NEPAL ECONOMIC FORUM

nefport

Docking Nepal's Economic Analysis

DECEMBER 2011 | ISSUE 7

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Issue 7 | **December 2011**

Publisher: Nepal Economic Forum
Website: www.nepaleconomicforum.org

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EDITORIAL

With our seventh issue of the nefport, we are happy to bring to you an overview of Nepal's economy over the past three months. With this issue, we introduce a new section to the nefport. We call this analytic piece, that delves into a specific sector, the nefsearch. With this new section, we hope that this publication will continue to be even more essential to business executives and development practitioners in Nepal.

Building upon the general structure established in previous issues, this issue is divided into three sections. The first section provides a general overview of the overall macro-economic state of Nepal's economy. It goes into some depth within each sector and provides an overview of key stories that have developed over the last quarter. It also provides an outlook for the Nepali economy for the next quarter.

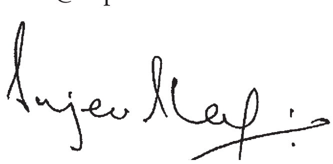
Like with previous issues, the second part of nefport is more analytical. In this issue, we have decided to look into two specific areas – the Financial and Capital Market and Foreign Investment in Nepal, with a particular focus on the recently signed Nepal-India Bilateral Investment Promotion and Protection Agreement. We provide a detailed analysis and assessment on each of these topics. We hope that this analysis will be beneficial for those who make critical decisions in these sectors, as well as those interested in the general economic well being of the country.

The nefsearch, the latest addition to the nefport, provides a new perspective towards Nepal's hydropower sector. We have re-framed the debate on hydropower and emphasized the need to reduce the opportunity cost of power outages by expediting hydropower development. It looks critically at what key actors are (not) doing and suggests areas where immediate attention is needed.

While the US dollar has appreciated in value considerably during the course of the last quarter, we have used a USD conversion rate of NPR 72.90 to a dollar, the one year average.

Nepal Economic Forum is a not for profit organization and a wing of beed management. We would like to thank beed invest and beed management for their support in making this issue possible. We also thank all our readers for their invaluable feedback. Your input helps us develop this publication and better cater to your needs. We appreciate your encouragement.

We are eager to receive your valuable feedback on how to make future issues of nefport more useful and user friendly. Please email us your suggestions at info@nepaleconomicforum.org



Sujeev Shakya
Chairman
Nepal Economic Forum

GENERAL OVERVIEW

POLITICAL OVERVIEW

The past quarter has raised some hopes for the successful completion of the peace process and the drafting of the new constitution. Major progress was made in terms of the integration and rehabilitation of former Maoist rebels. The government has also formed a State Restructuring Commission (SRC), which will work out the federal model of the country. The government also signed the Nepal-India Bilateral Investment Promotion and Protection Agreement which is expected to send a positive message to investors and attract more foreign direct investment into Nepal.

HIGHLIGHTS

Arms Handover: The Unified Communist Party of Nepal (UCPN-Maoist) on September 1, 2011 handed over the keys to their arms containers to monitors deployed by the Army Integration Special Committee at cantonment sites as per the parties decision. This was a major breakthrough in the peace process although there was stiff opposition from certain factions within the Maoist party.

Parties agree to grant amnesty to conflict related crimes: Despite major opposition from civil society and human rights groups, the government and ruling parties struck a deal to withdraw court cases and grant amnesty to people indicted in conflict-related crimes.

Bilateral Investment Promotion and Protection Agreement signed: Prime Minister Baburam Bhattarai signed a Bilateral Investment Promotion and Protection Agreement between the government of Nepal and India on Friday, October 21st in New Delhi in the presence of his counterpart, Prime Minister Manmohan Singh.

Parties sign an agreement on army integration, constitution drafting and power sharing: The major political parties signed an agreement on army integration, constitution drafting and power-sharing on November 1, 2011. The deal commits to integrate a maximum of 6,500 Maoist combatants in the Nepal Army. It offers a package between NPR 600,000 - 900,000 (USD 8,230.45 - 12,345.68) for combatants who choose rehabilitation and NPR 500,000 - 800,000 (USD 6,858.71 - 10,973.94) for combatants choosing voluntary retirement. The deal incorporates the integration of combatants, the return of property seized during the conflict, and the dismantling of the paramilitary structure of the Young Communist League (YCL) by November 23, 2011.

Government seeks pardon for Maoist Constituent Assembly member: The government, with the backing of Prime Minister Baburam Bhattarai, has recommended that President Ram Baran Yadav give Constituent Assembly (CA) member Balkrishna Dhungel an amnesty in a murder case. The District Court, Okhaldhunga, on May 10, 2004 sentenced Dhungel for life imprisonment for the crime of murdering Ujjan Kumar Shrestha, who had married a Brahmin girl against the wishes of her family.

Government forms an eight member State Restructuring Commission: The government formed an eight-member State Restructuring Commission (SRC) with the mandate of working out a federal model for the country.

OUTLOOK

The government's primary challenge is to ensure the smooth integration of Maoist combatants into the security forces and to move the peace process forward. The agreement signed on integration, constitution drafting and power sharing is a good first step. However, the government now needs to turn this into action and move forward with the constitution drafting process. The formation of the SRC is a good step in this direction, but the government needs to keep the aspirations of the people in mind while ensuring a federal structure that is effective and has proper checks and balances. Additionally, the government faces the challenge of ensuring the rule of law is maintained, acts of impunity are prevented and the rights of its citizens are protected. The government's policy of forgive and forget rather than delivering justice sets a bad precedence. The case for pardoning Maoist Constituent Assembly member Balkrishna Dhungel is a prime example of the dangers inherent in a process that overlooks and denies justice.

INTERNATIONAL ECONOMY

Global economic growth remains upon precarious grounds. The results and consequences of the Euro zone crisis being central to what happens to the global economy. Economic growth in Nepal's two neighbors, while slowing, is expected to continue with China's GDP growth rate estimated at over 9% and India's at over 7%. Growth in these two economies provides Nepal with ample opportunities to benefit from.

HIGHLIGHTS

Euro zone crisis: There are growing concerns over the euro zone's debt crisis with a growing fear that this could lead to the collapse of Euro. Europe is already entering a recession and unless the European Central Bank (ECB) and Germany take concrete actions, many fear that the single currency will be a thing of the past.

Recession risks: The International Monetary Fund (IMF) has warned that the US and the euro zone are at increased risk of falling back into recession, a move which it says could threaten other economies worldwide.

Massive floods in Thailand: Heavy monsoon rains that first began in July have caused the worst flooding in Bangkok and outlying regions of Thailand. This is the worst flood in almost 70 years. The floods led to the death of more than 500 people, damaged 1,000 factories and destroyed 1.6 million hectares of farmland. The United Nations has warned that the flooding across Southeast Asia including Cambodia and Vietnam, could lead to serious food shortages and rising prices. The impacts of the flood will be felt by global consumers from food shortages to higher-priced electronics.

OUTLOOK

With predications of an American and Euro zone recession in the remaining months of 2011, the global economy still looks shaky. Though slow, the impact will be felt even in the smallest of economies like Nepal via reduced exports and remittances. However, the growth nearby in India and China provides some cushion to the Nepali economy.

NEPAL ECONOMIC FORUM

macroECONOMIC OVERVIEW

At the turn of the century, Nepal's GDP for the 2000/01 fiscal year stood at NPR 413 billion (USD 5.62 billion). Since then, Nepal's economy, as estimated for the 2010/11 fiscal year, has painstakingly grown to NPR 637 billion (USD 8.76 billion) at 2000/01 prices. The decade saw momentous change in Nepal's political spectrum through the removal of the monarchy and the end of the civil war. However, economic progress has at best trudged forward with socio-political issues consistently trumping the economy. According to the Central Bureau of Statistics (CBS), Nepal's per capita Gross National Income (GNI) during this time period doubled from NPR 19,144 (USD 260) in 2000/01 to NPR 46,859 (USD 645) in 2010/11. However, this still keeps Nepal close to the bottom of global income tables.

AGRICULTURE

The agriculture sector witnessed major changes this quarter with prices rising due to an increase in demand during the festival season. However, this did not deter consumers and aggregate demand was higher than normal. Low domestic output meant that the demand was met by increased imports. Volatile prices and limited domestic output continues to make food security a major issue for the country.

Food prices soar: Essential food items (rice, lentils, oil) saw an increase in prices due to a drop in supply from India caused by stringent customs regulations and a surge in transportation costs. Prices have increased by 400% from NRP 5 (USD 0.07) to NRP 20 (USD 0.28) per kg between October-November.[1] These fluctuations make it evident that the governments' plan to formulate a price control policy for essential commodities has not been successful. According to the policy, prices are fixed on the basis of production cost and a legitimate profit margin. It also provides for ration cards that extend food subsidies for people living below the poverty line.

Vegetable and fruit market watch: Nepal has been flooded by vegetables and fruits that come in from India, China, Bhutan, Thailand, Australia, New Zealand etc. While most of these items come from India, significant quantities of garlic and onions are imported from China. Nepal has not been able to satisfy demand through local production due to labor shortages in the agricultural sector. A key reason behind this is that most workers leave the countryside in search of employment abroad.

Over the years, direct supplies from India have gradually increased. According to data from the Kalimati Fruit and Vegetable Market Development Board (KFVMDB), during the first six months of the year 2010/11, Indian supplies accounted for about 28% (24,655,318 kg) of total vegetables and fruits imports. Consumption rose during the festivals of Dasain and Tihar. The average daily import of fruits into the valley, according to the Nepal Fruit Wholesale Entrepreneurs Association, is 300 tons, which increases to around 500 tons during Tihar.

Pesticide mania: Public pressure and the support of the German Society for International Cooperation (GIZ) finally led to the disposal of hazardous pesticides stored in Nepal. Financial constraints had prevented the Nepali government from disposing the pesticides. The Stockholm Convention and Rotterdam Convention, of which Nepal is a signatory, bans the use of certain chemicals and requires these hazardous pesticides to be disposed by the manufacturer. However, in this case, most of

CHEMICAL FERTILIZER USAGE IN NEPAL

Fertilizers are considered the catalyst for agricultural growth. The Agriculture Perspective Plan (APP) expects fertilizers to contribute 64-75% to its agriculture growth targets.[2] However, a scarcity of fertilizers in the country means that the targeted growth rates will likely not be met. Actual demand for fertilizers is difficult to quantify as Nepal lacks a scientific system for projecting fertilizer demand and documenting unofficial imports from India. But, according to the Agriculture Sector Performance Review (ASPR), total demand for fertilizers during the 2011/12 fiscal year is estimated at 785,200 tons. However, actual fertilizer demand collected by the Ministry of Agriculture and Cooperatives from all 75 districts show a demand for 726,000 tons during 2009/10 fiscal year itself.[3]

Table 1: Projected fertilizers demand as per ASPR growth percentage

	Urea	DAP	MOP	Total
Annual Growth Percentage	16%	20.20%	19.90%	18.20%
Fiscal Year	Tons			
2007-08	253,051.04	164,621.74	15,986.67	433,659.45
2008-09	293,539.21	190,961.22	18,544.53	503,044.96
2009-10	340,505.48	221,515.01	21,511.66	583,532.15
2010-11	394,986.36	256,957.41	24,953.52	676,897.29
2011-12	458,184.17	298,070.60	28,946.09	785,200.86

