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The Role of Bilateral Investment Treaties in Promotion of Foreign Direct Investment Inflows: Evidence from Small Open Economy

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ABSTRACT

Many developing countries have targeted foreign direct investment as a significant policy variable in the recent past. To promote foreign direct investment, various governments across the globe are focusing on bilateral negotiations with other countries. Currently, the government of Pakistan is also part of 48 treaties. These treaties aim to promote foreign direct investment and provide legal protection to foreign investors. The current study investigates the role of these treaties in promoting foreign direct investment. The study used panel and time-series data to credibility the research findings. The timespan for time series analysis is from 1985 to 2015, whereas panel data analysis is from 1998 to 2015. Sixteen countries have been selected for panel data analysis. The study's findings show that Bilateral Investment Treaties have an insignificant contribution to achieving the specific goal of attracting FDI inflows. However, the study's findings reveal that other factors such as trade openness, physical infrastructure and size of the economy facilitate foreign direct investment. In contrast, the factors that hurt the motivation of foreign investors are exchange rate volatility and political instability.

Introduction

Over the last three decades, a strong impetus for economic development across countries has been provided by the (FDI) inflows. Among all forms of capital inflows, the importance and impact of foreign direct investment (FDI) is considered superior. FDI provides additional capital inflows and helps the host economy enhance economic growth and development by introducing modern technology and managerial skills (Bhasin & Manocha, 2016). An inspiring characteristic of FDI inflows is to create opportunities for ameliorating the level of production and service sector (Hayakawa et al., 2020; Piteli et al., 2021). These impacts have increased the level of interest among the researchers to aim theoretical and empirical literature to investigate the relationship among FDI flows for the related determinants. One of the determinants used by developing countries to increase FDI volume is signing bilateral investment treaties (BITs).

On the other hand, only individual commitments will be affected in case of a breach of obligation. BITs provide a clear path for foreign investors for understanding possible ways with the help of which they can file a suit against the governing agencies in charge of default. The developed states also sign BITs to protect investments in less developed countries (Salacuse & Sullivan, 2005). Elkins et al. (2004) stated that the studies conducted in recent decades have shown that BITs have become unanimously adopted international legal mechanisms that play a vital role in the effective governance and encouragement of FDI. The ground realities of the numerous BITs predict the need of moving toward BITs to promote FDI flows within the country.

Moreover, the popularity of BITs is because of the perceptions of the policymakers that signing them will increase the ratio of FDI flows. But it is an important question whether these treaties accomplish their stated purpose or not. Soon after the 1990 election, an intense privatisation and liberalisation program was started. Since being liberalised in 1990, Pakistan has been inviting vast FDI inflows. The liberalisation regime has become part of the enhancing negotiation in BITs regarding the frequency of its trade and increasing investment partners. Pakistan is currently part of 48 BITs that have been involved in extending legal protection to foreign investors. Pakistan started the talk on forming a BIT with the US in 2005. Afterwards, Pakistan-US relations weakened, and these talks stopped.

Meanwhile, Pakistan signed BIT with Turkey in 2012. Then negotiations with the US resumed in 2013, but BIT couldn't be signed again. In 2014 a BIT was signed with Bahrain, which came into force in 2015. Currently, the government is trying to enforce the BIT signed with Turkey. An overview of Pakistan's FDI net inflow from other countries over the years is shown in figure 1, and the Volume of FDI along with BITs is shown in figure 2, respectively. Figure 1 represents the aggregate (from 1985 to 2015) FDI net inflows of each country selected in the panel data analysis. Foreign direct investment is measured on Y-axis, and the countries are labelled on X-axis. It can be observed from the figure that the massive volume of FDI inflows came from the US.

On the other hand, Pakistan hasn't signed the BIT with the US. Pakistan hasn't signed BITs with the other three countries, i.e. Hong Kong, Saudi Arabia and Canada. These four countries make 35% (the only US makes 25.6%) of aggregate (from 1985 to 2015) FDI inflows. The results showed that none of the variables is highly correlated.

