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Macroeconomic Impact of Foreign Direct Investment: A Study on SAARC Countries

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Abstract
With the greater integration of world economy foreign direct investment (FDI) has become a very common feature in almost every countries of the world. But, there is a trend of these FDI flows to be directed towards the developing nations because of emerging opportunities and huge market potentials. However, there are a lot of debates about the contribution of FDI in the developing economies. Therefore this study is intended to measure the macroeconomic impact of FDI in SAARC countries. This study has selected six macroeconomic variables: gross domestic product, inflation, current account balance, government revenue, total foreign exchange reserve and gross capital formation to test the impact of FDI on them. Required data have been collected from the websites of World Bank and International Monetary Fund for a period of 11 years from 2002 to 2012 and analyzed applying correlation and simple regression methods using SPSS 16.0. From the analysis this study has found that if FDI flows into a country increase, the level of gross domestic product, inflation, government revenue, foreign reserve and gross capital formation of that country are also expected to be increased. On the other hand, if FDI increases, current account balance is expected to be decreased in a country.
Keywords: FDI, gross domestic product, inflation, current account balance, government revenue, foreign exchange reserve, gross capital formation.

1. Introduction

Being part of the global village, each country's development and growth is now affected by the forces other than just its own. Globalization is the process in which countries have become integrated through trade, transportation and communication by the exchange of economies, societies and culture. Such integration through trade and investment, in form of export-import, portfolio investment or foreign direct investment (FDI) are very much crucial for the developing countries. Again, with the establishment of different cooperative agreements among corporations and countries throughout different regions of the world, rapid growth of FDI during 1980s to 1990s has suppressed the even growing trend of international trade (Adewumi *et al.* 2006). FDI is assumed to accrue more benefits than other types of financial flows. There are numerous opinions and debates about the possible benefits and downsides of FDI. However, policy makers and governments of most of the countries are trying to increase FDI inflows to overpass the gap between the domestic saving and investment to accelerate growth. Besides supplementing domestic capital stock, FDI brings productivity growth (United Nations, 2005), employment opportunities, new technology, efficient management practices; reduces vulnerability of capital flows and boosts the development of local firms through backward and forward linkages (De Mello, 1997; Lipsey, 2002 and Alguacil *et al.* 2008). However, there are some arguments against FDI also. It is also said that FDI causes current account deficits, deteriorates other accounts in balance of payment, increases inflation, move out part of Gross Domestic Product (GDP) in the form of income and profit, negatively affect the growth of domestic firms and in actual sense doesn't transfer any important know how and technology. In the way of continuous cost benefit analysis of FDI, scholars often argue that, developing countries having appropriate policies and a basic minimum level of educational, technological and infrastructure development can effectively milk the opportunities from FDI and circumvent the threats, thereby create a better economic environment.

Recognizing such significance of FDI, this study has set the objective to analyze the macroeconomic impact of FDI on the economies of SAARC countries. It has in fact attempted to examine the impact of FDI on Gross Domestic Product (GDP), inflation, current account balance, government revenue, total foreign exchange reserve and gross capital formation. SAARC stands for South Asian Association for Regional Cooperation. Established on 1985 and having Secretariat is based in Kathmandu, Nepal, it is an economic and geopolitical organization of eight countries that are primarily located in South Asia. The countries are: Bangladesh, Pakistan, Bhutan, India, Maldives, Nepal, and Sri Lanka and recently Afghanistan (Wikipedia, 2014). All of these countries are just developing towards their paths of progress. Therefore this study can help these countries to identify the actual impact FDI is causing to their different macroeconomic factors. Moreover, these countries will be able to adjust their positions regarding the vulnerabilities and also to exploit the newly identified opportunities and strengths.

2. Literature Review

2.1 Foreign Direct Investment (FDI)

FDI is the sum of equity capital, reinvestment of earnings, long term and short term capital that usually involves participation in management, joint ventures, transfer of technology and experience in a foreign country (Abbas *et al.* 2011). FDI is often credited as source of economic growth and development as it enhances exports and improves the production efficiency of the host country. Though it is frequently defined as the long term investment in foreign country with long term profit expectation (Caves, 1996), the definition is incomplete. It is because, unlike portfolio investment, FDI involves investor's participation in the control and management of the business venture and results in internationalized production. The issue of lasting interest is also stressed in the Balance of Payment Manual fifth edition by International Monetary Fund, which requires the investor to have 10% or more as minimum contribution to management and control (Adewumi *et al.* 2006).

