

## 2. FOREIGN DIRECT INVESTMENT IN SOUTH ASIA

### Introduction

Foreign direct investment (FDI) is an important type of private capital financing for developing countries. It is normally defined as foreign acquisition of at least 10% of the assets of a firm (Markusen 2000). In recent years, FDI in developing Asia has risen tremendously, largely induced by the liberalization of investment policies such as investment incentives, and the lowering or removal of capital controls and other types of investment barriers. The promotion of these policies was triggered by a myriad of factors, including (i) rapid improvements in technology, (ii) the advent of global and regional production networks, (iii) the forging of bilateral investment agreements, (iv) policy advice coming from international agencies, (v) and increasing recognition of the positive effects of FDI (Asian Development Bank [ADB] 2004).

Recent years have seen the rise of FDI in South Asia. This can be partly attributed to liberalization policies initiated by most South Asian governments during the 1990s and early 2000s, as well as to the strong economic growth of most countries in the region. The flow of foreign investment into the region will continue its upward trend. However, South Asian countries face challenges that could hamper the inflow of foreign capital.

This section provides an in-depth discussion of FDI in South Asia. The trends in FDI in the developing Asia region as a whole are discussed first, highlighting the important role of FDI in boosting economic growth, as well as its main economic benefits to host countries. Also examined are the main economic drivers that induce investment in capital-scarce developing countries by investors in capital-rich developed countries. The current picture of FDI in South Asia is then assessed—including the latest trends at regional, country, and sectoral levels—as are the major barriers to FDI in the region. This leads to an examination of the potential for FDI growth in South Asia, and the policy implications for South Asian governments wishing to attract greater amounts of FDI.

## FDI Flows in Developing Asia

### Background and Trends

Developing Asian economies have maintained high levels of economic growth in recent years, particularly since the late 1980s after the 1985 Plaza Accord. Before then, these economies were unable to mobilize enough domestic savings to fulfill their huge investment requirements and sustain growth. Even though their savings rates were relatively high, the amount of capital needed was enormous. Also, financial intermediation was limited because domestic financial and capital markets were not developed enough to supply sufficient long-term capital to domestic firms. To overcome the shortage of capital and sustain growth, Asian governments actively and successfully promoted inward FDI. Despite the economic stagnation and other severe effects of the 1997 financial crisis, the growth potential of the developing economies of Asia is still considered high compared to most other developing countries. The capital requirements to sustain developing Asia's robust growth continue to be very high.

A key factor that enabled Asian economies to sustain high growth rates was foreign demand for manufactured goods produced by these countries. Accordingly, Asian economic growth often has been characterized as export-led development. Multinational corporations (MNCs) in developed countries invested in developing Asian economies to profit from factor endowments that account for the region's comparative advantage, particularly low labor costs. This was instrumental in promoting the export of manufactured goods from developing Asian economies. Initially, FDI concentrated on relatively low value-added and labor-intensive industries, such as textiles and food processing. Subsequently, however, high value-added industries such as those for electronic components and automobiles benefited from considerable FDI.

The following are prominent features of export-oriented growth in developing Asia and worldwide. First, globalization of trade and investment, as well as stronger economic links between Asian economies, contributed to the active flow of funds from developed countries to developing Asia, and—in some cases—between developing Asian countries. Globalization of trade lowered material and transaction costs. Globalization of investment facilitated easier and faster movement of capital. This was complemented by the progressive development of capital markets in developing Asian countries. In addition, Asian governments proactively promoted FDI through such measures as tax incentives, marketing campaigns, and the establishment of industrial estates and export processing zones. FDI from developed countries, especially Japan, increased dramatically after the 1985 Plaza Accord, spurred by the appreciation of the yen. Since the currencies of many developing Asian countries at that time

were pegged to United States (US) dollar, those currencies depreciated against the yen. Additionally, Japan was then experiencing a surge in the cost of domestic labor. Many Japanese firms, including small and medium-sized enterprises (SMEs), consequently started to invest in developing Asian economies, particularly in countries belonging to the Association of Southeast Asian Nations (ASEAN) and in the People's Republic of China (PRC), to take advantage of lower labor costs.

Second, while some Asian economies such as Hong Kong, China; Republic of Korea; Singapore; and Taipei, China suffered from labor shortages and increasing labor costs because of their relatively small populations, high levels of unemployment and underemployment were prevalent in other developing Asian countries. This generated wage differences between the two groups, and promoted direct investment from the former group in the latter. In general, most developing Asian countries have a reservoir of unutilized and underutilized labor. This labor force is of relatively high quality compared with that in other developing countries, and is attractive to foreign firms seeking lower labor costs—particularly in labor-intensive industries. This promoted FDI among developing Asian economies.

Finally, the development of ICT has created a new and dynamic forum for business relationships and transactions. ICT has expanded business networks around the world, including developing Asia, and lowered business costs. It has also contributed to the global distribution of manufacturing facilities, service centers, and research and development (R&D) centers. The development of ICT has created new business opportunities for countries worldwide.

## **Benefits of FDI**

FDI can play a role in the transfer of capital from developed countries to developing countries, thereby benefiting developing countries and the world as a whole. There is extensive literature assessing the economic impacts of FDI on host countries. In general, FDI inflows can contribute to the growth and development of the economy in host countries by generating employment, increasing earnings of foreign currencies through exports, and expanding the supply of goods. FDI associated with MNCs can create spillover effects, providing new skills, technologies, and marketing networks for local producers. It is important to note, however, that FDI benefits are not evenly distributed within the host country, or across countries. This suggests the need for policies in host countries aimed at widening the distribution of the benefits of FDI (ADB 2004).

A successful policy of FDI promotion can create employment opportunities in domestic labor markets in developing countries with large populations. Foreign firms also can provide training for workers—not only in manufacturing processes but also in

management. Such training can make local workers more productive, particularly when technology transfer is involved, and increase their wages. In the case of the automobile industry—a common target for FDI, the production of one passenger car is conservatively estimated to generate direct and indirect employment of 5.3 people (Mohnot 2007).

FDI can help earn foreign currencies for host countries by increasing the manufacture of goods and services that are exported. The earning of foreign currencies is critical for developing countries to generate a current account surplus to finance the import of necessary inputs, among other things. If a current account surplus is not available to finance imports, the country's capital account must be relied upon, which can lead to debt accumulation. FDI focused on export-oriented industries can positively affect the volume of trade in the host country, and stimulate economic growth. In addition, the global marketing network of MNCs that invest in export-oriented industries can be used to market products of local affiliates and other worthy local firms in the host country. In India, FDI from the US has been observed to positively and significantly affect the export intensities of domestic firms operating in the nontraditional export market (Banga 2002).