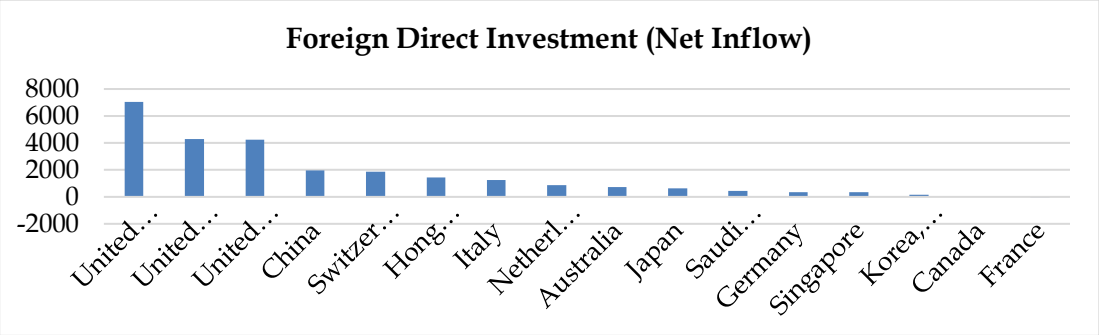


Figure 1: Country-Wise Foreign Direct Investment

Following figure 2 shows the minimum of both FDI and BIT's from 1985 to 1995. However, the number of BITs increased from 9 to 20 from 1995 to 1996, and the FDI has also risen sharply in the same era. In contrast, the Number of BITs grew to 36 till 2001, but FDI has shown a downward trend in this era. From 2001 to 2007 number of BIT's hasn't increased much, but FDI has increased with its maximum potential. From 2008 till the end of the data, BIT's has remained almost constant, but FDI has shown an explosive trend. Hence, it could be summarised that no clear relationship exists between the frequency of Bilateral Investment Treaties and FDI.

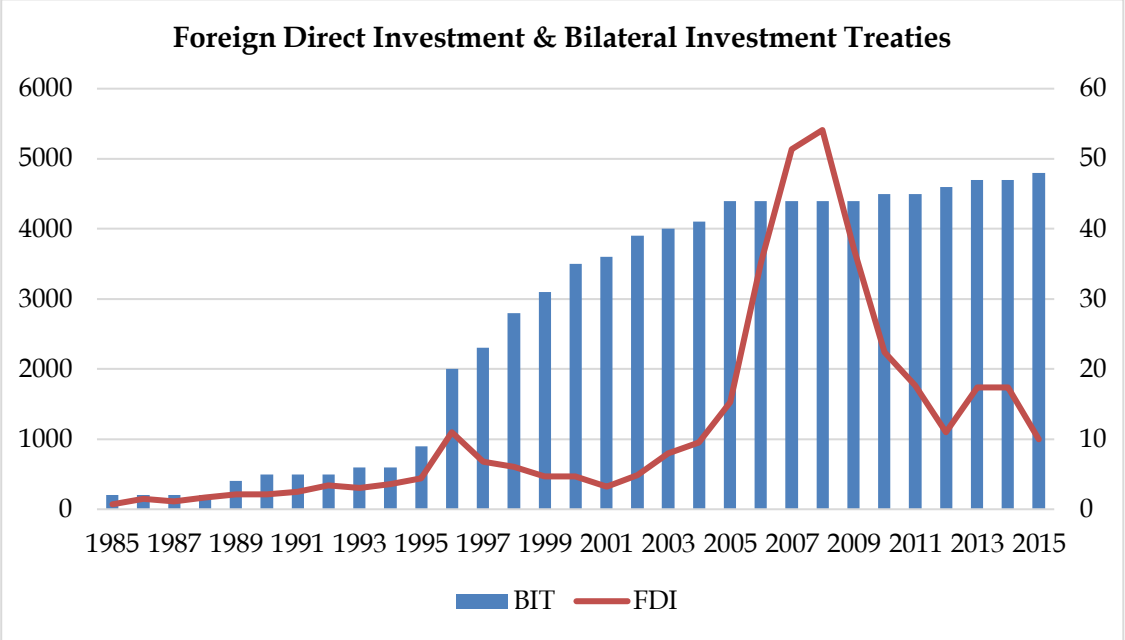


Figure 2: Foreign Direct Investment & Bilateral Investment Treaties

To the best of our knowledge, the relationship between FDI and BITs is not evaluated empirically, even by a single study specifically for Pakistan. Thus, the current study will fill this gap by analysing the role of previous BITs in attracting FDI. The study has manifold objectives (a) To estimate the empirical relationship between BITs and FDI, (b) To find the impact of economic factors on FDI, and (c) To identify the non-economic factors that influence the FDI.

