

Foreign Direct Investment, Grant, Remittances and Pension; Case of Nepal

Kundan Pokhrel Majagaiya

glorious Sun, school of Management, Donghua University

Abstract: All Foreign Investment, Remittance, Grant and Pension and other has become a lifeline for economic development in developing countries and have contribution to the Gross Domestic Product (GDP). In the recent decade, Nepal has been achieving Remittances Pension, Grant and FDI Parall. Not so far research has been done for comparison of contribution to GDP by Remittances and FDI. This paper focuses the contribution of Remittance and FDI and remittance, Grants and Pension; to national GDP using time series analysis of data.

Key words: FDI, Remittances, Economic Development

INTRODUCTION

Remittances and foreign direct investment in developing countries has become a lifeline for economic development. By remittance we mean sending income in terms of money or goods in home by the migrants or workers who have their earnings outside their home country. They do hard work for earning large remittance income to support their families. Remittance as a major source of foreign currency to the developing nation has become a substantial component of making current account surplus in the balance of payments.

According to the IMF and OECD definitions, direct investment reflects the aim of obtaining a lasting interest by a resident entity of one economy (direct investor) in an enterprise that is resident in another economy (the direct investment enterprise). The "lasting interest" implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprises. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.

FDI occurs with the purchase of the "physical assets or a significant amount of ownership (stock) of a company in another country in order to gain a measure of management control."

Now-a-days, this source of foreign income has been growing rapidly in each year in developing countries. Since long time in Nepal, many migrants have been transferring their income through the unofficial channels. Today due to the establishment of different agencies like Western Union, International

Money Express (IME) etc. in several district headquarters of the country, the remittance flows has become popular for transferring cash or money in time to the recipients. However, it is difficult to calculate the exact size of remittance flows in Nepal due to the emergence of unofficial channels even though it has recorded in balance of payments account. In this regard, it is estimated that unrecorded flows through informal channels are believed to be more than 50 percent of the recorded flows in developing countries. Basically, remittances are private funds that should be treated like other sources of household's income. In terms of asset formation, larger number of remittance receivers uses their funds to purchase land or buildings in town areas. In short, it could be asserted that the productive use of remittance income is yet to be sought though it forms a significant part of GNP.

If we observe the economic growth rates of some SAARC countries in 2006, we find the highest growth rate (8.2 %) of India and the lowest growth rate (1.9 %) of Nepal. Sri Lanka has received the second position (7.0 %) then Bangladesh (6.7 %) and Pakistan (6.6%). In such a circumstance, Nepal has reached the insignificant growth rate because of prevalence of the political conflict, unfavorable climate for agriculture and reduction in export of readymade garments. However, Bangladesh has received the third position in economic growth rate mainly by increasing the flow of remittances and maintaining strong production sector. Thus, remittance as a major source of foreign exchange earnings can improve a country's creditworthiness and enhance its access to international capital markets.

Initially, remittance in Nepal was introduced with Gurkha remittances. 'The Gurkhas' were renowned for good qualities of soldiers. That is why British India formally recruited Nepalese youth as a regular army,

which later divided into British and Indian army. Now-a-days, Nepalese going abroad are not only for armies but also spread all over the world for work and mostly they are concentrated in Gulf areas in civilian front. Any Nepali to go for work legally, he/she needs to get permission from the Department of Labor under the Ministry of Labor and Transport of the Government of Nepal. But still some people are found going abroad without permission and working in the government restricted areas too. Because of this trend, data on foreign employed workers are not available in exact form. Majority of those who have left home for overseas job are eager to earn foreign currency by hard working to support their families.

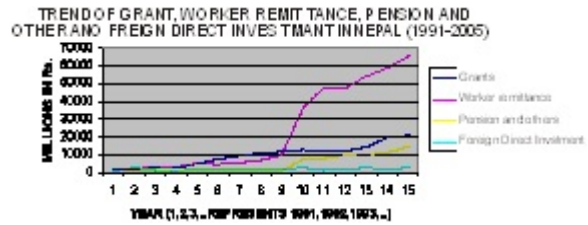
Today, Nepal is one of the most liberalized countries in the South Asian region. However, growth performance has been very poor in recent years. There are highly liberal FDI related policies supplemented by important Acts. In the aftermath of liberalization that began in the early 1990s, FDI increased substantially. However, that could not be sustained for long. After becoming a World Trade Organization (WTO) member in 2004, Nepal has been pursuing further opening up and liberalization policies on the 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 (BIMST-EC FTA). New initiatives on FDI have been taken with the aim of enhancing sustained growth and reducing poverty.

In the pre-liberalization period, the investment regime was more restrictive. Investors had to obtain a government licence before undertaking any production and business activities. The FDI was almost nil before 1980. Although some attempts to liberalize the investment policy were made from the beginning of the 1980s, it was speeded up only after 1990. To ensure investment, both domestic and foreign, the Government adopted various liberal policies, which are still in operation. These policies include the Industrial Policy, 1992, Industrial Enterprises Act, 1992 (first amendment, 1997), Foreign Investment and One-window Policy, 1992, and the Foreign Investment and Technology Transfer Act, 1992.

FDI is considered beneficial in view of its contribution to technological transfers, enhancement of managerial capability and new opportunities for market access. FDI, particularly in the form of equity investment, adds to the capital stock of the country and thus enables the recipient country to achieve faster economic growth through momentum in capital formation. Increases in FDI are also seen as leading to increases in exports by creating international markets through new marketing and organizational skills.

Many foreign investors in Nepal are individuals

rather than corporate entities. Much of the FDI inflow is for joint ventures and most of the FDI projects are of small size followed by medium-sized and large-sized industries. Most of the FDI in Nepal is Greenfield-type investment rather than acquisition.



