Exploring the Link between Foreign Direct Investment (FDI), Industrial Policy & Trade Policy: A Case Study of Pakistan

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ABSTRACT: The main objective of this systematic literature review is to analyze the relation between Foreign Direct Investment (FDI) and Industrial Policy with Trade Policy within the time period of 2000-2025 in Pakistan. In this in-depth analysis of 25 peer-reviewed studies and policy documents, we explore the interactions between these three policy streams in determining the economic trajectory of Pakistan. The results show a complex and sometimes disjointed policy framework, with the overall policy focus on sector-specific incentives for attracting FDI and the processes of trade liberalization has largely eschewed industrial development. The China-Pakistan Economic Corridor (CPEC) launched in 2015 is a paradigm shift in the attraction of FDI through infrastructure investments, but issues of technology transfer, local content and sustainable industrial development remain. We highlight key trade-openness–industrial upgrading policy gaps and FDI promotion–domestic industrial capacity gaps. The review emphasizes the importance of integrated policy frameworks connecting FDI attraction and targeted industrial development and strategic trade policy. Overall, our analysis adds to the existing body of work on development economics by offering a detailed analysis of development economics interactions in a developing economy context.

KEYWORDS: Foreign Direct Investment, Industrial Policy, Trade Policy, Pakistan, CPEC, Special Economic Zones, Economic Development, Systematic Review

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Introduction

Background and Context

Since 2000, Pakistan has had many policy experiments in three key areas of economic development: Promotion of Foreign Direct Investment (FDI), Industrial Policy and Trade Policy. Theoretically, these three policy areas are interdependent in the sense that FDI can be used as a vehicle for technology transfer and the industrial upgrading process, industrial policy can create an enabling environment for productive investment and trade policy determines the competitive environment of domestic and foreign firms (Khan & Khan, 2011; Hussain & Ahmed, 2011).

However, in reality in Pakistan, there is more complexity and a contradiction. Although successive phases of trade liberalization that started from the late 1990s and continued through the 2000s have not yet been able to ensure sustained competitiveness for the manufacturing sector in Pakistan (Nazli et al., 2018). Likewise, the inflows of FDI have been seen to increase from time to time, particularly since the start of the China Pakistan Economic Corridor (CPEC) in 2015, but there is growing concern about the quality and sectoral allocation of FDI and its impact on development in Pakistan (Yusuf, 2013; Ullah & Hussain, 2022).

The period between 2000 and 2025 contains several phases of policies in Pakistan:

1. **Post-Structural Adjustment (2000-2008)**: trade liberalization, privatization and comparatively unfree FDI regimes during the Musharraf government.
2. **Democratic transition and crisis (2008-2013)**: Economic instability, energy crises and changing policy orientations.
3. **CPEC Era Begins (2013-2018)**: commencement of CPEC with major investments in the infrastructure and energy sector by China.
4. **Industrial Focus and Deepening CPEC (2018–2025)**: Industry cooperation, Special Economic Zones (SEZs) and Industry partnerships.

Research Objectives

This systematic literature review will answer the following research questions:

1. What has been the understanding and research of the link between FDI, industrial policy and trade policy so far in Pakistan?
2. What is the empirical evidence on the effectiveness of policy interventions in each domain?
3. In what ways do these three policy areas interconnect, and what are the linkages and overlaps or tensions between them?
4. What policy gaps and disconnects have been revealed in the literature?
5. What were some of the lessons learned for future policy integration?

Scope and Significance

This review is specific to Pakistan and illustrates a case study that adds to the other discussions in the field of development economics on the role of the state in economic development, the sequencing of trade and industrial policies and using FDI as a strategic development tool (Chatha et al., 2026; Sarwar, 2025). The Pakistani situation is especially interesting as it has been a strategic geopolitical location, it is a part of the Belt and Road Initiative of China, and it continues to struggle in implementing policy changes and turning them into sustainable industrial development.

Methodology

Review Protocol

This SLR is conducted in a systematic manner that is tailored to the context of policy literature synthesis, and adapted from the PRISMA (Preferred Reporting Items for Systematic reviews and Meta-Analyses) guidelines. The following stages were part of the review protocol:

Search Strategy: A comprehensive search was done in Google Scholar, Crossref, and ArXiv databases with the combinations of the following keywords: Pakistan, FDI, foreign direct investment, industrial policy, trade policy, trade liberalization, CPEC, Special Economic Zones, manufacturing, economic growth.

Inclusion Criteria:

- Many studies are covered on Pakistan's economy.
- Publication years between 2000 and 2026
- An empirical or theoretical examination of FDI, industrial policy or trade policy.

