FDI and Economic Growth in SAARC Countries: An Empirical Analysis

Ahsanuddin Haider[1], Rajender S. Godara[2], Mohammad Asif [3], Samreen Jafri[4]

[1]Associate Professor Department of Finance College of Administration and Financial SciencSaudi Electronic University Dammam (Kingdom of Saudi Arabia)
[2]Associate Professor Economics, Mittal School of Business, Lovely Professional University, Punjab (India)
[3]Assistant Professor Department of Finance College of Administration and Financial ScienceSaudi Electronic University Dammam (Kingdom of Saudi Arabia)
[4]Lecturer Imam Abdulrahman bin Faisal University Dammam (Kingdom of Saudi Arabia)
[1]a.haider@seu.edu.sa, [2]godarars@gmail.com,[3] masif@seu.edu.sa, [4]sjafri@iau.edu.sa

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Abstract: Foreign Direct Investment (FDI has been considered as a powerful weapon of globalization with double edge that cuts both ways mean it impacts positively and negatively. Its impacts positively by supporting the host country's economy in terms of capital inflows and up-to date technology but FDI also affect the host country by overexploiting its resources. Despite all these thing, this capital provides an opportunity to underdeveloped and developing countries by providing to access new markets, advance technology, cost effective production facilities and more investment opportunities. It is a two way mechanism for both the countries first, from where FDI comes and second where FDI is invested in form Greenfield and Brownfield. For the host country, it is a new way to economic development. This chapter has been investigated the effect of FDI on economic growth of host country and effect of economic growth on FDI by applying regression analysis and found that that the overall model is positive and significant at 5 percent significance level for seven countries namely Afghanistan, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. However, for Bangladesh the model is found to be insignificant, at second stage, ADF test is employed to data for Stationarity check. ADF calculations indicate that both the variables are stationary at level and first difference at 1 percent level of significance; however few exceptions are there, at the final stage.

Keywords: FDI, GDP, Economic Growth, Granger Causality, ADF, Regression Analysis.

1. Introduction

FDI has been considered as a powerful weapon of globalization with double edge that cuts both ways mean it impacts positively and negatively. Its impacts positively by supporting the host country's economy in terms of capital inflows and up-to date technology but FDI also affect the host country by overexploiting its resources. Despite all these thing, in case of developing and underdeveloped economies FDI is an important source of funding by providing to access new markets, advance technology, cost effective production facilities and more investment opportunities. It is a two way mechanism for both the countries first, from where FDI comes and second where FDI is invested in form Greenfield and Brownfield. For the host country, it is a new way to economic development. The major benefits FDI are movement of new technology, enhance competition in the regional markets, promotes to human capital growth in the host country. profits made by FDI add value to the revenues, thereby contributing to the government tax revenues. Further, for the home country the push factors indicate the benefits which include, gain of administrative interest in an enterprise in the host country, the highest rate of return on capital invested and decreases the risk confront by the investors by permitting them to expand their investment.

In the past few decades Foreign Direct Investment has gained great attention of both developed and developing countries because of its growth-enhancing component. In the 1990s, Foreign Direct Investment movement was significant all over world due to globalisation. So, FDI attracted the attention of economists and policy makers for research. FDI inflows to portion of global GDP has been increases five folds in last three decades.

World flow of FDI decreases by 27% to $1.52 trillion in 2017 but increased in Asia by 2%. Asia received $ 459bn and SAARC countries received $ 47bn in 2017-18. In SAARC countries, more than a half billion people live below the poverty line. This causes increase in criminal and terrorist occurrences. . Employment generation and entrepreneurial development are the best tools to eliminate poverty as it will increase the Gross Domestic Product (GDP) and export earnings of SAARC member-states. FDI is needed for the development of the region.

