

RESEARCH ARTICLE

Can FDI and Tax on Producer Interrupt the Industrial Development: An ARDL Based Evidence from Pakistan

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Abstract: Foreign Direct Investment (FDI) and Taxes on Producer (TP) are crucial to locate the industrial development of particularly the developing economies like Pakistan. This study is initiated to locate the joint effect of FDI and TP on producer on the industry value added. For the analytical purpose, the data was collected from 1980 to 2023. The regression technique of Autoregressive Distributed Lag (ARDL) is used to meet the objectives of the study. The results confirm long run relationship with the nonlinear relationship of FDI×TP and industrial value added. For the government, it is suggested to have a catharsis before announcing the taxation policy that is good for the industrial sector.

Keywords: FDI, Tax on Producer, Industrial Development, ARDL, Pakistan

Introduction

FDI is a cornerstone for the development of the industry. Countries like Pakistan effort to engage FDI for addressing their macroeconomic concerns. According to United Nations Conference on Trade and Development ((UNCTAD), 2021), the industrial growth is linked with the innovations and employment spread-outs in the host country.

FDI is always treated as a remedy to resolve the macroeconomic issues (Ministry of Finance, 2023). According to UNCTAD (2024), FDI inflows to Pakistan have been recorded \$1.81 billion by 2022-2023 which is 24.3 percent higher than corresponding preceding fiscal year. By the end of the same fiscal year, the total stock of FDI reached at \$28.61 billion which is significant to state as being 8.5 percent of the GDP. The statistics of the Board of Investment show that by November 2011-2012, the power sector was the primary recipient of heavy FDI inflows which is 29.7 percent of the total followed by the oil and gas which is 17.9 percent and the financial business 15.2 percent. moreover, the communication i.e., information technology and telecommunication recorded for 3.6 percent with trade, transport, chemical, and construction to be at 3, 2.1, 2.0, and 2.0 percent respectively.

The countries with the highest pledges of investment are China with 27 percent of the total FDI inflows, UK 12.9 percent, Hong Kong and US are the contributories of 11.3 and 9.3 percent. Also, in the bracket of the contribution, it is listed Switzerland with sum of 5.8 percent of the FDI to Pakistan. According to State Bank of Pakistan (2024), the FDI inflows have reached \$1.33 billion which is \$1.1 billion higher than the corresponding previous fiscal year. The China's investment is totaled at \$535.5 million which reflects a surge of 48.2 percent, and it is 42.9 percent of the total FDI inflows realized in Pakistan.

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Table 1*Summary of Current FDI Inflows*

Foreign Direct Investment (\$ million)	2020	2021	2022
FDI Flows	2057	2147	1339
FDI Stock	31960	32543	31924
No. of Greenfield Investments	8	15	32
Value of Greenfield Investment	231	919	1709

Source: UNCTAD (2023)

It is worth noticing that the potential attractiveness of Pakistan towards the foreign investors has remained lower in the region. Pakistan's attractiveness towards the foreign investors is lacking due to the internal challenges such as secure environment, shortage of electricity and the high prices of utilities, and the burdensome investment climate with the imposition of taxes on the business that are even not mentioned in the federal budget statement rather are decided off and on during the specific year earlier and are to come. This myth of undeclared taxes shatters the confidence of the investors (local and foreign) to carry on with the investment activities within the country for a longer time frame.

Pakistan ranks at 91st position among the 133rd economies on the Global Innovation Index and at 135th number out of 180 on the Corruption Perception Index. Moreover, the state of economic freedom also lacks in Pakistan as being at 150th out of 184 world economies.

Such positions are evident due to many factors and to be precise in a write-up, foreign investor is reluctant due to tax imposition which is an objective of this study to discover how it jointly causes industrial value added to alter with FDI inflows. Whereas, as per the policy initiatives, the Pakistan's government offers the tax incentives for the establishment of the industrial units especially in the sector like, energy, highways, ports, electronics and software. Also, some of the incentives are offered at federal and provincial level on the exports and other duties on the equipment, machinery, and material used as an intermediary in the industries operating in Pakistan (Lloyds Bank, 2025). The novelty of this study rest in an exploration of how taxes on producers and FDI jointly affect the industrial value added.

Literature Review

Keynesian and Neo-classical economists possess that low interest rate effectively favors investment. However, the economists such as McKinnon (1973) and Shaw (1973) take hold of the fact that low interest rate causes inflation in the country. Moreover, Solow (1973) located that efficient funds allocation results in bringing the desired industrial progress (Fischer, 1998; Summers, 2000; Obstfeld, 1998; Obstfeld & Rogoff, 1994).

