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Impact of Globalization on HDI (Human Development Index): Case Study of Pakistan

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Abstract

The purpose of the study is to find out whether the foreign direct investment (FDI) and international trade extension is an effective tool of economic stability and development in the current international scenario in case of Pakistan or not, this our research question in this study. The data which have been selected in this research is from 1975 to 2008, which was the age of economic and financial liberalization under an open economy (globalization). The Statistics have been analyzed through Ordinary least squared (OLS) with HDI as dependent variable and ratio of FDI to GDP, real GDP growth rate along with export and import as independent variables. The coefficient of FDI is significant as anticipated, however the coefficient of real GDP- ratio is insignificant and has negative sign because of income inequality in the case of Pakistan.

Keywords: FDI, HDI, International trade

1. Introduction

Classical economists explained that economic development depends upon capital accumulation (Harrod and Dommar and Solow growth model etc). Later in 1986's export-led growth hypothesis (Romer) which states that export can play a key role to enhance economic growth. Augment in export results increase in domestic output through the multiplier process that depends on MPC, MPE and MPI etc. Nevertheless rise in production cause to decline cost of production due to economies of scale or efficiency (law of comparative advantage), Cyper and Dietz, (1997). Having a strategy to concentrate and differentiate the export-led production, a country can anticipate main advantage of trade and static gain will be gradual to establish dynamics of comparative advantages, this dynamic gain can stimulate innovation and explore better economies of scale results better economic growth can be obtained in short. The hypothesis of export promotion explains the export especially in manufacturing sector is an important priority to the economic growth. Lee (1995) argued that any strategy which imposes a tariff

on import (capital goods) consequently increase the price of imported goods cause to reduce growth rate by forcing the economy to use domestic goods more than efficient level, in case of developing countries these capital and intermediate goods are necessary inputs for the production of exported goods. Such strategy to import would lead to deteriorate export performance and simultaneously reduce the rate of economic growth. The expansion of international production is determined by economic and technological forces along with ongoing trade liberalization, Foreign Direct Investment (FDI) and trade policies. In this context, globalization suggests a unique opportunity for developing countries to attain quicker economic growth by trade and investment. Shujiro Urata, (1998) found that the significance of FDI has risen by transferring technologies, acquiring channels and establishing marketing for efficient production and global trade.

FDI permits the foreign investors to acquire benefits from their resources and assets efficiently, while FDI recipients acquire technologies, international production and trade channels etc. Globally FDI flows improved by 24 per cent throughout the period from 1991 to 2000, while the FDI flow in developing countries stay growing at 20 percent (World Development Report, 2002).

The concept of an open economy was floated with the set of polices and initiatives includes deregulation, free trade ,social welfare, enhancing technology, free markets, financial liberalization, flexible labor force, enhanced foreign investment, privatization, curtailed public expenditures implementation of ISO-Standards, laws protecting and intellectual property rights etc. These measures were introduced by the World Bank and International Monetary Fund i.e. structural adjustment programs specifically in the developing countries. These new liberal structural adjustment have been affected all countries of the world irrespective rich or poor in the age of globalization.

FDI provides much desirable funds to developing countries such as capital, innovation, technology, research, entrepreneurial ability, managerial skills, brands, and access to markets. Above requirement are crucial for developing countries to industrialize, develop, and employment opportunities, poverty situation in their countries. Globalization and regional integration change the pattern of FDI also decline the costs of trade.

Table 1: Flow of FDI in different decades:

	Average			
	1970's	1980's	1990's	2000
FDI Inflows in Millions \$	18.00	88.83	500.27	305.10
FDI stock as % of GDP		3.06	8.93	11.31
FDI Inflows as % OF GFCF	8.89	16.54	54.93	3.62

Source: Economic survey of Pakistan 2008

Table 4: FDI inflows sector wise in Pakistan:

