Role of Foreign Direct Investment in Economic Growth:
South Asian Perspective

Macroeconomic issues are in the center of my area of interest in research. Especially international trade and monetary economics attracts me a lot. Here, I have tried to portray an issue of my interest from the international trade in brief.

1 Background

Investment has always been a constraint for the developing countries of the world. Along with other problems, the dearth of investment hinders economic progress a country which is mostly experienced by the developing countries. Foreign Direct Investment (FDI) can potentially help to fill in the investment void in the developing countries. Developing countries have their own advantages in terms of abundant labor with a lower wage which often turns them into an attractive destination for FDI. Foreign capital through FDI not only can reduce the gap between capital requirement and national saving but also can raise the skill level and transfer technology to the FDI receiving country which are likely to encourage the economic growth directly or indirectly. Now, this may not be the case always as the higher productivity of FDI applies only when the host country has a minimum threshold stock of human capital (Borensztein, De Gregorio, & Lee, 1998). So, the role of FDI in igniting economic growth may not be very much certain. As a result, discovering the relationship between FDI and economic growth becomes more challenging. Various research came up with different result regarding the impact of FDI on economic growth. Some research outcomes show a positive impact of FDI on economic growth (Nair-Reichert & Weinhold, 2001; Choe, 2003; Iqbal, Shaikh, & Shar, 2010) when some research outcomes cast doubt on the positive impact of FDI on economic growth (Sarkar, 2007). In addition, researchers also show different impact depending on the country or economic sector (Ericsson, 2001; Chowdhury & Mavrotas, 2006; Chakraborty, Nunnenkamp, et al., 2006).

2 Global FDI Scenario

In spite of having a comparative advantage to attract FDI in developing countries, the global FDI flow trend shows that developing countries still are not its top destination.Global FDI experienced 2 percent fall in 2016 to USD 1.75 trillion compared to 2015 (UNCTAD, 2017). In the total FDI inflow in 2016, Developed, developing economies and transition economies received USD 1032 billion, USD 646 billion and USD 68 billion respectively. This huge amount of FDI has a potential contribution to world economic growth. Now, as various research shows, this contribution may vary by country, region and economic sector. From this token, the role of FDI in the economic growth of South Asia becomes an interesting case of empirical study.

3 FDI in South Asia

South Asian countries: India, Pakistan, Bangladesh, Sri Lanka, Nepal, Bhutan and Maldive, members of the South Asian Association for Regional Cooperation *(SAARC)* are developing countries facing the same challenge of lack of domestic investment. These countries received USD 50.26 billion FDI in 2016 (UNCTAD, 2017). This amount of FDI in theses country is likely to contribute to raising their economic growth. We can examine this hypothesis using empirical data. Using following econometric model, we can divulge the FDI and economic growth nexus in the context of the stated South Asian countries.

$$Y_{it} = \alpha_i + \delta_i t + \beta_i X_{it} + e_{it}$$

Here, for each panel, time series Y_{it} and X_{it} are economic growth and FDI respectively for the countries $i = 1, 2, ..., N$ and for period of time $t = 1, 2, ..., T$.

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