

# FOREWORD

We are pleased to present the third issue of the *South Asia Economic Report (SAER)*, a series of biannual reports on economic and development issues in South Asia. The *SAER* is a cooperative effort of the South Asia Department and the Central and West Asia Department of the Asian Development Bank (ADB).

The *SAER* provides a biannual update on the South Asian economy and a theme chapter on an important development issue. In the first *Report*, published in October 2006, the theme was “Banking, Governance, and the Investment Climate.” The second *SAER*, issued in June 2007, featured “Social Sectors in Transition: Accelerating Inclusive Growth and Human Development,” and covered education and health. The theme of the third *Report* is “Foreign Direct Investment in South Asia.” The *SAER* also incorporates a country section assessing the current economic situation in South Asia.

Reflecting accelerated economic growth since the early 1990s, this issue confirms that South Asia remains on a solid track of high growth as it continues to be one of the leading regional economies in developing Asia and the world. This is because of its strong macroeconomic fundamentals, price stability, implementation of appropriate macroeconomic policies, and promotion of structural and market-oriented reforms. The region’s strong economic performance has also been bolstered by international trade and investments, particularly by fast growth of merchandise exports and imports, buoyant services exports, huge inflows of workers’ remittances, and a surge in private capital inflows—including foreign direct investment (FDI). All these favorable economic developments can help alleviate regional poverty in the medium to long run.

FDI is a vital requirement for sustained economic growth in South Asia. It can generate employment in the host countries, in addition to supplementing domestic savings and helping meet the huge demand for investment. FDI can also bring foreign currencies into the host countries by stimulating exports of goods and services. Expectations of significant future domestic demand, especially in countries with large populations such as those in South Asia, can result in FDI from foreign companies establishing large production bases for these domestic markets. Such FDI will expand product variety and consumer choices, and promote technology transfers and knowledge spillovers through forward and backward linkages in the host economies.

The *Report* highlights the strong inducements for FDI offered by South Asia, such as its robust economic growth with the impressive showing of the services sector and exports, its large domestic markets, and the positive perceptions of foreign investors. However, the level of FDI inflow into South Asia is still low compared to other Asian regions. This is considered to be the result of the poor business climate, poor infrastructure, restrictive labor policy and labor unrest, political uncertainties and civil conflicts, weak regulatory systems, and rampant corruption.

The *Report* consequently urges South Asian countries to maximize efforts aimed at macroeconomic and political stability, institute appropriate regulatory and policy frameworks for foreign investment, promote infrastructure development, facilitate the development of small and medium-sized enterprises, enhance the quality of local labor through education and training, and facilitate greater regional cooperation in terms of promotion of trade and investment. These measures are also necessary to sustain the current momentum of economic growth in the region.

We hope this *SAER* will help all stakeholders—especially senior policy makers in governments—appreciate important global and regional trends and take effective proactive steps to capitalize on opportunities and mitigate risks in order to help promote FDI and ensure accelerated and inclusive growth. ADB is committed to catalyzing the provision of technical and financial support to the region to help sustain growth and eradicate poverty.

We would like to thank the staff and consultants from the South Asia Department and the Central and West Asia Department of ADB for preparing this issue of the *SAER*, in close collaboration with the Economics and Research Department. The work was conducted under the overall guidance of Sultan Hafeez Rahman and Yukiko Kojima. Production of the *SAER* was led by Shunsuke Bando, assisted by Tadateru Hayashi and Angelo Taningco.

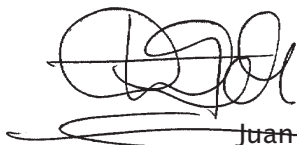
The introduction and section on foreign direct investment in South Asia were prepared by Shunsuke Bando, Tadateru Hayashi, and Angelo Taningco. The country section was written by the following country economists: Mohammad Ishaque Sarwari for Afghanistan, Rezaul Khan for Bangladesh, Abid Hussain and Tadateru Hayashi for Bhutan and Maldives, Hiranya Mukhopadhyay for India, Paolo Spantigati and Shyamal Krishna Shrestha for Nepal, Farzana Noshab for Pakistan, and Johanna Boestel and Nimali Hasitha Wickremasinghe for Sri Lanka. Angelo Taningco compiled the statistical appendix.