The current study comprises five sections, and they are organised in the following manner. The literature review is provided in the 2nd Section. Material and methods are described in the 3rd Section. The results and discussion have been presented in the 4th Section. And lastly, the 5th Section contains the conclusion and policy implications..

Literature Review

An extensive literature has been carried out to analyse the role of BITs in promoting the FDI in developing countries. In this regard, Busse, Koniger, and Nunnemkamp (2008) found that the BITs could substitute weak domestic institutions. On the other hand, BITs promote FDI flows to developing countries. Similarly, Buthe and Milner (2004) hypothesised that BITs with a developing country as a partner are more attractive for making profitable investments. Considering the economies of Southeast Asia, East Asia, and South Asia, Banga (2003) accounted for

the effect of summarised frequency of agreed BITs on flows of FDI. This study was conducted comprising 15 developing economies. The study's findings showed that BITs contracted with the developed countries did not yield a significant positive effect on the growth of aggregate FDI.

With the help of accounting for the regime shift incurred with the 1997 Asian Financial Crisis and using random coefficient panel models, Aisbett (2007) investigated the link between BITs and FDI inflows. This study revealed the positive effects of BITs on flows of FDI even in the pre-1997 era. This study also revealed that with each increasing number of BIT, the positive impact starts diminishing, suggesting that enhancing the frequency of BIT yields a comparatively lower FDI payoff. Considering the period of the Asian Financial Crisis, no statistically significant effects of Bilateral Investment Treaties on the inflows of FDI have been found.

Siegmann used a Gravity type and Knowledge-Capital type model, T. (2007) to assess the FDI flows from industrialised into developing countries. A panel data of 1364 country pairs and 25 observation years was used to conduct random effects, fixed effects, and Pooled OLS estimations. The results obtained from this study provided clear evidence about the significant positive impact of the investment agreements and DTTs on the growth of FDI flows.

Yackee (2008) examined the behaviour of foreign investors. The study observed whether formal international legal protections are strongly considered by foreign investors when they are deciding on an investment. Using extensive data from 1985 until 2011, Lejour & Salfi (2015) examined the BITs on bilateral FDI stocks. With the help of indicators for membership of international organisations and governance, they corrected for endogeneity. They found a 35% increase on average bilateral FDI stocks due to ratified BITs compared to pairs of the countries without a treaty. The study also revealed that the countries with high income and high governance levels do not profit. Compared to this, the countries with Upper middle-income were found very successful in benefiting from ratified treaties. The study found that mainly in Middle & Eastern Europe and East Asia, the ratified BITs increase FDI stocks.

Transition and developing countries use BITs as legal instruments to ensure protection to investors and promote enhanced levels of inflows of FDI. An in-depth study of the relationship between bilateral investment treaties and FDI revealed the influence of trade agreements on different modes of investment. Keeping this fact into consideration, the researcher examined the impacts of BITs on both horizontal and vertical FDI flows. In this regard, Sirr et al. (2017) found a positive relation of BITs with the vertical FDI flows compared to the horizontal FDI flows. The researchers also found that Bilateral Investment Treaties tend to play a vital role in establishing better institutions for vertical flows of FDI.

For dealing with the self-selection problem, Falvey & Foster-McGregor (2018) adopt a difference-in-difference analysis while budgeting the impacts of Bilateral Investment Treaties on FDI flows by considering a sample of OECD countries as compared to a large selection of less developed economies. There are mixed results from the studies conducted in the different developing countries. However, studies

found that the effect of BITs on FDI depends upon the stage of development of the economy. The current study identifies the determinants of FDI inflows in Pakistan with a particular focus on the role of Bilateral Investment Treaties.