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Oil & Gas	80.7	268.2	186.8	202.4	193.8	312.7	545.1	634.8	775.0
Financial Business	(34.9)	3.6	207.4	242.1	269.4	329.2	930.3	1,864.9	707.4
Textiles	4.6	18.5	26.1	35.4	39.3	47.0	59.4	30.1	36.9
Trade	13.2	34.2	39.1	35.6	52.1	118.0	172.1	175.9	166.6
Construction	12.5	12.8	17.6	32.0	42.7	89.5	157.1	89.0	93.4
Power	39.9	36.4	32.8	(14.2)	73.4	320.6	193.4	70.3	130.6
Chemical	20.3	10.6	86.1	15.3	51.0	62.9	46.1	79.3	74.3
Transport	45.2	21.4	87.4	8.8	10.6	18.4	30.2	74.2	93.2
Communication (IT&Telecom)	NA	12.8	24.3	221.9	517.6	1,937.7	1,898.7	1,626.8	879.1
Others	140.9	66.2	90.4	170.1	274.0	285.0	1,107.2	764.5	763.4
Total	322.4	484.7	798.0	949.4	1,523.9	3,521.0	5,139.6	5,409.8	3,719.9

Source: annual report state bank of Pakistan 2008-09

This research sequence is as: section 1 introduction, section 2 Literature review, section 3 methodology and data source, section 4 empirical results, section 5 conclusion and implication, section 6 exhibits appendix.

2. Literature Review

Aahad M. Osman-Cani et al. (1998) found interesting results regarding human resource strategy's contribution in economic development in case of Singapore concluded that Singapore's remarkable development was done by investment in human capital, especially in education. In 1970 it had a GDP per capita US\$3,021 but in 2009 it had US\$ 37,293. Pedro Flores-Crespo (2007) applied Amartya Sen's Capability Approach to find the impact of education and human development on economic development in case of Mexico, concluded that the creation of technical university in a poor areas of Mexico has helped young graduates to achieve jobs and contributed in economic development. J. Shola Omotola (2008) identified that poverty reflects deprivation which can slow down the human development consequently distortion in economic development in the case of Nigeria. ANGELA W. LITTLE (2003) suggests that the motivation is the central concept of human development which influences the economic development. Yaw A. Debrah et al. (2000) found that Globalization led to strengthen the East Asia regional economic co-operation and promoting economic growth. J. BEN COX et al., (2005) identified the human development factors i.e. socio-cultural, political, economic, and technology in developing countries. KRISTINE SYDHAGEN et al. (2007) argued that there is need for skills development and training to increase the labor skilled for economic development, this strategy has been appropriated for Sub-Saharan African region and the developing economies. Ajit K.Ghose (2004) analyzed "the Capital inflows and investment in developing countries" he identified that FDI inflows in particular can certainly help to accelerate economic growth, especially when these enable the recipient country to promote exports of manufactures. Wasantha Athukorala (2003) has concluded that the path of direction is not in the way from FDI to GDP growth but GDP growth to FDI in the case of Srilanka. Ahmed Nawaz Hakro et al. found that macro economic factors pursued by cost associated factors which come out as the leading determinants both in short run dynamic and long run association among these macro economic variables i.e. the employment, investment, output growth, and human capital with FDI.

3. Econometrics Methodology and Data Source

3.1. Data Source

In this empirical evaluation yearly data was employed from 1975 to 2008. Data of HDI was collected from SPDC Social Development report, Pakistan review 2005-06 and UNDP, FDI data from Hand Book of Statistics of Pakistan Economy 2008-09, (published by State Bank of Pakistan) and State Bank Bulletin, as well as data of real GDP growth rate and remaining variables were selected from world development indicator and international financial statistics (soft wear 2009).

3.2. Econometrics Methodology

Augmented Dickey Fuller (ADF) Unit root test is employed to check the order of integration. ADF unit root test for checking integrated series is based with the following equation:

$$\Delta Y_t = \alpha + \beta Y_{t-1} + t + \sum \beta_2 \Delta Y_{t-k} + \mu_t$$

Where, μ_t is a pure white noise error term where

$$\Delta y_{t-1} = (y_{t-1} - y_{t-2}), \Delta y_{t-2} = (y_{t-2} - y_{t-3})$$

ADF test estimates the coefficient β whether they are equal to zero or not. Cumulative distribution of the ADF statistics is introduced by Fuller (1979), if the calculated value of the coefficient β is less than its Fuller tabulated value, then y is said to be stationary.

