

Economic Institutions and Foreign Direct Investment in South Asia

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Abstract

Two fundamental questions about multinationals global investment behaviour are: Why do some nations receive more Foreign Direct Investment (FDI) than others? and How do multinational companies select which countries to invest in? This paper will try to answer both of them by analysing the significance of the presence of rigorous economic institutions in five SAARC member nations, that are, Sri Lanka, Bangladesh, Nepal, India and Pakistan for multinational investors from the five major OECD outward FDI makers, that are, United States of America, United Kingdom, France, Japan and Germany. The long-term characteristic of FDI vis-à-vis the host economy makes the existence of resilient economic institutions a desirable pre requisite. Specifically for the ones like a SAARC member that lacks abundant natural resources to lure overseas investors. The provision of such assistance reduces their scepticism of the host nation. Dyadic data from 1997-2021 for FDI from the source into the host nations is used for regression analyses. Results from random effect panel estimation technique shows that among the institutional indicators the ones' regulating labour disputes, business and credit issues and favourable business conditions related to freedom of international trading, from Economic Freedom of the World Index provided by the Fraser Institute significantly influences overseas investors from the major OECD economies in SAARC. Germany is the leading investor and India proves to be the most sought after FDI destination.

Key words: Foreign Direct Investment, Economic Institutions, South Asia, OECD and Panel Data, JEL Classifications: C330, C550, F550 and F680

Introduction

The economic turmoil in early twenty first century and the 2008-09 recession in the developed nations initiated a stark decline in the available investment funds (Shah, 2013b; 2019; 2021; Vaupot & Fornazarič, 2021). This coupled with the paucity of domestic capital in the developing countries ensued a fierce competition among them for Foreign Direct Investment (FDI). The results varied between countries from different geographic regions (Asamoah, Mensah & Bondzie, 2019; Shah, 2014b). The efforts were even more profound in the developing nations lacking natural resources like the members of South Asian Association for Regional Cooperation (SAARC). These efforts included providing favourable economic and political settings to the overseas investors to make for the lack of natural resources (Shah & Afridi, 2015). However, given the notoriety that has be fallen the SAARC in general due to corruption, political instability, absence of credible economic institutions etc. it has become difficult for the sub-region to attract substantial FDI compared to its peers such as ASEAN, Latin-Americas and the Middle East (Shah & Faiz, 2015). In this contextual background, the current research investigates the effectiveness of stable economic institutions availability on the flow of FDI to five South

Asian economies, that are, Sri Lanka, Bangladesh, Pakistan, Nepal and India. They are selected subject to data availability. The source countries are the Organisation for Economic Cooperation and Development (OECD) leading five FDI exporters that are, France, Germany, and United Kingdom from European Union, Japan from Asia and the United States of America.

Investment capital scarcity in developing nation's causes its expected marginal productivity to be comparatively higher than the capital abundant developed economies (Bom & Ligthart, 2014; Shah, 2009; 2016a). This partly prompts the investors of an industrialised nation to make FDI in a developing economy (Ashraf, Herzer, & Nunnenkamp, 2015; Shah, 2011c; 2015). Nonetheless, due to the enduring FDI related long-term commitments the realisation of the likely returns necessitates the continuous existence of a positive, business friendly institutional environment (Cuervo-Cazurra, Gaur & Singh, 2019; Shah & Gulelala, 2017). These investment facilitating intangible economic institutions help the multinationals in optimally utilising their intrinsic firm specific competencies along with the tangible host specific location advantages (Luo & Tung, 2018; Shah & Zeb, 2017). The crucial argument remains the same: A realistic multinational company (MNC) will invest in an economy where economic institutions governing the functioning of overseas enterprises are instrumental in lowering production costs, thereby increasing profits and investment returns of the overseas investors (Bailey, 2018; Shah & Khan, 2019).