Source: Agriculture Sector Performance Review, 2000/01

Table 2: Fertilizer Procurement from Various Sources*

Quantity per Fiscal Year (tons/yr)	
Year	Tons
2006/07	44,662
2007/08	10,000
2008/09	10,000
2009/10	70,000
2010/2011	119,330

*Includes MMTC & IPL in India, Turkey, Egypt, China, Jordan, Japan

Source: Compiled from Yearly Statistics of the Agriculture Inputs Company

Currently, Nepal procures most of its chemicals fertilizers from India. The Agriculture Input Company's (AIC) database shows that procurement peaked during the last fiscal year.[4] However, this remains well short of the estimated demand. To ease the supply situation and raise outputs, the government reintroduced subsidies up to NPR 3 billion (USD 41.15 million) for the 2011/12 fiscal year.[5]

These subsidies have had a negative impact on supply by creating artificial cross border price differences. Since the AIC introduced the subsidies, the difference in the price of fertilizers between the Indian and Nepali markets is over 25%.[6] This has resulted in a surge in the illegal trade of fertilizers from Nepal back to India, creating a huge deficit in the Nepali market. In a bid to curb this, the Ministry of Agriculture and Cooperatives (MOAC) had stopped supplies to farmers and plans to raise the price of subsidized fertilizers by about 20%.[7] This shortage has been aggravated by changes in the clearance provisions for the import of chemical fertilizers.[8]

The failure of the subsidies suggests that the government should refrain from utilizing market distorting tools without adequate planning. The illicit trade these subsidies fostered not only harmed farmers but further destabilized the fertilizer market. The government should rather focus on expanding distribution, regulating quality and ensuring accessibility to fertilizers for farmers. On a more positive note, the government's plans to distribute liquid fertilizers to ease the supply. Liquid fertilizers are high in nutrients, cheaper to transport and easier to distribute.[9] Its distribution is being planned through Agriculture Inputs Company Ltd. (AICL) outlets and cooperative offices in different parts of the country.

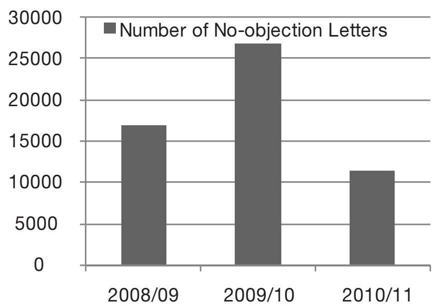
the companies that manufactured these pesticides have closed down. The pesticides (70 tons) were brought in from various European countries 40 years ago for agricultural use.

Committee for food security: The food security situation in Nepal is likely to worsen. Whereas large countries have been able to use trade restrictions and other policy instruments to help deal with the crisis, poorer developing nations dependent on imports have been more severely affected. However, the government has taken the initiative to address the growing concerns by forming a steering committee. The committee's role is to find ways of enhancing agricultural productivity and is intended to address issues of malnourishment through effective food distribution in Nepal.

EDUCATION

Although Nepal spends 17% of its budget on education, the quality of education in government institutions is poor. High dropout rates at the primary level have kept Nepal from fulfilling its commitment to its the Millennium Development Goals of achieving universal primary education.

Figure 1: Number of Students Going Abroad

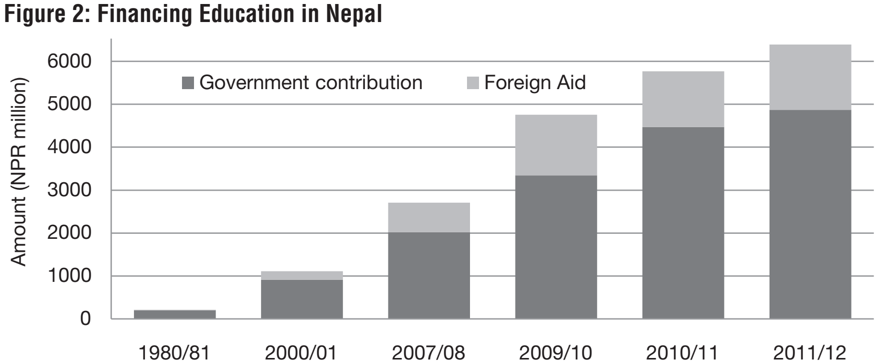


Fewer Nepalis study aboard: Changes in visa policies and stricter regulations on working hours imposed by countries like the UK, Australia and USA have reduced the number of Nepali students leaving for higher education. Because Nepali students relied heavily on the money they earned while they studied to finance their education, students are unable to go abroad for education. This is corroborated by a sharp decline in the number of students seeking no-objection certificates at the Ministry of Education.[10] Applications for no objection certificates dropped by more than 55% in the 2010/11 fiscal year. There was a significant rise in 2009/10 because the UK had liberalized its visa and work regulations. Around 70% of all Nepali students who left Nepal that year went to the UK. This decline has affected revenue collection at the Education Ministry. Collection went down to USD 3.15 million (NPR 230 million) in 2010/11 from the USD 7.40 million (NPR 540 million) in 2009/10.[11]

Rising education budget: Nepal's education budget has more than doubled in the past four years, rising from USD 371 million (NPR 27.04 billion) in FY2007/08 to USD 877 million (NPR 63.93 billion) in FY2011/12. The government has allocated 3.4% of national Gross Domestic Production (GDP) amounting to 17% of the national budget to the education sector. This comes close to global standards of allocating at least 5% of GDP and 20% of the total budget to education programs and activities. Of the education budget, 60% is allocated to secondary level education while 40% is allocated to primary level education. Expenditure per child in primary education is among the lowest in the world. The discrepancy in funding versus quality can be attributed to the high administrative and wage costs. The education sector's dependency on foreign aid has also increased. Foreign aid in education stands at over NPR 15 billion (USD 205 million) in 2010/11 up from NPR 12.2 million (USD 167,353) in 1980/81. Almost 24% of the foreign aid that comes to Nepal is put into education projects.[12]

Education for All program, still a long way to go: Universal Primary Education or Education for All is one of the eight Millennium Development Goals that Nepal adopted at the UN Millennium Summit in September 2000. The goal is to ensure that all boys and girls complete a full course of primary schooling.[13]

Figure 2: Financing Education in Nepal



Nepal has shown remarkable improvement in the net enrolment rate (NER) at primary level. Its major challenge lies in retaining students. The number of students starting grade 1 and finishing grade 5 decreased between 2005 and 2010. This was due to a high dropout rate of 9.9% and a repetition rate at 26.5%.[14] Despite the difficulty in retaining students, literary levels have improved significantly.

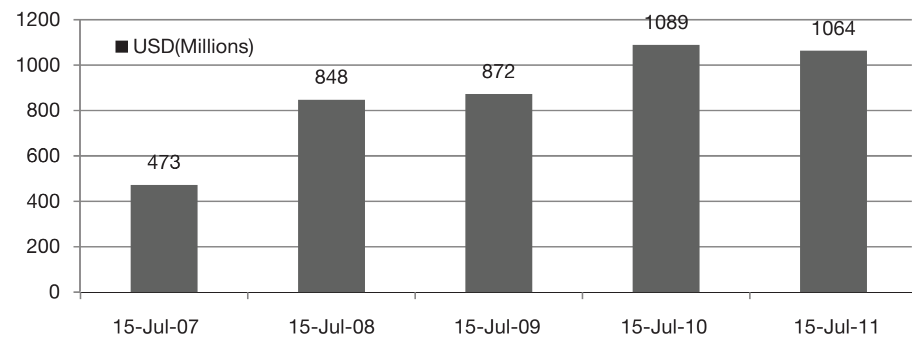
Table 3: Millennium Development Goal Indicators for Education

Indicators	1990	2000	2005	2010	2015 (Target)
Net enrolment rate in primary education	64.0%	81.0%	86.8%	93.7%	100%
Proportion of pupils that start Grade 1 and reach Grade 5	38.0%	63.0%	79.1%	77.9%	100%
Literary rate of 15-24 year olds, women and men	49.6%	70.0%	79.4%	86.55	100%

Source: 'Nepal Millenium Development Goals' – Progress Report 2010, Government of Nepal, National Planning WCommission and United Nations Country Team of Nepal,

Government bans cell phones, junk food in schools: The Department of Education (DOE) has banned the use of cell phones up to the higher secondary level as it affects student performance. In response, some schools have implemented the ban and adopted tough measures against defiant students. The government's directive was been prompted by a series of discussions held with school administrators and parents who believe cell phones are a nuisance. The government's decision has invited some disapproval from people who believe that is irrelevant and anachronistic. The DOE also made it mandatory for parents to only send homemade lunches for their children as junk food such as readymade noodles and snacks can adversely affect children's health. Unlike the decision on cell phones, the DOE believes that it will take a lot longer for the decision on junk food to be implemented.[15]

Figure 3: World Bank Lending to Nepal in USD Millions



Source: World Bank Group http://go.worldbank.org/D8KQYUQ460

FOREIGN AID

Nepal remains largely dependent on Foreign Aid for major development projects and a substantial portion of government expenditure. Even through the western economies are undergoing a major financial and economic crisis, several donor agencies have pledged further aid assistance to Nepal.

Nepal office to be restored by IMF: The International Monetary Fund (IMF) has accepted the government's request to reinstate the IMF office in Nepal.[16] The request was sent by the Ministry of Finance in October. The IMF office in Kathmandu was closed on November 2010 and operations were shifted to New Delhi. Given Nepal's unstable financial system, a resident representative and an office in the country seems logical.

Nepal may lose US aid over Tibetans: Frank Wolf, a member of the House Appropriations Committee, which determines US funding to Nepal, stated that the US could not only cut funding but also block it completely unless Nepal issues exit visas to Tibetans wishing to seek refuge in the US.[17] In the past, Nepal has faced accusations for unnecessarily arresting and harassing Tibetans. In July, Tibetans in Nepal were forbidden from celebrating the birthday of their spiritual leader, the Dalai Lama.

Indian aid for construction of embankments: The Government of India is to provide NPR 345.73 million (USD 4.7 million) in financial assistance for the construction of embankments along the Lalbakeya, Bagmati and Kamla rivers. The total sum of the grant provided for the project has reached NPR 2.37 billion (USD 32.5 million) over a period of four years starting in 2008.[18]

USAID funds *Hariyo Ban* program: United States Agency for International Development (USAID) launched a five year *Hariyo Ban* program to reduce carbon dioxide emissions, improve forest management and pay local communities to protect endangered animals. The grant, set aside for this undertaking, stands at USD 30 million (NPR 2.2 billion) and its overall objective is to control climate change and its adverse effects on people and wildlife.[19]

World Bank drafts new interim strategy: The World Bank (WB) continues to be a major source of foreign aid to Nepal. It has prepared an Interim Strategy Note (ISN) 2012-13 for Nepal, under which Nepal could potentially be allocated around USD 400 million (NPR 29.2 billion) from the International Development Association (IDA).[20] However, the amount is subject to good performance and prudent economic development in the nation. The grant can finance four to five operations per year and the International Finance Corporation (IFC) can also add USD 25 million (NPR 1.8 billion) to USD 30 million (NPR 4.4 billion) annually in aid depending on the availability of investment opportunities. IDA is the concessionary lending arm of the WB Group, while IFC is the private sector arm.

ADB assists water supply projects: The Asian Development Bank (ADB) is assisting the Kathmandu Valley Water Supply Improvement Project to improve the water distribution system in Nepal. The ADB extended a USD 80 million (NPR 5.8 billion) loan in September to increase piped water access and focus on the continuation of the Melamchi Water Supply.[21] The completion of the project is targeted by December 31, 2016.

