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## Economic Diplomacy and Its Impact on Nepalese Economy

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### ABSTRACT

*Economic diplomacy is concerned with how a government maintains economic relations with other nations and what steps it might take to enhance its economy. If economic and diplomatic relations are good, more benefits can be reaped from diplomatic partner countries. Economic diplomacy plays an important role in a country's ability to prioritize and benefit from deployment partners. By developing economic diplomatic connections, Nepal has the opportunity to profit from the neighboring countries. Despite the differences in the ideology and vision of political parties, it is necessary for the country, the people and development to rise above partisan vision and move forward with a new vision. Reaching more economic benefits from respectable and balanced economic diplomacy has become imperative. This study has been conducted to review economic diplomacy and examine the impact of economic diplomatic relations on foreign direct investment, foreign employment, and the tourism economy. It measured the impact of economic diplomatic relations on FDI, foreign employment and the tourism economy by applying multiple regression models. The impact of FDI, foreign employment and the tourism economy has been analyzed from 2001 to 2019. The study's finding shows that there has been a significant impact on remittance income and incomes from the tourism industry.*

## 1. INTRODUCTION

Economic diplomacy is concerned not only with broader diplomatic agendas that emerge from market integration processes, such as negotiations to achieve a low-carbon economy, intellectual property rights bargaining, e-commerce agreements, and transitional finance negotiations, but also with changes in diplomacy, particularly the emergence of new modes of diplomacy. Economic diplomacy also contributes to our understanding of the international political economy by forcing us to acknowledge that diplomats as agents are important players in a complex system that has yet to be fully studied (Lee & Hocking, 2018).

Economic diplomacy is related to economic policy issues such as negotiation of international trade under the different international organizations where economic diplomats monitor and report on economic policies in foreign countries and advise their governments on how best to respond to those policies. Economic diplomacy includes economic resources as a reward and punishment to achieve a specific foreign policy goal. Economic diplomacy is a relationship with different countries to expand economic activities using the tools of economic relations. Export and import trade, investment, loans, grants, free trade agreements, etc., are policies related to economic diplomacy. Economic diplomacy deals with economic policy issues. Economic diplomats also study, monitor, and report on economic diplomacy abroad and advise the government on maximizing their impact.

With the policy changes made in the 1990s, Nepal gradually accepted the values of economic liberalization and privatization. Nepal brought the Industrial Policy, Trade Policy, Foreign Investment, and Technology Transfer Act 1992 are vivid examples. Policies related to economic diplomacy with foreigners include trade treaties and agreements, agreements related to foreign investment, foreign loans, and grants. Nepal's accession to the World Trade Organization can be considered a sign of globalization. Similarly, after the 1990s, Nepal has embraced the recognition of globalization and entered towards globalization. For economic diplomatic relations, Nepal has signed bilateral and multilateral treaties and agreements to promote bilateral and multilateral trade. Economic diplomacy initiatives are an example of economic diplomacy.

Nepal has not been able to receive the sufficient economic benefits it needs due to its weak economy and economic diplomacy, even though it has embraced the open economy as a member of associations and organizations such as the Bilateral Investment Protection and Promotion Agreement (BIPPA), member of World Trade Organization (WTO) and member of South Asian Free Trade Area (SAFTA). Nepal has made policy reforms in line with the changes in the world. Despite adopting the economic policy, economic diplomatic relations have not been able to increase accordingly.

The economic diplomatic of Nepal would be conducted so as to contribute to Nepal's socio-economic development, and diplomatic missions would be mobilized for the expansion of trade, enhancement of development cooperation and investment, development and transfer of technology, promotion of tourism industry and safe as well as dignified foreign employment (GoN,2020).

Nepal has established diplomatic relations with 170 countries, including the European Union. To establish good diplomatic relations with diplomats, Nepal's foreign policy has included enhancing the dignity of the nation by safeguarding sovereignty, territorial integrity, independence, and promoting the economic well-being and prosperity of the country. Nepal aims to contribute to global peace, harmony, and security (MoFA, 2021).

