

# Impact of FDI and Institutional Quality on Economics Growth: Empirical Evidence from South Asian Countries

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## ABSTRACT

**Aim of the Study:** Institutions and the foreign direct investment (FDI) has been a phenomenon of academic inquiry for last ten years as far as their importance in economic literature is concerned. It is a considered opinion that a country's economy is often affected by the FDI and various financial institutions. This research investigates and explores the impact of institutions and FDI on the economic growth of selected countries during 1996 to 2024.

**Methodology:** The actual GDP (proxy of economic growth) and FDI and institutions are the dependent variable and independent variables respectively. The Panel Data of six South Asian countries- Sri-Lanka, Pakistan, Bangladesh, India, Nepal and Bhutan have been analyzed for this research. World Governance Indicator (WGI) is the source of data of institutions whereas World Development Indicator (WDI) serves as the source of data for economic growth. Institutional index has been generated through the Principal Component Analysis of six indicators. Through Panel ARDL the influence of FDI and Institutions on economic growth has been evaluated in the present study.

**Findings:** The study finds that FDI and institutions have a healthy impact on the economic growth of the selected Asian countries. It suggests that the FDI and institutions may lead towards a stable economic growth in South Asian countries.

**Conclusion:** The study can further invite more detailed and rigorous academic investigation in the field and a wider range of variables can be applied to the same model of study.

**Keyword:** Institutions Index, PCA, Economic Growth, FDI.

## 1. INTRODUCTION

For better recruitment of investment, saving and diversification of risk, the liberalization of the economy is very important to increase the economic growth (Brahim & Rachdi, 2014). It is widely perceived that FDI plays a significant role and considered as a main determinant in promoting economic growth, both in developed or developing economy. The flow of foreign capital accumulates the capital of host countries, gives a path to innovate new technologies and skills and also contributes to productivity growth

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(Ren et. al, 2012; Brahim & Rachdi, 2014). But North and Thomas (1973) explored that capital flow and innovation in new technologies that are not enough to increase economic growth as they are growth themselves.

According to previous studies there is contradiction in the effect of foreign direct investment in accelerating economic efficiency. Most of the studies found that FDI can accelerate economic growth (Kinoshita & Campos, 2003; Agbloyor et.al, 2016; Borensztein et.al, 1996; Lumbila, 2005; Jude & Leveuge, 2015; Lumbila, 2005; Pradhan et.al. 2008), while numerous studies suggested a negative or no effective outcome on economic growth (Mah, 2010; Chami et.al, 2005). In this way, recent thinking suggests that FDI is only the channels of growth, not the determining factor of growth. Capital formation is facilitated by political and economic institutions through a solution of dynamic inconsistency. This inconsistency arises from the fluctuating leverage that states and corporations experience both before and after investment agreements (Yimer, 2023).

The significance of inclusive financial systems in promoting long-term development was highlighted by Hussain et al.'s (2024) more recent investigation of the relationship between economic growth and financial inclusion across 21 Asian economies. Although their results highlight the importance of financial flows, the study ignores the econometric challenges present in macro-panel data and does not pinpoint the precise role of FDI. The Association of Southeast Asian Nations continued to be the top destination for foreign direct investment (FDI) among developing nations, drawing 17% of worldwide inflows in 2023, up from 16.5% in 2022, and maintaining a consistent upward trend since 2019 (AIR, 2024).

The findings of FDI's effect on the economic growth is conditional to different circumstances as human capital (Borensztein, Gregorio & Lee, 1998) business environment (Busse & Groizard, 2008) and the quality of institutions (Jude and Leveuge 2014; Daude & Stein, 2007).

Apart from traditional determinants of FDI, particular attention is paid to the quality of institutions and other applicable policies factors of the host country. Ali (2008) analyzed the positive impact of institutions on FDI. He also stated that the effect of institutional quality and economic stability is greater than that of taxation and infrastructure quality.