- All peer-reviewed journal articles, working papers from reputable institutions (PIDE, SDPI, IGC) and policy documents
- Research in the areas of the FDI-industrial-trade nexus, at least one dimension

Exclusion Criteria:

- Studies that are not directed towards Pakistan.
- Stranger-than-fiction stories such as descriptions of a person or object, without any framework.
- The student should include articles from news, opinion and non-academic publications.
- Studies published before 2000

Data Extraction and Synthesis

We selected the following data from each study included:

- The bibliographic information (author(s), venue, year, and the DOI, if available)
- Level of difficulty (Tablet, calculator, no calculator)
- The key findings and conclusions are not only obvious, but also evident.
- Policy recommendations
- Recognized and identified limitations and gaps

The synthesis was done thematically, by grouping the findings under:

1. Temporal/policy period
2. The function of policy (as a tool for education, a means of social control, a mechanism for social change)
3. Regional bias (North-South, East-West, west or north coast)
4. Methodological approach

Quality Assessment

Studies were assessed for quality based on:

- How rigorous and appropriate the method is
- Data Quality/Sources of Data
- Reporting Method, Transparency; Reporting Limits
- Whether able to add to the understanding of the policy or not.

Theoretical Framework

FDI Theories and Development

Theoretical literature on FDI has highlighted that foreign investment may be beneficial for economic development in a number of ways:

Capital Formation: FDI also acts as a supplement to domestic savings and investment, thus helping in the financing of productive activities beyond domestic sources (Khan & Khan, 2011).

Technology Transfer: Multinational enterprises (MNEs) transfer advanced technologies, management and organizational skills to domestic enterprises (Rahman & Bakar, 2018).

Human Capital Development: FDI brings employment opportunities and facilitates skill development; this is done by training and introducing best practices from around the world (Khan et al., 2023).

Market Access: MNEs can facilitate access to international markets by integrating into global value chains (Khan & Bilal, 2017).

But these advantages depend on the country where the FDI is invested, such as the country's absorptive capacity, complementary human capital and infrastructure investments, and the policy frameworks in the host country (Nazli et al., 2018).

Industrial Policy Frameworks

Industrial policy is used to describe any policy action by the government to influence the composition of production in sectors that are expected to have more successful economic growth and development. (Chatha et al., 2026). It is important to note that the following theoretical frameworks are used:

Industry Protection: The classical argument that infant industries require some protection until they become competitive is infant industry protection (Hussain & Ahmed, 2011).

Strategic Trade Theory: (recognition) that strategic interventions can alter rents in global markets, which can be oligopolistic.

New Industrial Policy: Shift focus from picking winners to solving the coordination problems and providing public inputs (Chatha et al., 2026).

Trade Policy Linkages

There are several links between trade policy and both FDI and industrial policy:

Export Orientation: Trade liberalisation can encourage export-oriented FDI, providing access to the global market and at the same time building capability.

Import Competition: Openness means exposure to competition, which can lead to increased efficiency and/or deindustrialisation if local capacity is inadequate.

The effects of exporting on learning are as follows: Exporting provides exposure to international practices, quality standards and technological opportunities (Majeed et al., 2010).

The Tripartite Nexus

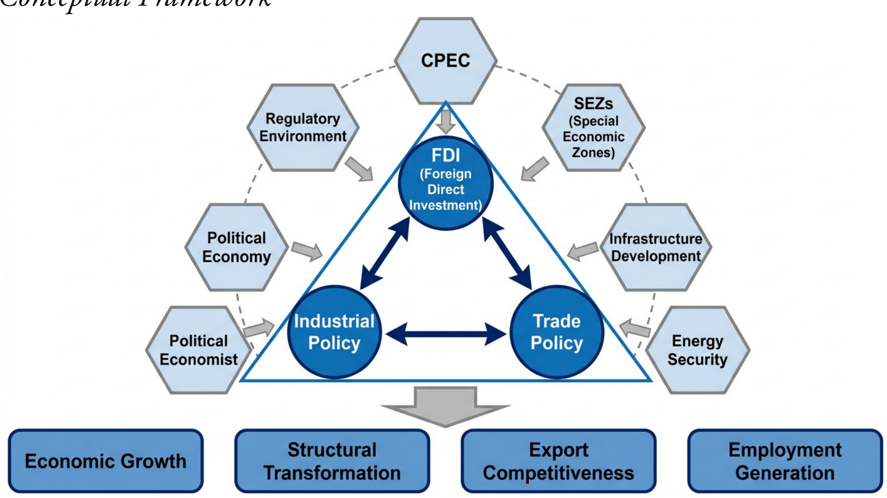
If we model the impact of FDI, industrial policy and trade policy as a dynamic system, then the theoretical relationship between the three could be conceptualized as:

- Industrial policy sets the enabler and direction for economic development.
- The competitive landscape and conditions of market access are set by trade policy.
- FDI is a means of capital, technology and market integration.

These three aspects are necessary for development outcomes to be effective, and when considered in the context of the Pakistani case, it is evident that coherence has been missing in most instances (Sarwar, 2025; Naqvi, 2025).

Figure 1

Conceptual Framework



Note: This framework presents the main linkage among the three policy arenas (central triangle), some of the moderating conditions specific to Pakistan (middle ring) and desired economic outcomes (outer ring).

The conceptual framework is shown in Figure 1, which is based on the Tripartite Relationship between FDI, Industrial Policy and Trade Policy in Pakistan.