If the domestic market of a prospective host country is expected to be large in the future, especially in countries with large populations, MNCs may use FDI to establish large domestic production bases in those markets. Purchasing power and consumption can expand quickly in developing economies with rapidly expanding economies. Countries with large populations can thus provide rich business opportunities for MNCs for the production of goods for domestic markets at local production bases. Such production can replace imports and reduce the burden of foreign borrowing. This type of FDI can also expand consumer welfare in the host country if local consumers are provided a wider range of products of better quality at lower prices.

Technology transfer and knowledge spillovers often can be expected from FDI in developing countries. Spillovers are indirect effects of FDI, and can be defined as circumstances where FDI improves the technology or productivity of domestic firms. Spillover effects can have both vertical and horizontal impacts on host economies. Vertical spillovers refer to inter-industry impacts. For example, when foreign manufacturing firms tap local suppliers for procurement of inputs, the demand for local inputs expands production possibilities in the host country through backward linkages. Horizontal spillovers occur when FDI promotes intra-industry competition in local markets through imitation effects, and positive effects on human capital, industrial relations, market competition, and technology transfer. Vertical and horizontal effects can help local firms raise productivity as a result of improvements in human capital and industrial management skills, competition and efficiency, production processes, technological capabilities, and R&D. Through these linkages, FDI can help diversify

local industries and thus diminish the economic vulnerability of host economies to external shocks that result from a narrowly based industrial structure.

Empirical studies have confirmed the economic benefits of FDI in South Asian countries. Agarwal (2000) showed that FDI inflows in South Asia led to greater domestic investment and faster economic growth, particularly during the late 1980s and early 1990s. Bosworth, Collins, and Virmani (2007) found that augmenting FDI in India will likely stimulate the country's economic growth. Bergman (2006) demonstrated that FDI in the pharmaceutical industry in India rendered positive spillover effects, such as greater competition and improved industrial management skills in that industry.

## FDI in South Asia

Private capital flows to developing countries have risen dramatically in recent years. This was mainly the result of a more integrated global environment, robust domestic economic activity, and more conducive domestic policies and institutions (World Bank 2007c). A major type of private capital that has been flowing into these countries is FDI. The World Bank (2007c) reports that net FDI flows to developing regions increased sharply to \$324.7 billion in 2006, higher by \$44 billion than in 2005 (Table 2.1). It also noted that annual FDI growth rates were in double digits in the last 3 years.

**Table 2.1: Net FDI Flows into Developing Countries, Annual Net Growth of FDI Inflows, and the South Asia Share of World FDI, 2000–2006**

	2000	2001	2002	2003	2004	2005	2006e
Net FDI Inflows (\$ billion)	166.5	171.0	157.1	160.0	217.8	280.8	324.7
Annual Growth (%)	(6.5)	2.7	(8.1)	1.8	36.1	28.9	15.6
South Asia Share of FDI (%)	2.6	3.6	4.3	3.5	3.4	3.5	4.0

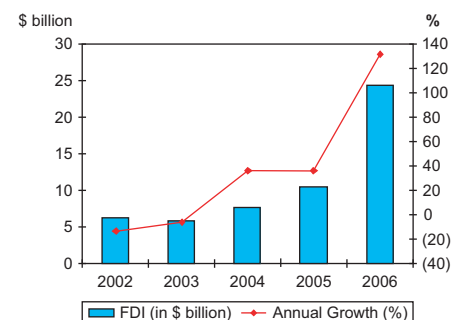
e = estimate, FDI = foreign direct investment.

Source: World Bank. 2007c. *Global Development Finance 2007*. Washington DC.

In developing Asia, one of the recipients of FDI is South Asia. Since 2004, FDI in the region has been increasing rapidly (Figure 2.1). In 2006 alone, FDI inflows reached a high of \$24.3 billion, a 132.9% increase from 2005 and the highest FDI growth rate in recent years. This is in sharp contrast to the dismal FDI performance in the region during the early 2000s.

Across South Asia, India is by far the leading host country for FDI. It received around \$19.4 billion in fiscal year (FY) 2006, or about 80% of total regional FDI (Table 2.2). India's dominance in FDI in South Asia is in large part due to the size of its economy, the largest in the region. However, India's policy reforms geared toward liberalization also played an important part in India's dominance of FDI. After its independence in 1947, India adopted a socialist

**Figure 2.1: Net FDI Inflows and Growth in South Asia, 2002–2006**



FDI = foreign direct investment.

planned economy. Inefficiency was a problem in all sectors, making it a high-cost economy. Regulations on imports and FDI were strict, and the domestic market was virtually closed. In the late 1980s, however, the Government gradually liberalized the economy and lifted restrictions on FDI. Consequently, India achieved high economic growth in 1988 and 1989. In July 1991, the New Industrial Policy was announced. Under this policy, foreign investment was approved without conditions, formalities for granting import licenses were simplified, and private companies were permitted to enter fields that previously had been dominated by government-owned companies. India changed itself from a closed economy to an open economy. Movement toward liberalization in terms of FDI promotion is now common to all countries in South Asia.

**Table 2.2: Net FDI Inflows for South Asian Countries, 2005-2006**

	FDI (\$ million)		Annual Growth (%)	Share of Reg'l FDI Total (%)
	2005	2006		
Afghanistan	271	231	(14.8)	1.0
Bangladesh	800	743	(7.1)	3.1
Bhutan	9	6	(32.2)	0.0
India	7,661	19,442	153.8	79.9
Maldives	10	14	46.3	0.1
Nepal	2	(6)	(441.6)	0.0
Pakistan	1,459	3,451	136.5	14.2
Sri Lanka	234	451	92.7	1.9

FDI = foreign direct investment, Reg'l = regional.

Source: Asian Development Bank. 2007c. *South Asia Economic Report: Social Sectors in Transition*. Manila.

Other countries in the region that also fared well in attracting more FDI in FY2006 were Pakistan and Sri Lanka, with FDI growth that year of 136.5% and 92.7%, respectively. Nepal, on the other hand, suffered from net FDI outflows in FY2006.

FDI in India is highest in the country's services sector. In FY2006, that sector received the most, at \$4.8 billion, followed by the electrical equipment sector, with \$2.7 billion (Table 2.3). This differed from FY2004-FY2005, when the electrical equipment sector was the largest recipient. In FY2006, the services sector also registered the highest FDI growth rate, at 717.4%, while construction came in next with 552.3%. Conversely, three sectors experienced a decline in FDI that year—cement and gypsum (-46.2%), chemicals (-53.9%), and telecommunications (-23.4%). The attractiveness of India's services sector to FDI is explained by robust sectoral growth, rapid deregulation and liberalization of sector policies, and the successful privatization of government-owned services (Gordon and Gupta 2004).

