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Original Article

Foreign Direct Investment in Nepal



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Abstract

This article is about the relationship between Foreign Direct Investment (FDI) and Gross Domestic Product (GDP). It explores the FDI's linkage with the national income. The data for the study comprised different factors that have a direct linkage with the national economy and its impact. This article is based on the FDI in various sectors in terms of the number of projects, employment created, and the amount invested. It is based on secondary data. The study revealed that FDI sometimes has an independent influence on the economy of the country. A fresh finding of this article is that the contribution of FDI in capital formation and employment is not significant in the Nepalese economy, eventually making less contribution to the GDP of the Nepalese economy. It also revealed that 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.

Keywords: Foreign Direct Investment; Gross Domestic Product; Economy; Nepal

Introduction

Foreign Direct Investment (FDI) is the net inflows of the investment in a country, which is widely believed to have positive effects in the economy of a country. Any investment that flows from one country into another is known as foreign investment. As such, foreign investment is “encouraged since it complements and stimulates domestic investments in capital scarce economies of developing countries” (Cristina & Leveige, 2013, para. 3). The

combination of many involved variables determines the analysis of the economic growth of a country according to their contribution to the growth rate of Gross Domestic Product (GDP). FDI serves as a catalyst for development in an open, integrated economic system of a country (Organisation for Economic Co-operation and Development [OECD], 2002).

FDI has been one of the important features of the country's development. In developing countries, FDI has a

significant contribution to economic growth (Nair-Reichert & Weinhold, 2001). The impact of the FDI in the developing countries has been well documented as an integral part of the modernization, economic growth, industrial development.

FDI is considered as a source of capital formation. In the context of developing countries, it is directly linked with the overall development of the nation through economic growth. FDI has come as economic source of development and modernization for economy and employment in the developing countries (OECD, 2002).

Table 1: FDI Flows by Region (in US\$ Billions)

Year	2016	2017	2018
World	1918.68	1497.37	1297.15
Developed countries	1197.73	759.26	556.89
Developing countries	656.29	690.58	706.04
Asia	473.33	492.71	511.71
South Asia	54.22	52.34	54.20

(Source: UNCTAD, 2019, as cited in Nepal Rastra Bank, 2019, p. 6)

Nepal is one of the liberalized countries in the South Asian region. However, growth performance has been very poor in recent years. In this context, a closer examination of the linkages between

foreign direct investment and economic development is critically important from a policy point of view (Johnson, 2006). Nepal, being a least developed country, one-quarter of the total population are under the poverty line (Ranjit, 2016) definitely needs FDI as the growth-enhancing factor. Agriculture is the mainstay of the economy, providing a livelihood for three-fourths of the population and accounting for a little over one-third of the gross domestic product (GDP) which is one of the primary indicators used to gauge the health of a country's economy (Shrestha, 2003).

FDI is seen low while compared to other developing countries (Phuyal & Sunuwar, 2018). The potential and major markets of FDI in Nepal are because of the cheap labour, utilization of natural resources and the favourable climate necessary for the development (Bhattarai, 2009). Many studies are done in the FDI and its relation with the nation's development, but what is the direct impact or the significance of FDI is still worthy of declaring.

The purpose of this study is to analyse the present situation of Foreign Direct Investment (FDI) in Nepal and to suggest the measures to attract FDI

within the country. In addition to this, the paper aims to review the implementation status of the policies in this field.

Insights From Literature

The literature is critically reviewed on the established knowledge on the contribution of FDI on GDP related several studies from several aspects. It also explores the themes, empirical studies, methodologies and policy documents around the subject of FDI and its relationship with GDP.

Foreign Direct Investment

OECD (2002) defines FDI as “Foreign direct investment (FDI) is an integral part of an open and effective international economic system and a major catalyst to development” (p. 3). This shows that FDI is an important element in the present context. It is taken as a source of capital formation of a nation, which has mainly three common motives of foreign direct investment: resource-seeking, market seeking and efficiency-seeking (Dunning, 1993).

