

STATUS AND CONTRIBUTION OF FOREIGN DIRECT INVESTMENT IN NEPAL

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LETTER OF RECOMMENDATION

The thesis entitled **Status and Contribution of Foreign Direct Investment in Nepal** has been prepared by Mr. Matrika Pokharel under my supervision in Partial Fulfillment of the Requirements for the Degree of Master of Arts in Economics.

I forward it with recommendation for approval.

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APPROVAL LETTER

The Thesis entitled **Status and Contribution of Foreign Direct Investment in Nepal** prepared by **Matrika Pokharel** has been accepted as a partial fulfillment of the requirements for the Degree of Master of Arts in Economics.

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ACRONYMS

ADBBL	Agricultural Development Bank Limited
ASEAN	Association of South East Asian Nations
BIPPA	Bilateral Investment, Promotion and Protection Agreement
BBI	Bangladesh Board of Investment
CAAN	Civil Aviation Authority of Nepal
CBS	Central Bureau of Statistics
CPA	Comprehensive Peace Agreement
CSR	Corporate Social Responsibility
DoI	Department of Industry
EU	European Union
FDI	Foreign Direct Investment
FNCCI	Federation of Nepalese Chambers of Commerce and Industries
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GoN	Government of Nepal
HMG/N	His Majesty's Government/Nepal
IB	Insurance Board
IDP	Investment Development Path
IMF	International Monetary Fund
IPB	Industrial Promotion Board
MA	Master in Arts
MNEs	Multinational Enterprises
MoFAs	Ministry of Foreign Affairs
MW	Mega Watt

NIDC	National Industrial Development Cooperation
NRB	Nepal Rastra Bank
NRN	Non-Residential Nepali
NT	Nepal Telecom
NTA	Nepal Telecommunications Authority
OECD	Organization of Economic Cooperation and Development
OLI	Ownership, Location International
RBB	Rastriya Banijya Bank
SAARC	South Asian Association for Regional Cooperation
SOEs	State-Owned Enterprises
SWOT	Strength, Weakness, Opportunity, Threat
TNCs	Transnational Companies
TU	Tribhuvan University
UNCITRAL	United Nations Commission for International Trade Law
UNCTAD	United Nations Conference on Trade and Development
US	United States
VAT	Value Added Tax
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

CHAPTER - I

INTRODUCTION

1.1 Background of the Study

A Himalayan country wedged between two emerging economic powers, India in the east, west and south with an open border and China in the north, Nepal is least developed, landlocked and economically vulnerable nation. The total population of Nepal is 26,494,504, the total number of household is 5,427,302 and the average annual growth rate the population is 1.35 percent(CBS, 2011).

Nepalese economy is passing through the critical phase of low level equilibrium trap circumscribed by poverty and stagnation. The economy is the manifestation of an acute disguised employment and subsistence farming with limited prospect for mechanization where foreign direct investment (FDI) have continued to play a critical role over the years in sustaining the economy. Microeconomic indicators exhibit that Nepal's economic status is vulnerable in terms of per capita, commercial viability of natural resources, the extent of poverty and the status of manufacturing sector,

The developing countries have been trying to attract foreign investment in different sectors. The majority of foreign investment is concentrated in some more advanced countries and middle income developing countries whereas the low income countries have been able to attract proportionately less investment. The reasons for high concentration of foreign direct investment in these countries are their economic characteristics such as large domestic market, rich natural resources and scope for export oriented production. ON the other hand, the small countries with limited internal market and with poor natural resources have been facing difficulty in attracting foreign investment. International Monetary Fund (IMF) states that countries with small internal markets, poor natural resources, a relatively underdeveloped infrastructure and limited possibilities for manufacture exports may not be able to attract substantial direct investment even with liberal regulations and generous incentives. It should, however, be remembered that the large countries with rich natural resources also cannot attract FDI if their policies are restrictive.

Foreign direct investment plays significant role to accelerate the economy to increase of capital formation, technology transfer and production process as well. FDI is

viewed as an instrument for exploring the resources, promoting industrial growth, enhancing the competitiveness of the domestic firms; and also promoting export particularly in developing countries. FDI maintains relatively open economies, stable macro-economic conditions and limited restrictions on foreign exchange transactions. The world FDI has increased its importance by transferring technologies and establishing marketing and procuring networks for efficient production and sales internationally (Shujiro, 1998).

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 export, and employment, transfer of technology and knowhow, management skills as well as to initiation or acceleration of the economic growth and development of the country (Rijal, 2010).

Foreign direct investment offers extraordinary opportunity for developing countries to achieve faster economic growth through trade and investment. The experiences of emerging market economy Brazil, Former USSR, China, Vietnam, Thailand, and India postulate this fact clearly. In developing Asia, FDI is the most important source of capital from abroad.

The increasing flow of FDI in developing economy is found crucial in expanding the extent of infrastructure development. The fastest growing economy China and India are moving towards the emerging power of the world. Similarly, Latin American country Brazil, Mexico, Asian and African economies South Korea, Singapore, South Africa are exercising market economy utilizing the flow of FDI.

The inflow of FDI in Nepal began in the early 1980s through the gradual opening up of the economy. This was primarily due to Nepal's more liberal trade policies, which comprised tariff rate reductions, the introduction of a duty drawback scheme, the adoption of a current account convertibility system and liberalization of the exchange rate regime. A reversal in the rising trend took place from the beginning of the 2000s. All in all, FDI inflow is the lowest in Nepal even when compared with other landlocked countries (World Bank, 2003).

1.2. Statement of the Problem

With the backup of globalization, liberalization and privatization Nepal has been attempting to attract FDI since 1990. It has made couple of efforts in increasing the

inflow of FDI including amendment of laws, initiating investment friendly programs, enforcing private sector via public-private partnership, Providing incentives and facilities to the industries under industrial Enterprise Act and Foreign Investment & Technology Transfer Act, Providing term loans, credits, and subsidy for industrial development, Providing infrastructures like utility services and other facilities. Besides, government as well as private institutions is working collaboratively in making investment friendly situation. The recent BIPPA agreement made between Nepal and India can be taken as an example of joint effort of government and private sector.

Moreover, GoN has enacted dozens of acts aiming to accelerate FDI inflow. Industrial policy 2067 (amended), industrial enterprise Act, Foreign Exchange Act and regulations, Immigration Rules, Customs Act, Industrial Enterprises Act, Foreign Investment and Technology Transfer Act, Electricity Act, and Privatization Act are the major legal attempts made by GoN. Despite these attempts, FDI inflows in Nepal is not adequate (Biggs 2000). World Bank & FNCCI (2000) states "*A key finding of this report is that government policy and its implementation are currently the greatest obstacles for doing business in Nepal*". This argument clearly hints on the leakage of the GoN in pursuing the FDI policy.

This study focuses on the following research questions:

- i. What is the present status and contribution of FDI in Nepal?
- ii. How can policies and institutional arrangements of FDI in Nepal can be generalized in right direction?

1.3. Objectives of the Study

The general objective of the study is to analyse the status and contribution of FDI and to review the policy mechanisms of FDI in Nepal.

The specific objectives of the thesis are as follows:

1. To explore the present status and contribution of FDI in Nepal,
2. To assess the policies and institutional arrangements of FDI in Nepal,

1.4 Significance of the Study

There is a considerable change in the attitude of both developing and developed countries towards FDI. They both consider FDI as a most suitable form of external

finance. Now a days, increase in competition for FDI inflows particularly developing nation like Nepal.

Foreign direct investment is the major concern of Nepalese economy. From the First Plan to till date share of FDI has significant contribution in plan formulation process. Major portion of development expenditure has been covered by FDI. Unlike this, implementation of plans and programs are always found in problems due to weak political willpower. Government mechanisms are found inefficient in grasping the FDI and utilizing properly. At this context, it is necessary to have a glimpse at the overall scenario of FDI and efficacy of its utilization part. This assessment may help development actor by providing right way to channelize the FDI in the days to come.

1.5 Limitations of the Study

This study has following limitations:

- Only secondary data are used. So, the reliability and validity of the study depends upon the quality of data.
- The short period of (1990-91 to 2011-12) has been taken into consideration. Therefore the findings of the study might not be generalized.

1.6 Organization of the Study

This study has included seven major chapters. In the first chapter, general background, objectives, scope and limitations of the study have been explained.

The second chapter reviews some literatures, books, articles, reports etc. In this chapter, the theoretical concept of foreign direct investment as well as empirical findings on foreign direct investment have been reviewed.

The research methodology analyzes in the third chapter, which provides information regarding the nature and sources of data used in this study. In this chapter, setting of the specific models and the significance has been presented which are the core of the thesis.

The fourth chapter highlights the FDI status in Nepal. A brief historical background of FDI in Nepal is also given.

The fifth chapter has examined the FDI related Acts, Regulations & legal arrangements. The major concerns of this chapter is to highlight how the available Acts and Regulations are useful to the FDI in Nepal.

The sixth chapter suggests the contribution of FDI in the economy of Nepal.

The seventh chapter concludes summary of finding & recommendations are made on the basis of the study that might be helpful in formulating policies. References are presented after the contents of the last chapter of the study.

CHAPTER - II

REVIEW OF LITERATURE

Foreign direct investment is regarded as a factor that drives economic growth of the country. Many governments from developed countries believed that FDI can help them get through stagnation and even circumvent the poverty trap. In this context, the detail analysis of the inflows of FDI has provided invaluable information.

Various scholars and organizations have made researches and documents refereeing FDI in developing countries. Some of the literatures relating to this study has reviewed.

2.1 Theoretical Review in FDI

One of the earliest attempts to introduce market imperfections in the theory of FDI was made by Hymer (1976). He has argued that the investing firm must have some advantages specific to its ownership which are sufficient to outweigh the disadvantages they faced in competing with indigenous firms in the host country. These exclusive advantages imply the existence of some kind of market failure. This is because in a perfectly competitive world, all firms are competing equally and have no advantage over others. FDI cannot take place in such a world. However, as other writers (Hood & Trijuens 1993) have pointed out, the existence of ownership advantages does not necessitate production abroad, for the foreign firm can exploit its advantage through licensing or through producing at home and exporting. To explain the choice of FDI over producing at home and exporting, it is necessary to take into account local-specific factors such as trade barriers and market characteristics.

Internalization theory also focuses on market imperfections. But these imperfections are in the markets for intermediate inputs and technology. Intermediate inputs in this context are not just semi-processed materials but more often are types of knowledge incorporated in patents and human capital, among others (Hood & Young, 1984). Imperfections in markets for intermediate inputs create difficulties and uncertainty for the firm to fully exploit its advantages. A profit-maximizing firm faced with such imperfections will try to overcome these in the external market by internalizing them in their operation, either through backward or forward integration. There are a number of such imperfections that are considered important in stimulating internalization. An example is government intervention in the form of tariff, taxation, and exchange rate

policies that create difficulties in the firm's sourcing activities and in exploiting location-specific advantages. All these factors stimulate firms to internalize.

The explanations of FDI have been based upon static advantages, either specific to firms or specific to a location. However, the relative importance of these advantages will change over time as the product develops through its life cycle. As a consequence the firm's choice between export, FDI and licensing might also hang. Vernon (1966) has developed the product cycle model to deal with such dynamic aspects of FDI activities. Initially, Vernon attempted to explain US investment in Europe during the post-war period by answering two questions. The first concerns why innovations occur in developed countries and the second concerns why they are transferred abroad. Vernon tried to answer these questions by relating the product life cycle, which is divided into three stages progressing from the 'new' to the 'mature' and ultimately the 'standardized' product, to the location decisions made by firms and the choice between exports and overseas production. Although the product cycle hypothesis has several weaknesses and might be an oversimplification of reality, it has provided an explanation of why innovations occur mostly in developed countries, while at the same time it explains both trade and investment flows.

Dunning (1979) has discussed that the product cycle hypothesis is only a partial explanation. He developed an eclectic approach to the problem. The principal hypothesis of this eclectic theory is that a firm will engage in FDI if the following three conditions are met: (a) It possesses ownership advantages over firms of other nationalities in serving particular markets. These advantages are specific to the firm. It must be more beneficial to the firm to exploit the advantages itself rather than to sell or lease or license them to foreign firms that are to internalize its advantages through an extension of its activities rather than externalizing them. (c) Given (a) and (b) are satisfied, it must be profitable for the firm to combine these advantages with some factors in the foreign country. The key point of the eclectic theory is that any one of these advantages may be necessary but not sufficient to give rise to FDI. It is necessary to consider all three conditions together. Dunning (1993) concludes that all forms of FDI can be explained by the above three conditions.

The Investment Development Path (IDP) theory was introduced by Dunning (1981) as an extension of Eclectic Paradigm, to explain the net outward investment position of countries in relation to their development stages. The Eclectic Paradigm suggests that

the direct investment stock of countries is determined by three factors: ownership, location and internalization (OLI) advantages. According to the IDP theory, the country passes through five main development stages determined by the changes in the OLI parameters of domestic firms of the country. These changes affect the international investment position of the country with respect to its development.

Hymer (1960) has introduced microeconomic theory on international production. Hymer noted four discrepancies as noted by Heledd Straker (Understanding the global firm), (I) the older theory suggested that flow of capital was one directional, from developed to underdeveloped countries, whereas in reality, in the post-war years, FDI was two – way between developed countries, and (II) a country was supposed to either engage in outward FD or receive inward FDI only. Hymer observed that MNEs, in fact moved in both directions across national boundaries in industrialized countries, meaning countries simultaneously received inward and engaged in outward FDI, (III) the level of outward.

Caves (1971) has classified multi plants in to three groups:

- (I) Horizontal multi plant enterprises: multi plants which produces the same types of goods from its plants and serve across the geographic markets and they can control with lower costs and higher productivity to exist in the market.
- (II) Vertically integrated MNEs: Such MNEs produce goods as the input for other plants to reduce the costs and reduce the uncertainties of products.
- (III) Portfolio diversification and the diversified MNE. He also argues MNEs pursues profits by moving equity from countries its return is to low countries where it is high. The firm's make profit because of the activity.

Buckley & Casson (1976) have suggested that multinationals came into existence because of market imperfections created the opportunity to internalize transactions within a firm. Rather than conduct business externally between two firms- in separate countries, it made sense to instead maximize profits by doing business internally across national boundaries. Two things are important here (i) firms would choose the least cost location and (ii) firms would internalize until the cost outweighed the benefits.

- In reality, all MNEs do not choose the least cost location to internalize the profit from abroad. Cultural, regulatory and environmental factors are also considered by the entrepreneur to set up MNEs instead of cost factors (Jigme, 2006)

Vernon (1966 & 1976) have suggested that Product Life Cycle theory is another development in theory of internalization in FDI literature. According to Vernon, the form of entry into foreign market depends on stages of product life. Products pass through introductory phase, growth, maturity and decline phase. Many firms launch in new products where the products are developed and FDI will local market oriented. In latter stage, when products become standardized and mass production prevails. Cost considerations in the context of increased competition will pressure on MNEs to relocate its production to less advanced countries with comparative advantage of cheap labor. Hence, FDI in the later phase of PLC will be export oriented, influenced by cheaper labor force. In the decline stage of PLC, the product innovating country becomes the net importer of the products.

- PLC theory is applicable for some products but it is not applicable for the vertically integrated MNEs. Some critics say that sometimes entrepreneurs purchase foreign assets prior to actually launching the products (Jigme, 2006).

Kojima(1978) has focused the FDI move abroad due to the location advantage because hence, FDI should move from industries in countries which have less comparative advantage to the host countries where better comparative advantages are prevailing and not realized yet.

Duce (2003) has stated that foreign direct investment reflects the aim of obtaining a lasting interest by a resident entity of one economy (direct investor) in an enterprise that is resident in another economy (the direct investment enterprise) the lasting interest implies the existence of long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the latter. Direct investment involves both the initial transaction establishing the relationship between the investor and the enterprises and all subsequent capital transaction between them and among affiliated enterprises, both incorporated and unincorporated.

