

# CHAPTER ONE

## INTRODUCTION

### 1.1. Background of the Study

FDI is a cross-border investment made by a resident in one economy with the objective of establishing a lasting interest in an enterprise that is resident in an economy other than that of the direct investor.

FDI promotes stable and long-lasting economic links between countries through direct access for direct investors in home economies to production units of the host economies. A proper policy framework, FDI assists hosts countries in developing local enterprises, promotes international trade through access to markets and contributes to the transfer of technology and know-how. Also FDI, has an impact on the development of labour and financial markets, and influences other aspects of economic performance.

FDI is a key element in this rapidly evolving globalization. FDI provides a means for creating direct, stable and long-lasting links between economies. Under the right policy environment, it can serve as an important vehicle for local enterprise development, and it also may help the competitive position of both the recipient and investing economy. In particular, FDI encourages the transfer of technology and know-how between economies. It also provides an opportunity for the host economy to promote its products more widely in the international markets. FDI, in addition to its positive effect on the development of international trade, is an important source of capital for a range of host and home economies.

The significant growth in the level of FDI in recent decades, and its international pervasiveness, reflect both an increase in size and number of individual FDI transactions, as well as the growing diversification of enterprises across economies and industrial sectors. Large multinational enterprises are traditionally the dominant players in such cross-border FDI transactions. This development has coincided with an increased propensity for the multinational enterprises to participate in foreign trade. In recent years, it is believed that small and medium-size enterprises have also become increasingly involved in FDI (OECD, 2008).

The regulation of FDI can be traced back over many centuries. The early trading nations, such as Phoenicians, maintained a constant vigil over investments in their territories. Versions of what we know now as eminent domain can be found in ancient Rome. The Roman Empire confiscated property from non-Romans in the course of conquest and

eventually developed the practice using private Roman property in the furtherance of public projects.

These practices that developed in the Roman Empire were adopted by the Civil Codes in the ensuing centuries, and the common law adopted similar practices from the civil law. In the early eighteenth century, the British Parliament developed the practice of paying compensation when appropriating land for public purposes. Shortly after the American Revolution, the United States and Britain signed Jay Treaty, which among other things, stipulated the protection of their investor nationals from the host government.

Prior to the end of WWII, global economic relations were fostered by establishment of commercial trade ties. However, in this environment, many states were distinctly protectionist in regulating foreign investment. The post WWII era ushered in a new reality in global economic relations. Geopolitical developments became the driving force behind the FDI. The Bretton-Woods System was intended to liberalize global trade and guard against the protectionist sentiment. However, FDI was not accepted by the Socialists-block and decolonized nations as they took it as modern form of neocolonialism attacking their sovereignty. The international agreements to form ICSID in 1965 & WTO in 1995 and, agreements like GATS, TRIMS, TRIPS and many others help boost the confidence of the reluctant nations to accept the FDI (leon & Nicola, 2013).

For a least developed-country (LDC) like Nepal with huge saving-investment gap, limited albeit growing revenue to gross domestic product (GDP) ratio and limited amount of foreign aid flow, foreign direct investment (FDI) is considered an indispensable mode of development financing. Although FDI is traditionally viewed as foreign investments made in manufacturing and services sectors which undoubtedly contribute to employment opportunities as well as economic growth, they are increasingly attracted by host countries for meeting financing requirements for large infrastructure projects. This is an area in which foreign investors used to shy away from investing in the past due to various risks associated with such projects resulting from long gestation and pay back periods. In the context of Nepal, although FDI is generally welcome in all sectors, due to acute dearth of resources for infrastructure financing, it has become an imperative in the latter sector. It must be noted that the utility of foreign investment for a country like Nepal does not end there. It is an instrument for the transfer of technology from the technology-rich countries to technology-deficient countries. Similarly, leadership and managerial skills transferred by foreign investors and eventual expansion of local knowledge and skill base, whether at the enterprise level or at the sectoral level are considered yet another spillover impact of foreign investment (Adhikari, 2013).

Foreign Direct Investment (FDI) is one of the most important factors of economic development in the contemporary world. Today, FDI is a basic mechanism of capital

flows in the globalized economy, and the key factor for economic development in many countries. Foreign investments are of substantial importance for both the host country and foreign investors. For the host country, foreign direct investment contributes to the growth of business activities, increase of export, and employment, transfer of technology and know-how, management skills as well as to initiation or acceleration of the economic growth and development of the country. Firm specific assets, such as capital, technology, technical, managerial and human resource skills, according to some estimation are scarce and lacking in the most part of developing countries. So, FDI is a valuable source of capital, but also an advantageous source of new technologies, technical and managerial know-how, and in this way it represents the source of human capital improvement (Rijal, 2010).

FDI is a flow of entrepreneurial capital in the form of some mixture of managerial skills and financial lending. It directly increases the capital formation of the recipient country. FDI is the outcome of mutual interests of multi-national firms and host countries. FDI is investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor. The investor's purpose being to have an effective voice in the management of the enterprise. IMF definition of FDI treats both reinvested and other direct capital flows such as debt securities, trade credits and grants as part of FDI. This definition is accepted by most countries and also by UNCTAD for reporting FDI data. Briefly speaking, economic benefits of FDI include contribution to physical capital formation, contribution to human capital development, transfer of technology and know-how, expansion of market and expansion of trade. The technological changes that it brings about increase factor productivity, change product and export composition, encourage research and development practice and efficiency to local production.

Foreign direct investment (FDI) is an investment made by a company or individual in one country in business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company. Foreign direct investment are distinguished from portfolio investments in which an investor merely purchases equities of foreign-based companies. The key feature of foreign direct investment is that it is an investment made that establishes either effective control of, or at least substantial influence over, the decision making of a foreign business.

Foreign Direct Investment (FDI) occurs when an investor based in one country acquires an asset in another country with the intent to manage that asset. Theories of FDI suggest that national and foreign private-sector enterprises, if permitted to operate in competitive market conditions, offer developing countries the best prospects for faster national economic growth. FDI is considered beneficial in view of its contribution to technological transfers, enhancement of managerial capability and new opportunities for market access. It includes the transfer of intangible assets such as trademark, technology

and business management as well as the authorization given to the investor to control the investment.

Most economic theorist and developing practitioners accept that external capital is necessary for accelerating growth and industrialization. Today, every developing country irrespective of their size and political systems tries to attract foreign investment. A large number of developing countries have now established export processing zones (EPZ) to attract foreign private and public foreign investment.

The developing countries of the world have in genera been recipient of both official and private financial flows over the last four decades. Understandably so, since in most of there countries, the level of domestic savings is generally very low, the financial sector is widely underdeveloped and in most cases repressed, and therefore the capacity to harness domestic financial resources for development of key sectors of the economy is quite limited. A wide body of literature has investigated the role that this flow of external financing could play in development of recipient countries. The convergence of opinion seems to be that on balance, there is a net positive relationship between external financial assistance and economic performance of countries. Particularly if and when such assistance is accompanied by conducive policy environment (Burnside & Dollar, 2000).

Foreign direct investment are the net inflow (total inflows minus outflows) of the investment to acquire a lasting management interest (10 percent or more voting stock) in an enterprises operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short terms capitals.

Foreign direct investment takes a significant role in the development of modern economic relations. It's more important today, especially for developing countries. With its enormous potential to create jobs, raise productivity; enhance exports and transfer technology, foreign capital is a vital factor in the long-term economic development of the world's developing and developed countries. The substantial flow of FDI to a least developed country like Nepal is instrumental in developing and expanding its industrial base, promoting industries of national priority and having comparative advantage, improving competitiveness of the existing industries thereby increasing industrial productivity and ultimately contribution to creating a broad based and high economic growth rate (Dahal, 2007).

Foreign direct investment (FDI) has become an essential source of economic development growth for many developing countries. Asian countries continue to greatly influence the global economy. However, the South Asian countries are comparatively lagging behind, among which Nepal is one of the least beneficiaries of inward FDI. Surprisingly, Nepal is one of the liberalized countries in the South Asian region, but it does not attract much FDI despite policy reforms initiated in the early 1990s to attract

inward FDI. This is partly because a small, least developed, landlocked, mountainous country has little to offer to foreign investors. However, this could not be a good excuse because other similarly situated countries and some of South Asian countries have continued to receive much more investments than Nepal. Nepal provides access to a friendly and rapidly growing two neighboring economies with huge market with a low wage, trainable labor force, and a booming local entrepreneurial culture in business, as well as well-known tourist landmarks. Moreover, Nepal's moderate climate is also best for cultivating medicinal herbs, whose market is getting larger day by day. These advantages can boost Nepal's status as an attractive FDI host country. However, there are serious flaws in the investment framework that deserve priority consideration. Regardless of hindrances, Nepal seems to provide several unexplored opportunities, and it could stand as the next most desirable target for FDI. Regardless of the fact that Nepal has embarked the liberal economic policies on 1990s. Right after introduction of economic policies, Nepal has successfully attracted good amount of FDI flow, but it could not sustain the momentum for a long.

## **1.2. Statement of the Problem**

As political stability and peace are the necessary condition for attracting greater volume of FDI in Nepal, Nepalese economy has suffered from serious structural constraints accompanied by unprecedented political turmoil since many years. Economy is characterized by landlocked position, poverty and not a free of corruption. Similarly, Nepalese economy seems to suffer from underdeveloped infrastructure, technical know how, unskilled manpower, ineffective implementation of planning and policies etc.

Trade liberalization and generous investment per se in the absence of basic pre-conditions cannot achieve anticipated developmental objectives. The provision of required supportive services, political stability, policy certainty and efficient administrative mechanism have an equally perhaps even more -important role to play. Nepal obviously has disadvantages arising from its geography in attracting FDI. However, comparative international experience suggests that her lack lustre record as a host to foreign investors cannot be explained in terms of its geography alone. The overall investment climate does matter (Athukorala & Sharma, 2006).

However, Nepal has enormous economic potential comprising water resources, tourism, human resources and biodiversity, which require huge spending through bilateral and multilateral assistance and private sector participation to exploit potential ensuring targeted growth. In a poverty-stricken economy like Nepal where internal financial resources are limited, not enough to supplement current expenditures and dependence on foreign aid (grants and loans) is increasing with poor performance shown by economic growth rate, and where political conflict is getting momentum, the role of Foreign Direct

Investment (FDI) is crucial not only to sustain development activities but also for poverty alleviation.

An assessment of the policies adopted, incentive given that address FDI and its nature, trend and prospects are recognized as the focus of the study or problem of present study. So that some question are raise issued of the study.

1. What are the policies and incentives relating to FDI in Nepal?
2. What is the trend of FDI in Nepal?
3. What are the prospects of FDI in Nepal?

### **1.3. Objective of the Study**

The main objectives of the study are highlighted below:

1. To examine the current status of FDI in Nepal.
2. To examine the prospects of FDI in Nepal.

### **1.4. Significance of the Study**

Nepal is a least developed country with low domestic saving, lack of capital and where development expenditure in large extend depends on foreign aid and FDI, it is very important to study its status and trends and possibilities of FDI. FDI helps to maintain stable macroeconomic condition and limited restriction on Foreign exchange and a relatively open economy. Further it helps in income and employment generation, technology transfer and increased foreign exchange. FDI adds to investible resources and capital formation; and it is also a mechanism of transferring production technology, skills, innovative capacity, and organizational and managerial practices between locations, as well as of accessing international marketing networks. It also allows new local entrants to learn about exports markets, provide training for workers and stimulates competition with local firms. The main advantage is that it helps in overall development of the host country which would be not permitted by domestic saving itself.

Thus, Nepal is to achieve faster rate of economic growth at the present context, it is essential that it create the necessary and amicable condition to attract FDI.

### **1.5. Limitation of the Study**

This study is conducted for the partial fulfillment for Master in Economics. The study is done bounded within certain limitations and constraints, which are as follows:

1. The study based on the data of 27 years from 1989/1990 to 2015/2016 after the restoration of democracy period.

2. This study has been mainly based on secondary data to assess the policy framework of FDI in Nepal and analyze trend, structure and prospect of FDI.
3. In this work the validity and reliability are not checked in secondary data.

## **1.6. Organization of the Study**

This study comprises of seven chapters and each chapter is further divided into different sections and sub-sections.

The first chapter, which is the introductory portion, gives the general overview of the whole study.

Chapter two is related to the review of literature. It includes a discussion on the theoretical framework as well as the review of the major empirical works. The theoretical analysis and review of related literature conducted in this chapter provide a framework and with the help of which this study has been accomplished.

Chapter three is concerned to the research methodology used in this study. This chapter comprises of research design, nature and sources of data method of analysis and definitions of key terms.

Chapter four is related to trends and performance of FDI in Nepal.

Chapter five is related to prospect of FDI in Nepal.

Chapter six includes summary and conclusions of the study and the recommendations that may be helpful in formulating policies.

# **CHAPTER TWO**

## **REVIEW OF LITERATURE**

### **2.1. Concept and Definition of FDI**

Multinational corporations (MNCs) commonly capitalize on foreign business opportunities by engaging in direct foreign investment (DFI), which is investment in real assets (such as land, buildings or even existing plants) in foreign firms, acquire foreign firms, and form new foreign subsidiaries. Any of these types of DFI can generate high returns when managed properly. However, DFI requires a substantial investment and can therefore put much capital at risk. Moreover, if the investment doesn't perform as well as expected the MNCs may have difficulty selling the foreign project it created. Given these return and risk characteristic of DFI, MNCs tend to carefully analyze the potential benefit and costs before Implementing any type of DFI.

(OECD, 2008) a foreign direct investor is an entity (an institutional unit) resident in one economy that has acquired, either directly or indirectly, at least 10 percent of the voting power of a corporation (enterprise), or equivalent for an unincorporated enterprise, resident in another economy. A direct investor could be classified to any sector of the economy and could be any of the following:

- I. an individual;
- II. a group of related individuals;
- III. an incorporated or unincorporated enterprise;
- IV. a public or private enterprise;
- V. a group of related enterprises;
- VI. a government body;
- VII. an estate, trust or other societal organization;
- VIII. or any combination of the above

In the case where two enterprises each own 10 percent or more of each other's voting power, each is a direct investor in the other.

Economy watch defines FDI as foreign direct investment is a type of investment that involves the injection of foreign funds into an enterprise that operates in different country of origin from the investors. Investors are granted management and voting rights if the level of ownership is greater than or equal to 10 percent of ordinary share. Shares and ownership accounting to less than 10 percent is termed as portfolio investment and is not categorized as FDI.

Foreign investments are categorized into foreign portfolio investment and foreign direct investment. Portfolio investments are equity of investment without control on the management of the entity. Whereas FDI are direct investment on the entity with certain degree of control along with the inclusion of technology, skills and other required resources. It was introduced in early nineteenth century and its growth and development continued over the period since first UN development decade in 1960. Along with its development voice against and for of FDI have been raised. Some argued that it is totally unhelpful, threat to national sovereignty and culture and most of the time transfer inappropriate technology to the developing country.

FDI is the international movement of capital for specific investment purposes. Such investments are made for the purpose of actively controlling property, assets, or companies located in host countries. Business organizations undertake FDI to expand foreign markets or gain access to supplier of resources or finished products. FDI occurs when overseas companies set up or purchase operations in another country.

FDI can be categorized into three components: equity capital, reinvestment earnings, and intra company loans. Equity capital comprises of the shares of the companies in countries foreign to that of investor. Reinvested earning includes the earning not distributed to shareholders but reinvested into the company. Intra-company loan relate to financial transactions between a parent company and its affiliates. FDI thus may take many forms, including

- I. Purchase of existing assets in a foreign company.
- II. New investment in property like land and building.
- III. Participation in a joint venture with a local partner.
- IV. Merger and acquisition of activities

Balance of payment accounts define foreign direct investment as any flow lending to or purchase of ownership in a foreign enterprise that is largely owned by residents of the investing country.

FDI is the act of acquiring assets may be financial, such as bonds, bank deposits, and equity shares or direct investment and involves the ownership of means of production such as factories and land. Direct investment is considered to take place also if the ownership of equity shares provides control over the operation of firm.