FDI is taken as a source of economic development and modernization, income growth and employment

(OECD, 2002). FDI is often seen as an important contribution for economic growth, and some development economists have long argued that countries pursuing outward-oriented development strategies are more likely to achieve higher rates of economic growth than those that are internally focused (Sethi & Sucharita, 2011). Bista (2017) highlights that the delivery reality of FDI, which is the reflection of FDI policy and expectation, is illustrated by FDI size, trend, and structure. Bista further explains, “three indicators explain whether economic liberalization and FDI policy can deliver policy thrust also explain whether the policy is effective to attract FDI as required and as expected, as well as where we are at the regional and international level” (pp. 34-35). Thus, FDI has great impact and influence in the overall development of the national economy and the development of the nation

Gross Domestic Product

Dynan and Sheynar (2018), defines GDP as, “GDP concept as a measure of aggregate economic well-being needs to recognize that many of the shortcomings are addressed by looking at measures that are already available as

part of the standard national income accounts” (p. 7). So it is the value of the goods and services produced and available within the country. The Bureau of Economic Analysis (BEA) gives a clear definition of GDP:

GDP is the value of the goods and services produced by the nation’s economy less the value of the goods and services used up in production. GDP is also equal to the sum of personal consumption expenditures, gross private domestic investment, net exports of goods and services, and government consumption expenditures and gross investment. (as cited in Dynan & Sheiner, 2018, p. 4)

GDP is about the measurement of the nation’s input and output for a given country’s economy at a given period. The definition of GDP is based on the total goods and services that are produced in a country within the given year and its total calculation in the market value (Abbas et al., 2011). The evaluation process also involves the sum of value added at every stage of production (the intermediate stages) of all final commodities (goods and services) produced within a country in a given period monetarily (Kira, 2013).

This GDP is one of the major element and determinants of the national economic growth

Empirical Review

Falki (2009) has done a study on the impact of foreign direct investment. The study has provided several variables like domestic capital, foreign-owned capital and labour force of the country as the major. The study was done with the help of regression analysis, and the endogenous growth theory was applied. The major findings of the study are, there is a negative statically insignificant relationship between GDP and FDI inflows.

Adam and Tweneboah (2009) examined the Foreign Direct Investment and Stock Market Development in Ghana. This study shows that FDI has a significant influence on the development of the country. There is a long-run relationship between the FDI and the exchange rate with the stock exchange of the country.

The study by Hoang, Wiboonchutikula and Tubtimtong showed that there is a strong impact of FDI on economic growth in Vietnam. The main findings of the study are there is a significant effect in the financial market, capacity,

human capital and the technology of the foreign direct investment in the country.

Aizhan and Makaevna (2011) explored the “Impact of Foreign Direct Investment on Economic Growth in Kazakhstan” to show the role played by FDI in Kazakhstan economic growth and its future prospects. Within Central Asia and CIS countries, Kazakhstan is one of the rapidly growing and one of the most FDI attractive countries which attracted 58 percent of all FDI to land-locked developing countries in 2009. According to UNCTAD, Kazakhstan is FDI attractive. Meanwhile, it has a high dependence on the energy sector. Being highly dependent on energy sector can bring negative impact on the economy of Kazakhstan. They suggested that it could be better to direct FDI to other sectors to assure long time growth.

In a study done by Pyakurel (2018), on foreign direct investment, FDI in the context of Nepal has several location factors like cost, market, infrastructure, technological, political, legal and socio-cultural factors. The main objective was to assess volume and status of FDI (i.e. sector-wise, country wise and district wise) and to analyze contributions of FDI on employment generations through the secondary data followed by

descriptive/explanatory research approach. The findings were that the country owns its unique advantages and opportunities of FDI are useful for a country’s prosperity.

In a study on Economic liberalization in Nepal by Bista (2005), the relationship between FDI and GDP was examined. Multiple regression model, following the econometric model, was used to analyze the data. The major findings are there is a positive relationship between the FDI and GDP. The major determinants of the FDI are FDI stock, GDP, Policy environment and security. This shows that FDI is the potential resource which can contribute to the GDP with the help of industrial growth in the nation.