The relationship of FDI and industrial progress is traced by Alfaro et al. (2004). FDI displays uncertain effects on industry especially in case of less financially liberal economies. Likewise, some studies hold an empirical finding that; FDI exhibits meek and negative effects on industrial output however, some go against this version (Alfaro et al., 2004; Agosin & Mayer, 2000; Singh, 1992; Caves, 1974; Globerman, 1979; Haddad & Harrison, 1993).

The welcoming effects of FDI are seen evident in countries having capability of adapting latest technology and economic stability (Fauze et al., 2015; Bengoa & Sanchez-Robles, 2003; Borensztein et al., 1998). For countries like Pakistan, foreign capital is a blessing (Mehmood et al., 2025a, 2025b; Mehmood, 2023). FDI is sensitive to macroeconomic state of position of the host country (Caves, 1974; Globerman, 1979; Haddad & Harrison, 1993; Liu, 2012).

Ali et al. (2024), Adegbite and Ayadi (2011), and Sen (2008) concluded positive relationship of industrial growth and FDI. To Sen (2008), FDI has a promising role towards an industrial progress. Nevertheless, internal economic conditions such as political stability, governance, and law and order

situations further enhance the positive effects of FDI (Suleiman et al., 2015; Mehmood et al., 2021). To Khan et al. (2023) and Mehmood (2018a, 2018b), FDI, employment, and economic growth are linked, alike industrial progress. It is worth to notice that FDI does not have linear relationship with such macroeconomic contents. In this regard, Wang et al. (2021), Overy (2020), and Hasan and Zaheer (2022) pointed out that unemployment is caused by FDI.

FDI carries a significance of improving labor force participation (Ali & Akhtar, 2024). Likewise, industrial sector also transmits positive results on the labor force participation (Korgbeelo, 2024; Eromosele, 2023; Ebhorta & Ugwu, 2014; Kalejaiye, 2022). There is an interplay between industrial sector and FDI (Mehmood et al., 2022). The CO₂ emission is not caused by FDI, and delicate industrial set up leaves no traces of CO₂ emission in the host country (Munir & Ameer, 2019; Mehmood et al., 2022).

In supplement to the FDI, ease of doing business is also essential to affect industrial sector (Rehman et al., 2024). The projects like China Pakistan Economic Corridor (CPEC) are aligned with internal factors such as economic and political stability (European Commission, 2017; The Friedrich Naumann Foundation, 2017). FDI is linked with ease of doing business, expressed by Ani (2015), Akame et al. (2016), Corcoran and Gillanders (2015), Shahadan et al. (2014). Iweama et al. (2021), Chizema et al. (2025), Mahuni and Bonga (2017) explored that FDI and ease of doing business are useful ingredients for industrial development.

The reviewed literature assists to note the importance of FDI, labor force participation, and ease of doing business towards the industrialization. Whereas, from the government side, it is essential to find the ways to improve the tax base. Therefore, the government initiates the taxes on the business class. This study wants to locate if the together effects of FDI and taxes on producer cause industrial value added affected.

Methodological Issues
Variables and Data Collection

The objective of this study is to investigate the joint effect of FDI and taxes on producer on the industrial production. For the analyses, the secondary data is collected from The World Bank Development Indicators and Trading Economics for the range of 43 years from 1980 to 2023. The variables’ description is given in Table 2.

Table 2
Descriptions of the Variables

Variables	Notation	Description	Source of Data
Foreign Direct Investment	FDI	Foreign direct investment, net inflows (% of GDP)	World Bank Development Indictors
Access to Electricity	AET	Access to electricity as a % of total population	Trading Economics
Domestic Credit to Private Sector	DCPS	Domestic credit to private sector by banks (% of GDP)	World Bank Development Indictors
Tax on Producer	TP	Taxes less subsidies on products (net indirect taxes) measured in local currency unit	World Bank Development Indicators
Industry Value Added	IND	Industry (including construction), value added (annual % growth)	World Bank Development Indictors

Specification of Regression Equation

The specification of equation is given in term of simple linear regression form in Eq [1]

$$IN_t = \beta_0 + \beta_1 FDI_t \times TP + \beta_2 AET_t + \beta_3 DCPS_t + \mu_t \quad [1]$$

Where β_0 is the intercept of regression model and μ_i is the error term.

The condition for the application of the ARDL model is that; series must be stationary at I (0), I (1), or either a combination of both but not of I(2). The ARDL technique is appropriate due to its pertinence on the series of varied states of stationarity. Furthermore, ARDL is advantageous over conventional regression techniques of Johansen Cointegration and Engle and Granger (Mehmood et al., 2025a,2025b).

