Available Online
Journal of Economic Impact
ISSN: 2664-9764 (Online), 2664-9756 (Print)
https://www.scienceimpactpub.com/jei

DECODING THE DRIVERS OF PAKISTAN'S FDI STORY: THE ROLE OF DEMOCRACY

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ARTICLE INFO

Article history
Received: December 18, 2024
Revised: February 25, 2025
Accepted: March 03, 2025

Keywords
Democracy
FDI
Pakistan

ABSTRACT

With an emphasis on foreign direct investment (FDI) inflows, research on Pakistan's democracy and political corruption can guide policy decisions, and promote sustainable growth by finding viable areas and avoiding risks. Utilizing up to date data, time series data from 1992 to 2021 the study documents significant historical shifts, including the COVID-19 pandemic, the 2008 global financial crisis, the energy crisis, the China-Pakistan Economic Corridor, the war on terror, US sanctions, and the war on terror. The objectives are to find how FDI inflows respond to democracy in Pakistan and to provide valuable policies for the future. The stationarity of variables is checked by using an Augmented Dicky Fuller (ADF) test. The results of the ADF test show that stationarity in variables is at I(0) and I(1). It justifies the use of an autoregressive distributed lag model (ARDL). The results obtained through the ARDL model reveal that democracy has a positive impact on FDI. It also empirically proves the short-run result convergence towards the long run. Pakistan's democracy faces obstacles such as economic downturns, corruption, and military takeovers. To improve FDI inflows it's required to support a democratic regime, expand trade openness, and strengthen investor protection.

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https://doi.org/10.52223/econimpact.2025.7108

INTRODUCTION

The investment made by a citizen of one nation to purchase long-term ownership in another nation is known as FDI. It is a significant driver behind the integration of global economies. It can improve societal well-being, foster economic growth, and offer financial stability when combined with the appropriate policy framework. FDI is crucial for a transparent global economic system and progress. However, its benefits are not evenly distributed among nations, industries, and local populations. National policies and an effective international investment framework are needed to attract FDI to developing nations and fully utilize its developmental advantages. Host countries must develop a transparent, inclusive, and efficient investment policy framework. Citizens view democratic politics and systems as more legitimate, and most states use democracy as a vertical legitimization technique to connect institutions, society, and regimes. Democracy indirectly influences growth by promoting Political Stability (PS), inhibiting extra-constitutional change, and favoring constitutional change. Over the past two decades, FDI has boosted global productivity, attracted domestic firms, and moved low-productivity industries closer to international efficiency standards. However, due to elevated political risk in developing nations, FDI is mainly concentrated in a few countries. Redirecting FDI to less corrupt nations may have an impact on other nations (OECD, 2002; Jensen, 2003; Mody, 2004; Mathur and Singh, 2013; OECD, 2009; Qazi, 2013). Investors prioritize stable democracy in investment decisions despite democratic governments. However, Pakistan's democratic environment, characterized by political instability and incumbents who are disadvantageous, has historically encouraged extractive behavior among politicians and governments, leading to a vicious cycle of collapse (Rehman et al., 2009; Afzal, 2019).

Foreign companies prioritize institutional properties and government leaders' time horizons when considering FDI; regulations are crucial determinants of inward FDI. A democratic state, Pakistan's democracy allows diverse ideologies to participate in politics, allowing for political revolution. In Pakistan, FDI is more successfully attracted by the military government than the democratic one (Uddin et al., 2019). Democracy does not attract FDI, but consolidated democracy does. Investors prefer low political risk, a corruption-free economy, and excellent governance, while state fragility makes a state vulnerable. (Raza et al., 2021; Lacroix et al., 2021). Pakistan scores weak for political stability in the 2020 corruption perception index (Bokhari et al., 2021). Political instability leads to investment mistrust, polarization, and uncertainties. Maintaining stability requires political will, dialogue, and due process (Fernández et al., 2023).