This review is guided by a conceptual framework as shown in Figure 1. The three policy domains are shown in the central triangle, and the arrows represent the interdependency of the three domains. The moderating factors reflect the conditions in Pakistan that impact the effectiveness of policies, and the outcomes reflect development goals that the process of policy integration seeks to attain.

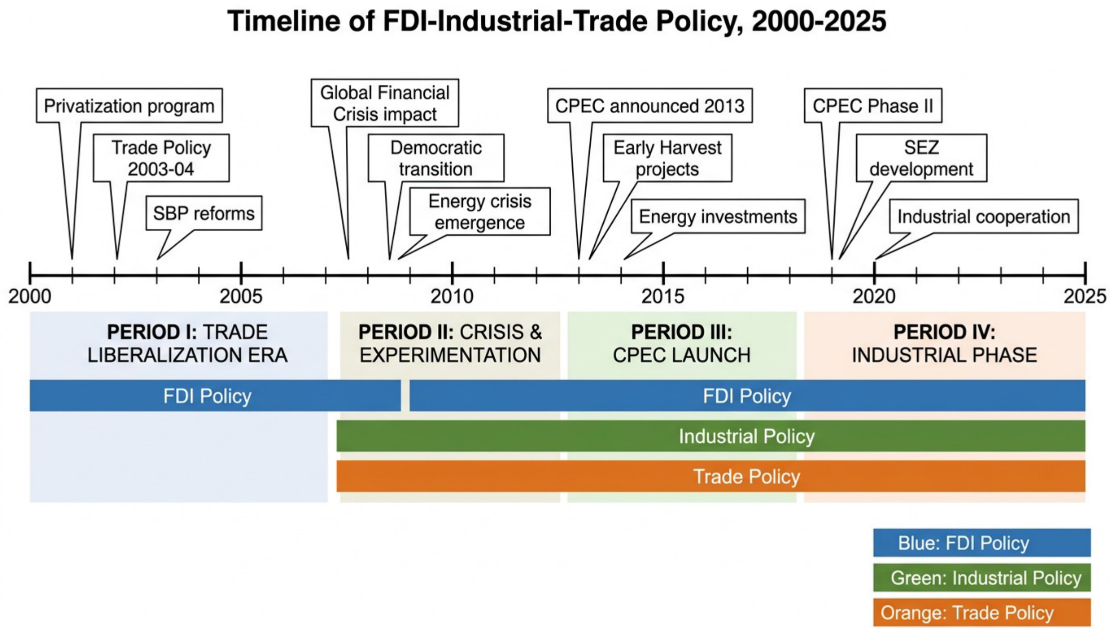
Chronological and Thematic Analysis

Pre-2000 Baseline: Structural Adjustment and Its Legacy

Before our analysis window, Pakistan had been going through a number of structural adjustment programmes with the guidance of the IMF and World Bank. These reforms included corporatization of the state-owned enterprises, trade liberalization and foreign investment (Hussain & Ahmed, 2011). The manufacturing base was, however, narrow, and was based largely on textiles and light manufacturing, although there was not much depth in the technology. The context in which this baseline is measured is essential to understanding the path that will follow in the future as a result of the policy interventions.

A timeline of the key policy changes in the four periods reviewed in this review is shown in Figure 2. The timeline shows the change in focus on the policy from trade to development.

Figure 2



Note: The color coding represents the policy domain of primary focus: blue represents FDI policy, green represents Industrial policy, and orange represents Trade policy

The timeline of Pakistan's FDI, industrial policy and trade policy developments (2000-2025) is shown in Figure 2. From the liberalisation era of the early 2000s to the CPEC-centric approach since 2013, the development of one policy into another is a process that has undergone a gradual transformation. A gradual transformation in one policy to another has been experienced since the liberalisation era of the early 2000s to the CPEC-centric approach since 2013.

Period I: Trade Liberalization and Early FDI Reforms (2000-2008)

Pakistan embarked upon a trade liberalization process that commenced during the 1990s and continued into the early 2000s. Majeed et al. (2010) study the systematic impact of trade liberalization on total factor productivity growth between 1971-2007, and conclude that the evidence on the impact of trade openness on productivity is mixed. They find that the gains from trade liberalization are critically dependent on some of the key complementary factors, such as infrastructure, human capital, and institutions.

During this time, there were low and limited inflows of FDI in specific sectors. Iram & Nishat (2009) perform a sector analysis of the FDI-growth nexus, dividing it into two categories, namely services and manufacturing FDI. Their findings suggest that services FDI had a larger contribution towards economic growth as compared to manufacturing FDI, which is in accordance with Pakistan's sectoral FDI profile, while highlighting the competitiveness of the manufacturing base.

During this time period, there are a number of experiments documented in Pakistan for industrial policy by Hussain & Ahmed (2011), who pointed out that despite the rhetoric of promoting industrial development, industrial policy was lacking in coherence and unity. The authors find a prevailing trend of "stop-go" interventions that have not offered the kind of sustained support needed for bringing about industrial upgrading.

