DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN SRI LANKA

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Abstract - This study focuses on empirical analysis to find out the role of international trade volume, gross domestic product, infrastructure, interest rate, exchange rate and rate of inflation in foreign direct investment in SriLanka. The analysis based on time series data for the period 1978 to 2015. This study uses ADF tests to find out stationary of the variables and Ordinary Least Square techniques have been used for the estimation. However positive impact on real gross domestic product, Interest rate, Exchange Rate and Infrastructure Quality but not significant impact of inflation rate and International Trade Volume. Furthermore, foreign direct investment and trade are considered vital elements that improve the influence of foreign Direct Investment. If suitable policies are formulated then Exchange rate can be enhanced by FDI at a large scale. Single digit inflation is essential condition for a growing economy like SriLanka.

Keywords - Foreign Direct Investment, Exchange Rate, Inflation, GDP and Interest rate

I. INTRODUCTION

Foreign Direct investment (FDI) refers to long term participation by one country to another country. It usually involves participation in management, joint-venture, transfer of technology and expertise. This is used to measure the number of foreign firms that owns productive assets such as factories, land and mines. Growth in FDI can be associated with growth in the overall economy.

Foreign direct investment can play a significant role in achieving rapid economic growth in developing countries such as Sri Lanka by bridging the gap between domestic savings and investment, and bringing the latest technology and management know-how from the developed countries. Hence, it can easily be understood why many developing countries seek new ways to attract FDI inflows. Some developing countries have been successful in attracting FDI while others have not. The reason for this lies in how a country handles the factors that determine FDI inflows. Identifying the factors that determine FDI inflows into a country is a complex problem.

There are many theories which attempt to explain the determinants of FDI. However, Dunning's research work (1977, 1981) provides a comprehensive analysis based on ownership, location and the internationalization (OLI) paradigm. It is also called an eclectic theory and has remained the dominant analytical framework for accommodating a variety of operationally testable economic theories of the determinants of FDI and the foreign activities of Multinational enterprises (MNEs) (Dunning, 2000). United Nations Conference on Trade and Development (UNCTAD, 1998) also refers to Dunning's OLI paradigm and confirms that FDI usually goes to the countries where it is possible to combine the ownership advantages with the location specific advantages of the host countries through the internationalization of foreign investments.

Sri Lanka is one of the developing countries that need FDI as its capacity to allocate its own funds for development is very low due to its lower level of domestic savings. The investment favorable policies adopted by the successive governments over the past three decades did result in FDI inflows into Sri Lanka. However, the growth of FDI inflows into Sri Lanka has performed below the government's post-war expectations. Despite the rapid growth of infrastructure, sound macroeconomic conditions, favorable investment climate and huge government support for FDI inflows, Sri Lanka has still failed to attract a significant amount of FDI inflows compared to its South Asian neighbors.

The importance of FDI to Sri Lanka arises in light of the dismal performance of previous policies that emphasized more attraction of FDI in Sri Lanka (Sahoo et al, 2014). Although many relevant investment policy reforms have been introduced in Sri Lanka, the institutions and investment authorities supporting FDI were weak, fragmented and uncoordinated.

Their services are quite basic, mainly focusing on short term benefits. There were hardly any initiatives for targeted, comprehensive and sustained support specifically to facilitate upward mobility of FDI in Sri Lanka. As a result, in Sri Lanka, FDI has performed below expectations. This situation is likely to worsen as competition intensifies with ongoing globalization. It is in line with the above argument that this paper intends to identify the determinants of FDI in Sri Lanka.

II. STATEMENT OF THE PROBLEM

It is now widely acknowledged that FDI has potential benefits that can accrue to developing countries. FDI