Favourable economic institutions facilitate multinationals in acquiring vital business statistics (Shah, 2010; 2017c), essential not only for accommodating the distinctive set of market hazards, optimising production processes but also to improvise the internal dynamics of the firm required for product quality improvement (Buckley et al. 2018; Shah, 2018a). The long-term character of FDI prompts the foreign direct investors to be highly sensitive to domestic market risk perception (Irandoost, 2016; Shah, 2013a). The FDI hosting potential of a developing country to a certain extent is expected to be determined by the transparency, existence and effectiveness of its prevailing institutional structure (Orcos, Pérez-Aradros & Blind, 2018; Shah, 2018c). This is due to the overseas investor's sensitivity to the host market business environment governing fundamentals, as well as, their expectations of the continuity of MNC friendly market policies (Shah, 2017a; King, Loncan & Khan, 2021).

Sustained conducive business climate attracts foreign investors (Shah, 2011d). However, they get sceptical about developing countries because, although prevailing, business environment may appear adequate and suitable, suggesting profitable future prospects, the possibility that adverse political state of affairs may hinder their materialisation cannot be ruled out (Burger, Ianchovichina, & Rijkers, 2016; Shah & Azam, 2018). Therefore, stability of economic and political institutions along with transparency in laws and regulations governing MNCs ownership and operations are crucial factors effecting would-be investors (Shah & Jamil, 2016). Thus, warranting risk free business, economic and political settings are essential for a developing economy (Demir, 2016).

This study investigates the possible effects of economic institutions on bilateral dyadic FDI from France, Germany, Japan, United Kingdom and the United States of America i-e the five leading FDI exporters, into five SAARC economies, namely Bangladesh, India, Nepal, Pakistan and Sri

Lanka by a random effect model for the years 1997 to 2021. It was found that among them the ones governing business, credit and labour related regulations; gauging the ease and freedom for global multinational trade are the indicators that are positively and statistically significantly linked with the accrual of inward FDI. Market size and the domestic market's development level are also significant among the established FDI location determinants.

The rest of the study proceeds in the following manner. The FDI-economic institutions relationship is discussed in section two. Section three discusses data and the estimation model along with the empirical concerns. Findings and analysis are presented in section four, while, section five summarises and concludes with some policy implications.

Literature Review on Foreign Direct Investment and Economic Institutions

The state and quality of the contemporary economic, investment and business environment of the host economy shall decisively affect the investors FDI choice (Cortina, Köhler & Nielsen, 2015; Shah 2012; 2016c). However, according to Morrissey and Udomkerdmongkol (2016) it needs to be remembered that a multitude of business, commercial and non-commercial factors determines the corporate climate. Hence, Marano and Kostova (2016) argue that it is fairly challenging to develop an indicator which can suitably envisage the health of economic institutions governing the overall operations of multinational and domestic firms. Contractor, Dangol, Nuruzzaman and Raghunath (2020) states that Apple Inc. is reluctant to invest in India due to hostile economic institutions, lax contracts enforceability and labour laws. Mahmood, Shakil, Akinlaso, and Tasnia (2019) analysing FDI in Canada from 1981-2014 found that institutional strength positively influence foreign investors. Slesman, Abubakar and Mitra (2021) considering 97 emerging economies from 2006 to 2016, through System Generalized Method of Moments (SGMM) found that countries need a minimum threshold level of institutional capacity to positively influence multinationals investment decision. Fon, Filippaios, Stoian and Lee (2021) utilising bilateral Greenfield investments between 56 countries for the period of 2003 to 2015 found that institutional quality not only influences inward FDI but are strengthened by developed nation's MNCs presence in the host nation. Silajdzic and Mehic (2022) using investment promotion and facilitation policy measures as institutions proxy found that they lure FDI into South East Europe. Tag and Degirmen (2022) using system-GMM approach on panel data of 127 states for 19 years find that economic institutions and policies assisting effective exercise of property rights encourage foreign firms to invest. Kwaw-Nimeson and Tian (2023) exploring FDI into Sahel Saharan States through one-step system generalized method of moments (SYS-GMM) found that it has a positive rapport with institutional reforms. Contractor et al (2021) and Li and Huang (2023) concluded with the same empirical evidence. Adegboye and Okorie (2023) used cross country data for 30 SSA nations from 2001-2020 and determined through five panel estimation techniques, namely Differenced Generalized Moments of Method (DGMM), Fixed Effect (FE), Panel Two-Stage Least Square, Pooled Regression and Random Effect (RE) that they need an enabling institutional framework to attract FDI. Chen and Cheng (2023) using cross-sectional data for 111 Chinese FDI destination states empirically established through 2SLS that institutional quality clearly effect their investment decision.