**Table 2.3: FDI Inflows by Sector in India, 2004–2006**

	(\$ million)		
	2004	2005	2006
Cement and Gypsum Products	0	452	243
Chemicals	198	447	206
Construction	152	151	985
Drugs and Pharmaceuticals	292	172	215
Electrical Equipment	721	1,451	2,733
Fuel	166	94	250
Food Processing	38	42	98
Services Sector	469	581	4,749
Telecommunications	129	680	521
Transportation	179	222	466

Source: Department of Industrial Policy and Promotion. 2007. *Factsheet on Foreign Direct Investment*. New Delhi: Government of India.

In Pakistan, the communications sector has consistently been the top sectoral FDI recipient, with \$1.9 billion in FY2007 and a FY2005–FY2007 yearly average of \$1.5 billion (Table 2.4). However, the sector suffered a decline in FDI of about 2.0% in FY2007. Following communications in FDI in FY2007 were the financial sector, with \$930 million, and the oil and gas explorations sector, with \$545 million. The surge in FDI in the communications sector is largely attributed to foreign investment incentives, such as no minimum requirement of foreign ownership, and full repatriation of profits, among other things (Pakistan Telecommunication Authority 2007). On the other hand, the large FDI inflow in the financial sector was due mainly to banking consolidation brought about by mergers and acquisitions (ADB 2007a).

**Table 2.4: FDI Inflows by Sector in Pakistan, 2005–2007**

	(\$ million)		
	2005	2006	2007
Communications	518	1,938	1,899
Financial Business	269	329	930
Oil and Gas Explorations	194	313	545
Tobacco and Cigarettes	7	3	390
Power	73	321	205
Trade	52	118	173
Construction	43	90	157
Petroleum Refining	24	31	155
Beverages	6	6	89
Personal Services	24	62	84

FDI = foreign direct investment.

Source: State Bank of Pakistan. 2007. *Statistical Bulletin, October*. Available: [http://www.sbp.org.pk/reports/stat\\_reviews/Bulletin/2007/Oct\\_07/index.htm](http://www.sbp.org.pk/reports/stat_reviews/Bulletin/2007/Oct_07/index.htm)

In Bangladesh, the telecommunications sector has also been the major host of FDI. The latest FDI survey by the Bangladesh Board of Investment in 2004 revealed that the telecommunications sector received \$237 million, or 35.9% of total FDI (Table 2.5). The other top FDI host sectors in 2004 were energy and power (\$133 million or 20.1%), textiles (\$117 million or 17.7%), other services (\$71 million or 10.7%), and chemicals (\$47 million or 7.2%).

**Table 2.5: FDI Inflows by Sector in Bangladesh, 2004**

	2004	
	(\$ million)	% Share
Telecommunications	237	35.9
Energy and Power	133	20.1
Textiles	117	17.7
Other Services	71	10.7
Chemicals	47	7.2
Leather and Rubber	19	2.8
Engineering	13	1.9
Misc/Nec	10	1.5
Agro-based	9	1.4
Food and Allied	3	0.5
Glass and Ceramics	1	0.2
Printing and Publications	1	0.1

FDI = foreign direct investment, Misc = miscellaneous, Nec = not elsewhere counted.

Note: 2004 is calendar year.

Source: Bangladesh Board of Investment. 2005. *FDI in Bangladesh in 2004*. Dhaka.

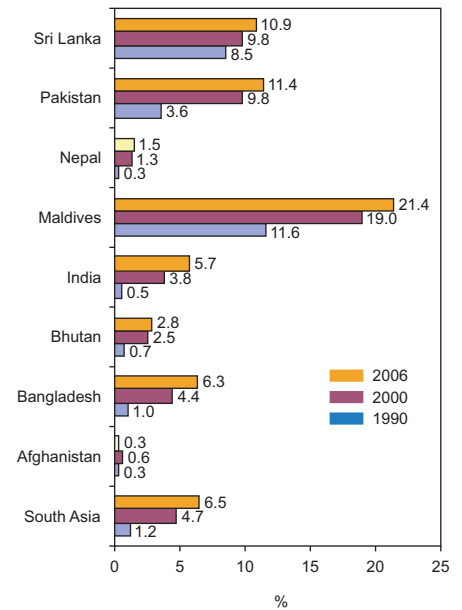
In Sri Lanka, the services sector has been the leading sector recipient of FDI since 2000, followed by manufacturing. In 2000, for example, FDI in the services sector accounted for 55.6% of the FDI total, while the manufacturing sector received around 41.7% (United Nations Conference on Trade and Development [UNCTAD] 2004). The major subsectors that continue to attract large amounts of FDI are telecommunications and business process outsourcing (World Bank 2007e). Telecommunications alone received about half of the total FDI in the services sector (UNCTAD 2004). Prior to the 2000, the manufacturing sector accounted for the largest share of FDI.

In Nepal, a large share of FDI has been in the manufacturing sector. In 2003, around 49.1% of the total approved FDI projects in Nepal were in that sector, while 24.0% and 21.4% were in the tourism sector and services sector, respectively (Pant and Sigdel 2004). In manufacturing, the key recipients were the food, beverage, and tobacco subsector, with an FDI-approved project share of 25.0% of the total, and the textile and garment subsector, with a 24.0% share.

In terms of FDI stock as a percentage of GDP, the South Asia ratio of 1.2% in 1990 gradually rose to 4.7% in 2000 and 6.5% in 2006 (Figure 2.2). Maldives FDI stock was consistently the highest since 1990, reaching 21.4% in 2006—reflecting the small size of its economy. Notably, most South Asian countries were able to raise their FDI stock ratios since 1990. However, the FDI stock of South Asia remains small compared to that of East Asia and Southeast Asia (Figure 2.3). In 2006, South Asia’s FDI stock to GDP ratio of 6.5% was far below Southeast Asia’s 39.5% and East Asia’s 29.1%. In the same year, Thailand and Viet Nam had FDI stock to GDP ratios of 33.0% and 54.8%. It is also noteworthy that the PRC acquired more FDI than India, as the former had a ratio of 11.1% compared to the latter’s 5.7%. This shows the huge potential of South Asia for attracting more FDI.

FDI flows between South Asia, East Asia, and Southeast Asia have risen in recent years and now account for almost 50.0% of the Asian region’s total FDI inflows. FDI flows between East Asia and Southeast Asia have been significant. However, FDI flows between South Asia and East and Southeast Asia are relatively small. Within East Asia, there is a relatively high level of intra-regional FDI, due mainly to the presence of the PRC, an attractive destination for foreign investment. On the other hand, cross-border FDI within South Asia is negligible (Ahmed and Ghani 2007), as may be seen in Table 2.6. India is the only country in the region that is investing to any extent in its neighbors.