(Dunning, 1993) this approach was pioneered by Dunning, who suggested that firms undertake FDI when three factors are present, and the resulting advantages are sufficient to offset the natural disadvantages of having to operate in foreign country. These are known as the “Ownership, Location and Internalization”(OLI) advantages. A firm must have some product or technology that enables it to enjoy some market power in foreign market (ownership advantage), the firm must see some advantage in producing in foreign

location rather than at home (location advantage), and there must be some reason for it to want to exploit the ownership advantage internally, rather than use a market based mechanism to gain payments for it (Such as license or sell its product or technology in the market for a fee.

(Hymer, 1960) found that American FDI was mainly concentrated in a few industries and monopolized by several companies. Multinational companies (MNC's) were the product of imperfect markets and monopoly advantages where the companies had the advantage with regards to choosing where to invest. A number of conclusions can be drawn from Hymer's analysis that helps frame up this study:

- I. First, FDI tends to flow into differentiated markets where a MNC believes they will have an advantage competitively.
- II. Second, companies that are able to make investments overseas all have certain advantages, such as economies of scale, differentiated products, special skills, and low-cost production. These companies will make investments in regions that do not have these advantages.
- III. Third, there are many ways in which MNCs can invest overseas in such as exporting, and licensing, in addition to direct investment. MNCs without local partners always prefer to choose foreign direct investment.
- IV. Last but not the least Hymer found that about half of the overseas operating capital of American firms came from host countries; thus FDI tends to flow into the countries or regions that have developed financial systems and capital markets.

(Chitrakar, 1986) FDI is considered as a means of obtaining not only capital and technology but also scarce management and skill, and improved marketing know-how and outlets for non- traditional exports of manufactures, processed commodities and traded services.

(Kindleberger, 1973) he found major difference between portfolio and direct investment is that direct investment involves control, whereas portfolio investments do not. Control is a legal concept and rests on hundred, ninety eight, fifty one or forty eight percent ownership of the equity of a foreign corporation. Or control is thought of in decision-theory terms, which meant that the head office makes decisions respecting foreign operations, within a clearly laid-out scheme, on such questions as choice of top personnel, new products, capital budgeting, research and development, and dividend policy. But direct investment is a capital movement combined with control and perhaps other elements, such as technology.

It is observed however that direct investment often does not involve a capital movement. A firm will undertake investment abroad with funds borrowed in the local country. It may

provide the equity in foreign exchange, but if it is going into a joint venture, this equity investment may take the form of patents, machinery, technology, or other real considerations. Once the investment become profitable, it grows from local borrowing and reinvested profits.

(Dunning, 1993) the literature on FDI identifies three most common investment motivations: resource-seeking, market-seeking, and efficiency-seeking.

1. Resource-seeking: the main motive of the firm is the acquisition of particular resources not available at home (natural resources or raw materials) or available at a higher cost (unskilled cheap labour). The availability of natural resources, cheap unskilled or semiskilled labour, creative assets and physical infrastructure promotes resource seeking activities. Historically, the most important host country determinant of FDI has been the availability of natural resources, e.g. minerals, raw materials and agricultural products.

Even when it is prominent as an FDI determinant, the presence of natural resources by itself is not sufficient for FDI to take place. Comparative advantage in natural resources usually gives rise to trade rather than to FDI. Investment takes place when resource abundant countries either lack the large amount of capital typically required for resource extraction or do not have the technical skills needed to extract or sell raw materials to the rest of the world. In addition, infrastructure facilities for getting the raw materials out of the host country and to its final destination have to be in place or needed to be created (UNCTAD, 1999). Labour-seeking investment is usually undertaken by manufacturing and service MNEs from countries with high real labour costs which set up or acquire subsidiaries in countries with lower real labour cost to supply labour intensive intermediate or final products. Frequently, host countries have set up free trade or export processing zones.

2. Market-seeking: firms invest abroad to profit from foreign markets. Various reasons can actually lead to follow supplies or customers that have built foreign production facilities; to adopt goods to local needs or tastes; to avoid the cost of serving a market from distance; to have a physical presence on the market in order to discourage potential competitors.

Market seeking investment is attracted by factors like host company's market size, per capita income and market growth. For firms, new markets provide to chance to stay competitive and grow within the industry as well as achieve scale and scope economies. Traditionally, market size and growth as FDI determinants related to national markets for manufacturing products sheltered from international competition by high tariffs or quotas that triggered "tariff-jumping" FDI (UNCTAD, 1998). A part from market size and trade restrictions, MNEs may be prompted to engage in market-seeking investment when their main suppliers or

customers have set up foreign producing facilities and in order to retain their business, they need to follow them overseas.

3. Efficiency-seeking: FDI that occurs when:
  - a) firms take advantage of differences in the availability and the costs of traditional factor endowments in different countries; or
  - b) they take advantage of the economies of scale and scope and of differences in consumer's tastes and supply capabilities.

The motivation of efficiency-seeking FDI is to rationalize the structure of established resource based or market seeking investment in such a way that the investing company can gain from the common governance of geographically dispersed activities. The intention of the efficiency seeking MNE is to take advantage of different factor endowments, cultures, institutional arrangements, economic systems and policies and market structures by concentrating production in a limited number of locations to supply multiple markets. In order for efficiency seeking foreign production to take place, cross-border markets must be both well developed and open, therefore, it often flourishes in regionally integrated markets.

However, it is worth noting that many of the larger MNEs are pursuing pluralistic objectives and most engage in FDI that combines the characteristics of each of the above categories. The motives for foreign production may also change as, for example, when a firm becomes an established and experienced foreign investor.

(OECD, 2002) developing countries, emerging economies and countries in transition have come increasingly to see FDI as a source of economic development and modernisation, income growth and employment. Countries have liberalised their FDI regimes and pursued other policies to attract investment. They have addressed the issue of how best to pursue domestic policies to maximise the benefits of foreign presence in the domestic economy. The study Foreign Direct Investment for Development attempts primarily to shed light on the second issue, by focusing on the overall effect of FDI on macroeconomic growth and other welfare-enhancing processes, and on the channels through which these benefits take effect.

The overall benefits of FDI for developing country economies are well documented. Given the appropriate host-country policies and a basic level of development, a preponderance of studies shows that FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps create a more competitive business environment and enhances enterprise development. All of these contribute to higher economic growth, which is the most potent tool for alleviating poverty in developing countries. Moreover, beyond the strictly economic benefits, FDI may help improve environmental and social conditions in the host country by, for

example, transferring “cleaner” technologies and leading to more socially responsible corporate policies.

(Feldstein, 2000) of course, countries often choose to forgo some of this revenue when they cut corporate tax rates in an attempt to attract FDI from other locations. For instance, the sharp decline in corporate tax revenues in some of the member countries of the Organization for Economic Cooperation and Development (OECD) may be the result of such competition. In principle, therefore, FDI should contribute to investment and growth in host countries through these various channels”.

(UNCTAD, 1999) Foreign direct investment (FDI) can play a key role in the economic growth and development process. The importance of FDI for development has dramatically increased in recent years. FDI is now considered to be an instrument through which economies are being integrated at the level of production into the world of globalization by bringing a package of assets, including, capital, technology, managerial capacities and skills, and access to foreign markets. It also stimulates technological capacity-building for production, innovation and entrepreneurship within the larger domestic economy through catalyzing backward and forward linkages. FDI is perceived to be superior to other types of capital inflows for several reasons:

- I. In contrast to foreign lenders and portfolio investors, foreign direct investors, typically, have a longer term perspective when engaging in a host country. Hence, FDI inflows are less volatile and easier to sustain at times of crisis.
- II. While debt inflows may finance consumption rather than investment in the host country, FDI is more likely to be used productively.
- III. FDI is expected to have relatively strong effects on economic growth, as FDI provides for more than just capital. FDI offers access to internationally available technologies and management know-how, and may render it easier to penetrate world markets.

## **2.2. Empirical Review**

(Stecher, 2005) he has tried to answer three questions with regard to a favorable investment climate: what will developing countries gain, what they have to provide and how can we support them. According to him, FDI not only supplies additional capital, which is necessary to speed productivity growth, but also imports best practice management expertise and technology that has already proven its excellence in other countries and other markets. Attracting FDI thus facilitates the structural changes required for growth and helps integrate countries into the international value chain. Countries such as Ireland, Malaysia, Singapore, and Thailand and now in a most impressive way, China have successfully followed the path of openness. They have

attracted FDI and substantially increased their income per capita within a short period of time.

According to him, to attract FDI the developing countries need to provide investors with openness and regional integration. Open borders and free entry and exist for goods, capital and businesses are relevant factors for the investment decisions of companies as these define market size and the long term allocation of their invested capital. These factors are especially important for the small countries. Developing countries should also improve their infrastructural facilities and along with this good governance is also very important. Last but not the least, there must be peace and security in the host country.

He has concluded that foreign companies can transfer management skills and technological knowledge that can easily spread among local business communities. Beyond any facilitating support and development aid from industrial countries, which is clearly necessary, the best help industrial countries can provide is to open up their markets to agricultural and manufactured goods from the developing world. But at the same time, it is the primary task of the government of any developing country to provide the framework of good governance.

(Hassan & Kim, 2014) the volume of FDI inflows into Nepal has not been satisfactory, averaging only about \$8 million per year. The inevitable consequence is that FDI is a significant mechanism for economic development of country like Nepal. However, a comparison with different Asian countries brings out the poor performance of Nepal in terms of attracting FDI inflows, and its influence on economic development also seems to be minimal. As Nepal has comparative advantages in sectors such as tourism and hydro power capability, country offers some potential sectors to attract FDI. A though Nepal has opened most sectors to FDI, there is requirement of consistent implementation of existing polices to meet up the global standard. There need to be overall improvement in a business climate to assure the investor-friendly environment.

Before 1990s, in the pre-liberalization period the FDI inflow in Nepal was almost negligible. In 1990, with the restoration of multiparty and parliamentary democracy, democratically elected government initiated the most of the market-oriented reforms. The investment climate was dramatically changed resulting distinctive acceleration in FDI inflow. The inflow was quite small averaging \$8.3 million per annum during 1996-2000, which reached highest at \$23 million in 1997. The reason explaining this significant increased FDI inflow in the 1990s was caused by the introduction of liberal trade policy. The import tariff rate was drastically cut up to 16 percent in 1992 from 111 percent in 1989. Moreover, the introduction of a duty drawback scheme and establishment of several bonded warehouses abridged the prior trade policy's anti-export bias.

World Investment Report (2012) FDI suffered a setback in the recent past due to global financial crisis, followed by the ongoing debt crisis. The report reveals that although global FDI flows exceeded the pre-crisis average in 2011, reaching US\$1.5 trillion, they still remained some 23 percent below their 2007 peak. Buoyed by the growth in FDI inflow into the largest economy of the region (India), South Asia witnessed a robust growth of 23 percent in 2011 compared to the previous year. However, Nepal remains one of the worst performers in the region despite robust growth of 125 percent attained in 2011 according to the UNCTAD data. In terms of the FDI potential index, Nepal ranks the lowest in the region, i.e., 175 out of 182 countries ranked globally.

(Hinds, 2005) he has mentioned some of the factors which are essential for attracting investment. Macroeconomic stability remains crucial in his opinion as the relative prices relevant for each investment must remain stable and predictable. Expatriate managers are expensive, so the availability of local managerial talent that can be trained to manage a proposed investment is a key element in the investment decision. Along with this telecommunication costs remain high in many developing countries largely because local monopolies are controlled by state owned companies, so it must be lowered down to attract investment.

(Athukorala & Sharma, 2006) the Nepalese Experience aims to contribute to the literature on the development role of foreign direct investment through an examination of the Nepalese experience during the period 1988-2001. The methodology they have adopted is descriptive in nature.

According to them, Nepal has made a promising start in implementing market oriented reform and promising FDI as a part of it, but it has to go a long way in reaping the benefits from the greater global integration through FDI. Foreign firms are relatively capital-intensive as compared with the local firms. These firms employ only about 0.6 percent of economically active workforce which is not impressive in a labor abundant country like Nepal where about 20 percent of the work force is unemployed or underemployed. This low level of employment intensity in foreign firms appears to be due rigidity in labor market and shortage of semi-skilled workforce. In the absence of basic pre-requisites (namely, efficient and reliable physical infrastructure and access to semi-skilled workforce) gains from foreign firms has been rather lopsided. Most of the foreign firms are located in the Kathmandu valley or in Terai belt while hilly and mountain regions have failed to attract such investment due to poor infrastructural facilities, despite liberalization in trade and investment climate. An obvious, but important, inference coming from their analysis is that trade liberalization and generous investment per se in the absence of basic pre-conditions cannot achieve anticipated developmental objectives. Nepal obviously has intrinsic disadvantages arising from its geography in attracting FDI. However, comparative international experience suggests that her lackluster record as a host to foreign investors cannot be explained in terms of

geography alone. The overall investment climate also seems to matter. The provision of required supportive services, political stability, policy certainty and a flexible administrative mechanism have an equally and perhaps even more important role to play.

(Sapkota, 2002) in 1974, foreign investment was allowed from 51 percent to 100 percent in the basic industries like cement, fertilizer, steel and consumer basic goods like dairy, pharmaceuticals, paper textiles etc. However, the preference in medium scale industries was given to national investors, while in large scale industries; there was a provision to treat both national and foreign investors equally.

Though, the government introduced the industrial enterprise act to attract FDI, there was not any significant flow of FDI in Nepal through 1974 to 1981. The causes behind it were the restrictive laws and policies, which the foreign investors did not find investment friendly. During these periods there was shortage of energy, which is very essential to attract FDI. Besides this, Nepal had very poor infrastructural facilities, like, roads, communication etc.

(Timilsina & Mahato, 2000) in 1981, Government of Nepal had first legislated the foreign investment law under the Foreign Investment and Technology Transfer Act. Through this act, the provision for non-nationalization of industries was guaranteed and it had also ensured the equal and the same treatment for both national and foreign investors, resembling to standard treatment norms. Foreign investors were permitted to have majority of shares in medium scale industries and to have 100 percent investments in large-scale industries with more than Rs 10 million investments in fixed assets.

After the introduction of this law, FDI has increased to some extent, but the number was very insignificant. During 1981 to 1987 the total number of industries under manufacturing sector in which FDI involved was only 48. The total fixed capital contributed by FDI during these periods was Rs.1123.2 million. Similarly, at the same period of time total 26 industries were recorded in the service, tourism and other sectors in which FDI was involved. The amount of total fixed capital invested by FDI in these industries was Rs.427.8 million. But in the subsequent years of 1980, Nepalese economy experienced various macro economic crises, viz, increasing negative balance of payments, sluggish in export trade growth, high rate of inflation, growth of debt burden, budget deficit, high level of poverty and unemployment. Nepal had no alternative but to implement Structural Adjustment Program (SAP). In the SAP, Nepal could get financial assistance from World Bank and IMF. In 1980s, government of Nepal also liberalized the financial sector for joint venture and during this period Nepal-Arab Bank (1984 A.D.), Nepal Grindlays Bank (1987 A.D.) and Nepal-Indo Suez Bank (1985 A.D.) were established.

(Chitrakar, 1986) found that the flow of foreign investment in manufacturing sector was not so enough in mineral based sector was negligible. The main problem was due to the non- implementation of policies and the act made by HMG/N, Bureaucratic Harassment, hard to get incentives according to the provision made by government etc. The impact of solitary Ministerial Meeting and Investment Promotion Meeting held for promoting foreign investment in Nepal has become less effective that fail to motivate foreign investors towards Nepal.

The research found that national attention and attempt to the policy reforms to attract FDI is not sufficient to increase the inflow of FDI in the country like Nepal. The collective efforts at the regional and international level are required for the growth of FDI inflow. The study has also mentioned some problems in attracting FDI like lack of predictable and transparent policy, absence of monitoring mechanism to accurately monitor the flow of FDI, political instability, and so on.

