NEPAL
ECONOMIC
FORUM

nefsearch

January 2013 Issue 5

£¥€$₹

FOREIGN DIRECT INVESTMENT IN NEPAL

FOREIGN DIRECT INVESTMENT IN NEPAL

Nepal started undergoing reforms in the 1990s once multi-party democracy returned after 30 years. The government introduced a 'one window policy' whereby the Department of Industries was designated as the sole agency for all FDI related work.

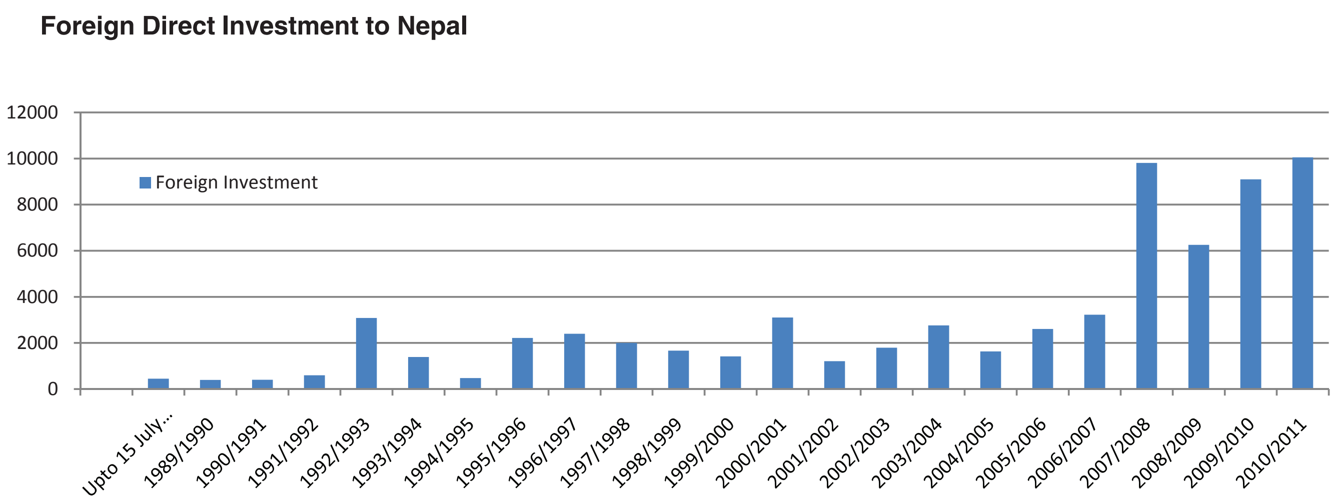
1. BEGINNINGS OF FDI IN NEPAL

Observing past trends, the earliest foreign direct investment (FDI) inflows to Nepal can be traced back to the early 1980s when the Nepali economy gradually opened up to the world. However, the magnitude of such inflows was only nominal initially, aggregating to NPR 449 million (USD 5.78 million) during the entire decade[1], as against the amounts received by its neighboring countries - USD 364.9 million received by India and USD 16.92 billion received by China during the same period. The reason for the lack of inflows in Nepal could be attributed to political instability, cumbersome regulations and unfavorable tax regimes.

However, Nepal started undergoing reforms in the 1990s once multi-party democracy returned after 30 years. The government introduced a One Window Policy' whereby the Department of Industries was designated as the sole agency for all FDI related work. A new Foreign Investment and One Window Policy was also drafted in 1992 that liberalized trade policies, reduced tariff rates and introduced a duty drawback scheme. Nepal also adopted a current account convertibility scheme wherein the NPR would be freely convertible to purchase all foreign goods and services, except capital goods. The positive impact of such changes was seen in the amount of inflows thereafter which averaged at approximately NPR 1.9 billion (USD 22.1 million) every year during the latter years of the decade.

Since then, Nepal has been successful in creating a favorable environment to attract FDI. The figure below traces FDI inflows to Nepal since the 1990s. The year 1996 saw the launch of the almost decade-long insurgency; which led to foreign investors being skeptical about investing in Nepal. During FY 1995-96, Nepal received FDI inflows amounting to NPR 2.2 billion (USD 25.6 million). As a result of the insurgency, a reversal took place; FDI inflows dropped from previous amounts and more or less stabilized at figures received in 1996. As the decade reached its end, the insurgency ended and monarchy was abolished. Thereafter, FDI inflows have increased substantially, amounting to NPR 9 billion (USD 104.6 million) in FY 2009-10 and NPR 10 billion (USD 116.3 million) in FY 2010-11. The following graph depicts the amount of FDI inflows to Nepal since the 1980s.

