

**A STUDY ON THE IMPACT OF FDI IN MACRO  
ECONOMIC PARAMETER OF NEPAL**

**A THESIS**

**Submitted By:  
Sharadha Chalise  
Nepal Commerce Campus  
Exam Symbol. No. 250666/066  
T.U. Reg. No. 7-2-52-154-2004  
Roll No. 1464/064**

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## **RECOMMENDATION**

This is to certify that the Thesis

Submitted by:

**Sharadha Chalise**

Entitled

**"A STUDY ON THE IMPACT OF FOREIGN DIRECT INVESTMENT IN MACRO ECONOMIC PARAMETER OF NEPAL"** has been prepared as approved by this department in the prescribe format of faculty of Management T,U .This thesis is forwarded for examination.

\_\_\_\_\_

(Dr. Sushil Bhakta Mathema)  
Head, Research Department  
and Thesis Supervisor

\_\_\_\_\_

(Dr.Surendra Uprety )  
Thesis Supervisor

\_\_\_\_\_

(Mrs.Jyoti Pandey)  
Campus Chief

Date: \_\_\_\_\_

## VIVA-VOCE SHEET

We have conducted the viva-voce examination of the thesis

Submitted by

Sharadha Chalise

Entitled

**"A STUDY ON THE IMPACT OF FOREIGN DIRECT INVESTMENT IN MACRO ECONOMIC PARAMETER OF NEPAL"** and found that Thesis to be the original work of the student written in accordance with the prescribe format. We recommend the thesis to be accepted as partial fulfillment of the requirement for **Master Degree of Business Studies (M.B.S)**

### VIVA-VOCE Examination Committee:

Member (Research Department Head) \_\_\_\_\_

Member (Thesis Supervisor) \_\_\_\_\_

Member (External Expert) \_\_\_\_\_

Date: : \_\_\_\_\_

## DECLARATION

I hereby declares that this thesis entitled " **"A STUDY ON THE IMPACT OF FOREIGN DIRECT INVESTMENT IN MACRO ECONOMIC PARAMETER OF NEPAL"** Submitted to the office of the Dean faculty of Management Tribhuvan University is my original work done in the form of partial fulfillment of the requirement for the Master of Business Studies (MBS) under the supervision of Dr.Sushil Bhakta Mathema,Head of Research Department and Dr.Surendra Uprety lecturer of Nepal Commerce Campus.

Sharadha Chalise

Researcher

Exam Symbol. No. 250666/066

T.U. Reg. No. 7-2-52-154-2004

Campus Roll No. 1464/064

Nepal Commerce Campus

April,2013

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Sharadha Chalise

Researcher

Exam Symbol. No. 250666/066

T.U. Reg. No. 7-2-52-154-2004

Campus Roll No. 1464/064

Nepal Commerce Campus

Date :April,2013

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# CHAPTER I

## INTRODUCTION

### 1.1 Background of the Study

Nepal possess abundant potential for economic development, due to the lack of Proper utilization of resources development potential area uncovered so the process of industrialization remain slow in Nepal Most developing theories, development advocates and export accept that the external capital is necessary for accelerant growth and industrialization. In this more competitive and globalize world today no countries are self sufficient and self reliant. Every developing countries irrespective of their size and political system try to attract foreign investment. Nepal is one of the least developed countries in the world, having a capital poor economy with low domestic saving where development expenditure to significant extend are dependent on foreign aid. Nepal is one of the three landlocked countries of the SAARC region. It lies between world's two giant nations India and China and has an age-old friendly tie with both the neighbors.

Nepal is still at an early stage of industrial development and endeavoring to catch the pace of industrialization. Economic development has become a main objective of every modern state. It has been proved that economic, political and social justice cannot be maintained until and unless economic prosperity is achieved. Since the contribution of agriculture to GDP is about 40%, Nepal is primarily based on agriculture. Nepal falls in one of the least developed countries. In a least developed country like Nepal, the investment level is not sufficient to keep up with the population growth level. It is not an easy task to obtain economic prosperity within a short span of time. If we really want to accelerate economic development and the pace of industrialization, we must accept the reality that we may have to depend on foreign direct investment, as we have neither sufficient capital to invest nor adequate technology for industrializing our country. (Sharma, 1998)

Nature had provided the glorious and valuable natural resources but still uncovered an unexplored due to the lack of sufficient economic infrastructure and strategies. In this context foreign direct investment plays crucial role in employing the natural resources, making the economy industrialized and for the development of the nation through connecting the broad network with developed countries. This is an era of industrialization. Industrialization increases production volume and productivity, which creates employment opportunities and utilize idle capacity of the country. It helps country to become economically strong. Many underdeveloped countries are trying to change their economic fate by the means of industrialization but they couldn't get sufficient capital for the effective investment due to the low level of income and saving on same pace. So. The foreign direct investment is not option but necessary to drive the nation towards the economic prosperity by the way of raising productivity and employment through industrial development.

The investment made on any country by the foreign entrepreneur and institutions is known as foreign investment, it is the long-term capital investment. To acquire ownership of the firm by making investment in any country and control the enterprise by the foreign investor is called direct investment. Foreign direct investment is a major economic policy issue for the great majority of nation around the world .the increasing mobility of international firms and the gradual elimination of barriers to global capital flows have stimulated competition among governments to attracts foreign direct investment foreign direct investment have been one of the core features of globalization and the world economy over the past two decades F D I is an important indicator boost the economic growth of Nepal .FDI is regarded as an engine of growth as it provides much needed capital for investment ,increases competition in the host countries, and aids local firms to become more productive by adopting more efficient technology or by investing in human and physical capital so we can say that it is a medium for acquiring skills, technology, organizational and managerial expertise. Foreign direct investment is critical to enhance the transfer of capital, modern technology, management and technical skill. Foreign investment is considered an important for the industrialization of Nepal. As it attracts capital, technology, skills and expertise and also help to share risks, exploit resources presently and provide access to export market. Actually, FDI occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset (UNCTAD,1999). In other words, it involves the acquisition of a business of

other commercial assets in a country (the host country) by multinational enterprises, other foreign firms, or individual foreign residents with intent to manage the business or commercial assets in the host country. FDI is considered as a means of obtaining not only capital and technology but also scarce management and skill, and improved marketing 'know-how' and outlets for non- traditional exports of manufactures, processed commodities and traded services. FDI flows include equity investment by multinational enterprises, their reinvested earnings in foreign countries .( Sharma, 2008)

When we analysis the economic indicators of Nepal, it shows that Nepal has suffered from vicious circle of poverty. The economy of Nepal has been running through low income, low investment low employment, low saving, low productivity, poor public service insufficient use of public resources, misuse of natural and human resources etc. these factors have also contributed to creating social unrest and political instability. In the absence of capital investment these poor economic indicators cannot be that correct results, land will barren, labor will remain idle, natural resources will collapse and organizer will be seriously hampered in the per suit of productive enterprises. The investment level of Nepal is not sufficient to manage all the above factors. So, The foreign investment may play a roll of backbone to develop the national economy of Nepal.

It has been universal truth that development of the country is not possible without industrialization. But it is not an easy task, government of Nepal alone cannot forward due to its limited resources and unlimited needs, similarly the private sector are also not interested to invest in the industrial sector because of less profit, underdeveloped nature of capital market, inefficient management, unstable government of the country and changing rules and regulations of the government. In such situation the government should promote the foreign investment for right solution, realizing the importance of foreign investment, both developed and developing countries are trying offering several incentive packages and concessions to foreign investors in these days.

In spite of the above facts, foreign investment is still a new concept for Nepal, the government of Nepal has not been able to promote the foreign investment to the desired extent, the obstacles of industrialization in the economy like the limited market, limited resource endowment, communication, skilled manpower, transport and scarcity of power and fuel. These

factors undoubtedly discourage the foreign investors as well. Complaints are often heard from the foreign investors about the problems; they have to face before and after investing in Nepal. Hence the government will have to give priority to the development of infrastructure through the foreign investment.

Nepal is one of the least developed countries in the world. It is one of the three landlocked countries of the SAARC region. It lies between world's two giant nations India and China and has an age-old friendly tie with both the neighbors. Ecologically it is divided into Terai in the South, hills in the Middle and Mountain in the North.

Capital is one of the most important factors affecting the economic growth, which is rare in under developed countries like Nepal. In the absence of capital land will lie barren, labor will remain idle and organizers will be seriously hampered in the pursuit of productive enterprises. Availability of insufficient capital resource leads to a very low level of development, investment that, in turn, hinders vigorous economic growth and capital formation. Capital formation involves (a) Creation of saving (b) Mobilization and channelization of saving, and (C) acquisition of capital goods. Saving is a condition for capital formation. In an Underdeveloped economy like that of Nepal, since the domestic sources of financing is constrained by an ability to save, investment requirements are fulfilled by an inflow of international fund both private and official. Foreign private investment is influenced by monetary, credit, fiscal and other policies such as those on profit repatriation, labor use at permissive level and rate of exploitation of available financial and physical resources. (K.C,2000)

Most of the developing countries have lack resources required to meet the financial requirement of economic development. There requires foreign capital and technology for socio-economic development. Previously much of the resource gap was managed through foreign grants and loans, but due to the worldwide economic crisis of 1980s, many donor countries curtailed their official development assistance and therefore foreign private capital remained the only alternative sources available to many developing countries (Sharma; 1999). Obviously foreign capital serves the purpose of increasing capital investment, inflow of secure technology technical information and expertise, opening the doors of foreign markets and helping upgrading the management, marketing, production and organizational skill (Chitrakar, 1994).

In fact foreign direct investment provide fund along with manpower technology which are suppose to encourage to local enterprise with foreign investor especially in case of LDCs this paves way for expansion, modernization and development the vast rural economy helping to metalized the dream of industrialization .Beside FDI makes available an employment opportunity to the local people. It further brings new and innovative know how or skill production and distribution/marketing. It is regard as a powerful means of transfer of technology which help strengthen the trade with widespread market within and outside the country .In this way ,It also assist to maintain and utilized the available capital and natural resources to maximized possible extant so that a country may get every ambience to prospe (khanal, 2006).

Foreign capital is also seen as the useful instrument to break the vicious circle of poverty and market imperfections. The contestability of the market is enhanced when the firms do not face any kind of regulation in the matter of entry and exit including their mode of operation. This confirms the optimal allocation of resources and as such proves to be helpful in breaking the vicious circle of poverty, in the opinion of Prof. Nurkse, “The use of foreign resources is one way of breaking the vicious circle of poverty and low capital formation. The flow of foreign capital and other resources will provide on increase in productivity fast enough to outrun population growth and thus launch a process of cumulative expansion and will acquire a sufficient portion of this capital in foreign exchange to permit importation of raw materials and equipments needed for development in addition to essential food stuff. (Nurkse,1972)

It is no doubt to say that Nepal needs FDI for its economic progress. Nepal is an ideal destination for FDI owing to its rich natural endowments, abundant and cheap labor force, huge market in neighboring countries, growing internal market, a well- developed banking and non-banking financial institutions to cater investors' needs for finance fully convertible current account preferential entry of products in India and investor friendly government policy. Investment opportunities are open to almost every sector of economy from tea to mining industries.( Sharma ,2008)

Slightly over one percent of the total agriculturally dependent population is in a position to hold saving, mostly in the form of jewelry and ornaments and land property in city areas and residential buildings. The capital hoarded hardly appears to be employed for productive purposes in the absence of a developed network of banking system and industrial infrastructure. The

capital that is in the hands of some traders is used in quick yielding ventures. These people are not interested in making investment in industries which probably would yield a lower profit rate than they are getting at present. (Bhatta, 1993)

Against this backdrop, it is great problem for the government to generate capital resources domestically. International financial inflow is thus necessary for accelerating growth and industrialization. If capital is used for development process, gross fixed capital formation can be accelerated and particularly important in increasing the pace of industrialization. The process of industrialization in Nepal began only after the country opened its borders to the outside world in 1951.

Emphasis to foreign investment was given since the sixth plan (1980-85) in Nepal. Separate rules, regulations and some lucrative incentives have been provided to the foreign investors especially since 1981 (Sigdel, 2004). The Foreign Investment and Technology Act (FITA) was promulgated in 1981 and it accorded various facilities and provisions for foreign investors. For example, industries with 25 percent to 50 percent value added in their productions were granted full exemption from income tax for five years. Furthermore, facilities of convertible foreign currencies were also provided for joint venture industries under FITA for the import of necessary machineries, equipment and tools, spare parts and components, raw materials technical consultancy, assistance and so forth. The Foreign Investment and Technology Act 1981 was replaced by the Foreign Investment and Technology Transfer Act (1992) with amendments made in 1993 and 1996 (Bhatta, 1993). The basic tenets of this Act were the provision of 100 percent equity investment; full remittances of profits, dividends and repatriations of capital; facilities and concessions to foreign investors through one window system, tax exemptions, etc (See FITTA; 1992). In July 2000 Government formed a Fast Tract Committee (FTC) with a view to make quick decisions on FDI related projects.

According to (FIOWP,1992) After the emergence of multiparty democratic system, New Industrial Policy'2010 and Foreign Investment and one Window policy 1992 were introduced for the speeding up the process of industrialization through mobilizing the local capital as well as attracting foreign direct investment and technology in the country (Singh, 1998). Private foreign investment has not been very important in the country's growth strategy until the restoration of multiparty democracy in 1990. Only 86 joint venture projects have received approval to operate

in Nepal with a total foreign capital investment of nearly RS 6 billion. The approved joint ventures were concentrated mainly in manufacturing and service sector including tourism. Investment is allowed in any form, be it either 100% foreign owned or any ratio of equity participation on joint venture collaboration with local investor. Full repatriation of dividends is guaranteed and a liberal exist policy has been adopted. A 'one window' system was introduced to provide all government services to domestic and foreign investors through a single institution

In sum, FDI in Nepal is the latest concern. Despite the liberal FDI- related policies Nepal could not attract a substantial level of investment. Lack of political commitment on the one hand, and the structural deficiency including corruption, red- tape, unnecessary licensing procedures, multi- windows process etc. were responsible factors for the poor performance. Similarly, the restrictive national priority contributed to the lack of foreign investment. The recent initiation of Indian investors to take part in joint ventures in Nepal is a signal for the futures growth of foreign investment. For promoting FDI the government is ready to provide tax incentives, liberalization of laws with deregulations of rules and regulations. The internal overall performance is a necessary condition to improve foreign investment. Foreign investment is influenced by a many considerations besides investment law. Out of these, uninterrupted flow of raw materials and extension of market are considered major determining factors. Moreover, from the view point of the investors, the most desirable situation is the one without any kind of restriction. The more arbitrary the procedures, the more discouraging it are to the potential investors. With the changed political situation, the government should be aware of the problems and is expected to improve the investment climate. The Foreign Investment and Technology Transfer Act, 1992, governs the entry of FDI in Nepal. FDI is permitted in all industries in Nepal except for those reserved exclusively for national investors and statutory state monopolies. Foreign individuals are not permitted to own land but resident companies may does even if foreign owned. ( Sharma,2008)

Nepal lacks industrial, commercial and marketing know-how. It is also a resource constrained county and lacks the critical mass in terms of wealthy inhabitants to stimulate investment internally. Therefore foreign direct investment has been recognized as a major strategy for country's future prosperity and many concessions and incentives are being offered to promote and encourage investors in Nepal. ( FNCCL, 2003)

Foreign direct investment is playing the role of engine of growth particularly in the developing countries like Nepal. FDI has been a major source of financing economic development. Nepal is trying to establish well equipped laboratory for FDI generation in various sectors with a view to accelerate capital formation and alleviate poverty utilizing abundant natural resources available in the country. Moreover, if Nepal is able to invite and attract FDI on Nepalese terms and conditions. It would really create a new era of employment generation. If FDI is diverted properly in the productive sectors, it helps to expand the Gross Domestic product (GDP) and upgrade the economic status of the economy.

## **1.2 Statement of the Problem**

The concept of attracting foreign direct investment was introduced in Nepal since late 1980s and several reforms have been made to modernize the law and policies related to foreign direct investment but still the result is not satisfactory.

Nepal suffers from underdeveloped infrastructure, limited resources endowments particularly capital, technical know-how, poor manpower, improper planning, ineffective implementation of policies, political instability etc. Nepal is bound with traditional or conventional society where people almost depend upon the old primary and traditional industries having insufficient modernized tools and technology.

Against these shortcomings, it is a great challenge for the government to mobilize capital resources domestically. Hence this has led the country to depend on external sources to some extent for the process of economic development. Thus no one can deny the role of foreign direct investment in economic growth and the development of the country.

An assessment of the policies that addresses domestic and foreign direct investment prospects on the basis of existing investment climate is thus considered as the problem of the present study.

### **1.3 Objectives of the Study**

The main objectives of the present study are as follows:

- i. To examine and analyze the status of foreign investment in Nepal.
- ii. To examine existing policies and incentives relating to foreign direct investment in Nepal.
- iii. To analyze the problems and constraints of foreign direct investment in Nepal.
- iv. To analyze the impact of FDI in Nepalese macro economic parameters
- v. To explain the role of FDI in economic development of Nepal.
- vi. To provide necessary recommendations and suggestions on the basis of major findings.

### **1.4 Importance of the Study**

The importance of this study lies in studying the trend of foreign direct investment in Nepal and the problems associated with its attraction to the designed extent in spite of several efforts from time to time. The importance of this study also lies in seeking answers to some questions like:-Has foreign direct investment in Nepal shown positive impact in the national economy? What is the contribution of the existing joint ventures in terms of employment generation and mobilization of domestic saving etc? Another importance of this research study also lies in its endeavor to contributing to the researchers of foreign direct investment in Nepal in which very few studies have been done so far.

### **1.5 Limitations of the Study**

Since the concept of Foreign Direct investment covers wide range of subject of which detailed study is not possible due to time and economical constraint. so the study is based on the following limitations.

This study is focused on the trend and structure of FDI in Nepal. This study includes existing policies and incentives relating to foreign investment in Nepal. Secondary information and data collected and recorded by reliable persons, institution are used to analyze the objectives. Different statistical tools are used for the analysis of data.

## **1.6 Organization of the Study**

The structure of present study is organized in to different five chapters. First chapter contains the introduction. This chapter contains background, statement of problem, importance of the study, objectives of the study limitation and structure of the research study

Chapter two contains review of literature on foreign direct investment in Nepal, studies on FDI, Legal provisions and institutional arrangement for FDI in Nepal and its conclusion

Chapter Three deals with research methodology. This chapter includes data and information, sources of data, data collection procedure, data processing and analysis.

Chapter Four contains trend and situation of FDI in Nepal. It includes year wise plane wise category wise sector wise, country wise joint venture projects in Nepal. It also includes FDI and Economic development.

