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An Outline of FDI Inflows and Nepal's Economic Evolvement

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Abstract

The objective of this research is to examine into and explain the role of foreign direct investment (FDI) on Nepal's economic growth. The major goal of this paper is to describe the post-liberalization FDI trajectory in Nepal from 1990/91 to 2019/20, as well as its influence on economic growth. A basic regression model is also used in the research to look at FDI and timelines, as well as FDI with employment level as a trend. When data was acquired from secondary sources, descriptive and analytical research approach were used to examine the data. According to the findings, FDI-based industries provide a considerable contribution to the national economy in terms of output, productivity, employment, and resource mobilization. The employment rate has progressively grown during the research period. Both regression equations are significant, and the R^2 prediction indicated that FDI and timeframe are approximately 50 percent equivalent. Also, the R^2 prediction between EMP and FDI appears to be 40%. Furthermore, such negative opinions, in light of recent political developments, should lead us to conclude that FDI inflows are not on a potential to compete. We are, nonetheless, hopeful about our ability to attract FDI.

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Introduction

Foreign Direct Investment (FDI) allows economies to form direct, secure, and long-term relationships. FDI, in particular, promotes technology and know-how transfer between economies. It also helps the host economy's goods to be exported on a wider scale in foreign markets. Foreign direct investment is a significant source of resources for both the host and host economies (Acharya & Khatiwada, 2003).

Nepal is a developing country with a wide savings-to-investment gap. Foreign direct investment (FDI) is widely regarded as a crucial source of development funding. Due to a severe lack of funding for infrastructure financing, FDI is generally welcomed in most all sectors (Chitrakar, 1986). FDI is assumed to be components for transferring technology from advanced countries to under-advanced countries. It also helps to broaden the foundation of local expertise and skills. For a country like Nepal, the benefits of foreign investment don't stop there (Adhikari, 2013).

One of the most significant factors in economic growth is foreign direct investment (FDI). In a globalized economy, foreign direct investment (FDI) is a fundamental process of capital flows. Both the host country and international investors benefit greatly from foreign investments (Balsubramanyam, 1966). As remarked by Rijal (2010), FDI is not only a valuable sources of resources but also a beneficial sources for new technology and managerial know how which tends to sources of human growth.

An influx of capital into a business in the form of management skills and financial lending is known as foreign direct investment (Agrawal & Sahoo, 2003). It directly boosts capital creation in the recipient nation. FDI is the product of multinational companies and host countries sharing a common interest. Allowing private-sector businesses to operate in competitive market conditions and FDI creates the best options for faster national economic growth in the developing nations.

External capital is needed for accelerating growth, according to most economists and developing-country practitioners. For the attraction of foreign private and public investment in the nations it needs developing export processing zones (Lama, 2010).

For the past four decades, the world's developing countries have received financial assistance. Domestic savings are poor in most countries, and the financial sector is underdeveloped. The ability to mobilize domestic financial capital for the growth of key economic sectors is limited. Overall, there is a strong correlation between external financial assistance and a country's economic growth (Burnside & Dollar, 2000).

FDI is the net inflow which is derived from the deduction of outflows from total inflows of an investment to gain a long-term management interests. It is also known as foreign direct investment. Foreign capital is a critical component of both developing and developed countries' long-term economic growth. FDI helps a developing country like Nepal grow and expand its manufacturing base, promote industries of national importance, and gain a competitive advantage (Dahal, 2007).

In the South Asian zone, Nepal is one of the countries that receive the least inward FDI. This is due in part to the fact that it is a small, underdeveloped, mountainous, landlocked nation. Nepal offers access to two neighboring economies with large markets that are friendly and rapidly expanding. It has a low-wage, trainable workforce as well as a thriving local entrepreneurial community. However, there are significant shortcomings in the investment process that must be addressed first.

Literature review

Athukorala and Sharma (2006) pointed that FDI oriented most of the firms are based on capital intensive having local firms. Bista (2005) remarked that most of FDI based firms are heavily located in the Kathmandu valley and Terai zone. So, the foreign investor can invest in the urban areas of Nepal. They focused on the positive attraction of FDI based industries in Nepal.

