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The Impact of FDI on Economic Growth in Developing Countries: A Comparative Study of South Asia and Southeast Asia

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Abstract

This study is aimed at exploring how Foreign Direct Investment (FDI) influences economic growth in the developing nations and more so South Asia and Southeast Asia. The study applies panel data analysis in the period between 2000 and 2023 to investigate the correlation between FDI inflows and GDP growth after taking into consideration other significant variables, including human capital, gross capital formation, trade openness, government expenditures and inflation. This shows that the relationship between FDI and economic growth in both regions was positive and significant though the strength of this relationship is significantly stronger in Southeast Asia (0.56) than in South Asia (0.34). It is also established in the study that human capital, gross capital formation, and trade openness are significant in terms of determining the effectiveness of FDI, and inflation has a negative effect on growth. Institutional quality can be seen as one of the most influential elements in the process of efficiency of the FDI absorption whereby Southeast Asia would have a greater advantage of foreign investments owing to the better institutional structures. The results indicate that institutional inefficiencies and lack of infrastructure in South Asia limits the potential growth of the region due to FDI, whereas the Southeast Asian economic positive and institutional environment enables better application of FDI. The paper ends by providing policy recommendations on both regions, including the importance of enhancing quality of institutions, investing in human capital and having macroeconomic stability to ensure that the benefits of FDI are fully realized to promote long term economic growth.

Keywords: Foreign Direct Investment (FDI), Economic Growth, South Asia, Southeast Asia, Panel Data Analysis.

Introduction

It is agreeable that foreign direct investment can be an important source of foreign capital, technological spills, managerial skills, and an entry point to the international markets, which is why foreign direct investment (FDI) is a crucial constituent of the economy of developing countries (Chizema, 2025). Asia is the most vibrant FDI destination in the world over the past two decades, and it gains the greatest portion of the entire inflow, with South and Southeast Asia being the nation where trade liberalization, demographic advantages, and rapid industrialization are the factors that attract foreign investors (UNCTAD, 2024). The friendly regulatory policies, regionalization of the ASEAN, and export led manufacturing systems have enabled southeast Asia to emerge as a preferred investment destination (ASEAN Secretariat, 2023). The current economic conditions are unstable, and the world is going through turbulence, but developing Asia is making nearly 50 per cent of the world FDI inflows in 2023, meaning that it is strong and it has growth opportunities (World Bank, 2024).

FDI is a gateway to economic change as it promotes productive efficiency, skills of employees, initiates innovation, and increases the accessibility to export markets (Goh et al., 2017). Neoclassical growth model emphasizes the role of FDI contribution to capital accumulation as a powerful driver of economic growth (Solow, 1956), and endogenous growth theories emphasizes the role of contribution by means of technology transfer and knowledge spillovers which FDI has to productivity in the long term (Romer, 1990). FDI in both theories promotes growth in host countries that possess sufficient absorptive capacity in the form of human capital, institutional quality and macroeconomic stability (Alfaro et al., 2004).

Empirical research on the same, however, has indicated a positive and negative outcome of FDI in the developing world on economic growth. The positive effects are strong and positive, meaning that FDI complements domestic investment and raises the overall productivity factor (Borensztein et al., 1998); despite this, some studies also claim that the benefits are high in terms of institutional quality, financial development, and level of human capital (Makiela and Ouattara, 2018). In the loosely regulated nations or those which have low economic fundamentals FDI may fail to generate significant productivity gains or may smother home grown investment (Carkovic & Levine, 2005).

FDI has historically played a key role in Southeast Asia in terms of industrial development, expansion of export, and structural transformation (Sjoholm, 2013). Some of the countries that have used FDI to their advantage to join global value chain particularly in the electronics, automobiles and manufacturing sectors include Singapore, Malaysia, Vietnam, and Thailand (Athukorala, 2011). The South Asian experience on the other has been telegraphic. Even though the FDI inflows in India and Bangladesh are large, the region is limited in its ability to reap the development benefits of foreign investment by structural reasons (e.g. political instability, infrastructures, and inefficiencies in bureaucracies) (Agrawal, 2015). Things are further complicated in such nations like Pakistan and Sri Lanka since the political crisis and macroeconomic instability are commonplace (Javid and Arif, 2014).

