

KARADENIZ TECHNICAL UNIVERSITY * SOCIAL SCIENCES INSTITUTE

DEPARTMENT OF ECONOMICS

PhD PROGRAM

**THE ECONOMIC AND INSTITUTIONAL DETERMINANTS OF FOREIGN DIRECT
INVESTMENT FOR THE SAARC COUNTRIES**

PhD THESIS

MOHAMMAD MANSOOR LODIN

DECEMBER-2024

TRABZON

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Thesis Supervisor: Prof. Dr. Ayça SARIALIOĞLU HAYALİ

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APPROVAL

Upon the submission of the dissertation, **Mohammad Mansoor LODIN** has defended the study “**The Economic and Institutional Determinants of Foreign Direct Investment for the SAARC Countries**” in partial fulfillment of the requirements for the degree of Doctor of Philosophy in English Language and Literature at Karadeniz Technical University, and the study has been found fully adequate in scope and quality as a thesis **unanimous/majority** vote on **08.01.2025**.

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PREFACE

Foreign Direct Investment (FDI) is a critical component of economic development, particularly in regions seeking to strengthen their position in the global economy. In recent decades, FDI has proven to be not only a source of capital but also a conduit for technology transfer, job creation, and skills development. For the South Asian Association for Regional Cooperation (SAARC) countries, comprising Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka FDI has the potential to accelerate economic growth, reduce poverty, and foster greater regional integration.

This study examines both institutional determinants such as rule of law, control of corruption, political stability, and economic determinants, including market size, infrastructure quality, and macroeconomic stability, human capital, trade openness, labor productivity, and natural resources of FDI for the SAARC countries. Panel data model is applied to investigate the economic and institutional determinants of FDI in SAARC nations.

The objective of this study is to uncover the primary factors influencing FDI in South Asian countries, focusing on both economic conditions and institutional structures that play a role in shaping foreign investment levels across the SAARC region. By analyzing the complex interactions between these determinants and FDI inflows, this research aims to offer valuable insights into strategic approaches and policy measures that could enhance the region's appeal to foreign investors. Through a detailed examination of these dynamics, the study aspires to support policymakers and stakeholders in designing policies that not only attract higher FDI but also maximize its positive impact on economic growth, job creation, and regional integration within SAARC countries.

I would like to extend my heartfelt gratitude to my family, whose unwavering support and encouragement have been my foundation throughout the journey of writing this thesis. Their belief in me gave me the strength to persevere through challenges and stay focused on my goals. I am also deeply thankful to my teachers for their guidance, knowledge, and dedication over the years; each of them has contributed to my growth and has inspired me to strive for excellence. I owe a special debt of gratitude to my supervisor Prof. Dr. Ayça SARIALİOĞLU HAYALİ, and Committee members Prof. Dr. Rahmi YAMAK and Prof. Dr. Murat Can GENÇ whose insightful guidance, patience, and expertise have been invaluable to this work.

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Mohammad Mansoor LODIN

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ABSTRACT

This study provides an in-depth analysis of the key economic and institutional determinants that influence Foreign Direct Investment (FDI) in the South Asian Association for Regional Cooperation (SAARC) countries. Understanding the drivers of FDI is especially relevant for SAARC nations, which include Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka, as these countries seek to leverage foreign investment to accelerate economic growth, promote development, and strengthen regional ties. The research examines a comprehensive set of economic factors that are hypothesized to attract or deter FDI, including market size, infrastructure quality, macroeconomic stability, human capital, trade openness, labor productivity, and natural resource endowments. These economic variables collectively shape the business environment and can significantly impact investor confidence, influencing both the volume and sustainability of FDI inflows.

In addition to economic conditions, this study also explores institutional determinants that affect the attractiveness of SAARC countries for foreign investment. The rule of law, control of corruption, and political stability are essential aspects of the institutional environment that can enhance or undermine investor trust. Strong institutions not only support smoother business operations but also reduce the perceived risks associated with political or regulatory unpredictability. By investigating these institutional dimensions, the research seeks to provide a balanced view of both economic and governance factors in shaping FDI trends across the SAARC region.

The study employs quantitative analysis to assess the relative impact of each economic and institutional factor on FDI inflows, utilizing data spanning from 2004 to 2018 and encompassing all SAARC countries. Panel data Fixed Effects Estimation with Driscoll-Kraay Standard Errors method is used for analyzing and estimating the relationship between variables.

The findings underscore the critical importance of a dual focus on strengthening both economic indicators and institutional frameworks to create a stable, transparent, and competitive investment environment. The results suggest that while improvements in infrastructure, human capital, market size, trade openness can attract investors, these efforts are less effective if institutional weaknesses persist, such as political instability. Also, the study concludes that control of corruption and macroeconomic stability is not affecting the inflows of FDI in the mentioned category countries.

Keywords: FDI, SAARC, Economic Determinants, Institutional Determinants

ÖZET

Bu çalışma, Güney Asya Bölgesel İş Birliği Örgütü (GABİÖ) ülkelerinde Doğrudan Yabancı Yatırımı (DYY) etkileyen temel ekonomik ve kurumsal faktörleri ayrıntılı bir şekilde analiz etmektedir. Afganistan, Bangladeş, Bhutan, Hindistan, Maldivler, Nepal, Pakistan ve Sri Lanka gibi ülkeleri kapsayan GABİÖ ülkeleri, yabancı yatırımı ekonomik büyümeyi hızlandırmak, kalkınmayı teşvik etmek ve bölgesel bağları güçlendirmek için kullanmayı hedeflediğinden, DYY'nin itici güçlerini anlamak özellikle önemlidir. Araştırma, DYY'yi çekmesi veya caydırması öngörülen piyasa büyüklüğü, altyapı kalitesi, makroekonomik istikrar, beşeri sermaye, ticaret açıklığı, işgücü verimliliği ve doğal kaynak zenginliği gibi kapsamlı bir ekonomik faktörler setini incelemektedir. Bu ekonomik değişkenler topluca iş ortamını şekillendirir ve yatırımcı güvenini önemli ölçüde etkileyebilir, DYY girişlerinin hacmini ve sürdürülebilirliğini belirleyebilir.

Ekonomik koşulların yanı sıra, bu çalışma GABİÖ ülkelerinin yabancı yatırım açısından çekiciliğini etkileyen kurumsal faktörleri de incelemektedir. Hukukun üstünlüğü, yolsuzlukla mücadele ve siyasi istikrar, yatırımcı güvenini artırabilecek veya zayıflatabilecek kurumsal ortamın temel unsurlarıdır. Güçlü kurumlar yalnızca işlerin daha sorunsuz yürütülmesini desteklemekle kalmaz, aynı zamanda siyasi veya düzenleyici belirsizliklerle ilişkili algılanan riskleri de azaltır. Bu kurumsal boyutları araştırarak, çalışma GABİÖ bölgesindeki DYY eğilimlerini şekillendirmede hem ekonomik hem de yönetim faktörlerine dengeli bir bakış sağlamayı amaçlamaktadır.

Çalışma, her ekonomik ve kurumsal faktörün DYY girişleri üzerindeki göreceli etkisini değerlendirmek için 2004 ile 2018 yıllarını kapsayan veri kullanarak nicel analiz yapmaktadır. Değişkenler arasındaki ilişkiyi analiz etmek ve tahmin etmek için Driscoll-Kraay Standart Hataları yöntemine sahip Panel Veri Sabit Etki Tahmin Yöntemi kullanılmıştır.

Bulgular, istikrarlı, şeffaf ve rekabetçi bir yatırım ortamı yaratmak için hem ekonomik göstergelerin hem de kurumsal çerçevelerin güçlendirilmesine yönelik çift odaklı bir yaklaşımın kritik önemini vurgulamaktadır. Sonuçlar, altyapı, beşeri sermaye, piyasa büyüklüğü, ticaret açıklığı gibi iyileştirmelerin yatırımcıları çekebileceğini, ancak siyasi istikrarsızlık gibi kurumsal zayıflıkların devam etmesi durumunda bu çabaların daha az etkili olduğunu göstermektedir. Ayrıca, çalışma yolsuzlukla mücadele ve makroekonomik istikrarın bahsi geçen ülkelerde DYY girişlerini etkilemediği sonucuna varmaktadır.

Anahtar Kelimeler: DYY, GABİÖ, Ekonomik Belirleyiciler, Kurumsal Belirleyiciler

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LIST OF ABBREVIATIONS

AISA	: Afghanistan Investment Support Agency
ARDL	: Autoregressive Distributed Lag
ASEAN	: Association of Southeast Asian Nations
BRICS	: Brazil, Russia, India, China, South Africa
CPEC	: China-Pakistan Economic Corridor
FDI	: Foreign Direct Investment
FM-OLS	: Fully Modified Ordinary Least Squares
GDP	: Gross Domestic Product
GLS	: Generalized Least Squares
GMM	: Generalized Method of Moments
GNH	: Gross National Happiness
ICT	: Information and Communications Technology
IMF	: International Monetary Fund
M&A	: Mergers and Acquisitions
MNCs	: Multinational Corporations
MNEs	: Multinational Enterprises
NATO	: North Atlantic Treaty Organization
OECD	: Organization for Economic Co-operation and Development
OLI	: Ownership, Location, and Internalization (a paradigm for FDI)
PIL	: Public International Law
PPP	: Purchasing Power Parity
R&D	: Research and Development
SAARC	: South Asian Association for Regional Cooperation
SARC	: South Asian Regional Cooperation (often refers to SAARC)
SITC	: Standard International Trade Classification
TNCs	: Transnational Corporations
UAE	: United Arab Emirates
UK	: United Kingdom
UNCTAD	: United Nations Conference on Trade and Development
USA	: United States of America

INTRODUCTION

The increase in private capital through Foreign Direct Investment (FDI) played a significant role in shaping globalization during the 1990s. Multinational companies increasingly sought to expand into new markets, particularly in developing regions, contributing to a more interconnected global economy. FDI serves as a vital contributor to the development of the financial sector, enhancing productivity by introducing new capital, advanced technology, managerial expertise, and access to export markets.

In many emerging economies, limited resources and inadequate domestic investment have led to a growing reliance on market forces and the private sector to drive economic growth. As outlined by the neoclassical growth model, FDI promotes economic expansion by increasing both the quantity and efficiency of investments.

Because of the numerous advantages that FDI delivers to the host country's economy, all nations, especially emerging and least developed nations, attempt to draw FDI inflows to their countries. Foreign investment, especially FDI, plays a critical role in broadening local investment opportunities. Beyond simply increasing the capital available for domestic projects, FDI also brings in valuable foreign currency, helping to alleviate pressures from balance of payments constraints that can otherwise limit economic growth.

Recognizing the significant advantages of FDI for fostering economic development, many countries have introduced extensive policy reforms aimed at creating a more favorable environment for foreign investors. These reforms are designed to attract and sustain FDI as a key driver of economic progress.

The literature generally agrees that FDI occurs when three key factors are present simultaneously. According to Dunning's Eclectic Paradigm (1993), the first factor is the presence of unique competitive advantages within a multinational company. The second is the local advantages in the host country. The third factor involves superior commercial benefits compared to an intra-firm relationship between the investor and buyer. The first and third factors are company-specific, while the second is related to the host country and strongly influences FDI inflows. Among these, only local factors can be directly influenced by host country governments to attract FDI.

Therefore, there are many studies in the literature that focus on identifying the determinants that encourage/limit FDI's choice of host country. The theoretical and empirical studies in the literature have revealed that there are many motivations that are effective on the decisions of multinational companies to realize FDI to countries. According to the classification made by Dunning (1993) the motivations that are effective in choosing the host country of multinational companies are to search for natural resources, market seeking, efficiency seeking and strategic assets seeking. However, it should also be noted that many larger multinational companies, especially since the early 2000s, pursue more than one goal and are able to carry out FDI activities that combine the characteristics of two or more of the above motivations.

This thesis explores the economic and institutional factors that influence FDI in SAARC countries- Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka-over the period from 2004 to 2018. The study aims to identify the key determinants of FDI within these South Asian nations, examining both economic conditions and institutional frameworks that may impact foreign investment levels across the region.

This research intends to give useful insights into tactics and policy actions that might boost FDI attractiveness and optimize its potential benefits for SAARC nations' economies by evaluating the complicated link between these variables and FDI inflows.

The thesis is organized in the following manner: The first chapter explains the conceptual and theoretical framework of FDI. It starts with definitions of FDI, and participants of the FDI market. Following the forms of FDI there are the theories of FDI, which include the theories supposing imperfect markets, the theories supposing perfect markets, additional theories of FDI, and the theories based on other considerations. These theories attempt to explain why businesses invest in other nations and what variables impact their location choices. The impacts of FDI on various institutional and economic elements, as well as the factors that facilitate business investment (FDI), including institutional and economic determinants, were addressed in the final portion of this chapter.

The second chapter starts with the introduction of SAARC, the objectives of SAARC, areas of cooperation, and SAARC's organizational framework. This section discusses FDI in SAARC countries, including the ranking of these countries based on their ability to attract foreign investment. It also identifies the main sources of FDI flowing into the SAARC region and highlights the top sectors that receive the most investment. Overall, this section provides a comprehensive understanding of how SAARC countries attract and utilize FDI, the major international players involved, and the sectors that benefit the most from this inflow of capital. In the last part of this chapter, the macroeconomic dynamics aspect of SAARC nations and SAARC countries briefs are studied.

In the third chapter, literature related to FDI is reviewed and divided into two parts. In the first section, the empirical studies of FDI determinants in other countries and regions are explained and in the second section, empirical studies of FDI determinants in South Asia and SAARC countries are explained.

Chapter Four presents the data set for the study, description of the variables which comprise both economic factors and institutional determinants of FDI in SAARC countries. Followed by the research methodology, description of the statistical model of the study, and types of panel data analysis are handled. Furthermore, in the last part of this chapter, the empirical results of the research and the findings of the diagnostic tests are explained. In addition, the conclusion of the study and recommendations for how to attract more FDI into SAARC countries are also presented in the last part of chapter four.



CHAPTER ONE

1. FOREIGN DIRECT INVESTMENT

1.1. Definitions of Foreign Direct Investment

In accordance with OECD (2008) “The objective of developing a long-term stake by a resident business in one economy (the direct investor) in a firm (the direct investor enterprise) that is located in an economy distinct from the direct investor is referred to as FDI”. The sustained interest indicates a significant level of influence over the management of the corporation, reflecting a lasting relationship between the direct investor and the entity receiving the investment. This connection is evident when an investor from one country holds, either directly or indirectly, 10% or more of the voting power in a business based in another country. This level of ownership establishes a stable, cross-border partnership, allowing the investor meaningful involvement in the entity's strategic decisions (OECD, 2008: 48).

The process by which citizens of one nation (the origin country) purchase assets with the intention of controlling a company's manufacturing, shipping, and other operations in a different economy (the host country) is known as FDI (Moosa, 2002: 1).

According to the IMF (1993), "direct investment" is a category of foreign investment wherein a company or individual from one country seeks to establish a lasting interest in a company based in another country. This type of investment reflects not only sustained commitment but also a close, long-term relationship between the investor and the foreign company, allowing the investor a considerable level of influence over its management and strategic decisions. The IMF (1993) further suggests that direct investment contracts become particularly meaningful when the investor holds at least a 10% equity stake in the foreign company, as this threshold signifies a significant degree of control and active participation in the company's governance. This level of ownership highlights the investor's involvement in shaping the organization's direction and operations, indicating more than just financial backing (IMF, 1993: 86).

The World Bank (1985) defines that FDI aims to obtain a lasting interest in a firm functioning in an economy other than the investor. The investor aims to have an effective voice in the firm's administration (Worldbank, 1985: xi).

In its most basic form, FDI refers to investors making investments in a nation other than their own and acquiring control of the business they invest in (Russell & Kouraklis, 2017: 59).

The usual features of these descriptions include terms like "control" and "continuing interest," which establish the crucial distinction between FDI and portfolio investment because portfolio owners do not desire control or ongoing interest (Moosa, 2002: 2).

1.2. Participants of Foreign Direct Investment Market

1.2.1. Foreign Direct Investor

A foreign direct investor is a company (or institutional unit) headquartered in one nation that has owned at least 10% of the voting power of an enterprise (or business) in that nation, or the equivalent for an unincorporated entity abroad. Any sector of the economy and any of the following can be categorized as a direct investor:

- a person
- a group of related individuals
- an incorporated or unincorporated enterprise
- a public or private firm
- a group of associated firms
- a government body
- an estate, trust, or other societal organization
- any combination of the above.

In the situation when two businesses each hold 10% or more of each other's voting power, each is a direct investor in the other.

1.2.2. Foreign Direct Investment Enterprise

It is an enterprise in one nation where a direct or indirect investor from a different economy holds 10% or more power to vote. A threshold of 10% voting power ownership is used to determine if there is a direct investment relationship between the direct investor and the direct investment business (OECD, 2008: 50).

1.3. Types of FDI

When it comes to the enterprise, there are two main categories of FDI: greenfield and brownfield (also known as mergers and acquisitions, or M&A).

Greenfield FDI

Greenfield FDI covers investment projects that involve the movement of intangible capital (largely in services) and the creation of new manufacturing facilities, such as offices, homes, plants, and industries. Capital transfers that impact the direct investor's accounting records in their home country as well as the company receiving the investment in the host nation are included in this type of FDI. The latter (or foreign affiliate) uses capital flow to recruit workers for production in the host country and to purchase commodities, equipment and machinery, goods, and services. Therefore, greenfield FDI immediately boosts the host nation's manufacturing capacity, which in turn helps the nation's capital development and job creation (UNCTAD, 2006: 15).

A business may opt to build a new facility instead of buying or leasing an existing one for several reasons. The main advantage of constructing a new facility is the extensive flexibility it offers in both design and functionality, allowing the company to tailor the building precisely to its unique operational needs. This approach maximizes efficiency, as the facility can be customized to support specific workflows, technology requirements, and future expansion plans, all without the limitations that an existing structure might impose. Additionally, building from the ground up can incorporate the latest energy-efficient technologies and sustainability practices, which may lead to cost savings and align with corporate environmental goals. In contrast, an existing facility often requires adjustments and modifications to fit current design and operational requirements, limiting the ability to optimize processes or layout.

Another significant factor is the maintenance of capital equipment. Older facilities typically come with used equipment that may require frequent repairs or upgrades, adding to operational costs. New construction, on the other hand, often involves the installation of modern, more efficient equipment, which reduces ongoing maintenance and operating expenses. This makes a newly built facility considerably more cost-effective in the long run compared to an older one. Additionally, when a firm plans to expand its operations or hire new workers, new facilities tend to be more attractive, not only because they are tailored to the company's needs but also because they project an image of innovation and growth. These factors make new facilities appealing for businesses aiming to promote new ventures, increase efficiency, and attract talent (UNCTAD, 2000: 97).

Brownfield FDI (M&A)

Transnational Corporations (TNCs) from other countries often expand their presence by acquiring or merging with the capital, assets, and liabilities of existing companies within a target country through cross-border M&As. These M&As typically involve the acquisition of established assets and business operations, allowing TNCs to rapidly integrate into the local market and leverage the existing infrastructure, workforce, and customer base. A change in ownership has an impact on the intended organization that is being sold and obtained.

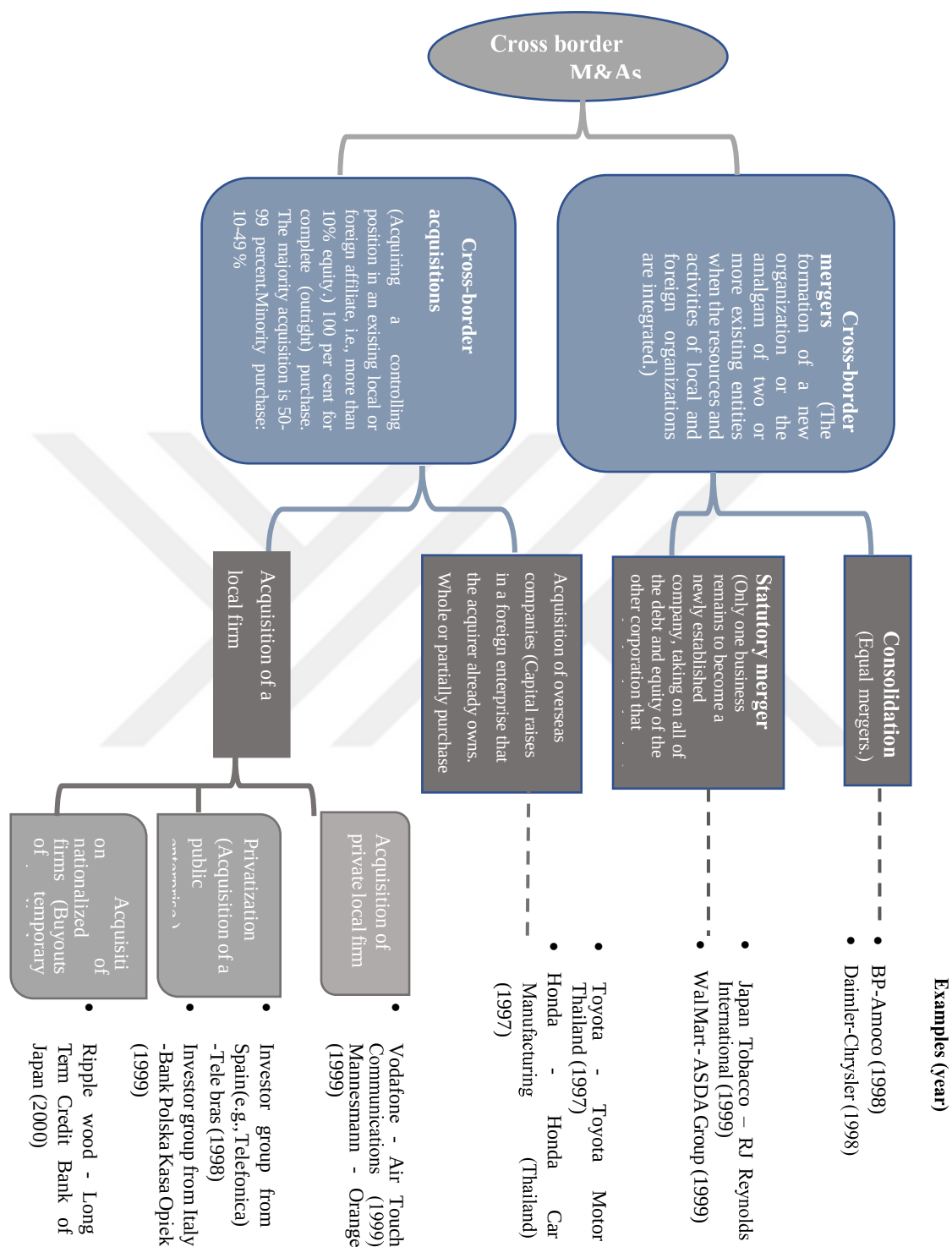
The obvious benefit of a brownfield investment is that the structure is already constructed. Brownfield facilities may already comply with current regulatory standards if the applicable national or municipal authorities mandate specific permits or approvals. When a facility has previously been used for a similar industrial process, investing in such a brownfield site can offer significant advantages for the right company. This approach can save time and resources on renovations, retrofitting, and compliance, making it a highly attractive option for companies looking to establish operations quickly and cost-effectively. The cost of launching business is significant. It is also possible to avoid the time spent on building.

The fundamental distinction between the impact of FDI through cross-border M&As and greenfield investment on the host country is the immediate or short-run consequences on capital creation and employment. Greenfield Investment adds to the host nation's stock of productive capital (and employment). In contrast, a merger or purchase signifies a shift in leadership that does not necessitate any immediate additions to investments or occupation in the host nation.

There are cases when cross-border M&As are the only realistic choice for FDI entry, for example, when struggling businesses need to be rescued during a financial crisis or when large-scale privatization is under progress. FDI is a collection of assets, includes capital for investments and possibly as well as technology, organizational and management techniques, and market access.

Greenfield FDI may offer this, whereas the potential effect of cross-border M&As on these elements of host-country progress is less known (UNCTAD, 2006: 17).

Figure 1: The Structure of Cross-border M&As



Source: UNCTAD, 2000:100

FDI can be categorized from the investor's standpoint and from the perspective of the host nation. From the investor's viewpoint, FDI divides into three-part; horizontal FDI, vertical FDI, and conglomerate FDI.

Horizontal FDI

Horizontal FDI enables companies to produce the same or similar goods and services in the host country as they do in their home country. This replication across markets makes product differentiation a critical factor in the structure of global FDI. Typically, companies engage in horizontal FDI to take fuller advantage of certain monopolistic or oligopolistic benefits, such as patents or differentiated products, especially in cases where further expansion in the home market might breach anti-trust regulations (Moosa, 2002: 4). Two main factors drive global FDI: The presence of positive trade costs and economies of scale at the firm level. The primary incentives behind international FDI include reducing transportation costs and establishing a local presence in foreign markets that require on-the-ground operations to be effectively served (Head, 2007: 121).

Vertical FDI

Vertical FDI occurs when multinational enterprises (MNEs) geographically segment their production processes into distinct phases, with each phase being performed in different countries. This fragmentation of production is undertaken to capitalize on variations in relative factor costs, such as labor or raw materials, across different regions. The term "vertical" is used because the stages of production, conducted sequentially in various countries, mirror the vertical integration of supply chain processes.

The underlying rationale for this type of FDI is that manufacturing typically consists of multiple stages, each requiring different inputs. When input costs vary between nations, it becomes advantageous for firms to geographically divide the production chain to minimize costs and improve efficiency. For instance, a company might manufacture components in a country where labor is inexpensive and then assemble the final product in another location with access to advanced technology or skilled labor (Brakman & Garretsen, 2008: 19).

Forward Vertical FDI

If the foreign affiliate gets input products from the parent for further manufacturing, this is known as Forward Vertical FDI.

Backward Vertical FDI

It occurs when the affiliate returns its final products to the parent for further manufacturing or sales (Brakman & Garretsen, 2008: 19).

Conglomerate FDI

It is a kind of FDI that includes both horizontal and vertical FDI.

From the viewpoint of the receiving country, FDI can be divided into three categories:

- Import-substituting FDI
- Export-increasing FDI
- Government-initiated FDI

Import-substituting FDI

Import-substituting FDI entails producing previously imported items within the host nation, implying that the host country's imports and the investing country's exports would decline. The size of the destination nation's market, cost of transportation, and limitations on trade are all likely to have an impact on the amount of this sort of FDI.

Export-increasing FDI

This form of FDI enhances the export capabilities of the host country by tapping into new sources of input, such as raw materials and intermediate goods. As a result, the host country experiences an increase in the export of these materials to both the investing nation and other international markets. This not only supports the local economy by fostering production and resource utilization but also strengthens trade relationships and diversifies the export base, ultimately contributing to economic growth and development in the receiving country.

Government-initiated FDI

This might be mitigated by a government providing advantages to foreign investors to minimize the balance of payments deficit.

FDI can be separated into two primary classes as follows.

Expansionary FDI

The goal of this kind of FDI is to take advantage of the advantages of the company in the receiving country. It additionally offers a further benefit to helping the investing company's sales develop both domestically and abroad.

Defensive FDI

It seeks inexpensive labor in the receiving country with the purpose of decreasing the cost of production (Moosa, 2002: 6).

1.4. Theories of FDI

With the growing significance of FDI and the increasing interest in its underlying causes and effects, a variety of theories have developed to elucidate why Multinational Corporations (MNCs) engage in FDI. These theories explore factors influencing MNCs' preferences for certain countries over others for their foreign business operations and the specific entry strategies they choose to implement. Additionally, they aim to explain the varying levels of activity among countries in attracting FDI. As a result, some theories focus on inbound FDI, examining a nation's ability and willingness to attract investment, while others delve into outward FDI, which addresses the motivations behind MNCs' decisions to invest abroad. The theories of FDI can be categorized into several key frameworks, each providing insights into different aspects of the FDI phenomenon (Moosa, 2002: 23).

- Theories Assuming Perfect Markets
- Theories Assuming Imperfect Market.
- Other Theories
- Theories Based On Other Variables

1.4.1. Theories Assuming Perfect Markets

Three key theories fall under this category of FDI analysis: The Differential Rates of Return Theory, the Diversification Theory, and the Market Size Theory.

1.4.1.1. The Differential Rates Of Return Theory

The primary motivation for FDI, according to the Differential Rates of Return Theory, is the difference in investment returns across various countries. This theory posits that capital tends to flow from countries with lower returns on investment to those with higher returns, with the goal of maximizing profits. Essentially, investors seek out opportunities that offer the best potential for financial gain, leading to a natural migration of capital towards more lucrative markets, provided that other factors remain constant. This movement reflects the strategic behavior of investors who prioritize maximizing their returns by leveraging the varying economic conditions present in different nations. Until all nations provide the same capital return, this arbitrage phenomenon will continue. But this hypothesis is unable to clarify how FDI and portfolio investment vary from one

another. An investor may think about lending money abroad if interest rates are greater, but they are not required to maintain control over the business receiving the funds.

As a result, the incapacity of the rate of return theory to account for the element of control is its primary fault. The rationale behind this theory is that firms contemplating FDI behave in a manner that seeks to equalize the marginal return on capital with its marginal cost. It operates under the assumption that risk is not a factor in the investment decision; rather, the sole consideration is the expected rate of return. In this context, risk neutrality implies that the investor perceives both domestic and foreign direct investments as perfect substitutes. More broadly, it suggests that direct investment in any country, including the investor's home country, can be seen as an ideal alternative to direct investment in any other nation. Consequently, the theory highlights the importance of return differentials while downplaying the potential risks associated with international investments (Marandu & Ditshweu, 2018: 31).

1.4.1.2. The Portfolio Diversification Theory

While making an FDI decision, risk becomes another factor to consider when the risk neutrality assumptions are weakened. The various degrees of return assumption are no longer enough to clarify FDI if this argument is accepted, and we must instead resort to the probability differentiation hypothesis. Risk has an impact on the choosing between various projects in addition to the projected rate of return. This also applies to the idea of diversity as a means of reducing risk, which is pertinent to portfolio investing. A rate of return differential won't cause capital flows to shift in one way until arbitrage eliminates the gap because of risk aversion.

The diversification theory, which incorporates risk considerations, is considered superior to the differential rates of return theory for several reasons. First, the diversification theory offers a higher level of generalizability, making it applicable to a broader range of contexts and investment scenarios. Second, it provides a credible explanation for the occurrence of cross-investment between countries and enterprises, addressing the complex dynamics of FDI flows. Finally, diversification theory explicitly accounts for risk, which is a crucial factor in FDI decision-making, offering a more comprehensive evaluation of investment choices (Moosa, 2002: 26).

According to this hypothesis, investment is a positive function of return and a negative function of risk. For this reason, investors consider both the return on capital and the risk factor while creating their investment portfolio. They tend to diversify their investments among different countries or sectors to reduce the risks they face (Öztürk, 2004: 115).

1.4.1.3. The Market Size Theory

The market size theory suggests that the amount of FDI a host country attracts is closely linked to the size of its market. This market size can be measured through various indicators, such as the total sales of MNCs operating within the country or the country's Gross Domestic Product (GDP). The underlying idea is that larger markets offer greater opportunities for sales, economies of scale, and profit potential, making them more attractive to foreign investors. Therefore, countries with larger market sizes are more likely to draw higher levels of FDI, as MNCs seek to expand into areas where they can achieve significant returns. When a nation's market size reaches a point where economies of scale can be effectively utilized, it becomes an attractive destination for FDI. A large market enables the specialization of production factors, leading to cost reduction (IMF, 1993).

1.4.2. Theories Assuming Imperfect Markets

Hymer (1976) was the first economist to propose that FDI could be explained by the structure of markets and the characteristics of investing firms. His work laid the foundation for understanding how factors such as monopolistic advantages drive FDI. Kindleberger (1969) further refined and popularized Hymer's ideas, emphasizing the role of market imperfections and the advantages firms seek to exploit through FDI. Later, Martin (1991) used cross-sectional analysis to explore the importance of market structure—specifically market concentration and economies of scale—in influencing FDI inflows into the United States (Moosa, 2002: 30).

1.4.2.1. The Industrial Organization Theory

According to Hymer (1976), the Industrial Organization Theory is a foundation for explaining and describing the motives of an active multinational corporation. Hymer was a well-known economist who developed a systematic approach to studying local companies' motivations for expanding their operations worldwide. This concept emphasizes how TNCs can utilize their unique capabilities and cross-border assets to overcome perceived operational and informational disadvantages when competing against domestic firms. By leveraging these distinct resources, TNCs can mitigate challenges such as unfamiliarity with local markets or regulatory environments, thereby positioning themselves competitively despite being foreign entrants (Nayyar, 2014: 23).

This hypothesis posits that when a corporation establishes a subsidiary in a foreign country, it faces various challenges in interacting with local businesses due to differences in language, culture, and legal frameworks, among other factors. For instance, MNCs may find it necessary to offer higher salaries to attract local employees, who might perceive employment with an international firm as riskier than with domestic companies. Despite these challenges, a company still chooses to engage in FDI because it possesses unique advantages derived from intangible assets. These advantages may include a well-recognized brand, patented technologies, superior management capabilities, and other firm-specific

resources that can provide a competitive edge in the host market. Such intangible assets enable MNCs to navigate local complexities more effectively and establish a successful presence in foreign markets, despite the inherent risks and difficulties.

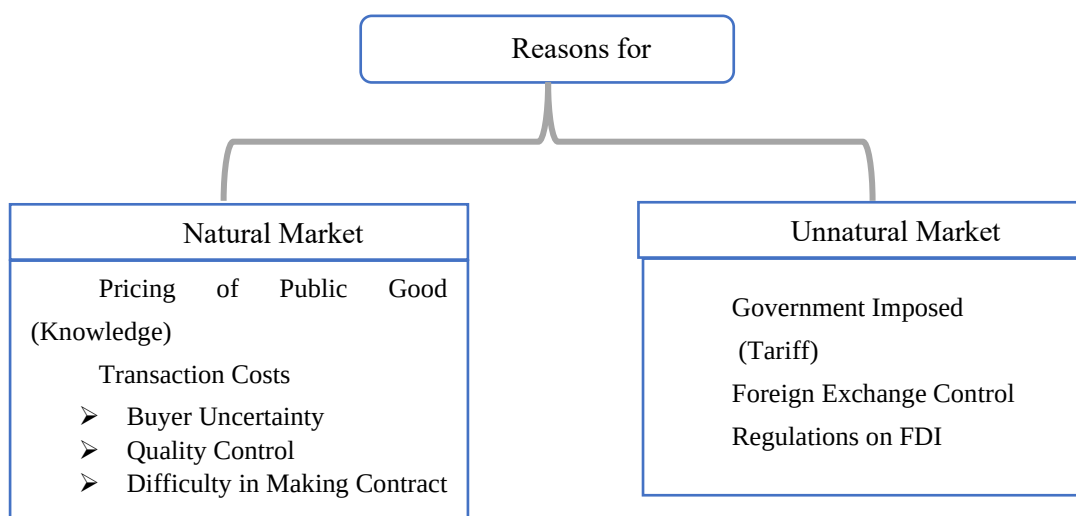
According to Kindleberger (1969), the comparative advantage must be specific to the firm, transferable to overseas subsidiaries, and substantial enough to counterbalance these challenges (Moosa, 2002: 31).

1.4.2.2. The Internalization Theory

Casson and Buckley (1976) formulated the Internalization Theory. Internalization is about imperfections in intermediary product markets. Products that are intermediate are transferred across operations in the manufacturing sector.

Market performance leads to transaction costs, which are often minimized for the sector by putting independent activity under common ownership and control. As a result, the primary goal of Internalization Theory is to identify institutions where intermediating goods markets are likely to occur. Market improvements may be classified into two types, as illustrated in Figure 2: Natural market improvements and unnatural market improvements. The first section addresses public goods pricing and transaction costs. The second is concerned with external market impositions that cannot be included in the natural workings of markets (Gülcan, 2001:77). This theory explains why companies choose to use FDI instead of engaging in exporting and importing from foreign nations. The advantages of internalization include avoiding time delays, negotiation, and buyer uncertainty.

Figure 2: Reasons for Internalization



Source: Gülcan, 2001:78

In the context of Internalization Theory, the key idea is that externalities market imperfections or inefficiencies in the goods and factors markets provide a strong incentive for firms to internalize transactions across borders. This process leads to FDI as firms seek to control operations in different countries to mitigate risks associated with market externalities.

The internalization continues until firms reach a point where the marginal gains from internalizing equal the marginal costs. However, the theory is not without critique. The first issue, raised by Rugman (1980), is that internalization theory is overly broad. This broadness dilutes its empirical rigor because it encompasses various types of market imperfections without offering specific, testable hypotheses. The second criticism comes from Buckley (1988), who suggests that internalization theory is not easily subjected to direct empirical examination (Moosa, 2002: 33).

1.4.2.3. The Location Theory

According to this perspective, FDI emerges as a response to the limitations on moving certain production elements internationally, such as labor and natural resources. Consequently, multinational enterprises opt for locations in proximity to markets or sources of raw materials. This theory highlights that the selection of a host country for FDI is influenced by a variety of factors that can either promote or hinder investment opportunities. These factors can be broadly classified into two main categories.

The first category consists of geographical endowments, which primarily focus on the availability of natural resources and access to markets. Countries that are rich in valuable natural resources, such as minerals, fossil fuels, or agricultural products, are often particularly appealing to foreign investors. These resources can be critical for companies looking to establish production facilities or supply chains that rely on these inputs.

Additionally, access to large and emerging markets can serve as a significant draw for multinational corporations. Nations with substantial consumer bases or strategic locations that facilitate trade, and logistics can be especially attractive, as they offer opportunities for companies to expand their market presence and increase their sales potential. In addition to geographical endowments, the second category encompasses a range of economic, political, and social factors that further influence a country's attractiveness for investment. Elements such as the stability of the political environment, the robustness of regulatory frameworks, the quality of infrastructure, and the cost of labor play critical roles in shaping investment decisions.

Moreover, the overall business climate-including tax policies, incentives for foreign investors, and the protection of property rights-can significantly impact a company's willingness to invest in a particular country. By understanding these factors, businesses can make informed decisions about

where to allocate their resources for FDI, maximizing their chances for success while navigating the complexities of the global marketplace. Secondly, there are several human-made factors within a host nation, including the availability of skilled labor, political stability, economic conditions, and infrastructure quality. Both sets of factors wield significant influence over a company's decision-making process regarding FDI in a host nation (Marandu & Ditshweu, 2018: 33).

1.4.2.4. The Eclectic Theory

John H Dunning (1977) introduced this theory by integrating industrial organization, internalization, and location theories. This theory is the most widely recognized FDI theory, which is frequently referred to as (OLI); "Ownership, Location, and Internalization."

According to this proposition, for a corporation to engage in FDI, it must satisfy three conditions. First, it needs to possess a comparative advantage over other enterprises derived from owning certain intangible assets. These assets, designated as advantages of ownership, contain benefits like exclusive possession of certain technologies, monopolistic influence and scale, accessibility to raw resources, and financing that is inexpensive. Second, it must be more beneficial to the businesses to make use of these benefits internally instead of leasing or selling them. These are the internalization incentives that pertain to the option amongst internal expansion and delegating the right to grow to other firms.

Third, combining these advantages with at least some factor inputs from outside the country must be more beneficial. If that is not the case, exporting would do. These are the location advantages, which have to do with whether growth should be done at home or overseas (Musabeh, 2018).

According to the Eclectic Approach, all types of FDI may be explained in terms of their circumstances. It recognizes that the benefits of ownership, internalization, and location may change over time. It accepts that if country-specific features are essential determinants of FDI, generalizing from one country's experience to another country may be incorrect (Moosa, 2002: 38).

This theory also introduces the notion of a "seeker." A company or individual is viewed as a "seeker" when they pursue investment opportunities, driven by four main motivations. First, natural resource seekers aim to find countries with abundant, low-cost natural resources. Second, market seekers invest to gain access to larger or untapped markets. Third, efficiency seekers invest in multiple countries to benefit from economies of scale and reduce costs. Finally, "strategic asset searchers" are looking for assets that can assist them in increasing their competitiveness in the global economy (Marandu & Ditshweu, 2018: 35).

1.4.2.5. The Product Life Cycle Theory

The Product Life Cycle Theory, developed by economist Raymond Vernon in 1966, aims to explain specific patterns of FDI by U.S. companies in Western Europe following World War II, particularly within the manufacturing sector. This theory outlines how a product's lifecycle from introduction to decline affects the location of production and investment decisions. According to the theory, products typically progress through distinct stages: Introduction, growth, maturity, and decline. In the initial stage, when a new product is developed, production is usually concentrated in the home country, where the company can closely monitor the manufacturing process and make necessary adjustments based on consumer feedback.

As the product gains acceptance and demand increases, companies may seek to expand production to other countries, particularly those with lower labor costs or favorable market conditions, leading to the establishment of foreign subsidiaries. Vernon (1966) outlines the production process as having four phases: Innovation, Expansion, Maturity, and Decline. Petrochilos (1989) asserts that this theory is particularly useful because it provides multiple perspectives on FDI, especially concerning products with advanced technology and high-income demand elasticity (Denisia, 2010: 107).

The theory proposes that companies engage in FDI at a particular point in the product life cycle of the goods they originally developed. The stages of this cycle include:

In the first phase, production occurs domestically in the country of invention, primarily serving the home market with minimal exports. At this stage, the innovative firm is focused on satisfying domestic demand. The country of innovation holds a competitive advantage because the "technology gap" between the innovator and other nations gives it a monopolistic edge. At this initial stage, production usually takes place in a developed country.

In the second phase, growing demand in foreign markets may justify setting up local manufacturing operations, either by the original firm or by competitors replicating the product. As production shifts internationally, the originating country's exports decline, and local producers compete for market dominance.

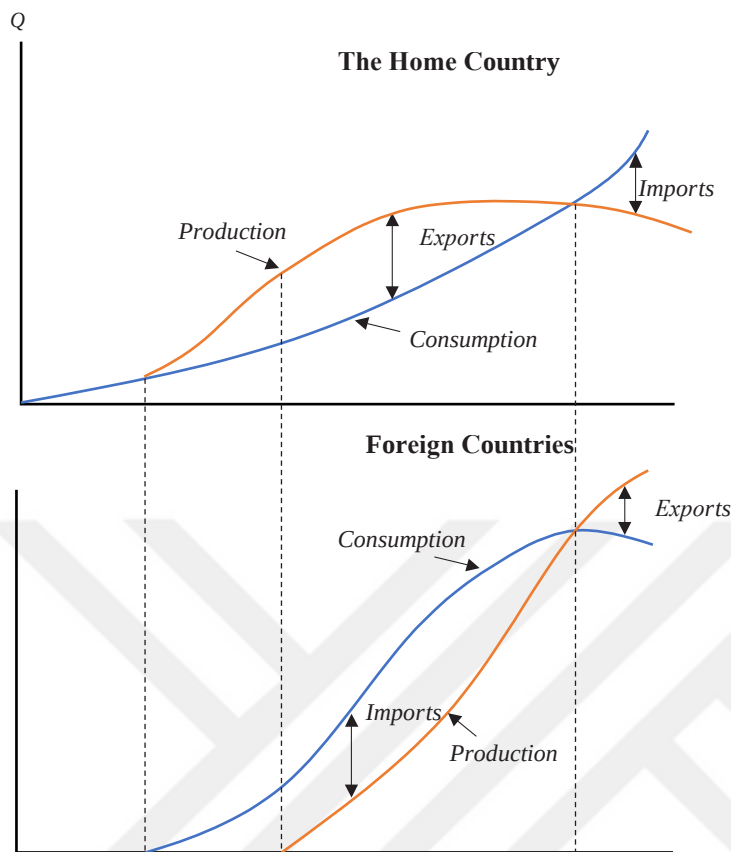
During the third phase, the product becomes standardized and relies on established technologies, requiring less skilled labor. At this point, less developed countries might leverage their low-cost labor to produce the now-mature product. Consequently, these developing nations become attractive manufacturing hubs for multinational companies, and the product may even be exported back to more developed economies.

In the final stage of the product life cycle, referred to as the decline phase, production tends to concentrate in developing nations. During this phase, the country that originally innovated and manufactured the product often transforms into a net importer of the very product it once created. This shift occurs as the comparative advantage of producing the product transitions from the innovative country to developing nations, which can offer lower labor costs and potentially fewer regulatory constraints.

As the product matures and faces increased competition, firms may relocate their production facilities to these developing countries to capitalize on cost efficiencies. This movement of production not only reflects a change in the geographical focus of manufacturing but also influences FDI patterns. Companies that once invested heavily in their home markets may begin to channel their resources into emerging economies where they can produce goods more economically (Marandu & Ditshweu, 2018: 35).

According to the product life cycle theory, as outlined in Figure 3, the dynamics of production, consumption, exports, and imports evolve over time as the product progresses through its stages. The home country, once an exporter of innovation, eventually becomes an importer as the cycle completes.

Figure 3: Production and Consumption During The Product Life Cycle



Source: Moosa, 2002: 40

1.4.3. Other Theories Of FDI

1.4.3.1. The Internal Financing Theory

According to this theory, internal financing involves using profits generated by a subsidiary to finance the FDI activities of a MNC in the nation where the subsidiary operates. The concept, which is based on Barlow and Wender's (1955) 'gamblers' earnings' theory, proposes that MNCs invest a small fraction of their resources in their initial direct investment and then fund subsequent developments by reinvesting revenues from operations in the destination country. This argument tends to be more suitable for understanding FDI in nations that are developing for two primary reasons: First, due to constraints on the flow of money; and second, because of the undeveloped and inefficient character of financial markets (Moosa, 2002: 43).