Period II: Post-Crisis Industrial Policy Experimentation (2008-2013)

This was a challenging time for investment due to the global financial crisis, and domestic issues such as energy shortages and security concerns. Energy constraints affected the industrial sector, as well as a reduction in FDI inflows.

In this regard, Siddiqui (2010) suggests a framework for a services-led industrial policy for Pakistan as a nation that is becoming more and more competitive in providing services. This approach called into doubt the traditional approaches to industrial policy and policy changes to fit new economic structures.

Trade policy in this time period was somewhat ambivalent. The norm of rhetorical liberalisation persisted, although various protectionist measures were adopted as a result of pressure from the balance of payments and pressure from the domestic industry (Nazli et al., 2018).

Period III: CPEC Era and Infrastructure-Led FDI (2013-2018)

The launch of CPEC in 2013 was a turning point in the policy paradigm of Pakistan on FDI and infrastructure investments. The corridor was expected to bring in huge amounts of Chinese capital in the areas of energy, transport and telecommunications.

Yusuf (2013) discusses whether Chinese FDI can speed up the growth of Pakistan, and identifies opportunities and risks. Although Chinese investment might help solve the problem of infrastructure bottlenecks, the authors point out that there were worries that there would be no technology transfer, local content, and financing of infrastructure through debt.

Khan et al. (2016) discuss the background, problems, and solutions for SEZs in the context of CPEC and the importance of institutional capacity and policy coordination of the SEZs to achieve the goal and benefits of SEZs under CPEC. They note some of the major lacunae in the SEZ policy implementation in Pakistan vis-à-vis international best practices.

Mehar (2017) empirically explores the relationship between infrastructure development, CPEC and FDI, and concludes that there exists a positive association between infrastructure development and investment attraction. But the authors warn that sustainable industrial development is not possible without infrastructure, too.

Period IV: Deepening Industrial Cooperation (2018-2025)

During the last time frame, there has been a greater emphasis on industrial cooperation under the second phase of CPEC, particularly SEZs and manufacturing alliances.

In his work, Mahmood (2019) argues that CPEC-SEZs can play a pivotal role in reindustrializing Pakistan, and that this role will only be realised if the SEZs are not just used as vehicles for infrastructure development, but also for skills development, technology transfer and conducive trade policies.

Naeem et al. (2020) carry out a detailed analysis of the drivers and barriers of successful SEZs under CPEC, which include institutional capacity, regulatory structures and the labour market. Conditions were used as Critical Success Factors. The results of their study indicate that Pakistan has large hurdles in establishing SEZs, which can both attract quality FDI and yield sustainable development.

Ullah & Hussain (2022) empirically study the linkage between Chinese investment under CPEC and economic growth by applying the ARDL approach. According to their results, there are positive long-run relationships between economic growth and CPEC-related investment; however, its distributional and structural implications are still under discussion.

The impacts of CPEC on the broader economy analysed by McCartney (2022) range from the development of infrastructure, social savings and spillover effects. The writer observes that CPEC not only resolves the issues of critical bottlenecks, but there are still a number of questions regarding the corridor's game-changing ability in the industrial sector in Pakistan.

The work of Chatha et al. (2026) and Sarwar (2025) is recent work that offers some valuable assessments of policy coherence. Chatha et al. (2026) have analysed the need for an industrial policy in today's Pakistan, suggesting that while industrial policy should not be divorced from trade and investment policy, it needs to complement it. Sarwar (2025) has pointed out that there are basic gaps between the policies for trade, industrial development and FDI, which are the major factors affecting sustained export growth and industrial development.

Naqvi (2025) discusses the structural bottlenecks in the trade sector and their connection with the lack of competitiveness in manufacturing and the liberalisation of the trade policy without giving sufficient consideration to constraints on supplies. Safdar (2026) offers a critical political economy perspective on structural transformation under CPEC, which claims that CPEC might be more likely to strengthen Pakistan's prevailing economic structure absent an active industrial policy.

FDI-Industrial Policy Nexus

Sectoral Distribution of FDI

T The fact of unequal distribution of FDI by the sectors in Pakistan has been well reported in the literature. Patterns are analyzed by Khan & Khan (2011), and they observe that the concentration is in the telecommunications, financial services and energy industries, and relatively weak in manufacturing, in a small number of manufacturing sectors, such as automotive and chemicals.

See Rahman & Bakar (2018) for a detailed study of FDI in manufacturing in Pakistan, which suggests that while policy measures have been taken to encourage FDI in the manufacturing sector in Pakistan, services still remain the main source of FDI inflows. The authors note that there are several factors:

Uncertainties arising out of the policies and regulations have been a major challenge.

- A lack of energy resources
- Likely shortages of skilled people for high-tech manufacturing
- Lack of strong local supplier networks
- Existing manufacturing sites were competitive in the area

Special Economic Zones as Industrial Policy Instruments

SEZs are one of the important tools to align FDI attraction with industrial policy goals. The literature presented a picture of the SEZ experience in Pakistan, with some opportunities and challenges identified.

