Pakistan.

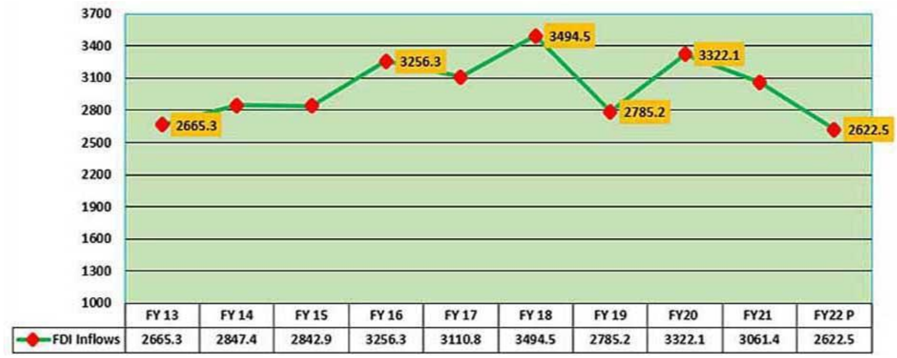
The law of effective contract enforcement mechanism in Pakistan is one of the major obstacles to being attractive for foreign direct investment. To unlock its true economic growth Pakistan needs a more business-friendly environment to make it a more attractive country for FDI (Shahid, 2023).

Taxation policy

There is a long-run relationship between taxation policy and the inflow of FDI in Pakistan. To attract more FDI, States try to change their tax policies by introducing some incentives such as tax holidays, investment allowances, exemptions, deductions etc. Pakistan needs to re-consider text policies to welcome more FDI in the country. New incentives can help to bring more FDI in Pakistan (Nomaan, 2021).

Discussion and Analysis

Table 1 shows the fluctuation in Foreign Direct Investment in Pakistan from 2012.2022. In the period of 2012 to 2014, foreign investors invested 2665.3 million US dollars. In the next year, minor changes occur in FDI such as 2847 million US dollars till 2014. As a statistic represents that in 2022, FDI witnessed a record decline and reached its lowest figure at 2622.5 Million US dollars.



Source: Board of Investment

Conclusion

Investing in Pakistan has both opportunities and challenges at the same time to deep-rooted political risks. Geo-strategic location of Pakistan makes it an ideal destination for investors but, unfortunately, Pakistan could not catch the real potential of her location. Political factors such as political instability, military-civil imbalance relations, abrupt policy changes, and deeply rooted institutional Corporations remain high-risk factors which hinder foreign direct investment.

Moreover, the lack of quality infrastructure, pathetic local administration Outlook, and Strict test tax policies also contributed highly to the decline of foreign direct investment in Pakistan. Despite all these political risks, the lack of government commitments is also an issue which makes things unfavourable for foreign investment. In addition to this, Pakistan only attracts very few countries, including China, which makes a minor difference in the overall inflow of FDI in Pakistan.

Moreover, Pakistan needs to make concrete efforts to improve overall political environment transparency and the rule of law to attract foreign investors and establish a good atmosphere for the long-term benefit of FDI. With a dynamic landscape, a balanced approach to investment taking into account both the opportunities and risks can lead to success in the Pakistan market.

Policy Recommendation

Pakistan can create a more conducive environment for investors, reduce overall political Rises and attract more inflow of foreign direct investment ultimately contributing to development and growth in the country by making a more attractive environment for foreign ministers. Here are some important policy recommendations.

Firstly Pakistan should make a priority to make solid efforts to reduce political instability. These include institutional reforms, and promoting transparency. Stability can enhance investors' confidence.

Secondly, legal protection for investors and legal reforms are needed to ensure a fair dispute resolution mechanism. It will provide investors with great security and confidence.

Thirdly, Pakistan should enhance its efforts to eradicate deep-rooted corruption. Pakistan needs to strictly implement anti-corruption laws it will reduce real tapism bribery and Rises of investors.

Fourthly, Pakistan needs to work on establishing a dedicated Institute to facilitate foreign investors. These bodies can act as a one-stop for investors.

Fifty lack of productive infrastructure is a major obstacle in the way of effective FDI. Pakistan needs to boost the quality of infrastructure in order to provide a more conducive environment to investors. It also helps to reduce operational Rises.

Sixthly, security concerns are another where concrete measures demand time. Collaborations with functional partners to ensure the security of foreign investors.

Seventhly, Pakistan needs to bring a diversity of investment in the sectors within the state. By doing this multiple options will move foreign investors in multiple sectors it will reduce the overall uncertainty created by political Risks.

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