The unrestricted, long run, and short run ARDL models are given in Eq. [2], Eq. [3], and Eq. [4], respectively.

$$\Delta IN_i = \beta_0 + \beta_1 IN_{t-1} + \beta_2 FDI \times TP_{t-1} + \beta_3 AET_{t-1} + \beta_4 DCPS_{t-1} + \sum_{i=1}^p \partial_1 \Delta IN_{t-i} + \sum_{i=1}^q \partial_2 \Delta FDI \times TP_{t-i} + \sum_{i=1}^q \partial_3 \Delta AET_{t-i} + \sum_{i=1}^q \partial_4 \Delta DCPS_{t-i} + \mu_t \quad [2]$$

Where Δ signifies the difference operator, the β 's are the intercept of model and coefficients of the variables in unrestricted ARDL model. The p and q are the lag orders of ARDL. The ∂_i are the coefficients of short run.

The long run coefficient estimation is given below in Eq. [3]

$$\Delta IN_i = \beta_0 + \beta_1 IN_{t-i} + \beta_2 FDI \times TP_{t-i} + \beta_3 AET_{t-i} + \beta_4 DCPS_{t-i} + \mu_t \quad [3]$$

The error correction form of ARDL is given in Eq. [4].

$$\Delta IN_i = \sum_{i=1}^p \partial_1 \Delta IN_{t-i} + \sum_{i=1}^q \partial_2 \Delta FDI \times TP_{t-i} + \sum_{i=1}^q \partial_3 \Delta AET_{t-i} + \sum_{i=1}^q \partial_4 \Delta DCPS_{t-i} + \partial ECM_{t-1} + \mu_t \quad [4]$$

The ∂ is a speed of adjustment for the residuals of ECM. The long run relationships exists if the coefficient of ECM is significant and negative in sign.

Diagnostic Checks

The diagnostics are accomplished to find the stability and legitimacy of the estimates. The diagnostics are completed through Breusch-Godfrey serial correlation (LM Test). In this test, if the chi-square value is greater than 0.05, it confirms that there's no serial correlation and otherwise true.

Similarly, for the heteroskedasticity exploration, the probability of chi-square value must be higher than 0.05 and if vice versa, the series is homoscedastic (Wang et al., 2021). Also, Cumulative Sum of Recursive Residuals (CUSUM) and of the CUSUM squared are run to know the stability of the results.

If the series diagram shows that the trend line remains within the boundaries of red lines at 5 percent significance level, the parameters are then according to the requirement and are stable in structure and otherwise true (Zaman et al., 2022). The Ramsay RESET Test and Jarque Bera Test of correctly specified model and the issue of abnormality of residuals are also check for proving reliability of regression results.

Results & Discussions

The results and discussions are presented in this section. In the beginning, the descriptive statical results are presented in Table 3

Table 3

Descriptive Statistics

Variables	IN	FDI	AET	DCPS	TP
Mean	55.6	0.79	73.7	20.7	70830
Maximum	17.2	3.04	95.2	29.7	396287
Minimum	-5.8	0.10	49.4	13.8	2392
Std. Dev.	3.1	0.65	14.5	4.55	100102
Skewness	-0.28	2.15	-0.04	-0.09	1.92
Kurtosis	4.9	7.41	1.72	1.74	5.69
Jarque-Bera	6.4	68.2	2.92	2.89	39.32
Probability	0.04	0.00	0.23	0.23	0.00

The findings show that wider dispersion is visible in case of IN, AET, TP, and DCPS from the respective mean values. However, FDI is recorded for the less divergence though maximum and minimum value is of significant difference. Other than FDI and TP, the series are negatively skewed. IN, FDI, and TP are observed to be leptokurtic. As far as Jarque-Bera is concerned, AET and DCPS are also evident for being normal in distribution. The unit root test is given in Table 4 which confirms that the series are stationary of order I (0) and I (1) therefore, ARDL technique of analyses is justified.

Table 4*Stationarity Test Results*

Variables	Test Statistics (At 5% level of significance)	Augmented Dickey Fuller test statistic (At Level)	Augmented Dickey Fuller test statistic (At 1st Difference)
IN	-2.935001	0.0001	0.0000
FDI	-2.935001	0.0012	0.0409
AET	-2.935001	0.6972	0.0000
DCPS	-3.596616	0.0442	0.0000
TP	-2.933158	0.9999	0.0071

Table 5 is published with the information of Bound Test. The results show that the F-statistic (computed) is significant and higher than table value at I (1). Hence, the long run relationship is found on the model prescribed in Eq. [2].

Table 5*Bound Test*

Test Statistic			F-statistic	
Value			6.131295	
k			3	
Significance	10%	5%	2.5%	1%
I (0) Bound	2.37	2.79	3.15	3.65
I (1) Bound	3.2	3.67	4.08	4.66

The long run coefficient estimations are given in Table 6. The results are meaningful. It is recorded that the joint effect of FDI and tax on producers are significant also there is a negative sign. It is therefore concluded that when tax on producers is combined with FDI either of the positive effects on industrial value added are off set. However, it is worth to notice that the negative impact of combined FDI and tax on producer is quite small. AET is found insignificant. Moreover, the coefficient of DCPS is found positive which is sufficient to highlight that domestic credit issuance to private sector is helpful in boosting the industrial progress. The coefficient of the model is also found significant thus show that the effect of omitted variable is significant and positive on industrial value added.