Figure 1: FDI Inflows to Nepal upto FY 2010-11(Amount in NPR millions)



Source: Industrial Statistics FY 2067/68, Department of Industries

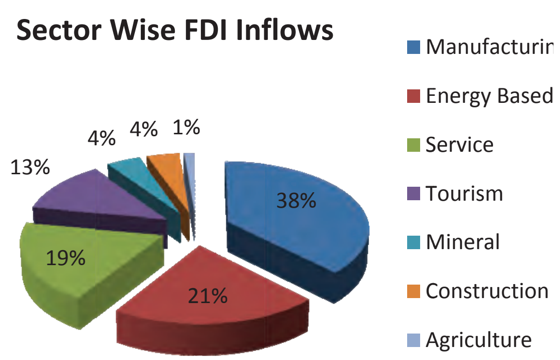
2. POTENTIAL SECTORS AND INVESTORS

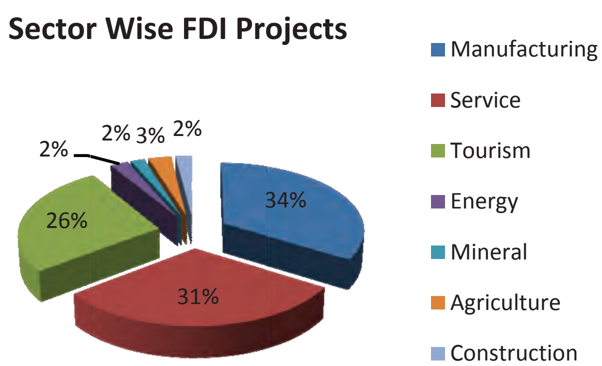
As per past investments trends, the Nepal Trade Integration Strategy Report 2010 (NTIS) and the report prepared by the Ministry of Industries and the Ministry of Commerce and Supplies, the manufacturing sector remains the most attractive for FDI in Nepal due to availability of low cost manpower and the track record of industries for garments and Pashmina being profitable. However with the country's natural and geological attractiveness backing the investments, tourism has been the safest sector to invest in.

Table 1: Sector Wise FDI Inflows, Projects and Employment Generation up to FY 2010-11

Foreign Investment			No. of Industries			Employment Generation		
	Amount	%	Sector	Amount	%	Sector	No. of Jobs Created	Percentage
Manufacturing	25,596	38%	Manufacturing	712	34%	Manufacturing	78,409	50%
Energy Based	14,519	21%	Service	6W50	31%	Service	32,127	21%
Service	12,975	19%	Tourism	561	27%	Tourism	24,862	16%
Service	8,400	12%	Agriculture	60	3%	Energy	7,947	5%
Mineral	2,904	4%	Energy	47	2%	Mineral	5,574	4%
Construction	2,763	4%	Construction	42	2%	Agriculture	3,497	2%
Agriculture	893	1%	Mineral	36	2%	Construction	3,016	2%
Total	**68,050**			**2,108**			**155,432**	

Source: Industrial Statistics FY 2067-68, Department of Industries





Source: Industrial Statistics FY 2067/68, Department of Industries

The Energy sector, due to huge amounts of investments required and tremendous potential for hydropower development in Nepal, has also been a potential FDI destination. Currently, a total of 42,133 MW[2] of energy is deemed economically feasible. However, the total installed hydroelectricity capacity in Nepal stands at only 698 MW.[3] An economy which is perpetually short of power offers an obvious market. Further, development of hydropower resources raises the prospect of developing energy-intensive manufacturing activities.

Further, IT, Education, healthcare, bio-technology and food processing have also been sunrise sectors. There has been a tremendous increase in the number of IT solution providers in Nepal like Verisk (earlier D2Hawkeye), Deerwalk, Pixar and Disney, beneficially engaging professionals in providing integrated IT solutions. Since the need for education is vast in Nepal, and in South Asia as a whole, the potential for setting up educational institutions for study of health, alternative medicine, bio diversity, liberal arts, climate change, hotel management and tourism, music and theatre is huge and ready to be exploited. Further, with the natural resources and medicinal herbs Nepal is endowed with, creation of world class health care institutes, alternative medicine, healing and wellness centers have high potential. High outbound health tourism from Nepal is a ready market to be tapped.

Nepal is a predominantly an agricultural economy with 75% of the population engaged in agriculture, but contributing only around 33% to the GDP. Nepal has diverse climatic conditions as well as a variety of terrains favorable for many agricultural products. However, only 18% of the land is cultivated and only 25% of the cultivated land has access to irrigation facilities. Hence, there is a lot that can be improved in this sector, through infusion of foreign capital, in terms of modernized techniques and facilities which would help increase the quality and quantity of the produce.