In a survey done by Nepal Rastra Bank (2018) on Foreign Direct Investment in Nepal, it shows that the FDI inflows are low while compared to the neighbouring countries. Compared to the other sectors, the service sector is seen receiving the major share of the FDI. The second one is the industry, and the third one is the agricultural sector. Within the service sector, transport, storage and communication receive a higher amount of the share. This shows that the major attraction of

FDI is in the service sector. The study has shown that 39 countries have invested in 252 firms where India is the top investor in terms of paid-up capital.

The above literature shows that there are higher chances of FDI in the context of developing countries like Nepal. The relation between the FDI and the GDP is also seen positive as there are some hindrances in the implementation. If the FDI friendly acts are implemented, and the conducive environment is made, then FDI can be a good resource for the development of the nation.

Policies and Plans Related to FDI

There are some policies related to FDI. Nepal Rastra Bank (2019) has focused on different policies related to FDI in Nepal. The legal arrangements that govern FDI in Nepal include Foreign Investment and Technology Transfer Act (FITTA), 1992, Foreign Exchange (Regulation) Act, 1962, Investment Board Act, 2010 and Industrial Enterprises Act, 2016, Company Act, 2017, Contract Act, 2000, Arbitration Act, 1999, Income Tax Act, 2002, Labor Act, 2017, and Privatization Act, 1992. The major acts have tried to make the investment-friendly environment in

the country. Though the acts are developed, and many changes are made in the investment sector, the major problem is the implementation of the acts, which has a direct impact on the investment.

The apex body to address the proposal for foreign direct investment is investment Board, which is chaired by the Prime minister. Similarly, there is an Industrial Promotion Board that is chaired by the minister for industry, Commerce and Supplies and represented by the different government as well as private agencies. Ministry of Industry, Commerce and Supplies and Department of Industry are there to deal with it. Besides these, we have Office of Company Registrar, Nepal Rastra Bank, Department of Labour, Department of Immigration, which are responsible for providing services for investors.

The Government of Nepal has introduced new Foreign Investment Policy, 2015 by replacing the policy of 1992 to make the economy more dynamic and competitive by maintaining trade balance through export promotion and import management, and by attracting foreign investment, technology, skills and

knowledge in the priority sectors NRB, 2018).

We have Industrial Policy 2010 and Foreign investment policy 2015 to address the issues from the policy perspective. Similarly, there is the Industrial Enterprise Act, 2016 and FTFTA 1992. The new Foreign Investment Bill is under discussion in the parliament now. There is patent, Design and Trademark Act 1965, which is the older one. We have company Act 2006, which deals with the company registration for foreign investment. Lastly, there is investment Board Act 2011. This act describes the structure of the Investment Board as well as provides the jurisdiction of the Board. The scope of the Board is fast track road, tunnel, railway, trolley bus, airports, urban waste management, chemical fertilizer, petroleum refinery, construction of big bridge specified by the government of Nepal, bank and financial institution, hydropower project above 500 MW.

The FITTA 1992 has enlisted several areas where foreign investment is prohibited. These are:

- Micro and cottage industries
- Arms and ammunition
- Minting and security printing

- Real estate
 - Multi-brand retail business with fixed investment less than 500 million rupees.
 - Tourist, Trekking, Mountaineering guides, porter
 - Poultry, fisheries, apiary and primary agro products
 - Radioactive materials
 - Mass communication media (Radio, TV, Newspaper)
- (Government of Nepal, 2018)

The foreign investment policy defines foreign investment. According to the policy, foreign investment is:

- Share investment in the form of a foreign currency or capitalised assets / re-investment from the earnings from thereof
- Loan in the form of a foreign currency or capitalised asset
- Machineries, equipment on lease finance
- Foreign currency raised by the Nepali companies Issuing Bond and debenture in other countries, with the prior approval of NRB
- Investment by the foreign Institutions in the listed companies in the secondary market

Similarly, technology transfer is also regarded as foreign investment. Within this:

- Technological right, specialization, formula, process, patent or technical know-how of foreign origin
- Trademark of foreign ownership
- Foreign technical, consultancy, management and marketing service
- Assignment, User's License, Technical Knowhow sharing, Franchising could be the medium for TT.

