Foreign Direct Investment (FDI) Flows in SAARC Countries

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Abstract: Foreign Direct Investment (FDI) has grown steadily in volume and is a major source of development finance. Recognizing that FDI can contribute to economic development, all countries want to attract it. However, the experience has been mixed. The paper examines the regional trends in FDI inflows and the experiences of SAARC countries i.e., Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

KEY WORDS: FDI, inflow, outflow, SAARC, World Bank, trends.

Foreign direct investment is treated as an important mechanism for channelizing transfer of capital and technology and thus perceived to be a potent factor in promoting economic growth in the host countries. Moreover, multinational corporations consider FDI (Foreign Direct Investment) as an important means to reorganize their production activities across borders in accordance with their corporate strategies and the competitive advantage of host countries. These considerations have been the key motivating elements in the evolution and attitude of EMEs (Emerging Market Economy’s) towards investment flows from abroad in the past few decades particularly since the eighties. This section reviews the FDI policies of select countries to gather some perspective as to where does India stand currently and to draw policy imperatives for FDI policy in India (RBI research paper 2010).

Heads of Seven South Asian Countries of SAARC (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) signed a charter to establish the South Asian Association for Regional Cooperation (SAARC) on December 8th, 1985. Afghanistan joined SAARC as a member at the fourteenth SAARC Summit, Delhi, April 2007. SAARC is a unique concept of regional cooperation. With very distinct geographical, cultural, environmental diversity, the SAARC member states compress of the world’s highest mountains, landlocked mountains terrains to deltaic low line flood – prone areas and one of the smallest low-line island nation in the world. With the world’s most populous country, SAARC is home to nearly 1.5 billion people or about 22% of world’s population. (http://www.saarc-sec.org/Charter-Day/6).

SAARC countries face different challenges in building a conducive business environment and an attractive investment climate, which are crucial for promoting economic development. These challenges include, for instance, stabilization in Afghanistan, security concerns in the Pakistan, and macroeconomic as well as political issues in India. Two issues standout as major concerns: political risks and obstacles at a country level and weak integration processes at the regional level. At the country level, high political risks and obstacles have been an important factor deterring FDI inflows. Countries in the region rank high in the country risk guides of political-risk assessment services, and political restrictions on both FDI and business links between countries in the region have long existed. This has deterred FDI inflows and negatively affected the countries’ FDI performance. However, recent developments have highlighted new opportunities. For instance, the political relationship between India and Pakistan, the two major economies on the subcontinent, has been moving towards greater cooperation, with Pakistan granting India most-favored nation status in November 2011 and India recently announcing that it will allow FDI from Pakistan. In Afghanistan, some FDI has started to flow into extractive industries (Parvakar sahoo 2006 and EXIM bank occasional paper 2008).

At the regional level, progress in economic integration (with the South Asian Association for Regional Cooperation as the key architect) has been slow, and the trade barriers between neighboring countries in the region are among the highest in the world. South Asia is perhaps one of the least integrated developing regions: intra-regional trade accounts for about 2 percent of total gross domestic product (GDP), compared with more than 20 per cent in East Asia. In addition, investment issues have not yet been included in the regional integration process. As a result, the region has not been able to realize its potential for attracting FDI inflows, especially in promoting intra-regional FDI flows. In 2011, intra-regional Greenfield investment accounted for merely 3 per cent of the regional total, compared with 27 percent in East and South-East Asia. Nevertheless, high economic growth in major
economies in the sub-region has created a momentum for regional integration in recent years, and SAARC countries have increasingly realized that regional integration can help them improve the climate for investment and business. The inclusion of an investment agenda in the regional integration process and in particular the creation of a regional investment area can play an important role in this regard (UNCTAD and UNESCAP reports 2012).