China to assist army hospital: The People's Liberation Army of China is to assist the Nepal Army with a grant of NPR 602.7 million (USD 8.26 million) to modernize the Birendra Army Hospital.[22] The agreement for the assistance was signed by the Chief of the Army Staff General Chhatra Man Singh Gurung and his Chinese counterpart General Chen Bingde during Gurung's official visit to China in November.

ADB, Japan Fund partner for Nepal: The Japanese Government and the Asian Development Bank launched three projects in Nepal in coordination with the Nepali Government to reduce child malnutrition, develop new livelihood opportunities for the poor, and promote greater access to clean energy for poor rural women. The Japanese Fund for Poverty Reduction will provide USD 2.7 million (NPR 196.83 million) to fund these projects.[23]

HEALTH

The effectiveness of community health workers in the polio eradication and Vitamin A distribution, has encouraged the government to mobilize health worker-teachers, students and especially female community health volunteers to create awareness and provide immediate basic services.

Equal pay for equal work: Nepali Doctors at Manipal College of Medical Science (MCOMS) in Pokhara went on a strike for over 10 days as the management refused to pay them on par with non-Nepali doctors. Interventions from the Ministry of Labor and Transport Management (MoLTM) did not resolve the issue. Talks are yet to be concluded, however the Manipal Group of Companies, may decide to pull out of Pokhara[24] as incessant closures from trade unions and doctors continues to disrupt their operations.

Technological advances in Typhoid research: Researchers believe the source of Typhoid outbreaks is related to the use of communal water spouts. They identify people living near communal water spouts and at a lower elevation are at far greatest risk of contracting the disease. The latest DNA sequencing techniques and GPS signaling using Google Earth has helped map the spread of typhoid in Kathmandu for the first time.[25]

Table 4: Number of persons infected with *Kala-Azar* disease

Year	Infected Persons[29]	Death
Till November, 2011	600	0
2010	900 (192 Indian nationals)	2
2009	935 (202 Indians nationals)	5
2008	1,197 (223 Indians)	4
2007	1,433 (374 Indian nationals)	10

Source: Republica

Yet another health campaign: Door to door campaigns will be launched in December in 12 Terai districts[26] in an effort to eliminate *kala-azar* or black fever, Visceral leishmaniasis (VL), from the country. Leishmaniasis is a disease caused by protozoan parasites of the Leishmania genus.[27] The campaign will deploy health officials to the districts to raise awareness and visit the homes of the affected to conduct on the spot blood tests. Currently, the ratio of infection is 1.9 in every 10,000 people. The government aims to reduce this to one in every thousand by 2015 to achieve its Millennium Development Goal (MDGs).[28]

Failure of the smoking ban: Despite the approval of the anti-smoking ban on public places in April, the government has been ineffective in forming a mechanism to punish those who smoke in public. The government has also failed to implement the Tobacco Control and Regulation Act-2068. According to the directive, all tobacco manufacturers, including international companies, must cover 75% of the package surface with explicit anti-tobacco images and written health warnings. However, even after six months after approving the act, tobacco companies have been allowed to sell their products without fulfilling this obligation.

Table 5: Few Indicators from the Multiple Cluster Survey in the Mid and Far Western Regions

S. No	Topic	Indicator	Percentage unless otherwise noted
1.	Environment	Use of improved drinking-water sources	83%
		Use of improved sanitation facilities	36%
2.	Education	Primary-school net attendance ratio (adjusted)	86
		Gender parity index(primary school)	0.99
3.	HIV/AIDS, orphaned and vulnerable children	Comprehensive knowledge about HIV prevention among young people	34%
4	Child Labor	Children involved in child labour in the age group 5-14	44%
5	Access to mass media	Once a week	
		Newspaper	8%
		Radio	49%
		Television	29%
		All three forms once a week	5%

Source: Multiple Indicator Cluster Survey 2010 in the Mid and Far Western Regions.

Program to curb neonatal mortality: One of the many challenges in meeting the MDGs is in reducing neonatal mortality rate. Infant mortality and child mortality stands at 46 and 9 respectively per 1,000 live births in Nepal.[30] Neonatal mortality has not seen significant improvements. The risk of neonatal and post-neonatal death stands at 33 and 13 respectively per 1,000 live births. The government has introduced a community based Newborn Care Program to bring down the existing rate to 15 and achieve the MDG by 2015. The program, running since 2007, is present in 25 districts[31] and will be extended to six more. The program will use female community health volunteers (FCHV) to provide free post-natal care to newborns and mothers.

Nepal Multiple Indicator Cluster Survey: The Nepal Multiple Indicator Cluster Survey (NMICS) conducted by the Central Bureau of Statistics (CBS) in 2010 with technical and financial support from UNICEF was recently released. The study looked at nutrition, child health, environment, reproductive health, education, child protection, and HIV/AIDS issues in various parts of the country.[32]

Fight against epidemics: Epidemics such as dengue fever and malaria are still prevalent in the Terai regions of Nepal. Several international organizations are keen on supporting awareness campaigns by mobilizing community health workers. The World Health Organization (WHO) has provided assistance in conducting campaigns on dengue fever. Similarly, Population Service International (PSI) Nepal has been distributing mosquito nets for free to prevent malaria with the help of a grant from the Global Fund. The Global Fund had set aside US$ 9,126,452 (NPR 66.53 million) for malaria control in its seventh round. The organization provides mosquito

The Pharmaceutical Industry of Nepal

Table 6: Trade statistics of drugs with India

	2006/2007	2007/2008	2008/2009	2009/2010	2010/11	2011/12P
Import (NPR million)	4442.5	5434.1	6558.1	1354.8	1739	2072.1
Export	156.3	132.1	163.407	138.8	92.3	216.6

Source: Macro-economic Situation, Nepal Rastra Bank.

The pharmaceutical industry of Nepal witnessed a major surge in the 1990s with an increase in the number of companies. Currently, it is one of the fastest growing industries in Nepal with an annual projected growth rate of around 19%[33] and has the capability to compete in foreign markets. The total market size is estimated to stand at about USD 250 million (NPR 18.23 billion)[34] of which the domestic sector claims 35% of the total market and foreign companies occupy almost 65% of the drug market.[35] Among foreign brands, Indian companies are dominant. Currently there are 12,709 licensed pharmacies, 87 domestic pharmaceutical companies of which 41 manufacture modern medicine, 7 veterinary medicines and 37 herbal preparations.[36] About 200 foreign companies, mainly India and Bangladesh, operate as major players in the country.

Despite significant manufacturing of drugs in the domestic market, Nepal is still dependent on foreign pharmaceutical producers to a great extent. Most of the drugs are imported from India. However, Nepal has contributed to India's growing herbal medicine market. The total amount of herbal medicines exported in the fiscal year 2010/11 was NPR 92.3 million (USD 1.27 million) whereas total imported medicines stood at NPR 1,739 million (USD 23.85 million).

Table 7: Quick Facts on the Pharmaceutical Industry of Nepal

Industry Size	**NPR billion**
- Total Market Size - Domestic Market players	**8 billion** **3 billion (35% of total)**
Growth Rate	**19% per annum**
Import from India, 2010/11	NPR 1739 million
Export to India (Herbal Medicines), 2010/11	NPR 92.3 million
Licensed Pharmaceutical Manufacturers	Number
- Nepali - Foreign Number of licensed Pharmacies	87 200 12709
Policies Governing the Sector	**Institutions**
National Drug Policy 1995, National Health Policy, Good Governance Act and the Consumer Protection Act	Ministry of Population and Health, Medicines Regulatory Authority (MRA)- Department of Drug Administration (DDA)
Associations of drug and pharmaceutical companies	
Association of Pharmaceutical Producers of Nepal (APPON)	Nepal Chemist and Druggist Association (NDCA)

nets to people living in districts affected with malaria once every three years.

Improving sanitation: Local governing bodies have adopted new ways to promote sanitation. In Dadeldhura district, the Rupal Village Development Committee (VDC) has not issued any recommendations for citizenship, school admission, scholarship and other paper work, unless the household has a toilet of its own. Grants have also been made available to impoverished villagers for the construction of toilets. Of the 938 households in the VDC, 735 are without toilets.

INFRASTRUCTURE

Slow progress can be observed in the various infrastructure projects currently being executed by the government. Several new ones have also been planned but financial constraints mean that most of them are dependent on donor assistance. Road linkages, waterways, dry ports and incentives for private hydropower developers are some of the areas the government is working on. The development of this infrastructure will make a significant contribution towards economic growth.

Hydropower developers battling for survival: Rising interest rates have forced 28 hydropower companies to approach the Ministry of Energy to declare their projects sick and request relief. Interest rates have increased by 5-7% in the last two years. The Independent Power Producers (IPP) have demanded relief in interest, a facility for refinancing or the purchase of the project by the Nepal Electricity Authority (NEA), and a hike in the Power Purchase Agreement (PPA) rate. Addressing the problem, the government is offering Value Added Tax (VAT) exemption on construction materials instead of subsidizing the interest rates. The government also hiked the PPA rate by 20% for new projects but has not increased it for projects that are already under construction. [37]

Kathmandu-Terai Fast Track land acquisition: The committee formed for acquiring land along the Kathmandu-Terai Fast track had recommended providing compensations worth the full price of the land for legal land owners and 75% for settlers having no land ownership certificate. The report submitted by the committee show that 70% of the total land required is public land and the remaining portion belongs to local people who are either registered holders or settlers who have resided there for over 20 years.[38] On September 31, the compensation fixation committee fixed the price of land to be acquired in the range of NPR 110,000 (USD 1509) to NPR 280,000 (USD 3841) per Kattha[39] (.034 hectares) in Makwanpur district. The project has to acquire 1609 Kattha (54.7 hectares) of land in six Village Development Committees (VDCs) of Makwanpur district.[40]

Humla-Tibet bridge: In September, the finance minister laid the foundation stone for the much awaited bridge to be built over the Karnali River. The bridge will connect the 90 kilometer Simikot-Hilsa (Humla) road section with Tibet. A total of NPR 70 million (USD 960,219) has been allocated for the construction of the bridge within a year. The new bridge will help in procuring construction material from Tibet which will increase the construction pace of the Simikot-Hilsa road and reduce costs substantially.[41]

Mechi-Mahakali electric railway: Sixteen international firms had submitted an expression of interest for preparing the Detailed Project Report (DPR) for the Bardibas-Simara-Birgunj section of the Mechi-Mahakali electric railway. Chungsuk Engineering Company from South Korea has been short listed for it. Currently, negotiations with Chungsuk Engineering are taking place on issues related to taxes, consultancy fee and the technology to be adopted for the study. The DPR is estimated to cost NPR 320 million (USD 4.39 million) and will be completed within one year.[42]

Kakarbhitta dry port: The Kakarbhitta dry port, spread over 7.5 hectares of land was built with a NPR 390 million (USD 5.35 million) loan from the Asian Development Bank to facilitate trade between Nepal and countries like India, Bangladesh and Bhutan. Currently, the port handles around 80-90 trucks of goods a day which is far lower than the government estimate of 160 trucks. The main objective of building the port was to boost Nepal's exports to Bangladesh. However, in the last three years, Nepal's exports to Bangladesh have declined from NPR 5.13 billion (USD 70.37 million) to NPR 3.47 billion (USD 47.60 million). This can be attributed on the decision to ban wheat exports and the high import duties levied by Bangladesh on select Nepali agricultural products. The facilities provided in the dry port have not been utilized fully as forward and clearing agents have resisted moving into the space due to unaffordable rentals being charged by the government. The state owned Nepal Intermodal Transport Development Committee (NITDC) which operates the dry port had initially fixed monthly rent at NPR 730 (USD 10) per square meter which it later reduced to NPR 375 (USD 5) per square meter.