While analyzing the SEZ framework in Pakistan under CPEC, Khan et al. (2016) have highlighted some of the gaps with regard to successful international experiences:

- **Institutional Capacity**: Lack of administrative capacity to manage the zone and facilitate investors.
- **Regulatory Framework**: Complex and inconsistent regulations for zone operations
- **Infrastructure Quality**: Heterogeneous quality of infrastructure provided inside and outside Zones.
- **The backward linkages** were limited, with little development of linkages with the domestic market.

Naeem et al. (2020) carry out a comprehensive study on success factors of CPEC SEZs, focusing on the fact that factors other than tax privileges and infrastructure are also relevant for the success of SEZs. They found that the role of key considerations is:

- A strategic location and connectivity
- Skilled labour is available
- An effective customs and regulatory clearance process.
- Concentrate on development and agglomeration economies.
- Technology transfer mechanisms

If accompanied by a clear industrial upgrading policy, SEZs can help drive industrial development more widely under CPEC, says Mahmood (2019). The author, however, points out that the existing SEZ models have the potential of fostering the development of enclave economies with few linkages to the mainstream economy.

Manufacturing FDI and Industrial Upgrading

There is mixed evidence in the literature on manufacturing FDI in relation to technology transfer and upgrading of industries.

Khan et al. (2023) study the associations between FDI, industrialization, and employment, and conclude that there are positive but weak connections. Although manufacturing FDI has resulted in some small contribution to industrial output and employment, their analysis indicates that the promised transformation has not yet come to pass, as was hoped by policymakers.

Waqar et al. (2023) use the automobile industry as a case study of the impact of FDI and conclude that the industry experienced technology transfer and productivity gains from FDI through joint ventures with foreign firms. The sector has experienced significant protection and low levels of export, however, with questions of sustainability.

Javed & Suleri (2019) investigate the employment status in the manufacturing sector, and find that manufacturing FDI has created relatively few direct jobs as compared to services FDI. The authors call for industrial policies to focus on creating jobs as well as productivity gains.

Policy Coordination Challenges

There is also a recurring strand in the literature that sees a lack of coordination between the promotion of FDI and industrial policies. As described by Chatha et al. (2026), investment promotion has been frequently happening in isolation from the focus of industrial development:

"This growth has been based on large-scale FDI and labour-intensive growth, and since the mid-80s, manufacturing has faced difficulties in sustaining economic growth and innovation."

This is not connected and happens in a number of ways:

- The emphasis is on quantity, not quality or on industry priorities, of FDI investment promotion agencies.
- Industrial policies are not developed taking into account the potential of FDI.
- There is a lack of integration of trade, investment and industrial aspects in sectoral strategies.

FDI-Trade Policy Nexus

Trade Liberalization and Investment Patterns

The drive for trade liberalization has largely been independent of FDI policy in Pakistan, resulting on the one hand in opportunities and on the other in challenges.

Nazli et al. (2018) studied the impact of trade reforms on productivity in manufacturing, and found that there are differential impacts across sectors. There was considerable competition in import-competing industries, and favorable access to imported inputs for export-oriented industries.

The authors point out that:

" Other variables, such as trade liberalization, have significant impacts on productivity, "technical efficiency of manufacturing sub-sectors '."

But the trade liberalisation benefits have been dampened due to complementary factors such as inadequate infrastructure, energy constraints and technology limitations.

Majeed et al. (2010) examine the effects of trade liberalization on TFP growth during 1971-2007 and conclude that there are positive, albeit small, effects. Their analysis indicates that the productivity effects of trade openness are very sensitive to:

- Human capital levels
- Infrastructure quality
- Financial sector development
- Institutional quality

Export Processing Zones and Trade-Investment Linkages

Attempts are made to build an institutional framework to connect the trade and investment policies through Export Processing Zones (EPZs) and, in recent times, through SEZs under CPEC. The efforts to create an institutional framework to connect the trade and investment policies include the Export Processing Zones (EPZs) and, in recent times, the SEZs under CPEC.

Azam (2020) contrasts the export performance of military and democratic governments, and concludes that the effect of policy coherence and commitment has been greater during countries' economic periods of military rule. The author suggests that export success demands the need for combining the two policies, namely export and industrial policy (capability development).

Khan & Bilal (2017) examine the relationship between FDI and export and their impact on economic growth and conclude that export-seeking FDI has been more positive on economic growth than domestic market-seeking FDI. Our finding is in line with the notion that the developmental effect of FDI is affected by trade policy orientation.

Import Liberalization and Domestic Industry

There are references in the literature to the conflict between the two types of competition in trade liberalization and domestic industrial development. Sarwar (2025) points out that there are some basic misalignments:

There is a lack of coherence between trade, investment and industrial policies, which negatively impacts export growth and industrial competitiveness."

