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Policy Brief

Impact of Corruption on Foreign Direct Investment (FDI): Empirical Evidence from Pakistan

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Executive Summary

This Policy Brief provides empirical evidence on how corruption affects foreign direct investment (FDI) in Pakistan. Despite the country's persistently low Corruption Perceptions Index (CPI) score of 27, there is limited empirical research on the relationship between corruption and investment within Pakistan. Globally, the relationship between corruption and FDI remains debated. Some scholars view corruption as a lubricant in rigid bureaucratic systems, while others emphasise its long-term damage to institutional credibility and economic efficiency. In this context, exploring the complex role of corruption in Pakistan's investment landscape becomes crucial.

Based on multiple time series regression models, the study highlights that higher corruption levels are positively associated with FDI inflows. However, this trend is not unique to Pakistan. Regional counterparts like India, Bangladesh, and Sri Lanka exhibit similar dynamics.

It also emphasises that, in Pakistan, the FDI is primarily concentrated in the energy, finance, and food sectors, which are susceptible to informal transactions. Despite substantial FDI inflows, Pakistan continues to fall behind in economic growth and productivity. Even with steady FDI inflows, the energy sector grapples with high costs.

The study highlights that FDI from countries with higher CPI scores continues to flow into Pakistan, raising questions about whether these investors are motivated solely by returns or if they may also be involved in informal practices. Additionally, while reducing corruption is a long-term objective, the Brief argues that institutional reforms focusing on transparency, simplification, and accountability are urgently needed to ensure that FDI leads to developmental gains.

Recommendations

- An independent oversight body may monitor FDI transactions using AI-based tools or software to detect anomalies and enforce proper documentation of all financial flows.
- Streamline fuel procurement processes by introducing third-party audits and mandatory disclosure of tariff calculations and other cost-related figures.

1. Introduction

Over the years, scholars and policy practitioners have become increasingly interested in exploring the relationship between corruption and Foreign Direct Investment (FDI) due to the contrasting role of corruption. On the one hand, corruption can deter foreign investors by increasing transaction costs. On the other hand, corruption may act as a “grease” that enables investors to bypass institutional or bureaucratic inefficiencies, particularly in environments with excessive bureaucracy[1].

The literature suggests two contrasting views regarding the role of corruption in an economy. The first is the ‘grabbing hand’ view, which states that corruption stifles investment by creating uncertainty, increasing costs, undermining trust in institutions, weakening institutional confidence, and diverting critical resources while imposing substantial economic costs. In contrast, the second view is called the ‘helping hand’ view, which states that corruption can sometimes facilitate investment in rigid and inefficient bureaucracies by cutting through red tape and accelerating business processes. This dual nature makes a compelling case for exploring how corruption shapes FDI inflows across different institutional and economic contexts.

This Policy Brief critically examines the role of corruption in FDI inflows, assessing whether it acts as a deterrent or a facilitator. It begins with a theoretical and empirical literature review on corruption’s impact on investment. This is followed by an introduction to corruption, and finally, it provides an empirical examination that explores the relationship between corruption and FDI.

Based on a time series and a panel regression model, the findings of this brief highlight that there exist significant bureaucratic hurdles in Pakistan. Overcoming these bureaucratic hurdles requires fast money to ensure the smooth inflow of investment. Positioning Pakistan on a new economic trajectory of better economic well-being requires addressing numerous regulatory distortions that impact the inflow of FDI and reduce the adverse effects of strict regulatory activities in the Pakistan economy.

The findings moreover state that corruption does not always hinder FDI. In some cases, corruption may even facilitate FDI while providing investors with quicker access to

[1] Alharthi (2024). Determinants attract & discourage FDI in GCC countries: Do macroeconomic & environmental-factors matter?

permits, reducing bureaucratic red tape, or offering opportunities to bypass certain regulations. This is often seen in developing countries like Pakistan, where informal practices like bribery are present in the business culture.

Corruption In Pakistan

In many developing countries, including Pakistan, the impact of corruption on FDI inflow is significant due to weak institutional frameworks and governance challenges. Pakistan, with a Corruption Perception Index (CPI) score of 27, consistently ranks low on global corruption indices (see Figure 1)[2]. Systemic issues are consistently affecting both the public and private sectors in the country. This low CPI score sparks discussions in Pakistan about the need for stronger corruption-related regulatory frameworks. However, these debates lack clear empirical evidence on whether corruption attracts more FDI or leads to its decline, and how the state should address the issue of corruption.