2.2 Positive Contributions of Foreign Direct Investment (FDI)

Different authors have noted different benefits of FDI both to the host country and the home country. Among the mostly cited benefits, there are promotion of industrial development (Markusen *et al.* 1999), technology and know-how transfer (Blomstrom and Persson, 1983; Kokko, 1996; Zhou et al, 2002; Sinani and Meyer, 2004), creation of backward linkages with local firms, addition to the supply of capital (Lin and Saggi, 2005, 2007; Nguyen and Minda, 2012), potential to create jobs, raise of productivity, efficient management of acquired firm and enhancement of exports. Multinational corporations (MNCs) generally have greater investment and risk taking capability to pursue projects beyond the domestic investors. FDI supplements domestic savings and increases the capital base of the host country (Jones, 1996). It also helps to minimize the government intervention in some types of businesses establishing foreign ownership and control. Many of the developing nations depend on tax as the prime source of government revenue. FDI helps to increase both corporate tax from greater business and income tax from higher income of the citizens (MacDougall, 1960). Thus the benefits of FDI can be summarized as: it brings new technology and know-how, contributes to the development of companies and their restructuring, enhances international trade and integration into the world economy, increases competition, raises government revenue, contributes to the creation of human capital and fosters economic growth (Mahmood and Chaudhary, 2013 & United Nations, 2003).

2.3 Negative Side-Effects of Foreign Direct Investment (FDI)

Despite the benefits that can be derived from FDI, it should be noted that it can also bring about some negative impact. The main reason for which FDI is often criticized by local investors is that, MNCs with their higher competitive capability may replace the local firms, thereby reducing the growth of the local firms (Jones, 1996). In some cases FDI can reduce competition to an extent enough to establish a powerful monopoly that deters the establishment of new domestic firms (Mencinger, 2007). Again, without proper regulation FDI can cause capital flight from the developing countries to the developed ones due to more congenial business environment in developed countries with minimal economic and political risks. Moreover, in order to utilize higher production capacity and to achieve economies of scale, MNCs may hasten large scale environmental damage especially in the natural resources sectors (Bora 2002 and Adewumi *et al.* 2006). Very often, specialization and purchases of raw materials within a multinational chain breaks down the backward and forward linkages among domestic firms which are worsened by the use of transfer prices enabling MNCs to avoid or lower taxes on profits (Adewumi *et al.* 2006). Thus the entry of multinational firms may hurt the development of the host country by lowering the production of domestic firms (Nguyen *et al.* 2010), reducing total factor productivity (Haddad and Harrison, 1993 & Barrios and Strobl, 2002) or transferring out domestic investment (Boreinszten *et al.* 1998).

2.4 Macroeconomic Variables Affected by FDI

FDI affects almost all variables, either directly or indirectly of the macroeconomic environment of a country. Among the mostly affected areas, here are some discussions below-

2.4.1 Gross Domestic Product (GDP)

Gross Domestic Products refers to the market value of all final goods and services produced within a country in a given period. GDP growth is usually the parameter to measure the economic growth and is often considered an indicator of standard of living for a country (Adewumi *et al.* 2006 and Abbas *et al.* 2011). Foreign direct investment is a part of GDP. So, there is a significant relationship between these two. FDI and trade contribute to economic growth and development of the recipient country (Kaur *et al.* 2012). FDI increases capital base, enhances domestic investment in productive sectors, creates employment, improves technical know-how and expertise of workers, raises production of higher quality goods and helps greater volume but lower price services production and boosts income level and thereby contributes to GDP (Lipsey and Sjoholm, 2004).

2.4.2 Inflation

Inflation refers to a sustained increase in the average price level and is measured by the consumer price index

(Abbas *et al.* 2011). Inflation has positive as well as negative effects on the economy and investment is mostly effected by it. Increase in capital inflow raises the local currency value which in turn decreases export and increases inflation. The relationship between inflation and foreign capital inflow has been viewed in different ways by different scholars. Kim and Yang (2008) suggested that capital inflows cause asset prices to appreciate and Agcaoili (2011) supported the later exclaiming that domestic economy of the emerging markets is capable of absorbing the strong inflow without resulting inflation. Therefore, it is important to evaluate whether there is a significant inflationary impact of capital inflows from FDI (Nazir *et al.* 2012).