Johansen co integration technique was applied to find out long run association among the chosen variable series. Six variables have been applied in this study; the traditional co integration approach Engle Granger is not applicable because it is applied for only two variables (bivariate). An another reason is to select the Johansen co integration technique is that all selected variables were integrated at same order, other wise we can consider Auto Regressive Distributed Lag (ARDL) model for co integration. If the co integration (long run relationship) exist than we move to check towards the short run dynamics. The generalized form of Error Correction Mechanism is as:

$$\Delta y_t = \beta_0 + \beta_1 y_{t-1} + \beta_2 x_{t-1} + \sum_{j=1}^{q-1} \beta_{y,j} \Delta y_{t-j} + \sum_{j=1}^{q-1} \beta_{x,j} \Delta x_{t-j} + \varphi \Delta x_t + \mu_t$$

According to this study ECM equation formulated as below:

$$\Delta HDI = \alpha + \beta_1 \Delta FDI_t + \beta_2 \Delta (EX - IM) + \beta_3 \Delta RGDP + \beta_4 \mu_{t-1} + \varepsilon_t$$

β_4 = speed of adjustment that is link with co integration equation.

ECM mechanism also analyzed the behavior of the said coefficients whether they are significant or not, their signs can be negative and positive accordingly.

4. Empirical Result

Table 5: Augmented Dickey Fuller Unit root test

Variable	Level with trend and intercept	First difference with trend and intercept
HDI (Human Development index)	0.060793 (0)	6.138123* (1)
FDI (Foreign Direct Investment)	2.028159 (0)	7.550610* (8)
BOT (Balance of trade)	2.909415 (0)	3.957625* (0)
RGDP (real Gross domestic product)	0.26685 (0)	3.7085* (0)

*significant at 5% level, Lag selection ()

Table no 5 exhibits Human development index (HDI), Foreign direct investment (FDI), Balance of trade (BOT) and real gross domestic product (RGDP) are integrated of order $I(1)$. ADF-Test is applied because it captures serial correlation problem, trend and intercept because it is more reliable. Selected actors are significant at 5 percent of significance level. Lag of actors are according to Akaike Information Criteria and Schwartz Bayesian Criteria.

It is common characteristics of social sciences variables that they are difference stationary. In this study, variables are integrated at first difference. The study tried to confirm whether the variables have long run relationship or not. Johansen co-integration was applied because the variables meet all requirement of Johansen co-integration. The statistics of Johansen co integration test is as below:

Table 6: Johansen co integration test (Maximum trace value)

Null Hypothesis	Alternative Hypothesis	Maximum trace statistics	5% critical value	Probability
$r=0$	$r \leq 1$	70.10517*	47.85613	0.0001
$r=1$	$r \leq 2$	37.86665*	29.7907	0.0048
$r=2$	$r \leq 3$	16.371997*	15.49471	0.0325
$r=3$	$r \leq 4$	3.154101*	3.841466	0.0757

Table 7: Johansen co integration test (Maximum Eigen statistics)

Null Hypothesis	Alternative Hypothesis	Maximum Eigen statistics	5% critical value	Probability
r=0	r=1	32.23853*	27.58434	0.0117
r=1	r=2	21.14668*	21.13162	0.498
r=2	r=3	13.56587	14.2564	0.0642
r=3	r=4	3.1584	3.841466	0.0757

Table no. 6 exhibits Maximum Trace Eigen Statistics and table no7 exhibits Maximum Eigen Statistics both statistics confirms that there are cointegration among the said variables. Maximum Trace and Maximum Eigen results hypothesize r=4 co integration equation. Optimum lag order is 2 by (SCB) criteria.