Chapter Five reviles the summary, conclusion and recommendations on the basis of study analysis.

## CHAPTER-II

### LITERATURE REVIEW

#### 2.1 Conceptual Framework

FDI is considered beneficial in view of its contribution to technological transfers, enhancement of managerial capability 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 increases in exports by creating international markets through new marketing and organizational skills. (Khanal, 2009)

Nepal is one of the poorest countries in the world and requires a basic foundation for economic growth and social justice. There is a need to build a highly productive society and to change the country's development strategy from one that is poverty responsive to one that is poverty influencing through industrial development for self-sustained economic growth for the sake of the development of the industrial sector and enable it to significantly contribute to the economic growth and overall development of the country. There is a need to develop an environment that is conducive to industrial development. (Wagle, 2004)

FDI is a flow of entrepreneurial capital in the form of some mixture of managerial skills and financial lending. It directly increases the capital formation of the recipient country. FDI is the outcome of mutual interests of multi-national firms and host countries. According to the International Monetary Fund (1997), FDI is, "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor. The investor's purpose being to have an effective voice in the management of the enterprise". IMF definition of FDI treats both reinvested and other direct capital flows such as debt securities, trade credits and grants as part of FDI. This definition is accepted by most countries and also by UNCTAD for reporting FDI data. Briefly speaking, economic benefits of FDI include contribution to physical capital formation, contribution to human capital development, transfer of technology and know-how, expansion of market and expansion of trade. The technological changes that it brings about

increase factor productivity, change product and export composition, encourage research and development practice and efficiency to local production. The role of FDI has been accepted as very important in the development of developed as well as developing countries. It has always attracted a good deal of attention and given rise to heated controversy. ( sapkota,2011)

Broadly speaking, foreign direct investment (FDI) is a transfer of entrepreneurial capital in the form of some conglomeration of managerial skills and the supply of finance to a host country. A case in point of FDI would be a British company gaining a majority venture in an enterprise in China. Another instance would be an Indian incorporation establishing a joint endeavor to promote a mineral deposit in Nepal. Countries hail FDI for its heterogeneous inherent advantages which encompass employment generation, capital build-up, transposition of technology, advanced equipping of services and escalated competition. (Pant ,2012)

"There is an increasing preference for investment in equity from over commercial bank borrowing , which has proved to be unpredictable, one raws, inflexible in its' servicing obligations and un-obtainable for many countries. Direct investment is considered not only as the means of obtaining capital but also technology, scarce management and skill, improve marketing 'know-how' and outlets for non traditional exports of manufactures, processed commodity and trade services"(Cable and Persud ,1987)

Foreign direct investment are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net outflows of investment from the reporting economy to the rest of the world and is divided by GDP.([www.indexmundi.com](http://www.indexmundi.com),2012)

Kindleberger defines foreign investment as "Balance of payments accountants defined as direct foreign investment as any flow of lending to, or purchase of ownership in a foreign enterprise that is largely owned by residents of the investing country"(Kindelberger, 1987).

### **2.1.1 Potential economic benefits of FDI**

FDI inflows can lead to a range of economic benefits for transitional and developing countries, including( Dunning, 1994)

- i) restructuring their economic activities in line with dynamic comparative advantage;
- ii) reducing their costs of structural adjustment;
- iii) fostering more demanding purchasing standards by firms and consumers
- iv) raising the productivity of national resources and capabilities
- v) improving quality standards
- vi) Stimulating economic growth

### **2.1.2 The basic reasons for attracting FDI by developing countries are: (khanal,2009)**

- i) Capital Transfer: Developing countries lack capital resources. FDI is an Importance means of capital flows.
- ii) Productivity Improvement: FDI facilitates technology transfer. Technological up gradation results in productivity improvement.
- iii) Management Development: Local management people get trained in foreign firm. They acquire new concepts, tools and techniques of management
- iv) Employment: Foreign Company generates employment. Due to cheap labor in developing countries, outsourcing is on the increase by global companies. Worker acquires new skills.
- v) Better Product: Foreign Company produces qualitative and branded products. They have high image. They assure quality and supply of product

### **2.1.3 Process of permission for FDI**

In accordance with given foreign investment and technology transfer act. A foreign investor should have to obtain these permissions from the concerned department. Following are the basic permissions which are supposed to be obtained by a foreign investor. (Timilsina,2000)

- i) Permission of the department shall be required to be obtained for foreign investment and technology transfer.
- ii) A person desiring to avail foreign investment or technology transfer shall be required to make an application to the department in the prescribed form, along with the prescribed particulars for obtaining permission in that behalf.
- iii) If an application is made pursuant to sub section (2) above the department shall, as per the decision of the Board, grant permission in the prescribed format within thirty days from the date of application. If the board decides not to grant permission for the establishment of the industry, the department shall inform the application of such decision.
- iv) Notwithstanding anything contained in sub section (1) and (2) above, on permission shall be granted for making foreign investment in the industries set forth in subsection 3.1.3.1 permission may be granted for the transfer of technology in certain prioritized industries.

#### **2.1.4 Development of FDI in Nepal**

In the context of Nepal, history of joint stock venture or foreign investment is very short. At the time of Prithivi Narayan Shah, foreign enterprises were prohibited to enter in the country . but this policy did not last long are also appeared with rise of Rana ruler especially when Janga Bahadur came in power.

The formulation of Udyog Parisad in 1935 the initial support towards industrialization in Nepal, this was followed by Nepal Company Act 1936. the act made provision for the incorporation at industrial enterprises or joint stock principles. Biratnagar Jute Mill, the first joint stock public company was established in 1936 in the collaboration with Indian enterprises and local counter part with a paid up capital of Rs 8,00,000. During the world ward (II) economy created the huge demand of jute product and earned enormous profit. As a result , number of joint venture industries were established. The trend of industrial development continuous up to 1945 by incorporating joint stock companies which manufactures hand made papers, soaps,

furniture, mats, textile and cigarette etc. all these events belongs to war period. But most of these were closed due to many causes "..(Chitrakr,1986)

"In the year 1961, provision for foreign investment in medium scale industries with the investment of Rs 50,000 to 5,00,000 and large scale industries with the investment of more than Rs. 50,000.

In 1974, foreign investment allowed from 51 percent to 100 percent in the basic industries like cement, fertilizer, steel or consumer basic goods like diary, pharmaceuticals, papers, textiles. But preference for Nepalese investors in medium scale industries with the investment of Rs. 1 Million to 5 million. But large scale industries both type of investors are equally treated.

In 1982, the separate act for foreign investment is promulgated as "foreign investment and technology act 1982." It is established that industrial units established under the Act would not be nationalized. It also established equal treatment for foreign investors as Nepalese investors. Foreign investors are permitted to have majority of shares in medium scale industries (Rs 2 Million in fixed assets) but allowed 100 percent in large scale industries with more than Rs 10 million investment in fixed assets.

In the year 1987, 50 percent of equity is allowed for foreign investors in medium scale industries, which require the investment Rs 3 million to Rs 10 million, where as in large scale industries with more than Rs 10 million investment, 100 percent ownership for the foreign investment are allowed , which export 90 percent of the product, otherwise only 80 percent equity participation is allowed.

In 1992, 100 percent equity is allowed for foreign investors in large and medium scale industries with more than Rs 20 million fixed investment in other industries with less than Rs 20 million investments, only transfer of technology is allowed." (Timilsina,2000)

At present , foreign investment is directed in all seven important sector of industry namely, manufacturing , services, tourism, agro based, construction, mineral based and energy based.

## 2.2 Foreign Direct Investment in Nepal

Foreign investments in Nepal are normally in the form of foreign currency or capital assets. Reinvestments of earnings from foreign investment also constitute form of foreign investment. Together with this, direct form of foreign investment, foreign loans, use of technological rights, specialization, formula process and patents relating to technology of foreign origin, use of foreign-owned trademarks and use of foreign technique, consultancy, management and marketing services also constitutes foreign investment. (FITTA, 1992)

In the context of Nepal, history of joint ventures or foreign investment is very short. At the time of Prithvi Narayan Shah, Foreign enterprises were prohibited to enter in the country. But this policy did not last long and disappeared with rise of Rana ruler especially when Janga Bahadur came in power. (FITTA, 1992)

(Pant, 1994) Argues that the history of organized industry in Nepal dates back to 1936 when Nepal Company Act was enacted. The Act made provisions for incorporation at industrial enterprises or joint ventures. Biratnagar Jute Mill was the first organized industrial venture established in 1936 in collaboration with Indian enterprises and local counterparts with a paid up capital of Rs. 800,000. As the Rana Prime minister Juddha Sumsher enacted a company law in 1936, which made provisions for the establishment of joint stock companies in Nepal, other Indian enterprises were attracted to undertake new ventures like the Morang Sugar Mill, Raghupati Jute Mill, Juddha Match Factory and few others. During 1936 to 1951 some 65 joint stock companies were established in Nepal (Sapkota, 2002). The registration process of joint ventures was quite slow in Nepal during 1960's with not more than 10 registered units (Sigdel; 2004). During 1980s many developing countries were forced to ease their restriction on foreign direct investment and changes their policies to attract foreign direct investment over and above, owing to lack of alternative financing, Government of LDCs realized that foreign direct investment has a potential benefit in an era of increasing international competition and globalization

In recent years, Government of Nepal has accorded a top priority to attract foreign direct investment. Article 35(12) of the Interim constitution of Nepal 2007 states that "The state shall, for the purpose of national development, pursue a policy of attracting foreign

capital and technology, giving priority to national investment." (The interim Constitution of Nepal, 2007). The Ninth Plan (1997-2002) had 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; 1997-2002). The Tenth plan (2002-2007) also aims to meet increasing investment requirements and invites modern technology and management. The Tenth Plan (2002-2007) and three years interim plan focuses on the challenge of attracting direct and portfolio foreign investment to Nepal amidst intensive competition from other emerging countries since it is recognized that a large amount of capital investment is required for establishing, developing and expanding infrastructures such as energy, communication, roads, railways as well as industrial projects and financial institutions which is currently not met by domestic investments .(Sigdel, 2004)

The promulgation of the Industrial Policy 1992, 2010, The foreign investment and technology Transfer Act 1992 and Industrial enterprise Act 1992 agreement of BIPPA 2011, were the significant steps towards attracting foreign direct investment in Nepal that played a crucial role in importing foreign capital and transfer of advanced technology and efficient management.

After the implementation of different FDI related policies, significant numbers of joint venture projects were established. Up to now, there are altogether 2108 foreign venture projects were registered in Nepal comprising all categories of industries worth a total investment equal to 152181.75 million. The total fixed capital is estimated to be 129116.39 million while the total foreign direct investment marked Rs. 68049.97 million from the beginning to 2067/68 Available data for FDI reflect that out of 2108 joint venture projects 50.10% are from single country India with the investment value of NRs.32390.31 million. The

other SAARC countries as Pakistan, Bangladesh, Sri Lanka and Bhutan's investment in Nepal have found to be dismal. There are no traces of investment in Nepal from the Maldives.

### **2.3 Foreign direct investment inflow to Nepal**

A FDI inflow to Nepal was US\$ 5.94 million in 1990. It then decreased to almost nil up until 1995. In 1996, FDI inflow was US\$ 19.16 million and fluctuated quite a bit until 2000, when FDI inflow was negative US\$ 0.48 million. Till 2006 FDI inflow has turbulent fluctuation and after 2007 it has been increasing and reached to \$87,799,640.00 in 2010. The Foreign direct investment; net (BoP; US dollar) in Nepal was last reported at 87,799,640.00 in 2010, according to a World Bank report released in 2011. The Foreign direct investment; net (BoP; US dollar) in Nepal was 38,176,180.00 in 2009, according to a World Bank report, published in 2010. The Foreign direct investment; net (BoP; US dollar) in Nepal was reported at 9,95,123.90 in 2008, Over the past 14 years, the value for this indicator has fluctuated between 87,799,640.00 in 2010 and (\$6,647,984.00) in 2006. *As the news published in Abhijan Daily dated 3<sup>rd</sup> March 2012*, on the month of Magh 2068 total 15 companies with investment amount of NPR. 76crore 82 lakhs, 15 companies were registered on Department of Industry, Nepal. Out of these, 10 companies are going to be invested by foreign investors, with the total investment of NPR 18crore 79 lakhs. Among the registered companies 5 are production oriented and 5 are service oriented with 4 from foreign investment. (Sharma, 2012)

FDI inflows to Nepal was the second lowest in South Asia in 2010. It received approximately US\$39 million last year. The highest recipient was India with US\$ 24 billion and the lowest Bhutan with US\$ 11.69 million. The total FDI inflows in the world was US\$ 124.37 billion, to developing countries US\$ 573.57 billion, and to South Asia US\$ 31.95 billion (South Asia excluding India received US\$ 7.3 billion of which approx 30 percent went to Pakistan). FDI inflows to Nepal was US\$ 5.94 million in 1990. It then decreased to almost nil up until 1995. In 1996, FDI inflows was US\$ 19.16 million and fluctuated quite a bit until 2000, when FDI inflows was negative US\$ 0.48 million. In the last two years FDI inflows have been stable at around US\$ 39 million. Nepal received 0.12 percent of total FDI inflows to South Asia in 2010. Similarly, it received 0.15 percent and 0.17 percent of FDI inflows to LDCs and landlocked

developing countries in 2010. The corresponding figures in 1990 to these destinations, respectively, were 2.79 percent, 1.04 percent, and 0.98 percent. In 2005, they were 0.02 percent, 0.02 percent and 0.04 percent . (sapkota, 2011)

"FDI to Nepal has been skimpy. According to the UNCTAD Report of 2012, FDI inflows to Nepal in 2011 was \$95 million, an uptick from \$ 87 million in 2010. This is an opprobrium especially when inflows to Bangladesh recorded \$ 1136 million in 2011 and Maldives received \$ 282 million".(Dr. pant, 2012)

During the period 1988-2001, the amount of total realized FDI expressed as a percentage of gross domestic capital formation was, on average, less than 1%. (10) The relative contribution of FDI projects to domestic employment has also been small. According to the official records of the Foreign Investment Promotion Board, total employment in realized FDI projects during the period 1988-2001 was 41,320, which amounted to a mere 0.06% of the increase in the total labour force in the country during the same period. (11) The data on the sectoral distribution of FDI projects in manufacturing points to a high concentration of projects in relatively more capital-intensive sectors, which receive relatively greater protection. (12) Based on data relating to investment approval, total investment per worker in FDI projects is around \$14,000, which is extraordinarily high for a labour-abundant and capital-scarce country like Nepal. For example, in Malaysia, a country which is at a much advanced level of development with virtually full employment from the early 1990s, average investment per worker in foreign firms is as low as \$18,000. This vast difference in the degree of capital intensity of production by foreign firms in the two countries can be explained in terms of the nature of the market-orientation of such production. As noted earlier, foreign firms in Nepal are largely involved in import-substitution activities whereas in Malaysia, they are heavily concentrated in export-oriented production. Import-substitution (market-seeking) FDI in developing countries, driven mostly by high import tariffs and other entry barriers rather than relative factor cost differentials, generally tend to be more capital intensive compared to efficiency-seeking (export-oriented) FDI . (Bhagwati, 1991)

Nepal has been receiving some foreign direct investment (FDI), but the amount has been insignificant when compared with that received by other developing countries, including South Asian one. But the list of foreign investors includes such renowned companies as British American Tobacco (BAT), Unilever, Coca- Cola, Standard Chartered and Hyatt. India is the major source of FDI in Nepal so far (about 40%), followed by the United States, China, The British Virgin Islands, Norway, Japan, the Republic of Korea, Canada and Hong Kong (China) in

terms of the amount of approved FDI. The major area of FDI has been manufacturing, followed by services and, in particular, tourism more specifically, FDI is concentrated in manufacturing products for export to India (e.g. vegetable fat, soap, tooth paste, Ayurvedic preparations) and overseas (ready made garments). This is followed by hotels. More recently there has been significant FDI in hydropower, taking advantage of the further policy liberalization in this sector. (mskathayat, 2011)

## **2.4 Current Situation of Foreign Trade Investment in Nepal**

Many things have done but we are still less benefited of FDI. In Nepal many policies. Bilateral agreements directly and indirectly effected to FDI for example agreement between Nepal and India trade, facilitated Nepalese product in India by which FDI improved in Nepal by modification of agreements in 2002 which creates many hinders to export Nepali product in India FDI in Nepal negatively effected. Like his huge operating cost, level locked structures of Nepal small market, increasing the distance and fight between owner and worker, Load shedding, long decision process, ect. Many cause are effect manufacturing companies operated by FDI. Thus gross domestic product and number employee decreases. Number of project are also decrease in spite of them service, tourism, Agriculture section project are increased.

### **2.4.1 Problem of FDI in Nepal**

#### **- Policies Problems**

- i False of long term economic policy.
- ii Foreign direct policy are not updated still foreign investment policy. and policies are not harmonized.
- iii Lack of effective implementation of one door system.

#### **- Policies implement problems:**

We do not have any proper action plan. How to implement our policies effectively regarding promoting & attracting and implements FDI policies.

- i We don't have adequate resources like financial, information are still barriers for implement policies.

☐ **Ecological problems;**

- i In ecological we can find two factors domestic and international.
- ii In domestic factor we are in renovation phase. We do not have stable government and political parties don't have positive attitude regarding FDI. Investment environment is less competitive for FDI
- iii International factor We have not modern technology maker is the support FDI.

☐ **Economy Problem:**

- i We have poor economy we cannot bear large investment. We have very poor infrastructure for FDI like load shedding, water supply problem transport physical infrastructure are also not supported for FDI

- **Organization problems:**

- i The structure of FDI in Nepal is not need base. It is downer base which is major problems for FDI in Nepal.
- ii The land is very costly as well as we don't have skill human power industry thus foreign direct investor are not attracted to invest in Nepal. For example: In China many foreign companies are operated and investor are attract to invest their because in China they can get Land and worker very cheap.

- **Management Problems:**

We don't have project proposal skill and staffing, motivating.

- **Human Behavioral problem:**

Many Nepali people are from way from the knowledge of FDI they don't know the value of FDI as well as we people don't have positive attitude towards FDI for example Bilateral investment promotion and protection agreement (BIPPA) was criticized by Nepali which is a great achievement of Nepal to increase the inflow of FDI in Nepal.

#### **2.4.2 Challenges of Nepal to increase the inflow of FDI in Nepal which are as fallows :**

Nepal is the midst of a historic political transition from monarchy system to a modern; democratic federal system.

Key governance issue includes deficiencies in the policy and legal from work for promotion and regulation of business as a result Nepal's investment climate remains less competitive to FDI.