Fraser Institute publishes an index titled Economic Freedom of the World (EFW), for around 150 countries, starting in 1970. EFW index and the economic & investment related components of the

one provided by Political Risk Services (PRS) group, called the International Country Risk Guide (ICRG), from 1984 onwards are considered as reliable measures of the host nation investment climate.

Fraser Institute's Index is planned with the objective to gauge a country's institutions consistency and durability of regulations governing personal choice, extent of competition and entry in the host market, safeguarding the investors and their properties from expropriation, and free market coordinated deliberate exchange (Shah, 2011a). The Fraser Institute's Index considers policies and institutions in line with economic freedom only where they are letting people make individual choices, sign accords voluntarily without any pressure, and the business environment is devoid of aggressors taking others property. In order to get a better EFW score, a state needs to ensure safety of property owned by individuals, a steady fiscal and monetary settings and warrant unbiased timely contract enforcement. Taxes shall be kept low and tariff and other barriers effecting local and foreign trade shall be avoided. Resource allocation shall be determined through the market criterion rather than political considerations and processes (Shah, 2017d). Consequently, the EFW summary index essentially illustrates the extent of market liberalisation pursued by the host economy. It is made of five sub-area indexes. Freer countries have high scores in all of them.

These areas (components) are:

Area one: Government size: Enterprises, Taxes and Expenditures,

Area two: Property Rights Security and Legal Structure,

Area three: Access to Sound Money,

Area four: International Trade Liberty and

Area five: Credit, Labour, and Business Bylaws and Regulations¹.

As these are indicators of a host nation's market affability to overseas investors. Therefore, a positive connection with FDI inflows is expected. It shall be remembered that the Heritage Foundation's Economic Freedom Index (EFI), though, equally important is different from EFW index because more freedom is exhibited by a smaller value in EFI².

Moreover, socioeconomic conditions and investment profile from the international country risk guide (ICRG) are also utilised to further evaluate the current state of the FDI host's economic institutions comprehensively (King, Loncan & Khan, 2021). Socioeconomic conditions have three sub-components: consumer confidence level, prevalence of poverty in the populace and extent of unemployment. This index reveals a valuation of, social and economic, work related pressure in the society. This hints apropos the possibility of people hampering state action or adding to social disgruntlement, especially, among the labour class or the employed work force (Shah, 2017b). Investment profile comprises of expropriation risk, viability of contract, payment delays and profit repatriation possibilities. This summarises investment risk factors in the FDI host economy (Shah, 2018a). Both indexes risk ratings varies from zero to twelve. All the subcomponents start with a minimum of zero and the highest of four, with zero exhibiting

¹. The details on the sub-components of EFW Index are available at Gwartney, Lawson, Hall & Murphy (2022).

². Details about EFI can be found at: <http://www.heritage.org/index/about>.

maximum risk and four pointing towards the lowest risk. As higher scores show lesser risk possibilities for investor's capital a positive rapport with inward FDI is assumed.

Methodology, Estimation Model, Data and Empirical Concerns

Multinationals desire big domestic markets (Mayer, Melitz & Ottaviano, 2014; Contractor et al. 2020), somewhat developed nations (Fillat & Woerz, 2011) and economies facilitating investors and open to world trade (McGrattan, 2012; Lartey, 2017). In addition to these MNC's investment decision is probably effected by a motley combination of indeterminate factors. Therefore, establishing a standard model to capture the effects of institutions on MNCs investment location choice seems to be extremely complicated owing to the fact that most of the institutional variables are hardly quantifiable. Nevertheless, in this study based on the prior discussion in section one and two it is assumed that the FDI inflows in SAARC economies are a function of the variables given in equation one.