Construction of Tatopani dry port: The total cost of constructing the Tatopani dry port is estimated at NPR 300 million (USD 4.12 million) out of which China will provide NPR

Table 8: Waterways identified in three river basins of Nepal

S.No.	Water ways	River Section	Length (Km)
1.	Koshi Waterway	Chataraghat-Koshi barrage	47
		Chataraghat-Tribeni	8.5
		Tribeni-Simhawati Saune	48
		Simhawati-Ghurmi	70
		Total	173.5
2.	Gandaki Waterway	Waterway along Devghat-Ramdi	130
		Devghat-Muglin	33
		Muglin-Fishling	16
		Mirmi-Setibeni	4.5
		Total	183.5
3.	Bheri Waterway	Karnali Bridge-Ghatgaun	15
		Ghatgaun–Taranga	37
		Taranga-Haripur	20
		Haripur-Bhotechaur	50
		Total	122
		Grand Total	**479**

Source: Adapted from 478 Km of waterways possible in Koshi, Gandaki and Bheri', Republica, November 7, 2011

250 million (USD 3.43 million) in assistance. The dry port will be spread over 468 ropanis (24.19 hectares) of land and will have a warehouse, checking yard, parking lot and residential complexes. Upon completion of the dry port, customs will be able to check 40 containers at a time with a capacity to park 200 containers. The current customs at Tatopani can only hold around 60 containers.

Waterways: The inception report prepared by East Consult and ECoCoDE Nepal proposed four routes along the Koshi river totaling 173.5 km, four routes along the Gandaki river totaling 183.5 km and four routes along the Bheri river totaling 122 km to run two way water transports in Nepal. It is estimated that 1.4 million people in 17 districts could benefit from the Koshi waterways, 2 million people of 17 districts from the Gandaki Waterways and 0.3 million people in 6 districts from the Bheri waterways if the proposed waterways prove feasible.

MANUFACTURING AND TRADE

The 2011/12 fiscal year started on a positive note with considerable growth in exports. However, increasing imports continues to put pressure on the trade balance. Albeit delayed, the government is working towards providing Special Economic Zones to facilitate industries focusing on exports. The government has also taken encouraging steps to attract foreign direct investments, including declaring 2012, Nepal Investment Year. However, Nepal has done little in terms of product diversification although the government claims that the Nepal Trade Integration Strategy (NTIS) 2010 played a vital role in diversifying export items and destinations.

Changes in Nepal's top five trading partners: For the 2010/11 fiscal year, Nepal's top five export destinations are India, European Union (EU), United States of America (USA), Bangladesh and Bhutan. The USA, Nepal's second largest export destination in 2009/10, slipped to third position in 2010/11 as Nepali readymade garments lost its competitiveness after the quota system was phased out in the US and gained competitiveness in the EU after EU gave preferential market access (duty free and quota free market access) to almost all exports from the Least Developed Countries.[47] Similarly, increased demand of electricity poles for rural electrification and hydropower projects in Bhutan has made Bhutan the leading country for importing iron and steel products from Nepal over the past two years and consequently became Nepal's fifth largest export destination. Similarly, changes were also witnessed in major import destinations. India and China are still the top two import destinations for Nepal. Large quantities of gold imports meant that the United Arab Emirates (UAE) is the Nepal's third largest import destination accounting for 8.9% of total imports in 2010.[49]

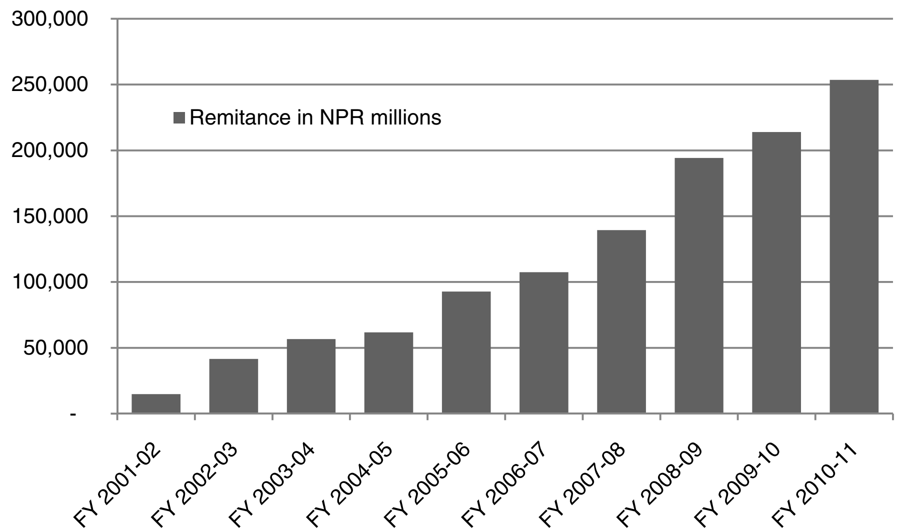
Nepal records trade deficit despite a surge in exports: Nepal´s exports over the first two months of the 2011/12 fiscal year grew by 16.9%. Exports to India increased by 17.7% while export to third countries (countries other than India) increased by 15.5%. August-September 2011 saw merchandise imports increase by 14.5% to USD 959 million (NPR 69.91 billion) from USD 123 million (NPR 8.96 billion) in the first two months of the 2010/11 fiscal year. The sharp rise in imports, compared to exports widened the country´s trade deficit to USD 788 million (NPR 57.44 billion).

Carpets, readymade garments and pashmina exports on the rise: Hand-knotted woolen carpets have shown signs of a revival with the export of carpets increasing to USD 17 million (NPR 1.23 billion) during the first two months of the 2011/12 fiscal year, a growth of 65% compared the first two months of the last fiscal year.[50] Exports of readymade garments have also grown by 20% to USD 14 million (NPR 1 billion) during the same period. Further, pashmina exports in the same period have grown 3 folds to USD 9 million (NPR 656 million).[51]

Government allocates budget for Special Economic Zones: This year's budget has allocated USD 82,000 (NPR 6 million) to conduct feasibilities studies to develop Special Economic Zones (SEZs) in Dhanusha, Siraha and Jhapa districts. Of the eight planned SEZs, the ones in Simara and Bhairawa are currently under construction. It has allocated USD 2 million (NPR 146 million) to develop infrastructures in Bhairawa, acquire land in Simara and conduct an Environment Impact Assessment (EIA) study in Panchkhal. Further, to institutionalize the SEZ concept, the government has registered the SEZ Act in the parliament. It envisages that the government developing the necessary infrastructure, providing tax incentives and other facilities for industries to be opened inside the SEZ. It also incorporates a mandatory provision that the industries operating inside SEZs must export 75% of total production.[52]

Balance of Payment records a surplus: Nepal´s balance of payment (BOP) recorded a surplus of USD 237 million (NPR 17.27 billion) over the first two months of the FY2011/12 compared to a deficit of USD 80 million (NPR 5.83 billion) in the same period last year.[53] The BOP surplus can be attributed to a rise in remittance inflows. Remittance inflows to Nepal increased by 24.9% to NPR 47.33 billion (USD 649 million) in the same period.[54]

Figure 4: Remittance Inflow to Nepal for Past Ten Years



Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-April 2011, http://red.nrb.org.np/publications/economic_bulletin/Quarterly_Economic_Bulletin--2011-04%20(Mid_April)-New.pdf

Nepal Investment Year 2012: The Federation of Nepalese Chambers of Commerce and Industry (FNCCI) is set to observe the year 2012 as 'Nepal Investment Year.' It intends to put Nepal on the map of international investments.[55] Prime Minister Baburam Bhattarai has announced that the government will mark the years 2012 and 2013 as investment years. The Government of Nepal has also started developing a comprehensive network on investment to attract foreign direct investment.

REMITTANCE

Nepal's dependence on remittance has been increasing over time. According to the Department of Foreign Employment, the number of migrant workers annually leaving the country has jumped from 55,025 in 2001/02 to a staggering 369,644 in 2010/11. The number of migrant workers leaving the country has already reached 109,554 in the first three months of the 2011/12 fiscal year.[56] However, not much change is seen in terms of the destination countries. Malaysia, Saudi Arabia, Qatar and UAE are still the most popular destination for migrant workers.

Remittance benefits offset by disease: The benefits of remittances have been offset by the simultaneous increase in diseases the workers bring back. It has been found that remittance and epidemic diseases such as HIV/AIDS are on the rise due to a lack of awareness among the workers.[57] As per the 2007 Integrated Bio-Behavioral Surveillance Study (IBBS), 1.5 -2 million migrant workers accounted for the majority of Nepal's HIV-positive population.[58] Although counseling on HIV/AIDS is provided to those going abroad for employment, its effectiveness is reduced due to lack of proper training in districts.

Remittance in Myagdi decreases: The

Government launches Foreign Employment Bond III

Despite two unsuccessful attempts, the government is set to launch the third installment of the Foreign Employment Bonds (FEB) to attract investments from migrant workers.[62] The earlier FEBs, launched in 2009/10 and 2010/11 were both undersubscribed by significant amounts.

The interest rates on the bonds were raised from 9.75% to 10.5% for the second FEB in an attempt to attract more investment, but to no avail. The FEB 2073 was made available for sale in five foreign countries, South Korea, Malaysia, United Arab Emirates, Saudi Arabia and Qatar. The migrant workers could subscribe to the bonds in their or in their family member's names. Moreover, the interest earned from the bond was made tax free and they could also take out loans against the bond.

Even with the aforementioned benefits, the FEB 2073 could not attract the desired investments. The reasons that accounted for its failure were a lack of publicity and thus awareness of such bonds among migrant workers. Other reasons, according to the agencies involved, were cited as complicated procedures and concerns with regards to the maturity of the bond as the exchange rate for maturity was to be maintained at the rate prevalent during the time of subscription.

In order to ensure the success of the FEB to be launched this year, certain changes have been made to ensure effectiveness. Table 11 provides a comparative analysis of the changes made.

The main purpose of the FEB is to channel remittance inflows into productive projects. However, success depends on publicity and on whether families receiving remittance have enough funds to invest in such bonds. Migrant workers spend most of their earnings on daily consumption leaving very little for capital formation. Most of the time, exorbitant fees are charged by manpower agencies robbing workers from whatever little they could save. Therefore, the government can ensure success of the FEB through policy level changes such as fixing a maximum rate that can be charged by manpower agencies and by conveying the benefits of such bonds to migrant workers.

Table 9: Subscription Amount of Past Foreign Employment Bonds

Particulars	FY 2009/10	FY 2010/11
Bond	"FEB "	"FEB 2073"
Issue worth	NPR 1 billion (USD 13.7 million)	NPR 5 billion (USD 68.6 million)
Interest Rate	9.75%	10.5%
Subscription	NPR 4.6 million (USD 63,100)	NPR 3.38 million (USD 46,365)
Percentage Subscribed	0.40%	0.07%

Table 10: Comparison of Earlier FEBs and Current FEB

Particulars	Earlier FEBs	Current FEB
Purchase of the Bond	• Only migrant worker were allowed to issue the bond	• Family members also allowed to issue bond using the remittance money • Migrant workers can open account at zero balance • Family members can then use the deposits made in that account to purchase the bond

British Government has decided to provide ex-Gurkha army servicemen with citizenship and residential facilities. As a result, the population and remittance inflow to Myagdi district has reduced significantly as 300 families have already taken up the offer.[59] Each family used to receive an average of NPR 100,000 (USD 1372) in remittance every month. Nonetheless, the overall figure for remittance received by Nepal has not been adversely affected.