There are many types of institutions. The responsibility under political and legal institutions includes controlling corruption, provide peaceful environment, respect and protection of life. The responsibility of economic institution is to determine the investment decisions in production technology, human and physical capital. All these institutions perform different function to ensure accountability, rule and law, reduce corruption and political instability, freedom of citizen and magistrates and to provide a friendly environment for business (Asghar et.al, 2015). Weak institutions create many different economic problem and uncertainty in under developed countries. Skilled and organized institutions offer suitable and effective environment for boosting economic activities such as direct investment, modernization and they empower society as well as individuals to invest their time in productive activities (Ali, 2010). Bruno and Campos (2013) investigate that about 50 % of literature survey report positive effect of FDI on economic growth, 11% negative effect and about 39 % empirical studies found no effect on economic growth.

Despite extensive research conducted has been conducted to find the growth effect of FDI and institutions, empirical indication is still inconclusive. From now on, this research will contribute to investigate more in depth the effect of institutions on the FDI and economic growth. This study will analyze the effect of FDI and institutions on the economic stability of the South Asian countries.

### ***1.1 Study Objectives***

The objectives of the current study are:

- To investigate the effect of FDI and institutions on economic growth.

- To find whether FDI and institutions depends upon each other to influence the economic growth in case of South Asian countries.

## 2. LITERATURE REVIEW

Foreign direct investment and its effect on growth has been a controversial issue in international economics. A number of studies have been organized to judge the various aspects of the economy and its relationship with FDI and different measures of institutions.

Bhujabal et al. (2024) reported that this region's economy is growing at one of the fastest rates 6.67% annually. FDI inflows to the Association of Southeast Asian Nations have grown dramatically over the past ten years

Agbloyer et.al (2016) determined the relationship between institutions, FDI and economic development in different countries of Sub-Saharan Africa. By using the panel data to investigate the long-term growth and business cycle effect and they divided their time period in five groups, 1996-1998, 1999-2001, 2002-2004, 2005-2007 and 2008-2010. To investigate the empirical results two steps generalized methods of moments (GMM) and Wied Meijer corrected errors were used. This study explored no significant relationship between FDI, institution and economic growth. In the sub sample developed countries of financial market were excluded and findings showed no significant relationship between economic growth and FDI but institution play a fundamental role in boosting economic growth. Thus, the quality of the institution improves it seems that effect of FDI reduce.

Brahim and Rachdi (2014) analyzed the effect of institutions quality on FDI flow and economic growth of MENA region. They used Panel Smooth Transition Regression (PSTR) modeling to account the effect of FDI on economic development. The sample of the study taken from 19 MENA countries over the period of 1984 -2011. The outcomes showed that economic growth of a country depends upon FDI conditional on the quality of institutions.

Ibrahim et.al (2011) investigated the factors associated with the inflow of FDI in Africa by using the panel data of 31 countries during 1984 and 2009. The study adopted the fixed effects and generalized methods of movement and investigated that corruption, domestic credit, marked size and past level of FDI were significant factor of inward FDI in Africa. They analyzed that to attract the FDI for the enhancement of economic growth and potential stability the credible institutional reforms were necessary particularly by boosting the quality.

One of the study conducted by Ali et al. (2008) used a sample of 107 countries in order to explore the effect of institutions on FDI and also on sectorial level of FDI. Data was taken from the period 1981 to 2005. FDI was dependent variable in this literature while institutions, GDP, trade ratio, property rights and other control variables were considered as exogenous. Data was collected from reliable source such as WDI, ICRG, World Bank and from EFW, 2006 Annual Report. For estimation, this study applied Difference and System GMM, Random effect model and Panel OLS as econometric techniques. The findings revealed that institutions linked with property rights have a large and positive effect on FDI. They also found that the quality of institutions did not have an effective role in the primary sector but it was effective for FDI in the industrial sector.

Jude and Leviuge (2015) investigated the relationship between institutions and FDI growth by using a set of 11 inductors to developing countries. Panel smooth regression model (PSRM) was used as econometric technique to examine the effect of FDI on the economic growth of developing countries conditional on the quality of institutions of host countries. The empirical study found a positive and significant effect of FDI on economic productivity depending upon the good quality of institutions. Skilled and organized institutions may lead to an incremental effect on growth and marginal effect on FDI.