In additional improvement in trade and fiscal policies and practices are necessary to generate more revenue from the government fruition.

Maximum utilization of available resources can be enhance by FDI so we have many potential areas like tourism, Hydropower, Herbs product, Service, Agreements to attract FDI to make Nepal an attractive place for investment in the context of this competitive world is the main challenge for us.

## **2.5 Legal provisions and institutional Arrangements for FDI in Nepal**

### **2.5.1 Legal provisions for FDI in Nepal**

Nepal has been experiencing foreign investment and technology transfer since the 1930s when the industrialization was introduced. The Rana Prime Minister Juddha Shumsher enacted a company law in 1936, which made a provision for the establishment of joint stock companies in Nepal. During 1936-1951, 65 joint-stock companies were established in Nepal. The Biratnagar

Jute Mills is the first joint stock company of Nepal established by Indian and Nepalese entrepreneurs .

In 1951, after the establishment of multiparty democracy, the government realized the importance of foreign private capital for the promotion of industrial development of Nepal. The government, in its first plan (1956-61) welcomed foreign direct investment and technology to establish large scale industries. In 1958, Government of Nepal formulated its first industrial policy making provision for FDI, particularly in medium and large scale industries in 1961, Government of Nepal enacted the Industrial Enterprises Act (IEA) giving legal effect of the policy statement. The subsequent periodic plans (1962-1965), (1965-1970) also followed the industrial policy of 1961. (Sapkota, 2002)

In 1974, Government of Nepal announced a new industrial policy and also enacted a new IEA introducing criterion for establishing and financing process, co-ordination process among government agencies in providing facilities to industries, chanelization of various policies related to industrial development through one window. The Act also allowed an extensive system of incentives such as more exemption of income tax, duty free imports of raw materials and spare parts, exemption from excise duties and sales tax, and preferential interest rates for backward areas. Foreign investors were allowed to repatriate only 35% of their profits . (Sapkota,2002)

However many problems had to be confronted during the implementation of this Act of 1974 because of which the government introduced a new industrial policy in 1981. Foreign Investment and Technology Act of 1981 was the first legislation of the government outlining policies, facilities and incentives and the legal framework within which foreign investment was welcomed. Since then a separate division foreign investment promotion Division had been set up in the Ministry of Industry to deal with all matters concerning foreign investment. (Young presidents organization,1989)

‘Foreign Investment Opportunity in Nepal’ published by Ministry of Industry, is quoted as saying “Nepal has given high priority to encourage foreign investment. The Foreign investment and technology transfer Act 1992 lays down the basic law governing foreign investment in the country. The foreign investment and technology transfer Act has undergone its first amendment in 1996 aiming at making the environment of industrial investment more

congenial, straightforward, encouraging and transparent. The industrial policy of 1992 identifies foreign investment promotion as an important strategy in achieving the objectives of increasing industrial production to meet the basic needs of the people, create maximum employment opportunities and pave the way for the improvement in balance of payments. Foreign investment is expected to supplement domestic private investment through foreign capital flows, transfer of technology, improvement in management skills and productivity and providing access to international markets. In this context, Government of Nepal is encouraging foreign investment in Nepal by providing attractive incentives and facilities with in a liberal and open policy. The importance attached to foreign investment is clearly reflected in the constitution of the Kingdom of Nepal. In the directive principles of the constitution, it is stated that a policy of attracting foreign capital and technology shall be adopted.” (MOI, 1999)

After the installation of Multiparty democratic system in the country, the elected government adopted the new policy measures in several economic spheres including new industrial and foreign investment and one window policy for speeding up the process of industrialization through mobilizing the local capital as well as attracting foreign direct investment. According to the spirit of these policies, the Industrial Enterprises Act (IEA) 1992 and Foreign Investment and Technology Transfer Act 1992 were enacted. Accordingly foreign investment is welcome in Nepal in all types of industries except the defense related industries, cottage, small scale and the medium scale industries having less than Nrs 20 Million in the fixed assets as well as cigarette, bidi, alcohol, excluding 100% export oriented industries. Foreign investors are permitted to have a joint venture unit with Nepalese partners or 100 Percent foreign owned unit. However permission may be granted for the transfer of technology in cottage, small scale, and the medium scale industries with less than Nrs 20 million investments in fixed asset (Singh; 1998). Government of Nepal has made the provision to the foreign investors for attracting foreign direct investment. The Government of Nepal provides many concessions and incentives to promote and encourage foreign investors in Nepal; some of the major legal provisions found in FDI policy include:(FNCCI,2003)

- i FDI in the form of equity, reinvestment of the earnings and loans with up to 100 percent foreign ownership is welcome.
- ii Foreign investment is allowed in almost all sectors of economy.

- iii Bilateral Investment Guarantee Agreements with some countries to protect FDI from these countries. Nepal is member of the World Bank and has been a member of Multilateral Investment Guarantee Agency (MIGA) providing guarantees to foreign investors against non commercial risks like currency transfer, expropriation, and breach of contract, war and civil disturbance in the host country.
- iv Bureaucracy is relatively flat and accessible. The procedure involved in investment is straight forward and simple.
- v Efforts are continuing to bring consensus among all political parties to make anti-corruption measures effective. Agreement avoiding double taxation on the dividend and return on FDI has been reached with a number of countries including Thailand, India, China, Austria, Republic of Korea, Mauritius, Pakistan and Sri-Lanka.
- vi Foreign investors are entitled to all the facilities and incentives, such as tax incentives assistance for access to infrastructure facilities such as land, water supply, electricity connection, communication facilities through the one window system set up for expanding facilities and services as promised.
- vii The general corporate tax is 25%. Financial institutions are liable to pay the rate of 30%. Establishments identified as manufacturing industries by the IEA are levied with a lower rate of 20percent.
- viii The value added Tax (VAT) is levied at a flat rate of 13 percent. Few items are exempted from VAT. Exports are zero-rated and VAT credit is available for all VAT paid for inputs.
- ix For taxation purpose the SMEs and large scale industries are treated equally and are levied VAT, excise duty, and other taxes at the rate made public in the budget speech and Finance Act.
- x Labor is available in plenty at low cost. The skill may be lacking but labor is trainable.
- xi The government has brought different acts and policies into effect with a view to attract more foreign direct investment taking it as an indispensable tool for the economic

development of the country. Industrial policy 1992, Industrial Enterprises Act 1992, Foreign Investment and Technology Transfer Act 1992, Electricity Act 1992, company Act 1997, are some of the new acts and policies in which the legal provisions have been mentioned.

The Industrial Policy 1992 identifies the foreign investment as a significant strategy in achieving the objective of increasing industrial production expanding export base and there by improving the trade balance generating employment opportunities, injecting managerial and technical know-how and ensuring higher but fair competition in the product and factor market. The industrial policy assumes the foreign investment to supplement domestic private investment through the inflow of foreign capital, technology transfer and providing access to international market. The Industrial Policy (IP) 1992 has made the provisions to the foreign investors who have received permission to invest in convertible foreign currency to repatriate the following amount outside Nepal at the prevailing rate of exchange (See Industrial Policy,1992).

- i The amount received as benefits or dividends from foreign investment.
- ii The amount received as payment of principal and interest on foreign loans.
- iii The amount received under an agreement for the transfer of technology.
- iv The amount received as compensation for the acquisition of any property.
- v Foreign Experts, working in Nepalese industries with prior approval from countries where convertible currencies are permitted to repatriate in convertible foreign currency up to 75 percent of the amount received by them as salaries, allowances etc.

This IP (1992) has also made provisions to provide the facilities and concessions to the foreign investors as follows:

- i Interest income on foreign loans is levied at a rate of 15 percent only.
- ii Royalties technical and management fees are levied at a rate of 15 percent.
- iii No income tax is levied on the dividend and income earned from exports.

Industries established with foreign investment are entitled to enjoy all the facilities and incentives including income tax facilities provided to local investment under the industrial Enterprises Act 1992.

2010, New industrial policy has been formulated with the objective of bringing positive change in overall economic and social sector of the country by means of rapid industrial development doing away with the weaken of the past. There has been no significant program in Nepal of industrial development although it has given lots of way to develop industrial sector such as one window policy but the political changes occurred in the country, economic liberalization and globalization and no expected success could achieved from ex-policy 1992 in respect to employment has generation production, export promotion and investment, so new industrial policy has been formulate for the development of industrial sector as well s FDI in Nepal for FID in Nepal new industrial policy has included for FDI in main objective of the policy such as.

2010, industrial policy has also encourages FDI by arranging of institution which can attract FDI like investment board, on stop service center industrial promotion Board industrial estate management authority Nepal business forum has been made for making available protection, facilitation and concession to industries.

A new liberal comprehensive industrial policy including the subject that could not have been including in the policy reform efforts in the past. The new IP (2010) has also made special provision to provide the facilities and concession to the foreign investor which are as follows:-

**In policy-**

The non-resident Nepali people shall be encourage to invest in Nepal for protection diversification and promotion of foreign investment and economic diplomacy units at Nepalese embassies and mission located in the countries making more foreign direct investment shall be strengthened for promotion of industrial investment.

**In strategies:-**

- i) Necessary institutional arrangement, policy reform and provision for

incentive shall be made available to attract native and foreign capital in construction of hydro power projects mining industries, tourism physical infrastructure.

- ii) Foreign investor shall be encouraged for making available technology and market promotion service.
- iii) While making foreign investment in industrial enterprise , permission shall have to be obtained as per the law enforce further time being.

**In facilities and concessions:-**

An exemption of 50% shall be given in income tax table in the income to be earned by as foreign investor from foreign technology, intellectual property or management service charge and royalty.

There are so many other provisions to make attract for foreign investor to invest in Nepal and to enjoy all the facilities and incentives including tax, custom tariff institutional and legal arrangement etc. under the industrial policy 2010.

To attract promote and protect the foreign direct investment agreement between the Government. of Nepal and the government of India for the promotion and protection of investment (BIPPA) has done 21 October 2011 which was a great achievement for us to attract of FDI.

In 1984 Nepal has done first BIPPA agreement with France then after German, USA, Mauritius, Finland and recently with India all to gather Nepal has an agreement BIPPA with 6 countries. In 2011 BIPPA has made some provision which can help Nepal to attract FDI .Some provision are as follows.

## **Provisions**

- i). Promotion and Protection of investment
- ii.) National treatment and most favoured National treatment
- iii) Compensation for lessen
- iv) Repatriation at in investment and rectums

Nepal government formally announced that fiscal 2012-13 would be observed as Nepal Investment Year (NIY). The first meeting of the National Directory Committee (NDC) NIY is one of ambitious programmed of the government that seeks to double foreign direct investment.

Recently Nepal has done DTAA double tax avoidance agreement which can also attract FDI in Nepal. In the Double Tax Avoidance Agreements (DTAA) is essentially bilateral agreements entered into between two countries , in our case, between India and another foreign state. The basic objective is to avoid, taxation of income in both the countries (i.e. Double taxation of same income) and to promote and faster economic trade and investment between the two countries.

The advantage of DTAA are as under

- i). Lower Withholding Taxes (Tax Deduction at Source)
- ii). Complete Exemption of Income from Taxes
- iii). Underlying Tax Credits
- iv). Tax Sparing Credits

In accor dance with FTTA 1992 FDI is allowed in Nepal in every sector of economic activities with the exception of the following:-

- i Cottage Industries.
- ii Personal Service Business.

- iii Arms of Ammunition Industries.
- iv Explosives, Gunpowder.
- v Industries related to Radio-Active Materials.
- vi Real Estate Business (excluding construction industries).
- vii Motion Pictures Business (produced in national languages and the language of the nation).
- viii Security Printing.
- ix Currencies of Coinage Business.
- x Retail Business.
- xi Trekking Agency.
- xi Water Rafting.
- xii Pony Trekking.
- xiii Horse Riding.
- xiv Cigarette, Bidi (Tobacco), Alcohol (excluding there exporting more than 90%).
- xv Internal Courier Service.
- xvi Atomic Energy.
- xvii Tourist Lodging.
- xviii Poultry Farming.
- xix Bee-Keeping.
- xx Consultancy Services Such as management, Accounting, Engineering and Legal Services.

However, no restriction made for the transfer of technology in industries specified above.

Nepal encourages foreign direct investment as joint venture operations with Nepalese investors or as 100% foreign owned enterprises. The broad areas open for FDI include manufacturing industries, energy based industries, tourism industries, and mineral resource based industries, agro-based industries and service industries.

The FITTA, 1992 has made a provision for the permission to be obtained as follows:

- i Permission of the Department shall be required to be obtained for foreign investment or technology transfer.
- ii A person desiring to avail the foreign investment of technology transfer shall be required to make an application to the Department in the prescribed form along with the prescribed particulars for obtaining permission in that behalf.
- iii If an application is made pursuant to sub section (2) above the Department shall, in the case of an industry with fixed assets up to five hundred million rupees, itself, and in the case of an industry with fixed assets in excess thereof, in accordance with the decision of the Board's grant permission within thirty days from the date of application. The department shall communicate the decision made in regard to such permission to the applicant.
- iv Notwithstanding anything contained in subsections (1) and (2) above, no permission shall be granted for making foreign investment in the industries set forth in the Annex. Provided that permission may be granted for the transfer of technology in such industries.

The FITTA, 1992 has also made a provision for the settlement of disputes as follows:

- i If any dispute arises between a foreign investor, national investor and the concerned industry, the concerned parties shall be required to settle the disputes by mutual consultations in the presence of the Department.

- ii If the dispute could not be settled in the manner as referred above, it shall be settled by arbitration in accordance with the prevailing arbitration rules of the United Nations Commission on International Trade Law. ( UNCITRAL)
- iii The arbitration shall be held in Kathmandu, The laws of Nepal shall be applicable in the arbitration.
- iv Notwithstanding anything contained in sub-sections (1) (2) and (3) above, disputes arising in regard to foreign investment made in the industries with investment as prescribed may be settled as mentioned in the foreign investment agreement.

Provisions made in the FITTA, 1992 regarding the visa facilities for foreign investors are as follows:

- i A foreign national visiting the kingdom of Nepal connection with undertaking any study or carrying out any research with the objective of making investment in the kingdom of Nepal shall be provided a non-tourist Visa for up to six months.
- ii A foreign investor or dependent family or authorized representative of such a foreign investor, and dependent family of such authorized representative shall for the purpose of stay in Nepal be provided a business visa until the foreign investment is retained.

Provided that a foreign investor who, at a time makes investment in an amount no less than one hundred thousand of United States Dollar or in convertible foreign currency equivalent there to, and his dependent family shall be granted a residential Visa until such investment is retained.

On the other hand, the Electricity Act 1992 has been enacted particularly with a view to attract national as well as foreign investor for the generation, transmission and distribution of electricity and to standardize and safeguard the electricity services. The Act is designed to provide a specialized system of incentives to attract foreign participation for the potential

development of the electricity sector. The Act, supplemented by the electricity regulation 1993 in relation to foreign direct investment, has made following provisions:

- i Any foreign investor who wishes to conduct survey, generation transmission or distribution of electricity, is required to submit an application to the secretary of minister of water resources through the Electricity Development Center on the prescribed format along with the economic, technical, and environmental study report and with other prescribed particulars on the relevant subject. But such study report is not required while applying for the license to conduct the survey relating to electricity. On receipt of an application, the secretary examines necessary requirements and issues license to the applicant according to the format as prescribed within 30 days of receipt of such an application in case of conducting survey relating to electricity and with in 120 days in case of generation, transmission or distribution of electricity. A license can be sold or otherwise transferred with the prior approval from the prescribed officer.
- ii Section 5 of the Act prescribes the term of license in case of the survey of electricity may be of 5 years in maximum. Similarly, the term of license for generation, transmission or distribution of electricity may be of fifty years in maximum. After the expiry of the term as prescribed in the license, the land building, equipment and distribution line established by the foreign national or corporate body as more than 50% of the total investment shall be under the ownership of Government of Nepal. The assets coming under the ownership of Government of Nepal may be purchased by prior license on the amount by a committee constituted for assessing the amount.
- iii The electricity generation plant, transmission or distribution line established by the foreign national or corporate body as up to 50% of total investment shall be operated or managed by the poor license by entering to an agreement with Government of Nepal after the expiry of the terms as prescribed in the license on conditions as mentioned in the agreement so made.

The Electricity Act 1992 has also made provisions to provide various facilities, concessions and incentives to foreign investor who is involved in the generation, transmission and distribution of hydro-electricity.

- i Section 12(1) of the Act grants income tax to a foreign investor who is generating, transmitting and distributing hydro-electricity up to 1000 K.W. Section 12(1) of the Act levies corporate tax on the income of hydro-electricity project by 10%. Any foreign investor who has obtained license for hydro-electricity generation, transmission and distribution is exempted from income tax for 15 years from the date of generation, transmission and distribution of electricity for commercial purpose. Similarly, foreign investor who has obtained license for hydro-electricity transmission or distribution is exempted from income tax for 10 years from the date of transmission or distribution of electricity.
- ii If any foreign investor takes the responsibility to operate and manage hydro-electricity generation plant, transmission or distribution line owned by Government of Nepal or purchases the same, such investor is exempted from income tax for 5 years from the date of such undertaking or purchase.
- iii If the foreign investor re-invests in hydro-electricity generation plant, transmission or distribution line for its diversification or extension of installed capacity by twenty-five percent or more for modernization of technology and develops subsidiary industry, such investor is entitled to deduct 50% of the cost of few additional fixed assets from the net income earned from such hydro- electricity generation plant, transmission and distribution line. Such deduction shall be provided in lump sum or in installment within 3 years.
- iv For the import of construction equipment, machines, tools and equipment required for repair and maintenance as well as the spare parts there of for hydro-electricity generation, transmission or distribution which are produced and sold by local industries, custom duty is levied as per the prevailing schedule. Only 1% custom duties shall be levied for the import of materials, which are not produced in Nepal and no charge for import license.

- v Foreign investor, who invested foreign currency in the generation, transmission or distribution of hydro-electricity as a loan or share capital can exchange necessary foreign currency at the prevailing market rate of foreign exchange for repartition of investment or repayment of principle or interest of loan.
- vi Foreign investor desirous to export electricity generated by his own to the foreign country may do so by entering in to an agreement with Government of Nepal on such matters. Similarly, the act provides facility to foreign investor to import electricity for the distribution within the country by obtaining prior approves of Government of Nepal as prescribed.
- vii If the land and house of any person is required for the purpose of generation, transmission or distribution of electricity, Government of Nepal may make available to any corporate body under the prevailing law. If the government owns the land, such premises shall be made available on lease for a period up to the term of license.
- viii The act provides protection from Nationalization of land, building, equipment and structure related to electricity generation, transmission or distribution. But for the extensive public use, Government of Nepal may take over such project and may make necessary arrangements for the security of any electricity plant on the request of the license if it deems necessary to provide such security.

