ANALYSIS OF FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH IN NEPAL

A Thesis

Submitted to

the Central Department of Economics
the Faculty of Humanities and Social Science
Tribhuvan University, Kirtipur, Kathamndu, Nepal
in Partial Fulfilment of the Requirement for the Degree of
Master of Arts

in

Economics

Submitted by

Roshan Poudel

Class Roll No.:117/070

Examination Roll No.: 310

T.U. Registration No.:5-2-3-1240-2007

September, 2018

LETTER OF RECOMMENDATION

This thesis entitled Analysis of Foreign Direct Investment and Economic Growth in Nepal

has been prepared by Roshan Poudel under my supervision. I hereby, recommend this thesis for

examination to the thesis committee as a partial fulfillment of the requirements for the degree of

Masters of Arts in Economics. Therefore I recommend this work for approval and acceptance.

Tara Prasad Bhusal

Associate Professor

Thesis Supervisor

Date: September 13, 2018

ii

APPROVAL LETTER

We member of thesis committee, evaluated the thesis entitled **Analysis of Foreign Direct Investment and Economic Growth in Nepal** prepared by **Roshan Poudel** to the Central Department of Economics, Faculty of Humanities and Social Sciences in partial fulfillment of the requirements of the Master Degree in Economics have found satisfactory in scope and quality. Therefore, we accept this thesis as a part of the Degree.

| quality. Therefore, we accept this thesis as a part of the Degree. | | | |
|--|--|--|--|
| | | | |
| | | | |
| | | | |
| Dr. Kusum Shakya | | | |
| Professor | | | |
| Head of the Department | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| Roshni Pradhan | | | |
| Associate Professor | | | |
| Padma Kanya Multiple college | | | |
| External | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| Tara Prasad Bhusal | | | |
| Tara Prasad Bhusal Associate Professor | | | |
| | | | |

Date- September 13, 2018

ACKNOWLEDGEMENT

The thesis entitled **Analysis of Foreign Direct Investment and Economic Growth in Nepal** has been prepared for the partial fulfillment of the requirements for the degree of Masters of Arts in Economics. My special gratitude goes to the Prof. Dr. Kushum Shakya (HoD) Central Department of Economics Tribhuvan University, for providing me valuable suggestions.

I would like to express my gratitude to my supervisor Associate Professor Tara Prasad Bhusal for useful comments, remarks and engagement through the learning process of my master thesis. He continually and convincingly conveyed a spirit of adventure in regard to research and an excitement in regard to teaching. Without his guidance and persistent help this thesis would not have been possible. I heartily appreciate his invaluable supervision and useful guidance and no words can fully express my feeling of gratitude to him.

I am very grateful to all the teaching staffs of central department of economics for their suggestions, continuous encouragement and help through my study. I am also grateful to non teaching staff of the department for their great cooperation.

I would also extend my gratitude to my respective family, my wife manju and friends sagar, laxman, bhupendra and all other friends who support me regularly during my whole study.

Roshan Poudel

TABLE OF CONTENTS

| | | Page No. |
|-----------------|------------------------------------|----------|
| LET | TER OF RECOMMENDATION | i |
| APPROVAL LETTER | | ii |
| ACF | KNOWLEDGEMENT | iii |
| TAE | BLE OF CONTENTS | iv-v |
| LIST | T OF TABLES | vi |
| LIST | T OF FIGURES | vii |
| ACF | RONYMS | viii |
| CHA | APTER I: INTRODUCTION | 1-6 |
| 1.1 | Background of the Study | 1 |
| 1.2 | Statement of the Problem | 3 |
| 1.3 | Objectives of the Study | 4 |
| 1.4 | Significance of the Study | 5 |
| 1.5 | Limitations of the Study | 5 |
| 1.6 | .6 Organization of the Study | |
| CHA | APTER II: REVIEW OF THE LITERATURE | 7-20 |
| 2.1 | Theoretical Concept | 7 |
| 2.2 | Empirical Studies | |
| 2.2 | 2.1 International Context | 12 |
| 2.2 | 2.2 Nepalese Context | 16 |
| 2.3 I | Research Gap | 20 |
| CHA | APTER III: RESEARCH METHODOLOGY | 21-29 |
| 3.1 | Research Design | 21 |
| 3.2 | Nature and Source of Data | 22 |
| 3.3 | Description of the Variables | 22 |
| 3.4 | Model Specification | 22 |
| 3.5 | Tools of Analysis of Data | 23 |
| 3.5.1 | 1 Unit Root Test | 23 |