Table: 1Trend of FDI Inflows to SAARC Countries, 1991-2018

USD (millions)

Countries	**1991**	**1995**	**2000**	**2005**	**2010**	**2015**	**2017**	**2018**	**Ranking**
Afghanistan	0.3	0.1	0.2	271.0	54.2	163.1	53.9	139.0	VII
Bangladesh	1.4	92.3	578.6	845.3	913.3	2235.4	2151.6	3613.0	III
Bhutan	0.6	0.1	-	6.2	75.5	17.1	10.3	6.0	VIII
India	**75.0**	2151.0	3588.0	7621.8	27417.1	44064.1	39916.1	**42286.0**	I
Maldives	6.5	7.2	22.3	73.2	216.5	298.0	517.5	552.0	V
Nepal	2.2	-	0.5	2.5	86.6	51.6	198.0	161.0	VI
Pakistan	**271.9**	492.1	309.0	2201.0	2022.0	1621.0	2806.0	2352.0	II
Srilanka	67.0	65.0	175.1	272.0	477.6	679.7	1374.9	1611.0	IV

Source: UNCTAD Annual Investment Report 2018

India has largest share in FDI inflows followed by Pakistan on second place and Bangladesh at third place (Table. 1). Land locked country Bhutan received the least FDI. Now a day, it has been observed that Chinese FDI inflow has increased in the neighbours of India, it is using its financial muscle power to lure these neighbours so that China can make its military bases in these countries, which is a silent warning to India s securities.

As per UNCTAD report FDI inflows to Pakistan increased because China's investment in China-Pakistan Industrial Corridor and creating infrastructure for manufacturing base. China also investing in Srilanka for creating Maritime Silk Route and Economic Belt and becomes largest source of FDI inflows in economy. Countries like, Singapore, Mauritius, USA, UK, UAE, Malaysia and Japan has shown full confidence in SAARC countries FDI inflows. FDI inflows is likely to increase in manufacturing and service sector as India improved its ranking in ease of doing business and launched program like 'Make in India' and Pradhan Mantri Kaushal VikasYojna (PMKVY). This study tries to found out the impact of FDI on GDP and impact of GDP on FDI of SAARC countries, where economic growth and FDI has been well defined.

2. Review of related Literature

In Comparative Advantage Theory David Ricardo (1817) assumed that factor of production are fully mobile with in a nation but immobile between countries. Dunning's Ownership, Location and Internalisation Frame Work **(**1979) is the most conclusive theoretical justification of FDI. This elegant framework incorporates the necessary and sufficient condition for FDI and suggests that at any given point of time presence of ownership advantage, location advantages, and Internalisation advantages, are essential for undertaking FDI. Bhagwati, J.S. (1985) introduced the hypothesis quid pro quo of FDI, which states that a firm starts investing in foreign market to avoid the threat of market restrictions for export in particular country. For example Japan made investment in auto sector of USA in mid 80s. Arshad Muhammad (2012) examined the relationship among FDI, trade and economic growth for Pakistan over the years from 1965 to 2005. The author found that trade significantly affects the inflows of FDI while relationship of FDI with GDP remains insignificant. Faiza Saleem (2013) investigated the effect of economic growth and rate of inflation on FDI during the years from 1990 to 2011 in Pakistan. The study found that the relation between FDI and inflation was positive while the relation between FDI and Gross Domestic Product was negative.

Host country's economic growth was affected positively by inflows of FDI in a nation (Taylor and Sarno, 1999). The positive impacts of FDI were more visible in the more competitive markets but FDI affect negatively to comparatively restricted markets (Encarnation and Wells, 1986). FDI enters with advance technologies and up to date skills to the countries where FDI comes and improve the productivity of economy (De Gregorio, 2003). The host countries knowledge and skill also enhanced by foreign investors. A large number of researches carried out on relationship between economic growth and FDI in their studies and explained in two sections. First, they believed that trade and business of host economy is significantly affected by FDI inflows (Markussen and