The research investigates the impact of democracy on FDI inflows in Pakistan, aiming to find how FDI inflows respond to democracy in Pakistan and to provide valuable insights for future policies. It focuses on the variations among Pakistan's democratic regimes to better understand their circumstances and outcomes. The study uses up-to-date data from notable historical events including the United States sanctions after Pakistan`s nuclear tests in 1998, the dictatorship to democratic shift, the war on terror, the global financial crisis in 2008, the energy crisis in Pakistan, China Pakistan Economic Corridor (CPEC), and the COVID-19.

Developing countries like Pakistan struggled to attract significant FDI due to balance-of-payments issues, political instability, and economic imbalances despite liberalized FDI regimes and incentives (Khan, 1997). Economic globalization pressed states to manage changes, perform tasks, and provide public goods, affected PS through deep integration and capital mobility, and

potentially caused new ethnic violence (Van, 1998). Institutional quality affected FDI statistically and economically. FDI is discouraged by a government`s lack of commitment, a heavy regulatory burden, and unpredictable policies (Daude and Stein, 2007). Institutional and political connections have a detrimental regulatory effect on the success of FDI (Peng et al., 2008). A reduction in political risk and favorable business conditions increased FDI inflows. Institutions play a significant influence in recruiting foreign investors (Krifa and Matei, 2010). Higher corruption and less democracy draw more significant FDI inflows, while host countries with higher political rights saw higher FDI outflows. Democracy and government corruption negatively correlated with FDI inbound performance (Kim, 2010). Political Stability (PS) was crucial in attracting investment; the global financial crisis had drastically decreased FDI inflows into developing market countries (Arbatli, 2011).

Strong governance attracts more FDI than weak government. Accountable authority and political framework encouraged long-term investment (Mengistu and Adhikary, 2011). U.S. policy doesn't significantly impact Pakistan's FDI in the long term, but trade openness and deteriorating diplomatic relations may have short-term negative effects (Khan, 2011). PS at higher levels facilitates the efficient intake of FDI advantages by financial development (Dutta and Roy, 2011). Good governance increased total investment, and corruption and political instability were significantly influenced. PS is critical to the link between FDI and domestic private investment, as rising FDI reduces private investment while increasing total investment (Morrissey and Udomkerdmongkol, 2012).

Political instability negatively affected FDI inflows in Pakistan, while trade openness positively influenced FDI (Talat and Zeshan, 2013). Democratization increased labor's political clout and benefits from unrestricted inflows, which increased FDI openness. Democracies imposed restrictions on the manufacturing and service sectors, underscoring the political economy roots of the modern global economy (Pandya, 2014). Political risk, both short and long-term, has an adverse effect on Pakistan`s FDI (Nasreen and Anwar, 2014). PS, regulatory quality, market size, and development level positively impacted FDI inflows, and good governance significantly influenced these inflows. Corruption discouraged multinational investment, making the host economy's human capital and openness insignificant (Shah and Afridi, 2015). The FDI in Pakistan was positively impacted by currency exchange rates, open trade, and GDP durability, while credit rating adversely affected it (Nadem, 2015). Pakistan needs PS to draw in FDI. In developing nations, FDI was considered a growth-promoted factor that enhanced technology, reduced unemployment, fostered talent development, and boosted market competition and exports (Najaf and Najaf, 2016).

FDI was significantly influenced by PS and human capital. Trade openness was successful in South Asia. Meanwhile, PS, inflation, and GDP strongly influenced FDI in East Asia and the Pacific (Sabir and Khan, 2018). Political instability in domestic and labour politics are critical factors in drawing FDI. The inconsistent effects of labour politics draw attention to the conflict between globalization and democratic accountability, as well as the necessity for an advanced approach to labour preferences (Li et al., 2018). Pakistan's PS, low law and order risk, and the absence of foreign conflicts encourage short-term investment. In contrast, long-term investment is adversely influenced by internal conflicts and the country's investment profile (Asif et al., 2018). FDI in South Asian countries is primarily driven by government spending exceptions, PS, trade openness, and corruption control (Afzali, 2018). According to studies, FDI positively correlated with PS (Zangina et al., 2019). Institutional quality was in favor of FDI. Government effectiveness, PS, and regulatory quality exhibit higher coefficients for developed countries (Sabir et al., 2019). Political regimes significantly influenced FDI. (Sarajcic and Muslija, 2020). Political instability negatively impacted international investment and trade but insignificantly impacted long-term FDI and imports, limiting short-term foreign portfolio investment and export (Qadri et al., 2020). PS played a significant role in the gain of FDI since investors choose to do business in nations that uphold their rights. Additionally, FDI promotes PS (Sarajcic and Muslija, 2020). Although the effects differ between nations, PS indicated that it has a beneficial effect on FDI inflows. Regarding PS indicators, developed nations that received investment typically have higher significance levels. Conversely, developing economies that export FDI tend to have lower levels of influence from PS drivers (Groznykh et al., 2020).