Chenery and Strout (1966) examined the FDI situation in Nepal and found it to be dire. In comparison to South Asia, Nepal appears to attract just a small amount of international capital and firms despite having free market reforms and incentives. According to Dunning (1993), three

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conditions are required for enterprises to engage in FDI in another country. The advantages of ownership, location, and internalization are known as the ownership, location, and internalization advantages. Firms must have a product or technology that gives them a competitive advantage in overseas markets. As noted by (UNCTAD, 1999), for the attraction of FDI, infrastructure facilities for getting raw materials out of the host country and to its final destination. The inflows of FDI needs to be through various ways for contributing investment and growth in host countries.

Feldstein is a physicist who (2000) Through these numerous avenues, FDI should contribute to investment and growth in host countries. As a result of this competition, certain OECD member countries' corporation tax collections have dropped dramatically. Despite the multiple facilities and incentives available in Nepal, the flow of foreign investment is modest. Tariff and non-tariff restrictions on market access have been introduced.

Hassan and Kim are a couple (2014) Foreign direct investment (FDI) is an important vehicle for Nepal's economic development. Prior to the 1990s, FDI influx into Nepal was essentially non-existent during the pre-liberalization period. In areas like tourism and hydropower, Nepal has a competitive advantage. To ensure an investor-friendly environment, there must be an overall improvement in the business climate. According to Hinds (2005), macroeconomic stability is still important since relative prices for each investment must stay constant and predictable. Because expatriate managers are costly, the availability of local managerial expertise is critical. According to Hymer (1960), American FDI was concentrated in a few industries and monopolized by a few companies.

The primary difference between portfolio and direct investment, according to Kindleberger (1973), is that direct investment entails control. Control is a legal term based on a foreign corporation's stock being owned by one hundred, ninety-eight, fifty-one, or forty-eight percent of its shareholders. OECD (2002) has come to consider FDI as a source of economic development in developing nations, emerging economies, and countries in transition. To attract investment, countries have liberalized their FDI rules and adopted various initiatives. The second issue is addressed in the research foreign direct investment for economic development.

As per Pant & Sigdel (2004), Nepal is very competitive in attracting FDI. China's political stability is strong and this stable climate is one of the main reasons for investment. Nepal can benefit from China's expertise in developing sound foreign direct investment policies. According to Sapkota (2002), foreign investment in basic industries in 1974 was allowed to reach 51 to 100 percent. This was due to restrictive regulations and practices that international investors did not find useful. During this time, there was a significant energy shortage to attract FDI.

Stecher (2005) states that FDI will provide the additional capital needed to accelerate productivity growth. Attracting foreign direct investment facilitates the structural changes needed for growth and contributes to the integration of countries into the international value chain. Ireland, Malaysia, Singapore, Thailand, and now, impressively, China has been successful. Timilsina & Mahato (2000), in the view of FDI, considers foreign investment to be important for the industrialization of Nepal. Some basic requirements are capital, proper skills, and qualified personnel. In 1981Government of Nepal legislated the foreign investment law under the Foreign Investment and Technology Transfer Act During 1981 to 1987 the total number of industries under manufacturing sector in which FDI can play a key role in the economic growth and development process.

The importance of foreign direct investment for development has increased dramatically in recent years. FDI is considered superior to other types of capital inflows for several reasons. Market-seeking investments are attracted by the size of the host company's market, per capita income, and market growth. For companies, new markets provide the opportunity to remain competitive and grow within the industry. According to the World Investment Report (2012), FDI has recently suffered a setback due to the global financial crisis and the subsequent ongoing debt crisis. Nepal has the lowest rank in the region in terms of FDI potential index. H. 175 out of 182 countries around the world.

Research objectives

The main objectives of the paper are to investigate the trend and current status of FDI in Nepal; to analysis of the impact of foreign direct investment on Nepal's postal liberalization.

Research methodology

The present study has conducted by using secondary data over the period of 1990-2019. The descriptive and analytical research design has been applied to analyze the data. The

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quantitative information has been gathered from the sources of Ministry of Industry, Nepal Rastra Bank and other national and international sources whereas the literature has been reviewed from national and international research documents. Data has been presented in graph, table and figure. Simple regression model have been used to diagnosis the data.

The simple regression model has been applied in the overall FDI which is:

$FDIt = \beta 0 + \beta 1\, Tt + \varepsilon$……………………………………………..(i)

Where, FDIt = Overall FDIt, Tt = Time periods, β_0 and β_1 are the parameters.