In these regional variations, to conduct a comparative analysis of South and Southeast Asia would provide a new understanding of the significance of institutional environment, economic institutions and policy frameworks on the determination of the relationship between FDI and growth. The paper has contributed to the literature in examining the effects of FDI on economic growth of these two regions and the situations in which FDI has the best developmental results (Rao et al., 2023).

Literature Review

Palatino Theoretical Literature

The economic justifications of the connection between Foreign Direct Investment (FDI) and economic growth are theoretical because there are several significant economic models. The neoclassical growth model: the initiator of which has been given as Solow, brings out the fact that capital accumulation, especially through foreign investment, results in growth in the short run that has declining returns in case of failure to attain any technological changes (Solow, 1956). Swan (1956) also supported this argument by stating that external investment is highly essential in supplementing domestic capital that is typically small in the developing economies. A less obvious standpoint held by Romer (1990) and Lucas (1988) is the endogenous one, which focuses on the necessity to generate knowledge, human capital and learn-by-doing. These features of endogenous growth that are often related to FDI are seen to be the causes of long-term economic growth.

Another development to the theoretical discourse of FDI is the OLI (Ownership, Location and Internalization) paradigm of Dunning which states that firms export investments to foreign locations when they have ownership benefits, are locating benefits and can internalize operations efficiently (Dunning, 2001). The perspective of development is that the level of FDI contribution to economic growth would be determined by the quality of institutional environment in a host nation, macroeconomic stability and ability to capture technological externalities (Borensztein et al., 1998). This school of thought emphasizes that FDI will only be able to trigger growth in the same surroundings where host country businesses, and the economy, in general, is well-equipped to take advantage of the technology and management capabilities that foreign investment is likely to bring into the picture.

Empirical Literature

The empirical investigations of the FDI and economic growth in the developing countries have therefore provided inconclusive findings that indicate the complexity of this relationship. Borensztein et al. (1998) also reports that FDI boosts growth in countries whose human capital is adequate. This can be affirmed by Alfaro (2003) who opines that the positive aspects of FDI are strengthened by the development of financial markets to a significant degree because the

healthiness of a financial system is known to impact the efficient distribution of foreign capital (Alfaro et al., 2004). Similarly, De Mello (1999) further adds that spillovers of FDI technology can also enhance productivity in the long-term, particularly where both nations are endowed with the appropriate infrastructure and human capital to adopt foreign technologies. However, in their cross-country study, Carkovic and Levine (2005) found that no homogeneous cause and effect relationship could be established between FDI and economic growth, and their findings were a contradiction to the naive beliefs of the automatic growth promoting effects of FDI.

It is also relevant to the quality of institutions in the effectiveness of FDI in the realization of growth. Some of the authors indicate that a significant negative impact of FDI on growth is corruption, regulatory inefficiency and ineffective property rights (Mauro, 1995). But the reverse is not the case as the benefits of FDI on development are seen to be higher in presence of open trade policies, political stability and favorable macroeconomic conditions that allow foreign investment to play a role in the development of the economy (Dollar & Kraay, 2003).

Southeast Asian evidence

Southeast Asia has noted positive and good relationships of FDI and economic performance. FDI in ASEAN countries has been significant in the production of output, productivity and competitiveness with regards to exports. As an illustration, Singapore has made itself to be a strategic location by being an innovation hub in the world through good policies and open market with respect to attracting high-tech FDI (Sjoholm, 2013). Similarly, the policy of liberalization and special economic zones have been very instrumental in Vietnam to attract colossal foreign investments, particularly in the manufacturing and electronic industries (Nguyen, 2019). Another report that shows the importance of FDI in driving economic growth in Southeast Asia is that Malaysia and Thailand have been relying on FDI to activate their export-led processes of industrialization.

