CHAPTER IX
SUMMARY, MAJOR CONCLUSIONS AND POLICY IMPLICATIONS

The present study examines the impact of international trade and foreign direct investment on the economic growth of selected South Asian Economies with special reference to Indian Economy.

Enabled by increasingly liberal policy frameworks, made possible by technological advances, Globalization more and more shapes today’s world economy. Global trade and foreign direct investment, the two main drivers of Globalization process have undergone a tremendous change during the last two and a half decades. There have been marked shifts in their flows, destinations, determinants and policies. Relative to world output, international trade and foreign direct investment have risen sharply. In this process, developing countries have found their economic activities being increasingly internationalized. FDI by Transnational Corporations (TNCs) now plays a major role in linking many national economies, building an integrated international production system – the productive core of the globalizing world economies. TNCs deploy their tangible and intangible assets (capital, research & Development capacity and technology, organizational and managerial practices, trade links) with a view towards increasing their competitiveness and profitability. At the same time, the deployment of these assets by firms strengthen the resource base of countries and their capacity to produce, to reach and expand markets for their products and to restructure their economies – in brief to improve their overall economic performance. Due to increased importance of FDI, a number of countries have amended their policies.

South Asia, consisting of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka, represents an important segment of the developing world. Like most of the developing countries, the countries of the South Asian region also pursued a development strategy based on import substituting industrialization in the early years of their independence. As a part of this
closed macro economic policy, a protectionist trade policy regime and selective FDI policy had been evolved to encourage and nurture domestic industries. At the same time, a dominant role was assigned to the State in the development process. These import substitution strategies coupled with large public sectors, resulted in rent-seeking activities and uncompetitive production processes. Following the success of East Asian Countries and Newly Industrializing Economies during the period from the early seventies to early eighties, a process of policy reforms was initiated. Although Sri Lanka was an early liberalizer, for most of the countries, it was the 1990s which saw an accelerated pace of liberalization – in India after the Balance of Payments shocks of early 1990s and in Bangladesh and Pakistan under the Structural Adjustment Programme pursued in the late 1980s and early 1990s.

The economies of the South Asian Region manifest very different values with regard to GDP, Per Capita GDP and Population. India is the largest economy of the region with a population of about 75% of the regional total and Gross Domestic Product, about 80% of the regional total. Pakistan and Bangladesh are two moderately large economies of the region, whereas the remaining four economies viz. Sri Lanka, Maldives, Nepal and Bhutan are the small economies in terms of both GDP and population. The economies of the region, though, separated by physical or political boundaries, share a unique political, social, ethnic, religious and linguistic heritage. In addition to integrating their economies to the world markets, these economies also began a process of regional cooperation. These are the members of a political Forum called SAARC (South Asian Association for Regional Cooperation) and have also signed a South Asian Free Trade Agreement (SAFTA) on Jan.6, 2004 that came into effect from Jan.1, 2006 with the objective to promote and enhance mutual trade and cooperation among themselves by eliminating barriers to trade and facilitating cross-border movement of goods, promoting conditions of fair competition in the free trade area and ensuring equitable benefits to all contracting parties taking into account their respective level and pattern of economic development.
The major aims of the study were to examine both on theoretical and statistical analysis grounds (i) the contribution of international trade and foreign direct investment as sources of economic growth in the selected economies of South Asian Region especially in India through its macro economic indicators, Gross Domestic Product and Gross Domestic Savings, (ii) the structural changes that have taken place in the international trade and foreign direct investment scenario, their policies and determinants during the period 1981-2005 in the South Asian Region and (iii) to suggest suitable measures which could be taken at the national, regional and international levels to meet effectively the problems confronted by the economies of the South Asian Region in the areas of Foreign Trade and Foreign Direct Investment inflows to enhance their economic growth on the basis of the past experience particularly seen in terms of macro economic performance.