In this way, the Act opens the door of FDI in electricity sector granting extensive facilities and concessions for the attraction of FDI into the county. After the enactment of specific legal framework, foreign investors including big multinational corporations are interested to invest in the electricity sector (See Electricity Act, 1992 for detail).

Water Resources Act 1992, has also made provisions to the attraction of FDI for the rational utilization conservation, management and development of water resources

- i Section (3) of the Act has established the ownership of water resources available in the kingdom of Nepal. Section (12) of the Act opens the door of FDI in water resources sector. It provides that any foreign company, corporate body or person desired to develop or cause to develop, utilized and extend the services of any water resources has

to enter into a contract with Government of Nepal under the prevailing law in terms and conditions as mentioned in such contract. The Act prescribes the Electricity Act, 1992 as the governing law for utilization of water resources to the generation of hydro-electricity. Similarly, the Act also requires entering into contract with foreign investor for the utilization, management and development of water resources. Any foreign investors are entitled for the utilization of facilities, concessions and incentives granted by FFITTA, 1992 and IEA, 1992.

The Company Act 1997 is also closely concerned with FDI, which stipulates provisions relating to incorporation, administration and regulation of a company in Nepal. The Company Act, 1997 has brought some fundamental changes of the previous Company Act, 1964 on provision concerning FDI. The new Act has completely eliminated the provision relating to branch operation of foreign company in Nepal. The Act has introduced the concept of one-man company. Section 3 (1) of the Act permits only a single person to be entitled to establish company with motive of earning profits with one or more objectives as mentioned in the memorandum of association. Similarly, the Act does not permit foreign company to establish its subsidiary company in Nepal.

In addition to this, the Act has also made the following provisions:

- i Any foreign investor wishing to invest in Nepal is required to incorporate company under existing Company Law. Foreign investor intending to establish a company with the motive of earning profits has to furnish the permission approved by the DOI obtained under FITTA. The other requirements to foreign investors to incorporate a company are stated in section and the company Act, 1997.
- ii Foreign Investors desirous to invest in Nepal as 100% owned or under joint venture with Nepalese partners were allowed to incorporate company as purely Nepalese company.
- iii The procedures relating to registration and incorporation of a company are stated in section 3, 4, 5 and 16 of the Act. In-case of a private company, even a single persons as a promoter is also entitled to apply for the registration, whereas seven promoters at least are required in case of public limited company. The maximum number of promoters in

case of private company shall be 50 but there is no limitation of the number of promoters in case of a public company. Any person who desires to establish a company must submit an application to the office of the company register in the prescribed form along with the necessary documents: (See Company Act, 1997,for detail)

The company Act, 1997 prescribes the procedures of registration and incorporating of a company for both domestic and foreign investors. Other administrative and regulatory provision of the Company Act, 1997 are equally applicable to all companies-either wholly national owned company or wholly foreign owned company or joint venture Nepalese companies. Companies either foreign participating or not are bound by the same rules and procedures for the operation of such companies.

Similarly, Communication Act 1996 has also made provisions to provide communication services by including foreign private investors. Also, foreign private investors should seek permission from Government of Nepal to operate communication services in Nepal. There is also a provision for the ownership of Government of Nepal in FDI projects in communication services. Some of the provisions are:

- i Government holds ownership of land, buildings, Machineries, tools and equipment used by foreign investors or foreign companies whose capital investment is more than 50%, after the termination of permission letter.
- ii After of the termination of permission period, foreign investors or foreign companies having more than 50% of their capital investment should seek re-permission from Government of Nepal to operate their communication services.

Likewise Communication Act 1996 has also made following provisions for foreign exchange facilities:

- i Government of Nepal provides foreign currency in the prevailing exchange rate for importing necessary tools and equipments to investors who hold permissions to operate communication services.

- ii Government of Nepal provides foreign currency to the investors who hold permission to operate communication services in Nepal while signing a contract with foreign investors or foreign companies.
- iii Government of Nepal provides foreign currency in the prevailing exchange rate for the payment of principal amount and interest or to return investment of foreign investors who operate communication services in Nepal.

The Nepal Rastra Bank Act of 2002 was promulgated to boost the financial reform program through various rules and directives. It is stated in the act that, “It is expedient to establish Nepal Rastra Bank to function as the central bank to formulate necessary monetary and foreign exchange policies, to maintain stability of price to consolidate balance of payment for sustainable development of the economy of Nepal.” (NRB Act,2002)

NRB has granted operating licenses to commercial banks that fulfill its policies criteria, emphasizing on policy oriented issues with the prime objective of promoting efficient financial intermediation through increased competition. In this regard, a new licensing policy for opening commercial bank (domestic and joint venture) was made effective from May 15, 2002 Whereby new commercial bank are require to have a minimum paid of capital of Rs. 1.0 billion (Economic Report; 2010). Permission would also be granted for the setting up of a head office in Kathmandu provided that the commercial bank is a joint venture with a foreign bank or financial institution or it has a technical service agreement for at least 3 years.

NRB has issued some directives concerning agent activities of commercial banks (including joint venture banks) in 2001. Commercial banks have to get prior permission from the foreign exchange management department if they wish to set up their own account in foreign currencies (NRB Act; 2002). Similarly such banks are not allowed to convert foreign currencies into Indian currencies for the purpose of making deposits abroad. Provision is also given by the foreign exchange department for the conversion of foreign investors’ dividends or profits in any convertible currency they choose. For this, the foreign investors has to fill an application form issued by the foreign exchange department providing information on the total repatriation amount, investment ratio on capital activities of the firm. Directive 290 of the foreign exchange department issued on July 2001, provides for the declaration of FDI and FPI investment amounts

by potential investors but these are largely ignored by investors due either to ignorance or apathy (NRB Act,2002).

The Trade Policy reform initiated in 1992, introduced currency convertibility on current account, duty drawback facilities for export industries and the introduction of foreign exchange accounts. The aim of the export duty drawback scheme is to provide a refund on taxes paid on its imported raw materials. The bonded warehouse scheme has facilitated tax refunds paid on imported raw materials for the exports of readymade garments industry.

The Trade Policy 1992 has also made some provisions which are as follows:

- i Custom tariffs have also undergone rationalization and simplification. The peak tariff rate has been reduced from a high of 300% in early 1950s to 80% in 1997/98. In addition; the tariff structure has also been simplified, with tariff slabs brought down from 10% to 5% in 1995/96. In addition, additional duties charged on third country imports have been abolished.
- ii Under the structural adjustment program, the Open General License (OGL) has been expanded in scope and important licenses have been categorized into three divisions namely industrial OGL, commercial OGL and import license auction. In order to enhance industrial production, entrepreneurs receive foreign exchange entitlement based on past production levels and current estimated production. Commercial OGL has aided in improving the supply of raw materials impacting positively on production and export of woolen carpets. Moreover the policy has resulted in the removal of import and export licenses, removal of import restrictions, replacements of tariff with quotas, and the ability of banks to determine import cash margins. Furthermore, the central bank now requires only 2% deposits of the total value of letter of credit. As a consequence the trade regime is now more open and liberal, as quantities restrictions on imports have been abolished.

Tenth Plan (2002-2007) has mentioned the following policies concerning FDI : (See Summary of Tenth Plan, 2003)

- i Policy reforms in order to make environment conducive for foreign investments.

- ii In the process of attracting foreign investment, the regulations and laws for the operations of businesses relating to accounting, legal security, intermediation of foreign persons and institutions are improved as determined by the commitment of WTO.
- iii Special policies will be made to attract investment of NRNs.
- iv Direct and indirect foreign investors will be provided with physical facilities and other incentives through the One Window System (OWS) in order to have an easy market access with the removal of existing administrative bureaucracy.
- v When dissolving foreign investment companies that are not operational, a one window procedure is arranged for minimizing administrative procedures and appropriate bankruptcy laws are introduced by redefining existing provisions.

Foreign direct and portfolio investments are encouraged in such sectors as industry, water resource, tourism, road, railway, insurance and savings and investment management through the timely review of existing foreign investment policies.

### **2.5.2 Institutional Arrangements for FDI in Nepal**

Registration of Medium and Large Scale Industries are made at the Department of Industries of the government of Nepal. All cases of foreign investment and technology transfer have to be approved by the Industrial Promotion Board. The Industrial Enterprises Act of 1992 (with first amendment) has mentioned Industrial Promotion Board (IPB) under the chairmanship of the State Minister for Industries (See IEA,1992, for detail).

The amendment of FITTA 1992 also provides the DOI with authority to approve foreign investment projects up to Nrs 500 million. In case of industries with fixed assets in excess of this limit, the DOI through the Industrial Promotion Board (IPB), is mandated to decide on approvals within 30 days from the receipt of an application in a prescribed form which contains essential information on the project such as total capital, location of project, requirement of machinery, equipment and raw materials and the specific contribution to be made by foreign and local investors (IEA,1992).

The major functions, duties and powers of the IPB are as follows:

- i Provision of necessary cooperation in formulating and implementing policies, laws and regulations pertaining to the industrialization of the country.
- ii Pursuance of liberal, open and competitive economic policies.
- iii Encouraging coordination between policy level and the implementation level of industrial policy.
- iv Smoothing the process of application for investment and provision of information on facilities and concessions.

In addition to this, a One-Window Committee has been setup under the coordinator ship of Director General of Department of Industries, with a view to provide and expedite all services and to settle any bottlenecks relating to facilities guaranteed under the existing rule and regulations (See IEA,1992 for detail).

New industrial policy 2010 has also propose institutional arrangement of institution like investment board ,one step service center, industrial promotional board industrial estate management authority industrial human resources development institution Nepal business forum which shall be made for making available protection ,facilities and concession to industries(see IP ,2010)Industrial Policy 2010 has also proposed to establish a Technology Transfer Centre which will provide information about state of technology for different industries (See IP,2010)

## **2.6 Review of Related Studies**

### **2.6.1 Review of Nepalese Studies**

Studies on FDI have been undertaken in two levels - National and International. National study of FDI has been carried out by Nepalese scholars while international study of FDI has only been done by foreign researchers. Therefore, the review of their studies has been done differently.

Chitrakar (1986) finds that the flow of foreign investment in manufacturing sector is not so enough; investment in mineral based sector is negligible. The main problem is due to the lack

of implementation of policies and act made by Government of Nepal, Bureaucratic Harassment, hard to get incentives according to the provision made by government etc.

Bhatt (1993) points out many obstacles for attracting foreign investment in Nepal. According to Bhatt the main shortcomings for the investors are size of the country, skill shortage, inadequacy of the domestic infrastructure, corrupted bureaucratic system, lack of human resources, etc.

Chitrakar (1994) further finds tremendous flow of foreign investment in different forms after launching different acts and policies such as Foreign Investment and Technology Transfer Act 1992, Foreign Investment and One Window Policy 1992, Industrial Policy 1992, Industrial Enterprises Act 1992, etc.

Aryal (1994) analyzes status, institutional arrangement and composition of foreign investment. He also observes a number of grey areas in the field of foreign investment in Nepal and points out limited market as one of the reasons for being unable to pick up desired foreign investment in Nepal. Also, it is concluded that technical collaboration is more for technical consultation and guidance than for use of certain patented products. He suggests that industrial environment for local investors must be made favorable before inviting foreign investors in Nepal by encouraging investments in potential areas such as hydropower development and tourism related industries.

Pant (1994) analyzes benefits, cost and determinants of foreign direct investment. Pant explains certain benefits of FDI. According to him “it supplies capital which might not otherwise be available due to a low level of domestic saving and because access to bond and other portfolio finance from developed countries has been limited on the one hand and FDI carries with it a complementary package of

inputs that include managerial and marketing expertise, knowledge of technical processes, scarce labour skills and, in some cases, facilities for training local workers in variety of skills on the other.”

Pant also points out limitations such as its concentration, historically, in few countries and in a few sectors, creation of enclaves by foreign firms, stultification of the development of

local enterprises, and that remittance of profits and capital cannot bring about changes in severe balance of payment difficulties of the host countries. He also points out the determinants of FDI. According to him” The chief determinants of FDI seem to be the firm specific attributes that underlie the competitive advantages of transnational corporations, the ability of transnational corporation to gain from internationalization market relationship, the strengths of particular host countries as locations for foreign production by transitional corporation, and the policies of both the host and home countries.” (Pant;,1994)

He also analyzes the traditional factors responsible for FDI flows to the developing countries such as labour cost weakening of product life cycle and the servicing of protected markets. He concludes that Nepal should create a stable macro economic environment, which is a key factor, to attract FDI.

Timilsina and Mahato (1998) have focused their study basically on the historical development, importance trends and structure of FDI in Nepal together with the analysis of legal provisions and incentives and facilities offered through it. Their studies also touch the problems of foreign direct investment. They conclude that industrialization is necessary for poverty alleviation and overall economic development, for which capital, appropriate technology, skilled human resources, market, infrastructure, and favourable administrative and legal environment are some of the basic requirements that could be fulfilled through the inflow of FDI.

Poudel (1999) discusses that Nepal is passing through the critical phase of two gap situation-saving gap and the foreign exchange gap which are equal to foreign capital inflow that includes grants as well as loans. Since the past few years, the proportion of loan is increasing. The continued dependence on foreign loan for bridging the gap may soon invite the danger of debt crises. Under such condition, Poudel suggests that FDI can be the alternative source.

Dabadi (1999) makes clear that in the absence of our ability to save and invest in sufficiently large volume we have to attract foreign direct investment to meet the gap between investment requirement and resources availability. Given the uncertainty to significantly increase the flow of official capital, the only option left is to bring in foreign private capital, especially FDI. FDI is also required to meet our technological knowledge gap and skill deficiency. Dabadi in the same study further opines that we have a number of disadvantages like the small size of the

market, location outside the major international trade routes, high transit and transport cost associated with physical location, absence of spectacular reserves of natural resources, low skill level of the Nepalese people etc.

Dabadi, again, suggests that the investment scenario in Nepal is not good and therefore, the government needs to carry out significant reforms in many areas for attracting foreign direct investment at a significant scale

Dhakal and Khanal (2000) explain the positive impacts of foreign investment, mainly in trading sector and in employment generation. They categorize the problems as short term and long term. The short-term problems are the problems of rising security threat, bureaucratic hassles and issue of duty drawback, trade dispute with India, frequent changes in laws and tax structure, ineffectiveness of one window policy and worsening law and order situation. The long term problems include the problem of shortage of power, inadequate roads for transportation and trade unionism.

K. C. (2001) asserts that foreign direct investment can help industrial growth and promote economic development by supplementing the domestic private capital, promoting the process of industrialization through technical know-how and managerial expertise, developing organized capital market in the country, promoting employment opportunities, helping national savings and imparting training and development to entrepreneurs and promoters in the form of collaboration.

Writer in the same study further writes that the Industrial Enterprise Act 1992 and the Foreign Investment and Technology Transfer Act 1992 are some of the few legislative acts that address foreign private investment in Nepal. Nepal's failure in attracting FDI despite the liberal policy and attractive incentives has been mainly because of low per capita income, its landlockedness, limited market with almost no potential for large scale projects.

Thus, Dr. K.C. (2001), again, opines that attraction of a good volume of FDI is of utmost importance for the economic development of a country and for the purpose; obstacles like political instability, weak macro economic performance, inadequate infrastructure facilities, limited domestic market, insufficient institutional arrangements, bureaucratic harassment, poor information base and inequality in treatment among foreign investors should be avoided.

According to K.C. a gradual shift from SAPTA to SAFTA, and accession to WTO could be an additional positive climate in this regard.

Pant (2003) makes further clear that development of domestic capabilities help to attract quality FDI and to facilitate an upgrading of existing activities. He also suggests that linkages could strengthen competitiveness of domestic firms, offering them a good position in international production. He clearly explains that the promotion of export oriented FDI should form integral portion of the overall development strategy of Nepal. Pant points out the following reasons for the success of certain countries in enhancing export competitiveness and attracting export oriented FDI by (a) ensuring that what is targeted through investment promotion matches the country's broader development and industrial strategies;(b) offering an incentive package in a focused way to encourage MNCs to invest in strategic activities; (c)involving foreign affiliates in the development and upgrading of human resources;(d)developing high quality infrastructure, such as export processing zones, science parks; and (e) providing targeted support for local enterprises and suppliers.

Bista (2005) has published the book entitled Foreign Direct Investment in Nepal and he has mentioned some conditions of FDI in Nepal and they are:

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

It suggests to the investors that Nepal has good and normal business environment. Concerning security, the ground situation to the FDI is not affected. So, the foreign investor can

invest in the urban areas of Nepal at present situation like as normal situation. It will be positive to attract FDI in Nepal at the critical situation.

"Foreign direct investment provides fund along with manpower technology which encourages local enterprises to invest with foreign partner or investors. No matter the profit repatriate to the partners countries but few partial return is generally bloughed back into expansion, modernization and the development of related industries. Side by side host countries, too enjoying employment of local people, know how or skill. FDI help to strengthen the trade along with widespread market within and outside the country. It properly maintain and capacity utilized at the full extent nation prosper.

Rai (2002) Comparing with the two decade back foreign investment is growing up but it doesn't mean all are running smoothly. Complains are often heard from the foreign investors about the problem they face before and after investing in Nepal.

"Foreign investment to some extent to create employment opportunities in Nepal. The total gain being provided by manufacturing equity firms follows by tourism firms, services firms, in term of average per firm, however, energy based firms seems to have provided the highest benefit due to the possibility of higher wages paid by them. They also employ more labour than mineral based firm and manufacturing firms.

The foreign investors who have invested in Nepal are found to be motivated by commercial and non commercial objectives. The non commercial motive included an interest in Buddhism, the desire to live in a small society. However as natural beauty and culture is the response of tourism firm's, this factor can be taken as market opportunity in business firms. Except for tourism, other firms with these motives are not big investors.

Dangol( 2003)Says that "Nepal has formulated laws and policies governing FDI money facilities and incentives have been offered in order to maximize the location advantage of foreign investment firms. Tax exemption and deduction facilities along with duty drawback facilities are some of measures declared in the foreign investment acts. The set up mechanism for one window facility and the attempt to wards establishing EPZ are applaudable task of the government. However the laws governing intellectual property rights has created the fear of plagiarization and

duplication. There are also the inconsistencies in the existing laws and policies with the acts policies related to the FITTA.