2.4.3 Current Account Balance

One of the mostly cited undesirable effects of FDI is widening the already existent current account deficits in the developing countries (Calvo *et al.* 1996). FDI increases profit repatriation and import of high tech services and affects import and export of goods and services, thereby influencing balance of income and trade (Kaur *et al.* 2012). Some experts mention that FDI in tradable goods stimulates short-term exporting (Kinoshita, 2011 & Gheorghea and Vasilea, 2012). But, whenever FDI is just a sale of assets in the process of privatizations it leads to higher deficits. Because, cash from sales are generally spent on consumption and imports while benefits of such FDI flow abroad in the form of profits and dividends (Mencinger, 2007).

2.4.4 Government Revenue

Taxes, direct and indirect, are crucial among the prime sources of government revenue. Generating positive effect on the economic growth and income levels FDI can help the government to generate more indirect taxes. It also increases the collection of corporate income taxes (Caves, 1971 & Mahmood and Chaudhary, 2013) and helps to fill the saving and foreign exchange gaps (Streeten, 1969). At the same time, it fosters foreign competition that may reduce the production and profit of domestic firms and thereby lowers the level of corporate tax revenue (Markusen and Venables, 1999 and Nguyen *et al.* 2010). The degree to which FDI contribute to government revenue in the host country depends upon the extent of positive technological spillovers, demand for inputs and locally input sourcing by multinational firms that create supplemental demand for inputs (Lin and Saggi, 2005 & Nguyen *et al.* 2013).

2.4.5 Foreign Exchange Reserve

Foreign exchange reserves are the external assets including a country's gold holdings and convertible foreign currencies held in its banks along with special drawing rights (SDR) and exchange reserve balances with the International Monetary Fund (IMF). For direct financing of payments, such reserves are readily available to and controlled by monetary authorities. Technological, marketing and managerial advantages of FDI create immense possibilities of increased foreign exchange reserves in the recipient country. It is because multinationals have greater capabilities to tap international market than domestic firms with extended information access and marketing networks that allow them to contribute more to increase foreign exchange reserves in the host country (Chopra, 2002).

2.4.6 Gross Capital Formation

Gross capital formation is the total investment or addition to the physical stock of capital in the economy for the given period which includes domestic as well as foreign direct investment (Adewumi *et al.* 2006). It is also called the creation of productive assets used to produce goods and services and is used as a macroeconomic parameter that determines the growth of an economy (Scott, 2003). Establishing backward and forward linkages with local industries to encourage domestic investment, transferring technologies and better management techniques, having access and capability to consider a wide variety of investment options, FDI also serves to boost the formation of gross capital in the host country (Sun, 2002).

2.5 Previous Studies in This Field

Numerous researches have been conducted concerning the impact of foreign direct investment (FDI) on different macroeconomic variables. Some of these researches focused on a single country, some on more than one country while some other focused on several countries or a continent. Again some researchers included only one macroeconomic variable and some other considered several variables at a time.

Abbas *et al.* (2011) investigated the impact of foreign direct investment on growth (GDP) of SAARC countries by applying multiple regression models and using data from 2001 to 2010. They found a positive and significant relationship between GDP and FDI while an insignificant relationship between GDP and inflation. Gheorghea and Vasilea (2012) focused on the relationship between main determinants of FDI efficiency for host and origin countries in order to analyze the impact of FDI in Romania. They centered on macroeconomic aggregates of GDP, exports, imports, trade balance, current account and balance of external payments. As the impact of FDI is different in different recipient countries, Lipsey and Sjoholm (2004) attempted to find out the answer behind such controversies studying the impact of inward FDI on host countries. Adewumi *et al.* (2006) checked the contribution of foreign direct investment to economic growth in Africa using graphical and regression analysis, taking data from 1970-2003 for eleven countries. They discovered that the contribution of FDI to growth is estimated to be positive in most of the countries but not significant. Karbasi *et al.* (2005)

analyzed the role of FDI and trade in promoting economic growth by examining data from 42 developing countries over the last three decades and found a positive interaction. Applying time series data regression from 1990 to 2011 Saleem *et al.* (2013) found that FDI has a positive relationship with inflation and a negative relationship with GDP. Between FDI and GDP, a slightly negative and highly significant relationship has been found by Stohldreier and Zilibotti (2009). They analyzed panel data of 1985-2005 for all Chinese provinces using a regression model in order to identify the impact of the Chinese FDI promotion on its economic performance and the development of the rural and coastal provinces.