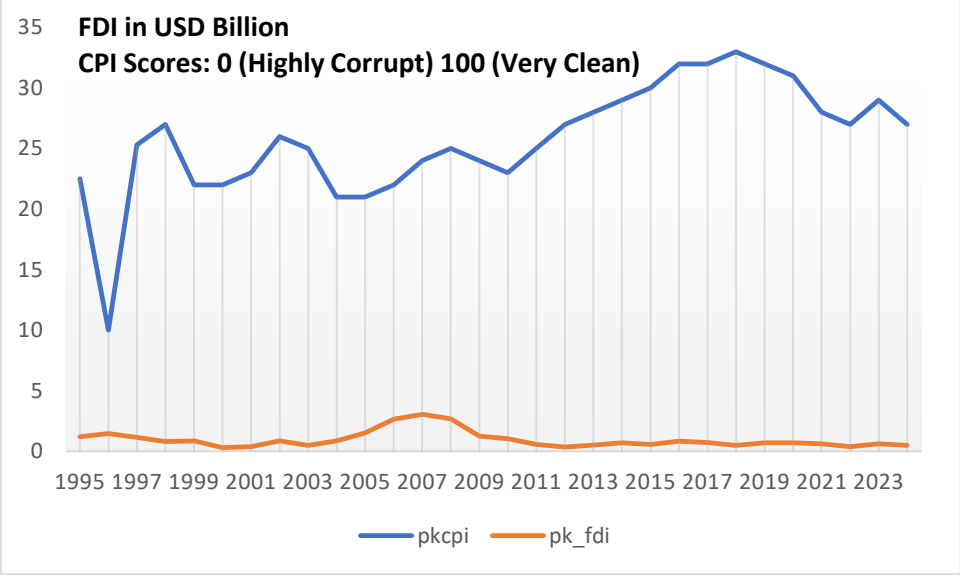

Figure 1: Pakistan FDI and CPI Trend (1995 *to* 2024)
Source: Tranaprancy Interantional and WDI data (1995 *to* 2024)

The State of Corruption (Worldwide)

Corruption can smooth the way for investment in rigid and inefficient bureaucracies by cutting through red tape and accelerating business processes. However, corruption

[2] A low CPI score indicates high corruption. A high CPI score shows otherwise. CPI (2025). https://www.transparency.org/en/cpi/2024

significantly affects economic efficiency by misallocating resources and reducing public spending effectiveness[3]. Globally, estimates suggest that the cost of corruption exceeds 5% of global GDP. Approximately USD 1 trillion in bribes is exchanged worldwide annually[4]. Moreover, corruption within the public (particularly in developing countries) results in losses ranging between USD 20 billion and USD 40 billion annually. These figures underscore the severe economic distortions caused by corruption.

The impact of corruption tends to be exacerbated during crisis periods, as seen during the COVID-19 pandemic. Reports highlight instances of corruption in vaccine distribution, medical supply procurement, and financial relief programs across various nations. The diversion of essential funds not only weakens economic resilience but also disproportionately affects vulnerable populations, further entrenching economic disparities.

[3] BB (2020). https://www.bb.org.bd/pub/halfyearly/fdisurvey/fdisurveyjuldec2019.pdf
[4] Wathne (2021). Credibility-corruption-statistics. *Global estimates-Corruption-Resource-Centre*

2. Review of Literature

Over the years, an ample body of studies have been conducted to explore the two contrasting viewpoints on corruption and investment (e.g., Laffont (2000) and Newbery (1999). Mauro (1995) uses survey data over the years to explore how corruption affects investment. Based on a sample of 67 countries, the study finds that corruption adversely influences the net GDP-investment ratio. Campos (1999) states that the nature of corruption significantly determines the coefficient of corruption in a regression analysis. A corrupt but predictable regime has a negligible as well as meagre adverse effect on investment compared to one that is less predictable.

Vinod (2003) analysed data from various Asian nations and concluded that FDI is scarce in corrupt economies. Zhao (2003) discovered that lower levels of corruption correlate with higher FDI. Ayadi (2014) examined the impact of transparency on FDI flows in Saharan African nations, revealing a positive relationship. According to the study's model, a 1% reduction in corruption can lead to a 9.1% increase in inward FDI flows. Egger (2005) investigated a large panel of 73 developed and developing countries from 1995 to 1999, finding that corruption positively affects growth in both the short and long run, thereby supporting the "helping hand view. "

In contrast, Ledyaeva (2013) performed micro firm-level panel research to assess the relationship between corruption and the political regime type in the investor's home country. The results indicate that investors from less corrupt, more democratic nations prefer to invest in equally less corrupt, democratic countries. Conversely, those from more corrupt, less democratic countries tend to invest in nations with similar characteristics.