(Pant & Sigdel, 2004) they found that it has become very competitive to attract FDI for a country like Nepal. Being a small land locked country; Nepal has to make extra efforts to counter balance the negative impact by implementing several policy measures. It has to offer more generous and attractive incentives to potential investors partly to demonstrate the fact that it has to compete with other parts of the world in attracting FDI from the same sources and in similar industries. In Nepal, there is an absence of a monitoring mechanism to accurately monitor the flow of FDI. The Board of Investment, a kind of institutional arrangement, in Sri Lanka and Bangladesh are quite sound and effective. In this respect, Nepal could learn from the experiences of these countries. Nepal has formed a Board of Investment (BOI) under the chairmanship of the Prime Minister in December, 2001. Yet, the BOI has not been carrying its due functions since its establishment. The bureaucratic rules and processes in Nepal are complicated and time consuming. The one window system has not been effectively utilized for providing proper follow up of all procedures and clearances that proposals involving foreign investments demand and also for providing stated facilities. They have recommended that to attract FDI, first of all there should be peace and security in the country. The environment of investment, in the country, is very crucial to foreign investors in making their decision to invest given that they need to stay in Nepal with their families. A poor and scary situation puts prospective investors on the sidelines. Secondly, to attract FDI Nepal should identify potential countries. The country can target FDI from South-east Asian countries such as Thailand, Malaysia, Korea, Indonesia, Singapore although a nominal amount of FDI do flow from some of these countries. Moreover, Australia and Canada have provided duty free and quota-free access to all products from the LDCs including Nepal. These two countries could be two possible FDI avenues in the long run.

Thirdly, Nepal should improve her poor physical infrastructure. At the same time there is paucity of skilled and educated labor force. Vocational and technical training

programmes are poorly developed in Nepal. Hence, trained labor is a critical input while frequent labor strikes discourage investment. The country needs to ensure the supply of quality human resources to the industry, and give emphasis in improving productivity. Nepal should also learn some lessons from other countries. China is a vast potential market for foreign investors. The Chinese authorities are also aware of crucial role of technology and export-oriented investment in modernizing their economy. All foreign-owned enterprises in China are governed by a uniform tax system. A host of incentives have been provided to foreign investors. Investment climate should be developed first for smaller, domestic firms. If it improves for them, it will, in most likelihood, improve for foreign firms. Political stability in China has been strong, and this stable environment is definitely one overriding factor that has attracted investment, both domestic and foreign. In this context, Nepal could learn from the Chinese experience for formulating sound FDI policies. Lastly there must be dialogue between government and foreign investors. With the promotion of interaction between the government and the foreign investors, monitoring the activities of foreign investors should be undertaken on an annual basis that would provide important inputs on the issues to be addressed by the government or the investors.

(Timilsina & Mahato, 2000) they found that the foreign direct investment is a means of industrialization which would lead to diversify the economy for a durable, social, psychological and institutional framework. To quote them, foreign investment is considered important for the industrialization of Nepal. Some basic features associated with the direct foreign investment are that it will attract capital, technology, and expertise. Furthermore it will help to share risks, exploit resources presently and provide access to export market, all these factors are either in short supply or absent in Nepal.

Nepal where industrial development is considered necessary for the purpose of achieving various economic goals like higher rate of growth, fulfillment of the basic needs, creation of more employment opportunities etc. Further they opine that industrialization is to overcome the limited carrying capacity of agricultural sector in terms of employment, poverty alleviation and overall economic development. For this, some basic requirements are capital, appropriate technology, skilled human resources, market, infrastructure and favorable administrative and legal environment that could be fulfilled through the inflow of foreign investment.

They have focused the study basically on the historical development, importance and structure of FDI in Nepal together with the analysis of legal provision and incentives and facilities offered through it. The study also touches the problems of foreign investment in Nepal. However, the analysis on this topic is less detailed than the others they have observed.

(Dangal, 2011) he studied the need, nature and extent of FDI in Nepal, observed the laws and policies and other general determinants of FDI including motivating factors affecting decision to invest in Nepal, problems and prospects of FDI in Nepal. His study supported by both primary and secondary sources revealed foreign investment scenario in Nepal has been dismal. Despite it's free market reforms and incentives, Nepal has attracted only a small portion of FDI flowing to south Asia. The analysis of flow of FDI in the country reveals that it commenced to flow remarkably into Nepal from the time liberal policies in the matter of getting private domestic or foreign investors involved into the economic activities of a country.

(Bista, 2005) he has mentioned some conditions of FDI in Nepal and they are;

- I. Most investments in Nepal are small and most investors are individual than companies as such. Most of those consulted by UNCTAD were however corporate investors. Some 40 percent of the FDI in Nepal are Indian. This is of course, to be expected, given the open border between India and Nepal and the historic links between the two countries.
- II. That the insecurity created by the Maoist insurgency is not a greater concern to the private sector than it appears, is a further fact worth noting. The past trends show that the larger volume of FDI has been concentrated to Kathmandu valley which has been relatively unaffected by the insurgency.

It suggests to the investors that Nepal has good and normal business environment. Concerning security, the ground situation to the FDI is not affected. So, the foreign investor can invest in the urban areas of Nepal at present situation like as normal situation. It will be positive to attract FDI in Nepal at the critical situation.

(Ghimire, 2006) he has analyzed the nature and extent, policies adopted, incentives given for attracting foreign investment, problems of promoting foreign investment in Nepal and the motivational factors of foreign investor's decision to invest in Nepal. The methodology adopted in his study is both descriptive and exploratory in nature. His research objectives are:

- I. To examine and analyze the nature and extent of Foreign Investment in Nepal;
- II. To analyze the policies adopted and incentives given for attracting foreign investment in Nepal;
- III. To analyze the problems of promoting foreign investment in Nepal; and
- IV. To analyze the motivational factors of foreign investor's decision to invest in Nepal.

Since the study is pioneer of its kind in Nepal, the study is basically an exploratory one. The analytical dimension has been given where possible. The information necessary for

the study is collected both from primary as well as secondary sources. In his research work he has reached at the conclusion that there are certain motives of foreign investors investing in Nepal. The survey conducted in the study shows that the most important motivating factor for investing in Nepal is access to market by way of tariff and non-tariff restrictions imposed or expected by the government on goods planned for production. Other motivating factors affecting foreign investors' decision to invest in Nepal include the expansion program of the investing firm, locally available raw materials and low production cost. He has found that the flow of foreign investment is negligible despite the various facilities and incentives offered in Nepal. The main problems of foreign investment promotion in Nepal are the long procedures to initiate the business, non implementation of preferential treatment guaranteed by the law and underdeveloped infrastructure. His research work accepts the foreign private investment as an important vehicle for the diversification and transformation of the existing most backward agrarian Nepalese economic structure into the advanced modern economic country.

The government is suggested to increase the necessary infrastructural facilities, simplify the procedures of initiating business and reduce the bureaucratic harassment to the minimum level in order to promote foreign investment in the country. The office of foreign investment promotion in Nepal should try to increase its promotional drive and communicate with developed as well as less developed market economies about the facilities of foreign investment in Nepal.

### **2.3. Policy Review**

FDI has gained much attention as an effective cure to solve the economic problems of a host country. Developing countries are always in shortage of domestic investment and suffering from high unemployment rate, unhinged development of local areas, trade deficit and so on. To overcome these serious economic problems a developing country needs to welcome foreign investments from MNEs. In order to become a suitable destination for foreign investors and to maximize the positive FDI impact, a host country's government must articulate and implement best FDI policies and strategies.

Looking back the history of Nepal before 1990s, so called preliberalization period, the investment during this period was more preventive and restrictive. It was very tough to acquire a government license before undertaking any production and business activities. There was no FDI inflow before 1980. Nepal accepted the fact and the importance of FDI for the nation's economic development. So, Nepal has started its determination to attract foreign investment since early 1980s. To reach the international standards and warrant both domestic and foreign investment, the Government embraced several liberal policies: the Industrial Policy, 1992; the Foreign Exchange (Regulation) Act of 1962; Industrial Enterprises Act, 1992 (first amendment, 1997), Foreign Investment and One-window Policy in 1992 allowing and accepting the investment forms for foreign shares up to 100

percent in business areas were not on its "negative list," starts currency repatriation guidelines, and frameworks visa arrangements, negotiation guidelines, and a special "one window committee" for foreign investors; the Foreign Investment and Technology Transfer Act (FITTA), 1992, which was revised in 1996, 2000, 2002, and 2010 removed the minimum investment requirement, while opening legal, management consulting, accounting, and engineering services to foreign investment, with a 51 percent ownership limit and also explained rules concerning to business and resident visas.

### **2.3.1 Foreign Investment and Technology Act, 1981**

In 1974, foreign investment was permitted from 51 percent to 100 percent in basic industries such as cement, fertilizer, steel or basic consumer goods such as dairy, pharmaceutical, paper, textiles, but there prevailed preferences for Nepalese investors to foreign investors in medium scale industries with the investment of Rs. 1 million to Rs. 5 million. But in large-scale industries, both types of investors were equally treated. Though there were a few instances of foreign investment and technology transfer prior to 1981, the first official acknowledgement of the importance of foreign investment was recognized in the Sixth Plan (1980/81-1984/85), where it was delineated that foreign investment and technology was required primarily in large scale industries and mineral-based industries. Consequently, the Foreign Investment and Technology Act 1981 was enunciated. The salient features of the Act were: a) industrial units set up under the Act would not be nationalized; and b) industrial units set up under the Act would receive the same facility, concession and protection as provided by the Industrial Enterprise Act, 1982. Foreign investors were permitted to have majority of shares in medium scale industries but were permitted 100 percent in large-scale industries, with more than Rs. 10 million investment in fixed assets.

Various facilities and provisions were included in the Act. For instance, production-oriented industries with 25-50 percent value-added would be granted full income tax exemption for five years. Analogously, tourism-based industries were granted full income tax exemption for a minimum of 7 years and the industries set up in underdeveloped areas were exempted from excise duty for a minimum of 5 years. Moreover, convertible foreign currency facilities were to be provided to joint-venture industries for importing machineries, equipment and tools, spare parts and components, raw materials as well for technical consultancy and management fee. Still, the Act restricted any foreign investment and transfer of technology to small and cottage industries to 'keep' the sector solely for Nepalese entrepreneurs. Still, the pre-1990 era could be characterized as a closed economy. There was hardly any legislative framework for the entry of foreign investment, import tariffs were high, customs procedures were complex, enough to discourage potential foreign investors.

### **2.3.2 One Window Committee and Industrial Promotion Board**

In Nepal, there was a provision to establish the One Window Service (OWS) as per the Industrial Enterprises Act, 1992. The aim of the OWS was to provide all services needed by foreign investors under one roof. Specifically, the policy spelled out two types of services to be provided by the OWS: a) permission, facilities, and other administrative services under the Foreign and Technology Transfer Act, and b) other infrastructural facilities (such as registration, land, electricity, telecommunication, water) and other services as required by the investors. It has been acknowledged in the Nepalese context that the One Window Committee has not fully addressed the genuine needs of the investors adequately. As per the Industrial Enterprises Act, 1992, an Industrial Promotion Board was also formed under the chairmanship of the Minister of Industries. The primary objectives of the Board are a) to provide necessary co-operation in developing and implementing policies, laws and regulations relating to industrial development of the country; b) to provide guidelines in meeting the aims of liberal, open and competitive economic policies followed by the country in order to make the industrial sector competitive; c) to coordinate between the policy level and the implementation level of the industrial policy; and d) to suggest to the Government for including any other industry in the classification of industries. An evaluation of the functions, duties and powers of the Industrial Promotion Board depicts that they are confined to a large extent to policy.

### **2.3.3 Foreign Investment and Technology Transfer Act, 1992**

Foreign Investment and Technology Transfer Act, 1992 was enacted to attract technology transfer and foreign investment.

As per the Act, Foreign Investment means investment in share, reinvestment of the earnings derived from the investments and investment made in the form of loan and loan facilities by a foreign investor in any industry.

A person desiring to avail the foreign investment shall be required to make an application to the Department of Industries in the prescribed form along with the prescribed particulars for obtaining permission in that behalf.

The Act provides for the various facilities and incentives to the industries with foreign investments, like repatriation of various specified incomes, waiver of income taxes, priorities in supply of electricity, water supply and communication facilities.

The Act was amended in 1996 to provide 100% foreign equity participation in all industrial enterprises except for cottage and other few types of industry in order to reserve them for domestic investment.

### **2.3.4 Industrial Policy, 2011**

The Industrial Policy, 1993 was framed with the objective of accelerating industrial development. However, no significant progress can be made even after the promulgation of this policy. Keeping the shortcomings of this policy, new Industrial Policy, 2013 was introduced.

The main objectives of this policy are to increase export of industrial products along with the growth in national income and employment through enhancement of quality and competitive industrial products and productivity, to increase contribution of industrial sector in the balanced national and regional development by mobilizing local resources, raw materials, skills and means.

The main problems of industrial development in Nepal are political instability, industrial insecurity, unfavourable labour relation, minimal availability of energy, weak industrial infrastructures, lack of competent human resources, lack of capacity to adopt new technology, low productivity, lack of diversification of exportable items and weak supply management and so on.

In addition to above, the challenges such as geographical location of the country, structure of the topography, worldwide rapidly increasing competitive atmosphere, economic liberalization, impact of globalization, increasing and changing use of information technology, environmental challenges have to be taken into account and industrial and commercial processes have to be made simple, easy, transparent and scientific.

The objective of the industrial policy is to create strong basis for investment having developed production of human resources and managerial capacity required for industrial development there by establish Nepal as an attractive place for investment in the South Asian region and in the world. To fulfill the objective the non-resident Nepali shall be encouraged to invest in Nepal for protection, diversification and promotion of foreign investment and economic diplomacy units at Nepalese Embassies and missions located in the countries making more foreign direct investment shall be strengthened for promotion of industrial development. The strategy to adopt this objective is to have necessary institutional arrangement, policy reform and provisions for incentives shall be made available to attract native and foreign capital in construction of hydropower projects, mining industries, tourism and physical infrastructure.

### **2.3.5 FDI under Thirteenth Plan (F/Y 2013/14- 2015/16)**

Nepal is a country blessed with the abundant water resources, touristic opportunities, biodiversity and cultural heritage but it needs foreign investment to develop and expand the infrastructure sector, introduce modern technology, cultivate managerial and technical skills, increase the presence of Nepali goods and services in the international markets through industrial development , reduce the trade deficit, attain a high economic growth rate and reduce poverty by creating employment opportunities.

The objectives regarding the foreign direct investment were to foreign capital investment and to link foreign investment with local resources.

### **2.3.6 FDI under Fourteenth Plan (F/Y 2016/17 - 2018/19)**

To narrow the gap between savings and investments, advanced technology, import of management technical skills to increase produce and productivity, to produce the goods and services that can be produced in the country to meet the domestic demands but which have been imported, we need foreign direct investment. So far the country has not utilized the huge potential to attract the foreign investment in industry, service and tourism.

The major challenges to attract the FDI are high business operation and transpiration costs, shortage of electricity and inadequate infrastructure, unavailability of skilled manpower and absence of investment friendly policies.

The political stability after the promulgation of the new Constitution, richness in natural resources and biodiversity, cultural diversity, low wages, presence of Nepali workforce in foreign countries and their skills, regional and international treaty for the easy access to the international market, high economic growth in the neighboring countries and increasing number of families with middle-class income are the opportunities to attract the foreign investment in Nepal.

# **CHAPTER THREE**

## **METHODOLOGY OF THE STUDY**

### **3.1 Source of Data**

This study has been based on secondary data. Therefore, in order to gather the information relevant to research an objective, secondary studies has been made.

### **3.2 Collection of the Secondary Data**

The secondary data have been collected from many sources such as Department of Industry, Foreign Investment Promotion Section of Ministry of Industry, Central Library of T.U., Economic Survey, Ministry of Energy, Ministry of Culture, Tourism and Civil Aviation, Nepal Telecommunication Authority, Ministry of Physical Infrastructure and Transport, CBS, NRB, MOF, NPC etc. Secondary data thus collected from different offices and departments have been further processed and analyzed to find out the past trend and structure of FDI in Nepal, Policy and prospects of FDI in Nepal.