Table 1

FDI inflow in SAARC countries

<table>
<thead>
<tr>
<th>Year</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
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<td>Afghan</td>
<td>58</td>
<td>187</td>
<td>271</td>
<td>238</td>
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<td>94</td>
<td>76</td>
<td>211</td>
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<td>156</td>
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<td>Banglad</td>
<td>268</td>
<td>449</td>
<td>813</td>
<td>697</td>
<td>653</td>
<td>1,010</td>
<td>733</td>
<td>918</td>
<td>798</td>
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<td>Bhutan</td>
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<td>3</td>
<td>9</td>
<td>6</td>
<td>74</td>
<td>3</td>
<td>7</td>
<td>19</td>
<td>16</td>
<td>16</td>
</tr>
<tr>
<td>India</td>
<td>4,323</td>
<td>5,771</td>
<td>7,269</td>
<td>20,029</td>
<td>25,228</td>
<td>43,406</td>
<td>35,581</td>
<td>26,502</td>
<td>32,190</td>
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<td>53</td>
<td>53</td>
<td>64</td>
<td>126</td>
<td>175</td>
<td>154</td>
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<tr>
<td>Nepal</td>
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<td>0</td>
<td>2</td>
<td>-7</td>
<td>6</td>
<td>1</td>
<td>38</td>
<td>88</td>
<td>94</td>
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<tr>
<td>Pakistan</td>
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<td>2,201</td>
<td>4,273</td>
<td>5,590</td>
<td>5,438</td>
<td>2,338</td>
<td>2,018</td>
<td>1,309</td>
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<td>Sri Lanka</td>
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<td>272</td>
<td>480</td>
<td>603</td>
<td>752</td>
<td>404</td>
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<td>32469</td>
<td>50127</td>
<td>39331</td>
<td>30450</td>
<td>35728</td>
<td>26533</td>
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</tbody>
</table>

Source: worldbank.org

Figure 1: FDI inflow in SAARC countries

Source: World bank.org

In SAARC countries, FDI inflows have turned around after a slide in 2008–2009, reaching $ 50785 million, mainly as a result of rising inflows in India, which accounted for more than four-fifths of the region’s FDI. Countries in the region face different challenges, such as political risks and obstacles to FDI, that need to be tackled in order to build an attractive investment climate. Nevertheless, recent developments such as the improving relationship between India and Pakistan have highlighted new opportunities.

**Afghanistan:**

Almost more than 20 years of insurgency and civil disputes due to political and economic instability, at this time, the majority of Afghans still live in depressing poverty without access to even safe drinking water or electricity to improve their living standards. To attain prosperity and development, Afghanistan offers broad opportunities for foreign as well as domestic investors. However, poor infrastructure and inland security situation make Afghanistan a challenging business environment. Though, the Silk Route, Afghanistan’s location makes it a natural hub for trade and transit between Central and South Asia and has million people’s domestic markets. In fact, many foreign companies find great rewards in setting up training programs for Afghan workers. Afghanistan Transitional Commercial Law Project also helps through the Afghan Embassy in USA to encourage FDI inflows into Afghanistan.
Government of Afghanistan is trying to promote a business-friendly environment and to enhance more FDI. FDI inflows into Afghanistan during 2007 was US$ 288 million and total FDI stocks at US$1,116 million, representing 12.6% of gross domestic product (GDP). The top FDI destination sectors were services, agriculture, and construction. The largest investors were the USA, Turkey, South Africa, Pakistan, and Iran (EXIM bank occasional paper 2008 & http://20012009.state.gov/e/eeb/ifd/2005/44813.html)

**FDI trends in Afghanistan**

The Inflow of FDI into Afghanistan is low compared to other SAARC countries. Afghanistan is the third lowest in SAARC FDI inflow. GDP of Afghanistan is $33.55 billion, GDP growth rate 11%, GDP by sector- Agriculture 20%, Industry 25.6% and Service 54.4% during 2012-13. The total FDI inflow is amounting US$ 1563.33 Million from 2003 to 2012.

**Bangladesh:**

In the late 1980s and the 1990s, Bangladesh announced a series of measures and liberalized its FDI policy framework. In recent years, Bangladesh has significantly improved its investment and regulatory environment, including the liberalization of the industrial policy, abolition of performance requirements and allowance of full foreign-owned joint ventures. Since 1996, new sectors have been opened up for foreign investment, including the telecommunications sector. Foreign direct investment is encouraged in all industrial activities in Bangladesh. The government has liberalized its industrial and investment policies in recent years by reducing bureaucratic control over private investment and opening up many areas. Some of the major incentives are tax exemptions for power generation, import duty exemptions for export processing, an exemption of import duties for export-oriented industries, and tax holidays for different industries. On the whole, Bangladesh has taken considerable steps to reform and liberalize in all its economic policies including FDI. With low-labor costs and almost no restrictions on the entry and exit of foreign investors, Bangladesh on the track toward becoming an attractive destination for FDI in the South Asian region (Pravakar Sahoo, 2006 & M Azam, 2008)