IMF's Balance of Payment Manual (1993) has defined the owner of 10 percent or more of a company's as a direct investor. The guideline is not a fast rule, as it acknowledges that smaller percentage may entail a controlling interest in the company. But the IMF recommends using this percentage as the basic dividing line between direct investment and portfolio investment in the form share holdings. Thus, when a non-resident who previously had no equity in a resident enterprise purchases 10 percent or more of the shares of that enterprise from a resident, the price of equity holdings acquired should be recorded as direct investment. From this movement, any further capital transactions between these two companies should be recorded as direct investment.

IMF (2008) has defined that FDI is a category international investment that reflects the objective of a resident in one economy (the direct investor) obtaining a lasting interest in an enterprise resident in another economy (the direct investment enterprise). The lasting interest implies the existence of a long term relationship between the direct investor and the direct investment enterprise. A direct investment relationship is established when the direct investor has acquired 10% or more of the ordinary shares or voting power of an enterprise abroad.

UN(2008) has defined that FDI is investment made to acquire a lasting interest in or effective control over and enterprise operating outside of the economy of the investor., FDI net inflows are the value of inward direct investment made by non-resident investors in the reporting economy, including reinvestment earnings and intra-company loans, net of repatriation of capital and repayment of loans. OECD Benchmark definition (2008) stated that FDI is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor. The motivation of the director is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. The "lasting interest" is evidenced when the direct investor owns at least 10% of the voting power of direct investment enterprise. Direct investment may also allow the direct might otherwise be unable to do. The objectives of direct investment are different from those of portfolio investment whereby investors do not generally expect to influence the management of the enterprise.

Direct investment enterprises are corporations, which may either be subsidiaries, in which over 50% of the voting power is held, or associated, in which between 10 % and 50% of the voting power is held, or they may be quasi-corporations such as branches which are effectively 100% owned by their respective parents. The relationship between the direct investment enterprises may be complex and bear little or no relationships are inherited according to criteria of the framework for direct investment relationships.

The liberalization policy of Nepal opened the way for the inflow of FDI after 1990. As the then Government of Nepal (HMGON) has accorded a top priority to attract foreign direct investment (FDI). Article 26 (12) of the Constitution of the Kingdom of Nepal 1990 states that the state shall, for the purposes of national development, pursue a policy of taking measures necessary for the attraction of foreign capital and technology, while at the same time promoting indigenous investment (Constitution of the Kingdom of Nepal, 1990: 19).

Article 51(d10) of the Constitution of the Nepal 2015 states that to encourage foreign capital and technological investment in areas of import substitution and export promotion, in consonance with national interest, and encourage and mobilize such investment in infrastructure building.

The Ninth Plan (1997/98-2001/02) has the objectives to ensure the safe entry of foreign capital, technology and managerial and technical skills particularly for the development of industry, tourism, water resources and infrastructure; to accelerate the process of industrialization through mobilization of foreign investment and private sector participation; to promote export in the international market by improving production, productivity and quality; and to raise the living of the people by expanding the opportunities for gainful employment and income generation. Thus, special emphasis had been given in the Ninth Plan to mobilize foreign investment to meet the increasing investment need of the country through the creation of investment-friendly environment (Ninth Plan, 1992/93-1996/97). The Tenth Plan (2002/03-2006/07) also aims to meet increasing investment requirements and invite modern technology and management (Tenth Plan, 2003).

According to the 13th Plan (2013/14-2015/16), one of the principle policies is the promotion of domestic and foreign investment for the country's economic

development. The primary objective of foreign investment included augmenting foreign investment level by broadening the industrial base, seeking foreign aid to supplement resources required for a sustainable high economic growth and employment generation, and enhancing technology and management skill transfer. However, not much could be achieved as per the objective.

Promulgation of the Industrial Policy 1992, The Foreign Investment and One Window Policy 1992, The Foreign Investment and Technology Transfer Act 1992 and Industrial Enterprises Act 1992 were the significant steps toward attracting foreign investment in Nepal that played a crucial role in importing foreign capital and transfer of advance technology and efficient management. Besides, Finance Act 2001, The Immigration Rules of 1994, The Customs Act 1997, The Electricity Act 1992, The Copyright Act 1965 and Patent Design and Trade mark Act 1996 have been instrumental to accelerate the pace of economic development of Nepal.

Agrawal (2000) has studied on economic impact of foreign direct investment in south Asia by under talking time-services, cross-section analysis of panel data from five South Asian Countries, India, Pakistan, Bangladesh, Sri Lanka, and Nepal that there exist complementarily and linkages effects between foreign and national investment. Further he argues that the impact of FDI inflows on GDP growth rate is negative prior to 1980, mildly positive for early eighties and strongly positive over the late eighties and early nineties. The result of the analysis carried out by Klohpaidboon(2008) on the impact of FDI on growth performance in investment receiving countries through a case study at Thailand for the period 1920-2000. shows that the growth impact of FDI tends to be greater and export promotion trade regime compared to an import substitution regime.

Dahal & Aryal (2003) have studied that the impact of foreign direct investment and transfer of technology in Nepal examine the role of FDI in economic development of Nepal. This study is based on primary and secondary data and information derived from both Nepal and India. The main objective of the study is to examine the effects of FDI on revenue, employment, trade and industrialization of Nepal. This study concludes that India both have liberalized foreign investment polices that would help promote FDI to Nepal. In Nepal total investment is found Rs. 83.7 billion, total fixed capital equal to 69.7 billion and joint ventures provided employment to 93325 people

during the period of 1989 to 2003. Nepal received highest magnitude of FDI in manufacture sector and the magnitude of India's FDI is 35 percent of the total FDI in Nepal. The study identify that the potential area of FDI in Nepal are hydropower, tourism especially travel-trek and hotels. Infrastructure, education, and health services. IT and software, food processing and biodiversity especially forest and herbal products etc. In this way FDI from India helps to rise the economic activities of Nepal.

Maskey, Pant & Sharma (2006) have examined the role and determinants of FDI in service sectors of Nepal with especial reference of healthcare sector. The prime objective of this study was to examine the practices of service sector investment. The study concluded that for Nepal to capture the benefit of investment liberalization, it must continue enhancing the existing facilitating mechanism, the determinants of FDI along with the incentives in the services sector. Ensuring a stable domestic environment will be much more important to win confidence among investors.

In Nepal the main determinants of FDI inflows are quality of infrastructure, level of skill and human capital, regulatory environment and incentives.

Nepal had attracted more FDI in different sectors. It had positive impacts on exports, particularly Garments, and economic growth. FDI has also enabled the country to export non-traditional manufactured products such as micro-transformers and personal consumer's products, Investment was mainly in low technology, labor intensive production., The impact of FDI had also been modest, primarily in job creation. According to study FDI inflows was constraint by political instability, outdate foreign investment policies, rigid labour regulation and poor physical infrastructure. This situation remains constraint due to political instability.

FDI is considering beneficial in view of its contribution to technological transfers, enhancement of managerial capabilities and new opportunities for market access. FDI, particularly in the form of equity investment, adds to the capital stock of the country and thus enables the recipient country to achieve faster economic growth through momentum in capital formation. Increases in FDI are also seen as leading to increase in exports by creating international markets through new marketing and organizational skills.

The inflow of FDI in Nepal began in the early 1980s through the gradually opening up of the economy. But the FDI inflows in Nepal are very poor to compare with other Asian underdeveloped countries.

FDI in Nepal is highly concentrated in the manufacturing sector, which accounted for slightly more than 45 percent of approved FDI projects. Tourism is second, accounting for almost 20.5 percent of total FDI projects, followed by the service sector with 10 percent of FDI projects. Other sectors have just received 10 percent FDI projects.

In the recent decade Nepal is well coming FDI and has been benefited. Some of the literature suggests that FDI INFLOWS HAVE A POSITIVE IMPACT ON ECONOMIC GROWTH OF HOST COUNTRIES. However, FDI in itself is not a development but may act as a catalyst for the needed progress.

Adhikari & Sharma (2006) have examined the role of FDI in economic development of Nepal. The objective of this study is to examine the nature, trend and determinants of FDI in Nepal and development implications of FDI in late-comer countries in order to place the Nepalese Experience. The study shows the trend and patterns of FDI during 1988-2001. The study based on the descriptive analysis, This study shows that under the new policy regime, foreign firms have played a role in different export oriented industries, but their exports largely depend upon the Generalized System of Preferences and Quotas rather than the country's comparative advantage. The majority of foreign firms are involved in import substitution activities characterized by high capital intensity. Consequently, the contribution of FDI to employment generation has been negligible. It seems that FDI attracted to 'Easy profit' activities (import substitution manufacturing as well as the quota-protected industry) has failed to make a significant contribution to productivity growth in the Nepalese manufacturing sector.

Ghimire (2011) has explored that the current scenario of foreign direct investment in Nepal. The main objective of this study is to show the present scenario of FDI in Nepal. This study shows that foreign investment is the most important resource for the economic development of the country. It helps to stimulate competition, productivity and innovation. Further, it generates income and employment opportunities resulting in higher wages, competitive prices, more revenue, skill and technology transfer and increased foreign exchange earnings. This study is based upon the descriptive analysis.

The descriptive analysis concluded that capital is one of the prerequisites of economic development which have to either provide from the internal source or to be managed by the external sources. FDI is one of the major external sources to fulfill the capital gap. However, the inflows of FDI in Nepal are very low.

Adhikari (2013) on foreign direct investment in Nepal current status, prospects and challenges has examined the trend of FDI inflows in South Asian countries. South Asia as whole has been receiving reasonable good amount of FDI, although the total FDI received by the region represents a measure 2.6 percent of the global FDI inflow, even with in this, 80 percent of FDI went to India., leaving other seven countries in the region with share of remaining 20 percent. It is disheartening to note that despite a recent growth in FDI achieved by Nepal, the country still receives the lowest amount of FDI in the region.

2.2 Empirical Review on FDI

Thomsen (1999) has presented the policy mechanism of ASEAN countries. According to him at a time of continuing financial crisis in Asia, the question of the appropriate policies for recovery and for future sustainable development is paramount. One area of particular importance is the treatment of foreign investors. Foreign direct investment (FDI) has played a leading role in many of the economies of the region, particularly in export sectors, and has been a vital source of foreign capital during the crisis. The four countries reviewed in this study - Indonesia, Malaysia, the Philippines and Thailand - have all to varying degrees welcomed inward investment for its contribution to exports. As a result, although only a small share of total investment or employment in each economy, FDI has been a key factor driving export-led growth in Southeast Asia. Foreign firms have by no means been the only actors, but they have played a leading role in those sectors with the fastest export growth such as electronics. Through such investment, host economies have rapidly been transformed from agriculture and the exploitation of raw materials into major producers and exporters of manufactured goods.

For many years, Malaysia and Thailand were among the most open in the developing world to foreign investment. They were quick to recognize the powerful role that foreign investors could play in fuelling export-led growth, and they were well-placed to attract such investment during the years of regional structural adjustment in the late

1980s. Partly as a result of FDI inflows, the two countries were among the world's fastest growing economies before the crisis. At the same time, however, the years leading up to the crisis revealed a growing disquiet in some ASEAN countries about their continuing ability to attract FDI in the face of competition from countries such as China. Related to the issue of possible investment diversion, questions were also raised about whether FDI inflows were contributing sufficiently to technology transfer and industrial upgrading.

In the wake of the financial crisis which has swept through the region, it is useful to look once again at the experience of various ASEAN countries and the role of foreign investors in their economic development. In all four countries, development strategies include a selective approach to investment promotion with a clearly circumscribed role for foreign direct investors. Such partial openness allows foreign firms to contribute to rapid economic growth driven by exports, but it has been less adept at delivering sustainable development. In many cases, indigenous capabilities have not been developed sufficiently in those export sectors dominated by foreign multinational enterprises (MNEs), leaving the host country vulnerable to hang in investor sentiment and to growing competition for such investment from other countries. This study draws on the experience of the ASEAN4 countries to suggest that a more balanced treatment of foreign investors which allows foreign MNEs to play a greater role in the domestic economy could yield substantial benefits in terms of restoring investor confidence and placing economic development in the ASEAN4 on a more sustainable basis in the future.

Asafo (2007) has presented the importance of FDI in South African economy. As he argues" this study focuses on FDI and its importance to the economy of South Africa. Recognizing that FDI, notwithstanding the type, can contribute to economic growth and development, most countries including South Africa are constantly working to attract it, and hence its demand has become highly competitive. However, FDI does not go without some negative effects, such as conflicts between host and investor country, and the creation of damaging competition to local firms. These negative effects could be minimized if policies and strategies for the promotion and attraction of FDI is part of, and integrated into, general economic development and economic reform policies, and not seen in isolation. Although South Africa has implemented

strategies to attract more FDI, a refinement of some of these policies is needed if the country is to be successful in this regard.

Thomo (2010) has insisted that FDI should have the power to create employment opportunities. His research work "An investigation of the impact of inward FDI skill development and job creation in south Africa" shows the challenges being faced by South Africa. Two of the most serious challenges facing South Africa today are the availability of skills and unemployment. Inward FDI has been promoted by the IMF and the World Bank as a solution for sustained growth in developing countries. This growth impact can be achieved through a combination of FDI benefits which include access to foreign funds, adoption of superior technology, skills transfer and job creation. A number of researchers have investigated the impact of FDI and have come up with different conclusions. The purpose of this study is to investigate the impact of inward FDI on skills development and job creation in South Africa. Telephonic interviews were conducted with 3 multinational companies based mainly in the Gauteng Province during August 2010. A qualitative approach was used in the methodology by comparing the data collected across the companies that participated in the survey. The study concluded that inward FDI has a positive impact on skills development and job creation in South Africa and therefore significantly impacts economic growth.

Alam (2010) has provided some measures to make FDI cost effective. As he argue the empirical literature offers regional integration arrangements reduce trade costs among partner countries this reduction in cost not only increase trade but also act as a stimulus to increase FDI flow. South Asian Association for Regional cooperation (SAARC) was established in 8th December 1985 with the seven South Asian countries (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) but after 25 years of its establishment very low level of intra regional trade (less than 5%) and in case of FDI the major source is outward flow than intra regional flow. Despite the major difference among the member countries in different macroeconomic parameter there is a scope of potential for intra regional FDI inflow. In this study different research papers was presented with respect to regional trade and integration was studies. The major focus is on SAARC economic integration and FDI status. The study one other economic integration areas and FDI inflow was suggested for future

research. Majagaiya (2009) has presented the effect of different form of FDI in the economic development of Nepal.

All Foreign Investment, Remittance, Grant and Pension and others have become a lifeline for economic development in developing countries and have contribution to the Gross Domestic Product (GDP). In the recent decade, Nepal has been achieving Remittances Pension, Grant and FDI Parall. Not so far research has been done for comparison of contribution to GDP by Remittances and FDI. This paper focuses the contribution of Remittance, FDI, and remittance, Grants and Pension to national GDP using time series analysis of data.

FDI may have wider and technological benefits through its spill-over effects, it could also discourage the development of technological know-how by and in local firm and institutions, to the detriment of the growth of domestic producers and the national economy.

The possible benefits of FDI include the transfer of technology to individual firms and technological spill-over to the wider economy; increased productive efficiency due to competition from multinational subsidiaries; improvement in the quality of the factors of production including management in other firms and not just the host firm; benefits to the balance of payments through the inflow of investment funds; increase in exports; increase in savings and investment, and hence faster growth of output and employment, consumers may benefit both from lower prices of goods and the introduction of new or better quality goods.

. “The benefits of FDI consists of (a) transfer of technology (b) transfer of capital (c) enhancement of managerial capacity and skills, (d) access to world market, and (e) employment opportunities” (Dahal & Aryal, 2000).

“Foreign direct investment has come to be widely recognized over the past decade as a major potential contributor to growth and development. It can bring capital, technology, management know-how and access to new markets. In comparison with other forms of capital flows, it is also more stable, with a longer – term commitment to the host economy” (Ricupero & Cattai, 2003).

“Foreign direct investment (FDI) can play a key role in the economic growth & 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” (UNCTAD, 1996).