Indicators of PS were insignificant for industrialized and developing countries alike, but FDI flows significantly influenced different levels of development, while "Government Stability and Democracy" negatively impacted FDI flows (Vasilyeva and Mariev, 2021). PS did not significantly influence FDI inflows, but a stable foreign investment ecosystem can boost production capacity, trade balance, GDP, and welfare (Wijaya et al., 2021). FDI promotes PS, quality institutions, and human rights preservation while aiding development through investment promotion programs and political agencies (Okara, 2022). Southeast Asia's FDI benefits from political stability, economic growth, and corruption perception index but not inflation or exchange rates (Nairobi and Amelia, 2022). PS and trade openness both attracted FDI, but trade openness enhanced the effects of PS in drawing FDI (Le et al., 2023). Foreign investment despite the negative impact of PS. (Sari et al., 2023). Political instability and Corruption control negatively impacted economic progress in Southeast Asia, while FDI positively correlated with government spending and growth in developing nations (Rosli and Kamaluddin, 2023). PS and trade openness both were favorable in drawing FDI, with trade openness functioning as a moderator to amplify PS's benefits. Political instability adversely impacted FDI (Perveen and Ayyoub, 2023).

In this study we initially provide an introduction of the study covering different aspects, then we critically evaluate the literature review of prior research. Thirdly, outlines both the conceptual and theoretical frameworks guiding the research, and then the details of data and methodology are discussed after that we present the estimation and results, with subsections on the bound test, long-run estimates, short-run estimates, and diagnostic tests. Finally, we conclude the study and offer recommendations.

Conceptual Framework

Figure 1 shows a conceptual framework that hypothesizes the relationship between democracy, corruption, trade openness, gross fixed capital formation, and FDI. This framework serves as a visual guide for empirical investigations, highlighting the influential relationship between political and economic variables that influence investment mobility.

Figure 1. Conceptual framework illustrate by author.

Theoretical Framework

Before 1950, A subset of portfolio investment was considered to be FDI, with no distinct theory. The rate of return theory, an early neoclassical theory explaining FDI, postulated that to obtain the best returns, capital moves from nations with low to high returns (Hymer, 1976). Democracy, however, may also lessen the incentive for governments to provide "sweet deals" to FDI and hinder monopolistic profits. Another study argued that democratic institutions can hinder and promote FDI by weakening monopolistic positions, preventing incentives, and providing broad access to elected officials. It contends that Open market policies are more effective in attracting FDI, especially for developing nations. Capable governments are committed to a profitable investment environment, while incapable ones may promote policies that hinder FDI. Higher FDI levels are drawn to democratic regimes because they pose less risk. Doubts arise regarding the apocalyptic relationship between FDI and democratic political institutions, with some arguing that FDI to GDP is up to 70% higher under democratic regimes. Corruption in 73 nations attracts FDI, proving Leff's 1964 assertion (Jensen, 2003; Egger and Winner, 2005; Jakobsen and de Soysa, 2006; Coan and Kugler, 2008). There is a need to be a comprehensive theory of FDI, and most theories focus on incentives from advanced countries. Clarity is needed regarding the motivations behind FDI by less developed nations. Ricardo's comparative advantage theory could be a starting point for understanding FDI driven by natural and acquired elements (Marandu and Ditshweu, 2018).