$FDIt = \beta 0 + \beta 1 FDI_{t-1} + \varepsilon$……………………………………..….(ii)

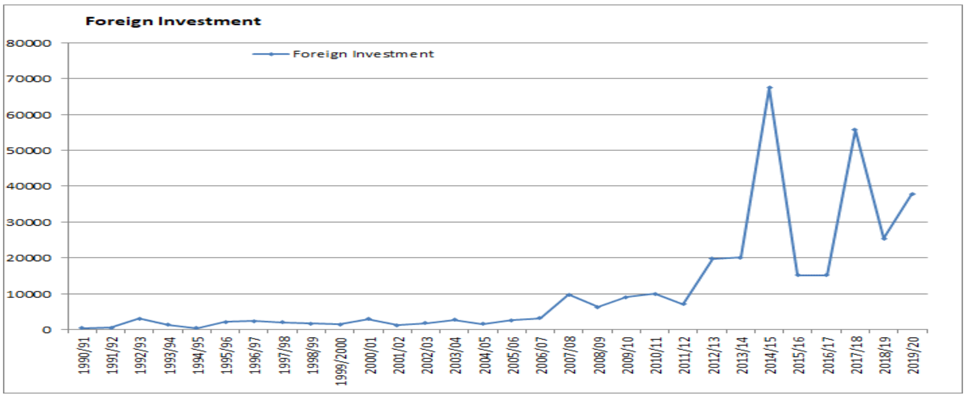
$EMPt = \beta 0 + \beta 1 FDIt + \varepsilon \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (iii)$

Where, EMPt = Employment, β_0 and β_1 are the parameters.

Growth Trends of FDI in Nepal

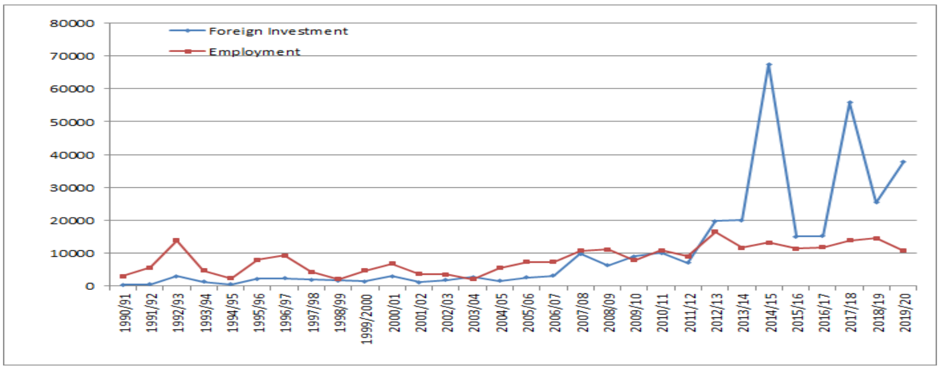
It studies the FDI situation from 1990/91 to 2019/20. Based on this 30-year study period, the total FDI is 331047.37 million. The total FDI of this period is 11,034.91. The total number of industries operating under FDI during this 30 year period is 4952. The total average number of industries operating under FDI during these 30 years is 165.06. The total number of employment is 248362 while the average total employment is 8278. The highest FDI in 2014/15 was 67480.04 million while the lowest was 406.28 million in 1990/91. The highest number of employment is 14544 in 2018/19 and the lowest number is 2154 in 2003/04. Also, the number of industries is highest at 400 in 2016/17 and lowest at 23 in 1990/91.

Figure 1: Trends of FDI with Timeline



Source: Economic Survey and Investment Board Nepal, 2020.

Figure 2: Trends of FDI and Employment



Source: Economic Survey and Investment Board Nepal, 2019/20

Sector-wise FDI Inflow in Nepal

The table depicts that six types of categories in FDI in 2019/20. The highest number of industries is 89 under tourism and the lowest number is 4 under agriculture. Also the highest investment in tourism is 11572.98 million and the lowest investment in agriculture is 447.40 million.