More recently, Alharthi (2024) investigated the factors that attract or deter foreign direct investment in GCC countries, paying attention to macroeconomic and environmental influences. The findings supported varying perspectives across multiple countries worldwide.

Since the 1990s, following globalisation, Pakistan has enacted several liberalisation policies aimed at attracting FDI to move its needle of growth and development. These policies have, however, facilitated corruption. A significant amount of money (or

investment) flowed into the country. However, due to the presence of corrupt practices, it has not brought considerable development in the economy.

Ang (2020) states that much of the global literature agrees that corruption hinders economic growth. The study argues that this perspective is “over-simplistic”. Without corruption, investments may not enter a country with a rigid bureaucratic system.

Abosti (2016) argues that corruption is an inherent component of many developing economies. The study shows that corruption positively influences FDI when institutional quality is high. Meanwhile, it negatively impacts FDI at lower levels of institutional quality. Interest in this topic increased significantly after Transparency International (TI) started publishing corruption perception indices for each country in 1995.

In Pakistan, the empirical research on whether corrupt practices deter or encourage foreign investment remains debated. Some scholars advocate for the “grabbing hand hypothesis”, while others endorse the “helping hand hypothesis”. However, there is a lack of extensive literature addressing the corruption-investment relationship. Therefore, this brief focuses specifically on the corruption–investment nexus and its implications for the Pakistan economy.

3. METHODOLOGY

This chapter outlines the methodology used for designing, collecting, and analysing data to investigate how corruption impacts FDI in Pakistan. This research employs a Multiple Linear Regression (MLR) model. The MLR is based on OLS (Ordinary Least Squares) estimation. It examines the influence of several independent variables on the dependent variable (DV) and tells about the direction and nature of these relationships. This model helps understand how several factors together influence an outcome, like how corruption affects foreign investments. The coefficients of the model inform about the impact of Corruption on FDI. Based on Hall (2021)[5], mathematically, this model is specified hereunder:

$$FDI_t = \beta_o + \beta_1 \mathrm{CPI_t} + \beta_2 \mathrm{Pplitical\ Stabilty_t} + \ldots + \beta_k \mathrm{X_t} + \varepsilon_t \quad (1)$$

Where

FDI_t: the dependent variable

β_s: are the parameters or coefficients for the independent variable

ε_t: *an* error term distributed normally

t is the time period, ranges from 1995 to 2023

The dependent variable is FDI, while the independent variables are CPI and political stability. This study uses the multiple linear regression model to regress FDI on CPI and political stability.

Ledyaeva (2013) explores the relationship between the level of corruption and the type of political regime in the country of origin of overseas investors. The study finds that investors from less corrupt and more democratic regimes tend to invest in countries with lower corruption and more democratic institutions. Conversely, investors from more corrupt and less democratic countries tend to invest in more corrupt and less democratic countries. This raises the question “Does the regulatory framework of a country deter outward FDI, or do countries with higher CPI values still invest in Pakistan?” Or “Do investors from less corrupt and more democratic countries investing in Pakistan follow a similar trend?”

[5] Hall (2021). *Econometrics- Applied*-Bloomsbury-Publishing.

For this, a panel data model is employed. Panel data refers to data or time and multiple cross-sections. That is to say, multiple countries investing in Pakistan over the years, unlike the overall FDI coming to Pakistan, which this brief explored using the MLR model. This approach is widely discussed in the FDI-corruption literature (Jernigan, 2000).

Australia, Canada, China, France, Germany, Japan, the Kingdom of Saudi Arabia (KSA), Qatar, the United Arab Emirates (UAE), the United Kingdom (UK), and the United States (USA) have been selected for the panel regression model. These countries represent Pakistan's major and most consistent sources of FDI over the past decade (see Figure 2). For instance, China, the UAE, the USA, and the UK have historically ranked among the top contributors to Pakistan's FDI inflows.