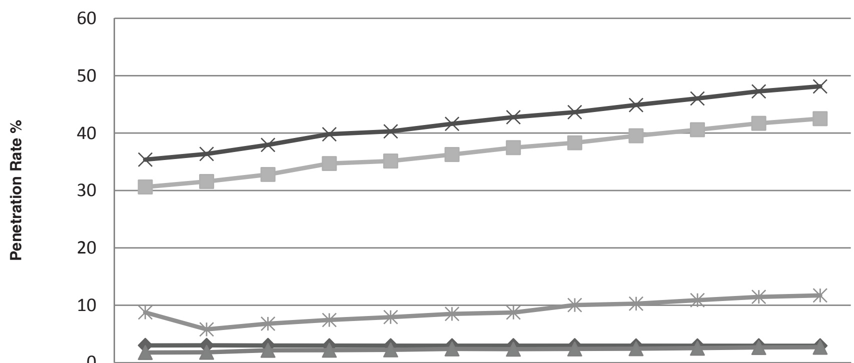
License provided to foreign employment agencies to send workers to Israel: The Department of Foreign Employment authorized foreign employment agencies to send Nepali workers to Israel. Of the 245 agencies that had applied for the license 206 were granted a license based on their performance over the last three years. Israel had stopped hiring Nepali workers since April 2009 due to a lack of skilled labor and also due to the exorbitant prices charged by the agencies. The Ministry of Transport and Labor Management is planning to set a ceiling for these charges.[60]

Reforms to be made in the Foreign Employment Policy: The Department of Foreign Employment is set to make reforms in the foreign policy so that Nepali workers don't face any hassles during their term of foreign employment.[61] The main goal is to correct policy level problems and dissuade agents from cheating workers. Provisions governing women will also be made stricter.

TELECOMMUNICATION AND MEDIA

Nepal's telecommunication sector is dominated by Nepal Doorsanchar Company Limited (Nepal Telecom) which controls 50% of the entire market. It's primary challenger is Ncell which has a 43.83% share of the market. The remaining market share is controlled by United Telecom limited (UTL) with 4.22%, Nepal Satellite Telecom Pvt. Ltd. (NSTPL) with 0.70%, Smart Telecom Pvt. Ltd with 1.17%, and STM Telecom Sanchar Pvt. Ltd with 0.03%. Among data and internet subscribers, Ncell holds 58.45% of the market, followed by Nepal Telecom (NT) with 38.21%, UTL with 1.68% and other internet service providers with 1.64%.[63]

Figure 5: Growth trend of telephone and data service penetration



	Sep-Oct (2010)	Oct-Nov	Nov-Dec	Dec-Jan	Jan-Feb	Feb-Mar	Mar-Apr	Apr-May	May-Jun	Jun-Jul	Jul-Aug	Aug-Sep (2011)
Fixed	3	3.01	3	2.94	2.95	2.95	2.96	2.96	2.93	2.93	2.94	2.94
Mobile	30.61	31.56	32.79	34.7	35.13	36.27	37.47	38.31	39.53	40.59	41.7	42.52
Other	1.76	1.8	2.15	2.16	2.22	2.39	2.34	2.38	2.43	2.52	2.63	2.68
Total	35.37	36.37	37.94	39.8	40.3	41.61	42.77	43.65	44.89	46.04	47.27	48.14
Data/Internet	8.76	5.79	6.78	7.43	7.93	8.49	8.74	10.03	10.28	10.89	11.46	11.72

Qatar Telecom and Nepal Telecom to improve network connectivity: Qatar Telecom (Qtel) signed an agreement with Nepal Telecom to establish and manage a Multi-Service Point of Presence (PoP) in Doha, Qatar. This new telecommunication hub will link Nepal Telecom's network to Qtel's

Nepal Telecom

The largest telecommunication company of Nepal, Nepal Telecom (NT), was established in 1913. It started its services by laying telephone lines in Kathmandu in 1913 but pubic distribution of telephones only started in 1962 when the first public telephone exchange was established in Kathmandu with 300 lines.

Competition in the telecom industry has encouraged Nepal Telecom to provide more services. It has signed a non-disclosure agreement with Apple Inc. to introduce the iphone 4 in Nepal.[67] Apple announced plans to provide a low priced iphone with decreased memory for developing countries. NTC plans to sell this iphone for NPR 15,000 (USD 206) with a lock system for a 2 year contract.

Critical Success Factors

After its failed attempt to bring blackberry services into the market in co-operation with Canadian company RIM, some of the key issues that will be imperative for Nepal Telecom to implement the iphone 4 scheme so as it increase its demand and consumer base are:

- **Infrastructure:** The iphone is a sophisticated smart phone which uses high speed internet and greater carrier services. NT will need to enhance its current infrastructure hold to maintain quality standards. It will also have to enhance carrier strength and provide high speed internet services, 3G and GPRS, throughout the nation.

- **Quality services:** Though the current plan is to offer the service for NPR 15,000 which is significantly cheaper than the market price of NPR 55,000 (USD 754), NTC will have to draw up other competitive service plans. To attract a large number of subscribers, the service plans must be competitive in terms of both data and voice services.

Table 11: Nepal Telecom and the spread of Telecommunications in Nepal

Date	Milestones
1913	Establishment of first telephone lines in Kathmandu
1950	Establishment of Telegram Service
1950	Introduction to High frequency Radio System (AM)
1950	Establishment of Telegram Service
1955	Distribution of telephone line to general public
1962	First Public Telephone Exchange in Kathmandu (300 lines CB
1964	Beginning of International Telecommunications Service using HF Radio to India and Pakistan
1965	First Automatic exchange in Nepal (1000 lines in Kathmandu)
1971	Introduction of Telex Services
1983	Establishment of digital Telephone Exchange
1984	Commencement of STD service
1996	Introduction of VSAT services
1999	Launching of GSM Mobile service
2000	Launching of Internet Service
2003	GSM Prepaid Service
2004	Pre-paid Calling Card Service (IN Services)
2005	Soft launch of CDMA
2006	CDMA Limited Services in Kathmandu Valley
2007	Expansion of Internet Bandwidth through India-Nepal cross border optical link
2008	Introduction of ADSL Internet Service

Global Internet network, allowing for greater connectivity and capacity in Qatar as well as across the region. As a communication hub for Nepal, Qatar will enable clearer communication with neighboring countries such as Kuwait, Saudi Arabia, UAE and Bahrain.[64]

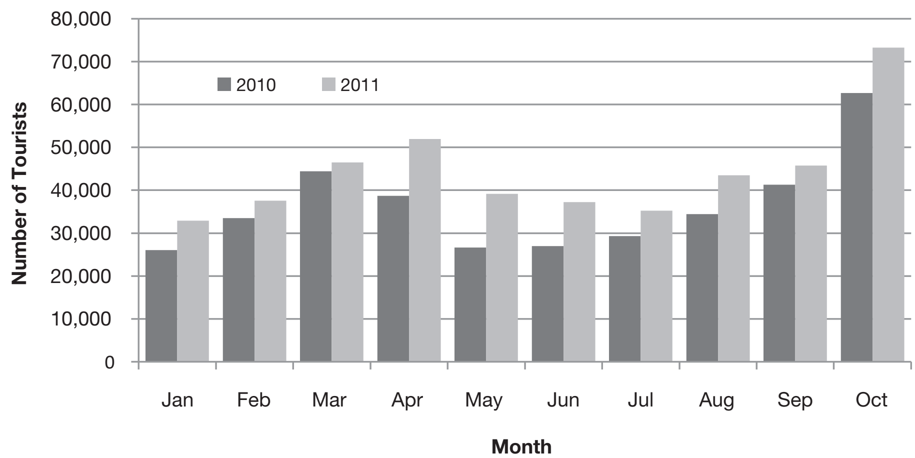
Nepal Telecom's deal with Chinese firms: Nepal Telecom has given the contract for installing the Next Generation Network (NGN) to two Chinese telecom firms, ZTE Corporation and Huawei. As per the contract, ZTE would install the equipment for the NGN in Kathmandu Valley, while Huawei will do so in the rest of Nepal. The two companies will complete the project in six months with an estimated cost of USD 19 million (NPR 1.39 billion). ZTE and Huawei will erect 2,500 towers all over Nepal, in addition to the 700 odd towers Nepal Telecom has in operation for its Code Division Multiple Access (CDMA)network.[65]

Television channels to go digital by 2017: The Ministry of Information and Communication (MOIC) has instructed all analog television channels to switch to digital technology by 2017. The MOIC's decision is in line with the International Telecommunication Union (ITU) which has asked least developed countries including Nepal to digitalize broadcasting media by 2020. The decision of MOIC will directly impact all terrestrial transmission channels such as Image Channel, Kantipur Television, Nepal Television including eight channels in Chitwan, Butwal, Palpa and Biratnagar.[66]

TOURISM

Tourism has been one of the fastest growing and best performing sectors this year, reasserting its importance in the national economy. October saw a 16.8% increase in the number of tourists

Figure 6: Number of Tourist Arrivals 2010/11



Stuck, without Luck, in Lukla

For 10 days from the October 31st commercial flights between Kathmandu and Lukla, the gateway to the Everest region, were disrupted due to bad weather conditions. This resulted in around 3,500 travelers being stranded in the Solu Khumbu[75] town located 2,860 meters above sea level. Over half the stranded population were tourists, some of whom reported becoming ill and had problems eating the available food. They also ran into problems related to visa expiration and missed international flight departures.

During this time of year, the Lukla airstrip handles up to 50 scheduled flights a day[76] making it one of the busiest airports in the country. Tara Air is the main operator with an average of 20 daily flights in the sector during peak season. Other airlines include Agni Air, Sita Air and Nepal Airlines Corporation (NAC). In total, over 1,000 scheduled flights to the sector were put off due to bad weather. As a result, operators lost up to USD 40,000 (NPR 29.16 lakhs)[77] a day.

Private helicopters and airlines were able to airlift some tourists out of Lukla during the week but the main rescue effort took place on November 9th. On this day, Lukla airstrip handled 61 flights, including 10 by helicopters. These efforts were mostly conducted by commercial companies but also included the help of the Nepal Army earlier in the week, to whom the Trekking Agents Association of Nepal (TAAN) had deposited NPR 2 million (USD 27,435). Scheduled flights resumed as normal the next day.

Trekking agents worry that the inefficient handling of these kind of events will send a negative message to the international tourist community. Although it is not known if it did result in any tourist cancellations, the recent event highlights the need for efficient contingency plans for dealing with unpredictable weather patterns in the future. Government participation in these contingency plans gives foreign visitors a reassuring message of commitment. Further, steps should be taken to heighten travelers' awareness on the possibility of these occurrences so as to avoid liability disputes.