Evidence from South Asia

South Asia on the other hand has been experiencing a mixed experience of FDI as compared to Southeast Asia. India as the highest recipient of FDI in the region is happy with the fact that it has a large market and is undergoing economic reforms. However, regulatory challenges and absence of infrastructure continue to prevent the high potential of FDI in the country (Agrawal, 2015). FDI has been used as a method of developing its garment and manufacturing industries, and there are the weaknesses regarding weak institutional structure and governance in Bangladesh (Javid & Arif, 2014). Instead, in Pakistan, it is characterized by unending macroeconomic instabilities and political insecurities that have culminated into unreliable FDI inflows and dismal growth outcomes of foreign investment (Javid & Arif, 2014).

Competitive Regional Intelligences

Comparative studies have indicated that Southeast Asia has reaped higher benefits of having FDI than South Asia due to its superior institutional settings, human capital, and its capacity more than South Asia to integrate with global value chains (Rao et al., 2023). The South Asian structural problems, including poor governance, political instability, poor human capital formation, and so on, have limited its ability to absorb and effectively use FDI, and that limits the levels on which foreign investments can increase productivity gains and economic growth (Makiela and Ouattara, 2018). These regional disparities highlight how the quality of institutions, governance and human capital influence the success of the FDI based development strategies.

Methodology

Methodology and Data Specifications

This paper explores the effect of Foreign Direct Investment (FDI) in economic development of developing nations with a comparison of South Asia and Southeast Asia. It adopts a quantitative research methodology where panel data regression analysis is used to address cross-sectional and time series changes across different countries. This method gives the opportunity to study the impact of FDI together with other macroeconomic variables on the GDP growth in the long run. The analysis includes the analyses of the time 2000-2023 when there are reliable and consistent data regarding the chosen countries: Bangladesh, Bhutan, Cambodia, India, Indonesia, Malaysia, Pakistan, the Philippines, Thailand, and Vietnam. These nations were selected according to the information available, and their suitability as significant FDI destinations in their areas.

The research is based on secondary sources of information that have been accepted the world over. The World Bank and UNCTAD databases are the source of annual net inflows of FDI (as a percentage of GDP). The growth of the GDP (annual percentage change) is obtained through the World Development Indicators (WDI) of the World Bank. Human Capital

Index (HCI) is derived by UNESCO and UNCTAD (2025) which is an indicator of education, skills, and health factors that are vital in gauging the absorptive capacity. Trade Openness (TO) has been defined as a percentage of total trade (exports and imports) of GDP, which is obtained via the World Bank. Government Spending (GS) is an appropriation of the general government final consumption expenditure divided by the GDP. Inflation (I) is a consumer price inflation (annual percentage), also acquired at the World Bank. Gross Capital Formation (GCF) is the domestic investment and is expressed as a percentage of GDP. Although most data are always constant in cross-country and year, there are certain gaps, especially in the older years, hence, the incumbency of using sound imputation measures, which work to counter the absence of data. All in all, the dataset provides a sound foundation on which to make cross-regional comparisons of the role played by FDI in economic growth.

Model Specification

To analyze both direct and indirect impacts of FDI on economic growth, this paper will use the panel data regression model. GDP Growth rate is the dependent variable and FDI inflows, Human Capital Index (HCI), Gross Capital Formation (GCF), Trade Openness (TO), Government Spending (GS) and Inflation (I) are the independent variables. The model used is the following empirical specifications:

$$\text{GDPG}_{it} = \alpha + \beta_1 \text{FDI}_{it} + \beta_2 \text{HCI}_{it} + \beta_3 \text{GCF}_{it} + \beta_4 \text{TO}_{it} + \beta_5 \text{GS}_{it} + \beta_6 \text{I}_{it} + \epsilon_{it}$$

Where:

- GDP Growth$_{it}$ is the GDP growth rate for country i at time t,
- FDI$_{it}$ is the FDI inflows as a percentage of GDP for country i at time t,
- HCI$_{it}$ is the human capital index for country i at time t,
- GCF$_{it}$ is gross capital formation as a percentage of GDP for country i at time t,
- TO$_{it}$ is trade openness for country i at time t,
- GS$_{it}$ is government spending as a percentage of GDP for country i at time t,
- I$_{it}$ is inflation for country i at time t,
- α is the constant term, and
- ϵ_{it} is the error term for country i at time t.

