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An Analysis to Evaluate and Quantify Investment Flows Between India and Sri Lanka Following the Implementation of the ISFTA

Dr. Gagan Deep [a] | **Dr. Dev Prakash Singh** [a,*]

[a]Assistant Professor, University School of Applied Management, Punjabi University Patiala, Punjab-147002 (India)

*Corresponding Author Email: devprakash26@gmail.com

Abstract: This study evaluates the consequences of the India-Sri Lanka Free Trade Agreement (ISFTA) on foreign direct investment (FDI) flows between India and Sri Lanka during the period of 2006-2024 with some comparisons towards the increasing impact of China. The study investigates whether the ISFTA has stimulated sustained Indian FDI growth, what is its comparative role to China, and whether the agreement contributed to long-term bilateral investment. It employed a mixed-methods perspective involving a quantitative aspect (CAGR, trend analysis, percentage share based on BOI Sri Lanka, RBI, Central Bank of Sri Lanka data) and a qualitative review of the policy framework, agreements and investment reports. The results suggest some considerable increases in Indian FDI since 2006, which peaked at US$341 million in 2018 but fluctuated significantly. Conversely, it suggests that there was significant expansion within Chinese FDI from 2012 onwards and has consistently surpassed Indian investment levels. In 2022, 34% of Sri Lanka FDI inflows were Chinese. Overall, ISFTA made a positive contribution to strengthen investment relations between India and Sri Lanka, however its impact on supporting ongoing competitiveness of investment in the long-term - in relation to China's emergence - has been modest. The study concludes that although India has considerable unutilised potential in certain sectors, like information technology, tea etc., there is an urgent need for strengthened policy support and investment strategies for India's deeper involvement in the economic development of Sri Lanka.

Keywords: ISFTA, FDI, Bilateral Trade Interactions, Policy Framework, Investment Strategies

Introduction

Economic ties between India and Sri Lanka have deep historical roots, tracing back to pre-colonial times. Trade between the two nations began gaining momentum in the 1990s, with a major boost coming from the signing of the ISFTA on December 28, 1998, which became effective on March 1, 2000. The agreement was recognized by the World Trade Organization in 2002. The ISFTA's primary goal is to strengthen economic relations between the two countries by enhancing trade and investment opportunities. Focused solely on goods, the agreement mandates duty-free access and reduced tariffs on exports between the two nations. However, it does not address the elimination of non-tariff barriers. Should either country encounter balance-of-payment challenges or face critical situations, they are permitted to

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temporarily suspend the preferential terms after notifying the other party (Kelegama, 2014).

Sri Lanka's economic goals were centered on strengthening trade relations with South Asia's leading economic force, India. The aim was to shift the country's export profile from low-value goods to higher value-added products targeted at specialized markets. Additionally, Sri Lanka sought to provide affordable consumer imports from India, benefiting its lower-income population (Padmakumara and Senanayake, 2019).

In particular, Sri Lanka (since 1978) and India (since 1991) implemented reforms that fostered an environment favorable for boosting trade and investment between the two countries. While the ISFTA is often credited for enhancing Indian investment in Sri Lanka, the broader strengthening of economic ties and growing investor confidence played a larger role (Ravinthirakumaran et al., 2015).

The FTA increased the possibilities of trade in products by promoting investment to capture the bilateral trade advantages. In support of this, Sri Lanka signed a Double Taxation Avoidance Agreement (DTAA) with India on May 19, 2010 that was to promote foreign investment and prevent evasion of tax. These treaties established the platform of safer and more appealing investment between the two nations. The information and communication innovations as well as the competition among firms have also not left behind foreign direct investment (FDI) in the past 20 years. Several countries have liberalized their economy to foreign investment, further eased the working conditions of foreign business, and enhanced improved protection and treatment levels of the foreign organizations (Consolidated FDI Policy, April 2010 Circular).

FDI is considered to be a major source of capital, technology, employment and access to markets by most countries. India promotes foreign direct investment (FDI) with well-defined policies and the entry of ISFTA into the market further encourages bilateral investment due to the exposure of lower trade barriers and grants preferential access. Following the challenges that South Asia faces in producing similar commodities, the ISFTA provides avenues to trade and invest more. It promotes the combination of investment and trade, promotes the vertical integration and assists in enhancing production and distribution. All in all, the ISFTA enhances economic connectivity and results in an increment in the FDI between Sri Lanka and India (Iqbal et al., 2018).

Experience from regional initiatives like the European Common Market and the Association of Southeast Asian Nations (ASEAN) shows that reducing trade barriers and costs, alongside creating favorable investment conditions, can significantly increase both intra-regional and bilateral trade and investment. This occurs as companies develop backward and forward linkages across the region. Additionally, it is crucial to consider the relationship between trade and foreign direct investment (FDI) through horizontal integration. In horizontal FDI, firms establish production of the same product in various countries to avoid the costs of exporting from a single source to multiple destinations. In South Asia, only a few country pairs, India and Sri Lanka, Pakistan and Sri Lanka, and Pakistan and Bangladesh, have shown moderate trade complementarities. However, the lack of vertical specialization through production-sharing arrangements has hindered further development of these complementarities within the region. Vertical specialization enables countries to achieve economies of scale by focusing on specific stages of the production process within the value chain, thereby enhancing trade relationships among regional partners. To foster this, it is crucial to establish regional production agreements in key sectors. Industries such as textiles and apparel, leather, rubber, and electronics present opportunities for this type of production integration. Over time, such arrangements would allow each country to focus on a specific segment of the value chain, becoming niche players in their specialized areas (Sengupta and Puri, 2018).

Review of Studies

Athukorala (2003) examined the connection between foreign direct investment (FDI) and GDP growth in Sri Lanka using time series data. Despite a significant rise in FDI since the 1980s, the study finds that FDI has not directly influenced economic growth. Instead, the relationship runs from GDP growth to FDI. Although FDI is crucial for development, the investment climate in Sri Lanka has not improved significantly due to these issues. To attract more FDI, the country needs to implement reforms, such as deregulation, better infrastructure, transparency in trade policies, and more flexible labor markets. While Sri Lanka offers favorable investment conditions, investor response has been limited. To meet its goals of development and growth, the government must adopt a more effective policy approach.