In the past, Nepal has not been able to reap the benefits of keeping diplomatic relations with all the countries with which it has had diplomatic relations. Analyzing the situation to date, Nepal has not been able to reap satisfactory economic benefits due to its inability to maintain balanced economic diplomatic relations with neighboring countries and donor countries. Nepal has given priority to promoting foreign direct investment, foreign employment and tourism development through the good economic diplomatic relations in the recent days. This study aims to evaluate the economic diplomacy and examine the economic impact of economic diplomacy on FDI, FEE, tourism, and the GDP of Nepal

Economic diplomacy connects closely with the country's brand because a country's trade and investment destination profile contributes to and is influenced by the country's reputation internationally (Rana & Chatterjee, 2011). The economic diplomacy of China has found multidimensional and complex, which provided an enlightened perspective of the strategies and employed to foster her economic ties with African countries. The authors critically examined why the Washinton consensus and Beijing model were complementary development strategies. Many African countries were embracing the Beijing model because the Western model had failed to deliver on a number of fronts (Asongu et al., 2014). It's a new frontier of foreign policy in an interconnected world. The strategy must consider new considerations such as access to markets, telecommunications, energy infrastructure, financial resources and tariff and non-tariff barriers. A comprehensive global strategy must include a combined approach utilizing those agencies and all economic devices at their disposal (Lorenz, 2015).

Zirovcic's (2016) remark is that economic diplomacy activities are distinguished as economic diplomacy and commercial diplomacy. Economic diplomacy includes the economic instruments of foreign policy, which are divided into economic aid and economic sanctions. Besides this, economic diplomacy is used in different systems of organizations to promote their economic interests in the global periphery of some countries. Japan has set the objectives for accelerating promoting diplomatic policy by making rules bolstering free and open global economic systems, supporting the overseas business expansion of Japanese companies through the promotion of public-private partnerships and promoting resources diplomacy with an inward investment towards the nation (Foreign Policy of Japan, 2018).

Arystankulova (2018) analyzed the theoretical aspects of studying economic diplomacy, especially the importance of economic diplomacy in implementing foreign policy in the modern state. As per the researcher's analysis, the world system has been in the process of actively forming new trade and the economic world by forming large blocks to the advent of

a new era, the era of geo-economics aimed at increasing the competitiveness of the state in conditions of a qualitatively new level of development of the world economy and integration processes.

Economic diplomacy connects the sphere of corporate players who invest abroad and the sphere of diplomats presenting the state on the international scene and implementing geopolitical decisions. The author further stated that economic diplomacy is a principles-based public policy (Ruffini, 2016). The economic diplomacy of BRICSAM countries' dialogue process in particular. The challenges of globalization require new and innovative approaches, both in terms of composition and the institutions' function (CIGI, 2018). Saudi Arabia has used its petrodollars to carry out economic diplomacy by increasing the amount of aid and expanding aid targets with multiple goals (Li, 2019).

Economides & Wilson (2001) pointed out that economic aid includes the transfer of funds of the government or public agency of one state or group of states to another state's government or public agency. Economic aid, as opposed to economic sanctions, represents the intention of the donor country to provide assistance and try to influence or change the behavior of the receiving state. Bayne and Woolcock (2007) showed that economic diplomacy could conceive as applying a country's favorable environment by conferring rewards and penalties with specific foreign policy objectives.

Veenstra, Yakop and Bergeijk (2010) highlighted that economic diplomacy influences bilateral trade flows and the effectiveness of economic diplomacy could be substantially increased by the close appropriateness. Turvey (2014) pointed out that economic diplomacy has a great role in societies across the globe in which diplomatic tools and techniques improve networking relations. Rana (2013) has analyzed that foreign aid is one of the major external priorities, and embassy networks are tasked with maximizing inflows. This may raise important queries about the country's foreign policy.