The role of foreign trade and FDI in the economic development of the developing countries has been extensively debated among the academicians and no definite conclusion has emerged in the research findings based on theoretical and empirical evidence. There is also no unanimity among the economists regarding the different determinants of FDI and the impact of FDI on the Export promotion in the developing countries. It is also felt that more work is needed to carry out country or region specific study. Therefore, this issue has been re-examined in the case of South Asian Economies especially Indian Economy in the present study. Moreover, the economies of South Asia which have adopted the path of globalization only in the late 1980s provide a valuable laboratory for the study. The question of policy which these countries should follow relating to FDI and international trade to maximize their benefits and to minimize their negative effects is extremely important given the competitive liberalization and their increasing role in the economic development.

Various statistical techniques particularly correlation and regression have been used with the help of Statistical Package in Social Science Research (SPSS) software to process the time series data pertaining to the study for the period 1981-2005 of the individual countries and thereafter the
data has been pooled in order to have a clear picture at the regional level. The time series data has been further divided into two periods 1981-90 and 1991-2005 to analyze the impact of trade and FDI on the economic development of South Asian Economies. The data was collected mainly from the various publications of national agencies, both government and public, of the countries concerned and international institutions viz. World Bank, IMF, United Nations Conference on Trade and Development, United Nations Year Book of International Trade Statistics, South Asian Association for Regional Cooperation, World Investment Reports and Economic, Social Council for Asia and Asian Development Bank. Internet has also remained as an important source of secondary data.

To examine the impact of international trade and foreign direct investment (individually as well as jointly) on the economic growth of South Asian Economies through their effects on macroeconomic indicators of development like the growth rate of Gross Domestic Product and the Saving rate, we specified and estimated a single equation model using the Ordinary Least Square Method. The specifications of our single equation relationships are more appropriate than those of previous studies in the literature and these estimations allow us to compare our results with those of previous studies. The following form of regression equations was estimated:

\[ Y = a_0 + a_1 \frac{FDI}{Y} + a_2 \text{Trade} + \mu_1 \]  
\[ S/Y = b_0 + b_1 \frac{FDI}{Y} + b_2 \text{Trade} + \mu_2 \]  

Where \( Y \) = Real Income Level (Growth rate of Real GDP used as a proxy for economic development), \( S/Y \) = Gross Domestic Saving taken as a %age of GDP, \( FDI/Y \) = Foreign Direct Investment as a %age of GDP, \( \text{Trade} \) = Total trade used as a proxy for openness of the economy measured as a sum of ratio of exports and imports to GDP in percentage) and \( \mu_1 \) and \( \mu_2 \) – Random disturbance terms assumed to be normally distributed with zero means and constant variance. \( a_0 \) and \( b_0 \) are the constants and \( a_1, a_2, b_1, \) and \( b_2 \) are the regression coefficients estimated.
The single equation approach, while useful as a first approximation, yet is rather deficient. There exists, however, a substantial body of literature, both theoretical and empirical, to suggest that both savings and growth rate affect each other. For a proper appreciation of the quantitative magnitudes of FDI and trade, we must allow for this simultaneity. Therefore, the study also estimated simultaneous equation model using Two Stage Least Square technique (2SLS) for Indian Economy and South Asian Region as a whole in which growth and savings were jointly determined. Moreover, our simultaneous equation model results allow us to compare our results with our own single equation results. The simultaneous equation model has been represented by the following equations:

\[ Y = a_0 + a_1 \frac{S}{Y} + a_2 \frac{FDI}{Y} + a_3 \text{Trade} + \mu_3 \quad \ldots \ldots .(iii) \]
\[ a_1 > 0, a_2 < 0, a_3 > 0 \]

\[ \frac{S}{Y} = b_0 + b_1 Y + b_2 \frac{FDI}{Y} + b_3 \text{Trade} + \mu_4 \quad \ldots \ldots .(iv) \]
\[ b_1 > 0, b_2 < 0, b_3 > 0 \]

The above structural model consists of a saving and a growth equation expressed in linear form, both in variables and parameters. The expected signs of the various coefficients were shown immediately below them which could either be positive or negative given the controversy among the economists.