Krishna et al. (2003) examines the patterns of causation between income, export-import, and investment growth for 39 developing countries. They use model selection techniques based on ex ante predictive ability criteria to identify the best predictive model for each country. The study specifically investigates the incidence of causation and reverse causation between various economic variables typically associated with economic growth. The findings reveal that there is less reverse causation from income to these variables than previously thought. Additionally, the authors construct an index of global business cycle conditions and discover that models for countries with high trade exposure, growth rates, and investment rates improve in predictive ability with the inclusion of this variable.

According to Kelegama (2006) ISFTA exemplifies the potential of bilateral cooperation to pave the way for regional cooperation. The agreement has significantly boosted the growth and diversification of Sri Lanka’s exports to and imports from India. Additionally, India has become the second largest investor in Sri Lanka, with increased investments and cooperation in the service sector following the growth in trade. Although there were challenges, they were successfully resolved, and the economic cooperation has mitigated past political issues. By the end of December 2006, a Comprehensive Economic Partnership Agreement is expected to be operational. The ISLFTA demonstrates that economic cooperation between a large and a small country can benefit both parties. Bilateral free trade agreements can invigorate dormant complementarities and uncover new comparative advantages, further stimulating trade.

Fernando (2010) describes China's contemporary relations with Sri Lanka and the Maldives as exemplary models of good relations between large and small countries. China has become a key trading partner for Sri Lanka, maintaining a significant and growing trade surplus in its favor in recent years. Additionally, China has been a major source of investment and foreign economic assistance to Sri Lanka. Similarly, China has a large trade surplus with the Maldives and serves as a vital source of economic assistance and tourism for the country. Given India's status as the dominant power in South Asia, China's relations with Sri Lanka and the Maldives are analyzed within the context of two strategic triangles: China–India–Sri Lanka and China-India-Maldives. This analysis underscores that maintaining cooperative momentum in China-India relations is essential for improving China's overall relations with South Asia.

Saroha and Verma (2013) analyze the ongoing power sector reforms in several South Asian countries. These reforms are characterized by changes in investment and ownership patterns, with a growing role for private investment, both domestic and foreign. Despite these reforms, the region continues to suffer from low per capita energy consumption, poor energy infrastructure, uneven distribution, and high energy costs. The interconnection and coordinated operation of power systems among neighboring countries offer significant technical and economic benefits. The primary challenge is to operate these systems in a free and fair manner, ensuring quality power delivery to consumers at the most economical prices through safe, secure, and reliable operations, leading to transparent price discovery. While many market models exist internationally, they cannot be directly applied to the South Asian regional power market. This paper focuses on integrating the power market in South Asia, exploring the opportunities, benefits, and challenges. It analyzes the complexity of the electricity market in a cross-border international context and proposes a model for a South Asian Regional Power Pool. The paper includes case studies on demand and supply side bidding scenarios.

According to Kelegama (2014), economic ties between China and Sri Lanka, an area that has been underexplored in literature. Since the 1952 Rubber-Rice Pact, economic relations between the two countries have steadily grown, with a notable surge since 2005. Chinese military assistance was crucial in ending three decades of conflict in North/East Sri Lanka, and Chinese financial aid, particularly in infrastructure development, has further strengthened the relationship. Sri Lanka is expected to sign a Free Trade Agreement with China, likely in 2014. While the growing economic relationship with China offers significant opportunities, it also presents challenges for Sri Lanka.

According to Wani et al. (2017) India’s economic relations with Afghanistan are likely to strengthen over time, supported by significant trade potential. Using a gravity model, which assesses economic strength through GDP and distance via import oil prices, it was shown that stronger economies positively impact trade.

Sengupta and Puri (2018) examine the effect of Foreign Direct Investment (FDI) on the economic growth of five countries through their GDP. FDI serves as a key factor in increasing capital and enhancing the competitiveness of local economies, though its impact varies across nations. In India, FDI is particularly important, making the country a leading choice for foreign investors. In contrast, Bangladesh receives less FDI than others, although it has been increasing, especially in the textile sector. Sri Lanka presents mixed findings, with some studies suggesting FDI supports growth, while others show little effect. In Pakistan, there is a weak connection between FDI and GDP, likely due to political instability and decreasing foreign investments. Nepal's FDI influences GDP, but there is little impact from GDP on FDI. Among these nations, India demonstrates the strongest correlation between FDI and GDP, but primarily in the direction from FDI to GDP.

According to Iqbal et al. (2018), there is no significant relationship between market size and inward FDI for India, either positive or negative. However, for Sri Lanka, a significant positive relationship exists between market size (measured by real GDP growth) and inward FDI, making it a key determinant for the country. Regarding inflation, neither India nor Sri Lanka showed any significant relationship between inward FDI and the consumer price index (CPI). While using the wholesale price index (WPI) could potentially yield different results, this remains a topic for future research. The study highlights the nuanced differences in how FDI determinants function for India and Sri Lanka, particularly in relation to market size and CAB, while showing similarities in areas like trade openness and inflation.

Singh et al. (2018) highlighted the persistent issues of electricity shortages, underinvestment, and limited energy access in the South Asia Region (SAR). They emphasize that enhancing cooperation for cross-border electricity trade can yield significant benefits through greater regional coordination in capacity investments. Such trade can complement domestic investments, improving supply availability and reliability, achieving economies of scale, and enabling more cost-effective expansion of renewable energy.

Singh and Kaushal (2020) discussed that trade is essential towards enhancing bi-lateral relations. The greater trade opportunity lies in India which is in the same geographic proximity, has parallel cultural traditions and has historical connections in Afghanistan. This paper involves the analysis of both pre and post SAFTA trade between India and Afghanistan by considering the twenty leading commodities. The statistics reflect a consistent growth with the projections set in 2028 to import goods as $619.49 million, export as $973.16 million, and total trade activity as 1.592 billion. India can be advised to diversify its exports, enhance its infrastructure and friendliness with other nations, provide financial assistance and increase cultural relations to improve its trading status and compete with other countries such as China and Iran.

