
FOREIGN DIRECT INVESTMENT IN NEPAL: A STUDY ON ITS IMPACT ON EMPLOYMENT

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Abstract

Foreign direct investment (FDI) plays an important role boosting industrial development and promotion of manufactured exports for the developing countries. FDI helps mobilization of capital, human and natural resources of the country, which in turn supports to make the economy dynamic and competitive. FDI is an important source of inflow of capital for economic growth and employment generation in developing countries. It also provides a package which constitutes new technologies and management techniques, financial and market access for the production and movement of goods and services. Though, attracting foreign direct investment has become the major challenges for host countries as it faces the challenges of identifying the major factors that motivate and affect the FDI location decision. That's why Nepal is at a point wherefrom it can excel for economic goals via FDI. Foreign investment is critical to enhance the transfer of capital, modern technology, management and technical skill, increase culture. This article attempts to explore the growth and trends as well as condition of FDI. The results show a significant association between the changes in FDI on Employment. The finding of multiple regression analysis between FDI and employment indicates that FDI is a significant predictor of employment.

Key Words: *Foreign Direct Investment, Trends, Employment, Labour Markets*

Introduction

Industrialization process began with the initiative of Indian capital, management and labour after 1936 (NCP, 1983). The first company Act was enacted in 1936 and in the same year, the first joint stock enterprise, the Biratnagar Jute Mills was established in the joint collaboration with Indian entrepreneurs. During the period of World war, many businessmen from India were attracted to undertake new ventures in Nepal. As a result, within a short period of 10 years (1936-1946) as many as 63 industrial units were opened with a total capital investment of Rs.72 million, of which Rs.70 million (97.22 percent) was investment by Indian investors and left was Nepalese investors (Giri,1976). The fact clearly shows that there was decisive role of foreign private investors in the early industrialization process of Nepal. In a post 1950, the emphasis to foreign investment was given since the sixth five year plan (1980-85). Separate rules and regulations as well as lucrative incentives had been provided to foreign investors since 1981 and that was done to enhance foreign investment in Nepal.

Formally, the inflow of FDI in Nepal began in the early 1980s through the gradual opening up of the economy. From 1980 to 1989, FDI inflows to Nepal were minimal with an annual average of

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US\$ 500,000. FDI inflow showed a distinct acceleration during the 1990s averaging US\$ 11 million per annum during 1990-2000, peaking at US\$23 million in 1997 (UNCTAD, 2006). That was primarily due to Nepal's more liberal trade policies, which comprised tariff rate reductions, the introduction of a duty drawback scheme, the adoption of a current account convertibility system and liberalization of the exchange rate regime. A reversal in the rising trend took place from the beginning of the 2000s. FDI inflow was the lowest in Nepal even when compared with other landlocked countries (World Bank, 2003). A comparison of other Asian countries, Nepal indicates a poor performance of FDI (UNCTAD, 2003b). The fact that Nepal is landlocked, coupled with its infrastructure and low level of labor productivity has also constrained FDI inflow in Nepal.

In the early 1990s, a number of policy reforms were initiated in the country. The Industrial Policy 1992, Industrial Enterprises Act 1992(IEA), Foreign Investment and One Window Policy 1992, Foreign Investment and Technology Transfer Act (FITTA) 1992, etc. were enacted. The Industrial Policy 1992 introduced foreign investment promotion as an important strategy in achieving the objectives of increasing industrial production to meet the basic needs of the people, create maximum employment opportunities and pave the way for the improvement in the balance of payments. With growing global trends for economic liberalization, The IEA 1992 and FITTA 1992 were such few important legislative Acts which address foreign private investment in Nepal. The Industrial Policy (2010) aims at creating industry-friendly and conducive investment environment for domestic and foreign investors, raising industrial production and productivity, creating more employment opportunity; and facilitating import replacement and export promotion, etc.

Literature Review

Developing priorities of Nepal include achieving sustained economic and human development to reduce poverty and hunger by strengthening technological capabilities and skills improving access to world markets, and creating more and better employment opportunities. To pursue these strategies confidently, the country needs significantly increased flow of investment capital, especially FDI. However, globalization has led to increase in competition for FDI among developing countries thereby making it even more difficult for Nepal to attract new investment flows.