Keeping in view the fact that now-a-days, almost every developing country is in a race to attract more and more FDI, it would be of utmost importance to identify the factors influencing inward flows of FDI in India, we, after reviewing comprehensively the existing studies, estimated the following regression model with the help of step-wise multiple regression analysis emphasizing the simultaneous influence of economic and political factors:

\[ \text{FDI} = a_0 + a_1 G + a_2 T + a_3 \text{INF} + a_4 \text{ED} + a_5 E + \mu \]
\[ a_1 > 0, a_2 < 0, a_3 < 0, a_4 < 0, a_5 > 0 \]

where FDI as %age of GDP was taken as dependent variable, G- Growth rate of GDP, INF- Rate of inflation measured as %age change in GDP.
deflator, T-Total trade used as a proxy for openness of the economy, ED-
Total external debt outstanding and disbursed as ratio of exports, E-per capita
electricity consumption taken as indicator of infrastructure were independent
variables. \( \mu \) was the stochastic error term.

The expected nature of the relationship between the independent and
dependent variables were shown immediately below them.

An attempt was also made to examine the role of foreign direct
investment along with other variables on the growth of exports in India as the
export related success stories of some of the countries suggest that FDI has
been a powerful tool for export promotion because of the relative superiority of
multinational corporations help domestic firms, directly or indirectly and
provides market access to export markets, but no unanimity among the
economists was found on the positive impact of FDI on exports and therefore,
we estimated the following regression model:

\[
X/Y = a_0 + a_1 \text{FDI}/Y + a_2 \text{GDCF}/Y + a_3 \text{INF} + a_4 G1 + a_5 \text{ED}/X + \mu
\]

Where \( X/Y \): exports as percentage of GDP was taken as a dependent
variable and \( \text{FDI}/Y \): foreign direct investment as %age of GDP; \( \text{GDCF}/Y \):
Gross Domestic Capital Formation as a %age of GDP; \( \text{INF} \): Annual %age
change in implicit GDP deflator and \( G1 \): Per capita Income, were independent
variables. \( \mu \) was the stochastic error term.

In order to examine whether the data suffers from the problem of
autocorrelation, Durbin-Watson test was applied and a correlation matrix
using the Karl Pearson formula was also prepared. Another purpose of
correlation matrix was to discuss the significance of international trade and
foreign direct investment on real national income and savings in the South
Asian Economies.

The study is organized in nine chapters as follows:

Chapter 1 describes the process of globalization in the world economy
in terms of FDI flows and international trade, as well as objectives, importance
and data and methodology of the present study. Chapter 2 deals with the
importance of foreign trade and FDI in the economic development and review
the existing literature both on theoretical and empirical grounds regarding the relationship between international trade and economic growth and foreign direct investment and economic growth. Chapter 3 throws light on the data source and methodology of the study. Chapter 4 presents a synoptic picture of the economic and social profile of South Asian Countries. Chapter 5 reviews briefly the policy reforms undertaken by the major South Asian economies in the areas of international trade and foreign direct investment. Chapter 6 makes an analysis of the structural changes that have taken place in the field of international trade in the region especially in India. Chapter 7 presents emerging trends in FDI inflows in the South Asian Region. Chapter 8 examines statistically the impact of international trade and FDI on the economic growth of the South Asian Countries as well the factors affecting FDI in India and the impact of FDI on the growth of exports in India. Chapter 9 provides the brief summary of the study, major findings and some policy implications based on them.

The economic growth measured in terms of growth rates of Real Gross Domestic Product, Per capita income and population has shown a significant improvement in the countries of South Asia during the period 1981-2005 especially after following the economic reforms in the late 1980s and early 1990s. Even the small economies viz. Bhutan and Maldives (in terms of GDP and population) have achieved impressive growth rates of real GDP. During the first half of the present decade, the performance of the region has been more impressive, the growth rate of GDP in the region being the highest in Developing Asia. It has significantly outpaced the world economy with its higher growth rate of GDP of 8.1% during 2005. The world economy has registered 4.8% of growth in the year 2005. The annual average growth rate of population has declined in all the countries of the region over the period of time which has resulted in the improvement of growth rate of per capita income in these economies.