Material and Methods

This section comprises three subsections. In the first sub-section model specification is explained. Variables and data sources are described in sub-section 2. Whereas, the econometric methodology is explained in sub-section 3.

Model Specification

The current study used both panel data and time-series data to investigate the role of bilateral investment treaties in promoting foreign direct investment. Hence, this Section is divided into two subsections, i.e. panel data analysis and time series analysis.

Panel Data Model

Tinbergen (1962) proposed the basic gravity model to explain international bilateral trade. This model, in literature, has been intensively used by researchers to evaluate bilateral trade and investment patterns. Two distinct domains are catered for foreign investment. These domains include market size expansion and production processes easing (Mishra, 2019; Dorakh, 2020). The market expansion is associated with horizontal motives, whereas the production process easing is associated with cheaper labour for vertical motivation. For explaining the investment, including vertical dimensions and horizontal explanation of FDI, Carr et al. (2001) used the extended gravity model. The determinant of the market size was used as an aggregate of GDP related to the contracting countries for encompassing horizontal motives. Furthermore, for examining the vertical motives, the variation in the GDP per capita of contracting countries was calculated. Thus, the CMM model, also known as the extended gravity-knowledge capital model, was used to evaluate the determinants of FDI inflows.

FDI flows or FDI have been used as a dependent variable in most empirical works on the gravity model for investment. In this regard, current research has selected panel data from different source countries. Thus, the usage of FDI flows would be more appropriate. Globerman and Shapiro (2002) presented that this is because the calculation of FDI stock would be heterogeneous across countries. The other reason behind this is the non-availability of the data for Pakistan's FDI stock. For this purpose, as a dependent variable, the data of the net FDI inflows were used. The variable takes negative values in some periods, so the log can't apply to the dependent side. On the independent side, a log is applied, so a nil-log (semi-log) is used in the model to calculate the regression for panel data to analyse the determinants of FDI inflows among Pakistan and its investing partner. For conducting this study, the basic regression equation used is as follows:

$$FDI_{it} = \alpha_0 + \alpha_1 BIT_{it} + \alpha_2 \ln(GDP_{it}.GDP_{jt}) + \alpha_3 \ln(GDPP_{it} - GDPP_{jt}) + \alpha_4 POL_{it} + \alpha_5 DIS_i + \varepsilon_{it} \quad (1)$$

In equation (1),

FDI_{it} = FDI inflows from the home country i to Pakistan for year t,

BIT_{it} = Dummy variable for Bilateral Investment Treaty,

GDP_{it} = Real GDP of the home country i,

GDP_{jt} = Real GDP of the host country j (Pakistan),

$GDPP_{it}$ = Real per capita GDP of the home country i,

$GDPP_{jt}$ = Real per capita GDP of host country j (Pakistan),

DIS_i = Distance between the home and the host country (Pakistan),

POL_{it} = Measure of political stability of host country (Pakistan) relative to home country,

Bilateral investment treaties being considered the variable of our interest is incorporated as a dummy variable. The value of the variable is taken as 1. This value is one only when a BIT exists between Pakistan and the investing countries in the given year, otherwise considered 0. For expecting to have a positive sign, the variable is used to capture the impact of BITs on Pakistan's FDI inflows.

The distance between the home country and the host country shows the geographical proximity. In this regard, the attraction of FDI can be evaluated through the geographical proximity between the host and home country. Distance is linked with the cost of transportation in the studies related to trade coverage as a dependent variable. Moreover, when FDI is taken as a dependent variable, the type of FDI will be affected by the distance between the countries (Egger, 2008; Kayam & Hisarciklilar, 2009). In investments made to achieve the production objectives and efficiency, the distance between the countries and the flow of investment is inversely proportional.

On the other hand, in the case of market expansion, a larger distance will have a positive relationship with the greater flow of investment to a destination economy. The study uses the Polity IV dataset from Penn World Table. After subtracting the score of autocracy from the score of democracy, the polity score has been computed. On the other hand, the unified polity scale ranges from +10 to -10, which represents highly democratic to highly autocratic, respectively.