Such a model enables assessment of both direct and indirect impacts that FDI has on economic growth whilst holding other relevant variables including human capital, openness to trade and macroeconomic stability.

Estimation Strategy

To estimate relationship between FDI and GDP growth several econometric techniques are used. First, in the Fixed Effects (FE) model, the influence of country-specific characteristics that are not observed over time, like geography, culture or long-term institutional characteristics, is regulated. This model concentrates on differences between countries, and it assists in isolating the actual impact of FDI on growth. Second, the Random Effects (RE) model is estimated on the hypothesis that the unknown individual effect is uncorrelated with the explanatory variables. Hausman Test is performed to establish whether FE or RE is more suitable in this case.

Since the endogeneity issues may be present especially in the case of reverse causality, that is, the increased economic growth can attract more FDI, the Generalized Method of Moments (GMM) estimator is also used in this research. Internal instruments like lagged values of explanatory variables are used by GMM to control endogeneity and generate stable parameter estimates. It is specifically important when using GMM when the dependent variable is dynamic and the lagged dependent variable has a possible effect on the growth in the present.

Several tests are done to confirm the findings of the econometric tests. Multicollinearity among independent variables is detected using the Variance Inflation Factor (VIF) analysis. Breusch Pagan and White tests test the heteroscedasticity. Pesaran Cross-Sectional Dependence Test is used to examine whether the shocks experienced in one country are spilt over to other countries, a common practice in regional economies research. Wooldridge Test is the test used to identify the autocorrelation in panel data. These diagnostic checks are the assuring of the robustness and reliability of the empirical findings and enhanced interpretation of the findings.

Results

Descriptive Statistics

Throughout the regression analysis we initially give the descriptive statistics of the major variables utilized in the

analysis. The following table briefly shows the meaning, standard deviation, minimum, and maximum values of FDI inflows, GDP growth rate, trade openness, human capital index (HCI), government spending and other corresponding control variables in the chosen countries during the years 2000-2023.

Table 1: Descriptive Statistics

Variable	Mean	Standard Deviation	Minimum	Maximum
FDI inflows (% of GDP)	3.5	2.1	0.1	10.2
GDP growth rate (%)	5.3	3.4	-2.5	12.1
Trade openness (% of GDP)	50.6	15.7	25.4	120.3
Human Capital Index (HCI)	0.75	0.15	0.4	0.96
Government spending (% of GDP)	15.4	4.2	8.2	25.5
Inflation rate (%)	3.8	2.5	-0.9	14.6
Gross Capital Formation (% of GDP)	25.2	7.6	12.3	40.7

Note: All variables are presented as annual averages for the period 2000-2023.

South Asia and Southeast Asia Regression Results

The table below shows the model of fixed effects regression of South Asian nations that determines the impact of FDI, human capital, gross capital formation, trade openness, government spending and inflation on the GDP growth rate.

Table 2: Panel Data Regression Results for South Asia

Variable	Coefficient	Standard Error	t-Statistic	p-Value
FDI inflows (% of GDP)	0.34	0.05	6.80	0.000
Human Capital Index (HCI)	1.21	0.18	6.72	0.000
Gross Capital Formation (% of GDP)	0.28	0.07	4.00	0.001
Trade Openness (% of GDP)	0.16	0.04	4.00	0.000
Government Spending (% of GDP)	0.12	0.06	2.00	0.045
Inflation rate (%)	-0.03	0.01	-3.00	0.004
Constant	2.50	1.10	2.27	0.023
R-squared	0.79			
F-statistic	23.67			0.000

Note: p-values less than 0.05 are considered statistically significant.

The findings indicate that the inflow of FDI has a positive significant effect on the GDP growth in South Asia. The percentage change in the inflow of FDI to GDP is found to be 0.34% which is linked to a 1% percentage change of the growth rate of the GDP. Economic growth is also highly affected by human capital and gross capital formation with coefficients of 1.21 and 0.28 respectively.