### **3.3 Data Analysis**

Data has been presented in graph, table, figure, etc. within the log frame of the study. After completion of data presentation, descriptive and the statistical methods of analysis have been selected and applied to get the expected outcome.

### **3.4 Time Period of the Study**

This study has been mainly based on secondary data for a period of 27 years from FY 1989/90 to FY 2015/16.

### **3.5 Definition of Key Terms**

The key terms have been defined in order to avoid misunderstanding regarding variables.

**Investment:** New capital additions to a firm's capital stock. Although capital is measured at a given point in time (a stock), investment is measured over a period of time (a flow). The flow of investment increases the capital stock.

**Capital:** Goods produced by the economic system that are used as inputs to produce other goods and services in the future.

**Capital Market:** The Input/factor market in which households supply their savings, for interest or for claims to future profits, to firms that demand funds to buy capital goods.

**Foreign Direct Investment (FDI):** Overseas investments by private multinational corporations.

**Multinational Corporation (MNC):** An international or transnational corporation with headquarters in one country but branch offices in a wide range of both developed and developing countries. Examples include general motors, coca-cola, firestone, Philips, Exxon, Sony, etc. Multinational corporations based on industrial countries are taken as the principal source of FDI.

**Developing Countries:** The countries of Asia, Africa, the middle East, Latin America and East Europe and the Former Soviet Union which are mainly characterized by low levels of living, high rates of population growth, low income per capita, and general economic and technological dependence on developed countries.

**Economic Growth:** The steady process by which the productive capacity of the economy is increased over time to bring about rising levels of national output and income.

**Privatization:** Selling public assets (Corporations) to individuals or private business interests.

**Private Foreign Investment:** The investment of private foreign funds in the economy of a developing nation, usually by multinational corporations.

**Portfolio Investment:** Financial investments by private individuals, corporation, pension funds, and mutual funds in stocks, bonds, certificates of deposit, and notes issued by private companies and the public agencies of LDCs.

**Savings:** The portion of disposable income not spent on consumption by households plus profits retained by firms.

**World Trade Organization (WTO):** Geneva-based watchdog and enforcer of 1995 Uruguay Round agreement. It Replaced GATT.

**World Bank:** An international financial institution owned by its 181 member countries and based in Washington D.C.

**United Nations Conference on Trade and Development (UNCTAD):** A body of the United Nations whose primary objective is to promote international trade and commerce with a principal focus on trade and balance of payments problems of developing nations.

**International Monetary Fund (IMF):** An autonomous international financial institution that originated in the Bretton Woods conference of 1994. Its main purpose is to regulate the international monetary exchange system, which also stems from the conference but has since been modified.

**Globalization:** The increasing integration of national economies into expanding international markets.

**Gross investment:** The total value of all newly produced capital goods (Plant, equipment, housing, and inventory) produced in a given period.

**Capital Formation:** Increasing the stock of real capital, which obviously helps in raising the level of production of goods and services.

**Foreign Aid:** Foreign aid refers to the international transfer made at concessional terms rather than at market rates for promoting economic development. The transfer includes both grants and loans.

## **CHAPTER FOUR**

### **TREND AND STRUCTURE OF FOREIGN DIRECT INVESTMENT IN NEPAL**

#### **4.1 Trend of Foreign Direct Investment in Nepal**

The volume of FDI inflows to Nepal has historically been very low. In the current situation of Nepal FDI has become a hope to Nepal for economic development. Today, almost all developing countries are trying to attract foreign direct investment with objectives of getting access to foreign capital, technology and market. Similarly, Nepal is no different than other countries. Nepal started its effort to attract foreign investment since early 1980s during the sixth plan (1980-1985). The industrial policy of 1981 has made a separate provision relating to foreign investment. In order to make legal provision for a promotion and for the regulation of the foreign investment and technology a separate act entitled foreign Investment and Technology Act has been introduced in 1992. FDI trend seems to be more fluctuating during the last 27 years. As political stability and peace are the sine quo non for attracting greater volume of FDI in Nepal, Nepalese economy has suffered from serious structural constraints accompanied by unprecedented political turmoil since many years. Present scenario reveals that Nepal has not been able to attract desirable size of FDI inflow within the country.

During 1980-1989, FDI flows to Nepal were minimal or even negative, with an annual average of Rs.45 million. There was a distinct acceleration during the 1990s, although total flows remained small: averaging Rs.18 billion per annum during 1990-2000. One factor explaining the increased FDI in the 1990s is Nepal's more liberal trade policy. Available data for FDI reflects that 3674 foreign investment projects were approved in Nepal comprising all categories of industries, worth a total of Rs. 358642.81 million. The total fixed capital is estimated to be Rs. 307471.66 million, while the total foreign direct investment (FDI) marked Rs. 197632.99 million as the end of 2015/2016. FDI has provided employment to 217551 people.

#### **4.2 Year Wise Flow of Foreign Direct Investment in Nepal**

The year wise flow of Foreign Direct Investment (FDI) in Nepal from the year 1989/90 shown in the table 4.1. During the period 1989/90 to 2015/16, the number of foreign investment projects in Nepal marked 3611. The project cost and fixed cost were Rs. 353490.02 and 303164.06 million and total foreign investment was Rs197146.23 million. FDI was Rs 398.51 million in 1989/90, which was reached to Rs 15139.63 million in 2015/16. The contribution of FDI was as high as Rs 67480.04 million in 2014/15 and it decreased to Rs 15139.63 million in 2015/16. In the 2014/15 there is highly increased in

FDI compare to other years because that year government approved 5 large scale of Hydropower project.

**Table 4.1: Summary of Foreign Investment Project in Nepal**

Rs. In Million

| Fiscal Year | No of Industry | % change in Industry | Total Project Cost | Total Fixed Cost | Foreign Investment | % change in FDI | share of FDI in Project cost | Employment |
|-------------|----------------|----------------------|--------------------|------------------|--------------------|-----------------|------------------------------|------------|
| 1989/90     | 30             |                      | 2438.19            | 2139.6           | 398.51             |                 | 16.34                        | 9515       |
| 1990/91     | 23             | -23.33               | 863.56             | 690.74           | 406.28             | 1.95            | 47.05                        | 2974       |
| 1991/92     | 38             | 65.22                | 3508.17            | 2902.1           | 597.84             | 47.15           | 17.04                        | 5615       |
| 1992/93     | 64             | 68.42                | 17886.22           | 16210.81         | 3083.67            | 415.80          | 17.24                        | 13873      |
| 1993/94     | 38             | -40.63               | 3733.23            | 3175.66          | 1378.76            | -55.29          | 36.93                        | 4734       |
| 1994/95     | 19             | -50.00               | 1627.28            | 1247.85          | 477.59             | -65.36          | 29.35                        | 2386       |
| 1995/96     | 47             | 147.37               | 10047.47           | 9398.54          | 2219.86            | 364.80          | 22.09                        | 8032       |
| 1996/97     | 77             | 63.83                | 8559.25            | 6692.15          | 2395.54            | 7.91            | 27.99                        | 9347       |
| 1997/98     | 77             | 0.00                 | 5572.6             | 5145.54          | 2000.28            | -16.50          | 35.89                        | 4336       |
| 1998/99     | 50             | -35.06               | 5324.42            | 4380.17          | 1666.42            | -16.69          | 31.30                        | 2146       |
| 1999/2000   | 71             | 42.00                | 2669.09            | 1910.24          | 1417.61            | -14.93          | 53.11                        | 4703       |
| 2000/01     | 96             | 35.21                | 7917.62            | 6122.49          | 3002.56            | 111.80          | 37.92                        | 6880       |
| 2001/02     | 77             | -19.79               | 3318.53            | 1559.59          | 1209.65            | -59.71          | 36.45                        | 3731       |
| 2002/03     | 74             | -3.90                | 4921.82            | 3608.25          | 1793.77            | 48.29           | 36.45                        | 3572       |
| 2003/04     | 78             | 5.41                 | 4323.74            | 3775.86          | 2764.8             | 54.13           | 63.94                        | 2154       |
| 2004/05     | 63             | -19.23               | 1796.1             | 1149.49          | 1635.77            | -40.84          | 91.07                        | 5559       |
| 2005/06     | 116            | 84.13                | 4121.08            | 3296.95          | 2606.31            | 59.33           | 63.24                        | 7358       |
| 2006/07     | 188            | 62.07                | 3425.57            | 2650.56          | 3185.98            | 22.24           | 93.01                        | 7389       |
| 2007/08     | 213            | 13.30                | 20406.38           | 16897.97         | 9812.6             | 207.99          | 48.09                        | 10709      |
| 2008/09     | 231            | 8.45                 | 9417.89            | 7530.02          | 6255.09            | -36.25          | 66.42                        | 11108      |
| 2009/10     | 171            | -25.97               | 13953.78           | 14987.98         | 9100               | 45.48           | 65.22                        | 7848       |
| 2010/11     | 210            | 22.81                | 11252.69           | 9377.26          | 10053.21           | 10.47           | 89.34                        | 10902      |
| 2011/12     | 226            | 7.62                 | 11909.82           | 10736.33         | 7138.31            | -28.99          | 59.94                        | 9035       |
| 2012/13     | 317            | 40.27                | 51990.78           | 41046.35         | 19818.73           | 177.64          | 38.12                        | 16569      |
| 2013/14     | 305            | -3.79                | 40712.27           | 35026.93         | 20107.42           | 1.46            | 49.39                        | 11732      |
| 2014/15     | 371            | 21.64                | 81395.6            | 77459.09         | 67480.04           | 235.60          | 82.90                        | 13208      |
| 2015/16     | 341            | -8.09                | 20396.69           | 14045.54         | 15139.63           | -77.56          | 74.23                        | 11426      |
| Total       | 3611           |                      | 353489.84          | 303164.06        | 197146.23          |                 | 55.77                        | 206841     |

Source: Department of Industry, 2016

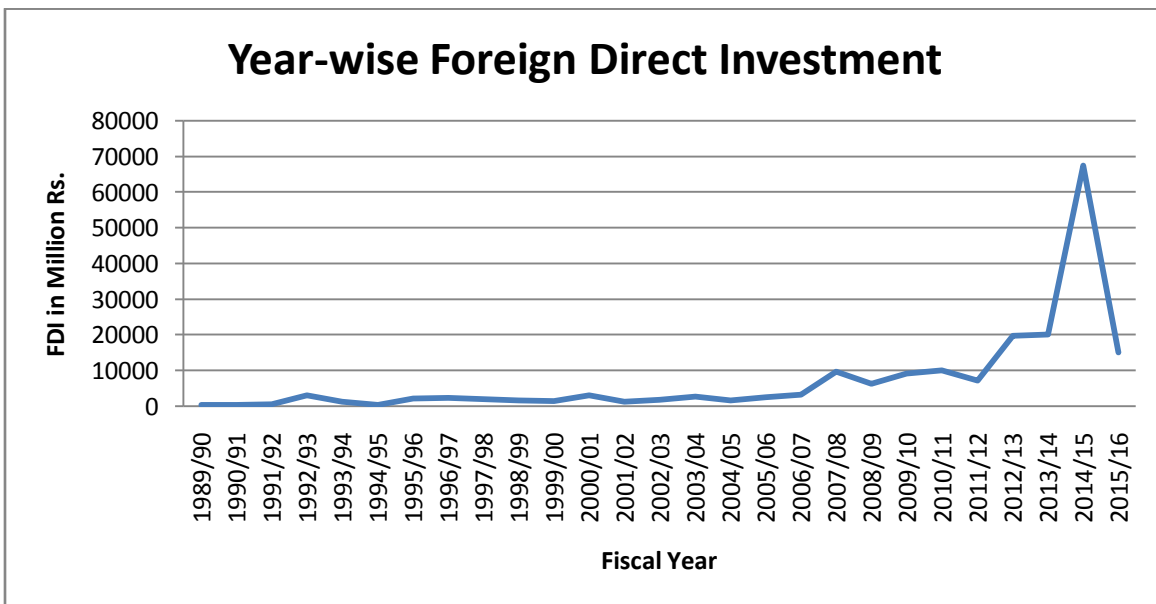
From the table it is shows that for the period the average number of industry that attracted FDI is 133. Similarly, average project cost, average fixed cost, foreign investment and

employment are 133092.22 million, 11228.3 million, 7301.71 million and 7660 people respectively. The average project cost on the project is found 97.89 million. Similarly, average fixed cost, average foreign investment and employment are 83.95 million, 54.59 million and 57.28 people respectively.

The table 4.1 manifests that during the year 1990 total number of industry registered were 30 with total foreign investment amount 398.51 million after that registration process increased it reached to 341 number of industry with 15139.63 million foreign amount in 2016. In the study period the average growth rate of industry is found 17.61 percent. The share of foreign investment in the project is found 16.34 percent in the beginning and at the end it reached 74.23 percent it shows the share of foreign investment on the project cost increased by nearly five times.

Thus, from the table 4.1 it shows that the flow of FDI projects in the beginning of 1990s was encouraging. The main cause behind this was the incorporation of various facilities in the Foreign Investment and Technology Transfer Act (FITTA-92), and Industrial Enterprise Act (IEA-92), which were not in existence prior to 1992. In these acts various facilities like, repatriation facilities, visa facilities, various tax incentives, convertible foreign exchange facilities, land facilities were offered to foreign investors and hence foreign investors have shown interest in investing in Nepal in the early 1990s. And after in 2012 the government made the minimum amount of FDI has increased to Rs 5 million for each investor from USD 20000 (Approximately NPR 1.6 million) that policy also lead to increase FDI flow in Nepal

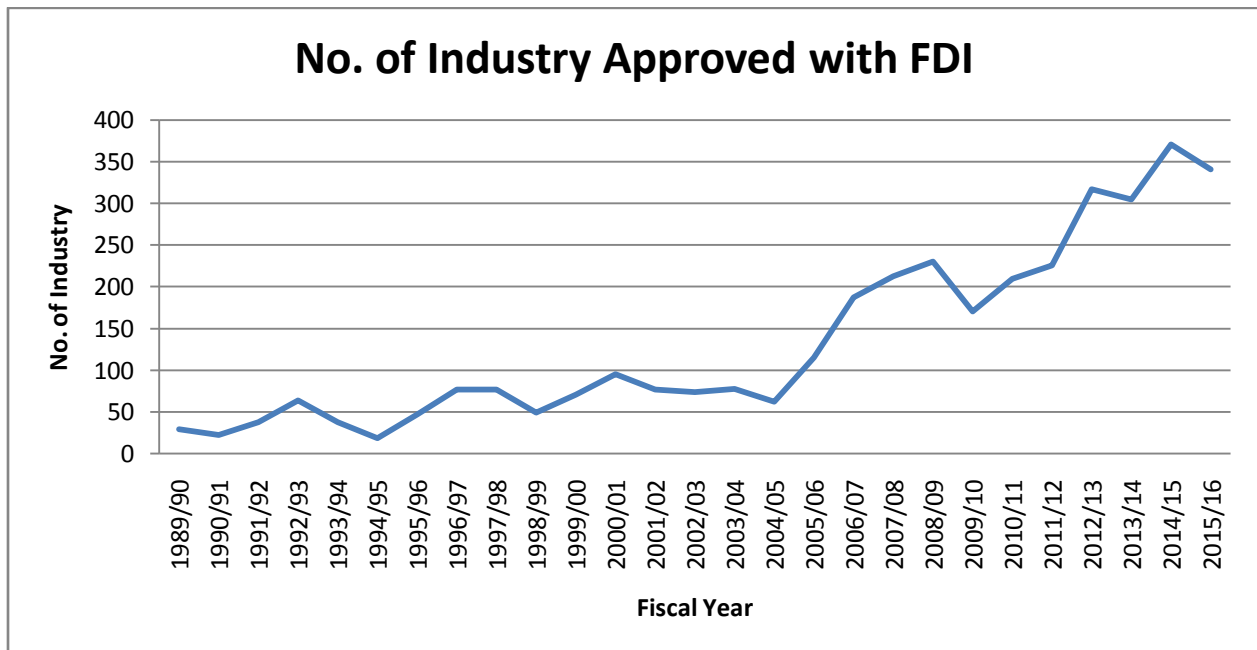
**Figure No 4.1: Year Wise Foreign Investment**



Source: Department of Industry, 2016

During the study period trend of FDI were found erratic and jumping. The government of Nepal and Maoists signed a comprehensive peace agreement in 2006 after this agreement foreign direct investment and number of project found significantly increased. The FDI trend is erratic the main causes of which were the inefficient enforcement of laws and policies and political instability in the country. Thus, for smooth flow of FDI, the environment of the country must be made favorable. There must be security of investment and the laws and policies should be enforced efficiently.