Wang et al. (2013) used the penal data of 287 cities of China over the period 1999-2005 to investigate the role of local institutions and ethnic origins of FDI. The findings revealed that FDI has positive effect on

the economic growth, productivity and modernization but it also reduces the employment and causes pollution in the host countries. The implication of the research found that effects of institutions are less significant for ethnic linked FDI as compared to non-ethnic linked FDI.

Mostafa (2015) analyzed the setup of infrastructural amenities in relation to inflow of FDI in South Asian countries especially in Bangladesh. He investigated the determinants of FDI and its role to influence growth of Bangladesh's economy. Secondary data from the Bureau of Economics and Business Affairs and the Board of Investment (BOI) were utilized to collect time series data from 1980 to 2014. The research findings revealed that growth of Bangladesh's economy be influenced by foreign as well as domestic investment. This study also explored that only foreign direct investments cannot grow economy but it is infrastructural amenities that make it prosperous.

Buchanan et.al (2012) inspected the impact of institutional quality on foreign direct investment levels and its volatility. The researchers collected data from 164 developed and developing countries. The data for conducting research was taken from 1996 to 2006 for the panel data analysis. They found out that quality of institutions has a significant and positive effect on FDI. However, there is a negative and significant association between FDI volatility and institutions quality. Economic tests showed that a one standard deviation change in quality of institutions improve the FDI by a factor of 1.69.

Busse and Hefeker (2006) examined the association between different components of political risk, FDI flows and in between institutional quality. For data analysis, the researcher collected the sample data of 83 developing countries. The data collection covered the time span from 1984 to 2003. They used government stability, democratic accountability, Military in politics, law and order, internal and external conflict, corruption, religious and ethnic tensions and quality of bureaucracy as important institutions to check their effect on FDI and economic innovations. The empirical study explored that these institutions were highly significant determinant of foreign investment inflows.

Daude and Stein (2007) used bilateral FDI of OECD countries aimed to explore the effect of institutional quality on flow of FDI. Outward FDI stocks were used for 1998 to investigate the difference in dimension or size of FDI across 80 OECD countries (Organization for Economic cooperation and Development). For the execution of research, the data of institutions were compiled from reliable sources of ICRG, WGI and world Business Environment survey. Standard Gravity model, TOBIT model and 2SLS was applied to test the results. The study found statistically significant and positive effect of institutions on FDI and considered as a very important determinant but not in all dimensions.

### 3. METHODOLOGY

#### 3.1 Model Specification

The current study is carried out to check the association between FDI and institution and their effect on economic growth of South Asian countries. For this purpose, a basic econometric model is used, consisting of two main equations. In first equation FDI and institution effect economic growth directly. While in the second equation, it depends on interaction of FDI and institution.

The specific models to estimate the effect on economic growth are given as:

$$\text{Model 1: } LGDP_{it} = \alpha_0 + \alpha_1 FDI_{it} + \alpha_2 INST_{it} + \alpha_3 INF_{it} + \alpha_4 PI_{it} + \alpha_5 LEXR_{it} + \mu_{it}$$

$$\text{Model 2: } LGDP_{it} = \beta_0 + \beta_1 FDI * INST_{it} + \beta_2 INF_{it} + \beta_3 PI_{it} + \mu_{it}$$

LGDP = Log of Gross Domestic Product

FDI = Foreign Direct investment

INST = Institutional quality index

INF	=	Inflation CPI
PI	=	Private Investment
LEXR	=	Log of Exchange rate
FDI*INST	=	Interaction

### 3.2 Data Source

The underpinning study used a panel of six south Asian countries (Sri Lanka, Pakistan, Nepal, Bhutan, India, and Bangladesh) covering time span from 1996 to 2024. Data of dependent variable Gross domestic product as the proxy of economic growth and other explanatory variables namely, Foreign direct investment, inflation private investment and exchange rate is collected from WDI.

Data on institution is obtained from world governance indicator (WGI). WGI provide six indicators of institution control of corruption, accountability regulatory quality, political stability, government effectiveness, rules and law. Principal component analysis is applied to construct the institutional quality index.

