Impact of Covid-19 Pandemic on FDI In Nepal

Krishna Kumar Regmi[1]

Abstract

Foreign Direct Investment (FDI) and Foreign Aid is an essential source of economic development for developing countries. However, FDI depends on the economic environment, as do other development assistance depends on the country's foreign diplomacy and relation. The study aims to find the impact of Covid-19 on FDI,inflow and other barriers for receiving FDI commitment in Nepal. The study is descriptive and analytical. Secondary data are used in the study. The Covid-19 pandemic has reduced FDI commitments funds as envisioned. However, pandemic is not the only barrier of investment commitment. Still, there are barriers such as business environment, poor infrastructure, lack of skilled human resource, political transitions, weak governance, natural calamities, and tax slab which are critical in Nepal. Although FDI in Nepal was in an upward trajectory till 2019, the COVID-19 pandemic has reduced it as the primary economic development source of Nepal.

Key words: COVID-19, FDI, inflow, infrastructure

I. Introduction

Foreign Direct Investment (FDI) plays a vital role in raising capital formation and productive capacity as well as the transfer of technology, skill, innovative and managerial ability. Internalizing the importance of FDI in economic growth and transformation, Nepal has adopted the policy of regular improvement of major factors determining FDI inflow. In this context, Nepal has also introduced policy and procedural improvements along with the policy of national treatment to foreign investors. In addition, the government is committed to provide some tax and non-tax facility, post-investment services and hassle-free business environment. The government attempts to attract more foreign investment through growing market, natural resources, flexible labor market and bilateral investment and double-taxation avoidance agreements.

From the beginning of the 1980s, worldwide capital movements have been liberalized FDI has grown and become more competitive. FDI has become an important source of private external finance for developing countries. Productive use of such resources may boost up the sustained startup and industrial competition. FDI is considered a very significant economic growth facilitator (Srinivasan et al., 2011). The literature in this area suggests that FDI boosts economic development by providing capital, foreign exchange, technology, and easing access to foreign markets (Fontoura & Crespo, 2007).

1. *Mr. Krishna Kumar Regmi is Lecturer at Rammani multiple Campus,Tribhuvan University, he can be reached at regmikrishna08@gmail.com*

They also believed that FDI has been injecting domestic investment and innovation to derive economic growth.In the indigenous growth model, for enhancing economic growth FDI has a significant impact on improving human capital, e.g., managerial skills, research, and development (Mankiw et al., 1992). To provide incentives to foreign firms to close the idea gap, bring resources from develop economies and use them with the local resources to gain or to keep pace with developed economies,developing economies should adopt the policies(Romer, 1993).

According toneoclassical growth models, the impact of FDI in the long-term is negligible; however, in short run it might have positive impact (Solow, 1956). In developing countries FDI is negatively correlated with economic growth (Rahman, 2015). On the economic development of developing countries there is no positive effect of FDI(Haddad & Harrison, 1993). Whether FDI can be deemed to be a catalyst for output growth, capital accumulation, and technological progress seems to be a less controversial hypothesis in theory than in practice (Mello, 1997).Blomstrom & Kokko (1998) explained thatFDI has a positive effect on economic growth. There was a positive relationship considering technological diffusion through FDI in developing countries. The positive effect of FDI is more massive in open economies and bidirectional towards economic growth(Borensztein et al., 1998).

FDI is different from other major types of external private capital flows in that it is motivated largely by the investors' long-term prospects for making profits in production activities that they directly control. Foreign bank lending and portfolio investment, in contrast, are not invested in activities controlled by banks or portfolio investors, which are often motivated by short-term profit considerations that can be influenced by a variety of factors; for example, interest rates, natural deserters etc. are prone to herd behavior(Zhang, 2001). These differences are highlighted, for instance, by the pattern of bank lending and portfolio equity investment, on the one hand, and FDI, on the other, to the Asian countries stricken by financial confusion in 1997: FDI flows in 1997 to the five most affected countries remained positive in all cases and declined only slightly for the group, whereas bank lending and portfolio equity investment flows declined sharply and even turned negative in 1997.