The facilities offered for foreign investment are:

- 100% tax rebate for a certain period - hydro, manufacturing industry, mine based, tourism, infrastructure
- Cash incentive for tax fees on construction materials for electricity and infrastructure projects
- Tax rebates on re-investment
- Minimized custom duty on import of machine as equity

- Rebate on custom duty on hydro equipment and machinery.

The policy offers a tax rebate on R&D investment. There is the offer of cash incentive on the export item with value addition at least 50%. The policy has guaranteed 100% repatriation of profit from foreign investment.

Later on, FITTA has been effective. It has also highlighted the industry registration and provide the related services to the customers (Government of Nepal, 2018). Also, it has the provision of investment and loan approval, too, including the work permit for the use of the labour. For the establishment of the industry, the Environment Impact Assessment is necessary, and approval is mandatory. Different focal points, quality measurement and control for the products of the industry are also other necessary things for the establishment of the industry.

Forms of Foreign Investment

Table 2: Forms of Foreign Investment

Foreign Capital Investment Technology Transfer	Foreign Capital Investment Technology Transfer
<ul style="list-style-type: none"> • Share investment in the form of foreign currencies or capital assets and reinvestment of its earning • Loan to the industry in the form of foreign currencies or foreign assets • Lease financing provided by a foreign investor in the form of equipment tools, machines etc. • Fund raised by the company, established in Nepal, issuing equity, debt and debenture abroad • Investment in the listed securities in the secondary market by foreign institutional investors 	<ul style="list-style-type: none"> • Use of intellectual property rights such as patent, specification, formula, process and technical knowledge, • Foreign-owned trademark or goodwill • Foreign technical services, assistance, training, management services and market services.

(GoN, 2015, as cited in NRB, 2018, p. 10)

Methodology

This study is based on the secondary data and the desk - analysis of the data is done. This analytical study is based on the data from the Ministry of Industry related to foreign direct investment. The secondary data includes the articles, books, published in different mediums and acts, policies are reviewed. The data were collected, and statistical analysis with the help of different diagrams was done. The collected data were analysed based on the policies and practices.

FDI in the Last Decade

The table below shows the number of the total as well as yearly projects from FY 2066/67 to 2075/76. It shows the total project cost, total amount realized and the number of employment.

FDI in Nepal

The below charts is about the total number of the project, total project cost, the total amount of foreign direct investment and the number of employment through FDI from the fiscal year 2066/67 to 2075/76.

Table 3: FDI in Nepal

Fiscal year	No. of projects	Total project cost	Total amount of foreign investment	No. of employment
		(Rs. in million)	(Rs. in million)	
2066/67	171	13,954	9,100	7,848
2067/68	210	11,253	10,053	10,902
2068/69	226	11,910	7,138	9,035
2069/70	317	51,991	19,819	16,569
2070/71	307	40,737	20,132	11,790
2071/72	370	81,371	67,455	13,167
2072/73	348	20,544	15,254	11,663
2073/74	400	17,124	15,206	11,842
2074/75	399	61,349	55,760	13,940
2075/76	343	29,462	24,999	14,544

(Source: Ministry of Industry, 2020, p. 105)