As per the NTIS Report by the Ministry of Commerce Supplies in June 2010, 8 out of 19 areas identified to have high export potential are agro products namely, cardamom, ginger, honey, lentils, tea, noodles and medicinal herbs/essential oils.

The charts below show the top 10 countries with the most amounts of foreign investment to Nepal, number of projects and the number of employment opportunities generated till date.

As can be seen in table 2, India and China have dominated FDI inflows to Nepal since such inflows began. This can be attributed to the proximity of the two countries to Nepal. Although India's contribution towards the total amount of FDI is significantly higher at 48% as compared to that of China's which stands at 10% of the total amount received by Nepal, the number of projects that China has invested in is almost as much as that of India. Similarly for FY 2010-11, the FDI inflows from India and China stood at NPR 7 billion and NPR 1.2 billion respectively. Conversely, the number of projects that received FDI from China stood at 69 whereas the same number for India was 38. Therefore, it can be established that although small in amounts, the number of projects that receive FDI from China are significant. Also, in the same fiscal year, India and China generated 52% of the employment opportunities. Other countries that have significant contribution towards FDI flowing into Nepal are USA, UK, South Korea and Mauritius.

3. FDI PERFORMANCE IN NEPAL

Twenty years ago when Nepal made historical moves like creating the Foreign investment Promotion Board and brought about legislations like Foreign Investment and Technology Transfer Act, 1992 (FITTA), immense interest in Nepal was generated that resulted in the establishment of many joint venture companies. However, with time these institutions that were created started acquiring political hues. Further, the Nepali private sector started feeling the heat of the FDI players coming in and began lobbying for protectionism. Business associations that comprised mostly

> Nepal is a predominantly agricultural economy with 75% of the population engaged in agriculture, but contributing only around 33% to the GDP.

Table 2: Country Wise FDI Inflows, Projects, and Employment Generation up toFY 2010-11 (Amount in NPR Millions)

	Foreign Investment			No. of Industries			Total No. of Employment		
Rank	Country Ranking	Amount	Percentage	Country Ranking	Number	Percentage	Country Ranking	Number of jobs created	Percentage
1	**India**	32,390	48%	India	501	24%	**India**	56,407	36%
2	**China**	7,036	10%	China	401	19%	**China**	23,325	15%
3	**USA**	4,956	7%	USA	174	8%	**USA**	12,287	8%
4	**S. Korea**	4,521	7%	Japan	154	7%	**UK**	8,578	6%
5	**Mauritius**	2,845	4%	S. Korea	149	7%	**Japan**	6,683	4%
6	**Canada**	2,167	3%	UK	103	5%	**S. Korea**	6,232	4%
7	**UK**	1,540	2%	Germany	79	4%	**Bangladesh**	4,136	3%
8	**Singapore**	1,505	2%	France	49	2%	**Germany**	3,848	2%
9	**Japan**	1,171	2%	Australia	34	2%	**Netherlands**	3,046	2%
10	**Norway**	1,136	2%	Netherlands	34	2%	**Hong Kong**	2,616	2%
	Total	**68,070**		**Total**	**2,108**		**Total**	**155,432**	

Source: Industrial Statistics FY 2067-68, Department of Industries

The dependency of government on foreign aid instead of foreign investment is evident from the fact that 26% of our budget is still dependent on foreign aid.

Table 4: Key Indian FDIs in Nepal

1	Asian Paints (Nepal) Pvt. Ltd.
2	Berger Jenson and Nicholson (Nepal) Pvt. Ltd.
3	Nepal SBI Bank Limited4
4	Everest Bank Limited
5	Surya Nepal Pvt. Ltd.
6	Dabur Nepal Pvt. Ltd.
7	Unilever Nepal Ltd.
8	Varun Beverage Nepal Pvt. Ltd.
9	United Telecom Limited
10	Manipal Education and Medical Group Pvt. Ltd.

of domestic businesses did not think that FDI promotion was their agenda and FDI remained mere lip service at meetings and seminars. The challenge continues, with apex business associations not comprising of foreign investors, and foreign investors not finding their voice in any form.

The Department of Industries has been the nodal agency and the 'one-window' for foreign investors. However, the credibility of the department has been seriously hit with allegations of delays and rampant corruption.

Development work of Nepal has not been able to create a sustainable impact due to political hold ups and conflicts, and government has not been able to maintain institutions and policies for sustaining such development work. Institutions and organizations in Nepal have never been accountable to the people. With so much focus on restructuring the state, the nation barely pays attention to development. Moreover, the development agenda of Nepal has always been donor driven. The dependency of government on foreign aid instead of foreign investment is evident from the fact that 26% of our budget is still dependent on foreign aid. It has been proven time and again that aid programs seldom focus on productive sectors, do not engage stakeholders and hardly contribute to the national economy. It is only private capital that can bail Nepal out of the current impasse.