| | 3.5.1.1 | ADF Test | 24 |
|--|----------------|---|-------|
| 3.5.2 ARDL Model | | | 25 |
| | 3.5.2.1 | Diagnostic Test | 25 |
| | 3.5.2.2 | ARDL Bound Testing /Cointegration Test | 28 |
| | 3.6.2.3 | ECM or Short Run Dynamics | 29 |
| | 3.6.2.4 | Stability Test: CUSUM and CUSUMQ | 29 |
| CH | APTER I | V: PRESENTATION AND ANALYSIS OF DATA | 30-40 |
| 4.1 Introduction | | | 30 |
| 4.1.1 Trend and Nature Analysis RGDP and RFI | | | 30 |
| 4.1.2 Status of Approved FDI and Actual FDI | | | 32 |
| 4.2 | Empirica | al Analysis of Impact of RFI on RGDP | 33 |
| 4.2.1 Statistical Analysis | | | 33 |
| 4.3 Short Run and Long Run Association | | | 34 |
| 4.3.1 Augmented Dickey Fuller Test | | | 34 |
| 4.3.2 ARDL Model to Co integration | | | 35 |
| | 4.3.2.1 | Long Run Equilibrium | 36 |
| | 4.3.2.2 | ECM/ (Short Run Dynamics) of the Models | 37 |
| | 4.3.2.3 | Diagnostic Test | 38 |
| | 4.3.2.4 | Stability Test: CUSUM and CUSUMQ | 39 |
| CH | APTER V | : SUMMARY OF THE FINDINGS, CONCLUSIONS | |
| | | AND RECOMMENDATIONS | 41-44 |
| 5.1 | Summar | y of the Findings | 41 |
| 5.2 | .2 Conclusions | | 42 |
| 5.3 | Recomm | nendations | 43 |
| APPENDICES | | | 45-48 |
| REFERENCES | | 49-53 | |

LIST OF TABLES

| Table | No. | Title | Page No. |
|-------|-----|--|----------|
| 3.1 | | Conceptual Framework of Research Design | 21 |
| 3.2 | | Description of Variables | 22 |
| 4.1 | | Statistical Analysis | 33 |
| 4.2 | | Augmented Dickey Fuller Test | 34 |
| 4.3 | | Estimation of Bound Test for ARDL Co integration Model | 35 |
| 4.4 | | Long run Coefficient of ARDL | 37 |
| 4.5 | | Error Correction Representation of the Selected ARDL Model | 37 |
| 4.6 | | Diagnostic Test | 38 |

LIST OF FIGURES

| Figure No. | Title | Page No. |
|------------|---|----------|
| 4.1: | Trend of GDP and FDI | 31 |
| 4.2: | Status of Approved FDI and Actual FDI | 32 |
| 4.3: | Plot of Cumulative Sum of Recursive Residuals | 39 |
| 4.4: | Plot of Cumulative Sum of Squares of Recursive Residual | 40 |

ABBREVIATIONS/ACRONYMS

ADF - Augmented Dickey Fuller Test

ARDL - Auto Regressive Distributive Model

BIMSTEC - Bengal Initiative for Multi-Sectoral Technical and Economic Co-

operation

CBS - Central Bureau of Statistics

CDECON - Central Department of Economics

CUSUM - Cumulative Sum Control Chart

EPZ - Export Processing Zone

FDI - Foreign Direct Investment

GDP - Gross Domestic Product

IMF - International Monetary Fund

MNE - Multi National Enterprise

NRB - Nepal Rastra Bank

RFDI - Real Foreign Direct Investment

SAPTA - South Asian Preferential Trade Arrangement

OECD - Organization for Economic Co operation and Development

UNCTAD - United Nation Conference on Trade and Development