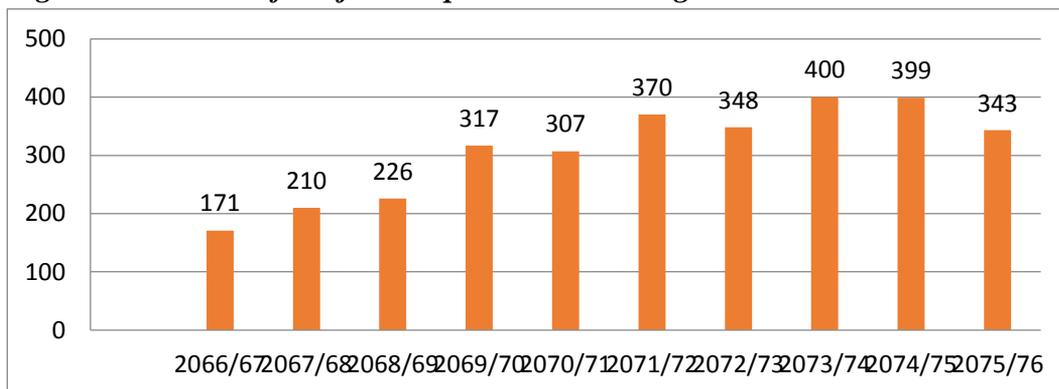
The diagram below shows the yearly distribution of projects. From 2066/67 to 2075/76, the status shows that the projects are increasing and the amount invested is also increased. But in

2068/69 it was decreased gradually. The people involved in the job market in response to FDI are also increased. This shows that FDI has created employment for the people.

Number of Projects

Figure 1 shows that the total number of projects implemented through FDI.

Figure 1: Number of Projects Implemented Through FDI

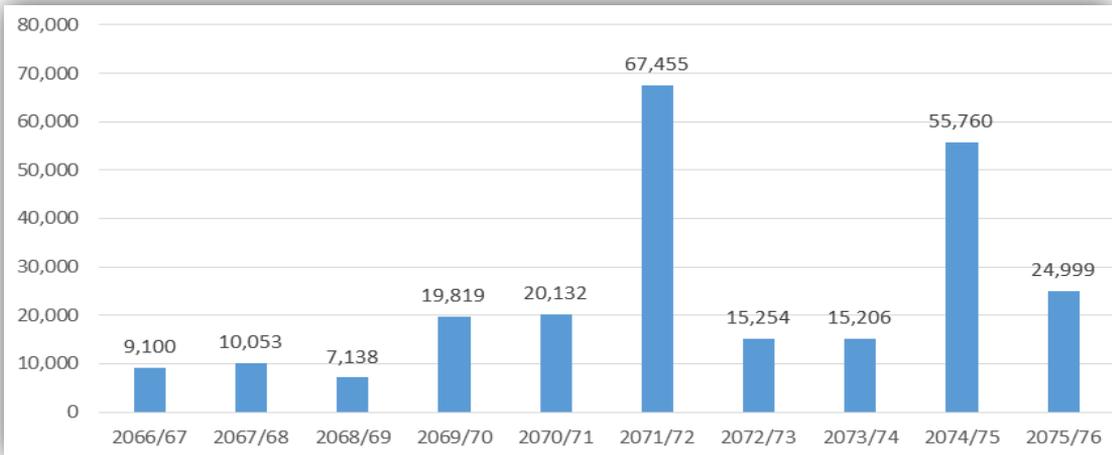


(Source: Ministry of Industry, 2020, p. 105)

The diagram below shows the total amount of foreign investment (Rs. In million). The ten years analysis in the number of the projects through FDI are

presented in the chart. The number was 400 in the year 2073/74 but decreased in the year 2074/75 and 2075/76.

Figure 2: Total Amount of Foreign Investment in Nepal (Rs. in million)



(Source: Ministry of Industry, 2020, p. 105)

The above chart shows that the total amount of investment in the last 10 years in Nepal. The amount of

distribution in the years is uneven. The fluctuating status of the investment is seen in different years.

