EFFECT OF FINANCIAL DEVELOPMENT AND FDI ON ECONOMIC GROWTH IN SAARC COUNTRIES: A PANEL ARDL APPROACH

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Abstract

This paper explores the impact of financial development and foreign inflows on economic growth in the following SAARC nations: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka from 2006 to 2019. The econometric tool used is the Autoregressive Distributed Lag Model (ARDL) in panel settings and Pedroni cointegration test to observe the connection between financial development, foreign influx, and economic growth. The financial advancement indicator used in the study includes the ratio of domestic credit, broad money, and gross savings, whereas the net foreign inflows as a percent of GDP are used as the proxy for FDI. The preliminary investigation of the macroeconomic variables has revealed substantial variation among the sample countries. Findings from the Pedroni panel cointegration test show that the variables are cointegrated in the long run. PMG estimates suggest that Broad money positively affects economic growth, while gross savings have an undesirable influence on economic growth. Similarly, the influence of domestic credit is negative but insignificant. The influence of external influx on output growth is found to be adverse. The findings suggest that the economic policies of these countries should be defined by considering the financial sector of these countries. Further, these countries are attracting larger external investment, but the influence of external funds on economic growth is negative. Therefore, the focus of policymakers should be to utilize FDI for productive purposes and provide a good business climate, refining the financial infrastructure and enlarging the financial inclusion to realize sophisticated economic growth while designing financial policies.

Keywords: Economic growth, Financial development, India, Panel ARDL, Pedroni cointegration, Pooled mean group method