FDI is gradually diminishing in size and foreign aid and the inflow of remittance are projected to decline, this article aims to assess the impact of COVID-19 pandemic to FDI on the Nepali economy. As the economies of the major industrialized countries are severely affected, it is obvious that the flow of foreign aid and FDI from the developed countries to the developing and underdeveloped countries will be affected. FDI source countries for Nepal include India, China, Singapore, Bangladesh South Korea (Nepal Rastra Bank, 2018) and the European Union (EU) member countries, and the USA, which shows that FDI flows to Nepal, is not only from the developed countries but also from the developing countries.

Since the outbreak and spread of COVID-19, numerous studies have sought to analyze the implications of the resulting pandemic for economies. Some scholars have analyzed the impact of the pandemic on not only liquidity markets, such as stock price (Hayakawa & Mukonoki, 2021), oil price (Gill-Alana & Monge, 2020), and exchange rates (Phan & Narayan, 2020), but also international trade (Vidya & Prabheesh, 2020) and socioeconomic consequences, such as labor, health, and environmental aspects. Few studies, however, have discussed the impact of COVID-19 on FDI flow. Based on current studies, we find that FDI flow, either extensive or intensive margin, plays a crucial role in supporting economic development across countries (Maryam & Mittal, 2020). UNCTAD (2020b) predicted the global FDI flow to fall dramatically after the outbreak and spread of COVID-19. Because FDI flow is an aspect most affected by the COVID-19 pandemic, investigating the implications of this pandemic on it is vital, particularly from an international perspective.

III. Research Methodology

The effect of covid-19 pandemic spread globally, which raises a question regarding the role of FDI flows that are expected by developing as well as developed nations. Therefore, with South Asian perspectives the debate about the impact of covid-19 on commitments of FDI in Nepal also has been increased. This study's main objective is to find the impact of covid-19 and other related barriers to receive the commitment of FDI in Nepal. To fulfill the objective of the study, the inflow of FDI commitment in and after covid-19 is discussed. This study is quantitative which is based on secondary data and information. And the data are extracted from World Bank 2022, UNCTAD 2022, Depart of industry Government of Nepal, and Nepal Rastra Bank and relevant literature that appeared in reliable and recognized sources. Moreover, research has followed the review of published periodic reports and articles.

IV. Results and Conclusion

This article aims to appraise the impact of the global pandemic on the inflow of FDI in Nepal. The economy of Nepal is dependent on remittances, and infrastructure development is driven by foreign aid and FDI. The impact of COVID-19 on Nepalese economyisexplained as follow.

FDI is necessary for emerging and developing economies, and it could be only given another international financing (OECD, 2020).During the economic recovery FDI will play a crucial role in supporting the national economy (Alfaro & Chen, 2012).The investment decision of multinational business firm will directly or indirectly influence by the degree of policy response of the government. The pandemic related action of the government has caused severe economic interference that ultimately influence the decision related to FDI flows.Even under the most favorable environment, OECD report shows that worldwide FDI may decline at least 30 percent in 2020 compared to 2019.

Government of Nepal hosted the investment summit in 2019,signed 15 MOUs withinvestors from various countries of the world. But the actual report was very much less than the commitments of the investors. To create the doing business climate in Nepal investment summit becomes a real platform.Aiming to educate and promote investment in Nepal the Office of the Investment Board of Nepal (OBIN) was established in 2011.

Table 1

Doing Business Score of Nepal and South Asian Countries, 2021

Rank	Economies	DB Score 2021	DB Score 2020
63	India	71.0	67.5
89	Bhutan	66.0	66.0
94	Nepal	63.2	59.7
99	Sri lanka	61.8	61.8
147	Maldives	53.3	53.3
168	Bangladesh	45	42.5
173	Afghanistan	44.1	44.2

Source: World Bank, 2021

Table 1 presents the doing business score of Nepal and South Asian countries in 2020. Doing business score of Nepal has been 59.7 in 2020 and it was reached at 63.2 in 2021, ranked with 94th position among the 190 countries of the world. Nepal has improved cross border indicators, time and cost of export and imports, improved construction services, electricity, enforcement of the contract, and free use of online platforms (World Bank, 2021). But, for starting a business, registering property and paying taxes still Nepal is facing business hazards. Among the south Asian countries India has a top score of 71.0, similarly, ranked in 63rd position globally. In the south Asian region, Afghanistan has ranked 173rd place with a 44.1 doing business score.

