

**TREND ANALYSIS OF FOREIGN DIRECT  
INVESTMENT IN NEPAL**

**A Thesis**

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## LETTER OF RECOMMENDATION

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**APPROVAL LETTER**

We certify that this thesis entitled “**TREND ANALYSIS OF FOREIGN DIRECT INVESTMENT IN NEPAL**” submitted by Manoj Kumar Bam to the Central Department of Economics, Faculty of Humanities and Social Sciences, Tribhuvan University, in partial fulfillment of the requirements for the Degree of MASTER OF ARTS in ECONOMICS has been found satisfactory in scope and quality. Therefore, we accept this thesis as a part of the said degree.

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**Manoj Kumar Bam**

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## **LIST OF ABBREVIATIONS**

ADF	Augmented Dickey Fuller
BIMSTEC FTA	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation-Free Trade Area
BOI	Board of Investment
CEDA	Centre for Economic Development and Administration
DI	Domestic Investment
DOI	Department of Industry
ECM	Error Correction Model
EPZ	Export Processing Zone
FCs	Finance Companies
FDI	Foreign Direct Investment
FITTA	Foreign Investment and Technology Transfer of 1992
FNCCI	Federation of Nepalese Chamber of Commerce & Industries
FY	Fiscal Year
GDO	Garage Door Opener
GDP	Gross Domestic Product
GI	Government Investment
GMM	Generalized Method of Moments
GoN	Government of Nepal
IMF	International Monetary Fund
IP	Industrial Policy
IPB	Industrial Promotion Board

LDCs	Least Developed Countries
MNC	Multinational Company
MOF	Ministry of Finance
NIDC	National Industrial Development Corporation
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Squares
PI	Private Investment
R	Real term (deflated)
SAARC	South Asian Association for Regional Cooperation
SAPTA	South Asian Preferential Trade Arrangement
TU	Tribhuvan University
UNCTAD	United Nations Conference on Trade and Development
UNO	United Nations Organization
USD	US Dollar
VAR	Vector Auto Regression
WTO	World Trade Organization
Y	Gross Domestic Product (GDP)

# CHAPTER I

## INTRODUCTION

### 1.1 Background of the Study

Foreign investment is an important form of foreign capital flowing to both the developed as well as developing countries of the world in the form of direct investment or portfolio investment. Most economic theorists and development practitioners accept that external capital is necessary for accelerating growth and industrialization. However, foreign direct investment (FDI) is not above dispute. Despite all controversies, FDI has been a major economic policy issue for the great majority of countries around the world. The increasing mobility of international firms and the gradual elimination of barriers to global capital flows have stimulated competition among governments to attract FDI. Foreign direct investment is not only one of the causes that stimulate the deepening of globalization, but also a manifestation of globalization in economics (Donciu, 2013).

For a least developed country (LDC) like Nepal with hung saving–investment gap; limited, albeit growing, revenue to gross domestic product (GDO) ratio; and limited amount of foreign aid flow, foreign direct investment (FDI) is considered an indispensable mode of development financing. Actually, FDI occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset (UNCTAD, 1998). In other words, it involves the acquisition of a business or other commercial assets in a country (the host country) by multinational enterprises, other foreign firms, or individual foreign residents with intent to manage the business or commercial assets in the host country. FDI is considered as a means of obtaining not only capital and technology but also scarce management and skill, and improved marketing 'know-how' and outlets for non- traditional exports of manufactures, processed commodities and traded services. FDI flows include equity investment by multinational enterprises, their reinvested earnings in foreign countries.

Observing past trends, the earliest foreign direct investment (FDI) inflows to Nepal can be traced back to the early 1980s when the Nepali economy gradually opened up to the world. However, the magnitude of such inflows was only nominal initially, aggregating to NPR 449 million (USD 5.78 million) during the entire decade, as against the amounts received by its neighboring countries-USD 364.9 million received by China and USD 16.92 billion by India

during the same period. The reason for the lack of inflows in Nepal could be attributed to political instability, cumbersome regulations and unfavorable tax regimes. Capital is one of the most important factors affecting the economic growth, which is scarce in underdeveloped countries like Nepal. Therefore, every developing country irrespective of their size and political system are now trying to attract foreign investment. A large number of developing countries have now established Export Processing Zone (EPZ) to attract foreign private and public investment.

At present private and public foreign capital mostly flow in the form of direct and indirect investment from Europe to underdeveloped countries. In the 1920s, it flowed in the form of direct investment mainly into production and export. Later, the FDI has been concentrating almost in the major development sectors such as agriculture, production, manufacturing, energy based, mineral based. No matter the profit repatriate to the parent countries but little partial return is generally ploughed back into expansion, modernization and the development of related industries. Thus, host countries enjoy employment of local people and their teaching know how and skill. FDI helps to strengthen the trade along with widespread market within and outside the country. In addition, if properly maintained and resources utilized at full extent nation prospers.

Nepal started its efforts to attract Foreign Direct Investment since the Sixth Plan (1980-85). The Industrial Policy (IP) of 1981 has made a separate provision relating to Foreign Direct Investment. The government introduced a One Window Policy whereby the Department of Industries was designated as the sole agency for all FDI related work. In order to make legal provisions for promotion and regulation of the Foreign Investment and Technology, a separate Act entitled “Foreign Investment and Technology Act 1981 (2038)” was introduced in 1992 which was again reviewed and a new Act entitled Foreign Investment and Technology Transfer Act, 1992 was introduced.

The positive impact of such changes was seen in the amount of inflows thereafter which averaged at approximately NPR 1.9 billion (USD 22.1 million) every year during the latter years of the decade. Since then, Nepal has been successful in creating a favorable environment to attract FDI. Foreign Direct Investment in Nepal increased by 5920.90 NPR Million in 2016. Foreign Direct Investment in Nepal averaged 2741.39 NPR Million from 2001 until 2016, reaching an all-time high of 9195.40 NPR Million in 2012 and a record low of -469.70 NPR Million in 2006.

Foreign investment is welcomed in Nepal in all types of industries except the defense related industries having less than NPR 30 million in the fixed assets and the cigarette, Bidi, alcohol, excluding 100 percent export oriented industries. Foreign investors are permitted to establish a joint venture unit with Nepalese partner or 100 percent foreign owned industries. However, permission may be granted for the transfer of technology in all cottages, small and medium scale industries.

Today, Nepal is one of the most 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 growth is critically important from a policy point of view. In the aftermath of liberalization that began in the early 1990s, FDI increased substantially. However, that could not sustain for long. After becoming a World Trade Organization (WTO) member in 2004, Nepal has been pursuing further opening up and liberalization policies on FDI. Nepal is also a member of the South Asian Preferential Trade Arrangement (SAPTA) and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation-Free Trade Area (BIMSTEC FTA). Although the Government of Nepal (GON) is open to FDI, implementation of its policies is often distorted by bureaucratic delays and inefficiency. Besides this, Nepal is still facing some problems for FDI because of lack of direct access to seaports, difficult land transport and lack of trained person, scarce raw materials, inadequate power insufficient water supply, non-transparent capricious tax administration inadequate and obscure commercial legislation, and unclear rules regarding labor relations.

## **1.2 Statement of the Problem**

Nepal has suffered from undeveloped infrastructure, limited resource endowment, particularly capital, technical knowhow, poor manpower, improper planning, ineffective implementation of policies, political instability etc. Nepal is bound with the traditional society where people almost developed the old primary and traditional industries having not adequate modernized tools and technology. Moreover, poor performance by the traditional industrial sectors having shortage of competent entrepreneurial class make realize the need of foreign assistance whether in the form of capital investment or dissemination of technical know-how. A large mass of people having an almost zero propensity to save in Nepal made almost impossible to generate an adequate domestic capital for further investment in the

economy. In Nepal, Foreign Investment has served the purpose of closing the gap between domestic saving and investment and generally consists of portfolio investment, Foreign Direct Investment and official unrequited transfers. While each of these three-component serve the same purpose.

While in the present context of globalization and international protection, government has indeed recognized that international cooperation is desirable. They have therefore consulation bilateral, regional and multilateral agreements dealing with FDI. These have created a more favorable policy environment for FDI by rising practices and norms most important to foreign investments to the level of international commitment. The present array of international arrangement for FDI has been expanding at a fast pace, indicating that the governments are responding to internationalization of markets and production. An assessment of the policies that assessed Domestic and Foreign Investment prospect on the basic of existing investment climate in Nepal is thus recognized as the problem of present study. In overall the statement of problem of present study is as given below:

- i. Problem of traditional industrial sector, shortage of competent entrepreneurial class, poor domestic capital and saving.
- ii. Government has not created a favorable climate to attract FDI.
- iii. Foreign Direct investment has served the purpose of closing the gap between domestic saving and investment.
- iv. Undeveloped infrastructure, limited resources, particularly capital, traditional technology, poor manpower, political instability, narrow market, lack of internalization market and production.
- v. Inflow of FDI is only centralizing within manufacturing sector.

### **1.3 Objectives of the Study**

The main objectives of this study are:

- i. To examine the trend, composition and structure of FDI in Nepal.
- ii. To review the FDI policies of Nepal.
- iii. To analyze the prospects and challenges of FDI in Nepal.



iv. To examine the empirical relationship between FDI and GDP.

#### **1.4 Significance of the Study**

Most of the developing countries including Nepal are rich in natural resources but they are poor in capital, skill and management while the developed ones have sufficient capital and skill. The hung amount of ideal resources, either in terms of natural or physical or human can be mobilized with the inflow of Foreign Investment.

Foreign Direct Investment is very necessary lubricant to generate economic growth. FDI is frequently viewed as instrumental in promoting industrial growth and foreign trade particularly in developing countries. FDI maintains relatively open economies, stable macroeconomic condition and limited restrictions on foreign exchange transactions. It frequently stimulates competition, productivity and innovation by local suppliers because local suppliers compete for lucrative contracts with multinational enterprise.

Further, it generates income and employment opportunities resulting in wages, competitive price, and more revenue, skills and technology transfer and increased foreign exchange earnings. It contributes to the development of a host country by increasing the countries investment level beyond what would be permitted by domestic saving alone. Similarly, it enhances entrepreneurial capacity when the foreign firms bring with it some firm specific knowledge in the form of technology, managerial expertise, and marketing know-how. It also allows new local entrants to learn about export markets, provide training to workers and stimulates competition with local firms. Thus, if Nepal has to achieve faster rate of economic growth in the present context, it is essential to create the necessary and amicable conditions to attract FDI.

#### **1.5 Limitations of the Study**

Due to limited time and resource constraints, the researcher visits only the enterprises having offices in Kathmandu Valley, the Department of Industry, FDI Department, and National Industrial Development Corporation (NIDC), T.U library, Ministry of Finance, FNCCI and others. Therefore, the opinion survey of the foreign collaborated industries included in the study may not be the true representative of the foreign direct investors working in Nepal. Similarly, the enterprises under banking and financial sectors have been excluded from the study as the present study is confined to tourism and manufacturing sectors only.

## **1.6 Organization of the Study**

This study comprises of seven chapters and each chapter is further divided into different sections and sub-sections. The first chapter, which is the introductory portion, gives the general introduction of the whole study. Chapter two is related to the review of literature. It includes a discussion on the theoretical framework as well as the review of the major empirical works. The theoretical analysis and review of related literature conducted in this chapter provides a framework and with the help of which this study has been accomplished. Chapter three is concerned with the research methodology used in this study. This chapter comprises of research design, nature and sources of data method of analysis and definitions of key terms. Chapter four is related to laws and policies relating to foreign direct investment. Chapter five is related to trend and performance of FDI in Nepal. Chapter six is related to prospects and challenges of FDI in Nepal. Lastly, chapter seven includes summary and conclusions of the study and the recommendations that may be helpful in formulating policies. This chapter is followed by appendices and references.

## **CHAPTER-II**

### **LITERATURE REVIEW**

#### **2.1 Theoretical Review**

Foreign Direct Investment (FDI) is the act of acquiring assets which may be financial, such as bonds, bank deposits, equity shares or they may be so called Direct Investment and involve the ownership of means of production such as factories and land. Direct Investment is considered to take place also if the ownership of equity shares provides control over the operation of a firm (Jhingan, 2012).

In the 19<sup>th</sup> century, Foreign Investment involved mostly the ownership of financial assets. After World War II FDI began to dominate and attract much theoretical and empirical research efforts of economists and the concerns of politicians. The brain drain, international technology transfers and international bank lending, occupied many researchers after the 1960s.

Numerous economic analysis of FDI has begun with the assumption that real capital is exported from the home to the host nations, but this assumption is not necessarily true. Thus, FDI is not a special case or international transfer problem, which has been a favorite subject of economist since John Maynard Keynes's early treatment of it (Jhingan, 2012). Indeed, even when economic investment result FDI, capital may not be transferred from the home nation to the host nation. Rather, the multinational corporation (MNC) may acquire real capital from local sources; the multinational firm may thus act to intermediate host nation saving into host investment.

Meier and Baldwin study finds the Foreign Direct Investment as a complementary tool for encouraging local investment and enterprise. According to them it encourages local investment in two ways: firstly, by entering into partnership with local entrepreneurs, and secondly, by creating demand for ancillary or subsidiary products. To quote them, in many instance Foreign Direct Investment may also help to induce domestic investment, either in partnership with foreign capital or into local ancillary industries which the foreign enterprise has directly established (Meier and Baldwin 1957).

A Foreign Direct Investment yield to the recipient country it increases real income resulting from the operation of investment is greater than the resultant increases in the income of the foreign investor. To quote Meier again, there is a national economic benefit if the value

added to output by the foreign capital is greater than the amount appropriated by the investor: social return exceeds private returns (Meier 1957). The benefits Meier lists out are:

- a) Consumer by way of lower prices,
- b) Domestic labor in the form of higher real wages,
- c) The government through the expanded revenue,
- d) Indirect gains through the realization of external economics,
- e) The investors for the improvement and expansion of industry,
- f) The local professionals for the improvement of their skills.

Foreign capital is also used as the useful instrument to break the vicious circle of poverty and market imperfections. The contestability of the market is enhanced when the firms do not face any kind of regulation in the matter of entry and exit including their mode of operation. This confirms the optimal allocation of resources and such proves to be helpful in breaking the vicious circle of poverty. In the opinion of Professor Nurkse, *the use of foreign resources is one way of breaking the vicious circle of poverty and low capital formation. The flow of foreign capital and other resources will provide an increase in productivity fast enough to out run population growth and thus launch a process of cumulative expansion, and will acquire a sufficient portion of this capital in foreign exchange to permit import of raw materials and equipment needed for development in addition to essential food stuffs* (Nurkse 1972).

Foreign Direct Investment is superior to foreign aid in terms of the impacts these flow breed in developing countries. The aid absorptive capacity of developing countries is substantially low because of which the returns from it cannot even cover the interest of loan and thus compels the aid receiving country to undertake loan for loan payment and intimately takes the country into debt trap. Further excessive dependence upon foreign aid coerces the recipient country to lose national autonomy and sovereignty as they are turned into their rubber stamp in terms of decision making process and formulating policies. To quote prof. Nurkse again, being subject to private motives and business calculations, it is likely to be productively employed. It helps to promote the spread of modern technology and efficient management methods. It is free from rigid interest and amortization requirements, which affects international loans (Meier 1957).

In the words of Dunning, Foreign Direct Investment not only involves flow of capital but transfers other important assets as well. These include management, organizational expertise,

technology entrepreneurship and access to market across the national boundaries (Dunning 1987).

Speaking about the role of Foreign Direct Investment Prof. Raymond C. Mikesell has said, *the private investor from an industrially advanced country not only brings capital, technology and managerial experience, but also introduces new business concept which helps to revolutionize the thinking and practice of the area*". He further observes *"Economics growth is in part a sociological phenomenon which can be transported and encouraged to spread through the economically backward areas by socially responsible foreign investors* (Mikesell 1974).

Foreign Investment is also considered as a vehicle for creating employment opportunities and raising the level of domestic wages. It is also known as an agent for cross-cultural exchange. According to Kobrin, S.J. Foreign Investment is an agent in the process of cultural borrowing that constitutes industrialization. The aspect of cultural transfer tends to be diffused throughout the host society by the re-employment of trained personnel, backward and forward linkages and competitive emulation (Kobrin 1977).

According to the balance of payment manuals (IMF 1977) Foreign Investment refers to investment made to acquire lasting interest in enterprise. Further, in case of FDI, the investor's purpose is to gain as effective voice in the management of the enterprise.

Moreover, the benchmark definition of the Organization for Economic Co-operation and Development is more explicit than the IMF definition in that it specifies a percentage of ownership as a threshold for FDI. It defines a direct investment enterprise as an incorporated or unincorporated enterprise in which a single foreign investor either owns 10 percentage or more of the ordinary shares or voting power of an enterprise (unless it can be proved that 10 percentage ownership does not allow the investor an effective voice in the management) or owns less than 10 percentage of the ordinary shares or voting power of an enterprise, yet still maintains an effective voice in management. An effective voice in management only implies that direct investors are able to influence the management of an enterprise and does not imply that they have absolute control. The most important characteristic of FDI, which distinguishes it from portfolio investment, is that it is undertaken with the intention of exercising control over the enterprise.

Foreign Investment has been taken as stimulating factor for the domestic saving in the long run if the investment is employed in the productive areas. In the initial phase of development, developing countries cannot finance development expenditure internally as their governmental revenue is either just sufficient to cover ordinary expenses or even falls short of it. If the developmental project is financed through the forced lending, it will ultimately curtail aggregate demand and hence crowds out the private investment lending to the economy into the downswing direction. So, the external finance becomes indispensable for the developing countries in the initial phase of their developmental process. As its benefit, it will improve the economic status of the people and stimulates the domestic saving. According to the UNO report of 1990, Domestic saving tends to be at a low level in the developing countries because of the poor incomes. Thus, it is impracticable to cut the already lower consumption levels. Hence external finance becomes necessary not only to increase the rate of development, but to as a stimulant to domestic saving.

For FDI has been an important feature of the world economy. Throughout this century but it became particularly prominent during the last 1950, and the 1960s, when large number of European and Japanese firms did likewise FDI now economic activity then is international trade: the combined sales overseas subsidiaries all international firms significantly exceed the volume of trade (Julias 1991).

FDI usually involves large amount of capital and may include a wide variety of possible variations and combinations of debt and equity. Once the project is up and running, additional funds may be required for working capital. If import of materials and equipment's is necessary or if an expected program seems probable, standard export import trade financing forms as domestic expansion projects or business acquisition (UNCTAD, 1998)

However, the sources of funds for FDI are significantly different from those encountered in domestic expansion. They fall broadly into seven categories:

- a. Joint ventures
- b. Host country commercial banks
- c. Regional or local development banks
- d. Bilateral financial Aid organization
- e. Multilateral financial Aid organization
- f. Local stock market
- g. Counter Trade

In nearly every case, FDI are at least partially, many times wholly financed within the host country or through host country channels.

Most companies learn quickly that a merger or business acquisition is the fastest and in many cases the only way to proceed with a direct investment. Local business licensing regulation, host country and home country tax laws and creative financing schemes point to one form or another of a business acquisition as the most feasible way to establish a foreign beachhead.

Since, late 1980s there have been excessive practices by developing countries to inflow of high magnitude of foreign direct investment and as such various facilities and incentives have been offered for MNCs to operate in the respective countries. One of the significant practices in this direction is to pave the way for FDI liberalization through necessary mechanism to ensure high degree of competition so that the resources remained idle would be optimally allocated and efficiently utilized. However, the world investment report of 1999 asserts that the mere flow of hefty amount of FDI does not confirm the developing country's objectives of growth and development. According to the report, *the ultimate objectives of FDI liberalization are to enhance growth and welfare in countries. Success in this regard depends not only on increasing FDI flows and the capital, technology, managerial know-how and markets access associated with them but also on ensuring that the industries and markets in which MNCs participate and operate efficiently.* In market based economies, the efficient functioning of markets depends on the contestability of the markets or the ease with which firms can enter and exit them and the extent and the nature of competition in markets. Foreign Direct Investment liberalizations, the report enumerates, the opening up of economics to inward FDI can contribute directly towards increasing the contestability of or potential competition in host country markets. Seller participating in these markets can now include not only domestic producers and exporters from other countries, but also MNCs from other countries that establish affiliates (as well as contractual arrangements with other firms) to produce in and for local markets. Furthermore, MNCs, with their owner specific or competitive advantages, are often better able than domestic firms to overcome some of the cost related barriers to entry that limit the number of firms in an industry and the market for its products. This potential for increasing competition by allowing FDI entry is particularly important for many service markets, in which competition through arm's length (non-interfering) international trade is not possible or limited.