1.4.3.2. The Currency Areas Theory

Aliber's (1970) theory sheds light on FDI by exploring the influence of currency strength. According to this theory, companies hailing from nations with strong currencies are more likely to venture abroad for investments, while businesses from countries with weaker currencies tend to stay

the receiving ones. Essentially, the flow of FDI originates from strong-currency nations, with weaker-currency countries playing the role of investment recipients.

The core of this theory lies in the interplay between capital markets, currency risks, and investor preferences for assets in robust currencies. Aliber (1970) argues that an MNC based in a strong-currency region can capitalize on its solid reputation to secure loans at lower interest rates in a weaker-currency country, outperforming local firms in borrowing. This dynamic highlights how financial power and currency strength shape the global investment landscape (Agarwal, 1980: 757).

1.4.3.3. The Macroeconomic Theory (Kojima Theory)

This theory was presented by Kojima (1973) to describe that FDI provides the mechanism of transferring capital, technology, and management skills from the source to the host nation. According to Kojima (1973), FDI is divided into two types.

The first category, known as trade-oriented FDI, arises when there is an imbalance in trade, with excess demand for imports and an oversupply of exports under existing trade conditions. This form of FDI helps to address these imbalances by encouraging investment that adjusts the flow of goods between countries. As a result, it leads to improved economic welfare for both the investing and the host nations, as it helps optimize production and resource allocation across borders. Additionally, it commonly entails investment in sectors where the source country lacks competitive advantage. As a result of this, both nations would benefit from increased commerce and favorable industrial restructuring.

The second type of FDI is known as anti-trade-oriented FDI, which has the opposite impact of trade-oriented FDI. Unlike the latter, which fosters trade and economic welfare, anti-trade FDI tends to disrupt existing trade patterns, often leading to negative consequences. This type of investment can reduce the flow of goods between nations by encouraging local production that replaces imports or by shifting export patterns in a way that distorts trade relations. As a result, anti-trade FDI can lead to inefficient economic restructuring, with both the investing and the host countries potentially experiencing adverse effects on their trade balances and overall economic health (Moosa, 2002: 49).

1.4.4. Theories Based On Other Factors

Several additional factors have been used to explain FDI. These include political risk, which refers to the likelihood of changes in government or instability that could affect investment decisions; country risk, encompassing economic conditions and stability within a nation; tax policy, which influences the attractiveness of a country for investors based on the tax benefits or burdens they may face; and trade barriers, such as tariffs or quotas, which can either encourage or deter FDI depending

on their impact on market access and costs. These variables play a crucial role in shaping the flow and location of FDI.

1.4.4.1. Political Risk and Country Risk

The absence of political stability significantly impedes the flow of FDI. Political risk arises from unexpected changes in the host country's legislative and budgetary frameworks, which can substantially affect the economic outcomes of specific investments. For example, if a host government implements measures to restrict the repatriation of capital back to the investor's home country, this could severely disrupt the parent company's cash flow, making the investment less attractive. Political instability may not always increase the risk of FDI, for example, in the scenario of an anticipated transition in political power from an extreme leftist to a more democratic or even dictatorial regime. Furthermore, the level of political risk posed by political instability in a nation is likely to vary for FDI originating from different sources and across multiple sectors (Agarwal, 1980: 761).

1.4.4.2. Tax Policies

Domestic and international tax policies influence the motivation to participate in FDI as well as the methods of financing it. According to Jun (1989), there are three ways via which tax policy influences MNC actions. First, the taxation of revenue earned overseas directly impacts the net return on FDI. Moreover, the taxation of domestic income is a key factor in assessing the net profitability of investments, whether they are made domestically or internationally. Tax policies also greatly influence the relative cost of capital for investments made in both local and foreign markets (Moosa, 2002: 54).

1.4.4.3. Trade Barriers

FDI can serve as a strategy to bypass trade barriers, including tariffs, as it can act as an alternative to traditional trade. This suggests that countries with open economies and minimal restrictions on international trade may experience lower inflows of FDI. However, the potential for host governments to adopt protectionist measures can sometimes actually promote FDI, as investors seek to establish a local presence to mitigate the risks associated with possible trade restrictions. By investing directly in the host country, companies can safeguard their operations from the adverse effects of protectionism and ensure continued access to the market (Moosa, 2002: 54).

1.5. The Effects of FDI

FDI is commonly viewed by many international organizations, politicians, and economists, as a force that boosts economic development and a solution for the economic issues of developing nations.

As it is well known, FDI teaches financial resources, technology, and other skills (management, marketing, accounting, etc.); this process creates opportunities for the two participating nations. The receiving country (host country) and the invading country (home country).

FDI from developing nations may help both the investing country and host economies, but it can also have negative impacts. The net effect is determined by different variables, including a country's degree of development, the economy's structure, policies, the incentives of TNCs, the investment industry, and the mode of entrance. TNCs' private profits and benefits to home and host nations may converge depending on the exact environment and the effectiveness of the source country and host country governmental actions (UNCTAD, 2006: 169).

There are three categories of FDI consequences on the host country: Social, political, and economic. In terms of the economy, FDI affects both macro and micro elements including production, the balance of payments, and market structure. Politically, FDI raises concerns about national sovereignty, given the potentially overwhelming influence of investing MNCs. Socially, FDI impacts involve the establishment of enclaves and a foreign elite within the host nation, along with cultural ramifications on the local population. Social apprehensions are particularly likely in scenarios marked by significant economic, social, and cultural gaps between the home and host nations.

The economic impacts of FDI are as follow.

1.5.1. The Effect of FDI on Output and Growth

One of the most critical facets of FDI is its effect on production and, consequently, on economic growth within the host country. This influence is particularly vital for developing nations, where inward investment is frequently regarded as an essential catalyst for economic advancement. For FDI to effectively boost production, it is imperative that there is an increase in the capital stock of the host country. This can occur through new investments, which inject fresh capital into the economy, or, in cases of acquisitions, by enhancing the efficiency of existing resources. Improved capital stock not only facilitates greater production capacity but also leads to technological advancements and better management practices, ultimately contributing to sustained economic development.

When FDI occurs through M&As, the effect on production may be less substantial. This is because M&As might not lead to a significant increase in new capital but rather a reallocation of resources that could limit the overall growth potential. Generally, FDI can boost production in the host country, if there is sufficient capacity to absorb additional resources and improve efficiency through better resource allocation. However, it is also possible that varying outcomes could arise, depending on the specific context of the investment and the conditions of the host economy (Moosa, 2002: 75).

According to standard neoclassical theories, FDI is likely to be a significant driver of economic growth in the host country for several reasons:

1. **Employment and Capital Formation:** Inward FDI can stimulate job creation and enhance capital formation by bringing in new investments, which can lead to an increase in the overall productive capacity of the economy.
2. **Boosting Manufacturing Exports:** FDI has the potential to increase manufacturing exports, as foreign companies often establish operations in the host country to take advantage of local resources and labor, thereby enhancing the country's export capacity.
3. **Access to Unique Resources:** FDI can introduce unique resources to host nations, including management expertise, skilled labor, access to international production networks, and established brand recognition. These resources can improve the competitive position of local firms.
4. **Technological Advancements:** Lastly, FDI may lead to technological advancements as foreign firms often bring new technologies and innovative practices to the host country, which can further enhance productivity and economic growth.

Overall, these factors combined suggest that FDI plays a crucial role in fostering economic development in host nations (Zhang, 2006: 3).

The ways that FDI might boost economic growth are divided into five categories: Introduction of new technologies and knowledge; development of human resources; integration into the global economy; escalation of competition in the home country; and development and restructuring of companies. Negative effects on economic growth may be caused by several of the factors mentioned, namely the first four. FDI may also make it more difficult to implement economic policies. Table 1 summarizes these mechanisms:

Table 1: Factors Describing The Influence of FDI on The Host Nation Economic Growth

FDI influences the host nation's economic growth through...		impacts	
		Positive	negative
1	Transferring of new technology and know-how	√	√
2	Formation of the human resources	√	√
3	Integration into the world economy	√	√
4	Increased competition	√	√
5	Firms development and restructuring	√	
6	The difficulty of applying economic policies		√

Source: Moura & Forte, 2013: 3

Table 1 presents that the impacts of FDI on the economic growth of the host nation are a priori ambiguous. In addition, there are mechanisms that should cause FDI to impact GDP positively, but the same mechanisms might also have a negative impact.

1.5.2. The Effect Of FDI On Employment

The impacts of FDI on employment manifest both directly and indirectly. In countries where capital is scarce but labor is abundant, one of the most noticeable effects of FDI has been the creation of job opportunities, either through direct employment or indirectly (Kurtishi-Kastrati, 2013: 28).

Direct impact occurs when TNC foreign affiliates employ workers in their mines, plantations, manufacturing sites, and service organizations. The secondary consequences emerge when they additionally generate job opportunities in enterprises that act as their suppliers, subcontractors, or service providers. This encompasses both local and international branches of other TNCs, some of which might have been established due to related investments attracted to the country by the demand for their offerings from initial investors.

Foreign affiliates indirectly generate jobs by increasing production and revenue and, as a result, attracting further investment. Other variables are held constant; inward FDI has both direct and indirect effects that contribute to job creation in a host nation (UNCTAD, 1999: 261).

Vertical FDI typically results in the transfer of production processes from the home country to the host nation, primarily to take advantage of variations in factor costs. By relocating certain manufacturing operations, MNEs can significantly reduce their production expenses, which in turn enhances their competitiveness in the global market. This heightened competitiveness is expected to lead to an increase in market share, expansion of business operations, and greater demand for labor

within the host country. The combination of these factors ultimately influences the overall labor demand dynamics in the host nation. Notably, as lower-skilled labor is outsourced to the host country, the relative demand for skilled labor in the home nation is anticipated to rise, as firms in the source country focus more on high-skill jobs.

In contrast, horizontal FDI involves a shift in production activities that results from substituting exports with domestic production in the host market. This type of investment generally leads to a reduction in export volumes from the source country, which can negatively affect labor demand there. However, this decline in exports may be offset by an increase in overall production and business activity within the MNE's operations in the host country, potentially leading to positive labor demand effects in the home country. Thus, the implications of horizontal FDI on labor demand are multifaceted, reflecting both the decline in exports and the corresponding growth in domestic production activities (Johnson, 2005: 27).

In general, the impacts of FDI on employment may be described as follows:

- FDI has the potential to increase employment directly via the establishment of new facilities or indirectly through the stimulation of distribution jobs.
- FDI can help to keep jobs by purchasing and restructuring failing businesses.
- Through divestiture and the closure of industrial facilities, FDI may decrease employment.

1.5.3. The Effect of FDI on Trade

The influence of FDI on the international trade of the host country will vary depending on its driving force, whether it's seeking resources, strategic assets, efficiency, or market access. FDI can play a significant role in driving economic growth in nations which are developing by bolstering export expansion. Productions resulting from efficiency-seeking FDI are typically geared toward export markets, leading to an upturn in the host country's exports.

A substantial increase in the local components of value-added exports could be achieved if domestic firms supplied inputs to affiliates engaged in producing goods for export. Efficiency-seeking FDI tends to stimulate both exports and imports, particularly when intermediate goods are sourced externally. However, as some value-added activities take place within the host economy, the overall outcome tends to be a sustained improvement in the trade balance. While export growth often correlates with trade liberalization, it also entails a rise in imports (Kurtishi-Kastrati, 2013: 30).

The primary advantage of FDI for developing countries, particularly in the context of trade, lies in its long-term potential to deepen the integration of the host economy into the global marketplace. This integration is expected to lead to an increase in both imports and exports. As

foreign companies establish operations in developing nations, they often facilitate the importation of necessary technologies, raw materials, and capital goods that are essential for production. At the same time, these companies typically enhance the capacity and quality of local production, enabling the export of goods to international markets. This dual flow of trade can help diversify the economic base of developing countries, increase foreign exchange earnings, and ultimately contribute to sustainable economic growth. Furthermore, greater participation in global trade networks can lead to improved competitiveness, access to broader markets, and enhanced opportunities for local businesses to engage in international trade (OECD, 2002: 10).

FDI and trade are often viewed as key economic indicators that reflect the health and dynamism of an economy. Increased trade openness typically encourages greater FDI inflows, as countries that are more open to trade create a favorable environment for foreign investors. This openness can take the form of reduced tariffs, fewer trade barriers, and improved regulatory frameworks, which collectively make it easier for foreign companies to operate within the host country (Zaman *et al.*, 2018: 386).

1.5.4. FDI And Technology

The importance of technological advancement in economic development is now universally accepted. In the discussion of FDI, the link between FDI and technology is regarded to be of enormous and crucial significance. Indeed, technology transfer has become the most prominent topic of controversy among MNCs and their interactions with developing nations. Technology is regarded as a fundamental driver of economic advancement, trade, capital accumulation, and even transformations in the structure of social and production relationships.

Its significance lies in its ability to facilitate innovation, improve efficiency, and create new opportunities for growth and development across various sectors. As such, technology plays a pivotal role in shaping not only the economy but also the societal dynamics that govern production and interaction within communities. Challenges in this aspect encompass the effective transfer and assimilation of foreign technology by the host nation and its subsequent impact on the host country's economy (Moosa, 2002: 86).

The transmission of technology and distribution take place via four interlinked channels: horizontal connections with purchasing or supplier companies in the same sector; vertical connections with supplier companies in the relevant sector; competent labor migration; and internationalization of R&D (Research and Development) (OECD, 2002: 13).

According to OECD (2002), for foreign investment to have a more significant positive impact on productivity compared to domestic investment, the "technology gap" between local businesses

and overseas investors must be relatively small. Local companies are unlikely to effectively assimilate foreign technology conveyed through MNEs when significant disparities exist or if the absolute technical level in the host nation is low.

Technologies brought into developing nations through FDI often represent more advanced and environmentally friendly options compared to domestic alternatives. Moreover, there have been instances where the local adoption of these technologies, coupled with turnover in employment and supply chain dynamics, has led to broader environmental improvements within the host economy (Kurtishi-Kastrati, 2013: 28).

1.5.5. Effects of FDI on Balance of Payments

A country's balance of payments is a systematic record of all economic transactions conducted between the citizens of that country and residents of other nations over a specified period. This record is essential for understanding international payment dynamics, as it captures the flow of money and resources between nations. By documenting these transactions, the balance of payment provides insights into the country's economic relationships with the rest of the world. All such transactions are meticulously recorded in the balance of payments account, which helps policymakers assess the country's economic performance, monitor its financial stability, and formulate appropriate economic policies (Rahman, 2016: 111).

For developing nations, the balance of payments impact is more essential than for developed nations. Because the foreign currency is considered as a limited resource that has an impact on growth via the foreign exchange difference. As a result, the influence of FDI can either mitigate or exacerbate the constraints imposed by the balance of payments on achieving key macroeconomic goals, such as economic growth and employment levels. While FDI can bring numerous benefits, it is often scrutinized for its effects on the balance of payments. Typically, when FDI occurs, the investing country experiences a swift increase in its deficit due to the outflow of capital.

Conversely, the host country may encounter a more persistent shortfall because of the repatriation of profits to the investor's home country. When a successful FDI venture generates profits that are sent back to the investor's country in foreign currency, it results in significantly higher outflows in the balance of payments compared to a similar project that is funded domestically. This disparity highlights the complex nature of FDI's impact on both the investing and host countries, as the benefits of increased investment can be counterbalanced by the potential for negative effects on their balance of payments. This situation can complicate the economic environment for both the investing and host countries, as the advantages of FDI may be counterbalanced by detrimental effects on their respective balances of payments (Moosa, 2002: 62).

FDI inflows have a crucial role in determining the surplus or deficit in the balance of payment statement's capital and financial accounts. The early impact of FDI inflows on BOP is positive, but the long-run effect may be positive or negative when foreign investors raise export production, import intermediate goods and services, and begin to deport earnings back to their home country (George, 2014).

FDI aids in the balance of payments of developing nations, but not in production. Due to the high investment coefficient and the more flexible pricing mechanism used by multinational corporations, restructuring investments appears to have a negative impact on developing nations' balance of payments. The large import percentage of MNC output systems stems from the locality of goods and resources, the lack of competitiveness in local pricing, and poor quality.

1.5.6. Competition Effects

The presence of MNCs and FDI may have a significant impact on competitiveness in high-end markets. The presence of foreign companies can boost local competitiveness, which raises productivity, lowers prices, and improves resource allocation, all of which can have a negative impact on economic growth. To outmaneuver their rivals, businesses are often encouraged to invest cash in plant, equipment, and R&D when there is increased rivalry. Conversely, MNE entrance tends to increase concentration levels in host-country markets, which may stifle competition. Any of the following factors heightens this risk. The scenario changes when the host country serves as a unique geographic market, encounters formidable entry barriers, has a limited market scope, the new entrant commands a substantial international market share, or the competition regulations in the host nation lack strength or are poorly enforced (OECD, 2002: 16).

The impact of FDI on local market competition can be particularly notable in service sectors like telecommunications, retail, and various financial services. In these industries, exporting is often not feasible as services need to be produced where they are provided (Kurtishi-Kastrati, 2013: 31).

1.5.7. The Effect of FDI on Productivity

Productivity is anticipated to rise, and unit costs are poised to decline if: (i) FDI prioritizes export promotion, directing the subsidiary's products towards expansive international markets; and (ii) the prevailing circumstances and regulatory framework facilitate the establishment of factories geared towards attaining full economies of scale. Conversely, in cases where FDI leans towards import substitution and the market size is insufficient to support the optimal plant size, achieving productive efficiency may prove challenging (Moosa, 2002: 86).

In normal conditions, FDI increases productivity (both TFP and labor productivity) for manufacturing enterprises. This continuously remains good for non-family-held enterprises. In this category, there are two small exceptions: First, when local enterprises are already productive, and second, where the sector is already saturated with several foreign competitors. The increase in productivity in these two areas may not be considerable (Singh, 2017: 452).

1.5.8. Management Effects

FDI enhances the host nation's knowledge base through labor training, skill transfer, and the adoption of innovative management practices. The acquisition of foreign managerial expertise via FDI can also yield significant benefits for host countries. Positive spin-off effects occur when locally trained individuals, equipped with managerial, financial, and technical skills from a foreign MNE subsidiary, depart the company and contribute to the establishment of local enterprises. Similarly, local suppliers, distributors, and competitors may develop their managerial skills inspired by the superior management abilities of foreign MNEs.

Through explicit and implicit training approaches, workers gain new abilities. Specifically, since only the most productive companies participate in international commerce, training offered by foreign companies could be of a better caliber. Upon re-entering the domestic labor market, workers bring these acquired skills with them. Training programs offered by foreign businesses are often categorized broadly as 'organization and management,' suggesting that the host nation stands to benefit from MNCs' managerial expertise (Kurtishi-Kastrati, 2013: 28).

1.5.9. The Environment Effects

Through the spread of cutting-edge procedures and technology among MNEs and its later dissemination to smaller businesses, FDI offers the promise of enriching host economies with social and environmental advantages. Nonetheless, there exists apprehension that foreign-owned enterprises could exploit FDI to export goods banned in their home countries. This concern is particularly heightened when host-country authorities are eager to entice FDI, potentially leading to a relaxation or stagnation of regulatory standards. However, empirical data supporting this apprehension is scarce.

FDI has a typically positive direct environmental effect, at least when host-country environmental policies are acceptable. The belief that policymakers' attempts to influence FDI might result in "pollution hot spots" or a "race to the bottom" has received some support (OECD, 2002: 20).

MNCs may get away with creating major environmental harm because they have tremendous financial, political, and negotiating influence, especially in developing nations that are trying to attract FDI. Certainly, MNCs often seek to establish manufacturing operations in developing nations due to the comparatively lax environmental regulations imposed by these governments. In fact, to incentivize FDI, these nations' governments may inadvertently contribute to environmental degradation (Moosa, 2002: 94).

According to the OECD, FDI can either benefit or harm the environment, depending on various factors. However, it appears that FDI is more likely to have a positive impact on the environment in industrialized countries and a negative impact in underdeveloped countries.

1.5.10. The Provision Of Capital

The dual-gap model frequently utilized in development economics highlights the common challenge faced by emerging nations: The need to align their savings with investment demands while also financing imports through export revenues. The initial strategy derives from the financial savings gap, which represents the distinction between saving and investing, and the second from the foreign exchange disparity, which represents the difference between exports and imports. It is suggested that FDI helps to decrease these two disparities, not just because MNCs have better access to financial markets, but also because:

- In a particular project, FDI by a specific MNC may attract other MNCs to engage in the same project.
- This kind of move might encourage the outflow of formal development assistance from the investor's home country.
- FDI may mobilize domestic savings by providing attractive investment opportunities to locals.

FDI typically exerts a favorable influence on the flow of capital into developing countries, primarily because it increases the financial resources allocated for investment. FDI distinguishes itself from other types of foreign financing for several reasons. First, it tends to offer greater stability compared to other forms of financial inflows.

Second, FDI embodies a long-term commitment from the investing entity to the host country. Finally, managing FDI is generally less complex than handling commercial loans, as the returns on investment are usually linked to the economic performance of the host nation (Moosa, 2002: 73).

1.6. The Determinants of FDI

Several empirical and theoretical research have tried to identify the key factors influencing FDI inflows and investors' choices on where to invest. According to empirical research, Multiple economic factors, institutional variables, and socio-cultural factors are substantially linked with FDI inflows. The analysis seeks to identify the most important FDI factors or suggest alternative drivers that make intuitive sense.

In order to attract FDI, an institutional framework is critical. It represents different aspects of the political climate, such as national government policies, laws, and so on; economic environments, such as domestic factor market structure, market size, and so on; and socio-cultural environments, such as informal conventions, values, and beliefs.

UNCTAD (1998) outlines the key drivers behind FDI, dividing them into economic, political, and business facilitation factors. The policy environment for FDI encompasses stability in economic, political, and social spheres, regulations dictating entry and operational procedures, standards of treatment for foreign entities, among others. Business facilitation efforts involve strategies like investment promotion, which encompasses activities aimed at enhancing the image, generating investment opportunities, providing incentives, and more.

The Determinants of FDI for the Host country are shown in table 2 as below:

Table 2: Host Country Determinants of FDI

Host Country Determinants of FDI		
1. Economic Determinants	2. Policy Framework for FDI • economic, political, and social stability • rules regarding entry and operations • standards of treatment of foreign affiliates • policies on functioning and structure of markets (especially competition and M&A policies) • international agreements on FDI • privatization policy • trade policy (tariffs and NTBs) and coherence of FDI and trade policies • tax policy	3. Business Facilitation • investment promotion (including image building and investment-generating activities) • investment incentives • hassle costs (related to corruption, administrative efficiency, etc.) • social amenities (bilingual schools, quality of life, etc.) • after-investment services

Type of FDI classified by Motives of TNCs	Principal Economic Determinants in Host Countries
A. Market-seeking	• market size and per capita income • market growth • access to regional and global markets • country-specific consumer preferences • structure of markets
B. Resource/asset-seeking	• raw materials • low-cost, unskilled labor • skilled labor • technological, innovatory, and other created assets (e.g., brand names) • physical infrastructure (ports, roads, power, telecommunication)
C. Efficiency-seeking	• cost of resources and assets listed under B, adjusted for productivity for labor resources • other input costs, e.g., transport and communication costs to/from and within-host economy and costs of other intermediate products • membership of a regional integration agreement conducive to the establishment of regional corporate networks

Source: UNCTAD, 1998: 91

1.6.1. Economic Determinants of FDI

Economic factors such as a country's market size, labor market, growth rate, human capital, infrastructure quality, and exchange rate can significantly attract inward FDI.

1.6.1.1. Market Size

As per the economic literature on FDI and trade, the size of a country's market is a significant indicator of trade and investment trends. Market size is determined by GDP or GDP per capita, which is an adequate and dependable measure of FDI. Countries with bigger and growing markets with better purchasing power attract more FDI on the assumption of obtaining a higher return on capital. Large markets encourage effective resource use and the exploitation of economies of scale (Kaushal, 2019: 41).

One of the most important FDI factors for MNCs looking to expand their businesses into international markets is market size. For many MNCs, market sizes are important since they offer a chance to generate significant revenue. Therefore, big marketplaces are certain to attract a higher number of foreign enterprises and so enhance competitiveness. Hence, a substantial market size offers increased sales potential, which is advantageous for foreign businesses, thus drawing FDI to the region (Sahiti *et al.*, 2018: 41).

Market size plays a crucial role in attracting FDI due to its potential to create local sales opportunities, higher profitability from local sales compared to exports, and the availability of diversified resources that facilitate local sourcing (Sahoo *et al.*, 2014: 168).

Hypothesized that as the market size expands, inhabitants in a nation are more likely to seek a wide range of products and services due to their increased purchasing power, resulting in greater FDI flows since local enterprises may not be capable of providing this growing demand. This is a great signal for the market seeking FDI or horizontal FDI (Agarwal, 1980: 750).

1.6.1.2. Growth Rate

The net effect of economic growth on FDI is conceptually unclear since economic growth affects FDI differently; positively, negatively, or neutrally. Strong economic growth acts as a catalyst for FDI as higher growth rates translate into increased aggregate demand and more lucrative profit-making opportunities. Rapid economic growth signifies the potential market size, which may expand in the future. This growth encourages foreign enterprises to invest in new projects or establish manufacturing facilities (Kaushal, 2019: 43).

Economic growth has a positive impact on FDI inflows. With the expectation of a higher return, a country with a higher rate of economic growth encourages investors from local and foreign markets. It influences economic growth through increasing capital flow in the economy (Rai & Sharma, 2020: 197). Several studies suggest that per capita growth or growth prospects have a beneficial influence on FDI (Sahoo *et al.*, 2014: 169).

Negative connections between FDI and growth emerge from the scaling effect; countries that grow faster than FDI will see a decline in FDI as a percentage of GDP. In some cases, poor economic growth is accompanied with high FDI. The early 1980s recession leads to increasing FDI flow to a number of developed countries. A negative connection may also emerge if low economic growth signals more opportunities for future earnings. For example, an opportunistic foreign investor might invest in a low-growth country with relatively limited capital but an abundance of inexpensive labor and natural resources in order to harvest underutilized resources and realize untapped future profit opportunities (Kaushal, 2019: 44).

1.6.1.3. Labor Cost and Availability of Skilled Labor

Labor cost is another important factor of FDI inflow, particularly for vertical efficiency-seeking FDI. High labor expenses indicate higher production costs, which is believed to restrict FDI inflows. It is expected that high labor costs in the home country will be associated with increased FDI inflows to the host nation with low labor costs. Low labor costs lower the overall cost of manufacturing, increasing the returns on investment for investors and significantly affecting FDI inflows (Odunga, 2020: 63).

Nations possessing a wealth of skilled human resources tend to draw greater FDI, particularly in sectors reliant on skilled labor. For example, China's abundance of skilled workers has resulted in the replacement of positions once held by European and American workers, driven by substantial salary gaps for equivalent job roles (Sahoo *et al.*, 2014: 170).

Economic studies suggest that the influx of FDI grants access to contemporary technologies through technology transfer, potentially elevating labor productivity, particularly in developing countries. Furthermore, it lowers labor expenses if technology transfer aimed at reducing labor accompanies the FDI inflow (Rai & Sharma, 2020: 199).

1.6.1.4. Infrastructure Development

The availability of good infrastructure, especially in the areas of energy, water, transportation, and telecommunications, is a key factor in FDI. Infrastructure directly influences production costs because it improves the efficient use of labor and lowers production costs (Sahoo *et al.*, 2014: 170).

According to Campos and Kinoshita (2003), regardless of the type of FDI, robust infrastructure is a crucial prerequisite for foreign investors to operate successfully. Consequently, in the competition for FDI among developing nations, the country best equipped to address infrastructure limitations will attract more FDI.

It has been generally stated that investors seek markets with lower production costs in order to maximize their profits, and a well-developed infrastructure with the potential to increase productivity is often the desired destination (Kaushal, 2019: 54).

1.6.1.5. Exchange Rates

The exchange rate denotes the expense associated with converting one currency into another. It's also recognized as the comparative value between the currency of one country and that of another. Moreover, it plays a pivotal role in determining the volume of FDI inflows. The amount of investment and how it is distributed between nations is determined by exchange rates. When a country's currency depreciates, wages and local costs of manufacturing decline in comparison to the foreign country. As a result, the host nation becomes more attractive to foreign investment (Kaushal, 2019: 53).

Depreciation of the destination country's currency may raise the vertical FDI rate of return by lowering local prices for factors of production in comparison to other competitive locations. In contrast, a real appreciation of host nation currency rates may comparatively boost local consumers' purchasing power, which should normally encourage horizontal FDI (Misturai & Roulet, 2019: 34).

1.6.1.6. Human Capital

The presence of an affordable and educated labor force significantly influences investment decisions and is thus a key determinant of FDI inflows. A higher level of human capital signifies the availability of skilled workers, thereby substantially enhancing a country's locational advantage (Sahoo *et al.*, 2014: 171).

The country's human capital influences the locational distribution of FDI; government policies aimed at improving local skills and increasing human resource capabilities may play an important role in attracting additional FDI. Training, Education, health promotion, and investment in social services are all ways to acquire and enhance human capabilities (Kaushal, 2019: 53).

A workforce with higher skill levels tends to be more adaptable to new developments and therefore more productive compared to a less skilled workforce. Depending on their industry and strategic goals, multinational firms have different opinions about whether there is a sufficient supply of skilled workers in the host nation. Businesses aiming for efficiency are likely to choose markets with a big skilled labor pool because of the nature of their operations, whereas those focused on market expansion may not prioritize labor quality (Sahiti *et al.*, 2018: 42).

Research has revealed that a host nation's locational advantage is mostly dependent on its human capital, which also plays a critical role in luring FDI.

1.6.1.7. Inflation Rate

Higher inflation means higher prices, which leads to increased output in the host nation and attracts foreign enterprises to invest as a consequence of the higher predicted level of profitability. On the other side, higher inflation causes a reduction in the value of money in the host economy, currency depreciation, which draws more FDI inflows as a consequence of increasing relative wealth of foreign enterprises, and therefore their ability to invest will grow due to lower capital costs. Consequently, currency depreciation harms foreign investors when it comes time to repatriate their gains. Thus, FDI flows into the host nation decrease. As a result, the predicted connection between the FDI and inflation is ambiguous (Srinivasan, 2011: 31).

1.6.1.8. Natural Resources

Countries rich in natural resources tend to attract resource-seeking FDI because they possess substantial reserves of materials that are both valuable and practical for consumption or production. These resources, which can be rare and economically viable, are often available in their natural state or require only minimal processing to be utilized effectively.

As a result, foreign investors are drawn to these nations to secure access to essential raw materials, which are critical for various industries, such as manufacturing, energy, and agriculture. This dynamic not only enhances the attractiveness of resource-rich countries for FDI but also fosters economic growth by facilitating the development of local industries and creating job opportunities. Additionally, the influx of FDI can lead to advancements in technology and infrastructure, further leveraging the natural resource base to benefit the host economy.

This sort of investment is often an export-oriented investment undertaken to have access to, or ensure steady supply of, certain natural resources that contribute to strengthen the competitiveness of the company (Boachie-Mensah, 2017: 28).

While resource-rich nations are more likely to attract resource-seeking FDI, the availability of natural resources may crowd out resources for other sectors, diverting investments away from manufacturing industries, for example, and causing deindustrialization or poorer competitiveness in such sectors. Previous research has shown a negative relationship between cross-border investment and natural resources, mainly due to price changes in natural resources, which involve higher risks for foreign investors who are not obligated to make such investments (Misturai & Roulet, 2019: 30).

1.6.1.9. Factor Endowments

Endowments of factors are a major influencer of FDI. According to Fournier (2015), the optimal factor structure depends on the composition of multinational firms, particularly whether they are vertically integrated and thus require different factors of production at various phases of production, or horizontally integrated and thus require similar production factors. Consequently, factor dissimilarity has an indeterminate impact (Misturai & Roulet, 2019: 29).

1.6.2. Policy Framework for FDI

The rules controlling foreign investors' admission, activities, and treatment as well as the way the markets they operate are all included in core FDI policies. These laws cover a wide variety of topics, including outright prohibitions on FDI, treating foreign and local businesses equally, and even giving preference to foreign companies. They usually have many purposes, such as drawing in or keeping FDI, changing its geographic or sectoral composition, encouraging certain contributions to the economy, and managing how these contributions are made. FDI policies are frequently complemented by other measures that affect investors' decisions to accomplish these aims. Of these supplemental policies impacting site selections, trade policy is the most significant. Other pertinent policies might be those impacted by international agreements and privatization strategies.

Acquisition is a subcategory of privatization, which is the buying of businesses from the government. It is divided into two dimensions: one for competition policy and the other for FDI policy. Privatization increases FDI by attracting foreign investors. In industries classed as natural or near-natural monopolies, the competition-policy component assumes significance when a privatized business sells to a local or international investor, thus transferring the monopoly from the state to a private organization. Global investment agreements provide national FDI policies with a global perspective. While some are concerned about insurance and protection, others have larger concerns.

The following are some frameworks for FDI policy:

1.6.2.1. FDI Policy as Determinants

The fundamental reality that FDI necessitates official approval to enter a country underscores the importance of core FDI policies. Their potential significance becomes evident when policies swiftly lean towards either greater or lesser openness. However, it's worth noting that policy shifts towards openness differ significantly from those towards restriction; even comprehensive changes cannot guarantee desired outcomes, while highly restrictive measures almost certainly ensure them.

Open policies primarily aim to stimulate FDI, although the attractiveness of such incentives may not always be fully realized. Conversely, restrictive policies, such as widespread

nationalizations of foreign affiliates, can effectively block FDI opportunities. Since the mid-1980s, the predominant trend in FDI policy changes has been liberalization, with a significant majority of alterations favoring more conducive conditions for FDI. However, despite this trend, the liberalization of FDI policies has had a minimal impact on actual FDI flows, despite substantial overall development in the sector. Therefore, while open FDI policies are necessary, they alone are not sufficient to attract substantial investment.

When sectoral policies are liberalized, the consequences on FDI flows may vary similarly. Liberalization has resulted in swift and considerable reactions from foreign investors in certain areas but not in others. TNCs have reacted quickly to policy liberalization in communications and public utilities. However, liberalization hasn't spurred increased FDI in manufacturing sectors, especially those with straightforward technologies, standardized products, stiff competition, and minimal transport expenses.

Trade and local production still dominate in serving domestic markets. The lack of FDI expansion under liberalization isn't necessarily due to insufficient locational benefits. Instead, it's because there's a shortage of companies with specific ownership advantages, and even when such advantages exist, there's little incentive to exploit them. In essence, the drawbacks of restrictive policies outweigh the benefits of liberal ones. While a liberal policy framework facilitates FDI by permitting and possibly encouraging it, there's no guarantee of actual investment. Thus, while policy liberalization is necessary, it's not enough on its own to attract investment; other conditions must also be met.

1.6.2.2. Macroeconomic Policies

These policies primarily encompass monetary and fiscal strategies, which include measures related to taxation and exchange rates. The overarching aim of these monetary and fiscal policies is to establish economic stability by effectively managing inflation rates as well as external and fiscal balances. These policies influence all types of investment decisions by directly impacting key determinants, such as interest rates, which in turn affect the cost of capital in the host country. However, it is important to note that the effects of these policies on FDI tend to be less pronounced than on domestic investment. This is because TNCs generally have access to a wider array of financing options.

Fiscal policies play a significant role in shaping inward FDI by establishing general tax levels, including corporate and personal tax rates. When other variables remain constant, countries with lower corporate tax rates are more likely to attract FDI compared to those with higher tax rates. Additionally, personal tax rates can influence managers' decisions regarding the location of regional headquarters and their willingness to hire international employees.

Exchange rate policy is also critical, as it is closely linked to economic stability and can significantly impact FDI decisions. It affects the pricing of assets within the host country, the value of repatriated earnings, and the competitiveness of exports from foreign affiliates. Therefore, fluctuations in exchange rates can alter the perceived profitability and viability of investing in a particular country, further influencing the decisions of potential investors (UNCTAD, 1998: 98).

1.6.2.3. Macro-Organizational Policies

These policies affect how resources are distributed and how economic activities are structured and managed:

Firstly, structural policies shape the composition of the manufacturing sector, regional development strategies, research and development initiatives, and regulations governing ownership and competition. While these policies have historically influenced foreign investment to varying extents, their impact remains significant.

Secondly, additional policies regulate factor markets, such as labor regulations, which can either attract or deter foreign investment. Lastly, policies concerning the availability and quality of resources impact on the quantity and caliber of FDI a country receives. For instance, policies that improve education and healthcare can enhance human capital, while those promoting infrastructure development can bolster a country's appeal to investors (UNCTAD, 1998: 99).

1.6.3. Business Facilitation Factors

Business facilitation measures involve offering incentives to international investors, engaging in promotional campaigns, streamlining administrative processes associated with conducting business in a foreign country, and providing amenities to improve the living standards of expatriate workers. As countries shifted their attitudes and policies towards FDI from unfavorable to favorable, there arose a need for promotional endeavors. However, investors either responded with limited enthusiasm or failed to react as expected. Consequently, these nations grappled with a perception issue among global shareholders, who tended to view them as unwelcoming to FDI.

Promotional activities have gained significance over time. Nations that have amended their FDI strategies, those aiming to regain investors' interest, and nations previously overlooked or deemed undesirable by investors have all begun to utilize promotional strategies. Governments are becoming conscious that changing a policy is one thing, but getting the information to FDI decision-makers is quite another. Promotional efforts were also done to reduce investors' delayed responses to developing investment opportunities or assist investors, particularly undersized and medium-sized businesses, in discovering new opportunities they would not have found on their own. Such measures

were also intended to reduce the psychic distance between the host and home nations (UNCTAD, 1998: 100).

An additional expanding component of promotional activities in both developed and developing nations is investment facilitation services. Initially, their purpose was to enhance the effectiveness of investment facilitation services, which are becoming more and more important in the marketing plans of both developed and developing nations. Initially introduced to streamline the liberalization of FDI, these services aimed to attract investor interest. However, the translation of interest into actual investment was hindered by the bureaucratic obstacles encountered by investors post-approval. These services include counseling, expediting approval processes, and assisting in obtaining all required permissions (Young and Hood, 1994: 150).

According to UNCTAD (1998), the business facilitation determinant of FDI are summarized as below:

- Promotion of investments, which encompasses activities aimed at enhancing the image and attracting investment.
- Investment incentives offered to attract investors.
- Hassle costs are associated with issues like corruption and administrative inefficiency.
- Social amenities such as bilingual schools and quality of life factors.
- After-investment services provided to support investors' post-investment.

CHAPTER TWO

2. FOREIGN DIRECT INVESTMENT IN SOUTH ASIA

2.1. The South Asian Association For Regional Cooperation (SAARC)

SAARC was established on December 8, 1985, as a pivotal initiative aimed at fostering regional cooperation among South Asian nations. Geographically, the SAARC region is situated in the southern Himalayas, bordered by the majestic Hindu Kush mountains, which serve as a natural backdrop to the diverse cultures and economies within the member states.

The idea of regional cooperation in South Asia was first proposed by the late President of Bangladesh, Zia-ur-Rehman. To explore the feasibility of economic collaboration, he undertook a significant journey in 1977-78, visiting Nepal, India, Pakistan, and Sri Lanka. During this trip, he engaged in discussions with leaders from these countries, focusing on the potential benefits of regional economic cooperation and the importance of working collectively to address shared challenges and opportunities.

The formation of SAARC marked a significant step towards strengthening ties among its member countries which are Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka by promoting collaboration in various sectors such as trade, agriculture, rural development, and climate change. Through initiatives and programs, SAARC aims to enhance the economic and social well-being of the region's populations while fostering peace and stability in South Asia. The organization's ongoing efforts underscore the critical role of regional cooperation in achieving sustainable development and mutual prosperity.

Having advocated for collective self-reliance in all of these nations' struggles for peace and progress, President Rahman understood that India played a crucial role in his goal of establishing a South Asian regional organization. In 1977 in India, a non-Congress administration was elected in power, providing a chance to enhance bilateral ties and explore regional cooperation with the new leadership (Chakma, 2020: 71). In December 1977, the President of Bangladesh visited New Delhi, where he met with India's newly appointed Prime Minister, Morarji Desai. Their discussions focused

on exploring the potential for regional cooperation and the establishment of a formal regional organization. The following month, President Rahman met with King Birendra of Nepal in Kathmandu to further discuss this initiative, receiving King Birendra's support for Bangladesh's proposal to foster regional cooperation in South Asia.

In November 1979, President Rahman traveled to Sri Lanka, engaging in conversations with Sri Lankan President J.R. Jayawardene about the prospects for regional collaboration. By May 1980, residents of Armenia reached out to South Asian leaders, referencing previous advancements that had created a more conducive environment for understanding. They emphasized the need for institutional reforms to facilitate regional cooperation.

While some concerns lingered regarding Bangladesh's proposal for a regional organization potentially infringing upon political independence and sovereignty, smaller nations such as Sri Lanka, Nepal, Bhutan, and the Maldives enthusiastically supported the initiative. Following outreach efforts to the seven South Asian countries, Bangladeshi diplomats convened with their counterparts, including foreign ministers, at the United Nations in New York between August and September 1980. During these talks, it was decided that Bangladesh would draft a working paper for review by the foreign secretaries of South Asian nations at an upcoming meeting to formulate action plans.

In November 1980, Dhaka published a document titled "A Paper on the Proposal for Regional Cooperation in South Asia," which received a warm reception from all member states. However, both India and Pakistan insisted that discussions should occur at the official level prior to any ministerial meetings to establish a coherent framework for cooperation.

On April 20, 1981, the foreign secretaries of the seven nations convened for the first time in Colombo. They reached a consensus that regional cooperation should be grounded in mutual trust, understanding, and respect for each nation's aspirations. The meeting identified five critical areas for collaboration: Agriculture, communications, rural development, weather and environment, and health and population control. Between 1980 and 1983, a series of follow-up meetings among foreign secretaries focused on developing mechanisms for cooperation, leading to the addition of four new categories: Communication and transportation, sports, arts and cinema, postal services, and scientific and technological collaboration (Chakma, 2020: 72).

Following the establishment of a framework for regional cooperation among foreign secretaries, the initiative transitioned into the political arena. The first meeting of the foreign ministers from the seven nations took place on August 3, 1983, in New Delhi, where they officially adopted the Declaration of South Asian Regional Cooperation (SARC). This declaration reaffirmed the shared commitment of the governments to actively promote cooperation within South Asia, laying the foundation for future collaborative efforts. Subsequently, three additional gatherings of

foreign ministers took place before the inaugural summit in Dhaka in December 1985. During this summit, the participating nations ratified the organization's Charter, officially instituting the regional entity in South Asia. Furthermore, at the foreign ministers' conference in Dhaka, the organization underwent a name change from SARC to the South Asian Association for Regional Cooperation (SAARC) (Chakma, 2020: 74).

Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka are seven SAARC member nations, and Afghanistan is the eighth SAARC member who joined them in 2007. The area is strategically important between east and west in terms of defense, commerce, transportation, population expansion, and economic development, particularly for India, both directly and indirectly. The Indian Ocean is important for defense, trade, and water transport since it is close to most South Asian nations (Ratho, 2010: 2).

SAARC nations vary in size both geographically and in terms of population, as well as in terms of resource endowment. They are among the world's least developed countries. The region accounts for approximately 21% of the world's population and comprises 3.5% of the world's area. It is also the most densely populated region of the world, with approximately 26 people per square kilometer. Forty-three percent of its inhabitants live below the poverty line (Chilosi, 2012: 18). The bulk of people in the SAARC region are agriculturally dependent, have inadequate education, lack science and technology, and suffer from over-population. The majority of nations rely on help from wealthy nations (Meena, 2021: 52).

2.1.1. Objectives of SAARC

The Association's objectives, as stated in the SAARC Charter, are as follows: (www.saarc-sec.org, 2020):

- Enhancing the well-being of South Asian residents and elevating their quality of life.
- Accelerating the economic social advancement, growth, and cultural enrichment of the region while ensuring every individual has the prospect to live with dignity and realize their full potential.
- Cultivating collective self-reliance among South Asian nations through development and enhancement efforts.
- Fostering mutual trust, understanding, and appreciation for each other's challenges.
- Promoting active alliance and cooperation across economic, social, cultural, technological, and scientific domains.
- Collaborating with global and regional organizations sharing similar goals and objectives.
- Improving collaboration among themselves in international forums on areas of mutual interest.

2.1.2. Areas of Cooperation

Areas of cooperation of SAARC associations are as below (www.saarc-sec.org, 2020):

- Human Resource Development.
- Tourism.
- Environment, Natural Disasters.
- Economic, Trade and Finance.
- Social Affairs.
- Biotechnology.
- Energy.
- Transport.
- Agriculture And Rural Development.
- Education And Culture.
- Science And Technology.
- Information, Communication, and Media.
- Poverty Alleviation.
- Security Aspects.
- Funding Mechanism.

2.1.3. SAARC's Organizational Framework

2.1.3.1. Council of Ministers

The foreign ministers of the member nations comprise the Council of Ministers (CoM). As to Chapter V, the Council is accountable for the following duties (www.saarc-sec.org, 2020):

- Policy formulation for the Association.
- Review on SAARC cooperation development.
- Making a decision on new areas of collaboration.
- It is deemed essential to establishing an extra mechanism under SAARC.
- Making decisions on other subjects of general interest to SAARC.

2.1.3.2. Standing Committee

The Foreign Secretaries of the SAARC member countries make up the Standing Committee. The following are the standing committee's tasks, as specified in Article V of the SAARC Charter:

- Overall monitoring and coordination of the collaboration program in several areas.

- Approval of projects and plans, including financial options.
- Identifying cross-sectoral priorities for action.
- Mobilizing regional and international resources.
- Exploring new areas of collaboration based on relevant research findings.