Wagle,(2004)Argue that "The factors to motivate foreign investment in Nepal are found to be adequate availability of natural resources, electricity facility, cheap labor, tax and duty, drawback facility, repartition facilities, land facility, depreciation facility, growth of market potentials and friendly socio economic environment. Macroeconomic policies; fiscal and monetary have al little impact on their decision to invest in Nepal leaving aside the exchange rate policy. On the country, less market opportunity due to small size of market, inadequate infrastructural base, poor state of law and order, lack of skilled and trained manpower, land lockless position of country, lack of insurgency instable government, insecurity, instability in polices, non implementation o facilities and incentives given by the act, bureaucratic harassment, procedural hurdles, corruption, frequent misunderstanding between India and Nepal over transit and other trade issues and inadequacies and inconsistencies in policies with adversely affect the flow of foreign investment in Nepal"

"The foreign investments have both positive and adverse effects. The benefits of foreign investment is may accrue to the host country by way of :

- i Reducing the shortage of domestic savings
- ii Increasing the supply of foreign exchange and ,
- iii Generating external economies as foreign investment involves non monetary transfers of other resources like technological knowledge, market information, management and supervisory personnel, organizational experience and innovation in product and production techniques all of which are in short supply in developing countries.

The cost under the FDI are: (Chitrakar,1994)

- i Fiscal cost to be borne because of special incentives and facilities offered
- ii Adverse affects on domestic saving because of redistribution of income as foreign investment involves the share of profits between domestic and foreign investors.

- iii Adverse effects on term of trade of host country in case it includes the structural changes at home and abroad in term of supply and demand for exports, import substitute and domestic commodities and ,
- iv Adverse effects on balance of payments as it causes the outflow of fund in the form of loan and interest payment, profit and dividends on the accumulated investment and the repartition of capital.

Sharma,(2008) Says foreign direct investment is more preferred than other means of foreign finance such as concessionary commercial loans and unrequited transfers. There are good reasons to believe that FDI is preferred to other types of investment flow. One convincing argument is that FDI consists of a package of capital, technology, and market access that tends to go to those manufacturing sectors that enjoy actual or potential comparative advantage. On the other hand, official flow and ever commercial loans are often tied with social overheads and sectors of long gestation period that do not enjoy comparative advantage in the developing recipient countries. The inflow of FDI would give rise to economies of scale and higher productivity and create linkage effects. Moreover, there are number of financial advantages of FDI over other types of flow for developing recipient counties. In case of FDI, there is also a closer match between the maturing structure of earnings and repayments and hence the liquidity problem is avoided, which arises for other types of flow using short-term loans to finance long-term projects. With FDI, both the commercial risks and the exchange rate risks are passed on the investor rather than having to be borne by the host government

Again writer focused on why Nepal needs foreign finance-particularly foreign direct investment is exhibited by the basic macroeconomic indicators such as acute resource gap transmitted into foreign exchange gap, low domestic investment caused by low saving, growing government expenditure, sticky revenue- GDP ratio, swelling public debt accompanied with ever rising debt payment burden and high underutilization of resources. To mitigate all these problems, Nepal must raise its productive capacities through carrying out the transformation in internal and external economic structures, which are not possible by the injection of foreign capital alone but also along with the infusion of skill, technology, technical and management know-how. These factors are supposed to bring about lofty changes in human resource quality and hence in the culture, institutions and traditional values and norms.(Sharma,2008)

Basnet ,( 2003) Says to be precise, foreign investment are different in degree rather than kind they should not be regarded as fundamentally different from domestic investment although the political system, economic policies and value system are more variable. In fact, direct investment is so much more than just a capital movement that in many cases begin without any net flow of capital of all. Some times the parent company borrows the initial financial capital exclusively in the host country, adding only its brand name managerial formulas and other assets at the less tangible variety. Once the subsidiary becomes profitable, it grows from reinvestment internal profits and newly borrowed funds, while sending a pact of profits back to the parent whose investments were so hard to see."

He also add in any developing nations FDI plays a key role to promote the economic standard. FDI on the area permitted by any nation strengthen these sector, which ultimately brings out the overall growth and development of country's economy.

### **2.6.2. Review of International Studies**

A number of studies have been undertaken to determine whether FDI impacts positively on economic growth. Two types of studies –macro and micro- have generally been conducted to study the relationship between FDI and growth. Micro studies usually find no positive evidence that FDI makes a positive contribution to growth. Macro studies, on the other hand, often find FDI to positively affect economic growth under certain conditions.

Foreign investment os also considered as a vehicles for creating employment opportunity and raising the level of domestic wages .It is also known as an agent for cross cultural change “According to Kobrin S.J foreign investment is an agent in the process of cultural borrowing that constitutes industrialization. The aspect of cultural transfer tends to be diffused throughout the host society by the reemployment of trained personanel, backward and forward linkages and competitive emulation. (korbin,1977)

Rodan ,(1961,) Chenery and Strout,(1966) Says that in the early 1960s argue that foreign capital inflows have a favorable effect on the economic efficiency and growth towards the developing countries. It has been explained that FDI could have a favorable short-term effect on growth as it expands the economic activities (Chenery; 1966). However, in the long run it

reduces the growth rate due to dependency, particularly due to “Decapitalization.” (Bornschieer; 1980).

Bornschieer and Chose-Dunn (1985) consider that flows of foreign investment has short-run positive effects on economic growth, but accumulated stock of foreign capital has a long-term retardant effect on economic growth and is associated with greater income inequalities

Borensztein et al. (1998) test the effect of FDI on economic growth in a cross-country regression framework. They used data on FDI received by developing countries from industrial countries only. The results suggest that FDI is an important vehicle for the transfer of technology, contributing more to growth than domestic investment. There were also indications that FDI has a positive effect on economic growth, but this impact was dependent on the human capital stock in the host economy.

The author also found some evidence of a crowding in effect, i.e., FDI is complementary to domestic investment. A one-dollar increase in FDI inflows is associated with an increase in total investment in the host economy of more than one dollar. This implies that FDI exerts a positive effect on domestic investment, ranging from 1.5 to 2.3, probably due to the attraction of complementary activities that dominate the displacement of domestic competitors. Most of the effect of FDI on growth likely derives from efficiency gains rather than on overall higher induced level of investment.

Balasubramanyam et al. (1996) test the hypothesis that export- promoting (EP) countries enjoy greater efficiency from FDI using a production function in which FDI is considered an additional input to domestic capital and labor. They argue that, since it is a prime source of human capital and new technology for developing countries, the FDI variable captures the externalities, learning by watching, and spillover effects. Exports are also used as an additional factor input into the production function, following the large number of empirical studies that investigate the export-led growth hypothesis. The model, they have used real GDP dependent on labor, domestic capital stock, foreign capital stock, exports, and a time trend capturing technical progress.

Bhagwati’s (1973) hypothesis, in which an EP strategy is likely to attract higher levels of FDI and promote its efficient utilization more than an import-substituting (IS) strategy, the FDI

coefficient in the econometric model is expected to be positive and greater for EP countries than for IS countries. Also, for EP countries, it is expected that FDI is a more potent growth contributor than domestic investment because of the spillover effects and externalities associated with human capital, and the higher rate of technical innovation associated with FDI. Their results for the entire sample of countries indicate that the impact of foreign capital on growth exceeds that of labor, which in turn exceeds that of exports. The parameter estimate for the impact of domestic capital is not significantly different from zero. Meanwhile, their results from the sub sample of EP and IS countries provide further support for the Bhagwati's hypothesis. Their findings indicate that FDI is a positive and significant contributor to growth for EP countries, while having no influence on growth for IS countries. In addition, as far as EP countries are concerned, it is FDI and not domestic investment that acts as a driving force in the growth process.

Later, Balasubramanyam et al. (1999) test four hypotheses of FDI's contribution to growth: (i) FDI can promote growth in the presence of a liberal trade regime; (ii) a threshold level of human endowment is necessary for the promotion of growth through FDI; (iii) effective utilization of human capital in conjunction with FDI requires an adequate domestic market for the goods produced; and (iv) technology and skill spillovers from FDI do not materialize from the mere presence of FDI, but from a competitive environment.

Their first hypothesis is the same as the one they tested in 1996. While the authors used the ratio of imports to GDP to determine whether a country is EP or IS in their 1996 study, they used the residual approach, calculating the deviation between actual and predicted export volumes, to measure trade policy orientation in their 1999 study. Classifying countries according to this method yielded the same results as their 1996 study. To test their second hypothesis, the authors included an FDI –human capital interaction term in their model, but found the coefficient to be statistically insignificant. In testing their third hypothesis, the authors used per capita GDP as a proxy for the role of the domestic market. While the coefficient of this variable turned out to be statistically significant, its sign was negative. The authors explained that the variable may be picking up the dominance of convergence effects observed in endogenous growth literature. In addition, the coefficient of the FDI-human capital interaction term became statistically significant with the inclusion of the domestic market proxy. Finally, the authors tested their

fourth hypothesis by including the share of manufacturing to total value added as a proxy for local competition, but the coefficient of the variable turned out to be insignificant.

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UNCTAD(1995) Studied that "Foreign direct investment is becoming increasingly important in the world economy in many developing countries. It has become more important than trade in terms of delivering goods and services to foreign markets and in addition, it has become an important mechanism for organizing production internationally. All governments now recognize the role of direct investment in development are actually competing for it. "further more " foreign direct investment is not only a factor of economic development in its own right but is also closely linked with trade, technology transfer and financial flow.

NSFAE,(2000) Foreign investment is considered an important for the industrialization of Nepal. As it attracts capital, technology skills and expertise and also help to share risk, exploit resources presently and provide access to export market.

Market imperfection, as noted earlier from the basic rationale for public programs to promote FDI in developing countries in unfamiliar environments is either unavailable to outside investors or too difficult to find under normal circumstances. Moreover it is expected that foreign investors are unwilling to search out information because they overestimate risk in developing

countries. For these reasons foreign investment is thought to be below levels that would be warranted on grounds both of real profitability and of the benefits such investment would convey to the host developing countries.

interview of foreign investment decision show that even the largest firm do not systematically search the environment for investment opportunities. Rather, such a search is often a response to problems and other stimuli from the external environment. While firms follow strategies that can include foreign investments, these strategies are usually shaped within a narrow range of options. As a result, it has been documented that foreign investors tend to exhibit follow the leader behaviors. That is they respond to the action of competitors rather than acting as independent decision makers searching the environment for investment opportunities.

In these circumstance, promotional activities may have an impact on a firm's decision. There will be opportunities un identified and countries uninvestigated because there has been no significant reason to do so. Promotional activities can provide that reason by introducing new information in to the bureaucratic process at firm, forcing them to enlarge the set of option considered.

As with sales of industrial equipment, investment promotion programs can influence foreign firm to invest in developing countries and a number of host countries, including Ireland and Singapore, have done this successfully. These and other developing countries have used a series of promotional techniques to include firms, which otherwise would not have considered investing to investigate possibilities and ultimately make investment. The success of these host countries programmes demonstrates that properly structured promotional prgrammes can have a positive impact on investment flows.

World Bank,( 2005) Argues that programme of the industrial countries can be improved in a number of ways, some of these simply amount to improving the administration and organization of existing programs. Others involve changing the program emphasis by deleting generally unproductive activities and adding some that are likely to be more productive in current environment. Finally more substantial structural changes are needed that take into changes will strengthen of links between industrial and host country programme so as to improve the functioning both.

Mikesell (1974 )Speaking about the role of FDI Prof. Raymond C. Mikesell has said "The private investor from an industrially advanced country not only brings with him capital, technology and managerial experience, but he introduces new business concepts which help to revolutionize the thinking and practice of the area" The further observes, economic growth is a part of sociological phenomenon which can be transported and encouraged to spread through out the economically backward areas by socially responsible foreign investor & Sons. Ins.

Chambers Eencyclopaedia, (1959) Says that Lending money, whether to comp tries or foreigners is a means where by those with purchasing power which they do not wish to employ at once (or which they expect to need more urgently in the future then at present) can accommodate those who require immediate command of purchasing power. It is the opportunity to invest purchasing power in productive enterprise that gives rise to most of the demand for loans, international as well as internal, a port from governmental borrowing for war propose.

Meier Gerald M ,(1995) Prof. Gerald Meier opines foreign direct investment brings to the recipient country no only capital and foreign exchange but also managerial ability, technical persons technological knowledge, administrative organization and innovation in product and production technique.

Speaking about the role of FDI Prof. Raymond C. Mikesell has said "The private investor from an industrially advanced country not only brings with him capital, technology and managerial experience, but he introduces new business concepts which help to revolutionize the thinking and practice of the area" The further observes, economic growth is a part of sociological phenomenon which can be transported and encouraged to spread through out the economically backward areas by socially responsible foreign investor.

## 2.7 Research Gap

Several studies by Nepalese Scholars and researchers have been carried out on FDI. From the review of various studies mentioned above, we reach to conclude that almost all the studies have similar views regarding the role, scope, determinants and prospects of FDI. Required methodology and statistics are defined in next chapter with the help of review made in this chapter. My study is not empirical because of unavailability of statistical facts. But on the other hand, different foreign scholars and researchers have done empirical studies of FDI using cross-section data from various developing countries of the world.

Government of Nepal has accorded a top priority to attract FDI in recent years. The Interim constitution of Nepal 2007 has pursued a policy of attracting FDI. Three year intream plan, Government of Nepal also promulgated Industrial Policy 2010 for Foreign Investment and One Window Policy 1992, Foreign Investment and Technology Transfer Act 1992, Industrial Enterprises Act 1992 to attract FDI, Nepal has just done Bilateral investment promotion and protection agreement (BIPPA) with India to protect and promote FDI in Nepal as well as the Double tax avoidance agreement (DTAA) t has done which could be a great achievement to increase the inflow of FDI in Nepal .

mentioning provisions for legal and institutional framework. Therefore, this study makes an attempt to present some of the weaknesses of these Acts and Policies and offers recommendations to overcome such weaknesses.

## **.CHAPTER -III**

### **RESEARCH METHODOLOGY**

Present study in view of its objectives and scope has tried to examine the role, status and policy perspectives in the Nepalese context. Its methodology is specified accordingly as follows.

#### **3.1 Research Design**

To address the objectives in chapter I, descriptive and analytical research methods have been applied. For this, secondary data and information are used. The required data and information are collected from the secondary sources.

#### **3.2 Source of Data**

The secondary data are collected from official and unofficial sources including Department of Industry; Foreign Investment Promotion Section of Ministry of Industry (MOI); Central Library of T.U.; NIDC; Central Bureau of Statistics; CEDA Library; FNCCI, FDI Department etc.

#### **3.3 Data Collection Procedures**

For this study, first of all, the policies and acts relating to foreign direct investment in Nepal are studied seriously. Publications, books, journals, articles etc. are studied to understand the basic concept about foreign direct investment. To collect policies and acts relating to foreign direct investment, I visited the Department of Industry, Foreign Investment Promotion Section of Ministry of Industry, and National Industrial Development Corporation (NIDC). T. U. Library, FNCCI, Nepal Rastra Bank and others.

### 3.4 Data Processing

All the relevant data and statistics have been tabulated according to the need of the study.

### 3.5 Data Analysis

The tabulated data have been analyzed and interpreted using different statistical tools like pie-chart, bar diagram, etc. All the relevant data and statistics collected have been tabulated according to the need of the study. The tabulated data have been analyzed and interpreted using different statistical tools like pie-chart, bar diagram, line graph, etc.

#### 3.5.1 Tolls for data analysis

Data have been analyzed through Trend analysis and regression considering the following models

3.5.1.a.To assess the impact of FDI on GDP we have following equation

$$\text{Lngdp}_t = a_1 + \beta_1 \text{Lnfdi}_t + e_t$$

3.5.1.b.. Like wise to analyze FDI impact on Trade tax revenue we have following equation

$$\text{LnTTR}_t = a_1 + \beta_1 \text{Lnfdi}_t + e_t$$

3.5.1.c..Again to analyzed the impact of FDI on Total Revenue we have following equation

$$\text{LnTR}_t = a_1 + \beta_1 \text{Lnfdi}_t + e_t$$

3.5.1.d.. To analyze the impact of FDI on Employment we can explain by following equation

$$\text{LnEmp}_t = a_1 + \beta_1 \text{Lnfdi}_t + e_t$$

3.5.1.e.. To assess the study the impact of Economic openness on FDI we have following equation

$$\text{Lnfdi}_t = a_1 + \beta_1 \text{LnTOI}_t + e_t$$

3.5.1.f.. To study the impact of FDI on import we have following equation

$$\text{LnImport}_t = a_1 + \beta_1 \text{Lnfdi}_t + e_t$$

3.5.1.g.. Again to assess the study about impact of FDI on Export we have following equation

$$\text{LnExport}_t = a_1 + \text{lnfdi}_t + e_t$$

3.5.1.h To study about the impact of FDI on Total Trade we have following equation

$$\text{LnTTrade}_t = a_1 + \text{lnfdi}_t + e_t$$

## CHAPTER IV

### PRESENTATION AND ANALYSIS OF DATA

This chapter covers the situation and trend of foreign direct investment in Nepal in terms of facts and figures. The trend has been observed in different aspects on registration basis such as year wise, country wise, sector wise, plan wise trend etc.

#### 4.1 Year wise Joint Venture Projects in Nepal

According to data of year wise joint venture projects of Nepal the number of foreign investment projects in Nepal marked 1898 for the period 2046/47 to 2067/68. The total project cost leveled Rs 152181.75 million. The total fixed cost was 129116.39 million, whereas FDI was equal to 68049.97 million. The magnitude of FDI leveled Rs 449.56 million in up to 2046 Ashad. The contribution of FDI was as high as Rs 10050.71 million in 2067/068.