**FDI trend in Bangladesh**

The Inflow of FDI in Bangladesh ranks third among SAARC countries. Bangladesh GDP growth rate 6% GDP by sector- Agriculture 17.3%, Industry 28.6% and Service 54.1% during 2012-13. The main FDI sectors are power and energy, manufacturing, telecommunications, agricultural, industrial and trade and commerce. The total FDI inflow is amounting to US$ 7043 from 2003 to 2012.
The above figure shows that there is no stability in FDI inflows. FDI inflows peaked during the year 2005, 2008 and 2010. Since 2003 inflow maintained fall and rise due to countries crisis. The FDI was US$ 268 million in 2003 and reached over 1,010 million in 2008. During 2012 it was only US$ 704 million.

Nepal

The FDI in Nepal is not at the peak. The flow of inward FDI was at peak during mid-1990 and thereafter declined due to country’s civil war of Maoist insurgency. However, as Maoist ended up the decade’s civil war and joined the Government, Presently Nepal is creating a peaceful environment for the Foreign Investors. The political disputes are cooling, and several foreign investors are keeping an eye to Nepal. Nepal’s FDI projects include mostly in manufacturing, hydropower, mineral exploitation, construction, Agro based, chemicals, tourists hotels and restaurants, specialized services and in food and beverage industries. By the year 2005, Hotel & Resorts undertook 440 projects under manufacturing industries followed by 227 projects. In context to the approved FDI projects, more than 40% of investment comes from India; Nepal has been widely entertaining most of its FDI in Manufacturing industries. The low-labor cost might have pursued it. More than 32% of its total investment has been only in Manufacturing projects (Krishna KC 2011, R. Adhikari 2013)

FDI trends in Nepal:

The Inflow of FDI in Nepal is 7th position in the SAARC countries FDI inflow. GDP of Nepal is $40.81 billion GDP growth rate 4.6% GDP by sector- Agriculture 35%, Industry 20% and Service 45% during 2012-13. Nepal FDI inflow is modest rising trend. The total FDI inflow is amounting 263 US Million dollars of Nepal from 2003 to 2012.
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Source: World bank.org

From the above diagram the FDI inflows in Nepal initially it was not attracted and sometimes negative growth (-7 billion dollars) due to armed insurgency and political instability as well as lack of economic policy. Although growth rate of FDI in the recent past (2009 onwards 38 billion dollars) are reasonably good despite the same situation, as it needs to be there is a tremendous untapped potential for attracting foreign investment in Nepal, which can be achieved through serious and concerted efforts on the part of Nepalese stakeholders.

Bhutan

There are two countries in SAARC region Nepal and Bhutan where India is the predominant source of FDI. Bhutan one of the world's smallest and least developed countries, is based on agriculture and forestry, which provide the main livelihood for more than 60% of the population. It is the only nation development is guided by the concept of Gross National Happiness. Rugged mountains dominate the terrain and make the building of roads and another infrastructure difficult and expensive. Bhutan introduced a FDI as developmental strategy in 2002 and it is keen to attract Indian investors in areas like generation of Hydel power, Information and Communication technology, Hospitality, Agriculture and infrastructure. With such an objective, the Bhutanese government is liberalizing its FDI laws and sectoral cap to make the nation an attractive investment destination (Dorji P.2010)

FDI trends in Bhutan

The Inflow of FDI in Bhutan is 8th position in the SAARC countries FDI inflow. GDP of Bhutan is $3.789 billion GDP growth rate is 6.6% GDP by sector- Agriculture 22.3%, Industry 37.9 % and Service 39.8 % during 2012-13. Bhutan FDI inflow is rising and falling trend. The total FDI inflow is amounting to 156 US Million dollars from 2003 to 2012.

Source: World bank.org

From the above figure, the FDI inflow of Bhutan is nascent stage during 2003 FDI inflow is 3 billion dollars and again maximum rise in 2007 is 74 billion dollars thereafter again fall to 3 billion dollars during 2007. The performance of the recent past is reasonable good and upward trend due to open economy policy to attract FDI.