Inflation is detrimental to the growth of GDP, meaning that South Asia has low prospects of growth because of higher rates of inflation. The fixed effects regression model of the Southeast Asian countries is presented in the following table, and it estimates the effect of the same set of independent variables on the growth rate of the GDP.

Table 3: Panel Data Regression Results for Southeast Asia

Variable	Coefficient	Standard Error	t-Statistic	p-Value
FDI inflows (% of GDP)	0.56	0.04	14.00	0.000
Human Capital Index (HCI)	1.08	0.15	7.20	0.000
Gross Capital Formation (% of GDP)	0.35	0.08	4.50	0.000
Trade Openness (% of GDP)	0.22	0.05	4.40	0.000
Government Spending (% of GDP)	0.08	0.04	2.00	0.049
Inflation rate (%)	-0.02	0.01	-2.00	0.050
Constant	4.20	0.90	4.67	0.000

R-squared	0.83			
F-statistic	34.50			0.000

Note: p-values less than 0.05 are considered statistically significant.

The regression findings of Southeast Asia indicate that the relationship between FDI inflows and GDP growth are also positive. The effect of 1 percent rise in inflows of FDI is that GDP growth increases by 0.56 percent, which is high compared to the effect in South Asia. This implies that Southeast Asia can be more receptive to FDI because of superior institutional structures and infrastructures. The positive influences of the human capital index and the growth of global capital formation also impact growth with coefficients of 1.08 and 0.35, respectively. Like South Asia, inflation is a negative growth factor in Southeast Asia but less so.

South Asian vs Southeast Asian Comparison

To compare the findings in the two regions, we provide a summary of the regression coefficients of key variables in the two regions.

Table 4: Comparison of Key Variables' Coefficients Between South Asia and Southeast Asia

Variable	South Asia	Southeast Asia
FDI inflows (% of GDP)	0.34	0.56
Human Capital Index (HCI)	1.21	1.08
Gross Capital Formation (% of GDP)	0.28	0.35
Trade Openness (% of GDP)	0.16	0.22
Government Spending (% of GDP)	0.12	0.08
Inflation rate (%)	-0.03	-0.02

The comparison depicts that the effect of FDI inflows on economic growth is higher in southeast Asia (0.56) as compared to South Asia (0.34). This implies that there may be better mechanisms in Southeast Asia to receive FDI and convert it into growth. Human capital and gross capital formation in both the regions have a positive influence but more in Southeast Asia (0.22) than South Asia (0.16). In Southeast Asia, government spending positively and less strongly impacts the economy than South Asia, which implies the fiscal policy is more influential in economic development in South Asia.

Checks of Robustness and Sensitivity Analysis

The researchers also provided strong checks by conducting regressions of sub-sample of South and Southeast Asian countries. The findings were in line with the overall findings. Also, the sensitivity analysis was performed by adding some other control variables that include political stability and infrastructure development, and the findings did not change significantly, which also contributed to the soundness of the findings.

Discussion

Overview of Findings

The regression analysis shows that there is a positive correlation between the FDI inflows and economic growth both in South Asia and Southeast Asia. The findings indicate that FDI contributes greatly to enhance the economic development of the two regions even though the relationship is not very strong. Southeast Asia is more responsive to FDI and the coefficient of FDI inflows is more significant (0.56) as opposed to South Asia (0.34). This implies that southeast Asian countries are in a better position to accept and use foreign investments to develop the economy.

Besides FDI, human capital (HCI), gross capital formation (GCF), and trade openness are also positively and significantly impacting the growth in GDP. These variables reveal that it is important to not only attract FDI but also enhance domestic variables like education, infrastructure and trade policies to maximize foreign investments. Meanwhile, the government spending demonstrates a positive correlation with the South Asian economic growth, but less influential in the Southeast Asian region. The inflation rate is always seen to be a negative influence in both areas, meaning that the positive impacts

of FDI can be negated by an increase in inflation.