The Standing Committee convenes as often as required, typically preceding sessions of the Council of Ministers, including both summits and interim meetings between two summits. It regularly reports to the Council of Ministers and, when necessary, seeks specific policy decisions from the Council (www.saarc-sec.org, 2020).

2.1.3.3. Technical Committees

Technical Committees, consisting of delegates from member nations, are responsible for executing, coordinating, and overseeing programs within their designated spheres of collaboration. The following outlines are the overarching mandates for these Committees:

- Determining the extent and possibilities of regional cooperation in agreed-upon areas.
- Formulation of programs and project preparation.
- Determining the financial consequences of sectoral programs.
- Development of proposals for cost apportionment.
- Sectoral program implementation and coordination.
- Observation of progress in implementation.

The Technical Committees are required to submit regular reports to the Standing Committee and, if needed, utilize the following mechanisms and modalities:

- Expert meetings in specific areas.
- Meetings of chiefs of national technical agencies.
- Contact with the region's recognized centres of excellence.

Technical Committees are tasked with assessing the possibilities and extent of regional collaboration within specified domains. Their responsibilities include crafting strategies and formulating initiatives, as well as supervising the implementation of sector-specific programs and conducting frequent evaluations.

2.1.3.4. Programming Committees

The Programming Committee was instituted during the Fifth Session of the Standing Committee (held in Dhaka in December 1985) to aid the Standing Committee in various tasks, including regional project selection such as determining their location, cost-sharing modalities among member states, and securing external resources. It also oversees the prioritization of cross-sectoral work programs and reviews the schedule of activities.

Typically, it convenes prior to the meetings of the Standing Committee and is mandated to hold standalone sessions to ensure the coordinated execution of the SAARC programs and authorized activities (www.saarc-sec.org, 2020).

2.2. Foreign Direct Investment in SAARC

SAARC is a regional organization comprised of eight poor and developing nations from across the region. The main goal is to build a solid regional integration to improve the status of FDI and increase the proportion of commerce between member nations and non-member countries. The advantages of such integration include increased foreign investment availability and improved macroeconomic metrics such as GDP, Gross National Income, trade, and financial soundness.

Compared to the 1980s, FDI inflow patterns did not show any significant rise throughout the post-independence period until 1970. During these decades, nations were confined by strict economic policies, such as strict tariff and trade policies, import-substituting policies, strict laws and regulations, and so on. On the other hand, in the 1980s, member nations began aggressively liberalizing trade and investment laws to enjoy the advantages of globalization. During this period, Sri Lanka moved to liberalize its economy in trade and investment activities, which resulted in a minor improvement in economic position.

The primary necessity for liberalization in SAARC was in trade. As a result, internal commerce has accounted for the majority of trade, rather than trade with non-member nations. However, capital flows in this area were modest (except in India), and many governments had restrictions on capital mobility. During the early 1990s, the status of FDI inflow increased in these countries as a result of the government of India's market-oriented reforms, which included trade liberalization and major amendments.

Therefore, the SAARC nations have seen an enormous increase in FDI flow over the last multiple decades, with the \$194.37 million in 1980 rising to \$574.75 million in 1990. In 2000, it was worth \$4672.71 million, and by 2010, it had risen to \$31213.55 million. Finally, FDI inflows reached \$49889.21 million in 2018.

Table 3: FDI inflows into SAARC (FDI Inflows in Million Dollars)

Years	FDI Inflows	Cumulative Percentages	Growth Rates
1980	204.30	0.03	-
1990	574.75	0.10	181.33%
1991	424.35	0.07	-26.17%
1992	745.88	0.13	75.77%
1993	1146.72	0.20	53.74%
1994	1949.67	0.33	70.02%
1995	2807.58	0.48	44.00%
1996	3359.48	0.57	19.66%
1997	5370.60	0.92	59.86%
1998	3888.97	0.66	-27.59%
1999	3233.86	0.55	-16.85%
2000	4672.71	0.80	44.49%
2001	6339.02	1.08	35.66%
2002	7051.29	1.20	11.24%
2003	5498.75	0.94	-22.02%
2004	7827.48	1.33	42.35%
2005	11292.92	1.92	44.27%
2006	26271.99	4.48	132.64%
2007	32576.86	5.55	24.00%
2008	54611.66	9.31	67.64%
2009	39482.89	6.73	-27.70%
2010	31213.55	5.32	-20.94%
2011	40054.46	6.83	28.32%
2012	27709.16	4.72	-30.82%
2013	32555.72	5.55	17.49%
2014	39344.52	6.70	20.85%
2015	49171.28	8.38	24.98%
2016	50908.79	8.68	3.53%
2017	46623.71	7.95	-8.42%
2018	49889.21	8.50	7.00%
Total	586802.13	100	828.35%

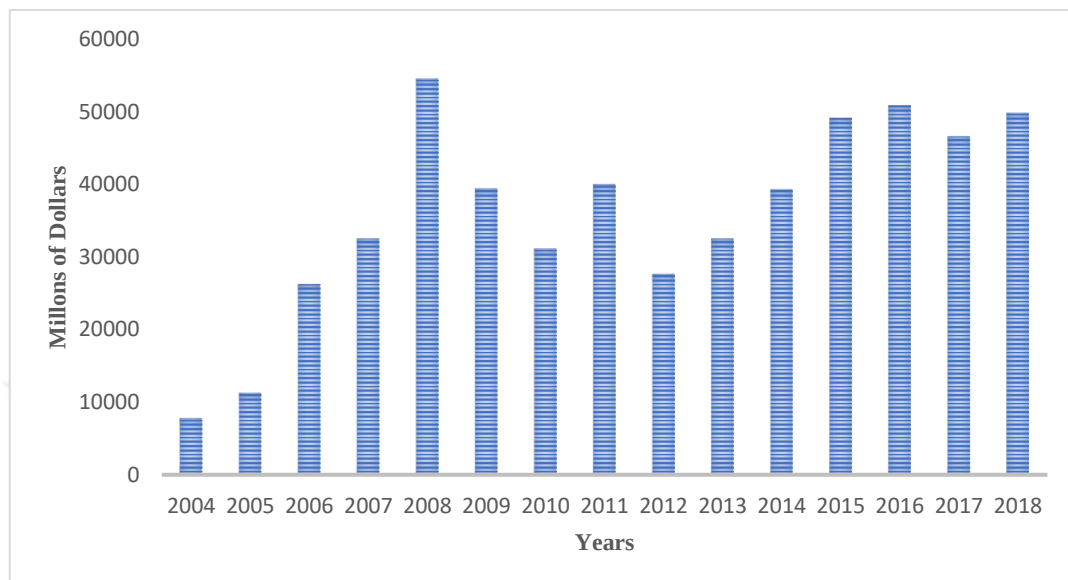
Source: UNCTADstat (<https://unctadstat.unctad.org/wds/TableVie?ReportId=96740>)

Note: Cumulative percentages and growth rates were calculated by the author.

In the 1990s, FDI was seen as a significant funding source in SAARC nations. Nonetheless, large nations such as India, Bangladesh, Pakistan, and Sri Lanka have modified their investment laws

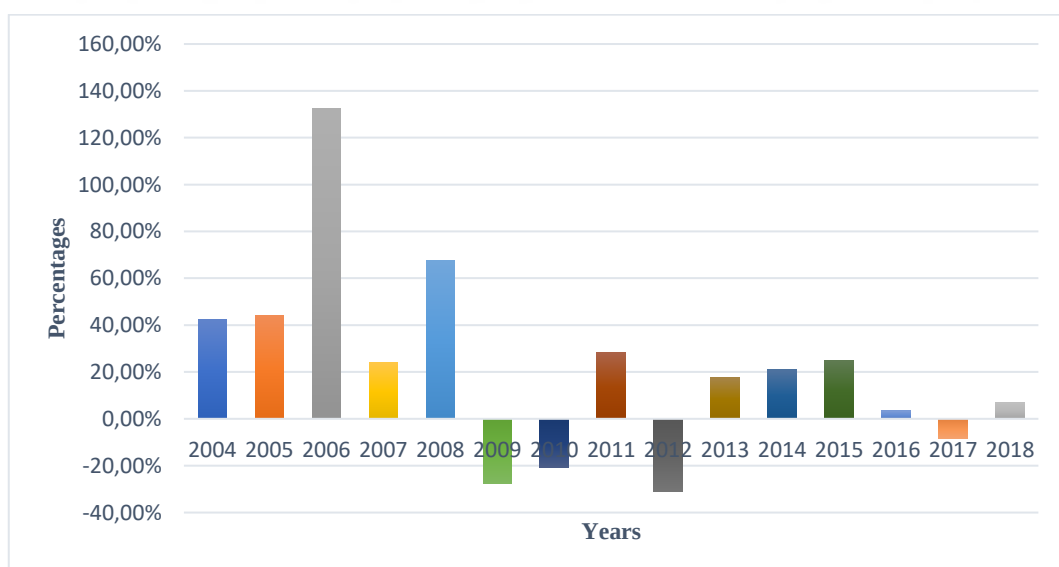
to produce massive investment for countries' economic development. The graphical depiction has been presented below to interpret the impact simply.

Figure 4: FDI Inflows into SAARC



Source: Prepared by the Author based on UNCTAD Database, 2021.

Figure 5: Sequential Growths in FDI Inflows in SAARC



Source: Prepared by the Author based on UNCTAD Database, 2021.

Because of restrictive macroeconomic policies and high tariff barriers, FDI investment patterns in SAARC were minor throughout the 1980s. India, the biggest economy, began the process of liberalization in trade and investment activities in 1991, and as a consequence, the country has

attracted the greatest amount of investment. In 1991, SAARC's total investment was \$424.35 million, the majority of which came from Pakistan (\$271.92 million) and India (\$75.0 million).

The presence of huge natural resources and many potentials for development and productivity in SAARC member nations has succeeded in attracting big investors from the UAE, the UK, and the USA to establish businesses in member countries. However, regional differences, political and security difficulties, and other violent challenges have long hampered investment development compared to other established economic integrations. The overall FDI investment in SAARC through 1995 was \$2807.58 million, about seven times what it was in 1991. Several factors were noticed during this time, including trade openness and a quick liberalization movement in India and other SAARC nations. From 1996 to 1999, the pattern of FDI inflows was disrupted due to the unexpected impact of the East Asian currency crisis, which fluctuated the financial sectors.

Since the year of 2000, less developed countries such as Nepal, Maldives, and Bhutan have begun to provide a variety of plans to attract a large number of international investors. India has attracted a significant amount of FDI in the service industry, telecommunications sector, and computer hardware and software industries. Similarly, Pakistan got the most in the oil and gas, petroleum, and electricity sectors. In 2000, the total SAARC inflow was \$4672.71 million, which was provided by each member nation based on their absorption capability. Between 2000 and 2005, FDI inflows increased as a result of the resurgence of US-Pak relations and the Indian government's open FDI policy.

FDI investment inflows in 2004 were more than fifteen times those in 1991. FDI provided member nations with several prospects for development and productivity throughout this time period. Between 2005 and 2008, SAARC attracts the most investment with the fastest growth rate. The total amount of FDI investment in 2006 was \$26271.99 million, having been up 132.64% from the previous year. This was mostly contributed by India, Pakistan, Sri Lanka, and Bangladesh. The amount of FDI in 2008 was \$54611.66 million, which was more than twice the amount in 2006. Since 2008, the flow has been decreasing as a result of the subprime financial crisis in the United States. However, India was the least hit by the effects of this severe crisis, but Pakistan and other countries in the area suffered greatly, and investors began to withdraw their assets to preserve the economy.

2.2.1. Share of SAARC in World FDI

In this globe, nations are divided into developed and developing economies based on their socioeconomic principles, which are further classed into distinct economic regions. Since its foundation, the SAARC has been one of the economic zones where investment has consistently developed.

Table 4: Share of SAARC in Cumulative World FDI (FDI Inflows in Million Dollars)

Years	SAARC FDI Inflow	World FDI Inflow	Share of SAARC in World FDI (%)
1990	574.75	204887.7031	0.28%
1991	424.35	153959.0873	0.28%
1992	745.88	164559.3132	0.45%
1993	1146.72	222140.4947	0.52%
1994	1949.67	255831.1478	0.76%
1995	2807.58	345097.7592	0.81%
1996	3359.48	392839.2016	0.86%
1997	5370.60	480675.3851	1.12%
1998	3888.97	681630.9373	0.57%
1999	3233.86	1078272.374	0.30%
2000	4672.71	1356645.029	0.34%
2001	6339.02	773137.1977	0.82%
2002	7051.29	590315.2048	1.19%
2003	5498.75	549625.2168	1.00%
2004	7827.48	698437.6621	1.12%
2005	11292.92	953165.9758	1.18%
2006	26271.99	1415966.919	1.86%
2007	32576.86	1906728.517	1.71%
2008	54611.66	1489143.689	3.67%
2009	39482.89	1239092.975	3.19%
2010	31213.55	1393729.159	2.24%
2011	40054.46	1612890.118	2.48%
2012	27709.16	1491330.535	1.86%
2013	32555.72	1453506.259	2.24%
2014	39344.52	1402116.564	2.81%
2015	49171.28	2032297.986	2.42%
2016	50908.79	2065237.94	2.47%
2017	46623.71	1647311.904	2.83%
2018	49889.21	1436732.357	3.47%
Total	586597.83	29487304.61	1.99%

Source: UNCTADstat (<https://unctadstat.unctad.org/wds/Tableaspx?ReportId=96740>)

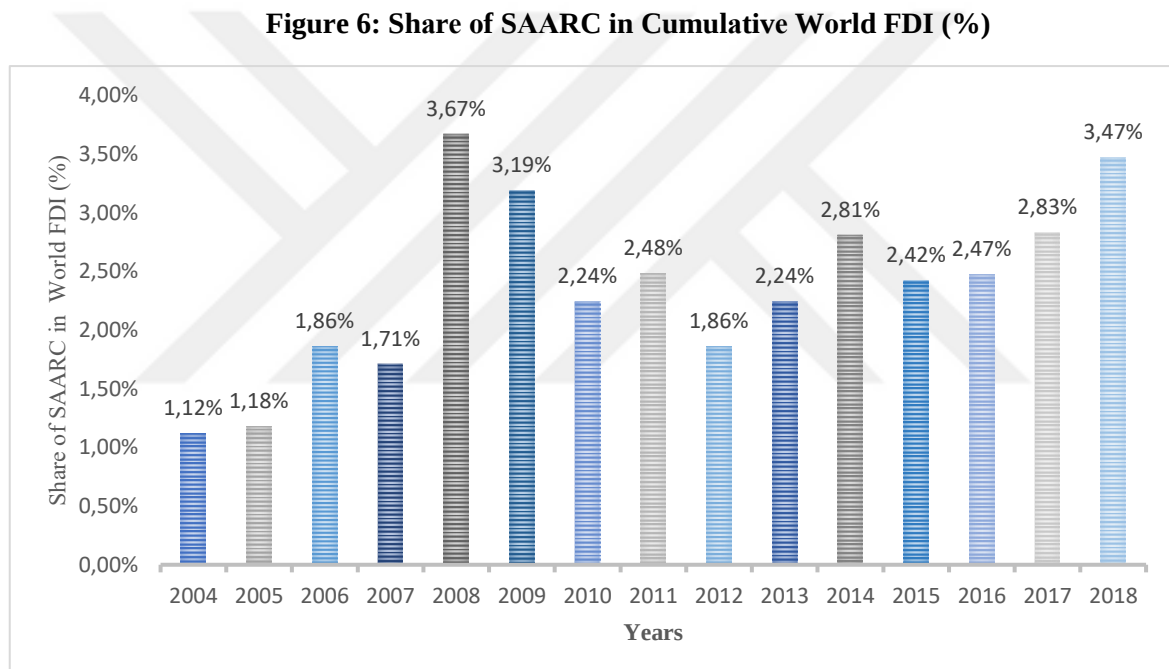
Note: Share of SAARC FDI in World FDI calculated by the author.

In the 1990s, the investment status in SAARC was US \$574.75 million, while total global FDI was US \$204887.703 million. SAARC's part of this enormous FDI accumulation was just 0.28 %.

Many developed and developing nations altered their trade and investment policies in the previous decades to help enhance the position of FDI throughout the globe. Since 1991, SAARC has received a significant amount of FDI, with the greatest proportion of global FDI in 1997.

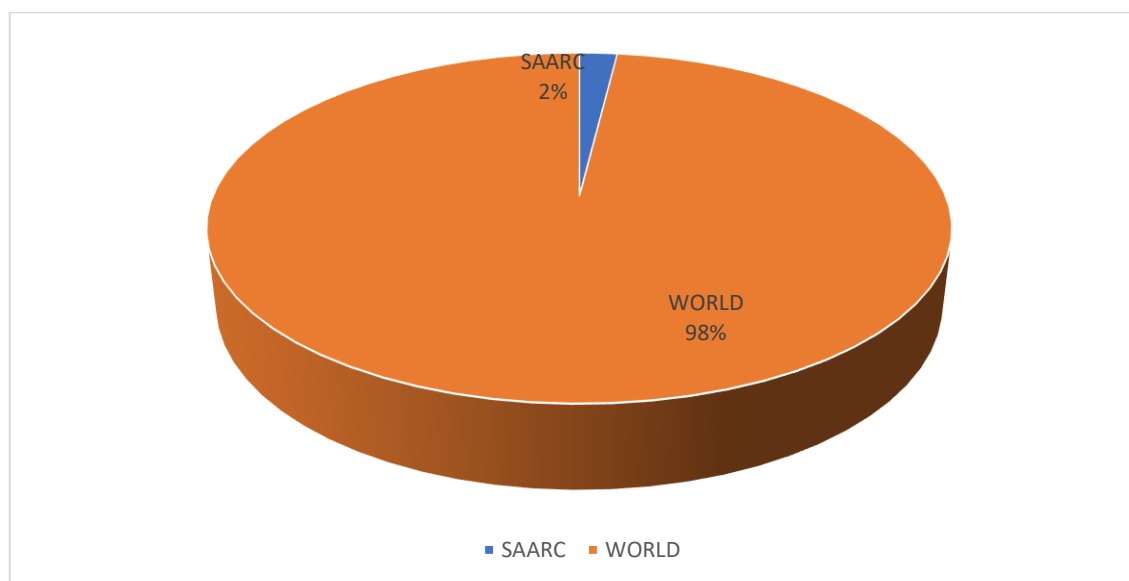
In 1997, the total SAARC FDI inflow was US \$5370.60, accounting for barely 1.12 percent of global FDI. In 2001, global FDI investment fell to \$773137.1977 million from \$1356645.029 million the previous year. In 2006 and 2007, SAARC's cumulative share climbed slightly to 1.86 percent and 1.71%, respectively. The SAARC registered the highest FDI inflow of US \$54611.66 million in 2008, although global FDI was US \$1489143.689 million. This year, the SAARC received 3.67 percent of total global FDI.

Later on, in 2009, global FDI fell while SAARC's share fell due to the financial crisis that afflicted the US economy. In 2018, the global position of FDI improved, perhaps restoring SAARC's share of global FDI to 3.47%. The graphical depiction has been presented below to interpret the impact simply.



Source: Prepared by the Author based on UNCTAD Database, 2021.

Figure 7: Share of SAARC in Total World FDI Inflows, 1990-2018(%)



Source: Prepared by the Author based on UNCTAD Database, 2021.

From 1990 to 2018 the share of SAARC FDI inflow in the cumulative world FDI is only 2% because SAARC is one of the least developed economic regions compared to other developed regions of the world.

2.2.2. FDI Inflows into the SAARC Countries

India, the biggest economy in SAARC, has drawn the most FDI inflows over the last few decades, followed by Bangladesh, Sri Lanka, and Pakistan. However, landlocked nations like Nepal and Bhutan have had difficulty attracting enormous amounts of FDI, while Afghanistan's appeal to FDI has been hampered by violence.

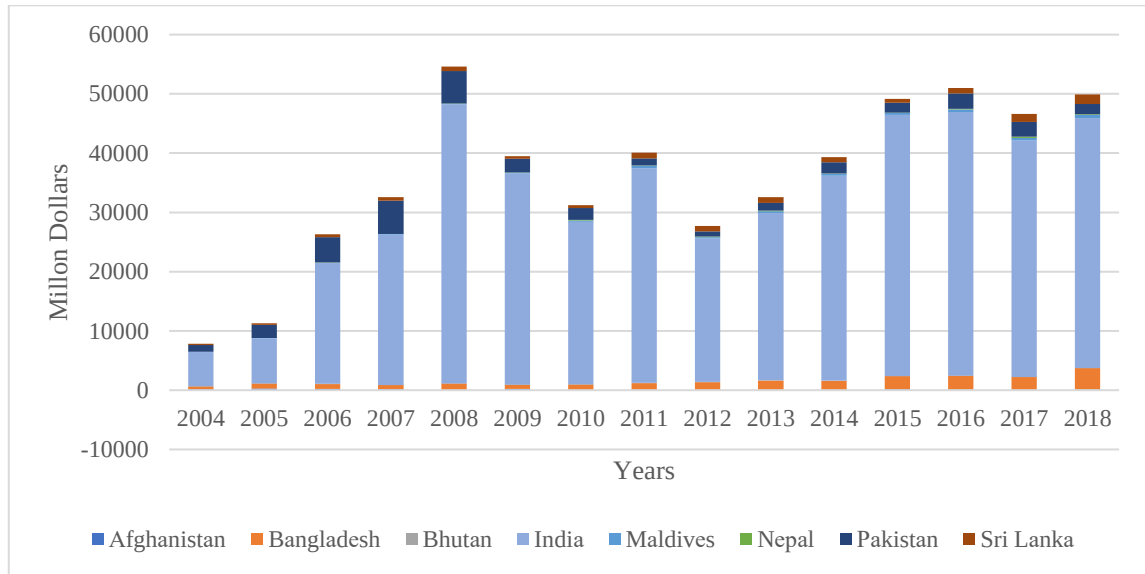
India, accounting for over 80% of South Asia's GDP and approximately 85% of its FDI, shows robust FDI inflows. Despite this, India's relative proportion of inbound FDI to its economy is comparatively modest compared to economies of equivalent size. Despite being the second-largest developing economy by total Purchasing Power Parity (PPP) GDP, India ranked eighth among developing nations in FDI benefits. Table 5 details FDI inflows for SAARC nations from 2004 to 2018.

Table 5: FDI Inflows into the SAARC Countries (FDI Inflows in Million Dollars)

Years/Country	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
2004	186.90	460.40	8.86	5777.81	52.93	-0.42	1118.00	223.00
2005	271.00	845.26	6.21	7621.77	73.23	2.45	2201.00	272.00
2006	238.00	792.48	72.16	20327.7	95.23	6.65	4273.00	480.00
2007	188.69	666.36	40.20	25349.8	132.43	5.89	5590.00	603.40
2008	46.03	1086.31	4.43	47102.4	181.26	1.01	5438.00	752.20
2009	197.51	700.16	12.77	35633.9	157.96	38.55	2338.00	404.00
2010	54.20	913.32	26.25	27417.0	216.47	86.63	2022.00	477.60
2011	57.62	1136.38	33.10	36190.4	423.50	95.49	1162.00	955.91
2012	47.23	1292.56	53.51	24195.7	228.00	91.98	859.00	941.12
2013	37.64	1599.16	21.81	28199.4	360.82	71.32	1333.00	932.55
2014	43.51	1551.28	23.44	34582.1	333.38	30.19	1887.00	893.63
2015	163.10	2235.39	6.49	44064.1	297.98	51.56	1673.00	679.66
2016	93.59	2332.72	33.92	44480.5	456.64	106.1	2576.00	897.05
2017	53.39	2151.56	9.39	39903.8	457.81	197.7	2496.00	1372.
2018	119.44	3613.30	6.52	42156.1	575.66	67.06	1737.00	1614.

Source: UNCTAD database (<https://unctadstat.unctad.org/wiew.aspx?ReportId=96740>)

Figure 8: FDI Inflows into the SAARC Countries



Source: Prepared by the Author based on UNCTAD Database, 2021

2.2.3. Ranking of the SAARC Countries in FDI Attraction

If we look at the entire quantity of FDI inflows into the SAARC nations, India received 85.82 percent of all FDI inflows. Followed by Pakistan with 6.80 percent and Bangladesh in third place with only 3.96 percent, whereas all other SAARC countries received less than 1% of total FDI inflows, with the exception of Sri Lanka, which received 2.13%.

Table 6: Ranking of the SAARC countries in FDI attraction

Country	Total FDI Inflows (2004-2018)	Each Country Share	FDI Ranking
Afghanistan	1797.85	0.33%	6 th
Bangladesh	21376.64	3.96%	3 rd
Bhutan	272.44	0.05%	8 th
India	463002.48	85.82%	1 st
Maldives	4043.3	0.75%	5 th
Nepal	838.86	0.16%	7 th
Pakistan	36703	6.80%	2 nd
Sri Lanka	11498.12	2.13%	4 th
(Grand Total)	539532.69	100.00%	

Source: Compiled by the author based on UNCTAD Database (<https://unctadstat.unctad.org>)

2.2.4. Top Ten Sectors Receiving More FDI Into The SAARC Countries

Since SAARC countries have nearly identical products in their export markets, they are attempting to attract investment into the same industrial sector of their own.

Table 7: Top Ten Sectors Receiving More FDI Into the SAARC Region

Countries/ Rank	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
1	Agriculture and Related Industries	Textiles, clothing and leather	Hotels	Unspecified secondary	Tourism	Hydroelectricity	Petroleum	chemical products
2	Construction	Finance	Arms & Food	Hotels and restaurants	Fisheries	Tourism	Finance	Food, and tobacco
3	Telecommunications	Electricity, gas and water	Financial Services	Finance	Transportation & shipping	Health	Chemicals and chemical products	Metal and metal products
4	Transport and logistics	Transport, storage and communications	IT	Electricity, gas and water	Telecommunication & ICT	Education	Motor vehicles and other transport equipment	Non-metallic mineral products
5	Mining	Non-metallic mineral products	Ferro Alloys	Construction	Power	ICT	Electricity, gas and water	Other manufacturing
6	Power	Chemicals and chemical products	Power	Business activities		Carpets & Woolen products	Construction	Textiles, clothing and leather
7	Water	Other manufacturing	Metals	Unspecified tertiary		Readymade Garment	Non-metallic mineral products	Unspecified tertiary
8		Food, beverages and tobacco	Pharmaceuticals	Wholesale and retail trade		Pashmina and Silk Products	Business activities	Wood and wood products
9		Unspecified tertiary	Gases	Transport & storage		Handicrafts	Coke, petroleum & nuclear	
10		Metal	Mineral Based	Education		Tea	Textiles, & leather	

Source: ITC Investment Map (<https://www.investmentmap.org>) and (Abdin, 2015)

For instance, the textiles, clothing, and ready-made garments sector is a prominent industry across all SAARC nations, which include Bangladesh, India, Sri Lanka, and Pakistan. Each of these countries is actively working to expand its local garment industry and attract FDI to support this growth. In addition to textiles, other significant sectors that are common among SAARC countries include telecommunications, information technology, tourism, and information and communication technology (ICT). For example, India, Bangladesh, and Afghanistan lead the way in attracting FDI within their respective telecommunications and ICT sectors.

Meanwhile, nations such as Bhutan, Nepal, Bangladesh, India, Sri Lanka, and the Maldives are all making concerted efforts to boost their tourism sectors and increase the number of visitors to their destinations. Although all SAARC countries are competing within the same industries, it is important to recognize the fundamental differences among them. To better capitalize on their strengths, it is crucial to categorize these sectors based on their unique competitive advantages and assign specialized sectors to the most suitable countries.

Instead of engaging in direct competition, these nations can work collaboratively to support each other's industries as complementary rather than substitutive entities. For example, hill stations are highly sought-after tourist destinations in Nepal, Bhutan, Afghanistan, Bangladesh, India, and Pakistan. However, the natural environments of these regions differ significantly. Pakistan, India, and Nepal feature snow-covered hill stations, whereas the hill stations in Bangladesh are known for their lush greenery.

Similarly, coastal beaches can be found in Bangladesh, India, Sri Lanka, and the Maldives, while Nepal, Bhutan, and Afghanistan lack such coastal features. Consequently, these countries could promote their attractive seaside destinations to tourists who have already visited hill stations this year and may be interested in exploring beach destinations in the following year. This strategy would encourage a more integrated approach to tourism in the region, maximizing the strengths of each nation while minimizing competition.

2.2.5. Major Sources of FDI into the SAARC Countries

The majority of SAARC nations received FDI investment from Western countries such as the United States and EU member states. There are a few regional investments including Singapore, Japan, and China. Except for India, there is no intra-SAARC investment.

Table 8: Sources of FDI into SAARC Nations

Countries/No	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
1	India	China People's Republic (P.R)	India	Mauritius	Italy	India	USA	China
2	USA	U.K	Singapore	Singapore	UK	China	UK	Hong Kong
3	China	Hong Kong: SAR of China	Japan	Japan	Germany	EU member states	UAE	Singapore
4	UAE	U.S.A	USA	UK	France	USA	Japan	Netherlands
5		Singapore	EU member states	Netherlands	Japan	South Korea	Hong Kong	Malaysia
6		Norway		USA	China		Switzerland	UK
7		South Korea		Germany	India		Kingdom of Saudi Arabia	India
8		India		Cyprus	Switzerland		Germany	
9		Netherlands		France	Russia		South Korea	
10		Malaysia		UAE			Norway	

Source: Collected by the author from the following sources: Alam (2012), Abdin (2015), Kathuria and Yatawara (2021)

2.2.6. FDI Outflows of the SAARC Countries

In terms of FDI outflow, most SAARC nations, other than India, are insignificant, despite the fact that FDI outflow has fluctuated around the same level throughout the previous decades.

India, Sri Lanka, Pakistan, and Bangladesh stand out as the main sources of outward investment from South Asia, with India alone contributing over 94% of this total. Additionally, India leads in investment within the region, particularly in Sri Lanka and Pakistan. Notably, India's most substantial bilateral investments are directed towards Sri Lanka, followed by investments in Bangladesh and Nepal.

Table 9: FDI Outflows of the SAARC Countries (FDI Outflows in Million Dollars)

Years/Country	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
1990	-	0.50	-	6.00	-	-	2.0	0.82
1991	-	0.40	-	-11.00	-	-	-4.0	4.52
1992	-	0.10	-	24.00	-	-	-12.0	1.63
1993	-	0.20	-	0.35	-	-	-2.0	6.90
1994	-	0.20	-	82.00	-	-	1.0	8.26
1995	-	1.70	-	119.00	-	-	0.0	5.60
1996	-	12.50	-	240.00	-	-	7.0	6.92
1997	-	3.07	-	113.00	-	-	-24.0	5.00
1998	-	3.00	-	47.00	-	-	50.0	13.00
1999	-	0.06	-	80.00	-	-	21.0	24.00
2000	-	2.00	-	514.45	-	-	11.0	2.00
2001	-	20.60	-	1397.44	-	-	31.0	0.00
2002	-	4.10	-	1678.04	-	-	28.0	11.45
2003	1.00	6.20	-	1875.78	-	-	19.0	27.31
2004	-0.70	5.70	-	2175.37	-	-	56.0	6.00
2005	1.50	3.30	-	2985.49	-	-	44.0	38.00
2006	-	3.60	-	14284.9	-	-	109.0	29.00
2007	-	21.00	-	17233.5	-	-	98.0	55.00
2008	-0.48	9.30	-	21142.4	-	-	49.0	61.70
2009	0.33	29.30	-	16057.7	-	-	71.0	20.00
2010	-0.71	15.40	-	15947.4	-	-	47.0	42.50
2011	1.18	13.04	-	12456.1	-	-	35.0	60.00
2012	-9.04	43.37	-	8485.70	-	-	82.0	63.93
2013	0.54	33.73	-	1678.74	-	-	212.0	65.07
2014	-0.02	44.46	-	11783.4	-	-	122.0	66.82
2015	0.83	45.50	-	7572.42	-	-	25.0	52.99
2016	14.78	40.53	-	5072.36	-	-	52.0	236.81
2017	10.80	141.96	-	11140.5	-	-	52.0	71.79
2018	40.53	23.24	-	11446.9	-	-	-21.0	67.86

Source: UNCTAD database (<https://unctadstat.unctad.org/wds/TableViewer/tableVtId=96740>)

Collected on March 22, 2022.

2.2.7. South Asian Intraregional Investment

Regional investment pioneers have reappeared after a long hibernation. Firms from various nations have invested in a variety of areas for a number of reasons and at variable capital costs. Table 10 contains an example of such a circumstance.

Investors from South Asian countries such as India, Nepal, Pakistan, Bangladesh, and Sri Lanka are actively participating in the regional market, with Bangladesh, India, Nepal, and Sri Lanka emerging as the main destinations for foreign investments.

In the clothing industry, two notable entrepreneurs from Sri Lanka have successfully established brands to capitalize on the opportunities created by the end of global apparel quotas in 2005. One of these pioneers concentrated on building a strong brand identity, while the other focused on retailing, selling its brand through various stores. Additionally, an Indian entrepreneur has adopted a strategy emphasizing high volume and rapid production cycles by creating an apparel park in collaboration with local value chain partners.

This approach aims to streamline operations and enhance efficiency in production. Another interesting case involves a Pakistani entrepreneur who began by running a marketing agency that specialized in selling denim fabric to Bangladeshi textile manufacturers. However, this entrepreneur eventually transitioned from marketing to production by opening their own manufacturing facility, further contributing to the textile landscape in the region. Overall, these examples illustrate the dynamic and evolving nature of the clothing sector in South Asia, highlighting how entrepreneurs are leveraging local resources and market conditions to drive growth and innovation in the industry.

A major Bhutanese ferrosilicon producer, crucial for steel production in India, is part of the automotive supply chain due to its role in making car bodies and auto parts. Another Indian entrepreneur owns a tire company investing in Sri Lanka's rubber industry. Moreover, a Bangladeshi manufacturer of vehicle batteries supplies the Indian aftermarket.

In the agri-food sector, a pioneer from Nepal in instant noodles initially invested in production facilities in India's North-East before expanding into a nationwide retail network. Similarly, an Indian firm ventured into Nepal's juice-making business to cater to local and international markets.

Regarding the hospitality industry, a leading Indian hotel chain expanded into Sri Lanka and received financial support from a Nepali entrepreneur during the civil conflict in 2008 (Kathuria & Yatawara, 2021: 34).

Table 10: South Asian Intraregional Investment

Firm Name and Product	Home	Destination	Engagement Type	Products and Activities
Apparel value chain				
Brandix Lanka Limitd	Sri Lanka	India	Export platform investment	Developed an apparel park in Andhra Pradesh. Dual role as park manager and manufacturer of weft fabric and complex intimate garments, destined for the United States.
MAS Brands Ltd	Sri Lanka	India	Distribution investment, branding, retail investment	Introduced own “amanté” brand of brassieres in 2007, specifically suited to South Asian women. Distribution office dealt with department stores for sales. Own retail store opened in 2015
Raymond Ltd	India	Bangladesh, Nepal, Pakistan, Sri Lanka	Franchise	Developed its wide South Asian presence through a network of franchisees for its well-known suiting store. Fabrics are sent from headquarters.
Soorty enterprises Ltd	Pakistan	Bangladesh	Trade-supporting, production investment	Opened marketing office to boost sales of denim fabric in 1992. In 2010, opened a manufacturing plant in the Comilla Export Processing Zone
Timex Garments Pvt. Ltd.	Sri Lanka	India	Retail investment	Brand retail investment in 2011, starting in Bengaluru, for its line of women’s Western wear, Avirate. Retail stores in all major cities and some Tier 2 cities. Production in Sri Lanka.
Agri-food industry				
CG Foods Pvt. Ltd. (instant noodles)	Nepal	India	Production, distribution, and retail investment	Invested in factories in NER to produce Wai instant noodles. Moved into food retailing in 2017. Started in Asaam.
Dabur India Limited	India	Nepal	Production investment	Invested to produce fast-moving consumer goods and shampoos but restructured into fruit juice manufacturing. Maintains a nursery of herbal plants

Table 10: (Continue)

Firm Name And Product	Home	Destination	Engagement Type	Products and Activities
Firm name and product				
Bhutan Ferro Alloy Limited	Bhutan	India	Exporting, via related distributor	Key global exporter of energy-intensive ferrosilicon used in steel production. Sold in India through a related distribution firm to steel manufacturers of auto bodies and parts
CEAT Limited	India	Sri Lanka	Production investment	Joint venture with management control of tire manufacturing plants in rubber-producing Sri Lanka
Rahimafrooz Batteries Pvt. Ltd.	Bangladesh	India	Distribution investment	Export of car batteries with its own brand, Lucas and Spark, for the replacement battery market. Initially exported to India only; now includes Sri Lanka.
Hotels				
Taj Hotels and CG Hospitality Ltd	Nepal and India	Sri Lanka	Production investment and management contracts	Taj Hotels owns and manages two hotels in Sri Lanka. Received a capital injection from CG Hospitality in 2008 to maintain operations during the height of the country's civil war.

Source: Kathuria and Yatawara, 2021:35

2.3. Macroeconomic Dynamics Aspect of SAARC Countries

SAARC is home to 21% of the world's population, although covering just 3% of the world's land area and contributing to only 3.8 percent of the world economy. The majority of SAARC nations have a per capita GDP of above a thousand dollars and are growing at a good pace. Almost all SAARC countries have a trade deficit till 2018. Therefore, their imports exceed their exports. As a consequence, the SAARC as a whole is one of the world's major purchasers. Most SAARC nations previously depended on imports of capital equipment, raw materials, and chemicals. Conversely, their range of exports was relatively narrow and mostly comprised of similar or comparable items. To enhance their position in global trade, they need to broaden their export portfolio through diversification.

Table 11: Macroeconomic Dynamics Aspect of SAARC Countries (2018)

Countries /indicator s	Territory (km ²)	Population	GDP (PPP, in bn. USD)	GDP (Nominal in bn. USD)	GDP Per capita (nominal, in USD)	Total Export (in USD thousand)	Total Import (in USD thousand)	Trade Balance (in USD thousand)
Afghanistan	652,000	37171923	77.4	18.4	582.3	875241	7406590	-6531349
Bangladesh	147,570	161376714	785.9	273.3	1,693.77	45564305	57694651	-12130346
Bhutan	38,394	754456	8.435	2.411	3,280.72	318592	814609	-496017
India	3,287,590	1352642282	9,029.4	2,701.1	1,997.0	323997680	509273228	-185275548
Maldives	298	515707	9.924	5.293	14,476.59	181663	2960470	-2778807
Nepal	147,181	28095718	84.37	33.112	1,178.53	781143	12857931	-12076788
Pakistan	803,940	212228294	1,026.94	356.789	1768	23778621	60391133	-36612512
Sri Lanka	65,610	21670213	285.37	87.95	4,058	11741037	21316200	-9575163

Sources: Collected by the author from ITC Trade MAP (<https://www.trademap.org>), International Monetary Fund (<https://www.imf.org>), and World Bank (<https://data.worldbank.org>).

2.4. SAARC Countries Briefs

In the initial decades after gaining independence, South Asian countries upheld strict regulatory frameworks. It's only recently that they've relaxed these regulations, making their policies regarding FDI more accommodating to global investors. At the outset, FDI was permitted on a controlled basis, with local businesses maintaining the majority stake. However, in the 1990s, all South Asian nations attempted to attract FDI more aggressively by changing their macroeconomic policies as well as trade and FDI regulations.

2.4.1. Afghanistan

Afghanistan, often referred to as the "Heart of Asia," is a landlocked nation positioned at the crossroads of Central and South Asia. It shares borders with several countries: To the east and south is Pakistan, while Iran is located to the west. Turkmenistan lies to the northwest, Uzbekistan to the north, Tajikistan to the northeast, and China borders the country to the northeast and east. Spanning an area of 652,864 square kilometers, Afghanistan is characterized by its mountainous landscape, with the rugged Hindu Kush Mountain range dividing the country and plains primarily found in the northern and southwestern regions. The capital and largest city is Kabul, which functions as the political, cultural, and economic hub of the country.

In the past decade, Afghanistan's economy has demonstrated signs of steady improvement, largely driven by the repatriation of a significant number of wealthy expatriates, modernization initiatives within the agricultural sector, and the creation of new trade routes with neighboring and

regional countries. Billions of dollars in foreign aid from expatriates and external investors surged as political stability increased following NATO's involvement in Afghanistan's reconstruction efforts.

Despite these advancements, Afghanistan remains one of the least developed nations globally. The unemployment rate stands at a staggering 23%, with over half of the population living below the poverty line. The country has long pursued international investment to support and revitalize its economy, aiming to leverage its strategic location and abundant natural resources to foster economic growth and development.

The challenges of political instability, inadequate infrastructure, and security concerns continue to hinder progress, but ongoing efforts to attract foreign investment may play a pivotal role in Afghanistan's future economic trajectory.

Despite improvements in life expectancy, income levels, and literacy rates since 2001, Afghanistan remains highly impoverished, lacking access to the sea and heavily reliant on international aid. Many of its citizens still face shortages in essential areas such as housing, clean water, energy, healthcare, and job opportunities.

Challenges such as corruption, political instability, ineffective governance, insufficient infrastructure, and the government's struggles to enforce laws uniformly across the country pose significant obstacles to its economic advancement (Economic Indicators, 2022).

The majority of Afghanistan's GDP comes from the services sector, which includes various industries such as retail and wholesale trade, hospitality, transportation, communication, finance, real estate, and public services, contributing to 49% of the GDP.

Although agriculture remains the primary source of employment, engaging a generous portion of the population, it only contributes 26% of the total output. Manufacturing, mining, and construction sectors also play significant roles, contributing 13% and 12% respectively to the nation's wealth (Trading Economics, 2022).

As per World Bank data, Afghanistan's GDP was estimated at 20.12 billion US dollars in 2020, representing a very small fraction (approximately 0.02%) of the global economy.

Table 12: Macroeconomic Aspect of Afghanistan

Indicators	2020
Territory (km2)	652,864
Population	38,928,341
Life expectancy at birth, years	65.17
GDP (PPP, in bn. USD)	80.92
GDP (Nominal in bn. USD)	20.12
GDP Per capita (nominal, in USD)	516.75
GDP per capita (in US\$ PPP)	2,078.65
Currency	Afghani (AFN)
GDP Growth (real)	-2.35%
Inflation Rate (in Percent)	2.30% (2019)

Source: World Bank (<https://data.worldbank.org>).

2.4.1.1. FDI in Afghanistan

Afghanistan joined SAARC in 2007. Foreign investment in Afghanistan helps to boost development and reduce poverty. In September 2003, the High Commission on Investment established the Afghanistan Investment Support Agency (AISA). This apex organization was established to provide the groundwork for attracting domestic and international investment via different tax incentive programs. The Afghanistan Investment Support Agency (AISA) has also helped to aggregate economic investment statistics across industries. Afghanistan officially joined the WTO on July 29, 2016, which resulted in a variety of advantages for the country, including increased opportunities for FDI.

Foreign and domestic private enterprises have equal status under the Private Investment Law (PIL) and are free to create and operate businesses, participate in all types of remunerated activity, and freely acquire and dispose of commercial interests. While foreigners are not required to secure Afghan partners, foreign ownership of property is prohibited under the Afghan Constitution and the PIL. In actuality, most Western companies must collaborate with an Afghan partner. Although foreign ownership of property is prohibited, Foreigners have the authorization to lease land for a period of up to 50 years.

Although The High Commission on Investment (HCI) has the right to limit the percentage of foreign investment in certain industries, economic sectors, and enterprises, it has never used that authority. In actuality, investments may be entirely owned by foreigners (Investment Climate Statements: Afghanistan, 2022).

Table 13: FDI Inflows and FDI Growth Rate in Afghanistan

Years	FDI Inflows (US\$ Millon)	FDI Inflows Growth Rate%
2004	186.90	
2005	271.00	45%
2006	238.00	-12%
2007	188.69	-21%
2008	46.03	-76%
2009	54.20	18%
2010	197.51	264%
2011	57.62	-71%
2012	47.23	-18%
2013	37.64	-20%
2014	43.51	16%
2015	163.10	275%
2016	93.59	-43%
2017	53.39	-43%
2018	119.44	124%
Total	1797.85	438%

Source:UNCTADstat (<https://unctadstat.unctad.org/wds/TableViex?ReportId=96740>).

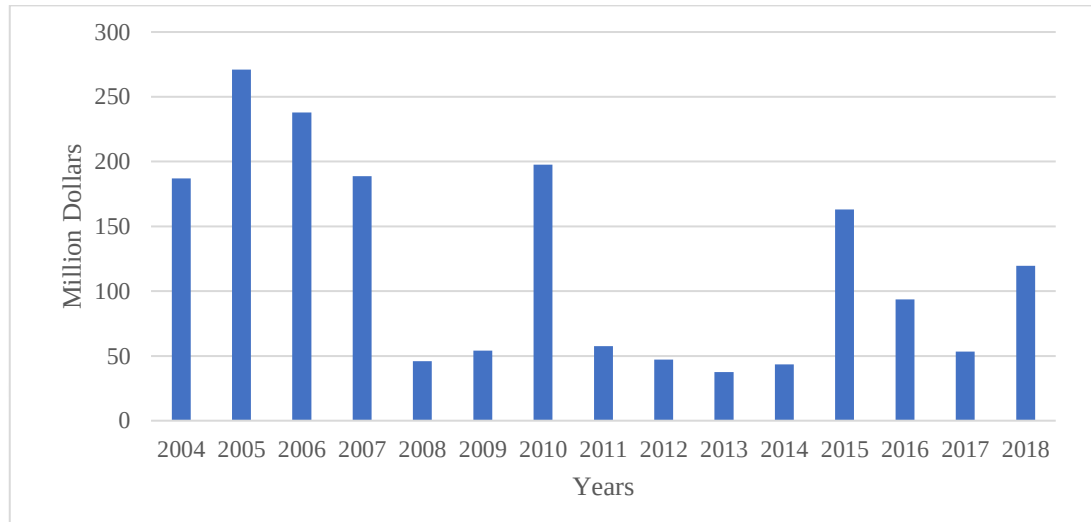
Note: FDI growth rate calculated by author based UNCTADstat database.