Table 3: FDIs amongst the Top ten taxpayers in the FY 2011-12

Rank in top 10	Company	Amount in mio rupees
2	Ncell	1,480
4	Nabil Bank	800
6	Standard Chartered Bank	570
8	Surya Nepal	420

Source: "Income Tax: Service sector pays more", Ekantipur, August 16, 2012 http://www.ekantipur.com/2012/08/16/business/income-tax-service-sector-pays-more/358823.html

However, despite various hurdles and unfavorable circumstances, Nepal has proven to be a successful destination for a large number of foreign investors as the return on investments (ROI) has been above expectations. This has compensated substantially for the risks associated with investments in Nepal. Since Nepal is moving towards a service-led economy, the FDI flow to the service sector in recent years has taken a giant leap - from telecom to

As we saw in Figure 1, the past few years have seen a significant growth in FDI flows into Nepal. (Amount in USD Million)

FDI inflows	1990-1995	1996-2000	2001-2005	2006-2010	2,009	2,010
Afghanistan	(0.01)	572	566	1,042	185	76
Bangladesh	126	4,609	2,339	4,159	700	913
Bhutan	2	19	17	138	15	12
India	4,221	43,361	28,828	148,512	35,649	24,640
Maldives	42	250	183	565	112	164
Nepal	**8**	**90**	**32**	**78**	**39**	**39**
Pakistan	2,592	7,556	5,059	19,655	2,338	2,016
Sri Lanka	659	2,192	1,102	2,717	404	478
Total FDI Inflows to South Asia	**7,530**	**72,400**	**51,560**	**188,430**	**42,460**	**31,950**
Nepal's Share	**0.108%**	**0.124%**	**0.061%**	**0.041%**	**0.091%**	**0.122%**

Source: World Investment Report, 2011, United Nations Conference on Trade and Development

banking and from Information Technology to education and health.

Table above shows that amongst the top 10 tax payers of Nepal in FY 2011-12, four were foreign investments. Of the total tax revenue collected by the top ten tax payers which amounted to NPR 11 billion (USD 128 million), companies with FDI contributed 27%.

4. SITUATIONAL ANALYSIS AND STUMBLING BLOCKS FOR INVESTORS

However, comparing these figures with those of other similar South Asian countries (as seen in the table above), it can be seen that as a percentage of the total FDI flows into South Asian countries, Nepal receives only 0.12% on average. This means that although FDI flows to Nepal are increasing every year, the amount is miniscule when compared to what other similar countries in South Asia are receiving. FDI can be one of the key drivers for economic development in a developing economy. Lack of proper information coupled with inadequate infrastructure, poor post investment services and lack of security in the country are reasons for its inability to attract enough FDI. These hurdles are not communicated properly to the prospective investors and they end up assuming the worst.

4.1 Inadequate support from the government

Although the Department of Industries (DoI) provides investors with a Procedure Manual for Foreign Investment in Nepal, the latest version of the document dates back to 2005. All procedures regarding the investment process, including those not handled by the DoI, are listed in the manual. However, any changes that may have come in these processes over the years have not been incorporated in the document.

Nepal Electricity Authority (NEA) and Nepal Oil Corporation (NOC), both state owned sole suppliers of electricity and fuel respectively, never manage to provide an uninterrupted supply of either of the two.

Also, even if the procedures are mentioned, bureaucracy in all government agencies slows down the process. What happens in practice differs from what is listed in the procedure manual and support from government officials is inadequate. For instance, the law requires the government to provide foreign investors with a five year visa; however in practice, visas are issued for one year at a time on a rolling basis for the next four years.

There has also been a level of deterioration in the administration services provided by the government to existing investors during the post-investment period. In the initial years, obtaining FDI was more difficult than it is now and hence the efforts the government put in then were more substantial. A sense of complacency has now set in. Despite the 'one window' policy, DoI has failed to meet the challenges and investors have had to run to various government and private agencies for information and assistance.

4.2 No reliable information bank for potential investors

In the absence of a credible information bank for foreign investors, various agencies feed the prospective investors with their versions of information regarding the investment process in Nepal through their websites.

- DoI, being the designated agency under the 'one window' policy, is supposed to be the focal point for all investment related inquires
- The embassies of Nepal in investee countries are first source of information and act as intermediaries between the potential investors and agencies such as the Department of Industries.
- Bi-lateral Chambers of Commerce, such as the Nepal India Chamber of Commerce and the Nepal China Chamber Commerce also provide information to investors from their countries.
- Organizations set up by existing foreign investors like Foundation for Foreign Investment in Nepal (FFIN) also provide information and support to the prospective investors.