The high growth rate of GDP is due to the impressive growth in service and industrial sectors. Service sector has grown more than industrial and agricultural sectors in the region. Most of the countries of the region have
experienced the structural shortcut as the relative decline in agriculture is accompanied by a greater increase in the services than in industry and have been transformed into modern structural type and thus shifting away from the agrarian economy towards a modern service economy. However, there has not been any perceptible change in the occupational structure. Still, traditional employment structures i.e. more dependence on agriculture is prevalent in the economies of the Region.

Saving and investment ratios as a percentage to GDP have risen in almost all the major South Asian Economies and India and Pakistan have also been able to achieve self reliance in financing investment by their own savings, the existence of resource gap is still apparent in Bangladesh, Nepal and Sri Lanka which shows that the region is still in the grip of Saving-Investment gap. The investment productivity is also very low in all the economies of the Region. It necessitates the need of foreign resources not only in terms of finance, but also modern technology, know-how etc. Fiscal deficit is also visible in these economies because of the increase in the government expenditure more than the revenue. Therefore, money supply as a percentage of GDP has shown an increasing trend during the whole period which has resulted in high inflation rates. However, the countries of the region have experienced reduction in the inflation rates in the present decade which is one of the main advantages that the region can offer to foreign investors to increase FDI in their economies. Soundness of the financial system in terms of banking sector has also improved in most of the South Asian countries over the period of time in terms of domestic deposits and credits, capital adequacy ratio and profitability of the banks which would further enhance the efficiency and stability of the regional economy.

The absolute level of poverty has been slowly declining in the region, but still 431 million people out of 1.1 billion poor of the world are living on less than one dollar a day in the South Asian Region, which is a big challenge for the region. Percentage of population living in poverty in India has also declined. Both rural and urban population have registered significant decline in the incidence of poverty over the period of time in India. Incidence of
inequality has also been prevalent in all the major economies of the region to a greater extent. It has been highest in Nepal, followed by Sri Lanka, Pakistan, Bangladesh and India.

The countries of the region have been able to make improvement in the socio-economic indicators and Human Development Index value. Infant Mortality rate (under 1 year and 5 years) per 1000 and total fertility rate (children per woman) has declined in all the economies of the region. Life expectancy rate for both male and female has increased. There is also improvement in HDI value and rank and now these economies come under the Medium Human Development range, but still, the figures are discouraging when compared with other developing economies. Only two of its economies, Maldives and Sri Lanka are having their ranks below 100 out of 177 countries.

The data regarding the infrastructure level, business indicators, indicators of technology creation and diffusion presents a very dismal picture in case of most of the economies of the region. These countries are far behind in the area of R & D. These variables have been assuming greater importance in the present scenario of competition and globalization and this has remained one of the main reasons for the low FDI in the region.

The importance of international trade has been continuously increasing in all the South Asian economies and in the region particularly after the 1990s trade policy reforms adopted by these economies and this integration is especially more visible during the first half of the present decade. The ratio of exports and imports to GDP as well as the degree of openness to trade has increased in almost all the countries of the region. However, the exports were always lagging behind the volume of imports which indicates the import financing capacity of exports has been low, though subsequently increasing. A foreign exchange gap is visible in almost all South Asian countries which necessitates the need of foreign resources.