**Figure 2.2: FDI Stock as a Percentage of GDP in South Asia in 1990, 2000, and 2006**



FDI = foreign direct investment, GDP = gross domestic product.  
Source: United Nations Conference on Trade and Development. 2007. *World Investment Report 2007*. Geneva.

**Table 2.6: Intra-Regional FDI in South Asia**

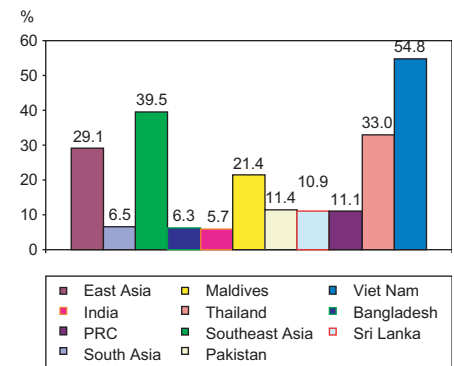
(% of total regional FDI inflows)

Source of FDI	Recipient of FDI				
	India	Pakistan	Sri Lanka	Bangladesh	Nepal
India	■	—	2.60	0.20	51.00
Pakistan	—	■	0.60	0.10	0.03
Sri Lanka	0.01	—	■	0.10	—
Bangladesh	0.01	0.08	0.18	■	—
Nepal	—	—	—	—	■
Share of South Asia	0.04	—	2.10	0.40	37.60

— = data not available, FDI = foreign direct investment.

Source: Bhattacharya, Debapriya. 2007. *South Asia: Intra-Regional Opportunities and Challenges*. Presented at the Fostering Trade through Private-Public Dialogue Expert Meeting on Regional Integration in Asia, New Delhi, 28–29 March; other sources and time periods.

**Figure 2.3: FDI Stock as a Percentage of GDP in Selected Asian Regions and Countries, 2006**



FDI = foreign direct investment, GDP = gross domestic product, PRC = People’s Republic of China.

Source: United Nations Conference on Trade and Development. 2007. *World Investment Report 2007*. Geneva.

The major source countries of FDI in South Asia are predominantly in developed regions—North America and Western Europe. But other important FDI suppliers are located in East Asia and the Middle East.

For India, the top three FDI source countries were Mauritius, the United Kingdom (UK), and the US in FY2006 (Table 2.7). Mauritius<sup>1</sup> invested \$6.4 billion while the UK and the US infused \$1.9 billion and \$856 million, respectively. Notably, Singapore, Japan, and the Republic of Korea were included in the list of top FDI sources for India.

For Pakistan in FY2007, the countries that provided most of foreign private investments were the UK, the US, the Netherlands, and the PRC (Table 2.8). The largest amount of foreign private investment in Pakistan came from the UK, at \$1.8 billion, while the US provided the second-largest amount. The PRC was the largest Asian investor in Pakistan in FY2007, with foreign private investments amounting to \$712 million.

For Bangladesh, the top three FDI source countries are all in developed regions. In 2004, Norway accounted for the most FDI in Bangladesh, at \$176 million or 26.6% of the year's total, followed by the UK (\$108 million or 16.3%) and the US (\$61 million or 9.2%) (Table 2.9). Notably, 5 out of the top 10 FDI suppliers in Bangladesh in 2004 were based in Asia—in Hong Kong, China; Republic of Korea; Malaysia; Taipei, China; and Japan.

Overall, the increasing investments from countries in East Asia indicate the future possibility that these countries may become large investors in South Asia through promotion of interregional FDI.

**Table 2.7: Leading Source Countries of FDI in India, 2004–2006**

	(\$ million)		
	2004	2005	2006
Mauritius	1,129	2,570	6,363
United Kingdom	101	266	1,878
United States	669	502	856
Netherlands	267	76	644
Singapore	184	275	578
Germany	145	303	120
France	117	18	117
Japan	126	208	85
Republic of Korea	35	60	71
Switzerland	77	96	56

FDI = foreign direct investment.

Source: Department of Industrial Policy and Promotion. 2007. *Factsheet on Foreign Direct Investment*. New Delhi: Government of India.

<sup>1</sup> Foreign investors from various countries use the India–Mauritius Double Taxation Avoidance Agreement (DTAA) to their advantage by first establishing their holding companies in Mauritius and then investing in India, thereby significantly lowering their tax obligations. The DTAA allows for the bypass of capital gains tax and other tax payments in India. See Office of Industries, US International Trade Commission (2007).

**Table 2.8: Leading Source Countries of Foreign Private Investment in Pakistan, 2005–2007**

(\$ million)

	2005	2006	2007
United Kingdom	199	225	1,820
United States	373	821	1,767
Netherlands	60	120	778
People's Republic of China	1	2	712
United Arab Emirates	417	1,488	677
Singapore	11	16	139
Saudi Arabia	18	279	105
Mauritius	65	83	91
Germany	15	25	86
Japan	42	48	68

Note: Foreign private investment refers to foreign direct investment and foreign portfolio investments.

Source: State Bank of Pakistan. 2007. *Statistical Bulletin*, October. Available: [http://www.sbp.org.pk/reports/stat\\_reviews/Bulletin/2007/Oct\\_07/index.htm](http://www.sbp.org.pk/reports/stat_reviews/Bulletin/2007/Oct_07/index.htm)

**Table 2.9: Leading Source Countries of FDI in Bangladesh, 2004**

	2004	
	(\$ million)	% Share
Norway	176	26.6
United Kingdom	108	16.3
United States	61	9.2
Republic of Korea	60	9.1
Malaysia	45	6.8
Hong Kong, China	33	4.9
Taipei, China	32	4.9
Japan	31	4.7
Canada	27	4.1
Egypt	20	3.0

FDI = foreign direct investment.

Note: 2004 is calendar year.

Source: Bangladesh Board of Investment. 2005. *FDI in Bangladesh in 2004*. Dhaka.

## Constraints to FDI in South Asia

Despite the gains of recent years, South Asia remains a less attractive destination for FDI compared to other regions in the world. In 2006, FDI inflows into South Asia were very limited. The top two FDI host regions were the European Union (EU) and North America, with shares of world total FDI of 40% and 19%, respectively (UNCTAD 2007). Among Asian regions, South Asia was the least attractive FDI destination.

Several surveys have identified bottlenecks that hinder FDI in South Asia: the poor business climate, poor infrastructure, restrictive labor policy and labor unrest, political uncertainties and civil conflicts, weak regulatory systems, and rampant corruption. The perception of investors of the business climate in host countries is a primary determinant of FDI. This is in turn dependent on economic and political conditions in host countries, such as the development of infrastructure, labor relations, the political situation, and enforcement of regulations and laws. Surveys discussed below indicate the bottlenecks to activities of MNCs in host countries that affect investor perceptions.