Afghanistan's economic structure was weaker than that of other SAARC nations except for Nepal and Bhutan, and FDI remained minimal until 1990. Even in 1991, the volume of investment was well below expectations. In addition, this investment process shifted significantly by the end of the decade. Between 1991 and 2001, FDI investment in Afghanistan was hampered by several political and investment-related difficulties, including corruption, electricity, crime, theft, and access to land. Despite these, high tax rates, high financing costs, and ineffective tax administration were identified as important roadblocks in Afghanistan's economy.

In 2002, the government worked hard to change investment rules and provide more incentives to foreign investors to invest in Afghanistan. In 2004 the FDI inflow was US\$ 186.90 million. Due to abundant opportunities in the services and construction sectors, investment increased to 45% in 2005 compared to 2004. In the following year, FDI inflow decreased to US\$ 238 million, which showed a 12% decline in FDI inflow than the previous year. Due to the USA crisis, the FDI inflow fell to US\$ 46.03 million in 2008, which showed a 76% decrease compared to 2007. However, the value of FDI inflow increased dramatically in 2010 and reached US\$ 197.51 million, which revealed a 264% increase compared to the year 2009. In the year 2014, due to the uncertain situation and

presidential election in Afghanistan, FDI inflow fell to US\$ 43.57 million. Figure 9 shows the FDI inflow in Afghanistan from 2004 to 2018.

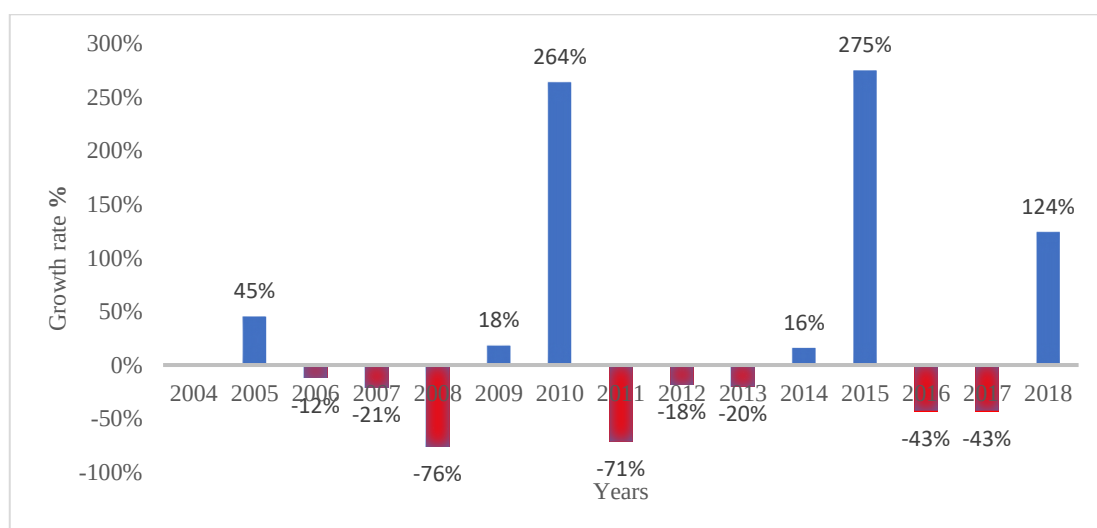
Figure 9: FDI Inflows into Afghanistan



Source: Prepared by the Author based on UNCTAD Database, 2021.

Figure 10 reveals Afghanistan's FDI Inflows Growth Rate from 2004 to 2018. According to the graphical depiction, the FDI inflow's growth rate was 45% in 2005 compared to 2004. From 2006 to 2008, the FDI growth rate in Afghanistan was negative. In 2010 FDI inflow increased by 264% compared to the year 2009. Since 2011 FDI growth rate has been up and downturn, even having a negative rate in 2012, 2013, 2016, and 2017.

Figure 10: FDI Inflows Growth Rate in Afghanistan



Source: Prepared by the Author based on UNCTAD Database, 2021.

Table 14: Comparative Studies of Afghanistan and SAARC FDI

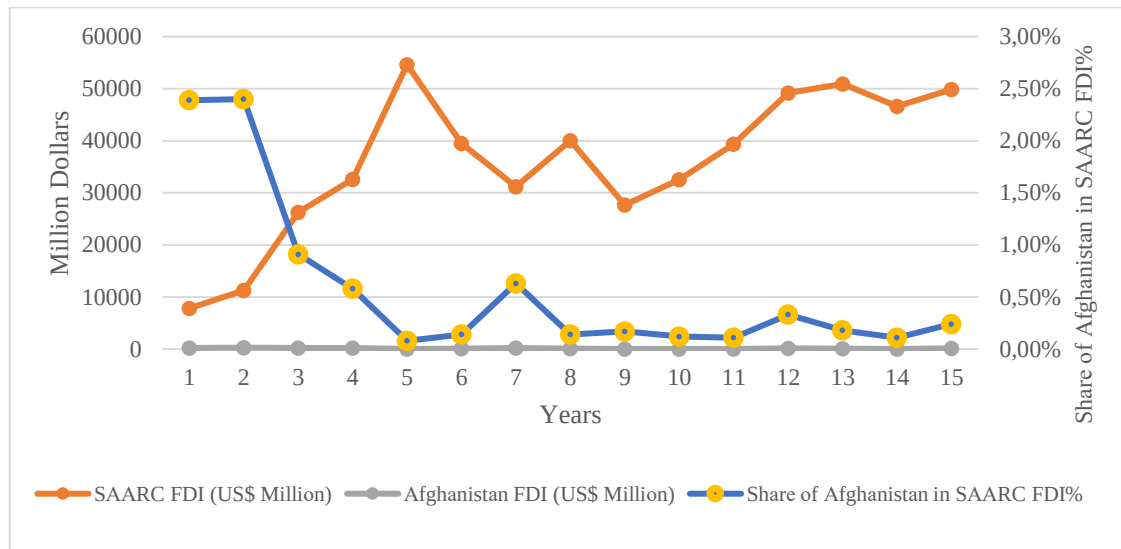
Years	SAARC FDI (US\$ Million)	Afghanistan FDI (US\$ Million)	Share of Afghanistan in SAARC FDI%
2004	7827.48	186.90	2.39%
2005	11292.92	271.00	2.40%
2006	26271.99	238.00	0.91%
2007	32576.86	188.69	0.58%
2008	54611.66	46.03	0.08%
2009	39482.89	54.20	0.14%
2010	31213.55	197.51	0.63%
2011	40054.46	57.62	0.14%
2012	27709.16	47.23	0.17%
2013	32555.72	37.64	0.12%
2014	39344.52	43.51	0.11%
2015	49171.28	163.10	0.33%
2016	50908.79	93.59	0.18%
2017	46623.71	53.39	0.11%
2018	49889.21	119.44	0.24%
Total	539534.2	1797.85	0.33%

Source: UNCTAD database (<https://unctadstat.unctad.org/wds/TableVie?ReportId=96740>)

In the year 2004, the FDI inflow in Afghanistan was US\$ 186.90 Million, which was 2.39% of SAARC's total FDI. In 2005, Afghanistan's economy received the most foreign investment, accounting for 2.4 percent of total SAARC FDI investment. The next year, Afghanistan's portion of SAARC FDI inflow declined since most of the FDI inflow was received by India.

From 2004 to 2012, there were just two consecutive years, 2004 and 2005, when Afghanistan's share of SAARC FDI was greater than 2%. In the year 2008, the share of Afghanistan in SAARC FDI was just 0.08%, and it was the lowest during the period of 2004 to 2018. From 2009 to 2018, the share of Afghanistan in SAARC's total FDI inflow was below 1%.

Figure 11: Comparison of Afghanistan and SAARC FDI



Source: Prepared by the Author based on UNCTAD Database, 2021.

2.4.2. Bangladesh

Bangladesh, officially known as the People's Republic of Bangladesh, is a South Asian nation that ranks eighth in the world in terms of population, with over 163 million residents living within its territory of 148,460 square kilometers. This high population density renders it one of the most densely populated countries globally. Bangladesh shares land borders with India to the west, north, and east, and Myanmar to the southeast. Additionally, the country boasts a picturesque coastline along the Bay of Bengal to the south.

The capital city, Dhaka, is the largest urban center and serves as the focal point for the nation's economic, political, and cultural activities. Dhaka, often referred to as the "City of Mosques," is renowned for its vibrant culture and rich history, making it an important player in the region's social and economic landscape. The country has made significant strides in various sectors, including textiles, agriculture, and remittances from its overseas workers, contributing to its growing economy.

However, Bangladesh also faces challenges, such as environmental issues, political instability, and infrastructure development, that it continues to address in its pursuit of sustainable growth and development. As a member of various international organizations and regional initiatives, Bangladesh is actively working to strengthen its position in the global arena and improve the quality of life for its citizens.

Bangladesh's substantial agricultural dependency has historically led to seasonal unemployment among rural farmworkers and a generally poor quality of life in many places. An

industrialization program was implemented in the mid-twentieth century to address this imbalance. Bangladesh's economy has largely stayed focused on agriculture, with around half of its population employed in this sector during the early twenty-first century. While rice remains the foremost agricultural product, jute and tea also play significant roles, serving as important sources of foreign exchange. Indeed, the nation is a major provider of raw jute across the globe (Britannica, 2022).

Bangladesh has shown remarkable progress in both economic growth and poverty reduction. In recent years, it has been among the world's fastest-growing economies, benefiting from factors like a demographic dividend, thriving ready-made garment exports, and a stable economic environment. Forecasts suggest that with the anticipated recovery in exports and domestic consumption, growth rates could reach 6.4 % in the fiscal year 2021-22.

Table 15: Macroeconomic Aspect of Bangladesh

Indicators	2020
Territory (km ²)	148,460
Population	164,689,383
Life expectancy at birth, years	72.87
GDP (PPP, in bn. USD)	1007.0
GDP (Nominal in bn. USD)	323.24
GDP Per capita (nominal, in USD)	1,961.6
GDP per capita (in US\$ PPP)	6,380
Currency	Bangladeshi taka (BDT, ট)
GDP Growth (real)	5.2%
Inflation Rate (in Percent)	5.6 %

Source: World Bank (<https://data.worldbank.org>).

Bangladesh presents the world a wonderful narrative of poverty reduction and progress. Since its establishment in 1971, Bangladesh has made impressive strides, transitioning from one of the world's poorest countries with the tenth lowest per capita GDP to attaining the classification of a lower-middle-income nation by 2015. Projections indicate that by 2026, it will no longer be classified as one of the UN's Least Developed Countries (LDCs). Notably, poverty rates have seen a substantial decrease, dropping from 43.5% in 1991 to 14.3% in 2016 (World Bank, 2022).

Bangladesh's economy is based on the free market. It has the 44th biggest economy in the world. Agriculture, manufacturing, and finance are Bangladesh's three major economic sectors. Bangladesh depends on various enterprises, including textiles, pharmaceuticals, natural gas, leather, fisheries, shipbuilding, telecommunications, steel, and food processing.

Until the 1980s, all of Bangladesh's banks were state-owned. The government concentrated on developing risk-based policies between 2000 and 2006. There are now four government-owned specialized banks, nine foreign commercial banks, and 39 private banks operating in the country (The Economy of Bangladesh, 2022).

2.4.2.1. FDI in Bangladesh

Bangladesh has been quickly rising for more than a decade and has been called the "next Asian Tiger." GDP growth has been gradually increasing and has surpassed 8% in the fiscal year 2018-19. Inflation is under control, and there is long-term stability.

FDI is making a significant contribution to economic development in Bangladesh. Since its independence, Bangladesh has made a concerted effort to attract foreign investors. FDI inflows into the nation are continuously growing year after year. Despite various variables influencing FDI inflows into Bangladesh, FDI is steadily expanding. Political stability, liberalization, development in both the public and private sectors, infrastructure improvement, adequate electricity supply, and other factors have all helped to gain the trust of domestic and foreign investors. After all, FDI investment in services, telecommunications, apparel and textiles, power production, and information technology is increasing fast (Hasan, 2017: 60).

FDI is likely to grow further due to regulatory changes, infrastructural development, and stable political conditions, which have come from expanded government investment in a variety of initiatives. FDI increased by 67.94% in 2018-19 as reinvestment increased, equity investment doubled, and inter-company loans increased, indicating a high level of investor confidence. A wide range of significant tax reductions and other fiscal incentives and facilities are available to international investors. Bangladesh has the most liberal FDI regime among South Asian nations.

Facilities and Incentives provided by the Bangladesh government for foreign investors are below (Abdin J, 2015:40):

- Royalties, technical knowledge fees, and technical assistance fees are exempt from taxation, and there are options for their repatriation.
- Overseas loan interest is tax-free.
- Capital gains tax exemptions apply to share transfers by investing in businesses.
- No restrictions exist on granting work permits to foreign nationals and workers involved in projects.
- Capital, earnings, and dividends can be repatriated.
- Foreign owners can transfer shares to domestic investors.
- Reinvested remittable dividends are treated as new investments.
- Royalties, technical knowledge fees, and technical assistance fees can be remitted.
- Full dividend and capital repatriation are allowed upon exit.

- Citizenship can be obtained with a minimum investment of US\$ 500,000.
- Permits for permanent residence with the investment of US\$75,000.

Bangladesh is the third-largest SAARC country that has successfully attracted major FDI inflows since 1991. Bangladesh has gradually modified its investment rules and given investment incentives to attract foreign investment. From 2004 to 2018, FDI inflows were good, despite certain years showing a little up and downtrend. In 1972, yearly FDI inflows were 0.090 million USD, but 46 years later, in 2018, FDI inflows reached 3613.30 million USD, indicating tremendous economic development. Table 16 shows the FDI inflows in Bangladesh.

Table 16: FDI Inflows and FDI Growth Rate in Bangladesh

Years	FDI Inflows (US\$ Millon)	FDI Inflows Growth Rate%
2004	460.40	
2005	845.26	84%
2006	792.48	-6%
2007	666.36	-16%
2008	1086.31	63%
2009	700.16	-36%
2010	913.32	30%
2011	1136.38	24%
2012	1292.56	14%
2013	1599.16	24%
2014	1551.28	-3%
2015	2235.39	44%
2016	2332.72	4%
2017	2151.56	-8%
2018	3613.30	68%
Total	21376.64	492%

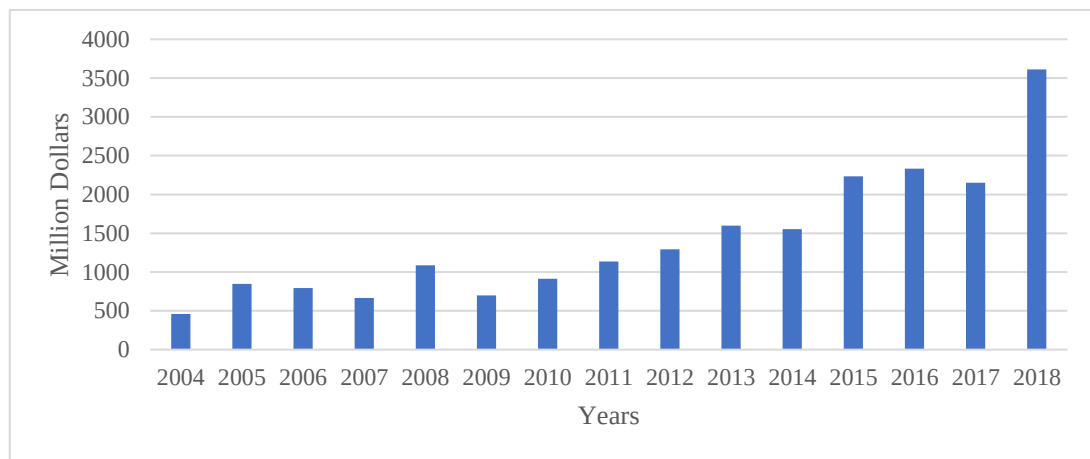
Source: UNCTAD database, (<https://unctadstat.unctad.org/wds/Tab?ReportId=96740>)

Note: FDI growth rate calculated by author based UNCTADstat database.

Despite the availability of beneficial variables such as a varied range of low-cost labor, attractive investment regulations, and the establishment of economic processing zones, Bangladesh has struggled to attract the same level of FDI as other emerging nations such as India and China. Nonetheless, the inflow situation has significantly improved in 2005 and 2006. Since the formation

of SAARC, the patterns of FDI outflow growth in Bangladesh have been much lower than those of FDI inflow.

Figure 12: FDI Inflows into Bangladesh

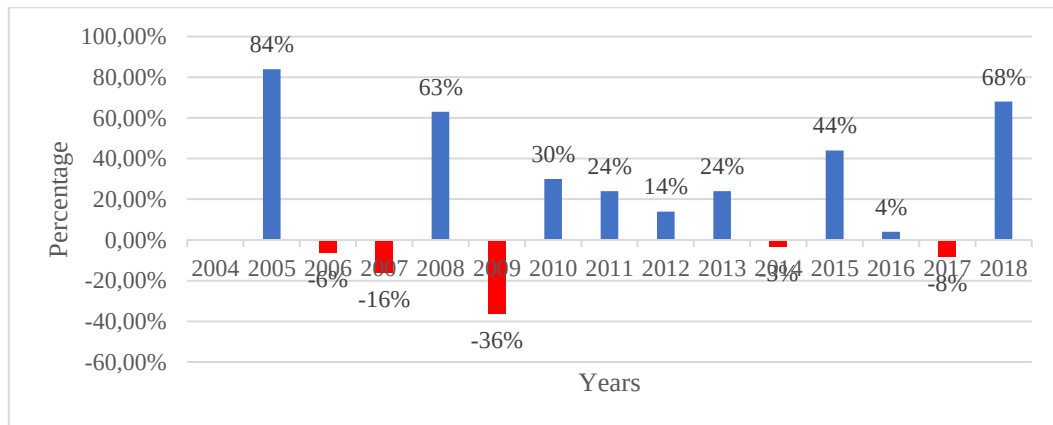


Source: Prepared by the Author based on UNCTAD Database, 2021.

Figure 12 depicts the ups and downs in FDI inflow from 2004 to 2018 and a steady increase from 2010 to 2018. According to the data, FDI inflows decreased in 2007 and 2009, with a minor decrease in 2010. In 2009, FDI inflows totaled 700.16 million US dollars, whereas, in 2010, they totaled 913.32 million US dollars. It took some time for the situation to regain the investors' trust and confidence. From 2011 to 2018, the flow of FDI investment increased, reaching an all-time high of 3613.30 million US dollars.

Figure 13 shows the FDI Inflows Growth Rate in Bangladesh from 2004 to 2018. The graphical depiction of FDI clearly shows that the flow of FDI into Bangladesh is rising in absolute terms, but the pace of growth is not very striking, even having a negative rate in 2006, 2007, 2009, 2014, and 2017. The greatest increase was witnessed in 2004-05, with a rate of 84 %.

Figure 13: FDI Inflows Growth Rate in Bangladesh



Source: Prepared by the Author based on UNCTAD Database, 2021.

Table 17: Sector-wise FDI Inflow in Bangladesh (US\$ Million)

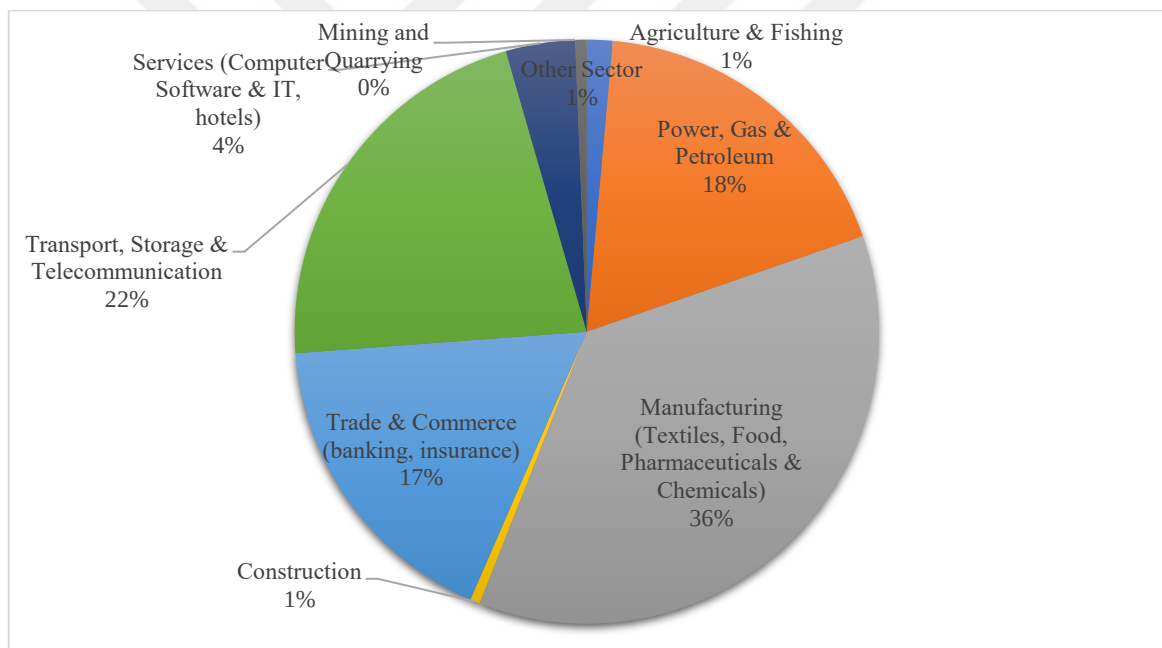
<i>Ranks</i>	Sector	2016	2017	2018	Cumulative Inflows 2004-2018	Sector-wise Cumulative percentage of FDI Inflow
1.	Agriculture & Fishing	43.15	35.17	18.95	303.85	1.42%
2.	Power, Gas & Petroleum	434.31	260.37	1122.56	3905.25	18.27%
3.	Manufacturing (Textiles, Food, Pharmaceuticals & Chemicals)	846.81	980.24	1497.48	7754.6	36.29%
4.	Construction	5.52	32.08	55.18	116.31	0.54%
5.	Trade & Commerce (banking, insurance)	282.22	409.58	479.25	3697.6	17.30%
6.	Transport, Storage & Telecommunication	582.05	238.71	229.27	4637.5	21.70%
7.	Services (Computer Software & IT, hotels)	104.47	168.87	186.81	818.87	3.83%
8.	Mining and Quarrying	0.30	-0.08	-0.05	0.3	0.00%
9.	Other Sector	33.89	26.62	23.85	136.14	0.64%
	Total	4348.72	4168.56	5631.3	21370.42	100%

Source: Bangladesh Bank Survey report, 2019

Except for government-reserved industries, Bangladesh's economy is divided into numerous sectors, each of which receives considerable FDI investment. Between 2004 and 2006, the highest investment in the electricity, gas, and petroleum sectors resulted in the formation of "Asia Energy" in the Fulbari coal mining project. However, FDI inflows into the gas and petroleum industry peaked at \$229.93 million in 2006-07 and then began to fall, with FDI inflows peaking at \$128.40 million in 2007.

Overall the manufacturing sector (Textiles, Food, Pharmaceuticals & Chemicals...) has attracted the highest FDI inflow, 7754.6 US\$ million from 2004 to 2018. In the second position, the Transport, Storage & Telecommunication sector stands with a total of 4637.5 US\$ million. Power, Gas & Petroleum with 3905.24 US\$ million and Trade & Commerce (banking, insurance...) with 3697.6 US\$ million stand in the third and fourth positions, respectively.

Figure 14: Sectors-wise Distribution of FDI in Bangladesh



Source: Prepared by the Author based on Bangladesh Bank Survey report, 2019

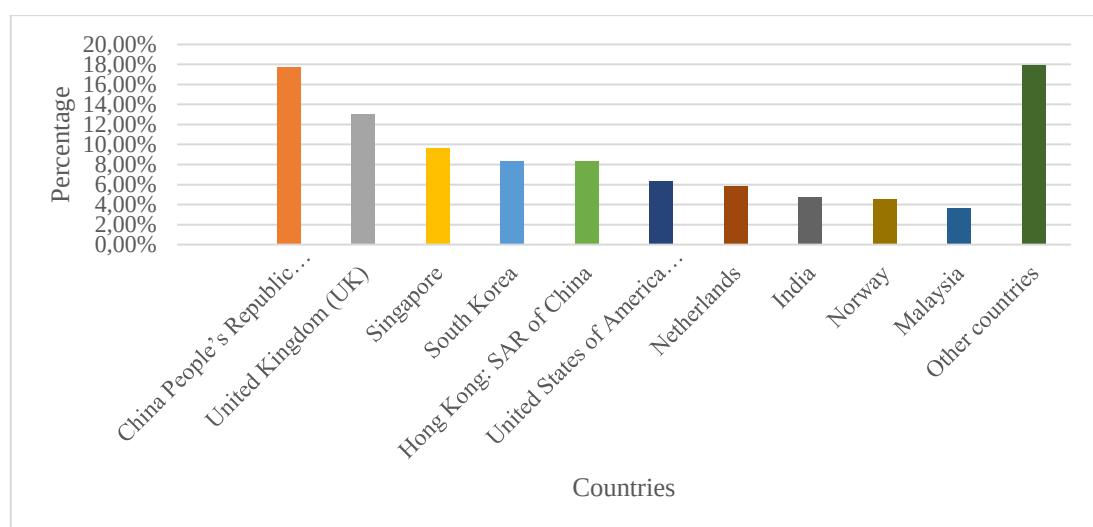
The manufacturing sector (Textiles, Food, Pharmaceuticals & Chemicals...) has attracted 36 % of the total FDI inflow from 2004 to 2018. The Transport, Storage & Telecommunication sector with 22%, Power, Gas & Petroleum with 18% and Trade & Commerce (banking, insurance...) with 17% stand in the second, third and fourth positions, respectively.

Table 18: Top Ten FDI Investing Countries in Bangladesh

Ranks	Country	FDI Inflow 2018 (million US\$)	%age to total Inflows in 2018
1	China People's Republic (P.R)	534.5	17.71%
2	United Kingdom (UK)	393.4	13.04%
3	Singapore	291.5	9.66%
4	South Korea	252.3	8.36%
5	Hong Kong: SAR of China	250.4	8.30%
6	United States of America (USA)	192	6.36%
7	Netherlands	175	5.80%
8	India	142.5	4.72%
9	Norway	136	4.51%
10	Malaysia	110	3.65%
11	Other countries	540	17.90%
Total FDI Inflows from All Countries		3018	100%

Source: Bangladesh Bank Survey report 2019.

Bangladesh has given a variety of investment packages as well as more open and sophisticated policies for investment goals. However, political insecurity, a financial crisis, and tiny market size have made it difficult for investors to invest in Bangladesh. In 2018 China People's Republic ranked first among all investing countries by investing 534.5 US\$ million, which counts for 17.71 % of total FDI in Bangladesh. The United Kingdom and Singapore invested 393.4 US\$ million and 291.5 US\$ million, standing in the second and third positions, respectively.

Figure 15: Percentage of Total FDI Inflow in 2018 By Country

Source: Prepared by the Author based on Bangladesh Bank Survey report, 2019.

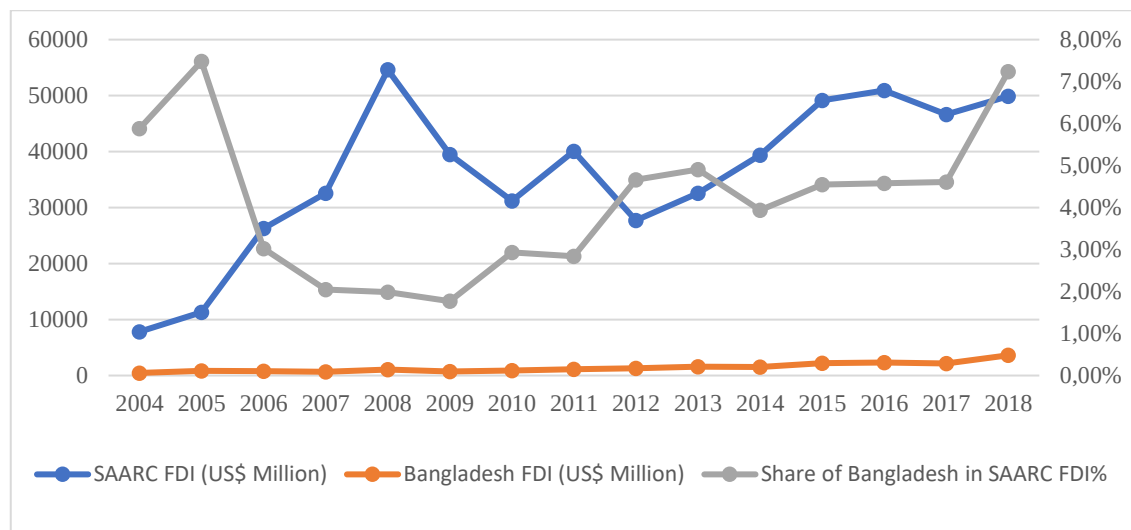
Table 19: Comparative Studies of Bangladesh and SAARC FDI

Years	SAARC FDI (US\$ Million)	Bangladesh FDI (US\$ Million)	Share of Bangladesh in SAARC FDI%
2004	7827.48	460.40	5.88%
2005	11292.92	845.26	7.48%
2006	26271.99	792.48	3.02%
2007	32576.86	666.36	2.05%
2008	54611.66	1086.31	1.99%
2009	39482.89	700.16	1.77%
2010	31213.55	913.32	2.93%
2011	40054.46	1136.38	2.84%
2012	27709.16	1292.56	4.66%
2013	32555.72	1599.16	4.91%
2014	39344.52	1551.28	3.94%
2015	49171.28	2235.39	4.55%
2016	50908.79	2332.72	4.58%
2017	46623.71	2151.56	4.61%
2018	49889.21	3613.30	7.24%
Total	539534.2	21376.64	3.96%

Source:UNCTAD database (<https://unctadstat.unctad.org/wds/TableVieReportId=96740>)

Since 1991, Bangladesh has ranked third among SAARC countries regarding FDI inflows. In 2004, Bangladesh's contribution to the total SAARC FDI was 460.40 US\$ million, which counts for 5.88 percent. In the following year, it increased to 845.26 US\$ million, which comprised 7.48 percent of total SAARC FDI.

Figure 16: Comparison of Bangladesh and SAARC FDI



Source: Prepared by the Author based on UNCTAD Database, 2021.

In 2008, FDI inflows were 1086.31 US\$ million, which counts approx two percent of total SAARC FDI. In 2009, the influence of the worldwide crisis was plainly seen among global investors; this impact was particularly visible in Bangladesh's FDI inflows, which fell to 700.16 US\$ million; this year, Bangladesh recorded the lowest share in SAARC FDI with comprised just 1.7 % of SAARC's total FDI inflow.

2.4.3. Bhutan

Bhutan, a tiny landlocked country nestled deep in the Himalayas between India and China, is renowned for its towering peaks and serene valleys, fostering a unique pattern of scattered settlements. The nation is distinguished by its holistic approach to development, encapsulated in the concept of Gross National Happiness (GNH), which serves as its guiding principle. Its lush valleys, blessed with ample water resources, offer optimal conditions for harnessing renewable energy through hydroelectric projects, thus driving economic growth by ensuring widespread access to affordable electricity. Revenues generated from surplus electricity sales to India and a burgeoning tourism industry have enabled significant investments in human capital, leading to tangible improvements in service delivery, education, and healthcare.

Bhutan's political and economic landscapes remain stable, with notable progress achieved in poverty eradication and gender equality, alongside ongoing efforts to address social and regional disparities. Having transitioned from a low-income to a lower-middle-income nation, Bhutan has made significant strides in reducing extreme poverty, with the number of severely impoverished individuals declining by two-thirds over the past decade. Utilizing the \$3.20/day poverty line, the poverty rate plummeted from 36% to 12% between 2007 and 2017. The country has sustained an

impressive average annual real GDP growth of 7.5% since the 1980s, primarily fueled by rapid expansion in hydroelectric power generation led by the public sector. Substantial revenue from hydroelectric projects has bolstered poverty alleviation efforts. Despite the stability provided by the electricity sector, non-hydro sectors have struggled to compete due to the challenging investment environment, characterized by high trade costs and a limited domestic market. Consequently, job creation has been limited to the public sector and agriculture (World Bank, Bhutan overview, 2022).

The agriculture sector's contribution to GDP fell from almost 55 % in 1985 to around 33 % in 2013. The industry sector comprises approximately 22% of the total economy (Paull, 2017:66). Bhutan's primary industrial industries are cement, ferroalloy, and iron.

Hydropower is Bhutan's most important export. As of 2015, Bhutan has been generating approximately 2,000 MW of electricity from its Himalayan River valleys. The country possesses the potential to produce up to 30,000 MW of hydropower. This power is supplied to several Indian states, and there are plans for future initiatives with Bangladesh (Siebert & Belsky, 2015:221). In 2019, the GDP growth rate stood at 6.7%. However, in 2020, it experienced a sharp decline to -10.08%. The closure of the tourist industry led to a 3.6% decline in production in the services sector. Labor shortages and high input prices had negative effects on construction and manufacturing, while the hydro sector supported industrial growth.

Table 20: Macroeconomic Aspect of Bhutan

Indicators	2020
Territory (km ²)	38,394
Population	771,612
Life expectancy at birth, years	72.08
GDP (PPP, in bn. USD)	8.59
GDP (Nominal in bn. USD)	2.32
GDP Per capita (nominal, in USD)	3,000.78
GDP per capita (in US\$ PPP)	11,130.22
Currency	Ngultrum (BTN)
GDP Growth (real)	-10.08%
Inflation Rate (in Percent)	5.63%

Source: World Bank (<https://data.worldbank.org>).

2.4.3.1. FDI in Bhutan

Bhutan introduced its first FDI policy in 2005, reflecting a growing focus on private sector development as a key driver of economic growth. Two major policy documents, Vision 2020 and the Economic Development Policy 2016, serve as foundational guides for Bhutan's investment

framework. Since its inception in 2002, Bhutan's FDI policy has undergone multiple revisions to adapt to the evolving investment landscape and to position the country as a welcoming destination for investors. The most recent change was completed in 2019 (Investment Opportunities in Bhutan, 2022).

The service sector dominated Bhutan's FDI inflows, which included the hotel, IT, and IT-enabled services, followed by manufacturing, dairy, and agricultural projects.

According to the FDI Policy 2019, the Bhutanese government permits foreign companies to make a maximum equity investment of 49 % in local ventures. Additionally, there is a minimum project cost requirement of Nu. 5 million for investments in small-scale production and manufacturing sectors.

Bhutan has revised its strategy and increased its attempts to attract FDI inflows in recent years. Since 2010, total FDI inflows have been extremely minimal, averaging less than US\$ 20 million per year. Bhutan's FDI inflows were negative in 2016 (US\$-33 million) and rose in 2018 to US\$ 6.2 million. This is substantially lower than in the rest of South Asia countries. In 2016, South Asia secured a total of \$54 billion in FDI.

The lion's share of this investment flowed into India, reaching \$44 billion, while Bangladesh received \$2.3 billion, Pakistan \$2.0 billion, Sri Lanka \$898 million, Nepal \$106 million, and Afghanistan \$100 million.

India emerged as the primary investor in the region, primarily channeling investments into the manufacturing sector. Singapore (15%) and Thailand (13%) followed India as significant investors, with a predominant focus on the service sector. Notably, Asia contributed 65% of the total FDIs, Europe 25%, America 9%, and Oceania less than 1%.

Most FDI projects were concentrated in Thimphu, the capital city. Bhutan, due to its diminutive size, continues to attract the least FDI in Asia.

Table 21: FDI Inflows and FDI Growth Rate in Bhutan

Years	FDI Inflows (US\$ Millon)	FDI Inflows Growth Rate%
2004	8.86	
2005	6.21	-30%
2006	72.16	1062%
2007	40.20	-44%
2008	4.43	-89%
2009	12.77	188%
2010	26.25	106%
2011	33.10	26%
2012	53.51	62%
2013	21.81	-59%
2014	23.44	7%
2015	6.49	-72%
2016	33.92	-623%
2017	9.39	-72%
2018	6.52	-169%
Total	272.44	292%

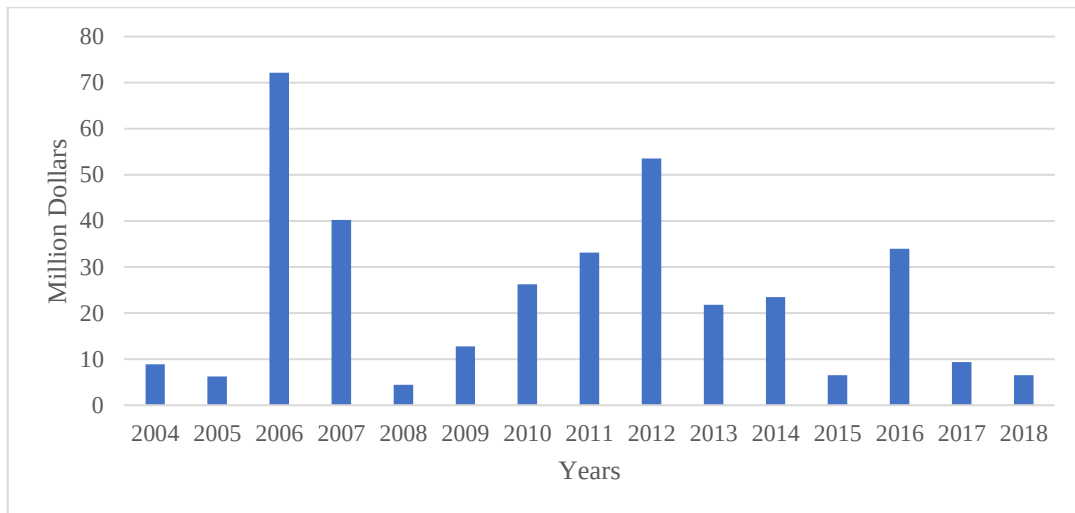
Source: UNCTAD database (<https://unctadstat.unctad.org/wds/TableVReportId=96740>)

Collected on April 30, 2022. Note: FDI growth rate calculated by author based UNCTADstat database.

Bhutan is a developing country in the globe that shares a border with India. India's involvement complicates Bhutan's progress. From 1991 to 2000, the volume of FDI arrivals was quite low; it didn't even reach a substantial level.

In 2004 and 2005, the FDI inflow of Bhutan was US\$ 8.86 million and US\$ 6.21 million, respectively. In 2005, FDI inflow decreased -by 30% than the previous year.

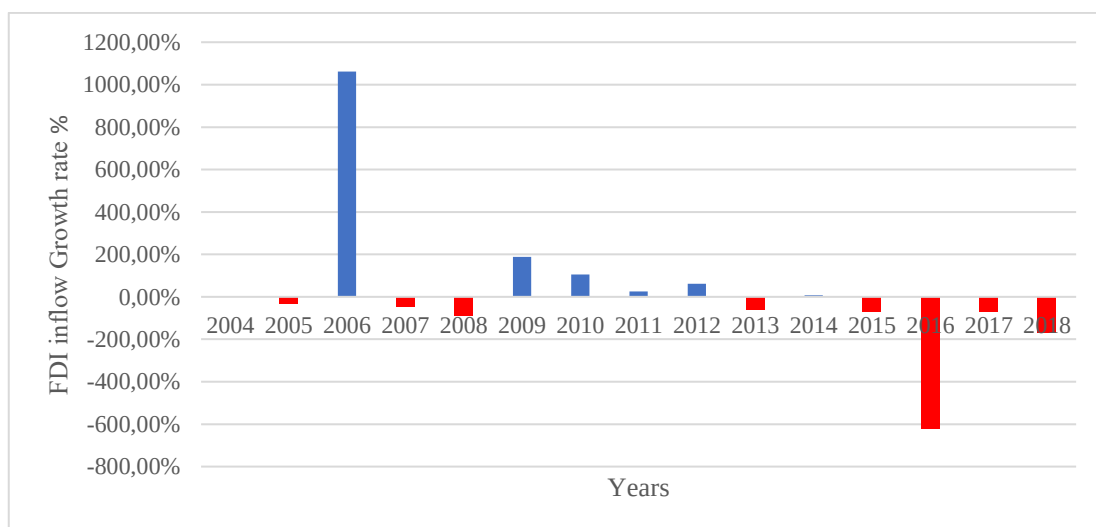
Figure 17: FDI Inflows into Bhutan



Source: Prepared by the Author based on UNCTAD Database, 2021.

The total inflow in 2006 was US\$ 72.16 million, which was almost twelve times more than the previous year. During this time, the government has loosened trade and investment regulations and revised taxes rates to expand the scope of foreign inflows. Total FDI inflows fell to US\$ 4.43 million in the fiscal year 2008. Due to the economic crisis, all international investors withdrew their investments. In 2009 FDI inflow reached US\$ 12.77 million and increased by 188% from the year 2008. Since 2010, total FDI inflows have been extremely minimal, averaging less than \$20 million yearly. Bhutan's FDI inflows were negative in 2016(US\$ -33.92 million), and climbed in 2018 to US\$6.52 million.

Figure 18: FDI Inflows Growth Rate in Bhutan



Source: Prepared by the Author based on UNCTAD Database, 2021

Figure 18 reveals the FDI inflow growth in Bhutan from 2004 to 2018. In 2004 total FDI inflow was US\$ 8.86 million; this amount decreased in 2005 by -30 %. In 2006 the total FDI inflow experienced an all-time high growth of about 1062% than the previous year. In 2008 due to the USA crisis, FDI declined -by 89%. From 2012 to 2018 FDI inflow growth rate experienced an up and downturn, even having a negative rate in 2013, 2015, 2016, and 2017.

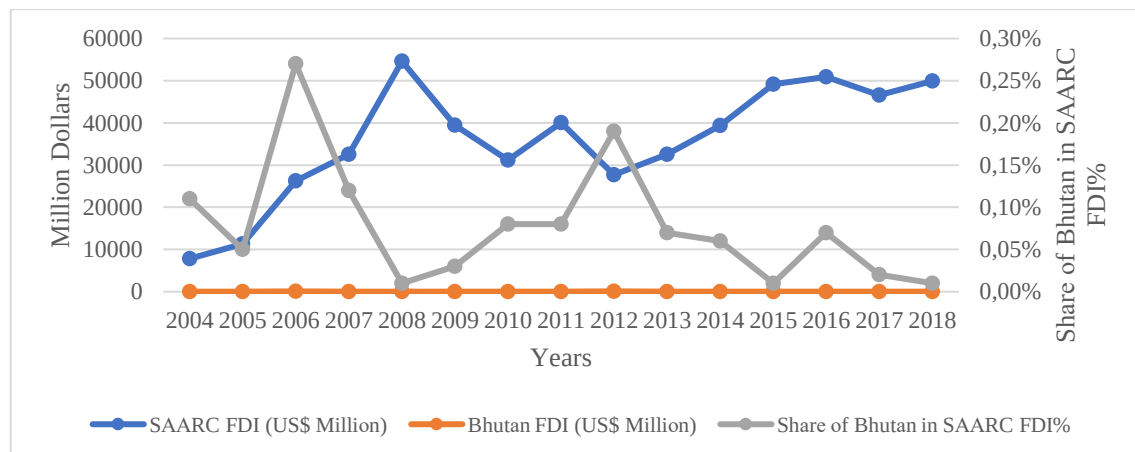
Table 22: Comparative Studies of Bhutan and SAARC FDI

Years	SAARC FDI (US\$ Million)	Bhutan FDI (US\$ Million)	Share of Bhutan in SAARC FDI%
2004	7827.48	8.86	0.11%
2005	11292.92	6.21	0.05%
2006	26271.99	72.16	0.27%
2007	32576.86	40.20	0.12%
2008	54611.66	4.43	0.01%
2009	39482.89	12.77	0.03%
2010	31213.55	26.25	0.08%
2011	40054.46	33.10	0.08%
2012	27709.16	53.51	0.19%
2013	32555.72	21.81	0.07%
2014	39344.52	23.44	0.06%
2015	49171.28	6.49	0.01%
2016	50908.79	33.92	0.07%
2017	46623.71	9.39	0.02%
2018	49889.21	6.52	0.01%
Total	539534.2	272.44	0.05%

Source: UNCTAD database (<https://unctadstat.unctad.org/wds/TableVie?ReportId=96740>)

Collected on May 11, 2022.

Figure 19: Comparison of Bhutan and SAARC FDI



Source: Prepared by the Author based on UNCTAD Database, 2021

In 2004, Bhutan contributed 0.11 % of total SAARC FDI. It decreased to 0.05% next year. In 2006, FDI inflows into Bhutan expanded dramatically, resulting in a 0.27 % share of total SAARC's FDI, and it was the highest contribution of Bhutan to SAARC's FDI. The Bhutan's contribution to SAARC FDI was 0.01 % in 2008, 2015 and 2018, the lowest level between 2004 and 2018. The overall share of Bhutan in SAARC's total FDI from 2004 to 2018 was 0.05%.