Initiatives such as the China-Pakistan Economic Corridor (CPEC) and investments linked to the diaspora from Western countries exemplify such inflows. Countries like KSA, Qatar, and UAE (as well as China) engage in frequent FDI transactions due to cooperation in the energy sector. Including countries with regular and significant FDI flows, along with diverse CPI scores, provides a focused and analytically rich sample for examining the corruption-FDI relationship.

Fixed Effects (FE) and Random Effects (RE) Models

Two types of panel data models exist: the FE and RE models. The Hausman test is used to make an appropriate choice between the FE and RE models. This test examines whether the RE estimation is nearly as good as the FE. The Hausman test evaluates H0, which posits that the RE model is consistent and efficient, versus Ha, which states that the RE model is inconsistent. The test investigates whether the regressors are correlated with the individual effect.

DW statistics, R^2, p-values, and the Hausman test, along with its test value of the model, were used to see the robustness and reliability of the model. In case, the value or the test statistic is large; in that case, the difference between the estimates is significant, so the null hypothesis is rejected, and the RE model is considered inconsistent, and the FE estimator is used. However, a small value for the Hausman test statistic implies RE. In simple terms, a small value of the Hausman test or a p-value of greater than 0.05 says that the RE model should be employed.

This study employs the RE model as the Hausman test's p-value is greater than 0.05. Another advantage of using the RE model is that it has fewer parameters to estimate than a FE model. Moreover, within a group, it allows for supplementary explanatory variables that have equal values for all values–that is, it will also enable the use of dummies.

Mathematically, the RE Panel data model is provided hereunder:

$$FDI_{it} = \beta_o + \beta_1 \mathrm{CPI}_{it} + \beta_2 \mathrm{GDP}_{it} + \varepsilon_{it} \quad (2)$$

The institution behind the panel data model remains the same. Here, "t" once again means periods/years. However, the subscript "i" shows the country from which FDI originates in Pakistan. Similarly, the CPI reflects the corruption level of the country providing the FDI. Therefore, in this model, multiple countries are represented by "i" and multiple periods are shown by "t". Cautiously, one might refer to the panel data model as a collection of multiple OLS models (ceteris paribus).

Variables of the Study

Globally, Researchers use macroeconomic factors, viz. trade openness, tariffs, governance, and capital formation, as well as multiple indices, to explore the impact of corruption on FDI inflow. Based on Alharthi (2024)[6], this Policy Brief uses net FDI and a combination of all these variables: Corruption Perception Index and Political Instability in the analysis. Details of these variables are provided hereunder.

CPI, the independent variable, informs about the state of corruption in a country. The CPI is published by Transparency International (TI). It ranks countries based on how corrupt their institutions are perceived to be. It ranges from 0 to 100. "0" means highly corrupt country. Meanwhile, "100" means zero corruption and vice versa. The CPI is based on the prevalence of bribery, misuse of power, lack of transparency etc. in a country. It is based on expert assessments and surveys, unlike the direct measurements of corruption. It focuses on perceived corruption since corruption is a shadow activity and cannot always be visible or directly measurable.

FDI, the dependent variable, is an investment made by a foreign entity in a business or assets within another country. The State bank of Pakistan (SBP) provides detailed FDI data. FDI can also be in the form of establishing new operations such as subsidiaries or

[6] Ibid.

joint ventures. It is essential as it creates job opportunities and enhancing skills in the host country. However, FDI can also present risks, such as profit repatriation and exposure to political and cultural instability.

The Political Stability/Absence of Violence/Terrorism variable measures how likely a country is to experience instability. It is scored from -2.5 to 2.5. Higher scores indicate more stability. This variable acts as a determinant of FDI because investors prefer stable countries/economies, as they are less likely to face risks like government changes, violence, or business interruptions. A stable political environment promotes confidence and long-term investment as well as makes the country more attractive for foreign investments.

Data and parameter estimates for corruption within a specific entity are not available in Pakistan. Estimating and calculating these variables at the micro level would not be individually possible due to time and resource issues[7]. This is the case for using broader FDI and CPI variables. Besides this, such variables are also often highly correlated with multiple economic indicators of a country and therefore serves as reliable indicators in exploring the CPI-FDI relationship.

Gross Domestic Product (GDP) is used as a control variable to account for the size of an FDI sending country. In the literature GDP is considered is a key determinant of FDI inflows. A larger GDP typically signals greater economic activity. In this study, GDP is measured in current U.S. dollars to control for cross-country/time comparisons. This is how the model isolates the effect of other main variables.