MacDougall (1960) remarked that the initial theoretical and empirical literature on the effects of foreign Direct Investment (FDI) focused on the direct impacts of multinationals such as additional capital brought into the country, the creation of jobs, the effects on the balance of payments. Lucas (1990) introduced that FDI has been instrumental in the development of developing countries because the inflow of FDI could bring a better economic performance for the country. The policies designed on the accumulation of human capital surely have a much larger potential for attracting FDI needed for development.

Blomstrom & Kokko (1997) acknowledged that spillovers from foreign direct investment could essentially positive externalities from the presence of multinationals companies on the local economy. Yahaya et al. (2017) had conducted a study to determine the effect of foreign direct investment and financial performance of the listed manufacturing companies based on the

secondary data from the financial statement of those companies which were subjected to both descriptive and inferential statistics. The results show a significant positive relationship between the two variables (financial performance and foreign direct investment). The findings also revealed that the company with the highest percentage of foreign direct investment had nearly 20% of its assets contributed by the foreign direct investors. They suggested that effects should be made FDI environment attractive in order to attract more FDI in to the listed manufacturing companies in Nigeria.

Benedict & John (2017) showed that Foreign Direct Investment (FDI) being one of the key macro-economic variables has a positive relationship with economic growth. The study specifically test the hypothesis on whether or not FDI has positive and significant impact on output growth in the Nigeria economy using a model based on a modified neoclassical production function where FDI is taken as an input in the production process. The results of the estimation analysis obtained revealed that there exists a positive relationship between FDI and output growth in the Nigerian economy. The study recommended that the policies that could increase FDI should be encouraged.

According to the FITTA 1992, foreign investment means the following investment made by a foreign investor in any industry: a) Investment in share (equity), b) Reinvestment of the earnings derived from the investment in share (equity); and c) Investment made in the form of loan or loan or loan facilities. New Foreign Investment Policy 2015 was approved by the council of ministers of Nepal revoking the previous Foreign Investment Policy 1991 in the first week of March 2015. The provisions of the policy not covered by the current Foreign Investment and Technology Transfer Act (FITTA) 1992 which will be implemented by the new foreign investment act.

Different foreign studies reports show that there is significant impact on domestic economy. For the economic betterment of a country, the emphasis should be given foreign investment for generating employment level, economic growth and development and economic prosperity. The specific study toward impact of FDI on employment in has not been conducted. Hence this study will be a comprehensive asset to the concern areas.

Research Problems and Objectives

Developing countries and least developed countries are generally capital scarce and available resources like labour and natural resources remain unutilized because of the scarcity of complementary resources like capital, technology and organizational skills. Foreign investment is therefore seen as an important means of through which Nepal could avail of such complementary resources in other countries. Foreign direct investment is the most important. Providing facilities or exemptions only to fully locally owned businesses will not send a good message to foreign investors.

The political instability and inconsistency in the successive government policies along with the insufficient response of the bureaucracy are the major reasons for not increasing FDI at satisfactory rate. The unclear laws governing the foreign investment policies, time consuming and complex procedures for approval and registration of foreign investments to invest in Nepal are other factors for less FDI inflows.

The basic objective of this study is to analyze the overall environment of foreign investment of Nepal. The specific objective of the study is to analyze the growth and trends of FDI and examine the impact of foreign direct investment on employment.

Research Methodology

This study is the descriptive and analytical in nature. So the descriptive and analytical research design has been applied. In case of descriptive research design, different tables, diagrams and examples has been presented in the different section as necessary.

The study is based on secondary data. The published as well as unpublished relevant literature has been used to review the provisions of foreign investment in Nepal. Data published by Ministry of Finance, Department of Foreign Investment, Nepal Rastra Bank, Central Bureau of Statistics and National Planning Commission were the major sources of statistical information. Apart from this, reports published by international organizations such as World Bank, International Monetary Funds (IMF), UNDP etc. were also used. To analyze the impact of FDI on employment level, simple regression model has been applied.