Last ten years have remained turbulent in both political as well as economic arena of Nepal. Thus, the size of FDI confined to Rs 1209.65 million in 2058/59 primarily attributing to disruption in security to investment due to intensified Maoist activities all over the nation. During the last twenty years between 2046/47 to 2066/67 trends in FDI were found to be erratic, jumping Rs 398.51 million in 2046/47 to Rs 3102.56 million in 2057/58. The status of FDI relegated to the extent of Rs 477.59 million in 2051/52 with further increase to Rs 2395.54 million in 2053/54. Again, FDI continued to decline for three consecutive periods between 2054/55 and 2056/57. Take off in FDI was further visualized in 2062/063. However, FDI has increasing trend in recent years that confined to Rs. 10050.71million in 2067/68. Details of year wise inflows of joint venture projects of Nepal is in Annex I

## 4.2 Plan wise Joint Venture Projects in Nepal

The inflow of FDI in Nepal in different plan periods can be analyzed with the help of following table

**Table 1:**  
**Plan wise Inflow of Joint Venture Projects in Nepal**

Rs in million

Plan period	No. of Industries	Total Projects cost	Total Fixed Capital	Foreign Investment
Before 8 <sup>th</sup> Plan	149	11912.72	10004.04	1852.19
8 <sup>th</sup> Plan	245	41853.45	36725.01	9555.42
9 <sup>th</sup> Plan	371	24799.04	19114.81	9396.52
10th Plan	519	18588.31	14481.11	12027.44
3yr interim plan	614	45675.55	39414.27	25166.09
Current 3yr interim plan	209	11250.19	9375.46	10050.71
<b>TOTAL</b>	<b>2108</b>	<b>152181.75</b>	<b>129116.39</b>	<b>68049.97</b>

*Source: Industrial Statistics 2067/68*

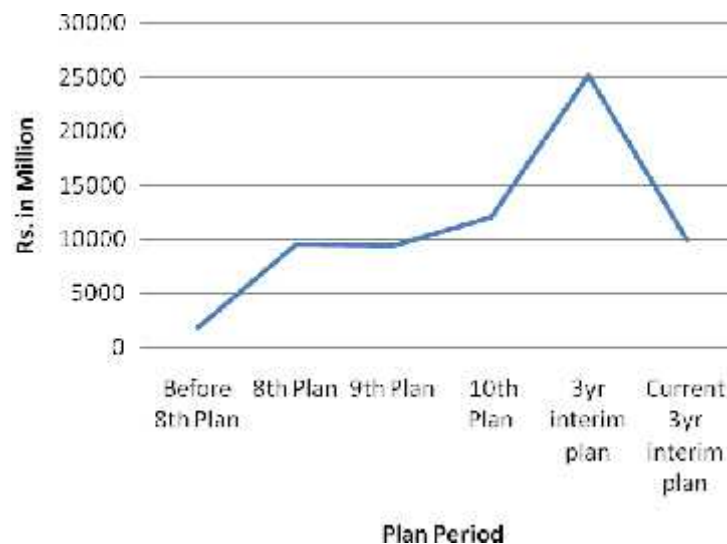
Above table indicates that the total number of projects before 8<sup>th</sup> plan was 149. That is to say, before the Eighth Plan, there was dismal entrance of joint venture projects into Nepal. But during the eighth plan alone, which covers the period after the restoration of the multiparty democracy, Trade and Transit Treaty with India and the enactment of new acts and policies, 245 new joint venture projects were registered. This number increased to 371 in the 9<sup>th</sup> Plan, which is a mere increment of 51.42 percent. In the period of 10<sup>th</sup> plan 519 joint venture projects have

entered into the nation like wise in the last 3 year interim plan there were 614 joint venture project registered in Nation and during current three year interim plan till yet there are 209 joint venture projects are registered.

Total foreign investment before 8<sup>th</sup> plan was 1852.47 million which during the 8<sup>th</sup> plan period rose significantly to 9555.42 million, whereas the increase in the number of foreign projects is by 64.42%, the increase in total project cost by 251% and the increase in foreign share is by 415.89%. This shows that foreign participation in joint ventures increased significantly during the 8<sup>th</sup> plan period. Before 8<sup>th</sup> plan there were 159 number of joint venture project up to 67/68 there are 2108 joint venture project registered in Nepal which is a more increment of 1314 percent like wise in total project cost the increment is about 1177.47 percent from before at plan to 67/78. In foreign investment before at plan the volume was 1852.19 million foreign investments up to 67/67 the flow of FDI is 68049.97 million which is more increment of 3574.02 percent.

**Figure 1**

**Line Graph Showing FDI and Plan Periods**



*Source: from table 4.1*

### 4.3 Category wise Joint Venture Projects in Nepal

The following table helps to analyze the FDI in Nepal that has been categorized into various sectors.

**Table 2:**  
**Category-wise Inflow of FDI in Nepal**

*(Rs. in million)*

<b>Types of Industries</b>	<b>No.</b>	<b>Total Project Cost</b>	<b>Total Fixed Cost</b>	<b>Foreign Investment</b>	<b>Employment</b>
Agriculture	60	1674.42	1095.61	893.29	3497
Construction	42	3605.34	2683.10	2762.81	3016
Energy Based	47	40759.24	40381.02	14518.77	7947
Manufacturing	712	54611.18	40355.50	25595.87	78409
Mineral	36	5162.62	4223.60	2904.24	5574
Service	650	25955.40	21220.18	12974.65	32127
Tourism	561	20413.55	19157.38	8400.34	24862
<b>Total</b>	<b>2108</b>	<b>152181.75</b>	<b>129116.39</b>	<b>68049.97</b>	<b>155432</b>

*Source: Industrial Statistics 2067/68*

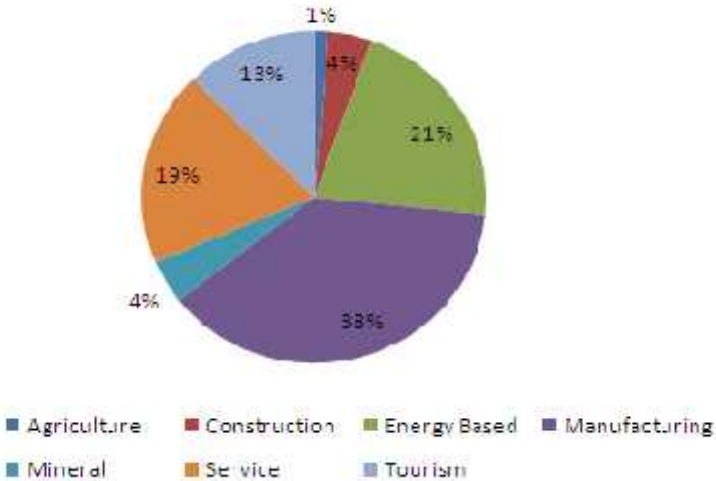
Table 4.2 Indicates that highest number of joint venture projects that have entered into Nepal is the manufacturing . It covers 33.77percent of the total number of joint venture projects that have been registered so far. The next place is taken by service or with 32.43 percent and the least by the mineral which is just 36 in number that is 1.70 percent. One reason for the manufacturing sector to hold the first place is due to the entrance of many Indian joint venture taking benefit of

the neighborhood, the trade and transit treaty with India, low labor cost etc. In terms of foreign direct investment, the manufacturing sector holds the highest share of 37.61 then after energy based sector holds 21.33 percent then service sector hold 19.06 percent. The least amount of foreign direct investment is made in the agriculture sector which is only 1.31 percent of the total foreign investment in the nation.

**Pie Chart Showing Percentage Shares in the Number of Projects and Foreign Direct investment.**

**Figure 2**

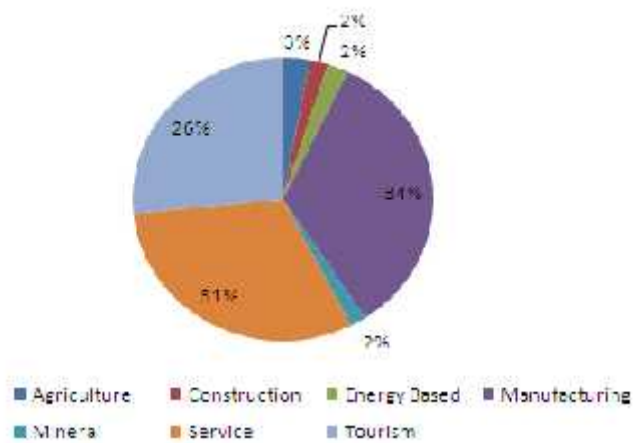
**Types of Industry and Percentage Share of FDI**



Source: from table no 2

Figure: 3

**Types of Industry and Percentage Share of No. of Projects**



Source: from table no 2

**4.4 Sector wise Joint Venture Projects in Nepal**

Data regarding sector wise Joint venture projects in Nepal shows that there were 715 manufacturing units receiving FDI. Manufacturing sector received top priority to attract FDI to the level of Rs.27321.65 million, which was 40.14 percent of total beginning to 2068/03/31. Manufacturing sector includes industries relating to Food, Beverage and Tobacco; Textile and Readymade Garments; Wood and Wood Product; Paper and Paper product; Chemical and Plastic Products, Non-metal, M/C and Other manufacturing units. In the context of FDI, electricity, water, gas sector industries that account for Rs 13579.55 million occupied second position, which was 19.95 percent of the total foreign investment during the same period, service industries that account for Rs 9268.75 million occupied third position, which was 13.62 percent

of total FDI. Hotel and resort sector received the fourth priority that accounted for Rs 8688.95 million, which was 12.76 percent of the total FDI.

It was committed that the highest number of employment was provided by Manufacturing sector, which was 50.72 percent of the total employment in foreign investment projects, followed by Hotel and Resort (16.23 Percent), Service Industries (13.56 percent) Transport and Communication (4.30 percent), Electricity Water and Gas (5.11 percent), Construction (3.82 percent), Housing and Apartments (1.44 percent). In Manufacturing Sector, the share of Textile and Readymade Garment alone was 26.08 percent in the total employment through FDI from beginning to 2068/03/31. Details of sector wise Joint venture projects in Nepal is in Annex II.

#### **4.5 Country wise Joint Venture Projects in Nepal**

According to data regarding the number of Indian joint venture projects was highest (501) in Nepal, followed by China (401), the USA (174), Japan (154), South Korea (149), , UK (103), Germany (79), France (49), Australia (34), Switzerland (31), Bangladesh (26) Hong Kong (19), Italy (19), Pakistan (15), and rest of other countries. The magnitude of FDI from India was Rs 32390.31 million, which was 47.59 percent of total FDI. The size of FDI from major countries such as China marked Rs 7036.17 million (10.33 percent), followed by USA Rs 4955.90 million (7.28 percent) and followed by Holand 1.79 million (0.003percent ). Out of total foreign investment Indian joint ventures provided the highest employment through FDI in Nepal, which was 36.29 percent of total employment . Details of number of Indian joint venture projects is in Annex III .

**4.6 Year wise impact of FDI in macroeconomic parameters has been analyzed with the help of following regression tables**

**4.6.a** To observe the impact of FDI on GDP the following regression has been run

**Table 3:  
FDI impact on GDP**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNFDI	0.666192	0.099157	6.718554	0
C	7.750367	0.747219	10.37228	0
R-squared	0.692964	Mean dependent var		12.735
Adjusted R-squared	0.677612	S.D. dependent var		0.733788
Durbin-Watson stat	1.260465	Prob(F-statistic)		0.000002

Source : : *Industrial Statistics, 2067/68*

The above table shows there is positive relationship between FDI and GDP having coefficient with 0.66 which is significant at one percent critical value .This implies that the change n FDI brings about the change in GDP.

**4.5.b** Like wise to analyze FDI impact on Trade tax revenue following regression has been derived.

**Table :4**  
**FDI impact on TT**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNFDI	0.660374	0.11129	5.933829	0
C	4.180263	0.838647	4.984531	0.0001
R-squared	0.637749	Mean dependent var		9.121364
Adjusted R-squared	0.619636	S.D. dependent var		0.758214
Durbin-Watson stat	1.192935	Prob(F-statistic)		0.000008

Source *Industrial Statistics, 2067/68*

The study explain about the relation ship between FDI and Trade tax revenue. There is positive relationship between FDI and Trade tax revenue. The increases of inflow in FDI increases trade tax but according to principal when the FDI increases the total tax revenue should decrease. Unfortunately inflows of FDI has given positive impact on custom tax revenue which is surprising. And the coefficient is significant due to less then 1percent critical value which means there is absolute impact of FDI in trade tax revenue.

**4.6.c.** Again to analyzed the impact of FDI on Total Revenue we have following regression table

**Table :5**  
**FDI impact on Total Revenue**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNTR	0.846968	0.130104	6.50992	0
C	-1.22841	1.342862	0.914771	0.3712
R-squared	0.67938	Mean dependent var		7.482273
Adjusted R-squared	0.663349	S.D. dependent var		0.91691
Durbin-Watson stat	1.827067	Prob(F- statistic)		0.000002

Source *industrial Statistics, 2067/68*

From Table No.4.6

The study shows there is positive relationship between FDI and Total revenue having coefficient with 0.84 which is significant at one percent critical value that implies the change in FDI brings about the change in total revenue.

4.6 d. To analyze the impact of FDI on Employment we can explain by following regression has been run

**Table :6**  
**FDI impact on Employment**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNFDI	0.199433	0.129264	1.542827	0.1385
C	7.141428	0.974098	7.331321	0
R-squared	0.106358	Mean dependent var		8.633636
Adjusted R-squared	0.061675	S.D. dependent var		0.56071
Durbin-Watson stat	1.370202	Prob(F-statistic)		0.138548

Source :*Industrial Statistics, 2067/68*

The study shows that the relation between FDI and employment. The result shows that there is a positive relationship between FDI and Employment but the inference can be drawn that the coefficient is found to be insignificant. This means we cannot claim that FDI increases Employment.

4 6..e. To assess the study about the impact of Economic openness on FDI

**Table :7**  
**TOI impact on FDI**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
TOI	0.097691	0.033804	2.889958	0.0091
C	4.109789	1.179032	3.485733	0.0023
R-squared	0.294579	Mean dependent var		7.482273
Adjusted R-squared	0.259308	S.D. dependent var		0.91691
Durbin-Watson stat	0.887429	Prob(F- statistic)		0.009055

Source *Industrial Statistics, 2067/68*

The study shows that the relation between FDI and economic openness The relationship between FDI and economic openness is positive The increases of inflows in economic openness increases the FDI having coefficient with 0.097 which is significant at less than one percent critical value.

4.6.f To observe the impact of FDI on import the following regression table has been derived

**Table: 8**

**FDI impacts on Import**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNFDI	0.783852	0.112692	6.955708	0
C	5.5041	0.849213	6.481412	0
R-squared	0.707525	Mean dependent var		11.36909
Adjusted R-squared	0.692901	S.D. dependent var		0.854456
Durbin-Watson stat	1.391768	Prob(F- statistic)		0.000001

Source *Industrial Statistics, 2067/68*

The study explain about the relation between FDI and Import The relationship between FDI and import is positive having coefficient with 0.78 which is significant having less then one percent critical value .this implies the change n FDI brings the change in import.

4.6.g Again to assess the study about impact of FDI on Export the following regression has been run

**Table :9**  
**FDI impact on Export**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNFDI	0.718085	0.129555	5.542702	0
C	4.886638	0.976289	5.00532	0.0001
R-squared	0.60569	Mean dependent var		10.25955
Adjusted R-squared	0.585975	S.D. dependent var		0.846013
Durbin-Watson stat	0.933491	Prob(F-statistic)		0.00002

Source : : *Industrial Statistics, 2067/68*

The Again the analyzed table explain t there is positive impact of FDI on export The increases of inflows in FDI increases the Export having coefficient with 0.71 which significant due to less than 1percent critical value which means there is absolute impact of FDI on Export.

4.6.h To study about the impact of FDI on Total Trade we have following regression table

**Table: 10**  
**FDI impact on total Trade**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNFDI	0.770322	0.114363	6.735781	0
C	5.896696	0.861804	6.842271	0
R-squared	0.694053	Mean dependent var		11.66045
Adjusted R-squared	0.678755	S.D. dependent var		0.847818
Durbin-Watson stat	1.298262	Prob(F-statistic)		0.000001

Source : *Industrial Statistics*2067/68

The above table shows the relation between FDI and total trade. The impact of increases in inflows of FDI has a positive impact on total trade, having a coefficient of 0.77, which is significant at less than one percent critical value. This implies that the change in FDI brings about the change in GDP.

Above regression tables show that the impact of FDI is positive in macroeconomic parameters of Nepal, like it has a positive impact on GDP, generating employment, total trade as well as total revenue. Details of data relating to the above study are in Annex IV.

#### **4.7 FDI and Economic Development: Nepalese Experience**

The study has not used any econometric tool for verifying relationships between FDI and domestic indicators of economic development. It is for data constraints. However, it has made trend analysis of FDI using tables and graphs. It is presumed that FDI brings not only capital and foreign exchange but also managerial ability, technical personnel, technological knowledge, administrative organization and innovation in product and production techniques to the recipient country. FDI can assist industrial growth and have economic development in several ways. First, FDI can supplement the domestic private capital. Next, foreign expertise may demonstrate the ways in which industrial expansion and development could take place. In addition to this, foreign capitals accompanied by technical know how and organized capital market in the countries. Besides that, FDI can promote the employment opportunities and also help national savings. Finally, FDI may impart training and development to entrepreneurs and promoters (Chitrakar, 1994).

Internal source of the country alone is not sufficient to solve the challenges of economic development. The overall macroeconomic situation of a country is passing through the two gap situation - saving gap and foreign exchange gap. Both gaps are equal to foreign capital inflow which includes grants as well as loans. However, since past few years, the proportion of loan is increasing. The continued dependence on foreign loan for bridging the gap may soon invite the danger of debt crises (Poudel; 1999). In such a condition, FDI can also contribute to overcome the problems of debt crisis. Therefore, FDI is considered as an engine of economic development.

FDI projects directly contribute in raising the living standard of the Nepalese people by creating job opportunities. They can play a crucial role to raise the 'living standard', which is one of the indicators of economic development. (Timilsina and Mahato, 1998).

Even though the study is unable to express the quantitative dimensions of the contributions of FDI projects, it is held that they are still playing a significant role in economic development of the country. Nepal being an agricultural country and still lacking modernization in it, most of the Nepalese people is living under poverty line. Under such a situation, FDI projects also play a crucial role in alleviating poverty. Nepal, In spite of being agricultural

country, the overall economic development is almost impossible by being dependent on agriculture alone. So it is necessary to industrialize the country but there is lack of sufficient domestic capital for the industrialization of the country. Therefore, it is very much necessary to industrialize the country through FDI. Industrialization is the means of breaking the vicious circle of poverty and thereby raising the formation and accumulation of capital in the capital scarce countries like Nepal where Industrial development is considered necessary for the purpose of achieving various economic goals like higher rate of growth, fulfillment of basic needs and creation of more employment opportunities. Industrialization is to break vicious circle of poverty and create prosperity, through. The process: For this some basic requirements are capital, appropriate technology, skilled human resources, market infrastructure and favorable administrative and legal environment that could be fulfilled through the inflow of FDI.

FDI projects also play a determining role in the capital formation of the country. FDI also increases the real saving of the people. Investment in the economy through FDI increases output and employment opportunities, and as a result of this both purchasing power and saving keep on increasing. Therefore, FDI contributes greatly in the overall economic development of the country along with capital formation. Similarly, illiteracy and lack of socio-economic infrastructures are the bottlenecks of developing countries. Investment in the form of collaboration with foreign entrepreneurs in such a condition makes labor force and entrepreneurs more skilled and trained. Human resource development is very important for the economic development of the country and this importance of HRD has been enhanced to some extent by FDI. Thus, FDI plays a pivotal role in human resource development of the country. Investment in the form of collaboration with foreign entrepreneurs should focus in promoting export oriented and import substituting Industries. As a result, FDI can also help to minimize the existing trade imbalance to a certain extent.