The Three Year Interim Plan (2007-10) has accorded priority to foreign investment. It aims to increase the level of foreign investment through the expansion of industrial base and, to receive resources in the complementary basis for the generation of employment opportunities and high, broad-based and sustainable economic growth. Similarly, it aims to increase the Technology and Management Transfer.

The Plan has committed to policy reforms. One-Window Committee would be made more active and provide the basic facilities to the investors. Some of the major policies adopted by this plan are as follows:

1. Diplomatic agencies situated in foreign countries shall be mobilized to encourage the volume of FDI.
2. Proper policy will be developed in order to attract the capital, skills and technology of NRNs.
3. Foreign investment shall be encouraged in "Venture Capital".
4. Foreign investors are permitted to own up to 100 percent equity share in medium and large scale industries.
5. A high level Investment Promotion Board will be established to facilitate the foreign direct investment. This Board will help to provide project approval, license, tax concessions and so on.
6. Investment with foreign collaboration shall be encouraged in different areas such as, electricity generation, tourism, especially to build airport, air services, agriculture, education and health, fiscal services, information technology and bio-technology relating industries.

Dangal (2002) has 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 its 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 when democratically elected first government of Nepali Congress adopted liberal policies in the matter of getting private domestic or foreign investors involved into the economic activities of a country.

Timilsina & Mahato (1998) have explained 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”.

Available latest data for FDI reflect that 835 foreign investment projects are registered in Nepal comprising all categories of industries, worth a total of investment equal to Rs. 83.7 billion. The total fixed capital is estimated to be Rs. 69.7 billion, while the total foreign direct investment (FDI) marked Rs. 22.6 billion as of July 2003. FDI is likely to provide employment to 92, 325 people. Of the total, 91 JVs are either closed or cancelled for various reasons (DoI, 2003)

Indian joint ventures account for more than 35 percent of the total projects. The joint ventures of US, Japan, China, Germany and South Korea are also prominent in the structure of FDI. Shift in the policy of the government especially after 1990 have signaled to foreign investors that Nepal is open for business. Private operations have been allowed in some sectors that were previously government monopolies such as telecommunication and civil aviation. Licensing and regulations have been simplified and 100 percent foreign ownership is allowed. New banking institutions and nascent stock exchange provide alternative sources of investment capital. Multinational investors based or looking to expand in the growing Indian market have also expressed an interest in Nepal. However, foreign investors complain about complex and opaque government procedures and a working level attitude that is more hostile than accommodating.

FDI is considered as an important tool for economic development in a developing country. If the investing country is wealthier than the host country then capital will flow to the host country. It contributes to growth of GDP; create employment generation, technology transfer, human resource development, etc. It is also perceived that FDI can play a significant role to reduce poverty of a developing country.

Foreign Direct Investment can be defined as investment in which a firm acquires a substantial controlling interest in a foreign firm or set up a subsidiary in a foreign country (Chen, 2000). IMF (1993, 2003) and OECD (1996) defined FDI as a long-term investment by a foreign investor in an economy where higher volume of investment. According to the Balance of Payment Manual (1977 & 1993) FDI refers to investment made to acquire lasting interest in enterprises operating outside of the economy of the investor.

In the developing world, the East Asian countries - South Korea, Hong Kong, Taiwan and Singapore were the first to use effectively the FDI from TNCs to achieve economic development. After opening up their economy towards FDI, these countries emerged as 'Asian Tigers' and witnessed rapid economic developed within a relatively short period of time. In recent years, many countries have introduced open door policy to attract FDI with a view to increase investment, employment productivity and economic development (Agiomirgianakis 2003). A number of empirical studies have shown that developed and developing countries both desire to attract FDI. Developing countries always are in disadvantage in terms of technology, capital, and human resources at the early stage of development. In FDI literature it is already recognized that FDI not only brings capital for productive development to the host economy, it also transfers a considerable amount of technical and managerial knowledge and skills, which is likely to spill over to domestic enterprise in that economy (Balasubramanyam 1996, Kumar & Podhan, 2002). It is recognised that FDI can contribute to the growth of GDP, Gross Fixed Capital Formation (GFCF) (total investment in a host economy) and balance of payments (Baskaran & Muchie, 2008).

Most Developing countries are always at a disadvantaged position in terms of technology and in this regard FDI contribute to transfer technology and can contribute towards income, production, prices, employment, economic growth, development and general welfare of the host country (Kok & Ersoy, 2009). Agiomirgianakis (2003) has suggested that as FDI increases the total output of the host country, it eventually

contributes to the economic development of the host country. To achieve industrial expansion a country should produce high quality products and accomplish market efficiency. To facilitate this technological development is imperative. A developing country like Bangladesh that is at an early stage of development has to rely on FDI as an important vehicle to bring in technological development. Hence, it is perceived that FDI is capable of increasing the technical capabilities of the host country.

Sun (1998) has examined that FDI has extensively helped economic growth in China by enriching domestic capital formation, increasing exports, and creating new employment. Khoda (2003) has stated that FDI can raise domestic capital, engender employment by using underutilized labour, build up organizational formation as well as managerial standards of the host country, transfer technology, get better internal and overseas marketing network and also assist to improve the technical expertise of the Government. It is argued that “MNEs are subject to use up more on R&D abroad than at home and their foreign affiliates act comparatively better in terms of productivity” (Chen, 2000 : 37). Mmieh & Frimpong (2004) have studied on the FDI experience in Ghana reveals that the economic reform has contributed to attracting significant multinational investment. They also stated that changes to policies and regulations have helped to increase FDI inflow in China, India, Korea and Mexico.

The year 1990 was considered as the year of liberalization of laws, rules, regulations which influenced the foreign direct investment of developing countries. World Development Report (1991) has concluded that development perspective had changed significantly. Bangladesh opened up its economy in 1990 and started drawing the attention of foreign investors. Mortoza & Das (2007) have empirically shown that liberalization of trade had an impact on FDI in Bangladesh. As per Investment Handbook (2007) of Bangladesh Board of Investment (BOI) it is now simpler to do business in Bangladesh than many developing economies. Report of ‘Doing Business’ jointly published by the World Bank and IMF ranked Bangladesh in the 68th position in terms of starting business among 175 economies. World Bank (2005) has advocated that Bangladesh can attain physical capital, technology transfer, sharpen the competitiveness among domestic investors through the proper utilization and allocation of resources. In 1990, the economy of Bangladesh has made remarkable advancement in terms of Gross Domestic Product (GDP) growth, which was around 5 percent. The 4th survey of FDI inflow by BOI in Bangladesh stated that the cost of

investment in Bangladesh has become cheaper compared to the previous years. But Mandal (2003) found that FDI inflow to Bangladesh is constrained by six factors: (i) Political instability, (ii) Sluggish steps towards privatization, (iii) High business cost, (iv) Tax hazards, (v) Threats related to finance, and (vi) Incompetent or futile capital market.

Other studies also identified infrastructural, bureaucratic, environmental factors and political instability as constraints that restrict the inflow of FDI (Mian & Alam, 2006, Kafi, 2007). According to Musila & Sique (2006) it is important to maintain political, sound macroeconomic stability and a favorable policy regime to successfully attract a large volume of FDI. Alam (2006) have empirically shown that the macroeconomic environment in Bangladesh is congenial for attracting foreign investment. Since the inception of BEPZA it has been playing a very important role for economic development of Bangladesh through export promotion, employment creation, technology transfer, and development of forward and backward linkages of industries and so on. SWOT analysis of Bangladesh economy by Salman (2009) has suggested that the Bangladesh has huge investment opportunities, but it has to develop and exploit it properly. The study highlighted that as Bangladesh has access to major export markets such as the EU, Canada, Japan, New Zealand, and Australia, it is essential to diversify products if the country intend to avail the benefits from trade concessions. But, according to WEF's Global Competitiveness Report (2008-2009) Bangladesh ranks 111 out of 134 countries in terms of business environment and "the business climate in Bangladesh is poor and less competitive in global context and the environment is deteriorated in 2007. It also pointed out that the ranking deteriorated compared to the previous year when it ranked 107 out of 131 countries.

To sum up, the literature review suggests that FDI is an important tool for the economic growth in a developing country such as Bangladesh. Literature review also revealed that there are contradicting perceptions, facts, and findings about the investment environment and doing business in Bangladesh. In the next section we will propose an analytical framework to evaluate the FDI flow in Bangladesh and to analyze the perceptions and experiences of two target groups: the policy makers and the foreign investors.

Blomström & Koko (2003) & Borenstein, Gregorio & Lee (1998) have discussed that the contributions of FDI to the development of a country are widely recognized as

filling the gap between desired investments and domestically mobilized saving, increasing tax revenues, and improving management and technology, as well as labor skills in host countries. These could help the country to fight its way out of poverty. Empirical studies suggest that FDI provides a source of capital and complements domestic private investment.

Some studies (Blomström & Kokko, 2003, & Chen & Démurger, 2002) have concluded that FDI contributes to total factor productivity and income growth in host economies, over and above what domestic investment would trigger. These studies find, further, that policies promote indigenous technological capability, such as education, technical training, and R & D, increase the aggregate rate of technology transfer from FDI and that export promoting trade regimes are also important prerequisites for positive FDI impact. For instance, the study by Borenzstein, Gregorio, & Lee (1998) using data on FDI received by developing countries tested the effect of FDI on economic growth in a cross-country regression framework. They found some indications that FDI has a positive effect on economic growth, but this impact was dependent on the human capital stock in the host economy. However, there is growing empirical evidence suggesting that the impact of FDI on economic growth is not automatic.

Borenzstein, Gregorio, & Lee (1998) have showed that for FDI to contribute to economic growth, the host country must have achieved a minimum threshold level of development in education, technology, infrastructure, financial markets, and health. Thus, FDI contributes to economic growth only when the host country has reached a developmental level capable of absorbing the advanced technology that it brings. Excessive FDI may not be beneficial. Through ownership and control of domestic companies, foreign firms know more about the host country's productivity, and they could overinvest, at the expense of domestic producers. Possibility exists that the most solid firms will be financed through FDI, leaving domestic investors stuck with low productivity firms. Such "adverse selection" is not the best economic outcome.

2.3 Research Gap

Varies studies conducted by several researches reviewed in the present study has different objectives, methodologies, findings and recommendations. Large number of variables which appear significant in some cases appear insignificant in other cases.

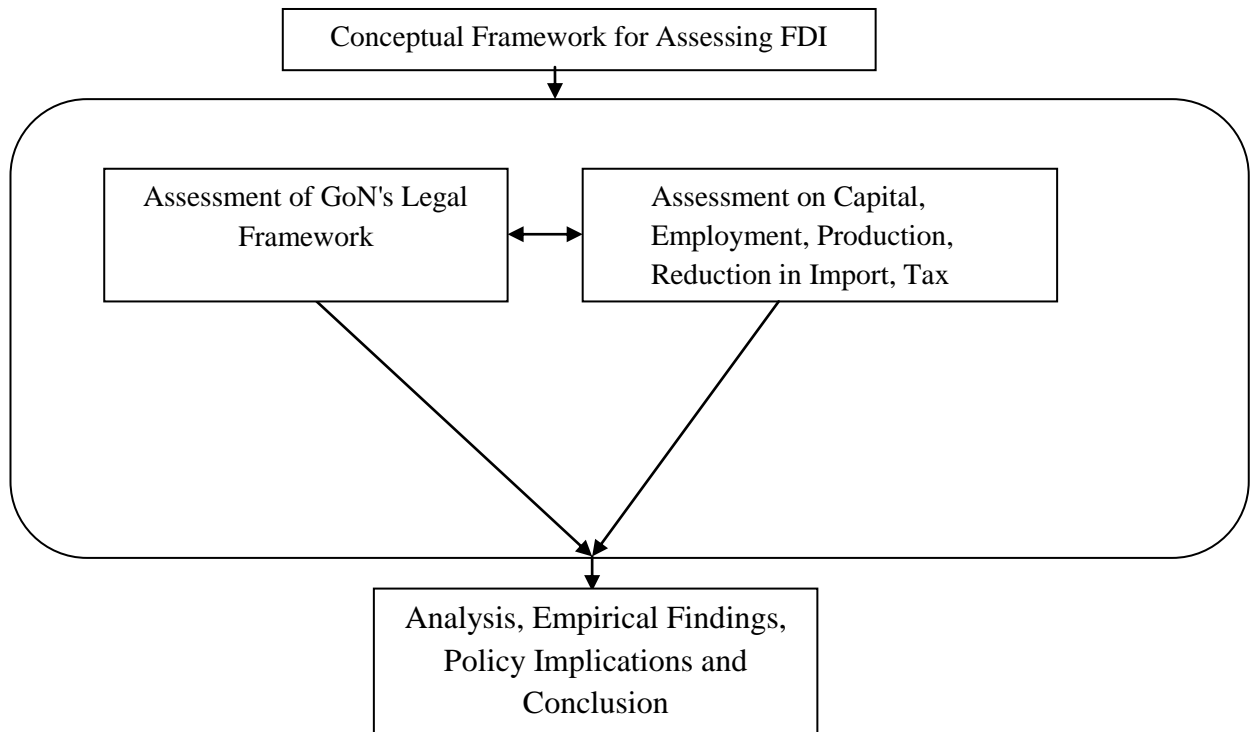
Some studies have produced conflicting results. In context of Nepal, there are a few studies which analyze the Acts and Regulations of FDI in flows and show the status and contribution of FDI in Nepal. So, this study intends to link and fill gaps on the literature of past at academic level covering large span of time series annual data. Therefore, an in-depth study of status, contribution and policy analysis with FDI inflows in Nepal is utmost importance and it is expected that it will contribute extra knowledge in the existing field.

CHAPTER-III

RESEARCH METHODOLOGY

3.1 Conceptual Framework

The conceptual framework to carry out the research work has been presented below:



Clarification of Conceptual Framework

3.2 Research Design

The research design to be followed in the study is descriptive as well as analytical. The analytical type of research design will be followed for clarifying the existing trends in different parameters pertaining to FDI in Nepal, on the basis of the collected data and facts. The descriptive type of research design will be used to make the analyzed facts more meaningful and useful for the purpose.

a) Assessment of GoN's Legal Framework

This research assesses the policies, acts, regulations and directives governing FDI (Foreign Exchange Act and regulations, Immigration Rules, Customs Act, Industrial Enterprises Act, Foreign Investment and Technology Transfer Act, Electricity Act, and Privatization Act).

b) Assessment on Trends, Impact, Barriers to Attract FDI, and, FDI Related Issues

In this section, trends, impacts, different forms of barriers of attract FDI, along with specific FDI measures are assessed.

In the process of assessment of FDI following aspects are considered.

- Objectives of the policy
- Definitions
- Origins, types, eligibility, conditions, and issues/transfer of investments
- Policy on route, caps and entry conditions

c) Analysis, Empirical Findings, Policy Implications and Conclusion

This session has a core idea of study where the analytical part on the basis of available data as well as related Acts are critically analyzed. Some empirical findings and policy implication are listed. The core idea of study is mentioned in conclusion.

3.3 Nature and Sources of Data

The nature of this study is descriptive as well as analytical. The secondary data has collected from various sources such as Department of Industry, Ministry of Industry, Investment Board, Central Library of TU, MoFA, NIDC, CBS, CEDA Library, NRB, DoI, MoF, FDI Department, NPC, World Bank Reports, UNCTAD reports, published as well as unpublished reports, books and documents, various articles, research papers, journals, NGOs/NIGOs' reports and publications dealing in the subject matter the study, websites,- etc. Secondary data has further processed and analyzed to find out the past trend and structure of FDI in Nepal.

3.4 Tools and Techniques of Data Collection

The quantitative data have collected, processed and analyzed to get the answer of the research questions and to fulfill the objectives of the study.

3.5 Processing of Data

A master sheet of information have prepared and the raw data or information has been tabulated. On the basis of this master sheet of information, further grouping, sub-grouping, and classification of data has done to make it fairer and to meet the

objectives of the study. It helps the research to analyze the result of collected data and then to be interpreted the findings.