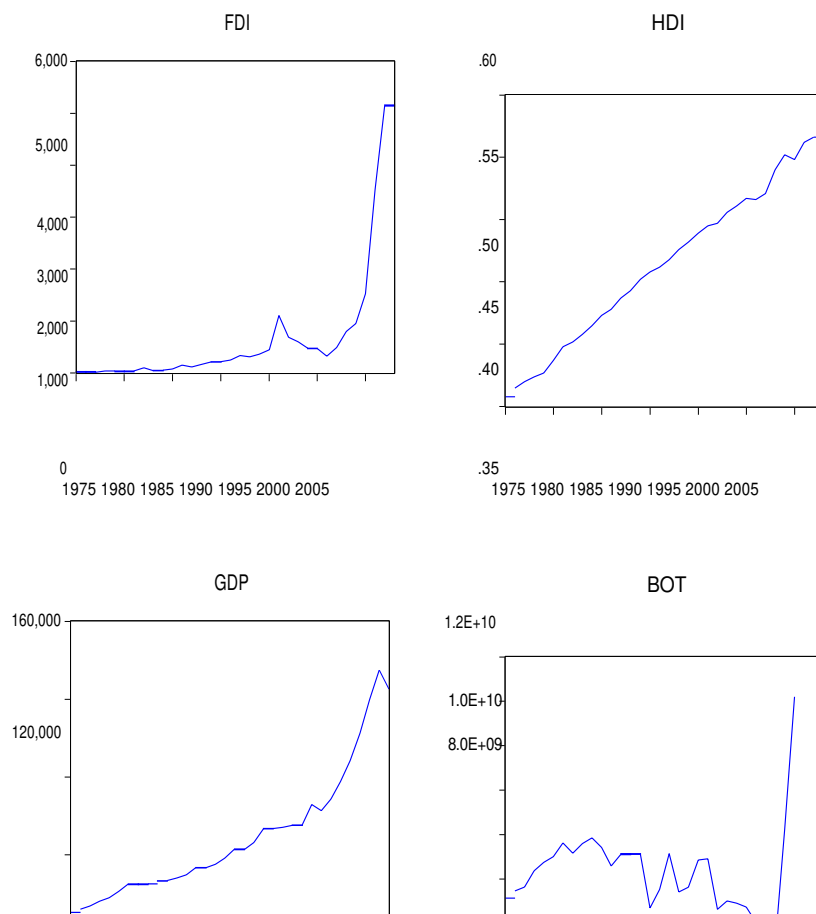
Table 8: Normalized First co integration equation: (Dependent variable HDI)

Independent Variables	Coefficient	Standard Error	t value
FDI (Foreign direct investment)	0.000130*	0.00000547	24.0741
BOT (Balance of Trade)	3.691*	1.25698	2.9364
RGDP	-8.632	9.2114	0.937997

Significant level at 5%

The projected slope coefficient of foreign direct investment (FDI) shows significant impact on Human development index (HDI) because rise in FDI leads to increase employment opportunity that cause improve standard of living. The focus of this study is on service sector, banking and telecommunication sectors and found foreign investment significantly and positively impact which enhance quality of work in these sectors. Rate of change in balance of trade (BOT) is significant and it explains the standard of living as improved because a large part of export covered by cotton industries (textile industry). Contemporary coefficient of real gross domestic product (RGDP) is insignificant and negative, which explains rise in RGDP increase inequality due to inefficient resource mobilization and failure of government regarding fiscal policy management.

Further Graph highlighted this study.