India

The economy of India is the ninth-largest in the world by nominal GDP and the third-largest by purchasing power parity (PPP). The country is one of the G-20 major economies and a member of BRICS. On a per-capita-income basis, India ranked 141st by nominal GDP and 130th by GDP (PPP) in 2012, according to the IMF. India is the 19th-largest exporter and the 10th-largest importer in the world. As the third-largest economy in the world in PPP terms, India is a preferred destination for FDI; India has strengths in telecommunication, information technology and other significant areas such as auto components, chemicals, apparels, pharmaceuticals, and jewellery (source: Wikipedia on Indian economy). Despite a surge in foreign investments, rigid FDI policies were a significant hindrance. However, due to positive economic reforms aimed at deregulating the economy and stimulating foreign investment, India has positioned itself as one of the front-runners of the rapidly growing SAARC region. The inordinately high investment from Mauritius is due to routing of international funds through the country given significant tax advantages; double taxation is avoided due to a tax treaty between India and Mauritius, and Mauritius is a capital gains tax haven, effectively creating a zero-taxation FDI channel.

India's liberalized FDI policy as of 2005 allowed up to a 100% FDI stake in ventures.
Industrial policy reforms have substantially reduced industrial licensing requirements, removed restrictions on expansion and facilitated easy access to foreign technology and foreign direct investment. The upward moving growth curve of the real-estate sector owed some credit to a booming economy and liberalized FDI regime. A number of changes were approved on the FDI policy to remove the caps in most sectors. Fields which require relaxation in FDI restrictions include civil aviation, construction development, industrial parks, petroleum and natural gas, commodity exchanges, credit-information services and mining. But this still leaves an unfinished agenda of permitting greater foreign investment in politically sensitive areas such as insurance and retailing. The critical factor in determining India’s continued economic growth and realizing the potential to be an economic superpower is going to depend on how the government can create incentives for FDI flow across a large number of sectors in India (RBI 2010 research paper and ASSOCHAM report 2012)

FDI Trends in India

The Inflow of FDI in India is at high compared to other SAARC countries. India is one among the top countries in the Asia continent receives a highest FDI inflow. GDP of India is $1.824 trillion GDP growth rate is 3.986% GDP by sector- Agriculture 17.2%, Industry 26.4 % and Service 56.4 % during 2012-13. The main sector of FDI inflow are Retailing, Insurance, civil aviation, Mining, petroleum and natural gas, media and telecommunication, commodity exchange, Banking and others. The total FDI inflow amounting is 222554 US Million dollars from 2003 to 2012.

FDI Trends in Maldives

The Inflow of FDI in Maldives is sixth place in the SAARC countries. GDP growth rate is 7.4% , GDP by sector- Agriculture 5.6%, Industry

Source: World bank.org

The above figure explains the trend of FDI is rising, and was peak during 2008-2009. Thereafter inflow maintained fall and rise due to countries economic crisis as well as global economic crisis. Where the FDI was 7,269 million in 2005 and reached over 43,406 million in 2011, this shows the increasing trend of inward FDI flow of India. Government FDI policy on Private banking 100%, NBFC 100%, Insurance 26%, Telecommunications 100%, Petroleum and exploration 100%, Housing and real estate 100%, Power 100%, Drugs and pharmaceuticals100%, Road, ports and highway 100%, Hotel and tourism 100%, Advertising and films 100%, SEZ 100%, Township, housing and infrastructure 100%, Retail sector- single brand retail sector and multi-brand retail sector (FDI policy, GOI,2012-13, ).

Maldives

Foreign Direct Investments (FDI) has always played a crucial role in the economic development of the Maldives. The Government acknowledges the importance of foreign investment and recognizes its contribution to economic development. The success of foreign investments in Maldives can be attributed to its open and liberal economic environment, relative political stability and the consistent growth of the economy, which has achieved an average annual growth rate of 7.5 percent over the last 15 years. Foreign investors are offered a simple and transparent policy environment and continuous efforts are being made to make the investing environment more predictable and transparent. Capitalizing on the numerous benefits of investing in the Maldives, many reputed international brand names have established their investments in the country (EXIM bank occasional paper 2008 & Maldives FDI rules and regulations 2012)

FDI trend in Maldives

The Inflow of FDI in Maldives is sixth place in the SAARC countries. GDP growth rate is 7.4% , GDP by sector- Agriculture 5.6%. Industry
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16.9% and Service 77.5%. The main industries include fish processing, tourism, shipping, boat building, Coconut processing, Garments, Woven mats, Rope, handicrafts, Coral, Sand mining. The total FDI inflow amounting is 1283 US Million dollars from 2003 to 2012.