3.6 Methods of Data Analysis

The study is based on quantitative as well as qualitative data. Various statistical tools have used to meet the objective of the study. Especially these analytical tools have used to estimate the economic effect of the foreign direct investment in development of different sectors of Nepal. The correlation analysis has been used to show the relationship between FDI inflows in different sectors and economic growth of these sectors.

3.7 Analysis and Interpretation of Data

In order to produce convincing logical conclusion and to rule out alternative interpretations, the data collected from different sources to process, analyze and interpret them to drive meaningful conclusion.

The various data collected from different sources have been compiled, condensed, analyzed and presented in the form of tables and diagrams, graphs and charts. In order to exclude the irrelevant unnecessary data and process them as per thesis requirements, data has edited and properly tabulated. The data has arranged, grouped and accordingly entered into appropriate tabular form. Moreover, simple one-way table has been used to present the data, which has been followed by an in-depth interpretation.

CHAPTER - IV

STATUS OF FOREIGN DIRECT INVESTMENT IN NEPAL

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.

Increase in FDI is seen as leading factor to increase exports by creating international markets through new marketing and organizational skills. Therefore, it is not unusual for economists to emphasize the importance of FDI in fueling economic growth. In fact, since the early 1950s, FDI has been recognized as the most crucial factor in enhancing economic development and ensuring a reasonable standard of living for countries which have been the recipient of FDI. South Korea, Singapore, and Taiwan have been examples of nations outside the OECD countries that have benefitted greatly from FDI. In recent years, China and India have made remarkable progress in attracting FDI and in realizing technological and economic successes.

4.1 Status of FDI in Nepal

Available latest data for FDI reflect that 2,335 foreign investment projects are registered in Nepal comprising all categories of industries, worth of total investment equal to NRs 1645,101 million. The total fixed capital is estimated to be NRs.139,858 million as of 2011.12. FDI is likely to provide employment to 164,482 people in Nepal. Out of total project (2,335), 756 are service related project comprising worth of total investment NRs.28,070 million. FDI in service sector is likely to provide employment to 35,942 people in Nepal (Industrial Statistic 201/13). Similarly 743 projects are manufacturing industries with NRs 58,152 million project cost.

The main sources of FDI are multinational companies, which are based in industrial countries. The benefits of FDI consists of transfer of technology, transfer of capital, enhancement of managerial capacity and skills, access to world market, raising

employment opportunities and economic growth. In Nepal, government's efforts to attract FDI began with policy reform. It must develop, legislate and implement a range of policies that support a favorable business and investment climate. Government has played role in promoting foreign investment-investor services that contains two functions: promote investment opportunity, and facilitate the investment process. Thus, the government of Nepal has spent abundance of resources to attract FDI to gear up our economy.

As per the industrial Act, 1992, there existed a provision to establish the one window service (OWS) whose aim was to provide all services required by foreign investors under one roof. The policy listed two types of services to be provided by the OWS (a) permission, facilities and other administrative services under the foreign investment and technology transfer Act, 1992 and (b) Other infrastructures facilities like land, registration, electricity, water, telecommunication etc. and other services as required by investors. However OWS was not successful to addressing the true need of the investors. An industrial promotion Board was formed under the chairmanship of the minister of industries on the basis of foreign investment and industrial Act, 1992. The principle objectives of the Board were (a) providing necessary co-operation in developing and implementing policies. (b) Developing guidelines in meeting the aim of liberal, open and competitive economic policies under taken by the country. (c) Coordinating between the policy level and the implementation level of the industrial policy.

Nepal formed a Board of investment (BOI) under the chairmanship of the prime minister in 2001. The BOI was established for promoting domestic as well as foreign investment and making it more transparent and reliable. However, the BOI has not been functioning smoothly as per its objectives. A powerful institutional arrangement with appropriate policy helps to promoting and attracting FDI in Nepal.

To sum up there have been gradual, sincere and sustained efforts on the part of policy makers to give a boost to the FDI inflows in to Nepal in the post liberalization period.

4.2 Inflows of FDI in SAARC Countries

Table 4.1 exhibits the FDI inflows in SAARC countries. The table shows the low inflows of FDI in Nepal to compare with India, Pakistan, Bangladesh and Sri Lanka. The FDI inflows in Nepal is negative during 2000, which is US \$ -0.48 similarly, In

terms of the FDI potential index , Nepal ranks the lowest in the region , i.e., 175 out of 182 countries ranked globally (UNCTAD 2012) .

Table 4.1: Trend in FDI Inflows SAARC Countries

Name of the country Year	1980	1990	2000	2010	2012
Bangladesh	8.51	3.23	578.64	913.3	990.0
Bhutan	0	1.6	0	25.84	15.91
Nepal	0.3	5.94	-0.48	86.74	91.98
Maldives	-0.13	5.6	22.26	216.47	293.98
India	79.16	236.69	3597.66	21125.45	25542.84
Pakistan	63.63	278.33	309	222	846.75
Sri-Lanka	49.9	43.35	172.95	477.6	775.5

Source: UNCTAD World Investment Report, 2013

4.3 Inflows of FDI in Nepal after Liberalization (1990 onward)

In order to understand the impact of macroeconomic stabilization policy, structural adjustment program and the changes in the foreign investment policy on the FDI inflows, quantitative information is needed on broad dimensions of FDI and its distribution across sectors and regions. However there is a considerable amount of ambiguity on the quantitative data of FDI in Nepal. The secondary data sources, which published the FDI data in Nepal, are not similar. There is inconsistency in the data given by different sources. The present study had diagnosed the FDI data given by the ministry of industry to access the trend of FDI inflows in Nepal. This chapter deals with analysis of secondary data related to foreign direct investment. In this section of the study, the researcher has attempted to present and explain the results of these data. The major objective of this study is to analyze the nature, composition and trend of FDI inflows in Nepal. The data collected were presented and analyzed here with detail elucidation of the results.

Structure of foreign direct investment in Nepal has been examined for the period of 1989/9 to 2011/12. The efforts have been made to analyze the details of foreign investment projects in Nepal- year wise, sector wise and category wise for the same period. The nature composition and trend of FDI inflows in Nepal can be explored under the following heads.

4.4 Inflows of FDI by Scale-wise Industry

According to industrial policy of Nepal 2010, the industry having fixed investment up to 50 million is taken as small scale industries and fixed capital having Rs. 50 million

to Rs. 150 million and above Rs. 150 million are taken as medium scale and large scale industries respectively .

Table 4.2: Licensed Industries For FDI on Project Cost Basis

(Rs. in million)

Types of Industries	Number of Industries	Total Project Cost	Total Fixed Cost	Foreign Direct Investment
Large Scale Industries	195	12,456.81	11,273.97	5,216.92
Medium Scale Industries	262	1,888.74	1,337.53	898.10
Small Scale Industries	1,878	2,064.47	1,374.27	1,399.98
Total	2,335	164,101	139,858	7,5150.0

Source: Department of Industry, Government of Nepal, 2012/13

Table 4.2 exhibits that the total number of industries with foreign capital in Nepal marked 2,335 as of 2013. The data reflects that the size of total project cost is Rs. 164,101 million and FDI accounts for Rs. 75,150 million during the period of 1988/89-2011/12. The industries with FDI by the end of FY 2011/12 on the project cost basis 195 (8.4 percent) are large scale industries, 262 (11.2 percent) are medium scale industries and 1878 (80.4 percent) are small scale industries. Out of total foreign investment of Rs. 75,150 million, share of large scale industry has been the highest with 69.4 percent while those of medium and small scale industries are 18.6 percent and 12 percent respectively.

4.5 FDI Project in Nepal Year-wise and Growth Rate of FDI

The growth rate of FDI inflows in Nepal was not significant until 1990 due to the regulatory policy framework. However, under the new policy regime, it has expected to get momentum and assume a much larger role in catalyzing Nepal economic development. It can be observed from table 4.2 that shows the actual FDI inflows in Nepal during 1988/89-2011/12.

Table: 4.3: Foreign Investment Project in Nepal by Year-wise**(Rs. in Million)**

Fiscal Year	No. of Industry	Total Project Cost	Total Fixed Cost	FDI Inflows (Y)	Trend Value of FDI (Y_c)	Fluctuation (Y-Y_c)
Up to 1988/1989	58	5,106	4,272	450	-138.89	588.89
1989/1990	30	2,438	2,140	399	145.50	253.50
1990/1991	23	864	691	406	429.83	-23.83
1991/1992	38	3,506	2,902	598	714.36	-116.83
1992/1993	64	17,886	16,211	3,084	998.55	2,085.45
1993/1994	38	3,733	3,176	1,379	282.00	97.00
1994/1995	19	1,627	1,248	478	1,567.27	-1089.27
1995/1996	47	10,047	9,399	2,220	1,851.00	369.00
1996/1997	77	8,559	6,692	2,396	2,135.99	260.01
1997/1998	77	5,573	5,146	2,000	2,420.35	-420.35
1998/1999	50	5,324	4,380	1,666	2,707.71	-1041.71
1999/2000	71	2,669	1,910	1,418	2,989.07	-1571.07
2000/2001	96	7,918	6,122	3,103	3,273.43	-170.43
2001/2002	77	3,319	1,560	1,210	3557.79	-2347.79
2002/2003	74	4,922	3,608	1,794	3,842.15	-2048.15
2003/2004	78	4,324	3,766	2,765	4,126.51	-1361.51
2004/2005	63	1,796	1,149	1,636	4,410.87	-2,774.87
2005/2006	116	4,121	3,279	2,606	4,695.23	-2089.23
2006/2007	188	3,426	2,651	3,186	4,979.59	-1793.59
2007/2008	213	20,406	16,898	6,255	5,548.31	706.69
2008/2009	231	9,418	7,530	6,255	5,548.31	706.69
2009/2010	171	13,954	14,988	9,100	5,832.67	3,267.33
2010/2011	209	11,250	9,375	10,051	6,117.03	3,933.97
2011/2012	227	11,912	10,738	7,141	6,401.39	739.61
Total	2,335	164,101	139,858	75,150		

Source: Department of Industry, Government of Nepal, 2013/14

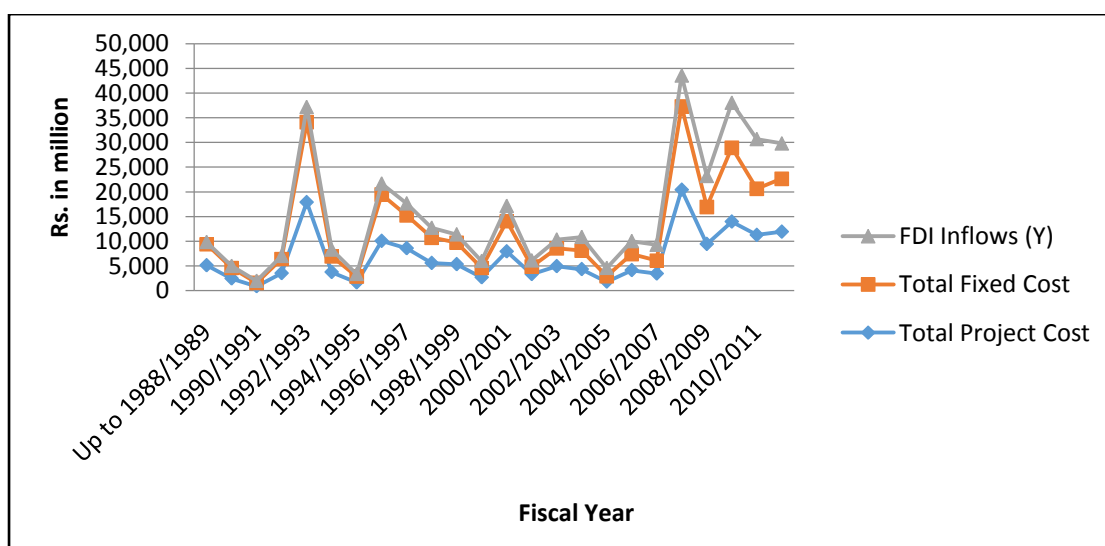
Table 4.3 manifests that the number of foreign investment projects in Nepal marked 2,335 for the period 1988/89-2012/13. Total project cost is estimated to be Rs.164,101 million, Total fixed cost is estimated to be Rs.139,858 million, whereas FDI is equal to 75, 150 million. The size of FDI as very minimal Rs.450 million up to FY 41989 due to the regulatory policy framework, which increased to Rs.7141 million in 2011/12 and marginally decreased to Rs.2910 million from FY 2010/11 to FY 2011/12. The annual average inflow of FDU in Nepali is Rs.3267.39 million. The FDU in flows in Nepal before FU 2007/08 were below the average and after FY 20 0 8/ 08 above the average.

The trend value of FDI inflows in Nepal shows the high fluctuation in FDI inflows in the study period are the various reason. One of the strong reasons for the fluctuation is the political instability and conflict. The Maoist movement started from 1995 in the political in the country and from the same time FDI inflows started to have negative impact. The Maoist movement continued for 11 years till 2006, it is found the high fluctuation in FDI inflows. But when Maoist movement ended, FDI inflows started to increase, So, the political instability and conflict was the major reason for fluctuation FDI inflows in the country. The other reason may be the frequent change in policies, corruption, bureaucratic complexity, insufficient infrastructure and so on.

The short term fluctuation value of FDI inflows in Nepal shows Negative trend during the years 1990 to 2007/08.

The trend of FDI inflows in different fiscal year has been shown in following trend line.

Figure 4.1: Foreign Investment Project in Nepal by Year-wise



Source: Table 4.3

Figure 4.1 depicted the trend of FDI inflows during a period of FY 1988/89-2011/12 there was not constant trend of FDI inflows during this period. The inflows of FDI in FY 2010/11 was high to compare other fiscal years.

4.6 Sector-wise FDI Pattern

An analysis of Sector wise FDI stock over the study period shows that, manufacturing, service, energy based, construction and agriculture sector attracted FDI in Nepal.

Table 4.4: FDI Projects Nepal by Category - wise

(Rs. in million)

Types of Industries	No. of Industries	Total Project cost	Total Fixed Cost	Foreign Investment	Percentage of FDI
Agriculture	75	1,849	1,246	1,055	1.40
Construction	42	3,605	2,683	2,763	3.68
Energy based	51	45,769	45,214	17,516	23.31
Manufacturing	743	58,152	43,373	26,544	35.32
Mineral	43	5,334	4,354	3,062	4.08
Service	756	28,070	23,042	14,973	19.92
Tourism	625	22,321	19,946	9,238	12.29
Total	2,335	164,101	139,858	75,150	100

Source: Department of Industry, Government of Nepal, 2012/13

Table 4.4 shows that the magnitude of FDI is highest in manufacturing sector that marked Rs. 26,544 million, which is 35.32 percent of total. With Rs. 17,516 million (23.31 percent) energy based occupied second position to attract FDI in Nepal. In the context of FDI service sector received third priority that leveled to Rs. 14,973 million (19.92 percent), while tourism sector occupied fourth position to attract FDI to the tune of RS> 9,238 million, Which is 12.29 percent of total. Construction (3.68 percent), agriculture (1.04 percent) and mineral sectors (4.08 percent) received lowest priority in obtaining FDI. Thus highest percentage of FDI inflows is in manufacturing sector and lower percentage of FDI inflows in agriculture sector.

Structure of FDI reflects that the number of total Industries under different categories marked 2,335 in Nepal during FY 1988/89-2011/12. Out of total number of Industries 5,110 (economic survey FY 2012/13), 2,335 industries are the foreign based capital, which is the 45.69 percent of the total industry in Nepal.