2.4.4. India

India, situated in South Asia, stands as the seventh-largest country globally in terms of land area and ranks as the second most populous nation with approximately 1.38 billion people, making it the world's most populous democracy. Its cultural tapestry is rich and diverse, encompassing a wide spectrum of languages, customs, and ethnicities. While the Indian economy has embraced multinational corporations since liberalization in the 1990s, its populace has been cautiously receptive to global trends and talents. Rural communities take pride in agriculture, including sophisticated farming techniques and traditional crafts, while urban sectors, such as industry and professional services, are experiencing rapid expansion.

Benefiting from a range of sectors, investment prospects, and government support, India is attracting significant interest from global corporations seeking strategic investments. With a large and youthful population driving demand and contributing to the workforce (IBEF: India Brand Equity Foundation, 2022). India is positioned as a pivotal economic force on the global stage. Forecasts suggest that India, with its robust democratic framework and international alliances, will ascend to become one of the top three economic powerhouses within the next decade or so. India is also one of the few markets in the world that has strong growth and profit potential in virtually all fields of business. Yet, despite almost limitless opportunities for foreign enterprises in India, the world's most populous democracy has, till recently, struggled to garner the type of passionate interest created by other growing countries such as China.

In nations such as India, several critical infrastructure components are vital for propelling economic advancement: education, energy, transportation, communication, irrigation, finance, and healthcare. The first five primarily contribute to economic development, while the latter two focus on social welfare.

India features the second-largest road network in the world, covering an impressive 6.38 million kilometers, which plays a vital role in enhancing connectivity and facilitating trade across the nation. Moreover, India holds the distinction of being the third-largest producer and consumer of electricity globally, indicating its significant energy demands and production capacity, which are crucial for supporting its expanding economy. The banking sector in India is notably diverse and comprehensive, consisting of 12 public sector banks, 21 private sector banks, 44 foreign banks, 43

regional rural banks, 1,474 urban cooperative banks, and a remarkable 97,006 rural cooperative banks. This extensive banking framework underpins the country's financial stability and economic growth, ensuring that various segments of the population have access to banking services. Together, these attributes reflect India's vast infrastructure capabilities and its critical role in the global economy. For a comprehensive overview, Table 23 presents India's macroeconomic landscape for the year 2021.

Table 23: Macroeconomic Aspect of India

Indicators	2021
Territory (km2)	3,287,590
Population	1,393,409,038
Life expectancy at birth, years	68.8
GDP (PPP, in bn. USD)	10,207.3
GDP (Nominal in bn. USD)	3,049.7
GDP Per capita (nominal, in USD)	2,190.9
GDP per capita (in US\$ PPP)	7,332.9
Currency	Indian rupee (INR, ₹)
GDP Growth (real)	12.5%
Inflation Rate (in Percent)	4.9%

Source: World Bank (<https://data.worldbank.org>).

2.4.4.1. FDI in India

In India, foreign investment inflow is not a new phenomenon. Foreign capital may be traced back to the 16th century when the East India Company first entered the Country. However, this was a painful experience for India since it resulted in over 200 years of slavery. Immediately after independence, the Indian government recognized the country's critical need for economic growth and development. However, the percentage of savings and investment was extremely low, resulting in FDI re-entry into the Indian economy. Because the government was initially hesitant to provide international investors independence, foreign capital inflows were limited to a few areas. With the passage of time, and in light of the advantages associated, the government has liberalized its FDI policy. Now, in India, greater channels for foreign investment are accessible (Khosla & Sharma, 2020: 116).

FDI stands out as a crucial non-debt financial resource driving India's economic growth trajectory. It serves as a significant catalyst for development, with overseas companies seeking to capitalize on India's abundant labor force and various investment incentives such as tax exemptions. Since India's economic liberalization in 1991, governmental policies have actively fostered an environment conducive to FDI. India has actively positioned itself as an appealing destination for

FDI, boasting a burgeoning market. As per the Investment Commission of India, the country's economic landscape is fortified by several strengths (ADB, 2009: 104):

- A vibrant democracy fostering a free-market ethos.
- Holding the prestigious position as the world's fifth-largest economy.
- A consistent and predictable policy framework.
- A track record of sustained GDP growth averaging 7%–8%.
- Strong adherence to the rule of law and an independent judiciary system.
- A robust and efficient financial infrastructure.
- Sound foreign exchange reserves, bolstering economic stability.

Technology transfer has been one of the key benefits of FDI in India, and there has been a concerted push in this regard. The United States, Germany, Japan, the United Kingdom, and Italy are among the countries from whom such transfers have taken place (ADB, 2009: 106).

Table 24: FDI Inflows and FDI Growth Rate in India

Years	FDI Inflows (US\$ Millon)	FDI Inflows Growth Rate%
2004	5777.81	
2005	7621.77	32%
2006	20327.7	167%
2007	25349.8	25%
2008	47102.4	86%
2009	35633.9	-24%
2010	27417	-23%
2011	36190.4	32%
2012	24195.7	-33%
2013	28199.4	17%
2014	34582.1	23%
2015	44064.1	27%
2016	44480.5	1%
2017	39903.8	-10%
2018	42156.1	6%
Total	463002.48	323%

Source: UNCTAD database(<https://unctadstat.unctad.org/wds/View.aspx?portId=96740>)

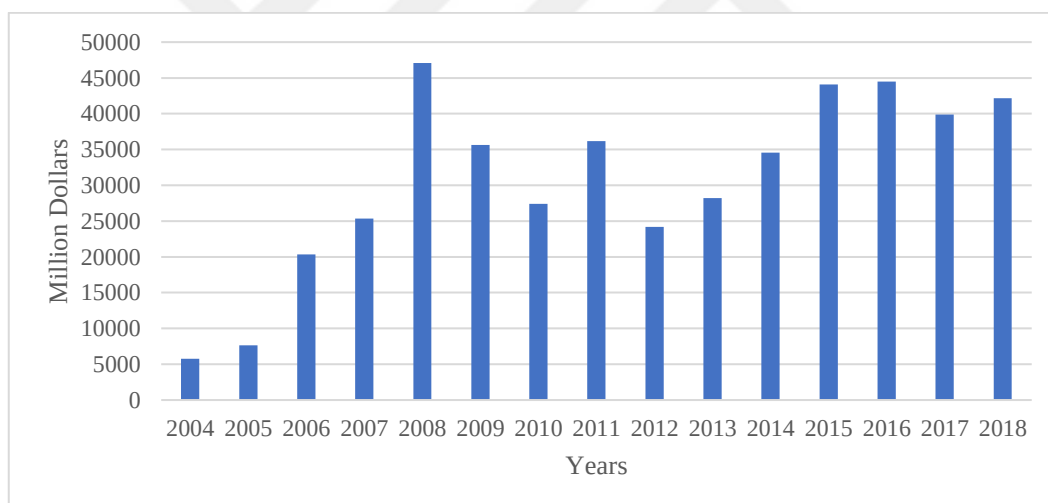
Collected on March 26, 2022.

Table 24 illustrates the state of FDI inflows into India and its growth rate during a 15-year period. Nonetheless, India has the most cumulative FDI inflow among the SAARC nations due to

the liberalization of FDI and industrial policy. On the other hand, the trend of inflow is weaker in comparison to other Asian nations due to inadequate infrastructure, transportation facilities, corruption, and a low level of life for the majority of the people.

The Indian government reformed its FDI regulations and passed the Industrial Act in 2005, encouraging foreign investors such as the United States, Singapore, and others to engage in the Indian economy through the FIPB route. In 2006 FDI inflows totaled \$20327.7 million, up from US\$ 7621.72 million the previous year. In the years 2006 and 2007, the most investment in productive sectors came from Mauritius and Singapore. In 2008, the same trend of FDI was seen, with a total of US\$47102.4 million, the greatest amount until 2018. Furthermore, at the conclusion of the financial year 2008, the US economic crisis had a significant impact on the global stock market. This crisis created a tumultuous situation as foreign investors withdrew their funds from the Foreign Institutional Investor market and invested in India through FDI. Later, the FDI pattern in India decreased as investors demonstrated their confidence in the Portfolio market.

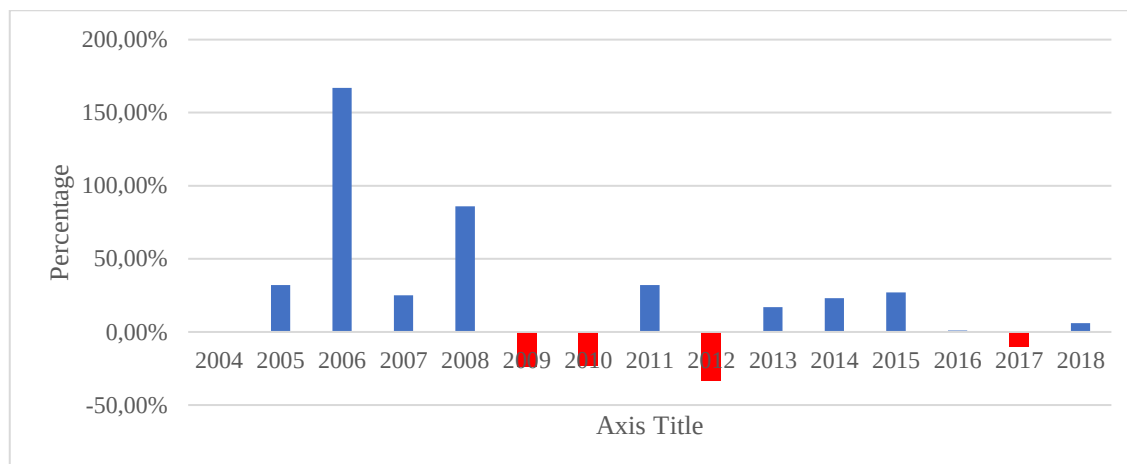
Figure 20: FDI Inflows into India



Source: Prepared by the Author based on UNCTAD Database, 2021.

The graphical depiction of FDI clearly shows that the flow of FDI into India is rising in absolute terms, but the pace of growth is not very striking, even having a negative rate in 2009, 2010, 2012, and 2017. The greatest increase was witnessed in 2005-06, with a rate of 167 %, but it has not shown the same attitude afterward.

Figure 21: FDI Inflows Growth Rate in India



Source: Prepared by the Author based on UNCTAD Database, 2023.

Table 25: Top 10 Sectors Attracting Highest FDI Inflows in India (US\$ Million)

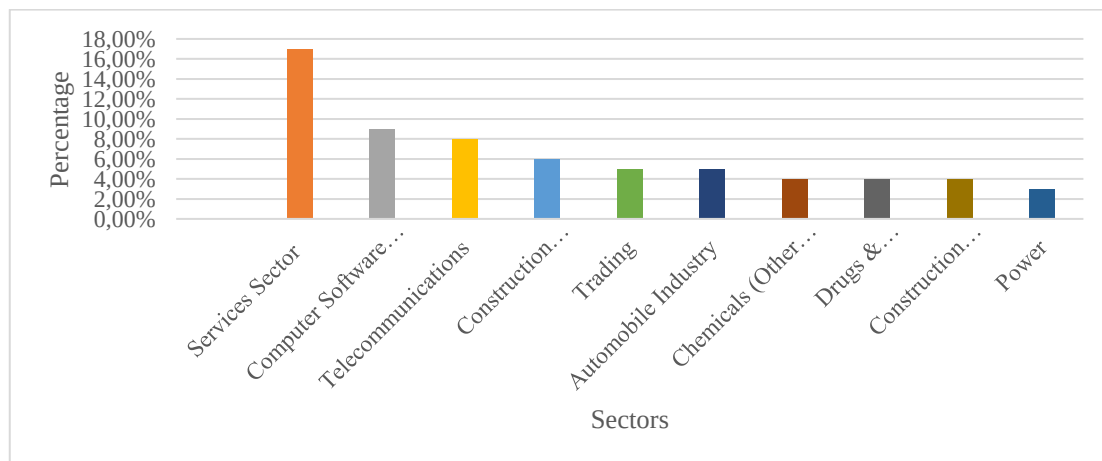
<i>Ranks</i>	<i>Sector</i>	2016-17	2017-18	2018-19	Cumulative Inflows 2000-2018	Sector-wise Cumulative percentage of FDI Inflow
1.	Services Sector	8,684	6,709	6,587	71,579	17%
2.	Computer Software & Hardware	3,652	6,153	4,996	35,819	9%
3	Telecommunications	5,564	6,212	2,292	32,450	8%
4.	Construction Development Townships, Housing, and Construction-Dev-Projects	105	540	77	24,910	6%
5.	Trading	2,338	4,348	3,035	21,594	5%
6.	Automobile Industry	1,609	2,090	2,083	20,846	5%
7.	Chemicals	1,393	1,308	1,817	16,418	4%
8.	Drugs & Pharmaceuticals	857	1,010	218	15,934	4%
9.	Construction Activities	1,861	2,730	1,826	14,373	4%
10.	Power	1,113	1,621	1,008	14,218	3%

Source: Department for Promotion of Industry and Internal

Trade(<https://dpiit.gov.in/publications/fdi-statistics/archives>) collected on MAR 29, 2022

FDI in the service sector has remained a top priority for foreign investors in India. However, these foreign investments are smaller, but they are growing at a faster rate than other industries. In 2016 and 2017, the Telecommunications sector jumped to second place. It succeeded in gaining the trust of foreign investors, while the computer software and hardware fell to third place in terms of FDI inflows. Still, in 2018 the computer software and hardware sector attracted more FDI than the telecommunications sector. Furthermore, other industries, such as construction development (Townships, Housing, and construction development projects) and the automobile industry, had substantial development, which may be attributed to the availability of a diversified labor force or a large population, which could stimulate the expansion of construction prospects in India.

Figure 22: Sector-wise Distribution of FDI in India



Source: Prepared by the Author based on Department for Promotion of Industry and Internal Trade, 2022.

During the period 2000 to 2018, India got around 40 percent of total FDI inflows, with specific emphasis on four sectors: services, telecommunications, construction activities, computer software, and hardware, with the remainder received by the rest of the economy. Because of the lower cost of labor and the imbalance between demand and supply of funds, the service sector has seen the most FDI inflow.

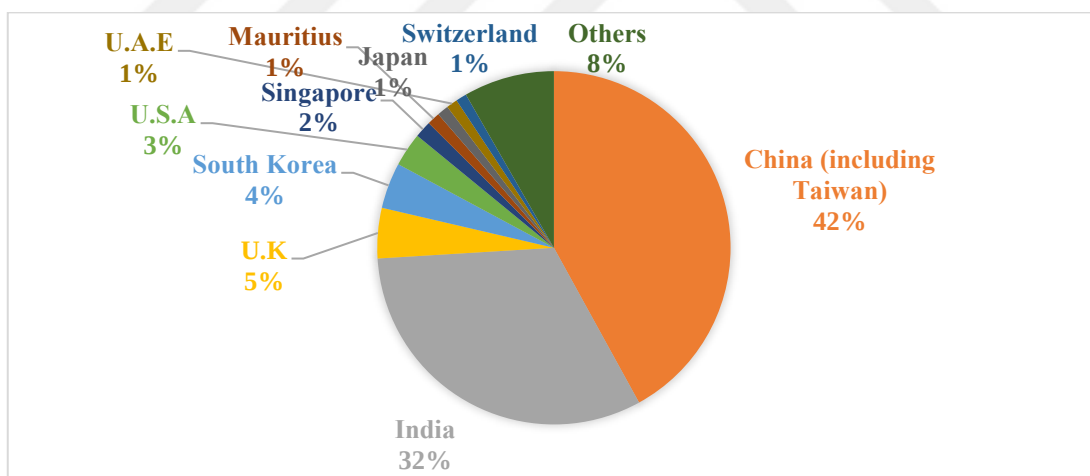
After the service sector, the computer software and hardware sector received the second biggest volume of FDI inflows in 2018-2019. And the telecommunications and construction development sectors are in third and fourth position respectively.

Table 26: Top 10 FDI Investing Countries in India (US\$ Million)

Ranks	Country	FDI Inflow (2018/2019)	%age to total Inflows
1	China (including Taiwan)	123363	42.00%
2	India	94111.04	32.04%
3	U.K	13549.11	4.61%
4	South Korea	12323	4.20%
5	U.S.A	9063.7	3.09%
6	Singapore	4517.39	1.54%
7	Mauritius	3434.7	1.17%
8	Japan	3076.21	1.05%
9	U.A.E	2984.51	1.02%
10	Switzerland	2920	0.99%
11	Others	24363.54	8.30%
Total FDI Inflows from All Countries		293706.2	100%

Source: Department for Promotion of Industry and Internal Trade (<https://dpiit.gov.in/publications/fdi-statistics/archives>) collected on MAR 29, 2022.

Figure 23: Top 10 Investing Countries in India



Source: Prepared by the Author based on Department for Promotion of Industry and Internal Trade, 2022.

During the period 2000-2018, India received a total of US \$409,267.96 million in FDI from 160 countries. Furthermore, from 2002 to 2018, just ten nations generated around 84% of overall FDI inflows, while the rest of the globe contributed the remaining 16%. Mauritius led the way in terms of FDI inflows, accounting for 32% of total inflows, while Singapore climbed up to the second place, accounting for 19% of total inflows. Japan earned third place with 7%, followed by the UK with 6%, the Netherlands with 6%, the USA with 6%, Germany with 3 %, Cyprus with 2 percent, France with 2%, UAE with 1%.

Table 27: Comparative Studies of India and SAARC FDI

Years	SAARC FDI (US\$ Million)	India FDI (US\$ Million)	Share of India in SAARC FDI%
2004	7827.48	5777.81	73.81%
2005	11292.92	7621.77	67.49%
2006	26271.99	20327.7	77.37%
2007	32576.86	25349.8	77.82%
2008	54611.66	47102.4	86.25%
2009	39482.89	35633.9	90.25%
2010	31213.55	27417	87.84%
2011	40054.46	36190.4	90.15%
2012	27709.16	24195.7	87.32%
2013	32555.72	28199.4	86.62%
2014	39344.52	34582.1	87.90%
2015	49171.28	44064.1	89.61%
2016	50908.79	44480.5	87.37%
2017	46623.71	39903.8	85.59%
2018	49889.21	42156.1	84.50%
Total	539534.2	463002.5	85.82%

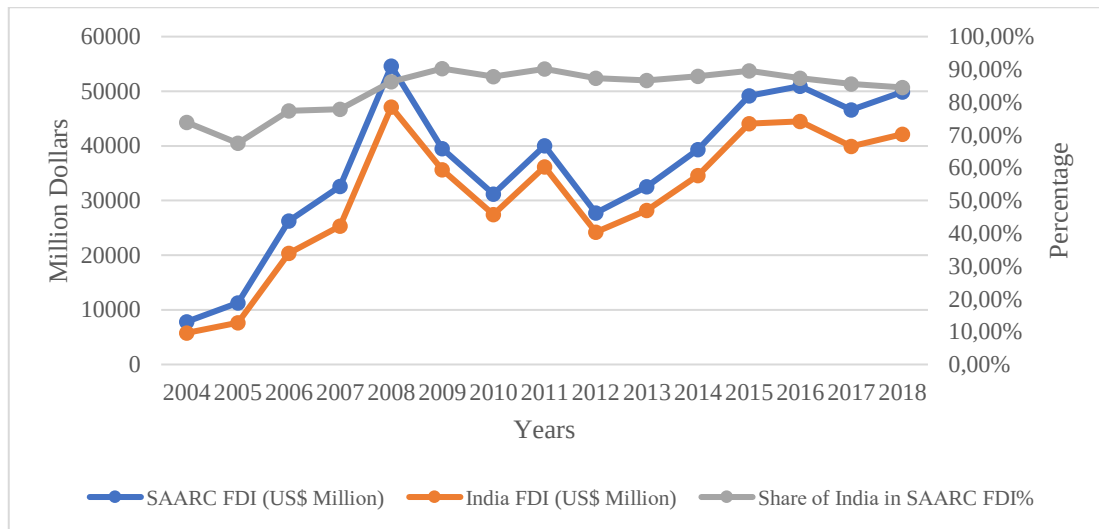
Source:UNCTAD database (<https://unctadstat.unctad.org/wds/TableV?ReportId=96740>)

Collected on March 31, 2022.

SAARC is a developing trade bloc that consistently draws international investment because of the immense opportunities for growth and development and the abundance of natural and human resources. Because all of the nations in SAARC are growing in terms of character, their saving and investment capacity is limited.

To meet the requirements and demands of individual countries, they welcome international investors to invest via attractive FDI incentives and packages. The situation of FDI inflow has increased substantially since liberalization, from US\$ 5777.81 million in 2004 to US\$ 42156.1 million in 2018. If we look at India's contribution to SAARC's cumulative inflow, we can see that it is the greatest since liberalization. Despite India, other SAARC member nations such as Pakistan and Bangladesh also benefit from large FDI inflows.

Figure 24: Comparison of SAARC and India FDI



Source: Prepared by the Author based on UNCTAD Database, 2021

In 2004, India's contribution to total SAARC FDI was 73.81 percent. In the following year, it decreased to 67.49 percent. After 2005, the contribution of India to SAARC's total FDI increased continuously. In 2009, India recorded the highest share in SAARC total FDI, but the effect of the global recession impeded the world economy, resulting in a decrease in inflows among the other SAARC nations.

2.4.5. The Maldives

The Maldives, formally designated as the Republic of Maldives, is an archipelagic nation situated in the Indian Ocean, positioned southwest of Sri Lanka and India, making it one of the most geographically dispersed sovereign states globally. It holds the title of being Asia's smallest country in terms of land area and the second least populated nation on the continent, with an approximate population of 540,542 inhabitants. The capital city, Malé, renowned historically as "King's Island," historically served as the epicenter of ancient royal dynasties owing to its strategic geographic location.

During the early 1970s, the Maldives, housing a population of 100,000 individuals, stood among the world's poorest nations. At that time, its economy heavily relied on fishing and the trade of indigenous commodities like coir rope, ambergris (Māvaharu), and coconut de mer (Tāvakkāshi) with neighboring and East Asian nations. However, in the 1980s, the Maldivian government embarked on a largely effective economic reform initiative, commencing with the removal of import restrictions and the expansion of opportunities for private enterprise. Notably, the tourism sector, which would later emerge as a pivotal factor in the nation's development, was in its infancy during this period.

The proliferation of tourism played a significant role in bolstering the country's overall economic advancement, fostering the creation of both direct and indirect employment opportunities, and driving revenue generation in ancillary industries. According to statistics from the Ministry of Tourism, the introduction of tourism in 1972 catalyzed a transformative shift in the economy, diversifying it away from dependence on fishing towards a burgeoning tourism sector. Within a mere three and a half decades, tourism evolved into the primary revenue source, emerging as the country's principal foreign currency earner and the largest contributor to its Gross Domestic Product.

The manufacturing and agriculture sectors continue to play fewer roles in the economy due to a lack of cultivable land and a labor shortage in the country.

In 2018, real GDP increased by 6.7% due to excellent tourism, construction, and commerce performance. In 2020, real GDP growth fell to -33.50 % due to Covid 19 Pandemic and lockdown because the Maldives rely on the tourism sector.

Youth and women continue to face difficulties in the labor market. Over 25% of women are unemployed or do not want to work. Unemployment among young people is high, at 15.3%. The government employs the majority of Maldivians. The major drivers of growth are tourism and construction, which rely heavily on foreign labor and male employment. About two-thirds of Maldivians work in professions unrelated to tourism (World Bank, 2019).

Table 28: Macroeconomic Aspect of Maldives

Indicators	2020
Territory (km ²)	300
Population	540,542
Life expectancy at birth, years	79.21
GDP (PPP, in bn. USD)	7.27
GDP (Nominal in bn. USD)	3.74
GDP Per capita (nominal, in USD)	6,924.11
GDP per capita (in US\$ PPP)	13,443.48
Currency	Maldivian rufiyaa (MVR, Rf)
GDP Growth (real)	-33.50%
Inflation Rate (in Percent)	-1.37

Source: World Bank (<https://data.worldbank.org>).

2.4.5.1. FDI in the Maldives

FDI has long been a pivotal element in the economic development of the Maldives. The Maldivian government acknowledges the importance of foreign investment as a key driver of economic growth and development. Several factors contribute to the successful attraction of foreign investments in the country, including a welcoming and liberal economic environment, relative political stability, and a record of consistent economic growth, averaging 7.5% annually over the last 15 years.

Foreign investors in the Maldives enjoy a straightforward and transparent policy framework, which is continually being refined to enhance the reliability and clarity of the investment climate. This proactive approach to governance and regulation has positioned the Maldives as an appealing destination for international investors seeking lucrative opportunities in the region. The government's commitment to fostering a favorable investment environment is evident in its initiatives aimed at simplifying processes and improving the overall experience for foreign entities looking to invest, thus bolstering the Maldives' reputation as a competitive market for FDI (R.H & H, 2014: 190).

FDI is helping to boost Maldives' economic growth through creating jobs, promoting exports, and increasing the country's growth rate. Furthermore, the use of foreign investments is closely linked to the availability of economic fundamentals, the political environment, and the country's total commerce. In the 1980s, the Maldives began to accept FDI in resort management rather than telecommunications, accountancy, finance, insurance, air transport, courier services, and some industrial concerns.

Additionally, investments are concentrated in the most advantageous areas, such as transportation and telecommunications, water supply and distribution, and the financial sector. Many worldwide resorts and hotel brands, including Hilton, Four Seasons, One & Only, Club Med, and other regional names, have opened operations in the Maldives in order to take advantage of the country's large economic market.

The Maldives' government provides the following incentives for foreign investors:

- The right to full foreign ownership.
- Investing guarantee supported by law.
- Disagreements may be resolved through international arbitration.
- Long-term contractual commitments and land leases.
- The freedom to hire foreign managers, technicians, and unskilled labor.
- No limits on currency exchange.
- There are no limits on earning or profit repatriation.

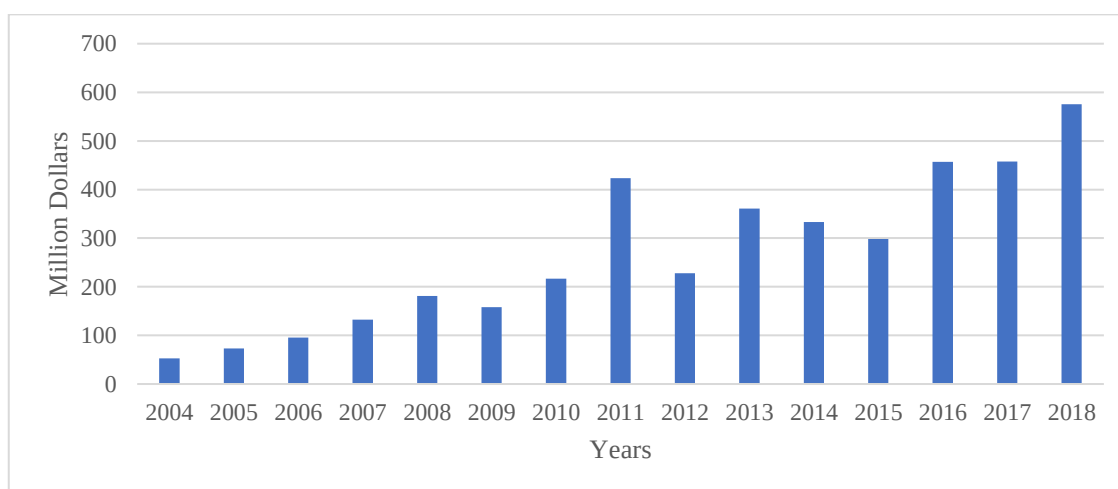
Table 29: FDI Inflows and FDI Growth Rate in the Maldives

Years	FDI Inflows (US\$ Million)	FDI Inflows Growth Rate%
2004	52.93	
2005	73.23	38%
2006	95.23	30%
2007	132.43	39%
2008	181.26	37%
2009	157.96	-13%
2010	216.47	37%
2011	423.50	96%
2012	228.00	-46%
2013	360.82	58%
2014	333.38	-8%
2015	297.98	-11%
2016	456.64	53%
2017	457.81	0%
2018	575.66	26%
Total	4043.3	337%

Source: UNCTAD database (<https://unctadstat.unctad.org/wds/TablepxReportId=96740>)

Collected on April 27, 2022. Note: FDI growth rate calculated by author based UNCTADstat database.

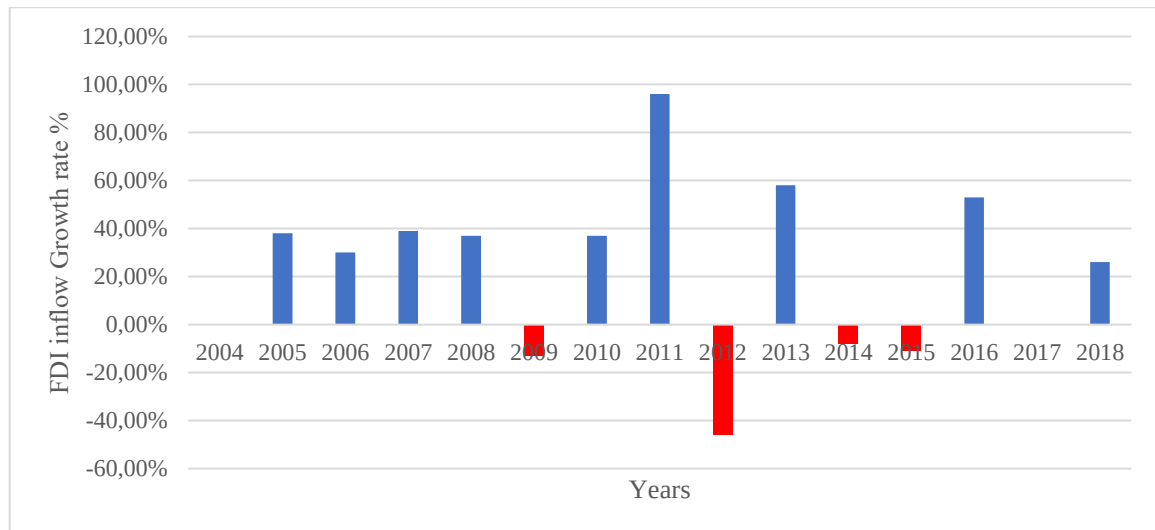
The Maldives ranks fifth among SAARC nations in terms of FDI inflow. The FDI inflow trend from 2004 to 2018 was an upturn in the Maldives. In the year 2018, Maldives recorded its all-time high FDI inflow, which was US\$ 575.66 million, and it was 11 times greater than the year 2004.

Figure 25: FDI Inflows into the Maldives

Source: Prepared by the Author based on UNCTAD Database, 2021

Figure 25 depicts the growing FDI inflows of Maldives from 2004 to 2018. FDI inflows were quite low, but after 2007, FDI inflows increased due to policies and programs that favored FDI. FDI increased from US\$ 52.54 million in 2004 to over US\$ 575 million in 2018.

Figure 26: FDI Inflows Growth Rate In the Maldives



Source: Prepared by the Author based on UNCTAD Database, 2021.

Figure 26 depicts Maldives's FDI Inflows Growth Rate from 2004 to 2018. From 2004 to 2008, Maldives's FDI inflow had almost a constant growth with an average of 36 %.

In 2009 the FDI growth rate declined to -13 percent. In 2011, the FDI growth rate increased by 96% compared to the previous year. From 2012 to 2018 FDI inflow growth rate experienced an up and downturn, even having a negative rate in 2012, 2014, and 2015.

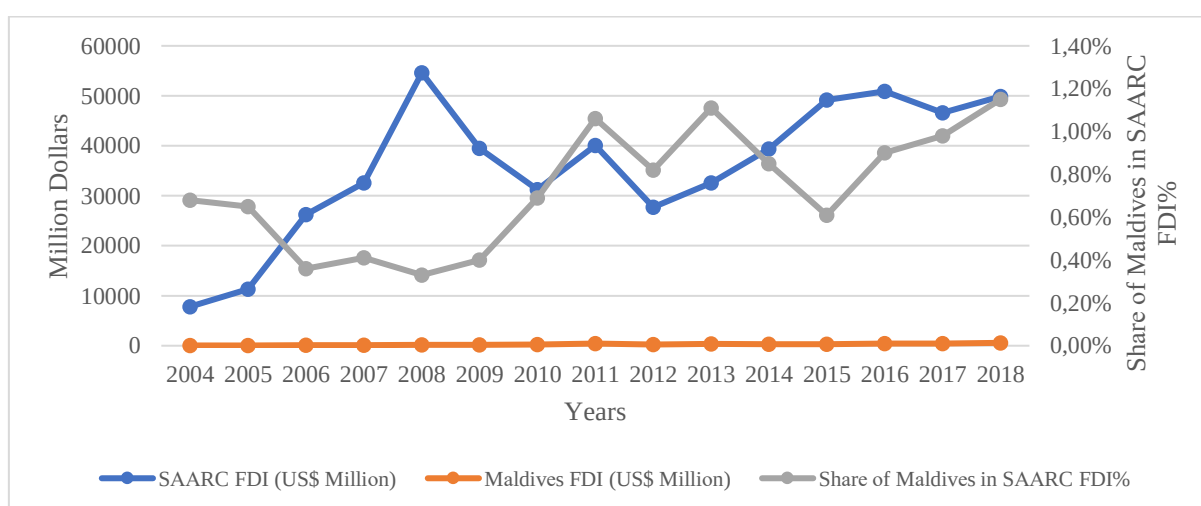
Table 30: Comparative Studies of Maldives and SAARC FDI

Years	SAARC FDI (US\$ Million)	Maldives FDI (US\$ Million)	Share of Maldives in SAARC FDI%
2004	7827.48	52.93	0.68%
2005	11292.92	73.23	0.65%
2006	26271.99	95.23	0.36%
2007	32576.86	132.43	0.41%
2008	54611.66	181.26	0.33%
2009	39482.89	157.96	0.40%
2010	31213.55	216.47	0.69%
2011	40054.46	423.50	1.06%
2012	27709.16	228.00	0.82%
2013	32555.72	360.82	1.11%
2014	39344.52	333.38	0.85%
2015	49171.28	297.98	0.61%
2016	50908.79	456.64	0.90%
2017	46623.71	457.81	0.98%
2018	49889.21	575.66	1.15%
Total	539534.2	4043.3	0.75%

Source: UNCTAD database (<https://unctadstat.unctad.org/wds/Tablpx?ReportId=96740>)

Collected on April 27, 2022.

Figure 27: Comparison of Maldives and SAARC FDI



Source: Prepared by the Author based on UNCTAD Database, 2021.

In 2004, Maldives's contribution to total SAARC FDI was 0.68 percent. In the following year, it remains almost constant. In South Asia, FDI inflows increased dramatically in response to rapidly rising economies such as India, Pakistan, and Bangladesh. In comparison, FDI inflows into the

Maldives increased significantly, resulting in a decrease in share to 0.36 percent in 2006. In the year 2008, the share of Maldives in SAARC FDI was just 0.33%, and it was the lowest during the period from 2004 to 2018. Maldives recorded the highest share in SAARC total FDI in 2011, 2013, and 2018, which was 1.06%, 1.11%, and 1.15%, respectively.

2.4.6. Nepal

Nepal, formally known as the Federal Democratic Republic of Nepal, is a landlocked country located primarily in the heart of the Himalayas, with some areas extending into the Indo-Gangetic Plain. It shares its northern border with China's Tibet and is flanked by India to the south, east, and west. Additionally, the Siliguri Corridor separates Nepal from Bangladesh, while Sikkim lies adjacent to Bhutan.

The country's diverse topography features fertile plains, lush, wooded hills, and eight of the tallest peaks in the world, including the iconic Mount Everest. Nepali is the official language spoken throughout the nation. The capital city, Kathmandu, serves as a vibrant cultural and political hub and is also home to the permanent secretariat of the SAARC, an organization that Nepal helped establish as a founding member.

Nepal ranks among the world's least developed nations due to its landlocked status, limited resources for economic advancement, and challenges posed by an underdeveloped transportation network. Its economy heavily relies on the importation of essential materials and the exportation of forest and agricultural products to international markets. Nepal imports key goods like construction materials, fertilizers, metals, and most consumer items, while it exports commodities such as rice, jute, timber, and textiles (Britannica, 2022).

Nepal has seen a significant decline in its economic growth over the past five years, particularly from 2017 to 2019. The situation worsened in 2020 due to various factors, leading to a notable economic downturn. However, this trend was followed by a recovery in 2021, indicating signs of improvement in the country's economic performance. There has been a consistent downward trajectory in economic freedom over this period, marked by a substantial decline in fiscal health scores, resulting in Nepal's downgrade from the "Mostly Unfree" to the "Repressed" category in terms of total economic freedom. Despite minimal taxation in Nepal's economy, there remain severe limitations on investment opportunities and financial liberties (The Heritage Foundation, 2022).

According to the Nepal Rastra Bank (NRB) data, Nepal's economic indicators do not appear optimistic. The central bank statistics showed a worsening picture of the economy. According to central bank data, the country's inflation averaged 7.14 %, which is the highest in the last 67 months.

Table 31: Macroeconomic Aspect of Nepal

Indicators	2020
Territory (km ²)	147,516
Population	29,136,808
Life expectancy at birth, years	71.07
GDP (PPP, in bn. USD)	116.8
GDP (Nominal in bn. USD)	34
GDP Per capita (nominal, in USD)	1,155.14
GDP per capita (in US\$ PPP)	4,008.51
Currency	Nepalese rupee (Rs, ₹) (NPR)
GDP Growth (real)	-2.09%
Inflation Rate (in Percent)	-2.09%

Source: World Bank (<https://data.worldbank.org>).

2.4.6.1. FDI in Nepal

FDI is seen as an essential source of external finance in Nepal, helping boost the country's economic progress. In this context, the FDI policy was changed in 1992 to attract significant inflows and to expand the scope of job prospects in the Nepalese economy. Though this excellent attempt failed to meet the government's goals, the country was unable to attract considerable FDI due to many challenges, including its status as a small, underdeveloped, mountainous country.

Political disagreements, the country's insurgency phase, a lack of infrastructural facilities, an untrained workforce, a landlocked economy, and political instability are all factors that contribute to a lower amount of FDI inflow in Nepal. Despite of these disadvantages, Nepal has created a stable economic climate for investors, resulting in a high level of FDI in manufacturing, hydropower, mineral extraction, construction, agriculture, chemicals, tourism, hotels and restaurants, and specialized services (Investment Climate Statements: Nepal, 2022).

Compared to other South Asian countries, Nepal has struggled to lure investors. Inward FDI is higher in India, Pakistan, Bangladesh, and other SAARC countries than Nepal. Nepal has failed to attract global investment despite having abundant natural resources and scenic beauty. Nepal is ranked 7th among the SAARC countries.

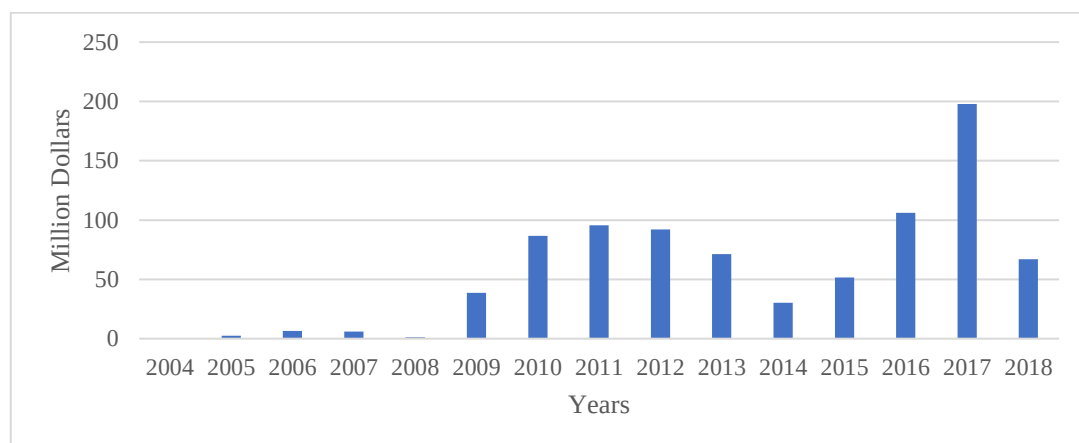
Table 32: FDI Inflows and FDI Growth Rate in Nepal

Years	FDI Inflows (US\$ Million)	FDI Inflows Growth Rate%
2004	0.42	
2005	2.45	-683%
2006	6.65	-371%
2007	5.89	-189%
2008	1.01	-83%
2009	38.55	3717%
2010	86.63	125%
2011	95.49	10%
2012	91.98	-4%
2013	71.32	-22%
2014	30.19	-58%
2015	51.56	71%
2016	106.1	106%
2017	197.7	86%
2018	67.06	-66%
Total	838.86	2639%

Source: UNCTAD, database (<https://unctadstat.unctad.org/wds/Tablpx?ReportId=96740>)

Collected on April 20, 2022. Note: FDI growth rate calculated by author based UNCTADstat database

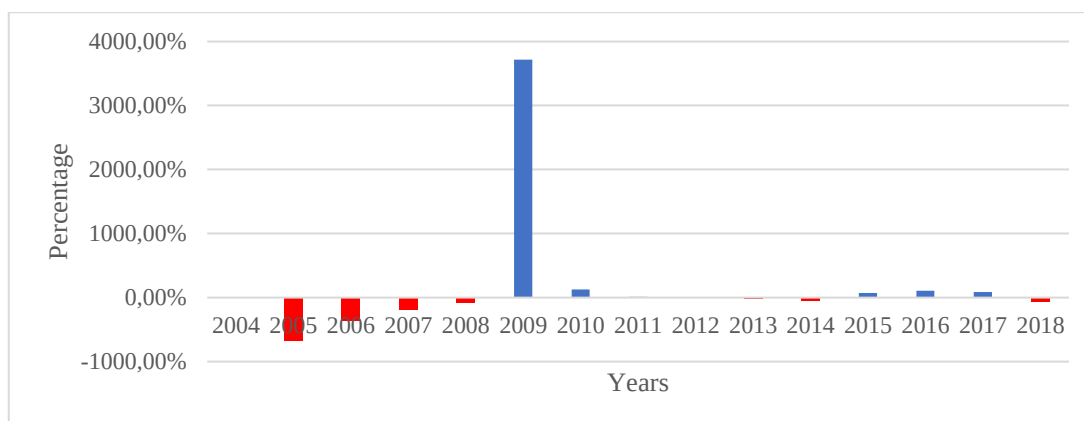
The country's political crises and insurgency caused FDI to sharply decline and reach a negative level between 2004 and 2008. FDI increased to more than US\$ 38.55 million in 2009, from US\$ 1.01 million in 2008.

Figure 28: FDI Inflows into Nepal

Source: Prepared by the Author based on UNCTAD Database, 2021.

The early 2010s revealed an improvement in FDI inflows due to institutional changes and the government's attempts to attract more international investment. FDI inflows have remained consistent in recent years, marking a significant shift from previous decades.

Figure 29: FDI Inflows Growth Rate in Nepal



Source: Prepared by the Author based on UNCTAD Database, 2021.

Figure 29 reveals Nepal's FDI Inflows Growth Rate from 2004 to 2018. The graphical depiction of FDI clearly shows that the FDI growth rate in Nepal from 2004 to 2008 was negative. Because of institutional changes and the government's attempts, the FDI inflow increased from US\$ 1.01 million in 2008 to US\$ 38.55 million in 2009, which means that the FDI inflow increased by 3717%. Since 2010 FDI growth rate has been up and downturn, even having a negative rate in 2012, 2013, 2014 and 2018.

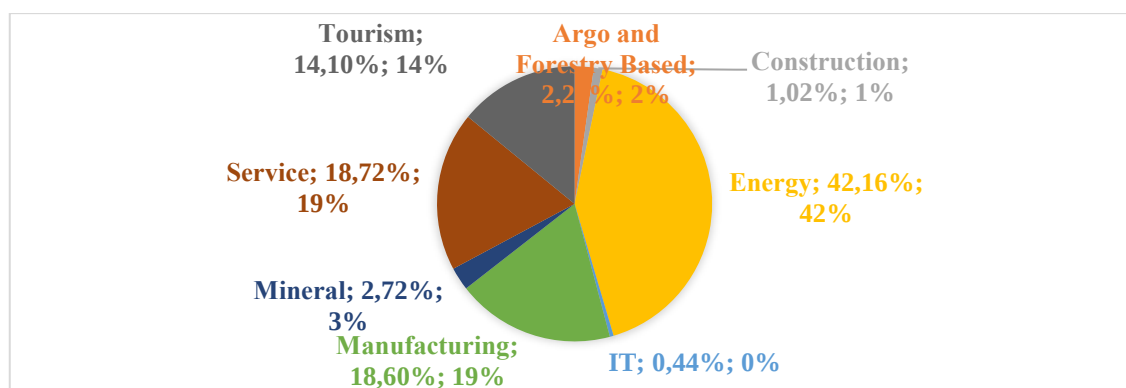
Table 33: Sector-wise FDI Inflow in Nepal (Rs. Million)

<i>Ranks</i>	Sector	Cumulative Inflows 2018/2019	Sector-wise Cumulative percentage of FDI Inflow
1	Argo and Forestry Based	6611.82	2.25%
2	Construction	2983.01	1.02%
3	Energy	123822.97	42.16%
4	IT	1281.02	0.44%
5	Manufacturing	54628.47	18.60%
6	Mineral	7981.01	2.72%
7	Service	54985	18.72%
8	Tourism	41413.38	14.10%
Total		293706.68	100.00%

Source: Department of Industry, Nepal. (<https://doind.gov.np/industrial-statistics>)

Nepal is one of SAARC's least developed and most influential members, yet it has been unable to attract more FDI. On this front, the active administration worked hard to change investment rules and open up diverse sectors for maximum efficiency, including manufacturing, agriculture, tourism, construction, and others. The energy industry is prioritized for investment, while the services sector is ranked second. This is reflected in the FDI investment spreadsheet, which shows that energy accounts for 42.16% of total investment, followed by the services sector at 18.72%. The manufacturing sector comprises 18.60% of total FDI inflow in Nepal and stands in the third position.

