

## WORLD ECONOMY AND INTERNATIONAL COOPERATION

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### THE IMPACT OF FOREIGN DIRECT INVESTMENT FROM INDIA TO NEPAL ON THEIR BILATERAL TRADE

**Abstract.** The main purpose of this paper is to identify the influence of investment by India to Nepal can increase of bilateral trade between India and Nepal. In order to achieve the aim, the paper has applied the empirical study to know the impact of FDI inflows from India on export and import between India and Nepal. The paper uses data from fiscal year 1997/98 to fiscal year 2015/16 due to lack of more recent data. The study shows the positive impact of FDI inflows from India to Nepal on their bilateral trade. One percent in FDI inflow increases import by 53.17 percent and export by 26.15 percent.

**Key words:** FDI, investment relations, Nepal, India, import substitution, export promotion, bilateral trade, national economy.

*JEL:* F21, F36

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#### Introduction

Foreign Direct Investment (FDI) is an important instrument for economic development, especially for the least developed countries. FDI has become a major source for creating job opportunities, transfer technology and skills which helps to enlarge productivity, exports spillovers through the channel of capital investment in host country and support integrate the domestic economy with the global economy [Zobov et al., 2016], have specified the signs of FDI functioning in the global market of innovations, described with the dynamic, aggressive, and multi-faceted competitive environment. By integrating the domestic economy with the global economy, it impacts on the Balance of Payment (BoP) of countries. FDI may establish import substitution or provide intermediate inputs for trade as well facilitate export promotion. These trade connections of FDI could be ascertained between the host and home country or with a group of other country markets.

Nepal is a least developed landlocked country situated between two largest growing economies India and China. As Nepal is a landlocked country, its trade is happened through India to all over the world. The top 5 importers are India, USA, Germany, UK and Turkey and exporters are India, China, UAE, Indonesia and Switzerland. The highest percent partner share has occurred by India for both import and export 63.48 and 60.62 respectively with the larger amount of trade than other countries<sup>2</sup>.

Industries approved for foreign investment by country of origin till the fiscal year 2015/16. The 89 countries have

invested in Nepal, the total number of projects is 3776, total amount of FDI is 199881.57 million NPR and the total number of employment is 220496. The top 5 countries on the basis of foreign investment in industries up to FY 2015/16 are India, China, USA, South Korea and UK with 80925.86, 30252.93, 7434.59, 9434.33 and 5180.97 million NPR respectively. The investment from these countries provided 65506, 49566, 16513, 10434 and 10418 employment respectively in Nepal<sup>3</sup>.

The study from Mishra et al., finds that there is significant impact of the total number of employments approved for foreign investment on GDP real growth rate of Nepal [Mishra, Degtereva & Paneru, 2017]. Since India has the largest amount of trade and investment to Nepal including the highest number of employment provided by the investment from India, this paper is going to identify the impact of investment by India in Nepal on trade (export and import) between these two countries because trade has a great impact on economic development of country also it is an indicator of economic growth. The paper look for these questions – Does investment inflow from India to Nepal promotes on their bilateral trade? Does India get benefit on trade by investing in Nepal? How FDI inflows from India to Nepal influences on export and import of Nepal to and from India?

#### Literature review

Theories of FDI postulate that, depending on factors such as transportation costs, trade barriers and plant-level fixed costs, a firm will choose the mode that yields the highest profits. FDI would therefore be expected to displace exports [Head & Ries,

2 World Integrated Trade Solution, URL: <http://wits.worldbank.org/countrysnapshot/en/NPL>

3 Government of Nepal, Ministry of Industry commerce and supply, URL: [http://www.doind.gov.np/images/industrial-static/Industrial\\_statistics\\_7273.pdf](http://www.doind.gov.np/images/industrial-static/Industrial_statistics_7273.pdf)

2001]. The relationship between FDI and international trade has been discussed widely and found that it is an important source for economic development. The economic literature has highlighted the role of export promotion and import substitution strategies along with FDI for better economic development. Multinational companies (MNCs) want to market their products at international level that promote exports of host country. Most of economic literature is also based on positive association among FDI, imports and exports but still some studies have also argued about negative association between FDI and imports that make it inconclusive about predicting the relationship [Chani, Azam, Younas, 2014].