Table 6*Long Run ARDL Results*

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FDI×TP	-0.004741	0.002097	-2.261093	0.0320
AET	-0.088082	0.125803	-0.700153	0.4898
DCPS	0.678620	0.357458	1.898463	0.0684
C	28.799195	15.641622	1.841190	0.0766

Following the long run coefficient estimations, the short run ARDL results are presented in Table 7. Mixed effects are found in case of joint variable i.e., FDI and tax on producer. The effect of DCPS is mostly similar to what is found in case of long run. The effect of ECM is significant and correctly signed. It is important to note that all of the deviation from equilibrium is adjusted in long run.

Table 7

Short Run ARDL Results

Dependent Variable (IN)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(FDI×TPJ)	-0.007009	0.001727	-4.057470	0.0004
D (FDI×TP (-1))	0.001959	0.001825	1.073473	0.2926
D (FDI_TP (-2))	0.005471	0.001904	2.872693	0.0078
D(AET)	-0.062907	0.300477	-0.209359	0.8357
D(DCPS)	0.479841	0.258819	1.853965	0.0747
D(DCPS (-1))	0.399639	0.307433	1.299922	0.2046
D(DCPS (-2))	0.694659	0.255412	2.719762	0.0113
D(DCPS (-3))	0.692295	0.274033	2.526321	0.0177
ECM (-1)	-1.034907	0.149683	-6.913984	0.0000

The diagnostics are summarized in Table 8. The model passes the test of serial correlation, Heteroskedasticity, correct specification, and the normal distributed residuals.

Table 8

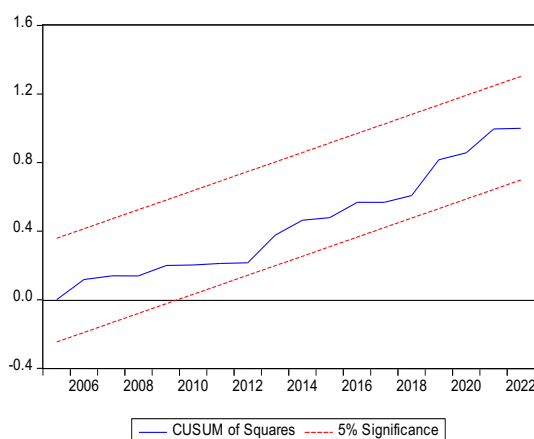
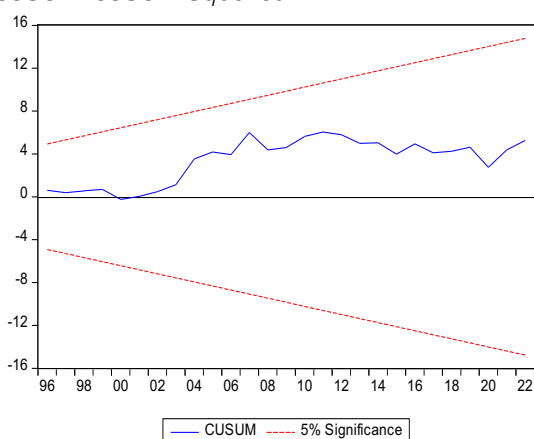
Diagnostic Analyses

Test	Statistics (Prob. Chi-Square)	Conclusion
Breusch-Godfrey Serial Correlation LM Test	0.72	No serial correlation
Heteroskedasticity Test: Breusch-Pagan-Godfrey	0.88	No issue of heteroskedasticity
Ramsey RESET Test	0.44	Model is correctly specified
Jarque-Bera	0.89	Residuals are normally distributed

Finally, the CUSUM and CUSUM squared results are represented in Figure 1. The analyses conclude the stable regression estimates with structural stability.

Figure 1

CUSUM-CUSUM Squared



Conclusions and Policy Suggestions

This study was carried out to trace the joint effect of FDI and tax on producer on the industry value added of Pakistan. For the purpose of regression analyses, the secondary time series data was assembled for the year 1980 to 2023. The methodology of ARDL gave the results that the joint effect of FDI and tax on producers is significant and negative on the industrial value added of Pakistan. Therefore, the long-term policy making by the stake holders need to focus upon these two variables for a fruitful industrial output at the back of FDI and tax on producers. As a policy option, the government of Pakistan needs to have a catharsis while introducing new taxes on producers since either of the positive effects of FDI are settled down due to taxes on producers. Also, it is essential to take care of the variables like domestic credit to private sector, which is founded as an industrial build-up in this study. Doing that so can support industrial advancement to be reckoned without any futile.

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