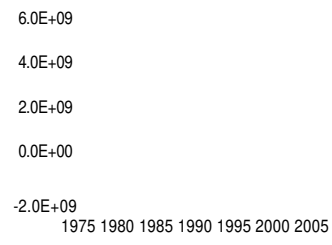
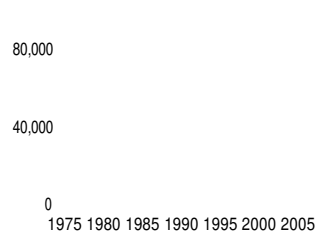
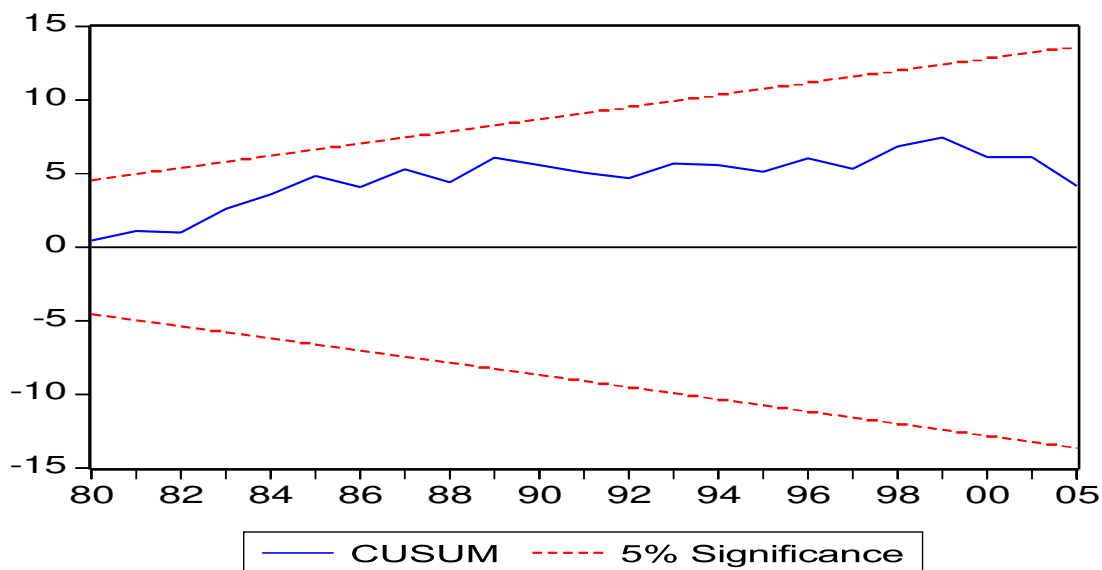


Table 9: Error Correction Model: Dependent variable D(HDI)

Variable	Coefficient	Standard error	t value
D(FDI)	0.000909	0.004541	0.20093
D(GDP)	0.116039	0.023354	4.968607
D(BOT)	-0.003320	0.003218	-1.031580
ECM(-1)	0.186504	0.1624789	1.147866
$R^2 = 0.59$ Durbon Watson=1.82 F=5.068			

Table no. 9 exhibits the short run statistics where (FDI) and (BOT) coefficient prove co-integration results and found both variables have no short run impact on (HDI) and (ECM) speed of adjustment coefficient (0.18) shows the speed of adjustment towards long run adjustment.

CUSUM stability test was employed for the short run adjustments stability. Results of CUSUM stability test as below:



Graph shows the coefficients of ECM(-1) speed of adjustment is stable at 5 percent significance level, there is no fluctuations outside the critical level and the CUSUM curve is above the origin line that proved significance of our short run dynamics.

5. Conclusion and Implication

Foreign direct investment is an important factor of economic growth and development in the present economic scenario of the world. Transfer of technology, supply of the scarcest resources such as physical and human capital, research and innovation, enhance skills and management capacity, employment opportunities etc are the benefits of the FDI to the host countries, which can not be denied. It is observed that foreign direct investment has been concentrated on the services sector as a result society became consumption oriented in case of Pakistan. It is suggested that policy makers should focus on the direction of foreign investment and it can be very useful to divert the flow of foreign direct investment towards export oriented industries which are facing technological and skill gap. This research has concluded that the foreign direct investment is not a sole factor of human development index. The study also concluded that the international competitive environment and foreign direct investment can play a fundamental role in the economic development and growth. This study highlighted that there is no impact of real gross domestic product on human development index due to the income inequality in Pakistan.