Both interest rate and GFCF were initially included in the model specification. However, their inclusion did not significantly improve model performance. Specifically, model stability, residual diagnostics, and parameter significance remained unaffected or worsened.

[7] Hall (2021). *Applied-econometrics*. Bloomsbury-Publishing.

4. Regression Results, Discussions, and Interpretations

Section 4 depicts the regression outcomes of both models and discusses their coefficients regarding the assessment of CPI's impact on FDI inflows in Pakistan. According to Equation 1, the findings from the MLR model are detailed here:

Table 1: Multiple Linear Regression Model's Statistics		
***Dependent Variable*: FDI**		
Independent Variables	***Coefficients***	***Significance***
Intercept	2.16	**
CPI	-0.08	**
Political Stability	-0.45	*
R^2: (0.54)		
Significance: *** p<0.01, ** p<0.05, * p<0.1		
Source: *Author's* Regression Statistics, *based on TI and WDI data* (1995 *to* 2024)		

Table 1 shows the regression coefficients of the MLR model, namely CPI and Political Stability, are -0.08 and -0.45, respectively[8]. The model's R-squared value is 0.54 with a Durbin-Watson (DW) value of 1.69. The R^2 and DW tests show whether a model's results are significant. The R^2 value ranges from 0 to 1, while the DW value ranges from 0 to 4. An R^2 value close to 1 indicates a good fit, whereas a value of 0 indicates otherwise. A rule of thumb for assessing the significance of a model is that the R^2 value should be between 0.5 and 0.9, and the DW value should typically fall between 1.5 and 2.5.

The selected countries (see Figure 2 below) for the panel regression are Germany, Canada, China, France, Australia, Japan, Saudi Arabia, Qatar, UAE, the UK, and the USA. These nations are significant contributors to FDI and have demonstrated consistent and reliable data without any interruptions/breaks.

Table 2: Random-Effects (RE) Regression		
***Dependent Variable*: FDI**		
Independent Variables	***Coefficients***	***Significance***
Intercept	-244.61	*
CPI	-2.46	***

[8] The Intercept in simple shows the impact of CPI on FDI in the absence of other variables.

GDP	14.77	***
R^2 (between): (0.40)		
Significance level: *** p<0.01, ** p<0.05, * p<0.1		
Source: *Author's* Regression Statistics, *based on TI and SBP data* (2018 *to* 2024)		

Table 2 shows the impact of other countries' CPI values on the FDI directed towards Pakistan. The regression coefficients for CPI and GDP are -2.46 and 14.77, respectively. The model's R-squared value is 0.73. The Hausman test statistic is recorded at 4.96, with a p-value of 0.18. These values indicate the significance of the model. Furthermore, no outliers are identified in the variables of the study (see Figure 1). The GDP series had some outliers due to COVID-19 shocks. However, the natural logarithm of the GDP series was taken to address this issue.