$$FDI_{ijt} = f \left\{ \begin{array}{l} \text{Market Size, Economic Development,} \\ \text{Openness, Distance, Economic Institutions} \end{array} \right\} \dots 1$$

To investigate the possible influence of economic institutions on inward FDI in the five SAARC countries from 1997 to 2021, the log-linear specification of the form given below as equation two is derived from equation one.

$$\ln FDI_{ijt} = \alpha_0 + \beta_1 \ln \text{Market Size}_{it} + \beta_2 \ln \text{Economic Development}_{it} + \beta_3 \ln \text{Openness}_{it} + \beta_4 \ln \text{Distance}_{ij} + \beta_5 \text{Economic Institutions}_{it} \dots 2 \\ + \beta_6 \mu_t + \beta_7 \phi_i + \beta_8 \Omega_j + \epsilon_{it}$$

Here \ln symbolises natural logarithm. Using natural logarithm renders the distributions nearly normal bringing it close to become homoscedastic (Tang, 2021). FDI_{ijt} represents the foreign direct investment in the host country i from the source country j at time period t . The data on FDI is collected from OECD Stat. ϕ_i is used to control for host economies dummies whereas Ω_j will cater for source countries dummies. μ_t is used for any possible time effect. ϵ_{it} will contain all the other factors (omitted variables) influencing FDI inflows in SAARC. ϕ_i and Ω_j both varies from one to five and t varies from one to twenty five. Therefore, I will have a maximum of $5 * 5 * 25 = 625$ observations for all the variables. Replacing the explanatory variables with appropriate proxies gives:

$$\ln FDI_{ijt} = \alpha_0 + \beta_1 \ln \text{GDP}_{it} + \beta_2 \ln \text{GDPPC}_{it} + \beta_3 \ln \text{Trade \% GDP}_{it} + \beta_4 \ln D_{ij} + \beta_5 \text{Economic Institutions} \{ (\text{EFW Index}) \text{ or } (\text{ICRG}) \}_{it} \dots 3 \\ + \beta_6 \mu_t + \beta_7 \phi_i + \beta_8 \Omega_j + \epsilon_{it}$$

Gross Domestic Product (GDP) proxy's market size and per capita GDP is used for level of host's development, the data for the two of them is taken from World Bank, World Development Indicators. Bilateral trade as a fraction of the host GDP is obtained from OECD, STAT. It gauges the degree of openness and association of the investment host with the source economy. D_{ij} is the population weighted distance between the cities with the highest population of both the host

country i and the source country j from Centre d'Etudes Prospectives et d'Informations Internationales (CEPII). The rest of the variables are as explained earlier.

Hypothesis of the Study

In accordance with section two and three, as well as, equations one to three the primary and secondary hypotheses of the paper are as follows:

Primary Hypothesis

The hypothesis given below shall answer the primary objective of the paper:

H₀: In SAARC FDI is not affected by health of host economy's economic institutions.

H₁: In SAARC it is significantly affected by health of host economy's economic institutions.

Secondary Hypotheses

The secondary hypotheses set to cover for the established conventional FDI location determinants in the SAARC countries would be:

H₀: In SAARC FDI inflows are not affected by host economy's Market Size.

H₂: In SAARC they are significantly affected by host economy's Market Size.

H₀: In SAARC FDI inflows are not affected by Economic Development of host economy.

H₃: In SAARC FDI is significantly affected by Economic Development of host economy.

H₀: In SAARC FDI inflows are not affected by Openness of host economy.

H₄: In SAARC they are significantly affected by Openness of host economy.

H₀: In SAARC FDI inflows are not affected by Distance of host from source countries.

H₅: In SAARC they are significantly affected by Distance of host from source countries.

H₀: In SAARC FDI inflows are not affected by a time trend.

H₆: In SAARC they are significantly affected by a time trend.

H₀: In SAARC Foreign Direct Investors have no Host Country specific preferences.

H₇: In SAARC they have some significant Host Country specific preferences.