However, none of the above provides a complete and accurate picture of the current situation and systems in Nepal.

- There is lack of timely updates; even the most basic information concerning Nepal varies from website to website.
- Contextual review of policies is missing; links provided to entire acts are weighty and do not precisely suit the diverse enquiries of the investors.
- Accessibility of information provided in the websites is compromised as most links are in Nepali.
- Also, these websites use the B.S. date format rather the A.D. format, which is not commonly used in other countries.

Further, availability of sector analysis on potential sectors and some logistic support to the investors during the entire investment process like marketing, hiring services, legal support and connection to consultants or potential partners would help bridge the gap between the expectations of the potential investors and what is provided to them.

4.3 Infrastructural issues

Nepal Electricity Authority (NEA) and Nepal Oil Corporation (NOC), both state owned sole suppliers of electricity and fuel respectively, never manage to provide an uninterrupted supply of either of the two. Consequently, the manufacturing sector has always faced problems relating to increase in costs of production. Though some government agencies claim that 40% of the population has access to electric power, the actual figure is less than that.

In the absence of an extensive railway network, the only means of transport is either via air or by road. Though there has been considerable improvement in telecommunications over the past five years, the road network continues to be seriously inadequate. Connections among the major centers have improved, but the feeder roads in rural areas have not. This needs attention in an economy where dependence on agriculture and tourism is immense.

The number of fixed telephone lines per 100 inhabitants was only 2.81 in 2010 as per a World Bank report published in 2012. However, it must not be forgotten that the tele-density rate stands at 66.14% as on Mid August, 2012.[4] Therefore, a positive trend in infrastructural strengthening could be attributed to the tele-density figure. Nonetheless, other areas need to be developed in order to create a favorable business environment.

4.4 Labor issues

The Labor Act 2048 (1992) of Nepal has certain inherent lacunas. It is a two-decade old Act and thus does not capture the spirit of the current industrial dynamics. Various lawyers and legal counsels have been suggesting changes in the old Act for some time now.

The current Labor Law is silent on the rationality of demands that workers or employees can make on their management; and if the demands are not met and the workers wish to go on strikes, they can do so by following prescribed processes.

The current Labor Law has no provisions to cover situations where contract employees are not directly employed by the companies but services have been outsourced to another entity.

Besides the above, the culture of corruption is pervasive, legal system is weak and rampant with misuse of intellectual property, and thrives on kickbacks. 'Registering a new company is a long and tortuous process and bureaucracy penalizes businesses for growths and capital increases'[5]. Lack of transparency is a major dampener for FDI.

5. GOVERNMENT INITIATIVES – NEPAL INVESTMENT YEAR, BOARD OF INVESTMENT, BIPPA

The Nepal government is observing fiscal 2012-13 as Nepal Investment Year (NIY). NIY is an ambitious government programme that seeks to double foreign direct investment (FDI) in the country.The government expects NIY to attract FDI in at least 50 mega projects during 2012-13.

So far, to ensure the success of the proposed NIY campaign, a high level 42-member National Directory Committee (NDC) chaired by Prime Minister Baburam Bhattarai has been formed. Further, two secretariats - one at the Ministry of Industries and the other at the Federation of Nepali Chambers of Commerce and Industries (FNCCI), and four subcommittees - Programme, Investment Promotion, Investment Project Identification and The Act, Rules and Policies Revision have also been formed. However, not much has happened.

Under NIY, the government aims to lay a special emphasis on our neighbouring economic giants – India and China - this year when it comes to attracting investors, claiming that doing so will not only help bolster the relations between the countries but also help Nepal step up its reputation in the international market and draw attention from Europeans and Americans.

Further, the government has set up the Investment Board (IB) (www.investmentboard.gov.np) to overlook all investment related issues, find investment ready projects for potential investors, provide incentives such as tax holidays and free land and provide all services relating to the investment process such as registration, licensing and immigration issues under one roof to simplify the process. The IB also has a crucial role in determining the success of the NIY. Recently, the government endorsed the NIB's regulation and also handed over 14 large-scale national priority development projects to interested private players -West Seti, Upper Marsyangdi, Upper Karnali, Tamakoshi III, Arun III, Kathmandu-Tarai Fast Track , Mid-Hill Highway, North-South Corridor Road, Tribhuvan International Airport up gradation , Nijgadh Airport, Kathmandu Metro Railway, Kathmandu Waste Management, Chemical Fertilizer Manufacturing and Nepal Infrastructure Bank. Moreover, NIB has been asked to find investors to build two five star hotels.

In addition, the government is supporting the Confederation of Nepali Industries (CNI) for collation of investment related information under an information web portal(investnepal.gov.np); the office for the management and development of the portal is housed at CNI.