Time Series Model

The impact of BITs on FDI inflows is also analysed through time series analysis to improve our findings' reliability of our results. The FDI flows can be determined based on different country-specific variables. One of the main determinants in this regard is the market size of the host country. The FDI investment is directly proportional to the host area's (country, region, and sub-region) total income and its potential for development (Billington, 1999). The larger the size, the greater the investment and vice versa. Investors pay more attention to the market size factor than the other variables. Goldberg and Klein (1998) suggested that FDI fosters more significant trade in intermediary inputs, increase exports, or import

substitution. Dunning (1993) and Markusen and Maskus (2002) stated that encouraging FDI-based activities is one of the major factors responsible for varying the impact of trade openness on FDI inflows.

At present, literature related to the effects of exchange rate variation on FDI starts with the basic assumption of the imperfection of the capital market. This element will ultimately encourage foreign investors to make further investments internally. In the same way, the FDI outflows will be enabled in case of the appreciation of the host country (Xing and Zhao, 2008). Furthermore, Pain and Van Welsum (2003) concluded that the effect of BIT on FDI inflows depends on the type of investment that a foreign investor is going to make.

A conducive business environment and average macroeconomic balance are entirely based on political stability. The country's political risks are most probably dependent upon the good governance in the country and political stability (Shahzad et al., 2012). In addition to this, Husain (2009) argued that political stability plays an essential role in enhancing the ratio of attracting more FDI inflows to developing countries. Schneider & Frey (1985) stated that other factors could act as a barrier in bringing foreign investment within the country. These factors include government intervention in the economic situations, change of regime, red tape, and property rights legislation. However, the investment behaviour of the foreign investor and that of international organisations could change with a good value of governance index. The study used political instability dataset from Penn World Table.

The time series model is as follows:

$$FDI_t = \beta_0 + \beta_1 BIT_t + \beta_2 VOL_t + \beta_3 POL_t + \beta_4 OPEN_t + \beta_5 PI_t + \beta_6 GDP_t + \beta_7 RER_t + \varepsilon_{it} \quad (2)$$

In eq. (2)

FDI_t = Total FDI net inflows in period t,

BIT_t = number of active bilateral investment treaties in period t,

VOL_t = volatility based on monthly data of real exchange rate. Volatility is measured using standard deviation,

POL_t = Political instability of Pakistan,

$OPEN_t$ = Economic Openness measured as total trade as a percentage of GDP,

PI_t = Physical infrastructure, measured by the length of roads,

GDP_t = Real GDP of Pakistan in period t,

RER_t = Real exchange rate, calculated by multiplying and dividing the official exchange rate with CPI inflation of the US and Pakistan, respectively.

Variables & Data Sources

Data related to the inflows of Pakistan's FDI from partner countries are taken from the Hand-Book of statistics in 2015. Data about the BITs negotiated by Pakistan has been collected from the Board of Investment Pakistan. The database of the World Bank has been used for collecting the data related to the independent variables the GDP per capita, the GDP, domestic credit to the private sector (FD) and trade as a percentage of GDP(OPEN). The monthly data on the official exchange rate and inflation (calculated based on the consumer price index) is taken from International Financial Statistic Database. The data relating to the political instability (Polity IV) is taken from the Penn world table database. The data relating to the distance between the capitals of contracting countries was collected from CEPII (French Research Centre for International Economics, 2013).

The timespan for time series analysis is from 1985 to 2015, whereas time in the case of panel data analysis is from 1998 to 2015. Following 16 countries have been selected in panel data analysis. The name of the countries is given in Table 1. More than 90% of FDI inflows are generated from these selected countries. Out of these 16 countries, ten countries have signed BIT's before 1998, two countries have signed BIT's during the specified time, and finally, four countries haven't signed the treaties.