The report of UNCTAD (1998) accepts the Foreign Direct Investment is more important than trade. To quote the report, *Foreign Direct Investment is becoming increasingly important in the world economy in many developing countries. It has become more important than trade in terms of delivering goods and services to foreign markets and in addition, it has become an important mechanism for organizing production internationally. All governments now recognize the role of FDI in development and are actually competing for it.* Furthermore, the report says *Foreign direct investment is not only a factor of economic development in its own right, but it is also closely linked with trade, technology transfer and financial flows.*

The Earth Summit, United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro in 1992 discussed in chapter 33 of Agenda 21 and then recommended about FDI as follows.

- i. FDI should account for a larger share of poverty alleviation and sustainable development financing,
- ii. Need to link to local enterprise development, and
- iii. Promotion of incentives for environmentally and socially responsible investments, particularly in the least developed countries.

According to UNCTAD (2002), *Private international capital flows particularly foreign direct investments are vital complements to national and international development efforts. Foreign direct investment contributes towards financing sustained economic growth over the long term. It is especially important for its potential to transfer knowledge and technology, create jobs, boost overall productivity, enhance competitiveness and entrepreneurship and ultimately eradicate poverty through economic growth and development.* In a similar vein, the OECD (2002a:11) reckons that *Increasingly, FDI has been recognized as a powerful engine and a major catalyst for achieving development, poverty- reducing growth and global integration process.*

### **Theories on FDI**

Eventually after the end of Second World War, FDI developed gradually with the passage of time and technological development. The theories on FDI widened rapidly in the past six decades and published explaining MNCs applying FDI, determinants of FDI, trends of FDI, FDI effects and surplus to the host country and economy, etc. There is not a single universally applicable theory of FDI. It differs in terms of factors and variable, which rise to



different theories and make them stand. Macro factors, micro factors, strategic factors play a vital role in determining FDI. Morris (1991) explains that the macro factors study FDI as the capital flows across borders from origin country to the host country in terms of balance of payment. On the other hand, micro factors, explain the motivation for investment. Moosa (2002) has briefly explained the theories of FDI into four different categories. The different theories on FDI construct a theoretical understanding of foreign direct investment. The main theories are:

- a) Theories assuming perfect market
- b) Theories assuming imperfect market
- c) Other theories
- d) Theories based on other variable

Among these four theories, the study mainly focuses on the theories about perfect and imperfect market. The investors get a vivid understanding on different types of foreign direct investment (FDI) in the corresponding markets. A study on the market size is necessary before commencing investment in a foreign economy.

### **2.1.1 Theories assuming perfect market**

The three hypotheses lie under this heading: Moosa (2002) categorizes the theories as the differential rates of return hypothesis, the diversification hypothesis and output and market size hypothesis. A perfect market theory explains how the capital flows, marginal returns, risk assessment and market size affects foreign direct investment.

#### **i. The Differential Rates of Return Hypotheses:**

This hypothesis pretends to be one of the first attempts to explain FDI flows. This hypothesis explains that FDI is a result of capital flowing from countries with low rates of returns to high rates of return expecting a marginal return with the marginal cost of capital (Morris 1991,). It assumes that Marginal return is the only variable factor in this approach, and when marginal returns are higher than at home where marginal cost of capital is constant at both investments (home & abroad), it is wise to invest abroad. This theory went viral in the late 1950's, when America (USA) invested in Europe. Agarwal (1980) explains that most of the empirical studies based on this approach failed to provide strong supporting evidences. As the theory

primarily stands on marginal returns or the expected profits and the actual profit always differs than the reported profit, this theory could not precisely describe the determinants of FDI flows (Morris 1991,).

**ii. The Diversification Hypothesis:**

As the differential rates of return hypothesis failed to provide an adequate explanation to FDI considering risk factors, the phenomenon moved to Diversification hypothesis to describe FDI. The investment simply does not depend upon the marginal returns; risk is also equally equated before doing any investment. The projects, therefore, supplemented by both expected returns and the risk factors. Tobin (1958) and Markowitz (1959) have led to the theoretical definition of this hypothesis under the theory of port-folio selection. Morris (1991) explains, *A firm can reduce its risk by investing in various countries as the returns on individual countries are likely to have less than perfect correlation.* Various attempts undertook to test this theory. One way to test this approach was to determine the share of FDI going to a group of countries in context to the average return on those investments and to the risk associated with that investment, and risk as measured by the variance or the standard deviation of the rate of return (Hufbauer 1975; Agarwal 1980; Morris 1991) further criticizes that the empirical testing of this approach provides only weak support for portfolio diversification theory. This theory failed significantly, as sometimes the favorable condition for a group of countries was unfavorable for an individual country. However, this empirical definition contains many theoretical problems it was superior to the theories of returns. According to Morris (1991), *The portfolio diversification theory is an improvement over the differential rates of return theory, in the sense that, the inclusion of risk factor can account for countries experiencing simultaneously inflows and outflows of FDI.*

**iii. Market Size Hypothesis**

Moosa (2002) has defined market size hypothesis as *the volume of FDI in the host country depends on its market size, measured by the sales of an MNC in that country, or by the country's GDP (that is, the size of the economy).* This is particularly so for the case of import- substituting FDI. *As soon as the size of the market of a country has grown to a level warranting the exploitation of economies of scale, the country becomes a potential target for FDI inflows.*

The output of FDI can be derived from the models of neoclassical domestic investment theory. This theory is more popular and enlisted in many empirical findings. This theory undertakes empirical testing in a number of ways. One way to test it as explained by Moosa (2002) is *to find out whether or not the share of FDI of a given country going to a group of host countries correlated the individual income level of the host country*. This theory assumes that size and growth of a host's market affects FDI. Host country's income, level of sales by a foreign subsidiary etc. result in higher FDI. Despite of popularization of this theory, Agarwal (1980) points out the hazards of implanting this theory. One of the Problems with this theory was the decision of a firm regarding FDI based on the various considerations depending upon whether the FDI is initial or explanatory (Morris, 1991).

### **2.1.2 Theories Assuming Imperfect Market**

The earlier theories lacked the information on market failures. Hymer (1976) was the first analyst to mark out that the structure of a market, and the characteristics of a firm play a vital role in defining FDI (Morris, 1991). This theory focuses on the industrial organization hypothesis, the internalization hypothesis, the location hypothesis, the eclectic theory, the product life cycle hypothesis and the oligopolistic reactions hypothesis. Among these six factors of imperfect market theory, this study primarily focused on the crucial four theories (The industrial, the internalization, the eclectic and the product life cycle theory).

#### **iv. The Industrial Organization Hypothesis:**

According to Moosa (2002), Hymer (1976) developed the industrial organization hypothesis. Kindleberger (1969), Caves (1982) and Dunning (1987) further extended the theory. *This theory assumes that the firms when it establishes a business in another economy it passes through several disadvantages in comparison to local investors. The cultural sectors, languages, legal system and other factors play a vital role in determining FDI*. This theory explains about why firms invest in foreign countries but fails to explain the motivation for choosing; which the Location hypothesis fulfills. This theory benefits in terms of capital, management, technology, marketing, and access to raw materials, economies of scale and bargaining and political power. The firm gets many facilities and several offers by the host government.

**v. The Internalization Theory:**

This theory tends to be the general theory of FDI. Morris (1991) explains that almost all of the hypotheses of FDI are cases of this general theory. Moosa (2002) explained this theory as *FDI arises from efforts by firms to replace market transaction with internal transactions*. This theory explains about firms using FDI regarding export and import from foreign countries. Buckley and Casson (1985) suggest, *if markets in intermediate products are imperfect, firms have an incentive to bypass them by creating internal markets, such that the activities linked by the markets brought under common ownership and control*. As this theory was general, Buckley (1988) pointed that it cannot be tested directly but can be sharpened to obtain 'relevant testable implications' (Morris 1991). According to Moosa (2002), *Buckley also cited evidence showing that the pattern of FDI across industries and nationalities is broadly consistent with the theory's predictions, but he emphasized that tests need to be more precise and rigorous to increase confidence in the theory*.

**vi. An Eclectic Approach**

Dunning (1998) developed the eclectic theory. He introduces this theory integrating the industrial organization theory, the internalization theory and the location theory. These three theories need to be acquired if the firm tends to practice foreign direct investment. He further argues that the following three conditions must be fulfilled to involve in FDI.

1. Ownership advantages (includes the right to technology, monopoly power and size, access to raw materials and access to cheap finance).
2. Use of these advantages rather than selling or leasing to other firms.
3. Must be beneficial to use these advantages with at least some factor inputs located abroad. Therefore, it makes location advantages else, it is an export job.

Thus, to practice the firm must have ownership advantages and internationalization advantages along with the location advantages than the firm's home country. Moosa (2002) has clearly defined FDI into following three possibilities:

1. If there are no internalization gains, the firm will license its ownership advantage to another firm, particularly if location factors favor expansion abroad.

2. If there are internalization gains and if location factors favor home expansion, the firm expands at home and exports.
3. If there are internalization gains and, if location factors favor foreign expansion, FDI will take place and an MNC will emerge.

This theory suggests that all forms of FDI can be defined with reference to its condition. It also further explains that these advantages are not likely to be uniformly spread among countries, industries, and enterprises and are likely to change over time (Morris, 1991).

#### **vii. The Product Life Cycle Hypothesis**

Vernon developed this theory in 1966 to explain various types of FDI made by US companies in Western Europe after the Second World War in the manufacturing industry (European Journal of Interdisciplinary Studies). Vernon (1966) claims that a product goes through four stages: Innovation, growth, maturity and decline. Moosa (2002) has explained that the products initially introduced as innovation. According to Moosa (2002), *the product life cycle hypothesis predicts that the home country where the innovative product first appeared switches from an exporting to an importing country. This prediction is consistent with the pattern of dynamic changes observed for many products.*

### **2.1.3 Other Theories**

According to Moosa (2002), four hypotheses fall under this heading.

#### **viii. The Internal Financing Hypotheses:**

It refers to the utilization of profit by a MNC to finance the expansion of FDI in the same host country. Initially modest investments, while subsequent expansions incurred by reinvesting profit generated by a subsidiary in the host country.

#### **ix. The currency areas hypothesis and the effect of the exchange rates:**

It relies on the assumption that MNC provides diversification opportunities and barriers to capital flows.

#### **x. The Kojima Hypothesis:**

It relies on two sections; trade oriented and antitrade oriented. The former establishes welfare improvement and promotes trade in both countries while the latter promotes unfavorable restructuring and has an adverse effect on trade in both countries.

#### **2.1.4 Theories Based on Other Variable**

Moosa (2002) further explains three theories of foreign direct investment. These factors play a crucial role in understanding the business environment and choosing host economies.

##### **xi. Political Risk and Country Risk:**

This factor plays a vital role in discouraging FDI inflow. Political instability has an adverse effect on FDI. A country's economic and geographic measurement widely affects FDI inflows.

##### **xii. Tax Policy, Trade Barriers and Government Regulations:**

Foreign direct investment closely relates toward these factors. The tax policy of the host country severely affects FDI. Trade is an alternative to FDI, which implies open economies receive fewer FDI flows. Government regulations are either effective or defective in attracting or distracting FDI. They offer incentives on one hand and put restrictions on the activities of MNCs on the other which eventually encourages and later discourages inward FDI.

##### **xiii. Strategic and Long - Term Factors:**

Moosa (2002) explains that a further set of strategic and long term factors sum up together to describe FDI. Desire to defend existing competitors (local and foreign), and build a strong base for longer term, involvement of technology for longer periods, maintaining a parent-subsidiary relationship, etc are factors often considered being the instrumental for decision making to invest abroad.

#### **2.1.5 Summary of Theoretical Review**

In reference to above mentioned theories of FDI, we can clearly assume that theory on FDI has been changing accordingly. Foreign direct investment is increasing these days. However, developing countries ranks highest in terms of inward FDI.

The perfect market theory and imperfect market theories of FDI are vital for entrepreneurs in terms of foreign investment. These theories build a strong base on choosing the location and setting business in an unknown economy. Above mentioned theories can be summarized as follows;

Market imperfection theory proposed by Hymer (1976) states that Firm's decision to invest overseas is explained as a strategy to capitalize on certain capabilities not shared by competitors in foreign countries.

International production theory proposed by Dunning (1987) and Fayerweather (1982) put forth that the propensity of a firm to initiate foreign production will depend on specific attractions of its home country compared with resources implications and advantages of locating in another country.

Internalization theory proposed by Buckley (1988), Buckley and Casson (1985) states that FDI concerns extending the direct operations of the firm and bringing under common ownership and activities conducted by intermediate markets that link firm to customers.

## **2.2 Empirical Review**

### **2.2.1 International Context**

Carcovic and Levine (2002), they examined the relation between FDI and economic growth in 72 countries within the period of 1960-1995 by using new statistical techniques and two new databases. Firstly, they formed a panel data set linked to World Bank data set and basing on the averages of seven five-year periods between 1960 and 1995. Besides, the results were verified by using the FDI data received from IMF database. Methodologically, Generalized Method of Moments (GMM) was used. According to the results of empirical applications, it has been seen that FDI do not have an effect on economic growth solely.

Chowdhury and Mavrotas (2003), they used an innovative econometric method in order to defined the direction of the causality between FDI and economic growth in Chile, Malaysia and Thailand. They applied Augmented Dickey Fuller (ADF) unit root test and Toda-Yamamoto causality test to the time-series data belonging to 1969-2000 period. According to results of empirical analyses, while the GDP is the cause of FDI in Chile, there is two-way causality between FDI and GDP in Malaysia and Thailand.

Lyrroudi et al (2004), they examined the effect of FDIs on economic growth of transition economies. To this aim, they focus on Eastern European and Balkan countries in the period of 1995-1998. According to the results of the study, FDIs do not have any significant effect on the economic growth of transition economies.

Roy and Berg (2006), they considered whether FDI inflow have a contribution on the growth of the U.S. economy in their study covering the period of 1970-2001. In order to define two-way relation between FDI and economic growth, they used time-series data and simultaneous equation model. As a result, they saw that FDIs have a positive and significant effect on the growth of the U.S. economy.

De er and Emsen (2006), they examined the relationship between FDI and economic growth in transition economies in the period of 1990-2002 by making a distinction of Central Eastern Europe and Central Western Asian country through panel data regression analyses. According to results estimated, they observed that FDIs have positive effects on transition economies.

Erçakar and Yılıgör (2008), they analyzed the long-term relation between FDI and economic growth in 19 selected countries by using the data of 1980-2005 period through panel unit root test and panel co-integration test. While the results of panel unit root test show that FDI and GDP do not have a unit root, the results of panel co-integration test verify a long-term relation between FDI and GDP.

Tang and Selvanathan (2008) in their study titled “Foreign Direct investment, Domestic Investment and Economic growth” A Time Series Analysis in China over the period 1988-2003, had used a multivariate VAR system with error correction model (ECM) and the innovation accounting (variance decomposition and impulse response function analysis) techniques are used. The results show that there is a bi-directional causality between domestic investment and economic growth, there is only unidirectional causality from FDI to domestic investment and to economic growth. Rather than crowding out domestic investment. FDI is found to be complementary with domestic investment. Since FDI complements domestic investment, less-developed countries ought to encourage and promote FDI inflows, for which appropriate FDI policies and regulations are required. The hosts government should not only encourage FDI inflows, they should also impose regulations on MNEs to urge them



undertake export obligations or encourage direct investors to invest in high risk areas or in resource industries where domestic investment is limited.

Yilmazer (2010) analysed the effect of FDI on economic growth in Turkey within the period of 1991:1-2007:3 in terms of quarterly data by means of Granger causality test. GDP, export and import data was used in relation to economic growth. At the end of analysis, a strong causality between FDI and economic growth was not detected. Besides, it has been found that FDIs pursue import and export weakly.

Ekinci (2011) looked at whether a long-term relation between FDIs and economic growth in Turkey in the period of 1980-2010 exists or not by applying Granger causality test. As a consequence, a bi-directional relationship between FDIs and economic growth was found, but it has not been observed any relation between FDIs and employment.

### **2.2.2 National Context**

Mr. Ramesh Chitrakar for the first time in 1986 had undertaken the research study on foreign investment in Nepal. The study carried out by CEDA was conducted with the objectives of analyzing;

- i. Nature and extent of foreign investment in Nepal,
- ii. Factors affecting decision to invest in Nepal,
- iii. MNCs motives for investing abroad and
- iv. Legal provisions including facilities and incentives lying there under.

Chitrakar R (1994) in his Ph.D. dissertation entitled “Foreign Direct Investment and Technology Transfer in Developing Country” submitted at University of Bradford, London in 1994 made an extensive study on foreign direct investment in Nepal with cross country references of SAARC regions. In this study, based on primary as well as secondary sources, he analyzed the trend and form of foreign investment, its determinants, facilities and incentives offered to attract it and causes of its sluggish and disappointing flow in Nepal. He found that the flow of foreign investment in Nepal is less impressive than that of neighboring countries despite the adoption of more liberal policies and promised facilities and incentives. His findings in this matter are that the government needs to simplify the bureaucratic procedures, avoid bureaucratic harassment and strongly put the promised facilities and incentives into practice within the stable political, business and long-term policy framework.

According to him, the benefits of Foreign Investment may be imparted to the host country in the following ways by:

- i. Reducing the shortage of domestic savings,
- ii. Increasing the supply of foreign exchange and,
- iii. Generating external economies as foreign investment involves non-monetary transfers of other resources like technological knowledge, market information, management and supervisory personal, organizational experience and innovations in products and production techniques and of which are in short supply in developing countries.

Bhatt (1993) points out many obstacles for attracting foreign investment in Nepal. According to his study, the main shortcomings for the investors are size of the country, skill shortage, inadequacy of the domestic infrastructure, corrupted bureaucratic system, lack of human resources, etc.

Pant (1994) analyses benefits, cost and determinants of foreign direct investment. The study mentions the benefits of FDI. According to the study, *FDI supplies capital which might not otherwise be available due to a low level of domestic saving and because access to bond and other portfolio finance from developed countries has been limited on the one hand and FDI carries within it a complementary package of inputs that include managerial and marketing expertise, knowledge of technical processes, scarce labor skills and, in some cases, facilities for training local workers in varieties of skills on the other.*

Timalsina PP and Mahato BP in their book *Economic Development and Foreign Investment in Nepal: Issues and presentment* published in 1998 by Nepal society for Applied Economic explains that the foreign direct investment is a means of industrialization which would lead to diversification of the economy for a durable, social, psychological and institutional framework. To quote them, Foreign investment is considered important for the industrialization of Nepal. Some basic features associated with the direct foreign investment are that it will attract capital, technology and expertise. Furthermore, it will help to share risk, exploit resources presently and provide access to export market, all these factors are either in short supply or absent in Nepal.

Paudyal (1999) discusses that foreign direct investment would enter Nepal only if the investors were ensured for maximum profit. Nepal, a low-cost economy by dint of abundant labor and low wage rate are strengths for attracting foreign direct investment. But the

component of labor in the real cost is declining significantly with the increasingly larger use of high-tech components. Moreover, the unskilled nature of labor eliminates the advantage of low cost. Thus, it is imperative to concentrate on producing skilled and technical manpower by orienting the educational system and operating for a coordinated approach by the universities in line with the emerging demand of international business.

Dahal and Aryal (2002) write: In a poverty-stricken economy like Nepal where internal resources are extremely limited, not enough to supplement current expenditures, and dependence of foreign aid (grants and loans) is increasing with poor performance shown by economic growth rate; and where political conflict is getting momentum, the role of FDI is crucial not only to sustain development activities but also for poverty alleviation.