Figure 5-FDI Trends in Maldives

![Graph showing FDI trends in Maldives]

Source: world bank.org

The above figure explains the trend of Maldives inflow of FDI is towards rising, and it was peak during 2010-2011; initially it was very low inflow but after 2007 the inflow of FDI raised due policies and schemes in favour of FDI. Where the FDI was 32 million in 2003 and reached over 282 million in 2011.

Pakistan

Pakistan has thrown its doors wide open to FDI, which is expected to bring huge benefits. However, unlike China and India, Pakistan has not been successful in obtaining substantial and consistent FDI inflows. Furthermore, the meager inflows that the country has received have not been utilized appropriately to enhance the economic performance. FDI inflows are still too low and this might be because the economic reforms went far enough to change the character and type of FDI. The type of FDI and its structural composition matter as much for economic growth. After following somewhat restrictive economic policies, the government of Pakistan initiated market-based reforms in the 1990s. These reforms included gradual liberalization of trade and investment regime by providing various trade and fiscal incentives to foreign investors through tax concessions, credit facilities, tariff reduction and easing foreign exchange controls. In the early 1990s, the government undertook a number of policy and regulatory measures to improve the business environment and attract foreign investment. Restrictions on capital inflows and outflows were also gradually lifted. In 1994, restrictions on some capital transactions were partially relaxed and foreign borrowing and certain outward investments were allowed to some extent (Muhammad Arshad Khan, Shujaat Ali Khan 2011).

FDI trend in Pakistan:

The Inflow of FDI in Pakistan is at high compared to other SAARC countries. FDI Inflows to Pakistan were the second highest in SAARC countries; GDP growth rate is 3.7% GDP by sector-Agriculture 21.2%, Industry 25.4% and Service 53.4%. The main sectors of FDI inflows are Manufacturing/Industrial Sector, Tourism, Housing and Construction, Information Technology, Others-Services Sector, Infrastructure Sector, Social Sector and Agriculture Sector the total FDI inflow amounting is 27576.6 US Million dollars from 2003 to 2012.

Figure 6

FDI trend in Pakistan
The above figure explains the FDI was at peak during 2007-2008. Thereafter inflow gradually decreased from 2009 to 2012, due to country's insurgency period and political disputes. Where the FDI was 5,438 million in 2008 and reached over 1,309 million in 2011, this shows the increasing trend of inward FDI flow.

**Sri Lanka**

There are basically two distinctive phases in Sri Lanka's FDI policy. The first phase was from 1948-1977, when the public sector was the dominant entity and controlled the country's resources. The second distinctive phase is of course the post-1977 period, when Sri Lanka launched its economic reform which favored private-sector led, export-oriented development including a greater role for FDI. Many barriers were dismantled, including trade and payment barriers, the exchange rate was unified, agricultural and export taxes were restructured, administered prices were adjusted, and restrictions on pricing and investment by the private sector were reduced. The most important feature of FDI policy measure in Sri Lanka was the establishment in 1992 of the Board of Investment (BOI), with wide powers of tax relief and administrative discretion in all matters related to FDI (Pravakar Sahoo 2006).

**FDI Trends in Sri Lanka**

The Inflow of FDI in Sri Lanka is fourth place in the SAARC countries. GDP growth rate is 7.2% GDP by sector- Agriculture 12.8 %, Industry 29.2 % and Service 58 %. The main sectors of FDI inflows are Tourism, Power and energy, Telecommunication and Ports development sector. The total FDI inflow amounting is 4896 US Million dollars from 2003 to 2012.

Source: World bank.org
The figure explains the trend of FDI is rising, and was peak during 2011; the trend line is towards rising. Since 2006 inflow maintained fall and rise due to countries crisis. Where the FDI was 480 million in 2006 and reached over 956 million in 2011, this shows the increasing trend of inward FDI flow of India.

**Conclusion:**

FDI has grown steadily in volume over the past two decades and is a major source of development finance. Recognizing that FDI can contribute to economic development, the world market for such investment is highly competitive, and south Asian developing countries, in particular, seek such investment to accelerate their development efforts. With liberal policy framework becoming common place and losing some of their traditional power to attract FDI, Governments are paying more attention to measures that actively facilitate it. The economic determinants are imperative. The principal economic determinants are: market size and per capita income, access to regional and global markets, market growth, raw materials, skilled labor, physical infrastructure and technology. The country experiences also indicate that it is not the FDI-specific policies that are important but the broader economic policies including corporate taxes, trade openness and other business climate issues such as regulations. However, it is likely that in the future, SAARC countries can offer potential investors would emerge as major determinants of FDI.

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