OUTLOOK

IN THE ABSENCE OF READY FINANCES IN THE COUNTRY,

FDI can bring much-needed capital investments, technical knowhow, management skills, global exposure and international competitiveness to the country.

There have been two schools of thought about the impact of FDI in a developing economy – one recognizes the potential of FDI in job creation and resource transfer in terms of capital and technical knowhow and utilization of resources that were earlier inaccessible; and the other believes that FDI could lead to economic colonialism, leaving developing countries vulnerable to exploitation by FDI countries where local corporations can lose their market share due to relative incompetency.

Politicians, bureaucrats and local industrialists promote notions such as foreign investment being inimical to the interests of developing countries like Nepal so that they are able to continue enjoying monopoly power. The fact, however, is that if markets are competitive and if macro-economic environment is managed well by the government, FDI can positively impact a country's economy. For example, in Vietnam, approximately USD 14.2 billion was injected over the 1988–1998 period. These inflows accounted for one third of the total investments made and 1.5% growth in the GDP. The success of attracting and implementing FDI was made possible by tax preference policies and domestic protection policies that reduced the detrimental effects of FDI. Therefore, the lesson learnt from the Vietnam example is that the role of the government in striking a correct balance between two principal objectives of attracting FDI - desire for economic independence and the demand for economic development - are key factor in deciding the impact of FDI inflows to a country.

Perhaps the benefits of FDI are not unknown to the developing countries, as most of the developing countries are competing with each other to attract FDI by liberalizing their policy regimes and offering various incentive packages such as tax rebate, trade liberalization, establishment of special economic zones and packages to foreign investors. For example, during 1997, a total of 76 countries made 151 changes in the FDI related policies of which 89% changes were made to create an FDI friendly environment(UNCTAD, 1998)[6]. With a few exceptions, however, most of the developing countries have not been very successful in attracting FDI. Thus, the question arises as to what determines the inflow of FDI? Factors such as good governance, macro-economic policy initiatives to encourage investors, Return on Investment and nature of government consumption in terms of provision of infrastructure and enabling environment have a positive relation with FDI, suggesting that all these factors will encourage FDI inflows. On the contrary, political instability has a negative relation with FDI.

Hence, we feel the following initiatives, by both the government and private organizations, could go a long way in creating an enabling and positive environment for foreign investment in Nepal:

1. DECLARING FY 2012-13 AS NEPAL INVESTMENT YEAR (NIY) is a positive step towards attracting FDI; however, just a declaration will not attract investors into this country. Drawing our neighbors' attention towards the country and convincing them about the strong prospects of investment and business in Nepal is a daunting task and its success depends on how the government prepares itself. Due to the current political impasse, the Prime Minister has not been able to garner support for this initiative. Additionally, lack of budget(s) has been a setback and the program has not been formally launched. Owing to this, no concrete plans and strategies have so far been laid out by the government for the smooth functioning of projects and plans that are to drive the Investment Year.

Further, with the liberalization of markets and the opening up of the economy, Nepal has been exposed to global markets, and this exposure which initially brought with it an excitement amongst the Nepali private sector, has also led to a cry for protection from the local businesses that are realising the threat international players pose. Obstacles faced by FDIs like J. Walter Thompson, Maersk and DHL in venturing into Nepal are proof that such protectionist attitudes of the local business lobbies and corrupt bureaucracy have been hampering reforms. Attacks in the past on foreign ventures like Coke, Pepsi and Unilever have destroyed faith in the system and governance and permanent shut down of operations by

> "Investors however need more than words. Words are easy. But progress requires action as well as words."
>
> ('Nepali economy – Challenges a nd Potential': speech by Ambassador Scott DeLisi at the Neftalk, May 16, 2012)

Colgate Palmolive has given conflicting signals to foreign investors. Further, shutting of its garment factory by Surya Nepal, problems at Unilever, repeated closure of Fire and Ice (a popular Pizzeria in Thamel with FDI), closure of international food chains KFC, Pizza Hut and Cream Bell, are some recent cases that show how the going has not been trouble-free for FDIs even in the NIY.

On the other hand, the newly formed Investment Board(IB) has been making remarkable efforts in liaising with various ministries to streamline policies and procedures to facilitate and fast-track investments, organizing stakeholder meetings to identify issues with policies pertinent to investment in Nepal, coordinating with different agencies/policymakers to identify and package projects for Nepal Investment Year and developing templates of project development agreements and investment tracking systems for documentation of investment services. An FDI working group has been formed under the aegis of the Nepal Business Forum - facilitated by IFC - with members from embassies, bilateral chambers, investors and the government to verify FDI related issues that need to be addressed. Nonetheless, "Investors however need more than words. Words are easy. But progress requires action as well as words." It is yet to be seen how effective the IB is and how closely it works with the ministries and the support it gets from various government authorities. Further, the government needs to seriously and promptly work on finding convincing answers to investors' issues related to availability of energy, investment subsidies, security and transportation; otherwise, this initiative may well turn out to be yet another failed attempt by the government, like various other dampened reforms.