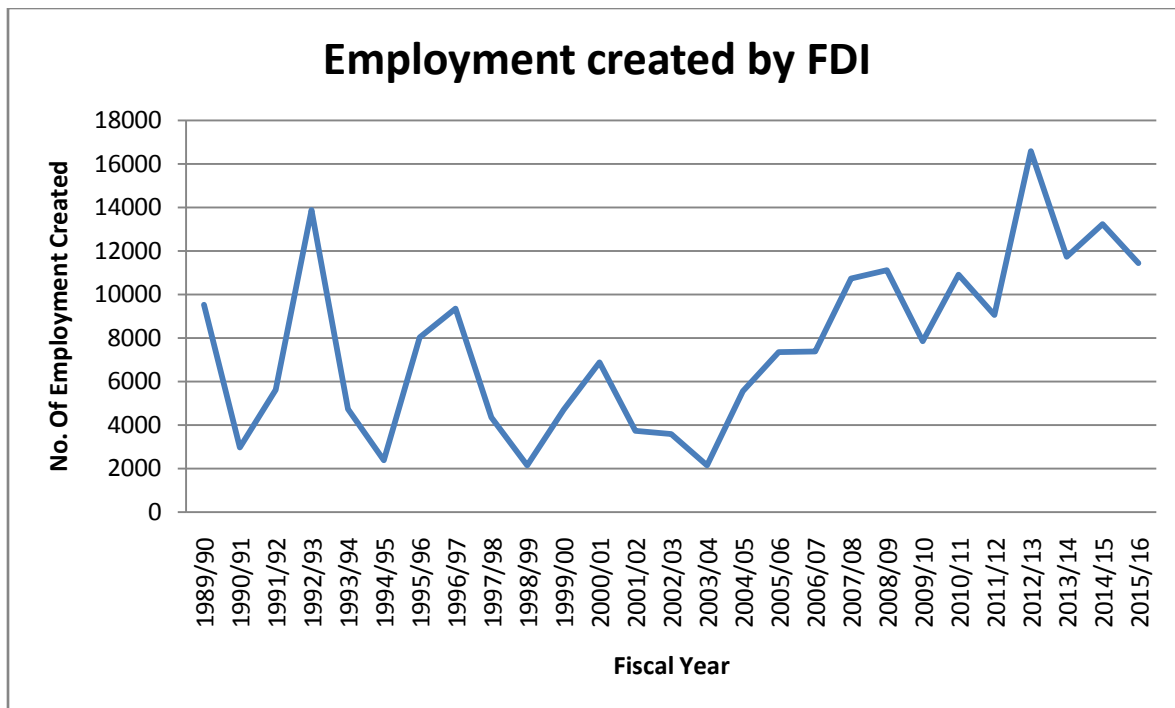
**Figure No 4.2: Number of Industry Approved**



Source: Department of Industry, 2016

Figure no. 4.1 and 4.2 shows the trend of industries approved and FDI, it shows that there is no constant trend. Nepal can attract more industries and FDI in coming days if it focuses to improve the determining factors like private property rights, infrastructure, regulation, tax rates, corruption transparency etc.

**Figure 4.3: Number of Employment**



Source: Department of Industry, 2016

In average no of industries and FDI is increasing year by year but the no of employment people are decreasing compare to number of industries and FDI. The reasons behind it may be lack of skilled manpower and brain drain etc. Most of the companies which are invested by the foreign investors, are hiring foreign workers. In such scenario Nepal has to focus in technical and practical education, develop the policies to retain skilled and educated manpower to reduce the rate of brain drain as well as to focus in establishing the stable business environment.

### **4.3 Category-Wise Flow of Foreign Direct Investment**

Categorically, there are seven sectors which include agro and forestry, construction, energy based, manufacturing, mineral, service and tourism. The amount of foreign investment and number of project up to F/Y 2015/16 in each industry are shown in the table 4.2

**Table 4.2: Number of Industries Approved for Foreign Investment by Category (up to FY 2015/16)**

| Category          | No of Project | Total Project cost | Total Fixed Cost | Rs. In million      |              |            |
|-------------------|---------------|--------------------|------------------|---------------------|--------------|------------|
|                   |               |                    |                  | Total amount of FDI | Share in FDI | Employment |
| Agro and Forestry | 227           | 5455.62            | 4247.66          | 4021.08             | 2.03         | 8733       |
| Construction      | 45            | 3825.34            | 2856.1           | 2972.81             | 1.5          | 3151       |
| Energy Based      | 75            | 153564.68          | 150102.15        | 87572.36            | 44.31        | 10917      |
| Manufacturing     | 981           | 91718.76           | 72692.11         | 37662.27            | 19.05        | 92475      |
| Mineral           | 65            | 6508.12            | 5160.1           | 4129.35             | 2.09         | 8030       |
| Service           | 1223          | 61805.41           | 39450.95         | 40572.79            | 20.53        | 53733      |
| Tourism           | 1059          | 35775.75           | 32972.37         | 20718.42            | 10.84        | 40515      |
| Total             | 3675          | 358653.69          | 307972.37        | 197649.08           |              | 217554     |

Source: Department of industry, 2016

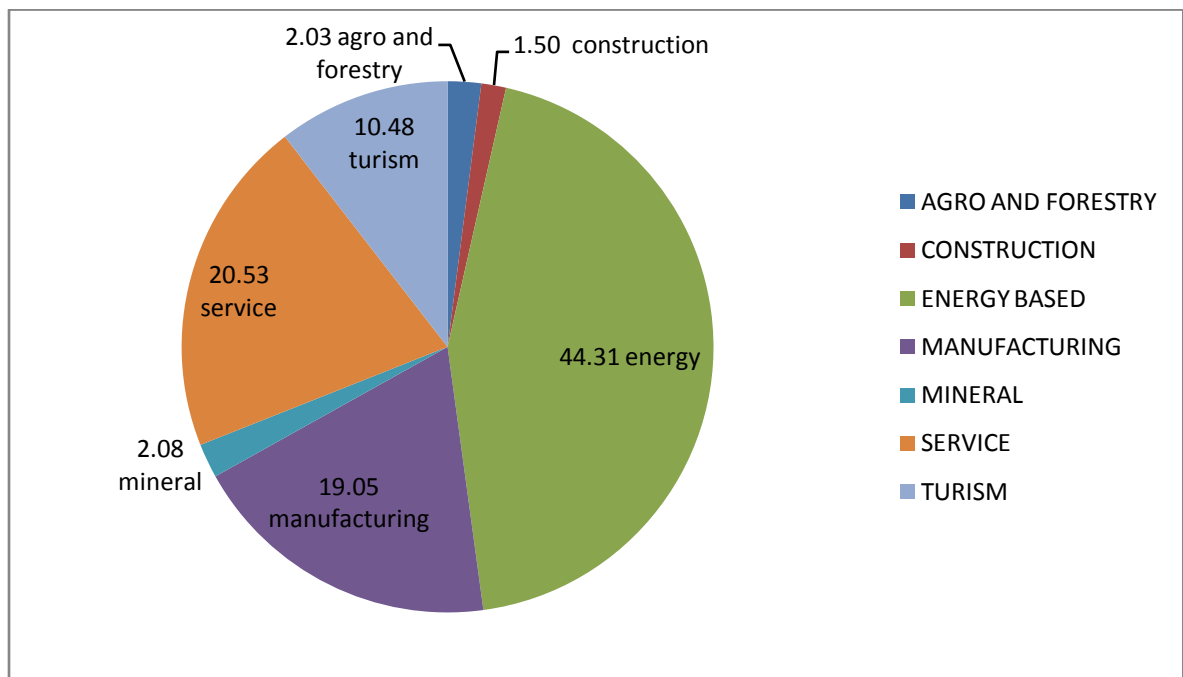
From the table the average project cost, average fixed cost, average foreign investment and average employment are 24.03 million, 18.71 million, 17.71 million and 38.47 people respectively on the project in agro and forestry based industry. Similarly, in construction based industry average are 85.01 million, 63.47 million, 66.06 million and 70 people respectively, in energy based industry are 2047.52 million, 2001.36 million, 1167.63 million and 145.46 people respectively, in manufacturing based industry average are 93.05 million, 74.10 million, 38.39 million and 94.26 people respectively, in mineral based industry average are 100.12 million, 79.39 million, 63.52 million and 123.54 people respectively, in service based industry average are 50.53 million, 32.26 million, 33.17 million and 43.94 people respectively, in tourism based industry average are 33.78 million, 31.13 million, 19.56 million and 38.36 people respectively. This data shows the highest total project cost, fixed cost foreign investment and employment on the project is in energy based industry.

The table 4.2 shows that the number of industries in the agro and forestry sector was 227, the number of industries in the construction sector was 45, in energy based it was 75, in

manufacturing it was 981 while in mineral based, service based and tourism based industries it was 65, 1223 and 1059 respectively.

The energy based industries constitute the highest position in terms of total project costs, total fixed cost and foreign investment but in terms of total number project and employment the service and manufacturing sector was in highest position. The flow of such investment in energy can be due to the policy liberalization and higher potentiability of hydropower.

**Chart 4.1: Percentage Distribution of FDI by type of Industries up to FY 2015/16**



Source: Department of Industry, 2016

The flow of FDI was highest in energy based sector that marked Rs. 87572.36 million, which was 44.31 percent of the total. With Rs. 40572.79 million (20.53 percent) services sector occupied the second position to attract FDI in Nepal. In the context of FDI, manufacturing sector received the third position that leveled Rs. 37662.27 million (19.05 percent), while tourism sector occupied the fourth position to attract FDI to the tune of Rs. 20718.42 million (10.48 percent), construction, agriculture and mineral sector received the lowest priority in obtaining FDI.

The highest employment was provided by manufacturing sector i.e. 92475, which was 42.51 percent of the total employment received through FDI. The contribution of service sector to employment was 24.69 percent, while the share of tourism sector to employment was 18.62 percent followed by energy (5.02 percent), agriculture (4.01 percent), mineral (3.69 percent) and construction (1.44 percent).

A look at the table 4.2 and chart 4.1 its shows the energy based sector has 44.31 percent foreign direct investment net inflow and service sector was in the first position in total number of industry with 33.28 percent but in employment generation manufacture sector was in the first with 42.5 percent.

#### 4.4 Number of Industries Approved for Foreign Investment by Scale Wise

From the table 4.3 it is shows that the average project cost, average fixed cost, average foreign investment and average employment are 1039.18 million, 959.03 million, 516.42 million and 200.36 people respectively on the project in large scale industry. Similarly in the medium scale industry average are 102.39 million, 64.13 million, 64.96 million and 104.52 people respectively, in small scale industry average are 14.73 million, 9.62 million, 11.97 million and 41.23 people respectively.

**Table 4.3: Number of Industries Approved for Foreign Investment by Scale**

Rs in million

| Category | No of industry | Total Project cost | Total fixed cost | Total amount of FDI | Share in total FDI | Employment |
|----------|----------------|--------------------|------------------|---------------------|--------------------|------------|
| Large    | 265            | 275381.57          | 254142.09        | 136850.73           | 69.22%             | 53095      |
| Medium   | 377            | 38599.81           | 24178.11         | 24491.33            | 12.39%             | 39405      |
| Small    | 3036           | 44726.42           | 29199.95         | 36355.93            | 18.39%             | 125181     |
| Total    | 3678           | 358707.80          | 307519.55        | 197697.99           | 100%               | 217681     |

Source: Department of Industry, 2016

The Table 4.3 shows that highest inflow of foreign direct investment in large scale industries which is equal to 69.22 percent after that small and medium industry has 18.39 percent and 12.39 percent respectively. If we see the number of industry small scale industry has 82.55 percent and, medium and large scale industry has 10.25 percent and 7.2 percent respectively. Similarly, in terms of employment, again small industries come front with 57.51 percent of total employment followed by large scale industries with 24.39 percent and Medium scale industries with 18.10 percent.

#### 4.5 Country Wise Flow of Foreign Direct Investment in Nepal

There are top ten foreign countries which are investing in Nepal as FDI from F/Y 1989/90 to F/Y 2015/16 by mid-march 2016.

A total of 3,905 industries from 90 different countries have been registered by the first eight months of current fiscal year 2016/17 securing approval for foreign investment of

Rs. 208.04 billion. Through this, a total of 224,286 individuals are expected to receive employment. By the first eight months of the current fiscal year, India, on the basis of project cost, comes first with its shares of 39.12 percent to the total foreign investment among the licensed industries operating with foreign investment, while China stood second to India with 16.23 percent followed by Hong Kong China with 13.06 percent. The investment of South Korea shared 5.28 percent to the total foreign investment followed by Ireland with 3.64 percent and UK with 2.5 percent. Likewise, Mauritius shared 1.59 percent, Singapore 1.39 percent and Switzerland shared 1.38 percent the share of other 80 countries to the total foreign investment stood at 11.92 percent.

**Table 4.4: Country-Wise Foreign Investment**

|        |                  |               |                          | Rs in million     |
|--------|------------------|---------------|--------------------------|-------------------|
| S. no. | Country          | No of project | Total foreign investment | Cost best Percent |
| 1      | India            | 662           | 81312                    | 39.12             |
| 2      | China            | 1093          | 33768                    | 16.23             |
| 3      | Hong Kong China  | 33            | 27188                    | 13.06             |
| 4      | South Korea      | 312           | 10999                    | 5.28              |
| 5      | British Iceland  | 14            | 7967                     | 3.83              |
| 6      | USA              | 344           | 7581                     | 3.64              |
| 7      | UK               | 160           | 5330                     | 2.56              |
| 8      | Mauritius        | 9             | 3315                     | 1.59              |
| 9      | Singapore        | 38            | 2896                     | 1.39              |
| 10     | Switzerland      | 55            | 2891                     | 1.38              |
| 11     | Other 80 Country | 1185          | 24796                    | 11.92             |
| Total  |                  | 3905          | 208043                   | 100               |

Source: Department of Industry, 2016

From the table 4.4 it is clear that India contributes most in the overall development of the Nepal as it provides highest amount of FDI (39.12 percent) in comparison with other investing countries. India has been investing on different 662 projects which are running in different parts of Nepal with the total FDI amount of 81312 million. In addition, Nepal and India share common heritage from the time immemorial, which has played a crucial

role in determining more FDI from India. Besides this, Nepal and India enjoy a special trading relationship and the Trade treaty signed for on December 5, 1996, which lays the foundation for an open trade relationship based on the spirit of mutual benefit. One of the central feature of the treaty is that it provides duty-free access to Nepali manufactured goods giving them equal footing in the Indian Market with Indian goods. As China has been investing on 1093 numbers of different projects but still the total amount of FDI is less in comparison to that of India (33768 million) which clears that India has been investing in large projects. Besides India and China other several countries are playing important role in increasing FDI in order to complete different projects in Nepal. The data shows that all together 90 different countries are contributing to increase the total amount of FDI as it shows that 3905 projects are running with the total FDI amount of 208043 millions.

#### 4.6 Nepal's Position in Doing Business

Nepal ranks 107th among 190 countries on Doing Business, 2017 which measures the environment position for doing industry businesses.