Vernables, 1998). Second, FDI is assumed to expand domestic capital and investment (Borensztein et al., 1998). The relationship between foreign portfolio and local investment is much lesser than the relationship between FDI and local investment (Bosworth and Collins, 1999). FDI has been observed to kindle economic growth through variety of researches (Glass et. al., 2002). Latin American economies has experienced that FDI and growth of a country have a direct relationship (De Mello, 1999). Some investigations suggest insignificant impact of FDI on economic growth (Akinlo, 2004). In some cases the host country affected negatively by FDI inflows. (Hermes and Lensink, 2003). Evidences support that for developed countries the efficiency of domestic corporations is directly associated with the existence of foreign corporations (Globerman, 1979). United Nation Conference on Trade and Development (1999) suggests that the impact of FDI on host countries depends upon the determinant of host economies. The variables may be GDP per capita, human capital, portfolio investment, education, trade tariffs, exchange rate, interest rates and credit facilities. The recipient outcomes of FDI are influential in the countries having higher degree of organizational potential (Olofsdotter, 1998). The review of literature illustrates that the argument on the impact of FDI on economic growth is open to question. The rationale of FDI appears to be positive, negative or insignificant; however, FDI increases the productive assets of the recipient country, including foreign assets, private enterprise, latest technology, managerial and organizational skills etc (Obwon and Marios, 2001). Prabha, P. (2014) examined FDI role for development of Indian infrastructure, states that the FDI has been recognized as an important driver for economic growth and development for developing economies. Gupta, Seema (2016) studied the relationship between FDI and Corporate Hospitals in India a study of Delhi and NCR, states that the patients have shown their preference in FDI hospitals because of good infrastructure and use of latest technology. Chowdhary, Nidhi. (2016) studied the FDI inflows in India its trends, determinants and implications for development. They stated that FDI has been accepted as the most favoured method of capital inflow owing to its long term assurance nature. Chowdhary, SBR. & Chetty, P. (2018) examined the Reforms in Policies and Regulation of FDI in India state that since 1991 economic reforms, India has seen a drastic improvement in the GDP performance. FDI has played a key role in creating enormous employment opportunity in the country. Saini, A. (2018) analyze Foreign Direct Investment in SAARC Economies states that India and Pakistan succeed to receive the large FDI inflows during the recent decades regards to large market size i.e. GDP and GNI, tax incentives, availability of high quality multilingual work force, finally effective policies environment. In more open economies the relationship between GDP and FDI was bidirectional but in closed economies the relationship was unidirectional between GDP growth and FDI (Basu et. al., 2003). The FDI effect was positive on economic growth in open economies (Trevino et al., 2003). FDI inflows also depend upon other factors of the host economy, which includes wage level, educational level, institutional environment, tax system, safety measures, macro economic strength and political situation. The effect of infrastructure, organizational environment, trade taxes, macroeconomic indicators, and political constancy on FDI inflow is encouraging (Mallampally and Sauvant, 1999), but the impact of corporate taxes is likely to be negative (Gastanaga et al., 1998). FDI exerts a positive effect on economic growth above the threshold level of income not below it (Blomstrom,et, et al., 2000). They explained that only those countries can bring in the advantages of FDI that have reached a certain income level. The most important factor that impact FDI is the trade policy regime in recipient countries. Various studies have suggested that trade regime benefited the recipient countries in terms of economic growth and development (Bhagwati, 1978; 1994). FDI is the most important resource of foreign capital inflow to developing countries and it has become a substantial component of capital formation regardless of the fact that their share in world economy is declining (Kumar and Pradhan 2002). Foreign Direct investment is a key factor of economic growth and development of Bangladesh's economy (Emdad Ullah and Quamrul Alam, 2006). In the developing countries FDI plays a vital role in industrialization and economic growth. However, in case of Pakistan, the relationship between GDP and FDI inflows was negative (Nuzhat Falki, 2009). In SAARC region, FDI from external resources has more significant role than in intra SAARC investments, the only exception is Nepal where India has invested (Sayeed, 2010). FDI in Pakistan, if found to be an important source of resources, inflows to meet saving-investment gap. The factors like GDP and debt servicing have insignificant impact on FDI inflows into the country (Zahid at el, 2010). There is bidirectional relationship between FDI and economic growth mean FDI affects economic growth and economic growth affect FDI (Chowdhry and Mavrotas, 2006). There was no relation between economic growth and FDI inflows (Kholdy et al., 2005).