Top Six Foreign Investment Countries Till 2076-03-31

Table 4: Top Six Foreign Investment Countries

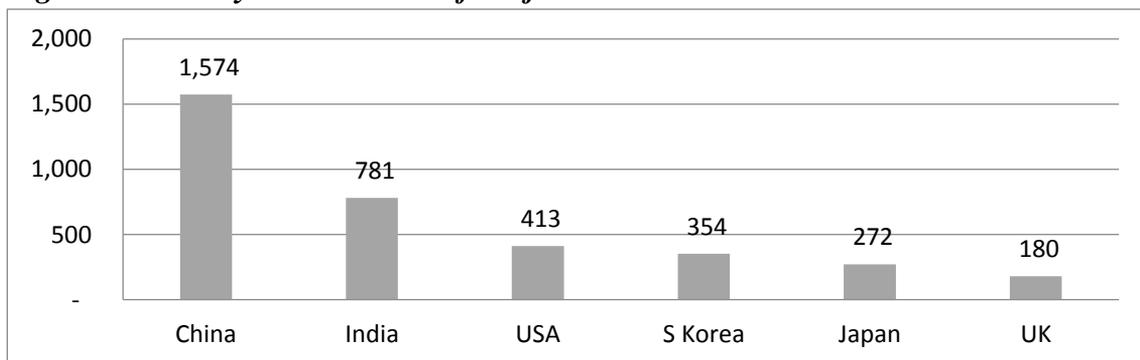
SN	Country	No. of Project	Total Project Cost (NRs. In Million)	Total Amount of Foreign Investment (NRs. In Million)
1	China	1,574	166,351	126,064
2	India	781	146,897	94,111
3	USA	413	22,155	9,063
4	S Korea	354	17,487	12,324
5	Japan	272	7,567	3,076
6	UK	180	9,104	5,485

(Source: Department of Industry, 2019, p. 100)

The above table is about the top six countries investing higher amount. China comes in the first position while we distribute it country-wise. China has

invested in 1574 projects whereas UK is the sixth one with investment in 180 projects.

Figure 4: Country-wise Number of Projects

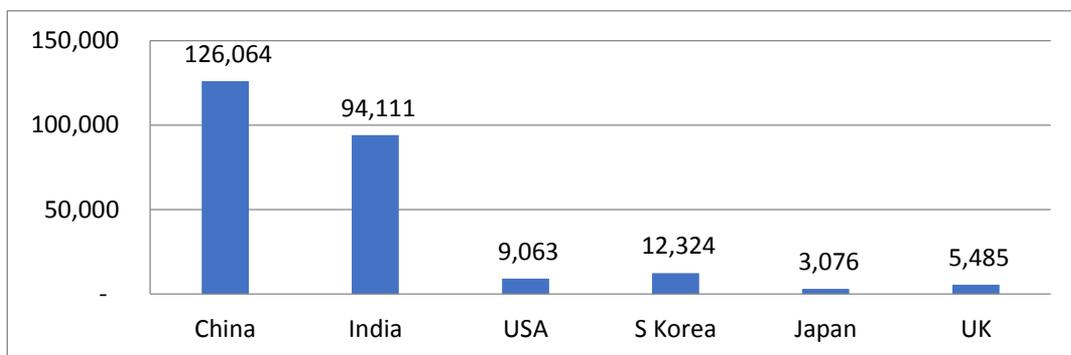


(Source: Department of Industry, 2019, p. 101)

The above chart is about the country-wise distribution of the projects where China is the top country in the

investment according to the number of projects.

Figure 5: Total Amount of Foreign Investment (NRs. In Million)



(Source: Department of Industry, 2019, p. 101)

The above chart is about the country-wise distribution of the projects where

China is the top country in foreign investment.