**Table 4.5: Nepal's Position in Doing Business among SAARC Nation**

| Country     | Position among 190 country | Score |
|-------------|----------------------------|-------|
| Bhutan      | 73                         | 65.37 |
| Nepal       | 107                        | 58.88 |
| Sri Lanka   | 110                        | 58.79 |
| India       | 130                        | 55.27 |
| Maldives    | 135                        | 53.94 |
| Pakistan    | 144                        | 51.77 |
| Bangladesh  | 176                        | 40.84 |
| Afghanistan | 183                        | 38.1  |

Source: Economic survey, 2016

Nepal scored 58.88 percent. Nepal that ranked 100th in 2016 with 59.36 points slipped by 7th position in 2017 and stood second among the SAARC nations. The time and cost required for registration and operation of industry business in Nepal need to be reduced further while enhancing the competency and quality to facilitate in doing such businesses.

In addition to this, investment environment needs to be improved through single window service.

#### **4.7 Bilateral Investment Promotion and Protection Agreement (BIPPA)**

Of the total 90 countries to invest in industrial sector, BIPPA has been signed with 6 countries including France, Germany, UK, Mauritius, Finland and India. These countries have contributed almost 44 percent to total foreign investment.

**Table 4.6: BIPPA Signed Countries**

| Countries    | Date of Agreement | Project No  | Total FDI(in Million) |
|--------------|-------------------|-------------|-----------------------|
| France       | May 2, 1983       | 81          | 545                   |
| Germany      | October 20, 1986  | 102         | 1310                  |
| UK           | March 2, 1993     | 160         | 5330                  |
| Maturitius   | August 3, 1999    | 9           | 3315                  |
| Finland      | February 3, 2009  | 10          | 336                   |
| India        | October 21, 2011  | 662         | 81312                 |
| <b>Total</b> |                   | <b>1042</b> | <b>92148</b>          |

Source: Economic Survey, 2016

From the table 4.7 it is clear that Nepal had signed BIPPA on May 2, 1989 for the first time which clearly shows that Nepal has targeted France for FDI and for the last time the treaty was signed with India on October 21, 2011 by Dr. Baburam Bhattarai who was the finance minister at that time which shows the FDI figure of 81312 millions. Thus the treaty has played an important role in overall increase of FDI as the total figure of FDI is 92148 million by the BIPPA treaty signed country.

## **CHAPTER FIVE**

### **PROSPECTS OF FDI**

Nepal has the potential to attract FDI. Compared with most other low income countries, it has a surprisingly long list of advantages. These include a large and friendly neighboring country that offers market potential, a flourishing local entrepreneurial culture in both small and large business and established international recognition and image. But this potential is severely constrained by the poor investment framework. In these circumstances the usual elements of FDI strategy, including general programmes of investment promotion, linkages with national firms, and longer-term plans to improve competitiveness, will have a limited impact on Nepal's ability to attract FDI and benefit from it. Nepal's FDI strategy must consist first and foremost of a firm and orderly process of relieving the constraints in the investment framework.

Nepal is one of the attractive destinations for foreign investors due to various reasons. First of all, Nepal's attractiveness increases for FDI as a strategic location between India and China. The political change has created new environment for the foreign investors in the country because there is a good sign of political stability and peace in the country after the popular people movement of 2006. Nepal is supposed as attractive location for startup new business opportunities especially in the area of tourism, agriculture and information technology. Nepal has had a continuous attachment to neutrality in foreign relations, membership to WTO, enactment of favorable policies and laws, availability of wide range of human resources, latest infrastructure in communication, stable currency backed by strong balance of payments, exclusive protective right for foreigners property. These entire situations make Nepal a strategic place to invest for foreign investors.

In spite of the difficulties that Nepal experiences in attracting FDI in any appreciable amount, there are some sectors where FDI currently comes in. The following are the sectors where FDI can be accelerate.

#### **5.1 Hydro-power**

Water resource has been one of the most important natural resources for the Nepal's economic development. Availability of abundant water resources and geo-physical features provide myriad opportunities for hydropower production in Nepal. Hydropower is a sector full of enormous possibilities to attract FDI. The estimated volume of generation production is 83,000 megawatts, more than half of which has been identified as economically feasible to develop. Nonetheless, Nepal has been successful to generate only approximately 965 megawatts. The demand for electricity continues increasing. The Nepalese government opened the hydropower generation sector to private development and allowed foreign ownership. In August 2011, the Ministry of Energy proclaimed the

new Hydropower License Management Procedure. Hydropower projects with capacity to generate more than 10 MW through competitive process are assured to obtain award licenses by the government

The traditional sources of energy shares approximately three-fourth of total energy consumption. Likewise, Firewood alone shares two-third of total energy consumption. Despite immense potential for generating hydroelectricity, share of electricity to total energy consumption is still very low. The share of electricity to total energy consumption stood at 3.7 percent in FY 2015/16 which grew marginally and reached 4.1 percent by the first eight month of the FY 2016/17.

**Table 5.1: Energy Consumption Status (In TOE: Tons of Oil Equivalent)**

| Source               | F/Y 2014/15(000 TOE) and Share% | F/Y 2015/16 (000 TOE) and Share% | F/Y 2016/17 (000 TOE) and share% (first eight month) |
|----------------------|---------------------------------|----------------------------------|--|
| Traditional          | 9104 (77.6)                     | 9227 (78.4)                      | 6152 (74.5)  |
| Firewood             | 8264 (70.5)                     | 8376 (71.2)                      | 5584 (67.6)  |
| Agricultural Residue | 408 (3.5)                       | 414 (3.7)                        | 276 (3.3)  |
| Cow Dung             | 432 (3.7)                       | 438 (3.7)                        | 292 (3.5)  |
| Commercial           | 2334.44 (19.99)                 | 2248.2 (19.1)                    | 1811.97 (22)   |
| Coal                 | 465 (4)                         | 536.35 (4.6)                     | 332.11 (4)   |
| Petroleum Products   | 1469.16 (12.5)                  | 1275.39 (10.8)                   | 1139 (13.8)  |
| Electricity          | 397.28 (3.4)                    | 436.56 (3.7)                     | 340.86 (4.1)   |
| Renewable            | 292.12 (2.5)                    | 292.49 (2.5)                     | 293.12 (3.5)   |
| Grand Total          | 11727.56 (100)                  | 11767.69 (100)                   | 8257.09 (100)  |

Source: Economic Survey, 2016

The share of petroleum products and traditional sources of energy could be reduced if hydroelectricity production is increased. It can help to decrease the trade deficit of the economy which was increased by the petroleum product and electricity imported from the India. Domestically produced energy helps for the foundation of industrialization and brings positive changes in the lives of the people.

The total electricity production that had stood at 855.89 MW by the end of FY 2015/16 grew by 105.3 MW (12.3 percent) in the first eight months of the fiscal year 2016/17 and reached 961.2 MW. The total electricity generation in Nepal has reached 965.7 MW (production at full capacity) with the inclusion of 4.5 MW electricity generated through rural electrification projects which are not associated with National Integrated Power System.

**Table 5.2: Electricity Demand, Consumption, Production and Import**

| Description             | F/Y 2014/15 | F/Y 2015/16 | F/Y 2016/17(first eight month) |
|-------------------------|-------------|-------------|--------------------------------|
| Production(MT)          | 829.2       | 855.9       | 965.7                          |
| Available Energy(GWh)   | 4966.7      | 5077.2      | 3964.2                         |
| Peak Demand(MW)         | 1291.1      | 1385        | 1444.1                         |
| Demand Supply(MW)       | 461.9       | 529.1       | 482.9                          |
| Imported from India(GW) | 1369.89     | 1782.86     | 1171.38                        |

Source: Economic Survey, 2016

The electricity demand has reached 1444.06 MW in the fiscal year 2016/17. The gap between demand and supply has stood at 482.9 MW. The demand for electricity has continued to grow with the increased production of electricity. The gap between demand and supply between FY 2011/12 and FY 2015/16 has widened further. Such gap remained at 461.9 MW by the first eight months of previous fiscal year while this further grew by 21 MW reaching 482.9 MW in the review period. About 1171.38 GW of electricity has been imported from India in fiscal year 2016/17 to reduce load-shedding hour. Such import stood at 1782.86 GW last year. The daily power shortage still remains close to 2.4 million units.

Hydroelectricity produced in Nepal can cater to the growing India and China. Nepal's hydropower potential can also act as a strategic asset for India as most of its populated states are located in northern region which is close to some of the mega hydropower projects such as Weat-Seti (750 MW) and Karnali-Chisapani (10800 MW) that are situated in the south western part of Nepal. These sorts of storage type project also help reduce floods and landslides in both countries because water is stored during the rainy season in mega dams and released during the winter seasons. It also helps irrigate the land of Nepal and India which in return helps increase agricultural production.

Opportunities

- I. Nepal faces acute power shortages and opportunities exist in the hydropower sector to meet this gap in demand.
- II. Nepal is targeting graduating from least developed country (LDC) status to developing country status by 2022 and aims to become a middle income country by 2030. To meet its growth aspirations, Nepal will need to add 6,000+ MW (which requires investment of approximately USD 10 billion). Consequently, a lot of industries and infrastructure projects are in the pipeline opening up huge opportunities.
- III. In addition to energy development, investment opportunities lie in the upgradation and expansion of distribution systems (for which investment of approximately USD 2 billion is required) and transmission systems (for which investment of approximately USD 4.45 billion is required).
- IV. The Power Trade Agreement (PTA) signed with India has opened up a large market for exporting electricity to India.
- V. The SAARC Framework agreement on Energy Cooperation signed during the 18th SAARC Summit in 2014 will pave the way for the eventual formation of a regional energy market.

## **5.2 Tourism**

Nepal is the major tourist destination in the world as it is known by its unrivaled natural beauty, abundant bio-diversity, multiethnic, multilingual, multi religious, and multi cultural identities. Tourism has been one of the important sectors in service industry for economic growth from the perspective of comparative and competitive advantages. Diversification and expansion of tourism sector have enhanced people's livelihoods and employment opportunities thereby raising their living standard.

With a view to invite higher number of tourists in Nepal, various programs were organized including 'Visit Nepal 1998'; 'Destination Nepal Campaign' in 2002 and 2003; 'Visit Pokhara Year Campaign' in 2007; 'Nepal Tourism Year, 2011'; and Lumbini Visit Year in 2012. The number of tourist arrival has increased due to the impact of such program.

National Tourism Strategic Plan has targeted to make 2,522,000 tourists visit and create 898 thousand employments by 2025. While observing the tourist arrival trend of last decade, the number of tourist arrival except that of Indian tourists arrived via land totaled 602867 in 2010 while this number rose to 753,002 in 2016. The number of tourist arrival in 2015 had dropped by 32 percent due to the negative impact that devastating earthquake and border obstruction rendered to tourism activities. Its subsequent years saw gradual

progress in tourism sector. The number of tourist arrival that stood at 538,970 in 2015 grew by 40 percent in 2016.

**Table 5.3: Number of Tourist Arrival and length of Stay**

| Year | No of Tourist | No of Tourist Arrival using Air route | No of Tourist Arrival via Land | Estimated Average Length of Stay/Tourist (In Days) | Annual Growth Rate of Tourist Arrival |
|------|---------------|---------------------------------------|--------------------------------|--|---------------------------------------|
| 2010 | 602867        | 448800                                | 156067                         | 12.67  | 18.21                                 |
| 2011 | 736215        | 545221                                | 190994                         | 13.12  | 22.1                                  |
| 2012 | 803092        | 598258                                | 204834                         | 12.87  | 9.08                                  |
| 2013 | 797616        | 594848                                | 202768                         | 12.51  | -0.7                                  |
| 2014 | 790118        | 585981                                | 204137                         | 12.44  | -0.94                                 |
| 2015 | 538970        | 407412                                | 134137                         | 12.8   | -32                                   |
| 2016 | 753002        | 572563                                | 180439                         | 13.4   | 40                                    |

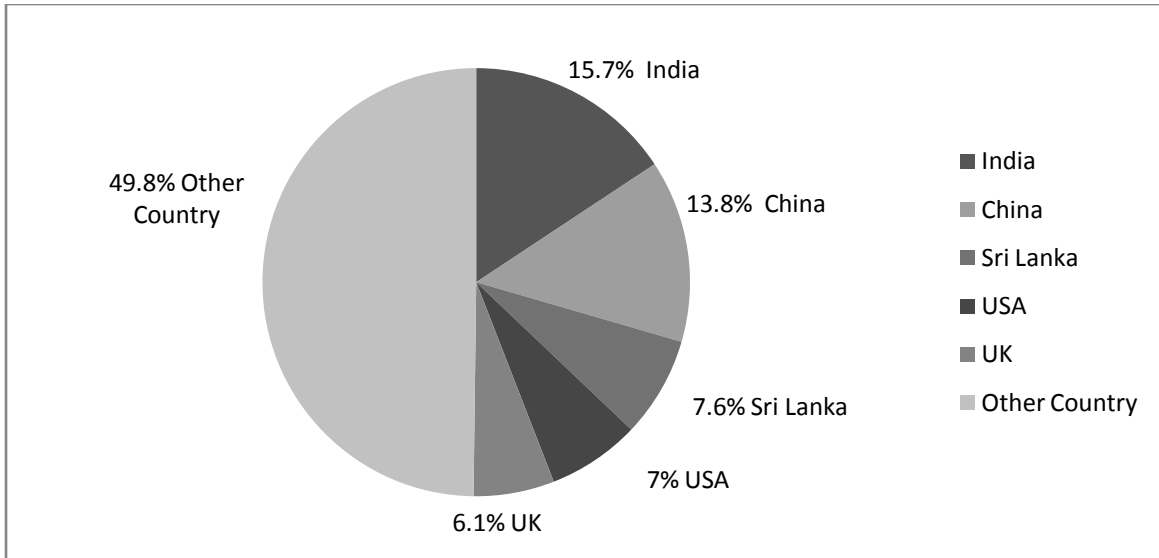
Source: Economic Survey, 2016

Note: Above Figure do not include Indian Tourists arriving via Land

While analyzing the number of tourist arrival by country, top five countries with largest number of tourist arrival have been India (15.7 percent) followed by China (13.8 percent), Sri Lanka (7.6 percent), USA (7 percent), and UK (6.1 percent) in 2016. The share of tourists arrived from these countries is more than 50 percent in the total number of tourist arrival. These figures were 14 percent for India, 12 percent for China, 10 percent for USA, 8 percent for Sri Lanka and 6 percent for Thailand in 2015.

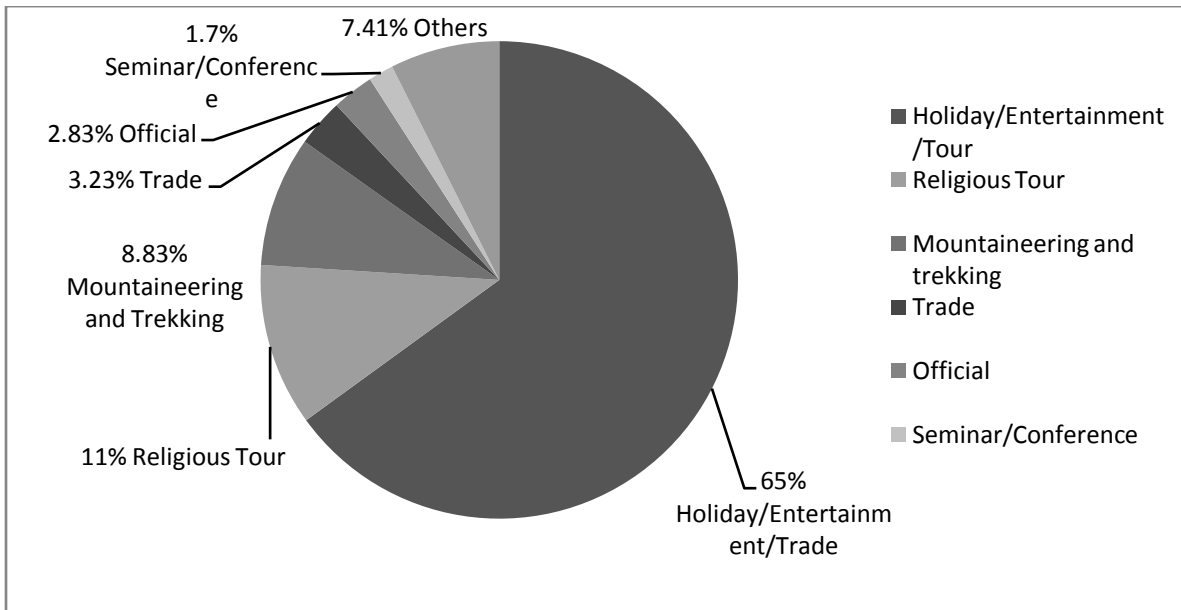
Of the total number of tourists visiting Nepal during 2016 by purpose, 65 percent of them came for vacation/entertainment/travel. Likewise, 11 percent of them arrived for religious tour, 8.83 percent for mountaineering and trekking, 3.23 percent for trade, 2.83 percent for office visit, 1.7 percent for meeting/conference and the rest 7.41 percent for other purposes. While analyzing tourist arrival statistics of last 10 years based on their travel purposes, more than two third of tourists have been for vacation recreation/travel, trekking/mountaineering and religious purposes.