Table 12: Overall change in arrivals 2010/11 (Jan-Oct)

Nationality of Tourists	Cumulative Percentage Change (%)
China	66.7
India	42.4
USA	14.3
Germany	11.2
UK	6.6
France	3.8

Source: Nepal Tourism Board

arriving by air as compared to the previous year. It was also the first time that more than 70,000 tourists landed at Tribhuvan International Airport (TIA) in a single month. By the end of October a total of 443,108 tourists had arrived in Nepal by air.[68] If the Nepal Tourism Year (NTY) 2011 target of 700,000 air arrivals is to be reached, a further 128,446 tourist will need to land in both November and December.

Planning to prolong the NTY 2011 affect: NTY 2011 has injected dynamism and growth in the tourism industry. For instance, there has been a 40% increase in the number of para-gliding firms licensed to operate in Pokhara,[69] while hotels have recorded annual revenue increases of 60% over the last two years. The government is planning to extend NTY 2011 into a "tourism decade" to prolong its impact. The earmarked NPR 130 million (USD 1.78 million) for tourism promotion in the current fiscal year is due to be allocated again for next year.[70]

Expanding accommodation capacity: With average occupancy rates in the last two years standing at around 70-75%, many hotels have decided to expand. It is estimated that five star hotels in Kathmandu will invest over NPR 500 million (USD 6.85 million) this year. Landmark hotel properties like Everest, Yak and Yeti, and Annapurna intend to build an additional 90, 100 and 200 rooms respectively. Soaltee is refurbishing 130 rooms and Radisson is expecting to complete 100 additional rooms by the year's end.[71] Incumbent high-end players' are bullish on the market. Occupancy levels at guest houses and other budget accommodation options also reflect an influx of low-end tourists. Growth in this segment is giving rise to new options for tourists and different types of opportunities for domestic entrepreneurs. A recent example is the introduction of home-stay programs in villages.[72]

The Chinese are coming: Tourist arrivals from neighboring countries, India and China, are increasing at a much faster rate than other countries as a result of their ascending economic status. Nepal Rastra Bank's estimates that Chinese tourists now spend USD 80 (NPR 5832) per day, which is almost double the overall average. More Chinese tourists can be attracted if connectivity is improved. Nepal Airlines Corporation (NAC) no longer transports passengers to and from Shanghai, which is a potentially lucrative connection. Instead tourists must compete with Nepali traders, who travel often to Guangzhou, Chengdu and Shanghai, for one of the 3,500 seats offered each week by a number of Chinese airlines.[73] Tastes and preferences of Chinese tourists are noticeably different compared to North American and European ones, as is their attitude towards the natural environment. Chinese tend to travel in groups of between 15-22 people and are more inclined to shop and sightsee in urban areas than do adventurous outdoor activities. This signals an onset of changes for the domestic tourism industry. Already tour operators have begun adapting their packages. Further, Chinese speaking Nepali guides can earn as much as NPR 400 (USD 5) per person extra in each group due to their short supply.[74]

macroeconomic OUTLOOK

Progress in the peace process is a positive sign for the overall economy. The political parties have finally come to an agreement on the integration of Maoist combatants. The government has also formed a committee to design the federal structure of the country and there seems to be some progress towards drafting the new constitution. These are positive signs and can be hoped to be an indication that the political players and parties are maturing. However, the government has a lot to improve on if it is to encourage economic growth.

The government faces the challenging task of ensuring food security and price stability. With rising domestic wages, an increasing labor migration rate and low agricultural production, Nepal is becoming more reliant on food imports to meet domestic food demand. With the current trend of import substitution and trade deficits, Nepal is likely face severe setbacks within the context of rising inflation and food prices. The government needs to monitor the market and protect consumers against unjustified price escalations. It needs to implement Good Agriculture Practices (GAP) to enhance productivity and ensure proper distribution of food grains. The government also needs to draw up a more effective intervention plan targeted at food deficit populations. However, it faces financial constraints from carrying out pertinent welfare, health and safety spending. It remains heavily dependent on foreign aid and has largely been unable to meet the challenge of food security. Given the time it takes to address such systemic imbalances, food insecurity is likely to persist in Nepal.

As anticipated, foreign aid has been flowing into the country and the government's dependence on aid is further corroborated by the extent to which foreign aid is expected to cover government expenditures this fiscal year. Foreign assistance is expected in diverse areas like health, environment, education, SMEs and micro finance to name a few. India and China will remain major contributors of foreign aid in addition to USAID, ADB and other such agencies. Nepal is still in political transition with the ongoing peace process yet to be concluded. Once the new constitution is drafted, a new governance structure may be adopted, altering ways of operation. Development agencies needs to be flexible to ensure effectiveness during this transitional period.

To improve the overall health situation of the country, the government needs to be strong and effective in implementing policies and strategies. For instance, tobacco companies cannot be forced to replacing their packages unless the directive is finalized. The effectiveness of community based programs means the government is likely to give continuity to them. However, these programs should be regulated by the government. Denying basic rights like education to force compliance is counter-productive and can lead to more severe inequalities. Such coercive measures should best be avoided when dealing with impoverished households. Innovative new programs like micro-health insurances should be explored as a mechanism for health care financing to meet the Millennium Development Goals (MDGs).

Infrastructure remains a major bottle beck towards economic development. Road networks in Nepal have been poorly managed. Various feasibility studies have been conducted for constructing new highways connecting various parts of the country. However, work on most of these projects is yet to commence. This is partly because donor aid has not been utilized well and external initiatives have also created a situation whereby the road system is unaffordable and fails to reflect the country's needs. Pressure is increasing on the government to improve the road systems and infrastructural support needed in cities. The Kathmandu Valley in particular has seen dramatic growth due to increased migration from rural areas putting pressure on its already overburdened infrastructure.

The migratory trend of Nepali workers seeking jobs abroad continues. Although an increase in remittance has led to a BOP surplus, Nepal needs to focus on attracting more FDI and increasing exports to move towards a more sustainable and productive position. Declaring 2012 as Nepal investment Year is an encouraging step towards attracting FDI in Nepal but a lot depends on how the government prepares for it. Militant labor is one of the primary reasons investors balk at investing in Nepal and the government needs to address this problem in preparation of 2012.

As per the Nepal Living Standards Survey (NLSS) 2011, poverty in Nepal has decreased by 5.5% over the past five years, despite a state of political instability when industries are shutting down and employment opportunities are scarce. The reason behind such a decline can be attributed to an increased inflow of remittance. Nonetheless, since a major proportion is used for non productive purposes such as real estate, gold and other lifestyle goods, little or nothing is left for investment in developmental projects. Remittance inflow needs to be directed towards such productive sectors, to create a steady flow of income in the country.

During the last decade, the telecom sector underwent major changes. These changes were driven by policy reforms introduced by the government. The impetus for these changes is expected to continue at a much faster rate. Wireless telephony and the internet are expected to be the preferred means of communication as convergence of telecommunication, broadcasting and information technology progresses.

As per international standards, the Ministry of Information and Communication has taken the decision to switch television broadcasts over to digital transmissions by 2017. Digital technology will help television operators save up on operating costs as a single frequency can be used to operate up to 14 channels. Though the decision will not impact satellite transmissions, switching to digital may be a time consuming and challenging ordeal for broadcasters. Since Nepal's ICT infrastructure is at a preliminary stage, this may take longer than anticipated. A developed country like Japan took almost seven years to switch to digital technology.

With Nepal Tourism Year 2011 coming to an end, it can be said that the record breaking number of arrivals reflects its success. But it is very unlikely that the official target of one million arrivals will be achieved. The demographic makeup of tourists also appears to be changing with significant increases in the number of Chinese and Indian arrivals. Services offered in the domestic market are likely to adapt to the tastes of this new market segment in the years to come, especially if their spending power continues to rise at the current rate. Given the investment taking place in upgrading and expanding accommodative capacity it is important to increase number of arrivals. Improving connectivity to neighboring China and India seems like an appropriate step for ensuring a higher number of tourist arrivals. Failure to deliver strong arrival figures in the coming years could have severe financial consequences for local businesses.

REVIEW

Financial & Capital Market

The first three months of the 2011/12 fiscal year proved to be a challenge for the banking industry. Based on the first two months data of the current fiscal year published by the Nepal Rastra Bank (NRB), broad money (M2) increased by 1.8% as compared to a decline of 1.7% during the same period last year. Likewise, the imbalance between deposit mobilization and lending by commercial banks narrowed as the deposit mobilization of commercial banks increased by NPR 16.66 billion (USD 228.53 million) while the Loans and Advances increased by NPR 9.98 billion (USD 136.89 million).

The slight increase in the deposits of commercial banks can be attributed to a positive Balance of Payment (BOP) position and the transfer of deposits from 'B' and 'C' class licensed financial institutions to commercial banks. Overall BOP recorded a surplus of NPR 17.27 billion (USD 236.89 million) compared to a deficit of Rs.5.90 billion (USD 80.93 million) in the same period last year.

Loan Repayment Period Extended

For a second consecutive time, the NRB has allowed BFIs to adjust their Balance Sheets. The NRB on November 15 allowed BFIs to adjust the interest recovered in the fourth month of the current fiscal year in their first quarter Balance Sheets. NRB took the decision as the Nepal Bankers Association (NBA) along with other associations of financial institutions and real estate traders made a collective request to the NRB citing problems in loan recovery during the first quarter due to the festival season. In July 2011, NRB had allowed BFIs to adjust their fourth quarter Balance Sheets for the 2010/11 fiscal year.

Upgrading and Merging

NRB has given its nod for upgrading Sanima Bikas Bank into an 'A' class commercial bank. After the up-grade, Sanima will be the 32nd commercial bank of the country. The NRB has also upgraded Annapurna Finance Company into a development bank and has given principle agreement to the Infrastructure Development Bank to merge with Swastik Merchant Finance Company; Annapurna Development Bank to merge with Suryadarshan Finance; Pashupati Development Bank to merge with Lord Buddha Finance, and Business Development Bank to merge with Universal Finance.

Deposit Insurance

Only five commercial banks have insured their deposits as per the central bank's directive to commercial banks to insure individual deposits up to NPR 200,000 (USD 2,743) with the Deposit and Credit Guarantee Co-operation (DCGC). These banks include Citizens Bank, Mega Bank, Machhapuchhre Bank, Civil Bank and Standard Chartered Bank Nepal. As per the DCGC,[78] Nabil and Nepal Investment Bank are in the process of insuring their deposits. 'B', 'C' and 'D' class licensed financial institutions have already insured their individual deposits up to NPR 200,000 in the last fiscal year. In the future, the government intends to gradually increase the insured deposit amount to NPR 500,000 (USD 6,859).

Commercial Banks Performance Analysis

Despite the NRB allowing BFIs to adjust their Balance Sheet, the first quarter results (unaudited) of commercial banks for the current fiscal year are slightly alarming. Out of 31 commercial banks, 24 banks saw their operating profit decline and 22 banks saw net profits slump as compared to the same quarter last year. At the end of first quarter, Standard Chartered Bank Nepal, Nepal SBI Bank, Everest bank, Janata bank and Kumari Bank were the only banks able to beat the previous year's operating profit and net profit. Similarly, the average Non Performing Assets (NPA) of commercial banks went up to 3.31% as compared to 2.65% during the same period the previous fiscal year.

Since the beginning of the current fiscal year, the banking system have witnessed an ease in the liquidity position as signaled by an increment of deposits in commercial banks, declining interbank lending rates and a decline in lending. The weighted average interbank rate during the period has dropped to around 1.76% compared to the 5.17% during the same period last year. Commercial banks deposit went up by around 5.5% while lending grew by around 2.3%.