Tabassum (2021) analysed the trade analysis between India and Bangladesh indicates that India's exports to Bangladesh exceed expectations and hold significant value compared to global exports to the country. In contrast, Bangladesh's exports to India fall short of expectations and are less significant in relation to global exports to India. There is a high complementarity between Bangladesh's import requirements and India's export capabilities, whereas the match between India's import demands and Bangladesh's export supply is comparatively weak.

Joshi et al. (2023) examined the need for India to implement sustainable policy changes across various sectors. The paper explores how India can bolster its resilience amid the Russia-Ukraine conflict, offering examples of strategies that could be applied to the economy and foreign trade to assess their potential impact. The aim is to draw attention to key developments and encourage ongoing research. These concepts hold true value only if they can be translated into practical studies that inform and inspire a global audience. There is still much work to be done, and academics play a crucial role in delivering timely and persuasive insights that can shape future decisions. In a world marked by uncertainty and rapid change, this responsibility is more significant than ever.

Akram et al. (2024) discussed that in the last 20 years trade between India and Sri Lanka has been minimal. Between 2001 and 2020, it has contributed to less than 0.75 percent to the total Indian international trade with an average export performance of 1.34 percent and average imports of 0.19 percent only. The trade is greatly lopsided towards India, such that, Sri Lanka has been trading on a 68 percent deficit. With SAFTA and ISFTA, a minor rise in bilateral trade was encountered, which questioned previous research findings that denoted a high rise of the bilateral trade. Main problems are underdeveloped trade complementarity and non-existence of comparative advantage. The study to enhance trade advises alleviations of non-tariff barriers, diversification of goods and enhancing service sectors such as IT, tourism and education.

Evidence from Other Free Trade Agreements (FTAs)

Many researchers have considered how free trade agreements (FTAs) alter bilateral and regional FDI flows. Waldkirch (2010) showed that the North American Free Trade Agreement (NAFTA) increased both trade among the members, as well as allowed intra-regional FDI especially in manufacturing where tariffs had decreased enough to create new possibilities. Petrova and RoyChoudhury (2024) also found that regional trade agreements across Asia and Latin America led to increased FDI because they reduced uncertainty about the host country policies and reduced transaction costs for investors.

The data from the Association for Southeast Asian Nations (ASEAN) is another illustrative example. Verico (2016) explained that ASEAN Free Trade Agreement (AFTA) led to vertical specialization among firms located in member states, and higher levels of FDI flows from firms that could create production structures and benefit from tariff reductions. The experience from the European Union's single market has been examined as a mechanism for FDI flows, Chinagorom-Abiakalam and Leibovici (2025) identified harmonization of regulatory systems and reduced non-tariff barriers as strong encouragement for intra-EU FDI.

Turning closer to South Asia, the South Asian Free Trade Agreement (SAFTA) has been correlated with modest increases in intra-regional FDI. Alam and Zubayer (2010) stated that the effects of SAFTA on FDI were limited versus ASEAN or NAFTA primarily because of ongoing non-tariff barriers and the weakness of its institutional mechanisms. This comparative evidence indicates that while FTAs can facilitate FDI inflows, the success of FTAs lies less in tariff liberalization and more in the credibility of policy actors employing various modes of policy implementation as well as the degree of economic complementarity among its members.

By framing ISFTA within this scholarship, it may be determined that while ISFTA has facilitated Indian FDI into Sri Lanka, it has not provided the same transformative effect that agreements such as NAFTA or AFTA have had on their member countries. The comparison between ISFTA as a shallow institutional structure and institutional depth in CAFTA provides insight about the importance of depth of institutions and sectoral integration when comparing the success of FTAs as a means of facilitating sustained, bilateral investment.

Research Objective

1. To examine the trend and patterns of growth of Indian Foreign Direct Investment (FDI) in Sri Lanka under ISFTA/ISFTA (2006-2024).
2. Comparing both India and China contribution in Sri Lankan FDI inflows and the relative competitive positioning of India in the Sri Lankan Investment markets.
3. To determine how effective ISFTA is in promoting bilateral investments of a sustainable nature between India and Sri Lanka.

Research Methodology

This is a mixed-method study, wherein both the quantitative and qualitative research methodologies used to analyse Indian FDI trends in Sri Lanka during ISFTA between 2006 and 2024. The quantitative data is retrieved based on country and sector based FDI inflows gathered using institutions such as the BOI Sri Lanka, RBI and the Central Bank of Sri Lanka. The CAGR, trend analysis, and percentage share are analytical tools employed to pattern identify where ISFTA impact and India-China investment dynamics are concerned. The qualitative study involves a review of bilateral trade agreements, policy statements, MoUs and investment reports to determine the institutional and strategic forces of FDI. An evaluation of the comparison of Indian and Chinese investments aids in the evaluation of relative competitiveness. Such a combined approach facilitates a holistic insight into the success of ISFTA and the dynamic association investment between India and Sri Lanka.

Status and Structure of FDI between India and Sri Lanka

India began liberalizing its foreign direct investment (FDI) policies in the early 1990s, with a significant shift in approach as part of the New Industrial Policy (NIP) introduced in July 1991. After decades of maintaining a selective stance on FDI, the new policy represented a major break from the past. It eliminated the industrial licensing system, except for certain strategic or environmentally sensitive industries, and introduced automatic approval for FDI proposals that met specific conditions, such as foreign equity ownership levels of 50 percent, 51 percent, 74 percent, and 100 percent. The policy also opened new sectors to foreign investors, including mining, banking, insurance, telecommunications, construction, and infrastructure management (such as ports, roads, and highways), as well as airlines and defense, subject to sectorial limits. In most manufacturing industries, foreign ownership of up to 100 percent is allowed, with some sectors even offering automatic approval. However, in defense manufacturing, foreign ownership is capped at 26 percent, and for products reserved for small-scale industries, it is limited to 24 percent.