H₀: In SAARC for FDI inflows there are no source country effects.

H₈: In SAARC for FDI inflows there are significant source country effects.

Descriptive Statistics

The descriptive statistics provide the summary of the highest and lowest values. Moreover, they include the extent of dispersion and central tendency, as well as the number of observations for all the variables. These statistics are summarised in table one.

Table 1 Summary Statistics

Variables	Number of Observations	Mean	Standard Deviation	Min	Max
Ln FDI	625	7.58	8.52	3.6	22.04
Ln GDP Host	625	28.59	0.76	26.87	30.33
Ln GDP/PC Host	625	5.97	0.51	5.05	7.39

Ln Trade % GDP	625	19.96	1.78	14.41	24.55
Ln Distance	625	8.95	0.30	8.45	9.60
EFW Area 1	625	6.27	1.07	4.29	8.12
EFW Area 2	625	4.08	1.09	2.3	6.44
EFW Area 3	625	6.60	0.44	5.5	7.87
EFW Area 4	625	4.90	1.19	1.79	6.83
EFW Area 5	625	5.71	0.41	5.03	6.61
EFW Summary Index	625	5.54	0.49	4.06	6.58

All the values given in table one are rounded off to two decimal places

Empirical Issues

The possible empirical concerns are addressed in this section.

Heteroscedasticity

Heteroscedasticity was tested by the Breusch - Pagan / Cook-Weisberg test for heteroscedasticity, which shows that the dependent variable exhibits a constant variance or homoscedasticity with the following statistic values $\text{Chi}^2(1) = 0.11$ and Probability $> \text{Chi}^2 = 0.7431$. Using the right hand side option to check for heteroscedasticity in the explanatory variables the Breusch - Pagan / Cook-Weisberg test confirms it with these statistical values $\text{Chi}^2(5) = 32.56$ and Probability $> \text{Chi}^2 = 0.0000$. The Baum and Cox (1999) white test with $\text{Chi}^2(20) = 150.3060$, and Probability value = 0.0000 also confirms the presence of heteroscedasticity. Therefore, the results presented in table six are with robust standard errors, that is, after controlling for heteroscedasticity.

Table 2 Heteroscedasticity Tests

Test	Probability Value	Conclusion
Breusch-Pagan/Cook-Weisberg Test	0.0000	Heteroscedastic
Baum and Cox White Test	0.0000	Heteroscedastic

Multicollinearity

To check for the existence of problematic multicollinearity the correlations between the independent variables are calculated. They are given as table three. They clearly show the absence of extreme multicollinearity as the linear associations among the explanatory variables are far below the yard stick of ninety per cent or above (Shah & Khan, 2017). Variance inflation factor (VIF) is also calculated for all the regression models considered in table six in the results and analysis section. As evident from table four, problematic multicollinearity was not found because in all the regressions the mean VIF is less than the bench mark of ten (Kennedy, 1992).

Specification Tests

There are five source and five host economies, resulting in five dyadic pairs for 25 years each. Therefore, to apply apposite empirical estimation method between the panel and pooled OLS techniques the specification diagnostics tests were applied. The Fischer-Test approves the use of Fixed Effects panel method over P-OLS with the following results:

$$u_i = 0 \quad F(24, 547) = 12.86$$

Probability > F = 0.0000.

The Breusch and Pagan Lagrangian multiplier test supports Panel Random Effects against P-OLS as evident from the results given below:

$$\ln FDI[id, t] = Xb + u[id] + e[id, t]$$

$$\text{Chibar}^2(01) = 642.22$$

$$\text{Probability} > \text{Chibar}^2 = 0.0000$$

As both these test favour the use of panel methods, the Hausman (1978) specification test was applied. The following statistics: $\text{Chi}^2(4) = 1.91$ and $\text{Probability} > \text{Chi}^2 = 0.7530$ summarises the results. As the results are unable to reject the null, the efficient random effect empirical panel estimation method will be used (Shah & Khan, 2018). The results for all the three specification tests are given in table five.