It is well known that foreign direct investment (FDI) brings in newer technology to the country. This, in turn, leads to the general up gradation of technology and enhances the overall technological capabilities of the population. Besides development of skilled manpower, it also helps in developing high ethical standards, value based system and legal compliance. The power and utility of strong positioning, superior quality and creative skills have helped local talent

blossom, given an opportunity for taking pride in a “Made in Nepal” label and enables Nepal to complete with international brands. (Kathmandu Post, 2003)

FDI projects essentially have professional management and are run by a board of directors, which has wide outside representation in the best traditions of corporate governance. They also operate with very high standards of financial and professional integrity with a very strong internal audit and control mechanism.

Besides, providing an occupationally safe and friendly environment workplace, the FDI projects are also known for their excellent and competitive human resource development endeavors. From the job, technical training to courses, classroom training, behavioral training, personnel training and foreign deputations they have always been a pioneer in introducing modern management practices, FDI projects are considered a fertile training ground for managerial resources in all countries.

It should be noted that most of the FDI projects have a predominantly Nepalese workforce; very few expatriates are employed, that too in highly technical senior management positions only, as per the provisions of the law. All FDI projects follow very enlightened labour policies, unlike criticism from certain quarters that FDI projects are more interested in taking back higher profit from the host country. Perhaps the most important contribution of the FDI projects has been the sense of pride among Nepalese workers and the smile in their face.

#### **4.8 Major Findings of the Study**

- i. The impact of FDI is positive in macroeconomic parameter of Nepal like it has positive impact on GDP, generating employment, total trade as well as total revenue.
- ii. The number of foreign investment projects in Nepal marked 2108 for the period 2046/47 to 2067/68. The total project cost leveled Rs. 152181.75 million. The total fixed cost was 129116.39 million, whereas FDI was equal to 68049.97 million. The magnitude of FDI leveled Rs. 449.56 million in up to 2046 Ashad. The contribution of FDI was as high as Rs. 10050.71 million in 2067/068.

- iii. Last ten years have remained turbulent in both political as well as economic arena of Nepal. Thus, the size of FDI confined to Rs. 1209.65 million in 2058/59 primarily attributing to disruption in security to investment due to intensified Maoist activities all over the nation. During the last twenty years between 2046/47 to 2066/67 trends in FDI were found to be erratic, jumping Rs. 398.51 million in 2046/47 to Rs. 3102.56 million in 2057/58. The status of FDI relegated to the extent of Rs. 477.59 million in 2051/52 with further increase to Rs. 2395.54 million in 2053/54. Again, FDI continued to decline for three consecutive periods between 2054/55 and 2056/57 then again started decline in 2058-61/62 Take off in FDI was further visualized in 2062/063 . However, FDI has increasing trend in recent years that confined to Rs. 10050.71 million in 2067/68.
- iv. The total number of projects before 8<sup>th</sup> plan was 149. That is to say, before the Eighth Plan, there was dismal entrance of joint venture projects into Nepal. But during the eighth plan alone, which covers the period after the restoration of the multiparty democracy, Trade and Transit Treaty with India and the enactment of new acts and policies, 245 new joint venture projects were registered. This number increased to 371 in the 9<sup>th</sup> Plan, which is a mere increment of 51.42 percent. In the period of 10<sup>th</sup> plan 519 joint venture projects have entered into the nation like wise last three years interim plan (2064/065-2067/068) there were 614 joint venture projects were registered in Nepal and current three years interim plan up to (2067/68) there were 209 joint venture projects were registered in Nepal.
- v. Total foreign investment before 8<sup>th</sup> plan was 1852.47 million which during the 8<sup>th</sup> plan period rose significantly to 9555.42 million, whereas the increase in the number of foreign projects is by 64.42%, the increase in total project cost by 251.12% and the increase in foreign share is by 415.89%. This shows that foreign participation in joint ventures increased significantly during the 8<sup>th</sup> plan period then after in 9<sup>th</sup> plan foreign investment decrease by 1.66% then 8<sup>th</sup> plan. The trend of FDI is increasing after 9<sup>th</sup> plan. In 10<sup>th</sup> plan it increased by 27.99% then 9<sup>th</sup> plan same in last 3 year interim plan FDI increase by 109.24 % then 10<sup>th</sup> plan.

- vi. Indicates that highest number of joint venture projects that have entered into Nepal is the manufacturing sector. It covers 33.77% of the total number of joint venture projects that have been registered so far. The next place is taken by service sector with 30.83 percent and the least by the mineral sector which is just 36 in number that is 1.70 percent. One reason for the manufacturing sector to hold the first place is due to the entrance of many Indian joint venture taking benefit of the neighborhood, the trade and transit treaty with India, low labor cost etc.
- vii. In terms of foreign direct investment, the manufacturing sector holds the highest share of 37.61 percent followed by the energy based 21.33 percent The least amount of foreign direct investment is made in the agriculture sector which is only 1.3 percent of the total foreign investment in the nation.
- viii. There were 715 manufacturing units receiving FDI. Manufacturing sector received top priority to attract FDI to the level of Rs.27321.65million, which was 40.14 percent of total beginning to 2068/03/31.
- ix. Manufacturing sector includes industries relating to Food, Beverage and Tobacco; Textile and Readymade Garments; Wood and Wood Product; Paper and Paper product; Chemical and Plastic Products, Non-metal, M/C and Other manufacturing units. In the context of FDI, electricity, water, gas sector industries that account for Rs. 13579.55 million occupied second position, which was 19.95 percent of the total foreign investment during the same period, service industries that account for Rs. 9268.75 million occupied third position, which was 13.62 percent of total FDI. Hotel and resort sector received the fourth priority that accounted for Rs. 8688.95 million, which was 12.76 percent of the total FDI.
- x. It was committed that the highest number of employment was provided by manufacturing sector, which was 50.72 percent of the total employment in foreign investment projects, followed by Hotel and Resort (16.23 Percent), Service Industries (13.56 percent) Transport and Communication (4.30 percent), Electricity Water and Gas (5.11 percent), Construction (3.82 percent), Housing and Apartments (1.44 percent). In Manufacturing

Sector, the share of Textile and Readymade Garment alone was 26.08 percent in the total employment through FDI from beginning to 2068/03/31.

- xi. The number of Indian joint venture project was 501 which was highest in Nepal it covers 23.76 % of total number of join venture projects. Then after there were 401 Chinese joint venture project in Nepal which covers 19.02 % of total number of project. The volume of FDI from India was rupees 32390.31 million which 47.59 % of total FDI likewise China marked Rs. 7036.17 million which covers 10.33 % of total volume of FDI.

## CHAPTER -V

### SUMMARY, CONCLUSION AND RECOMMENDATIONS

#### 5.1 Summary

Investment in its broadest sense, means the sacrifice of current rupees for future purpose. Two different attributes are generally involved: time and risk. The sacrifice take place in the present and is certain. The reward comes later, if it all, and the magnitude is generally uncertain. The investment made in a country by the foreign entrepreneur is known as foreign investment.

History of FDI in Nepal is very short as compared to others countries. Foreign investment and Technology Transfer Act - 1992 and Tenth Five Year Plan (2002-2007) describe the policy environment for FDI attraction, utilization and management in Nepal as compared with South Asian countries and China but the policies couldn't have practiced economically, efficiently and effectively.

Foreign direct investments in Nepal are still unsatisfactory in spite of provisions made in various regulations and exemptions because of the existence of various weaknesses to attract more foreign capital and technologies with desire extent. In light of this, the following suggestions have been recommended for the improvement in FDI climate and thereby attract more FDI in Nepal in the coming years.

- i. Seeing small market in Nepal, most of the foreign investors are reluctant to invest in Nepal. The topographical location of Nepal between two giant countries can have a good prospect in influencing their markets by Nepalese product but government must take initiative by signing treaties with these countries to foster trade without any hindrance for its promotion.
- ii. The joint recent publication by UNCTAD and ICC on “An Investment Guide to Nepal” has described the investment climate in Nepal using some key factors. These factors include strengths, opportunities, weaknesses and threats of investment in Nepal. Close

studies of these key factors must be done in order to create conducive environment for investment.

- iii. According to the guide, Nepal's location in between the two potentially largest markets in the world is the greatest strength for investment. Similarly, Nepal's macroeconomic stability and relatively liberal economy, trainable and low cost labour force, substantial natural and cultural assets, small and accessible bureaucracy and generally business friendly environment are other strengths among a few
- iv. The opportunities of investing in Nepal include tourism-sport and adventure tourism, health and cultural tourism, and a variety of niche agricultural and agro based business activities, hydro power generation, infrastructure development and IT based industries.
- v. The government must make an effort to prove these strengths and opportunities for inducing FDI to the prospective foreign investors.
- vi. Nepal's landlocked position, poor infrastructure and unskilled work force, rigid and intrusive labour legislation, political instability and conflict, weak implementation of policies and persistent corruption are the weaknesses of Nepal in attracting FDI.

Among the mentioned weaknesses of Nepal, landlocked being an exception, other weaknesses can be overcome if government is deeply concerned for it:

- i. It is a fact well-known to all that infrastructure facilities in Nepal are poor but there has been a significant progress in the power supply and telecommunication extensions since last few years. Infrastructure on roads is still poor because of which transportation problems have been faced by the people. Therefore, initiative should be taken to invest in constructing infrastructures, roads being the primary one.
- ii. As stated above, one of the strengths of investing Nepal is trainable and low cost labor force but the illiteracy among the laborers is the greatest weaknesses which the government must overcome. According to the "Macroeconomic Indicators", Published by Nepal Rasta Bank about 46% of the total population are illiterate. So illiteracy can also be

the hindrance for attracting FDI. The available labor force is either semi-skilled or completely unskilled. Therefore, government must invest in human capital to generate skilled manpower to attract FDI.

- iii. Most of the foreign investors complain about the rigid and intrusive labor law of Nepal. It has become one of the main reasons for FDI projects to be either cancelled or closed, particularly because of impractical and arbitrarily defined labor law. Therefore, the labor laws should be made practical and well- defined to suit the requirement of foreign investors.
- iv. Political unrest is the major factor impeding the growth of FDI. Overall policies get changed with the change in government which affects FDI. Therefore, utmost efforts from every sector should be made to create stable political environment.
- v. Small and accessible bureaucracy of Nepal is considered favorable by the foreign investors but their complain lies with implementation hassle (to cause trouble by making constant demands) and persistent corruption. Reforms should be made in administrative procedures and bureaucratic system to enhance FDI projects in Nepal.
- vi. The Maoist insurgency that began in Nepal since 1997 has been a threat for foreign investors in Nepal. Therefore, everyone must make an effort to solve the crises and pave the way not only to attract FDI but to foster Nepalese economy as well.
- vii. Nepal is not the only country in the world viewed by the prospective investors as a prospective zone for investment but there are many other countries as well. Therefore, Nepalese authorities have to realize that lack of reliable mechanism to market Nepal's potentials keep tab on prospective investors and follow up available opportunities are some of the prominent bottlenecks for attracting FDI in Nepal.
- viii. The country wise statistics of foreign investment in Nepal shows that the Indian projects are the largest in number. It is natural to have highest number of projects and largest amount of foreign investment in Nepal from India because it is not only shares open border but has also established beneficiaries of the Trade and Transit Treaty with India. But Nepal should not depend on such economic relationship with a single country

because any turmoil between them would ruin a part of the Nepalese economy. Therefore, government must exercise more liberal foreign policies to attract more other foreign projects apart from India.

- ix. Nepal should seek more export-oriented FDI. So as to have best practice technology, this will have beneficial information spillovers on the export opportunities and hence could facilitate export activities of domestic enterprises as well.
- x. Nepal should make efforts to maximize the benefits of FDI by building cooperative labor force management relations, putting in place the fundamental conditions for technological advancement, improving productivity etc. Additionally, Nepal should be effortful to attract a greater proportion of efficiency seeking FDI.
- xi. There is still lack of harmonization among various corporate laws and acts such as labour law, company act, privatization act and various banking regulations in Nepal. One major task is to coordinate these laws in the Foreign Investment and Technology Transfer Act in light of Nepal's accession to WTO.
- xii. The policies concerning FDI in the Tenth Plan of Nepal needs to be translated properly into laws. The FITTA of 1992 has not made provisions for non-nationalization of foreign investment.
- xiii. To attract FDI effectively, there needs to be close coordination among various authorities such as the Ministry of Industry, Commerce and Supply, Ministry of Foreign affairs, Ministry of Finance and Central Bank so that a comprehensive strategy can be formulated.
- xiv. The Board of Investment requires its own full time secretariat with qualified professionals to conduct research on trade and investment and formulate strategies on FDI and coordinating activities of relevant Government bodies and ministries.

## 5.2 Conclusion

The inflows of foreign direct investment in Nepal have shown a positive trend after the restoration of multiparty democracy in 1989 after which the government enacted and amended various acts and policies relating to FDI like FITTA 1992, IEA 1992, and IP 1992 etc. The Trade and Transit Treaty with India also contributed in this direction. Nepal opened the door for FDI since the sixth plan. Foreign direct investment has definitely given the positive impacts to the organized sector and productive activities in the economy. But it is difficult to say out right that all these changes are FDI induced because the study does not include any technique to separate the effects of foreign direct investment from other effects. There are chances that the changes shown by this study are somehow affected by other exogenous and endogenous variables.

On the basis of analysis and interpretation of the data, the following conclusions have been derived.

- i. The impact of FDI is positive in macroeconomic parameter of Nepal like it has positive impact on GDP, generating employment, total trade as well as total revenue.
- ii. The number of foreign investment projects in Nepal marked 2108 for the period 2046/47 to 2067/68. The total project cost leveled Rs. 152181.76 million. The total fixed cost was 129116.39 million, whereas FDI was equal to 68049.97 million. The magnitude of FDI leveled Rs. 449.56 million in up to 2046 Ashad. The contribution of FDI was as high as Rs. 10050.71 million in 2067/068.
- iii. Last ten years have remained turbulent in both political as well as economic arena of Nepal. Thus, the size of FDI confined to Rs. 1209.65 million in 2058/59 primarily attributing to disruption in security to investment due to intensified Maoist activities all over the nation. During the last twenty years between 2046/47 to 2066/67 trends in FDI were found to be erratic, jumping Rs. 398.51 million in 2046/47 to Rs. 3102.56 million in 2057/58. The status of FDI relegated to the extent of Rs. 477.59 million in 2051/52 with further increase to Rs. 2395.54 million in 2053/54. Again, FDI continued to decline for three consecutive periods between 2054/55 and 2056/57 then again started decline in 2058-2061/062 Take off in FDI was further visualized in 2062/063. However, FDI has increasing trend in recent years that confined to Rs. 10050.71 million in 2067/68.

- iv. The total number of projects before 8th plan was 149. That is to say, before the Eighth Plan, there was dismal entrance of joint venture projects into Nepal. But during the eighth plan alone, which covers the period after the restoration of the multiparty democracy, Trade and Transit Treaty with India and the enactment of new acts and policies, 245 new joint venture projects were registered. This number increased to 371 in the 9th Plan, which is a mere increment of 51.42 percent. In the period of 10th plan 519 joint venture projects have entered into the nation like wise last three years interim plan (2064/065-2067/068) there were 614 joint venture projects were registered in Nepal and current three years interim plan up to 2067/6e there were 209 joint venture projects were registered in Nepal.
- v. Total foreign investment before 8th plan was 1852.47 million which during the 8th plan period rose significantly to 9555.42 million, whereas the increase in the number of foreign projects is by 64.42%, the increase in total project cost by 251.12% and the increase in foreign share is by 415.89%. This shows that foreign participation in joint ventures increased significantly during the 8th plan period then after in 9th plan foreign investment decrease by 1.66% then 8th plan. The trend of FDI is increasing after 9th plan. In 10th plan it increased by 27.99% then 9th plan same in last 3 year interim plan FDI increase by 109.24 % then 10th plan.
- vi. Indicates that highest number of joint venture projects that have entered into Nepal is the manufacturing sector. It covers 33.77% of the total number of joint venture projects that have been registered so far. The next place is taken by service sector with 30.83 percent and the least by the mineral sector which is just 36 in number that is 1.70 percent. One reason for the manufacturing sector to hold the first place is due to the entrance of many Indian joint venture taking benefit of the neighborhood, the trade and transit treaty with India, low labour cost etc.
- vii. In terms of foreign direct investment, the manufacturing sector holds the highest share of 37.61 percent followed by the energy based 21.33 percent The least amount of foreign direct investment is made in the agriculture sector which is only 1.3 percent of the total foreign investment in the nation.

- viii. There were 715 manufacturing units receiving FDI. Manufacturing sector received top priority to attract FDI to the level of Rs.27321.65million, which was 40.14 percent of total beginning to 2068/03/31.
- ix. Manufacturing sector includes industries relating to Food, Beverage and Tobacco; Textile and Readymade Garments; Wood and Wood Product; Paper and Paper product; Chemical and Plastic Products, Non-metal, M/C and Other manufacturing units. In the context of FDI, electricity, water, gas sector industries that account for Rs. 13579.55 million occupied second position, which was 19.95 percent of the total foreign investment during the same period, service industries that account for Rs. 9268.75 million occupied third position, which was 13.62 percent of total FDI. Hotel and resort sector received the fourth priority that accounted for Rs. 8688.95 million, which was 12.76 percent of the total FDI.
- x. It was committed that the highest number of employment was provided by manufacturing sector, which was 50.72 percent of the total employment in foreign investment projects, followed by Hotel and Resort (16.23 Percent), Service Industries (13.56 percent) Transport and Communication (4.30 percent), Electricity Water and Gas (5.11 percent), Construction (3.82 percent), Housing and Apartments (1.44 percent). In Manufacturing Sector, the share of Textile and Readymade Garment alone was 26.08 percent in the total employment through FDI from beginning to 2068/03/31.
- xi. The number of Indian joint venture project was 501 which was highest in Nepal it covers 23.76 % of total number of joint venture projects. Then after there were 401 Chinese joint venture project in Nepal which covers 19.02% of total number of project. The volume of FDI from India was rupees 32390.31 million which 47.59 % of total FDI likewise China marked Rs. 7036.17 million which covers 10.33 % of total volume of FDI.