The data for FDI reflects that investment from India is prominent, attributing to both economic and social proximity between Nepal and India. A pragmatic strategy for development based on two pillars would help to achieve the target of attaining a high level of growth and poverty alleviation. These are (a) improving the investment climate through strengthening of macroeconomic stability, trade openness and competitive markets, improving governance and institutions and infrastructure and (b) through social inclusion, good governance and poverty reduction (Stern 2002).

Dangal (2002) has observed the laws and policies and other general determinants of FDI including motivating factors affecting decision to invest in Nepal, problems and prospects of FDI in Nepal. The study supported by both primary and secondary sources revealed foreign investment scenario in Nepal has been dismal. Despite its free market reforms and incentives, Nepal has attracted only a small portion of FDI flowing to South Asia. The analysis of flow of FDI in the country reveals that it commenced to flow remarkably into Nepal from the time when democratically elected first government of Nepali Congress adopted liberal policies in the matter of getting private domestic or foreign investors involved into the economic activities of a country.

Bist (2005) deals with impact aspects of FDI at micro and macro level and its structure and policy environment. The study concludes that Nepal still needs a big push for achieving sustainable higher economic growth, macro-economic stability and welfare to the poorest of the poor when we observe back to the weak performance of the planned development and huge resource expenses over 56 years. The study further focuses on that national attention and attempt to the policy reforms to attract FDI is not sufficient to increase the inflow of FDI

in the country like Nepal. The collective efforts at national and international level are required for the growth of FDI inflow.

The study about distribution of FDI at the global level showed 49 LDCs remain marginal recipients with just two percent of total FDI being delivered to developing countries or 0.5 percent of global level. It implies that almost all FDI move to the developed countries. In this context, the growth of FDI may be myth to developing countries and LDCs if the developed countries do not change the structure of FDI. Therefore, the FDI policies of the developed countries should be revised to address the real global issues like poverty, inequality, unemployment, hunger etc. Only then FDI may be a hope to developing countries for their economic development.

They take industrialization as a means of breaking the vicious circle of poverty and thereby raising the formation and accumulation of capital scarce countries like Nepal where industrial development is considered necessary for achieving various economic goals like higher rate of growth, fulfillment of the basic need, creation of more employment opportunities etc. Further they opine that industrialization is to overcome the limited carrying capacity of agricultural sector in terms of employment, poverty alleviation and overall economic development. For this, some basic requirements are capital, appropriate technology, skilled human resources, market, infrastructure and favorable administrative and legal environment that could be fulfilled through the inflow of foreign investment.

They have focused their study basically on the historical development, importance, trend and structure of foreign direct investment in Nepal together with the analysis of legal provision and incentives and facilities offered through it. The study also touches the problem of foreign investment in Nepal. However, the analysis on this topic is less detailed than the others they have observed.

Majagaiya (2010) showed in his study titled "A Time Series Analysis of Foreign Direct Investment and Economic Growth: A case study of Nepal" had used granger causality test, unit root test and co-integration test. The empirical analysis on the basis of OLS method, suggests that there is positive but small relationship even considered negligible whereas unit root reveals non-stationary I their levels. The result showed that from FDI to GDP there exist long term relationship between the variables and FDI granges the GDP after four years. This study reveals that Nepal's GDP especially does not depends on FDI but may depend on

further factors like agriculture inputs, industrial inputs, remittances. So, the further research must be done in this area.

### **2.3 Motives of Foreign Direct Investment**

The literature on FDI identifies three most common investment motives: resource-seeking, market-seeking, and efficiency-seeking (Dunning, 1993).

1. Resource-seeking: the main motive of the firm is the acquisition of particular resources not available at home (natural resources or raw materials) or available at a higher cost (unskilled cheap labor). The availability of natural resources, cheap unskilled or semi-skilled labor, creative assets and physical infrastructure promotes resource seeking activities. Historically, the most important host country determinant of FDI has been the availability of natural resources, e.g. minerals, raw materials and agricultural.

Even when it is prominent as an FDI determinant, the presence of natural resources by itself is not sufficient for FDI to take place. Comparative advantage in natural resources usually gives rise to trade rather than to FDI. Investment takes place when resource-abundant countries either lack the large amount of capital typically required for resource extraction or do not have the technical skills needed to extract or sell raw materials to the rest of the world. In addition, infrastructure facilities for getting the raw materials out of the host country and to its final destination have to be in place or needed to be created (UNCTAD, 1998).

Labor-seeking investment is usually undertaken by manufacturing and service MNEs from countries with high real labor costs which set up or acquire subsidiaries in countries with lower real labor cost to supply labor intensive intermediate or final products. Frequently, host countries have set up free trade or export processing zones (Dunning, 1993).

2. Market-seeking: firms invest abroad to profit from foreign markets. Various reasons can actually lead to follow supplies or customers that have built foreign production facilities; to adopt goods to local needs or tastes; to avoid the cost of serving a market from distance; to have a physical presence on the market in order to discourage potential competitors.

Market seeking investment is attracted by factors like host company's market size, per capita income and market growth. For firms, new markets provide to chance to stay competitive and grow within the industry as well as achieve scale and scope economies. Traditionally, market

size and growth as FDI determinants related to national markets for manufacturing products sheltered from international competition by high tariffs or quotas that triggered “tariff-jumping” FDI (UNCTAD, 1998, 107). A part from market size and trade restrictions, MNEs may be prompted to engage in market-seeking investment when their main suppliers or customers have set up foreign producing facilities and in order to retain their business, they need to follow them overseas (Dunning, 1993,).

3. Efficiency-seeking: FDI that occurs when:

- a) firms take advantage of differences in the availability and the costs of traditional factor endowments in different countries; or
- b) they take advantage of the economies of scale and scope and of differences in consumer’s tastes and supply capabilities.

The motivation of efficiency seeking FDI is to rationalize the structure of established resource based or market seeking investment in such a way that the investing company can gain from the common governance of geographically dispersed activities. The intention of the efficiency seeking MNE is to take advantage of different factor endowments, cultures, institutional arrangements, economic systems and policies and market structures by concentrating production in a limited number of locations to supply multiple markets (Dunning, 1993,). In order for efficiency seeking foreign production to take place, cross-border markets must be both well developed and open, therefore, it often flourishes in regionally integrated markets (Dunning,1993,).

However, it is worth noting that many of the larger MNEs are pursuing pluralistic objectives and most engage in FDI that combines the characteristics of each of the above categories. The motives for foreign production may also change as, for example, when a firm becomes an established and experienced foreign investor (Dunning, 1993,).

#### **2.4 Benefits of Foreign Direct Investment to LDCs**

FDI may have wider and technological benefits through its spill-over effects; it could also encourage the development of technological know-how by and in local firm and institutions, to the detriment of the growth of domestic producers and the national economy (WTO, 1996).

The possible benefits of FDI include the transfer of technology to individual firms and technological spill-over to the wider economy; increased productive efficiency due to

competition from multinational subsidiaries; improvement in the quality of the factors of production including management in other firms and not just the host firm; benefits to the balance of payments through the inflow of investment funds; increase in exports; increase in savings and investment, and hence faster growth of output and employment, consumers may benefit both from lower prices of goods and the introduction of new or better quality goods (WTO, 1996).

Unrestricted capital flows may also offer several other advantages. First, international flows of capital reduce the risk faced by owners of capital by allowing them to diversify their lending and investment. Second, the global integration of capital markets can contribute to the spread of best practices in corporate governance, accounting rules, and legal traditions. Third, the global mobility of capital limits the ability of governments to pursue bad policies. In addition to these advantages, which in principle apply to all kinds of private capital inflows, the gains to host countries from FDI can take several other forms:

- i. FDI allows the transfer of technology particularly in the form of new varieties of capital inputs that cannot be achieved through financial investments or trade in goods and services. FDI can also promote competition in the domestic input market.
- ii. Recipients of FDI often gain employee training in the course of operating the new businesses, which contributes to human capital development in the host country.
- iii. Profits generated by FDI contribute to corporate tax revenues in the host country.

Of course, countries often choose to forgo some of this revenue when they cut corporate tax rates in an attempt to attract FDI from other locations. For instance, the sharp decline in corporate tax revenues in some of the member countries of the Organization for Economic Cooperation and Development (OECD) may be the result of such competition. In principle, therefore, FDI should contribute to investment and growth in host countries through these various channels. (Feldstein, 2000)

The benefits of FDI consists of (a) transfer of technology (b) transfer of capital (c) enhancement of managerial capacity and skills, (d) access to world market, and (e) employment opportunities (Dahal and Aryal, 2000,).

*Foreign direct investment has come to be widely recognized over the past decade as a major potential contributor to growth and development. It can bring capital, technology, management know-how and access to new markets. In comparison with other forms of*

*capital flows, it is also more stable, with a longer-term commitment to the host economy (Ricupero and Cattai, 2004).*

*Foreign direct investment (FDI) can play a key role in the economic growth and development process. The importance of FDI for development has dramatically increased in recent years. FDI is now considered to be an instrument through which economies are being integrated at the level of production into the world of globalization by bringing a package of assets, including, capital, technology, managerial capacities and skills, and access to foreign markets. It also stimulates technological capacity-building for production, innovation and entrepreneurship within the larger domestic economy through catalyzing backward and forward linkages (UNCTAD, 1998). FDI is perceived to be superior to other types of capital inflows for several reasons:*

- i. In contrast to foreign lenders and portfolio investors, foreign direct investors, typically, have a longer-term perspective when engaging in a host country. Hence, FDI inflows are less volatile and easier to sustain at times of crisis.
- ii. While debt inflows may finance consumption rather than investment in the host country, FDI is more likely to be used productively.
- iii. FDI is expected to have relatively strong effects on economic growth, as FDI provides for more than just capital. FDI offers access to internationally available technologies and management know-how, and may render it easier to penetrate world markets.

## **2.5 Policy Framework of FDI in Nepal**

The most significant foreign investment laws are: the Foreign Exchange (Regulation) Act of 1962; the Foreign Investment and One Window Policy of 1992; the Foreign Investment and Technology Transfer Act of 1992 and its Amendments; the Immigration Rules of 1994; the Customs Act of 1997; the Industrial Enterprises Act of 1992; the Electricity Act of 1992; the Privatization Act of 1994 and the annual Finance Act, which outlines customs, duties, export service charges, sales, airfreight and income taxes, and other excise taxes that affect foreign investment.

The Foreign Investment and One Window Policy lists acceptable forms of investment, allows for foreign shares up to 100 percent in business areas not on its negative list, establishes



currency repatriation guidelines, and outlines visa arrangements, arbitration guidelines, and a special one window committee for foreign investors. The Foreign Investment and Technology Transfer Act (FITTA) 1992, which was revised in 1996, 2000, 2002, and 2010, eliminated the minimum investment requirement, while opening legal, management consulting, accounting, and engineering services to foreign investment, with a 51-percent ownership limit. It also clarified rules relating to business and resident visas. In general, under the FITTA all agreements related to foreign investment are governed by Nepali law and subject to arbitration in Kathmandu under United Nations Commission for International Trade Law rules. However, foreign law can be applicable in cases where the foreign investment exceeds NRS 500 million (approximately USD 6 million) and where the parties make this choice clear in their agreement.

The Customs Act and the Industrial Enterprises Act, revised in 1997, established invoice-based customs valuations and eliminated many investment tax incentives, replacing them with a lower, uniform rate. The Electricity Act defines special terms and conditions for investment in hydropower development. The Privatization Act of 1994 authorizes and defines the procedures for privatization of state-owned enterprises to broaden participation of the private sector in the operation of such enterprises.

Additionally, the terms and conditions of intellectual property protection are defined by the 1965 Patent, Design and Trademark Act and the 2002 Copyright Act. The latter covers all types of electronic audio and visual materials and subject's violators to fines and imprisonment, as well as the confiscation of unauthorized materials. Violators also have to pay compensation claimed by the copyright holder. However, it does not meet the standards for trade-related intellectual property rights required by the World Trade Organization. The Government of Nepal is working to revise its intellectual property rights legislation to meet international standards.

The Competition Law 2004 controls anti-competitive practices, protects consumers against monopoly rights of trading enterprises, promotes fair competition for the growth of trade and commerce, and includes provisions for the control of mergers and acquisition of two or more firms that have the potential of gaining dominance in the market and acquisition of monopoly rights. The Competition Law also contains special provision for controlling black marketing and misleading advertisements.

Most of the acts and policies, and their amendments, governing foreign and private investment in the potential sectors were brought out during the last decade. However, implementation and enforcement of these laws and policies remain a challenge. Additionally, the transitional political atmosphere renders the investment climate in Nepal uncertain.

## **2.6 Institutional Arrangements**

In August 2011, a high-level Investment Board was created to serve as a one window facility for domestic and foreign investors pursuing large projects greater than Rs.10 billion or approximately USD 130 million or projects in “priority areas” such as fast-track roads, hydropower projects over 500 MW, railways, medical colleges, tunnel roads and bridges, cable cars, international and regional airports, urban solid waste management, chemical fertilizers and petroleum refinery plants. The Board, chaired by the Prime Minister, has the authority to formulate investment policies, prioritize and approve projects, facilitate the signing of agreements among different ministries, provide financial and nonfinancial facilities, procure land, monitor project progress, order government agencies to issue necessary project approvals and override any regulations in the existing laws in the name of investment promotion. The creation of the Board is meant to help cut through bureaucratic red-tape and expedite investments coming into Nepal.

Prior to the establishment of the Investment Board, the Department of Industry, under the Ministry of Industry, was designated as the “one window servicing agency” for all foreign investment to facilitate corporate registration, land transfers, utility connections, administrative services agreements, and coordination among various agencies. The Department also registers and classifies foreign investments and manages the income tax and duty drawbacks granted to some foreign investments. The Department of Industry remains the focal point for foreign investments of less than NRs. 10 billion, or investments outside of the priority areas.

The Industrial Promotion Board (IPB), chaired by the Minister of Industry, is the primary government agency responsible for foreign investment. It is charged with coordinating policy-level institutions, establishing guidelines for economic policy, approving foreign investment proposals, and determining applicable investment incentives.

Under current administrative procedures, foreign investors are required to obtain licenses for manufacturing or service sector investments, and each license request is considered individually. Investments below 2 billion rupees (approximately USD 25 million) are referred to the Department of Industry for action and are typically approved at the departmental level without the involvement of the IPB. However, investors frequently complain about bureaucratic delays and lack of transparency in procuring investment licenses. For investments exceeding Rs.2 billion, up to six ministries other than the Ministry of Industry review a business proposal prior to consideration by the IPB.

The Department of Electricity Development, under the Ministry of Energy, is responsible for licensing all investments in hydropower projects. However, decisions on project proposals that involve foreign investment are invariably made by the Ministry of Energy itself. Similarly, Nepal Rastra Bank (NRB), the country's central bank, is responsible for issuing licenses to operate commercial banks and financial institutions. The Insurance Board (IB) is responsible for issuing licenses to operate insurance companies, both life and general. The Civil Aviation Authority of Nepal (CAAN) is responsible for granting operating licenses to both domestic and foreign airline operators, and the Nepal Telecommunications Authority (NTA) is responsible for issuing licenses for operating any type of telecommunications and information technology services.

Licensing of new investments is often time-consuming and requires legal counsel and patience. The IPB, for example, is mandated by law to make a licensing decision within 30 days of submission of an application, but this deadline is not generally met because of the legal provision that all necessary information must have been submitted before a decision can be made. In practice, multiple meetings are usually required before the information is deemed sufficient.

The Board of Investment was formed in Nepal on 27 December 2001 under the chairmanship of the Prime Minister. The Board was set up in order to promote investment and make it more transparent and reliable. The other objectives of Board include: formulation of new policies by reviewing the existing investment policy, maintaining coordination between various government and non-government organizations for the promotion of investment, pinpointing the areas of priority sector for investment promotion, monitoring the activities associated with investment promotion and providing directives to the concerned department to boost up investment.

## **CHAPTER III**

### **RESEARCH METHODOLOGY**

Research methodology is a systematic way to solve the research problem. It may be understood as a science of studying how research is done scientifically. In it we study the various steps that are generally adopted by a researcher in studying his research problem along with the logic behind them.

The main objective of this study is to analyze the Foreign Direct Investment of Nepal. So, the present chapter outlines the entire research methodology used and followed in this study. It has focused on research design, nature and sources of data, processing procedure and statistical tools analysis.

#### **3.1 Research Design**

Research design is planned structure and strategy of investigation conceived to obtain answer to research objective through analysis of data. The first step of the study is to collect necessary information and data concerning the study. Therefore, research design means the definite procedure and technique, which guides the study and propounds ways of doing research.

It is the entire process of planning and procedures that are employed for carrying out a research study i.e. collecting, analyzing and interpreting the data and evidence. As the objectives of the present study, viz. examine the FDI in the different sectors and their nature, employment opportunity and technology transfer, examine existing policies relating to foreign investment role of FDI in economic development and the constraints in promoting FDI, type of research design covered in the study are both descriptive and analytical in nature.

#### **3.2 Instrument Sources of Data**

The study is based on secondary data; present study is basically an exploratory one. The analytical dimension, has been however, given where possible.

The secondary data including information collected from Department of Industry, Foreign Investment Promotion Section, Ministry of Industry, Central Library of TU, NIDC, Central Bureau of Statistics, CEDA Library, Federation of Nepal Chamber and Commerce Industry (FNCCI), and FDI Department.

### **3.3 Data Collection Tools and Techniques**

To understand the basic concept about the Foreign Direct Investment, its trends, policies, institutional arrangements and composition different kinds of Journals, Books, Articles, documents etc. are used as a secondary source of information. The researcher visited the Department of Industry, FDI Department, T.U library, Ministry of Finance, Ministry of Industry, FNCCI and also visited different websites to collect the relevant data for the research purpose.

### **3.4 Data Analysis**

The goal of presentation and analysis of data is to handle the evidence fairly, to produce convincing logical conclusions and to rule out alternative interpretations. Data analysis involves turning a series of recorded observations into descriptive statements (Y in 1994). Therefore, after the data is collected from different sources, the next step is to process, analyze and interpret them to drive meaningful conclusion.

The various data collected from different sources will be compiled condensed, analyzed and presented in the form of tables and diagrams, graphs and chart with the help of Microsoft Excel. In order to exclude the irrelevant unnecessary data and process them as per thesis and project work requirements, data will be edited, coded, categorized and property tabulated. The data will be arranged, grouped and accordingly entered into appropriate tabular form.

To fulfill the other objectives of FDI in different sectors, role of FDI in economic development, employment opportunity and technology transfer; the collected data has been analyzed by using tabular and graphical presentation and its description using Microsoft Excel. Moreover, the theories, policies, empirical evidences related to FDI have been used to discuss about the findings of the research.

### **3.5 Statistical Methods**

#### **3.5.1 Regression Analysis**

It attempts to establish the nature of relationship between dependent and one or more independent variables. It also provides a mechanism for prediction or forecasting. The regression of  $Y_{GDP}$  on  $X_{FDI}$  is used to estimate the value of the dependent variable  $Y_{GDP}$  for any given value of independent variable and vice versa.

To examine the relationships between independent and depend variables, the estimated equation is:

$$Y = a + bX$$

Y = depend variable ( $GDP_n$ )

X = independent variable ( $FDI_n$ )

a = constant    b = coefficient

The regression equation of GDP is estimated on total foreign direct investment. For this estimate, it is used as equation:

$$Y = a + bX$$

Y =  $GDP_n$

X =  $FDI_n$

a = regression constant

b = regression co-efficient

### 3.5.2 Statistical Test of Significance

Standard errors of estimates SEE, like SD, measure the reliability of the estimating equation and estimating coefficients. The larger the SEE, the greater happens to be the dispersion of scattering of given observations around the regression line (or coefficients) and no better the estimates. On the other hand, the smaller value of SEE, better the regression line (or coefficients) and the better the estimated based on the equation for this line. With help of SEE, it is possible to ascertain how good and representative the estimated regression line (or coefficients) are as a description of the average relationship between two series. For this study, the SEE, for regression coefficients have been calculated by using SPSS software.