Table 1
List of Countries Included in Panel Data Analysis

Countries having BITs			**Countries didn't Sign BITs**
Australia	Italy	Singapore	Canada
China	Japan	Switzerland	Hong Kong
France	Korea, Rep.	United Arab Emirates	Saudi Arabia
Germany	Netherlands	United Kingdom	United States

Econometric Methodology

Three approaches are used for panel data estimation. The probability value of the redundant fixed effects model is 0.00, which ultimately rejects the null hypothesis, i.e. there is no cross-sectional heterogeneity. It could also be expressed as; fixed and random effects models are preferred over pooled least square. Hausman test indicates that the results of the random-effects model are more efficient and consistent than the results obtained from the fixed-effects model. In addition to this, the time-wise fixed variable's distance variable could not be used in the fixed-effects model because it will create Perfect Multi-collinearity with dummies of fixed effects. In this case, the researcher cannot estimate the fixed effects model. For the time-series data, due to the mixed order of integration of the variables, the ARDL model is employed.

Results and Discussion

The results of panel data and time series data are reported separately. The results for panel data are reported in section 4.1, whereas the time series results are presented in section 4.2.

Panel Data Results

Table 2 shows the results of parameters of equation1 by using the random effects and fixed effects models considering the factors responsible for Pakistan's

inflows of FDI. The Hausman test dictated that the random-effects model is appropriate. Thus, the results of the random-effects model are used to interpret the coefficients of parameters.

Table 2
Panel Data Results

Dependent Variable: Foreign Direct Investment				
Variables	**Fixed effects**		**Random effects**	
	Co-efficient	**P-value**	**Co-efficient**	**P-value**
BIT	24.98	0.720	-20.08	0.689
MKT[1]	64.02**	0.019	52.17*	0.005
DWAGE[2]	24.38	0.321	22.31	0.218
POL	-5.25*	0.000	-4.99*	0.000
DIS			-82.20	0.239
C	-3649.22*	0.007	-2254.32**	0.023
Diagnostics	R^2	0.389	R^2	0.102
	Observations	288	Observations	288
	Redundant fixed effects test	120.2 (0.000)	Hausman test	3.95 (0.412)

Variables significant at 1% and 5% are represented by * and **, respectively.

If the probability value is low for the Redundant fixed effects test, then the Fixed effects model is preferred over the Pool model.

If the probability value is low for the Hausman test, the Fixed effects model is preferred over the Random-effects model.

[1] $MKT = \ln(GDP_{it}.GDP_{jt})$, [2] $DWAGE = \ln(GDPP_{it} - GDPP_{jt})$

A positive and significant value of market size (MKT) indicates the attraction toward horizontal inflows in FDI to Pakistan. Pakistan is a captive destination for market-seeking FDI due to its large market size. Meanwhile, the difference coefficient among the GDP per capita in both economies is quietly insignificant. It implies that Pakistan has failed to attract FDI as being host economy for vertical integration. Furthermore, the difference in the wage level may not be compensated for productivity. This element might negatively affect the differential GDP per capita (Globerman & Shapiro, 2002). Coefficient of time-invariant variable, distance has been found insignificant. Theoretically, the distance variable is positively related to FDI when the investment objective is to capture the local market, i.e. the distance between contracting countries is directly proportional to FDI (horizontal).

On the other hand, if the goal is gaining the level of efficiency of production, then, a lesser distance is favourable. So, distance has different motives for different kinds of FDI, and it isn't easy to separate them empirically. As distance is insignificant, Pakistan receives both vertical and horizontal FDI.

The variable evaluating the political stability is negative and significant. The negative sign depicts that the democratic and political environment is not investor-friendly. This result is quite surprising; it will be explained in the time series analysis. The value for the variable of interest, BIT, has also been found insignificant, showing that the BITs are unfavourable and failed to enhance the FDI inflows in Pakistan.

Thus, only signing the BIT's not enough to attract FDI. In time series analysis, it will explain the factors making BITs ineffective.

