Foreign Direct Investment and Current Account Balance: The Case of South Asian Economies

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INTRODUCTION

INTRODUCTION

- In the world of globalization current account balance of a country is considered as the main determinant of future path of the economy.
- FDI is the category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy (IMF's BPM-5, 1993).
- Foreign Direct Investment (FDI) has emerged as safe and easiest form of capital inflows to developing nations (Agiomirgianakis, Asteriou, & Papathoma, 2003).

CONTI……..

South Asia has received 41.2 billion US $ FDI inflows which is the 3.4% of total FDI flows in the world (World Investment Report, 2015).

FDI inflows are found to:

- Granger cause profit remittance (Seabra and Flach, 2005; for Brazil)
- Have positive impact on income outflows (Ali, 2013; for Pakistan)
- Have positive impact on current account balance (Ehimare, 2011; for Nigeria)
- Have negative impact on current account balance (Jaffri et. al., 2012; for Pakistan).

CONTI……..

FDI inflows are found to:

- Have not any significant impact on host country's current account balance, exports and imports (Nguku 2013; for Kenya),
- Have causal relationship to current account balance and exports (Goswami and Saikia, 2012; for India).

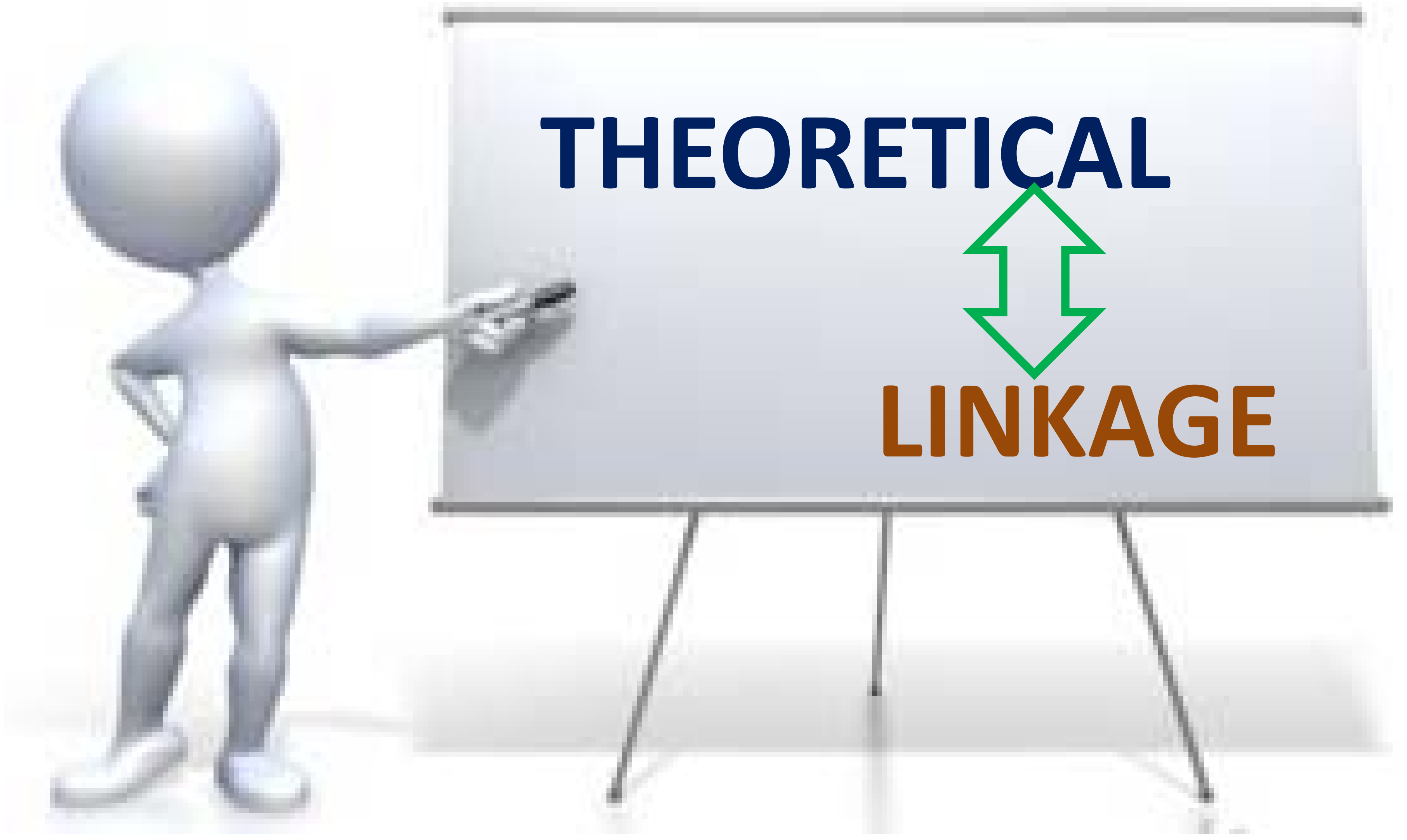
FDI inflows can:

- cause larger profit repatriations in long run; hence can deteriorate the current account balance of the host economy (Ali and Shaheen, 2013; Jaffri *et. al.*, 2012; Seabra and Flach, 2005).
- contribute to correct the current account balance of a host economy, if the economy is under developed and resources are available in the economy (Ehimare, 2011).

Objectives of the Study

To examine the impact of FDI (inflows) on:

- The current account deficit
- The exports
- The imports


THEORETICAL
LINKAGE

CONTI……..

It has been concluded that the impact of FDI inflow on current account balance could be negative or positive depending upon the relative elasticities of exports and imports with respect to FDI (Hossain, 2007).

THEORETICAL LINKAGES

Increased level of FDI inflow

Increase import of capital and intermediate goods and import of raw material

It widens the gap of exports and imports instead to reduce it (widens trade deficit)

Overall negative impact on CAB

Increase FDI will lead to increase in exports

It may overcome the gap of exports and imports (Reduce trade deficit)

Overall positive impact on CAB

Inspiration from Hossain (2008)


resources
identify
publishers
publishing
provenance
datasets
owners
data
Open
metadata
transformed
public
formats
well
Data
ontologies
known
reuse
dataset
unique
codebooks
bodies
vocabularies
Methodology
descriptive
together
readable
published
machine

DATA AND DATA SOURCES

2000
to
2016

WORLD BANK

UN Conference on Trade and Development (UNCTAD)

Model Specification

Model # 01

$$CAB = \alpha + \beta 1FDI_{it} + \beta 2REER_{it} + \beta 3GDP_{it} + \beta 4TOT_{it} + \beta 5GFCF_{it} + \mu$$

Model # 02

$$Exports = \alpha + \beta 1FDI\ inflows_{it} + \beta 2FDI\ inflows_{it-1} + \beta 3GDP_{it} + \beta 3REER_{it} + \beta 4Openess_{it} + \beta 5TOT_{it} + \mu$$

Model # 03

$$Imports = \alpha + \beta 1FDI\ inflows_{it} + \beta 2FDI\ inflows_{it-1} + \beta 3GDP_{it} + \beta 3REER_{it} + \beta 4Openess_{it} + \beta 5TOT_{it} + \mu$$

Conti…

Where;

CAB: Current Account Deficit (CAB excluding workers' remittances in million US $)

FDI: Foreign Direct Investment Inflows (in million US $)

GDP: GDP (in million US $)

TOP: Trade Openness [measured as : (Exports + Imports)/ GDP]

REER: Real Effective Exchange Rate

TOT: Terms of Trade

Exports: Volume of Total Exports (in million US $)

Imports: Volume of Total imports (in million US $)

ESTIMATION TECHNIQUE

The study employed **system GMM** to estimate the models. This method can: (1) minimize unobserved country's heterogeneity, (2) overcome omitted variable biasedness, (3) and can handle potential endogeneity problem that frequently affect the estimation (Bond *et al.*, 2001).