Economic diplomacy and all other work of external relationship management is a single, holistic activity that can divide into political, economic, cultural, public, and others. However, the interconnections are crucial in pursuing what may be called total diplomacy. Shrestha (2021) remarked that it has potential for development and economic growth, which prospects for conducting coordinated economic diplomacy. The study identified that the main focus of economic diplomacy should be on trade promotion, investments, technology transfer and tourism.

By reviewing various research articles, research books, government policies and other related documents, economic and diplomatic relations enhance the developing economic relations of the countries. Good economic diplomatic relations improve the investment environment of the nations. Nepal needs to improve its economic diplomatic policy to attract foreign investment and tourists to the country in the context of Nepal.

## 2. METHOD AND DATA

The present study is based on secondary data and a descriptive research design has been applied. The published and unpublished relevant literature has been used to review the concept of economic diplomacy. Economic Survey published by the Ministry of Finance, data published by the Department of Industry, Statistical Year Book and other reports published by the Central Bureau of Statistics and National Planning Commission (NPC) were the major sources of statistical information. Quarterly Economic Bulletin published by Nepal Rastra Bank. To examine the economic impact of diplomacy on FDI, foreign employment and tourism industry, simple linear regression model has been applied.

In the context of Nepal, the ultimate goal of economic diplomacy is to attract FDI, and foreign employment and promote tourism inflow; keeping these in consideration, the following model is specified to examine the effect of FDI, Remittance and Foreign Exchange Earnings from the tourism industry on GDP:

$$GDP = \alpha_0 + \beta_1 FDI + \beta_2 REMIT + \beta_3 FEEs + \varepsilon \dots \dots \dots (i)$$

where GDP is employment generated due to foreign direct investment, remittance and foreign exchange earnings from the tourism industry, FDI is foreign direct investment. Remittance is income from foreign employment, and FEEs are foreign exchange earnings from the tourism industry. The  $\alpha_0$  is constant,  $\beta_1$ ,  $\beta_2$  and  $\beta_3$  are coefficients parameters. GDP is expected to increase due to FDI, remittance from foreign employment, and foreign exchange earnings from the tourism industry. For analyzing and interpreting the data collected through the different sources in the process of presentation and analysis, both the qualitative and quantitative parameters have been used. Required econometrics, accounting and statistical tools and techniques have been applied. Data are also presented in tables, graphs and diagrams as required.

## 3. RESULTS AND DISCUSSION

### 3.1 Evolution of Economic Diplomacy of Nepal

As practiced by states and their diplomatic systems within the past 50 years, economic diplomacy usually traverses four stages in its development. Trade promotion is sometimes the primary key goal supplemented by the promotion of inward investments; when around the 1970s; the mobilization of foreign direct investment (FDI) became a priority for governments. Developing countries discovered the importance of economic diplomacy around that point, impelled partly by the urge to boost their trade earnings.

The second broad objective that economic diplomacy has pursued, starting within the mid-1980s, was networking, the mobilization of wide clusters of supporters and participants, in trade and investment promotion and technology-acquisition activities. This led to public-private partnership (PPP) and outreach to multiple actors at home and abroad as contributors to economic diplomacy. Companies, industry bodies, chambers of commerce, think tanks and business schools were all validated and legitimized as crucial partners. The third phase

was a country promotion, connecting with all the economic activities, including the inflow of foreign tourists, which could be a key source of employment and foreign exchange earnings. Many countries took that up as a sustained activity within the 1980s and 1990s. At the same time, business takes place even in situations of adversity; a positive country's image facilitates trade exchanges. Overseas investments are tied even more closely with the reputation of the country.

The final regulatory phase has gained importance because external economic activity management has complexities. The establishment of the World Trade Organization (WTO) in 1995 has elevated multilateral, regional and bilateral trade diplomacy to a new high. The complex negotiations of the ambitions and highly diverse agenda of the WTO raised the salience of regulatory issues. They posed new challenges for developing states regarding their capacity to interact with those negotiations. The difficulty of investment and trade development couldn't wither away by networking and regulation management existence as necessities where country image pervades all other activities and actions even small countries now exert themselves to boost their brand reputation. Foreign ministers and their agents, the network of embassies, are directly concerned. It can be another matter that a full-of-state approach either doesn't exist in many developing countries or is under evolution.