### 3.5.3 Test of the Goodness of Fit ( $R^2$ )

After estimating the regression parameters,  $R^2$  is used for judging the explanatory power, which measures the dispersion of observation around the regression line. It is essential, because the closer the observation to the line, the better the goodness of fit, that is the better explanation of the variations of Y by the change in the explanatory variables.  $R^2$  shows the percentage of the total variation of the dependent variable that can be explained by the independent variables of the multiple determinations and is the square of the correlation coefficient. The formula to derive  $R^2$  is mentioned below:

$$R^2 = \frac{\hat{b}_1 \sum y_{x1} + \hat{b}_2 \sum y_{x2} + \dots + \hat{b}_n \sum y_{xn}}{\sum y^2} \quad \text{or, } R^2 = \frac{SSR}{SST}$$

Where,

$$y = Y - \bar{Y} \quad x = X - \bar{X}$$

### 3.5.4 Test of Significance of the Parameters Estimates

It is applied for judging the statistical reliability of the estimates of the regression co-efficient. The following tests have been performed to test the hypothesis of the study.

#### t-test

This test performs in order to identify the statistical reliability of the estimates of the regression co-efficient and the formula for calculating the value is:

$$t = \frac{\hat{b}}{SE(\hat{b})}$$

Where,  $\hat{b}$  = estimated value of b,       $SE(\hat{b})$  = standard error of b,

$$SE(\hat{b}) = \sqrt{\text{var}\hat{b}}$$

The calculated t- values are compared with tabulated t- values at a certain level of significance, for a given degree of freedom. If the calculated t- value exceeds the tabulated value, it is inferred that estimated co-efficient is significantly different from zero.

#### F- test

F-test is used to examine the overall significance of the model

The formula for calculation is 
$$F = \frac{R^2/k-1}{(1-R^2)/N-K}$$

Where,       $R^2$  = co-efficient of determination  
               $K$  = Number of explanatory variable  
               $N$  = Number of observation in the sample

The calculated F-variance ratio is compared with the tabulated value at a specific level of significance with (K-1) and (N-K) degree of freedom.

If  $F_{\text{cal}} < F_{\text{tab}}$ , we accept null hypothesis

If  $F_{\text{cal}} > F_{\text{tab}}$ , we reject null hypothesis or we accept alternative hypothesis.

## CHAPTER IV

### POLICIES OF FOREIGN DIRECT INVESTMENT IN NEPAL

The history of foreign investment goes back to 1951-52 when Nepal Commercial Corporation was set up as a joint venture with 67 percent equity of Indian investors. The registration process was slow with slightly more than 10 units being registered during the 1960s. In 1961, there was a provision of foreign investment in medium scale industries with the investment of Rs 50,000 to Rs 500,000 and large-scale industries with the investment of more than Rs 500,000 (MoI, 2016).

#### 4.1 Definition and Classification of Industry

According to the “Foreign Investment on Technology Act (1992)” of Nepal, “Foreign Investment” means the Investment in Share (Equity), reinvestment of the earnings, Investment made in the form of loan or loan facilities made by a foreign investor in any industry.

“Foreign Investor” means any foreign individual, firm, company or corporate body involved in foreign investment or technology transfer including foreign government or international agency.

“Technology Transfer” means any transfer of technology to be made under an agreement between an industry and a foreign investor on the following matters:

- i. Use of any technological right, specialization, formula, process, patent or technical knowhow of foreign origin.
- ii. Use of trademark of foreign ownership.
- iii. Acquiring any foreign technical, consultancy, management and marketing service.

With the establishment of Industrial Enterprise Act 1992 Foreign Investment is welcome to the medium and large scale industries with 50 percent and 100 percent ownership having more than Rs.30-100 million investment in the fixed Assets.

In section 3 of the Industries Enterprises Act 1992, industries will be classified into following broad categories:



### **a. Manufacturing Industries**

Industries which produce goods by utilizing or processing raw materials, semi processed materials, by products or waste products or many other goods.

### **b. Energy Based Industries**

Industries which generate energy from water resources, wind, solar, coal, natural oil, gas, bio gas or any other sources.

### **c. Agro and Forest Based Industries**

Business mainly based on agriculture or forest products such as integrated agriculture and silk production, horticulture and fruit processing, animal husbandry dairy industry poultry forming, fishery, tea gardening and processing, coffee farming and processing, vegetable seed farming, mushroom, vegetable farming or vegetable processing, tissue culture, green house, bee keeping, honey production, floriculture and production and forestry related business such as lease-holder, agro forestry etc.

### **d. Mineral Industries**

Mineral excavations or processing industries.

### **e. Tourism Industries**

Tourism lodging, motel, hotel, restaurant, resort, travel agency, skiing, gliding, water rating, cable car complex, pony-trekking, trekking, hot air ballooning, parasailing, golf course, polo, horse riding, etc.

### **f. Service Industries**

Workshop, printing press, consultancy service, baling business, public transportation business, photograph, hospital, nursing house, education and training institution, laboratory, air services, cold storage, etc.

### **g. Construction Industries**

Road, bridge, ropeway, railway, trolley bus, tunnel, flying bridge and industrial, commercial, commercial and residential complex construction and operation.

## **4.2 Foreign Investment and Technology Act, 1981**

The first official acknowledgement of the importance of foreign investment was recognized in Sixth Five Year Plan (1980/81- 1984/85), where it was delineated that foreign investment and technology was required primarily in large scale industries and mineral-based industries. As a result, the Foreign Investment and Technology Act 1981 was enunciated. The salient features of the act were: (a) industrial units set up under the Act would not be nationalized; and b) industrial units set up under the act would receive the same facility, concession and protection as provided by the Industrial Enterprise Act, 1982. Foreign investors were permitted to have majority of shares in medium scale industries but were permitted 100 percent in large scale industries, with more than Rs.10 million investments in fixed assets.

Various facilities and provisions were included in the Act for instance, production oriented industries with 25-50 percent value-added would be granted full income tax exemption for five years. Analogously, tourism-based industries were granted full income tax exemption for a minimum of 7 years and the industries set up in underdeveloped areas were exempted from excise duty for a minimum of 5 years. Moreover, convertible foreign currency facilities were to be provided to joint venture industries for importing machineries, equipment's and tools, spare parts and components, raw materials as well for technical consultancy and management fee. Still, the Act restricted any foreign investment and transfer of technology to small and cottage industries to keep the sector solely for Nepalese entrepreneurs.

## **Foreign Investment and Technology Transfer Act, 1992**

According to Foreign Investment and Technology Transfer Act (FITTA) of 1992, the foreign investment means:

- i. Investment in share (equity)
- ii. Reinvestment of the earnings derived from the investment in share (equity), and
- iii. Investment made in the form of loan or loan facilities.

According to Act, "Technology Transfer" means any transfer of technology to be made under an agreement between an industry and a foreign investor on the following matters:

- i. Use of any technological right, specialization, formula, process, patent or technical know-how of foreign origin.
- ii. Use of any trademark of foreign ownership.

iii. Acquiring any foreign technical, consultancy, management and marketing service.

By the Act, “Foreign Investor” means any foreign individual, firm, company or corporate body involved in foreign investment or technology transfer including foreign government or international agency.

Foreign Investment and Technology Transfer Act lays down the basic law governing foreign investment in the country. The FITTA has undergone its first amendment in 1996 aiming at making the environment of industrial investment more congenial, straightforward, encouraging and transparent.

According to FITTA, 1992 permission is given to the foreign investor to repatriate the following income outside the country:

- a) Amount received by the sale of the share of foreign investment as a whole or any part thereof.
- b) The amount received as profit or dividend in lieu of the foreign investment.
- c) The amount received as the payment of the principal of and interest on any foreign loan.

Some other major features of FITTA, 1992 are as follows:

**a) Provision Relating to Visa**

The provisions relating to Visa according to FITTA, 1992 are as follows:

- 1) A foreign national visiting the kingdom of Nepal in connection with undertaking any study or carrying out any research with the objective of making investment in the kingdom of Nepal shall be provided a non-tourist visa for up to six months.
- 2) A foreign investor or dependent family or authorized representative of such a foreign investor and dependent family of such authorized representative shall for the purpose of stay in the Kingdom of Nepal be provided a business visa until the foreign investment is retained (Amended by the First Amendment).
- 3) Provided that a foreign investor who, at a time, makes investment in an amount no less than one hundred thousand United States dollar or in convertible foreign currency equivalent thereto, and his dependent family shall be granted a residential visa until such investment is retained.

## **b) Settlement of Disputes**

FITTA, 1992 provides separate dispute settlement procedures which are as follows.

- 1) If any dispute arises between a foreign investor, national investor or the concerned industry, the concerned parties shall be required to settle the dispute by mutual consultations in the presence of the department.
- 2) If the dispute could not be settled in the manner as referred to in subsection (1) above, it shall be settled by arbitration in accordance with the prevailing arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL).
- 3) The arbitration shall be held in Kathmandu; the laws of Nepal shall be applicable in the arbitration.
- 4) Notwithstanding anything contained in sub sections (1), (2) and (3) above, disputes arising in regard to foreign investment made in the industries with investment as prescribed may be settled as mentioned in the foreign investment agreement.

### **4.3 Procedures for Repatriating Facilities**

For the repatriation of the sale of shares of the foreign investor, he/she or the concerned company must apply to the DOI for recommendation to the central bank.

#### **4.3.1 Documents Required for the Repatriation of Sales of Shares**

- a) Proof of investment and number of shares owned.
- b) Letter from the company stating the completion of the transfer of the related shares duly certified by the Company Registrar's Office or such competent body.
- c) Prior approval of DOI, if the share was transferred to any foreign national.
- d) Tax Clearance Certificate.
- e) Custom declaration from and the approval letter if the investment was made in the form of plant, machinery and equipment.
- f) Copy of the Board of Director's Resolution.

#### **4.3.2 Documents Required for Applying to the DOI to Get Recommendation for Repatriation of Dividend**

- a) Documentary proof of investment made which is issued by the commercial bank. This document is needed only for the first time and again only when further investment is made by the investor,

- b) Custom declaration certificate of the import of plant machinery and equipment if the investment by the foreign investor has been made in the form of capital equipment.
- c) Auditor's report including balance sheet and profit and loss account.
- d) Tax Clearance Certificate.
- e) Proof of dividend declaration.

#### **4.3.3 Documents Required for Repatriating Loan and Interest**

- a) Certificate from the commercial bank regarding the transfer of loan amount into Nepal,
- b) Custom declaration certificate and invoice of the plant machinery if the loan was obtained in the form of machinery,
- c) Letter of approval of the loan agreement,
- d) Tax Clearance Certificate.

#### **4.3.4 Documents Required for Repatriating Technology Transfer Fees**

The industrial unit with approved technology transfer agreement, trademark, license agreement, management agreement and technical assistance agreement can apply to the DOI for the transfer of fees as per the agreement. The company has to submit the calculation of the amount due to the foreign technology transfer certified by the auditor along with the certificate of payment of income tax on royalty as per the prevailing tax rate.

#### **4.3.5 Documents Required for Repatriation of the Salaries and Allowance of the Expatriates:**

- a) Work permit issued by the Department of Labor.
- b) Document showing the amount of salary and allowance received during the period for which the repatriation is sought.

### **4.4 Visa Arrangement**

#### **4.4.1 Types of Visa**

There is provision of seven categories of visa in the Immigration Act 2049 and Immigration Regulation 2051. There are.

- a) Diplomatic Visa
- b) Official Visa
- c) Study visa
- d) Non-tourist visa
- e) Business visa
- f) Tourist visa
- g) Residential visa

But only the last four categories of Visa (d-g) are relevant to foreign investors and expatriate personnel.

#### **4.4.2 Charges for Obtaining the Visa**

##### **a) Tourist Visa**

A tourist can be granted tourist visa for up to 150 days in one visa year (Jan. 1 to Dec. 31)

The charges for this category of visa are as follows:

- i. Single entry (first time in one visa year), for 60 days' duration, the fee is US\$ 30 or equivalent. Any extension of such visa will be charged US\$30 or equivalent for a period of 30 days.
- ii. Multiple entries for one visa-year duration, one off payment, the fee is additional US\$ 50 or equivalent
- iii. Single entry (Re-entry in Nepal), for 30 days' duration, the fee is US\$ 30 or equivalent. However, if the tourist had not spent more than 15 days in earlier visit, no visa fee will be charged.

But citizens of China and SAARC countries will not be charged visa fees. Similarly, any visitor spending less than 3 days in Nepal will not be charged fee.

##### **b) Non-Tourist Visa for Carrying Out the Feasibility Study**

###### **b.1 Non-Tourist Visa**

Foreign visitors, wishing to undertake research and study with a purpose of investing in Nepal may be granted a non-tourist visa by the Department of Immigration for a maximum period of 6 months on recommendation of the DOI. The charge for this category of visa is as follows:

- i. If issued at the port of entry US\$ 25 for 30 days.
- ii. In another situation, US\$ 60 per month.

## **b.2 Non-Tourist Visa for Expatriates**

If required skilled manpower is not available locally, industry can employ foreign nationals by obtaining work permit. Such expatriate personnel working in the industries will be granted a non-tourist visa for duration of one year at a time on recommendation of DOI and Department of Labor.

The charges for this category of visa are:

- i. First year US\$ 60 per month.
- ii. Second year onwards US\$ 100 per month.

## **c) Business Visa**

Foreign investors and/or his/her authorized representative and their dependents will be granted a business visa for up to a period of five years at a time on recommendation of DOI.

The charges for this category of visa are;

- i. For a period of one year and multiple entry -US\$ 100.
- ii. For a period of five years and multiple entry- US\$ 250.

## **d) Residential Visa**

Foreign investor making an investment equivalent to more than US\$ 100,000 a one time and in convertible foreign currency, will be granted a residential visa on recommendation of DOI. This visa can be granted for one year at a time.

The charge for this category of visa is US\$ 200 per year for the first time and US\$ 100 per year for each renewal.

## **4.5 Land Facilities**

Pursuant to the Muluki Ain's (Country Code) provision in the section 3 of chapter on Adal, any foreigners are not allowed to possess any land in any form except otherwise permitted by the government. However, in case of foreign investments, such restrictions are related. Any business parties who incorporate a company in the kingdom of Nepal has rights to hold land without the Government's permission as the company by law is treated to be the juridical

person of Nepalese nationality and hence the company will enjoy the similar rights as Nepali does. Moreover, Pursuant to the section 7.2 of the industrial policy industries are given priority for government land and sites in industrial districts for the establishment of the industries. Further, a one-window committee formed under the Foreign Investment policy is responsible for providing facilities, such as registration, land, electricity, water and facilities on taxation etc., for industries established or to be established through foreign investment. Therefore, notwithstanding to the Adal no. 3 of Muluki Ain, there is no theoretical or practical problem for a company owned by a foreign investment to hold land in Nepal.

#### **4.6 Convertible Foreign Exchange Facilities**

The Act has provided with the convertible foreign exchange facility for importing necessary equipment and tools, spare parts and components, auxiliary raw material and chemical required for the operation of an industry or for the sake of technical consultancy, technical assistance, service fee, management fee, patent duty, market research, industrial promotion, sales promotion etc.

#### **4.7 Procedural Arrangements**

Under FITTA, government approval or permission is required for foreign investment or technology transfer. Pursuant to 12 of Industrial Enterprise Act, a high-level Industrial Promotion Board has been established under the chairmanship of the Minister or State Minister for industries to deal with matters concerning the approval of foreign investments under FITTA. For the establishment of either 100 percent foreign owned enterprises or joint venture industry on a prescribed form along with a detailed feasibility report. The application form calls for information on project objectives, location, total project cost, source of finance, plant capacity, equipment, machinery, raw material requirements and the other specific contribution to be made by the foreign investor and the local investor.

The project proposal is passed by the Department of Industry and operation permission is granted to the industries with the fixed asset investment up to five hundred million rupees within 30 days from the date of application. In case of the fixed asset investment exceeding 500 million rupees, the DOI submits its recommendation to the Industrial Promotion Board for approval. The DOI notifies the applicant about the decision of the Board within 30 days from the receipt of the application. In granting the permission for investment, the DOI specifies facilities and concessions the investor is entitled to. After the issuance of license, the applicant has to apply for the registration of company with the company registrar's office within 35 days from the date of receipt permission.



## CHAPTER V

### TREND ANALYSIS OF FOREIGN DIRECT INVESTMENT IN NEPAL

Foreign Direct Investment in Nepal increased by 5920.90 NPR Million in 2016. Foreign Direct Investment in Nepal averaged 2741.39 NPR Million from 2001 until 2016, reaching an all-time high of 9195.40 NPR Million in 2012 and a record low of -469.70 NPR Million in 2006.

Reform of laws and regulations has allowed the growth of private operations in sectors that were previously government monopolies, such as telecommunications and civil aviation. In 2005, the GON also opened some service sectors to foreign investment. Licensing and regulations have been simplified, and 100-percent foreign ownership is now allowed in the travel and tourism sector, and the production of cigarette and alcohol. Government policy also permits 51 percent foreign investment in consultancy services, such as management, accounting, engineering and legal services, and retail chain stores and franchises having presence in more than two countries. New banking institutions and a small stock exchange provide alternative sources of investment capital. On January 1, 2010, per its accession commitments to the World Trade Organization (WTO), Nepal opened the domestic banking sector to foreign banks, which are now allowed to engage in wholesale, but not retail, banking. Foreign banks operating branches in Nepal can invest only in major infrastructure projects.

The Government has opened the hydropower generation sector to private development, including foreign ownership. In August 2011, the Ministry of Energy announced the new Hydropower License Management Procedure, which promised to award licenses for hydropower projects above 10 MW through a competitive process. However, the process for obtaining licenses for hydropower projects remains cumbersome, and the new policy has created uncertainty about pending license applications. Unreasonable delay in the evaluation of hydropower survey license applications, a poor security environment, corruption, and political instability also discourage long-term investment in this sector.

Despite these steps to open additional sectors, significant barriers to increased foreign investment remain. Basic infrastructure needed to support investment is inadequate. The supply of power and water is insufficient. Transport is difficult and expensive, a problem compounded by the fact that Nepal is landlocked. Most products imported and exported by

ships enter through Kolkata, India, and are then shipped overland. Nepal also lacks trained personnel and basic raw materials. In addition to these challenges, foreign investors must also deal with inadequate and obscure commercial regulations, vague and changeable rules governing labor relations, a non-transparent and capricious tax administration system, and difficulties in obtaining long-term visas. Furthermore, there is often variance between the letter of the law and its implementation.