The New Industrial Policy of India, introduced in 1991, signaled a substantial change for India regarding foreign direct investment. The New Industrial Policy incorporated elements of factor market reform, notably, liberalization and reduced restrictions on foreign equity ownership in companies through automatic approval routes, sectoral openings, and higher caps on foreign equity. Consequently, these reforms stimulated inward FDI in India while granting Indian companies policy scope and financial capital to pursue outward FDI. Before these changes, Indian investment abroad, including in payments to Sri Lanka, was constrained on both the magnitude and scope of investments.

The post-liberalization period obviously saw a sharp uptick in Indian multinationals expanding regionally, and in the case of Sri Lanka, the country represented a logical destination, given geographic proximity, cultural affinities, and preferential access associated with ISFTA. As an illustration, according to the Board of Investment of Sri Lanka, FDI inflows from India rose from a modest US$27M in 2006 to US$341M in 2018 (Table 2). This path is indicative of the ways in which India's domestic reforms produced outward-facing firms, while ISFTA provided the institutional context that reduced entry barriers for Indian firms into Sri Lanka.

In the pre-1991 period, Indian investment in Sri Lanka was incidental and its allocation largely directed towards traditional sectors. However, after liberalization and as Indian firms diversified their investments in sectors like telecommunications, IT, energy, infrastructure and retail, there was a similarity with India's overall trends of outward FDI. This comparison highlights the cumulative effect of benefits derived from India's liberalization policies and the ISFTA on the relative patterns of FDI flows to Sri Lanka.

The ISFTA has had a notable impact on foreign direct investment (FDI) between the two countries, significantly strengthening their economic ties. Here's how ISFTA has influenced FDI The ISFTA created a more predictable and stable trade environment, encouraging Indian and Sri Lankan companies to invest in each other's economies. With reduced tariffs and improved access to each other's markets, businesses found more reasons to establish operations across borders, leading to a rise in FDI Sector the ISFTA had initially opened up more sectors in the traditional sectors such as agriculture and textiles. The Indian companies increased their investment levels in such areas in Sri Lanka as manufacturing, telecommunications and infrastructure where the Sri Lankan firms ventured into India in food processing and retailing. Bilateral Trade-Linked Investments Bilateral trade-traded investments the growth trade opening promoted under the ISFTA promoted investment interest to exploit the trade streams. Existing example is Indian firms having production units in Sri Lanka to leverage on the reduced tariffs on goods exported back to India and other markets whereas the firms in Sri Lanka enjoy expanded access to the huge Indian consuming market. The deal created better cooperation between Indian and Lanka companies in the joint venture and collaboration. This enabled the two nations to share resources, knowledge and market access to enhance competitiveness. The ISFTA contributed to making economic relationship between India and Sri Lanka even stronger due to the facilitated settlement of trade flows. This has been the driving force to providing more FDI since both sides of the business became familiar with the regulatory structures and the opportunity in the markets. In general, ISFTA has been instrumental in increasing FDI between two countries between India and Sri Lanka making the environment more conducive to cross-border investment and growth of the economy at both ends.

Table 1 showed that the total FDI has increased between 2006-2007; it was 480M rising to 603M in 2006-2007. India leaped up to 7 percent, which means there is a deepening cooperation. However, China remained at the reserve value of 1 percent, with tentative participation in the same period. 2008 FDI figured a total amount of US$752M. India was growing and added 17 percent and it showed there was further entanglement with Sri Lanka. China saw its share rise by a modest point to 3 percent attesting to its greater interest but at a slower rate. 2009 Global economic conditions caused total FDI to fall to $404M. Nonetheless even when times are tough, both India and China have added up and continued to be resilient and strategically T-focused on Sri Lanka with India at 19 percent and China at 15 percent.2010-2011 Total FDI rose back to $478M in 2010 and surged forward to $956M in 2011.India's contribution peaked at 23 percent in 2010 but dropped to 15 percent in 2011, possibly reflecting market corrections. China maintained steady growth, increasing its investment from 20 percent to 17 percent during this period. Between 2012 and the year 2013, the Total FDI was stabilized around 940M. India's contribution was stable at 17 percent in 2012 but dropped sharply to 5 percent in 2013, indicating a potential shift in priorities. China, on the other hand, significantly increased its investment from 26 percent to 43 percent, demonstrating its expanding influence in the region.2014-2015 Total FDI saw a slight decline to $894M in 2014 before rebounding to $970M in 2015. India's contribution remained modest, at 6 percent and 9 percent, respectively, while China continued its strong presence with 41 percent in 2014 and 32 percent in 2015, reflecting a solidified commitment to Sri Lanka.2016-2017 FDI inflows remained relatively stable at $897M in 2016 before surging to $1373M in 2017. The contribution of India gradually increased as compared to 12 percent to 13 percent. The share of China has been moderate with slight fluctuations between 24 percent and 32 percent in 2018 it recorded 1614M and the next year came down to 1200M. In 2018, India contribution rose to 21 percent, but it decreased to 12 percent in 2019, whereas China contribution rose to 23 percent in 2019, signifying a steady interest despite the decline in overall FDI.2020-2023 The pandemic years witnessed FDI crash to $687M in 2020, but it started to recover to reach 1300M in 2023. During this time, the contributions of India have not fluctuated much as it reached 21 percent in 2021 but dropped to 7 percent in 2023. The contributions of China were more stable because they reached 34 percent in 2022 and became 26 percent in 2023, indicating a stable interest even in global uncertainty. The fluctuations in FDI in terms of the year are accentuated in the analysis and in the case of India and China, they are two of the most important participants although providing dissimilar strategies and intensities throughout the years. FDI In the framework of foreign direct investment, Sri Lanka exhibits interesting changes in the proportion of incoming resources by countries over the period of 2006-2024. Interest of China exceeded 40 pc in 2013, whereas in 2006 it was below 1 pc, and the level has remained high since then the agreement or its participation in 2024 remains high at 25.9 pc. India was also quite active and their contribution varied, reaching its peak of more than 23 percent in 2010 and 7.5 percent in 2024. The United Kingdom was the consistence investor, as it averagely invested 9 percent to 13 percent in the years. Singapore, Malaysia, the USA, France, and the Netherlands were the other contributors with their share of contributions preserved at stable levels, whereas the Hong Kong and Luxembourg submitted minor though consistent shares. Foreign investments, which used to dominate in the initial years when they had a value of well over 60 percent in 2006, steadily decreased to reach 16.78 percent by the year 2024.Overall, the data reflects a gradual concentration of Sri Lanka's FDI sources, with China emerging as the dominant player alongside contributions from both regional partners and Western economies.