### Poor Business Climate

The World Bank (2007c) reported that South Asia is the second-least business-friendly region in the world, after Sub-Saharan Africa, based on its *Doing Business 2008* survey of the perceptions of foreign investors of 178 countries. As shown in Table 2.10, South Asian countries' global rankings on the ease of doing business averaged 107. Table 2.11 shows the World Bank's global ranking of the ease of doing business for each South Asian country for 2007 and 2008. Maldives was ranked the most business-friendly South Asian country in both 2007 and 2008. On the other hand, Afghanistan was ranked the most business-unfriendly country in the region. India, the largest economy in South Asia, ranked relatively low, at 120, but this was an improvement over its 2007 ranking of 132. Only India and Bhutan posted slight improvements in their global rankings in 2008, suggesting an improving business climate in those countries. Conversely, the global rankings of the remaining South Asian countries deteriorated in 2008, indicating a worsening business environment in those countries. These deteriorating rankings are considered to derive from foreign investor perceptions of poor infrastructure, restrictive labor policy and labor unrest, political uncertainties and civil conflicts, weak regulatory systems, and rampant corruption.

**Table 2.10: Global Ranking on the Ease of Doing Business, by Region, 2007**

Region	Average of Regions' Country Rankings
OECD	22
Eastern Europe and Central America	76
East Asia and Pacific	77
Latin America and Caribbean	87
Middle East and North Africa	96
South Asia	107
Sub-Saharan Africa	136

OECD = Organisation for Economic Co-operation and Development.

Note: South Asia comprises Afghanistan, Bhutan, Bangladesh, India, Maldives, Nepal, Pakistan, and Sri Lanka.

Source of basic data: World Bank. 2007c. *Doing Business 2008: Overview*. Washington DC. Available: <http://www.doingbusiness.org/documents/DB-2008-overview.pdf>

**Table 2.11: Global Ranking on the Ease of Doing Business, by South Asian Country, 2007–2008**

	2007	2008
Afghanistan	156	159
Bangladesh	102	107
Bhutan	122	119
India	132	120
Maldives	58	60
Nepal	104	111
Pakistan	73	76
Sri Lanka	100	101

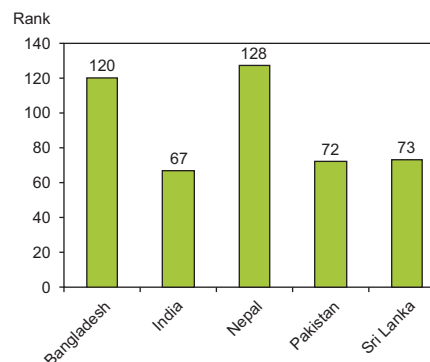
Source: World Bank. 2007c. *Doing Business 2008: Overview*. Washington DC. Available: <http://www.doingbusiness.org/documents/DB-2008-overview.pdf>

## Poor Infrastructure

Inadequate and poor quality infrastructure is a primary reason the business environment in South Asia is not that attractive to foreign investors. In the 2007–2008 Global Competitiveness Report of the World Economic Forum (WEF), South Asian countries were ranked low on the quality of infrastructure (WEF 2007). As shown in Figure 2.4, out of 131 countries and based on WEF's Global Competitiveness Index scores on infrastructure, India had the best ranking in the region at 67, followed closely by Pakistan (72) and Sri Lanka (73). Bangladesh and Nepal were judged to have the poorest quality infrastructure in the region and placed among the lowest ranked countries in the world, with rankings of 120 and 128, respectively.

Indeed, infrastructure directly influencing business activities has been one of the bottlenecks to FDI in South Asia. Table 2.12 shows that out of 7 regions around the world, South Asia has the second-highest number of days required to obtain an electricity connection (56.3); the most days of power outages (121.5); the second-highest proportion of sales lost due to power outages (5.6%); the longest delay in acquiring a telephone connection (66.3 days); and the third-lowest percentage of firms that interact with their clients/suppliers using the Internet (29.2%). Table 2.13 provides a set of infrastructure access indicators for South Asian and East Asian countries as of the end of 2004. East Asian countries performed relatively better in terms of accessibility to most types of infrastructure compared to their South Asian counterparts. For example, the PRC posted relatively high scores in infrastructure accessibility for electricity, sanitation, and telephones, while India scored poorly in all aspects except water and roads. Infrastructure accessibility for residents is also poor in most South Asian countries.

**Figure 2.4: Global Competitiveness Index Ranking of Infrastructure in Selected South Asian Countries, 2007–2008**



Note: The 2007–2008 Global Competitiveness Index Ranking of Infrastructure covers 131 countries.  
Source: World Economic Forum. 2007. *Global Competitiveness Report 2006–2007*. Geneva.

**Table 2.12: Infrastructure Indicators, by Region**

Region	Delay in Obtaining an Electrical Connection (days)	Number of Electrical Outages (days)	Value Lost Due to Electrical Outages (% of sales)	Number of Water Supply Failures (days)	Delay in Obtaining a Mainline Telephone Connection (days)	Firms Using the Web in Interaction with Clients and Suppliers (%)
East Asia and Pacific	14.2	9.0	2.4	3.1	11.3	25.2
Europe and Central Asia	9.3	14.0	3.1	7.5	13.4	56.7
Latin America and Caribbean	33.0	17.8	3.1	14.5	46.5	41.0
Middle East and North Africa	57.5	46.1	4.7	41.7	64.0	32.8
OECD	9.7	1.5	2.3	0.3	9.0	80.2
South Asia	56.3	121.5	5.6	12.0	66.3	29.2
Sub-Saharan Africa	43.8	56.4	5.7	37.2	58.4	20.4

OECD = Organisation for Economic Co-operation and Development.

Source: World Bank. Various dates. *Enterprise Surveys*. Available: <http://www.enterprisesurveys.org>

**Table 2.13: Infrastructure Access Indicators in South Asia and East Asia, end- 2004**

Region/Country	Electricity (% of population with access to network)	Water (% of population with access to improved sources)	Sanitation (% of population with access to improved sanitation)	Teledensity (fixed line and mobile subscribers per 1000 people)	Roads (% of rural population living within 2 kms. of an all-season road)
<b>South Asia</b>					
Afghanistan	5	13	8	12	—
Bangladesh	25	75	48	16	1.6
India	40	86	30	71	3.2
Nepal	15	84	27	18	0.6
Pakistan	55	90	54	44	1.8
Sri Lanka	75	78	91	122	—
<b>East Asia</b>					
Cambodia	10	34	16	38	1.0
PRC	97	77	44	424	1.4
Indonesia	80	78	52	127	1.7
Myanmar	5	80	73	8	—
Viet Nam	60	73	41	88	1.2

— = data not available, kms. = kilometers, PRC = People's Republic of China.