The significance of democratic governance in economic reforms was emphasized in the 1980s and 1990s. The macroeconomic stabilization and budgetary adjustments that underpin the Washington Consensus have remained the same. The emphasis of New Institutional Economics was on norms that shape outcomes. Contrary to popular belief, a well-functioning democracy could support market economies. Collaborations with various trade associations and organizations were essential to a sustainable shift to democratic, market-oriented systems (Sullivan, 2002).

METHODOLOGY

The study used time series data from 1992 to 2021 from reliable and credible sources, including WDI (World Development Indicators) and V-dem (Varieties of Democracy) for dependent variable FDI, independent variable democracy, and also for the gross fixed capital formation, corruption, and trade openness as a controlling variable. All variables are described in Table 1.

Table 1. Description of variables.

Variable	Measurement	Description	Source
Foreign Direct Investment (FDI)	FDI, net inflows (BoP, current US$)	The equity movements in a reporting economy, which include equity capital, earnings reinvestment, and other capital, are referred to as FDI. When a citizen of one economy controls or exerts influence over another enterprise, it is referred to as a cross-border investment. Direct investment relationships need ownership of 10% or more voting shares. Current U.S. dollars are used for data.	World Development Indicators (WDI)
Democracy	Participatory Democracy Index (PDI)	PDI provides comprehensive information on voting rights, election freedoms, association and expression, citizen engagement in government, civil society, and direct democracy, ranging from 0 to 1.	Varieties of Democracy (V-dem)
Gross Fixed Capital Formation	Gross fixed capital formation (constant LCU)	Gross capital formation is the sum of fixed asset expenditures and net inventory changes. Fixed assets consist of land upgrades, plant purchases, and buildings. Inventories are stockpiles of items kept by businesses to cover production changes. Capital formation includes net acquisitions of valued assets.	WDI
Corruption	Political corruption index	It assesses bribery and theft in the executive, legislative, judiciary, and bureaucracy, as well as the potential for corruption in law-making and implementation.	Varieties of Democracy (V-dem)
Trade Openness	Trade (% of GDP)	The total amount of products and services imported and exported, represented as a percentage of GDP, is known as trade.	WDI

Model Specification

In the times series framework, we should employ autoregressive distributed lag (ARDL) if the variables are stationary at I(0) and I(1), Or if all variables are stationary at I(0) then we use ordinal least square (OLS), Or if all variables are stationary at I(1) then we use Johansen co-integration by using EViews. In order to ascertain whether the variables are stationary, the unit root test is utilised.

Foreign Direct Investment = f (Democracy, Gross Fixed Capital Formation, Corruption, Trade Openness)

$$\ln FDI_t = \alpha_0 + \beta_1 \ln D_t + \beta_2 \ln GFCF_t + \beta_3 \ln C_t + \beta_4 \ln TO_t + \epsilon_t \quad (1)$$

$\ln FDI_t$ (Foreign Direct Investment) is a dependent variable where $\ln D_t$ (Democracy), $\ln GFCF_t$ (Gross Fixed Capital Formation), $\ln C_t$ (Corruption), and $\ln TO_t$ (Trade Openness) are independent variables with β`s that are coefficients that show the change in FDI due to change in the independent variable α is intercept and ∈ is the residual term that shows unexplained variance in the model. t represents time series data.

ADF Stationary Check

The finding in Table 2 indicates that the study`s variables are stationary at I(0) and I(1). Dickey & Fuller created the Augmented Dicky Fuller (ADF) test in 1979 to demonstrate stationarity (Kurecic and Kokotovic, 2017). In the event of the critical value ADF > t, demonstrating the stationarity of the data at 5%, the decision method is followed in rejecting the null hypothesis. The outcomes of the ADF test will guide the model's methodology; Pesaran et al. (2001) introduced method autoregressive distributed lag (ARDL) can be used when all the variables are stationary at a position between I(0) and I(1) (Kaleemuddin and Masih, 2017; Nasrullah et al., 2021; Abdullah et al., 2023) can be utilized in place of the Johansen co-integration approach, which fails.