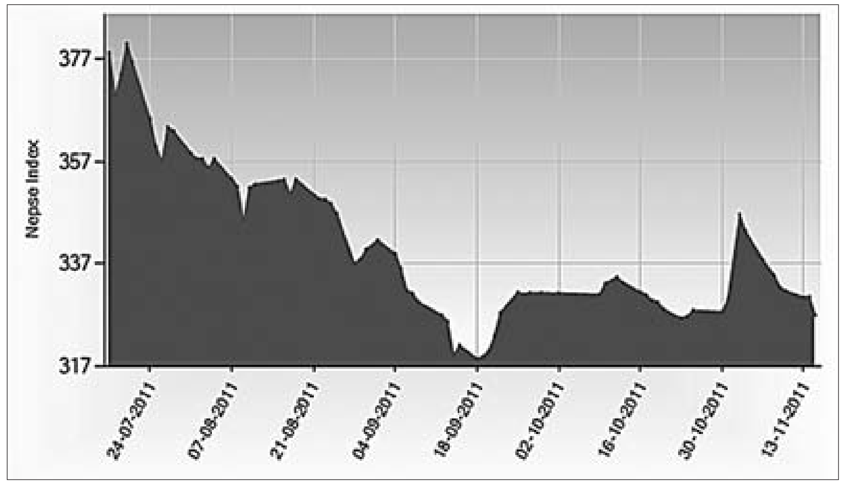
Loan recovery has been the biggest hurdle for bankers due to the festival season and bank's exposure to the realty sector. Similarly, the slowdown in lending is largely due to the NRB's Credit to Deposit (CD) ratio requirement and limited avenues for lending against the surge in high cost deposits. These deposits have proved to be expensive to banks as the spread rate gap between deposits and lending is narrowing whereas operating costs are increasing. Likewise, the decision of the NRB to restrict BFIs to open interest earning deposit accounts amongst themselves has somewhat affected the earnings of BFIs, especially development banks and finance companies.

Performance Analysis of Capital Markets

The secondary market continued to disappoint investors as the Nepal Stock Exchange (NEPSE) Index slipped by 35.58 points to 326.94 points during the first four months of the current FY 2011/12. The drop can be primarily attributed to lower investor's confidence coupled by lower than expected returns from key listed companies in the NEPSE.

During the first four months of the current fiscal year 2011/12 all the sub indices shed value. The commercial banking sector (-15.45%) was the biggest loser as it shed 50.79 points to close at 277.92 points. Similarly, the Finance sector (-10.25%) declined by 31.01 points to close at 271.28 points. The Hydropower sector followed suit as it declined by 9.58 points to close at 597.07 points and the Development banking sector (-5.67%) declined by 16.7 points to close at 277.45 points. The Insurance sector (-0.46%) showed some resistance as it lost 1.9 points to close at 408.91 points likewise, the Others sub-sector (-0.23%) dropped marginally by 1.17 points to close at 491.14 points.

Figure 7: NEPSE index performance (first four months of the FY 2011/12)



Block Share Trading

NEPSE has introduced a Block Share Trading (BTS) option under its Automated Trading System (ATS) effective from November 15, 2011. The new option is expected to benefit investors who want to bulk trade but are not satisfied with the prevailing market price. Likewise, the new option is also expected to attract foreign investments and facilitate foreign investments involved in Nepali companies to take back their investments without any difficulty.

Under the new option, Oberoi Group sold 1,020,144 units of Soaltee Hotel shares at NPR 140 (USD 2) per unit to local investor Shivakrim Land and Industries. The previous day closing price was NPR 186 (USD 3) per unit. The transaction was done as per the Sale and Purchase Agreement reached between them on September 14, 2011 and with approval by SEBON and Department of Industry (DOI).

New Chairman for SEBON and NEPSE

Babu Ram Shrestha has been appointed as the new chairman of Securities Board of Nepal (SEBON) succeeding Surbir Poudyal effective from October 20, 2011. He is the first chairman of SEBON to be appointed from open competition. Similarly, the cabinet meeting held on November 17 has appointed Jiwanath Dhital as the new chairman of the Nepal Stock Exchange Limited for two years; Dhital replaced Tanka Prasad Paneru as his term expired on November 3, 2011.

NEPSE Revises First Trading Price Rules

In a bid to kick-start the trading of newly listed companies, NEPSE has revised its open base price rules

Table 13: Unaudited Financial Highlights of Commercial Banks as of 1st qtr for the FY 2011/12 (In NPR crore)

			Deposit			Loans and Advances			Operating Profit			Net Profit			NPL to total loan (%)	
	Bank	Paid up Capital	FY 10/11	FY 11/12	% Change	FY 10/11	FY 11/12	% Change	FY 10/11	FY 11/12	% Change	FY 10/11	FY 11/12	% Change	FY 10/11	FY 11/12
			4 QTR	1 QTR		4 QTR	1 QTR		1 QTR	1 QTR		1 QTR	1 QTR		1 QTR	1 QTR
1	Nabil Bank	203.0	4,969.6	5,414.2	8.21	3,890.5	4,035.1	3.71	48.2	47.1	-2.38	30.9	30.5	-1.30	1.79	2.83
2	Standard Chartered	161.0	3,799.9	4,070.5	6.65	1,866.2	1,863.8	-0.13	40.7	46.8	15.18	26.6	33.2	24.97	0.69	0.75
3	Nepal Investment Bank	301.1	5,013.9	5,159.9	2.83	4,188.8	4,254.6	1.57	51.7	45.0	-13.07	33.6	29.5	-12.21	0.64	1.03
4	Everest Bank	139.2	4,112.8	4,395.6	6.43	3,166.2	3,269.0	3.25	32.5	38.3	17.95	20.7	24.5	17.99	0.40	0.37
5	Bank of Kathmandu	160.4	2,101.8	2,216.2	5.16	1,795.7	1,840.4	2.49	24.6	20.2	-17.85	16.5	13.5	-18.47	1.84	1.94
6	Himalayan Bank	200.0	4,092.1	4,451.6	8.08	3,296.8	3,444.2	4.47	30.7	26.1	-14.99	19.6	16.5	-15.65	3.61	4.74
7	NIC Bank	131.2	1,839.4	1,909.5	3.67	1,493.4	1,439.2	-3.63	21.1	9.8	-53.50	14.0	6.3	-55.36	0.66	1.42
8	Laxmi Bank	161.4	1,830.0	1,880.7	2.70	1,538.9	1,579.6	2.64	15.5	14.3	-7.44	10.0	9.3	-7.37	0.87	1.01
9	Kumari Bank	148.5	1,698.6	1800.7	5.67	1,466.6	1556.9	6.16	2.9	5.8	97.28	1.9	4.2	125.00	1.18	2.20
10	Nepal SBI Bank	186.9	4,241.5	4,611.2	8.02	2,136.6	2,111.8	-1.16	14.1	14.6	4.06	9.4	9.6	1.59	2.55	1.59
11	NMB Bank	200.0	1,286.6	1,346.1	4.42	1,134.3	1,143.0	0.77	8.9	5.2	-41.48	6.9	4.2	-38.28	1.25	0.71
12	Siddhartha Bank	161.8	2,157.6	2,142.9	-0.68	1,839.3	1,809.7	-1.61	11.9	4.1	-65.38	7.6	2.6	-65.39	1.0	1.80
13	KIST Bank	200.0	1,580.8	1,766.8	10.53	1,343.7	1,325.6	-1.35	4.9	1.2	-76.07	3.0	0.8	-74.75	0.14	1.62
14	Machhapuchchhre Bank	162.7	1,641.1	1,659.7	1.12	1,473.1	1,383.0	-6.11	1.3	1.2	-13.53	0.9	0.7	-22.34	4.91	4.14
15	Global Bank	160.0	1,506.6	1,632.4	7.70	1,279.9	1,344.2	5.02	13.8	9.0	-35.21	8.8	5.7	-35.08	0.74	2.76
16	Prime Commercial Bank	224.6	1,893.9	2,018.7	6.18	1,687.1	1,734.4	2.80	13.4	9.0	-32.79	8.5	5.7	-32.86	0.19	0.77
17	Sunrise Bank	201.5	1,339.5	1,552.4	13.72	1,202.2	1,244.6	3.52	11.2	5.1	-54.51	7.1	3.5	-51.26	1.65	3.80
18	Citizens Bank	210.2	1,347.8	1,517.4	11.17	1,251.4	1,210.3	-3.29	9.3	8.2	-11.84	5.9	5.3	-10.83	0.39	3.06
19	Bank of Asia Nepal	200.0	1,367.7	1,432.4	4.51	1,163.9	1,202.5	3.32	10.9	6.7	-39.12	7.0	4.3	-37.79	0.23	1.24
20	DCBL Bank	192.1	932.3	991.9	6.02	904.3	934.8	3.36	8.5	6.6	-22.17	4.9	5.5	11.94	1.35	1.50
21	Lumbini Bank	143.0	677.3	703.2	3.68	621.3	679.1	9.30	6.1	2.4	-60.43	5.5	2.3	-58.48	3.58	1.87
22	Nepal Bangladesh Bank	200.1	1,151.2	1218.9	5.56	1,023.7	1060.1	3.55	11.6	2.6	-78.00	14.7	3.2	-78.33	14.96	18.62
23	NCC Bank	140.0	1,095.1	1,154.5	5.14	923.0	911.4	-1.25	4.4	2.6	-40.05	2.9	2.2	-25.34	4.11	4.11
24	Janata Bank	140.0	350.2	443.7	21.09	358.4	442.6	23.49	0.5	2.1	281.48	0.3	1.3	285.29	0.00	0.00
25	Mega Bank	163.1	537.3	692.5	22.41	476.8	656.2	37.62	-2.4	0.3	-113.52	-2.4	0.2	-108.61	0.00	0.88
26	Civil Bank	120.0	295.2	423.8	30.33	312.4	408.2	30.69	NA	1.0	NA	NA	0.6	NA	NA	NA
27	Commerz & Trust Bank	140.0	248.8	354.4	29.80	248.6	340.9	37.10	NA	0.3	NA	NA	0.2	NA	NA	NA
28	Century Bank	108.0	135.9	185.9	26.91	117.5	176.7	50.33	NA	0.9	NA	NA	0.6	NA	NA	NA
	Public Sector Banks															
29	Agriculture Dev. Bank	947.4	3,439.9	3,481.1	1.18	3,481.0	3,640.9	4.59	-28.8	7.1	-124.65	27.1	28.5	5.17	8.54	11.05
30	Nepal Bank	38.0	4,680.4	4669.9	-0.23	2,671.0	2635.5	-1.33	22.6	2.6	-88.32	19.7	2.0	-89.66	4.87	5.29
31	Rastriya Banijya Bank	117.2	7,392.4	7,203.5	-2.62	3,686.6	3,538.8	-4.01	18.1	0.08	-99.56	34.4	10.7	-68.73	11.98	11.46
	Total	**5,962.3**	**68,757.5**	**72,502.0**	**5.45**	**52,039.5**	**53,216.9**	**2.26**	**408.1**	**346.1**	**-15.19**	**346.0**	**267.1**	**-22.81**	**2.65**	**3.31**

(first trading price) for a newly listed company. As per the new rules,[79] the starting price for newly listed companies can be fixed at a range falling between paid up value of the unit share and three times the paid up value, or net worth or three times the net worth, whichever is lower. NEPSE has revised its pricing rules upon request of brokers and merchant bankers, as the opening base price of newly listed companies was too high as per the earlier rule. The earlier rule stated that the starting price of the newly listed companies had to fall between three to five times the net worth of the company. The new rule is expected to expedite the transaction of around six newly listed companies whose shares have not been traded for over a month now.