Source: Estache, Antonio, and Ana Goicoechea. 2005. *A "Research" Database on Infrastructure Economic Performance*. World Bank Policy Research Paper 3643. Washington DC.

An important reason for poor infrastructure in South Asia is the scant investment in infrastructure by the private sector. Although such investment has been increasing, between 1984 and 2005 South Asia received only one fourth of total private sector investment in infrastructure in developing Asia, while Southeast Asia received half of the total (Nataraj 2007).

## Restrictive Labor Policy and Labor Unrest

According to the World Bank (2007b), labor policy in South Asia is characterized as restrictive and inflexible, and may hamper FDI in the region. Out of 7 regions in the world, based on the World Bank's Doing Business in South Asia survey for 2007 (Table 2.14), South Asia ranked sixth in terms of "employing workers," making it the second-worst region in this category. South Asia ranked last in terms of the "cost of firing" workers, with firing cost equivalent to 72 weeks of wages (the highest in the world). In addition, South Asia ranked second-worst in terms of the "difficulty of firing" index, and was the poorest performer in terms of "enforcing contracts." On the other hand, it had the lowest hiring cost worldwide. Among South Asian countries, Maldives was the best in terms of employing workers—ranking fifth in the world out of 175 countries, while Bhutan had the best rank (56th) in South Asia with respect to enforcing contracts. The worst South Asian country in employing workers was Nepal (150), while in enforcing contracts, the lowest ranking was Bangladesh (174). India was likewise ranked relatively low in employing workers (112) and enforcing contracts (173).

**Table 2.14: Global Rankings of Selected Labor Policy Indicators, by Region and South Asian Country, 2007**

Region/Country	Employing Workers	Cost of Firing	Enforcing Contracts
<b>Region</b>			
High Income: OECD	2	2	1
East Asia and Pacific	1	3	3
Eastern Europe and Central Asia	5	1	2
Latin America and Caribbean	3	5	6
Middle East and North Africa	4	4	4
South Asia	6	7	7
Sub-Saharan Africa	7	6	5
<b>South Asia</b>			
Afghanistan	74	—	165
Bangladesh	75	—	174
Bhutan	116	—	56
India	112	—	173
Maldives	5	—	83
Nepal	150	—	105
Pakistan	126	—	163
Sri Lanka	98	—	90

— = data not available, OECD = Organisation for Economic Co-operation and Development.

Note: This global ranking covers 175 countries.

Source: World Bank. 2007b. *Doing Business in South Asia 2007*. Washington DC.

There are a number of explanations as to why labor policies in South Asia are perceived as inflexible. In India, Nepal, and Sri Lanka, for example, procedures for redundancy dismissal remain rigid. The mandated notice period for firing a worker in India is around 13 weeks, and the severance payment in Sri Lanka is around 39 months of wages. There are also maximum time limits on term labor contracts—1 year in Bhutan and 9 months in Pakistan. Such limits and procedures may hurt employment and firm performance. They may discourage both local and foreign firms to hire, leading to low employment, and can reduce the ability of firms to expand and improve performance (World Bank 2007b).

Such rigidities in labor regulations increase the likelihood of frictions between employers and workers, which can affect decisions on foreign investment. Menon and Sanyal (2004) demonstrated that labor unrest in various states in India negatively influenced foreign investment inflows into that country. Similarly, labor disputes in Nepal, brought about by restrictive labor policies, have contributed to the reduced attractiveness of that country's investment climate (ADB 2007a).

### **Political Uncertainties and Civil Conflicts**

Political instability and civil conflicts have been found to be a major factor in reducing the attractiveness of South Asia as a host for foreign capital. Afghanistan, Pakistan, and Sri Lanka continue to face political uncertainties and security challenges that are likely to hinder FDI. Empirical evidence demonstrates that FDI inflows into Sri Lanka are vulnerable to the ongoing civil conflict there (Chaitanya 2007). Likewise, in Afghanistan, the pace of foreign investment also may be slow because of the sporadic suicide bombings, kidnappings, and attacks (World Bank 2007d). Sahoo (2006) cited political instability as a major drawback for foreign investment in Nepal, while the worsening political situation in Pakistan (particularly in late 2007) may also hamper FDI inflows into that country.

### **Weak Regulatory Systems and Rampant Corruption**

It is well documented that existing regulatory systems governing investment in South Asia are weak. Specifically, corruption continues to be rampant; governance remains poor; "red tape regulatory obstacles" commonly affect the conduct of business activities; capital flows are stringently controlled; and there are a lack of "facilitating harmonized frameworks on competition and infrastructure" (Dutz 2004). The 2006 Corruption Perceptions Index (CPI) of Transparency International, based on a survey of 163 countries (Transparency International 2007), showed that Bhutan is the least-corrupt country in South Asia (Table 2.15). Conversely, the remaining countries of the region are positioned well down in CPI scores and country ranking. Bangladesh scored as the most corrupt country in the region and positioned lowest in the ranking of regional countries. Transparency International's Bribe Payers Index (BPI), a measure of the propensity

of the leading exporters in a country to offer bribes (out of a sample of 30 countries), is presented in Table 2.16. It shows that India had the worst BPI in 2006 among the 30 countries sampled, including the 8 Asian countries sampled. Transparency International notes that one of the most corrupt branches of government in South Asia is the judiciary.

**Table 2.15: Corruption Perceptions Index (CPI) for South Asian Countries, 2006**

Country	CPI Score	CPI Country Ranking
Bangladesh	2.0	156
Bhutan	6.0	32
India	3.3	70
Nepal	2.5	121
Pakistan	2.2	142
Sri Lanka	3.1	84

Note: CPI score has a range from 0 (highly corrupt) to 10 (highly clean).

Source: Transparency International. 2007. *Global Corruption Report 2007*. United Kingdom.

**Table 2.16: Bribe Payers Index (BPI) for Selected Asian Countries, 2006**

Country	BPI Score	BPI Country Ranking
Japan	7.1	11
Singapore	6.8	12
Hong Kong, China	6.0	18
Republic of Korea	5.8	21
Malaysia	5.6	25
Taipei, China	5.4	26
PRC	4.9	29
India	4.6	30

PRC = People's Republic of China.

Note: BPI score has a range from 0 (high propensity of firms to bribe) to 10 (low propensity of firms to bribe)

Source: Transparency International. 2007. *Global Corruption Report 2007*. United Kingdom.

South Asia also continues to rank low relative to the other regions in the world in terms of cross-border trade, credit availability, property registration, contract enforcement, and business closure. An example is Bangladesh, where registering property requires 425 days. For the whole of South Asia, the average number of days needed to transfer a property is 118. In the Organisation for Economic Co-operation and Development (OECD) and East Asia, the number of days needed to transfer a property is 32 and 86 days, respectively (World Bank 2007b).