These disconnects include:

- Lack of capacity development in domestic industries by the country to benefit from trade liberalization.
- Lack of capacity building within the country to take advantage of trade liberalization.
- The sectors that do not have much export potential as a target for FDI attraction. This mismatch between tariff design and upgrading priorities of industries has been a major concern. Non-coordination of tariff structures with industrial upgrading priorities has been a major concern.
- There is a low focus on improving trade facilitation and logistics competitiveness.

The relevance of structural flaws in Pakistan's trade to failures in industrial policy is discussed by Naqvi (2025), who states that the structural trade deficits are symptoms of inability to build up industrial competitiveness in a wider range of goods.

Toward Export-Led FDI

Some studies indicate that Pakistan should consider policies which specifically relate the attraction of FDI to export development. The relationship between FDI and exports in Pakistan and India is compared in Khan & Bilal (2017), who conclude that the Pakistan FDI-export linkages have been less productive because of a lack of export orientation and a strong manufacturing base in Pakistan.

According to the literature, the following are crucial to making export-led FDI strategies effective:

- Promotion of export-oriented investments.
- Trade facilitation/Logistics improvements
- Quality standards and certification are all supported.
- Acquire market intelligence and develop trade promotion.
- Market intelligence and trade promotion.
- Competitive exchange rate management

Three-Way Interactions and Systemic Coherence

The Integration Challenge

It is found that in Pakistan there is still a lack of integration between the policies of FDI, industry and trade. The literature has focused on each of the policy domains, but across the board, disconnects have been identified that limit the overall effectiveness of development.

According to Chatha et al. (2026), the following changes in the working of the state-market nexus are needed to build any effective industrial policy in the current context in Pakistan:

- To coordinate the strategy between policy dimensions
- Learning by doing with adaptive policy learning from implementation experience

- Sticking to the topic of institutional capacities, the capacity of the institutions for policy implementation is looked at, as well as their capacity for monitoring.
- The efforts of the government, private sector and non-governmental organizations will be coordinated with the involvement of the interested parties.

CPEC as a Test Case

CPEC offers an opportunity to make a natural experiment to study three-way policy interactions:

- Inward investment (mainly Chinese) has been huge
- Funds for infrastructure (industrial policy output)
- The development of trade corridors (trade policy dimension)

The effects of positive growth of CPEC are supported by empirical evidence from Ullah & Hussain (2022), while Safdar (2026) has done a more critical examination of outcomes of structural transformation. The differences in results are due to different perceptions, timeframes and analytical approaches, but both indicate that policy coherence is an important factor in determining the final effect of CPEC.

Positive Effects

- Helped to resolve the energy crisis
- Improved transport connectivity
- Attracted significant FDI
- Created jobs and employment in construction

Concerns

- Today, relatively little technology transfer has been achieved.
- This has led to a reliance on Chinese inputs and labor. This has created a heavy reliance on Chinese inputs and labour.
- Debt sustainability concerns
- Future of industrial upgrading is unclear
- There is a potential to develop enclaves.

Mehar (2017) states that infrastructural development is not sufficient to spur industrial transformation if coupled with other policies that focus on skills development, technology development and market access.

SEZs as Integration Mechanisms

SEZs under CPEC are efforts to establish an institutional framework where the policies of FDI, industry and trade converge. But the research indicates that these zones are yet to reach the level of integration for transformative development.

According to Naeem et al. (2020), there are certain requirements encompassed within the three policy domains which are essential for the success of SEZs.

Table 1

Policy Requirements for SEZ Success

Policy Domain	Key Requirements
FDI Policy	Targeted promotion, investment facilitation, dispute resolution, investor protection
Industrial Policy	Skills development, supplier networks, technology transfer, clustering
Trade Policy	Duty exemptions, customs efficiency, logistics connectivity, export promotion

The evidence indicates that Pakistan has done well in certain areas (specifically provision of infrastructure) but has not done well in others (such as skills development, supplier network development and trade facilitation).

Evidence of Policy Learning

Although the challenges have continued, the literature does show signs of policy learning in the period of the review. Hussain & Ahmed (2011) report that the policies for industrial development have gone from protectionism and import substitution to a more sophisticated one that focuses on competitiveness and export.

More recent contributions argue increasing awareness of the need to have integrated approaches. Sarwar (2025) and Naqvi (2025) both make calls for fundamental reforms in order to achieve coherence in all the policy areas related to trade, industry and investment.