Table 1: Industries approved for foreign investment by category (FY 2019/20) *(Rs. in million)*

Category	No. of Projects	Total Project Cost*	Total Fixed Cost*	Total Working Capital*	Total Amount of FDI*	Total Employment**

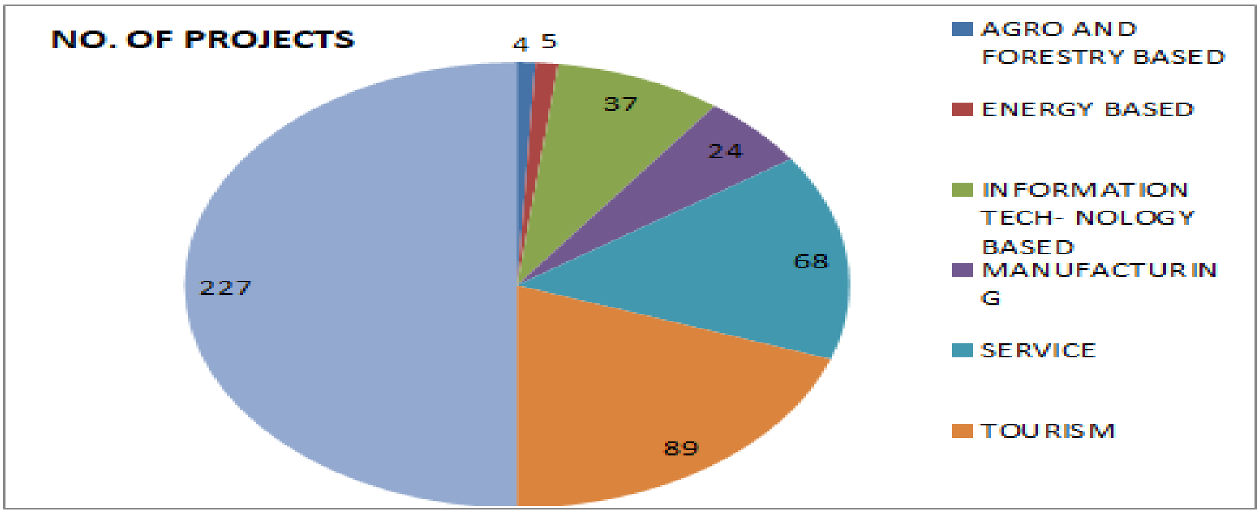
Agro & Forestry Based	4	535.00	332.00	203.00	447.40	180
Energy Based	5	11822.64	11635.53	187.11	4978.78	0
Information Technology Based	37	11654.46	10202.95	1451.51	7081.23	2808
Manufacturing	24	3343.50	2402.50	941.00	2969.87	960
Service	68	11818.00	6308.64	5509.36	10752.00	3796
Tourism	89	11722.24	9370.30	2351.94	11572.98	2966
Total	227	**50895.83**	**40251.91**	**10643.92**	**37802.27**	**10,710**

* in million Rupees ** in Number

Source: Department of Industry, 2020

Table 1 depicts the FDI approved industries

Figure 3: Foreign investment by category (FY 2019/20)



Source: Drawing from Table 1

Number of Industries Approved for Foreign Investment by Scale Wise

It divides into three based on the FDI category of industries. The highest number of small and medium scale industry now appears in the table is 154 while the smallest 9 large scale industries have been established. Also, investment is highest in small and medium industries and lowest in large scale industries. Similarly, employment opportunities are also seen in small and medium enterprises while the number of employment in large scale industries is also low.

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Table 2: Industries approved for foreign investment by scale (FY 2019/20) *(Rs. in million)*

Scale	No. of Projects	Total Project Cost*	Total Fixed Cost*	Total Working Capital*	Total Foreign Investment*	Employment**
Large	9	19252.06	18654.49	597.57	7806.23	258
Medium	64	13613.39	12129.37	1484.02	13187.27	3909
Small	154	18081.38	9498.55	8582.83	16859.77	6 543
Total	**227**	**50946.83**	**40282.41**	**10,664.42**	**37853.27**	**10,710**

Source: Department of Industry, 2020

Country-wise Flow of FDI in Nepal

The table does not show this FDI received from all over the country. But only FDI from major countries is shown. Most of the 176 industries are operating under China while only one industry is operating under FDI by four countries. The highest FDI amount is Rs 25,582.65 million from China while the lowest amount is from Hong Kong Rs 50 million. The highest number of employment is seen in FDI from China and the lowest is zero in the United Arab Emirates.