Hansen and Rand (2004) examined the causal links between FDI and growth in developing countries, analyzing Granger-causal relationships between FDI and GDP in a sample of 31 developing countries covering the period 1970-2000. They found that FDI causes growth affecting gross capital formation through knowledge transfers and new technology adoption. In their analysis based on cross sectional data of a sample of 66 developing counties over three decades, Makki and Somwaru (2004) indicated that FDI and trade contribute significantly towards advancing economic growth in developing countries. They showed that FDI interacts positively with trade and stimulates domestic investment. They also pointed that macroeconomic policies and institutional stability are necessary pre-conditions for FDI-driven growth to materialize. Alguacil *et al.* (2008) evaluated the relationship between inward FDI and growth and the role of macroeconomic and institutional environment in this relationship estimating both dynamic panel data and cross-section regressions for a group of emerging countries from Latin America and Asia during the period 1976-2005. The analysis revealed the importance of considering the macroeconomic environment as well as institutional quality factors when evaluating the economic impact of foreign inflows.

Banerji (2013) attempted to analyze the merits and demerits of FDI with respect to India and its economy. Kaur *et al.* (2012) conducted a causality analysis between foreign direct investment and current account deficit in context of India using the Toda-Yamamoto (T-Y) granger causality technique for the period 1975-2009. They found FDI and current account to be co-integrated in the long run and unidirectional causality from FDI to current account. Devajit (2012) also conducted a study to investigate how FDI can stimulate domestic investment, increase human capital formation and facilitate technology transfers to affect economic growth in India. On the other hand, in Pakistan, Mahmood and Chaudhary (2013) endeavored to find the impact of FDI on tax revenue applying augmented Dickey Fuller, Phillips-Perron, Ng-Perron, Zivot-Andrews unit root tests, Auto-Regressive Distributive Lag and its error correction model and found a positive and significant impact. By testing data from 1980 to 2010 for Pakistan and applying ADF unit root test, Johnson co-integration and Vector error correction methods Yasir *et al.* (2012) found that there are long run relationship among exchange rate, FDI and foreign exchange reserves. Besides, nominal exchange rate was found to have a significant positive impact while FDI have insignificant impact on foreign exchange reserves. Jaffri *et al.* (2012) also investigated and found positive effect of FDI on income outflow and negative effect on current account balance excluding current transfers in the long-run in case of Pakistan. They employed autoregressive distributive lag (ARDL) approach for the period 1983-2011.

Nguyen *et al.* (2013) showed that the impact of FDI on government revenue will depend on the competition effect and the technological spillovers in an investigation of the effect of FDI on the welfare of the host country through the process of corporate tax rate determination. Kingombe (2002) explored the effects of globalization relating to FDI and employment, taking employment as dependent variable and the inflow and outflow of FDI, the gross and net domestic investment along with GDP as the independent variables. Nazir *et al.* (2012) used data from 1980-2010 to find out the impact of capital inflows on domestic inflation, including export, FDI, remittances, and inflation in their analysis, while applying unit root test, co-integration test and Error Correction Mechanism (ECM). They found a long run and significant positive relationship between FDI, remittance, export and inflation. Kr. (2011) proposed a new model to predict the affect of FDI, index of industrial production, per capita income, employment and inflation on GDP and proved the model to be successful using data for ten years. In Malawi, Kazembe and Namizinga (2007) analyzed the impact of foreign direct investment on development and policy challenges while they found the key deterrents to attract and retain FDI on a sustainable basis. Nair-Reichert and Weinhold (2000) used a Mixed Fixed and Random (MFR) panel data estimation method to consider cross country heterogeneity in the causal relationship between FDI and growth. Based on their findings, they suggested that the relationship is highly heterogeneous and assuming homogeneity by the traditional estimation methods can yield misleading results. Acar *et al.* (2004) explored the relationship between FDI and domestic investment in the MENA region for the post-1980 period through panel data analysis. The data used for FDI and domestic investment were inward FDI flows to the region and gross capital formation, respectively. Beyond analyzing the relationship for the whole region, MENA countries have been examined in specific groups according to their natural resource abundance. Based on a panel of bilateral FDI flows of 11 OECD countries over 1984-2000, Benassy-Quere *et al.* (2004) showed that, although agglomeration-related factors are strong determinants of FDI, tax differentials also play a significant role in understanding foreign location decisions. Sahoo (2006) provided an overview of FDI in South Asia with its policy, trends, impact and