Investment Relations between India and Sri Lanka

India and Sri Lanka have long-standing economic ties that date back to pre-colonial times, but it was during the 1990s that trade between the two countries truly began to flourish. The landmark moment came with the signing of the ISFTA on December 28, 1998, which officially came into force on March 1, 2000. This agreement that was later to be recognized by the WTO in 2002 was one in the many steps towards enhancing economic cooperation between the two neighbors in the goal of ensuring increased bilateral trade and investment. Through trade in goods, ISFTA provided the benefit of preferential tariffs and concessions to both countries promising duty-free market access. Nevertheless, the agreement did not cover the non-tariff barriers, allowing the possibility of temporary suspension, in the event of financial crisis, e.g. balance-of-payments crisis. In the case of Sri Lanka, ISFTA was viewed as a means to open up trade with India as well as to transform the character of its exports to be of higher value as opposed to lower value goods, especially niche markets. It also opened doors for more affordable imports from India, particularly for consumers in lower-income brackets. In the broader context of South Asia, both nations had liberalized their foreign direct investment (FDI) policies, with Sri Lanka initiating reforms in 1978 and India following with its New Industrial Policy in 1991. These reforms, combined with the confidence inspired by ISFTA, helped pave the way for stronger bilateral investment ties. Indian investment in Sri Lanka has grown not only due to the trade agreement but also because of the improving economic relationship between the two countries. Sri Lanka had already signed a Bilateral Investment Promotion and Protection Agreement (BIPPA) with India in 1997 and followed this with a Double Taxation Avoidance Agreement (DTAA) in 2010, further encouraging cross-border investments. India's FDI regime, dramatically liberalized in the early 1990s, now permits foreign investment in most sectors, excluding sensitive industries such as retail (barring single-brand retail), gambling, and atomic energy. This open policy has positioned India as a welcoming destination for foreign investors and a key player in South Asian trade relations.

Table 2 and figure 1 indicated, in 2007 FDI into Sri Lanka stood at $42.99 million, marking a robust 58.52 percent growth, indicating a healthy increase in foreign investments. By 2008, FDI surged to $126 million, with an extraordinary 193.84 percent growth, highlighting a peak in investor confidence. However, in 2009, FDI declined to $78 million, reflecting a -38.10 percent drops, likely due to the global financial crisis that had ripple effects across economies. The following year, in 2010, investment recovered, reaching $110.2 million with a 41.28 percent growth rate, showcasing renewed investor interest. In 2011, FDI continued its upward trend, rising to $147 million with a 33.39 percent growth. By 2012, FDI increased to $160.00 million, though the growth rate slowed to 8.96 percent, suggesting stabilization in investments. 2013 saw a significant dip, with FDI plummeting to $50.00 million and a corresponding -68.46 percent decline, possibly due to external economic pressures or internal market conditions. Economy: In 2014, FDI was held low at $52.00 million with a low growth of 2.69 percent signifying that investment inflows remain on standstill. There was a significant improvement in FDI in 2015 which increased to 87 million dollars and the growth-rate was 67.82 percent. This recovery received the next lead into 2016, as FDI was the highest with 104.85 million, but of a lesser growth, 19.79 percent. This increased rapidly to $174 million in 2017 with growth rate of 67.10 percent indicating an improved trust in the Sri Lanka economy. FDI settled on the high of 341 million dollars in 2018, with a very impressive increase of 95.98 percent mostly due to the existing major investment projects in major sectors. In 2019, however, the FDI experienced a sharp decline back to $139 million, which translates to -59.24 percent. This could be facilitated by political instabilities or the economy of the world. FDI continued to decline in 2020 to the figure of $88 million and a -36.69 percent contraction, mostly explained by the economic effects of the COVID-19 pandemic. However, in 2021, investment rebounded significantly to $161 million, growing by 82.95 percent, as global markets began to stabilize. FDI continued to rise in 2022, reaching $180.00 million, though at a slower pace, with a growth rate of 12.61 percent. By 2023, the positive trend persisted, with FDI reaching $90 million, reflecting a strong 64.01 percent growth, showing substantial foreign investment inflows. Overall, this period saw significant fluctuations in FDI, driven by both global economic conditions and domestic challenges in Sri Lanka, with periods of rapid growth followed by steep declines. Since 2003, India has been a major investor in Sri Lanka, with investments exceeding $800 million across multiple sectors. FDI continued to rise in 2024, reaching $102.00 million, though at a slower pace, with a growth. These include petroleum, retail, information technology, financial services, real estate, telecommunications, hospitality, tourism, banking, food processing (such as tea and fruit juices), and industries like vanaspati, copper, metal manufacturing, tires, cement, glass, and infrastructure (such as railways, energy, and water supply). According to Sri Lanka's Board of Investment (BOI), Indian Foreign Direct Investment (FDI) in 2015 was $33.05 million out of a total of $515.09 million. In 2014, Indian FDI reached $51.8 million, while Sri Lanka's total FDI stood at $1.616 billion. In 2013, India was one of Sri Lanka's top eight investors, contributing $50.52 million to a total FDI of $1.391 billion. In 2012, India ranked as the fourth largest investor in Sri Lanka, with $160.17 million, following the UAE, Hong Kong, and China. ICI Limited, Tata house and Shree Renuka sugars are some of the Indian companies that have said they would invest more in Sri Lanka. On the same note, the Sri Lankan firms have been expanding further investments in India, and accessing its vibrant economy and huge market. Indian firms have also improved their presence in Sri Lanka including the Slave Island Re-Development Project that was launched on May 12, 2014. This project, a Tata Housing agreement with the Sri Lankan Urban Development Authority, is likely to be fulfilled in 30-36 months and produce employment of 1,500- 2000 people. Phase I will provide 536 residential units and 100 business stores and phase II will include mixed use developments that include office, apartments and hotels. The total investment is valued at approximately $430 million, with $110 million in FDI.