The composition and direction of trade has undergone a tremendous change during the period 1981-2005 in the South Asian region. The countries of the region have been diversifying their export structure in favour of manufactured goods. The exports of agriculture and allied products have
been losing significance in the exports of these economies which depicts that the structural transformation of the exports of these economies has been taking place. The structure of imports has also been changing overtime. The importance of imports of agricultural and allied products has shown a declining trend and that of raw materials and intermediate manufactured goods, machinery and equipment has been increasing which clearly indicates that these economies have been moving ahead on the development path. A significant change in the exports and imports patterns of these countries by main regions of origin and destination has also been recorded. Although the share of developed countries in the exports of the economies has shown an increasing trend, but their share in the imports of these countries has significantly declined over the period of time. In India's exports as well as imports, the share of the developed countries has shown declining trend particularly after 1990-91. The share of developing countries, especially the Asian countries has been increasing over the period of time in all the South Asian Countries.

The statistical estimation with OLS technique of the impact of exports on the economic growth of the region has shown that exports have been playing a major role in increasing economic growth in all the countries of the region.

Trade in services has also becoming increasingly important in the South Asian region and has more than doubled during the period 1995-2003. However, it varied across countries in the region and is mainly driven by India’s strong performance in the I.T. and B.P.O services.

Uneven growth in exports and imports has given rise to cumulative deficits in the balance of payments and accumulation of huge external debt in the countries of the region. High rise in the oil prices have added more to the problem of deficit in the balance of payments. The terms of trade have also not been showing favourable trend in Pakistan and Bangladesh. In Sri Lanka there has been a positive trend of terms of trade but that is insignificant. However, in the Indian economy, terms of trade has remained favourable.
since 1985. Depreciation in the currencies of the countries of the region has also been visible in almost all the countries.

South Asian countries have been taking regional cooperation initiatives to integrate and enlarge their trade, but the proportion of intra-regional trade is still quite modest. The quantum of mutual trade was almost stagnant during the eighties, but has found to be taken shape particularly after the inducement of SAPTA and trade liberalization measures. But till now, intra-regional trade has remained more concentrated within the small economies of the region. It is hoped that with the meaningful implementation of SAFTA, there would be further increase in the volume of intro-regional trade, thereby enabling the countries of the region to achieve economic growth through collective efforts and mutual cooperation.

The countries of the region remained under turmoil and faced political instability, higher degree of corporate tax, and lack of infrastructural facilities and institutional support in the decades of 1980s and accordingly, there have been much lesser inflows of foreign direct investment. Most countries in South Asia were not seen by the international investors as attractive investment destinations and in any case, these countries did not welcome foreign investments and that is why FDI inflows were quite minimal. Only in the late 1980s and during 1990s, FDI flows to the region started picking up largely as a result of progressive liberalization of FDI policies and the adoption of generally more outward oriented policies. During the 1980s, whatever inflows of FDI came to South Asia, were mainly concentrated in the four major economies i.e. India, Pakistan, Sri Lanka and Bangladesh. Much of the increase in FDI in the region is accounted for by India, followed by Pakistan, Sri Lanka and Bangladesh. Bhutan, Nepal and Maldives always remained at the lower profile in attracting FDI inflows. The share of South Asia in world FDI inflows as well in developing countries is also very small.

South Asian countries are far behind in terms of UNCTAD’s inward FDI performance and potential indices and come under the category of under performers. In terms of cross border M & As by region/economy of seller/purchase as well as in the number of deals, Greenfield Projects,
number of parent corporations as well as foreign affiliates, South Asian region has not fared well. The TNCs of South Asia are still not comparable to those from East and South East Asia. Only one Indian company ONGC features in the UNCTAD's top 100 developing country TNCs.

The service sector has emerged in all the economies of the region as one of the most attractive sector leaving behind primary and secondary sectors. The share of FDI has increased mainly in telecommunication. In India, telecommunication is followed by fuels, power, transport, industry, electrical equipment and computer software in receiving highest FDI. Sources of foreign direct investment have also undergone a tremendous change. At present USA followed by Kingdom of Saudi Arabia is the leading source of FDI in Bangladesh. In Pakistan, the highest FDI is coming from UAE followed by US. Singapore, UK and Japan are the leading investors in Sri Lanka. USA, PRC and India are the main investors in Nepal. In India, Mauritius is at number one followed by USA to invest in the country.