Total investment is found to be Rs. 164,101 million, total fixed capital equal to RS. 139,858 million and total FDI is RS. 75,150 million. According to economic survey FY 2012/13 total amount of total project cost is RS. 584,096.5 million at the end of FY 2011/12. Thus out of total project cost FDI occupied 12.87 percent of project cost up to FY 2011/12

Table 4.5: Foreign Investment Projects in Nepal by Sector-wise

(Rs. in million)

Types of Industries	No.	Total Project Cost	Total Fixed Cost	Foreign Investment	% of FDI
Agriculture and Forestry	75	1,849	1,246	1,055	1.4
Manufacturing	879	112,860	95,623	49,885	66.38
Service sectors	1,381	49,392	42,989	24,210	32.22
Total	2,335	164,101	139,858	75,150	100

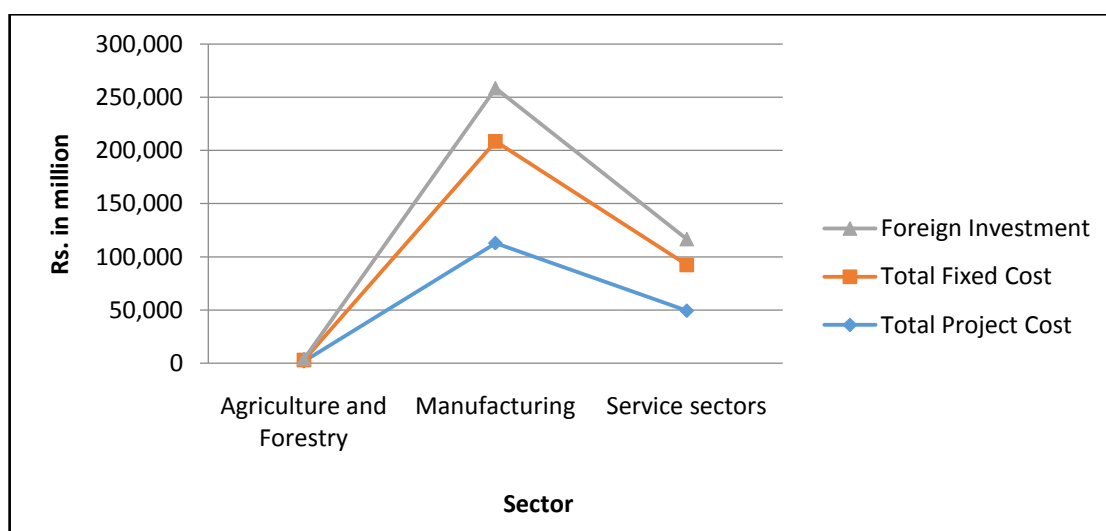
Source: Department of Industry, Government of Nepal FY 2012/13

(Note: manufacturing refers to the sum of construction, energy based, manufacturing and mineral and service sectors refers to the sum of service and tourism sectors)

Table 4.5 indicates that there were 879 manufacturing units receiving FDI. Manufacturing sector received top priority to attract FDI to the level of RS. 49,885 million, which is 66.38 percent of total during the period FY 1989/90-2011/12. Service sectors included 1,381 industries, which received Rs. 24,210 million, Agriculture sectors only received the Rs. 1,055 million FDI which is the minimum magnitude of FDI inflows in Nepal.

Structure of FDI reflects that the number of total Industries under different categories marked 2,335 in Nepal during FY 1988/89-2011/12. Out of total industries, 75 are agro-based industries and 49,392 are service based industries. The statistical data reflects that highest number of FDI based industries are service industries in Nepal.

Figure 4.2: FDI Projects in Nepal by Sector-wise



Source: Table 4.5

Table 4.5 indicates that there were 879 manufacturing units receiving FDI. Manufacturing sector received top priority to attract FDI to the level of RS. 49,885 million, which is 66.38 percent of total during the period FY 1989/90-2011/12. Service sectors included 1,381 industries, which received Rs. 24,210 million FDI and agriculture sector only received the Rs. million FDI.

The total project cost of the FDI based industries is 164,101 million. Out of total project cost FDI occupied 45.69 percent. Out of total FDI manufacturing sector occupied 66.38 percent. Similarly, out of total FDI service sector occupied 32.33 percent. On the average all of the industry related to FDI occupied the more than 45 percent of foreign capital on their total projects cost in different sector.

While FDI in agriculture sector was very low amount (1.4 percent of total FDI) but it occupied 57.06 percent of total projects cost during the period FY 1989/90-2011/12.

Table 4.6: Inflows of FDI in Different Sectors of Nepal

(Rs. in million)

Year	FDI in Agriculture Sector	Growth Rate of FDI (%)	FDI in Manufacturing Sector	Growth Rate of FDI (%)	FDI in Service Sector	Growth Rate of FD (%)
Up to 1989/1990	-	0	470.19	0	377.89	0
1990/1991	-	0	399.09	-9.15	7.19	-0.98
1991/1992	5.43	0	362.75	-0.09	229.66	30.94
1992/1993	-	-1	1,516.42	3.18	1,567.24	5.82
1993/1994	28.19	1	991.88	-0.35	358.59	-0.77
1994/1995	12.8	-0.54	411.92	-0.58	52.87	-0.85
1995/1966	26.97	1.12	1,769.08	3.29	423.82	7.02
1996/1997	1.39	-0.95	846.22	-0.51	1,547.92	2.65
1997/1998	-	-1	394.7	-1.14	1,605.58	0.03
1998/1999	4.7	1	1,259.85	2.20	401.88	-0.74
1999/2000	-	-1	513.02	-0.59	904.59	1.25
2000/2001	10	1	22,211.61	3.31	880.95	-0.02
2001/2002	4.9	-0.51	967.57	-0.56	237.18	-0.73
2002/2003	-	-1	1,129.78	0.17	603.99	1.54
2003/2004	-	0	1,020.36	-0.09	1,744.44	1.89
2004/2005	7.38	1	1,245.93	0.22	382.46	-0.78
2005/2006	-	-1	1,108.7	-0.11	1,497.61	2.92
2006/2007	5	1	1,975.66	0.78	1,205.32	-0.19
2007/2008	107.35	20.47	8,145.37	3.13	1,559.88	0.29
2008/2009	302.07	1.82	3,953.95	-0.51	1,999.08	0.28
2009/2010	10	-0.96	7,466.35	0.89	1,623.64	-0.18
2010/2011	367.12	35.71	7,580.46	0.02	2,163.14	0.33
2011/2012	162.2	-0.56	4,143.71	-0.45	2,835	0.31
Total	1,055	-	49,885	-	24,210	-

Source: Department of Industry, Government of Nepal, 2012/13

(Note: percentage growth rate is calculated)

Table 4.6 exhibits that the amount of FDI inflows of different sectors (agriculture, manufacturing, service) during FY 1989/90-2011/12. Manufacturing sector received top priority to attract FDI to the level of Rs. 49,885 million, which is 66.38 percent of total FDI inflows in Nepal. Foreign Capital received in the service sector is equal to 24,210 million. It is the 32.23 percent of total FDI inflows in Nepal. Similarly agriculture sector received low amount of FDI to the level of Rs. 1,055 million, which is the 1.39 percent of total FDI inflows in Nepal. It is important to note that agriculture and forestry sectors attracted less FDI in flows in Nepal.

The table 6.4, relating data to FDI inflows in agriculture and forestry sectors reveal the poor situation of FDI as it is in some year zero and in some year very low amount of inflows. The growth rate of FDI inflows in the sector calculated in above table has also shown the inconsistent trend of FDI inflows and highly insignificant growth rate whatever is there. The FDI inflows in the sector during the study period are highly fluctuated as it is zero at the period of 1989/90, 1990/91, 1992/93, 1997/98, 1999/2000, 2002/03, 2003/04 and 2005/2006 and positive inflows of FDI at the other period. The highest FDI inflows in volume during the study period are 367.12 million rupees in this sector which is also marked as the highest growth rate i.e. 35.71 times at the year of 2010/2011. The growth rate of FDI inflows in the sector is negative in the most of the year in study period and very insignificant in other period even if it is positive except in the year 2010/11. This has proved that agriculture sector is unable to attract significant level of foreign capital and other resources though this sector has very significant and important role in national economy.

In the above table, the data relating to FDI inflows in manufacturing sector are also presented which have also shown inconsistent trend. The volume of FDI inflows in this sector as well, highly fluctuated as the lowest volume of FDI is Rs. 362.75 million and highly volume is Rs. 8,145.37 million in the year 1990/91 and 2007/08 respectively. The growth rate of FDI inflows in this sector is also inconsistent and highly fluctuated. The growth rate in most of the year during the study period is negative. The highest growth rate of FDI inflows in the sector is 3.31 at the year of 2000/01. Though this sector has more FDI inflows in volume compared to agriculture and forestry sector and the service sector, it is insignificant and thus the data indicates the inconsistent and highly fluctuated inflow of FDI in this sector.

The above table also presents the FDI inflows in the service sector in Nepal. While analysing the trend of FDI inflows in this sector, it also seems highly fluctuated and inconsistent. The inflows of FDI in volume in this sector are very insignificant up to

the year 1989/90. Then it is found that the sector is attracting the FDI but not consistently. During the study period, the lowest amount of FDI inflows is Rs. 2,835 million in the year 2011/12. The growth rate of FDI inflows in this sector is also highly fluctuated. Out of the total study years, the growth rate of FDI inflows are positive rate of FDI inflows are negative. The highest growth rate of FDI inflows in service sector is 30.94 in the year 1991/92 but the volume in nominal. From the year 2004/05, the volume of FDI inflows are increasing but the growth rate is very nominal again. Thus the growth rate if FDI inflows in different sector is not so much encouraging and consistent. This indicates that the above listed sectors of Nepalese economy are their unattractive for FDI inflows or still to be developed.

4.7 Sources of FDI

An analysis of the origin of FDI in to Nepal shows that (after the restoration of democracy) the new policy has broadened the source of FDI in to Nepal. There were 70 countries in 2011/12 as compared to 21 countries in 19 89/90. Thus the number of c countries investing in Nepal increased during the period of study. Nevertheless, still a lion's share of FDI comes from only a few countries.

An analysis reveals the fact that during the study period beginning from 1988 /89, developing countries, such as India, China South Korea and many others made their appearance on the list of major investors in Nepal. The developing countries investing in Nepal can be grouped in to two sets. The first set in represented by those developing countries that have developed their industrial base with the help of technology imported from the industrialized world and now in a position to import technology and capital to the Nepalese enterprises' India, China, South Korea are some examples. On the other hand the second set of developing countries is those that have not so fare developed their industrial base to that extent, such as Mauritius, Bangladesh etc. Since the tax rates in these countries are very low, the multinational corporations headquartered in other countries developed as well as developing are found diverting their receipt of funds on different account to these tax haven countries, In other words, these countries ply as a hot for easy positioning of the multinational companies., This ay they possess huge investable surplus a party of which has found its way in to Nepal.

The following table shows the inflows of FDI in Nepal from developed as well as developing countries:

Table 4.7: Country-wise FDI Projects in Nepal

S.N.	Name of Country	No. of Industries	Total Project Cost (Rs. in Millions)	Foreign Investment (Rs. in Millions)	No. of Employees
01	India	525	66,613	34,810	58,161
02	China	478	14,558	7,861	26,651
03	USA	198	14,120	5,139	12,876
04	South Korea	171	10,452	6,422	6,820
05	Japan	167	3,264	1,220	6,986
07	UK	110	4,733	1,582	8,726
08	Germany	80	2,348	930	3,870
09	France	57	649	350	2,273
10	Netherland	39	1,350	624	3,193
11	Australia	36	474	44	1,018
12	Switzerland	36	780	365	813
12	Bangaldesh	31	562	298	4,332
13	Singapore	26	6,026	1,765	2,330
14	Canada	25	5,082	2,167	1,926
15	Italy	24	1,484	1,341	615
16	Denmark	21	766	199	969
17	Russia	20	294	157	880
18	Hong Kong	19	1,862	741	2,616
19	Pakistan	17	2,179	157	2,451
20	Malaysia	17	764	317	528
21	Australia	16	210	83	591
22	Spain	13	155	107	365
23	Beklgium	12	66	54	395
24	Norway	12	8,117	1,136	726
25	Philippines	11	1,181	97	1,663
26	Turkey	11	593	605	418
27	Thailand	11	1,032	116	1,159
28	New Zealand	9	297	30	2,069
29	Iran	9	40	33	199
30	Taiwan	9	415	175	596
31	Sweden	8	30	28	223
32	Poland	7	138	55	194
33	Bermuda	6	1,995	118	1,474
34	UAE	6	1,977	1,056	765
35	Ireland	6	724	341	320
36	Mauritius	5	2,980	2,895	922
37	Brazil	5	540	521	524
38	Bri.Virg. Is	5	2,790	1,012	1,098
39	Finland	5	25	20	149
40	South Africa	5	47	47	137
41	Sri Lanka	5	93	51	129
42	Kyrgyzstan	4	37	23	175
43	Six country	18	259	391	786
44	Five country	10	1,082	356	539
45	Seventeen country	17	224	147	667
Total	70	2,335	164,101	75,150	164,482

Source: Department of Industry Government of Nepal, 2012/13

Table 4.7 shows that the number of Indian joint ventures industry is highest (525) in Nepal followed by China (478), USAA (198), S. Korea (171), Japan (167), UK (110), Germany (80), France (57), Netherland (39), Austria (36), and Switzerland (36) so on. Seventeen countries have invested only one project in Nepal. The magnitude of FDI from India is Rs. 34810 million, which is 46.32 percent of total FDI inflows in Nepal. The size of FDI from major countries such as China marked Rs. 7861 million (10.46), followed by S. Korea Rs. 6422 million) 8.54 million), USA Rs. 5139 million (6.83 percent), Canada Rs. 2167 million (2.88 percent), Singapore Rs. 1765 million (2.02 percent) inflows of total foreign capital. I this way the FDI inflow from India is the largest 46.32 percentage and other six countries like China, South Korea, USA, Canada, Singapore and Uk collectively shared 33.08 percent of the total actual FDI inflows in Nepal. It implies that only seven countries accounted for well over 79. 4 percent of the FDI inflows during the study period.

Structure of FDI reflects that the number of total industries marked 2335 in Nepal during FY 1989/90-2011/12. Total investment is found to be Rs. 164101 million, FDI in Rs. 75150 million. Nepal received highest magnitude of FDI (10051 million) in FY 2010/11. During the period manufacturing sector received a to prority of FDI in terms of total project cost. India has the highest number of projects in the list of 70 countries that provided FDU to Nepal. The magnitude of FDI from India is 46.32 percent of the total during the same period.

4.8 National Laws for FDI Promotion, Protection, and Regulation

At the end of FY 2010/2011 (Nepal's fiscal year runs from mid-July to mid-July), there were 2,108 foreign investment projects in Nepal, worth a total of approximately USD 2.61 billion, according to official GON statistics. India was by far the most important foreign investor in Nepal with 501 ventures, accounting for nearly 47.6 percent of total foreign investment. Ten of the 20 largest foreign enterprises in Nepal had Indian investment. China with 401 ventures ranked second, accounting for 10.34 percent, and U.S. with 174 ventures ranked third, accounting for 7.28 percent of total foreign investment. Japan, South Korea, and the United Kingdom are also prominent sources of foreign investment.

Reform of laws and regulations has allowed the growth of private operations in sectors that were previously government monopolies, such as telecommunications and

civil aviation. In 2005, the GON also opened some service sectors to foreign investment. Licensing and regulations have been simplified, and 100-percent foreign ownership is now allowed in the travel and tourism sector, and the production of cigarette and alcohol. Government policy also permits 51 percent foreign investment in consultancy services, such as management, accounting, engineering and legal services, and retail chain stores and franchises having presence in more than two countries. New banking institutions and a small stock exchange provide alternative sources of investment capital. On January 1, 2010, per its accession commitments to the World Trade Organization (WTO), Nepal opened the domestic banking sector to foreign banks, which are now allowed to engage in wholesale, but not retail, banking. Foreign banks operating branches in Nepal can invest only in major infrastructure projects.

