Case study of fdi practice in nepal

\n[toc title="Table of Contents"]\n

\n \t

\n[/toc]\n \n

Most Theorist advocate that Foreign Direct Investment (FDI) facilitate host countries by providing resources that they otherwise would not obtain, as far as FDI is efficiency seeking. Nepalese economy is a perfect example of poverty and stagnation which requires a big push, especially through FDI which acts as an important source of capital flow along with multiple benefits to host country in order to accelerate growth and combat poverty.()

Over past few decades, Nepal has adopted various policies and acts to attract capital flow to the country. Nepal has received FDI from various countries on various dates. However the volume of FDI flow is very small amount this is mainly due to the reason of political situation, in attractive policies, a lower growth rate of macro-economic indicators, the concentration of the government mainly on the economic development projects and fiscal policies. Poor monitoring mechanism, lack of promotional measures, ineffective institutional arrangements, inadequate infrastructure and skilled manpower, bureaucratic disturbances have further hindered the FDI inflow to Nepal. Hence, in order to accelerate the volume of FDI, the government needs to facilitate investment-friendly environment and develop attractive policies in the country.

Introduction

Most economist and developing practitioner assert that Foreign Direct Investment (FDI) facilitates countries by giving access to resources that they lack in acquiring them. For instance, foreign exchange that is necessary to buy capital goods either by exporting or by borrowing in international financial market.(through export or through borrowing) Secondly, (they also advocates that FDI boost economic growth of a country.)they also advocate that FDI encourages transfer of advance technology and knowledge and increases human capital stock from foreign investment to host countries. According to this view, foreign firms are demonstrating new technologies, providing technological assistance to their local suppliers and customers, and are training workers who may subsequently work in domestic firms (Kokko, 1994). Furthermore, the technologies that these imported intermediate goods may contain could spill over into the domestic economy along the lines of the endogenous growth model of Bayoumi et al. (1999). (which facilitates domestic country enjoy technological and technical knowledge and employment opportunity which might create further endogenous growth .) Additionally, FDI might bring about(strong position in trade, develop linkages) export opportunities, develop linkages and even crowd in investment. Likewise, host country would also benefit as FDI allows the inflow of international capital and hence compensate the lack of domestic financial development which is the prerequisite for accelerating growth and industrialization(growth and development). Finally, the additional competition created by foreign firms might even result in domestic firms becoming more efficient and innovative. (fill the gap of insufficient domestic finance which are prerequisites for development and growth. Therefore, FDI flow also creates environment for domestic company to become efficient and innovative)

On the contrary, critics argue that FDI may discourage domestic firms by (creating intense competition in the host country)pushing them out of the market as they are technically advanced. FDI might also lead to less research and development and even take away scarce resources from home country. Additionally, FDI might destroy domestic upward and downward linkages or even bring their own linkage in host country. Finally, if foreign firm is market seeking, it might lead to negative balance of payment effects later on (Nunnenkamp and Spatz, 2003). For instance, the foreign company will try to repatriate (part of) its earnings later, the inflow of FDI will result in an outflow of profit incomes in their home country in the future. This constitutes a debit in the current account of the balance of payments; this might weaken the external position and might even lead to a deficit in the current account, making further inflows of foreign capital necessary and hence increase the risk of balance of payment crisis in future.(Lastly, foreign firm could also outflow profit to their home country, if the FDI is market seeking rather than profit seeking which could lead to negative balance of payment.)

Introduction of Nepal and its economic situation:

Nepal is a land locked country which is located between two economic giants of the world i. e. Tibet autonomous region of People’s Republic of China to the north and Republic of India to the east, west and south. Nepal is one of the poorest countries in the world(china to the north and India to the East, West and South). Currently, Nepalese economy is passing through a critical phase of (Nepal is experiencing a situation of poor economic growth and poverty) poverty and stagnation immersed by conflict. The analysis of key macroeconomics reveals true picture of its economy which shows that the per capita GDP is $ 320 (2006). Still 30. 85 percent(%) Nepalese live below poverty line. GDP growth account to 5. 3% in 2008 (see Figure1 in appendix), (share of revento in GDP is) revenue/ GDP was 15% (see Table1 in appendix), (share of) government expenditure/GDP was 20% (Figure2), and capital formation rose to 3. 18 in 2008/09. Export/GDP was 5. 2%, import/GDP was 31. 0% and trade deficit was negative by 19. 57% (Figure3) and even foreign exchange reserve was negative by 9. 5% (Economic Survey, 2009/10). Likewise domestic saving/GDP accounts to 9. 7% and investment/GDP account to 28% (Table2). Nepal is currently suffering from stagnation due to inadequate domestic resource which has consequently lead to it becoming a highly aid dependent country contributing to grants/GDP as 3. 6% and foreign loan/GDP as 1. 1% along with the domestic borrowing/GDP as 2. 7% (Table1). Agriculture, tourism and remittance are the main economic activity which contributes to 36%, 46% and 17% of GDP respectively. Industrial sector mainly involves the processing of agriculture product such as pulses, jute, sugarcane, tobacco and grains among others. Furthermore, Trade deficit of Nepal is mainly (largely backed)financed by export earnings, tourism income(earning), remittance, foreign aid (aid from abroad)etc. Nepal is a perfect example of poverty and stagnation which requires big push especially through FDI which is a more effective indicator of capital source and economic development then foreign aid, agriculture and remittance in order to accelerate long term economic growth, combat poverty and lower balance deficit. But FDI flow to Nepal is very low which accounts for just about 1% of GDP.

Trend and pattern of FDI in Nepal:

(FDI creates an opportunity to host country to access international market as well as facilitating modern technology and know-how, management skill , technical skill???, marketing skill and most importantly capital which most of the LDC lacks to make available). FDI facilitates access to the international market and develops the competitive trading culture in the economy along with the availability of capital, modern technology and know- how, management skill, technical skill, marketing skill to the host country. In order to gain these benefits, Nepal gradually opened its economy and started attracting FDI in the early 1980s?????. From 1980 – 1989, FDI inflow to Nepal were nominal which accounted for annual average of US$ 500, 000. At that time, Nepal recognized foreign capital, technology transfer as part of its strategy for industrial development(attracting foreign capital , technology had become the important strategy for economic development in Nepal.)(as it was a potential emerging economy). Nepal propagated its first industrial act in 1987(Government of Nepal, 1987) which provided legal frame work for many FDI in medium and large scale(size) ventures (firms)in all the industries except for those related with(except defense and environment related sector) defense and environment.

After 1990’s, FDI grew remarkably, mainly due to the fact that Nepal adopted various liberal trade policies to attract FDI in the country which encompassed the introduction of duty drawback schemes, tariff rate reductions, the adoption of a current account convertibility system and liberalization of the exchange rate regime(liberalization). In 1992, Nepal opted for new policies such as “ one window system”, Industrial Enterprise Act and Foreign Investment Technology Transfer Act. During 1990s, FDI grew strongly, accounting for an average US$ 11 million per annum during 1990-2000, summiting at US$ 23 million in 1997(UNCTAD, 2003b and 2006) . Nepal became member of World Trade Organization (WTO) in 2004. In 2010, Nepal endorsed new international “ industrial policy 2010” of “ No work No pay” in order to enhance the overall development of the industrial sector.

Despite adopting several liberalization policies of the foreign investment regime, reform and acts, the volume of(the amount of) FDI inflow to Nepal is(was) still very low and the lowest among the SAARC(South Asian Association for Regional Cooperation) member countries. Table 3 depicts inflow of FDI in Nepal from 2000 to 2008, whereby FDI contributed a mere US$ 995124 in 2008, which is even less than 1% in South Asia.

Nepal Industrial Statistics 2007/08 (Central Bureau Statistics, Nepal) shows 1, 423 firms operating as FDI from 139 countries which contributed 121, 484 employment opportunity to people in 2007/08. India being the prime investor in Nepal accounts for 393, followed by China 179, Japan 132, South Korea 94, UK 94, Germany 61 and Switzerland 27. According to the data from Department of the Industry (DOI), Tourism, Service and Manufacturing sectors has the highest number of FDI inflow to Nepal accounting to 30%, 27 % and 25% respectively followed by Agriculture, Construction, Energy and Mineral (Figure 4).

Importance of FDI in Nepal

Over the past few decades, FDI is identified as a prominent source of capital inflow and development in many developing economies, especially low income ones like Nepal. Nepal being a low income country with less resource endowment and a weak economic growth, FDI could provide a more stable source of external financing which could ultimately contribute to sustaining current account imbalances rather than foreign debt. FDI has the potential to improve the quality of growth as: (a) to reduce the volatility of capital flows and income, (b) to improve asset and income distribution at the time of privatization, (c) helps to improve social and environmental standards, and (d) helps to improve social safety nets and basic services for the poor.(?????) The source of domestic capital in Nepal is insignificant and hence it is insufficient for economic investment and growth whereas, foreign capital such as aid, remittance, debt and borrowing is inappropriate for long term growth. Therefore, FDI is an ambitious source of capital which not only facilitates capital flow but also contributes sustainable development in the country.