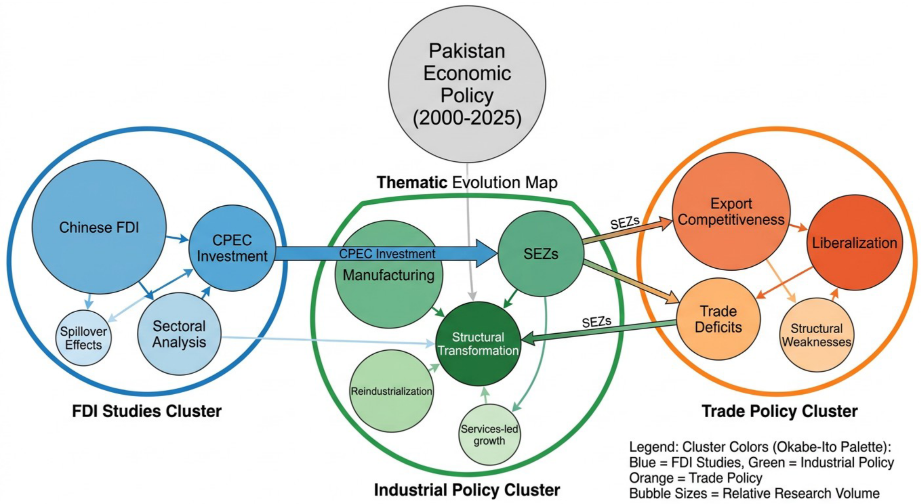
Empirical Evidence Synthesis

Research Themes and Evolution

The literature examined shows clear theme clustering, which has developed over the time frame of the study. It is observed from Figure 3 that the thematic research of FDI, Industrial policy and trade policy nexus in Pakistan is divided into six thematic areas.

The analysis of the themes shows three main streams of research. The FDI Studies cluster has expanded significantly since 2013, especially with the launch of CPEC, on matters of Chinese investment and sectoral analyses.

Figure 3



Note: The volume of research is represented by the size of the bubbles. Lines show thematic links as they have been found in the literature.

Thematic map of literature related to the FDI-Industrial-Trade policy Nexus in Pakistan (2000-2025) is shown in Figure 3, during recent years, with special focus on manufacturing revival and development of SEZs. The Trade Policy cluster has been persistently engaged in the issue of the effects of liberalisation and export competitiveness, the latter being the subject of recent work, which identified weaknesses in the structure.

Productivity Effects

The empirical evidence on productivity effects is inconclusive but has, on balance, a positive sign and with important qualifications for both FDI and trade liberalization.

According to Nazli et al. (2018), the productivity growth resulting from the implementation of trade reforms has been observed in manufacturing but has been found to be heterogeneous across different sectors, and efficiency varies within the sector depending on the firm characteristics. The authors point out that productivity has been less than expected, due to a lack of infrastructure and skills.

The findings from the studies on the spillover effects of FDI are also mixed. The evidence of positive growth impacts from FDI is found by Khan et al. (2023), but the impact is relatively small and is sector-specific. This suggests that the FDI inflows were mainly from services FDI, with spillovers being larger than those of manufacturing.

Growth and Employment Effects

There is evidence in the literature that there are positive links between FDI, openness of trade and economic growth, but there is debate over causality.

Ullah & Hussain (2022) conduct an ARDL analysis to establish long-run relationships between economic growth and investment inflows in CPEC. Based on their results, they believe that the possibility of infrastructure has evidence of growth-promoting processes, but the extent and pattern of benefits is still a research topic.

The impact of employment seems to be more limited. Javed & Suleri (2019) mention that manufacturing FDI has been less effective in creating jobs, compared to services FDI and that jobs created by manufacturing FDI are of poor quality, in terms of wages, working conditions, skill development, etc.

Structural Transformation

In the literature, the answer to the question of the impact of FDI and trade policy on structural transformation (shifting resources to higher productivity activities) is mixed. Safdar (2026) states that the structural shift envisaged by CPEC has not been realised yet, highlighting:

“If Pakistan doesn't have any industrial policy then it is not possible to change the economic structure of the country through CPEC.”

This assessment follows the general trend of the limited role of FDI in the tradable sector, especially manufacturing, and the focus on infrastructure, energy and telecommunication.

Meta-Findings Summary

Combining information from several studies, there are several meta-findings:

- **Policy coherence is important**: Repeatedly, it is found that isolated policy interventions do less well than integrated policy interventions.
- **Complementary factors matter**: Policies on FDI and trade are likely to have a positive effect on the success of such adjustments only if they are complemented by other policies such as infrastructure, human capital and institutional quality.
- **Sector effects**: The spillover impacts of FDI are sector-specific – manufacturing FDI has demonstrated fewer spillovers than desired.
- **Time horizon is long**: Structural transformation and capability development take a long time, which needs a long-term policy commitment.
- **Limited administrative** capacity and coordination failures hinder policies from being effective.

Policy Gaps and Disconnects

Identified Disconnects

The literature identifies several critical disconnects between FDI, industrial, and trade policies:

Disconnect 1: Trade Liberalization Without Industrial Upgrading

Sarwar (2025) and Naqvi (2025) For both of these, Sarwar (2025) and Naqvi (2025), trade liberalization was carried out in the absence of an effort to build up domestic capabilities to compete. This has helped to make a positive impact on:

- In some sectors, deindustrialization will take place. There will be deindustrialisation in some sectors.
- Persistent trade deficits
- The extent to which a company can expand its operations is constrained along the value chain.

Disconnect 2: FDI Attraction Without Industrial Strategy

Chatha et al. (2026) point out that the promotion of FDI has been separated from the priorities of the development of industry.