Figure 30: Sector-wise Distribution of FDI in Nepal



Source: Prepared by the Author based on Department of Industry Nepal, 2019

The tourism sector succeeded in attracting more FDI than other sectors; this sector shares 14.10% of total FDI in Nepal and stands fourth. Argo and forestry, mineral, construction, and IT sectors jointly comprised 6.43% of the total FDI inflow in Nepal.

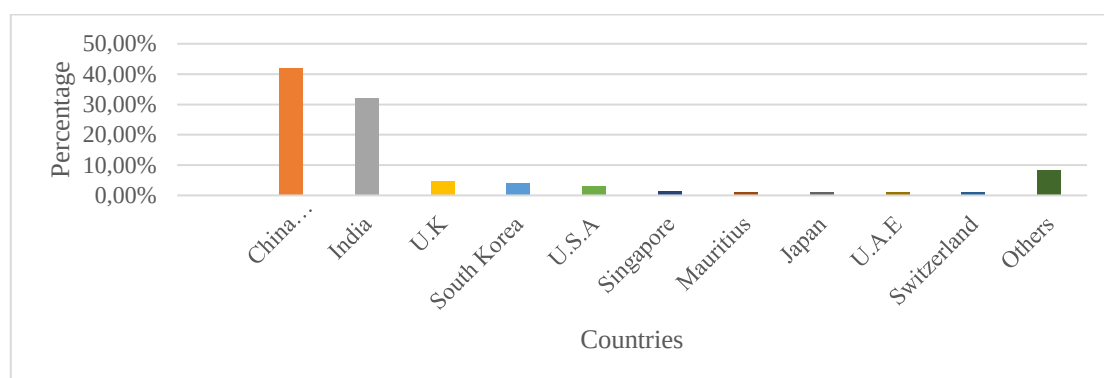
Table 34: Top Ten FDI Investing Countries in Nepal (Rs. Million)

Ranks	Country	FDI Inflow (2018/2019)	%age to total Inflows
1	China (including Taiwan)	123363	42.00%
2	India	94111.04	32.04%
3	UK	13549.11	4.61%
4	South Korea	12323	4.20%
5	USA	9063.7	3.09%
6	Singapore	4517.39	1.54%
7	Mauritius	3434.7	1.17%
8	Japan	3076.21	1.05%
9	U.A.E	2984.51	1.02%
10	Switzerland	2920	0.99%
11	Others	24363.54	8.30%
Total FDI Inflows from All Countries		293706.2	100%

Source: Department of Industry, Nepal. (<https://doind.gov.np/industrial-statistics>)

In Nepal, about 40 countries invest in various sectors every year. However, Nepal receives the largest FDI inflow from China, about Rs123363 million. Followed by its southern neighbor country India with Rs 94111.04 million. The U.K with Rs 13549.11 million and South Korea with Rs 12323 million stand in the third and fourth positions.

Figure 31: Top 10 Investing Countries in Nepal



Source: Prepared by the Author based on Department of Industry Nepal, 2019

In 2018/2019, both China and India jointly comprised 74.04 % of total FDI in Nepal. The U.K placed third with 4.61%, followed by South Korea with 4.20% of total FDI in Nepal. USA and South Korea ranked fifth and sixth with 3.09% and 1.54%, respectively.

Table 35: Comparative Studies of Nepal and SAARC FDI

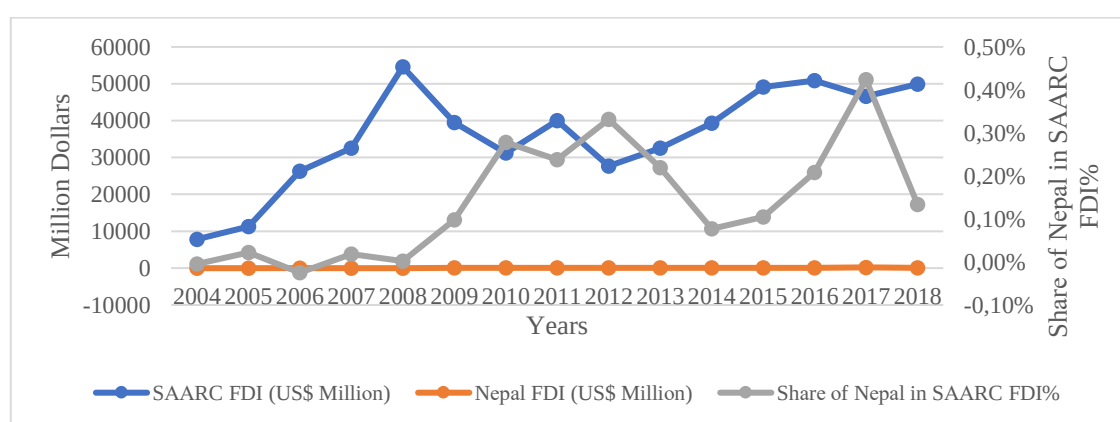
Years	SAARC FDI (US\$ Million)	Nepal FDI (US\$ Million)	Share of Nepal in SAARC FDI%
2004	7827.48	-0.42	-0.005%
2005	11292.92	2.45	0.022%
2006	26271.99	-6.65	-0.025%
2007	32576.86	5.89	0.018%
2008	54611.66	1.01	0.002%
2009	39482.89	38.55	0.098%
2010	31213.55	86.63	0.278%
2011	40054.46	95.49	0.238%
2012	27709.16	91.98	0.332%
2013	32555.72	71.32	0.219%
2014	39344.52	30.19	0.077%
2015	49171.28	51.56	0.105%
2016	50908.79	106.1	0.208%
2017	46623.71	197.7	0.424%
2018	49889.21	67.06	0.134%
Total	539534.2	838.86	0.155%

Source: UNCTAD database(<https://unctadstat.unctad.org/wdseV?ReportId=96740>)

Nepal's economic prospects are not as bright as those of the other economically powerful nations in the region. Due to tight economic sustainability, natural disasters, and harsh investment rules, FDI inflows were negative in 2004. Major investors such as the United States, the United Arab Emirates, the United Kingdom, and China have had several possibilities to invest in India and other SAARC nations other than Nepal.

From 2004 to 2018, the share of Nepal in total FDI of SAARC was only 0.155% which stands in the 7th position among the SAARC countries. From 2004 to 2018, the country has received an average FDI of around US\$ 55.924 million per year.

Figure 32: Comparison of Nepal and SAARC FDI



Source: Prepared by the Author based on UNCTAD Database, 2021

Figure 32 illustrates the FDI comparison in Nepal and SAARC from the year 2004 to 2018. In 2004, Nepal attracted US\$ -0.42 million FDI inflow, which counts for -0.005% of total SAARC FDI. In the year 2005, the status of FDI inflows increased and reached US\$ 2.45 million, which comprised 0.022% of the SAARC FDI. In 2009, FDI inflow reached US\$ 38.55 Million, which was only 0.098% of SAARC FDI. This share further increased to 0.332% in the year 2012, when the FDI inflow was US\$ 91.98 Million. In 2017 FDI inflow in Nepal reached its highest level, and it was US\$ 197.7 million, which shares 0.424% of total FDI in SAARC.

2.4.7. Pakistan

Pakistan, officially recognized as the Islamic Republic of Pakistan, is a country located in South Asia. It is the fifth most populous nation in the world, boasting a population of approximately 220 million people, and it is home to the second-largest Muslim community globally. Covering an area of 881,913 square kilometers, Pakistan ranks as the 33rd largest country in terms of land size. The capital city of Pakistan is Islamabad, strategically positioned at the country's heart. Geographically, Pakistan shares its borders with India to the east, Afghanistan to the west, Iran to the southwest, and China to the northeast. Additionally, it features a coastline of 1,046 kilometers along the Arabian Sea

and the Gulf of Oman to the south, which plays a significant role in its trade and maritime activities. This strategic location not only enhances Pakistan's geopolitical significance but also serves as a gateway for trade between South Asia, Central Asia, and beyond.

Pakistan has a mixed economy, with both private and government-owned enterprises governed by government policy. It is a developing economy and one of the "Next Eleven," a group of nations with the potential to become the world's largest economies, Pakistan economy is ranked as 42nd largest economy in 2020 according to IMF estimates (The Economy Of Pakistan, 2022). Political and societal instability limit economic progress. Textiles and garments contribute for most export profits, although most of the sector is informal, and underemployment is widespread. China has committed more than \$60 billion in infrastructure and energy development in the China–Pakistan Economic Corridor (CPEC), despite considerable difficulties and criticism (The Heritage Foundation, 2022)

Years of war and political instability, a fast growing population, and low levels of FDI have all hampered Pakistan's economic progress. Pakistan's negative trade balance has widened the country's deficit and reduced its reserves. Every year, the trade deficit widens as imports outnumber exports. Part of the reason for the country's dependency on imports is that the country's poor infrastructure and industries prevent expansion. For many years, many of the industries in this region have been state-owned, resulting in inefficiency and lower earnings. Economic Prospects for the Future Despite these hurdles. The government has worked to privatize a wide range of sectors to fight poor economic development. This action is anticipated to lower the fiscal deficit and encourage foreign investment. Both are required for enhanced infrastructure and industries, which are crucial to economic progress (The Economy of Pakistan, 2022).

Table 36: Macroeconomic Aspect of Pakistan

Indicators	2020
Territory (km2)	881,913
Population	220,892,331
Life expectancy at birth, years	67
GDP (PPP, in bn. USD)	1,063
GDP (Nominal in bn. USD)	262.61
GDP Per capita (nominal, in USD)	1465.89
GDP per capita (in US\$ PPP)	4622.77
Currency	Pakistani rupee (Rs) (PKR)
GDP growth (real)	-0.9
Inflation rate (in Percent)	9.7

Source: World Bank (<https://data.worldbank.org>).

2.4.7.1. FDI in Pakistan

Since SAARC integration, Pakistan has consistently received the amount of FDI inflows in lieu of a vast domestic market and an economic policy environment that is generally favorable to investors; however, terrorist violence and other natural disasters have created obstacles for investors resulting in an irregular trend in investment. However, the United States and the United Kingdom provide continual investment in the oil, gas, and petroleum industries, as well as financial and non-financial sectors, throughout the year. Additionally, even before independence, a large number of foreign corporations were functioning with the goal of dominating the available resources and efficiency. It includes the Swiss Cotton Company in 1861, Volkart Brothers in 1863, the chartered Bank of London in 1863, Shell Petroleum in 1903, Siemens in 1922, and the Imperial Chemical Industry in 1944. In general, FDI is generated via the engagement of foreign-based enterprises with local partners in Pakistan. Despite this, FDI inflow patterns began to fall in 2007-08, owing to a loss of trust and the formation of an adverse economic environment. However, Pakistan achieved a record FDI of US \$5590 million in 2008, but it decreased dramatically over the next several years, reaching US \$846.7 million in 2012.

Table 37: FDI Inflows and FDI Growth Rate in Pakistan

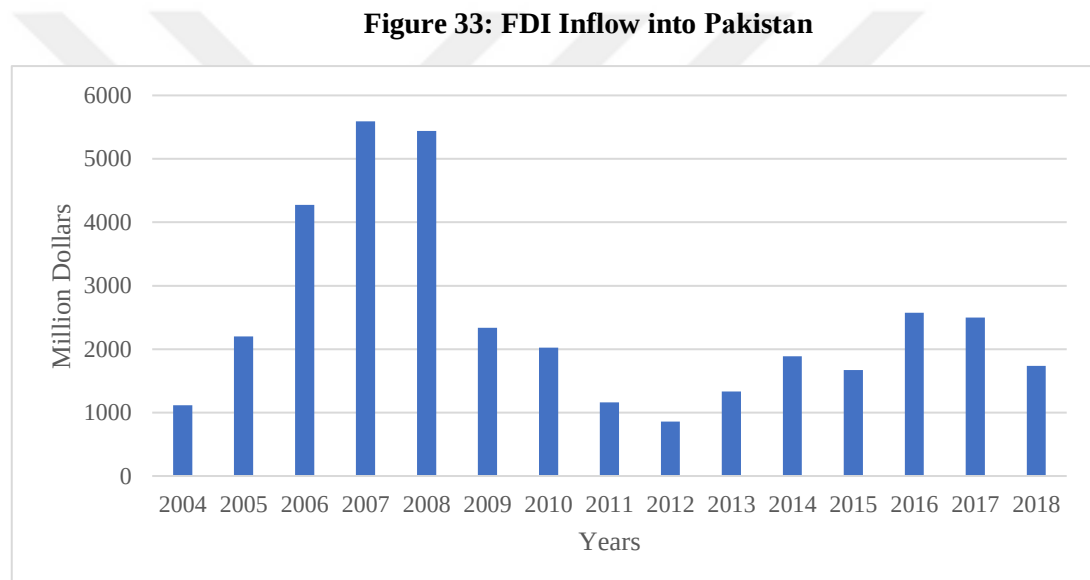
Years	FDI Inflows (US\$ Millon)	FDI Inflows Growth Rate%
2004	1118.00	
2005	2201.00	97%
2006	4273.00	94%
2007	5590.00	31%
2008	5438.00	-3%
2009	2338.00	-57%
2010	2022.00	-14%
2011	1162.00	-43%
2012	859.00	-26%
2013	1333.00	55%
2014	1887.00	42%
2015	1673.00	-11%
2016	2576.00	54%
2017	2496.00	-3%
2018	1737.00	-30%
Total	36703	186%

Source: UNCTAD database (<https://unctadstat.unctad.org/wds/TableViewex?ReportId=96740>)

Collected on April 03, 2022. Note: FDI growth rate calculated by author based UNCTADstat database

After India, Pakistan has the second-largest economy in SAARC. This consistently draws international investors for FDI, portfolio investment, and other capital investments. The component Loan, which is the most desired investment vehicle, comprises the other capitals. In Pakistan, FDI largely comes in three forms: equity capital, reinvested earnings, and other capital, which have been steadily increasing since 1991.

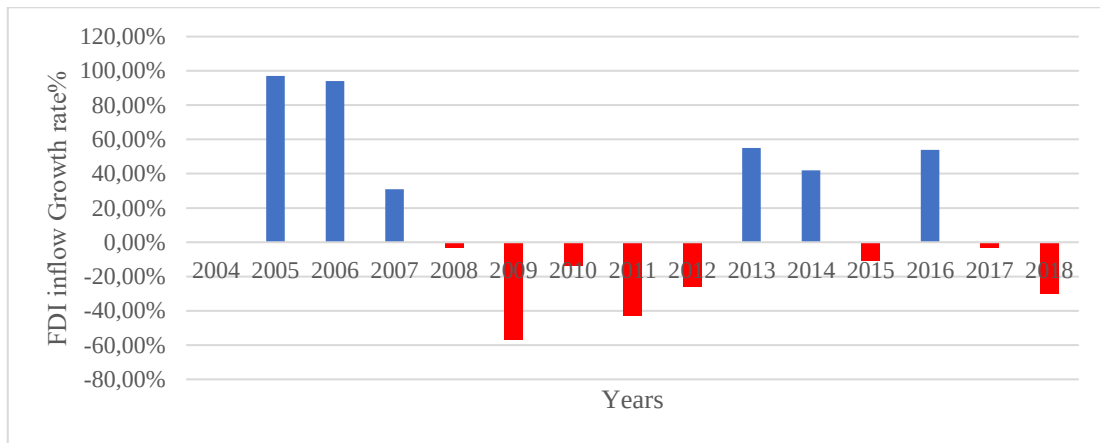
The resumption of US-Pakistan relations in 2001 resulted in a slew of possibilities over the next several years. Since 2004, foreign investors' interest has been drawn to Pakistan, which reported a status of US\$ 2201 million in 2005. In 2007, major investors such as the United States, the United Arab Emirates, and Japan invested in the oil and gas and industrial sectors of the economy, causing FDI inflows to more than double from the previous year.



Source: Prepared by the Author based on UNCTAD Database, 2021.

In 2007 FDI inflow reached the all-time highest total, US\$ 5590 million. Investment began to decline from the beginning of 2008 as the largest investor USA's economy crashed due to sub-prime financial crises. The effect of a sudden crisis was felt by the majority of industrialized and developing countries throughout the globe. During 2017 and 2018, the FDI inflow was US\$ 2496 million and US\$ 1737 million, respectively.

Figure 34: FDI Inflows Growth Rate in Pakistan



Source: Prepared by the Author based on UNCTAD Database, 2021

Figure 34 shows the FDI Inflows Growth Rate in Pakistan from 2004 to 2018. The graphical depiction of FDI clearly shows that the FDI growth rate in 2005, 2006, and 2007 was 97%, 94%, and 31%, respectively. From the start of 2008 FDI growth rate decreased, even having a negative rate in 2008, 2009, 2010, 2011, 2012, 2015, 2017, and 2018.

Table 38: Sector-wise FDI Inflow in Pakistan (US\$ Million)

<i>Ranks</i>	Sector	2016	2017	2018	Cumulative Inflows 2004-2018	Sector-wise Cumulative percentage of FDI Inflow
1.	Oil & Gas	146	372	349.8	6822.3	18.43%
2.	Financial Business	297.3	400.3	286.5	6674.3	18.03%
3.	Textiles	15.5	49.7	76.8	513.6	1.39%
4.	Trade	32.6	143	76.3	1210	3.27%
5.	Construction	8.3	40.4	70.2	991.7	2.68%
6.	Power	716	1,179.50	-323.9	3865.9	10.44%
7.	Chemicals	88.5	5.4	48.9	914.5	2.47%
8.	Transport	166.8	163.5	56.9	921.9	2.49%
9.	Communication (IT&Telecom)	-49.2	113.5	-55.7	7170	19.37%
10.	Others	1,071.20	375.7	739.2	7931.7	21.43%
Total		2,406.60	2,780.30	1,362.40	37015.9	100.00%

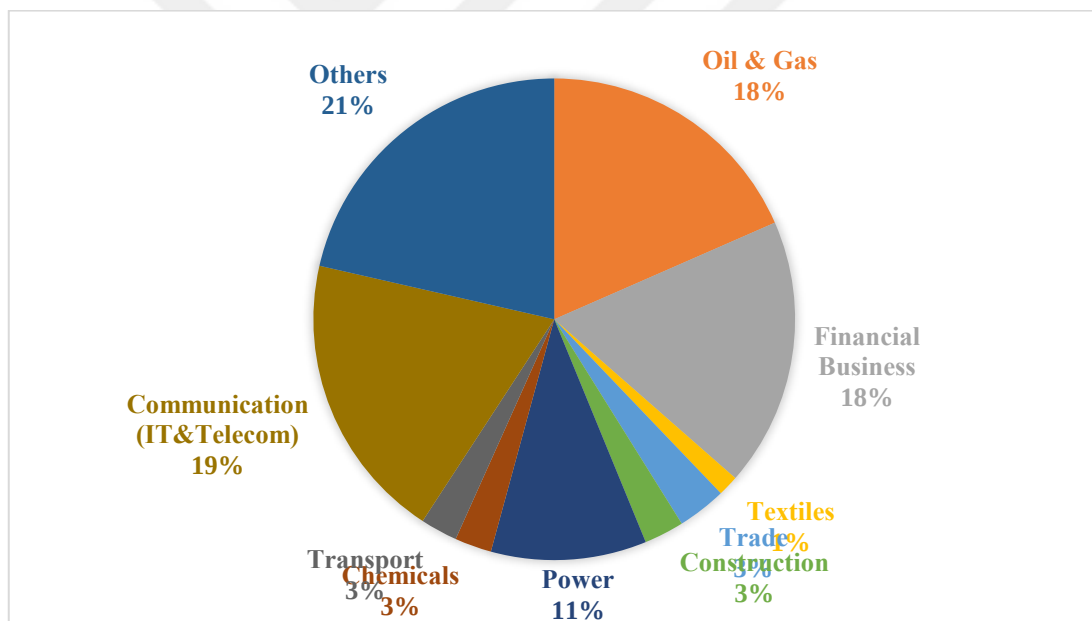
Source: Board of Investment, Pakistan, 2022 (https://invest.gov.pk/statistics?language_id=en)

The sectoral-wise distribution specifies the investment made in several economic sectors such as the financial business sector, the oil and gas sector, the textile and trade sector, the telecommunications sector, the construction sector, etc.

These industries are usually a good source of attraction for investors. According to the statistics, the oil and gas industry has been the most significant source of FDI inflows in Pakistan since liberalization, and the oil and gas industry has provided enormous opportunities for international investors. From 2004 to 2009, the patterns of FDI in the power industry have decreased, resulting in increased debt in order to circulate energy in the nation.

The volume of FDI investment in the financial business sector and telecommunications expanded and achieved huge progress. In 2005-2006, neither of the sectors achieved double-digit growth except for the telecommunications industry, which attracted 55% FDI inflow.

Figure 35: Sectors-wise Distribution of FDI in Pakistan



Source: Prepared by the Author based on UNCTAD Database, 2021

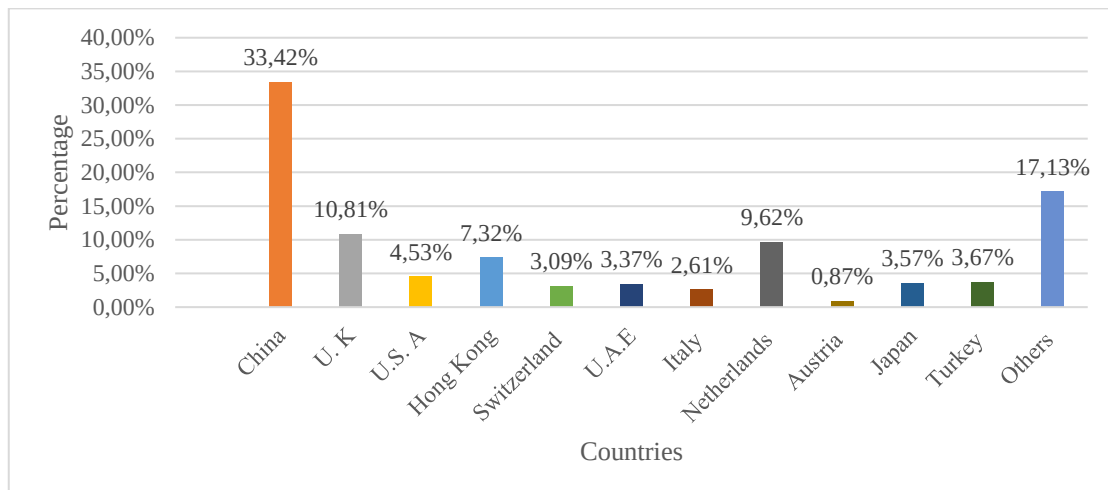
According to the data from 2004 to 2018, the telecommunications sector stands at the first position with 19% of total FDI inflow, followed by the oil and gas industries with 18.4% of total FDI. The financial business sector succeeded to attract 18% of total FDI in Pakistan and placed in the third position. And the energy sector with 11% stands at the fourth position.

Table 39: FDI investing countries in Pakistan (US\$ Million)

Ranks	Country	2016-17	2017-18	2018-19	FDI Inflow	%age to total Inflows
					(2016-2018)	
1	China	736.2	1311.9	130.9	2179	33.42%
2	UK	215.4	304.6	185	705	10.81%
3	USA	45.7	161.7	88.1	295.5	4.53%
4	Hong Kong	123	183	171	477	7.32%
5	Switzerland	101.7	78.5	21.3	201.5	3.09%
6	U.A.E	120.1	-4.4	103.7	219.4	3.37%
7	Italy	61.5	56.6	52.1	170.2	2.61%
8	Netherlands	457.6	100.3	69	626.9	9.62%
9	Austria	21.7	27.4	7.6	56.7	0.87%
10	Japan	57.7	57.8	117.3	232.8	3.57%
11	Turkey	135.6	29.8	73.7	239.1	3.67%
12	Others	303.4	470.5	343	1116.9	17.13%
Total FDI Inflows from All Countries		2379.6	2777.7	1362.7	6520	100.00%

Source: Board of Investment, Pakistan, 2022 (https://invest.gov.pk/statistics?language_id=en)

Countries all over the globe are drawn to Pakistan for investment because of the many chances for expansion in all sectors and the availability of a huge cheap labor population appropriate for manufacturing enterprises.

Figure 36: Country-Wise FDI Inflows into Pakistan

Source: Prepared by the Author based on Board of Investment, Pakistan, 2022

From 2016 to 2018, China invested 33.4% of total FDI in Pakistan and stands at the first position, followed by the UK with 10.8% of total FDI. The Netherlands and Hong Kong comprised 9.6% and 7.3% of Pakistan's total FDI and stand in third and fourth positions. The USA is the fifth country that invests the most FDI in Pakistan, with 4.5%.

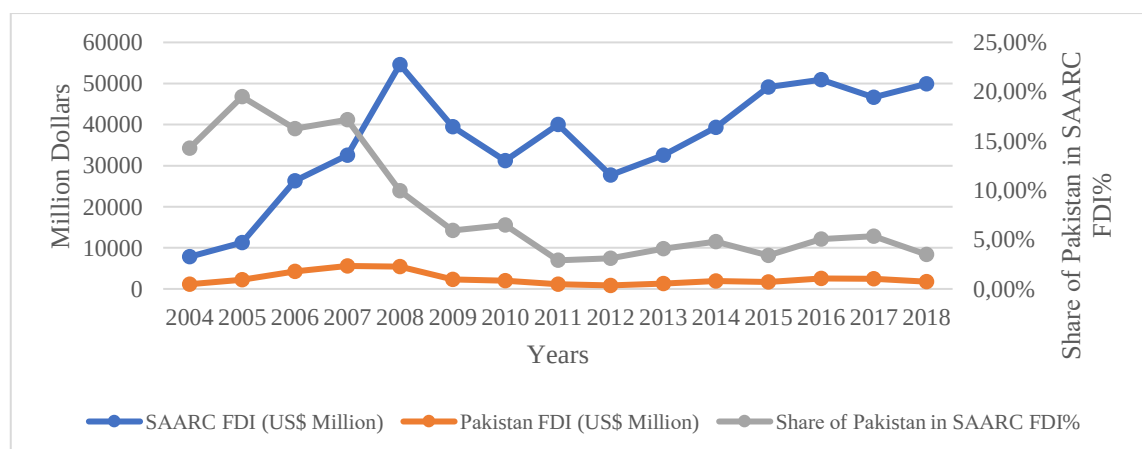
Table 40: Comparative Studies of Pakistan and SAARC FDI

Years	SAARC FDI (US\$ Million)	Pakistan FDI (US\$ Million)	Share of Pakistan in SAARC FDI%
2004	7827.48	1118.00	14.28%
2005	11292.92	2201.00	19.49%
2006	26271.99	4273.00	16.26%
2007	32576.86	5590.00	17.16%
2008	54611.66	5438.00	9.96%
2009	39482.89	2338.00	5.92%
2010	31213.55	2022.00	6.48%
2011	40054.46	1162.00	2.90%
2012	27709.16	859.00	3.10%
2013	32555.72	1333.00	4.09%
2014	39344.52	1887.00	4.80%
2015	49171.28	1673.00	3.40%
2016	50908.79	2576.00	5.06%
2017	46623.71	2496.00	5.35%
2018	49889.21	1737.00	3.48%

Source: UNCTADstatdatabase (<https://unctadstat.unctad.org/wds/TableV?ReportId=96740>)

Collected on March 31, 2022.

After India, Pakistan is the second-largest FDI destination in SAARC. Since the liberalization of the economy, Pakistan has consistently influenced foreign investors for investment. Pakistan's economy has successfully attracted the largest foreign investment from 2002 to 2008, which may be due to the recovery of US-Pakistan relations. SAARC's cumulative FDI has climbed in the years after, whereas Pakistan's investment has decreased.

Figure 37: Comparison of Pakistan and SAARC FDI

Source: Prepared by the Author based on UNCTAD Database, 2021.

In 2004, Pakistan's contribution to the total SAARC FDI was 1118 US\$ million, which counts for 14.28 %. In the following year, it increased to 2201 US\$ million, which comprised 19.49 % of the total SAARC FDI, and this was the highest share of Pakistan in SAARC FDI. After 2007, Pakistan's FDI inflows start downturn trends. In 2008, FDI inflows were 5438 US\$ million, which counts as almost 9.96 % of total SAARC FDI. In 2009, the influence of the worldwide crisis was plainly seen among global investors; this impact was particularly visible in Pakistan's FDI inflows, which fell to 2338 US\$ million. In 2017 share of Pakistan in SAARC FDI was 5.35%; in 2018, it fell to US\$ 1737, which counts for only 3.48 % of SAARC FDI.

2.4.8. Sri Lanka

Sri Lanka, formerly known as Ceylon and officially designated as the Democratic Socialist Republic of Sri Lanka, is an island nation located in South Asia. Strategically positioned in the Indian Ocean, it is situated to the southwest of the Bay of Bengal and southeast of the Arabian Sea. The Gulf of Mannar and the Palk Strait serve as natural barriers, distinguishing Sri Lanka from the Indian subcontinent. The country also shares maritime boundaries with its neighbors, the Maldives and India, further highlighting its strategic location in the region.

The administrative capital of Sri Lanka is Sri Jayawardenepura Kotte, which houses the country's legislative activities, while Colombo serves as the primary urban center and economic hub, bustling with commercial activities and cultural significance. As the largest city in Sri Lanka, Colombo is a vibrant metropolis that plays a critical role in trade, finance, and tourism, drawing visitors from around the world.

According to the International Monetary Fund (IMF), Sri Lanka ranks second in terms of per capita income within the South Asian region when assessed using purchasing power parity (PPP). This high per capita income reflects the country's overall economic development and growth potential. During the nineteenth and twentieth centuries, Sri Lanka experienced substantial economic growth, fueled by a plantation-based economy.

The nation became renowned for its production and export of various commodities, including cinnamon, rubber, and the famous Ceylon tea. Ceylon tea has garnered international acclaim and is considered a hallmark of Sri Lankan exports, contributing significantly to the nation's economic prosperity and cultural identity. In recent years, Sri Lanka has been diversifying its economy, moving beyond traditional exports to embrace tourism, information technology, and other emerging sectors. This shift aims to enhance sustainable development and reduce reliance on agriculture while leveraging the country's rich cultural heritage and natural beauty to attract international investments and visitors alike. Today, the country continues to rely significantly on the manufacturing and exportation of commodities such as sugar, tea, coffee, and rubber, alongside diversifying its industrial

landscape with advancements in food processing, textiles, telecommunications, and financial services.

Agriculture, industry, and services were among the key sectors of the economy that declined in 2020. Despite significant development in the fruits, rice, spices and vegetable sectors, the Agriculture sector decreased by 2.4 % in 2020, compared to 1.0% growth in 2019, owing to declines in marine fishing, coconut, tea, animal production, and forestry and logging sectors. The Industry sector decreased by 6.9% in 2020, compared to 2.6 % growth in 2019. Because of the hard-hit subsectors such as transportation, housing, food and drinks, real estate, and professional service activities, the Services sector decrease by 1.5% in 2020, compared to 2.2 % growth in 2019. GDP per capita fell from USD 3,852 in 2019 to USD 3,682 in 2020 (Ministry of Finance, Annual report 2020).

Table 41: Macroeconomic Aspect of Sri Lanka

Indicators	2020
Territory (km ²)	65,610
Population	21,919,000
Life expectancy at birth, years	77
GDP (PPP, in bn. USD)	289.88
GDP (Nominal in bn. USD)	80.71
GDP Per capita (nominal, in USD)	3,682
GDP per capita (in US\$ PPP)	13,225
Currency	Sri Lankan rupee (Rs) (LKR) (රු) (₹)
GDP growth (real)	-2.4%
Inflation rate (in Percent)	3.4%

Source: World Bank (<https://data.worldbank.org>).

2.4.8.1. FDI in Sri Lanka

FDI in Sri Lanka has progressed significantly in recent years. Sri Lanka and its government have taken significant steps and procedures to attract international investors' interest in the different economic sectors accessible throughout the country. The Sri Lankan government has simplified and made it easier to understand the company registration formalities for international investors and business owners. This assisted foreign investors in gaining greater interest in Sri Lankan local industry (FDI.lk, 2022).

Sri Lanka is the fastest-growing economy in SAARC, attracting significant international investors from all over the world. In Sri Lanka, the Board of Investment (BOI) was founded in 1992

to consistently give incentive packages and taxes reduction programmes to increase volume FDI inflow.

Investors believe that launching a business in Sri Lanka is simpler and more rapid than other emerging economies. However, scalability is a challenge since expansion is limited by a shortage of trained workers, a narrow talent pool, and land scarcity. Investors argue that staff retention in Sri Lanka is strong, but the country's many public holidays, workers' aversion to working at night, a lack of labor mobility, and problems hiring women can all diminish efficiency and lengthen start-up periods (Climate Statements: Sri Lanka, 2022). FDI, towards Sri Lanka climbed to around US\$ 1614 million in 2018, up from US\$ 1372 million in 2017. Recent FDI has been centered on the real estate, mixed development projects, ports, and telecommunications industries. With over two million tourists each year and a range of cultural, animal, and recreational activities, the tourism sector is a top priority for investors.

Table 42: FDI Inflows and FDI Growth Rate in Sri Lanka

Years	FDI Inflows (US\$ Millon)	FDI Inflows Growth Rate%
2004	223.00	
2005	272.00	22%
2006	480.00	76%
2007	603.40	26%
2008	752.20	25%
2009	404.00	-46%
2010	477.60	18%
2011	955.91	100%
2012	941.12	-2%
2013	932.55	-1%
2014	893.63	-4%
2015	679.66	-24%
2016	897.05	32%
2017	1372	53%
2018	1614	18%
Total	11498.12	293%

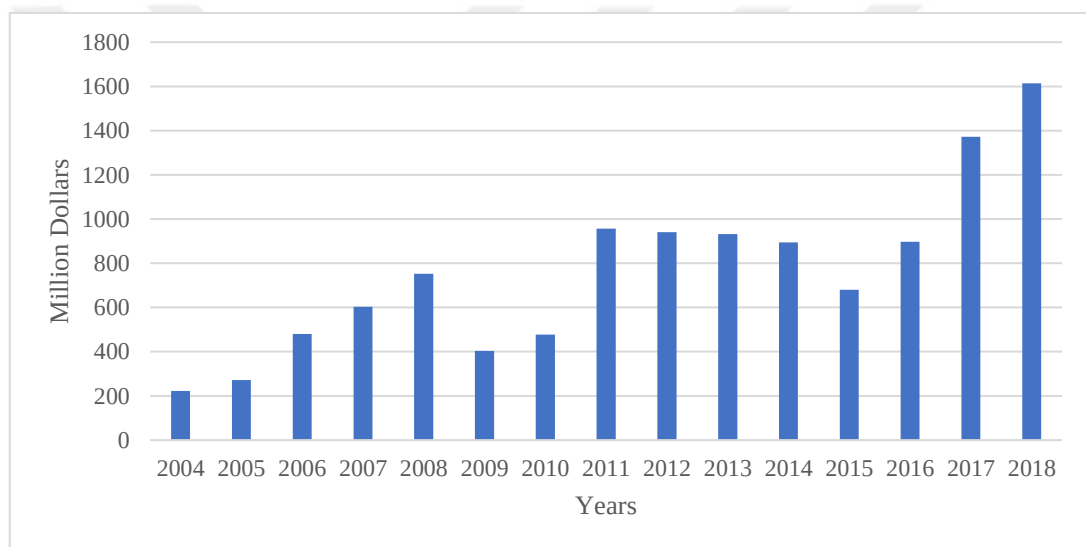
Source:UNCTADdatabase (<https://unctadstat.unctad.org/wds/TableVie?ReportId=96740>)

Collected on April 04, 2022. Note: FDI growth rate calculated by author based UNCTADstat database

FDI into Sri Lanka's economy increased steadily between 2004 and 2008. Since 2005, FDI inflows into Sri Lanka's economy have increased at a rapid rate, reaching US\$ 480 million in 2006 and US\$ 752.20 million in 2008. This may be achieved due to the abundance of possibilities in the service and textile industries.

In 2011, Sri Lanka received the greatest amount of FDI inflow of US\$ 955.91 million, representing a 100% increase over the previous year; however, in 2012, it fell to US\$ 941.12 million. The downturns trend continued until 2015, which was US\$ 897.05 million. In 2017 FDI inflow increased to US\$ 1372 million. In 2018, the total FDI inflow into Sri Lanka was US\$ 1614 million, which illustrates an 18 % growth over the last year.

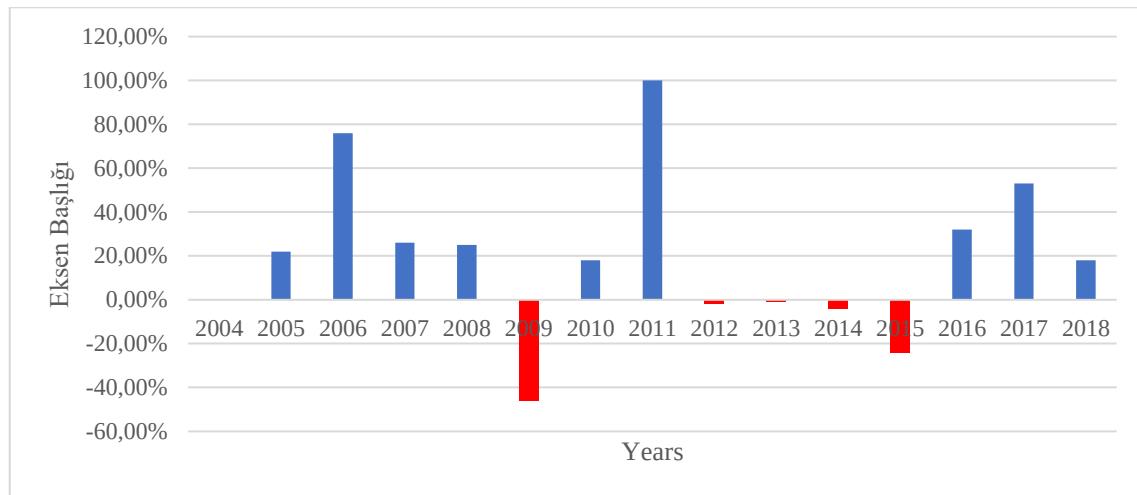
Figure 38: FDI Inflows into Sri Lanka



Source: Prepared by the Author based on UNCTAD Database, 2021

Figure 38 shows the FDI Inflows Growth Rate in Sri Lanka from 2004 to 2018. The graphical depiction of FDI clearly shows that the FDI growth rate in 2005, 2006, and 2007 was 22%, 76%, and 26%, respectively. Because of the U.S.A crisis, the FDI inflow into Sri Lanka decreased to -46% in 2009. Since 2010 FDI growth rate has up and downturn d, even having a negative rate in 2012, 2013, 2014 and 2015.

Figure 39: FDI Inflows Growth Rate in Sri Lanka



Source: Prepared by the Author based on UNCTAD Database, 2021

Table 43: Sector-wise FDI Inflow in Sri Lanka (US\$ Million)

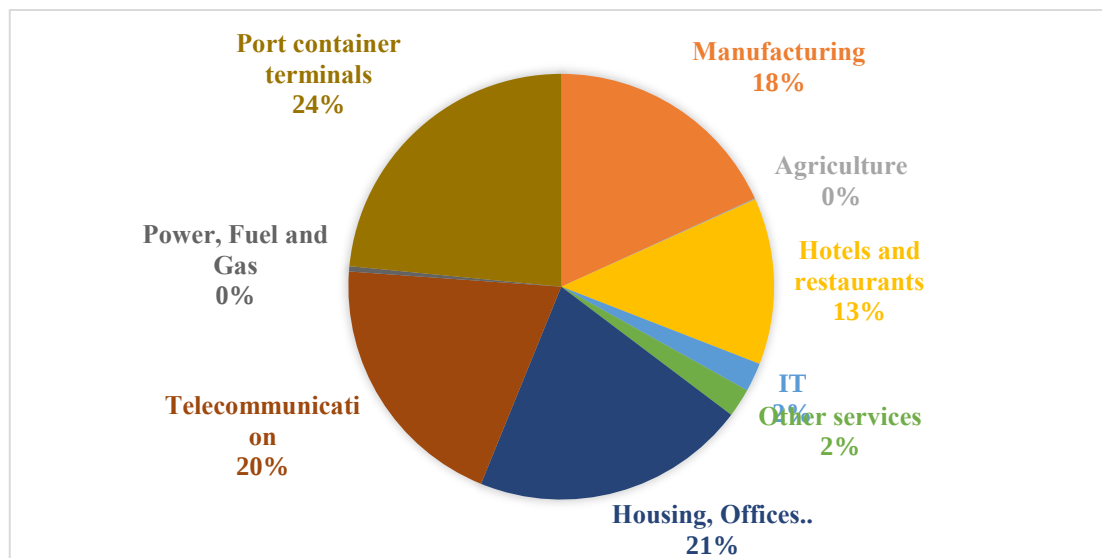
Ranks	Sector	2016	2017	2018	Cumulative Inflows 2016-2018	Sector-wise Cumulative percentage of FDI Inflow
1	Manufacturing	247.7	347.6	291.5	886.8	18.19%
2	Agriculture	1.9	1.4	0.5	3.8	0.08%
3	Hotels and restaurants	141	252.3	223	616.3	12.64%
4	IT	23	25	59	107	2.19%
5	Other services	47	40	19.2	106.2	2.18%
6	Housing, Offices..	79.5	540	397.8	1017.3	20.87%
7	Telecommunication	243.6	209	522.2	974.8	19.99%
8	Power, Fuel and Gas	14.8	1.1	3.7	19.6	0.40%
9	Port container terminals	1.6	292.2	850	1143.8	23.46%
Total		800.1	1708.6	2366.9	4875.6	100.00 %

Source: CBSL (<https://www.cbsl.gov.lk>).

Sri Lanka endeavours to provide relatively better infrastructural facilities to overseas investors to invest in several areas such as hotels and restaurants, textiles, and services. According to statistics from 2016 to 2018 top 5 sectors which succeeded in attracting more FDI were port container terminals, housing and offices, telecommunications, manufacturing and hotels. Port container terminals and housing and offices sectors which stand in the first and second positions, had a huge growth from 2016 to 2017 and 2018. Figure 3.23 shows the distribution of FDI in several sectors of Sri Lanka. Port container terminals sector share 24% of total FDI, followed by housing and offices with 21%, telecommunications with 20% and manufacturing with 18% stand in the third and fourth

position respectively. Agriculture and power, fuel and gas are the sectors which fail to attract more FDI in Sri Lanka.

Figure 40: Sector-wise Distribution of FDI in Sri Lanka



Source: Prepared by the Author based on CBSL, 2018

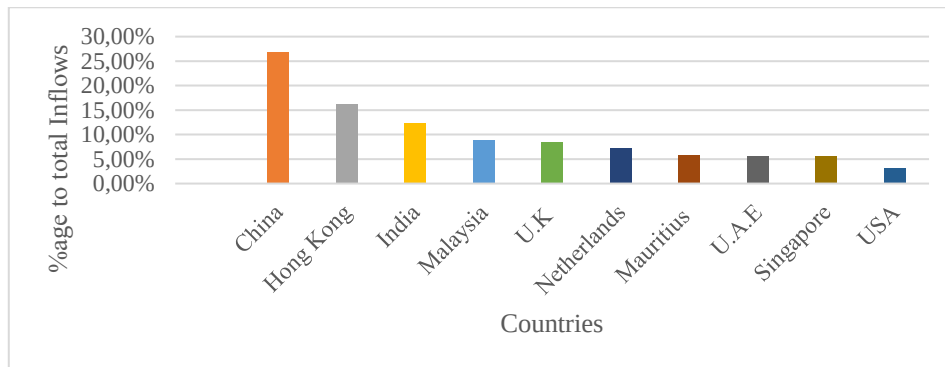
Table 44: Top Ten FDI Investing Countries in Sri Lanka (US\$ Million)

Ranks	Country	FDI Inflow (2009-2018)	%age to total Inflows
1	China	2783	26.75%
2	Hong Kong	1681	16.16%
3	India	1292	12.42%
4	Malaysia	917	8.81%
5	U.K	887	8.53%
6	Netherlands	745	7.16%
7	Mauritius	597	5.74%
8	U.A.E	589	5.66%
9	Singapore	588	5.65%
10	USA	325	3.12%
Total FDI Inflows from All Countries		10404	100.00%

Source: Board of Investment, Sri Lanka (<https://investsrilanka.com>)

With US\$ 1,088 million in FDI in 2018, China was the leading source of FDI in Sri Lanka. Followed by Hong Kong with US\$ 411 million, India with US\$ 341 million placed third, Malaysia with US\$ 88 million and the United Kingdom with US\$ 70 million stands in the fourth and fifth position respectively.

Figure 41: Top Ten Investing Countries in Sri Lanka



Source: Prepared by the Author based on Board of Investment of Sri Lanka, 2018

Figure 41 shows the major source of FDI in Sri Lanka from 2009 to 2018. According to data China comprised 26.75% of total FDI in Sri Lanka, followed by Hong Kong with 16.16% of total FDI. The participation of India was 12.42% which placed third among investing countries. Malaysia with 8.81%, the UK with 8.5%, and the Netherlands with 7.16% stand in the fourth, fifth and sixth-placed respectively.