FDI Commitment by the economies

According to World Investment Report 2022 the global FDI inflow increased by 64.3 percent to USD 1,582.3 billion in 2021 from USD 963.1 in 2020. Booming merger and acquisition (M&A) markets and rapid growth in international project finance resulted significant recovery of FDI inflows around the world. Inflow of FDI in developed economies increased by 133.6 percent to USD 745.7 billion in 2021 from USD 319.2 billion in 2020. Inflows to developing economies increased by 29.9 percent to USD 836.6 billion in 2021 from USD 643.9 billion in 2020 (UNCTAD, 2022).

Table 2

FDI inflow and percentage change in 2021

Year	2018	2019	2020	2021	Percent Change 2021
World	1448.3	1480.6	963.1	582.3	64.3
Developed Economies	753.3	764.5	319.2	745.7	133.6
Developing Economies	695.0	716.2	643.9	836.6	29.9
Asian	478.1	501.4	496.9	511.6	19.3
China	138.3	141.2	149.3	181.0	21.2
Hong Kong-Chaina	104.2	73.7	134.7	140.7	4.4
Singapore	73.9	106.3	75.4	99.1	31.4
South Asia	49.9	57.6	69.6	51.0	-26.8

Source: UNCTAD (2022)

Table 2 reflects that Asia is the largest FDI recipient region, accounting for 40 percent of global FDI (UNCTAD, 2022). FDI is increased by 19.3 percent, from USD 518.9 billion in 2020 to USD 619.0 billion in 2021 in this region. However, the inflows remain highly concentrated among its largest recipients: China (USD 181.0 billion), Hong Kong-China (USD 140.7 billion) and Singapore (99.1 billion). The FDI inflow in south Asian country is decreased by 26.8 percent point in 2021 than in 2020.

Table 3

Fall in Foreign Direct Investment after Covid-19 in Nepal

Fiscal Year	FDI inflow (in Million Rs.)	Percentage Change
2018/19	1306.48	-25.39
2019/20	1947.87	49.09
2020/21	1408.32	-27.69

Source: MoF, Nepal

According to table 3in 2020/21Nepal received Rs. 1408.32 millionwhereas; it was Rs. 1947.87 in 2019/20 in the same last period. The amount is predicted that this will create 2,068 employment opportunities.

The FDI has fallen because of COVID -19 pandemic. China has committed Rs. 6.77 billion till July 12, 2020, whereas in 2019, at the same time as last year 8.38 billion with the perspective of Belt and Road Initiative. One of the successful examples of impactful Chinese FDI in Nepal has to be Hongshi-Shivam Cement, a joint partnership between Hong Kong Red Lion No 3 Cement Co Ltd (70 percent), a wholly-owned subsidiary of Hongshi – China and Shivam Cement Pvt. Ltd. Nepal (30 percent) (Government of Nepal, 2018). China's proposals are based on mining, construction, hydropower, forest, and the tourism and service sectors. Nepal is receiving FDI as an improvement in process, law, and policy. Till March 2020, the investment worth of Rs. 100.55 billion commitments for FDI in 2019 is being disrupted due to pandemic, approved by the Investment Board of Nepal. The total FDI has funded 83 percent of small scale industries, 11 medium scale industries, and 6 percent of large-scale industries (DoI Nepal, 2021).

Table 4

Foreign Direct Investment Inflow and Greenfield Investments in Millions USD

Foreign Direct Investment	2018	2019	2020	2021
FDI Inward Flow (million USD)	67.1	185.0	126.5	196.0
FDI Stock (million USD)	1 921.4	1 620.5	1 706.8	1 849.8
Value of Greenfield Investments (million USD)	260	425	225	31
Number of Greenfield Investments	9	9	5	2

Source: UNCTAD 2022

Table 4 shows FDI inflow, FDI stock and Greenfield investments in millions. According to UNCTAD's 2022, FDI inflows is USD 185 million in 2019, whereas in 2020, it was reached 126.5 million USD and FDI total amount earned at USD 196 million in 2021. Besides, FDI stock was 1921.4 million in 2018. The stock of FDI was decreased in 2019 than the 2018 after that it started to increase in 2021 than 2019 from 1620.5 to 1849.8. From the figure, it has been found that FDI is increasing in Nepal as Nepal has high investment potentials. On the other hand, 9.0 number of Greenfield investments stood in 2018 and 2019, whereas it was decreases5 numbers in 2020. The value of Greenfield investment (venture of the parent company in a foreign country) in 2018 was 260 USD million, which was increased in 2019 totaled 425 USD million. In 2021, it was decreased andreached to 31 USD million.