ARDL

ARDL models examine dependency with time series data. It allows explanatory variables and prior realizations to have an impact on the dependent variable's current value. Apart from conducting cointegration tests and determining the optimal number of lags through the use of Akaike or Schwarz/Bayesian information criterion, Long and short-term effects can be distinguished using ARDL models. (Kripfganz and Schneider, 2023). The ARDL model analyzes long and short-run variable effects, cointegration analysis, and error correction mechanisms with high adjustment speed (Shaari et al., 2022; Abdullah et al., 2023). The scientific procedure is illustrated in Figure 2.

Table 2. Stationary check (Unit root test results).

Variables	At level			At first difference			Order of Integration
	Constant	Trend	None	Constant	Trend	None	
lnFDI	-1.7302	-3.4395	0.7573	-4.3767			I(1)
	(0.4061)	(0.0678)	(0.8710)	(0.0019)			
lnD	-1.8770	-2.0714	-0.2538	-3.8328			I(1)
	(0.3377)	(0.5386)	(0.5860)	(0.0071)			
lnGFCF	-0.9687	-4.3662					I(0)
	(0.7502)	(0.0098)					
lnC	-1.8538	-2.1124	0.0047	-4.5958			I(1)
	(0.3483)	(0.5177)	(0.6760)	(0.0011)			
lnTO	-9080	-2.2784	-0.7921	-5.6221			I(1)
	(0.3242)	(0.4317)	(0.3642)	(0.0001)			

Note: P-value in Parentheses or (round) brackets.

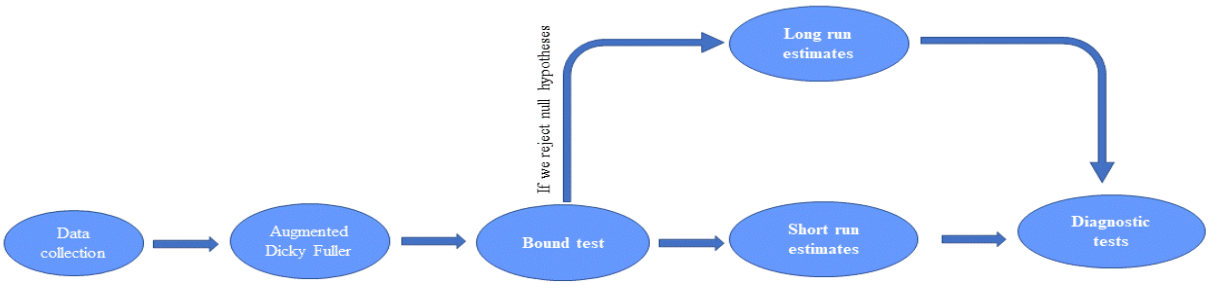

Figure 2. Scientific procedure.

ARDL Model

$$\Delta \ln FDI_t = \alpha_0 + \sum_{i=1}^{p_1} \delta_1 \Delta \ln FDI_{t-1} + \sum_{i=0}^{p_2} \delta_2 \Delta \ln D_{t-1} + \sum_{i=0}^{p_3} \delta_3 \Delta \ln GFCF_{t-1} + \sum_{i=0}^{p_4} \delta_4 \Delta \ln C_{t-1} + \sum_{i=0}^{p_5} \delta_5 \Delta \ln TO_{t-1} + \beta_1 \ln FDI_{t-1} + B_2 \ln D_{t-1} + \beta_3 \ln GFCF_{t-1} + \beta_4 \ln C_{t-1} + \beta_5 \ln TO_{t-1} + \epsilon_{it} \quad (2)$$

Error Correction Model

$$\Delta \ln FDI_t = \alpha_0 + \sum_{i=1}^{p_1} \gamma_1 \Delta \ln FDI_{t-1} + \sum_{i=0}^{p_2} \gamma_2 \Delta \ln D_{t-1} + \sum_{i=0}^{p_3} \gamma_3 \Delta \ln GFCF_{t-1} + \sum_{i=0}^{p_4} \gamma_4 \Delta \ln C_{t-1} + \sum_{i=0}^{p_5} \gamma_5 \Delta \ln TO_{t-1} + \omega ECM_{t-1} + \epsilon_{it} \quad (3)$$

