
IMPACT OF FOREIGN DIRECT INVESTMENT ON ECONOMIC GROWTH IN NEPAL

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Abstract

Foreign Direct Investment (FDI) is an engine of economic growth. This study explains the relationship between economic growths with FDI of Nepal. The objectives of the study are to study the FDI inflows in Nepal and to analyze the impact of FDI on GDP of Nepal. The Ordinary Least Square (OLS) model has been used to examine the relationship between FDI and economic growth of Nepal. The analysis is based on data for the period of 1090/91 to 2019/20. The empirical evidence indicates that there is long run relationship between FDI and economic growth in Nepal.

Key Words: *FDI, GDP, OLS, Nepal,*

Introduction

An investment made by the firm or individual in one country into business interests located in another is known as foreign direct investment (FDI). Generally, FDI takes place when an investor establishes foreign business operation or acquires foreign business assets in a foreign company. FDI can serve as an important sources of financing to compliment domestic investment for the economic growth and development of the least developed countries (LDCs) (NRB survey report, 2018/19). FDI is a category of cross – border investment associated with a resident in one economy having control or a significant degree of influence on management and enterprise that is residency in another economy (IMF, 2009).

In Nepal, industrialization process began with the initiative of Indian capital, management and labour after 1936 (NCP, 1983). In recent years, Nepal has encouraged FDI inflows by creating investment friendly environment and prioritizing foreign investment related reforms. FDI policy 2015 and Foreign Investment and Transfer of Technology Act, 2019 (FITTA) and institutional reforms such as one stop service center validates the commitment and efforts of government of Nepal to attract foreign capital, technology and investment to achieve sustainable economic growth. Moreover, FITTA, 2019 has broadened the scope of foreign investment and following investment as foreign investment.

FDI flows inflows to Nepal are low compared to its neighboring countries. However, they have almost steadily in recent years. According to UNCTAD's 2020 world investment report, FDI inflows has increased basically due to Indian Investment in hydropower projects.

As a member of WTO and the multilateral investment laurate agency (MIGA), Nepal has signed the Bilateral Investment projection and promotion Act (BIPPA) with six countries including India – encourage FDI flows. Foreign investment in Nepal is regulated and administered by the Foreign

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Investment and Technology Transfer Act and Industrial Enterprise Act. The FDI significantly related to the growth of nation. The incremental growth of FDI is good sign of economic growth. The financial facilities faster economic growth through pooling fund, encouraging and mobilizing overseas investment.

The data shows that profitable areas of investment include hydropower, industrial manufacturing, tourism, construction, agriculture, minerals and energy.

Nepal encourages FDI both as joint venture operations with Nepalese investors or as 100 percent foreign – owned enterprises. The few sectors that one not open to foreign investment are either reserved for national entrepreneurs in order to promote small local enterprises and protect indigenous skills and expertise or are restricted for national security sections. Approval of the GoN is required for foreign investment in all sectors. No FDI is allowed in cottage industries. However, no restriction is placed on transfer of technology in cottage industries.

FDI's are the net flows of investment to acquire a lasting management invest in an enterprise operating in an economy other than that of investors. It is sum of equity capital, reinvestment of earning, other long term capital and short terms capital as shown in the balance of payments (World Bank 2012).

Objectives:

The general objective of the study is to analyze the FDI of Nepal. The specific objectives of the study are as follows:

1. To study the FDI inflows to Nepal.
2. To analyze the impact of the FDI on GDP of Nepal.

Hypothesis

In this study, the following hypothesis has been developed:

H₀ = The independent variable foreign direct investment is not significantly influencing the dependent variable gross domestic product.

H_a = The independent variable foreign direct investment is significantly influencing the dependent variable gross domestic product.

H₀₁ = The data series is not suffering from heteroscedasticity.

H_{a1} = The data series is suffering from heteroscedasticity.

H_{0 2} = The residuals of the data series are normally distributed.