Table 3: Industries approved for foreign investment by country-wise (FY 2019/20)

(Rs. in million)

SN	Country Name	No. of Projects	Total Project Cost	Total Fixed Cost	Total Working Capital	Total Amount of Foreign Investment	No. of Employment
1	Australia	2	100	89	11	100	181
2	Bangladesh	2	200	169	31	200	63
3	Canada	1	500	333.9	166.1	500	70
4	China	176	25900.70	19914.24	5986.46	25582.65	8946
5	Hong Kong	1	50	35	15	50	35
6	France	2	250	237	13	250	72
7	India	19	10867.47	6780.96	4086.51	3897.09	561
8	Japan	3	200	139.5	60.5	151	161
9	Malaysia	2	89	61	28	80.01	56
10	Pakistan	2	100	68	32	100	105
11	Poland	1	150	140	10	150	35
12	Singapore	1	50	30	20	50	25
13	South Korea	3	260	225.4	34.6	250	79
14	Netherlands	2	56.48	26.23	30.26	56.48	35

15	UK	4	6664.32	6468.24	196.08	1926.59	41
16	UAE	2	1124.89	1108.64	16.25	480.5	0
17	USA	4	4583.97	4534.31	49.66	4228.94	268
Total		**227**	**50946.83**	**40282.41**	**10664.42**	**37853.27**	**10710**

Source: Department of Industry, 2020

Trends Line of Overall FDI

In bid to fit the future trend of the overall FDI, the following model has been applied:

$$FDIt = \beta_0 + \beta_1 Tt$$

Where, FDIt = overall FDI in million, Tt =Time period 0, 1, 2, 3………, 29, $\beta 0$ and $\beta 1$= parameters.

Table 3: Regression analysis of FDI

Regression Statistics					
Multiple R	R Square		Adjusted R Square	Standard Error	Observations
0.693886498	0.481478473		0.462959847	12012.47839	30
	df	SS	MS	F	Significance F
Regression	1	3751745350	3.75E+09	25.99969	2.11577E-05
Residual	28	4040389841	1.44E+08		
Total	29	7792135191			
	Coefficients	Standard Error	t Stat	P-value	Lower 95%
Intercept	-2580096.818	508170.5354	-5.07723	2.25E-05	-3621036.972
Fiscal Year	1292.01283	253.3860896	5.098989	2.12E-05	772.9749542

With the help of Microsoft Excel, the normal equation is:

$$FDIt = -2500096.81 + 1292.01Tt + \varepsilon$$

This fitted line shows that the overall FDIt has an upward trends and it has annually grown by 1292.01 million rupees during the study period. The regression line predicts that in the F/Y 2021/22 (Tt = 30) overall FDIt will be Rs. 29769.09 million. However the parameter of the equation is statistically significant at 5% level of significance. From the regression statistics P value is the 2.11577E-05, this means P value is almost zero which is less than the 0.05, hence, the equation is statistically significant. R^2 and adjusted R^2 are 0.4814 and 0.4629; this prediction has around 50% significance in practical terms. This prediction line is in the figure no 4.

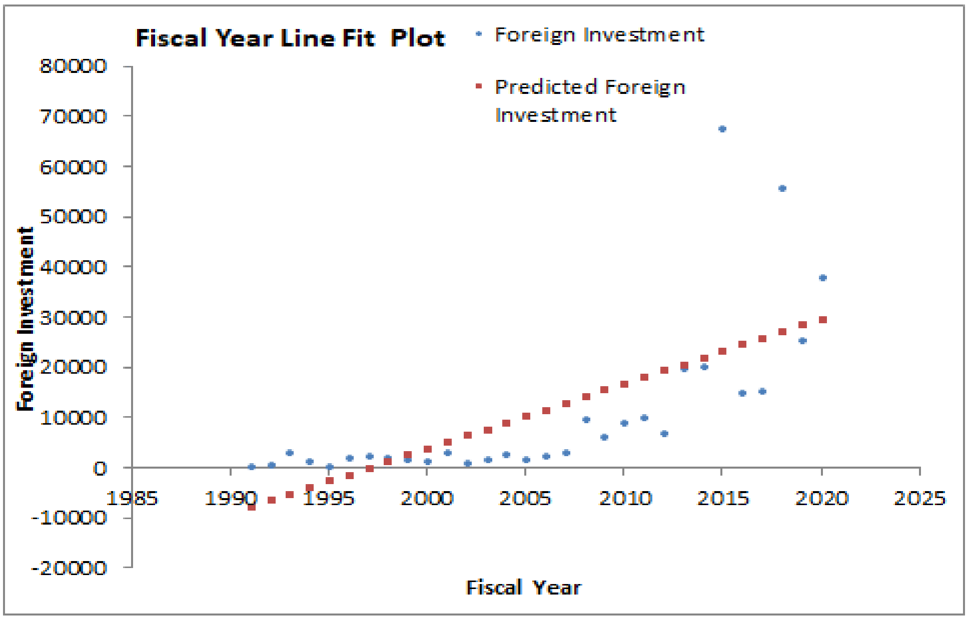


Figure 4: Prediction line of FDI

Trend Line of FDI with lag 1:

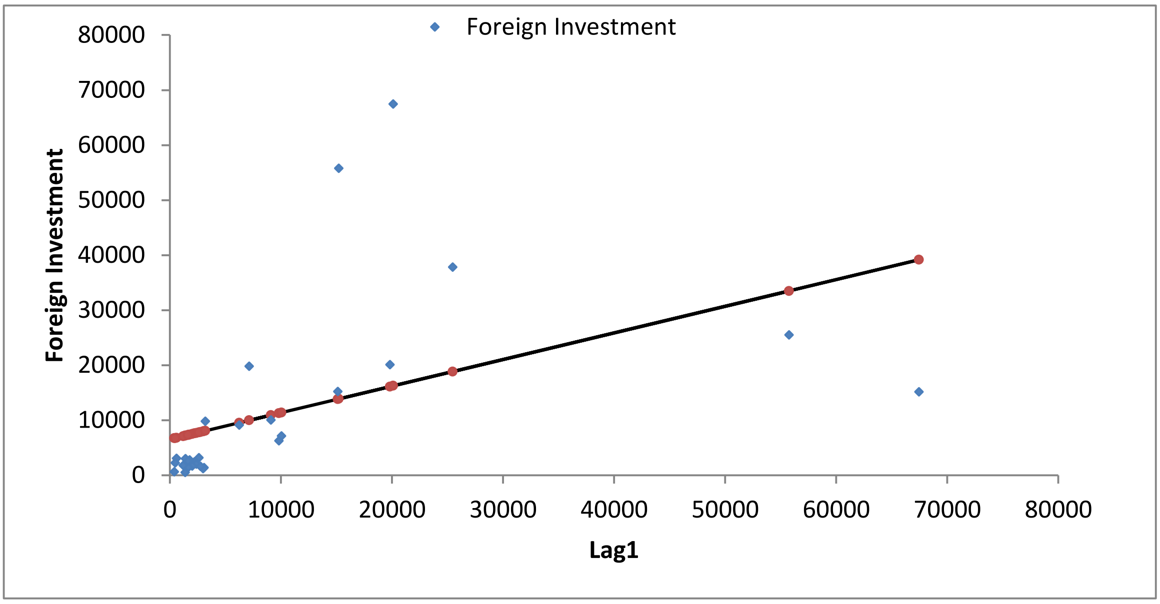
Regression Statistics					
Multiple R		R Square	Adjusted R Square	Standard Error	Observations
0.463325679		0.214670685	0.185584414	14941.38677	29
	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	1647655882	1647655882	7.380481525	0.011364892
Residual	27	6027616041	223245038.6		
Total	28	7675271923			
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*
Intercept	6513.158586	3306.918173	1.969555413	0.059228532	-272.0770361
Lag1	0.48350049	0.177973184	2.716704166	0.011364892	0.11832968

With the help of Microsoft Excel, the normal equation is:

$$FDIt = 6513.158 + \beta 10.48350$$

This fitted line shows that the overall FDIt has an upward trends and it has annually grown by 0.48350 million rupees during the study period. The parameter of the equation is statistically significant at 5% level of significance. From the regression statistics P value is the 0.001, this means P value is less than the 0.05, hence, the equation is statistically significant. R^2 and adjusted

R^2 are 0.2146 and 0.1855; this prediction has only 21% significance in practical terms. This prediction line is in the figure 5.



Figure

Trend Line of Employment

In bid to fit the future trend of the employment, the following model has been applied:

$$EMPt = \beta_0+\beta_1 FDIt + \varepsilon$$

Where, EMPt = employment of certain time period, FDIt = Foreign Direct Investment of the certain time period 0,1,2,3………,29, β_0 and β_1= parameters.