Table 3 Correlation Matrix

No.	Variable	1	2	3	4	5	6	7	8	9	10	11	12
1	Ln FDI	100											
2	Ln GDP Host	56	100										
3	Ln GDP / PC Host	31	-	100									
4	Ln Trade	44	68	23	100								
5	Ln Distance	-05	-	11	14	100							
6	EFW Area one	10	-	42	10	06	100						
7	EFW Area two	42	47	26	38	02	03	100					
8	EFW Area three	-02	26	-	10	-	-	16	100				
9	EFW Area four	23	-	62	-	05	23	36	-	100			
10	EFW Area five	28	-	66	-	08	19	04	-	70	100		
11	EFW Sum Index	37	10	66	19	04	53	62	10	84	52	100	
12	Ln Time Trend	22	-	42	-	-	65	35	01	64	35	79	100

Correlation values are rounded off to nearest whole numbers.

Findings and Analysis

Models one to eleven, table six endorse the widespread predominant results of the existing empirical research on FDI flows concerning the multinationals inclination for host development level and bigger markets (Shah & Qayyum, 2015). Moreover, gross domestic product per capita

represents people's purchasing power and labour wages in addition to the host country's overall progress (Shah, 2014a). Low wages are obviously sought, especially, by vertical FDI investors for value addition in the host economy (Nielsen, Asmussen & Weatherall, 2017). Degree of openness and distance between the source and host are insignificant in all the models (Shah & Khan 2016).

The proxies for institutions from Fraser Institute, Economic Freedom of the World Index area four and area five are significant with the anticipated signs as evident from model five to eleven. In model five, area four summarising freedom for international trade is significant at 5 % level (Shah & Samdani, 2015). Whereas, in the sixth regression, area five summarising regulations of credit, labour, and business is significant at 1 % with a much stronger coefficient, therefore, in the remaining regressions area five have been used. The two measures utilised from ICRG as well as the other proxies from Fraser Institute were all insignificant hence their results are not included.

Table 4 Variance Inflation Factor Table

No	MODEL	VIF
1	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \zeta_{it}$	1
2	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \zeta_{it}$	1.06
3	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \beta_3 ln Trade_{it} + \zeta_{it}$	1.19
4	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \beta_3 ln Trade_{it} + \beta_4 ln D_{ij} + \zeta_{it}$	1.29
5	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \beta_3 ln Trade_{it} + \beta_4 ln D_{ij} + \beta_5 EFWA4_{it} + \zeta_{it}$	1.62
6	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \beta_3 ln Trade_{it} + \beta_4 ln D_{ij} + \beta_5 EFWA5_{it} + \zeta_{it}$	1.69
7	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \beta_3 ln Trade_{it} + \beta_4 ln D_{ij} + \beta_5 EFWA5_{it} + \beta_6 \mu_t + \zeta_{it}$	1.88
8	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \beta_3 ln Trade_{it} + \beta_4 ln D_{ij} + \beta_5 EFWA5_{it} + \beta_6 \mu_t + \beta_7 India + \zeta_{it}$	2.01
9	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \beta_3 ln Trade_{it} + \beta_4 ln D_{ij} + \beta_5 EFWA5_{it} + \beta_6 \mu_t + \beta_7 Nepal + \zeta_{it}$	2.49
10	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \beta_3 ln Trade_{it} + \beta_4 ln D_{ij} + \beta_5 EFWA5_{it} + \beta_6 \mu_t + \beta_7 Japan + \zeta_{it}$	3.03
11	$Ln FDI_{ijt} = \alpha_o + \beta_1 ln GDP_{it} + \beta_2 ln GDPPC_{it} + \beta_3 ln Trade_{it} + \beta_4 ln D_{ij} + \beta_5 EFWA5_{it} + \beta_6 \mu_t + \beta_7 Germany + \zeta_{it}$	1.77