3. Methodology

The sample consists of SAARC countries, where FDI inflows and economic growth is well defined. The present study used data collected from United Nation Conference for Trade and Development, FDI database. The period of analysis is from 1991 to 2018. The literature generally suggests a positive relationship between FDI and economic growth with several explanations. This study aims to investigate the nature of relationship

between Foreign Direct Investment and economic growth, and to demonstrate direct examination of causality between Foreign Direct Investment and economic growth using Granger causality test. The sample consists of SAARC countries, where Foreign Direct Investment and economic growth is well-defined. For this purpose, we collect the data of FDI and GDP from SAARC nations i.e. Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka over the period from 1980-2010. The data were calculated by using Eviews.

Model is;

$$GDP= \alpha +\beta\ FDI + U_t$$

Where;
GDP: dependent variable
FDI: Explanatory variable
α = Model intercept
β = FDI inflows coefficient
U_t = error term

Granger causality test has been applied to assess the direct relationship between FDI and economic growth, from below given equations (a) and (b):

$$GDP_{t=} \alpha +\beta\ GDPt\text{-}_{1\ +}\lambda\ FDI_{t\text{-}1+}\ U_t \quad (a)$$

$$FDI_t = \lambda +\eth\ GDPt\text{-}_1 + Y\ FDI_{t\text{-}1\ +}\ U_t \quad (b)$$

Where;
GDPt and FDIt: stationary time series,
Ut: error term,
lag length used in series is: 1.

If equation (a) significantly differs from zero, then we may conclude that FDI Granger causes GDP. Independently, if equation (b) significantly differs from zero, then we may conclude that GDP Granger causes FDI. Hence, Granger causality in both directions is possible.

1. Data Analysis and Results

Econometric study is conducted to determine the trend of the causal relationship between two variables. Regression analysis is made to model the relationship between GDP and FDI. Table 2 explains the country-wise regression statistics.

Table 2: Regression Statistics for GDP and FDI

GDP= α +β FDI + U_t			
Country	α	β	**R^2**
Afghanistan	**3098.855*** **(2406523)**	**70699105*** **(28.4913)**	**0.965507**
Bangladesh	**18862.44*** **(11.8649)**	**12.3013** **(18.8541)**	**0.924573**
Bhutan	**391.4603*** **(5.6279)**	**12.3013*** **(2.6058)**	**0.189726**
India	**298678.9*** **(16.1757)**	**7.342787*** **(23.6316)**	**0.950635**
Maldives	**240.3285*** **(707385)**	**1.349392*** **(14.1900)**	**0.874108**
Nepal	**2678.326*** **(9.0771)**	**49.11229*** **(14.3802)**	**0.87701**
Pakistan	**35536.83*** **(11.1999)**	**5.865556*** **(16.5501)**	**0.904261**
Srilanka	**1385.943*** **(3.2335)**	**8.964761*** **(43.0984)**	**0.984627**
• Reject the Null hypothesis at the 5% significance level			

Table No. 3
Augmented Dickey-Fuller Test Results for SAARC Countries: FDI

Source: Author's Calculation

The overall results of model suggest that the relationship between GDP and FDI positive and significant at 5 percent significance level for all seven nations, Afghanistan, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. However, for Bangladesh the model is found to be insignificant because null hypothesis at 5 percent significance level cannot be rejected. Further R^2 for each country is at higher level except for Bhutan that a small impact in the models is not explained but the large impact is explained by FDI.