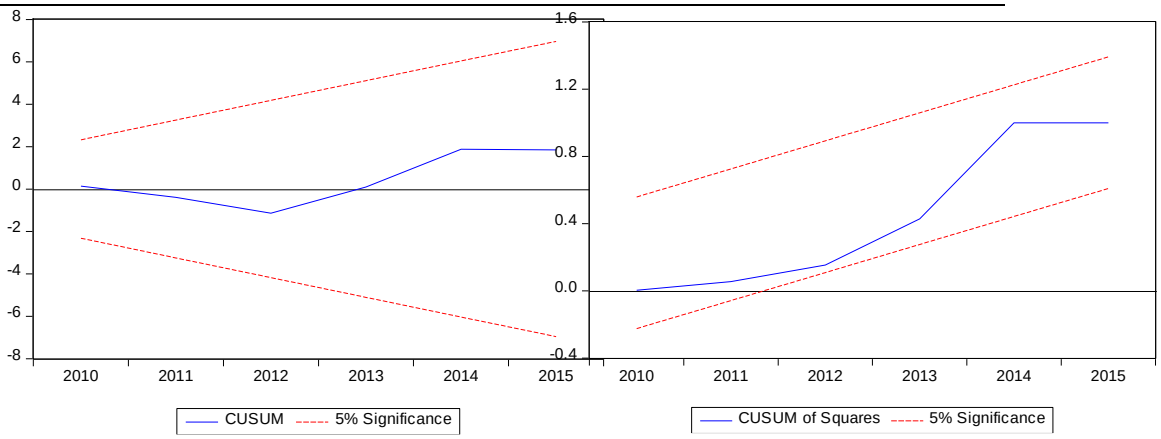
Time Series Results

Before discussing the time series results, as the efficiency and reliability of the model and coefficients depend upon the diagnostic test, the results of diagnostics of the ARDL model are presented in Table 3. The top panel in Table 3 shows that the value of bounds cointegration tests (i.e. F-stat) 7.93 is significant at a 1% level. The Akaike Information Criterion (AIC) selects an ARDL (2, 1, 1, 1, 2, 2, 2, 2) model for net foreign direct investment (FDI) for Pakistan. Jarque Bera test for normality to confirm whether residuals follow the white noise process. The results of LM, ARCH LM and Jarque Bera tests authenticate that there is no problem in the residuals. On the other hand, the Ramsey Reset test confirms no problem with the model's specification. And finally, the stability of parameters is assessed using CUSUM and CUSUMSQ tests.

The Adjusted R^2 is 0.981; hence our model explains 98.1% variations of the aggregate investment. The error correction (ECM) coefficient can also confirm the long-run and short-run relationship. For a significant relation, it should be between 0 and -1. In the Pakistan foreign direct investment model, it is negative and significant, i.e. -0.586. It means 58.6% of error is adjusted in one period, i.e. a year.

Table 3
Diagnostics of Time Series Regression (ARDL)

			I(0)	I(1)
Bounds test	F-statistic = 7.93	10%	1.92	2.89
		5%	2.17	3.21
		2.50%	2.43	3.51
		1%	2.73	3.90
	Test statistics		P-value	
Normality test	Jarque-Bera =1.91		0.384	
Serial Correlation	Obs*R^2= 1.61		0.203	
Heteroscedasticity Test: ARCH	Obs*R^2= 0.520		0.470	
Ramsey Reset Test	T-statistic = 1.324		0.243	
	F-statistic = 1.754		0.243	
Co-int Eq(-1)	-0.586		0.0000	
Number of observations 1985-2015 (31obs)		R^2 =0.994 Adj R^2 = 0.981		



For time series analysis, equation 2 is estimated by employing the ARDL model. The results of estimates are reported in Table 4. The coefficients of most independent variables are significant in the short run and the long run.

Table 4
Long Run and Short Run Results of ARDL Model

Dependent Variable: Foreign Direct Investment			
Variables	**Co-efficient**	**t-stats**	**P-value**
BIT	-0.052	-0.102	0.921
VOL	-0.50**	-2.859	0.021
POL	-0.156*	-4.298	0.003
OPEN	15.51*	7.433	0.000
PI	6.110*	3.629	0.007
GDP	7.497*	3.687	0.006
RER	-0.034*	-1.451	0.005
C	-209.3*	-3.688	0.006
Co-int Eq (-1)*	-0.586*	-11.951	0.000
D(BIT)	0.763*	6.269	0.000
D(VOL)	0.170*	9.110	0.000
D(POL)	-0.061*	-7.760	0.000
D(OPEN)	3.535*	10.749	0.000
D(PI)	-2.808	-1.137	0.288
D(GDP)	12.67*	8.952	0.000
D(RER)	0.008*	1.462	0.002

Variables significant at 1%, 5% and 10% are represented by *, ** and *** respectively.