The Government has opened the hydropower generation sector to private development, including foreign ownership. In August 2011, the Ministry of Energy announced the new Hydropower License Management Procedure, which promised to award licenses for hydropower projects above 10 MW through a competitive process. However, the process for obtaining licenses for hydropower projects remains cumbersome, and the new policy has created uncertainty about pending license applications. Unreasonable delay in the evaluation of hydropower survey license applications, a poor security environment, corruption, and political instability also discourage long-term investment in this sector. Additionally, Parliament has yet to approve the Nepal Electricity Regulatory Commission Act, designed to unbundle the functions of the bankrupt Nepal Electricity Authority (NEA), and create an independent regulatory body. Experts consider these steps necessary to reform NEA and stimulate private investment in the energy sector. Although a small number of private-sector hydropower projects have either begun operations or are in the planning stages, development of the sector has been very slow, and projects designed for the export of electricity to India remain politically sensitive.

Despite these steps to open additional sectors, significant barriers to increased foreign investment remain. Basic infrastructure needed to support investment is inadequate. The supply of power and water is insufficient. Transport is difficult and expensive, a problem compounded by the fact that Nepal is landlocked. Most products imported and exported by ship enter through Kolkata, India, and are then shipped overland.

Nepal also lacks trained personnel and basic raw materials. In addition to these challenges, foreign investors must also deal with inadequate and obscure commercial regulations, vague and changeable rules governing labor relations, a non-transparent and capricious tax administration system, and difficulties in obtaining long-term visas. Furthermore, there is often variance between the letter of the law and its implementation.

Foreign investors complain about complex and opaque government procedures and a working-level attitude that is often more hostile than accommodating. Efforts intended to establish a "one window policy" and streamline government procedures related to foreign investment have produced few results, although the recently created Investment Board is designed to play such a role and coordinate domestic and foreign investors. The Board will focus on large investment projects worth more than Rs. 10 billion (\$ 130 million) and certain key sectors, and could help cut through bureaucratic delays and improve interagency coordination. The GON has long been aware of the deficiencies in the investment climate, but has moved slowly on creating a more investor-friendly climate. The Foreign Investment and Technology Transfer Act of 1992 abolished the minimum capital investment requirement and eliminated other significant barriers to investment. The Act also allowed investment in the legal sector, management consulting, accounting and engineering services, with a 51-percent limit on foreign ownership.

In order for the protection of foreign investment, Nepal has signed the BIPPA agreement with India recently. BIPPA entails commitments by the signatories to protect investment from each other and accept liability for losses caused by war, riots or any kind of unrest that are not covered by insurance companies. The agreement bars the host country from nationalizing businesses from foreign countries without paying proper compensation. Similarly, the agreement allows FDI and investment in stocks. The agreement is aimed at specifically protecting private FDI in the host state. BIPPA has set forth standards for treatment of foreign investors in areas such as expropriation of property, repatriation of funds, and settlement of disputes. When a host state violates the rights guaranteed to the investor by the treaty, an investor has recourse on an international arbitration (www.unctad-docs.org/UNCTAD-WIR2012-Chapter-III-en.pdf).

Most of the acts and policies, and their amendments, governing foreign and private investment in the potential sectors were brought out during the last decade. However, implementation and enforcement of these laws and policies remain a challenge. Additionally, the transient political atmosphere renders the investment climate in Nepal uncertain.

CHAPTER - V

POLICY AND INSTITUTIONAL ARRANGEMENTS OF FDI IN NEPAL

Government of Nepal has accorded a top priority to attract foreign direct investment in recent years. The previous plans have focused to ensure the safe entry of foreign capital, technology and managerial and technical skills particularly for the development of manufacturing industry, health industry, tourism industry, infrastructure development etc. The main objective of ensuring the safe entry of foreign capital in different sectors is to expand the different opportunities to the people and to raise the employment opportunities and income generation activities in different sectors. Thus, special emphasis had been given in the plan to mobilize foreign investment to meet the increasing investment need of the country through the creation of investment-friendly environment, Promulgation of the Industrial policy 1992. The foreign investment and one window policy 1992, the foreign investment and technology transfer Act 1992 were the significant steps towards attracting foreign capital in Nepal which played a vital role in improving foreign capital and transfer of advance technology and efficient management.

The most significant foreign investment laws are: the Foreign Exchange (Regulation) Act of 1962; the Foreign Investment and One Window Policy of 1992; the Foreign Investment and Technology Transfer Act of 1992 and its Amendments; the Immigration Rules of 1994; the Customs Act of 1997; the Industrial Enterprises Act of 1992; the Electricity Act of 1992; the Privatization Act of 1994 and the annual Finance Act , which outlines customs, duties, export service charges, sales, airfreight and income taxes, and other excise taxes that affect foreign investment.

The Foreign Investment and One Window Policy lists acceptable forms of investment, allows for foreign shares up to 100 percent in business areas not on its "negative list," establishes currency repatriation guidelines, and outlines visa arrangements, arbitration 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, eliminated the minimum investment requirement, while opening legal, management consulting, accounting, and engineering services to foreign investment, with a 51-percent ownership limit. It also clarified rules relating to business and resident visas. In general, under the FITTA all

agreements related to foreign investment are governed by Nepali law and subject to arbitration in Kathmandu under United Nations Commission for International Trade Law rules. However, foreign law can be applicable in cases where the foreign investment exceeds NRS 500 million (approximately USD 6 million) and where the parties make this choice clear in their agreement.

The Customs Act and the Industrial Enterprises Act, revised in 1997, established invoice-based customs valuations and eliminated many investment tax incentives, replacing them with a lower, uniform rate. The Electricity Act defines special terms and conditions for investment in hydropower development. The Privatization Act of 1994 authorizes and defines the procedures for privatization of state-owned enterprises to broaden participation of the private sector in the operation of such enterprises.

Additionally, the terms and conditions of intellectual property protection are defined by the 1965 Patent, Design and Trademark Act and the 2002 Copyright Act. The latter covers all types of electronic audio and visual materials and subjects violators to fines and imprisonment, as well as the confiscation of unauthorized materials. Violators also have to pay compensation claimed by the copyright holder. However, it does not meet the standards for trade-related intellectual property rights required by the World Trade Organization. The Government of Nepal is working to revise its intellectual property rights legislation to meet international standards.

The Competition Law 2004 controls anti-competitive practices, protects consumers against monopoly rights of trading enterprises, promotes fair competition for the growth of trade and commerce, and includes provisions for the control of mergers and acquisition of two or more firms that have the potential of gaining dominance in the market and acquisition of monopoly rights. The Competition Law also contains special provision for controlling black marketing and misleading advertisements.

Most of the acts and policies, and their amendments, governing foreign and private investment in the potential sectors were brought out during the last decade. However, implementation and enforcement of these laws and policies remain a challenge. Additionally, the transient political atmosphere renders the investment climate in Nepal uncertain.

5.1 Institutional Arrangements

In August 2011, a high-level Investment Board was created to serve as a one window facility for domestic and foreign investors pursuing large projects greater than Rs. 10 billion or approximately USD 130 million or projects in “priority areas” such as fast-track roads, hydropower projects over 500 MW, railways, medical colleges, tunnel roads and bridges, cable cars, international and regional airports, urban solid waste management, chemical fertilizers, and petroleum refinery plants. The Board, chaired by the Prime Minister, has the authority to formulate investment policies, prioritize and approve projects, facilitate the signing of agreements among different ministries, provide financial and nonfinancial facilities, procure land, monitor project progress, order government agencies to issue necessary project approvals and override any regulations in the existing laws in the name of investment promotion. The creation of the Board is meant to help cut through bureaucratic red-tape and expedite investments coming into Nepal.

Prior to the establishment of the Investment Board, the Department of Industry, under the Ministry of Industry, was designated as the "one window servicing agency" for all foreign investment to facilitate corporate registration, land transfers, utility connections, administrative services agreements, and coordination among various agencies. The Department also registers and classifies foreign investments and manages the income tax and duty drawbacks granted to some foreign investments. The Department of Industry remains the focal point for foreign investments of less than NRs. 10 billion, or investments outside of the priority areas.

The Industrial Promotion Board (IPB), chaired by the Minister of Industry, is the primary government agency responsible for foreign investment. It is charged with coordinating policy-level institutions, establishing guidelines for economic policy, approving foreign investment proposals, and determining applicable investment incentives.

Under current administrative procedures, foreign investors are required to obtain licenses for manufacturing or service sector investments, and each license request is considered individually. Investments below 2 billion rupees (approximately USD 25 million) are referred to the Department of Industry for action and are typically approved at the departmental level without the involvement of the IPB. However,

investors frequently complain about bureaucratic delays and lack of transparency in procuring investment licenses. For investments exceeding Rs. 2 billion, up to six ministries other than the Ministry of Industry review a business proposal prior to consideration by the IPB.

The Department of Electricity Development, under the Ministry of Energy, is responsible for licensing all investments in hydropower projects. However, decisions on project proposals that involve foreign investment are invariably made by the Ministry of Energy itself. Similarly, Nepal Rastra Bank (NRB), the country's central bank, is responsible for issuing licenses to operate commercial banks and financial institutions. The Insurance Board (IB) is responsible for issuing licenses to operate insurance companies, both life and general. The Civil Aviation Authority of Nepal (CAAN) is responsible for granting operating licenses to both domestic and foreign airline operators, and the Nepal Telecommunications Authority (NTA) is responsible for issuing licenses for operating any type of telecommunications and information technology services.

Licensing of new investments is often time-consuming and requires legal counsel and patience. The IPB, for example, is mandated by law to make a licensing decision within 30 days of submission of an application, but this deadline is not generally met because of the legal provision that all necessary information must have been submitted before a decision can be made. In practice, multiple meetings are usually required before the information is deemed sufficient.

5.2 Eligible Sectors

Foreign investment proposals must fall within eligible industry categories. These include: agriculture and forestry; manufacturing; electricity, both water and diesel-generated; civil aviation, including airport construction and installation of navigational equipment and facilities; road construction; hotels and resorts; transport; communications; housing and apartments; and a restricted range of services. The GON opened service sectors, along with a few others, in December 2005 to comply with its WTO commitments. These sectors include business and management consulting, accounting, engineering and legal services, travel and trekking services, tourist lodging, international retail sales services, and production of alcohol or cigarettes. In 2010, the GON further opened the commercial banking sector to foreign

investment. Foreign investment is forbidden in the defense sector, and the IPB will not license foreign investments that are judged to be either hazardous to general health or the environment.

Foreign investors are permitted to acquire real estate in the name of the business entity they own, but are not allowed to acquire real estate as personal property. Although local law permits foreign investors to buy shares on the local stock exchange, in practice investment in the stock exchange is not yet open to foreign investors. This is due mainly to the provisions of the Foreign Investment and Technology Transfer Act of 1992, which requires the Department of Industry to approve the purchase of local shares by foreigners. Also, in cases of investment in banks and insurance companies, prior approval of the regulator is required. Further, approval by the NRB is also required for such purchase of shares under the Foreign Exchange (Regulation) Act 1962. All of these hurdles make investment in the local stock market cumbersome for foreign investors.

Foreign investors are allowed to buy shares of government corporations by participating in the bidding for privatization of such corporations. In such cases, Nepal's Ministry of Finance sells the shares to the buyer after carrying out a lengthy screening during the bidding process. Through a July 2006 amendment in the licensing policy of financial institutions, the NRB increased the maximum foreign equity participation limit in domestic financial institutions to 85 percent from 67 percent. With the amendment, equity participation of foreign investors in joint venture financial institutions can range between 20 percent and 85 percent, with the remaining shares open for purchase by the general public. Joint venture financial institutions with less than 50 percent foreign equity participation are required to earmark at least 30 percent of their shares for sale to the general public.

The Privatization Act of 1994 generally does not differentiate between national and foreign investors. However, in cases where proposals from two or more investors are identical, the government gives priority to Nepali investors. The process of privatization, dissolution and liquidation of government-owned private enterprises started in 1993. To date, 15 state-owned corporations have been privatized, seven corporations have been liquidated and two other corporations have been closed. The last privatization completed by the government was in January 2006. Foreign investors have taken over two of the 15 corporations privatized. The privatization

process of three other state-owned corporations, which began in early 2006, was put on hold in April 2006 when Nepal's monarchial rule ended. Since the Constituent Assembly elections held in April 2008, no government has demonstrated a willingness to restart the privatization process. In fact, leaders of various political parties often express their support for reviving moribund state-owned corporations.

On June 17, 2010, the Privatization Committee of the Constituent Assembly directed the GON to furnish detailed plans for divestment of two state-owned corporations, the Agricultural Development Bank Limited (ADBL) and Nepal Telecom (NT), to strategic partners. Plans are still pending. In August 2010, the Finance Ministry announced it would sell shares of eight other public enterprises and run them under the public private partnership (PPP) model; however no further action was taken.

Hydropower is a sector with enormous possibilities – the estimated generation potential is 83,000 megawatts, more than half of which has been identified as economically feasible to develop, but its installed hydro capacity is only about 652 MW. The demand for electricity continues to increase faster than generating capacity. All hydropower plants, except one, are run-of-river facilities, the generating capacities of which are greatly diminished during the winter dry season.

The peak demand of power in the dry season (January to June 2011) is estimated to reach over 1,000 MW, and the monopoly power supply corporation, the NEA estimated more than 67 percent deficit during this season. Additionally, Nepal's demand for power is estimated to grow at an annual rate of 12 percent. On the other hand, the neighboring states of India (Northern-Grid) have an average monthly power deficit of roughly 3,500 MW. The GON opened the sector to private development, including foreign investment, but has done little to realize a greater share of hydropower's vast potential.

In April 2004, the state-owned Nepal Telecommunications Corporation was converted into a public limited company, and its name was changed to Nepal Doorsanchar Company Limited (commonly known as Nepal Telecom). However, the GON retained full ownership of the company. At the time of conversion, the estimated amount of paid-up capital and authorized capital of the corporation stood at 15 billion Nepali rupees (USD 238 million) and 25 billion Nepali rupees (USD 397 million) respectively.

On January 23, 2008, Nepal Telecom launched an initial public offering (IPO) to sell 15 million shares, a 10-percent stake in the company. It also offered a 5-percent stake in the company – 7.5 million shares – to its employees as required by the government. The IPO fell well short of government expectations, with the public purchasing roughly five million shares. In September 2008, the Finance Minister announced that the unsold shares will be sold through secondary markets. However, further action in this regard was never initiated. On March 29, 2010, Nepal Telecom passed a resolution to sell minority shares to an international telecommunications operator – a change deemed necessary for Nepal Telecom to remain competitive. In May 2010, the Government formed a high-level task force that recommended divesting 26 to 30 percent stake of the company to a foreign strategic partner. The Privatization Committee of the Constituent Assembly directed the Ministry of Information and Communications to present detailed modalities for divesting shares, but so far no decision has been taken by the government. Government of Nepal retains a 91.5 percent stake in Nepal Telecom.

Per its accession commitments to WTO, on January 1, 2010, the GON opened the domestic banking sector to foreign banks to engage in wholesale banking but not retail banking. Foreign banks operating branches in Nepal can invest only in major infrastructure projects. Investment in the retail banking sector is available through joint ventures only, and such operation will have to be incorporated in Nepal.

Since 2003, the World Bank has been working to restructure two of the largest state-owned commercial banks, the Rastriya Banijya Bank ("National Commercial Bank" or RBB) and the Nepal Bank Limited (NBL). Even after eight years of direct supervision and NRs. 8 billion in subsidized loans, the NRB failed to prepare the two banks for divestment. In early December 2010, the GON made it clear that it will not inject additional funds to recapitalize the two ailing banks and hinted at divestment of its shares to induct strategic partner to turnaround their financial outlook. However, the reform, revitalization, and professionalization of these institutions are long-term tasks, and the banks have not indicated that they are ready for privatization.

The civil aviation sector has emerged as another potential sector for foreign investment in Nepal. The sharp increase in the number of air travelers in and out of Nepal in the last few years has brought in 29 airlines companies operating roughly 47 international flights a day, and 18 airlines companies operating around 100 flights in

the domestic sector. In order to address the need, the GON is upgrading a number of domestic airports and the international airport in Kathmandu, and planning construction of a second international airport.