Results and Findings

Growth and Trends of Foreign Investment in Nepal

Nepal has recognized foreign investment as a major economic instrument for the economic development of the country. The open liberal economic policy has been adopted to attract foreign investors. In the following section, an attempt has been made to examine the pattern and trends of foreign investment in Nepal. There are altogether 4,102 projects from 2000/01 to 2018/19 First Eight months with foreign collaboration approved so far. Many of these projects involve technology transfer as well as financial participation. Under 4,102 projects the foreign investment was Rs.263462.86 million which covers approximately 7 percent of GDP (Appendix-I). During that 1 lakh 73 thousand 1 hundred and 59 people were employed in these projects. The growth of FDI shows the unbalanced at different fiscal years. It is the evident from the above figures that total numbers of projects as well as total investment under joint ventures have been added every year. There is mostly increase in the number of foreign approved projects as well as amount of foreign investment in Nepal.

Figure 1: Foreign Investment in Nepal from 2000/10-2018/19* (Rs. in million)

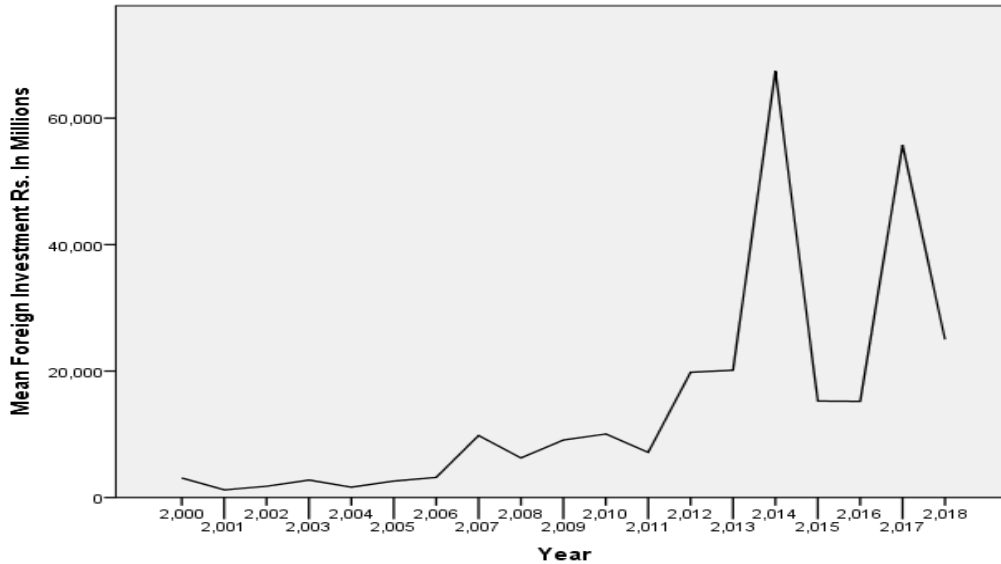


Figure 1 shows that the highest foreign investment was in 2014/15 and lowest foreign investment was in 2001/02. Figure 2 shows that the employment generation on FDI based projects from 2000/01 to 2018/19 first eight months. In the fiscal year 2014/15, employment level was highest and the employment level was lowest in fiscal year 2003/04 (See Annex-I).

Figure 2: Employment Generation from FDI Projects (2000/01-2018/19*)



In spite of various efforts made by the government, FDI activities in Nepal is not so encouraging. Absence of political stability, unavailability of productive and skilled labor, inadequate infrastructure facilities, particularly the shortage of power, etc. are some of the economic and environmental factors responsive for discouraging FDI in Nepal.

Country-wise Joint Venture Industries

The foreign investment share has been nearly 16 percent in the industries to total investment in the approved industries by the first eight month of the 2018/19 FY. On the basis of project cost of the approved industries for foreign investors, the Chinese investors have occupied 39.81 percent to total foreign investment. Similarly, Indian investors occupied the second position in the investment which is 33.4 percent and UK was the third place with 4.82 percent investment in share.