determinants. Even not affecting domestic investment in short-run, FDI affects investment positively and significantly through dynamic effects and has a positive and significant impact on growth and export. Major determinants of FDI in South Asia were found to be market size, labor force growth, infrastructure index and trade openness. Using bounds testing methodology for the period 1976-2010, a composite index and trade openness Nowbutsing (2012) discerned impacts of public, private, and foreign fixed capital formation on growth in the short-run and long-run. The study found, overall capital formation has positive and significant effects on FDI, but private capital formation has positive but insignificant and public capital formation has negatively insignificant impact on economic growth. Alfaro (2003) using cross-country data for the period 1981-1999 showed that FDI in the primary, manufacturing, and services sectors has a negative, positive and an ambiguous effect on growth respectively. Kiat (2008) performed linear regression analysis on economic data, collected from 30 countries, to determine the relationship between FDI inflows, economic growth, exchange rate and inflation, and found that FDI follows economic growth while inflation has a negative impact, but the effect of exchange rate and of FDI on GDP is inconclusive. Goldberg (2006) studied and found that exchange rates can influence the total flow of FDI and where these flows will be directed among a range of countries. In their paper Timmer and Ark (2002) examined the impact of rapid technological progress on FDI and consequently on the rise in the capital stock of Korea and Taiwan after reconstructing the non-residential capital stock of these two countries and comparing capital-output ratios, capital-labor ratios and labor productivity levels with those in the United States for both the total economy and manufacturing. Indexed by the level of ability an economy was modeled with a continuum of agents by Alfaro *et al.* (2003) to examine links among FDI, financial markets and growth. They found that the level development of local financial markets is very important to realize the contributions of FDI to economic growth. Wenkai and Song (2009) examined FDI's both direct and indirect effects on foreign exchange reserves 1986 to 2007 in China. Results indicated that before 2003 direct effect was dominant but indirect effect was the major source of the contribution after 2004. Hejazi and Pauly (2002) inquired what happens to capital formation when FDI outflow is greater than FDI inflow using annual industry-level data for the period 1983 to 1995 in Canada. No statistically significant impact of FDI outflow and supplementary impact of FDI inflow on Canadian domestic capital formation were found.

From the review of literature in can be found that, most of the researches were conducted considering a particular country. Most of the studies considered very few numbers of variables. Though some studies considered developing economies for analysis, there is no such research work considering the impact of Foreign Direct Investment on so many macroeconomic variables like gross domestic product, inflation, current account balance, government revenue, total foreign exchange reserve and gross capital formation considering SAARC countries. Therefore, this study will contribute a lot to fulfill this gap in the literature.

3. Methodology

In this study, secondary data analysis technique has been applied. It involved review of literature from related academic papers, magazines and websites to decide on the variables to be focused on. Gross Domestic Product (GDP), inflation, current account balance**,** government revenue, total foreign exchange reserve and gross capital formation have been considered as macroeconomic variables. Data on FDI, GDP, inflation, total foreign exchange reserve and gross capital formation have been collected from World Bank and data on government revenue and current account balance have been taken from the website of International Monetary Fund. Time period covered eleven years starting from 2002 to 2012. Data have been collected for seven countries namely, Bangladesh, Pakistan, India, Bhutan, Maldives, Nepal and Sri Lanka. Though the title of the study suggests it as an analysis of SAARC countries, Afghanistan has not been included in the analysis because of the unavailability of all the required data. Correlation and Simple Regression methods have been used to identify the direction and extent of impact of FDI on particular variables. For Regression analysis, Foreign Direct Investment (FDI) has been selected as independent variable and the individual macroeconomic variables have been selected as dependent variables. In addition, p value <0.05 represents statistically significant, while p value >0.05 represents statistically insignificant results. SPSS 16.0 has been used for these analyses.

4. Analysis and Interpretation

4.1 Impact of Foreign Direct Investment (FDI) on Gross Domestic Product (GDP)

In table 1 regression results for the impact of FDI on GDP is shown. From the table it can be observed that for the SAARC countries, overall, there is a very strong positive correlation between FDI and GDP ($R = .922$). Again, 85.10% of the change in GDP can be explained by the change in FDI ($R^2 = .851$). Moreover, these relationships are statistically significant. Looking at the individual country perspectives it can be found that, in most of the countries, strong positive correlations also exist between FDI and GDP, where change in FDI can explain a considerable portion of change in GDP and the results are statistically significant. It is found in case of Bangladesh ($R = .868$, $R^2 = .754$, $p = .001$), India ($R = .754$, $R^2 = .568$, $p = .007$), Maldives ($R = .957$, $R^2 = .916$, $p = .000$), Nepal ($R = .904$, $R^2 = .818$, $p = .000$) and Sri Lanka ($R = .880$, $R^2 = .774$, $p = .000$). On the other hand,

in case of Pakistan this positive correlation is very weak (R = .181), only 3.3% change of GDP can be explained by the change in FDI (R^2 = .033) and the results are also not statistically significant (p = .595). In case of Bhutan, there is only moderate correlation (R = .532), 28.3% change in GDP can be explained by FDI and the results are also insignificant (p = .092).