RESULTS AND DISCUSSION

Bound Test

Table 3 presents the Bound Test results for long-run relationship in model. The F statistic value is 5.0465, with K = 4. The null hypothesis is rejected as the F statistic is larger than the upper bound critical values at 5% significance levels. This implies that the variables form a long-run equilibrium relationship, indicating their long-term relationship.

Long-run Estimate

In Table 4, long-run estimation reveals that all variables in the model are statistically significant at a 5% level. Pakistan's FDI inflows have been positively impacted by democracy, with a 1% increase in democracy leading to a 3.6030% increase in FDI. FDI inflows are favorably impacted by gross fixed capital formation (GFCF) for every 1% increase in GFCF, FDI inflows rise by 3.7016 %. FDI inflows decreased by 15.9223% for every 1% increase in corruption, indicating the adverse impact of corruption. Trade openness (TO) has a favorable impact on FDI inflows; an increase of 1% in TO brings a 3.4219% increase in FDI. C is the intercept of -41.4953% of the change in FDI inflows when all the other variables are constant.

Short Run Estimate

The model's short-run dynamics shown in Table 5 that the dependent variable is the log net FDI inflows, with no significant short-run effect of government consumption expenditure (LGCE) on FDI inflows. However, a significant negative impact of political corruption (LPC) on FDI inflow is observed at a 5% level with a 1% increase in political corruption leads to 4.37% decrease in FDI inflows. The model concludes that FDI inflows in the short term are significantly influenced by government effectiveness (GE(-1)), with a 1% increase in government effectiveness brings 0.64% FDI inflows.

Diagnostic tests

Ramsey's RESET test, developed in 1969, assesses the suitability of a regression's functional form. RESET test identifies missing variables and unsuitable functional forms, making it a helpful misspecification test (Ramsey, 1969; Shukur and Mantalos, 2004). Our results in Table 6 indicates no problem in the model's functional form. The Breusch-Pagan test is a statistical approach for detecting linear heteroskedasticity (Breusch and Pagan, 1979) developed by contrasting the alternative, which is that error variances are multiplicative functions of several variables, and the null hypothesis, which is equal error variances. Hence, our results indicate that the error variance is constant, a desirable attribute for the fitted model.

The Breusch-Godfrey test yielded a p-value of 0.1820, which suggests that there isn't a significant serial link among the residuals. One popular technique for figuring out univariate normality is the Jarque and Bera (1980) test. This test is commonly used in econometrics to determine normalcy. In statistics, it was often called the D'Agostino and Pearson (1973) or Bowman and Shenton (1975) test. As noted by Kim (2016) modifications were proposed by Urzua (1996), subsequently elaborated by Gel and Gastwirth (2008). A statistical method for assessing if a dataset has a normal distribution is the Jarque-Bera test. The findings, often reported as a p-value, are utilised to analyse the data. If the p-value is less than the significance threshold of 0.05, the null hypothesis needs to be rejected (Khadka, 2023).

Table 3. Bound results.

Test Statistic	Value	K
F-statistic	5.0465	4
Critical Value	Lower Bound I(0)	Upper Bond I(1)
10%	2.2	3.09
5%	2.56	3.49
1%	3.29	4.37

Table 4. Long-run results.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Log of Democracy	3.6030	1.2312	2.9264	0.0081
Log of Gross Fixed Capital Formation	3.7016	0.5798	6.3838	0.0000
Log of Corruption	-15.9223	4.9359	-3.2258	0.0041
Log of Trade Openness	3.4219	1.0063	3.4004	0.0027
C	-41.4953	8.5365	-4.8609	0.0001

Note: The log of net FDI inflows is a dependent variable; Sample: 1992 – 2021.

Table 5. Short-run results.