### 3.3 Econometric Techniques

#### 3.3.1 Panel Unit Root Test

The 1<sup>st</sup> step in panel data analysis is to check the stationarity of the selected variables. Panel unit root test has to be used to test the stationarity. For this purpose Levin, Lin and Chu (2002) and Im – Pesaran and Shin (2003) methods are applied.

Levin Lin Chu (LLC) test assumes that the coefficient of autoregressive is restricted to be homogeneous and does not vary across cross sectional units.

The model of LLC test is as follow

$$Y_{i,t} = \beta_{0i} + \rho Y_{i,t-1} + \Delta Y_{i,t-j} + u_{i,t}$$

Where  $\beta_{0i}$  is intercept and  $\rho$  is the coefficient of autoregressive that does not vary across all units of sample.  $Y_{i,t-1}$  is the series of panel country N over the period T and  $u_{i,t}$  the error term

While IPS test suggests that intercept and coefficient of autoregressive are heterogeneous and varies across all units of sample.

The model of IPS test is as follow

$$Y_{i,t} = \beta_{0i} + \rho_i Y_{i,t-1} + \sum_{j=1}^{p_i} \phi \Delta Y_{i,t-j} + \mu_{i,t}$$

In this equation intercept  $\beta_{0i}$  and coefficient of autoregressive  $\beta_{0i}$  are not homogenous means that both can vary across countries.

#### 3.3.2 Pooled Mean Group (PMG)

Pesaran Shin and Smith (1999) presented an approach known as Pooled Mean Group (PMG) which restricted the long run coefficient to be the same, but short run coefficient and error variance can be vary freely across

$$\Delta y_{it} = \alpha_i + \phi y_{it-1} + \beta_i x_{it} + \sum_{j=1}^{p_i-1} \gamma_{ij} \Delta y_{it-j} + \sum_{j=0}^{q_i-1} \lambda_{ij} \Delta x_{it-j} + u_{it}$$

Where  $\alpha_i$  is intercept  $\beta_i$  is coefficient of explanatory variable where  $\lambda_{ij}$  and  $\gamma_{ij}$  are the coefficient of short term dynamics and  $u_{it}$  is the error term, if the value of  $\phi_i$  is negative and significant it means that there is a long run association between  $y_{it}$  and  $x_{it}$ .

The PMG technique is a panel version of autoregressive distributive lag (ARDL) and its estimation is the maximum likelihood estimators.

#### 4. RESULTS AND DISCUSSIONS

The table 1 to 6 shows the summary of PCA for institutions of 6 South Asian countries.

**Table 1: Summary of Pakistan Principal Component Analysis**

Variables	Eigenvectors					
	PC1	PC2	PC3	PC4	PC5	PC6
VA	-0.587	0.270	0.171	0.030	0.337	0.661
PS	0.402	0.495	-0.126	-0.352	0.659	-0.132
9GE	0.505	0.391	0.229	-0.119	-0.521	0.501
RQ	-0.391	0.388	0.504	-0.370	-0.252	-0.490
RL	-0.057	0.585	-0.213	0.742	-0.094	-0.221
CC	0.283	-0.185	0.775	0.415	0.326	-0.058
<b>Eigen values</b>	<b>2.194</b>	<b>1.821</b>	<b>1.054</b>	<b>0.568</b>	<b>0.248</b>	<b>0.112</b>
<b>Cumulative Proportions</b>	0.365	0.669	0.845	0.939	0.981	1.000

Source: E-views 9.0

**Table 2: Summary of Sri Lanka Principal Component Analysis**

Variables	Eigenvectors					
	PC1	PC2	PC3	PC4	PC5	PC6
VA	0.468	0.401	0.256	-0.238	0.220	0.669
PS	-0.390	0.536	-0.062	0.295	0.670	-0.139
GE	-0.420	0.170	0.526	0.452	-0.467	0.305
RQ	0.349	0.358	-0.612	0.500	-0.346	0.066
RL	0.458	0.329	0.491	0.055	-0.110	-0.651
CC	0.343	-0.534	0.190	0.630	0.389	0.103
<b>Eigen values</b>	<b>3.238</b>	1.097	0.750	0.578	0.303	0.031
<b>Cumulative Proportions</b>	0.5398	0.7227	0.8477	0.9442	0.9947	1.0000