## 5.1 Trend and Composition of FDI in Nepal

**Table: 1 Trend of FDI in Nepal (1989 to 2017)**

(NPR in million)

Year	Projects No.	Project cost	Fixed cost	Working capital	FDI	Employment No.
Up to 1989	63	5153.0	4307.6	767.6	486.8	10710
1989/90	30	2438.2	2139.6	310.1	398.5	9515
1990/91	23	863.6	690.7	172.8	406.3	2974
1991/92	38	3508.2	2902.1	600.5	597.8	5615
1992/93	64	17886.2	16210.8	1652.8	3083.7	13873
1993/94	38	3733.2	3175.7	547.6	1378.8	4734
1994/95	19	1627.3	1247.9	101.5	477.6	2386
1995/96	47	10047.5	9398.5	464.3	2219.9	8032
1996/97	77	8559.3	6692.2	1486.5	2395.5	9347
1997/98	77	5572.6	5145.5	343.4	2000.3	4336
1998/99	50	5324.4	4380.2	802.5	1666.4	2146
1999/00	71	2669.1	1910.2	707.1	1417.6	4703
2000/01	96	7917.6	6122.5	1795.1	3002.6	6880
2001/02	77	3318.5	1559.6	1701.2	1209.7	3731
2002/03	74	4921.8	3608.3	1313.6	1793.8	3572
2003/04	78	4323.7	3775.9	548.6	2764.8	2154
2004/05	63	1796.1	1149.5	646.6	1635.8	5559
2005/06	116	4121.1	3297.0	824.1	2606.3	7358
2006/07	188	3425.6	2650.6	775.0	3186.0	7389
2007/08	213	20406.4	16898.0	3508.4	9812.6	10709
2008/09	231	9417.9	7530.0	1887.9	6255.1	11108

2009/10	171	13953.8	14988.0	865.8	9100.0	7848
2010/11	210	11252.7	9377.3	1875.4	10053.2	10902
2011/12	226	11909.8	10736.3	1173.5	7138.3	9035
2012/13	317	51990.8	41046.4	10944.4	19818.7	16569
2013/14	305	40712.3	35026.9	5685.4	20107.4	11732
2014/15	371	81395.6	77459.1	3936.5	67480.0	13208
2015/16	341	20396.7	14045.5	6351.2	15139.6	11426
2016/17	4	65.0	47.9	17.1	65.0	130
Total	3678	358707.8	307519.6	51806.4	197698.0	217681

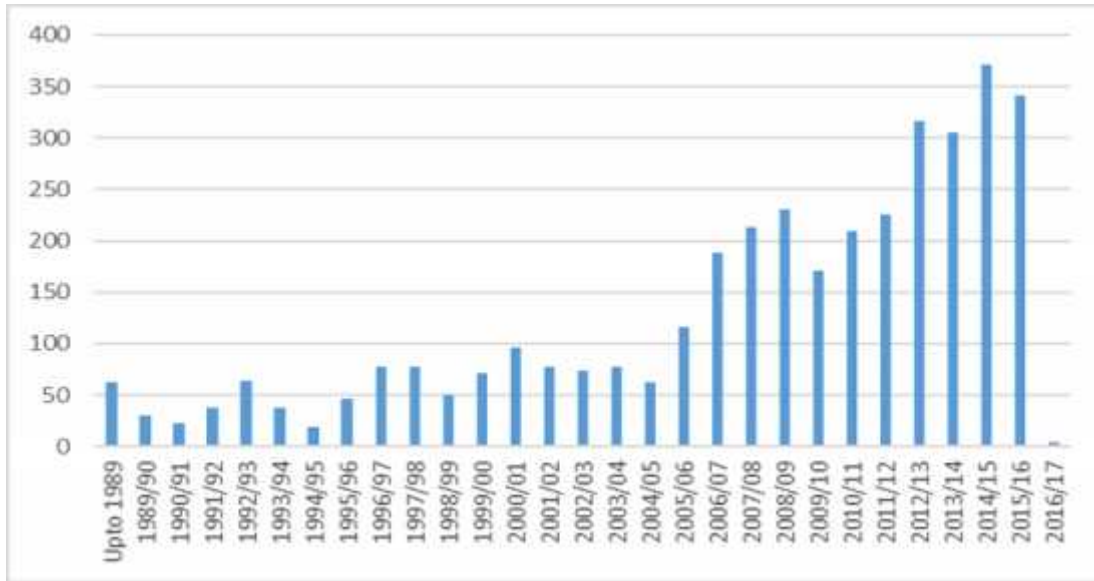
Source: DOI (2017)

Foreign Direct Investment in Nepal increased by 5920.90 NPR Million in 2016. Foreign Direct Investment in Nepal averaged 2741.39 NPR Million from 2001 until 2016, reaching an all-time high of 9195.40 NPR Million in 2012 and a record low of -469.70 NPR Million in 2006.

The trend of year-wise FDI flow in Nepal is erratic and unpredictable. The table 1 shows the investment flow as per the record of DOI from beginning to 2016. It reveals that the highest FDI of Rs.67480.04 million was received in the year 14/15 followed by Rs.20107.42 million and Rs.19818.73 million in the year 13/14 and 12/13 respectively whereas least FDI of Rs.65 million was received in the year 16/17.

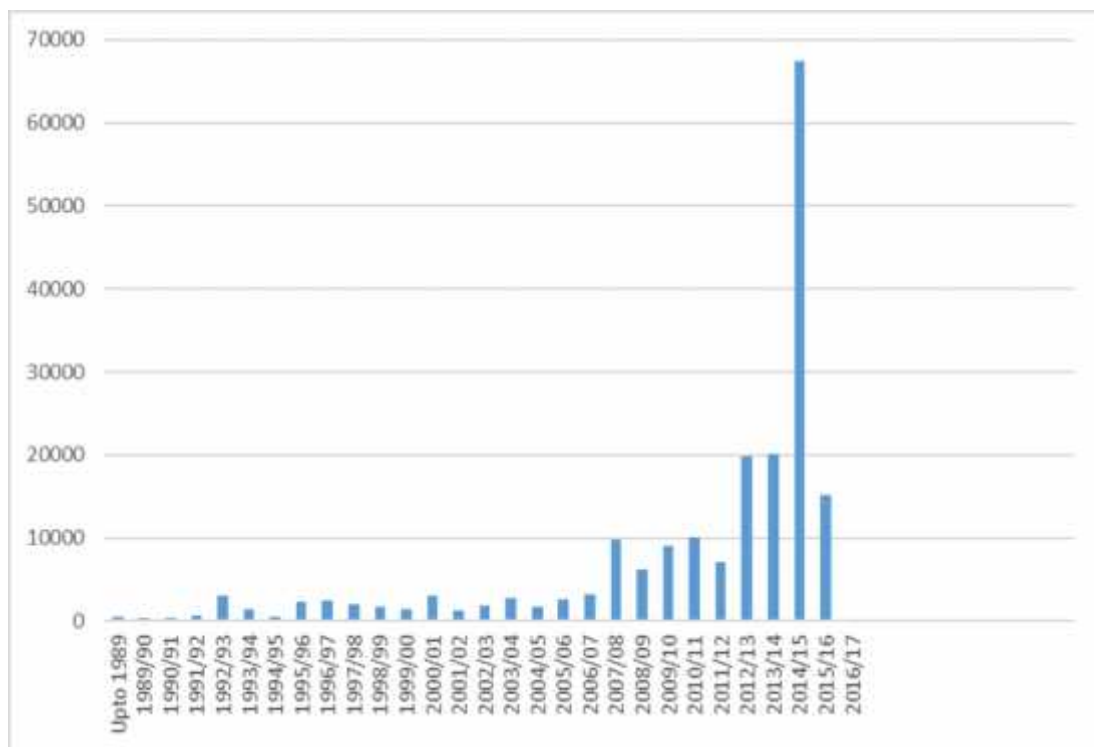
In terms of number of projects, 63 projects were carried out up to 1989. This number increased up to 371 in the year 14/15 followed by 341 and 317 in the year 15/16 and 12/13 respectively. Currently 19 FDI based projects are being carried out in the FY 16/17. As per employment is concerned, highest number of employment recorded till date is 16569 in the year 12/13 followed by 13873 and 13208 in the year 92/93 and 14/15. Whereas only 2146 in the year 98/99 followed by 2154 in the year 03/04. In the current fiscal year, till date number of employment has reached up to 130.

**Figure 1: Number of FDI Projects in Nepal (1989 to 2017)**



Source: DOI (2017)

**Figure 2: Amount of FDI Projects in Nepal (1989 to 2017)**



Source: DOI (2017)

Figure 1 and 2 depicts the trend of number of industries approved for foreign investment, we can find that there is not the constant trend some time it goes up and some time it goes down but in average the number of industries is increasing year by year. Nepal can attract more industries in coming days if it focuses to improve the determining factors like private property rights, infrastructure, regulation, tax rates, corruption transparency etc.

## 5.2 Growth of FDI, DI and FDP in Nepal

**Figure 3: Annual Percentage Change of FDI, DI and GDP in Nepal**

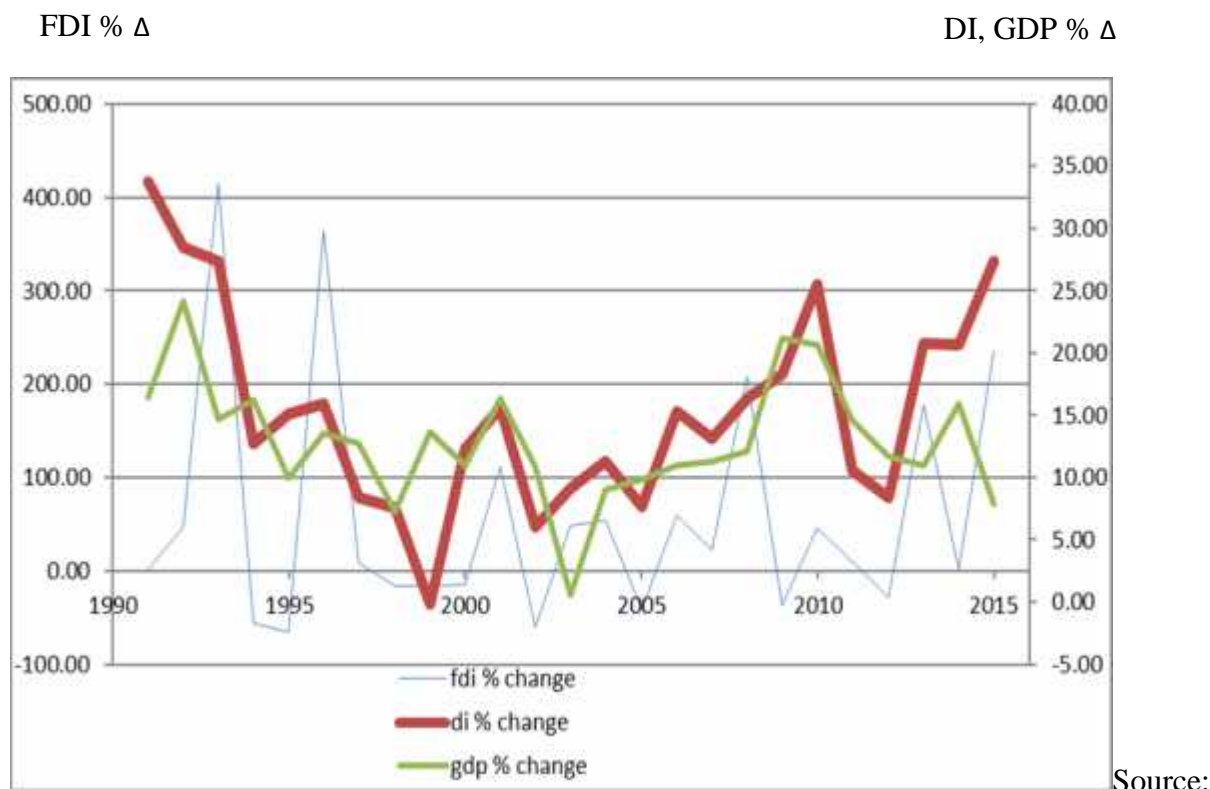


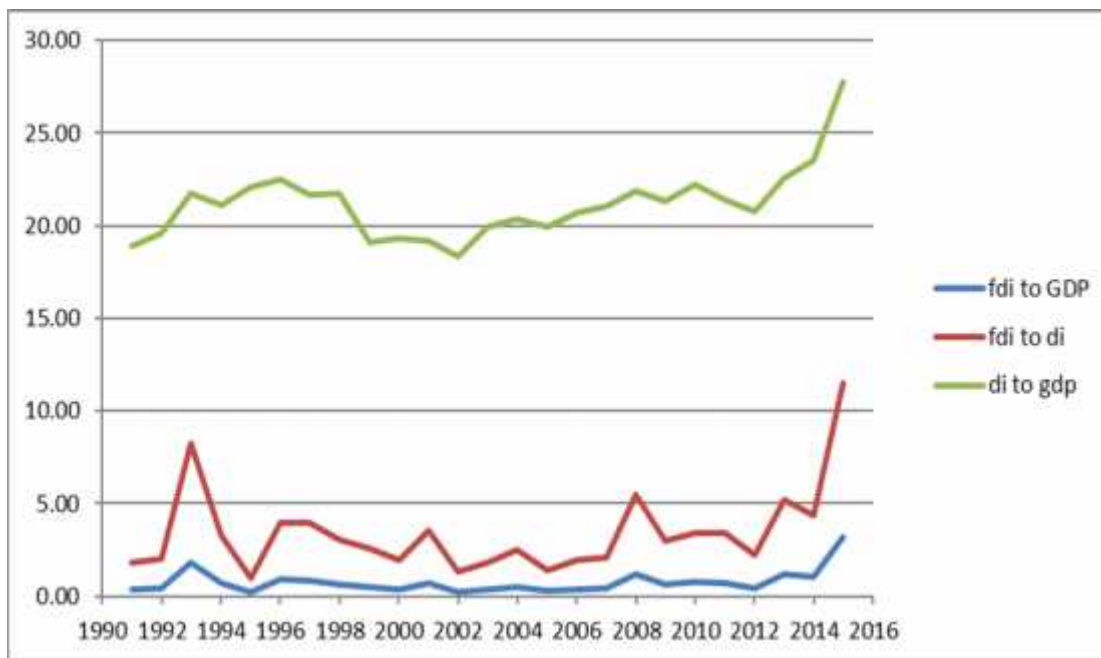
Figure 3 shows the uneven pattern of percentage change in foreign direct investment, Domestic Investment and Gross Domestic Product in Nepal. The then existing Maoist conflict, insurgency and earthquake affected the development activities of Nepal. After the initiation of the peace and reconstruction process in the country, the government has launched the new policies for the attraction of FDI and growth of DI and GDP. Thus, in current period, the size of the FDI has increased. However, the change in FDI is almost positive except in fiscal year 1989/99, 1993/94, 1994/95, 1997/1998, 1998/99, 1999/00, 2001/02, 2003/04, 2007/09, 2011/12, 2015/16 and 2016/17 due to the political instability, Maoist conflict reaching peak point and earthquake disasters.

In case of DI, in the year 1991 highest growth rate of 33.75% was observed followed by 27.34% in the year 2015. Whereas in the year 1999 a negative growth (-0.16%) was observed.

Regarding GDP, highest growth rate (24.19%) was observed in the year 1992 followed by 21.16% in the year 2009. Whereas only 0.57% in the year 2003.

### 5.3 Share of FDI and DI

**Figure 4: Share of FDI to GDP, FDI to DI and DI to GDP**



Source:

DOI (2017)

Fig 4 shows maximum share (27.74%) of DI to GDP in the year 2015 whereas least (18.37%) in the year 2002. In the year 2015, 3.18% and 11.47% of FDI was utilized in the GDP and DI respectively whereas only 0.22% and 0.99% of FDI was shared to GDP and DI respectively in the year 1995.

### 5.4 Category-wise Flow of Foreign Direct Investment

Categorically, there are seven industries which include agriculture, manufacturing, tourism, construction, energy-based, service and mineral- based. The amount of foreign investment in each of these industries is shown in the table 2.

**Table 2: Category-wise Flow of Foreign Direct Investment (up to 2016/17)**

(NPR in million)

Category	Projects No.	Project cost	Fixed cost	Working capital	FDI	No. of Employ
Agro Based	227	5455.6	4247.7	1208.0	4021.1	8733
Construction	45	3825.3	2856.1	964.7	2972.8	3151
Energy Based	75	153564.7	150102.2	5362.5	87572.4	10917
Manufacturing	981	91718.8	72692.1	18164.7	37662.3	92475
Mineral	65	6508.1	5160.1	1348.0	4129.4	8030
Service	1223	61805.4	39451.0	22208.8	40572.8	53733
Tourism	1059	35775.8	32972.4	2533.7	20718.4	40515
Total	3675	358653.7	307481.4	51790.4	197649.1	217554

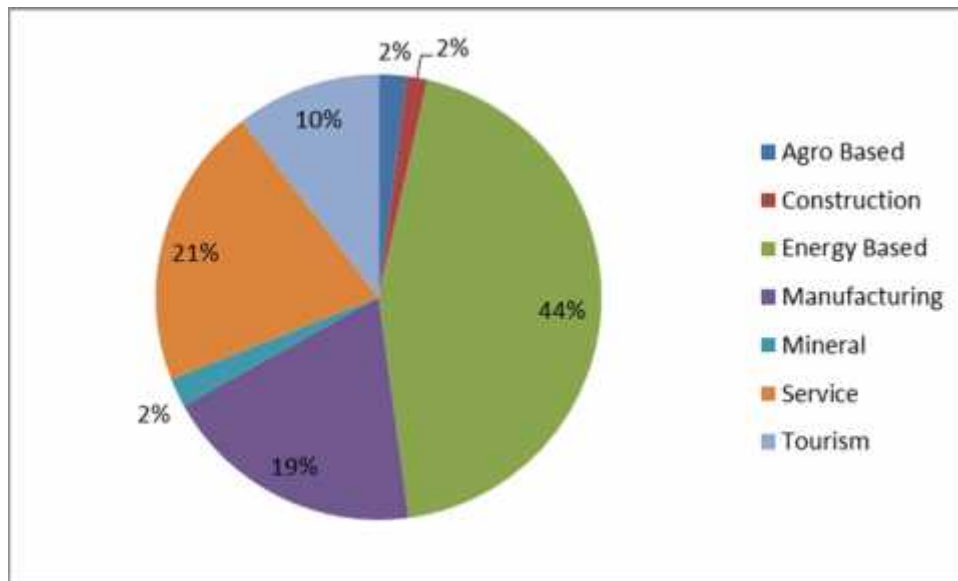
Source: DOI (2017)

The structure of FDI reflects that the number of total industries under different categories marked 3675 in Nepal from beginning to fiscal year 2016. Table 2 reflects that the magnitude of FDI was highest in energy based projects that marked Rs.87572.36 million, which was 44.31% of the total. With Rs.40572.79 million (20.53%) service sector occupied the second position to attract FDI in Nepal. In the context of FDI, manufacturing sector received the third position with Rs.37662.27 million (19.05%), while tourism occupied the fourth position to attract FDI to the tune of Rs.20718.42 million (10.48%), followed by mineral (2.09%), agriculture and forestry based (2.03%) and construction (1.50%) with lowest FDI.

The highest employment was provided by manufacturing sector i.e. 92475, which was 42.51% of the total employment received through FDI. The composition of manufacturing sector consists of nine components in Nepalese context. They are namely food beverage and tobacco, textile and readymade garments, wood and wood product, paper and pulp product, chemical and plastic product, non- metallic MI product, basic metal product, fabric metal and other manufacturing units.

The contribution of service sector to employment was 24.70%, while the share of tourism sector to employment was (18.62%) followed by energy based (5.02%), agriculture (4.01%), mineral (3.69%) and construction (1.45%).

**Figure 5: Percentage Distribution of FDI by type of industries up to FY 2016/17**



Source: DOI (2017)

A look at the figure 5 reveals that energy based sector has commanded 44.31% of total foreign investment inflow, 48.82% of total fixed cost and 42.82% of total project cost. Service sector has highest percentage (33.28%) of projects. Manufacturing industry alone constitutes 42.51% of total employment generation.

In average number of industries is increasing year by year but the number of employed people is not increasing simultaneously. The reasons behind it may be lack of skilled manpower and brain drain, etc. Most of the FDI based companies are hiring foreign workers. In such scenario, Nepal has to focus on technical and practical education, develop the policies to retain skilled and educated manpower to reduce the rate of brain drain as well as in establishing the stable business environment.

As we know that Nepal can attract more FDI in agro-Based, energy based and tourism industries than other sectors but here after energy based industries more investment is done in service and manufacturing industries.

### 5.5 Scale-wise FDI Projects in Nepal



**Table 3: Scale-wise Foreign Investment Projects in Nepal (up to 2016/17)**

(NPR in million)

Scale	Number of projects	Total project cost	Total fixed cost	Total working capital	Total amount of foreign investment	No. of employment
Large	265	275381.57	254142.09	22775.35	136850.73	53095
Medium	377	38599.81	24178.11	13878.52	24491.33	39405
Small	3036	44726.42	29199.35	15152.52	36355.93	125181
Total	3678	358707.80	307519.55	51806.38	197697.99	217681

Source: DOI (2017)

Table 3 shows scale wise distribution of FDI which reveals highest FDI of Rs.136850.73 million was received for large scale industries followed by small and medium scale industries with an FDI of Rs.36355.93 and Rs.24491.33 million respectively. In terms of employment, small scale industries provided highest percentage of employment (57.51%) followed by large scale (24.39%) and medium scale industries (18.10%).

Though Nepal can attract foreign investment in large and medium scale projects, from the above table we can identify that most of the foreign direct investment is directed in increasing the number of small industries. The main reason behind this may be that the Government of Nepal is not being able to establish the amicable and stable business environment to attract foreign investor as well as the foreign investment and technology transfer act is not clear and suitable to foreign investment.