Table 45: Comparative Studies of Sri Lanka and SAARC FDI

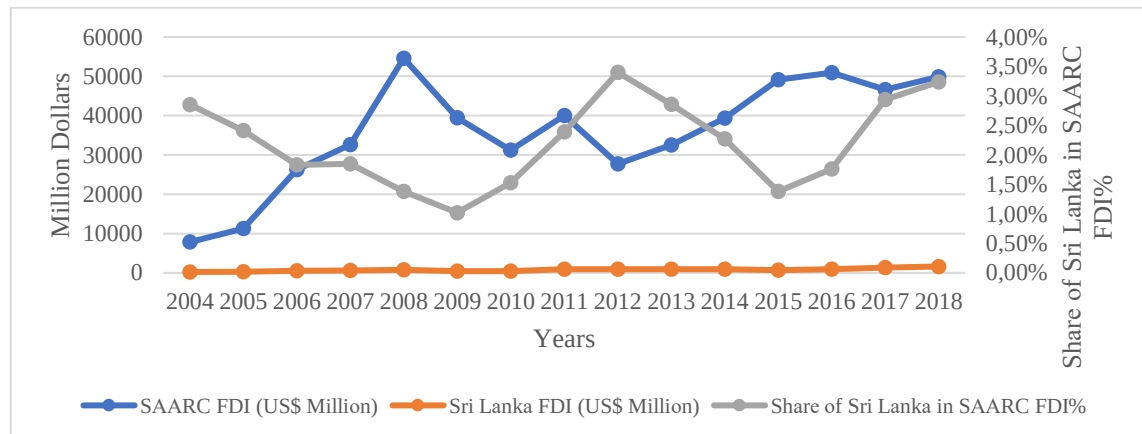
Years	SAARC FDI (US\$ Million)	Sri Lanka FDI (US\$ Million)	Share of Sri Lanka in SAARC FDI%
2004	7827.48	223.00	2.85%
2005	11292.92	272.00	2.41%
2006	26271.99	480.00	1.83%
2007	32576.86	603.40	1.85%
2008	54611.66	752.20	1.38%
2009	39482.89	404.00	1.02%
2010	31213.55	477.60	1.53%
2011	40054.46	955.91	2.39%
2012	27709.16	941.12	3.40%
2013	32555.72	932.55	2.86%
2014	39344.52	893.63	2.27%
2015	49171.28	679.66	1.38%
2016	50908.79	897.05	1.76%
2017	46623.71	1372	2.94%
2018	49889.21	1614	3.24%
Total	539534.2	11498.12	2.13%

Source:UNCTAD database (<https://unctadstat.unctad.org/wds/Table?ReportId=96740>)

Collected on April 11, 2022.

Sri Lanka consistently welcomes international investors to invest in its economy. They provide a variety of schemes and incentive packages for FDI. From 2004 to 2018, the share of Sri Lanka in total FDI of SAARC was only 2.13% which stands in the fourth position among the SAARC countries. From 2004 to 2018, the country has received an average FDI of around US\$ 766 million per year.

Figure 42: Comparison of Sri Lanka and SAARC FDI



Source: Prepared by the Author based on UNCTAD Database, 2021.

Figure 42 shows the FDI comparison in Sri Lanka and SAARC from the year 2004 to 2018. In 2004, Sri Lanka attracted US\$ 233 million in FDI inflow, which counts for 2.85% of total SAARC FDI. In the year 2006, the status of FDI inflows nearly doubled and reached US\$ 480 million, while SAARC FDI also grew, resulting in a decrease in the share of Sri Lanka in SAARC FDI. In 2008, FDI inflow reached US \$752.2 Million, which was only 1.38% of SAARC FDI. This share further increased to 2.39% in the year 2011, when the FDI inflow was US\$ 955.91 Million. Sri Lanka's FDI trends were better than some of the other SAARC members. In 2018 FDI inflow in Sri Lanka was US\$ 1614 million, which comprised 3.24% of total FDI in S

CHAPTER THREE

3. LITERATURE REVIEW

A systematic review of the literature is critical for research since it offers relatively comprehensive knowledge on the subject and improves understanding of the research study's objectives.

Several empirical research on the variables that influence FDI has been done. In order to examine the empirical connection between FDI and a range of economic, social, and political factors, most research use numerous theories or hypotheses. A large percentage of these empirical research uses country-level cross-sectional or panel data models to examine the effect of different factors that may affect FDI. In this regard, the study uses two different headings to conduct the literature review. First, it tackles the Empirical Studies of FDI Determinants in general. Second, it focuses of empirical studies of FDI Determinants in South Asia and SAARC.

3.1. Empirical Studies of FDI Determinants in Other Countries and Regions

FDI is regarded as a crucial element in the economic progress of nations within the framework of market economies. FDI is believed to play a significant role in the economic advancement of countries and in enhancing their overall welfare levels. This situation has led to an intense analyses of the factors that encourage/limit the attracting of FDI to national economies.

Yasmin *et al.* (2003) investigated the factors influencing FDI inflows in 15 developing countries utilizing both fixed effects and random effects models. Urbanization, GDP per capita, salaries, inflation, the current account, and the standard of living all have a significant influence on FDI inflows, according to statistics.

Çeviş and Çamur (2007) used panel data analysis to study the economic effects of FDI in 17 developing countries and transition economies between 1989 and 2006. According to the study's findings, the main economic factors that influence FDI in development and exports are the following: inflation rate, trade openness, growth rate, and interest rate.

Busse and Hefeker (2007) conducted research into the interplay among political risk, institutions, and FDI inflows across 83 developing nations spanning from 1984 to 2003. Their results

indicated that various factors, including law enforcement, governmental stability, corruption levels, both internal and external conflicts, ethnic tensions, democratic governance, and bureaucratic effectiveness, all exert considerable influence on the volume of FDI entering these countries.

Khan and Nawaz (2010) analyzed the effects of export volume, GDP growth rate, population size, price index, and import tariffs on FDI inflows in Pakistan. The findings suggest that export volume is the primary factor influencing FDI inflows in the country.

Özcan and Arı (2010) used dynamic panel data analysis to investigate FDI determinants in 29 OECD countries. The study revealed that FDI was positively influenced by GDP growth rate, infrastructure development, and inflation. Interestingly, contrary to theoretical expectations, trade openness and current account balance were found to have a negative association with FDI.

Azam and Lukman (2010) explored the economic drivers behind FDI inflows into Pakistan, India, and Indonesia through Log-linear regression modeling spanning from 1971 to 2005. Their analysis revealed that internal investment, external debt, market size, trade openness, and infrastructure emerged as pivotal economic influences of FDI. Moreover, their study highlighted that India's economic determinants closely resembled those of Pakistan, with the exception of two variables (trade openness and government consumption). Conversely, Indonesia's economic determinants showed discrepancies compared to those of Pakistan and India.

Narayanamurthy and Vijayakumar (2010) used a panel data analysis to investigate the determinants of FDI inflows in the BRICS nations. The findings indicate that several key factors significantly influence FDI inflows in these countries, including market size, quality of infrastructure, labor costs, currency valuation, and levels of gross capital formation. In contrast, variables such as economic stability, growth prospects, and trade openness appear to have a limited effect on attracting FDI in this context. This suggests that while these latter factors are typically regarded as important in FDI literature, their influence may be overshadowed by more direct indicators of attractive investment in the BRICS economies.

According to Mohamed and Sidiropoulos (2010), the primary factors influencing FDI inflows in MENA countries include the size of the host economy, abundance of natural resources, the scale of government involvement, and institutional factors.

Jadhav (2012) delved into the influence of economic, institutional, and political factors in attracting FDI across the five BRICS countries, employing panel data analysis spanning from 2000 to 2009. The results underscore that market size, as gauged by real GDP, significantly determines FDI, indicating that investment in BRICS nations is predominantly motivated by market-seeking motives. Moreover, aspects such as trade openness, natural resource availability, the rule of law, and

voice and accountability all exhibit statistical significance. Additionally, both market size and trade openness coefficients emerge as positive, suggesting a favorable impact on overall FDI inflows. However, the presence of natural resources negatively affects total inward FDI.

Khachoo and Khan (2012) examined the key factors driving FDI inflows into developing countries through the use of panel data analysis. The research findings highlighted that market size, infrastructure quality, total reserves, and labor costs play pivotal roles as the main determinants impacting FDI inflows into these economies. These factors collectively shape the investment landscape, making certain regions more attractive for foreign investors due to their economic scale, resource availability, and cost-efficiency.

Jayasekara (2014) examined FDI determinants in Sri Lanka using a (FM-OLS) regression model throughout 1975-2012. The findings indicated that the labor force, infrastructure quality, inflation rate, GDP growth rate, lending interest rate, exchange rate, and corporate income tax were significant factors determining FDI inflows in Sri Lanka

Haslia *et al.* (2015) employed a fixed-effects model to investigate the factors influencing FDI inflows across Asia from 1993 to 2013. The results highlight that trade openness, lending rates, and money supply positively affect FDI per capita, while high levels of debt, unemployment rates, and environmental pollution negatively impact FDI inflows.

According to Artan and Hayaloğlu (2015), in OECD nations, the significant factors influencing FDI are more tied to institutional aspects like governmental stability, socio-economic conditions, investment patterns, internal conflicts, military involvement in politics, religious and ethnic tensions, as well as bureaucratic efficiency, rather than solely economic parameters.

Çiftçi and Yıldız (2015) investigated the economic determinants of FDI within the Turkish economy. The findings indicated that several factors positively influence FDI inflows, including GDP, the real exchange rate, and the level of financial development. Conversely, it was observed that a trade deficit and high external debt exert a negative impact on FDI. This suggests that while certain economic indicators foster a conducive environment for attracting foreign investment, others can create barriers that deter potential investors.

Gupta and Singh (2016) examined the factors driving FDI inflows in BRICS countries from 1983 to 2013 by employing both fixed-effects and random-effects models within a panel data framework. The results reveal that FDI inflows in these nations are significantly affected by several economic indicators, including the industrial production index, unemployment and inflation rates, trade openness, and real effective exchange rates. These variables collectively shape the investment landscape in BRICS countries, suggesting that robust industrial output, favorable trade policies,

stable currency values, and controlled inflation are key to attracting foreign investors. This research highlights the importance of economic stability and openness in fostering FDI growth within emerging markets.

Bayar and Öztürk (2016) conducted a comprehensive review of the literature on the determinants of FDI inflows. Their review highlights that factors like market size, inflation, trade openness, human capital, economic growth, infrastructure, political stability, institutional quality, taxes, and population play significant roles in attracting FDI.

Aziz and Mishra (2016) applied Arellano–Bover/Blundell–Bond linear dynamic panel data estimation to investigate the factors influencing the geographical distribution of FDI across 16 Arab nations. Their study found that market size, preferential trade agreements, and trade openness, and financial development positively affect FDI inflows into Arab countries. FDI in Arab countries seems to be resource-seeking.

Rodriguez-pose (2017) investigated FDI determinants in 22 sub-Saharan Africa countries using panel data analysis. The results suggest that political stability, governmental effectiveness, decreased corruption, citizen participation and accountability, and adherence to legal principles are not just more influential factors in attracting FDI compared to local market size but also have a lasting influence on the African countries' capacity to draw FDI.

Wani and Tahiri (2017) used the OLS model for 2005 to 2015 to investigate FDI determinants in Afghanistan. The findings indicate that factors such as total debt service, overall external debt, gross domestic product (GDP), and gross fixed capital formation all positively contribute to economic growth and attract higher FDI inflows. In contrast, inflation was found to have a negative impact on FDI, suggesting that while capital investment and economic expansion drive foreign investment, high inflation can deter it by creating an unstable economic environment. This highlights the importance of managing inflation to foster a favorable climate for sustained foreign investment and growth.

Saini and Singhania (2018) used both static and dynamic panel data analysis methods to examine what drives FDI in 20 developed and developing countries. The findings show that in developed countries, FDI is largely influenced by policy-related factors, including GDP growth, openness to trade, and measures of economic freedom. On the other hand, in developing countries, FDI is more closely linked to economic factors, such as gross fixed capital formation (investment in physical assets), trade openness, and efficiency indicators. This suggests that while policy stability attracts FDI in wealthier nations, investment in infrastructure and efficiency improvements are key to attracting FDI in developing economies.

Paul and Jadhav (2020) examined the institutional determinants of FDI inflows in emerging markets. The findings revealed that several key factors influence FDI in developing countries. Among these, the quality of infrastructure and trade costs—encompassing both tariffs and non-tariff barriers were identified as critical determinants. Additionally, institutional factors play a significant role, with aspects such as the rule of law, political stability, regulatory quality, and control of corruption being pivotal in shaping the investment climate. This underscores the importance of robust institutional frameworks in attracting FDI to emerging markets. These factors together play a crucial role in shaping the investment landscape, as reliable infrastructure and lower trade barriers make these markets more accessible, while strong institutions and political stability build investor confidence.

Jahan and Paul (2021) utilized a fixed-effects model to analyze data from 1995 to 2019, focusing on the factors that influence FDI inflows in the Next 11 countries: Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, the Philippines, Turkey, South Korea, and Vietnam. The findings suggest that key predictors of FDI inflows in these nations include economic stability, availability of natural resources, trade openness, and market size. However, infrastructure appears to play a less significant role in attracting foreign investment compared to these other factors. This indicates that while solid economic fundamentals and resource access are crucial for drawing FDI, the state of infrastructure may not be as critical in these specific countries.

Table 46: Empirical Studies of FDI Determinants in Other Countries and Regions

Determinants Of FDI	Observed Influence on FDI in Various Research		
	Positive effects	Negative effects	Insignificant
The Market Size	Lunn (1980) Schneider & Frey (1985) Dunning (1980) Root & Ahmed (1979) Kravis & Lipsey (1982) Nigh (1985) Culem (1988) Bandera & White(1968) Swedenborg (1979) Sader (1993) Pistoresi (2000) Papanastassiou&Pearce(1990) Wheeler & Mody (1992) Tsai (1994) Shamsuddin (1994) Billington (1999) Schmitz & Bieri (1975) Azam & Lukman (2010) Narayanamurthy & Vijayakumar (2010) Jadhav (2012) Khachoo & Khan (2012) Bayar & Öztürk (2016) Aziz & Mishra (2016)		
Labor Cost	Swedenborg (1979) Caves (1974) Wheeler & Mody (1992) Nankani (1979) Narayanamurthy & Vijayakumar (2010) Khachoo & Khan (2012)	Schneider&Frey(1985) Flamm (1984) Goldsbrough (1979) Saunders (1982) Shamsuddin (1994) Pistoresi (2000) Culem (1988)	Gupta (1983) Rolfé and White (1991) Lucas (1990) Sader (1993) Owen (1982) Tsai (1994)
Trade Barrier	Schmitz & Bieri (1972) Lunn (1980) Paul & Jadhav (2020)	Culem (1988)	Beurdeau (1986) Blonigen&Feenstra(1996)
Growth Rate	Bandera & White (1968) Lunn (1980) Schneider & Frey (1985) Culem (1988) Billington (1999) Çeviş & Çamur (2007) Khan & Nawaz (2010) Özcan & Arı (2010)		Nigh (1988) Tsai (1994) Narayanamurthy &Vijayakumar (2010)

Table 46 (continue)

Determinants Of FDI	Observed Influence on FDI in Various Research		
	Positive effects	Negative effects	Insignificant
Trade Openness	Kravis & Lipsey (1982) Culem (1988) Edwards (1990) Pistoresi (2000) Çeviř & Çamur (2007) Azam & Lukman (2010) Jadhav (2012) Haslia <i>et al.</i> (2015) Gupta & Singh (2016) Bayar & Öztürk (2016) Aziz & Mishra (2016) Saini & Singhanian (2018)	Özcan & Arı (2010)	Schmitz & Bieri (1972) Wheeler & Mody (1992) Narayanamurthy & Vijayakumar (2010)
Trade Deficit	Culem (1988) Tsai (1994) Shamsuddin (1994)	Torissi (1985) Schneider & Frey (1985) Hein (1992) Dollar (1992) Lucas (1993) Pistoresi (2000) Çiftci & Yıldız (2015)	
Exchange Rate	Edwards (1990) Jayasekara (2014) Çiftci & Yıldız (2015) Gupta & Singh (2016)	Caves (1988) Contractor (1990) Froot & Stein (1991) Blonigen (1995) Blonigen & Feenstra (1996)	Calderon-Rossell (1985) Sader (1991) Blonigen (1997) Tuman and Emmert (1999)
Tax	Swenson (1994) Jayasekara (2014)	Hartman (1984) Grubert and Mutti (1991) Hines & Rice (1994) Loree & Guisinger (1995) Guisinger (1995) Cassou (1997) Kemsley (1998) Barrel and Pain (1998) Billington (1999) Khan & Nawaz (2010) Bayar & Öztürk (2016)	Wheeler & Mody (1992) Jackson & Markowski (1995) Yulin & Reed (1995) Porcano & Price (1996)
Infrastructural Facilities	Özcan & Arı (2010) Azam & Lukman (2010) Narayanamurthy & Vijayakumar (2010), Mohamed & Sidiropoulos (2010) Khachoo & Khan (2012) Jayasekara (2014) Bayar & Öztürk (2016)		

Table 46 (continue)

Determinants Of FDI	Observed Influence on FDI in Various Research		
	Positive effects	Negative effects	Insignificant
Inflation	Vasmin <i>et al.</i> (2003) Çeviř & Çamur (2007) Özcan & Arı (2010) Jayasekara (2014) Gupta & Singh (2016) Bayar & Öztürk (2016)	Wani & Tahiri (2017)	
Human Capital	Khan & Nawaz (2010) Bayar & Öztürk (2016)		
Political Stability	Bayar & Öztürk (2016) Rodriguez-pose (2017) Paul & Jadhav (2020)		
Corruption		Busse & Hefeker (2007) Rodriguez-pose (2017) Paul & Jadhav (2020)	
Good Governance	Busse & Hefeker (2007) Artan & Hayaloğlu (2015) Rodriguez-pose (2017)		
Natural Resource	Mohamed & Sidiropoulos (2010)	Jadhav (2012)	
Rule Of Law	Busse & Hefeker (2007) Jadhav (2012) Artan & Hayaloğlu (2015) Rodriguez-pose (2017) Paul & Jadhav (2020)		

3.2. Empirical Studies of FDI Determinants in South Asia and SAARC

Vogiatzoglou (2007) employed a dynamic panel-gravity model to investigate the factors driving inbound FDI in South and East Asia. The findings highlighted the importance of vertical specialization, trade, and elements of international integration as central locational factors that attract foreign investment to these regions. Furthermore, certain gravity-related variables, such as geographical proximity and economic size, emerged as significant determinants of FDI flows. Interestingly, some traditional factors commonly thought to influence FDI showed minimal or statistically insignificant effects in these regions, suggesting that non-traditional factors may be more influential in shaping investment patterns in South and East Asia. This underscores the unique investment dynamics at play, where global supply chain linkages and regional trade integration appear to outweigh other conventional considerations.

Vadlamannati *et al.* (2009) delved into the macroeconomic policies, political dynamics, institutional frameworks, and socio-economic factors affecting obstacles to FDI across 17 Southeast Asian nations using cross-sectional time-series data spanning from 1996 to 2005. The findings unveiled that all identified sets of barriers exerted a substantial negative influence on per capita FDI while fostering volatility in FDI influxes.

Srinivasan (2011) scrutinized the determinants of FDI within selected SAARC Nations from 1970 to 2007, employing both Fixed Effects and Random Effects models. The study highlighted market size, infrastructure, trade openness, GDP per capita, inflation, risk perception, and uncertainty as pivotal factors shaping FDI within the SAARC region. Moreover, several other variables like human capital, real exchange rate, industrialization level, domestic investment, and terms of trade were found to lack significance, indicating their negligible impact on attracting FDI in SAARC nations.

Bhavan *et al.* (2011) explored the Determinants and Growth Effect of FDI in four South Asian countries from 1995 to 2008. Their analysis underscored the significance of both attracting and pushing factors, alongside cyclical influences, in determining FDI trends in these nations. Furthermore, FDI in South Asian countries demonstrated substantial volumes and exhibited a positive correlation with the growth rate.

Azam *et al.* (2011) investigated how institutional factors and macroeconomic policies influenced FDI inflows across 7 South Asian countries spanning from 1996 to 2007. Their findings underscored the crucial role of robust institutional quality in attracting FDI, while weak macroeconomic policy frameworks were associated with diminished FDI attraction. Particularly, the combination of strong institutional quality and deficient macroeconomic policies had an adverse effect on FDI inflows.

Pradhan and Saha (2011) applied a panel VAR model to examine the determinants of FDI in seven SAARC countries from 1980 to 2010. The results indicate that FDI inflows are significantly influenced by economic growth, trade balance, exchange rate, labor population, inflation, and current account balance. Notably, the impact of economic growth and the exchange rate on FDI inflows is bidirectional, meaning these factors influence FDI and are, in turn, influenced by it. However, the effects of other factors, such as trade balance and inflation, are unidirectional, solely affecting FDI inflows without reciprocal feedback. These findings highlight the complex interactions between economic conditions and FDI, with certain factors driving investment while others maintain a one-way influence.

Sahoo (2012) delved into the factors shaping FDI patterns in South Asian nations, with a particular focus on infrastructure development, trade liberalization, and economic reforms. The

study's findings reveal that key drivers of FDI in South Asia include market size, labor force availability, investment in infrastructure, trade openness, and economic restructuring efforts. Additionally, panel causality analysis highlights a strong connection between infrastructure development and FDI inflows, suggesting that improvements in infrastructure not only attract FDI but may also create a favorable cycle that further encourages investment. These factors together underscore the importance of a supportive economic environment and targeted infrastructure investments in boosting FDI across South Asian countries.

Azam *et al.* (2012) employed Autoregressive Distributed Lags (ARDL) to explore how political risk and uncertainty in macroeconomic policies affect FDI in South Asia. The analysis shows that political risk and uncertain macroeconomic policies reduce FDI inflows over time. Trade openness boosts FDI in the short term but has a negative effect in the long term. Market size, however, consistently attracts FDI in both the short and long run, highlighting its key role in drawing investment to South Asia.

Hoang (2012) examined factors influencing FDI inflows in Southeast Asian countries between 1991 and 2009. The findings indicate that key determinants positively affecting FDI include market size, human capital, trade openness, high-quality infrastructure, and labor productivity. Conversely, low-cost labor does not attract FDI to the region, suggesting that investors prioritize skilled labor and robust infrastructure over merely inexpensive labor.

Teulon (2013) analyzed the factors affecting FDI in six SAARC countries from 1998 to 2010, utilizing panel data methods. The results show that trade openness, economic growth rate, exchange rate, and economic instability all significantly influence FDI inflows over the long term.

Quazi (2014) assessed how corruption influences FDI inflows in East and South Asia by applying the Generalized Least Squares (GLS) method on panel data from 1995 to 2011. The findings demonstrate a strong and consistently negative impact of corruption on FDI, providing robust support for the "grabbing hand" theory. This theory suggests that corruption acts as a deterrent to foreign investment by increasing operational costs and creating an unpredictable business environment. The study thus underscores the importance of transparency and anti-corruption measures in fostering an investment-friendly climate in these regions.

Shah and Afridi (2015) explored the role of good governance in attracting FDI inflows to SAARC countries from 2006 to 2014, employing a panel data random-effects model. The findings indicate that political stability and regulatory quality significantly and positively influence inward FDI, highlighting these as key factors in making the region more appealing to investors. Conversely, high levels of corruption deter global corporations from investing in SAARC countries, underscoring the need for transparency and effective governance to boost foreign investment.

Azhar *et al.* (2015) utilized the Generalized Method of Moments (GMM) technique to investigate the effect of exchange rate volatility on FDI in three SAARC countries, using time-series data spanning from 1981 to 2013. The analysis revealed a negative relationship between exchange rate volatility and FDI inflows, suggesting that fluctuations in exchange rates discourage foreign investment in the selected SAARC nations by creating uncertainty in returns for foreign investors.

Adhikary (2017) employed fully modified ordinary least squares (FMOLS) and two-stage least squares (2SLS) estimation techniques to examine the macroeconomic factors affecting FDI in the five leading South Asian economies. The findings highlight that market size and human capital are the main drivers of FDI inflows in South Asia, with the exception of Nepal, where these factors are less influential. Other variables—such as domestic investment levels, infrastructure quality, lending rates, inflation, exchange rates, financial stability, and stock market turnover—were found to impact FDI to differing extents. This suggests that while large markets and a skilled workforce are key to attracting foreign investors, additional economic conditions and financial stability also play a significant role in shaping FDI patterns across the region.

Bimal (2017) scrutinized the economic, institutional, and political drivers of FDI in South Asian countries through a dynamic panel data model spanning from 1999 to 2013. The study revealed that countries boasting larger market sizes, higher existing FDI levels, stable macroeconomic environments, open trading regimes, and lower country risk in terms of financial, economic, institutional, and political stability tend to attract more FDI.

Irfan and Arshad Khan (2017) examined the institutional and economic factors influencing FDI in SAARC, Central Asian, and ASEAN countries from 2002 to 2014. The findings indicated that in SAARC countries, factors such as Real GDP, domestic investment, and the economic freedom index had a positive impact on FDI inflows, while the governance index and labor force exerted negative effects. In Central Asia, Real GDP and domestic investment were positively associated with FDI, along with the governance index; however, the economic freedom index had a negative and insignificant effect. In contrast, the ASEAN region demonstrated that, in addition to GDP, several other factors positively influenced FDI inflows, highlighting the critical role of institutional determinants in attracting foreign investment, especially when compared to SAARC and Central Asian countries. This suggests that robust institutions and favorable economic conditions are essential for fostering a conducive environment for FDI.

Ali (2017) investigated the interplay between governance, economic performance, and FDI inflows across 70 SAARC and ASEAN countries. Their findings suggested that indicators such as human development, global competitiveness, and a favorable business environment exerted positive effects on FDI inflows. Furthermore, countries with high per capita income, substantial domestic savings, and other strong domestic economic indicators are more likely to attract greater FDI inflows.

Additionally, nations that demonstrate effective governance—characterized by strong government effectiveness, well-protected property rights, and effective corruption control—tend to receive higher levels of foreign investment. This emphasizes the importance of both economic health and governance quality in creating a favorable environment for attracting FDI.

Rashid *et al.* (2017) utilized a panel data fixed-effects model to investigate the determinants of FDI in the 15 most competitive countries in the Asia Pacific region between 2000 and 2013. The analysis revealed that several factors significantly influence FDI inflows. Notably, trade openness, gross domestic product (GDP), and political stability were found to have a positive effect on attracting FDI. Conversely, the inflation rate was identified as a negative determinant, suggesting that higher inflation may deter foreign investment. These findings highlight the importance of stable economic conditions and open trade policies in fostering a conducive environment for FDI in the region. Political stability emerged as the most influential factor in the presence of other variables, emphasizing its pivotal role in shaping FDI trends.

Kafait (2018) investigated the determinants of FDI within the services sector of South Asian and Southeast Asian nations using static panel data analysis. The results indicated that several factors are positively and significantly correlated with FDI in this sector, including the exchange rate, market size, quality of infrastructure, human capital, and trade openness. These variables suggest that a robust economic environment, characterized by favorable exchange rates and substantial market opportunities, is conducive to attracting foreign investment in services. Conversely, inflation was found to have an insignificant and negative relationship with services-related FDI, implying that rising inflation may not significantly deter investment in this sector, but it does not provide a positive incentive for foreign investors. These insights underscore the importance of economic stability and structural quality in fostering FDI in the services industry. This indicates that while a stable economic environment and robust market conditions are conducive to attracting foreign investment in services, high inflation does not appear to facilitate investment in this sector.

Gunawardhana and Damayanthi (2019) investigated seven SAARC countries using time-series data from 1980 to 2019, revealing that nations with higher GDP growth rates may effectively attract FDI. Conversely, FDI significantly impacts a country's economic development. Furthermore, they demonstrated that the current account balance, financial deepening, and trade openness play crucial roles in affecting FDI flows to host nations.

Rai and Sharma (2020) examined the Causal Nexus of FDI Inflows and Their Determinants in six SAARC nations. Their results depicted a long-run, short-run, and joint causal relationship between infrastructural development, political stability, economic openness, market size, corporation taxation, and FDI inflows.

Adeel-Farooq (2020) employed a panel data fixed-effect model and robust least square (RLS) from 2002 to 2017 to evaluate the impact of governance on FDI inflows in selected SAARC countries. The findings revealed that improving governance is highly advantageous for these nations in attracting more FDI.

Tahir and Alam (2020) employed panel data analysis to investigate the relationship between the performance of the banking sector and FDI inflows in five SAARC countries. The results revealed a significant negative correlation between banking sector performance and FDI inflows, suggesting that weaker banking performance may deter foreign investment. Conversely, inflation and trade openness were found to have a significant positive association with FDI inflows, indicating that higher levels of trade liberalization and manageable inflation rates can attract FDI to the region.

Beloucif *et al.* (2020) employed both random effects and fixed effects models using panel data to analyze the determinants of FDI in South and Southeast Asia from 1996 to 2016. This methodological approach allowed for a comprehensive examination of the factors influencing FDI in these regions over a two-decade span, enabling the researchers to identify both time-invariant and time-varying influences on FDI inflows. The results suggested that labor productivity, market size, and host nation infrastructure significantly impact FDI inflows to both areas. For foreign investors, trade openness, inflation rates, availability of natural resources, and unemployment rates are key factors in South Asia. In contrast, exchange rates, corruption control, and political stability are more significant for investors in Southeast Asia.

Ayomitunde *et al.* (2020) explored the factors influencing FDI inflows in five major countries of South Asia by utilizing panel data analysis from 1990 to 2017. The findings revealed that market size and GDP per capita emerge as the key determinants of FDI inflows in this region. Specifically, larger market size indicates greater potential for sales and consumer demand, making these countries more attractive to foreign investors. Similarly, higher GDP per capita reflects a wealthier population, which can enhance purchasing power and create favorable conditions for investment. Overall, the study underscores the importance of economic indicators, such as market size and income levels, in attracting foreign investment to South Asia, suggesting that policymakers should focus on strategies that enhance these factors to boost FDI inflows.

Zeb *et al.* (2021) used Pooled OLS estimates to examine socio-economic and institutional determinants of FDI in South Asia countries from 2008 to 2016. The outcomes indicated that economic and institutional determinants are important in attracting FDI, but social determinants have no major impact. This research does not discover an intervening role for social and institutional factors.

According to the literature review numerous of studies have looked at the factors that influence FDI in SAARC countries, but most of the studies focused on economic determinants of FDI such as: Market size, GDP growth rate, trade openness, infrastructural development, labor costs, and natural resources etc. The difference of this study is from literature review: In this study both economic and institutional determinants of FDI will be included in the analysis, as the literature review shows that most studies focus on economic determinants. In addition, according to the literature review, not all SAARC countries participated in the analysis in studies. But in this study, all SAARC countries (India, Maldives, Pakistan, Sri Lanka, Bhutan, Nepal, Bangladesh and Afghanistan) will participate in the analysis. Comparative analysis will be made between SAARC countries in attracting FDIs. A theoretical analysis of FDI from a sectoral perspective will also be made in the study. This study can help SAARC countries to determine the real impact of FDI causing different macroeconomic factors. Moreover, accordingly, these countries will adjust their positions on security vulnerabilities and take advantage of newly identified opportunities and strengths. By examining the interplay between economic and institutional factors, researchers can gain insight into the drivers and barriers of FDI inflows and provide valuable recommendations for policymakers and investors seeking to enhance FDI in these countries. In conclusion, the economic and institutional determinants of FDI in SAARC countries present a complex and evolving landscape. This literature review highlights the significance of market size, GDP growth, trade openness, infrastructure, institutional quality, and institutional factors in attracting FDI. Addressing institutional challenges and implementing targeted policy reforms are crucial for leveraging the potential of FDI to drive economic development in SAARC countries.

Table 47: Empirical Studies of FDI Determinants in South Asia and SAARC

Determinants Of FDI	Observed Influence on FDI in Various Research		
	Positive effects	Negative effects	Insignificant
The Market Size	Srinivasan (2011) Sahoo (2012) Azam <i>et al.</i> (2012) Hoang (2012) Teulon (2013) Adhikary (2017) Bimal (2017) Rashid <i>et al.</i> (2017) Kafait (2018) Rai & Sharma (2020) Beloucif <i>et al.</i> (2020) Ayomitunde <i>et al.</i> (2020)		
GROWTH RATE	Bhavan <i>et al.</i> (2011) Pradhan & Saha (2011) Teulon (2013) Gunawardhana and Damayanthi (2019)		
TRADE OPENNESS	Srinivasan (2011) Sahoo (2012) Azam <i>et al.</i> (2012) Hoang (2012) Bimal (2017) Rashid <i>et al.</i> (2017) Kafait (2018) Gunawardhana and Damayanthi (2019) Rai & Sharma (2020) Tahir & Alam (2020) Beloucif <i>et al.</i> (2020)		
EXCHANGE RATE	Pradhan & Saha (2011) Teulon (2013) Kafait (2018) Beloucif <i>et al.</i> (2020)		Srinivasan (2011) Azhar <i>et al.</i> (2015)
TAX	Rai & Sharma (2020)		
INFRASTRUCTURAL FACILITIES	Srinivasan (2011) Azam <i>et al.</i> (2011) Sahoo (2012) Adhikary (2017) Kafait (2018) Rai & Sharma (2020) Beloucif <i>et al.</i> (2020) Paul & Jadhav (2020)		

Table 47 (continue)

Determinants Of FDI	Observed Influence on FDI in Various Research		
	Positive effects	Negative effects	Insignificant
INFLATION	Srinivasan (2011) Pradhan & Saha (2011) Adhikary (2017) Tahir & Alam (2020) Beloucif <i>et al.</i> (2020)	Rashid et al. (2017) Kafait (2018)	Kafait (2018)
HUMAN CAPITAL	Sahoo (2012) Hoang (2012) Ali (2017) Adhikary (2017) Kafait (2018)		Srinivasan (2011)
POLITICAL STABILITY	Azam <i>et al.</i> (2012) Shah & Afridi (2015) Bimal (2017) Ali (2017) Rashid <i>et al.</i> (2017) Rai & Sharma (2020) Beloucif <i>et al.</i> (2020) Zeb et al. (2021)		
TRADE DEFICIT	Culem (1988) Tsai (1994) Shamsuddin (1994)	Torissi (1985) Schneider&Frey(1985) Hein (1992) Dollar (1992) Lucas (1993) Pistoresi (2000) Çiftci & Yıldız (2015)	
CORRUPTION		Quazi (2014) Shah & Afridi (2015) Ali (2017) Beloucif et al. (2020)	
GOOD GOVERNANCE	Shah & Afridi (2015) Ali (2017) Adeel-Farooq (2020)		
NATURAL RESOURCE	Beloucif et al. (2020)		
RULE OF LAW	Rodriguez-pose (2017)		

CHAPTER FOUR

4. DATA SET, RESEARCH METHODOLOGY AND EMPIRICAL RESULTS

4.1. Data Set

This research delves into the economic and institutional factors influencing FDI inflows in SAARC nations. Table 48 offers a comprehensive list of the SAARC countries covered in this study.

Table 48: List of SAARC Countries

No.	Countries
1	Afghanistan
2	Bangladesh
3	Bhutan
4	India
5	Maldives
6	Nepal
7	Pakistan
8	Sri Lanka

The variables in this study cover the years 2004 to 2018, and yearly data were used for the econometric analysis.

Table 49 presents the variables used in this study with information about the proxies for the relevant variables and the sources from which the data were obtained

Table 49: Descriptions of the Variables

Variables	Proxy	Expected sign	Data source
Dependent Variable			
Foreign Direct Investment (FDI)	FDI Inflows		UNCTADstat database
Independent Variables			
Macroeconomic Stability (MACROSTB)	Annual Inflation Rate	+	World Bank, World Development Indicator
Human Capital (HCPT)	Secondary School Enrolment Ratio ¹	+	World Bank, World Development Indicator
Infrastructure (INFRS)	Telephone Lines and Cellular Subscribers per 100 Populations	+	World Bank, World Development Indicator
Trade Openness (TOPENNSS)	Trade (% of GDP)	+	World Bank, World Development Indicator, Tradingeconomics.com
Market Size (MARSIZE)	Real GDP (constant 2015 US\$)	+	World Bank, World Development Indicator
Labor Productivity (LBPROD)	GDP Per Person Employed (GDP constant 2017 US\$)	+	International Labour Organization (ILO), World Development Indicator
Natural Resource (NATRS)	Fuel Exports (% of Merchandise Exports) ²	+	World Bank, World Development Indicator.
Political Stability (POLSTB)	Political Stability and Absence of Violence Index	+	World Bank, Worldwide Governance Indicators.
Rule Of Law	Rule Of Law Index	+	World Bank, Worldwide Governance Indicators.
Control of Corruption (COC)	Control of Corruption Index	+	World Bank, Worldwide Governance Indicators.

4.1.1. Description of the Variables

¹ The data on secondary school enrollment in the Maldives for some years was taken from the Ministry of Education of the Republic of Maldives.

² For Afghanistan, Bhutan, and Nepal the fuel exports percentages as merchandise exports for some years were calculated by the author based on the World Bank data.

4.1.1.1. Dependent Variable

4.1.1.1.1. FDI

SAARC is a regional organization comprised of eight poor and developing nations from across the globe. The main goal was to build a solid regional integration to improve the status of FDI and increase the proportion of commerce between member nations and non-member countries. The advantages of such integration include increased foreign investment availability and improved macroeconomic metrics such as GDP, Gross National Income, trade, and financial soundness. However, compared to the 1980s, FDI inflow patterns did not show any significant rise throughout the post-independence period until 1970. During these decades, nations were confined by strict economic policies, such as strict tariff and trade policies, import-substituting policies, strict laws and regulations, and so on.

In the 1980s, member nations began aggressively liberalizing trade and investment laws to enjoy the advantages of globalization. During this period, Sri Lanka moved to liberalize its economy in trade and investment activities, which resulted in a minor improvement in economic position. The primary necessity for liberalization in SAARC was in trade. Internal commerce now accounts for the majority of trade, rather than trade with non-member nations. However, capital flows in this area are modest (except in India), and many governments have restrictions on capital mobility. In the early 1990s, there was a surge in FDI inflows to these nations due to India's government initiating market-oriented reforms. These reforms encompassed trade liberalization and substantial alterations to FDI regulations, like eliminating the necessity for government endorsement for foreign investments, permitting foreign equity participation of up to 100 %, and the capacity to negotiate payment terms and conditions. Therefore, the SAARC nations have seen an enormous increase in FDI flow over the last multiple decades.

This study used natural log of FDI inflows of the SAARC countries as a dependent variable. The data were taken from UNCTADstat database for the period of 2004-2018.

4.1.1.2. Independent Variables

4.1.1.2.1. Macroeconomic Stability

A stable macroeconomic backdrop can reduce uncertainties in the investment environment and bolster economic confidence. Investors typically favor macroeconomic settings characterized by stability, implying lower levels of unpredictability. Metrics like inflation, interest rates, government fiscal balance, and exchange rates are used to gauge the macroeconomic stability of a host nation.

Investor trust and willingness to invest tend to rise in economies that have demonstrated fiscal discipline, financial stability, and adept management of inflation and interest rates without sudden fluctuations in exchange rates (Shah, 2010: 30). Following the precedent set by previous research (Vijayakumar *et al.*, 2010; Shah, 2010; Mhlanga *et al.*, 2010; Srinivasan, 2011; Hoang & Bui, 2015; Rahman & Bristy, 2015, *etc.*), this study utilized the inflation rate as a surrogate measure for macroeconomic stability. A higher inflation rate can erode the net worth of investments for foreign investors. The majority of prior studies (Sabir and Khan, 2018; Kafait, 2018; Rashid *et al.*, 2017; Asiedu, 2006, *etc.*) have shown a negative correlation between inflation rates and FDI. Therefore, the expected influence of macroeconomic stability on FDI is positive.

4.1.1.2.2. The Market Size

The market size of the host nation is typically seen as one of the most significant determinant variables, specifically for market-seeking FDI. The size of the host nation's market represents the economic climate and future demand, and it has a significant role in how international investors decide (Hoang & Bui, 2015). FDI inflows seem to be significantly influenced by the size of the market, which is normally measured by the GDP and GDP Per Capita. The greater market size offers opportunities for local sales, better profitability of local sales than export sales, and more diversified resources, which make local sourcing more feasible. Therefore, a greater market size encourages FDI inflow to a host country, since it offers foreign companies additional potential for sales and profits. Following the previous studies (Asiedu, 2006; Vijayakumar *et al.*, 2010; Srinivasan, 2011; Hoang & Bui, 2015; Rai & Sharma, 2020; Beloucif *et al.*, 2020; Ayomitunde *et al.*, 2020, *etc.*) the study used Real GDP (constant 2015 US\$) to measure the market size of the host country. Previous research (Srinivasan, 2011; Sahoo, 2012; Azam *et al.*, 2012; Hoang, 2012; Teulon, 2013; Adhikary, 2017; Bimal, 2017; Rashid *et al.*, 2017; Kafait, 2018; Rai & Sharma, 2020; Beloucif *et al.*, 2020; Ayomitunde *et al.*, 2020, *etc.*) showed the positive relationship between FDI inflows and market size of the host country. The expected impact of the market size of the host country on FDI inflows is positive.

4.1.1.2.3. Infrastructure

A critical determinant of FDI is the availability of high-quality infrastructure. This includes a well-developed network of roads, airports, and water supply systems, along with dependable power sources, and accessible telecommunications services such as telephones and internet connectivity. These infrastructure elements are essential for supporting efficient business operations, reducing logistical challenges, and ensuring consistent communication. High-quality infrastructure not only enhances the attractiveness of a location for foreign investors by improving operational efficiency but also signals a commitment to economic development and modernization, which are appealing to

potential investors (Srinivasan, 2011: 27). The quantity, accessibility, and caliber of supporting infrastructure are crucial for the efficient operation of affiliate manufacturing and trade operations of multinational corporations. Improved infrastructure may dramatically decrease overhead costs, which can favorably influence investors' location decisions and it gives international businesses a better business climate so they may increase their rate of return on investment (SHAH, 2014). Following the literature (Asiedu, 2006; Srinivasan, 2011; Shah, 2014, etc.), the study uses Telephone lines and Cellular subscribers per 100 populations as a proxy for infrastructure. The studies such as Srinivasan, 2011; Azam *et al.*, 2011; Sahoo, 2012; Hoang, 2012; Adhikary, 2017; Kafait, 2018; Rai and Sharma, 2020; Beloucif *et al.*, 2020; Paul and Jadhav, 2020 confirmed a positive relationship between infrastructure and FDI inflows.

4.1.1.2.4. Human Capital

Human capital is a measure of the labor force's quality in the host nation; a worker's productivity is often greater when they can manage machinery and new technologies effectively and quickly (Hoang & Bui, 2015: 217). It has been acknowledged that one of the key determinants of FDI inflows is the availability of labor force that are well-trained and equipped to work in modern business enterprises. Hoang and Bui (2015), and Asiedu (2006) used the ratio of skilled labor to numbers of employees as a proxy for human capital, and studies (Noorbakhsh *et al.*, 2001; Cleeve, 2008; Dutta *et al.*, 2017; Srinivasan, 2011, etc.) used the secondary school enrolment ratio to measure human capital. In this study gross secondary school enrolment will use as a proxy for human capital. Previous research (Noorbakhsh *et al.*, 2001; Asiedu, 2006; Cleeve, 2008; Hoang & Bui, 2015; etc.) identified a strong positive link between FDI inflows and human capital, suggesting human capital is a major factor in attracting FDI into the host nation. The expected impact of human capital on FDI inflows is positive.

4.1.1.2.5. Trade Openness

The degree of trade openness reflects how integrated a host nation is with the global economy, indicating its willingness to engage in international trade. A higher level of trade openness suggests that restrictions on goods produced within the host country have been gradually reduced. This environment allows foreign investors to leverage the comparative advantages offered by the host nation, which can enhance their exports both to their own country and to other markets worldwide.

Many economic theories propose that the returns on FDI are generally more favorable in countries that promote exports rather than those that prioritize imports. As such, trade openness often has a positive impact on attracting export-oriented FDI into a country. This relationship highlights the importance of creating an open trade environment to maximize the benefits of foreign investment,

as it not only facilitates greater capital inflow but also contributes to overall economic growth through increased export activities. It is expected that a nation would be more accessible to foreign capital if its commerce was more open and more focused on the external market (Srinivasan, 2011: 28). In this research, trade openness is defined as the aggregate of exports plus imports as a percentage of GDP. Various studies (Nooorbakhsh *et al.*, 2001; Asiedu, 2006; Azam *et al.*, 2012; Hoang, 2012; Bimal, 2017; Rashid *et al.*, 2017; Rai & Sharma, 2020; Tahir & Alam, 2020; Beloucif *et al.*, 2020, etc.) have identified a significantly positive impact of trade openness on FDI inflow. This study anticipates a positive correlation between trade openness and FDI.

4.1.1.2.6. Labor Productivity

Labor productivity, a fundamental economic statistic, is intricately tied to economic advancement, competitiveness, and living standards. It quantifies the total output, often measured by GDP, produced per unit of labor, typically gauged by the number of workers or hours worked, within a defined timeframe (ilostat.ilo.org). Economic studies suggest that FDI can provide access to modern technologies through technology transfers, potentially boosting labor productivity, especially in developing countries.

Previous studies such as Hoang and Bui (2015) and Rai and Sharma (2020) used GDP per employee as a proxy for labor productivity. This study uses GDP per person employed (GDP constant 2017 US\$) to measure labor productivity. The studies by Axarloglou (2004), Peluffo (2014), Hoang and Bui (2015), and Rai and Sharma (2020) discovered a favorable correlation between FDI inflows and labor productivity.