OUTLOOK

The Nepali financial market after experiencing tight liquidity in the 2010/11 fiscal year has seen surplus liquidity in recent months. The NRB has scrapped all refinancing facilities, except the 'lender of last resort' facility as commercial banks are currently witnessing NPR 40 billion[80] (USD 549 million) worth of surplus liquidity. BFIs are likely to face hardships in the coming months, due to the narrowing gap between the deposits and lending rates. Limited avenues for lending may also pose a challenge to BFI's. Development banks and financial institutions may continue to struggle to maintain its deposit base.

Due to the excess liquidity and sluggish lending, a few commercial banks have already announced cutting their short term lending including; demand loans, bank overdraft and export bill rates by 0.5-2.0% to encourage borrowing. This may lead to a positive development, as the reduction in interest rates is expected to relieve traders and short-term borrowers. However, it may take some time for long-term borrowing rates to come down as banks need to meet the regulatory CD ratio requirement of 80% from the current 85% by the end of the second quarter of the current fiscal year.

The secondary market has continued to shed value and is expected to hover around the long term support level with random highs and lows. Bulk share trading introduced by NEPSE should be applauded as it ensures that the market price of listed companies and the NEPSE Index will not fluctuate due to bulk tracings. Moreover, the revision of open base price rules should expedite the transactions of newly listed companies and it can also expect to encourage investors to invest in Initial Public Offers (IPOs) which have not received a good response in recent days.

Foreign Investment in Nepal

Foreign Direct Investments (FDI) in Nepal as of July 16, 2011, amounted to NPR 68,04 billion (USD 0.93 billion) creating over 155,432 jobs through 2100 projects. Of these projects, 712 are in manufacturing, 650 in service, 561 in tourism, 42 in construction, 60 in agriculture, and 36 in mineral sectors.

India is the largest contributor (47%) to Nepal's FDI with approved investments of NPR 32.39 billion (USD 0.44 billion) in 501 projects providing employment to over 56,000 individuals. China is Nepal's second largest source of FDI with total approved investment of NPR 7.03 billion (USD 0.096 billion) in 401 projects providing employment to over 23,000 individuals. The United States stands is Nepal's third largest investor with total approved investments of NPR 4.95 billion (USD 0.067 billion) in 174 projects providing employment to over 12,000 individuals.

Figure 8: Growth of foreign projects and employment

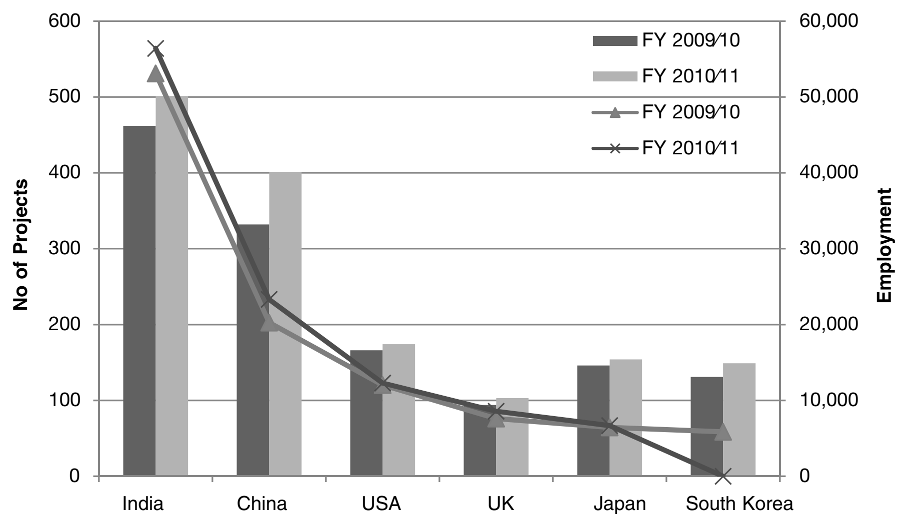


Table 14: Details of top six countries approved FDI in Nepal (as of FY 2010/11)

S.N.	Country	Foreign Investment	
		FY 2009/10	FY 2010/11
1	**India**	25,381.45	32,390.00
2	**China**	5,848.77	7,036.17
3	**USA**	4,874.50	4,955.90
4	**UK**	1,479.04	1,539.71
5	**Japan**	1,140.49	1,171.24
6	South Korea	4,245.34	4,320.89

Source: Department of Industry (DOI)

Nepal-India Bilateral Investment Promotion and Protection Agreement

Nepal and India signed a Bilateral Investment Promotion and Protection Agreement (BIPPA)during Prime Minister Bhattarai's recent visit to India on October 21 2011. The agreement was signed with his Indian counterpart.

A Bilateral Investment Promotion and Protection Agreement (BIPPA) is a treaty signed between two countries for the encouragement, promotion and protection of investments by companies in each other's territories. The purpose of the agreement is to fostering a conducive environment that encourages cross-border investments. It intends to benefit both the countries by stimulating business.

Most bilateral agreements have standard elements that provide a legal basis for enforcing the rights of investors in the countries involved. They give assurance to investors that their foreign investments will be guaranteed fair and equitable treatment, full and constant legal security and dispute resolution through international mechanisms.[81]

New Delhi had been pushing for the BIPPA to protect its investment in Nepal for over a decade. India first came up with the BIPPA proposal during the insurgency period when Maoist rebels attacked the Indian Multi National Company (MNC), Colgate Palmolive in 1998. Nepal had deferred signing the BIPPA because of its far reaching implications.

Nepal has already signed BIPPAs with France, Germany, Britain, Mauritius, Qatar and Finland, even though these countries do not have significant investments in Nepal. On the other hand, The Government of India has signed BIPPAs with 68 countries out of which 53 BIPPAs have already come into force while the remaining agreements are in the process of being enforced.

Table 15: Details of approved Indian FDI in Nepal (In NPR million)

Fiscal Year	No. of Projects	Authorized Capital	Fixed Capital	Foreign Investment	Employment
Prior to 2006-07	338	34,540.00	26,610.50	12,297.08	44,126
2006-07	26	2,202.62	1,725.80	2,037.93	1,880
2007-08	37	8,116.73	5,927.16	4,553.21	3,155
2008-09	34	4,096.47	2,925.57	2,499.69	2,105
2009-10	27	7,789.53	7,372.05	3,993.54	1,835
2010-11	38	7,876.51	6,555.85	7,007.26	3,274
Total	501	64,621.86	51,116.93	32,390.00	56,407

Source: DOI

Key Highlights of the Nepal-India BIPPA:

- Both countries shall encourage and create favorable conditions for investors to make investments in its territory.
- The BIPPA promises investors of both countries that it will not nationalize the foreign investment project and also pledges national treatment and most favored nation treatment.
- The government will compensate investors in their respective territories for any losses they might suffer from non-commercial factors including war, armed conflict, national emergency, insurrection or riots.
- Each county shall, in accordance with its laws, permit all funds of an investor from another country, related to an investment in its territory, to be freely transferred, without unreasonable delay and on a non-discriminatory basis.
- The agreement shall remain in force for a period of ten years and thereafter it shall be deemed to have been automatically extended unless either country gives to the other country a written notice of its intention to terminate the agreement.

Table 16: Details of approved Indian FDI in Nepal by sector (as of FY 2010/11) In NPR million

Sector	No. of Projects	Foreign Investment	Employment
Agriculture	7	416.81	784
Construction	17	1,876.32	830
Energy Based	12	5,146.55	1,222
Manufacturing	296	14,687.28	36,142
Mineral	6	2,260.7	1,521
Service	112	6,485.21	11,781
Tourism	51	1,517.43	4,127
Total	501	32,390.31	56,407

Source: DOI

Political Wrangling

Despite having numerous positive implications, major political parties including the Prime Minister's own party, the UCPN-Maoist's, responded negatively to the agreement. The UCPN-Maoist members have alleged the PM of not communicating about the BIPPA at party meetings. Moreover, politicians who supported the BIPPA have opted to shy away from appreciating the agreement. Politicians have blamed the PM of keeping the house in the dark about the BIPPA and claim that the agreement is anti-national and brings high risks to the nation. However, the response from the private sector has been very positive.

Table 17: Direction of Foreign Trade (In millions of NPR)

	FY 2008/09	FY 2009/10	FY 2010/11	Percent Change	
				FY 2009/10	FY 2010/11
Total Exports	67,697.50	60,824.00	64,560.40	-10.2	6.1
To India	41,005.90	39,993.70	43,346.00	-2.5	8.4
To Other Countries	26,691.60	20,830.30	21,214.40	-22	1.8
Total Imports	284,469.60	374,335.20	394,901.20	31.6	5.5
From India	162,437.60	217,114.30	261,631.20	33.7	20.5
From Other Countries	122,032.00	157,220.90	133,270.00	28.8	-15.2
Total Trade Balance	-216,772.10	-313,511.20	-330,340.80	44.6	5.4
With India	-121,431.70	-177,120.60	-218,285.20	45.9	23.2
With Other Countries	-95,340.40	-136,390.60	-112,055.60	43.1	-17.8
Total Foreign Trade	352,167.10	435,159.20	459,461.60	23.6	5.6
With India	203,443.50	257,108.00	304,977.20	26.4	18.6
With Other Countries	148,723.60	178,051.20	154,484.40	19.7	-13.2

Source: NRB

Status of Foreign Trade

A growing trade imbalance between other countries is one of the primary reasons for Nepal's negative Balance of Payments (BOP) in the 2010/11 fiscal year. This was further aggravated by the liquidity crunch in the Nepali financial system. The trade imbalance is predicted to increase due to growing inward remittances and decreasing exports.

During the 2010/11 fiscal year, Nepal's overall trade imbalance increased by 5.4%. However, its trade imbalance with India increased by 23.2% and accounted for almost 66% of the overall trade imbalance. Nepal's major trade imbalance is with India, in the past three years, Nepal has seen a Cumulative Annual Growth Rate (CAGR) of over 34.07% in its trade imbalance with India whereas during the same period Nepal has just seen a marginal CAGR of 2.81% in its exports to India.

OUTLOOK

FDI plays a crucial role in Nepal's economic growth. As outlined above, Indian investments contributes to almost 50% of Nepal's total FDI. Despite huge investment opportunities in Nepal, investors at largely opted not to invest due to security concerns. However, since the peace accord was reached in 2006, the investment climate has improved. As a result, Indian FDI in Nepal since 2006 has seen an encouraging CAGR of 36.18%.

India is Nepal's largest business partner and the signing of BIPPA with India is expected to increase bilateral investment. This is expected to address a part of the trade imbalance with India. By signing the BIPPA, Nepal may have to bear some unfavorable obligations in the future, but, in the long run, it can create a win-win situation for both countries. As Nepal's plans to celebrate 2011/12 as 'Nepal Investment Year', the signing of the BIPPA sends out a positive message to the international business community.

Endnotes

1. Nepal Retailers Association, http://www.kbsnepal.org.np/priceLists.php
2. Shrestha, Ram Krishna ," Fertilizer Policy Development In Nepal," The Journal of Agriculture and Environment (June 2010): 11, accessed September 28, 2011
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8. Imports are now required to be made in bulk instead of small bags (of 50 kgs), making the process cumbersome and costly
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