## 5.6 Country-Wise Foreign Investment Projects In Nepal

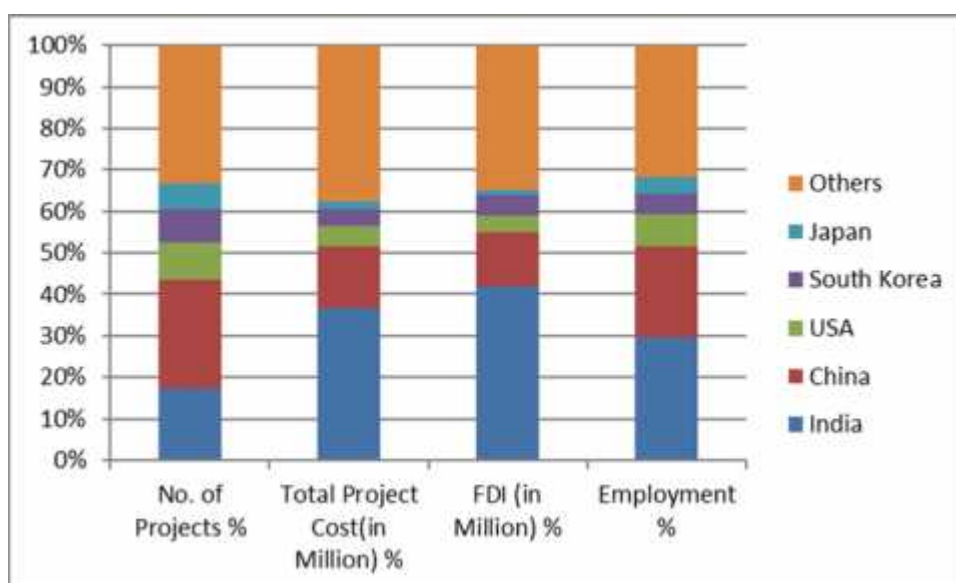
**Table 4: Top five Country-wise Foreign investment Projects in Nepal (up to 2016/17)**

(NPR in million)

SN	Country	Project No.	Project Cost	Fixed Capital	Working Capital	FDI	Employ No.
1	CHINA	951	52,918.85	46,292.37	6,609.91	26,017.50	46,821
2	INDIA	634	129,918.02	113,101.86	18,163.90	80,686.92	65,162
3	JAPAN	223	6,389.33	5,656.16	666.63	2,247.17	8,702
4	SOUTH KOREA	303	13,631.71	11,016.29	2,579.06	9,399.29	10,345
5	USA	322	18,452.45	16,456.29	1,746.12	7,333.26	16,293
	TOTAL	2,433	221,310.36	192,522.97	29,765.62	125,684.14	14,323

Source: DOI (2017)

**Figure 6: FDI-related indicators for the top-five foreign investors in Nepal (up to 2016/17)**



Source: DOI (2017)

Figure 6 shows that with 951 projects China is leading in FDI based projects in Nepal (951), followed by India (634), USA (322), South Korea (303), Japan (223), UK (150), Germany (98), France (80), Australia (59) and Bangladesh (56) and other countries (755). Highest FDI of Rs.80686.92 million was received from India, which was 41.62% of total FDI. The size of FDI from major countries such as China (Mainland) marked Rs26017.50 million (13.42%), followed by China (Honkong) Rs.25187.58 (12.99%), South Korea Rs.9399.29 million (4.85%), USA Rs7333.26 million (3.78%). Indian joint ventures provided the highest

employment through FDI in Nepal, which was 30.18% of the total employment, followed by China (21.69%), USA (7.55%), South Korea (4.79%), UK (4.77%), and Japan (4.03%).

## 5.7 District-wise Foreign Investment Projects in Nepal

**Table 5: Top Five District-wise Foreign Investment Projects in Nepal (up to 2016/17)**

(NPR in million)

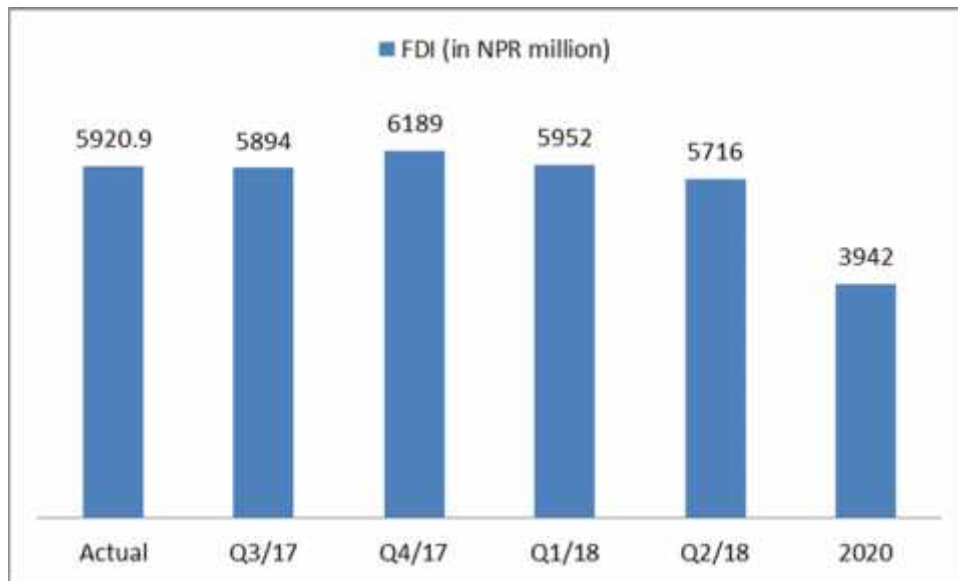
District	Projects No.	Project cost	Fixed cost	Working capital	FDI	Employment No.
Kathmandu	2010	100158.2	77130.4	22757.7	53980.8	97440
Kalikot	1	42106.6	41400	706.6	33685.3	80
Myagdi	3	39015	38707.8	307.2	24335	904
Lalitpur	587	24160.9	15651.1	8496.8	19761	26318
Kaski	248	26747.9	25146.2	1442	11327.4	8949

Source: DOI (2016)

In the Kathmandu district 2010 FDI based projects were carried out, followed by 587 in Lalitpur, 248 in Kaski and so on. In terms of FDI, Kathmandu district received highest FDI of Rs.53980.79 million followed by Kalikot (Rs.33685.28 million), Myagdi (Rs.24335.00 million). Whereas FDI flow in Dhankuta was nil followed by Parbat Rs.1.50 million, Mahottari Rs.3.44 million, Mugu Rs. 9 million, Bajhang Rs. 12 million. Kathmandu district with 97440 employment opportunities tops the list, followed by 26318 in Lalitpur, 8959 in Chitwan whereas only 9 in Mahottari followed by 18 in Mugu district.

## 5.8 FDI Forecast of Nepal

**Figure 7: FDI Forecast of Nepal**



Source: Trading Economics (2017)

Fig 7 shows last year total FDI received was 5920.9 million, which reached 5894 million in the third quarter of 2017. Highest FDI of 6189 million was collected in the fourth quarter of 2017. A drop of 237 million FDI is supposed to occur in the first quarter of 2018 than that of fourth quarter of 2017. FDI inflow is supposed to decrease further in the second quarter of 2018 and will remain constant in 2020.

## CHAPTER VI

### EMPIRICAL ANALYSIS AND INTERPRETATION OF DATA

#### 6.1 Impact of Foreign Direct Investment on Economic Development of Nepal

To study the impact of Foreign Direct Investment on the economic development of Nepal, the present study has used regression equation by using ordinary least-square method. Regression equation is used to analyze the cause and effect relationship between GDP with Foreign Direct Investment (FDI). In statistical analysis, number in parenthesis below indicates the t values of the coefficients. To identify the validity of regression estimates and the value of the parameters; various statistical tests have been used. On the basis of the values of the parameters, we have analyzed the impact of FDI on the economic development of Nepal. However, no attempt has been made to correct the problem of serial correlation. Regression equation in this chapter is conducted by using Excel program.

##### 6.1.1 Effects of Foreign Direct Investment on GDP

This analysis shows the relationship between GDP and Foreign Direct Investment by using the regression equation Y on  $X_1$  which is as:

$$Y = a + bX$$

Where, Y = GDP<sub>n</sub> (Dependent Variable)

X = FDI<sub>n</sub> (Independent Variable)

a, b = Regression parameters

The result of this regression model is:

$$GDP_n = 217685.5 + 87.19 FDI_n$$

$$t \text{ value } a = (9.27)^{***}, b = (9.48)^{***} \quad SEE = 282839.0$$

$$a = 217685.5 \quad b = 87.19 \quad R^2 = 0.782 \quad \bar{R}^2 = 0.773 \quad F\text{-test} = 86.0^{***} \quad D\text{-W test} = 1.69$$

**Interpretation of the Result:**

The fitted equation above shows that there is positive relationship between GDP (Y) and Foreign Direct Investment (X) which means when we increase foreign direct investment than GDP increases. The intercept term (a) is 217685.5 which indicates that Y will be 217685.5 if the independent variable X is zero. The result shows that coefficient of foreign direct investment is 87.19, which explains that one unit increase in foreign direct investment (X) causes GDP (Y) to increase by 87.19 units. The coefficient of determination  $R^2$  is 0.782 which means that 78.2 percent of variation of GDP (Y) is determined by the explanatory variables i.e. Foreign Direct Investment. In other words, if we are trying to explain what may affect to GDP. There might be others factors that could explain this variation, but above model which includes only foreign direct investment can explains about 77 percent of it. This means that 22.8 percent of the variation in GDP cannot be explained by foreign direct investment alone. Therefore, there must be other variables that have an influence also. Adjusted value of  $\bar{R}^2$  is 0.773 which means 77.3 percent of foreign direct investment is influenced by GDP. Similarly, the calculated F-value is 86.0 at 5 percent level of significance which is greater than tabulated F-value 4.24 which implies that the model is statistically very significant. To test the significance of regression coefficient, the t- test is used with at a certain level of significance at n-1 degree of freedom. Since the calculated t value of a (9.27) is greater than tabulated value 2.056 so it is statistically significant. However, the calculated t value of b (9.46) is greater than tabulated value so they are statistically significance. The D-W test (d) is 1.69 at 5 percent level of significance we can find the tabulated value of  $d_l = 1.001$  and  $d_u = 1.312$ . Thus,  $0 < 1.69 < 1.312$  or  $d_u < d < 4-d_u$ . So, there exists no positive or negative autocorrelation

Since the standard error of the estimate of the model seems to be enough i.e. 282,839.0, this model has been run again in log-linear form. The model originally is expressed as

$$GDP_n = \delta_0 + FDI_n \delta^1 \dots\dots\dots(i)$$

The form of the above model may be related in the log-linear form as under,

$$\ln GDP_n = \delta_0 + \delta_1 FDI_n$$

where,  $\delta_1$  assumed as a positive integer

$$\ln GDP_n = 7.772 + 0.665 \ln FDI_n$$

t= value, 0.072, (9.21) \*\*\*

$$R^2 = 0.779$$

$$\bar{R}^2 = 0.77$$

$$SEE = 0.42177$$

$$D-W = 1.60$$

$$F = (84.83)^{***}$$

$$df = 25$$

### Interpretation of the Result:

After analysis of the data there exist significant positive relationship between GDP and foreign direct investment (FDI) of Nepal. If FDI of Nepal increase by 100 percent, GDP will increase by 66.5 percent on an average, which is statistically significant at 10 percent of significance level. The coefficient of determination  $R^2$  is 0.779 which means that 77.9 percent of variation of GDP (Y) is determined by the explanatory variables i.e. Foreign Direct Investment. In other words, if we are trying to explain what may affect to GDP. There might be others factors that could explain this variation, but above model which includes only foreign direct investment can explains about 77 percent of it. This means that 23 percent of the variation in GDP cannot be explained by foreign direct investment alone. Therefore, there must be other variables that have an influence also. Adjusted value of  $\bar{R}^2$  is 0.77 which means 77.0 percent of foreign direct investment is influenced by GDP. Similarly, the calculated F-value is 84.83 at 5 percent level of significance which is greater than tabulated F-value 4.24 which implies that the model is statistically very significant. To test the significance of regression coefficient, the t-test is used with at a certain level of significance at n-1 degree of freedom. Since the calculated t value of a (0.072) is greater than tabulated value so it is statistically significant. However, the calculated t value of b (9.21) is greater than tabulated value so they are statistically significance. The D-W test (d) is 1.60 at 5 percent level of significance we can find the tabulated value of  $d_l = 1.001$  and  $d_u = 1.312$ . Thus,  $0 < 1.69 < 1.312$  or  $d_l < d < 4-d_l$ . So, there exists no positive or negative autocorrelation.

The results on derived through the aforementioned model are explained as below. As the explained percent of variation ( $\bar{R}^2 = 0.77$ ) is good enough and all the statistics seem to be using the acceptable bounds the model is good.

## **CHAPTER VII**

### **PROSPECTS AND CHALLENGES OF FOREIGN DIRECT INVESTMENT IN NEPAL**

#### **6.1 Prospects of FDI in Nepal**

Nepal is one of the attractive destinations for foreign investors due to various reasons. First of all, from location point of view there is tremendous production opportunity for meeting domestic demand. Nepal's attractiveness increases for FDI as a strategic location between India and China. The recent political change has created new environment for the foreign investors in the country because there is a good sign of political stability and peace in the country after the popular people movement of 2006. Nepal is supposed as attractive location for startup new business opportunities especially in the area of tourism, art and crafts, herbs and information technology. Nepal has had a continuous attachment to neutrality in foreign relations, membership to WTO, enactment of favorable policies and laws, availability of wide range of human resources, latest infrastructure in communication, stable currency backed by strong balance of payments, exclusive protective right for foreigner's property. These entire situations make Nepal a strategic place to invest for foreign investors.

Nepal is a second richest country in the world in the matter of water resources. Data reveals that theoretical viability of generating hydroelectricity in Nepal is nearly 83000 MW and economically or commercially 42000 MW. Nepal possesses wide range of investment prospects which if exploited prudentially would turn out to be highly profitable and beneficial to both investors and general masses including government itself in terms of revenues, prices, terms of trade, balance of payment and employment generation through which the objectives of poverty alleviation and attaining higher rate of growth of the country could be achieved. Nepal must build up her competitive capacities to grab the global market by supplying the goods and services in low prices with standard quality maintenance, which would be made possible only if unexploited sectors are brought optimally into use. For the proper exploitation of these unexploited sectors, Nepal needs more funds and modern machines and machineries and as such must be rendered to foreign investors, firm or corporations to operate singly or in Joint Ventures with domestic firms.



There is no doubt to say Nepal is one of the ideal destinations for foreign investors to invest. But there are still so many obstacles existing in the country like conflict in the different parts of Terai and some areas of eastern Nepal etc. If the government addresses the proper demand of opponents in the right time, it will be further beneficial for attracting larger volume of FDI in the country. Some major prospects of foreign direct investment (FDI) in Nepal are discussed below:

### **6.1.1 Hydro-Power**

Economic indicators reveal that Nepal is one of the underdeveloped countries of the world but in terms of natural resources, Nepal is regarded as a rich country, especially in terms of water resources. It is often argued that water resource is the backbone of Nepalese economy, which could be instrumental to provide a new lease of life to sinking economy. It is believed that nearly 42000 MW. Hydroelectricity can be generated in the commercial level. Nepal possesses more than 6000 rivers, many fountains, lakes, ponds and other sources of water. Most of the rivers flow from northern part of the country to the southern part with very high velocity. Therefore, it is very suitable to generate hydroelectricity in different parts of the country.

The total electricity production that had stood at 855.89 MW by the end of FY 2015/16 grew by 105.3 MW (12.3%) in the first eight months of the current fiscal year and reached 961.MW. The total electricity generation in Nepal has reached 965.7 MW (production at full capacity) with the inclusion of 4.5 MW electricity generated through rural electrification projects which are not associated with National Integrated Power System. All these data indicate that Nepal has not been able to harnessing water resources properly. The problem of power generation is not limited only to financial resource but equally important inhibiting factors are the lack of skilled human resources, scientific equipment's and instruments and lack of advanced technology and technical know- how.

### **6.1.2 Tourism Industry**

Nepal is the major tourist destination in the world as it is known by its unrivaled natural beauty, abundant bio-diversity, multiethnic, multilingual, multi religious, and multicultural identities. Tourism has been one of the important sectors in service industry for economic growth from the perspective of comparative and competitive advantages. Diversification and expansion of tourism sector have enhanced people's livelihoods and employment opportunities thereby raising their living standard.

The recent political changes have also created good environment for tourism sector. There are still some challenges to address the socio-economic problems existing in the country. In order to promote foreign investment in tourism industry, investment in travel, trekking, rafting and pony trekking business have been opened for foreigners. Despite of all these potentials, Nepal still lacks sufficient tourism spots, luxurious hotels and parks in the tourist area due to the unavailability of funds. To mitigate these physical problems, Nepal must shake or join hands with foreign governments, business firms and individuals in order to fulfill the ultimate goal of the country to make the Switzerland of Asia in one hand and to create sound physical infrastructure and other facilities needed for the tourist on the other.

Present data reveals that 1059 tourism industries based on FDI are operating in Nepal till the FY 2073/74 (Department of industry- 2073) with the employment generation of nearly 40515 people. In the context of FDI, tourism sector received the fourth priority that leveled Rs.20718.42 million (10.48% of total FDI).

Hence, there are greater prospects of FDI in the tourism industry. But Nepal is still receiving very low amount of FDI in tourism sector. In order to promote FDI into tourism sector peace, political stability, good administration, good governance, investor's friendly policies are crucial.

### **6.1.3 Electrical and Electronic Industries**

The electrical and electronics industry sub-sector in Nepal is still in an early stage of development. According to the annual survey of manufacturing establishments 1994/95, there were 37 firms operating in formal sector activities of which 33 were engaged in electrical industries and 4 in electronic industries.

The domestic demand for electrical goods is expected to increase with expansion of the electric power generation system, telecommunication and radio and TV broadcasting. According to preliminary estimates, significant demand exists for heaters, radio, TV and communication equipment and apparatus, electrical appliances and apparatus, batteries, wires, cables, plugs, switches, lighting fixtures and so on. Prospects for setting up industries to produce these items are, therefore, promising.

Nepal offers very good prospects for the development of electronic assembly industries. The low cost of labor would give Nepal a competitive edge over her locations in South and South East Asia. The labor force has the ability to master quickly assembly operations, which involve use of hand tools such as screwdrivers, pliers etc. In addition to the advantage of low

cost labor, Nepal provides a conducive environment for dovetail assembly schedule with the production of finished goods in overseas locations on a planned basis. Assembly industries that use airfreight for import of components and export of assembled units should be feasible. The products should have a high value to weight ratio. Kathmandu, the capital, has good air connections to Europe through Frankfurt, London, Paris, Amsterdam, Vienna and Moscow and to the Far East through Singapore, Bangkok, Hong Kong, Sanghai and Osaka.

Some of the electronic industries which could be established in Nepal are computer keyboard assembly, single and double side circuit boards, circuit board stuffing and text service, cable harness assembly, domestic mains multi- socket power strips and similar assembly requiring a high labor content. Therefore, FDI can be attracted in the country for the establishment of electrical and electronic industries.

#### **6.1.4 Mineral Exploration and Exploitation**

Nepal is rich in mineral resources. Preliminary geological surveys have revealed that there are varieties of mineral ores, natural gas, coal etc. deposited in various parts of Nepal. However, the extent and possibility of commercial utilization of those mineral deposits are yet to be known.

The mineral resources that could be commercially exploited have been identified as limestone, dolomite, talc, silica, clay, building and construction stone, iron- ore, lead- zinc, petroleum and natural gas.

Iron ore deposits have been found in various parts of Nepal. About 10 million tons of iron ore deposit is estimated in Fulchoki. Similarly, Labdikhola (10 million tons of iron ore), Those (8.4 million tons), Jiwang (1 million ton), Kulekhani, Godawari, Bhaise etc are important sites for iron deposits. More than 30 million metric tons of iron ore deposit is estimated in various parts of Nepal.

Similarly, copper is estimated to be found in about 30 places within Nepal including Budhakhola (Bandipur), Gyaji (Gorkha), Arkhaule (Makanwanpur), Nangre (Nuwakot), Wapsa (Okhaldhunga), Siddhakhani (Illam), Bhutkhola (Tanahun) and others.