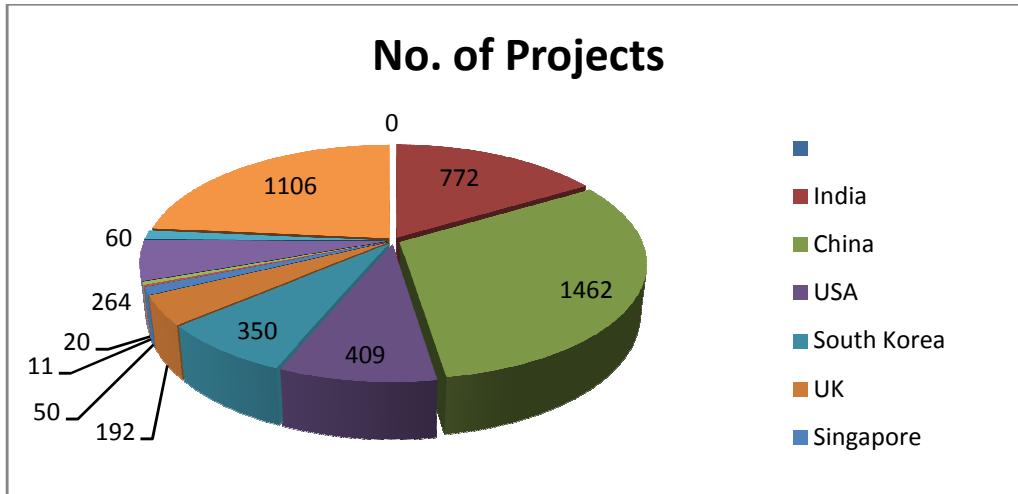
Table1: Country-wise Joint Venture Industries (Up to 2018/19) (Rs. in millions)

<i>Country</i>	<i>No. of Projects</i>	<i>Foreign Investment</i>	<i>Cost Based (%)</i>	<i>Employment</i>
<i>India</i>	772	93496.00	33.4	72280
<i>China</i>	1462	111458.00	39.81	67645
<i>USA</i>	409	9053.00	3.23	18519
<i>South Korea</i>	350	12251.00	4.37	11,721
<i>UK</i>	192	13508.00	4.82	13049
<i>Singapore</i>	50	4507.00	1.61	3500
<i>Mauritius</i>	11	3435.00	1.23	1055
<i>UAE</i>	20	2985.00	1.06	1877
<i>Japan</i>	264	3042.00	1.09	10147
<i>Switzerland</i>	60	2920.00	1.04	1575
<i>Others Countries</i>	1106	23309.00	8.34	50321
Total	4,696	279963.00	100	2,51,689

Source: Department of Industry, 2018/19.

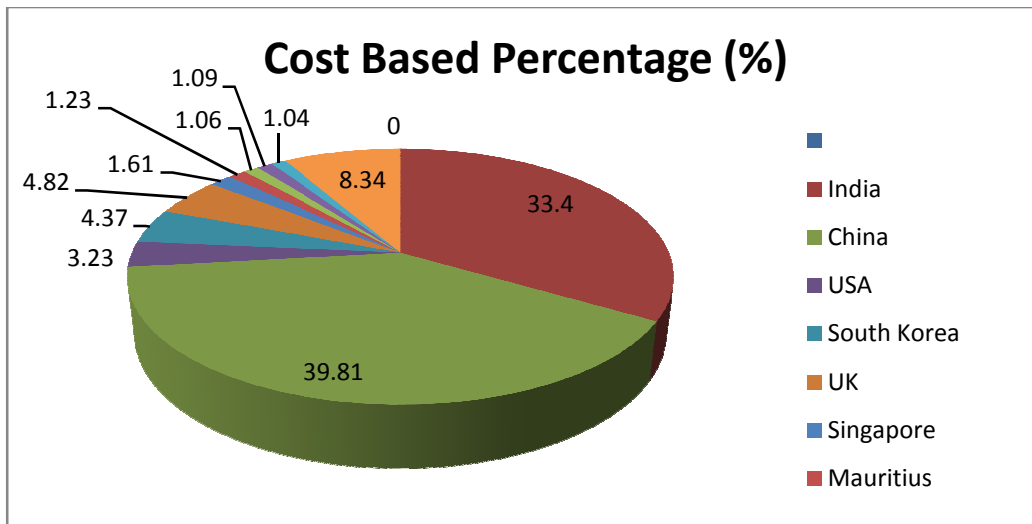
Table 1 depicts that from the beginning to the eighth months of 2018/19, there are 4,696 joint venture projects approved so far, the largest number of industries have been set up by Chinese investors i.e. 1,462 projects and second place is being occupied by Indian investors , i.e.772. On the projects based USA (409 projects), South Korea (350 projects) and United Kingdom (192 projects) and so on. On the basis of project cost of the approved industries for foreign investors, the Chinese investors have occupied 39.81 percent to total foreign investment. Similarly, India occupied the second position in the investment which is 33.4 percent and UK is in the third place with 4.82 percent investment in share. The table shows that there is slight bit growth in foreign investment in Nepal after the adoption of Foreign Direct Investment Policy in Nepal.