4.1.1.2.7. Natural Resource

The World Trade Report (2010) defines natural resources as “stocks of materials found in the natural environment that are both rare and economically viable for consumption or production, whether in their raw form or after undergoing minimal processing.” This definition underscores the economic significance of these resources, positioning them as crucial assets that fuel both production and consumption activities. By framing natural resources as foundational to economic development, the definition highlights their dual role in enabling various industrial processes and supporting sustainable consumption. Countries abundant in natural resources are more inclined to draw resource-seeking FDI. This sort of investment is often an export-oriented investment undertaken to have access to, or ensure steady supply of, certain natural resources that contribute to strengthen the competitiveness of the company (Boachie-Mensah, 2017: 28).

While resource-rich nations are more likely to attract resource-seeking FDI, the availability of natural resources may crowd out resources for other sectors, diverting investments away from manufacturing industries, for example, and causing deindustrialization or poorer competitiveness in such sectors. Previous research has shown a negative relationship between cross-border investment and natural resources, mainly due to price changes in natural resources, which involve higher risks for foreign investors who are not obligated to make such investments (Misturai & Roulet, 2019: 30).

It's crucial to explore how natural resources impact FDI inflows received by SAARC countries. Studies conducted by Phung (2016), Asiedu (2006), and Montero (2008) discovered that natural resources (fuel exports as a % of merchandise exports) were statistically significant and positively associated with FDI inflows. However, Liu *et al.* (2017) found natural resources to be an insignificant factor in FDI inflows. This study adopts the methodology used in the previously mentioned research and utilizes fuel exports as a percentage of total merchandise exports to serve as a proxy for natural resources. In this context, fuels are defined as commodities classified under the Standard International Trade Classification (SITC) section 3, which includes mineral fuels, lubricants, and related materials. This approach allows for a quantitative analysis of the relationship between natural resource exports and other economic variables, providing insights into the significance of fuel exports within the broader framework of merchandise trade.

4.1.1.2.8. Control of Corruption

Control of corruption pertains to the perceived extent to which public power is exploited for private gain. This concept includes a range of corrupt practices, from grand corruption which involves large financial sums and often implicates senior officials or influential individuals to petty corruption, which typically involves smaller amounts and occurs in routine, day-to-day transactions. This distinction highlights how corruption can pervade different levels of society, influencing not only large-scale governance but also everyday interactions with public institutions. Additionally, it includes the idea of state "capture," where elites and private interests manipulate state resources and policies to serve their own interests rather than the public good. This measure is crucial in assessing the integrity and effectiveness of governance within a country, as high levels of corruption can hinder economic development and undermine trust in public institutions. Studies by Al-Sadig, 2009; Brada *et al.*, 2012; Pupovic, 2012; Kersan, 2013; Castro and Nunes, 2013; Quazi, 2014 have affirmed a negative connection among corruption and FDI inflows, while some research such as Bellos and Subasat, 2011; Mudambi *et al.*, 2013; Helmy, 2013; Bayar and Alakbarov, 2016; Ross, 2019 and Khushnood *et al.*, 2020 have revealed no statistically significant association between corruption and FDI inflows. The study employs the "Control of Corruption" indicator, developed by the Worldwide Governance Indicators (WGI) project, as a proxy for measuring corruption levels. The index is structured on a scale ranging from approximately -2.5, which indicates weak governance

performance, to 2.5, signifying strong governance performance. By utilizing this indicator, the study aims to assess the impact of corruption on various economic factors, providing a clear framework for understanding governance quality in relation to corruption dynamics.

4.1.1.2.9. Political Stability

The measure of Political Stability and Absence of Violence/Terrorism captures the perceived risk of political instability and the potential for violence, including terrorism, within a country. This metric assesses the likelihood of disruptions stemming from political unrest, as well as the prevalence of acts motivated by political agendas. It reflects concerns over both sudden changes in governance and the risks posed by internal or external threats that could affect national security and social order. These indicators assess the degree to which a country is free from political turmoil and violence, providing insight into the security and stability of the political environment. A high score in this area suggests a stable political climate with minimal risks of unrest or violence, while a low score indicates potential threats from political instability and violent acts driven by political motivations. These factors are crucial for evaluating the overall investment climate, as stability is often a key determinant for foreign investors considering a country's viability for investment. Political stability is necessary for markets to function properly in directing resource allocation and boosting economic participants' confidence in making long-run investments. Although international businesses are hesitant to place their investments in very risky areas, political stability in the host nation is crucial. Previous studies (Azam *et al.*, 2012; Quazi, 2014; Shah & Afridi, 2015; Bimal, 2017; Ali, 2017; Rashid *et al.*, 2017; Rai & Sharma, 2020; Beloucif *et al.*, 2020; Zeb *et al.*, 2021, *etc.*) found a positive connection among political stability and FDI inflows. In this study, the "Political Stability and Absence of Violence" index from the Worldwide Governance Indicators (WGI) project serves as a proxy for evaluating political stability. This index ranges from approximately -2.5, representing low governance performance, to 2.5, which reflects high governance performance. It is hypothesized that there is a positive correlation between political stability and FDI inflows, implying that countries with more stable political conditions are generally more attractive to foreign investors. Consequently, higher index values are expected to correspond to increased FDI, as stability reduces investment risk and supports a favorable business climate. This relationship underscores the importance of a secure and stable political climate for fostering investment opportunities and economic growth.

4.1.1.2.10. Rule of Law

The concept reflects perceptions regarding the degree of trust that individuals and businesses have in the societal rules and norms, which encompasses several critical factors. These factors include the quality of contract enforcement, the protection of property rights, the effectiveness of law enforcement agencies, and the overall integrity of the judicial system. Additionally, it also considers

the likelihood of crime and violence within society. A high level of confidence in these aspects suggests a stable and reliable environment for economic activities, fostering investment and growth. Conversely, low levels of trust can deter investment and economic engagement, highlighting the importance of strong legal and institutional frameworks in promoting a secure and productive society. In simpler terms, the rule of law indicates both the effectiveness of contract enforcement and the propensity for crime and violence. In its broadest sense, the rule of law refers to a legal system that is effective, fair, and transparent in protecting private property and rights of the individual as well as the integrity of public institutions and the support of free and open markets by the government. By preventing arbitrary direct or indirect expropriation of privately owned assets, these requirements promote FDI and probably private domestic investment as well. It emphasizes the critical role that the rule of law plays in influencing FDI inflows, indicating that a stable legal environment is essential for attracting foreign investment. This research utilizes the "Rule of Law" index created by the Worldwide Governance Indicators (WGI) project as a stand-in for the rule of law, with scores ranging from roughly -2.5 (indicating weak governance) to 2.5 (indicating strong governance). As the negative value of the rule of law index increases, it reduces the likelihood of attracting FDI. Specifically, a decrease in the rule of law (where the index value shifts from 2.5 towards -2.5) correlates with a less favorable investing environment, making it less appealing to potential investors. Therefore, strengthening the rule of law is crucial for enhancing the attractiveness of these countries for foreign investment. It could be due to the fact that the rule of law may generate fear and uncertainty from the perspective of investors. In this regard, studies by Asiedu (2006); Teixeira *et al.*, (2017); Mengistu and Adhikary (2011) found rule of law positively significant to FDI inflows, while Brunetti and Weder (1997) found negative relationship between rule of law and FDI inflows. On the other hand, Ross (2019) and Khushnood *et al.* (2020) didn't identify any statistically noteworthy link between the rule of law and FDI inflows.

4.2. Research Methodology

This study examines The Economic and Institutional Determinants of Foreign Direct Investment for SAARC Countries (Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) for the period of 2004 to 2018. The natural log of FDI inflows is used as dependent variable and independent variables include Macroeconomic stability (annual inflation rate), natural log of infrastructure, natural log of human capital, trade openness, natural log of labor productivity, natural log of market size, natural resource (percentage of fuel exports in merchandise trade), political stability, control of corruption and rule of law. Data source and more description about variables are showed in Table 4.2. STATA 14.2 program was applied for analyzing and estimating the results. Panel data model is applied to investigate the economic and institutional determinants of FDI in SAARC nations.

The Hausman specification test (1978) is used to determine which of the models (Fixed Effects Model or Random Effects Model) is more appropriate for studying panel datasets. The Fixed Effects Estimates with Driscoll and Kraay Standard Errors method is employed to the panel dataset for estimating and analyzing the results.

Modified Wald's Test was applied to check Groupwise Heteroskedasticity in the model, in order to check autocorrelation across the individuals the Baltagi-Wu (1999) LBI test and Bhargava, Franzini and Narendranathan's (1982) Durbin-Watson test was employed, the existence of cross-sectional independence was check with Pesaran's (2004) CD Test and Friedman's (1937) Test.

4.2.1. Statistical Model of the Study

In this study units fixed effects model is used, which is vary across units and constant over time. The model is as below:

$$\begin{aligned} \text{LnFDI}_{it} = & \beta_{0i} + \beta_1 \text{MACROSTB}_{it} + \beta_2 \text{LnHCPT}_{it} + \beta_3 \text{LnMARSIZE}_{it} + \\ & \beta_4 \text{LnINFRS}_{it} + \beta_5 \text{LnLBPROD}_{it} + \beta_6 \text{TOPENNSS}_{it} + \beta_7 \text{NATRS}_{it} + \beta_8 \text{RULEOFLAW}_{it} + \\ & \beta_9 \text{POLSTB}_{it} + \beta_{10} \text{COC}_{it} + \varepsilon_{it} \end{aligned} \quad (1)$$

where i represents the countries and t represents time.

- β_{0i} : Intercept
- β_i : Slope coefficients
- LnFDI_{it} : Natural log of FDI inflows in SAARC countries.
- MACROSTB_{it} : Macroeconomic stability in SAARC countries.
- LnHCPT_{it} : Natural log of human capital in SAARC countries.
- LnMARSIZE_{it} : Natural log of market size in SAARC countries.
- LnMARSIZE_{it} : Natural log of infrastructure in SAARC countries.
- LnLBPROD_{it} : Natural log of labor productivity in SAARC countries.
- TOPENNSS_{it} : Trade openness (trade % of GDP) in SAARC countries.
- NATRS_{it} : Percentage of fuel exports in merchandise trade in SAARC countries.
- RULEOFLAW_{it} : Rule of law index in SAARC countries.
- POLSTB_{it} : Political stability index in SAARC countries.
- COC_{it} : Control of corruption index in SAARC countries.
- ε_{it} : Error term.

4.2.2. Panel Data Analysis

In empirical research, scholars typically utilize three primary types of data: time series, cross-sectional, and panel data. Time series data consists of observations of a particular variable collected over a designated period at consistent intervals. These intervals can vary significantly, including daily measurements (such as stock prices or weather reports), weekly data (like money supply figures), monthly statistics (for instance, unemployment rates or the Consumer Price Index), quarterly assessments (such as GDP), annual records (including government budgets), and more extended periods like every five years for manufacturer censuses or every ten years for population censuses. This data type is crucial for analyzing trends, seasonal patterns, and long-term changes within the same variable over time.

Cross-sectional data, on the other hand, involve collecting data points for one or more variables across a range of sample units or subjects all at the same point in time. For instance, this could include gathering crime rates for all 50 states in the US within a particular year (Gujarati & Porter, 2009: 22).

Panel data refers to the pooling of observations on a cross-section of families, nations, businesses, and so on over several time periods. This can be accomplished by surveying and tracking a number of houses or people over time (Baltagi, 2005:1).

There are two types of panels: balanced panels and unbalanced panels. The term "balanced panel" refers to a panel where each company has the same number of observations. Unbalanced panels are those where the number of observations is different for every organization (Gujarati & Porter, 2009: 25).

A panel data collection for economic study has numerous significant benefits over traditional cross-sectional or time series data sets. Some benefits of Panel data set are listed below (Baltagi, 2005: 4-7):

1. Adjusting for individual heterogeneity. According to panel data, there is heterogeneity among people, businesses, states, and nations" Cross-sectional and time-series analyses that are not suitable for this heterogeneity run the danger of generating skewed conclusions. Time-series or cross-section studies cannot manage state- and time-invariant factors but panel data can control these variables.
2. Panel data provide more accurate information, greater variety, less collinearity across variables, greater levels of freedom, and greater effectiveness. But Multicollinearity is a problem that plagues time-series investigations.

3. Panel data are particularly valuable for understanding dynamic processes, especially in areas where surface-level stability may conceal substantial underlying changes. Unlike cross-sectional data, which offer a snapshot view, panel data enables researchers to trace how variables like unemployment, job turnover, residential mobility, and income mobility evolve over time. With sufficiently extended timeframes, panel data can also illuminate the rate at which economic policies are adopted and the persistence of socioeconomic conditions, such as poverty and unemployment. For instance, while cross-sectional data can measure the percentage of the population unemployed at a given time, only panel data can reveal the likelihood that these individuals remain jobless in subsequent periods, providing a more nuanced view of economic resilience and vulnerability.
4. Compared to purely cross-sectional or time-series datasets, panel data provide a unique advantage in identifying and measuring effects that remain hidden in other data structures. For instance, consider a hypothetical where a group of women shows an average annual labor force participation rate of 50%. This outcome could reflect two different dynamics: (a) each woman has a 50% likelihood of entering the workforce in any given year, or (b) half of the women participate full-time, while the remaining half do not participate at all. Scenario (a) would suggest frequent entry and exit from the labor force, indicating high turnover, whereas scenario (b) would imply stable participation among a subset of women. Only panel data can distinguish between these patterns, revealing underlying behaviors that cross-sectional or time-series data alone cannot capture.
5. Panel data models, in contrast to cross-sectional or time-series data, offer the capability to develop and assess more sophisticated behavioral models. For instance, employing panel datasets to analyze and simulate technological efficiency yields more nuanced insights. A distributed lag model is also subject to less limitations in panels than in a research that only analyzes time series.
6. Provide micro-foundation for analyzation of aggregate data. Economists frequently make use of the "representative agent" hypothesis in macroeconomic research. However, if micro-units are heterogeneous, aggregate data's time series features might be substantially different from those of disaggregate data, and policy assessment based on aggregate data could be extremely deceptive. Additionally, aggregating micro-equations can result in predictions of aggregate outcomes that are more accurate than those made using aggregate data. The "homogeneity" vs "heterogeneity" debate is best studied using panel data, which include time series observations for a variety of individuals.

7. Macro panel data contain lot longer series and do not suffer from the nonstandard distributions issue that plagues time-series analysis tests using unit roots.

Limitation of panel data sets (Baltagi, 2005: 7-8):

1. Issues with design and data gathering. These include issues with coverage (an incomplete picture of the population of interest), non-response (caused by the respondent's unwillingness to cooperate or interviewer error), recall (respondent's incorrect recollection), interview frequency, interview spacing, reference period, usage of bounds, and time-in-sample bias.
2. Mistakes in measuring distortion. Mis recorded replies, memory lapses, purposeful manipulation of responses, improper informants, confusing questions, and interviewer effects can all lead to measurement mistakes.
3. Issues with selectivity. These include:
 - (A) Self-selection: Due to the fact that the reserve wage is more than the offered salary, some people opt not to work. Here, we focus on the traits of these people rather than their salaries. The sample has been filtered as only their pay is absent. This would be a shortened sample, nevertheless, if we did not witness all of these individuals' data.
 - (B) Nonresponse. Due to unwillingness to participate, no one being home, an untraceable sample unit, and other factors, this might happen during the first wave of the panel. Item (or partial) nonresponse occurs when one or more survey questions remain unanswered or fail to yield useful information. This type of nonresponse often results in gaps within specific sections of the data. In contrast, complete nonresponse arises when no data at all is obtained from the sampled unit—such as when a household does not participate in the survey entirely—leading to a total absence of information for that case. Both forms of nonresponse can introduce bias, but complete nonresponse is especially challenging as it leaves no opportunity to fill in or estimate the missing data from the sample unit. In addition to the efficiency loss brought on by missing data, this nonresponse can seriously impair population parameter identification.
 - (C) Attrition. Although nonresponse can also happen in cross-sectional research, it is a bigger issue with panels since nonresponse can still happen in waves after the first panel. Respondents can pass away, relocate, or discover that it is expensive to react.

4. Micro panels often feature a limited time-series dimension, typically using annual data for each individual over a relatively short period. Consequently, asymptotic properties of such models rely heavily on assumptions that the population size approaches infinity, as extending the panel's time dimension can be costly. In practice, the short duration of micro panels complicates panel data modeling, especially for cases with few dependent variables, as they become computationally intensive. Moreover, the risk of attrition—where participants drop out over time—increases with prolonged panel studies, potentially impacting the quality and reliability of the data collected.

5. Cross-sectional dependence refers to situations where macro panels focusing on nations or regions with extended time series overlook cross-country dependencies, potentially leading to erroneous conclusions.

4.2.2.1. Panel Data Models

In econometrics and statistics, panel data is concept which describe multi-dimensional data that usually includes measurements across time. For the same entities, whether companies or individuals, panel data consists of observations of numerous phenomena collected across several time periods. Unlike a typical time-series or cross-sectional regression, a panel data regression contains the double subscript on its variables (Baltagi, 2005: 1).

Generally, a linear panel data model expressed as follows:

$$Y_{it} = \beta_{0it} + \sum_{k=1}^k \beta_{kit} X_{kit} + u_{it} \quad i=1,\dots,N ; t=1,\dots,T \quad (2)$$

In the equation above; i standing for homes, people, businesses, nations, etc. and t representing time such as day, month, years. In other words, i represents the cross-section dimension and t represents the time dimension. β_{0it} is a constant term; β_{kit} represents the $K \times 1$ dimensional vector of parameters. X_{kit} , k . shows the value of the explanatory variable for i units at time t . Y_{it} is the value of the dependent variable for i units at time t . u_{it} denotes the error terms.

In panel data, the variables that vary according to the individuals and are constant according to time are called unit effects, and the variables that are constant according to the individuals and vary according to time are called time effects. Panel data models can be classified as follows, depending on whether the coefficients are valued by individuals and/or time (Tatoğlu, 2021: 37):

1. Classical models in which the constant and slope coefficients are both constant in terms of individuals and time.

$$Y_{it} = \beta_0 + \sum_{k=1}^k \beta_k X_{kit} + \mu_{it} \quad i=1,\dots,N ; t=1,\dots,T \quad (3)$$

2. Unit effects models where the intercept varies according to the individuals and the slope coefficients are constant:

$$Y_{it} = \beta_{0i} + \sum_{k=1}^k \beta_k X_{kit} + \mu_{it} \quad i=1,\dots,N ; t=1,\dots,T \quad (4)$$

3. Unit and time effects models in which the slope coefficients are constant, and the intercept varies over individuals and time:

$$Y_{it} = \beta_{0it} + \sum_{k=1}^k \beta_k X_{kit} + \mu_{it} \quad i=1,\dots,N ; t=1,\dots,T \quad (5)$$

4. Models in which all coefficients are changeable in individuals but constant in time:

$$Y_{it} = \beta_{0i} + \sum_{k=1}^k \beta_{ki} X_{kit} + \mu_{it} \quad i=1,\dots,N ; t=1,\dots,T \quad (6)$$

5. Models in which all coefficients are varies in both individuals and time:

$$Y_{it} = \beta_{0it} + \sum_{k=1}^k \beta_{kit} X_{kit} + \mu_{it} \quad i=1,\dots,N ; t=1,\dots,T \quad (7)$$

The model may be further characterized in each of these scenarios based on whether the coefficients are considered to be random or fixed (Hsiao, 2014: 15).

Models 2 and 3 are the most widely used models in panel data analysis and are expressed as intercepts are varies and slop coefficients are constant. Model number 2 is called a one-way model because it varies only according to individuals, while model number 3 is called a two-way model because it varies over individuals and time. However, in the literature, models in which only the unit effect is concerned in the intercepts, are mostly used. In the case of the unit effect, if the unobserved

unit effects occurring in each unit are treated as a random variable, such as the error term, it is called "random effects". When unobservable unit effects are treated as an estimated parameter for each cross-sectional observation, it is called "fixed effects" (Tatoğlu, 2021: 39). In panel data, the model selection must be dependent on information about the individual's particular components as well as the exogeneity of the independent factors. Which model is appropriate, fixed effects or random effects model, is decided by the Hausman (1978) test. Following the Hausman (1978) test outcomes, within a panel data framework, if no correlation exists between the error term and the independent variables, the random effects model is deemed suitable. Conversely, if a statistically significant relationship is detected between the error term and the independent variables, the fixed effects model is deemed more appropriate over the random effects model (Tatoğlu, 2021: 195).

4.2.2.2. Diagnostic Tests

4.2.2.2.1. Hausman's Specification Test

The Hausman specification test (1978) is used to determine which of these two models (Fixed Effects or Random Effects Models) would be appropriate for studying panel datasets. Based on a knowledge of the trade-off between bias and variance in the two estimators, this test is designed to analyze how parameter estimations differ between approaches. For one, a random effects model can increase bias but minimize the variation of coefficient estimates, whereas a fixed effects model remains unbiased but has a large degree of variance. Random effects model does not allow for correlation across unobserved effects (or heterogeneity) and explanatory variables of interest, but fixed effects model do. This test necessitates two conditions: first, the error term must be strictly exogenous so that $E(u_{it} | x_i, \alpha_i) = 0$ to guarantee that the random effects and fixed effects estimators are consistent; and second, both the idiosyncratic error component and the unobserved effect must have constant variances (Clark & Linzer, 2015).

Null hypothesis: There is no correlation between the explanatory variables and the error term and the random effects model is more appropriate.

Alternative hypothesis: The explanatory variables and the error term are correlated. In this case, the random effects model is inconsistent, and the difference is expected to be large. The fixed effects model should be preferred because it is consistent.

The standard Hausman test statistic is as follows (Tatoğlu, 2021: 195):

$$H = (\hat{\beta}_{FE} - \hat{\beta}_{RE})' [Avar(\hat{\beta}_{FE}) - Avar(\hat{\beta}_{RE})]^{-1} (\hat{\beta}_{FE} - \hat{\beta}_{RE}) \quad (8)$$

In this equation FE shows Fixed Effects model and RE presents Random Effects model, furthermore, the vector of fixed effects estimations is represented by $\hat{\beta}_{FE}$, and the vector of estimates for time invariant or aggregate time variables is represented by $\hat{\beta}_{RE}$.

4.2.2.2.2. Modified Wald's Test for Groupwise Heteroskedasticity

For testing groupwise heteroscedasticity with the modified Wald test the null hypothesis is as follow (Tatoğlu, 2021: 244):

$$H_0: \sigma_i^2 = \sigma^2 \text{ for all } i, \quad (\text{The variances are homoscedastic to the units})$$

Alternative hypothesis is:

$$H_a: \sigma_i^2 \neq \sigma^2 \quad (\text{The variances are heteroscedasticity to the units})$$

Wald Test statistics is as below:

$$W = \sum_{i=1}^N \frac{(\hat{\sigma}_i^2 - \hat{\sigma}^2)^2}{V_i} \quad (9)$$

In the equation above $\hat{\sigma}_i^2$, i is the estimator of the residual variance of the cross-section units.

4.2.2.2.3. Baltagi -Wu's LBI Test

Baltagi-Wu (1999) LBI test is used to test serial correlation in the disturbance. The test can be applied in both fixed and random effect models. In addition, the test may also be used in unbalanced panel data models. The null hypothesis for Baltagi-Wu LBI test is as follow (Tatoğlu, 2021: 246):

$$H_0: \rho = 0 \quad \text{“There is no first-order autocorrelation”}$$

And the alternative hypothesis is:

$$H_{a1}: \rho > 0 \quad \text{or} \quad H_{a2}: \rho < 0 \quad \text{“There is first-order autocorrelation”}$$

d statistics for LBI test is,

$$d = \frac{z' A_0 z}{z' z} \quad (10)$$

Where,

$$A_0 = \left\{ \frac{\partial \Omega_{\tilde{u}}^{-1}(\rho)}{\partial \rho} \right\} \Big| = - \left(\frac{\partial \Omega_{\tilde{u}}^{-1}(\rho)}{\partial \rho} \right) \Big| \text{ and } z = \bar{P}_x \tilde{Y} \quad (11)$$

4.2.2.2.4. The Durbin-Watson's Test

Durbin-Watson test is developed by Bhargava, Franzini and Narendranathan (1982), following an AR (1) process. The test performs autocorrelation for both fixed effects and random effects models (Baltagi, 2005: 98).

Hypotheses of Durbin-Watson test is as follow:

$$H_0: \rho = 0 \quad \text{“There is no autocorrelation”}$$

And the alternative hypothesis is;

$$H_a: |\rho| < 0 \quad \text{“There is autocorrelation”}$$

Bhargava, Franzini and Narendranathan's Durbin test statistics are compared with 2 and it is concluded that there is autocorrelation in the model when the test statistics are less than 2 (Tatoğlu, 2021: 248).

4.2.2.2.5. Pesaran's CD Test

Pesaran (2004) proposes a simple error Cross-section Dependency (CD) test which can be applied to a wide range of panel models, include stationery and unit root dynamic heterogeneous panels with shorter T and big N (Baltagi, 2005: 247).

Hypotheses;

The null hypothesis is set up as $H_0: \rho_{ij} = 0$, $H_1: \rho_{ij} \neq 0$. Here ρ_{ij} : i and j represents the correlation coefficient between the residuals of the units (Tatoğlu, 2021: 259).

Pesaran's CD test statistic is as fallow:

$$CD = \sqrt{\frac{2T}{N(N-1)}} \left(\sum_{i=1}^{N-1} \sum_{j=i+1}^N \hat{\rho}_{ij} \right) \quad (12)$$

Where $\hat{\rho}_{ij} = \frac{\sum_{t=1}^T e_{it} e_{jt}}{(\sum_{t=1}^T e_{it}^2)^{\frac{1}{2}} (\sum_{t=1}^T e_{jt}^2)^{\frac{1}{2}}}$ with e_{it} representing the OLS residuals for each $i = 1, \dots, N$

observations. When both N and $T \rightarrow \infty$, the CD test converges to a normal distribution with mean 0 and variance 1 under the null of no cross-sectional dependence conditional on x . The traditional Breusch-Pagan LM test performs poorly for $N > T$ panels, but Pesaran's CD test performs well even for short T and big N (Baltagi, 2005: 247).

4.2.2.2.6. Friedman's Test

Relying on Spearman's rank correlation coefficient, Friedman (1937) presented a nonparametric test. The coefficient is similar to the standard product-moment correlation coefficient in terms of the proportion of variability accounted for, with the exception that Spearman's rank correlation coefficient is calculated using ranks (Hoyos & Sarafidis, 2006: 485).

Friedman's test statistic is as below:

$$FR = [(T - 1)((N - 1)R_{AVE} + 1)] \quad (13)$$

Here R_{AVE} represents the average Spearman's correlation and it is formulated as follow,

$$R_{AVE} = \frac{2}{N(N - 1)} \sum_{i=1}^{N-1} \sum_{j=i+1}^N \hat{r}_{ij} \quad (14)$$

Here $\hat{r}_{ij}$ stats Spearman's rank correlation coefficient and it equals to:

$$r_{ij} = r_{ji} = \frac{\sum_{t=1}^T \{[\rho_{i,t} - (T + 1/2)][\rho_{j,t} - (T + 1/2)]\}}{\sum_{t=1}^T [\rho_{i,t} - (T + \frac{1}{2})]^2} \quad (15)$$

where r_{ij} is the sample estimate of the rank correlation coefficient of the residuals. Greater values of R_{AVE} demonstrated the existence of non-zero cross-sectional correlations. Friedman demonstrated that $FR = (T-1) \{(N-1) R_{AVE} + 1\}$ is asymptotically χ^2 distributed with $T-1$ freedom degrees for given T as N increases (Tatoğlu, 2021: 261).

4.3. Empirical Results

4.3.1. Diagnostic Tests Findings

4.3.1.1. Hausman's Test

The Hausman test provides the choice of selecting between a random or fixed effects model. Both methodologies' outcomes have been estimated before being put to the test in this instance. Comparing probability values is the criteria for deciding which of the model is more appropriate for panel data estimations, if the p-value is smaller than 1%, 5%, or 10% then the fixed effects model is more suitable for panel data estimation and the null hypothesis (H_0 : Difference in coefficients not systematic and random effects model is appropriate) is rejected.

According to the test results the p-value is less than 5% and it is significant, and the null hypothesis is rejected. The better model for panel data estimation is fixed effects model. The results of the Hausman test are showed in Table 50.

Table 50: Hausman Test (selection between Fixed effects or Random Effects models)

Hypothesis	Value	Decision
H_0 : Difference in coefficients not systematic. H_0 : Difference in coefficients systematic.	p-value $> \chi^2 = 0.0223$	Fixed Effects Model

4.3.1.2. Modified Wald's Test for Groupwise Heteroskedasticity

Modified Wald's test is applied to check heteroskedasticity problem in the model. According to the test results the null hypothesis ($H_0: \sigma_i^2 = \sigma^2$ for all i, the variances are homoscedastic to the units) is rejected, which means the variances are heteroskedasticity to the units. The test findings are presented in Table 51.

Table 51: Modified Wald's Test for Groupwise Heteroskedasticity

Hypothesis	Value	Decision
$H_0: \sigma_i^2 = \sigma^2$ for all i. $H_a: \sigma_i^2 \neq \sigma^2$	$\chi^2(8) = 137.21$ p-value $> \chi^2 = 0.0000$	The variances are heteroskedastic to the units.

4.3.1.3. Bhargava, Franzini and Narendranathan's Durbin-Watson and Baltagi -Wu's LBI Tests

To check the autocorrelation problem in the model the Baltagi-Wu's (1999) LBI test and Bhargava, Franzini and Narendranathan's Durbin-Watson were applied. For making decision the statistics of both tests are compared with 2 and it is concluded that there is autocorrelation in the model when the test statistics are less than 2. It means the null hypothesis (There is no autocorrelation) is rejected. Test results are presented in Table 52.

Table 52: Durbin-Watson and Baltagi -Wu's LBI Tests of autocorrelation

Durbin - Watson	Baltagi – Wu LBI
1.3329787	1.5656513

4.3.1.4. Pesaran's CD Test and Friedman's Test

To assess the issue of cross-sectional independence in the model, both Pesaran's CD test and Friedman's test were employed. The results from both tests led to the rejection of the null hypothesis, which posited that there is no cross-sectional independence. These findings confirmed the presence of cross-sectional dependence among the observations, indicating that the data points are not independent of one another and may influence each other. This suggests that the model needs to account for these dependencies to produce more accurate and reliable results. Tests outcomes are showed in Table 53:

Table 53: Pesaran's CD Test and Friedman' Test of Cross-Sectional Independence

Pesaran' CD Test	Friedman' Test
2.893 (0.0038)	25.612 (0.0006)

The diagnostic test results indicated the presence of several issues within the model, including heteroskedasticity, autocorrelation, and cross-sectional independence. To address and mitigate these problems, Fixed Effects Estimates were utilized along with the Driscoll-Kraay standard errors method when analyzing the panel dataset. This approach helps to provide more reliable and robust estimates by accounting for potential correlations and variations across different cross-sections and time periods, thereby enhancing the accuracy of the results.

4.3.2. Panel Data Analysis Results

This study used Fixed Effects Estimation with Driscoll-Kraay Standard Errors method³ for analyzing and estimating the results of the model. Table 54 presents the empirical outcomes of the model.

Table 54: Fixed Effects Estimation with Driscoll-Kraay Standard Errors method

Regressors	Dependent variable: LnFDI			
	I		II	
	Fixed Effects Estimation with Driscoll-Kraay Standard Errors.		Random Effects Estimation with Driscoll-Kraay Standard Errors	
	Coefficients	P-value	Coefficients	P-value
MACROSTB	0.0126 (0.0169)	0.469	0.0164 (0.0145)	0.279
LnHCPT	3.0231** (1.2423)	0.029	-0.9504 (0.8718)	0.294
LnMARSIZE	1.7535** (0.8206)	0.051	1.5228*** (0.1017)	0.000
LnINFRS	0.0764** (0.0289)	0.019	0.0224 (0.0202)	0.286
LnLBPROD	-1.5785* (0.8021)	0.069	0.9524*** (0.1929)	0.000
TOPENNSS	0.0225*** (0.0075)	0.01	0.0188*** (0.0025)	0.000
NATRS	0.0088 (0.0110)	0.437	0.0122 (0.0094)	0.213
RULEOFLAW	-2.0257*** (0.6383)	0.007	-1.7019*** (0.4922)	0.004
POLSTB	0.9600*** (0.2630)	0.003	0.7989** (0.3363)	0.032
COC	0.7809 (0.8347)	0.365	0.4387 (0.4129)	0.306
CONSTANTS	-12.3034 (14.3297)	0.405	-26.946*** (3.6832)	0.000

The coefficients. ***, **, * show Significance at 1%, 5%, and 10%, respectively.

³ Alternative model: By making changes in the independent variables (dropping rule of law from the equation and taking the log of trade openness), the Hausman specification test suggested the random effects model as an appropriate model. After the diagnostic tests, random effects with Arellano (1987), Froot (1989), and Rogers (1993) estimation were applied. The outcomes showed some different results in contrast to Fixed effects with Driscoll-Kraay standard errors method. The results present that macroeconomic stability, infrastructure, and natural resource are insignificant to FDI inflows in SAARC countries, while market size, trade openness, labor productivity, and political stability are positively significant to FDI inflows, and human capital and control of corruption are negatively significant to FDI inflows in SAARC nations.

Table 54 (continue)

Diagnostic tests				
Hausman Test	p-value $> \chi^2 = 0.0223$		Fixed Effects Model	
	Fixed Effects Model		Random Effects Model	
Heteroskedasticity	Wald's Test		Levene, Brown ve Forsythe Test	
	$\chi^2(8) = 137.21$ p-value $> \chi^2 = 0.0000$		W0 = 5.6770227 (7, 112) Pr > F = 0.00001249 W50 = 4.1955142 (7, 112) Pr > F = 0.00038544 W10 = 5.2502691 (7, 112) Pr > F = 0.0000332	
Aoutocorrelation (Bhargava, Franzini and Narendranathan's Durbin-Watson and Baltagi -Wu's LBI Tests)	DW= 1.3329787 B-Wu LBI= 1.5656513		DW= 1.3329787 B-Wu LBI= 1.5656513	
Cross sectional independence	Pesaran'CD Test	Friedman' Test	Pesaran'CD Test	Friedman' Test
	2.893 (0.0038)	25.612 (0.0006)	3.056 (0.0022)	26.000 (0.0005)
R²	0.4406		0.9107	
Model Significance	F (10, 14) = 77.81 P-value > F = 0.0000		Wald χ^2 (10) = 22579.34 P-value > χ^2 = 0.0000	

The coefficients. ***, **, * show Significance at 1%, 5%, and 10%, respectively.

As shown in the Table 54, most of the variables considered to be affecting the inflows of FDI in the SAARC countries in this research are statistically significant. As the Table 54 above presents macroeconomic stability is not affecting the inflows of FDI in the mentioned category of countries since its coefficient is positive but it's not statistically significant. Another important factor effecting the inflows of FDI in the SAARC countries is human capital, its coefficient is positive, and the p-value is meaningful at five percent level. According to the results 1% increase in human capital (Secondary school enrollment) of SAARC countries attract 3.02% more FDI inflows to SAARC region. Its reason could be that human capital gives the investor the opportunity to increase its profitability and result in the reduction of production costs and waste of resources.

According to this study market size is yet another important determinant resulting in a hike of FDI inflows in the SAARC countries. Its coefficient is positive and statistically significant at 5%

level. When market size (real GDP) in the SAARC nations increase by 1% it increases FDI inflows by 1.75% in SAARC countries. The reason for this factor positively affecting the FDI inflows could be that the investors might see the market size as a signal for making a potential profit and capitalizing on it (the bigger the market the more chances of selling and making profit).

In terms of the infrastructure, as the Table 54 shows it's yet another important determinant affecting the FDI inflows positively since its coefficient is statistically significant at five percent level. 1% rise in infrastructure of SAARC nations increases FDI inflows by 0.07% in SAARC countries. Just as mentioned in the case of human capital, it may help the investor to decrease its production costs, transportation costs *etc.*, which all result in more profitability.

According to the outcome of this study, trade openness is also positively affecting the inflows of FDI into the SAARC countries. Its coefficient is positive and statistically significant at five percent level. A one unit increase in trade openness (total % of GDP) will cause an increase by 2.25% in FDI inflows in SAARC countries. The reason for this factor could be the lower trade barriers that the investors may see as an opportunity in terms of the availability of market for sales and acquiring the factors of production.

The Rule of Law, particularly concerning the enforcement of contracts and the protection of property rights, has been shown to exhibit a statistically significant negative correlation with FDI at the 1% significance level, with an estimated beta coefficient of -2.0257. Just as the Rule of Law, the labor productivity is also negatively influencing the FDI inflows into SAARC countries. Its coefficient is negative and statistically significant at ten percent interval. According to results of the model a one percent improvement in labor productivity will results 1.57% decrease in FDI inflows into SAARC nations. The reason for this factor could be linked to higher wages (the higher the productivity the more the expectations of higher wages).

Political Stability and the Absence of Violence were found to have a statistically significant positive association with FDI inflows, with significance at the one percent level. The beta coefficient for this relationship is 0.96. This indicates that higher levels of political stability increase the likelihood of attracting FDI to SAARC countries. As political stability improves (with the index value moving from -2.5 to 2.5), the overall investment climate becomes more favorable for investors. Therefore, a rise in the political stability index suggests a stronger and more secure environment, enhancing the attractiveness of these nations for foreign investment. It means that as the political stability improves it helps these countries to attract more FDI inflows. The reason for this factor affecting FDI positively could be that it avoids uncertainty from the perspective of the investors. Control of Corruption is not influencing the FDI inflows at all. According to the results of the model the coefficient is not statistically significant. As shown in Table 54 natural resource (fuel exports as

percentage of merchandise trade) is statistically insignificant factor and it is not affecting the FDI inflows in the mentioned countries



CONCLUSION AND RECOMMENDATIONS

FDI is a key element of economic growth and development in developing nations. There is competition taking on a worldwide scale to attract significant amount of FDI inflows. The current quality of education, technologies, and infrastructure based in developing nations must change in order to compete in such a competitive environment. In this regard, in the case of SAARC country's economies, this endeavor undoubtedly helps to advance nations' economic positions. In SAARC, each nation has established its own factors to attract significant foreign investors at various time intervals. On the other side, investor countries often choose to invest in countries with high-quality infrastructure and a diversified labor population, as well as abundant natural resources.

SAARC includes eight countries as follows. Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. Despite the region's tremendous economic growth potential, the SAARC countries get comparatively modest amounts of FDI in comparison to other developing economies. Among the SAARC countries, India and Pakistan are the SAARC nations with the biggest economies and populations, making them the main recipients of FDI. The two nations have also made considerable investments in building their human capital and infrastructure, which are essential components in luring FDI. However, Sri Lanka and Bangladesh have also made progresses in building their human capital and infrastructure, which led to a rises in FDI inflows in recent years. However, because of their smaller economies and populations, Afghanistan, Bhutan, the Maldives, and Nepal have only attracted modest amounts of FDI. Furthermore, India is the SAARC nation with the most advanced legal and regulatory systems and has made tremendous progress in recent years in combating corruption. Like India, Sri Lanka has improved governance and reduced corruption, leading to a rise in FDI inflows. However, Afghanistan and Pakistan continue to experience political instability, poor governance, and high levels of corruption, which have negative impacts on FDI levels.

This study investigates the economic and institutional determinants of FDI in SAARC countries, which include Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka, over the period from 2004 to 2018. The analysis aims to identify the key factors influencing FDI inflows in these nations, focusing on both economic indicators and the quality of institutions. By examining these determinants, the research seeks to provide insights into how various economic conditions and institutional frameworks affect the attractiveness of SAARC countries for foreign investors during this timeframe. The natural log of FDI inflows is used as dependent variable and independent variables include Macroeconomic Stability (Annual Inflation Rate), Natural Log of

Infrastructure, Natural Log of Human Capital, Trade Openness, Natural Log of Labor Productivity, Natural Log of Market Size, Natural Resource (Percentage of Fuel Exports in Merchandise Trade), Political Stability, Control of Corruption and Rule of Law.

The Hausman (1978) Specification Test is utilized to determine the most appropriate model, either the Fixed Effects Model or the Random Effects Model—for analyzing panel datasets. This test helps to assess whether the unique errors are correlated with the independent variables, which influences the choices of model. In this study, Fixed Effects Estimates with Driscoll and Kraay standard errors are employed for estimating and analyzing the results based on the panel dataset. This approach is designed to provide robust estimates that account for potential autocorrelation and heteroskedasticity within the data. Modified Wald's Test was applied to check Groupwise Heteroskedasticity in the model and in order to check the autocorrelation across the individuals the Baltagi-Wu (1999) LBI Test and Bhargava, Franzini and Narendranathan's (1982) Durbin-Watson Test were employed. In addition, the existence of cross-sectional independence was checked with Pesaran's (2004) CD Test and Friedman's (1937) Test.

The empirical results showed that most of the variables considered to be affecting the inflows of FDI in the SAARC countries in this research are statistically significant. The results present that macroeconomic stability is not affecting the inflows of FDI in the mentioned category of countries since its coefficient is positive but it's not statistically significant. This indicates that while better macroeconomic conditions, such as low inflation, stable currency, and fiscal discipline, might theoretically encourage FDI, the relationship is not strong or consistent enough to be statistically significant for these countries. This suggests that macroeconomic stability is not a decisive factor for investors in the region. Instead, FDI in SAARC countries appears to be motivated by other factors, such as the large consumer markets in countries like India, Pakistan, and Bangladesh, pointing to the "Market Seeking FDI", or the availability of low-cost production resources, including cheap labor and raw materials, pointing to the "Resource Seeking FDI". Investors may also be drawn to specific industries or sectors with lucrative opportunities, irrespective of broader economic conditions. Moreover, government policies that offer tax incentives, relaxed regulations, or subsidies might play a more critical role in attracting FDI. This implies that while improving macroeconomic stability remains important for overall economic health, policymakers in SAARC countries should focus more on enhancing sector-specific policies, improving infrastructure, and creating a business-friendly regulatory environment to better attract foreign investment.

Another important economic determinant is human capital which affects the inflows of FDI in the SAARC countries positively. Its reason could be that human capital gives the investor the opportunity to increase its profitability and result in productivity, the reduction of production costs and waste of resources.

According to this study, market size is yet another important determinant resulting in a hike of FDI inflows in the SAARC countries. When market size (real GDP) in the SAARC nations increase by 1% it increases FDI inflows by 1.75% in SAARC countries. The reason for this could be that the investors might see the market size as a signal for making a potential profit and capitalizing on it (the bigger the market the more chances of selling and making profit), which potentially points to the “Market Seeking FDI”. Infrastructure is also an important economic factor which affects the FDI inflows positively in SAARC countries. Just as mentioned in the case of human capital it may help the investor to decrease its production costs, transportation costs *etc.* which can all result in more profitability.

According to the outcome of this study, trade openness is also positively affecting the inflows of FDI in the SAARC countries. Its coefficient is positive and statistically significant at five percent level. The reason for this factor could be the lower trade barriers that the investors may see as an opportunity in terms of the availability of market for sales and acquiring the factors of production.

The Rule of Law, particularly regarding the quality of contract enforcement and property rights and identified as a significant institutional factor, was found negatively associated with FDI inflows. A negative relationship between the Rule of Law and FDI suggests that stringent legal enforcement or rigid property rights might be perceived as burdensome by investors. Alternatively, weak enforcement might provide more "flexibility" for investors to operate, making such environments unintentionally attractive.

Surprisingly, labor productivity in SAARC countries negatively influences FDI. This could indicate that investors are not primarily seeking highly productive labor, but are instead drawn by cost advantages in less productive but cheaper labor markets. It highlights a potential preference for low-cost labor over efficiency in the SAARC region.

Political Stability and the Absence of Violence are among the most significant institutional determinants of FDI in SAARC countries. A statistically significant positive association exists between Political Stability and FDI inflows, particularly at the one percent level. Higher values of the political stability index enhance the likelihood of attracting FDI into SAARC nations. As political stability improves—reflected by the index value moving from -2.5 towards 2.5— the investment climate becomes increasingly favorable for investors. This means that enhanced political stability contributes to a greater influx of FDI in these countries. One reason for this positive relationship is that improved political stability reduces uncertainty for investors, creating a more secure environment for investment decisions. Control of corruption and natural resources are the two factors which have been found as statistically insignificant, namely, not influencing the FDI inflows into the SAARC region.

The study's conclusions have notable policy implications for the SAARC nations aiming to attract additional FDI inflows. To attract FDI inflows, governments should focus on enacting policies that promote economic development, boost market access, and improve institutional quality. Furthermore, governments should prioritize political stability, regulatory excellence and corruption control to promote a positive investment climate.

This study contributes to literature by giving empirical information on the factors that influence FDI inflows into the SAARC nations as a whole. The findings may assist developing-country policymakers in understanding the characteristics that attract FDI and designing effective strategies to attract additional investment. Finally, by recognizing the need for further research on the function of institutions in attracting FDI inflows, this study gives a route for future research.

Recommendations:

- To attract significant capital flows into the long-term assets of SAARC countries, the governments must concentrate on policy initiatives.
- To draw in global investors, SAARC nations should concentrate on fostering a business-friendly atmosphere. This entails streamlining rules, lowering administrative barriers, and enhancing financial access.
- In order to encourage foreign investment, governments could provide tax advantages, investment guarantees, and special economic zones.
- Regional cooperation and integration can assist in creating a more appealing investment climate by creating a fair playing field for firms and lowering trade barriers. This can help to attract foreign investment to the region and encourage economic progress. Furthermore, regional collaboration may assist the SAARC nations that confront similar concerns such as poverty, food insecurity, and climate change, as well as foster sustainable development in the area.
- Because these nations are heavily impacted by terrorism and other activities that pose a great danger, the governments must take some positive steps to create a calm and acceptable atmosphere in the domestic countries

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