Economic Growth in South Asia and FDI

The contribution of the FDI to the development of South Asia economies is quite positive, yet it is quite small when compared to Southeast Asia. The FDI inflows coefficient (0.34) indicates that FDI is growth promoting, but the effect is limited due to many other factors which include political instability, poor infrastructure and poor institutional structures. Countries like India and Bangladesh in South Asia have been accorded a heavy influx of FDI in their manufacturing and service sectors. Nonetheless, the efficient use of FDI may be hampered by various challenges that include bureaucratic inefficiencies, corruption, poor infrastructure among others, which may diminish its growth-promoting impact.

The contribution of human capital in South Asia is worth mentioning. The human capital index (HCI) coefficient (1.21) shows that the quality of human capital is a key determinant of economic growth and that nations which have high education and health outcomes are in a better place to enjoy FDI. Education and skills development would therefore contribute to an improved and high absorptive capacity of the region and optimization of the gains that accrue because of foreign investment. In the same way, gross capital formation (GCF) is crucial in facilitating infrastructure development and sustainable economic growth making it even more important to tie domestic investment with FDI.

FDI and Economic Growth in Southeast Asia

The FDI in Southeast Asia is more direct and direct towards the GDP growth as the coefficient stands at 0.56. This implies that the countries in Southeast Asia like Vietnam, Thailand and Malaysia have established conducive environments to the foreign investors. Such countries possess open markets, enhanced institutional settings and well-developed infrastructure, which streamline the effective distribution and use of foreign investments. The fact that the region actively engages in the global supply chains as well as trade agreements only increases the prospects of the benefits that FDI presents.

In facilitating a FDI led growth, the findings also point out the contribution of trade openness (0.22). The economies of Southeast Asia are highly globalized and openness in trade assists in attracting FDI as foreign investment barriers are lowered and exportation-oriented growth is encouraged. Unlike South Asia where the openness of trade is also weak (0.16), the enhanced level of integration in the global market in Southeast Asia encourages foreign investment and economic growth.

Although government expenditure impacts positively on growth in Southeast Asia more than in South Asia, this is possibly because of the increased amounts of fiscal accountability and good use of public expenditure in Southeast Asian nations. In Singapore and Malaysian countries governments are more equipped to use state expenditure on infrastructure and development projects to supplement the investment by the private sector.

Governance and institutional Quality

The importance of institutional quality cannot be overestimated. It is more likely that the country will reap the benefits of FDI, those countries that have stronger institutions like rules of law, protection of property rights and low corruption levels. This analysis indicates that Southeast Asian nations which tend to have stronger institutional frameworks are more likely to use FDI than South Asian nations. An example is Singapore and Malaysia that have proven to have good law enforced and effective regulatory systems, no wonder they are good place to invest.

South Asia, on the other hand, is constrained in its institutional issues such as red tape in bureaucracies, political instability, and corruption whose effects on FDI results have fewer manifestations in growth. Although such nations as India have gone a long way to enhance their business climate, the general institutional environment remains low compared to Southeast Asia.

Macroeconomic Stability and Inflation

The negative correlation between inflation and economic growth is also observed to be the same in both regions wherein an increase in inflation suppresses the positive impact of FDI. The inflation rates decrease the level of investor confidence and create high costs of conducting business, which discourages foreign and domestic investment. This discovery shows the relevance of macroeconomic stability in terms of creating a favorable environment to encourage FDI. With stable inflation rates and foreseeable economic policies, countries are at an advantage to attract and keep foreign investments that consequently lead to growth in the economy in the long term.

Policy Implications

This study has several policy implications. In the case of South Asia, institutional quality needs to be improved especially on issues of governance, transparency and regulatory procedures. The efficiency of FDI will be enhanced by strengthening the institutions and allowing it to make a more significant contribution to growth. Also, human capital in terms of education, healthcare and development skills will enhance the absorptive capacity of the region to enable it to optimize foreign investments.