**Chart 5.1: Country with most Number of Tourist Arrival**



Source: Economic survey 2016

**Chart 5.2: Tourist Arrival by Purpose**



Source: Economic Survey, 2016

Hence, there are greater prospects of FDI in the tourism industry. But Nepal is still receiving very low amount of FDI in tourism sector. In order to promote FDI into tourism

sector, peace, political stability, good administration, good governance, investor's friendly policy are crucial.

#### Opportunities

- I. There are opportunities in developing tourism infrastructure (hotels, restaurants, roads, airports, etc).
- II. There is also great potential for expanding the market for meetings, international conferences and events (MICE).
- III. Plans to upgrade the current international airport are underway, which will increase the tourist traffic significantly.
- IV. The expansion of existing tourism products and introduction of new and innovative products has the potential to attract different types of tourists and extend their average length of stay.

### **5.3 Agro and Forest-based Industries**

Traditionally, agriculture has been a major occupation for livelihood. Despite decreasing share of the agriculture in the world economy with development and expansion of other sectors, size of the production of this sector has been growing. The agriculture sector occupies 28.9 percent of the Nepalese economy. Population engaged in agriculture profession, however, is around two third. Agriculture sector could not be linked to other sectors of the economy while modernizing this sector. Due to the failure to make feel agriculture a dignified occupation, this sector has not developed to the extent desired.

Agriculture sector is estimated to have contributed 28.9 percent to GDP in FY 2016/17. Such contribution of the Agriculture sector in the previous FY 2015/16 stood at 31.1 percent. Annual growth rate of the Agriculture sector in FY 2016/17 at basic prices is estimated at 5.3 percent whereas such growth remained negative by 0.03 percent in the previous FY 2015/16. Growth of the Agriculture sector, which is dependent on favorability of weather condition, has not been satisfactory during previous 10 years.

Forest, vegetation, herbs, wildlife, biodiversity, watershed together with protected areas are among the Nepal's natural resources to be protected, promoted and utilized in an appropriate manner. This would maintain balance between improved livelihood of deprived groups and contingency approach by increasing income opportunities through the creation of employment. Similarly, it is necessary to develop overall forest sector as a reliable source of agriculture, energy, tourism, clean water and industrial raw materials by increasing the forest product and productivity through sustainable forest management. Through this, opportunities of wider economic benefits could be created with sustainable conservation of environment.

Agricultural and forest-based industries are another area of Nepal's comparative advantage. Because of unique topography and climatic variations of the country, Nepal has a huge potential for commercial cultivation and processing of various types of agricultural and forest-based products on medium to large scale. With capital from abroad, technology, and better management and marketing techniques, the untapped potentials can be profitably exploited for the mutual benefit of both the parties. For these goods, Nepal can be utilized as the production base for satisfying not only Nepal's needs but also for meeting the MNCs' requirements, at a relatively cheaper price.

### Opportunities

- I. Herbs and their extracts in the form of oils, traditional medicines, and essences as ingredients for cosmetics, perfumes, herbal teas and natural health products.
- II. Sericulture and silk production. There is huge potential of silk production, for export to third countries, from Kathmandu valley and Dhading.
- III. Floriculture. Apart from different types of cut flower, Nepal is also popular for some exotic species of orchids. The diverse climatic conditions give good prospects for the production of a wide variety of flowers and flowering seeds for exports.
- IV. Vegetable seed production. Opportunities do exist for producing seed of a wide range of varieties owing to a wide variation in agro-climatic regions from tropical to temperate and alpine climates.
- V. Fruit processing. Good ecological conditions prevail for the cultivation of different types of fruits. There are ample scope for establishing industries to process fruits for sale in the export market as fruit juices and squash, jams and jellies and fruit-based special liquors.
- VI. Tea plantation and processing. Although the domestic demand for tea is about 10,000 MT, only about one-third is fulfilled by local production. The comparative advantage of Nepal in tea lies in the young plants and in the long period of rainfall that Nepal (especially the eastern part) receives.
- VII. Mushroom cultivation. Suitable climatic conditions prevail in Kathmandu valley for growing oyster mushroom and paddy-straw mushroom throughout the year.
- VIII. Cashmere shawls. A huge potential exists for producing cashmere shawls by importing wool and thread from Tibet for export to the Indian and overseas markets.

## 5.4 Information Communication Technology

Nepal's ICT sector is one of the fastest emerging sectors in the country, with huge potential for growth in the coming years. All the services related to the ICT sector are open to foreign direct investment, except for media. For telecommunications, 80 percent foreign ownership is allowed. The Government of Nepal has identified IT and business process outsourcing (BPO) in the Nepal Trade Integration Strategy 2010 as one of the five priority potential export service sectors. The Trade Policy 2015 also reemphasizes the importance of developing this sector. IT has the potential to generate high growth and significant profits and is expected to be one of the most significant growth sectors in Nepal. The major telecommunications service providers in Nepal are Nepal Telecom Corporation (government owned) and Ncell (mainly foreign owned). This is a cross cutting sector which will enhance the performance of all other sectors.

**Table 5.4: Total Number of Distributed Telephones**

| Service Provider              | 2013/14  | 2014/15  | 2015/16  | 2016/17 (first eight month) |
|-------------------------------|----------|----------|----------|-----------------------------|
| Nepal Telecom limited         | 10903344 | 12981942 | 15014434 | 16921403                    |
| United Telecom Limited        | 508841   | 524768   | 526689   | 526857                      |
| Ncell PVT. Ltd.               | 11924552 | 12905513 | 14145758 | 15215701                    |
| STM Telecom Sanchar Pvt. Ltd. | 3095     | 2987     | 2987     | 2987                        |
| Nepal Satellite Telecom Pvt.  | 150000   | 366463   | 371668   | 371668                      |
| Smart Telecom Ltd.            | 1064998  | 1322556  | 1398100  | 1493922                     |
| Others                        | 1742     | 1742     | 1742     | 1742                        |
| Total                         | 24556572 | 28105971 | 31461378 | 34534280                    |

Source: Economic Survey, 2016

The number of telecommunication service providers and its service users has increased. Telecommunications service has gained both quantitative and qualitative growths due to the availability of modern and sophisticated technological telecommunication facilities. By mid-March 2015, the total number of telephone subscribers reached 31,461,378.

### Opportunities

- I. Foreign BPO companies can tap into the young English-speaking population and benefit from the cost advantages offered by the low wages and low establishment and operating costs.

- II. As there are only two major telecommunications companies (NTC and Ncell) dominating the sector, there is room for new firms to enter the market.
- III. There are unmet needs for the use of ICTs in governmental agencies and the private sector.
- IV. There are plans to develop an IT Park (an area set aside by the government for software developers, IT-based businesses, IT service providers and investors in related fields).

## **5.5 Transport**

Diverse geographical and economic sectors remain scattered in the country. Economic and social development needs to be promoted by binding geographical and economic sectors to each other through infrastructures like Roads, Railways, Waterways and Ropeways, and strategic transport network. Promoting various economic activities like agriculture, tourism, electricity, and industry, and projects has become necessary while linking remote rural areas to local markets. By now, Except for Dolpa and Humla districts, all districts headquarter are connected to the road network. Sixty seven districts headquarter have access to Black topped roads. A total of 1,952 motor vehicles worthy bridges have been constructed. A balanced social and economic integration through the development of road transport is necessary. The condition calls for strengthening of domestic and international air transport services by making such services safe and accessible to all. Development of, road, air transport and water transport is the utmost necessity for overall development and economic growth.

The transportation sector in Nepal contributes 8.8 percent of GDP and grew at a rate of 6.8 percent in 2013/14. The average growth rate of the sector in the last five years was 6.9 percent. During the three year plan period (FY 2013/14–2015/16), a total of 25,133 km of strategic roads were built. Nearly all districts (73 out of 75) now have road access and an additional 1,609 bridges are in operation. Nepal also has 56 domestic airports and 1 international airport in Kathmandu.

On roads transport, 639 Km of earthen (new roads) road, 345 Km of graveled road and 264 Km of black topped road was upgraded in fiscal year 2015/16, while 312 Km of earthen road, 405 Km of graveled road and 132 Km of black topped road have been upgraded by the first eight months of the fiscal year 2016/17. Likewise, periodic maintenance works of 85 Km road has been completed.

**Table 5.5: Status of Road Facility Expansion**

| Description                            | F/Y 2013/14 | F/Y 2014/15 | F/Y 2015/16 | F/Y 2016/17 (first eight month) |
|--|-------------|-------------|-------------|---------------------------------|
| New Road Construction(km)              | 1180        | 648         | 639         | 312                             |
| Graveled Road(km)                      | 685         | 401         | 345         | 405                             |
| Upgraded to Black Topped(km)           | 538         | 601         | 264         | 132                             |
| Road Maintenance(km)                   | 8200        | 8908        | 9200        | 9500                            |
| Periodic Maintenance(km)               | 400         | 350         | 443         | 85                              |
| Bridge Construction(unit )             | 72          | 73          | 63          | 22                              |
| Road Linking District Headquarters(No) | 1(Mugu)     | 1(Mugu)     | -           | -                               |

Source: Economic Survey, 2016

The number international airline to make the flights from Nepal has stood at 25 as of the first eight months of current fiscal year 2016/17 while this number was 26 last year. The number of Nepali airlines to make international flights stands at 2. Likewise, the number of countries signing bilateral aviation agreement has been 3 while the air seats on both sides of the aisle have been same (8 million) as that of last year. The number of airlines making domestic flights with fixed wing rooter wing that had stood at 17 in previous fiscal year 2015/16 has reached 19 by the first eight months of the current fiscal year. The number of total airports operating in Nepal rose from 32 to 33 while the number of all season airports has reached 24 from 22.

Master plan has been prepared for the construction of second international airport at Nijgadh, Bara and About 27 percent of the runway and taxiway construction work has been competed at Gautam Buddha Airport of Lumbini which is regarded as the important destination from the tourism perspective. Likewise, first phase of compensation distribution work at Pokhara Regional International Airport has been completed and preliminary works for the acquisition of additional land have also been accomplished. Test flight has been conducted at Kalikot airport on 11<sup>th</sup> February, 2017. Approval has been granted to Nepal Airlines Corporation for it to procure two wide-body aircrafts to the selection of supplier.

**Table 5.6: Civil Aviation Related Indicators**

| Major Indicators                               | Mid-March 2016 | Mid-March 2017 |
|--|----------------|----------------|
| Nepalese Airlines with International flight    | 2              | 2              |
| International Airlines in Nepal                | 26             | 25             |
| Country with Bilateral Air Service Agreement   | 38             | 38             |
| Number of Domestic Airlines                    | 17             | 19             |
| Number of International Airport                | 1              | 1              |
| Number of All Season Airports                  | 22             | 24             |
| Total Number of Domestic Airports in Operation | 32             | 33             |

Source: Economic Survey, 2016

Rail transport related works have been commenced on 945 Km East-West railway, and 519 Km of Rasuwagadhi-Kathmandu-Pokhara-Lumbini railway. Besides, work has been initiated with the objective of linking east-west with the railway networks of Indo-Nepal border towns. Feasibility study of east-west railway has been completed, and based on this, detailed project report has been prepared on a total of 372 Km railway line including 108 Km Simara-Bardibas link, 127 Km Simara-Tamsaria link, 65 Km Tamsaria-Butwal link, 28 Km Simara-Birgunj link and 44 Km Butwal-Bhairahawa-Lumbini link. Of this total railway line, contract is signed for construction of 30 Km (Bardibas-Lalbandi) stretch of 108 Km long Simara-Bardibas section, of which construction of railway track-bed, culverts, and bridges have been completed on 9 Km of this stretch in the review period. Preparation of detailed project report on Bardibas-Kakarbhitta section and Itahari-Biratnagar link (262 Km) is underway. Selection of consultant for the preparation of detailed project report on Butwal-Gathachauki section (421 Km) is in the final stage, Feasibility study has been carried out on (135 Km) Nawalparasi section that will pass through Nijgadh-Hetauda-Bharatpur. Task has been initiate for preparing detailed project report on Rasuwagadhi-Kathmandu-Pokhara-Lumbini railway within 2 years.

#### Opportunities

- I. Only 19% of roads in Nepal are all weather roads and 2 out of the 75 districts are still not connected by roads. Hence, there are many opportunities to expand the road network, for which the government is seeking to form public-private partnerships.
- II. Nepal's main highways require expansion to accommodate the increase in traffic, which is another area for public-private partnerships.
- III. In order to cater to the needs of the growing population, the development of mass public transportation systems – bus-rapid transport (BRT), railways, monorails,

airports – has been prioritized. To finance these projects, the government is looking at public-private partnerships.

- IV. Eight north-south corridors (roads) linking China and India through Nepal, a cross-border railway line connecting Kathmandu with China, five cross-border railway lines, ultimately connecting Kathmandu with India, a railway line along the East-West Highway, and cable cars in the hilly regions are planned.

## **5.6 Mineral Exploration and Exploitation**

Nepal lies in the centre of the 2,500 km Himalayan belt, which has favorable geography for various minerals (metallic, non-metallic) and fuel. As many as 63 minerals have been identified in Nepal. In 2010/11, 80 mines and quarries for 12 different minerals were in operation. Of these, 29 are limestone quarries and 6 are gem mines. For the economic development of the country exploitation and proper use of such valuable resources, especially mineral resources, is extremely important. The mountainous region and the geological environment therein are suitable for metallic, nonmetallic (industrial, gemstones and energy/fuel) mineral deposits as well as huge amount of construction materials, dimension and decorative stones. Continues efforts are required to find the more mineral deposits and exploit them for the benefit of the people.

Minerals are the nonrenewable natural resources. Sustainable development of such resources helps to strengthen the national economy. Mineral exploration activities were at peak during 1974 - 1980 when Department of Mines and Geology (DMG) and UN funded Mineral Exploration Development Project (MEDP) was in action. They were able to delineate quite a few prospective areas and identify some economic, sub-economic and non-economic mineral deposits in different parts of the country. Now the Government of Nepal (GON) should prioritize exploration, evaluation and sustainable development of industrial minerals, high price metals, base metals, fuel minerals, precious and semi precious stones. It should also invite potential national and international investors to invest in mineral and mining sector and establish mineral based industries by giving some incentive to attract the investors in the beginning.

The mineral resources that could be commercially exploited have been identified as limestone, dolomite, talc, silica, clay, building and construction stone, iron- ore, lead-zinc, petroleum and natural gas.

Iron ore deposits have been found in various parts of Nepal. About 10 million tons of iron ore deposit is estimated in Fulchoki. Similarly, Labdikhola (10 million tons of iron ore), Those (8.4 million tons) , Jiwang (1 million ton), Kulekhani, Godawari, Bhaise etc are important sites for iron deposits. More than 30 million metric tons of iron ore deposit is estimated in various parts of Nepal.