Data source and Methodology: The data used in this study is aggregate annual time series are foreign Direct investment and remittances (grants, worker remittances, pensions and others), covering the period of 1991-2005 in 15 pairs of observations. The data was extracted from the department of industries, government of Nepal, economic survey of various issues Ministry of Finance, Government of Nepal and NRB, Research Department.

The method used in this paper is regression analysis. Regression analysis is useful for generalizing functional relationships between variables.

Multiple regression analysis⁶

Let us define a model,

$$y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \dots + \beta_n x_n + \mu \quad (1)$$

Where variable μ is called error term, y is called dependent variable, x 's are called independent variable and β_0 is the intercept and $\beta_1, \beta_2, \beta_3$ are the parameters associated with x_1, x_2, x_3 respectively.

RESULTS AND DISCUSSION

A) Multiple regression analysis (GDP, FDI and W/Remit.)

$$GDP = \beta_0 + \beta_1 FDI + \beta_2 W/remit. + \mu \quad (1a)$$

Table 1: Regression Result.

Variable	Coefficient	t-value	R ²	Adj. R ²	F
			0.089	0.019	1.266
β_0	230082	2.542**			
β_1	49.745	1.125			
β_0	192049.9	5.465*	0.875*	0.854	42.072*
β_1	6.181	0.348			
β_2	5.116	8.696*			

$$GDP = 230082.0 + 49.745 FDI \dots \dots \dots (i)$$

(2.542) (1.125)

$$GDP = 192049.9 + 6.181 FI + 5.116 W/remit \dots \dots \dots (ii)$$

(5.465) (0.348) (8.698)

B) Multiple regression analysis (GDP, W/reit., Grants, Pension and others)

$$GDP = \beta_0 + \beta_1 W / ret. + \beta_2 Gr + \beta_3 Pen. + \mu \quad (1b)$$

Table 2: Regression Result

Variable	Coefficient	t-value	R ²	Adj. R ²	F
β_0	202374.3	11.109*	0.874	0.864	90.115*
β_1	5.174	94.93*			
β_0	133463.2	10.029*	0.974	0.970	224.595*
β_1	2.13814	6.793*			
β_2	14.302	4.144*			
β_0	132492.5	8.184*	0.963	0.957	158.101*
β_2	15.431	6.160*			
β_3	8.972	2.960**			
GDP = 202374.3 + 5.174 W/ ret. (iii)					
(11.109) (94.93)					
GDP = 133463.2 + 2.138 W/ ret. + 14.302 Gr. (iv)					
(10.029) (6.793) (4.144)					
GDP = 132492.5 + 15.431 Gr. + 8.972 Pen. (v)					
(8.184) (6.160) (2.960)					

Note: GDP represents nominal GDP, W/reit. Represents worker remittances, Gr. Represents Grants, Pen. Represents pension and other.

Figures in parenthesis are t values, * denotes 1% level of significance, ** denotes 5% level of significance.

Discussion: There was no direct way of identifying the linkage between FDI, Remittance, Grants, Pension and GDP. Unavailability of necessary data was an additional constraint. There were no official data required to research. Moreover, getting a quick response from the respondents involved in FDI

activities was also a difficult task; therefore, the research had to be based on the secondary, which may not provide a representative picture of the overall situation of FDI remittances and GDP in Nepal. In the Nepalese context, no study that examines the linkages between FDI, Remittances and GDP and possible channels establishing linkages has been found.

From the table: 1, the value of R² for FDI is even positive but consider as negligible but for worker remittance value of R² indicates positively strongly related and t-values in equation (i) and (ii) are not significant incase for FDI and are significant for worker remittances indicates that worker remittance is more and more effective than FDI to increase the GDP.

From Table. 2, coefficient of remittances in equation (iii) and (iv) indicates that 1% change in remittances will increase the GDP by 2.138% to 5.174% respectively and similarly coefficient of grants in equation (iv) and (v) indicates that 1% increase in grants will increase the GDP by 14.302% to 15.431%, which seems to be very high. Beside this; t-values of the above equation are highly significant in 1% level of significance indicates that both remittance income and Grants are more responsible to increase GDP. Also the range of R² is from 0.874 to 0.974 indicates the strongly related positively and the range seems to be very good.

From the above analysis, it has been accepted that Worker Remittance income and Grants appear to be the most relevant variables to raise nominal GDP but also Pension and other items have also significant impact on increasing nominal GDP in Nepal where as Foreign investment seem to be very small comparison with others.

Annexes

Year	Remittances			Rs .in millions	
	Grants	W/Remit.	pension and others	Foreign Direct Investment	Nominal GDP
1991	1694	2128.3	218.2	597.84	122517
1992	1689.5	2316.5	483.9	3083.67	152202
1993	3498.5	2994.3	582.7	1378.76	174705
1994	3039.9	3469.1	494.9	477.59	203135
1995	5339.1	5063.6	824.5	2219.86	223992
1996	7582.8	4283.6	899.9	2395.54	252479
1997	9743.2	5595	1009.1	2000.28	285173
1998	10919.7	6987.8	1157.8	1666.42	306870
1999	11648.3	10314.6	1204.6	1417.61	352917
2000	12874.8	36818.1	7259.9	3102.56	392613

Continue

2001	12046.4	47216.1	7765.2	1209.65	427447
2002	12650.5	47536.3	9970.5	1793.77	441182
2003	13842.2	54203.3	9719.6	2764.8	472869
2004	19557.8	58587.6	11016.4	1639.52	509700
2005	21067.2	65416	14601.2	2606.31	543902

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