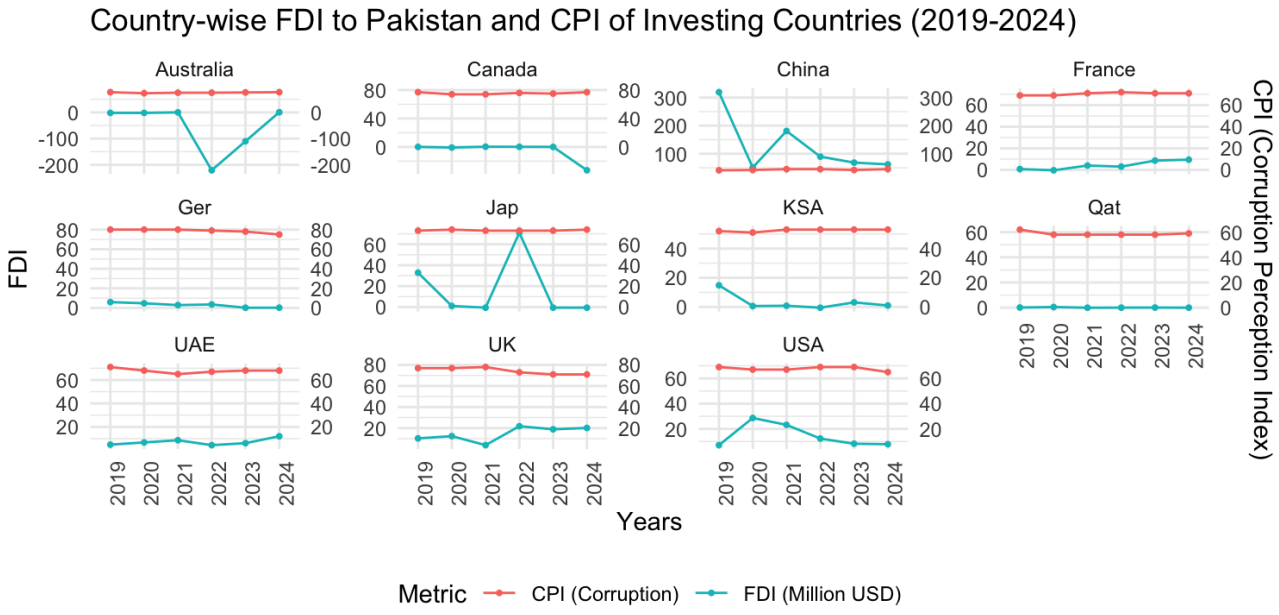

Figure 2: FDI Trend (2019-2024)

Source: *Author's depiction, based on SBP and TI data from* 2019 *to* 2024

Discussion and Interpretation of Results

This segment explains the relationship between the CPI and FDI. In Table 1, CPI, with a coefficient of -0.08, shows that, in Pakistan's case, more corruption is associated with

FDI. It suggests that, reportedly, corruption acts as an informal enabler in the bureaucratically constrained environments of Pakistan.

The FDI series was not normally distributed. However, the sample size is quite large. Wooldridge (2010) states that in time series with a large sample size, i.e., above 30 years, normality is not an issue. However, in time series, stationarity is essential. So, the Levin-Lin-Chu stationarity test was performed to explore it. The test value was -5.390 with a p-value of 0.0000. It suggests that the variables are stationary[9].

Stability typically enhances economic performance. However, an unstable business environment creates uncertainty, which negatively impacts economic well-being as individuals face hurdles in their financial activities[10]. In essence, this negative coefficient aligns with the literature. It implies the basis for a stable environment to attract FDI and promote economic efficiency. However, their poor design, weak enforcement, or excessive complexity deters FDI.

The model's results, however, reveal a significant relationship between corruption and FDI. For Pakistan, corruption exhibits a positive association with FDI, supporting the "helping hand" view. It indicates that corruption reduces FDI in less corrupt countries. However, for developing nations like Pakistan, a 27 CPI score, higher corruption levels, is associated with increased FDI inflows.

As stated, it is important to explore the impact of other countries' CPI on Pakistan. For this, the panel regression model was employed. The results of the panel data model are provided in Table 2.

The results presented in the RE regression (Table 2) suggests that, as the host countries' corruption perception, the country tend to send more FDI to Pakistan since the country prefers to invest in Pakistan. This suggests that other factors viz. political instability the size of an economy also play a role in determining the flow of foreign capital into Pakistan. However, the corruption levels in the source countries are also among the key drivers. Pakistan, meanwhile, itself faces significant governance and corruption challenges; investors from more FDI-sending countries overlook these challenges when deciding to invest. This also raises the question, "Are they used to operating in similar environments?"

[9] Wooldridge (2010). *Econometric-Analysis.*

[10] World Bank (2023). Private-Sector-Pakistan-Transforming.

Why do source countries choose to invest in nations with limited transparency and accountability?

According to Malik (2024)[11], for an FDI-sending country, apart from the CPI values, the key factors are the return on profits, royalties, and technical fees that the FDI source country/firm incurs. Moreover, when a country/firm/venture invests in consumer or daily-use products, rather than focusing on long-term development, as in Pakistan's case, the incentives shift. There is also a negative impact on the external account, as much of what is produced in the host country is not locally made but instead imported. For example, Pakistani IPPs import foreign coal to produce energy. This process involves extensive bureaucratic channels, often requiring "speed money".

Table 2 of this Brief also supports the "helping hand hypothesis/view". However, the underlying reasons behind this–i.e., why negative factors like corruption persist across multiple states require further exploration.

Sectoral Look at Pakistan's FDI Inflows

Mauro (2019) stated that, in high corruption countries, sectors such as oil and mining, energy, food, retail & transportation, and public sector spending on purchases of goods/services by the government are the main sectors exposed to corruption.