Sally Mabaquiao and Jane de Ocampo provided administrative support. Barry V. Lanier did the style and copyediting. The publication was made possible by the cooperation of the Department of External Relations and the Printing Unit.

Finally, we would like to thank these and other numerous colleagues from different departments who provided invaluable inputs and comments: Francis J. Harrigan, William E. James, Diwesh Sharan, Myo Thant, Ganeshan Wignaraja, and Xianbin Yao.



Kunio Senga  
Director General  
South Asia Department



Juan Miranda  
Director General  
Central and West Asia Department

# CONTENTS

Foreword iii

Abbreviations and Acronyms vii

Explanatory Notes viii

1. Introduction 1

2. Foreign Direct Investment in South Asia 5

Introduction 5

FDI Flows in Developing Asia 6

FDI in South Asia 9

Constraints to FDI in South Asia 15

Potential for FDI in South Asia 22

The Way Forward—Promotion of More FDI in South Asia 25

3. Country Section 29

Afghanistan 29

Bangladesh 30

Bhutan 32

India 34

Maldives 36

Nepal 37

Pakistan 39

Sri Lanka 41

References 43

Statistical Appendix 47

## Tables

1.1 Major Items in Balance of Payments for South Asian Countries, 2006 2

2.1 Net FDI Flows into Developing Countries, Annual Net Growth of FDI Inflows, and the South Asia Share of World FDI, 2000–2006 9

2.2 Net FDI Inflows for South Asian Countries, 2005–2006 10

2.3 FDI Inflows by Sector in India, 2004–2006 11

2.4 FDI Inflows by Sector in Pakistan, 2005–2007 11

2.5 FDI Inflows by Sector in Bangladesh, 2004 12

2.6 Intra-Regional FDI in South Asia 13

2.7 Leading Source Countries of FDI in India, 2004–2006 14

2.8 Leading Source Countries of Foreign Private Investment in Pakistan, 2005–2007 15

2.9 Leading Source Countries of FDI in Bangladesh, 2004 15

2.10 Global Ranking on the Ease of Doing Business, by Region, 2007 16

2.11 Global Ranking on the Ease of Doing Business, by South Asian Country, 2007–2008 17

2.12	Infrastructure Indicators, by Region	18
2.13	Infrastructure Access Indicators in South Asia and East Asia, end-2004	18
2.14	Global Rankings of Selected Labor Policy Indicators, by Region and South Asian Country, 2007	19
2.15	Corruption Perceptions Index (CPI) for South Asian Countries, 2006	21
2.16	Bribe Payers Index (BPI) for Asian Countries, 2006	21
2.17	GDP Growth Rates by Region in Asia and the Pacific, 2005–2008	22
2.18	Inward FDI Performance Index and Inward FDI Potential Index Rankings of Selected South Asian Countries	23
2.19	Scores on Variables Included in UNCTAD Inward FDI Potential Index for Selected South Asian Countries, 2003–2005	24
2.20	Global Rankings on Starting a Business and Protecting Investors, by Region and South Asian Country, 2007	25
3.1	Country Macroeconomic Indicators: Afghanistan	29
3.2	Country Macroeconomic Indicators: Bangladesh	30
3.3	Country Macroeconomic Indicators: Bhutan	32
3.4	Country Macroeconomic Indicators: India	34
3.5	Country Macroeconomic Indicators: Maldives	36
3.6	Country Macroeconomic Indicators: Nepal	37
3.7	Country Macroeconomic Indicators: Pakistan	39
3.8	Country Macroeconomic Indicators: Sri Lanka	41