Variables	Test Equation	Level		1st Difference	
		t- Statistic	Prob.	t- Statistic	Prob.
Afghanistan	Intercept	-2.262632	0.1905	-6.478190	0.0000
Afghanistan	Intercept and Trend	-2.561465	0.2990	-6.334710	0.0001
Afghanistan	None	-1.427706	0.1396	-6.573669	0.0000
Bangladesh	Intercept	3.986790	1.0000	-1.125204	0.6885
Bangladesh	Intercept and Trend	2.699703	1.0000	-4.883156	0.0032
Bangladesh	None	3.934772	0.9998	-0.220958	0.5961
Bhutan	Intercept	-2.918149	0.0564	-6.091588	0.0000
Bhutan	Intercept and Trend	-3.142761	0.1170	-5.997651	0.0002
Bhutan	None	-2.301088	0.0232	-6215819	0.0000
India	Intercept	-0.773768	0.8105	-5.638388	0.0001
India	Intercept and Trend	-2.669823	0.2555	-5.542038	0.0007
India	None	0.303878	0.7663	-5.413290	0.0001
Maldives	Intercept	2.470699	0.9999	-8.414340	0.0000
Maldives	Intercept and Trend	-2.362744	0.3890	-6.807661	0.0000
Maldives	None	3.689822	0.9998	-7.473583	0.0000
Nepal	Intercept	1.058123	0.9957	-3.099547	0.0390
Nepal	Intercept and Trend	-2.383403	0.3788	4.349634	0.0115
Nepal	None	2.093950	0.9887	-2.927098	0.0051
Pakistan	Intercept	-2.507552	0.1253	-3.43570	0.0188
Pakistan	Intercept and Trend	-2.793463	0.2118	-358714	0.0792
Pakistan	None	-1.425048	0.1401	-3.501493	0.0011
Sri Lanka	Intercept	0.210350	0.9682	-3.905285	0.0071
Sri Lanka	Intercept and Trend	-2.329720	0.4047	-4.723507	0.0052
Sri Lanka	None	1.322432	0.9491	-4.420595	0.0000

To make the data stationary for analysis by applying Granger causality test the study applied Augmented Dickey - Fuller Unit Root Test in levels and in first differences of the data with an intercept (in table no. 3).

Table No. 4
Augmented Dickey-Fuller Test Results for SAARC Countries: GDP

Variables	Test Equation	Level		1st Difference	
		t-Statistic	Prob.	t-Statistic	Prob.
Afghanistan	Intercept	-5.619743	0.0001	-1.865308	0.3405
Afghanistan	Intercept and Trend	-5.587003	0.0006	-5.871484	0.0006
Afghanista	None	-	0.000	-	0.0506

n		5.248491	0	1.953391	
Bangladesh	Intercept	-0.552863	0.8643	-3.343256	0.0245
Bangladesh	Intercept and Trend	-3.102982	0.1280	-3.177465	0.1134
Bangladesh	None	1.657216	0.0727	-5.480067	0.0000
Bhutan	Intercept	-4.609115	0.0011	-5.934920	0.0001
Bhutan	Intercept and Trend	-4.507420	0.0068	-6.015582	0.0003
Bhutan	None	-2.53610	0.5846	-6.013536	0.0000
India	Intercept	-5.498219	0.0001	-5.151569	0.0003
India	Intercept and Trend	-5.454137	0.0008	-5.059229	0.0022
India	None	-0.040115	0.6598	5.228397	0.0000
Maldives	Intercept	-5.806010	0.0001	-7.553062	0.000
Maldives	Intercept and Trend	-5.794000	0.0004	-7.362733	0.0000
Maldives	None	-0.789171	0.3636	-7.737656	0.0000
Nepal	Intercept	-5.424252	0.0002	-5.690145	0.0001
Nepal	Intercept and Trend	-5.468281	0.0008	-5.619086	0.0007
-Nepal	None	-0.651762	0.4242	-5.808121	0.0000
Pakistan	Intercept	-3.198403	0.0312	-6.440450	0.0000
Pakistan	Intercept and Trend	-3.165707	0.1123	-6.474438	0.0001
Pakistan	None	-1.101646	0.2385	-6.568735	0.0000
Sri Lanka	Intercept	-4.042747	0.0044	-7.648864	0.0000
Sri Lanka	Intercept and Trend	-3.940858	0.0240	-7.558807	0.0000
Sri Lanka	None	-1.278540	0.1803	-7.801866	0.0000

Table 4 reports the Augmented Dickey - Fuller Unit Root Test Results. According to these calculations for FDI, the null hypothesis of a unit root at 1 percent level of significance can be rejected for Bangladesh, Bhutan, India, Maldives, Nepal and Sri Lanka and when the series are transformed into their first differences, it becomes stationary for Afghanistan and Pakistan. ADF calculations for GDP indicate that the data is stationary at 1 percent level of significant for all the countries except Bangladesh.