The consistency of the system GMM estimator depends on the validity of the instruments. For this purpose, two **specification tests** were applied:

1. Sargan-test to test the overall validity of instruments

2. AR2-test which examines that error term of the differenced equation is not serially correlated


RESULTS

Variables	Dependent Variable: Current Account Deficit				
	(1)	(2)	(3)	(4)	(5)
CAB –Deficit (-1)	1.0009***	0.9883***	0.9762***	0.9686***	0.8909***
	89.81	81.20	73.82	68.15	18.82
FDI/GDP	-0.6556***	-1.06639***	-0.63271*	-0.8463**	-0.88109**
	-2.64	-3.57	-1.74	-2.16	-2.33
REER		0.00493*	0.00653**	0.00607**	0.006445**
		1.71	2.13	1.96	2.15
LGDP			-0.1435**	-0.1252*	-0.1869***
			-2.29	-1.96	-2.62
TOT				-0.2468	-0.44164**
				-1.48	-2.24
LGFCF					0.9079*
					1.72
Constant	0.2207	0.01913	1.0745**	1.3835**	1.4623***
	0.94	0.08	2.05	2.45	2.67
AR(2)P-value	0.422	0.377	0.268	0.265	0.204
Sargan P-value	0.999	0.233	0.197	0.534	0.916

Variables	Dependent Variable: Log of Exports				
	(1)	(2)	(3)	(4)	(5)
Log Export (-1)	0.9999***	0.7671***	0.6891***	0.6878***	0.6176***
	114.57	11.07	9.86	7.57	6.99
LFDI	5.2422**	5.8403***	3.3937*	3.3889*	3.3441*
	2.40	3.23	1.78	1.77	1.78
LFDI (-1)	-4.8115**	-1.0639	-2.1646	-2.1688	-1.3958
	-2.20	-0.50	-1.11	-1.11	-0.74
LGDP		0.2328***	0.3588***	0.3601***	0.4215***
		3.38	4.47	3.70	4.49
TO			0.00706**	0.00708**	0.006494**
			2.47	2.32	2.19
REER				0.0004	0.001778
				0.02	0.94
TOT					0.1690*
					1.70
Constant	0.07248	-0.3628**	-1.3189***	-1.3261**	-1.6258***
	0.77	-2.42	-3.22	-2.57	-3.28
AR(2)P-value	0.421	0.313	0.462	0.467	0.254
Sargan P-value	0.380	0.569	0.645	0.595	0.665

Variables	Dependent Variable: Log of Imports				
	(1)	(2)	(3)	(4)	(5)
Log Imports (-1)	0.9948***	0.6281***	0.6265***	0.6343***	0.6632***
	132.12	7.10	6.71	10.77	12.20
LFDI	2.6805***	3.9743***	2.8574**	3.0918***	2.5077**
	2.74	2.91	2.25	2.68	2.34
LFDI (-1)	-2.4794***	-0.8131	-1.4288*	-1.1860	-1.4814*
	-3.38	-1.01	-1.81	-1.31	-1.73
LGDP		0.33042***	0.3484***	0.3536***	0.3413***
		4.58	3.57	6.49	6.42
TO			0.00234	0.00195	0.00302*
			0.79	1.07	1.85
REER				-0.00375**	-0.00394**
				-2.10	-2.20
TOT					0.01846
					0.25
Constant	0.14068**	0.0592	-0.2236	0.0648	-0.1214
	2.39	0.72	-0.65	0.24	-0.44
AR(2)P-value	0.233	0.318	0.137	0.332	0.379
Sargan P-value	1.000	0.975	0.995	0.119	0.413

CONCLUSION AND POLICY RECOMMENDATION

The study concludes that in case of the panel of South Asian economies, inward FDI decreases the current account deficit. Overall positive impact on current account balance shows that inward FDI encourages exports more than imports of the host country.

On the basis of the results of the present study it is suggested that the South Asian countries should have more open policies towards FDI inflows as an external source of capital accumulation for the development of the host country as FDI improves the current account balance of the host country by improving its exports.


Thank you