Nepal has practiced economic diplomacy in terms of trade promotion from ancient times. Trade relations with Tibet and the British during the 18<sup>th</sup> and 19<sup>th</sup> centuries were some problems in an ancient era. Nepal started aid diplomacy in the 1950s and Nepal opened for tourism in the 1950s. The trade and commerce treaty with India was held in 1950. Nepal adopted economic liberalization in the 1990s. Various policy reforms and emphasize outward economic policies. The high-level task force report in 1996 emphasized reviewing diplomacy to concentrate on economic interests. The consequent reforms and structural changes were made and foreign policy was reoriented to specialize in economic interests. Nepal has also emphasized the importance of economic diplomacy for the overall development endeavors of the country in its periodic plans. The government has allocated budgets for economic diplomacy since 2009. Nepal has given emphasized international trade, tourism, development assistance, foreign direct investment, hydropower development and foreign employment in its economic diplomacy of Nepal.

### 3.2 Economic Impact of Economic Diplomacy

**Contribution to Employment:** Economic diplomacy improves the economic relations with the rest of the countries. Nepal is increasingly recognized as a tourist destination where tourists' arrival has been increasing from different countries. The trends of foreign exchange earnings have been increasing since the 2000s. Foreign direct investment has been increasing since the 1990s. The number of industries with joint ventures investment has been increasing significantly. The foreign capital inflow has increased in the name of FDI. This study has analyzed economic diplomacy and its impact on FDI, remittance flow from foreign employment, and foreign exchange earnings from the tourism industry, which significantly contribute to Nepal's GDP.

Many Nepalese workers have been migrating to the foreign labor market for employment each year. Remittance income from foreign employment has been contributing to poverty alleviation and expansion of economic activities for a long time. More than 5 million workers have taken labor permits for foreign employment, and more than 4.46 million have left for foreign employment until 2020. Foreign employment holds more than 16 people out of the total population. FDI and the tourism sector have also generated little employment in the country.

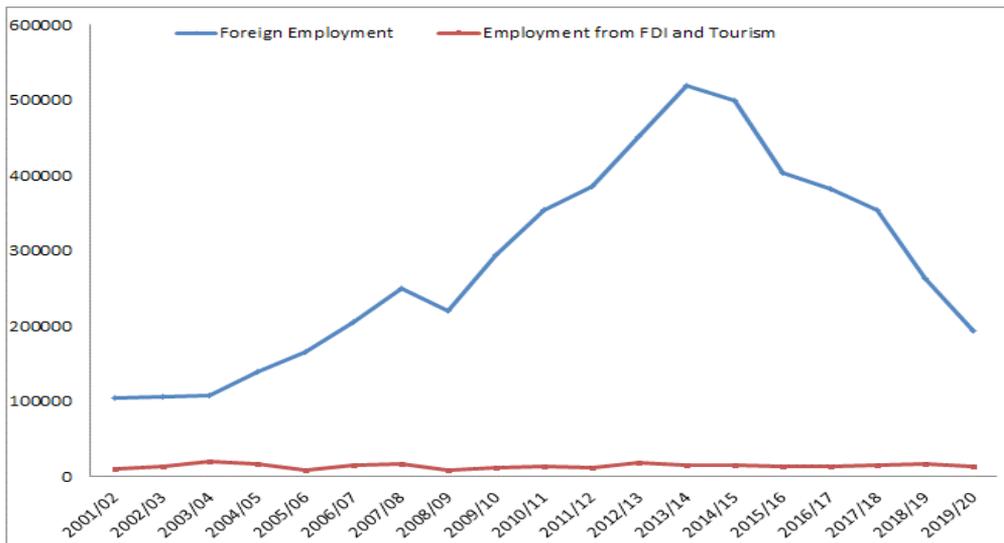


Figure 1: Foreign Employment and Employment from FDI Projects & Tourism Industry  
 Source: MOF, Economic Survey (2010/11 & 2020/21) and Department of Tourism, 2020.