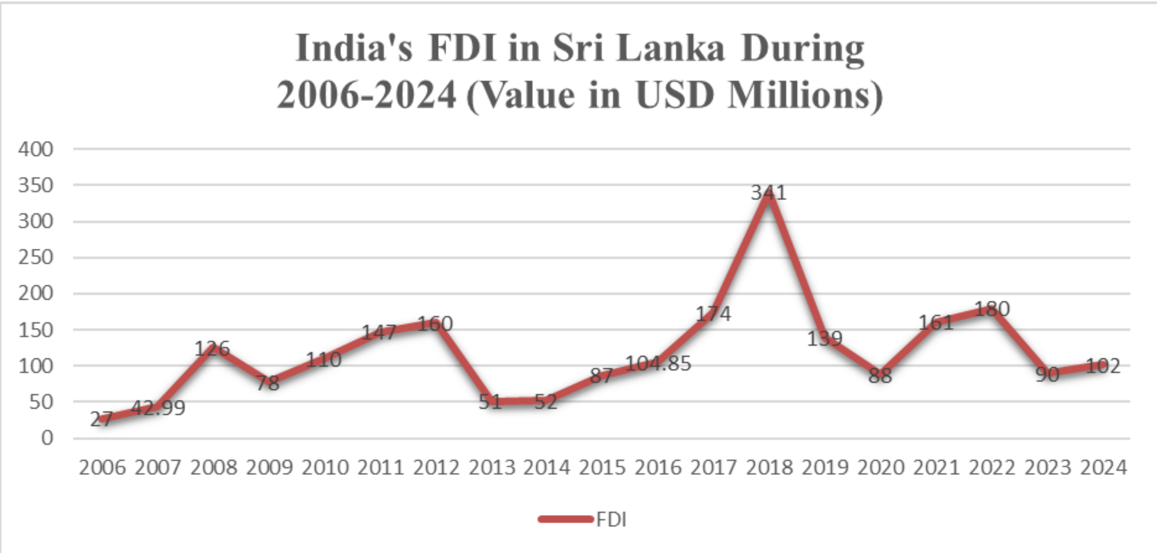

Figure 1: India's FDI in Sri Lanka During 2006 to 2024

The ITC Colombo One project broke ground on November 19, 2014, with ITC Ltd expanding its original $140 million investment by an additional $160 million, for a total of around $300 million. Other Indian companies, such as Ion Exchange, Pratibha Engineering, Kirloskar Brothers Ltd, J.K. Cement, and Parasakti, are exploring business opportunities in sectors like sanitation, renewable energy, and cement in Sri Lanka. There are also strong ties between the business chambers of both nations. In January 2015, the Indian Merchants' Chamber of Navi Mumbai signed a Memorandum of Understanding (MoU) with Sri Lanka's National

Table 1: Sri Lanka's FDI Inflows from various countries during 2006 to 2024

(percent)

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
India	5.63	7.13	16.76	19.31	23.01	15.38	17	5.47	5.82	8.97	11.59	12.67	21.13	11.58	12.81	20.64	16.36	6.92	7.5
China	0.83	1.49	3.06	14.85	19.87	17.36	25.82	42.87	41.39	31.86	23.52	31.61	17.84	22.5	24.75	20.9	33.64	26.15	25.9
UK	13.54	11.94	10.37	13.61	13.6	9	9.67	9.86	11.52	11.24	12.37	6.92	4.34	13.08	16.74	11.79	8.64	10	9
Netherland	2.92	3.81	2.66	4.21	4.39	2.82	4.78	5.36	5.82	8.04	10.48	7.06	3.35	3.58	3.06	2.56	3.64	6.62	6.8
Hong Kong	1.04	1.16	1.2	2.72	2.72	1.67	1.91	2.47	3.13	3.09	3.79	2.69	2.42	3.42	7.71	4.49	3.82	3.23	3.2
Malaysia	5	5.31	4.79	9.9	9.83	5.86	6.48	8.25	9.84	9.69	12.26	8.38	2.6	4.5	7.28	4.62	3.82	6.31	7
USA	2.71	3.15	2.79	4.46	4.6	3.14	4.04	4.29	5.26	5.46	6.69	5.24	4.65	6.83	10.19	10.38	8.27	7.69	7.5
France	1.04	1.16	1.33	1.98	2.51	1.88	2.34	3	3.91	3.92	4.46	3.28	2.97	4.17	6.11	5.64	5.27	4.62	5.02
Singapore	3.13	3.65	3.32	4.46	5.86	3.45	4.46	5.89	6.71	7.22	8.92	6.19	1.55	8.08	5.53	7.05	10	8.85	9.2
Luxembourg	0.63	0.66	0.66	0.74	1.26	0.73	0.85	1.07	1.23	1.24	1.56	1.09	0.99	2.42	2.91	2.82	2.18	1.92	2.1
Other Countries	63.54	60.53	53.06	23.76	12.34	38.7	22.64	11.47	5.37	9.28	4.35	14.86	38.17	19.83	2.91	9.1	4.36	17.69	16.78
Total FDI inflows in Sri Lanka (in Million $ USD)	480	603	752	404	478	956	941	933	894	970	897	1373	1614	1200	687	780	1100	1300	1362

Source: Annual Reports Board of Investment of Sri Lanka (BOI Sri Lanka)

Table 2: India's FDI in Sri Lanka During 2006-2024

(US$ million)

Sr. No.	Year	FDI
1	2006	27
2	2007	42.99
3	2008	126
4	2009	78
5	2010	110
6	2011	147
7	2012	160
8	2013	51
9	2014	52
10	2015	87
11	2016	104.85
12	2017	174
13	2018	341
14	2019	139
15	2020	88
16	2021	161
17	2022	180
18	2023	90
19	2024	102
Overall CAGR During 2006 to 2024 is 10.58 percent		

Source: Board of Investment Sri Lanka.