Figure 3: Countrywise FDI on Projects Based



The figure depicts the country-wise FDI on projects based where China is the largest country where as India is the second largest Country. Similarly, USA takes third largest place, South Korea takes fourth largest place, UK holds fifth largest place as well.

Figure 4: Country-wise FDI on Cost Based



The figure 4 shows that FDI projects on cost based where China holds first position, India takes second position, South Korea holds third position, UK takes fourth position as well.

Foreign Investment in Nepal as Per Province

There are disparities of foreign investment projects in accordance of seven providences in Nepal. The scenery of providence-wise foreign investment is shown in the Table 2.

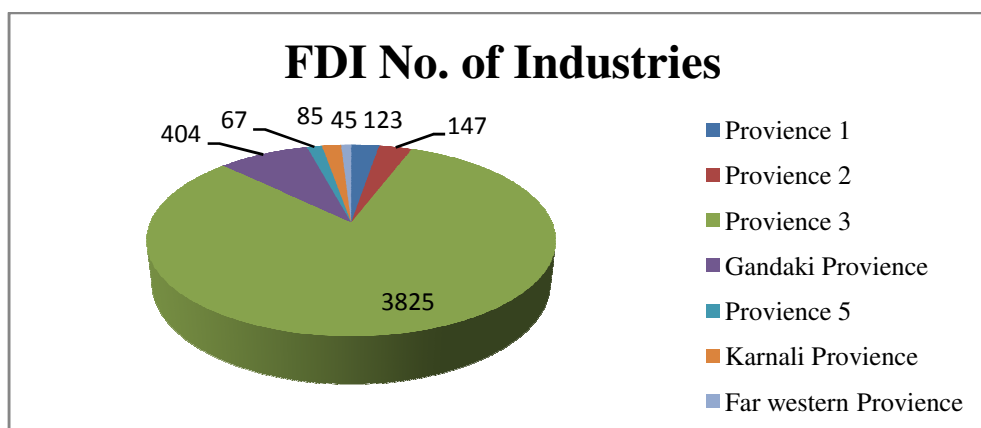
Table 2: Foreign Investment on Industry as per Province

<i>Proviences</i>	<i>FDI No. of Industries</i>
<i>Proviencie 1</i>	<i>123</i>
<i>Proviencie 2</i>	<i>147</i>
<i>Proviencie 3</i>	<i>3825</i>
<i>GandakiProviencie</i>	<i>404</i>
<i>Proviencie 5</i>	<i>67</i>
<i>KarnaliProviencie</i>	<i>85</i>
<i>Far western Proviencie</i>	<i>45</i>
Total Projects	4,696

Source: Economic Survey, 2018/19.

As shown in Table 2, upto the first eight months of the fiscal year 2018/19, the registered numbers of foreign investment industries are more in Bagmati Province and the lowest in Karnali Province. Compared to the commitment of total investment, more than half of the investment is in Bagmati Province and the least part is in Sudurpashchim Province. On the basis of number, 81.45 percent of the total foreign investment industries are in Bagmati province. The figure 5 depicts that one basis of projects more than 81.45% FDI projects are established in Bagmati Province. By comparing the FDI, Providence Far western seems to be less allocated of FDI i.e; less than 1 percent. The figure clears that there are inequalities of FDI attraction in accordance to providences.

