Foreign Direct Investment (FDI) plays an imperative role in the development of a country particularly in case of underdeveloped and developing economies. For such economies, FDI plays a significant role of bridging the gap between the existing resources and the required resources.

This study investigates the long run relationship between the economic growth and FDI using data from 1971-2012. For this purpose we have used cointegration approach. In order to investigate short run relationship between the economic growth and FDI we have used Error Correction model. We also have used interactive dummy variable in order to compare the impact of FDI in the aftermath of 9/11 incident. Empirical results confirm the existence of long run cointegrating relationship between FDI and economic growth.

The result is robust even if we exclude the FDI as independent variable and include it as interactive dummy. Error Correction model show that both of the models (First without FDI and second with the inclusion of FDI as independent variables) are stable and show convergence towards equilibrium. It shows that when we include both FDI as well as dummy variable, the model is stable and the adjustment is 22 % each year toward the long run equilibrium. Whereas, when we use only interactive dummy the adjustment is 11 percent annually.

As far the impact of FDI is concerned, it has negative but insignificant impact when used separately however, its impact become positive and significant when use it as interactive dummy. Similarly, in the second model when we include only interactive dummy for FDI, it has negative but insignificant impact on economic growth. Other independent variables also have almost positive impact on economic growth.