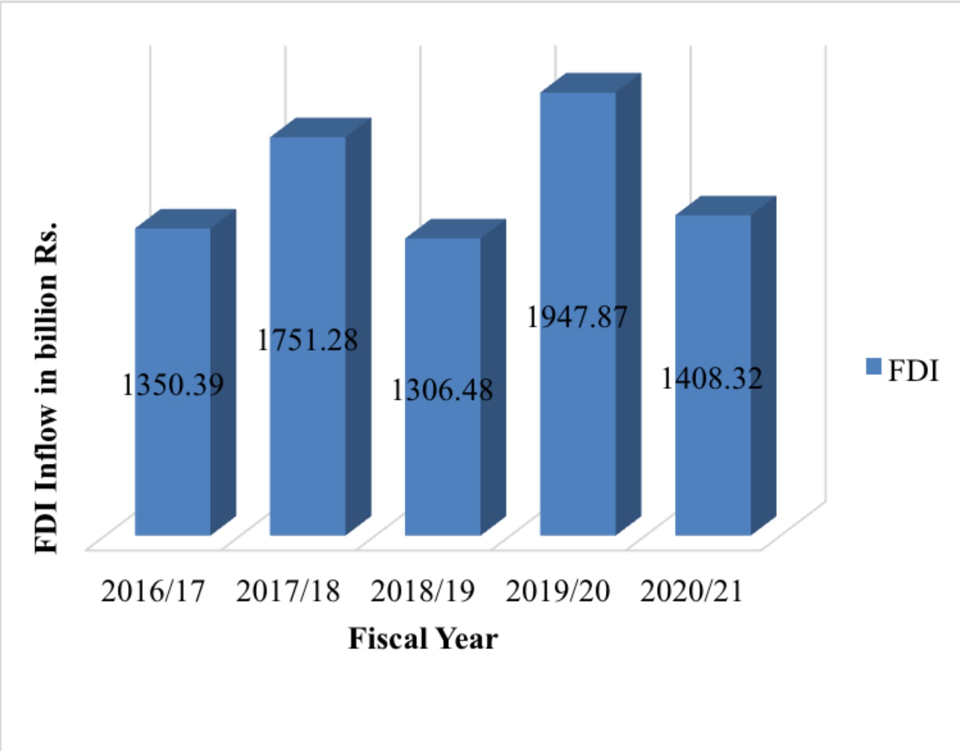

Figure 1: FDI in Nepal (NPR in Millions)

Figure 1 shows that the FDI inflows from 2016/17 to 202021. In 2016/17, it was 1350.39billion, whereas, in 2017/18, the FDI reached 1751.28 billionsimilarly it was reached 1408.32 billion in 2020/21 as Nepal has ease of doing business and investment prospects. It tells that the country's Development has been injecting by FDI. It can be the engine of economic growth. Since FDI has great importance in the development of infrastructure of the host country. Higher the FDI flow in the recipient country. Besides, FDI may hurt the economy like dependency and less resource endowment. This could also result in structural unemployment and weaken local producers'competitive position (Melnyk, Kubatko, & Pysarenko, 2014). Despite the considerable potential, particularly in the agriculture, tourism, energy, IT, and infrastructure sectors, widespread corruption, cumbersome bureaucracy, and weak implementation of laws and regulations have generally kept investors at bay (US Department of State, 2019).

Impact of COVID19 on the Inflow of FDI to Nepal

The COVID-19 pandemic has negatively impacted the inflows of FDIs in developing and underdeveloped countries with the unprecedented impact on globalization. UN Conference on Trade and Development (UNCTAD)by a study concluded that the global FDI flows are expected to contract between 30% and 40% from 2020 to 2021. Such a contraction in global FDI, developing and underdeveloped countries will be hit the hardest, as the FDI inflows are going to drop out when they need it. Such a drop out of FDI has been triggered by the disruption in global supply chains, as the result of the pandemic (Seric & Hauge, 2020).