Likewise, Mica is found in several places such as Bajhang (Chainpur), Doti, Bhojpur, Lamjung Nuwakot, Dhankuta and so on. Limestone is also found in different parts of the country. The places where limestone is found are Chovar (ktm), Jogimara (Dhading) Bhaise, Udayapur and so on. The total deposits in these places are -8 million tons, one million tons,

25 million tons, and 60 million tons respectively. Moreover, about 30 million tons of limestone in Surkhet and 10 million tons of limestone in Dhankuta is found to be deposited.

Lead is also found in the different parts like Ganesh Himal (0.5 million tons of lead is expected to be found), Arkhaule and Durlang (Makawanpur) Rasuwa, Baglung, Phulchoki, Tripling (Nuwakot), Salmor Valley (Bajhang) and so on. Slate is deposited in Bandipur, Bajhang, Pokhara and some other places of the country. Similarly, Dailekh, Muktinath (Mustang), Phyuthan, Kathmandu, Dhangadhi, Chisapani are some potential areas for natural gas and petroleum deposits. Other notable minerals like magnesite, zinc, coal, nickel, gold, graphite, marble, pyrite etc. are also deposited in various parts of Nepal.

For the exploration and exploitation of all these mineral resources, sufficient capital, efficient manpower, scientific technology, modern equipment's are needed. But Nepal is lacking most of these requirements. In this context, foreign direct investment is crucial for the proper exploitation of the mineral resources which helps to finance the required capital, technology and modern equipment's needed for the proper exploration and exploitation of mineral resources. Natural gas deposit in KTM Valley can be utilized for domestic and industrial uses. Mineral exploration and exploitation in some of the areas identified above offer promising prospects for foreign direct investment.

#### **6.1.5 Air Services**

There are 51 domestic airports in Nepal and some of which are all weather and some fair-weather airports. The government has embarked on open- sky policy permitting private airlines to operate domestic as well as international air services. 16 international airlines are operating their services in Nepal. Private helicopter services are also coming up in Joint Venture. As Nepal is assumed as one of the ideal destinations for tourism and still most parts of the country are lacking airports facilities, private investment with foreign collaboration would be beneficial for the development of tourism sector also. Therefore, Nepal possesses grater prospects of attracting foreign investment in the further development of air services.

#### **6.1.6 Pharmaceutical Industries**

Nepal has a large and growing demand of drugs and pharmaceuticals that are being met by domestic production about 20 percent of the requirements and the balance is met by importation. The market for pharmaceuticals is estimated to be more than Rs. 5,000 million. India based national and multinational companies supply much of the demand. The demand for pharmaceutical is expected to increase significantly over the next decades due to

improvement of modern health care facilities and establishment of a good transportation network within the country.

Good prospects exist for the establishment of a few industries producing pharmaceuticals and drugs. The best areas for investment are in the production of the major high volume product lines of Essential Drugs out of National list of essential drugs, categorized by Ministry of Health, Department of drug Administration.

### **6.1.7 Agro and Forest Based Industries**

Nepal is rich in bio-diversity. Extraordinary similarities and diversities can be seen here. Nepal comprises diverse topographical structure, multitude soil variety and varied climatic environment because of which various biotic and biotic factors are capable of being existent here. The existence of these living and non -living beings lets Nepal to undertake various kinds of manufacturing, textile, tourism, construction, processing and service industries operation of which supplies basic human needs such as medicine, food, clothes to highly deluxe goods like cosmetics, beverages etc.

## **6.2 Challenges of FDI in Nepal**

Geographically Nepal possesses enormous natural beauties. Despite of acquiring numerous medicinal herbs, mines, water resources, agricultural land, etc, it has been failing to attract foreign investors. political risk, seem to be the crucial factors discouraging FDI inflows in Nepal. On the other hand, the incentives (investment policy reforms) have highly attracted FDI. The following factors are responsible for deluding FDI in Nepal.

### **6.2.1 Political Disputes**

Nepal has been suffering states insurgency for a decade. Maoists were responsible for the unpleasant environment, which according to them were fighting against the king's monopoly rule. Several strikes, civil war, 41 riot, etc. reluctantly occurred during this period. Thus, political disputes and loud environment may have been the vital reason to delude foreign investors. The country's political dispute during (2000-2007) severely affected the inward flow of investment, resulting in a nil FDI flow.

### **6.2.2 Geographical Distribution**

Nepal is a landlocked country. The country possesses mountains, hill, river, lakes. Investment in hills or mountain region required more manpower and efficient technology.

The geographical distribution of countries might have hindered investors attraction excluding tourism sector. Road transportation and airways are the only means to flow goods.

### **6.2.3 Lack of Skilled Manpower**

This is another vital reason, why Nepal is lacking FDI. A country with a population of almost 30 million has a majority of unskilled worker. Vocational colleges and institute providing or training people are exceptionally rare in the country. A lump of workers is uneducated, unskilled and possesses no knowledge about technical work.

### **6.2.4 Infrastructure**

This is another sector where Nepal fails. Many villages of Nepal are still untouchable to infrastructure facilities such as road, electricity, health. A lump of villages has substantial resources, but due to lack of road facilities, many investors turn around. For example, due to lack of road transportation in a remote village Jumla, Hundreds of quintals of Apple exploit every year.

## **CHAPTER VIII**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

This chapter presents the summary, conclusion and recommendations. The whole chapter is divided into three sections. The first section deals with summary while the second section deals with key findings and the third section deals with recommendations.

#### **7.1 Summary**

The key goal of developing countries like Nepal is to attain high economic growth rate and reduce poverty with macroeconomic stability. GDP at base prices is estimated to grow by 6.94 percent in current fiscal year 2016/17. Such growth rate remains 2.97 percent in FY 2014/15 and at 0.01 percent in 2015/16. In order to achieve these goals FDI is considered as an accelerator for economic development of Nepal as it provides necessary capital and technology and creates employment opportunities and thus, idle resources get utilized which, in turn, helps to expand production capacities of the country and also opens the access of products to world markets. Thus, FDI plays a vital role to pave the way for economic development for underdeveloped countries like Nepal.

Given the importance of foreign direct investment, this study has specific objective of analyzing the nature and trend of foreign direct investment and its prospects in Nepal.

In order to analyze the trends of foreign direct investment in Nepal, different tools like graph, table, figure etc. have been used. The trend and structure of foreign direct investment has been analyzed by sector, year and country for the period from FY 1989/1990 to 2016/2017.

The amount of FDI was Rs. 398.51 million in FY 1989/90 which has increased to Rs. 15139.63 million in FY 2016. According to DOI records, the highest foreign investment flow after 1989 was Rs. 67480.04 million in FY 2014/15. Till now, Nepal has been able to attract FDI of only Rs. 197697.99 million which is very low in comparison to other countries. Available data for FDI reflects that 3675 foreign investment projects were approved in Nepal comprising of all categories of industries, worth a total of Rs358653.69 million. The total fixed capital is estimated at Rs. 307481.44 million at the end of fiscal year 2016/17. FDI provided 217681 employments to people. The Joint Ventures of India, China, US, Japan, Germany and South Korea are prominent in the structure of FDI.

Categorically, there are only seven industries based on FDI in Nepal which include Agriculture, Manufacturing, Tourism, Construction, Energy-based and service. The inflow of FDI was found highest in energy based sector that marked Rs. 87572.36 million (44.31%) while FDI inflow was found lowest in mineral-based enterprises that marked Rs 4129.35 million at the end of 2016.

By scale flow of FDI reflects that most of FDI has mostly been concentrated in small scale industries in which there are 3036 total industries followed by medium scale industries (377) and large scale industries (265).

Nepal has formulated laws and policies governing FDI. Many facilities and incentives have been offered in order to maximize the location advantage of foreign investing firms. In this regard, the Foreign Investment and Technology Act 1981 was enacted. The salient features of the Act were, a) Industrial units set up under the Act would not be nationalized; and b) Industrial units set up under the act would receive the same facility, concession and protection as provided by the Industrial Enterprise Act, 1982. Similarly, Foreign Investment and Technology Transfer Act, 1992 came into existence to attract technology transfer and foreign investment. According to the Act, foreign investment implies the investment made by a foreign investor in any industry as investment in share (equity), reinvestment of the earnings derived from the investment in share (equity) and investment made in the form of loan or loan facilities.

For underdeveloped countries like Nepal, FDI is indispensable in order to mobilize the idle resources. Nepal is facing the problems of revenue-expenditure gap, trade gap and investment-saving gap. In order to mitigate such problems, FDI is needed for this country. Similarly, FDI is needed to fulfill technological, managerial and entrepreneurial skills, and to expand economy through linkage effects.

Nepal is an ideal destination for FDI owing to its rich natural endowments abundant and cheap labor force, huge market in neighboring countries, growing internal market, a well-developed banking and non-banking financial institutions to cater investor's need for finance, fully convertible current account, preferential entry of products in India, and investor friendly government policy. Investment opportunities are open to almost every sector of economy from tea to mining industries. Tourism is the biggest business in the world and there is hardly a country that does not seek either tourists or investment in tourism. Uniquely, Nepal offers some of the most spectacular tourist attractions in the world. Similarly, Nepal is the second



richest country in water resources. Therefore, there is a greater prospect of attracting FDI for the proper exploitation of water resources, especially for generating hydroelectricity. Likewise, mineral exploration and exploitation in some of the areas of the country offer promising prospects for foreign direct investment. Good prospect exists for the establishment of pharmaceutical industries, leather industries, carpet industries, industries for readymade garments, tea industries and agro and forest-based industries with foreign collaboration in Nepal.

### **Key Findings**

The major conclusions derived from this study are as follows:

1. Economic indicators reveal that Nepal's performance is very poor in terms of GNI per capita, commercial viability of natural resources, the extent of poverty and human development prospects. Nepal has not been able to utilize its existing resources. In this regard, FDI is a crucial factor which helps to mitigate all these problems to some extent.
2. Despite various policy and legal reforms that have been undertaken and incentive provided in the field of FDI, Nepal has been receiving limited FDI.
3. According to present study, the constraining factors for foreign investment in Nepal are inadequate infrastructural base, poor state of law and order, lack of skilled and trained manpower, lack of facilitation and effectiveness of one window system, landlocked ness position of the country, government instability, small market size, bureaucratic hassles, frequent stalemate between India and Nepal over trifle transit and other trade issues and inadequacies and inconsistencies in policies.

Manufacturing sector alone has generated 92475 employment opportunities that constitute 42.51% of total employment provided.

With respect to these data, we may conclude that category-wise possesses very limited employment opportunities but is dominated by manufacturing sector, which is an example of unequal FDI distribution in Nepal. Therefore, FDI has become critical.

A total of 52 countries have invested in Nepal, in which India, China, U.S.A., South Korea and Japan are major FDI sources. India alone has invested 42% of total FDI and 37% of total project cost. This shows that FDI is mainly concentrated from India compared to other countries.

The prospective investment areas in Nepal include energy based sectors like hydropower, agriculture and agriculture related production, manufacturing industries, such as readymade garment and carpet, tourism and service industries.

Despite various challenges faced by foreign investors, Nepal possesses a lot of prospects to attract foreign investors because of friendly socio-cultural environment and high incentives and facilities available in the country. The availability of cheap labor force, markets and other raw materials also attract them to invest in the country.

Even if both saving and investment are growing; the growth rate of saving is lower than growth rate of investment, which causes the widening saving-investment gap in Nepal. Due to high investment-saving gap, the inflow of FDI has become essential in order to maintain the targeted growth rate. The FDI has contributed to bridge the saving-investment gap to some extent.

## **7.2 Conclusion**

From the above analysis despite we see the growing salience of FDI, not only for traditional business related activities but also for financing development, LDCs in general have not been able to grab this opportunity. It is unfortunate to note that despite a recent growth in FDI achieved by Nepal, the country still receives the lowest amount of FDI in the region. Nepal's FDI potential is heavily under-exploited, despite the fact that the country offers a huge potential not only for market seeking investors but also resource seeking ones. Besides, because of the favorable market access opportunities it has got, in the European and Indian markets, investors should find it worthwhile to invest in Nepal. Similarly, resource seeking investors can invest in Nepal to exploit the immense hydropower potentials.

Besides this, investment in other infrastructure projects such as road, rail and airport construction. On the contrary, Nepal does not seem to offer a pleasant investment climate for foreign investors. Although there are several reasons that could lure investors from making long term investment in Nepal, there are three main problems to be noted. First, the political instability, legal uncertainty and lack of rules of law which make foreign investors think twice before making any investment. Second, poor infrastructure on transportation and energy increases the cost of investment. Third, power of trade unions, which have become emboldened particularly after the declaration of Nepal as a republic, has created a certain amount of threat for the overall business climate of the country.

Their never-ending demand for increased benefits/facilities, which, according to them, should not necessarily be linked to their productivity, coupled with their cavalier attitude towards work and poor work ethics, means that foreign investors would most likely invest in other countries or locations (such as those Indian states which are Nepal's immediate neighbors) where they can lead a comfortable life as well as earn a reasonable amount of profit. (Adhikari).

Further, the new Constitution in Nepal can be an opportunity for all governmental as well as the non-governmental organizations to formulate new policies by reviewing the existing investment policies. In order to promote the investments, all the organizations working in collaboration can be an elevating approach.

### **7.3 Recommendations**

Following recommendations are suggested to resolve the challenges and create smoother FDI environment in Nepal.

1. The queries of the investors must be addressed instantly by the Department of Industry (DOI) and other governmental agencies through efficient and equipped modern facilities.
2. In order to attract the foreign investors and foreign investment Nepal should come forward to create Special economic zone (SEZ) and special investment zone (SIZ) which can minimize the legal procedure and other lengthy procedures.
3. Power crisis should be solved through minimizing leakage and corruption. Special emphasis should be given to complete ongoing and stopped hydro projects. Alternatives sources of energy should be identified.
4. Board of Investment should be given power for providing fast track approval to big projects, contradictory of lengthy procedure which encourage for big investors.
5. Created a peaceful environment and maintain political stability.
6. More emphasize on marketing of different investment sectors.
7. Vocational training institute should be developed rapidly to produce technically skilled labor.
8. Development of infrastructure facilities

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## APPENDICES

### Appendix-I: Trend of Nominal GDP, Domestic & Foreign Investment in Nepal

(NPR in Billions)

Year	GDP	GFCF (DI)	GI	PI	FDI
1975	16.6	2.2	0.5	1.7	
1976	17.4	2.4	0.6	1.8	
1977	17.3	2.6	0.7	1.9	
1978	19.7	3.3	1.1	2.2	
1979	26.1	3.3	1.1	2.1	
1980	23.4	3.7	1.5	2.2	
1981	27.3	4.3	1.8	2.5	
1982	31.0	5.5	2.5	3.0	
1983	33.8	6.6	2.9	3.6	
1984	39.3	6.9	3.1	3.8	
1985	46.6	9.4	3.6	5.8	
1986	55.7	9.4	3.9	5.5	
1987	63.9	11.8	4.7	7.1	
1988	76.9	13.4	6.2	7.2	
1989	89.3	16.4	7.9	8.5	
1990	103.4	17.0	8.0	9.0	0.4
1991	120.4	22.8	8.7	14.1	0.4
1992	149.5	29.3	10.3	18.9	0.6
1993	171.5	37.3	11.8	25.5	3.1
1994	199.3	42.0	13.4	28.7	1.4
1995	219.2	48.4	15.1	33.3	0.5
1996	248.9	56.1	17.6	38.5	2.2
1997	280.5	60.8	19.4	41.4	2.4
1998	300.8	65.4	22.6	42.8	2.0
1999	342.0	65.3	24.0	41.3	1.7
2000	379.5	73.3	26.4	46.9	1.4
2001	441.5	84.8	18.1	66.7	3.0
2002	489.4	89.9	17.4	72.4	1.2
2003	492.2	98.1	14.7	83.4	1.8
2004	536.7	109.2	15.0	94.2	2.8
2005	589.4	117.5	17.2	100.3	1.6
2006	654.1	135.5	17.5	118.0	2.6
2007	727.8	153.3	24.6	128.7	3.2
2008	815.7	178.4	33.0	145.5	9.8
2009	988.3	211.0	44.3	166.8	6.3
2010	1192.7	264.9	53.7	211.2	9.1
2011	1367.0	292.7	63.8	228.9	10.1
2012	1527.3	317.2	71.6	245.6	7.1
2013	1695.6	383.0	75.4	307.6	19.8
2014	1965.5	462.0	95.0	367.0	20.1
2015	2120.7	588.3	110.3	478.1	67.5

Source: MOF (2016)

## Appendix-II: Growth of Nominal GDP, Domestic & Foreign Investment in Nepal

(In Growth Percent)

Year	GDP	DI	GI	PI	FDI
1975					
1976	4.8	9.9	25.1	5.4	
1977	-0.7	5.6	9.0	4.4	
1978	14.2	27.7	61.5	15.3	
1979	32.4	-0.9	2.2	-2.6	
1980	-10.6	12.8	28.8	4.2	
1981	16.9	16.8	24.4	11.8	
1982	13.5	27.1	36.4	20.3	
1983	9.1	20.3	18.3	22.1	
1984	16.2	5.0	6.7	3.7	
1985	18.6	35.9	15.6	52.8	
1986	19.6	0.5	7.7	-4.1	
1987	14.6	25.4	20.9	28.5	
1988	20.4	13.4	30.8	1.9	
1989	16.1	22.2	27.8	17.4	
1990	15.8	3.9	1.2	6.4	
1991	16.4	33.7	8.6	56.0	1.9
1992	24.2	28.5	19.0	34.4	47.1
1993	14.7	27.3	13.9	34.6	415.8
1994	16.2	12.8	13.7	12.3	-55.3
1995	10.0	15.1	12.6	16.2	-65.4
1996	13.6	15.9	16.9	15.5	364.8
1997	12.7	8.4	10.0	7.7	7.9
1998	7.2	7.5	16.4	3.4	-16.5
1999	13.7	-0.2	6.2	-3.5	-16.7
2000	10.9	12.3	10.3	13.5	-14.9
2001	16.3	15.6	-31.7	42.2	111.8
2002	10.9	6.1	-3.5	8.6	-59.7
2003	0.6	9.1	-15.6	15.1	48.3
2004	9.0	11.3	1.6	13.0	54.1
2005	9.8	7.7	15.1	6.5	-40.8
2006	11.0	15.3	1.7	17.6	59.3
2007	11.3	13.1	40.8	9.0	22.2
2008	12.1	16.4	33.9	13.0	208.0
2009	21.2	18.3	34.2	14.6	-36.3
2010	20.7	25.5	21.2	26.7	45.5
2011	14.6	10.5	18.9	8.4	10.5
2012	11.7	8.4	12.1	7.3	-29.0
2013	11.0	20.7	5.4	25.2	177.6
2014	15.9	20.6	26.0	19.3	1.5
2015	7.9	27.3	16.1	30.3	235.6

Source: MOF (2016)

### Aappendix-III: Trend of Real GDP, Domestic & Foreign Investment in Nepal

(NPR in Billions)