In India, there is a large gap between the approvals and actual FDI inflows. The inflows of FDI are far short what is needed by India. Though, India has emerged as the major recipient of FDI in the South Asian Region, but in comparison to other emerging destinations for global FDI inflows, India is at the bottom. Most of the FDI is coming through automatic route. Maharashtra, Tamilnadu, Karnataka, Delhi are the attractive locations, whereas Bihar, UP, Punjab etc. are lagging behind.

Intra-regional investments have been increasing and the major outward FDI flows have been from Indian firms within the region. It is the largest investor in Bangladesh investing in service sector and in Nepal, as well; India is the single investor dominating regional investment. But in India, despite its huge internal market, investment from the region has not been significant.

The results of statistical estimation of single equation model reveal that in Bangladesh, the impact of trade and FDI on the overall economic development in terms of both savings and real national income has been positive particularly in the post liberalization period. In case of Indian economy, we found that FDI and trade have positive impact on the national economy.
income of the economy but these variables have shown negative impact on savings. The negative impact tends to support the decapitalization thesis which postulates that foreign capital crowds out or substitutes domestic savings in India.

Foreign direct investment and international trade have not been found playing any significant role in Pakistan in affecting both national income and savings in the economy. For Sri Lankan economy, we found that both FDI and international trade have been the important variables in explaining the positive increase in the national income and savings. However, in case of Bhutan and Nepal, being the small and least developed economies in the region, the impact of these variables has not shown any significant impact.

The analysis of the simultaneous equation model in case of South Asian region as a whole presents a clear picture of the impact of FDI and international trade. Foreign direct investment has shown a positive and significant impact on the growth function for the period 1981-2005 with and without time lags. However, its impact on savings was found to be negative, showing crowding out effect on domestic savings in the region. The regression coefficient of international trade was also found to be negative for growth function yet not significant but it has shown a positive impact on savings.

Estimates of regression coefficients for Indian economy for the period 1981-2005 with the help of 2SLS technique show that international trade has been affecting positively both savings as well as growth function. It is highly significant in its positive impact on savings. This is very much true, as the exports in the Indian economy have shown a significant increase in the post liberalization period and terms of trade have also shown favourable trend since 1985 (analyzed in chapter VI).

Foreign direct investment has also shown positive impact on the growth function though not significant, but has been affecting negatively the saving function in the Indian economy, thus confirming our results of single equation model for the period 1991-2005. The negative impact of FDI inflows
on domestic savings in India has again verified the presence of
decapitalization thesis in the economy.

Theoretically, there exists a positive relationship between national
income and savings and vice versa. We have also found a significant positive
relationship between the two both in case of South Asian Region as a whole
as well as for Indian Economy when estimating the simultaneous equation
models.

Thus, our results of statistical analysis of both the single equation and
simultaneous equation models estimation show that FDI and trade have
played a supplementary and favorable role in the economic development of
the South Asian region with some exceptions, but due to the absence of
complementary factors, viz. infrastructure, entrepreneurial and managerial
skills leading to inefficiencies, low absorptive capacity, corruption etc., their
impact on the economic growth of these countries could not be significant.

The results of statistical estimation of the multiple regression model of
the economic and political determinants of foreign direct investment in India
for the period 1981-2005 have shown that the coefficients of the model have
theoretically expected signs. International trade, the openness of the
economy has been highly positively significant in its impact on foreign direct
investment. The other important determinants viz. GDP growth rate and
electricity consumption (variable of infrastructure) do have positive influence
on the FDI inflows but these variables have not been very significant in their
impact. Inflation and external debt burden reduces the foreign direct
investment inflows in an economy, a negative non significant impact was
found.

The analysis of the multiple regression model on the impact of FDI on
India’s exports has shown that FDI affects significantly the growth of exports
in India. The value of regression coefficient of FDI was found be positive and
highly significant. Gross domestic capital formation was found to be another
significant variable which has shown a positive impact on exports of India.
Inflation, External debt and domestic demand, all the variables were found to
be negative in their impact on the export growth in India. Thus, we concluded
that inward FDI contributes to productivity growth which in turn helps to increase trade.