Chamber of Commerce to promote trade and investment. The Confederation of Indian Industry (CII) and the Ceylon Chamber of Commerce also have an agreement in place, while the Federation of Chambers of Commerce and Industry of India collaborate with the FCCISL. The Indo-Sri Lanka Chamber of Commerce and Industry was inaugurated in September 2006 by Shri P. Chidambaram, India’s then Finance Minister.

Tourism plays a significant role in the relationship between India and Sri Lanka, with India being the largest source of visitors to Sri Lanka. In fact, every fifth tourist in Sri Lanka is from India, making it the top contributor to the country's tourism sector. Between January and September 2015, 220,907 Indian tourists visited Sri Lanka, accounting for approximately 16.8 percent of the total tourist arrivals. According to the Sri Lanka Tourist Development Authority, a total of 1,527,153 tourists visited the island in 2014, marking a 19.81 percent increase compared to the previous year. Of these, 242,734 were from India, representing 15.89 percent of the total visitors. Similarly, Sri Lankan tourists rank among the top ten sources for India's tourism industry. In 2014, the Indian High Commission in Colombo and its posts issued over 195,000 visas, facilitating travel between the two countries. In 2014, Indian visitors ranked among the top five foreign tourists to Sri Lanka. In terms of civil aviation, Sri Lanka maintains a close relationship with India and is the largest foreign airline operator in the country. A key meeting under the framework of the Air Services Agreement, originally signed on December 21, 1948, took place in New Delhi on April 20-21, 2011. During this meeting, it was agreed that designated airlines from both countries would be permitted to operate 112 flights per week. Additionally, both sides allowed their airlines to operate any number of services using aircraft with capacities not exceeding a Boeing 747 on specified routes. The Indian side also shared a revised Air Services Agreement with Sri Lanka.

During the 8th Joint Commission meeting in New Delhi on January 2, 2013, it was agreed that civil aviation officials from both countries would meet soon to review the Bilateral Air Services Agreement and explore the possibility of signing a new, upgraded Civil Aviation Agreement. Bilateral Air Services talks were held in Colombo on September 12-13, 2013, where both sides finalized and initialed the revised agreement. In the realm of science and technology, the first meeting of the India-Sri Lanka Joint Committee on Science & Technology took place in New Delhi on September 22, 2011. The Indian delegation was led by Dr. Arabinda Mitra, Advisor and Head of the Bilateral Cooperation Division, Department of Science & Technology, while Mrs. Dhara Wijayatilake, Secretary of Sri Lanka's Ministry of Technology & Research, led the Sri Lankan side. Both countries agreed to enhance cooperation in science and technology, signing a Programme of Cooperation (POC) for 2011-14. A joint call for project proposals led to the submission of 54 proposals, with nine projects and two workshops selected for collaboration.

This POC has been operational with the first workshop taking place in February 2013 in Vijayawada and the second in March 25-28, 2013 in Colombo. The second session of the India Sri Lanka joint committee meeting was held on April 18-19, 2013 at Colombo and both parties again discussed the POC and ways of future cooperation, and this time it has also covered cooperation in space technology. The POC has been and is still under implementation. India and Sri Lanka signed an agreement called Memorandum of Understanding (MoU) on January 7,2011 related to the sea transport of the passengers. The agreement was to put in place the ferry services between Colombo and Tuticorin and between Talaimannar and Rameswaram. These ferry services are regaining and a major milestone in restoring the previous relationship between the two countries. Colombo-Tuticorin ferry service was launched on June 13, 2011, but terminated later by the operator in November 2011 because of the difficulties of the operation. Now both the countries are trying to find ways to resume this service. But when it comes to the Talaimannar-rameswaram there has to be at least some infrastructure development on either side of the waters before resume of the ferry services. Plans are underway which could see these routes restart early.

On January 17, 2012, India and Sri Lanka entered into a Memorandum of Understanding (MoU) in the agricultural field. This was formalized when the Indian High Commissioner and Mr. W. Sakalasooriya, the Secretary of Sri Lankan Ministry of Agriculture saw an opportunity of being signed when the External Affairs Minister of India was on a visit to Sri Lanka. Within this MoU the two countries decided to expand the cooperation by exchanging biennial work plans and joint programs in most areas, encompassing crop production, agricultural extension activities, horticulture, machinery, post-harvest technology, plant quarantine procedures and credit assistance. The Work Plan 2015-16 was jointly signed in February 2015, when the Sri Lankan President Maithripala Sirisena visited India, to chalk out the roadmap on concerted action in these areas. Dr. J.S. Sarma, Chairman of the Telecom

Regulatory Authority of India (TRAI) and Mr. Anusha Palpita, Director General of the Telecommunications Regulatory Commission of Sri Lanka (TRCSL) singed an MoU on January 17, 2012 in a meeting in Colombo. This agreement is supposed to initiate technical and institutional cooperation between the two countries on telecommunication sector, in a bid to develop the telecommunication sector towards the two countries.

Another current project is the rehabilitation of the Southern Railway in Sri Lanka with a Line of Credit of 167.4 million USD which was executed by IRCON International and RITES in the month of April 2012. Moreover, India offered concessional lending of about $800 million to facilitate the Northern Railway Rehabilitation project in Sri Lanka which was also undertaken by the IRCON International. In March 2015 the project with upgrading tracks and the installation of signaling and communication infrastructure was completed. On 19 March 2015, the Prime Minister of India opened the Talaimannar Pier train part of the railway and caught the first train of Talaimannar Pier-Madhawachchiya railway. On January 17, 2012, Mr. T.C.A. Ranganathan, Chairman and Managing Director of EXIM Bank of India, and The External Affairs Minister visited Sri Lanka and signed a Buyer Credit Agreement amounting to 60.69 million dollars during the visit Dr. P.B. Jayasundera, the Secretary of the Ministry of Finance and Planning of Sri Lanka signed in respect of a Buyer credit secured by an interest charge over the Government of Sri Lanka to the Government of India of 60.69 million dollars. This credit facility will fund the Greater Dambulla Water Supply Project which on May 25, 2011, was granted to Indian firm V A Tech Wabag Limited by the one in Sri Lanka. In the project, the funds are provided under the Buyer Credit Scheme of the EXIM Bank sourced through the National Import Insurance Account (NIEA).