## Potential for FDI in South Asia

There is still much potential for South Asian countries to promote FDI despite the barriers discussed above. Surveys and other evidence support this assertion.

Robust economic growth is one of the principal factors supporting the strong potential for FDI in South Asia. The region posted GDP growth rates of 8.7% in 2005 and 8.8% in 2006, both of which were higher than the average GDP growth rates of developing Asia in the same years. Robust regional growth was due in large part to the booming economy of India, but the strong showing of the services sector region-wide was also an important factor. A liberalized regulatory environment in the services sector can help attract more FDI into South Asia (Ahmed and Ghani 2007). South Asia is expected to continue to experience relatively high economic growth in the short to medium term, with GDP expansion projected at 8.1% for both 2007 and 2008 (Table 2.17). Such high rates of economic expansion will allow for an improvement in disposable incomes, thereby making South Asia more attractive to “market-seeking” FDI.

**Table 2.17: GDP Growth Rates, by Region in Asia and the Pacific, 2005–2008**

Region	2005	2006	2007f	2008f
Central Asia	11.1	12.4	11.1	10.1
East Asia	8.3	9.0	8.9	8.7
South Asia	8.7	8.8	8.1	8.1
Southeast Asia	5.6	6.0	6.1	6.1
Pacific	2.6	2.6	3.5	3.2
<b>Average</b>	<b>8.0</b>	<b>8.5</b>	<b>8.3</b>	<b>8.2</b>

f = forecast, GDP = gross domestic product.

South Asia continues to experience impressive export growth, which is also an important driver of FDI. In 2005 and 2006, exports of goods grew sharply by 21.0% and 19.6%, respectively. They are expected to continue double-digit expansion, reaching 14.4% in 2007 and 14.5% in 2008. Indeed, buoyant export growth will enable the region to attract more FDI, especially if intra-firm and intra-regional trade increases. Another aspect of the region that enhances its potential for FDI is its vibrant services sector. The sector is now the main engine of growth, as regional services output expanded by 10.5% in 2006. In most South Asian countries, including India, the services sector hosted more FDI than any other sector.

The development of India’s ICT sector and its expanding role in a knowledge-based economy has likewise spurred FDI inflows into the region, making it an attractive location for ICT-related activities of MNCs. Indeed, global firms have established R&D centers in India in recognition of that country’s capabilities and resources (Kumar 2003). India’s endowment of skilled workers, the high quality of its

tertiary education, and its use of English as a medium of instruction have all been important factors boosting ICT-related investment by MNCs (Balasubramanyam and Sapsford 2007).

Table 2.18 shows the global rankings of selected South Asian countries (out of 141 countries) in UNCTAD's Inward FDI Performance Index and Inward FDI Potential Index.<sup>2</sup> Based on Inward FDI Performance Index rankings, Pakistan is the only South Asian country that has been consistently improving its FDI performance, as its ranking went up sharply from 114th in 2004 to 89th in 2006. Pakistan also had the highest Inward FDI Performance Index ranking in the region since 2005. This may be attributed to the country's strong economic growth and successful privatization program, among other things. Bangladesh, India, and Nepal also showed higher rankings in this index in 2006 compared to 2004.

**Table 2.18: Inward FDI Performance Index and Inward FDI Potential Index Rankings of Selected South Asian Countries**

Country	Inward FDI Performance Index Country Rankings			Inward FDI Potential Index Rankings		
	2004	2005	2006	2004	2005	2006
Bangladesh	122	119	121	117	119	—
India	117	121	113	83	85	—
Nepal	139	139	138	138	135	—
Pakistan	114	104	89	127	126	—
Sri Lanka	103	108	108	120	123	—

— = data not available, FDI = foreign direct investment.

Source: United Nations Conference on Trade and Development. 2007. *World Investment Report 2007*. Geneva.

Based on its Inward FDI Potential Index ranking in recent years, India has the highest level of FDI potential in South Asia. Table 2.19 shows the variables that are captured in UNCTAD's Inward FDI Potential Index for selected countries in South Asia. It confirms India's dominance over its South Asian counterparts in most FDI factors such as real GDP growth, energy use, R&D expenditure, share of tertiary-level education students in total population, country risk, exports of

<sup>2</sup> The UNCTAD Inward FDI Performance Index shows the amount of FDI a country receives relative to its economic size, and is computed as a ratio of the country's share in world FDI inflows to its share in world GDP. This index indicates to what extent factors other than economic size influence FDI in that country. The UNCTAD Inward FDI Potential Index is an unweighted average of the scores of 12 economic and structural variables, each with a range of 0 to 1. The variables used are commercial energy use per capita, country risk, export/GDP ratio, GDP per capita, real GDP growth, import share of automobile and electronic parts and components to world total, inward FDI stock as a percentage of world total, natural resource exports as a percentage of world total, service exports as a percentage of world total, share of R&D expenditure to gross national income, share of tertiary-level education students to total population, and telecom infrastructure. For more details, see UNCTAD (2007).

natural resources, imports of automobile and electronic parts and components, services exports, and inward FDI stock. The Japan Bank for International Cooperation (JBIC) (2006) noted that India is one of the most promising destinations for FDI for Japanese manufacturing companies, as it received the largest increase in recognition in 2006. JBIC also reported that about 80% of 153 companies surveyed in 2006 indicated willingness to expand or strengthen their business activities in India.

**Table 2.19: Scores on Variables Included in UNCTAD Inward FDI Potential Index for Selected South Asian Countries, 2003–2005**

Variables	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Real GDP Growth	0.651	0.696	0.538	0.524	0.569
GDP Per Capita	0.005	0.007	0.002	0.007	0.012
Total Exports	0.026	0.031	0.032	0.030	0.116
Telephone Mainlines	0.008	0.058	0.021	0.042	0.075
Mobile Phones	0.021	0.034	0.002	0.030	0.084
Energy Use	0.007	0.023	0.015	0.021	0.020
R&D Expenditures	0.133	0.182	0.143	0.046	0.029
Students in Tertiary Education	0.090	0.157	0.077	0.044	0.032
Country Risk	0.393	0.566	—	0.332	0.347
Exports of Natural Resources	0.000	0.117	0.000	0.005	0.002
Imports of Parts/Accessories of Electronics and Automobiles	0.001	0.032	0.001	0.004	0.001
Exports of Services	0.003	0.023	0.001	0.009	0.004
Inward FDI Stock	0.002	0.025	0.000	0.006	0.002

— = data not available, FDI = foreign direct investment, GDP = gross domestic product, R&D = research and development, UNCTAD = United Nations Conference on Trade and Development.