Table 3: Regression analysis of employment

Regression Statistics					
Multiple R	R Square	Adjusted R Square	Standard Error		Observations
0.631524226	0.398822848	0.377352236	3271.961913		30
	df	SS	MS	F	Significance F
Regression	1	198862124.6	198862124.6	18.5752897	0.000182144
Residual	28	299760573.2	10705734.76		

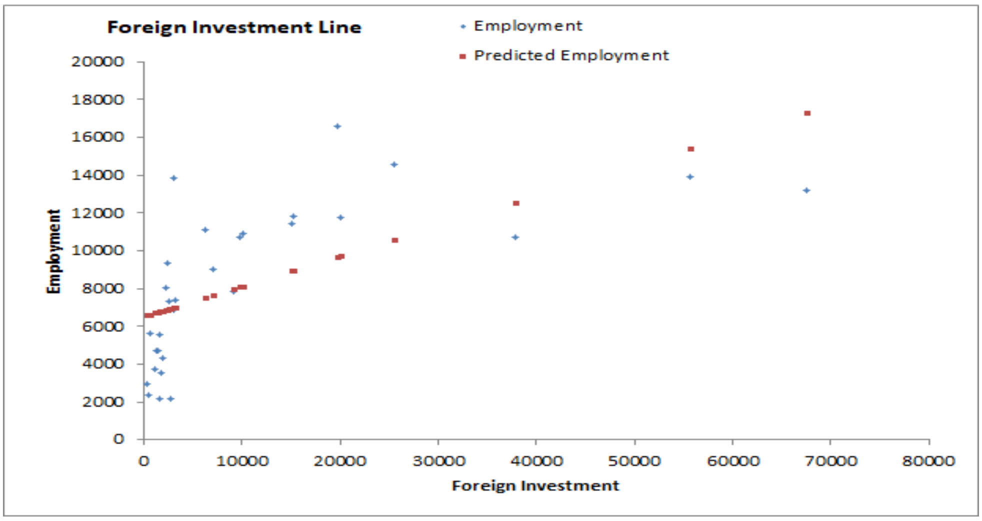
Total	29	498622697.9			
	Coefficients	Standard Error	t Stat	P-value	Lower 95%
Intercept	6515.877953	723.9879362	8.999981391	9.33982E-10	5032.855894
Foreign Investment	0.15975255	0.037066365	4.309905997	0.000182144	0.083825542

With the help of Microsoft Excel, the normal equation is:

$$EMPt = 6515.87 + 0.15975\ FDIt + \varepsilon$$

This fitted line shows that the EMPt has an upward trends and it has annually grown by 0.1597 during the study period. The regression line predicts that in the F/Y 2021/22 (FDIt = 30) EMPt will be 17295 employed. However the parameter of the equation is statistically significant at 5% level of significance. From the regression statistics P value is the 0.000182144, this means P value is almost zero which is less than the 0.05, hence, the equation is statistically significant. R^2 and adjusted R^2 are 0.3988 and 0.3773; this prediction has around 40% significance in practical terms. This prediction line is in the figure no 5.

Figure 5: Prediction line of employment



Conclusions

For the 30-year research period, total FDI is 331047.37 million. In 2014/15, the highest amount of foreign direct investment (FDI) was 67480.04 million, while the lowest was 406.28 million in 1990/91. The maximum number of employees employed in 2018/19 was 14544, while the lowest number in 2003/04 was 2154. Tourism receives the most funding, totaling 11572.98 million, while agriculture receives the least funding, totaling 447.40 million. With Rs 25,582.65 million in FDI, China has the most, while Hong Kong has the least. China's FDI provides the most employment, whereas the United Arab Emirates' FDI creates none. Large-scale enterprises receive the least investment, whereas small and medium-sized businesses receive the most.

China controls the bulk of the 176 industries, with just one industry managed by four nations through FDI. China receives the most FDI, at Rs 25,582.65 million, while Hong Kong receives the least, worth Rs 50 million. China's FDI provides the most employment, whereas the United Arab Emirates' FDI creates none. Over the research period, the overall FDI trend has been favorable, with yearly increase of 1292.01 million rupees. Overall FD in F/Y 2021/22 (Tt = 30) is expected to be Rs. 29769.09 million, up Rs. 1292 million rupees over the previous year, according to the regression line.

Over the last two to three decades, foreign direct investment (FDI) has been more important as a source of capital, technology, skills, and capacity. Economic development is critical for all countries, but it is especially critical for post-conflict countries like Nepal. Development aid alone will not be enough to rebuild a post-conflict economy, but FDI may help revive industry and restore infrastructure. During the present global recession, the country must remain attractive to FDI, particularly for investment that would help it achieve its long-term development goals. Maintaining existing investment is also crucial, especially given the present deteriorating security environment, which may encourage MNCs to shut or shift foreign affiliates to safer locations.

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