Log of net FDI inflows in dependent variable Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LGCE)	0.4177	0.7050	0.5925	0.5598
D(LPC)	-4.3678	1.5768	-2.7700	0.011
D(GE(-1))	0.6434	0.1050	-6.1228	0.0000

Table 6. Diagnostic tests.

Diagnostic tests	Test	Prob.	Null Hypothesis	Decision
Functional Form	Ramsey Reset	0.9111	No problem with the functional form	Do not reject the null hypothesis
Heteroskedasticity	Breusch-Pagan	0.1613	No problem of heteroskedasticity	Do not reject the null hypothesis
Serial Correlation	Breusch-Godfrey (LM)	0.1820	No problem of serial correlation	Do not reject the null hypothesis
Normality	Jarque-Bera	0.7520	Data is normally distributed	Do not reject the null hypothesis
CUSUM	Unstable			
CUSUM of Square	Stable			

The CUSUM and CUSUM SQUARE illustrated in Figure 3 and Figure 4 respectively, tests are used to examine the model's structural stability, ensuring that its coefficients remain consistent throughout the analyzed period. The Recursive Coefficient Test was conducted to confirm the parameters' stability (Alam and Ahmed, 2012), with coefficients showing no significant variation as more data is added to the estimating equation.

Pakistan has had many military takeovers, corrupt administrations, leaders that are power-hungry, economic failures, and acts of Islamic terrorism (Bora, 2010), which is why the CUSUM test illustrated in Figure 3 results indicate unstable. Military domination has been fostered by the lack of international backing for democratic governance. Pakistan has had democratic governments since independence, but it faces challenges such as delayed elections, a political elite-public divide, martial law, civil-military relations, and a lack of public education and awareness. Pakistan's democracy is widely supported by the population, but 63% have lost faith in its governance, economic management, law enforcement, and corruption reduction. Economic inequality, corruption, fraud, and foreign interference are serious risks to democracy. The ruling class gets greater privileges than the poor. Akbar Zaidi contends that challenges to democracy exist, with the higher judiciary posing a greater concern (Bibi et al., 2018).

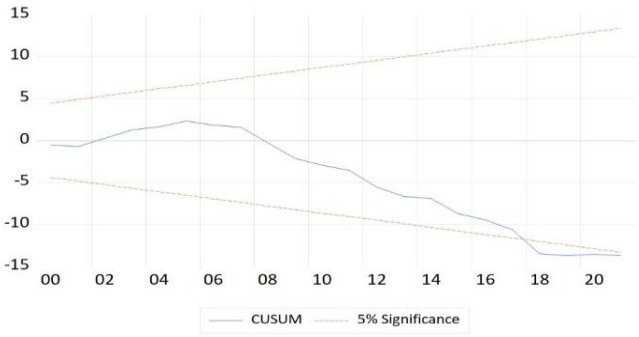

Figure 3. CUSUM

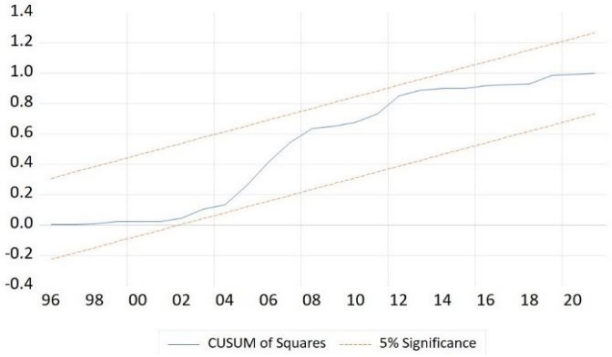

Figure 4. CUSUM of square.

Recursive Coefficient Test

Recursive estimates shown in Figure 5 explain the updating parameters as new observations become available.