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Appendix

FDI and Trade History of Pakistan

Table 1: Average tariff rate and share of tariff in total taxes:

Year	Average Tariff rate %	Share of Tariff in total taxes
1987-88	150	43.0
1988-89	125	40.6
1989-90	125	41.9
1990-91	125	40.4
1991-92	95	39.2
1992-93	90	37.6
1993-94	80	32.7
1994-95	70	32.9
1995-96	65	30.3
1996-97	65	26.7
1997-98	45	22.8
1998-99	45	16.1
1999-00	35	16.7
2000-01	35	14.1
2001-02	29	18.9
2002-03	25	25.4
2003-04	22	28.5
2004-05	17	28.3
2005-06	15	25.8
2006-07	14	24.7
2007-08	10	22.5

Source: Economic survey of Pakistan 2008

Table 3: FDI inflows countries wise in Pakistan:

Country	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
USA	92.7	326.4	211.5	238.4	325.9	516.7	913.1	1,309.3	869.9
UK	90.5	30.3	219.4	64.6	181.5	244.0	860.1	460.2	263.4
U.A.E	5.2	21.5	119.7	134.6	367.5	1,424.5	661.5	589.2	178.1
Japan	9.1	6.4	14.1	15.1	45.2	57.0	64.4	131.2	74.3
Hong Kong	3.6	2.8	5.6	6.3	32.3	24.0	32.6	339.8	156.1
Switzerland	3.6	7.4	3.1	205.3	137.5	170.6	174.7	169.3	227.3
Saudi Arabia	56.6	1.3	43.5	7.2	18.4	277.8	103.5	46.2	(92.3)
Germany	15.5	11.2	3.7	7.0	13.1	28.6	78.9	69.6	76.9
Korea(South)	3.7	0.4	0.2	1.0	1.4	1.6	1.5	1.2	2.3
Norway		0.1	0.3	146.6	31.4	252.6	25.1	274.9	101.1
China	41.9 NA	0.3	3.0	14.3	0.4	1.7	712.0	13.7	(101.4)
Others		76.6	173.9	108.6	369.3	521.9	1,512.2	2,005.2	1,964.2
Total	322.4	484.7	798.0	949.0	1,523.9	3,521.0	5,139.6	5,409.8	3,719.9

Source: annual report state bank of Pakistan 2008-09

Table 4: Export and Imports of Goods and Services:

ITEM	Jul - Jun		Jul-Sep		Oct - Dec		Jan-Mar	Apr	Jul-Apr	
	FY09*	FY08*	FY10*	FY09*	FY10*	FY09*	FY10*	FY10*	FY10*	FY09*
Balance of Goods & Services	-16008	-21427	-3527	-5778	-3809	-4778	-2759	-961	-11056	-14354
Goods : Exports fob	19121	20427	4620	5711	4678	4379	5022	1835	16155	15817
<i>Of which General merchandise Exports FOB</i>	18918	20207	4562	5633	4626	4329	4961	1817	15966	15641
Exports of Services	4106	3589	838	1133	1021	941	1150	596	3605	3126
Transportation	1231	1035	288	284	281	437	285	98	952	1106
Travel	314	264	67	98	71	85	77	23	238	272
Communication services	196	117	59	25	73	19	52	16	200	111
Construction services	31	37	3	7	5	15	4	1	13	28
Insurance services	59	54	8	21	12	13	13	2	35	48
Financial services	63	43	62	20	10	14	8	4	84	58
Computer & information services	184	154	47	48	51	52	42	15	155	155
Royalties and license fees	11	51	2	9	2	1	2	0	6	11
Other business services	493	450	133	133	117	130	135	46	431	411
Personal & cultural & recreational services	1	4	0	0	0	0	3	1	4	0
Government services	1523	1380	169	488	399	175	529	390	1487	926
Of which logistic support	912	655	0	365	0	0	349	188	537	465
EXPORTS OF GOODS & SERVICES	23227	24016	5458	6844	5699	5320	6172	2431	19760	18943
Goods : Imports fob	31747	35397	7429	10229	7656	8077	7360	2804	25249	26952
<i>Of which General merchandise Imports FOB</i>	31410	35027	7366	10124	7597	7964	7297	2775	25035	26653
Imports of Services	7487	10046	1556	2392	1852	2021	1571	588	5567	6344
Transportation	3633	3785	851	1118	849	1037	808	304	2812	3119
Travel	1002	1578	147	421	286	329	231	81	745	910
Of which Exchange Cos.	685	1297	107	364	106	166	173	63	449	632
Communication services	144	107	22	29	69	33	27	11	129	116
Construction services	70	56	9	10	6	15	10	2	27	50
Insurance services	133	152	47	33	35	37	34	9	125	114
Financial services	166	184	25	45	24	56	18	12	79	148
Computer & information services	122	129	25	30	43	22	53	15	136	99
Royalties and license fees	93	130	17	21	29	28	32	13	91	81
Of which: Exchange Cos.	0	0	0	0	0	0	0	0	0	0
Other business services	1648	3432	279	592	303	391	226	93	901	1388
Of which: Exchange Cos.	530	2504	29	315	31	134	32	12	104	506
Personal & cultural & recreational services	3	2	5	0	8	0	5	0	18	0
Government services	473	491	130	93	200	73	127	48	505	319
IMPORTS OF GOODS & SERVICES	39234	45443	8985	12621	9508	10098	8931	3392	30816	33296