A closer look at Pakistan's sectoral FDI gives a foundation to the above discussion. In Pakistan, the food sector (USD 4.38 million), power sector(USD 40.65 million), and financial business sector (USD 54.25 million) have attracted significant FDI, particularly in recent decades (Feb 2025)[12]. However, the extent to which these investments have improved growth/productivity and overall economic wellbeing remains a subject of significant debate. In the power sector, investment inflows have led to an increase in installed capacity, particularly in coal, hydro, and renewable energy projects. CPEC power projects, such as the Sahiwal Coal Power Plant and Karot Hydropower Project, have added thousands of megawatts to the national grid. Despite this expansion, the sector is grappling with a circular debt exceeding PKR 2.6 trillion. High reliance on costly imported

[11] https://www.youtube.com/watch?v=c2jXBykM4q8

[12] SBP (2025. https://easydata.sbp.org.pk/apex/f?p=10:211:::NO:RP:P211_DATASET_TYPE_CODE,P211_PAGE_ID:TS_GP_FI_FIPK_M,210&cs=1EEC988B2E32EA2F5343C1705B38CBE3D

fuels (LNG and coal) by foreign investors (as well as the locals) has made the sector unsustainable despite FDI inflows[13].

Pakistan's financial sector, particularly banking, insurance, and fintech, has also attracted foreign investment. Multiple banks and financial institutions, such as Standard Chartered, HBL, and UBL, have expanded operations with foreign backing. However, the financial sector remains small relative to the economy, with limited impact on broad-based economic growth. High interest rates, inflation, and economic instability have discouraged private sector borrowing/limiting productivity gains. The banking sector is more focused on government borrowing rather than financing industrial growth. That is to say, inefficient capital allocation. The food sector creates and provides jobs. However, as stated, it results in import dependency, no local production, and an unstable external account.

Sectoral FDI coming into Pakistan, moreover, reveals that the FDI from these countries has limited multiplier effects. It has not significantly improved economic conditions or increased productivity levels in Pakistan; it has failed to foster the desired outcomes. After years of FDI, Pakistan struggles with low growth rates and persistent corruption challenges.

Corruption in FDI Inflows

One example of "How corruption undermines the developmental impact of FDI in Pakistan" can be found in Pakistan's energy sector. Independent Power Producers (IPPs) and the Rental Power Plants (RPPs) initially attracted significant foreign investment under the promise of alleviating Pakistan's power shortages/issues. However, systemic corruption, weak contract enforcement, and regulatory failures significantly eroded the intended benefits of such inflows.

The RPPs, launched in the late 2000s, invited foreign firms (mainly from the Gulf) to deploy short-term electricity generation rapidly. These were structured as FDI-backed rental power contracts. Within a few years, most of these contracts were found illegal due to significant corrupt practices in procurement[14]. This not only diverted public funds but

[13] https://www.dawn.com/news/1834574
PIDE (2024). https://file.pide.org.pk/pdfpideresearch/wp-2024-2-power-sector-debt-and-pakistans-economy.pdf
[14] Pakistan has paid a billion in damages to foreign firms due to corruption.

also signaled to global investors that Pakistan's institutional environment posed serious risks[15].

Likewise, the IPPs also attracted both domestic and foreign investment (including Chinese and Gulf-backed firms). They also ended up in circular debt and delayed payments. Despite significant FDI into energy production, the sector remains financially unsustainable. Investors have raised concerns over a lack of transparency in tariff calculations and political interference. Significant corruption and governance issues resulted in the underutilisation of capacity, an increased fiscal burden, and weak long-term returns on foreign capital. These case studies reiterate the FDI experience of Pakistan as well as emphasise the broader theme highlighted in this Brief.

Regional FDI Trends

Similar patterns of FDI inflows exist in the neighbouring countries of Pakistan. Sri Lanka has a CPI score of 32, while Bangladesh has an even lower score of 23. And, India recently moved from a CPI score of 39 to 38. In November 2024, the U.S. authorities accused the Adani Group (the biggest investment conglomerate of India) and its associates are allegedly involved in arranging a bribery scheme worth over $250 million. However, Sri Lanka has received around USD3 billion in assistance from India during its financial crisis.

Additionally, in 2023, India received USD 21.05 million in net FDI from Bangladesh, which accounted for 70.45% of Bangladesh's total outward FDI (despite having a relatively low CPI score of 23). In FY24, India was the fourth-largest investor in Bangladesh, contributing USD132.83 million, an increase from USD115.99 million in 2019.

These trends suggest that despite challenges in governance and transparency, investments continue to flow between regional countries. Investors, especially from nations with similar corruption issues, may prefer to invest in countries where they are familiar with the challenges of navigating such an environment.