5 Specification Tests

Specification Test	Used To Choose Between	Probability Value	Decision
Fischer Test	Panel Fixed Effect and Pooled Ordinary Least Squares	0.0000	Fixed Effects
Breusch and Pagan Lagrangian Multiplier Test	Panel Random Effect and Pooled Ordinary Least Squares	0.0000	Random Effect
Hausman Test	Panel Fixed Effect and Panel Random Effect	0.7530	Random Effect

Table 6 Random Effects Panel Estimations

Variables	Proxy Used	Regression Models										
		1	2	3	4	5	6	7	8	9	10	11
Market Size	Ln GDP Host	5.26 46 ** (0.0 602)	3.56 68 ** (0.4 221)	3.90 29 ** (0.4 806)	3.90 19 ** (0.4 866)	3.94 54 ** (0.4 487)	3.71 32 ** (0.4 857)	3.69 74 ** (0.4 496)	2.44 19 ** (0.8 519)	4.24 77 ** (0.6 138)	3.57 07 ** (0.4 423)	3.82 56 ** (0.3 897)
			7.68 07 ** (1.0 528)	7.83 82 ** (1.0 617)	7.85 24 ** (1.0 747)	5.34 55 ** (1.3 591)	4.63 28 ** (1.3 013)	4.48 33 ** (1.6 800)	4.34 34 * ** (1.7 021)	5.60 66 ** (2.1 703)	4.32 14 ** (1.5 227)	3.96 81 ** (1.4 204)
Openness	Ln Trade % GDP			- 0.39 85 (0.2 336)	- 0.39 30 (0.2 339)	- 0.38 91 (0.2 297)	- 0.26 99 (0.2 337)	- 0.26 91 (0.2 344)	- 0.28 33 (0.2 341)	- 0.18 82 (0.2 143)	- 0.20 06 (0.2 226)	- 0.33 76 (0.2 425)
					0.20 50 (2.4 933)	0.06 30 (2.1 346)	- 0.34 70 (2.3 119)	- 0.32 76 (2.2 914)	- 0.82 28 (1.9 232)	0.12 14 (1.9 663)	- 4.07 29 (2.3 696)	1.55 16 (1.9 973)
Fraser Institute Economic Freedom Index (EFW)	Area Four					1.10 53 * (0.5 029)						
	Area Five						4.65 68 ** (1.4 689)	4.65 98 ** (1.4 736)	4.75 13 ** (1.4 820)	4.43 33 ** (1.4 612)	4.73 78 ** (1.4 714)	4.76 11 ** (1.4 671)
Ln Time Trend								0.09 18 (0.5 899)	0.35 04 (0.6 119)	- 0.38 59 (0.7 774)	0.13 65 (0.5 543)	0.25 15 (0.4 720)
Source / Host Country Dumm	India								5.61 03 * (2.4 878)			
	Nepal									4.62 56		

y										(2.7359)		
	Japan										-5.3516** (2.0059)	
	Germany											5.8483** (1.2711)
R-Squared	35.46 %	46.77 %	47.48 %	47.47 %	50.64 %	51.07 %	51.17 %	53.45 %	53.53 %	55.75 %	58.73 %	
Number of Observations	625	625	625	625	625	625	625	625	625	625	625	
Standard errors robust to heteroscedasticity are reported in parenthesis under the coefficient estimates. ** represents significance at 1 % and * at 5 %.												

These results collectively exhibit the relative relevance of EFW index, area four and area five in explaining the inflow of FDI to SAARC members. The insignificance of the other variables may be as a result of the collective feature of these measures making them essentially unable to comprehensively proxy the phenomenon that influence the commerce, trade and investment related variables. Nevertheless, I cannot exclude the possibility that they will have some positive indirect effect for example, through affecting the optimal functionality of the multinational firm (Shah & Ali, 2016). Due to the fact that the variables summarising institutions are usually correlated very highly with one another, I didn't employ several of them in the same model to mitigate the possibility of problematic multicollinearity (Baek, 2016).