Grubert and Mutti evaluated the relationship between FDI and international trade (exports and imports), using data from 1982 for 33 countries that have commercial relationships with the United States (U.S.). In order to avoid endogeneity problems, the authors sustain that the relationship between FDI and trade is more correctly analyzed using exogenous indicators of the relative attractiveness of operating abroad, such as the average effective tax rate. In particular, if trade and FDI are complementary, then as the cost of operating in a certain country decreases (measured by the rates that firms pay in that country), the level of exports to that country will increase. The United States appears both to import more from and export more to low-tax countries where MNC investment is greater, but this bilateral focus must be amplified to consider multilateral effects if trade benefits are to be projected [Grubert, Mutti 1991].

Whether FDI and exports are net substitutes or net complements thus is indeterminate on the basis of principles and, as a practical matter, the issue becomes an empirical one. Most studies of this relationship in fact tend to indicate that the relationship is complementary, that more FDI is associated with more, rather than less, exports [Liu, Graham, 1998].

Clausing examines the empirical relationship between multinational activity and trade and finds that there is

evidence that multinational activity complements, rather than displaces, trade. The relationships between imports and foreign multinational activity in the United States are demonstrated that a 1% increase in net local sales by foreign affiliates in the United States is associated with a 15% increase in imports. This net complementarity between imports and multinational activity is the result of a strong complementarity between intrafirm imports and sales [Clausing, 2000]. Markusen mentions that, although FDI and trade seem complementary at a superficial level, recent empirical works suggest that they are substitutes at a fine disaggregation level [Markusen, 2000].

According to Head and Ries, an important aspect of empirical research on the effects of FDI on exports is addressing the issue of a spurious statistical relationship, they also found that firms who increased their manufacturing investment overseas also tended to increase exports [Head & Ries, 2001]. FDI interacts positively with trade and stimulates domestic investment [Makki, Somwaru, 2004]. Increasing FDI could also promote trade by opening and expanding market opportunities [Modou, Liu, 2017].

Chernikov & Konovalova has mentioned despite a significant increase in absolute indicators in the trade and investment cooperation of the Russia and India over the last decade and a half, their mutual shares in the total volume of foreign trade and investment are still insignificant [Черников, Коновалова, 2016]. There is noted that credit lines are the main form of the power that India provides to other developing countries. There is a clear understanding that such a form of assistance is aimed at achieving concrete result – the promotion of Indian exports and lytic relations with the recipient and Nepal is one of recipient from India [Shikin, Degtereva 2014].

Investment plays a vital role on trade either by import substitution or by export promotion. Mukhin, N.Y., Zobov, A. M. et al. [Mukhin, 2016; Zobov et al., 2016], has mentioned the import substitution and export promotion is also connected to investment.