4.2 Impact of Foreign Direct Investment (FDI) on Inflation

Relationship between FDI and inflation is found to be very weak but positive from the overall analysis concerning SAARC countries. From table 2 it can be observed that, the correlation between FDI and inflation is very weak (R = .127) and only 1.6% change in inflation can be explained by the change in FDI (R^2 = .016). Besides, the results are not statistically significant also (p = .271). Individual country analysis shows that, in case of India and Maldives, FDI is strongly and significantly affecting inflation (R = .808 and .839; R^2 = .653 and .705; p = .003 and .001 respectively) in the positive direction. For Bangladesh and Nepal the causal relationship is moderately strong (R = .625 and .615; R^2 = .390 and .378; p = .040 and .044 respectively). In case of Pakistan it is only moderate (R = .471) where only 22.2% change in inflation can be explained by FDI. But this relationship is insignificant as p = .143. Finally, with respect to Bhutan and Sri Lanka, the positive correlation between inflation and FDI is found to be very weak (R = .253 for Bhutan and R = .222 for Sri Lanka). A very minor portion of change in inflation can be explained as to be caused by FDI in case of these two countries (R^2 = .064 for Bhutan and R^2 = .049 for Sri Lanka). Results of these relationships are also statistically insignificant (p = .453 for Bhutan and p = .511 for Sri Lanka).

4.3 Impact of Foreign Direct Investment (FDI) on Current Account Balance

Irrespective of the arguments in the literature about the causal relationship between FDI and current account balance, this study has found very strong negative relationship between FDI and current account balance. For the SAARC countries, from the overall results found in this study and represented in table 3, it can be said that FDI is negatively affecting current account balance. That means, if FDI inflow is increased in a country, current accounts balance of that country is expected to be decreased (R = -.796). Strength of this negative relationship is found to be 63.4%, that means about 63.4% negative change in current account balance is caused by the positive inflow of FDI into a particular country (R^2 = .634). The result is also found to be statistically significant (p = .000). Except for Bangladesh and Bhutan, where the relationship between FDI and current account balance is found to be positive, all other five countries show negative relationships. Bangladesh represents very insignificant positive relationship between these two factors (R = .068, R^2 = .005, p = .843) and for Bhutan, though slightly better than Bangladesh, relationship is also very weak and insignificant (R = .176, R^2 = .031, p = .604). On the other hand, India (R = -.660, R^2 = .435, p = .027), Pakistan (R = -.772, R^2 = .596, p = .005), Maldives (R = -.696, R^2 = .485, p = .017) and Sri Lanka (R = -.946, R^2 = .894, p = .000) show strongly negative and significant relation between FDI and current account balance and Nepal (R = -.064, R^2 = .004, p = .851) shows negative but very weak and insignificant relationship.

4.4 Impact of Foreign Direct Investment (FDI) on Government Revenue

Government revenue is also found to be very strongly and positively correlated (R = .910) with FDI in this study considering SAARC countries. This study also found that about 82.8% change in government revenue can be explained by the change in FDI inflow (R^2 = .828). The relationship is also found to be very much significant (p = .000) as shown in table 4. The results represent that if FDI inflow into a country is increased, government revenue is also expected to be increased. Similarly, very strong positive correlations between government revenue and FDI are found for Bangladesh (R = .858), India (R = .704), Maldives (R = .911), Nepal (R = .959) and Sri Lanka (R = .882). In these countries, the change is government revenue is being significantly affected or caused by the FDI inflows. The strength of the relationships are R^2 = .736 (p =.001) for Bangladesh, R^2 = .496 (p =.016) for India, R^2 = .830 (p =.000) for Maldives, R^2 = .919 (p =.000) for Nepal and R^2 = .777 (p =.000) for Sri Lanka. Bhutan shows moderately positive correlation (R = .562) between its government revenue and FDI as only 31.6% of the change in its government revenue can be explained by the FDI (R^2 = .316) while the result is not significant as well (p = .072). Only Pakistan shows negative correlation between its government revenue and FDI (R = -.049) which is very weak (R^2 = .002) and insignificant also (p = .887).