H_{a 2} = The residuals of the data series are not normally distributed

H_{0 3} = The data series is not suffering from serial correlation

H_{a 3} = The data series is suffering from serial correlation

Literature Review:

Malhotra (2014) analyzed that FDI initiation is the results of globalization and liberalization and India is one of the countries that has involved in FDI. Indians FDI policy has been gradually

liberalized to make the market investor friendly. FDI has had a positive impact .FDI inflow supplements domestic capital as well as technology and skills of existing companies and to establish new companies results economic growth of the Indian Economy.

Merus and Olasunknmi (2015) analyzed that FDI positively contributes to economic growth in Negeria. The OLS results shows positive contributions but not statistically significant at the 5% level of significance.

Munetal (2008) used ordinary least square regression and the empirical analysis were conducted by using annual data on FDI and economic growth in Malaysia. The results shows that there are significant relationship between economic growth and foreign directinvestment inflows in Malaysia.

Pokharel and Pokharel (2019) viewed that FDI is suggestive of a positive trend of investment which ultimately translates in increase in GDP and economic growth of the country. The findings of the research proved that increasing trend of FDI also increases the GDP of the country.

Bista (2005) examined the relationship between FDI and GDP along with the impact of FDI determinants on FDI inflows in Nepal. By using Cobb Douglas Production model and a theoreticalgrowth model, the result shows positive relationship between GDP and FDI.

Kharel (2020) viewed the significant association between the changes in FDI on GDP and employment. The finding of multiple regression analysis between FDI and employment indicates that FDI is a significant predictor of GDP and employment.

Neupane (2020) believed that the contribution of FDI in capital formation and employment in Nepal is not significant in the Nepalese economy, eventually making less contribution to the GDP of the Nepalese economy.

Research Methodology

The study is based on secondary data. The descriptive and analytical research design has been applied in the study. The tables and diagram has been presented for descriptive research design.

The various published and unpublished relevant literature has been used to review the FDI in Nepal. Nepal Rastra Bank, Central Bureau of Statistics, department of Industry are the major source of statistical information. Apart from this, reports published by international organizations are also used. To analyze the impact of FDI on GDP, Simple ordinary least square (OLS) method has been used.

Model Specification

The relationship between FDI & GDP is expressed in the form of mathematical equation. Due consideration has been given to the model applied by Tamilselvan, M. and Manikandan, S. (2015) so as to click the relationship between FDI & GDP.

The model which specifies that economic growth influenced by the foreign direct investment is as follows:

$$\text{GDP} = f(\text{FDI})$$

$$\text{LnGDP} = \beta_0 + \beta_1 \text{LnFDI} + e$$

Where, GDP= Gross Domestic Product

FDI = Foreign Direct Investment

β_0 = Intercept

β_1 =Coefficient of independent variable

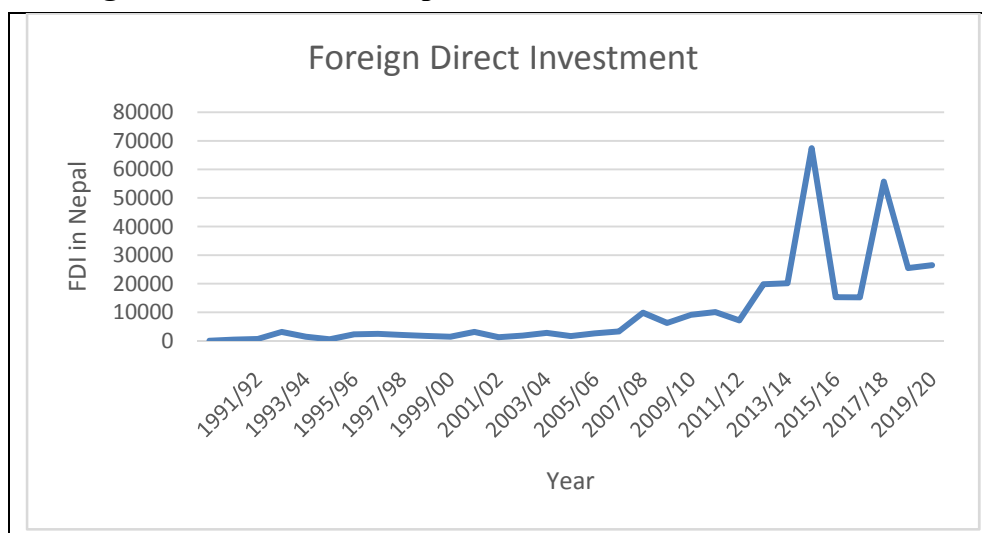
e = Error term

Results and Findings

FDI Inflows to Nepal

The FDI inflows to Nepal in 1990's and 2000's were meager. Early 2010's should some sign of increase in FDI inflows. There is fluctuating in the FDI flow in Nepal. Before 2010, the FDI inflows were meager. After 2010, there is increasing in FDI inflows (NRB Survey) due to the institutional reforms and government's efforts in attracting foreign investment. FDI flows have been steadily in recent years except 2015/16 and 2016/17 that represents a clear break from earlier decades. It is presented by following figure;

Fig: 1 –FDI Inflows to Nepal



Source: Department of Industry, 2020

Effect of FDI on Economic Growth of Nepal

The relationship between economic growth and FDI can be analyzed with the help of economic model.

Regression Analysis – GDP Vs FDI

The Ordinary Least Square (OLS) regression provides simple relationship between dependent and independent variables. The study uses OLS to examine the simple long run relationship between FDI and GDP growth in Nepal between 1990-91 and 2019-20 by using e-views 10 data software. The result of OLS test is presented in the table.

Table – 1: Ordinary Least Square Test

Coefficient of Determination - R^2	0.835007
P-Value of 'F' Statistics	0.000000
P-Value of FDI Independent Variable	0.000000
P-Value of Obs * R^2 - square: Breush – Godfrey Serial Correlation LM Test	0.602400
P-Value of Obs * R^2 – square – Heteroscedasticity: White Test	0.915100
P-Value of JarqueBera – Normality	0.201952

In ordinary least square method, we reject the null hypothesis that the independent variable foreign direct investment is not significantly influencing the dependent variable gross domestic product and the results of the ordinary least square regression is summarized in table 1. The empirical analysis on the basis of OLS suggests that there is positive and long run relationship between foreign direct investment and GDP.

The above results are obtained from data analysis. It shows that Coefficient of Determination - R^2 0.835007 which means the independent variable FDI is explaining the GDP growth in Nepal by 83.50%. The p-value of F-Statistic is 0.0000 indicates the model is fit for the overall population. It is ensured that the independent variable FDI is significantly influencing the dependent variable GDP with the p-value of 0.0000 smaller than 5%. Hence the null hypothesis H_0 is rejected.

The p-values of Breush-Godfrey Serial Correlation LM Test, Heteroscedasticity:White Test and JarqueBera –Normality Test are 0.602400, 0.915100 and 0.201952 respectively. From the p-values, it is understood that the existence of heteroscedasticity is not found since the p-value of white test is larger than 5% and the null hypothesis H_{01} is accepted, the p-value of JarqueBera – Normality Test is larger than 5%, hence the null hypothesis is H_{02} accepted which means that the residuals are normally distributed. The p –value of Breush-Godfrey Serial Correlation LM Test is larger than 5% and the null hypothesis is H_0 accepted, which means the data series is not suffering from serial correlation.

Conclusion and Recommendation

The study analyzed the impact of foreign direct investment on Nepal's economic growth over the period 1990/91 to 2019/20. The findings revealed that economic growth is directly related to inflow of foreign direct investment. This implies that good performance of the economy is a positive signal for inflow of foreign direct investment. FDI is attracting in Nepal because our tax slabs is one of the lowest and our position is fairly good in case of doing business. It can be concluded that foreign direct investment is an engine of economic growth. Therefore there is need to have a stable political and economic environment and improve on the critical infrastructure, level of security in the country. The governance system should be based on accountability, transparency, effective and efficient resource. FDI comprises new technologies, management techniques, finance and market access for the production and movement of goods and services. So, Nepal should adopt policies to attract more FDI and implement accordingly.

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