Sector-wise Foreign Investment Projects

The government of Nepal has classified the industries in eight categories, and

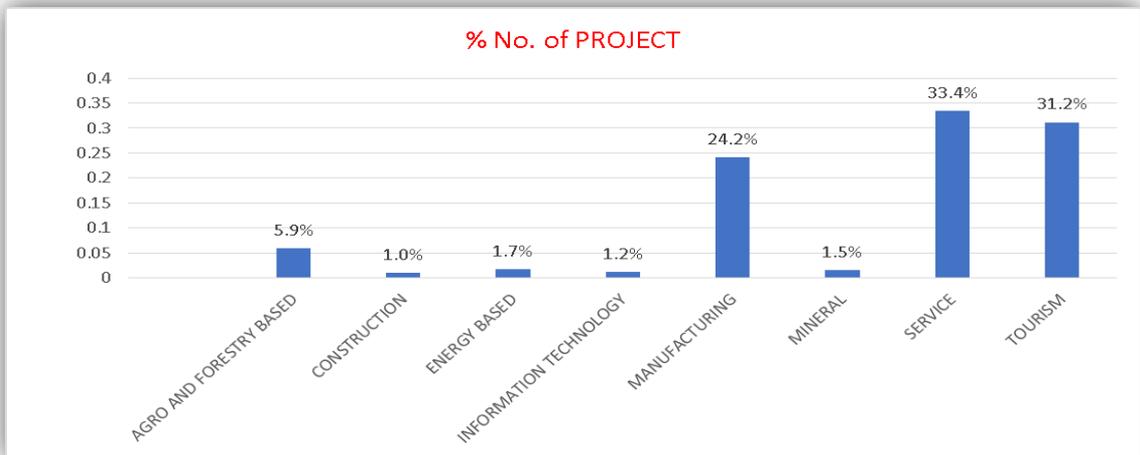
the table below shows the category-wise number of projects, their cost and number of employment generated from the beginning to 2076.

Table 5: Category-wise Projects, Cost and Generated Employment

Category	No. Of projects	Total project cost (Rs. in million)	Total amount of foreign investment (Rs. in million)	No. Of employment
Agro and forestry based	284	8,315	6,612	10,199
Construction	46	3,842	2,983	3,226
Energy based	81	191,467	123,823	11,595
Information technology	59	1,561	1,281	2,257
Manufacturing	1,167	113,568	54,628	101,795
Mineral	72	10,367	7,981	8,786
Service	1,610	78,056	54,985	67,376
Tourism	1,503	59,531	41,413	52,891
Total	4,822	466,708	293,707	258,125

(Source: Department of Industry, 2019, p. 92)

Figure 6: Sector-wise Number of projects

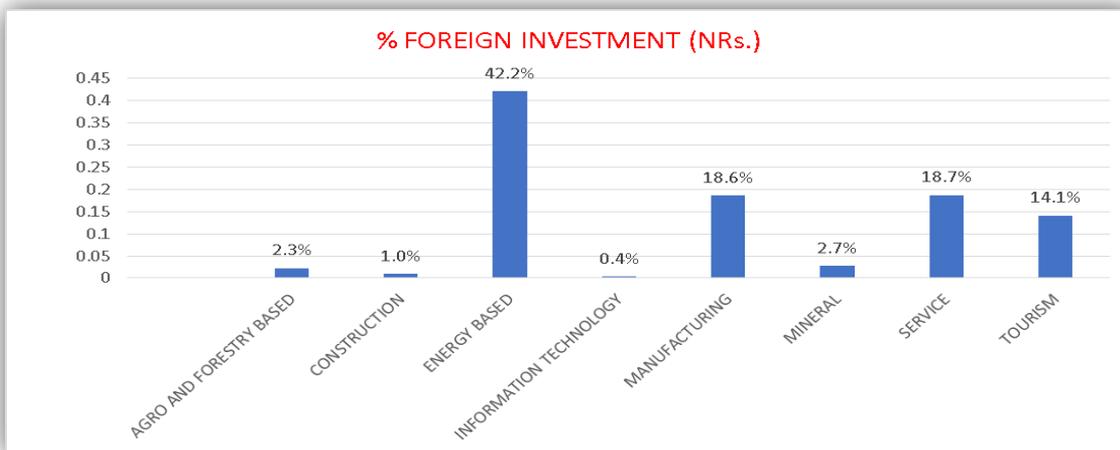


(Source: Department of Industry, 2019, p. 92)

The above chart shows the category wise bar diagram of foreign investment. And, it shows the percentage of foreign

investment in NRs. The service sector has the highest projects where construction has the lowest.

Figure 7: Percentage of Foreign Investment



(Source: Department of Industry, 2019, p. 92)

The above chart shows the total percentage of foreign direct investment in Nepal according to different sectors. 42.2% of investment is done in energy-based investment which is the highest one, whereas 0.4% is invested in information technology, which is the lowest one. Priority and investment are uneven.