Similarly, copper is estimated to be found in about 30 places within Nepal including Budhakhola (Bandipur), Gyaji (Gorkha), Arkhaule(Makanwanpur), Nangre (Nuwakot), Wapsa (Okhaldhunga), Siddhakhani( Illam), Bhutkhola (Tanahun) and others.

Likewise, Mica is found in several places such as Bajhang (Chainpur), Doti, Bhojpur, Lamjung Nuwakot, Dhankuta and so on. Limestone is also found in different parts of the country. The places where limestone is found are-Chovar (ktm), Jogimara (Dhading) Bhaise, Udayapur and so on. The total deposits in these places are -8 million tons, one million tons, 25 million tons, and 60 million tons respectively. Moreover about 30 million tons of limestone in Surkhet and 10 million tons of limestone in Dhankuta is found to be deposited.

Lead is also found in the different parts like Ganesh Himal (0.5 million tons of lead is expected to be found), Arkhaule and Durlang (Makawanpur) Rasuwa, Baglung, Phulchoki, Tripling ( Nuwakot), Salmor Valley (Bajhang) and so on. Slate is deposited in Bandipur, Bajhang, Pokhara and some other places of the country. Similarly, Dailekh, Muktinath (Mustang), Phyuthan, Kathmandu, Dhangadhi, Chisapani are some potential areas for natural gas and petroleum deposits. Other notable minerals like magnesite, zinc, coal, nickel, gold, graphite, marble, pyrite etc. are also deposited in various parts of Nepal.

For the exploration and exploitation of all these mineral resources, sufficient capital, efficient manpower, scientific technology, modern equipments are needed. But Nepal is lacking most of these requirements. In this context, foreign direct investment is crucial for the proper exploitation of the mineral resources which helps to finance the required capital, technology and modern equipments needed for the proper exploration and exploitation of mineral resources. Natural gas deposit in KTM Valley can be utilized for domestic and industrial uses. Mineral exploration and exploitation in some of the areas identified above offer promising prospects for foreign direct investment.

Mineral resources play vital role in industrial development and overall increase in the national GDP. Minerals and mine contribute about 0.5 percent to national GDP and industries sector based on these just around 2.4 percent which is not encouraging. It could go above 10 percent if we can exploit and utilize existing mineral resources appropriately. Mining activities can damage natural environment and it should be minimized by applying various methods and immediate rehabilitation of the mined land.

### Opportunities

- I. In recent times, the western part of Nepal has witnessed gas and oil seepage, confirming the presence of oil and natural gas in Nepal. About 10 petroleum and natural gas exploration sites have been identified.

- II. Nepal has more than 20 million metric tonnes of ore reserves in more than 80 locations.
- III. Copper occurs in Nepal in more than 107 locations.
- IV. Recent studies have shown that Nepal may have 2.5 billion metric tonnes of cement grade limestone.
- V. Nepal has an estimated 5 billion metric tonnes of dolomite and 180 million metric tonnes of high-grade magnetite.

## CHAPTER SIX

### SUMMARY, CONCLUSION AND RECOMMENDATION

#### 6.1 Summary

The key goal of developing countries like Nepal is to attain high economic growth rate and reduce poverty with macroeconomic stability. The fourteen plan (2072/73 to 2075/76) aims at attaining GDP growth rate of 7.2 percent and reducing overall poverty ratio from 31.6 to 17 percent. In order to achieve these targets, foreign direct investment (FDI) is viewed as an engine for economic development of Nepal as it provides required capital and technology and generate employment opportunities and thus, idle resources get utilized which, in turn, helps to expand production capacities of the country and also opens the access of products to world markets. Thus, foreign direct investment plays the vital role to pave the way for economic development for underdeveloped countries like Nepal.

Given the importance of foreign direct investment, this study has specific objective of analyzing the nature and trend of foreign direct investment and its prospects in Nepal.

Nepal has formulated laws and policies governing FDI. Many facilities and incentives have been offered to attract FDI in the country. Before 1990, acts and policies relating to FDI were not so investment friendly, so the flow of FDI during this period was largely insignificant. After 1990s, various facilities were offered in the acts like Foreign Investment and Technology Transfer Act (FITTA-92), Industrial Enterprise Act (IEA-92), and industrial Policy-92 and it revised in 2011 to attract FDI in the country. In this regard, the Foreign Investment and Technology Act 1981 were enacted. The salient features of the Act were, a) Industrial units set up under the Act would not be nationalized; and b) Industrial units set up under the act would receive the same facility, concession and protection as provided by the Industrial Enterprise Act, 1982. Similarly, Foreign Investment and Technology Transfer Act, 1992 was came into existence to attract technology transfer and foreign investment. According to the Act, foreign investment implies the investment made by a foreign investor in any industry as investment in share (equity), reinvestment of the earnings derived from the investment in share (equity) and investment made in the form of loan or loan facilities. Tax exemption and deduction facilities along with duty drawback facilities are some of the measures declared in the foreign investment acts. However, the laws and policies addressing FDI are found to be inadequate and inconsistent. Though various facilities were offered after 90s, but still they are inadequate to attract good amount of FDI in the country.

Nepal has failed to offer investors satisfactory standards of policy, administration of taxes and regulations and stable political environment which are of vital interest to business. Indeed, apart from the important liberalization of power generation, there has been little focus on removing these barriers, even those in selected industries of high FDI potential. Therefore, better performance in attracting FDI requires fundamental changes.

In order to analyze the trends of foreign direct investment in Nepal, different tools like graph, table, figure etc. have been used. The trend and structure of foreign direct investment has been analyzed by year, category, scale and country for the period from FY 1990/91 to FY 2015/16. The amount of FDI was Rs. 398 million in FY 1989/90 which has reached to Rs. 15139.63 million in FY 2015/16. According to data, the highest foreign investment flow after 1990 was Rs. 67480.04 million in FY 2014/15. Till now, Nepal has been able to attract FDI of only Rs.197146.23 million in total. From the data 3611 foreign investment projects were approved in Nepal comprising of all categories of industries from 1989 to 2016.

Categorically, there are only seven industries based on FDI in Nepal which include Agro and Forestry, Manufacturing, Tourism, Construction, Energy-based and service. The inflow of FDI was found highest in energy based sector that marked Rs. 87572.36 million (44.31 percent) while FDI inflow was found lowest in mineral-based enterprises that marked Rs 4129.35 million as of up to 2015/16.

By scale wise flow of FDI shows that most of FDI found in large scale industries which is 136850.73 million (69.22 percent) but in no of industry small scale industry is in the first with 3036 industry.

India alone accounts for 39.12 percent, followed by China with 16.23 percent, Hong Kong with 13.06 percent, South Korea with 5.28 percent, British Iceland with 3.83 percent, USA with 3.64 percent, UK with 2.56 percent, Mauritius with 1.59 percent, Singapore with 1.39 percent, Switzerland with 1.38 percent and other 80 country with 11.92 percent. In total, investors from 90 different countries have invested in Nepal.

Nepal is 107<sup>th</sup> position among 190 countries on Doing Business, 2017. Nepal scored 58.88 percent and Nepal is in second position in SAARC nation.

Nepal signed with 6 countries in BIPPA agreement including France, Germany, UK, Matritius, Finland and India. These countries have contributed 44 percent to total foreign investment.

For underdeveloped countries like Nepal, FDI is indispensable in order to mobilize the idle resources. Nepal is facing the problems of revenue-expenditure gap, trade gap and investment - saving gap. In order to mitigate such problems, FDI is needed for this

country. Similarly, FDI is needed to fulfill technological, managerial and entrepreneurial skills, and to expand economy through linkage effects.

Nepal is an ideal destination for FDI owing to its rich natural endowments abundant and cheap labour force, huge market in neighboring countries, growing internal market, a well-developed banking and non-banking financial institutions to cater investor's need for finance, fully convertible current account, preferential entry of products in India, and investor friendly government policy. Investment opportunities are open to almost every sector of economy from tea to mining industries. Tourism is the biggest business in the world and there is hardly a country that does not seek either tourists or investment in tourism. Uniquely, Nepal offers some of the most spectacular tourist attractions in the world. Similarly, Nepal is the second richest country in water resources. Therefore, there is a greater prospect of attracting FDI for the proper exploitation of water resources, especially for generating hydroelectricity. Likewise, mineral exploration and exploitation in some of the areas of the country offer promising prospects for foreign direct investment. Good prospect exists for the establishment of transport, information communication technology industries and agro and forest-based industries with foreign collaboration in Nepal.

## **6.2 Conclusion**

With the introduction of market oriented policies in 1980s, Nepal embarked an intensive economic liberalization policies in early 1990s. The fact is that Nepal, in terms of taxation policies and openness, is currently one of south Asia's open economies. The introduction of highly liberal investment policies aimed at encouraging investment, including FDI has made this possible. Investment grew rapidly after its trade became liberalized in 1990. However, the momentum could not be maintained over years. This is probably the reason for Nepal's inability to sustain growth in investment and economy. Policy and FDI growth analysis in this paper and experiences among other countries indicate inflow of investment, including domestic and FDI, only when there is suitable investment climate and business environment. Investment policy requires strong market institutions which include a guarantee of property rights and a stably policy environment backed by stable politics and efficient bureaucracy. Government should seriously consider the reformed through appropriate and effective measures.

Most of studies have found the investment and business environment indicate that under taking business in Nepal is very challenging and complicated task despite the liberal policies. The requirements of supportive services such as, political stability, policy certainty and efficient administrative mechanism have an equally perhaps even more important role in delivering secured and confidential business climate to both domestic and foreign investors. Nepal obviously has disadvantages arising from its geography in attracting FDI. However, comparative international experience suggests that her

lackluster record as a host to foreign investors cannot be explained in terms of geography alone. The overall investment climate does matter.

Year wise flow of FDI from the year 1982 to 1989 shows only a modest rather fluctuating foreign investment both in terms of total fixed capital and authorized capital, although authorized capital is in no way an important indicator of investment. The total numbers of industries registered in the manufacturing sector between the years 1982 to 1989 were 48, which involved the total fixed capital of Rs.1123.2 million and in the service, tourism and other sectors registered 26 industries, which involved the total fixed capital of Rs.808 million. Thus, the study shows that the number of industries established under FDI was very insignificant during these periods. One of the main causes behind this slow increment might be the restrictive laws and policies adopted by the government. The policies were not investment friendly. In the subsequent period of 1980s Nepalese economy was suffering from various macro economic crisis like increasing negative balance of payment, high rate of inflation, growth of debt burden, budget deficit etc, due to which it was difficult to attract FDI in Nepal. Along with this the other causes which were responsible for the slow flow of FDI were the shortage of electricity in that period from which Nepal was suffering, which is very essential for establishing industries and for attracting FDI into the country. Besides this, the country was suffering from poor infrastructural facilities like roads, communication etc. Roads are the backbone for market extension and the necessary condition for economic activities. Lack of adequate transportation system would raise the cost of production thereby eroding competitiveness in the international market. The same period also witnessed inadequate and inefficient communication facilities. So, all these causes were responsible for the low FDI during these periods.

The size of FDI was confined to Rs. 15139.63 million in 2015/16. During the last 27 years between 1990/91 to 2015/16 trends in FDI were found to be erratic, jumping. When policy changes FDI inflow was rises and in the implementation period its shows declining. In 1990s and 2012 its shows the positive effect in 2013/14 government approve 5 large scale of hydro project with 67480.04 million FDI which is highest. In scale wise large scale industry is in the first with 69.22 percent but in the number of project small scale industry approve highest industry.

Sector wise flow of FDI in Nepal indicates that FDI has flowed mainly into the energy based industry. Energy based sector has succeeded to attract FDI to the level of Rs. 87572.36 million, which is 44.31 percent of total FDI. This is mainly because the hydro projects are approved in last year. Service and manufacturing sector has succeeded to attract FDI to the level of 20.53 and 19.05 percent of total FDI. The flow of FDI into the service and manufacturing sector, which is mainly because the goods produced in this sector are consumed in the market easily and also gets relatively easy access to the international market. The goods which are easily sold in the market attract more FDI.

Along with this, availability of cheap labor cost has also attracted FDI in this sector. In employment manufacturing sector is in the highest position.

A total of 90 countries have invested in Nepal, in which India, China and Hong Kong are major FDI sources. India alone has invested 39.12 percent of total FDI. This shows that FDI is mainly concentrated from India compared to other countries. Nepal has successfully signed BIPPA agreement with 6 countries which country has invested 44 percent. Which shows the FDI is reflected highest with the policy agreement.

The prospective investment areas in Nepal include agriculture and agriculture related production, manufacturing industries, such as readymade garment and carpet, hydropower, tourism and service industries. Despite various constraints faced by foreign investors, Nepal possesses a lot of prospects to attract foreign investors because of small bureaucracy, friendly socio-cultural environment and high incentives and facilities available in the country. The availability of cheap labor force, growing markets and other raw materials also attract them to invest in the country.

Thus, from study we can conclude that the flow of FDI projects in the beginning of 1990s was encouraging. The main cause behind this was the incorporation of various facilities in the Foreign Investment and Technology Transfer Act (FITTA-92), and Industrial Enterprise Act (IEA-92), which were not in existence prior to 1992. In these acts various facilities like, repatriation facilities, visa facilities, various tax incentives, convertible foreign exchange facilities, land facilities were offered to foreign investors and hence foreign investors have shown interest in investing in Nepal in the early 1990s and after the 2012.

### **6.3 Recommendation**

**Political Stability:** Majorly political instability is being the strong reason behind this low FDI inflow. Political stability is one of the key factors in the policy framework of the Government to aid FDI in host countries. However, there should be mutual understating and intention to move together between political, business, bureaucratic leaders and act in a chorus to offer investors friendly business climate. It is not possible to meet the challenge that arises from international competitiveness without adequate infrastructure. It is the obvious duty of the State to provide an investment friendly environment to domestic and foreign investors. This can be achieved only when nation has stable politics, financial stability, and better implementation of existing policies.

**Standard of policy:** What are the reasons behind this low level of FDI inflow in Nepal? It's certainly not that Nepal lacks potential nor it is because landlocked in nature. The reason is that Nepal has failed to deliver satisfactory standards of policy and its consistent implications to the domestic and foreign investors. So, satisfactory standard of policy and implementation must be required for higher level of FDI inflow in Nepal.

Technology and Infrastructure: Nepal also lacks high tech and adequate infrastructure (resulting in high transportation cost), sufficient energy source. Nepal is still lacking the basic infrastructures due to which the flow of foreign investment and other development activities are less than impressive. The most serious problem in this regard is the skewed distribution of roads, the communication network highly concentrated in a few towns and cities and the meager supply of power for industrial use. So, it is necessary to expand technology and infrastructural base in the economy with the concentrated effort in those regions where these facilities are not adequate.

Practice Good Governance and Maintain Transparency: Good governance envisages the concept of a balanced role of government with room for private sector and civil society and emphasizes transparency and accountability in the government bureaucracy, the rule of law and effective system of public management. Therefore, Nepal should extensively practice the principle of good governance in order to increase administrative capacities and avoid unfair dealing of power and corruption in order to encourage the foreign investors. The transparent behavior of high ranked officials, transparency in government decisions and their behavior help to create civic consciousness and sense of contribution for the sake of nation. That would help to promote domestic as well as foreign investment in the country.

Friendly Investment and business environment: on the whole, a friendly investment and business environment must be provided. One major challenge is the situation where foreign investment-friendly environment has not been created. The development of entrepreneurship, use of advanced technology, and promotion of technical capacity have to be encouraged in order to reap benefits and face challenges emerging after the WTO membership and the SAPTA, SAFTA and BIMSTEC agreements. Similarly, we have to create friendly environment for foreign and domestic investment for the exploration, development, and commercial operation of national mineral endowments.

Long term development goals; the country needs to remain attractive for FDI in the current competitive market, especially for such investment that serves its long term development goals and enhances competitiveness (for instance, investment in areas such as infrastructure and hydropower). Retaining existing investment is equally important; particularly in the present deteriorating security conditions may consider closing foreign affiliates or transferring them to other safe locations.

Priority for other country also; Country-wise FDI commitment shows that although India still accounts for the highest share it has needed the broad in other countries.

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