POLICY IMPLICATIONS

The major policy implications which emerge from the foregoing are as follows:

The South Asian economies, no doubt, will depend in the near future on the substantial amount of foreign resources in terms of increasing international trade and foreign direct investment in order to achieve a goal of rapid economic growth, reduction in the poverty and inequality in the region, to fill the Saving-Investment gap and technological gap, to increase investment productivity and to help in managing the balance of payments so as to bridge the foreign exchange gap. But the rate of growth of an economy over the long run, in fact, depends more on the capital accumulation from the internal sources. If south Asian countries wish to achieve rapid economic growth, maximum efforts will have to be directed towards raising saving rate, increasing the productivity of investment and labor force, improving export performance, technology restructuring and better management. The government of the respective countries should keep strict check on the inflationary pressures which helps in the flight of savings and investible capital from the productive to the non-productive uses. Though most of the countries of the region have taken many measures in this direction but still much remains to be done. Macroeconomic policies, in fiscal and monetary spheres should be harmonized to achieve a stable, non-discriminating macroeconomic environment for all the countries in the region. Appropriate pricing and investment policies both in commodity and factor market needs to be adopted.

The countries of South Asian region have been able to attract only a meager amount of FDI due to lack of sound international credit worthiness, low level of economic growth, continuous political instability and unfavorable investment environment. Hence, the region should make extra efforts not only to attract more of foreign direct investment but also to sustain the present level of FDI inflows.
The countries of the region should create a sound and a stable internal environment including macroeconomic and political environment as well as a transparent and predictable business environment. The role of State must be redefined. South Asian policy makers must realize that credible efforts for economic reforms must involve an upgrading of technology, scale of production and linkages to an increasingly integrated globalization production system chiefly through the participation of multinational corporations. Communication and transport infrastructure between the bordering countries should be improved and upgraded to facilitate increased trade and factor mobility. The most important factor that needs to be addressed is the institutional development. Institutions must be strengthened to ensure transparency, accountability and predictability.

Fiscal and monetary reforms, partial to full convertibility of their respective currencies, abolition of controls over industrial growth, reduction in the tariff and non-tariff barriers etc. have been undertaken in these economies, but the implementation of these programs require political firmness and steadfastness.

The impressive growth performance of the region especially in the post liberalization period has not been accompanied by a significant decline in the poverty and inequality. It points out that there is an urgent need of the development of human resources in the region.

Most of the countries of the region have opened their economies for multinational corporations, but these should be allowed in those critical areas where domestic resources do not provide an adequate substitute. FDI might be encouraged in sectors such as power generation, oil refinery etc. which have large scope for the transfer of technology. Even at an early stage of their development, countries should need to attach importance not just to the size of FDI, but also its qualitative aspects should be taken care of. MNCs should be discouraged especially by India, where it has acquired remarkable expertise and also in the areas which can provide maximum employment to the maximum number of people.
Reduction in fiscal deficits, decontrol, deregulation/delicensing, devaluation of the respective currencies, limited monetary expansion will increase income and output in the short run, but in the long run, easy access to markets of industrialized countries will enable these countries to service and eventually repay their debt services. This aspect should be taken care of at international level by the international agencies.

The government of the respective country must evolve a clear cut policy regarding the equity of MNCs, repatriation of profits, capital, technology transfers. For this the effective regulatory institutions and safeguards will have to be developed not only at the national level but also at the international level to ensure that these multinational corporations should not be allowed to flourish at the cost of domestic investor. Risks of an open economy are well known. But the opportunities should not be missed that the global system can offer. Countries should guard themselves and voice their concerns and in cooperation with other developing countries, modify the international trading arrangements to take care of the special needs of such countries. At the same time, countries must identify and strengthen their comparative advantages.