Figure 1 depicts foreign employment and direct employment status from FDI projects and tourism industry-related projects from 2001 to 2019. These sectors are the potential areas for employment generation in Nepal. This sector contributes the generating employment opportunities in Nepal. Nepal's economic diplomacy has established bilateral and multilateral relations with different countries, which has attracted FDI, tourism industry, and foreign employment in Nepal. Economic diplomatic relations have extremely expanded foreign employment during the study periods.

**Contribution to GDP:** There have been a significant contribution of FDI, remittance and foreign exchange earnings from the tourism industry to the GDP of Nepal. After the 1990s, the flow of foreign labor market has become the attraction point to the Nepalese workers. Foreign employment has been increasing, so remittance flow has significantly increased since the 2000s. Non-resident Nepalese's investment attraction has been growing and Nepal's role in international forums is visible. Similarly, donors' large commitments to Nepal's reconstruction have justified the economic diplomatic relations with Nepal. The contribution of FDI, remittance and foreign exchange earnings from the tourism industry are shown in Figure 2.

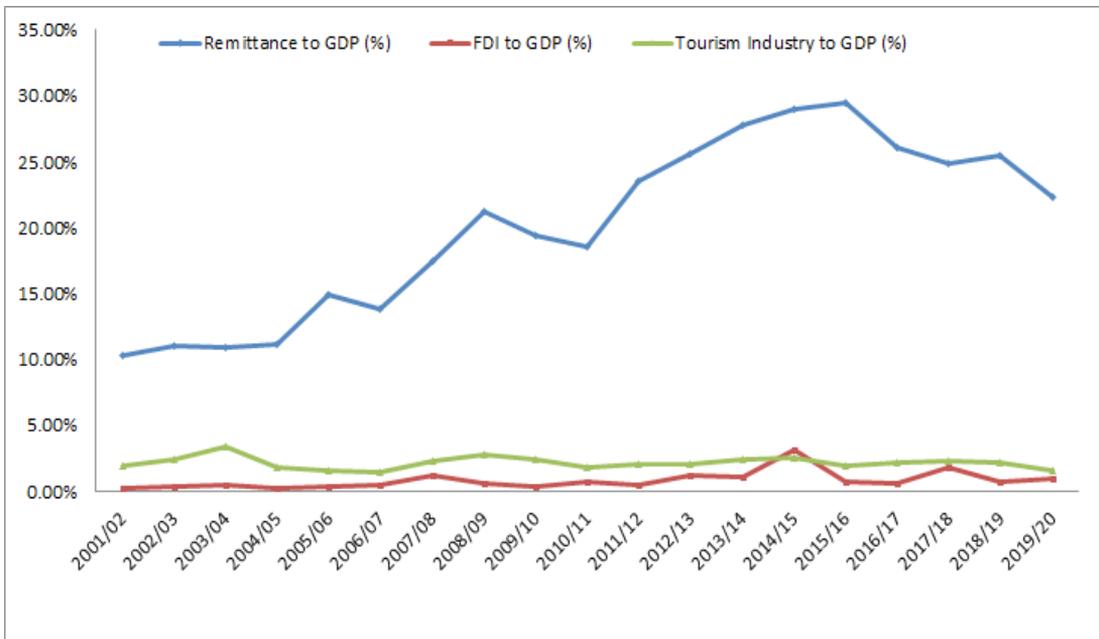


Figure 2: Ratio of FDI, Remittance and Foreign Exchange Earnings to GDP

Source: MOF, Economic Survey (2010/11 & 2020/21).