I check for the individual country effects and the time trend from model seven onwards. There is no significant time effect. The strong positive preference for India is evident from model eight. The results for the Nepalese Dummy, though insignificant is included because it will control for a land locked country effect as well. Japan is withdrawing its investments from the region as evident from model ten, probably shifting investments to neighbouring China, Taiwan, Malaysia and Indonesia. On the contrary, Germany seems to be the one making the highest investments in the region. The country dummies for the other host and source economies were all insignificant. Moreover, Morrissey and Udomkerdmongkol (2016) and Rose-Ackerman and Palifka (2016), states that dimly weak economic institutions and endemically pervasive corruption precludes MNCs from undertaking FDI into the developing countries. Shah (2018b) terms corruption and bureaucratic red tape to be the root cause of FDI decay in South Asia (SAARC). Therefore, even in case they intend to enter these economies they choose joint ventures on wholly owned or green field investments to reduce their risk. The most recent example being the Saudi Aramco effort for buying a mere twenty per cent share in Reliance India, enabling them to jointly share not only the profits but the risks as well. Consequently, unlike India the low FDI in Nepal, Bangladesh, Sri

Lanka and Pakistan shall partly be due to insufficiency or unavailability of adequate joint venture opportunities (Shah, 2017d).

So, far the results obtained suggests that improved/healthier business and commerce settings of the host nation and relatively developed, freer and large domestic market boost FDI inflows, while institutional dis-functioning causes the contrary. Walmsley, Hertel and Ianchovichina (2006) states that the 1997-1998 decline in foreign direct investment inflows to even China and it's economic slowdown was somewhat attributed to the absence of rule based economy making it difficult for foreigners to operate effectively in China.

Conclusion

The globalisation of the world economy has made the research on multinational activity extremely important. Its increasing intricacies make it intriguingly interesting to grasp the phenomenon responsible for their investment decisions. These fresh complexities, despite researchers continuous efforts, not only demands for approaching/revisiting the existing findings with new techniques but also to explore new-fangled factors (Shah, 2016b). Therefore, it is expected that the current paper will certainly add some new vistas of knowledge to the FDI literature.

The present empirical work was an effort to evaluate the possible effects of presence and shape/condition of the five South Asian host nation's economic institutions on potential foreign direct investors from the leading OECD, FDI exporters. It was hypothesised that the existence of MNCs facilitating economic institutions in the host economies are deemed indispensable for the optimal functioning of multinationals operations abroad (Shah, 2011b). The long-term characteristic of FDI requires the presence of such features in the foreign markets to let them ideally match their innate organisational core competencies with the location specific attributes offered by the foreign host. Using bilateral FDI data of five SAARC member countries from 1997 to 2021, it is found that multinationals seek larger, relatively developed open markets. Better economic conditions are the sought after institutional traits. A strongly positive preference for India is also witnessed. Time trend though positive was insignificant. The established relevance of the ICRG indicators in explaining the FDI inflows in the international finance literature was found to be relatively feeble than the other measures of institutional strength from Fraser Institute in South Asia. Put in other words, although, it is expected that multinational companies are inclined to locations offering effectively working institutions; this seems to be contrary to the case in SAARC with ICRG data.

Providing a conducive environment in terms of quality institutions could foster the regions access to unrestricted advantages including FDI in intermediate goods which is essential for take-off. Thus, for SAARC countries, except India, that are neither large enough nor growing at a faster pace, policies that improve these factors are their best options to attract more FDI. Building institutions as part of a comprehensive development strategy thus, provides added advantage to curbing the long-standing corruption/red tape curse faced by majority of developing economies. Furthermore, policies that promote trade, develop human capital and improve infrastructure should also be pursued to improve the investment environment (Shah, 2011e). This affords a tentative podium for skill acquisition and technology transferral as well. Moreover with the availability of micro project/sector specific data; institutions effect vis-à-vis FDI possibilities into

manufacturing, technological, research & development, internet, sales and retail etcetera may also be considered.

It is a fact that, though, modifying a country's image is time consuming. Nevertheless, SAARC countries by enhancing the state of multinational governing economic institutions, fostering investment promoting policies, warranting the continuation of these programs, reducing corruption and nurturing a socioeconomic environment that supports MNCs can regain overseas investors confidence and lure them to invest.

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