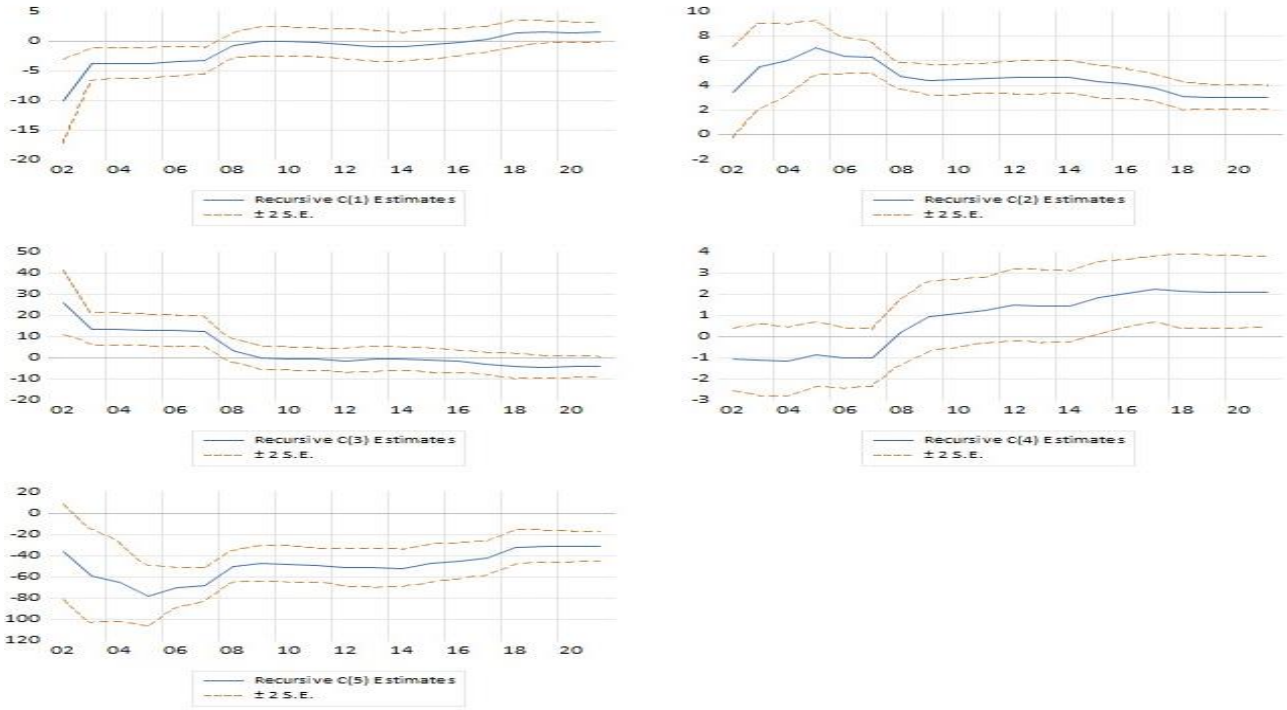

Figure 5. Recursive coefficient.

CONCLUSIONS AND RECOMMENDATIONS

Pakistan has seen substantial changes during the last three decades, with foreign direct investment (FDI) being an important player in boosting economic integration, employment, and growth. The time series data from Pakistan taken and the ADF test are utilised to ascertain the model's approach, and the variables show stationary at I(0) and I(1). The study used ARDL to analyze the impact of the times series framework. The model allows for the influence of previous realizations and explanatory factors. Because the null hypothesis of ARDL long run form and Bound test is rejected. So, the long-run and short-run impacts are analysed by the ARDL model, which demonstrates that at a 5% level of significance, all the variables are significant in the long run. The empirical evidence indicates that FDI is positively impacted by democracy, gross fixed capital formation, and trade openness. However corruption influences adversely FDI inflows into Pakistan. Short-run results show the convergence toward equilibrium. The CUSUM test shows unstable because Pakistan`s

democracy has faced numerous challenges, including military coups, corruption, and economic setbacks. Economic inequality, corruption, and foreign interference pose serious risks to democracy, with the ruling class receiving greater privileges. Pakistan's FDI inflows should be improved by ensuring a democratic regime, combating corruption including streamlining regulatory procedures through focusing on long-term reforms, promoting trade openness by providing incentives for FDI, and strengthening investor protection.

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