An MoU was signed on April 4, 2013 between EXIM Bank of India and the Sri Lankan government concerning about 124 million dollars in buyer credit finance to supply two Offshore Patrol Vessels by Goa Shipyard Limited. Several other Indian firms in the infrastructure business like Ion Exchange, Pratibha Engineering and Kirloskar Brothers Limited also consider the use of Buyer Credit to undertake projects in Sri Lanka. Moreover, the Prime Minister of India in his visit to Sri Lanka made an announcement of a Currency Swap Agreement 1.5 billion between the Reserve Bank of India and the Central Bank of Sri Lanka.

Between 2015 and 2023, India's Foreign Direct Investment (FDI) in Sri Lanka has been a key contributor to various sectors, including infrastructure, energy, telecommunications, and tourism. Despite Sri Lanka's political and economic challenges during this period, Indian FDI maintained steady growth. Notably, Indian companies have had a strong presence in Sri Lanka's economy. For instance, in 2022, the Adani Group made a significant $442 million investment in wind power projects. India has increasingly focused on the renewable energy sector in Sri Lanka, with a particular emphasis on solar and wind energy. In 2023, companies like the MCS Group signed agreements worth $20 million for mineral processing, further strengthening ties between the two nations. India has consistently been a leading source of FDI for Sri Lanka, even surpassing investments from countries like the UK and China in recent years India's extension of more than $800 million in credit for rehabilitating Sri Lanka’s northern railway, a project completed in 2015, which forms part of India's broader focus on infrastructure development in the country. Additionally, sectors such as telecommunications and tourism have remained attractive for Indian investments. The partnership between India and Sri Lanka is expected to deepen as both countries explore new opportunities to strengthen economic cooperation (High Commission of India).

The annual growth rate of FDI inflows to Sri Lanka generally fluctuates between 40 to 60 percent. However, certain years, like 2018 and 2021, saw a more substantial increase due to the signing of key Memorandums of Understanding (MoUs) during these periods, which played a pivotal role in boosting investor confidence and encouraging more foreign investments. Analyzing the data from 2006 to 2023, Sri Lanka's compound annual growth rate (CAGR) in FDI exceeded 14 percent. This steady growth reflects the growing potential for further Indian investments in Sri Lanka in the near future. Companies such as the Adani Group have already laid the groundwork by planning to establish power projects in the country, signaling stronger economic ties. With such positive investment trends and ongoing economic collaboration between the two nations, Sri Lanka continues to be an attractive destination for Indian investors. The favorable environment created by these agreements promises further opportunities for expansion and investment in diverse sectors.

The table 2 indicates that India’s FDI in Sri Lanka has shown strong growth, recording a compound annual growth rate of 10.58 percent. The upcoming projects in Sri Lanka highlight significant investment potential between the two countries.

Findings

Findings concluded that Indian FDI increased significantly in Sri Lanka after the implementation of the ISFTA, with a compound annual growth rate of 10.58%, but that the pattern of investment was largely erratic, with significant declines during periods of global crises and domestic concerns. So, while ISFTA was a catalyst for investment, it did not create consistent harmonization or guarantee the constant inflow of FDI from India.

It was noted second objective was to develop a comparative analysis, which showed that since 2011, China became the major foreign investor in Sri Lanka overtaking India. China's peak share occurred in 2013 with 43% and it maintained its share to 2024, when China with 26% was unaffected by the decline in investment from India at 7.5%. This shift of investment dynamic has created a competitive hardship for India, which historically has led in inward foreign investment in Sri Lanka.

For the third objective, we see that ISFTA did have a positive, though moderate, influence through its ability to promote sustainable bilateral investments. The effects of the agreement had, to some extent, negative impacts as China grew as a partner to Sri Lanka and the ISFTA agreement was not able to translate into bilateral investment opportunities with India. The institutional platform is still available for India to exploit market opportunities, especially in high-potential sectors such as IT, tea, and infrastructure developments.

Thus, ISFTA has achieved its objective of creating greater bilateral economic connection and stimulating Indian investments, however, its effect on sustaining competitiveness is more limited. If India is to improve its future prospects within Sri Lanka, it will need to leverage the opportunities of ISFTA more effectively; this can be done by accessing emerging sectors, identifying and enhancing policy support, and improving investor confidence. If India's investment presence were to revive, it would enhance an even broader life goal as economic stability and growth within the region.

Conclusion

FDI in Sri Lanka rose from US$480 million to US$603 million, with India's share increasing from 1 percent to 7 percent, and China's remaining steady at 1 percent. By 2008, FDI grew to US$752 million, with India reaching 17 percent and China 3 percent. Despite the 2009 global crisis, India's share rose to 19 percent and China's to 15 percent. Between 2012 and 2013, India's share dropped from 17 percent to 5 percent, while China surged to 43 percent. By 2023, FDI recovered to US$1.3 billion, with China maintaining a strong presence at 34 percent, while India's share declined to 7 percent. Investment between India and Sri Lanka showed steady growth from 2006 to 2023, with only a few dips, such as in 2006 and 2013. Starting at US$27 million in 2006, Foreign Direct Investment (FDI) gradually increased, reaching US$126 million in 2008. FDI initially declined a bit in 2009, and reached its peak in 2012 at US$160.2 million. This was however followed by a downward situation in 2013-2014, but came back up to US$174 million by 2017. It saw the greatest upward jump in 2018 to reach US$341 million. Though there was a mild decline thereafter, the investment level was high, and US$300 million was reported in 2023 indicating a further cadence and investor nerves. There exists a large potential of investment between India and Sri Lanka.

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