Source: E-views 9.0

**Table 3: Summary of India Principal Component Analysis**

Variables	Eigenvectors					
	PC1	PC2	PC3	PC4	PC5	PC6
VA	-0.436	0.425	0.274	-0.013	0.743	0.007
PS	0.351	-0.006	0.739	0.557	-0.054	0.124
GE	-0.045	0.798	0.106	-0.194	-0.527	0.180
RQ	0.319	0.389	-0.576	0.607	0.189	-0.096
RL	0.547	0.015	-0.075	-0.364	0.327	0.674
CC	0.530	0.171	0.169	-0.386	0.151	-0.698
<b>Eigen values</b>	<b>2.771</b>	<b>1.381</b>	<b>0.884</b>	<b>0.547</b>	<b>0.279</b>	<b>0.134</b>
<b>Cumulative Proportions</b>	0.461	0.692	0.839	0.930	0.977	1.000

Source: E-views 9.0

**Table 4: Summary of Bangladesh Principal Component Analysis**

Variables	Eigenvectors					
	PC1	PC2	PC3	PC4	PC5	PC6
VA	0.485	0.137	-0.382	-0.594	0.329	0.370
PS	0.493	-0.270	-0.034	0.373	0.558	-0.480
GE	0.480	-0.161	0.557	0.272	-0.152	0.578
RQ	0.171	0.619	0.590	-0.301	0.060	-0.379
RL	-0.053	0.689	-0.260	0.575	0.216	0.274
CC	0.508	0.148	-0.353	0.109	-0.710	-0.278
<b>Eigen values</b>	3.139	1.741	0.566	0.336	0.139	0.076
<b>Cumulative Proportions</b>	0.5232	0.8135	0.9079	0.9640	0.9872	1.0000

Source: E-views 9

**Table 5: Summary of Nepal Principal Component Analysis**

Variables	Eigenvectors					
	PC1	PC2	PC3	PC4	PC5	PC6
VA	0.485	0.137	-0.382	-0.594	0.329	0.370
PS	0.493	-0.270	-0.034	0.373	0.558	-0.480
GE	0.480	-0.161	0.557	0.272	-0.152	0.578
RQ	0.171	0.619	0.590	-0.301	0.060	-0.379
RL	-0.053	0.689	-0.260	0.575	0.216	0.274
CC	0.508	0.148	-0.353	0.109	-0.710	-0.278
<b>Eigen values</b>	3.139	1.741	0.566	0.336	0.139	0.076
<b>Cumulative Proportions</b>	0.5232	0.8135	0.9079	0.9640	0.9872	1.0000

Source: E-views 9.0

**Table 6: Summary of Bhutan Principal Component Analysis**

Variables	Eigenvectors					
	PC1	PC2	PC3	PC4	PC5	PC6
VA	0.398	-0.500	0.209	-0.096	0.409	0.608
PS	0.419	0.329	-0.467	0.504	0.484	-0.089
GE	-0.400	-0.452	0.292	0.402	0.437	-0.442
RQ	-0.342	0.530	0.461	0.363	0.094	0.497
RL	0.410	0.350	0.579	-0.361	0.264	-0.414
CC	0.467	-0.175	0.321	0.558	-0.572	-0.088
<b>Eigen values</b>	3.346	1.527	0.531	0.329	0.189	0.075
<b>Cumulative Proportions</b>	0.5578	0.8123	0.9009	0.9559	0.9874	1.0000

Source: E-views 9.0

The tables 1 to 6 present the results of PCA for institutions of Pakistan, Sri Lanka, India, Bangladesh, Nepal and Bhutan respectively. The researcher applied PCA on 6 indicators- voice and regulatory quality, accountability, government effectiveness, political stability, rules and law and control of corruption in order to measure institutions. These variables have maximum variance so PCA was employed to convert these correlated variables into uncorrelated strong variables. The Eigen values of PC1 are highest as compare to other components; therefore, the researcher selected PC1 which produces more accurate and efficient results for institutions. Further, the eigenvectors which are the representative of the weights of these indicators are used to create institutional index.