Figure 5: FDI Projects by Province



Impact of Foreign Direct Investment on Employment

Since the relationship between Foreign Direct Investment to employment has been established in this study, further, this study also focused on examining the effect of changes in Foreign direct investment over employment. For hypothesis testing, regression analysis was done in SPSS v22.

Table 3: Descriptive Statistics

	Mean	Std. Deviation	N
Foreign Investment Rs. In Millions	14593.79	18122.248	19
Nominal GDP Rs. In Millions	1298359.21	779502.686	19

Table 4: Correlations

		Foreign Investment Rs. In Millions	Nominal GDP Rs. In Millions
Pearson Correlation	Foreign Investment Rs. In Millions	1.000	.694
	Nominal GDP Rs. In Millions	.694	1.000
Sig. (1-tailed)	Foreign Investment Rs. In Millions	.	.000
	Nominal GDP Rs. In Millions	.000	.
N	Foreign Investment Rs. In Millions	19	19
	Nominal GDP Rs. In Millions	19	19

Table 5: Model Summary

Model	R	R ²	Adjusted R ²	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.694 ^a	.482	.451	13421.548	.482	15.816	1	17	.001

Table 6: ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	2849140753.452	1	2849140753.452	15.816	.001b
Residual	3062345173.706	17	180137951.394		
Total	5911485927.158	18			

a. Dependent Variable: Foreign Investment Rs. In Millions

b. Predictors: (Constant), Nominal GDP Rs. In Millions

a. Predictors: (Constant), Nominal GDP Rs. In Millions

d. Dependent Variable: Foreign Investment Rs. In Millions

Table 7: Coefficients

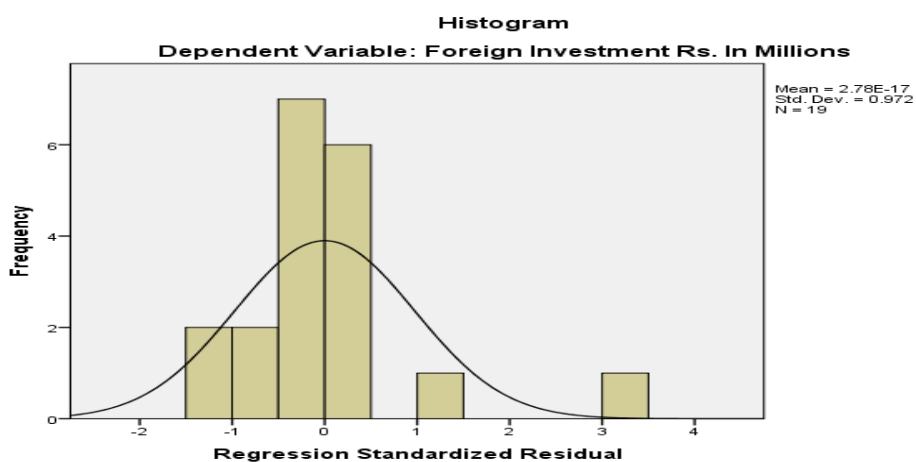
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-6361.707	6102.891		-1.042	.312
1 Nominal GDP Rs. In Millions	.016	.004	.694	3.977	.001

a. Dependent Variable: Foreign Investment Rs. In Millions

Table 8: Residuals Statistics

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	-9.56	40972.73	14593.79	12581.160	19
Residual	-16191.510	43165.441	.000	13043.400	19
Std. Predicted Value	-1.161	2.097	.000	1.000	19
Std. Residual	-1.206	3.216	.000	.972	19

a. Dependent Variable: Foreign Investment Rs. In Millions



To understand the change relationship between Foreign Direct Investment to employment. The result shows that there is a significant impact of Foreign Direct Investment on Employment. It signifies that a change in Foreign Direct Investment has improved position of Employment. It shows a significant association between the changes in FDI on Employment. The finding of multiple regression analysis between FDI and Employment indicates that FDI is a significant predictor of Employment. The variable of FDI has 16%, contributed towards Employment.