5.3 Visas

The GON offers different types of visas to investors and businesses. Potential investors are generally given six-month visas to conduct research and feasibility studies. To obtain a six-month visa, applicants must provide biographic information and a description of relevant work and professional experience. If the Department of Industry can readily identify the applicant as a legitimate business representative, the process can be expedited. Endorsement by a recognized foreign industrial enterprise is one means of accomplishing this. The Foreign Investment and Technology Transfer Acts allow foreign investors to have one residential representative in Nepal. In cases where the foreign investor wishes to have more than one representative, the visa process becomes difficult. In the past, investors have even had problems obtaining visas for a second foreigner to serve as general manager responsible for their Nepali operations.

Business visas are generally issued to approve investors for a period of one to five years. However, investors describe the business visa process as bureaucratic and time-consuming. Many say they spend more than 24 work hours per visa, over a period of 20 to 30 days.

Although the GoN authorized five-year, multiple-entry visas for resident foreign investors and their families in 1998, very few have been issued. Investors have complained that despite no legal revisions to the five-year business visa provision, the government generally issues only one-year business visas. Nepal's business visa fee is USD 300 for a five-year visa and USD 100 for a one-year visa for investors who bring more than NRS 10 million, and USD 1,000 for a five-year visa and USD 300 for a one year visa for investors who bring NRS 10 million or less. A non-tourist visa, however, costs USD 60 per month for the initial six-month period. This visa period can be extended for another six months or more at an additional USD 60 per month.

5.4 Rankings

The following table lists Nepal's most recent ranking by organizations that monitor economies' economic corruption, freedom, and ease of doing business.

Table: 5.1

Nepal in Global Ranking

Measure	Year	Index/Ranking
Heritage Economic Freedom	2011	2.2/154
World Bank Doing Business	2012	107th out of 183
World Bank Doing Business	2012	107th out of 183
TI Corruption Index	2012	2.2/154
TI Corruption Index	2013	127th out of 187
TI Corruption Index	2014	129 th out of 187
TI Corruption Index	2015	130 th out of 187

Source: Transparency International Nepal Report, 2015.

5.5 Conversion and Transfer Policies

The Foreign Investment and Technology Transfer Act of 1992 permits foreign investors to repatriate all profits and dividends, all money raised through the sale of shares, all payments of principal and interest on any foreign loans, and any amounts invested in transferring foreign technology. Foreign nationals working in local industries are also allowed to repatriate 75 percent of their salaries, allowances, and emoluments, etc. Repatriation facilities (such as opening accounts or obtaining permission for remittance of foreign exchange) are made available on the recommendation of the Department of Industry, which normally provides approval of the original investment.

However, convertibility is difficult and not guaranteed. The relevant GON department and the NRB, which regulates foreign exchange, must approve the repatriation of funds. In most cases, approval must also be obtained from the Department of Industry. In the case of telecommunications, the Nepal Telecommunications Authority must approve the repatriation. In joint venture cases, the NRB and the Ministry of Finance must grant approval. After administrative approvals, a lengthy clearance process in the banking system also slows the transfer of foreign exchange. The experience of

U.S. and other foreign investors indicates there are discrepancies between the government's stated policy of repatriation and its implementation.

Foreign investors must apply to the NRB to repatriate funds from the sale of shares. For repatriation of funds connected with dividends, principal and interest on foreign loans, technology transfer fees, expatriate salaries, allowances, and emoluments, the foreign investor applies first to the Department of Industry and then to the NRB. At the first stage of obtaining remittance approval, foreign investors must submit remittance requests to a commercial bank. Generally, foreign investors rated services provided by private banks as satisfactory. However, final remittance approval must be made by the NRB foreign exchange department, at which stage the process slows down significantly. For this reason, foreign investors rated the NRB's administration of exchange regulations as unsatisfactory.

In general, Nepalese are not permitted to invest outside of Nepal. Exceptions, however, can be granted on a case-by-case basis, and policing of the prohibition is weak. In 1995, a private airline was permitted to invest in a regional carrier based in Kolkata. However, the Nepali airline closed down in 2005. The next year, another private airline operator formed a joint venture with a regional carrier based in India to operate flights in northeastern Indian states. These are the rare instances of approved direct foreign investment by Nepali nationals. During the peak of the Maoist insurgency in 2004 and 2005, a few industrial houses made unauthorized investments in India and Gulf countries.

5.6 Expropriation and Compensation

The Industrial Enterprise Act of 1992 states that "no industry shall be nationalized." The GON routinely reiterates this point in negotiations with private-sector firms interested in the hydropower sector. However, some hardliner leaders of the Unified Communist Party of Nepal – Maoist, which leads the current government and is the largest political party in Parliament, have stated that their party seeks to nationalize major sources of production and property in the country. Although they have never initiated any action to nationalize industries while in control of the government – and the current Maoist Prime Minister has publicly welcomed private investment -- this rhetoric keeps the debate open and raises concerns among potential investors. To date, there have been no cases of nationalization in Nepal, nor are there any official policies

either existing or planned that suggest official expropriation should be of concern to prospective investors. Nevertheless, companies can be seized or confiscated if they do not pay taxes in accordance with Nepali law. Such cases have not involved major Nepali business houses, however.

5.7 Dispute Settlement

In the event of a dispute with a foreign investor, the concerned parties are encouraged to settle it through mediation in the presence of the Department of Industry. If the dispute cannot be settled, cases involving investments of less than NRS 500 million (approximately USD 6.5 million) are referred to arbitration in Nepal in accordance with the Arbitration Rules of the United Nations Commission for International Trade Law (UNCITRAL). For investments that exceed this amount, the GON will permit stipulation of legal jurisdiction other than Nepal in shareholder agreements and contracts.

Disputes have not been frequent, but investors should be aware that in recent years there have been two investment disputes in which the U.S. investor claimed the GON did not honor portions of contracts.

All real property transactions must be registered, and property holdings cannot be transferred without following established procedures. Even so, property disputes account for half of the current backlog in Nepal's overburdened court system, and such cases can take years to settle. Moreover, laws and regulations regarding property registration, ownership and transfer are unclear, and interpretation can vary from case to case.

Liquidation is covered by both the Company Act and the Insolvency Act of 2006. If a company is solvent, its liquidation is covered by the Company Act. If the company is insolvent and unable to pay liabilities, or liabilities are more than assets, then its liquidation is covered by the Insolvency Act. Under the Company Act, the claimant priorities are: 1) government revenue; 2) creditors; and 3) shareholders. Under the Insolvency Act the government ranks with all other unsecured creditors. Monetary judgments are made in local currency.

Nepal is a signatory to and adheres to the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards, and it has updated its legislation on dispute settlement to bring its laws into line with the requirements of

that convention. The Arbitration Act of 1999 allows the enforcement of foreign arbitral awards and limits the conditions under which those awards can be challenged.

5.8 Performance Requirements and Incentives

The Nepal Laws Revision Act of 2000 eliminated most tax incentives, even those connected with performance requirements. Exports, however, are still favored, as is investment in certain "priority" industries such as tourism, civil aviation and hydropower. There is no discrimination against foreign investors with respect to export/import policies or non-tariff barriers. There is no local content or export performance requirement. There is no requirement that nationals own shares of foreign investors, that the share of foreign equity be reduced over time, or that technology be transferred. However, to promote joint ventures with Nepali nationals, foreign investment in the service sectors is limited, ranging from 51 to 80 percent. Foreign investment in cottage industries is still not allowed. The GON offers tax incentives to encourage industries to locate outside the Kathmandu Valley to reduce pollution and overpopulation in the Valley and to encourage investors with an interest in developing poorer parts of the country.

Profits from exports are taxed at 20 percent. Customs, value added tax (VAT), and excise duties on raw materials used in the production of export items are supposed to be reimbursed within 60 days. In practice, however, these duty paybacks are often extensively delayed. Although income in certain priority industries, such as garments, carpets and jewelry, used to be taxed at a concessional rate of 10 percent, the Income Tax Act 2002 removed most of these concessions.

The Electricity Act of 1992 governs foreign investments in hydropower generation. The Act exempts developers from income tax for the first 15 years of a project's operation and provides a flat 1-percent customs rate on all imported construction materials, equipment and spare parts, provided that such goods are not manufactured in Nepal.

Foreign investors are not required to disclose proprietary information to government agencies as part of the regulatory approval process. There are no restrictions on participation by foreign firms in government-sponsored research and development programs; however, depending upon the nature of the job and expertise required, government agencies sometimes limit such participation to Nepali nationals.

5.9 Right to Private Ownership and Establishment

Foreigners are free to establish and own business enterprises and engage in all forms of business activity with the exception of defense industries and security printing. In addition, investment is restricted in some areas, such as certain service industries. The GON is moving slowly toward open competition in most sectors of the economy. Former public monopolies in banking, insurance, airline services, telecommunications and trade have already been eliminated, and the remaining restrictions on private and foreign operations in other areas are being scaled back.

The Competition Promotion and Market Protection Act, which came into force in January 2007, defines anti-competitive practices and bars them. The Act outlaws tied selling, bid rigging, cartel formation, collective price fixing, market restrictions, dial-system, market segregation, undue business influences, syndicates, and exclusive dealing. It also prevents companies from engaging in business takeovers which would help establish monopolies in the market. Sale of inferior quality goods is illegal. The law was drafted through a joint initiative of the private sector and the then Ministry of Industry, Commerce and Supplies, but to date has been largely ineffective because the government has yet to establish the necessary enforcement mechanisms.

5.10 Protection of Property Rights

In accord with its commitments on accession to the World Trade Organization, Nepal must enact new legislation on trade-related intellectual property rights to bring the country into compliance with international norms. Trademarks must be registered in Nepal to receive protection. Once registered, trademarks are protected for a period of seven years. However, protection of intellectual property rights is inadequate. Patents registration, under the Patent, Design and Trademark Act of 1965, does not provide automatic protection to foreign trademarks and design. Similarly, Nepal does not automatically recognize patents awarded by other nations. The Copyright Act of 2002 is similar in that it does not recognize foreign registrations. The Act, however, covers most modern forms of authorship and provides adequate periods of protection. Enforcement is weak, with the result being that much of the software and most audio and visual recordings now circulating in Nepal are pirated. Nepal has not yet signed the World Intellectual Property Organization (WIPO) Copyright Treaty or the WIPO Performances and Phonograms Treaty.

5.11 Transparency of the Regulatory System

Foreign investors in Nepal must deal with a largely non-transparent legal system in which basic legal procedures are neither quick nor routine. The bureaucracy is generally reluctant to accept legal precedents. As a consequence, businesses are often forced to re-litigate issues that had been previously settled. Furthermore, legislation limiting foreign investment in financial, legal, and accounting services has made it difficult for investors to find help cutting through regulatory red tape.

Labor, health, and safety laws exist but are not properly enforced. Some companies report that the process of terminating unsatisfactory employees is cumbersome and that protective labor laws make it very difficult to bring skilled foreign-national specialists, such as pilots, engineers, and architects, into Nepal.

5.12 Efficient Capital Market and Portfolio Investment

Credit is generally allocated on market terms, although special credit arrangements exist for farmers and rural producers through the Agricultural Development Bank of Nepal. Foreign-owned companies can obtain loans on the local market. The private sector has access to a variety of credit and investment instruments. These include public stock and direct loans from finance companies and joint venture commercial banks.

Legal, regulatory, and accounting systems are neither fully transparent nor consistent with international norms. Though auditing is mandatory, professional accounting standards are low, and many practitioners are either poorly trained or lack in business ethics. Under these circumstances, published financial reports are often unreliable, and investors are better advised to rely on general business reputations, except in the few cases in which companies have applied international accounting standards.

The Nepali banking system is relatively small, and, in some cases, plagued by bad loans. Banking system assets totaled approximately USD 13.94 billion as of mid-June 2011, while its capital (total deposits) totaled USD 9.06 billion. As of October 17, 2011, 3.8 percent, of the total asset base was estimated as non-performing. Foreign commercial lending is scarce and expensive. Currently, there are no resident or non-resident foreign commercial banks that have standing credit limits for loans of a maturity of more than one year.

There is no regulatory system to encourage and facilitate portfolio investment in the industrial sector. Lack of transparency or regular reporting of reliable corporate information also presents problems for potential foreign investors. There are no legal provisions to defend against hostile takeovers. The GON has made certain exceptions to promote foreign direct investment (FDI) in tourism and hydropower by allowing 100 percent foreign ownership. The Clean Energy Development Bank has established a development fund of approximately US\$ 3 million for funding feasibility studies of small- and medium-sized hydropower projects. The “Hydro Development Fund” will fill the early-stage financing gap for development of small- and medium-sized hydropower plants in Nepal.

5.13 Competition from State-Owned Enterprises

There are 30 state owned enterprises in Nepal. Since 1993, Nepal has initiated numerous market policy and regulatory regime reforms in an effort to open eligible government-controlled sectors to domestic and foreign private investment. The result has been that the majority of private investment has been made into manufacturing and tourism, sectors where there was either very little government interest or the existing state-owned enterprises performed miserably. However, even though some sectors have opened for foreign investment, a large part remains under state monopoly of some form. For instance, regulatory changes allowed 100 percent foreign direct investment in hydropower generation, but distribution of electricity remained under state monopoly, effectively limiting the ability of the private sector to sell electricity. Investors face the added burden of passing through a maze of regulatory requirements and negotiating with multiple agencies in India, while the state-owned Nepal Electrical Authority enjoyed the advantage of using GoN clout to negotiate a deal with various Indian agencies.

Corporate governance of state owned enterprises (SOEs) is poor, with heads often appointed by politically-appointed line Ministers. Board seats are generally allocated to senior government officials – typically the secretary of a ministry – and the SOEs are often required to consult with government officials before making any major business decisions. However, in late 2011, the GON adopted a new policy to encourage the selection of heads of SOEs through a competitive and merit-based selection process, a positive development.

The Telecommunications Act 1997 and other policies enacted subsequently opened the sector to private investment, but the state-owned Nepal Telecommunications Company often used its influence to deny certain privileges to private sector telecom

service operators and indirectly blocked them from expanding their services. The Privatization Act of 1994 generally does not discriminate between national and foreign investors; however, in cases where proposals from two or more investors are identical, the government gives priority to Nepali investors.

5.14 Corporate Social Responsibility

The level of Corporate Social Responsibility (CSR) in the business community is generally low, except among trade and industry association leaders who have benefitted from studying abroad and/or exposure to multinational company practices. Very few companies are listed on the stock exchange, so there is little shareholder pressure on companies to act in a socially responsible manner. Furthermore, there are no laws or government policies promoting CSR.

Those most visibly engaged in CSR activities are multinational companies, of which there are very few in Nepal. Nepali businesses are mostly small- and medium-sized enterprises owned by individuals or one of the small number of business houses. The CSR activities of these companies are driven by the owners' personal convictions and interests rather than by corporate norms or standards.

5.15 Political Violence

The signing of the Comprehensive Peace Agreement (CPA) in November 2006 marked the official end of a bloody, 10-year Maoist insurgency. The Department of State lifted its Travel Warning for Nepal on December 6, 2011 to reflect improvements in country conditions. Nonetheless, criminal violence, sometimes conducted under the guise of political activism, continues to be a problem. Additionally, bandha (general strikes) called by political parties and other agitating groups sometimes halt transport and shut down businesses, sometimes nationwide.

Business owners, especially those in the Tarai, the southern plains bordering India, are sometimes the target of extortion and kidnapping by political party activists and criminal groups aligned with them. In a bid to extort ransom, armed groups often target business entrepreneurs and local government employees, and generally not foreigners. Media and human rights agencies reported the killing of 459 people and 185 cases of abduction during 2010 across the country, the majority by unidentified groups. Some of the killings were in connection with the kidnappings. Most of these criminal acts took place in the Central and Eastern Tarai regions.

The political violence has resulted negative environment for the increment of FDI in Nepal. Prevalence of unstable political scenario has become the major hurdle for the foreign investors to invest in Nepal.