### Data and Analysis

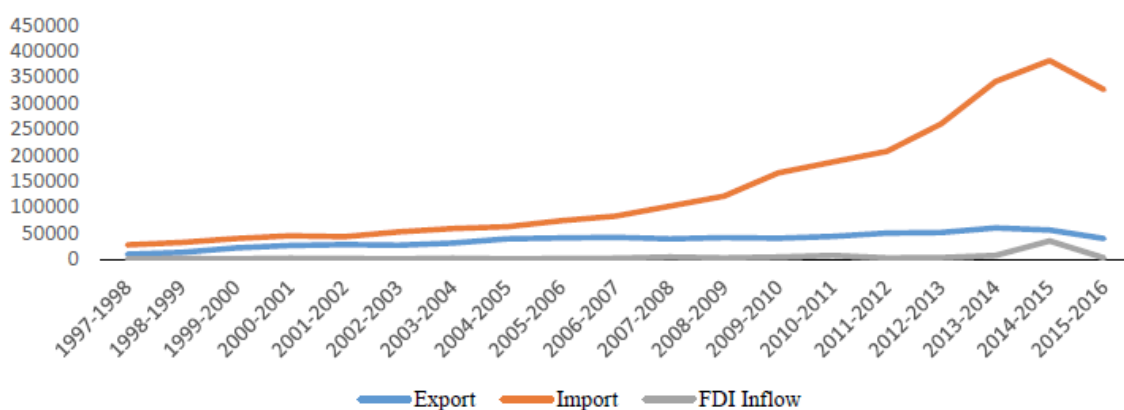
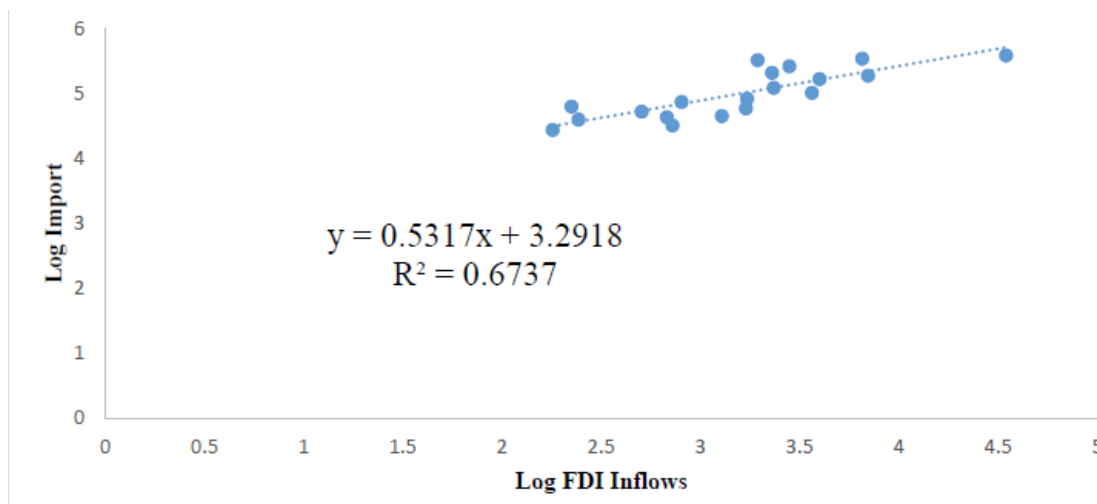


Fig. 1: Nepal-India FDI and Trade Statistics from 1997/98 to 2015/16

Source: NICC.org and Department of Industry of Nepal

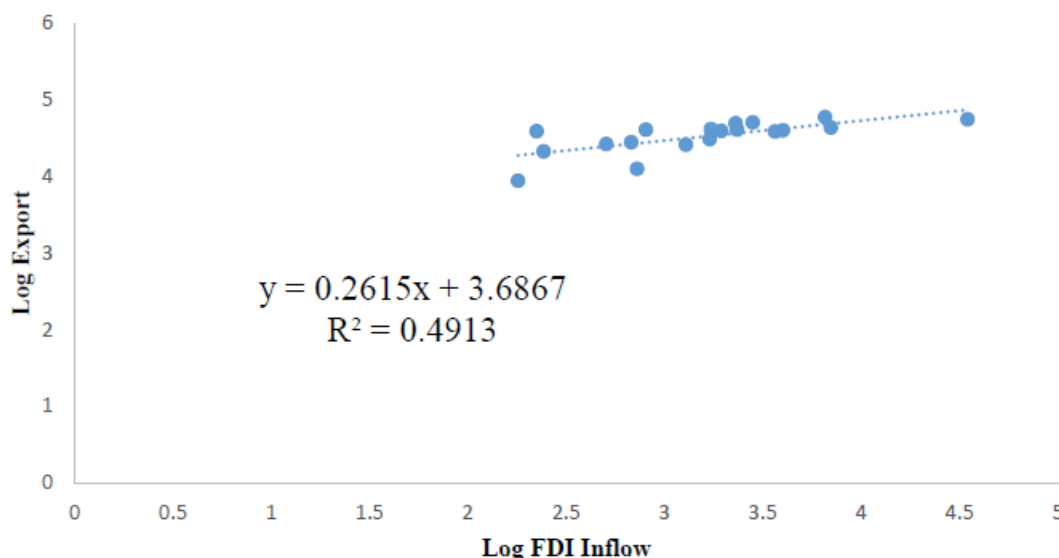
The figure 1 shows the trend of Nepal–India FDI and trade statistics from the fiscal year 1997/98 to 2015/16 due to lack of recent data of the year 2016/17 and 2017/18 on the government source. The grey line shows the FDI inflows from India to Nepal, blue line shows export from Nepal to India and orange line shows the import to Nepal from India. Import is all the time higher than export. FDI inflow is very low all the years from 1997-98 to 2013-14 after that it has a bit higher in the year 2014-15, in the same year import has also increased and again FDI inflow and import both have decreased in the year 2015-16.