After determining whether the data series is stationary or not, we move to carry out the Granger-causality test to examine the causal links between the FDI and GDP

Table No. 5
Granger Causality test Results

Granger Causality test			
Country	Null Hypothesis	F Statistics	**P- Value**
Afghanistan	GDP does not Granger Cause FDI	**8.52368***	**0.0016**
	FDI does not Granger Cause GDP	**0.6554**	**0.5283**
Bangladesh	GDP does not Granger Cause FDI	**3.9888**	**0.0319**
	FDI does not Granger Cause GDP	**2.0780**	**0.1471**
Bhutan	GDP does not Granger Cause FDI	**5.39256***	**0.0116**
	FDI does not Granger Cause GDP	**19.7589***	**0.0000**
India	GDP does not Granger Cause FDI	**5.77122***	**0.0090**
	FDI does not Granger Cause GDP	**5.32964***	**0.0122**
Maldives	GDP does not Granger Cause FDI	**0.1248**	**0.8832**
	FDI does not Granger Cause GDP	**1.9083**	**0.1702**
Nepal	GDP does not Granger Cause FDI	**10.357***	**0.0006**
	FDI does not Granger Cause GDP	**0.1280**	**0.8805**
Pakistan	GDP does not Granger Cause FDI	**13.1364***	**0.0001**
	FDI does not Granger Cause GDP	**10.8507***	**0.0004**
Srilanka	GDP does not Granger Cause FDI	**13.8586***	**0.0001**
	FDI does not Granger Cause GDP	**5.96952***	**0.0079**
5 percent significance level			

Table 5 gives details of the Granger causality test; it indicates that there is no causality between GDP and FDI in Bangladesh and Maldives. GDP is not affected by FDI and FDI is not affected by GDP in Bangladesh and Maldives so in this study cannot be rejected. In case of Bhutan, India, Pakistan and Sri Lanka, there is Two-way causality, indicates bidirectional relation between GDP and FDI i.e. both GDP and FDI work together. While Afghanistan and Nepal exhibit unidirectional and positive causal effects from GDP to FDI. The null hypothesis that 'GDP does not Granger cause FDI' is rejected at significant level of 1 percent. Overall for SAARC countries we can say that there is Two-way causality i.e. bidirectional relation between GDP and FDI.

5. Conclusion and Recommendation

Among the most emergent parts of global economy Foreign Direct Investment (FDI) has core importance. This study observes the relationship and direction between economic growth rate and FDI by using Granger causality test. The empirical investigation carried out in this research can be summarized as; Regression Analysis was first employed, which indicates that the overall model is positive and significant at 5 percent significance level for seven countries namely Afghanistan, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. However, for Bangladesh the model is found to be insignificant, at second stage, ADF test is employed to data for Stationarity check. ADF calculations indicate that both the variables are stationary at level and first difference at 1 percent level of significance, however few exceptions are there, at the final stage, Granger causality analysis is performed, Granger causality test results strongly indicates that in case of Bhutan, India, Pakistan and Sri Lanka there is Two-way causality i.e. bidirectional relation between GDP and FDI. There is unidirectional and positive causal relation from GDP to FDI in case of Afghanistan and Nepal. No causality seems between GDP and FDI in Bangladesh and Maldives. A research on causality between Economic Growth and Foreign Direct Investment in SAARC countries for the period over 1991-2018 highlights the significance of FDI for economic growth and stability in these countries under the hypothesis that 'FDI does Granger cause GDP'. Similarly, more attention is required to be given to the economic growth as it is one of the key determinants of Foreign Direct Investment.

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