Most importantly, there is a growing skepticism about whether the IB will still hold firm ground once the government changes, or when the PM - who has been behind this initiative - changes. The challenge would be to get all other political parties to treat this as a national agenda rather than as an individual agenda.

2. STAKEHOLDERS like government agencies, private sector organizations, consultants and existing FDIs, should work in collaboration for provision of realistic information and assistance to prospective investors. NIB has been designated to work as a single window for the investment of over NPR 10 billion. But one wonders what will happen to the earlier one window policy, where DoI was the designated agency; questions like what will be the coordination between NIB and the DoI and the existing authorities responsible for FDI processing have to be clarified by the government. As in many lucrative government agencies, people have different incentives to keep control of the procedures, it will be interesting to see how the DOI will react to BOI given so much of advisory powers. The risks of projects approved by BOI advisory, facing problems at the DOI remain high.

3. PAST DATA SUBSTANTIATES THE FACT THAT WITH THE END OF THE DECADE LONG CIVIL WAR, FDI inflows significantly improved from FY 2006-07. However, the enthusiasm about the expectation of the constitution being drafted, hoping that it would bring about the much needed political stability that is required to attract FDI in Nepal, has again been dampened with the dissolution of the Constituent Assembly. However, we need to take into consideration that the only constant in Nepal in the past 60 years has been political uncertainty. We also see thoughts emerging as to how economic growth should be seen divorced from politics; how we should view Nepal as a country with the 40th largest population in the world with 30 million people, a demographic of 50% of the people under 25 years of age and 70% under 35 along with the country being land-linked to India and China - the two fastest growing economies in the world.[7]

4. THE LEGAL FRAMEWORK of a country plays a pivotal role in determining its economic development. The recently revealed Immediate Action Plan (IAP) 2068, Ministry of Finance) for Economic Development and Prosperity by the government has indicated that the sluggish growth of the economy is largely due to the failure to attract FDI to the country. In this regard, the IAP aims to make Bilateral Investment Promotion and Protection Agreements (BIPPA) with various countries.

Nepal has recently signed a BIPPA with India and has already signed BIPPAs with France, Germany, Britain, Mauritius, Qatar and Finland, even though these countries do not have significant investments in Nepal. Moreover, the IAP aims at signing BIPPA and Double Taxation Avoidance Agreement (DTAA) with China, South Asian nations, and five other countries to attract FDI worth NPR 75.29 billion (USD 1 billion) within the current fiscal year.[8]

India is Nepal's largest business partner and the signing of BIPPA with India is expected to increase bilateral investment and address a part of the trade imbalance. 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. With 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. The BIPPA promises investors of both countries that it will not nationalize the foreign investment project and also pledges a 'most favored nation' treatment.

In addition current acts and policies governing the FDI sector are now coming under review. Recent labor issues at Surya Nepal Garments, Hotel Vaishali, Surya Nepal, Unilever Nepal, Himal Power Limited, Fire and Ice Restaurant are a few examples of issues that could not be addressed with the old Labor Law. The Ministry of Labor and Transportation Management (MOLTM) is in the process of revising three existing Labor Laws - Labor Act 1992, Trade Union Act 1992, and Bonus Act 1996. In addition, the ministry has also drafted two new laws - the Social Security Act and the Labor Commission Act.

The new Labor Law proposes that workers can agitate to express their demands, but their demands cannot be irrational and have to be linked to productivity. In case of unlawful strikes, there is a provision for no pay and in case of lawful strikes the pay can be cut down by 50%. This change can ease the pressure on the management to give in on all demands. They would have room to ask workers to justify their demands and whether there has been an increase in productivity. Further, the new Labor Laws would provide for lawful outsourcing of jobs which are not part of the core business operations of an enterprise. For all core business activities, permanent staff shall have to be hired and such jobs cannot be outsourced. This would not only provide clarity to management in making recruitment decisions, it would prevent corporate houses in Nepal from misusing outsourcing as a medium to bypass legal requirements regarding pays and prerequisites.

Bikram Samvat, the official calendar of Nepal, is 56.7 years ahead (in count) of the solar Gregorian calendar. In a globalized world such difference in dates/ years and complexity of understanding dampens the very spirit of integration and ...

Additionally, the Ministry of Industry is working on amending several other acts, including the Foreign Investment and Technology Transfer Act, Industrial Enterprises Act, Company Act, Intellectual Property Act and Special Economic Zone (SEZ) Act, to create a favorable investment climate.