The coefficient of a variable of our interest, i.e. BITs, is again insignificant in the long run. It only attracts FDI in the short run, as it is positive and significant in the short run. The plausible reason could be that, due to weak institutions, energy shortage, lack of infrastructure and lack of supremacy of the rule of law, the investors get disappointed and leave the country (Busse et al., 2008;). The development of institutions to protect property rights plays a vital role in promoting as compared to signing BITs (Mina 2010). Banga (2003) argued that BITs signed only with developed

countries efficiently to boost FDI inflows. Meanwhile, BITs succeeded in attracting FDI in developing countries only in the Pre-Asian financial crisis era (Aisbett, 2007).

The volatility in the exchange rate promotes Foreign Direct Investment when it is utilised explicitly in terms of exports (Itagaki, 1981; Cushman, 1985). Goldberg and Kolstad (1995) stated that an increase in the volatility of the real exchange rate during the short run would automatically increase the level of foreign production to the overall production. Hence coefficient of volatility is negative and significant in the long run. Kohlhagen (1977) and Dixit (1989) emphasised postposing the investment if the desires of the foreign investor are at risk. Despite knowing that postponing the investment will cut off how profits could be earned from that investment thus, the likelihood of delay in investment is more for industries with a long product life cycle. This delay could also be observed in firms whose estimated lifespan of specific firm assets is long (e.g., Blonigen, 1997; Dunning, 1993).

Political stability has a negative and significant coefficient in both the short and long run. Polity IV scores from the Penn world table have been used to proxy political stability. Polity IV score gives a high value to the variable when the government is democratic. In the case of Pakistan, FDI had grown drastically from 2001 to 2007 (see figure 2), and it was a period of autocracy. On the other hand, FDI has reduced from 2008 to 2015, a democratic regime. Openness has a significant and positive coefficient in the short and long run. Hence protectionist policies will reduce the FDI inflows, in the case of Pakistan (Biglaiser, & DeRouen, 2006; Chakrabarti, 2001). Market size (GDP) has a positive and significant coefficient value that has been included by market size (GDP) in the short and long run. So, an argument could be acknowledged that larger markets attract more FDI (Asiedu 2006). Market size is essential for investors because it results in economies of scale and higher sales (Wheeler, & Mody, 1992; Kok & Ersoy, 2009). The exchange rate coefficient is insignificant in the short and long run. Considering the effects of exchange rate on FDI, it has been observed that these are complicated and ambiguous.

Conclusion and Policy Implications

Since being liberalised in 1990, Pakistan has been inviting vast FDI inflows. With the enhancing negotiation in BITs regarding the frequency of its trade and increasing investment partners, the liberalisation regime has become its part. In the current study, the researcher sought to observe whether the Bilateral Investment Treaties successfully achieved desired goals, i.e. enhanced inflows of FDI to Pakistan or not. With the help of an augmented gravity model in the case of panel data and the ARDL model in time series analysis, the study found that Bilateral Investment Treaties failed to achieve the planned goal of attracting FDI inflows within Pakistan in the short and long run. In other words, the study does not find any importance of BITs in promoting FDI both in Panel data analysis and times series analysis. The underlying reason is that, currently, the country is facing many challenges that threaten foreign investors from investing in Pakistan: the problems of severe shortages of gas and electricity, a weak and stagnant economic situation, the threat of terrorism and a deprived legal system. But the study found multiple factors supporting other factors that facilitate FDI, such as trade openness, physical infrastructure, and economy of considerable size, and similar others. The factors that hurt the motivation of foreign investors are exchange rate volatility and political

instability. It is mandatory to examine whether BITs provide their expected rewards compared to Bilateral Investment Treaties' increasing concern and unanticipated costs. In this regard, policymakers have to establish even more authentic standards to measure the opportunity cost before selecting any BIT. However, if there is little or apparent benefit in an agreement, making those terms favour the investor becomes challenging.

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