Figure 2 represents the contribution of FDI, remittance, and foreign exchange earnings to the GDP of Nepal from 2001/02 to 2019/20. There has been a significant contribution of remittance income from foreign employment. The remittance income covers more than 20 percent of GDP after the 2010s. The tourism industry has also covered more than 2 percent after 2010s, and FDI inflow has also been increasing these days. The contribution of FDI to GDP is somehow significant to the GDP of Nepal. Economic diplomacy has created a business environment and foreign employment market in the country.

**Impact of FDI, Remittance, and Foreign Exchange Earnings on GDP :** There have been significant contributions of FDI, remittance income from foreign employment and foreign exchange earnings from the tourism industry in Nepal. Economic diplomacy has created an increasing flow of foreign investment and foreign exchange profits in Nepal.

The study reveals a positive relationship between remittance income and foreign exchange earnings from the tourism sector and Nepal's GDP from 2001 to 2019. The conclusion appears true because all diagnostic criteria supported the relationship, such as the regression coefficient, which is significant at a 5% P-value and  $R^2$  of 0.963. The data indicates that remittance revenue considerably impacted GDP during the study period. Similarly, the tourism industry's foreign exchange earnings and GDP have a significant relationship. The total model is statistically significant ( $R^2= 0.963$ , P-value is less than 0.05, 5.78442E-11, which means zero).

**Table 1***Regression Output*

	Multiple R	R Square	Adjusted R Square	Standard Error	Observations
	0.981342021	0.9630321	0.9556385	233.32904	19
	df	SS	MS	F	Significance F
Regression	3	21273825.5	7091275.19	130.252703	5.78442E-11
Residual	15	816636.624	54442.4416		
Total	18	22090462.2			
	Coefficient	Standard Error	t Stat	P-value	Lower 95%
Intercept	214.23397	125.123577	1.71217909	0.10745335	-52.46061839
FDI	-5.5873045	4.537289186	-1.23141908	0.23712416	-15.25830749
Remittance Income	2.9939287	0.726525697	4.12088488	0.00090704	1.445375899
FEES from Tourism Industry	12.026454	10.77031128	1.11663014	0.28172051	-10.92992085

However, this relationship is opposed to the relationship between FDI and GDP (FDI to GDP and tourism industry to GDP). The diagnostic P-value is negligible at a 5% P-value, indicating no relationship between FDI and GDP. This suggests that FDI does not affect Nepal's GDP. This can be justifiable because the volume of FDI in Nepal is very small due to the lack of an investment-friendly policy environment during the study periods.

#### 4. CONCLUSIONS

Economic diplomacy is becoming a hot topic in today's competitive global economy. Economic diplomacy has come to be defined as using a country's good economic conditions to achieve certain foreign policy goals through the imposition of rewards or penalties. Although emerging economies are increasingly deploying economic diplomacy in broader policy areas, existing literature concentrates on how it has been used in trade-related negotiations, FDI, and tourism attractions.

Since 1950, Nepal has engaged in economic diplomacy through trade and transit agreements. Nepal has maintained economic links with many nations to increase and boost international trade. Grants, aid from various nations, and loans from outside should only be accepted if Nepal and Nepalese needs are prioritized and returned. Nepal has joined a variety of international and regional organizations. It is vital to learn from the past and current experience to move forward by developing long-term plans and cost-effectively mobilizing the country's resources to solve future difficulties.

The country can become self-sufficient in prospective commodities such as agriculture, hydropower, cement, herbs, and labor. The country's self-esteem will rise, and economic

diplomacy will improve if we become self-sufficient in these areas. As a result, states should examine their economic strengths, the necessity of transparency, and how best to operate in a fragmented international system when conducting diplomatic relations.

Nepal, in particular, should be able to profit from having balanced and positive economic diplomatic connections with wealthy countries. What economic diplomacy policy should the government pursue the country's development, and which sectors should be prioritized? Nepal must determine which industry it will link economic diplomacy with. Nepal must be guided to maximize profits in all areas of activity, including investment, commerce, and economic exchange, by forging economic diplomacy relationships with the rest of the globe. Nepal must develop economic-diplomatic relations aggressively and with an emphasis on benefits.

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