Source: State Bank of Pakistan 2008

International Investment Position of Pakistan

(Million US Dollars)

	Stock as on 31-12- 2003 (R)	Stock as on 31-12- 2004 (R)	Stock as on 31-12- 2005 (R)	Stock as on 31-12- 2006 (R)	Stock as on 31-12- 2007 (R)	Stock as on 31-12-2008 (P)
International Investment Position - net	(26,544)	(27,791)	(29,117)	(35,379)	(50,754)	(69,691)
A. Assets	17,033	17,082	17,751	19,818	22,769	17,271
1. Direct investment abroad	604	702	870	1,010	1,249	1,269
1.1 Equity capital and reinvested earnings	604	702	870	1,010	1,249	1,269
1.2 Other capital	-	-	-	-	-	-
2. Portfolio investment	155	158	452	311	330	111
2.1 Equity securities	154	155	447	307	316	97
2.2 Debt securities	1	3	5	4	14	14
3. Financial derivatives	-	-	-	-	-	-
4. Other investment	3,529	5,495	5,339	5,755	5,654	6,258
4.1 Trade credits	1,692	1,957	2,258	2,500	2,765	3,073
4.2 Loans	80	83	86	89	92	95
4.3 Currency and deposits	867	2,452	1,894	1,939	1,617	1,970
4.4 Other assets ^e	890	1,003	1,101	1,227	1,180	1,120
5. Reserve assets	12,745	10,727	11,090	12,742	15,536	9,633
5.1 Monetary gold	860	904	1,059	1,313	1,732	1,791
5.2 Special drawing rights	246	243	216	216	215	183
5.3 Reserve position in the Fund	-	-	-	-	-	-
5.4 Foreign exchange	11,639	9,580	9,815	11,213	13,589	7,659
5.4.1 Currency and deposits	9,682	6,040	6,686	7,838	9,933	5,976
<i>of which: Cash in Foreign Currency</i>	54	13	70	50	43	434
<i>: Sinking Fund</i>	810	-	-	33	25	64
5.4.2 Securities	1,957	3,540	3,129	3,375	3,656	1,683
5.4.3 Financial derivatives ,net	-	-	-	-	-	-
5.5 Other claims	-	-	-	-	-	-
B. Liabilities	43,577	44,873	46,868	55,197	73,523	86,962
1. Direct investment in Pakistan	7,195	7,606	10,209	13,682	25,621	31,059
1.1 Equity capital and reinvested earnings	6,269	6,628	9,109	12,241	23,065	28,503
1.2 Other capital	926	978	1,100	1,441	2,556	2,556
2. Portfolio investment	542	1,162	2,173	4,064	6,767	6,784
2.1 Equity securities	217	495	1,064	1,960	3,859	3,859
2.2 Debt securities	325	667	1,109	2,104	2,908	2,925
3. Financial derivatives	-	-	-	-	-	-
4. Other investment	35,840	36,105	34,486	37,451	41,135	49,119
4.1 Trade credits	162	140	221	506	445	445
4.2 Loans	33,850	34,161	32,414	35,109	39,038	46,620
4.3 Currency and deposits	1,143	1,152	1,200	1,182	1,159	1,606
4.4 Other liabilities	685	652	651	654	493	448
^e includes the unsettled claims on India	3	3	3	3	3	3

Source: State Bank of Pakistan 2008