[15] https://supremecourt.nadra.gov.pk/downloads_judgements/cma.3685-3686_of_2012_in_hrc.7734-g_of_2009_dt_31.01.2013.pdf

5. Conclusion, Findings, and Recommendations

Conclusion

This Policy Brief provides empirical evidence on how corruption affects FDI in Pakistan. Its findings are consistent with those of Winner (2005) and Quazi (2014). It concludes that corruption in Pakistan may facilitate short-term FDI inflows due to bureaucratic inefficiencies and regulatory bottlenecks. However, it undermines long-term economic development by distorting institutional integrity, compromising sustainable productivity, and reducing the credibility of governance systems.

For Pakistan, the real challenge lies in overcoming bureaucratic structures and making regulatory mechanisms transparent, efficient, and investor-friendly. Institutional reforms should aim not just at reducing corruption, but at eliminating the underlying causes that make corruption a necessary lubricant in the investment process.

Additionally, Pakistan may understand that foreign investors often come to maximise their profits. Finally, the country may take responsibility for managing its finances effectively, maximising the benefits of FDI, and redirecting funds lost to corruption into more productive uses. It may consider reforms that go beyond trivial/superficial changes and address underlying systemic inefficiencies.

Moreover, the FDI-corruption dynamic in developing countries like Pakistan needs further empirical exploration. Corruption, often seen as a “grease” to navigate institutional obstacles, questions responsibility, making it difficult to clearly identify who is complicit, the investor or the recipient. Therefore, a broader, more inclusive definition of corruption is essential. One that captures informal mechanisms and systemic loopholes that perpetuate corrupt behaviours. Additionally, regulatory frameworks in developed economies may also be scrutinised to understand why they permit outward FDI into corrupt countries.

However, these results should be taken with caution. A few papers argue about the nature of the FDI-corruption relationships, whether it is non-linear or linear. In the future, researchers could focus on the non-linear relationship. Besides this, the study used a sample of FDI sending economies with a major share in FDI inflow to Pakistan, but not all economies. Hence, the results of this brief may or may not be generalised.

Since countries differ significantly in terms of their economic and political environment and regulatory structure, a country-specific study–that is to say, Pakistan and Australia can provide more specific results.

Findings

Key findings of this Brief are provided hereunder:

- In Pakistan corruption functions as an informal mechanism that facilitates business transactions and bypasses formalities. Investors in Pakistan prioritise returns over institutional integrity.
- Countries with higher CPI scores (i.e., lower corruption) still invest in Pakistan, implying that investors from such countries are not necessarily deterred by corruption or bribery.
- Sectoral trends in FDI show concentrated inflows in the energy, finance, and food sectors. Despite significant FDI, these three sectors exhibit limited productivity gains because they are typically vulnerable to rent-seeking behaviours.
- The energy sector is grappling with unsustainable circular debt exceeding PKR 2.6 trillion.
- The financial sector is underdeveloped, largely servicing government borrowing instead of industrial growth.
- The food sector generates employment opportunities. However, its heavy dependency on imports and lack of productivity gains contribute to external account pressures.
- Similar regional trends in Bangladesh, Sri Lanka, and India suggest that corruption is often an expected condition for capital movement in South Asia.

Recommendations

While reducing corruption remains a long-term objective, developing countries may prioritise institutional reforms that promote transparency and improve regulatory efficiency. Such measures can help diminish reliance on informal mechanisms. To address Pakistan’s corruption-FDI conundrum, the following recommendations are provided here:

- To combat corruption, the government may use digital channels for FDI-related transactions to eliminate discretion, reduce “speed money,” build institutional memory, and ensure transparency.
- An independent oversight body may monitor FDI transactions using AI-based tools or software to detect anomalies and enforce proper documentation of all financial flows.
- In sectors that are prone to corrupt practices, such as energy, construction, and procurement, the government may improve communication and real-time data-sharing mechanisms between government departments, ministries, and the public.

- Simplify and digitalise/online licensing procedures for foreign firms to reduce informal payments and bureaucratic frictions.
- Streamline fuel procurement processes by introducing third-party audits and mandatory disclosure of tariff calculations and other cost-related figures.
- Enforce performance-based FDI contracts to link FDI with actual delivery, not feasibility studies.
- Develop long-term capital markets (e.g., infrastructure bonds) to channel FDI into growth-enabling sectors.

About the authors

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