Conclusions and Policy Recommendations

Conclusions

Foreign investment refers to any investment in another country which is made by private companies or individuals. It, broadly involves equity participation, portfolio investment, technology transfer, management involvement and intellectual property rights. Capital deficient developing countries like Nepal require foreign capital and technology for their rapid socio-economic development. Like Nepal in many developing countries have also adopting liberal economic policy for the purpose of attracting FDI inflows into the country.

Despite the liberal policy and attractive incentives provided by the government, the overall picture of FDI is not encouraging. The pattern and trends of FDI suggest that liberal policy framework is no longer adequate to attract foreign investment.

There were altogether 4,696 projects with foreign collaboration approved so far. Many of these projects involve technology transfer as well as financial participation. The total project cost of these 4,696 projects under which foreign direct investment portion was just Rs.279963.00 millions which covers approximately 9 percent of GDP. During that periods, 2,51,689 employment level was generated. However, exact inflows of foreign capital is unknown due to lack of systematic and comprehensive information. It is evident from the above figures that total numbers of projects as well as total investment under joint ventures have been added every year. There is mostly increase in the number of foreign approved projects as well as amount of foreign investment in Nepal.

To understand the change relationship between Foreign Direct Investment to employment, simple regression model was applied. The result shows that there is a significant impact of Foreign Direct Investment on Employment. It signifies that a change in Foreign Direct Investment has improved position of Employment. Nepal shall have immense strategic advantages. Nepal has not been able to even exploit its own potential because of lack of protection as well as promotion to its investors. When it comes to the promotion and management of foreign investment, Nepal should amend its institutional capability through training.

The finding of multiple regression analysis between FDI and Employment indicates that FDI is a significant predictor of Employment. The variable of FDI has 16%, contributed towards Employment.

Recommendations

Developing countries and least developed countries are generally capital scarce and available resources like labour and natural resources remain unutilized because of the scarcity of complementary resources like capital, technology and organizational skills. Foreign investment is therefore seen as an important means of through which Nepal could avail of such complementary resources in other countries. Providing facilities or exemptions only to fully locally owned businesses will not send a good message to foreign investors. The unclear laws governing the foreign investment policies, time consuming and complex procedures for approval and registration of foreign investments to invest in Nepal are other factors for less FDI inflows. There should be certain reforms in the foreign investment policy:

- Effective development strategy, proper exposure and promotion of business opportunities, and strengthening institutional capabilities can help go a long way in terms of attracting foreign investment.
- The government should implement more strategies and plan to attract foreign investors. The below listed factors are crucial for promoting FDI.
- To create a peaceful environment and maintain political stability. More emphasize on marketing of different investment sectors.
- The laws, regulations and policies must be in harmony with the Foreign Investment and Technology Transfer Act.
- Maintaining industrial zones and progressive and longer transport windows for investors.
- In order to promote the investments, all the organizations working in collaboration can be an elevating approach.
- To attract FDI effectively one needs a coordinate comprehensive strategy of economic diplomacy, law and conceptualized by a powerful inter-agency board of investment working in tandem with the ministries of commerce, finance and foreign affairs.
- The contributions of Non-residential Nepalese (NRNs) should be maximized by reforming the policy provisions.

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Appendix

FDI Projects in Nepal from 2000/01 to 2018/19

<i>Year</i>	<i>No. of Projects</i>	<i>Foreign Investment (Rs. in millions)</i>	<i>Employment</i>
2000/01	96	3102.56	6880
2001/02	77	1209.65	3731
2002/03	74	1793.77	3572
2003/04	78	2764.80	2144
2004/05	63	1635.77	5559
2005/06	116	2606.31	7358
2006/07	188	3186.00	7389
2007/08	213	9811.00	10709
2008/09	231	6255.00	11108
2009/10	171	9100.00	7848
2010/11	210	10053.00	10902
2011/12	226	7138.00	9035
2012/13	317	19819.00	16569
2013/14	307	20132.00	11790
2014/15	370	67455.00	13167
2015/16	348	15254.00	11663
2016/17	400	15206.00	11842
2017/18	399	55760.00	13940
2018/19*	218	11181.00	7953
Total	4,102	263462.86	173159

Source: Various Economic Surveys