**Fig. 2:** Scatter Plot of Log FDI inflow and import

The figure 2 shows the linear equation of log FDI inflows and log import. The R square is 67.37% demonstrates that the model fit perfectly. The equation shows that the coefficient for FDI inflows is 0.5317. The coefficient indicates that for an additional percent in FDI inflow increases import by 53.17 percent. The FDI inflows has significant effect on import to Nepal from India.

The figure 3 shows the linear equation of log FDI inflows and log export. The R square is 49.13% demonstrates that the model fit moderately. The equation shows that the coefficient for FDI inflows is 0.2615. The coefficient indicates that for an additional percent in FDI inflow increases export by 26.15 percent. The FDI inflows has significant effect on export from Nepal to India.



**Fig. 3:** Scatter Plot log of FDI inflow and export

**Conclusion**

The paper discusses FDI inflow from India to Nepal and their bilateral trade. It looks for answer the question of whether FDI inflows from India affects bilateral trade between Nepal. To answer the research question, the paper examined the impacts of FDI inflows to Nepal from India on trade between

these two countries, reviewed the literature related to FDI and trade, collected data of 19 years and accomplished statistical approach to find the effect of FDI inflows from India to Nepal on their bilateral trade. The result shows that there is significant impact, 1% in FDI inflow increases import by 53.17% and export by 26.15%. It is evident that the current correlation should be

carefully researched upon the official publication of the 2017 than Nepal in every aspect with similar culture and tradition, and 2018 data. investment from India to Nepal could be advantage for both

Nepal, the country with low income can benefited from countries trade relation since they have open border as well. its neighbor large income country, India. As India is larger This bilateral relation could improve their economic condition.

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## ВЛИЯНИЕ ПРЯМЫХ ИНОСТРАННЫХ ИНВЕСТИЦИЙ ИНДИИ В НЕПАЛ НА ИХ ДВУСТОРОННЮЮ ТОРГОВЛЮ

**Аннотация.** Основная цель данной статьи – определить влияние инвестиций Индии в Непал, которое может увеличить двустороннюю торговлю между Индией и Непалом. Для достижения этой цели в документе было применено эмпирическое исследование, чтобы узнать о влиянии притока ПИИ из Индии на экспорт и импорт между Индией и Непалом. В документе используются данные за 1997/98 финансовый год до 2015/16 финансового года, вследствие отсутствия опубликованных более поздних данных. Исследование показывает положительное влияние притока ПИИ из Индии в Непал на их двустороннюю торговлю. Один процент притока ПИИ увеличивает импорт на 53,17 процента и экспорт на 26,15 процента.

**Ключевые слова:** ПИИ, инвестиционные отношения, Непал, Индия, импортозамещение, стимулирование экспорта, двусторонняя торговля, национальная экономика.

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