The twin goals of Nepal, i.e., meeting the Sustainable Development Goals (SDG) by 2030 and becoming a middle-income country have been challenged by the impact of COVID-19 on the inflow of FDI to Nepal. Before COVID-19 Nepal has faced a financial crunch the COVID-19 pandemic has further worsened the situation.

National Planning Commission (NPC) frames the country's development plans and programs in June 2019. The 14thplan projected that Nepal would face a financing gap of US$4.96 billion per year to meet the SDGs (14th Plan, NPC). Nepal hosted the third Nepal Investment Summit in 2019, and 15 memorandums of understanding (MoUs) were linked with investors from different countries. Thus, amid such an unfavorable situation, further negative feeling by the global pandemic, no initiatives have been undertaken to revive the FDI.

While unveiling the budget for the Fiscal Year 2020–2021 government budget of Nepal stated that US$12.19 billion in FDI has been pledged through the Investment Board, Nepal.The budget did not elaborate on the areas that could attract foreign investors because the goal to achieve the SDGs by 2030, the required investment, estimated before the COVID-19 pandemic, stood at US$17.202, 024.8 billion. It was approximately 47.8% of the GDP of the total investment requirement, poverty accounts for 7.5%, while inclusive growth (mainly labour and tourism), agriculture, health, education, and gender account for 2.8%, 5.8%, 6.6%, 15.5% and 0.7%, respectively (Budget Speech, 2020-21). Thus, already before the pandemic struck, a realization was developed that the government needs to work on assorted macroeconomic policies, and make them more investment-friendly, and should leave no stone unturned to win the confidence of investors.

Conclusion

This article has attempted to explain the impact of the decline of the inflow of FDIs during the global pandemic, to Nepal. It has been observed that while protracted lockdown has already taken a toll on the country, the sharp decline of FDI has pushed the economy further in crisis. Despite the grave economic crises looming large over the Himalayan nation, the entire country has been held hostage by the power struggle in the ruling party, undermining government capacity to deal with the economic downfall, when it should be focused in making collective efforts to address the economic crisis through the implementation of required containment policies and strategic reopening of the economy. Even though it has been argued by the development thinkers and planners that multilateral aid would not decline in comparison to the bilateral aid, Nepal has not made any policy-level preparations to attract more multilateral aid for the economic recovery.

Nepal's recovery plan seems to have lacked the strategic direction from the very beginning. Nepalese policymakers have already missed an opportunity to transform the crisis into opportunity. Crisis resilience should have been the policy priority of Nepal, preliminarily addressing the informal economy and its linkage with the vulnerability of workers during the lockdown. But because of government's misplaced priorities, the economic recovery plan of the country lacks a strategic coherence, upsetting already fractured sectors, including tourism, agriculture, FDIs. Thus, before it is too late, the Nepal government should mull overusing the skill and technology of repatriated migrant workers on the productive sectors of the economy. Nepal should introduce a concrete road map in attracting more FDI by improving the investment environment than being over-dependent on investment commitment on the energy sector has increased recently, from the foreign investors, even during COVID-19. Thus, Nepal should leave no stone unturned in tapping such opportunities, which may eventually transform the crisis into opportunities.

References

Alfaro, L., & Chen, M. (2012). Surviving the Global Financial Crisis: Foreign Ownership anf Establishment performance. American Economic Journal : Economic Policy 4(3), 30-55. Retrieved from nber.org/system/files/working_papers/w17141.pdf

Blomstrom, M., & Kokko, A. (1998). Multinational Cooperation and Spillovers. Journal of Economic Survey, 247-277. doi:https://doi.org/10.1111/1467-6419.00056

Borensztein, E., Gregorio, J. D., & Lee, J.-W. (1998, March). How does Foreign Direct Investment Affect Economic Growth ? Journal of International Economics 45(1), 115-135. doi:https://doi.org/10.1016/S0022-1996(97)00033-0

Fontoura, P., & Crespo, N. (2007). Determinant Factors of FDI Spillovers- What do we Really Know? World Development, 410-425. Retrieved from https://dx.doi.org/10.1016/j.worlddev/j.2006.04.001

Gill-Alana, L. A., & Monge, M. (2020). Cruide Oil Prices and COVID-19: Persistence of the Shock. Latters 1(1), 13200. doi:https://doi.org/10.46557/001c.13200