5.16 Tabulation SWOT Analysis Keys

Table: 5.2: Tabulation SWOT Analysis

<p>Strength</p> <ul style="list-style-type: none"> • Location between the two potentially largest markets in the world: China and India • Macroeconomic stability and a • relatively liberal economy • Trainable and low-cost work force • Substantial natural and cultural assets • Small and accessible bureaucracy • generally business-friendly Government 	<p>Opportunity</p> <ul style="list-style-type: none"> • Tourism, including sports and adventure tourism, health tourism and cultural tourism • A variety of niche agricultural and • Agro-business activities • Hydropower generation and infrastructure development generally • I T-based services
<p>Weakness</p> <ul style="list-style-type: none"> • Landlocked country • Poor infrastructure and mostly unskilled workforce • Rigid and intrusive labor legislation • Political instability, weak implementation and persistent corruption 	<p>Threats</p> <ul style="list-style-type: none"> • Political instability • internal environment • Infrastructure

Source: UNCTAD, 2004

This figure shows the real scenario of potentiality of FDI in Nepal. Two great giant India and China have big market that offers goods and service to be consumed huge in quantity as well as hub center to transfer the goods and services from one country to another. There are certain barriers having land locked and weak infrastructure but these are also opportunity to build new and timed technology based infrastructure as well.

CHAPTER - VI

CONTRIBUTION OF FDI IN THE ECONOMY OF NEPAL

There has been a growing interest and huge competition to strength the respectively attracting forces of FDI as a part of globalization agenda in most of the developing countries like Nepal. The main interest for such agenda is to use these FDI in the developing process of the economy as FDI may provide intangible assets including technology, potential spillover and externalities, which are highly beneficial for host country's economic growth. In the race of seeking more and more FDI inflows the country's have over looked the fact that all the FDI do not benefit their host countries similarly. The impact of FDI on the domestic economy mainly depends on the domestic policy, the kind of FDI the domestic country receive and the strength of domestic enterprises. The questions of measuring the role of FDI inflows in Nepal is pertinent, as FDI become a preferred finance for growth than the formal contractual agreements for foreign loans. In fact FDI appears particularly attractive, as exiting stocks are low in Nepal. Low stock of foreign owned capital implies low flow of profits on their investment. However, success in attracting FDI in Nepal is the healthy investment environment in Nepal for foreign investors.

The role of FDI on host economy can be adjusted from two effects on of FDI on economy. These two effects included the real effect an the financial effect. The real effect includes both qualitative and quantitative effects. The quantitative effects of FDI include the effect on the domestic investment, productivity, price level, income and employment and export growth. The qualitative effect of FDI includes the effect on the domestic investment , productivity p rice level, income and employment and export growth. The qualitative effect of FDI includes the effect on technological change, spillover effects and the effect on structural change of the economy. The financial effects of FDI on the host economy are the impact on balance of payment. The direction of all these effects as mentioned earlier depends upon domestic policy, the kinds FDI that a country receives, the strength of domestic enterprises and the structure of domestic economy.

In order to estimate the role of FDI on Nepalese economy, the study has considered only the impact on t he macroeconomic variable like gross capital formation, real GDP export etc. Similarly, the main purpose of this study is to examine the

contribution of FDI on real GDP of the Nepalese economy. This study also examine the direct effect of FDI on economic growth using time series data for the time period 1988/89-2011/12.

6.1 Indicators to Assess the FDI

Foreign direct investment (FDI) is always contributing in the positive growth toward the economy of one country due to the investment by another country or country's personnel's. The effectiveness and efficiency of Global economy depends upon the investor's perception, if investment seen with the purpose of long terms investment in the social-economical development then it is said that the investment contributes positively towards global economy. The FDI may also be affected due to the governmental trade barriers and policies for the foreign investments and leads to less or more effective toward contribution in economy as well as GDP and GNP of the country. In Nepal more than 25 percentage of the registered projects under FDI fall in sectors such as, service, manufacturing, tourism and energy. The various indicators to assess the input of FDI are as follows:

- **Productivity**

Multinational companies are bringing with them some firm-specific knowledge (in the form of technology, managerial expertise, marketing know-how etc.) that cannot be effectively leased or purchased on the market by host contry firms. For instance, affiliates of MNCs-as part of the parent company's global network-have excellent marketing networks, possess experience and expertise in the many complex facets of product development and international marketing, and are well placed to take advantage of inter-country differences in the cost of production. On these grounds, FDI is widely considered as an effective means of acquiring technologh and marketing know-how.

- **Investment Inflow**

The investors are bringing capital in Nepal. The total 2652 projects have been registered in Nepal comprising seven categories of industries, worth a total of investment equal to Rs. 216 billion. The total fixed cost is estimated to be Rs. 181 billion while the total foreign direct investment (FDI) is estimated to be Rs. 52 billion as of July 2012/13. The FDI is also helping to reduce the balance of payments of the

country. The goods produced by the industries under FDI are exported to foreign countries bring foreign currencies to Nepal (Economic Survey, 2013/14).

- **Technology Transfer**

The foreign investors are also bringing the new technologies to Nepal which is helping the local producers to learn know-how and apply it in the domestic companies and ultimately help in increasing the productivity of the companies as well as workforce.

- **Capital Development**

The local capital is not enough for the required investment in the big projects like mega hydropower projects, mining projects and big hotels where there is huge investment in billions of dollars. For example NPR 140 billions of commitment is under mining projects whereas more than NPR 400 billion is under hydropower projects. These amounts of capital are not possible from the local capital (DoI, 2013).

- **Employment Generation**

The registered projects under FDI are providing employment ooto local workforce. They have created employment to 181,051 till 2012/13 whereas the number of employment created by FDI in the 2012/13 was 16,569 (Three Year Plant, 2013)..

- **Reduction in the import items**

From the data available the FDI is second highest in the manufacturing sector which means the import items are displaced by the product manufactured in the country.

- **Tax Revenue**

Profits generated by FDI are contributing to corporate tax revenues in the country.

- **Human Resource Development**

The local staffs are gaining employee training in the course of operating the new generation and experiencing the multinational concept of operating the company.

6.2 Overview on Potential Sectors to invest in Nepal

Nepal has great potential for investment, and the country is pursuing a liberal Foreign Direct Investment ((FDI) policy to create an investment-friendly environment to

attract FDI. The major areas of investment include hydropower, manufacturing, services, tourism, construction, agriculture, and mineral and mining.

- **Hydropower**

Nepal has the capacity to generate 83, 000 MW of hydroelectricity, of which about 43, 000MW is techno-economically feasible. At the end of 2014, only about 800 MW was generated from hydropower projects. Of that total, 174.53 MW (24.9%) was generated through private investment. Nepalese industries and consumers suffer from huge power cuts each year. The annual domestic energy demand is estimated at 4,833.35 GW, of which 3,850.87 GW is generated from various sources and the remaining 982.48 GW is cut as load shedding. Nepal is unable to meet the demand, and approximately 694.05 GW is imported from India annually.

The Government of Nepal (GON) has already declared a national power crisis. So far, the Nepal Electricity Authority (NEA) has signed Power Purchasing Agreements (PPAs) worth 714.77 MW during 2011, which is almost double the total capacity of power purchase agreements signed in the past. The total capacity of PPAs signed has reached 1118.35 MW (NEA 2014).

- **Tourism**

Nepal's abundance of natural resources, diverse culture and ethnicity, numerous archaeological and heritage sites, and diverse topography, including eight of the world's ten highest peaks (including Mt. Everest), are some of the attractions for potential investments.

World heritage sites such as Lumbini (the birth place of Buddha), Chitwan National Park, Sagarmatha National Park, Pashupatinath, Janakpur Swayambhunath, Bouddhanath, Changuarayan, Kathmandu Durbar Square, Bhaktapur Durbar Square, and Patan Durbar Square are attractions to tourists worldwide.

Nepal offers a variety of interests to tourists, ranging from cultural tourism, nature eco-tourism, adventure tourism, health and education tourism and religious tourism. The Himalays, foot trails, rafting, paragliding, fauna, religious sites, eco-tourism and biodiversity are potential areas for investment.

- **Industrial Manufacturing**

The GON has promulgated a new Industrial Policy 2010 to develop the industrial sector and to provide protection and facilities to investors. Similarly, the draft of a

Foreign Investment Policy has been prepared. Industrialization is considered one of the most vital indicators of economic growth and prosperity of the nation, Therefore the GON is committed to supporting industrialization by establishing industries based on agriculture and local resources in rural sector, and establishing and developing industrial zones in urban areas.

Steel-rolling mills, cement, cigarettes, jute, sugar, tea, beer, carpets, garments, textiles, oilseed mills, and food mills are some of the most viable areas for investment in manufacturing and production industries in Nepal.

- **Agriculture**

Agriculture is the mainstay of the Nepalese economy, contributing approximately one-third of total GDP. A total of 74% of the total population still depends on agriculture for their subsistence. However, the growth rate of agriculture has not been encouraging, due to low investment both by the GON and the farmers themselves.

Nepal has great potential in tea, ginger, cardamom, and sugarcane production which have high demand in the international market. Rice, wheat, and maize are the main food crops, and mustard, soybean and sunflower are the major oilseeds. Potato, lentil, tobacco and jute are the major cash crops, which have high demand in local market.

The Terai, Hills, and Mountains are suitable for various types of agriculture. There is considerable scope for commercial farming, tea, cardamom, coffee, honey, and ginger.

- **Mine and Minerals**

The GON has formulated acts and regulation to promote mineral exploration and development on the country. Two separate acts and corresponding regulations exist to deal with different minerals. These are categorized into:

- **All Mineral Resources (Except Petroleum) Petroleum**

There are several areas in which to invest in commercially viable mining and mineral industries. Milestone, dolomite, quartz, talc, coal, peat, precious and semiprecious stones, and brine water (salt) are some of the economic minerals used by cement, soap marble, paper, dead magnesite, and agriculture lime industries. The promotion of gum industries is highly recommended. Ruby, sapphire, tourmaline, aquamarine, garnet, kyanite, and quartz crystals also have high potential in Nepal. International companies

can invest in cement, coal, petroleum exploration and production, and precious and semi precious stone.

- **Service**

Possible sectors for investment in service industries include medical colleges, schools, hospitals, and IT businesses.

- **Information and Communication**

IT includes telecommunications, electronic media, print media, postal services, and the development and production of motion pictures in Nepal. The tele-density per hundred persons is 27, which includes the involvement of the private sector. At present, 70 percent of the population has access to television: however a much larger percentage has access to mobile phone services. Difficulties have arisen in the expansion and development of these services to rural areas due to geographical complexities and the lack of infrastructure development.

The GON aims to promote national unification by providing access to all in the IT sector. The government plans to establish a optical fiber network in all 75 districts of Nepal by 2015. Therefore, there is the increased opportunity for private sector investment in this sector.

CHAPTER – VII

FINDINGS, CONCLUSION AND RECOMMENDATIONS

7.1 Major Findings

The major findings of this study are as follows:

- In law, Nepal has an open and liberal investment regime but in practice established investors, including major transnational and global companies, have had many problems in implementation of their projects.
- The foreign investment laws contain important assurances of protection and rights to the foreign investors. However, a good existing written legislation is not enough, as the effectiveness of the country's legal framework depends to an important extent on the effectiveness of existing enforcement mechanisms.
- Clearly, Nepal presents a difficult business environment. Major administrative obstacles to investment are inconsistent implementation and interpretation of laws and regulations, corruption and unofficial payments, bureaucratic "red tape", insufficient institutional capacity of governmental agencies. These and other administrative barriers resulted in projects delays and increased transactions costs.
- Transparency in the application of laws remains a major problem in Nepal and an obstacle to expanded trade and investment. While foreign participation is generally welcomed, some foreign investors allege that the Government is not always evenhanded and sometimes reneges on its commitment. Nepal's institutional governance is weak, further adding to the problems of transparency in commercial transactions.
- When disputes develop between the interpretations of the conflicting laws, the judicial system, instead of helping, appears to add to the existing problem. Some investors indicated a low level of confidence in the ability of the courts to adjudicate disputes in a fair and equitable manner. According to foreign investors and legal experts, the courts frequently do not accept foreign court decisions.
- There are important issues, which could undermine the attractiveness of Nepal as a preferred location for prospective investors, including stability of

legislation, particularly stability or sanctity of contracts, settlement of disputes, work permit quotas for expatriates, modality for determining world market prices under transfer pricing law, etc.

7.2 Conclusion

Inflows of FDI into Nepal accelerated after the economic liberalization of the 1990s but remain low in relation to the size of population and economic activity, and also in comparison with other least developed landlocked states in the Asian region. From the perspective of private investors, the existing legal environment does not provide the sense of security needed to justify major investments in Nepal. Confidence in the domestic legal system and particularly in the enforcement of legislation generally remains low. Vagueness of laws, contradictory legal provisions and uncertainties in practical implementation translate into serious risks, which many investors would like to see minimized prior to committing to major capital investments. The overall inflows are so low that, overall, FDI has not been a significant development catalyst. It is not necessarily due to a lack of potential. Nor it is because FDI has been excluded from most sectors of the economy. The answer is that Nepal has failed to offer investors satisfactory standards of policy, administration of taxes, regulations, and stable political environment, which are of vital interest to business.

The foreign investment laws contain important assurances of protection and rights to the foreign investors. However, a good existing written legislation is not enough, as the effectiveness of the country's legal framework depends to an important extent on the effectiveness of existing enforcement mechanisms. 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.

To sum up, it can be said that the Nepalese Government has created a healthy atmosphere for FDI inflow by introducing structural adjustment and stabilization policy in Nepal. The government of Nepal has tried to improve the economic policy to raise the inflows of foreign capital in Nepal. The present government is also moving in the same direction and it has welcomed foreign capital in sectors of national interest. such as infrastructure, core industries, hydro projects as well as in the case of some consumer goods industries, hydro projects, as well as in the case of

some consumer goods industries. It has become clear that the intentions of government are no longer in questions, the implementation is questionable. In order to time a boost to the FDI inflows, it has become quite essential to trace out the determinants of FDI inflows in Nepal.

The major findings of the study at macro level suggest that FDI played a vital role in the economic growth of the country. It also contributed significantly to raise the gross capital formation in Nepal. The global share of the FDI inflows in Nepal is very low; it is able to take the overall economy in a positive direction. In the context, the FDI inflows are very important and should be encouraged significantly in all spheres of the Nepalese economy. It is also importance to note that FDI inflow in the country has also not been able to fulfill the objectives of increasing exports. In this case of export promotion through FDI inflows, it is necessary to reduce the tariff rates of the country.

To sum up, it can be concluded that the FDI inflows have the potential to give a boost to the Nepalese economy, but the inflow of FDI should be high enough for a economy like Nepal. It require a judicious and sustained decision on the part of the policy markers to lure more foreign firms in to Nepal, Which may bring positive effect on the Nepalese economy in the future.

7.3 Policy Recommendations

Followings are the policy recommendations:

- One of the lessons learned from Nepal's economic performance in the last decade is that the country needs to expand and deepen its economic reforms to protect its economy from external demand shocks. A key way to achieve these objectives is to remove current administrative barriers and offer opportunities for investment.
- Creating necessary environment is to ensure implementation of structural reforms including transparency and corporate governance, privatization and commercialization of public utilities, and liberalization of trade policy.
- In order to guarantee regional competitiveness of Nepal, the Government has to adopt better policies and procedures than its neighbors and thus differentiate itself from its neighbors as the best place to do business in South Asia. Nepal

is at the forefront in the region, namely in respect of reform of legislation with regard to commercial laws, in reform of the financial system, in pension reform, in maintaining macroeconomic stabilization and others. But there are still many areas where Nepal is far from being the best and indeed has a poor reputation. This is particularly true in respect of administrative barriers. There is an opportunity to change this.

- The investment policy and procedure should be clear and simple for all foreign investors within a country, which helps to raise the inflows of FDI in Nepal.
- Institutional reforms and legislative changes are also included in broad definition of the development of agriculture sector, manufacturing sector and service sector of the country through FDI to pave the way for sustainable economic growth. Therefore, it is essential that policies are focused on creating a holistic enabling environment to achieve overall economic growth.

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