The main problems faced by these countries in attracting foreign direct investment include the uncertain security situation prevailing in the region, paucity of basic physical and institution infrastructure, and the very limited size of the markets of most of the economies like Nepal, Bhutan and Maldives. For the smaller and the least developed countries of the region, establishment of a free trade area and the consequent enlargement of their markets can be effective means of attracting enhanced private capital than an international regime on investment.

There is an urgent need of political will in the South Asian Region leaving behind the internal conflict and tensions with the countries as well as within the region to move ahead in a unified manner, to travel together to foster economic cooperation among themselves so as to transform their present potential into future prosperity. These countries have many advantages to offer to potential investors, including high and steady economic
growth, single digit inflation, vast domestic market, a growing number of skilled personnel, an increasing entrepreneurial class and constantly improving financial systems including capital markets.

The expense of maintaining security forces at the border can be reduced and these financial resources utilized for economic and social development. Removal of travel restrictions would also have an impact that would outweigh the negative factors involved in a visa-free South Asia. The Region has a great potential in terms of knowledge capital, natural resources and rich cultural heritage, which could be employed to transfer it into an economic powerhouse where there is a movement of free trade and people and promotion of cultural exchange and tourism. This would also help to create the jobs needed to alleviate problems of poverty, inequality and discrimination. Mutual trust and confidence is the main measure for the effectiveness of regional integration.

South Asian countries require financial assistance to meet their investment constraints for infrastructure and private business investment and to concentrate on improving its investment environment. It should develop a detailed and comprehensive common investment policy. Other regions have already realized the importance of regional cooperation and have taken steps in this direction. As a result, they have now started receiving the rewards. South Asia should learn from this and should address sincerely and promptly to face the challenges ahead so that they should not lag behind and the potential for huge FDI inflows will not be harnessed.

The issue of protecting environment and culture has also become inevitable when there is too much stress laid on industrialization and exports. It should be taken care of that the environment of the country is not polluted and culture is not robbed. The role of the state has become all the more important to keep a strict check.

Signing of SAFTA has opened a new possibility for the countries of the region to move ahead towards close economic integration. The member countries should accord higher importance to regional approach by sharing experience and expertise. These countries have largely similar export baskets.
and can expand trade by promoting intro-industry trade in the region. The countries should pursue bilateral as well as regional endeavors to improve the existing conditions for the rapid expansion of regional trade including transport, communication, marketing intelligence, storage, travel rules and facilities, custom procedures and cooperation, financing etc. Harmonization of laws including investor's protection, intellectual property rights, anti-trust laws, commercial laws, etc. could pave the way for the meaningful implementation of SAFTA and thereby economic integration in South Asia. There is an urgent need to evolve unified marketing policies and practices by the SAARC member countries to improve their terms of trade. The countries of the region are un-equal from the view point of pace of industrialization and technology. Hence production strategy is to be devised so as to match the demand and supply of export products among themselves and in international markets. This process definitely would boost intra-regional trade as well as boost the cross border foreign direct investment.

India’s competitiveness in exports require to be strengthened to achieve a sustained export growth of at least 12 percent per annum in order to achieve the goal of increasing India’s share in world exports to 1 percent. India also need to make the transition from exports of labour intensive low technology goods to a wider variety of goods, including technology intensive goods. India’s tariff levels continue to be high; accelerated pace of reduction of tariffs and removing the constraints on the small scale industries would be conducive to industrial growth and exports. Rapid growth in exports would also require addressing the domestic constraints of supply bottlenecks and inadequate infrastructure.

India is by far the largest economy in South Asia. The current accelerated growth of Indian economy will naturally have positive externalities for the neighboring economics. Proactive policies to increase economic integration with other South Asian countries could multiple these benefits manifold and the impact on the economic development of the neighboring countries could also be dramatic.
Thus, both factors internal and external discussed above should be taken care of so as to increase both international trade and foreign direct investment to foster rapid economic growth in the south Asian Economies and making the region a successful regional entity.