4.5 Impact of Foreign Direct Investment (FDI) on Total Foreign Exchange Reserve

In case of foreign reserve, this study has found very strong positive correlation (R = .947) of this variable with FDI. In SAARC countries, according to the results in table 5, about 89.7% change in foreign reserve can be explained by the change in FDI. This strength of relationship (R^2 = .897) is also found to be statistically significant (p = .000). This result represents that, in case of the SAARC countries included in this study, FDI is strongly affecting total foreign reserves of the countries and their reserves are expected to rise if FDI rises as well. Detailed analysis of the countries represents that except for Pakistan and Bhutan, all other five countries

confirm to the overall result of the analysis. Pakistan shows very weak and insignificant positive relationship between FDI and reserve (R = .016, R^2 = .000, p = .962) and Bhutan shows moderate, yet insignificant positive relationship (R = .595, R^2 = .354, p = .053). In contrast, Bangladesh (R = .765, R^2 = .586, p = .006), India (R = .864, R^2 = .747, p = .001), Maldives (R = .882, R^2 = .778, p = .000), Nepal (R = .908, R^2 = .825, p = .000) and Sri Lanka (R = .666, R^2 = .443, p = .025) show significantly strong positive relationship. These results indicate that in these countries, greater amount of FDI inflow is expected to increase the amount of total foreign reserve.

4.6 Impact of Foreign Direct Investment (FDI) on Gross Capital Formation

Analysis regarding the relationship between FDI and gross capital formation is conducted for five countries excluding Maldives because of the data unavailability about this country's capital formation. Therefore, overall result shown in table 6 represents that there is a very strong and significant relationship between FDI and gross capital formation (R = .929, R^2 = .864, p = .000) for the five SAARC countries, namely Bangladesh, India, Pakistan, Bhutan, Nepal and Sri Lanka. Again, this relationship is positive, meaning that if FDI increase, it will also cause the gross capital formation to be increased. The overall result is comparably accurate for Bangladesh (R = .877, R^2 = .769, p = .000), India (R = .781, R^2 = .611, p = .005), Nepal (R = .851, R^2 = .725, p = .001) and Sri Lanka (R = .911, R^2 = .829, p = .000), as in these countries, gross capital formation is strongly and significantly being affected by the amount of FDI inflow. In case of Pakistan, the correlation is positive but weak (R = .499) and insignificant (p = .119). Only 24.9% change in this county's capital formation can be explained by change in FDI inflow (R^2 = .249). Conversely, in case of Bhutan, only 35.3% change in capital formation can be explained by change in FDI inflow. Correlation is thus very weak, though positive (R = .125). Moreover, this relationship is also statistically insignificant (p = .287). In the following page, there is a graphical representation of the regression results that shows the impact of FDI on respective macroeconomic variables:

5. Findings

From the analysis done in the previous part of this study it has found that, for the SAARC countries, there is a very strong positive correlation between FDI and GDP and this relationship is statistically significant. Such strong relationship between FDI and GDP has also been found in case of Bangladesh, India, Maldives, Nepal and Sri Lanka. Conversely, in case of Pakistan the relationship is very weak and insignificant and for Bhutan, there is only moderate relation between FDI and GDP. However, relationship between FDI and inflation is found to be very weak and insignificant though positive for the SAARC countries. Though for India and Maldives, FDI is strongly and significantly affecting inflation, for Bangladesh and Nepal the causal relationship is moderately strong. In case of Pakistan, it is only moderate but insignificant. While with respect to Bhutan and Sri Lanka, the relationship between inflation and FDI is very weak and statistically insignificant. For the SAARC countries, this study has found very strong negative relationship between FDI and current account balance where FDI is negatively affecting current account balance. This significantly negative relationship has been found for India, Pakistan, Maldives and Sri Lanka but for Bangladesh and Bhutan, the relationship is found to be positive. But, the positive relationships between FDI and current account balance in Bangladesh and Bhutan are very weak and insignificant. On the other hand, in case of Nepal the relationship is negative yet very weak and insignificant. Another variable found to be positively correlated with FDI in this study is government revenue. This very strong and significant result represents that if FDI inflow into a country is increased, government revenue is also expected to be increased. Very strong positive causal relationships are found for Bangladesh, India, Maldives, Nepal and Sri Lanka. Bhutan shows moderately positive but insignificant relationship while Pakistan shows negative correlation between its government revenue and FDI which is very weak and insignificant. In case of foreign reserve, the causal relationship found in this study is very strongly positive and statistically significant. It means that reserves of these countries are expected to rise if FDI rises as well. Though for Pakistan this positive relationship is very weak and insignificant and for Bhutan it is moderately positive, yet insignificant, for all other countries included in this study, namely Bangladesh, India, Maldives, Nepal and Sri Lanka the relationship is significantly strong and positive. Finally this study examined the impact of FDI on gross capital formation and found that there is a very strongly positive and significant relationship between these two in case of Bangladesh, India, Nepal and Sri Lanka. The result indicates that if FDI increases, amount of gross capital formation will also be increased. In case of Pakistan, the correlation is positive but weak and insignificant while for Bhutan, the relationship is very weak, though positive but insignificant.