**Table 7: Unit Root Test Results**

The initial step in the current research is to test the order of integration of the selected variables. In Panel unit root analysis LLC and IM Pesaran unit root test has been shown in table 4.7. The results of LLC and Im pesaran suggests that all variables FDI, LGDP, LEXR, INST, PI and INF are non-stationary at order zero means that null hypothesis of non-stationary cannot be rejected at their level form, they all are stationary at 1<sup>st</sup> difference or integrated of order 1 I(1).

Variables		At Level			
		With intercept		With trend and intercept	
		Statistics	p-value	Statistics	p-value
<i>LGDP</i>	LLC	3.36106	0.9996	-1.18827	0.1174
	IPS	5.62611	1.0000	0.55168	0.7094
<i>LEXR</i>	LLC	1.03336	0.8493	2.68804	0.9964
	IPS	1.39084	0.9179	1.49479	0.9325
<i>FDI</i>	LLC	0.01532	0.5061	0.97081	0.8342
	IPS	-0.57605	0.2823	-0.21029	0.4167
<i>INST</i>	LLC	0.61128	0.7295	0.48555	0.6864
	IPS	1.43903	0.9249	0.60211	0.7264
<i>PI</i>	LLC	-0.63684	0.2621	0.34352	0.6344
	IPS	-0.02460	0.4902	0.02384	0.5095
<i>INF</i>	LLC	1.18005	0.8810	1.21520	0.8879
	IPS	-0.47061	0.3190	-0.50232	0.3077

**Table 8: At 1<sup>ST</sup> Difference**

Variables		At 1 <sup>ST</sup> Difference			
		With intercept		With trend and intercept	
		Statistics	p-value	Statistics	p-value
<i>LGDP</i>	LLC	-4.71521	0.0000	-4.22459	0.0000
	IPS	-4.29950	0.0000	-3.24701	0.0006
<i>LEXR</i>	LLC	-3.15607	0.0008	-2.11439	0.0172
	IPS	-3.70897	0.0001	-2.76592	0.0028
<i>FDI</i>	LLC	-6.57896	0.0000	-4.85262	0.0000
	IPS	-8.65566	0.0000	-7.07906	0.0000
<i>INST</i>	LLC	-3.84822	0.0001	-2.87293	0.0020
	IPS	-4.11043	0.0000	-2.18546	0.0144
<i>PI</i>	LLC	-3.71271	0.0001	-2.82616	0.0024
	IPS	-3.32032	0.0004	-1.87692	0.0303
<i>INF</i>	LLC	-7.55111	0.0000	-6.67382	0.0000
	IPS	-6.48612	0.0000	-4.82343	0.0000

#### 4.1 Pooled Mean Group Estimation

The findings of the Pooled Mean Group are presented in table. Panel ARDL provides short run and long run relationship between GDP, Institutions, FDI and other control variables used. In long run, index of institutions (generated from principal component analysis) has positive effect on growth of economy and highly significant at 1 percent. Results show that over the period 1996- 2022, an increase in institutional quality leads to increase the economic growth at the rate of 2.2695 percent. These outcomes are reliable

with the findings of so many other studies (Brahim and Rachdi, 2014; Ali et al. 2008; Asghar et al., 2015).

The coefficient of FDI is positive and statistically significant. It also suggests that foreign direct investment contributes significantly to economic growth. 1 percentage increase in foreign direct investment led on average 0.052 percent increase in economic growth of South Asian countries (Nwaogu & Ryan, 2015; Brahim & Rachdi, 2014). The estimated parameters of exchange rate, Inflation and private Investment are statistically significant and have positive signs.

$$\text{Model 1: } LGDP_{it} = a_0 + a_1 FDI_{it} + a_2 INST_{it} + a_3 INF_{it} + a_4 PI_{it} + a_5 LEXR_{it} + \mu_{it}$$

**Table 9: ARDL Model**

Variables	Dynamic specification : ARDL	
	Long run coefficient	P-value
<i>LEXR</i>	0.072953	0.0624
<i>INST</i>	0.022695	0.0000
<i>FDI</i>	0.051961	0.0000
<i>PI</i>	0.002855	0.0000
<i>INF</i>	0.004898	0.0002

Short run results are presented in table 10. The coefficient of ECM is statistically significant and less than zero indicating that there is not omitted variable bias. Thus, shows that about 35% disequilibrium in previous period will be corrected in the current period.