Sources: UNCTAD, based on data from the World Bank and International Monetary Fund (IMF) (real GDP growth); UNCTAD (GDP per capita, exports); World Bank, World Development Indicators Online (telephone mainlines, mobile phones, energy use, R&D expenditures); United Nations Educational, Scientific, and Cultural Organization (UNESCO) (students in the tertiary level); the PRS Group/International country risk guide (country risk); United Nations Statistics Division, Department of Economic and Social Affairs, and COMTRADE database (exports of natural resources, imports of parts and accessories of electronics and automobiles and exports in services); and UNCTAD FDI database (inward FDI stock).

Among the advantages of South Asia relative to other regions, from the point of view of foreign investors, is the relative ease in starting a new business, and ample investor protection. Out of 7 regions in the world in 2007, South Asia ranked the second-best—after high-income OECD countries, in starting a new business and in protecting investors (World Bank 2007b) (Table 2.20). Afghanistan ranked 17th out of 175 countries in the world—and 1st in South Asia—in starting a new business. This is because of the minimal procedures and time needed to register a new business in that country. India, on the other hand, was the worst performer in the region in this category because of demanding procedures and high costs. With respect to investor protection, the World Bank (2007b) ranked Bangladesh as one of the top performers in the world and the best in South Asia with a global rank of 15. The relative ease for investors to sue directors and shareholders, and effective information disclosure requirements,

are some of the key factors of Bangladesh's high global ranking. Conversely, Afghanistan is the worst performer in South Asia and one of the worst in the world in terms of protecting investors. This is largely explained by the lack of: an active stock market, procedures for information disclosure, and penalties for abusive directors and managers.

**Table 2.20: Global Rankings on Starting a Business and Protecting Investors, by Region and South Asian Country, 2007**

	Starting a Business	Protecting Investors
<b>Regional Ranking</b>		
High Income: OECD	1	1
East Asia and Pacific	3	3
Eastern Europe and Central Asia	4	5
Latin America and Caribbean	5	4
Middle East and North Africa	6	6
South Asia	2	2
Sub-Saharan Africa	7	7
<b>Country Ranking</b>		
Afghanistan	17	173
Bangladesh	68	15
Bhutan	79	118
India	88	33
Maldives	31	60
Nepal	49	60
Pakistan	54	19
Sri Lanka	44	60

OECD = Organisation for Economic Co-operation and Development.

Note: The global rankings cover 7 regions and 175 countries. The lower (higher) the ranking, the better (poorer) the performance. The ranking on "starting a business" is the average ranking on the time, procedures, minimum capital requirements, and costs in registering a business. The ranking on "protecting investors" is based on an average index of subindices measuring disclosure, director liability, and shareholder suits. See World Bank (2007b) for details.

Source: World Bank. 2007b. *Doing Business in South Asia 2007*. Washington DC.

## The Way Forward—Promotion of More FDI in South Asia

Rapid changes in consumer tastes and consumption patterns now affect production patterns globally. Products can quickly become obsolete. Firms must closely follow the life cycles of their products as well as world market trends, and make every effort to maintain their competitive edge. This is particularly true in labor-intensive industries

characterized as “footloose.” In these industries, foreign companies, particularly MNCs, may shift their production bases from one country to another in search of lower labor and production costs. In addition, the globalization of production processes has accentuated the division of labor worldwide. In this context, advantages in attracting FDI can be gradually lost, such as the competitive edge in labor costs. Host countries should proactively prepare for changes in products and locations of production bases by foreign firms. The population of South Asian countries is still growing much faster than in other Asian countries. Consequently, South Asian countries must create employment opportunities as well as maintain sustained pro-poor and inclusive growth. Their efforts to promote FDI may be seen as crucial in this context.

South Asia can become one of the more attractive FDI destinations in developing Asia, as shown by rising regional FDI inflows, and by surveys. Liberalization policies as well as increasing private sector participation in investment projects have been instrumental in the growth of FDI inflows in recent years. A number of bilateral and regional trade and investment agreements with countries outside the region have also contributed. This type of integration, together with ongoing domestic policy reforms, will contribute further to attracting more FDI into South Asia.

Compared to other regions, however, South Asia is still far from fulfilling its potential as a destination for FDI. Unfavorable perceptions by foreign investors of the business climate in South Asian countries, for the reasons discussed above, remain an impediment. To realize more of the region’s potential for FDI, the following measures should be pursued to improve the business climate and investor confidence.

Infrastructure development is a vital ingredient in measures needed to attract more foreign investment and accelerate regional economic development (World Bank 2005). It has been argued that private sector participation is necessary to improve the quality of regional infrastructure (Nataraj 2007). Additionally, regional cooperation should be continued. This is seen as critical in reducing the infrastructure deficit and addressing the energy requirements of the region (Ahmed and Ghani 2007). Cross-border infrastructure supply systems, such as power, road, and telecommunication networks, are promising for regional cooperation and for the promotion of FDI.

South Asian countries also need to establish macroeconomic and political stability, and an appropriate policy and regulatory framework for foreign investments—including labor policy. The region must continue to attain high economic growth; ensure price stability; maintain trade, investment, and exchange rate policies conducive to local and foreign businesses; and mitigate the risks associated with investment. Further, there may be a need to harmonize regulatory mechanisms in the region—such as investment laws—to make the domestic investment climate more attractive for FDI (Dutz 2004). This

could lead to region-wide FDI promotion. For example, unification of custom systems among South Asian countries and one-stop customs are very useful to facilitate the flow of people and goods among the countries. Importantly, the enforcement of laws and regulations related to FDI should be ensured. Improvement in governance should be prioritized in the region.

The development of human resources and associated industries in the region is vital, not only to attract FDI but also to achieve sustainable and inclusive economic growth. South Asian countries have an abundant supply of labor. The problem, however, is the quality of that labor. An abundant labor force that lacks skills will not contribute sufficiently to the attraction of FDI and, more importantly, to national economic development. Formal education and vocational training are essential to enhance the quality of the labor force and its productivity. They will also contribute to social development, expansion of employment opportunities, and higher incomes—all critical elements of inclusive economic growth.

The development of supporting industries, particularly SMEs, is also essential to promote more FDI and to help sustain economic growth. FDI that benefits the local economy through forward and backward linkages will contribute to sustained economic growth. SME development is quite important to ensure the growth of forward and backward linkages with manufacturers established with FDI. If not procured from domestic SMEs, inputs of such manufacturers are likely to be imported, deteriorating the balance of payments of the FDI host country. Development of SMEs is also critical in terms of job creation, in that most SMEs are in labor-intensive industries.

Finally, regional cooperation should be vigorously promoted. Policies to facilitate cross-border trade and investment are also required to promote FDI regionally. It is important to note that intra-regional FDI in South Asia remains small compared to the levels in other Asian regions. India stands almost alone as an investor in its regional neighbors. Measures to encourage investment from India in other South Asian countries may help promote regional cooperation.