In a word, in this study concerning SAARC countries, FDI is found to be positively affecting GDP, inflation, government revenue, total foreign reserve and gross capital formation while it is found to be negatively affecting current account balance of the countries.

6. Conclusion

Foreign direct investment (FDI) and trade are often seen as important catalysts for economic growth in the developing countries. FDI is an important vehicle of technology transfer from developed countries to developing

countries. FDI also stimulates domestic investment and facilitates improvements in human capital and institutions in the host countries. On the other hand, economic literature has also found several negative impacts of FDI on the economies of countries, especially in developing countries. However, worldwide flow of FDI has increased to a great extent due to the facilitation of international trade and enhanced cooperation among countries. In SAARC countries also, flows of FDI has been increased. Therefore this study has been conducted to find out actually how FDI is affecting the macroeconomic environment of SAARC countries. Results found in this study indicate that in SAARC countries FDI is causing gross domestic product, government revenue, total foreign reserve and gross capital formation to grow. But it is found that FDI is contributing to inflation and also negatively affecting current account balance of these countries.

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Analysis Tables

Table 1. Analysis of the impact of FDI on GDP

Serial No.	Country Name	R	R square (R^2)	p – value
	Overall	**.922**	**.851**	**.000**
1	Bangladesh	.868	.754	.001
2	India	.754	.568	.007
3	Pakistan	.181	.033	.595
4	Bhutan	.532	.283	.092
5	Maldives	.957	.916	.000
6	Nepal	.904	.818	.000
7	Sri Lanka	.880	.774	.000

Table 2. Analysis of the impact of FDI on Inflation

Serial No.	Country Name	R	R square (R^2)	p - value
	Overall	**.127**	**.016**	**.271**
1	Bangladesh	.625	.390	.040
2	India	.808	.653	.003
3	Pakistan	.471	.222	.143
4	Bhutan	.253	.064	.453
5	Maldives	.839	.705	.001
6	Nepal	.615	.378	.044
7	Sri Lanka	.222	.049	.511

Table 3. Analysis of the impact of FDI on Current Account Balance

Serial No.	Country Name	R	R square (R^2)	p - value
	Overall	**-.796**	**.634**	**.000**
1	Bangladesh	.068	.005	.843
2	India	-.660	.435	.027
3	Pakistan	-.772	.596	.005
4	Bhutan	.176	.031	.604
5	Maldives	-.696	.485	.017
6	Nepal	-.064	.004	.851
7	Sri Lanka	-.946	.894	.000

Table 4. Analysis of the impact of FDI on Government Revenue

Serial No.	Country Name	R	R square (R^2)	p - value
	Overall	**.910**	**.828**	**.000**
1	Bangladesh	.858	.736	.001
2	India	.704	.496	.016
3	Pakistan	-.049	.002	.887
4	Bhutan	.562	.316	.072
5	Maldives	.911	.830	.000
6	Nepal	.959	.919	.000
7	Sri Lanka	.882	.777	.000

Table 5. Analysis of the impact of FDI on Total Foreign Exchange Reserve

Serial No.	Country Name	R	R square (R^2)	p - value
	Overall	**.947**	**.897**	**.000**
1	Bangladesh	.765	.586	.006
2	India	.864	.747	.001
3	Pakistan	.016	.000	.962
4	Bhutan	.595	.354	.053
5	Maldives	.882	.778	.000
6	Nepal	.908	.825	.000
7	Sri Lanka	.666	.443	.025

Table 6. Analysis of the impact of FDI on Gross Capital Formation

Serial No.	Country Name	R	R square	p - value
	Overall	**.929**	**.864**	**.000**
1	Bangladesh	.877	.769	.000
2	India	.781	.611	.005
3	Pakistan	.499	.249	.119
4	Bhutan	.125	.353	.287
5	Maldives	-	-	-
6	Nepal	.851	.725	.001
7	Sri Lanka	.911	.829	.000