"The FDI-led growth with no industrial policy has resulted in fewer spillovers and enclave development."

Disconnect 3: Infrastructure Investment Without Industrial Coordination

Although the investments in infrastructure in the framework of CPEC have helped overcome major bottlenecks, Mehar (2017) and Mahmood (2019) assert that there is a lack of strong linkages between infrastructure provision and industrial development strategies.

Disconnect 4: SEZ Development Without Linkage Creation

SEZs under CPEC are facing the possibility of developing into enclaves which are not connected with the domestic economy. Naeem et al. (2020) mention meagre efforts being put in place to strengthen backward linkages with domestic suppliers.

Institutional Fragmentation

Fragmentation in the institutions is cited by multiple authors as a cause for policy disconnects. There is a lack of coordination between various ministries and agencies, and the responsibilities of FDI, industrial policy and the trade sector are spread.

Hussain & Ahmed (2011) cite the following institutional issues that are experienced in making an industrial policy in Pakistan:

- There is little continuity in policies over the course of political cycles.
- Low capacity in the areas of monitoring and evaluation
- NSKI has not received extensive input from the private sector.
- Bureaucratic inefficiencies

Capacity Constraints

The literature also mentions capacity limits at various levels besides the institutional level:

- **Administrative capacity**: Lack of technical knowledge in designing and implementing policy

- **A weakness in this area is the implementation capacity**, where there is a lack of capacity to implement the outcomes of the policy.
- **Inadequate absorptive capacity**: weak domestic absorptive capacity, not being able to take advantage of FDI and technology transfer.

Conclusions and Future Research Directions

Summary of Findings

This systematic literature review has explored the linkages between FDI, industrial policy and trade policy in Pakistan for 2000-2025. Key findings include:

- **Fragile Policy Coherence**: The three policy domains have developed rather less autonomously, but there is not yet much integration and synchronisation.
- **Mixed FDI Outcomes**: FDI inflows have increased especially through CPE; however, limited spillovers to domestic industry.
- **Trade policy liberalization has taken place without adequate consideration** for the ability of industries, leading to structural weaknesses.
- **CPEC's Transformative Potential**: Though CPEC has fulfilled its role of filling the deficit of critical infrastructure, the impact of CPEC on industrial development in the long term is unclear.
- **SEZ Implementation Gaps**: SEZs under CPEC have a lot of implementation gaps in integrating the three policy goals of FDI, industrial and trade policy.

Policy Implications

According to the literature, there are some indications that policy could be reformed in the following ways:

- **Integrated Policy Frameworks**: Create clear and defined policy frameworks as a coordination mechanism between FDI promotion, industrialisation and trade policy. This will need institutional changes so cross-ministerial co-ordination is possible.
- **Targeted FDI Strategies**: Go beyond a generic approach to FDI promotion to targeted strategies which focus on sectoral industrial development priorities and take into account technology transfer and linkages.
- **Trade-Industrial Coordination**: Facilitate coordination of trade and industrial development policies, based on strategic sequencing and complementary investments to support industrial development goals.
- **Support SEZ Reform**: Enhance the SEZ framework to focus on the development of linkages and skills development. The provision of technology transfers in addition to infrastructure provision and implementation.
- **Capacity Building**: Support institutional and human resources to design, implement and monitor policies.

Future Research Directions

The following are a few priorities for future studies identified in this review:

- **Long-term CPEC Impact Studies**: Comprehensive studies of the long-term impacts of CPEC on industrial structure, technology transfer and economic transformation will take place as CPEC matures.
- **Micro-level Analysis**: Studies at the firm level focusing on FDI spillovers, technology transfer and productivity effects.
- **Comparative Studies**: Comparative analysis with other countries in similar situations that are developing.
- **Policy Process Research**: Analysis of institutional and policy-economic factors influencing policy coordination.

- **SEZ Performance Evaluation**: Systematic evaluation of SEZ outcomes in relation to the objectives.
- **Green Industrial Policy**: New literature about connecting industrial policy and climate policy.

Limitations of This Review

There are a number of limitations in this review. Firstly, there is still limited evidence to support some periods and topics, especially the latest developments on CPEC. Second, not all of the empirical studies are of high quality; some may have only a small amount of data, or the method used is not optimal. Third, in some studies the political economy aspects of policy coordination are touched on, but should be explored in greater depth.

Concluding Remarks

The experiences of Pakistan over 2000-2025 demonstrate the potential and the difficulties of developing an integrated approach towards FDI, industrial and trade development policy co-ordination. Generally, although much has been invested in this region, especially under CPEC, literature indicates that policy fragmentation has brought less development. Continued investment is required to make progress, but basic reforms are needed to attain coherent policies and effective institutions.

This Pakistani case is part of the larger discussion on development and the importance of structural change, and how even significant resource transfers (CPEC) can be ineffective without supporting policies and institutional capacity. The country is moving into a new phase of CPEC development where industrial cooperation will be key, and lessons learned from the past 20 years indicate that success will heavily rely on the achievement of the integration that has been elusive.

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