Year	Deflator	GDP	RDI	RFDI	RPI	RGI
1975	12.6	131.3	17.6		13.6	4.0
1976	12.8	136.1	19.1		14.2	4.9
1977	12.5	138.4	20.7		15.1	5.5
1978	13.8	142.8	23.9		15.8	8.1
1979	15.3	170.8	21.3		13.9	7.4
1980	16.0	145.7	23.0		13.8	9.1
1981	17.2	158.7	25.0		14.4	10.6
1982	18.6	166.4	29.4		16.0	13.4
1983	20.1	168.5	32.8		18.1	14.7
1984	21.5	182.5	32.1		17.5	14.6
1985	22.7	205.0	41.3		25.3	16.0
1986	26.0	214.5	36.3		21.3	15.0
1987	29.2	218.5	40.5		24.3	16.2
1988	32.7	235.3	41.0		22.1	18.9
1989	36.4	245.4	45.1		23.3	21.7
1990	40.3	256.7	42.3	1.0	22.4	19.9
1991	44.0	273.6	51.8	0.9	32.0	19.7
1992	52.3	285.6	55.9	1.1	36.2	19.7
1993	57.7	297.1	64.6	5.3	44.2	20.4
1994	62.0	321.5	67.8	2.2	46.2	21.6
1995	65.9	332.4	73.3	0.7	50.5	22.9
1996	71.1	350.1	78.9	3.1	54.1	24.8
1997	76.2	367.9	79.7	3.1	54.3	25.4
1998	79.3	379.5	82.5	2.5	54.0	28.5
1999	86.3	396.3	75.6	1.9	47.8	27.8
2000	90.3	420.4	81.2	1.6	51.9	29.3
2001	100.0	441.5	84.8	3.0	66.7	18.1
2002	103.9	471.1	86.5	1.2	69.7	16.8
2003	107.1	459.6	91.6	1.7	77.8	13.7
2004	111.4	481.7	98.0	2.5	84.6	13.4
2005	118.0	499.7	99.6	1.4	85.1	14.6
2006	126.2	518.4	107.4	2.1	93.5	13.9
2007	135.4	537.6	113.3	2.4	95.1	18.2
2008	142.9	570.6	124.8	6.9	101.8	23.1
2009	165.8	596.2	127.3	3.8	100.6	26.7
2010	189.6	629.2	139.7	4.8	111.4	28.3
2011	210.3	649.9	139.2	4.8	108.8	30.3
2012	224.1	681.5	141.5	3.2	109.6	31.9
2013	237.8	713.1	161.1	8.3	129.4	31.7
2014	259.2	758.4	178.3	7.8	141.6	36.6
2015	272.7	777.5	215.7	24.7	175.3	40.4

Source: MOF (2016)

### Appendix-IV: Growth of Real GDP, Domestic & Foreign Investment in Nepal

(In Growth Percent)

Year	RGDP	RDI	RFDI	RPI	RGI
1975					
1976	3.7	8.7		4.3	23.8
1977	1.7	8.1		6.9	11.6
1978	3.2	15.4		4.3	46.1
1979	19.6	-10.6		-12.0	-7.7
1980	-14.7	7.7		-0.5	23.0
1981	8.9	8.8		4.1	15.8
1982	4.8	17.5		11.1	26.0
1983	1.2	11.6		13.2	9.7
1984	8.3	-2.1		-3.3	-0.5
1985	12.3	28.7		44.7	9.5
1986	4.7	-12.1		-16.1	-5.8
1987	1.8	11.4		14.2	7.5
1988	7.7	1.5		-8.9	17.0
1989	4.3	9.8		5.5	14.8
1990	4.6	-6.2		-3.9	-8.6
1991	6.6	22.5	-6.6	42.9	-0.6
1992	4.4	8.0	23.7	13.0	0.0
1993	4.0	15.5	367.7	22.1	3.3
1994	8.2	5.0	-58.4	4.6	5.9
1995	3.4	8.2	-67.4	9.2	5.9
1996	5.3	7.5	331.1	7.1	8.5
1997	5.1	1.1	0.6	0.4	2.6
1998	3.1	3.4	-19.7	-0.6	12.0
1999	4.4	-8.3	-23.5	-11.4	-2.5
2000	6.1	7.4	-18.7	8.6	5.5
2001	5.0	4.3	91.2	28.4	-38.3
2002	6.7	2.1	-61.2	4.6	-7.1
2003	-2.4	5.8	43.8	11.6	-18.1
2004	4.8	7.0	48.1	8.6	-2.3
2005	3.7	1.7	-44.1	0.6	8.7
2006	3.7	7.8	48.9	10.0	-4.9
2007	3.7	5.5	13.9	1.6	31.2
2008	6.1	10.2	191.7	7.0	26.8
2009	4.5	2.0	-45.0	-1.1	15.7
2010	5.5	9.8	27.2	10.8	6.0
2011	3.3	-0.4	-0.4	-2.3	7.2
2012	4.9	1.7	-33.4	0.7	5.2
2013	4.7	13.8	161.7	18.0	-0.7
2014	6.3	10.7	-6.9	9.5	15.6
2015	2.5	21.0	218.9	23.8	10.3

Source: MOF (2016)

**Appendix-V: Share of FDI to GDP & DI and DI to GDP (Y)**

(Share in Percent)

Year	DI_Y	FDI_Y	PI_Y	GI_Y	FDI_DI
1975	13.4	0.0	10.3	3.0	
1976	14.0	0.0	10.4	3.6	
1977	14.9	0.0	10.9	4.0	
1978	16.7	0.0	11.1	5.6	
1979	12.5	0.0	8.1	4.4	
1980	15.8	0.0	9.5	6.3	
1981	15.7	0.0	9.1	6.7	
1982	17.6	0.0	9.6	8.0	
1983	19.4	0.0	10.7	8.7	
1984	17.6	0.0	9.6	8.0	
1985	20.1	0.0	12.4	7.8	
1986	16.9	0.0	9.9	7.0	
1987	18.5	0.0	11.1	7.4	
1988	17.4	0.0	9.4	8.0	
1989	18.4	0.0	9.5	8.9	
1990	16.5	0.4	8.7	7.7	2.3
1991	18.9	0.3	11.7	7.2	1.8
1992	19.6	0.4	12.7	6.9	2.0
1993	21.7	1.8	14.9	6.9	8.3
1994	21.1	0.7	14.4	6.7	3.3
1995	22.1	0.2	15.2	6.9	1.0
1996	22.5	0.9	15.4	7.1	4.0
1997	21.7	0.9	14.8	6.9	3.9
1998	21.7	0.7	14.2	7.5	3.1
1999	19.1	0.5	12.1	7.0	2.6
2000	19.3	0.4	12.4	7.0	1.9
2001	19.2	0.7	15.1	4.1	3.5
2002	18.4	0.2	14.8	3.6	1.3
2003	19.9	0.4	16.9	3.0	1.8
2004	20.3	0.5	17.6	2.8	2.5
2005	19.9	0.3	17.0	2.9	1.4
2006	20.7	0.4	18.0	2.7	1.9
2007	21.1	0.4	17.7	3.4	2.1
2008	21.9	1.2	17.8	4.0	5.5
2009	21.4	0.6	16.9	4.5	3.0
2010	22.2	0.8	17.7	4.5	3.4
2011	21.4	0.7	16.7	4.7	3.4
2012	20.8	0.5	16.1	4.7	2.3
2013	22.6	1.2	18.1	4.4	5.2
2014	23.5	1.0	18.7	4.8	4.4
2015	27.7	3.2	22.5	5.2	11.5

Source: MOF (2016)

### Appendix-VI: Nominal Raw Data of GDP and FDI

Year	NGDP	NFDI	Ingdp	Infdi
1990	103415.8	398.5	11.5	6.0
1991	120370.3	406.3	11.7	6.0
1992	149487.1	597.8	11.9	6.4
1993	171473.9	3083.7	12.1	8.0
1994	199272.0	1378.8	12.2	7.2
1995	219175.0	477.6	12.3	6.2
1996	248913.0	2219.9	12.4	7.7
1997	280513.0	2395.5	12.5	7.8
1998	300845.0	2000.3	12.6	7.6
1999	342036.0	1666.4	12.7	7.4
2000	379488.0	1417.6	12.8	7.3
2001	441518.5	3002.6	13.0	8.0
2002	489442.6	1209.7	13.1	7.1
2003	492230.8	1793.8	13.1	7.5
2004	536749.1	2764.8	13.2	7.9
2005	589411.7	1635.8	13.3	7.4
2006	654084.1	2606.3	13.4	7.9
2007	727827.0	3186.0	13.5	8.1
2008	815658.2	9812.6	13.6	9.2
2009	988272.0	6255.1	13.8	8.7
2010	1192744.0	9100.0	14.0	9.1
2011	1366953.0	10053.2	14.1	9.2
2012	1527344.0	7138.3	14.2	8.9
2013	1695642.0	19818.7	14.3	9.9
2014	1965517.0	20107.4	14.5	9.9
2015	2120650.0	67480.0	14.6	11.1

Source: MoF (2016)

**Appendix –VII: Calculated Result of OLS**

S. N	Variable		Result Regression Coefficients		R <sup>2</sup>	Adj. R <sup>2</sup>	t-test		F-test	D-W test
	Dependent	Independent	a	b			a	b		
1	GDP	FDI	217685.5	87.19	0.782	0.773	9.27	9.46	86	1.69

Where

GDP = Gross Domestic Product

FDI = Foreign Direct Investment

R<sup>2</sup> = Refers to coefficient of multiple determinations

Adj. R<sup>2</sup> = Refers to coefficient of multiple determinations

**Appendix-VIII: Log-linear Model Calculation Results**

S. N	Variable		Regression Coefficients		R2	Adj. R2	t-test		F-test	D-W test	SEE
	Dependent	Independent	A	b			a	b			
1	lnGDP	lnFDI	7.772	0.665	0.779	0.77	0.072	9.21	84.83	1.6	0.4217

**Appendix-IX: Country-wise Foreign Investment Projects in Nepal (up to 2016/17)**

SN	Country	Project No.	Project Cost	Fixed Capital	Working Capital	FDI	Employ No.
1	AFGHANISTAN	2	5	4	1	5	45
2	ARGENTINA	2	18.01	16.1	1.91	18.01	51
3	AUSTRALIA	59	756.21	643.51	111.62	604.07	1,557
4	AUSTRIA	19	234.67	182.27	35.97	107.47	664
5	AZERBAIJAN	4	40.9	27.6	13.3	40.9	190
6	BAHRAIN	2	101.31	41.89	59.43	85.66	62
7	BANGLADESH	56	881.6	561.2	302.25	644.93	5,320
8	BELARUS	1	5	4.1	0.9	5	15
9	BELGIUM	17	226.37	193.8	32.57	180.24	590
10	BERMUDA	6	1,995.25	1,694.03	214.09	118.27	1,474
11	BHUTAN	4	32.26	23.08	6.95	8.61	123
12	BRAZIL	7	566.07	532.88	33.19	545.83	590
13	BRITISH VIRGIN ISLANDS	14	16,206.28	13,632.89	2,573.39	7,967.28	2,054
14	CAMBODIA	1	5	2.48	2.52	5	14
15	CANADA	38	7,187.87	6,958.48	229.1	2,681.24	2,246
16	CHAD	1	2.5	1.86	0.64	2.5	18
17	CHILE	1	30	26.8	3.2	30	29
18	CHINA (MAINLAND)	951	52,918.85	46,292.37	6,609.91	26,017.50	46,821
19	CHINA (HONG KONG)	32	34,585.91	30,138.38	4,441.86	25,187.58	4,518
20	CHINA (TAIWAN)	15	515.25	432.38	82.87	274.62	760
21	COLOMBIA	3	49.08	40.9	8.18	23.7	48
22	COOK ISLANDS	1	833.32	828	5.32	666.66	35
23	CROATIA	1	2.5	2.1	0.4	2.5	15
24	CYPRUS	3	1,015.50	986.5	29	312.5	275
25	CZECH REPUBLIC	2	14.5	12.2	2.3	8.89	37
26	DENMARK	33	1,190.19	1,045.66	144.53	391.53	1,448
27	ECUADOR	1	2.5	1.3	1.2	2.5	45
28	EGYPT	3	22.1	16.2	5.9	14.1	119
29	ERITREA	1	2.5	1.8	0.7	2.5	15
30	FINLAND	10	432.91	416.5	16.41	335.88	260
31	FRANCE	80	870.85	719.87	137.6	534.28	2,871
32	GERMANY	98	2,744.43	2,447.28	286.59	1,281.22	4,479
33	GHANA	1	6.5	6.18	0.33	1.95	10
34	GREECE	1	5	4.3	0.7	5	15
35	GUATEMALA	1	10	5	5	2.5	84
36	HUNGARY	1	10	8.9	1.1	5	29
37	INDIA	634	129,918.02	113,101.86	18,163.90	80,686.92	65,162
38	INDONESIA	1	35	31.8	3.2	35	29
39	IRAN	12	74.7	55.85	18.85	68.2	273



40	IRELAND	7	738.9	692.6	46.3	355.97	355
41	ISRAEL	16	754.2	629.14	125.05	182.75	536
42	ITALY	32	1,589.81	1,432.61	63.5	421.1	907
43	JAPAN	223	6,389.33	5,656.16	666.63	2,247.17	8,702
44	JORDAN	1	30	26.8	3.2	12	29
45	KAZAKHSTAN	4	20.4	16.03	4.37	20.4	87
46	KYRGYZSTAN	4	36.5	32.05	4.45	22.5	175
47	LEBANON	2	7	5.5	1.5	7	49
48	LIBYA	1	5	2.8	2.2	5	80
49	LITHUANIA	1	5	4	1	5	38
50	MALAYSIA	31	948.74	855.32	93.42	496.28	1,007
51	MAURITIUS	9	3,878.00	3,784.27	93.73	3,314.70	952
52	MEXICO	4	33.73	30.05	3.68	31.13	84
53	NEPAL	1	20	17.5	2.5	6	20
54	NETHERLANDS ANTILLES	1	25	20	5	10	80
55	NEW ZEALAND	19	397.53	314.11	83.12	116.27	2,238
56	NORTH KOREA	3	64.82	58.8	6.02	32.55	147
57	NORWAY	16	8,146.09	6,790.60	1,350.95	1,165.33	845
58	PAKISTAN	25	2,288.04	1,977.33	309.82	254.82	2,764
59	PANAMA	1	83.28	65.17	18.11	24.98	121
60	PHILIPPINES	17	1,227.12	1,047.68	179.43	143.28	1,811
61	POLAND	8	158.22	144.55	13.67	75.39	214
62	PORTUGAL	1	2.5	2	0.5	2.5	23
63	QATAR	2	580	275.5	304.5	156.7	60
64	REPUBLIC OF THE CONGO	1	2.5	2.1	0.4	2.5	28
65	RUSSIA	35	561.86	439.44	122.42	393.09	1,286
66	SEYCHELLES	1	7,600.00	7,372.00	228	684	100
67	SINGAPORE	37	8,036.82	7,179.44	842.39	2,888.39	3,013
68	SLOVAKIA	1	5	4	1	5	21
69	SLOVENIA	2	34.19	29.94	4.25	34.19	45
70	SOUTH AFRICA	8	72.3	58.94	13.36	72.3	217
71	SOUTH KOREA	303	13,631.71	11,016.29	2,579.06	9,399.29	10,345
72	SPAIN	20	2,236.52	2,131.34	105.18	1,975.23	597
73	SRI LANKA	6	103.15	76.6	26.56	61.41	148
74	SWAZILAND	1	15	12.9	2.1	15	0
75	SWEDEN	11	50.4	39.16	11.24	47.6	330
76	SWITZERLAND	51	5,150.27	4,980.70	159.15	2,836.22	1,411
77	SYRIA	9	58	46.8	11.2	56	232
78	TAJIKISTAN	2	35	21.8	13.2	35	65
79	THAILAND	11	1,032.37	884.79	138.03	116.29	1,159
80	THE NETHERLANDS	61	2,265.97	1,347.66	916.25	1,402.28	3,754
81	TURKEY	21	1,737.70	671.7	1,066.01	1,775.04	733
82	UK	150	7,585.41	6,799.70	767.01	4,125.97	10,289

83	UKRAINE	9	171.4	154.04	17.37	87.7	241
84	UNITED ARAB EMIRATES	14	4,821.57	1,974.84	2,796.72	2,320.41	1,660
85	USA	322	18,452.45	16,456.29	1,746.12	7,333.26	16,293
86	UZBEKISTAN	3	45	36.4	8.6	45	103
87	VIETNAM	2	24.6	22.8	1.8	24.6	55
88	YEMEN	2	105	94.2	10.8	105	33
	TOTAL	3,631	354,817.30	306,876.70	48,558.73	193,860.10	215,872

### Appendix-X: District-wise Foreign Investment Projects in Nepal (up to 2016/17)

District	Projects No.	Project cost	Fixed cost	Working capital	FDI	Employment No.
Achham	4	571.2	550.7	20.5	418.2	411
Arghakhachi	2	1342.1	199.3	1142.8	449.6	331
Baglung	2	503.9	253.5	250.4	503.9	299
Baitadi	7	115.5	97.8	17.7	100.5	485
Bajhang	1	15.0	12.3	2.7	12.0	70
Banke	25	3082.0	2797.9	279.3	510.0	1887
Bara	52	8154.6	6351.4	1621.7	2617.1	4897
Bardiya	12	212.5	168.7	43.9	179.8	509
Bhaktapur	66	5376.2	4446.9	929.3	3821.7	5077
Chitwan	71	5182.8	4235.7	910.8	1713.4	8959
Dadeldhura	3	33.0	26.5	6.5	19.5	75
Dang	16	4911.4	4592.5	318.9	423.9	1861
Darchula	2	40.4	36.2	4.2	7.4	117
Dhading	17	2689.9	2573.6	116.3	2420.0	1232
Dhankuta	1	46.6	37.6	9.0	0.0	120
Dhanusha	3	291.0	249.7	41.3	165.5	292
Dolkha	9	6655.2	6121.9	533.3	1937.4	420
Doti	1	10.0	7.2	2.8	10.0	33
Gorkha	8	750.1	688.6	61.5	117.0	845
Humla	7	61.0	52.3	8.7	36.7	134
Ilam	6	1615.9	1560.4	55.5	884.9	433
Jajarkot	2	630.0	603.0	27.0	630.0	320
Jhapa	20	2179.1	1703.5	475.7	1238.2	3623
Jumla	1	10.0	8.0	2.0	10.0	29
Kailali	12	1088.2	991.8	96.4	330.8	1257
Kalikot	1	42106.6	41400.0	706.6	33685.3	80
Kanchanpur	22	909.8	803.8	106.0	262.4	1885
Kapilbastu	9	421.7	206.4	150.6	307.8	300

Kaski	248	26747.9	25146.2	1442.0	11327.4	8949
Kathmandu	2010	100158.2	77130.4	22757.7	53980.8	97440
Kavre	74	4494.0	3763.5	734.4	3207.3	6056
Lalitpur	587	24160.9	15651.1	8496.8	19761.0	26318
Lamjung	7	2324.9	2271.5	53.5	524.4	581
Mahottari	1	3.4	2.6	0.9	3.4	9
Makwanpur	68	8312.1	6417.9	1684.5	3294.5	5388
Manang	3	990.0	967.8	22.3	250.0	924
Morang	33	4123.9	3095.1	1012.4	2155.8	5399
Mugu	1	8.6	6.0	2.6	8.6	18
Mustang	5	852.7	829.7	22.9	316.9	188
Myagdi	3	39015.0	38707.8	307.2	24335.0	904
Nawalparasi	30	7888.8	7022.3	818.8	1379.1	3595
Nuwakot	21	2499.8	2328.7	170.1	380.4	1248
Okhaldhunda	2	300.0	286.2	13.9	66.5	127
Palpa	4	342.9	193.4	149.6	317.8	270
Parbat	1	1100.0	1089.0	11.0	1.5	2614
Parsa	49	3776.3	2611.0	1147.1	2430.7	6219
Pyuthan	2	90.0	78.0	12.0	90.0	200
Ramechhap	1	291.3	237.9	53.5	262.2	200
Rasuwa	8	9922.4	8852.3	1055.1	4562.4	215
Rautahat	2	569.2	515.8	50.0	54.1	639
Rolpa	3	32.2	28.3	3.9	29.0	156
Rupandehi	41	9521.7	8141.8	1207.0	4635.8	3910
Sankhuwasabha	1	500.0	488.0	12.0	500.0	250
Saptari	3	430.0	394.5	35.5	299.4	190
Sindhuli	1	9.0	7.7	1.3	9.0	105
Sindhupalchok	15	7196.7	6849.2	347.5	1455.1	3160
Siraha	5	3464.0	3058.9	405.0	2113.2	928
Solukhumbu	16	3754.2	3508.6	174.4	1450.6	546
Sunsari	28	2764.6	2061.0	703.6	1657.8	3541
Surkhet	4	3617.4	2842.2	775.2	2207.2	366
Tanahu	7	193.0	152.5	40.5	141.5	426
Taplejung	2	12.1	10.1	2.0	11.9	44
Total	3668	358473.0	305523.7	51667.4	196033.4	217104