## Figures

1.1	Growth in South Asia	1
1.2	Major Sectors in the South Asian Economy—Shares of GDP and Annual Growth Rates	1
2.1	Net FDI Inflows and Growth in South Asia, 2002–2006	9
2.2	FDI Stock as a Percentage of GDP in South Asia in 1990, 2000, and 2006	13
2.3	FDI Stock as a Percentage of GDP in Selected Asian Regions and Countries, 2006	13
2.4	Global Competitiveness Index Ranking of Infrastructure in Selected South Asian Countries, 2007–2008	17
3.1	India Inflation Rate, 2007	34
3.2	Nominal Exchange Rate of Indian Rupee vs United States Dollar, 2007	35
3.3	Sector Contribution to GDP Growth in Nepal, 2002–2007	38
3.4	Value of Nepal Exports and Workers' Remittances, and Growth Rates of Exports and Imports, 2005–2007	39
3.5	Pakistan Government Revenues and Expenditures, 2004–2007	40
3.6	External Sector of Pakistan, 2006–2007	41

## ABBREVIATIONS AND ACRONYMS

ADB	—	Asian Development Bank
ADO	—	<i>Asian Development Outlook</i>
ASEAN	—	Association of Southeast Asian Nations
BPC	—	Bangladesh Petroleum Corporation
BPI	—	Bribe Payers Index
CPI	—	Corruption Perceptions Index
EU	—	European Union
FDI	—	foreign direct investment
FY	—	fiscal year
GDP	—	gross domestic product
ICT	—	information and communication technology
IMF	—	International Monetary Fund
JBIC	—	Japan Bank for International Cooperation
MNC	—	multinational corporation
NCB	—	nationalized commercial bank
NPL	—	nonperforming loan
OECD	—	Organisation for Economic Co-operation and Development
PRC	—	People's Republic of China
PRGF	—	Poverty Reduction Growth Facility
R&D	—	research and development
RBI	—	Reserve Bank of India
SAER	—	<i>South Asia Economic Report</i>
SMEs	—	small and medium-sized enterprises
UK	—	United Kingdom
UNCTAD	—	United Nations Conference on Trade and Development
US	—	United States
WEF	—	World Economic Forum

NOTE: In this report, "\$" refers to US dollars.

## EXPLANATORY NOTES

For the purposes of this issue of the *South Asia Economic Report*, the following analytical or geographical groupings apply:

- South Asia comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
- Developing Asia refers to the 44 developing member countries of the Asian Development Bank.

In section 2, tables and figures containing regional comparisons follow the regional classification and years of the World Bank, the United Nations Conference on Trade and Development (UNCTAD), and others, as indicated.

The countries in South Asia have varying fiscal years. The fiscal years of Maldives and Sri Lanka correspond to the calendar year. The fiscal years of other South Asian countries are shown below. Unless otherwise indicated, “year” refers to calendar year in the text and fiscal year in figures and tables.

<b>Country</b>	<b>Fiscal Year</b>	<b>Caption</b>
Afghanistan	21 March 2007 to 20 March 2008	FY2007
Bangladesh	1 July 2006 to 30 June 2007	FY2007
Bhutan	1 July 2006 to 30 June 2007	FY2007
India	1 April 2007 to 31 March 2008	FY2007
Nepal	16 July 2006 to 15 July 2007	FY2007
Pakistan	1 July 2006 to 30 June 2007	FY2007

Regional aggregates (sums and averages) for South Asia that are reported in the text and in figures and tables reflect aggregates of national-level data of all South Asian countries for the relevant fiscal year.

This issue of the *SAER* incorporates data available as of 15 November 2007. Unless otherwise specified, data in the figures and tables presented in this issue were obtained from the *Asian Development Outlook (ADO) 2007* and *ADO 2007 Update*, and updated with official statistical publications. A detailed explanation of the computations and sources of data may be found in the Statistical Notes of the Statistical Appendix.