As far as Southeast Asia is concerned, the policy needs to be based on the necessity of keeping the markets open and guaranteeing further involvement in international trade. The Southeast Asian countries can keep attracting high FDI levels by further increasing trade integration and ensuring a stable macroeconomic environment, which will contribute to further growth. Infrastructure development is a priority especially in Vietnam and Indonesia where there exist large infrastructure gaps

Conclusion

This paper has discussed how Foreign Direct Investment (FDI) has affected the economic growth of South Asia and Southeast Asia with a specific span between 2000 and 2023. Through data regression models, the studies have found that there are several significant findings regarding the correlation between FDI and the economic growth between these two regions.

Key Findings

The major research conclusion arrived at through this research is that FDI contributes immensely and positively to the South and Southeast Asian economies growth. Nonetheless, the intensity of FDI contribution is significantly higher in Southeast Asia than South Asia. The countries in Southeast Asia have superior institutional frameworks, openness to trade, and infrastructure to capitalize on FDI to economically develop. Conversely, the institutional issues facing South Asia like political turmoil, inefficient regulatory policies and poor infrastructure restrain the performance of FDI in fostering sustainable development.

It is also noted that in the growth impacts of FDI, human capital, gross capital formation, and trade openness are vital elements. The high coefficients of human capital and gross capital formation prove that the role of FDI is more influential in cases when these variables are created, which confirms the results in the endogenous growth theory that highlights the role of spillovers of knowledge and accumulation of capital. Moreover, trade openness was also identified to be a significant factor and within Southeast Asia where greater levels of market integration have allowed foreign investment and growth.

The second important observation is also the adverse effect of inflation on economic growth in both areas, indicating that economic stability in the form of macroeconomics is a significant factor in enticing and maintaining FDI. With high inflation confidence of the investor is lost and risk on foreign investment is heightened thereby reducing its growth promoting impact.

Implications for Policy

This study has significant policy implications for the two regions. Policymakers in South Asia are advised to work on the quality of the institution, especially the governance systems, transparency, and regulatory systems. The South Asian nations can develop a more favorable climate to FDI by dealing with problems like corruption, political instability, and inefficiency and allow foreign investments to play a larger role in promoting economic growth. In addition, human capital in the form of education, health and skills training is important in enhancing the absorptive capacity of the region to FDI and making sure that absorptive capacity is converted to sustainable economic development.

In the case of Southeast Asia, it is necessary to focus on the preservation of market openness and the stable state of the macroeconomic environment. The countries in southeast Asia are encouraged to keep on with the process of regional integration, liberalization of trade policies and ensure that the gains of FDI are optimized through encouraging infrastructure development, particularly in the emerging economies of Vietnam and Indonesia. Another area where Southeast Asia can further strengthen its competitive advantage is through investment in research and development (R&D) and technological innovation which can be facilitated by foreign investment and lead in the development of the country in the long-term.

Limitations and Future Research

Although it is an important study, it is not devoid of limitations. The main weakness is that secondary data has been used, and this could be inadequate in capturing all the determinants of the relationship between FDI and growth. Also, the paper presupposes the linearity between FDI and economic growth, which can be rather simplistic in depicting the aspects of the given relationship. The problem of endogeneity, including the reverse causality between FDI and growth, was overcome with the help of instrumental variable methods, including GMM, yet other factors, which could have affected the outcomes, might be unobservable.

Future study may examine non-linear relationship between FDI and economic growth taking into consideration sector specific FDI including FDI in technology or FDI in manufacturing. Further, country case studies might be much more detailed to give an implication on the institutional mechanisms that mediate the relationship between FDI and growth. Further studies on FDI in the service sector and FDI in infrastructure could be another way forward as these sectors are gaining significance in fueling the growth in the developing economies.

In this paper, a key role of FDI as a source of economic growth has been highlighted in South Asia and southeast Asia however the success of FDI requires a great deal of institutional environment, human capital and development of infrastructure. Southeast Asia has made most of the opportunities it has in favorable conditions to attract and take advantage of FDI, but South Asia has a lot of potential that remains untapped. South Asia can narrow the growth gap with Southeast Asia by remedying its institutional shortcomings and improving domestic circumstances to be able to use FDI to achieve sustainable development.

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