Haddad, M., & Harrison, A. (1993). Are there positive spillovers from direct foreign investment ? : Evidence from panel data for morocco. Journal of Development Economics , 51-74. Retrieved from https://doi.org/10.1016/0304-3878(93)90072-U

Hayakawa, K., & Mukonoki, H. (2021). Impact of COVID-19 on Global Value Chain. 154-177. doi:10.1111/deve.12275

IMF. (2020). The Great Lockdown: Worst Economic Downturn Since the Great Depression.https://www.imf.org/en/News/Articles/2020/03/23/pr2098-imf-managing-irector

Mankiw, N. G., Romer, D., & Weil, D. N. (1992). A contribution to empirics of economic growth. Quaterly Journal of Economics, 407-437. Retrieved from https://doi.org/10.2307/2118477

Maryam, J., & Mittal, A. (2020). Foreign Direct Investment into BRICS: an empirical analysis. Transnational Corporations Review 12(1), 1-9. doi:10.1080/19186444.2019.1709400

Mello, L. R. (1997). Foriegn Direct Investment in Developing Countries and Growth: A selective survey. The Journal of Development Studies 34(1), 1-34. Retrieved from https://doi.org/10.1080/00220389708422501

Melnyk, L., Kubatko, O., & Pysarenko, S. (2014). The impact of foreign direct investment on economic growth: a case of post communism transition economies. Problem and Prospective in Management 12(1), 17-24. Retrieved from https.//www.essuir.sumdu.edu.ua

Nepal Rastra Bank. (2020). Current Macroeconomic and Financial Situation of Nepal. https://www.nrb.org.np/contents/uploads/2020/04/CMEs-Seven-Months-Final-CompilationEnglish-2076-77.pdf

OECD. (2020). Foreign direct investment flows in the time of COVID-19. https://www.oecd.org/coronavirus/policy-responses/foreign-direct-investment-flows-in-the-time-of-covid19-a2fa20c4/

Palamalai Srinivasas, M. K. (2011). An emperical investigation of foreign direct investment and economic growth in SAARC Nation. Journal of Asia Business Studies.

Phan, D. H., & Narayan, P. K. (2020). Country Responses and Reaction of the Stock Market to COVID-19-a Preliminary Exposition. Emerging Markets Finance and trade 56(10), 2138-2150. doi:https://doi.org/10.1080/1540496X.2020.1784719

Rahman, A. (2015). Impact of Foreign Direct Investment on Economic Growth: Emperical Evidence from Bangladesh. International Journal of Economics and Finance , 178-185. Retrieved from http://dx.doi.org/10.5539/ijef.v7n2p178

Romer, P. (1993). Idea gaps and objective gaps in economic development. Journal of Monetary Economics, 543-573. Retrieved from https://doi.org/10.1016/0304-3932(93)90029-F

Seric, A., & Hauge, J. (2020). Foreign direct investments could contract by 40% this year, hitting developing countries hardest. World Economic Forum. doi:

Solow, R. M. (1956, february). A Contribution to the Theory of Economic Growth. The Quarterly Journal of Economics, 65-94. doi:https://doi.org/10.2307/1884513

Srinivasan, P., Kalaivani, M., & Ibrahim, P. (2011). An emperical invastigation of forieng direct investment and economic growth in SAARC nations. Journal of Asia Business Studies., 232-248. doi:10.1108/15587891111152366

US Department of State. (2019). Investment Climate Statements: Nepal Centre. https://www.state.gov/reports/2019-investment-climate-statements/nepal/

Vidya, C. T., & Prabheesh, K. P. (2020). Implication of Covid-19 Pandamic on the Global Trade Networks. Emerging Markets Finance and Trad 56(10), 2408-2421. doi:https://dio.org/10.1080/1540496X.2020.1785426

WEF. (2020). Foreign direct investments could contract by 40% this year, hitting developing countries hardest.https://www.weforum.org/agenda/2020/06/coronavirus-covid19-economics-fdi-investment-united-nations/.

Zhang, K. H. (2001). How does foreign direct investment affect econoic growth in China. Economics of Transition 9(3), 679-693. doi:https://doi.org/10.1111/1468-3051.00095