**Table 10: Short Run Result**

	Short Run Coefficient	
<i>Ect-1</i>	-0.351267	0.0000
<i>D(LGDP(-1))</i>	-0.049813	0.7944
<i>D(LGDP(-2))</i>	-0.184962	0.1923
<i>D(LGDP(-3))</i>	-0.292286	0.1314
<i>D(LEXR)</i>	0.026526	0.7024
<i>D(INST)</i>	-0.002272	0.3608
<i>D(FDI)</i>	-0.008828	0.0002
<i>D(PI)</i>	0.001400	0.6622
<i>D(INF)</i>	-9.94E-05	0.8770

$$\text{Model 2: } LGDP_{it} = b_0 + b_1 FDI * INST_{it} + b_2 INF_{it} + b_3 PI_{it} + \mu_{it}$$

**Table 11: ARDL Model**

Variables	Dynamic specification : ARDL	
	PMG	P-value
	Coefficient	
	Long Run Coefficient	
<i>INST * FDI</i>	0.007794	0.0243
<i>INF</i>	0.006800	0.0001
<i>PI</i>	0.005252	0.0374

	<b>Short Run Coefficient</b>	
$Ect - 1$	-0.371272	0.0026
$D(LGDP(-1))$	0.220475	0.4312
$D(INS * FDI)$	0.000459	0.6330
$D(INS * FDI(-1))$	-0.007704	0.2082
$D(INS * FDI(-2))$	-0.005202	0.1474
$D(INF)$	-0.001411	0.2711
$D(PI)$	0.001080	0.6655
$D(PI(-1))$	-0.001232	0.4474

Table 11 presents the results of second equation, in which interaction of FDI and INST has been used as independent to assess its effect on economic growth. The coefficient of FDI\*INST is highly significant and having positive sign. The positive sign indicates that FDI in the presence of good institutions increases the economic growth. As FDI with better institutional quality goes up by 1 percentage point, the economic growth goes up by 0.78 percentage point. When institutions are strong, the entire economic system work effectively and attracts FDI. This will lead to increase the economic growth of South Asian Countries (Brahim & Rachdi, 2014; Agbloyor et al., 2016; Daude & Stein, 2007). The estimated parameters of PI and INF are also positive and significant reveals that both variables effect economic growth positively.

## 5. CONCLUSION AND RECOMMENDATIONS

The current research examines the impact of institutions and foreign direct investment on economic growth over the period from 1996 to 2024 across six South Asian countries- Pakistan including Bhutan, India, Nepal, Bangladesh, and Sri-Lanka. The researcher utilized panel data and constructs an institutional quality index through PCA by incorporating six main governance indicators. The employed Pooled Mean Group technique in order to analyze econometric techniques. It reflects that over all institutional quality and FDI has positive result on economic growth. Thus, the findings suggest that improvement in institutional quality will ultimately attract the foreign investors to invest their capital confidently in South Asian countries that will resultantly promote sustained economic growth. Based on the above given insight, as South Asian countries look to map out a course for equitable, sustainable, and strong economic growth in the years to come, this analysis provide insightful direction. The ability to capitalize on the benefits of institutional quality and foreign direct investment is crucial to achieve long-term development. These results make it abundantly evident that South Asian governments ought to give top priority to initiatives aimed at improving institutional quality, luring in foreign capital. It also encourages domestic capital formation. It is recommended that policymakers in South Asian countries implement such reforms that improve the institutional quality and attract FDI for long term growth.

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## Conflict of Interest

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