5. ON ACCOUNT OF BEING AN IMPORT-DEPENDENT COUNTRY, our trade deficit is soaring with no exports to back the imports. The remittance inflows do ease the deficit to a certain extent, but it is not enough. An increased FDI inflow into Nepal can help set up industries which can ease our dependence on imports. Even more so, if foreign investment is made in sectors with huge export potential as identified by the NTIS report, it can lead to an increase in exports and help Nepal in reducing its trade deficit.

6. EVIDENTLY, INFRASTRUCTURE FACILITIES IN NEPAL ARE POOR, as is the case in most developing economies. Opportunities are being explored to harness electricity through hydro power projects. Other options for import of fuel are also being explored. An extensive road expansion plan is in place. Therefore, it can be said that positive steps are being taken to improve the infrastructure of Nepal.

7. STORIES OF SUCCESSFUL FDI VENTURES must be conveyed to potential investors -from big construction companies to small foreign investment ventures like Fire and Ice, Kalinta, Skylight, briquette factories and eateries that are employing 30 to 50 people and generating handsome returns.

8. FURTHER, THERE ARE NO CREDIT RATING AGENCIES in Nepal. Though, there are regulations in place, none of the aspiring credit rating firms have started operation. In the absence of credit rating, none of the international players will be interested in Nepal.

9. DESPITE THE STATUS QUO AND CURRENT POLITICAL FLUIDITY, Nepal is still attractive for a certain target segment of investors. For European investors who have 2 million to 5 million of foundation money, Nepal is a good option; small Indian investors wanting to invest a million dollars, who would get lost in other bigger places, would prefer Nepal as an investment destination due to physical and cultural proximity. For these, investment delegations to neighboring countries, especially India, can make investors aware of the potential opportunities in Nepal and at the same time, address and put to rest unfounded hype about the hopelessness of the situation in Nepal.

11. CAPITAL MARKET REFORMS LIKE REFINING AND SIMPLIFYING MARKET SYSTEMS AND PROCEDURES, effective functioning of Central Depository System (CDS) and standardization of legal documents would instill immense confidence in investors. Companies like Surya Nepal and Dabur should be encouraged to list themselves on the secondary market for value capture. Laws and regulations should be extensively explained so there is less room for individual judgment and interpretation by relevant officials. Over-regulation is debatable because countries like India have companies' acts which run into 600-700 pager documents, however they have been able to plug loopholes with various amendments and provisions to the main laws and to an extent make them as comprehensive as possible.

12. FINALLY, THE GOVERNMENT NEEDS TO OWN THE AGENDA OF PROMOTING FOREIGN INVESTMENT in Nepal, which ironically, seems to be imposed on Nepal and is perceived as something the outsiders want for the country. In the past, initiatives to address issues faced by existing and prospective foreign investors have been taken up by foreign agencies rather than the government. For instance, in the energy sector, the government preferred to rely on donors for building power plants rather than allowing investors to take on the challenge.*(Source: Nepal in Transition- Unleashing Nepal's Economic Potential).*

However, one wonders how effective the investment promotion initiatives can ever be, given Nepal's history of successive governments striving to secure their political survival by keeping labor unions happy and handing out protectionist policies to the private sector instead of providing a conducive labor market and investment environment, combined with the lack of a home grown desire for economic development through investment.

ENDNOTES

1. “Industrial Statistics FY 2067-68”, Department of Industries
2. Hari Man Shrestha “Cadastre of Potential Hydropower Resources in Nepal” (PhD diss. Moscow Power Institute, 1966)
3. Nepal Electricity Authority, Annual Report, 2011, Accessed November 1, 2011, http://www.nea.org.np/
4. Nepal Telecommunication Authority, Management Information System, September 2012
5. Nepali economy – Challenges and potential - speech by Ambassador Scott DeLisi at the Neftalk, May 16, 2012
6. Khondoker Abdul Mottaleb, KaliappaKalirajan, “Determinants of Foreign Direct Investment in Developing Countries: A Comparative Analysis”, ASARC Working Paper 2010-13, Crawford School of Public Policy, Australian National University
7. SujeevShakya, Unleashing Nepal (India: Penguin, 2009)
8. Annual Report FY 2011-12, Ministry of Finance

Issue 5, January 2012 | Publisher: Nepal Economic Forum | www.nepaleconomicforum.org
P. O.Box 7025, Krishna Galli, Lalitpur-3, Nepal | Phone: +977-1-5548400
email: info@nepaleconomicforum.org
nefsearch team: Puja Tandon, Rojesh Shrestha, Shristi Singh
Design: Big Stone Medium, contact@bigstonemedium.com