Is FDI a good substitution of domestic capital in Nepal?

FDI is an important source of financing for developing countries like Nepal as it helps to cover(which is a potential source to support) the ()current account deficit(which results from net import of consumption and investment good), fiscal deficit (lead to development of infrastructure and welfare and further reduce volume of aid and borrowing) and (. FDI also)even supplement inadequate domestic resources to finance both (to finance domestic investment)ownership change and(as well as) capital formation as long as FDI is efficiency seeking rather than market seeking. FDI further facilitates financing options in transferring technology and know- how, management and marketing skills , (capital formation)and helping local enterprise to expand (broaden their economy) into foreign market that Nepal would otherwise not obtain.

(FDI inflow also act as indirect source of financing infrastructure development and facilitates budget revenue constraints.)(?????)() There is a strong relation between FDI and other macroeconomic variables. Privatization related FDI inflows help to finance the fiscal deficit in countries where the need for large infrastructure spending and generous welfare programs are inconsistent with budget revenue constraints, including inefficient tax administration. Foreign capital inflows are also needed to cover often large current account deficits caused by the inflow of consumer and investment goods which are not produced domestically. Undeveloped financial sectors as well as a history of macroeconomic instability and high inflation contribute to a savings gap, with domestic savings lower than domestic investments, while obsolete capital needs to be replaced. FDI is not the only source of financing for either the fiscal deficit or the current account deficit, but stable long-term capital inflows in the form of FDI are preferable to short-term flows or debt financing to avoid an increase in macroeconomic instability. (Libor Krkoska, 2001). Hence FDI is not just only a substitute of domestic capital in host country but even can be considered as a complementing factor which enhances growth in least developed countries like Nepal.

Conclusion:

Nepalese economy is a classic example of poverty and stagnation which requires a big push, especially through FDI which acts as an important source of capital flow along with multiple benefits to host country in order ()to accelerate growth and combat poverty.

Nepal has adopted(several policies and act in order to a) various policies and acts to attract capital inflow to the country over time. There are various sources of capital flow such as FDI, portfolio investment and other investments. However, only FDI is taken as the indicator of capital flow in this study and despite various benefits of FDI, our main emphasis is in capital inflow in the domestic market. In the contest of FDI flow to Nepal by sector, manufacturing sector comprises the highest share in FDI, followed by service, hotel and restaurant and electricity sector respectively.

Over past few decades, Nepal has received FDIs from various countries on various dates. However, due to the economic and political situation, the amount of FDI in Nepal did not accelerate significantly according to the expectation. Therefore, Nepal needs to maintain sound workable business environment and develop attractive policies in order to boost capital inflow to the country.

Capital inflow also aids a country to maintain foreign reserves at a desired level while simultaneously also increases the Net Foreign Assets which might affect the monetary base, putting an upward pressure on money supply. Hence, monetary authority of Nepal has to sterilize the money supply pressure by using effective monetary tools.

FDI commitment has gone up by 236% in 2008 which account for NRS 9, 807 million compared to the record in 2007 , which was accounted for NRS 2, 920 million(US $1= NRS 65). Such increment of FDI has helped Nepal to maintain its foreign exchange reserve and money supply at a desired level. (Shrestha, M & Lim, C., 2009)

Nepal has been trying to attract capital inflow since past few decades by developing various attractive policies and acts. However, Nepal has to face several obstacles in attracting a desired level of capital flow because of major challenges such as an unstable political situation, a lower growth rate of macro-economic indicators, the concentration of the government mainly on the economic development projects and fiscal policies and similarly, the attention of the central bank mainly on managing financial and fiscal policies.

Poor monitoring mechanism, lack of promotional measures, ineffective institutional arrangements, inadequate infrastructure and skilled manpower, bureaucratic disturbances have further hindered the FDI inflow to Nepal. Hence, in order to accelerate the volume of FDI, the government needs to facilitate investment-friendly environment in the country(hence investment-friendly climate need to be maintained in order to attract sufficient amount of FDI in Nepal).() In order to provide better incentive to the investor,(FDI related effective policy, acts, rules and regulation effective institutions are needed to be developed.) policy consistency in FDI related acts, rules, regulations and directives are required to be enhanced.