Discussion

Nepal has highlighted the policies related to foreign direct investment. Though foreign investment has always been in priority, this remains only in

paper. The investment is seen in the major areas, but what about the impact on those investments and what are the benefits to the country from those investments are not highlighted in regards to the policies. The higher level of investment is seen in the energy sector, but what has its influence and what benefits the people engaged in that sector are getting is still lacking.

FDI is an important source for the economic growth of developing countries. KC (2011) highlights that FDI is the source of growth having a higher number of resources but weak in

finance, technology and the competencies in management. FDI also helps to introduce new skills, technology and the new knowledge being competitive in the global world. This has a direct impact on creating job opportunities (Fortanier & Van Wijk, 2010) and increases the GDP of the nation.

The investment is seen in different sectors. Still, more investment can be emphasised, making the conducive environment to work with (Wells & Allen, 2001). Authokorala and Sharma (2004) focus on the favourable investment environment exists, what are the characteristics that determine a country's comparative advantage in international production.

If we see the number of projects in Nepal, the total number is increasing day by day, and the employment generation is created too many people. Still, the impact of the project in the context of the local need should be analysed; this finally stimulates and encourages domestic investment of the country (Cristina & Leveigue, 2013). This drives the necessity of FDI in the future context, too (Ranjit, 2016).

The highest number of projects and the highest number of investment is seen from China in the investment. Increasing the number of projects and the number of the amount is increasing year by year. The projects are increased, and the income has been invested in different areas which seems constant inflows of FDI among developing countries (Adhikari, 2013).

The highest number of projects is seen in the energy-based, manufacturing, service and tourism sector. These are the major areas highlighted by the government of Nepal too. So investment in Nepal seems that Nepal's investment policy is attracting the investors in different sectors (Department of Industry, 2005, 2016). Though the investment is in various sectors, still the government prioritizing the sectors that are fruitful to the country are lacking.

FDI is also a challenge in its implementation. Gurung (2010) agrees that the major problems are on the lack of direct access to the seaports, and transportation is difficult. Also, there are unclear rules regarding labour relations. In this regard, KC (2011) also signifies that there is a political risk as well, and the nations risk too. Tax policies, trade barriers and the

government regulations will set the strategic and long term problem in the investment where global competitors need to be defended.

Nepal's FDI potential is heavily under-exploited, although the country offers a huge potential not only for market seeking investors but also resource seeking ones. There are several opportunities and chances for creating the investment-friendly environment, but the implementation is very weak. There are several hindrances in the implementation, and the approval process, registration and other process need a lengthy process. After establishment, the investors are working more in the service sector where other sectors that have the highest products are missing.

Conclusion

Foreign investment is inevitable in the present context. This is the phenomenon of globalization as well. It helps to fulfil the gap of investment and boost the economy strongly. So, Nepal also needs to make pragmatic policies, and implement other reforms to attract big investment. It is found that the development of infrastructures leads to increment in export. Hence, the

Government should focus on to keep developing transport and road facilities to bring a balance of trade between export and import.

Furthermore, the development of Human capital leads to economic growth. So the country must concentrate heavily on import substitution and in setting up and furtherance of export-oriented industries, which can be done through making the investment friendly and secure environment in the country. FDI is positively correlated with the economic development of the nation, which can be maintained through the favourable economic policy of the nation. The focus on attracting FDI will be necessary, not only to increase investment in the economy but also to maintain external stability.

Though foreign investment has always been in priority, this remains only in paper. Behind this, there are several reasons for it. Some recommendations are listed below:

1. We have a less friendly environment for the investment. The overall environment is not conducive. So if a friendly environment is created, then there would be a proper investment.

2. The policy has provisioned one door one window, one step policy but the reality in practice is different. Many doors and windows are there in practice. Focusing on the one door policy is the urgent need.
3. The current level of investment made on education should be maintained, and skill development trainings should be provided by mobilizing government resources as well as those of the private sector and donors.

Disclosure Statement

The author declares that no potential conflict of interest exists.

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