FDI is indeed an important source at capital and economic growth of Nepal as well as developing countries. It provides a package of new technologies, management techniques finance and market access for the production of goods and service. The history of FDI in Nepal is not very old before 6th plan there were 149 projects hand by FDI up to 2067/68 there were 2801 projects hand by FDI in Nepal. There are so many policies at issued by Nepalese Govt. to attract FDI like FITTA IP, BIPPA. How even the political instability, geographical structure

weak infrastructure lack of sufficient skill human power and poor investment environment have been playing negative impact on attracting FDI in Nepal. FDI inflows are associated with multiple benefits such as technology transfer, market access and organizational skills. Consequently, there is an increasing and intense competition between countries to maximize the quantity of FDI inflows. FDI contributes to growth in a substantial manner because it is stable then other forms of capital inflows. The ration of inflames of FDI is increase in Nepal and the impact of FDI in Macroeconomic parameters, like GDP, total tax revenue employment, export, import also positive. Despite at various struggle, issues contingencies and worst political scenario Nepal is well positioned among low income economics to more emphatically on development policy and spending polities attributes are plenty and fiscal policies have created a modern and stable macroeconomic frame work with the potential to create a dynamic competition and investment attracting economy in the decade ahead.

Foreign direct investment is a major economic policy issue for the great majority of nation around the world .the increasing mobility of international firms and the gradual elimination of barriers to global capital glows have stimulated competition among governments to attracts foreign direct investment foreign direct investment have been one of the core features of globalization and the world economy over the past two decades F D I is an important indicator boost the economic growth of Nepal .FDI is regarded as an engine of growth as it provides much needed capital for investment ,increases competition in the host countries ,and aids local firms to become more productive by adopting more efficient technology or by investing in human and physical capital so we can say that it is a medium for acquiring skills, technology, organizational and managerial expertise

### **5.3 Recommendations**

All foreign investment is contributed to economic development. Therefore all the positive as well as negative aspects of a particular foreign investment should be taken into account before accepting the foreign investment.

- i. Political stability and peace: As political stability and peace are the sine quo non for attracting greater volume of FDI in Nepal, security concerns about foreign investor should be guaranteed/ addressed

- ii. Nepal should attract foreign direct investment by providing better information on investment opportunities with a proper research in her economy. Most of the multinational corporation will be attracted if there will forward sufficient information on the quality of workforce, infrastructure and incentives offered by the host countries
- iii. Government of Nepal should simplify bureaucratic procedures and avoid bureaucratic harassment. One window policy seems beautiful only in name and the government should make it effective in practice also.
- iv. GoN should invest more in the development of physical infrastructure like road, water, electricity, power supply etc. which are also the pre-requisites of developing industries. Infrastructure is an important factor to attract foreign investment.
- v. In order to attract foreign investment, the industrial development policy needs to be kept clear and stable which provides the foreign investors a clear map of getting whatever facilities and incentives are being provided legally and from which they will feel the cost exceeds benefits than other countries.
- vi. Nepal does not process separate institutions for research and development to explore the potential area of investments and the other natural resources from which foreign investors may get driven force for active involvement in economic activity with the benefits earned by these exploration.
- vii. The office of foreign investment promotion in Nepal should try to increase its promotional drive and communicate with developed economic market about the facilities of foreign investment in Nepal. This should be done not only by arranging seminars and meetings but also by arranging discussions worldwide.
- viii. Visas and Repatriation Procedures: There is need for a) Speedy granting of Visa to the foreign investors or authorized representatives of foreign companies on the recommendations of FNCCI on preferential basis, b) Granting of multiple entry visa for the businessmen and their spouses and dependents, and c) an increase in the period of residence visa.

- ix. **Build up National Consensus:** National consensus is the foremost requirement of the overall development of the country. It is particularly required for restoring peace in the country, for the stability of any policies formulated and effective implementation of the planned programme. Any matters concerning people and the country must be decided unanimously so that the domestic institutions, foreign individuals, foreign government and other institutions have confidence over that matter in the sense of its continuity for a long time, irrespective of the change in government. In reality, the fear in the mind of domestic as well as foreign investors hovers in that the policies once formulated by one government will discontinue in case the government changes. This is a consequence of absence in national consensus, particularly absence in political consensus. So it is recommended to maintain national consensus over the issues affecting people and the development of country.
- x. **Practice Good Governance and Maintain Transparency:** Good governance envisages the concept of a balanced role of government with room for private sector and civil society and emphasizes transparency and accountability in the government bureaucracy, the rule of law and effective system of public management. Therefore, Nepal should extensively practice the principle of good governance in order to increase administrative capacities and avoid unfair dealing of power and corruption in order to encourage the foreign investors. The transparent behavior of high ranked officials, transparency in government decisions and their behavior help to create civic consciousness and sense of contribution for the sake of nation. That would help to promote domestic as well as foreign investment in the country.

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## Annex- I

### Number of Industries Approved for Foreign Investment by Fiscal Year

(From beginning up to FY 2067/68)

Rs. in million

Fiscal Year	No. of Industry	Total Project Cost	Total Fixed Cost	Foreign Investment
Upto Ashad 2046	58	5102.80	4271.60	449.56
2046/047	30	2438.19	2139.60	398.51
2047/048	23	863.56	690.74	406.28
2048/049	38	3508.17	2902.10	597.84
2049/050	64	17886.22	16210.81	3083.67
2050/051	38	3733.23	3175.66	1378.76
2051/052	19	1627.28	1247.85	477.59
2052/053	47	10047.47	9398.54	2219.86
2053/054	77	8559.25	6692.15	2395.54
2054/055	77	5569.38	5142.32	2000.28
2055/056	50	5324.42	4380.17	1666.42
2056/057	71	2669.09	1910.24	1417.61
2057/058	96	7917.62	6122.49	3102.56
2058/059	77	3318.53	1559.59	1209.65

2059/060	74	4921.82	3608.25	1793.77
2060/061	78	4323.74	3775.86	2764.80
2061/062	63	1796.10	1149.49	1635.77
2062/063	116	4121.08	3296.95	2606.31
2063/064	188	3425.57	2650.56	3226.79
2064/065	212	20403.88	16896.27	9811.00
2065/066	231	9417.89	7530.02	6255.09
2066/067	171	15853.78	14987.98	9100.00
2067/068	209	11250.19	9375.46	10050.71
<b>TOTAL</b>	<b>2108</b>	<b>152181.75</b>	<b>129114.68</b>	<b>68048.37</b>

Source: Department of industry, Government of Nepal, Industrial Statistics, 2067/068

## Annex- II

### Number of industries approved for Foreign Investment by sector

(From beginning up to FY 2067/68)

Rs. in million

Types of Industries	No.	Total Project Cost	Total Fixed Cost	Foreign Investment	Employment
Agriculture & Forestry	91	3696.06	2900.17	1975.78	7452
Manufacturing	715	58291.54	44271.56	27321.65	78844
<i>Food, Beverage &amp; Tobacco</i>	<i>106</i>	<i>10887.32</i>	<i>9188.94</i>	<i>3499.65</i>	<i>11375</i>
<i>Textile &amp; Rea. Garment</i>	<i>256</i>	<i>13209.06</i>	<i>8739.66</i>	<i>6304.69</i>	<i>40544</i>
<i>Wood &amp; Wood Product</i>	<i>19</i>	<i>425.06</i>	<i>292.14</i>	<i>457.42</i>	<i>2006</i>
<i>Paper &amp; P. Product</i>	<i>42</i>	<i>2070.78</i>	<i>1702.50</i>	<i>541.56</i>	<i>1513</i>
<i>Chem. &amp; Pl. Product</i>	<i>122</i>	<i>9190.72</i>	<i>6965.88</i>	<i>4762.30</i>	<i>9737</i>
<i>Non-Met Mi. Product</i>	<i>33</i>	<i>11661.02</i>	<i>8789.68</i>	<i>6451.42</i>	<i>4195</i>
<i>Basic Metal Product</i>	<i>26</i>	<i>1930.86</i>	<i>1158.71</i>	<i>729.72</i>	<i>2134</i>
<i>Fabric Metal, M/ C &amp;</i>	<i>88</i>	<i>8011.22</i>	<i>6790.03</i>	<i>4339.78</i>	<i>5833</i>
<i>Other Manufacturing Units</i>	<i>23</i>	<i>905.50</i>	<i>644.02</i>	<i>235.12</i>	<i>1507</i>
Electricity, Water Gas	50	38718.70	38220.83	13579.55	7953
Construction	79	6124.92	4044.52	4815.41	5943

Hotel &Resort	565	21318.13	19993.66	8688.95	25227
Transport &Communication	82	4575.34	3205.48	2060.50	6688
Housing &Apartment	25	1136.13	443.94	339.38	2234
Service Industries	501	18320.53	16036.22	9268.75	21091
<b>Total</b>	<b>2108</b>	<b>152181.75</b>	<b>129116.39</b>	<b>68049.97</b>	<b>155432</b>

Source: *Department of industry, Government of Nepal, Industrial Statistics, 2067/068*

**Annex- III**

**Number of Industries Approved for Foreign Investment by Country of Origin**

**(From beginning up to FY 2067/68)**

Rs. in million

S.N.	Country	No.	Total Project Cost	Total Fixed Cost	Foreign Investment	Employment
1	Australia	34	463.91	400.11	395.22	974
2	Austria	15	205..56	158.46	81.36	561
3.	Azerbaijan	2	9.90	8.60	9.90	50
4	Bangladesh	26	520.56	263.10	264.66	4166
5	Belgium	11	53.77	18.10	41.84	335
6	Bermuda	6	1995.25	1694.03	118.27	1474
7	Bhutan	3	27.26	20.58	3.61	98
8	Brazil	5	541.07	513.20	520.83	524
9	Bri. Virg. Is	3	2739.78	2636.19	961.43	1018
10	Canada	25	5081	513.220	2166.54	1926
11	China	401	13547.542.40	20.58	7036.17	23325
12	Colombia	1	2.40	1.50	2.40	7
13	Congo	1	2.50	2.10	2.50	28
14	Croatia	1	2.50	2.10	2.50	15
15	Cyprus	1	1000.00	974.00	304.00	235
16	Czech Replibul	1	3.50	2.50	3.50	12

17	Denmark	20	760.69	666.56	193.36	930
18	Dutch	1	18.90	13.90	18.90	80
19	Ecuador	1	2.50	1.30	2.50	45
20	Egypt	2	20.00	14.50	12.00	98
21	Finland	5	25.00	19.76	14.55	149
22	France	49	296.85	497.77	309.85	2036
23	Germany	79	2364.31	2124.64	926.72	3848
24	Ghana	1	6.50	6.18	1.95	0
25	Guatemala	1	10.00	5.00	2.50	84
26	Holand	1	7.00	0.00	1.79	0
27	Hong Kong	19	1861.54	1438.34	740.84	2616
28	Hungeri	1	10.00	8.90	5.00	29
29	India	501	62725.01	51118.64	32390.31	56407
30	Iran	7	24.20	15.355	19.70	132
31	Ireland	6	723.90	680.60	340.97	320
32	Israel	12	681.20	566.64	139.25	405
33	Italy	19	1423.69	1300.45	264.63	516
34	Japan	154	3195.03	2713.48	1171.24	6683
35	Kazakistan	3	15.40	13.03	15.40	67
36	Kyrgystan	4	36.50	32.05	22.50	175
37	Lebnon	2	7.00	5.50	7.00	49
38	Libiya	1	5.00	2.80	5.00	80

39	Malaysia	13	691.24	645.22	245.18	444
40	Mauritius	5	2980.00	2909.87	2845.00	892
41	Mexico	2	17.93	16.35	15.33	35
42	N. Korea	3	64.82	58.80	32.55	147
43	Netherlands	34	1309.42	1076.07	588.89	3046
44	New Zealand	9	296.63	239.71	30.07	2069
45	Norway	12	8116.59	6766.80	1135.83	726
46	Pakistan	15	2169.45	1883.77	149.73	2403
47	Panama	1	83.28	65.17	24.98	121
48	Philippines	11	1181.12	1009.68	97.28	1633
49	Poland	7	138.22	128.55	55.39	194
50	Portugal	1	2.50	2.00	2.50	23
51	Russia	18	254.80	189.19	125.78	793
52	S. Africa	5	47.30	37.84	47.30	137
53	S. Korea	149	8343.56	7840.81	4320.89	6232
54	Singapore	23	2916.32	2788.34	1505.39	1965
55	Slovenia	1	4.19	3.94	4.19	0
56	Spain	13	154.02	103.04	107.23	365
57	Sri Lanka	4	89.15	65.10	47.41	99
58	Sweden	8	30.40	23.26	27.60	223
59	Switzerland	31	734.48	665.05	331.25	628
60	Syria	1	2.50	2.10	2.50	17

61	Taiwan	9	414.75	360.43	174.62	596
62	Tchad	1	2.50	1.86	2.50	18
63	Thailand	11	1032.37	884.79	116.29	1159
64	Turkey	9	48.20	38.32	60.70	225
65	UAE	5	1635.74	733.74	886.31	721
66	UK	103	4684.35	4150.54	1539.71	8578
67	Ukraine	2	91.70	83.25	16.40	52
68	USA	174	13892.46	12560.48	4955.90	12287
69	Uzbekistan	1	10.00	7.50	10.00	52
70	Vietnam	2	24.60	22.80	24.60	55
	<b>TOTAL</b>	<b>2108</b>	<b>152181.75</b>	<b>129116.39</b>	<b>68049.97</b>	<b>155432</b>

Source: Department of industry, Government of Nepal, Industrial Statistics, 2067/068

## Annex- IV

### Year wise impact of FDI in macro economic parameters (From beginning up to FY 2067/68)

Rs. In Million

fy	trade tax	Total Revenue	gdp	fdi	emp	toi	imp	exp	ttrad
1988-89	2289.921	6287.264	89269.62	449.56	1058	22.9182	16263.7	4195.3	20459.0
1989-90	2684.873	7283.942	103415.83	398.51	9515	22.7055	18324.9	5156.2	23481.1
1990-91	3044.282	8176.337	120370.27	406.28	2974	25.4331	23226.5	7387.5	30614.0
1991-92	3358.888	9875.568	149487.14	597.84	5615	30.5354	31940.0	13706.5	45646.5
1992-93	3944.986	11662.516	171473.89	3083.6	1387	32.9333	39205.6	17266.5	56472.1
1993-94	5255.042	15371.459	199272.00	1378.7	4734	35.5615	51570.8	19293.4	70864.2
1994-95	7018.112	19660.072	219175.00	477.59	2386	37.1021	63679.5	17639.2	81318.7
1995-96	7327.364	21667.967	248913.00	2219.8	8032	37.8990	74454.5	19881.1	94335.6
1996-97	8309.119	24424.253	280513.00	2395.5	9347	41.4205	93553.4	22636.5	116189.9
1997-98	8502.234	25939.818	300845.00	2000.2	4336	38.7294	89002.0	27513.5	116515.5

1998-99	9517.674	28752.935	342036.00	1666.4 2	2146	36.0200 7	87525.3	35676. 3	123201. 6
1999-00	10813.30 4	33152.181	379488.00	1417.6 1	4703	41.7213 7	108504. 9	49822. 7	158327. 6
2000-01	12552.10 4	38865.002	441519.01	1209.6 5	3731	38.8072 3	115687. 2	55654. 1	171341. 3
2001-02	12658.73 8	39330.588	459442.81	1793.7 7	3572	33.5914 9	107388. 9	46944. 8	154333. 7
2002-03	14236.43 3	42586.935	492231.28	2764.8	2144	35.4066 7	124352. 1	49930. 6	174282. 7
2003-04	15554.77 5	48173.000	536748.88	1635.7 7	5559	35.4332 9	136277. 1	53910. 7	190187. 8
2004-05	15701.59 9	54104.700	589411.55	2606.3 1	7358	35.3198 5	149473. 6	58705. 7	208179. 3
2005-06	15344.00 0	57430.400	654084.00	3226.7 9	7389	35.7774 2	173780. 3	60234. 1	234014. 4
2006-07	16707.60 0	71126.700	727827.00	9811	1067 7	34.9090 8	194694. 6	59383. 1	254077. 7
2007-08	21062.50 0	85155.500	815658.00	6245.0 9	1106 8	34.4757 5	221937. 7	59266. 5	281204. 2
2008-09	26792.90 0	117051.90 0	988053.00	3746.9 8	4368	35.6425 3	284469. 6	67697. 5	352167. 1
2009/10	35150.80 0	156294.90 0	1171905.0 0	7289.1 1	8116	37.1326 3	374335. 2	60824. 0	435159. 2

Source: Industrial Statistics, 2067/68

fy	lnnt	lntr	lngdp	lnfdi	lnemp	toi	lnimp	lnxport	lntrad
1988-89	7.74	8.75	11.40	6.11	9.27	22.92	9.70	8.34	9.93
1989-90	7.90	8.89	11.55	5.99	9.16	22.71	9.82	8.55	10.06
1990-91	8.02	9.01	11.70	6.01	8.00	25.43	10.05	8.91	10.33
1991-92	8.12	9.20	11.91	6.39	8.63	30.54	10.37	9.53	10.73
1992-93	8.28	9.36	12.05	8.03	9.54	32.93	10.58	9.76	10.94
1993-94	8.57	9.64	12.20	7.23	8.46	35.56	10.85	9.87	11.17
1994-95	8.86	9.89	12.30	6.17	7.78	37.10	11.06	9.78	11.31
1995-96	8.90	9.98	12.42	7.71	8.99	37.90	11.22	9.90	11.45
1996-97	9.03	10.10	12.54	7.78	9.14	41.42	11.45	10.03	11.66
1997-98	9.05	10.16	12.61	7.60	8.37	38.73	11.40	10.22	11.67
1998-99	9.16	10.27	12.74	7.42	7.67	36.02	11.38	10.48	11.72
1999-00	9.29	10.41	12.85	7.26	8.46	41.72	11.59	10.82	11.97
2000-01	9.44	10.57	13.00	7.10	8.22	38.81	11.66	10.93	12.05
2001-	9.45	10.58	13.04	7.4	8.18	33.5	11.5	10.76	11.95

02				9		9	8		
2002-03	9.56	10.66	13.11	7.92	7.67	35.41	11.73	10.82	12.07
2003-04	9.65	10.78	13.19	7.40	8.62	35.43	11.82	10.90	12.16
2004-05	9.66	10.90	13.29	7.87	8.90	35.32	11.91	10.98	12.25
2005-06	9.64	10.96	13.39	8.08	8.91	35.78	12.07	11.01	12.36
2006-07	9.72	11.17	13.50	9.19	9.28	34.91	12.18	10.99	12.45
2007-08	9.96	11.35	13.61	8.74	9.31	34.48	12.31	10.99	12.55
2008-09	10.20	11.67	13.80	8.23	8.38	35.64	12.56	11.12	12.77
2009-10	10.47	11.96	13.97	8.89	9.00	37.13	12.83	11.02	12.98

Source: Department of industry, Government of Nepal, Industrial Statistics, 2067/068